

REWARD

WORK

NOT

WEALTH

A Plan to Reform Corporate Governance, Empower Workers and End the Looting of Public Companies to Create Shared Prosperity in America



Office of Tammy Baldwin
U.S. SENATOR *of* WISCONSIN

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Dear Friends,

On March 22, 2018, I introduced the *Reward Work Act* in the United States Senate. The legislation was the first in Congress to ever propose the idea that workers at public companies should have a direct role in the governance of the businesses that employ them—an idea I have come to call “worker empowerment.” In order to build on the success of last year’s introduction, I am providing this report of research on the benefits of worker empowerment to accompany the re-introduction of the *Reward Work Act* in the 116th Congress. In addition to worker empowerment, the report provides research on the impact of rising stock buybacks and the Securities and Exchange Commission’s (SEC) role in allowing shareholders and corporate executives to use buybacks to reward wealth, not work.

Today, a greater share of Americans work for a large corporation than at any point in our history—and the trend is growing.¹ The decisions made at large companies influence how much we earn and the cost of the products we buy. In the aggregate, these decisions reverberate through our economy and become part of our long-term economic trends. Lately, those trends have not been good: income inequality in the U.S. has steadily risen as wages have stagnated to the point that each new American generation is less likely to out earn its parents’ generation.² Income inequality is now at levels last seen immediately preceding the Great Depression and researchers believe it is slowing the growth of our Gross Domestic Product (GDP) by 2 to 4 percent annually.³

In spite of (or possibly because of) their power, public companies are among the institutions least accountable to everyday Americans. We had a hunch that increasing the accountability at public companies could make their decisions benefit everyone, not just those at the top. In order to test our theory, we looked at companies that already provide workers an opportunity to participate equitably in corporate board-level decision making. This is common in Germany and a few other European countries. Here is what we found:

- Companies with worker representation invest *twice* the amount that similar firms without worker representation do;

1 Theo Francis, “Why You Probably Work for a Giant Company, in 20 Charts,” *The Wall Street Journal*, April 6, 2017.

2 Jim Tankersley, “American Dream collapsing for young adults, study says, as odds plunge that children will earn more than their parents,” *Washington Post*, December 8, 2016; Chetty et al, “The Opportunity Atlas: Mapping the Childhood Roots of Social Mobility,” *National Bureau of Economic Research*, October 2018.

3 Gabriel Zucman, “Global Wealth Inequality,” *National Bureau of Economic Research*, January 2019, Josh Bivens, “Inequality is slowing US economic growth,” *Economic Policy Institute*, December 12, 2017.

- Companies with worker representatives on their boards created nine percent more wealth for their shareholders than comparable companies without board-level worker representation;
- Communities that are home to companies with worker representation distribute income more equally and provide their citizens greater economic opportunity; and,
- Wages in countries that require worker representation on corporate boards are 18 – 25 percent *higher* than wages in the United States.⁴

As a result of these findings, I became convinced that broadening the base of corporate decision-makers could yield more shared economic prosperity in the United States. That is why the *Reward Work Act* requires that one-third of the directors of each public company be elected by its employees. While this idea is bold, I have been pleasantly surprised to learn that most Americans agree with it. Public polling has shown strong support for this proposal among Democrats, Independents, and Republicans, resulting in a positive approval rating in every Congressional district in the country.⁵

The enclosed report provides detailed analysis to support findings on worker representation, stock buybacks, and the failure of the SEC to fulfill its mission. The SEC's misguided rules on buybacks allow executives and wealthy shareholders to extract undeserved cash from public companies. Given these results, it is clear to me that empowering workers—as envisioned in the *Reward Work Act*—would lead to better economic opportunities for many Americans. I hope that after reading the report, you will agree.

Sincerely,



Tammy Baldwin

United States Senator

4 See "Findings."

5 Data for Progress, *The New Progressive Agenda Project*, August 10, 2018. <https://www.datafor-progress.org/the-new-progressive-agenda-project>

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Executive Summary

The evidence presented in this paper supports three findings:

1. Worker empowerment increases wages, investment, and firm performance; decreases offshoring; lowers income and wealth inequality, and provides upward economic mobility.

Nations with more worker empowerment have higher wages and higher real wage growth than the United States. Firms with worker empowerment produce nine percent higher returns for shareholders and undertake twice as much investment as firms that do not have workers on their boards. Finally, stronger worker participation on corporate boards is positively correlated with lower national levels of economic inequality and higher intergenerational socioeconomic mobility.

2. Buybacks suppress wages, drive income and wealth inequality, decrease investment, increase systemic risk, harm retirement savers, and jeopardize capital formation by allowing speculators to extract value from public companies.

Buybacks increase shareholder wealth in the short term but decrease it in the long term, rewarding speculators and corporate executives who sell out while harming retirement savers who stick around. During 2014 – 2016, the 30 Dow Jones Industrial Average (DJIA) companies spent 126 percent of their income on dividends and buybacks. Executives call it “returning capital to shareholders,” yet the vast majority of public-company shareholders bought their stock from other shareholders and therefore have never contributed financial resources to the firms whose shares they hold. Encouraged by stock-based executive pay and the “maximizing shareholder value” ideology, buybacks suppress wages and drive income and wealth inequality higher. Finally, the buyback binge has pushed corporate debt to record highs, increasing systemic risk.

3. By refusing to address pervasive extraction of public-company value through stock buybacks, the SEC has failed in its mission.

In repeated communications to Congress, SEC Chairmen of both political parties have refused to re-evaluate the Commission’s buyback rules or even commit resources to studying the buyback phenomenon. This is in spite of the direct tie from the SEC’s Rule 10b-18 to the explosion of buybacks. By refusing to address the buyback phenomenon, the SEC has failed in its stated mission. The SEC proclaims its mission is to “protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.” There is

evidence that buybacks undermine all three components of this mission. SEC Commissioner Robert Jackson Jr. has shown that corporate insiders use buybacks to boost their stock-based compensation at the expense of other investors. Capital formation is undermined when companies spend in excess of their earnings and take on risky debt to buy back stock.

These findings are put in context in the background section, which explains the history of the public corporation; the consequences of the “shareholders first” ideology; and the role the stock market plays in the extraction of value from public companies.

The report provides a plan to address the problems raised by the findings, described in three policy recommendations:

- 1. Require that one-third of the seats on each public company’s board be directly elected by its workers.** To provide the workers—who create value—a say in how the company’s profits are distributed.
- 2. Ban open-market buybacks.** To end the value extraction from public companies by short-term speculators and corporate executives.
- 3. Take legislative action.** To force the SEC to address the buyback problem it created with Rule 10b-18.⁶

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6 In 1982 the SEC adopted Rule 10b-18, which provides corporate executives a safe harbor from charges of stock price manipulation when repurchasing company stock on the open market under certain conditions. For further reading on the history of 10b-18, see Lenore Palladino, “The \$1 Trillion Question: New Approaches to Regulating Stock Buybacks,” *Yale Journal on Regulation*, Vol. 36, 2018.

Background

● Role of Public Corporations

Corporations are granted special rights and privileges in our society. Under the law, their shareholders are treated differently than sole proprietors or partners in a business partnership. Unlike other business organizations, corporations are treated as legal entities with interests separate from their shareholders' interests. Because shareholders hold transferrable stock for which there is a liquid market, they can easily transfer their interests, allowing the corporation to continue on if a shareholder wishes to terminate their interest. This separation provides **limited liability**, meaning that if the company fails, the shareholders will not be held responsible for the company's debts and vice versa—a shareholder's personal debts cannot be transferred to the company.⁷ It is through these legal innovations that—over the course of the 20th century—shareholders became less likely to be direct investors in a company, and more likely to be portfolio investors—able to accumulate wealth while remaining separate from the company's day-to-day operations.

For much of American history, these legal rights were granted in exchange for a corporation's undertaking specific obligations. Corporate charters that granted these rights required the business to serve some public interest, building a road for example. However, the responsibilities placed on corporations by early corporate charters have been eroded by state governments and the courts, to the point that today many erroneously believe that the only legal obligation of the officers and directors of the corporation is to maximize yield for the corporation's shareholders, when in fact corporate law requires no such thing.⁸ Today, the legal rights afforded to shareholders and corporations have retained their power, while the responsibilities have been whittled away.

7 Kent Greenfield, "The Failure of Corporate Law," *University of Chicago Press*, 2006.

8 Lynn Stout, "The Shareholder Value Myth," *Berrett-Koehler Publishers, Inc.*, 2012; Stout et al, "The Modern Corporation Statement on Company Law" Purpose of the Corporation Project, October 29, 2016 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2848833: "Contrary to widespread belief, corporate directors generally are not under a legal obligation to maximise profits for their shareholders. This is reflected in the acceptance in nearly all jurisdictions of some version of the business judgment rule, under which disinterested and informed directors have the discretion to act in what they believe to be in the best long term interests of the company as a separate entity, even if this does not entail seeking to maximise short-term shareholder value. Where directors pursue the latter goal, it is usually a product not of legal obligation, but of the pressures imposed on them by financial markets, activist shareholders, the threat of a hostile takeover and/or stock-based compensation schemes."

● Problems with Shareholders First

The “maximizing shareholder value” ideology is pervasive and the concomitant rise in economic inequality raises serious questions about the ideology’s effect on the way corporations allocate their financial resources.⁹ We should begin by examining those the ideology purports to put first—shareholders. To illustrate, consider that the CEO of the world’s largest asset manager, Larry Fink of BlackRock, has called on chief executives to ensure that their companies serve a social purpose that benefits all of their stakeholders, “including shareholders, employees, customers, and the communities in which they operate.” Fink believes that companies that do not articulate a social benefit will “lose the license to operate from key stakeholders.”¹⁰

While BlackRock at least claims to represent the interests of long-term shareholders, there are many¹¹ shareholders who, for various reasons, have a far shorter time horizon¹² and demand that public companies make decisions that generate high yield immediately. Compounding the pressure for short-term performance, corporate managers’ compensation is increasingly tied to manipulative boosts of the company’s share price. Stock-based pay now makes up as much as 82 percent of the compensation of the nation’s highest-paid executives.¹³ This provides strong incentives for actions like buybacks that might provide a share-price pop in the short term, but hurt the firm’s competitiveness long term—creating a mechanism by which some shareholders can **extract value** from the company.¹⁴

In order to benefit from an increased share price, a shareholder must *sell*, severing their relationship with the company. The ability to cut ties with the company quickly and easily is unique to shareholders among the company’s stakeholders. A **share-seller** receives cash—usually from the company’s retained earnings or from a loan—in exchange for their share. This is how activist shareholders and CEOs are able to extract value from companies (more on that in the next section). In contrast, other stakeholders, like workers and taxpayers, contribute

9 William Lazonick and Mary O’Sullivan, “Maximizing Shareholder Value: A New Ideology for Corporate Governance,” *Economy and Society*, 29, 1, 2000: 13-35; Jia Lynn Yang, *Maximizing shareholder value: The goal that changed corporate America*, The Washington Post, August 26, 2013; James Montier, *The World’s Dumbest Idea*, GMO White Paper, December 2014.

10 Larry Fink, *2018 Letter to CEOs: “A Sense of Purpose,” BlackRock*, 2018, <https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter>

11 Lindsay Fortado, “Investing: activism enters the mainstream,” *Financial Times*, February 14, 2018, <https://www.ft.com/content/e04547b8-0d0b-11e8-839d-41ca06376bf2>

12 Sam Ro, “Stock Market Investors Have Become Absurdly Impatient,” *Business Insider*, August 7, 2012, <https://www.businessinsider.com/stock-investor-holding-period-2012-8>

13 William Lazonick, “The Value Extracting CEO,” *Institute for New Economic Thinking*, December 3, 2018

14 Graham, Harvey, Rajgopal, “The Economic Implications of Corporate Financial Reporting,” *National Bureau of Economic Research*, January 11, 2005; Keasler & Byerly, “An Examination of Corporate Stock Buybacks: Do They Really Create Value?,” *Economics, Management, and Financial Markets*, October 21, 2014.

productive resources, labor in the case of workers and public goods in the case of taxpayers, that are used to **create value** at the company. Yet increasingly, these contributions are receiving less in return—in wages and in tax revenue. The *value creators are losing out to the value extractors* and the implications for our economy are far reaching.

The chief consequence of the warped priorities of public companies is that wage growth has consistently fallen short of productivity growth since the late 1970s.¹⁵ While shareholders are reaping the gains of higher productivity and higher profits—that is, benefiting from the engine of economic growth—workers have not gotten their fair share. This is particularly inequitable when one considers that productivity gains are driven by worker innovation.¹⁶

Finally, we should consider how taxpayers (and by extension, members of the local community) fare under the shareholders first ideology. Taxpayers invest in resources that corporations put to productive use. For example, they pay for infrastructure, education, market regulation, and public health—all resources that business corporations draw heavily upon to make profits.¹⁷ And yet, the amount that corporations provide to the Treasury in federal tax revenue was declining even before President Trump’s Tax Cuts and Jobs Act dramatically lowered the corporate rate.¹⁸ The tax bill helped shareholders continue their value extraction as companies announced over \$1 trillion in buybacks in 2018,¹⁹ while only 14 percent of companies said they would use the tax cuts to increase workers base salaries.

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- 15 William Lazonick, “Profits Without Prosperity,” *Harvard Business Review*, September 2014, <https://hbr.org/2014/09/profits-without-prosperity>
 - 16 William Lazonick, “The Theory of Innovative Enterprise,” *Academic-Industry Research Network*, February 2013; William Lazonick and Tony Huzzard, “Corporate Governance, Employee Voice, and Work Organization: Sustaining High-Road Jobs in the Automotive Supply Industry.” *Oxford University Press*, April 30, 2014.
 - 17 Matt Hopkins and William Lazonick, “Who Invests in the High-Tech Knowledge Base?,” *Institute for New Economic Thinking*, May 2014
 - 18 Center on Budget and Policy Priorities, *Policy Basics: Where Do Federal Tax Revenues Come from?*, December 6, 2018, <https://www.cbpp.org/research/federal-tax/policy-basics-where-do-federal-tax-revenues-come-from>; Pub. L. 115 – 97.
 - 19 Emily Stewart, “What the Republican tax bill did – and didn’t – do, one year later,” *Vox*, December 22, 2018, <https://www.vox.com/policy-and-politics/2018/12/18/18146253/tax-cuts-and-jobs-act-stock-market-economy>

● The Role of the Stock Market

“Conventional wisdom has it that the primary function of the stock market is to raise cash for companies for the purpose of investing in productive capabilities. The conventional wisdom is wrong. Academic research on the sources of corporate finance shows that, compared with other sources of funds, stock markets in advanced economies have been insignificant suppliers of capital for corporations.”

– William Lazonick

As discussed earlier, because corporations have diverse shareholders, any given shareholder can terminate their stake without threatening the continuity of the company’s operations. While diverse shareholder interests can make it easier for corporations to raise money, this is not the primary reason major U.S. stock markets that trade in these shares developed. The histories of the New York Stock Exchange and NASDAQ show quite clearly that they were developed by industrialists and their financiers seeking to exit their investments, rather than to raise new capital for the corporation to put to productive use.²⁰

This is how the stock market still works today. Professor William Lazonick has shown that cash from equity investors is an insignificant source of funds for public companies.²¹ According to data from the Federal Reserve, through stock buybacks and mergers, stock markets were used to siphon an annual average of \$412 billion in cash *out* of public companies from 2006 to 2016.²²

Therefore, the vast majority of shareholders in American public companies—having purchased their shares from other shareholders on the secondary market—contribute zero cash to the company’s balance sheet. And yet, public-company management’s incentives are aligned to prioritize what is inaccurately termed “returning capital to shareholders.”²³ In order to demonstrate why this is a misnomer, let’s review the example of activist investor Carl Icahn and Apple. Icahn purchased \$3.6 billion of Apple shares in 2013 and 2014.²⁴ Despite the characterization of

20 Thomas Navin and Marion Sears, “The Rise of a Market for Industrial Securities, 1887–1902,” *Business History Review*, 1955; Mary O’Sullivan, “The Expansion of the U.S. Stock Market, 1885–1930: Historical Facts and Theoretical Fashions,” *Enterprise and Society*; Mary A. O’Sullivan, “Dividends of Development: Securities Markets in the History of U.S. Capitalism,” 1865-1922, *Oxford University Press*, 2016.

21 William Lazonick, *The Functions of the Stock Market and the Fallacies of Shareholder Value*, Institute for New Economic Thinking, July 20, 2017.

22 Ibid.

23 William Lazonick, “Apple’s ‘Capital Return Program’: Where Are the Patient Capitalists?,” *Institute for New Economic Thinking*, November 13, 2018, <https://www.ineteconomics.org/perspectives/blog/apples-capital-return-program-where-are-the-patient-capitalists>

24 Nathan Vardi, “Carl Icahn Makes Huge \$3 Billion Bet on Apple,” *Forbes*, January 22, 2014 <https://www.forbes.com/sites/nathanvardi/2014/01/22/carl-icahn-makes-huge-3-billion-bet-on-apple/#3120db845727>; Neil Hughes, “Carl Icahn invests another \$500M in Apple, promotes increased buyback in letter to shareholders,” *Apple Insider*, January 23, 2014, <https://appleinsider.com/articles/14/01/23/carl-icahn-invests-another-500m-in-apple-promotes-increased-buyback-in-letter-to-shareholders>; Carl Icahn, “Open Letter to Apple Shareholders,” January 23, 2014 https://carlicahn.com/apple_shareholder_letter/.

this purchase by Icahn and the media as an “investment,” Icahn Enterprises’ cash doesn’t end up on Apple’s balance sheet for the company to put to productive use. When Apple wants to research and develop its next innovative gadget, it doesn’t have Icahn’s cash at its disposal. That is because—as is the case with most stock purchases—Icahn bought his shares from other shareholders, not the issuing company (Apple in this case).

Despite contributing zero to Apple’s balance sheet, Icahn still loudly demanded that Apple accelerate its buyback program. Apple did—and it has now spent over \$239 billion on buybacks since 2012.²⁵ Apple calls its buyback program the “Capital Return Program,” yet the company isn’t *returning* cash to shareholders like Icahn, because they haven’t given the company anything. Icahn sold his Apple shares after holding them for 32 months for a \$2 billion gain. This example illustrates how activist investors use stock markets to take cash out of companies, rather than supply companies cash to put to productive use—rewarding the wealth of the activist, not the work of the employee who generated the profits.

25 Carl Icahn, “Carl Icahn Issues Open Letter to Tim Cook,” May 18, 2015 <https://carlicahn.com/carl-icahn-issues-open-letter-to-tim-cook/>; William Lazonick, “Apple’s ‘Capital Return Program’: Where Are the Patient Capitalists?,” *Institute for New Economic Thinking*, November 13, 2018, <https://www.ineteconomics.org/perspectives/blog/apples-capital-return-program-where-are-the-patient-capitalists>



Findings

Many of the findings below are drawn from examples of worker empowerment in Europe. Of the 31 nations in the European Economic Area, 19 require employee representation on corporate boards. In 13 of these, worker empowerment rights exist not just in state-owned or recently privatized companies, but in most large private business sector companies.

● **Finding #1: Worker Empowerment Increases Wages, Investment, and Firm Performance; Decreases Offshoring; Lowers Income and Wealth Inequality, and Provides Upward Economic Mobility**

EXHIBIT 1: Higher Wages, Growth in Nations with Worker Empowerment

According to the U.S. Department of Labor, total compensation for all Americans employed in the private sector in 2017 averaged \$35.51 per hour. Adjusted for inflation and purchase power parity, hourly wages in 2017 in the five largest co-determination economies averaged 18 to 25 percent higher. Further, the five largest nations with co-determination (France, Germany, the Netherlands, Norway, and Sweden) averaged 7.3 percent wage growth after inflation across all occupations between 2010 and 2017. This increase was more than double the rise in the U.S. over the same period.²⁶

EXHIBIT 2: When on Corporate Boards, Workers Improve Firm Performance

In 2006, in the *Journal of Financial Economics*, two economists published research showing that the German corporate-governance system—which requires worker representation on the board of directors—ensured that corporate decision-making would benefit from valuable first-hand operation knowledge provided by workers. The result was improved firm performance: “[f]irms with employee representation are significantly larger with respect to sales and assets and are relatively more profitable.” When labor represented between one-third and one-half of board seats, shareholder wealth increased by almost nine percent. Further, research from William Lazonick and Tony Huzzard found, “that the involvement of workers in enhancing productivity increases both the earnings of workers and the competitiveness of the products that they produce. There is fresh evidence of the importance of worker involvement in the productivity improvements that contribute to making their own

26 George Tyler, “The Codetermination Difference,” *The American Prospect*, January 10, 2019; Bureau of Labor Statistics, “Employer Costs for Employee Compensation,” March, June, September, December 2017 <https://www.bls.gov/web/ecec/ececqrtn.pdf>; Eurostat, “Investment rate of non-financial corporations,” August 17, 2018 at https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Hourly_labour_costs_in_euro_CORR.png

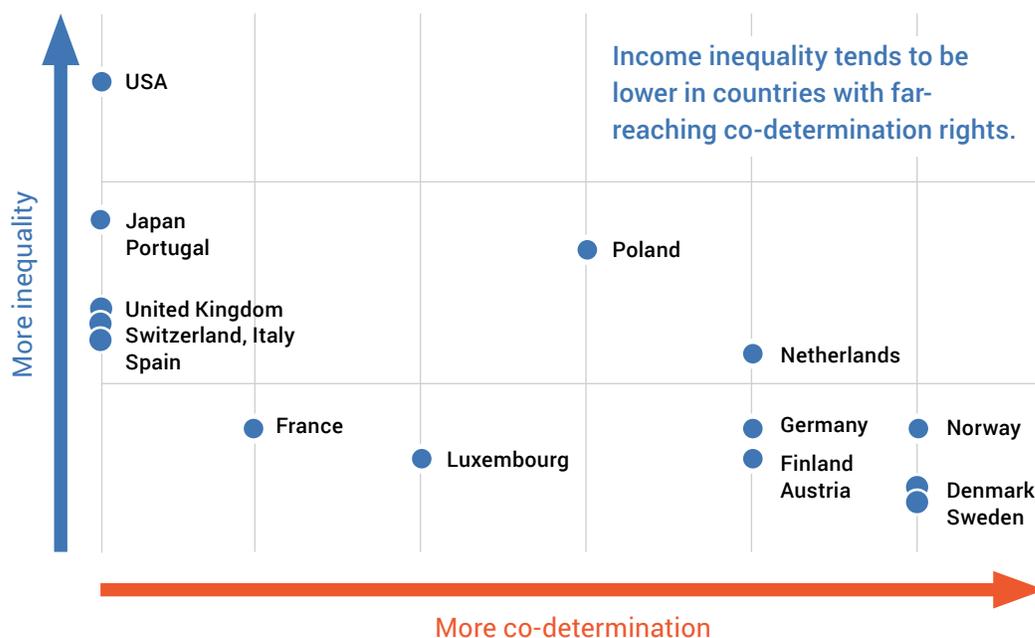
jobs, and the companies for which they work, competitive on a global scale."²⁷

EXHIBIT 3: Firms with Worker Empowerment Invest at Higher Rates Than Those Without

Investment data from 2006 to 2016 shows non-financial public firms in the U.S. trailing those in all European co-determination countries in investment. Researchers at the Berlin Social Science Center concluded in a 2016 analysis of German enterprises that capital investment at co-determination firms was twice that at firms lacking co-determination.²⁸

Strong co-determination, fair distribution

Income inequality and co-determination (at board level) in



Income distribution based on the Gini-coefficient; degree of co-determination according to 'Co-determination Index'
 Source: Hans-Boeckler Foundation Download: bit.do/implus0928

Hans Böckler
 Stiftung

27 Larry Fauver, Michael Fuerst, "Does good corporate governance include employee representation? Evidence from German corporate boards," *Journal of Financial Economics*, December 2006, pgs 673-710; William Lazonick and Tony Huzzard, "Corporate Governance, Employee Voice, and Work Organization: Sustaining High-Road Jobs in the Automotive Supply Industry," *Oxford University Press*, April 30, 2014.

28 Eurostat, "Non-financial corporations-statistics on profits and investment: Investment rates between 2006 and 2016," May 2018 at https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Non-financial_corporations_-_statistics_on_profits_and_investment#Investment_rates_between_2006_and_2016; Hans-Boeckler Foundation, "Where employees have a say, more is invested," June 27, 2016 at <https://www.mitbestimmung.de/html/wo-arbeitnehmer-mitbestimmen-wird-mehr-5004.html>; European Foundation for the Improvement of Living and Working Conditions, "Social partners divided over issue of co-determination at company level," January 3, 2007, at <https://www.eurofound.europa.eu/publications/article/2007/social-partners-divided-over-issue-of-co-determination-at-company-level>

EXHIBIT 4: Stronger Co-determination Is Associated with Fairer Distribution

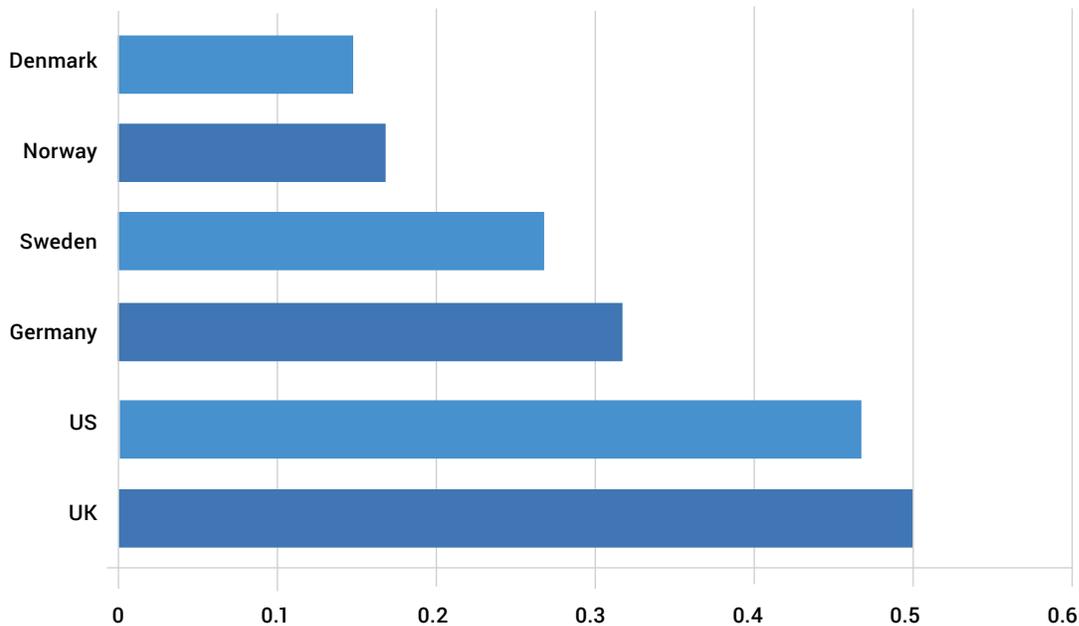
In 2012, a leading international think tank found co-determination rights led to lower levels of income inequality in an analysis of 32 Western countries. The Hans-Boeckler Foundation has found a trend indicating that nations with stronger co-determination rights had more equitable income distributions. While there are many variables that affect distribution (measured here by the Gini coefficient), the fact that there are varying levels of co-determination rights provides a strong indication that stronger rights are correlated with higher economic equality. This is a question of economic efficiency as well as fairness. The Economic Policy Institute estimates that rising wage inequality has created a significant drag on GDP growth in recent years.²⁹

EXHIBIT 5: Worker Empowerment Increases Economic Opportunity, Mobility

The lack of economic opportunity in the United States is well documented. Not only are wages stagnant, but children are becoming increasingly less likely to earn more than their parents did. Children in Northern European nations with strong

Intergenerational Earnings Elasticity

(Odds of a son being in the same earnings quintile as his father)



Source: George Tyler

29 Felix Horisch, "The Macro-economic Effect of Codetermination on Income Equality," *Mannheim Center for European Social Research*, 2012; Hans-Boeckler Foundation, Josh Bivens, "Inequality is slowing US economic growth," *Economic Policy Institute*, December 12, 2017.

co-determination are two to three times more likely than their American peers to move up the socioeconomic ladder.³⁰

EXHIBIT 6: Companies with Strong Co-determination Rules Outsource Fewer Jobs

A review of DAX30 companies (German equivalent of the Dow Jones Industrial Average) found that large multinational German companies with co-determination, and abundant overseas sales, maintained a greater percentage of jobs at home than German firms with comparable overseas sales but no co-determination. This data suggests that without worker input, companies are more likely to send jobs overseas. Further, the German companies with co-determination bring back foreign profits to create jobs at home, something that both recent repatriation efforts in the U.S. have failed to achieve.³¹

EXHIBIT 7: Workers May Discourage Mergers, Improve Market Competition

Over 40 percent of respondents to a November 2006 German survey of co-determination firm executives believed that co-determination was either a “slight” or “great obstacle” to mergers with other German firms or foreign firms.

30 George Tyler, “How to Establish More Balance in the Top-Heavy US Economy?”, *The Globalist*, January 21, 2019 at <https://www.theglobalist.com/us-europe-capitalism-inequality-codetermination/>; Raj Chetty et al, “Is the United States Still a Land of Opportunity? Recent Trends in Intergenerational Mobility,” *National Bureau of Economic Research*, January 2014

31 George Tyler, “The Codetermination Difference,” *The American Prospect*, January 10, 2019, <https://prospect.org/article/codetermination-difference>; Rubin and Francis, “Trump Promised a Rush of Repatriated Cash, But Company Responses are Modest,” *The Wall Street Journal*, September 16, 2018 <https://www.wsj.com/articles/companies-arent-all-rushing-to-repatriate-cash-1537106555>

● **Finding #2: Buybacks Suppress Wages, Drive Income and Wealth Inequality, Decrease Investment, Increase Systemic Risk, Harm Retirement Savers, and Jeopardize Capital Formation by Allowing Speculators to Extract Value from Public Companies**

EXHIBIT 8: Buybacks Are Suppressing Wages and Increasing Economic Inequality

From the post-WWII period until the late 1970s, productivity gains and workers' wages increased in tandem. Changes in the management of public companies, and the SEC's 1982 rule providing a safe harbor to those repurchasing shares on the open market, contributed to a decoupling of productivity gains and workers' wages. The U.S. has experienced decades of middle-class wage stagnation despite rising profits and productivity because of the downward pressure that buybacks put on wages. This has driven inequality to levels not seen since the period immediately preceding the Great Depression.³²

EXHIBIT 9: Buybacks Hurt Retirement Savers, Reward Stock Speculators

Two different studies have shown that buybacks hurt shareholders who invest for the long term, such as retirement savers. In the first, Terrill Keasler and Robin Byerly found that buyback announcements increased shareholder wealth after one-day and ten-day periods. However, the researchers found that shareholder wealth at buyback companies *declined* when measured over five-year and ten-year periods. In the second study, Robert Ayers and Michael Olenick showed "that there is a strong causal relationship between buybacks and *lower growth rates*." For retirement savers—average people who invest in public companies for long term gains—this research clearly demonstrates that buybacks hurt their returns.³³

EXHIBIT 10: Buybacks and Demand for Short-Term Results Have Led to Decreased Investment, Hurting Company Value

Analysis by the Roosevelt Institute has shown that while "firms once borrowed to invest and improve their long-term performance, they now borrow to enrich their investors in the short run." The study found that, "in the 1960s and 1970s, each additional dollar of earnings or borrowing was associated with a 40-cent increase in investment. Since the 1980s, less than 10 cents of each borrowed dollar is invested." A separate analysis by Roosevelt found that investment growth is very

32 William Lazonick, "Profits Without Prosperity", *Harvard Business Review*, September 2014, <https://hbr.org/2014/09/profits-without-prosperity>; Stanford Center on Poverty & Equality, "20 Facts About U.S. Inequality that Everyone Should Know," *Publications*, 2011, at <https://inequality.stanford.edu/publications/20-facts-about-us-inequality-everyone-should-know>

33 Keasler & Byerly, "An Examination of Corporate Stock Buybacks: Do They Really Create Value?", *Economics, Management, and Financial Markets*, October 21, 2014; Ayers & Olenick, "Secular Stagnation (Or Corporate Suicide?)," *INSEAD Working Paper*, July 11, 2017.

weak relative to that seen in previous business cycles and has been restrained by corporate preferences for shareholder payouts. A 2017 survey by Boston Consulting Group found “capital expenditure levels relative to revenues at a 20-year low, having dropped almost 20 percent between 1995 and 2015.” The consultancy found that companies that are valued in the top third of their industry groups “invest approximately 50 percent more in capital expenditure than their peers and achieve approximately 55 percent higher returns on assets, and approximately 65 percent higher sales growth.”³⁴

EXHIBIT 11: Stock Markets Pull Trillions out of Public Companies with Buybacks

According to Worm Capital, between 2010 and 2016, “over \$3 trillion in cash has been taken from corporate accounts and sent to the stock market for buybacks, generating zero tangible benefit for stakeholders—mainly shareholders.” Over the period 2014 to 2016, the 30 companies in the DJIA spent an average of *126 percent of their income* on dividends and buybacks. General Electric spent *354 percent of its income* on buybacks and dividends, which has no doubt contributed to its decline.³⁵

34 JW Mason, “Disgorge the Cash: The Disconnect Between Corporate Borrowing and Investment,” *Roosevelt Institute*, February 25, 2015; JW Mason, “Understanding Short-Termism, Questions and Consequences,” *Roosevelt Institute*, November 6, 2015; Ulrich Pidun and Sebastian Stange “The Art of Capital Allocation,” *Boston Consulting Group*, March 27, 2017.

35 Arne Alsin, “Stock Buybacks: What corporations are not telling you,” *Worm Capital*, November 2017 <https://www.wormcapital.com/insights/stock-buybacks-report-worm-capital>

EXHIBIT 12: Stock-Based Pay Is Warping Corporate Decision-Making

A study that surveyed 401 financial executives found that “the majority of managers would avoid initiating a positive [net present value] project if it meant falling short of the current quarter’s consensus earnings target.”³⁶ Similarly, over 75 percent of those surveyed would forgo creating economic value in exchange for “smooth earnings.” The managers said that because predictable earnings drive higher share prices (which trigger bonus payments), achieving earnings predictability was preferable to improving the firm’s performance.³⁷

S&P 500 Executive Compensation Structure



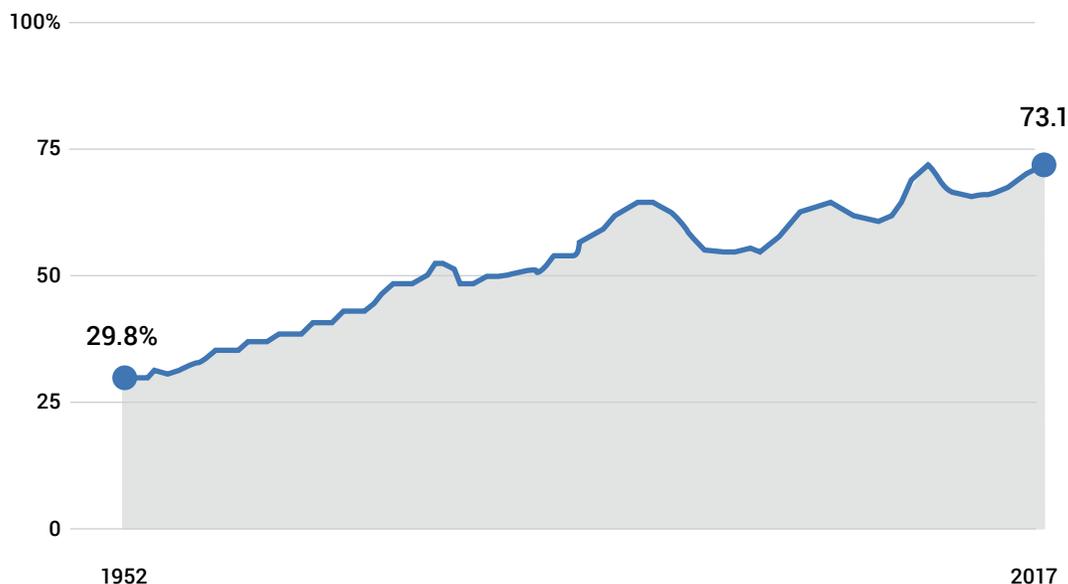
Source: 720 Global

36 Net present value is the sum of expected cash inflows and outflows over a certain time horizon

37 Graham, Harvey, and Rajgopal, “The Economic Implications of Corporate Reporting,” *National Bureau of Economic Research*, January 11, 2005.

Corporate debt is at a record high - and still rising

Total credit to nonfinancial corporations, as a percent of GDP



Source: The Millstein Co.

THE WASHINGTON POST

EXHIBIT 13: Buybacks have Created a Dangerous Corporate Debt Bubble

As Steven Pearlstein has written in *The Washington Post*, “The most significant and troubling aspect of this buyback boom, however, is that despite record corporate profits and cash flow, at least a third of the shares are being repurchased with borrowed money, bringing the corporate debt to an all-time high, not only in an absolute sense, but also in relation to profits, assets and the overall size of the economy.” Corporate debt is at a record high and still rising, with total credit issued to nonfinancial companies as a percentage of GDP reaching 73.1 percent in 2017. Buybacks are increasingly fueled by corporate borrowing, in particular leveraged loans—which are extended to companies that already have high debt levels. Companies are able to borrow because there is strong investor demand for higher-risk, higher-yield leveraged loans—especially when they’re sliced up, packaged into different tranches of risk, and sold. This dynamic has led former Fed Chair Janet Yellen to say, “I am worried about the systemic risks associated with these loans. There has been a huge deterioration in standards; covenants have been loosened in leveraged lending.”³⁸

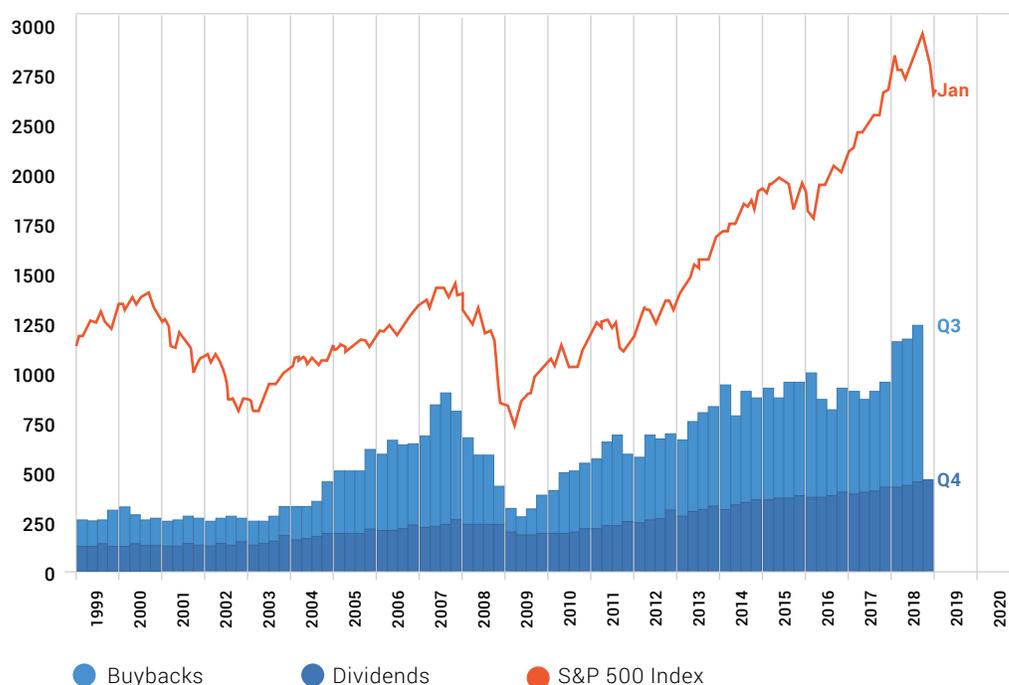
38 Steven Pearlstein, “Beware the ‘mother of all credit bubbles’”, *The Washington Post*, June 8, 2018; Megan Greene and Dwight Scott, “Do leveraged loans pose a threat to the US economy?”, *Financial Times*, February 11, 2019; Brian Chappatta, “Leveraged-Loan Protections Go From Bad to Worse,” *Bloomberg*, January 24, 2019.

EXHIBIT 14: Open Market Buybacks Are Almost Always Bought at Excessive Prices

As William Lazonick wrote in *Harvard Business Review*, “Though executives say they repurchase only undervalued stocks, buybacks increased when the stock market boomed, casting doubt on that claim.” The chart below shows buyback activity peaking and dipping in unison with the S&P 500 market index. By definition, if executives are buying high and selling low, they are managing their company’s cash poorly, which should disturb all of their stakeholders—not just shareholders, but bondholders, employees, and taxpayers—as the potential for insolvency rises.³⁹

S&P Dividends & Buybacks

(trillion dollars, annualized)



Source: Standard & Poor’s, Yardeni Research Inc.

EXHIBIT 15: Executives Use Buybacks to Cash Out at Retirement Savers’ Expense

On June 11, 2018, SEC Commissioner Jackson published research showing that “executives personally capture the benefit of the short-term stock-price pop created by the buyback announcement.” Corporate executives are twice as likely to sell their compensation stock in the eight days following a buyback announcement as they are on an ordinary day.⁴⁰

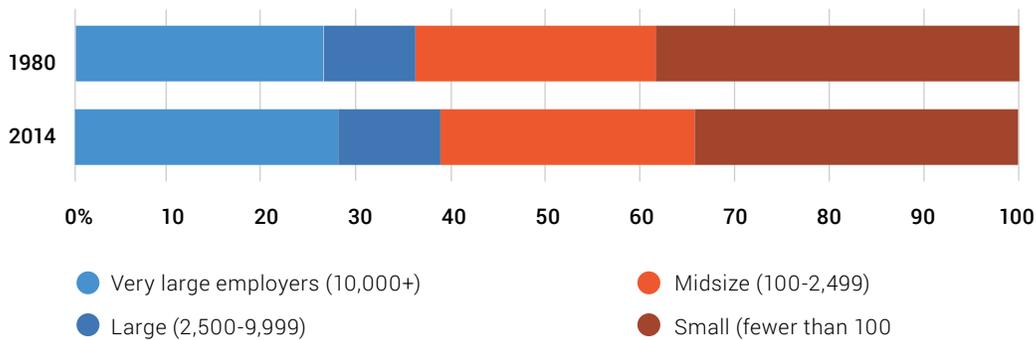
39 Edward Yardeni, “Stock Market Indicators: S&P 500 Buybacks and Dividends,” *Yardeni Research*, February 15, 2019; William Lazonick, “Profits Without Prosperity,” *Harvard Business Review*, September 2014, <https://hbr.org/2014/09/profits-without-prosperity>

40 Robert J. Jackson Jr., “Stock Buybacks and Corporate Cashouts,” *U.S. Securities and Exchange Commission*, June 11, 2018, https://www.sec.gov/news/speech/speech-jackson-061118#_ftn22

EXHIBIT 16: Large Public Corporations Have Increasing Power over Workers and Economy

Americans are now more likely to work at a large company than ever before. “In the late 1970s, an American employee was more likely to work at a company with fewer than a hundred workers than one that employed 2,500 or more. Today, Americans are more likely to work for the larger firms.” This evidence suggests that these larger firms’ capital allocation strategies and labor practices are having an increased impact on American workers and our economic lives.⁴¹

Share of total employment by employer size



Source: Census Bureau

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EXHIBIT 17: The Tax Cuts and Jobs Act Led to Buybacks, Little Economic Benefit To General Economy

American firms announced over \$1 trillion in buybacks in 2018 after the Trump tax cuts, while workers’ wages increased at barely the rate of inflation. Business investment increased after the tax bill but has fallen for four out of the last five months.⁴²

41 Theo Francis, “Why You Probably Work for a Giant Company, in 20 Charts,” *The Wall Street Journal*, April 6, 2017.

42 The New York Times Editorial Board, “You Know Who the Tax Cuts Helped? Rich People,” *The New York Times*, August 12, 2018, <https://www.nytimes.com/interactive/2018/08/12/opinion/editorials/trump-tax-cuts.html>; Sharon Nunn, “Business Investment Falters Amid Growing Global Economic Uncertainty,” *The Wall Street Journal*, February 21, 2019, https://www.wsj.com/articles/u-s-durable-goods-orders-rose-in-december-11550756072?mod=djemRTE_h

● **Finding #3: By Refusing to Address Pervasive Extraction of Value from Public Companies through Stock Buybacks, the SEC Has Failed in Its Mission**

EXHIBIT 18: The SEC Is Failing in Its Mission

The SEC's declares its mission is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." Yet all three of these goals are undermined by the Commission's encouragement of open-market stock buybacks through Rule 10b-18. Commissioner Jackson has shown how ordinary shareholders are defrauded by corporate insiders who use buybacks to manipulate the prices of the shares they are awarded as compensation. This practice clearly violates the Commission's goal of protecting investors and keeping markets fair. As the previous section demonstrated, buybacks threaten capital formation by sending a corporation's retained earnings out to shareholders in the form of buybacks. Companies are taking on record amounts of debt to buy back stock instead of using their retained earnings to finance reinvestments into the company and create value.

EXHIBIT 19: SEC Leadership Gave Bogus Excuse for Refusing to Study Buybacks

On July 13, 2015, in response to a request from Senator Baldwin to study stock buybacks, SEC Chair Mary Jo White claimed that the Commission lacked the necessary data to provide an analysis to the Senator on the effects of buybacks on investors, markets, and the economy. Chair White wrote, "performing data analysis for issuer stock repurchases presents significant challenges because detailed trading data regarding repurchases is not currently available." This claim stands in direct contrast to research published by Commissioner Jackson, who used *publicly available data* to show that "executives are using buybacks as a chance to cash out their compensation at investor expense."⁴³ This raises serious questions about the Commission's mission and how it views its obligations to Congress.

EXHIBIT 20: The SEC Cannot Articulate How Its (Lack of) Regulation of Stock Buybacks Fulfills Its Mission

On June 28, 2018, Senator Baldwin and 20 of her colleagues wrote to SEC Chairman Jay Clayton to request that he review SEC Rule 10b-18, which provides a "safe harbor" for buybacks. The request was prompted by record-breaking buybacks following the passage of the Tax Cuts and Jobs Act, as well as research from Commissioner Jackson that found that "the percentage of insiders selling shares more than doubled immediately following their companies' buyback announcements." In response, Chairman Clayton said that the Commission does

43 Mary Jo White, "Response to Senator Baldwin," *U.S. Securities and Exchange Commission*, July 13, 2015, <https://www.baldwin.senate.gov/imo/media/doc/SENATOR%20BALDWIN%20-%20STOCK%20REPURCHASES%20-%20ES153283%20Response.pdf>

not have the authority to “prescribe actions in the area of corporate planning, execution, and performance,” within which falls the decision to repurchase shares. Chairman Clayton did not respond to the Senators’ concerns about how buybacks are undermining capital formation; harming fair, orderly, and efficient markets; or defrauding investors.⁴⁴

EXHIBIT 21: The SEC Is Not Monitoring Stock Buybacks

In April 2015, Senator Baldwin wrote to SEC Chair Mary Jo White “with concerns about the recent explosion in stock buybacks by U.S. corporations.” Senator Baldwin requested that the SEC, as the regulator responsible for fair and efficient capital markets, provide any analysis it had undertaken on the long-term impact of the 1982 SEC Rule 10b-18 (which provides a safe harbor for buybacks). In her response, Chair White noted that “detailed trading data regarding repurchases is not currently available” and had no response to questions about the proposed long-term economic impacts of the SEC’s rules.⁴⁵

EXHIBIT 22: The SEC Refused to Discuss How Worker Empowerment Could Improve Capital Formation

On October 15, 2018, Senator Baldwin and 12 of her colleagues wrote to SEC Chairman Clayton to request that the Commission’s “Staff Roundtable on the Proxy Process” add agenda topics “address[ing] the obligations of corporations to *all* of their public stakeholders, including employees, consumers, local communities, and taxpayers—in addition to public shareholders.” Despite Chairman Clayton’s response, in which he said he felt “confident that the topics you raise . . . are likely to be well discussed,” there was no mention of them at the roundtable, even though the Chairman Clayton was present at the discussion.⁴⁶

44 Baldwin et al, “Senators Letter to Clayton on Buyback Rules,” Office of Senator Tammy Baldwin, June 28, 2018, <https://www.baldwin.senate.gov/imo/media/doc/Senators%20Letter%20to%20Clayton%20on%20Buyback%20Rules%20FINAL.SIGNED.6.28.18.pdf>; Jay Clayton, “Response to Baldwin et al,” Office of Senator Tammy Baldwin, September 12, 2018, <https://www.baldwin.senate.gov/imo/media/doc/Baldwin%20et%20al%20-%20Stock%20Buybacks%20-%20ES157032%20Response.pdf>

45 David Dayen, “SEC Admits It’s Not Monitoring Stock Buybacks to Prevent Market Manipulation,” *The Intercept*, August 13, 2015.

46 Tammy Baldwin et al, “Letter to Clayton on Proxy Roundtable,” Office of Senator Tammy Baldwin, October 15, 2018, <https://www.baldwin.senate.gov/imo/media/doc/Proxy%20Roundtable%20Signed%20Final%2010.15.18.pdf>; Jay Clayton, “Response to Baldwin et al,” Office of Senator Tammy Baldwin, November 7, 2018, [https://www.baldwin.senate.gov/imo/media/doc/Baldwin%20-%20Proxy%20Roundtable%20\(Clayton%20Response\)1.pdf](https://www.baldwin.senate.gov/imo/media/doc/Baldwin%20-%20Proxy%20Roundtable%20(Clayton%20Response)1.pdf)

EXHIBIT 23: Rule 10b-18 Opened the Door to the Buyback Explosion

According to an analysis from Worm Capital, during the three years prior to 10b-18, 1979 – 1981, companies in the DJIA spent \$16.7 billion on buybacks and \$152.3 billion on dividends. In the years 2014 to 2016, DJIA companies spent \$580.5 billion on buybacks and \$435.4 billion on dividends. Companies have gone from spending ten percent of the amount of their dividends on buybacks to now spending almost one third *more* on buybacks than they do on dividends. According to an analysis by Erdem Sakinc, the 226 companies that have been in the S&P 500 continuously since 1981 *alone* have distributed \$5 trillion in 2017 dollars as buybacks and \$4.8 trillion as dividends, equal to 87 percent of those companies' profits, during the 1981 to 2017 period. Since the adoption of Rule 10b-18 in 1982, all listed firms have spent a total of \$10.7 trillion on buybacks. In 1981, the S&P 500 spent approximately two percent of its profits on buybacks. In 2017, those same companies spent 59 percent of their profits on buybacks.⁴⁷

47 Erdem Sakinc, "Calculations for Senator Baldwin," *Academic-Industry Research Network*, March 3, 2019; Lazonick and Jacobson, "End Stock Buybacks, Save the Economy," *The New York Times*, August 23, 2018; Arne Alsin, "Stock Buybacks: What corporations are not telling you," *Worm Capital*, November 2017 <https://www.wormcapital.com/insights/stock-buybacks-report-worm-capital>



Policy Recommendations

The findings above show that the American system of corporate governance yields economic outcomes far inferior to those in nations with stronger worker empowerment. The evidence also shows that Wall Street insiders and corporate executives have abused the American system of corporate governance, spending trillions on buybacks to benefit themselves at the expense of employees and other corporate stakeholders. In light of these findings, which are based on extensive evidence, this report recommends the following policy changes.

● **Recommendation 1:** **Empower Workers to Elect Directors to Corporate Boards**

The aggregate evidence from comparison countries provides strong support for the theory that worker empowerment can foster several key economic benefits, most notably: higher wages, improved firm performance, increased investment, less offshoring, lower income inequality, and greater socioeconomic opportunity.

In order for firms to achieve better performance, workers must have truly *board-level* representation that allows them to influence corporate decision-making. Research from Larry Fauver and Michael Fuerst, referenced in Exhibit 2, shows that results only become significant once workers have voting representation equal to at least one-third of the board. In other words, simply providing workers a forum to blow off steam will not yield results.

Requiring that workers directly elect one-third of corporate boards will ensure that value creators are able to reap the rewards of their labor. Workers invest their time, skill, and effort in the company and depend on managers both to generate a return on that investment and to share that return in the form of increased compensation. Workers also face much higher switching costs than shareholders (the average job hunt is currently over 20 weeks).⁴⁸ And while shareholders are given the ability to ignore the day-to-day operations of the company, the workers live those operations in their personal as well as their professional lives—workers almost always reside in the community in which their employer operates. Finally, because taxes on wages make up an increasing percentage of federal revenue, workers are also ideal

48 Bureau of Labor Statistics, *Unemployed persons by Duration of Employment*, February 1, 2019, <https://www.bls.gov/news.release/empsit.t12.htm>

representatives for the interests of taxpayers on corporate boards.⁴⁹

● **Recommendation 2:** **Ban Open-Market Stock Buybacks**

The proposed ban on open-market buybacks would end a practice that has been used to extract value from public companies at the expense of workers, taxpayers, and retirement savers. Stock buybacks undermine capital formation needed to build sustainable and innovative companies. Research has shown that companies are decreasing their value over the long term by buying back too much stock. Retirement savers will pay the price in the form of a lower stock return, while short-term speculators will have cashed out in the days immediately following a buyback announcement. By creating constant downward pressure on wages, buybacks also restrict the ability of workers to contribute more of their wages to their retirement accounts over the course of their working career.

The buyback binge has led companies to borrow significantly—and at higher cost—in order to buy back still more stock. This dynamic has pushed corporate debt to record highs. The share-sellers reap short-term gains, yet they bear none of the risks of the other stakeholders, who are left to face the prospect of a default. Long-term retirement savers suffer the permanent loss of their investment if the company goes bankrupt. Workers face the loss of their job and pension cuts, possibly resulting in a delayed retirement. Taxpayers deal with further strain on public resources when they are used to assist workers who lose their jobs.

● **Recommendation 3: Take Legislative Action**

The actions of the two most recent SEC Chairmen (appointees of both Democratic and Republican Presidents) make clear that the Commission will refrain from taking action unless required by Congress. Since Rule 10b-18's adoption, trillions have flowed through national stock exchanges out of public companies. The Commission has ignored Congressional requests to update its rules governing buybacks. It has refused requests to commit staff resources to studying the buyback phenomenon. It has even ignored the advice of one of its own Commissioners to address buybacks. The Commission's refusal to admit that its Rule 10b-18 has dramatically changed public-company behavior indicates that it will be unable to address the problem it has itself created.

49 Center on Budget and Policy Priorities, "Where Do Federal Tax Revenues Come From?", December 6, 2018, https://www.cbpp.org/sites/default/files/atoms/files/PolicyBasics_WhereDoFederalTaxRevsComeFrom_08-20-12.pdf

Conclusion

● The Reward Work Act

The *Reward Work Act* incorporates the above recommendations by requiring all public companies to allow workers to directly elect one-third of the company's board of directors and by banning open-market stock buybacks. These two reforms will ensure that American companies are run for those who invest the most in the company's productive capabilities.

These contributors are workers—who invest time, skill, and effort; taxpayers—who supply the preconditions for business such as infrastructure to get products to market and education to improve labor productivity; and finally communities—which provide the ability for workers to live near their jobs, but more importantly, make life worth living.

The Reward Work Act will improve the way public companies are run to ensure that value creators are rewarded for their work while value extractors are not allowed to use their wealth to claim the profits that workers have created.

Acknowledgements:

This report would not be possible without the help of William Lazonick, Ken Jacobson, Erdem Sakinc, George Tyler, and many others. Thank you.

For more information about this report contact:

Brian Conlan

Senior Economic Policy Advisor

Senator Tammy Baldwin

brian_conlan@baldwin.senate.gov

202-224-5653



