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Broad-based employee stock ownership and profit sharing

History, evidence, and policy implications

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Abstract

Purpose – The purpose of this paper is to review the historical background for broad-based ownership in the USA, the development of forms of employee ownership and profit sharing in the USA, the research literature on employee ownership and profit sharing and related employee participation, the development of policy and options for new policies.

Design/methodology/approach – It is a literature review.

Findings – There are four reasons to be interested in employee stock ownership and profit sharing today: first, employee share ownership and profit sharing can increase worker pay and wealth and broaden the overall distribution of income and wealth, a key ingredient for a successful democracy. To be a tool for reducing inequality, employee stock ownership and profit sharing must be spread more widely and meaningfully than it is today. Second, employee share ownership and profit sharing provide incentives for more effort, cooperation, information sharing and innovation that can improve workplace performance and company productivity. Third, employee share ownership and profit sharing can save jobs by enhancing firm survival and employment stability, with wider economic benefits that come from decreasing unemployment. Fourth, employee share ownership and profit sharing can create more harmonious workplaces with greater corporate transparency and increased worker involvement in their work lives through access to information and participation in workplace decisions.

Research limitations/implications – Growth has been extraordinarily sluggish in the recovery from the Great Recession and has weakened in advanced countries over a longer period, leading some analysts to believe that the authors have entered a new economic era of small to modest growth. This may turn out to be true, which will increase the importance of growth-enhancing policies. The evidence that firms with employee stock ownership and/or profit-sharing perform better than others suggests that policies that extend ownership would boost the country's lagging growth rate. The evidence that employee share ownership firms preserve jobs and survive recessions better than others suggests that policies that extend ownership could help stabilize the economy when the next recession comes down the pike.

Practical implications – Because there may be informational or institutional barriers about the benefits of ownership and sharing and the ways firms can introduce such programs that government can help overcome. Government has often played a role in promoting performance-enhancing work practices to enhance overall economy-wide outcomes from higher productivity and innovation, such as the long history of agricultural extension services (since 1887) to spread information on best practices in farming, and employer education on safety practices conducted by the Occupational Safety and Health Administration.

Social implications – Because of the “externalities” – effects that extend beyond the firm and its members – that greater ownership/profit sharing can bring us. If employee ownership and profit sharing lead to fewer layoffs and firm closures, this can reduce recession-created drops in consumer purchasing power and aggregate demand; government expenditures on unemployment compensation and other forms of support; decreased tax base for supporting schools and infrastructure; and potentially harmful social and personal effects, such as marital breakups and alcohol abuse. Apart from unemployment, more broadly shared prosperity and lower inequality may also have wider benefits for macroeconomic growth, stability and societal outcomes, as described by a number of social scientists. To the extent the ownership and profit sharing is a public good, a nudge in policy to consider the idea makes sense.

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Originality/value – Because it is hard to find policy options that are as bipartisan as the shares policy. In *The Citizens' Share*, and in other articles and venues, the authors lay out the areas in which there is evidence or logic for in-depth development of, and experimentation with, several broad policy directions, with the details to be worked out by members of Congress based on their deliberations.

Keywords Public policy, Employee ownership, Profit sharing, Broad-based stock options, Employee stock ownership, Worker ownership

Paper type Literature review

In the first place, it is a point conceded, that America, under an efficient government, will be the most favorable country of any kind in the world for persons of industry and frugality, possessed of moderate capital, to inhabit. It is also believed that it will not be less advantageous to the happiness of the lowest class of people because of the equal distribution of property. George Washington, letter to Richard Henderson, Mount Vernon, June 19, 1788[1].

Introduction

Broad-based employee stock ownership and profit sharing can be found throughout the USA. Most members of Congress have most likely met business owners, entrepreneurs, managers and employees who share in the rewards of the productivity, profit and wealth that they have built, often through employee stock ownership plans (ESOPs) established by Congress in 1974 and profit sharing, along with other approaches. ESOPs provide companies tax incentives to finance the purchase of shares through loans to an employee benefit trust where the employees do not have to pay for the shares. Many corporations grant restricted stock or stock options to employees. Profit sharing provides employees a percent of annual profits in cash or in a deferred profit-sharing trust[2]. Businesses of all sizes in every part of the country and in every industry have policies that provide opportunities for employee stock ownership or profit sharing, or both, with most if not all workers. In recent years, worker cooperatives, which have the longest tradition in America, often in smaller single-site local firms, have emerged as an increasingly popular way for citizens to do much smaller entrepreneurial start-ups where they have an ownership stake[3]. When these approaches work well, employee share ownership and profit-sharing plans help increase the productivity of employees enough to pay for any extra cost on the firm for ceding part of ownership or profits for employees.

Examples of companies using employee ownership and/or profit sharing include large stock market companies like Procter & Gamble, which has had meaningful employee ownership along with profit sharing for over a century, and Southwest Airlines, which has both employee share ownership and an annual cash profit-sharing plan that in 2015 paid \$620m in profits to all employees, adding 15 percent on top of their wages and salaries[4]. Divisions of stock market companies are sometimes spun off and sold to workers through ESOPs: the 100 percent employee-owned Scot Forge in Clinton, Wisconsin, and the 100 percent employee-owned Houchens in Bowling Green, Kentucky, are examples. There is also the highly successful worker cooperative, Equal Exchange, which sells fair-trade coffee and chocolate nationwide with about 100 employees.

Many family entrepreneurs use ESOPs to sell their ownership to the employees and managers who helped them build the business when the founding family member retires. A sale to the employees living in an area helps protect the jobs and wealth of the employees, benefit the local community and allow the entrepreneurs who built the businesses to cash out their equity interest so they can enjoy their retirement. Employee share ownership thus helps address the problem that small businesses face in business succession. Many businesses, small and large, use cash profit sharing to give incentives to employees and to share the benefits from good economic outcomes – it is highly popular in family-owned businesses. Profits and wealth from stock that go to employees living in an area boost local economic activity and businesses. In Silicon Valley, Seattle, and other tech “innovation clusters,” large and small high-tech firms have both equity compensation and

forms of profit sharing for employees. Prominent examples are Google, Intel, and Microsoft. High-tech start-up companies, such as Jet.com and Juno in New York State, have used profit and equity sharing to build the companies[5]. It is hard to find high-tech firms and start-ups that do not have some form of equity sharing and profit sharing with employees.

The theme of this paper is that the public policies to expand capital ownership and profit sharing that the founders of the USA saw as the right way to address the inequality and economic problems of their day are as appropriate – or even more so – to the inequality and economic problems of our day. We first review the history of public policy on employee ownership and profit sharing in the USA, examining the various forms of support since the USA began along with the pullback from these policies in recent years despite the growth of positive evidence. Second, we describe the four main reasons for interest in employee ownership and profit sharing – reducing economic inequality, improving workplace performance, enhancing firm survival and employment stability and creating more harmonious workplaces with greater corporate transparency and increased worker involvement – and summarize the evidence on each of these sources of interest. We then address the two major objections to employee ownership and profit sharing. Finally, we lay out the case for new public policies and give several examples of policies that are being, or could be, considered. We conclude with some observations on what types of future research will most benefit the development of sound policies.

History of public policies on employee ownership and profit sharing in the United States

Shares of property ownership are a major American tradition. As illustrated by Washington's quote at the beginning, the founders of the American Republic believed that broad-based property ownership was necessary for republican democracy to exist and sustain itself. They believed this because they feared that extreme economic inequality would undermine the ability of people to elect representatives who would govern in their interest, a worry that is with us still today. In the largely agrarian economy in which the founders lived, land was the primary form of business capital, so the founders endorsed broad access to land ownership as the main tool for promoting greater economic equality[6]. From land grants to efforts to save the early cod fishing industry with profit sharing "tax credits," the founders supported steps to make sure that wealth would be shared by employees as well as owners. The founders supported major steps to put this into action. Before the Constitution created the USA as a unitary country, the Congress of the Confederation of States passed the Northwest Ordinance in 1787 to make large segments of land available to citizens in the area that later became the states of Ohio, Indiana, Illinois, Michigan, Wisconsin and Minnesota. The second President, John Adams, favored making available public land so that every citizen could be an independent property holder, and wrote the right to acquire property into the Massachusetts Constitution. One of President George Washington's first economic policies was to encourage cash profit sharing. Cod fishing was the third largest export industry of the colonies, with salted cod mainly from New England fisheries sent to Europe. During the American Revolution, the British destroyed much of the American cod industry in an effort to weaken the colonies' economy. When the war ended, President Washington asked the Secretary of State Thomas Jefferson to find a way to encourage the rebuilding of the cod industry for economic and national security reasons. Cod fishing was important for national security because it trained sailors who could help develop the nascent US Navy. Jefferson researched the industry and produced the *Report on the American Fisheries* that was submitted to Congress on February 1, 1791. For over a hundred years, cod fishery had used broad-based profit sharing to give the crews of ships incentives for their performance and teamwork. In the beginning of the report, Jefferson cited a letter from a major Philadelphia merchant who testified that the

cod ships with profit sharing were more productive than the cod ships with wages not tied to performance. The sailors worked better with a share in the wealth created by the industry.

Jefferson, Washington and the Congress chose to help the industry get back on its feet by what was essentially a tax cut (in lieu of tariffs paid for supplies coming from outside the USA) to the owners and workers of the cod fishery on the condition that the ship owners share the tax credits with all the workers. In doing so, they rejected government ownership of cod fishery on the basis of Britain's failure to strengthen its whaling industry by nationalization, and rejected outright subsidies to the wealthy owners who controlled the boats and warehouses on the basis that any government tax credits had to include workers. The law was explicit in its sharing criterion: owners had to share five-eighths of the credit with the crew, and additionally have a signed agreement with the captain and crew for broad-based profit sharing on the entire catch throughout the voyage. The tax credits were administered by the Treasury Department headed by Alexander Hamilton through the port Customs' Houses. The arrangement helped rejuvenate the industry. Congress continued it for many decades[7].

This was just the first in a long history of public policies aimed at reducing inequality. The primary tool in the 1800s was to make federal lands available at low prices so that average citizens could acquire a homestead to support their families. When Jefferson became the president, he made the Louisiana Purchase of almost a million square miles in order to advance a citizen-property-holder "empire of liberty." Successive administrations followed with major initiatives in trying to broaden land ownership, sometimes getting embroiled in political battles and important issues of justice (Blasi *et al.*, 2013, pp. 16-32, 33-35, 51-53).

President Abraham Lincoln took the biggest step with the Homestead Act of 1862 that helped make available 270m acres, or 10 percent of the land mass of the entire nation, to encourage independent farm ownership. The Republican Speaker of the House of Representatives, Pennsylvania's Republic, Galusha Grow, who managed the Act through Congress, echoed a point made years earlier by former President James Madison that population growth would eventually make obsolete a broad-based property ownership policy limited only to the ownership of land. Speaker Grow recognized that business and corporate assets, unlike land, were unlimited, so he saw broad-based profit sharing and capital shares in businesses by employees as the successor idea[8].

From the late 1800s through the early 1900s, industrialists took the lead in pushing for profit sharing and employee share ownership. Charles A. Pillsbury of Minnesota's Pillsbury Flour Mill, William Cooper Procter of Procter & Gamble and John D. Rockefeller Jr of Standard Oil, among many others, developed broad-based profit sharing and employee share ownership designs for companies, formed national associations of business people to advance these ideas and supported research on the issues at universities. With the emergence of individual and corporate income taxes following the 16th Amendment to the Constitution, business leaders such as Andrew Carnegie – who, like others, specifically referenced the founders' ideas on broad property ownership in his writings – pushed for integrating the tax treatment of these practices into the new corporate income tax system. The initial tax incentive for profit sharing made cash profit sharing a deductible expense when figuring corporate income taxes like other forms of employee compensation. Unions had done some early experimentation with broad share ownership ideas with the United Steelworkers developing cash gain sharing, a close relative to profit sharing[9].

Many forms of employee share ownership in the 1920s and earlier were based on the workers buying the stock with wage deductions or retirement savings. These formats had some tax benefits, but workers paying for stock with their wages and their savings can be highly risky. Members of Congress and successive Presidents saw broad-based profit sharing and employee stock ownership as worthy of Federal encouragement but did relatively little in committing federal resources to spur its development until the late 1930s

and 1940s for broad-based profit sharing, and the 1970s for broad-based employee stock ownership[10].

A major bipartisan initiative led by Republican Senator Arthur Vandenberg and the administration of President Franklin Roosevelt produced Congressional hearings and legislation that allowed tax incentives for deferred profit sharing trusts in the 1940s. In addition to the deductibility of cash profit sharing as an expense against corporate income taxes, the new bipartisan policy allowed companies deductions for contributing to deferred profit sharing plans that would come to be funded with cash and company stock. Deferred profit sharing trusts grew and subsequently would fall under the Employee Retirement Income Security Act when it became a law in 1974[11].

In the early 1970s, Senator Russell Long took the ideas of law professor and investment banker Louis O. Kelso and added sections to the Employee Retirement Income Security Act of 1974 that defines ESOPs and establishes the tax-advantaged status for these plans. Kelso's idea and Long's legislation directly addressed the key issue of risk of earlier employee share ownership plans in the 1920s where workers bought the stock with their wages and savings. The ESOP they designed was based on employees receiving grants of stock that were financed by the company setting up an employee benefit trust that bought the stock with credit, not with workers' wage contributions or savings.

By being included in ERISA, company contributions of cash or stock to an ESOP-defined contribution plan became deductible similarly to company contributions to other retirement plans. ESOPs under ERISA received additional tax encouragement with the company payments of the principal and the interest on the loan also being tax deductible. This legislation led to ESOPs becoming the dominant form of employee stock ownership in the country, although mainly in closely-held small businesses[12].

Ten years later, in another bipartisan effort, this time led by President Ronald Reagan and Senator Russell Long, the Tax Reform Act of 1984 altered the tax incentives to make ESOPs with modest levels of generally 5–20 percent of employee stock ownership attractive to publicly traded stock market corporations. It did this by allowing banks, investment banks and insurance companies to deduct half of the lender's interest income in computing their own corporate taxes for loans or structured bonds to corporations to access credit to finance ESOPs for broad groups of employees. This led most large banks and other lenders to set up entire employee stock ownership divisions to market the idea to corporations nationwide and pass some of their own tax savings to the companies doing ESOPs in the form of lower interest rates. This facilitated a large increase in ESOPs in stock market companies. Because most of these ESOPs in stock market companies depended on actually financing and buying newly issued shares with credit rather than simply granting shares that brought in no new capital to the corporation, the dilutive aspects of these ESOPs were moderated. The deduction of dividends used to pay back the loans on this stock was also given a tax incentive[13].

Subsequent tax incentives in the eighties (such as Section 1042 of the Internal Revenue Code) allowed owners of privately-held businesses to defer their capital gains taxes when they sold more than 30 percent of C corporations to the employees and managers through ESOPs or eligible worker cooperatives[14]. Often, retiring entrepreneurs would sell 100 percent in stages so that they could fully retire if they had no heir to operate the company or the family wished to cash out on their stake. Because most ESOPs in closely-held companies take place in situations where the founding owner wants to retire and cash out of the business, the issue of diluting profit per share and diluting the ownership and governance rights of majority shareholders is not a material issue in these cases. The dilution question is more complex in ESOPs in stock market corporations and broad-based equity compensation plans such as restricted stock plans and stock options, which also have tax deductions. The estimates of tax expenditures for ESOPs by the Joint

Committee on Taxation are \$0.9–\$1.0bn per year from 2014 to 2018 for ESOPs. No composite estimate exists for all other broad-based equity compensation plans exists in the Joint Committee on Taxation’s publications[15].

In spite of this long record of federal support for profit sharing and employee stock ownership, since the late 1970s, the Federal Government backed off its support for broad-based employee stock ownership and profit sharing during virtually every recent Presidential administration for almost four decades, a trend that has lasted to the present. In the Carter administration, the 1978 section of the Internal Revenue Code made 401(k) defined contribution retirement plans possible and created a competitive form of retirement savings that many firms preferred to ESOPs. The 401k plan on balance weakened Federal incentives for profit sharing and encouraged employees to buy stock in their companies with their wages, which gives them greater individual risk exposure than when they receive grants of stock[16].

The George H.W. Bush administration eliminated the tax incentives encouraging ESOPs in stock market companies that had been earlier supported by President Ronald Reagan and Senator Russell Long. This spelled the end of the spread of ESOPs in stock market companies and their ensuing decline in importance there. In the Clinton administration, Internal Revenue Code 162(m) allowed companies to deduct as a cost of business billions of dollars for corporate profit sharing and employee share ownership programs only for the top five executives of stock market companies, while incentives for ESOPs were cut back. In the George W. Bush administration, changes in accounting regulations and Federal policies made granting of broad-based stock options and restricted and other stock grants to employees in high technology and other companies less attractive, and led to a huge drop in employee share ownership among the middle class in such companies and in those industries. The Obama administration regularly called for slashing ESOP tax incentives in their annual budget messages. And, as noted, over the last several decades, a variety of regulatory and tax changes made deferred profit sharing plans less attractive to businesses.

The 162(m) expansion of tax benefits for top five executives is of special concern. One can argue that this policy was by intention created to tie executive pay to performance since it was tied to the capping of deductions for top five executive salaries at \$1m. After several initial years of experience with 162(m), it became clear that the new law added to rather than restricted the expansion of top executive pay. Even so, every administration and Congress continued to support Internal Revenue Code 162(m)’s super-deductions for top executive forms of stock ownership and profit sharing while each of these administration cut or did not expand support for broad-based profit sharing and employee share ownership plans that could benefit the middle class. It is estimated that 162(m) tax expenditures cost the Federal Government \$5–10bn per year over the last 20 years[17].

The reasons for this decades-long abandonment of significant Federal support for broad-based employee stock ownership and cash and deferred profit sharing are varied and complex. This massive policy reversal continued even as concern was rising about the plight of the middle class and the growing economic inequality in America. The causes for the reversal differed by Presidential administration and discussions in Congress, including a focus on deficit cutting, lack of coordination in the White House and Congress on overall policies for broadening profit sharing and employee share ownership, the manipulation of the tax system by moneyed interests for their own benefit, potential misunderstanding by top decision makers of how broad-based profit sharing and employee share ownership work, and a common and misguided belief by economists and policy makers that wage growth could be spurred by policies that did not include shares. Policy leaders did not appreciate the connection between these long-standing concepts in

American history and the rising problem of economic inequality. The older political tradition of the founders became lost in the post Second World War era. Potentially, most important of all, most of the cutbacks occurred before the severity and persistence of the upward trend in economic inequality was fully recognized and before the economic evidence showed the large economic payoff from ownership and profit sharing to workers and firms[18].

The pullback in government support was often justified by the idea that employee stock ownership may be a risky substitute for fixed worker pay, but as will be seen in the review of evidence, almost all the studies indicate that employee stock ownership and profit sharing do not come at the expense of workers taking lower wages or other forms of compensation.

Reasons for and evidence on employee stock ownership and profit sharing

There are four main sources of current interest in employee stock ownership and profit sharing:

- (1) Employee share ownership and profit sharing can increase worker pay and wealth and broaden the overall distribution of income and wealth, a key ingredient for a successful democracy. To be a tool for reducing inequality, employee stock ownership and profit sharing must be spread more widely and meaningfully than it is today.
- (2) Employee share ownership and profit sharing provide incentives for more effort, cooperation, information sharing and innovation that can improve workplace performance and company productivity.
- (3) Employee share ownership and profit sharing can save jobs by enhancing firm survival and employment stability, with wider economic benefits that come from decreasing unemployment.
- (4) Employee share ownership and profit sharing can create more harmonious workplaces with greater corporate transparency and increased worker involvement in their work lives through access to information and participation in workplace decisions.

In this section, we summarize the evidence on these four rationales.

Reducing inequality

Employee ownership and profit sharing may help to reduce inequality if they distribute economic rewards more broadly, and they do not substitute for standard worker pay or benefits. If they do substitute, this presents serious issues of financial risk since workers will have sacrificed fixed pay for more variable pay and wealth (although financial risk may be reduced by greater job security, as described above). With a few exceptions where workers gave wage concessions for ownership, firms that adopt ESOPs add ownership to paying normal market levels of pay. A comprehensive study of all ESOP adoptions over 1980–2001 found that employee wages apart from the ESOP either increased or stayed constant after adoption, so that ESOP contributions was an add-on to existing pay. Consistent with this, comparisons of matched ESOP and non-ESOP firms found similar levels of pay and other benefits, apart from the ESOP in the two types of firms. Other comparisons among firms and among workers also find that employee stock ownership and profit sharing generally comes on top of standard pay, and employee owners are more likely to say they are “paid what they deserve” (Kim and Ouimet, 2014; Kardas *et al.*, 1998; Scharf and Mackin, 2000; Handel and Gittleman, 2004; Long and Fang, 2012) One study finds that an extra dollar of

employee ownership value is associated with an extra 94 cents of wealth, indicating that employee-owned stock appears to add to wealth in general.

Comparing pay and wealth within firms having different organizational and sharing arrangements shows more equal distribution in employee stock ownership firms than in other firms (Bernstein, 2016; also see Buchele *et al.*, 2010). But the broader sharing of the fruits of economic performance is too limited at current levels of employee stock ownership to impact income and wealth distribution across the entire economy. The potential of employee ownership and profit sharing to reduce inequality is a rich area for further research.

Workplace performance

The skeptic may react to the above evidence on employee ownership and profit sharing-supplementing pay by wondering how this can be? How can firms add employee ownership/profit sharing to existing compensation and remain in business? After all, one might argue that if the company is giving away shares of profit or stock for free, then profits per share will be less, and the company's stock will be less competitive in the marketplace. For ESOPs in closely-held companies, this is not an issue since typically the entire company is being sold to the employees, and managers and the exiting owner are not focused on the dilution of the majority shareholder since that shareholder desires to cash out its majority equity. Closely-held companies starting minority ESOPs would have to evaluate if the dilution is outweighed by the productivity and financial performance of the firm. This dilution is an issue in publicly traded stock market firms, but it has been historically addressed by keeping the size of the ESOP modest compared to the rest of shareholders (most ESOPs in stock market companies are under 20 percent) and by establishing a corporate culture where employee stock ownership is likely to increase the performance of the firm so as to offset the modest dilution of profits per share of non-employee shareholders. In such firms, the board and executive management assess if the type of employee share ownership offered is likely to have a greater positive effect than any expected dilution[19].

A more subtle interpretation that fits with evidence on company performance, worker behavior and pay is embodied in George Akerlof's model of "gift exchange" (Akerlof, 1982) In this model, workers respond to the "gift" of employee share ownership or profit sharing on top of market compensation with a reciprocal "gift" of high effort, cooperation and work standards. The group incentive nature of employee stock ownership and profit sharing makes this an effective way to create and reinforce a sense of common purpose, and to encourage higher commitment and productivity (Blasi *et al.*, 2013, Chapter 5; see Blasi, Kruse and Markowitz, 2010). It is also the case with ESOPs that the new ownership might not be viewed by the firm in the same way as other added compensation because the ownership is financed through loans to buy new capital as company stock, with Federal tax incentives, and the shares are not paid as normal wages and benefits out of company budget reserved for this purpose.

A recent meta-analysis of studies with 102 samples covering 56,984 firms finds a small but significant positive relationship on average between employee stock ownership and firm performance (O'Boyle *et al.*, 2016). The positive relationship holds across firm size, and has increased over time, possibly because firms are learning to implement employee stock ownership more effectively. Prior reviews and meta-analyses of employee stock ownership and profit sharing likewise found positive average relationships with performance, with only a small minority of negative estimates[20].

While it is sensible economics to interpret the positive link of employee stock ownership and profit sharing to company performance as reflecting worker responses to the incentives in the plans, it is possible that the positive relation comes from a very different causal link, in

which higher productivity companies introduce profit sharing or ESOPs for whatever reason. To get a handle on causality in the relation of organizational form with company performance, many studies use before/after comparisons and various statistical corrections for endogeneity of company form. These methodologies yield positive effects flowing from profit sharing or employee ownership to performance. Further evidence on causation comes from a field experiment in which several fast food outlets were randomly assigned profit sharing plans and had improved performance and lower employee turnover compared to outlets in the control group (Peterson and Luthans, 2006). These positive results are consistent with laboratory experiments where subjects are randomly assigned into employee-owned “firms”[21].

The evidence that incentives based on group outcomes are associated with higher productivity contravenes the oft-repeated critique that employee stock ownership and profit sharing cannot possibly work due to the incentive to “free ride.” With a large group of persons sharing group output, this view holds that each person has good reason to slack and let others contribute to the whole. What prevents free riding from destroying the incentive effects of profit sharing and employee stock ownership? In our National Bureau of Economic Research study of over 40,000 workers, we asked workers whether they would intervene when they saw a fellow worker not working well. Workers with company stock and other group incentives were actually more likely to say they would take action to reduce free riding than workers without group incentive pay. They were far significantly more likely to say that they would talk to the worker, supervisor or members of the work team. When asked why they would do this, many workers reported that “Poor performance will cost me and other employees in bonus or stock value.” In addition, our and other studies find that employee owners generally have lower turnover and absenteeism, more company pride and loyalty, greater willingness to work hard and make more suggestions to improve performance (Freeman *et al.*, 2010).

Positive effects of employee stock ownership and profit sharing are not automatic. A majority of companies do well with these systems but some companies do not. The positive effects appear to depend on workplace policies and norms that support cooperation and higher effort, such as employee involvement in decisions, participation in company training and job security. An economy with expanded employee stock ownership and profit sharing is likely to perform better than the current economy. However, it is important to recognize that to support such policies, one would only need evidence that the firms perform as well as the current economy in terms of their profitability and their stock price performance. The only difference would be broader property ownership, which, what the founders thought, was important to sustain American democracy.

Firm survival and employment stability

In the Great Recession and the previous recession, employee stock ownership firms had smaller employment cutbacks and higher survival rates than similar firms. A study of S corporations (small firms with 100 or fewer shareholders who are taxed as a partnership) found that those with ESOPs had higher average employment growth in the 2006–2008 pre-recession period than did the economy as a whole, and also had faster growth following the recession from 2009 to 2011. This is consistent with national survey reports from the General Social Survey where employee owners report that they have greater job security and lower likelihoods of being laid off in the previous year compared to other employees (Brill, 2012; also see Kurtulus and Kruse, 2016) When faced with recessionary pressures, employee ownership firms may retain workers to sustain a workplace culture based on cooperation, information sharing and commitment to long-term performance. In such a culture, it may be especially important to preserve worker skills during economic downturns, and possibly increase skills by having workers engage in extra training until demand recovers.

Increased corporate transparency and worker involvement

Employee stock ownership under ESOPs gives workers confidential voting rights on major corporate issues, so that they have some formal corporate governance rights in closely-held corporations, and in stock market companies, employee owners have the same rights as other public shareholders. Employee owners also report more informal participation in decisions at the job and department level compared to other employees, along with higher quality of work life, more training opportunities and better management–employee relations. They also report lower intention to leave the firm for another job, but consistent with the idea that the context matters, and the favorable effects appear to depend on the presence of other supportive workplace policies. Without supportive policies (employee involvement, training, job security and low supervision), workers with company stock and other group incentives may even have lower satisfaction and higher turnover intention. This may reflect mixed messages to employees when they are given employee ownership without supportive workplace policies: “We want you to be more productive as employee-owners, but we’re not going to give you the tools to be more productive, and we’re going to keep a close eye on you.” In such cases, the employee stock ownership may be seen as an attempt to shift financial risk onto workers, rather than to empower workers. However, survey evidence gives encouraging news on this score, showing that managers in companies with employee share ownership appear to implement a greater number of these supportive employment policies. (Kruse *et al.*, 2010; Blasi *et al.*, 2013, 2016).

Potential drawbacks/downsides

The two major objections to employee stock ownership and profit sharing are that the incentive to free ride will ultimately destroy the “ownership/sharing magic,” and that having assets in one’s workplace creates excessive financial risk for worker-owners.

While free riding undeniably occurs in group incentives as in many types of teamwork, the evidence on firm performance and worker behaviors reviewed above shows that the free riding problem is overcome more often than not under employee ownership and profit sharing. Many companies and workers implement policies and norms that discourage free riding by increasing team spirit, loyalty and high work standards. As noted, our analysis of the 100 Best Companies to Work For in America data set compiled by the Great Place to Work Institute, which is the basis for *Fortune Magazine’s* annual issue on Best Companies to Work For, finds that companies with more employee stock ownership and profit sharing have more participative cultures so many private-sector managers appear to understand how to do it in an optimal fashion (Blasi *et al.*, 2016).

Having one’s job and a portion of one’s wealth in the same firm can create undue financial risk for workers, as it does for individuals and families who use some or all of their life savings to start their own businesses, or otherwise invest heavily in one asset. The risks for employee owners are exemplified by the experiences of United Airlines and the Tribune companies, where employees traded stock for wage and benefit concessions, which point to the need for policies that mitigate risk (Walter and Corley, 2015). These two cases were not classic ESOPs where workers received the grants of stock based on financing the purchase of the shares. Rather, the United and Tribune cases were based on the exceedingly risky trading of wage, benefit and work rule concessions for stock, namely, where the workers bought the stock with wages or give-backs.

While financial risk is real in every case of private market economy ownership, there are offsetting factors that make it more tolerable than critics of profit sharing and employee stock ownership realize for regular employees. First, since the evidence shows that profit sharing and employee stock ownership generally come on top of standard pay and benefits, workers are not sacrificing for risky pay. As noted earlier, a comprehensive

study of all ESOP adoptions over 1980–2001 found that employee wages apart from the ESOP either increased or stayed constant after adoption, so that ESOP contributions were an add-on to existing pay. A recent study using population data from Department of Labor files comparing about 4,000 ESOP companies to all other non-ESOP firms with 401k plans has shown that most ESOPs do not replace more diversified retirement plans; virtually all of the assets in ESOPs are from company contributions, not employee contributions, as is typical in 401k plans, and the net plan assets per participant are 20 percent higher in ESOPs than in the non-ESOP companies. This study found that 47 percent of ESOPs under 100 employees and 57 percent of ESOPs over 100 employees had a second diversified retirement plan. Another population study of all ESOPs found that 75 percent of employees were in firms with a second diversified pension plan, and other studies substantiate these findings. Using credit to finance new ownership for ESOP workers can allow workers to accumulate capital wealth on top of their wages while still having access to diversified retirement plans that are funded through the firm's compensation budget[22].

A second important point is that the biggest form of financial risk faced by most workers is job loss, which is lower for employees of worker owned firms than most other firms. Employee owners may face less total risk than other employees because employee ownership increases employment stability and firm survival, as reviewed above. Third, individuals weigh financial risk in their choices. Even risk-averse employees tend to like variable pay associated with profit sharing and employee stock ownership. In our National Bureau of Economic Research study of over 40,000 employees, two-thirds of the most risk-averse employees reported that they would like at least some ownership, profit sharing or stock options in their pay package. Employees apparently recognize that capital ownership and capital income provide an opportunity for greater economic wealth. Fourth, the founder of the portfolio theory, 1990 Nobel Prize winner Harry Markowitz has shown that employee share ownership can be part of an efficient diversified portfolio. Based on standard assumptions about individual preferences, he estimated that an optimal investment of company stock in an overall diversified portfolio would be to hold around 9 percent of the workers' entire wealth portfolio, while "ten or even 15 percent would not be imprudent." This analysis did not take into account whether the added equity wealth was a grant on top of fair wages and other diversified benefits. Evidence from the 2013 Survey of Consumer Finances shows that five-sixth of US families that own employer stock fall below Markowitz's 15 percent threshold, indicating that excessive risk is likely confined to a minority of employee owners[23].

The case for new public policy

Current facts on inequality and economic growth make as strong a case for public policy to increase a variety of employee share ownership and profit sharing formats as in the early days of the Republic. Measures of inequality in the late eighteenth century are problematic but the best scholarly estimates indicate that colonial USA had lower Gini coefficients than in other countries with measures of inequality. The USA now has the highest inequality among advanced countries and a level that exceeds, possibly substantially, the estimated inequality in 1774. If Washington, Adams, Jefferson, Madison and other founders were to time travel to 2016, they would almost surely be troubled by the threat that inequality poses to the well-being of citizens and democratic governance and ask, "What are your policies to make the US what it should be, the most favorable country in the world for persons of industry and frugality, possessed of moderate capital, to inhabit?" (Lindert and Williamson, 2012; also see Weissman, 2012).

Capital income is the most unequal part of the income distribution. The top 10 percent of households own over 80 percent of financial assets and the top 20 percent of individuals

receive almost 90 percent of all capital income. By one metric, wealth is 100 times more unequally distributed than income. Data on the Internal Revenue Service website show that in 2013, the top 400 taxpayers (the upper 0.000027 percent of taxpayers) earned 1.17 percent of adjustable gross income 6.1 percent of taxable interest, 5.3 percent of dividends and 9.8 percent of capital gains. The four wealthiest persons – the two Koch brothers, Warren Buffett and Bill Gates – have as much wealth as the 128m persons in the bottom 40 percent of the wealth distribution. The families whose wealth is increasing in the economy are receiving this wealth through access to capital ownership and capital income. In addition, part of the inequality in labor incomes is associated with access to capital income. The stock options, stock grants and profit and gain sharing bonuses that companies pay to executives are counted in official statistics as compensation for work with no asterisk that they are also income to capital[24].

Growth has been extraordinarily sluggish in the recovery from the Great Recession and has weakened in advanced countries over a longer period, leading some analysts to believe that we have entered a new economic era of small to modest growth. This may turn out to be true, which will increase the importance of growth-enhancing policies. The evidence that firms with employee stock ownership and/or profit sharing perform better than others suggests that policies that extend ownership would boost the country's lagging growth rate. The evidence that employee share ownership firms preserve jobs and survive recessions better than others suggests that policies that extend ownership could help stabilize the economy when the next recession comes down the pike.

Expanding employee share ownership and profit sharing formats is not a panacea for all that ails the economy. No single policy can address persons and firms facing diverse problems in a dynamic modern economy. But the same can be said for other policies designed to improve economic outcomes for the bulk of citizens – increasing the minimum wage, increased spending on infrastructure, establishing a guaranteed minimum base income, regulatory reforms, increased spending on R&D, cuts in corporate taxes, whatever your favorites may be. Given that spreading ownership of capital and increasing employees' share in economic rewards has bipartisan appeal[25], the only valid answer to the question by Washington, Adams, Jefferson, Madison or other time travelers is that, after four decades of neglecting policies to stimulate broad-based profit sharing and employee share ownership, we have changed course and are now placing them in the policy portfolio, if not at the center of economic policy making that they occupied from the days of Washington to Lincoln.

If Congress and future administrations wish to expand these policies, measurements every four years of broad-based employee share ownership and profit sharing every four years are already in place since 2002 as part of the General Social Survey mainly supported by the National Science Foundation. In 2014, 19.5 percent of adult employees owned some company stock, 7.2 percent held company stock options, 38.5 percent received profit sharing and 25.3 percent received gain sharing, with 52.4 percent participating on one or more share formats. However, the median value of the employee share ownership holdings was only \$10,000 and profit/gain sharing annual compensation was \$2,000, so a case can be made for encouraging these capital share approaches[26].

Why is Federal encouragement needed?

- (1) First, because as documented in this paper, the American tradition of using meaningful Federal incentives to broaden equity and profit shares has been going backwards in the mistaken belief that other policies would assure rising earnings for most workers and in forgetting the Founders' concern that broader citizen capital ownership and capital income contribute to a stronger democracy.
- (2) Second, because there may be informational or institutional barriers about the benefits of ownership and sharing and the ways firms can introduce such programs

that government can help overcome. Government has often played a role in promoting performance-enhancing work practices to enhance overall economy-wide outcomes from higher productivity and innovation, such as the long history of agricultural extension services (since 1887) to spread information on best practices in farming, and employer education on safety practices conducted by the Occupational Safety and Health Administration.

- (3) Third, because of the “externalities” – effects that extend beyond the firm and its members – that greater ownership/profit sharing can bring us. If employee ownership and profit sharing lead to fewer layoffs and firm closures, this can reduce the following: recession-created drops in consumer purchasing power and aggregate demand; government expenditures on unemployment compensation and other forms of support; decreased tax base for supporting schools and infrastructure; and potentially harmful social and personal effects, such as marital breakups and alcohol abuse. Apart from unemployment, more broadly shared prosperity and lower inequality may also have wider benefits for macroeconomic growth, stability and societal outcomes as described by a number of social scientists. To the extent the ownership and profit sharing is a public good, a nudge in policy to consider the idea makes sense.
- (4) Fourth, because it is hard to find policy options that are as bipartisan as the shares policy. In *The Citizens’ Share*, and in other articles and venues, we lay out the areas in which there is evidence or logic for in-depth development of, and experimentation with, several broad policy directions, with the details to be worked out by members of Congress based on their deliberations.

These include:

- The Federal Government helping state governments with seed funds to set up independent nonprofit centers (that later would become self-supporting) in order to provide information about how to move companies to implement employee share ownership and profit sharing plans, and the best practices in operating firms locally in that state, much as it has historically provided information to small businesses through the small business administration and to farmers through agricultural extension services.
- Congress shifting corporate tax expenditures that do not serve to broaden ownership or profit sharing participation (which total about \$1 trillion over every four to five years), including those that subsidize the wealth of top executives[27] under the Treasury interpretation of Internal Revenue Code 162(m), to be conditional on a recipient company having broad-based employee stock ownership and profit sharing plans.
- The Federal Government or state and local governments adding a small preference in contracting and purchasing with firms that meet a minimum employee share ownership or profit sharing criterion while insuring that companies that already have special purpose preferences (such as majority veterans, women or minority-owned businesses) do not lose their preference when they become majority employee-owned.
- Congress creating modest short-term tax breaks for companies that introduce profit sharing, as candidate Secretary Hillary Clinton has proposed as part of her Democratic economic agenda and is in the 2016 Democratic Party Platform.
- Congress implementing different tax benefits to expand ESOPs, as the Republican Party and then-presidential candidate Senator John McCain proposed in 2012, also

including other forms of employee stock ownership such as broad-based restricted stock and stock option plans for entrepreneurial firms and worker cooperatives for smaller local firms.

- Congress or the President creating an Office of Broad-based Employee Share Ownership and Profit Sharing in the White House to coordinate policies across the government to assure that there are sufficient data, research and analysis to encourage responsible policies and avoid unintended consequences as the many policy disasters of the past noted above[28].

The phenomenal appreciation in value that is reaped by a small group of founders and their backers in IPOs and top executives in stock market companies, mergers and private equity buyouts can be turned into an opportunity for the middle class if more such businesses are encouraged through tax incentives to have employee share ownership or profit sharing plans early in their development. A Congress or Administration that wants to support broader employee share ownership and profit sharing in economic rewards could develop a checklist on any major program or legislation that is proposed to examine its likely effects on, and capacity to increase, financial participation and capital ownership and access to income on capital of employees and citizens in our economy. We believe there is a good case for political leaders and their advisors to consider these and develop other practical policies to deal with inequality and our economic problems in a way consonant with America's broad-based ownership tradition.

Conclusion

With the experience of the past to draw upon and a large and growing set of studies on how different forms of employee share ownership and profit sharing work in modern settings, it is time to examine how ownership and profit sharing policies can help make US capitalism more efficient and equitable in the current economic environment. Our argument is straightforward: policies that encourage firms and workers to broaden capital ownership and access to capital income, consistent within the long American tradition of encouraging broad-based private property ownership, should be part of any effort to address today's economic inequality.

What are the implications for future research, in particular to inform policy efforts? The most popular research topic has been the effect of employee ownership and profit sharing on company performance. The accumulated findings on company performance show clearly that these programs are linked to higher performance on average, so at a minimum there is no support for the objection that efforts to increase employee ownership and profit sharing will harm economic performance. There is, however, substantial dispersion in firm outcomes with some firms doing extremely well and others doing poorly, and it would be useful to have more solid evidence on the workplace policies and other factors that condition the performance outcomes.

Given the large number of company performance studies and the relative paucity of studies on other outcomes, there is more of a need for research on employment stability, worker outcomes and inequality. While several studies have found that employee ownership is linked to more stable employment and higher firm survival, it is important to test and explore these findings, in particular to address the reverse causation argument that more stable firms are more likely to adopt employee ownership and profit sharing. This is a valuable area for research, given that higher stability and survival have benefits not just for the firm and its workers, but also for the community and larger economy by stabilizing the tax base, purchasing power and community relationships. As noted earlier, to the extent that these positive externalities occur, they create a strong case for government policy support.

Another valuable area for research is the relationship between employee ownership and profit sharing to pay and wealth. This topic is central to debates over the financial risk faced by workers, and the potential for these policies to reduce inequality. The current findings that employee ownership and profit sharing generally add to, rather than substitute for, fixed pay and benefits need to be more closely examined with longitudinal and other methods that control for worker quality, job conditions and other circumstances that underlie pay and benefit differences.

It would also be valuable to have more research on worker outcomes in addition to pay. Do employee ownership and profit sharing contribute, either directly or in conjunction with other workplace policies, to greater worker control over their work lives and a higher quality of work life? Does financial risk contribute to negative attitudes, and, if so, what types of policies can reduce the risk? How do employee ownership and profit sharing affect relations with co-workers and managers? While there are some studies on these topics, the questions remain underexplored.

For policy purposes, it would be especially useful to have more research on the wider societal impact of employee ownership and profit sharing. Apart from the broader benefits of employment stability as noted above, other important societal outcomes that may be affected by employee ownership and profit sharing are corporate transparency, accountability, corporate social responsibility and citizen engagement. The most compelling case for spreading these policies widely is their potential to help reduce the growing levels of inequality both in the USA and around the world. While the limited evidence points to the potential for employee ownership and profit sharing to reduce inequality, this is the topic around which we know the least, and for which the returns from research are likely very high. Given the views of Washington and other founders of the USA that broad ownership is necessary for a healthy functioning democracy, we owe it to them and ourselves to find out whether and how employee ownership and profit sharing may help to address the growing levels of inequality.

Notes

1. George Washington (2007). Original source: Confederation series (January 1, 1784–September 23, 1788), letter to Richard Henderson, Mount Vernon, June 19, 1788.
2. A “deferred profit sharing trust” is a defined contribution plan under the Employee Retirement Income Security Act of 1974 that is a group retirement plan with individual employee accounts, which, in this case, are funded by profit shares from a company which are deposited into employee’s accounts either as cash or as company equity shares (employee stock ownership). Historically, both companies and employees have had some say over how much of a cash profit-sharing payment would go into the deferred retirement trust and how it would be invested. Today, companies typically contract with a major financial services firm such as Charles Schwab, Fidelity, Morgan Stanley, T. Rowe Price, etc., to provide employees with mutual fund choices about how to invest these assets. Often, company stock is one investment choice, although since this form of employee ownership is actually paid for by the employees with their profit sharing, employees are often advised to have company stock be a modest percent of the overall investment account. Since the popularity of the 401k plan has spread, deferred profit sharing trusts and 401k plans are often combined. The Plan Sponsor Council of America is a non-profit association that provides research on such trends (www.pasca.org/401-k-plan-research).
3. Worker cooperatives are businesses where the employee members typically invested in the start-up capital of the business as a joint entrepreneurial venture and own significant stakes. The modern worker cooperative has professional management, a substantially more flat salary structure and a commitment to the local economy. While traditionally in lower profit and lower value industries such as food and retail and other services, worker cooperatives are now on the upswing in high-tech and other business sectors (www.isthmuseng.com/inWisconsin) and by

converting existing small businesses to this model (<http://institute.coop/workers-owners> and <http://institute.coop/resources/successful-cooperative-ownership-transitions-case-studies-conversion-privately-held>). For a census of worker cooperatives, see http://institute.coop/sites/default/files/resources/State_of_the_sector_0.pdf. Worker cooperatives are now far more mature with some of them being organized as LLCs (limited liability partnerships) and some having various kinds of outside investor/shareholders as partners. Former Senator Russell Long (D-Louisiana), the Chairman of the Senate Finance Committee, foresaw this relevance, and provided worker cooperatives parity in some ERISA bills offering tax incentives to ESOPs. See eligible worker owned cooperatives (EWOCs) which Senator Long included in Internal Revenue Code Section 1042 ESOP tax incentives at: www.law.cornell.edu/uscode/text/26/1042, which extends Internal Revenue Code 1042 ESOP tax incentives to worker cooperatives as defined by Federal law.

4. See www.prnewswire.com/news-releases/southwest-airlines-gives-employees-record-620-million-in-2015-profit-sharing-300218638.html
5. See stories at www.nytimes.com/2015/12/27/technology/jetcoms-strategy-low-prices-fast-delivery-happy-workers.html?_r=0 for Jet and <http://thenextweb.com/opinion/2016/04/05/anti-uber-ride-sharing-service-juno-launches-month-heres-itll-fail/#gref> for Juno. For companies involved in inventing, selling or writing software for the internet with broad equity participation, see Blasi *et al.* (2001).
6. On the founders and property shares, see Chapter 1, Blasi *et al.* (2013, pp. 16-56, 229-233). Previous work of the co-authors contains a larger number of background references for the material presented here. The historical review and summary of evidence and policies draw on Chapters 1, 3, 4, 5 and 6 of this work.
7. See Blasi *et al.* (2013, pp. 1-8). See also the Report on the American Fisheries by the Secretary of State, <http://founders.archives.gov/documents/Jefferson/01-19-02-0013-0014>
8. See Blasi *et al.* (2013, pp. 35-40) on President Lincoln, 42-43 on Speaker Galusha Grow, and 33-35 and 51-53 on President Madison.
9. Gain sharing involves granting shares of some gain in the performance of the business to employees that is based on a measure other than stock price (as in employee stock ownership) or profit (as in profit sharing). For example, the company might agree to offer employees a share of the gain in sales, productivity, customer service or other business goals that can be fairly and objectively measured.
10. There is a long history of government support for employee stock purchase plans (ESPPs) back to the 1920s. These plans typically allow employees to buy company stock at a 10–15 percent discount on the market price. This paper focuses principally on broad-based employee ownership plans that involve grants of equity to workers as they have a larger capacity to broaden wealth. Some elements of ESPPs can significantly moderate employee risk.
11. On the Vandenberg/Roosevelt initiatives, see Blasi (2015a).
12. On the work of business leaders to develop share plans, see Blasi *et al.* (2013), Chapter 4, “How It Evolved,” 123-166 and 252-258.
13. On the legislation for stock market company ESOPs, see Blasi *et al.* (2013, pp. 219-221). The impact on stock market companies is reported in Blasi and Kruse (1991) and Appendix D, 313.
14. A C corporation under Federal law pays corporate income taxes directly on its corporate income. Section 1042 of the Internal Revenue Code originally assigned that tax benefit only to C corporations. S corporations are corporations under Federal law where there is no Federal corporate taxation at the Federal level because these corporations pass through their corporate income to their shareholders who then pay Federal tax at the individual level on the gains. There is 2016 pending legislation before the Senate (S. 1212) and House (H.R. 2096) to extend section 1042 capital gains exclusion to entrepreneurs who sell to S corporation ESOPs. This would update ESOP legislation since many small businesses are now S corporations and increase ESOP growth.

15. See Joint Committee on Taxation (2014, JCX-97-14). For a review of the accounting and tax issues for equity compensation plans, see www.nceo.org/Accounting-Equity-Compensation/pub.php/id/2/. For closely-held companies that do ESOPs, the dilution issue is generally a non-issue. In virtually all uses of the ESOP in closely-held companies, the founding family or entrepreneur is the controlling shareholder and decides to sell the company in parts (typically until 100 percent is sold) to the ESOP so she or he can cash out their equity holdings and wealth and go retire and share this value with their family which may not want to continue to operate the business. However, for stock market companies simply creating new shares or issuing stock options by fiat that are given away to employees without the company selling them at full value, existing shareholders would experience an economic dilution in profits (dividends) per share going down because of a larger number of shares and, importantly, in economic value being given away (shares of the company are literally being simply granted to someone else, namely, employees). They would also experience a governance dilution with more shares diluting the percentage stakes of large shareholders. For this reason, the SEC requires such dilutive employee share ownership plans (typically called restricted stock, performance shares or stock options) to be pre-approved by shareholders and sometimes large ones are rejected and employee share ownership become a shareholder rights issue. However, the role of leveraged ESOPs, specifically in stock market companies, is quite different. In virtually all stock market companies that have done ESOPs in the last 20 years, the company sets up the ESOP trust which borrows money to finance the purchase of newly issued shares and the trust pays the market price on that day for the shares. While the shares are granted without the employees having to pay for the shares personally, unlike the example above of restricted stock, the ESOP shares are sold and paid for. The shares are financed and not simply created and given away. Thus, there is no dilution in the sense that pieces of the company are not being literally given away. There is dilution in profits (dividends) per share with sales of new shares to ESOPs and there is also governance dilution. However, in the case of ESOPs, we have not identified any documented cases of shareholders objecting after the fact. Typically, a stock market company would select a modest ESOP size, in the 5–20 percent range, that would be acceptable to shareholders. Management will select an appropriate ESOP size, assessing that the benefits of employee stock ownership for the company's performance will play a role in offsetting any dilution.
16. The explanation is complicated. As part of a strategy by many businesses to withdraw from financing retirement savings with their own funds 401(k) plans were based on the notion that employees would largely finance their own retirement savings. Companies hired financial service firms to provide employees with a menu of equity and bond mutual funds as investments. The Federal Government tried to encourage companies to match employee contributions with company matching payments. As it developed, the overall impact of the 401k plan on both profit sharing and employee stock ownership had some negative consequences. Many companies that used to offer cash profit sharing began to designate their match to the employee contributions to 401k plans as the profit-sharing contribution. Over time, some companies started cutting these company matches to employee contributions to lower and lower levels, essentially minimizing profit sharing. Some Federal regulations put in limitations on the amount of deductions for deferred profit sharing plans that were often integrated with 401k plans. As for the impact of 401k plans on employee stock ownership, in addition to mutual funds where the 401k assets could be invested, some companies with 401k plans began offering employees the choice of the employees themselves buying company stock with their own wage deductions and savings. This actually encouraged the more risky approach of employees buying the stock with their savings rather than the grants of stock on which ESOPs are based. In some cases, as in the case of Enron, employees were overinvested in company stock they purchased and lost their retirements. Thus, the 401k plan recreated a form of employee stock ownership that was common in the 1920s where employee savings and wages had more exposure. Most employees in 401k plans have very low 401k balances, many do not contribute or participate in these plans and “deferred profit sharing” option has lost some of its public persona as a result of its integration with 401k plans. The 401k phenomenon has become a mainly employee-funded retirement plan supported by wage deductions that does not build new capital ownership and capital income on top of wages. In our view, there is one responsible employee stock ownership dimension of 401k plans, namely, when companies match employee contributions to the plan with company stock grants that the

employee does not have to purchase with wages. It is consistent with the policy option of encouraging grants of company stock not employee purchases of shares.

17. See Blasi *et al.* (2013, pp. 214-223) for a more detailed discussion of these changes and cutbacks.
18. Previous work of the co-authors contains a larger number of background references for the material presented here. The summary of evidence and policies draws on Douglas (2016). Chapters 1 and 6 of Kurtulus and Kruse (2016); and Chapter 5 of Blasi *et al.* (2013). Employee ownership and profit sharing come in diverse forms. Common types of employee ownership include: first, employee stock ownership plans (ESOPs) where employees own accounts in a group retirement trust, which can borrow money to finance stock purchases (paid back by the company) so employees do not have to put up their own money or assets as collateral. In 2015, there were 9,323 employee ownership Plans, with about 15m employees, and \$1.3 trillion in assets. ESOPs typically own about 5–25 percent of stock market companies but more than 30 percent of stock in closely-held companies. The 6,329 closely-held companies with ESOPs have about 3m workers and \$263bn in ESOP assets. A few thousand companies are estimated to be majority or 100 percent employee-owned. Most stock market ESOPs have a lot of employees but a very small amount of employee ownership. This is based on National Center for Employee Ownership analysis of US Department of Labor Form 5500 data from 2013, available at: www.nceo.org/articles/statistical-profile-employee-ownership. For detailed numbers on ESOPs, see the center's January-February 2016 newsletter. Second is employer stock in other retirement plans, such as 401(k) plans where companies may match pretax employee contributions with company stock, or where workers buy the stock themselves, also exists. There were 5.9m participants in such plans in 2012. Third are employee share purchase plans which allow employees to buy company stock at a discount. About half of all large companies in the USA offer ESPPs, and an average 30 percent of employees in these companies participate in the ESPP. See Babenko and Sen (2014) for stock held after the exercise of granted stock options or grants of restricted stock. Options give an employee the right to buy shares of a company at some future time at a price specified in the option, thereby providing workers an incentive to improve performance and raise the stock price. As options are risky, many employees cash them out quickly. If workers hold options but not stocks, they have no voting rights. Options are effectively a form of potential profit-sharing rather than ownership. Fifth, employee ownership shares in broad-based worker cooperatives or LLCs or perpetual trusts facilitate such ownership or EWOCs (eligible worker owned cooperatives) under Internal Revenue Code Section 1042. There are about 256 worker cooperatives nationally with a median workforce of 10 worker-owners and median sales under \$300,000, and about 7,000 employees in total. See Palmer (2014).
19. Indeed, weighing whether having employees and managers as partners can contribute more to all shareholders of a stock market company than the dilution of a share plan that is based on newly issued shares is common in stock market companies. It is examined in detail in the book, *In the Company of Owners*, which focuses on high-tech internet stock market firms. See Blasi *et al.* (2001). Empirical research on this is in Blasi *et al.* (2016), showing that such companies had higher return on equity than low equity and profit sharing companies, based on a sample representing 10 percent of sales and employment and 20 percent of total market value of the entire NYSE and NASDAQ comparing companies with broad-based shares to companies without broad-based shares.
20. See Kaarsemaker (2006), Doucouliagos (1995) and Freeman (2007) (www.lb7.uscourts.gov/documents/WIWD/09-413.pdf) These are summarized with additional evidence in Blasi *et al.* (2013, pp. 167-194). The UK Treasury's sponsored analysis of confidential tax records on tax-advantaged share schemes at over 16,000 UK firms reported that broad-based employee stock ownership was linked to improved value added and productivity with correlations consistent with those in many studies of smaller numbers of firms. See Oxera Tax Advantaged Employee Share Schemes: Analysis of Productivity Effects, Report 1, Productivity Measured Using Turnover and Report 2, Productivity Measured Using Gross Value Added. (London: HM Revenue and Customs; see also Weitzman and Kruse (1990). See also Kruse (2016) and Kruse and Blasi (1997).

21. See Peterson and Luthans (2006), Frohlich *et al.* (1998) and Mellizo (2013), *Advances in the Economic Analysis of Participatory and Labor-managed Firms Series*.
22. See Rodgers (2010). On the other population study using all US DOL data, see Testimony of Professor Douglas L. Kruse, PhD, Rutgers University. (Washington, DC: Committee on Education and the Workforce, February 13, 2002); see <http://archives.republicans.edlabor.house.gov/archive/hearings/107th/ee/enronthree21302/kruse.htm>. Another study comparing a matched sample of ESOP vs non-ESOP firms in with similar industries and workforce sizes among closely-held companies, again, using population data on all available US DOL data followed the ESOP firms before and after their adoption of the ESOP from 1988 to 1998 along with the matched firms and found that 20 percent of the ESOP firms had a defined benefit plan before adopting their ESOP and ten years later after adopting their ESOP they had defined benefit plans five times more than non-ESOP firms), 33.3 percent of ESOP firms had a 401k plan before adopting their ESOP with 52.4 percent ten years later (five times more than non-ESOP firms) and 35.7 percent of ESOP firms had a deferred profit sharing plan before adopting their ESOP with 51.2 percent ten years later (five times more than non-ESOP firms). See Blasi *et al.* (2013). The most recent study in 2015 focuses on S corporation ESOPs by Dr Robert J. Carroll. Dr Carroll is the National Director, Quantitative Economics and Statistics (QUEST), Earnst & Young and former Deputy Assistant Secretary for Tax Analysis of the US Treasury Department, finds ESOPs have higher distributions than 401k plans and that 65 percent of S corporation ESOPs offer an additional retirement plan compared to 45 percent of all establishments. See Carroll (2015).
23. On NBER, see Kruse *et al.* (2010). On Markowitz, see Blasi, Freeman, Mackin and Kruse (2010) and Markowitz *et al.* (2010). On Survey of Consumer Finances, see Kruse *et al.* (2016). Recent research from the main lenders to ESOPs suggests very low default rates on loans to ESOPs used to purchase stock for grants to workers. See Corey (2014).
24. See Blasi *et al.* (2013, pp. 9-15). On the IRS, see <http://metrocosm.com/wealth-vs-income-inequality/>; www.irs.gov/pub/irs-soi/13intop400.pdf. See also Saez and Zucman (2014). On capital income, see also www.stateofworkingamerica.org/chart/swa-income-figure-2v-share-total-household/ and the chart on page 16 “Capital Income Highly Concentrated” of the Urban Institute-Brookings Institution Tax Policy Center: file available at: [///Users/josephblasi/Downloads/2603-3524-1-SM.pdf](http://Users/josephblasi/Downloads/2603-3524-1-SM.pdf).
25. Bipartisan support for employee ownership and profit sharing has been documented by researchers. As noted in the article, Profit Sharing: An American Presidential History in endnote 12, regarding profit sharing, Republican businesspeople initiated many of the leading profit sharing plans in American history, Republican members of Congress led the fight for legislative support for profit sharing, while the actual incentives were developed under President Franklin D. Roosevelt’s administration with bipartisan support. On employee ownership, many Republican business leaders supported the idea in the early 1900s through the Special Conference Committee initiated by the Rockefellers. The initial ESOP legislation was written by Senator Russell Long and passed under President Gerald Ford with bipartisan support. The most significant expansion of ESOP legislation happened under President Ronald Reagan in a bipartisan effort with Democratic Senator Russell Long. For a video of President Reagan discussing the Founders’ tradition on broad-based property ownership and employee ownership, see: www.youtube.com/watch?v=06vP84SqN54 and www.youtube.com/watch?v=nEyUnCIkhMs. Employee ownership was part of the 2012 Republican Party platform as reported in www.nceo.org/employee-ownership-update/2012-09-04. On the Democratic side, the DC-based think tank founded by leaders of the Democratic Party, the Center for American Progress has published several policy papers on employee ownership policy Freeman *et al.* (2011); www.americanprogress.org/issues/labor/report/2011/03/02/9356/inclusive-capitalism-for-the-american-workforce/; Madland and Walter (2013), <https://cdn.americanprogress.org/wp-content/uploads/2013/04/InclusiveCapitalism.pdf>; Walter *et al.* (2015), www.americanprogress.org/issues/economy/report/2015/07/21/117742/capitalism-for-everyone/; and Walter and Corley (2015), <https://cdn.americanprogress.org/wp-content/uploads/2015/10/28102559/MitigatingRiskReport.pdf>; and Summers and Balls (2015), which adopted most of the recommendations of The Citizen’s Share book (www.americanprogress.org/issues/economy/report/2015/01/15/104266/report-of-the-commission-on-inclusive-prosperity/). Another DC-based group, hoping to encourage 50 percent

of the workforce in employee ownership firms by 2050, 50x50, has two relevant reports Kelley *et al.* (2016), namely, [www.fiftybyfifty.org/report-learning-design-session.html](http://www.fiftybyfifty.org/the-initiative.html), as does the Democracy at Work Institute under “Our Work” at <http://institute.coop/projects>. The American Sustainable Business Council also supports shares. See <http://asbcouncil.org/issues/worker-ownership#.V-2T3pMrLUo> and www.chillicothgazette.com/story/opinion/columnists/guest/2016/09/03/esops-one-way-improve-worker-treatment/89725374/ by their Vice President Richard Eidlin. Also, the Surdna Foundation has a recent position paper on the topic at: www.surdna.org/whats-new/news/920-ours-to-share-how-worker-ownership-can-change-the-american-economy.html, drafted by Dr Sanjay Pinto. The W.K. Kellogg Foundation has supported a research program at Rutgers University to study whether employee stock ownership can build significant wealth for citizens of modest income and minorities.

26. On the General Social Survey, see Kruse *et al.* (2010) with data from 2002 and 2006; and Blasi *et al.* (2013, pp. 109-122) with data from 2010, with a recent draft report available from the authors on the 2014 data. Data showing the distribution of equity and profit shares by income, gender and race are also available. The General Social Survey supplement measuring of broad-based employee stock ownership, profit sharing and stock options is conducted by the National Opinion Research Center at the University of Chicago on contract with the Employee Ownership Foundation. For a history of public opinion polls on employee stock ownership and profit sharing, see Kruse and Blasi (1999) and Blasi (2015b) A recent 2016 poll by Public Policy Polling shows bipartisan support for employee stock ownership (www.nceo.org/employee-ownership-update/2016-08-01) and a strong preference for products and services of businesses with employee stock ownership (www.nceo.org/articles/surveys-show-strong-preference-employee-owned-products-services).
27. See Joint Committee on Taxation (2014): www.jct.gov/publications.html?func=startdown&id=4663
28. The largest policy disasters causing the greatest reversals and the most in tax expenditures are summarized in Blasi *et al.* (2013, Appendix 6.1, pp. 214-227).

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