

## On Tocqueville, Pauperism, and Employee Ownership

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### ABSTRACT:

There seems to be two rather different philosophies of aid to development and poverty relief. (1) The progressive/social-democratic approach is for the government or aid agencies to do more and more good things for people. (2) The classical-liberal approach is to change the underlying conditions so that people are empowered to do good things for themselves. In this paper, we analyze Alexis de Tocqueville's approach to these questions in his First Memoir and his (unfinished) Second Memoir on Pauperism.

**KEYWORDS:** Tocqueville; Democracy; ERISA; Employee Ownership;

## 1. INTRODUCTION

### 1.1 The Helping Paradoxes

Alexis de Tocqueville's treatment of persistent poverty ("pauperism") in the two *Memoirs on Pauperism* is (aside from an occasional anachronism) quite relevant to today's debates about domestic welfare reform and about the international aid and development assistance institutions that have arisen largely since WWII. Modern scholars of welfare reform and international aid seem to be constantly rediscovering Tocqueville's points with a more modern terminology.

Much foreign aid undercuts the incentive for people or countries to strive harder to help themselves. This is akin to "moral hazard" in the insurance business where too much insurance softens the incentives to take normal but costly precautions to avoid calamities. In broad terms, self-help is undercut by benevolence which can create a culture of learned disability.

Similarly, Tocqueville's statements about the "depravity" created by long-term pauperism might be restated in more delicate modern terms as the creation of a "culture of poverty."

Even Tocqueville's presentation of the argument using paradoxes is quite common in modern discussions of domestic welfare programs and foreign aid, e.g., <sup>[12]</sup> or <sup>[6]</sup> on the "helping conundrums" or on development aid <sup>[1]</sup>. In my own analysis of development assistance, the basic paradox is the "helping self-help conundrum":

The problem is how can the helpers "supply" help that actually furthers rather than overrides or undercuts the goal of the doers helping themselves. This is actually a paradox or conundrum; if the helpers are supplying help that directly influences the doers, then how can the doers really be "helping themselves"? Autonomy cannot be externally supplied. And if the doers are to become autonomous, then how can external helpers have any direct influence? <sup>[4]</sup>

Other writers have also emphasized this paradox, conundrum, or dilemma:

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- David Korten calls it the "central paradox of social development: the need to exert influence over people for the purpose of building their capacity to control their own lives." <sup>[10]</sup>.
- Julie Fisher <sup>[9]</sup> refers to the problem as the "central paradox of social development"<sup>[11]</sup>.
- Thomas Dichter takes it as the "Classic development dilemma—how can you help people become self-sufficient?" <sup>[3]</sup>.

## 2. PUBLIC VERSUS PRIVATE POOR RELIEF

Another Tocquevillian theme that still resonates strongly today is the whole set of problems that arise from the government being the provider of poverty assistance, either domestically or internationally.

Tocqueville sees shame and disgrace as major motivations for the poor to better their conditions. But if the government provides poor relief as a matter of right, then those motivations are minimized. He would have opposed the "Welfare Rights Movement" <sup>[13]</sup> that followed the Civil Rights Movement in the 1960s and early 1970s.

In what may be the weakest part of his argument, Tocqueville considers that private aid, which he sees as being based on individual beneficence, as being more effective in leveraging shame as a motivation for self-betterment. But the image of the poor, with bowed heads, as supplicants to the well-to-do benefactor is not realistic since private aid is typically delivered through institutions. And this privately funded institutional philanthropy goes back to the period of the Poor Law of 1601 in England.

The same Parliament that passed the Poor Law of 1601 encouraged private philanthropy through enactment, the same year, of the Law of Charitable Uses which, in the words of W. K. Jordan (*Philanthropy in England 1480-1660*), 'was far more important to the history of Tudor-Stuart philanthropy than the great Elizabethan Poor Law of the same year.' According to Jordan, until 1660, the mainspring of the English charity system remained private, both in organization and financing. The Trust Law directed the spirit of generosity into the founding of numerous free private schools, hospitals, almshouses, dispensaries, and the like. In short, private philanthropy at least complemented public relief at this time, providing a second cluster of institutions and services for the needy. <sup>[21]</sup>

It is doubtful that the poor at that time, or the homeless today, see much difference in institutional relief being publicly or privately funded.

## 3. THE IMPORTANCE OF LOCAL COMMUNITIES

Perhaps Tocqueville's argument about the source of poor relief is best seen as an argument for localness where there is some sense of community or social fabric, much like his emphasis on local associations in *Democracy in America* <sup>[19]</sup>

This point is illustrated by one of today's more successful anti-poverty NGOs (in the author's opinion), the Family Independence Initiative <sup>[17][7][8]</sup>. The basic unit of self-help is a small peer group of families who have some commonality (e.g., from the same church or ethnic neighborhood) so that respect within that small community is a salient motivator (reminiscent of the small affinity groups of Alcoholics Anonymous). An individual or family needs to take the initiative to approach FII and then they have to recruit this "small platoon" of associated families in order for the group to be accepted by FII. Instead of the traditional social worker role, FII plays a background role of facilitating and nudging to get each family to document their progress on specific efforts (e.g., buying a car or house, getting a job, starting a small business, getting a child into college, etc.) developed by the group or suggested by FII from their past experience. When a family succeeds, then the other families have access to the documentation and they don't have the excuse: "that might work for middle-class families, but it doesn't work for us" since it has already worked for a family in their peer group.

All it takes is one person in a peer group to be the first to buy a home or send a child to college for others to believe it's possible. That role model not only inspires others but also becomes a resource. It's much easier to buy a home if you know someone like you who has done it and they can tell you how they did it.

The combination of families working together and peer role models breaking through traditional barriers creates a ripple effect throughout communities. Expectations of success rise. People believe in themselves and one another. They gain control over their future and that power sustains in ways that social service programs cannot. [FII 2009, 2]

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While Tocqueville's image of the pauper, with hat in hand, appealing to a private benefactor is quite anachronistic, his emphasis on the importance of local community points to an efficacy that is quite unlikely in a government social welfare agency staffed by "professional social workers" giving out "advice" often as a conditionality for receiving aid.

#### **4. ANALOGIES WITH INTERNATIONAL DEVELOPMENT ASSISTANCE**

Development assistance, by multilateral (e.g., World Bank or the regional development banks), bilateral (e.g., USAID in the US or DFID in the UK), or private agencies (e.g., NGOs like Oxfam) is a relatively recent institutional development dating from the post-WWII and Cold War period. Yet there are strong analogies to the problems and paradoxes of poverty relief in Tocqueville's time.

It is useful to try to clearly distinguish between at least three different types of assistance:

- Development assistance: which often focuses on institutional change and, in terms of people, does not focus on the poor—who are the least likely to start up real businesses with any growth potential [in spite of much unsupported hype during the recent microfinance (particularly micro-lending) fad].
- Poverty reduction: where the focus is not on institutional development but on increasing the income of poor people—which might include programs detrimental to long-term development such as facilitating remittances (largely for consumption spending) from out-migration to take jobs in more developed or at least richer countries.
- Disaster-relief: which is a more direct and nominally temporary form of poverty relief necessitated by various natural and man-made calamities.

Over a half-century of international development assistance cannot be counted as much of a success. Where the development assistance has had the largest footprint (e.g., sub-Saharan Africa), development has been the least, and where there has been the most development (e.g., East Asia), the role of the international agencies has been minimal. Moral hazard and aid dependency has become rampant in the least developed countries—where the bulk of the national budget is often from aid sources. Tocqueville's language about "depravity" would not be politically correct in international aid circles, but the deleterious effects of long-term aid-dependency are nevertheless evident regardless of the description.

Tocqueville's admonitions about the agencies on the "supply-side" of poor relief are also prescient. Development banks that do not "move the money" will have no interest income to pay their salaries and other expenses. Bilateral aid agencies that do not "move the money" will find their budgets reduced in the next funding cycle. Hence the "leverage" of attaching conditionalities to aid in order to make institutional reforms has become something of a charade. In a variation on the old joke about socialist work: "We will pretend to make the reforms demanded by your conditionalities, and you will pretend that you don't have to move the money anyway."

The failure of the development agencies in promoting institutional reforms has led to the mission creep of the agencies implicitly resetting their goal as poverty reduction. In the multilateral and bilateral development agencies there is now almost a complete confusion and conflation of "development assistance" and "poverty reduction." This is an easy "confusion" since the country's most in need of institutional reforms are often the same as the countries that have a large poor population. There is also a small well-to-do and well-entrenched population that often depends on the institutions not making anything more than cosmetic changes, changes that can nevertheless be "pointed to" so the aid bureaucracies can justify "moving the money anyway."

And since those largely poor countries can be seen as "disasters," the mission creep continues from "poverty reduction" to long-term "disaster-relief." As Tocqueville might have said, "Relief corrupts; and long-term relief corrupts long-term."

#### **5. PROGRESSIVISM VERSUS CLASSICAL LIBERALISM**

In the end, Tocqueville's argument should probably be seen as an expression of a basic political philosophy. Then, as now, it is useful to ask why any political group or party wants to obtain governmental power. There seem to be two fundamentally different answers which might be labeled as "progressivism/social-democracy" versus "classical liberalism" (where there is substantial overlap with civic republicanism).

- *Progressivism/social-democracy*: This general viewpoint emphasizes using the powers of government or aid agencies to "do good things for people."

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- *Classical-liberalism*: This general viewpoint emphasizes changing the conditions to empower people to “do good things for themselves” (that doesn’t rule out targeted government social safety-net programs that are addressed to “public calamities” and that are “as temporary as the evil itself.”<sup>[18]</sup>)

One key distinction is that the classical-liberal perspective is focused on the active agency of people, while the progressive/social-democratic perspective is focused on using the agency of the government to do good things for people whose own agency must at least include re-electing the social democratic government to power. The liberal philosopher, John Dewey, made the point well.

The best kind of help to others, whenever possible, is indirect, and consists in such modifications of the conditions of life, of the general level of subsistence, as enables them independently to help themselves.<sup>[2]</sup>

The welfare rights movement focused on getting the government to do more good things for people instead of any structural changes so people could better help themselves. In contrast, Tocqueville thought along classical liberal lines. For instance, government programs of land reform might make individual parcels of land available to landless agricultural workers or larger parcels available to agricultural cooperatives. But, even in his time, the economy was becoming more industrial than agricultural.

In my opinion the crux of the problem to be solved is this:

To find a means of giving the worker the small farmer's spirit and habits of property ownership.<sup>[20]</sup>

How can this be applied to an economy more industrial than agricultural? Firms with the “aristocratic form”<sup>[20]</sup> could be gradually converted into more employee-owned companies. This approach would inspire the “habits of property ownership” in the industrial sector. But progressivist government programs would focus more on labor legislation to better protect and care for wage workers—not to create employee-owners.

In the current marketplace of ideas, a campaign for a government-mandated minimum wage would be a progressive strategy whereas a classical liberal strategy would be a government-sponsored, if not mandated, employee ownership program. It is the difference between trying to deliver good results for workers versus empowering workers to make their own decisions and to bear the consequences themselves. For instance, in a 100% employee-owned company, the worker-members could set whatever “wage” (take-home pay) they wanted for themselves in the immediate short-term, and they would then bear the consequences. There may always be some overlap in these two perspectives, but the focus and aims of governmental action are nevertheless strikingly different in the two cases.

## 6. ON TOCQUEVILLE'S SUGGESTIONS

At one point in Tocqueville's discussion of solutions in the *Second Memoir*, he makes some technical mistakes that, however, would not be obvious in his time. His discussion of getting land ownership to small farmers assumes that farming is a relatively small affair without the need for much capital equipment. Today the need for capital equipment and the possibilities of returns to scale in agricultural enterprises are more evident so he might consider that small owners would no longer be feasible. But that is to incorrectly infer that large assets on the balance sheet of an agricultural enterprise would require “large” owners and thus would not be a “solution” for small farmers. But the rise of, say, the whole agricultural cooperative movement in Europe and America in the late 19<sup>th</sup> and 20<sup>th</sup> centuries shows that “large assets” do not require “large owners.”

Tocqueville explicitly makes this mistake in his discussion of industrial enterprises where the need for large capital to exploit returns to scale was evident even in his time. The mistake is to infer that this requires “large” owners.

Until now, experience has shown that in order to engage in most commercial enterprises with any hope of success, large capital concentrated in a small number of hands is necessary. Thus, we find a few individuals who possess great wealth and who put to work on their behalf a multitude of workers who possess nothing themselves. Such is the spectacle that French industry presents nowadays. It is exactly what happened here in the Middle Ages, and what we see still happening to agricultural industry over much of Europe.<sup>[20]</sup>

Today, there are large public markets in shares but the small passive owners in public security markets are not the industrial analogues of the small farmers *actively* working their own land. Day-trading on the stock market is hardly an anti-poverty program for the poor.

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Tocqueville recognizes that the "most efficacious" means of improving the situation of the industrial worker is for them to have an interest in the factory. This would produce effects in the industrial class similar to the division of landed property among the agricultural class. <sup>[20]</sup>

But he considers that the only way for workers to acquire such an interest in an existing factory is for the:

industry's capitalist entrepreneurs...to give their workers a proportionate amount of the profits or to contribute to the company small sums which could be shared with the workers. <sup>[20]</sup>

However, he finds little inclination among the capitalist entrepreneurs for such profit-sharing. Tocqueville recognizes the possibility of workers' industrial associations but considers them as not being ripe for his own time.

Nevertheless, I am led to believe that a time is approaching when a large number of industries might be run in this manner. As our workers gain broader knowledge and as the art of joining together for honest and peaceful goals makes progress among us, when politics does not meddle in industrial associations and when government, reassured about their goals, does not refuse them its benevolence and its support, we will see them multiply and prosper. In democratic ages like ours, I think that associations of all sorts must gradually come to take the place of the commanding action of a few powerful individuals.

It thus seems to me that the idea of workers' industrial associations is bound to be a fertile one, but I do not think it is ripe. <sup>[20]</sup>

It is only after this argument that Tocqueville finally focuses on savings accounts. "Since one cannot give workers an interest in the ownership of the factory, one can at least help them in the creation of their independent property, with the aid of their salaries drawn from the factory." <sup>[20]</sup>

It is surprising how, after over a century and a half, there has been so little progress getting beyond the suggestion of saving accounts in anti-poverty circles. Indeed, Tocqueville's treatment largely foreshadows the fairly recent anti-poverty fad of asset-building strategies <sup>[15][16]</sup> such as subsidized and restricted-use savings accounts. There has also been similar "microfinance" programs that focus on micro-savings programs—which are at least better than the quite dubious micro-lending programs (as if what today's poor or yesterday's share-croppers needed was more cheap credit to get further in debt). Even in the Ante-bellum period, good-hearted reformers promoted the practice of allowing slaves to accumulate their own *peculium* presumably as a way to foster the virtues of industry and thrift.

However, asset-building and micro-savings accounts have been, at best, the poor-person's version of the idle wealth accumulation of the well-to-do. Unlike the case of the yeoman farmer working his own land, there is no necessary connection to any active agency or businesses of the poor people themselves.

## **7. ON MODERN MEANS FOR TOCQUEVILLE'S EMPLOYEE-OWNERSHIP SOLUTION**

As in the case of Tocqueville's argument of large capital requiring large owners, modern institutional innovations ("social inventions") have obsoleted Tocqueville's pessimism about employee ownership. It is not necessary for the old owners to gift shares to employees or even for employees to buy shares out of their individual saving accounts or individually collateralized loans.

There are legal ways for both the industrial employee (or small farmer) to pay for their ownership with their additional earning power by using the industrial capital (or farmland). One simple example of this is the lease-purchase contract. Suppose a person wants to set up a small business using a truck. Instead of trying to accumulate savings from some other job to buy the truck outright or to get a loan to buy the truck, a lease-purchase arrangement would allow the person to already use the truck in the business to earn the money to pay for it.

The key is "using the to-be-purchased asset to pay for the asset." That basic idea has now been implemented on a rather large scale in the United States in the leveraged Employee Stock Ownership Plan (ESOP) enabled in the *Employment Retirement Income Security Act* of 1974 (ERISA) <sup>[14]</sup>.

In the pre-ESOP era in the United States and in most other countries today, the main means for employees to acquire shares in employer stock is to save up the money in a savings account or to take out a loan from a bank using some marketable asset, like a car or house, as collateral. Many companies here and abroad might have Employee Share Purchase Plans so employees could use

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their savings (including payroll deductions) or loans to buy employer stock at a reduced price. Such plans almost never account for more than a minuscule percent of a company's ownership.

The ESOPs have changed all that. The basic idea is that the company's earning power (and assets) are the collateral for a loan to the ESOP trust (guaranteed by the company) to buy shares from, say, a retiring owner (with no interested heirs) or to buy newly issued shares. These shares are held in the trust and they are initially held in "suspension" without any vesting to individual employees. Then the company's repayment of the loan is channeled through the ESOP trust functioning as a pension plan so the money leaves the company as the deductible expense of deferred labor compensation (like any pension contribution). Ordinarily, only the interest portion (and not the principal portion) of each loan payment is a deductible expense. Then the ESOP trust passes the money through to pay off the loan. At that time, shares equal to the principal portion of the loan payment are taken out of "suspension" and are allocated to the individual employee share accounts still in the trust.

The outside shareholders who sell their shares to an ESOP are not making a gift; the shares are paid for at their market value (as determined by an independent valuation if the shares are not publicly traded). When an employee retires or leaves the job, then a typical arrangement is for the ESOP to "provide the market" by buying back (at their appraised value) the shares "in" the employee's share account in the trust.

The "leveraging" of the purchased asset to pay off the loan for the purchase—has long been a technique used by merger & acquisition firms and private equity funds. But the ESOP mechanism made this leveraged technique available to employees to "give workers an interest in the ownership of the factory" as envisaged by Tocqueville. And unlike the employee share purchase plans, the ESOPs have had a significant impact. Since the enabling legislation in 1974, over 9% of American workforce now work in companies with ESOPs (which might be compared to about 7% working in unionized companies).

Tocqueville's suggestion to implement his classical-liberal philosophy (use government to empower people to do good things for themselves) by workers getting "an interest in the ownership of the factory" was not "ripe" in his time, but today there are institutional innovations that make it much more ripe for our time <sup>[5]</sup>.

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