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WHAT THE FACEBOOK IPO REALLY SAYS ABOUT AMERICA'S ECONOMY

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Is the Facebook initial public offering – one of the largest IPOs in history – a symbol of American prosperity? In some sense, yes. A technological innovation that began as an extracurricular obsession of a brilliant college student has now become a global "social utility" with 900 million users. In important ways, Facebook has transformed how people interact with each other and demonstrated yet again the dominance of American ingenuity.

And yet, Facebook's success also dramatically illustrates deeply troubling problems with the U.S. economy that threaten core American values. Six troubling features of the Facebook IPO stand out:

1. GROWING INEQUALITY

Facebook's IPO will contribute to the extreme concentration of wealth. As a result of the IPO, CEO Mark Zuckerberg will have a net worth greater than the combined bottom fifth of all U.S. households. Facebook's founders and investors have scored historic gains in recent years even as most U.S. households have been flat and their wealth assets have declined.

2. DISCONNECT BETWEEN CORPORATE SUCCESS AND JOB CREATION

Facebook has a far smaller number of employees than any company of comparable value. Facebook's high valuation and relatively tiny labor force shows that building successful companies no longer necessarily means creating many jobs that grow the middle class.

3. INSIDER ADVANTAGES

Beyond its founders, early employers, and family members, the biggest winners from Facebook's IPO will be well-connected insider investors who parlayed their wealth and contacts into a piece of Facebook equity – a common story in today's unequal economy. Ordinary investors have been largely excluded from this opportunity.

4. LOTTERY ECONOMY

While Facebook's founders and key employees have displayed tremendous creativity and vision, many of those getting fabulously rich have not demonstrated outstanding skills and simply happened to be in the right place at the right time. The IPO showcases a "lottery economy," where there is a growing disconnect between wealth and merit, with individuals reaping outsized gains from pure luck.

5. TAX AVOIDANCE

While Mark Zuckerberg's large tax bill has drawn much attention, Facebook will get a huge tax deduction thanks to the stock-option loophole. In addition, some of the company's largest shareholders have moved to shelter some of their gains from estate and gift taxes. Most egregiously, Facebook co-founder Eduardo Saverin renounced his U.S. citizenship earlier this year, a move that will save him hundreds of millions in taxes.

6. CIVIC INEQUALITY

The new wealth created by the IPO will empower Facebook stockholders to exercise significant sway over American politics, policy, and culture through campaign donations and philanthropy – further tilting influence over U.S. life to wealthy elites and exacerbating civic inequality.

This report explores each of these concerns. Our goal is not to disparage or demean the success of an important company that has created a service enjoyed by millions. Nor is it to question the right of successful entrepreneurs and investors to become extremely wealthy. Rather, we seek to draw attention to the dangerous ways in which even the most spectacular business breakthroughs do not always translate into gains for ordinary Americans – and, in fact, can reduce the relative influence of such Americans over the direction of U.S. society and generate strong doubts, if not outright cynicism, about whether the social contract works any longer in America.

GROWING INEQUALITY

If Facebook is worth around $100 billion as a result of its IPO, a number of its shareholders will become billionaires and multi-millionaires – putting vast new wealth into a handful of individuals associated with the company. Mark Zuckerberg – who owns a 28.4 percent stake in the company will be worth as much as $25 billion, making the 28-year-old CEO among the top ten richest Americans. Facebook co-founders Dustin Moskovitz and Eduardo Saverin will be worth over $7 billion and $4 billion respectively, and other billionaires will also be created from the IPO, including Sheryl Sandberg, the company's Chief Operating Officer.

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This explosion of new wealth must be understood in the context of broader wealth distribution. The wealthiest 1 percent current holds about 35 percent of all U.S. household wealth, according to an analysis by economist Edward Wolff, while the top 20 percent of households has about 85 percent of all wealth. According to study last year by the Pew Research Center, about a third of black (35%) and Hispanic (31%) households had zero or negative net worth in 2009. In addition, 15 percent of all white households had zero or negative net worth.

Extrapolating from Census data on the number of households in each demographic group, Mark Zuckerberg had a higher net worth than 21,468,489 of the poorest households in America – or nearly a fifth of all U.S. households. And given the low wealth holdings among many Americans who do have assets – Latino and African-Americans households have a median net worth of $6,325 and $5,677 respectively – it appears that Zuckerberg is worth more than the bottom quarter of all U.S. households.

It would be one thing if the vast new Facebook fortunes were being minted during prosperous times and amid an overall increase in U.S. household wealth. But this is not the case. Many Americans have suffered devastating declines in their wealth during recent years: As the Pew study reports, "the median wealth, or net worth, of U.S.

households fell from $96,894 in 2005 to $70,000 in 2009, a drop of 28 percent. Black and Latino households lost over half of their net worth during this period on average." The percentage of U.S. households with zero or negative net worth is now at the highest level in a quarter century.

Facebook and its founders are not responsible for growing inequality and the economic hardship endured by millions of Americans. But it's notable and troubling that one of America's fastest growing sectors, technology, tends to concentrate huge winnings in the hands of so few. Indeed, studies show that inequality is closely linked to the rise of the tech sector. Between 1994 and 2000, for example, just five counties in the U.S. contributed disproportionately to the rise in income inequality over this period: New York, New York; Santa Clara, California; San Mateo, California; King, Washington (home of Seattle and Redmond); and San Francisco, California. Four of these counties are well known for their robust tech sectors.

There is no rising wealth tide lifting the boats of all Americans. A great many boats, in fact, are under water. Nevertheless, the biggest yachts in the nation are rising in breathtaking ways.

In a more recent analysis, Richard Florida found that the counties with the greatest amount of inequality are those with strong high-tech industries. The top five most unequal counties in the U.S., according this study, are: Huntsville, Alabama (a capital for semi-conductor research and industry); San Jose, California (again, Silicon Valley); College Station-Bryan, Texas; Boulder, Colorado (recently named the number-one place for new start-ups); and Durham, North Carolina (home of the research Triangle).

The recent success of the tech sector, and the Facebook IPO, shouldn't be confused with the broader success of U.S. households. There is no rising wealth tide lifting the boats of all Americans. A great many boats, in fact, are under water. Nevertheless, the biggest yachts in the nation are rising in breathtaking ways.

DISCONNECT BETWEEN CORPORATE SUCCESS AND JOB CREATION

Technology companies deliver amazing products and services, and Facebook is a prime example of how breakthroughs in the tech sector can change how we live. But what the tech sector does not reliably deliver are many jobs compared to revenues and profits. Facebook illustrates this reality. Even as the company has become spectacularly successful, and vastly enriched individuals associated with it, it has generated relatively few jobs.

Facebook added just over 1,000 jobs in 2011, bringing its total work force to 3,200 employees. Indirectly, through the apps and other subsidiary components supported by Facebook, the company is estimated to have created between 53,000 and 129,000 jobs in the United States.

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For example, PepsiCo has 285,000 employees with a market value of $103 billion, according to Fortune. Abbott Laboratories employs 91,000 people with a market value of $95.6 billion. Walt Disney has 156,000 employees with a market value of $77 billion. Bank of America, with a market value of $102 billion has 284,000 employees.

Facebook also has many fewer employees than older technology and Internet companies, showing how a new generation of tech firms may be able to generate greater wealth without large labor forces. Amazon has 56,200 employees and market value of $93.1 billion. Cisco has 71,000 employees and a market cap of $113 billion. Intel has 101,000 employees with a market cap of $114.6 billion.

Facebook's high valuation on the NASDAQ also speaks to a larger disconnect between corporate profits, stock prices, and the labor market during the post-recession recovery. According to a recent analysis from Northeastern University, in the first two years of the recovery, the Dow Jones Industrial average increased 49 percent, the Standard and Poor 500 index had increased 46 percent, yet real mean hourly earnings of all private sector workers had decreased 1 percent. Put a different way, recent years have been fantastic for owners of capital – who are largely part of the top 20 percent of households, as noted – and terrible for workers.

PAYDAY FOR WEALTHY INSIDERS

Nearly three quarters of Americans believe the "rich are getting richer and the poor are getting poorer," accord to a Harris Interactive poll taken last year. The Facebook IPO confirms at least half of this view: it will shower vast new wealth on investors who were only able to get a stake in Facebook because they were already wealthy and had inside connections.

Investors who support start-ups with capital play a crucial role in spurring growth and creating jobs. These investors often take big risks and deserve big rewards. But the ability of those with wealth and connections to achieve even greater wealth, through opportunities not available to the rest of us, illustrates how the U.S. economy delivers outsized gains to existing "haves," exacerbating the wealth divide.

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Beyond its founders and first employees, the biggest winners from Facebook's IPO will be its early investors – most of whom were wealthy Silicon Valley insiders even before they invested in Facebook and only got an opportunity to invest in Facebook because of their connections and existing wealth. These winners include Peter Thiel, who owns 2.5 percent of the company, according to Facebook's registration statement to the SEC. Thiel was already extremely wealthy in his role in founding PayPal and a hedge fund when he became the first major outside investor to Facebook, writing a check for $500,000 after a meeting with Zuckerberg. Thiel met Zuckerberg through his connections with Reid Hoffman, another wealthy PayPal co-founder who knew Sean Parker, the company's president. (Hoffman secured a 0.5 percent stake in Facebook.) Another major winner is Jim Breyer and the venture capital firm of Accel Partners, which owns 10 percent of the company worth as much as $10 billion. Breyer not only arranged the Accel investment, but – thanks to his personal wealth and proximity to the deal – was able to invest his own money in the company, which is now a 0.6 percent stake worth $600 million.

While most of those getting rich from Facebook did not start with family wealth, such wealth did play a key role in both launching the company and enriching one of the biggest winners in the Facebook story: 29-year old co-founder Eduardo Saverin. The son of a wealthy Brazilian industrialist, Saverin had the means as a college student to help bankroll Facebook's startup, becoming its first investor and helping Facebook afford server space and other early costs. Saverin, who played no role in the company after its earliest days, is now worth some $4 billion thanks to his Facebook holdings.

Well-connected investors who didn't get in on Facebook in the early days may still have a chance to do very well as the result of IPO. While the first sale of Facebook's stock is called an initial public offering, and the company has pledged to give ordinary investors a shot at buying shares early on, few in the broader investing public have any chance of getting in on this action. Instead, those with the best chance to buy shares at their initial offering price will be financial advisors and investors closely connected to the Wall Street firms underwriting the IPO. As the *New York Times*' Dealbook reported: "Depending on the size of the offering, Facebook will end up paying more than $100 million in fees to the underwriters. The firms that receive the most in underwriting fees typically get the biggest number of retail shares. In the case of Facebook, that is likely to be Morgan Stanley, which has a large network of brokers. Those shares are highly coveted and typically go to the firm's top-producing brokers – and their best clients." In other words, wealthy brokers and well-heeled clients have the biggest chance of being able to buy Facebook shares at their opening price – and reap huge gains if the stock then climbs dramatically in value.

Finally, it is worth mentioning the large gains that Mark Zuckerberg's family will reap from the public offering. Zuckerberg's father, who provided family money and other forms of help to Facebook and his son in its early days was granted the option to buy 2 million shares of Facebook stock by the company's board. He will likely be worth $60 million after the IPO, according to *New York* magazine. Mark Zuckerberg's sister, Randi, is also likely to do well from the IPO, since she was hired by her brother as Facebook's first marketing director with stock options.

LOTTERY ECONOMY

The free market is supposed to grant its biggest rewards to those with the best ideas, strongest work ethic, or greatest savvy. Parts of the Facebook story confirm this link between wealth and merit – particularly Zuckerberg's success, given his wide reputation as the visionary behind the company. Other players in the story also clearly earned huge rewards, including Sean Parker who instantly saw the value of Facebook and orchestrated the company's key early successes in Silicon Valley; and COO Sheryl Sandberg, a Google veteran who played an instrumental role in figuring out how to monetize Facebook.

But the Facebook IPO will also place huge fortunes in the hands of early employees who – very talented though they may be – were mainly in the right place at the right time. While comparably skilled professionals who took jobs at different companies are now earning low-six figure salaries, some of Facebook's lucky early employees are worth hundreds of millions of dollars, in some cases for just a few years of work. These fortunes more resemble lottery winnings than a rational payout based on effort, boldness, or creativity.

Four former or current Facebook employees are now estimated to each hold 0.8 percent of equity in the company, worth some $800 million: Matt Choler, a former vice president of product management; Jeff Rothschild, a computer scientist who worked with Facebook on its early data management; Adam D'Angelo, an early chief technology officer for the company; an early chief operating officer.

Others who will win big from the IPO include employees who came in well after the company's founding when it was well on its path to huge success. These include chief financial officer David Ebersman, $400 million, hired in 2009; vice president for engineering Mike Schroepfer, $370 million, hired in 2008; and general counsel Theodore Ullyot, $370 million, hired in 2008.

David Choe is perhaps the most famous case of winning the Facebook lottery. As reported by the *New York Times*, Choe was hired to create murals in Facebook's offices in Silicon Valley and chose to be paid in stock rather than case. His personal fortune from Facebook stock is now estimated at $200 million.

Of course, there may be no Facebook multi-millionaires who have done less to earn their wealth than Cameron and Tyler Winklevoss, who played no role in building the company but successfully sued Facebook and Mark Zuckerberg for allegedly stealing their idea. Their combined fortune from Facebook stock is estimated at over $40 million.

TAX AVOIDANCE

Much has been made of the large tax bill that Mark Zuckerberg will pay to the U.S. Treasury and State of California when Facebook goes public. According to an analysis by PrivCo, Zuckerberg is likely to pay $714 million to the IRS and $189 million to California, for a total of $903 million.

Equally significant, though, is how the Facebook IPO showcases the ways that corporations and the wealthy can avoid paying their fair share of taxes. Under current tax law, Facebook can utilize a controversial tax loophole to claim a huge tax deduction, get a large refund from the federal government for past taxes paid, and greatly reduce its future tax bills. As well, Facebook's founders and key shareholders are exploiting other loopholes to lower their tax bills.

For nearly 15 years, Senator Carl Levin and other lawmakers have been trying to close the so-called "stock-option" loophole. This tax break allows corporations to hand out abundant stock options and yet claim that those options are worth very little money in reporting their expenses and profits to shareholders – thereby improving their bottom line. But when employees exercise such options, corporations are allowed – under the tax code – to turn around and claim the options are worth full market value. In a speech in Congress in February, Senator Carl Levin noted that this loophole could not only entitle save Facebook to a refund of $500 million on previously paid taxes but result in "a tax break of up to $3 billion" in future years. As the largest stockholder in Facebook, Zuckerberg will directly benefit from these tax savings, with his eventual gains helping offset his large up-front tax bill that has attracted such attention.

In addition to exploiting the stock-option loophole, several Facebook founders or investors have reportedly set up grantor-retained annuity trust, or GRATs, to avoid paying estate and gift taxes on some of their new wealth. As reported by the *Wall Street Journal*, those creating GRATs with Facebook shares in recent years include Dustin Moskovitz, Sean Parker, Sheryl Sandberg, Reid Hoffman, and Zuckerberg. GRATs are complex, but basically these vehicles will allow Facebook shareholders to allow some of their shares to appreciate in value and yet not have that appreciation subject to future estate taxes. According to the Wall Street Journal, the GRATs created so far by Facebook shareholders will allow their heirs or beneficiaries to avoid $200 million in taxes.

Eduardo Saverin did not get rich in Singapore: he got rich in America, a society with strong public structures that facilitate wealth creation and are paid for by tax dollars.

Finally, and most egregiously, is how Facebook co-founder Eduardo Saverin renounced his U.S. citizenship earlier this year, a move that will allow him to save hundreds of millions of dollars in capital gains taxes. Saverin now lives in Singapore, which doesn't have a capital gains tax. Of course, though, Saverin did not get rich in Singapore: he got rich in America, a society with strong public structures that facilitate wealth creation and are paid for by tax dollars. Saverin met Mark Zuckerberg at Harvard, an institution partly subsidized by federal grants and got rich using the Internet, a technology invented by a U.S. government agency. Facebook has prospered in Silicon Valley, a tech region spawned in part by early U.S. government military and science spending, and in the United States, a country with strong intellectual property rights and other legal protections for entrepreneurs. As well, many of Facebook's employees were educated at public schools and universities.

Saverin is not alone among wealthy individuals who have gotten rich with the help of American public structures and then renounced U.S. citizenship. For some of the super wealthy, it turns out, money comes before loyalty.

CIVIC INEQUALITY

Much of the wealth generated by Facebook may never be taxed at all because it will be donated to charity. Mark Zuckerberg has pledged to give away at least half of his wealth, as part of The Giving Pledge organized by Bill Gates and Warren Buffett. Zuckerberg has already begun giving away his money, most notably with a major gift to improve public schools in Newark. Co-founder Dustin Moskovitz has also pledged to give away at least half of his fortune.

The American tradition of philanthropy has yielded many positive benefits to the U.S. and to humanity, and the new philanthropists minted by Facebook are sure to do much good with their money. But a cautionary note is also in order as these vast new philanthropic fortunes come online: Philanthropy allows private individuals to use money sheltered from taxation to advance their own personal agenda for public policy, culture, science, and so on, and to exercise vastly more influence over society than ordinary citizens or voters can. In other words, all taxpayers are subsidizing the ability of the super wealthy to try to shape America or the world as they see fit.

Mark Zuckerberg's gift to improve Newark's schools shows the benefits and dangers of how the new wealth created by Facebook will be deployed in the public sphere. On the one hand, it's positive that Zuckerberg is trying to help one of the poorest and most troubled school districts in America. On the other hand, the large size of the donation – $100 million, before matching gifts – cannot help but help shape the direction of school policy in Newark, which should more rightly be decided by the citizens of Newark. Education has traditionally been among the most democratic areas of American life. But that has changed in recent years as the result of large-scale philanthropy by donors like Bill Gates and Eli Broad, with these private individuals profoundly influencing public schools. Zuckerberg's entry into this activity could exacerbate a troubling trend whereby ordinary citizens have diminished influence over crucial policy questions relative to wealthy philanthropists.

Facebook's IPO will also put considerable political power in the hands of its shareholders, if the trajectory of other tech companies is any indication. Prior to Google's IPO in 2004, its employees gave little money to political candidates. Such giving jumped dramatically after Google went public and its employees were among the top five groups bankrolling President Obama's 2008 presidential campaign, ultimately giving Obama $814,540 according to OpenSecrets.org. (Google employees are again among the top five groups giving to Obama in the current election cycle.)

Facebook employees and directors are already using their wealth to try to influence electoral outcomes – donating $459,251 to candidates and party committees over the past three election cycles. COO Sheryl Sandberg alone has given $108,000. In short, the wealth of Facebook shareholders will allow them to have a much bigger say in U.S. politics than is available to most Americans, subverting the egalitarian ideal that lies at the heart of America's democracy.

Finally, Facebook can be expected to use some of the new funds raised by its IPO to expand its lobbying and PAC activity. The company's spending on lobbying rose from $207,878 in 2009 to $1,350,000 in 2012. It is sure to increase further in coming years.

CONCLUSION

Facebook is a great success story in many ways. Thanks to the vision and creativity of the company's founders and investors, people worldwide can share better information and stay in contact. Those who helped create Facebook rightly deserve big rewards. But the vast size of these rewards amid high inequality and widespread hardship raises troubling questions about how well the U.S. economy is working. If such new riches came during prosperous times from a company that created a large number of good jobs, that would be one thing. But this is not the case. And the ability of the company and its founders to exploit tax loopholes raises additional fairness concerns, as does the outsized influence that Facebook shareholders are likely to wield in U.S. politics and philanthropy.

Facebook founders are operating in a society that advantages corporations and the wealthy at nearly every turn.

Facebook founders have not done anything wrong or immoral, with the exception of Eduardo Saverin. But they are operating in a society that advantages corporations and the wealthy at nearly every turn, pushing tax burdens onto Americans of more modest means while also diminishing the civic voice of ordinary citizens. For these reasons, Facebook's IPO should be less a cause of celebration, than an alarm bell drawing attention to how America has become dangerously tilted in favor of the rich and powerful.

ABOUT DĒMOS

Dēmos is a non-partisan public policy research and advocacy organization founded in 2000. Headquartered in New York City, Dēmos works with policymakers around the country in pursuit of four overarching goals—a more equitable economy with widely shared prosperity and opportunity; a vibrant and inclusive democracy with high levels of voting and civic engagement; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world.

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