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The Secretary
House of Representatives Standing Committee on Employment, Education and Workplace Relations
Suite R1 116 Parliament House
CANBERRA ACT 2600

April 30th , 1999

Extent of Employee Ownership Schemes:
And their role in socialising capitalism

Dear Sir or Madam:

Objective of submission

This submission advocates government initiatives to deepen the extent of employee ownership and extend ownership plans to all other enterprise stakeholders. In this way, the government could assist all voters to become financially independent and so reduce the need for government taxes and welfare to reduce the size of government and the current alienation of voters with government and its leaders. It would also raise the income of all citizens by reducing the export of profits overseas.

Recommendations

That the government introduces "Expanded Ownership" legislation to:

1. Provide re-insurance facilities for financiers of Leveraged Share Ownership Plans (LSOPs) with appropriate changes in monetary policy (refer to APPENDIX E);
2. Introduce an optional lower tax rate for corporations that adopt arrangements to transfer their ownership and control to citizens involved as strategic stakeholders on who the business depends for its existence, ie to form an Ownership Transfer Corporation (OTC) – refer to Note;
3. Prepare "Ownership Impact" statements on legislation, regulations and expenditures so as to introduce expanded ownership at all opportunities, eg. When the government:
   (a) Provides support, subsidies any other types of "commercial welfare" outlined in APPENDIX A) to a business, it is conditional upon the firm becoming an OTC.:
   (b) Enters into Build Own Operate Transfer (BOOT) schemes to finance infrastructure projects, the ownership and control is transferred directly to stakeholder citizens rather than to the government.
   (c) Sells any assets to the private sector, the contract specifies that the long term ownership and control is transfered to the strategic stakeholders through an OTC.
   (d) Or its agencies award any business an operating licence/franchise, the business becomes an OTC so as to distribute its privileged income and power democratically;
   (e) Participates in international forums it promotes OTCs as a basis for a World Community Investment Code to attract investment with increasing local ownership (APPENDIX B).

Note. There are many ways in which an OTC can be formed. For example a company could issue deferred shares to stakeholders who would acquire the rights of the ordinary shares at a fixed annual rate. A 5% rate would transfer all ownership from investors to other stakeholders in 20 years according to the economic contributions made during that time by citizens involved as employees, customers and suppliers.

Relevant background of Author

I am a founding member, past president and current board member of the Australian Employee Ownership Association (AEOA) and this submission is to complement the one made by the Association dated April 15th, 1999.

The AEOA describes "Kelso Plans", which I introduced to Australia (1) when I organised their inventor, Louis Kelso, to visit Australia in 1975 and by describing them in my book *Democratising the Wealth of Nations* (2). The former Deputy Prime Minister, Dr. Jim Cairns, reviewed (3) and launched my book at the beginning of the Kelso's visit. The publisher provided a copy to every Member of Parliament including our current Prime Minister. The book presents proposals for distributing to all voters, the ownership and control of enterprises, land and housing. The book is the manifesto of "Social Capitalism". It describes how to create a more equitable, efficient and ecologically sustainable political economy than currently exists to capture the support of voters currently alienated. Employee ownership provides a foundation stone to building a stakeholder economy where competitive advantages arise from cooperative relationships.

As part of this submission I attach as APPENDIX C, my article on 'Building a Stakeholder Democracy' published by the Economic Planning Advisory Commission for the *National Strategies Conference* convened by our previous Prime Minister, Mr. Paul Keating in November 1994. This article outlines how a 'Third Way' is created by adopting OTCs and Community Land Banks (CLBs) described in my book and the many articles listed on my web page http://www.peg.apc.org/~shann. This submission will focus on both OTCs and the complementary role of LSOPs described in the AEOA submission as "Kelso Plans".

In 1991 I was invited to advise on privatisation in the Czech & Slovak republics by their Central Research Institute of National Economy and in the Peoples Republic of China by their State Commission for Restructuring the Economic System. The PRC invitation was at the instigation of US expert, Jeff Gates, who led the delegation and recognised that my proposals provided a simpler and more widely applicable technique than LSOPs for transforming a socialist economy.

The role of LSOPs

LSOPs provide a technique for assisting voters to become financial independent be they employees, customers, suppliers or just members of the host community of an enterprise. While all types of share plans can be used to introduce participation of stakeholders in the ownership and control of a business and finance its growth, only LSOPs achieve this objective without the shareholders or any other stakeholders needing to forgo income.

LSOPs achieve this objective when borrowed funds are use to finance the purchase of newly issued shares to finance the expansion of the business being acquired by stakeholders. The reason why no stakeholder has to forgo income to become a shareholder is that all viable business expansion becomes self-financing so any funds borrowed to purchase shares can be paid back from the increased cash-flow from the growth in the business financed by the share issue. This feature can be used to profoundly change the way the national economy operates because it allows economic growth to be financed from the saving generated from investment rather the other way around of Australians forgoing income or accepting foreign ownership and control.

LSOPs provide a way for new investments to create savings rather being financed by foreigners or by income forgone by Australians. Income forgone reduces consumer demand and so demand for new investment, jobs, and economic development to create a "contrary" development process. LSOPs introduce a "confluent" development process with a virtuous circle of increasing investment, jobs, income, and demand to encourage even more investment and savings. LSOPs allow investment to be financed from it increasing productivity and the savings it creates in contrast with the contrary process of investment being financed by saving accumulated from income forgone.

Many economic "experts" and most political commentators overlook the fact that economic growth must by definition be self-financing. This means that there is no financial reason why Australia should allow itself to become subjected to foreign financiers and build up unstainable foreign account deficits. The theoretical explanation for this point is developed in my article, 'Theorists Confuse Savings Debate', published in the *Australian Financial Review* of January 10th 1996 attached as APPENDIX D.

Because of the profound changes LSOPs can make to the operations of the Australian economy they deserve special incentives to encourage their introduction. A basic requirement is for the government to facilitate the introduction of insurance for LSOPs loans. While we have insurance for home loans we do not have insurance for loans to democratically expand business. The insurance would average the risks over time and through the economy of democratically owned business expansion becoming self-financing. Kelso suggested the establishment of a "Capital Diffusion Insurance Corporation" (4) to provide re-insurance for insurers of LSOP loans. Another approach considered by leading US economists meeting at the Brookings Institution in 1977 was for LSOP loans, fully insured, by the non-bank sector to be discounted with the Federal Reserve Bank (5). This would allow the cost of loan insurance to replace the cost of money and allow market forces to distribute and discipline loan insurance as explained in APPENDIX E. This was written during "The recession we had to have" as described by our previous Prime Minister.

These ideas have been developed into a "Capital Homestead Act" by the Washington D.C. based Centre for Economic and Social Justice also described as the Capital Homestead Plan by the Institute for the Public Good. The benefits of the CESJ proposal are set out in APPENDIX F down-loaded from their web pages. Details on how the proposal operates will be found at http://www.cesj.org/homestead/cha_summary.htm Unlike other forms of ESOPs, LSOPs can be introduced without tax incentives. However, they require changes in the way the financial system operates. The tax incentives available for ESOPs in the US are set out at the bottom of Appendix F

The role of OTCs

The unique feature of LSOPs is that they introduce an institutional structure for an economy to internally finance its economic growth as was achieved in the beginning of this century, in different ways, by Japan and the US (6). However, LSOPs do not correct the major fundamental defect of market economies, which concentrates wealth resulting in higher taxes, welfare and the alienation of voters. OTCs ameliorate this fundamental defect by distributing surplus profits and corporate power from investors to other stakeholders on who all businesses depend for their very existence.

Accountants do not measure surplus profits so economists cannot detect them even though they are produced by all investments, which return cash to investors after her/his time horizon. No investor will rely on obtaining cash after her/his time horizon to justify putting funds at risk. So by definition, an OTC will not inhibit even the greedy from investing when it only transfers surplus profits from investors to employees, customers, and suppliers. This is abundantly demonstrated by funds being attracted to time limited investments like physical assets, which wear out with use, leasehold property, mines, movies and any intellectual property as it all has limited life. It is also demonstrated by Build Own Operate and Transfer (BOOT) projects, which provide investors with returns for a limited period before ownership is transferred to the government. This is a perverse transfer as it concentrates control and "sterilises" ownership rather than distributing it to stakeholders so as to both enrich democracy and democratise wealth.

Many opportunistic investors readily give away ownership to key stakeholders to bond and motivate them as is common practice in start up companies and is widely practices in Japan (7). Shareholders in many Australian listed companies commonly approve dilution of their investment through the issue of new shares and options to employees without necessarily requiring higher performance hurdles. Because opportunistic investors' value higher immediate profits rather than long term, uncertain and unknown profits, they will voluntary give up long term ownership for a relatively small immediate incentive which can be provided through the tax system.

Any reduction in the corporate tax rate introduced to provide the incentive for shareholders to convert their companies to OTC is likely to increase government revenue and save welfare expenditure. This is because more profits would be distributed by the company to minimise the effect of ownership dilution and more tax would become payable at a higher rate from income being distributed to voters rather than to other corporations, institutions and foreigners. OTCs provide a way to attract more foreign investment in a way that would introduce more localised ownership and control to reduce the leakage of profits and foreign exchange earnings. OTCs, which involved strategic stakeholders in their ownership and control, would be implementing the recommendations of Professor Porter (8) to make corporations more competitive. A conclusion supported by Blair (9), Fukao (10) and my own analysis (11).

An "Expanded Ownership" program has much to offer to voters, business, the economy and those who promote the concept. I would be available to provide additional information in person as desired and permission is granted for this submission to be made public.

Yours faithfully

Shann Turnbull
Principal

Appendices:

A. Turnbull, S. 1998 'Grants to employees not the rich', published as 'Federal Grants merely concentrates wealth', Letters to the Editor, The Australian Financial Review, Thursday, December 10th, p.17, Sydney.
B. Turnbull, S. 1999 'Replace the MAI initiative with one for a Community Investment Code', Department of Foreign Affairs and Trade, April 14th, Sydney.
C. Turnbull, S. 1994, 'Building a Sustainable Fulfilling Stakeholder Democracy' published as 'Building a stakeholder Democracy', in Conference Report No. 3, Ambitions for our Future: Australian Views, Economic Planning Advisory Commission, Australian Government Publishing Service, pp. 83-90, October, Canberra.
D. Turnbull, S. 1996, 'Savings from Investment' published as 'Theorists Confuse Savings Debate,' The Australian Financial Review, Opinion, p.13, January 10th, Sydney.
E. Turnbull, S. 1992, 'Investing our way out of recession', The Australian Insurer, 3:3, p.2, March 19, Sydney
F. 'Capital Homestead Act' Refer also to: Capital Homestead Plan

There is a number of other web sites around the world which can be accessed from the AEOA web site and others such as http://www.kent.edu/oeoc/links.htm

References and notes:

1. Turnbull, S. 1994, 'The Origins of ESOPs in Australia', *Equity Report* Australian Employee Ownership Association, 4:1, pp. 10-11, June, Sydney.
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3. Cairns, J. 1976, Review of Shann Turnbull's book, *JASSA*, Journal of the Securities Institute of Australia, No. 1, pp. 9-13, Sydney.
4. *Two-Factor Theory: The Economics of Reality,* Louis O. Kelso & Patricia Hetter, Vintage Books, 1967, p.102/3, New York.
5. 'Appendix A pp 133-135', *The USOP Handbook: A Guide to Designing Universal Share Ownership Plans For the United States and Great Britain*, Stuart M. Speiser, The Council on International and Public Affairs, New York.
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8. Porter, M.E. 1992, Capital Choices: Changing The Way America Invests in Industry, A Research Report Presented to The Council on Competitiveness and Co–sponsored by The Harvard Business School, Boston
9. Fukao, M. 1995, Financial Integration, Corporate Governance, and the Performance of Multinational Companies, The Brookings Institution, Washington, D.C.
10. .Blair, M.M. 1995, Ownership and Control, The Brookings Institution, Washington, D.C.
11. Turnbull, S. 'Stakeholder Governance: A cybernetic and property rights analysis', *Corporate Governance: An International Review*, Blackwell, 5:1. pp. 11-23, January, 1997. http://papers.ssrn.com/sol3/paper.taf?ABSTRACT_ID=11355

    __________ 'Stakeholder Co-operation', *Journal of Co-operative Studies*, Society for Co-operative Studies, 29:3, pp 18-52, (no.88), Manchester, January 1997. http://papers.ssrn.com/sol3/paper.taf?ABSTRACT_ID=26238

    __________ 'Corporate Governance Reform: Improving competitiveness and self-regulation', Corporate Law Economic Reform Program Conference, Australian National University, Canberra, November 21, 1997. http://papers.ssrn.com/sol3/paper.taf?ABSTRACT_ID=41383

APPENDIX A

Published as 'Federal Grants merely concentrates wealth', Letters to the Editor, *The Australian Financial Review*, Thursday, December 10th, 1998, p17, Sydney.

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Letters to the Editor (for publication) Fax: 02 9282-3137
The Australian Financial Review
GPO Box 506, Sydney 2001
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December 7th, 1998

Dear Sir or Madam

Grants to employees not the rich

I am outraged by the $40 million in government grants being provided directly to Visy Industries to finance the cost of pulp and paper mill in NSW (*AFR* December 7). The grants should have been made through a stakeholders trust so the money could be used twice: Firstly to fund co-ownership of the mill with its employees, subcontractors, local schools and hospitals and secondly to fund the mill.

Because all viable projects must by definition become self-financing to payback their full cost, the government should not even make a grant but an interest free loan to a stakeholders trust. In this way the government would get its money back, local stakeholders would obtain an equity interest in the project and Visy Industries would obtain interest free unsecured equity funding!

It is not too late for the government to correct its current obscenely inequitable and inefficient "Investing for Growth Strategy" which makes the rich richer. It would be especially regressive to utilise the current procedures with the prospective foreign investors mentioned in your article.

All government decisions, regulations and laws which affect business should be subject to an ownership impact statement on the distribution or concentration of wealth. It is good politics, economics and business to connect as many voters as possible to new investment by making sure that stakeholders obtain "a piece of the action". Minority shareholdings by suppliers, employees, customers and community services provides a way to control transfer pricing tax abuses, enrich democracy and build a strong political mandate for business.

Yours sincerely,

Shann Turnbull
Past President, Australian Employee Ownership Association
sturnbull@mba1963.hbs.edu

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APPENDIX B

Submission to Department of Foreign Trade, April 14th, 1999
(E-mail sent at 12:27 PM 14/4/1999 +1000)

To: Steve Moran <trade.consult@dfat.gov.au>
Subject: Replace the MAI initiative with one for a Community Investment Code
Cc: milne@itlite.com.au, John Hermann <hermann@dove.net.au>

Mr. Steve Moran
Trade Negotiations Division
Department of Foreign Affairs and Trade
R.G. Casey Building, Barton
Australian Capital Territory 0221

Dear Mr Moran

I am responding to the invitation by the Government for the Public to make submissions on further Multilateral Trade Negotiations.

I wish to point out that the proposed Multinational Agreement on Investment (MAI) would allow multi-national corporations to usurp Australian sovereignty and every effort should be made to resist its implementation. This means Australia should resist MAI being placed on any future agenda of the WTO or at any other forum.

To counter and replace the MAI initiative, Australia could provide world leadership to establish a "Community Investment Code" which would allow nations to regain their sovereignty from foreign investors while still attracting new investments. Australia has more to gain from such an initiative than most other developed nations. My proposal for such a code outlined below would provide a way to stop the loss of foreign exchange earnings through the remittance of profits on a basis which Professor Penrose described in *The Economic Journal* as "unlimited, unknown and uncontrollable" in her 1957 article on 'Foreign Investment and the Growth of the Firm'.

My proposals for a Community Investment Code to convert Multi-national corporations into locally owned and controlled stakeholder co-operatives were published in Geneva by the United Nations *Development Forum* of June 1974 & September 1975 and in *The Canadian Forum*, June 1976. Because of the unique advantages of my proposals for privatisation, US experts invited me in 1991 to present them in Beijing to a week long workshop hosted by the State Commission for Restructuring the Economic System of the PRC. At the request of the Prague based Central Research Institute of National Economy, the Australian Ambassador arranged for our government to pay my expenses to present the proposals to the Czech & Slovak Republics as a privatisation technique in 1991.

The basic idea is for 5% of the ownership and control of any foreign direct investment to be transferred at no cost to local citizens EACH YEAR for the following 20 years after the first profits are remitted. This would create an Ownership Transfer Corporation (OTC) as described in my 1975 book *Democratising The Wealth of Nations* and many other articles listed on my web page <http://www.peg.apc.org/~shann> OTC's eliminate the export of profits and foreign exchange after the time horizon required by investors to obtain the incentive to invest. All profits created after the investment time horizon are surplus profits and these then become owned and controlled by the stakeholders who contributed to their creation and were responsible for the foreign investor obtaining their money back with profit.

Following the recommendations of my report commissioned by the Premier of NSW in 1977 the OTC concept was used to finance the Eraring Power station. A number of OTC's have since been established in Australia to finance other infrastructure projects such as the Sydney Harbour Tunnel. These projects are described as Build Own Operate and Transfer (BOOT) schemes. While the ownership transfer in these schemes are used to socialise rather than privatise the investment, they could also be used to democratise ownership and control as proposed in my book.

A World Community Investment Code would specify various strategies for introducing OTC's in addition to the BOOTing out approach. One approach for existing businesses would be to provide a relatively small tax benefit to offset the annual loss of ownership to make OTCs more attractive to either foreign and/or local investors than paying tax at the standard rate. The incentive would be small because investors' value short term profits much more highly than long term profits, which are also much more uncertain. In the jargon of financiers, the Present Value of profits in ten years time discounted at an equity opportunity rate and discounted again for risk approaches zero. Some calculations to illustrate this effect are presented in my refereed academic article:

'Stakeholder Governance: A cybernetic and property rights analysis', *Corporate Governance: An International Review*, Blackwell, 5:1. Pp. 11-23, January 1997, London. http://papers.ssrn.com/sol3/paper.taf?ABSTRACT_ID=11355

A search of my name in the Social Science Research Network (SSRN) web site listed above will identify a number of my other papers explaining how to build a locally owned and controlled sustainable stakeholder economy. The TOES book "Building Sustainable Communities" listed on my web page provide an analysis and guide to achieve this objective. By placing my name in leading search engines a number of popular articles on, or related to, my proposals may be identified. The most relevant recent refereed academic articles published in international journals are:

'Re-inventing Corporations', *Human Systems Management*, IOS Press, 10:3, pp. 169-186, 1991

'Stakeholder Democracy: Redesigning the Governance of Firms and Bureaucracies', *Journal of Socio-Economics*, 23:3, Fall, pp. 321-360, 1994.

'Stakeholder Co-operation', *Journal of Co-operative Studies*, Society for Co-operative Studies, 29:3, pp 18-52, (no.88), Manchester, January, 1997. http://papers.ssrn.com/sol3/paper.taf?ABSTRACT_ID=26238

'Should Ownership Last Forever?', *Journal of Socio-Economics,* 27:3, pp. 341-363, 1998.
http://papers.ssrn.com/paper.taf?abstract_id=137382
http://papers.ssrn.com/paper.taf?abstract_id=132108

I look forward to your advice as to how the matter may be best progressed and developed. I would be pleased to provide assistance to you and the department in this regard.

Yours faithfully

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APPENDIX C

Building a Sustainable Fulfilling Stakeholder Democracy

Published as 'Building a Stakeholder Democracy', in Conference Report No. 3, *Ambitions for our Future: Australian Views*, Economic Planning Advisory Commission, Australian Government Publishing Service, pp. 83-90, October, 1994, Canberra. Briefing paper for **National Strategies Conference**, Sydney, November 24-25th 1994.

Shann Turnbull*
President of the Australian Employee Ownership Association

Many Australians are demoralised by unemployment, alienated by insensitive bureaucracies, exploited by business, depressed by environmental degeneration, powerless to take control of their lives and cynical about the interest or the ability of politicians to make things better. Stakeholder democracy would resolve these problems by reducing the size and power of bureaucracies in either the public or private sectors. Citizens would obtain power to directly control their lives, neighbourhood and look after their environment. As stakeholder democracy would create a universal minimum income, policies of full employment could be replaced with a policy of fulfilment in employment.

The opportunity for Australia to establish itself in the next 30 years as an ecologically sustainable stakeholder democracy to provide all citizens with personal fulfilment will require fundamental changes in the way we govern ourselves. Beside significant changes to the Australian constitution, we need to also make substantial changes in our social institutions. Instead of relying only on market forces and the authority systems found in public and private bureaucracies to govern our lives we should place far more reliance on family and community relationships or common interest voluntary associations.

As property rights and money significantly govern our lives, their distribution and characteristics require changing if we are to build an equitable and ecologically sustainable society. To preserve the integrity of our bioregions, we need congruent political structures. To maintain bioregional capacity to yield nature's resources and preserve bio-diversity, we need matching diversity in our economic institutions, the means of production and choice of consumption. To achieve choice and diversity, we need to decentralise control of the economy.

Decentralisation facilitates economic equity, efficiency and the ability to manage the information complexity of new technology. New technology will in turn facilitate the development of a decentralised political economy. Decentralised communities create the best defence against political exploitation by foreign interests.

Decentralised control of government departments and large private enterprises would improve their performance if stakeholders who have the most knowledge and interest in their operations were involved. Operational stakeholders are individuals with some physical interaction with the organisation such as employees, clients, suppliers or members of the host community.

The Aboriginal and Torres Strait Islander Commission is an illustration of decentralised stakeholder democracy in the public sector. Its clients elect seventeen of its 20 commissioners. In the private sector, Australian research has confirmed overseas studies, which show that listed corporations with employee ownership out-perform those without stakeholder involvement. Businesses totally controlled by workers and customers around the town of Mondragón in Spain have a far lower failure rate and greater profitability than investor owned firms.

Both the Australian and State governments should immediately introduce stakeholder participation in the public sector. Privatisation provides an opportunity to create benchmarks of world's best practice for the private sector. Australia could become a world leader and export the social technology of stakeholder democracy.

However, while stakeholder democracy could improve the performance of both public and private sector institutions, it may not improve economic equity. Economic equity does not exist in Australia as less than 10% of the voters own more than 90% of the means of production. Substantial foreign ownership exacerbates this inequality. Expanding local ownership would reinforce the benefits of stakeholder democracy by expanding the number of voters who obtained the right to control through ownership.

It is only through local ownership that communities can obtain the power to control the nature and degree of exploitation of their environments. Stakeholder ownership becomes a fundamental strategy for building sustainable societies. Local ownership also maximises the incomes of voters by eliminating the export of economic values. This avoids resource rich bioregions becoming cash poor and allows each community to obtain the power to decide the trade-off between income and nurturing their environment. Stakeholder ownership minimises dependency, social alienation and exploitation while maximising the quality of life consistent with sustaining the environment.

Most importantly, stakeholder ownership introduces a 'Third Way' (refer to figure) for distributing national income. This new 'plumbing' creates a universal income to replace welfare. As all citizens are consumers, they would all become stakeholders and obtain property rights to dividend income. Dividends are the <u>only</u> way to distribute national income without work or welfare and taxation. This Third Way allows the scope, size and cost of government to be substantially reduced. It also increases incentives for expanding the breadth and value of private investment to increase dividends. An 'expanded ownership' strategy provides a way to privatise the tax and welfare system!

The opportunity for reducing taxes and expanding investment should be tied to expanding stakeholder ownership of investments. Foreign investment should be attracted only on the basis that local ownership is increased over time. The ownership transfer principle is illustrated by Build Own Operate and Transfer (BOOT) projects such as the Sydney Harbour Tunnel.

No commercial investor requires ownership forever to obtain the incentive to invest. Commercial investments are made on the expectation of obtaining a return of and on money invested within the investor's 'time horizon' during the foreseeable future. Any profits after the time horizon become surplus profits, as they are not required to provide <u>any</u> investment incentive. For most productive assets the foreseeable future is less than ten years unless there is some government support as found in infrastructure projects. For most investments, dividends after ten years represent surplus profits. Surplus profits are totally inconsistent with the economic or moral justification for a market economy.

The transfer of business ownership from investors to stakeholders after the investor's time horizon cannot, from the definition of a time horizon, produce any disincentive to invest. Australian law limits the life of patents to 16 years and so the capture of surplus profits after this period. Our government does not create a level playing field for investors by allowing them to capture surplus profits from corporations after 16 years. It is also against the interest of Australian voters to have their income and spending power reduced through the export of surplus profits to overseas investors. This now costs Australian voters billions of dollars, absorbs foreign exchange earnings, and exacerbates our overseas debt.

To minimise these costs, tax incentives are required to attract investors on the basis that ownership reverts to resident stakeholders over time. Companies should be given the choice of obtaining the rights to surplus profits by paying tax at the existing level or having their tax rate reduced, on condition that, say 5% of the ownership were transferred each year without cost to their resident stakeholders. In this way, participating corporations would become 100% resident owned within 20 years to terminate the export of surplus profits and introduce economic democracy.

A win-win result is created for shareholders, corporations, the government, the economy, citizens, management and other stakeholders. Shareholders would obtain higher dividends from the reduction in tax and profit retention. Corporations would continue and/or expand their operations through dividend re-investment into their "offspring" Ownership Transfer Corporations (OTCs). Government revenues would increase as the tax base transferred from corporations to resident individuals with a higher tax rate. At the same time, the distribution of income to stakeholders would reduce welfare entitlements and so the cost to government. The economy would export less surplus profits and lose less foreign exchange for all citizens. Management and employees would legitimate their control with part ownership shared with customers and all other stakeholders. The surplus profits captured by stakeholders would help expand the economy with new spending and investment.

Succession of business operations, management and investment would be provided through the creation of offspring companies and the re-capitalisation of OTCs after 20 years. To build an ecologically compatible society, the dynamic, time limited property rights inherent in OTCs also need to be incorporated in the structure of money and the way we own realty. These features are inherent in negative interest rate money and Community Land Banks (CLBs) described in *Building Sustainable Communities* and a number of my other writings.

CLBs would manage a contiguous precinct containing around 50,000 people and create a local government unit from which all higher levels of government would be based. No higher level of government would undertake any function, which would be better carried out at a lower level. Health, education and welfare services would be provided through the CLB, which would capture and re-distribute most economic values created by the community. CLBs, rather than individuals, would pay tax and appoint the next level of government. Economic and political power would trickle up rather than down this cascade system of governance. The control of business, social infrastructure and land would be exercised directly by their stakeholders to introduce locally owned economic democracy.

Dividends from CLBs would underwrite a universal minimum income for all residents. Unemployment would no longer be a concern as financially independent citizens competed to undertake meaningful unpaid activities. Voluntary associations and communitarian activities would replace much of the alienating and dysfunctional market forces and hierarchies which currently govern and intrude into our lives. Voluntary community activities would both occupy and support those without paid employment. Dividends for all citizens would allow residents to develop their personal potential and achieve fulfilment without the need for paid employment or welfare.

This is the world I would like to create for our children and their descendants.

oooOOOooo

Shann Turnbull, Dip. Elec. Eng. (Hobart); B.Sc. (Melbourne); MBA (Harvard); FAICD; FSIA; FAIM; FRSA has a stake in the future with three children aged 11, 10 and 8. Author of: *Democratising The Wealth of Nations* (1975); Parliamentary Papers on *The Economic Development of Aboriginal Communities in the Northern Territory* (1977/8) and co-author of *Building Sustainable Communities* (1989). He has won overseas awards for his proposals for economic reform and been invited to present them to the State Commission for Reform of the Economic System in Beijing and to the Central Research Institute for National Economy in Prague.

In 1975 he pioneered the teaching of company directors and the study of corporate governance as a founding author of *The Company Directors Course.* He has been Chairman of three listed corporations and has created and/or managed a number of enterprises and controls a business manufacturing industrial gearboxes.

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APPENDIX D

Savings from investment

Published as 'Theorists Confuse Savings Debate',
The Australian Financial Review, Opinion, p.13, January 10th 1996

Shann Turnbull*

The debate over national savings has been captured by opinion makers who do not understand that all procreative investments must create savings by increasing productivity. The best way to increase national savings is to increase the value of procreative investments rather than forcing people to forgo consumption by contributing to their superannuation or through other means.

Any government action which encourages people to forgo consumption will reduce the demand for goods and services. As demand is reduced, the incentive to invest to expand the economy will diminish. A contrary development process is established requiring a step backwards in consumption to create investment to go forward. It is also contrary because the money saved by forgoing consumption is more likely to be used for financing government debt, speculation in property, or other investments which do not expand output, income and savings.

Theorists have confused the debate by assuming that all savings are automatically channelled into investments which expand output. The only type of investment which can expand output are those which become procreative. These investments produce sufficient income over their operating life to generate values surplus to that required to pay for their cost.

The formation of procreative assets creates the only way in which nature can be made to yield her resources more abundantly without requiring people to work harder or longer. The productivity of procreative assets counters inflation. By generating surplus values they increase national income to permit savings to rise without the need to forgo consumption.

The higher standard of living may be reflected in a better quality of life through investments in environmental protection, collectables or consumer durables such as cars, household goods, houses, sporting and recreation facilities. Investment in these consumption assets absorb surplus values. They reflect rather than produce higher living standards.

The savings debate has been confused because policy makers do not distinguish between procreative and consumption assets. The confusion is created by economic text-books no longer identifying procreative assets and by economists defining investment as being identical to savings in the form of forgone consumption. Confusion is compounded by commentators who do not distinguish between investments that create new assets and those which simply finance the transfer of their ownership.

Confusion also arises from the word “capital” being used in misleading and/or ambiguous ways. The word can be used to describe many things including money, credit, paper assets like government debt, paper claims to real assets like corporate equity, total assets of a corporation, or physical assets which may or may not be procreative!

In political terms, the formation of procreative assets allows economic gains to be achieved without the pain of forgone consumption. In economic terms a virtuous circle is created of increased consumption generating new investment to raise both incomes and savings. Investment, income, consumption and savings can all be increased together to create a confluent development process.

The formation of procreative assets should never be constrained by the availability of finance. This is because all procreative assets must be self-financing. The banking system can be used to bridge their payback period. Even if domestic consumer demand did not increase, procreative assets can still reduce the current account deficit through the export of their output or by import substitution As Australia has under-employed labour and materials the only limitation for accelerating economic growth is the policy know-how of nurturing world competitive business investment.

Neither foreign loans or foreign equity investments are required to generate economic growth if we adopt monetary and fiscal policies to facilitate the formation of appropriate procreative assets. However, if our policy advisers do not understand the difference between consumption and procreative assets then they will see a level playing field and resist initiating policy changes.

Policy initiatives to create economic gains without political and social pain would provide a compelling basis for electing our next government. The question is do we have politicians who are not captive of muddle headed theorists?

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APPENDIX E

INVESTING OUR WAY OUT OF RECESSION: THE CASE FOR SELECTIVE MONETARY POLICY

Published as 'Investing our way out of recession',
The Australian Insurer, 3:3, p.2, March 19, 1992, Sydney

By Shann Turnbull*

A selective monetary policy is needed to roll back the recession without inflation. The recession was accentuated by a non-selective policy. This distorted the Australian monetary playing field by raising official interest rates 140% higher than their present level of 7.5%.

Small business creates more than 50% of the jobs and are the seed bed for new internationally competitive value adding growth activities. Yet, while big business may only pay 1% or 2% more than the official rate for their loans, small business can pay in excess of 6%.

With official rates at 7.5%, a 6% bank-lending margin creates a borrowing cost of 13.5%. If a business borrowed as much money as it had in turnover, its interest costs would now be 13.5% of revenues. However, a typical business has bank debts of only half its turnover, so interest costs would now be 6.75% of revenues.

Official rates of 18% during the last two years created bank-borrowing costs for some small businesses of 24%. This meant that interest costs represented 12% of sales. It is no wonder that this tilting of the playing field destroyed many businesses and made others even more uncompetitive internationally as the value of the high interest rates kept the Australian dollar around 5% higher then it would otherwise have been. Recent monetary policy has thus had the effect of placing a turnover tax on exporters equal to the 12% interest cost plus the 5% increase in the value of the dollar, a total of 17%!

The government has a dilemma in reducing interest rates further because this could reduce the value of the dollar and so increase the price of imports to fuel inflation. Too much government expenditure could have the same effect.

The answer is a selective monetary policy or the introduction of what is described in the literature as 'free banking'. Free banking is not an immediate practical policy option because it represents a fundamental change in the financial system and would require time to implement. We need to consider the free banking option to understand how the government system corrupts the playing field.

Before the creation of the Federal Government and its Reserve Bank at the beginning of this century, the structure of money, credit and banking was largely determined by the private sector and so by market forces. If such decentralised free banking existed today, competition would drive interest rates lower and provide as much low cost credit as was required to finance all sound productive investments. Competition between banks to issue sound money would keep inflation consistently low – as was achieved in both Australia and the U.S.A. before central banking.

If the government insists on eliminating free banking where interest rates and the volume of credit is determined by market forces, then it should use its monopoly monetary power to selectively introduce other market forces to make the economy more efficient.

One approach would be for the Reserve Bank to create money without an interest cost to provide the finance for qualified Employee Share Ownership Plans (ESOP's) which purchase newly issued shares in their employers to finance expansion of output. The loans would be distributed by the trading banks to ESOP's which qualified by meeting four conditions: (1) repayment of the loan, and so contraction of the money supply, was guaranteed with loan insurance from the non-bank sector – like home mortgage insurance, (2) funds are used to increase production and so reverse inflation, (3) employees are not liable for repayments of the loans which would be secured by the employer and/or the credit insurer, and (4) trading banks distributing the loans do not charge a handling fee in excess of 1%.

The cost of financing new investment would then become the 1% handling fee plus the guarantee fee charged by the non-bank sector to ensure that the loan would be repaid. The volume and cost of money to finance economic recovery would then be determined by the cost of the guarantee fee, which would be determined by market forces. Market forces would also determine which investments obtain low cost funds.

The government does not have to pick winners. It does not have to distort the playing field. Some people might consider interest free loans to qualified ESOP's as a concession or subsidy. It is not. It is simply the government giving up its power to earn a monopolist profit from official interest rates.

The cost of the guarantee fee might vary from less than 1% to more than 6%, depending upon the perceived risk. The cost of money to finance new investments would then become 2% to 7%. This would be in line with the cost of long term industrial finance in Japan.

The Managing Director of the Bank of Tokyo in Australia, recommended to a CEDA seminar last May that long term low cost finance should be made available for investment in plant and machinery. He pointed out that this is provided in leading manufacturing economies under GATT rules.

Our economic influence leaders do not seem to want to accept that Australia has substantial biases against industrial growth. They see any government initiative to assist business as creating a distortion rather than removing a cost introduced by the government. The cost of official interest rates is not created by market failure, but by the government!

Qualified ESOP loans would improve the integrity of the banking system, as they would not introduce any exposure to bad debts. Economic management is greatly simplified and improved as interest rates, which fuel property and currency speculation, need not be reduced. The need or incentive for businesses to attract foreign loans to finance their growth is also eliminated and hence reduces our foreign debt.

Our current non-selective monetary policy is recognised as a blunt instrument, which has bludgeoned business into the ground. Decentralised free banking was much more selective, as lenders preferred limiting loans based on credit expansion, to self-financing investments, which could pay for themselves. Business investments, which increase productivity to reverse inflation, meet these criteria. This is how inflation was kept under control in the last century. Selective credit creation was the means by which the "Japanese economic miracle" was financed without foreign debt or equity earlier this century.

Qualified ESOP's would create a market driven criteria for establishing selective monetary policy. They provide the means for financing investment out of the increased savings created by the resulting improved productivity. Australia would obtain the ability to internally finance economic growth without foreign debt or equity and without the need to reduce consumption to increase savings and investment, which inhibits the incentive to invest. Selective monetary policy would create a self-reinforcing development process where investment, savings, consumption and incomes could all increase together.

Qualified ESOP's loans provide a way for Australia to invest its way out of recession as proposed by the trade union movement. Union members would benefit directly with an ownership interest in the expanded productive capacity. This would also provide a way to increase the equity base of business and increase Australian ownership on a basis, which would be far more equitable and democratic. Without a selective monetary policy, what wealth that may be created will become more concentrated.

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APPENDIX F

Center for Economic and Social Justice

CAPITAL HOMESTEAD ACT

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THE CAPITAL HOMESTEAD ACT

The Capital Homestead Act is a comprehensive national economic strategy for empowering every American citizen, particularly the poorest of the poor, with the means to acquire, control and enjoy the fruits of productive corporate assets. This long-range agenda involves major restructuring of our tax system and our Federal Reserve policies to foster more equitable distribution of future corporate capital, faster rates of growth of private sector investment, and a shifting of mass purchasing power from inflationary wage and welfare patterns to profit sharing and dividend incomes. The Capital Homestead Act's central focus is the democratization of capital credit.

The Goals of the Capital Homestead Act

As summarized below, the Capital Homestead Act is designed to:

1) Generate millions of new private sector jobs by lifting ownership- concentrating Federal Reserve credit barriers, with the aim of accelerating private sector growth linked to expanded ownership opportunities, at a zero rate of inflation.

2) Radically overhaul and simplify the Federal tax system to eliminate budget deficits through a flat rate tax on all individual incomes from wages, profits and investment incomes, while:
a) eliminating payroll taxes on working Americans and their employers;

b) integrating corporate and personal income taxes; and

c) exempting incomes of the poor.

Major Policy Elements of the Capital Homestead Act

To shift the Federal Government's role from today's income redistribution policies to the more limited and healthier role of encouraging "economic justice" through free enterprise growth, a Capital Homestead Act should begin establishing:

<u>National Ownership Goals and Targets</u>. Set a realistic long-term target, based on the nation's industrial growth potential, to achieve a minimum Capital Homestead Stake for every American family, perhaps $100,000 over the next 20 years.

<u>Capital Homestead Exemption</u>. Establish a personal "Capital Homestead Exemption" (perhaps $500,000 per individual), thus providing every American an opportunity to accumulate over his or her working lifetime an income-producing, space-age equivalent of the 160 acres of land offered to landless Americans under the original Homestead programs, free from capital gains, inheritance, and gift taxes.

<u>Positive Policies for Private Sector Growth</u>. Re-create the conditions that resulted from the first Homestead Act of 1862: Full employment, declining prices--and a broad distribution of property ownership.

Planning for Maximum Growth, with a Balanced Budget and Zero Inflation Rate. Implement a peace-time counterpart of World War II's War Industrialization Board to bring together America's finest minds and prime movers to recommend ways to unharness maximum rates of sustainable private sector growth to achieve a balanced Federal budget and a zero inflation rate under the Capital Homestead Act, including reasonable national ownership targets and priorities.

Anti-Monopoly Reforms. Link all economic reforms to methods that discourage privileged access to or monopolistic accumulations of private property ownership of the means of production. Enforce anti-trust laws by providing access to capital credit to broadly owned new competitors to enhance and sustain market-oriented growth.

Democratization of Federal Reserve Credit. Reform Federal Reserve monetary policy (especially by reactivating the Fed's power to discount "eligible" commercial, industrial, and agricultural paper) to bring about a two-tiered, non-subsidized interest rate structure within member banks of the Fed. This reform would encourage more widespread individual access to lower-cost bank credit for ownership-expanding private-sector productivity growth, while allowing savers to receive market interest rates for non-productive or ownership-concentrating uses of credit, including government deficits.

Liquidity for Local Banks. Require the Fed to supply sufficient money and credit through local banks to meet the liquidity and broadened ownership needs of an expanding economy. Such "Fed facilitated" loans would be subject to appropriate feasibility standards administered by the banks and limited only by the goal of maintaining a stable value for the dollar.

Stabilized Value of Currency. Create a stable currency backed by productive private sector assets rather than non-productive public sector debt. Terminate use of the Fed's money-creating powers to support foreign currencies or to buy and sell Treasury securities, thus forcing governments to borrow directly from savers in the open markets.

A Tax System More Accountable to Taxpayers. Radically simplify the existing Federal tax system in ways that automatically balance the budget and make Congress more directly accountable and responsive to all taxpayers.

Removal of Tax Obstacles to Broadened Ownership. Eliminate tax provisions that unjustly discriminate against or discourage property accumulations and investment incomes, especially for poor and non-rich families.

Reduced Growth of Social Security System. Supplement and reduce growth of the Social Security System, by enabling every American to accumulate (through inheritances, gifts, ESOPs, IRAs, and other expanded ownership vehicles sheltered from taxes under the "Capital Homestead Exemption") sufficient wealth-producing assets to provide each person with an adequate and secure taxable income from property, independent of Social Security benefits and incomes from other sources.

Pro-Competition Policies. Remove economic bottlenecks to effective market competition so that just prices, just wages and just profits can be controlled by the laws of supply and demand, rather than by central planners, by fiat or regulation, by government-sanctioned monopolies, or by other coercive pressures.

A Market-Driven Wage and Price System. Gradually eliminate rigid, artificially-protected wage and price levels and other restrictions on free trade, which afford special privileges to some industries, businesses and workers at the expense of American and foreign customers of U.S. products. Selectively target duties on foreign products produced in violation of just market principles.

More Just Social Contract for Workers. Focus top priority during the next decade on developing a more just "social contract" for persons employed in the private sector, geared to maximum ownership incentives, so that instead of inflationary "wage system" increases, all employees can begin to earn their future gains increasingly through production bonuses, equity accumulations, and profit earnings linked to their personal efforts and to the productivity and success of their work team and the enterprise for which they work.

Restoration of Property Rights in Corporate Equity. Restore the original rights of "private property" to all owners of corporate equity, particularly with respect to the right to profits and in the sharing of control over corporate policies, while still safeguarding the traditional functions of professional managers.

More Harmonious Industrial Relations. Promote the right of non-management employees to form democratic trade unions and other voluntary associations for negotiating and advancing their economic interests, including their ownership rights, vis-à-vis management.

Expanding Equity Opportunities for Farm Families. Preserve farm families as the basic unit for maintaining self-sufficiency in meeting America's food supply, while discouraging the spread of ownership-concentrating conglomerate and foreign takeovers of prime agricultural lands. Equity sharing among dozens of farm families working together in large corporate agribusinesses would update the "family farm" concept.

Phasing-out of Agricultural Subsidies. Assist farmers who wish to associate together voluntarily in cooperatives and in enterprises jointly owned by farmers and workers, including integrated agribusinesses, for supplementing their farm incomes and reducing the need for subsidies.

Incentives for Research and Development. Encourage special ownership incentives for those engaged in research and development, especially in the search for new sources of energy and labor-saving technology.

Conservation of Resources. Develop new methods of conserving and re-cycling non-replenishable and limited natural resources that are vital to society's long-term survival, until suitable substitutes can be discovered and developed.

Property Incomes for Public Servants. Provide America's military, policemen and firemen, teachers, and other public employees with a growing and more direct equity stake in the free enterprise system, both as a supplement to their costly pension plans and so that they will better understand and defend the institution of private property.

Downsizing of the Public Sector. "People-ize" government-owned enterprises and services into competitive private sector companies, whenever feasible, by offering their employees (and customers in capital-intensive operations like TVA) opportunities to take over their ownership and control.

Prototype Policy Reforms for Local and Foreign Governments. Encourage State and local governments and other countries to promote widespread capital ownership as a basic pillar for building a sound market economy.

Localized Free Enterprise Zones. Launch several Capital Homesteading demonstrations, possibly in areas of high unemployment (like the Super Empowerment Zone proposed in 1996 for the District of Columbia) to evaluate ownership-broadening Federal Reserve reforms, innovative broadened ownership mechanisms and advanced concepts of worker participation in decision-making and self-management.

New Challenges for Multinationals. Provide special encouragement to U.S.-based multinational corporations to become instruments of peace and a more just world economic order, by broadening access to their ownership base to all citizens of the world community, especially for exploiting the resources of the sea and other planets.

Capital Homesteading Vehicles

The "employee stock ownership plan" or "ESOP" channels low-cost credit for financing the needs of business corporations (such as expansion, capitalization and ownership transfers), and links private sector workers to ownership shares and dividend incomes in the companies for which they work. Shares acquired by worker-owners are paid for out of the future corporate profits they help to generate.

The "community investment corporation" or "CIC" allows residents of a community to share in the control and profits associated with land planning and development.

The "consumer or customer stock ownership plan" or "CSOP" lets customers of utilities share in the governance and profitability of "natural monopolies," like telecommunications, water and power companies, mass-transit and cable television.

The "individual stock ownership plan" or "ISOP" is a way for individuals who do not work for profit-making enterprises to accumulate wealth and receive dividend incomes from newly issued shares in new and growing companies without being taxed on the accumulations (including property and shares gained through inheritance, savings, and arrangements like ESOPs, CSOPs and CICs). People who would use an ISOP could include school teachers, civil servants, military personnel, police, and individuals who have no remunerative employment, such as the totally disabled.

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For more details, see "The Capital Homestead Act: National Infrastructural Reforms to Make Every Citizen a Shareholder," published by the Center for Economic and Social Justice, Arlington, VA.

See also "Beyond ESOP: Steps Toward Tax Justice," Chapter 8 in Curing World Poverty: The New Role of Property, John H. Miller, ed., Social Justice Review: St. Louis, 1994.
To obtain these and other writings on tax and monetary reforms to promote expanded capital ownership, see the publications list appearing on our Web page, or contact:

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ESOP Incentives in the United States.   http://www.cesj.org/homestead/cha_esop.htm

Employer tax deduction. Up to 25% of participants' payroll may be deducted from the gross income of an employer to make principal payments on an ESOP loan used to acquire employer securities. Deductible contributions in excess of 25% are permitted to the extent the excess is used to pay interest expense on an ESOP loan.

Employee tax deferral. The annual addition that may be allocated to each participant's account in the plan cannot exceed the lesser of 25% of pay or $30,000. Stock acquired for employees' accounts is not taxed until distributed. Distributions are taxed at original cost utilizing 5-year averaging rates if received in a lump sum after age 59-1/2, on account of separation from service or due to death or disability.

Rollover of gain. If, after a sale of stock to an ESOP, at least 30% of the stock of a closely-held company is held by the plan, tax is deferred on any gain realized by selling shareholders to the extent that proceeds are "rolled over" (reinvested) within a 15 month period beginning three months prior to the sale in securities of other operating companies.

Dividend deductions. Companies may claim a deduction for dividends paid on ESOP-held stock, provided the dividends are either applied to repay an ESOP loan or paid out to employees on a current basis.

The tax incentives for share investing in the UK are set out in the web pages of Proshare

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