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By Mr. LONG (for himself, Mr. BAUCUS, Mr. BENTSEN, Mr. BINGAMAN, Mr. BOREN, Mr. BURDICK, Mr. BYRD, Mr. COHEN, Mr. CRANSTON, Mr. DECONCINI, Mr. DENTON, Mr. DIXON, Mr. DURENBERGER, Mr. EAGLETON, Mr. GLENN, Mr. HART, Mr. HATCH, Mr. HATFIELD, Mrs. HAWKINS, Mr. HEFLIN, Mr. HOLLINGS, Mr. HUDDLESTON, Mr. INOUYE, Mr. JOHNSTON, Mr. KENNEDY, Mr. LAUTENBERG, Mr. LAXALT, Mr. LEVIN, Mr. MATTINGLY, Mr. MATSUNAGA, Mr. MELCHER, Mr. MITCHELL, Mr. MOYNIHAN, Mr. MURKOWSKI, Mr. NUNN, Mr. PELL, Mr. PRYOR, Mr. RANDOLPH, Mr. RIEGLE, Mr. ROTH, Mr. SARBANES, Mr. SASSER, Mr. STEVENS, Mr. SYMMS, Mr. TOWER, Mr. TSONGAS, and Mr. ZORINSKY).

S. 2128. A bill to amend the Internal Revenue Code of 1954 to provide a rollover of the gain on stock of an employer sold to certain employees, and for other purposes; to the Committee on Finance.

EMPLOYEE STOCK OWNERSHIP ACT OF 1983

Mr. LONG. Mr. President, on behalf of myself and 46 cosponsors, I introduce the Employee Stock Ownership Act of 1983, for appropriate reference.

Mr. President, it is with the greatest of pleasure that I rise to introduce this measure. Employee stock ownership has grown in popularity all across this country over the past decade, and it is my hope that the provisions of this bill will soon be adopted so that employee stock ownership will continue to grow.

I am convinced that this ownership issue goes to the very heart of just what sort of economic system we mean to have in the United States, and just what sort of Nation we intend to leave for succeeding generations of Americans.

It is particularly heartening to have so many Senators join me in this effort to increase the number of Americans who have an ownership stake in our free enterprise system. The large number of cosponsors is evidence not only of the growing popularity of employee stock ownership but also of its extraordinary broad political appeal.

Employee stock ownership is not a partisan issue; rather, it is an issue that cuts across party lines in an attempt to bring out the best in our free enterprise system. It is only fair and right that those who work to make this economy succeed should have an opportunity to share in that success. It is a matter of simple commonsense and basic equity.

If we want this private property system of ours to succeed, we simply must insure that as many Americans as possible have an opportunity to earn an ownership stake in that system. A continuing fundamental weakness of our system is that so many Americans own so very little while a relative few Americans own a great deal.

This does not mean that we should redistribute the wealth of current owners. The intent is not to take from those who own to give to those who do not. Rather, the goal is to provide incentives for financing to be structured in such a way that, in the future, more Americans will have a chance to accumulate a capital estate.

Although increase productivity has a generally positive ring to it, for the average hourly worker increased productivity suggests that the company will benefit at his expense—for example, through speedups or through job insecurity due to automation.

The inference is clear: When employees themselves become stockholders, their attitudes toward productivity will change. This commonsense conclusion gains support from a series of studies of companies with the foresight to embrace employee ownership. One of the first studies focused on employee-owned cooperatives in the Pacific Northwest in which the average output exceeded industry productivity levels by more than 30 percent.

In 1977, five MBA candidates at UCLA conducted a survey of 180 companies with employee stock ownership plans (ESOP's). These students found that improved employee motivation was the most commonly cited benefit of establishing an ESOP.

In a related finding, a 1977 report on employee-owned companies by the Survey Research Center at the University of Michigan—sponsored by the Economic Development Administration of the U.S. Department of Commerce—found that companies with a substantial degree of employee ownership are 1.5 times more profitable than comparable conventionally owned firms. They also discovered that the more equity the employees own, the more profitable the company. Managers surveyed indicated a noticeable improvement in work attitudes and a positive effect on productivity.

Similar results are reflected in a 1979 study of 72 companies with employee stock ownership plans (ESOP's) sponsored by the ESOP Association of America. The typical ESOP company studied had been in business for 24 years and had established its ESOP 3 years prior to the study. Over the 3 years, an average of 7 percent of the stock of the company was transferred to the ESOP each year; at the time of the survey, the typical ESOP in the survey held 20.6 percent of the company stock.

During those 3 years with an ESOP, annual sales per employee increased an average of 25 percent, total annual sales rose an average of 72 percent, and annual profits grew an average 157 percent. In addition, the results showed a close correlation between ESOP's and a growth in both employment and tax revenue, the study finding an average 37-percent jump in total jobs per company and an average 150-percent increase in company-paid taxes.

A 1981 survey of 229 ESOP companies by the Journal of Corporation Law at the University of Iowa School of Law found that while other companies' productivity was declining during the 1975-79 period, productivity in ESOP companies was increasing. In addition, one-third of the companies surveyed reported reduced employee turnover and improved quality of work.

In May of this year, the American Business Conference published the results of a 2-year study designed to explain how and why mid-sized growth companies have outpaced the Nation in sales, profits, jobs, and exports. In the high-growth companies studied, employees own over 30 percent of the company stock—a surprisingly high proportion for companies averaging over $200 million in annual sales volume. This is in sharp contrast with the "Forbes 100" companies, where insiders own an average of less than 4 percent of company stock. In every company surveyed, top management had a significant ownership interest, and in 85 percent of the companies, employees below the senior management level owned an average of 6.6 percent of the stock.

On the basis of the research to date, it is clear that companies with employee ownership are likely to be more productive and more profitable than those without, and the more ownership held by employees, the better the performance of the company. Just as the company with employee ownership will have an advantage over a conventionally owned competitor, so, too, will the U.S. economy enjoy a competitive advantage with a policies and programs supportive of widespread employee ownership.

The question facing policymakers is what type of economic policy is best designed to tap the abilities and skills of this Nation's increasingly well educated work force? How can we realistically expected to enlist their interest, their enthusiasm, and their commitment when what is being offered as an opportunity is not the chance to own but the chance to work for those who own? Or else the chance to be employed at a make-work job that results in a rising tax burden for others?

Why should they enthusiastically support a system of which they are not fully a part? And, most disturbingly, of which they are not likely to become a part?

In searching for the solution to this vexing problem, we should take a lesson from Pope John Paul II and his suggestion that "Every effort must be made to ensure that * * * the human person can preserve his awareness of working 'for himself'."

The evidence indicates that employee stock ownership has the potential for creating a work environment and a reward system that can bring out the best that the American worker has to offer.

A national policy supportive of widespread employee ownership would help to tap that reserve of human energies, resources, and commitment. Commitment is dependent upon a sense of participation; however, for the most part, we have thus far limited that participation to jobs alone. Employee stock ownership would provide an opportunity for commitment by providing an opportunity to participate in ownership of the Nation's capital growth.

An encouraging—and growing—trend is reflected in the number of U.S. companies experimenting with participative management, quality work circles, and other programs designed to enhance the quality of work life. For example, the growing appreciation of the benefits available through participative styles of management is well reflected in a 1982 New York Stock Exchange survey of management's attitude toward participative management. Eighty-two percent of those surveyed in corporations with 500 or more employees consider participative management to be "a promising new approach," versus only 3 percent who consider it "a fad destined to disappear."

This "People and Productivity" study concluded that—

> . . . higher productivity is achieved by improving the quality of life in the workplace itself—when people are better educated, more humanely treated, more involved in decisionmaking, and better rewarded for their efforts. Thus, we find that ends and means are the same: The challenge to corporate America is to improve quality of life in the workplace; by doing so, it will boost productivity—and in that way help achieve a better quality of life generally.

Employee stock ownership helps to create an environment in which companies are more likely to establish these types of programs. Such programs can have a beneficial effect, not only on productivity but also on job satisfaction, individual dignity, general mental health, community cohesiveness, et cetera.

COMMUNITY AND COMMITMENT

All too often, Federal programs perpetuate people's dependency, poverty, and powerlessness. Many of our Federal jobs creation programs, for example, are meaningless except as a necessary source of income. As Ray Marshall, former Secretary of Labor, once observed:

> There is no more complete rejection of human beings than to give them a job you know and they know is useless.

A life without work is a poor life indeed. But when that work is useless, pointless, and a dead end, then that is truly a life of poverty. It has little meaning, vitality, or challenge.

Living in decency and dignity is impossible without a stable source of income. Yet it is clear that there is more to life than material well-being. Who would claim that the wholly wage-dependent family enjoys the dignity, the security, the range of choice, and the autonomy—not to mention the leisure and the freedom—of the family even partially supported by capital ownership?

company's performance. On that point, it is encouraging to note that a 1981 Louis Harris survey of employee attitudes indicates that 63 percent of those surveyed would be willing to link their salaries to higher personal productivity.

It is also intended for those companies and those employee groups who feel that a climate of cooperation and compromise may now be better suited to their purposes than continued confrontation. That 1981 Harris survey also found that one in four Americans thinks better relations between management and labor is one of the changes that would do the most to improve productivity in the workplace. Only financial rewards for productivity gains, 30 percent, are thought to be more effective. A well-designed employee stock ownership arrangement can, of course, address both of those concerns.

Business executives surveyed—44 percent—likewise think that better labor-management relations are one of the changes that would best contribute to increased productivity. Only the use of better equipment or tools—65 percent—is viewed by them as more important.

Employee stock ownership provides a healthy new dimension to the economic development process. It enables those affected to examine the issue in a different frame of reference, one in which the effect on them becomes much more real, and one in which they can realize how important their productive efforts are to that process.

Employee stock ownership is for those who believe in the worth of the individual employee, and for those who see the rank and file as the root source of quality, creativity, and productivity.

In short, Mr. President, employee stock ownership is intended for those companies and for those employees who are ready to shift the context of the workplace, for those who are ready for a new way of thinking, and for those who are prepared for a whole new array of options, opportunities and outcomes.

ESOP FINANCING

The employee stock ownership plan (ESOP), a technique of corporate finance, offers sponsor corporations certain tax incentives and cost reductions not available under traditional methods of finance. ESOP financing also grants employees access to ownership of productive capital in a tax-free manner during their employment while incurring tax only on their ownership incomes—in the form of dividends paid to them on their ESOP shares—and on their stock when distributed from their ESOP accounts.

The ESOP is designed to accomplish corporate financing through an employee benefit plan. As an employee benefit plan, the ESOP has many of the same legal characteristics as more traditional pension plans. For example, the plan must meet certain minimum requirements concerning eligibility, participation, vesting, and reporting and disclosure. In addition, distributions receive the favorable tax treatment available to other types of pension plans.

The ESOP's primary purpose, however, is not to serve as a retirement vehicle but, rather, to serve as an incentive for corporations to structure their financing in such a way that employees can gain an ownership stake in the company for which they work.

What the Congress sanctioned with the ESOP is a socially improved technique of corporate finance that also serves as a new type of employee benefit. Thus, as a tax-qualified plan for providing employee benefits, in the form of employer stock, an ESOP is subject to many of the same standards imposed on other types of employee benefit plans but interpreted in light of the special purposes for which ESOP's are intended.

The term "technique of corporate finance" refers primarily to the "leveraged" ESOP, an ESOP that uses borrowed funds to acquire employer stock, with the employer, or a related party, guaranteeing repayment of the loan. It is this guarantee, plus the underlying security provided for the loan, that puts the logic of corporate finance to work for a company's employees.

In a 1953 revenue ruling, the Internal Revenue Service sanctioned this type of leveraging by a defined contribution plan, thus laying the legal groundwork for the leveraged ESOP. The first known use of ESOP-type financing, pioneered by attorney Louis Kelso, involved a 1956 employee buy out of a chain of California newspapers that was threatened with a takeover by a major chain. But only in the last few years has the business world at large become aware of this innovation.

Suppose, for example, that corporation X wants to build a new plant costing $10 million. With traditional debt financing, the company would borrow the $10 million, provide adequate collateral and guarantee of repayment to satisfy the lender, use the borrowed funds to build the plant, and then utilize the income generated by the new plant to repay the loan.

The ESOP adds a third element to this transaction—an employee stock ownership trust. The trust borrows the funds based on the sponsoring corporation's guarantee that it will make periodic payments to the trust sufficient to repay the loan. As with traditional financing, the corporation may be required to secure this guarantee with collateral.

The ESOP trust then uses the borrowed funds to acquire newly issued employer securities, and the corporation applies the funds to build its new plant. As the new plant generates income, corporation X makes payments to the trust which are used to pay its obligation to the lender.

The primary difference is that with conventional debt financing, only interest payments are deductible for income tax purposes; amounts used to repay loan principal are not. The employer's contributions to the ESOP, however, are fully deductible, as employer contributions to an employee benefit plan, incuding those applied by the trust to repay loan principal.

Consequently, where corporation X uses the ESOP as its financing vehicle, it may repay its indebtedness, both principal and interest, with tax-deductible dollars. The Internal Revenue Code limits to 25 percent of payroll the amount that can be deducted each year for principal payments; interest payments are deductible without limit.

Thus, assuming, for example, a 50-percent tax rate and conventional debt financing, corporation X would need to generate $20 million in revenues to repay the $10 million in loan principal. With ESOP financing, however, the corporation would need to generate only $10 million to repay the loan principal through tax-deductible contributions to its ESOP.

By enabling a company to expense its capital investment, the ESOP lowers the sponsor company's taxable income and increases its available capital for other purposes; and the same dollar that finances the company's capital requirements also finances an employee benefit in the form of employer stock.

After purchase, the stock is held in an escrow account for allocation to employees' individual ESOP accounts as the loan is repaid. In no sense is this a "gift" to employees; rather, the capital is paid for out of the future flow of earnings that the new capital itself generates. As the already-rich know so well, the new capital's productiveness generally pays for itself.

The ESOP participants, however, also "earn" their ownership interest in the company through the ESOP's requirement that employees work for the company for a prescribed period of time before the stock in their ESOP accounts becomes nonforfeitable, that is, vested. An appropriate analogy can be drawn to the Homestead Act of 1862 under which the potential owner earned his or her acreage by homesteading the land for at least 5 years.

THE VERSATILE ESOP

The ESOP can also be used, with or without leveraging, as an "in-house market" for the sale of stock owned by the shareholders of a closely held company. For example, suppose the sole shareholder of corporation Y wants to begin to convert his shares to cash over a period of years in contemplation of retirement.

The corporation could contribute cash each year to its ESOP and the ESOP could use the cash to purchase shares from the owner. Should the owner wish to sell out before the ESOP has adequate funds to pay him, the ESOP could borrow the money to pay the owner, with the corporation guaranteeing the loan—or the owner himself could act as lender by accepting a note for the amount due.

Similarly, an ESOP can be used to refinance existing debt, or to finance mergers, acquisitions, or divestitures. For example, at his confirmation hearing before the Senate Finance Committee, Treasury Secretary Regan explained how Merrill Lynch & Co. used an ESOP to divert itself of the Lionel-Edie Co. Rather than sell the company to someone else, the former chief executive explained:

> We used an employee stock ownership plan, letting them buy it, and they have prospered as a result of that. I am definitely in favor of that.

TAX CREDIT ESOP'S

The investment tax credit has been an on-again, off-again stimulus to capital investment since its introduction in 1962 during President Kennedy's administration. In the Tax Reduction Act of 1975, the standard investment tax credit was raised from 7 percent to 10 percent. In addition, that act permitted corporations to claim an additional 1 percent, an 11th percent, credit provided the company used its tax savings to invest in company stock for its employees through a specially defined type of ESOP. These plans were quickly labeled Tax Reduction Act Stock Ownership Plans (TRASOP's); the Internal Revenue Code now refers to this type of plan as the tax credit employee stock ownership plan or the tax credit ESOP.

Initially, these plans did not prove very popular, primarily because the additional 1-percent credit was available for only 2 years. In 1976, Congress approved legislation extending through 1980 the period during which the ESOP credit could be claimed. In addition, the Senate approved expansion of the ESOP credit to a full 2 percent. In conference, however, that was scaled back to the original 1 percent, approving instead an additional one-half percent credit to the extent employees contributed a matching amount of cash. In the Revenue Act of 1978, this arrangement was extended through 1983.

A primary objection to expansion of the ESOP credit to a full 2 percent was that the tax incentive is primarily used to buy stock for employees of capital-intensive companies. For labor-intensive companies, the ESOP credit generally was not large enough to be worthwhile.

The Economic Recovery Tax Act of 1981 addressed this objection by providing an ESOP tax incentive based on the amount of payroll paid to participants in a company's ESOP, thereby making these plans attractive to labor-intensive companies as well. It was my preference, and the preference of the 30 cosponsors of the Expanded Ownership Act of 1981, that companies be granted the option, on an annual basis, of claiming either the investment-based ESOP credit or an ESOP credit of up to 1 percent of payroll.

Instead, the investment-based ESOP credit was phased out at the end of 1982 and a payroll-based credit, now known as the PAYSOP, enacted in its place with an available credit of one-half of 1 percent of payroll for 1983 and 1984 and three-quarters of 1 percent for the 3 years thereafter. As with the TRASOP, amounts allocated to employees' PAYSOP accounts must be immediately 100 percent vested.