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**Testimony before the U.S. Joint Economic Committee: Hearing on “Examining
the Impact of Shareholder Primacy: What it Means to Put Stock Prices First”**

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Chairman Beyer, Ranking Member Lee, Members of the Joint Economic Committee, thank you so much for the invitation. I am honored to be here today.

My name is Lenore Palladino, and I am an Assistant Professor of Economics and Public Policy at the University of Massachusetts Amherst. My research focuses on large corporations and their critical role in generating innovation, as well as how public policy can enable sustainable prosperity.

I see shareholder primacy as a flawed theory of the corporation because it makes incorrect assumptions about the role of both shareholders and other corporate stakeholders in the process of production. The arguments from scholars of law and economics that shareholders are ‘residual claimants’ and thus the only group who should have power in corporate governance is silent on how companies actually produce better-quality products over time (i.e., how they make use of their inputs to produce better outputs). The theory of shareholder primacy misunderstands the role of shareholders trading on secondary markets and assumes that employees and other stakeholders take less risk than such shareholders, even though most of us have only one job, and if we’re lucky enough to hold corporate equity, we hold it in completely diversified portfolios—our risk comes from the stressors the entire economy faces, not just one company. My work is rooted in the economics of innovation as developed by economists like Schumpeter and Chandler, and today, William Lazonick.

In practice, the orientation towards ever-increasing share prices by corporate and financial leaders has created constant pressures to pay shareholders or face activist shareholder wrath¹. The gains from spending corporate funds on financial practices like stock buybacks disproportionately benefit white, wealthy American households, because these are the households who hold the vast majority of corporate securities.² Federal Reserve data tells us that only half of U.S. households hold any

¹ My message is summed up by this quote from former Chief Justice from the State of Delaware, Justice Leo Strine: “Corporations have created financial returns for shareholders, but largely at the expense of other constituencies like workers. The imbalances in our current system have also left it brittle and less capable of avoiding or responding to crisis.” Kovvali A., Strine, L. (2022) “The Win-Win That Wasn’t.” Harvard Law School Discussion Paper 2022-1.

² The Federal Reserve’s Survey of Consumer Finances tells us that only half of U.S. households hold any stock at all, directly or indirectly². For corporate equity and mutual funds, the top 1 percent of households by wealth holds 53.8 percent of stock and the next nine percent hold thirty five percent; what this means is that the other 90 percent of households hold 11 percent. Pension entitlements, which include corporate equity and other financial assets, are less concentrated, but the bottom fifty percent of households by wealth still holds just three percent. Black households hold 1 percent of non-retirement corporate equity, while Latino households hold half a percent; in terms of pension

stock at all. Meanwhile, there are countless examples where the focus on spending corporate funds on shareholders has left companies ill-equipped to face shocks and been used as a justification for holding down labor costs.

Policymakers have a critical opportunity to strengthen American innovation and resilience as we emerge from the pandemic. The economic and geopolitical challenges that face us are not going to stop. That is why it is time to strengthen our commitment to American productivity by reorienting our public policy away from enabling a single-minded focus on share prices and towards enabling innovation.

My testimony today focuses on three key points:

1. First, defining the key components of economic innovation and resilience in the 21st century;
2. Then, where corporations and finance have gotten off track – what the harms have been of the prioritization of shareholder primacy and “putting stock prices first;”
3. Finally, what the opportunities are today to rewrite the rules to orient our economy towards innovation and shared prosperity.

1. What Drives Innovation

What are the requirements for innovation, sustainability, and good jobs in America? Only by understanding what enables innovation and resilient economies will we have a clear framework for understanding the challenges of shareholder primacy. Corporations are the hot-blooded engines of *production*: it is inside corporations that the decisions are made about what gets produced, by whom, and how firms collaborate and compete to innovate and market.

We know from the history of successful companies that innovation comes about from long-term risk-taking by businesses, enabled by collective and cumulative learning³. It requires complex

entitlements, Black households hold ten percent while Latino households hold 3.5 percent, disproportionately less than their share of the population².

³ Lazonick, W. (2017) Innovative Enterprise Solves the Agency Problem: The Theory of the Firm, Financial Flows, and Economic Performance.

organization, investment and retention of the workforce, and long-term financial commitments. The theory of the corporation as an innovative enterprise—engaged in productive innovation by producing higher-quality goods and services for lower unit costs—explains what makes corporations successful producers. In the formal language of economics, innovative corporations seek to reduce both fixed and variable costs of production, and do not take fixed costs as a given. Both fixed and variable inputs-or "resources"-- are not just lying around waiting to be used: the alchemy of innovation is in trying new ways to utilize such resources, even though some new methods will succeed while some will fail. In other words, innovation depends on both resource development and utilization, neither of which can be accomplished a single time and never again⁴.

Innovation requires a committed workforce that is engaged in improving the production process over time. Its financial base has been retained earnings leveraged by debt (and, in some sectors, a base of public investment): while corporate equity issuances bring financial resources into the firm when firms go public, subsequent trading of equity does not directly support innovation.

Theories of innovation should guide economic policymaking. However, over the last forty years, instead the theory and practice of shareholder primacy has come to dominate the American business landscape. Shareholder primacy is a flawed theory of corporate purpose and corporate governance, as it posits that shareholders take a certain kind of risk while no other corporate stakeholders do-- including the workforce, customers, suppliers, and the taxpaying public—and that putting the power of corporate governance in the hands of shareholders will best maximize social welfare. I have written at length about the flaws of shareholder primacy as a theory in addition to in practice⁵. Let me make a few points in that regard; first, I will offer a quote from Judge Leo Strine Jr., commenting on the concept that shareholder primacy will benefit social welfare:

“The argued ‘win-win’ has been a win for one constituency—stockholders-- and at best another — top management — to the detriment of those most responsible for corporate success: the workers.” (Kovvali and Strine 2022, p. 5).

⁴ O’Sullivan, M. (2000) The innovative enterprise and corporate governance. *Cambridge Journal of Economics*, **24**, 393-416. See also Penrose, E. (1959) *The Theory of the Growth of the Firm*. Wiley, New York.

⁵ Palladino, L. (2020) Financialization at work: Shareholder primacy and stagnant wages in the United States. *Competition & Change*. 25(3-4), 382-400. See also Kassoy, A. et al. (2020) From Shareholder Primacy to Stakeholder Capitalism; Lazonick, W. & O’Sullivan, M. (2000) Maximizing shareholder value: a new ideology for corporate governance. *Economy and Society*, **29**, 13-35.

Shareholder primacy is usually framed as necessary – i.e., shareholders must have authority in corporate decision-making, and see their share prices rising, in order for the companies that produce our goods and services to have the financing available that they need to innovate. Yet it is the hard work of employees, customer needs and interests, and public infrastructure that determine today whether businesses succeed. This theory misunderstands the role of shareholders of publicly traded corporations who are *traders* – meaning that when I purchase financial assets to save for retirement, the funds that I spend do not go to the operating companies whose stock is now in my portfolio—the money I spend goes to the entity that sells me the shares.

The argument that shareholders should supervise corporate decisions because they take more risks and therefore care more about the actual decisions of a given company than other corporate stakeholders is especially flawed in the 2020s, as most households today hold fully diversified portfolios, meaning that we do not even know what individual stocks we hold. Put simply, there is no reason for second-by-second stock price fluctuations to be more important to corporate leaders than long-term innovation and resilience in production and supply chains, along with the well-being of the workforce required to produce.

What we need fundamentally is a full-scale reorientation towards innovation, which I know this committee and the Biden-Harris Administration has prioritized. We have seen leading organizations like the Business Roundtable call for a reorientation away from a sole focus on financial metrics, and some companies, such as Intel, start to move in that direction. We've also seen some Republicans understand the need for this reorientation⁶. Yet financial sector pressure for short-term returns will continue unless structural reforms are made.

2. How Corporations & Finance Have Gotten off Track

Shareholder primacy and the relentless focus on short-term share price increases by "activist" investors has changed the priorities within American businesses. Let me give some examples.

⁶ Rubio, M. (2019) *American Investment in the 21st Century*. Office of Senator Marco Rubio. https://www.rubio.senate.gov/public/_cache/files/9f25139a-6039-465a-9cf1-feb5567aebb7/4526E9620A9A7DB74267ABEA5881022F.5.15.2019.-final-project-report-american-investment.pdf

My research has focused on open-market share repurchases, or “stock buybacks”⁷. U.S. corporations spent \$6.3 trillion on stock buybacks in the decade from 2010-2019 and are on track for record spending in 2022⁸. Stock buybacks harm the economy broadly because they benefit mainly the share-sellers, not those households holding stock for long-term lifecycle needs, and they have the potential to manipulate stock prices while benefitting corporate insiders because of the way they are currently regulated⁹.

It is the single-minded commitment to raising share prices that have driven the explosion of stock buybacks. Buybacks raise price *mechanically* by raising the value of the shares that remain outstanding and the all-important Earnings-Per-Share metric¹⁰. They are announced by corporate leaders as an explicit mechanism to raise share prices and satisfy share-sellers who are anxious for gain. Because they are such a high percentage of corporate net income, they have an *opportunity cost*-- improving innovation and productivity across the American economy, strengthening our capacity to produce and support a broad-based middle class. In addition, it is perfectly legal for corporate insiders to personally benefit from conducting stock buybacks and then turning around and selling their own personal shares—all before disclosing such activity to shareholders. This is an example of the kind of incentives that ties the fortunes of executives and shareholders that distort corporate decision-making away from its true purpose: innovative production.

Let me give an egregious example is reporting that the Oil Majors will spend nearly \$40 billion on stock buybacks this year¹¹. While the need to transition to a net zero economy grows more and more urgent, oil companies are prioritizing keeping their share prices up through mechanically affecting the math of earnings per share (despite rising pressure from certain shareholders for a faster move to invest in renewables)¹². US companies such as ExxonMobil and Chevron are far behind European competitors when it comes to low-carbon expenditures; researchers estimate that ExxonMobil spent

⁷ Lazonick, W. (2014) Profits without prosperity. *Harvard Business Review*, **92**, 46-55.

⁸ Palladino, L. & Lazonick, W. (2021) Regulating Stock Buybacks. *Roosevelt Institute*.
<https://rooseveltinstitute.org/publications/regulating-stock-buybacks-the-6-3-trillion-question/>

⁹ Palladino, L. (2020) Do corporate insiders use stock buybacks for personal gain? *International Review of Applied Economics*, **34**, 152-174.

¹⁰ Almeida, H., Fos, V. & Kronlund, M. (2016) The real effects of share repurchases. *Journal of Financial Economics*, **119**, 168-185.

¹¹ Wilson, T. (2022) Big Oil on course for near-record \$38bn in share buybacks. *Financial Times*.
<https://www.ft.com/content/2852b800-4a03-4cf6-a47f-65c306a22657>

¹² <https://www.ft.com/content/0e5a0373-ee69-438a-9026-4588338f6ee4>

\$19.3 billion on low-carbon investment, while they spent \$15.1 billion on dividends and stock buybacks.¹³

Stock buybacks are the tip of the spear; I am not claiming that simply eliminating them would not automatically reorient the economy. However, I think they are a useful issue for policy intervention right away as they clearly demonstrate the harms of relentless prioritization of shareholder payments, and the lack of guardrails has been a competitive disadvantage for some of our critical industries¹⁴. My research documents the set of available policy interventions for Congress and the Securities and Exchange Commission¹⁵.

Many economists have been documenting the negative effects of shareholder primacy on corporate investment and innovation. Studies at the aggregate, sectoral, and firm level have demonstrated a relationship between rising shareholder payments—primarily stock buybacks—and stagnant innovative investment¹⁶. Descriptive data analysis at the firm level for publicly traded firms shows a major transition towards shareholder payments and away from net new investment over the last few decades. For example, one study shows that business net investment fell as a percentage of operating surplus from 20% in the late 20th century to ten percent in the 21st¹⁷. While it is hard to estimate counterfactuals with precision, it is critical for policymakers to reduce the incentives that currently exist for corporate leaders to prioritize financial metrics over sustainable investment and prosperity.

There are myriad other effects of shareholder primacy, including its contribution to rising income and wealth inequality and the racial wealth gap; its effect on climate change; and the current lack of resiliency in our supply chains. However, its effects are not inevitable, and in fact, policymakers have many approaches available to them to strengthen the U.S. economy.

¹³ Baines, J. & Hager, S.B. (2022) Performing Without Transforming: The Case for a Windfall Tax in the United States. *Common Wealth*. <https://www.common-wealth.co.uk/reports/performing-without-transforming-the-case-for-a-windfall-tax-in-the-united-states#footnotes2>

¹⁴ One important example is the semiconductor industry. See, for example, Lazonick, W. & Hopkins, M. (2021) Why the CHIPS Are Down: Stock Buybacks and Subsidies in the U.S. Semiconductor Industry.

¹⁵ Palladino, L. (2018) The \$1 Trillion Question: New Approaches to Regulating Stock Buybacks. *Yale Journal on Regulation Bulletin*, **36**, 89-106.

¹⁶ See Appendix I.

¹⁷ Philippon, T. (2019) *The Great Reversal: How America Gave Up on Free Markets*. Belknap Press.

3. Opportunities for Reform

Congress can lead a reorientation towards innovation. This is the moment to focus on re-shoring of crucial productive capacities and to put in place guardrails so that public investment serves the public good. For example, we are all aware of the challenges of chip shortages and the semiconductor sector. The Department of Commerce recently noted in its report on supply chains in the Information, Communication and Technology (ICT) sector how innovation is “the foundation for a thriving ICT industry.”¹⁸ Economist William Lazonick and co-authors have documented in detail how the focus on share price derailed U.S. semiconductor companies, along with sectors like pharma and PPE, which became more critical than ever during the pandemic¹⁹. As we emerge from the pandemic, it is incumbent upon policymakers to rewrite the rules that have enabled shareholder primacy. It is worth noting that Intel’s new CEO, Pat Gelsinger, has made clear that Intel is focusing on investing in innovation, stating clearly that this means less of a focus on stock buybacks and short-term share prices²⁰.

One place to start is by reining in open-market share repurchases through putting in place bans or common-sense limits to the volume of such activity, which is the approach taken in peer financial markets²¹. Another area for urgent reform is the set of policies contained within the Accountable Capitalism Act, with its focus on worker voice in corporate decision-making and limiting incentives for short-termism. There is no corporate productivity without the workforce, and passage of the PRO Act is the best way to ensure a level playing field for workers to have dignity and respect at work. My research has also shown the potential for worker representation on corporate boards and broadening employee access to equity in the United States²². Reshaping how decisions are made

¹⁸ “Innovation through research and development (R&D) efforts is the foundation for a thriving ICT industry. While the United States remains the global leader in the research and development of cutting-edge technologies, continued investment is needed to sustain a prosperous R&D ecosystem and remain globally competitive.” P. 79¹⁸

¹⁹ See <https://www.ineteconomics.org/research/experts/wlazonick> for extensive research on the semiconductor industry, pharmaceuticals, and PPE and ventilators.

²⁰ Intel CEO stresses more U.S. chip production, fewer stock buybacks. Marketwatch. May 2, 2021.

<https://www.marketwatch.com/story/intel-ceo-stresses-more-u-s-chip-production-fewer-stock-buybacks-11620001650>

²¹ Chen, N.-Y. & Liu, C.-C. (2021) The effect of repurchase regulations on actual share reacquisitions and cost of debt. *The North American Journal of Economics and Finance*, **55**, 101298.

²² Palladino, L. (2021) Economic Democracy at Work: Why (and How) Workers Should Be Represented on US Corporate Boards. *Journal of Law and Political Economy*, **1**, 373-396. Palladino, L. (2021) The potential benefits of employee equity funds in the United States. *Journal of Participation and Employee Ownership*.

within the corporation must go hand-in-hand with the important work to take on outsized market dominance and to ensure that asset managers and financial institutions are acting in the interest of the economic beneficiaries of the shares they hold—U.S. households who have long-term interests in a healthy economy and planet, rather than short-term share price fluctuations²³. Disclosure is a critical first step: I support real-time disclosure of stock buybacks, as proposed recently in the Securities and Exchange Commission’s “Proposed Rule SR,” regarding stock buybacks, and company disclosure of workforce investments, as proposed in the *Workforce Investment Disclosure Act*.

Let me end with several stories that illustrate the transition over the past forty years from innovation to shareholder primacy: the story of GE; and then two examples of companies making different choices in 2022: Amazon and Intel.

GE was a paradigmatic innovative company for much of the 20th century. My grandfather Arthur Palladino Sr. worked for GE for several decades after World War II. Even though he had served in the Air Force and been a Prisoner of War, he was unable to take advantage of the GI Bill because he had a young family. He had the brains of an engineer, and even with no college degree, he still had a good job that provided for his family, enabled my father to go to college. He participated in the innovations in aviation that were occurring at the GE plant in Lynn, Massachusetts. In other words, he was part of the process of collective and cumulative learning necessary for innovation, supported by a company whose financial commitment was to improving production over the long-term, not constantly manipulating short-term financial metrics.

GE’s turn towards prioritizing Wall Street payments under Jack Welch in the 1980s is one of the best-known examples of where American ingenuity went off the rails²⁴. But by 2009, it is worth noting, Jack Welch proclaimed shareholder value maximization “the dumbest idea in the world.”²⁵ No less than Vanguard founder Jack Bogle wrote in 2018 that, “the outcome of the GE story of financial engineering and faulty management decisions is not a happy one... The net loss in market

²³ Palladino, L. & Alexander, F. (2021) Responsible Asset Managers: New Fiduciary Rules for the Asset Manager Industry.

²⁴ Kay, J. (2019) The concept of the corporation. *Business History*, **61**, 1129-1143.

²⁵ Kay, J. (2019) The concept of the corporation. *Business History*, **61**, 1129-1143..

cap since 2000 is \$440 billion—likely the largest decline in a company’s market valuation in history.²⁶”

In this first quarter of 2022, we are seeing examples of the power of shareholder primacy, but also corporate leaders standing up and being willing to say that innovation is more important than short-term fluctuations in share prices. Amazon, which for decades has not focused on its share price, authorized \$10bn in stock buybacks on March 9th, 2022; Amazon had previously authorized just a \$5 billion stock repurchase authorization in 2016, of which it had executed \$2.12 bn, of which \$1.3 bn was spent in January 2022²⁷. The *Financial Times* Lex columnist noted that “the company’s long-term investment in infrastructure is a better use of its funds.²⁸” Meanwhile Amazon workers, which now number over 1 million in the United States, have themselves clearly raised myriad ways in which cost-cutting is affecting their health and well-being²⁹. Amazon’s high turnover rate and difficult working conditions at Amazon warehouses have only intensified during the pandemic, and Amazon should invest in its workforce rather than spending \$10bn on stock buybacks³⁰.

Intel, the global revenue leader in the semiconductor industry, spent \$80bn on stock buybacks from 2011-2020, and \$128 bn on shareholder distributions, while during the same decade they lost Apple as a customer, who instead turned to TSMC³¹. However, Intel’s new CEO, Pat Gelsinger, stated publicly in May 2021 that Intel would reduce its stock buyback activity in order to engage in long-term investment and innovation, adding that this decision had the support of his board³². This is a hopeful sign that leading American corporate leaders are starting themselves to recognize the harms of shareholder primacy and turning towards a renewed focus on innovation and resilience.

²⁶ Bogle, J.C. (2018) The Modern Corporation and the Public Interest. *Financial Analysts Journal*, **74**, 8-17.

²⁷ “Amazon Board Approves 20-for-1 Stock Split, \$10 Billion Share Repurchase.” *Wall Street Journal*, March 9th, 2022. <https://www.wsj.com/articles/amazon-board-approves-20-for-1-stock-split-10-billion-share-repurchase-11646863156>

²⁸ “Amazon: stock splits and buybacks equal short-term thinking.” *Financial Times*, March 10, 2022. <https://www.ft.com/content/bb9f3927-d30d-4f8c-a612-5132dacbb7fb>

²⁹ Kelly, J. (2021). “A Hard-Hitting Investigative Report into Amazon.” *Forbes.com*. <https://www.forbes.com/sites/jackkelly/2021/10/25/a-hard-hitting-investigative-report-into-amazon-shows-that-workers-needs-were-neglected-in-favor-of-getting-goods-delivered-quickly/?sh=20efdf7b51f5>

³⁰ “Amazon Leave Errors.” (2021). *New York Times*. <https://www.nytimes.com/2021/10/24/technology/amazon-employee-leave-errors.html>

³¹ Lazonick W and Hopkins H. (2021) How Intel Financialized and Lost Leadership in Semiconductor Fabrication. *Institute for New Economic Thinking*. <https://www.ineteconomics.org/perspectives/blog/how-intel-financialized-and-lost-leadership-in-semiconductor-fabrication>

³² Intel CEO stresses more U.S. chip production, fewer stock buybacks. Marketwatch. May 2, 2021. <https://www.marketwatch.com/story/intel-ceo-stresses-more-u-s-chip-production-fewer-stock-buybacks-11620001650>

It is my hope that the JEC, Congress, and the Administration will continue this important focus on shareholder primacy. Thank you and I look forward to our discussion.

Appendix I

- Gutierrez and Philippon have produced a series of studies documenting the weakness of private fixed investment relative to measures of profitability and valuation. For example, in *Investment-less Growth*, they find that industries with higher concentration and common ownership by asset managers invest less, while spending a disproportionately high level of free cash flows on stock buybacks³³.
- Asker et. al compared corporations that are publicly traded versus privately held and found that “private firms invest substantially more than do public ones on average, holding firm size, industry and investment opportunities constant,³⁴” and that privately-held firms are more responsive to changes in investment opportunities (their study is for the period 2001-2011).
- Cass (2021) categorized U.S. firms in terms of whether or not they replenished their capital stock out of earnings (EBITDA) and found that “firms that consume their fixed capital faster than [they] make new capital expenditures, while still returning cash to shareholders, though EBITDA would be sufficient to replenish their capital base” rose from 1% of all firms listed on NYSE & NASDAQ in 1980 to 49% in 2017. He also found that 37 of the 60 largest firms by market capitalization fall into this category, of making shareholder payments without investing in net new investment (that is, above that which is required for depreciation)³⁵.
- Davis (2018) estimates a significant relationship between declining NFC investment rates and shareholder value orientation for non-financial corporations, most notably for the largest U.S. corporations³⁶.

³³ Gutiérrez, G. & Philippon, T. (2016) Investment-less growth: An empirical investigation.

³⁴ Asker, J., Farre-Mensa, J. & Ljungqvist, A. (2014) Corporate Investment and Stock Market Listing: A Puzzle? *The Review of Financial Studies*, **28**, 342-390.

³⁵ Cass, O. (2021) The Corporate Erosion of Capitalism. American Compass. <https://americancompass.org/essays/the-corporate-erosion-of-capitalism/>

³⁶ Davis, L.E. (2018) Financialization and the non-financial corporation: An investigation of firm-level investment behavior in the United States. *Metroeconomica*, **69**, 270-307.

- Davis & McCormack (2021) show that the average share of surplus allocated towards investment in an industry has been declining since 1980. They then find that firms in such industries are more likely to engage in a higher magnitude of share repurchases³⁷.

³⁷ Davis, L. & McCormack, S. (2021) Industrial stagnation and the financialization of nonfinancial corporations. *Review of Evolutionary Political Economy*, 1-33.