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Capitalism for Everyone? *A History of Employee Stock Ownership in America*

The origins of employee stock ownership plans (ESOPs) in America were grounded in a proposition that is simultaneously radical and deeply conservative: perhaps the best response to concerns about the unequal distribution of wealth is not to weaken capitalism, but to create more capitalists. At the risk of being incendiary from the jump, employee ownership is one of the rare policy ideas that tries to broaden wealth without first confiscating it.

That proposition distinguishes ESOP policy from most of the other ways U.S. federal policy attempts to address economic inequality. The estate tax redistributes wealth after death. Social welfare programs redistribute income through taxation and government spending. Labor laws attempt to improve the terms on which employees exchange their work for wages. An ESOP tries something different. It uses the machinery of private property, credit, tax incentives, and corporate finance to allow employees to acquire an ownership interest in the productive capital of their employer. And the kicker is that this is ordinarily achieved without requiring employees to invest their own savings.

In theory, it offers something to nearly every political persuasion. Conservatives can appreciate its reliance on private ownership, voluntary transactions, and market economics. Progressives can appreciate its effort to distribute wealth more broadly. Business owners gain a succession option. Employees gain an opportunity to accumulate capital. Congress, meanwhile, gets to encourage all of this through the tax code without creating another direct federal spending program.

It is almost suspiciously elegant. And like most elegant ideas that must operate in the real world, it is far more complicated than it first appears.

The Problem Kelso Was Trying to Solve

By the middle of the 20th Century, American capitalism had delivered extraordinary growth, but ownership in the publicly traded companies producing much of that growth remained concentrated in roughly 4% of American hands.¹ Most Americans participated in the economy principally through labor. They earned wages, consumed goods, and perhaps accumulated modest savings. A much smaller group also owned substantial productive capital: businesses, factories, equipment, and shares of stock. As Hugh McColl

¹ The New York Stock Exchange's 1952 shareholder census estimated that 6.49 million individuals owned shares in publicly held corporations, representing approximately 4.2% of the U.S. population. The SEC later cited the same 1952 figure in its 1959 Annual Report.

has been known to say, “Only two things make money: people at work and money at work.”

Louis O. Kelso, a San Francisco lawyer and economist, believed that distinction mattered. Technological progress, in his view, would cause an increasing share of production to come from capital rather than human labor. If income continued to flow primarily to those who already owned capital, workers could become more productive while capturing too little of the wealth that productivity created. Higher wages or government transfers might soften the result, but neither would solve the underlying ownership problem.

Kelso's proposed solution was not socialism. He did not propose that the government seize productive assets or manage the economy. He wanted workers to acquire capital within the existing system of private property. In 1956, he used a leveraged trust structure to help employees of Peninsula Newspapers purchase the company from its retiring owners. Two years later, Kelso and philosopher Mortimer Adler published The Capitalist Manifesto, arguing that a healthy capitalist democracy required broader participation in capital ownership.²

The title was deliberately provocative. Their aim was to preserve capitalism by expanding it.

The Unlikely Political Partnership

Ideas, even good ones, rarely become federal policy without a powerful sponsor. Kelso found one in Senator Russell B. Long of Louisiana, the Democratic chairman of the Senate Finance Committee and son of the famously populist, Huey “The Kingfish” Long.

The younger Long shared his father's concern about concentrated wealth but not necessarily his father's preferred remedies. After meeting with Kelso in 1973, Senator Long reportedly described employee ownership as “Huey Long without the Robin Hood.” The phrase captured the political appeal perfectly: broaden wealth without first taking it from someone else.³

Long helped secure formal recognition for ESOPs in the Employee Retirement Income Security Act of 1974, better known as ERISA. That may seem an unusual home for a theory of democratic capitalism, but the placement proved decisive. Congress treated the ESOP as a qualified retirement plan while giving it a special purpose: unlike nearly every other retirement plan governed by modern diversification principles, an ESOP is specifically designed to invest primarily in the stock of the sponsoring employer.

Over the following decades, Congress added tax incentives under both Republican and Democratic administrations. The modern ESOP was not the product of one ideological moment. It became one of the rare areas of economic policy to attract a durable bipartisan coalition because it joined several American instincts that are usually in tension: private property and broader ownership; business continuity and employee opportunity; tax incentives and retirement policy.

² Louis O. Kelso created the first leveraged employee stock ownership structure in 1956 for Peninsula Newspapers. Kelso and Mortimer J. Adler developed the broader theory in *The Capitalist Manifesto* (Random House, 1958).

³ The phrase and historical account are commonly attributed to Senator Russell B. Long following his meeting with Kelso. See [National Center for Employee Ownership, The History of ESOPs](#).

How an ESOP Actually Works

An ESOP is a tax-qualified retirement plan that holds employer stock in trust for employees. In a simple transaction, a company contributes cash or shares to the trust, and the trust allocates shares among eligible employees under the plan's formula. In the transaction most business owners have in mind, however, the ESOP is leveraged.

The ESOP trust borrows money and uses the proceeds to purchase some or all of the owner's shares. The company then makes tax-deductible contributions to the ESOP, which the trust uses over time to repay the acquisition debt. As the loan is repaid, shares are released from a suspense account and allocated to employee accounts, generally based on compensation or another nondiscriminatory formula. Employees earn the benefit through continued service; they typically do not purchase the shares with payroll deductions or personal savings.

The tax incentives can be substantial.

- Contributions used to repay qualifying ESOP debt are generally deductible within statutory limits.
- A selling shareholder of a qualifying closely held C corporation may be able to defer capital gain under Internal Revenue Code Section 1042 by selling at least 30% of the company to the ESOP and reinvesting the proceeds in qualified replacement property.
- When an ESOP owns stock in an S corporation, the trust's share of the company's income is generally not subject to current federal income tax. A company owned entirely by an S corporation ESOP can therefore operate without federal income tax at the entity or shareholder level, although it continues to bear payroll, property, sales, and other taxes.⁴

Those benefits are not accidental loopholes. They represent an affirmative policy choice by Congress to subsidize employee ownership. In effect, the government is intentionally accepting less tax revenue in exchange for the possibility of broader capital ownership, business continuity, and retirement wealth.

The Promise of Employee Ownership

At its best, an ESOP can align interests that are often treated as adversarial. A founder can receive liquidity while preserving the company's identity and workforce. The company can remain independent rather than being sold to a competitor or private equity buyer. Employees can accumulate meaningful retirement wealth in addition to wages. Communities may retain employers that might otherwise be consolidated or relocated in a more traditional private equity transaction.

There is also intuitive appeal to the idea that people who help create a company's value should participate in that value. Wages compensate labor in the present. Ownership allows an employee to share in the long-term consequences of good decisions, improved

⁴ For an overview of the governing requirements and tax treatment, see Internal Revenue Service, Employee Stock Ownership Plans (ESOPs), and Internal Revenue Code Sections 401(a), 409, 1042, and 4975(e)(7). The Section 1042 rules are highly technical and require case-specific tax and legal advice. Another good summary may be found [here](#).

productivity, and enterprise growth. Research generally associates employee ownership with stronger employment stability and improved firm performance.⁵

The philosophical achievement is more important than the tax mechanics. ESOPs attempt to broaden wealth through participation rather than transfer. The employee receives capital not because the government has declared someone else has too much, but because the employee belongs to an enterprise capable of creating additional value.

Where the Ideal Meets the Real World

An ESOP is not free money, and it does not repeal economic risk. An appropriate balance must be struck to ensure the idealized outcome is to survive contact with economic reality. The company must generate enough cash to service the acquisition debt, operate the business, and eventually repurchase shares from departing or retiring employees. A transaction that overpays the selling shareholder can burden both the company and the employees it was intended to benefit.

Because closely held company stock has no public market price, valuation is therefore arguably the most consequential and contested part of the process. The trustee must act for plan participants and may pay no more than fair market value, even when every other participant in the transaction has reasons to want a higher number.

The retirement-policy tension is equally obvious. Paraphrasing Warren Buffett, concentration builds wealth, and diversification preserves wealth. An ESOP sits directly atop that tension. Modern Portfolio Theory tells investors to diversify, while an ESOP intentionally concentrates assets in a single company – the same company that provides the employee's paycheck. If the business fails, employees can lose both employment and retirement wealth at the same time. Federal law provides diversification rights for older, longer-tenured participants, and many responsible ESOP companies maintain a separate 401(k) plan. Still, concentration is not an incidental feature. It is the instrument through which employee ownership is created.

Nor does employee ownership necessarily mean employee control. ESOP participants generally vote on a limited category of major corporate transactions. Meanwhile, the trustee votes most shares, and existing management continues to run the business. Some companies develop transparent, participatory cultures in which employees think and act like owners. Others change the capitalization table without meaningfully changing the workplace. The difference is cultural, not merely legal.

Finally, ESOPs are expensive and complex. Lawyers, trustees, lenders, valuation firms, administrators, and financial advisers all play necessary roles. Those costs help protect employees and preserve the plan's tax-qualified status, but they also mean the structure is generally a poor fit for a small or fragile company. There are bad ESOP transactions just as there are bad third-party sales. Employee ownership is a policy preference, not a substitute for sound economics.

⁵ See [Fidan Ana Kurtulus and Douglas L. Kruse](#), The Effect of Employee Ownership on Employment Stability and Firm Survival During the Past Two Recessions, W.E. Upjohn Institute for Employment Research (2017). The available research generally reports association rather than a guarantee of causation or performance.

Where We Are Today

The most recent available data suggests that approximately 6,600 ESOPs cover more than 15 million participants and hold more than \$2 trillion in assets. The number of plans has declined from earlier decades even as the number of participants and total assets have grown, reflecting both consolidation and the significant presence of ESOPs at large public companies.⁶ The most interesting future for ESOPs may be among privately held businesses. America is entering a generational transition in which thousands of founders and family business owners must decide what happens when they are ready to step away. The conventional choices may be imperfect: sell to a competitor, sell to private equity, transfer the company to children who may or may not be ready or interested, or wind it down. An ESOP adds another possibility: sell the company, gradually or at once, to a trust for the people who helped build it.

Congress continues to encourage that option. The SECURE 2.0 Act created new federal support for employee-ownership education and, for sales occurring after 2027, extends a limited version of Section 1042 capital-gain deferral to qualifying S corporation stock. The details remain technical, and the S corporation benefit is capped far below the deferral available for qualifying C corporation sales. But the direction is clear: fifty years after ERISA, employee ownership remains an active federal policy objective rather than a historical curiosity.

Capitalism's Middle Path?

The political conversation about inequality often presents Americans with two unsatisfying poles. One side can sound indifferent to how concentrated ownership affects opportunity, social mobility, and confidence in the economic system. The other side can sound as though inequality itself proves injustice and that, therefore, government redistribution is not just necessary but desirable.

ESOP policy offers a more characteristically American middle path. It accepts that private ownership, profit, and unequal outcomes are essential features of a dynamic economy. And it also recognizes that capitalism becomes politically and socially fragile when too few people believe they have a meaningful stake in it.

Critics might fairly ask why taxpayers should subsidize a business owner's exit or allow a 100% ESOP-owned S corporation to avoid federal income tax. Advocates could fairly respond that the tax code subsidizes countless behaviors with less compelling social benefits, and that broadening ownership through voluntary private transactions may be preferable to addressing concentrated wealth later through taxes and transfer programs.

Both arguments contain truth. The appropriate question is not whether ESOPs are perfect but whether the public benefits – employee wealth, business continuity, job stability, and a wider distribution of productive capital – justify the tax advantages and administrative complexity required to produce them.

⁶ <https://www.nceo.org/research/employee-ownership-by-the-numbers>

Conclusion Without Utopia

Kelso's grandest vision remains unrealized. Employee ownership has not transformed the American economy or eliminated the divide between those who work for capital and those who own it. Most American workers still participate in capitalism primarily through wages, and many own productive assets only indirectly through retirement accounts.

But utopia was never the right standard. ESOPs have allowed millions of employees to become beneficial owners of the companies where they work. They have preserved independent businesses, created succession options for founders, and demonstrated that broader ownership need not require hostility to private property.

The estate tax asks how much wealth one family should be able to carry forward. Retirement policy asks how much responsibility should rest with the individual. ESOP policy asks a different version of Arketa: how concentrated can ownership become before too many Americans conclude that capitalism belongs to someone else?

The genius of the ESOP is that its answer is neither to punish ownership nor to promise equality. It is to create more owners. That may not resolve America's argument over wealth, but it is one of the more imaginative compromises our tax code has ever attempted. And perhaps the instincts to broaden opportunity without abandoning liberty, and to reform capitalism without rejecting it represent the American experiment at its best. Not utopia, but something nearly as remarkable in human history: a society capable of correcting itself without surrendering the principles that made it prosperous and free.

At the outset of this summer history series, we explained that our purpose was not necessarily to provide answers, but to offer some historical perspective and encourage the intellectual curiosity to ask thoughtful questions about our own Arketa. As we conclude the series, we hope you have enjoyed reading these pieces as much as we have enjoyed writing them. More importantly, we hope they have encouraged you to think more deeply about what is "enough" for ourselves, for our families, and for this incredible Republic we share.

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