EMPLOYEE OWNERSHIP: A NEW STRATEGY FOR ECONOMIC DEVELOPMENT

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INTRODUCTION

Currently, most economic development strategies are based on one of two approaches: providing incentives to those who have capital to invest in target areas to provide what end up being mostly low-paying jobs to the poor, or finding new ways to help those without capital create their own new jobs. Although these two approaches have met with some success, they both ignore a viable alternative which would provide workers with new jobs and income while helping them build capital ownership. This alternative is employee ownership. If development strategies could incorporate expanded ownership, low-income people could accumulate wealth in addition to receiving income.

Making people owners is not as quixotic as it might seem. Thousands of American companies now share ownership with their employees.[1] Most are not doing so out of altruism; rather, they are responding to the substantial tax benefits available to companies with employee ownership plans, (particularly ESOPs — employee stock ownership plans), to the belief that employee owners will be more productive and conscientious workers, and to indications that employee-owned companies may have a competitive edge.

Unfortunately, economic development programs have not used these existing lures effectively to encourage companies to set up employee ownership plans. These programs must start promoting business incentives in order to convince local industries that the cost of establishing an employee ownership plan is small compared to the resulting benefits. At the same time, employees will acquire a significant capital stake in their companies, and the community will profit because employee-owned firms are less likely to relocate.

Once publicized, the benefits of employee ownership will themselves persuade many companies to set up plans. A more aggressive strategy may be needed in those rare situations where employee ownership is used to save a failing firm, but substantial financial resources for this purpose are already available.[2] The continuing vital role for economic development specialists, however, will be to provide interested groups with guidance on setting up a

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1. U.S. GENERAL ACCOUNTING OFFICE, EMPLOYEE STOCK OWNERSHIP PLANS, INTERIM REPORT ON A SURVEY AND RELATED ECONOMIC TRENDS 8, GAO-PEMD-86-4BR (Feb. 7, 1986).

2. *See* C. ROSEN & W.F. WHYTE, ENCOURAGING EMPLOYEE OWNERSHIP: THE ROLE OF GOVERNMENT 16, 23 (rev. 1985).

plan, and with counseling on contouring the plan to provide the greatest benefit to the employees.

As mentioned above, there are numerous advantages to a company utilizing an employee ownership plan. The primary criteria of an effective economic development program is that the companies involved succeed financially. Several studies now indicate that employee ownership companies are more successful than their conventional competitors.[3] A recent study in the *Journal of Corporation Law* found that companies with ESOPs had average annual productivity increases 1.5% greater than the national production average for the period 1975-79.[4] A 1985 National Center for Employee Ownership (NCEO) study of publicly-traded companies with at least 10% of their stock owned by their employees found that these firms did better than 51-75% of their competitors, depending on the financial measure used.[5] More importantly, a 1983 NCEO study showed that companies in which employees owned a majority of the stock generated three times more net new jobs per year than comparable conventional firms.[6]

Employee ownership is not just good for the company; it is good for the financial health of employees as well. According to a 1985 NCEO survey of 140 ESOP companies, an employee earning the 1983 median wage of $18,000/year would accumulate over $31,000 in stock in the typical ESOP after just ten years.[7] That figure is approximately three times the median amount of net financial assets acquired by the average American family at retirement.[8] Congress' central purpose in encouraging employee ownership was to broaden the distribution of capital ownership.[9] Since employees rarely give up anything to get their ownership stake (as will be explained below), this goal is being met.

It is not a new idea that the economy — and the polity — would work better if employees owned and participated in the management of the workplace. Albert Gallatin, Secretary of the Treasury under Jefferson, believed that "the democratic principle on which this nation was founded . . . should be applied to the industrial operations as well."[10] This notion is currently gaining bipartisan support. In 1984, the Democratic party incorporated it into its

3. *See* M. QUARREY, EMPLOYEE OWNERSHIP AND CORPORATE PERFORMANCE 9-11, 28-30, 47 (1986); M. QUARREY & A. COHEN, EMPLOYEE OWNERSHIP COMPANIES AFTER THE FOUNDER RETIRES 2-3 (1985); and I. WAGNER, REPORT TO THE NEW YORK STOCK EXCHANGE: PERFORMANCE OF PUBLICLY TRADED EMPLOYEE OWNERSHIP COMPANIES 3, 6-7 (1984) (all three reports available through National Center for Employee Ownership).

4. Marsh & McAllister, *ESOPs Tables: A Survey of Companies with Employee Stock Ownership Plans*, 6 J. CORP. LAW 551, 614 (1981).

5. Wagner & Rosen, *Employee Ownership — Its Effect on Corporate Performance*, EMPL. REL. TODAY, Spring 1985, at 73, 74, 76-77.

6. Rosen & Klein, *Job-Creating Performance of Employee-Owned Firms*, MONTHLY LAB. REV., Aug. 1983, at 15, 17.

7. Rosen & Feldman, *How Well Do ESOPs Reward Employees?* PENS. WORLD, Feb. 1986, at 34, 36.

8. *Survey of Consumer Finances, 1983*, FED. RES. BULL. Sept. 1984, at 679, 686.

9. 129 CONG. REC. S16,629 (daily ed. Nov. 17, 1983) (statement of Sen. Long).

10. R. MASON, PARTICIPATORY AND WORKPLACE DEMOCRACY 149-50 (1982).

platform.[11] Moreover, political leaders such as Ronald Reagan and Russell Long have espoused the concept,[12] as has the New York Stock Exchange.[13] The Pope, in his recent encyclical on work, has strongly endorsed it as well.[14]

In American industry, over 7,000 companies now have ESOPs, while thousands more have implemented other types of employee ownership plans. At least 10% of these firms have a majority of their stock owned by employees and collectively employ over 1,000,000 people.[15] Despite this nascent development — and despite all the political support and the increasing evidence that ownership and participation work — due to obstacles discussed later in this piece, only about 8% of American workers are involved in these plans, and many of these are in companies in which the workers own only a small piece of the firm.[16]

Ownership, however, is not the only issue. As American institutions, both public and private, have become larger and more bureaucratic, individuals have seen a steady erosion in their ability to control their own lives. In more and more areas, we have seen a functional end to anything resembling democracy. For most people, the workplace is the most important economic and social community in their lives; democratizing it is our best hope of reinvigorating democracy in society.

I
How Employee Ownership Works

Understanding how employee ownership works first requires some understanding of the mechanics of the various types of plans. ESOPs are the most popular type of employee ownership plans. Developed in the 1950's by San Francisco attorney and investment banker, Louis Kelso, they did not gain favor until 1974, when Senator Russell Long persuaded Congress to provide them with a series of tax benefits and a legal framework within which to operate.[17]

In an ESOP, the company sets up a trust to which it makes contributions

11. 138 Daily Rep. Exec. (BNA) X-14 (July 18, 1984).

12. Letter from Ronald Reagan to Pierre S. du Pont IV, Governor of Delaware, (June 22, 1981) (available through the National Center for Employee Ownership); 129 CONG. REC. S16,629-44 (daily ed. Nov. 17, 1983) (statement of Sen. Long).

13. *See generally* W.C. FREUND & E. EPSTEIN, PEOPLE AND PRODUCTIVITY: THE NEW YORK STOCK EXCHANGE GUIDE TO FINANCIAL INCENTIVES AND THE QUALITY OF WORK LIFE (1984) (series of studies examining the impact of individual incentive plans, profit sharing, job training, and employee ownership on worker productivity).

14. Pope John Paul II, Laborem Exercens (On Human Work) (papal encyclical, Sept. 1981) *reprinted in* 127 CONG. REC. S21,273, 21,279 (daily ed. Sept. 18, 1981).

15. These figures include both conventional ESOPs and stock bonus plans that are similar to ESOPs but do not borrow money. NCEO compiles this data on a quarterly basis as determined from Internal Revenue releases.

16. NCEO calculated this figure by dividing the total number of ESOPs by the total estimated U.S. private sector workforce.

17. C. ROSEN, K. KLEIN & K. YOUNG, EMPLOYEE OWNERSHIP IN AMERICA: THE EQUITY SOLUTION 14-15 (1986).

of stock or cash to buy stock. Stock held in the trust is allocated to accounts for individual employees. Generally, all full-time employees participate, with stock being allocated according to salary or some more equitable formula (e.g., per capita, by seniority, etc.). It cannot be allocated by any *less* equitable method. The stock is essentially a gift from the company; employees rarely forfeit wages or any other benefit in exchange for an ESOP.[18] Employees acquire "vesting" rights to this stock as they accumulate seniority. That is, an increasing percentage of the stock allocated to their accounts belongs to them with each extra year they work for the company. Vesting generally must be complete in not more than seven years. When an employee leaves, the company must buy back the shares at their fair market value unless there is a public market for them.

The employees pay no tax on the stock while it is in the trust, and can limit the taxes they owe when it is distributed. They must be able to vote their allocated shares on all issues in publicly traded companies (companies whose stock is listed on an exchange), and they must be able to vote *at least* on issues which require more than a majority vote in privately held companies (generally, sale, liquidation, etc., but not elections for members of the board).

The company can deduct from taxable income the value of any contributions to the ESOP. For example, if a new stock issue is contributed to the ESOP, it is deductible, even though these shares do not cost the company anything. A company in the current highest tax bracket (34%) receives $0.34 from the federal government for every dollar's worth of stock contributed. Companies can also have the ESOP borrow money, which the company uses to buy assets or for working capital. It then makes tax-deductible contributions to the ESOP to enable the plan to repay the loan. In effect, the company can deduct both principal *and* interest from its taxable income, rather than just interest, as with a conventional loan. Moreover, banks and other commercial lenders can deduct 50% of the interest income they receive from loans to an ESOP. This 1984 tax change has lowered ESOP loan rates and interested more lenders in ESOPs.

The second most common employee ownership plan is the worker cooperative, a much simpler arrangement than an ESOP. Whereas ESOPs are found in all sizes and types of American firms, worker cooperatives are generally small and more often established in retail and service industries. This is mainly because the one-person, one-vote requirement of a cooperative is not appealing to existing substantial businesses or to new individual entrepreneurs. Cooperatives are thus usually start-ups by a limited number of people interested in a very democratically structured business, most of whom lack the capital to go into any business other than those requiring a limited initial investment.

In a cooperative, only workers can be owners (although cooperatives can

18. *Id.* at 17-18.

hire non-owning workers). To become an owner, workers either buy a share in the company or pay a membership fee. In most cooperatives, new workers have a waiting period before they can join and their share purchases or membership fees are deducted from their future earnings. Each owner receives one and only one vote. Net profits (or losses) may be returned to workers or put into ongoing employee accounts that are increased or decreased each year. Either way, earnings are not taxable to the company. In a conventional company, these earnings would probably be considered dividends, and both the company and the owner would have to pay taxes on them.

Although ESOPs and cooperatives account for the majority of all employee ownership companies,[19] there are several other kinds of plans presently in use. In some companies, profit-sharing dollars are used to buy company stock rather than other assets and are held in a trust, much as in an ESOP. In other companies, employees are required to purchase a specified minimum number of shares, often at a substantial discount. Different features of the plans are included to fit the needs of individual operations.

II
THE USES OF EMPLOYEE OWNERSHIP: SOME CASE STUDIES

A. An Employee Benefit and Incentive Program

The Lowe's Companies is a good example of using an employee ownership plan as an employee benefit and incentive, which is the most popular use of an ESOP. By 1986, Lowe's controlled a chain of over 200 home improvement and lumber stores throughout the Southeast, employing over 7,000 people. In the early 1950's, however, Lowe's had just seven stores and 700 employees. The former president of Lowe's, Carl Buchan, decided that the company would perform better if employees thought and acted as owners, not just workers, so he set up a profit-sharing plan that was functionally equivalent to an ESOP. (Lowe's formally converted to an ESOP in 1978.) Asked why he wanted to give away all that ownership, Buchan replied that if the idea worked, the employees would get rich — and, in the process, so would he.[20]

Over the next 25 years, the employees proved Buchan right. According to Lowe's current president, Bob Strickland, Lowe's employees now own about 30% of the company. The company's sales per employee are twice those of their competitors; their shrinkage rate (loss due to theft, breakage, etc.) is just one-sixth.[21] Lowe's major competitors have either been bought by other companies or have set up ESOPs of their own. "Survival of the motivated,"

19. *Id.* at 17, 32.

20. *Id.* at 156-60; Robert L. Strickland, Chairman of Lowe's Companies, Inc., Remarks at Second Annual ESOP Symposium, Georgetown University Law Center, Washington, D.C. (Sept. 25, 1980).

21. *See* ROSEN, KLEIN & YOUNG, *supra* note 17, at 19-20.

says Strickland.[22] Lowe's employees vote their shares, and Strickland says he wouldn't have it any other way. Most impressive, however, have been the account values employees have received: one eighteen year employee who averaged $125 per week in account values retired with $600,000 in stock. While those high values reflect the good fortune of working for the company during its period of rapid expansion, current employees who stay with the company for 10-20 years or more can reasonably expect to leave with stock worth well into five or even six figures.[23]

B. Providing for Business Continuity

Another common use of an employee ownership plan is to provide a market for an owner's stock. In many closely-held companies (businesses whose stock is not publicly available), owners find that as they near retirement, there is no market for their company. Even though the firm is profitable, it may not be sufficiently profitable for potential buyers, especially when there are other safer, higher-yield investments available. Many times, these companies end up being liquidated so that the owner can get cash on which to retire, or, if the owner dies, so that the estate can pay taxes. If the owner has no heirs who want to take over the company, a logical (and often desirable) alternative to this scenario is to offer the company to the employees. Moreover, under the 1984 tax law, selling to the employees is the most tax-favored approach available.[24]

Ed Sanders of Allied Plywood is one businessman who wanted to sell to his employees. By 1979, he had successfully built his thirty employee plywood wholesale business into a very profitable company. When he decided to retire, he tried to sell his stock directly back to the company, but that alternative would have required the company to use *after-tax* dollars while Sanders had to pay ordinary income tax on the sale (now a maximum of 28%). Instead, Sanders set up an ESOP and had the company contribute *tax-deductible* cash to the plan (a savings of 46%, which was then the firm's tax bracket) to buy out the shares. Since the sale was to an ESOP, he only had to pay capital gains tax, meaning a maximum tax of 28%, (now a maximum of 20%) on the proceeds.[25] The 1986 tax law has eliminated this capital gains benefit, but even without this plus, the ESOP sale is still financially attractive.

Sanders could have sold to a larger firm for an exchange of stock and deferred any tax until that new stock was resold, but he preferred selling to the employees. Afterward, he decided to lobby for a change in the law that would give people who sell to employees (through an ESOP or worker cooperative) the same tax deferral they would receive from a sale to a larger firm. This would make it easier for other owners to sell to their employees. In 1984, this

22. *Id.* at 156-57.
23. Rosen & Feldman, *supra* note 7, at 36.
24. *See* ROSEN, KLEIN & YOUNG, *supra* note 17, at 21-22.
25. *Id.* at 22-24.

proposal became law.[26] It allowed an owner who sells at least 30% of the company to an ESOP or worker cooperative to reinvest the proceeds from the sale in the stock of other companies, deferring taxation until the new stock is resold. Since the owner can put the proceeds in a diversified portfolio, rather than into just one company, this is an extremely financially attractive way for most people to sell their businesses, provided the operations are profitable enough to buy out the owner. In 1986, the tax reform act expanded this provision to allow an estate to deduct 50% of the income it receives from the sale of stock to an ESOP.

Allied Plywood's employee owners, it should be noted, are doing very well. Their company is profitable and they are getting a better financial return than workers in comparable firms.[27] In fact, a 1985 NCEO study of businesses sold to their employees by retiring owners found that after the owner left, these companies created 1.75 times more net new jobs than comparable firms in their industries.[28] Clearly, the cost of buying out the owner and the loss of his or her management skills did not prevent these companies from outperforming their competitors.

C. *Starting New Firms*

A less common, but growing use of employee ownership is to start new firms. When Peter Barnes established the Solar Center, a solar energy company, in 1977, he decided to set up the firm as a cooperative. Because his initial group of recruits lacked business experience and financing was difficult to find, salaries in the early years were low and employees put up their own money to provide capital. Nonetheless, through dedication and persistence the company's employees managed to create a niche in the northern California market. Today, twenty-three people work for the Solar Center. Each full-time employee, after a twelve-month probationary period, becomes a member of the cooperative, paying $3,000 into a membership account (out of deferred wages).[29]

Ownership by employees has contributed to morale, according to Barnes, but its most important benefit is that it has allowed the company to survive the instability of the solar energy market. Changes in the tax law and oil prices cause frequent fluctuations in the industry, but the Solar Center has been able to retain employee owners at lower wages during poor market periods, compensating for it in more profitable ones. Other similarly situated companies would have had to lay people off during these periods, imposing a cost on them and society.

Employee ownership also may be a practical method for establishing larger operations. Founded in 1979, Science Applications is a 6,000 employee

26. *Id.* at 22-23.
27. *Id.* at 23.
28. M. QUARREY & A. COHEN, *supra* note 3, at 9.
29. *See* ROSEN, KLEIN & YOUNG, *supra* note 17, at 35, 176-78, 239-40.

research and development firm which is 90% employee-owned and completely employee-controlled. Since 1973, its stock earnings per share have increased over 1000%, making many employees millionaires. All employees own a significant amount of stock through a variety of plans.[30] Other impressive start-ups include People Express,[31] where employees own 33% of the company, and W.L. Gore Associates (not employees — associates), where the 3,000 workers own 95% of this high-technology manufacturing company. Gore has grown at a compound annual rate of 40% per year over the last several years.[32] Like Science Applications, Gore is one of the fastest growing firms in its field. Both are also extremely participatory, allowing employees a high level of control over the company as well as ownership.

D. Saving Failing Companies

Although only a very small percentage of ESOPs are set up to save distressed companies or in return for wage concessions, this is a dramatic, and therefore much publicized, use of employee ownership. Much of this publicity focuses on the impact such closings have on the local economy.

In 1982, employees at Weirton Steel learned that their parent firm, National Intergroup, planned to reduce their plant to a small finishing mill. The mill employed more than 7,000 of the town of Weirton's 32,000 residents and was West Virginia's largest taxpayer. Obviously, if the plant had closed, the social and economic consequences on the area would have been devastating.

Instead of going through with their original plan, however, National offered to sell the company to the employees. National was not simply being altruistic. By keeping the plant going, National could avoid hundreds of millions of dollars in pension and other closing cost obligations. After two years of study and negotiation, Weirton's workers bought the plant, using an ESOP to raise over $300 million, with an additional $700 million to be financed over ten years. After the first year and a half, Weirton was making more money from steel production than any integrated company in the U.S. and had increased employment to 8,000.[33]

In Philadelphia, Local 1357 of the United Food and Commercial Workers ("UFCW") was faced with the closing of 80 A&P stores. Rather than see his union members lose their jobs, UFCW President Wendell Young proposed to A&P that the workers accept a 20% wage cut if, in exchange, A&P would reopen some of the stores and allow workers to purchase two others. The stores were opened as worker cooperatives under the "O&O" (Owned and

30. *Id.* at 238-39.

31. *Id.* at 231-32.

32. *Id.* at 220. People Express, of course, subsequently failed, primarily due to an overaggressive expansion strategy. For a critical review of both the management decisions leading to the buyout and the employee-management structure itself, see *Behind People Express's Fall: An Offbeat Managerial Style*, N.Y. Times, Sept. 23, 1986, at A1, col.5.

33. *See* ROSEN, KLEIN & YOUNG, *supra* note 17, at 27-28, 242-44.

Operated) name, and have since exceeded all sales expectations.[34] In fact, a third employee-owned store has been built from scratch and was opened for business in 1985, this time in a low-income neighborhood.

While Weirton and O&O have been success stories, other employee buyouts have not fared as well. Rath Packing was purchased by its employees in 1979, but market problems and an outdated plant forced the company into bankruptcy four years later.[35] Hyatt-Clark Industries was bought by its employees in 1981, and although the company initially showed a profit, employee ownership was not, in itself, enough to overcome the bitter divisions between management and labor that had preceded the buyout. These divisions eventually led to the sale of the company in 1985 (although most of the jobs were saved).[36] An employee buyout is a risky strategy that needs to be undertaken only in the most promising cases.

E. As Part of a Community Development Corporation Strategy

Many community development corporations ("CDCs") are starting their own businesses to create employment and provide a source of funds for the CDC's activities. Since the CDCs usually expect to sell the company at some later time anyway, a preferable option would be to sell it to the employees. Using the borrowing features of an ESOP, the employees could buy all or part of the company, using future earnings of the firm to repay the loan.

This is precisely what the Cooperative Community Enterprise Development Corporation ("CCEDC") did in 1977. CCEDC had acquired the Alaska Commercial Company, a chain of general stores throughout rural Alaska. Eventually, CCEDC wanted to generate cash from the business and provide employees with an ownership stake, so an ESOP was established at Alaska Commercial to purchase one-third of the stock. The company has been doing extremely well ever since, providing much needed services and jobs to rural Alaskans.[37]

III
BENEFITS OF EMPLOYEE OWNERSHIP

While the value of employee ownership is suggested by these success stories, it is useful to discuss briefly in list form the specific benefits that flow from its development.

A. Employee Ownership Can Contribute to Increased Productivity

A recent NCEO study supports the common sense notion that employee owners are better workers than "rented labor."[38] The study collected data on

34. *Id.* at 228-30.
35. *Id.* at 28-29.
36. *Id.* at 153-56, 221-22.
37. *Id.* at 206.
38. M. QUARREY, *supra* note 3, at 47.

347 companies: 55 ESOP companies, each matched to five or more similar, non-ESOP companies for a fifteen year period from 1970-1985. Previous studies had found that employee ownership companies out-performed non-employee ownership companies only after they had set up ESOPs. This earlier research, while it suggested that employee ownership might cause better performance, failed to rule out the possibility that companies which set up ESOPs were simply more successful to begin with and would have been highly successful with or without ESOPs. By comparing pre-ESOP to post-ESOP performance, this study resolves this question.

In terms of employment, the employee ownership companies grew 5.05% more quickly per year than their competitors after establishing their ESOPs, compared to only 1.21% more quickly per year before establishing their ESOPs.[39] On measures of sales growth, the employee ownership companies grew 5.40% per year more rapidly after their ESOPs, compared to only 1.89% per year before.[40] These figures represent a very high degree of statistical certainty.

The study also differentiates among employee ownership companies to determine what company characteristics are most associated with economic success. While simply having an ESOP was sufficient to explain a substantial improvement in corporate growth, companies that combined ownership with job-level participation did even better. The most participatory companies improved their performance by 8% to 11% per year compared to about 3.5% per year for the average ESOP company.[41] By contrast, company size, line of business, contribution to the ESOP, plan structures and many other factors did not significantly improve company performance.[42]

B. *Employee Ownership Makes Work and Compensation More Flexible*

Most American companies use a system of fixed compensation and variable employment. Society pays the tab for this policy in unemployment insurance and job retraining, among other things, when people are laid off. Employee ownership offers an alternative to this eventuality. In an employee-owned company, there may be a greater willingness to pull in everyone's belt a little tighter until better times return. Likewise, there is more willingness to share the greater profits those times bring. A number of employee-owned companies have no-layoff policies, and use down-time to build up inventory and make improvements in the physical plant.[43] Employee ownership also makes labor concessions more palatable and fair to workers than in conventional companies. From their dual perspective as employees and owners, workers

39. *Id.* at 30.
40. *Id.*
41. *Id.* at 42.
42. *Id.* at 47.
43. *See* ROSEN, KLEIN & YOUNG, *supra* note 17, at 150, 219.

can better understand how the concessions they make as employees are really tradeoffs for the benefits they will ultimately receive as owners.

C. Employee Ownership Can Save Existing Jobs Directly

We have estimated that between 30,000 and 60,000 jobs have been saved in approximately sixty successful buyouts over the last ten years.[44] As mentioned earlier, one beneficial side effect of this result is the substantial public gain from avoiding welfare and unemployment payments and the costs of plant shutdowns.

D. Employee Ownership Can Keep Profitable, Independent Firms Open and Locally Owned

Smaller, independent businesses often are forced to close when the principal owner retires because there are no heirs or buyers. Even when there is a buyer, the business may still close because conglomerates and competitors may buy the company, not for the purpose of continuing operations, but simply to get hold of customer lists, trademarks, or equipment. Once again, employee ownership may be an appealing alternative that can provide important benefits to the community by keeping these operations locally owned. Smaller, independent firms tend to be more innovative and create more jobs than larger firms, and they support a more diverse economic base than will exist if larger firms buy them or assume their markets when they close.

E. Employee Owners Are More Responsible Stockholders

One of the current problems with American management is its short-term perspective. Investors demand quarter-to-quarter profit gains or they move their investments to companies or portfolio managers who can provide them. An alternate model would be to invest for long-term competitiveness. Creditors are more interested in a company's long-term ability to repay its loans than in its short-term profits.

While the United States is not likely to shift to this alternate model, employees also favor long-term strategies, in their case because they are much more concerned with keeping their jobs than maximizing their stock value. Few companies can return more in stock appreciation than they do in wages. To keep those jobs, employees need to press for a long-term investment strategy which will maximize market shares, not short-term profits.

F. Employee Ownership Helps Keep Profits in the Community

Employee-shareholders have another salutary effect in that they are not draining profits away from the community to Wall Street or remote corporate

44. Rosen & Cohen, *Employees to the Rescue: The Record of Worker Buyouts*, 6 J.L. & COMM. 213, 219-20 (1986).

headquarters. Capital gains and dividends earned by employee owners are reinvested in the local economy.

G. Employee Ownership Can Create More Jobs

As several NCEO studies point out, employee ownership firms create many more net new jobs per year than comparable non-employee ownership firms.[45] The reasons for this include all of the points mentioned above.

H. Employee Ownership May Be a Way to Use the Free Enterprise Incentives to Create a More Socially and Economically Just System

Employee ownership has the potential to reintroduce democracy into our economic lives, a concept that was lost when people left their own farms and small businesses to work in the factories of the industrial revolution. Broadened capital ownership was a basic goal of the founding fathers, as witnessed by the abolition of primogeniture rules requiring land to be passed only to the first son and by the opening of the West through homesteading and reclamation. More than ever, this goal is worthy of pursuit today.

IV
EMPLOYEE OWNERSHIP AND LOCAL ECONOMIC DEVELOPMENT

The idea of employee ownership is now widely accepted by the American people. In a 1975 poll, Peter Hart found that Americans would prefer to work in an employee owned company by a 66%-20% margin.[46] There is also a growing network of people actively involved in employee ownership, including students and professors capable of providing technical assistance and research, non-profit organizations, professional consultants, government institutions, and a variety of other groups.

Still, the idea faces enormous obstacles, most notably, inertia and a lack of understanding. Some unions still think of employee ownership only as a device for saving failing companies. Others are concerned that ownership will divert employees' attention from wage and work-rule gains, or that it will confuse them as to the role of the union. In fact, unions continue to play a strong role even in the most democratic employee-owned companies, acting not only as the agent for workers in bargaining for wages with management, but also acting to organize the workers as owners when it comes time to vote their shares.[47] A number of unions, including the Steelworkers, Bricklayers, Team-

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45. M. QUARREY, *supra* note 3, at 28, 47; M. QUARREY & A. COHEN, *supra* note 3, at 9; Rosen & Klein, *supra* note 6, at 17-18.

46. From a nationwide telephone survey of 1,237 Americans selected between July 18-25, 1975, by The Hart Poll (Peter D. Hart Research Associates of Washington, D.C.); detailed data appear in J. RIFKIN, OWN YOUR OWN JOB: ECONOMIC DEMOCRACY FOR WORKING AMERICANS 106-07, 122, 145 (1977).

47. *See* S. WESSINGER & C. ROSEN, EMPLOYEE OWNERSHIP: A UNION HANDBOOK (1986) (available from National Center for Employee Ownership).

sters, and several airline unions, have taken aggressive roles in promoting employee ownership.[48]

Business leaders as well are often uninformed about the concept of employee ownership, or think that it only applies to special cases. Those that have heard of it sometimes fear that it will require a loss of control that they are not ready to accept. Many owners of closely-held companies are nearing retirement age and have no plans for providing business continuity, but do not know that ESOPs could be an ideal vehicle for them.

Given these obstacles, the role of affirmative government programs becomes clearer. While the role of the federal government has been limited to providing businesses with tax incentives, there is much that state and municipal governments, working with local economic development organizations, can do to overcome inadequate information and unwarranted fear.

In 1981, for example, New York City became the first American municipality to declare an official employee ownership policy.[49] The city was following the example of 10-15 states which had previously made it a policy to promote broadened ownership.[50] Formally articulating a clear and coherent policy like this is the first step toward implementing concrete programatic objectives. Delaware and Maryland, for instance, directed each state agency to report annually on what it has done to promote employee ownership.[51] Some agencies can provide preferential financing for employee ownership projects, while still others can change regulations that may have the effect of discouraging employee ownership, as California directed its comptroller to do with respect to certain securities laws.[52]

As noted above, two major reasons that employee ownership is not more widespread are inertia and a lack of awareness. By providing education through outreach activities, local governments and economic development organizations can encourage people to move towards sharing ownership and help create a more just and effective economy. Institutions at the local level are in a unique position to provide these kinds of information services because, unlike the federal government, and to a greater extent than the states, local organizations can work on a regular and ongoing basis with local businesses.

Although many cities have departments of commerce or economic development, only a few of these departments have made an effort to learn about employee ownership. Local economic development groups and independent professional consultants in this field should encourage these municipal departments to present workshops, develop brochures, make referrals, suggest sources of financing, and provide other informational services. For example, a

48. *Id.*; W.F. WHYTE, EMPLOYEE OWNERSHIP: LESSONS LEARNED 394 (1985) (available through the ILR Press, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, New York 14851-0952).

49. C. ROSEN & W.F. WHYTE, *supra* note 2, at 39.

50. *Id.* at 21.

51. *Id.* at 31, 34.

52. *Id.* at 29.

number of states, and now the city of St. Paul, have distributed brochures on how ESOPs work to local business owners.[53] New York City has distributed a guidebook on employee buyouts of businesses that would otherwise close.[54]

Other cities, including San Antonio, St. Paul, Burlington, and Milwaukee have held employee ownership workshops for members of the local business community, as have several local non-profit organizations. These workshops included discussions of the legal and financial considerations in setting up ESOPs, research on what makes employee ownership work best, and presentations by people from local employee ownership companies. In addition to distributing valuable information, the workshops serve an important function by bringing professional employee ownership practitioners together with interested business owners and union officials.

In addition to these informational services, employee ownership can be encouraged directly by providing technical or financial assistance. The New York City program empowers its Office of Economic Development to provide financial assistance to employees seeking to buy companies that would otherwise close.[55] The city is also training its officials to provide technical assistance and referrals to businesses interested in setting up employee ownership plans. The city of Burlington, Vermont, provides similar technical assistance, not only to businesses on the verge of closing, but also to newly-transferred successful companies and to new ventures in the community. Whether cities provide informational services or technical assistance, by utilizing federal tax incentives for ESOPs, cities can make employee ownership an unusually inexpensive tool for promoting a more efficient and just local economy.

CONCLUSION

Economic policy over the last two decades has been increasingly unable to find a way to promote two apparently conflicting goals: stimulating growth and promoting social equity. The current federal policy assumes that the only way to stimulate long-term growth is to provide the wealthy with tax incentives to invest their wealth, while at the same time reducing government transfer payments which take money away from corporations and investors and put it into the hands of low-income consumers. Although the short-term effects may be harsh, the long-run results will make everyone better off — the "rising tide lifts all boats" economic theory. Opponents of this policy point out that this robs the poor even of the chance to compete in the market, that it underinvests in human resources (through underfunding training and education programs, for instance), and that it runs the risk of creating serious social strains. Conversely, liberals have emphasized social equity, even if it means reducing the funds available for investment.

Employee ownership may be a bridge between these two views. It will

53. *Id.* at 21.
54. *Id.* at 21, 39.
55. *Id.* at 39.

not solve every problem. It will not make companies less prone to pollute; it will not increase investment in education; it will not present any immediate solutions for people who do not work steadily enough to become owners of their companies.

What employee ownership can do under the right circumstances is provide a means to use the free enterprise system to create a more efficient and equitable economic system, one in which greater investment and capital growth can benefit the average employee, not just the wealthy capitalist. Moreover, there is some evidence that employee ownership companies are more productive and create more new jobs than comparable conventional firms.[56] Finally, where employees can control their stock, ownership can foster a better congruence between our democratic polity and our very undemocratic corporate structure.

These qualities have motivated thousands of firms to set up employee ownership plans, but there is a long way to go. The efforts of local development organizations are necessary to keep the idea growing.

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56. *See supra* note 3; Rosen & Klein, *supra* note 6, at 17-19.