Elizabeth Warren's War on Private Equity Could Cost 24 Million Jobs

Sen. Elizabeth Warren, D-Mass. (Elijah Nouvelage/Getty Images)

By Marisa Herman | Tuesday, 26 January 2021

Progressives won't back down from their efforts to raise taxes and create stricter oversight on private equity firms now that Democrats control Congress — moves that financial experts say could cripple the industry that employs millions of Americans and invests trillions into businesses.

Massachusetts Sen. Elizabeth Warren is leading liberals' charge against private equity, which could lead to the loss of up to 24.3 million jobs.

What makes the war on private equity so dangerous at this point is that it is expected to play a crucial role in the economic recovery from the coronavirus pandemic, according to experts.

Warren has been gunning for the private equity industry for years. In 2019, she unveiled her overhaul, the Stop Wall Street Looting Act, that proposed a slew of changes to practices that she views as a threat to the economy and workers subjected to takeovers by these firms. Financial experts say Warren isn't expected to back down from her war against private equity, even if she faces opposition from moderate Democrats, Republicans, or even Biden's inner circle that has close ties to the industry.

"The more regulations that are passed, the worse it could be for firms, workers, and communities," said Peter Earle, an economist and research fellow at the American Institute for Economic Research.

"Private equity is a sector of our economy that could accommodate some regulatory tweaks, but nothing like the dismantling the progressives have in mind," industry expert and principal of New Jersey-based The Boyd Co. John Boyd said. "The fact that Warren's proposals are characterized as going after 'looting' might give you a feeling of how they will be received on Wall Street."

According to the American Investment Council, which is the leading advocacy organization for the private investment industry, 35,000 private equity-backed businesses employ 5.8 million Americans. Between 2013-2018, private equity invested about $3.4 trillion into businesses to help them grow.

When Warren first introduced her bill, American Investment Council President and CEO Drew Maloney issued a statement blasting the proposal that targeted private equity. "Extreme political plans only hurt workers, investment, and our economy," he said.

The U.S. Chamber of Commerce also warned of the grave impact Warren's bill would have on the economy. It issued a report indicating that anywhere between 6.2 million and 24.3 million jobs would be lost if the bill were enacted. It also found that the regulations would reduce government tax receipts and investment returns of public pension funds. According to the American Investment Council, private equity is the highest performing asset class for public pension funds, which has delivered a median 10-year annualized return of 8.6%.

Boyd said private equity is a key tool that will become even more important as the economy recovers from the coronavirus pandemic. "Private equity is a vital cog in the wheel of our national economy," he said, adding the industry will already be navigating an entirely different landscape under President Joe Biden if his planned tax hikes go into effect.

Earle pointed out that certain practices within the private equity industry may "look sketchy" to outsiders. He said private equity firms typically look for opportunities where they can take control over a company and extract gains from it. Often, they target cash cows — companies that have been around for a long time but don't have a lot of room left to grow. The firms come in and look to make changes that will financially help the company and also result in a big pay day for their investment. But they also put measures in place to protect them from losing too much of their investment should the deal go sidewise.

"Profits are usually quite big, but failure rates are quite high," Earle said. "A lot of firms get involved and they just can't turn it around. They don't lose, but they don't gain. They might break even."

To protect themselves, Earle said private equity firms often have the company they are taking over pay them a management fee, so they make money whether or not the takeover works. Other practices involve hardnose bargaining with unions and even eliminating personnel through restructuring positions or layoffs to cut costs.

Warren is looking to curb and even eliminate some of those practices, which could threaten the future of private equity. Under her plan, the monitoring or management fees the firms charge would be taxed at 100% and dividends would be banned for two years after a transaction; firms would be responsible for debts and retirement pension obligations of the companies they purchase; workers and consumers would be prioritized higher in bankruptcy proceedings; and the carried interest loophole would be closed.

For Boyd, the most dangerous aspect of the proposal would be holding firms liable for debt placed on the companies they control.

As a package, Earle said the regulations amount to a "punitive measure against individuals involved in a certain activity."

While increasing transparency "is rarely a bad thing," he said he would much rather see the Securities and Exchange Commission come out with regulations or guidelines for private equity firms to follow rather than politically-motivated measures dictated by Congress. "I would hate to see a law passed targeting private equity," he said. "All of these changes, if enacted, they would be devastating."

Warren already has some support from her Democrat Senate colleagues. Sen. Sherrod Brown, D-Ohio, backs Warren's plan and will serve as chairman of the Senate Banking Committee. Sen. Ron Wyden, D-Ore., is chairman of the Senate Finance Committee. He has discussed scaling back tax benefits that would likely hit companies' bottom lines.

Boyd said his Wall Street clients are hopeful that Biden's inner circle, which has deep ties to the industry, will keep Warren in check. It could be just one example of how moderates and progressives will clash over policy under the Biden administration. "The hope is that Biden's inner circle will emphasize the importance of keeping capital flowing, especially as the country recovers from the pandemic," Boyd said, adding the firms also make large investments in startups owned by minorities and women.

Private equity firms backed Biden big when it came to fundraising for the 2020 election. According to the Center for Responsive Politics, which tracks political contributions, Biden's campaign received about $3.5 million from private equity and investment firm employees, while former President Donald Trump received a mere $560,000. Big Biden donors included Blackstone's Jonathan Gray and Bain Capital's Joshua Bekenstein.

Closer to Biden, his White House chief of staff Ron Klain served as general counsel at venture capital firm Revolution, Brian Deese, the National Economic Council director, was the head of sustainable investing at asset manager BlackRock, and the new coronavirus response czar Jeff Zients was CEO of investment firm Cranemere.

While Warren's bill claims it would "fundamentally reform private equity by closing the legal, tax, and regulatory loopholes that allow private equity firms to capture all the rewards of their investments while insulating themselves from risk," Earle said it will likely result in firms liquidating and pivoting into a related field like investment banking.

"They are doing a lot of good out there," he said of private equity. "They do take risks. They do fail. There's a lot of deals that don't work out. It shows the incredible difficulty that it takes to run a business."