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KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

A G E N D A

November 10, 1978

Introductory Comments

Review of Federal GSOP Legislation

GSOC Design Questions

Reserved for Mr. Jack Bachman

Alaskan Bond Financing - Discussion Leader
Mr. Terrence E. Comerford, Senior V.P.
and Director of Blyth Eastman Dillon & Co.

Open Discussion

Luncheon (1:00 to 2:30 p.m.) - Pacific Union Club

Continuation of Meeting - 2:30 p.m.
Conference Room A, St. Francis Hotel

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 [415] 788-7454

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

PROBABLE ATTENDANCE AT MEETING
OF NOVEMBER 10, 1978

Mr. Jack Bachman
Mr. Milt Barker
Mr. Frederick H. Boness
Rep. C. V. Chatterton
Mr. Joseph Chomski
Senator Mike Colletta
Rep. Sam Cotton
Mr. Larry Eppenbach
Senator Frank R. Ferguson
Commissioner Sterling Gallagher
Rep. Terry Gardiner
Mr. Jerry Gauche
Senator Mike Gravel
Rep. Bill Miles
Mr. Doug Pope
Mr. Jim Rhodes
Senator John C. Sackett
Mr. Bill Sheffield
Senator Bill Sumner

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 [415] 788-7454

REVENUE BILL OF 1978
(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 snareholders.
"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 CORPORATIONS. - 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 electing 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 it's 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 DIVIDENT. - 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.

"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 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 3202 (relating to income collected at source) is amended by adding at the end thereof the following new subsection:

"(r) EXTENSION OF WITHHOLDINGS 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.

AgSOP

The Washington Post

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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, children—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 multibillion-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 legis-

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 propsition 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.' "

REVENUE ACT OF 1978

Report of the Committee on Finance

United States Senate

H.R. 13511

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. (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 nonelecting 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.

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Senate

GENERAL STOCKOWNERSHIP PLANS

Mr. GRAVEL. Mr. President, I would like to take a moment to compliment the Senate on one provision of this bill. This tax bill goes far toward stimulating the much needed growth of capital in our economy. But, there is one provision in this bill, a provision which I am proud to say was added by the Senate, which addresses the question of who will own this new capital.

The Joint Economic Committee estimated in 1974 that 1 percent of our population owned 25 percent of our wealth and more than 50 percent of all corporate stock. Studies indicate that these concentrations of wealth have not changed significantly in 50 years despite all our efforts at income redistribution and amelioration of poverty. The amendment regarding general stockownership plans in this bill is a significant step toward broadening the ownership of American wealth.

Leadership on the issue of broadening capital ownership has long and ably been carried by my colleague and friend, the chairman of the Finance Committee. His work in the area of employee stock ownership plans has laid the foundation for Federal policy on expanded capital ownership. Following in his footsteps I sought to extend the concept of broadened capital ownership beyond the employer/employee relationship. The general stock ownership plan legislation contained in this bill is an important step in that direction. I would lke to thank Chairman LONG for his help in seeing these provisions adopted and to thank my fellow Finance Committee members who were supportive of my efforts.

There are a number of questions which my colleagues have put to me over the past few months and I would like to include some explanation of these issues for the RECORD.

First. What is a general stockownership corporation and how is it organized?

A general stockownership corporation would be formed either by act of a State legislature or by statewide referendum and each resident would be issued a share of stock. The residents would not be charged for their stock and would receive it free and clear. The corporation would borrow money to invest in profit-making ventures with the loan secured by the assets and, if necessary, by a State guarantee. Through this method the citizens of a State would become owners of capital. The earnings from the GSOP investments would be used to retire the loan and the balance distributed to the shareholders.

Second. What sort of technical requirements must be met in order to establish a general stock ownership corporation?

The bill authorizes States to establish privately owned GSOC's for the benefit of their citizens. A GSOC is a private corporation chartered by an act of a State legislature or by statewide referendum with a charter providing for first, the issuance of at least one share of stock to each eligible individual who does not elect within 1 year from the date of issuance not to receive such share; second, restrictions on transferability of shares (a) to nonresidents, (b) to an individual owning more than 9 shares or (c) until the earliest to occur

of 5 years from issuance, 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 reelect. 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 be 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

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 nontaxpayers. The amount of such withholding will be allowed as a refundable credit to the shareholders.

Eleventh. Will the GSOP 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.

THE IMPLICATIONS
OF
TWO-FACTOR THEORY AND THE SECOND INCOME PLAN
FOR
INVESTMENT BANKING AND THE SECURITIES INDUSTRY

The preponderance of our goods and services are produced by capital, yet families owning significant capital holdings are a minute fraction of the population.

No one has refuted, or can refute, the basic argument of *THE CAPITALIST MANIFESTO*,[1] *THE NEW CAPITALISTS*[2] and *TWO-FACTOR THEORY: THE ECONOMICS OF REALITY*[3] that it is the productivity of capital which is rising and that the productivity (or productiveness) of labor is at best stationary, and more probably shrinking.

The serious qualitative studies of the distribution of ownership of productive capital show that at most, 5% of the households in the United States own capital holdings capable of significantly adding to their incomes and providing sources of purchasing power for them.

Robert A. Lampman, *THE SHARE OF TOP WEALTH-HOLDERS IN NATIONAL WEALTH, 1922-1956*, National Bureau of Economic Research.

Jean Crocket and Irwin Friend, *"Characteristics of Stock Ownership," PROCEEDINGS OF THE AMERICAN STATISTICAL ASSOCIATION*, Business and Economic Statistics Section, 1964, pp. 146-168.

Herman P. Miller, *RICH MAN, POOR MAN*, Thomas Y. Crowell, New York, 1964.

FERDINAND LUNDBERG, *THE RICH AND THE SUPER-RICH*, Lyle Stuart, Inc., New York, 1968.

The studies by the Stock Exchange showing *quantitatively* the number of families who own equity stocks are not in conflict with the qualitative studies.

If we are to preserve private property in the ownership of capital, radical changes in our techniques of financing must be made.

If the means of production are to be privately owned, it is elementary that every household must own either one or both of the input factors. But technology is rapidly shifting the input burden to capital instruments while diminishing the relative productiveness, and in fact obsoleting increasing numbers of the labor force. The strenuous efforts of the economy to conceal this reality through government-subsidized production of non-consumer-destined goods and services (mostly military) are wearing thin, particularly in the face of growing resentment of poverty.

While labor power is almost universally distributed throughout the households of the economy, capital ownership is very narrowly held. Since private property functions in a private enterprise economy much like wiring in an electronic circuit, namely, to connect input to out-take, it is clear that the institution of private property must progressively disintegrate where a few of the households own the great bulk of the input factor, yet all must participate in out-take — the distribution of purchasing power.

The economy looks to Wall Street for financial leadership, but Wall Street fails in this respect.

Against this background of increasing capital productiveness and the failure of our financing techniques aggressively and logically to build millions of new capital-owning households, those financial institutions popularly called "Wall Street," led, in the minds of the American people, by the New York Stock Exchange, have failed to come forward with effective new ideas. In general, member firms of the New York Stock Exchange are engaged in bringing together the owners of existing capital (financial savings) and businesses which need to finance new capital formation in the time-honored and empirically discredited method described by Merwin Waterman in *INVESTMENT BANKING FUNCTION* in 1958. It takes no sophistication to understand that these methods are designed to give the owners of existing capital a monopoly of access to the ownership of newly-formed capital. They are techniques for concentrating the ownership of capital, rather than for building new capital-owning households in our economy. They are techniques for aggrandizing the productive power of those who already produce vastly more than they can or wish to consume, and systematically depriving the underproductive or the nonproductive of the means of becoming economically productive and to so gain more purchasing power.

Glaring examples of steps towards concentration are added to the financial scene daily. Nearly a hundred billion dollars of newly-formed capital are put into place annually in the U.S. economy without adding significantly to the number of viable capital estates.

It seems unlikely that this disastrous course towards the destruction of the private property economy can be interrupted unless leadership in investment banking and in the securities industry champions new financing tech-

[1] Louis O. Kelso and Mortimer J. Adler, Random House 1958
[2] Louis O. Kelso and Mortimer J. Adler, Random House 1961
[3] Louis O. Kelso and Patricia Hetter, Random House 1968

SUGGESTED READING ON TWO-FACTOR ECONOMICS

Books

THE CAPITALIST MANIFESTO by Louis O. Kelso and Mortimer J. Adler (Originally published by Random House, New York, 1958. Republished 1975 and presently available through Greenwood Press, 57 Riverside Avenue, Westport, Connecticut 06880, Tel. (203) 226-3571.)

THE NEW CAPITALISTS by Louis O. Kelso and Mortimer J. Adler (Originally published by Random House, New York, 1961. Republished 1975 and presently available through Greenwood Press, 57 Riverside Avenue, Westport, Connecticut 06880, Tel. (203) 226-3571.)

TWO-FACTOR THEORY: THE ECONOMICS OF REALITY by Louis O. Kelso and Patricia Hetter (Random House, New York, 1967; Paperback Edition, Vintage Press, 1968)

Testimony

Testimony by Louis O. Kelso before the Joint Economic Committee, U.S. Congress, December 11-12, 1975, on "Employee Stock Ownership Plan Financing and Other Financing Concepts Based on Two-Factor Economics"

Testimony by Louis O. Kelso, Norman G. Kurland and Patricia Hetter before the Senate Finance Committee, U.S. Congress, March 31, 1976, on "Major Tax Revisions and Extension of Expiring Tax Cut Provisions"

Reports and Publications

"ESOPS: An Analytical Report" prepared for the Profit Sharing Council of America, Chicago, Illinois, by Hewitt Associates, Deerfield, Illinois

"Employee Stock Ownership Plans" prepared by The Committee of Publicly Owned Companies, New York, New York

"A Symposium on Employee Stock Ownership Plans", The American University Law Review, Spring 1977, Volume 26, No. 3, prepared by The Washington College of Law, American University, Washington, D.C.

"Making New Capitalists -- A Creative Response to Income Inequities" prepared by the 1977-78 Twentieth Session, Executive Seminar in National and International Affairs, Department of State

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PLEASE NOTE: THE PRECEDING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

"ESOP Legislation - Past and Future"

February 21, 1980

ESOPs - Pros and Cons on the
Latest Developments and Techniques
for Installing and Maintaining an
Employee Stock Ownership Plan

Sponsored by

Continuing Education in Business and
Management, University Extension,
University of California, Berkeley
and
The ESOP Association of America

Jeffrey R. Gates
Hewitt Associates
Lincolnshire, Illinois

Hewitt Associates
100 Half Day Road
Lincolnshire, Illinois 60015
312/295-5000

Jeffrey R. Gates

Thought you might enjoy the attached.

Best regards,

ESOP Legislation Past & Future

I'd like to step back some 50-odd years and provide you with a chronological capsule history of employee stock ownership. I want to do that not only to give you some idea of its legislative origins but also to leave you with a flavor of the philosophy underlying ESOPs, and a sense of why the ESOP concept seems to have caught the interest, and indeed the imagination, of legislators not only in the U.S but in other countries as well. In fact, it is perhaps more important to understand the general thrust of the various ESOP-type proposals than to concentrate on their detailed and endless similarities.

So step back with me for a moment to 1921. At the time, there was no Social Security. The U.S. income tax was just a few years old. World War I had only recently ended, and the United States Congress was considering the Revenue Act of 1921. Legislators were looking for a method by which industry could "attract and retain" qualified employees. They settled on the idea of profit sharing plans and stock bonus plans. And the Revenue Act first granted tax-favored status to those two types of employee benefit plans. Interestingly, it was not until five years later that legislation was passed granting similar tax-favored status to pension plans.

I mention the 1921 legislation because profit sharing plans are similar to ESOPs and, more importantly, because stock bonus plans form the nucleus of ESOPs. In fact, ESOPs are actually a special type of stock bonus plan. Keep in mind, however, that profit sharing plans and stock bonus plans were not intended so much as retirement plans as they were intended to be participation plans. They were intended as a way to "attract & retain" employees. And, in the case of stock bonus plans, where distributions are generally in employer stock, they were meant to provide a way for employees to share in the "ownership and growth" of their employer. So although such plans may serve a retirement purpose, that was not the primary purpose for which they were written into the law. As you will see, the same holds true for ESOPs.

Next we jump to 1944 and to the Panama Canal Zone where a naval intelligence officer from Colorado by the name of Louis Kelso was, in his spare time, working on a manuscript titled, "The Fallacy of Full Employment". In that manuscript, he was questioning the ability of the U.S. economy to solve its income distribution problem solely through full employment. But by 1945, when attorney Kelso returned to the States, the Congress was debating the "Full Employment Act of 1945". A more modest version of that Act was passed the next year as the Employment Act of 1946, which still serves as the legislative guidepost for economic matters in the U.S. That Act also established the Council of Economic Advisors, who were directed to assist the

President in promoting "maximum employment, production and purchasing power." Given that environment, Kelso took his "Fallacy of Full Employment" manuscript and put it in his closet.

We now skip to 1953, when the Internal Revenue Service published a ruling allowing corporations to use a profit sharing or stock bonus plan to borrow money for the investment in employer securities. Based on that ruling, a few years later (in 1956), we find the first so-called "ESOP".

That was at Peninsula Newspapers Inc. about an hour south of San Francisco--where Louis Kelso was, by that time, practicing law. The three major shareholders of a small newspaper chain wanted to sell their stock to their employees. On Kelso's advice, and based on that 1953 ruling, a down payment was made from the assets of the corporation's 7 profit sharing plans, with the balance to be paid over 20 years. And the three shareholders took a note from the trustees. The distinguishing feature, and why it's regarded as the first so-called "ESOP", was the fact that the employees bought stock in their employer without having to put up their own money. That financial concept, the idea of using debt, or financial leverage, for such a purpose is the hallmark of what has been termed the ESOP philosophy. Note that as of yet there has been no mention of ESOPs legistatively.

That takes us to 1958 and the first "CSOP," or Consumer Stock Ownership Plan, at Valley Nitrogen Producers, Fresno-based, consumer-owned, fertilizer-producing cooperative. Again, financed without, in this case, the farmer/consumer having to put up any of his own money. Instead, farmers signed a requirements contract under which they agreed to purchase their fertilizer from Valley Nitrogen Producers, provided the company could deliver a product that was competitive as to both quality and price. With contracts to provide fertilizer for roughly a million acres of California farmland, financing was arranged and consumer-owned Valley Nitrogen Producers began operation. Today they are still going strong, with $150-plus million in capital equipment and supplying roughly 25% of California's nitrogen requirements. Again, this fellow Louis Kelso was the legal architect on the project.

Sometime between the first ESOP and the first CSOP, Kelso met philosopher Mortimer J. Adler at a course given in conjunction with the Great Books program. The Great Books of the Western World were a mid-1950's phenomenon promoted in conjunction with Encyclopedia Brittannica. It was a program in which you bought, and hopefully read, a multi-volume set of the classics. The editor was Robert Hutchins (who you may recall served as president of the University of Chicago for many years and left to start the Santa Barbara-based think tank called the Center for the Study of Democratic Institutions). Adler (who

is currently chairman of the board of editors of Encyclopedia Britannica) was associate editor of the Great Books and at that time also headed the Chicago-based Insititue for Philosophical Research, which he had temporarily relocated in San Francisco. And while here, he also conducted a regular series of classses in conjunction with the educational arm of the Great Books program.

Well, Kelso disagreed with a point Adler made in one of his classes. And Adler later asked why. Kelso replied that Adler's comment was inconsistent with what he called the "Theory of Universal Capitalism". Adler, I am told, replied, "Don't B.S. me; I've read everything there is to read on capitalism and there is no theory of capitalism, universal or otherwise." To which Kelso responded, "Yes, Mortimer, but you haven't been thorough in your research; you haven't read the manuscript that's been sitting in my closet since 1945." With that, Adler interrupted, asking that he be spared the task of leafing through some dog-eared manuscript. Instead, he suggested that Kelso give him his two or his five-minute summary. And, as Kelso tells it, about two minutes into his five-minute summary, Adler dropped his pipe, stamped his feet, jumped up and down and shouted "Damnit, why did you have to come up with that? I've been looking for that for 22 years."

Then Adler began to badger Kelso, calling him an intellectual coward for not publishing his book. So Kelso began working at it. And in a year or so he came walking into Adler's office with a manuscript--a reworking of his 1945 manuscript--titled simply, "Capitalism". It was 1200-plus, heavily-footnoted, typewritten pages, 300 of which were single-spaced. Adler, who'd had some publishing success, said he thought that no one but the ivory tower academics would read it. So he suggested that he sign aboard as co-author and help write a version that would be read by the business community.

Kelso, by this time, was sick of the project. And being familiar with Adler's schedule, he knew Adler wouldn't be able to work on the book for at least six months. So Kelso agreed. To his surprise, Adler dropped everything. They wrote and rewrote the book three times over the next month and sent the manuscript to four publishers, all of whom accepted it. The book appeared in 1958 as, believe it or not, The Capitalist Manifesto.

Cap Weinberger, later to serve as Secretary of Health, Education and Welfare from 1973-75, and currently head of Bechtel Corporation's legal department, reviewed the book in Time magazine, saying, "Kelso and Adler's book could start a revolution". Pravda, the Communist party newspaper, also reviewed the Manifesto, commenting, "In those discussions there is as much of the wanderings of a madman as there is of cannibalism."

In the book, Kelso mentioned something called the "Financed Capitalist Plan," the details of which were developed in a 109-page book published two years later (again with Adler as co-author) titled, The New Capitalists. Its financial theme, and a dominant theme later found in ESOP legislation, is well revealed in its subtitle: A Proposal To Free Economic Growth from the Slavery of Savings.

The basic idea was that capital formation need not be based on savings; it can also be financed from future earnings. For example, the modern corporation generally will not approve capital expansion plans unless they are supported by financial projections indicating that they will pay for themselves out of future earnings. Kelso's idea was to stimulate capital formation by severing the link between investment and savings. And at the same time that more capital was being created, his Financed Capitalist Plan would ensure that more capitalists would be created as well.

For this he called for a two-tiered, Federal Reserve discounting system to provide access to low-interest funds in order to: (1) bring new capital investment into the economy, and (2) to do that in such a way as to ensure that it would be broadly owned. He also called for several basic changes in the U.S. tax system to encourage the full payout of corporate earnings.

This idea of a two-tiered, or a two-level, Federal Reserve discount system can perhaps best be illustrated with a story, a story first told (to the best of my knowledge) by the late Alan Watts, San Francisco's popular Zen Buddhist philosopher. Remember, if you will, that back in the 1930s we experienced what most economists call a "financial slump." We ran out of money. One day there was a flourishing economy, with everyone on the up-and-up; and the next, unemployment, poverty and bread lines. What happened? The physical resources of the country - the brain, brawn and raw materials - were in no way less plentiful. But suddenly there was an absence of money, a so-called financial slump.

According to Watts, it was just as if someone had come to work on building a house and, on the morning of the Depression, the boss had said, "Sorry, baby, but we can't build today. No more inches." "What-d'ya mean, no inches? We got wood. We got nails. We even got tape measures." "Yeah, but you don't understand business. We been using too many inches and there's just no more to go around." The point is that money is of the same type of reality as centimeters, or pounds, or hours, or lines of longitude. Money is a handy way of measuring wealth but is not wealth in itself.

Thus, Kelso was searching for a way to match physical capacity (or real productive wealth) with physical needs. As a youngster in Colorado in the 1930s, he had seen the paradoxial

mismatch of unmet physical needs alongside untapped physical capacities: people wanting to work and wanting the goods that work could provide -- yet factories standing idle and consumer goods scarce or unattainable.

His two-tiered discount system (the heart of the Financed Capitalist Plan) is intended as a way to resolve this paradox, to ensure that the absence of money does not stand in the way of an economy's ability to tap its productive capacity. The Financed Capitalist Plan later served as the model for the GSOC, the General Stock Ownership Corporation, which was signed into law this past November in the Revenue Act of 1978. I'll discuss the GSOC in a moment.

The New Capitalists sold about 10,000 copies, 4,600 of which were purchased by Leonard Spacek, the then Chief Executive Officer of the Arthur Andersen & Co. accounting firm.

Seven years later, Kelso published a book the title of which, perhaps more than any book or article published since, most accurately sums up the financial philosophy of ESOPs. The title: How To Turn 80,000,000 Workers Into Capitalists with Borrowed Money. This was later republished in paperback under the less sensational title of Two-Factor Theory--The Economics of Reality.

Kelsc calls his Two-Factor idea a "physical" theory or economics, the idea being that in order to participate in a capital-intensive market economy, a person should have an opportunity to participate not only directly with his labor but indirectly as well through a property relationship to the productive capital of the economy in which he lives.

Why? Well the political rationale has a lot to do with the philosophy of a private property versus a collective economy. But it also has a more pragmatic side that was perhaps best summed up by Senator Russell Long, who suggested that, "When capitalism goes to the polls, we'd best be damn sure that there are enough capitalists out there to vote in its favor."

The economic rationale, however, has been widely attacked by established economists. Commenting on Two-Factor Theory in Time magazine in 1970, economist Milton Friedman characterized Kelsonian economics as, "a crackpot theory. Instead of saying labor's exploited, as Marx did, Kelso says capital's exploited. It's worse than Marx. It's Marx stood on its head."

And in April of 1972, M.I.T. economist Paul Samuelson writes, "Kelsoism is not accepted by modern scientific economics as a valid or fruitful analysis of the distribution of income but rather it is regarded as an amateurish and cranky fad." Another economist, Sar Levitan, complains that, "Like the emperor's clothes, it looks beautiful. But when you look closely, you find there's nothing there."

Newspaper columnists, on the other hand, found the idea a bit more appealing, with William F. Buckley labeling it "The Middle Class Share" and James J. Kilpatrick summarizing, "Kelso's formula sounds like Lydia Pinkham's Vegetable Compound. The whole theory sounds crazy. But, then, one may recall, they said all that of Copernicus too."

Other commentators from the 70's scan the political spectrum: The Berkeley Daily Gazette echoed Cap Weinberger, editorializing, "Louis O. Kelso, possibly the only genuine revolutionary in the United States."

While John D. Rockefeller III, writing in his 1973 book, The Second American Revolution comments, "Taxation has its limitations as a method for achieving better economic distribution since for this purpose it is essentially remedial. We must also take a positive approach by finding new ways to spread the ownership of future capital growth more broadly in our society. This will be a fertile field for creative ideas and experimentation in the years ahead by both government and the private sector. One such approach has been developed by Louis Kelso. Kelso makes a convincing argument that many of the deficiencies of our economic system could be alleviated if ways were found to broaden the ownership of the means of production."

Another book was published in 1973 by Fred Harris, the former Democratic Senator from Oklahoma. You may recall that Harris, in his 1972 bid for the Presidential nomination, was generally known as the populist candidate. In his book, The New Populism, he devoted a chapter to ESOPs and to ESOP financing. His title for that chapter: "If a Little Capitalism Is Good, What's Wrong with a Lot?"

Keep in mind now, all of this is prior to the passage, or even the mention, of the first piece of ESOP-related legislation. That came late in November of 1973 and was brought about by a dinner meeting in Washington's Madison Hotel, just around the corner from The Washington Post. In attendance: Senator Russell Long, Chairman of the Senate Finance Committee, and his executive assistant, and Louis Kelso and his Washington representative. A primary topic of discussion was the "Regional Rail Reorganization Act of 1973", about to be voted on the next day in the final mark-up session of the Commerce Committee, of which Senator Long is a senior member. The bill under debate was to provide Federal money for a financially-ailing group of railroads in the Northeast, the Penn Central being the best known of the lot.

After a four-hour discussion, Senator Long, I am told, asked simply, "What can I do?" The next morning he stormed into the Commerce Committee meeting talking about ESOPs. And about how U.S. taxpayers shouldn't be asked to bail out incompetent management and a small group of stockholders without the

employees also sharing. And about how the employees should be provided an ESOP as an incentive to restrain their wage increases so as not to drive the new taxpayer-financed railroad back into bankruptcy. And about how an ESOP seemed to hold great promise for increased motivation and productivity. And about how employee stock ownership would be a way for labor and management to pull together in a common effort in which they shared an economic stake.

Well, Senator Long couldn't persuade his fellow Committee members to require an ESOP as a condition of federal funding. But he was able to convince them that ConRail (as the consolidated group of railroads is now known) should at least study the ESOP before it qualified for government assistance. ConRail didn't implement an ESOP. At least not in 1973. ConRail was back again this past year, however, for another $1.2 billion from Uncle Sam. 15% of that amount will be funded through an ESOP.

The original ConRail legislation brings us up to 1974--and we find Ronald Reagan on the stump for ESOPs and for a nationwide Financed Capitalist Plan. Again, I quote: "Over one hundred years ago Abraham Lincoln signed the Homestead Act. There was a wide distribution of land and they didn't confiscate anyone's already privately-owned land. They did not take from those who owned to give to others who did not own. It set the pattern for the American capitalistic system. We need an Industrial

Homestead Act.... It is time to formulate a plan to accelerate economic growth and production and at the same time broaden the ownership of productive capital. The American dream has always been to have a piece of the action."

In September of 1974, President Ford signed the Pension Reform Act of 1974, ERISA, which first legislatively legitimated the ESOP. I once heard an ESOP critic complaining that the ESOP part of the bill convinced him that the acronym ERISA clearly stood for Every Ridiculous Idea Since Adam.

After a bit of infighting with the Treasury, the so-called "leveraged ESOP" first appeared in the law, the underlying committee reports characterizing it as a "technique of corporate finance." That language, "a technique of corporate finance," is, and continues to be, at the heart of what ESOPs are all about. The thought, as I mentioned, being that in a technologically-advanced market environment, the working man needs more than his labor as stock in trade. Left with only his labor, he finds himself in the position whereby if he wants to raise his standard of living he must demand a higher wage, a wage not necessarily related to increased input or increased productive power but related instead to his need or to his desire for more purchasing power.

So a long-term goal of ESOP-type legislation is to provide a broad-based access to a capital source of income. And to move away from jobs or full employment as the sole means for distributing income. I once heard it explained like this. Consider if you will the word "salary" versus the word "compensation". Salary comes from the Latin for salt. We find it in the book of Genesis: "by the salt of thy brow...." Here is where we begin to find the origins of the work ethic. You may recall that the Roman legions were paid a salt allowance for their exertions on behalf of the crown. And everyone knows what it means when a person is described as a man "not worth his salt."

Compensation, on the other hand, is from the Greek for a balancing of accounts. It's the quid pro quo of a market economy. In a sense, the work ethic is not a sweat ethic or a toil ethic, or even a job ethic--it's really more of an exchange ethic. Or a bookkeeping ethic. It has to do with keeping the scale in balance. The very idea of someone having purchasing power implies a matching amount of productive power. And to the extent that purchasing power is not backed by the power to produce, we have inflation.

So in a sense the philosophy behind the ESOP is concerned with what is now being called "supply side" economics. The idea is to match income with input, to balance purchasing power with productive power. The long-term economic goal is to ensure

that money comes into the economy not simply because people need it. Or desire it. Or have the political or economic clout to bargain for it. The idea is to restore that sense of balance, that sense of "compensation" to the marketplace.

Perhaps now you're beginning to understand why some people regard ESOPs as such a revolutionary idea, the dominant idea being to more broadly distribute income by more broadly distributing input. Not by redistributing present capital, which already has owners, but by financing new capital by means that will result in it being more widely owned. At least that's the general idea, very general. Basically a very appealing concept. But as the philosopher Alfred North Whitehead once observed, "Although we think in generalities, we live in detail."

ERISA, with its exemption for leveraged ESOP financing, brought the first real detail. ERISA permitted an employer to use a modified stock bonus plan as a technique of corporate finance. And the media, in a word, ate it up. Early in 1975, the television program "60 Minutes" ran a 20-minute segment, with commentator Mike Wallace teaming up with Louis Kelso and Senator Long to talk about ESOPs while also making economist Paul Samuelson look ridiculous for opposing the idea.

Shortly thereafter, The Village Voice, New York's famous underground newspaper, featured a lead article questioning whether Kelso might be the "Marshall McLuhan of economics?". In an article titled, "Crazy Louis and His Creeping Two-Factorism," they wrote, and I quote, "When Russell Long put his arm around Louis Kelso on television a few weeks back, the academic economists reacted with predictable distress. Crazy Louis was back. For 20 years, reputable economists have been telling America that Kelso was a self-deceiving charlatan, a utopian fool, he wasn't even an economist; he was just a rich San Francisco lawyer who wrote books that sounded like Huey Long with good grammar."

The conventional business press soon picked up the story, Forbes commenting: "One of the great things that ESOPs have going for them is that they are such a natural from a political viewpoint: Who in populist Washington, whether liberal or conservative, would knock the idea of spreading corporate ownership?"

Confirming that ESOPs had indeed struck a responsive chord in Washington, Barron's commented in July of 1975 that: "The Kelso doctrine is the only economic doctrine introduced in generations that could become a plank in either the Democratic or the Republican platform."

And indicating that no one really knew just <u>how</u> to evaluate this new idea, <u>Fortune</u> magazine, in what is perhaps my favorite quote, commented that: "Like the case for acupuncture, it sounds bizarre, even alarming--but a suspicion remains that there may be something to it."

About that same time, <u>Newsweek</u> announced that <u>Ms.</u> magazine had adopted an ESOP, founding editor Gloria Steinem noting that she and the publisher, Patricia Carbine, had been looking for the best way to share the equity with their sisters and that an ESOP seemed to fill the bill.

This widespread public interest led to hearings held in December of 1975 by the Joint Economic Committee of the Congress, at that time chaired by Senator Hubert Humphrey. In his opening remarks, the former Vice-President noted that: "These plans have been heralded as the basic solution for many of our economic ills. Specifically, one of our chief proponents who will be testifying today (referring to Louis Kelso), has said that the widespread adoption of ESOPs will accomplish the following objectives: the restoration and acceleration of economic growth to unprecedented levels; create legitimate full employment for two or three decades; and lay the foundation for arresting inflation. I must confess that these are some claims. Certainly no one since I have been chairing this committee has come before us with any program that promises that much."

And, indeed, by 1975 we began to see some of the strengths and weaknesses of the real world of ESOPs. Politically, as Forbes said, they're a natural. Yet as Senator Humphrey implied, they can be, and often have been, over sold.

As a Business Week ESOP editorial commented: "Panaceas have a way of turning into Pandora's boxes." Furthermore, rest assured that few ESOPs, if any, have been established by corporations whose chief concern was with reforming free enterprise capitalism. As a pension consultant quoted in the New York Times in 1975 so aptly noted, "No one is putting in an ESOP just to be a nice guy."

The remarkably flexible ESOP attracted nationwide attention in the American business community, with many nationally-known companies finding that an ESOP could be tailored to meet their particular needs. For example, Sutro & Co., the local brokerage house, converted its profit sharing plan to an ESOP and made a contribution of shares large enough to generate a tax loss permitting the recovery of about $750,000 in back taxes.

And Gamble-Skogmo, the Board-listed Midwest retailer, converted its thrift and profit sharing plan to an ESOP, the primary objective being to acquire their stock when selling at what the firm believed to be depressed prices. Thus, an ESOP was used not to raise capital but simply to benefit employees.

Estate planning has been, and continues to be, a principal use for ESOPs. At Hallmark Cards, for example, members of the controlling family agreed that, upon death, 65% of their privately-held stock will be sold to an ESOP, which will use company contributions to pay for the securities. The family thereby assures estate liquidity without resort to a public offering.

Staying private is becoming an increasingly important consideration. For example, the Statesman Group, Inc.--a group of insurance companies--used its ESOP to raise $1.8 million of new capital in-house instead of making a public offering. Similarly, ESOP financing provides a method for publicly-held corporations to "go private", using pretax ESOP dollars rather than after-tax stock redemption dollars to finance the transaction. For example, R. B. Jones (a Kansas city insurer) and its ESOP conducted a joint tender offer in what turned out to be an unsuccessful attempt to go private.

In short, corporations found that ESOPs could be designed to accomplish a variety of objectives:

- Assure estate liquidity
- Provide a market for closely held stock
- Buy out dissident stockholders
- Combat tender offers
- Refinance existing debt
- Divest subsidiaries

- o Recover taxes
- o Retire outstanding shares
- o Acquire other companies
- o Maximize the investment tax credit

Well, the ESOP concept, and the press coverage it attracted, generated considerable interest not only in the business community but in Washington as well. Conserative Republican Senator Jesse Helms soon introduced his "Employee Business and Capital Formation Act of 1975," whereby a tax deduction would be provided to corporations that made outright gifts of stock to employees in amounts of up to $25,000 per year, with a lifetime maximum of $500,000. No plan. No trust. An outright gift. That bill didn't go anywhere.

Neither did President Jerry Ford's proposal for the broadened stock ownerhsip plan, or the BSOP. In his 1976 State of the Union address, he promised to provide tax incentives for moderate income families to invest in U.S. companies. His idea was to permit a deduction of up to 15% (with a $1500 maximum) for buying corporate stock. The BSOP died of Congressional neglect, particularly after being labeled "The Stockbroker's Relief Act of 1976".

In April of 1976, Senators Javits and Humphrey introduced their "Employee Stock Ownership Fund Act" that would have made employee stock ownership a subject of collective bargaining as part of Taft-Hartley Plans (which are jointly trusteed by the

employer and the union). But any potential ESOP company would first be required to have a pension plan. And no more than 30% of the ESOP's assets could be invested in employer stock. This legislation didn't go anywhere either.

The legislation that did go somewhere was a different sort of ESOP that came into being in March of 1975. Due to its origins in the Tax Reduction Act of that year, this new ESOP was labeled the "TRASOP". With this type of ESOP, a corporation could claim an additional 1% investment tax credit, provided the tax savings were invested in employer stock.

Although an extra 1% investment tax credit may not seem like much, if you're a corporation like AT&T, with an $8.7 billion capital expansion program, that extra 1% meant $87 million that could be used to buy AT&T stock for employees rather than sending it to the federal Treasury.

In 1976, this incentive was amended to provide another 1/2% tax credit, provided employees paid a matching amount of cash into the plan. In addition, TRASOP companies were permitted to use part of the tax credit to reimburse themselves for the expense of implementing and administering their plans. Not surprisingly, these plans have become enormously attractive to large, capital-intensive corporations. Uncle Sam will not only fund it, he'll also pay your expenses for setting it up and maintaining it. Needless to say, the TRASOP got the attention

of the business community. The title of an article in the November '75 issue of the American Bar Association Journal perhaps best describes the response, "Will Every Corporation Have an ESOP? Senator Long Makes It Hard To Say No."

For the past three years, Hewitt Associates has surveyed the 1,000 largest industrial companies in the U.S. and the 300 largest non-industrial concerns to determine the prevalence of TRASOPs and their common plan characteristics. Of the 533 companies responding to our 1979 survey, roughly 31% now have ESOPs--up from 12.6% in 1977.

Among the 35 major utilities responding to the survey, almost 90% now have such plans. As do 86% of the responding oil refining companies, 2/3 of the firms in paper, fiber and wood, and 45% of companies in metal manufacturing. In short, where you find significant capital expenditures, you're also likely to find a tax credit-type ESOP.

The employee matching element, however, has not been nearly as popular. In our 1977 survey, we found that only 2.5% of TRASOP companies included the matching feature. That has since increased to 33% as of April of 1979. A very real weakness of the TRASOP program has been the administrative complexities accompanying the matching feature. The Revenue Act of 1978, however, contained several simplifying provisions and I expect that over the next several years quite a few more TRASOPs will include employee contributions.

The benefit under a TRASOP is generally small. Our survey indicates that although 10% of such plans have an annual average per employee benefit of $500 or more, 55% expect each participant to receive less than $200 per year. Another drawback is the fact that TRASOPs are currently attractive almost solely to capital-intensive companies. Labor-intensive companies (retailers, banks, airlines and such) simply don't have enough capital investment to make the TRASOP worthwhile. The resulting per employee benefit is just too small . Many U.S. Senators have questioned the equity of that. Consequently, currently pending legislation contains a provision that would provide companies an alternative of claiming either an extra 1% investment tax credit or a tax credit equal to 1% of the payroll of participating employees.

Jack Curtis will have further comments on the payroll-based TRASOP. Let me just make one philosophical point about TRASOPs. Tax credits are classified as tax expenditures, as liabilities otherwise owed to the Federal government. Thus, the foregone tax revenue has an impact on the budget. The investment-based version of the TRASOP currently has an annual price tag in the neighborhood of $1.0 billion. Adding the payroll-based alternative would raise that to $4.3 billion by 1985.

As you might have noticed, there is a conceptual inconsistency in this tax credit approach. Recall that the ESOP idea, philosophically, was to use future corporate earnings to pay for company stock acquired for employees. The goal was to break away from the use of savings. Well, if you accept the idea that a tax credit is a budget item, you can see that the TRASOP is funded with savings. It is not, of course, funded with the individual savings of the employees for whose benefit the stock is acquired. Instead, the overall savings of the U.S. economy, the nation's "macro savings" if you will, are drawn upon to fund the plan. In addition, the tax savings are typically used not to generate new capital but to acquire outstanding shares.

Ironically, the initial rationale for implementing this type of ESOP was to "introduce major U.S. corporations to the ESOP as a technique of corporate finance." Not suprisingly, major capital-intensive corporations in the U.S. have not found it to their advantage to use a modified stock bonus plan as a means for raising new capital.

Another legislative change in also proposed. Recall that one philosophical argument for ESOPs was to create a second source of income for employees, a capital or property source of income to supplement the wages from their labor.

That, of course, doesn't really make very good sense, at least under the current tax structure. Typically, dividends paid are so small that a person would need to own an immense amount of capital for that second income to be meaningful. Although U.S. corporations generally expect to earn between 10 and 20% on invested capital, they (1) retain a substantial portion of those earnings for growth, (2) they must pay federal and state corporate income tax on those earnings, and (3) the individual is again taxed on those earnings when paid to him or her as a dividend.

Well, the pending legislation introduced by Senator Long is meant to address this second income concept. The bill would permit companies to deduct the expense of dividends paid out to employees on their ESOP stock. The provision is also intended to generate debate on the question of double taxation. Given the current pattern of capital ownership in the U.S., eliminating double taxation is not exactly a grassroots issue. A statistic developed by the Joint Economic Committee in 1975 indicates that 50% of the individually-owned corporate stock in the U.S. is held by less than 1/2 of 1% of the U.S. population. And 46% of corporate dividends flow to 1% of the population. So if that double taxation issue is to become a popular issue--well, it goes back to Sen. Long's comment about having enough capitalists at the polls.

In fact, the primary obstacle to proposals encouraging capital formation is the fact that they almost always involve reducing taxes for wealthier taxpayers and increasing taxes for less wealthy taxpayers. And packages weighted too heavily for business are simply too heavy to sail legislatively.

The deductibility of dividends is also meant to make stock ownership more meaningful by providing companies the incentive to pay out those dividends. A common problem of ESOPs is that of how to get employees to appreciate stock ownership. You can communicate it, that's an absolutely essential ingredient in generating appreciation and motivation. But I am reminded of the comment by the great cynic Moliere, who once observed that: "There is no appreciation quite like the kind you can put in your pocket."

In addition to the TRASOP, 1975 saw the beginnings of another type of ESOP, one financed with the help of government loans or loan guarantees. The first of these was South Bend Lathe in South Bend, Indiana, some 90 miles east of Chicago. At the time, South Bend Lathe was owned by Amsted Industries and they wanted to sell. As it turns out, the only purchaser was a corporate liquidator.

But instead, South Bend's management found a way to use an ESOP to purchase the company. They went to the Commerce Department, which has an agency whose mandate is to use innovative means to

alleviate pockets of unemployment. The city of South Bend qualified. The South Bend Lathe operation occupies a portion of the 570-acre former Studebaker facililty, an area of 33% unemployment at the time.

The Commerce Department made a $5 million grant to the city of South Bend. The money was placed in a revolving fund for loan purposes and the first borrower was South Bend Lathe. With that $5 million (loaned at 3% for 25 years), they were able to attract an additional $5 million in private sector loans. Since then, there have been more than a dozen similar government loans or loan guarantee programs utilizing an ESOP for employee buy-outs.

South Bend Lathe, with its 500 employees, is serving as a good model from which we are beginning to learn some things about ESOPs. One thing is pointed out in article on employee ownership in the December/January issue of Harvard Business Review, which discusses the South Bend situation and draws the conclusion that the peer pressure of employee stock ownership is perhaps the most effective form of shop floor discipline. That observation is well summed up in a comment by a South Bend Lathe employee who is quoted as saying that the spirit among his fellow employees is one of, "Hey, you've got your hand in my pocket if you don't do your job." Thus, in their first six

months with an ESOP, the waste from poor workmanship dropped 70%, absenteeism declined, productivity went up, and grievances went down. And earnings per share since 1975 have increased from $20 to $45.

A related and currently pending piece of Federal legislation would set aside funds for buy-outs similar to South Bend Lathe. The bill would provide, however, not only for employee acquisitions but for employee and community buy-outs as well, sort of a combined ESOP and CSOP.

Although not an ESOP, an example of that sort of arrangement dates from 1975 when Sperry Rand announced that they would close their library furniture division in Herkimer, New York. The 270 employees put up $200,000 of their own money and, in addition, sold stock to 3,500 people in the community at $2 per share, thereby raising another $1.4 million. That, when combined with a $2 million government loan and $2 million from a group of banks, enabled the employees and the community, through the Mohawk Valley Community Corporation, to buy the company.

Another piece of ESOP-type legislation was recently enacted into law by the Revenue Act of 1978. A section of that Act provides that any state may, by state-wide referendum or by action of the legislature, charter a General Stock Ownership Corporation, or GSOC for short. Such a corporation may elect

to be tax exempt. As a condition of tax-exempt status, every resident of the state as of a specified date (unless he or she declines) must be a shareholder and receive at least one share. Shares cannot be transferred for five years. Should a shareholder leave the state, the shares must be sold back to the GSOC. Also, no one person may own more than 10 shares. In addition, the corporation is required to pay out 90% of its earnings on a current basis.

I think you can readily recognize much of the Kelso/ESOP philosophy: widespread stock ownership, combined with a limit on the amount any one person may own; no taxation of corporate earnings; and substantially all of the earnings paid out as current income to the shareholders.

This philosophy (which also permeates ESOP law by the way) stems from Kelso and Adler's writings, published 20 years earlier. In their Capitalist Manifesto, they described what they term "the three relevant principles of justice" as they apply to the production and distribution of wealth. The first is the principle of distribution, or the private property principle. Simply stated, this means that each person is entitled to the wealth he or she produces, whether produced with labor or with other tools of production. The second is the principle of participation, which is their way of saying that everyone has a right to earn a living by participating in the production of wealth. This right to earn a living, they argued, implies a

right to property in the means of production. Effective participation in a modern economy says that every consumer unit must own property in the means of production capable of earning a viable income. Their third and last principle is the principle of limitation which says that injustice is done when the ownership of capital is so highly concentrated in the hands of some that others are excluded from even that minimum degree of participation which would enable them to earn a viable income for themselves. It is these three principles that provide the philosophical context for both the ESOP and the GSOC.

Alaska is the first state to push forward with a GSOC. Alaska Senator Mike Gravel, who is also a member of the Senate Finance Committee, sponsored the enabling legislation. The proposed Alaskan venture is called the AGSOC--Alaska General Stock Ownership Corporation. A petition is currently circulating that may bring the AGSOC to a vote. Or the Alaska legislature may pass enabling legislation during its session now in progress. If such a venture is feasible, certainly Alaska is the state in which it is arguably <u>most</u> feasible. Alaska has only 405,000 citizens, so the numbers aren't overwhelming. The most likely initial investment would be British Petroleum's interest in TAPS, The Trans-Alaskan Pipeline System. To give you an idea, the 1978 pretax profit from British Petroleum's share of the pipeline was $127 million. Divided among 405,000 Alaskans, that comes to $314 per person or $1,256 per family of four.

As I mentioned, in the initial drafting stages the GSOC legislation was modeled directly after Kelso's 1958 Financed Capitalist Plan, right down to providing for a two-tiered Federal Reserve discount rate for GSOC lending. That provision was deleted. It now appears that AGSOC financing will be structured around a combination of state loan guarantees, private sector lending and possibly a bond issue. So that's another type of ESOP.

A continuing trend in the ESOP field is the use of ESOPs to help ailing companies. In fact, it appears that an ESOP may now be a price of doing business with the Federal government. Certainly it has become an issue for anyone dealing with the Senate Finance Committee. ConRail was the beginning. And, indeed, Senator Long was quoted back in 1973 as saying that he wishes he'd known about ESOPs when Lockheed came to the Federal government for help. Well, several railroads recently came looking for aid, including the Delaware-Hudson and the Milwaukee Road. They'll have ESOPs. And as part of the recent federal loan guarantee bill, the Chrysler Corporation will find itself with an ESOP as well.

Other nations are also beginning to implement ownership-oriented programs. The first, as far as I know, is the "Law for the Expansion of the Ownership of Productive Enterprises," signed into law in April of 1975 by the Shah of Iran as part of his 14-point "White Revolution". Under this law, all major

privately-owned companies in that oil-rich and rapidly developing nation were required to offer 49% of their common stock for sale to their employees and the general public. In addition, all non-essential public companies were required to offer 99% of their stock.

Two organizations were established to make loans of $500 per year for three years (for a total of $1500). The loans were for 10 years at 4% interest, the idea being that at that interest rate, the loans could be repaid largely with dividends. These new shareholders were not to be taxed on their dividends, and corporate taxes were geared to a sliding scale that favors companies with broad equity ownership.

The Iranian Council for the Expansion of Industrial Ownership selected 320 companies with total capital of $1.5 billion. The companies were required to have a total capital of $1.5 million, or fixed assets of $3 million, or sales of $3.75 million. In addition, they must have a production record of at least five years. Basic industries (such as oil producers) were exempt due to their "special significance" to the Iranian economy. Included, however, were such companies such as GM of Iran, B.F. Goodrich of Iran and Esso of Iran. In order not to flood the infant Teheran stock exchange, the offerings were staggered over a three-year period, with the final offering completed in March of 1978.

The share participation program was combined with a program of land reform, the Shah declaring that the program for broadened stock ownership "is as important as, if not more so than, the abolition of landed feudalism." Another government official explained that, "It isn't fair t[illegible] only a comparative handful of the rich families owni[illegible]e companies which are benefitting from our developing ec[illegible]y; the new stock program allows a more equitable distributio[illegible]f profits."

Another ownership-oriented program is under way in British Columbia. During its three years in power, a socialist government in Canada's westernmost province succeeded in nationalizing or buying into a number of British Columbia natural resource companies. In 1975, exasperated voters threw the socialist premier out and elected William Bennett, the well-to-do son of a previous premier and a champion of free enterprise.

The Bennett government set up a holding company called British Columbia Resources Investment Corporation (more popularly known as Brick). And early last March 80% of Brick's stock--some 12 million shares--was distributed (5 shares each) to every adult sixteen years or older who applied for them. Only two things were required: that the applicant be a Canadian citizen and a resident of British Columbia.

Each resident was also given an opportunity to purchase up to an additional 5,000 shares at $6 each. Initial expectations were that the Brick issue would bring in $180 million. But when the shares went on sale last July, BC residents, urged on by brokers and bankers who collected about $29 million in commissions, snapped up an astonishing $487 million worth.

I also see that a report commissioned by Canada's Progressive Conservative Party recently recommended that most of the assets of state-owned Petro-Canada be put into a new company whose shares would be distributed free to Canadian citizens.

In a similar vein, I notice that Senator Long received a letter from Margaret Thatcher dated August 31st in which she mentions that the Conservative Government currently has under study a plan for converting Britain's nationalized industries back to private ownership through employee stock ownership devices.

In conclusion, let me say simply that if past legislation is any guide to the future, one thing I have noticed over the past seven years of following the ESOP concept is that in Washington, D.C. there seems to be a new question being asked, a question that may develop into a significant side issue when economic matters are debated. Previously, most economic issues under consideration centered around the question of how many new jobs a program would create. That's still an important

question. But I now see more and more legislators asking a second question as well, that being, "How many new owners will it create?" It appears that question is now being asked by other nations as well.

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Senate

GENERAL STOCK OWNERSHIP PLANS

Mr. GRAVEL. Mr. President, the United States is the world's wealthiest Nation. Our net national worth has tripled since 1925 and now stands at over $6 trillion. This growth has been dramatic, but we should be concerned that a quarter of this growth, nearly $1 trillion of capital expansion, is owned by 1 percent of the population. This is the same 1 percent of our population which controlled 25 percent of our national wealth in 1925 and which today owns over half of all privately held corporate stock and more than 60 percent of all bonds.

Concentrations of wealth are not bad per se, but do create serious problems when many Americans find their labor income insufficient and must rely on Government subsidies for survival. In such a situation it is incumbent upon policymakers to review and correct structural defects which prevent the great majority of citizens from sharing in the Nation's growth.

There is continuing concern over the concentration of wealth in our economy. The Joint Economic Committee has recommended that the broadening of capital ownership be adopted as a national goal. Secretary of the Treasury Blumenthal and other Treasury officials have expressed concern over this concentration as well. But, in spite of this "gnashing of teeth" over the issue, little of substance has been accomplished. The great bulk of our national wealth is still controlled by a very few.

One of our greatest legislative failures is that we have not significantly broadened the ownership of American wealth during the past 50 years. In spite of all our income transfer programs and massive Federal deficits 25 percent of our wealth is still owned by 1 percent of the people. It would be a tragedy indeed if, through our own negligence, the future expansion of our capital stock is similarly concentrated. If it can be said in the year 2000 that 1 percent of our population controls 25 percent of our wealth it will be a great American tragedy and it will be our fault. The failure to insure broader participation in the economy will be laid at our doorstep and the epitaph of the capitalist system may well read, "In failing the people they themselves were doomed to failure."

IT TAKES MONEY TO MAKE MONEY

The old addage, "It takes money to make money," holds more than a grain of truth. To a great extent new wealth is a function of existing wealth. Wealth is generated either through credit or saving. Savings are invested to create new capital while debt may be used in the same way with the earnings of the investment amortizing the loan.

The poor and middle classes are precluded from accumulating wealth through either of these means. Because of our failure to provide access for the less affluent in our society to either existing wealth or debt for the generation of new wealth they are locked into their present status. The great bulk of our citizens cannot save enough from their incomes to generate capital wealth, they must consume what they earn. Neither can they finance new wealth through credit because that requires a guarantee for repayment. The lender needs assurances of repayment if the investment fails to throw off sufficient income to amortize the debt. Existing wealth performs this function for the rich, but the poor have no guarantee to support debt financed access to new wealth. The key to new wealth for the vast majority of Americans is the capacity to guarantee debt. I have structured a program which allows the citizens of a State, acting through their State government, to avail themselves of the guarantee power of the State itself to provide access to new wealth.

I want to emphasize at the beginning that this plan is not one designed to transfer the ownership of existing wealth. I do not propose to play Robin Hood, taking from the rich and giving to the poor. I do propose that more Americans be allowed access to the new wealth required by the future expansion of our economy. I am offering a vehicle through which we can involve all our citizens in the process of generating new productive capacity. By bringing more people into the capital formation process we also allow more people to share in the fruits of that capital, increased income.

ESOP'S: A FIRST STEP

Employee stock ownership plans were developed more than 20 years ago under the pension provisions of the Internal Revenue Code. They have recently received congressional attention and sup-

port beginning with the Pension Reform Act in 1974. In addition to its pension potential, the ESOP also provides a means for the diffusion of capital ownership. Through an ESOP employees can use the corporation's credit to guarantee their leveraged purchase of the company for which they work.

Under an ESOP the employer company establishes a tax exempt pension trust with its employees as beneficiaries. A loan to the trust is guaranteed by the company. The loan proceeds are used to purchase employer stock on behalf of the employees. The debt is repaid by the trust out of pension contributions made to the trust by the employer corporation. The employee receives the stock held for him by the trust either when he retires or terminates his employment.

The ESOP is a very important and useful device for spreading capital ownership, but its scope is severely limited. ESOP's are not available to those Americans who are not employed by corporations sponsoring such plans. Although some 10 million employees are covered by these plans we have neglected the welfare of hundred of millions of Americans. I would like to propose a program offering some opportunity for other Americans to share in our capital growth. My program is a parallel to the ESOP which would be available to all Americans.

THE GENERAL STOCK OWNERSHIP PLAN

Today I urge the adoption of legislation to enable the adoption by States of general stock ownership plans. This proposal finds its origins in the ESOP. It is designed to parallel the tax treatment of ESOP's while expanding the category of eligible individuals beyond the employees of a single company. As with the ESOP the key feature of the GSOP is a tax-exempt trust. However, the GSOP trust is sponsored by a State government with eligibility open to all residents of the State. Payments to the trust are deductible to corporations and tax free to the trust. The trust is required to distribute all its income annually either in repayment of debt or as dividends to the trust participants, the citizens of the State.

Before discussing the operation of GSOP's I should emphasize that the GSOP is not a vehicle for State ownership. In fact, the concept is offered as an alternative to State ownership. In Alaska we have been discussing the possibility of an Alaska State equity interest in the proposed gas pipeline. While such an investment is an exciting opportunity I am concerned about State ownership of private business. Under existing law it would be possible for the State government to make such an investment and pass the profits through to its citizens either in services or tax reductions.

However, I think it is important that ownership in such investments be held by the people directly rather than through the State government. Direct ownership puts spending decisions in the hands of the consumers. State ownership tends to concentrate both economic and political power in the same hands, an unhealthy combination. In addition bureaucratic spending decisions are not always consistent with the needs or desires of the people. Therefore, I think the people of the State should hold direct ownership of any equity interest the State chooses to make in private business. The GSOP can accomplish this goal by using the credit of the State to acquire interests on behalf of the State's citizens.

THE GSOP AT WORK

The GSOP provides an additional and expanded vehicle for capital diffusion. It creates a means for the transfer of what would otherwise be government-owned interests directly to the people. It can be used for the ownership of any revenue producing government project from a sports complex to a power plan. The GSOP puts the profits of operating these essentially private sector enterprises back into the hands of the people where they belong.

To form a GSOP the sponsoring government forms a GSOP trust and appoints trustees. Based on revenue and financial projections, and perhaps a guarantee by the sponsoring State government, the trust borrows money in the private market to make investments. In order to provide for allocation of ownership interests within the trust investment is limited to corporate stock. If the target project is one which is to be initiated by the GSOP a corporation is formed to hold the assets themselves.

Within the GSOP trust the newly acquired stock is allocated one share each to persons who have resided in the State for at least a year who choose to participate. All residents are eligible regardless of age and new residents may apply for participation once they have fulfilled the 1 year requirement. The stock of the corporation allocated to the trust participants is voted by them so that control of the investment is in the hands of the citizens and not the sponsoring State government.

The loan to the trust used to finance the purchase of stock must be repaid through the use of the investment proceeds. The corporation makes payments to the trust for this purpose which are deductible to the corporation up to its full taxable income. The trust, however, cannot accumulate income and must distribute out what it receives from the corporation either as loan payments, operating expenses or dividends to the participants. Cash dividends to participants are treated as dividends on corporate stock and taxed accordingly. Since this dividend amount is deductible to the corporation when paid to the trust we have effectively eliminated the double tax on corporate earnings.

The GSOP trust is designed not only to provide income for the participants, but to provide actual capital ownership

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as well. Without access to the GSOP stock the participant would be like the spendthrift nephew whose uncle provides a trust from which he can only receive the income. Despite his extreme need he cannot sell off the trust assets to pay his gambling debts and avoid the malice of his creditors. I believe that there are a minimum of never-do-well nephews in our society and that most Americans are capable of making their own spending and capital allocation decisions.

Without providing for direct ownership of the stock a plan such as the one I propose would be unduly paternalistic. Therefore, the GSOP trust must, upon request, distribute the stock held for a participant to him after 5 years of participation. Distribution of the stock to the participant will not preclude continuing integration of the corporate tax so long as the corporation continues to make its dividend payments through the trust. The stock is not taxed upon distribution to the participant, but if the participant sells the stock the proceeds are taxed as ordinary income. In addition to the tax consequences upon a sale of the GSOP stock no person may own more than 10 shares of any corporation's GSOP stock.

WHAT CAN A GSOP MEAN

In working with the GSOP concept I became curious as to what such a program might mean to individuals participating in the program. Using Alaska as an example I turned to our oil pipeline since State participation was being sought in the comparable gas pipeline. British Petroleum owns a 15.85-percent interest in the oil pipeline and their revenue and cost figures are available through testimony before the Federal Energy Regulatory Commission. Assuming a purchase price of $1.5 million with 100-percent financing through tax-exempt bonds over 20 years at 5.5 percent interest this asset could produce $500 annually in 1978 dollars for every citizen of the State of Alaska and more than $800 annually after the debt is retired; $2,000 per year for a family of four is a substantial amount for citizens in parts of Alaska where median income is less than $3,000 per year.

I am not suggesting that GSOP's are appropriate for all State owned and operated activities or that they constitute the whole solution to the problem of capital concentration. However, they can and will provide an additional tool available to assist the broad mass of Americans to participate in capital ownership. Mr. President, I would ask unanimous consent that my bill be reprinted in the RECORD.

There being no objection, the bill was ordered to be printed in the RECORD, as follows:

S. 3223

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. GENERAL STOCK OWNERSHIP TRUSTS.

Subsection (c) of section 501 of the Internal Revenue Code of 1954 (relating to list of exempt organizations) is amended by adding at the end thereof the following new paragraph:

"(22) A general stock ownership trust which is established in writing by the United States or the government of a State or a political subdivision of a State exclusively for the purpose of broadening stock ownership and integrating the corporate income tax by purchasing, receiving, holding, pledging, and distributing securities (within the meaning of section 251(b)) of one or more corporations, and which is empowered to receive, hold, and distribute amounts paid to the trust by corporations whose securities are held by the trust (or trust participants) and incur, amortize, and guarantee indebtedness in furtherance of the trust purposes, but only if the trust—

"(A) provides for participation by all residents of the sponsoring jurisdiction as of the date each such resident completes at least 12 consecutive months of residency within the jurisdiction,

"(B) provides for the allocation of one share of each issue of securities held by the trust to the account of each participant (within the meaning of section 251(b)) as of the last day of the trust year in which the individual initially becomes a participant in the trust in a manner which does not discriminate among such participants on the basis of race, sex, age, income, or ownership of property,

"(C) provides that each participant has a nonforfeitable right to any stock allocated to his account, but that no stock allocated to a participant's account may be distributed to the participant from that account before the last day of the trust year next following the trust year of the participant's death or, if earlier, the last day of the trust year next following the later of—

"(i) the participant's completion of 5 years of participation in the trust, or

"(ii) the participant's attainment of 18 years of age,

"(D) provides that all amounts received by the trust will be distributed not later than the due date for the filing of the trust's information return under section 6033 for the trust year in which such amounts are received,

"(F) provides that no person may purchase or otherwise acquire except by gift or devise from any participant directly or indirectly more than ten shares of any security held by or upon which dividends are distributed through the trust, and

"(G) meets such other requirements as the Secretary may be regulation prescribe.".

SEC. 2. INCOME TAX TREATMENT OF DISTRIBUTIONS FROM GENERAL STOCK OWNERSHIP TRUSTS.

Securities (as defined in section 251 (b) of the Internal Revenue Code of 1954) transferred to a participant or to the account of a participant in a trust described in section 501 (c) (22) of the Internal Revenue Code of 1954 shall not be considered income of the participant under the Internal Revenue Code of 1954 until such time as the participant sells or exchanges such a security. Amounts paid by the trust in connection with securities held by the trust in the account of a participant shall not be considered income of the participant under the Internal Revenue Code of 1954 until actually received by the participant and, at such time, shall be

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treated, for purposes of such Code, as dividends.

SEC. 3. CORPORATE DEDUCTION FOR AMOUNTS PAID TO GENERAL STOCK OWNERSHIP TRUSTS.

(a) In General.—Part VIII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to special deductions for corporations) is amended by adding at the end thereof the following new section:

"SEC. 251. AMOUNTS PAID TO A GENERAL STOCK OWNERSHIP TRUST.

"(a) GENERAL RULE.—In the case of a corporation there shall be allowed as a deduction an amount equal to the amount paid for the taxable year by such corporation to a trust described in section 501 (c) (22), not in excess of the amount determined by multiplying the corporation's net taxable income (determined without regard to any deduction allowable under this section) by a fraction, the numerator of which is the total number of shares of the corporation's securities held by the trust (including shares held by participants in the trust which were acquired, other than by purchase, from the trust) and the denominator of which is the total number of shares of the corporation's securities outstanding. Amounts paid to the trust not later than the date established by law for filing the corporation's return of tax for a taxable year, including any extension thereof, shall be treated as paid for that taxable year.

"(b) DEFINITIONS.—For purposes of this section and sections 4975(c)(4) and 501(c)(22)—

"(1) Distributed.—The term 'distributed' means actually paid to the participants of the trust, paid as ordinary and necessary expenses of trust operation, or paid in retirement of debt principal and interest incurred in furtherance of the trust's purposes.

"(2) Participant.—The term 'participant' means any individual for whom an account is maintained under a trust described in section 501(c)(22), for whose benefit allocations are made under the trust, and to whom benefits are distributed from the trust, and any individual who succeeds to the interest of a participant in a transaction in which gain is not recognized.

"(3) Securities.—The term 'securities' means common stock issued by a corporation with voting power and dividend rights no less favorable than the voting power and dividend rights of other common stock issued by the corporation.".

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 251. Amounts paid to a general stock ownership trust.".

SEC. 4. FAILURE TO DISTRIBUTE.

Section 4975(c) of the Internal Revenue Code of 1954 (relating to prohibited transactions) is amended by adding at the end thereof the following new paragraph:

"(4) Special rule for general stock ownerships trusts.—It shall be a prohibited transaction within the meaning of this section for a trust described in section 501(c)(22) to fail to distribute all amounts transferred to it as required by section 501(c)(22)(E).".

SEC. 5. EXEMPTION OF GENERAL STOCK OWNERSHIP TRUSTS FROM TAX ON UNRELATED BUSINESS INCOME.

Section 511(a)(2) of the Internal Revenue Code of 1954 (relating to organizations subject to tax) is amended by inserting "or in section 501(c)(22)" after "section 501(c)(1)".

SEC. 6. ELIGIBILITY FOR INDUSTRIAL DEVELOPMENT BONDS.

Section 103(b)(3) of the Internal Revenue Code of 1954 (relating to exempt persons) is amended by adding at the end thereof the following new subparagraph:

"(C) an organization described in section 501(c)(21).".

SEC. 7. EFFECTIVE DATE.

The amendments made by this Act, and the provisions of section 2 of this Act, shall apply with respect to taxable years beginning after December 31, 1978.

MIKE GRAVEL

U.S. Senator-Alaska

APRIL WASHINGTON, D.C. 1978

Fellow Alaskan:

As you may know, I have proposed that the state of Alaska institute a financial device called a General Stock Ownership Plan on behalf of all citizens of the state.

Under such a plan, each Alaskan would become a share-holding owner in one or more of the large and financially-sound energy projects in the state. Alaskans would acquire this ownership without personal expense -- and over a period of years, they would collect substantial income from the profits which the energy projects will generate.

The General Stock Ownership Plan (GSOP) concept is a complicated one, and many questions remain to be answered about its feasibility. Nevertheless, I feel the concept has great potential, and this newsletter has been prepared to explain the mechanics and the rationale for such a plan in Alaska.

Further intensive research by financial professionals is necessary -- and I have suggested to members of the Alaska Legislature that they appropriate funds for a study of this concept. If you think such a study would be worthwhile, I hope you will contact your state senators and representative.

General Stock Ownership Plan

A Proposal for Alaska

As a public policy proposal, the General Stock Ownership Plan (GSOP) suffers from a peculiar liability: it sounds too good to be true.

How can great numbers of people, without personal expense, become the owners of capital estates? More particularly, how can they acquire this ownership without spending the public's money and without taking away from wealthy people what they already possess?

On first exposure, the proposition that this may be feasible -- and through means which basically are traditional and tested -- strikes one as unlikely, even preposterous. If it is indeed possible, then why has it not already been done?

This paper is an effort to answer these and other questions about the GSOP concept and its potential application in Alaska. In summary, the paper is meant to show that:

1) the concept, in a related form, is already working successfully in Alaska and throughout the United States;

*2) it works by diffusing the **new** wealth that is generated by capital investment, **not** by raiding the wealth of those who are already well off;*

3) it calls for the state to guarantee loans, in essence extending the state's credit for the benefit of each individual citizen; but it does not involve significant expenditure by the state;

4) it relies on tax policy which is already either wholly or partially in place; and,

5) if successful, GSOPs might significantly improve the health of capitalist economies, helping to solve problems as seemingly diverse as capital accumulation and growing welfare rolls.

The GSOP concept was developed by Mr. Louis Kelso, an investment attorney in San Francisco. It is based on his success with the Employee Stock Ownership Plan (ESOP), which he invented and which is now used throughout the United States.

The basic thrust of Mr. Kelso's work has been to broaden capital ownership -- to make more Americans owners of the companies which produce

Potential Alaska GSOP Dividends

GSOP Investment Level	First Year Income		Year 2000 Income (6% inflation)	
	per Alaskan	per Family (4)	per Alaskan	per Family (4)
$1.5 billion	$500	$2,000	$1,512	$6,048
$3.5 billion	$1,162	$4,648	$3,528	$14,112
$10 billion	$3,333	$13,332	$10,070	$40,280

For assumptions, see Page 2, "Income Estimate"

our nation's wealth. Through his ESOP device, he has enabled people to do this in a very direct way by becoming the owners of the companies they work for.

Under an Employee Stock Ownership Plan, the owner of a company *sells* the company to its employees, who make the purchase entirely on credit, using the company's profits to gradually pay off their loan. In other words, their labor is making them the new owners instead of further enriching the present owners. This is how ESOPs are now successfully working, both in Alaska and throughout the rest of the U.S. *(See inset, "Alaska's ESOPs," on this page.)*

The principle at work in the ESOP mechanism is very simple: employees are allowed to borrow against the future profits which they themselves will be generating. The GSOP goes one step further: it allows a larger number of people to borrow money with which to purchase a profit-making enterprise -- and then those profits are used to pay back the loan.

As in the ESOP, when the loan is paid off, profits go to the people who "financed" and therefore own the enterprise, even though they didn't use their own money to provide the financing and acquire this ownership.

In both cases, the basic progression is the same:

-- *a group of people borrow money*

-- *the money is invested in a profit-making company*

-- *the profits of the company pay off the group's loan*

-- *the group is left with ownership of the company and of all its further profits.*

WHY IT WORKS

An obvious question arises at this point -- Who's going to lend us all that money? The answer is -- If the investment is credit-worthy, the money will be lent by the same banks, insurance companies and other private sources who would be financing the project without the GSOP.

And why would they lend money to the GSOP? For two reasons, in addition to the basic financial soundness of the venture:

1) Because their loan will be guaranteed by the state

2) Because tax policy will make GSOP investment more profitable than conventional investment (done presently for ESOPs.)

Let me elaborate on those two points.

First, the common principle in both the ESOP and the GSOP is the *extension of credit* to those who normally would not have such credit. In the case of the ESOP, the employees, would not normally be able to borrow the amount necessary to buy their company -- but the ESOP allows them to borrow, in essence, from future profits of the company. This system, as I've already noted, is working now in Alaska and throughout the country.

In the case of the GSOP, certainly the greatest number of citizens could not normally borrow for the kind of significant capital investment that is envisioned here. Banks are happy to lend to those who already have money -- and, in fact, this is exactly why "the rich get richer." They don't spend their own money on new profit-making ventures -- they borrow the money and pay back their loan out of their new profits, just as the GSOP is designed to do.

The difference is that the rich have enough assets to "guarantee" their own loan. In the GSOP, a way has been found to use the huge collective credit of the state such that each citizen has the kind of borrowing power that the wealthy have now.

Under a GSOP, a corporation is formed with each citizen as a shareholding owner. This corporation can borrow large sums for capital investment because the state will guarantee the loan. Thus, in essence, the state has extended its credit for the benefit of each individual citizen.

The *second* factor in making both the ESOP and GSOP plans work is favorable tax treatment. In the ESOP case, when a company is purchased by its employees, its earnings are exempted from the 50 per cent corporate tax for as long as it takes the employees to pay off their loan. In other words, Congress has decided to forego substantial tax revenues in the interest of broadened capital ownership. This provison helps make it especially attractive for company owners to sell to their employees, as well as helping to secure the necessary financing.

In the case of the GSOP, there are

Alaska's ESOPs

Ten million American workers benefit today from Employee Stock Ownership Plans.

In Alaska, six companies with 867 employees have operating ESOPs.

As in the proposed GSOP, the ESOP device permits these Alaskans to borrow, in essence, from future company profits in order to become owners of the companies they work for.

Alaska's ESOP companies are --

-- *The Daily News Miner, Fairbanks*

-- *Yukon Office Supply, Anchorage*

-- *Alaska Bank of the North, Fairbanks*

-- *Alaska Magazine, Anchorage*

-- *Madison Lumber & Hardware, Ketchikan*

-- *Porter Spaulding Insurance, Ketchikan*

Income Estimate

How much income could a General Stock Ownership Plan bring to Alaskans?

The chart on Page 1 shows annual income per person, depending on the amount invested by the GSOP. The chart shows how much might be expected during the years when loans are being paid off *("First Year Income")* and how much after the debt is retired *("Year 2000 Income.")* The post-debt figures include inflation, estimated at 6 per cent, and population growth.

The levels of investment are $1.5 billion (as in purchase of BP's share of TAPS), $3.5 billion ($1.5 billion in TAPS, $1.5 billion in a gas line, and $500 million in ALPETCO), and a large round figure, $10 billion.

In order to compute the income estimates, actual cost and earnings figures are needed. As shown in the chart below, we have used BP's experience as a TAPS owner. Therefore, the figures show with some accuracy the income that might be expected from GSOF purchase of BP's share in TAPS: $500 per person during loan pay-off; and $812 per person after debt pay-off -- or $1,512 in 2000, counting inflation and population growth. *(Total cash flow, minus operating costs and debt service, divided by state population; and total cash flow, minus operating costs, divided by state population in 2000 -- and inflated at 6 per cent.)*

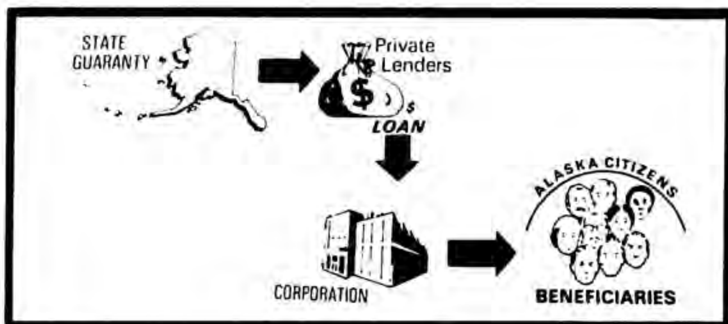
For gas line, ALPETCO, or other investment, of course, cost and earnings figures are not available, so it is necessary to assume that BP's experience with TAPS would be typical. The income figures for investment of $3.5 billion and $10 billion are multiples of the estimates derived from TAPS.

TAPS ownership:	15.85 per cent	(BP share)
Loan:	State bonding	(subject to referendum)
Interest rate:	5.5 per cent	(Moody average, March, 1978 long-term tax exempts)
TAPS throughput:	64,062,000 bbls/yr	(current BP -- Dillon, Read & Co.)
TAPS tariff:	$6.35/bbl	(current BP tariff)
GSOP revenue:	$406,794,000	(64,062,000 x $6.35)
Operating costs:	$80,452,000	(current BP -- Dillon, Read & Co.)
Debt service:	$123,820,000	(20-year bonds, as above)
State population:	406,000/777,500	(current/2000; state Commerce Dept.)
First year:	1978	

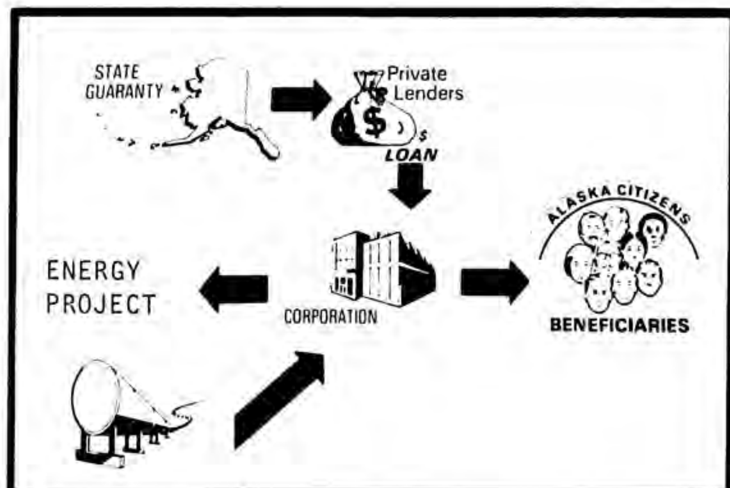
How a GSOP Could Work

A corporation is formed, and its stock is issued to all Alaskans, making them the owners of the corporation.

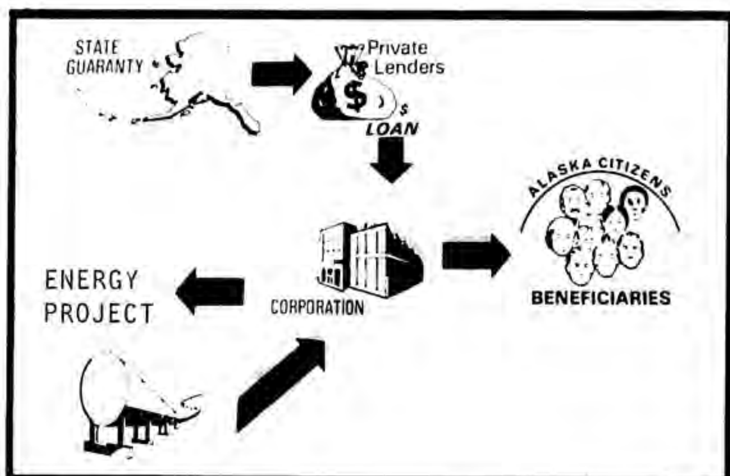
The corporation borrows money from private sources, and the state guarantees the loan.



The corporation invests the money in an energy project, making the corporation a part-owner of the project and thus making all Alaskans part-owners.



Earnings from the project are used to pay off the loan and to pay dividends to Alaskans. When the loan is paid, all profits are passed through as dividend payments to Alaskans.



two possibilites for avoiding corporation taxes. First, if the IRS finds the GSOP corporation to be technically a state agency, then it would be exempt from all federal taxes. Or, second, Congressional action could take place to provide an exemption from corporate tax, just as in the ESOP.

THE ALASKA PLAN

How, then, might a GSOP be applied in Alaska, and what would it mean for Alaskans?

First of all, Alaska appears in many ways to be an ideal ground for a General Stock Ownership Plan. On the one hand, similar ideas have been discussed previously, so Alaskans are better prepared for its novelty.

In addition, a form of "general stock ownership plan" already exists in the state: the Native Regional Corporations. The Regional Corporations differ from the GSOP concept insofar as they receive actual funds from the government, and not simply government guarantees for loans. But as a means of spreading the ownership of new wealth, they are true to the GSOP intention and method.

More than either of those reasons, however, the particular position of Alaska and its stage of development today appear to make the state a good ground for GSOP plans.

A great amount of new wealth will be created in Alaska during the coming decades. It will be created through the capital-intensive projects which enable us to exploit our natural resources.

If these projects are financed in the traditional way, then those who benefit will be those who already are wealthy -- in most cases, non-Alaskans. Through a General Stock Ownership Plan, however, the opportunity may exist for financing these projects in a way that will help distribute the new wealth among Alaska's citizens.

Mr. Kelso has noted the particularly favorable conditions in Alaska for a potential GSOP. In Anchorage last November, he suggested a plan for applying general stock ownership in the financing of the proposed gas pipeline.

I feel that, assuming financial soundness, GSOP investment would be possible for any of the large energy projects which will be built in Alaska. Today, in addition to the gas pipeline, there is the proposal to build a petrochemical plant (ALPETCO), which will require a great amount of capital. Still more projects are inevitable. And investment is even possible in the existing oil pipeline, especially as it is known that British Petroleum, a major TAPS owner, may be willing to sell its share.

How would an Alaskan GSOP work? As already broadly outlined above:

-- *a corporation would be formed and each resident of Alaska would be given an equal ownership share of the corporation*

-- *the corporation would borrow*

"...If these projects are financed in the traditional way, then those who benefit will be those who already are wealthy -- in most cases, non-Alaskans. Through a General Stock Ownership Plan, the opportunity may exist for financing these projects in a way that will help distribute the new wealth among Alaska's citizens."

money to invest in the energy project, having assured itself of the project's soundness

private lenders would be willing to provide this loan because it would carry a state guarantee (however, the state's guarantee would not involve any significant expenditure of public money)

-- the loan would likely be in the form of state-issued bonds, and if these had a tax-exempt status, they would bear a particularly low interest rate

-- the money would be invested in the project, making the corporation a part owner and thus making each Alaskan (as a shareholder of the corporation) a part owner

-- earnings from the project would be used to pay off the loan

-- dividend payments could be made to Alaskans as soon as profits were being realized; and once the loan was paid off, all profits from the corporation's share of the pipeline would belong to the Alaskans.

As a final addition to this picture, a trust would be needed to hold Alaskans' shares in the GSOP corporation, and dividends would be distributed by the trust. In addition, the state's bonds or other guarantee would be subject to referendum.

How much could Alaskans hope to realize from such a plan? As shown on Page 2, investment in BP's share of the TAPS line could yield some $500 per Alaskan initially, and $805 per Alaskan after payment of a 20-year loan. For the family of four, this is $2,000 per year initially and $3,220 per year after pay-off of the loan.

Adjusted for 6 per cent inflation and for population growth, dividend payments per Alaskan could be $1,512 per year in 2000 on the TAPS investment alone. And assuming similar investment characteristics for other GSOP projects, dividend income to Alaskans can be estimated as a function of the level of investment: investment of $1.5 billion in each of the pipeline projects and $500 million in ALPETCO would yield $3,528 per person after loan pay-off, including inflation; or, assuming investment of $10 billion, $10,070 per person in year 2000 dollars would be generated -- $40,280 per family of four.

CONFLICT

A final consideration: the state itself, of course, could make these investments and add the earnings to its treasury, using them to increase services or decrease taxes.

But there are basic reasons for avoiding state ownership of the productive tools of society -- which of course constitutes socialism.

One legislator to whom I explained this proposal suggested that the plan be called "Corporate Democracy," and this name does indeed suggest the purpose of the plan.

Not only is it desirable *per se* to spread the ownership of wealth, but it is desirable also to keep a maximum of decision-making power at the individual level.

Finally, a plan like this makes more visible the conflicts and trade-offs between state regulation and taxation and the needs of an economy for self-sustaining growth.

Early in this century, it was found that about 5 per cent of Americans owned more than 50 per cent of the nation's wealth. Today, despite a three-quarter century effort to distribute our wealth more equitably, the figures are virtually unchanged.

In fact, according to the Bureau of Census, the same 5 per cent own 62 per cent of American business and 83 per cent of the stock. The top 1 per cent owns 25 per cent of the nation's wealth and 50 per cent of the stock.

Meanwhile, the U.S. economy has reached the trillion-dollar level, making this country the greatest productive entity in history. Yet there is a widespread and well-founded fear that this enormous economy is in deep trouble.

The government so far has treated these two problems as separate entities, trying to solve each with "fine-tuning" policies which are often short-sighted and even self-contradictory.

But are these problems really separable?

In fact, it seems clear, they are directly linked, because in trying to cope with economic injustice, the government pursues policies which hinder economic development.

For example, in order to achieve greater economic equity, "transfer payments" from the wealthy and the middle class to the poor are ordered. But what is this, really, except withdrawing from the economy the capital it needs to produce the nation's wealth?

Likewise, non-productive jobs are created or preserved because most people still must rely on their labor for income. And yet everyone can see that this policy is on a collision course with the technology which can improve our lives, precisely by freeing us from unrewarding labor -- the same technology which has been a primary factor in the ascendency of the American economy.

The fact is that the crisis of today's capitalist economics is very directly tied to their failure to bring about economic equity.

The key to both economic health and economic equity lies in spreading the ownership of the productive instruments of our society: our corporations.

We can begin to treat the root of both problems if we can spread among all citizens the ownership of the companies which produce the nation's wealth.

The General Stock Ownership Plan is conceived as a means of achieving this widespread ownership without confiscating the property of the wealth and without creating a monolithic socialist state.

A GSOP for Alaska could be a first step toward this larger goal.

U.S.S.

UNITED STATES SENATE
WASHINGTON, D.C. 20510

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Senate

GENERAL STOCKOWNERSHIP PLANS

Mr. GRAVEL. Mr. President, I would like to take a moment to compliment the Senate on one provision of this bill. This tax bill goes far toward stimulating the much needed growth of capital in our economy. But, there is one provision in this bill, a provision which I am proud to say was added by the Senate, which addresses the question of who will own this new capital.

The Joint Economic Committee estimated in 1974 that 1 percent of our population owned 25 percent of our wealth and more than 50 percent of all corporate stock. Studies indicate that these concentrations of wealth have not changed significantly in 50 years despite all our efforts at income redistribution and amelioration of poverty. The amendment regarding general stockownership plans in this bill is a significant step toward broadening the ownership of American wealth.

Leadership on the issue of broadening capital ownership has long and ably been carried by my colleague and friend, the chairman of the Finance Committee. His work in the area of employee stock ownership plans has laid the foundation for Federal policy on expanded capital ownership. Following in his footsteps I sought to extend the concept of broadened capital ownership beyond the employer/employee relationship. The general stock ownership plan legislation contained in this bill is an important step in that direction. I would lke to thank Chairman LONG for his help in seeing these provisions adopted and to thank my fellow Finance Committee members who were supportive of my efforts.

There are a number of questions which my colleagues have put to me over the past few months and I would like to include some explanation of these issues for the RECORD.

First. What is a general stockownership corporation and how is it organized?

A general stockownership corporation would be formed either by act of a State legislature or by statewide referendum and each resident would be issued a share of stock. The residents would not be charged for their stock and would receive it free and clear. The corporation would borrow money to invest in profit-making ventures with the loan secured by the assets and, if necessary, by a State guarantee. Through this method the citizens of a State would become owners of capital. The earnings from the GSOP investments would be used to retire the loan and the balance distributed to the shareholders.

Second. What sort of technical requirements must be met in order to establish a general stock ownership corporation?

The bill authorizes States to establish privately owned GSOC's for the benefit of their citizens. A GSOC is a private corporation chartered by an act of a State legislature or by statewide referendum with a charter providing for first, the issuance of at least one share of stock to each eligible individual who does not elect within 1 year from the date of issuance not to receive such share; second, restrictions on transferability of shares (a) to nonresidents, (b) to an individual owning more than 9 shares or (c) until the earliest to occur

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 nonelecting 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.

REVENUE ACT OF 1978

Report of the Committee on Finance

United States Senate

H.R. 13511

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 (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.

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 propsition 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 sone 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, children—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 subjust 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 electing 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 it's 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 nontaxpayers. The amount of such withholding will be allowed as a refundable credit to the shareholders.

Eleventh. Will the GSOP 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 issuance, 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 reelect. 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 be 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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FROM Jerry Gauche ... Gsop

By William Greider

A Radical Idea As (

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The questions themselves sound vaguely Marxist, which is one reason why welfare-state liberals have always ducked. Liberalism is defined and disciplined by its right-wing adversaries, whose red-baiting effectively scares 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 evasions 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 catastrophic illness.

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 coupons.

The liberal imagination, knowing that real improvements in ordinary lives have flowed from the security programs, will insist 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 invent new coupons for other items that these people cannot afford. Cars? Air conditioners? French bread?

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The other limitation 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 versions 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.

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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 earn 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.

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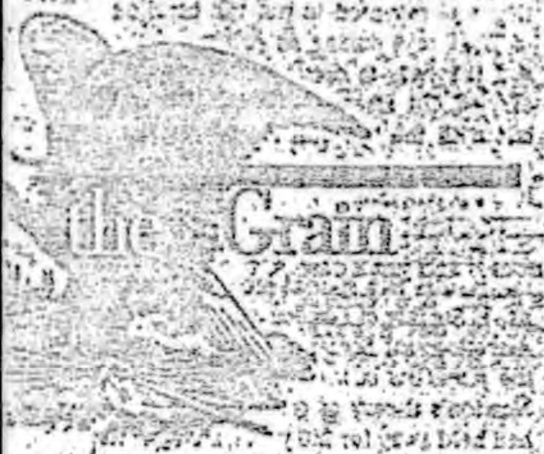
As Old As Lincoln



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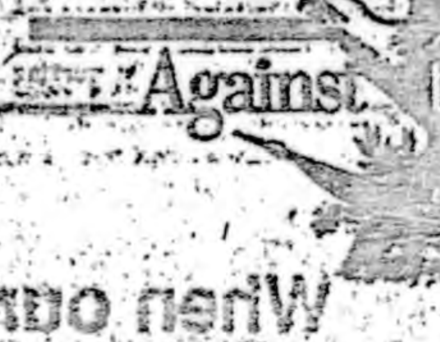

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WILMER, CUTLER & PICKERING
1666 K STREET, N.W.
WASHINGTON, D.C. 20006

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,

[3] 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.

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(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 nonelecting 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

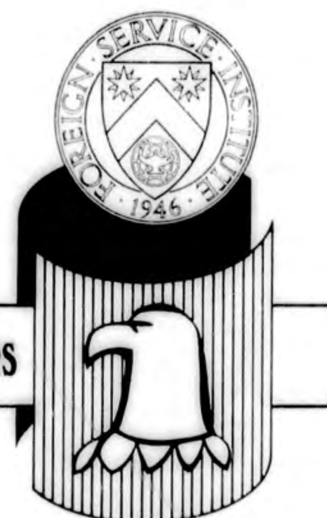
The provision applies to corporations chartered and organized after December 31, 1978.

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

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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 particpation 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.

Executive Seminar in National and International Affairs

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ACKNOWLEDGEMENTS

I want to express my special appreciation to Louis O. Kelso, who let me intrude with an early morning phone call to his hotel room for an extended conversation that must have had a jarring effect on his Washington schedule. His vision of universal capitalism and the dogged determination with which he has pursued it may yet have a major impact on the structure of capitalism. His former associate, Washington lawyer Norman Kurland, also gave me an essential early infusion of enthusiasm and hard information. Another early contact who provided an invaluable roadmap to key people and material was Jack Curtis on the Staff of the Senate Finance Committee.

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.

For my liberal education in the broad context of employee benefit schemes, I am most beholden to Lawrence O'Connor and Walter Holan of the Profit Sharing Council, and am especially thankful to have been invited to attend their regional conference in Atlanta. Bert Metzger of the Profit Sharing Research Foundation generously shared with me his vast scholarship in this area and gave me a sense of the history of employee ownership that I could not have obtained in any other way.

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 limiations, 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-factory 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 universl 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-Owning 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 prohibitious 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 ½%, if that was matched by a ½% 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 Republician 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 particiants 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 ½% 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. Moreoever, 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 wonderous 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 financer 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'", 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

64/ Hamrin, JEC Staff Study, op. cit., p. 7

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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

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

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****

THE ORGINAL FILE CONTAINS AN OVERSIZED DOCUMENT THAT IS UNSUITABLE FOR FILMING. PLEASE REFER TO THE ALASKA STATE ARCHIVES TO VIEW THE ORIGINAL.

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 persuavsive 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 tarrif, 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 statewide 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."

Anc Times

Gravel To Work For Plan

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4/01/79

Times Juneau Bureau

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

Anchorage Daily News/Fran Durner

Gov. Jay S. Hammond

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 a la 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 excessivestate 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