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The Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

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SENATE ECONOMICS REFERENCES COMMITTEE
INQUIRY INTO EMPLOYEE SHARE SCHEMES

Dear Mr Hawkins

This submission is being made in my private capacity and not as a co-founder and a current Vice President of the Australia Employee Ownership Association (AEOA). This is because I have been overseas since the terms of reference for the inquiry were announced and I have not had the opportunity to consult with my AEOA colleagues.

I have been involved in promoting Employee Ownership since I arranged for Louis Kelso, the US inventor of leveraged Employee Share Ownership Plans (ESOPs) to present his ideas in Australia in 1975. To introduce his ideas to Australia and promote my own complementary techniques I wrote *Democratising the Wealth of Nations*. In 2000 a Ford Foundation project arranged for my book to be placed on the web and it can now be downloaded from: http://ssrn.com/abstract_id=1146062. Dr Jim Cairns MP, who was then Deputy Prime Minister, launched my book, and his review published in the *Journal of the Australian Society of Security Analysts* (JASSA) as posted at http://cog.kent.edu/lib/cairns.html. Every Member of Parliament was presented with a copy of my book to introduce its ideas to lawmakers.

My recommendations in this submission are presented in three parts:

1. Complementary techniques for spreading ownership to employees and others citizens that become especially relevant with the financial crisis and the current review of the tax system;

2. Supplementary points to the AEOA submission.

3. Recommendations to the Productivity Commission on executive pay as presented by the AEOA and my additional proposals attached to this submission.

1. Complementary techniques for democratizing wealth through employee ownership

The complementary techniques raised in this submission represent a response to item (f) of the terms of reference to "any other related matters". The current financial crisis and/or the current inquiry into the tax system make the techniques outlined below especially relevant for consideration.

1.1 In return for any Government financial assistance to any privately owned firm in distress or **for any other assistance** the government should require that ownership be shared. The US government has used this approach on a number of occasions as described below.

1.2 The government should channel any funding assistance to a private firm in distress through an employee ownership trust so that the **funds can be used twice**. First by providing employees a basis for obtaining an ownership interest in the assets and/or shares of the company and secondly by providing funds for the firm to remain in business. In this way employees can form a joint venture relationship with the firm to negotiate on behalf of themselves and the government a successful outcome. A rescued business could then make tax-deductable contributions to the employee trust to provide it the means to repay the funds advanced by the government. This approach is especially relevant for government providing support to any fully owned foreign firms. This is the situation with the automobile industry. No shares need be issued to the employee trust as ownership of the firm's assets is shared with employees. This has a number of advantages such as:

(i) Giving employees a say on using the assets of the firm to borrow money from bankers with the opportunity for employees to protect their unpaid entitlements;

(ii) Provide employees with an incentive to care and maintain the assets to increase their operating life;

(iii) Providing employees a new source of income from renting the assets to their employer;

(iv) Obtaining rent from the assets in case the business transfers them overseas to be operated by lower paid foreign workers;

(v) Provide a basis for employees to set up a worker owned business; (v)

(vi) Obtain the liquidation value of the assets in the event that the firm does not survive.

1.3 Any firm that obtains financial or **ANY other support from government** should be required to write-off of the ownership of its assets at the same rate it obtains a tax deduction to write-off its assets. This **would not reduce the reported profit** of the business, as accounting rules also require assets to be written off. However, in this way ownership of the assets written off could be transferred to an employee ownership trust democratically managed by them. Employees would become a joint venture partner of their employer to reduce asymmetry in negotiating power and provide the benefits listed in point 1.2 above.

1.4 A much more efficient and effective technique for democratizing wealth to reduce the need for government transfers of tax and welfare and so reduce the size of government is to introduce Ownership Transfer Corporations (0TCs). OTCs are a core proposal of *Democratising the Wealth of Nations* and the concept has been accepted in articles published in a number of refereed academic journals including a book containing the seminal contributions of leading international scholars contributing to the Corporate Governance volume of *The History of Management Thought.*

OTCs can be introduced on a voluntary basis by reducing the corporate tax for those firms that change their constitutions so that all property rights in the firm transfer from investors to citizen stakeholders over say a 20-year period. As citizens pay tax at a higher rate than firms, tax revenues are increased as the tax base transfers from corporations to citizens who elect our politicians. It provides a way to attract more foreign investment while increasing local ownership and control of industry to reduce the "unknown, uncontrolled and unlimited" foreign liabilities introduced by foreign investment discussed by Professor Penrose. In this way the loss of foreign exchange from Australia are reduced with the revenues accruing to Australian citizens and the government increasing. OTCs provide a basis to democratise wealth on a systemic basis in a far wider, more efficient and effective manner than current tax incentives used in Australia, US and the UK.

1.4 All foreign investment approvals should be made on the condition of ownership reversion arrangements as set out in points 1.3 and 1.4 above.

1.5 The government could introduce cost carrying self-financing money to rescue distressed firms on condition that employee ownership is introduced. The use of cost carrying money could also be used to make renewable energy more economical than burning carbon to reduce the need for carbon taxing or trading as set out in my paper: "Money, Markets and Climate Change" presented in London last week. The paper can be downloaded from http://ssrn.com/abstract=1304083 with details developed in a sequel on "Rebuilding the Economy and the Financial System" that I presented at universities in Italy, France and the UK during the last few weeks. As the title suggests, it has much wider implications for re-invigorating the economy without the government needing to borrow or tax. It can be downloaded from http://ssrn.com/abstract=1322210.

1.6 A guarantee fund could be funded from the various proposals described above to provide a basis for employees to buy-out firms that would otherwise be taken over by private equity investors. The extent of private equity acquisitions illustrates how viable firms can pay for their purchase from their own cash flows. This means anybody can buy the firm provided they obtain bridging finance for the payback period. A guarantee fund would level the playing field for employees to allow them to engage in this activity.

1.7 An ownership impact statement be included with all economic laws and regulations to indicate the extent that any new initiative may concentrate or democratise the resources of the nations. This is especially important for privatisation initiatives.

2. Supplementary points to the AEOA submission.

Evidence of the difficulty of unlisted firms in Australia introducing employee ownership is provided by the fact that these firms only contribute to around 10% of employee ownership while in the US it is 90%. In Australia 90% of employee ownership is with publicly traded firms. It is with private firms that employee ownership can contribute special benefits such as: (i) providing a low cost source of equity; (ii) avoiding the need for the firm to become publicly traded; (iii) providing management succession for owners wishing to retire; (iv) increasing local ownership and control.

The University of Melbourne law faculty has recently completed a major research project into Australian employee ownership. Their published reports with their embedded URLs are provided below:

I Landau, R Mitchell, A O'Connell, I Ramsay and S Marshall, Broad-Based Employee Share Ownership in Australian Listed Companies: Survey Report (Research Report, Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, April 2009).

A O'Connell, 'Employee Share Ownership in Unlisted Entities: Objectives, Current Practices and Regulatory Reform' (Research Report, Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, December 2008).

M Brown, I Landau, R Mitchell, A O'Connell and I Ramsay, 'Why Do Employees Participate in Employee Share Plans? A Conceptual Framework' (Research Report, Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, February 2008).

I Landau, R Mitchell, A O'Connell and I Ramsay, 'An Overview of Existing Data on Employee Share Ownership in Australia' (Research Report, Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, March 2007).

I Landau, R Mitchell, A O'Connell and I Ramsay, 'Employee Share Ownership: A Review of the Literature' (Research Report, Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, March 2007).

I Landau and I Ramsay, 'Employee Share Ownership Plans in Australia: The Corporate Law Framework' (Research Report, Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, March 2007).

Their report of December 2008 provides the results of a survey from 139 employee ownership firms who responded. The feedback in brief was:

- Increase in $1,000 p.a./worker tax-free
- Tax deferral plans to use capital gains tax
- Single Act to promote/manage ESO
- Parliament to specify minimum disclosure
- Increase 5% limit for individual owner
- ESP exempted from disclosure filing requirements
- Establishment of ESP development promotional unit
- All ESPs to be registered with a regulatory agency
- Regulatory ESP agency established.

3. Productivity Commission submissions by AEOA and myself.

A key point of both submissions, as attached, is that shareholders should nominated the maximum number of shares and options any executive can obtain in relation to other employees and that at least 75% of employees should obtain entitlements to shares and/or options on a no less favourable basis as the executives. In this way separate executive share/option plans would still need to take into account share/options for other employees. It would also make shareholders accountable to public opinion on being socially responsible in how they treat employees.

I would be please to provide such further information in writing or in person as may be desired.

Yours faithfully

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