

Rt Hon Alan Milburn MP

**“Democratising the economy, redistributing opportunity in society:
the role of employee share ownership”**

**Speech to *ifs ProShare*
Peninsular House, 36 Monument Street, London
24th March 2009**

Thank you for inviting me and for organising this event. I very much admire the work that *ifs ProShare* does in making a reality of employee share ownership and I have long believed that the concept is one that we as a nation should more fully embrace.

Today I want to make the case for extending employee share ownership as part of a wider drive to redistribute power and opportunity in British society. I want to make a case for a parallel process of democratisation in our economy as an antidote to the failures in corporate practice that caused the painful global recession we are now in. I then want to suggest some practical ways in which that could be done including in the Government’s forthcoming Budget.

Some might think this an odd time to be arguing the case for more people owning shares. After all we are in the midst of a turbulent global financial crisis which has seen billions wiped off the value of shares and stock markets across the world fall off a cliff edge. Closer to home employees in banks like HBOS have watched in despair as their share pots have plummeted. The air is thick not just with chickens coming home to roost but with “I told you-so’s.” The critics say that the promise of ever rising returns was always a false one. That the epoch of excess was always going to end unhappily.

And in some ways they are right. Unfettered markets didn’t deliver. Regulation didn’t work. And greed produced gluttony which in turn has given the world a deep and painful bout of indigestion.

But those licking their lips at the prospect of an end to market capitalism – as distinct from an end to this particular form of unbridled financial markets – are gorging on a beast that still has life in it. Markets need to be appropriately managed and properly regulated. And when they are they work. They unleash innovation and realise potential. They have

given people in countries like our own unprecedented prosperity and opportunity. And globalisation – the world-wide meshing together of markets – has given millions in the very poorest countries on earth a route out of poverty in a way that nothing else has ever come close to matching. The issue for me is two-fold. First, to ensure that markets work in the interests of the majority not the minority. And, second, to ensure that more people are able to fairly share in the benefits they bring. That is why I believe in employee share ownership.

So what I want to do now is to set out the case for fair shares. Then I want to set out why I think this case is particularly relevant to the economic crisis we face today. Then I want to set out some of the immediate steps I hope the Government could take towards fostering a bigger asset-owning democracy in Britain.

Employees' sharing in the success of their employers is not a new concept. The idea has its origins in the social utopianism of the likes of Robert Owen and the early co-operative movement of the nineteenth century. But it was not by any means wholly a left-wing strain of thought. In 1897 Winston Churchill said that he hoped, that "...the labourer will become, as it were, a shareholder in the business in which he works". Nor is it an exclusively British idea. Indeed in countries like the USA it has – if anything – gained a deeper footing than here. There the American lawyer and investment banker Louis Kelso argued during the 1950s that the economy would be in better health if all workers, rather than a select few shareholders, could share in owning capital-producing assets.

ifs ProShare estimates that today there are approximately 5 million UK employees who participate in some form of employee share plan. According to the HMRC there are over 10,000 companies in the UK with Approved Employee Share Plans which offer tax benefits both for employers and the employees who participate. Co-owned firms probably account for around 2% of UK GDP with an estimated annual turnover in excess of £20 billion. They range from giant households names like John Lewis through to niche mid-size employers like Scott Bader, the Eaga Partnership, Arup and Unipart down to smaller worker co-operatives and SMEs.

The corporate impetus behind employee share ownership has come from a simple belief: that the more workers have a stake in the firm the greater their commitment to it is. People who co-invest in an enterprise have an investment in its success. One survey of co-owned firms found that 81%

of staff took on more responsibility and 72% worked harder. The most up-to-date research for the HMRC shows that 87% of employers reported improved relations with employees as a consequence of setting up share schemes. 82% of employees expressed loyalty to the firm in which they were co-investees. In an increasingly knowledge-led, skills-based economy where the contribution that labour makes is critical to success the ability to motivate employees is bound to become even more, not less, important in the future.

So there is a key economic driver behind employee share ownership. There is perhaps an equally significant social driver. Employee share ownership is a route to a fairer society. It is matter of great pride for me to have served in a Labour government that has delivered the biggest decreases in child and pensioner poverty that Britain has ever seen. But despite rises in living standards and falls in poverty a deep inequality gap still scars our nation. The decades-long decline in social mobility that we have seen in this country has been halted but it has not as yet been reversed.

Doing so means recognising as Amartya Sen, the Nobel Prize winner for economics has noted, that families and communities suffer not only economic disadvantage, but social, educational and cultural disadvantage as well. So if we are to not just raise the glass ceiling but break through it, we have to do more to empower individual citizens, the poorest especially, to exercise choice and power in the way that better off people take for granted.

If Britain is to get moving again socially, people need to be able not just to get a job or training or childcare but also to enjoy greater control and to have a bigger say in how they lead their lives. Of course beating crime, creating jobs, rebuilding estates all help. But I have come to believe something more fundamental is needed: a modern participatory politics which allows both local communities and individual citizens to more evenly and directly share in power. Of course the State has to step in where it is needed. The Government's intervention to stabilise the financial markets is necessary and it is right. But it should step back where it is not. That means enshrining a new principle at the heart of our governance as the philosopher David Marquand has argued: one of subsidiarity where power is located at the lowest possible level consistent with the wider public good.

So where individual citizens can exercise control and choice – such as over health and education – that should be the norm. And where it is less

easy for individual citizens to exercise such direct control – most people are hardly in a position to choose their own police officers for instance – power should be located at the next level: in the local community. Where services are failing communities should have the legal right to have them replaced. Where communities can directly run local services like children’s centres, estates and parks they should be helped to do so. And in other services – most notably the local police and health services – the community should be given a bigger say by making them subject to direct election at the ballot box. Doing things to people doesn’t really work. It is doing things with them that holds the key to fighting crime, improving health, regenerating communities. So we need to move from a top down approach to governance towards a bottom up one that gives citizens and communities far more of a stake. Progress in the future depends on sharing responsibility with citizens so that they become insiders not outsiders.

Such a change is in keeping with the times in which we live. Ironically globalisation has whetted the public appetite for localisation. In a world of swirling uncertainty, faced with forces that feel beyond control, people are taking refuge in what they know: their families, their communities, their local identities. At the same time public expectations have rightly moved up a gear. People nowadays are more informed and inquiring. Ordinary consumers are getting a taste for greater power and more say. The problem, a decade on from Bill Clinton declaring an end to the era of big government, is that while people may have become more empowered as consumers, they do not as yet feel empowered as citizens. Ours remains a ‘them and us’ political system. It was framed in an era of elitism. Rulers ruled – and the ruled were grateful. Economic advance and universal education have swept aside both deference and ignorance. Now the internet redistributes knowledge and offers us the chance of being active participants rather than passive by-standers. These changes open up the potential for a more participatory form of democracy in society.

It is here that asset ownership comes into play. I believe that one of the biggest contributions to social mobility is to give individuals and families a stake in the future by establishing Britain as an asset-owning democracy. Financial asset holding improves individual and social outcomes over and above factors such as educational attainment. Evidence from the National Child Development Survey of a cohort of children born in 1958 demonstrates a positive link between asset holding at age 23 and welfare outcomes later in life. Those with assets tend to spend less time unemployed and enjoy better health. Ownership works.

As Larry Summers once famously said: no-one ever washed a rental car. It is ownership that encourages people to act responsibly and independently.

Spreading asset ownership is also crucial to tackling inequality and speeding mobility. The most substantial inequalities in modern society are not simply between income groups, but between those who own shares, pensions and housing on the one hand and those who rely solely on wages and benefits on the other. That is why I favour employee share ownership and think we should be doing far more to encourage it.

I say that because over and above the fundamental economic and social rationale I have described for employee share ownership there is an even more immediate one. Employee share ownership fits the times in which we live. If greater democracy is needed in our society it is also needed in our economy. By importing a democratic spirit into how firms are run, I believe employee share ownership can help fashion a post-credit crunch economy that encourages a new culture of long-termism in place of the old culture of rampant short-termism.

In the first place, employee share ownership can contribute to moving our economy from one built on excessive levels of debt to one instead built on a culture of saving. There has long been a need to foster a better savings culture in the UK but the need is now more acute than ever. Last year, the UK's gross savings ratio fell to -0.2%. One of the principal motivations for people participating in all-employee share schemes like Save As You Earn (SAYE) and the Share Incentive Plan (SIP) are because they are easy ways to save. Indeed HMRC research finds that between 94% and 99% of employees cite this as a reason for their participation.

If anything current market conditions make such schemes even more attractive. SAYE plans, for example, offer generous tax breaks. When an employee's 3, 5 or 7 year SAYE plan matures they don't have to make a quick decision about what to do next. The investor has six months from the date of maturity to decide whether or not to use the cash to buy shares at the preset price or instead if they have dropped below that price he or she can opt for the safety net of taking the cash plus a bonus. That's the beauty of SAYE: it's totally risk free for the employee. The bonus rates payable for SAYE plans also provide a significant incentive for employees to save, not just because they are guaranteed but also because they are paid free of tax.

SIPs which were introduced by Labour in 2000 and give employees the opportunity to either buy shares (known as Partnership Shares), receive free shares from their employer or buy shares which the employer matches with free shares, have some similarly positive features. Hundreds of thousands of UK employees receive shares completely free of charge. These “free shares” clearly represent a win-win situation for employees and given that - according to the most recent *ifs ProShare* annual survey - almost 30% of companies operating a SIP offer free shares, a sizable number of employees will continue to benefit despite the pressures created by the credit crunch. Matching shares also offer a very good opportunity for employees. Here, the chances of an employees investment being worth less than their total outlay is very slim, especially given that more than 50% of employees participating in a SIP receive matching shares on either a 1 for 1 or 2 for 1 basis.

Underpinning all this is the fundamental point that for all the short term problems with share values, over the long term shares produce considerably better gains than other assets such as bank and building society savings accounts or property.

Second, employee share ownership can help move our economy from one built on too much short-term risk-taking to one that places a bigger premium on longer-term decision-making. The bigger the base of share ownership the wider the accountability net is drawn. Senior managers taking decisions in an employee-owned firm are responsible to their workers as fellow owners. Indeed one of the oft-cited criticisms of employee-owned firms is that wide accountability makes for slow and sometimes risk-averse decision-making. Maybe such conservatism is no bad thing. The last year has demonstrated that skating on thin ice all too often brings with it a potentially fatal dunking in inhospitable waters. When even the doyen of short-term shareholder value, Mr Jack Welch the former Chairman and CEO of General Electric now argues that firms which excessively focus on quarterly profit increases are pursuing “the dumbest idea in the world”, it is evidence of a wider shift in mood about how the corporate sector should go about running its business.

And there is another point here. Regulatory failure undoubtedly contributed to the current calamity in the world’s financial markets and now the wider global economy. And it is right that next week’s G20 meeting chaired by Gordon Brown examines what changes in regulatory systems, including in transparency, are needed to prevent any future recurrence. But a failure in regulation was only made possible by a more immediate failure: in corporate governance. The boards of financial

institutions simply did not do their job. Their memberships were drawn too narrowly. They showed too little independence. Too often they lacked, or failed to show their teeth. And they felt little if any sense of wider accountability. So it is welcome that Sir David Walker is now reviewing the governance of banks and that the Financial Reporting Council is looking to do the same for the broader corporate sector.

I very much hope both will consider a number of propositions. That a dose of greater democracy can make for more responsible corporate decision-making. That more active shareholders engaged in how a company is run is something to be encouraged not discouraged. And that employee share ownership can help strengthen corporate accountability. One example. The growing gap in earnings between the boardroom and the shopfloor has undoubtedly contributed to wealth inequality as well as fostering deep social resentment. By 2007, in the USA those at the top were earning 275 times those at the bottom. A firm where workers are also owners is far less likely to be tolerant of such excess.

Third, employee share ownership can help fashion a new model not just for how private sector organisations are run but for how public sector organisations are run too. Public services rely on the creativity and commitment of their staff. Teachers make a school. Nurses, doctors, porters and receptionists – amongst many others – make a hospital or a surgery. Yet all too often innovation is inhibited by the top down structure of how public services are run. That is why in recent years reforms have put a priority on devolving power to frontline public services. City Academies, Trust Schools, Primary Care Trusts and NHS Foundation Trusts have been created to relocate power and responsibility. In the case of the latter staff can become members of the Foundation Trust and elect governors to help oversee its management. And there has been growing interest in taking this model a stage further by establishing social enterprises - run and owned by public service staff - within the public sector. Community health services are an obvious area where this model could work. Indeed it is already being tested there. But there will be many others. The Government is right, for example, to encourage new forms of private investment in the Royal Mail. I also hope it will consider how as part of these reforms some element of the ownership could be made available to Royal Mail employees. More generally the time has come for the Government to drive forward the concept of employee share ownership with gusto as part of a wider drive to open up the public services not just to private and voluntary sector competition but to staff-owned enterprises.

So I believe employee share ownership has an important role to play in fashioning a fairer more stable economy. For that reason our policy objective should be to increase the number of employee share owners. I hope that the British Government shares that view. It has been very supportive in creating a favourable tax and regulatory regime in the past. I now want to propose how it can extend that support in the future. I have three proposals in mind.

First, private equity-backed companies should be permitted to offer HMRC approved all-employee share plans just like any other company. At present, employees who work for companies owned by private equity firms are prevented from participating in HMRC approved share plans. This is because where private equity funds invest in a company it often results in more than 50% of the share capital being held by one or a series of limited partnerships. SAYE and SIP legislation provides that the company whose shares are being used in the plan must not be under the control of any company, unless that company is listed. This is known as “the control test” – which private equity owned companies normally fail.

Ironically, some companies used to operate approved share plans before they were acquired by their new private equity owners. House builder Crest Nicholson and high street chain Boots are but two examples. The change of ownership makes tax-approved plans unavailable so causing an immediate and acutely felt loss to employees. There are also companies which have always been private equity owned and who, by virtue of their ownership model, have never had the opportunity to allow their staff to share in their success through employee share ownership.

This situation is anomalous and must be changed. Private equity is an increasingly important part of the UK economy. According to the British Private Equity and Venture Capital Association, the UK private equity industry has invested over £60 billion in approximately 30,000 companies since 1983. Firms currently backed by private equity employ over 1 million people, amounting to almost 5% of the private sector workforce.

As a matter of principle I believe it is wrong to deprive over one million private sector employees of the opportunity to participate in tax-approved employee share plans. In the interests of fairness, I hope the Government will look at making the necessary amendments to this legislation as quickly as possible. The forthcoming Budget provides an opportunity for the Government to signal its intention to do so.

Second, employees participating in a SIP should only need to hold their shares for three years before they become free of tax and national insurance contributions rather than the current five. This simple change would mean that SIPs are treated in the same way as other HMRC approved plans like Save As You Earn (SAYE) and Company Share Option Plans (CSOPs) - all of which allow participants to benefit from tax incentives after three years. I say that because especially in the current climate insisting that employees wait 5 years before they can remove their shares free of tax and national insurance contributions is a disincentive to saving.

What is more removing this anomaly will better reflect the increasingly mobile nature of the UK workforce. The Chartered Institute of Personnel & Development estimate, for example, that over 20% of private sector workers change their jobs each year.

Many employees, particularly those who have not participated in a scheme before, choose to participate for the shortest length of time. This is demonstrated by the fact that well over 60% of SAYE share plan participants are enrolled in a three year plan, compared to less than 1% for seven year plans. That isn't to say that employees only save for a three year period. Many will join a plan each year or go on to participate in another scheme at the end of the three year period as they will have experienced the benefits of participation and have adopted the savings habit. Reducing the holding period to three years should result in increasing numbers of employees purchasing shares through a SIP not just in the short term but in the medium to long term too. It is for this reason I hope that Ministers will look seriously at removing this anomaly so that employers and employees alike can benefit.

Third, it is time to raise the SAYE maximum savings limit. At present employees saving in an SAYE scheme put away a fixed monthly amount over a 3 or 5 year period. This fixed amount cannot be less than £5 or more than £250 a month. Many employers and employees would like to see the maximum amount of money that can be saved in such schemes increased. The maximum limit has not been increased in almost 18 years. Had the £250 limit risen in line with inflation it would now be equivalent of over £400.

It therefore seems fair and reasonable to increase the monthly amount that employees can save to £400. Interestingly, the Irish Government has already recognised the merits of doing so. It recently increased the

maximum monthly contribution to an Irish SAYE account from 320 Euros to 500 Euros.

According to a recent survey of *ifs ProShare* member companies, approximately 20% of SAYE savers are already investing the maximum £250 a month. Of course, not all of these employees would increase their savings to a new limit of £400 but some would. And in the process we could take a small step towards establishing a stronger savings culture in Britain. I hope the forthcoming Budget will examine this issue favourably.

I believe that making these three modest changes would open up more opportunities for employees to become engaged with their employers and improve the productivity of the British economy. They would not only boost employee share ownership in the short term but send a signal about the sort of economy the Government wanted to see for the long term. One which is more open and more democratic. That is why I also hope the Government will commit to bringing about a major expansion in employee share ownership in the future. In Austria the government has committed to doubling the proportion of the nation's shares held by employees. I hope the UK Government will consider doing the same.

The world in which we live is changing faster than ever before. Old solutions cannot deal with new problems. New ideas and new approaches are needed. Just as today's social problems cannot be solved without the engagement of individual citizens so today's economic problems call for a similar process of democratisation. Employee share ownership has a part to play in both. It is an idea whose time has come.