COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

COUNCIL RECOMMENDATION

concerning the promotion of employee participation
in profits and enterprise results
(including equity participation)

(presented by the Commission)

CONTENTS

EXPLANATORY MEMORANDUM

I. INTRODUCTION

1. In the context of the establishment of the Single European Market, the European Councils of Hanover, Rhodes and Madrid considered that the same importance should be attached to social as to economic aspects and that they should therefore both be developed in a balanced manner. The European Parliament (in numerous resolutions taken on own iniative) and the Economic and Social Committee (in its opinion of 22 February 1989) have taken a similar view.

2. In developing this approach, the Community Charter of the Fundamental Social Rights of Workers states, in point 12, inter alia, that employers or employers'organizations, on the one hand, and workers' organizations, on the other, shall have the right to negotiate and conclude collective agreements under the conditions laid down by national legislation and practice. In point 17 of the Charter it states that information, consultation and participation for workers must be developed along appropriate lines, taking account of the practices in force in the various Member States.

3. With this in mind, in its Action Programme relating to the implementation of the Charter, the Commission announced its intention to present a Community instrument on "equity sharing and financial participation by workers". Underlining its earlier declarations in favour of employee participation in asset formation and in productive capital formation as a device for a greater justice in the distribution of wealth and as a means for attaining an adequate level of non-inflationary growth, the Commission considered that "....the requirements of economic competition as well as new management approaches have led to the establishment of various mechanisms for the financial participation of salaried workers which meet the objectives referred to earlier, as well as others whereby the role of workers in enterprises is reconciled with their aspirations for a better remuneration and with the financial equilibrium of the enterprise."

   In accordance with the Charter and as announced in its action programme, the Commission therefore proposes a Recommendation aiming at facilitating and encouraging the development of such practices of:
   - "profit-sharing" in its various forms;
   - employee share-ownership.

   The nature of the instrument chosen, a Council Recommendation, is motivated on the one hand by the nature of the subject which, as shown below, strongly suggests that preference should be given to a non-binding instrument. On the other hand, a Council Recommendation is a more appropriate choice than a Recommendation by the Commission, given the view expressed by i.a. the European Parliament, that the status of this instrument should be sufficient to have an impact on all parties.

II. THE CONTEXT

A. Antecedents and preparations

4. The 24 June 1976 Tripartite Conference had asked governments and the two sides of industry to take appropriate measures to encourage asset formation by workers. The work undertaken in the few years thereafter, in close collaboration with experts from governments and the two sides of industry on the basis of a mandate from the Council

(Social Affairs), resulted in a Memorandum on Employee participation in asset formation" which was adopted by the Commission in August 1979. This Memorandum did not contain formal Commission proposals but rather two different sets of guidelines. The first set of guidelines aimed at reinforcing the social aspect of incentives to individual savings, the second set was directed towards the development of systems of financial participation by employees.

5. The main follow-up to this Memorandum and its 1983 addendum was a Resolution adopted by the European Parliament in October 1983 in which the EP supported the approach taken in the Memorandum and requested the Commission to draw up a Recommendation on the subject. The Commission was not able to meet this request in the years thereafter, because of other priorities in its work programme, but the issue continued to receive attention in the European Parliament.

6. In the announcement in the Action Programme of its intention to present a Community instrument on equity sharing and financial participation by workers, the Commission outlined an approach which is different from the one followed a decade ago and which takes account of the latest developments and of the present policies in this area within the EC. Rather than trying to cover all aspects of general asset-formation policy or of incentives offered to the population as a whole or to specific income-groups outside the employment context, the instrument will focus on employee participation in the profits and capital growth of their enterprise and on employee share-ownership.

7. In the process of preparing this Community instrument the Commission has funded a research project undertaken at the European University Institute of Florence, with the specific aim of obtaining a good overview of "the state of the art" concerning financial participation by employees in the EC. The results of this project are being described in the so-called "PEPPER-Report" (PEPPER standing for "Promotion of Employee Participation in Profits and Enterprise Results"). The following descriptive chapters (B-F) largely summarize the most significant findings of the Report. More details, bibliographical references etc. are to be found in the Report itself (Supplement 3/91 to Social Europe).

8. The two main competitors of the EC on world markets, the USA and Japan, both already practize financial participation schemes on a more substantial scale than the Community does.

Some estimates for the USA suggest that over the period 1977-1987 the number of profit-sharing plans has risen from 300,000 to 500,000. Even in 1978 around 17 million workers were covered by registered employee profit-sharing schemes. Following tax concessions encouraging a specific form of financial participation, Employee Stock Ownership Plans (ESOPs) have known an impressive growth to reach in 1990 a figure of some 10,000 ESOPs, covering 10 million employees.

In Japan financial participation by employees is already a long tradition, although some characteristics of the schemes may differ from what is usual in the West. Among Japanese enterprises profit-sharing is widely diffused; profit-sharing bonuses are usually paid twice a year and are estimated to account for as much as 25% of total employee earnings. Another frequent practice is to encourage employees to purchase company shares. Some have argued that Japan's low unemployment rate and level of inflation can be attributed to profit-sharing, but this is almost certainly an oversimplification.

B. Typology of schemes for financial participation by employees

9. There is a wide range of different forms of employee participation in enterprise results. These can be grouped under two main categories, which may or may not co-exist and may in some cases overlap: profit-sharing, and employee share-ownership.

B.1 Profit-sharing

10. "Profit-sharing" in a strict sense implies the sharing of profits by providers of both capital and labour, by giving employees, in addition to a fixed wage, a variable part of income directly linked to profits or some other measure of enterprise results. Profit-sharing provides employees with a regular bonus paid out of profits which would normally be allocated to capital but, contrary to traditional bonuses linked to individual performance (e.g. piece rates), profit-sharing is a collective scheme applied to all, or a large group of employees.

In practice, profit-sharing can take various forms. At the enterprise level, it can provide employees with immediate or deferred benefits; it can be paid in cash, enterprise shares or other securities; or it can take the form of allocation to specific funds invested for the benefit of employees. At higher levels, profit-sharing takes the form of economy-wide or regional wage-earners' funds.

Cash-based profit-sharing links employee bonuses directly to some measure of enterprise performance (profits, revenue, value-added, or other), most frequently providing an immediate payment. However, it can also be a deferred scheme: e.g. if a certain percentage of profits is allocated to enterprise funds which are then invested in the name of employees. A distinction is also made between gain-sharing and profit-sharing although both are clearly related; gain-sharing typically consists of a group incentive pay system that is geared to productivity, cost-reduction or other criteria, less comprehensive than profitability.

Share-based profit-sharing consists of giving employees, in relation to profits or some other measure of enterprise performance, a portion of shares of the enterprise where they work. These are usually frozen in a fund for a certain period of time before the workers are allowed to dispose of them. When shares are subject to a minimum retention period the term "deferred profit-sharing" is used.

B.2 Employee share-ownership

11. Employee share-ownership provides for employee participation in enterprise results in an indirect way, i.e. on the basis of participation in ownership, either by receiving dividends, or the appreciation of employee-owned capital, or a combination of the two. While such schemes are not directly related to enterprise profits, they are related to enterprise profitability and so enable participants to gain from the growth of company profits.

Employee share-ownership can be both individual and collective. Shares can be in the enterprise where the employee works or elsewhere. However, the draft Recommendation mainly focuses on those employee share-ownership schemes set up with the explicit intention of providing employees with an additional source of income related to enterprise results.

Employee share-ownership can take many different forms. Typically a portion of company shares is reserved for employees and offered at privileged terms; or employees are offered options to buy their enterprise's shares after a determined amount of time, under favourable tax provisions. Alternatively, an employee benefit trust is set up through Employee Share Ownership Plans (ESOPs), which acquire company stock that is allocated periodically to each employee's ESOP account. Workers' buy-outs of their enterprises are a special form of employee share-ownership.

In the literature, the generic term "employee share-ownership" is frequently used to denote both share-based profit-sharing, and employee share-ownership; "profit-sharing" is sometimes used to refer to both profit-sharing in the strict sense of profit-related pay, and to share-based profit-sharing. The distinction between individual and collective employee share-ownership is also not always clear-cut.

This draft Recommendation refers primarily to those schemes which are : internal (applied within an enterprise); collective (available for all, or a major part of employees); continous (applied on a regular basis); and providing for employee participation in some measure of enterprise performance (whether directly or indirectly).

C. Financial participation schemes in economic theory

12. During the 1980s, a lively debate developed among economists on the possible effects of financial participation schemes. Those <u>in favour</u> argue that there will be three main types of beneficial effects.

The first is the <u>incentive effect</u>, which is expected to result in higher labour productivity and improved overall enterprise performance. Employee income directly linked to enterprise results is expected to lead to higher motivation and commitment, greater identification of workers with the interests of their firm, lower absenteeism and labour turnover, reduced intra-firm conflict and labour-management tension, and improvements in work organization.

Other related possible effects are a contribution towards a greater social justice in the distribution of total wealth and an insurance against managerial opportunism, by an encouragement of joint wealth-maximizing behaviour. More indirectly related are effects and objectives such as an improvement of employee understanding of the fundamentals of enterprise economics or the encouragement of positive attitudes towards more industrial democracy.

The second theoretical argument is that profit-sharing provides for greater <u>flexibility of labour earnings</u>. By increasing the frequency of adjustments in remuneration, profit-sharing is likely to result in less variable employment, and can, therefore, reduce the pressure for redundancies.

In addition to these effects expected at the enterprise level, some economists (J. Vanek and M. Weitzman) have proposed that profit-sharing could have stabilizing macroeconomic effects. A "share economy" in which firms give employees a share of profits as a substitute for a part of their wages, could have important advantages over a "wage economy". Since firms would regard the base wage, and not total remuneration, as the relevant marginal cost of labour, profit-sharing would lower the marginal cost of employing extra labour, and therefore could not only raise employment, but shift the entire economy to a state of full employment. Monetary policies could then be used to fight inflation, without fear of creating unemployment.

13. A number of interrelated arguments against financial participation schemes can also be found in the literature, more particularly :

a) **Weakening of property rights.** Scholars belonging to the Property Eights School have argued that legislation encouraging any form of economic democracy represents a continuing erosion of property rights, by using the power of the state to transfer wealth from owners of capital to workers. profit-sharing is thus regarded as a purely distributive "vealth confiscation scheme" without potential incentive effects. They predict a large negative relationship between employee participation and performance, due to loss of managerial control and the weakining of the authority of capitalists, and increased demands for workers' participation in decision-making. Moreover, where workers' earnings include a share in profits, the reinvestable surplus will be lower and hence growth and future employment may be adversely affected.

b) **Inefficiency of group incentives.** It has also been argued that group incentives are ineffective, since incentives become diluted in a group setting where rewards are linked to group effort. Profit-sharing gives each worker only a small fraction of any additional profit due to his own effort; workers will therefore be tempted to free-ride, and difficulties in monitoring a single worker's contribution will arise. However, more cooperative behaviour resulting from financial participation (especially if accompanied by decisional participation), could offset these potential negative effects.

c) **Risk-bearing.** Financial participation schemes may also expose workers to an unacceptable degree of risk. Because of the physical impossibility of diversifying the use of their labour in different sectors and enterprises in the economy (as capitalists can do with their capital), by putting "all eggs in one basket", workers will not only bear the risk of unemployment, but will also face additional income risk, in particular when building up participation in holdings (directly or indirectly) of shares or bonds issued by their employer. This additional risk may however be compensated by higher employment security which profit-sharing is expected to provide, the exposure to risk may be limited if workers are excluded from full entrepreneurial profits and losses and in some cases forms of insurance may help to reduce the risks (but also potential returns).

In the whole, the theoretical debate on financial participation schemes has by itself not yet produced overwhelming support for the arguments in favour of or against financial participation schemes. A closer examination of the practice of such schemes will give more clues (see sections 20 to 30).

D. The existing legal and fiscal framework for financial participation schemes in the EC

D.1 General features

14. The legal and fiscal status of financial participation schemes in EC countries is very heterogeneous. The French experience, based on legislation which since 1967 has made deferred profit-sharing (employee participation in company growth) compulsory in enterprises of a certain size, clearly contrasts with the voluntary nature of financial participation schemes in all other EC countries. However, there is also substantial variety in the legal and fiscal framework between countries in which schemes are voluntarily implemented by enterprises, especially regarding conditions for qualifying for tax benefits and the incentives effectively offered.

For the moment two EC countries have comprehensive legislation, consisting of specific laws for the various types of financial participation schemes : France, since 1959; and the UK, since 1978. In most other countries, financial participation measures of a more limited scope have been adopted.

Thus in Belgium, Denmark, Germany, Greece, Ireland, the Netherlands and Portugal, favourable fiscal provisions have been granted to some financial participation schemes.

Nevertheless, measures adopted so far have regulated a limited number of specific forms of schemes, and most frequently when they offer tax incentives these are modest. Moreover, these provisions have usually been adopted as part of more general legislation, e.g. in Germany and the Netherlands on savings schemes, and in Belgium on company laws.

In Italy, Luxembourg and Spain, there are no specific legal provisions on financial participation and consequently no particular tax incentives are offered at present, although provisions contained in more general laws do envisage the possibility of introducing financial participation schemes, and in some of these countries the legal framework is not unfavourable (particularly in Spain).

D.2 Specific forms encouraged

15. At present, the prevalent types of financial participation encouraged by government policies through tax benefits are various forms of employee share-ownership and, to a lesser extent, deferred profit-sharing, whereas cash-based profit-sharing is for the moment actively supported in only a few EC countries.

16. Government measures encouraging various types of employee share-ownership are found in all countries where there is official support forsome form of financial participation. In some countries, it has been the only or principal form of financial participation offered preferential treatment. Thus in Belgium, tax incentives have for the moment been granted exclusively to various forms of employee share-

ownership; in Germany, the introduction of new fiscal provisions in 1984 was aimed primarily at encouraging individual workers' contributions to enterprise capital; while in Ireland, of the two laws adopted so far, one is specifically destined to a specific form of employee share-ownership (stock options).

Official encouragement of employee share-ownership has been far from lacking in other countries. In Denmark, offers of enterprise shares to employees at preferential terms have been encouraged since 1958. In France, favourable tax provisions have been granted to a variety of employee share-ownership schemes, including stock options (since 1970), offers of shares at preferential terms (since 1973), free distribution of shares to employees (since 1980), employee investment funds (since 1983), and employee buy-outs (since 1984). In Greece, legal obstacles for the free distribution of a company's shares to its employees were removed in 1987, and thereafter employee share-ownership (including share options) has been encouraged through favourable legal provisions. In Portugal, employee share-ownership has been promoted within the 1990 privatization measures. In the UK, fiscal measures have encouraged a number of specific employee share-ownership schemes, including "BOGOFs" (buy one, get one free, introduced in 1978), all-employee stock options (the so-called SAYE-"Save as you earn" scheme, promoted since 1980), discretionary share options (since 1987), and ESOPs (since 1989).

17. Deferred profit-sharing, most frequently consisting of the allocation of enterprise shares (or other securities) to employees which are frozen for a certain period of time, or directing profits to investment funds for the benefit of employees, has been encouraged in several countries (Denmark, France, Germany, Ireland, the Netherlands and the UK). In Denmark, employee share and bond schemes offered within a profit-sharing arrangement have been given preferential tax treatment since 1958. In France, a 1967 law introduced employee participation in company growth. This was obligatory for all enterprises with over 100 employees (in 1990 extended to all enterprises with more than 50 workers).Under the scheme a part of profits is allocated to a special enterprise fund which is then invested for the benefit of all employees; both enterprises and employees are exempted from tax and social security charges. In Germany, specific investment funds, sometimes combining enterprise resources with employees' savings (which, up to a certain amount, are tax free), have been encouraged since the early 1960s. It is only since 1984, however,that investment in specifically productive capital has been actively promoted through legislative measures. Share-based profit-sharing has been encouraged through tax exemption or deduction both in the UK (since 1978) and in Ireland (since 1982), on condition that shares are held in a trust for a determined period of time. In the Netherlands, minor fiscal advantages have been granted to profit-sharing since the 1960s,on condition that the bonuses are frozen on special accounts for a determined amount of time.

18. Finally, cash-based profit-sharing has been actively encouraged through specific laws in only two EC countries : in France (since 1959) and in the UK (since 1987). In Greece and Portugal, although no specific laws have promoted this type of financial participation, provisions contained in more general laws provide fiscal benefits for both firms and employees. In other countries, there is no supportive legislation for this type of profit-sharing, particularly in Belgium,

Germany and the Netherlands, where enterprises introducing such schemes incur high taxes and social security contributions.

19. In short, the large majority of schemes currently encouraged through governments policies are those which allow workers to acquire their enterprise's shares, whether automatically (as in the case of share-based profit-sharing or distribution of company shares), or by stimulating voluntary employee share-ownership (through workers' acquisition of enterprise shares). This seems to be reflection of common and interrelated objectives pursued by individual governments and enterprises. Because of obligatory retention and other resale restrictions on shares, the majority of schemes presently encouraged are of a savings-oriented nature, whether through the allocation of a part of profits to specific enterprise funds or trusts, or even more so through workers' voluntary contributions of capital.

E. Financial participation schemes in practice

E.1 General features

20. There is a great variety from one country to another in the types of financial participation schemes encountered in practice. These include cash bonuses, share-based and other forms of deferred profit-sharing, and a number of particular employee share-ownership schemes, such as free distribution of shares to employees or share offers at preferential terms, stock options for all employees or only for executives, employee share-ownership plans or trusts (ESOPs and ESOTs), and employee buy-outs. The most diversified forms are found in the UK and France.

In those countries where some form of financial participation has been encouraged by the government, the prevalent types applied by enterprises are indeed the ones promoted through official government measures. The preferential tax treatment granted particularly to employee share-ownership and/or deferred profit-sharing, does seem to have led to their prevalent adoption in practice (in Belgium, France, Germany, Ireland, the UK).

In Belgium, employee share-ownership - the only type currently encouraged by law - is the principal form of financial participation applied by enterprises, as the unfavourable and uncertain fiscal climate for other forms has resulted in limited practices of profit-sharing. In France, although cash-based profit-sharing has been institutionalized for more than three decades, the number of agreements on cash-based profit-sharing in 1986 was only 20 % of those concluded on "participation" (obligatory); moreover, the 1986 French legislation explicitly encourages workers to invest their cash bonuses in the savings fund of the enterprise (which is then reinvested, frequently in enterprise shares). In Germany, employee participation in enterprise capital is the dominant form, and 80 % of employees in firms using financial participation schemes hold capital shares. In Ireland, since only share-based profit-sharing and share options are currently offered preferential fiscal treatment, these forms are also the most widespread. In the UK, at present 84 % of all registered schemes are of this type (72% are various forms of employee share-ownership, and 12% share-based profit-sharing schemes), while only 16 % are profit-related pay schemes.

In countries without specific legislation on employee share-ownership (Italy, Luxembourg, Spain), and in those with only limited, or fairly recently introduced, incentives (Denmark, Greece, the Netherlands, Portugal), cash-based profit-sharing still today seems to be the prevalent form practised by firms.

E.2 Diffusion

21. Recently there has been a significant growth of various forms of financial participation schemes in the majority of EC countries. At present financial participation is most widespread in France, with over 10,000 agreements on employee participation in company growth, and an additional 7,000 agreements on cash-based profit-sharing. In the UK there are currently more than 7,000 different financial participation schemes in operation, applied by almost 30 % of all British firms (20 % have at least one all-employee scheme, and an additional 9 % have schemes for executives only). The large majority of schemes in the UK - over 4,300 - are discretionary share option schemes, as compared with 1,200 cash-based profit-sharing, around 900 all-employee share option, and 900 share-based profit-sharing schemes, and only around 20 ESOPs.

In general, in other countries financial participation schemes are less widely used. For some of these countries, only estimates are available at present. In some cases these are highly divergent depending mainly on the definition used.

In Ireland there are currently around 250 registered schemes, of which 60% concern stock options and 40% share-based profit-sharing. In Denmark the overall number of schemes is estimated to be no more than 200, the most common being cash-based profit-sharing. In Germany some 1,600 firms have introduced employee financial participation schemes but if informal and less regular arrangements are also included, there may be as many as 5,000 firms practising some kind of financial participation. For Italy it has been estimated that 25% of large firms currently give their employees variable remuneration, but only in sompe cases directly linked to an indicator of enterprise performance; in addition, around 30 quoted companies have offered shares at preferential terms to their employees in recent years. In the Netherlands about 30 % of enterprises currently use related schemes, but only 6% can be said to have a "real" profit-sharing scheme. For Belgium, no estimates are available at present on the use of profit-sharing; as to employee share-ownership, 20 quoted companies offered shares to their employees in 1989. In Luxembourg a recent survey found that 22 % of firms had introduced "profit-sharing" but without specifying which type. In Spain as many as 44 % of medium and large firms give employees a variable component of pay related to enterprise performance, but only in 6 % of firms are these payments directly linked to profits. For Greece and Portugal, no estimates are currently available on the use of financial participation schemes.

Not all the schemes providing employee financial participation effectively link employee earnings directly to an indicator of enterprise performance. Sometimes this link is very loose indeed, particularly in Spain, Italy and the Netherlands.

E.3 Enterprise size and sectoral distribution

22. No clear common pattern seems to emerge on the importance of firm size. In Germany employee financial participation schemes are adopted mainly by small firms, although quite a few very large enterprises (with over 10,000 workers) have also been involved. In the UK mainly large companies have adopted one of the registered schemes qualifying for tax benefits, while small firms have tended to introduce non-approved cash-based schemes. In France there is a mixture of both, since participation schemes used to be obligatory primarily in larger firms, while small firms mainly introduce cash-based profit-sharing. In Belgium, Italy, Spain and Portugal large firms seem to be predominant.

As far as the distribution of schemes by industry type is concerned, it appears that in most countries schemes are being introduced in a large variety of sectors, while in some countries such as Luxembourg, Portugal and the UK, the finance sector uses them more than the average.

E-4 Employees involved

23. In France and the UK large numbers of employees take part in financial participation schemes. In France, the different types of schemes cover almost 6 million employees, of whom around 4 million actually participate (around 18% of all employees). This is not surprising considering France has had the longest tradition, and has made some schemes compulsory. In the UK 3.5 million employees are eligible to participate in financial participation schemes, but the actual number benefiting has been estimated to be 2 million (around 8% of all employees).

In other countries the percentage of employees participating is lower. In the Netherlands some 350,000 employees participated in profit-sharing schemes in the mid-1970s (around 7.4% of all, or 12 % of market sector employees), while in Germany 1.3 million employees are currently involved in financial participation schemes (around 5 % of all employees). For Ireland no official figures are available but an estimate suggests that some 40,000 employees currently participate in share-based profit-sharing schemes (more than 3% of total). Variable remuneration linked to enterprise performance is given in Italy to some 2% of employees.

However, these figures may be overestimates considering that in some countries the same individuals may participate simultaneously in different types of schemes. Nor are these country figures directly comparable since they are sometimes related to quite different schemes.

Not all schemes are available for all employees nor do all eligible employees necessarily participate. In the case of discretionary schemes for certain groups of employees, which are by far the most popular type of scheme in some countries (UK, Ireland), most often only a small percentage of employees benefit (in the UK usually no more than 10% of employees). At the same time, in share options or other types of schemes available to all employees, the degree of participation is not always high. Although for example in Germany, the participation rate of employees in schemes offered has been around 80%, in the UK, in SAYE-type share option schemes the participation rate has frequently not been higher than 15%.

E-5 Employee benefits

24. At present the benefits accruing to workers from financial participation schemes, whether on the basis of profit-sharing or of employee share-ownership, in most cases remain small.

The amount allocated to profit-sharing hardly ever exceeds 10% of average employee earnings and 5 % of enterprise profits. In France the profit share per employee in both cash-based and deferred profit-sharing schemes amounts to around 3-4% of the wage bill, while in the Netherlands the share amounts to 4.5-6.5% of average employee earnings. In the UK profit-related pay accounts for around 7% of average earnings, but in share-based schemes it usually does not exceed 2-4% of total wages. Some Italian enterprises give their employees substantial variable pay, but the sectoral averages range from 3 to 8% of the minimum national wage. In Spain, variable payments to employees in some cases have amounted to 10-25% of total pay, but average payments linked to profits usually represent no more than 5% of labour costs.

In employee share-ownership schemes, excluding share offers as part of privatization measures, the percentage of shares reserved for employees in most cases has not exceeded 5% of the total shares issued, and the discount on shares (if available) has usually been rather low.

E-6 Summary Table

25. The annexed summary table based on the findings of the PEPPER-Report presents an overview, in a comparative framework, of the EC Member States' general attitude towards financial participation, legislation and tax benefits, the most frequent types of schemes adopted by enterprises and, where available, some other relevant figures (on the number of schemes, firms and employees involved; and average profit shares per employee or other benefits).

F. Evidence on the effects of financial participation schemes

26. Sections 12 and 13 contain the main theoretical arguments advanced in favour of or against financial participation schemes. In this chapter the empirical evidence concerning these arguments is examined.

Theoretical arguments advanced in favour of financial participation schemes claim the following principal types of beneficial effect : the incentive effect, which is expected to result in higher labour productivity and improved enterprise performance; and major wage flexibility, which is expected to result in less variable employment and/or higher employment, both at the enterprise and at the macro-economic level.

In evaluating the effects of financial participation schemes, two sources of information are available : econometric estimates and surveys on the attitude of employees and firms towards these schemes.

However, the evidence reported is preliminary and ought to be interpreted cautiously. On the one hand, attitude surveys are based on the perception of effects, and not the effects themselves. On the other hand, although econometric models are a more objective source of information, there are a number of specific problems involved, such as the high sensitivity of results to model specification, the indicators actually used and estimating techniques; difficulties in isolating the effects of profit-sharing from other organisational factors and external causes; ambiguity concerning the separation of cause from effect.

F.1 Incentive effects

27. Econometric estimates of the effects of financial participation schemes on employee motivation have so far been few in number, and have exclusively concentrated on three countries: Germany, the UK and France (for which only one econometric study is available). Evidence from all three countries points to positive net effects on employee motivation and on productivity. The positive link between profit-sharing and productivity is also supported by a number of similar studies on the US. However, these effects might for the moment be relatively small because of the low incidence of employee benefits on total earnings.

There is no specific scheme which a priori has significant advantages over the others. The experience to date nevertheless suggests that cash-based schemes may have had more significant incentive effects than share-based schemes. This is supported by both econometric estimates and by attitude surveys. In some of these surveys, cash-based profit-sharing was by far the most popular scheme, while many deferred profit-sharing and employee share-ownership schemes have not achieved the objective of increasing workers' involvement as shareholders and their greater identification with the interests of their enterprise. This seems to be confirmed by the fact that involvement of employees in capital participation schemes in Germany is below the maximum, and the frequent practice in both France and Britain of workers selling their shares as soon as they are allowed to. From the point of view of the individual employee, the crucial difference between the two types of scheme seems to lie in resale restrictions, since workers usually prefer to be able to cash in their profit share at any moment (in spite of the fact that cash-based schemes in general attract lower, if any, tax incentives).

Therefore, when for whatever reason non-cash-based schemes are to be given priority, they may need to be accompanied by certain advantages over cash-based schemes. Provided that they are properly designed, share-based schemes could not only have similar motivational effects to cash-based schemes, but could also provide for a longer-term commitment by employees. Indeed, there are cases in which share-based schemes may provide not only the right incentives, but would even be preferred.

F.2 Wage flexibility

28. The effects of profit-sharing on employment through greater wage flexibility are much more debatable, as the econometric evidence is mixed. On the one hand, some earlier evidence for the UK suggested that profit-sharing had a positive and significant effect on employment, but more recent estimates show that the size of the effect may not be very large. On the other hand, evidence from

France suggests that profit-sharing has resulted in greater wage flexibility, less frequent adjustments in employment, and in higher and more stable employment growth.

F.3 Macroeconomic effects

29. Given that profit-sharing for the moment is not sufficiently widespread in any single country to have significant macroeconomic effects, these effects cannot really be empirically verified. Nevertheless, several econometric studies suggest that enterprises in all three countries for which estimates are available - France, Germany and the UK - regard total remuneration, and not the basic wage, as the marginal cost of labour, thus contradicting the fundamental assumption of the Vanek-Weitzman hypothesis (see section 12).

F.4 Link with participation in decision making

30. The link between the effects of financial participation and participation in decision making essentially depends on the specific effects being tested. With regard to employment effects, existing econometric evidence is mixed, in some cases offering support to the hypothesis that the effects may be higher if participation in decision making is absent. On the other hand, prevailing evidence on incentive effects from both econometric and more informal studies does suggest that the combination of financial participation with participation in decision making can have significant beneficial effects. The less positive attitude of employees towards share-based schemes seems to be related to the practice in several countries whereby employees are not always offered the same rights as other shareholders (primarily voting rights). More employee participation in decision-making may indeed, in many instances, substantially facilitate the achievement of some of the objectives of financial participation schemes.

G. Cross-border extension of financial participation schemes in the EC

31. The data in the three preceding chapters about the existing legal and fiscal framework, the practice of financial participation schemes and on the evidence of their effects, are essentially drawn from the PEPPER-Report. The examination of the practice of financial participation in the EC-countries, the legal framework etc. by the PEPPER-Report, was basically carried out within the existing legal and fiscal framework of each individual country, i.e. with a "national" perspective, and then compared with the other countries. A number of reactions to this approach have made the Commission realise that in this way certain intra-community aspects of financial participation are not sufficiently covered.

A number of multinational enterprises operating at a European level (and this number is only likely to grow) want, for various reasons, to make the benefits of financial participation schemes available to their employees in different EC-countries under comparable conditions. In addition to the usual motives which companies may have for using financial participation schemes in a national context, these companies also have transnational motives like using financial participation as a means of reinforcing corporate identity and the sense of belonging to a multinational group. Alternatively they may be faced with practical problems arising when employees within the group wish to remain participant in a financial participation scheme also when they are transferred to work in a different part of the group in another country. In addition, when a multinational operates a successful scheme in one particular country, e.g. its country of origin, employees in other countries often ask for something similar.

At present, enterprises wishing to cross borders with their financial participation schemes, are confronted with a number of obstacles.

These obstacles can broadly be grouped into three general categories:

a) socio-cultural differences between the member states;
b) differences in fiscal/financial treatment of schemes;
c) administrative/procedural requirements.

The socio-cultural differences between member states are in themselves not the major obstacle, but may require of the enterprise concerned additional efforts to explain what is intended or may require it to engage in different ways of dealing with employees and their representatives than what it is used to do. More information about all aspects of financial participation schemes distributed on a wide scale as this Recommendation will encourage,should already have a favourable impact on overcoming such imponderable barriers.

The second category, differences in fiscal/financial treatment of financial participation schemes, is where the largest number of problems originate. In countries where some type of financial participation scheme is made attractive by government in particular through fiscal incentives, that type of scheme generally is the one most commonly introduced by enterprises (see also section 34). It is understandable that when those enterprises want to apply a similar scheme abroad and when these incentives then are not available, the scheme in question may become much less attractive and even conditions of taxation and social security contributions may make its use in certain countries prohibitively expensive. Enterprises recognize that each country has its own fiscal and social security system and that differences in those systems will persist for many more years in the EC. At the same time, however, they observe that certain details of these fiscal and social security regulations make cross-border application of financial participation schemes unnecessarily cumbersome and that things could be facilitated by revising such details without having to perform a major overhaul of these regulations. This could be done without any attempt to harmonize fiscal or social security systems - which would clearly lie beyond the scope of this Recommendation. Such observations are mainly related to the treatment of employee share-ownership and stock-option schemes in several countries.

The third category, administrative hurdles, creates similar problems, although of a less fundamental character, and therefore in the end of a less prohibitive nature.

In some countries there are procedures for recognition of financial participation schemes before one can benefit from an advantageous fiscal/financial treatment. These procedures can contain elements which are more difficult to satisfy by a foreign than by a domestic enterprise. There are often requirements for a considerable amount of information to be supplied e.g. when shares are issued to be made available to employees. Sometimes there is an obligation to use local intermediairies for the handling of a scheme in order for it to be recognized. Employee share-ownership may cause problems when the shares are not quoted nor traded in a particular country. Schemes which use trusts or joint investment funds may encounter problems when these entities are not easily recognized abroad (problem of legal status).

Although most of theseobstacles can in the end be overcome, their existence may either discourage enterprises from extending their financial participation schemes abroad or often at least increases their costs. It is worth examining to what extent things could already be facilitated by a wider use of an approach based on mutual recognition.

At this stage the Commission can offer no ready-made solutions to the problems caused by administrative hurdles and/or by differences in fiscal/financial treatment. It therefore proposes to have them examined by a working party composed of experts from all member states. Cross-border application of financial participation schemes in the EC would benefit tremendously from the existence of formulae, which, when adhered to, would be more or less automatically recognized in all member states and would then qualify in each country for treatment which would be known in advance and operate as far as possible under comparable conditions. Thus it is suggested to charge the working party with examining possibilities for the creation of formulae of financial participation by employees at a European level for each one of the following three types of schemes:

a) a profit-sharing scheme;
b) an employee share ownership scheme;
c) a stock options scheme.

H. Related issues and developments

32. The promotion of financial participation schemes does not take place in a vacuum, but is related to several other relevant socio-economic developments. The most important of these related developments are mentioned here not only to draw attention to their relationship with financial participation schemes, but also to indicate unambiguously that these issues themselves lie beyond the scope of this draft Recommendation and are therefore not being dealt with in any detail.

Related issues, not subject of this Recommendation are :

- general procedures for Information, Consultation and Participation in Enterprises;
- general trends in wage policies and wage negotiation, including (individual) performance related pay systems;
- general trends in private share-ownership and asset-formation;
- cooperative enterprises and the cooperative movement;
- the European Company Statute;
- the liberalisation of financial services and capital markets in connection with the achievement of the Internal Market;
- financing of (supplementary) pension provisions.

I. Role of the social partners

30. The social partners play a crucial role both in the preparation of financial participation systems and in their implementation. The positions and attitudes of the two sides of industry in various EC countries have so far been rather divergent. Of course, there are important differences concerning the extent to which financial participation schemes have been a topic for discussion between the social partners and this is reflected in their positions.

In countries where these schemes are rarely used, employers associations do not yet seem to have adopted a definite standpoint. Elsewhere, employers associations generally have emphasised their support for enterprise-level schemes, provided they can be introduced on a voluntary basis and the final design of the schemes can be decided at enterprise level. The availability of tax facilities is an important incentive to use such schemes but not the overriding motive. Employers usually consider financial participation schemes an important instrument for improving employee motivation and commitment to the enterprise's interests. In this connection the employers'first preference generally seems to be for share-based types of schemes (where practicable).

Trade unions have often been reluctant to facilitate the introduction of financial participation schemes.

They have several major concerns :

- they are unhappy that these schemes are frequently introduced unilaterally by employers, which makes them suspicious about the real motives behind the schemes;
- financial participation schemes might lead to increased inequality between wage-earners, e.g. between those working in very profitable sectors and others in less flourishing sectors;
- financial participation schemes may lead to high risks for the workers involved if for example a very substantial part of their income becomes variable or if they build up substantial holdings of bonds or shares issued by their employer (see section 13);
- the introduction of such schemes might be used to circumvent or weaken collective wage negotiations;
- if tax-incentives were to lead to a serious loss of tax income for the State, this money would then have to be sought elsewhere or the State might be tempted to reduce the level of collective services.

As an alternative trade unions have often put forward proposals on collective forms of profit-sharing by means of wage-earners' funds; these are regarded as an important instrument for a more even distribution of income and wealth.

Nevertheless, many trade unions now have more pragmatic positions on financial participation. These have evolved with the actual diffusion of schemes in practice and range from giving more outright support in some countries to a more wait-and-see attitude in others. In several countries where the central trade union associations do not yet fully accept financial participation, many local trade unions have a more positive stance, actively participating in the signing of agreements, which they expect to produce positive effects for their members.

In order to create a climate of constructive cooperation between the social partners on these matters, it seems therefore essential that when financial participation schemes are being introduced, this is done on a voluntary basis on both sides and seriously negotiated between them. The existence of financial participation schemes should not weaken nor substitute for the normal wage negotiations between the social partners dealing with basic wages and other work conditions.

J. Role of governments

34. The development of financial participation schemes is strongly influenced by government action. Governments are primarily responsible for the creation of a legal and fiscal framework that may favour such schemes but may also impede their introduction. This is illustrated by the finding of the PEPPER-report that in those countries where a particular type of financial participation scheme has been encouraged by government, the schemes most commonly introduced by enterprises are indeed the ones promoted through official government measures. In particular the availability of tax incentives makes a big difference. Such incentives may only be needed temporarily : once the relevant scheme has gained a certain momentum, the incentive may be reduced or phased out. The findings of the PEPPER-report suggest that the potential advantages of financial participation schemes would justify governments giving serious consideration to the introduction of such fiscal facilities.

At present, different official government positions in individual EC-countries must be seen against a background of differing traditions and especially large differences in actual experience in practise with regard to financial participation schemes. In countries like France and the UK government policies have been actively encouraging the use of financial participation schemes for a considerable number of years. In Belgium, Denmark, Germany, Greece, Ireland, Italy and the Netherlands, financial participation schemes of various types have been the subject of national debate but government support has either been limited or lacking, or has emerged fairly recently. An important issue in political discussions in many countries has been, and to some extent still is, whether schemes at enterprise-level, or more central collective schemes, ought to be encouraged. In Denmark, Germany and Italy in particular, the issue of economy-wide wage-earners' funds was at the centre of the debate, but due to the absence of a general consensus and insufficient support for compulsory collective arrangements, none of the proposals advanced have been adopted. In Luxembourg, Portugal and Spain, the financial participation issue has so far received only limited attention, nor has it been among the priority issues for discussion between the social partners. Only very recently and possibly in connection with the Commission's announcement of a Community instrument and the publication of the PEPPER-report, has interest in financial participation matters increased in some of these countries.

Governments have so far basically operated from a national perspective in matters of financial participation. As set out in section 31, the existing national legal and fiscal frameworks do contain a number of obstacles for enterprises practising a financial participation scheme in one EC-country, when they want to make the benefits of that scheme also available, under comparable conditions, to their employees in another EC-country. Solutions for such problems can only be found with the active help of governments.

Finally, governments can encourage the use of financial participation schemes by supplying adequate information to all potentially interested parties including in particular information about the experiences acquired in other Member Sates.

III. THE ELEMENTS OF THE PROPOSAL

35. This proposal is the product of a range of preparatory activities. These include the research project carried out at the European University Institute in collaboration with experts from the member states resulting in the PEPPER-report. There has also been a wide measure of consultation between the two sides of industry both centrally (under the social dialogue) and on an industry basis, involving all types of undertaking, including small and medium sized businesses.

These consultations have enabled the Commission to take note of the various points of view regarding both the timeliness of a Community proposal in this field and the legal nature and content of the proposed instrument. A Recommendation, a Community instrument of a non-binding nature, was chosen, because in the circumstances it was considered to be the most appropriate oneto obtain voluntary and active support for the introduction of financial participation schemes from all parties concerned.

36. Objective and scope

The objective of the proposal is to encourage the widespread use of different forms of participation by employees in profits and enterprise results, either by means of profit sharing, or through employee share-ownership or by a combination of both.

The Recommendation is addressed at all EC governments but acknowledges that there is a great diversity in the schemes currently encountered in the Community which it is not seeking to reduce. At the same time there are large differences between the member states as regards their actual experience with financial participation schemes, which makes it very useful, in particular for the less experienced countries, to spread adequate information about the different schemes practised, their possibilities, effects etc..

37. The proposed approach

More specifically member states are recommended:

- to ensure that legal structures are adequate to allow the introduction of the forms of financial participation referred to in this Recommendation;
- to consider the possibility of according fiscal or other financial incentives (the importance of such incentives was indicated in section 20);
- to facilitate the supply of information and to take account of experiences acquired elsewhere in the EC;

- to allow the social partners a sufficiently wide range of options, from which to chose at a level close to the employee and to the enterprise;
- to encourage consideration of a number of key characteristics (described in section 39) when setting up new schemes or when reviewing existing ones;
- to examine after three years to what extent financial participation by employees has increased in their country and to communicate the results within four years to the Commission.

38. In order to deal with the cross-border aspects of financial participation, described in section 31, the Commission will set up a working party with a view to examining possibilities for the creation of formulae for the following three types of financial participation schemes by employees at a European level, in order to improve the opportunities for the application under comparable conditions throughout the Community of such schemes:

a) a profit-sharing scheme;
b) an employee share ownership scheme;
c) a stock options scheme.

39. Key characteristics of financial participation schemes

In this draft Recommendation the importance of allowing for a wide range of alternative schemes from which the most appropriate ones can be chosen has already been underlined. However, since the success of these schemes mainly depends on certain key features, it would seem advisable to take into account experiences already acquired elsewhere in the EC. When new schemes are set up or when existing schemes are being reviewed, it is therefore recommended that special attention should be paid to the following characteristics, which appear to be of crucial importance:

a) **Regularity**: schemes benefit from application on a regular basis and from awarding any "bonus" at least once a year or over shorter periods, if major motivational effects are to be obtained;

b) **Pre-determined formula**: the formula setting employee benefits should be determined unequivocally before the beginning of each reference period. Individual governments may decide whether one or more parameters of the formula should be established at the national level (e.g. through specific legislation), or whether the formula can be freely negotiated between the two sides of industry, possibly within a legal framework set up to facilitate and encourage financial participation schemes. The formula itself should not be fixed once and for all, as it could be renegotiated; but neither should it be subject to too frequent (e.g. annual) changes, since a number of years' application will be required before sufficient experience is gained;

c) **No substitute for wage negotiations**: the existence of financial participation schemes is not to be considered a substitute for normal negotiations dealing with basic wages and other conditions of employment. The benefits of these schemes should be received in addition to basic wages and should not interfere, for example, with the existence of statutory minimum wages.

d) **Voluntary participation**: both enterprises and individual employees should be able to choose whether or not they participate in schemes.

e) **Calculation of employee benefits**: bonuses should not be fixed in advance but be variable and linked to enterprise performance (expressed in terms of profits or some other enterprise indicator) over a certain period of time, according to a previously agreed formula; this formula should also specify unequivocally the indicator of enterprise performance to be used. The findings of the PEPPER-report suggest that average benefits amounting to less than 5% of guaranteed employee wages in a year of regular profitability, can in themselves not be expected to produce substantial motivational effects.

f) **Risks**: apart from a degree of income variability inherent to financial participation schemes, employees may incur additional risks when they acquire risk-bearing securities (e.g. shares or bonds); when these risks are heavily concentrated (e.g. securities issued by the employing firm) and large in relation to the employee's total assets, they may come to be considered unacceptably high, even though additional risks linked to profit-sharing schemes may already to some extent be compensated for by the higher employment security which profit-sharing is expected to provide. Under such circumstances it may be advisable either to seek a better spread of risks or to examine possibilities of insurance against too heavy losses in the value of these assets.

g) **Beneficiaries**: beneficiaries are primarily employees, i.e. wage-earners covered by employment contracts; benefits should as far as possible be made available to all or at least the larger part of the enterprise's employees including part-time and temporary employees.

h) **Enterprise type**: schemes can be applied by both privately-owned firms and public enterprises, as long as suitable indicators of enterprise results or profits are, or can be, made available.

i) **Enterprise size**: small and medium-sized firms should have adequate opportunities to apply financial participation schemes; in particular it is important to ensure that administrative obligations are reasonable and minimum financial requirements, if needed at all, are not too high; in larger enterprises, especially multi-national companies, it may be useful to link all or part of employee benefits to the performance of separate profit units, rather than to overall enterprise results.

j) **Complexity**: schemes of a complex nature are to be avoided, as the results are likely to be better if the scheme can be easily understood by all employees.

k) **Information and training**: for the success of any type of scheme a substantial effort will be required to supply adequate information to all employees concerned. In this regard the implementation of financial participation schemes can also provide a link with activities promoted by the Community in other areas: information and consultation, training, education.

IV. CONCLUSIONS

40. In submitting this proposal for a Recommendation to the Council, the Commission, in accordance with its Action Programme relating to the implementation of the Community Charter of the Fundamental Social Rights for Workers, aims to underline the importance which it attaches to employee participation in profits and enterprise results either by means of profit-sharing, or through employee share-ownership or by a combination of both. This is the light in which the present draft Recommendation should be viewed.

Action at the Community level will mainly consist of:

- encouraging the use of financial participation schemes and the exchange between users of experiences with these schemes;
- the supply of relevant information about financial participation schemes;
- encouraging the creation of some types of financial participation schemes to be used community-wide under comparable conditions;
- monitoring further developments in this field.

ANNEX

FINANCIAL PARTICIPATION SCHEMES IN THE EUROPEAN COMMUNITY IN THE LATE 1980S - SUMMARY OF PRINCIPAL FINDINGS OF THE PEPPER REPORT

Abbreviations:
PS: profit-sharing; SPS: share-based profit-sharing; BSP: bond-based profit-sharing; CPS: cash-based profit-sharing; DPS: deferred profit-sharing/investment funds; ESO: employee share-ownership; SO: stock options; DSO: discretionary share options; ESOP: employee share ownership plans; EBO: employee buy-outs.

Country	General attitude	Legislation: Specific laws & year of introd.	Legislation: Tax benefits	Diffusion of PEPPER schemes: Prevalent types	Diffusion of PEPPER schemes: No. of schemes/ firms involved	Diffusion of PEPPER schemes: Employees involved	Diffusion of PEPPER schemes: Employee benefits or profit share/employee
BELGIUM	Mainly unfavourable, but today discussed	Various, but only on ESO (since 1982), including SO (1984)	Rather limited, especially for SO	ESO	Around 20 quoted companies	On average 5% (varying from 1-28%)	Shares reserved for employees: 4% on average of total shares issued
				CPS	Multinationals Insurance Banks Distribution		Around 5% of distributable profits; 8-15% of performance-related pay
DENMARK	Mainly favourable & discussed	On SPS and ESO (since 1958)	Some for SPS (shares or bonds) & ESO	CPS	Min. 50 schemes		
				SPS	20 "		2% of share capital
				DPS	27 "		DKR 3,400 per employee
				ESO	32 "		Less than 2% of total share capital
				Total	200 or more		
GERMANY	Mainly favourable except for CPS; intensively discussed	Some: on DPS (since 1961) & ESO (primarily since 1984)	Minor until 1984, only for DPS & ESO	ESO & DPS	1,600 firms (0.1% of total)	1.3 mln. 80% usually participate	Employee capital: DM 15 bln (only 5% of firms' annual balance)
				PS in general	Max. 5,000 firms, mainly small-scale	5.4% of individuals	6.8% of wages

Country	General attitude	Legislation		Diffusion of PEPPER schemes			
		Specific laws & year of introd.	Tax benefits	Prevalent types	No. of schemes/ firms involved	Employees involved	Employee benefits or profit share/employee
FRANCE	Very favourable & intensively discussed	Various: CPS (1959) DPS (1967) SO (1970) ESO (since 1973) Employee invest. funds (1973) EBO (1984) Unique legisl. on all forms in 1986, amended in 1990.	Substantial for both firms & employees	DPS	12,000 firms & 10,200 agreements	4.6 mln. (3 mln. benefitting)	Profit shares on average 3.4% of the wage bill
				CPS	7,000 agreements	1.4 mln.	Profit shares on average 4.1% of the wage bill
				ESO*	350 firms (2/3 quoted)	600,000*	Free distrib. of shares: 3% of the wage bill
				SO	600 quoted companies		
				EBO	10-20 per year in 1980-90		
GREECE	Growing acceptance	Provisions in several laws:on CPS (since 1984) & ESO (primarily since 1987)	Significant for CPS	CPS	Limited; in banking, insurance, clothing, food		Lump sum of GD 30,000 - 50,000
IRELAND	Favourable & discussed	SPS (1982) SO (1986)	Modest	SO	139 schemes	Executives	Probably high
				SPS	104 " All in the private sector	35,000	
ITALY	Not clearly defined, but some forms discussed	Non-existent, except general provisions (1942 Civil Code)	No	CPS	25% of all large firms; 60 private firms in 1988	400,000; applied to 80% of all employees	3% of average earnings (but can be as high as 10% or more)
				ESO	30 quoted companies		Less than 5% of total share capital
LUXEMBOURG	Not clearly defined	Non-existent	No	CPS ESO	22% of firms Mainly in banking		Usually not more than 0.5 - 2 months' salary

*Refers only to free distribution of enterprise shares to employees.

Country	General attitude	Legislation: Specific laws & year of introd.	Legislation: Tax benefits	Diffusion of PEPPER schemes: Prevalent types	No. of schemes/ firms involved	Employees involved	Employee benefits or profit share/employee
NETHERLANDS	Favourable & intensively discussed	Some incentives offered only to CPS	Minor, conditional on freezing of CPS	CPS	6-30% of firms	350,000 in 1975	4.5 - 6.5% of average earnings
				SPS, BPS & SO	Very limited(3% of all schemes)		
PORTUGAL	Not clearly defined & mainly not discussed	Only general provisions on PS & ESO (favourable)	Primarily for PS	Mainly CPS	Limited,but most diffused form. Large firms in finance	Sometimes restricted to executives	
SPAIN	Not clearly defined, but discussed	Only general provisions in Statute of Workers; & EBO (1986)	Minor, except for EBO	CPS	44% of medium & large firms but only in 6% directly linked to profits	2% of salaried employees (often restricted to executives)	Profit-linked payments: 5% of labour costs; in some cases as high as 10-25% of total pay
UK	Very favourable & discussed	SPS (1978) SO (1980) DSO (1984) CPS (1987) ESOPs (1989) ESO (1978 -	Substantial for both firms & employees	DSO	4,326 schemes		Substantial
				CPS	1,175 "	293,000	7% of employee pay
				SPS	890 "	757,000	2-4% of total wages
				SO	891 "	623,000	
				ESOPs	20 "		
				Total:	7,282 schemes 30% of firms	2 mln employees benefitting	

Source: Compiled on the basis of information contained in Chapters 4-15 on individual countries' experiences.

Proposal for a
COUNCIL RECOMMENDATION

concerning the promotion of employee participation
in profits and enterprise results
(including equity participation)

THE COUNCIL OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community, and in particular Article 235 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas in its Communication concerning the Action Programme relating to the implementation of the Community Charter of the Fundamental Social Rights of Workers the Commission announced its intention to present a Community instrument on equity sharing and financial participation by workers;

Whereas a report on the promotion of employee participation in profits and enterprise results in the Member States of the European Community has been prepared and whereas this report has established that there is a great variety in the types of scheme encountered in the Community, including cash payments, share-based and deferred profit-sharing schemes and various types of particular employee share-ownership schemes;

Whereas encouragement at Community level of schemes of financial participation by employees is to be seen as a means of achieving a better distribution of the wealth generated by enterprises, while encouraging a greater involvement of employees in the progress of their companies;

Whereas while the body of empirical research about the effects of such schemes in practice does not yet provide overwhelming evidence of strong overall advantages, there are sufficient indications that such schemes contribute to a number of positive effects, including improvements in employee motivation and productivity and in the competitiveness of enterprises;

Whereas it is appropriate to promote a larger diffusion of financial participation schemes within the European Community, without seeking an active harmonization or a reduction in the existing wide range of available schemes;

Whereas the ultimate success of this Community initiative will to a large extent depend on the active interest and involvement of the social partners themselves;

Whereas in the context of the completion of the internal market it is necessary to study the possibilities for the development of transnational formulae for employee participation in profits and enterprise results;

Whereas the present action appears necessary to attain, in the course of the operation of the common market, one of the objectives of the Community,

I. HEREBY INVITES THE MEMBER STATES:

To acknowledge the potential benefits of a wider use of a broad variety of schemes to increase the participation by employees in profits and enterprise results either by means of profit-sharing, or through employee share-ownership or by a combination of both.

II. HEREBY RECOMMENDS THE MEMBER STATES:

1. To ensure that legal structures are adequate to allow the introduction of the forms of financial participation referred to in this Recommendation;

2. To consider the possibility of according incentives such as fiscal or other financial advantages to encourage the introduction of certain schemes;

3. To encourage the use of such schemes by facilitating the supply of adequate information to all relevant parties;

4. To take account of experiences acquired elsewhere in the European Community when considering giving preferential treatment to particular types of financial participation schemes;

5. To ensure that the social partners have the opportunity to choose from a sufficiently wide range of options on the basis of consultations between employers and employees or their representatives;

6. To ensure that this choice can be made at a level which, taking account of the national practice in this regard, is as close as possible to the employee and to the enterprise ;

7. To encourage consideration of the key issues set out in the Annex when new financial participation schemes are being prepared or when existing schemes are being reviewed;

8. To examine, after a period of three years following the adoption of this Recommendation, the data available at a national level on the development of financial participation by employees and to communicate the results to the Commission;

9. To enhance social partners' awareness of the above matters.

III. TAKES NOTE OF THE COMMISSION'S INTENTION

10. To set up a working party to examine possibilities for the creation at a Community level of formulae of financial participation schemes by employees , in order to improve the opportunities for the application under comparable conditions throughout the Community of such schemes; these would include the following three types:

a) a profit-sharing scheme;
b) an employee share ownership scheme;
c) a stock options scheme.

11. To submit a report to the Council on the application of this Recommendation within four years of its adoption on the basis of the information supplied to it by the Member States.

Done at Brussels,

For the Council

The President

ANNEX

Key issues to be considered when new financial participation schemes are being prepared or when existing schemes are being reviewed

1. Regularity: schemes benefit from application on a regular basis and from awarding any "bonus" at least once a year or over shorter periods.

2. Pre-determined formula: the formula setting employee benefits should be determined unequivocally before the beginning of each reference period.

3. No substitute for wage negotiations: the existence of financial participation schemes is not to be considered a substitute for normal negotiations dealing with wages and other conditions of employment.

4. Voluntary participation: both enterprises and individual employees should be able to choose whether or not they want to apply for or participate in schemes.

5. Calculation of employee benefits: bonuses should not be fixed in advance but variable and linked to enterprise performance (expressed in terms of profits or some other enterprise indicator) over a certain period of time, according to a previously agreed formula; this formula should also specify unequivocally the indicator of enterprise performance to be used.

6. Amounts: in order to produce the expected motivational effects the average size of bonuses should on the one hand be significant in relation to the fixed part of employees' wages, while on the other hand a ceiling (in amounts or in percentages) might be advisable in order to avoid wide fluctuations in total income.

7. Risks: apart from some income variability inherent to schemes, employees may incur additional risks when they acquire risk-bearing securities (e.g. shares or bonds); when these risks are heavily concentrated (e.g. issued by the employing firm) and large in relation to the employee's total assets the possibility of some form of insurance against too heavy losses in the value of these assets merits careful examination.

8. Beneficiaries: beneficiaries are primarily employees, i.e. wage-earners covered by employment contracts; as far as possible access to schemes should be open to all employees of the enterprise. More generally, workers in the same objective situation should have equal rights with regard to access to participation schemes.

9. Enterprise type: schemes can be applied by both privately-owned firms and public enterprises, as long as suitable indicators of enterprise results or profits are, or can be, made available.

10. <u>Enterprise size</u>: small and medium-sized firms should have adequate opportunities to apply financial participation schemes; in particular it is important to ensure that administrative obligations are reasonable and minimum financial requirements, if needed at all , are not too high; in larger enterprises, especially multi-national companies, it may be useful to link all or part of employee benefits to the performance of separate profit units, rather than to overall enterprise results.

11. <u>Complexity</u>: schemes of a complex nature are to be avoided, as the results are likely to be better if the scheme can be easily understood by all employees;

12. <u>Information and training</u>: for the success of any type of scheme a substantial effort will be required to supply adequate information and training, if necessary, to all employees concerned.

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