SUBMISSION TO

PUBLIC CONSULTATIONS ON *AUSTRALIA'S DEMOGRAPHIC CHALLENGES*

Prepared by the

Employee Ownership Group

14 May 2004

The Employee Ownership Group (EOG) wishes to make the following submission to the Public Consultations on *Australia's Demographic Challenges*

Executive Summary

In this submission, the EOG

- Agrees with the proposition that to meet the demographic challenges of an ageing community in the future, the nation will need to both increase productivity and increase the participation rate of older employees in the workforce
- Contends that of equal importance to these two courses, there must also be a significant increase in individual and household savings to provide for the increased investments and financial resources required to meet the needs of an ageing population
- Believes that Employee Share Ownership Plans (ESOPs) will have a major role to play in increasing the levels of savings of individuals and families
- Supports the view taken in other countries that multiple savings instruments need to be established to meet the needs of people on low incomes, and of people who are not employed in organisations that can establish ESOPs, in order to integrate medium-term savings objectives with long-term retirement savings goals.
- Recommends that Australia needs to formulate an integrated, multi-instrument "National Savings Policy" to provide strategic direction and accordingly to develop a range of savings vehicles that go far beyond the narrowly retirement savings program that currently prevails.

About the EOG

The EOG is a network of corporations committed to promoting Employee Share Ownership Plans (ESOPS) for all employees

The EOG envisages an Australia in which employee ownership will be widespread in the workplace and will run deep within businesses. The EOG sees employee share plans making a significant contribution to both cultural change in the workplace and to individual and family savings.

SAVINGS POLICY AND AUSTRALIA'S DEMOGRAPHIC CHALLENGES

In its development of policies to support the growth of employee share ownership in Australia (see attached document "Employee Share Ownership in Australia: The Future", EOG, 2003) the EOG has been substantially influenced by the Australian Government's *Intergenerational Report 2002-03*. This study demonstrated the major imbalance between, on the one hand, the resources and standards that Australians expect to apply to their education, health and retirement and, on the other, the provisions that they, and their national government, are prepared to make in realising these expectations.

EOG submits that wider policy changes will need to be contemplated than those that have so far been placed before the nation for consideration. As the conflict between expectations and provision becomes more prominent in public thinking over the coming years, public policy development will need to broaden its scope to consider, not only those issues currently put forward about improving productivity and increasing participation in the workforce by older employees, but also the development of an integrated policy package which the EOG would call "A National Savings Policy". This package would integrate existing retirement savings policy with employee ownership policy and issue in a multi-instrument, national approach to medium- and long-term savings.

Treasury's consultation paper *Australia's Demographic Challenges* provides no further evidence than the *Intergenerational Report* - nor any new solutions - to the failure of Australia to save. Instead, it concentrates only on those necessary actions for improving productivity and increasing workforce participation by older workers.

With regard to the matters of productivity improvement and increased workforce participation, EOG agrees with the comments ASFA has made in their recent report *Intergenerational Modelling for Australian Families* (April, 2004) in that:

1. Australia will fail to meet it demographic challenges if it raises both productivity and participation, but still fails to save. This is because a large proportion of the benefits of increased productivity and more years spent toiling in the workplace will disappear into the hands of those other nations whose 'savers' fill our savings void by investing in our economy.
2. Participation and productivity rates are likely to lift in future as a local market response to changing circumstances, but are not likely to lift quickly enough to solve the financing problems driven by an ageing community. All reported indications are that we will need greater financial resources to cope with an ageing community, and higher rates of saving are the best way to build up these financial resources.

3. Home grown savings will give us a bigger bang for our buck further down the track as we will earn a substantial rate of return on these savings.

The EOG also agrees with ASFA that far too little attention has been given to solutions to the savings problem. This – along with the three points made above – are, however, the only areas in which the EOG would agree with ASFA. On the suggested solutions, we advocate a major departure from the ASFA outlook.

The EOG contends that building public confidence and investments in longer-term savings will take much more than an increased component of ‘compulsory superannuation’ in weekly earnings, as ASFA suggests, combined with a buoyant stock market. The key issue for the EOG is to escape the blinkered mindset of institutions which see savings as a narrow retirement issue when, in reality, savings are a whole-of-life labour encompassing both long-term (retirement) and medium-term objectives.

The Need for a National Savings Policy

If we draw the lesson of the *Intergenerational Report,* there are many other things besides retirement for which Australians might do well to save, eg: health, education, training and re-training needs, and the care of sick and aged family members stand out. Most of these demands are felt before retirement. When such obligations arise, individual and family savings often do not match the demands placed upon them. As a result, research in most developed economies shows that there are significant and complex barriers to increasing substantially the rate of long-term retirement savings among younger population groups.

A factor that is also often overlooked is that many people who are small business owners have their “retirement nest eggs” built up and tied into the value of their businesses. They can only realise this value through the sale of their business upon retirement. CPA Australia reported on 27th April, 04 in their report “Future Bleak for Small Business Owners set to Retire” that half of all small business owners depend on their business to fund their retirement but that a third believe they will have difficulty selling - thus adding great uncertainty to their prospects for a modestly comfortable retirement. In this context the importance of “small business succession planning” - through the agency of an ESOP - to savings policy should not be under-estimated. A growing proportion of new ESOPs created in North America arise form small business owners ‘transitioning’ the business to their employees over time, thus securing their retirement incomes.

Another factor that adds to the complexity of the savings issue – whether medium-term or long-term - is that there is a large number of “unwaged” and low income people for whom any plan to increase savings is a challenge and equity-linked savings products can be unsuitable.

The fact that such issues are clearly identifiable suggests that Australia needs to move in the direction of an integrated, multi-instrument, national savings policy. Australia has a retirement savings policy, and to meet its objectives has implemented a national system of superannuation whose funding has been underpinned by the “superannuation guarantee” system, but Australia does not have – and certainly requires - a “Savings Policy” of broader range and scope.

The EOG submits that such a policy would need to be more than a general set of principles covering appropriately broad classes of voluntary saving. Our view is that a national savings policy demands the development of a range of medium-term savings tools designed to encourage individuals and families to save for major, socially important objectives in addition to provision for retirement income.

Employee Share Ownership Plans (ESOPs)

The long-term shortage of savings in an ageing Australian community - as identified in the *Intergenerational Report* – requires the development of a more sophisticated approach to national savings policy.

One way of doing this would be to include ESOPs as a key component of national savings policy. While ESOPs are better known for their power of “spreading ownership” and of effecting “culture change” in the workplace, the instrument also has significant savings implications. Because of this ESOPs provide a way of combating our historically low levels of household savings by providing for a source from which both individuals and families can meet important medium-term financial demands.

ESOP savings can clearly be distinguished, on one hand, from obligatory, managed, indirect investments in a super fund and, on the other, from discretionary, personal share investment in businesses over whose fate the investor has little control. ESOP savings offer both the directness of a personal share investment and a measure of influence over the performance of the investment.

While EOG has a number of suggestions for improving existing ESOP policy, these are matters for consideration elsewhere. In moving from an existing ESOP Policy to a National Savings Policy, the important question that will need to be addressed will be how the government would provide for those members of the population who cannot participate in an employee share plan.

Medium Term Savings Tools

As mentioned, in addition to superannuation with its long-term savings objectives, a serious national savings policy would demand a range of savings instruments designed to meet a spectrum of different, medium-term savings objectives. ESOPs have a vital role to play here. However, savings for the medium term needs of people on lower incomes - many of whom might be “unwaged” – also requires consideration.

1. Savings objectives for low income people and young families

This has been an important area of public policy debate, development and innovation recently in other nations, and particularly in the UK. Programs in this area are usually termed as “asset-based welfare”. This area in Australia has attracted a number of worthwhile policy plans for instruments such as “Matched Savings Accounts” and “Nest Egg Accounts” recent discussion papers on which have been released by political parties into the public domain. This is not an area in which the EOG professes any special expertise, but such accounts do appear to have a potentially important role to play in the design of a national savings policy.

2. Savings plans for all employees

The area in which EOG would like to make a contribution is in the area of savings plans for all employees. EOG recognises that in the broader field of national savings policy, a response is required that would enable government to support those employees who cannot participate in an employee share plan in a similar way to those who can. Many employees (those employed by foreign based subsidiaries, by government and by small and unlisted companies where the owners do not wish to offer an equity stake) need to be able to benefit from savings plans.

Other nations have found solutions here. These solutions include:

1. The United States of America - the 401(k) Plan, and
2. The United Kingdom – the Individual Savings Account (ISA)

Both the 401(k) Plan and the ISA provide employee savers who cannot benefit from an ESOP with the opportunity to invest in a wide range of shares and other equities in a tax-favoured environment.

Mechanics of the UK’s Individual Savings Account

Savers in the UK can take advantage of – and, where possible, combine – a range of savings instruments that include the ESOP and the ISA. One key objective of the ISA is to provide for those who cannot benefit from an ESOP a comparable savings tool which operates under similar tax conditions.

The taxation supports provided to the ISA are as follows:

- A maximum of 7000 pounds can be invested by an individual resident in the UK
- No minimum investment, and no lifetime investment limit
- Free of income tax (on dividends and interest) and capital gains tax
- Investments can be made in shares, bonds, cash and life insurance
- ISA investments are not reportable to the Inland Revenue Service
- ISA can be managed by regulated managers including banks, building societies, insurance companies and brokers.

Were an Australian government to combine a reformed ESOP with a savings vehicle like the ISA, this would constitute a major development in our savings policy. The effect would be to create a range of savings instruments, along the following lines:

- superannuation and pensions providing for retirement income
- ESOPs together with an 'ISA like' instrument providing for medium term savings accessible prior to retirement

How an "ISA type" Medium Term Savings Plan might be Introduced in Australia.

With the objective of increasing national savings, the EOG has undertaken a study into how an 'ISA type' savings plan could be implemented in tandem with ESOPs.

The EOG has concluded that a savings plan, capped from a contribution perspective but which otherwise mirrors the operations and tax treatment of existing Division 13A (ITAA) share plans, could be developed to cater for those not eligible for an ESOP.

The EOG believes that this can be achieved in a way that will neither compromise the integrity of existing ESOP law and regulation, nor dilute the social character of the ESOP as a vehicle for extending the ownership of businesses to their direct employees.

The EOG would be ready to discuss the design and implementation of this proposal with Federal Government whenever a suitable occasion presents itself. The EOG believes that this could provide significant new direction to the solutions being considered to meet *Australia's Demographic Challenges*

Conclusion

ESOPs provide employees with legal title to part of the business which employs them. This, in turn, gives employees a clearly definable stake in their company's success. ESOPs, moreover, provide employees with a method of personal, productivity-linked, wealth creation and saving.

Importantly, ESOPs have a major contribution to make – in tandem with other, yet to be introduced savings instruments – to the savings needs of a nation faced with an increasing call on financial resources to meet the costs of an ageing community.

In order to meet *Australia's Demographic Challenges,* the nation needs above all the direction provided by an integrated, multi-instrument "National Savings Policy" to drive an increase in both medium- and long-term individual and household savings.