What to do about economic inequality?

BO ROTHSTEIN 9th January 2020

Economic inequality has burgeoned as income from capital has risen faster than growth. Time to change the owners of capital.

Bo Rothstein

The economic system we used to call liberal market capitalism has changed dramatically. Since the early 1980s, this socio-economic model has engendered a huge increase in economic inequality. This was not always so: for a long period during the 20th century, the economic gaps in western societies decreased. But during the last three decades the opposite has been true.

The magnitude of this change is such that important international economic organisations which previously did not care much about the problem—the World Bank, the OECD, the World Economic Forum and the International Monetary Fund—are now issuing strong warnings that the prevailing increase in inequality is incompatible with sound economic and social development. Moreover, while almost all economists used to take for granted a trade-off between economic growth and redistribution, many leading economists now affirm the opposite, namely that this new huge increase in inequality is bad also for growth.

There are many reasons to worry about this growing inequality. Trust between people in societies with high inequality is usually low, leading to a low stock of 'social capital', which in turn increases all sorts of transaction costs. Inequality is also both a cause and effect of different forms of corruption, leading to spiralling vicious circles. Furthermore, there are many indications that increasing inequality is a major cause of the successes of populist and often xenophobic political parties.

Suggestions from those who do worry as to what should be done have so far mainly returned to the more extensive redistribution policies which characterised many western democracies before neoliberal austerity began. Increased taxes for better public services and higher benefits are the recipe suggested by Thomas Piketty, for example.

I am definitely not opposed to this but we need to ask two questions. First, is the political situation in most western countries such that it will be possible to win a political majority for these polices? Secondly, are these proposals sufficient to remedy the huge increase in inequality? Unfortunately, the answer to both seems to be no.

Wage-earner funds

Is there any other way to go? After much digging into the research, I have reached the conclusion that, if something enduring is going to be achieved, wage-earners must somehow also benefit from the return on capital in companies. The most radical proposal for making this possible was the wage-earner funds implemented in Sweden by a social-democratic government in 1983 but abolished by a conservative-led administration in 1992.

Unlike most other large-scale social reforms launched by the social democrats, the funds were never popular—even most blue-collar workers were against them. The implications for individual employees in the companies where these union-controlled funds owned shares were never clear: there was no connection with the individual wage-earner's economic situation or her/his possibility to have any influence. The negative experience with the wage-earner funds has unfortunately made economic democracy a 'no go' area for Nordic social-democratic parties ever since.

Yet, as David Ellerman has argued, if in a market economy capital can employ (that is, hire) manpower, and the capital owners are entitled not only to manage the company but also to the return from its profits, employees can equally rent (that is, borrow) capital, and then it is the employees who are entitled to the return and to manage the company.

ESOP model

This is not a utopian claim. In the United States, for example, there is a model that makes it easier for employees to become owners of their companies. The ESOP (Employee Stock Ownership Plan) provides tax relief and functioning legislation to allow the employees of a company to buy it with the company's assets as collateral—which means they do not have to take personal financial risks.

Oddly, it is in today's 'super-capitalist' USA that this form of economic democracy is most prevalent. A recent study shows that just over a tenth of employees there work in the nearly 7,000 companies which have this model; in more than 4,000 the employees are majority owners.

Decades of studies have shown that these companies are as financially viable as conventional capital-owned companies, while employees have higher wages, are more satisfied with their working conditions and—not least in this context—receive a substantial share of the profits. On average, such employees have assets, often in the form of pension capital, which far exceed those of workers in capital-owned companies.

A cashier who has worked for a long time in the ESOP company Publix (a super-market chain in the US with over 180,000 employees) usually retires as a dollar millionaire. In Sweden, one of the largest banks (*Handelsbanken*) has had such a system since the 1970s. When an employee of the bank retires after about 30 years, the dividend is estimated to be between 1.5 and 2 million euro. Employee ownership thus usually delivers significant sums for the individual employee. In the UK, more than 200,000 employees work in employee-owned businesses, of which the John Lewis Group is the most well-known.

While this model has been seen as a way to establish economic democracy and increase employees' work satisfaction, left out of the discussion has been what it can imply for increasing equality in the current situation. Those who care about this issue have good reasons to support systems and legislation that make it easier to establish employee-owned businesses, as a way to pursue what some economists now call 'inclusive growth'.

Very positive

Would the capitalists be strongly against such a system? Some will, but many owners of small and medium-sized companies heading for retirement seem very positive about selling their companies to their employees, probably because their heirs are not interested in, or suited for, taking over the responsibility. Moreover, much capital is now in the hands of mutual and pension funds and those who manage these funds are usually not interested in actually managing the companies in which they have invested. And in the high-tech sector, owners are often interested in making employees co-owners since they are so dependent on their commitment, loyalty and knowledge.

This is not a perfect system. There will be employee-owned companies which are not profitable and cannot provide rents to their employees. Some will have to close because they are not viable. Those working in the public sector will not receive any similar dividends. But those who demand a perfect system will have to wait forever for effective measures against the vastly increasing, socially unsustainable and morally unacceptable increases in economic inequality which we have been suffering from for a long time now.

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