

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

903 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80 703

The heart of the scheme is credit, the power to borrow money. As Gravel and Kelso see the world, ordinary people, even poor people, could accumulate wealth in the same way that well-to-do people make their assets grow, if the government will intervene. A person who has sufficient assets or earnings to guarantee his or her credit can borrow money to make investments, pledging to pay back the loan with the new income expected from the investments.

If the venture is a success, the person winds up with new capital that paid for itself, but nobody calls this process a "giveaway." It's called "risk-taking" in the free enterprise system.

Gravel's notion is that government, which in effect aggregates the assets of all citizens, can provide a mechanism for extending a share of credit to everyone—a chance to buy something based on its anticipated future earnings.

That concept is the essential novelty of Gravel's scheme. Beyond that point, the proposition works more or less like ordinary business transactions, with the same tax benefits, the same risks. The citizen-owned corporation would enjoy the same tax treatment as a partnership or a certain corporation with a limited number of stockholders (known as "Subchapter S" Corporations). The GSOP would be exempt from paying corporate income tax on its own earnings, but it would have to distribute at least 90 percent of its profits every year to shareholders who would each pay individual income tax on the money. The GSOP could not, however, pass through losses, so its shareholders could not use it as a tax shelter.

The Treasury Department objected to Gravel's original version because he had tucked in additional, more exotic "tax benefits." When the tax experts studied his final proposal, however, they concluded that the U.S. Treasury would lose little or nothing.

Gravel contends the federal government will actually collect more revenue under his plan because the profits now collected by British Petroleum, for instance, are "sheltered" from taxation by various provisions of the tax code. If some of that profit goes directly to individuals, it could yield as much as \$40 million in income taxes, Gravel claims.

If the GSOP decided to buy BP's share, it would have to go to a friendly banker somewhere, presumably on Wall Street, and ask to borrow the \$1.5 billion needed. The banker would make a calculation on whether it is a good risk or not. If the pipeline looked as if it wouldn't "pay out" as handsomely as the company's projections, then the GSOP would either be turned down or be forced to pay high-risk interest rates that might kill the whole idea.

But, if the Trans-Alaskan pipeline

is such a good deal, how come British Petroleum wants to get out of it? That question leads into arcane subjects where only experts tread with confidence—pipeline economics, corporate debt structure and optimum rates of return for oil companies.

British Petroleum, which has expressed no more than an informal interest in selling, has complained about its low earnings from the pipeline so far, which suffered from an explosion and shutdown last year. It is the only major partner that doesn't also own a share of the North Slope oil field. The state of Alaska, like Exxon and Arco and the others, does own production shares in the oil field.

"If you own a share of the oil field," said John Gore, BP's Washington representative, "it's economic to own a share of the pipeline. If you don't hold a share of the oil field, it doesn't look so good."

BP has one of the highest debt-equity ratios among petroleum majors and some think the company would like to extract its investment from the Alaskan pipeline so it can spend the money closer to home—drilling more oil wells in Britain's North Sea fields.

In any case, one reason the pipeline looks less attractive to the British company today is that the state government of Alaska has been fighting the oil companies over how much the pipeline can charge to move the crude oil. The state collects a severance tax on all oil pumped in Alaska, but transportation costs are deducted from the tax—so a higher pipeline fee means less tax revenue for the state government and vice versa.

This is a political hook that could have important implications for the future development of energy projects.

Right now, the oil companies are asking federal regulators for a pipeline tariff of \$6.35 per barrel, while state tax officials insist that a fee of \$4.68 is all that can be justified. For the state treasury, the difference represents about \$140 million a year in severance tax revenue. But, if Alaskan citizens owned BP's share, the higher tariff would deliver an additional \$106 million to their citizen-owned corporation.

Question: Would Alaskans prefer a lower tariff that sends more tax money to the state capital or a higher tariff that adds more money to their own dividend checks? The political message from the citizens could very well be: Get off the backs of the oil companies.

Sen. Gravel claims this possibility is one of the major benefits of his proposal. "You set in motion a conflict between the citizens and the government," he said, "and you give the citizen a handle for seeing what the government is doing."

Alaska Revenue Commissioner Sterling Gallagher, originally skeptical about Gravel's proposal because of its tax implications, is now a supporter. He agrees this political tension is likely, but he sees that as healthy. In any case, Gallagher doesn't think the GSOP would go forward with the

pipeline purchase until the tariff issue is settled conclusively by the Federal Energy Regulatory Commission.

"It's hard for people to tell what government is doing for them," Gallagher said. "If there is wealth in the state — public wealth — I think we should distribute it to the people and let them decide how to use it."

Citizen ownership, in Gravel's argument, is an alternative to state socialism—a way to distribute the benefits of corporate capitalism without nationalizing private enterprises and turning over their management to politicians and bureaucrats. For several years, Alaska has been contemplating whether the state government should acquire shares of the new energy venture, so Gravel sees the GSOP approach as an alternative to state ownership.

Construction of the huge natural gas pipeline, for instance, still depends upon raising the capital, and some industry officials believe it can't be done without government participation of some kind, either direct investment or by loan guarantees.

If government is going to share in the risk-taking, Gravel thinks it makes more sense to pass on the benefits to individual citizens, rather than the public treasury.

In many ways, Alaska is a unique laboratory for this idea. It has a very small population and a promising, undeveloped future. But Gravel and Gallagher, among others, think the GSOP model can be widely copied in other states—as provided by the tax legislation — and applied to certain types of ventures seeking new capital, such as natural resource projects or public utilities.

Gravel likes to suggest that Potomac Electric Power Co., which sells electricity to metropolitan Washington, could be forced to obtain its new capital from a corporation owned by all of Pepco's customers, from the very poor to the very rich. Nobody would make a fortune, but it would take a little of the pain out of rate increases.

Despite Gravel's probusiness rhetoric, some conservatives are still offended by the idea of "giving" equity to people who haven't paid anything for it. In the Senate Finance Committee, Sen. John Danforth (R-Mo.) asked how he could explain this to his constituents, and Gravel responded rather tartly, considering that Danforth is an heir to the Ralston-Purina fortune.

"Here is how you explain it to the people of Missouri," Gravel replied.

"You say, if you are a citizen of Missouri and you inherited \$10 million, you are well off and you got it for nothing and that is okay in our capitalist society . . . so we are going to fix it so that you can do like the wealthy people—go borrow money on your net worth and take that money and put it into something and let that simply pay the cost of the loan and then pay you wealth thereafter. I think the people of Missouri would jump up in the air and say, 'Hosanna! Somebody finally is letting us have a piece of the action.'"

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Alaska Inc.: An Economic Experiment

Senator's Plan Would Distribute State's New Wealth to Citizens

By William Greider
Washington Post Staff Writer

Alaska, a state where pioneering is still a daily reality, wants to launch a grand experiment in economic democracy—distributing new wealth to all its citizens, giving each an owner's share in Alaska's bountiful energy development.

If the scheme works, every Alaskan—men, women, childrer—will hold stock shares in huge capital investments such as the Trans-Alaskan oil pipeline or the proposed natural gas pipeline or a future petrochemical complex. Every year, citizens would each receive dividend checks of several hundred dollars or more and, every year, their share of equity interest would grow.

In addition to spreading cash among the citizens, the idea might produce political benefits for the oil companies. If people have a personal stake in the profits, the public may be more sympathetic when private enterprise complains about government regulation and taxation.

Is the capitalist revolution upon us? The "general stock ownership plan" (GSOP) is the brainchild of Sen. Mike Gravel (D-Alaska), who derived the idea from the economic philosophy of Louis Kelso, a prophet of broadened capital ownership for workers. Last week, without any fanfare, the federal tax-law changes necessary for the venture were enacted by Congress in its omnibus tax bill, now awaiting the president's signature.

"This idea has floated around for years and nobody has taken it seriously," Gravel said. "But wait until the day when the first dividend checks go out to every citizen of Alaska. When the long green touches their hands, you will see a revolution begin."

Gravel, his enthusiasm getting somewhat ahead of events, predicts the Alaskan venture will alter American politics and economics in profound ways, as other states rush to copy the model. The senator sells it as the alternative to welfare-state liberalism, as the way "to build a constituency for capitalism."

The potential political effects are almost as intriguing as the presumed economic benefits. Gravel's plan would make all citizens into minority partners with the major oil companies, a fact that could greatly alter public opinion on issues such as state taxation of energy ventures. If a citizen holds a personal stake in energy profits, albeit a small one, he or she may not like the idea of the state government increasing its taxes on those profits in order to finance public programs.

In the meantime, the state government of Alaska has not yet committed itself to do anything beyond studying the idea.

The legislature has placed Louis Kelso's San Francisco investment firm under a \$180,000 contract to draw up the blueprint for this economic creature—a state-chartered corporation owned by everyone, empowered to borrow money, perhaps with a credit guarantee from the state, and to invest the money in private business ventures. Earnings from the venture would pay off the loan and the leftover profits would be distributed every year as dividends to each of the 405,000 citizen stockholders.

For starters, Gravel thinks the GSOP corporation might buy out British Petroleum's 16 percent share in the oil pipeline. Owned jointly by eight oil companies, the pipeline is already carrying North Slope crude oil south for distribution. BP has expressed an interest in selling its investment, valued at \$1.5 billion, and the senator's staff calculates that, when the pipeline is at full capacity, BP's share of the revenue would run about \$406 million a year.

This would be enough for the GSOP corporation, according to Gravel, to cover the operating costs plus the annual debt payments and still leave about \$158 million a year for distribution in dividends.

That means about \$390 per person. Nobody will get rich on \$390, but a family of four would have four dividend checks coming every year, or \$1,560. This could make a real difference to a poor family, Gravel reasons, offsetting some of the government obligations to provide welfare and subsidized services.

Since the value of an oil pipeline depreciates as it ages, the citizen stock would presumably be worth considerably less than \$1.5 billion when the debt is finally paid off in 15 or 20 years. After five years, however, a citizen could sell his or her share for the going price.

To avoid concentrated ownership, nobody could hold more than 10 shares.

Each share of stock would have a single vote to elect the officers of the GSOP corporation, who in turn would have 16 percent worth of influence over the pipeline company itself.

Among other things, the Alaska legislature has to decide who qualifies as a "citizen." One idea is to set a cutoff date of Jan. 1 this year, so the state would not be flooded with new immigrants seeking a share of stock.

Down the road a way, Gravel envisions several layers of citizen investment on a grander scale—another stock issue to help finance the multi-billion-dollar gas pipeline expected to be built in the 1980s, another to share in a vast petrochemical complex envisioned for the Kenai Peninsula. If Gravel's wish list were to become reality over the next decade, Alaskans would be drawing modest second incomes in addition to their wages—a collection of dividend checks.

At this point, the reader of normal intelligence is probably rolling his eyes and wondering if Sen. Gravel and the Alaska legislature have gone bonkers, not to mention the U.S. Congress, which has authorized the experiment. It all sounds too good to be true. Where is the hidden catch? And who pays the bill for this redistribution of wealth?

That is approximately the reaction that Gravel encountered last March when he first proposed the scheme to the state legislature and, again, this summer when he tried it out on the Senate Finance Committee. With a little persuasion from Sen. Russell B. Long (D-La.), the committee chairman and an advocate himself of broadened ownership, the Congress decided to let Gravel try out his mini-revolution.

Long has said privately that, if Gravel's idea works, and it may or may not, it would become the most significant item in the 1978 tax legislation.

"SEC. 1397. SPECIAL RULES APPLICABLE TO AN ELECTING GSOC.

"(a) **GENERAL RULE.**—The current earnings and profits of an electing GSOC as of the close of its taxable year shall not include the amount of taxable income for such year which is required to be included in the gross income of the shareholders of such GSOC under section 1393(a).

"(b) **SPECIAL RULE FOR AUDIT ADJUSTMENTS.**—

"(1) **TAXABLE INCOME.**—Taxable income of an electing GSOC shall, in the year of final determination, be increased or decreased, as the case might be, by any adjustment to taxable income for a prior taxable year.

"(2) **INVESTMENT CREDIT.**—The investment credit of an electing GSOC shall, in the year of final determination, be increased or decreased, as the case might be, by any adjustment to the net investment credit for a prior taxable year.

"(3) **METHOD OF MAKING ADJUSTMENTS.**—An electing GSOC shall include in gross income for the year of an adjustment the amount described in paragraph (1) and shall take into account the adjustment described in paragraph (2), and shall be liable for payment of interest in the amount that would have been payable by the GSOC under section 6601 (relating to interest on underpayment, nonpayment or extensions of time for payment, of tax) or receivable by the GSOC under section 6611 (relating to interest on overpayments) if such GSOC had been a corporation other than an electing GSOC."

(b) **TECHNICAL AMENDMENTS.**—

(1) **NET OPERATING LOSS DEDUCTION.**—Paragraph (1) of section 172(b) (relating to net operating loss carrybacks and carryovers) is amended by adding at the end thereof the following new subparagraph:

"(H) In the case of an electing GSOC which has a net operating loss for any taxable year such loss shall not be a net operating loss carryback to any taxable year preceding the year of such loss, but shall be a net operating loss carryover to each of the 10 taxable years following the year of such loss."

(2) **INCOME TAX COLLECTED AT SOURCE.**—Section 3402 (relating to income collected at source) is amended by adding at the end thereof the following new subsection:

"(r) **EXTENSION OF WITHHOLDING TO GSOC DISTRIBUTIONS.**—

"(1) **GENERAL RULE.**—An electing GSOC making any distribution to its shareholders shall deduct and withhold from such payment a tax in an amount equal to 25 percent of such payment.

"(2) **COORDINATION WITH OTHER SECTIONS.**—For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, distributions of an electing GSOC to any shareholder which are subject to withholding shall be treated as if they were wages paid by an employer to an employee."

(3) **ADJUSTMENTS TO BASIS.**—Section 1016 (a) (relating to adjustments of basis) is amended by redesignating paragraph (23) as (22) and by inserting after paragraph (20) the following new paragraph:

"(21) to the extent provided in section 1395 in the case of stock of shareholders of a general stock ownership corporation (as defined in section 1391) which makes the election provided by section 1392; and"

(4) **RETURN OF GENERAL STOCK OWNERSHIP CORPORATION.**—Subpart A of part III of subchapter A of Chapter 61 (relating to information returns) is amended by adding at the end thereof the following new section:

"SEC. 6039B. RETURN OF GENERAL STOCK OWNERSHIP CORPORATION.

"Every general stock ownership corporation (as defined in section 1391) which makes the election provided by section 1392 shall make a return for each taxable year,

stating specifically the items of its gross income and the deductions allowable by subtitle A, the amount of investment credit or additional tax, as the case may be, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purpose of carrying out the provisions of subchapter U of chapter 1, as the Secretary may by regulation prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012. Every GSOC shall file an annual report with the Secretary summarizing its operations for such year."

(c) **CLERICAL AMENDMENTS.**—

(1) The table of subchapters for chapter 1 is amended by adding at the end thereof the following:

"SUBCHAPTER U.—General stock ownership plans."

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following:

"Sec. 6039B. Return of general stock ownership corporation."

(d) **EFFECTIVE DATE.**—The amendments made by this section shall apply with respect to corporations chartered after December 31, 1978, and before January 1, 1984.

GENERAL STOCK OWNERSHIP PLANS: Title VI, Sec. 601, H.R. 13511

TITLE VI—GENERAL STOCK OWNERSHIP CORPORATIONS

Sec. 601. ESTABLISHMENT AND TAXATION OF GENERAL STOCK OWNERSHIP CORPORATIONS AND THEIR SHAREHOLDERS.

(A) IN GENERAL.—Chapter 1 (relating to normal taxes and surtaxes) is amended by adding at the end thereof the following new subchapter:

"Subchapter U—General Stock Ownership Corporations

"Sec. 1391. Definitions.

"Sec. 1392. Election by general stock ownership corporation.

"Sec. 1393. Corporation taxable income taxed to shareholders.

"Sec. 1394. Rules applicable to distributions of electing general stock ownership corporations.

"Sec. 1395. Adjustments to basis of stock of shareholders.

"Sec. 1396. Minimum distribution.

"Sec. 1397. Special rules applicable to earnings and profits of an electing general stock ownership plan.

"Sec. 1391. DEFINITIONS.

"(a) GENERAL STOCK OWNERSHIP CORPORATION.—For purposes of this subchapter, the term 'general stock ownership corporation' (hereinafter referred to as a 'GSOC') means a domestic corporation which—

"(1) is not a member of an affiliated group (as defined in section 1504), and

"(2) is chartered and organized after December 31, 1978, and before January 1, 1984;

"(3) is chartered by an act of a State legislature or as a result of a State-wide referendum;

"(4) has a charter providing—

"(A) for the issuance of only 1 class of stock,

"(B) for the issuance of shares only to eligible individuals (as defined in subsection (c));

"(C) for the issuance of at least one share to each eligible individual, unless such eligible individual elects within one year after the date of issuance not to receive such share;

"(D) that no share of stock shall be transferable—

"(i) by a shareholder other than by will or the laws of descent and distribution until after the expiration of 5 years from the date such stock is issued by the GSOC except where the shareholder ceases to be a resident of the State;

"(ii) to any person other than a resident individual of the chartering State;

"(iii) to any individual who, after the transfer, would own more than 10 shares of the GSOC;

"(E) that such corporation shall qualify as a GSOC under the Internal Revenue Code;

"(5) is empowered to invest in properties (but not in properties acquired by it or for its benefit through the right of eminent domain).

For purposes of this subsection, section 1504 (a) shall be applied by substituting '20 percent' for '80 percent' wherever it appears.

"(b) ELECTING GSOC.—For purposes of this subchapter, the term 'electing GSOC' means a GSOC which files an election under section 1392 which, under section 1392, is in effect for such taxable year.

"(c) ELIGIBLE INDIVIDUALS.—For purposes

of subsection (a), the term 'eligible individual' means an individual who is, as of a date specified in the State's enabling legislation for the GSOC, a resident of the chartering State and who remains a resident of such State between that date and the date of issuance.

"(d) TREATED AS PRIVATE CORPORATION.—For purposes of this title, a GSOC shall be treated as a private corporation and not as a governmental unit.

"(e) STUDY OF GENERAL STOCK OWNERSHIP CORPORATIONS.—The staff of the Joint Committee on Taxation shall prepare a report on the operation and effects of this subchapter relating to GSOC's. An interim report shall be filed within two years after the first GSOC is formed and a final report shall be filed by September 30, 1983.

"SEC. 1392. ELECTION BY GSOC.

"(a) ELIGIBILITY.—Except as provided in section 1393, any GSOC may elect, in accordance with the provisions of this section, not to be subject to the taxes imposed by this chapter.

"(b) EFFECT.—If a GSOC makes an election under subsection (a) then—

"(1) with respect to the taxable years of the GSOC for which such election is in effect, such corporation shall not be subject to the taxes imposed by this chapter and, with respect to such taxable years and all succeeding taxable years, the provisions of section 1396 shall apply to such GSOC, and

"(2) with respect to each such taxable year, the provisions of section 1393, 1394, and 1395 shall apply to the shareholders of such GSOC.

"(c) WHERE AND HOW MADE.—An election under subsection (a) may be made by a GSOC at such time and in such manner as the Secretary shall prescribe by regulations.

"(d) YEARS FOR WHICH EFFECTIVE.—An election under subsection (a) shall be effective for the taxable year of the GSOC for which it is made and for all succeeding taxable years of the GSOC, unless it is terminated under subsection (f).

"(e) TAXABLE YEAR.—The taxable year of a GSOC shall end on October 31 unless the Secretary consents to a different taxable year."

"(f) TERMINATION.—The election of a GSOC under subsection (a) shall terminate for any taxable year during which it ceases to be a GSOC and for all succeeding taxable years. The election of a GSOC under subsection (a) may be terminated at any other time with the consent of the Secretary, effective for the first taxable year with respect to which the Secretary consents and for all succeeding taxable years.

"SEC. 1393. TAXABLE INCOME TAXED TO SHAREHOLDERS.

"(a) GENERAL RULE.—The taxable income of an electing GSOC for any taxable year shall be included in the gross income of the shareholders of such GSOC in the manner and to the extent set forth in this subsection.

"(1) AMOUNT INCLUDED IN GROSS INCOME.—Each shareholder of an electing GSOC on any day of a taxable year of such GSOC shall include in his gross income for the taxable year with or within which the taxable year of the GSOC ends the amount he would have received if, on each day of such taxable year, there had been distributed pro rata to its shareholders by such GSOC an amount equal to the taxable income of the GSOC for its taxable year divided by the number of days in the GSOC's taxable year.

"(2) TAXABLE INCOME DEFINED.—For purposes of this section, the term 'taxable income' of a GSOC shall be determined without regard to the deductions allowed by part VIII of subchapter B (other than deductions allowed by section 248, relating to organizational expenditures).

"(b) SPECIAL RULE FOR INVESTMENT CREDIT.—The investment credit of an elect-

ing GSOC for any taxable year shall be allowed as a credit to the shareholders of such corporation in the manner and to the extent set forth in this subsection.

"(1) CREDIT.—There shall be apportioned among the shareholders a credit equal to the amount each shareholder would have received if, on each day of such taxable year, there had been distributed pro rata to the shareholders the electing GSOC's net investment credit divided by the number of days in the GSOC's taxable year.

"(2) NET INVESTMENT CREDIT.—For purposes of this paragraph the term 'net investment credit' means the investment credit of the electing GSOC for its taxable year less any tax from recomputing a prior year's investment credit in accordance with section 47.

"(3) RECAPTURE.—There shall be apportioned among the shareholders of a GSOC, in the manner described in paragraph (1), an additional tax equal to the excess of any tax resulting from recomputing a prior year's investment credit in accordance with section 47 over the investment credit of the GSOC for its taxable year.

"SEC. 1394. RULES APPLICABLE TO DISTRIBUTIONS OF AN ELECTING GSOC'S

"(a) SHAREHOLDER INCOME ACCOUNT.—An electing GSOC shall establish and maintain a shareholder income account which account shall be—

"(1) increased at the close of the GSOC's taxable year by an amount equal to the GSOC's taxable income for such year, and

"(2) decreased, but not below zero, on the first day of the GSOC's taxable year by the amount of any GSOC distribution to the shareholders of such GSOC made or treated as made during the prior taxable year.

"(b) TAXATION OF DISTRIBUTIONS.—Distributions by an electing GSOC shall be treated as—

"(1) a distribution of previously taxed income to the extent such distribution does not exceed the balance of the shareholder income account as of the close of the taxable year of the GSOC, and

"(2) a distribution to which section 301(a) applies but only to the extent such distribution exceeds the balance of the shareholder income account as of the close of the taxable year of the GSOC.

"(c) DISTRIBUTIONS NOT TREATED AS A DIVIDEND.—Any amounts includible in the gross income of any individual by reason of ownership of stock in a GSOC shall not be considered as a dividend for purposes of section 116.

"(d) REGULATIONS.—The Secretary shall have authority to prescribe by regulation, rules for treatment of distributions in respect of shares of stock of the GSOC that have been transferred during the taxable year."

"SEC. 1395. ADJUSTMENT TO BASIS OF STOCK OF SHAREHOLDERS.

"The basis of a shareholder's stock in an electing GSOC shall be increased by the amount includible in the gross income of such shareholder under section 1393, but only to the extent to which such amount is actually included in the gross income of such shareholder.

"SEC. 1396. MINIMUM DISTRIBUTIONS.

"(a) GENERAL RULE.—A GSOC shall distribute at least 90 percent of its taxable income for any taxable year by January 31 following the close of such taxable year. Any distribution made on or before January 31 shall be treated as made as of the close of the preceding taxable year.

"(b) IMPOSITION OF TAX IN CASE OF FAILURE TO MAKE MINIMUM DISTRIBUTION.—If a GSOC fails to make the minimum distribution requirements described in subsection (a), there is hereby imposed on the GSOC a tax equal to 20 percent of the excess of the amount required to be distributed over the amount actually distributed.

Liability would be generated. If investments have been made, the valuation of the shares should be made on a net asset basis so that if the GSOC investment were 100 percent leveraged, the shares distributed would have zero value and no income would accrue. If the shareholder receives his shares free of tax, he would have a zero basis in his stock at the time of receipt.

Eighth. If the GSOC shareholders are taxed on the income of the corporation, how do they receive this income and what is the treatment of distributions?

Distributions from a GSOC's taxable income previously taxed to a shareholder will be treated as a tax-free distribution. Any distribution in excess of such previously taxed income will be taxed in the same manner as a distribution from a regular corporation—section 301(c). Such distributions will first be treated as a tax-free reduction in basis to the extent thereof with any distribution in excess of basis treated as income from the sale or exchange of a capital asset. A GSOC will be required to distribute 90 percent of its taxable income to its shareholders by January 31 of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the difference between the required distribution and the actual distribution is imposed on the GSOC. The amount of such tax is allowed as a deduction to the GSOC for the year in which it is paid.

Ninth. Are there any special filing requirements for GSOC's?

GSOC's are required to file Federal income tax returns meeting the timing requirements of regular corporate returns and showing information reported to each shareholder. GSOC's are also required to provide each shareholder a form 1099 showing the shareholder's—first, pro-rata income from the taxable year; second, tax-free distributions for the year; third, tax treatment of other distributions; fourth, amount of any investment credit or recapture for such year; and fifth, amount withheld for Federal income tax purposes. Regulations implementing the reporting requirements and other provisions of subchapter U should be given priority in light of the limited time within which

GSOC's may be chartered.

Tenth. If the GSOC distributes all of the shareholder's portion of the GSOC earnings, what is to prevent the shareholder from spending this money prior to tax time and being left with a tax liability and no cash?

GSOC's must withhold an amount equal to 25 percent of every distribution made to their shareholder except shareholders who, under regulations issued by the Treasury, certify that they are non-taxpayers. The amount of such withholding will be allowed as a refundable credit to the shareholders.

Eleventh. Will the GSOC really be a breakthrough in the battle to broaden capital ownership. If so how will we know?

GSOC's are required to file annual reports with the Treasury summarizing their operations for each year. As the primary sponsor of the GSOC provisions I intend that these reports include studies of the effect of the GSOC on distribution of income and wealth, the level of transfer payments made or required, the social and demographic profiles of GSOC shareholders, the level of economic understanding of GSOC shareholders, and possible beneficial revisions to the GSOC legislation. The bill also requires the staff of the Joint Committee on Taxation to undertake a study of the operation and effect of GSOC's on capital formation, income and capital distribution, competing businesses, integration of the corporate and personal income tax, and the workability of the dividend withholding system. Through these studies I hope we can quantify the effect of GSOC's on expanding capital ownership. I would also like to see the Joint Committee address the broader question of capital ownership in our society and suggest to the Congress a system for annual measurement of our progress in broadening the ownership of capital in America.

of 5 years from ~~insurance, death, or failure to meet the State residency requirements.~~ The GSOC must be chartered after December 31, 1978 and before January 1, 1983 and may not own more than 20 percent of any subsidiary corporation. GSOC investments are not limited, but a GSOC may not acquire a business from an unwilling seller through the State's power of eminent domain. This limitation does not apply to the State's power to acquire a right-of-way for a particular project, but precludes the involuntary sale of a business to the GSOC.

Third. What does the legislation mean when it refers to stock being distributed to "eligible individuals?"

An eligible individual is any individual who is a resident of the chartering State as defined in the State's enabling legislation so long as the definition is consistent with constitutional principles.

Fourth. GSOC's are entitled to taxation in a unique manner. What is the special tax treatment of these corporations?

GSOC's may elect to be exempt from Federal income taxation. The shareholders of an electing GSOC will report their proportionate share of the GSOC's taxable income on their Federal individual income tax returns. The election, made in a manner to be determined by regulation, is effective for the taxable year for which made on a timely filed return. The election may be terminated with the consent of the Secretary of Treasury. It would be appropriate for the Secretary to consent to revocation for a taxable year where the tax liability of GSOC shareholders significantly exceeds cash distributions. Once the election is terminated the GSOC is subject to the normal Federal income tax and may not re-elect. The taxable year of an electing GSOC shall end October 31, unless the Secretary of Treasury consents to a different taxable year.

A GSOC will compute its taxable income in the same manner as other corporations, but is not eligible for a dividends received deduction nor any tax credits. The GSOC is entitled to a 10-year carryover of any net operating losses. An audit adjustment resulting from an Internal Revenue Service final determination will be reflected in the

GSOC's taxable year in which such adjustment is made and not the taxable year to which it relates. The amount of such adjustment will be subject to an interest charge in an amount computed as though the income had been taxed to a nonelecting corporation.

Fifth. The corporation itself does not pay Federal income tax, but the income of the corporation is taxed to the shareholders?

Yes, each shareholder will include in his gross income his daily prorated share of the GSOC's taxable income. The shareholder will also be entitled to his pro-rata share of the GSOC investment credit and liable for any recapture computed at the corporate level. Income credits and recapture will be included in the shareholder's gross income and reported on his return for the taxable year in which or with which the GSOC's taxable year ends. The income will be treated as ordinary income to the shareholders and will not be eligible for either the partial dividend exclusion—section 116—or the maximum tax on earned income. The shareholders of the GSOC will not be eligible to report any portion of a GSOC net operating loss on their returns and neither the corporation nor the shareholders will be entitled to the foreign tax credit on taxes paid by the GSOC.

Sixth. What about the shareholder's basis in his stock?

Shareholders will increase the tax basis of shares of GSOC stock to the extent they report income from the GSOC. Shareholders not required to file returns will increase the tax basis of shares to the extent they were attributed income from the GSOC. Distributions from the GSOC out of previously taxed income will decrease the tax basis of such shares.

Seventh. What about distributions of the stock itself. Will the shareholder be taxed upon receipt of the stock and will he receive a basis in his share at the time of receipt?

If the shares are distributed before any investment has been made by the GSOC, the shares will be treated as having a zero value as of the date of receipt. Therefore, no income would accrue to the shareholder upon receipt and no tax

Pro-rata-perceive future income

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By William Greider

THINKING has come, perhaps, to ask the question: "Does liberalism have always checked? Who checks liberalism? Why do the wealth of this fantastic capitalism nation distributed so unjustly? Why must capital and its attendant political power be concentrated in the hands of the few while the masses live only a mortgage and, if they are lucky, a modest pension? — The question themselves sound vaguely Marxist, which is one reason why welfare-state liberals have always checked. Liberalism is defined and disciplined by its right-wing adversaries, whose red-baiting effectively "cures off" new ideas, even new questions. I could make an argument that the long march of liberal solutions to social injustice — tinkering with wage floors, moving cash from one group to another, propping up the poor and the weak, protecting the sick and the jobless from catastrophe — all these are evidence of the more fundamental questions about wealth and its gross maldistribution.

If liberal government could not do anything about the distribution of wealth, then it must concentrate on wages and particular benefits, propelling the welfare state deeper and deeper into private economic choices. Essentially, the federal government hands out coupons, little tickets that entitle qualified citizens to buy food at a supermarket, to occupy an apartment in a subsidized building, to buy medicine at the ghetto pharmacy, to pick up a little cash on the first of the month, to bill the Treasury for cat's stretch skin.

No one who has talked to the rank and file of these people or examined their social conditions can feel very satisfied with the results. Real wages and suffering and hunger, truly are afflicted, but these people, still poor, have become enemies of the government.

The Ideal Songstress, knowing that real inspirations in ordinary

lives have flowed from the security programs, will limit on renewed dedication to the concept. If injustice persists, if some people still live in degradation while the rest of us live in royal luxury, then we must tinker with the coupons. Increase their cash value. Or invest new coupons for other items that these people cannot afford. Cars? Air conditioners? French bread?

Roughly speaking, this is the road American politics traveled to its present frustration. The liberal mind-set, honorable and well-intentioned, cannot confront the natural limits that always will stand in its way. One crucial boundary in the politics of redistributing cash is the private wage system. Nobody really believes Washington should give a nonworker coupons that are more generous than the wages earned by his neighbor, the worker.

The other innovation is less obvious but more harsh. As the welfare state created safety nets for the poor and the weak, other, stronger groups in society invented their own varieties of coupons, serving their own needs, and sold them to the government. Price-support systems for farmers; tax loopholes and housing subsidies for the middle class; guaranteed markets for industrial sectors; guaranteed jobs for unions strong enough to demand them.

I could argue that, in the final balance, the welfare state cares best for the prosperous, not the poor. But the main point is that virtually everyone, every economic sector, now participates in the government transfer of cash from one pocket to another. Meanwhile, the fundamental injustice of concentrated wealth is not altered in the slightest.

WHO OWNS America? I am pleased to report that this question will be raised next winter when all conventional politicians are campaigning in the New Hampshire presidential primary. Not by a bunch of party leeches. Not by desperate liberals searching for fancy new rhetoric. The

Against

question will be raised by a strange little group called the Ownership Campaign which, if one formed an ideological identity on this eclectic collection of individualism, probably would be called right-of-center.

This Ownership Campaign is an assortment of businessmen, government technocrats, old labor types, young idealists and blue-order political neophytes. All of them came from different starting points to a shared conclusion: The welfare state fails ultimately to achieve justice; the government must intervene instead to create a broad distribution of capital wealth, stock ownership in the new productivity capacity of the future. & o

These inspired nations think this is the idea of the 1990s, since it did not become the idea of the 1970s. They see a way to renew industrial growth in America, to share the benefits of capitalism more equitably and to climb out of the cul-de-sac created by modern liberalism, the continuous elaboration of compromise. They believe labor should own capital as well as wage. They believe citizens will have better economic security, not to mention environmental, as long as their well-being depends on government decisions.

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As Old As Lincoln



The Grain

At the edge, there is a barbarous yelp of protest borrowed from Ayn Rand. The heart of the idea, including the approach to banking and credit, is as old as Jefferson and Jackson, more radical than any reform entertained by the New Deal.

To grasp the full historical flavor, forget about all of the modern subsidy programs created in the last 49 years. Think instead of the really radical coupons handed out by government in the 18th century — Lincoln's Homestead Act. Through the national government, vast wealth was distributed free to ordinary Americans, including new immigrants, regardless of birth or education or economic status. The wealth was land and it was given freely, with one crucial condition: The people had to make it productive.

The ownership guerrillas believe stock in new industrial capacity can be distributed similarly, setting interest rates for ventures that represent real growth — not the paper games of borrowing and buying. Unlike the Marxist systems of shared wealth, nothing would be taken from the rich. Nor would the new industry become a state-owned industry, as in Britain or France. Anyone who has ever tried to use a telephone in France knows the limits of state control.

The problems and disruptive may be especially aggravated by the

Ownership Campaign. It is taking money to enter not one, but two contests in the New Hampshire primary — a Republican and a Democrat who will campaign jointly, share advertising costs and generally try to make the other conventional candidates take them seriously.

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Hold the snigg laughter, for now. Some folks out there already understand this ownership pitch. When the farmers took their fractions to the Federal Reserve Board, demanding 3 percent interest rates, they were responding to the credit arguments of Norman Kurland, chairman of the Ownership Campaign. Kurland knows little about politics but he is one of those brilliantly obsessed figures one encounters in Washington, a person who cares more about ideas than making a living. Kurland has been pushing stock-ownership plans for more than a decade, undaunted by his limited success. He is the rarest combination — a creature who understands the banking laws yet continues to believe in the possibility of economic justice.

His political director is 25-year-old Luis Granados, a newly graduated lawyer from Tulane Park, who knows the operations of a political campaign from serving local candidates but who lacks the faded spirituality of earnest-eyed operatives. Granados learned economics from ordinary experience.

"I grew up middle class," he said. "I got a scholarship to a fancy prep school and I saw that end. Then I saw the other end, campaigning in poor neighborhoods. I just think the distribution of wealth is wrong. There's not sufficient difference in people to justify the differences in wealth."

This observation matches my own experiences as a reporter. Over the years, I have had many encounters

with people on the bottom rung of our society — white mountaineers, black youths in the cities, migrant workers, poor people urban and rural. I always came away with a chilly feeling, a fresh recognition that most poor people could perform just as well as the rest of us if they had gotten a few lucky pulls of the dice.

Others in the Ownership Campaign are not exactly bleeding hearts. They include Tim Maloney, a young new state legislator from Prince George's County, Anthony M. Carey, partner in a high-toned Baltimore law firm Joe Bourke, a retired Massachusetts labor leader, and Wally Johnson, a former Republican mayor of Berkeley, Calif., who runs an aluminum scaffolding company called Up Right Inc.

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For the Ownership Campaign, the serious people will be

serious political people will be hostile to this idea. They will endorse the rhetoric of broadened ownership because it sounds like Mom and apple pie, but the major power centers of American politics feel threatened by the idea of actually distributing capital ownership to everyone.

Organized labor sees it as compressing the hard and clean lines of worker-management bargaining. Corporate management distrusts it as an ultimate threat to its own control of corporate behavior. Technocrats devoted to managing the welfare state do not wish for its demise. No growth environmentalists do want a new industrial boom for this country. Status-conscious conservatives are offended by the egalitarian premise.

Listen carefully to their objections. These people have impressive arguments on why this scheme will not work or why it should not be tried. Listen, then ask yourself what these opponents would have told Lincoln about his crazy plan for homesteading.

From Jerry Gaucho

By William Greider.

THE TIME has come, perhaps, to ask the question: where liberalism has changed. Checked. Who owns America? Why is the wealth of this fantastic, egalitarian nation distributed so unjustly? Why must capital and its attendant political power be concentrated in the hands of the few while the masses have only a mortgage and, if they are lucky, a modest pension?

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No one who has talked to the recipients of these benefits or examined their actual condition can feel very satisfied with the results. Real pain and suffering, even hunger, truly are alleviated, but these people, still poor, have become prisoners of the government coupon.

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These inspired amateurs think this is the idea of the 1980s, since it did not become the idea of the 1970s. They see a way to renew industrial growth in America, to share the benefits of capitalism more equitably and to climb out of the cul-de-sac created by modern liberalism, the continuous elaboration of coupons. They believe labor should own capital as well as wages. They believe citizens will never derive economic security, not to mention independence, as long as their well-being depends on government decisions.

This is the voice of economic individualism — the old American dream of yeoman independence that was buried in the modern era of big government, big corporations. These people are taking the original impulse of the American experience and trying to graft them onto modern corporate capital-

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Greider is the editor of Outlook. His columns appear weekly.

As Old As Lincoln



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WILMER, CUTLER & PICKERING
1666 K STREET, N.W.
WASHINGTON, D. C. 20006

December 15, 1978

MEMORANDUM

Summary of Conclusions and Recommendations
Regarding Constitutionality of Residency
Restrictions and Other Features of
General Stock Ownership Corporations

In light of the history of constitutional challenges to a number of Alaskan laws that have treated residents more favorably than non-residents, an eventual constitutional challenge to the state's creation of a General Stock Ownership Corporation ("GSOC") would not be unexpected. Many of the requirements restricting ownership and transferability of GSOC shares to Alaskan residents are mandated by Congress in the Internal Revenue Code and appear to have a rational basis that would withstand constitutional scrutiny. We believe also that certain additional limitations that may be added by the state legislature can be formulated in a way that will minimize the possibility of success of any constitutional challenge. However, a favorable result cannot be guaranteed because of the ever-shifting and sometimes inconsistent application of constitutional principles in this area.

To lessen the risk of a successful constitutional challenge, we recommend that the following points be considered by the state legislature in drafting the enabling legislation:

(1) The most difficult constitutional problem is caused by the "closed-class" feature of the GSOC, i.e., limiting ownership to residents on a certain date and precluding persons who later qualify as residents from becoming shareholders. Whether to provide a mechanism for opening the class is a policy decision for the legislature. One possibility would be to rely on the apparent requirement in the Internal Revenue Code for a closed-class and open the class only if required by court decision. Another possibility would be to provide a mechanism for extending GSOC membership to new residents; this approach, however, should be cleared with the Internal Revenue Service as being consistent with the federal legislation.

(2) The Internal Revenue Code requires that a person eligible to receive GSOC shares must be a resident on an eligibility date specified by the legislature and on the date of issuance of the shares. The time lapse between the eligibility date and date of issuance should

be minimized and the state law definition of resident liberally set in order to counter the argument that any substantial delay infringes the right to travel.

(3) The federal legislation does not require a resident to dispose of his GSOC shares if he ceases to be a resident. However, the state may wish to consider a provision requiring redemption by the GSOC or sale to a third party whenever a shareholder ceases to be a resident. This could be attacked as an infringement on the right to travel, but the success of any such challenge would be lessened if a shareholder is permitted to sell to a third party or redeem at fair market value.

(4) Great care should be exercised in drafting Alaska's legislative findings in support of the GSOC enabling legislation. Such findings provide an opportunity, in anticipation of litigation, to describe the government's interest and how the legislation is rationally related to the accomplishment of legitimate government ends. In particular, the record should show why each restriction is the most effective or only way to accomplish specific goals.

The major rationale of the federal legislation, which should be reaffirmed by the state, is that citizens should have a greater ownership stake in the private

enterprise system which would lead to a better understanding and operation of that system. Sen. Rep. No. 1263, 95th Cong., 2d Sess., at 107. A secondary rationale of Congress was that an experimental GSOC program would enable Congress to study a method of replacing transfer payments with dividend income. The state should not emphasize the reduction of transfer payment rationale because of a number of cases that impose stricter tests for residency restrictions on "necessities of life" -- such as welfare -- than on other benefits.

Our conclusions are necessarily abstract and preliminary since the enabling legislation has not been drafted; we recommend that the constitutional issues be revisited after they are focussed in terms of a specific legislative proposal.

J. General Stock Ownership Corporations

(Sec. 201 of the bill)

Present law

Under present law, there are no special provisions relating to the establishment of a private corporation for the benefit of the residents of a State.

Reasons for change

The committee believes that many citizens should have a greater ownership stake in the private enterprise system, and that this would lead to better understanding of the system and would encourage individuals to invest in other business enterprises. Also, in the case of individuals now receiving various forms of transfer payments from Federal, State, or local governments, the receipt of dividend income from a General Stock Ownership Corporation (GSOC) would, to some extent, reduce the need for such payments. The committee believes that an experimental program permitting States to form such private corporations for the benefit of their citizens may enable the Congress to study a method of replacing transfer payments with dividend income.

Explanation of provisions

General.—Under the committee bill, a State would be authorized to establish a GSOC for the benefit of its citizens. It is anticipated that the GSOC would be authorized to borrow money to acquire business enterprises. The cash flow from the operation of the business would be used to pay the loan, and the corporate revenues would be distributed to the GSOC shareholders (i.e., the citizens of the State).

Definition of GSOC.—The bill provides that a corporation must meet certain statutory tests in order to be treated as a GSOC. First, the corporation must be chartered by an official act of the State legislature or by a State-wide referendum. Second, the GSOC's corporate charter must provide for the issuance of all authorized shares to eligible individuals provided that at least one share is issued to each eligible individual, and such eligible individual does not elect within one year after the date of issuance not to receive such share, and provides for certain restrictions on the transferability of the share. The transfer restriction must provide that the share cannot be transferred until the earliest to occur of (1) the expiration of 5 years from issuance,

¹ This rule applies to an election made under either subdivision (i) or (ii) of Treasury Regulations § 1.761-2(b) (2), relating to the method of electing not to be treated as a partnership.

(2) death or (3) failure to meet the State's residency requirements. In no event may shares of stock of a GSOC be transferred to nonresidents. Also, an individual may not acquire more than 9 shares by purchase. Third, the charter must provide that the GSOC is empowered to invest in properties (not including properties acquired by it or for its benefit through the right of eminent domain). Fourth, the GSOC may not be affiliated with any other corporation. Fifth, the GSOC must be organized after December 31, 1978, and before January 1, 1984. An eligible individual is any individual who is a resident of the chartering State as of the date specified in the corporate charter. A State may define a resident for purposes of its GSOC so long as such definition is consistent with constitutional principles.

Election.—A GSOC must make an election to obtain the special statutory treatment provided for by the amendment. The election is effective for the taxable year for which it is made on a timely filed tax return. The manner in which the election is to be made would be determined by regulations. The election once made is irrevocable unless terminated with the consent of the Secretary of the Treasury.

Effect of election.—The effect of the election would be to exempt the corporation from Federal income taxation. Instead, the shareholders of the GSOC would report their proportionate part of the GSOC's taxable income on their Federal individual income tax returns.

Treated as a private corporation.—A GSOC would be treated as a private corporation.

Computation of GSOC income.—The GSOC would compute its taxable income in the same manner as a regular corporation with certain modifications. The GSOC would not be eligible for a dividends received deduction nor any tax credits.

Net operating loss deduction.—The shareholders of a GSOC would not be eligible to report any portion of a GSOC net operating loss on their individual income tax return. Instead, the GSOC would be entitled to a 10-year carryover of any net operating losses.

Investment tax credit and recapture of investment tax credit.—Under the bill, shareholders of the GSOC would be entitled to their pro-rata share of the GSOC's investment tax credit. The shareholders would also be personally responsible for any recapture of such investment tax credit. Neither the corporation nor its shareholders would be entitled to the foreign tax credit.

Taxation of shareholders.—Under the bill, each shareholder would include in his gross income his daily prorated portion of the GSOC's taxable income. Such income would be included in the shareholder's gross income for the taxable year in which or with which the GSOC's taxable year ends. The income in the hands of the shareholder would be treated as ordinary income and would not be eligible for either the partial dividend exclusion (sec. 116) or the maximum tax of earned income.

Shareholders would increase the tax basis of shares of stock in the GSOC to the extent they reported income from the GSOC. Distributions from the GSOC out of such previously taxed income would decrease the tax basis of such shares.

Taxation of GSOC distribution.—Under the bill, distributions from a GSOC's taxable income previously taxed to a shareholder would

be treated as a tax-free distribution. Any distribution in excess of such previously taxed income would be taxed in the same manner as a distribution from a regular corporation (sec. 301(c)).

Audit adjustments and amended tax returns.—Any audit adjustment resulting from an Internal Revenue Service determination would be reflected in the GSOC's taxable year in which such adjustment is made (and not the taxable year to which it relates). The amount of such adjustment would be subject to an interest charge in an amount computed as though the income had been taxed to a nonselecting corporation.

Reporting requirements.—Under the bill, a GSOC would be required to file a Federal income tax return and a computer-coded data showing information reported to each of its shareholders. The corporate tax return would be required to meet the same timing requirements as a regular corporation. In addition, a GSOC would be required to give each shareholder a Form 1099. The Form 1099 would report (1) the shareholder's pro rata income for the taxable year, (2) tax-free distributions for the year, (3) the tax treatment of other distributions, and (4) the amount of any investment tax credit and recapture thereof for such year, and (5) any amounts withheld for Federal income tax purposes.

Distribution requirements.—A GSOC would be required to distribute 90 percent of its taxable income to its shareholders by January 31 of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the deficiency (i.e., the difference between the required distribution and the actual distribution) would be imposed on the GSOC. The amount of such tax would be allowed as a deduction to the GSOC for the year in which it is paid.

Withholding requirements.—The bill requires the GSOC to withhold an amount equal to 25 percent of every distribution made to its shareholders. The amount of such withholding would be allowed as a refundable credit to the shareholder. The Treasury would be authorized to issue regulations providing a certification procedure for individuals who are nontaxpayers under which they may be exempted from the withholding requirement.

Studies.—It is expected that a study would be made of the effect GSOC's have on competition with regular private corporations. It is also anticipated that a study would be made of the GSOC as a form of full corporate integration.

Taxable year end of GSOC.—The bill requires a GSOC to adopt a taxable year end of October 31. It is anticipated that most GSOC's would elect an October 31 year end. This would enable them to close their books and meet their shareholder reporting requirements by January 31 of the next succeeding year.

Effective date

The provision applies to corporations chartered and organized after December 31, 1978.

Revenue effect

The revenue cost of the proposal is expected to be negligible during the next few years. However, the long-run cost could be substantial.

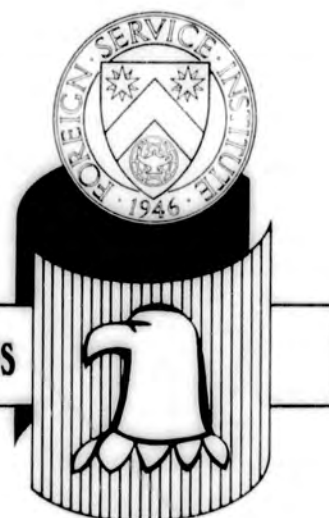
MAKING NEW CAPITALISTS - A CREATIVE RESPONSE TO INCOME INEQUITIES

Case Study by RICHARD J. SMITH

TWENTIETH SESSION

EXECUTIVE SEMINAR IN NATIONAL AND INTERNATIONAL AFFAIRS

DEPARTMENT OF STATE



1977-78

THIS IS AN EDUCATIONAL EXERCISE AND DOES NOT NECESSARILY REPRESENT THE VIEWPOINT OF THE
EXECUTIVE SEMINAR IN NATIONAL AND INTERNATIONAL AFFAIRS OR OF THE DEPARTMENT OF STATE

SUMMARY

Influenced by the controversial theories and proposals of San Francisco lawyer Louis O. Kelso, the Congress of the United States is in the process of making a major commitment to a policy aimed at broadening the ownership of equity capital.

Kelso's central thesis, which has been developed in a series of books and articles, is that the proportion of production attributable to capital is steadily increasing, while that attributable to labor is declining; at the same time, ownership of income-producing property is becoming increasingly concentrated as a result of the way in which the creation of new capital is financed. The principal element in his proposed solution to the resultant imbalances and inequities in the system is a fundamental change in the way capital creation is financed. This would result in the establishment of many new viable capital estates through the operation of Employee Stock Ownership Plans (ESOPs) and a Financed Capitalist Plan which uses insured loans to support the creation of such estates for those not employed by profitable private companies.

Kelso's writings have in general been ignored or treated with disdain by the economics profession. However, his main point regarding capitalism's persistent tendency to lead to undue concentration of capital ownership, and the need to broaden this ownership, finds support in the writings of some distinguished economic thinkers, i.e., Von Thunen, Keynes, and J. E. Meade.

Under the leadership of Senator Russell Long, Chairman of the Senate Finance Committee, who has become convinced of the merits of Kelso's arguments, the Congress has passed in the last several years a series of laws encouraging the establishment of ESOPs. These include a provision for an additional increment to the investment tax credit on the condition that it be passed on to the company's employees through the establishment of a specially defined ESOP called a TRASOP (Tax Reduction Act Stock Ownership Plan).

The experience with ESOPs has generally been quite favorable, although the estimated 2000 of them tend to be concentrated in relatively small, closely held firms, for which they present a number of special advantages. TRASOPs, however, which are of interest to large capital intensive firms, have caused a particular set of concerns which raise questions about the viability of that approach and require separate consideration.

In the next round, Congress will be considering legislation to further encourage ESOPs as well as legislation to deal with potential abuses. The future of the TRASOP will have to be resolved. Further, important new legislation calling for a pilot program to test the viability of the Financed Capitalist Plan is expected to be introduced. The need is for the Congress, drawing fully on the expertise of the economic and financial communities as well as the

Executive Branch, to proceed with a searching and systematic examination of the whole range of alternatives for broadening participation in the capitalist system, including profit sharing, stock bonus and option plans, pension plans, and individual retirement accounts, as well as the Kelso-inspired ESOP and Financed Capitalist Plans. The interactions among these techniques, and the potential impacts on the economy of various strategies to broaden equity ownership need to be studied in greater depth than has yet been done.

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I gratefully acknowledge the help given me in sorting out the issues by Stuart Speiser, a New York lawyer and chronicler of the Kelso movement, who combines an unbounded sympathy for universal capitalism with a cautious and questioning attitude towards the techniques that have been tried or proposed to achieve it. Dr. Robert Hamrin, until recently on the Staff of the Joint Economic Committee, was also particularly helpful to me in my attempt to gain a sound overall perspective. For giving me a direct sense of the remarkable motivational and productivity impact that employee ownership can have, I am especially thankful to Samuel Jones, President of the Katz Agency in New York, a 100 percent employee owned company.

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It isn't possible for me in the space available to individually acknowledge or express my gratitude to the many other people who have helped me in my effort to understand what is happening in the complex and dynamic area of employee ownership and broadened capitalism in general. If I succeed in saying something sensible and useful about this important issue, that will stand as a monument to their patience and generosity in assisting me. If I do not achieve that ambitious purpose, the failure is entirely my own, and they will be just as happy that I haven't mentioned their names.

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PREFACE

Given the limited time available to complete it, I started this project with the idea of narrowing the scope as much as possible, perhaps to looking just at Employee Stock Ownership Plans (ESOPs) and, even more narrowly, at their impact on labor relations or productivity. It quickly became apparent to me that this was an instance in which to narrow was to distort. ESOPs could not be properly understood except in the context of Louis O. Kelso's concept of universal capitalism and in relation to other techniques that have been used or proposed for broadening the ownership of capital. This broader approach requires, regretfully, that I touch quite lightly on some important and complex issues.

As a guide to those wanting to delve more deeply into various aspects of this subject, I have included in the bibliography to this paper reference to an excellent and extensive bibliography on ESOPs prepared by the Economic Development Agency (EDA) in the Department of Commerce, as well as references to selected works which I have found particularly useful.

My purpose in this paper is to give an overview of Kelso's theory of universal capitalism and of the early efforts at putting certain aspects of it into practice. I will also seek to place this issue in the context of other related developments regarding the ownership of equity capital. Finally, I will attempt to sort out some of the principal issues involved and speculate on how they may be resolved.

I will not attempt to deal with the issue of direct employee participation in management. Under the rubric of "co-determination" this has become a major issue in Europe; however, given the collective bargaining tradition here, neither labor nor management in the United States finds that approach appealing. As one national labor union official told me, "You can't sit on both sides of the table at once."

Richard J. Smith

I. THEORETICAL UNDERPINNINGS OF UNIVERSAL CAPITALISM

Kelsoism - A Man and His Vision

Louis O. Kelso, a San Francisco lawyer, is a man with a vision combined with the knowledge of the practical world of finance and with the energy that have permitted him to pursue it with vigor and considerable effect. In a ground-breaking 1958 book, written with the noted philosopher and educator Mortimer J. Adler, he argued that capitalism as currently practiced leads inevitably to ever increasing, and socially intolerable, concentrations of wealth. 1/ This results from financing procedures which assure that it is the owners of existing capital who become the owners of newly created capital.

Kelso sees attempts to deal with the inequities thus created by redistributing income through jobs programs, progressive taxation, and transfer payments as ineffective, inflationary measures which lead society away from free enterprise towards increasing government intervention and eventual socialism. 2/

Kelso buttresses or obscures, depending on your point of view, his case by developing an analytical framework he calls, "Two-factor Theory." In a book by that title, Kelso and his co-author expand on the argument that productivity increases are attributable basically to capital and are falsely credited to increased labor productivity. 3/

Kelso's thesis, which is referred to frequently in his books and articles, is that 90% of income is created by capital, but that labor gets 70% of that income as a result of political considerations, rather than the 10% that would accrue to it in an unregulated free enterprise situation. In his view, the strains and imbalances that this creates can only be corrected by providing an opportunity for every family to build a capital estate from which it derives a significant portion of its income.

In Two-Factor Theory, the authors contrast what they describe as the two possible distributive principles, one based on private property and one based on need.

Unlike the private property principle, the need principle has no intrinsic limitations, either physical or logical. Private property is objective and specific; need, subjective and universal. Under the rule of private property, a claimant is entitled only to the equivalent of his production; this is a built-in check that automatically proportions demand to what is available. Private property enforces productive responsibility; it establishes orderly, dependable relationships between men, and between men and their environment. The need principle,

by contrast, abolishes personal productive responsibility, severs dependable property relationships, and provides no mechanism to relate the size of the product to the demands of claimants. 4/

Kelso deserves to have the essential elements of his argument set out in his own words. In a second book written with Adler his theory of capitalism is summarized as follows:

Briefly summarized, that theory involves the following propositions:

(1) both labor (the human factor) and capital (the non-human factor) are producers of wealth in the same sense;

(2) the productiveness of labor, except for temporary interruptions, has been declining since the dawn of civilization, and the productiveness of capital has been--both relatively and absolutely--increasing, as has the amount of capital employed in production;

(3) technological change is the physical process by which the burden of producing wealth is gradually shifted from labor to capital;

(4) political and economic freedom in an industrial society depend not merely on each household's being entitled to consume economic goods but upon each household's being entitled to produce economic goods; and

(5) as labor progressively produces less, and capital progressively produces more, of the gross national product, a growing proportion of all households must participate in production through their ownership of capital and a diminishing number must depend upon the earnings of their labor. 5/

The Critical Economists

The response to Kelso from the economics profession, and indeed there has been very little response, has been generally disdainful. It is epitomized by Nobel Laureate Paul Samuelson's reference to Kelsoism as, "an amateurish and cranky fad." 6/ The economists tend to reject Kelso's two-factor analysis and go no further in their analysis of his ideas. To economists a factor is worth what it can get and they would view it as obvious that labor will command a higher price when there is less of it relative to capital. Thus,

they are uncomfortable with Kelso's assertion that capital creates 90 percent of the income while labor gets 70 percent of it.

Economists also are troubled by Kelso's lack of attention to the remarkable increases in productivity that labor achieves through training and education. In testimony before the Joint Economic Committee, Professor Hans Brem of the University of Indiana expressed concern on this point, noting that since World War II, "We have more than trebled the number of people who have some kind of higher education, and we have raised labor productivity accordingly." 7/

Kelso responds that economists are so set in their ways that they cannot recognize a truly new insight. As he put it in response to a question on a television talk show regarding the opposition of leading economists such as Samuelson and Friedman, "Well, what do you think the flat world fellows thought of a guy who said that the world is shaped like a ball?" 8/ He says government actions raise labor's return.

In my view, the validity of the two-factor theory is a side issue. In attributing virtually all production to capital, Kelso can be accused of making an error that is the mirror image of the one made by Karl Marx in saying labor does it all. On the other hand, economists may be showing undue rigidity in dealing harshly with an analysis intended to make a point to a non-technical, general audience and not couched in the jargon of the economic profession. In any case, that issue is not the central one. Kelso's main point relates to the need to deal with capitalism's tendency to concentrate the ownership of capital, and this is an important insight quite independent of his two-factor theory.

Stuart Speiser, a New York lawyer who has chronicled the Kelso movement, and has described himself as an enthusiastic supporter of universal capitalism, has cited two-factor theory as Kelso's one mistake. 9/ He argues that it has slowed down serious consideration of universal capitalism, which he believes may be "the most important idea ever originated by an American." 10/

The Economic Precursors of Kelso

On the issue of broadening capital ownership as an antidote to the over-concentration of wealth, Kelso has, in fact, impeccable economic antecedents. The distinguished German economist Johann Heinrich Von Thunen, a contemporary of Karl Marx, developed a theory of the natural wage which held that each working unit must have access to interest from investment to supplement an amount necessary for subsistence. 11/ Although Von Thunen is most famous for his work in econometrics, marginal productivity theory, and location theory, he considered his wage theory his greatest accomplishment. At his request, a formula expressing his wage theory is engraved on his tombstone. 12/

It is also interesting to note that, like Kelso, Von Thunen was a practical man, and he carried out his ideas on his own estates. He set aside a portion of his profits for his employees, which was

reinvested in the estate, and in subsequent years the worker would be paid interest on his investment, and finally receive his built up equity at retirement. The plan functioned successfully through several generations. 13/

Significantly, John Maynard Keynes, who is the father of the deficit spending, full employment policies which are anathema to Kelso, can also be cited in support of universal capitalism. In a 1940 book, Keynes warned of the inflationary implications of escalating wage rates and argued that as an alternative to higher wages the worker should be given, "a share in the claims on the future which would belong otherwise to the entrepreneurs." 14/

A Contemporary Supportive Analysis

More recently, a 1964 analysis by the widely respected British Economist J. E. Meade came to conclusions strikingly similar to those reached by Kelso. 15/ In a thin volume of less than 90 pages, Meade addresses in crisp, lucid prose the efficiency and distributional effects of the wage rate. He demonstrates that the most efficient wage rate will generally have unacceptable distributional effects, with most income going to a handful of owners of capital and land. He adds, "The problem is already a very real one in the highly industrialized developed countries in many of which there is a really fantastic inequality in the ownership of property." 16/ He goes on to note that in the United Kingdom in 1959, 99% of the pre-tax personal income from property went to 10% of the population, and shows that this imbalance has been increasing steadily since 1911-13, when the top 10% received 92% of the property income. 17/

Meade examines the various alternatives for ameliorating this progressive and ultimately intolerable concentration of wealth and income: the Socialist State; the Trade Union State; the Welfare State; and a Property-Ownning Democracy. His analysis leads him to clearly favor the final alternative, which he describes in glowing terms as follows:

Let us suppose that by a wave of some magic wand--the nature of which we will examine later--the ownership of property could be equally distributed over all the citizens in the community. What a wonderful culture could now result from our future automated economy! Imagine a world in which no citizen owns an excessively large or an unduly small proportion of the total of private property. Each citizen will now be receiving a large part of his income from property. For we are assuming that for society as a whole the proportion of income which accrues from earnings has been greatly reduced by automation. 18/

While suggesting a number of modifications of traditional techniques for the progressive taxation of income and wealth as helpful, Meade comes closest to Kelso when he says, "Arrangements which encourage the accumulation of property by those with little property are certainly as important as those which discourage further accumulation or encourage dispersal of their fortunes by large property owners." ^{19/} Among his suggestions for accomplishing this are "employee share schemes whereby workers can gain a property interest in business firms." ^{20/}

II. THE SECOND INCOME PLAN

Kelso has developed and proposed a systematic and comprehensive approach to making his vision a reality. The best overall presentation of that approach is in Two-Factor Theory, which outlines what is termed a "Second Income Plan". 21/ As a preliminary step, the authors say that the United States needs a Full Production Act, "... to be enacted by Congress, acknowledging the economic responsibility of business, labor unions and government to enable all Americans to participate fully in the economy and to produce affluence--through their labor, to the extent that labor is necessary under prevailing technology, and through capital ownership, to the extent that goods and services comprising affluence are the product of capital". 22/

The full scope of the plan is then set out as follows:

The objective of the Second Income Plan, as we stated earlier, is the building of the second economy--an economy that, in the United States, must have several times the per capita productive power of the existing one. The means of accomplishing that physical objective (changes in the invisible structure of industry and business) must be so designed that the Second Economy will be owned primarily by the 90% of families and individuals who do not own viable holdings of productive capital today. These new capital-owning families can then engage in the production of wealth both through their employment (to the extent required by the current state of technology) and through their capital ownership. Our proposed tools relate to the following areas of the invisible sector:

- (1) Estate planning and the pattern of testamentary and intervivos gifts as they are effected by national and state tax policy.
- (2) The conduct of the corporation and the design of corporate strategy.
- (3) Financing capital ownership for corporate employees.
- (4) Financing capital ownership for non-corporate employees. 23/

With regard to estate and gift taxation, the following approach is suggested:

Specifically, we would suggest modification of the tax laws to permit the wealthy, in various ways, to leave their wealth to individuals selected by them, tax free, as they now can to exempt foundations, providing that safeguards are imposed to prevent particular recipients from acquiring excessively large holdings in that manner. For example, tax-exempt gifts by individuals to employee deferred benefit trusts should be permitted. Similarly, tax-exempt gifts to individuals, whether related by blood or marriage or not, should be permitted, with a steeply graduated tax to apply if the capital estate of the recipient, after receipt of the gift, exceeds some legislatively defined viable capital holding. 24/

The authors estimate that this single measure would create a million new viable capital estates per year.

On the question of corporate behavior, the corporate income tax combined with the practice of retaining earnings are cited as principal barriers to the spread of capital ownership and the associated generation of adequate financing for the creation of new capital.

Clearly, the elimination of the corporate income tax, thus shifting the revenue-raising burden of government to the ultimate taxpayers--the individual citizens--where it belongs, combined with the forcing of corporations to pay their net earnings to those who own the corporate capital--the stockholders--will enormously increase the financeability of newly issued corporate equities by the nonaffluent. 25/

The two approaches to financing capital ownership are described as follows:

The Second Income Plan provides the corporation with two alternate sources for financing its new capital formation. The first is a form of employee deferred-compensation plan which we call the Second Income Plan Trust. It enables corporate employees to purchase newly issued corporate equities on pre-tax corporate earnings. The second is the Financed Capitalist Plan for enabling noncorporate employees to purchase newly issued corporate equities, and to pay for them out of the pre-tax earnings of the corporate equities so purchased. 26/

What is referred to as a Second Income Plan Trust later came to be known as an Employee Stock Ownership Plan (ESOP).

In a 1977 article, long time Kelso associate and supporter, Washington lawyer Norman Kurland, presented a variation of the Second Income Plan based on ESOPs, CSOPs, and ISOPs, which together would accomplish the transition to the era of universal capitalism:

"Under a comprehensive national plan for stimulating and redistributing future growth opportunities directly among Americans who have no capital, three basic ownership diffusing mechanisms would be employed to link capital to individuals: employee stock ownership plans (ESOP), to cover employees of viable enterprises; consumer stock ownership plans (CSOP), to cover all regular customers of regulated public utilities and mass transit systems; and individual stock ownership plans (ISOP), to provide people who do not work for viable corporations in the competitive sector of the economy with the means to gain a diversified holding of newly issued stock reflecting growth of the competitive corporate sector. Each of these tools is designed to reduce drastically the cost of new capital formation and to overcome present tax and credit barriers to a more equitable sharing of future ownership opportunities."27/

An important element in Kurland's ideal plan, as in Kelso's, would be the provision of discounting facilities by the Federal Reserve System to lower the interest rates on loans in connection with the financing of universal capitalism to levels consistent with "pure credit," freed of costs associated with risk and inflation. Kurland explains this aspect of the program as follows:

Under a national planned ownership strategy, the Federal Reserve System, using its present powers to expand bank credit through the discounting of eligible paper, would reduce bank interest rates to 2% to 3% for banks making loans to IRS-qualified ESOPs, ISOPs and CSOPs to enable mature, well-managed corporations to sell newly issued equity to their workers and other Americans. All loans would be non-recourse to the individual and would be repayable with projected pre-tax profits. The low-interest rates and the use of pre-tax dollars for servicing the capital formation debt would, of course, lower the

cost of capital expansion within the private sector, at least when compared to the use of after-tax dollars and today's high interest rates. Only when all wasted and non-productive human talent gained work opportunities in the growing private sector and all other resources became fully employed, would the Federal Reserve clamp down on the supply of low interest credit. Any further expansion would not increase production and would therefore be inflationary. A sound national ownership program would aim at a target of zero rate of inflation and a maximum rate of production. 28/

Thus, Kurland is proposing a two-tiered interest system, with lower rates applicable to new capital creation undertaken as part of a planned national strategy to broaden capital ownership.

III. THE CONGRESSIONAL CONNECTION

A Populist Convert With Clout

The likelihood of solid real world results in this area rose sharply one night in late November of 1973. It was then that Louis Kelso and Norman Kurland met in Washington with Senator Russell Long. On that occasion, Kelso persuaded the powerful Senate populist of the merits of his idea for creating new capitalists. The response of the Chairman of the Senate Finance Committee was reportedly direct and to the point: "Okay, what's your plan? What can I do to get this thing moving?" 29/

At Kurland's suggestion, Long went to work immediately in support of an ESOP provision in pending legislation to reorganize a number of bankrupt railroads, which had been proposed the previous August by Senator Hatfield in a "dear colleagues" letter. (Other early Congressional supporters of the ESOP concept included Senators Fannin, Hansen, and Dominick, who unsuccessfully sought legislation on ESOPs in March of 1973, the first time a bill dealing with them had been introduced). 30/ Senator Long's support was decisive and within a month the Regional Rail Reorganization Act of 1973 set up a consolidated Rail Corporation (Conrail) to acquire the assets of a number of bankrupt railroads in the Northeast and Midwest, including Penn Central, and called for the use of ESOPs to the extent found practicable. Although falling short of a legislative requirement to set up ESOPs, which supporters would have preferred, this was the first time that ESOPs were recognized and defined by legislation.

The Act described ESOP as a technique of corporate finance that uses an employee trust qualified under the applicable IRS regulation 491(a), which is designed to build beneficial equity ownership of shares into employees substantially in proportion to their relative incomes, without requiring any cash outlay, any reduction in pay or other employee benefits, or the surrender of any other rights. 31/

A Growing Legislative Commitment

Senator Long has maintained his interest in the ESOP concept and has worked for its inclusion in a number of subsequent laws:

Employee Retirement Income Security Act of 1974 (ERISA)

This law was passed to set standards for private pension plans and prevent abuses. The reference to ESOPs was for the purpose of exempting them from prohibitions against loan and stock sale and from the requirement for diversification of plan assets. Thus, ESOPs were generally

permitted to continue their existing method of operations. However, the law does require that transactions between the ESOP and the company be primarily for the benefit of the employees, and this has introduced a note of uncertainty since by design such transactions can also have important benefits for the company.

Trade Act of 1974

This included a provision which gives preferences for government guaranteed loans to companies injured by foreign competition to companies which establish ESOPs.

Tax Reduction Act of 1975

This contained a direct tax incentive for setting up a particular kind of ESOP. The Act increased the investment tax credit from 7% to 10%, and provided that the credit could be increased to 11% if the company contributes the additional 1% to an employee stock ownership trust. These trusts, which have come to be known as TRASOPs (Tax Reduction Act Stock Ownership Plans), incorporate some important features which do not apply to ESOPs generally, e.g., there must be immediate employee vesting and pass-through voting rights to employees.

Tax Reform Act of 1976

This Act extended the applicability of the TRASOP provision through 1980 and added a provision that the credit could be increased by a further $\frac{1}{2}\%$, if that was matched by a $\frac{1}{2}\%$ contribution by the employees, with a total of 2% going into a TRASOP.

The growing Congressional concern with ESOPs and broadening stock ownership culminated in the following recommendation in the 1976 Joint Economic Report:

To provide a realistic opportunity for more U.S. citizens to become owners of capital, and to provide an expanded source of equity financing for corporations, it should be made national policy to pursue the goal of broadened capital ownership. 32/

This is an idea with broad political appeal, and, while there remain differences of view on how best to reach that goal, there are no apparent Congressional centers of opposition to the concept

of broadened stock ownership. An article in Barron's went to the heart of Kelso's political appeal:

The Kelso doctrine has won enthusiastic endorsement from both liberals and conservatives in and out of Congress, albeit for different reasons. It is the only economic doctrine introduced in generations that could become a plank in either the Democratic or Republican platform. On one hand, the idea of letting workers share directly in the growth of profits appeals especially to liberals. On the other hand, the concept that business, not government, should be the arbiter of its fortunes is attractive to American conservatives. 33/

Concerned that an Executive Branch that did not generally share its enthusiasm for ESOPs might seek to frustrate its support for them, the Congress took the unusual step of specifying its intent in a law and cautioning the rule-makers not to block it. This important statement, aimed primarily at the IRS, was contained in the Tax Reform Act of 1976:

The Congress, in a series of laws (the Regional Rail Reorganization Act of 1973, the Employee Retirement Income Security Act of 1974, the Trade Act of 1974, and the Tax Reduction Act of 1975) and this Act has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees. The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of employee trusts and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans. 34/

More legislation on ESOPs and other measures for broadening capital ownership appears to be a certainty. The next legislative steps will be critical in terms of the way in which we proceed with efforts to broaden stock ownership. On the one hand, Senator Javits has been concerned that we are giving undue attention to ESOPs possibly to the detriment of other employee benefit plans, and he sees a need for a greater role for organized labor. In a bill sponsored jointly with the late Senator Hubert Humphrey, he concentrates on correcting perceived shortcomings and potential abuses of ESOPs. The major elements of the proposed Javits-Humphrey Employee Stock Ownership Fund Act of 1976, which would

amend the National Labor Relations Act, are as follows: 35/

- Permit jointly managed labor-management employee trusts, established through collective bargaining.
- Require diversification of 70% of such ESOP funds, with no more than 30% to be held in company stock.
- Preclude the establishment of ESOPs under the NLRA unless the employer already has in effect a pension benefit plan qualified under ERISA.
- Provide for 100% vesting after 3 years of employee participation.

Representative William Frenzel, ~~Democrat~~ *Republican* from Minnesota, on the other hand, has introduced a bill designed to further encourage the formation of ESOPs in a number of ways, including additional tax incentives. The principal provisions of his proposed accelerated Capital Formation Act of 1975 (H.R. 462) are:

1. Remove the present statutory limitation of 25% of covered compensation as the maximum amount an employer can contribute to a qualified employee stock ownership plan when such payments are used to enable the plan to repay stock acquisition debts incurred in connection with meeting the employer's capital requirements.
2. Provide a tax deduction to corporations for the amount of dividends they distribute either directly as taxable second incomes on stock held in an employee's account or which are used to repay stock acquisition indebtedness of the employee's trust.
3. Provide for advance IRS opinions on valuations of stock or other assets acquired by an ESOP where the parties to a financing transaction, which utilized an ESOP, would be subject to serious risk of penalties if the IRS, on a subsequent audit, disagreed with the valuation or other key features of the financing plan.
4. Exempt payments to an ESOP made for financing purposes from treatment as a conventional employee benefit for purposes of any wage, salary, deferred compensation, or other employee benefit controls or guidelines that might be established under executive order, regulations, future economic stabilization laws at the federal or state level. 36/

The Financed Capitalist Plan

A major new bill which is designed to test the viability of Kelso's "financed capitalist" approach will be introduced in this session by Senator Mike Gravel from Alaska. In a series of weekend meetings that have drawn in top economists and financial experts, a working draft has been prepared under the title, "The Financed Capitalist Plan--A Concept by Senator Mike Gravel". The 20-page document lays out a detailed plan for creating new capitalists, described in its essence as follows:

I propose a new approach to capital expansion which would diffuse ownership of new capital to those who have not previously reaped the benefits of capital ownership. In simple outline the plan would guarantee private loans to purchase corporate stock, with the new capital being used by the corporation to pay for the expansion of plant and equipment. The stock would be held as security for the loan, and dividends used for repayment. After the loan is fully or partially retired, the investor would receive dividend income. The plan provides investment capital for industry while developing an alternate source of income for those who historically have depended on their labor income alone. The plan would not transfer existing wealth from the rich to the poor, but rather allow the poor to obtain a share of the new wealth generated by our capital expansion. 37/

Senator Gravel specifically recognizes the revolutionary nature of his proposal and says that, "The plan should be tested on a limited scale to determine its effect on individuals, corporations, government, and the economy as a whole." 38/ The current draft calls for \$800 million in private, federally guaranteed loans in each of five consecutive years, with loans available to participants in amounts of \$20,000 per family unit. 39/

Key features of the Gravel draft plan include the following:

- Participants would be chosen at random from four target groups: the blind and disabled, low income working poor, middle income taxpayers, and Social Security recipients.
- A new class of stock, referred to as Full Return Stock, would be created which would distribute all per share earnings, beyond a reserve for contingencies, quarterly.
- The loan would be guaranteed by a new independent federal corporation, the Capital Development Insurance Corporation (CDIC) and would be non-recourse to the participant borrower.

- An interest rate of 4% would be assured either through direct Treasury subsidies or, alternatively, by providing for the notes acquired to be discounted by the Federal Reserve Bank.

Senator Gravel calls for careful further study of his plan, and elements of it may well be modified before it is introduced in the Senate. This important legislative initiative is already at the stage, however, where it would enter the Congressional process more carefully and thoroughly thought through than most bills.

The job of selecting individuals to be participants in a program of this kind is a daunting prospect, but at the same time it opens up some very appealing possibilities. For example, it could be used to provide income stability to non-affluent farm families to help them deal with the ups and downs of markets for agricultural products. It might also be used to cushion the impact of a scaling down of pension benefits for career military personnel. There are many attractive alternatives in this regard which should be examined.

IV. ESOPS AND TRASOPS

ESOP Technique Finds Specialized Uses

From a dozen or so in 1970, the number of Employee Stock Ownership Plans (ESOPs) has increased to an estimated 2000 currently. 40/ These have been quite heavily concentrated, however, in relatively small, closely held companies. They have often been used in special circumstances such as the divesting of a division from a conglomerate or the withdrawal of a founder and principal owner from a company.

One of the most potentially significant uses of ESOPs has been in the area of economic development as a technique for preventing the closure of companies and loss of jobs. The landmark case in this area is South Bend Lathe (SBL), a machine tool manufacturer in South Bend, Indiana. In 1975 the Chicago conglomerate, Amsted Industries, Inc., decided to close the South Bend plant. Since this was an economically distressed area, the city was able to obtain a \$5 million EDA grant to establish a revolving fund which made a loan to support the establishment of an ESOP by South Bend employees who purchased the plant. Thus, some 500 jobs at SBL were saved, plus some 200 jobs at SBL's suppliers. SBL has since shown a profit for 30 consecutive months and appears to be thriving. 41/

A number of already successful firms have found ESOPs helpful. Among the largest of the companies to establish ESOPs has been E-Systems, Inc., of Dallas, Texas, which has about 10,000 employees. E-Systems Vice President Harry Thurman testified before the Congress to the remarkable improvements which they attribute to the 1973 establishment of an ESOP:

Employee turnover has declined 50% since 1973 and is below the national average for our type of company. Our absenteeism has declined and is now 25% below the national average.

Since the ESOP was established, interest and participation in the company suggestion program has improved in that suggestions submitted have increased 140% with a marked increase in suggestions regarding cost and waste reduction and efficiency improvements. 42/

In the course of making contacts for this study, I discovered that plans are now well advanced for the most dramatic and newsworthy use of ESOP to date. In a development with far reaching implications, an ESOP package has been put together to save the last of the American flag passenger liners. With ESOP investment counselor Norman Kurland, the National Maritime Union (NMU) has prepared a proposal to keep the Monterey and the Mariposa operating in the Hawaiian tour trade. The two ships have used up their eligibility for operating subsidies and in the normal course of

events would follow many other such American ships into mothballs, razor blades, or the hands of foreign owners who would operate them more economically.

As it was explained to me, the NMU would agree to reduce manning costs by 60% in conjunction with the establishment of an ESOP through which the crews would share in the profits which would then be generated. No further operating subsidies would be required. The deal would require, however, low cost (3%) federal financing for all or part of the \$10 million purchase price, which is now being sought through the Economic Development Agency (EDA) of the Department of Commerce. NMU President Shannon Wall described the proposal to me as the last chance for saving some 600 jobs.

NMU Treasurer Gene Spector told me that the numbers look right, and he is hopeful the proposal can be brought to fruition. He said it would require a re-structuring of work and manning practices, but, if successful, could set a pattern that could save many thousands of jobs for American seamen.

The NMU proposal is an important precedent in many respects, not least of which is the direct and active early involvement of organized labor in an ESOP. Labor's reaction to ESOPs thus far has been mixed. One national labor union official told me that ESOPs, at best, were, "a conspiracy between companies and the government to [expletive deleted] the taxpayer." At worst, labor fears that ESOPs will be substituted for more reliable benefits, such as pensions, or that they will be used to weaken unions. On the other hand, local unions at plants that have been saved and re-vitalized by ESOPs tend to be much more positive in their view of them.

Overall, the experience with ESOPs, while limited, has been quite favorable. My direct contacts and observations of firms having ESOPs were entirely consistent with the results of a survey of 68 ESOP companies by the University of Michigan Institute for Social Research. The Michigan study found good industrial relations, higher than average productivity and profitability, and general employee and management satisfaction with the ESOP. ^{43/} The study concluded that whether the plan was adopted for financial or moral reasons, "...the data of this report indicate that employee ownership may contribute to the economic viability of a firm and to the economic well being of members as well as to the quality of working life within the firm." ^{44/}

The TRASOP Muddle

The TRASOP variation, which is tied to the investment tax credit, needs to be looked at separately. The attraction here is to companies with high capital expenditures and relatively few employees. The oil companies would be a prime example, and, in fact, most of them have set up TRASOPs. At the other end of the scale, a large retailer like Sears Roebuck would find the per employee amounts to be too small to bother with, i.e., on the order of less than \$10 per employee.

Although some 200 of them have been set up, I found little enthusiasm for TRASOPs even among the companies that have the most to gain. Certain of the special provisions, such as the immediate vesting requirement have proved to be quite burdensome, involving, for example, the requirement to chase after short-term employees with checks for trivial amounts. Also, many of these companies have long-standing plans through which employees can obtain company stock, frequently at a discount or with proportional contributions from the company. They consider these established plans to be successful and well understood, and are reluctant to muddy the waters with this new scheme. This is especially true since there is considerable uncertainty as to whether the TRASOP provision will be continued beyond 1980.

I was told by an official of one of the major oil companies that they set up a TRASOP because they felt that they had no choice but to pass on this 100% tax subsidized benefit to their employees even though they were skeptical about it. He said that the administrative requirements were extremely onerous, particularly with regard to the requirement to get a $\frac{1}{2}\%$ contribution from the employees in order to take full advantage of the investment tax credit under the Tax Reform Act of 1976. They have a well functioning and appreciated plan for employee stock purchases, with company contributions, which they believe far better serves their needs.

The pressures on a large company to set up a TRASOP, however reluctantly, can best be illustrated by reference to the situation involving American Telephone and Telegraph (AT&T). AT&T was among the all but a handful of companies that had not set up a TRASOP by the end of 1975. In October of that year, Senator Long made a speech at Louisiana State University which contained a message aimed directly at AT&T:

This great company is entitled at this very moment to claim \$50 million tax-free from the U.S. Treasury in order to buy stock for its employees and to help finance expansion, to buy new equipment, or whatever they might need. Now if I were a union organizer, I would have something to say about a company that would turn down \$50 million out of the U.S. Treasury rather than let their workers have it. 45/

Senator Long had made AT&T an offer they couldn't refuse, and they have subsequently set up a TRASOP. I suspect that many of the other companies that went on to set them up also got the message in that speech.

A number of the large, capital intensive firms pointed out to me that they had no interest in using an employee trust as a corporate financing technique. They depend heavily on retained earnings for new capital investment. Moreover, they would be concerned about

the impact on their widely traded stock were they seen to be, "borrowing from our employees." This is part of the reason why they have been so carefully examining the teeth of the TRASOP gift horse.

A Caveat on the Wonders of ESOP Financing

Actually, the corporate financing advantages of an ESOP of any kind are not quite as wonderful as they might at first appear. True, the company contributions to the ESOP for repaying the loan used to purchase company stock are untaxed, and in a certain sense this is equivalent to paying back principal as well as interest on a loan in pre-tax dollars. But the hooker is that in addition to paying back the loan, the company has to "give away" stock of the equivalent market value. The essence of the transaction can be better understood if one considers that a company would be in exactly the same financial situation if it took out a standard loan from a bank and then made comparable contributions of its stock to an employee trust as it paid back the loan. In either case, the tax saving involved relates to the contribution to the trust, not to the repayment of the loan. 46/

Thus, it does require a certain set of circumstances for ESOP financing to be seen as advantageous. These circumstances, which now exist mainly in smaller, more closely held firms, include lack of retained earnings and accompanying cash flow stringency, need to make a market for an untraded stock, and desire of an owner to capitalize equity most effectively from a tax viewpoint. It is significant in this regard that many ESOPs have not been employed as a corporate financing technique. This was true of more than half of the ESOP companies I contacted, which was consistent with the reported results of a survey by Hewitt Associates:

One of the most interesting questions concerning ESOP experience is whether companies are actually using their plan as a corporate finance technique. Five of the 10 companies in the survey reported that they have used their ESOP as a technique of corporate finance. 47/

The Hewitt study is one of the best available overall analyses of ESOPs, and, in particular, contains an excellent, detailed analysis of the financial implications of ESOP as compared to other financing alternatives. 48/

What Is This ESOP Animal?

A good part of the confusion that one encounters on this subject stems from the fact that the ESOP, like the elephant in the story of the three blind men, is perceived quite differently depending on the

direction from which it is approached. These differences are just as marked as those between the snake, the tree trunk, and the wall, that were separately perceived by the three blind men.

As an employee benefit scheme, it is often viewed suspiciously because of the lack of diversification that makes it vulnerable to changes in the fortunes of the company. In particular, its use as a pension fund is condemned on the basis that most firms decline or go out of business entirely over the 30-40 year working life of the average employee. Those that see it from this angle believe an ESOP has to be judged strictly on its merits in comparison to other employee benefit plans, such as pensions, profit sharing, and stock bonus plans.

Those interested in economic development in depressed areas see it as a way of saving jobs. Indeed, ESOPs have already shown their worth in that regard in companies which are effectively managed.

From a company's point of view, it can be seen under certain circumstances as an advantageous technique for financing new capital creation. The owner of a closely held company may look at it as a way of making a market for part or all of his equity in a way that minimizes both his taxes and his loss of control over the company.

The general taxpayer may think he is observing a slick corporate tax gimmick. Believers in Louis O. Kelso's universal capitalism are certain that an ESOP really is an essential element in the coming capitalist revolution.

As with the elephant, they all may be on to a piece of truth. But their different perceptions certainly make communication among them an awkward thing. A statement that ESOPs make lousy pension plans is likely to call forth the rejoinder that they make it possible for the common man to use the credit of corporations to build a viable capital estate, while in the process arresting America's drift towards socialism.

V. OTHER SHARE-THE-WEALTH APPROACHES

Profit Sharing

Programs aimed at broadening employee participation in industry profits are not new in America. For example, as the Profit Sharing Council points out, profit sharing is an old and widespread tradition:

Half a century has passed since Congress enacted the first legislation dealing with profit sharing plans and trusts. From a mere handful of plans in existence at the birth of tax-exempt profit sharing, the number of qualified plans has grown to well over 100,000. No one knows the number of nonqualified cash plans that have come into being since the first recorded plan was established in 1794, but informed estimates indicate that the number in existence today nearly equals the number of qualified plans. 49/

The Council's 1977 survey of its member firms revealed a number of interesting characteristics about these plans: 50/

- The average contribution amounted to 9.69% of participant's pay.
- Smaller companies tend to make discretionary determinations on contributions while large companies tend to use profit-related formulas.
- The large majority (78% of those surveyed) of companies with deferred profit sharing plans, which are by far the most prevalent, do not offer an employee pension plan.

Pensions

In a 1976 book, Peter Drucker describes what he terms the growth of "pension fund socialism" in America:

Through their pension funds, employees of American business today own at least 25% of its equity capital, which is more than enough for control. The pension funds of the self-employed, of the public employees, and of school and college teachers own at least another 10%, giving the workers of America ownership of more than one-third of the equity capital of American business. Within another ten years, the pension funds will inevitably increase their holdings, and by 1985 (probably sooner), they will own at least 50--if not 60--percent of equity capital. 51/

Drucker credits Charles Wilson, former Chief Executive of General Motors, with creating the first modern corporate pension fund in 1950. His innovation was a broadly diversified pension fund investment policy. Some one-stock pension funds such as Sears-Roebuck's, established in 1916, had been fabulously successful, making millionaires out of janitors. Drucker, however, agrees with the response Wilson gave at the time:

More than half the leading retailers of 1916 had disappeared by 1950, thirty-five years later--a good many of them even before the depression--and the surviving companies, including such well-known names as Montgomery Ward, J. C. Penney, or the A&P, had done so poorly on average that employees dependent for their pensions on funds invested in these companies would, in 1950, have had to retire with little or no retirement income. 52/

Drucker concluded that, "investing the worker's main savings in the business that employs him may be 'industrial democracy', but it is financial irresponsibility." 53/

As noted in Robert Hamrin's analysis, the growth of pension funds is not an unmixed blessing. 54/ They are generally managed by asset managers with a conservative approach to equity markets that dictates a concentration on the stock of large substantial companies, thus diminishing capital available for newer, growing businesses. They move large blocs of stock, often on the same side of the market, which increases the risks to smaller investors. (Hamrin records, in that regard, that individuals were replaced by pension funds as the largest buyers in the market in the 1950's. As a result of 18 years as net sellers, individuals reduced their share of outstanding stock from 87% to 65% by the end of 1975). 58/ While recognizing that pension funds have been a major source of funds for capital formation, he explains, "By the late 1980's, however, it is likely that pension funds will have become pure transfer mechanisms, perhaps even dissaving because of the demographic trends which will lead to more benefit payments and less receipts." 56/

More philosophically, it can be argued that ownership through a pension fund of equity capital doesn't give the individual a sense of participation in the capitalist system. In fact, all he does own is a promise of a fixed future payment. This is an important asset, but it is different from an individual capital estate which carries with it significant rights of ownership as well as some risks. He never gets his hands on a share of the actual assets that are collectively owned and managed by the pension fund. It may be indicative that Drucker chose to describe the phenomenon as "pension fund socialism" rather than "pension fund capitalism"--particularly in view of the close involvement of

government regulators in the activities of fund managers through legislation such as ERISA.

Stock Options and Related Plans

Many of the largest American companies have established preferential arrangements by which employees may acquire their stock. The scope of this development can be seen in a 1956 brochure published by the New York Stock Exchange covering plans set up in the 9 year period beginning in 1947, which notes, "Approximately 40% of all domestic companies have adopted stock purchase or stock option plans within the nine-year period. There are, of course, additional plans which started before 1947." 57/

Most stock plans offer the employee a clear incentive to acquire the stock. IBM, for example, offers a 15% reduction below current market price, the maximum allowed for plans approved by the IRS. Many others, such as Exxon, offer company contributions of stock to supplement purchases by employees who are regular participants in the plan.

VI. SORTING OUT SOME ISSUES

Productivity

Clearly, one key issue is whether employee ownership plans have any positive impact on productivity and employee motivation. Consultants and motivational researchers tend to downgrade this factor. In a study done for Conrail by a consortium of consultants, it was said that, "Research has shown that for employees in the middle income brackets, the minimum effective incentive ratio, excluding consideration of inflation and taxes, is somewhere between 20% and 35%. This means, in effect, that the payment of annual dividends below 20% of the employee's current earnings cannot reasonably be expected to increase productivity." 58/ The study concluded that for several reasons, including lack of motivational impact, Conrail should not institute an ESOP. 59/

It is difficult to demonstrate that morale and productivity increases have been caused by establishment of an ESOP, but it was impossible for me not to be impressed by the enthusiasm of those who have not been involved in these ventures. For example, the Virginia representative of Library Bureau, a Herkimer New York company that formed an ESOP in the course of splitting off from Sperry Rand in 1976, told me that his customers have been remarking on his improved service and asking what happened. He said he senses his own improved motivation and knows that the improvement in his productivity is due to the new status of the company. The chief executive of Library Bureau told me that the absentee rate at the company had dropped from 8% to 2% since the establishment of the ESOP.

Professor Hans Brems, in discussing differences between the European wage earner's investment funds (WEIF) and ESOPs, stressed the difference between one company productivity and productivity for the economy as a whole. 60/ He granted that with a one-stock ESOP fund productivity may well be raised in tangible ways on the plant floor. He added, however, that the more diversified non-job related WEIFs are more conducive to labor mobility, and this mobility in turn is an important factor in productivity for the economy as a whole.

The Big Picture

As with productivity, it is necessary generally to consider what impact various courses of action would have on the economy as a whole, not just the effect on individual firms. As we have seen,

for example, the widespread development of pension funds, which is highly desirable from the point of view of the individual worker, may be having an effect on equity markets and the economy's ability to raise venture capital that would be a source of serious concern if present trends continue.

The Kelso approach to universal capitalism raises some sensitive questions. In that regard, one must consider its potential for having an inflationary impact. Kelso's claim that his proposals would be consistently deflationary depends on his assumptions that: (1) the new investments generated would lead promptly to increased outputs of goods and services; and (2) that wage demands would moderate as workers developed a second income from property holdings. It is not obvious that either assumption would hold, in the aggregate, particularly as the economy approaches full employment, and production bottlenecks begin to develop. Hamrin expresses considerable concern on this point:

Widespread adoption of leveraged ESOPs, especially if accompanied by high economic growth rates, would contribute to inflation. The greatly expanded use of bank credit to finance new capital through ESOPs would result in a large increase in the money supply that would be fed into a demand for goods and services immediately. This process of sending more money after the productive capacity is an engine of inflation. Such use of bank credit on a small scale would do no harm, but on a massive scale, inflation would be aggravated. 61/

The impact of a widespread Kelso approach on equity and bond markets raises uncertainties that need to be examined. What would be the effect of a recession on a financial system structured along Kelso lines? It is not that universal capitalism would necessarily have seriously adverse impacts in any of these areas. It may be, for example, that tying credit expansion to productive new investment may be significantly less inflationary than the kind of deficit spending credit creation associated with traditional transfer payment policies. The effect on equity markets may be salutary and stabilizing. The problem is that we don't know and are not doing what is necessary to find out.

The clear need is for a major effort to study, including the use of extensive econometric analysis, what some of these effects might be. This is an urgent requirement that should be pursued before we get too far down any particular road to broadened stock ownership. It is a requirement that will not be fully met until the economics profession as a whole overcomes its distaste for what it views as Kelso's penchant for overstatement, if not hucksterism, and takes a sustained hard look at the implications of the policies he is recommending.

The aggregate numbers involved are easy to manipulate to support your particular point of view. Opponents of Kelso frequently point out that if all dividends in 1975 were evenly distributed to the non-government work force of 91 million, it would amount to \$360 for each of them. Kelso's thesis, however, requires that corporate income tax be eliminated and all earnings paid out as dividends. This would increase the 1975 figure to \$1,283 per worker. ^{62/} Also, Kelso is talking about a development that would occur over a period of decades and be the result of sharing the income on newly created capital, which, given the dynamics of the situation he is postulating, would be massive. Since it is not unreasonable to talk in terms of 4-5 trillion dollars in new capital being created in the United States over the next decade or so, one could on that basis project capital estates on the order of \$100,000 being created out of that pot for 50 million household units. ^{63/}

The Next Round

Most people, certainly most politicians, would agree in principle that broadened stock ownership is a good thing. The debate on what to do next will center largely on the question of the best means of accomplishing that objective.

(It is perhaps worth noting, however, that even the goal is not fully agreed. One Executive Branch official, while quite sensibly disavowing any intent to confront Senator Long on the issue, argued to me that stock was a much less desired form of compensation than money and that it was, therefore, inefficient to use it as such both for the employer and the employee. In particular, it was foolishness to encourage the use of this second rate form of compensation through tax subsidies. He took the position that if workers want stock, we should let them buy stock. He said, "let them buy stock" with much the same intonation that Marie Antoinette must have used when she said, "let them eat cake".)

For those that agree on the goal of broadened stock ownership, the question of what we should do next depends importantly on whether you are a convinced capitalist revolutionary or not. If you believe with Louis Kelso that we must fundamentally change the procedures for financing new capital creation, that suggests one set of alternatives. If not, then other alternatives become appealing.

For the advocates of Kelsoism, the path has been laid out. The requirement is to proceed to take measures that will encourage the payment of all dividends and encourage equity financing of new investment through ESOPs and a financed capitalist program. The non-believer would be more tempted to look at the full range of techniques including profit sharing plans, stock option and stock bonus plans,

individual retirement plans (IRA and Keogh accounts), pension plans, ESOPs and possibly some variation of a financed capitalist plan, as complementary methods for broadening the ownership of equity capital.

Those not convinced that ESOPs are the key to capitalist salvation are also more bothered by their lack of diversification, particularly to the extent that they are substituted for pension funds, which provide a more assured benefit for the employee. This concern is heightened by the impact of the Pension Reform Act of 1974 (ERISA). In the process of dealing with pension abuses, ERISA has increased the paperwork burden and expense of pension funds that were already becoming extremely burdensome for many firms. I was told by an official of the Pension Benefit Guaranty Corporation, which was set up under the Act, that some 20,000 firms have terminated their pension plans since the passage of the Act in 1974. These tend to be smaller firms, for which ESOPs already have the greatest attraction.

VII. CONCLUSIONS AND RECOMMENDATIONS

Concerned about a persistent imbalance in which one-half of America's wealth is owned by six percent of its people, 64/ the United States Congress has made a commitment to broadened stock ownership and will enact significant and far-reaching further legislation on this subject in the years immediately ahead. It is equally clear that not nearly enough thought and analysis has been devoted to this subject to provide a sound basis for a public policy development of this magnitude. In particular, the policy proposals of Louis O. Kelso, which have been instrumental in bringing this issue to a head and which have been reflected in a series of laws, have not been subjected to the kind of systematic, searching examination by economists that they require.

The need now is to proceed with a national debate which will assure that all aspects of this issue are fully illuminated. The Joint Economic Committee hearings in 1975 on ESOPs were a good beginning, but only a beginning. The issue must be looked at as a whole so that we can develop a sense of how the parts fit together and how the total program affects the economy in its entirety, not just individual firms and groups of employees. Consideration must be given to the potential and the limitations of the full range of techniques that can lead to broadened capital ownership, e.g., profit sharing, pension plans, individual retirement accounts, stock bonus and option plans, ESOPs, and a financed capitalist plan. Particular attention should be paid to how these techniques interact and how incentives for one may impact on others.

Early experience with ESOPs have shown that they can have an important favorable impact, at least over a particular range of companies. Further, they have been remarkably successful for certain specialized purposes, such as the saving of jobs through the rescue of divisions spun off by conglomerates, which would have otherwise closed. It remains to be seen whether they can achieve wider usage through further modifications in the conditions under which they are formed and operated.

TRASOPs have not worked well and need to be re-thought. As currently structured, they represent a straight transfer from the general tax fund to a select group of relatively high paid employees of capital intensive corporations, under conditions that create a considerable administrative burden for the companies concerned. They had the merit of being one immediately available means for getting some broadening of stock ownership for at least some part of the investment tax credit, the bulk of which represents, in effect, a gift to existing owners of capital. Senator Long, at the time it was debated in the Senate, told his critics that if they didn't like TRASOPs they should come up with some better idea for achieving the objective of broadened stock ownership. The time has come to do so.

In general, I would recommend that we continue in a measured and careful way with experiments designed to further test elements of Kelso's universal capitalism at the same time that we proceed with the debate and study of the concept of broadened stock ownership, which I would anticipate would continue over a number of years. ESOPs significantly differ from certain other employee deferred benefit schemes only in their use as a corporate financing device, and further legislative incentives should concentrate on that aspect. Congressman's Frenzel's bill is well designed to do this through further tax benefits tied to financing operations and an important procedural provision calling for advance IRS rulings on stock evaluations for ESOP purposes.

The approach aimed at precluding ESOP abuses seems to me to be premature. Required diversification, for example, could undercut the special character and potential of an ESOP as a financier of new equity capital, before its usefulness in this regard had been fully tested. A requirement for an ERISA approved pension fund in conjunction with an ESOP could also be counter-productive. Thousands of smaller firms have simply found they cannot sustain pension funds in the face of ERISA's requirements, and these companies would then also be precluded from establishing ESOPs. ESOPs may have real weaknesses as pension funds, but they are certainly better than nothing, if that is the alternative.

Senator Gravel's soon-to-surface legislation on a financed capitalist plan represents a major breakthrough in this area. It would effectively complement the ESOP approach and constitute a more controllable and clear-cut test of the viability of Kelso's Second-Income Plan. It deserves the most careful and serious consideration of the Congress and the country.

America's success in creating viable capital estates for many who would otherwise have little prospect of achieving them, would have important implications that would extend beyond our own society. If we can deal effectively with some of the inequities and imbalances in our system through such a fundamentally capitalistic approach, this will send a powerful message to others who are weighing the merits of collectivist and free enterprise solutions to the problems of their societies. Thus, we have a broad interest in making this creative response to income inequities work.

FOOTNOTES

- 1/ Louis O. Kelso and Mortimer J. Adler. The Capitalist Manifesto (New York, 1958), passim
- 2/ Ibid., pp. 121-137
- 3/ Louis O. Kelso and Patricia Hetter. Two Factor Theory (New York, 1967), passim
- 4/ Ibid., p. 17
- 5/ Louis O. Kelso and Mortimer J. Adler. The New Capitalist (New York, 1961), p. 4
- 6/ Paul A. Samuelson. San Juan Star (April 27, 1972), as quoted in Stuart M. Speiser. A Piece of the Action (New York, 1977), p. 93
- 7/ Hearings before the Joint Economic Committee, Congress of the United States. (December 11, 1975), part I, p. 523
- 8/ Wall Street Week, shown on the Public Broadcasting System and hosted by Louis Rukeyser (December 12, 1975), as quoted in "The New Capitalist" (San Francisco, July 1976), p. 5
- 9/ Speiser, Piece of the Action, op. cit., Chapter 5
- 10/ Ibid., p. 93
- 11/ J. J. Jehring. The Significance of Von Thuner's Theory of Wages for Profit Sharing and a Free Economy (Evanston, 1960), passim
- 12/ Ibid.
- 13/ Ibid.
- 14/ John Maynard Keynes. How to Pay for the War (London, 1940), as quoted, Speiser, op. cit., p. 327
- 15/ J. E. Meade. Efficiency, Equality and the Ownership of Property (London, 1964), passim
- 16/ Ibid., p. 27
- 17/ Ibid.
- 18/ Ibid., p. 40
- 19/ Ibid., p. 59
- 20/ Ibid.

- 21/ Kelso and Hetter. op. cit., passim
- 22/ Ibid., p. 67
- 23/ Ibid., p. 68
- 24/ Ibid., p. 71
- 25/ Ibid., pp. 78-79
- 26/ Ibid., p. 79
- 27/ Norman G. Kurland, "Beyond ESOP: Steps Toward Tax Justice", The Tax Executive (April 1950), pp. 386-402, as reprinted by WORLD INSTITUTE OF ECONOMIC JUSTICE, 2027 Massachusetts Avenue, NW, Washington, D.C.
- 28/ Ibid., pp. 389-390
- 29/ Speiser, Op. cit., p. 194
- 30/ "Moving to Broaden Stock Ownership", Pensions and Investments, January 3, 1977, as reprinted by Norman Kurland and Associates, Washington, D.C. This is a particularly useful article on the history of ESOPs and legislation effecting them.
- 31/ "ESOPS: An Analytical Report", Hewitt Associates (Dearfield, Illinois, 1976), pp. 8-13; includes a good summary and analysis of legislative provisions affecting ESOPs
- 32/ 1976 Joint Economic Report, Joint Economic Committee, Congress of the United States (Washington, March 1976), p. 100
- 33/ "Mighty Kelso, His Brainchild is Idea 'Whose Time Has Come'", Barron's, July 21, 1975, p. 3
- 34/ Tax Reform Act of 1976, Public Law 94-455, 94th Congress, Sec. 803(h)
- 35/ Summarized from an analysis by Hamrin, JEC Staff Study, p. 62 (see footnote 46)
- 36/ ESOPS: An Analytical Report, op. cit., p. 56
- 37/ Senator Mike Gravel, The Financed Capitalist Plan, a working draft, p. 3
- 38/ Ibid.
- 39/ Ibid.

- 40/ It is difficult to know for sure, but the 2000 estimate was given to me by two of my best informed contacts, Jack Curtis of the Senate Finance Committee Staff, and Bert Metzger, President of the Profit Sharing Council in Chicago
- 41/ Janice Shott, "Employee Stock Ownership Plans", Council on Urban Economic Development (Washington, April, 1978). This gives a good presentation on the use of ESOPs in economic development and contains details on the SBL case.
- 42/ ESOP Hearings before the JEC, op. cit., December 12, 1975, part 2, p. 624
- 43/ Michael Conte and Arnold S. Tannenbaum. Employee Ownership -- Report to the Economic Development Administration United States Department of Commerce (Ann Arbor, June 15, 1977) passim
- 44/ Ibid., p. 38
- 45/ Senator Russell Long, from a speech at Louisiana State University (October 1975), as quoted in Speiser, op. cit., p. 210
- 46/ Robert Hamrin, Broadening the Ownership of New Capital: ESOPs and Other Alternatives, a Staff Study prepared for the use of the Joint Economic Committee Congress of the United States (Washington, June 17, 1976), pp. 41-49.
- 47/ ESOPS: An Analytical Report, op. cit., p. 51
- 48/ Ibid., pp. 29-41
- 49/ Guide to Modern Profit Sharing, Profit Sharing Council of America (Chicago, March, 1973), p. iii
- 50/ 1977 Profit Sharing Survey (1976 Experience), Hewitt Associates in cooperation with the Profit Sharing Council of America (Chicago, 1977), passim
- 51/ Peter F. Drucker, The Unseen Revolution (New York, 1976), p. 1
- 52/ Ibid., p. 9
- 53/ Ibid., p. 8
- 54/ Hamrin, op. cit., Chapter 1
- 55/ Ibid., p. 14

- 56/ Ibid., p. 16
- 57/ Stock Ownership Plans for Employees, New York Stock Exchange (New York, December 17, 1956), p. 1
- 58/ "An Evaluation of the Employee Stock Ownership Plan as Applied to Conrail," prepared jointly by E. F. Hutton, Towers, Perrin, Forster and Crosby, Inc., and Dr. Saul Gellerman (Washington, May 12, 1975), p. 37, as quoted in JEC Hearings on ESOPs, op. cit., part 2, p. 692
- 59/ Ibid., pp. 712-715
- 60/ JEC Hearings on ESOPs, op. cit., part 1, p. 523
- 61/ Hamrin, JEC Staff Study, op. cit., pp. 49, 50
- 62/ Ibid., p. 50
- 63/ "Capital Crisis - the \$4.5 Trillion America Needs to Grow," Business Week, (September 22, 1975), as quoted in Speiser, op. cit., p. 31. The \$4.5 trillion figure is their estimate of U.S. Capital needs in the decade 1975-1984
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KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

October 3, 1978

Mr. Jerry Gauche
Legislative Aide
Office of United States
Senator Mike Gravel
3121 Dirksen Senate Office
Building
Washington, D.C. 20510

SUBJECT: GSOP Legislation

Dear Jerry:

While I gather from our telephone conversation of Tuesday afternoon that substantial restructuring of the proposed GSOP bill has been done by the drafting team on the Joint Committee since your outline of September 25, 1978, a copy of which you sent to me, nevertheless I will give you the benefit of the comments of our tax counsel, George Byron Gordon, on your draft of September 25, 1978. The information may be of some use in your attempting to obtain modification of the bill so that amortization of corporate debt incurred for the purchase of capital assets will be treated by each Alaskan AGSOC stockholder taxpayer as a deductible expense.

The following references are to the sections, subsections and paragraphs as enumerated in your memorandum of September 25, 1978, to Messrs. Ted Sims, et al.

Section I, Paragraph 3

Should not the word "ownership" be changed to "initial ownership" or "issuance"? While all of the design thinking must be hammered out yet, is it not possible that there will be something similar to a vesting schedule, under which, after a certain period of years, or the reaching of a certain age, vested shares may be removed from the state? For example, an Alaskan resident may wish to retire to Hawaii. His ability to do so may be dependent upon his ownership of AGSOC stock. This would not result in permanent removal of the stock from the state if the stock can only be sold back to AGSOC. In other words, if AGSOC becomes the sole market for the stock.

Section II-B

In line 2, after the figure "531", insert a semi-colon and the following words: "shall be deemed not to be a regulated investment company nor a personal holding company for any purposes of the Internal Revenue Code or for any purposes of regulation by the Securities and

Mr. Jerry Gauche
October 3, 1978
Page Two

Exchange Commission."

Section II-B, Paragraph 2

Strike present language and insert in lieu: "Corporation would be subject to all other provisions of Subchapter C, except that payments for amortization for and interest upon debt incurred to purchase capital assets shall be deemed deductible expenses and shall be included in the incidence of income, deductions and deductible amortization of debt principal flowing through to stockholders."

Section C, Paragraph 1

Change the period after "C" to a comma and add the same language as that inserted in the preceding paragraph beginning with the words "except that payments for amortization" etc.

Section II-C, Paragraph 4

Add at the end a new Subparagraph (d) reading: "Deductible share of debt amortization payments by the Corporation."

Section III-A, Paragraph 1

After the last word in the third line, "income", add "as computed under Section II-B, Paragraph 2 above."

Section III-B, Paragraph 1

In line 2, strike the words "but only", and after the next word, "to", add "the".

At the end of line 3, following the word "return", add the words "or is reported as deductible debt service in the information return filed by the Corporation under Section II-C, Paragraph 4, above."

Section III-B, Paragraph 2

Add the last four words "(but not below zero)" following the word "reduced" in the first line.

In the second line, following the word "holders", add the words "other than dividend amounts in excess of debt amortization deduction."

Among the arguments that you can use and I am sure have already thought of to persuade the Treasury to go along with the deductibility of each citizen-stockholder's share of the debt service are the following:

1. The working man and the average citizen have never been able, barring some negligible accidents, to acquire any significant capital

Mr. Jerry Gauche
October 3, 1978
Page Three

ownership in after-tax dollars. ESOPs, on the other hand, are presently building capital ownership into millions of working people, and this will make them better taxpayers. To attempt to substitute the use of depreciation for non-Federal-taxation of corporate income used to pay for the citizen-stockholder's stock ultimately amounts to denying depreciation to the corporation, and thus assuring that it will be a slowly dying enterprise. This deprives the Treasury of better individual stockholder taxpayers with incomes derived from a healthy enterprise. Furthermore, since many people will not understand that the failure of the GSOP as a business is directly the result of a tax legislation error, further disenchantment with broad ownership of capital will result. This flaunts the policy already set forth by Congress in the Tax Reform Act of 1976, as well as the policy recommendation of the staff of the Joint Economic Committee in its Annual Report for 1976.

2. If the GSOP legislation, which can first be used in Alaska, is properly designed and is successful, it may be used to set up a national financed capital ownership plan that could be used on the one hand to finance corporate growth in general with low-cost capital, and to provide capital incomes to take the place of Social Security, and perhaps eventually welfare in general at the national level. In other words, an error at this level can defeat the solution of some of the most solution-resistant problems that the nation's economy faces today.

3. Even the recent publication by the State Department, "Making New Capitalists -- A Creative Response to Income Inequities", in its title, as well as in its text, acknowledges the wholesomeness of the two-factor financing technique behind the ESOP. All that our proposals would do is extend this principle to some major assets at the state level.

I wish you great success.

With best regards,

Sincerely,



Louis O. Kelso

LOK:ch

DATE: August 8, 1978
TO: Jerry Gauche, Legislative Aide to The Honorable Mike
Gravel, United States Senator
FROM: Louis O. Kelso

SUGGESTIONS FOR REVISION OF S. 3223 AS
INTRODUCED INTO THE SENATE OF THE 95TH
CONGRESS, 2ND SESSION, ON JUNE 27, 1978
(CONGRESSIONAL RECORD, VOL. 124, NO. 96)

Purpose of Suggested Changes

It is suggested that the proposed changes will facilitate the use of GSOPs to finance economic growth and broaden direct and individual ownership of industry by the politically-selected constituency. These changes should also reduce the possibility of the abuse of the GSOP device to concentrate the control of industry as well as to prevent the potential politicizing of a GSOP. In other words, if a GSOP becomes simply another financial intermediary, even though it may pay out all of its earnings, it could become a threatening instrument for the control of industries and thus the election of its Board of Directors would inevitably become a political phenomenon. This is consistent with the comment made in Senator Gravel's floor statement at the time of introducing S. 3223 when he noted:

"Therefore, I think the people of the State should hold direct ownership of any equity interest the State chooses to make in private business."

* * *

"Without providing for direct ownership of the stock a plan such as the one I propose would be unduly paternalistic."

Suggested Changes in the Initial Draft of S. 3223

(References are to the draft bill taken from the Congressional Record and not to the Committee Print with numbered lines.)

(1) Since under these proposed amendments a GSOP, such as the one proposed tentatively in Alaska, may establish its own trust division, whereas it is probable in every other state, any banking firm or business authorized to engage in the trust business (a regulated business in all states), after having met the qualifications laid down by the GSOP by regulation, will undoubtedly be used as the escrow holder for individual accounts, the acronym "GSOP" should be substituted for the word "trust" wherever it occurs. This would have the added effect of inviting assistance, and avoiding opposition, of the banking community.

(2) Section 1, line 6, change the word "trust" to "plan (GSOP)".

(3) Section 1, line 8, strike the words "or a" and in line 9, following, the words "political subdivision of a State".

(4) In line 10, add an "s" to the word "purpose".

(5) In line 10, after the word "of", insert "financing the acceleration of economic growth of all types of business corporations intended to be profit producing".

(6) In line 10, after the word "broadening", insert the word "equity".

(7) In Section 1, line 22, which begins with "(A)", add the following: "if the sponsoring jurisdiction be a State, it".

(8) Amend Section 1(B) in its entirety to read as follows:

"(B) provides for the borrowing by the GSOP from individuals, banks, insurance companies, pension or other retirement funds, governmental agencies, or other loan

sources, for the purpose of investing the proceeds of such loans in the voting equity shares of any business corporation carrying on at least a significant part of its operations within the boundaries of the political entity that established such GSOP, with or without a limited or unlimited guarantee of the repayment of such debt by such political entity or a subdivision thereof or a governmental entity of which it is a subdivision, provided that:

(i) the corporate entity in which such investment is made by said GSOP shall fully meet criteria of credit worthiness established by regulations adopted by the political entity which established said GSOP or by the GSOP if the power to make such regulations has been delegated to it by such sponsoring political entity, which criteria shall be designed to assure the adequacy of the dividends to be paid by the corporation in which such investment is made over the term or terms of the loan or loans incurred by the GSOP to make such stock investment or investments, and which criteria shall take into consideration the added financial feasibility resulting from the guarantee of the repayment of such loan or loans by such political entity;

(ii) the shares of the issuing corporation purchased with each such investment shall have a fair market value at the time of closing of such purchase, or if such shares are not traded in any market or in quantities sufficient to constitute an effective market, an appraised value as determined by a qualified and experienced independent appraiser, at least equal to the purchase price paid therefor by said GSOP and

shall be sufficient in number (to be achieved by the splitting of said shares or the consolidating of said shares, as may be required) to permit the allocation of shares or fractions of shares to the approved GSOP stock purchase escrow account of each such participant, as of the times of each repayment of an installment of the GSOP's money purchase indebtedness. Such allocation shall be on the basis of the original purchase price and may be based upon the anticipated aggregate principal and interest of the indebtedness over the term of the financing loan or loans, with allocations being made substantially equally over the aggregate number of repayment periods, and equally to each participant account existing at the end of each installment repayment period;

(iii) "approved GSOP purchase escrows" may be established within the corporation whose shares are purchased by said GSOP if said corporation be authorized by law to carry on such trust and escrow functions, or in any bank or other corporation legally authorized to do a trust business within the jurisdiction of the political entity establishing said GSOP, if the escrow operations of such escrow holder conform to regulations relating thereto promulgated by the political subdivision establishing said GSOP or its duly authorized delegate;

(iv) the vesting of the ownership of such shares so purchased by the GSOP shall take place pro tanto only as the principal and interest of the loan financing incurred to purchase such shares is repaid;

(v) each participant shall be authorized to establish

only one GSOP purchase escrow account, and all shares purchased by such GSOP in all corporations in which it may invest, to the extent that such shares are allocated to such participant, shall be allocated to that sole escrow account;

(vi) after the loan financing, principal and interest, applicable to the purchase of particular shares of stock in which said GSOP has invested is repaid, the dividends paid upon such shares, reduced only by deductions of a proportionate part of the expenses of operating the GSOP, which shall be allocated equally among all accounts in said GSOP, shall be paid into the escrow accounts in which such shares are held, and shall thereupon be promptly paid, after deduction only for approved escrow fees of the escrow agent, to the GSOP participant as the owner of said escrow account;

(vii) each corporation having shares of its equity stock purchased by said GSOP, whether upon original issue, or upon subsequent purchase from an intermediate buyer, shall, in order to make said shares eligible for purchase by said GSOP, legally commit itself in writing, in terms satisfactory to the GSOP, periodically to pay to said GSOP its full net earnings (gross earnings, less operating expenses and necessary and reasonable operating reserves and depreciation) allocable to the shares of its stock so purchased by said GSOP, in return for which, said GSOP shall commit itself, with the approval of the political entity which established said GSOP, to equity stock purchase participation in the future growth requirements of such issuing corporation in the proportion

that the market value of the number of shares in said issuing corporation theretofore purchased by said GSOP shall bear, at the time of the closing of each such subsequent financing, to the total debt and equity capital of said issuing corporation;

(viii) the GSOP provides for the allocation to each existing GSOP purchase escrow of securities purchased by the GSOP since the last preceding allocation as of the last day of the GSOP's fiscal year in which the individual who established such escrow account became a participant in the GSOP, in a manner which does not discriminate among such participants on the basis of race, sex, age, income, or ownership of property."

(9) Section 1, paragraph "(C)", subparagraph "(i)", line 1, change the number at the end of the line from "5" to "10".

(10) Section 1, paragraph "(D)", line 2, after the words "by the trust" (changing as throughout the word "trust" to the word "plan"), insert the words "which it is authorized and directed to distribute to participants".

(11) Section 1, line 58, strike paragraph "(F)" in its entirety and insert the following:

"(F) provides that dividend payments made to a GSOP participant under the age of eighteen (18) years may be paid by the escrow holder for the account of such GSOP participant to his parent or other legally appointed guardian, but no dividends shall be paid, nor shall any of the securities held in such GSOP purchase escrow be distributed to the participant or his heirs or beneficiaries, and that before the distribution

of portfolio securities shall be made to a participant, or his heirs or beneficiaries, he, or such heirs or beneficiaries, shall have taken and passed with a grade established by the GSOP to be satisfactory, an economic literacy test which shall be prescribed by the political entity establishing said GSOP, which political literacy test shall be designed to determine that the participant seeking the release from escrow of his portfolio securities is aware of the full significance of the ownership of equity stock representing productive capital; of the necessity of maintaining intact so far as may be economically feasible for such individual the principal of such equity portfolio, with such sales and reinvestment of the proceeds thereof in other and presumably more desirable equity or debt securities, should such be available, and using for purposes of consumption the income or yield thereof; that productive capital contributes to the production of goods and services in the same senses that labor does and that an individual may just as legitimately and morally engage in producing his income through such private capital ownership as through the exercise of his privately owned labor power; that because productive capital is a major source of affluence and economic security in a modern economy, such participant should interest and involve himself in the adequacy of the economic performance of the companies in which he holds equity investments, and upon such other matters as said political entity or the GSOP as its delegate shall determine appropriate for such economic literacy tests with a view to promoting stable, long-term investors to the extent of

the capabilities of said GSOP."

(12) Section 1, last sentence beginning with "(G)", change the word "be" to "by".

(13) Section 2, line 9, after the word "security" insert "and only then to the extent he shall fail to reinvest the proceeds of such sale in income producing capital or equity stock representing such capital."

(14) Section 2, first paragraph, line 14 (the second line from the bottom of the page), after the figure "1954" add "to the extent that such sums are applied by the GSOP to the repayment of principal and/or interest of loans incurred for the purchase thereof, nor thereafter".

(15) Section 3, line 14, change the last word in the line, "a", to "General Stock Ownership Plan (GSOP) purchase escrow."

(16) Section 3, under subsection "(b) DEFINITIONS" in line 10, following the words "any individual for whom", change the word "an" to "a GSOP stock purchase escrow".

(17) In line 15, after the words "benefits are distributed from the", change the word "trust," to "GSOP stock purchase escrow,".

(18) Section 4, line 7, change the word "trusts" to "plans".

(19) Section 5, line 2 (in the title to the section), change the word "TRUSTS" to "PLANS".

****PLEASE NOTE****

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DESCRIPTION: XEROXED AND PIECED TOGETHER FULL NEWSPAPER PAGE

ANCHORAGE DAILY NEWS, THURSDAY, FEBRUARY 1, 1979

PAGE 11, ALASKA LIVING SECTION

"'FATHERING' AN ECONOMIC RENAISSANCE, INTERVIEW: LOUIS KELSO"

News

5/31/79

Editorial

When the AGSOC meets Alaska, Inc.

Sen. Mike Gravel has made his proposal for creation of a citizen-owned corporation a centerpiece of discussion in Alaska, and it's time to give the plan a close look.

The basic outline is a familiar one, and has been given voice in Alaska before by Gov. Jay Hammond's proposals for "Alaska, Inc." There are major differences between the plans advanced by the two men, however.

Basically, Sen. Gravel's plan calls for creation of a general stock ownership corporation where investments in private enterprise are guaranteed by the state and dividends would be distributed to residents. Sen. Gravel suggests that purchase of the British Petroleum share in the trans-Alaska pipeline would be a good start — and could yield about \$400 yearly for every Alaskan. By the year 2,000, by his projections, a portfolio of perhaps \$10 billion could be distributing \$10,000 annually to citizens.

The plan, pioneered by economist Louis Kelso, has been successfully implemented in companies, where employees become owners of their business. It has not been tried on nearly so grand a scale as envisioned by Gravel and others, but his persuasive salesmanship is certain to bring the issue to a boil here.

Gov. Hammond, whose Alaska Inc. idea is a personal favorite he now sees as "perhaps the only hope for a long-term stable economy," raises a serious question about a simple AGSOC plan. If citizens know their dividend checks depend solely on economic operations of the corporation, won't that create tremendous pressure for exploitation? A high pipeline tariff, for example, would be good news for citizen-owners, but a disaster for state oil tax revenues. Creating in voters an unrestricted vested interest in such a plan could mean dramatic conflicts of interest — perhaps evolving into a "fourth branch of government" that would lobby against legitimate state interests.

The governor proposes a system by which half the earnings of the permanent fund could be used to fund citizen dividends, earmarking the other half for funding government operating expenses. That balance, he argues, would help off-set the development pressure AGSOC owners would bring to bear.

Certainly the governor's concern over conflicts is a valid one. It is not sure even that some kind of 50/50 split would be enough to counter it. As the concept of redistributing public wealth to citizens — whether through an AGSOC scheme or a variation on the Alaska Inc. theme — gains momentum, that issue is one that demands attention.



Sen. Mike Gravel — pushing for AGSOC plan

Gravel goes on the stump for stock ownership plan

By SUZAN NIGHTINGALE

Daily News reporter

Sen. Mike Gravel is being followed these days — by a film crew recording Gravel's speeches for a state-wide advertising campaign.

The Anchorage Democrat said Tuesday he's planning the multi-media campaign to acquaint Alaskans with his Alaska General Stock Ownership Corporation, a plan Gravel says could pay every man, woman and child in Alaska \$400 a year.

Under Gravel's proposal, Alaska residents would form the corporation and, initially, purchase British Petroleum's share of the trans-Alaska gas pipeline. A nine-member board would run the corporation, with dividends being paid to "stockholders" on a quarterly basis.

The Alaska legislature declined to approve the plan earlier this year, prompting Gravel to launch a petition drive to place the AGSOC proposal before the voters. He says a statewide education program is needed to tell Alaskans about the plan.

"If we get 13,000 signatures, it'll go on the ballot," Gravel told the Dining and Speaking Society Tuesday. "I don't expect to have to go to the ballot because I think the state legislature will approve it, but what this does is force us to launch a state educational program."

Gravel says if the corporation bought British Petroleum's share of the pipeline for \$3.4 billion, it "could pay a dividend to every person in Alaska of between \$75 and \$100" its first quarter. Such secondary income could have far-reaching effects in Alaska,

especially in the bush, he added.

Looking ahead to the year 2000, Gravel said, "If we had a portfolio of \$10 billion, every person would realize a return of \$10,000 a year; a family of four would receive \$40,000."

Describing his proposal as "an effort to try and find a way to diffuse the wealth of our society," Gravel denied charges that the plan represents state involvement in private enterprise, and repeated his claim that a state loan guarantee wouldn't be necessary to finance the purchase.

"We're not doing anything that isn't already being done in the private sector," he said. "What I'm trying to do is create more democracy in the economic marketplace. Our job is to make people free and help them live better economic lives."

Saying that 52 percent of this nation's wealth is owned by 25 percent of the people, Gravel said, "So this great affluence we think we have is only our salary and not our ownership. Today we have freedom in our political structure, as best we find it, but in the private sector, in the economic sector, that was never done. Our economy is based on an autocratic and dictatorial system."

"If I'm right, Louis Kelso's (originator of the employee stock ownership concept) name will become more famous than Karl Marx. It will change the course of the free enterprise system."

"If I'm wrong, I'm prepared to suffer the consequences. I think this opportunity is so unique that if we are successful, for the rest of my career, I'll never equal this accomplishment."

The Times

Gravel To Work For Plan X

Times Juneau Bureau *4/21/79*

JUNEAU — Sen. Mike Gravel has postponed activity in Washington to work in Juneau for legislative passage of his Alaska General Stock Ownership Plan.

The senator testified here today on his plan and said he will stay through most of next week.

The plan would create a private corporation with all Alaskans as stockholders, to invest in development projects in the state.

The corporation would be required to give at least 90 percent of its earnings in dividends to its stockholders.

Until Gravel decided to stay in Juneau next week, the plan had been considered dead for this session by many legislative leaders.

But the senator said Friday he met with Senate President Clem Tillion and Juneau Rep. Mike Miller, sponsor of the bill in the House, and now believes he can secure passage of the measure.

Tillion said Friday the plan could pass the Senate if it makes it through

the House. But he said he would not hold up the session for it.

"I think we can get it through," Gravel said. Referring to almost weekly hearings the House State Affairs Committee has had on the matter, he added, "They've done good work. Essentially all the objections have been responded to."

The state's junior U.S. senator got an amendment to the Internal Revenue Service code in Congress last year which allows such a corporation to be created. It has a five-year time period for a plan in Alaska to take effect.

"We've spent hundreds of thousands of dollars in government money on this proposal, and it's just too important to let it go by," Gravel said.

The senator was hospitalized part of the day Thursday in Fairbanks for a pressure bubble in his inner ear. He has continued his full Alaska itinerary under medication for the infection.

AGSOC worries Hammond

News
5/31/79



Gov. Jay S. Hammond

Anchorage Daily News / Fran Durner

By BILL WILSON
Daily News reporter

Sen. Mike Gravel's plan to make Alaskans part owners of a publicly-owned corporation poses the danger of pitting the interests of the state treasury against those of the shareholders, Gov. Jay S. Hammond said Wednesday.

Hammond, who four years ago began working on a similar plan of his own called Alaska Inc., said the problem with Gravel's Alaska General Stock Ownership Corp. is "that you've created a situation that might be directly opposed to the interests of the people."

One of the projects Gravel has proposed AGSOC could undertake is the purchase of the BP share of the trans-Alaska pipeline. Pipeline profits climb with raises in tariffs charged for shipping the oil. At the same time state income from its one-eighth royalty share of the Prudhoe Bay pool is reduced by each tariff hike, and Hammond says the conflicting interests could pose a dilemma for shareholder-citizens.

Hammond said he plans to push "an expanded" Alaska Inc. bill during the next legislative session.

"We will try to put together a package that hopefully will fly," he said.

The big difference between AGSOC and Alaska Inc., Hammond said, is that "Alaska Inc. suggests resources be invested in a permanent fund," the Governor said, while AGSOC merely gives a share of stock to everybody who has lived here for 30 days or more. "I'm a little concerned about that," he said.

Hammond proposed an alternative to a straight residency requirement for participation in a publicly-owned corporation: Inclusion of a clause in legislation creating the corporation giving a share for "each year the citizen has been impacted by a cost of living 25 percent above the national average."

Attorney General Avrum Gross' first reaction to the idea was that it could be done without the legal hassles that sunk the Alaska hire law, Hammond said.

Hammond said he has not yet decided whether or not to call a special session of the legislature to consider previously negotiated state employee raises. "There is an increasing likelihood" that he will do so, he said. The decision will come within two weeks, and the session would probably begin in August.

The agenda of the session would

be set by Hammond, but a two-thirds vote of the legislature could change that.

Hammond said divergent proposals for the permanent fund can be accommodated by providing citizens with the option of filing for loans, tax credits, purchase of state land, tax credits or a straight dividend checks.

Sounding a favorite theme, Hammond warned against excessive dependence on oil tax revenue and its potential for "tremendous agitation" for quickly conceived development schemes needed to bankroll the state budget.

Hammond said the present tax level imposed on the oil industry is "just about right" and that if he had known what he knows today, he would have vetoed earlier bills abolishing the gross business receipts tax and establishing an income tax rebate. "If I had, I wouldn't be sitting here talking to

#32.7

SCOMM



en. Mike Gravel — pushing for AGSOC plan

Gravel goes on the stump for stock ownership plan

By SUZAN NIGHTINGALE
Daily News reporter

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Describing his proposal as "an effort to try and find a way to diffuse the wealth of our society," Gravel denied charges that the plan represents state involvement in private enterprise, and repeated his claim that a state loan guarantee wouldn't be necessary to finance the purchase.

"We're not doing anything that isn't already being done in the private sector," he said. "What I'm trying to do is create more democracy in the economic marketplace. Our job is to make people free and help them live better economic lives."

Saying that 52 percent of this nation's wealth is owned by 25 percent of the people, Gravel said, "So this great affluence we think we have is only our salary and not our ownership. Today we have freedom in our political structure, as best we find it, but in the private sector, in the economic sector, that was never done. Our economy is based on an autocratic and dictatorial system."

"If I'm right, Louis Kelso's (originator of the employee stock ownership concept) name will become more famous than Karl Marx. It will change the course of the free enterprise system."

"If I'm wrong, I'm prepared to suffer the consequences. I think this opportunity is so unique that if we are successful, for the rest of my career, I'll never equal this accomplishment."

Times The Legislative Session

By Tom Fink

THIS LEGISLATIVE SESSION ended with more pluses than minuses. It will be several weeks before we find out what all happened in the last 10 days but the overall balance is good.

There were many bills introduced which would have been damaging had they been passed. The pressure by the Senate president for a 100-day session was a big aid.

He set deadlines which some called arbitrary. However, unless you do establish a time schedule in the Legislature, it will go on indefinitely as it has in recent years.

First of all, the Legislature didn't pass any of the numerous tax increase bills the governor had introduced with the exception of the increased tax on fishing. We didn't need that tax, but that's still a pretty good score.

The Legislature didn't approve the salary increases, which although partially meritorious were too big. We have an expanding and uncontrollable state salary schedule. The fact that the Legislature did not fund the salary increase that the administration had agreed to will bring the issue to a head. The governor introduced legislation to put on the ballot any increases in case of a dispute. He really didn't push the bill. In fact, he introduced it in the House where he knew the bill would go to Mike Miller's committee, in which it would not move. He could have introduced it in the Senate where the bill would have been given consideration. In any case, the state salary schedules will be a topic of discussion between now and the next session.



THE LEGISLATURE didn't pass the Alaska General Stock Ownership Plan, which is a big plus. When the state has extra money, it should reduce debt, pay for capital improvements with cash and reduce taxes. I think most Alaskans would rather invest their own money than have another state corporation do it for them.

The Legislature stood up to the governor's pressure on making a commitment to the Northwest gas pipeline. The Legislature said it didn't have adequate information to make a decision and further than the state's decision was not necessary for the line to go forward. The legislature's position certainly has the support of the vast majority of the people of this state.

The Legislature did pass a new land law. It probably doesn't go as far as it should, but it will make land finally available to the residents of this state. The fact that the Legislature withheld 35 percent of the budget for the Division of Lands will be extremely helpful in seeing that land is made available. Also by the Legislature putting pressure on Mike Smith, we're told that he will be removed from the decision-making position.

The Legislature did make an accommodation to continue the various state loan programs. Unfortunately, it raised the interest rate from $7\frac{1}{2}$ to $9\frac{1}{2}$. With a little public pressure between now and next January, that increase in rates can be reversed.

The Legislature also made money available to start some small dam projects for power generation throughout the state. This is certainly an appropriate way to spend surplus state funds.

THE LEGISLATURE did not agree on a permanent fund bill. In my view this is a plus since the bills that were being proposed were not satisfactory. The House intended to tie up most of the money in conservative outside investments. The Senate, on the other hand, had a fancy system of leveraging money, but at least it intended to use all of the money within the state. The House bill also had proposed increasing the contribution to the permanent fund above 25 percent which would have been of no benefit to the state.

The Senate passed a resolution in favor of the Beaufort Sea sale in December and the House passed a resolution against the Beaufort Sea sale. The only important thing is that both houses did not agree to call it off. Hopefully, the governor will not hang his hat on the House's position and call the sale off.

The budget could have been worse. The fact that it is 2 percent less than last years is an achievement. The operational budget did go up. It should have gone down.

The Legislature did not come up with a solution to the capital move. It did pass a resolution directing the governor to negotiate with the Matanuska-Susitna Borough. If the borough keeps the pressure on the governor, it is possible that the next session will not be able to resist taking action with money.

With some trepidation, since I have not seen the final budget, I want to congratulate the 1979 Legislature and particularly the president of the state Senate.

Tom Fink, an Anchorage insurance man, is a former speaker of the Alaska House of Representatives.

\$3 million set aside for interim work

By CHARLIE SPENCER
News-Miner Bureau

JUNEAU—Legislators have allowed themselves nearly \$3 million for "interim committee work" during fiscal year 1980—more than \$1 million over what will have been spent for comparable activities in the fiscal year ending this June.

Interim spending two years ago, when all appropriations and newly passed legislation were added in, was, however, higher than last interim and amounted to about \$1.9 million.

Such interim spending generally is high in the off-election years. Budget records are complicated, with the amount set aside in the just-enacted 1980 budget bound to increase when all the figures filter down, say financial personnel in the Legislative Affairs Agency.

For example, for fiscal 1979, an item marked for the Legislative Council and interim committees was given about \$650,000. But more than double that amount ended up being spent out of the account.

The figure would be even higher, though some of the money will carry over another year.

This year for the same line item, the legislators are starting with \$2.7 million. All of that money will not be spent during the interim period between sessions. Some of the interim activities or committees continue year-round.

And besides the Legislative Council account, there is other money that will be spent in the interim.

The Legislative Finance Division budget, which was beefed up by about 70 per cent for 1980, supports interim

activities and staff for both houses' finance committees. The Legislative Budget and Audit Committee, funded through another account, also works during the off-session.

Though more will be spent during this interim than ever before, Sen. George Hohman, Legislative Council chairman, says it may make a bigger dent in next year's work.

"The interim work will streamline things next session," says Hohman, a Bethel Democrat.

Several committees have announced they will be studying and holding hearings on controversial and complicated issues this summer and fall.

Examples are a complicated school funding bill, which was held this session, and the controversial Alaska General Stock Ownership Corp. proposal.

That could speed up lawmakers' committee work next year during what many expect to be a much longer session than this year's 112-day stint.

Hohman also hopes to have faster, and better qualified staff, composed partly of graduates or participants of a new legislative internship program. Money for the program comes from the \$2.7 million line item.

Also in that line item is \$786,000 for activities of the 40-member House of Representatives. Some of the chamber's regular committees get a portion, topped by the Resources Committee with \$193,000 to be spread among subsistence, agriculture land and foreign investment activities.

A House special oil and gas leasing policy committee gets \$150,000.

Those committees had to submit proposed budgets to the House leadership, and each is now listed with its allocations on the newly printed budget document approved last weekend by the Legislature.

The balance, about \$1.9 million, goes primarily to committees of the 20-member Senate, with some left over for the council activities, additional House work and remodeling in the Capitol.

Hohman said Senate activities not broken out in the budget are mineral resources, Alaska in the Pacific Rim marketplace, beefing up the teleconference network, state tax policy and the constitutional convention project that is required every 10 years.

Hohman said that at the end of each decade the voters are given a choice of holding a constitutional convention. The interim work will focus on the issues around which the next session

could revolve.

Panels such as the Legislative Regulation Review Committee and the Personnel Blue Ribbon Commission are funded from the \$2.7 million.

For the present fiscal year as a control on the spending, the Legislature wrote into the budget the requirement that each interim committee chairman submit a report to the Legislative Council, for presentation to the Legislature next February.

"The reports shall include the business addressed by each committee, the recommendations made by each committee, and full fiscal information on committee expenses," says the document.

Additional guidelines will be set Tuesday by the council when it meets in Anchorage, says Hohman. Committee chairmanships and memberships will be filled then.

House Panel Passes AGSOC

By NANCY HARRIS
Empire Staff Reporter

After two months of extensive hearings, the House State Affairs Committee Wednesday adopted a substitute bill for creation of an Alaska General Stock Ownership Corporation. The bill attempts to alleviate fears of some witnesses and legislators that the proposed citizen-owned corporation would become an all-powerful economic and political force in the state.

Work on the bill (HB 240) seems to be at an end for this session. It is not clear what, if anything, will happen to the measure this year.

Sen. Mike Gravel, who pushed legislation through Congress last year to provide for AGSOC, has been in Juneau this week urging passage of the bill this session. But Juneau Rep. Mike Miller, chairman of the State Affairs Committee, indicated he might want to "take it on the road" in the interim to get comment from Alaskans.

"That doesn't preclude you from trying to sell your idea," Miller told Gravel, who has

also been lobbying members of the Senate Finance Committee to pass out a companion measure.

The Senate panel has had the bill (SB 170) for more than a month, but has done little work on it. Gravel said he is attempting to get that committee to adopt the House bill as a substitute.

The AGSOC proposal calls for creation of a general stock ownership plan in Alaska. The corporation would be exempt from federal corporate income taxes under the federal law allowing for GSOPs. Under the federal provisions AGSOC would have to distribute 90 percent of its earnings to its shareholders, who would pay personal state income taxes on the dividends.

All Alaskan residents as of the effective date of the bill would receive a free share in AGSOC.

AGSOC would set up as a private corporation and would borrow funds to finance its investments.

Gravel appeared before the House committee three times this week to explain why he

thinks AGSOC must be approved this session. Wednesday he outlined a scenario for getting the corporation in action which he said places it dangerously close to the five-year deadline, after which the special federal tax provisions will be revoked.

Gravel told the committee if any of the necessary start-up procedures take longer than expected, Alaska will have missed the opportunity to show whether a state-wide AGSOP will work.

"To wait until next year could be condemning all your efforts to naught," he said.

The committee has made numerous changes in the bill, adding an entire chapter to Alaska corporate law to govern AGSOC.

Several witnesses told the committee Alaska corporate law would be inadequate to govern AGSOC because the law concentrates too much power in the corporate directors.

Provisions to insure more director responsiveness to shareholders were added to the bill, including:

—Prohibiting the use of proxies. In their place, the corporation would send out a

ballot and information pamphlet. This would prevent proxy battles and give more voice to the individual shareholder, according to the committee.

—Allowing shareholders to amend the articles of incorporation and bylaws, place issues on the corporate ballot and nominate board of directors candidates through a petition signed by 1,000 shareholders.

—Requiring three-fourths of the board of directors to be Alaskans. The bill also requires that board and shareholders meetings be held in Alaska and that they may be teleconferenced throughout the state.

Some witnesses and legislators worried that AGSOC, with its large number of shareholders, would become a major political influence in the state if it were allowed the rights of other private corporations.

The committee substitute, in an attempt to reduce AGSOC's potential political activity, provides that:

—AGSOC could not endorse candidates or issues, spend money on political activity or

Continued on page 2

Hammond Favors Delay In AGSOC's Creation

By Empire Staff

Gov. Jay Hammond Wednesday said he does not want to see an Alaska General Stock Ownership Corporation created until his proposal for sharing Alaska's resource wealth with its citizens, "Alaska, Inc." is enacted.

In an outline of his position on AGSOC, he said he supports the concept of Alaskans receiving "some direct benefit from their resource wealth rather than simply receiving whatever more government we politicians think they should have."

But he said Alaska's long-term best interest would be served better if his Alaska, Inc. program is operating before AGSOC.

Under Hammond's Alaska, Inc. proposal, each Alaskan would receive one share of half the earnings of the Permanent Fund according to his length of residence.

Hammond has introduced a modification of his Alaska, Inc. proposal (HB99), under which the dividends would come in the form of tax credits. That measure so far has seen no action.

"The conclusion that an Alaska, Inc." type program should be established before an AGSOC proposal was reached primarily because of the potentials of an AGSOC to place the shareholders' interests precisely at odds with the state's interests," Hammond's position paper states.

For example, he said, if AGSOC purchased a portion of the trans-Alaska pipeline, one possible investment which has been discussed, AGSOC would be interested in the highest possible tariff to ensure higher profits for the corporation.

On the other hand, Hammond said, the state treasury's interest would be in a lower tariff so contributions to it and the Permanent Fund are higher.

AGSOC...

Continued from page 1

employ lobbyists.

—The incorporators would be appointed by the Governor, House Speaker and Senate President. The original board, named by the incorporators, would have to stand for election at the first shareholders' meeting. Under the original bill, the governor would have appointed all the incorporators, but Gravel, saying the administration was trying to block AGSOC, asked the committee to change that provision.

—The articles of incorporation and the bylaws must be submitted to the Legislature for approval.

—The Legislature would have the right to amend laws relating to AGSOC.

The committee decided the bill should limit the financial commitment of the state to

AGSOC. Under the substitute bill:

—There would be no commitment by the Legislature to finance AGSOC investments. Financial assistance would require legislative approval.

—The fund to guarantee private credit for AGSOC start-up expenses would be limited to \$5 million.

The committee substitute also provides that shareholders may not retain their shares if they leave Alaska. Federal law prohibits the sale of shares during the first five years unless the shareholder leaves Alaska. To discourage shareholders from leaving the state just to sell their shares, all sales during the first five years would have to be made to the corporation at book value. After that, shares could be freely traded within the state.

Gravel Mounts ^{Empire} AGSOC Drive ^{5/1/9} ^{HB 240}

By NANCY HARRIS
Empire Staff Reporter

Fearing the Alaska Legislature won't pass it next session, Sen. Mike Gravel has started an initiative drive to get his Alaska General Stock Ownership Corp. plan on the ballot in 1980.

Gravel was scheduled to leave Juneau today after more than a week of intense lobbying to get the Legislature to act this year on a bill setting up the citizen-owned corporation. He said Monday it would be "counter-productive" to continue the effort since he has met with "concern, suspicion and various levels of ignorance" among legislators.

Gravel called the AGSOC measure worked up by the House State Affairs Committee an "excellent bill," saying "It's obviously time to go forward."

She State Affairs panel worked on the bill, HB 240, and its Senate companion measure, SB 170, for more than eight weeks, holding hearings and taking testimony from several expert witnesses. But committee chairman Mike Miller of Juneau wants more public comment on the AGSOC proposal, possibly by holding hearings throughout the state during the period between sessions.

The legislation would set up a private corporation whose stockholders would be all Alaska residents on the effective date of the bill. With the help of state guarantees, the corporation would seek private financing to invest in capital-intensive projects.

Under federal legislation allowing for general stock ownership plans, 90 percent of the earnings of AGSOC would have to be paid out to shareholders.

Gravel said he didn't think the bill would be improved by more hearings and said he doubted hearings would add to the public's understanding of the AGSOC proposal.

"We've had hearings and teleconferences,"

Gravel said. "State Affairs has had over 30 meetings on AGSOC, all open to the public. You can just about hear something to death."

Gravel termed AGSOC is a very "esoteric" idea. "The only people who understand it will be the experts who bother to read economic theory," he added.

"I would venture to say there won't be 20 people who will read the entire 60 pages of legislation," Gravel said.

But Gravel said his initiative drive, which will force him to gather 13,000 to 14,000 signatures, will be an educational process, also.

Gravel admitted that it is "a little unusual" for a U.S. senator to lobby a state legislature on a bill and said he doesn't think his failure to get action on the bill reflects adversely on him.

More than half a million dollars in government funds has been spent to far on the AGSOC proposal, Gravel said. His office has been working on the idea for more than four years, he said. In addition, the Legislature contracted with Louis Kelso, a San Francisco economist who fathered Employee Stock Ownership Plans, for \$180,000 to come up with a similar plan for the citizens of Alaska.

Jerry Gauche, a tax lawyer on Gravel's staff, has been in Juneau since early March working on AGSOC legislation. Gravel said his office pays Gauche's salary, but the Legislature paid his per diem expenses while here. Gauche was not a "lobbyist" for the bill, but a staff person, Gravel claimed.

Gravel said he plans to spend a lot of his time promoting the initiative, and said he doesn't see a conflict in using government funds to plug AGSOC at the same time he is running for re-election.

"It would be an unfair criticism to say that I am doing this for political reasons," he said.

"It would be cruel, bad criticism."

Gravel Mounts ^{HB 240} Drive ^{Empire} To Get AGSOC Passed ^{4/23/9}

By The Associated Press

Sen. Mike Gravel, saying he was prepared to spend all of the week here if needed to get an Alaska General Stock Ownership Corporation bill out of committee, said there is "no logical reason for delay other than timidity."

The House State Affairs Committee, which has done the bulk of the work on the proposal, is holding several more hearings on it this week.

Gravel testified on Saturday that "a great momentum" would be lost if the bill is held over until next session. He also stressed that an AGSOC must be in operation within five years or the federal legislation providing tax and other special treatment of the plan would expire.

Under an AGSOC, all Alaskans would be shareholders and the citizen-owned corporation would invest in capital intensive projects.

Gravel said the "real test" on whether the

idea has merit will come in the bond marketplace on Wall Street.

He said AGSOC is an "esoteric" subject for which it would be pointless to hold further public hearings on.

The senator, who pushed general stock ownership legislation through the last Congress, said it was difficult to discuss what an AGSOC would invest in, saying a professional management team would come up with specific investment proposals.

Rep. Terry Gardiner, D-Ketchikan, suggested that AGSOC invest in petroleum production facilities.

He also said that the state has already aided Alaska Airlines, by selling revenue bonds so it can get reduced interest on its borrowing, and has already (last year) set up the mechanism to issue bonds for Northwest Alaskan, builder of the U.S. portion of the Alaska highway natural gas pipeline.

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Stock Plan Questions Abound

By NANCY HARRIS
Empire Staff Reporter

After five hearings and a string of witnesses made up mostly of economists, lawyers and financial consultants, House and Senate committees working on legislation creating an Alaska General Stock Ownership Corporation (AGSOC) have been left with more questions than answers.

While lawmakers have been told they would merely be setting up the framework for a private corporation which could then borrow money on the state's loan guarantees, make investments and pay dividends to its citizen shareholders, many have expressed concern about the social and political implications of establishing a general stock ownership plan for an entire state.

Bills introduced in the House and Senate (HB240 and SB170) would set up a general stock

ownership corporation whose shareholders would be all Alaskans who were residents on January 1, 1980.

The AGSOC plan is based on a plan developed by Dr. Louis Kelso, considered to be the father of general stock ownership plans nationwide (GSOPS).

The state would loan the corporation money for start-up costs and later guarantee private loans it would need for investments.

The committee Tuesday was given a list of questions by Fran Ulmer, head of the Governor's Division of Policy Development and Planning, outlining administration concerns with the legislation.

The questions range from "What are the political implications of a corporation whose shareholders comprise the voting public?" to, "What will be the impact on the state's credit rating if AGSOC requires dif-

ferent kinds of financial assistance?"

The initial appropriation required has been pegged at around \$2.5 million.

Members of the House State Affairs and Finance committees and the Senate Commerce Committee have questioned whether AGSOC would really be a private corporation.

Rep. Mike Miller of Juneau asked several of those testifying at hearings Tuesday and Wednesday what the chances are that AGSOC will need no other state assistance other than start-up costs.

Ron Ludwig, a San Francisco attorney who represents an association of companies with employee stock ownership plans, told the committee that if the corporation made good investments under favorable conditions, it would be able to survive without help.

"If the investment is a good

business deal, the corporation will make money on it," he said.

But John Miskimen, a consultant who has worked on the AGSOC plan for Kelso, told the State Affairs Committee Wednesday that the corporation would probably be limited in the kinds of investments it could make.

Under the plan outlined by Kelso, the corporation would make investments using 100 percent credit. The corporation would have little capital, since it would be required to pay out 90 percent of its earnings to shareholders in order to take advantage of federal provisions giving it tax exempt status.

Miskimen said, "If you took 10 separate investments, perhaps five could be accomplished on credit and five would require equity capital."

"My guess is that within three years the corporation would come back for state aid," he said.

Stephen Buser, a professor at Ohio State University, told the committee Tuesday that the corporation would have to have some money to put into investments.

"I don't think \$2.5 million will do," he said. "It's going to be a continuing thing."

Some lawmakers were concerned about what rights stockholders would have in managing the corporation.

"Can we create something that is out of control, that the owners don't control?" asked House Speaker Terry Gardiner, D-Ketchikan.

Jeff Gates, a consultant for Hewitt Associates, who has also been studying the GSOP concept, said the idea of GSOP is to make people owners, not managers.

"Management is a skill," he said, "while ownership is a right."