

# Seeking Alpha $\alpha$

## Stock Buybacks Are Proof of Tax Reform's Success

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As the Republican tax reform has gained popularity, the Democrats have had to update their messaging. To cast corporate tax cuts as a “scam” and redistribution to the wealthy, opponents have shifted their focus to the evils of stock buybacks and dividends.

“Corporations have been pouring billions of dollars into stock repurchasing programs, not significant wage increases or other meaningful investments,” declared Senate Minority Leader Chuck Schumer Feb. 14. Such buybacks, he claimed, “benefit primarily the people at the top” and come at the expense of “worker training, equipment, research, new hires, or higher salaries.” Other Democrats have echoed the theme, and their media friends are cheerfully passing it on.

Economic logic isn't strong in Washington these days, but this effort stands out for its incoherence.

Share buybacks and dividends are great. They get cash out of companies that don't have worthwhile ideas and into companies that do. An increase in buybacks is a sign the tax law and the economy are working.

Buybacks do not automatically make shareholders wealthier. Suppose Company A has \$100 cash and a factory worth \$100. It has issued two shares, each worth \$100. The company's shareholders have \$200 in wealth. Imagine the company uses its \$100 in cash to buy back one share. Now its shareholders have one share worth \$100, and \$100 in cash. Their wealth remains the same.

Wouldn't it be better if the company invested the extra cash? Wasn't that the point of the tax cut? Perhaps. But maybe this company doesn't have any ideas worth investing in. Not every company needs to expand at any given moment.

Now suppose Company B has an idea for a profitable new venture that will cost \$100 to get going. The most natural move for investors is to invest their \$100 in Company B by buying its stock or bonds. With the infusion of cash, Company B can now fund its venture.

The frequent rise in stock price when companies announce buybacks proves the point. In my example, Company A's share price stays fixed at \$100 when it buys back a share. But suppose before the buyback investors were nervous the company would waste \$40 of the \$100 cash. Imagine an overpriced merger or excessive executive bonuses. Not every investment is wise!

The \$100, stuck inside Company A, would be valued by the market at \$60, and the company's total value would be \$160, or \$80 a share. If it spent the \$100 to buy back one share, the other share would rise from \$80 to \$100, the value of its good factory. When a company without great

ideas repurchases shares, the price of the remaining shares rise. This stock price rise is no gift to shareholders. It is just the market's recognition that \$100 has been saved from inefficient investment.

The debate over whether companies will spend higher revenues on wages or buybacks misses the whole point. The economic argument for the corporate tax cut is that companies with good ideas, projecting a better after-tax return on new capital investments, will make such investments. This new investment will let companies expand and make their workers more productive. When that happens, companies will compete for workers, leading to higher wages. Not all companies should make new investments, and some of the best investments come from new companies that don't have profits yet.

The economic logic of the tax cut is to create good incentives for profit-maximizing management teams—not to “trickle down” cash to workers from philanthropic management. One can argue whether it will work, but echoing illogical claims is not a contribution to that debate. Granted, Republicans invited the attack by trumpeting worker bonuses. But a bad argument for the cut does not redeem a worse counterargument.

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