Should businesses have to share profits with employees?

Some governments are trying it, with surprising results - Soumaya Keynes - FT - 1/12/23

What if the government made companies hand a slice of their profits to workers? In Britain and America, the question is about as live as the pigeon that met my cat. But the idea is not crazy. Plenty of governments offer tax breaks to encourage profit-sharing. And in some countries, including Peru, Mexico and France (bien sur), they go all the way, forcing businesses to share spoils with staff. New evidence sheds light on the consequences.

Profit-sharing has two main aims. The one sung around leftie campfires is that it will motivate staff and enhance productivity. (Sounds lovely, though it is a bit unclear why the government would have to push companies to do it.) The other aim is blunter: to redistribute from capital to labour.

Evidence that it can deliver either has been hard to come by. Academics have found correlations between profit-sharing and productivity, but not much concrete evidence of what exactly causes what. One 2001 study found that after Continental Airlines offered a bonus for hitting company-wide targets, performance did improve. But the authors argued that this was because of staff carrying out "mutual monitoring". In other businesses it might be easier to freeride.

Shareholders worried about a raid on their profits might warn of some nasty unintended consequences. Any tax advantages, as exist in France, will cost the Treasury. (The British government ditched a voluntary "profit-related pay" scheme in the 1990s after it became a vehicle for tax avoidance.) And businesses can always cut wages, leaving employees with income that is more volatile but no higher. Lower retained profits could crimp investment. Or, as with any regulation, companies might contort to avoid paying up.

In Mexico, where profit-sharing is a constitutional obligation, contortion has been common. Rafael Avante, a Mexican labour lawyer, explains that historically companies have avoided regulations by using informal labour as well as hiring workers through subsidiaries. The latter in effect protects the parent company's profits. The government recently tried to ban bogus subcontracting, at which point employers demanded a cap on any profits to be shared.

In France, there have been distortions too. Their scheme requires big companies to share a fraction of "excess" profits with workers, defined as those above 5 per cent of equity value. In 2019, around two-fifths of the workforce got payouts. But as a new working paper finds, in the late 1980s when only companies with more than 100 employees were affected, there was a suspicious cluster of businesses around that threshold.

That study also assesses the effects of a French reform in 1991, which expanded the law's coverage to businesses with 50-99 employees. They compare the newly affected companies with those below and above the new and old thresholds, and so can isolate forced profit-shifting's effects.

David Sraer of the University of California, Berkeley, one of the authors, was surprised to find that investment did not drop in the affected companies. Disappointingly, productivity didn't rise either. And happily, on average the affected workers did seem to benefit from higher income. Four-fifths of that was paid for by shareholders. Taxpayers funded the rest.

Before finance bros in the Anglosphere start clamouring for policymakers to don berets, they should probably note a few caveats. The results might not hold for bigger companies, or could fade over time. More importantly for them, among highly paid workers the bump in income was not statistically distinguishable from zero. Instead, it was concentrated among

low- and middle-earners. Sraer and his co-authors think that is because rigid minimum wages made it harder for managers to squash pay.

Sraer suggests that the scheme has another benefit: it turns employees into corporation tax enforcement officers. In France, workers hire consultancies to make sure that they are not being stiffed by creative corporate accounting. That should discourage companies from trying to cook their books.

The French experience offers another lesson, based on a comparison of voluntary profit-sharing schemes and the mandatory version. A recent report from the French Council of Economic Analysis finds that the voluntary sort seems to come with “significant” substitution for wages. Camille Landais, an author, reckons that companies use the flexibility they are given to time payouts around pay negotiations in a way that does not raise overall pay. It doesn’t seem worth the state subsidising that.

For any political party eager to torch a reputation for being business friendly, profit-sharing schemes are an option. But if they want to redistribute effectively, it seems the only way is with a heavy hand.