By Re_Generation

Business Ethics

3.6 Economic Inequality

Description

Throughout the industrialized world, economic and wealth inequality has been rising for several decades. Although there are many drivers of economic inequality (including excessive compensation and offshore tax havens, as mentioned above), another key factor has been financialization, defined as the process by which the power and size of the financial services sector increases relative to the real economy. New research by the Bank of International Settlements has proven that, beyond a certain point, financial sector growth tends to **crowd out real economic growth** and thus contributes to wage stagnation and inequality. The **increased power of finance capital**, in its prioritization of short-term stock performance, has helped aid the rise of predatory practices like **corporate raiding, asset-stripping, widespread layoffs**, and an explosion of merger activity that greatly **increased the concentration of wealth** and the power of monopolies. To learn more about financialization, and how to recognize the warning signs of aggressive merger activity or predatory practices, continue reading this PDF guide.

Acknowledgements

Written by Gareth Gransaull, Associate Director of Re_Generation, with review by some of Canada and North America's most influential sustainability leaders.

About Re_Generation

Re_Generation is a Canadian youth movement that seeks to build a regenerative, sustainable, and just economy. We aim to reimagine our schools, repurpose our careers, and remodel our companies to be aligned with regenerative principles. In particular, we provide resources for individuals to launch impact-driven careers and advocate for change within their companies and schools. We also aim to advance public policies that promote regenerative and sustainable business practices.

Our successful 'Our Future, Our Business' Manifesto campaign received the support of 65 youth organizations, 130 high-level executives, and 100 civil society organizations recognizing the need for reform in business education on sustainability. After three years of existence as the Canadian Business Youth Council for Sustainable Development, we have changed our name to Re_Generation to become more inclusive of all youth, not just business youth.

We believe that the ideal society is a **regenerative** one. Regeneration to us means putting human and ecological **well-being** at the centre of every decision. It means restoring relationships, both within nature and within society, while helping all communities to thrive. Read more about our history and vision at our **About Us** page.

Issue Summary

Throughout the industrialized world, economic and wealth inequality has been rising for several decades, largely as a function of a prevailing **neoliberal** economic ideology that privileged '**trickle-down economics**', or the debunked theory that a combination of **privatization, deregulation, and trade liberalization** would increase overall economic prosperity. In 1970, Chicago school economist Milton Friedman wrote an influential New York Times article stating that "**the only social responsibility of business is to increase its profits.**" Friedman's argument, and the neoliberal theories he espoused, would go on to launch a **new age of shareholder primacy** in which the sole purpose of business was to make profits regardless of any negative social and environmental externalities. Friedman's dictates, spread across the industrialized world by an **army of disciples**, instigated a fundamental **change in corporate governance regimes**. After the neoliberal paradigm shift, corporate behaviour became more extractive and short-term in nature, focused on maintaining shareholder value at the expense of workers and communities. **Economic inequality rose sharply** across the Western world during a long period of downsizing, cost-cutting, offshoring, deunionization, automation, deindustrialization, tax-cutting, and rising executive pay, all driven by the desire to increase shareholder value. This was accompanied by a fundamental attack on social democratic institutions through a process of privatization, tax-cutting, and deregulation designed to unravel labour and environmental protections believed to be shrinking the bottom line.

A major strategy in the shift towards shareholder primacy has been a massive increase in financialization, seen through both the increasing dominance of the financial services sector as well as the more insidious way that regular corporations come to behave more and more like banks. The **increased power of finance capital**, in its prioritization of short-term stock performance, has **substituted value extraction for value creation**, leading to the rise of predatory practices like **corporate raiding, asset-stripping, widespread layoffs**, and an explosion of merger activity that greatly **increases the concentration of wealth** and the power of monopolies. As share-based compensation rose as a proportion of managers' overall pay, they began focusing on short-term stock performance at the expense of other activities (see Section 3.3 on excessive compensation). **Activist hedge funds routinely intervene in companies** to prevent long-term strategic investments that might be seen to temporarily depress share prices, while firms reduce spending on innovation and employee reskilling **in favour of stock buybacks** and exorbitant executive compensation. New research by the Bank of International Settlements has proven that, beyond a certain point, financial sector growth tends to **crowd out real economic growth**, indicating that not only are corporations unable to address intersecting social and environmental crises, but they are also increasingly unable to even generate basic economic prosperity.

Key Considerations

There are many mechanisms by which economic inequality has increased over the last 40 years, including in particular the expanding power of the financial sector and the increasing monopolization of the economy. This toolkit has already addressed some major drivers of inequality (including Section 3.2 on unfair taxation, and Section 3.3 on excessive compensation), while this section aims to address some others.

In both Canada and the United States, weak enforcement of antitrust laws combined with an exponential increase in the power of the financial sector has led to a period of **aggressive merger and acquisition activity** that has **increased market concentration, worsened income and wealth inequality**, and led to the **creation of new monopolies**. In addition, many firms in the private equity industry have found ways to use deal structures like leveraged buy-outs to **profit from the dismantling of under-**

performing companies, a predatory practice sometimes referred to as 'corporate raiding'. In many examples, firms believed to be underperforming are taken over by activist investors who seek to improve profitability through aggressive cost-cutting programs (which often include laying off thousands of employees), only to profit from the resale of the firm at a higher value down the road.

The growth of the private equity industry has been staggering, and there is significant evidence that private equity has substantially exacerbated economic inequality, particularly during the COVID-19 pandemic. There are many examples of the destructive social consequences of private equity ownership in a variety of industries, from healthcare to retail to home ownership. In 2020 alone, private equity deals helped result in 500,000 job losses in the American retail sector. But the income-polarizing effects of private equity long predate the pandemic; in a particularly egregious example highlighted by journalist Nicholas Shaxson, private equity mogul Wilbur Ross gained effective control of the US steel industry in the early 2000s, and pocketed $4.5 billion from its 'restructuring'--an amount roughly equal to the sum that steelworkers and retirees lost in health and pension plans. Wilbur Ross then went on to become the Secretary of Commerce for President Donald Trump. For more information about this issue, see The Buyout of America by Josh Kosman.

In coming years, it is also very likely that advances in artificial intelligence will displace many workers from the economy, lead to widespread unemployment and prompting the creation of a 'useless class'. Research by McKinsey finds that half of the activities people are currently paid to do could be automated, representing approximately $15 trillion in wages. The Shift Project has identified automation as a threat to human rights, specifically in the form of automation at a speed or scale that gives workers little chance to adapt.

Tools

1. Monopolistic Practices

Companies engage in a variety of monopolistic practices that have the potential to violate antitrust laws or provisions against price-fixing, collusion, and other forms of anti-competitive behaviour. The Global Reporting Initiative has developed a disclosure standard for monopolistic practices, which include the total number of legal actions pending or completed regarding anti-competitive behavior and violations of antitrust legislation.

Strafford Publications has compiled a list of red flags in business dealings that may lead to antitrust violations; while the recommendations are specific to the US, the underlying principles are similar for Canadian law. The National Contract Management Association has also published an article identifying red flags related to a variety of anti-competitive practices, including price fixing, bid rigging, and market allocation agreements.

For more information about competition law in Canada, review this briefing from the Competition Bureau of Canada, this primer from Fasken Partners, or this resource from McCarthy Tetrault.

2. Corporate Raiding

The negative consequences of private equity ownership are a direct result of short-termism in corporate governance. While some firms may see higher profits after a process of restructuring, this is often

at the **expense of long-term value creation**, and many of these firms collapse in the years following their eventual resale. To better understand how the private equity industry works and worsens economic inequality, see this **blogpost** from impact investor David O'Leary. For more information about private equity practices from affected stakeholders, see the work of the **Private Equity Stakeholder Project**.

Private equity firms must ensure that the social and economic consequences of potential deals are considered in all investment decisions as a matter of due diligence. Most importantly, employees working in the private equity industry have an ethical responsibility to raise these questions, and speak against the existence of predatory practices wherever they exist. If a potential deal appears likely to exacerbate economic inequality through cost-cutting culminating in significant job losses, investment analysts should not be afraid to voice opposition.

3. Automation and Reskilling

The ILO has done **comprehensive research on the threat of automation**, and for more information check out **these resources** from the Business and Human Rights Resources Centre. To avoid the unequal distributional effects of AI-related automation, employers should provide their employees with the opportunity to retrain themselves to work alongside new digital tools, rather than be replaced by them. Employers should ensure that they make optimal use of opportunities for **reskilling of employees**, while reminding themselves of the fact that digital technologies cannot replace the value of face-to-face interaction. Managers must consider the impact of their decisions on the communities they operate in while also **investing in digital literacy training for employees**. The Global Reporting Initiative has also developed a disclosure standard for **training and education of employees**, which includes provisions for training required to adapt to changing technologies and work requirements.

Case Studies

The **corporate pillaging of Toys "R" Us** is a classic instance of the exploitative nature of leveraged buy-out practices. The bankruptcy of Toys "R" Us was driven by unsustainable levels of debt accrued as a result of the deal; by 2017, Toys "R" Us had a **debt burden of $5.2 billion**, and was paying up to $517 million in interest every year. The ultimate collapse of the company resulted in 33,000 employees losing their jobs. This is far from an isolated example; as the **bankruptcy of Hahnemann Hospital** in Detroit indicates, the intrusion of private equity into the healthcare industry has caused a crisis of mismanagement driven by corporate short-termism and a structural inability to consider the needs of patients and employees. To provide a Canadian case, **the gutting of Sears** had devastating impacts for the **pension plans of Sears Canada employees**. For a **comprehensive list of predatory examples** of private equity practices, see this fact sheet on the proposed Stop Wall Street Looting Act from **Americans for Financial Reform**.

Organizations/Initiatives

For watchdogs specific to the global financial sector, see the following organizations:

- FinanceWatch
- Fair Finance Watch
- Fair Finance International
- Americans for Financial Reform
- Reclaim Finance
- Facing Finance
- BankTrack
- Global Financial Integrity
- Hedge Clippers
- Private Equity Stakeholder Project