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Securing Justice: Advice for the New Congress

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An interrelated set of phenomena have fueled four decades of rising wage inequality and economic insecurity. Stagnant wages and the increase in inequality are over-determined in the sense that that multiple causes can be marshaled to explain this development; chief among them, the decline in private sector union membership and bargaining power. In my presentation today, I want to focus on two under-appreciated causes of stagnant wages and increasing inequality: the increased fissuring of the labor market, and the replacement of a managerial model of capitalist enterprise by a financial model. The well-known divergence of median real wage growth from productivity growth since the late 1970s coincides with the increasing importance of fissuring and financialization, which occurred in the context of falling unionization rates. Looking at rising inequality through the lens of these developments provides a coherent rationale for prioritizing a set of progressive policies the new Congress would be well-advised to adopt. These policies will improve economic outcomes for large numbers of workers that have missed out on a generation of economic growth. And because they are truly pro-worker, they will put the Republican-controlled Senate and the President on the spot — either pass these pieces of legislation or it will be clear that Republicans do not actually care about working families.

Fissuring. Over the past 40 years, the bureaucratic, hierarchical firms that dominated the economy for most of the 20th century have largely been disassembled. Major corporations now focus on "core competencies" and outsource a large number of business functions and production activities. They retain control of such core activities as protecting the brand, engaging in R&D, designing products, and setting parameters for customer service. But they contract for a wide range of activities that are necessary to actually produce and deliver a product or service. The firms that retain these core activities

dominate a network of more vulnerable companies they contract with to actually create and deliver goods and services. Over time, and accelerating in recent decades, consolidation of dominant firms in an industry into a small number of powerful players has been accompanied by fragmentation as these firms contract out activities viewed as non-core. Dominant firms extract much of the profit and rents jointly created by all of the businesses engaged in producing the final output. Vendors, suppliers and contract companies compete for contracts with dominant firms that often go to the lowest bidder. Contract companies often end up in a race to the bottom — operating on thin margins, and unable to secure these contracts if they pay their workers fairly.

In many cases, employees on the payrolls of different contractor firms work side-by-side in fissured workplaces. The security guard in the hospital lobby, the person who took your insurance information in admissions, the person who brings your food, the person who cleans your room, the anesthesiologist who assisted your surgeon in the operating room, the person handling your billing questions may all work for different companies — and none of them work for the hospital. A low bid may win the contract, but the company will be operating on a shoestring, and workers' wages will be squeezed. Workers in the commercial laundry that washes linens for the hospital are also employed by a company that competes for a contract with the hospital. Even though their worksite is the laundry and not the hospital, their pay is constrained by the contract terms their employer accepts.

Financialization. The development of the managerial model of capitalist enterprise — in which shareholders own the company but it is managers that make the decisions about product lines, allocation of capital, jobs and employment relations — reached its apogee in the late 1970s with the rise of the diversified conglomerate. But the emergence of conglomerates proved terminal for the managerial model. Corporate executives lacked the necessary industry expertise to manage radically different businesses. Financial managers became more important in part because financial metrics could be applied across diverse business units, but also because profits fell dramatically in the 1970s. Line managers were now "managed by the numbers," and had less control over their budgets and less ability to affect the direction of their business units. The concept of the capitalist enterprise shifted from one based on production and marketing to one based on maximizing financial returns.

Remarks, Eileen Appelbaum, CEPR
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In the 1980s, the balance of power shifted from corporate stakeholders — including workers — with an interest in the success and survival of the company to corporate shareholders whose only interest is in the returns they receive. As with fissuring, the business strategy companies adopted to maximize shareholder value was to focus on the company's core competencies, outsource non-core functions, and eliminate non-core business lines and the workers they employed. The increased buying and selling of business units created a view of the company as little more than a lego set with assets to be bought and sold. Workers ceased being an asset and became an input like any other, whose costs the firm needed to minimize. Labor costs were an impediment to success on the only metric that matters — maximization of shareholder value, and unions and workers have faced downward pressure on wages and benefits.

The financialization of publicly traded corporations and the resulting discontents are a topic that Bill Lazonick has examined at length and with great insight. An extreme version of shareholder value maximization can be found in the activities of private equity firms. Private equity firms, famously, have no commitment to the long-term sustainability of the companies they buy; their goal is to exit these investments in three to five years. The heart of the private equity business model is the "leveraged buyout." A leveraged buyout is a deal in which a private equity fund uses capital supplied by pension funds, wealthy individuals, and other investors as a down payment, and buys a company using high levels of debt that it loads on the company it has acquired — typically in the range of 70 percent of the purchase price. Debt is the lifeblood of the private equity model and enriches the PE firm and its investors. Servicing this debt is the responsibility of the company the PE fund has bought. To meet the challenge of making interest payments, the acquired company must immediately increase its cash flow. This is accomplished most quickly and easily by cutting labor costs — laying off workers, outsourcing work, reducing wages and benefits. Post-buyout, PE firms often add on more debt in order to pay themselves and their investors — the company's shareholders — a dividend. Or they may sell off real estate and pay out proceeds from the sale to shareholders to boost returns. In these and other ways, private equity owners extract millions from the companies they acquire, funds the companies could have used to increase worker skills and pay or to invest in the company. As with the bankruptcies of iconic firms like Toys "R" Us, private equity owners may throw companies they own into unsustainable debt in order to capture high returns for themselves and their investors. While they

prefer that the companies they own do not go bankrupt, since they gain by reselling the firm or taking it public, this is the PE firm's second bite of the apple. If the company they have starved of resources goes broke, they've already made their bundle.

Priorities for the Democratic House Majority

This analysis suggests priorities for economic policies that can raise workers' living standards and economic security.

- Establish minimum employment standards that benefit all workers, protect the most vulnerable, and establish a level playing field for companies bidding on contracts to supply goods and services. Priorities:
  - Day 1: enact a $15 federal minimum wage indexed to the average wage
  - Increase eligibility for overtime pay
  - Guarantee severance payments to workers laid off through no fault of their own
- Share prosperity and expand the social wage through federal programs
  - Day 2: increase access to healthcare — voters' number 1 concern — and strengthen the ACA
    - Expand coverage — e.g., increase funding for women's health
    - Expand funding of community health centers to provide primary care, manage chronic conditions, treat opioid addiction — especially in rural areas
    - Expand Medicare to cover people from age 55
    - Set the table for Medicare for All in 2021
  - Enact a federal paid family and medical leave insurance program for all who work
  - Provide significant relief for student debt and, going forward, tuition-free undergraduate education at public colleges and universities
- Renew the national commitment to full employment and good jobs
  - Enact an infrastructure bill to fund bridges, roads, mass transit, schools, green development and that guarantees workers are paid prevailing wage
  - Urge Fed to strengthen its guidelines that limit the amount of debt on a company

  - Urge the Fed to adopt policies aimed at full employment as well as price stability
  - Set the table for a federal jobs guarantee in 2021
- Develop a definition of "joint employer" that recognizes the new realities of joint management of workers by dominant firms (e.g., franchisors) and private equity firms
- Reform bankruptcy laws — move workers from the rear to the head of the line to recoup lost pay
- Strengthen workers' bargaining power
  - Pass card check legislation
  - Require federal chartering of the largest corporations with provision for workers on corporate boards
- Hold oversight hearings on the true causes of economic anxiety — corrupt behavior by corporations that victimizes workers or the public and that regulators have failed to address. There may be a need for new legislation to end bad behavior, and hearings can develop momentum for legislation in 2021 to do this. Here are two examples out of dozens that might be considered:
  - Sears — driven into bankruptcy by the self-serving behavior of its owners Eddie Lampert and his ESL hedge fund with Treasury Secretary on Sears board. Workers and communities hurt by shuttering of stores while Lampert has enriched himself at Sears' expense. Why haven't regulators acted? Sears and the REIT to which Lampert sold some of the retailer's prime real estate are both controlled by him. Both are publicly traded — what is the SEC doing about this?
  - Wage theft at a fast food franchises hurts workers who are cheated and raises joint employer issues. What is the Wage and Hours unit in Labor Secretary Acosta's department doing to protect workers? The hearing could highlight how the previous Wage and Hours administrator, David Weil, handled this and could address the issue of what more needs to be done.