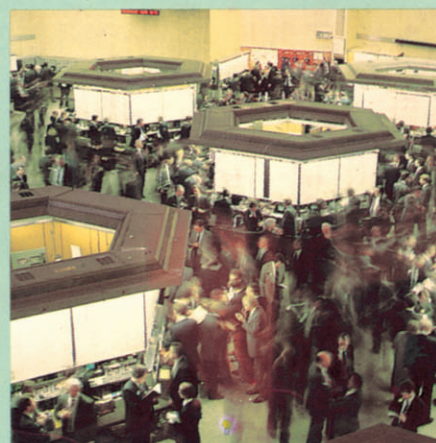


# SOCIAL EUROPE

The Pepper Report  
Promotion of employee  
participation in profits  
and enterprise results



COMMISSION OF  
THE EUROPEAN COMMUNITIES

DIRECTORATE-GENERAL FOR  
EMPLOYMENT, INDUSTRIAL RELATIONS  
AND SOCIAL AFFAIRS

SUPPLEMENT 3/91

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COMMISSION  
OF THE EUROPEAN  
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Directorate-General  
Employment, Industrial Relations and Social Affairs



EUROPEAN UNIVERSITY  
INSTITUTE, FLORENCE

**THE PEPPER REPORT:**  
**Promotion of Employee Participation**  
**in Profits and Enterprise Results**  
**in the Member States of the European Community**

1991 edition

by

Dr Milica Uvalic

Florence & Brussels

March 1991



## THE PEPPER REPORT

The first edition of the PEPPER Report (Uvalic, 1990) has been written by Milica Uvalic (European University Institute - EUI) on the basis of an initial research (Uvalic, 1989), extended and updated in cooperation with Mario Nuti (EUI) and Johan ten Geuzendam (CEC). For individual countries' chapters of the PEPPER Report, an extensive use was made of the contributions prepared for and made during the **Workshop on Employee Participation in Company Profits** (May 1990, EUI), by:

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M.U.

Florence, 15 March 1991

## Preface

The Commission of the European Communities (CEC) has announced its intention to present a Community Instrument on employee participation in company profits (see "Communication from the Commission concerning its Action Programme relating to the implementation of the Community Charter of Basic Social Rights for Workers", COM (89) 569 final, Brussels, 29 November 1989).

In the process of preparing such an instrument, the Commission had funded a research project on profit-sharing undertaken in 1989 at the EUI in Florence by Dr Milica Uvalic, then Research Fellow of the Economics Department. The project was directed by Professor Domenico Mario Nuti, as part of an EC-sponsored longer-term research on Employee Participation in Western Europe initiated by Professor Nuti at the EUI in 1983. The research resulted in a Report on Profit-Sharing in Western Europe (Uvalic, 1989). Since it did not cover all the EC Member States, the need was felt for a more complete and updated version. For this purpose the Directorate General for Employment, Industrial Relations and Social Affairs of the CEC has supported the revision of the initial Report and, in order to facilitate such a task, a Workshop on Employee Participation in Company Profits was held at the EUI in Florence from 14-16 May 1990, to which experts from Member States were invited to present "the state of the art" in their own country. The Workshop was organized by Milica Uvalic (EUI), Johan Ten Geuzendam (CEC) and Mario Nuti (EUI). A new acronym was also born there for the various forms of employee participation in enterprise results: "PEPPER", standing for Promotion of Employee Participation in Profits and Enterprise Results, a term which will be used throughout this Report.

The PEPPER Report was presented to social partners at a Conference organized by the Commission of European Communities in Namur at the beginning of October 1990, with the aim of exchanging views between representatives and experts of EC governments, trade unions and employers' associations. One of the conclusions



reached at the Namur Conference was that a wider circulation of the PEPPER Report would be welcome. This new edition of the Report offers an opportunity to incorporate a number of corrections and some of the most recent developments. Suggestions for corrections and changes were made not only by the participants of the Namur Conference, but also by other experts and by officials of Member State administrations, who have been asked to check the correctness of the information, in particular relating to their own country.

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Part I

**GENERAL FRAMEWORK**





## Chapter 1. INTRODUCTION: SCOPE AND OBJECTIVES

Two different types of employee participation in enterprises can be distinguished. The first includes various forms of employee participation in decision-making, usually referred to as "industrial democracy", which ranges from information disclosure and consultation, to minority or full parity codetermination. The second group includes various forms of employee participation in enterprise performance, usually referred to as "economic democracy", "financial participation", or, following recommendations of the 1990 Workshop in Florence, "PEPPER" (Promotion of Employee Participation in Profits and Enterprise Results).

Whereas employee participation in decision-making has been vastly discussed in the literature, research on PEPPER has been more limited, and has been prevalently theoretical. In particular, little is known about the concrete application of PEPPER schemes in practice - the principal types, their diffusion over time, existing legislation, and the effects PEPPER schemes have on enterprise performance.

The main aim of the Report is to address some of these less explored questions, by examining the practical experience in PEPPER schemes of conventional private and public enterprises in the Member States of the European Community (EC).<sup>1</sup> The central focus of the analysis will therefore be **employee financial participation in enterprise results**. Financial participation need not involve employee participation in decision-making, but since it is not always easy to disentangle the two forms, employee participation in decision-making will also be occasionally considered (in relation to those issues which are specifically linked to and relevant for PEPPER).

The examination of the practical experience with PEPPER schemes in the EC Member States was basically carried out from a "national" perspective, i.e. within the existing legal and fiscal framework of each country. A number of reactions to the first

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1. Thus cooperatives are not included. For a review of the theoretical and empirical literature on cooperatives, see Bartlett and Uvalic (1986).

edition of the PEPPER Report have underlined that another aspect - the intracommunity dimension - might still have to be taken into account: e.g. what obstacles are encountered by and what solutions can be offered to enterprises practicing a PEPPER scheme in EC country A, which have establishments in another EC country and which want to make the benefits of these PEPPER schemes available under comparable conditions to their employees in this other EC country? These and similar questions are not being dealt with in any detail in this Report, but the Commission is looking into these issues and intends to include them in its proposals for a Community instrument on financial participation.

The structure of the Report is as follows. After these introductory remarks, the origins and typology of PEPPER schemes are presented (Chapter 2). The central theoretical hypotheses in favour of and against PEPPER schemes are then briefly reviewed (Chapter 3).

The second part of the Report is devoted to the practice of PEPPER schemes. For each individual Member State of the EC, covered by a separate chapter, the following issues are examined: 1) the general attitude of social partners and political forces towards PEPPER schemes; 2) the legal and fiscal framework; 3) principal types of PEPPER schemes encountered in practice and their diffusion; and 4) evidence on the effects of PEPPER schemes (Chapters 4-15, corresponding to the twelve countries of the EC).

The third part of the Report consists of a summary of the principal findings of the research (Chapter 16) and some suggestions for CEC initiatives in this domain (Chapter 17).

## Chapter 2. ORIGINS AND TYPOLOGY OF PEPPER SCHEMES

### 2.1. ORIGINS OF PEPPER SCHEMES

Despite their recent popularity, PEPPER schemes are not a new phenomenon, as they stretch back to precapitalistic systems in which, for instance, they took the form of sharecropping in agriculture, or sliding scales in coal mines in Britain; these, however, were residual forms of a pre-wage economy, unlike the participatory innovations induced by the problems of modern capitalism (Nutti, 1988). In the second half of the nineteenth century, a series of British and French firms adopted profit-sharing. The schemes in France remained limited to a few companies, being regarded with reservation or even hostility by most employers (Bell and Hanson, 1989). Similarly in Britain, in spite of a continuous increase in the number of profit-sharing schemes from 1865 onwards,<sup>2</sup> by the beginning of this century profit-sharing covered only about 0.5% of the labour force (Hatton, 1988), whereas in 1954 only 1.5% of the working population (Bell and Hanson, 1989, p. 94).

Nevertheless, already at the beginning of this century a series of reports on profit-sharing had been published in Britain by the Board of Trade; profit-sharing was defined as "a voluntary agreement by virtue of which an employee receives a share, fixed beforehand, in the profits of an undertaking" (Board of Trade, 1912, in Hatton, 1988). This definition was subsequently modified, in order to exclude product sharing arrangements (common e.g. in the British fishing industry), by clarifying that profit-sharing referred only to systems which generate additions to wages and salaries (Bougen et al, 1988).

After the Second World War, some form of PEPPER has been implemented by enterprises throughout Europe,<sup>3</sup> but only in very few countries have PEPPER

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2. By 1919-20, there were some 120 profit-sharing schemes in Britain, whereas 140 new schemes had been introduced during the 1921-29 period (see Hatton, 1988).

3. For the different types of incentive schemes until the end of the 1970s, see the extensive reports on individual EC countries, in: European Foundation for the Improvement of Living and Working Conditions (1982).

schemes in particular been officially encouraged by government policies. Historically, policy measures aimed at promoting PEPPER schemes have been hampered by a series of factors: strong opposition from trade unions, since traditionally schemes were being introduced unilaterally by employers, in some cases also in order to discourage trade unionism, and were not subject to negotiation; reluctance of employers to implement such schemes if they increase workers' bargaining power, or require information disclosure on company policies and profits; limited government interest in schemes and unwillingness to grant specific fiscal benefits; tax and other legal barriers; difficulties with legislating economic democracy; etc.

From a historical perspective, industrial democracy has had a much more important role in most West European countries throughout this century, and the first wave in economic democracy is present only in the 1980s (Abell, 1985). Indeed, most European countries have experienced some form of employee participation in decision-making, whether through workers' councils or codetermination on company boards,<sup>4</sup> which has also been enhanced by EC active promotion of industrial democracy.<sup>5</sup> On the contrary, forms of economic democracy have, until the 1980s, been limited in extent, and it is only in the past decade that a new and growing interest in PEPPER schemes has emerged.

Recent theoretical discussions have contributed to a lively debate on the possibility of PEPPER schemes having a series of positive effects. The debate has influenced official government policies in several European countries, leading to the adoption of specific laws offering tax benefits to firms introducing PEPPER, which in turn have contributed to the continuous rise in the number of enterprises adopting some form of PEPPER for their employees.

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4. The most well-known is the system of *Mitbestimmung* in Germany, but a number of other European countries have also introduced legislation on codetermination.

5. During the 1970s, the EC has encouraged Member States to adopt codetermination laws, while today such policies are part of the Social Charter and the Project for the harmonisation of company laws.

However, in comparison with the USA where PEPPER schemes have shown very rapid growth since the mid-1970s, in Western Europe schemes have been spreading at a relatively slow pace. Some estimates for the USA suggest that the number of profit-sharing plans has risen from 300,000 to 500,000 over the 1977-87 decade (see Smith, 1988), while others indicate that already in 1978, there were some 560,000 registered employee profit-sharing schemes, covering around 17 million workers (see Estrin and Shlomowitz, 1988).<sup>6</sup> Following tax concessions encouraging a specific form of PEPPER - Employee Stock Ownership Plans (ESOPs) - the growth of the number of ESOPs has been impressive. In 1983, there were already some 4,174 active ESOPs, covering in 1985 around 7 million participants (Estrin and Shlomowitz, 1988); by 1988 their number had almost doubled, reaching 8,777 and involving 9 million employees, or 7% of the working population employed in the private sector of the US economy (Conte and Svejnar, 1990; Blasi, 1989). According to the National Center for Employee Ownership, today (1990) there are 10,000 ESOPs, covering 10 million employees.<sup>7</sup>

Another country well-known for its long tradition in PEPPER schemes is **Japan**. Profit-sharing is widely diffused among Japanese enterprises; profit-sharing bonuses are usually paid twice a year and are estimated to account for as much as 25% of total employee earnings (Blanchflower and Oswald, 1986). The practice of encouraging employees to purchase company shares is also frequent. Freeman and Weitzman (1986) argue that Japan's low unemployment rate and level of inflation are indeed attributable to profit-sharing. However, their evidence has been questioned by Wadhvani (1987) and the Japanese system is indeed much more complex than simple profit-sharing (see Aoki, 1988). Fitzroy and Hart (1989) show that overtime hours and premium wages are much more flexible than the profit-sharing bonus, which points against a profit-sharing interpretation.

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6. The divergence in estimates mainly derives from different definitions of terms.

7. For an account of the US experience, see Blinder (ed), (1990) which contains several very valuable contributions; Bradley and Smith (1987b, 1989); Smith (1988); Jones (1987, 1987a).

## 2.2. TYPOLOGY OF PEPPER SCHEMES

PEPPER is a shorthand label for a wide range of different forms of employee participation employees in enterprise results, which in the recent literature have been classified in different ways.<sup>8</sup> Although there is no general consensus among scholars about the precise scope of the term, these schemes can be classified into two broad categories, which may or may not co-exist, and may in some cases overlap: profit-sharing, and employee share-ownership.

1) **Profit-sharing.** "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 (and not expressed as a pre-fixed proportion of the wage rate). Hence profit-sharing provides workers 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, usually applied to all, or a large group of employees.<sup>9</sup>

Profit-sharing usually does not put at risk the basic salary as determined in employees' employment contracts. For the purpose of participation, "profits" never include the increase in the capital value of the enterprise as a going concern, which might be due to unanticipated success of the enterprise, although this is a very important part of the entrepreneurial reward; profit-sharing workers are usually excluded from participation in fuller entrepreneurial profits and losses.

In practice, profit-sharing can take different 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

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8. For some of these classifications, see Jones (1987); Estrin, Grout and Wadhvani (1987); Brannen (1983); Salamon (1987); Nuti (1989a); Estrin and Shlomowitz (1988); Rémus (1983).

9. According to the international standard classification of labour costs, profit-sharing belongs to the category of "bonuses and gratuities" (see Zoetewij, 1986, p. 69).

funds invested for the benefit of employees (sometimes also in enterprise shares, but not necessarily). At above-enterprise level, 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; or schemes envisaging the freezing of cash bonuses on special accounts for a determined amount of time. A further distinction is also made between gain-sharing and profit-sharing (although the two are clearly related); gain-sharing typically consists of a group incentive pay system that is geared to productivity, cost reduction, or other, less comprehensive than profitability (Weitzman and Kruse, 1990).

*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, which are usually frozen in a fund for a certain period of time after which workers are allowed to dispose of them. Since shares are subject to a minimum retention period, the term "deferred profit-sharing" is also used to denote share-based profit-sharing (although, as already mentioned, deferred profit-sharing does not necessarily have to provide employees with their company's shares).

Beside enterprise-level schemes, profit-sharing can also be set up at higher levels (regional or national),<sup>10</sup> in which case it takes the form of *wage-earners' funds* financed by contributions from enterprise profits, which are then invested for the benefit of all wage-earners. This type of profit-sharing represents participation in profits of not only the employees' enterprise, and is not at plant but higher levels, and hence is expected to have concrete macroeconomic implications. Wage-earners' funds have been discussed during the 1970s and 1980s in a number of European countries as a potential way of achieving a more even distribution of income and wealth, but only

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10. Sometimes these two forms are referred to as individual (enterprise level) and collective (higher level) profit-sharing.



the Swedish plan has actually been implemented (although in a diluted version of the original Meidner Plan; see Meidner 1978).

2) **Employee share-ownership.** 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, and/or the appreciation of employee-owned capital. While such schemes are not directly related to enterprise profits, they are related to enterprise profitability and hence enable participants to gain from the growth of company profits.

Employee share-ownership can be both individual and collective, internal and external to the enterprise of employment. However, only those employee share-ownership schemes set up with the explicit intention of providing employees with an additional source of income related to enterprise results, would be within the scope of PEPPER.

Internal and collective employee share-ownership schemes typically consist of reserving a portion of company shares for all, or a group of employees, which are offered at privileged terms (lower prices, priority in public offers, delayed forms of payment), and are limited to a worker's period of employment. Alternatively, employees are offered options to buy their enterprise's shares after a determined length of time at preferential terms, under favourable tax provisions. Another possibility are Employee Share Ownership Plans (ESOPs), which involve a bank (or other lender) lending money to an employee benefit trust, which acquires company stock that is allocated by periodic payments to each employee's ESOP account; the loan may be serviced either by payments from the company or from employees and, upon leaving the firm, workers may be obliged to sell their stock back to the trust. A special form of employee share-ownership are workers' buy-outs of their enterprises (but not management buy-outs, which are only apparently similar; see Nuti, 1989a).

Employee share-ownership bears similarities with share-based profit-sharing because both provide employees with their enterprise's shares, permitting their participation in company results (through the value of acquired shares); and both schemes

are usually offered to all, or a group of employees, and hence are of a collective nature. However, employee share-ownership differs from profit-sharing because it most frequently depends on the individual worker's decision to participate in the scheme (i.e. willingness of a worker to invest in his company's shares), and not, as in the case of profit-sharing, primarily on the enterprise's initiative. In practice, however, there are mixed cases: schemes envisaging the allocation of company shares to employees, which are financed through the combination of resources of both the enterprise and the employee.

Besides such internal schemes offered to employees within their own enterprise, there are also external share-ownership schemes (e.g. Personal Equity Plans in the UK). However, such schemes consist of individual share-ownership in no way linked to the enterprise of employment as they are available not only to workers but to the whole population, and hence they are not included under the PEPPER category.

These different types of schemes are often discussed jointly in the literature. The generic term "employee share-ownership" is frequently used to denote both share-based profit-sharing, and employee share-ownership. Similarly, "profit-sharing" is sometimes used in reference to both profit-sharing in the strict sense of profit-related pay, and share-based profit-sharing. And the distinction between individual and collective employee share-ownership is also not always clear-cut, as they are not mutually exclusive: certain individual share-ownership schemes which envisage shares being held in trusts (ESOTs) bear similarities with a collective scheme; while certain collective schemes offered to all employees in practice involve only a limited number of individuals.

In spite of these ambiguities, the present Report will concentrate primarily on those schemes which are: **internal** (applied within an enterprise); **collective** (available for all, or a major part of employees); **continuous** (applied on a regular basis); and providing for employee participation in some measure of **enterprise performance** (whether directly or indirectly).

### Chapter 3. PEPPER SCHEMES IN ECONOMIC THEORY

In the rich theoretical literature which has appeared in recent years a number of arguments have been put forward both in favour of and against PEPPER schemes. Since the main objective of the Report is to concentrate on practical experience, these arguments will only briefly be reviewed.<sup>11</sup>

#### 3.1. ARGUMENTS IN FAVOUR OF PEPPER

The main theoretical arguments advanced in favour of PEPPER can be classified into three main categories: incentive effects, wage flexibility, and macroeconomic effects.<sup>12</sup>

1) **Incentive effects.** PEPPER schemes are expected to have important effects on workers' motivation, resulting in higher labour productivity and improved overall enterprise efficiency. The change from a rigid system of guaranteed wages, in which rewards are independent of effort (over and above a monitored minimum), to a system which provides workers with an income directly linked to enterprise performance, is expected to lead to a number of beneficial effects: higher motivation and commitment, lower absenteeism and labour turnover, greater identification of workers with the interests of their firm, greater investment in firm-specific human capital, reduced intra-firm conflict and labour-management tension, and improvements in work organization. PEPPER can also reduce inequality in income and wealth, and can provide insurance against managerial opportunism, since it creates incentives for joint wealth-

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11. For more extensive reviews, see Weitzman and Kruse (1990); FitzRoy and Vaughan-Whitehead (1987); Estrin, Groult and Wadhvani (1987); Jones and Pfiskin (1988b).

12. These arguments have been put forward primarily for profit-sharing, but some of them also apply to employee share-ownership.

maximizing behaviour.<sup>13</sup>

The incentive effects are expected to be greater if employees are also involved in decision-making. The combination of employee financial participation and decisional participation is considered useful particularly in adjusting to a crisis, and hence a viable alternative to bankruptcy or costly subsidies to ailing concerns.

2) **Wage flexibility.** Profit-sharing is expected to make total employee remuneration more flexible, thus responding more quickly to unanticipated macro-economic shocks (Mitchell, 1982). By increasing the frequency of wage adjustments, profit-sharing may result in less variable employment policies and lower the risk of unemployment.<sup>14</sup> Profit-sharing can therefore lengthen the duration of employment contracts and reduce the pressure for redundancies (FitzRoy and Kraft, 1986). It has also been argued that by introducing cyclical flexibility of labour earnings, profit-sharing provides for greater stability of profit levels and rates, rather than employment (Nuti, 1988). Employee share-ownership is expected to induce wage moderation: the wage that management must offer workers to persuade them to accept it, is lower if workers lose capital gains and dividends by rejecting the wage offer (Grout, 1985).

3) **Macroeconomic effects.** The possible macroeconomic implications of profit-sharing have recently been intensively discussed, in particular whether such schemes could be a feasible solution to problems of unemployment and stagflation.<sup>15</sup> Vanek (1965) has first advanced the hypothesis on the stabilizing effects of profit-sharing which could lead to lower average unemployment rates, and the argument has been further developed during the 1980s by Weitzman.

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13. On these arguments, see Cable and FitzRoy, (1980); McCain, (1980); Sertel, (1981); FitzRoy and Kraft, (1986); Nuti, (1988); Estrin, Grout and Wadhvani, (1987); Bradley and Gelb, (1983).

14. "If more variable pay for the individual helps to preserve full employment for the group, while fixed pay for the individual tends to contribute to unemployment, overall welfare might be improved by having more profit-sharing" (Weitzman and Kruse, 1990).

15. It is interesting to note that some of the advantages of profit-sharing at the national level were advanced as long ago as 1940 by Keynes, who has advocated a system of state-administered savings out of wages (see George, 1985a).

Weitzman (1983, 1984, 1985, 1987) considers a "share" economy in which most or all firms introduce profit-sharing. Workers' compensation would consist of both a base wage and a share of profits. Enterprises would consider the base wage as the relevant marginal cost of labour, and would continue hiring workers up to the point of equating the value of the marginal product of labour to the base wage, rather than to total remuneration. Profit-sharing will, therefore, raise employment; if the base wage is set sufficiently low, demand for labour would exceed the available supply (determined by total remuneration).

Weitzman argues that profit-sharing can shift the entire economy to full employment, and indeed a permanent state of excess demand for labour. Monetary policies can then be used to combat inflation, without the fear of creating unemployment. In case of deflationary shocks under conditions of excess demand for labour, employment will not fall, or fall as much as it would otherwise; hence profit-sharing will, according to Weitzman, cure stagflation.

However, the most important condition for the realization of these benefits of the share economy is that workers do not take part in the decision-making process, since this could lead to restrictive employment policies. The increased labour demand, and hence employment, would dilute the existing workers' profit share. In order to prevent individual firms from returning to a wage system, Weitzman prescribes tax incentives high enough to compensate existing workers for their losses.

Weitzman's stronger claims to the possibility of achieving non-inflationary over-full employment have been questioned by a number of scholars on different grounds, because of the sensitivity of the alleged effects to a number of assumptions (in particular, that firms regard the base wage, and not total remuneration, as the marginal cost of labour).<sup>16</sup> Weitzman's view on the need to support profit-sharing through tax incentives is also not shared by all scholars. Those against supportive

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16. For some of the critiques of Weitzman's model, see Estrin, Grout and Wadhvani (1986); Wadhvani (1988); FitzRoy (1987); Gui (1985); Nuti (1985, 1986, 1986a, 1987); papers presented at a Symposium on Weitzman's share economy at Yale University in 1985, published in the *Journal of Comparative Economics*, vol. 10, no. 4. For a review of critical opinions, see FitzRoy and Vaughan-Whitehead (1987); Marini (1987-88).

legislation have argued that if PEPPER schemes are beneficial, there is no need to encourage them; schemes will develop spontaneously, as employers will increasingly introduce them for their own benefit and on their own initiative. Estrin, Grout and Wadhvani (1987) consider that there is no valid reason for giving a permanent subsidy to encourage profit-sharing, although there may be a case for a temporary one, and point to the danger that a subsidy may lead to "cosmetic" profit-sharing, i.e. its introduction only for the purpose of receiving subsidies. Nevertheless, Weitzman's provocative statements have resulted in a lively debate on PEPPER, and have also influenced official policies in several European countries.

Meade (1972, 1982, 1986, 1989) has extended the Vanek-Weitzman model by proposing an inegalitarian capital-labour partnership, in which workers would be given temporary shares for the duration of their employment, while capitalists would have the usual capital shares; all shares would be entitled to the same rate of dividend. New workers would be employed at a wage which could be lower than that of existing workers. Since the remuneration of existing workers would not be automatically lowered when employment is increased, such a partnership would not restrict employment, and conflict between insiders (employees) and outsiders (unemployed) would be reduced. Forms of partnership in which both capital and labour share the risks of success and failure hold out more promise than other forms in which labour/capital bears the whole of the risk.<sup>17</sup>

### 3.2. ARGUMENTS AGAINST PEPPER

A series of interrelated arguments against PEPPER schemes have also been emphasized in the literature: weakening of property rights, inefficiency of group incentives, and increased risk-bearing on the part of workers.

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17. For a review and further extension of Meade's model, see Nuti (1988a) and the introduction by Morley-Fletcher to the Italian translation of Meade (1989).

1) **Weakening of property rights.** Scholars belonging to the Property Rights School<sup>18</sup> 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 "wealth confiscation scheme" without potential incentive effects. A reversion to the classical firm is the most desirable development, since a large negative relationship between employee participation and performance can be predicted, due to loss of managerial control and the weakening 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 (Furubotn, in Pejovich, 1978; Jensen and Meckling, 1979; Alchian and Demsetz, 1972; Pejovich, 1978).

2) **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; hence workers will be tempted to free-ride, shirking and on-the-job leisure will be encouraged, and difficulties in monitoring a single worker's contribution will arise. Therefore, profit-sharing will result in a **lower** level of effort and productivity, negatively related to the number of workers, additional monitoring costs, and incorrect managerial decisions (Alchian and Demsetz, 1972; Jensen and Meckling, 1979; Samuelson, 1977).

However, more cooperative behaviour resulting from PEPPER schemes (especially if accompanied by decisional participation), could offset these negative effects. As FitzRoy and Mueller (1984) and Weitzman and Kruse (1990) emphasize, long-term association can foster cooperation and overcome the free-rider effect.

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18. Including A. Alchian, H. Demsetz, E. Furubotn, M. Jensen, W. Meckling and S. Pejovich.

FitzRoy and Kraft (1986) show that even small profit-sharing can induce large productivity gains under plausible assumptions with multiple Nash-equilibria. Property rights authors therefore ignore the relevant market imperfections. The above criticisms also neglect the possibility of mutual monitoring of effort levels by workers themselves, which could reduce (or eliminate) the free-rider problem and would reduce monitoring costs (FitzRoy and Kraft, 1987; Putterman and Skillman, 1988).

3) **Risk-bearing.** PEPPER 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, through PEPPER, also face additional income risk (Meade, 1972). This additional risk may however be compensated by higher employment security which profit-sharing is expected to provide, and the exposure to risk is weakened if workers are excluded from full entrepreneurial profits and losses (see above).

On the whole, the theoretical debate on PEPPER has so far not produced decisive results. Only more practical experience in applying PEPPER schemes and further empirical evidence (still in its embryonic phase), will be able to show whether the potentialities expected from PEPPER can be effectively realized. This Report is an attempt to contribute to this project.





Part II

**PEPPER SCHEMES IN THE MEMBER STATES  
OF THE EUROPEAN COMMUNITY**



## Chapter 4. BELGIUM

### 4.1. GENERAL ATTITUDE

The general climate for PEPPER schemes is not very favourable in Belgium, due to legal, fiscal, and political obstacles. PEPPER schemes are also a very recent phenomenon. Only in the 1980s have some fiscal measures been introduced to facilitate their expansion, but limited to a variety of employee share-ownership schemes. Although cash-based profit-sharing has also been discussed since 1986, mainly as a result of a policy of wage restraint and the high marginal tax rates which made wage increases either impossible or financially unattractive (Van Den Bulcke, 1990), the proposals advanced to encourage such schemes have not yet been implemented.

The position of trade unions and political parties on the different types of PEPPER schemes is divided. The Socialist Union perceives several dangers from employee share-ownership,<sup>19</sup> and considers that a general revaluation of labour income is to be preferred to fiscal advantages granted to such schemes. A more reformist position was until recently held by the Christian-Democrat Union, but its present attitude has become more unfavourable: at its last Congress in April 1990 it has rejected employee participation in enterprise capital on an individual basis. The branch of the Christian Union bringing together clerks and lower management accepts the idea of employee share-ownership and gives preference to company based schemes (Stallaerts, 1988; Van Den Bulcke, 1990).

At the same time, the main Belgian trade unions have in general been rather diffident towards profit-sharing, as they oppose wage flexibility which creates income insecurity and inequalities between wage-earners. At the macro-level they fear such

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19. In case of bankruptcy, workers would lose both their job and their savings; it can lead to higher dependence of workers on the enterprise, without real participation in its policies; and conflicts may result concerning income distribution, thus not always contributing to general social welfare.

schemes may lead to the reduction of the wage sum on which social security contributions are calculated, as well as to a reduction of social security allowances to individual employees in the future. However, since a growing number of companies have become interested in profit-sharing, the recent attitude of principal trade unions has become more pragmatic, and their views seem to coincide much more than in the past.

The Socialist Union in essence is willing to accept company-based profit-sharing schemes, if their introduction as well as the conditions can be negotiated in collective agreements, if they do not endanger the outcome of collective wage negotiations, and if profit-sharing is granted over and above the normally negotiated wage increases, but it will not accept the exemption of social security charges; this viewpoint was confirmed at its latest annual congress of November 1990. Similarly, the NVK (*Nationaal Verbond voor Kaderpersoneel*), a branch of the Christian Union regrouping middle and higher management, also accepts a certain form of wage flexibility, but on condition that schemes are integrated in the existing wage structure and remain limited in size, do not represent a disguised form of wage increase, and are the outcome of wage negotiations (Van Den Bulcke, 1989).

The Christian branch of Metalworkers has argued for collective forms of profit-sharing through the creation of wage-earners' funds, as company-based schemes are regarded as a threat to employee solidarity; however, a proposal for such a fund has been officially rejected. Similarly, the Christian-Democrat Union, in a resolution adopted at its last Congress in April 1990, opposes flexible wage systems such as "all individual formulas of profit-sharing and other pay systems related to company results"; in the future it will only accept "collective formulas of profit-sharing" provided that schemes cover all employees, that the normal social security contributions are paid, that company results can be controlled, and that neither the normal wage, nor employment will be reduced (Van Den Bulcke, 1990).

The attitude of the major political parties has been divided along the same lines as the trade unions. On the one hand, the Liberal Party is rather wary of new participative arrangements, especially those involving collective and generally obligatory

solutions. On the other hand, some Christian-Democrat politicians are in favour of fiscal policy measures to encourage profit-sharing. In 1986 a proposal for a law was submitted by the government coalition of Christian-Democrats and Liberals to stimulate profit-sharing by means of favourable tax treatment, but the proposal was not been implemented due to lack of support from the new government coalition of Socialists and Christian-Democrats formed in 1988. On 20 December 1990, a new bill on financial participation has been submitted to the Senate by E. Cooreman, in order to encourage and facilitate the introduction of financial participation schemes by employers for their employees (Van Den Bulcke, 1990).<sup>20</sup> A "project group" has also been created recently in the Ministry of Employment and Labour in order to examine these issues further.

Confederations of employers and related institutions do not seem to have a definite standpoint on PEPPER schemes. The advice of the Union of Employers (VBO) to the Central Council of Industry pleads against any general binding solution (Stallaerts, 1988). The decision whether to introduce a scheme should be left to employers, according to their wishes and suited to the needs and the objectives of the company. It is possible that the insecure fiscal and legal climate, especially in the field of social security, will encourage the VBO to take a more pronounced standpoint in the near future.

## 4.2. LEGAL AND FISCAL FRAMEWORK

During the 1980s a series of measures have been taken to encourage various forms of employee share-ownership, as part of a general policy meant to encourage risk capital and shareholding in general. For profit-sharing, on the other hand, there is still no specific legislation and there are no fiscal benefits.

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20. "Proposal of law to establish a system of participation certificates, company savings plans and the participation contribution aiming at the financial participation by employees in the company of their employers".

1) **Employee share-ownership.** Measures taken to encourage employee share-ownership include general provisions on share-ownership, measures applying specifically to innovative companies, legal norms on stock options, and proposals which should facilitate employee buy-outs.

a) *General measures (1982 onwards).* The individual purchase of shares by employees has been encouraged through fiscal measures adopted in 1982,<sup>21</sup> which have improved conditions for returns on shares (volet Cooreman) and have given direct incentives for the acquisition of shares (volet Monory-Declercq). Subsequently, the Monory-bis Law adopted on 28 December 1983 has offered the possibility for employees buying shares of their company to deduct a certain sum from taxable net income (a maximum of BFR 40,000 and an additional BFR 10,000 for spouses and other dependent persons), but shares cannot be sold for 5 years (Jongen, 1988; Van Den Bulcke, 1990). These conditions have been somewhat modified in 1986 and 1988.<sup>22</sup> The principal characteristics of the scheme are given in Table 4.1 (Appendix to Chapter 4).

In a draft law approved by the Council of Ministers on 6 April 1990,<sup>23</sup> a new provision has been introduced governing preferential share issues reserved exclusively for employees: the share issue may not exceed 20% of enterprise capital, shares must be offered to all employees and must be blocked for 5 years (Van Den Bulcke, 1990).

b) *Share-ownership in innovative companies (1984, 1988).* The Law of 31 July 1984 offers employees the possibility, in companies recognized as "innovative companies" and established during the 1984-1993 period, to deduct during the same period the entire sum devoted to the purchase of new "innovative" shares.<sup>24</sup> In 1988,

21. See "Royal Decree 15" of 9 March 1982, amended by "Royal Decree 150" of 30 December 1982.

22. The sum deductible from taxes is limited to BF 20,000 per buyer of shares; spouses no longer have the right to an additional deduction of BF 10,000, but are considered separate taxable persons, entitled also to a tax-deduction up to a maximum of BF 20,000.

23. The law concerns modifications of the legislation on commercial companies.

24. The deduction of the invested sum must, however, be spread over 5 fiscal years, up to one fifth of the total sum per fiscal year, and this to a maximum of 20% of total taxable net income.

conditions for the definition of an "innovative company" have been liberalised, and tax concessions have been extended to employees purchasing "innovative" shares in financial institutions (Programmation Law of 30 December 1988). The 1990 Fiscal Programmation Law (28 December 1990, Art., 18) has prematurely ended the recognition of the statute of innovative companies, which implies that new capital increases in these companies will no longer benefit from tax advantages (including those advantages applying to employees subscribing new shares) (Van Den Bulcke, 1990).

c) *Employee stock options (1984)*. According to a law adopted on 28 December 1984, all workers who have been employed for at least one year can be offered an option on their company's shares. The option can be exercised a minimum of 1, and a maximum of 6 years after it has been granted, and shares obtained through stock options are transferable only after a period of 2 years. A total of BFR 500,000, or 25% of the previous year's salary (whichever is lower) is the upper limit, and each employee can hold no more than 5% of total share options of the company (see Jongen, 1988, Van Den Bulcke 1990, and Table 4.2, Appendix).

Article 45 of the law explicitly envisages tax exemption of the capital gain realized from such options, but according to some legal experts the sum involved would not in any case be subject to taxation (see Jorgen, 1988). The 1987 proposals for the modification of the law try to eliminate some of the restrictions,<sup>25</sup> but these proposals have not yet been adopted. On the contrary, the Programmation Law of 28 December 1990, has extended the existing stock option law - which normally ended on 31 December 1990 - in its present form, and without any modifications, for an unlimited period (Van Den Bulcke, 1990).

d) *Employee buy-outs*. Leveraged-management buy-outs (LMBO) have so far been hampered by Article 52 of the Law on commercial companies, which stipulates

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25. These modifications are contained in the Eyskens-Maystadt draft law of 1987, and propose the raising of the 5% limit of total share options per employee by 20%, and the elimination of the condition of a minimum of one-year employment.



that a limited company cannot offer funds/credits, or give assurances in the form of acquisition of its shares, to third parties, thus creating difficulties in assuring the funds necessary for a LMBO (Johgen, 1988). In 1990 it has been proposed to exempt from this article the personnel of the company concerned, which should facilitate employee buyouts.<sup>26</sup>

2) **Profit-sharing.** The interest in profit-sharing in Belgium dates from the mid-1980s. The initiative taken in 1985 by the president of Agfa Gevaert, André Leysen (then also president of the Employers' Federation) to introduce "profit-sharing certificates" for his employees, served as an example to other companies, and has also inspired the government of Christian-Democrats and Liberals to submit a draft law on profit-sharing in 1987, as part of legislation to encourage risk capital and profit-related pay (the so-called Eyskens-Maystadt Law Proposal of 24 May 1987) (Van Den Bulcke, 1990).

The purpose of this initiative is to encourage collective agreements on profit-related pay, for all or a group of employees, up to a limit of 10% of the employee's previous year's gross salary and of 10% of net company pre-tax profits. Such profit-related pay would not be a substitute, but an addition to the normal wage. In order to benefit from tax concessions, the company must have realised an employment growth of 1% in 1987 which had to be maintained in the next year, in which case profit-sharing would be deductible from company tax, but would not be exempt from social security contributions; for employees, it would be subject to only a 25% capital income tax on dividends (Van Den Bulcke, 1990).

Since the proposal was not supported by the new government coalition of Socialists and Christian-Democrats formed in 1988, the same tax treatment is applied for profit shares as for normal wages. In the meantime a growing number of companies have introduced profit-sharing in the form of profit-sharing certificates, since

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26. See modifications of the legislation on commercial companies contained in the Wathélet draft law approved by the Council of Ministers on 6 April 1990 (Van Den Bulcke, 1990).

according to Company Law, a company can introduce such certificates in its statute and under the conditions stipulated in it. As owner of these certificates, the employee receives dividends and is taxed as such (i.e. at a rate of 25%), and as dividends they also do not count for social security contributions (Van Den Bulcke, 1990).

However, the National Social Security Institute (RSZ) is against such treatment; thus it has demanded the payment of social charges on the whole sum paid out as profit-sharing certificates to the employees of Agfa Gevaert in the 1986-89 period (Merckx, 1989). This has strengthened the attitude of the trade unions who are very suspicious about such schemes, which they consider primarily as a way to escape fiscal and social charges. Hence profit-sharing certificates as a profit-sharing method are fiercely discussed in Belgium (Van Den Bulcke, 1990).

#### **4.3. PEPPER SCHEMES IN PRACTICE**

The principal form of PEPPER applied in Belgium is employee share-ownership, while profit-sharing is still only marginally present.

1) **Employee share-ownership.** Employee share-ownership has developed only recently and to a limited extent. Tables 4.3. and 4.4. (Appendix) present data on capital increases by principal Belgian companies quoted on the stock exchange in 1982-85 and 1985-89 respectively, showing that the number of shares reserved for employees and the percentage of employees covered are relatively low. Thus in the 1982-85 period, 2.6% of the overall number of shares issued has on average been reserved for employees, and the average percentage of employees involved was 4.5% (although varying from 0.07% to 19%). The relatively low level of involvement is not surprising, considering that not all companies offered shares to their employees at a price lower than the normal market price (around 44% of companies did).

Especially during the 1983-89 period, public share issues reserved for employees have become a growing practice among Belgian companies. From 6 in 1985 (involving BF 1.181 millions) their number has increased to 20 in 1989

(involving BF 4,809 millions) (Banking Commission, 1989-1990; see Van Den Bulcke, 1990). The number of shares reserved for employees was on average 5.2% of total shares issued, while the average number of employees involved 6.2% of the total (again varying from less than 1% to 28%). However, the price of shares reserved for employees has in some cases been substantially lower than the market price (18.2% in the case of Petrofina and 16.7% in the case of Generale de Belgique).

As to LMBOs, some examples include the brewery Maes, and Danly International Associated Weavers.

2) **Profit-sharing.** As no registration or approval of profit-sharing schemes is needed in Belgium, there are no official statistics on their diffusion. There are, however, several indications that schemes are far less common than in the surrounding countries and occur mainly in multinational companies, banks and some large distribution companies (Van Den Bulcke, 1990).

Some recent surveys on remuneration systems in Belgian companies have shown that very often profit-sharing is applied in combination with performance-related pay systems, but premiums, bonuses and wage increases as forms of gain-sharing are more popular than profit-sharing. According to a recent survey conducted on the top 500 Belgian companies (184 respondents), among the 81% companies which have adopted performance-related pay systems for middle management, 20% is paid as premiums at the end of the year, 30% as bonuses, 67% as wage increases and only 8% as profit-sharing (Vanderveken and Van Keymeulen, 1988). A survey conducted in 1986 on 162 Belgian and foreign companies also found a rather low percentage of profit-sharing, i.e. 15%, against 58% for bonuses and 30% for commissions (Wyatt Ecs, 1986, in Van Den Bulcke, 1990).

In recent years, together with a rising interest in payment systems designed to motivate and reward a qualified workforce according to its skills and efforts, the number of companies practising employee financial participation is growing. An increasing number does so by granting profit-sharing certificates to their staff, but

many others hesitate to introduce a scheme because of the lack of appropriate legislation and the uncertain fiscal climate. In most cases the total sum of dividends paid on the basis of profit-sharing certificates amounts to no more than 5% of distributable profits (Van Den Bulcke, 1990).

The purpose of the recently introduced "Bill on financial participation schemes by enterprises for their employees" in the Senate on 20 December 1990, is precisely to end this disadvantageous legal and fiscal situation by creating an appropriate and flexible legal framework for profit sharing schemes (cash and deferred) and company savings plans.

#### **4.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

No econometric study testing the effects of PEPPER schemes in Belgium has so far been undertaken. What is available is a case study of a company with a deferred profit-sharing scheme and experts' general views on the obstacles for further expansion of schemes.

A case study of the HBK-SPAARBANK Limited, a medium sized savings bank, offers an example of the creativity which is needed in Belgium to establish a system of profit-sharing linked with employee share-ownership (see Stallaerts, 1988; Van Put, 1988, 1988a and 1989). The savings bank launched its participation model in 1979, mainly to protect itself against a possible take-over bid. Each year after the General Assembly, the bank pays a profit premium to the cooperative company "Personeelcooperatie HBK" which groups all the employees of the savings bank with a minimum one-year service. The profit premium is called a "continuity contribution" in order to make it clear that the primary motive of profits is to guarantee the continuity of the savings bank. The continuity contribution is now determined as 5% of growth of the proper means of the savings bank, multiplied by the growth coefficient of the HBK-market share within the savings bank sector. Each year the continuity contribution is divided evenly among its members by the adjudication of shares of the cooperative company. The shares of each member are blocked within the cooperative

society until the member leaves HBK-SPAARBANK (freely or under coercion). The shares of the cooperative society give the right to an annual dividend, as decided at the General Assembly of the cooperative society. The cooperative company uses the continuity contribution to buy the shares of HBK-SPAARBANK Limited. After 11 years of having introduced the scheme, the cooperative society now disposes of 19% of the issued shares. The participation of the cooperative society in the capital of HBK-SPAARBANK means an entrance ticket for the employees of HBK-SPAARBANK to the company organs of the limited liability company. This implies real participation: copartnership at the General Assembly and also co-management in the Board of Administration.

In evaluating the existing system of PEPPER schemes in Belgium, critics have most frequently stressed legal and fiscal barriers as the major obstacle to their diffusion. The measures taken so far to encourage PEPPER schemes have been evaluated as being ad hoc, partial and temporary, rendering schemes a fiscally uncertain and burdensome operation (Stallaerts, 1988).

Prevailing conditions for share options are considered especially unfavourable. Companies quoted and not quoted on the stock exchange are not treated equally; the condition of a minimum of one-year employment could affect rapidly growing firms; and the limit of 5% of total share options per employee could seem highly restrictive. Compared with the system of ESOPs in the US, the system in Belgium allowing for only a 8-13% tax deduction from dividends effectively distributed is much less advantageous. Legal obstacles are also considered the major reason why LMBOs have not been applied more frequently (Jongen, 1988).

## APPENDIX TO CHAPTER 4

**Table 4.1. CHARACTERISTICS OF EMPLOYEE SHARE-OWNERSHIP SCHEMES IN BELGIUM ("Monory Bis" or "Permanent Monory")**

Type of firms covered:	- Shareholding companies - Limited companies subject to company tax - Foreign companies subject to taxation in Belgium
Employees benefitting:	All wage workers
Fiscal benefits:	Sums devoted to the acquisition of shares are tax deductible (up to BFR 20,000 per buyer of share, which can be increased by Royal Decree).
Method:	Subscription of new shares.
Transferability of shares:	Free, but implies the loss of the fiscal benefit <i>pro rata temporis</i> if sold before 5 years have passed from the moment of acquisition.
Investment period:	No limits.
Cumulation of various schemes:	Cannot be cumulated with Savings Pension Scheme

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**Source:** Delahaut (1989).

**Table 4.2. CHARACTERISTICS OF STOCK OPTION SCHEMES  
IN BELGIUM**

Type of firms covered:	<ul style="list-style-type: none"> <li>- Shareholding companies</li> <li>- Companies subject to company tax</li> <li>- Foreign companies subject to taxation in Belgium</li> <li>- Subsidiaries of foreign companies</li> </ul>
Employees benefitting:	All workers in the largest sense (wage and administrative workers) who have been employed for at least one year.
Fiscal benefits:	Profit resulting from the raising of an option is exempt from tax.
Special conditions:	<ul style="list-style-type: none"> <li>- Options must be deposited in the National Bank (or in the company's headquarters), where they remain frozen for 2 years;</li> <li>- A maximum of 5% of company shares per employee (which will be raised to 20%);</li> <li>- The investment cannot exceed 25% of the previous year's remuneration, or BFR 500,000;</li> <li>- The price of options cannot be lower than its stock exchange price (if quoted) or its accounting value (if not quoted on the stock exchange).</li> </ul>
Method:	Subscription of new shares or acquisition of existing shares.
Transferability of shares:	Free after a period of 2 years.
Investment period:	1986-1990 (and possibly an additional 6 years, the maximum delay for options agreed for 1990). On 28 December 1990 the scheme has been extended for an unlimited period.
Cumulation of various schemes:	Cannot be introduced in the same period in which a Monory scheme is in course.

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Source: Jongen (1988).

**Table 4.3. CAPITAL INCREASES IN MAJOR QUOTED COMPANIES  
AND EMPLOYEE SHAREHOLDING IN BELGIUM  
1982 - June 1985**

Firm	Date of issue	No. of shares issued	No. reserv. for employees	% of employees involved	Price for employees	Employee capital *
Ebes	4.82	2,687,500	25,000	0.9	idem	40,625
	5.83	2,025,000	25,000	1.2	idem	47,500
Unerg	6.82	2,041,000	15,000	0.7	idem	13,500
	6.83	1,536,387	15,000	0.9	idem	19,125
Inter-com	11.82	3,008,876	36,000	1.2	idem	48,420
	12.83	3,021,876	45,000	1.48	idem	67,500
Tract-ionel	4.83	599,339	15,000	2.9	idem	37,500
Electro-bel	11.83	188,121	3,500	1.8	idem	19,950
General de Banque	5.82	1,368,877	110,000	8.0	idem	275,000
	4.85	1,628,937	125,600	7.7	idem	345,400
BBL	2.83	1,493,937	135,812	9.0	-6.0%	203,718
Belgo-laise	10.83	119,250	6,750	5.6	idem	27,000
AN-Hyp	10.83	63,600	2,400	3.7	-7.2%	12,240
Credit Gen.	5.83	241,572	7,096	2.9	-5.8%	11,354
Krediet-bank	11.83	386,100	35,100	9.0	idem	214,110
Almanij	11.83	194,852	1,328	0.07	idem	6,972
S.G. Belg.	11.83	3,676,204	50,000	1.3	idem	75,000
	12.84	3,260,063	50,000	1.5	idem	77,500
GBL	12.83	4,148,000	32,000	0.7	-6.1%	48,800
	12.84	3,494,409	55,512	1.5	-5.4%	95,758

(continued on next page)



Table 4.3. (cont.)

Firm	Date of issue	No of shares issued	No. reserv. for employees	% of employees involved	Price for employees	Employee capital *
Cobepa	4.85	850,000	10,000	1.1	-6.0%	23,500
Colruyt	4.82	70,435	2,500	3.5	idem	15,000
GB-INNO-BM	10.82	319,682	61,651	19.2	-10.6%	129,467
Cote d'Or	11.83	148,980	8,560	5.7	idem	17,120
C.B.R.	5.83	595,803	13,000	2.1	idem	22,100
	3.85	441,371	10,000	2.2	idem	22,000
UCB	6.83	306,164	27,833	9.0	-3.1%	86,282
Bekaert	9.83	355,104	40,000	11.2	-4.1%	92,000
Pap. Belg.	10.83	619,978	19,945	3.2	idem	19,945
RB Vie	11.82	285,334	30,001	10.5	idem	150,005
A.G.	11.83	118,524	11,000	9.2	-4.9%	78,430
<b>TOTAL</b>		<b>39,305,285</b>	<b>1,022,598</b>			

\*In thousands of Belgian Francs.

Source: Delahaut (1986), p. 36-37, as reported in Stallaerts (1988).

**Table 4.4. ISSUES OF SECURITIES IN MAJOR QUOTED COMPANIES IN BELGIUM  
AND EMPLOYEE OWNERSHIP  
mid-1985 - sept. 1989**

Firm	Date of issue	No. of shares issued	No. reserv. for employees	% of employees involved	Price for employees	Freeze period	Employee capital *
<b>1. Capital increases</b>							
Tessen-derloo							
Chemie Gener. de	12.85	177,338	50,000	28.10	-10.0%	3 yrs	112,500
Banque	4.86	1,674,851	155,000	9.25	idem	-	782,750
	4.89	2,105,270	64,000	3.00	idem	-	352,000
Ste Gen. de Belg. Cie							
Immob.de Belg.	5.86	92,803	600	0.60	idem	-	3,000
Krediet-bank							
	9.86	357,088	30,000	9.10	idem	-	390,000
C.B.R.	10.86	874,076	8,000	0.90	idem	3 mths	25,200
	11.88	653,775	12,000	1.80	n.a.	-	67,800
Credit							
Gener.	12.86	324,000	9,000	2.70	idem	-	25,650
	9.89	257,300	3,500	1.40	-4.8%	2 yrs	10,325
Walibi	6.88	233,000	12,000	5.20	-11.1%	1 year	14,400
Corona-							
Lotus	12.88	224,000	12,500	5.60	-7.4%	1 year	15,625
Petro-							
fina	2.89	1,493,161	150,000	10.00	-18.2%	5 yrs	1.350,000
Gener. de							
Belg.	6.89	7,000,000	50,000	0.70	-16.7%	-	125,000
Cockerill							
Sambre	9.89	35,000,000	2,200,000	6.30	n.a.	n.a.	484,000
<b>2. Warranted bonds</b>							
GB-INNO							
BM	11.86	207,352	25,000	12.00	-10.0%	1 year	200,000
GBL	6.87	2,171,785	15,535	n.a.	-12.2%	1.5 yrs	51,265

\*In billions of Belgian Francs.

Source: Delahaut (1989).

## Chapter 5. DENMARK

### 5.1. GENERAL ATTITUDE

PEPPER schemes have been the subject of political and economic debates in Denmark for over two decades. In particular, under the influence of the Swedish Meidner Plan,<sup>27</sup> wage-earners' funds have been intensively discussed, although due to disagreements over some core issues none of the proposals have been implemented. The principal form of PEPPER officially encouraged by law is profit-sharing at the enterprise level in the form of shares or bonds.

The divergence of opinions in past discussions was mainly concerned with whether PEPPER schemes should be compulsory or voluntary, collective or individual, at the national/regional or enterprise level, and how should decisional power be divided between employees and employers. The attitude of major social partners has been clearly divided along these lines.

On the one hand, the Danish Federation of Trade Unions LO (TUC) and the Social Democratic Party consider PEPPER schemes should be obligatory and on a collective basis, and have launched several proposals on wage-earners' funds with the aim of ensuring co-ownership, participation and joint decision-making for wage-earners, together with achieving a more equitable distribution of income and wealth and efficient capital accumulation. Their first two proposals, advanced in 1973 and 1979, were to establish a nation-wide wage-earners' fund, financed through contributions of employers in relation to the wage bill (1973 proposal) or as a percentage of booked profits (1979 proposal) from which all wage-earners would benefit; their 1986 proposal was to set up regional wage-earners' funds.<sup>28</sup> The Socialist Peoples Party has also advanced a similar proposal.<sup>29</sup> None of these proposals have been imple-

27. For a survey of the Swedish experience see Elvander, 1979 (in Roberts et al, 1979, pp. 130-163); for a theoretical discussion of wage-earners' funds, see George (1985) and (1986); on proposals in Denmark, see also Valentin (1979).

28. Detailed information on these proposals is given in the Appendix to Chapter 5.

29. According to their proposal, employers' contributions to the fund would be made as a percentage of value-added.

mented, as they encountered strong opposition from employers and some political parties. At the same time the LO (TUC) and the Social Democratic Party have criticized proposals on granting tax benefits for enterprise-level schemes, arguing that they are in contradiction with the principles of solidarity.

On the other hand, the Danish Employers' Federation and parties to the right of the political spectrum have strongly opposed compulsory arrangements. They have criticized proposals on the creation of a wage-earners' fund, as they were not willing to accept the compulsory transfer of ownership, the notion of a "central fund", and the influence which LO was likely to exercise in managing the fund. They have, on the contrary, persistently argued for voluntary schemes directly related to the individual employer, and have tried to promote the diffusion of such schemes by giving information and support to Danish firms. Their arguments in favour of enterprise-level schemes include the well-known expected effects of increased employee motivation and involvement, and greater employee identification with the interests of their enterprise.

In 1987 the Liberal Conservative government proposed a number of measures to encourage different forms of PEPPER: a bill on profit-sharing providing tax-free premiums on profit shares invested by employees in enterprise shares, a bill on stock options providing tax benefits for employees, and the extension of fiscal benefits for existing share-based schemes (Danish Ministry of Labour, 1987). Only the last of these measures has been adopted (see below).

Today the primary demand of the Social Democratic Party and LO is a general labour market pension reform based on pension funds. Present discussions are, to a large extent, similar to past discussions on PEPPER (obligatory vs. voluntary, collective vs. individual, and concerning the composition of the board of pension funds, the representation of employers vs. that of employees).

## 5.2. LEGAL AND FISCAL FRAMEWORK

The first tax benefits for share or bond-based profit-sharing schemes and employee share-ownership have been provided over three decades ago. On the contrary, up to the present there are no fiscal incentives for cash-based profit-sharing. All schemes in Denmark are voluntary.

1) **Share-based schemes (1958, 1987).** In 1958, the Act on Profit-Sharing was adopted with the intention of promoting share or bond-based profit-sharing and employee share-ownership, parallel to the granting of tax incentives in a provision of the Law on Special Income Tax (section 16) (Danish Ministry of Labour, 1987).

In order to have tax benefits, schemes are subject to approval by the Ministry of Finance, and authorization is granted if some general conditions are fulfilled: no group of employees is to be favoured (although differentiation on the basis of general criteria such as seniority is allowed); the value of shares or bonds given to employees, or the right to subscribe, should not be out of proportion in relation to the wage of the individual employee; and shares or bonds must be frozen for a determined amount of time (CEC, 1979, p. 69).

a) *Share/bond-based profit-sharing.* Employee shares or bonds can be issued by a limited company under a profit-sharing scheme or be given as a bonus to supplement regular earnings. According to the 1958 law, employee shares or bonds up to a maximum value of DKR 200 were not included in workers' taxable income, while the employer paid a tax of 50% on that part of the value of shares or bonds exceeding DKR 200, and could deduct the value of these securities, as well as the 50% tax, from his own taxable income. Shares and bonds had to be frozen for 5 years (CEC, 1979).

These 1958 provisions have had a very limited impact on the diffusion of schemes, and primarily because they have not, in the meantime, been adjusted to the general increase in prices. Amendments to the Law on Special Income Tax have been adopted only in 1987, substantially raising the tax-free amount: employee shares, up to

a maximum value of DKR 6,000, are not included in an employee's taxable income, on the condition that employee shares have full voting rights and are frozen for 7 years (Danish Ministry of Labour, 1987).

b) *Employee share-ownership*. Danish enterprises can also sell shares to their employees at a specially advantageous price, where the difference in price is made up by the enterprise and is not included in employees' taxable income, if shares are frozen for a period of 5 years (CEC, 1979, p. 69).

2) **Social funds**. Enterprises setting up social funds which provide different benefits for employees (holidays, grants, etc.) can deduct contributions to these funds from taxable income. However, these social funds are only sometimes directly related to profits (see below). Under the Holiday Act e.g. an enterprise must pay holiday allowances to employees on cash payments given within a profit-sharing scheme (Danish Ministry of Labour, 1987).

3) **Cash-based profit-sharing**. There are no tax incentives for cash-based profit-sharing schemes.

### 5.3. PEPPER SCHEMES IN PRACTICE

It is difficult to provide an accurate account of the diffusion of PEPPER schemes in Denmark, as these are not officially registered in national statistics. Information is available from other sources, although not containing detailed information: 1) tax authorities; 2) the annual reports of the the Minister of Finance, who is since 1987 committed by law to give a report to the Parliament on approved schemes; and 3) reports of the Government Committee set up in 1985 by the Liberal Conservative government with the aim of examining existing schemes. For non-approved schemes such as cash-based profit-sharing, the Danish authorities have no

information, but some estimates suggest that this is the prevalent form applied by Danish firms.

1) **Share-based profit-sharing.** In 1986, only 3 enterprises had issued employee shares under a profit-sharing arrangement. Concerning the question of regularity, all of the enterprises had issued employee shares more than once in the 1982-85 period. The employees' part of capital was on average less than 2% of total share capital issued (Redegorelse..., 1986, p. 60).

Following the 1987 legislative changes that have substantially raised the limit of the tax-free amount, the number of firms issuing employee shares has increased, but nevertheless remains very small: in 1987 there were only 6, and in 1988, 10 applications (Redegorelse... 1989, 1990), whereas in 1989, the number of approved schemes was 20 (Told-og...1990).

2) **Bond-based profit-sharing.** In the 1976-85 period, only 9 enterprises have issued employee bonds under a profit-sharing scheme, two of which only once during the whole period. On average, the value of bonds was DKR 3,400 per employee (Redegorelse... 1986, p. 65). There has been an increase in the number of schemes since 1985, which in 1989 amounted to 27 (Told-og... 1990).

3) **Offers of shares at a preferential price.** In the whole 1958-85 period (i.e. since the first tax incentives were introduced), some 160 companies have offered employees shares at preferential prices once or more frequently. Since the beginning of the 1980s such practices have been more frequent, but remain fairly limited: out of 139 firms examined, the number of firms offering shares to employees was 18 in 1982, 22 in 1983, 31 in 1984, and 30 in 1985 (Redegorelse... 1986, p. 71).<sup>30</sup> The average value of employee shares represented less than 2% of total share capital. In 1989, a

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30. In 1985 another two enterprises had got approval for a scheme, but the scheme was not yet implemented by the end of 1985.

total of 32 firms had offered shares to employees at preferential rates (**Told-og...** 1990).

4) **Cash-based profit-sharing.** Cash-based profit-sharing is limited in extent, but still seems to be the dominant form of PEPPER applied by Danish enterprises. In 1986, the Federation of Employers estimated that there were at least 50 schemes among their member firms, while the LO (TUC) estimated that there were 16 schemes in enterprises with more than 50 employees (**Redegorelse...** 1986, pp. 31-32). The Employers' Federation reports that cash-based profit-sharing has been spreading in recent years, but the exact number of schemes is not known. Cash-based profit-sharing is being introduced by firms of all sizes, primarily by industrial firms.

5) **Social funds.** In 1986, within the total of 226 social funds, only 10 were based on profit-sharing (**Redegorelse...** 1986, p. 72).

Therefore, the overall number of PEPPER schemes in Denmark remains rather low (see Table 5.1, Appendix to Chapter 5). At the end of 1985 there were in total some 100 schemes, but since other estimates have provided higher figures (probably due to a broader definition of the term), the Government Committee concluded that the total number of enterprises with some sort of PEPPER scheme including more "informal" arrangements, hardly exceeds 200 (**Redegorelse...** 1986, p. 73). In 1987, profit-sharing schemes existed in around 10% of all Danish firms (Danish Ministry of Labour, 1987).

The Government Committee has also examined the possible obstacles to the diffusion of PEPPER schemes, and has concluded very cautiously that, according to present legislation, enterprises have the possibility of introducing schemes. However, the Committee did consider that modifications of existing legislation could result in increased diffusion, and its proposals mainly consisted of providing additional tax benefits (**Redegorelse...** 1986, p. 11).



#### **5.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

No empirical research on the effects of PEPPER schemes is yet available for Denmark. More information may be available in the near future, as a research project, supported by the Danish Social Science Research Council, was started in 1990 with the aim of examining the effects of PEPPER schemes in large Danish firms.

## APPENDIX TO CHAPTER 5

**Table 5.1. DIFFUSION OF PEPPER SCHEMES IN DENMARK  
1985-1989**

Type of scheme	Until 1985	1986	1987	1988	1989
Issue of employee shares under a profit-sharing scheme (number of firms)		3	6	10	20
Issue of employee bonds under a profit-sharing scheme (number of firms)	9*				27
Share offers at preferential terms (number of firms)	160**				32
Cash-based profit- sharing schemes		50			
-of which in firms with more than 50 employees		16			
Social funds based on profit-sharing		10			
<b>TOTAL SCHEMES</b>	<b>100-200***</b>				

\*1976-85

\*\*1958-85

\*\*\*end of 1985

**Note:** Except for the period until 1985, these are yearly figures and not cumulative totals.

**Source:** Government Committee Reports (*Redegørelse...* 1986, 1989, 1990) and information provided by tax authorities (*Told-og skattestyrelsen*, 1990).

## PROPOSALS ON WAGE-EARNERS' FUNDS IN DENMARK

1) **1973 proposal.** In 1973, the Social Democratic government introduced a bill on a Wage-Earners' Investment and Profit Fund. The bill was drawn up in cooperation with LO on the basis of an outline proposal adopted at LO's congress in 1971. The proposal was presented to the Parliament as part of a wider campaign for "economic democracy". The fund's capital was to be financed through a contribution from employers, both in the private and public sector, in relation to the total wage bill, levied initially at 0.5% and rising to 5% in steps of 0.5% per year. All wage earners were to receive fund certificates of equal value based on the employers' annual contributions to the fund, which would be redeemed at their fully accumulated value after 7 years. A contribution in relation to profit could substitute or supplement the contributions in relation to the wage bill. In joint stock companies with 50 employees or more, two thirds of the employers' contribution would be made in shares, and the rest in cash. In small firms the contributions would be in cash. The part of the fund's capital not reinvested in companies was to be invested primarily as risk capital in industry at the discretion of the Management Board of the Fund, consisting of 60 members, of which 36 members were to be appointed by the wage-earners' organizations (18 appointed by LO), and 24 appointed by the Minister of Labour. The board would not exercise voting rights as they would be exercised by employees in the enterprise where the shares were issued. The fund was not permitted to own shares representing more than 50% of a joint stock company's total share capital.

2) **1979 proposal.** In 1979 the Social Democratic Party advanced a variation of the 1973 proposal on a wage-earners' fund, based on obligatory profit-sharing. The employers' contribution to the collective fund was to be 10% of booked profits, to be made in shares, or in case of disagreement, in cash (if the employers preferred it). If the contribution was paid in shares, an investment fund for the individual firm was to be established. Half of the share yield from the fund would be channelled to the collective fund, while the other half would remain in the individual enterprise investment fund, to be used for collective purposes.

3) **1986 proposal.** In 1986, the Social Democratic Party again advanced a proposal on the setting up of regional wage-earners' funds.

None of these proposals have passed in Parliament, although they have been important for the economic and political debate in Denmark (Bregm, 1990; George, 1985a).

## Chapter 6. FEDERAL REPUBLIC OF GERMANY

### 6.1. GENERAL ATTITUDE

In the Federal Republic of Germany, employee participation in capital has intensively been discussed during the past two decades, but not employee participation in results which so far has received only marginal attention. The lack of consensus as to which form ought to be officially encouraged has resulted in limited supportive legislation. Indeed, the emphasis in Germany has been on institutionalizing industrial democracy (i.e. employee participation in decision-making through extensive codetermination laws), rather than economic democracy.

In the earlier discussions on *employee participation in capital*, the main issue considered was whether and in what way instruments of capital formation policy at enterprise and/or higher levels could contribute to greater distributive justice in terms of income, prosperity and influence on business decisions. In some circles it was argued that capital formation was fundamentally ill-suited for these purposes, while in others support or opposition depended largely on whether the policy was considered at the level of the individual enterprise or a higher level. Thus a concept favoured in the early 1970s by the trade unions, the Social Democratic Party (SPD) and partly also by the Free Democratic Party (FDP), but vigorously opposed by the representative of employers' interests BDA (*Bundesvereinigung der Deutschen Arbeitgeberverbände*), was the creation of a wage-earners' fund at an economy-wide level. A government proposal was advanced in 1974: all companies from a certain size upwards were to contribute up to 10% of their profits into a fund, from which a certain beneficiary group would receive certificates. However, due to the 1974 economic crisis and technical problems in implementing the scheme, the proposal has been officially withdrawn (Schneider, 1990; Roberts et al, 1979; CEC, 1979).

During the 1980s, different parties have generally supported employee participation in enterprise capital. On the employers' side, the BDA welcomes private

initiatives to enhance employee participation in enterprise capital, perceiving that such schemes would take the edge off the struggle over the distribution of income and would improve a company's equity position thereby assisting in job creation. The BDA has therefore urged for fiscal incentives to facilitate the introduction of schemes, but it insists on the principle of voluntarism (Gurdon, 1985). An official of the BDA has emphasized recently that the failure of schemes to become widespread is partly explained by the scepticism of many employers as well as of workers, which could perhaps only be overcome if at least partial security could be provided against the dual risk involved, i.e. that workers might lose both their jobs and the savings they had invested in capital participation.

Official union positions on employee participation in capital range across the political spectrum (Gurdon, 1985). The IG Metall (*Industriegewerkschaft Metall*) is vehemently opposed to the concept of employee share-ownership, regarding a fundamental change in the socio-economic system as the only sure way of securing a more equal distribution of wealth. The sixteen trade unions grouped in the DGB (*Deutscher Gewerkschaftsbund*), with some 8 million members prior to German unification, regard the two-fold risk for employees the crucial weakness of participation in enterprise capital, as a number of recent cases demonstrate that this particular risk incurred by workers through capital participation is not simply theoretical. Therefore the DGB remains sceptical of such schemes; it considers public support through tax incentives to be unfeasible, points to the dangers of some existing schemes,<sup>31</sup> and regards stock-ownership plans as instruments to prevent the final implementation of parity codetermination in all industries. As an alternative, the DGB suggests the creation of multi-industry decentralized investment funds out of which workers would be paid a dividend on their contributions, which would be administered by elected workers' representatives. The salaried employees' union DAG (*Deutsche*

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31. In 1982, the DGB put forward the following arguments against the "investment wage": it would be regarded as a subsidy of companies through forced employee savings; management would consider it as a wage expense and hence pass it on to workers as consumers in the form of higher prices; it would reduce workers' mobility; and there was the added risk of financial loss in the event of bankruptcy (Gurdon, 1985).

*Angestellten-Gewerkschaft*), which does not belong to the DGB, has for a number of years been generally in favour of employee participation in enterprise capital, although it has so far remained vague on the details of how this might be done; according to its 1981 proposal, payments to employees ought to be split into wages and investment income, where an employee's investment would not be accessible for a period of 6 years (Gurdon, 1985).

In spite of such diversity of opinions, measures have been taken to officially encourage employee participation in enterprise capital, primarily from 1984 onwards. Such encouragement is considered to have marked the beginning of a new course in asset policy in Germany in the direction of promoting the formation of productive capital in the hands of employees (Guski and Schneider, 1987). The government recognizes these schemes as a way to stimulate savings, and has tried to integrate them into a broader policy of asset formation and distribution of wealth (Van Den Bulcke, 1987).

*Employee participation in enterprise results* (profit, turnover or other) has received only limited attention in Germany. The unions, including those belonging to the DGB, adopt quite a different attitude than on employee participation in capital, being either neutral or in favour. The precondition is that participation in results is not prejudicial to the normal wage increases negotiated by collective bargaining and that this participation is an additional cash income to which the workers have access quickly and without having to fulfil conditions laid down by the employer.<sup>32</sup> Thus in the 1960s, IG Metall indeed regarded participation in results as a welcome means of skimming off "excess profits" within a philosophy of "enterprise-related remuneration policy". For the same reason, however, many employers are not enthusiastic about participation in results, since, quite unlike capital participation, it generally means that they lose liquidity and forfeit part of their potential non-borrowed capital.

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32. This implies e.g. that the employer should not link result-related payments to the acceptance of capital participation by the worker.

## 6.2. LEGAL AND FISCAL FRAMEWORK

PEPPER schemes in Germany are usually divided into two broad categories: employee participation in capital, and employee participation in results. Legislative measures taken so far have only encouraged employee participation in capital, while the legal framework for profit-sharing is generally unfavourable (except for some specific forms).<sup>33</sup>

1) **Employee participation in capital.** Employees have been encouraged to participate in their company's capital primarily within specific savings schemes regulated through a series of Capital Formation Laws (*Vermögensbildungsgesetz*) enacted in 1961, 1965, 1970, 1984 and 1987 (see Perry and Kegley, 1990). These laws offer incentives related to individual workers' savings, "mixed" types in which employers' contributions are combined with workers' savings, and cases where the employer's contribution is the only one made, as envisaged by collective agreements on "employers' savings contributions". Under these agreements, employers undertake to pay their employees an "investment wage" in addition to their "cash wage", which is usually paid as a lump sum and is financed out of company profits, but unlike profit-sharing guarantees all workers a fixed payment.

Under the provisions of these laws, concessions are offered to workers whose annual income does not exceed a certain threshold if they commit their employer's savings contributions, or part of their cash wage if they are not covered by any savings promotion agreement, for a minimum retention period of 6-7 years in a specific form of investment with particular institutions (not only companies, but also banks, building societies, investment trusts). Such savings are invested as agreed with workers or the trade unions in collective agreements under favourable tax provisions, where several long-term investment possibilities are envisaged (investment in cash assets with banks,

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33. In Germany, it is very difficult to draw a line between employee share-ownership and share-based profit-sharing, since in some cases these schemes overlap (see below).

in building societies, in life insurance, or productive capital, both at the enterprise and higher level, including the buying of company shares at a favourable price). The concessions offered consist partly in a premium paid by the state (workers' savings bonus) in addition to the sum invested by the worker, and partly in reduced tax and social security contributions.

The maximum support limit, income threshold, investment catalogue and other provisions for savings promotion were changed several times. As an illustration, according to the provisions of the 1970 law (also known as the "DM 624" Law), a worker with an annual income of less than DM 24,000 if single and DM 48,000 if married, could make an investment of up to DM 624 per year, in which case he would receive an immediate cash premium equal to 30% of the sum invested (40% for workers who have more than two children), on condition that such savings were frozen for a period of 5 years (CEC, 1979; Gurdon, 1985).

In addition to the above arrangements, the Capital Increase Tax Law of 1959 (*Kapitalerhoehungssteuergesetz*) allowed joint stock companies which made stock available to their employees at less than the market price to deduct the difference between market and purchase price along with associated expenses from taxable income (Gurdon, 1985).<sup>34</sup>

In the early 1980s the government policy on asset formation began to shift its emphasis from state subsidized savings plans to the promotion of more specifically employee participation in productive capital (see Perry and Kegley, 1990). Within the Capital Participation Law of 1 January 1984, when a new (fourth) Capital Formation Law was adopted, the subsidized amount of savings was increased from DM 624 to DM 936 per year, but only if placed in productive capital, and the options were extended to include new investment alternatives. In addition, a new paragraph (19a) was attached to the Income Tax Law (*Einkommensteuergesetz - EStG*), enabling employees who are offered shares by their employers exemption from tax and social

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34. However, the incentive applied only to joint-stock companies (AG - *Aktiengesellschaft*), which are relatively few in number.



insurance payments, up to a maximum tax-free amount of DM 300, on the condition that enterprises subsidize the acquisition of employee shares up to 50% of the share value and that shares are frozen for a period of 6 years.

A 1984 juridical decision of the Federal Court (AZ: VI R 124/77) also enabled, under specific circumstances, companies allocating a part of profits to employees which are then invested, to pay the wage tax and social insurance contributions only when employee shares are free for disposal, and hence the transferring of these payments to more favourable periods.

On 1 January 1987, the Second Capital Participation Law was enacted, consisting of the Fifth Capital Formation Law and a modified paragraph 19a EStG. The procedure for investing in capital shares was simplified by allowing employees to obtain them directly from the employer (instead of through special savings contracts with a financial institution) and the exchange of invested shares was enabled during the blocking period, giving workers the chance to react to drops in share value without loss of state premiums. Changes were also introduced in the paragraph 19a EStG in order to match the forms of asset investments eligible for tax relief with those eligible for state premiums under the Capital Formation Law, and the tax-exempted amount was increased from DM 300 to DM 500. Therefore, while the Capital Formation Law and paragraph 19a EStG coexist independently, the legislation encourages their joint use as one of the main goals of the Second Capital Participation Law (Perry and Kegley, 1990, pp. 156-7).

Thus if employers offer their employees discounted shares, the gains realized by an employee are exempt from income tax and social security payments up to one-half of the shares' market price or a maximum of DM 500 per year, and the employer's share of the social security contribution would also be exempt.<sup>35</sup>

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35. If a company, e.g. offers its employees a participation of DM 600, an amount of DM 300 (one half of the value) would be exempt from income tax and social security payments. If a participation of DM 1,200 is offered, only a discount of up to DM 500 would be tax exempt.

Although there is no obligation on the part of the employer to offer discounted company shares, any discount granted by the employer has to be shown as liability on the balance sheet, and therefore it results in a corresponding reduction in taxable profit (see Perry and Kegley, 1990, p. 157).

The legislation was amended in 1989/90 in order to encourage further investment in productive capital. The maximum support limit of DM 936 remains unchanged, but the income threshold has been raised to DM 27,000/54,000 (single persons/married couples) in order to increase the number of eligible participants, and some forms of asset participation contracts may now only be concluded between the employee and his employing company (as in the past external asset participation models were often disadvantageous and risky for workers). Workers' savings bonus will no longer be paid for investment in cash assets or life insurance; the bonus for investment in building societies has been cut to 10%, while 20% is paid if the sum is placed in productive capital (up to the maximum limit of DM 936). The payment of employee savings bonuses will no longer be the employer's responsibility but will be handled, instead, by the Internal Revenue Service (see Perry and Kegley, 1990, pp. 159-161; Federal Minister of Labour, 1989).

2) **Profit-sharing.** Except for the above cases some of which can be considered a form of deferred profit-sharing, enterprises introducing profit-sharing schemes do not enjoy any particular tax or other benefits. There is no specific legislation on profit-sharing, but enterprises adopting schemes must respect other laws and tax regulations, such as labour legislation (e.g. the principle of equal treatment).

For both cash-based and deferred profit-sharing, profit shares given to employees are considered as operating costs for the company, and as wages for employees. In the case of cash-based profit-sharing, no particular tax or other benefits exist; on the contrary, compared to the past, more barriers exist today, since until 1984 companies could at least partly gain from reduced social insurance contributions (Schneider, 1990). As from 1984, profit shares became increasingly subject to social insurance regulations, and enterprises cannot save on social insurance payments added

to monthly wages (the so-called "*Zwoelftelungs-Prinzip*"). In other words, if a company gives a profit share to an employee, it will have to pay the usual social insurance contributions of 18-19%.

### 6.3. PEPPER SCHEMES IN PRACTICE

The principal type of PEPPER encountered in German enterprises are various forms of employee participation in capital, while employee participation in results is of minor importance today.

1) **Employee participation in capital.** Although no official data are published on the incidence of PEPPER schemes in Germany, some information is available on the application of the Capital Formation Laws, as well as, more specifically, on employee participation in capital.

Some 1,000 collective bargaining wage agreements have been concluded under the terms of the "DM 625" Law by 1979. The number of workers receiving employers' contributions has risen from 1 million in 1969, to over 16 million in 1978, when 92% of all employees received an asset-formation supplement. About 18% of beneficiaries received the maximum amount of DM 624 (Roberts et al, 1979; CEC, 1979). However, not all of these arrangements belong to the PEPPER category.

Until 1983, 98% of the asset-forming contributions were invested in cash assets with banks, life insurance and building societies, while only 2% constituted productive capital sharing in companies. It is only after the 1984 legislative changes that capital sharing practices began to be more diffused, and by 1986, their share increased to 5-10% of the total (Perry and Kegley, 1990, p. 154). Nevertheless, it is reported that both sides of industry have so far taken little advantage of the new provisions, as out of 18 million workers involved in collective bargaining, only 400,000 received asset-formation benefits in 1986 on the basis of such agreements (Guski and Schneider, 1987).

More detailed information on employee participation in enterprise capital is provided by Guski and Schneider, who have undertaken several surveys based on a questionnaire sent to German firms that let their workers participate directly or indirectly in their enterprise's capital.<sup>36</sup>

The first survey revealed that in 1976 some 770 firms were practising employee participation in capital schemes, involving almost 800,000 workers holding a total capital of DM 2.3 billion. The firms were mainly small-scale industrial firms. The size of employee shares varied greatly, but most shares were relatively small. About half of these firms had instituted some form of employee participation in what is normally regarded as managerial decision-making, ranging from minimal consultative and informative practice to employee control over certain issues, primarily in large firms (Guski and Schneider, 1977; Cable and FitzRoy, 1980).

Since the late 1970s, there has been a steady increase of such practices. By 1990, the number of enterprises with employee participation in capital schemes is estimated to have reached 1,600, involving 1.3 million workers, while employee capital has reached DM 15 billion (see Figures 6.1, 6.2, and Table 6.1, Appendix to Chapter 6).

However, the number of firms practising employee participation in capital remains small, because the majority of the 1.6 million German firms are not in a position to introduce schemes.<sup>37</sup> Excluding all categories which are not suitable, only some 80,000 firms are in a position to introduce such schemes, of which only 1.7% of firms did so in 1987 (0.1% of the total number of firms). Moreover, not all workers are entitled to capital participation schemes,<sup>38</sup> the entitlement rate being around 80-90%,

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36. The surveys were undertaken in collaboration with the *Institut der Deutschen Wirtschaft (IW)* and the *Gesellschaft fuer innerbetriebliche Zusammenarbeit GIZ GmbH (GIZ)*. Although these surveys have been criticized because of lack of specification of the method employed, unrevealed sources of information and other methodological weaknesses, for the moment they remain, to our knowledge, the only available published material on such practices in Germany.

37. Public enterprises, non-profit organizations (churches, associations, trade unions), regional bodies, social security funds, agriculture and forestry enterprises, large areas of the service sector (public services, theatres, kindergartens, hairdressers, liberal professions), and a large number of small businesses employing mainly family members.

38. The intention of the labour law is to keep at least the major part of the floating workforce out of involvement schemes.

and neither are all workers always willing to accept the involvement offer. The actual involvement rate on average in 1987 was 82.9%,<sup>39</sup> varying greatly with firm size (highest in small businesses and lowest in large enterprises) as well as with type of scheme.

There are a variety of forms of employees' capital contributions. The large majority of employees in the survey held enterprise shares (81.8% of all workers involved). The other forms of employee capital participation include certificates of the enterprise fund, bonds, bonus certificates/rights, and so-called "indirect" and "silent" partnerships<sup>40</sup> (see Table 6.2, Appendix). However, employee capital as a portion of total enterprise capital is not very high: in around 72% of firms it amounted to no more than 5% of a firm's annual balance.

In comparison with 1976, when in about 50% of firms the nominal value of workers' capital shares was below DM 500,000, by 1987 this was the dominant group in some 70% of firms (although an increase was also registered in the highest share value category - of over DM 100 million - from 0.6% in 1976 to 7.5% in 1986). Workers employed in large firms were found to have capital shares of lower value than those in small firms. Whereas in 1976 a substantial part of workers' shares was financed by firms,<sup>41</sup> in 1987 firms were financing workers' shares in barely 25% of cases, of which in 51% of firms workers contributed the larger part of capital.

The analysis of employee capital involvement by enterprise size (see Table 6.3, Appendix) reveals that the majority (52%) of German firms practising involvement schemes are small-scale and medium enterprises, employing less than 500 workers (of which 32% are firms with less than 200 employees), although there are also quite a few (15%) very large enterprises (with over 10.000 employees). Like the 1977 inquiry,

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39. This is a marked increase in comparison with 1983, when only slightly over 50% of entitled workers actually became involved.

40. "Indirect" and "silent" partnerships usually occur together, since indirect participation refers to a model in which employees share in their employer's capital as silent partners of a special employee participation company, which is usually established as a partnership with limited liability and which invests its capital in the company. Thus silent partners become indirect participants by acquiring share coupons in the partnership company (Perry and Kegley, 1990, p. 170). In 50% of cases, these arrangements do not provide employees with voting rights.

41. A worker's contribution amounted in most cases to half of the share price.

the 1987 survey revealed a relatively balanced distribution over all economic sectors (see Table 6.4, Appendix).

Among the most well-known examples of German firms which have offered shares at privileged terms to their employees are Hoechst AG (in which since 1960, some 85,000 employees have purchased 4.5 million shares, constituting 8.1% of the company's capital stock), Siemens AG (in which in 1987, 65% of the labour force participated in the share purchase plan), Daimler-Benz AG and BASF AG. Other companies have chosen different forms of employee involvement schemes. Thus BMW AG initially offered its employees debenture bonds; later it passed to profit-sharing certificates; finally, in 1989, it introduced non-voting employee shares, offered at a 50% discount which is tax exempt (see Perry and Kegely, 1990, pp. 166-170).

2) **Employee participation in results.** In spite of the lack of legislative support, employee participation in company results has developed spontaneously, but to a limited extent. Within this category, a further distinction is usually made between employee participation in company performance (turnover, gross or net results, value-added, production, productivity) and participation in profits (according to balance sheets or distributed profits). Employee participation in company performance is of minor importance today compared with profit-sharing, except for the sharing in turnover (Schneider, 1990).

The diffusion of profit-sharing took place at a different pace and with varying motivations (Gaugler, 1982). In the post-war years the main intention was to give employees a chance to increase their earnings (which on average were very low at that time) by an additional income dependent on results. Due to the rapid increase of wages in the 1950s and the 1960s, this motive became of secondary importance, and it became more important to consider profit-sharing as a management instrument to increase motivation and performance of employees. Today most companies consider profit-sharing as a tool to facilitate capital accumulation for employees (Schneider, 1990).

Profit-sharing can take the form of cash, or deferred benefits. If management bonuses are disregarded, cash schemes are less widespread today because of the advantages deferred schemes offer. For all-employee schemes, profit shares are usually calculated on the basis of balance sheets: profits according to the fiscal balance sheet are subject to deductions (e.g. salaries to management, return on capital), giving the amount of distributable profit, which is then allocated usually on the basis of equality between labour and capital. In more recent schemes, however, profit is allocated after deduction of the profit tax, and hence the equality principle is no longer respected (Schneider, 1990).

Profit-sharing in Germany is not registered in any official statistics, and the only available information on its diffusion consists of some very divergent estimates. Guski and Schneider (1977) found that in 1976 about half of the companies surveyed had introduced profit-sharing in order to introduce employee participation in capital at a later stage. The authors found that, in nearly all cases, there was a visible intention to use objective criteria for calculating the labour share in profits; only in some cases was the decision left to the management, or quotas were determined. The share given to labour was, in 84% of cases, based on profits according to balance sheets, and in nearly all cases the amount was subject to elements of correction. In about 65% of cases examined, distributable profits were allocated on the basis of equality between capital and labour.

In their second survey, Guski and Schneider (1983) found that within the subsample of 171 companies which had a scheme of employee participation in capital for at least 7 years, some 30% of firms had also introduced profit-sharing. The disincentives contained in the 1984 legislation are reported to have resulted in a drastic reduction of profit-sharing.

Some other estimates provide much higher figures on the incidence of profit-sharing in Germany, probably because of a broader definition of the term. Gaugler (1982, p. 72) gives an estimate of some 1,000 companies practicing profit-sharing, while according to internal estimates of the *Gesellschaft fuer innerbetriebliche Zusammenarbeit GIZ GmbH* and the summary of expert opinions, there are, today,

approximately 2,000-3,000 companies which systematically practise profit-sharing, and an additional 2,000 companies which only occasionally offer profit shares to their employees (Schneider, 1990).<sup>42</sup>

As to employees covered by profit-sharing, estimates based on the German Socio-Economic Panel suggest that amongst the 3,628 individuals in 1984-1985, 196 individuals were participating in profit-sharing schemes, i.e. 5.4% of the total (Hart and Hubler, 1989, 1989a, 1989b). Since the panel covered 34 industrial sectors, this figure is considered as being representative of German industry as a whole; it may, however, be subject to a slight upward bias, insofar as the sample excluded foreign workers (who may be less likely to be covered by, or qualify for profit-sharing) (Cable, 1989).

The amounts distributed to workers on the basis of profit-sharing in Cable's (1989) sample of 30 profit-sharing schemes in the engineering industry were on average equivalent to about 6.8% of total wages and salaries. However, there was substantial interfirm variation, with profit shares equivalent to less than 1% of wages and salaries in 11 cases (either because of low profits or because of low sharing fractions), but an average in excess of 10% for the remaining nearly two-thirds of profit-sharing firms in the sample (Cable, 1989). These profit-sharing schemes were often relatively newly introduced; the average number of years since their introduction was 4.9, although there was substantial interfirm variation (Cable, 1989; Fitzroy and Kraft, 1987).

#### **6.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

A number of studies based on samples of German firms have tried to evaluate the effects of PEPPER schemes on enterprise performance on the basis of econometric

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42. Since in Germany it is difficult to clearly distinguish between share-based profit-sharing and employee share-ownership, especially in those cases where the employer's contribution towards employee shares is the principal source of finance, these figures probably refer to the overall number of schemes.



estimates, while some surveys provide additional evidence on employees' general attitudes.

The principal findings of the most important econometric studies are reported in Table 6.5 (Appendix). Some of the earlier works (Cable and Fitzroy, 1980) suggested that firms adopting profit-sharing **together** with participation in decision-making had improved their economic performance (in terms of output per man, output per unit of capital, and profitability), leading to the conclusion that participation in decision-making is an important condition for achieving positive effects of profit-sharing. Other econometric estimates also support the productivity effect of profit-sharing (Cable and Wilson, 1988; FitzRoy and Kraft, 1986, 1987), although in some of them (FitzRoy and Kraft 1986, 1987) no effects were found of profits on the level of profit-sharing, suggesting that fairly fixed profit shares are given regardless of enterprise performance.

Cable (1987), however, has pointed to some major weaknesses of the methodologies used in previous studies. According to his own more recent estimates (Cable, 1988), there are systematic differences in the characteristics of profit-sharing firms and those with participation in decision-making, and the coincidence of the two forms of participation is quite low, indicating that one of the conditions stressed by Weitzman for the macroeconomic benefits of profit-sharing to be realized - absence of employee decision-making - may indeed be present in Germany.<sup>43</sup> Nevertheless, the study reinforced the hypothesis of the positive effects of decisional participation. Firms with participation in decision-making scored significantly higher in human capital related dimensions of the labour force; profit-sharing subsamples, by contrast, exhibited low indicators of embodied human capital and a propensity to more repetitive production methods; in general, profit-sharing did not seem a way of pursuing more genuinely participatory forms (Cable, 1988).

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43. However, this is doubtful for Germany, considering that profit-sharing is not very diffused and mainly takes the form of employee share-ownership (and not profit-sharing in Weitzman's sense of a variable wage).

Hart and Hubler (1989) found, contrary to Weitzman's hypothesis, that wages and profit shares do not act as substitutes; both wage and non-wage parts of income were positively associated with employee financial participation. The level of profit-sharing had a positive impact on average working hours, while the decision on whether to participate was set at the individual level, where profit-sharing represented a worker's share in specific investment.

Additional evidence is provided by different authors, although based on surveys of opinions, and hence on the perception of the effects, rather than on the effects themselves. Lieber (1982) has investigated the attitudes of German employees on profit-sharing. Compared to other incentives,<sup>44</sup> profit-sharing ranged as "partly rather important" and therefore belonging to a medium range. On average, employees interviewed considered profit-sharing to have only slightly positive effects; only a minority considered it to have negative effects, while 44% treated profit-sharing as neutral or slightly positive. However, as much as a third of interviewed workers were not prepared to improve their performance, increase cooperation with colleagues, identify more with their company, or reduce labour turnover because of profit-sharing. More positive responses were given by about one fourth to one third of employees; readiness to put in more effort because of profit-sharing was related more to the quality of performance (e.g. careful handling of company tools) than to the quantity of labour (Lieber, 1982).

Guski and Schneider's surveys suggest a more favourable attitude of employees towards PEPPER. Their 1983 survey indicated that both firms and workers equally drew advantages from employee participation in capital schemes: workers had improved their material position, and were more closely integrated within their firm; firms had improved their liquidity position, and had workers who had more understanding of the economic interests of the firm. In comparison with the industry average, firms with employee capital participation were mainly more successful, in

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44. E.g. company pension plans, wage increases, additional annual vacation, employee loans, sporting activities, reductions of weekly working hours.

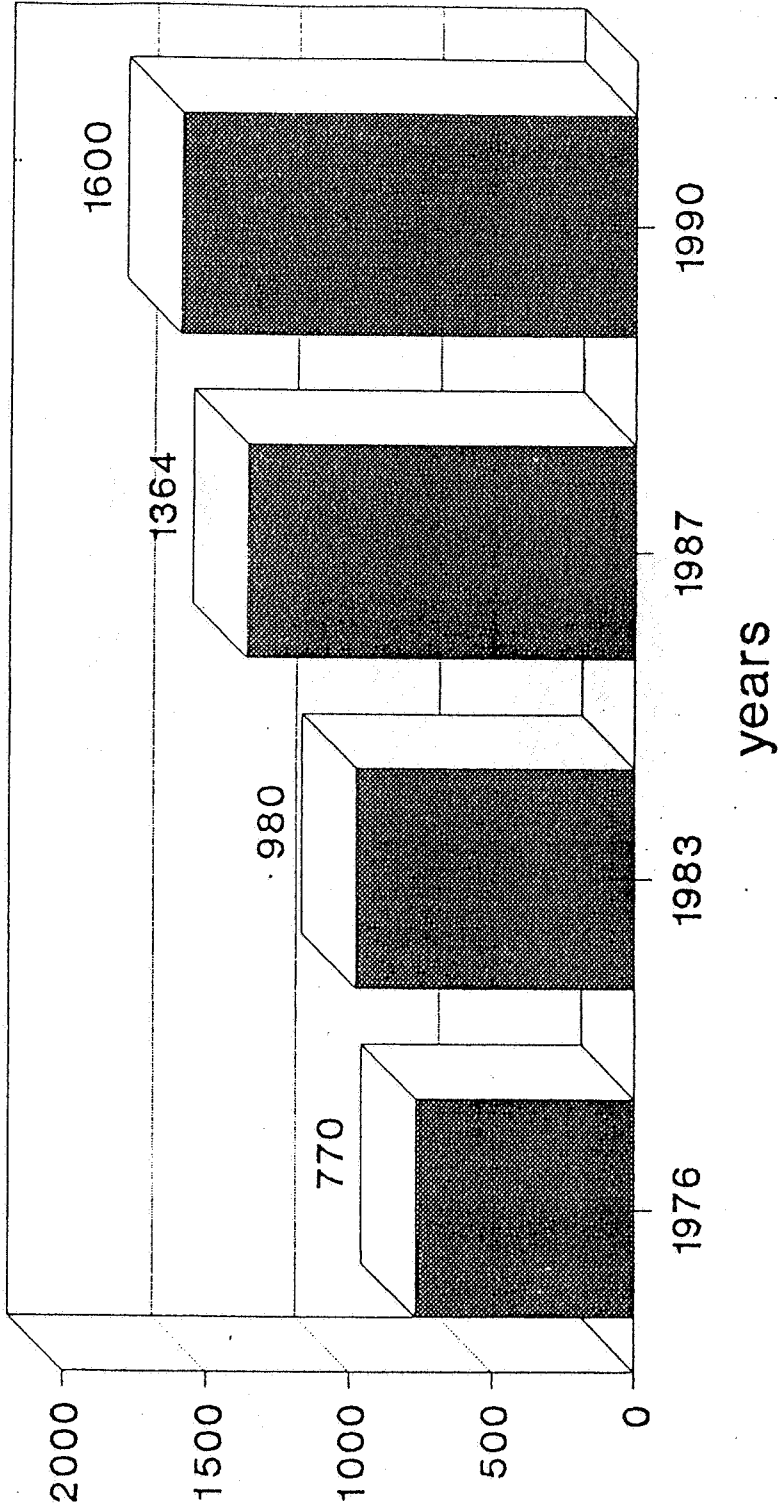
terms of own capital ratio, per capita turnover, turnover yield and other indicators. The authors also found that although profit-sharing may have resulted in increased motivation, such schemes in no way replaced incentive wages. Motivation was found to be higher the larger the personal profit share of the employee in relation to his other income, the more visible the link between an employee's profit share and his effort, and the shorter the lag between payment of profit shares and his working performance (Guski and Schneider, 1987).

Nevertheless, it has been reported that since the asset-forming payments, as envisaged by the Capital Formation Laws, are often made wholly or in part by the employer under the terms of a collective bargaining contract, there is not likely to be any psychological attachment on the part of the workers even where stock is involved (Gurdon, 1985).

Figure 6.1. DIFFUSION OF EMPLOYEE PARTICIPATION IN CAPITAL IN GERMANY

1976-1990

Number of companies

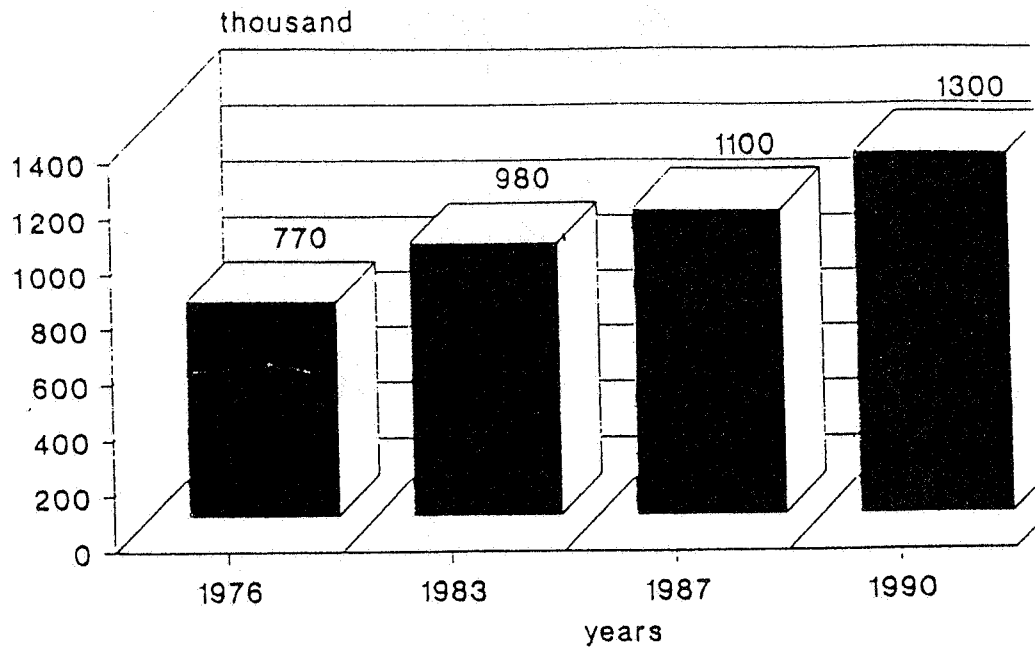


Source: Guski and Schneider (1987), p. 11, and Schneider (1990).

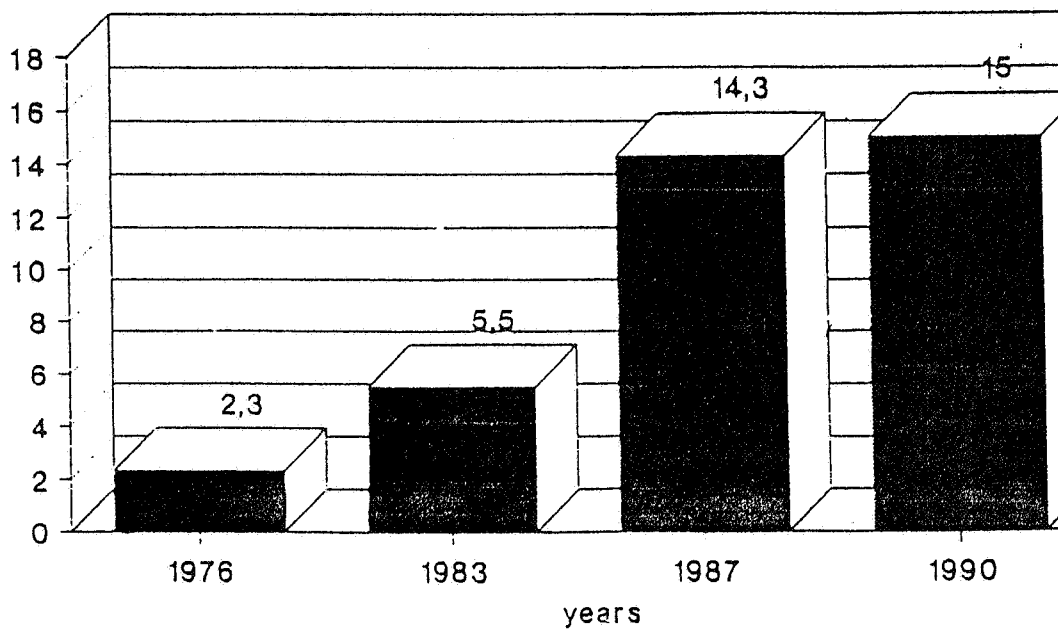
**Figure 6.2. EMPLOYEE PARTICIPATION IN CAPITAL IN GERMANY:  
NUMBER OF EMPLOYEES AND TOTAL EMPLOYEE CAPITAL**

1976-1990

Employees



**Capital of employees**  
(in billions of DM)



Source: Schneider (1990).

**Table 6.1. EMPLOYEE PARTICIPATION IN CAPITAL  
AND PROFITS IN GERMANY  
1976-1990**

	1976	1983	1987	1990*
<b>Participation in capital</b>				
Number of companies	770	980	1,364	1,600
Employee capital (DM mln)	2,300	5,500	14,300	15,000
Number of employees	770,000	980,000	1,100,000	1,300,000
<b>Participation in profits**</b>				
Number of companies	50%	n.a.	30%	n.a.

\*Based on estimates.

\*\*As % of the enterprises having employee participation in capital schemes.

Source: Guski and Schneider (1987); Schneider (1990).

**Table 6.2. GERMAN EMPLOYEES BY TYPE OF CAPITAL INVOLVEMENT  
SCHEME  
1987**

	Number of employees (in % of total)	
Shares	875,598	81.8
Fund certificates	78,506	7.3
Bonds	46,920	4.4
Bonus certificates/rights	37,509	3.5
Indirect partnerships	20,275	1.9
Silent partnerships	11,691	1.1
<b>TOTAL</b>	<b>1,070,499</b>	<b>100.0</b>

Source: Guski and Schneider (1987), Table 4, p. 4100.

**Table 6.3. GERMAN FIRMS WITH EMPLOYEE PARTICIPATION  
IN CAPITAL, BY SIZE  
1987**

Firms by number of employees	Number of employees in %
Up to 100 employees	20.6
101-200	11.3
201-500	20.1
501-1.000	8.9
1.001-2.000	7.7
2.001-5.000	9.8
5.001-10.000	6.7
Over 10.000	14.9

Source: Guski and Schneider (1987).

**Table 6.4. GERMAN FIRMS WITH EMPLOYEE PARTICIPATION  
IN CAPITAL, BY INDUSTRY  
(in % of all firms)  
1987**

Mechanical engineering/automotive	13.4
Chemicals/petroleum processing	10.3
Metal production/metal working	9.8
Electricals/precision engineering/opticals	8.2
Construction trades	7.7
Commerce	6.7
Foodstuffs/consumption products	5.7
Banking/insurance	5.7
Energy	5.4
Services/transport	5.3
Stone/earthenware/ceramics/glass/const. materials	5.1
Textiles/leather/clothing	5.0
Printing	4.5
Publishing/media	3.1
Wood and paper processing	2.1
Other branches	2.0

Source: Guski and Schneider (1987).

Table 6.5. ECONOMIC EFFECTS OF PEPPER SCHEMES - EMPIRICAL EVIDENCE FROM GERMANY

Study	Method & Data Source	Results	PS: Profit-sharing
Cable and FitzRoy (1980)	Econometric model 42 PS firms 1972-76	Participation in decisions and incentive payments found to be interrelated, both having impact on performance. High participation firms out-performed low participation firms in terms of output per man (by 5%), output per unit of capital (177%) and profitability (33%), but not in terms of output growth at constant prices.	
FitzRoy and Kraft (1985)	A case study of one PS firm and another in workers' property	Statistical comparisons of key economic indicators with industry average 1971-82 suggest that PS firm had remarkable performance in terms of several indicators (sales, employment, gross investment etc.), but not the employee-owned firm.	
FitzRoy and Kraft (1986 & 1987)	Econometric model 65 metal-working PS firms 1977-79	Strong and positive effects of PS and worker ownership on profitability and productivity. No effect of profits on PS. PS firms larger and more profitable, have higher labour productivity and lower capital intensity than non-PS firms. Hence both PS and capital-sharing have strong effects on productivity.	
Cable (1987)	Critical evaluation of methods used in econometric studies	Points to some of the principal methodological weaknesses (index measures) of earlier econometric studies on Germany, thus questioning previous estimates, especially the positive effect of participation on productivity.	
Cable (1988)	Econometric model & interview survey 61 PS engineer. firms 1977-79	Systematic differences found in characteristics of PS firms and those with participation in decision-making. The coincidence of the two forms of participation quite low, casting doubts on arguments on productivity gains being dependent on the joint use of participation in decision-making and PS, and suggesting that in Germany Weitzman's condition for positive effects of PS (absence of workers' decision-making) may indeed be present. Firms with participation in decisions scored significantly higher in human capital; productivity at worst was not lower than in other firms. PS firms by contrast exhibit low indicators of embodied human capital and a propensity to more repetitive production methods.	
Cable and Wilson (1988)	Econometric model 61 PS engineer. firms 1978-82	Productivity differentials of 20-30% in favour of PS firms, evaluated as being the joint effect of a set of organizational factors (and not only PS). Characteristics of firms very different in Germany as compared to the UK.	
Hart and Hubler (1989)	Econometric model Socio-Economic Panel data, 1984 & 1985	The level of PS had a positive impact on average working hours. Contrary to Weitzman's claims, wages and profit shares do not act as substitutes; both wage and non-wage parts of income are positively associated with participation. The decision whether to participate is set at the individual level, and PS represents a worker's share in specific investment. 5.4% of 3628 individuals participate in PS schemes in Germany.	



## Chapter 7. FRANCE

### 7.1. GENERAL ATTITUDE

The first PEPPER schemes in France date back to the 1850s, and government support of schemes is not a recent phenomenon.<sup>45</sup> But despite its long history and some initiatives taken in the 1940s,<sup>46</sup> PEPPER has been actively encouraged by the government mainly from the late 1950s. Since then, PEPPER has been promoted by different political leaders including Pompidou, Giscard d'Estaing, Chirac and Soisson; but since de Gaulle was among its main advocators, PEPPER has always had a political connotation reflecting the political tendencies of primarily the Gaullist Party which was in office continuously (with a majority or in a coalition) from 1958 to 1981. During the past three decades, various types of PEPPER schemes have been encouraged. Compared to other European countries, France has had the longest tradition in institutionalized forms of PEPPER.

In 1959, Michel Debré's government (in particular Antoine Pinay) saw in profit-sharing a means for increasing labour productivity and improving enterprise performance. Since de Gaulle was also in favour of employee financial participation, such a positive general attitude effectively led to the system of profit-sharing introduced in 1959. However, there was fierce opposition to profit-sharing by both employers and the trade unions, especially by the biggest French trade union confederation CGT (*Confédération Générale du Travail*), which saw in profit-sharing an attempt to defuse workers' ability to fight. Such opposition is considered one of the main reasons why initially the number of profit-sharing schemes did not increase

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45. As early as 1885 the Senate proposed obligatory employee participation in company profits (which, however, was not adopted), while in 1917 the so-called "Briand" Law introduced the possibility for an enterprise to freely distribute "labour shares" to its employees, which gave them all the rights of other shareholders except voting rights (Bornard, 1989, p. 29).

46. In 1945, Renault introduced obligatory participation of employees in company profits, while in 1947 the government proposed the introduction of collective bonuses linked to productivity (see Bornard, 1989, p. 30).

substantially, in spite of state intervention intended to promote their diffusion (Sandoval, 1989).

During the 1960s, a form of deferred profit-sharing, to be termed "participation in the benefits of growth", was intensively discussed. General de Gaulle considered this form of employee participation "the big reform of this century",<sup>47</sup> a starting point for establishing a "third way", and Georges Pompidou was also in favour of participation. This led to the introduction, in 1967, of obligatory participation schemes in enterprises above a certain size. The aim of "participation" was primarily redistributive: to enable employees to share in the proceeds of growth, in addition to wages and as a result of productivity gains (rather than the aim of spurring productivity, as in the case of profit-sharing). Here again, legislative government measures provoked limited enthusiasm on the part of employers, and strong opposition of trade unions.

Finally, during the 1980s, a renewal of general interest in PEPPER schemes led to a number of additional government measures to stimulate their spreading. Employee share-ownership has been encouraged, first on the initiative of President Giscard d'Estaing, and later, in the second half of the 1980s, of Chirac's right-wing government under President Mitterand. A vast programme of privatization was launched in 1986, intended to develop "genuine popular capitalism" or a "rightist" model of participation, with special advantages granted to employees acquiring shares of their enterprise (Sandoval, 1989; Jacob, 1989). At the same time, in order to further stimulate existing forms of PEPPER, the legislation has been improved and harmonized in 1986. The 1986 legislation has been amended in 1990, after a long debate and suggestions contained in the "Bornard Report" (Bornard, 1989).

Thus today there is a general political consensus that PEPPER schemes should be encouraged through official government policies, although the position of the trade unions remains ambivalent,<sup>48</sup> and there is disagreement over certain issues such as

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47. De Gaulle in 1967 declared "La participation, voilà la grande réforme de ce siècle!" (in Vaughan-Whitehead, 1989).

48. PEPPER is in general accepted by the CFDT (*Confédération Française Démocratique du Travail*) and the CGT (*Confédération Générale du Travail*), and these two trade unions are the ones which have most frequently participated in signing participation agreements; it is officially opposed by FO (*Force Ouvriers*) although this trade union in practice often includes schemes in its negotiations.

welfare contribution exemptions. The government remains concerned about the risk that employees may bear as a result of profit-sharing and about the possible substitution of profit-sharing for wage increases.<sup>49</sup> Nevertheless, in an official statement in September 1989, Prime Minister Rocard has emphasized that profit-sharing should be one of the government priorities. The principal objectives of PEPPER schemes stressed today is to provide employees with a stake in the equity of their firm, increase workers' motivation and efficiency, mobilize savings, and promote investment.

## 7.2. LEGAL AND FISCAL FRAMEWORK

The three principal forms of PEPPER encouraged by fiscal concessions in France are cash-based profit-sharing, participation in the benefits of growth, and employee share-ownership (see Vaughan-Whitehead, 1990). For each of these forms, specific laws have been adopted at the time of their introduction. These laws have subsequently been harmonized in a 1986 law regulating all types of PEPPER schemes. In November 1990, a new law has been adopted partly modifying the existing legislation.

1) **Cash-based profit-sharing (1959).** Although a government Decree of 17 September 1955 already gave enterprises introducing profit-sharing exemption from social security contributions (Bornard, 1989, p. 30), the first general law on profit-sharing in France was a government Decree adopted in 1959 (*Ordonnance du 7 janvier 1959*).<sup>50</sup> The Decree introduced a voluntary system of cash-based profit-sharing (*l'intéressement des salariés*), consisting of a periodic distribution to all

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49. Although a 1975 government Decree had specified that a profit-sharing bonus is not considered part of the basic wage and cannot substitute a wage increase, this provision was not included in the 1986 legislation (Bornard, 1989, pp. 12-13).

50. Decree no. 59-126 of 7.1.1959, modified by the law 73-1197 of 27.12.1973, decrees of 29.8.1959, 21.5.1960, and 17.5.1974, and a circular interministry document of 5.5.1975.

workers of a cash bonus linked to firms' profits, productivity gains, or other.<sup>51</sup> The legislation does not provide a formula, which is left to the negotiating parties to decide.

According to the 1959 legislation, the scheme could be applied by all, except certain public enterprises.<sup>52</sup> In order to have the right to tax exemptions the enterprise had to submit a request for approval to a special commission,<sup>53</sup> and acceptance was subject to the fulfilling of very precise conditions: the contract had to be for a period of 3 years; the scheme had to be economically justified and could not guarantee a minimum payment; beneficiaries, period, and modes of payment had to be specified; the period of payment had to differ from that of paying regular wages; the scheme had to be collective, applied to all workers on a non-discriminatory basis; the amount dedicated to profit-sharing could not surpass a maximum percentage of the wage bill; and different channels of informing workers had to be secured. Under these conditions, bonuses distributed to workers were exempt from company tax, from the tax on wages and salaries, and from social security contributions, but individual workers' bonuses were normally taxed.

In October 1986 a new Decree was adopted (*L'ordonnance de 1986*)<sup>54</sup> in order to harmonize the different laws and introduce stronger incentives for all existing PEPPER schemes. The 1986 legislation on profit-sharing removed some of the principal obstacles to its diffusion present in the 1959 law (time-consuming and complicated obligatory authorisation, administrative intervention, etc.). Thus ex-ante approval of profit-sharing agreements has been abandoned, except in the case of some public sector firms (but approval no longer involves CERC). The amounts devoted to profit-sharing can now be as much as 20% of the gross payroll, which is considerable.

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51. Thus the term "cash-based profit-sharing" may not be a fully satisfactory translation of "intéressement", since the bonus may be related to indicators other than profits. Nevertheless, in the English language literature, profit-sharing is the usual term adopted.

52. Those public enterprises where employees are protected by a special "statut", comprising mostly monopolies.

53. In case the commission refused approval, the agreement was sent to the Minister of Labour, who sought an opinion from the Centre d'étude des revenus et des coûts (CERC).

54. "Décret de la République française fixant les conditions d'application de l'ordonnance no. 86-1134 du 21 octobre 1986 relative à l'intéressement et à la participation des salariés aux résultats de l'entreprise et à l'actionnariat des salariés", amended by Decree no. 87-544 of 17 July 1987 and a document DRT no. 88-4 of 29 January 1988.

Individual workers receive certificates stating the amount of profits realized in the current period, as well as the percentage of profits they are entitled to. A major difference with respect to the previous law is that several contracts on profit-sharing can be signed within the same enterprise (and hence different contracts for different groups of workers), a provision explicitly requested by the French Employers Federation.<sup>55</sup>

Workers are now also offered tax benefits: if an employee decides to put his profit-sharing bonus in the enterprise's Savings Plan (*Plan d'épargne d'entreprise* - PEE), the bonus is exempt from income tax.

Part of the 1986 legislation on PEPPER has been amended in recent years. In 1987, a decree has extended profit-sharing to all public sector firms,<sup>56</sup> while directives issued in 1989 by the Prime Minister have limited the size of profit-sharing bonuses in the public sector to 4% of the gross wage bill when profits are positive, and to 2% in the case of companies making a loss.<sup>57</sup>

The 1990 Law has introduced the following modifications.<sup>58</sup> The maximum amount that can be devoted to profit-sharing is now 10% of workers' gross wages, except in enterprises which at the moment of introducing profit-sharing had been applying an enterprise or sectoral wage agreement for at least three years, in which case it can be 15% of the wage bill. However, there is no limit if profit-sharing bonuses exceeding 15% of gross wages are put into the Savings Plan of the enterprise. The amount an individual worker can receive on the basis of profit-sharing cannot be larger than half of the maximum average sum retained for social security contributions.

**2) Participation in company growth (1967).** A new Decree was adopted in 1967 (*Ordonnance du 17 août 1967*) introducing the obligatory participation of employees in the benefits of company growth (*participation aux fruits de*

55. CNPF - *Conseil national du patronat français*.

56. Decree no. 87-948 of 26 November 1987.

57. "Intéressement dans les entreprises du secteur public", Circulaire du Premier Ministre, 7 décembre 1989.

58. See Law no. 90-1002 of 7 November, 1990, in *Journal Officiel*, 11 novembre 1990.

*l'expansion*),<sup>59</sup> in all enterprises employing more than 100 workers and those which enjoy fiscal benefits (concerning company tax or income tax); for enterprises employing less than 100 workers, the scheme was voluntary. In November 1990, participation schemes have become compulsory for all enterprises employing more than 50 workers.

According to standard provisions, an enterprise must set aside a certain amount of its profits (where there are any) which cannot be converted into cash for a period of 5 years but must remain frozen in the Special Reserve of Participation (*Réserve Spéciale de Participation* - RSP). The profits put into the RSP are one half of taxable profits, after deducting a remuneration on capital employed of 5%, multiplied by the ratio of total wages to value-added, intended to reflect the proportionate contribution made by the labour force to profits (Rémus, in Bell and Hanson, 1989, p. 96). Thus the standard formula used to calculate the RSP is the following (Bornard, 1989, p. 8):

$$RSP = \frac{1}{2} \times (B - \frac{5 \times C}{100}) \times \frac{S}{VA}$$

where B = net taxable profits;  
 C = own capital;  
 S = gross wages  
 VA = value added

However, an agreement may specify that the RSP will be calculated differently, provided that the resulting benefits accruing to employees are at least equivalent to those provided by the standard formula, and that the RSP does not exceed certain levels (Pérotin, 1990).<sup>60</sup>

All workers, without discrimination, benefit from the RSP, but the amount any individual can be allocated is subject to two limits: the salary for determining the share of each employee must not exceed four times the maximum salary retained for social security contributions, and the actual share per employee must not exceed half of the

59. Regulated by Decree no. 67-693 and 67-695 (17.8.1967), laws no. 73-150 (27.12.1973) and 76-463 (31.5.1976), and decrees of 19.12.1967, 30.5.1968, 31.1.1968, 31.5.1969, 17.5.1974 and 30.12.1976.

60. Until 1986, approval of such non-standard participation agreements was conditional upon a positive recommendation from CERC (Centre d'étude des revenus et des coûts).

maximum salary so determined (Rémus, in Bell and Hanson, 1989, p. 96). Workers cannot withdraw their shares before the retention period has expired (only in some cases specified by law),<sup>61</sup> although during the retention period interest may be paid out annually to the recipient employees (Pérotin, 1990).

The RSP can be used in different ways: for buying different types of securities inside or outside the company, setting up an enterprise investment fund, or it can be directed towards the enterprise's Savings Plan (PEE). An employee can voluntarily put into the PEE additional resources, up to a limit of one fourth of his annual gross earnings, and so can the enterprise but also up to a limit per employee per year, which is then exempt from tax. Funds put into the PEE can in turn be invested either in different types of securities in the name of workers or for the constitution of company investment funds which are under the control of a supervisory board including both representatives of the employees and of the employer (Rémus, 1990). Participation agreements must also ensure a way of informing workers on the accountance of the RSP and the distribution envisaged.

The enterprise has substantial financial benefits. The RSP is considered a cost deductible from taxable profits, and is exempt from company tax and from social security contributions. Employees benefit from exemption from income tax and social security charges.

Since 1986, funds can be frozen for only 3 years (instead of 5) on condition that participation has been the subject of a collective bargaining agreement,<sup>62</sup> but in this case tax exemption on the amount allocated to employees is reduced to one half. In case an enterprise puts into the RSP larger amounts than the minimum determined by the law, it will have the right to a tax-deductible provision on investments, up to 15% over the minimum amount in the case of a 3-year retention period, and up to 30% in the case of a 5-year retention period (Rémus, in Bell and Hanson, 1989, p. 96), but

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61. In the case of retirement, buying one's home, leaving the enterprise, or other "force majeure".

62. Where no agreement exists, funds are frozen for 8 years (Pérotin, 1990).

tax concessions are lost on the investment provision if it is not used within a year.<sup>63</sup> The enterprise can now put into the PEE up to a maximum of FF 10,000 per year per employee, which may be as high as FF 15,000 if funds are used for buying the enterprise's securities, but no more than three times the amount voluntarily contributed by workers, which is exempt from tax (Bornard, 1989, p. 9).

The different tax benefits offered to enterprises and employees by the 1986 legislation on profit-sharing and participation are presented in Table 7.1 (Appendix to Chapter 7).

**3) Employee share-ownership.** During the 1970s and the 1980s, a series of measures have been adopted to encourage different types of employee share-ownership, including share options, free distribution or preferential offers of shares to employees, enterprise wage-earners' funds, and employee buy-outs. Employee share-ownership schemes are applicable in all firms, quoted or not quoted on the stock exchange, and significant tax reductions are envisaged.

a) *Share options (1970, amended in 1984-85 and 1987).* The law of 31 December 1970 introduced share options (*options de souscriptions ou d'achat d'actions*), offering options to employees to purchase company shares at a price fixed at the time the option is granted, under favourable tax conditions for both the enterprise and the employee.<sup>64</sup> The law was amended in 1984-85 when the permissible discount on options was fixed at 10%, and again in 1987 when the discount was increased to 20% and further tax incentives were offered. Today the permissible discount on options remains the same (20%), but according to provisions of the 1990 Finance Act, only 10% is exempt from income tax.

63. These provisions are less generous than those prior to 1986; initially, the permissible amount was 100% of the RPS, reduced to 80% in 1973, to 65% in 1974, to 50% in 1975 and finally to 0 in 1985, before being brought up to 15-30% in 1986 (Pérotin, 1990).

64. These are similar to stock options in the USA, but differ because they are not reserved only for executives.



b) *Offers of shares on preferential terms (1973, 1986, 1987)*. The law of 27 December 1973, which is still in force, created share-ownership plans (*plans d'achat d'actions*), giving the possibility of issuing (or buying back from the market) shares reserved for employees and offered at preferential conditions. The 1986 legislation allows for share-ownership plans within the company's PEE, giving the enterprise the possibility of contributing more towards these funds and generous tax benefits. Measures to encourage workers' acquisition of company shares have also been taken when a number of large public companies were privatised in 1986. Finally, the 1987 Law on savings permits a discount of 20% on shares bought by employees and deferred payment (up to 3 years), but shares must be frozen for 5 years.

c) *Free distribution of shares (1980)*. This type of scheme was introduced already in 1917 (see above). More recently, it was regulated by the law of 24 October 1980, which allowed the free distribution to employees of up to 3% of shares in public limited companies, where the state has provided for partial payment of shares given to employees. However, the law has since been repealed.

d) *Wage-earners' funds (1983)*. A law adopted on 29 December 1983 created wage-earners' funds, with the intention of enabling employees to benefit from putting their savings into a common enterprise fund, which is then invested. The resources are frozen for a period of 5 years, during which the company pays the worker interest which can be deducted from company tax. For the employee, the savings put into the fund bring him a tax credit of 25% within the maximum limit of FF 5,000 per year, while interest received is taxed in the same way as private bonds. Wage-earners' funds have been superseded by the 1986 legislation, although allowing those created before 1986 to continue functioning (Rémus, 1990).

e) *Employee buy-outs (1984)*. The law of 8 July 1984 is intended to promote employee buy-outs (*reprise d'entreprises par leurs salariés* - RES).

Therefore, the main aim of the recent legislation is to provide a direct link between the various forms of PEPPER. It is meant to promote profit-sharing as a scheme based on the philosophy of variable remuneration, while retaining existing participation in benefits of company growth based on the philosophy of savings, and stimulating employee share-ownership. Both profit-sharing and participation bonuses should be oriented towards the Savings Plan of the enterprise, which ought to become the main source for a privileged support of workers' share-ownership. Thus the different forms of PEPPER are all to be oriented towards the enterprise's Savings Plan (profit-sharing bonuses, participation bonuses, voluntary contributions by workers and by the enterprise).

### **7.3. PEPPER SCHEMES IN PRACTICE**

The three types of PEPPER schemes applied by French enterprises today are cash-based profit-sharing, participation in the benefits of growth, and employee share-ownership. Table 7.2 (Appendix) presents the number of agreements and the number of employees covered by the two main forms - profit-sharing and participation - from the end of the 1960s to date, as provided by official French statistics.

1) **Cash-based profit-sharing.** Until 1984, profit-sharing had limited success. Since then profit-sharing has expanded very rapidly, especially after the introduction of the 1986 legislation. The number of both agreements and employees covered has more than doubled from 1984 to 1987, when there were some 2,630 agreements on profit-sharing covering 730,000 workers. The number of profit-sharing agreements again doubled in 1988, reaching 4,600 agreements at the end of the year, and by the end of 1989, a total of 6,980 agreements had been signed, covering almost 1.4 million employees (see Table 7.2, Appendix). However, employees covered by profit-sharing schemes do not always receive a bonus, usually because the company does not make enough profits.

The distribution of profit-sharing agreements by company size reveals that the large majority of firms which introduce profit-sharing are small enterprises: in 1986-88, 75% of profit-sharing agreements in force were in enterprises employing less than 100 employees (see Table 7.3., Appendix). As to the sectoral distribution, the principal sectors where profit-sharing is wide-spread are trade and transport (31% of total), services (23%), and the steel and metal industry (17%) (Ministère... 1990, p. 68).

The profit share per employee remains, on average, relatively low, although it has been increasing in recent years. Whereas in 1983, the profit share per employee, in nominal terms, was FF 2,335 (about 3% of average earnings), by 1986 it rose to FF 3,739 (3.6% of the wage bill), to FF 4,662 in 1988 (4.1% of the wage bill), and further to FF 4,930 in 1989. The average profit share is highest in small enterprises and tends to decrease with company size: in 1988, it was FF 9,794 in enterprises with less than 10 employees (7.6% of the wage bill), and only FF 4,626 in those with 2,000 or more employees (4.3% of the wage bill) (see Table 7.4., Appendix). In comparison with such collective profit-sharing schemes, individual workers' bonuses are decreasing in importance, as in 1986 individual incentives involved only 6.5% of employees, compared to 10.2% in 1978 and 14% in 1972 (Sandoval, 1989).

More detailed information on the application of profit-sharing schemes, including interesting case studies, is contained in PENN (1988), and Bornard (1989).

2) **Participation in company growth.** Compared with profit-sharing, participation agreements are much more numerous: over 10,000, being applied by more than 12,000 enterprises and covering 4.5 million workers in 1988-89. Nevertheless, since 1977 the number of both agreements and of workers covered has been more or less stagnating (see Table 7.2, Appendix). In 1987 there has actually been a *decrease* in the number of participation agreements, enterprises and employees covered with respect to 1986; a possible explanation is that, following the 1986 legislation

encouraging cash-based profit-sharing, many small firms which originally had introduced participation have switched from participation to profit-sharing.<sup>65</sup> After 1988, there was a further increase in the number of agreements, enterprises and workers covered by participation and by the end of 1989, the number of agreements reached 10,219, while workers covered were 4,573,972.

Not all workers covered by participation schemes actually benefit; the number of beneficiaries was 2,729,313 in 1986 (as compared to 4,524,282 covered). Around 70% of all participation agreements in 1988 used the standard formula for the calculation of the RSP (Ministère... 1990, p. 14). Very few companies seem to have chosen a retention period of 3 years (including reduced tax advantages), as compared with the retention period of 5 years which remains the rule (Rémus, 1990).

The distribution of participation agreements by company size shows that although medium-sized enterprises remain the prevalent category, an increasing number of small firms, until 1990 not subject to obligatory introduction of participation agreements, has been introducing them (see Table 7.3, Appendix). Indeed, the percentage of enterprises employing less than 100 workers adopting participation schemes on a voluntary basis has increased from 13.6% in 1972 to almost 36% in 1988 (Ministère... 1990, p. 15). Hence the large number of participation agreements is only in part due to the obligatory nature of the scheme.

The sum allocated to employees through participation is small relative to other types of bonuses. In 1986, the average share per employee in the RSP was FF 3,527 in nominal terms (around 3.4% of the wage bill) but, as in the case of profit-sharing, the amount is substantially higher in smaller companies introducing participation on a voluntary basis (with 1-50 employees FF 6,774, and with 51-100 employees FF 4,385). Elsewhere the amount is around the overall average (see Table 7.4, Appendix). Profit shares represent under 2% of the wage for 43% of the employees that received any, and 2-5% of the wage for another 37% of beneficiaries.

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65. However, since the number of participation agreements is in part a function of the number of companies with over 100 employees, this may also be related to the recent recession (Pérotin, 1990).

A comparison of the average amounts workers are allocated on the basis of the two types of PEPPER schemes - participation and profit-sharing - reveals that the average profit share per worker from participation is only slightly lower than the average amount from profit-sharing (FF 3,527 respect to FF 3,739). In smaller firms, however, employees are in general allocated more on the basis of profit-sharing than on the basis of participation.<sup>66</sup> It is also of interest to note that an increasing number of enterprises (1,391 in 1988 as against 832 in 1987) have applied both participation and profit-sharing simultaneously (Ministère... 1990, p. 17).

The sectoral distribution of participation agreements reveals that they are applied in a wide range of industries, but the distribution seems heavily influenced by the size requirement; thus there is a prevalence in steel and metal industry, trade and transport, followed by services and food-processing (Ministère... 1990, p. 18).

Participation schemes seem to have fulfilled the objective of increasing enterprise savings, but not entirely the objective of increasing workers' involvement envisaged by the law, since a system of informing workers was frequently lacking, as well as their effective participation in decision-making (Sandoval, 1989; Vaughan-Whitehead, 1989). A 1979 survey suggests that the first ten-year experience in applying participation had not been very satisfactory: only 10% of interviewed workers considered progress had been made, while 73% considered little, or no progress had been made (see Ministère..., 1979, p. 14).

The overall experience in participation schemes can nevertheless be evaluated as positive. It is worth recalling that when first introduced in 1967, participation was strongly opposed by both employers and trade unions, and it is through political pressure that its obligatory introduction was imposed on enterprises, as part of workers' rights and with the objective of achieving more social equity (Rémus, 1990). The fact that today over 30% of enterprises adopting participation do so on a voluntary basis, is also indicative.

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66. However, there are difficulties in comparing these amounts, as in the case of participation there are delays in determining the actual amounts allocated to employees.

3) **Employee share-ownership.** No comprehensive information is available on the incidence of employee share-ownership. In the past, employee share-ownership schemes had very limited success: in 1971, only 25 enterprises had applied them, involving some 40,000 workers. In 1978, only 7% of Renault shares were held by workers (out of a 25% maximum allowed), as most workers had sold their annual quota as soon as they were allowed to.<sup>67</sup> More recent experience is mixed, but in general share-ownership schemes do not seem to have been very successful.

a) *Share options.* An estimate indicates that since the introduction of the 1970 law on share options, only 40 share option schemes have been introduced in the whole 1971-84 period (Bornard, 1989, p. 57). A recent survey undertaken by a French bank (BRED) based on 200 enterprises' respondents found that 8% of firms had introduced employee share options (as compared to 30% which had profit-sharing) (Bornard, 1989, p. 72); however the sample only included enterprises with up to 1000 employees, whereas today it is mainly large enterprises which introduce share options in France. According to a recent estimate, a minimum of 500-600 large companies quoted on the stock exchange have share options plans (Rémus, 1990).

b) *Offers of shares at preferential terms.* In 1986, on the occasion of privatization and the sale of a dozen large holdings,<sup>68</sup> around 10% of shares were reserved for employees, and most have been subscribed. However, the larger part was bought by executives; employees who did subscribe, did so for purely speculative reasons (Jacob, 1989). The stock exchange crash in October 1987 dampened enthusiasm and employees do not seem any longer prepared to share the risks and losses of a company over which they have no control (Sandoval, 1989). The recent BRED survey found

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67. However, Renault is a very special case, being a public sector firm, one of the few that still has employee share-ownership, and the first to have passed a law in 1945 allowing workers to have shares is the company (Pérotin, 1990).

68. Industries Saint Gobain and CGE, banks such as Société Générale and Crédit Commercial de France, financing institutions such as Suez et Paribas, and mass-media such as Tfl and Havas (Jacob, 1989). Some of the privatisations concerned companies that had been nationalized in 1982. Nationalisation had also introduced workers' representation on company boards (the "Auroux" laws) which has only partly been maintained after privatisation in 1986-88 (e.g. in subsidiaries) (Pérotin, 1990).

that 11% of firms within a sample of 200 enterprises had share-ownership plans (Bornard, 1989, p. 72).

c) *Free distribution of shares.* Not many enterprises have freely distributed shares to their employees as envisaged by the 1980 law: in 1987-88, around 350 firms (of which 2/3 were quoted companies), benefitting some 600,000 workers. The total value of freely distributed shares was FF 2 billion, while the average share per employee was FF 3,252 (see Table 7.5, Appendix).

d) *Employee buy-outs.* The most well-known examples of employee buy-outs are the large watch manufacturers LIP, the Manuest furniture factory, and Moulinex (see Bradley and Gelb, 1983). The French Cooperative Federation (*Confédération générale des SCOP*) has in the past decade been encouraging workers' buy-outs of sound companies (unlike LIP or Manuest) under the form of cooperatives, and in the past decade there have been about 10-20 such buy-outs per year (Pérotin, 1990).

#### 7.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES

Empirical work on PEPPER schemes in France has so far been limited. The most comprehensive study undertaken so far is a recent research (Vaughan-Whitehead, 1989, 1990), which offers a very detailed analysis of PEPPER schemes and is also the first econometric study using French data.<sup>69</sup> The data were collected in 1987 with the help of a professional agency,<sup>70</sup> while the research was based on several different sources.<sup>71</sup>

69. Several econometric studies have tested the effects of profit-sharing in France, but on a sample of cooperatives and not capitalist firms (see e.g. Defournay, Estrin, Jones, 1985).

70. CEGOS in collaboration with *l'Institut de l'entreprise*.

71. A questionnaire sent to employees in 7 large enterprises in which PEPPER schemes were especially developed, interviewing 300 workers; a questionnaire for managers sent to over 4,000 enterprises, of which there were 193 respondents; and an econometric analysis testing some of the principal theoretical arguments on profit-sharing.

Employees' answers to some of the questions revealed that profit-sharing is generally more popular than participation schemes or employee share-ownership (see Table 7.6, Appendix). Although the majority of workers were in favour of all three types of schemes (89%, 74% and 72% for participation, profit-sharing, and share-ownership respectively), when asked whether the scheme had had a positive influence on workers' behaviour, or the general climate in the enterprise, a larger percentage of workers gave a positive answer for profit-sharing (41%) with respect to those for participation and share-ownership (30% and 18% of positive answers respectively). Around 26% of workers considered they were sufficiently informed on profit-sharing (10% thought they were not); 35% considered they were sufficiently informed on participation (but 43% that they were not); while the answers on share-ownership were divided (Vaughan-Whitehead, 1989).

One of the main reasons for the negative attitude of workers towards participation was obligatory retention and the nature of the scheme as a form of forced savings, thus offering support to the hypothesis that cash-based profit-sharing is likely to have a more positive impact on motivation than deferred profit-sharing. Another interesting conclusion of the research, contrary to Weitzman's prediction but in line with evidence from other European countries, is that an overall improvement in enterprise performance through increased incentives is more likely to be achieved if profit-sharing is accompanied by giving workers some say in decision-making (Vaughan-Whitehead, 1989).

Managers' opinions revealed that the different schemes have not equally provided for the achievement of some of the principal social and economic objectives of their introduction. The objective of improved enterprise performance does seem to have been attained through profit-sharing and share-ownership, but less so through participation. The objective of wage cost flexibility was not fulfilled through participation schemes, whereas 84% of enterprises considered that profit-sharing did bring about higher flexibility. The analysis also revealed that, until 1986, mainly small and



medium-size enterprises were adopting profit-sharing schemes; after the 1986 legislative changes, several large enterprises have also adopted profit-sharing (such as Renault, Casino and EDF) (Vaughan-Whitehead, 1989).

Econometric estimates of the effects of PEPPER schemes offer interesting results. The presence of productivity effects of the different types of PEPPER schemes was generally confirmed. However, the effects were more pronounced in firms with cash-based profit-sharing which had higher productivity, profitability and sales, lower absenteeism rates and less pronounced turnover with respect to enterprises without such schemes.

Support was also found for the wage flexibility argument. Firms with cash-based profit-sharing had adjusted labour remuneration more frequently than employment, and the positive impact of profit-sharing on the maintenance of employment and on employment growth was generally confirmed. However, contrary to Weitzman's contention, both firms and workers do not consider the base wage as the marginal cost of labour, but include profit-sharing in such costs. The level of the base wage was found to have a very significant and negative effect on employment, whereas the impact of profit-sharing on employment (via productivity increases) was found to be positive and significant. The results also indicated that profit-sharing bonuses were directly linked to profitability, reinforcing the wage flexibility argument of profit-sharing and suggesting that profit-sharing is not being introduced only because of tax incentives.

In firms applying participation schemes, employment was less stable and such schemes do not seem to have had a significant impact on employment (Vaughan-Whitehead, 1989). This was, however, to be expected, considering that the RSP is a function of employment in the firm (through the ratio between wages and value added) (Pérotin, 1990).

## APPENDIX TO CHAPTER 7

**Table 7.1. FISCAL BENEFITS PROVIDED FOR PEPPER SCHEMES IN FRANCE**  
(1986 legislation)

	Profit sharing	Participation (3-year retention)	(5-year retention)
<b>Employee</b>			
Social security contributions	no	no	no
Income tax	yes*	1/2 taxed	no
<b>Enterprise</b>			
Social security contributions	no	no	no
Company tax	no	no	no
Investment provisions	-	15%	30%

\*Unless profit-sharing bonuses are put into the Savings Plan of the enterprise.

Source: Balladur et al, (1986).

**Table 7.2. FRANCE: DIFFUSION OF PRINCIPAL TYPES  
OF PEPPER SCHEMES  
1969-1988**

Year	Profit sharing		Participation		
	Number of agreements	employees*	Number of agreements	Number of companies	employees*
1969			1,503	1,720	
1970			3,252	4,298	
1971	219		6,863	7,576	3,403,000
1972			7,526	8,418	3,654,935
1974			9,291	10,443	4,666,375
1975			9,581	11,769	4,730,943
1976			9,852	11,049	4,729,135
1977	344	125,400	9,936	11,195	4,773,600
1978			10,178	11,509	4,969,802
1979			10,345	11,711	4,984,159
1980	575		10,091	11,453	4,878,937
1981	637		10,225	11,612	4,842,194
1982	845	255,800	10,360	11,759	4,832,104
1983	918	293,100	10,408	11,926	4,757,851
1984	1,086	335,200	10,483	12,090	4,698,904
1985	1,303	401,530	10,336	11,965	4,549,940
1986	2,162	589,540	10,253	12,019	4,524,282
1987	2,630	729,295	10,018	11,797	4,408,231
1988	4,600	984,811	10,111	12,001	4,478,214
1989	6,980	1,390,000	10,214	n.a.	4,573,972

\*The figures refer to employees covered by a scheme.

Source: Ministère du travail, de l'emploi et de la formation professionnelle (1990).

**Table 7.3. PEPPER SCHEMES IN FRANCE, BY ENTERPRISE SIZE**

**Profit-sharing**  
(in % of agreements)  
**1986-1988**

Firms by number  
of employees

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1-9	19.8
10-49	37.8
50-99	16.9
100-199	9.8
200-499	8.4
500-1999	5.7
2000 or more	1.6

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**Participation**  
(in % of companies)  
**1987-1988**

Firms by number  
of employees

	1987	1988
50 or less	21.4	21.8
51-100	14.1	13.9
101-500	50.9	50.7
501-1000	7.5	7.5
1001-5000	5.2	5.2
More than 5000	0.6	0.6

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**Source:** Ministère du travail...(1989), (1990).

**Table 7.4. PEPPER SCHEMES IN FRANCE: AVERAGE PROFIT SHARE  
PER EMPLOYEE BY COMPANY SIZE  
1984-1988**

**Profit-sharing**  
(average profit share per employee)

Firms by number of employees	1986		1987		1988	
	In FF	As % of wage bill	In FF	As % of wage bill	In FF	As % of wage bill
1-9	10,659	8.3%	10,109	8.2%	9,794	7.6%
10-49	5,739	5.4%	6,442	5.6%	6,432	5.2%
50-99	4,809	4.9%	5,309	4.7%	5,292	4.7%
100-199	5,136	4.7%	4,799	4.1%	4,725	4.0%
200-499	4,706	4.2%	4,274	3.8%	4,378	3.8%
500-1999	4,960	5.4%	4,037	3.6%	4,303	3.4%
Over 2000	2,944	2.7%	2,530	2.3%	4,626	4.3%
<b>Average</b>	<b>3,739</b>	<b>3.6%</b>	<b>3,385</b>	<b>3.0%</b>	<b>4,662</b>	<b>4.1%</b>

**Participation**  
(average share per employee in the RSP)

Firms by number of employees	1984		1985		1986	
	In FF	As % of wage bill	In FF	As % of wage bill	In FF	As % of wage bill
1-50	5,900		6,452		6,774	
51-100	3,207		3,279		4,385	
101-300	2,319		2,609		3,300	
301-500	2,481		2,883		3,705	
501-1000	2,588		3,114		3,596	
1001-5000	2,453		2,731		3,623	
Over 5000	2,877		3,034		3,359	
<b>Average</b>	<b>2,606</b>	<b>2.86</b>	<b>2,900</b>	<b>2.95</b>	<b>3,527</b>	<b>3.40</b>

Source: Ministère du travail... (1989), (1990).

**Table 7.5. FREE DISTRIBUTION OF SHARES TO EMPLOYEES IN FRANCE  
1987-1988**

	<u>Number of companies</u>		
	<u>TOTAL</u>	<u>Quoted</u>	<u>Unquoted</u>
Number of companies	350	220	130
Number of shares distributed	5,901,546	5,401,140	500,406
Value of shares distributed (in FF)	1,940,834,006	1,744,750,620	196,083,386
Number of beneficiaries	596,830	532,831	63,999
Average share per beneficiary (in FF)	3,252	3,274	3,064

Source: Ministère du travail... (1990), p, 71.

**Table 7.6. EMPLOYEES' ANSWERS TO SOME QUESTIONS  
ON PEPPER SCHEMES IN FRANCE (in % of answers)  
1987**

	<u>Participation schemes</u>		<u>Profit-sharing</u>		<u>Employee share-ownership</u>	
	<u>YES</u>	<u>NO</u>	<u>YES</u>	<u>NO</u>	<u>YES</u>	<u>NO</u>
Has the scheme had a positive impact on your behaviour or the general climate in the firm?	30	40	41	24	18	36
Are you in favour of introducing these schemes (do you regard them as a "good thing")?	89	1	74	3	72	4
Are you sufficiently informed on these schemes?	35	43	26	10	27	27

**Note:** The totals do not add up to 100; the difference are all employees who answered that they "did not know".

**Source:** The CEGOS Survey, June 1987, as reported in Vaughan-Whitehead (1989), p. 6.

## **Chapter 8. GREECE**

### **8.1. GENERAL ATTITUDE**

Although some forms of PEPPER have enjoyed favourable fiscal treatment already since 1974, it is primarily during the 1980s, and especially after 1987, that the Greek government has actively supported PEPPER schemes through legislation offering tax incentives to both enterprises and employees. Thus today, there is a special legal framework for employee participation in both enterprise profits and assets. As to the position of the trade unions, although in the past the General Confederation of Greek Workers was somewhat opposed to the promotion of PEPPER schemes,<sup>72</sup> today, together with public sector trade unions, they in general support them.

The political scene in Greece is therefore characterized by a growing support for PEPPER schemes. During 1990, two official texts on the general economic situation which were widely publicized - the Report of Professor Angolopoulos published a week before the April 1990 elections, and the Programme Declarations of the new government of Constantine Mitsotakis - refer to the necessity of encouraging further schemes of workers' participation in enterprise profits.

### **8.2. LEGAL AND FISCAL FRAMEWORK**

The legal framework for PEPPER schemes in Greece bears similarities with that of several other EC countries. Employee participation in enterprises operating surplus through profit-sharing, or the distribution of shares to employees, is based on

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72. It probably related such schemes to other mechanisms it was also not in favour of (such as the linking of wages and salaries to productivity) which have been among the priority issues for employers.

several provisions provided in different laws adopted primarily since 1984.<sup>73</sup> Provisions of these laws regulate two principal types of PEPPER schemes, namely cash-based profit-sharing and employee share-ownership. All PEPPER schemes in Greece are voluntary.

1) **Cash-based profit-sharing.** Joint stock companies are allowed to distribute part of their net revenue or profits to their employees in cash. However, there is a ceiling on both the global amount of profits that can be distributed, and on the amount an individual employee can receive. Profits distributed to employees may not exceed 15% of annual net profits,<sup>74</sup> while the amount given to each employee may not exceed 25% of his total gross annual remuneration, as recorded in the firm's payroll.<sup>75</sup>

Joint stock companies adopting this form of profit-sharing have the obligation to draw up a detailed list enumerating the beneficiaries, and the amounts granted to each individual employee. A copy of this list must be sent to the workers' council established under Law no. 1767/1988<sup>76</sup> within a month of approval of the decision to distribute profits, which is taken at the shareholders' regular general meeting.

Both employees and enterprises are granted tax benefits. For the employees, net profits distributed are not considered as remuneration of personnel, unlike bonuses in general.<sup>77</sup> In addition, for taxation purposes, they are considered not as income from services provided but as income from movable goods.<sup>78</sup> Likewise, distributed profits are not included when calculating employees' social security contributions to organizations and funds providing basic and supplementary social security.<sup>79</sup> For the

73. Among the most important are the following: Law no. 1473/1984, Article 9 (Bulletin of the Greek Government 127/A of 7 September 1984); Law no. 1731/1987, Article 18 (Bulletin of the Greek Government 161/A of 9 September 1987); Presidential Decree no. 30/1988 (Bulletin of the Greek Government 132/A of 21 January 1988); Law no. 1882/1990, Article 12 (Bulletin of the Greek Government 43/A of 23 March 1990); Law no. 1892/1990, Article 43 (Bulletin of the Greek Government 101/A of 31 July 1990); Presidential Decree no. 129/1989, Article 21 (1) (Bulletin of the Greek Government 62/A of 3 March 1989).

74. See Art. 15 of Law no. 2190/1920.

75. See Art. 12(1), first and second indents of Law no. 1882/1990.

76. See Bulletin of the Greek Government 63/A, 1988.

77. Under the terms of Art. 9 of Law no. 1479/1984 and Art. 18 of Law no. 1882/1990.

78. Art. 21 (1) of the Income Tax Code, Presidential Decree no. 128/1989.

79. Art. 43 (3) of Law no. 1892/1990.



employers, such net revenue/profits distributed to employees is not subject to income tax,<sup>80</sup> and since 1990 is exempt from employers' social security contributions.<sup>81</sup>

2) **Employee share-ownership.** In principle, shares transferred to firms' own employees in the form of gifts or bequests have enjoyed favourable tax treatment since 1974, provided the shares remained non-negotiable for 5 years after transfer.<sup>82</sup> However, a number of legal obstacles had to be removed before this provision could be implemented on a regular basis. The first step towards the introduction of the new regime was to allow joint stock companies to acquire their own shares, with a view of distributing them to their employees. This was achieved with the entry into force of Law no. 1682/1987, whose Art. 25 sets out the legal prerequisites. Subsequently, the distribution of shares to employees was regulated through Law no. 1731/1987.

Thus today, under the provisions of three laws adopted from 1987 onwards,<sup>83</sup> joint stock companies are allowed to distribute shares to their personnel or to the personnel of ancillary firms. The distribution of shares is based on a decision taken at the general meeting, and may take one of the following forms:

a) *Purchase of shares* from the stock market. In connection specifically to such a purchase, employees may also be offered stock options, i.e. an option to purchase shares which they must exercise within 5 years. A maximum of 10% of the firm's share capital may be distributed to employees (including stock options), and shares ought to be distributed within 12 months.

b) *New share issues* (increase in capital stock), either through non-distributed profits or through shareholders' contributions. If shares are distributed after a corresponding increase in the firm's share capital through the capitalization of non-distributed profits, this part of the profits may not exceed 20% of the total. The shares are made out in the recipient's name and cannot be transferred for 3 years without the

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80. See Art. 9, first indent, of Law no. 1473/1984.

81. Art. 43 (?) of Law no. 1892/1990.

82. According to provisions of Law no. 396/1974.

83. Law no. 1731/1987, Art. 18; Presidential Decree no. 30/1988; and Law no. 1882/1990, Art. 12.

approval of the general meeting. After this period, the shares become anonymous and are freely negotiable.

For the employees the income these shares represent is exempt from tax and from social insurance charges, while dividends and interest payments on shares distributed to personnel are subject to income tax on movable assets. For the enterprise, capital allocated for shares to be distributed to employees is exempt from tax, but cannot exceed 20% of the profits. However, these provisions on tax exemption for employees and enterprises are given only for a specific type of share-ownership scheme.

### **8.3. PEPPER SCHEMES IN PRACTICE**

Stimulated by the new fiscal benefits introduced primarily since 1987, there are indications that many Greek enterprises are introducing both cash-based profit-sharing and employee share-ownership schemes. Within 20-30 recently concluded collective labour agreements, the majority of which concern public enterprises and some private sector organisations of strategic importance, various forms of workers' participation, including participation in enterprise profits, are envisaged. However, no detailed evidence seems for the moment available on their actual diffusion.

1) **Profit-sharing.** Some Greek enterprises, mainly in the banking, insurance, clothing and food sectors, have in recent years distributed a certain percentage of profits to employees. In other cases, mainly in banks and insurance companies, the practice in the past three years has been to give employees half or a whole extra salary, or a lump sum of GD 30,000-50,000 in the case of positive profits. Therefore, profit-sharing schemes in Greece are not always directly related to profits, and are not offered on a regular basis.

2) **Employee share-ownership.** A well-known example of distribution of shares to employees is the big pipe company "Pentzetakis", where the founder of the enterprise in his will left 20% of all company shares to his workers.

#### **8.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

For the moment, there is no empirical evidence on the effects of PEPPER schemes in Greece.

## Chapter 9. IRELAND

### 9.1. GENERAL ATTITUDE

The last few years have seen a growing interest in PEPPER schemes in Ireland, a development which essentially started in 1982 and mirrors the evolution in the UK, particularly with regard to the legislation on share-based profit-sharing and stock options.

Successive Irish governments in the 1980s have given modest encouragement to PEPPER schemes in the private sector through the provision of tax incentives. However, the government's position is that all profit-sharing initiatives are voluntary and that the role of the government would be simply to create a climate in which interested companies, with their employees, can introduce schemes if they wish to do so. The issue has not been one of intense political debate but there would be a broad consensus across the political spectrum that suitable PEPPER schemes deserve support.

In its 1984 Plan on economic and social policy, the government of the time specifically alluded to support for PEPPER arrangements (see **Building on Reality**, 1984).<sup>84</sup> In 1987 the present government, in conjunction with the social partners introduced a "Programme for National Recovery" which in its essence is supportive of all arrangements to harness employer and worker efforts towards the achievement of current economic and social goals. As recently as February 1990 a Progress Report on the Programme refers to discussions being initiated by the Minister of Labour with the key employer and trade union institutions on the possible further progress on worker participation in the private sector; PEPPER arrangements are bound to feature in such discussions.

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84. As stated in the Plan, "The Government for their part, have a strong commitment to developing profit-sharing and worker shareholding, which they consider an effective step to ensure the success and efficiency of Irish industry and the prosperity and security of Irish workers for the future".

Employers' attitudes show a broad consensus on certain core issues. The viewpoints expressed by representatives of the Federation of Irish Employers and the Confederation of Irish Industry suggest that employers favour the introduction of PEPPER schemes on a voluntary basis and would oppose any mandatory arrangements. In general, employers support the concept of the worker as a "stakeholder" in the enterprise but would not agree that stakeholding should confer any special rights on a worker beyond those enjoyed by other shareholders.

There is no evidence to suggest that employers would necessarily favour the introduction of any "profit-related pay" arrangements with legislative support; indeed, the schemes already introduced confirm the view that employers by and large see profit-sharing as occurring outside the conventional wage/salary contract. Employers have constantly stressed the fluctuations which inevitably occur in company profits and the ensuing instability which could be introduced in determining allocations to schemes. In the case of multinational subsidiaries the question of a definition of "profit" can constitute a barrier, since the "profit" performance of the local unit might or might not match that of the entire corporation. Employers would see the government's role as essentially catalytic but, for approved schemes, would favour an improvement in the tax incentives so as to enhance the motivational aspect. However, current arrangements may arouse concerns about ownership and confidentiality, since 70% of all Irish companies are privately owned. PEPPER arrangements, while valuable, should not be seen as a panacea for poor company performance, and employers should be aware of other performance-enhancing approaches.

Viewpoints within the Irish Trade Union movement have evolved as experience with the various schemes has grown. The core trade union viewpoints, as outlined mainly by spokespersons of the Irish Congress of Trade Unions (ICTU), are that they have no fundamental objection to the concept of PEPPER schemes and generally would support the notion that workers should hold shares. However, representatives have consistently expressed reservations about the fact that the dominant form of PEPPER in Ireland, employee shareholding, is too narrow, pointing out that no serious consideration has been given to collective asset formation (such as those

developed in Sweden). This viewpoint is fundamental, since it contrasts the collective goals of the trade union movement with the individual based PEPPER schemes through shareholding, typical of current schemes in Ireland. The ICTU also considers that significant expansion of schemes in the private sector could be seen as discriminatory in the context of the public sector, particularly if significant tax concessions were involved.

The ICTU would wish to see the introduction of schemes tied in closely with complementary forms of workers' participation (in line with the argument that employee shareholding should not be seen as a substitute for involvement in decision-making). In recent times, the trade union movement has regularly argued for greater "disclosure" to workers as a prerequisite for the introduction of any scheme, and has regularly called for the appointment of workers as trustees in existing schemes, as it considers that the unilateral decision of management is not sufficient. An interesting dual opinion of both employer and trade union representatives was contained in a 1986 Report: "Financial participation, in the form of employee shareholding, may perhaps have been mainly availed of for tax reasons rather than from a commitment to participation as such, but it can be used in conjunction with other participative initiatives and in this context is warmly welcomed by the Committee" (**Report of the Advisory Committee... 1986**). Both employer and trade union representatives have alluded at times to the need for the actual individual profit share to be significant, since the transfer of derisory amounts could even have a negative impact. The views of both the employers and trade unions could be summarised therefore as cautiously pragmatic, with no fundamental objection to PEPPER schemes but with some reservations on the limited scope of present arrangements and on administrative and fiscal details.

Some unique factors influencing PEPPER arrangements in Ireland are different institutions promoting debate on the subject. The Irish Profit-Sharing Association (IPSA) provides a forum for companies to discuss progress with profit-sharing schemes, and it also acts as a collective lobby to government, e.g. when any changes in the prevailing legislative climate are sought. The Planned Sharing Research Association (PSRA) is primarily concerned with encouraging research into "planned

sharing", originally advocated by Dr. J. Fitzpatrick (1983) whose book has influenced much Irish thinking on the whole topic of financial participation. The Irish Productivity Centre (IPC) has also promoted participatory initiatives in both the public and private sectors for over 15 years.

## **9.2. LEGAL AND FISCAL FRAMEWORK**

A new era of PEPPER in Ireland began in 1982, when profit-sharing schemes began to be modestly encouraged. Prior to 1982 all payments to employees, even if additional to the prevailing wage and salary arrangements, were regarded as income for taxation purposes and treated as such. Schemes in Ireland today are voluntary both in the sense that no company is required to set up a scheme and, where a scheme is established, no employee is obliged to join it. The relevant legal framework and accompanying fiscal conditions only apply where a company seeks to formally register its scheme in order to avail of tax concessions.

1) **Share-based profit-sharing (1982)**. The 1982 Finance Act first introduced tax concessions for employees and for their companies in relation to approved profit-sharing schemes in share form, and the core regulations have been laid down by the relevant Finance Acts since 1982. Schemes have to be submitted to the Revenue Commissioners for approval. Approved schemes benefit individual participants by providing scaled exemptions from income tax on shares issued to them by their companies. Corporate incentives are provided in that both the amounts allocated in profit to approved schemes and reasonable expenditure incurred in administering schemes do not attract taxation. In approved schemes all employees are entitled to participate on an equal basis but such factors as length of service and level of wage/salary can be taken into account. The company is obliged to establish a trust, which acquires the shares on behalf of the employees and holds them for at least 2

years, after which they can be acquired by the individual participant; however, in order to gain full income tax relief, the shares must remain in trust for 5 years.<sup>85</sup>

Profit shares are issued on an annual basis, but there is no obligation of a company to issue shares in any year. In any one year an eligible employee can receive up to IRL 5,000 in shares within an approved scheme. The shares issued constitute a "gift" from the company concerned, since the employees are in no sense involved in purchasing them.

A separate legal provision since 1986 allows an employee to claim up to a maximum of IRL 750 as a deduction for income tax purposes if he subscribes to shares in a trading company employing him. The target of the share issue is the individual employee and no collective arrangements for shareholding prevail.

2) **Cash-based profit-sharing.** There are no tax concessions for profit-sharing in cash form. Although some companies continue to offer a cash alternative, those opting for it are liable to full income tax.

3) **Stock options (1986).** The 1986 Finance Act introduced the first favourable tax treatment of stock option schemes. Those qualifying for such options are relieved of income tax liability, subject to the relevant schemes being approved by the Revenue Commissioners. While such schemes are not directly related to profit, they are related to company profitability and enable participants to gain from the growth of company profits. The company is allowed to nominate who is entitled to exercise the stock option and the trend has been for this to be confined to key directors and senior management personnel (in contrast with "all employee" schemes where all employees are treated on equal terms).

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85. See Finance Acts of 1982 onwards, and Irish Productivity Centre (1985) booklet.



### 9.3. PEPPER SCHEMES IN PRACTICE

Prior to the 1980s there was no significant incidence of PEPPER schemes in Ireland although a number of companies, including some subsidiaries of multi-national corporations, did introduce bonuses related to corporate performance.<sup>86</sup> A wide range of individual and collective incentive or bonus plans were practised, related to individual or group productivity; the nature and amount of such incentives did not relate to profits as such. Today, the main types of PEPPER schemes on which information is available are approved share-based profit-sharing and share option schemes, all confined to the private sector.

1) **Share-based profit-sharing.** Since the introduction of tax benefits in 1982, there has been a continuous increase in the number of share-based profit-sharing schemes, and by January 1991 the number of approved schemes has reached 104 (see Table 9.1, Appendix to Chapter 9). It would be difficult to gauge the number of employees covered by these schemes, since this information is sometimes restricted to the companies and individuals concerned, but an estimate would place the present figure at about 40,000.

Additional information is provided in several surveys. Geary and Dempsey (1982) undertook a survey which covered 319 companies selected on a non-random basis, achieved 180 responses of which 30 (less than 17%) claimed to have had some profit-sharing arrangement. In 1984 the Federation of Irish Employers (then the Federated Union of Employers) had 428 responses to a postal questionnaire in which 31 companies indicated that they had a scheme in operation covering personnel other than managers, while 75 indicated that they had a scheme for management personnel only. Similar trends were evident in a subsequent study carried out by Irish Marketing

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86. E.g. the US subsidiary Donnelly Mirrors Ltd., which follows Scanlon Plan patterns, in line with its corporate philosophy.

Surveys in 1985.<sup>87</sup>

2) **Stock options.** Since tax incentives were introduced for stock options in 1986, these schemes have grown even more rapidly than share-based profit-sharing. The cumulative number of approved stock options has increased from 48 in 1986/87 to 169 in January 1991. As in the UK, the popularity of stock option schemes has been such that they now considerably outnumber "all employee" schemes.

The above figures indicate a steady though modest rise in approved PEPPER schemes in Ireland, but point in particular to the popularity of share option schemes. This popularity is likely to derive mainly from two reasons: they are executive oriented, and the companies can decide who qualifies for the options.

#### **9.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

The relatively recent incidence of PEPPER schemes in Ireland makes quantitative evaluation difficult, and there is no comprehensive evidence of the effects of existing schemes.

In the 1984 Federation of Irish Employers survey, out of 428 responses of companies, 235 indicated that an appropriate scheme might contribute to better company performance and improved employee relations. A 1986 survey by the same Federation indicated that just over 50% of those surveyed felt that performance and industrial relations could be improved through profit-sharing/employee share-ownership arrangements. This conclusion largely reflects those drawn by other parties, that no matter how attractive schemes were, they were unlikely to have a major effect on the employee relations climate.

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87. A private report prepared for the Irish Productivity Centre.

## APPENDIX TO CHAPTER 9

**Table 9.1. DIFFUSION OF PEPPER SCHEMES IN IRELAND  
1983-1991**

(Cumulative total of schemes approved under the Finance Acts)

Type of scheme and year of introduction	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
<b>Share-based profit-sharing (1982)</b>	2	8	15	26	44	68	84	104*
<b>Stock options (1986)</b>	-	-	-	48	78	98	143	169*

\* Up to 24 January 1991.

**Source:** Supplied by the Revenue Commissioners.

## Chapter 10. ITALY

### 10.1. GENERAL ATTITUDE

PEPPER schemes have, until recently, attracted limited attention in Italy, and no official measures have so far been introduced by the government to encourage their diffusion. As a topic of general public discussion, PEPPER has emerged only in the past decade.

Since the early 1980s, there has been a continuous debate in Italy about wage-earners' funds, rather than about enterprise-specific forms of PEPPER. From 1981 onwards, various proposals have been advanced on the setting up of a national wage-earners' fund by different political leaders and organizations, including all major Italian trade unions (CGIL - *Confederazione Generale Italiana dei Lavoratori*, CISL - *Confederazione Italiana Sindacati Lavoratori*, UIL - *Unione Italiana del Lavoro*.)<sup>89</sup> Although none of these proposals have so far been implemented due to disagreements between both political parties and trade unions, the debate is not over and proposals continue to flourish. Thus the most recent is a proposal on mutual investment funds for employees, advanced in 1990 by a working group coordinated by Morley-Fletcher within one of the major cooperative associations (*Lega Nazionale delle Cooperative e Mutue*) (see Preite, 1990).

Much less attention has been given to enterprise-level schemes in Italy, which have been discussed primarily since 1988 following the introduction of performance-related pay by several leading Italian enterprises. These initiatives have provoked a lively debate on flexible remuneration systems and the "variable wage", since these schemes are very different from the traditional system of incentives and seem to be substantially changing the existing system of industrial relations. One of the main

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89. E.g. the "CISL-Carniti" 1981 proposal advanced by the trade union *CISL*; the proposal by *Coopsind* representing both the trade union *CGIL* and the main national cooperative association (*Lega Nazionale delle Cooperative e Mutue*); the 1987 proposal by the secretary of the trade union *UIL*, Giorgio Benvenuto; the 1988 proposal by the Italian Communist Party; the 1989 "Formica proposal" by the Italian Minister of Labour and a variant of the proposal advanced by Nuti (1989).

issues presently under discussion is the choice of indicators, whether the variable wage ought to be linked to physical productivity, or to economic profitability.

In the present debate, James Meade's (1986, 1989) "capital-labour partnership" has received considerable attention (see Chapter 3, point 3.1.3. above). Some consider Meade's model as having many features in common with the "market socialist" concept of a "third way", and hence a possible solution for some of the existing problems of industrial relations in Italy (see Forcellini, 1989).

The position on PEPPER schemes of the three main Italian trade union confederations (CGIL, CISL, UIL) is divided. Trade unions in general remain suspicious of performance-related pay schemes. Although all three trade unions have usually signed agreements envisaging the introduction of such schemes, negotiations have been characterized by long discussions and divergence of views. In some cases, as e.g. the 1988 FIAT agreement, the CGIL had refused to sign on the grounds that it was not authorized to negotiate a fundamental change in pay practice (see Perry and Kegley, 1990, pp. 195-197); but a year later it did sign the 1989 FIAT agreement containing similar provisions. Trade unions in Italy are more in favour of employee share-ownership which has been promoted particularly by CISL, whereas UIL has recently expressed interest in a system of unit trusts enabling employees to invest in shares of their own and other companies (see Perry and Kegley, 1990, p. 199).

The employers' association *Confindustria* is in favour of PEPPER schemes and has therefore been advocating a reform of the existing system of industrial relations (see Figurati, 1989). The different forms of PEPPER are being proposed by employers as an additional tool of increasing labour cost flexibility, involving workers in overall enterprise performance and narrowing the gap between workers' and firms' interests, resolving conflicts and creating a more cooperative environment and thus boosting productivity. For workers, profit-sharing is expected to provide, in addition to material benefits, a higher degree of control over enterprise policies and strategies.

## 10.2. LEGAL AND FISCAL FRAMEWORK

Apart from some general provisions contained in the 1942 Civil Code on employee participation in enterprise results and employee share-ownership, there is no specific legislation on PEPPER schemes in Italy.

1) **Employee participation in enterprise results.** The possibility of introducing forms of employee participation in enterprise results is envisaged by the Civil Code, but Art. 2103 of the Civil Code and Art. 13 of the Workers' Statute envisage that all payments to workers are considered part of wages (see Ieva 1988, p. 11). Therefore, although the application of schemes is left to enterprise discretion, it is directly conditioned by terms set in national and enterprise-level wage agreements. Enterprises are not offered any specific fiscal benefits, and neither are employees. Precisely because of these features, the Italian case is interesting since several leading companies have introduced performance-related pay in recent years.

2) **Employee share-ownership.** The three possible forms of share offers to employees in Italy are: 1) offers of company shares reserved for employees, as envisaged by Article 2441 (last paragraph) of the Civil Code at a price which can be lower than normal, but the Shareholders' Assembly can decide not to give such shares voting rights; 2) a fixed portion of shares offered to employees on the occasion of public offers; and 3) offers of investment plans to employees, as part of a given share package (Cesarini, 1987). Such schemes are usually offered to all or to a group of employees (according to seniority, qualification, or other), at privileged terms (lower prices, privileged access, delayed payment). Shares reserved for employees can be issued only by companies quoted on the stock exchange (Cesarini, 1987), and there is usually a maximum value of shares per employee, often fixed as a percentage of the employee's wage (Danieli et al, 1989).

There are no tax incentives to encourage employers to introduce employee share-ownership. However, if shares are allocated to employees and are held in trust for two years, they are free of tax to the employee (Perry and Kegley, 1990, p. 199).

The main obstacle for a major application of PEPPER schemes in Italy is not only the absence of supportive legislation but also the inflexible wage determination system which gives limited possibilities to enterprises to increase employee remuneration through variable pay above the increases set in collective agreements (see Romiti, 1989). Only a relatively small percentage of wage increases is determined at the enterprise level, since areas already defined at higher bargaining levels cannot be treated in enterprise level agreements (Figurati, 1989, p. 1).

### 10.3. PEPPER SCHEMES IN PRACTICE

Italy has had a long tradition in piece rate type of incentives linking employee remuneration to individual or group productivity, which until recently was the most common type of incentive (Della Roca, 1989).<sup>90</sup> Although initially piece rates were meant to be a variable part of employee pay, employers have succeeded in fixing a maximum to be devoted to variable remuneration (7% above the basic wage), while trade unions have imposed a maximum 2% reduction of the basic wage in the case of bad economic performance (Della Roca, 1989).

Presently there are two principal forms of PEPPER schemes in Italy: employee participation in enterprise results, and employee share-ownership.

1) **Employee participation in enterprise results.** Contrary to the traditional system of piece rates, the recently introduced schemes consist of cash bonuses directly

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90. Piece rates were first introduced in collective bargaining agreements during the 1960s, and were initially calculated on the basis of physical productivity; today their calculation includes other measures, such as quality, time of delivery, or the maintenance of programmes (Danieli et al, 1989).

linked to some measure of enterprise performance, where there is a wide variety of formulas used for determining the variable component of pay; and such schemes are in general applied to all employees (although they are usually differentiated on the basis of professional groups).

For the moment there are no official data on the overall number of firms in Italy introducing employee participation in enterprise results. An estimate indicates that today about one fourth of employees in large industrial companies receive a part of their wage linked to some performance indicator (see Avitabile, 1989). More detailed information is provided in two recent surveys based on samples of enterprise wage bargaining agreements (hereafter wage agreements),<sup>91</sup> in which measures to be used for determining variable remuneration of employees are usually specified. These cases mainly involve large enterprises including several well-known multinational companies. Nevertheless it is believed that many small and medium-sized firms have also been introducing forms of PEPPER, on which, however, no information is presently available.

The first survey of enterprise wage agreements was undertaken by Prosperetti and Cossentino (1989), based on a sample of 60 agreements which had included a provision on variable remuneration concluded in the 1984-88 period.<sup>92</sup> The analysis showed that employee participation in company results has mainly been adopted by industrial enterprises and some enterprises in the service sector. There has been a marked increase in such arrangements especially in 1988 (see Figure 10.1, Appendix to Chapter 10), when around 50% of all wage agreements examined had a provision on variable remuneration for the next 5-year period, covering almost 400,000 employees.

These agreements have been adopted primarily by large enterprises in the engineering industry (37% of total) in which the management of human resources has come to represent a strategic value, followed by the steel industry (18%), textiles

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91. These agreements ("contratti integrativi aziendali") supplement the terms set in general wage agreements determined in collective bargaining at the national level.

92. The survey was undertaken by a private research institution in Bologna, Nomisma.



(13%) and retail trade (13%) (see Figure 10.2, Appendix). The analysis by enterprise ownership showed that, until the mid-1980s, employee participation in enterprise results was applied mainly by large retail enterprises of the private sector. Although after 1985, a number of public enterprises have also been introducing such schemes, over the whole 1984-88 period, schemes remain prevalent among private firms (see Table 10.1, Appendix).

A second study which offers information on employee participation in enterprise results in Italy is a survey undertaken by Biagioli (1990), based on a larger sample (264) of wage agreements concluded from 1981 to April 1989, in which employee remuneration was determined on the basis of different types of incentives.<sup>93</sup> The analysis showed that before 1988, reward systems containing "non-traditional" elements of pay, such as product quality premia, time-saving premia, lump-sum bonuses and profit-sharing, were rather limited in number, whereas thereafter their number has increased rapidly. Analysis of 157 agreements concluded in 1988 showed that 71 agreements had a provision on non-traditional elements of pay, of which 40 agreements included profit-sharing; similarly in the first four months of 1989, out of 38 agreements analysed, profit-sharing was included in 10 of these. Therefore, only in around 25% of these cases, the variable portion of pay is directly linked to enterprise profits.

The Italian experience is particularly interesting in view of very different performance indicators specified in these agreements, which can be grouped under two principle categories.

a) The first are *productivity indicators*, also termed "technical-productivity indicators", which however are not directly linked to profits but to productivity. In Prosperetti and Cossentino's (1989) survey, around 17% of firms had used this type of indicator for determining the variable part of pay (see Table 10.2, Appendix); the

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93. Production bonuses, piece rates, attendance premia, bonuses based on product quality, time-saving premia, lump-sum payments, gain-sharing and profit-sharing. Data were collected by the research institute (IRES) of one of the major trade unions (CGIL).

most frequent indicator was the change in productivity in physical terms, or indices of fulfillment of current orders.<sup>94</sup>

A variant of this type of indicator which comes closer to profit-sharing are "composite technical-productivity" indicators, linking the variable part of pay to several indicators measuring changes in productivity, quality, effective working hours, occupational structure of the labour force and others related to some measure of company performance. Some examples of indicators used in practice are ratios of sales/employees, value added/employees, effective hours worked/working hours, and production volume/production capacity (Danieli et al, 1989). In Prosperetti and Cossentino's (1989) sample, this type of indicator was chosen by some 22% of enterprises, and most frequently by those characterized by process technology (steel, textiles, artificial fibres) where the use of productivity measures alone would not have been sufficient.

b)The second type are *profitability indicators*, also termed "economic indicators" or "budgetary indicators", linking the variable part of employee remuneration to some measure of enterprise performance as reported in their balance sheets. Profitability indicators can be general indicators such as sales, value-added, mark-up, or profits; or composite indicators, based on both technical-productivity and profitability indicators. In Prosperetti and Cossentino's (1989) survey, general profitability indicators were used by 27% of enterprises, mainly in retail and engineering; composite indicators were used by 15% of enterprises; while 20% of enterprises had not defined in their wage agreements how variable pay was effectively going to be calculated (see Table 10.2, Appendix).

In Biagioli's (1990) survey, in most agreements several indicators were used in combination (on average 1.9 indicators per agreement). Although various quantitative indicators were more frequent, at least one profitability indicator was included in

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94. "Tempi di avanzamento delle commesse in lavorazione".

around 50% of agreements, the most frequent being total sales (in 22.7% of agreements), followed by net profit (4.9%), labour costs (4.5%), value added (3%) and gross mark-up (2.7%) (see Table 10.3, Appendix).

The variable part of employee remuneration in Italy has a relatively small effect on total pay. In Prosperetti and Cossentino's (1989) sample, it was on average around 3.6% of gross earnings of both workers and employees (see Figure 10.3, Appendix). In addition, these payments are not always effectively variable, since in some wage agreements a minimum guaranteed variable pay is fixed in advance regardless of performance in order to protect workers from risk; this was the case with 28% of agreements analysed, two thirds of which were public enterprises' agreements. This is also confirmed by Biagioli's (1990) survey in which variable remuneration was fixed in advance in around 30% of agreements.

If fixed payments from profits are deducted from what is defined as "variable pay" in wage agreements, the average share per employee in Prosperetti and Cossentino's (1989) sample was not higher than 3% of annual gross earnings. In Biagioli's (1990) survey, the average minimum values of variable remuneration for specific sectors ranged from 2.3-7.8% of the minimum national wage, while the average maximum values from 4-8%. However, there is substantial variation in the average amounts given to workers both between and within sectors (see Table 10.4, Appendix). This minimal impact on employee earnings may explain the willingness of the trade unions to sign such agreements.

It is also of interest to determine what percentage of firms apply "all-employee" schemes of variable remuneration. In Prosperetti and Cossentino's (1989) survey, 15% of firms envisaged bonuses equal for all employees and an additional 67% bonuses linked to occupational groups; thus only 18% applied bonuses based on individual performance (presence at work). Biagioli's (1990) survey confirms that most enterprises envisage schemes which are of a collective nature (82.5% of agreements analysed; only in 11.1% of agreements was the bonus paid individually).

Among the best-known examples of companies which have adopted employee participation in enterprise results in 1988-89 and thus aroused much public interest, are Fiat, Olivetti, Italgel, and the Zanussi group. Many of these leading companies have used profitability indicators for calculating the variable part of remuneration.

Fiat has been one of the first large companies that has favoured flexible employee remuneration which would effectively depend on company performance. In its agreement on wage supplements of 18 July 1988, it has included a provision on a "group performance bonus" calculated on the basis of four ratios with different relative weights: net profits/total employees (50%), net profits/net investment (20%), net assets/net investment (20%), and guarantee costs/net profits (10%).<sup>95</sup> The bonus was differentiated by occupational groups, and consisted of two parts: a fixed lump sum monthly payment and a variable annual payment, which in 1989 amounted to a total of LIT 170 billion. A similar provision on a group performance bonus was included in Fiat's agreement on wage supplements concluded in 1990 for a period of two years.<sup>96</sup>

Olivetti, in its agreement of 20 October 1988, has introduced a "competitiveness bonus" linked to gross mark-up, based on the ratio between operating profits and net consolidated revenue. The bonus is differentiated by occupational groups and is distributed only if the ratio between operating profits and net revenue of the group surpasses the average index measuring performance of principal competitors by 6% (Ghidoni, 1989; Danieli et al, 1989). The Italgel group has also chosen the profits variant: a "bonus on variable production" equal for all employees, and linked to the achievement of a certain gross mark-up (i.e. value added net of labour costs). The sum involved can oscillate both upwards and downwards, depending on whether the actual gross mark-up is less or more than 2% of the predicted mark-up; if it is lower than 2%, the bonus is not distributed. On the other hand Zanussi has preferred linking

95. "Guarantee cost" is a quality indicator referring to all costs incurred in repairing sold products with defects.

96. See "In diretta", *Notiziario per le società del gruppo FIAT*, 18 July 1988 and 5 July 1989, and "Come si conteggia...", 1989.

variable pay to labour productivity, including a measure which directly links a part of the wage to workers' actual presence at work (Ghidoni, 1989; Danieli et al, 1989).

Although most of these well-known examples of PEPPER in Italy are profit-related pay schemes, the majority of "non-traditional" remuneration schemes today are not profit-sharing in the strict sense, but arrangements based on various other indicators, including a number of quality-type indicators. Moreover, in some cases schemes do not provide variable remuneration, but a fixed bonus independent of enterprise results.

**2) Employee share-ownership.** This form of PEPPER has also been steadily spreading in recent years, although less than cash-based employee participation in enterprise results. One of the main reasons for the spread of workers' share-ownership is considered to be the upward swing in the stock exchange in Italy (Pianta, 1988). The principal objectives of these schemes is to increase enterprise capital, reinforce the position of management by improving intrafirm relations, and enable employees to realize capital gains (Cesarini, 1987).

A study (Cesarini, 1987) of 46 share offers reserved for employees in the 1981-87 period by 30 Italian enterprises quoted on the stock exchange has shown that shares bought by employees represented around 6.9% of capital raised by firms on the stock exchange through public offers, amounting to a total of over LIT 411 billion (see Table 10.3, Appendix).<sup>97</sup> During the 1980s, some companies have raised substantial capital in this way.<sup>98</sup> Reserving shares for employees was the most frequent form (65% of cases), but in the majority of cases shares offered to employees usually represented less than 5% of a company's total share issue, and were frequently non-voting shares (Cesarini, 1987). That is why some Italian scholars remain sceptical about employee share-ownership schemes, considering the parallel introduction of a

97. The actual figure is higher, since data were not available for Banca Nazionale di Lavoro, Banco di Napoli and Sondel, which have also reserved shares for their employees in 1985-1986.

98. E.g. Fiat (LIT 120 billion), Assitalia (LIT 58.3 billion), IRI (LIT 50 billion), Benetton (LIT 34.2 billion) and Olivetti (LIT 65 billion).

collective form of voting rights for employee shareholders to be essential, with the trade union acting as mediator (e.g. Treu and Bagioni; see Pianta, 1988).

However, there are exceptions. Montedison has recently introduced a savings plan envisaging employee contribution of 1% of pay, matched by a 1.1% contribution by the company, into a fund which will be invested in cash assets, government bonds, equity and real estate. The fund is managed jointly by representatives of the company, participating employees and the unions (Perry and Kegley, 1990 p. 149).

#### 10.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES

In a study of 34 enterprise agreements in the textile sector undertaken by **Filta-CISL** from Lombardia, it was found that enterprises introducing employee remuneration linked to enterprise performance had better economic results than firms with traditional pay systems (see **Il Sole 24 ore**, 23 September 1988, as reported in Ieva, 1988). Further empirical analysis of PEPPER arrangements was undertaken by Biagioli and Cardinaleschi (1990), and is currently being carried out by two Italian research institutes: Nomisma (by Prosperetti, Cossentino and A. Del Boca) and Seveso (by Della Rocca and Ponzellini). Although for the moment, econometric evidence on the effects of PEPPER schemes in Italy is non-existent,<sup>99</sup> an econometric study on the effects of profit-sharing has been initiated at the EUI in Florence (by M. L. Stefani).

In reference to theoretical arguments, the rationale behind the implementation of PEPPER schemes in Italy seems to have been more an attempt to increase labour productivity by enhancing human resources management strategies which are more cooperative than the ones based on individual bonuses, than to obtain wage flexibility. This is because profit-sharing in Italy has developed during a phase of

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99. Econometric studies have been undertaken using Italian data, but only on cooperatives (e.g. Jones and Svejnar, 1985).

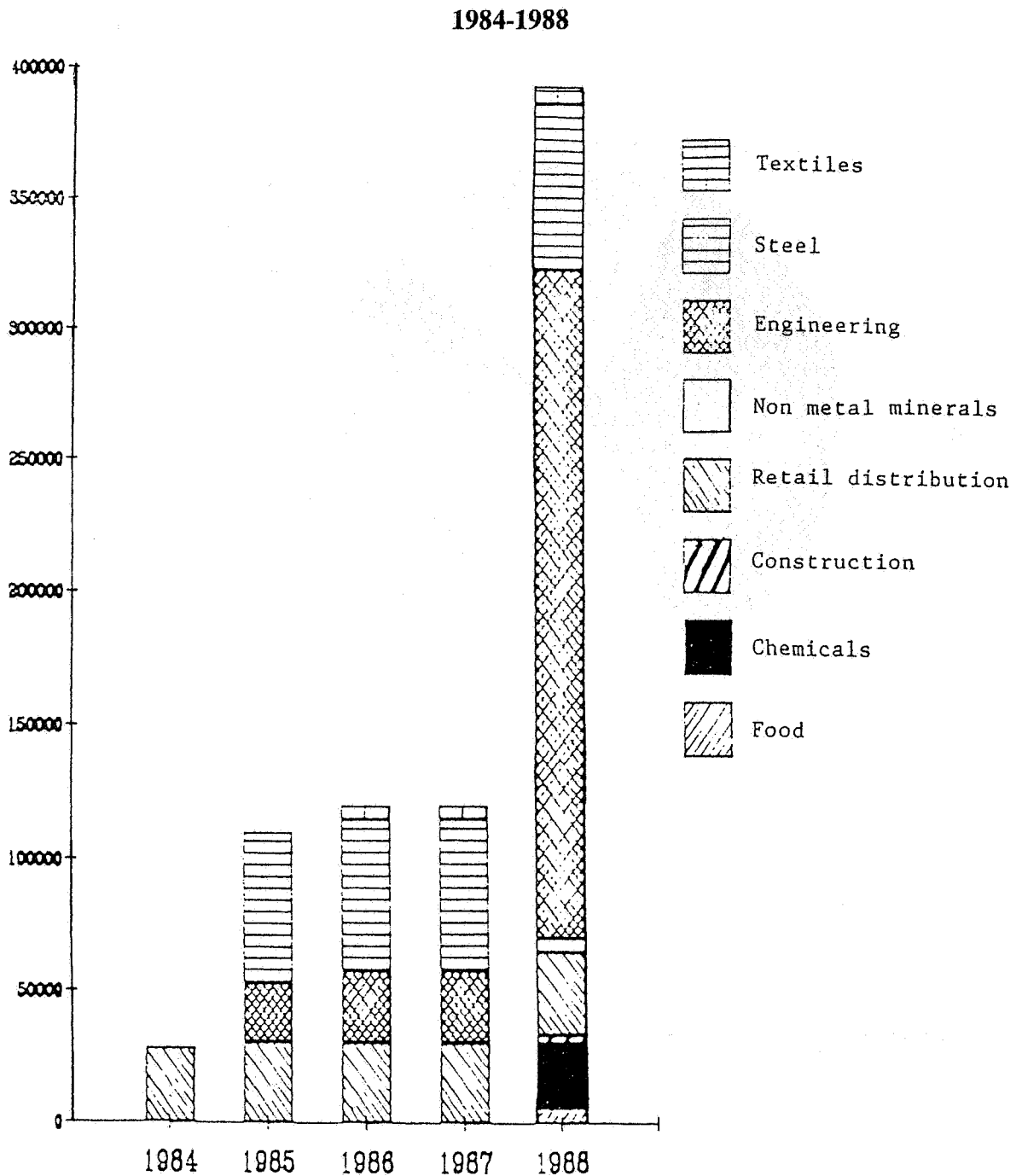
strong cyclical expansion of the economy, and hence the possible reduction of the marginal cost of labour is of little relevance; the wage flexibility provided for by these schemes is probably sought by firms as a remedy, should the economic situation worsen in the future (Biagioli, 1990).<sup>100</sup>

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100. A different interpretation is provided by Santì (1989) who considers that the main reason for the diffusion of schemes is the crisis of the system of industrial relations.

## APPENDIX TO CHAPTER 10

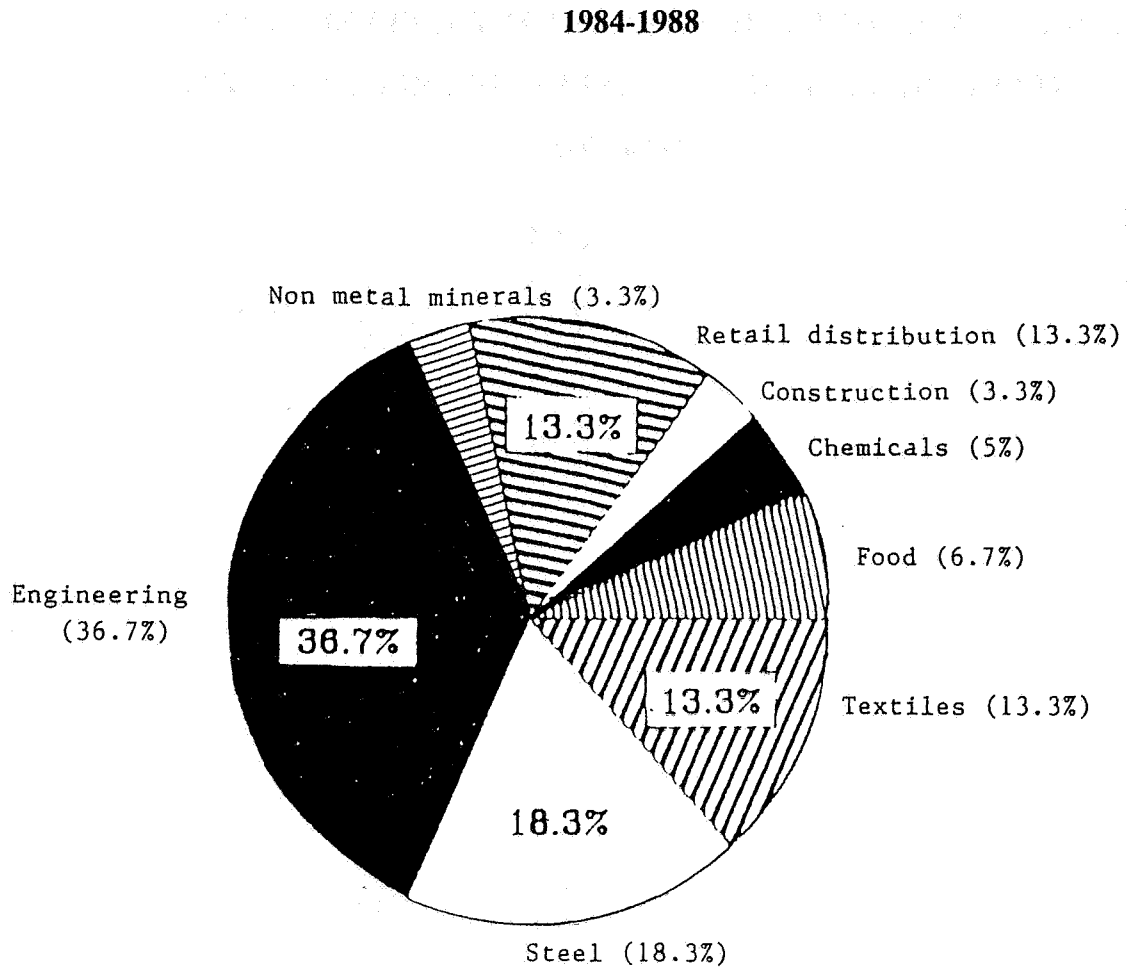
**Figure 10.1.EMPLOYEE PARTICIPATION IN ENTERPRISE RESULTS IN ITALY - NUMBER OF EMPLOYEES COVERED BY SECTOR**



Source: Prosperetti and Cossentino (1989).



**Figure 10.2. SECTORAL DISTRIBUTION OF EMPLOYEE PARTICIPATION  
IN ENTERPRISE RESULTS IN ITALY**

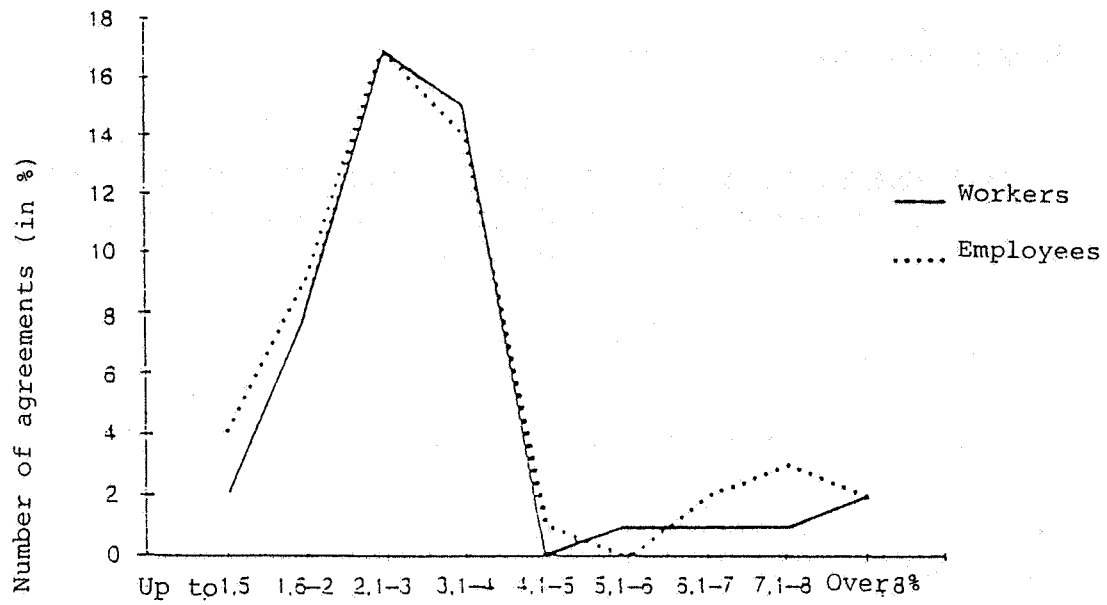


Source: Prosperetti and Cossentino (1989).

**Figure 10.3. ITALY: AVERAGE PAYMENTS TO EMPLOYEES  
ON THE BASIS OF PARTICIPATION IN ENTERPRISE RESULTS**

(as % of gross earnings)

1984-1988



Source: Prosperetti and Cossentino (1989).

**Table 10.1. EMPLOYEE PARTICIPATION IN ENTERPRISE RESULTS  
IN ITALY BY ENTERPRISE OWNERSHIP**

**1984-1988**  
(number of firms involved)

						TOTAL
	1984	1985	1986	1987	1988	1984-88
Private	6	5	6	1	21	39
Public	0	8	2	0	5	15
Cooperatives	0	0	0	0	6	6
<b>Total</b>	<b>6</b>	<b>13</b>	<b>8</b>	<b>1</b>	<b>32</b>	<b>60</b>

Source: Prosperetti and Cossentino (1989).

**Table 10.2. EMPLOYEE PARTICIPATION IN ENTERPRISE RESULTS  
IN ITALY BY TYPE OF INDICATOR AND BY SECTOR**  
**1984-1988**

Sector	T y p e o f i n d i c a t o r					TOTAL
	Technical- productiv.	Composite tech.-prod.	Profita- bility	Composite mixed	Not defined	
Food	0	1	2	1	0	4
Chemicals	0	0	0	0	3	3
Construction	0	0	1	1	0	2
Retail trade	2	0	5	0	1	8
Mineral processing and non metals	0	0	0	1	1	2
Engineering	7	3	4	5	3	22
Steel	0	5	2	0	4	11
Textiles	1	4	2	1	0	8
<b>TOTAL</b>	<b>10</b>	<b>13</b>	<b>16</b>	<b>9</b>	<b>12</b>	<b>60</b>
<b>In % of total</b>	<b>16.7</b>	<b>21.7</b>	<b>26.7</b>	<b>15.0</b>	<b>20.0</b>	

Source: Prosperetti and Cossentino (1989).

**Table 10.3. INDICATORS USED BY ITALIAN FIRMS FOR DETERMINING  
VARIABLE PAY, BY TYPE OF INDICATOR  
1985-1989**

Indicator	Number of agreements	Frequency in %
Total sales	60	22.7
Value added	8	3.0
Gross mark-up	7	2.7
Net profit	13	4.9
Labour costs	12	4.5
Other economic indicators	39	14.8
Quantity produced	95	36.0
Quality	66	25.0
Employees	26	9.8
Plants	27	10.2
Raw material consumption	2	0.8
Hours worked	113	42.8
Days worked	14	5.3
Other quant. indicators	30	11.4

\*The percentages do not add up to 100 since some agreements include several indicators.

Source: Biagioli (1990).

**Table 10.4. VARIABLE PAY AS % OF THE MINIMUM NATIONAL WAGE\*  
IN ITALY, BY ECONOMIC SECTOR  
1985-1989**

Sectors	Variable pay as a % of the minimum national wage		Number of agreements in which				TOTAL agreem. examined
	Minimum level	Maximum level	Minima exceed LIT per year		Maxima exceed LIT per year		
			1 mln	2 mln	1 mln	2 mln	
Engineer.	7.8	7.8	13	2	34	7	77
Chemicals	3.6	7.8	20	3	28	15	51
Textiles	2.3	6.3	3	1	13	1	28
Food	2.8	4.2	4	1	10	1	35
Services	3.3	6.8	3	1	11	2	28

\*Effective "variable pay" after deducting fixed profit bonuses, as a percentage of the minimum wage determined by the National Sectoral Agreements.

Source: Biagioli (1990).

**Table 10.5. VALUE OF SHARES RESERVED FOR EMPLOYEES IN  
ITALIAN COMPANIES QUOTED ON THE STOCK EXCHANGE  
1981-1987 (May)**

<u>Company</u>	<u>Year</u>	<u>Yearly value of reserved shares (in mln. LIT)</u>	<u>TOTAL/ company</u>
Assitalia	1986	58,290	58,290
Aturia	1982	100	
	1985	480	
	1987	500	1,080
Banco di Sardegna	1986	3,750	3,750
Benetton	1986	34,200	34,200
Caboto	1985	467.5	467.5
C.R. di Viterbo	1986	1,750	1,750
Cir	1985	3,000	3,000
Danieli	1986	450	450
Euromobiliare	1984	250	
	1985	300	
	1986	1,500	2,050
Faema	1985	620	620
Fiat	1982	7,500	
	1986	112,500	120,000
Gruppo Iri	1984	25,000	
	1985	25,000	50,000
Italgas	1986	18,000	18,000
Lloyd Adriatico	1981	12,000	
	1986	7,000	19,000
Mittel	1975	55	
	1982	267.5	322.5
Mondadori	1987	1,900	1,900
Olivetti	1984	30,000	
	1986	35,000	65,000
Ras	1986	2,600	
	1987	10,350	12,950
Recordati	1986	1,300	1,300
Sai	1982	1,155	
	1984	630	
	1986	3,880.65	5,665.6
Schiapparelli	1981	475.65	
	1982	291.6	676.2
Setemer	1986	1,207.5	1,207.5
Soc. Ital. Manufatti	1986	200	200
Uce	1981	20	20
Unipol	1986	7,480	7,480
Valeo	1986	840	840
Worthington	1975	27	
	1977	200	
	1978	150	
	1980	480	857
<b>TOTAL</b>			<b>411,167.4</b>

Source: Cesarini (1987), p. 77.

## **Chapter 11. LUXEMBOURG**

### **11.1. GENERAL ATTITUDE**

In Luxembourg, PEPPER is neither a real political issue nor a matter about which political parties, trade unions and employers' federations have taken a clear position.

The labour market of the Grand-Duchy is characterized by low unemployment figures; in a recent inquiry among its companies, more than 70% admitted that they had difficulties in finding sufficient qualified personnel. Against this background, PEPPER schemes could become an increasingly important instrument for companies to reinforce their competitive position on the labour market, as well as a means of retaining and motivating employees.

### **11.2. LEGAL AND FISCAL FRAMEWORK**

In Luxembourg there are no specific legal or fiscal provisions related to PEPPER schemes. Enterprises are not offered any fiscal benefits, while for employees, all payments they might receive under such schemes are subject to income tax.

### **11.3. PEPPER SCHEMES IN PRACTICE**

The only available estimate of the incidence of PEPPER schemes in Luxembourg is from a survey amongst all Luxembourg enterprises carried out in 1989 by CEPS/INSTEAD. Within the survey, 640 companies were contacted, of which 429 responded, a proportion high enough to be considered representative. To the question whether the company had any form of employee participation in enterprise profits, 21.8 % of the companies replied "yes", but no further information on the nature of schemes was provided. More information is generally to be found in company or

sectoral collective agreements.<sup>101</sup> The two principal types of PEPPER schemes are annual "gratifications" (which, however, are not always linked only to profits) and share offers to employees at preferential prices.

1) **Annual "gratifications"**. In the minority of cases where companies have some form of employee participation in profits, this is mainly incorporated in the annual "gratification" which is often related not only to company profits, but also to other criteria, such as seniority, performance appraisal, absenteeism, etc.

The collective agreement for the banking sector does not contain detailed prescriptions concerning the amount to be paid out as "gratification" linked to profits. The rules and criteria governing these amounts are confidential, and may differ from one bank to another. The amounts can be very substantial: for bank managers they could be equivalent to their annual basic salary, while for the average bank employee they could be in the range of half a month to two months' salary.

The practice of differential treatment of various categories of employees is also reported in a study carried out by the Wyatt Company S.A. The study found a correlation between the position occupied in a company and the degree of participation in profits: higher percentages were given to higher ranking personnel than to medium ranking personnel or workers.

2) **Share offers at a preferential price**. In the three major Luxembourg banks quoted on the stock exchange, when new ordinary stock issues are made, employees are usually given the right to acquire shares at a preferential price, up to a certain amount.

#### **11.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

No studies have so far examined the effects of PEPPER schemes in Luxembourg.

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101. In the industrial sector, there are only company collective agreements, while the banking sector has a sectoral collective agreement.

## Chapter 12. NETHERLANDS

### 12.1. GENERAL ATTITUDE

PEPPER schemes have been discussed on several occasions in the Netherlands. However, although the major Dutch political parties have, in general, been sympathetic to PEPPER schemes, so far very little has officially been undertaken by the government to facilitate their expansion.

The Christian Democrat Party (CDA), the largest and most important party which has formed part of all governments since 1945, has long been sympathetic to profit-sharing, motivated by the wish to strengthen the bonds between workers and their employers, contribute to a fair income distribution and a wider spread of property ownership, encourage moderation in wage demands, and increase the flexibility of the economy. Nevertheless, the CDA is against forcing firms to introduce PEPPER schemes and their too generous fiscal treatment.

The main actor in Dutch politics pushing for the expansion of PEPPER schemes is the Labour Party (PvdA), the second largest political party. The PvdA supports such schemes also to facilitate wage moderation and contribute to a fairer income distribution and a wider spread of property ownership. In 1976 a draft law on profit-sharing was introduced by a Cabinet in which the PvdA was the dominant coalition partner, which would have made it obligatory for firms to pay part of their "super profits" (profits in excess of a "reasonable level") in the form of equity or debt to a special fund, to be used for distribution to individual employees of the companies concerned and also for social purposes (e.g. for improving pensions for all employees). This draft law encountered massive business, public and political opposition and was not adopted. As to the other Dutch political parties, they are also broadly sympathetic to profit-sharing.

The current national discussion about PEPPER centres round a draft law submitted to Parliament by a PvdA member in 1987. During the national election



campaign of 1989, the PvdA strongly advocated profit-sharing. However, under current conditions in which reducing the large budget deficit is a major aim of government economic policy, both the CDA and PvdA are very cautious in proposing tax facilities for PEPPER schemes which might reduce the state's tax income. The current Cabinet, a coalition of CDA and PvdA, has made the following statement in its "Government Agreement"<sup>102</sup>: "A controlled development of wage costs can also be supported by encouraging profit-sharing schemes and the ownership by employees of shares in the firms for which they work. There is, however, no reason to reserve financial room for this at the expense of the community. The draft law on these matters will therefore be assessed by the criterion of budgetary neutrality". This standpoint was repeated by the Minister of Finance (PvdA) in a parliamentary debate on 30 November 1989.

The Dutch trade unions have traditionally had an ambiguous attitude to PEPPER schemes.

On the one hand, they have been cautious about the additional inequality between employees in profitable businesses and the rest of society which profit-sharing inevitably creates. The Dutch trade unions are strong supporters of a "solidaristic" development of incomes, in which wages of employees in the market sector, wages of employees in the budget sector, and benefits paid to recipients of transfer payments (e.g. pensions) all rise at roughly the same rate. Hence they cannot unambiguously support PEPPER schemes. This is especially the case for budget sector unions, faced with proposals for special tax facilities from which their members cannot benefit but which their members may have to pay for.

On the other hand, the trade unions, especially the market sector unions, have long been in favour of participation by their members in the profits resulting from their work and their wage moderation. In 1964 the three national trade union organisations published a report ("Property formation through capital gains sharing") in which they

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102. The agreement about objectives and policies on which the coalition is based.

argued that part of the profits of firms should be transferred to employees. The 1976 draft law on profit-sharing was partly a response to pressure from the trade unions. The trade unions see profit-sharing as an "extra", an additional amount over and above normal wages and salaries and in no way a (partial) substitute for the latter.

The employers are also in favour of PEPPER schemes. They see profit-sharing as a way of motivating employees, increasing their identification with their enterprise and increasing the flexibility of the economy. Hence in the current national discussion they are in favour of more generous tax concessions. However, they are strongly against compulsory national profit-sharing, but favour voluntary profit-sharing schemes, freely negotiated between the firm and its own employees (or introduced at the initiative of the firm above its contractual obligations). Virtually all existing PEPPER schemes have been voluntarily introduced by individual employers despite a hostile national fiscal climate (see below).

Profit-sharing was also one of the topics discussed in a 1987 report by the Committee of Economic Advisors of the Socio-Economic Council.<sup>103</sup> The main advantage of profit-sharing stressed in the Report was the increased flexibility of labour earnings, which was regarded as especially important for the open (i.e. internationally competitive) sector of the economy, where sudden price shocks under conditions of real wage inflexibility would otherwise generate unemployment; as subsidiary advantages a possible improvement in labour motivation and labour productivity was stressed. As disadvantages, the Report saw possible opposition by employees under conditions of profit-sharing to increasing employment, income insecurity, increased income inequalities between employees of different firms, and possible opposition from capitalists. The report reached a cautious conclusion: "The state and the social partners in negotiation should see to what extent it can be encouraged that, within a controlled development of real labour costs, profit-sharing

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103. This is the highest body in the corporatist system of negotiations between the state, the trade unions and the employers' organisations which characterises economic policy-making in the Netherlands.

payment systems can be introduced in sectors and firms where profitability is satisfactory and where there is equilibrium gearing" (**Rapport flexibiliteit...** 1987).

Therefore, the main motivation for politicians to advocate profit-sharing and the main reason given for supporting the draft law now before Parliament, is to facilitate continued wage moderation, in order to stimulate the growth of net exports and of employment, enable the uniform growth of wages in all sectors of the economy, and maintain the current low level of inflation. Since wage bargaining is very much influenced by the two nationally organised trade union organisations and takes place in a partially corporatist framework, profit-sharing is advocated as a way of encouraging the unions to show moderation in their wage demands in the profitable businesses in the market sector.

## 12.2. LEGAL AND FISCAL FRAMEWORK

Although there are no direct legal obstacles for the expansion of PEPPER schemes in the Netherlands, fiscal incentives are very minor ones, and the current tax regime is in general unfavourable.

1) **Cash-based profit-sharing.** The only tax incentive currently existing for profit-sharing is an extremely modest one. An employee of a firm with a profit-sharing scheme can agree to pay his/her share up to a maximum of HFL 750 per year (around 2% of average annual earnings) to a special account which is blocked for 7 years, all payments into which are free of income tax and social security contributions.<sup>104</sup>

With the exception of this minor tax advantage, cash payments to employees of a part of profits are treated as normal income, meaning that income tax and social security contributions are deducted from them before they are received by the employees and that employers have to pay social security contributions on them. As a

104. This was introduced as part of a savings premium scheme set up by a 1962 Decree, amended in 1965 (Stb. 1965-261) and again by an order of 21 December 1972 (Stb. 1972-719) (CEC, 1979, p. 68).

result of relatively high marginal tax rates, on average at least half the cost of such profit-sharing schemes appears to employers as voluntary taxation.

2) **Share-based profit-sharing.** Profit-sharing payments in the form of shares are treated differently, but also unfavourably. The market value of the shares is treated as income and the employee is assessed for income tax and social security contributions accordingly. The distribution to the employees of new shares does not reduce the employer's profits for corporation tax purposes.

There is currently a draft law before Parliament which aims at encouraging profit-sharing by providing additional tax facilities.<sup>105</sup> It would enable employees to receive a share of the profits of their firm in cash or shares up to a maximum of HFL 1,500 per year (around 4% of average earnings) free of tax and social security contributions. The politicians are hoping to use this proposal as an inducement for unions to accept moderate increases in wages and salaries.

There are no legal obstacles to the expansion of profit-sharing. There are a variety of existing and well established legal personalities which can be used to effect profit-sharing (e.g. a "cooperative association" (*coöperatieve vereniging*), a "closed company" (*besloten vennootschap* or private limited company) or a "nameless company" (*naamloze vennootschap* or public limited company). The main obstacles to profit-sharing are primarily fiscal.

The welfare state, with its high level of income tax, social security contributions and budget deficit, makes tax exemption for particular types of income costly and difficult. The Ministry of Finance is worried about the cost of any relaxation of the current rules and regularly makes this plain when such relaxation is under political discussion. In the Netherlands, the classical position of workers in a capitalist firm has been altered primarily by providing security of employment and income, and by

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105. This draft law forms part of the package of economic and social measures which are currently being discussed between the social partners in the context of wage bargaining and government economic policy.

introducing a system of industrial democracy in all large firms, while relatively little support has been given to PEPPER.

### 12.3. PEPPER SCHEMES IN PRACTICE

PEPPER schemes are, in general, quantitatively not very important in the Netherlands, and mainly consist of cash-based profit-sharing. Information about the extent of schemes and their evolution over time is, however, fragmentary.

In their well-known 1964 Report,<sup>106</sup> the three national trade union organisations estimated that, at the beginning of the 1960s, there were about 400 real profit-sharing schemes in existence, applying to about 300,000 employees (about 10% of all employees in the market sector).

In 1976 two national employers' organisations conducted an enquiry into the extent of profit-sharing in 1975, finding that 62% of the firms that cooperated in the enquiry had a "profit-sharing" scheme, involving more than 500,000 employees (around 17% of all employees in the business sector). Out of these, however, only 34% had a scheme in which the payment was directly related to profit, 17% had a scheme in which payments were made when profits were made, and in the remainder the "profit-sharing bonus" was a fixed amount which was independent of the actual profit or loss (although it is quite possible that in some of these schemes the bonus had once been dependent on the actual profit earned).

The 1976 enquiry also showed that the average amount paid out to employees was about 6% of annual income, with a wide dispersion (see Table 12.1, Appendix to Chapter 12). There were a number of different measures of profit used as the basis of profit-sharing schemes, the most frequent being profit as defined in business economics (see Table 12.2, Appendix). According to the two employers' organisations' estimates, when the figures were corrected for non-response, the total number of

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106. "Property formation through capital gains sharing".

employees enjoying a profit-sharing scheme was at least 750,000 or around 25% of all employees in the market sector. Allowing for the fact that about a half of these schemes were only nominally profit-sharing schemes, the number of employees in real profit-sharing schemes in 1975 was not less than 350,000 (around 7.4% of all, or 12% of market sector employees).

In 1984, the Department of Collective Labour Agreements of the Ministry of Social Affairs and Employment published a report on annual bonuses and savings schemes in collective labour agreements for 1982. The report showed that in 1982 a profit-sharing scheme was included in 9 of these agreements covering a branch of the economy, which together embraced 54,800 employees, or 2.3% of all employees covered by a branch collective labour agreement. In addition, profit-sharing schemes were included in 28 firm collective labour agreements, which together covered 123,008 employees, or about 30% of all employees covered by firm collective labour agreements applicable to firms with 250 or more employees (*Jaarlijkse extra...* 1984).

In 1988, the Ministry of Social Affairs carried out further research on a sample of 1,510 firms (out of a population of approximately 35,000) with 10 or more employees. Of these firms, 29% said that they had profit-sharing, but there was a very wide range of practices that currently go under the heading "profit-sharing". The majority of firms which said they had some "profit-sharing" did not have a written description of the scheme, with written rules for the calculation and allocation of profits; "profit-sharing" was a bonus provided by the management when it felt business was going well, but not a right of employees and not necessarily fluctuating directly with the size of profits. Even where a firm had written rules for profit-sharing, it was often the case that the payment was made only if profits reached some threshold, but the amount did not fluctuate directly in line with profits. In addition, in some cases, profit-sharing was confined to a limited number of key employees (see "*Onderzoek...*" 1990).

However, if profit-sharing is assumed to be a system that applies to at least 80% of the employees of the firm concerned, the payments made really do fluctuate in line with profits, and the scheme has written rules (so that the employees have rights to

their share rather than the possibility of benefitting from ex post management largesse), then in 1988 employees of only 6% of the firms on average benefitted from profit-sharing (see Table 12.3. Appendix).

The 1988 report also provided information on the size of profit payments to employees (see Table 12.4, Appendix), suggesting that in 1986 most beneficiaries received a profit share of about 4.5 - 6.5% of average annual national earnings (average earnings in 1986 were about HFL 40,000 p.a.). The great majority of beneficiaries (70%) received a profit-sharing bonus of less than 6.25% of average earnings, but a minority (13%) received an amount of more than 12.5% of average earnings. In the overwhelming majority of cases these profit-sharing payments were made in cash; in only 3% of the firms with a profit-sharing scheme was the payment in shares, bonds or options.

Profit-sharing schemes have been introduced by individual employers who have regarded them as beneficial for themselves, mainly in order to increase the integration of employees in the firms for which they work, or increase the flexibility of firms' employment costs. They have not been introduced in response to government incentives because there have not been any of any significance. In fact, not much use has been made of the minuscule tax facility offered for cash-based profit-sharing bonuses frozen on special accounts: an investigation in 1986 suggested that about 76,000 participants had benefitted from this provision, mostly in the financial services and business services sector.<sup>107</sup>

Therefore, there is a wide range of practices which are described as "profit-sharing" in the Netherlands, ranging from schemes where a few managers benefit from profit-sharing, via schemes where employees receive cash bonuses if a satisfactory profit level is achieved, to schemes where managers make discretionary bonus payments depending on the profit level, and schemes where there are written rules for a

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107. Much more use is made of other tax-favoured savings schemes which have nothing directly to do with profit-sharing.

profit-sharing payment which fluctuates directly with profits. Precisely how many employees benefit from existing "profit-sharing" schemes depends on how profit-sharing is defined. If it is defined in the broad sense used by many firms, then it appears to benefit employees in about 30% of all firms with 10 or more employees. If it is defined more strictly, so that payments only qualify as profit-sharing if they are made to 80% or more of the employees, the method of their calculation and the list of people eligible for them is set out in a written document, and the payments really do fluctuate directly with profits, then only 6% of firms with over 10 employees have profit-sharing.

#### **12.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

There are no empirical studies of the effects of existing PEPPER schemes in the Netherlands. In 1990 a new research report of the Ministry of Social Affairs is expected with an analysis of profit-sharing in 1989.



## APPENDIX TO CHAPTER 12.

**Table 12.1. NETHERLANDS: PROFIT-SHARING AMOUNTS  
PER EMPLOYEE  
1975**

<b>% of the number of firms with profit-sharing schemes</b>	<b>Amount of the payment (in weeks wages/salary)</b>
9	none
6	less than a week
16	between 1 and 2 weeks
5	two weeks
11	between 2 and 3 weeks
3	3 weeks
11	between 3 & 4.3 weeks
16	13th month, i.e. 4.3 weeks
9	between 4.3 & 8.6 weeks
1	2 months (8.6 weeks)
2	more than 2 months
5	no information

**Note:** The left hand column does not add up to 100% because of rounding errors.

**Source:** Ellman (1987), p. 3.

**Table 12.2. MEASURES OF PROFIT USED FOR  
PROFIT-RELATED BONUSES IN THE NETHERLANDS  
1975**

<b>Measure</b>	<b>% of firms</b>
Profit as defined in business economics	52
Profit for tax purposes	20
Dividend paid to shareholders	14
Other	12
No information	2

**Source:** Ellman (1987), p. 3.

**Table 12.3. NETHERLANDS: FIRMS WITH 10  
OR MORE EMPLOYEES WHERE AT LEAST 80%  
OF THE EMPLOYEES RECEIVE A PROFIT-RELATED PAYMENT**

(in % of firms)

1988

Sector	All types	Fluctuates with profits & governed by written rules
Industry	29	11
Construction & installation	10	1
Trade, catering & repairs	15	5
Transport, storage & communications	10	2
Banking, insurance, business services	28	8
<b>AVERAGE</b>	19	6

Source: "Onderzoek winstafhankelijk loon", The Hague, 1990, p. 3.

**TABLE 12.4. SIZE OF THE PROFIT PAYMENT PER EMPLOYEE IN THE  
NETHERLANDS**

1986

Payment	% of employees
Less than HFL 500	5
Less than HFL 1,000	9
Less than HFL 2,000	29
Less than HFL 2,500	70
Less than HFL 5,000	87

Source: "Onderzoek winstafhankelijk loon", The Hague, 1990, p. 4.

## Chapter 13. PORTUGAL

### 13.1. GENERAL ATTITUDE

The issue of PEPPER has not yet received the degree of attention in Portugal which it has received in most other EC countries. The government, political parties and social partners alike do not seem to rank this subject among their priorities. As a result, presently there is no "general attitude" towards PEPPER, and such schemes seem to be developing in a rather spontaneous, decentralized and informal way. Nevertheless, recent legislative measures in Portugal on some forms of employee financial participation suggest growing interest and attention of the government.

Castro (1990) has contacted the major social partners and political parties, requesting them to express their position on PEPPER.<sup>108</sup> The two Confederations of Trade Unions UGT (*União Geral de Trabalhadores*) and CGTP (*Confederação Geral de Trabalhadores*) have until recently looked at PEPPER schemes with a slight suspicion. Nevertheless, within the programme approved at the IV Congress of UGT held in 1988, under the heading "The Democratization of the Firm", the need was stressed for increased workers' participation and the possibility of its extension to areas like "participation in the capital and/or the profits of the firm". The UGT acknowledges that achieving such objectives will be difficult, requiring "a cultural revolution both among employers and workers", but still proposes that clauses allowing these forms of participation should be included in all new collective agreements. At the same time, UGT explicitly states that participation of employees is to be made with the strictest respect for unidirectional managerial power and the preservation of

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108. A letter was sent to the two trade union confederations (*União Geral de Trabalhadores* - UGT and *Confederação Geral de Trabalhadores* - CGTP), the confederation of Portuguese manufacturing employers (*Confederação da Indústria Portuguesa* - CIP) and the four major parties (*Partido Social Democrata* - PSD, *Partido Socialista* - PS, *Partido Comunista* - PC, and *Partido do Centro Democrático Social* - CDS).

the efficient operation of the firm. The UGT has also proposed the creation of wage-earners' funds, but these have not been implemented. The other trade union confederation CGTP does not seem to have an official position on PEPPER.

As to political parties, all of them, with the possible exception of the Communist Party, allow in their programmes for some type of PEPPER, but there are no indications that any specific initiatives in this area will be taken in the near future.

There are several and diverse reasons for this apparent lack of interest in PEPPER. In the political arena, an intensive debate about rigidity/flexibility of labour market operation has been going on in recent years, in particular on the rigidity introduced in the operation of the labour market by the legislation regulating employment contracts and the possibility of employers terminating the employment relationship. In the heat of the debate, most of the efforts of the parties involved were directed to defending or altering such legislation rather than to new initiatives.

In addition, in contrast with some microeconomic (employment) rigidity introduced by that legislation, real wages have revealed a very high degree of (macroeconomic) flexibility,<sup>109</sup> and hence unemployment never reached very high values when compared with some other EC countries.<sup>110</sup> At the same time, although arguably at the expense of some efficiency losses, employers were able to circumvent some of the employment rigidity by resorting massively to short-term or time contracts.<sup>111</sup> In this context, at least from the employers' point of view, there was neither need nor scope for PEPPER schemes.

There was also a period during which both employers and employees' organizations did not seem to favour PEPPER schemes. On the one hand, among the employers the experience with some types of "industrial democracy" (i.e. employee participation in decision-making) may have left a mark; PEPPER schemes could be regarded as a potential threat to property rights, managerial control and information

109. According to several economists, real wages were, in 1985, more or less at the 1973 level.

110. Presently the unemployment rate is down to about 5%.

111. Within the EC, Portugal is the country with the highest percentage of the labour force in short-term contracts (around 20%); more than 70% of new contracts are of this type.

discretion. On the other hand, trade unions would emphasize the increased risk imposed upon workers by such schemes, particularly given the asymmetry in information between owners/managers and employees. However, although presently some of these arguments are still valid, these do not seem to be a decisive obstacle for PEPPER arrangements.

Firm structure and inherent organizational problems are among other factors which might help to understand the current situation in Portugal, since 75% of the firms employ less than 10 workers, 98% less than 100 workers, while only 1.6% are corporations. Although economic literature is not very conclusive about the association of PEPPER with firm size and nature, it seems reasonable to presume that the achievement of a minimum of organization functions is a prerequisite for such schemes to be implemented.

Finally, PEPPER has not received much, if any, attention, even among academics. Most of the studies on workers' participation fall under the category of "industrial democracy" and ignore the "economic democracy" dimension.

## 13.2. LEGAL AND FISCAL FRAMEWORK

Although there is no specific legislation on PEPPER schemes in Portugal, other laws provide a legal framework.

1) **Profit-sharing.** The Commercial Company Code, in particular where articles of association are concerned, lays down that only members of a company can participate in the company's profits and losses. It does not give employees any special rights in this area, nor does it impose a corresponding obligation on management. Nevertheless, the latter is free, if it so desires, to make provision, in the articles of association or subsequently, for workers to participate in profits.

Under Articles 2 and 24 of the Income Tax Code for Collective Persons, costs incurred by an employer in paying bonuses and other forms of remuneration to employees under a profit-sharing scheme may be offset against taxable income for the

financial year to which the profits in question relate. This regime therefore provides fiscal benefits for both employers and employees. On the one hand, the amounts distributed to workers under a profit-sharing scheme are treated as company costs and thus are exempt from income tax; and on the other hand, these amounts are exempt from tax on workers' income as they are not considered as regular earnings. This regime concerns mainly public enterprises in which the allocation of profits, as well as the balance sheet in general, is subject to approval by the government. In certain situations the amount paid is to be frozen for a certain period of time (e.g. 1 or 2 years) before employees can dispose of it. The current regime, which only started in 1990, seems more favourable for firms than the previous one.<sup>112</sup>

**2)Employee share-ownership.** The 1990 Framework Privatization Act concerning the reprivatization of ownership, or right to exploit, means of production and other property nationalized after 25 April 1974,<sup>113</sup> provides for a special scheme allowing workers employed by a reprivatized enterprise to acquire or subscribe shares. The enterprises in question are public enterprises converted into limited companies in line with the rules of the Commercial Company Code, unless otherwise provided for in the 1990 Act. Ownership may alternatively be reprivatized cumulatively by the distribution of shares in company capital and/or an increase in company capital. In either case, a percentage of the capital to be reprivatized will be reserved for acquisition or subscription by workers in the enterprise in question (Article 10).

Accordingly, workers employed by the enterprise to be reprivatized, including those previously employed for at least three years by the nationalized enterprise or the private enterprises from which it arose, have the right, irrespective of the form of privatization chosen, to acquire or subscribe shares on a preferential basis. This

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112. Following its accession to the EC, Portugal revised its fiscal law shifting from a very complicated scheme of several different taxes to the regime of Income Tax whose general structure is similar to most other EC countries.

113. See Act no. 11/90 of 5 April 1990.

acquisition or subscription right, which may take into account the length of employment, is subject to restrictions regarding its transfer.

### 13.3. PEPPER SCHEMES IN PRACTICE

The principal types of PEPPER schemes practised by firms in Portugal are profit-sharing and employee share-ownership, but no official data are available on their diffusion.

1) **Profit-sharing.** A survey of some existing cases (Castro, 1990) revealed the typical existence of two major types of schemes: cash-based and share-based profit-sharing. Profit-sharing is very seldom institutionalized, as such schemes are usually strictly dependent on managerial discretion. In addition, they are not necessarily universal, offered to all employees, and share-based schemes are very frequently restricted to top level officials. The diffusion of profit-sharing is apparently limited to some large companies, primarily in the financial sector, but even in these cases schemes seem to have been introduced on a rather casual and ad hoc basis.

Of the two types, cash-based schemes are by far the more popular one, even if we exclude bonuses and other types of gratuities which are directly related to workers' performance and only indirectly to firm performance.<sup>114</sup> This scheme dominates the financial sector with most, if not all, firms having some form of profit-sharing. In the case of public firms, the government usually imposes a period during which distributed profits are frozen and, in other cases, profits are distributed in the form of Public Debt Securities.

2) **Employee share-ownership.** Direct distribution of shares is not very common. Typically a certain quota of shares is reserved for employees at a privileged

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114. The Portuguese law, apparently, acknowledges this difference considering "bonus and premium" as part of the wage costs (earnings) and excluding from this concept financial participation of employees in company performance.

price. Most corporations offer this option to their employees on the occasion of increasing capital.

Recently, in the process of privatization that is now under way, the government has given the same alternative to public firm employees, though with the restriction of a 2 year freezing period. In the case of privatized firms, a significant part of the employees (in one of the cases, the large majority) signed contracts waiving their rights and assuming the obligation of selling their shares after the freezing period. Even if the prices offered by the potential buyers were quite attractive, this preemption constitutes a clear sign that "economic democracy" is still far from being easily accepted among Portuguese workers, and that PEPPER schemes will indeed require a "cultural revolution".

#### **13.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

Since PEPPER is still a very embryonic and informal phenomenon in Portugal, no studies have so far been undertaken to examine its possible effects.



## Chapter 14. SPAIN

### 14.1. GENERAL ATTITUDE

PEPPER schemes are not very common in Spain, and there is no clear public opinion on the issue. The principal economic and social agents do not consider it a priority, and have not yet developed clear strategies for the implementation of PEPPER schemes.

Nevertheless, the major political parties - the Socialist Party (PSOE) and the Conservative Party (PP) - both consider that the diffusion of PEPPER schemes would be beneficial for Spain. The main effect expected from such schemes is increased workers' cooperation, while collective bargaining is proposed as the most appropriate framework for their expansion.

For the PSOE, one of the most attractive aspects of incorporating PEPPER schemes into employee-firm agreements is that such arrangements may increase penetration of trade unions amongst firms. Certain PSOE groups also maintain that PEPPER schemes could be related to the creation of investment funds within medium and large firms.

The Conservative Party (PP) considers that PEPPER should become a significant part of employee remuneration, but only if the intention is to include participation in profits as a variable component of labour compensation, hence rejecting the idea (and present practice - see below) of employee participation in profits based on fixed payments. For the moment, however, the government does not seem to have an intention of presenting legislative proposals on PEPPER.

As to the position of the two major trade unions - CCOO (*Comisiones Obreras*) and UGT (*Union General de Trabajadores*) - both have persistently rejected the idea of PEPPER schemes. Their main argument is that such schemes introduce variable components of labour remuneration, and can therefore contribute to a reduction of the importance of fixed components. Both trade unions prefer mechanisms

which provide certainty of wages and other benefits (even though smaller), to greater but riskier compensation, and have argued that any change in the payment system at firm level must first be approved by employee representatives.<sup>115</sup> Trade unions are also in favour of creating investment funds within enterprises: the channelling of a portion of annual enterprise profits into a fund used for internal investment, and paying employees a part of the benefits generated by such investment.

The employers' association, CEOE, is not against the integration of PEPPER schemes into the compensation system within firms. However, the CEOE presently considers it more urgent to increase the role of other forms of variable rewards (linked to productivity gains, production objectives or sales volume) which have not acquired much importance until now. At the same time, employers are not very enthusiastic about promoting profit-sharing in an indiscriminate way, as they fear that a general expansion of schemes would oblige them to greater disclosure of economic information to employee representatives.

## 14.2. LEGAL AND FISCAL FRAMEWORK

Spanish legislation offers the possibility of introducing employee participation in enterprise profits, although no special benefits are provided either to firms or to employees. A recent law has also regulated employee buy-outs.

1) **Employee participation in profits.** All issues concerning extra payments to employees find their legal basis in the Statute of Workers (SW), which permits the inclusion of issues associated with labour economic conditions and with employee participation in company profits in collective agreements (Article 85, SW). Employee participation in profits is regulated further in labour legislation referring to industrial

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115. The criteria they normally apply in collective bargaining is a target wage increase rate; if firms have above-average profit rates, the criteria would include an additional increase but not in the form of sharing in the enterprise's economic results.

branches or sectors (*Reglamentaciones*), by which firms are sometimes compelled to give their employees an extra compensation in the form of "profit participation".<sup>116</sup>

Employee participation in profits can be implemented in two different ways: as direct labour compensation or, alternatively, through the establishment of funds for specific collective goals; in both cases, it is usually included in labour costs. According to the company profit tax law, a share of profits given to employees is considered a labour cost on two conditions: that such compensation is included in collective agreements, and that the motive behind the compensation is work done. If these conditions are not fulfilled, profit shares are considered as a donation and, therefore, are subject to double taxation: as profits and as income. For the allocation to funds for specific collective goals, there are several categories which are treated as reducible expenses.<sup>117</sup>

From the employee side, the wage is the sum of all economic compensation, in money or in kind, received as payment for personal labour services, but reducible expenses from income include life, medical, and accident insurance premiums, and sums directed to the Retirement Fund (up to a certain fixed amount). Hence, from the fiscal point of view of the individual, it does not make a big difference whether he participates in company profits through a firm's retirement plan or by receiving a higher salary.

Participation in profits can have an individual or collective character; it can refer to all or part of profits; and must apply to profits in the current year. In the case of different sectors of activities within a single enterprise the calculation of profit shares can be done only for the sector where the worker is employed; and one sector's losses cannot be compensated with another sector's surpluses (unless the worker is employed in both). Information disclosure on profits is also envisaged by law, as

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116. This is one of the three principal forms of extra payments above the basic wage (along with piece rates, and extra salaries paid twice and, sometimes, three times a year).

117. Expenses included in income tax; settlements directed to pension funds; eating installations, day nurseries, etc; collective transportation expenses; funds for cultural activities and sports; employee vocational training; travel expenses; life and accident insurance.

employees and workers' committees have the right to consult accounting books (see Montoya-Melgar, 1988).

2) **Employee buy-outs (1986).** Workers' buy-outs have recently been introduced by law no. 15 of 25 April 1986.<sup>118</sup> The law allows traditional shareholding companies to be taken over by employees, in which case they are transformed into "Anonymous companies of workers" (*SSAALL*). A *SSAALL* is defined as a mixed type of company in which no less than 51% of capital is owned by its employees. Article 20 of the 1986 law gives *SSAALLs* privileged fiscal treatment: under certain conditions, *SSAALLs* have the right to a 99% tax exemption from the capital transfer tax (see Llorens-Urrutia, 1987).

#### 14.3. PEPPER SCHEMES IN PRACTICE

As a payment system, PEPPER schemes do not seem very important among Spanish firms. However, there is no reliable data and detailed information on their diffusion either in regular publications on collective bargaining nor in special reports, while in many cases schemes are not included in collective agreements but are introduced by firms in a confidential way.

"Employee participation in company profits" very broadly defined can take three principal forms in Spain: participation in profits as a variable payment, participation in profits as a fixed payment, and other payments from profits benefitting employees. However, except for the first category of variable payments, the other two deviate from the basic concept of PEPPER (unless these payments are conditional on a minimum predeterminate level of performance).

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118. See LEY 15/1986 of 25 April, *Sociedades Anonimas Laborales*, in BOE no. 103, 30 April 1986.

1) **Variable payments from profits.** Schemes consist of variable payments in cash, linked to some measure of enterprise performance (profits, sales, production), but sometimes also to an individual worker's performance. These schemes are usually not included in collective agreements and are often reserved only for executives (management staff).

There is little reliable information on the diffusion of variable compensation schemes. Within the sample of 20 collective agreements examined by Saez (1990), variable profit payments were included in only 2 company-level agreements in the advertising sector, where they amounted to as much as 10-25% of total pay, and in one national agreement for the banking sector, where the amount was a fixed minimum of profits (see Table 14.1, Appendix to Chapter 14). In 1988 around 44% of all Spanish firms applied variable compensation linked to sales, production or other indicators (59% of large firms, and only 32% of medium sized firms). However, in 1987 only 6% applied variable compensation directly linked to profits (8% of medium-sized, and 4% of large firms). Nevertheless, it can be expected that variable compensation linked to profits will expand in the future, especially in medium-sized firms; a survey reports that 24% of medium sized firms have plans to extend this form of compensation in the next few years (see Table 14.2, Appendix).

Variable compensation in general does not account for a large percentage of total labour costs in Spain. In firms with more than 200 employees, different types of variable compensation (linked to production goals, extra hours and no absenteeism, or profits) represented 13.7% of total labour costs in 1989, of which payments linked to profits, around 4.6% of labour costs (see Table 14.3, Appendix).

2) **Other payments from profits.** The most traditional form of extra compensation of workers are "fixed profit payments", usually given to all employees. However, these payments do not fluctuate with enterprise performance; in most cases they imply a fixed payment usually corresponding to one month or two weeks wage. Other forms of employee compensation from profits include allocations to the firm's

retirement fund and payments in kind (cars, apartments, tourist trips, etc.),<sup>119</sup> but it is not possible to determine the percentage of cases in which such payments are directly linked to annual company profits.

Instead of cash payments, the distribution of shares to employees is also practiced, but no information is available on the incidence of such schemes.

Some summary statistics on PEPPER schemes in Spain are reported in Table 14.4. (Appendix), confirming that schemes are still of marginal importance. Profit payments as a variable component of remuneration involve no more than 2% of salaried employees for schemes included in collective agreements, and around 6% of medium and large companies for schemes not included in collective agreements. In medium and large firms, variable participation in profits amounts to about 5% of total labour costs.

#### **14.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES**

There is no empirical evidence on the effects of PEPPER schemes in Spain.

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119. Payments in kind are very diffused among Spanish enterprises (96% of all firms in 1988), but are mainly given to management personnel (80-90% of companies give them only to management).

## APPENDIX TO CHAPTER 14

**Table 14.1. SPAIN: EMPLOYEE PARTICIPATION IN COMPANY PROFITS  
IN A SAMPLE OF COLLECTIVE AGREEMENTS, BY SECTOR  
1988-1989**

Sector	Sample of agreements Type	Number	Particip. in profits	Type of payment and amount
Metal industry	National	1	NO	
	Company	2	NO	
Vehicles	Company	4	NO	
Chemical industry	National	1	NO	
	Company	1	YES	Fixed, approx. 1 month's salary
Construction	Provincial	4	YES	Fixed, depending on duration of work and occupational category
Telephone	Company	1	YES	Fixed, approx. 1 month's salary
Sales	Company	2	NO	
Banking	National	1	YES	Variable, a fixed minimum of profits
Insurance	National	1	NO	
Advertising	Company	2	YES	Variable, 10-25% of total pay

**Source:** Based on a selection of 20 collective agreements for 1988 and 1989 by Saez (1990).

**Table 14.2.EMPLOYEE COMPENSATION IN SPANISH COMPANIES  
BY TYPE AND FIRM SIZE  
1986-1988**

Forms of compensation	Year	% of all firms	% of medium sized firms	% of large firms
<b>Fixed compensation</b> as the basic component	1986	51	56	48
<b>Variable compensation</b>				
-linked to sales, production, etc.	1988	44	32	59
-linked to profits	1987	6	8	4
<b>Payments in kind</b>	1988	96	95	97
<b>Firms planning to extend variable compensation linked to profits in the next few years</b>	1988	13	24	5

**Sources:** "Encuesta para el diagnostico de los recursos humanos en España", 1987; "Informe sobre Remuneraciones", 1989; and "La negociacion colectiva en las grandes empresas", 1988 and 1989.



**Table 14.3. DISTRIBUTION OF LABOUR COSTS IN SPANISH COMPANIES  
WITH MORE THAN 200 EMPLOYEES (in % of firms)  
1987-1989**

Type of scheme	1987	1988	1989
<b>Fixed compensation</b>	61.6	61.3	62.0
of which:			
-wages	46.0	45.6	46.0
-seniority	10.4	10.2	10.5
-other components	5.2	5.5	5.5
<b>Variable compensation</b>	13.0	14.0	13.7
of which			
-production goals	6.1	6.6	6.7
-overtime and no absenteeism	2.2	2.4	2.4
-profit participation and other	4.6	5.0	4.6
<b>Fringe benefits</b>	25.4	24.7	24.3
of which			
-social security	20.9	20.2	20.0
-social benefits	4.5	4.5	4.3
<b>TOTAL</b>	100.0	100.0	100.0

Source: "La negociacion colectiva en las grandes empresas", 1988 and 1989.

**Table 14.4. RELATIVE IMPORTANCE OF PEPPER SCHEMES IN SPAIN  
IN THE LATE 1980s**

Scheme	Weights (in %)
<b>Profit payments as a variable component</b>	
-included in collective agreements:	
number of salaried employees	Max. 2%
-not included in collective agreements:	
number of companies	Approx. 6%
-as % of total labour costs	
in medium and large companies	5%

Source: Previous tables, and "Boletín de Estadísticas Laborales".

## Chapter 15. UNITED KINGDOM

### 15.1. GENERAL ATTITUDE

PEPPER schemes have had a long and interesting history in the UK, characterized by waves of uneven advance from the mid-19th century onwards.<sup>120</sup> PEPPER schemes have been also widely debated and have been occasionally favoured by public policy. Since the end of the 1970s, PEPPER has come to the fore of public debate, following the decision of the government to directly encourage schemes through favourable legislation.

Historically, the political party with the longest and strongest commitment to PEPPER schemes has been the Liberal Democratic Party.<sup>121</sup> Today, the Liberal Party sees PEPPER schemes as a "third way" between the private enterprise model of the Conservative Party and the state ownership model of the Labour Party. The Conservative Party started promoting certain types of schemes in the early 1970s, for which the Heath government introduced legislation providing for tax benefits in 1972-73. An opposite position was held by the Labour Party, which has fiercely criticized PEPPER schemes in the past,<sup>122</sup> and has opposed much of the Conservative legislation so that when coming to power in 1973, it abolished favourable tax treatment for existing schemes. In contrast with company-based schemes advanced by the Conservatives, in 1973 the Labour Party proposed the creation of a national collective fund (similar to the Danish proposed wage-earners' fund). This, however, met with considerable resistance from employers and other parties and hence was not adopted (Baddon et al, 1989, p. 51).

120. For a historical review, see Poole (1989), pp. 8-12; Bell and Hanson (1989), pp. 8-10.

121. The Liberal Party has long promoted PEPPER schemes; for its early position, see, e.g., the "Yellow Book" of 1928 (Bell and Hanson, 1989, pp. 11-12).

122. In 1927, it officially condemned profit-sharing as "an insidious weapon in the employer's arsenal against trade unions" (see Baddon et al, 1989, p. 38).

There was a resurgence of interest in PEPPER schemes in the late 1970s as a result of the pact between the traditional advocate of PEPPER, the Liberal Party, and the Labour government. Part of the deal for the continuation of the pact was the Labour government's adoption of Liberal proposals on PEPPER (Baddon et al, 1989, p. 33). An important step was taken in 1978 when, following pressure from the Liberal Party, significant tax concessions were introduced by the Labour Government to encourage certain types of PEPPER schemes.<sup>123</sup> The 1978 legislation has marked a profound change in both government policies and general opinion, and has also led to a substantial expansion of PEPPER schemes.

Following the coming into power in 1979 of the Conservative government, during the 1980s these concessions have been extended for different reasons, and additional fiscal incentives for new types of PEPPER schemes were introduced. The Thatcher government has encouraged individual employee share-ownership within the privatization measures, as a means of broadening capital ownership and promoting "popular capitalism" and a "property-owning democracy", and tax concessions for employee share-ownership plans (ESOPs) were introduced in 1989. The Thatcher government has also promoted in 1987 a new type of scheme - profit-related pay - as a way of securing automatic changes in wages in response to changed market conditions. It is hoped that this will result in positive employment effects (in line with the Vanek-Weitzman argument),<sup>124</sup> providing at the same time for closer identification of employees with their enterprise.

Today there is a general political consensus that PEPPER schemes ought to be supported through government policies in order to assist their further spreading, although the objectives the political parties hope to achieve through their support are different. The principal objectives running through the policies of the different parties

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123. It was the Labour Chancellor, Denis Healey, who initiated the legislation which underpins the current wave of PEPPER schemes in the UK (see Poole, 1989, p. 13).

124. Making a "significant proportion of an employee's remuneration depend directly on the company's profitability" would mean that "when business is slack, companies would be under less pressure to lay men off and by the same token they would, in general, be keener to take them on" (Green Paper, HMSO, 1986, para. 2); see also *Financial Times*, 13 May 1986.

are the improvement of human relations, increasing the impact of market forces on wage flexibility and employee motivation, and the spreading of social ownership.<sup>125</sup>

As in some other European countries, trade unions in the UK have traditionally been suspicious (if not hostile) towards PEPPER schemes, as such schemes in Britain were sometimes contemplated by management in order to forestall collective employee activity (Baddon et al, 1989). The initial TUC (Trade Union Congress) position was one of extreme caution, if not outright opposition. The TUC considered that PEPPER schemes inhibited trade union influence and thus could reduce the security of earnings, since schemes were typically introduced unilaterally by management and were not negotiable. In contrast with company-based schemes which the TUC opposed, in 1973 it expressed support for the creation of a national wage-earners' fund. Since then the TUC has shown little interest in PEPPER schemes,<sup>126</sup> until 1986 when it opposed profit-related pay, suspicious of the alleged impact on employee commitment and even more critical of the employment effects of wage flexibility, again putting forward as the main argument the issue of non-negotiability. Thus the attitude of the TUC has been characterized as one of "bored hostility" (Baddon et al, 1989, pp. 43-57).

However, the present TUC position on PEPPER schemes is quite different. The TUC has produced guidance to unions on profit-related pay, and has held a seminar on ESOPs and other forms of financial participation in February 1990. Today quite a few local unions also support PEPPER schemes and propose their introduction to employers. Indeed, in the recently proposed privatization of electricity supplies, the unions are pressing the government to introduce employee share-ownership schemes on a large scale, involving a greater proportion of shares than in any previous privatization.

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125. For a detailed account of the different positions on PEPPER schemes of political parties in Britain, see Baddon et al. (1989), pp. 32-41.

126. The issue has not been a subject of debate at annual congresses of the TUC.

The Confederation of British Industry (CBI) has until the early 1980s shown only mild interest in PEPPER schemes. Today it accepts, in general, employee involvement through financial participation (in particular various forms of employee share-ownership),<sup>127</sup> although its views have not always coincided with those of the government.<sup>128</sup> The main motivations for the introduction of PEPPER schemes by individual employers is that they are expected to provide closer identification of employees with their enterprise, by enabling employees to share in the success and to build up a personal stake in their company, and to increase intra-firm cooperation (Bell and Hanson, 1989, p. 5).

## 15.2. LEGAL AND FISCAL FRAMEWORK

Tax advantages were granted to executive share option schemes already in 1972, extended to all employees in 1973, but the incoming Labour government had abolished the favourable tax treatment in 1973. PEPPER schemes have again been actively promoted from 1978 onwards. Since then, the government has introduced provisions in its annual Finance Acts granting significant tax advantages to enterprises introducing PEPPER schemes, but schemes are subject to approval or acceptance by the Inland Revenue authorities. The various types of PEPPER schemes which are currently encouraged by tax concessions are as follows.

1) **Approved profit-sharing schemes (APS) (1978 Finance Act).** The scheme consists of a bonus paid in the form of ordinary shares of the company or group of companies where the worker is employed, which is free of income tax provided shares are held by trustees for a minimum period of time.

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127. See the CBI 1984 publication on employee share-ownership.

128. Thus the CBI does not fully accept the model of flexible profit-related pay, rejecting the alleged employment effects of the scheme (Baddon, 1989, p. 41).

The enterprise channels a sum of money into a trust, which then buys either already issued, or newly issued shares of the company for employees. The main conditions which have to be met in order to get approval by the Inland Revenue (and hence qualify for tax concessions) are the following. The scheme must be open to all full-time employees who have completed a minimum period of service which may not exceed five years, and all employees must be eligible to participate on similar terms. The value of shares given to a single employee in any one year cannot exceed a stated maximum; the shares must be ordinary shares and must be held by trustees for a minimum retention period, and then for a further three years as a condition for the employee's entitlement to income tax relief. During the whole of this five-year period, employees are entitled to receive dividends, but do not have the right to attend shareholders' meetings (although they can instruct the trustees on how to vote at general meetings). The money provided by the company for financing the purchasing of shares is considered a chargeable expense and hence is not subject to corporation tax liability (Bell and Hanson, 1989, pp. 15-16).

The limits on annual share appropriations to individual employees have been increased since the original 1978 legislation, and changes have also been made in the trust holding period. In 1978, a company could share out up to UKL 500 worth of its stock per worker each year, no sale was permitted for a minimum period of 5 years but, in order to benefit from a 100% income tax exemption, shares had to be held by trustees for a period of 10 years. In 1985 the amount was increased to UKL 1,250 or 10% of the individual's annual salary (whichever the greater) with a maximum of UKL 5,000; the minimum retention period was reduced to 2 years, and employees were partly or fully exempted from income tax depending on when they decide to sell their shares, no income tax being paid if shares remain in the trust for a period of 5 years (Bell and Hanson, 1989, p. 16). In 1989, the maximum amount per employee per year was increased to UKL 6,000 (Grout, 1990).

It is also possible to use tax concessions provided by the 1978 Finance Act for share purchase schemes (also known as contributory share schemes, or "BOGOF" - buy one get one free), for which eligibility is restricted to employees who agree to

purchase one share for every one (or more) free shares received from the company (Grout, 1990). Shares provided by the company are free of income tax and are frozen in a trust under the same terms as for the conventional APS scheme, but there are no tax concessions for shares purchased by employees, which must also be held by trustees for a period determined by the company (usually one or two years) (Bell and Hanson, 1989, p. 81).

2) **Save as you earn (SAYE) share option schemes (1980 Finance Act).** The scheme consists of an offer of share options to employees. In order to be approved, it must be open to all full-time employees who have completed 5 years of service. In its standard form, the scheme binds an employee to save a minimum of UKL 10, and a maximum of UKL 150 per month (originally UKL 50) for 5 years. Each employee who takes out a SAYE contract is given options over shares to the value of their total savings over the 5-year period, plus a predetermined bonus (equivalent to interest) which depends on whether the savings are withdrawn after the 5 years or are left untouched for a further 2 years. At the end of the period, the employee can either opt to receive in cash the accumulated savings plus the bonus, or can exercise the option in whole or in part by buying company shares, at a price specified when the SAYE contract was entered into which is based on their market value at the beginning of the savings period, discounted by a maximum of 10% (Bell and Hanson, 1989, pp. 81-82). In the meantime, the permissible discount on options has been increased to 20% of the share price (Grout, 1990).

Employees are exempt from income tax on the bonus added to the employee's savings, and the only tax liability in the event of employees exercising their option and purchasing the shares is capital gains tax (if any) on their eventual sale (Bell and Hanson, 1989, p. 82). Given that SAYE schemes involve relatively small amounts, and in the UK the first UKL 6,600 (in 1987/88), and now (in 1990/91) UKL 5,000 per year is exempt from capital gains tax, most participants would not be liable to any capital gains tax (Grout, 1990; Baddon et al, 1989, p. 295).



3) **Discretionary share option schemes (DSO) (1984 Finance Act).** Under the scheme, options are granted to selected employees to buy their company's shares, which must be exercised if the tax relief is to apply between 3 and 10 years after the date of grant of the option, and not within 3 years of any other tax-relieved option exercise. The options may be over shares whose initial value is up to four times the employee's annual salary, or UKL 100,000 (whichever is the greater), and the exercise price for each share must be set at the market price on the day it is granted. There is no tax liability at the time the option is exercised, but only capital gains tax liability on any increase in value over the option price if and when the shares are sold (Bell and Hanson, 1989, p. 83). Since capital gains tax is now (1990/91) charged at the taxpayer's marginal rate, the attractions of participation in the scheme are that (i) the employee does not pay any tax when he obtains his shares on the exercise of his option, and (ii) he pays capital gains tax on his profit only when he sells his shares (after the first tax-free element of UKL 5,000 a year).

4) **Profit-related pay (PRP) (1987 Finance Act).** The scheme consists of an all-employee cash payment directly linked to the profits of the enterprise or a subunit of the enterprise in which the employee works. In order to be approved, certain conditions must be fulfilled. The scheme must last for at least one year, and must include at least 80% of all full-time employees who have completed more than 3 years' service, who should participate on similar terms (e.g. proportionate to salary or length of service). Distributable PRP must be linked to profits according to a formula determined in advance, and it was originally required that in the first year it must be such as would amount to at least 5% of total pay, including PRP, of all participating employees if profits are unchanged from the previous year. The rules of a scheme may provide that if profits fall in the first year, no distribution of PRP will be made, and that profits in excess of 160% of the previous year may be disregarded.

The current legal provisions (1990/91) permit employers to set up schemes for central units (headquarters) with PRP based on the profits of the whole undertaking, and certain alterations are allowed for PRP schemes which have already been

registered. Although this does not limit the amount of PRP employees may actually receive, tax relief applies to the PRP received by individual employee participants up to a limit. The limit is 20% of the employee's total pay or UKL 4,000, whichever is the lower (so tax relief applies to PRP up to 10% or UKL 2,000, whichever is the lower). The Inland Revenue has published a revised and improved edition of its Guide for enterprises planning to introduce PRP, as in the past there was some misunderstanding of some of the rules.<sup>129</sup>

5) **ESOPs (1989)**. Under the influence of the American system of employee share-ownership plans (ESOPs), in its 1989 Finance Act the government has introduced fiscal benefits for employers making special arrangements for their employees' share acquisitions through ESOPs or employee share-ownership trusts (ESOTs) (see more in Cornford, 1990). Fiscal benefits are given only to those ESOPs in which shares are distributed to employees before the end of the maximum period of 7 years after their acquisition. In 1989, the government has also introduced specific legislation on statutory employee share-ownership trusts, referred to as qualified trusts (abbreviated as QUESTS). Under this legislation, companies obtain a statutory tax deduction for contributions to a QUEST (Grout, 1990).

Quoted UK companies introducing one of the share-based PEPPER schemes offered tax benefits may need to not only seek approval from the Inland Revenue, but may also need to meet the requirements of the stock exchange and of the Investment Protection Committee (IPC). The IPC limit for all approved PEPPER schemes combined is 10% of the issued share capital over a 10-year period, while the number of share options offered to employees is restricted to 5% of the company's issued ordinary share capital over 10 years (Bell and Hanson, 1989, p. 83; Baddon et al, 1989, pp. 303-304).

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129. E.g., the rule requiring that PRP be distributed to employees on "similar terms".

### 15.3. PEPPER SCHEMES IN PRACTICE

Until the 1970s, the diffusion of PEPPER schemes in the UK has been limited.<sup>130</sup> In a survey carried out in 1954, the Ministry of Labour found about 500 companies practising some form of PEPPER (Poole, 1989, p. 13). However, prior to 1977 only about 2% of all employees benefitted from PEPPER schemes and only 10 companies with over 10,000 employees had a scheme; in 1977 there were barely 100 schemes open to all employees, though 1,000 for top executives (see Brannen, 1983, p. 130).

Following tax concessions offered from 1978 onwards, the number of all types of PEPPER schemes has been steadily growing (see Table 15.1, Appendix to Chapter 15). Schemes approved by Inland Revenue represent around 70% of all schemes available to employees. It has been estimated that, up to March 1988, more than 2 million employees had become involved in the different forms of approved all-employee share schemes (Bell and Hanson, 1989).

1) **APS.** APS schemes have experienced steady growth since the introduction of tax incentives in 1978. In the first ten-year period, there was a tenfold increase in approved APS schemes (from barely 78 in 1979, by March 1988 their number had increased to 737), and at the end of March 1990 there were 890 schemes. APS schemes have mainly been applied by large public companies quoted on the stock exchange, and much less by small and private enterprises, since private firms have greater difficulty in developing arrangements of a share-based type which can obtain Inland Revenue approval (Poole, 1989, p. 49).<sup>131</sup> According to the Inland Revenue, only around 15% of APS schemes are applied in non-quoted companies (Baddon et al, 1989, p. 68).

130. Some companies which have introduced PEPPER schemes during the 1950s or even earlier include the John Lewis Partnership, ICI, Rugby Portland Cement, and Tate and Lyle; in the 1970s, the leaders were National Westminster and Barclays, followed by Lloyds and the Midland; see Shenfield (in Pejovich, 1978), Bell and Hanson (1989).

131. E.g. the absence of a market value of shares makes it virtually impossible to set up a scheme and to get approval.

2) **SAYE.** SAYE share option schemes approved by the Inland Revenue increased from 22 in March 1981 to 891 in March 1990. Nevertheless, the percentage of employees participating has been low, on average not higher than 15% (with the exception of the privatised companies where take-up rates of 30% or more are common), and the main category of employees involved are top executives (managers) (Grout, 1990). Bell and Hanson's survey (1989) showed that the take-up rate in most firms was not much above 15%, except for a few mainly high technology service companies in which it was over 50% (Bell and Hanson, 1989, p. 82). The reason for such low take-up rates, according to another survey, is the long period of time before money can be made; workers' attitude towards this type of scheme was not always positive (Dewe, Dunn, and Richardson, 1988).<sup>132</sup> As in the case of APS schemes, around 85% of SAYE schemes are introduced by quoted companies (Baddon et al, 1989, p. 68).

3) **Discretionary share-option schemes.** DSO schemes have had an enormous success since they were first introduced in 1984. Their growth rate has by far outstripped that of other types of schemes, and their number had by March 1990 reached 4,326. Hence, today, the vast majority of PEPPER schemes in the UK are discretionary share option schemes, as there are more than twice as many companies operating these schemes as the all-employee schemes. These schemes usually do not involve a large percentage of employees, as they have been used almost exclusively to reward directors and higher management (Grout, 1990). A 1985 Wider Share Ownership Council survey found that in 48% of cases, less than 10% of the workforce participated in these schemes (see Estrin, Grout, and Wadhvani, 1987).

It is, however, misleading to attempt to assess the popularity or significance of discretionary schemes on the simple basis of the number of approved schemes. There are 2.5 approved discretionary schemes for every 1 approved all-employee scheme;

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132. Only 29% of workers thought the scheme had made workers richer; 26%, that such schemes built up team spirit; 18%, that they reduced conflict between management and labour; but 20-45%, that such schemes made companies successful.

but for every 1 employee granted participation in a discretionary scheme in 1989/90, 13 were granted participation in an all-employee scheme.

4) **PRP**. Although the growth of profit-related pay schemes has fallen short of expectations, the number of schemes approved by the Inland Revenue has grown steadily since the introduction of tax incentives in 1987. By March 1988 there were 616 schemes, covering around 120,000 employees, and by March 1990 the number of approved schemes reached 1,175, covering 232,000 employees (around 1% of the work force) (see Table 15.2, Appendix).

Some reasons for the limited diffusion of PRP so far can be found in existing legislation, e.g. the requirement for PRP to be equal to at least 5% of the employee's pay. Experience has shown that some employers have been discouraged by this 5% lower limit from setting up PRP schemes, as they would have preferred to have built up their commitment to PRP more gradually. Nevertheless, of the employers that did introduce the scheme, many have chosen to pay a larger PRP element than the 5% limit (Inland Revenue Press Release, 3 February 1989). It is probable that many schemes have been introduced by companies that already had a cash scheme before 1987, but have registered in order to give employees the tax relief offered by the 1987 Finance Act. The 5% pay requirement has been abolished at the beginning of 1989.

5) **ESOP**. ESOPs are a very recent phenomenon in the UK, as the first ones were only established in 1987.<sup>133</sup> In 1988, there were fewer than a dozen ESOPs (Pryce and Nicholson, 1988; Standing, 1988) and today there are still only around 20. Although several companies claim to be considering introducing ESOPs through the QUEST route, for the moment the 1989 legislation on ESOPs has had a slow start; the general view is that it is too complex and has been mostly ignored (Grout, 1990). The

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133. Among the companies that have set up ESOPs are Roadchef, People's Provincial Buses, and Armstrong Engineering in Coventry (Baddon et al, 1989, p. 55).

main financier of ESOPs in the UK is Unity Trust, and ESOPs have general support from both Labour and Conservative politicians.

6) **Other forms of employee share-ownership.** In the privatization of state-owned companies in which shares were offered to the public, and in the flotation of some major institution (e.g. the Trustee Savings Bank), it has become common practice to encourage widespread employee share-ownership by giving or offering shares to employees on special terms.<sup>134</sup> In most cases such practices have been successful,<sup>135</sup> leading to a rapid increase in the number of employee shareholders. In January 1987, about 4% of the adult population owned shares in the company where they worked, which compares with virtually nil a decade ago (Jones, 1987).

7) **Cash-based profit-sharing.** Apart from the schemes qualifying for tax concessions, there is also evidence of many cash-based profit-sharing schemes not registered by the Inland Revenue, which take the form of cash bonuses linked to profits or some other measure of company performance. Since these schemes are not officially registered, there is no reliable figure on their diffusion.

In a Department of Employment survey covering 1,125 enterprises (Smith, 1986), 6% of the firms screened had a cash-based profit-sharing scheme in 1985, prevalently private enterprises in manufacturing (see Table 15.3, Appendix). The bulk of small privately-owned firms never seriously considered adopting one of the schemes approved by Inland Revenue because they regard such arrangements as inappropriate to their way of operating. Another survey undertaken in the mid-1980s based on a much smaller sample (231) of firms found that cash-based profit-sharing was actually the most frequent form (31% of firms with schemes) (Baddon et al, 1989, pp. 62-63).

134. In the privatization of Rolls Royce in 1987, apart from a small allocation of free shares, employees were offered two matching shares for each one bought, up to a value of UKL 150, a 10% discount on further shares purchased up to a value of UKL 2,000, and priority allocation up to a further UKL 10,000 worth of shares (Bell and Hanson, 1989, p. 87).

135. E.g. in the privatization of Rolls Royce, British Airways, Cable & Wireless, British Gas, there was an extremely high response of employees to share offers.

The different types of PEPPER schemes are applied by over 30% of UK firms. The Department of Employment survey covering 1,125 enterprises found that in 1985 around 20% of firms had introduced at least one of the all-employee PEPPER schemes, while a further 9% of firms only had schemes for selected executives (see Table 15.3, Appendix). However, there is great variety depending on enterprise ownership, industry sector, and company size. Thus 54% of all publicly quoted companies had introduced a PEPPER scheme (of which 41% at least one all-employee scheme, and 14% a selective scheme only), compared with only 20% of privately-owned firms (11% had an all-employee, and 7% a selective scheme). The distribution by industry shows a prevalence in finance, where 50% of firms had introduced all-employee schemes, followed by services (30%) and manufacturing (21%). Large companies with more than 500 employees were more than twice as likely as smaller firms to have a scheme, SAYE schemes being particularly common in large companies. The goal for the introduction of schemes most often stressed was to bind employees more closely to their company (Smith, 1986). The survey also showed that in 1985, over 3.5 million employees in the UK were eligible for one of the main types of PEPPER schemes, of which 1,673,000 effectively participated (see Table 15.4, Appendix).

The amount destined to PEPPER schemes represents a relatively low proportion of both annual profits and workers' remuneration, as it usually does not surpass 5% of company profits and 10% of employee pay. A 1985 survey by the Wider Share Ownership Council found that the portion of profits (before tax) allocated to employee shares was less than 3%, and represented, in each year, less than 0.5% of previously issued share capital; in the majority of cases, the share component was less than 2% of total wages and salaries (Estrin, Grout, and Wadhvani, 1987). Another survey suggests that profit-sharing bonuses were most frequently around 2-4% of total pay, although 20% of the firms in the sample did provide bonuses amounting to over 10% of pay; where share capital schemes existed, the proportion of shares in employee ownership was rather low, with 56% of respondents indicating that less than 1% of the total share issue belonged to employees (see Baddon et al, 1989, p. 71, 65). ICI

(Imperial Chemical Industries Limited) gave annual profit-sharing bonuses equal to 5-7% of pay in 1976-77 (Clayre, in Clayre, 1980, p. 179), whereas in 1986 they were equal to 8.1% of pay (Bell and Hanson, 1989, p. 13). The average proportion of profit-related pay in registered PRP schemes is reported to be around 7% of employee pay (Inland Revenue Press Release, 3 February 1989).

There is also considerable variety in terms of the formulae for the calculation of profit-sharing,<sup>136</sup> and the forms of PEPPER introduced by single companies. Marks and Spencer and ICI have offered employees the option between immediate and deferred shares; Habitat and H. P. Bulmer have introduced only a deferred-share scheme; while the Midland Bank and Boots Company offer the choice between cash and deferred shares.<sup>137</sup>

#### 15.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES

The effects of PEPPER schemes have been analysed by a number of scholars using data from the UK,<sup>138</sup> who have either developed econometric models testing some of the principal theoretical hypotheses, analysed statistical data in order to compare the relative performance of firms with PEPPER schemes with respect to enterprises without, or undertaken attitude surveys.

A summary of the principal findings of the most important of these studies is presented in Table 15.5 (Appendix). Econometric evidence appears to be inconclusive. Some of the earlier studies seemed to indicate that PEPPER schemes have positive effects on motivation, productivity, and employment. Thus Estrin and Wilson (1986) found a strong positive effect of cash-based profit-sharing on the level of employment

136. See Warner (1982). E.g. ICI initially used pre-tax profits, but during the 1970s switched to a ratio of payroll to value-added, considering it a more objective criterion for calculating profit-sharing (Clayre, in Clayre, 1980, p. 179).

137. Other firms that have introduced PEPPER schemes include Briggs and South Metropolitan Gas, Conder International, Habitat, Wedgwood, Bentalls, Owen Owen, banks such as National Westminster, Barclays, Lloyds, breweries such as Bass, Vaux, and Burtonwood, and multiple stores groups such as Burton and Sainsbury; the National Freight Corporation is considered the largest employee buy-out in the UK (see Clayre, in Clayre, 1980; Bell and Hanson, 1989).

138. Indeed, the bulk of empirical work on PEPPER schemes in European countries has concentrated on evidence from the UK.



(higher by 13%), and they attributed this to the effects of higher productivity on the demand for labour. Bradley and Estrin (1987) report similar positive effects of cash-based profit-sharing on employment: a comparison between the John Lewis Partnership and its four main competitors showed that employment at John Lewis Partnership exceeded employment of each competitor by 20-37%.<sup>139</sup> As to the effects of profit-sharing on productivity, Cable and Wilson (1988, 1989) found productivity differentials of 3-8% in favour of profit-sharing firms, evaluated as being the joint effect of a set of organizational factors and not only profit-sharing, thus questioning policy measures which do not take into account organizational design.

In contrast with such findings, the work of Blanchflower and Oswald (1987, 1988) based on a much larger sample of enterprises (637) from the 1980 and 1984 Workplace Industrial Relations Survey, suggests that the effect of employee share-ownership on employment is insignificant, whereas its effect on performance is small. This sample, however, included only firms which had employee share-ownership schemes (and not cash-based profit-sharing), suggesting that the effects of different types of PEPPER schemes are indeed likely to be different.<sup>140</sup> Blanchflower and Oswald's results have been questioned by Jones and Pliskin (1988, 1989) because of inadequate measures used and, moreover, do not seem fully confirmed by the latest empirical evidence.

Jones and Pliskin (1988, 1989) tested for the effects of profit-sharing on employment using a sample of 127 firms with diverse sharing arrangements (both cash and share-based schemes), for some of which data were available for more than 100 years. Employment effects were very dependent on the measure of profit-sharing, on how the dynamics are modelled, and on whether measures of employee participation in decision-making were included. If profit-sharing was captured by a dummy variable (which has been the usual method applied in most other studies), large and significant

139. This is after controlling for remuneration, sales, retail sales, and employment in the previous year; the effects are triple if the effects of profit-sharing on employment in the previous year are taken into account.

140. Indeed in a later study, one of the authors (Blanchflower, 1989, p. 18) concludes that there is "absolutely no evidence that profit-sharing does any harm".

employment effects were often found. However, when a continuous measure of profit-sharing was used, the effects were lower, typically ranging from -6% to 6%, i.e. at best, much more modest than previous work suggested. In many of the specifications, the estimates indicated that workers' participation in decision-making had an important influence on the employment effect of profit-sharing; some of these results suggest that the employment effects of profit-sharing are greater if there is no worker participation in decision-making (in line with Weitzman's hypothesis, but in contrast with some findings for Germany and France; see above).

Estrin and Wilson's (1989) estimates suggest that profit-sharing firms regard the base wage, rather than total remuneration, as the marginal cost of labour but they adjust remuneration more, and therefore employment less, than their fixed wage counterparts. However, the size of the effect of profit-sharing on employment variability is small: profit-sharing raises employment by around 2%, but for an estimated elasticity of labour demand of around 13%, the overall impact on the change of employment, though significant, is negligible (only around 0.2%). This is attributed to the small proportion of pay coming in the form of profit-sharing.

The most recent econometric estimates of the effects of PEPPER schemes are provided by Wadhvani and Wall (1990). The sample included 101 UK firms in the 1972-82 period, of which 21 had operated a profit-sharing scheme at some time, and had given a profit-sharing bonus ranging from 0-10% of wages. The initial analysis of crude statistical data suggested that non-profit-sharing firms were more productive, as they showed an improvement in output per man and higher stock returns respect to profit-sharing firms. In their econometric estimates, on the contrary, the authors found that profit-sharing boosted productivity. Similar to findings of other studies for the UK, Germany and France, it was found that firms view the total level of remuneration (and not just the base wage) as the marginal cost of labour. As to employment effects, the evidence was inconclusive.

Other scholars have examined the effects of PEPPER schemes using less sophisticated techniques. Bell and Hanson's (1987, 1989) analysis of key indicators of 414 UK enterprises in the 1976-85 period, of which 113 were profit-sharing firms and

301 non-profit-sharing firms, suggests that over the whole period the economic performance of profit-sharing firms taken as a group was superior in 90% of cases than that of non-profit-sharing firms, in terms of nine major economic indicators measuring profitability, growth and investor's returns.

Richardson and Nejad (1986) have compared share prices of 41 UK firms with and without employee share-ownership. Apart from the 1978-79 period when employee share-ownership firms had losses, thereafter the balance shifts strongly in their favour, suggesting a positive impact of employee share-ownership on profitability.

A number of scholars have also investigated the general attitude of employees and firms in the UK towards PEPPER schemes.<sup>141</sup> Richardson (1987) carried out a survey of 165 firms with an all-employee PEPPER scheme. Nearly all firms gave at least one reason for doing so in addition to tax advantages, among which the most common was a change in attitude among workers, while only a small minority reported incentive effects (see Dewe, Dunn, and Richardson, 1988). Bell and Hanson's survey based on questions posed to 2,703 employees in 12 enterprises with PEPPER schemes revealed that the large majority strongly supported such arrangements, both in their company (88%) and in general (91%), considering that it increases workers' interest in the firm's profits (76%), improves employee attitudes (73%), creates a better atmosphere (65%), is good for company and employees (86%), is popular because people like bonuses (93%), and should not substitute for adequate wage (96%) (Bell and Hanson, 1989, pp. 23-24).<sup>142</sup>

As to workers' preferences for various types of schemes, in one of the attitude surveys cash-based profit-sharing was the most popular category of financial participation (Baddon et al, 1989, p. 272). The John Lewis Partnership initially gave its employees annually non-voting fixed interest shares, tradeable on the stock exchange,

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141. There are a number of attitude surveys on PEPPER which have been undertaken in the UK, but for the sake of brevity, will not be reviewed; see Poole (1989), or Baddon et al, (1989), which also include a number of interesting case studies.

142. The percentages refer to positive answers of employees surveyed.

but from 1970 switched to cash bonuses, a benefit of 15% of pay from the day of joining (i.e. a form of "pseudo" profit-sharing), since employees preferred it.

In Bell and Hanson's 1984 attitude survey, where the choice between cash and shares was available, 80% of employees chose cash. However, in companies that only had a deferred share-based profit-sharing scheme, 73% of employees answered that even if the cash option were available, they would still continue to take deferred shares. ICI used to offer immediately marketable shares (which were normally taxed), but in addition in 1978 introduced share-based profit-sharing (tax-free), giving employees the option between the two; prior to 1978 most employees sold their shares at once,<sup>143</sup> but more recent experience shows that employees prefer immediate shares with no tax benefits, to tax-free deferred shares (84% of employees). In Marks and Spencer, on the contrary, 79% of employees chose deferred shares, possibly because immediate shares were introduced only recently (Bell and Hanson, 1989, pp 17, 27).

Therefore, despite the legislation stimulating primarily share-based schemes, the evidence on workers' preferences seems to indicate that schemes providing for immediate payment are in general preferred by workers to deferred types of schemes.

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143. In 1971, only 37% of shares thus distributed were still in the hands of employees.

## APPENDIX TO CHAPTER 15

**Table 15.1. DIFFUSION OF PEPPER SCHEMES IN THE UNITED KINGDOM**  
 (cumulative total of schemes approved by Inland Revenue  
 as at March of each year)

1980-1990

Scheme &  
year of  
introd-  
uction

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
<b>APS</b>											
1978	117	210	278	344	392	462	532	634	737	795	890
<b>SAYE</b>											
1980		22	137	215	288	403	514	618	708	808	891
<b>DSO</b>											
1984					202	1,453	2,204	2,949	3,795	4,326	
<b>PRP</b>											
1987								616	869	1,175	

Source: All figures are based on Inland Revenue data provided by British authorities.

**Table 15.2. GROWTH OF PROFIT-RELATED PAY  
IN THE UNITED KINGDOM**

**1987-1989**

<b>Period</b>	<b>Number of live schemes registered</b>	<b>Number of employee participants</b>
<b>1987</b>		
End October	145	26,411
End December	430	71,827
<b>1988</b>		
End March	616	89,952
End June	729	103,800
End September	784	107,300
End December	830	122,400
<b>1989</b>		
End March	869	122,100
End June	902	129,000
End September	947	135,400
End December	1,112	226,500
<b>1990</b>		
End March	1,175	232,000

Source: Inland Revenue Press Release, 25 April, 1990.

Table 15.3. PEPPER SCHEMES IN THE UNITED KINGDOM - 1985 (in % of all 1,125 firms screened)

	1. All firms with at least one all- employee scheme				Type of scheme			2. Firms with selective employees		3. Firms with no scheme
	Any Inland Revenue scheme	APS	SAYE	Non-approved share scheme	Cash-based scheme					
TOTAL	21	15	8	9	1	6	9	69		
By ownership and size										
Publicly quoted	41	37	19	24	2	4	14	44		
Large	58	54	23	41	2	4	14	28		
Small	24	20	15	6	2	4	15	61		
Privately owned	11	4	2	2	1	7	7	81		
Large	24	16	9	7	1	8	8	68		
Small	10	3	2	1	1	7	7	82		
Foreign owned	13	5	3	3	5	3	8	79		
By industry										
Manufacturing	21	14	6	9	1	8	10	68		
Retail distribution	13	7	4	4	1	5	7	79		
Finance	50	46	36	18	3	3	6	44		
Services	30	28	10	18	1	4	14	57		
Other (mainly construction)	12	8	5	4	1	3	13	75		

Source: Smith (1986), p. 381.

**Table 15.4. EMPLOYEE ELIGIBILITY AND PARTICIPATION RATES IN PEPPER SCHEMES IN THE UK IN A SAMPLE OF 1,125 ENTERPRISES**

Type of scheme	1985			
	Employees eligible		Employees participating	
	Number	%	Number	%
APS	923,000	12	689,000	9
SAYE	2,211,000	29	623,000	8
Other all-employee share schemes	99,000	1	68,000	1
Cash profit-sharing	293,000	4	293,000	4
TOTAL	3,526,000		1,673,000	

Source: Poole (1989), p. 47, based on the Department of Employment 1985 survey.



Table 15.5. ECONOMIC EFFECTS OF PEPPER SCHEMES - EMPIRICAL EVIDENCE FROM THE UK

Study	Method & Data Source	Results
Estrin and Wilson (1986)	Econometric model 52 engin. & metal-working firms 1978-82	PS: profit-sharing Strong effects of PS on employment (an increase of 13%), attributed primarily to higher productivity.
Bradley and Estrin (1987)	Econometric model John Lewis Partnership and main competitors 1970-85	PS has no significant effect on the level of remuneration, but is associated with higher levels of employment (20-37%), and increases wage flexibility. Bonuses and wages found to have very different effects on employment.
Cable and Wilson (1988)	Econometric model 52 engin. & metal. firms 1978-82, comparisons with Germany	Productivity differentials of 3-8% in PS firms (thus substantially lower than in Germany), evaluated as being the joint effect of a set of organizational factors, and not only PS. Characteristics of firms very different in the two countries.
Cable and Wilson (1989)	Econometric model 52 engin. & metal. firms 1978-82	Overall gains in PS firms between 3-8%, gains which are associated with other organizational variables, suggesting that PS may need to be accompanied by other changes in organizational design.
Blanchflower and Oswald (1987 & 1988)	Econometric model 637 manufacturing firms, 1980 & 1984	Cannot reject the hypothesis that PS has no effect on financial performance, but the effects are small. Similar employment growth and quality of industrial relations in PS and conventional firms. Little evidence either for or against PS.
Jones and Pliskin (1988 & 1989)	Econometric model 127 firms, 3 sectors 1890-1975	PS employment effects varied (-6% to 6%), depending on measure of profit-sharing, model specification and whether measures on participation in decisions are included. Employment effects greater if PS captured by a dummy, and more modest (although significant) if a continuous measure is used.
Estrin & Wilson (1989)	Econometric model 52 engin. & metal. firms 1978-82	PS firms adjust remuneration more, and therefore employment less, than their fixed wage counterparts. PS schemes act to reduce employment variability, although the size of the effect is small (0.2%).
Richardson and Nejad (1986)	Data analysis 41 firms with and without share ownership, 1978-84	Comparisons of share prices indicated that apart from 1978-79, when PS firms had losses, thereafter the balance shifts strongly in favour of PS firms, suggesting a positive impact of employee share-ownership on profitability.
Bell and Hanson (1987)	Data analysis 113 PS firms 1976-85	Over the whole period, the economic performance of PS firms taken as a group was superior than that of non-PS firms, in terms of 9 economic indicators measuring profitability, growth and investor returns.
Wadhvani & Wall (1990)	Econometric model 101 firms (21 with PS) 1972-87	PS boosts productivity, but may not increase employment (evidence inconclusive). Firms view the total level of remuneration as the marginal cost of labour (contrary to Weitzman's hypothesis).

Part III

**CONCLUSIONS**



## **Chapter 16. PEPPER SCHEMES IN MEMBER STATES OF THE EC: PRINCIPAL FINDINGS OF THE REPORT**

A summary of the principal findings on PEPPER experiences in the Member States of the EC will now be presented. The general structure adopted in previous chapters on individual countries will again be used, but this time in a cross-national comparative framework.

### **16.1. GENERAL ATTITUDE**

The general attitude towards PEPPER schemes is very different both among Member States of the EC and within each individual country, as a variety of positions taken by governments, employers' associations and trade unions can be distinguished, in particular concerning the specific forms of PEPPER that ought to be supported through policy measures.

#### **Governments**

Official government positions in individual EC countries range from those which are strongly or partly in favour of PEPPER, to those without a definite standpoint.

In some countries, PEPPER has been given priority in general government policies, leading to active encouragement of schemes through a series of official measures. In France such a positive attitude towards PEPPER has been present since the late 1950s and different types of schemes have been encouraged; while in the UK government support of PEPPER has been present primarily since 1978 and, as in the case of France, has also been directed towards a variety of schemes.

In other countries such as Belgium, Denmark, Germany, Greece, Ireland, Italy and the Netherlands, PEPPER has been the subject of national debate, but official

government support has either been limited, lacking, or has emerged fairly recently. In Denmark, Germany and the Netherlands, although a positive general attitude has been present for several decades, official government support has so far been limited and directed towards only certain types of PEPPER schemes. In Greece, two main types of PEPPER schemes have been supported, but primarily since 1984. In Ireland, priority has been given to PEPPER in government policies since 1982, but support is currently directed towards only two forms of PEPPER. In Italy, PEPPER-related schemes have been intensively discussed since the early 1980s, but no official measures have been adopted so far to encourage their spreading. In Belgium, despite a rising interest in PEPPER in the late 1980s and several recent official proposals, government support has so far been limited to schemes only indirectly related to PEPPER.

An important issue in past and present discussions in many countries has been, and still is, whether enterprise-level, or collective schemes at a higher level, ought to be encouraged. Particularly in Denmark, Germany and Italy, a large part of the national debate has focused on the issue of economy-wide wage-earners' funds, but due to the absence of a general consensus and the opposition to obligatory collective arrangements (primarily from employers' associations), none of the proposals advanced have been adopted.

Finally, there are countries such as Luxembourg, Portugal and Spain, in which the government does not seem to have yet adopted a clear and definite position on PEPPER. Although in some of these countries the government may be generally supportive of PEPPER, the topic has not been among the priority issues discussed by social partners. Only very recently (1990) has PEPPER been emerging in some of these countries as a topic of discussion.

The specific positions of the two sides of the industry in EC countries - employers' associations and trade unions - have also been rather divergent.

### **Employers' associations**

In those countries in which PEPPER has been discussed by social partners, employers' associations have usually persistently opposed any binding arrangements. They have supported, on the contrary, enterprise-level schemes, if these are introduced on a voluntary basis leaving the design of the scheme to enterprise discretion, and have argued for the introduction or improvement of tax incentives. Employers usually consider PEPPER schemes an important instrument for improving employee motivation and commitment, as well as providing greater identification of employees with their enterprise's interests. Generally speaking, however, employers' first preference seems to be share-based types of schemes.

In countries in which PEPPER has not been very widespread, employers' associations do not seem to have yet adopted a definite standpoint on PEPPER.

### **Trade unions**

Many trade unions have traditionally opposed enterprise-level PEPPER schemes. Among the arguments most frequently stressed is that such schemes could increase income inequality. They were also unhappy about the non-negotiable nature of PEPPER schemes, since in the past schemes often remained outside the framework of negotiations. Trade unions have rather often pushed forward in another direction, advancing proposals on collective forms of profit-sharing at a higher level established through wage-earners' funds, regarded as an important instrument for a more even distribution of income and wealth.

Nevertheless, the present position of most trade unions on PEPPER is more pragmatic, as it has evolved with the actual diffusion of schemes in practice. Some Dutch, Irish and German trade unions today officially support PEPPER schemes. In other countries, although central trade union associations do not yet fully accept PEPPER schemes, many local trade unions have a more positive stance, actively participating in the signing of PEPPER agreements. Some trade unions consider

PEPPER schemes could in fact lead to a number of beneficial social effects. PEPPER is welcomed as a way of increasing employee involvement, improving or enhancing entrepreneurial spirit, and as an extra source of asset formation. Moreover, it is being recognized that while enterprise-level PEPPER schemes may increase income inequality between firms, it could substantially reduce income inequality within firms.

Trade unions have usually stressed that PEPPER should not endanger the outcome of periodic wage negotiations. PEPPER should be treated and negotiated separately, outside the framework of normal wage bargaining. In this perspective, trade unions could play an important role in the further promotion of PEPPER schemes.

## 16.2. LEGAL AND FISCAL FRAMEWORK

### General features

The legal and fiscal status of PEPPER schemes in EC countries is also very heterogeneous. The French experience, based on original 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 PEPPER 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.

Of the twelve Member States of the EC, for the moment only two countries have complex legislation on PEPPER, consisting of *specific laws* for the various types of schemes: France, since 1959; and the UK, since 1978. In other countries, a legislative framework specifically on PEPPER still seems to be lacking, although partial measures have been adopted in most EC countries.

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

Nevertheless, measures adopted so far have only regulated a limited number of specific forms of PEPPER, and most frequently, offering modest tax incentives (particularly in the Netherlands). 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), and in some cases have not even been directly and specifically linked to PEPPER (as in Belgium).

In Italy, Luxembourg and Spain, there are no specific legal provisions on PEPPER and consequently no particular fiscal concessions are presently offered, although provisions contained in more general laws do envisage the possibility of introducing schemes related to PEPPER, and in some of these countries the legal framework is not unfavourable (particularly in Spain).

### **Specific forms encouraged**

At present, the prevalent type of PEPPER 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.

Government measures encouraging various types of *employee share-ownership* have been the most frequent, and are found in all countries in which official support of some form of PEPPER is present. In some countries, it has been the only or principal form of PEPPER 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 have been 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 1984), and ESOPs (since 1989).

*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 a smaller number of 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, obligatory for all enterprises with over 100 employees (which in 1990 was extended to all enterprises with more than 50 workers), consisting of the allocation of a part of profits to a special enterprise fund which is then invested for the benefit of all employees, and providing exemption from tax and social security charges for both enterprises and employees. 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, but it is only since 1984 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),

conditional on shares being 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, conditional on the freezing of bonuses on special accounts for a determined amount of time.

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 PEPPER, provisions contained in more general laws provide fiscal benefits for both firms and employees. In other countries, there is lack of supportive legislation on this type of profit-sharing, particularly in Belgium, Germany and the Netherlands, where enterprises introducing such schemes are still given unfavourable treatment.

Therefore, the large majority of schemes presently encouraged through government 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 a reflection of common and interrelated objectives pursued by individual governments and/or 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. Such objectives may not fully conform with employees' preferences, as some surveys seem to suggest (see below).

### **16.3. PEPPER SCHEMES IN PRACTICE**

#### **General features**

There is a great country-to-country variety in the types of PEPPER 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 of PEPPER are found in the UK and France, while in all other countries schemes have mainly consisted of only a few principal types.

In those countries where some form of PEPPER 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 presently encouraged by law - is the principal form of PEPPER 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 more than three decades ago, in 1986 the number of agreements on cash-based profit-sharing was only 20% of those concluded on participation (which, being obligatory, were until then given priority);<sup>144</sup> 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 introducing PEPPER-related 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, presently 84% of all

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144. However, following the new legislation introduced in 1986, the balance has shifted strongly in favour of cash-based profit-sharing: by 1989, the number of cash-based profit-sharing agreements had already reached 70% of those on participation.

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 practiced by firms.

### **Diffusion**

Recently there has been a steady growth of various forms of PEPPER schemes in the majority of EC countries, with widely different relative weight. At present PEPPER 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 presently more than 7,000 different PEPPER 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 only for executives). 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,<sup>145</sup> 891 all-employee share option, and 890 share-based profit-sharing schemes, and only around 20 ESOPs.

In general, in other countries the diffusion of PEPPER schemes remains limited. For some of these countries, only estimates are presently available, which in some cases are highly divergent depending mainly on the definition of PEPPER.

In Ireland there are presently around 250 registered PEPPER schemes, of which 60% are 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 diffused being cash-based profit-sharing. In Germany some 1,600 firms have introduced

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145. The figure does not, however, include non-approved cash-based schemes not qualifying for tax benefits, for which no accurate statistics are available.

employee financial participation schemes (which is only around 0.1% of all German firms); but if informal and less regular arrangements are also included, there may be as many as 5,000 firms practising PEPPER-related schemes. For Italy it has been estimated that 25% of large firms presently give their employees variable remuneration, but only in some 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 presently use PEPPER-related schemes, but only 6% can be said to have a "real" profit-sharing scheme. For Belgium, no estimates are presently available on the diffusion of profit-sharing; as to employee share-ownership, 20 quoted companies have in 1989 offered shares to their employees. In Luxembourg a recent survey found that 22% of firms had introduced "profit-sharing" but without specifying of 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 presently available on the diffusion of PEPPER schemes.

Not all schemes providing employee financial participation effectively link employee earnings directly to an indicator of enterprise performance. Sometimes this link is very loose indeed, as is frequently the case particularly in Spain, Italy and the Netherlands, but also in other countries in which schemes are not very diffused.

### **Enterprise size and sectoral distribution**

No clear common pattern seems to emerge on the diffusion of PEPPER schemes by firm size. In Germany mainly small firms adopt employee financial participation schemes, although quite a few very large enterprises (with over 10,000 workers) have also been involved. In the UK there is a clear prevalence of large companies in adopting one of the registered schemes qualifying for tax benefits, but of small firms introducing 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 the prevalent category.

It is also not possible to make generalizations concerning the distribution of PEPPER schemes by industry type, as in most countries schemes are being introduced in a large variety of sectors. Nevertheless, in countries such as Luxembourg, Portugal and the UK, the sector in which PEPPER is most widespread is finance.

### **Employees involved**

PEPPER schemes involve an important percentage of employees primarily in France and the UK. In France, the different types of schemes cover almost 6 million employees, of which around 4 million actually participate (around 18% of all employees). This is not surprising considering France has had the longest tradition, and has rendered some PEPPER schemes obligatory. In the UK employees eligible to participate in PEPPER schemes are 3.5 million, but the actual number benefitting has been estimated to be 2 million (around 8% of all employees).

In other countries the percentage of employees participating in PEPPER schemes 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 presently 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 presently participate in share-based profit-sharing schemes (more than 3% of total employees). Variable remuneration linked to enterprise performance is given in Italy to some 400,000 employees (less than 2% of the total), and similarly in Spain to some 2% of salaried employees.

However, these figures may be overestimations considering that in some countries the same individuals may participate simultaneously in different types of schemes. Neither are these country figures directly comparable since they are sometimes related to quite different PEPPER schemes.

Not all PEPPER schemes are available for all employees and, even when schemes are offered to the majority of the labour force, not all employees do necessarily participate. This is almost by definition the case with discretionary schemes for certain groups of employees, which are by far the most popular type of scheme in some countries (UK, Ireland), and from which only a very small percentage of employees usually 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 e.g. 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%.

### **Employee benefits**

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

The amount designated 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. In Belgium profit-sharing is no more than 5% of distributable profits. In Denmark workers receive around 2% of total share capital issued on the basis of share-based profit-sharing, while the average share per employee in bond-based profit-sharing is around DKR 3,400. According to some estimates for Germany profit-sharing represents 6.8% of average employee pay. Some Italian enterprises give their employees substantial variable pay, but the sectoral averages range from 3-8% 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,<sup>146</sup> and the discount on shares (if available) has usually been rather low.

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A summary of the principal findings concerning the issues discussed are presented in Table 16.1 (Appendix to Chapter 16), in which a comparison is given among the EC Member States' general attitude towards PEPPER, 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). The Table has been compiled to give a general overview in a comparative framework, although for some countries information is incomplete, and there is an absence of common criteria for all countries.<sup>147</sup> For further details and clarifications, it is suggested to consult the previous chapters on specific experiences in individual countries.

#### 16.4. EVIDENCE ON THE EFFECTS OF PEPPER SCHEMES

Theoretical arguments advanced in favour of PEPPER schemes propose the following principal types of beneficial effects: 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

146. In Belgium it has on average been 4% of total shares issues; in Denmark around 2%; while in Italy around 7% of total share capital. In France shares freely distributed to employees have accounted for around 3% of the wage bill, while in Germany employee capital represents 5% of the firm's annual balance.

147. In particular, the data on the number of schemes are not fully comparable.



employment, both at the enterprise and at the economy-wide level. It has been suggested that these effects depend on whether or not employee participation in decision-making is introduced.

In evaluating the effects of PEPPER schemes, two sources of information are available: econometric estimates and surveys on the attitude of employees and firms towards PEPPER. 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 of PEPPER, 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, indicators actually used and estimating techniques; difficulties in isolating the effects of profit-sharing from other organisational factors; ambiguity concerning the direction of causality; etc.<sup>148</sup>

### **Incentive effects**

Econometric estimates of the effects of PEPPER 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 the prevalence of positive net effects of PEPPER on employee motivation and productivity.<sup>149</sup> The positive link between profit-sharing and productivity is also supported by a number of similar studies on the US (see Weitzman and Kruse, 1990). However, these effects might for the moment be relatively small because of the low incidence of employee benefits on total earnings.

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148. For a critique of existing econometric evidence, see Jones and Pliskin (1988b).

149. Support is found for Germany in Cable and FitzRoy (1980), Cable and Wilson (1988), FitzRoy and Kraft (1986, 1987); for the UK in Estrin and Wilson (1986), Bradley and Estrin (1987), Cable and Wilson (1988, 1989); for France in Vaughan-Whitehead (1989).

There is no specific type of PEPPER which *a priori* has significant advantages over the others, as the motivational effects will largely depend on the detailed design of the scheme and specific circumstances in which it is implemented, enterprise characteristics, etc.<sup>150</sup> 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<sup>151</sup> and by attitude surveys. In some of these surveys, cash-based profit-sharing was by far the most popular scheme, while the objective expected from deferred profit-sharing and employee share-ownership, of increasing workers' involvement as shareholders and their greater identification with the interests of their enterprise, has in many cases not been attained. This seems to be confirmed by the less than maximum involvement rates of employees in capital participation schemes in Germany, 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 schemes 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, in order to attain the same beneficial effects as from cash-based schemes, firms setting up share-based schemes would have to offer more generous conditions than has been the case to date (Estrin, Grout and Wadhvani, 1987). Provided they are properly designed, share-based schemes could not only have similar motivational effects as cash-based schemes, but could also provide for a longer-term

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150. Thus the incentive effect of cash-based schemes is likely to be greater in small private companies or newly created firms, since the value of shares in such companies is likely to be lower.

151. See e.g. Estrin and Wilson (1986), or Bradley and Estrin (1987). This view is also shared by several scholars, including Weitzman and Kruse (1990) and Bell and Hanson (1989).

commitment of employees.<sup>152</sup> Some scholars have pointed to cases in which share-based schemes may provide not only the right incentives, but would even be preferred.<sup>153</sup>

### **Wage flexibility**

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 has a positive and significant effect on employment, but more recent estimates show that the size of the effect is not necessarily very large.<sup>154</sup> On the other hand, evidence from France (Vaughan-Whitehead, 1989) suggests that profit-sharing has resulted in greater wage flexibility, less frequent adjustments in employment, and in higher and more stable employment growth.

### **Macroeconomic effects**

Given that profit-sharing for the moment is not sufficiently widespread in any single country to have a significant macroeconomic effect, the Vanek-Weitzman hypothesis cannot really be empirically tested (see Chapter 3, point 3.1.3. above). 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 base wage, as the marginal cost of labour,<sup>155</sup> thus con-

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152. In France, by e.g. providing more information on schemes, which frequently seems to have been insufficient; while in Italy, by giving workers more say in decision-making, since the practice so far has frequently been to give employees non-voting shares.

153. E.g. when a firm needs to invest heavily in new technology, which is likely to lead to low employee profit shares in early years, but later, through an increase in stock prices, would provide the right incentives (Conte and Svejnar, 1990).

154. For earlier evidence see Estrin and Wilson (1986) and Bradley and Estrin (1987); for estimates providing more modest results see Jones and Pliskin (1988, 1989), Blanchflower and Oswald (1987, 1988), and Estrin and Wilson (1989).

155. This specific hypothesis has been tested for Germany by Hart and Hubert (1989); for the UK, by Estrin and Wilson (1989); and for France, by Vaughan-Whitehead (1989).

tradicting the fundamental assumption on which direct effects on employment are based.

### **Link with decisional participation**

The link between the effects of PEPPER and decisional participation, proposed by the theoretical literature, 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 decisional participation is absent. On the contrary, prevailing evidence on incentive effects from both econometric and more informal studies does suggest that the combination of financial participation with decisional participation 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 PEPPER schemes.

### **Choice of objectives**

It has been suggested that policy makers may have to face the choice between profit-sharing alone with increased employment, and profit-sharing with participation in decision-making and higher productivity, but without employment effects (Cable, 1988). Indeed, the different theoretical arguments on PEPPER are based on mutually conflictual assumptions. Vanek-Weitzman employment effects are expected in the absence of decisional participation and without productivity effects (since profit-sharing is regarded as a substitute, and not an addition, to wages, and hence has a neutral effect on motivation), while the productivity effects are expected primarily if profit-sharing is an *addition* to the normal wage, having major effects if employees are also given some say in decision-making.

Nevertheless, if PEPPER schemes offered to employees provide sufficient incentives to result in *large* productivity effects, they are also likely to lead to long-term employment growth. Therefore, the different positive effects expected from PEPPER schemes may even be attainable simultaneously.

## APPENDIX TO CHAPTER 16

Table 16.1. PEPPER SCHEMES IN MEMBER STATES OF THE EUROPEAN COMMUNITY IN THE LATE 1980S - SUMMARY OF PRINCIPAL FINDINGS

### 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 & Tax year of introd. benefits	Diffusion of P E P P E R s c h e m e s		Employees involved	Employee benefits or profit share/employee
			Prevalent No. of schemes/ types firms involved	Employees involved		
BELGIUM	Mainly unfavourable, but today discussed	Various, but only on ESO (since 1982), especially for SO including SO (1984)	ESO	Around 20	On average 5% (varying from 1-28%)	Shares reserved for employees: 4% on average of total shares issued
			CPS	Multinationals Insurance Banks		Around 5% of distributable profits; 8-15% of performance-related pay
DENMARK	Mainly favourable & discussed	On SPS and ESO (since 1958)	CPS	Min. 50 schemes	"	2% of share capital
			SPS	20	"	DKR 3,400 per employee
			BPS	27	"	Less than 2% of total share capital
			ESO	32	"	
GERMANY	Mainly favourable except for CPS; intensively discussed	Some: on DPS (since 1961) & ESO (primarily since 1994)	Total	200 or more		
			ESO & DPS	1,600 firms (0.1% of total)	1.3 mln. 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

Table 16.1. (cont.)

Country	General attitude	Legislation		Diffusion of PEPPER schemes		
		Specific laws & Tax year of introd.	benefits	Prevalent No. of schemes/ types firms involved	Employees involved	Employee benefits or Profit share/employee
FRANCE	Very favourable & intensively discussed	Various: CPS (1959) DPS (1967) SO (1970)	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
		ESO (since 1973)		CPS 7,000 agreements	1.4 mln.	Profit shares on average 4.1% of the wage bill
		Employee invest. funds (1973)		ESO* 350 firms (2/3 quoted)	600,000*	Free distrib. of shares: 3% of the wage bill
		EBO (1984)		SO 600 quoted companies		
		Unique legisl. on all forms in 1986, amended in 1990.				
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
		SPS (1982) SO (1986)	Modest	SO 139 schemes	Executives	Probably high
IRELAND	Favourable & discussed			SPS 104 "	35,000	
				All in the private sector		
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 22% of firms		Usually not more than 0.5 - 2 months' salary
				ESO Mainly in banking		

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

Table 16.1. (cont.)

Country	General attitude	Legislation Specific laws & Tax year of introd.	Diffusion of Prevalent No. of schemes/ types	PEPPER Employees involved	Schemes Employee benefits or profit share/employee
NETHERLANDS	Favourable & intensively discussed	Some incentives offered only to CPS	Minor, conditional on freezing of CPS	6-30% of firms	350,000 in 1975 4.5 - 6.5% of average earnings
PORTUGAL	Not clearly defined & mainly not discussed	Only general provisions on PS & ESO (favourable)	Primarily for PS	Mainly CPS	Very limited (3% of all schemes) Limited, but most diffused form. Sometimes restricted to large firms in finance 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 CPS SPS SO	4,326 schemes 1,175 " 293,000 890 " 757,000 891 " 623,000 Substantial 7% of employee pay 2-4% of total wages
			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.



## Chapter 17. SUGGESTIONS FOR CEC INITIATIVES

On the basis of the principal findings of the PEPPER Report and experts' views presented at the Workshop on Employee Participation in Company Profits (EUI, Florence, May 1990), the following suggestions for CEC future initiatives on PEPPER are being made to the Commission. These suggestions are given without any prejudice to the usual consultations of the social partners, the Member States, the European Parliament and the Economic and Social Committee.

### 17.1. GENERAL CHARACTERISTICS

A Community PEPPER instrument should facilitate financial participation of employees in their enterprise's profits and results. The nature of the instrument ought to be such to provide a wide range of possible alternatives, from which Member States may choose those they consider most appropriate in the context of their own specific national priorities and traditions. However, since the success of PEPPER schemes can mainly depend on certain key features, it would seem advisable to take into account experiences acquired elsewhere in the EC. When new schemes are set up, it is therefore suggested to pay special attention to the following characteristics:

1) **Regularity:** PEPPER schemes ought to be applied by enterprises on a regular basis (e.g. payments at least once a year, or shorter periods), since continuity in implementation is likely to ensure major beneficial effects.

2) **Predetermined formula:** The formula setting employee benefits from PEPPER ought to be unequivocally determined before the beginning of each reference period in order to achieve the desired motivational effects. 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 PEPPER schemes. The formula itself would not be fixed once and for all, as it could be renegotiated; but it should neither be subject to too frequent (e.g. annual) changes, since gaining sufficient experience will require at least a certain number of years of application.

3) **No substitute for wage negotiations:** The introduction of PEPPER schemes should not substitute for the periodic wage negotiations dealing with basic wages and other work conditions. PEPPER benefits come in addition to basic wages and should not interfere with the existence of e.g. statutory minimum wages.

4) **Calculation of employee benefits:** The amounts which employees receive on the basis of PEPPER should not be fixed but ought to be variable, linked to enterprise performance expressed in terms of profits or some other enterprise indicator during a certain period of time, according to a previously agreed formula, which would also specify unequivocally the indicator of enterprise performance to be used. The amounts allocated to employees through PEPPER schemes ought to be a sizeable percentage of both enterprise results and employee earnings. As an indication, it can be reported that PEPPER benefits amounting to less than 5% of guaranteed employee wages in a year of regular profitability, cannot be expected to produce substantial motivational effects.

5) **Beneficiaries:** The PEPPER instrument should apply primarily to employees, i.e. wage-earners covered by employment contracts (and not to the population at large, or to the self-employed), and ought to be made available to all, or the larger part of employees. Temporary and part-time employees should also be eligible on a *pro rata* basis.

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

7) **Enterprise size:** Sufficient opportunities ought to be created for bringing PEPPER schemes within the reach of small and medium-sized firms, in particular by not imposing too high minimum financial requirements and by ensuring acceptable administrative obligations.

In larger enterprises it may be useful to have the possibility of linking employee PEPPER benefits to the performance of separate profit-units, rather than to overall enterprise results. This applies *a fortiori* to multinational companies.

8) **Complexity:** It is advisable to avoid PEPPER schemes of a very complex nature, as the effects are likely to be greater if the scheme can be easily understood by employees of all profiles.

9) **Information and education:** 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 PEPPER schemes can also provide a link with activities promoted by the CEC in other areas (information and consultation, training, education).

10) **Voluntariness:** Participation in or utilisation of PEPPER schemes should neither be imposed on companies nor on employees, but should be voluntary.

## 17.2. NUMEROUS OPTIONS AVAILABLE

PEPPER schemes can take many different forms, from which the parties concerned can choose the most appropriate type(s). Among the main categories are the following:

1) **Cash:** payments of cash bonuses to employees, i.e. nominal amounts linked to enterprise results, which can be made available immediately or blocked for a determined period of time. Although employees have sometimes expressed a

preference for this type of scheme, other forms may produce equivalent or even more lasting effects, and may also be given preference for other valid reasons.

2) **Shares and other securities:** payments to employees in the form of enterprise shares, bonds, warrants, or other securities, which could either provide employees with immediate benefits, or be frozen in a trust or a special enterprise fund for a determined period of time. Alternatively, employees could be offered options on their enterprise shares, but in such cases it would be important to make schemes available to all or at least a large part of the workforce.

3) **Investment funds:** Another possibility is to allocate a certain percentage of profits to enterprise funds, which would then be invested for the benefit of all employees. This type of PEPPER scheme at the enterprise level should not preclude the consideration of wage-earners' investment funds at higher levels.

The analysis of PEPPER schemes in practice in EC countries suggests that there are not many *legal* obstacles to their broader introduction, although certain modifications of existing laws, or the adoption of a framework law in some Member States, would indeed be useful. Of more fundamental importance are the differences in treatment of PEPPER schemes for fiscal and social security contributions. Only if the Member States create certain facilities in this regard, could the voluntary introduction of PEPPER schemes on a more substantial scale be expected.

The findings of the PEPPER Report therefore support the proposition that the potential advantages of PEPPERing our economies justifies giving serious consideration to the introduction of such facilities.



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