Ending Shareholder Primacy in Corporate Governance

Roosevelt Institute Working Paper

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February 8, 2019

JEL Classification: G30, G32, G35, G38, J3, K2

Keywords: Shareholder Primacy; Stock Buybacks; Wage Stagnation; Inequality; Corporate Governance; Securities Law.

ABSTRACT

For nearly half of a century, America's public corporations, driven by a shareholder primacy approach to corporate governance, have increasingly prioritized shareholder payments over other, more productive uses of corporate resources. Over the same period, employee bargaining power has fallen and wages for non-executive workers have stagnated across sectors. This paper examines the effects of shareholder primacy on employees and explores much-needed policies to rebalance power within US corporations. I examine the change over the last several decades in the relationships between rising profits, shareholder payments, and labor expenses, bolstering the hypothesis that shareholders' gains come at the expense of employees and the economy at large. To disincentivize corporate behavior that prioritizes shareholders, I propose a policy agenda that ends the practice of stock buybacks and institutes a stakeholder approach to corporate governance.

I. INTRODUCTION

Income and wealth inequality in the United States have climbed significantly in the past four decades. Real wages have not grown in proportion to productivity, and wages have fallen as a share of national income (Michel 2015).[1] Over the same period, the *shareholder primacy* approach to corporate governance has come to dominate corporate decision-making (Stout 2012). Shareholder primacy is a legal and economic framework for corporate governance that claims that the sole purpose of corporate activity is to maximize wealth for shareholders; thus, executives and boards of directors prioritize increasing share prices over all else (Greenfield 2018; Lazonick 2014).

I demonstrate that as shareholder primacy emerged as the guiding ideology for corporate governance, corporate leaders increasingly used corporate profits for shareholder payments—which, uncoincidentally, also benefits such executives, who are often compensated like shareholders. At the same time that the proportion of corporate profits going to shareholders and top executives has risen, employees' bargaining power has been eroded, and wages for typical (nonsupervisory and production) workers have stagnated.

Though multiple forces in the economy are responsible for the decline of worker bargaining power, this paper argues that pervasive shareholder primacy has shifted the balance of power inside corporate governance towards shareholders and away from other corporate stakeholders, particularly employees, resulting in management increasingly

[1] According to Mishel et al. (2015), in the 30 years after World War II, real hourly compensation of most workers grew 91%, well in line with overall productivity growth of 97%. But since the early 1970s, the gap between these two indicators has widened dramatically. Between 1973 and 2013, productivity increased 74% while hourly pay of a "typical" worker (i.e., production and nonsupervisory) grew only 9%. In turn, labor's share of income has declined.

prioritizing shareholder payments and decreasingly prioritizing labor costs.[2] In one sense, decisions about wages and shareholder payments occur separately. Wages are one of many costs that companies pay out of revenues from company sales, and they are determined by company management (and not always at the most-senior level). Shareholder payments—defined as dividends and stock buybacks—are approved by boards of directors and can be interpreted as allocations that leave fewer funds available for productive investment (Lazonick 2014; Mason 2015)[3]. In another sense, decisions about whether to raise wages or shareholder payments reflects the bargaining power that each group of stakeholders has within the corporation. Management may feel pressure to raise wages stemming from a tight labor market, the threat of a strike or a strong union negotiating committee, or a belief that paying higher wages than their competition will get them the most-productive workers and benefit the company most over the long term. Or, management may feel pressure from "activist" investors who clamor for seats on the board or the firing of a CEO who does not preside over an ever-rising share price, leading them to prioritize cutting employee costs as much as possible, either directly or through replacing employees with an outsourced workforce (Weil 2014).

This paper argues that the rising power of shareholders to extract higher and higher payments has hurt employee bargaining power and contributed to wage stagnation.

These competing claims for payments can be thought of as pitting shareholders and employees against each other. Put differently, this paper argues that the rising power of shareholders to extract higher and higher payments has hurt employee bargaining power and contributed to wage stagnation.

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[2] The mainstream explanation of globalization is that it has opened up labor markets across borders, thereby lowering demand for US unskilled labor, which, in turn, has pushed down wages. However, a basic power analysis of globalization's effect on wages argues that the way that economic globalization has played out is due to policy choices that favor corporate profit over labor protections. In terms of technological change, economists often use skill-biased technological change (SBTC) to argue that while technology enhances the marginal productivity of skilled workers, it lowers or leaves unchanged the marginal productivity of unskilled workers, which thereby leaves their wages unchanged (Autor 2013). The power analysis argument is that nothing about technological change is inevitable. According to Paul (2018), "When technology is a substitute for workers, it can be used to discipline workers, tipping the already skewed balance of power more towards the bosses and business owners. On the other hand, when technology complements workers, workers are more likely to share in the benefits through increased wages, improved working conditions, higher rates of employment, and rising living standards."

[3] "Payments" should not be taken to indicate that the shareholder paid something in to the firm. The vast majority of shareholders purchase their shares from other shareholders and therefore never contribute any funds to shareholders. The concept here is the payments that the company is making to all who hold shares.

The history of corporate governance is full of shifting frameworks for the balance of power between shareholders, management, and employees, starting in the 19th century with changes over the rights and responsibilities of incorporation and continuing into the early 20th century, when debates in corporate law were waged over the proper relationship between passive shareholders and powerful management (Dallas 2018; Ciepley 2013). In the mid-20th century, shareholders expected steady dividends and little else, while labor unions won wage gains from large employers.

Multiple developments within the economics and legal professions helped provide the ideological underpinnings for a broad shift in corporate governance, in which the power to decide corporate strategy and allocate corporate resources shifted away from managers to the most influential shareholders (G. Davis 2009). Milton Friedman marked the turn toward shareholder primacy in 1970 when he wrote that "a corporate executive is an employee of the owners of the business [i.e., the shareholders]. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible." The Chicago School of legal and economic scholars formalized the corporation as a "nexus of contracts," rather than its own legal entity, positing shareholders as the sole owners of the corporation. Jensen and Meckling developed agency theory to argue that the main purpose of corporate governance is to find ways to align the incentives of shareholders and executives (Jensen and Meckling 1976). Though the legal framework for shareholder primacy is questionable, it is clearly the dominant mode today (Stout 2014; Greenfield 2005). The current era of shareholder primacy has seen a decline in corporate investment and research spending, a rise in nonfinancial companies providing financial services, the explosion of stock-based equity pay for corporate executives, rising shareholder payments, and an increase in the corporate debt used to finance those payments (Lazonick 2014; Holmberg 2014).

This paper presents an original analysis of the changes over time in the relationship between corporate profits, shareholder payments, and labor expenses. I outline a variety of ways to analyze the increasing importance of shareholder payments to corporate decision-making. First, I look economy-wide at nonfinancial corporations; I find that there is an increasing association over time between profits and shareholder payments and a cautious case for finding a decreasing association between profits and wages. Specifically, I relate profits, payments, and wages over two time periods, 1972-1993 and 1994-2017, in order to see if there is a meaningful shift in the relationships between profits, payments, and wages that suggests rising shareholder primacy. Second, I look at the growth rates of shareholder payments and wages at the sectoral level and find that the trend of rising growth of shareholder payments occurs across sectors. As a wide variety of other factors clearly influence both wages and shareholder payments, I am not making a claim here that rising payments *cause* the stagnant wage bill, or vice versa. However, a shift in these relationships does support the claim that shareholders are gaining—and hoarding—power in corporate governance, as evidenced by the rising use of profits to reward shareholders, while employees are losing ground, as evidenced by nearly 50 years of stagnant wages for most workers. This shift naturally gives rise to the crucial question of what would happen to employees if shareholders did not have so much power. The paper concludes by proposing two sets of policies to rebalance power within corporate governance.

The paper proceeds as follows. In Section 2, I describe the rise of shareholder primacy and the policy changes that drove the shifts in corporate governance. The third section provides data that support the hypothesis that shareholder primacy has, over the last several decades, driven firms to prioritize using profits to increase shareholder payments, while rising profits have become decreasingly associated with rising wages. The fourth section presents policies to reorient corporate governance away from shareholder primacy, by limiting stock buybacks and instituting a stakeholder governance model. The final section concludes.

II. EXPLORING THE RISE OF SHAREHOLDER PRIMACY AND THE DECLINE OF WORKER PROSPERITY

In this section, I define shareholder primacy, describe its rise in becoming the primary mode of corporate governance, present evidence of the growth of stock buybacks as a key corporate practice, and provide an overview of the existing literature on the relationship between shareholder primacy and employees.

A. Defining and Refuting Shareholder Primacy

"Shareholder primacy" is the framework for corporate governance that claims that shareholder profit is the ultimate purpose for all corporate activity, and that corporate governance should be exclusively in the hands of shareholders, not other corporate stakeholders (Stout 2012). This framework has been justified by a variety of legal and economic theories. One legal theory justifies shareholder primacy by claiming that shareholders are the "owners" of the company and are owed the corporate profits remaining after accounting for contractual costs and investment in productivity gains. Another theory, the "nexus of contracts" approach, claims that all other stakeholders who contribute to the corporation—employees, customers, creditors, and the general public—have a contractual relationship to the firm that determines their share of corporate value, while shareholders are the "residual claimants" who have an open-ended claim on as much corporate profit as possible and bear the risk of loss. In both cases, the role of corporate management is to minimize all other costs in order to reward shareholders, as manager "agents" to the shareholder "principals" (Friedman 1970). The shareholder primacy model is highly contested as a legal theory and lacks a coherent economic analysis of how corporations actually create valuable goods and services (Greenfield 2005; Lazonick 2014a; Yosifon 2018). Notwithstanding these shortcomings, the theory guides decision-making in corporate boardrooms and has been upheld by Delaware courts in several cases (Yosifon 2018).[4]

It is useful to briefly sketch the arguments against shareholder primacy. First, legal scholar Lynn Stout demonstrates that as a matter of law, shareholders have ownership of their shares but not ownership of the corporation: The corporation, in fact, owns itself (Stout 2012). Additionally, most shares of public companies are bought and sold on the secondary markets; in other words, most shareholders never contribute capital directly to a particular company but instead pay the previous shareholder for temporary ownership of the share. Second, the shareholder primacy model is often predicated on the idea that other corporate stakeholders have contractual relationships with the firm. This idea ignores the variable claims that other stakeholders, notably employees, have on firm profits, as their rewards are also dependent on firm outcomes. Given the well-documented costs of job loss and the job-specific investments that employees make, workers arguably bear more risk than shareholders. The shareholder primacy model also ignores that many stakeholders (including but not limited to employees) do not have a contractual relationship with the corporation, even as they make investments in the firm through the development of specific skills and capabilities (Greenfield 2005). As an economic theory, shareholder primacy lacks an account of how companies actually innovate—in other words, "generate higher quality products at lower unit costs than those that had been previously available" (Lazonick 2013).

It is crucial to understand that the shareholder primacy framework became entrenched as the dominant mode for corporate behavior only in the 1980s, as part of the broader shift to neoliberalism (Kotz 2015). The postwar period was dominated by firms that saw stable relations with employees as key to their success under a "managerial capitalism" framework (G. Davis 2009; Wartzman 2018). Managerial corporate governance in the postwar era provided workers at large companies employment that secured basic economic needs, such as a stable income, health care, and retirement (albeit the availability of such employment was stratified by race, gender, and other social identities) (G. Davis 2016). Firms invested in and depended on a stable labor force, and unions held enough power to secure significant gains for their members. Fragile but steady labor peace meant that wage rates largely rose for the workforce of large companies. By the 1970s, as economic growth slowed and inflation rose, shareholders became dissatisfied with low and steady dividends. The structural shift towards neoliberal capitalism has its roots in economic, political, and even the rising cultural

[4] The majority of large corporations incorporate in Delaware, because corporate law's "internal affairs" doctrine allows companies to incorporate in any state, regardless of whether they have material contacts with that state. Because of Delaware's business-friendly governance law and courts, the rulings of its courts largely determine corporate governance law in the United States. See Greenfield (2012) for further discussion, as well as Section 4's analysis of the need for a federal corporate governance law.

power of finance and a broad anti-government, pro-markets agenda (Feher 2018). Prominent intellectuals, including Milton Friedman and Michael Jensen, began to reframe the purpose of the corporation as in service of its "residual owners," the shareholders. As shareholder primacy shifted the power in corporate governance from the managerial to the shareholder class in the 1980s, executives shifted their priorities from the growth of sales over the long term to a short-term focus on cutting costs in order to maximize payments for shareholders (G. Davis 2009).

A series of policy interventions by the Reagan administration and a Supreme Court ruling entrenched this new understanding of corporate purpose and the growing power of shareholders within corporate governance. A major shift in the Department of Justice's (DOJ) antitrust merger guidelines opened the door for companies to spin off unrelated businesses within the conglomerate structure and merge them with companies in similar industries, ushering in a new kind of corporate consolidation. The Supreme Court ruling in *Edgar v. MITE* found that state antitakeover statutes were unconstitutional, opening the door for shareholders to begin aggressive campaigns to downsize the conglomerates in the search for return on their share value. The era of hostile takeovers reinforced for management that those who failed to maximize shareholder value were in danger of losing their jobs. In 1981, the Reagan administration took on the labor unions with the Professional Air Traffic Controllers Organization (PATCO) strike, in which Reagan took on a union strike and fired over 10,000 federal air traffic controllers. And most germane to this paper, new rules governing stock buybacks—the promulgation of the stock buyback "safe harbor," Rule 10b-18—allowed shareholders to extract corporate funds. As shareholder primacy grew, executive compensation shifted so that executives are now paid largely in shares or in pay based on rising share value (Cable and Vermeulen 2016). This has led to further incentives for executives to raise share price through stock buybacks because they stand to benefit personally (Jackson 2018).

One of the claims that politicians, both Republicans and Democrats alike, make in support of shareholder primacy is that it benefits the public, as "we are all shareholders" now (Holmberg 2018). In order to analyze who is benefitting from shareholder primacy, it is important to understand who shareholders are—and who they are not—and that not all shareholders hold the same power in corporate governance. Participation in capital markets is deeply stratified: There is a wealthy elite who own the majority of shares in the US, while middle-class investing households generally hold small retirement or investment accounts. Retail shareholders are limited to investing in big public corporations and own shares for the long term, through an employer retirement account; an asset manager, such as a mutual fund; or a pension fund. Wealthy shareholders invest in both public and private companies as accredited investors, through hedge funds and private equity firms, have much higher average holdings, and invest through funds that turn over their holdings much more quickly.

Nearly 50% of American households own some stock, though only 14% own stock directly. Forty-six percent of Americans own stock indirectly, though a pension account (46.6%), mutual fund (9.8%), or trust fund (3.9%).[5] It is important to examine the dollar value of total wealth holdings: Only 37% of households have total stock holdings over $5,000, and only 25% have holdings worth over $25,000.[6]

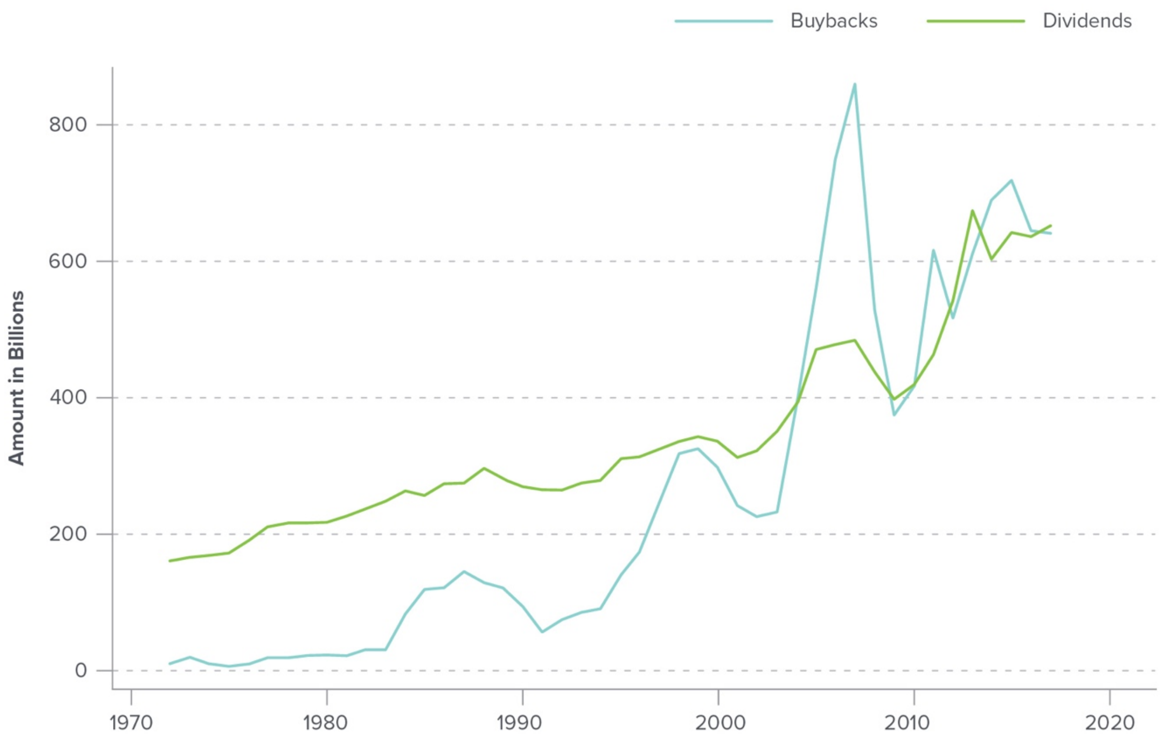
Share ownership is further stratified by race. The racial wealth gap is significant in holdings of direct and indirect stock and grows even starker when examining holdings over $10,000. Holdings have stayed nearly constant from 2001 to 2016: 57.5% of white households held stock in both 2001 and 2016, while the share of Black households holding stock fell four percentage points to 29.7% in 2016, and the share of Latinx households holding stock fell two percentage points to 26.3%. Perhaps more illuminating is the percentage of those holding stocks with a value of $10,000: In 2016, there was a gap of 28 percentage points between white and Black households (42.9% to 15.2%), and a gap of 30 percentage points between white and Latinx households (42.9% to 13.1%). Considering portfolios above $10,000, these are roughly the same gaps that existed in 2001 (the white-Black gap and the white-Latinx gap were 28% in 2001).[7] The concentration of larger shareholdings among a minority of wealthy and white households is important because it creates the potential for a divergence in interests between these shareholders and other corporate stakeholders—i.e., employees.

B. The Upsurge of Stock Buybacks

The dominance of stock buybacks, in which companies repurchase their own stock on the open market, is one of the clearest examples of shareholder primacy. While dividends have been issued to shareholders since the origin of the corporate firm, buybacks (also known as share repurchases) are a newer practice. Stock buybacks allow boards and executives to push up share prices by reducing the number of outstanding shares, thereby making each remaining share a larger portion of market value. Despite significant concerns about their potential for market manipulation within the Securities and Exchange Commission (SEC) in the 1970s, the practice became effectively legalized in 1982 and has grown tremendously over the subsequent decades (Palladino 2018d). US companies authorized over $1 trillion in share buybacks in 2018 (Cox 2018). The chart below shows the rise of stock buybacks and dividends—which, together, I call shareholder payments—since the early 1970s (adjusted for inflation).

[5] Because some households own stock directly and indirectly, the two proportions add up to more than 50% (Wolff 2017).
[6] Wolff (2017).
[7] Wolff (2018).

FIGURE 1. REAL BUYBACKS AND DIVIDENDS, 1970-2017



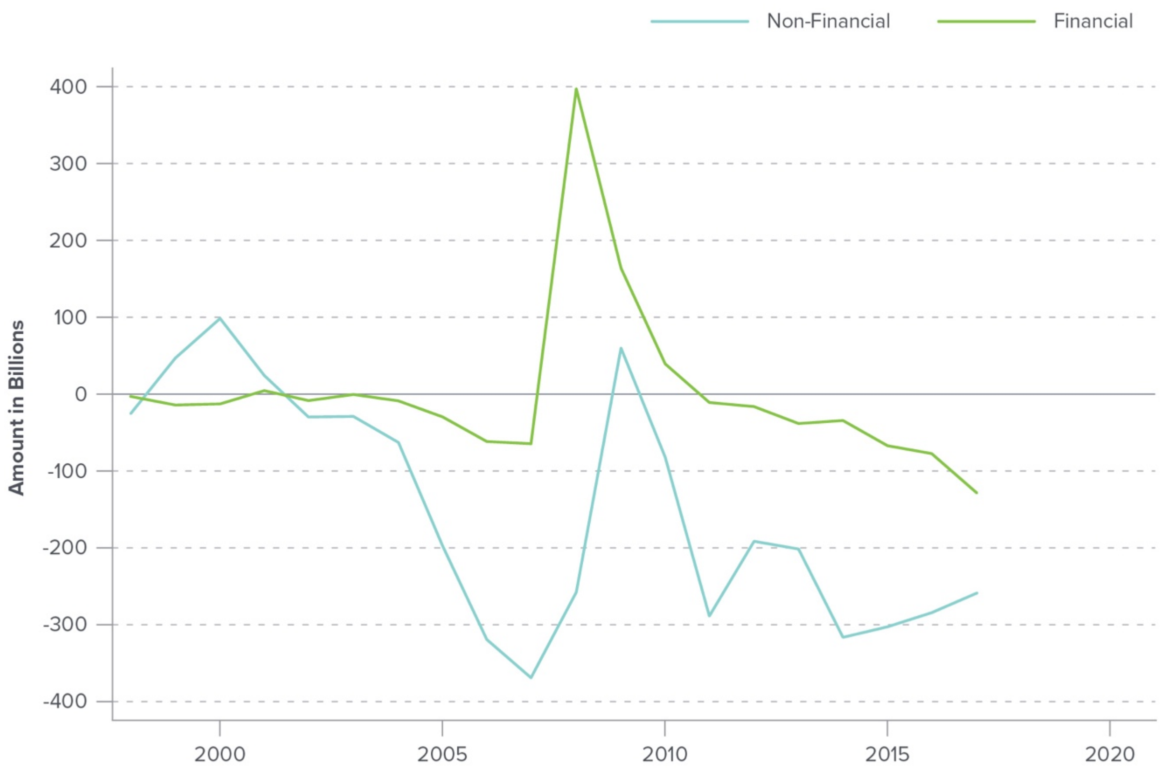
Source: Compustat

The figure shows the rise of stock buybacks and dividends, expressed in 2018 dollars, for all publicly traded corporations, as reported in Compustat. Stock buybacks peaked during the 2008 financial crisis, in part due to the structure of the bank bailout.

Buybacks proponents argue that they are an efficient mechanism to shift funds out of companies that have no efficient use for them and into companies that need capital to finance new innovation (Fried and Yang 2018). There are several issues with this argument. The first is, for the nonfinancial publicly traded corporate sector, more funds have been extracted by shareholders than have been reinvested through new equity issuances in all years but one for the last 15 years.[8]

[8] Because a part of the financial sector bailout during the financial crisis was the issuance of new stock by financial companies that was purchased by the government, including this sector greatly obfuscates equity issuances for productive purposes.

FIGURE 2. **NET EQUITY ISSUANCES, 1998-2017**



Source: Compustat

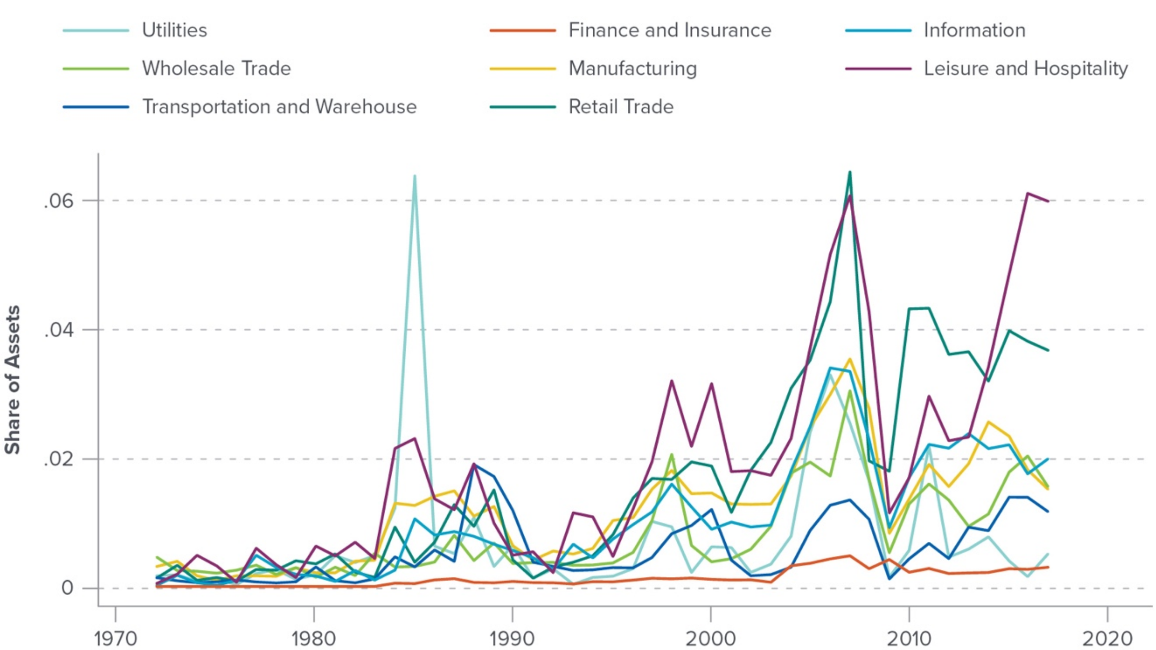
The figure shows the divergence between the financial and nonfinancial sectors. The financial sector's net equity issuances stayed mainly positive throughout the period, while the nonfinancial sector's net issuances are mainly negative, meaning that the level of stock buybacks was higher than new equity issuances, as reported in Compustat.

The second issue is that, especially at the level that buybacks have reached, there is real concern over whether they should be considered manipulation of companies' stock prices. The practice of open-market share repurchases is regulated by the SEC's Rule 10b-18, which places conditions around companies' stock buybacks. The rule limits the daily volume, timing, and manner in which buybacks can be conducted and requires quarterly disclosure and announcements of buyback programs. Because the SEC does not collect daily data on how much companies are spending on buybacks, regulators have no way of analyzing when a company is in, or out of, compliance with the daily limit requirement of the safe harbor. This tacit permission by the SEC for companies to engage in any level of buybacks that they choose has led to an explosion in the practice. Stock buybacks also provide a legally sanctioned mechanisms for corporate insiders to personally benefit, because no one but insiders know when stock buybacks are actually executed. A study by SEC Commissioner Robert Jackson Jr. found that corporate insiders are far more likely to sell their own personal shareholdings in the immediate aftermath of a buyback program (Jackson 2018). Finally, once funds are spent on stock buybacks and dividends, they are unavailable for other corporate uses in the future, including research and development (R&D), business expansion, and employee compensation.

This tacit permission by the SEC for companies to engage in any level of buybacks that they choose has led to an explosion in the practice.

Stock buybacks are not limited to a specific industry. The chart below shows stock buybacks as a share of total corporate assets for publicly traded corporations for all major industry sectors. Though there is some variation by sector, the growth of share repurchases across all industries is clear.

FIGURE 3. STOCK BUYBACKS AS A SHARE OF TOTAL CORPORATE ASSETS BY TWO-DIGIT NAICS SECTOR



Source: Compustat

Figure 3 shows that stock buybacks normalized by total corporate assets rose across the majority of sectors, though the retail and utilities sectors peaked at different moments. All data are for publicly traded corporations, as reported in Compustat.[9]

[9] Source: Author's analysis of Compustat database. Data organized by two-digit NAICS code, grouped by the following: "Manufacturing" = NAICS codes 31-33; "Wholesale, Transportation, and Warehousing" = NAICS codes 42, 48, and 49; "Agriculture, Utilities, and Construction" = NAICS codes 11, 21, 22, and 23; "Info. and Professional Services" = NAICS codes 51, 54, 55, 56; "Retail Trade" = NAICS codes 44-45; "FIRE (Finance, Insurance, Real Estate" = NAICS codes 52 & 53; "Social Services" = NAICS codes 61, 62, 71, and 81; "Food Service & Accommodation" = NAICS code 72. NAICS code 92, Public Administration, is not included in the analysis.

The table below shows that net issuances have been increasingly negative over time and across most sectors. Though there are exceptions in which net issuances grew, this shows that the trend of falling net issuances is not driven by one sector. The manufacturing, retail trade, and information sectors stand out as sectors in which buybacks outpace new issuances at the level of hundreds of billions of dollars over the past decade.

TABLE 1. NET EQUITY ISSUANCES BY SECTOR

Sector	Total Net Issuances (in Billions)	
	1998 to 2007	2008 to 2017
Agriculture, Forestry, Fishing, and Hunting	$0.83	-$12.27
Mining, Quarrying, and Oil and Gas Extraction	-$1.21	$158.90
Utilities	$5.18	$86.33
Construction	-$2.98	-$7.90
Manufacturing	-$645.02	-$1,478.24
Wholesale Trade	-$5.11	-$14.94
Retail Trade	-$170.15	-$396.80
Transportation and Warehousing	$20.20	$74.31
Information	-$82.09	-$577.25
Finance and Insurance	-$197.11	$228.70
Real Estate and Rental and Leasing	$87.70	$266.80
Professional, Scientific, and Technical Services	$16.91	-$62.81
Administrative and Support and Waste Management and Remediation Services	-$11.41	-$29.07
Educational Services	-$2.27	-$5.96
Health Care and Social Assistance	-$24.66	-$20.66
Arts, Entertainment, and Recreation	$3.20	$2.09
Accommodation and Food Services	-$32.83	-$90.03
Other Services (except Public Administration)	-$2.73	-$3.08
Unknown	-$11.86	-$11.32

The table expresses the change in net equity issuances over time for all two-digit sectors, using data on publicly traded corporations from Compustat.

Stock buybacks have not only grown in volume, but they have also taken up an increasing proportion of corporate profits. The table below presents spending on stock buybacks for the last 10 years for nonfinancial corporations and shows that public companies are spending, on average, 100% of profits on shareholder payments (buybacks and dividends combined). Perhaps more importantly, shareholder payments were over 75% of corporate profits in eight out of the last ten years, except for the two years during the Great Recession.

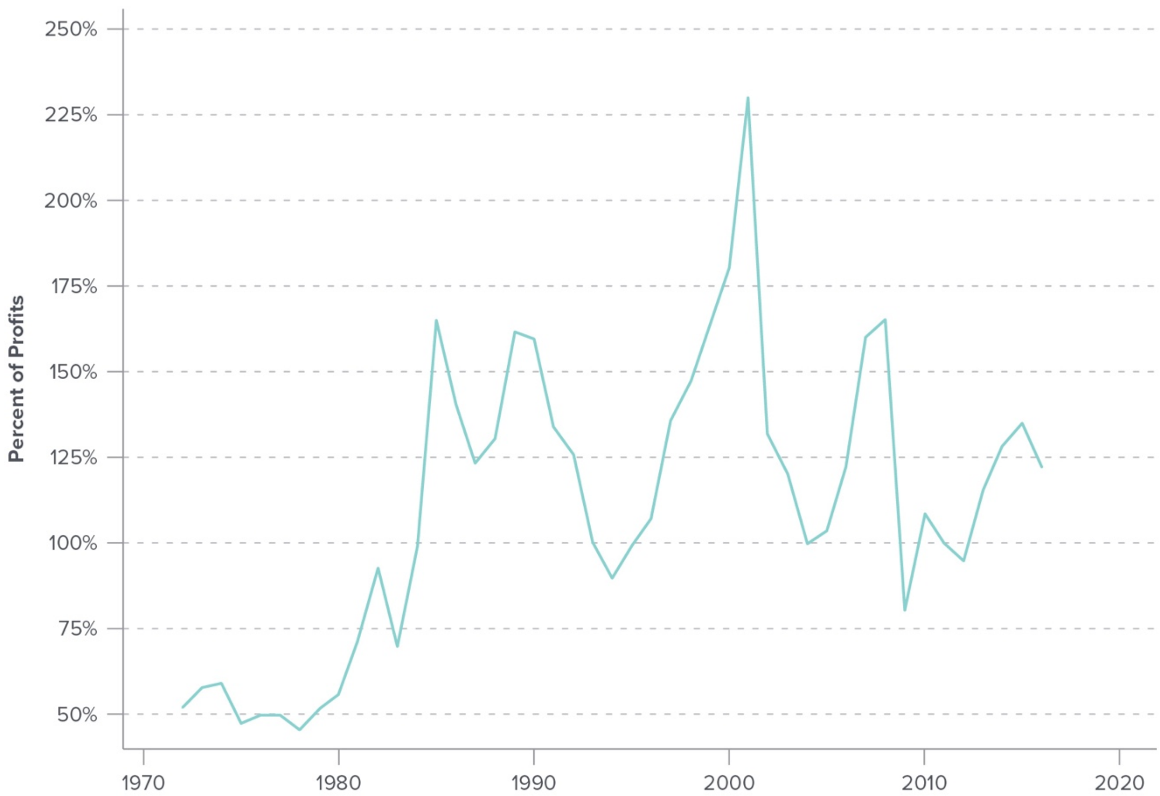
TABLE 2. STOCK BUYBACKS, DIVIDENDS, AND PROFITS OVER THE PAST 10 YEARS (NON-FIRE)

Year	Buybacks/Profit Ratio	Dividend/Profit Ratio	Shareholder Payments/Profit Ratio
2008	90%	72%	161%
2009	20%	42%	62%
2010	32%	35%	67%
2011	43%	35%	78%
2012	42%	49%	91%
2013	47%	44%	91%
2014	59%	52%	112%
2015	92%	86%	178%
2016	64%	64%	128%
2017	45%	50%	95%
Total/Avg.	50%	50%	100%

The table shows that, in eight of the last ten years, shareholder payments were over 75% of corporate profits for the nonfinancial sector. All data are from S&P Compustat.

For all firms, including the financial sector, the ratio is even higher: Shareholder payments have been above 100% for most of the last 20 years. All of these measurements indicate that changes within corporate governance have resulted in the increasing—and extractive—prioritization of shareholder payments.

FIGURE 4. SHAREHOLDER PAYMENTS AS A PERCENTAGE OF CORPORATE PROFITS



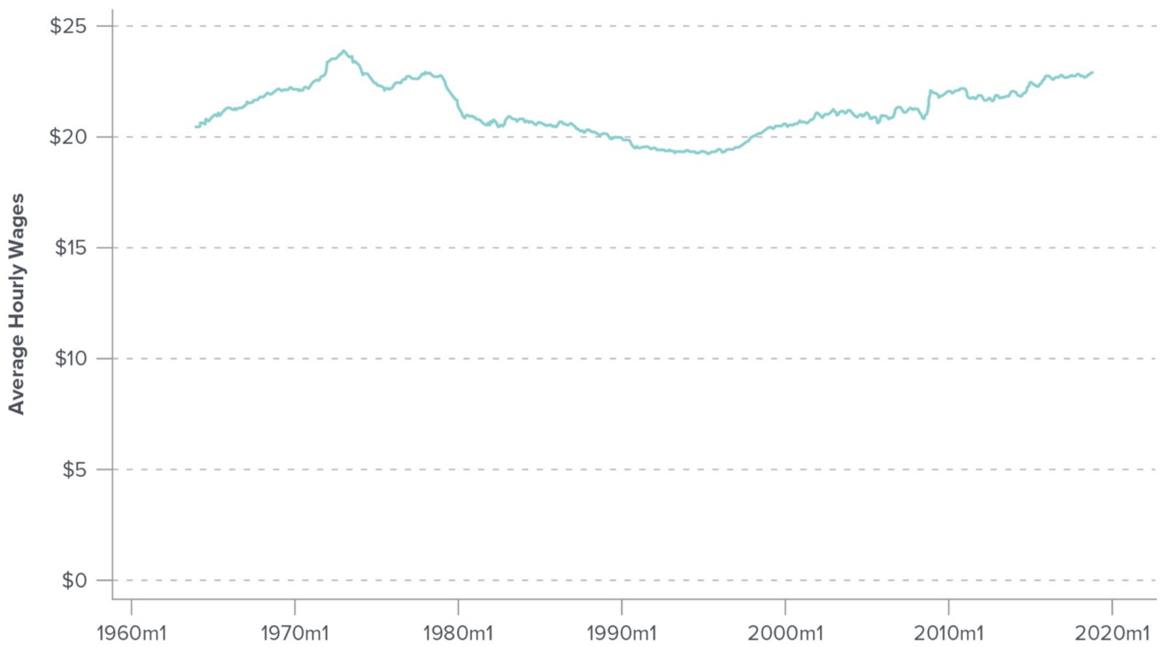
Source: Compustat

This figure shows the rise of shareholder payments as a percentage of corporate profits for all publicly traded corporations, as reported in Compustat.

C. The Decline of Worker Prosperity

At the same time that payments to shareholders rose, wages for typical non-executive workers stagnated. The table below shows the inflation-adjusted wages of nonsupervisory and production employees from the Current Employment Statistics (CES) survey of the Bureau of Labor Statistics (BLS) over the last 50 years, demonstrating the absence of real average wage growth during the rise of shareholder payments.

FIGURE 5. WAGE STAGNATION OF NONSUPERVISORY AND PRODUCTION EMPLOYEES



Source: Current Employment Statistics

This chart shows the lack of real average wage growth for nonsupervisory and production employees, as reported by the Current Employment Statistics survey. Data in 2018 dollars.

There are a multitude of explanations for the decline of the labor share and wage stagnation, including globalization (Stiglitz 2017), rising market power and decreased antitrust enforcement (Steinbaum 2018), the decline in the number of workers covered by a collective bargaining agreement (Michel 2016), financialization and the rising proportion of national income earned by the financial sector (Lin 2014), and fissuring of the workplace (Weil 2014). All of these trends play a role in the escalation of economic insecurity for employees. I argue that the rise of shareholder primacy and the resulting increase of shareholder payments, though related to many of the factors above, are distinct trends that have also jeopardized employees by placing increased pressure on management to minimize employment costs in order to extract maximum shareholder value.

A growing body of literature examines the relationship between shareholder primacy and employees.[10] Lin (2016) documents how a firm's shareholder value orientation affects total employment, emphasizing that different occupational groups are differently impacted. He finds that the return to shareholders has a long-term, negative effect on the size of employment for all occupational types, though the effect is strongest for service occupations.

[10] A broad literature studies rising financialization globally (e.g., Epstein 2005 and 2015; Palley 2008), and its impacts on investment and innovation. For a more thorough discussion of the literature connecting financialization and employees, see Palladino (2018b).

Lin and Tomaskovic-Devey (2013) find that increased corporate earnings from financial activity (as opposed to "traditional" productive and commercial activity) is associated with a decline in the labor share, higher compensation for top executives, and increased earnings dispersion among workers.[11] Using a counterfactual technique, they also find that financialization accounts for nearly 60% of the decline in labor's share between 1970 and 2008. Dunhaupt (2013; 2014) conducts a similar analysis across 13 countries, finding evidence of a distributional conflict between shareholders and wage earners. This paper builds on this literature by examining data on the relationship between profits, shareholder payments, and labor costs at the economy-wide, sectoral, and firm level.

III. EVIDENCE OF THE INCREASING PRIORITIZATION OF SHAREHOLDER PAYMENTS

To consider whether the hypothesis that rising shareholder primacy comes at the expense of employees is supported by data, in this section, I examine how corporate leaders use profits at the aggregate and sectoral levels. For the aggregate analysis, I divide the time period into earlier and later periods in order to see if there is a significant change as the pressures from shareholder primacy grew. I first describe the data sources and limitations and then present data on the changing nature of corporate behavior for the 45-year period from 1972 to 2017. This analysis gives support to, though not proof of, the argument that rising shareholder primacy has contributed to the loss of employee bargaining power. At the sectoral level, I similarly look at trends over the 45-year period to see if shareholder primacy is concentrated in a specific sector; I find that it is widespread.

A. Aggregate Analysis

Data and Methodology

At the aggregate level, I use the Bureau of Economic Analysis (BEA) Integrated Macroeconomic Accounts data for the nonfinancial sector, including profits, employee wages and salaries, and dividends. Corporations with publicly traded stock are required to report materially relevant data as part of regular filings with the SEC.[12] Because the only businesses that conduct stock buybacks are publicly traded corporations, I construct the shareholder payments variable by adding nonfinancial corporate business dividends from the Federal Reserve to nonfinancial corporate business stock buybacks data from S&P Compustat, a

[11] Notably, their research finds that financialization had a comparable impact on labor outcomes with the more common explanations for increased income inequality, including declining rates of unionization, and globalization, technological change, and capital investment.
[12] I exclude firms whose data are reported in a non-dollar currency and whose headquarters are located outside of the United States. I also exclude firms that are missing data for total assets, profits, cash flow, stock buybacks, dividends, or staff expenses.

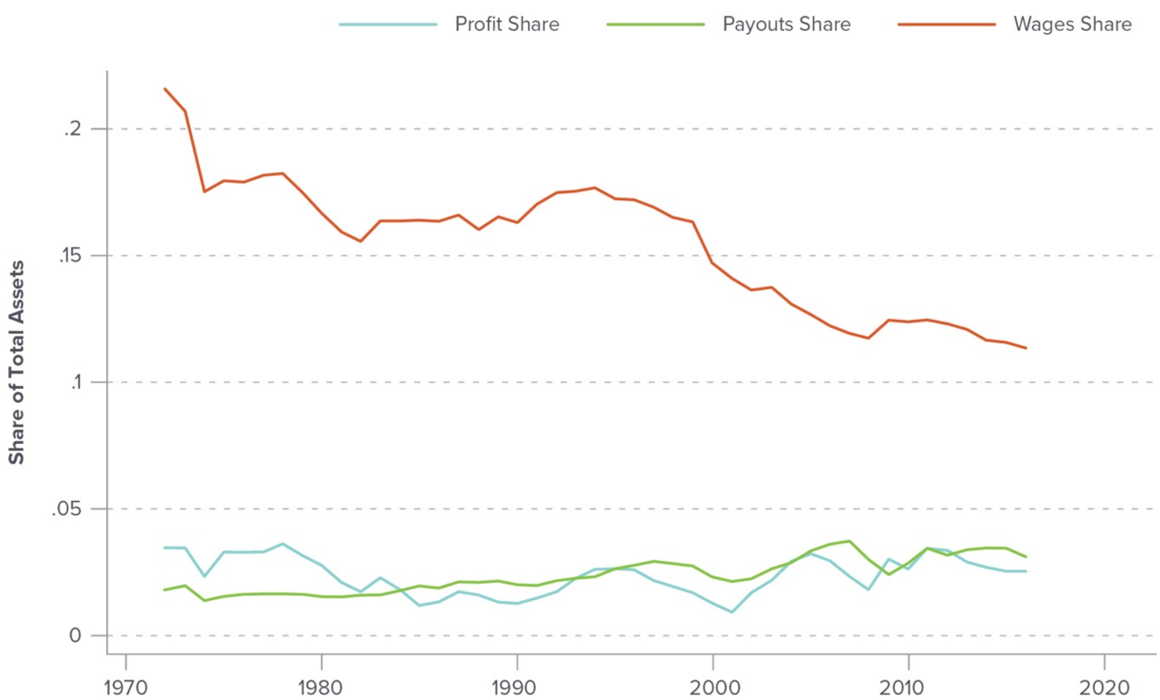
commercial database that aggregates data from corporate SEC filings. All variables are normalized by total corporate assets. The data are presented from 1972 to 2017, the most recent year for which complete data are available. All data are converted to 2018 dollars using the 2018 Consumer Price Index (CPI). One limitation here is that a growing wage bill represents both an increase in the wage of a given worker and the expansion of employment. This analysis thus explores the changing relationship between rising profits and payments to labor as a whole (i.e., both to rising wages and to increased employment).

Results

The purpose in analyzing the aggregate data for the nonfinancial corporate sector is to see whether there is any evidence that the relationship between corporate profits, shareholder payments, and employee compensation shifted in a way that is consistent with the argument that shareholder primacy has contributed to the loss of employee bargaining power.[13] For policymakers, the economy-wide level may be the most significant analysis because public policy is a blunt instrument. First, to illustrate the trends over time, I present the profits, the wage bill, and shareholder payments, all normalized by total corporate assets. The data show that wages fell relative to corporate assets, while shareholder payments rose. (Profits fluctuated relative to assets, in a manner that is expected given business-cycle fluctuations.)

[13] I focus on the nonfinancial sector because of the distinct use of equity issuances in finance, specifically during the financial crisis, as discussed above.

FIGURE 6. PROFITS, THE WAGE BILL, AND SHAREHOLDER PAYMENTS AS A PERCENTAGE OF TOTAL CORPORATE ASSETS, FOR NONFINANCIAL CORPORATIONS. 1972-2017



BEA Integrated Macroeconomic Accounts

This figure shows the decline in the wage bill as a percentage of total corporate assets, and modest growth in shareholder payments, for nonfinancial corporations. All data are from the BEA Integrated Macroeconomic Accounts.

Looking directly at the data, the wage bill fell steadily from 21% of total corporate assets in 1972 to 11% in 2017. Total wages have been below 15% of assets every year since 2001. Profits have fluctuated, starting the period at 2.84% and ending at 2.55%, with a high of 3.62% and a low of .93%. Meanwhile, payments to shareholders have doubled as a percentage of assets, from 1.7% in 1972 to 3.5% in 2017. These shifts are consistent with a story of rising shareholder power and declining employee bargaining power.

TABLE 3. PROFITS, WAGES AND SALARIES, AND SHAREHOLDER PAYMENTS AS FRACTION OF TOTAL ASSETS FOR SELECTED YEARS (See Appendix for table for all years)

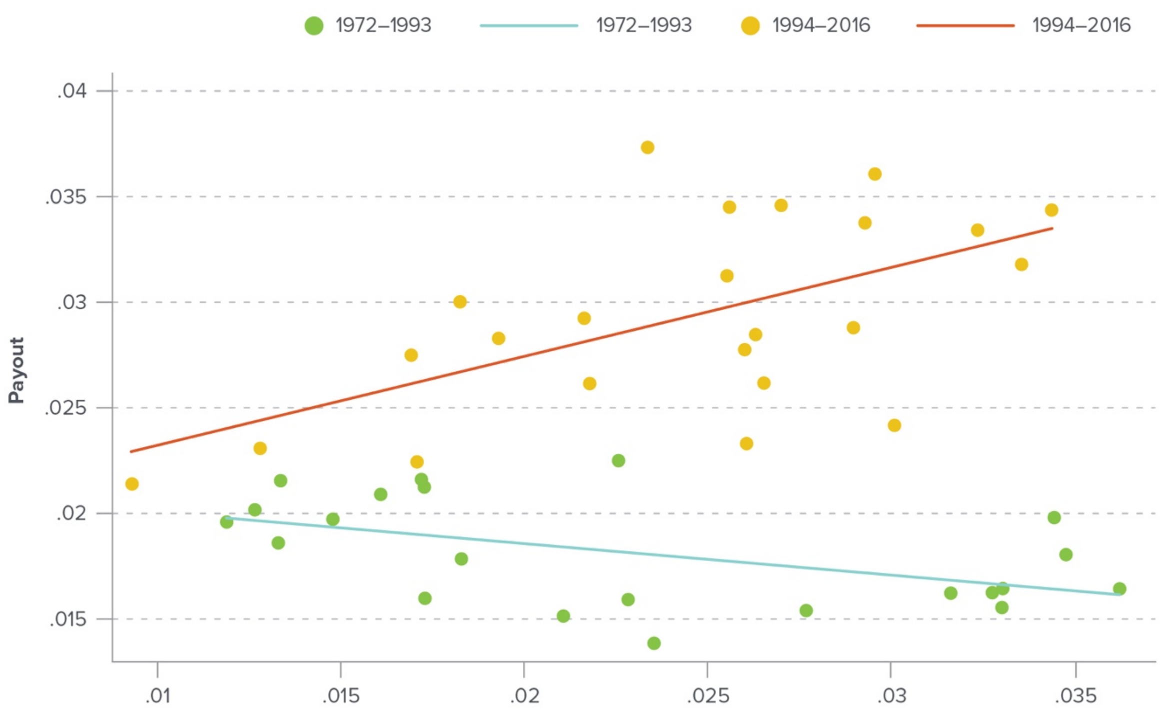
	1975	1985	1995	2005	2015
Profits	3.30%	1.19%	2.65%	3.23%	2.56%
Payments	1.56%	1.96%	2.62%	3.34%	3.45%
Stock Buybacks	0.05%	0.64%	0.61%	0.61%	1.39%
Dividends	1.51%	1.32%	2.01%	2.07%	2.06%
Wage Bill	18.0%	16.4%	17.2%	12.7%	11.6%

The table shows the increase of shareholder payments as a percentage of total assets over time, while the wage bill steadily declined. All data are for nonfinancial corporations, as reported in the BEA Integrated Macroeconomic Accounts.

Because shareholder primacy did not become dominant in any particular year, it is useful to compare the relationships between corporate uses of profits for an earlier period, when managerial corporatism was still a stronger corporate governance paradigm, to the later period, when a series of policy and business-practice changes had entrenched shareholder primacy. Of course, firms exhibit a wide variety of tendencies regarding shareholder payments and employee compensation. Amazon, perhaps the most important corporation of the 21st century, announced an increase of base pay to $15 an hour and does not use stock buybacks at all. In contrast, Walmart, the country's largest private employer, has historically pushed wages as low as possible (starting wages are still $11 an hour, where permissible) and engages in high levels of buybacks. No aggregate analysis can capture all of such nuance, but if there has been a general trend towards prioritizing shareholders, it should show up in the aggregate data.

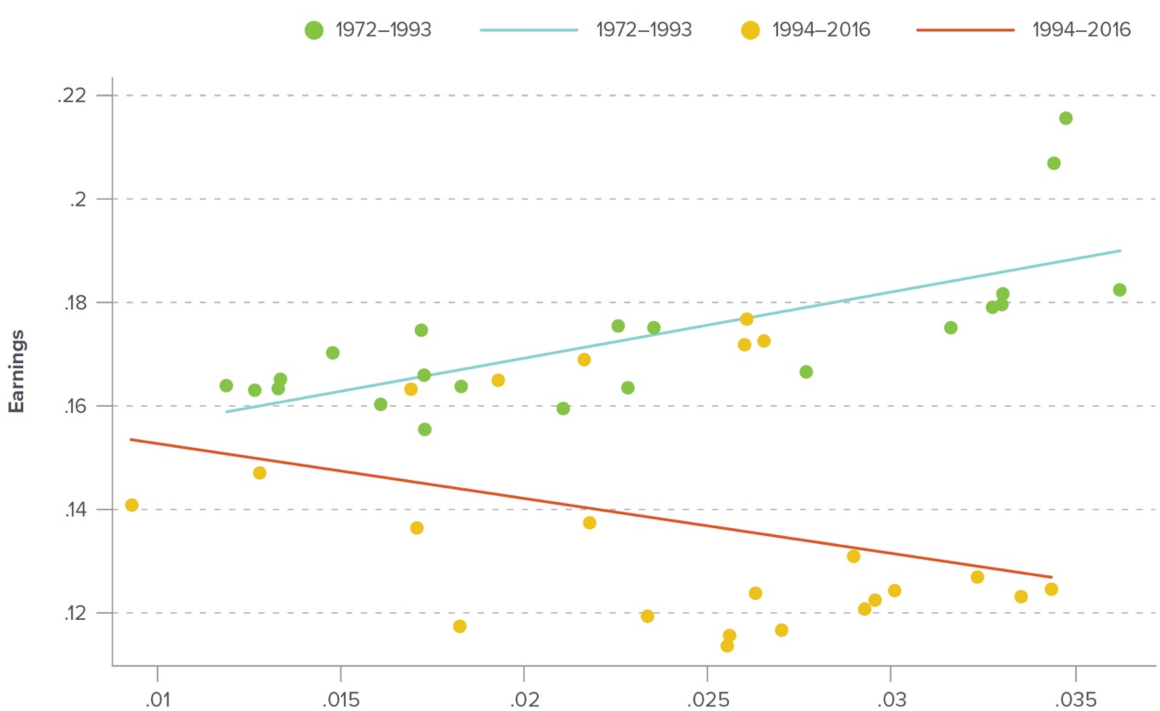
To study the change, I use two time periods: 1972-1993 and 1994-2017, which divide the study period in half. The break in the study period was chosen because of a policy change in 1994 that permitted corporations to deduct executive "performance-based pay," marking a new era of aligning the interests of management and shareholders by increasing the percentage of executive pay that is equity based. I present scatterplots showing the changing relationships between profits and shareholder payments, on the one hand, and profits and payments to employees (the variable for wages here represents the rising wage bill, which includes both rising wages per worker and expanding employment), on the other. All data are again normalized by total corporate assets.

FIGURE 7. PROFITS AND SHAREHOLDER PAYMENTS SCATTERPLOT



BEA Integrated Macroeconomic Accounts

FIGURE 8. PROFITS AND WAGE BILL SCATTERPLOT



BEA Integrated Macroeconomic Accounts

The first plot shows a downward-sloping relationship between profits and shareholder payments over the first period but a sharp upward slope for the relationship between profits and payments in the second period, suggesting the growing bargaining power of shareholders. The second scatterplot shows the opposite: Though profits and wages had a slightly upward-sloping relationship in the first period, the relationship reverses in the later period, as higher profits are associated with a lower wage bill. Of course, other factors are at work influencing all variables: changes in the labor market will influence wages, for instance; and changes in social programs will influence broader employee compensation (e.g., changes in the expectations of corporate-sponsored retirement have dramatically shifted over the last few decades). I cannot claim that a causal relationship exists between the rise of shareholder payments and stagnant wages. However, the shifting relationship between profits and payouts and wages, respectively, is a suggestive first step toward establishing a causal relationship.

It is important to note that some of the positive relationship will reflect the variation of assets over time, and the positive relationship in the first period between profits and shareholder payments may be exaggerated. However, this factor does not explain the shift in the relationship between the first and second periods; it actually makes the second period's negative relationship between profit growth and the growth of the wage bill all the more striking.

B. Sectoral Analysis

Data & Methodology

For the sectoral-level analysis, I use S&P Compustat to obtain firm-level data on corporate profits and shareholder payments, combining dividends and stock buybacks. Unfortunately, employee compensation data are not uniformly available at the firm level (see below for more detail). I instead obtain sector-level average wage data for nonproduction and supervisory employees from the CES, a monthly survey conducted by the BLS that is based on 149,000 businesses and government agencies that represent 651,000 worksites throughout the US. Data at the sector level are published as far back as 1939, though data at the industry level go back only to 1990. For this analysis, I obtain data on employment levels and weekly earnings from 1972 to 2017 in order to compute a yearly average wage rate for nonexecutive employees.[14] This variable measures changes in yearly average wages directly,

[14] I obtain monthly data that included seasonally adjusted employment levels and weekly earnings for nonsupervisory and production employees at the sector level. Then I calculate the 12-month average for each variable. I adjust average weekly earnings to average annual earnings. Then I multiply by average employment levels to create an annual worker compensation variable for each sector. From there, I match the CES industry sectors to the NAICS sectors from Compustat to merge the data.

disaggregating the growth of the total wage bill into the portion attributed to growth of average wages per worker.[15] This is likely a decent approximation of average wages for publicly traded companies, but it is not a firm-specific variable. I aggregate firm-level data at the two-digit sector from Compustat for the following discussion.

Results

Here, I present the growth rate of shareholder payments alongside the growth rate of average wages for each sector, for decades over the time period.

TABLE 4. GROWTH RATES OF SHAREHOLDER PAYMENTS AND AVERAGE WAGES, 1975-2015

Shareholder Payments				
Sector	**1975–1985**	**1985–1995**	**1995–2005**	**2005–2015**
FIRE	399%	290%	527%	12%
Info.	322%	73%	353%	11%
Manufacturing	330%	125%	172%	73%
Retail	257%	136%	400%	110%
Transp.	464%	31%	281%	167%
Utilities	1395%	-30%	213%	81%
Wholesale	231%	58%	236%	107%
Average Wages for Nonsupervisory and Production Employees				
Sector	**1975–1985**	**1985–1995**	**1995–2005**	**2005–2015**
FIRE	121%	43%	119%	47%
Info.	21%	9%	54%	30%
Manufacturing	33%	1%	21%	10%
Retail	26%	36%	52%	8%
Transp.	65%	55%	11%	7%
Utilities	11%	72%	25%	8%
Wholesale	5%	22%	30%	28%

The tables show growth rates by decades for major industry sectors for shareholder payments; for publicly traded corporations, as reported in Compustat; and for average wages for nonsupervisory and production employees, as reported by the CES survey of the BLS. Compustat does not provide adequate firm-level average wage data; thus, the CES average wage is a useful approximation.

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[15] To calculate a yearly wage variable, I used the following procedure: Weekly earnings are in dollars, so multiplying by 52 gives yearly earnings in dollars. Employment is in 1,000s, so I multiply by 1,000 to determine total employment in the industry; then multiply the two, which gives us yearly earnings of all production employees for all of the firms in these industries. Then, I divide that number by 1 million, because the Compustat variables are expressed in millions.

The comparison shows the much higher growth rate of shareholder payments versus the growth rate of average wages for nonproduction and supervisory employees. Of course, this does not indicate that rising payments to shareholders has *necessarily* had any impact on the slower growth rate of average wages. But the analysis does show that the rise in shareholder payments is not driven by any one sector, and that, similarly, the slowdown of wage growth is not limited to one or two areas of the economy. In the most recent decade, four out of seven sectors had growth rates for average wages of 10% or less. In those same sectors, shareholder payments grew between 73% and 167%. The FIRE and information sectors did see a slowdown in the growth rate of payments in the last decade, but the overall level of shareholder payments had already reached extreme heights in 2005, at nearly half a billion dollars in one year.

IV. BOLD POLICY REFORMS TO END SHAREHOLDER PRIMACY AND REBALANCE BARGAINING POWER WITHIN FIRMS

The analysis above demonstrates several ways to understand the cost of shareholder primacy to employees. To rebalance bargaining power between employees and shareholders, it is critical to rewrite the corporate governance and securities rules that drive firms to prioritize rewarding shareholders above all. In this section, I present specific proposals for policy reform (which are more fully developed in related papers) on two issues: first, how to limit stock buybacks; second, how to broadly reorient corporate law towards a stakeholder-centered corporate governance framework.

Policies to Limit Stock Buybacks

There is a wide range of policies that could limit unproductive stock buybacks. (For a longer discussion, see Palladino 2018c.) For example, Congress can ban open-market share repurchases by passing affirmative legislation that prohibits such stock buybacks, or, if not an outright ban, establish bright-line limitations.[16] Congress could also choose to condition or prohibit the ability of a company to conduct repurchases based on other corporate variables. For example, policymakers could prohibit buybacks if companies have unfunded pension liabilities, have engaged in layoffs, have failed to meet a certain level of productive investment, have wage dispersion below a certain threshold, or have executive compensation above a certain limit. Finally, Congress could institute a stock buyback transaction tax, in which each stock buyback transaction costs the firm a certain percentage of the dollar value of the trade in taxes.

[16] See, for example, the Reward Work Act, the Worker Dividend Act, and the STOP Walmart Act.

If Congress is unmoved to act, the SEC can act in its regulatory capacity and repeal Rule 10b-18. The SEC could revert to the pre-1982 norm, by which companies faced potential liability for conducting buybacks, or it could place bright-line limits on the amount of and timing for buybacks. Importantly, directors and executives must be prohibited from selling their personal shares for a meaningful period of time after buyback programs have been announced. The SEC could instead decide that it must authorize a company's use of stock buybacks, as is the case for banks, and could promulgate rules giving the commission wide latitude to reject buybacks that come at the expense of other corporate stakeholders. Finally, general company disclosure requirements, though not necessarily sufficient to curb substantive behavior, would at minimum inform the SEC when bright-line rules are violated and put directors and officers on notice that repurchase activity will be scrutinized in real time. The SEC should require firms to disclose repurchases immediately and publicly.

Policies to Institute Stakeholder Corporate Governance

Though limiting stock buybacks is necessary in the near term, to rein in shareholder primacy, the law of corporate governance itself must be reformed to a stakeholder governance model. (See Palladino 2018e for more detail on corporate law and the policies proposed below.) Corporations are privileged business entities that shield individuals from liability, have perpetual life, are able to raise huge amounts of capital, and become enormously profitable. As a result, they stand to make a large impact, positive or negative, in the communities they occupy and on our economy and society. Ultimately, shareholder primacy should be replaced with a more effective framework for corporate law in which all corporate stakeholders have a role in decision-making and are considered when corporate choices are made.

The first substantive policy change required for stakeholder governance is to rewrite corporate purpose statements such that corporations are committed by law to act in the public's best interests. The large majority of corporations simply state in charter documents that their purpose is to engage in all lawful activity under their enabling statute.[17] In exchange for the benefits that corporations receive and the public's permission to exist, they should be legally committed to not externalize the harms resulting from business decisions onto society. One model for how to codify new corporate-purpose language comes from public benefit corporations. In these statutes, public benefit is defined as a "materially positive effect (or the reduction of negative effects) on persons, entities, communities or interests" (Model Benefit Corporation Legislation 2017). Though the language of these statements presents enforcement challenges, a pledge to serve the public good is a necessary first step.

Second, board fiduciary duty should run to all corporate stakeholders. Currently, board "fiduciary duty"—the legal standards of care and loyalty owed by directors—states that directors are accountable only to shareholders for their decisions. Instead, corporate boards should be required to show that they considered the interests of all other corporate stakeholders as well. A third area for policy reform is to ensure that stakeholders are represented on the company's corporate board. Currently, large corporations have boards elected solely by shareholders. This appointment mechanism ensures that board members serve the interests of the investment community and corporate executives and that there can be no significant buy-in from employees. Worker representation is a necessary first step toward more inclusive corporate behavior.

Giving employees a seat at the table can be enacted in several ways. Most directly, firms could be required to reserve 40% of board seats for worker representatives, and these seats could be nominated by the workforce or union members. On a broader level, employees can be brought "inside" corporate governance through other mechanisms. For example, employees could have nonbinding votes or could be surveyed regularly. McDonell (2011) writes: "One can classify possible laws along three axes: the level within a corporation at which employees have a voice, the scope of decisions over which they have a voice, and the degree or kind of voice they have over a particular matter" (p. 108). Along these axes, a policy to include workers on boards would boost workers' voices to the highest level within a corporation, expose them to the greatest scope of decision-making, and grant them voting power on par with senior executives.

Worker representation is a necessary first step toward more inclusive corporate behavior.

V. CONCLUSION

The rise of shareholder primacy has contributed to America's high-profit, low-wage economy, in which the wealthy few capture much of value created by working people. In 2018, recognized unemployment is near record lows of the last several decades, but real average wages for nonexecutive workers have barely budged. Meanwhile, shareholder wealth is sky high, in part due to the choice by some corporations to spend more than 100% of profits on shareholder payments.

It is important to recognize that corporations, in having the available resources, can afford to create new jobs, pay employees living wages, and provide robust benefits. Laws that govern corporate behavior should be democratically determined, as corporations are businesses given immense privileges by a public grant of existence. Policies to restructure our economy back toward shared prosperity include restricting stock buybacks and enacting a stakeholder corporate governance model. The purpose of this paper has been to demonstrate how high the opportunity cost of shareholder primacy can be. The demand for rising shareholder payments constrains the ability of corporate funds to be put towards a stable and well-compensated workforce.

Along with other economic dynamics that impact working people, the assumption that corporate prosperity should benefit only shareholders has hurt the ability of employees to bargain for a share of corporate profits and a growing economy. Policymakers and the American public must understand how shareholder primacy hinders a brighter economic future for today's workers. Pragmatic reforms to the rules that govern stock buybacks and to corporate governance are achievable and will benefit not only employees but also the long-term prosperity of corporations themselves and our economy at large. Policymakers should counter runaway shareholder primacy with reforms that rebalance the relationship between corporate boards, employees, and society.

APPENDIX 1. AGGREGATE ANALYSIS: VARIABLES NORMALIZED BY TOTAL ASSETS, ALL YEARS

Year	Profit Share	Wage Share	Stock Buybacks	Dividends Share	Share. Payments
1972	3.47%	21.6%	0.10%	1.70%	1.81%
1973	3.44%	20.7%	0.16%	1.83%	1.98%
1974	2.35%	17.5%	0.08%	1.31%	1.39%
1975	3.30%	18.0%	0.05%	1.51%	1.56%
1976	3.27%	17.9%	0.07%	1.55%	1.63%
1977	3.30%	18.2%	0.13%	1.52%	1.64%
1978	3.62%	18.2%	0.12%	1.53%	1.64%
1979	3.16%	17.5%	0.13%	1.49%	1.62%
1980	2.77%	16.7%	0.14%	1.40%	1.54%
1981	2.11%	15.9%	0.13%	1.39%	1.51%
1982	1.73%	15.5%	0.18%	1.42%	1.60%
1983	2.28%	16.3%	0.17%	1.42%	1.59%
1984	1.83%	16.4%	0.44%	1.34%	1.79%
1985	1.19%	16.4%	0.64%	1.32%	1.96%
1986	1.33%	16.3%	0.58%	1.28%	1.86%
1987	1.73%	16.6%	0.68%	1.45%	2.13%
1988	1.61%	16.0%	0.59%	1.50%	2.09%
1989	1.34%	16.5%	0.57%	1.58%	2.16%
1990	1.27%	16.3%	0.44%	1.58%	2.02%
1991	1.48%	17.0%	0.27%	1.70%	1.97%
1992	1.72%	17.5%	0.37%	1.79%	2.16%
1993	2.26%	17.5%	0.41%	1.84%	2.25%
1994	2.60%	17.7%	0.39%	1.94%	2.33%
1995	2.65%	17.2%	0.61%	2.01%	2.62%
1996	2.60%	17.2%	0.71%	2.06%	2.78%
1997	2.16%	16.9%	0.92%	2.01%	2.93%
1998	1.93%	16.5%	1.10%	1.73%	2.83%
1999	1.69%	16.3%	1.03%	1.73%	2.75%
2000	1.28%	14.7%	0.85%	1.46%	2.31%
2001	0.93%	14.1%	0.67%	1.47%	2.14%
2002	1.71%	13.6%	0.61%	1.64%	2.25%
2003	2.18%	13.7%	0.66%	1.95%	2.62%
2004	2.90%	13.1%	0.94%	1.94%	2.88%
2005	3.23%	12.7%	0.61%	2.07%	3.34%
2006	2.95%	12.2%	1.62%	1.99%	3.61%
2007	2.33%	11.9%	1.83%	1.91%	3.74%
2008	1.82%	11.7%	1.30%	1.70%	3.01%
2009	3.01%	12.4%	0.55%	1.87%	2.42%
2010	2.63%	12.4%	1.01%	1.84%	2.85%
2011	3.43%	12.5%	1.38%	2.06%	3.44%
2012	3.35%	12.3%	1.20%	1.98%	3.18%
2013	2.93%	12.1%	1.34%	2.04%	3.38%
2014	2.70%	11.7%	1.42%	2.04%	3.46%
2015	2.56%	11.6%	1.39%	2.06%	3.45%
2016	2.55%	11.4%	1.16%	1.96%	3.13%

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ACKNOWLEDGMENTS

Special thanks to Adil Abdela, Susan R. Holmberg, and JW Mason for their comments and insight. Kristina Karlsson provided excellent research assistance, and Roosevelt staff Nell Abernathy, Kendra Bozarth, Steph Sterling, and Victoria Streker all contributed to the project.

This paper was made possible with the generous support of the Robert Wood Johnson Foundation. The contents of this publication are solely the responsibility of the author.

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