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Elevate CA: Employee ownership represents a fairer economic development strategy

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Elevate CA is a discussion about what can be done in California to improve upward mobility. Recent opinion pieces on the theme of the importance of valuing the employee in today's economy by SEIU's Dave Regan (http://cafwd.org/reporting/entry/why-unions-and-the-private-sector-should-work-together-as-partners-in-job-c) *and* Elizabeth Sholes of the California Council of Churches (http://caeconomy.org/reporting/entry/elevate-ca-more-empowered-workers-needed-to-grow-californias-middle-class) *inspired this contribution:*

A few years ago, the *New York Times reported (http://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html?pagewanted=all)* that state governments spend over $80 billion per year on business incentives. States, including California, offer tax reductions and other special subsidies to companies that promise to relocate jobs in state or even just promise not to move them out of state. The cost per job is usually in the tens of thousands of dollars. Despite all this taxpayer money, many of these companies end up moving or closing anyway.

There is a much better, cheaper, fairer way for California to retain jobs. With the retirement of baby boomers looming, hundreds of thousands of closely held companies will be up for sale. While some will be passed on to family members or managers, most will be sold to competitors, who often move the companies and reduce of even eliminate local staff. Other successful companies just get liquidated because buyers cannot be readily found.

Many of these businesses could very successfully be sold to an employee stock ownership plan (ESOP). An ESOP is a highly tax favored strategy to pass on ownership broadly to the company's employees. The company sets up a special trust for employees, and the trust uses contributions

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from the future profits the employees help generate to buy the business. The employees do not pay for the shares—the company does and gets a tax deduction in the process, while the seller can defer capital gains taxes by reinvesting in other companies. Sellers can sell all or part of the company this way. Not only do these plans provide tax benefits, but they let sellers retain the legacy they have worked so hard to create. Meanwhile the employees gain ownership of a valuable asset —their company.

There are over 9,000 ESOPs and ESOP-like plans in the U.S. They cover 14 million people. They have over $1 trillion in assets. Many of the plans own a majority of their company. Research (https://www.nceo.org/articles/studies-employee-ownership-corporate-performance) by the National Center for Employee Ownership, as well as scholars at Rutgers University and the National Bureau for Economic Research at Harvard (among others) have found that closely held companies—the ones the baby boomers would be selling—that become an ESOP generate 2.5 percent more jobs per year than they would have if they weren't using it. The companies pay their employees better wages, and their employees accumulate 2.5 times the retirement assets of employees not in these plans, money they will eventually spend mostly locally. Data from the General Social Survey show that employees in these companies are just one-third to one-fifth as likely to have been laid off in the last year as employees not in these companies—that means hundreds of thousands of people have jobs who would not have otherwise and tens of millions of dollars in California unemployment costs do not have to paid by taxpayers.

ESOPs are supported equally by both parties. The Republican Party Platform endorsed the idea; so did Hillary Clinton. Congress has repeatedly passed laws to encourage employee ownership.

But sadly most business owners have no clue this is even an option. About 4 percent of businesses that are reasonable ESOP candidates currently have ESOPs. Why so few? Misinformation abounds. Business brokers earn commissions by selling companies, but ESOPs do not involve any brokerage fees, so brokers generally don't tell their clients about ESOP. Accountants often know very little about these types of plans as well.

That is where state and local governments come in. Colorado, Ohio, Pennsylvania, and Vermont all have programs that help make business owners more aware of the ESOP option, funded by a mix of state, grant, and fee funding. These programs are very inexpensive—for the cost of saving a dozen jobs with tax breaks and subsidies, a state could set up a program with one or two mid-level staff people either directly or through a grant to a nonprofit, a cost about equal to what existing economic development programs cost per job for a handful of jobs saved or relocated. These programs have resulted in more and better ESOPs than would have been the case otherwise—ESOPs that generate more jobs, prevent many more layoffs, and spread wealth far more equitably than even the most efficient of the kinds of programs the *Times* articles discussed. It's a far better, far cheaper, far fairer path.

California should join this list. The state does not need to add more tax incentives, low-cost loans, regulatory forbearance or any other special benefits—the tax code already provides these. What is does need to do is to help business owners find this win-win situation.

Corey Rosen is the founder and senior staff member of the National Center for Employee Ownership (https://www.nceo.org/articles/studies-employee-ownership-corporate-performance), a nonprofit membership, information, and research organization.

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