



The PEPPER IV Report:

Benchmarking of Employee Participation in Profits and Enterprise Results in the Member and Candidate Countries of the European Union

**With a foreword by
the President of the Eurogroup,
Prime Minister of the Grand-Duchy of Luxembourg,
Jean-Claude Juncker**



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in Profits and Enterprise Results in the Member
and Candidate Countries of the European Union**

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Preface

This Report summarises and updates the previous PEPPER reports. It is the result of the Commission funded project 'Assessing and Benchmarking Financial Participation in the EU-27'.

Complying with the concept of the PEPPER reports and building on them it provides a solid basis for leveraging the development of Financial Participation in the European Union in the context of the current reform process triggered by the European Commission and Parliament.

The Project closes the gap between PEPPER I/II (1991: EU-12 / 1997: EU-15) and PEPPER III (2006: ten new Member States and four candidate countries). Furthermore it implements benchmarking indicators developed by the European Foundation for the Improvement of Working and Living Conditions in all 27 EU Member States and candidate countries.

The PEPPER IV Report has been edited by Jens Lowitzsch (Inter-University Centre), Iraj Hashi (Staffordshire University) and Richard Woodward (CASE Foundation, Poland / University of Edinburgh) and written in co-operation with a core team of experts in the field of Financial Participation, that is Milica Uvalić (Perugia University) and Daniel Vaughan-Whitehead (International Labour Organisation). The European Commission's Directorate-General Employment, Industrial Relations and Equal Opportunities and the Kelso Institute have supported the benchmarking project. The editing of the country reports was supervised by Patricia Hetter Kelso.

The Report is divided into three parts. Part 1 consists of an overview of the benchmarking project and the current situation in the countries under consideration, a presentation and discussion of the benchmarking results as well as an analysis of the fiscal framework and tax incentives in the EU-27. Part 2 provides country profiles, each covering the attitudes of social partners and government policies, the legal foundations for different schemes and, where available, the incentives for their application. Part 3 summarises the experience of employee financial participation in Western and Eastern Europe, its role in the changing world of work in the 21st century and its relevance in the context of the European integration process. Finally recommendations and suggestions for further initiatives are made.

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Foreword

Determining wages has at all times been a thorny issue. What is due, what is fair, what is preposterous? How to share profits between capital and labour? Which parts can be variable, which need to be guaranteed? Some of these debates have been led for centuries, others as with too often doubtful compensation schemes of managers, are more recent but equally worthwhile.

Already twenty years ago, Jacques Delors has with characteristic foresight guided the European Commission into a profound analysis of the larger theme of employee compensation in a new world of work that he saw emerging. The present report on 'Promotion of Employee Participation in Profits and Enterprise Results' contributes to feed these reflexions.

Financial participation of employees in the profits of their employer as a complement to monthly wages is nothing else but the practical implementation of the fundamental idea that the wealth creation in an enterprise is first and foremost the result of the labour and know-how of its employees. For employers, it offers the advantage of increasing alignment of interests with employees, of linking part of labour costs to company performance and, if it is well organised, of enhancing motivation.

As this report confirms, financial participation of employees has developed considerably over the last decade. This is to be welcomed. At the same time, we have to keep in mind that it is far from a general trend. Employees in management positions benefit more often from such schemes than those on the shop floor. Smaller firms only rarely develop complex compensation schemes. Working for a company listed on the stock market makes it more likely to be included in some form of an employee stock ownership plan.

One can furthermore witness a significant number of trends in the labour markets that constitute serious challenges to a further broadening the scope of financial participation schemes. A 'hire and fire' mentality is hardly compatible with the long-term motivation financial participation of staff is supposed to achieve. A particular worry lies in the increased recourse to atypical work contracts. While some forms of innovative contracts can be convenient for both parties, it is my firm conviction that the unlimited employment contract has to remain the standard form of employment. Employment is not only about labour needs of companies, it is also about family life, long-term personal projects, the basic assurance that also in three months time, mortgages can be repaid and a week-end trip planned.

As we have been witnessing since late 2008, employees often bear much more than just a fair share of the pain in an economic downturn. Tools allowing them to share the gain when the financial results of their employer are growing are, apart from all other aspects, part of a basic fairness in the relationship between employer and employee. The development of such mechanisms therefore needs to continue.

Fundamentals need at the same time to be respected. Prediction is very difficult, especially about the future, as Niels Bohr put it. Basic principles of prudence therefore demand that financial participation schemes come as a complement to wages. They should also prevent employees to run up significant debt in order to invest in shares, be it in those of their employer. Employee buy-outs, as for example the Employee Stock Ownership Plan (ESOP), can obviously be an attractive way to transfer ownership of a company. But they are the exception, not the rule.

The PEPPER IV report is a further step in developing financial participation in enterprise results in the European Union. Many steps need to follow. But Europe is heading in the right direction.

A handwritten signature in blue ink, consisting of a long horizontal line that curves upwards at the right end, and a vertical line that crosses it near the left end, forming a stylized 'J' shape.

Jean-Claude Juncker

Part 1

Benchmarking of Financial Participation

I. The Benchmarking Project, the Indicators Employed and the Current Situation in the EU-27

Jens Lowitzsch

1. Introduction

The PEPPER IV Report presents conclusive evidence, regardless of the data source, that the past decade has seen a significant expansion of employee financial participation in Europe. This is true of both profit-sharing and employee share ownership, although profit-sharing is more widespread (for details, see Chapters II and III). This rise is reflected in the data from a survey of thousands of European companies, which show that between 1999 and 2005, the percentage of companies offering broad-based share ownership schemes increased from an average of 13 to 18 per cent; for profit-sharing schemes, the increase was from 29 to 35 per cent (weighted country averages for all countries included in both samples). The percentage of company employees taking advantage of these schemes is also growing.

On the other hand, in spite of this positive trend it seems that financial participation has been extended to a significant proportion of the working population in only a handful of countries. The increase in all aspects of non-standard employment contracts may exacer-

bate this problem in future (for details, see Part 3, Chapter II). In order to guarantee the basic Commission principle that financial participation should cover all workers and not only the core labour force, further concrete policy actions to extend broad-based schemes are called for.

A review of the more than 30 years covered by PEPPER Reports indicates that employee financial participation (EFP), though slow to take off, has picked up surprising momentum. Reflecting the two main dimensions of European policy development in this period, that is, integration and enlargement, the reports document several important advances. (1) Economic research has empirically confirmed the positive effects of EFP. (2) The principles and definitions of PEPPER schemes were formally incorporated in the 1992 Council Recommendation¹. (3) Studies by the European Foundation for the Improvement of Working and Living Conditions from 2000-2004 analysed in depth various aspects of EFP over the course of its evolution and developed the benchmarking indicators. Although the particularly dynamic upturn in some countries (Austria, UK, Ireland) has specific causes, we surmise that the most recent, more general stimulus for the rise of EFP has been the prior Commission activities, that is, the PEPPER Reports as well as the reviewed strategy for growth and jobs in the EU, the Lisbon-Strategy, and the reform of the labour markets.

The different data sources of the PEPPER IV Report, each confirming the positive trend over time, show that actual financial participation of the working population of EU Member States (ECWS) falls short of the opportunities companies offer for such participation (CRANET). The shortfall can only partly be explained by the fact that naturally not all eligible employees participate or that schemes are not well communicated. This discrepancy in the different sets of cross country data can be explained by different definitions and methodology as well as diverse perspectives. None of these surveys specifically dealt with the subject of financial participation per se. It should be clearly understood that in this respect the PEPPER IV benchmarking represents a compromise to cope with the existing data deficit without undertaking a new survey.

How should policy makers implement that part of the Lisbon Strategy calling for broadened employee financial participation? The road to this goal has three clearly marked lanes: Construct a legal framework. Promote. Research.

- Legislate EFP at the EU level with a Council Recommendation on a European Platform utilising the Building Block Approach.

Resting on the principle of voluntariness, the trans-national Building Block Approach reflects the diversity of schemes, while opening national practise to new forms.

- Utilise optional tax incentives to encourage employee financial participation.

While not a prerequisite for EFP, tax incentives clearly have a positive influence in countries which offer them. Making their introduction optional avoids conflict with national law.

- Research the current state of EFP in the EU with a comparative, focused survey.

¹ Council Recommendation 92/443/EEC of 27 July 1992 ‘on the promotion of participation by employed persons in profits and enterprise results (including equity participation) in Member States’, *Official Journal* L 245, 26 August 1992.

No cross country data targeting financial participation exists to date. This data vacuum needs to be filled. Policy makers need a clear and precise overview of the *status quo* in order to work towards the goals of the Lisbon Strategy.

a) Recent Initiatives

Both the European Commission and Parliament launched an initiative, manifested in the opinion of the Economic and Social Committee of 26 February 2003,² on the Commission Communication ‘on a framework for the promotion of employee financial participation’.³ The European Parliament called on the Commission to submit studies on the issues raised in its Resolution of 5 June 2003⁴. Among these were the feasibility of financial participation in small and medium-sized enterprises and the possibility of implementing in other EU Member States share ownership schemes based on the ESOP (Employee Stock Ownership Plan). In his foreword to a 2008 study published in response to this request⁵, the President of the European Parliament, Hans-Gert Pöttering, stressed the value of the suggested ‘Building Block Approach’ therein proposed. This approach provides a broad incentive system made up of diverse and flexible alternative components, which correspond to existing national systems, thereby introducing a flexible European concept.

In the European Reform Treaty signed on 13 December 2007 in Lisbon, the EU for the first time expressly commits itself to the European Social Model as one of the pillars of its policy. Thus, Art. 3 III states that the Union ‘shall work for the sustainable development of Europe based on [...] a highly competitive social market economy, aiming at full employment and social progress’ and that ‘[...] It shall combat social exclusion and discrimination, and shall promote social justice and protection [...]’.⁶ In 2006, in his foreword to the PEPPER III Report⁶, the Commission’s Vice-President Günther Verheugen postulated a stronger link between pay and performance as one possible way to reform the labour markets. Further, in September 2007, Mrs Christine Lagarde, the French Minister for Economy, Finances and Labour, announced that on assuming the Presidency of the European Union in July 2008, France wishes to launch a European Model of financial participation supported by the member countries.⁷ In fall 2009 the European Economic and Social Committee is evaluating the possibility of an initiative report on the subject.

In the light of these remarkable political initiatives and against the background of the positive dynamic of Financial Participation, we surmise that the conditions for further developing employees’ financial participation are now especially favourable. Nevertheless,

² SOCI 115, Employee Financial Participation, CESE 284/2003.

³ COM (2002) 364 Final.

⁴ P5-TA (2003) 0253.

⁵ Lowitzsch et al. (2008) *Financial Participation for a New Social Europe* (Rome, Paris, Berlin, Brussels: Inter-University Centre Split/Berlin). The book was distributed in the European Parliament in English, French, German editions. In autumn 2009 also an Italian edition will be published.

⁶ Lowitzsch, Jens (2006) *The PEPPER III Report – Promotion of Employee Participation in Profits and Enterprise Results in the New Member and Candidate Countries of the European Union* (Rome and Berlin: Inter-University Centre Split/Berlin).

⁷ Speech on 12 September at the occasion of the 40th anniversary of FONDACT in the French Senate.

important challenges remain, both old and new, most urgently, the lack of a European legal framework for Financial Participation but also hardening global competition and the strain it is exerting on Europe's enterprises. While the former is familiar and has been addressed in recent initiatives⁸ the latter has been fundamentally changing the 'world of work' (see Part 3, Chapter II) leading to a growing demand for flexibility at the level of the individual company.

b) To Address Both Challenges...

Both challenges call for implementation of a European platform for Financial Participation while the role of Financial Participation in the reviewed 'Lisbon strategy' needs to be more precisely formulated. The framework conditions set by legislators are an important factor in enhancing the growth of PEPPER schemes, but only a well formulated policy can fully unleash their potential to boost motivation, productivity, and ultimately economic growth and jobs (see Part 3, Chapter I). To achieve their proclaimed goal of making 'the EU a more attractive place to invest and work in' European policy makers should ensure that the working people who are to bring about these changes also participate in the fruits of this process, that is, in profits and ownership stakes in European firms.

This is the context in which the question of **internal versus external flexibility** becomes of crucial importance. In addition to improving employee motivation and productivity, and thus the competitiveness of European companies, financial participation can play an important role in achieving internal flexibility. Flexibility no longer applies only to the options available to companies for production or other needs. The Commission's new Flexicurity approach also looks at flexibility in terms of enhanced mobility in the labour market and in work organisation. Table 1 contains a typology of work flexibility. Locational flexibility (or flexibility of place) was added to the classical types of flexibility, that is, working time, contractual arrangements, variable pay and financial participation as well as functional dispositions. They are grouped into external and internal types; by the internal types of flexibility we mean those that the firm applies to workers within the firm without changing the basic employment relationship, while we use the term external to refer to the interaction between the firm and the external labour market; that is, either to the firm's access to workers outside the company (as, for example, in the case of outsourcing) or to its ability to 'expel' workers and thereby 'externalise' them.

It seems that at the national policy level, up to now, contractual flexibility (external/numerical) has been considered the most important aspect of labour market flexibility. Financial participation as a means of providing internal financial flexibility, on the other hand, has received much less attention. Moreover, in general, most of the flexibility discussion has been focused on specific arrangements or a specific category of flexibility despite the fact that flexibility is multi-dimensional. There are substitutional as well as complementary effects and the type of flexibility that is developed is just as important as its extent. Increasing internal financial flexibility through financial participation would help to alleviate the pressure on contractual flexibility. This also is in line with many of the

⁸ The European Commission's Directorate General Employment, Social Affairs and Equal Opportunities has supported the project 'A European Platform for Financial Participation' which sets forth both a policy and a detailed proposal for a European concept of employee ownership and profit-sharing; for the project report see Lowitzsch et al. (2008).

general principles of flexicurity held by the heads of states and governments of EU Member States, such as ‘a better balance between external and internal flexibility’, ‘a climate of trust and dialogue’, ‘a better workers’ adaptability capacity’, etc. (see Part 3, Chapter II).

Table 1. A typology of work flexibility

| Flexibility Category | Internal | External |
|--|---|--|
| Numerical | Working Time (Temporal) – Part time / leave / flexible hours – Overtime / shift / annualisation | Contractual (Employment) – Temporary / Fix-term / Agency work – Relaxed hiring/dismissal regulations |
| Functional (work organisation) | – Job rotation / Team work / Task rotation – Workers training/options to bring change | – Outsourcing – Restructuring |
| Locational (spatial) | – Tele work / Home work – Out-workers /Relocation within company | – Relocation – Off-shoring |
| Financial / Wage | – Variable pay (individual/team related) – Profit-Sharing / Share- Option schemes | – Downsizing – Financial restructuring |

Source: compilation by the author.

What gives legitimacy to the current discussion of new forms of financial participation is the fact that the radical reforms of the European legal and economic order in the process of the EU’s eastward enlargement, together with privatisation and globalisation, have led not only to economic progress but also to widening social fissures. While enterprise profits have been on a steep rise for more than a decade, wages have been stagnant and the economic lives of many have been rendered insecure. The ‘society of owners’ must be simultaneously understood as the ‘society of non-owners’. The growing discrepancy between the few who are rich and the many others who are ‘working poor’ needs to be addressed.

c) ...in the Context of the Current Situation in the EU-27

In the EU–15, between 17 per cent (employee share ownership) and 36 per cent (profit-sharing) of employees in the private sector currently participate financially in the enterprise for which they work. These existing schemes constitute a pillar of the European Social Model. In spite of the unsatisfactory results of the PEPPER II Report which followed up the Council Recommendation of 1992 (see footnote 1), the number of share ownership schemes has seen a strong increase during the last decade (see below Chapter II and III). Furthermore, for example in France, the country where PEPPER schemes have had the longest tradition, there has been a gradual increase in the share of variable pay in recent years.¹⁵ This suggests a tendency in some countries to increase workers’ income more and more through variable forms of remuneration. On the whole, a generally favourable attitude within a given country has usually led to some supportive legislation

¹⁵ Profit-sharing bonuses have increased from 3.1 per cent in 1996 to 4.5 per cent in 2003 of total pay, while ‘participation’ schemes from 3.8 to 4.6 per cent.

for PEPPER schemes, which in turn has spread their practice. This suggests a clear link between national attitudes, legislation and diffusion (see Part 3, Chapter II). Nevertheless, the European Union still lacks a unified legal foundation on which to build a European system of financial participation.

A quite different situation obtains in the new EU member and candidate countries¹⁶ (see the PEPPER III Report). Very few laws specifically address employee financial participation, and these refer almost exclusively to employee share ownership¹⁷; legislation on profit-sharing is rare¹⁸. Although employees were frequently offered privileged conditions for buying shares of their employer companies, the purpose was not to motivate employees to become more efficient and productive. Nor was there more than mild concern for social justice. Rather, this method was simply an expedient for privatising state-owned enterprises for which at the time there were no buyers. Essentially it was a decision made by default. Given the limited support for PEPPER schemes, it is not surprising that empirical evidence on the effects of schemes is available for only some countries – the Baltic States, Hungary, Poland, and Slovenia. Although much of the evidence is preliminary and refers primarily to the 1990s, when employee ownership played a different role than today, these studies suggest that enterprises with employee ownership frequently performed no worse than firms with other ownership forms. The comparative analysis of the general attitude of governments and social partners shows the lack of concrete policy measures supporting PEPPER schemes, as well as limited interest of both trade unions and employer organisations.¹⁹ Rather than being actively promoted as in some old EU Member States, employee financial participation has most frequently not even been considered, or is viewed with suspicion.

Against the background of the different genesis of PEPPER schemes in the old and the new EU Member States it is surprising, that the data examined in the benchmarking project seem to indicate that a West-East divide exists only with regard to profit-sharing.

¹⁶ Cyprus, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Malta, Poland, Slovakia and Slovenia which joined the EU on 1 May 2004, Bulgaria, Romania on 1 January 2007 and Croatia, and Turkey as Candidate Countries.

¹⁷ Employee share ownership has largely developed in the course of recent privatisations, with different methods including sales of enterprise shares to insiders on privileged terms; employee-management buyouts; leasing; mass privatisation, and ESOPs and ESOP-type schemes.

¹⁸ Despite the fact that company laws in several countries do refer to the possibility of employees having a share of company profits, Romania is the only country that has specifically legislated a general scheme for cash-based profit-sharing in state owned companies (though implemented in a small number of firms). Among the non-transition countries, only Turkey has legislation on profit-sharing.

¹⁹ Only occasionally have trade unions been supportive of employee ownership, but they remain rather critical of profit-sharing. The employers have been generally indifferent towards financial participation, despite a few cases of active support (as in the case of ESOPs in Hungary).

2. Responding to the Data Deficit: The Benchmarking Project

The PEPPER IV Report is an interdisciplinary legal and economic comparative study. It provides a Comparative Assessment of Financial Participation in the EU-27 and in the candidate countries based on coherent and thus for the first time comparable indicators.

a) Aims

The Project closes the gap between PEPPER I (1991, EU-12), PEPPER II (1997, EU-15) and PEPPER III (2006, ten new Member States and four candidate countries), and utilises the benchmarking indicators developed by the Dublin Foundation in all 27 EU Member States and candidate countries. It consists of three complementary basic components that build on each other:

- Description of the legal environment, fiscal or other incentives and links to participation in decision-making with a specific focus on schemes for SMEs;
- Benchmarking financial participation, that is, the scope and nature of financial participation schemes;
- Comparative analysis of the national policies and characteristics that affect the environment for financial participation.

The final recommendations derived from the comparative analysis, best practise in the member countries and, in the context of the development of ESOPs, that in the United States, set forth both a policy and a proposal for promoting Financial Participation at the European and the National level.

b) Approach

The Benchmarking exercise continues the projects ‘Financial Participation of Employees in the New Member and Candidate Countries’ and ‘A European Platform for Financial Participation’ (both successfully concluded) funded under the same budget line and building on the PEPPER Reports. It digests their results and data from previous studies (EWCS, Eiro, CRANET, EFES).²⁰ The purpose of the project is fourfold:

- To systematically assess similarities and compatibility of the laws and practices governing financial participation in the EU-27 and candidate countries;
- To close information gaps (that is, between PEPPER I, II and III) that currently prevent a full profiling of financial participation policy and practice;

²⁰ EWCS: European Working Conditions Survey and Eiro: Comparative Study on Financial participation in the New Member States (both European Foundation for the Improvement of Working and Living Conditions); CRANET E: Cranfield Survey on International HRM (Cranfield School of Management); EFES: European Employee Ownership Top 100 (European Federation of Employee Share Ownership).

- To discuss individual country’s scores on the indicators against the background of comparable scores for the other EU Member States, providing a contextual frame of reference for each single profile;
- To further promote a common platform for financial participation within the European Union, in the context of comparative analysis.

An interdisciplinary conference, with key EU experts presenting preliminary project results, took place in October 2007 in Berlin; preliminary results of the PEPPER IV Report were presented in Brussels and in Strasbourg to the European Commission and Parliament in May 2008; this Final Report was launched in Rome in October 2009.

c) Specific Difficulties to Be Dealt with

In 2004, the European Foundation commissioned a report that developed 16 specific indicators of financial participation policy and practice facilitating like-for-like comparisons of the financial participation situation in each Member State. The second stage of the process, to ‘road test’ these indicators, was undertaken in 2005. While nine of the European Foundation’s 16 benchmarking indicators were supported by existing data, seven of the measures were not supported at all. The Benchmarking project addressed this data shortage not by undertaking a new study dedicated to financial participation; instead, as recommended by the pilot benchmarking study of Slovenia commissioned by the European Foundation, it referred to existing upgraded surveys (that is by the European Foundations ‘Eiro Comparative Study on Financial Participation in the New Member States’, to whose questionnaire our team contributed input).

Furthermore, the Pilot Study by the European Foundation clearly demonstrated how the Foundation’s nine supported indicators can be practically employed to produce a partial profile (in the test case of Slovenia). In order to be independent of new EU-wide surveys, the work programme initially aimed at such a partial profile using those nine indicators. Including the results of the complementary survey of our project partners, additional indicators were added. For individual country’s National Sources (see Part 2, Country Profiles) and ‘blank spots’ (in some cases for single countries and single indicators), our team provided the necessary supplementary information using our EU-wide network from the previous projects.

The Commission and Parliament identified transnational obstacles to the development of a European model for financial participation, which a High Level Group of independent experts had classified at the end of 2003.²¹ Our assessment of the legal environment investigates the possibilities for creating a European legal framework for financial participation. In so doing, the project, as recommended in PEPPER III, builds on the ‘Building Block Approach’ to combine established schemes in a single program with alternative options and to keep the different elements complementary.

²¹ European Commission (2003a) *Report of the High Level Group of Independent Experts on Cross-Border Obstacles to Financial Participation of Employees for Companies Having a Transnational Dimension*, December (Brussels: European Commission).

3. The Benchmarking Indicators²²

a) Sources

Any benchmarking exercise, especially one involving a large number of countries, relies on the availability of comparable and consistent data. While there are a large number of studies on the impact of employee participation on company performance²³, there are very few sources of information on the availability and take-up of financial participation schemes across countries. Below we briefly present the main sources of information on financial participation (FP) schemes in European countries on which the discussion of this chapter and country reports are based. These sources are very different from each other and need careful interpretation.

(i) CRANET Survey. This is a survey of companies with more than 200 employees²⁴ undertaken by the Cranfield School of Management (Cranfield University, UK) approximately every four or five years since 1992. It is largely a postal survey, sent to the Human Resources Departments of companies with the main aim of investigating the HR characteristics and practices of these companies. One section of the questionnaire is concerned with employees' remuneration and its components. In this section there are questions on whether the company offers any financial participation scheme (specifically, share ownership, profit-sharing or stock option schemes) to various occupational groups of employees (management, professional and technical, administrative, and manual workers). In 2005, the Survey covered 7,914 companies in 32 EU and non-EU countries (the EU member and candidate countries not included were Ireland, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania and Croatia).²⁵ Because of the postal nature of the survey, the response rate is rather low (16 per cent in 2005). The CRANET sample is selected randomly from the population of companies with more than 200 employees and is designed to represent the size and sectoral distribution of companies in the population.²⁶ The companies included in the sample are selected separately in each round of the Survey, thus the data is not in the form of a panel. In order to have a more complete picture of FP in all member and candidate countries of the European Union, we undertook surveys in seven of the missing countries (Latvia, Lithuania, Malta, Poland, Portugal, Romania and Croatia).²⁷ The surveys consisted of a smaller number of firms in each country

²² We are grateful to Edvard Orlic, our Research Assistant, for his diligent and dedicated work.

²³ These studies are usually concerned with individual or a small number of countries and use different methodologies in pursuing their objectives.

²⁴ The 2000 Survey covered companies with 100 or more employees. The unit of investigation in CRANET is an 'organisation' or a 'business unit'. While this may include a self-contained subsidiary of a larger company, in general it coincides with the boundaries of 'companies'. For the sake of simplicity, therefore, we refer to them as companies.

²⁵ The number of companies in the countries of interest to this study was 5,214.

²⁶ For more detailed information on the CRANET Survey, see CRANET (2005) and Pendleton, Andrew et al. (2001).

²⁷ The survey conducted in Latvia showed no financial participation scheme in any of 104 companies in the sample. Given the information from other sources (such as EWCS and various research papers) we believe this outcome is unrealistic, caused by a biased sample. As there was no time to repeat the exercise with a random sample, Latvia has been excluded from some of the tables. Luxembourg has been

and covered only those parts of the CRANET questionnaire related to remuneration and the general information about the company, thus were comparable to the CRANET survey.²⁸ It is essential to note that the CRANET Survey does not indicate the incidence of financial participation schemes in companies but only their availability. Furthermore, for the purpose of this research, we have been concerned with broad-based financial participation schemes (that is, schemes covering more than 50 per cent of employees) in private sector companies only, as profit-sharing or share ownership are largely not applicable to public sector organisations (which do not make ‘profit’ as such and do not always have shares to distribute to employees).

(ii) European Working Conditions Survey. This is a large scale survey of working conditions across Europe undertaken by the European Foundation every four or five years to investigate a variety of factors influencing individuals working and living conditions. One section of the questionnaire deals with remuneration and sources of income, asking the respondent whether they receive any income in the form of profit-sharing or any income from the ownership of shares in the companies for which they work. Given that individual subjects may be employed, unemployed, self-employed or retired, the present survey is only concerned with the individuals who are in employment. The 2005 Survey covered some 30,000 randomly selected individuals in 31 countries (including all EU and candidate countries as well as some non-EU countries). These surveys are conducted by face-to-face interviews and, consequently, the response rate is higher (48 per cent in 2005)²⁹. As with the CRANET Survey, only a small part of this investigation is related to financial participation. The previous round of this survey took place in two waves – in 2000 for the EU-15 and a few other European countries and in 2001 for the accession and candidate countries. Unlike the CRANET survey, which only shows the availability of financial participation schemes to employees, the EWCS represents the actual take-up of these schemes. However the data applies to all employees, irrespective of the size of their companies. Given that respondents may be from any category of employee (managers, professionals, clerical or manual), it is not possible to identify whether any financial participation scheme is broad or narrow. Unlike the 2000 and the 2005 survey, the 2001 round did not directly distinguish between employees of the public and private sector.³⁰

(iii) European Federation of Employee Share Ownership (EFES) data. For many years, EFES has been collecting data on the scale of employee share-ownership in large companies in 29 European countries, including all 27 EU Member States. The population

excluded from the benchmarking exercise altogether. Ireland was of course included in the 1999 CRANET.

²⁸ The planned number of firms in each of these countries was 100 in larger and 50 in smaller countries, randomly selected. In practice, the total number of observations in these countries was 533 – in Malta, in particular, the number of firms interviewed was 17 (and for this reason, the information on Malta should be treated with caution). Furthermore, given that the number of large firms in some of these countries (Latvia, Lithuania, Malta, in particular) was small, firms with less than 200 employees were also included in the sample.

²⁹ Of course, given that respondents either ‘did not know’ or ‘refused to answer’ some of the questions in the survey, the effective response rate was lower.

³⁰ However, given that the surveys identify the sector of activity of the respondents, the gap between the 2000 and 2001 surveys has been reduced by the elimination of those respondents working in ‘public services’.

of this database consists of all listed companies with a market capitalisation of at least Euro 200 million and large non-listed employee owned companies (those employing more than 100 people with employees owning more than 50 per cent of shares). The former group consists of 2,270 companies and the latter of some 207 companies. The emphasis of this dataset is not on financial participation schemes in general but only on share ownership and only in large companies. Although the second group of companies do not include all the large, majority-owned companies, this group is only a small part (less than 10 per cent) of the total sample and does not change the overall picture significantly. In this Benchmarking exercise, we use data from 2006 and 2007.

(iv) Country Profiles based on various sources, including the PEPPER I, II, and III Reports, the EIRO Survey and our Project Expert Network in the field. These profiles of all 29 target countries (EU-27 and Croatia, Turkey) cover developments in three areas: Evolution of Financial Participation Schemes, Social Partners' Attitudes and Current Government Policy and Legal Framework.

To sum up, it is clear that the three datasets are not comparable to each other, as they refer to different indicators of financial participation. They should be seen as complementary, each highlighting a different feature of the development of employee financial participation. The diversity of these sources also emphasises the need for a new, comprehensive and consistent large-scale survey of employee participation across the whole of EU and candidate countries.

b) The Indicators and their Link to the Commission Principles

Each of the Benchmarking Indicators selected complies with one of the essential principles of financial participation schemes set forth by the Commission in its Communication seeking 'a framework for the promotion of employee financial participation'³¹. Needless to say, sufficient data was not available for all of the chosen indicators for screening).

- Principle 1: Participation must be voluntary for both enterprises and employees.
- Indicator: Legislative and fiscal support for financial participation.

The Country Profiles provide detailed information on whether specific legislation concerning financial participation exists and whether any tax relief is given. Furthermore, the overview of taxation systems and tax incentives distinguishes between incentives for firms and employees, on the one hand, and for profit-sharing and share schemes on the other.

- Principle 2: Access to financial participation schemes should in principle be open to all employees (no discrimination against part-time workers or women).
- Indicators: Percentage of enterprises offering broad-based financial participation schemes to employees and the percentage of employees covered by such schemes.

CRANET Surveys measured this as the percentage of organisations offering financial participation to each of the four occupational categories (managers and three non-managerial groups). In terms of the all-employees criterion, the assumption is that or-

³¹ COM (2002) 364 Final, 5 July 2002, pp. 3, 10.

organisations that offer financial participation to a particular occupational group do so for all employees within that grade. Furthermore, CRANET Surveys indicate the percentage share of each organisation's workforce that falling into each occupational grade. Putting the two pieces of information together, it is possible to calculate the percentage of employees in each organisation that are offered financial participation.

- Principle 3: Schemes should be set up and managed in a clear and comprehensible manner with emphasis on transparency for employees.
- Indicator: Percentage of employees participating in financial participation.

The 4th EWCS asks whether the remuneration includes payments based on the overall performance of the company (profit-sharing scheme) and/or income from shares in the company the respondent works for.

- Principle 4: Share ownership schemes will almost inevitably involve a certain complexity, and in this case it is important to provide adequate training for employees so as to enable them to assess the nature and particulars of the scheme in question.
- Indicator: Countries with direct/indirect and consultative/delegative participation in decision-making.

The Country Profiles give an overview of the different types of participation in decision-making practised in different countries. Unfortunately, sufficient data for the screening of this indicator was not accessible. The available empirical evidence suggests that incentive effects of financial participation are much greater when accompanied by greater worker participation in decision-making.

- Principle 5: Rules on financial participation in companies should be based on a predefined formula clearly linked to enterprise results.
- Indicators: Percentage of employees whose financial participation is calculated on a predefined formula and the percentage participating in regular ongoing schemes.

The fourth EWCS asks whether profit-sharing payments are calculated on a predefined formula and whether these payments are received on a regular basis.

- Principle 6: Unreasonable risks for employees must be avoided or, at the very least, employees must be warned of the risks of financial participation arising from fluctuations in income or from limited diversification of investments.
- Indicator: European Employee Ownership Top 100 Index.

Sufficient empirical data for the screening of this indicator was not available. However, the information from the European Employee Ownership Top 100 Index permits an assessment of one dimension of risk through matching financial participation in quoted companies with their performance on the stock markets.

- Principle 7: Schemes must be a complement to, not a substitute for, the existing pay system.
- Indicator: Percentage of enterprises in which financial participation and regular salary are kept separate and distinct.

Sufficient empirical data for the screening of this indicator was not available.³² Nevertheless, a good test for this indicator is to examine whether negotiations on the two issues take place separately and at different times; however, there is a danger of respondent bias (employers may be reluctant to give any information which could suggest salary substitution).

- Principle 8: Financial participation schemes should be developed in a way that is compatible with worker mobility both internationally and between enterprises.
- Indicator: Legislative and fiscal support for financial participation.

The Country Profiles look at specific financial participation schemes that are suitable for cross border use. The overview of taxation systems and tax incentives provide complementary information about this dimension of financial participation.

4. Overview of Financial Participation in the EU-27

Table 2. The old Member States of the EU

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|----------------|---|---|---|
| Belgium | [A] TU opposed, but relatively more support for PS; EA in favour; [B] Since 1982, legislation for ESO; amendment 1991; since 1999 legislation for SO; since 2001 new law on ESO and PS. | All plans: EmpC up to 20% of after tax profit per annum; up to 10% of total gross salary; ESO: NCL - discounted ES in JSC, financing by firm possible; in capital increases: up to 20% of equity capital, ES discount limit 20%; NTL - (restricted stock grant) value reduced by 16.7%, taxation deferred if 2 years not transferable, 15% tax on benefit, no SSC; (stock purchase plan) benefit tax base 83.33% of fair market value; SO: NTL - since 1999 taxed at grant on a lump-sum basis, no SSC; PS: NTL - tax 15% for PS in an investment savings plan, 25% for other plans. | 2005 Cranet: ESO 21%, PS 3.7%; 2005 EWCS: ESO 4.3%, PS 5.9%; firms involved mainly from financial sector, large firms and multinationals; SO 2005 Cranet: 2%; EU-Report 2003: 75,000 employees benefit; most of 20 largest Belgian firms operate plans; 40% of firms with more than 50 employees. |
| Denmark | [A] TU indifferent to FP; EA opposed to any extension of FP; | ESO: NCL - ES in JSC: discounted, up to 10% of salary per annum, 7-year holding period, free maximum of DKK 8,000 per | 2005 Cranet: ESO 36%, PS 7.3%; 2005 EWCS: ESO 2.4%, PS 6.4%; |

³² The 2008 European Establishment Survey of the European Foundation for the Improvement of Working and Living Conditions envisages to include questions that could permit an assessment of this indicator.

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|---------|--|---|--|
| | <p>[B] Employee Funds discussed in 1970-80s, PS popular; later support for ESO and SO; in 2000s Government support for share-based schemes.</p> | <p>annum; financing by firm possible if qualified plan; in capital increases deviation from subscription/pre-emption rights possible; NTL - deferred taxation of benefit; EmplC: discount tax deductible;</p> <p>PS: NCL - SPS; NTL - up to 10% of annual salary;</p> <p>SO: NTL - exemption from PIT/SSC: broad-based if up to DKK 8,000, 5-year holding period; individual if up to 10% of annual salary or up to 15% difference exercise price/market price.</p> | <p>SO 2005 Cranet: 2%; EU-Report 2003: 20% of 500 largest firms by 1999, one third of quoted firms 2000.</p> |
| Germany | <p>[A] TU partly sceptical/partly hostile because of 'double risk', recently growing interest; EA support individual firms</p> <p>[B] Traditional focus on savings plans (total capital higher than that of ES company plans); FP since 2006 on political agenda of all parties. New law 2009.</p> | <p>ESO: NCL - discounted ES in JSC, financing by firm possible; state savings bonus of 20% of up to Euro 400 (Euro 80 per annum) invested in employer stock; no tax/SSC on up to Euro 360 per annum employer matching contribution; since 2009 Special Employee Participation Fund.</p> <p>PS: None</p> <p>SO: NCL - in capital increase, nominal amount restricted to 10%, that of increase to 50% of equity capital.</p> | <p>2005 Cranet: ESO 11%; PS 45%;</p> <p>2005 EWCS: ESO 0.8%, PS 5.3%;</p> <p>2005 IAB: ESO 3%, PS 12%;</p> <p>2003 WSI: PS in one third of firms;</p> <p>ESO: 2006 AGP, 3,000 firms, 2.3 million employees, Euro 19 billion;</p> <p>SO: EU Report 2003, in over two-thirds of DAX-listed firms.</p> |
| Greece | <p>[A] TU moved from scepticism to support in 1980s; EA indifferent, low priority not a current topic;</p> <p>[B] Some regulations on CPS (1984) and ESO (1987); since 1999 more attention on SO; not a current issue.</p> | <p>ESO: NCL - ES in JSC discounted or free; within capital increase for 3 years not transferable, up to 20% of annual profit; NTL - no PIT/SSC on benefit;</p> <p>SO: NCL - free/discounted; NTL - taxable at exercise; tax exempt if qualified plan;</p> <p>PS: NTL - up to 15% of company profits, 25% of employees' gross salary; no PIT, but SSC.</p> | <p>2005 Cranet: ESO 23,6%; PS 9.4%;</p> <p>2005 EWCS: ESO 1%, PS 2.8%;</p> <p>SO: 2005 Cranet 2%; SO EU-Report 2003: only a limited number of firms.</p> |
| Spain | <p>[A] Low priority: TU oppose income flexibility; EA ambivalent, fear information disclosure requirements;</p> <p>[B] Long tradition of social economy: COOPs (new law 1997) and EBO; PS supported in 1994 then shift to ESO/SO; active support.</p> | <p>ESO: NCL - ES/SO in JSC, financing by firm possible; NTL - tax benefits on PIT after 3-year holding period;</p> <p>PS: NLL;</p> <p>SO: NTL - after 2-year holding period 40% reduction of taxed plan benefit;</p> <p>EBO: 'Workers Companies' with more than 51% ESO, 10-25% of profits in Reserve Fund; NTL - if 25% reserve, tax exempt from:</p> | <p>2005 Cranet: ESO 5.7%, PS 17%;</p> <p>2005 EWCS: ESO 0.5%, PS 6.4%;</p> <p>ESO: 2003 CNMV 20% of large firms with share purchase plans;</p> <p>SO: 2005 Cranet: 19%; EU-Report 2003: plans in 40 firms of which 50% in IBEX 35;</p> <p>EBO: 2003 Heissmann, approx. 15,000 'Workers Companies'.</p> |

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|----------------|--|--|---|
| | | capital transfer tax, tax on formation/capital increase, notary fees. | |
| France | [A] TU show mixed attitudes: sceptical but actively involved, favour if not substitute to pay; EA generally in favour, especially if voluntary; [B] PS/ESO strong continuous support since 1959; also in privatisations; climate friendly toward FP, focused policy. | ESO: PrivL - 5% ES reserve, up to 20% discount; NCL – discounted ES in JSC, financing by firm possible, also capital increase; SAYE; NTL - flat rate tax of 7.6% and 10% on returns, no SSC; SO: NCL - capital increase; NTL - tax on exercise gain 26-30% after 4-year holding period; ESOP/EBO: Law on Trusteeship 2007; NCL - special reserve for EBO possible; PS: DPS compulsory/CPS voluntary; NTL - flat rate tax 7.6-10% if paid to company savings scheme/fund after 5-year holding period. | 2005 Cranet: ESO 34%, PS 92%; 2005 EWCS: ESO 5.3%, PS 12%; 2004 FONDACT: DPS covered 53% of non-agriculture private sector firms employees (that is 6.3 million); SO: 2005 Cranet 3%; SO EU-Report 2003: approx. 50% of quoted firms and 28% of limited companies, total approx. 30,000 employees. |
| Ireland | [A] EA strong support; TU support if financial and intrinsic reward to employees; managers/employees pragmatically motivated; Lobby groups/institutions for example banks for ESO ; [B] Support in privatisation; improvements in 1995 and 1997; promoting voluntary adoption of SPS, for example Approved Profit-Sharing Scheme (APSS). | ESO: PrivL - 14.9% ESOT stock paid for by loan/by state; NCL - ES/SPS in JSC, financing by firm possible; NTL - New Shares: limited PIT tax base deduction for employees, no SSC; SO: Savings Plan: bonus/interest on savings tax free, no PIT on grant/exercise, no SSC; Approved Plan: no PIT at exercise, no SSC; ESOP: Trust Act - taxed 15% interest / 10% investment; NTL - ESOT: tax incentives as for APSS if ESOT part of APSS; PS: NTL - APSS: at transfer no PIT, no SSC up to limit; salary foregone - up to 7.5% of gross salary deductible. | 1999 Cranet: ESO 14%, PS 15%; 2005 EWCS: ESO 5.3%, PS 9.2%; SO: 2002 IBEC: 90 firms with SAYE schemes, 15 firms with Approved Share Option Schemes; PS: 2002 IBEC: 400 firms with APPS; ESOP: n.a. |
| Italy | [A] TU mixed attitudes, recently interested in topic / EA mostly supportive; [B] Trilateral agreement 1993 supported PS ; then shift to support ESO/SO ; recently discussed on political agenda; new law planned 2009. | ESO: CivC - discounted ES in JSC, financing by company possible; in capital increases deviation from pre-emption rights and preferential 'ES' possible; NTL - PIT & SSC exemption up to Euro 2,065 after 3-year holding period; in limited liability companies free share up to Euro 7,500 tax exempt; PS: NCL - no SSC on up to 5% of total pay; SO: NTL - SSC exemption after 5-year holding period. | 2005 Cranet: ESO 13.7%, PS 6.2%; 2005 EWCS: ESO 1.4%, PS 3.1%; SO: 2005 Cranet 1%; EU-Report 2003, approximately 6% of employees involved. |

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|------------------|--|---|--|
| Luxem- burg | [A] TU/EA growing interest in 1990s, not supportive of share schemes; EA support profit-sharing; [B] FP not a current issue. | ESO: NCL - ES in JSC, financing by company possible; SO: NTL – ‘Tradable Option Plans’ reduced tax burden; PS: None. | 2005 EWCS: ESO 3.7%, PS 13.5%; PS: PEPPER II, 1995 CPS in 25% of firms, mainly banks; SO: EU Report 2003, estimates 25% of firms - mainly financial sector. |
| Nether- lands | [A] TU/EA generally in favour; TU support if supplement to pay, prefer PS to ESO; [B] Traditional focus on savings plans; support for SO in 2003. | ESO: NCL - ES in JSC, financing by company possible; NTL - up to Euro 1,226 from pre-tax salary after 4 years in a savings plan 15% flat tax, no SSC; PS: NTL - up to Euro 613 from pre-tax salary after 4 years in a savings plan 15% flat tax, no SSC; SO: NTL – specific tax incentives abolished; IEInt: Qualified Savings Funds. | 2005 Cranet: ESO 20%, PS 44.8%; 2005 EWCS: ESO 1.5%, PS 13.8%; PS: 3 million participants (2000); SO: 2005 Cranet 4%; EU-Report 2003, more than 80% of all listed firms. |
| Austria | [A] TU/EA currently support FP and co-operate; different views about participation in decision-making [B] Legislation since 1974; first tax incentives since 1993; more active support since 2001. | ESO: NCL - discounted ES in JSC; financing by company possible; NTL - PIT/SSC allowance for benefit; CGT or 1/2 PIT for dividends; tax exemption for share sale gain; IEInt: NCL - Employee Foundation: EmpC buys own stock, sheltered in IEInt, dividends paid out; NTL - EmpC: contribution to IEInt, setting-up/operation cost deductible; IEInt: tax allowance on contributions; Employees: CGT on dividends; SO: NCL - capital increase: nominal amount up to 10%, increase up to 50% of equity capital; up to 20% of equity capital for total amount of shares receivable; NTL - 10% of benefit per annum, up to 50% of total benefit tax free and carry forward of taxation for the remaining amount; PS: None | 2005 Cranet: ESO 12%, PS 32.8%; 2005 EWCS: ESO 1.2%, PS 5.4%; 2005 WKÖ/BAK: ESO 8%, PS 25%; SO: 2005 Cranet: 2%; 2005 WKÖ/BAK: 1% |
| Portu- gal | [A] TU/EA Indifferent, low priority: TU prefer PS to SO; [B] ESO mainly supported in Privatisation, especially around 1997; not on the Agenda; FP is generally ignored. | ESO: PrivL - discounted ES; NCL - ES in JSC, financing by firm possible; in capital increase: suspension of pre-emptive right of shareholders for ‘social reasons’ possible; PS: NLL - not considered remuneration, no SSC; SO: NTL – 50% of share sale gain liable to PIT. | 2008 PEPPER IV: ESO 5.3%, PS 28%; 2005 EWCS: ESO 0.9%, PS 1.9%; SO: EU Report 2003, from 60 firms listed at Euronext Lisbon Stock Exchange, about 22% have implemented SO. |

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|---------|--|---|---|
| Finland | <p>[A] TU/EA generally support FP, especially desire to improve the environment for personnel funds; other forms not discussed;</p> <p>[B] Discussions on FP since 1970s; 1989 law on Personnel Funds (major form until now).</p> | <p>ESO: NTL - discount tax free, no SSC; tax relief for dividends;</p> <p>SO: None; PS: Cash-based none; NCL - share-based 'Personnel funds': in firms with more than 30 employees, if all participate, registration with Ministry of Labour, after 5-year blocking period up to 15% per annum can be withdrawn; NTL - 20% of payments to employee tax free; earnings of fund tax free.</p> | <p>2005 Cranet: ESO 14%, PS 66%;</p> <p>2005 EWCS: ESO 0.7%, PS 11%;</p> <p>PS: 2007 54 Personnel Funds with 126,000 members;</p> <p>SO: 2005 Cranet 5%; 2003 EU-Report: 84% of companies listed at Helsinki Stock Exchange.</p> |
| Sweden | <p>[A] TU neutral/ opposed, advocated Wage Earners' Funds; EA favour PS for wage flexibility, but no active support;</p> <p>[B] From 1992–97 tax incentives for PS in firms; since then no support.</p> | <p>ESO: NCL - ES in JSC, financing by company possible; in capital increase suspension of pre-emptive right of shareholders possible;</p> <p>PS: Cash-based none; NCL - share-based 'Profit-Sharing Foundations': one third of employees on similar terms, after dissolution assets to be distributed; NTL - for the employer 24.26% payroll tax instead of 32.28% SSC;</p> <p>SO: None.</p> | <p>2005 Cranet: ESO 16%, PS 26%;</p> <p>2005 EWCS: ESO 1.6%, PS 15%;</p> <p>PS: 2003 Heissmann: 15%; Wage Earners' Funds created in 1983, abolished in 1991.</p> |
| UK | <p>[A] Climate friendly and supportive toward FP; TU involved, but reservations: prefer SO to PS; EA positive, favour flexibility with regard to form of schemes; employees interested;</p> <p>[B] Long tradition of FP, especially ESO and ESOP; now more active support for SO that is SAYE and Sharesave; 2000 new of Enterprise Management Incentives EMI; very little participation in decision-making.</p> | <p>ESO: NTL - Share Incentive Plan (SIP) discounted: no PIT/SSC; no dividend tax if dividends reinvested in shares, generally no SSC; no CGT if sale immediately after taking shares out of the plan;</p> <p>SO: NTL - Savings-Related SO-Plan, Firm SO Plan: generally no PIT at grant or exercise, no SSC; SAYE: tax bonus on savings; EMI: no PIT, no SSC at grant or exercise; (NCL - Employee Benefit Trust);</p> <p>ESOP: NCL - up to GBP 125 per month shares for pre-tax salary in Trust, EmpC up to 2 matching shares / share worth up to GBP 3,000 per annum; NTL - shares exempt from income tax and SSC after 5 years; EmpC contribution to trust tax deductible;</p> <p>PS: NTL - approved PS; tax benefits abolished in 2002.</p> | <p>2005 Cranet: ESO 19%, PS 13%;</p> <p>2005 EWCS: ESO 1.9%, PS 6.4%;</p> <p>2006 ifsProShare: ESO/ SO approved plans in 5,000 firms, some with ESOPs; SIP in 830 firms; SPS: 2002 1 million employees under approved schemes, average per head less than GBP 700;</p> <p>SO: 2005 Cranet: 2%; 2006 ifsProShare: Savings-Related Plans in 1,300 firms, 2.6 million employees; Company Plans in 3,000 firms; EMI in 3,000 firms.</p> |

Table 3. The new EU Member States and candidate countries

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|----------------|---|---|--|
| Bulgaria | [A] TU open to FP, EA indifferent; not a current topic on either of their agendas; [B] ESO strong support 1997-2000, then ignored; in 2002 PrivL incentives abolished; FP generally ignored. | ESO: None; NTL - Uniform 7% dividend tax; PS: None; NTL - SPS personal income tax exempt. | 2005 Cranet: ESO 38%, PS 5%; 2005 EWCS: ESO 1.8%, PS 6.3%; ESO: 10% Mass Privatisation, 4-5% Cash Privatisation; low, decreasing; MEBO: 1,436, 28% privatisations; managers took over most; PS: AI, few cases survey evidence; SO: 2005 Cranet 14%. |
| Cyprus | [A] FP not an issue on TU / EA agendas; [B] FP so far ignored. | ESO: NCL - discounted ES in JSC; financing ES by company possible; NTL - dividends/gains from share sale tax-free; PS: None. | 2005 Cranet: ESO 10%, PS 7.7%; 2005 EWCS: ESO 1.2%, PS 2.7%; SO: 2005 Cranet: 4%; ESO/PS: AI, insignificant. |
| Czech Republic | [A] TU / EA indifferent to FP, not a current topic on their agendas; [B] ESOP discussed in 1990; FP ignored after introduction of voucher concept. | ESO: NCL - discounted ES/SPS in JSC; not considered public offering; ES discount limit: 5% of equity capital, financing by company possible; NTL - uniform 15% dividend tax; PS: NCL - CPS/SPS in JSC; NLL: negotiable in collective bargaining agreements. | 2005 Cranet: ESO 14%, PS 27%; 2005 EWCS: ESO 1.6%, PS 11%; SO: 2005 Cranet: 3%; ESO: Insignificant; 0.31% of the privatised assets; PS: AI, insignificant. |
| Estonia | [A] TU indifferent to FP, EA opposed to any extension of employee participation; [B] PrivL supported ESO until 1992; after 1993 FP ignored. | ESO: NCL - rights attached to shares issued before 1995 remain valid; no public prospectus for ES needed; NTL Emp.: no income tax on dividends from resident firms; EmpC: 22% on distributed profit, only 'bonus issue' in capital increase exempt; PS: None. | 2005 Cranet: ESO 9.6%, PS 11%; 2005 EWCS: ESO 2%, PS 11%; ESO: 2005 2% (1995 after privatisation 20%) of firms majority employee-owned, 20% minority; PS: AI, survey evidence, very few cases. |
| Hungary | [A] FP for managers means to avoid external control, for employees to preserve workplace; TU lobbied ES/ESO in privatisation, recently passive; EA indifferent; [B] ESOP/ES strong support in PrivL until 1996; climate friendly toward FP but lack of concrete economic policy decisions. | ESO: PrivL - preferential sale; discount up to 10% firms assets and 150% of annual minimum pay, instalments; Decree 'Egyszerűsített' Credit; NCL - specific 'ES' in JSC, discounted/free, up to 15% of equity capital, financing by company possible; since 2003 tax-qualified stock plans, first HUF 0.5 million free, then 20% tax, 3-year holding period; | 2005 Cranet: ESO 15%, PS 15%; 2005 EWCS: ESO 1%, PS 3%; ESO: 1998 1% of assets privatised; preferential privatisation in 540 firms; CS strong decline; now AI, 30% of firms (70% SO, 30% ES), mostly foreign; ESOP: initially 287 employing 80,000, in 2005 151 left; 1.2% of employment by private firms; PS: AI, 20% of firms, mostly foreign, only 10% of entitled receive profit; |

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|-----------|--|--|---|
| | | <p>SO: NTL – PIT base is value at exercise; ESOP: ESOP Law 1992; preferential credit; corporate tax exempt until end 1996; contribution to Plan up to 20% tax deductible; tax base lowered; PS: None.</p> | <p>SO: 2005 Cranet 27%.</p> |
| Latvia | <p>[A] TU / EA indifferent to FP, not a current topic on their agendas; [B] Little support for ESO in PrivL; FP so far ignored.</p> | <p>ESO: PrivL - up to 20% ES; specific 'ES' in state / public firms; NCL - preferential ES in JSC free/discounted, in capital increases up to 10% of equity capital non-voting stock; PS: None.</p> | <p>2005 EWCS: ESO 0.6%, PS 8.5%; ESO: PrivL 110.6 million vouchers to 2.5 million people; AI, 1999 16% of 915 firms dominant ESO but falling over time; PS: AI, 7% of firms; mostly IT, consulting, real estate.</p> |
| Lithuania | <p>[A] Climate FP friendly; TU interested, lack of actions; EA support individual firms; [B] ESOP/ES strong support in PrivL until 1996; now FP not on political agenda of Parliament and Government.</p> | <p>ESO: PrivL - 5%ES deferred paym. up to 5 years; NCL - in corporations ES for 3 years non transferable/non voting, financing by company possible; NTL - uniform 15% dividend tax; after holding period profits from sale of shares not taxed; PS: None.</p> | <p>2008 PEPPER IV: ESO 4%, PS 36%; 2005 EWCS: ESO 0.9%, PS 4%; ESO: low and decreasing; AI, 2000 36% (1995 92%) privatised firms dominant ESO, falling over time; PS: AI; CPS mostly foreign (IT, consulting, advertising, etc); DPS few cases 2005 linked to employee savings plan.</p> |
| Malta | <p>[A] TU support schemes in practice; FP not a current topic in national tripartite dialogue; [B] FP collateral effect of nationalisation (80's) and privatisation (90's) not a current issue.</p> | <p>ESO: NCL – ES in corporations, exempt from prospectus/investment rules; up to 10% discount, financing by company possible; NTL - SO only taxable at exercise; ESOP: Trust Act refers to FP; taxed 15% interest / 10% investment; PS: mentioned in NLL.</p> | <p>2005 EWCS: ESO 0.7%, PS 3.9%; ESO: AI; banking sector: ES, SAYE scheme, SO; ESOP: AI, Trust Funds in Bank of Valetta / Malta Telecom; PS: AI; 2004 public sector (Shipyard 1,761 employees); private (foreign) firms, mostly reserved for management.</p> |
| Romania | <p>[A] TU support indiv. cases; EA avoid topic; Tripartite council tackled FP sporadically; [B] ESO supported until 1997 especially MEBO; then support declined; current government gives little support and has other priorities.</p> | <p>ESO: PrivL - aim 30% of privatised assets Vouchers/ES; Vouchers free; 10% discount ES; NCL - ES in JSC, financing by company possible; NTL - 10% dividend tax; ESOP: PrivL on Employee Associations; leveraged transaction, preferential credit, up to interest rate 10%; PS: Ordinance – CPS compulsory in state/municipal firms.</p> | <p>2008 PEPPER IV: ESO 6%, PS 42%; 2005 EWCS: ESO 1.6%, PS 5%; ESO: ES 10% of shares issued at privatisation, decreasing; ESOP: 1998 one third priv., most frequently used single method 2000: 2,632 firms, average 65% ESO, 1,652 majority ESO; PS: estimated 1.2 million employees in public sector covered.</p> |

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|-----------------|--|---|---|
| Poland | <p>[A] TU/EA indifferent to FP; managers/ employees pragmatically motivated; lobby groups/institutions (in particular banks) supportive to ESO;</p> <p>[B] FP Supported in early privatisation period; ESO in most privatisations, since mid-1990s more and more ignored; PS increased emphasis in the context of collective bargaining agreements.</p> | <p>ESO: PrivL - 15% ES for free, 2 years non transferable, up to value 18 months minimum pay, <i>National Investment Funds</i> 1995 (NIF), shares for symbolic fee; NCL - ES/SPS in JSC, financing by company possible; NTL - uniform 15% dividend tax;</p> <p>EBO: PrivL - Leverage Lease Buyout (LLBO), anticipated ownership transfer possible; interest 50% of refinance rate; interest part of lease payments are costs; Insolvency Law - buyout right;</p> <p>PS: NCL - CPS/SPS in JSC.</p> | <p>2008 PEPPER IV: ESO 40%, PS 26%;</p> <p>2005 EWCS: ESO 0.7%, PS 5%;</p> <p>ESO: low and declining; AI in privatised firms, 2000 approximately 11.4% (1998 12.7%); NIF adult citizens 1 share in 15 funds;</p> <p>EBO: LLBO 2002 one third of privatisations, most frequently used single method, 1,335 firms employing 162,000, 14% over 250 employees;</p> <p>PS: AI, limited to management.</p> |
| Slovakia | <p>[A] TU/EA indifferent to FP, not a current topic on their agendas;</p> <p>[B] ESOP discussed in 1990; EBO concept failed 1995; FP now generally ignored.</p> | <p>ESO: NCL - discounted ES and SPS in JSC; up to 70% discount and financing by company possible;</p> <p>PS: NCL - CPS/SPS in JSC.</p> | <p>2005 Cranet: ESO 12.7%, PS 17%;</p> <p>2005 EWCS: ESO 2.3%, PS 28%;</p> <p>SO: 2005 Cranet 10%;</p> <p>ESO: Insignificant; AI, banking sector / new privatisations;</p> <p>EBO: AI, in privatisation, usually management-led.</p> |
| Slovenia | <p>[A] TU/EA very supportive to FP; Employee Ownership Association lobbies legislation; active support by Works Councils/Managers Association;</p> <p>[B] Strong political support to FP; draft laws 1997/2005 in parliament rejected; new Law on FP in 2008.</p> | <p>All Schemes: since 2008 70% tax relief for PS and ESO with 1-year holding period (100% relief with more than 3-year); up to 20% profits or 10% total salaries per annum and up to Euro 5,000 per employee;</p> <p>ESO: PrivL - up to 20% ES for vouchers; vouchers free, shares for overdue claims;</p> <p>NCL – ES /SPS in corporations; discount / financing by company possible;</p> <p>EBO: up to 40%, shares 4 years non-transferable; Worker association proxy organisation under Takeover Law;</p> <p>PS: PrivL - SPS in internal buyout.</p> | <p>2005 Cranet: ESO 14%, PS 20%;</p> <p>2005 EWCS: ESO 2.6%, PS 18%;</p> <p>ESO/EBO: 90% of privatised firms; CS 1998 60% majority. ESO while only 23% of capital (2004 18% strong decline);</p> <p>PS: CS, in statutes of 32% of firms, but unexploited in 22%; for board members 20% of listed firms;</p> <p>SO: 2005 Cranet 4%.</p> |
| Croatia | <p>[A] TU recently promote ESO in revision of privatisation; EA indifferent to FP; long tradition of self-</p> | <p>ESO: NCL - ES in JSC financing by company possible; NTL - Dividends tax-exempt; profits from sale of</p> | <p>2008 PEPPER IV: ESO 34%, PS 29%;</p> <p>ESO: 2005 more than 10% of value of privatised firms (1996 20%); 2004</p> |

| Country | General attitude [A] Social Partners [B] Government | Legislation and Fiscal or other Incentives | Schemes and their Incidence CRANET: Offer in Firms >200 Empl. EWCS: Take-up Rate of Employees |
|---------|---|--|--|
| | management; [B] ESO supported until 1995, since then FP ignored; ESOPs planned in new PrivL. | shares not taxed; ESOP: general rules of NCL apply; PS: None. | 12% firms with majority ESO; ESOP: Survey evidence, ESOP elements in 9.4% of firms (52 out of 552), completed ESOP approximately in one quarter of them; PS: AI. |
| Turkey | [A] Climate FP friendly; TU supportive, EA undecided, split; employees interested; [B] FP issue 1968 in Tax Reform Commission; some attention in individual privatisations; 2002 program, lack of concrete measures. | ESO: PrivL decrees for individual firms; discount / instalments; NTL - after 1 year share-sale profits not taxed; for SO limited tax on dividends/profits from sale; IntE: NCL / CivC 'welfare/mutual assistance funds' of firms; financing by company profits/contributions; PS: NCL / CivC both CPS and SPS; up to 10% prior reserve. | 2005 EWCS: ESO 1.3%, PS 2.4%; 2005 Cranet: ESO 4.4%, PS 8.9%, SO , 1%; ESO: AI, PrivL 12 cases 9-37% ESO, 1 case majority, up to 15% discount; SO/ESO private firms mostly foreign (26 registered 35 applications) 2007 survey evidence: 3-4% of publicly traded companies; IntE: n.a.; PS: AI, retained profits from dividends widespread; CS 38 out of 50 listed firms; 2007 survey evidence: 20% of publicly traded companies. |

Source: PEPPER I-IV and: CNMV 2003; CRANET 2005/1999 (firms with more than 200 employees); EU Stock Options Report 2003; EWCS 2005 (take-up rate); FONDACT 2004; Heissmann 2003; IAB 2005; IBEC 2002; ifsProShare 2006; WKÖ/BAK 2005; WSI 2003; please note that the country data of the different surveys is incoherent due to inconsistencies in methodology and definitions. *Excluded from studies:* Management Buyout, General Savings Plans, Consumer and Housing Cooperatives;

Abbreviations: AI = Anecdotal Information only; CGT = Capital Gains Tax; CivC = Civil Code; CPS = Cash-based Profit-sharing; CS = Case Studies; DPS = Deferred Profit-sharing; EA = Employer Associations; EBO = Employee Buyout; EmpC = Employer Company; ES = Employee Shares; ESO = Employee Share Ownership; ESOP = Employee Share Ownership Plan; FP = Financial Participation; IntE = Intermediary Entities; JSC = Joint-stock Companies; MEBO = Management-Employee Buyout; NCL = National Company Law; NLL = National Labour Legislation; NTL = National Tax Legislation; PIT = Personal Income Tax; PrivL = Privatisation Legislation; PS = Profit-Sharing; SAYE = Save-As-You-Earn Schemes; SO = Stock Options; SPS = Share-Based Profit-Sharing; SSC = Social Security Contributions; TU = Trade Unions.

II. Availability of Financial Participation Schemes in EU Companies

Iraj Hashi and Richard Woodward

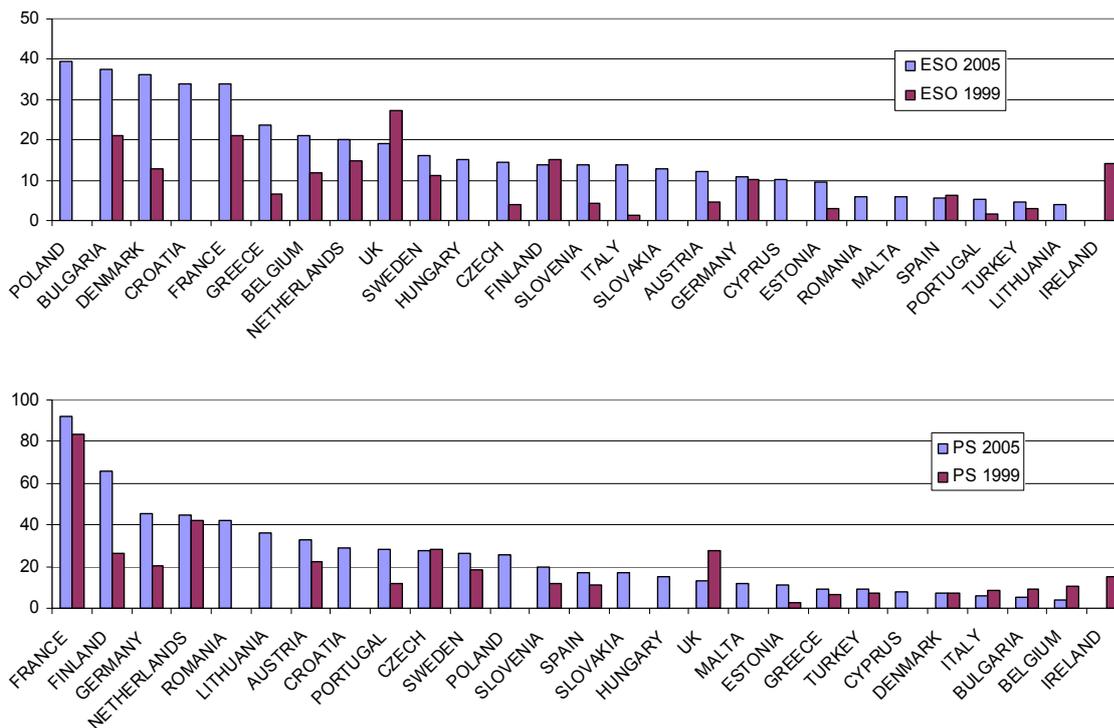
1. Percentage of Firms Offering Broad-Based Financial Participation to Employees

We begin with a look at broad-based employee share ownership (ESO) plans on the basis of data from the CRANET survey of companies (supplemented with data we collected in an independent survey). Figure 1 shows the percentages of companies with broad-based ESO and profit-sharing plans in 1999 and 2005 in 26 European countries (including six in which our surveys were conducted). As we see in Figure 1, between 1999 and 2005, ESO grew in almost every country except the UK and marginally in Spain and Finland (the weighted average for all countries included in both samples grew from 13 to 18 per cent).³³ If we look at the five leading countries in 2005 (with shares ranging from 33 to 40 per cent), we see that three of them (Poland, Bulgaria, and Croatia) are transition countries (indeed, the absence of Slovenia in this group is surprising, as the country's privatisation program generated a large amount of employee ownership); Denmark and France are the other two. The three lowest-ranked countries are Portugal, Turkey, and Lithuania. Estonia is also one of the lowest-ranked countries, indicating the low incidence of ESO in the Baltic States generally. Spain and Portugal's low rankings also indicate the low level of coverage in the Iberian Peninsula. It is interesting that Denmark is far ahead of other two Nordic countries (Sweden and Finland), which might indicate a divergence of that country from at least some aspects of the 'Scandinavian model.' We note that Finland was ahead of Denmark on this measure in 1999, and that Denmark's leadership is thus a recent development owing to what seems to be extremely strong growth of ESO there in recent years. Finally, it is also interesting to note that Hungary, the Czech Republic and Slovenia have such similar levels of coverage (all are middle-ranked) in spite of the very different privatisation methods used in these countries. This is possibly an indicator of convergence of ownership structures in transition countries.

³³ The reader should remember that, as noted in Part 1 Chapter I Section 3, in contrast to the EWCS data presented in the next chapter, Luxembourg and Turkey were not included in the CRANET surveys, and the following countries were not included in 1999 but were included in 2005 either by the CRANET research team or in our independent survey: Croatia, Cyprus, Hungary, Lithuania, Malta, Poland, Romania, and Slovakia. Latvia was also included in our survey, but the results are not reported here).

Figure 1 also shows how broad-based profit-sharing (PS) has developed between 1999 and 2005. Again we generally see growth, except in the UK, the Czech Republic, and the lowest-ranked countries (Belgium, Bulgaria, and Italy); the weighted average for all countries included in both samples grew from 29 to 35 per cent. We also note a much wider range of results than in the case of ESO (for ESO, the proportion of firms offering a scheme ranges from 4 to 40 per cent; for PS from under 4 to over 92 per cent). It is not surprising that France is the leading country, far ahead of all others, as deferred PS is mandatory there. The second-ranked country is Finland. Germany, the Netherlands and Romania are fairly similar, with coverage between 40 and 50 per cent. The lowest-ranked countries (with coverage under 10 per cent), in ascending order, are Belgium, Bulgaria, Italy, Denmark, Cyprus, and Turkey.

Figure 1. Proportion of sample firms offering broad-based employee share ownership and profit-sharing schemes in European countries, 1999 and 2005 (in per cent)



Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007).

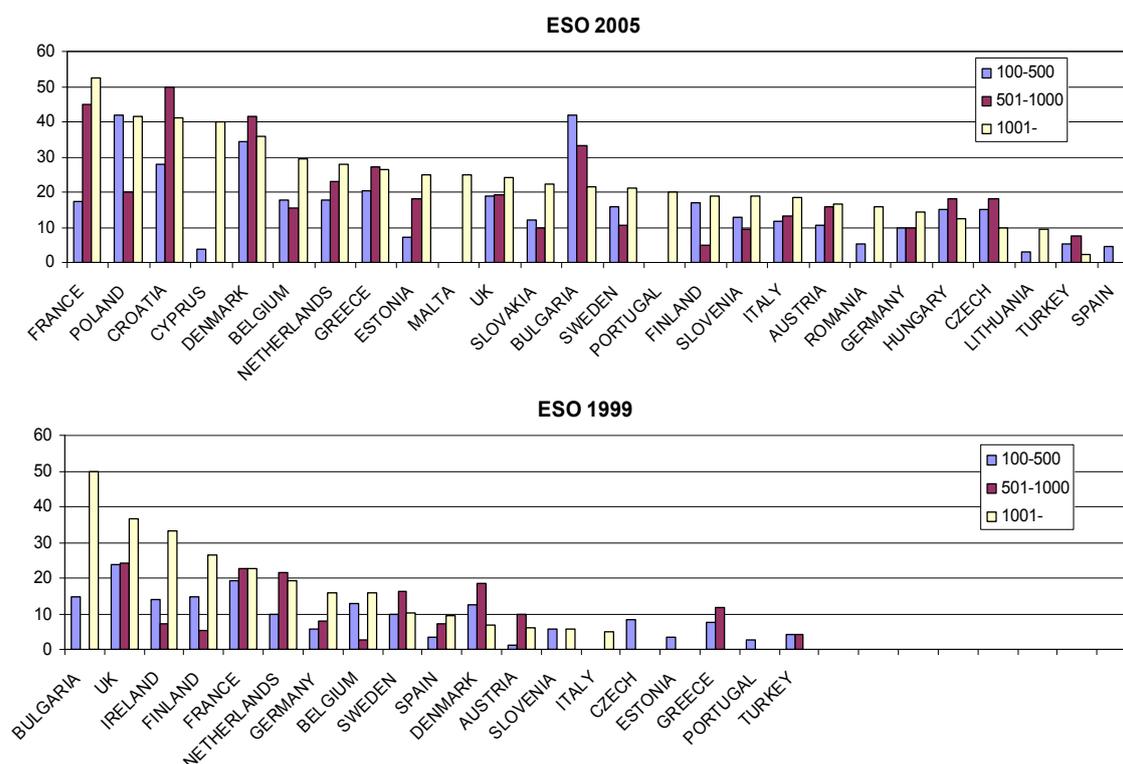
It is interesting to note that two of the countries among the highest-ranked for ESO – Bulgaria and Denmark – are among the lowest-ranked for PS. This indicates that firms and countries choose ESO or PS for different reasons and do not see them as alternative forms of involving employees in the company’s business; thus, there is no correlation between the two schemes.

2. Financial Participation Schemes by Size and Sector

We are also interested in how employee financial participation might differ across firms with respect to company size and sector of business activity.

The breakdown according to size is shown in Figures 2 and 3. The size categories can be described as medium (100-500 employees), large (501-1,000 employees) and very large (1,001 or more employees). For each country, we have calculated the proportion of firms in each size group offering an financial participation scheme. In general, it seems that both forms of employee participation are more prevalent in large and very large companies.

Figure 2. Percentage of firms in each size group offering employee share ownership schemes, 1999 and 2005

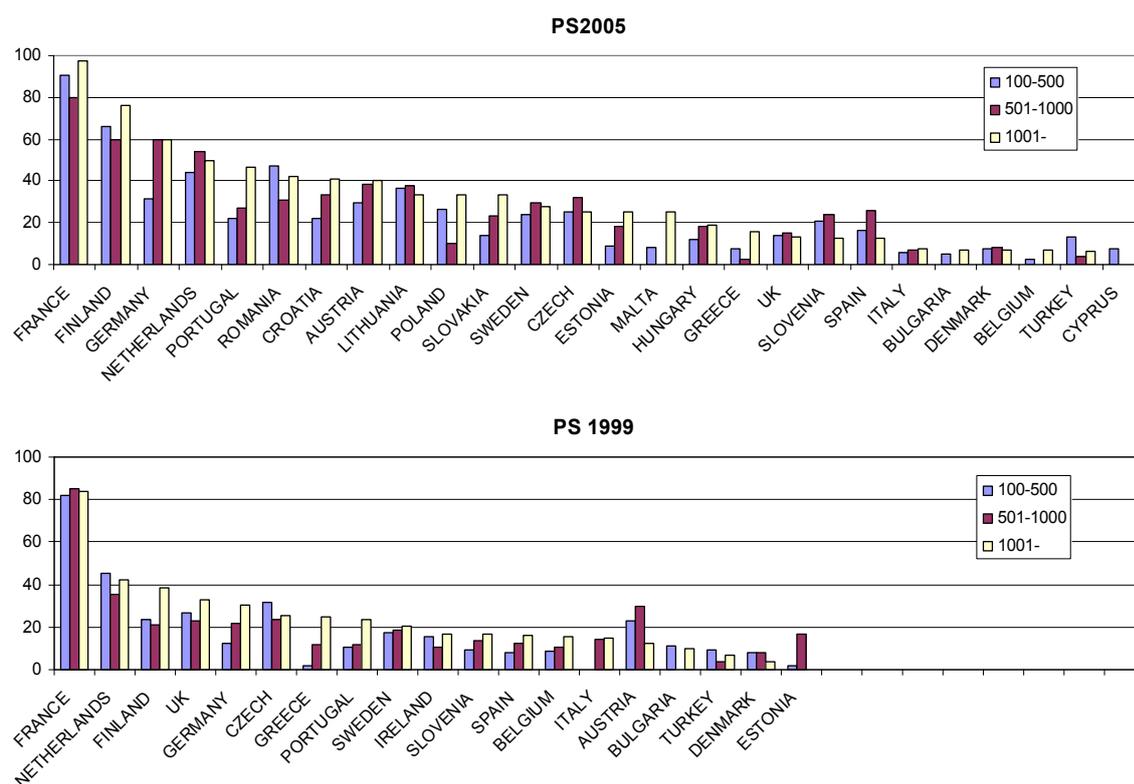


Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007).

Figure 2 shows the data for ESO. While the highest incidence is generally in the largest firms, we see notable exceptions in Croatia, Denmark, Greece, Hungary, the Czech Republic, and Turkey, where the highest percentages of firms with ESO is found among large (but not the largest) firms, and in Bulgaria, where the medium-sized firms have the highest incidence of ESO. The situation was fairly similar in 1999.

Figure 3 shows the data for PS. There is a much more even distribution across size classes here than in the case of ESO, although here again we see a prevalence (albeit a mild one) of the largest size firms. This situation appears to have changed little between 1999 and 2005.

Figure 3. Percentage of firms in each size group offering profit-sharing schemes, 1999 and 2005



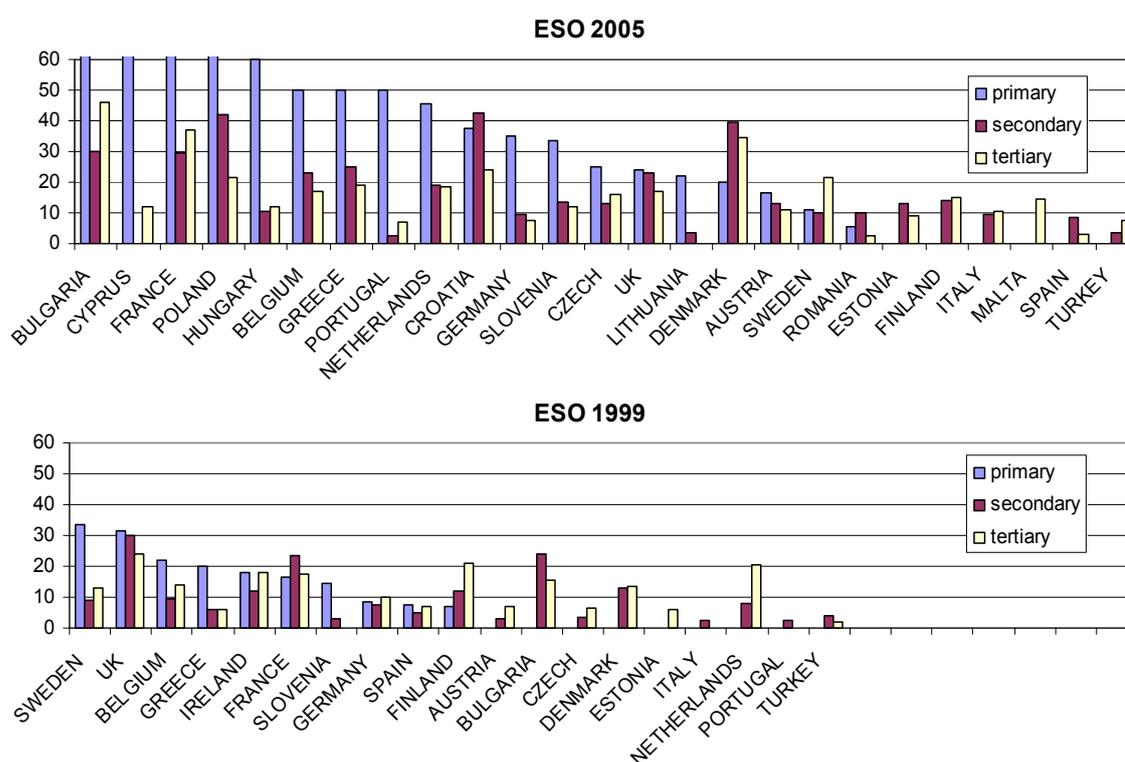
Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007).

We present a sectoral breakdown of financial participation schemes in Figures 4 and 5, classifying firms into one of three main sectors: primary (agriculture and extractive industries), secondary (manufacturing), and tertiary (services). For 2005, we see a high average rate of incidence of both ESO and PS in the primary sector. However, this is mostly likely a statistical artifact due to the very small percentage of firms in the sample from that sector³⁴, and we see no such pattern for the 1999 data. The really interesting differences would be between the manufacturing (secondary) and service (tertiary) sectors in which the vast bulk of the workforce in a modern economy is found.

³⁴ If, for example, only two firms in a given country sample are agricultural and one is a dairy cooperative, we would have a 50 per cent rate for the primary sector.

With respect to ESO, based on the information contained in Figure 4, there is little differentiation between these two sectors (manufacturing and services) on the whole. In Poland and Croatia (countries for which we lack 1999 data), we see significantly more ESO in the secondary sector, while there is significantly more ESO in the tertiary sector in Bulgaria and Sweden³⁵. In others, the tertiary and secondary sectors are close, with one of the two slightly higher than other, or virtually identical. In 1999, we see strong prevalence of ESO schemes in the secondary sector in France and Bulgaria, and strong prevalence in the tertiary sector in the Netherlands, Finland, Austria and Ireland. It is, however, difficult to say whether the changes between 1999 and 2005 reflect only changes in the sample or broader trends (especially given the generally much lower rates of incidence in 1999). It is perhaps worth noting the significant drops in the share of firms offering ESO schemes in all sectors in the UK (which can also be seen in Figure 1).

Figure 4. Percentage of firms in each sector offering employee share ownership schemes, 1999 and 2005

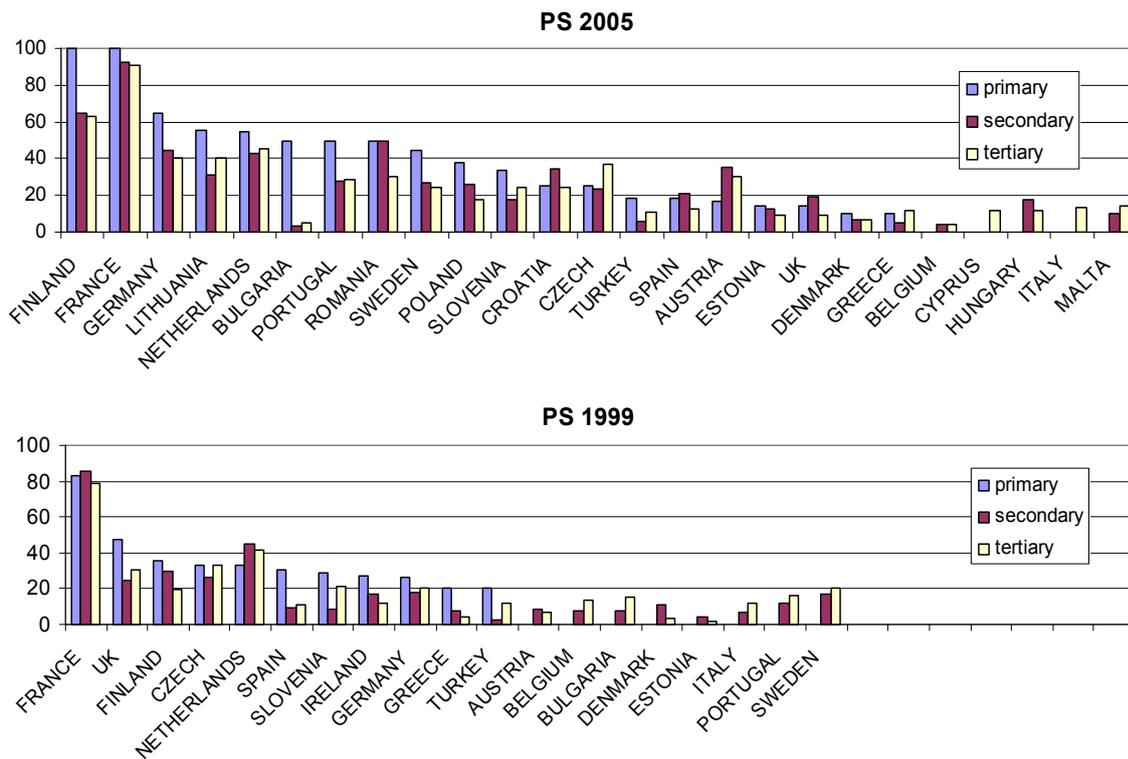


Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007).

³⁵ This appears to be the case for Cyprus as well, but only because there are no secondary sector companies in the Cypriot sample.

Figure 5 contains information on PS. Again, we generally observe the prevalence of PS schemes in primary sector firms. The number of countries with higher incidence in the secondary than the tertiary sector is roughly equal to that in which the situation is reversed. This was also largely the case in 1999, when overall incidence was lower across the board.

Figure 5. Percentage of firms in each sector offering profit-sharing schemes, 1999 and 2005



Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007).

3. Percentage of Employees Covered³⁶

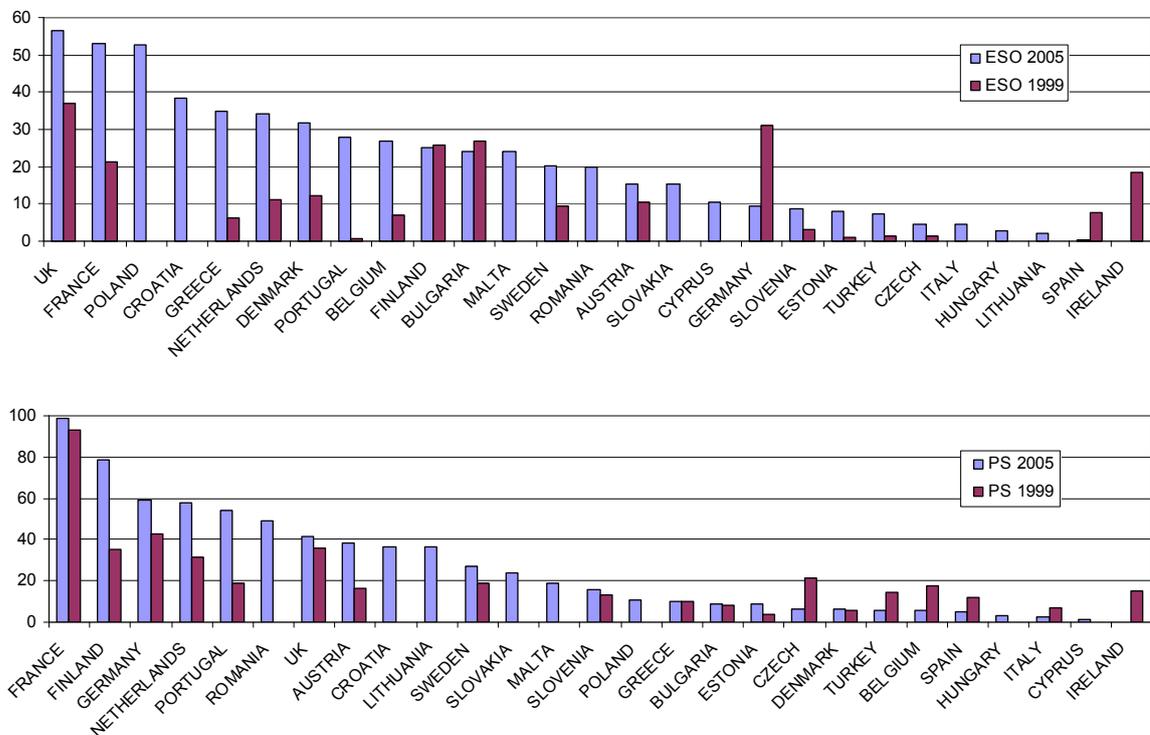
Next, we consider the share of employees in the sample covered by ESO and PS plans. This is an indicator of the extent to which broad-based financial participation plans have been adopted in each country. We present the data on this indicator in Figure 6.

³⁶ The CRANET questionnaire contains questions on the proportion of different categories of employees (managers, professionals, administrative and manual) to whom FP plans are offered and on the share of these different categories in the total workforce of the company. This allows us to calculate the number of employees in each company to whom FP plans are offered (and their share in the total number of employees in the sample for each country).

Looking at employee share ownership, we see that, as with the rise in the number of companies offering ESO plans, the coverage of employees by these plans is also growing in a large majority of countries (the weighted country average of all countries included in both samples grew from 19 to 25 per cent between 1999 and 2005). The three leaders (with employee coverage averaging over 50 per cent) are the UK, France and Poland. There is a fairly long tail of low-ranked countries (with coverage averaging under 10 per cent). In ascending order starting from lowest, these are: Spain, Lithuania, Hungary, Italy, the Czech Republic, Turkey, Estonia, Slovenia, and Germany. Again, Slovenia's position here is surprising, given its privatisation history. It is also interesting to note that Portuguese companies seldom offer a plan, but those that do are large, with many employees (see Figure 2, above).

Turning to PS, we see growth, albeit slower and from a higher starting point (the weighted average for all countries included in both samples rose from 36 to 42 per cent between 1999 and 2005). Here again we have a much wider range, from 100 per cent in France down to under 1 per cent in Cyprus, and again we have a long tail of low-ranked countries. After France, other leading countries (with over 50 per cent) are (in descending order): Finland, Germany, the Netherlands, and Portugal (Romania is just under 50 per cent).

Figure 6. Proportion of employees covered by employee share ownership and profit-sharing schemes, 1999 and 2005 (in per cent)

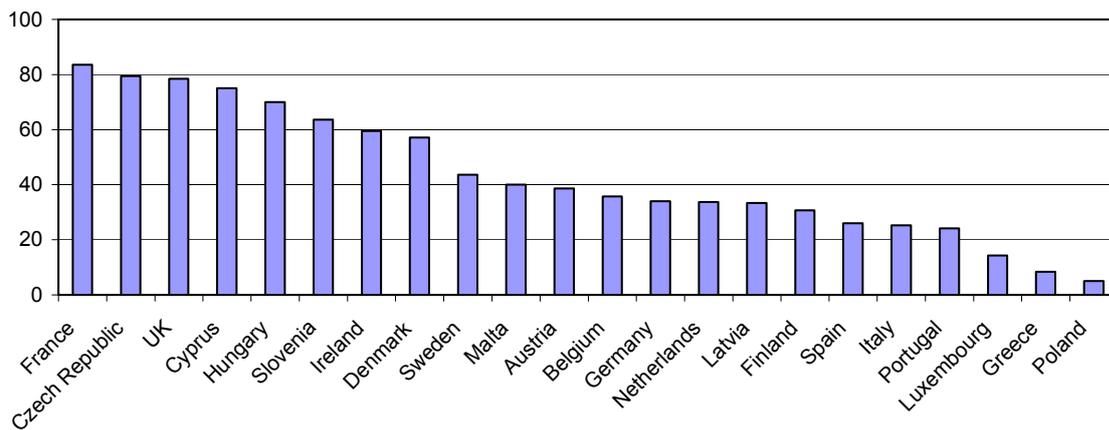


Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007).

4. Percentage of Large (Listed) Firms with Employee Share Plans

The EFES data cover Switzerland and Norway in addition to the 27 EU member countries; however, we ignore the Swiss and Norwegian figures in our discussion). The data on ESO in those companies presented in Figure 7 were gathered in 2007. On the basis of the data contained therein, we arrive at a quite up-to-date picture of the actual incidence of broad-based ESO schemes in the largest European companies, which we can contrast with the picture emerging from the CRANET survey. (Note that five countries – Bulgaria, Estonia, Lithuania, Romania and Slovakia – have values of 0 per cent and are therefore not included in the figure.)

Figure 7. Proportion of large EU companies with ESO schemes, 2007 (in per cent)



Source: EFES.

While it is not surprising to find France, the United Kingdom and Ireland with high rates of incidence of broad-based ESO plans among large companies, the presence of the Czech Republic (represented by 34 companies in the sample), Cyprus (only four companies) and Hungary (20 companies) among the group of leaders is quite surprising. Denmark ranks high, which is consistent with the CRANET data, and so does Slovenia, which is what we expected, but did not find in the CRANET data. Poland and Bulgaria, which were leaders in the CRANET data, are in the rear here. (If the CRANET and our survey data for these countries is reasonably representative, this would tend to indicate that ESO plans are concentrated in smaller and mid-sized companies in those countries, which would be quite unusual, although perhaps consistent with the Polish privatisation program's emphasis on restricting management-employee buyouts to SMEs.) However, the relatively low positions of Romania and the Iberian and Baltic countries in the CRANET data are replicated here and thus seem to provide quite strong corroboration for the CRANET picture of those countries. The high ranking of Hungary and the Czech Republic here and their mid-level ranking in the CRANET data seem to indicate that something

is going on with respect to the dissemination of employee ownership in those two countries which has thus far eluded the attention of researchers, probably due to the low level of employee participation in the privatisation programs of those countries. It would seem that, contrary to the experience of a number of other transition countries, post-privatisation ownership structure evolution has brought more, rather than less, employee ownership to those countries (possibly because of the policies of foreign investors).

III. Take-Up Rate of Financial Participation Schemes in the Workforce

Iraj Hashi and Richard Woodward

1. Percentage of Employees Participating in Financial Participation Schemes

The data from the EWCS survey presented in Figure 8 gives us a picture of the actual extent of employee financial participation in the population of employed persons, as this is a survey of individuals rather than firms. As in the case of CRANET, it covers both ESO and PS schemes as well as the level of participation at two points in time (2000/2001 and 2005), allowing us to draw some conclusions about the rate of diffusion of these schemes in recent years.³⁷

For ESO schemes, as in the case of the CRANET, we see growth in almost all countries (the weighted average for all countries included in both samples rose from 1.5 to 2.4 per cent). The exceptions were the UK, Germany, and Spain (the UK and Spain saw declines in both the CRANET and EWCS surveys). The top countries (with participation rates over 5 per cent) were Ireland, France, Belgium, and Luxembourg (France is the only one of these in both the CRANET and EWCS top country lists, although Ireland also does well in the EFES survey). The lowest-ranked countries (with participation rates under 1 per cent), in ascending order, were: Spain, Germany, the Czech Republic, Lithuania, Hungary, Malta, and Latvia (Spain and Lithuania ranked similarly low in both surveys; when we note that Portugal also has just over 1 per cent, we see these findings to be consistent with the earlier finding of a low incidence of ESO in the Baltic and Iberian countries³⁸). We see strongly contrasting figures for Poland, which ranks highest in our survey data and relatively low in the EWCS survey (and also very low in the EFES survey).

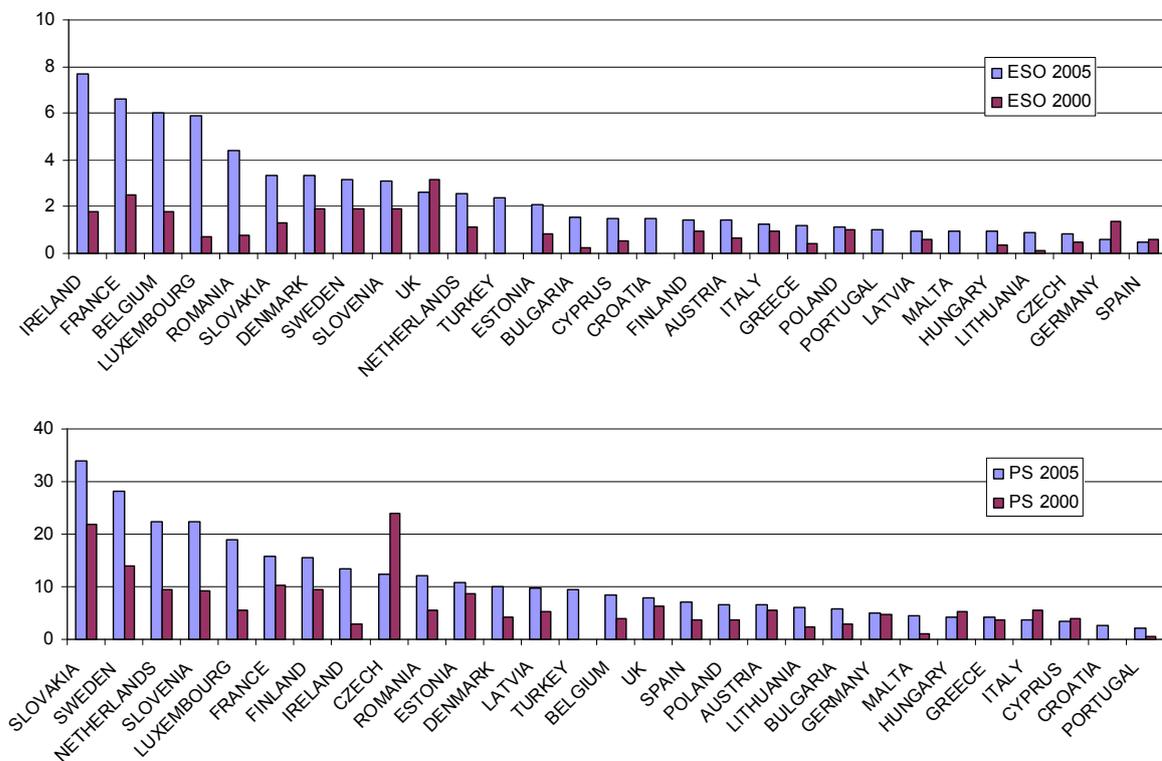
Turning to PS schemes, again as in CRANET, we see a much higher incidence than in the case of ESO (for ESO, the 2005 weighted average for all countries was 2.4 per cent, for PS 9.1, and the range for ESO was 0.5-7.7, whereas for PS it was 2.1-33.9). As in CRANET, we see growth in almost all countries (the weighted average for all countries included in both samples rose from 6.4 to 9.1 per cent). The exceptions were the Czech Republic, Italy, Hungary, and Cyprus (the Czech Republic and Italy saw declines in both CRANET and EWCS). The top countries (with participation rates of over 10 per cent), in descending order, were: Slovakia, Sweden, the Netherlands, Slovenia, Luxembourg, France, Finland, Ireland, the Czech Republic, Romania, Estonia and Denmark (with

³⁷ The earlier survey was done in two stages: EU-15 in 2000 and accession and other countries in 2001.

³⁸ Although Estonia does better here than in the CRANET results.

France, the Netherlands, Finland, and Romania ranking high in both the CRANET and EWCS surveys). The lowest-ranked countries (with participation rates under 5 per cent), in ascending order, were: Portugal, Croatia, Cyprus, Italy, Greece, Hungary, Malta, and Germany (Turkey, Cyprus, Greece and Italy ranked low in both CRANET and EWCS). The high ranking of Slovakia is very surprising, and we suspect that this may be due to the misunderstandings about the nature of profit-sharing schemes and the mistaken treatment of some bonuses as profit-sharing.

Figure 8. Proportion of employees involved in employee share ownership and profit-sharing schemes, 2000-2005 (in per cent)



Source: EWCS.

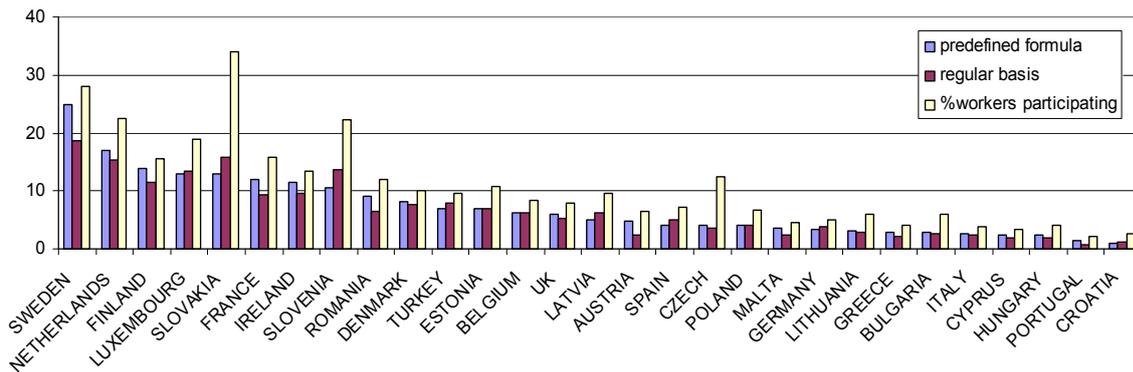
We also see high rates of ESO and PS for two countries for which recent CRANET data were not available: Luxembourg and Ireland. It must be remembered that the EWCS data does not distinguish broad and narrow schemes and, therefore, the high take-up rate of any scheme may only reflect the presence of share-based option schemes for management (which is likely to be the case in Luxembourg).

2. Percentage of Employees Participating in Profit-Sharing Schemes with Pre-Defined Formulas on a Regular, Ongoing Basis

To refine our picture of profit-sharing, we wish to distinguish profit-sharing schemes run according to pre-defined formulas and providing payments to employees on a regular, ongoing basis from those that are dependent on the discretion of employees' superiors and thus do not provide any ex-ante incentives to employees to improve their performance at work. To do this, we present EWCS data for the year 2005 in Figure 9 showing the depth of profit-sharing schemes (that is, the percentage of the workforce participating), of those which are run according to pre-defined formulas, and of those under which payments occur on a regular, ongoing basis. In all cases we see that profit-sharing schemes operating with high-powered incentives cover a smaller proportion of employees than those covered by schemes referred to (possibly incorrectly, that is Slovakia and Czech Republic) as profit-sharing. Using a strict definition of profit-sharing, we see that in the best cases approximately 20 per cent of the workforce is covered. Regardless of which of the three categories is used to rank the countries, there is little difference in the rankings.

The leading countries, independent of the category used to rank them, clearly include Sweden, the Netherlands, Finland, Luxembourg Slovakia, France, Ireland and Slovenia,. At the rear are, equally as clearly: Croatia, Portugal, Hungary, Cyprus, Italy, Bulgaria, Greece, and Lithuania. Given the similarity of results for more precisely defined types of profit-sharing and the general results presented in section 1 above, the comparison with the results from the CRANET survey and our survey here is basically the same as it was there.

Figure 9. Profit-sharing in 2005: A closer look



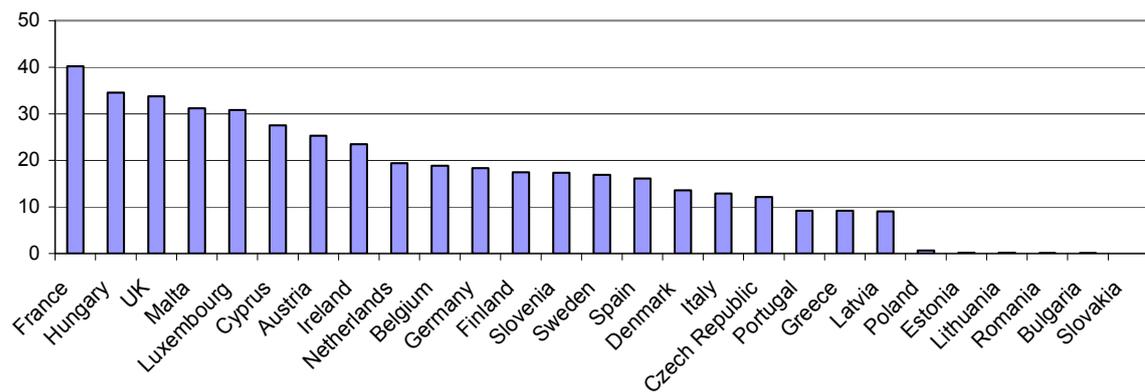
Source: EWCS.

3. Percentage of Employees Holding Shares in Largest (Listed) Firms

Returning to the EFES survey of large European companies, we now consider the question of take-up of ESO schemes by employees – that is, how many employees have actually become owners as a result of the schemes. Figure 10 provides us with information on employee owners as a percentage of the total number of employees in the companies surveyed by EFES. For the entire sample, 26.17 per cent of the total workforce is actually participating in ESO plans (15.05 per cent for the 12 new EU Member States). We can, to some extent, compare this with the CRANET-based information on ESO coverage in Figure 2, although take-up is not the same thing as coverage.

Again, as in Figure 4, France is in the lead, and Hungary and the UK also rank very high (the leading positions of France and the UK are consistent with the CRANET information presented in Figure 6, though Hungary's high position here is in stark contrast to its low position there). Given the small number of Maltese and Luxembourg companies in the sample (5 and 7 respectively), the leading positions those two countries have here can perhaps not be considered as representative (although the high ranking of Luxembourg is consistent with the EWCS survey results). Czech companies do not do as well with respect to take-up as they do in offering schemes, and rank among the last countries here. In Denmark we see a similar discrepancy, though not as large as that in the Czech Republic (in Denmark's case this may be due to the rapid diffusion of ESO plans in very recent times, as noted in Part 1, Chapter II, Section 1 – take-up may not have caught up with the rate of introduction of schemes). Not surprisingly, we again see Romania and the Baltic and Iberian countries in the rear (although Romania was mid-ranked in Figure 6).

Figure 10. Proportion of employees participating in ESO schemes in large EU companies, 2007



Source: EFES.

4. Conclusions

Regardless of the data source used, the evidence presented here shows conclusively that Europe has seen extensive growth of employee financial participation in recent years. This is true for both profit-sharing and employee share ownership, although profit-sharing is more widespread than employee ownership (although Figure 9 suggests that the difference between the two may diminish or even disappear if we adopt a very strict definition of profit-sharing). The percentage of companies with FP schemes of various forms in operation is growing steadily almost everywhere in the European Union, and the percentage of company employees covered by, and taking up, these schemes is also increasing.

On the other hand, on the basis of both company surveys (CRANET and EFES) and surveys of individuals in the workforce (EWCS), it seems that financial participation has extended to a significant proportion of the working population in only a handful of countries. It is therefore clear that, while much has been accomplished, much remains to be done.

Two other broad conclusions are that (leaving aside the recent members and candidate countries), first, the largest companies are more likely to offer their employees any FP scheme, and second, FP schemes are offered to, and have been taken up, on a larger scale by employees in the more developed EU countries – the UK, France, Scandinavian countries – and less so by the less developed members (Greece and Portugal). This implies that employers' recognition of the benefits of employee financial participation grows as economic development progresses and a country's GDP per capita rises.

Related to the above, the depth of FP schemes in most of the new members and candidate countries with a socialist past (the transition countries) is generally low. The ESO schemes, rooted in privatisation programmes, have survived in some countries like Poland but gradually weakened in other countries in the process of secondary privatisation.

Nevertheless, the data examined here seem to indicate that a West-East divide (that is, significant differences between the old EU-15 Member States on the one hand, and at least some of the ten post-Socialist states that have joined the EU since 2004) is less significant than one might have anticipated, or perhaps nonexistent. There seems to be much more variation within those two groups than between them. In fact, according to CRANET data, between 1999 and 2005 the percentage of companies offering broad-based share ownership schemes increased in the old EU-15 from an average of 13 to 17 per cent and in the new EU-12 from an average of 10 to 23 per cent; we observe a slightly different picture for the percentage of companies offering profit-sharing schemes, which increased in the old EU-15 from 29 to 36 per cent and in the new EU-12 from an average of 19 to 26 per cent (all weighted country averages).

There are some discrepancies between data sources with regard to certain countries; however, the overall picture is quite clear. While for most individual countries it would be rather risky to make definitive assertions about the degree of advancement of dissemination of FP schemes on the basis of the data we have examined, we can identify what seem to be some regional trends. For example, we can state with a great deal of confidence that a few regions seem to be much less advanced in the dissemination of FP than others, notably the Iberian Peninsula, the Baltic States, and the Southeastern corner of Europe (including Greece, Turkey and Cyprus).

IV. Taxation and Fiscal Support for Financial Participation

Jens Lowitzsch and Natalia Spitsa

1. The Problem

At the national level, taxation can either inhibit or support the spread of employee financial participation. At the EU level, cross-border migration of employees partaking in financial participation plans, as well as the transfer of such plans by multinational companies to subsidiaries in different Member States, may involve problems caused by conflicting tax regimes.³⁹ Generally, attention is centered on tax incentives, often considered the State's main instrument for promoting employee financial participation. Tax incentives, however, are relative; they need to be analysed in the context of the general taxation system in the given country. National tax systems are not easily compared; it is even more difficult to compare taxation laws governing national financial participation schemes.⁴⁰ Moreover, compulsory social security contributions must be taken into account since they add substantially to the overall burden of state levies, especially on labour; also, in many countries, they influence the tax base of the main income taxes. A systematic overview of the situation in the EU-27 shows, on the one hand, the impact and, on the other hand, the limits of tax incentives in encouraging employee financial participation.⁴¹

The objectives here are:

- To outline general systems of direct taxes as they affect employee financial participation in the EU. National tax systems will be classified as unfavourable, neutral or favourable for employee financial participation schemes.
- To review specific tax incentives for employee financial participation in order to determine whether specific tax incentives are a prerequisite for employee financial participation and whether some tax incentives are more effective than others irrespective of the country where they are offered.

³⁹ On obstacles to exportation, see European Commission (2003a), pp. 43.

⁴⁰ For the comparison of general tax systems, different types of taxes, different systems of individual taxes, different tax rates, tax bases and taxation moments all must be considered. Tax rates are only comparable if effective tax rates are calculated. However, that is only possible for a specific tax and for a specific personal status and situation. Since most major direct taxes should be examined to determine their effect on employee financial participation plans, effective tax rates cannot be calculated for every possible status or situation.

⁴¹ Due to the complexity of the issue, a discussion on comparability of individual country tax rates of EU Member States cannot be covered in this publication.

Tax incentives can be considered efficient if the number of specific financial participation plans supported by these tax incentives increases immediately after the tax incentives have been introduced.

2. General Taxation of PEPPER Schemes in the EU

The following direct taxes are relevant to employee financial participation:

- corporate income tax (CIT),
- personal income tax (PIT),
- taxes on dividends at shareholder level (special rates of personal income tax, ‘investment tax’, ‘dividend tax’, ‘share income tax’, etc.)
- taxes on sale of shares at shareholder level (special rate of personal income tax, capital gains tax, ‘investment tax’, etc.).

According to Art. 3 (1) h) ECT, an EU priority is to prevent the diversity of national tax systems from negatively affecting the development of the Common Market by harmonising national legal codes. As a special case of Art. 3 (1) h) ECT, Art. 93 ECT stipulates that indirect taxes (VAT and excises) must be made consistent. Prompted by this provision, numerous directives have been issued and indirect taxation has already been harmonised to a great extent. However, there is no special provision on harmonisation of direct taxes.⁴² Moreover, potential harmonisation in this area is restricted by Art. 5 (2) ECT. On the one hand, the European Commission supports competition of direct taxes⁴³, regarding tax autonomy as the core component of state sovereignty, closely related to country-specific economic, social and cultural structures. On the other hand, it recognises the importance of preventing unfair tax competition, especially in the area of corporate taxation.⁴⁴ Since there is neither a legal basis nor political support for harmonisation of corporate tax rates, the European Commission currently favours the development of the Common Consolidated Corporate Tax Base (CCCTB).⁴⁵ However, even if the CCCTB should

⁴² Only more general provisions of Art. 94, 96 and 97 ECT on prevention of market distortions and, in cases of substantial discrimination, Art. 87 ECT on prevention of state subsidies, Art. 39, 43, 49, 56 ECT (basic freedoms) and Art. 12 ECT (general anti-discrimination provision) apply. However, these aim at non-discriminatory taxation of physical persons and legal entities from other EU Member States as compared with domestic physical persons and legal entities and at prevention of double taxation. They do not lead to a higher degree of harmonisation.

⁴³ See COM (1980), 139; Weber-Grellet (2005), pp. 28, 152.

⁴⁴ Whereas the issue of unfair tax competition was originally connected with such traditional tax havens as the Channel Islands and Monaco, it has gained even more importance with the accession of new Member States having generally much lower corporate and partially also personal income taxes than Western European EU Member States, except Ireland (see Weber-Grellet, 2005, p. 163).

⁴⁵ See COM (2001) 582 of 23 October 2001; COM (2003) 726 of 24 November 2003; CCCTB/WP/046 of 12 December 2006; COM (2007) 223 of 2 May 2007; the proposal, due in 2008, has not yet been completed, but it seems probable that the CCCTB could be introduced in several years. Seven Member States with relatively low tax rates are opposed to the idea, but no unanimous decision is required in

be introduced in all Member States, it will not apply to enterprises having no cross-border activities.⁴⁷

Nevertheless, international tax competition is exerting considerable pressure, especially on corporate income tax rates, since the US tax reform of 1986. This is responsible for two persistent tendencies observable worldwide. Firstly, the tax burden has been shifted from direct to indirect taxes (see OECD, 2005a, p. 6) (with some exceptions, for example, France), and from capital to labour (see Weber-Grellet, 2005, p. 30).⁴⁹ Thus taxation of share-based plans may become more favourable over time than that of cash-based plans, since the tax burden on dividends and capital gains is lower than on employment income. Secondly, tax rates are lowered while the tax base is broadened (see OECD, 2005a, p. 6). Although this might lead to the abolishment of specific tax incentives, it does not necessarily mean less favourable taxation: if the rates become sufficiently lower, this may compensate for the loss of tax incentives. The general characteristics of national systems of direct taxes are illustrated in Figure 11 below.

A common feature of all direct tax systems of EU member and candidate states is that only income and not expenditure is taxable.⁵¹ Accordingly, as affecting the relationship between the respective tax burden on capital and labour, income tax systems can be divided into flat tax, dual tax and differentiated tax systems; all these systems have advantages and drawbacks from an economic standpoint and are currently present in different EU Member States. In a genuine flat tax system, represented by Romania and Slovakia, the tax burden falls equally on all sources of income, flat and relatively low, since the basic tax rate to which other tax rates are adapted is the tax on capital income. This system is generally equally favourable to all forms of employee financial participation. The same is true of tax systems which impose different tax rates on labour and capital income, but levy a flat personal income tax (Estonia, Latvia, Lithuania).⁵² Dual tax systems represented, for example, by Sweden and Finland, are characterised by a highly progressive personal income tax as opposed to a flat tax on capital income. This combination is, theoretically, negative for cash-based profit-sharing and positive for share-based schemes. Most EU Member States have a differentiated tax system which generally favours employee share ownership if taxes on capital are flat and relatively low. As far as tax systems are concerned, no common tendencies can be observed. Taxation traditions and goals of

this case. The EU Tax Commissioner declared that the initiative can, if necessary, be implemented by eight Member States through enhanced co-operation.

⁴⁷ Moreover, the usefulness of this instrument for harmonisation of corporate taxation is considered to be questionable if no limits for corporate tax rates are set at the same time, see Bundesministerium der Finanzen [Federal Ministry of Finance] (2007), p. 73).

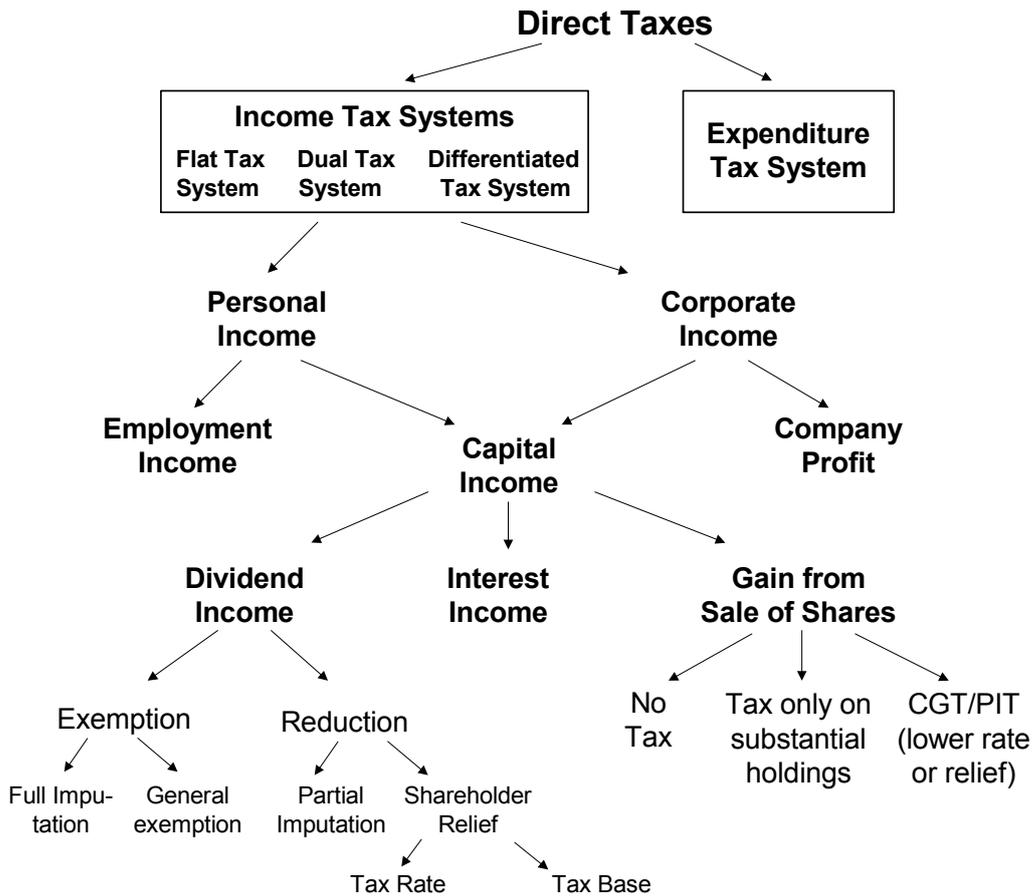
⁴⁹ See Weber-Grellet (2005), p. 30. There is no theoretical basis and/or empirical evidence for the assumption that the tax burden on capital should be lower than on labour, although the practice is based on it (see Ganghoff, 2004, p. 35).

⁵¹ However, Croatia has had an expenditure tax system from 1994 until 2000. For example, Bulgaria, Estonia and Hungary have an expenditure tax on fringe benefits payable by the employing company. The quite unusual Estonian corporation tax system (replacement of corporate income tax by the tax on distributed profits) could also be connected with the idea of expenditure tax.

⁵² These systems give more leeway to share ownership since tax rates on capital income are usually lower than those on labour. However, in practice the advantage of flat tax systems may not be so substantial since often relatively high compulsory social security contributions will be levied additionally.

EU Member States are different and none of the prevailing systems can be considered the best objectively.⁵³

Figure 11. General characteristics of national systems of direct taxes



As far as the system of corporate income tax (taxation of dividends at the corporate and shareholder level) is concerned, no EU Member State provides relief for corporations, but many mitigate double taxation by providing relief for shareholders.

⁵³ Most Western European countries cannot introduce a flat tax system because of the potential loss of revenue (see for Italy OECD, 2005b, p. 4).

Table 4. General taxation and compulsory social security contributions

| Country | Type of dividend treatment | CIT ⁵⁴ | Taxation of dividends at shareholder level ⁵⁵ | Taxation of share sale at shareholder level ⁵⁶ | PIT ⁵⁷ | Compulsory SSC ⁵⁸ |
|-----------------------|---|-------------------|--|--|---|---|
| Belgium | Shareholder Relief: reduced tax rate | 34% | 15% | Generally 0% | Progressive 25-50% central+0-9% sub-central; SSC deductible | Empl.: overall rate 13,07% EmpC: overall rate 35% |
| Bulgaria | Shareholder Relief: reduced tax rate | 10% | 7% | Shares of public firms listed at Bulgarian Stock Exchange 0% | Progressive 20-24%, voluntary SSC deductible | Empl.: (cumulative) 12.43-25.74% EmpC: (cumulative) 23.34-25.74 % |
| Croatia | Dividend tax exemption for shareholders | 20% | 0% | 0% | Progressive 15-45%+city surtaxes 0-18%; SSC deductible | Empl.: 20% to pension fund EmpC: 17.2% to the health, unemployment, injury funds |
| Cyprus | Dividend tax exemption for shareholders | 10% | Generally 0% | Generally 0% | Progressive 20-30%; SSC deductible | Empl.: overall rate 6.3% EmpC: overall rate 6.3%+2% to Social Cohesion Fund |
| Czech Republic | Shareholder Relief: reduced tax rate | 24% | 15% withholding tax at source | General PIT for sale of shares within 6 months | Progressive 12-32%; SSC deductible | Empl.: (cumulative) 12.5% EmpC: (cumulative) 35% |
| Denmark | Shareholder Relief: reduced tax rate | 28% | 28% Share Income Tax up to DKK 44,300, 43% above; not for professional traders | 28-43% | Progressive 5-26.5% central+29-35% sub-central; ceiling 59% | Empl.: 8% labour market tax EmpC: 0% |

⁵⁴ Data on corporate tax for 2007 are presented in the report of the German Federal Ministry of Finance (Bundesministerium der Finanzen, 2007, p. 68, Table 1). The generic term 'corporate tax' includes in this context all central and sub-central statutory taxes and surcharges on corporation profits.

⁵⁵ Data on dividend taxation from the database at <<http://www.deloittetaxguides.com>>, Log-in: 20 July 2007.

⁵⁶ Data on capital gains taxation from the database at <<http://www.deloittetaxguides.com>>, Log-in: 20 July 2007.

⁵⁷ Data on personal income tax rates for 2006 are generally downloaded from the database of the European Union <http://ec.europa.eu/taxation_customs/taxinv>, Log-in: 20 June 2007.

⁵⁸ Data on social security contributions for 2006 are downloaded from the homepage of MISSOC <http://ec.europa.eu/employment_social/missoc/2006>, Log-in: 20 June 2007.

| Country | Type of dividend treatment | CIT ⁵⁴ | Taxation of dividends at shareholder level ⁵⁵ | Taxation of share sale at shareholder level ⁵⁶ | PIT ⁵⁷ | Compulsory SSC ⁵⁸ |
|----------------|--|----------------------------|--|---|---|--|
| Germany | Shareholder Relief: reduced tax base | 38.7% | General PIT + solidarity surcharge 5.5%; tax base reduced to 50% of the dividend income (half-income system); no SSC | 0% for small long-term holdings; for substantial shareholdings General PIT on difference between 50% of proceeds and 50% of acquisition costs | Progressive 15-45.4% +solidarity surcharge 5.5%; limited by an absolute amount; pension and health care contributions partly deductible | Empl.: (average) 13-21.4% EmpC: (average) 20.5% Both limited by an absolute amount |
| Estonia | Tax exemption for shareholders; exemption of retained profits from corporate tax | 22% on distributed profits | 0% | General PIT | flat 22%; mandatory SSC deductible | Empl.: contribution to the unemployment fund 0.6% EmpC: 'social tax' 33% + contribution to the unemployment fund 0.3% |
| Greece | Dividend tax exemption for shareholders | 25% | 0% | Generally 0%; 20% on sale of shares of LLC or partnerships | Progressive 15-40%; SSC deductible | Empl.: 11.55% (16%) EmpC: 23.1% (28.06%); both limited by an absolute amount |
| Spain | Partial Imputation | 32.5% | 15%; imputation credit | 15% if held more than 1 year, otherwise general PIT | 15-45% savings income deductible | Empl.: 16.35% EmpC: 30.6% |
| France | Partial Imputation | 34.4% | General PIT with 40% tax credit + social levies (CRDS, CSG) - 11% | CGT 16%; on stock options 30-40% | Progressive 5.5-40% | Empl.: (cumulative) 10.6-17.8%; limited by an absolute amount EmpC: (aggregated) 29.72- 34.22 % |
| Hungary | Shareholder Relief: reduced tax rate | 17.5% | 25% for dividends on up to 30% of equity; 35% above + 14% health care contribution | 25%; on up to 30% of equity; 35% above | Progressive 18-36%; voluntary SSC deductible | Empl.: 17% limited by an absolute amount EmpC: 32% + health care contribution |
| Ireland | Classical system | 12.5% | 20% | 20% | Progressive 20-42%; voluntary SSC deductible | Empl.: 2-6% EmpC: 8.5-10.75% |

| Country | Type of dividend treatment | CIT ⁵⁴ | Taxation of dividends at shareholder level ⁵⁵ | Taxation of share sale at shareholder level ⁵⁶ | PIT ⁵⁷ | Compulsory SSC ⁵⁸ |
|--------------------|--------------------------------------|-------------------|---|---|---|---|
| Italy | Shareholder Relief: reduced tax base | 37.3% | General PIT; tax base reduced to 5% of dividend income; below 5% (or 2% of voting rights) 12.5% | 12.5% for small shareholdings; 27% on substantial; tax base reduced to 40% of gain | Progressive 23-43% + surcharge 0.9-1.4%; SSC deductible | Empl.: (cumulative) 9.2-10.2% EmpC: (cumulative) 32.08% |
| Latvia | Classical system | 15% | General PIT | General PIT | Flat 25% | Empl.: overall rate 9%; EmpC: overall rate 24.09%, both from after-tax income |
| Lithuania | Shareholder Relief: reduced tax rate | 15% | 15% | Generally 15%; 0% if held more than 1yer and no substantial shareholding for last 3 years | Flat 27% | Empl.: 3% EmpC: 30.7% |
| Luxembourg | Shareholder Relief: tax base reduced | 29.6% | 15%; tax base reduced to 50% of the dividend income; | General PIT for short-term holdings; high allowance and 1/2 PIT rate for long-term holdings | Progressive 8-38% | Empl.: 11.8-14.05% EmpC: 13.15-20.75% |
| Malta | Full Imputation | 35% | General PIT and tax credit for CIT | stamp duty; shares quoted on Malta stock exchange tax exempt | Progressive 15-35% | Empl.: overall rate MTL 2.84-13.38 weekly; EmpC: overall rate MTL 2.84-13.38 weekly |
| Netherlands | Shareholder Relief: reduced tax rate | 25.5% | 15% for small, 25% for substantial holdings | 0% for small, 25% for substantial shareholdings | Progressive 33.65-52% | Empl.: 5.2-31.7% EmpC: 6.5-11.31% |
| Austria | Shareholder Relief: reduced tax rate | 25% | 25%; optional: general PIT at a half rate; generally no SSC | 0% for small long-term holdings; for substantial shareholdings 25% | Progressive 23-50%; statutory and voluntary pension contributions partly deductible | Empl.: (cumulative) 16.85-17.2% EmpC: (cumulative) 20.5-20.7% deductible; both limited by an absolute amount |
| Poland | Shareholder Relief: reduced tax rate | 19% | 19% | 19% | Progressive 19-40% | Empl.: average 22.2%; EmpC: average 20.6% |

| Country | Type of dividend treatment | CIT ⁵⁴ | Taxation of dividends at shareholder level ⁵⁵ | Taxation of share sale at shareholder level ⁵⁶ | PIT ⁵⁷ | Compulsory SSC ⁵⁸ |
|-----------------|---|-------------------|--|---|---|--|
| Portugal | Partial Imputation | 27.5% | 20%; imputation credit of 50% | Generally 10%; tax exemption if shares are held more than 12 months | Progressive 10.5-42% | Empl.: overall rate 11% EmpC: overall rate 23.75% |
| Romania | Classical system | 16% | 'Investment Tax' 16% | 'Investment Tax' 16%; 1% for long-term investment | Flat 16%; voluntary contributions to private pension funds deductible | Empl.: (cumulative) 17% EmpC: (cumulative) 30.35-31.35% |
| Slovakia | Dividend tax exemption for shareholders | 19% | 0% | General PIT | Flat 19% | Empl.: 13.4% EmpC: 28.4% |
| Slovenia | Shareholder Relief: reduced tax rate | 23% | 20% | 0-20% according to the holding term | Progressive 16-41%; contributions to private pension funds deductible | Empl.: 22,1% EmpC: 16.1% |
| Finland | Full Imputation | 26% | 'Investment Tax' 28%; generally no SSC | 28% | Progressive 9-32% central+ 18.46% (average) sub-central; SSC deductible | Empl.: (cumulative) 6.61-7.18%; EmpC: (cumulative) 20.69-32.69%; both limited by an absolute amount |
| Sweden | Shareholder Relief: reduced tax rate | 28% | 'Individual Capital Income Tax' 30% | 30% | Progressive 20-25% central + 31.6% sub-central | Empl.: 7% EmpC: 32.28% |
| Turkey | Partial Rmputation | 20% | 15%; imputation credit of 50% | 0% if held more than 4 years, otherwise general PIT | Progressive 15-35% | Empl.: 15%; EmpC: 21.5%; both limited by an absolute amount |
| UK | Partial imputation | 30% | 10% up to the basic rate limit; 32.5% above; imputation credit | CGT 40%; taper relief | Progressive 10-40% | Empl.: overall rate 11% EmpC: overall rate 12.8% |

Abbreviations: CIT = Corporation Tax; PIT = Personal Income Tax; CGT = Capital Gains Tax; SSC = Social Security Contributions; EmpC = Employing Company; Empl. = Employee; IC = Intermediary Company.

Within the EU, classical, imputation, shareholder-relief and exemption systems are all represented. From the point of view of employee financial participation, classical systems (double taxation of dividend income, for example, Ireland, Latvia, Romania) are generally unfavourable.⁵⁹ Partial imputation generally leads to a higher tax burden at shareholder level than full imputation and shareholder-relief (see Spengel, 2003), p. 23) and is, therefore, relatively unfavourable. Most countries presently offer shareholder-relief, but it is difficult to assess the effect on employee financial participation without comparing effective tax rates.⁶¹ The best system for share-based plans is undoubtedly one that exempts dividend income from taxation by law (for example, Croatia, Cyprus, Estonia, Greece, Slovakia) or through full imputation (for example, Finland).

Taxation of capital gains from sale of shares is of great importance for employee share ownership. In this context, three concepts can be distinguished within the EU: exemption from taxation (for example, Belgium, Portugal, Cyprus, partially Bulgaria, Malta); taxation only on substantial holdings (defined differently in different countries, for example, Austria, Germany, Italy, Luxembourg, Netherlands) and taxation by capital gains tax or by personal income tax at a lower (and usually flat) rate. Obviously, tax exemption is the most advantageous for employee financial participation. Taxation of substantial holdings is also favourable, since employee shareholdings are usually small. There is no common tendency for the taxation of capital gains.

Compulsory social security contributions⁶² can either reduce the tax base of corporate and personal income tax or be calculated on after tax income (for example, Latvia). Otherwise, they impose an additional burden on gross income and are thus very unfavourable for cash-based profit-sharing, even when general taxes are low as in Slovakia. Further, social security contributions can be levied on capital income as in France (this would have had negative consequences for share-based schemes had France not introduced specific tax incentives). Generally, no common tendency in the development of social security is discernable, since in most countries contributions are connected to long-term insurance and thus are not as easily altered by the state as are taxes.

Tax and social security rates and deductions are interdependent within a national tax system, therefore each national system has to be analysed separately as a whole; details are presented in Table 4, above.

In the context of taxation, it is only relevant whether a financial participation scheme is cash-based or share-based and whether an ‘intermediary entity’⁶³ is used as a vehicle. The

⁵⁹ However, it depends on the personal income tax rate. For example, the income tax rates in Ireland, Latvia and Romania are relatively low.

⁶¹ Due to globalisation of business and to the requirements of the EU law, there is a tendency to exchange imputation for shareholder relief systems. See Spengel (2003) p. 25.

⁶² Whether social security is levied as a tax, for example, as in Denmark and Estonia, or takes the form of social insurance contributions merely means that in the case of taxes there is no corresponding claim against a social insurance institution.

⁶³ The generic term used for intermediary companies, funds with a separate legal personality and trusts (in common law countries UK, Ireland and Malta), which accumulate distributed profits, hold, allocate and transfer shares, options or certificates of the employer company for employees, sometimes pay out dividends or returns, administrate dividends, and make investments.

same taxation rules apply to employee share ownership schemes and share-based profit-sharing schemes, both direct and deferred.

a) Employee Share Ownership

Employee Shares

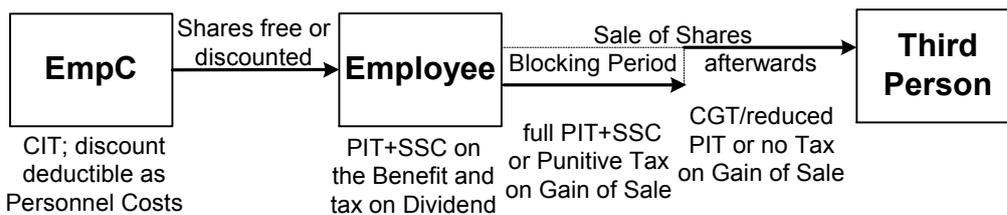


Figure 12: Taxation of employee shares

The benefit in value from transfer of discounted shares is generally deemed employment income and correspondingly subject to full personal income tax and compulsory social security contributions at the employee level. The employer company can generally deduct the discount as a personnel cost. However, valuation rules, especially for non-quoted shares, differ considerably between countries.⁶⁴ Taxation of dividends depends on the country-specific type of dividend treatment. Since there is no tax relief for the employing company in any EU Member State, full corporate tax generally is to be paid by the employer company on the entire profit, including the part to be distributed.⁶⁵ The Different systems of dividend taxation at shareholder level are explained above. Taxation of gains from sale of shares depends on whether the shares are sold during or after the end of the blocking period. If the shares are sold during the blocking period, there are no major differences between EU countries: either full personal income tax and social security contributions or a special (high) punitive tax will be imposed. If the shares are sold after the end of the blocking period, taxation depends on the system of taxation of capital gains presented above. If there is no general exemption, or exemption for small shareholdings, other forms of tax relief usually apply.

Stock Options

Taxation of employee stock options is complex due to differences in the taxation moment and valuation methods which depend on the taxation moment. In most EU Member

⁶⁴ The valuation of the same shares for the purpose of taxation of employees or employers may follow different rules and lead to different taxable amounts as in Austria. The moment of valuation of shares may also be different in different countries and lead to differences in value and in the tax base derived from it.

⁶⁵ However, in one EU Member State, Estonia, corporate tax is replaced by the tax on distributed profits. This original system may have a positive economic effect on accumulation of funds, but it constitutes a strong disincentive for the employer company in relation to share-based employee participation plans as well as to cash-based profit-sharing.

States, taxes are imposed at exercise; taxation at grant or optionally at grant or exercise, as well as taxation at sale of shares, are also practiced.

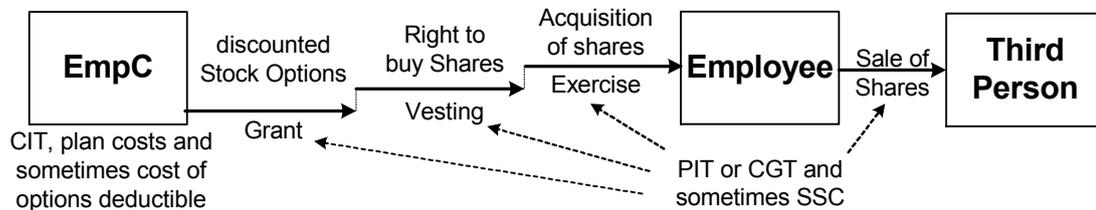


Figure 13: Taxation of stock options

Upfront taxation at grant is connected with considerable risks, so that special tax relief such as reduced tax rate or tax base and exemption from social security contributions are necessary as compensation. Although it could be argued that stock option benefits should be considered as capital gains, it is deemed to be employment income in most EU Member States; as such it is usually charged as personal income tax and partly also subject to social security contributions. The employer company can generally deduct setting up and operating costs of the plan as well as cost of options if the shares are repurchased (with the exception of, for example, Belgium). In some countries (for example, Denmark, Ireland, Luxembourg, Portugal), both the employer company and the employee are exempted from social security contributions (for details, see European Commission, 2003c; PriceWaterhouseCoopers, 2002).

b) Profit-Sharing

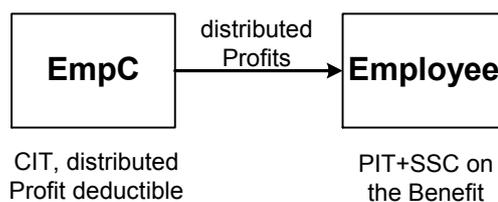


Figure 14: Taxation of profit-sharing

As far as cash-based profit-sharing is concerned, no major discrepancies exist between different EU Member States. Distributed profit is generally deductible for the employer company as a personnel cost (with the exception of Estonia, where it is instead subject to the tax on distributed profits), and it is subject to full personal income tax and social security contributions for the employees. The same taxation rules as for employee share ownership apply to share-based profit-sharing (see above).

c) Intermediary Entities

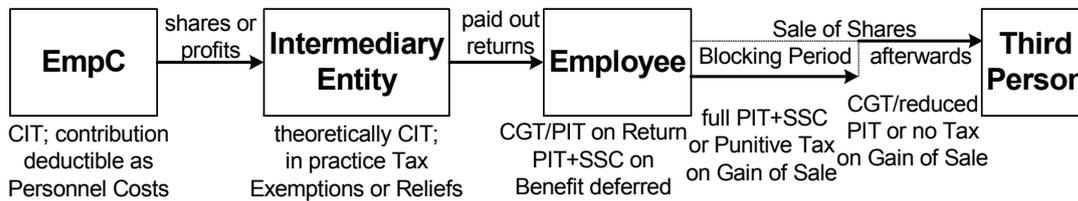


Figure 15: Taxation of share ownership plans and profit-sharing plans using intermediary entities

Share ownership plans and profit-sharing plans using a vehicle for the holding of shares and the investment of accumulated funds exist in many varieties in different EU Member States, especially because of substantial differences in company law. However, there is a similar basic logic: the employer company can usually deduct contributions to the intermediary entity, as well as set up and operating costs, from the tax base of the corporate income tax; the intermediary entity is usually established in a tax-friendly form. Taxation of employees would be the same as for simple share-based plans (see above) if it were not for specific tax incentives (for example, deferred taxation of the benefit), which in most cases are granted.

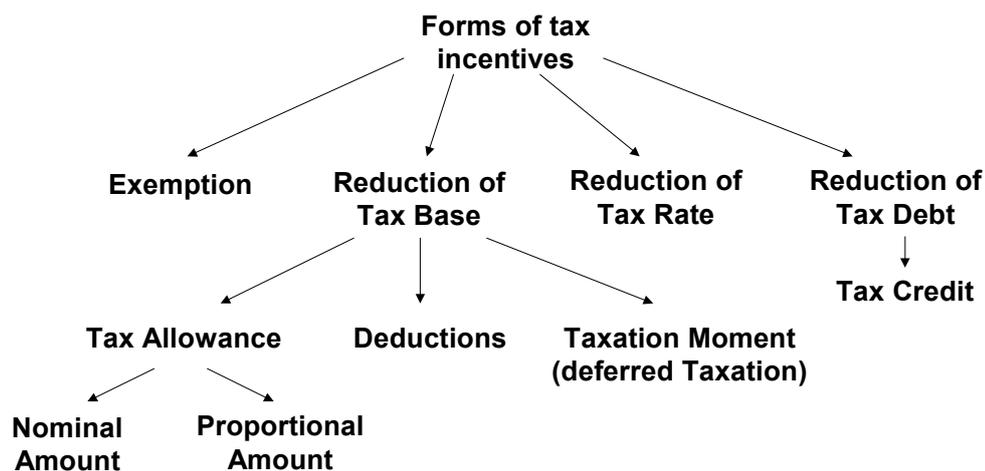
3. Specific Tax Incentives for PEPPER Schemes in the EU

Aside from specific tax incentives, most national taxation systems are more or less favourable to financial participation. The only tax system which actually hinders the development of financial participation is that of Estonia, due to taxation of distributed profits at company level instead of general corporate income tax.⁶⁷ National taxation systems which exempt dividends and capital gains from taxation and social security contributions are especially advantageous to share-based schemes. Although details differ, generally in most countries the same taxes apply to similar plans so that the important difference is the general level of the tax burden of standard income taxes and compulsory social security contributions determined by tax rates and tax bases. As mentioned above, comparable effective rates cannot be calculated for all possible situations. Nevertheless, a substantial difference in tax rates implies a difference in tax burden. Thus it can be argued that low-tax countries generally have more favourable tax regimes for financial participation so that specific tax incentives are not necessary. The example of Ireland, however, shows that the government of a low-tax country can have a strong political interest in promoting employee financial participation; it can offer additional tax incentives even though the low

⁶⁷ For this reason, it is contrary to the financial interests of the employing company to distribute profit to employees in cash-based profit-sharing schemes or as dividends to employees who have become shareholders. However, the Estonian tax system is to be changed in 2009 to comply with the EU Parent-subsidiary Directive (see KPMG, 2007, p. 15).

level of general taxation limits their impact.⁶⁸ Therefore the different instruments used to create specific tax incentives are important. Incentives may take the different forms diagrammed below.

Figure 16. Forms of tax incentives



Tax rate reductions and exemptions, although most effective because they are based on law rather than arbitrary judgments of tax authorities, and confer the same advantages to all categories of income, are seldom utilised (see Spengel, 2003, p. 28). One reason for this neglect is that such tax incentives result in heavier losses of revenue; also tax authorities have virtually no discretionary power over their use.⁷⁰ Deductions favour higher incomes under a progressive system of taxation, like the personal income tax in most EU Member States; tax credits (direct reduction of tax liability), on the other hand, are non-discriminatory and usually more valuable than an equivalent tax deduction or tax allowance.⁷¹ Tax allowances benefit lower incomes whereas nominal tax allowances benefit the taxpayer less and therefore involve smaller revenue loss than would a proportional determination of the tax allowance. Deferred taxation favours share ownership schemes avoiding otherwise necessary additional liquidity at the moment of acquisition.

Specific tax incentives for employee financial participation are currently in effect in 16 (mainly Western) countries out of the 29 Member States and candidate countries; these differ substantially in type and size. Details are presented in Table 5, below.

⁶⁸ See Irish Department of Finance, TSG 98/12.

⁷⁰ To compensate for revenue losses caused by lowering the tax rate, either rates of other taxes are increased or the tax base is broadened. Thus a lower tax rate does not necessarily lower the total tax burden. It is not surprising that countries with low statutory tax rates like Ireland have fewer tax concessions than countries with high statutory tax rates like France, Italy and Spain. See Spengel, (2003), p. 29.

⁷¹ However, more value for taxpayers means higher revenue losses for the state. In addition, tax credits generally cause higher tax administration costs. Recently, tax credit systems have been replaced by tax allowances in France and Italy (see Tipke and Lang, eds, 2005, pp. 799, 802).

Table 5. Tax incentives for employee financial participation

| Country | Employee | Employer Company |
|---------|---|---|
| Belgium | ESO ES: Since 2001: 15% tax on benefit, no SSC if 2-5 years blocking period; tax base: quoted shares market value-costs, non-quoted shares purchase price-net asset value of shares; Sale of shares: tax free up to 25% of equity; sale during blocking period 23.29% punitive tax; SO: Since 1999: taxation moment – at grant; taxation base: lump sum value = 15% of stock value at grant + 1% for each year before exercise, value reduced by half (7.5% + 0.5%) if options cannot be exercised within 3 years from grant, exercise period within 10 years from grant, no guarantee against fall in value, strike price determined at option offer; no SSC; IntE: Do not exist. | ES: Discount deductible from tax base of CIT; SO: Difference between market price of stock and exercise price of options deductible from tax base of CIT only if not EmpC, but a foreign company provides shares for employees at exercise and cross-charges the cost to EmpC; IntE: Do not exist. |
| | PS General: Since 2001: 15% tax for participation in the framework of an investment savings plan; 25% tax in other cases; but full SSC; IntE: Do not exist. | General: No SSC; IntE: Do not exist. |
| Denmark | ESO ES: Since 1987 (broad-based plan): no PIT, no SSC on discount, if value does not exceed 10% of annual salary, 5-year blocking period and shares deposited on trust with a bank; SO: (1) Broad-based plan (since 1987): no PIT, no SSC if value of options does not exceed 10% of annual salary and 5-year blocking period; (2) Individual plan under § 7H (since 2003): no PIT, no SSC if value of options does not exceed 10% of annual salary or exercise price less than 15% lower than market price of underlying shares; (3) Individual plan under § 28: no incentives; IntE: Do not exist. | ES: Discount deductible from tax base of CIT; SO: (1) Option costs deductible from tax base of CIT; (2) No; (3) Option costs deductible from tax base of CIT; IntE: Do not exist. |
| | PS General: (1) Broad-based plan (since 1987): up to DKK 8,000 tax-free if blocking period 7 years and shares deposited on trust with a bank (2) Individual plan under § 7H (since 2003): no PIT, no SSC on benefit if value does not exceed 10% of annual salary; IntE: Do not exist. | General: (1) Costs of shares deductible from tax base of CIT; (2) No; IntE: Do not exist. |
| Germany | ESO ES: No PIT, no SSC on benefit, if not exceeding 50% of the share value and Euro 135 annually; savings bonus of 18% on investment up to Euro 400 annually if annual income up to Euro 17,900 and 6-year blocking period; SO: No; IntE: Do not exist | ES: No; SO: No; IntE: Do not exist |
| | PS General: No; IntE: Do not exist | General: No; IntE: Do not exist. |
| Greece | ESO ES: Since 1987: (only for JSC) no PIT, no SSC on benefit – if shares issued in a capital increase 3-year blocking period; Dividends: tax on movable assets (10%); | ES: Discount deductible from tax base of CIT, no SSC; SO: (1) No; (2) Costs of distributed shares deductible from tax |

| Country | Employee | Employer Company |
|---------|--|---|
| | <p>SO: (1) Since 1999 ‘Qualified plans’: no PIT, no SSC at grant or exercise; (2) Since 1988 ‘non-qualified plans’: gift tax can be applied instead of PIT at discretion of tax authorities;</p> <p>IntE: Do not exist.</p> | <p>base of CIT;</p> <p>IntE: Do not exist.</p> |
| PS | <p>General: (only for JSC, usually cash-based) no PIT, but SSC on benefit if not exceeding 25% of annual gross salary;</p> <p>IntE: Do not exist.</p> | <p>General: Distributed amount deductible from tax base of CIT, but SSC;</p> <p>IntE: Do not exist.</p> |
| Spain | <p>ES: (1) Since 2003: no PIT, no SSC on benefit up to Euro 12,000, if plan regular, each employee and his family own not more than 5% of equity capital, 3-year blocking period; (2) Since 1997 Sociedades Laborales: no tax on company formation and tax credit of 99% on transfer tax, levies for notarial deeds on transfers to the company, debts, bonds and debenture bonds, if reserve for loss compensation 25% of annual profits;</p> <p>SO: 80% tax relief on up to 2 x (annual medium wage x number of years before vesting), if vesting period not exceeding 2 years, options granted not annually, 3 years between option grant and share sale, plan broad-based;</p> <p>IntE: Do not exist.</p> | <p>ES: No;</p> <p>SO: No;</p> <p>IntE: Do not exist.</p> |
| PS | <p>General: No</p> <p>IntE: Do not exist</p> | <p>General: No;</p> <p>IntE: Do not exist.</p> |
| France | <p>ES: No;</p> <p>SO: No;</p> <p>IntE: Do not exist.</p> | <p>ES: Training of employees on EFP: tax relief Euro 75 per hour and person, up to Euro 5,000 per company for 2 years (2007);</p> <p>SO: No;</p> <p>IntE: Do not exist.</p> |
| PS | <p>General: Since 1986/1994 (intéressement – gain sharing): no SSC, but full PIT, if transferred immediately; tax incentives only if combined with savings funds (PEE, PPESV); Since 1967/1986/1994 (participation – profit-sharing): no PIT, no SSC, special flat tax of 7.6% on benefit if blocking period 5 years, the amount does not exceed 25% of gross salary up to Euro 14,592; returns tax free if accumulated, 10% special flat tax if paid out during blocking period;</p> <p>IntE: Since 1986/1994 (PEE - short-term savings plan): no PIT, no SSC, flat tax of 7.6% if blocking period 5 years and EmpC match does not exceed the ceiling; Since 2001: (PPESV - long-term savings plan): like short-term, but 10-year blocking period; if EmpC match exceeds the ceiling for short-term, but is under the ceiling for long-term - flat tax of 8.2%; Returns: flat tax of 10%.</p> | <p>General: Since 1986/1994 (intéressement – gain sharing): no SSC; tax incentives only if combined with savings funds (PEE, PPESV); Since 1967/1986/1994 (participation – profit-sharing): no CIT, no SSC, special flat tax of 7.6% on benefit if blocking period 5 years, the amount does not exceed 25% of gross salary up to Euro 14,592; returns tax free if accumulated, 10% special flat tax if paid out during blocking period;</p> <p>IntE: Since 1986/1994 (PEE - short-term savings plan): no CIT, no SSC, flat tax of 7.6% if blocking period 5 years and EmpC match does not exceed the ceiling; Since 2001: (PPESV - long-term savings plan): like short-term, but blocking period 10</p> |

| Country | Employee | Employer Company |
|----------------|--|--|
| | | years; if EmpC match exceeds the ceiling for short-term, but is under the ceiling for long-term - flat tax of 8.2%; Returns: flat tax of 10%. |
| Hungary | <p>ESO</p> <p>ES: Since 2003 'Approved Employee Securities Benefit Programme': no PIT and tax relief for voluntary insurance on benefit, if not exceeding HUF 50,000 annually and programme approved;</p> <p>SO: Since 2003 'Approved Employee Securities Benefit Programme': incentives as for ES;</p> <p>IntE: Since 1992 ESOP: no PIT on shares transferred via ESOP; contributions to ESOP deductible from tax base of PIT.</p> | <p>ES: No;</p> <p>SO: No;</p> <p>IntE: Contributions to ESOP deductible from tax base of CIT.</p> |
| | <p>PS</p> <p>General: No;</p> <p>IntE: Do not exist.</p> | <p>General: No;</p> <p>IntE: Do not exist.</p> |
| Ireland | <p>ESO</p> <p>ES: (1) Purchase of new shares: at sale of shares no PIT, no SSC, only CGT on issue price, if full price paid, 3-year blocking period and not exceeding lifetime ceiling of Euro 6,350; (2) Restricted Stock Scheme: deduction from tax base of PIT on benefit from 10% for 1 year blocking period to 55% for 5-year blocking period;</p> <p>SO: (1) Since 1999 SAYE: no PIT, no SSC at grant or exercise, if plan broad-based, SAYE contract with a bank for 3, 5 or 7 years, exercise price of shares up to 25% under the market value of underlying shares at option grant, plan approved by tax authorities; (2) Since 2001 APOS: no PIT, no SSC at grant or exercise, if plan broad-based, 3-year blocking period, plan approved by tax authorities;</p> <p>IntE: ESOT enjoy incentives only if combined with APPS (see below).</p> | <p>ES: (1) No SSC; (2) No;</p> <p>SO: (1) No SSC; (2) No SSC;</p> <p>IntE: ESOT enjoy incentives only if combined with APPS (see below).</p> |
| | <p>PS</p> <p>General: No;</p> <p>IntE: (1) Since 1986 APSS: no PIT, no SSC on benefit not exceeding Euro 12,700, if plan broad-based, 3-year blocking period in trust, plan approved by tax authorities Sale of shares: CGT; sale during blocking period PIT at top rate on proceeds of sale less market value and CGT on increase in value; (2) Since 1997 ESOT: incentives only if combined with APSS trust.</p> | <p>General: No;</p> <p>IntE: (1) Costs of setting up and operating the plan deductible from tax base of CIT, no SSC; (2) EmpC: incentives only if combined with APSS trust; IntE: no tax on dividends if dividends used for qualifying purposes.</p> |
| Italy | <p>ESO</p> <p>General: sale gain taxed with 12,5 CGT instead of 40%;</p> <p>ES: Since 1999: no PIT, no SSC on benefit up to Euro 2,066 if 3-year blocking period ; in limited liability companies free share up to Euro 7,500 tax exempt</p> <p>SO: Since 1999: no PIT, no SSC if 5-year blocking period between option grant and sale of shares, unless proceeds of the share sale invested in securities with the value equal to the difference of shares value at option grant minus share purchase price; PIT exemption abolished in 2008;</p> <p>IntE: Do not exist.</p> | <p>ES: Discount deductible from tax base of CIT;</p> <p>SO: No;</p> <p>IntE: Do not exist.</p> |

| Country | Employee | Employer Company |
|-------------|---|--|
| PS | General: Since 2007: 23% deduction of PIT up to Euro 350 annually, no SSC; max bonus value Euro 6,000 with income ceiling of Euro 35,900 annually; IntE: Do not exist. | General: Since 1997/2007: 5% tax exemption for contributions distributed to employees, 25% deduction of SSC; IntE: Do not exist. |
| Netherlands | ES: Since 1994, usually JSC: tax incentives only in combination with a savings plan – no PIT, no SSC, instead 15% flat tax, if plan broad-based, 4-year blocking period, annual ceiling of the savings plan Euro 1,226; SO: No; IntE: Since 1994, usually LLC: regulation of tax incentives as for direct employee share ownership. | ES: No; SO: No; IntE: No. |
| PS | General: Since 1994/2003: tax incentives only in combination with a savings plan – no PIT, no SSC, instead 15% flat tax, if plan broad-based, 4 years blocking period, annual ceiling of the savings plan Euro 613; IntE: Do not exist. | General: No; IntE: Do not exist. |
| Austria | ES: Since 2001: Amount free of taxes and SSC up to Euro 1,453.46 annually, if 5 years blocking period, plan broad-based, shares deposited with a domestic credit institution; SO: Since 1999: tax allowance (10% of the benefit per year, but not more than 50% of the total benefit tax free) if options non-tradable, plan broad-based, value of underlying share at option grant not exceeding Euro 36,400 + carry forward of taxation for the remaining amount (taxation optionally at sale or at termination of employment, but at the latest at the end of the 7 th year after grant) if options deposited with a domestic credit institution; IntE: Since 2001: up to Euro 1,453.46 annually CGT; if more PIT; no SSC. | ES: The book value of transferred shares deductible as personnel costs; SO: Costs of share purchase or the amount not contributed to the equity in the case of capital increase deductible from CIT; IntE: payments to IntE and costs for IntE deductible from CIT; up to Euro 1,453.46 per annum and per person tax-free; if more CGT; dividends on shares tax free. |
| PS | General: No; IntE: Do not exist. | General: No; IntE: Do not exist. |
| Poland | ES: No; SO: No; IntE: Do not exist. | ES: Leverage Lease Buyout (LLBO), Corporate income tax law allows to include interest part of lease payments as costs reducing the tax base; SO: No; IntE: Do not exist. |
| PS | General: No; IntE: Do not exist. | General: No; IntE: Do not exist. |
| Portugal | ES: No; SO: No SSC; IntE: Do not exist. | ES: No; SO: No SSC; IntE: Do not exist. |

| Country | Employee | Employer Company |
|-----------------|--|--|
| PS | General: Since 1969 (usually cash-based): no PIT, no SSC, if individual agreement concluded and effective; IntE: Do not exist. | General: Profit distributed to employees deductible from tax base of CIT; IntE: Do not exist. |
| Slovenia | ES: Since 2008: 70% deduction from PIT on benefit not exceeding Euro 5,000 annually per employee, if 1 year blocking period, 100% deduction, if 3 years blocking period; SO: No; IntE: Do not exist. | ES: Value of distributed shares deductible from tax base of CIT in the year, when the blocking period ends; SO: No; IntE: Do not exist. |
| PS | General: Since 2008 (for share-based PS): same as for ES; IntE: Do not exist. | General: same as ES; IntE: Do not exist. |
| Finland | ES: Since 1992: no PIT, no SSC on discount, if it does not exceed 10% and plan broad-based; Dividends: in public companies 30% tax free; in private companies 100% tax free if earnings per share less than 9% and the total amount less than Euro 90,000; SO: No; IntE: Do not exist. | ES: Discount deductible from tax base of CIT; SO: No; IntE: Do not exist. |
| PS | General: No; IntE: Since 1989/1997: Personnel Funds no PIT, no SSC on 20% of pay-outs from the Fund, if 5-year blocking period. | General: No; IntE: EmpC: no CIT, no SSC on profits transferred to IntE; IntE: earnings tax free. |
| UK | ES: No; SO: (1) Since 1980 SAYE: no PIT, no SSC at grant or exercise, if plan broad-based, exercise price of shares up to 20% under market value of underlying shares at option grant, SAYE contract with a bank, plan approved by tax authorities; (2) Since 1984/1996 CSOP: no PIT, no SSC at grant or exercise, if value of outstanding options up to GBP 30,000 per employee, exercise price not lower than market value at grant, exercise period 3 to 10 years after grant, plan approved by tax authorities; (3) Since 2000 EMI: no PIT, no SSC at grant or exercise, if value of options granted annually not exceeding GBP 100,000 per employee and GBP 3 million per company, tax authorities notified; IntE: Since 2000 SIP: no PIT, no SSC on benefit, if plan broad-based, 5-year blocking period in trust, value of shares up to GBP 3,000 (free shares), up to GBP 1,500 (partnership and dividend shares) annually per employee, plan approved by tax authorities; Sale of shares: no tax, no SSC if sold immediately after withdrawal. | ES: No; SO: (1)-(3) Costs of setting up and operating the plan; since 2003: costs of providing shares to the plan deductible from tax base of CIT, generally no SSC; IntE: Costs of setting up and operating the plan; since 2003: costs of providing shares to the plan deductible from tax base of CIT, generally no SSC. |
| PS | General: No; IntE: Do not exist. | General: No; IntE: Do not exist. |

Abbreviations: APOS = Approved Share Option Scheme; APSS = Approved Profit-Sharing Scheme; CIT = Corporate Income Tax; CGT = Capital Gains Tax; CSOP = Company Share Option Plan; EMI = Enterprise Management Incentives; EmpC = Employing Company; ESOP = Employee Share Ownership Plan; ESOT = Employee Share Ownership Trust; IE = Intermediary Entity; JSC = Joint-stock Company; LLC = Limited Liability Companies; PIT = Personal Income Tax; SAYE = Approved Savings-Related Share Option Scheme, SIP = Share Incentive Plan; SSC = Social Security Contributions.

Although at first impression, the table seems to suggest unbridgeable diversity, the analysis of the data leads to the conclusion that pre-conditions as well as forms of tax incentives are generally similar, but differ substantially in size. The table columns correspond to the classification of employee financial participation forms in country profiles, but, as explained above, a different classification should be used for purposes of the following tax analysis: employee share ownership plans and share-based profit-sharing plans belong to one category (with certain specific features of indirect plans), stock option plans to a second category, and cash-based profit-sharing plans to a third category.

a) Share-Based Plans

Tax incentives in most countries apply to direct share-based plans, share-ownership as well as share-based profit-sharing. The most common pre-condition is a blocking period between one and seven years, the most common being 5 years (for example, Austria, Belgium, Denmark, France and Italy for some plans). A blocking period can be combined with an obligation to deposit shares with a bank. In indirect share-based plans, shares must be deposited with an intermediary entity (intermediary company, fund or trust) and cannot be withdrawn within a certain period of time (up to 10 years), which practically corresponds to the ‘voluntary’ blocking period in direct plans (for example, Austria, Finland, France, Ireland, UK). In some cases, tax incentives apply only if the primary plan is linked to a savings contract or scheme (for example, France, the Netherlands). In many countries, tax incentives apply only if the plan is broad-based (for example Austria, Denmark, Finland, Hungary, the Netherlands, Ireland, UK, France). However, some countries introduced broad-based as well as individual plans with partly different pre-conditions and tax incentives (for example Denmark). In some countries, where the plans are pre-defined in the law, approval of tax authorities is necessary (for example Hungary, Ireland, and UK).

The most common form of tax incentives for employees on the benefit in share-based plans (excluding stock option plans) is an allowance of tax and social security contributions, but the absolute amount differs significantly, from Euro 360 per employee annually in Germany to Euro 12,700 in Ireland. In Finland and Denmark, where the amount is given as a percentage of annual salary, the allowance might be even higher (10 per cent in Denmark and in Finland for direct share ownership plans and 20 per cent in Finland for indirect share-based profit-sharing). The tax-free amount in indirect plans is often larger than in direct plans. Another possibility is a special, relatively low flat tax instead of personal income tax and social security contributions (for example, 15 per cent in Belgium, 7.6 per cent in France). In France, the special tax is imposed on the employees as well as on the employing companies. Relatively rare tax incentives for employees are deduction from the tax base of personal income tax (Ireland for restricted stock schemes, Slovenia for a short blocking period) and a savings bonus (Germany for very low incomes). Tax incentives on dividends are also applied quite seldom (for example, Finland, France), since taxation of dividends is always lower, and social security contributions are not levied. Since the employer companies usually can deduct the value of distributed shares as personnel costs under general taxation rules and since they are not subject to social security contributions on that amount, special incentives are not required. However, in France it was necessary to exempt the employer companies from social security contributions, which are usually imposed, and to introduce a special flat tax of 7.6 per cent on the bene-

fit and of 10 per cent on the dividends, which also apply to employees. Specific tax incentives exist for intermediary entities in indirect plans: all earnings (for example, Finland) or at least a certain amount of contributions and dividends (for example, Austria, Ireland, France, UK) are either tax exempt or levied by a special low tax.

b) Stock Options

The greatest variety of tax incentives occur in connection with stock option plans. In addition, it is difficult to compare pre-conditions and incentive forms in different countries, since several stock option plans often exist in a single country. At a higher level of abstraction, the most common pre-conditions are blocking and exercise periods (for example, Belgium, UK, Ireland); restrictions on the difference between the market price of underlying shares and the exercise price (for example, Belgium, Denmark, Ireland, UK, Austria); the existence of a broad-based plan (for example, Austria, Denmark, Ireland, UK), and approval by the tax authorities (for example, Hungary, Ireland, UK). In the so-called SAYE plans in Ireland and UK, combination with a savings contract is required. As far as tax incentives for employer companies are concerned, eligibility often depends on whether the shares are to be purchased on the market or issued in the course of capital increase (for example, Austria, Greece).

The most common tax incentive forms for employees are an allowance of personal income tax and social security contributions, whereby the amounts are either the same as for shares, for example, Denmark, Hungary, or much higher, for example, CSOP (GBP 30,000) and EMI (GBP 100,000 !) in the UK. Such forms as deferred taxation (for example Austria) or taxation at grant (for example Belgium) are country-specific. Tax incentives for employer companies is the deductibility of costs of share purchase or option costs from the tax base of the corporate income tax.

c) Cash-Based Profit-Sharing

Only two countries (Greece and Portugal) have tax incentives for cash-based profit-sharing; in both cases these were introduced several decades ago. These tax incentives were obviously inefficient; the incidence of employee financial participation in Greece and Portugal is still the lowest among Western European countries. A possible reason for this inefficiency is restricted eligibility of – otherwise quite generous – tax incentives: in Portugal, tax incentives become applicable only on the basis of an individual contract limited in time; in Greece, tax incentives are applicable only to joint-stock companies.

4. General Principles

Two general principles may be drawn from the combined data on tax incentives and the incidence of financial participation from the various countries:

– **Tax incentives are not a prerequisite to financial participation**

Financial participation schemes without tax incentives (for example, profit-sharing plans in Austria and Germany) sometimes have a higher incidence than those with tax incentives (for example, share ownership plans in Austria and Germany).⁷² Therefore tax incentives are not to be considered a prerequisite to the development of financial participation. Furthermore, in low-tax countries (for example, Ireland), tax incentives are less important and, in any case, cannot be as large as in high-tax countries.⁷³

– **Tax incentives effectively promote the spread of financial participation**

Countries with a long tradition of employee financial participation (for example, UK, France)⁷⁴ universally confirm this experience, but so do countries where tax incentives are quite recent, for example, Austria,⁷⁵ where a substantial increase has been observed, even though total numbers are still relatively low.

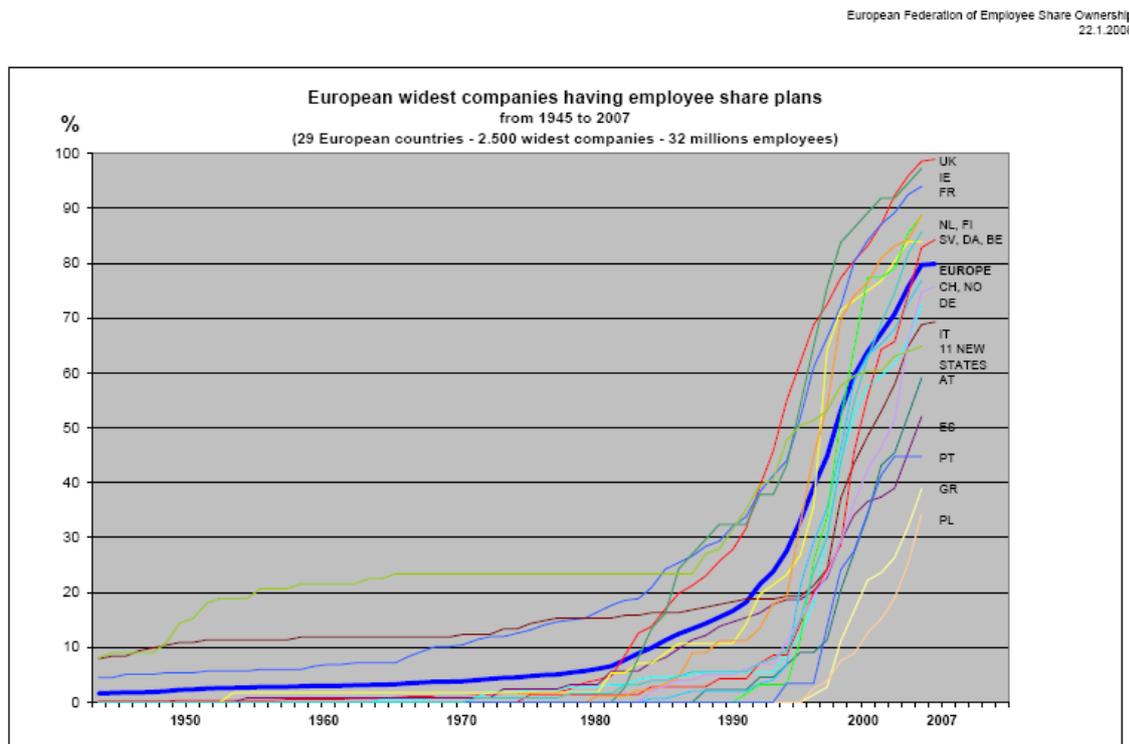
⁷² In Austria, only 8 per cent of enterprises and 6 per cent of the workforce participated in employee share ownership plans in 2005, tax incentives for which were introduced in 2001, whereas 25 per cent of enterprises operated profit-sharing plans without tax incentives (see Kronberger et al., eds, 2007, pp. 11, 17, 162). In Germany, 2.4 per cent of enterprises had an employee share ownership plan in 2001, supported by (marginal) tax incentives, whereas at the same time 8.7 per cent of enterprises operated profit-sharing plans without tax incentives (see Würz, ed., 2003, p. 59).

⁷³ It should be noted that in countries which are considered low-tax, not all statutory taxes are necessarily low; the statement refers only to low statutory taxes. For example, in Ireland, corporate income tax is exceptionally low (12.5 per cent), whereas personal income tax is close to the EU average (20-42 per cent). Therefore, most tax incentives for employee financial participation in Ireland concern employees and not employer companies. The Irish Government declared that no tax relief which reduced the revenue from corporate income tax can be introduced because the low tax rate leaves very little leeway (Irish Department of Finance, TSG 98/12).

⁷⁴ In France, legislation on voluntary employee financial participation without tax incentives of 1959 and even legislation on compulsory employee financial participation without tax incentives of 1967 did not lead to a significant number of plans in operation. Only in 1986 when the first tax incentives were introduced did the number of plans increase rapidly; this upward tendency has been supported by the introduction of new tax incentives (see Würz, 2003, p. 39). In the UK, although profit-sharing has existed since the 19th century and share ownership since the early 1950s, the number of plans remained small until the first tax incentives were introduced in 1978. Since then, the system of tax incentives and economic efficiency of incentives and plans are regularly reviewed by the government, and the number of plans is steadily increasing, especially Revenue Approved plans (see Würz, 2003, p. 130); <<http://www.ifsproshare.org>>, Log-in: 20 July 2007.

⁷⁵ In Austria, only 8 per cent of employee financial participation plans were implemented before first tax incentives were introduced in 1993, while 45 per cent of plans were introduced in four years after more substantial tax incentives became effective in 2001 (see Kronberger et al., eds, 2007, p. 32).

Figure 17. European largest companies having employee share plans



According to the graph by EFES (see Figure 17, above) representing the increase in the number of European widest companies offering financial participation plans from 1945 to 2007, introduction of tax incentives in most Western European countries has led to a significant increase in the number of plans in the short-term and a steady growth in the long-term. In most countries, the angle of the graph representing increase becomes steeper following the years in which tax incentives were introduced (for example Denmark 1987 and 2003; Finland 1996; France 1986 and 1994; Ireland 1986 and 2001; the Netherlands 1994 and 2003; UK 1980, 1984 and 2000). However, in some countries there is no correspondence between the introduction of tax incentives and the increase in the number of plans (for example Greece (increase since 1999, although tax incentives since 1987; Portugal (increase 1993 until 2000, although tax incentives since 1969); Austria (increase since 1997, although tax incentives since 2001). In each deviating case it can be explained by country-specific circumstances. It is common to all deviating countries that they have (or have had until recently) only insignificant tax incentives and a small number of financial participation plans. In Portugal, a vast majority of plans emerged as a result of privatisation in the 1990s, because in this procedure substantial incentives, not only concerning taxes, were granted to the workers of privatised enterprises; all these incentives were abolished after privatisation procedures were completed at the end of the 1990s. In Greece, complexity of regulation and lack of information about financial participation prevented the companies from introducing broad-based plans, although tax incentives were introduced quite early; since 1999, tax incentives for stock options were introduced and utilised generally by executives. In Austria, profit-sharing, although not linked to tax incentives,

traditionally makes up the major part of financial participation plans. However, the increase of originally almost non-existent share ownership plans was substantial after the introduction of tax incentives in 2001 according to national statistics; it can only not be seen on the graph due to the still low percentage of share ownership as compared to profit-sharing plans.

5. Conclusions

Firstly, tax incentives should (and in most countries actually do) target those taxes which constitute the heaviest burden in the national taxation system. Usually (with the exception of countries with flat tax systems which at present do not offer specific tax incentives) these are the progressive personal income tax and social security. Many countries therefore provide:

- exemptions from social security contributions for certain plans (for example, France, Belgium, UK, Ireland, Finland),
- levying a capital gains tax (for example, UK, for dividends Belgium),
- levying a special low tax (for example, France) in lieu of personal income tax, and
- tax allowances for personal income tax (for example, Austria, Finland, Ireland).

Secondly, tax incentives should be provided for both employees and the employer company, inasmuch as participation is voluntary for both parties in all EU Member States except France. However, this requirement is relative: in most countries the employer company has already been granted tax incentives in the form of deductions under general taxation law and only tax incentives for taxes involving the cost of shares and stock options are needed. In most countries, the only important incentive for the employer company is the exemption from social security contributions; this has actually been introduced in many countries (for example, France, Ireland, Finland, Belgium). The employee is usually more in need of direct incentives as the heaviest burden of progressive taxes falls on him or her.

Thirdly, even substantial tax incentives may prove inefficient when the pre-conditions of eligibility are too restrictive, complex or inflexible. This is the case (for example, in Greece) for cash-based profit-sharing and in Germany and Belgium for schemes of all types (see European Commission, 2003a, pp. 17, 24). The flexibility problem can be solved, as in Ireland and the UK, by allowing the employer company to choose between less flexible approved schemes combined with substantial tax incentives and more flexible unapproved schemes combined with minor tax incentives. Another interesting approach was presented in the EC Report on Stock Options (see European Commission, 2003b, pp. 42, 43): Since direct taxes cannot be harmonised under the effective EU Treaty, as shown above, it might be reasonable to harmonise the pre-conditions for the application of tax incentives where they exist in a particular country. National legislators would be authorised to introduce additional national plans and to decide the size and the form of tax incentives for these as well as for those plans encompassing all of Europe. Harmonisa-

tion can only be accomplished if the existing pre-conditions in different EU Member States are at least comparable for all types of employee financial participation schemes, as is apparently the case for stock options.

Fourth, some forms of tax incentives are more favourable for certain types of plans and also lead to higher efficiency:

- For share ownership and stock options as far as benefit taxation is concerned: generous valuation rules combined with a favourable taxation moment (for example, deferred taxation, often linked to holding period), and, if possible, exemption from SSC for both the employer company and the employee.
- For dividends and sale of shares: a special tax rate or capital gains tax in lieu of personal income tax and, if necessary, exemption from SSC.
- For ESOPs and Intermediary Entities: exemptions from income tax on share acquisition⁷⁸ or on share sale if the profit is realised after a holding period or within a retirement program; the company may qualify for tax relief on both interest and principal payments on the loan; sale of stock to an ESOP on a tax-deferred basis if the proceeds of the sale are reinvested in securities of other domestic corporations (tax-free rollover).
- For profit-sharing: a special tax rate in lieu of the progressive personal income tax as well as exemption from SSC for both the employer company and the employee.

However, the most effective forms of tax incentives do cause revenue losses. Therefore, efficiency should be weighed against the revenue requirements of each country independently. Should a government wish to introduce specific tax incentives, it might well begin with ‘soft’ tax incentives which do not cause substantial revenue losses, for example, tax allowances defined by nominal amount (as in Austria). Later, depending on revenue needs and the political climate, it may proceed to more effective measures: tax allowance as a proportional amount, deductions, tax credits, introduction of special low tax rates, and, finally, full exemption from taxation.

Fifth, in spite of the difficulty of their implementation at the European level (because of the exclusive jurisdiction of national legislation over tax law), tax incentives remain powerful tools for enhancing and broadening financial participation. This is especially true when they remain optional for the member countries and not subject to a unanimous vote of approval. Countries could voluntarily offer tax incentives singly or in groups. Such a step would create an increasingly favourable environment in which countries having an advanced tradition, such as France or the United Kingdom, would encourage emulation. Optional preferential treatment as part of the Building Block Approach requires distinguishing between profit-sharing schemes, share ownership schemes and employee stock ownership plans.

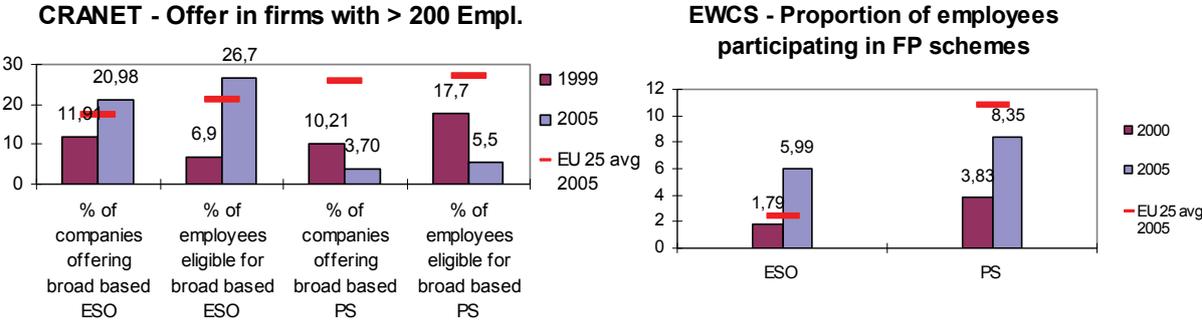
⁷⁸ In Ireland this is the case only where the ESOP comprises an ESOT working in tandem with an Approved Profit Sharing Scheme.

Part 2

Country Profiles

I. Belgium

Some forms of employee financial participation began to emerge at the end of the 19th century; the number of plans, however, remained very small, especially between 1945 and 1990. The Belgian government introduced its first incentives for employee share ownership in King’s Arrest ‘Monory-De Clerq’ on 9 March 1982. These provisions were primarily intended to support the stock exchange in the wake of a financial crisis; among them was employee share ownership, submitted in a proposal by the Liberal Party. Still applicable, these provisions have proved efficient. Additional incentives were introduced in 1991 by the Law on Equity Capital Incentives. The Law on Incentives for Stock Options of 26 March 1999 and the Law on Promotion of Employee Financial Participation of 22 May 2001 followed. The latter laws introduced tax incentives for profit-sharing and employee share ownership schemes; however, the number of plans continues to be relatively small.⁷⁹



⁷⁹ According to EFES from 2001 to 2007, only four share plans and around 40 cash plans were set up.

Approximately 10 per cent of large, primarily multinational companies in the financial sector had employee share ownership plans in 1999 (Prieue and Havinghorst, 1999). Stock option plans have become relatively widespread. Over 40 per cent of enterprises with more than 50 employees offered stock option plans in 2002 (PriceWaterhouse-Coopers, 2002). Many of these, however, are limited to management.

1. General Attitude

Especially since the end of the 1990s, the government has supported employee financial participation, regarding it as a pillar of the social security system. However, legislative proposals have been introduced into Parliament from the beginning of the 1970s. These were mainly sponsored by the Liberal Party, although until 1999 the Socialist Party blocked all such proposals. At the end of the 1990s, the government announced a new employee financial participation promotion campaign intended to spread financial participation to 25 per cent of all employees. The employers' associations (for example, Federation of the Belgian Enterprises, National Federation of Small Firms and Traders) had given support to employee financial participation even earlier, seeking to influence the government through campaigns in the mass media which were obviously successful. The employers' associations, however, mainly favour financial participation only for executives and higher management. The trade unions (especially the largest, the Christian Unions (CSC/ACV) and the Socialist Unions (FGTB/ABVV)) generally oppose any form of employee financial participation on the grounds that employees are powerless to influence competitiveness or profitability. To a certain extent, they do support employee share ownership plans not financed from the wages or salaries of employees.

2. Legal and Fiscal Framework

The Law on Promotion of Employee Participation of 22 May 2001 regulates the procedure for establishing employee financial participation plans, especially cash-based and share-based profit-sharing. Terms and conditions prescribed by law (for example, rules for calculating length of employment, duration, mandatory or non-mandatory participation of employees, and blocking period) must be introduced by a collective agreement or, in companies without union representation, by a collective agreement or an act of accession.⁸⁰ For group level plans, it is sufficient that the company which first proposed the plan within the group concludes the collective agreement and the other companies consult with their employee representatives. Moreover, the bodies representing employees must

⁸⁰ Terms and conditions not prescribed by law can be introduced by the employer company upon consultation with the workers' council; in companies without a workers' council, with the committee for prevention and protection at work; in companies without such a committee, with the union delegation, and in companies without union representation, with all individual employees.

be informed of how the plan relates to the company's employment development and employment policies before the plan is introduced. Plans must include all employees, with the possible exception of employees with less than one year of service; different classes of employees may be treated differently under the plan if this is the industry-wide collective agreement or a Royal decree. Plans are generally voluntary, unless the collective agreement or the act of accession provide otherwise. The size of the plan is limited by a double ceiling: the total annual amount of transfers under the plan cannot exceed 10 per cent of the payroll and 20 per cent of the annual profit after taxes.

a) Share Ownership

Companies are allowed to acquire own shares up to 20 per cent of the equity capital for distribution amongst their own employees without decision of the general assembly (Art. 620 para. 1 (2), 609 para. 1 (3) Law on companies - CL). Shares acquired in this manner are not transferable for the period of five years (Art. 609 para. 1 (4) CL). Furthermore Art. 329 para. 2 (1) CL allows companies to advance funds, make loans, and provide security, with a view to acquisition of the company's shares by employees of the company within the limits of the value of distributable reserves, unless the company's net assets do not fall below level of issued share capital. A discount is limited to 20 per cent of the share price (Art. 609 para. 1 (3) CL).

Employees may be granted shares, share certificates or stock options under an employee share ownership plan. If the shares are held two to five years, the special tax of 15 per cent on the benefit (if shares are transferred free or at a discount) applies. The blocking period terminates earlier if the employee is dismissed, resigns for serious cause, retires or dies, or if the plan shares are publicly offered, if control of the company has been changed by the transaction, or if the employee is transferred to a non-affiliated company under the collective agreement 32bis. Shares sold during the blocking period are subject to an additional punitive tax of 23.29 per cent. Stock option plans are governed by a special law.

Share ownership plans – If restricted stock is granted free, the benefit can be taxed at grant or, if ownership is transferred later,⁸¹ at vesting. The tax base is the market value of publicly traded stock. If ownership is transferred later, the tax base is reduced to the market value less 20/120 (that is, 16.7 per cent) to compensate for market risk. On common stock granted free or at a discount, the taxable benefit corresponds to the fair market value of quoted shares or so-called net asset value⁸² of non-quoted shares. For quoted shares the tax base can be reduced to 100/120 (that is 83.33 per cent) under certain conditions.⁸³ The employer company can deduct the discount from the tax base of the corporate income tax if the stock is purchased and sold by a foreign company which charges the discount back to a Belgian company. If a Belgian company purchases and sells the stock,

⁸¹ A criterion of a later ownership transfer is that no dividends are paid to the employee during the blocking period.

⁸² The net asset value defined as the amount of company net equity and reserves divided by the total number of shares.

⁸³ For example, if the company grants a 'substantial' number of discounted shares and the purchase of the shares on the stock market may be expected to result in a drop in price or a two-year blocking period applies.

the deduction is subject to debate: if the discount is regarded as capital loss, it is not deductible, but if it is regarded as personnel costs, it can be deductible. However, it is probable that the tax authorities will generally favour the more restrictive option.

Stock option plans – Stock option plans to which tax incentives apply are governed by the Law on Incentives for Stock Options of 26 May 1999. This law applies to stock options granted as of 1 January 1999. Stock options are taxed at grant. If the employee does not notify the tax authority within 60 days after grant, the option is considered refused.⁸⁴ Since employee stock options are usually not tradable, the tax base is generally a lump sum value equal to 15 per cent of the underlying stock value at grant plus one percent for each year or part of the year beyond the initial five years from grant to expiration. The following conditions apply: The tax base can be reduced by half (that is, to 7.5 per cent plus 0.5 per cent for each year or part of the year) if options cannot be exercised until three years from the date of issue; the exercise period does not extend beyond the tenth year following the year of issue; the options are transferable only upon death of the employee; the underlying shares are of the employer company, its parent or grandparent company; no guarantee was issued by the employer company or an affiliated company against fall in value of the underlying share after its grant; the strike price was determined at the time of offer. No compulsory social security contributions are to be paid on the lump sum benefit. Stock option plans and the prospectus must be approved by the Bank and Finance Commission prior to the introduction.

b) Profit-Sharing

Profit-sharing plans are usually cash-based. For small enterprises, defined in the Company Code, the so-called investments savings plan was introduced by the Law on Promotion of Employee Participation of 22 May 2001. Under these, an employee immediately loans his share of the annual profit to the company; the loan must be repaid within two to five years with interest. Tax incentives and pre-conditions for interruption of the blocking period for these plans are the same as for share ownership plans. All profit-sharing plans are subject to special tax rates on the attributed profit share minus the general rate of the social security contribution: 15 per cent for investment savings plans and 25 per cent for other profit-sharing plans. The employer company cannot deduct the profit attributed to employees from its corporate income tax base.

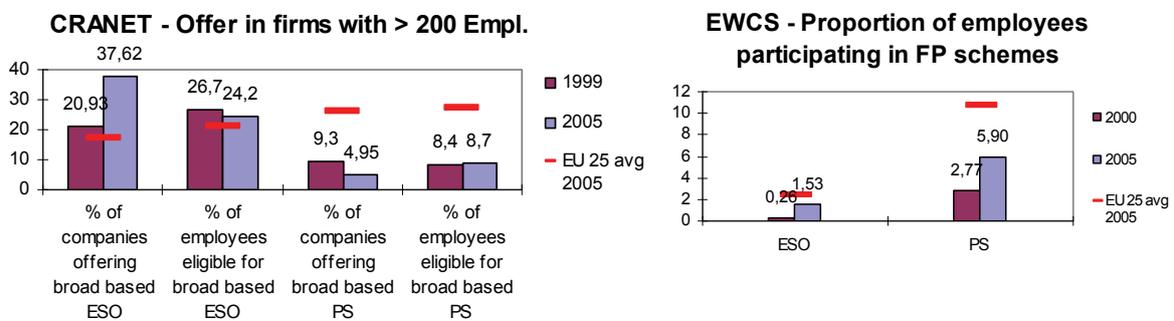
c) Participation in Decision-Making

Participation in decision-making has no connection with financial participation; financial participation plans are specifically forbidden to extend existing decision-making rights. However, the plan can only be introduced when a collective agreement or an act of accession and consultation with employees' representatives is prescribed for the remaining part of the plan so that terms and conditions are negotiated with employees' representatives; thus some elements of participation in decision-making may be included in the financial participation plan.

⁸⁴ Until 24 December 2002 it was considered as acceptance of the stock option.

II. Bulgaria

The development of PEPPER schemes in Bulgaria has been influenced by both the historical commitment to a strong co-operative movement⁸⁵ and the special circumstances accompanying the transition to a market economy. The main form of employee financial participation became employee share ownership, with the voucher system being the preferred privatisation method at the beginning of transition in 1992-1994. The proportion of enterprises privatised this way initially was low, approximately 4-5 per cent, but then increased with the management-employee buyout (MEBO) method gaining support from 1994 until 2000.⁸⁶ Close to half of the enterprises were privatised by insiders, but employee ownership has decreased over time. Although no data on the sales of shares by employees after privatisation are available, it can be fairly estimated that about 10 per cent of enterprises privatised by MEBO may still be under majority employee ownership. According to the Centre for Mass Privatisation, at the close of mass privatisation in 1998 shares were distributed as follows: 40.8 per cent state property; 6.4 per cent employees; 12.9 per cent individual shareholders, and 39.9 per cent privatisation funds. Later however, frequently employees' shares were transferred to managers and outside owners. Profit-sharing has developed only very recently, as the private sector began to stabilise and human capital became a major factor in company success.



1. General Attitude

Three trade union organisations are recognised at the national level: the Confederation of Independent Trade Unions in Bulgaria (CITUB), the Confederation of Labour Podkrepa, and Promiana. From early transition on, CITUB has been in favour of developing finan-

⁸⁵ The percentage of co-operations among industrial enterprises ranged from 8.5 per cent to 10.4 per cent between 1980 and 1988. The corresponding numbers for personnel was 6.8 per cent and 6.7 per cent. Source: NSI.

⁸⁶ 1,436 or 28 per cent of 5,165 deals (Minchev, 2004, pp. 55-57).

cial participation; its leader, Kastriot Petkov, has written books on the subject, including concrete proposals on helping workers get more involved in the capital, profits and decisions of their company. The transition period brought about a significant change in the power relationship between social partners. In the beginning, trade unions dominated the social dialogue. The end of the privatisation process however saw union power and influence drastically decrease. In recent years, the employers' associations have grown more powerful than trade unions. Until 2005, employers were represented by six national associations, which currently do not consider employee financial participation an important issue in either policy or practice.

The 39th Bulgarian Parliament which vested power in the national government under Prime Minister Simeon Saksoburggotski (2001-05) did show interest in questions relating to financial and decision-making participation of employees. Under the guidance of Prof. Dr. Ognyan Gerdzhiyov, then President of Parliament, a comparative legal survey on national solutions within the European Union and some adjacent states was conducted. The survey, focussing on joint-stock companies, identified a number of national regulatory mechanisms and possibly contributed to the popularity of the ideas behind them. However, the survey resulted in no relevant act of law. The new government (as of 2005), under Prime Minister Sergey Stanishev, is sceptical of financial participation. Further, this issue has not been on the political agenda of Parliament nor has any political party currently addressed it.

2. Legal and Fiscal Framework

Although no specific legal regulation applies to any PEPPER scheme, the legal framework provides neither incentives nor restrictions concerning employee financial participation.

a) Share Ownership

Privatisation (1992, 1997, abolished in 2002) – Under the Law on the Reorganisation and Privatisation of State and Municipal Enterprises of 7 May 1992 (LRP), employees with Bulgarian citizenship and permanent residency in Bulgaria prior to 2002 were entitled to preferential (free or discount) share acquisition. In voucher (mass) privatisation, each eligible individual could obtain free shares, with the total value of free shares distributed not exceeding 10 per cent of the nominal stock of the target entity. This privilege was abolished in 1998 when voucher privatisation was virtually abandoned. Under the stock-sales method, eligible individuals were entitled to acquire up to 20 per cent of the nominal stock at 50 per cent of the assessed price. This privilege was abolished in January 2002. The share acquisition itself had no tax relevance, subsequently, dividends received were subject to the general rule on dividend taxation. Furthermore, the LRP regulated so called '*MEBO-company*' ('rabotničesko-medidžarsko družestvo'), a legal entity established by a minimum of 20-30 per cent of an enterprises employees for the sole purpose of participating in the privatisation process. A general incentive for a MEBO-company was the permission to maintain stock of only 10 per cent of the minimum stock generally required

for stock corporations or limited liability companies and the VAT exemption of the privatisation deal. Further incentives subject to specific conditions were a 100 per cent profit tax exemption for three years after privatisation and 50 per cent for the following two years, payment privileges, and immediate transfer of property in the case of enterprises of minor value. Thus, an MEBO company had significant advantages, especially an acquisition price about 36 per cent less than for other buyers, until these were abolished in March 2000.⁸⁷

The effective Law on Privatisation and Post-Privatisation Control of 19 March 2002 (Art. 7) states as a general principle of Privatisation Law the equality of privatisation candidates. The law gives no privileges based on the status of applicants. In particular, there are no provisions favouring employees. Current privatisation legislation negates the former LRP which provided a number of preferential measures to facilitate employee participation. These were intended to narrow the social gap between capital owners and the labour force – a gap that the liberalisation of the Bulgarian economy opened during the post-communist era.

Private Companies – Commercial Law (hereinafter CL) and company law in general contain no specific regulations pertaining to employee share ownership.

b) Profit-Sharing

Bulgarian employers do not usually link employee bonuses to the company's financial success. While not forbidden, employers generally derive no benefits from such schemes under Bulgarian tax law. However, under Bulgarian Law it is possible to offer profit-sharing contracts on an individual basis.⁸⁸ These may be cash-based or share-based.

c) Participation in Decision-Making

In the majority of cases employee ownership did not lead to participation in management. Currently, most employees are minority shareholders without notable influence. The rights of employees to participate in decision-making under the Labour Code are extremely limited and have no significant influence on management. While the workers' meeting composed of all employees of a given business once accounted for more than 20 sections⁸⁹ of the socialist version of the Labour Code, only two relevant provisions are presently in force. These empower the workers' meeting to choose between two or more drafts of a collective bargaining agreement when the trade union organisations at the enterprise level cannot agree on a single version (Art. 51a (3) Labour Code). Also, the workers' meeting can decide the disposition of the company's social fund (Art. 293 (1) Labour Code). The employer, however, is not obliged to establish such a fund. The Commercial

⁸⁷ See Ivanova and Keremidchiev (2006), p. 29, according to the calculations of the authors.

⁸⁸ Joint-stock company offers of any of these incentives to a Council or Board member, must be approved by the general meeting for every beneficiary on an annual basis.

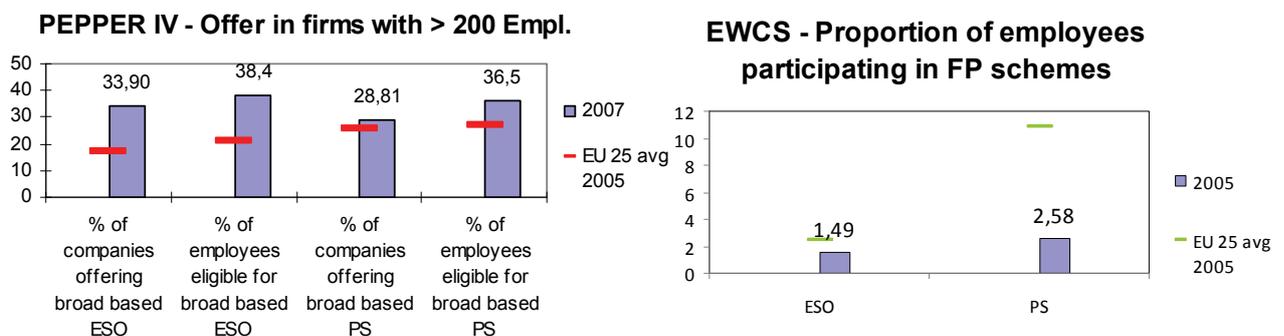
⁸⁹ The Articles 12-32 Labour Code were abolished in 1992.

Law provides that an employees' representative must be chosen in corporations⁹⁰ employing more than fifty persons. This representative must be given an advisory vote at the shareholders' meeting. The company is under no obligation to recognise more than one representative as its work force grows. Also, the number of employees has no effect on the form or the force of employee representation. Thus the Commercial Law establishes a model friendly to the employer.

⁹⁰ Commercial Law: Art. 136 (3) (for limited liability company), Art. 220 (3) (for joint-stock company) and Art. 253 (2) (for a partnership limited by shares).

III. Croatia

Despite the fact that the economic and political system of Croatia, while a part of the former Yugoslavia, was based on employee participation for more than 40 years, its role today is relatively minor. Employee stock ownership created in the early stages of privatisation is steadily diminishing; the position of employees, previously strong, has weakened. By 1995, small shareholders owned (bought or subscribed to) about 20 per cent of the nominal value of the enterprises privatised during this first stage. During the second (1995-1999) and third (1999-2002) stages of privatisation, support for employee participation ceased and employee ownership began to decline, falling to only 12 per cent in 1998; the decline continues up to the present moment, and there is little public support for measures which would reverse it. ESOP models, defined as any organised programme involving large numbers of employees as shareholders in the employer company, is almost the only form of employee financial participation to be developed and to gain momentum after privatisation; still, ESOPs are not widely diffused and lack broad support. In a study from late 2003, 'organised programmes of larger involvement of employees in the enterprise ownership' were found in 9.4 per cent of enterprises (52 out of the 552 total surveyed) (Tipurčić et al., 2004)⁹¹. Employees owned 10 per cent of shares in 68 per cent of enterprises reporting; in only 5 per cent of firms did employees own more than 90 per cent. Employees held a majority share (over 50 per cent) in 12 per cent of enterprises (see also Lowitzsch, 2006, pp. 118 f., 123: Table 1). Profit-sharing is rare; there is no mention of it in legislation, legal documents or collective agreements.



⁹¹ In many cases analysed in the study, ESOP programmes were stopped or completed, and some programmes had only a few ESOP characteristics in their design.

1. General Attitude

Trade unions had no part in the design of privatisation models, nor did they promote a stronger position for employees.⁹² Not until the first two stages of privatisation had been completed did some unions and union leaders begin to advocate employee ownership as a means of privatising remaining state-owned assets, as well as for restructuring distressed enterprises, and to propose models for doing this. Employees are represented by numerous trade unions organised at different levels for various purposes. Employers, represented by the Croatian Association of Employers, have a stronger position in most issues involving the interests of employers and employees. The fact that employers are represented by a single organisation and employees by many only partly explains this disparity in power. On the issue of employee financial participation, employers and their organisation remain publicly non-committed, neither positively in favour nor adamantly opposed.

Croatian governments did not support employee privatisation beyond the first stage. While this policy was entirely consistent with the ideological orientation of the right-wing governments in power during the first decade of transition, it is less easy to explain why the Social Democratic governments, in office from 2000-2004, made virtually no changes in the area of employee participation. Nor has the present government shown any serious intention of introducing measures to promote, or at least to regulate, employee financial participation. Some business spokesmen, representing firms that already have employee ownership in some form, have publicly advocated greater employee participation in the privatisation of the remaining state shares. They have also requested clearer regulation and support of existing schemes. Although these requests are currently being discussed, definitive feedback by either the government or political parties is still pending.

2. Legal and Fiscal Framework

Employee financial participation is at present not explicitly regulated. Privatisation legislation in the past, however, has supported employee share ownership. Various schemes of financial participation, including profit-sharing and ESOPs⁹³, occur in individual firms despite the absence of state regulation. Amendments to the Privatisation Law, now being drafted, are expected to bring ESOPs into the regulatory fold.

⁹² The Statute of Parliament 2000 authorises the social partners to participate in the work of Parliamentary committees, thus giving them direct influence over the drafting of laws dealing with such matters as employment and industrial relations.

⁹³ In this context, the term ESOP is applicable to all schemes where employees make an offer to buy shares of the company, the purchase is funded by special credit, and a new company is formed in order to administer the shares.

a) Share Ownership

Privatisation (1991, 1996) – The Croatian Law on the Transformation of Enterprises Under Social Ownership 1991 (Transformation Law) gave employees, including managers and former employees, the right to buy shares at a discount proportional to their years of employment, starting at 20 per cent and adding one percent for every working year up to a maximum of 60 per cent. Employees who paid for their shares in cash were given an additional discount of 10 per cent. Payment could also be made in instalments spread over five (later prolonged to 20) years. After having paid five percent of the total price, the employee received all his or her discounted shares outright. Amendments to this Law in 1993 entitled employees to buy no more than 50 per cent of total shares with a value not to exceed Euro 1 million. One third of the remaining shares were transferred to state pension funds and two-thirds to the state Privatisation Fund to be publicly tendered at market value.

After most enterprises had been privatised in 1996, a new act, the Privatisation Law (PL), was adopted, which provided no special provisions or preferential conditions to employees.⁹⁴ The Transformation Law, however, was not repealed, and after 1996, some enterprises were still utilising it. In companies where small shareholders owned a significant amount of stock, so-called small shareholder associations were established. Although these did not take the form of registered associations and their membership was unstable, they did gain some influence in some enterprises because of a close relationship with trade unions.

Since privatisation was partly reversed in 1999, many shares of state enterprises still remain to be privatised. After the bankruptcy of 22.2 per cent of all privatised firms, the remaining assets were transferred back to the state Privatisation Fund. By 1999, 379,030 out of 641,152 sales contracts of employees who were buying discounted shares in instalments were in default. Recognising that the objectives of privatisation had not been achieved, a new law, the Law on Revision and Transformation and Privatisation, went into effect on 16 May 2005. The privatisation of 1,556 enterprises was investigated under this law; procedural irregularities were discovered in all but 75.

Private Companies (2003) – According to Art. 233 (2) of the new Company Law from 2003 (CL), a company can issue special employee stock with a value not exceeding 10 per cent of registered capital. Employee shares are non-voting until fully paid for. Further, Art. 313 CL stipulates a ‘conditional capital increase’ for the purpose of fulfilling the employee acquisition right. In order to facilitate employee acquisition, Art. 234 CL exempts the company from the general prohibition against borrowing in order to acquire its own stock. This exemption is granted on condition that a reserve is created so as not to endanger equity capital by the sale of shares to employees. Since employees, including those who became shareholders during the course of privatisation, are usually minority shareholders, provisions protecting this class are also relevant.⁹⁵

⁹⁴ Instead vouchers were distributed to 230,000 persons who had suffered under the former socialist regime: refugees, displaced persons, war veterans, war invalids, families of dead or missing soldiers, and political prisoners; these, together with employees, made up the category of small shareholders.

⁹⁵ A three-quarters majority of votes representing equity capital is required to change the Articles of Association. Shareholders holding at least 10 per cent of the equity capital have a voice in decisions made by the General Meeting on liability of members of the Board of Directors or of the Supervisory Board

Draft Legislation (2006/2007) – Amendments to the PL are planned to provide several different schemes for selling shares to employees on preferential terms.⁹⁶ According to the present draft, the State Privatisation Fund would be authorised to sell shares to a joint-stock company on condition that the latter offer these shares to employees on the same or better terms. The ESOP model is an additional option. The management and employees of a joint-stock company could form a new ESOP limited liability company. The new company would take out a bank loan collateralised by the pledged shares and buy the shares from the Privatisation Fund in a single payment. If none of these schemes suit, the Privatisation Fund can sell shares directly to employees; shares thus acquired are voting shares. Enterprises that at the time of privatisation were not under social ownership but were administered by their managers and work force according to ‘rights to administer’ are a special case. They can transfer these rights back to the company, which, according to the draft, would increase the company’s capitalisation. The new shares created would be assigned to the Privatisation Fund, which would then offer them for sale to those employees who were with the company at the time of privatisation. Although the draft was withdrawn from Parliament in 2007, it is still referred to in the ongoing discussion.

b) Profit-Sharing

There is no legal regulation of profit-sharing and hence no incentives. Although individual enterprises offer monetary incentives, especially to managers, bonuses are usually not linked to company profit. They are regarded as wage compensation and taxed accordingly.

c) Participation in Decision-Making

Employees of a private company employing at least 20 regular employees have the right to a voice in decisions which affect their economic and social rights and interests, under conditions and procedures prescribed by the Labour Law. Employees of such companies are entitled to elect one or more representatives to the employees’ council by means of a free, direct and secret ballot. The function of the council is to protect and promote the interests of employees vis à vis the employer. If no employee’s council has been established, the trade union assumes its powers. According to Art. 158 of the Labour Law, at least one employee representative is to be a member of the Supervisory Board in companies employing an annual average of more than 200; also in companies which are public institutions, or in which the state owns at least 25 per cent of shares. It should be noted that this provision conflicts with a company law regulation on the establishment of a supervisory board.

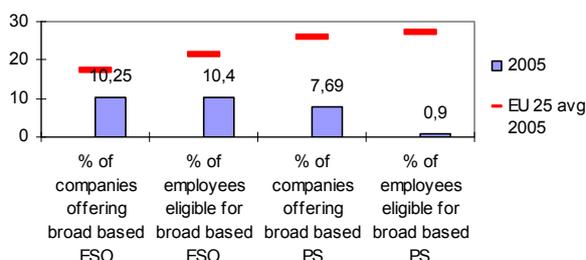
(Art. 273 CL); they can also lodge a claim at court to remove a board member for cause. Shareholders owning at least 5 per cent of shares can call the general meeting. A majority shareholder who holds at least 95 per cent of total shares can buyout minority shareholders, at fair compensation, if the general meeting so resolves (Art. 300 CL).

⁹⁶ The draft law is prepared by the legislative committee of Parliament in the course of harmonisation with the EU law and is supported by trade unions and employers’ associations; see the website of the Parliament <<http://www.sabor.hr/default.asp?mode=1&gl=200309170000001&jezik=1&sid=>>, Login: 12 December 2005 (in Croatian).

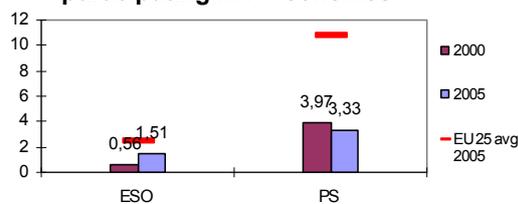
IV. Cyprus

Neither employee ownership nor profit-sharing have a significant extend in Cyprus. The country has developed financial institutions, with more than 50 per cent of households holding shares as financial assets, as well as a co-operative sector in which more than 50 per cent of the population are members. The industrial relations system is based largely on voluntary regulations that allow room for joint initiatives; it has at the same time a relatively high number of unions. Nevertheless, employee participation, either financial or in decision-making, does not appear on the agenda of either the government or social partners.

CRANET - Offer in firms with > 200 Empl.



EWCS - Proportion of employees participating in FP schemes



1. General Attitude

The long tradition of tight regulation of financial markets, capital controls, and limited financial assets available to households underwent change in the mid-1990s. A modern capital market has evolved through the Cyprus Stock Exchange (CSE), which officially launched operations in March 1996. Nevertheless, the boom and crisis of the CSE left the public sceptical of the financial markets.⁹⁷ With respect to the average size of enterprises, in 2000 only 70 companies in Cyprus employed more that 250 employees.⁹⁸ Self-employment is a permanent feature, with self-employed persons accounting for 20 per cent of the active labour force.⁹⁹ Voluntarism has been developed through the Industrial

⁹⁷ By October 2001, the market was approaching the 100 level, having fallen from 800 at the peak of a short-lived boom in 1999. During 2002/03 the market continued a long-term decline, reaching a level of 80 in late 2003.

⁹⁸ 58 per cent of the enterprises employed one person; 37 per cent two to nine persons; 4 per cent ten to 49 persons, and only 1 per cent had more than 50 employees (this amounts to 99.9 per cent), see Census of Enterprises 2000 (CYSTAT, 2001).

⁹⁹ It has also been observed that salary and wage earners undertake small-scale entrepreneurial activity, and are thus 'multiple jobholders' - especially with regard to the development of the services sector.

Relations Code and operates via National Tripartite Bodies, among them the Labour Advisory Board, dealing with the main issues of industrial relations, and an equally important Economic Advisory Committee, dealing with economic policy issues.

Trade Unions are mainly organised at the industry level and belong to strong federations or confederations, the most important being the Cyprus Workers Confederation (SEK, affiliated with the ETUC) the Pancyprian Federation of Labour (PEO), and the Democratic Labour Federation (DEOK). Employers are also organised into industry or branch level associations, most of which are members of the Cyprus Employers' and Industrialists' Federation and the Cyprus Chamber of Commerce and Industry. During the 1990s, only SEK initiated a stance in favour of employee representatives' participation in decision-making through participation of labour representatives at the board level of public and semi-public sector institutions and organisations; this effort met no success. While the social partners shape the evolution of industrial relations, employee financial participation has not been an issue on their agendas.

Government economic policy in the last decade has not embraced the idea of financial participation of employees, favouring voluntary arrangements in industrial relations instead. The current government, which took office in February 2008 for a five-year mandate, is unlikely to usher in any changes in relation to this issue. The process of harmonising national and European law has recently led to debates concerning the evolution of the voluntary system of industrial relations, but issues of employee financial participation have been left untouched.

2. Legal and Fiscal Framework

The Cypriot legal system is based upon the same principles as those of the United Kingdom; all laws regulating business matters and procedures are based essentially on English Common Law.¹⁰⁰ The institutional and legal framework generally does not, at least intentionally, create incentives for the development of PEPPER schemes, but neither do they prevent it.

a) Share Ownership

Registered companies in Cyprus are mainly governed by the Cyprus Company's Law (hereinafter referred to as CL), Chapter 113 of the Laws of Cyprus, as amended, which is identical to the UK's former Companies Act 1948. Under the CL, companies can be divided into companies limited by shares¹⁰¹ and companies limited by guarantee¹⁰². There is

¹⁰⁰ English case law is cited in the Cypriot Courts and is of persuasive authority.

¹⁰¹ Private companies limited by shares are those whose articles restrict the right to transfer their shares, limit the number of their member to 50 and prohibit any public subscription to shares or debentures. A public company limited by shares is one whose Articles do not contain these restrictions and thus may obtain a listing on the Cyprus Stock exchange.

no law in Cyprus on share option schemes for employees, but these may be included in private employment contracts or given to employees as part of an incentive scheme. The CL does not contain special rules on employee profit-sharing and contains only a mere notion of employee share ownership: The provisions of the Second Council Directive 77/91/EEC of 13 December 1976 were adopted by national legislation and specifically in the CL. Therefore, an exception to the general prohibition against acquiring its own stock, Art. 57a CL permits a company to acquire its own shares without a special resolution of the general shareholders assembly if the shares are acquired for the purpose of being transferred to the company's employees or to the employees of an associate company. In order to facilitate the acquisition of shares by employees, Art. 53 CL permits the company to advance funds, and make or secure loans, with a view to acquisition by employees of the company or employees of an associate company.

b) Profit-Sharing

There is no explicit law or regulation in the Cypriot legal system that prohibits companies from sharing profits with their employees. More general, companies may agree to implement bonus schemes with their employees according to their performance or for percentages (commissions) according to the sales made by their department.

c) Participation in Decision-Making

The Companies Law does not contain any special provisions concerning employee participation in control and decision-making bodies in companies. In state and semi-state companies, where government has the prerogative of appointing the persons to serve on the administrative boards, it is customary that some high-level trade union officials from the largest unions are selected to serve as members.¹⁰³ As the Cypriot system of employee representation is the single-channel system, there are no special elected works councils operating in Cyprus; rather information and consultation is conducted with trade union representatives. Information and consultation is also provided for under the provisions of the Industrial Relations Code in a range of cases, including when redundancies are to take place.¹⁰⁴ Though a non-legally binding document, this code has generally enjoyed a very high degree of compliance since its signing in 1977.

¹⁰² In the majority of cases, companies of this nature are incorporated as non-profit making organisations. Companies limited by guarantee can be registered with or without share capital and the liability of each member is limited to the amount agreed on in the memorandum of association to be contributed in the event of the company going into liquidation.

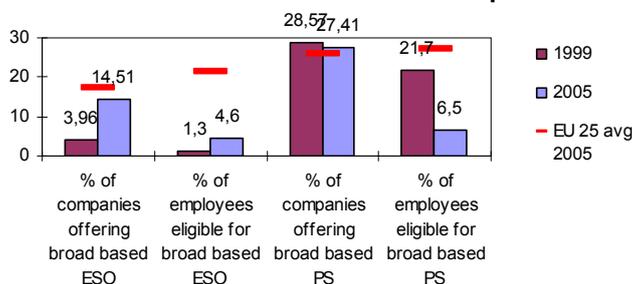
¹⁰³ The implementation of Directive 2001/86/EC supplementing the Statute for a European Company with regard to the involvement of employees, as well as of Directive 2003/72/EC, supplementing the Statute for a European Cooperative Society with regard to the involvement of employees and of Directive 2005/56/EC, on cross-border mergers of limited liability companies have introduced provisions on employee participation in supervisory or administrative organs in line with the provisions of the aforementioned directives. Laws implementing the Directives on Information and Consultation of employees and on European Works Councils provide for the right to information and consultation of employees' representatives in local and Community-wide establishments, respectively.

¹⁰⁴ This case is also covered under the provisions of the 28 (I)/2001, implementing Directive 98/59/EC.

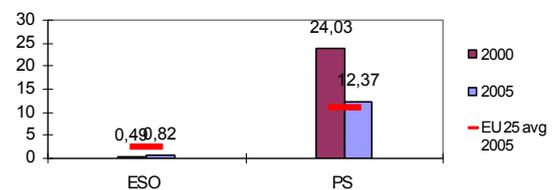
V. Czech Republic

The country whose privatisation policy has granted by far the fewest concessions to insiders is the Czech Republic. Despite some tradition of both financial participation of employees and employee participation in decision-making, the Czech privatisation framework did not include any special price reductions, credit arrangements, or pre-emptive rights for employees. Czech policy opted for the voucher concept, with no specific schemes for employees. After the split with Slovakia in 1993, the corporate governance and enterprise structures were – and remain – unfavourable to employee participation in general. Out of 1,688 state enterprises privatised into joint-stock companies, 480 proposed and received approval to issue part of their shares as employee shares, but only 171 of these eventually gave shares to their employees. Employee share ownership remained insignificant, representing only 0.31 per cent of privatised assets. Under voucher privatisation, about 1.5 per cent of the total shares were allocated to employees. Currently, profit-sharing plans are rare; most are found in foreign companies. Of the existing, rather restrictive, regulations on employee share ownership and (share-based) profit-sharing, only the former have been implemented, although to a very limited extent.

CRANET - Offer in firms with > 200 Empl.



EWCS - Proportion of employees participating in FP schemes



1. General Attitude

Trade unions, for example ČMKOSs, do not actively promote employee participation, nor do they plan to do so in future. After the outcome of voucher privatisation, public confidence in share ownership and similar programmes is slight or non-existent. Trade unions see employee financial participation in the near future as extremely limited in both scale and scope. A similar view is held by the Czech Association of Employers/Entrepreneurs SPČR: they have taken no official stand on employee participation models and neither have nor seek to acquire data on its practice by their members. While participation in decision-making – as part of the *acquis communautaire* – has been put on the agenda of tripartite negotiations, financial participation of employees has not. Today employee participa-

tion is no longer a political issue; none of the democratic parliamentary political parties includes it in their programmes. It was last a political issue at the end of the 1990s, when Social Democratic Prime Minister Miloš Zeman tried to move employee financial participation forward on the agenda. Since then, politicians have remained silent on the issue.

2. Legal and Fiscal Framework

Unlike some countries, the Czech legal framework contains no specific employee financial participation measure or regulation of any specific issue pertaining to PEPPER schemes. The only forms of corporate ownership the law makes available to employees are share acquisition and profit-sharing in joint-stock companies, and these only to a limited extent.

a) Share Ownership

Privatisation (1990) – Mass privatisation made employee share ownership possible in principle. Each company on the mass privatisation list had to submit a privatisation plan. This proposal could include any combination of available privatisation methods (for example, voucher scheme, domestic direct sale, foreign direct sale, public auction or tender, free transfer, or employee shares). It was possible for others besides company management to submit a competing privatisation plan for all or part of each enterprise. The supervising ministry and the Ministry of Privatisation decided on the winning project (foreign sales had to be approved by the government). Finally voucher privatisation itself provided an alternative way of creating employee ownership within the privatisation process. Nevertheless, in these programs, a small proportion of shares was offered to and reserved for employees.

Private Companies (2000, 2004) – In 2000, Art. 158 of the Commercial Code (CC) was revised in line with the *aquis communautaire* to abolish any type of special share; it also eliminated ‘employee shares’ as a special type of share. Instead, from then on, joint-stock companies could amend to their Articles of Association to allow their employees to buy company shares at a discount. Previously issued ‘employee shares’ had to be converted into regular shares by decision of the general shareholders assembly by January 2003. Since dissenting shareholders must be bought out in a public offering according to Art. 186a para. 3 ff. CC, employed shareholders were given the de facto opportunity to cash-out their shares. Acquisition of shares on preferential conditions according to Art. 158 CC is limited to current or retired employees.

As an exception to the general prohibition against acquiring its own stock, Art. 161a para. 3 CC, introduced in 2004, permits a company to acquire its own shares in order to sell them, in accordance with the Articles of Association, to employees of the company. In such case the shares must be transferred on preferential conditions to the employees within twelve months of acquisition. If the transfer is not carried out within the stipulated time period, Art. 161c CC requires that the shares be sold or the share capital be decreased accordingly; if the company does not comply, a court can order its liquidation (Art. 161c para. 2 CC). Furthermore, current legislation permits joint-stock companies to

issue new shares granting employees favourable conditions in the context of so-called mixed capital increases, that is, the capital increase of a company issuing new stock financed by the company's own capital. According to Art. 209a para. 3 CC, 50 per cent of the purchase price must be paid before the capital increase is registered in the commercial register, while the remaining 50 per cent may be paid for in instalments. According to Art. 203 para. 3, 209 para. 2 lit. d) CC, shares issued to be acquired by employees shall not be considered a public offering, provided that the designated employees shall have been identified in the decision of the general shareholders assembly on the capital increase.

In order to facilitate the acquisition of shares by employees, the legislation further permits the company to fully pay for the stock acquired by its own employees. The restrictions on the preferential conditions for the purchase of shares by employees are enumerated in Art. 158 para. 2 CC. As in the previous regulation, the overall value of the granted discount for the issued shares may not exceed 5 per cent of the enterprise's equity capital and must be covered by the company's own resources. In addition, Art. 161e para. 3 of the Czech Commercial Code contains a regulation excepting a company from the general prohibition against leveraging the acquisition of its own stock if these shares are to be sold, in accordance with the Articles of Association, to its own employees. Thus share acquisition by the employees of a particular company may be leveraged by the company's discounting the purchase price within the aforementioned limits, by credit financing, by providing collateral, or by a combination of these three preferential methods.

b) Profit-Sharing

Nothing in the Czech legal system prohibits profit-sharing. The only explicit regulation is Art. 178 para. 4 of the Commercial Code which states that in accordance with the Articles of Association employees may be entitled to a share of company profit (cash-based profit-sharing). According to Art. 158 CC, the Articles of Association may also stipulate that profits allocated to employees be used exclusively to purchase shares on preferential conditions or to offset the discount granted to employees for this purpose (share-based profit-sharing). Share-based profit-sharing is also mentioned in the context of capital increases. A capital increase generally requires the approval of the general shareholders assembly. However, Art. 210 CC, in accordance with the Articles of Association, assumes that this decision will be delegated to the management board. Art. 210 para. 4 CC regulates a capital increase by the issuance of shares to be transferred on preferential terms to employees. It emphasises that this option is especially suitable in cases where the general shareholders assembly has previously directed that profits allocated to employees be used exclusively to purchase these shares. These benefits are all taxable at the progressive personal income rate of 15 to 32 per cent. Therefore as personal income rises, the incentive to provide additional benefits progressively decreases. Benefits from profit-sharing, for example, may be as much as 17 per cent less than the same amount in dividends paid to shareholders.

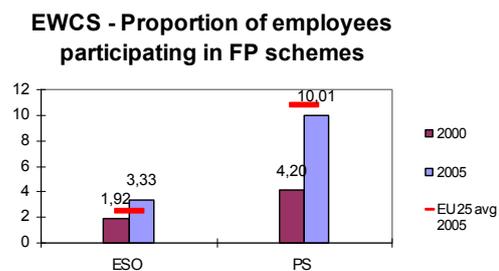
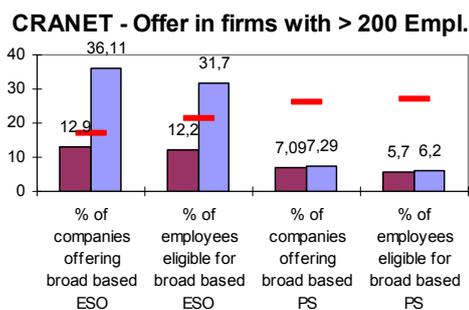
c) Participation in Decision-Making

Art. 200 CC requires joint-stock companies with more than 50 employees to have one-third of its supervisory board composed of employee-delegated members. There are no special rules on employee participation in decision-making with respect to PEPPER

schemes or privatisation matters. According to Law No. 1/1992 Sb. on Wages, Remuneration for Work Readiness and Average Earnings, as amended, among the negotiable issues in collective bargaining agreements are the amount of and the conditions for providing incentive wages (bonuses, rewards, etc.), which includes participation in company profits. The main structure for representing employees at the workplace is the local trade union group, which needs only three individuals to set it up. Until 2001 this was the only structure; since then it has been possible to set up a works council in companies with more than 25 employees where there is no trade union organisation and where at least one third of the workforce requests such a body. Nevertheless the majority of companies have no representation at all. The most important level of collective bargaining in the Czech Republic is at the company level, although in many companies bargaining does not occur. Industry level agreements cover some industries, and following legal changes in 2005 these can again be extended more widely.

VI. Denmark

Employee financial participation began to be discussed at the end of the 1950s, in connection with an ideological debate on the concept of economic democracy and in response to the Swedish wage earner fund model. In 1987, the Liberal Conservative Government introduced the first tax incentives for certain forms of broad, voluntary, share-based plans at the enterprise level. Many firms implemented these plans with success. But then the issue of financial participation disappeared from the political agenda, remaining dormant until the beginning of the new century. In 2003, several new individual share-based plans as well as stock option plans were added. In 2005, these new plans were amended, in response to problems that had emerged in practice. All plans are based on employee shares or stock options.



The Tax Ministry now regularly reports to Parliament on the progress of employee share ownership. According to the 2005 report, the number of employees participating in the various plans and the corresponding asset values were as follows: broad share-based profit-sharing – 10,000 employees, DKK 163 million; broad profit-sharing based on stock options – 1,000 employees, DKK 10 million; individual stock option plan without limitations – 4,047 employees, DKK 388 million. According to the 2006 report, the newly introduced individual profit-sharing plans based on shares and stock options covered 1,326 employee participants in 77 enterprises. It should be noted that these numbers reflect the ‘flow’, that is, the number of additional plan participants/shares in the respective year. Data in absolute numbers were presented by the trade union Dansk Metal for 1999: an estimated 160,000 employees were shareholders in their companies, while 13 per cent of companies in high-growth industries and 25 per cent of all IT companies operated a share-based plan for their employees.

1. General Attitude

In the 1960s and 1970s, the Danish Trade Unions Federation and the Social Democratic Party submitted several proposals for compulsory collective funds, national and regional, in response to the wage earner fund (the Meidner Plan) of Sweden. These proposals were strongly opposed by both the Danish Employers Federation and the parties of the central and right political spectrum; they preferred tax incentives for voluntary plans at the enterprise level. At the same time the government wanted to introduce additional tax incentives for existing schemes, but failed to get its draft law through Parliament.

Employee financial participation remained a highly controversial political issue until the late 1980s. During the 1990s, little attention was paid to financial participation by either the government or social partners. Since the beginning of the present decade, the government has actively supported employee financial participation by introducing and adopting new individual share-based plans. Trade unions have been reported to be rather indifferent, while employers associations seem to be sceptical and reluctant to an extension of employee participation in general.

2. Legal and Fiscal Framework

The following employee financial participation plans are currently regulated: broad-based share-based profit-sharing plans, including stock options; broad-based share ownership plans; individual share-based profit-sharing plans, including stock options, and individual stock option plans without limitations.

a) Share Ownership

Employee Shares – Under the broad-based share ownership plan connected with tax incentives (§ 7A of the Tax Assessment Law), shares of the employer company can be offered at discount to all employees; special rules may apply according to length of employment, working hours or seniority. The plan may not include management (for example, members of the supervisory board). If the reduced price is paid in full at appropriation, the value of the shares does not exceed 10 per cent of the annual salary, and the shares are placed under bank trusteeship for five years, the employee is only liable to share income tax at sale while the employer company can deduct its costs from its corporate income tax base.

Stock Option Plan – The stock option plan under § 28 of the Tax Assessment Law is individual and may include members of the supervisory board. The number of options under this plan has no limits. However, it must be filed with the tax authorities. The employee is taxed at exercise of the option on the difference between the market price and the purchase price and again at the time of sale with the share income tax. The employer company can deduct the options cost from its corporate income tax base.

b) Profit-Sharing

Broad, share-based – These plans, linked to tax incentives (§ 7A of the Tax Assessment Law), introduced in 1987, are based on share or stock options. They must include all employees, although special rules may pertain to length of employment, working hours or seniority; they must exclude management, for example, members of the supervisory board. The plan must be approved by the tax authorities. If free shares are allotted within the plan, no tax need be paid by the employee at grant on total share values not exceeding DKK 8,000 (2006), and shares are placed in trust with a bank subject to a blocking period of seven years. In the case of stock options, the employee pays no tax at grant or exercise if the value does not exceed 10 per cent of annual salary and the shares are placed in trust with a bank for a blocking period of five years. According to the 2005 amendment, the obligation of the employee to return shares to the issuing company under certain circumstances is not an obstacle to tax exemption. In both cases, general taxation rules in force at the time the shares are sold apply: if the income from sale of shares does not exceed DKK 44,300 (2006), the tax rate is 28 per cent; otherwise 43 per cent. The employer company can deduct from its corporate income tax base the value of shares or options transferred to employees.

Individual, share-based – First introduced in 2003 under § 7H of the Tax Assessment Law, these plans are based on shares and/or stock options. Only employees are eligible, and members of the supervisory board excluded. The employer company and the employee must conclude an agreement which is to be endorsed by an auditor or attorney and submitted to the tax authorities. Only common stock can be allocated. Value of shares may not exceed 10 per cent of annual salary. Value of stock options should not exceed 10 per cent of the annual salary or the exercise price should be less than 15 per cent lower than the market price of underlying shares. This means that an employee is eligible for tax incentives if he acquires shares under the 10 per cent rule and, additionally, stock options under the 15 per cent rule, but not stock options under both rules. If the above pre-conditions are fulfilled, the employee is exempted from personal income tax and social security contributions at grant or exercise and is only liable to the share income tax at sale according to general taxation rules. However, the employer company cannot deduct costs from the tax base of the corporate income tax.

Cash-based – Plans are independent of tax incentives; their incidence is reputedly low.

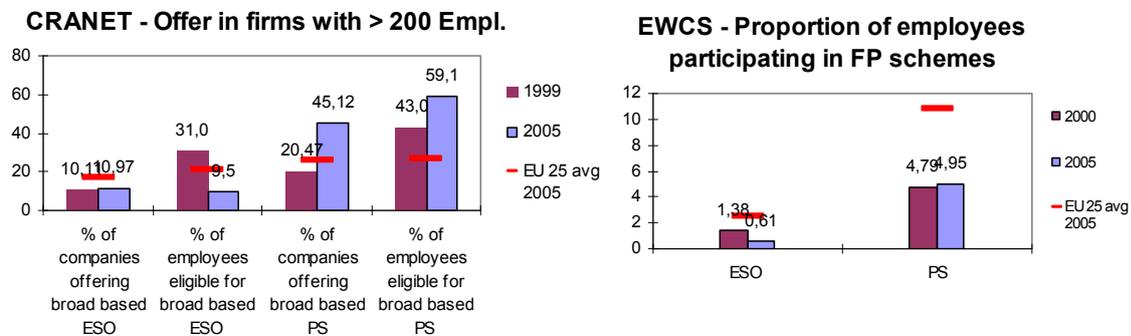
c) Participation in Decision-Making

No direct connection exists between participation in decision-making and employee financial participation. Financial participation plans are specifically enjoined from extending the existing rights in connection with participation in decision-making. Financial participation is generally not a part of collective bargaining agreements.

VII. Germany

Despite a long standing tradition and the general acknowledgement of the positive effects on both productivity and job creation, employee financial participation is not widespread. Traditionally German schemes focus on defined contribution savings plans with a total capital allocated much higher than that of all employee share plans; with regards to financial participation the combination of share ownership plans with these savings plans may be considered typical. Germany's lower standing in comparison to other countries and a recent decrease in employee share ownership may be attributed to insufficient government support. Another reason is the traditional skepticism of both trade unions and employers' associations towards employee financial participation.

Since 2007, a number of government officials as well as representatives of major political parties declared that employee financial participation should be better promoted in the future. Nevertheless, resulting from the substantial differences that divide the two member parties of the Grand Coalition the new 'Law on Capital Participation of Employees' which came into force in April 2009 merely increased existing insignificant fiscal incentives. Under the new Law and the Third Law on Asset Participation including previous provisions¹⁰⁵ these are only offered for employee share ownership, while profit-sharing is not supported by any tax incentives.



Although profit-sharing enjoys no tax incentives, it is more widespread than share ownership. In 2001, 8.7 per cent of enterprises were reported to have profit-sharing schemes, and 2.4 per cent share ownership schemes (Würz, ed., 2003, p. 59). In 2005, profit-sharing plans were operated by 9 per cent of enterprises according to the IAB company survey (Bellmann and Möller, 2006, p. 13)¹⁰⁶ and by 11 per cent according to the BISS project (Hauser-Ditz et al., 2006)¹⁰⁷; share ownership plans were implemented by 2 per cent of enterprises according to the IAB survey and by 3 per cent of enterprises according to the BISS survey. In 2006, 620 joint-stock companies maintained share ownership plans for

¹⁰⁵ The provisions of the Fifth Law on Asset Accumulation and § 19a Income Tax Law.

¹⁰⁶ Data based on questionnaires of 16,000 German companies.

¹⁰⁷ Data based on a representative survey of 3,254 German companies.

1,423,000 employees, and 250 limited liability companies for 8,000 employees; 17,000 employees of co-operatives had membership status (AGP/GIZ of 1 January 2007). According to the IAB company survey, profit-sharing plans are prevalingly implemented in companies with more than 500 employees (one third of all such companies) and in the mining, utilities, banking and insurance sectors (one quarter of all companies in the above sectors), whereas no relevant difference between the sectors exists as far as employee share ownership is concerned. Additionally, financial participation is much more widespread in Western German than in Eastern German companies, and in foreign companies located in Germany rather than in German-owned companies.

1. General Attitude

Regardless periodical discussions of the topic during the last 50 years, until recently, the attitude of the government and social partners towards employee financial participation has been - with some exceptions - generally indifferent or negative. After Federal President Horst Köhler endorsed employee financial participation in 2007, in response to his speech, the Federal Chancellor Angela Merkel and a number of politicians of the Grand Coalition announced to improve the legal framework. Nevertheless, the concepts of the members of the Grand Coalition remained contradicting¹⁰⁸ and – with new Law on Capital Participation of Employees that passed parliament on 23 January 2009 – resulted in a modest compromise leaving far behind previous ambitious plans for reform.

Trade unions continue to exercise strong political power through workers' codetermination, despite declining union membership. With some exceptions, until recently the majority of the Unions feared decentralisation and de-solidarisation of the wage policy along with a general loss of power. As an argument against profit-sharing, they cite the risk that employers could calculate a decrease in the amount of profit to the detriment of employees. Employee share ownership, they argue further, imposes on employees the risk of losing both jobs and share income. Profit-dependent wage components are usually accepted only as auxiliary earnings in good times, while participation in loss is refused. In the context of the financial crisis employee share ownership as a partial substitute for wages or in combination with wage reductions is now under consideration. Recently the employers' associations have paid more attention to employee financial participation. They generally favour voluntary company-level plans and share plans over profit-sharing.

¹⁰⁸ The Christian Democrats proposed to support voluntary schemes at the company level by introducing additional tax incentives for share schemes up to Euro 1,000 per employee annually with the possibility to defer taxation if connected to a retirement savings plan. The Social Democrats favoured a 'Germany Fund' under state guarantee with employees investing in the fund, that in turn would invest in German enterprises, especially SMEs.

2. Legal and Fiscal Framework

German legislation permits both, share ownership and profit-sharing, while no fiscal or other incentives are available for the latter. Asset formation or savings plans offer a vehicle to allocate and invest sums received as salary or as remuneration in financial participation schemes. In this context share schemes can be combined with such savings plans and, to promote asset formation of employees, the employee contributions may be matched by the state. The 2009 Law on Capital Participation of Employees did not change the incentive system under § 19a of the Income Tax Law and the Fifth Law on Asset Formation, but merely increased the amounts, percentages and income ceilings: With regard to an employer allowance the ceiling of the value of the tax free benefit from free or reduced shares from Euro 135 to Euro 360 annually; the absolute limit of the savings bonus matching employee investments of up to 400 Euro from 18 per cent to 20 per cent (that is, a maximum bonus of Euro 80 annually as compared with a maximum of Euro 72 previously); and the income ceiling for eligibility of the bonus from Euro 17,900 to Euro 20,000 annually, which is still exceptionally low. As previously a blocking period of six years applies.

a) Share Ownership

Share ownership is mostly practiced in joint-stock companies (Aktiengesellschaft) due to special features of German company law. In commercial partnerships (OHG, KG), the concept of co-ownership and thus co-entrepreneurship on the one hand and the inflexible transferability of the legal position of a partner on the other preclude the development of employee share ownership. In limited liability companies (GmbH), employee share ownership is rare because of specific legal obstacles, for example, the relatively strong position of a shareholder vis-à-vis management, the transfer of share ownership only by notarial deed. However, a partnership that serves to facilitate employee financial participation in a limited liability company and holds a share of this limited liability company as its sole asset (holding-GbR), is not required to make a notarial deed to transfer its shares.¹⁰⁹

Employee Shares – In joint-stock companies, stock can be distributed to employees in connection with the acquisition of the firm's own shares or with a capital increase. With regard to the acquisition of the firm's own shares with a view to the transfer to its (former) employees or employees of affiliated firms (§ 71 para. 1 no. 8 Law on Joint-Stock Companies (JSCL)) a decision of the General Assembly is not necessary provided that the shares are transferred within 12 months; prerequisite is a reserve fund for own shares to be established without reducing equity capital or reserve funds (§ 71 para. 2 sentence 2 JSCL, § 272 para. 4 Commercial Code (CC)). The company may advance funds, make loans, provide security in order to facilitate the acquisition of the shares by the employees (*financial assistance*, § 71a para. 1 sentence 2 JSCL). With regard to capital increase the law provides for a conditional capital increase (§§ 192 et seq. JSCL) and a capital increase by authorised capital (§§ 202 et seq. JSCL). In both cases a General Assembly's decision is necessary and the nominal amount restricted to 50 per cent, the amount of shares or stock

¹⁰⁹ See decision of the Federal High Court (Bundesgerichtshof) of 10 March 2008 regarding § 15 Abs. 4 Law on Limited Liability Companies and § 125 Civil Code; II ZR 312/ 06.

options to 10 per cent of equity capital (§192 para. 3 sentence 1). In the latter case, the board of directors is authorised by the general meeting to increase capital up to a certain nominal value. Such an authorisation, however, must be intended in the company statute. The general meeting's decision to authorise the board requires a majority of three quarters of the decision-making stock capital (§ 202 para. 2 JSCL). If an employee receives stock from the employer company under his employment contract free of charge or at a reduced price, the difference between the market value and the subscription price is regarded as a part of salary. If an employee receives stock from the employer company under his employment contract free of charge or at a reduced price, the difference between the market value and the subscription price is regarded as a part of his salary. However, the benefit is exempt from taxes and social security contributions with a maximum of 360 Euro in a calendar year (§ 19a para. 1 Income Tax Law).¹¹⁰ Proceeds from the share sale are not taxed if the period between the date of acquisition and sale is more than one year (§ 23 para. 1, no. 2 Income Tax Law).

Stock options – are more common as executive schemes, but broad-based schemes exist. The decision to adopt a stock option plan as part of a capital increase (see above §§ 192 et seq. and §§ 202 et seq. JSCL) the plan must contain a description of the allocation scheme (§ 193 para. 2 no. 2 JSCL). The plan itself must determine the strike price per share (§ 193 para. 2, no. 3 JSCL). In lieu of the strike price, the decision can state the basis for the calculation of the price. Details on the blocking period and vesting period shall be included in the decision on capital increase (§ 193 para. 2 no. 4 JSCL). The law stipulates a blocking period of at least two years.

Special Fund for Employee Participation – Introduced by the 2009 Law on Capital Participation of Employees primarily for SMEs these funds are governed by the Investment Law. They pool voluntary employee savings including savings bonuses as well as capital participation shares offered by participating companies to their employees and re-invest them in these companies and in the capital markets.

Table 6. Composition of the Special Fund for Employee Participation

(Limitations for certain types of assets/issuers in per cent of total value of the Special Fund)

| | | |
|--|---|--|
| minimum 60 per cent qualified assets of enterprises that grant their employees contributions in order to acquire shares in the Special Fund maximum 20 per cent of a single enterprise/group | | maximum 40 per cent qualified assets of other enterprises / other investments |
| up to 100 per cent – listed securities – selected financial instruments – non-bonded loan-claims | maximum 25 per cent – non-bonded holdings – non-listed securities | maximum 5 per cent of each issuer / investment fund: – Listed securities – Blocked current account – Money market: cash equivalents – Investment shares – Derivatives |

¹¹⁰ The previous requirement that the benefit was not to exceed 50 per cent of the share value was removed in 2009.

The funds may be set up at branch level in co-operation with employers association and/or trade unions and have to invest 60 per cent of their assets in the employer companies. While a company may apply for re-investment, it has no claim to actually receive financing from the fund. The model has yet to be accepted by the market and it is uncertain whether there will be a sufficiently large number of interested companies and fund management firms.

b) Profit-Sharing

Profit-sharing, while not legally regulated or linked to tax incentives, is believed to be more widespread than employee share ownership. The statistical evidence on this issue might reflect the fact that indirect financial participation (for example, employee loans, participation certificates and debenture bonds) sometimes is considered as profit-sharing. The only genuine form of profit-sharing practiced more commonly is cash-based profit-sharing within a bonus plan, which partly connects the share amount to the annual profit of the enterprise and partly to the individual performance of the employee.

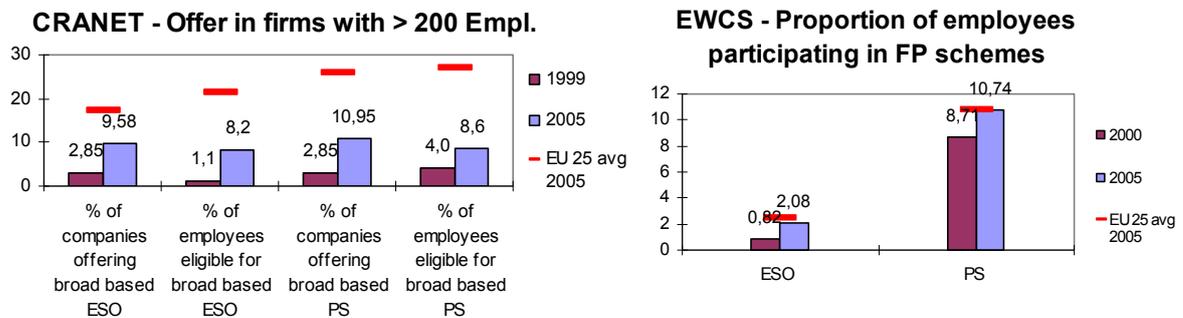
c) Participation in Decision-Making

Co-determination and participation rights of employees through their representatives are traditionally well developed under German labour law. Employees (and to a certain extent trade unions) are represented in the supervisory board as well as in companies with more than 1,000 workers in the management board, and the workers' council protects the rights of employees at the level of the individual undertaking. There is no direct connection between participation in decision-making and financial participation of employees in the sense that financial participation plans would automatically extend existing rights pertaining to decision-making.

An employee shareholder enjoys mandatory rights (right to control, right of participation, right to demand information). Examples of these rights are the right of a shareholder in a limited liability company (GmbH) to inspect and demand information pursuant to § 51a of the Law on Limited Liability Companies, and the right of the stockholder in a joint-stock company (AG) to demand information at the general meeting pursuant to § 131 of the Law on Joint-Stock Companies.

VIII. Estonia

Employee financial participation has made little progress in Estonia. PEPPER schemes did not develop during the period of independence between the two world wars or under the Soviet regime. Although employee participation in decision-making had some role in state enterprises during the Soviet era, it was later dismissed as a relic of that system. Employee ownership was briefly popular as a tool for privatising publicly owned assets in the early stages of privatisation, but turned out to be a temporary expedient. Neither was employee financial participation considered relevant to the solution of employment and social problems. In 1995, 29 per cent of employees were estimated to be owners; by January 1997, this figure had fallen to around 25 per cent (Jones and Mygind, 1998).¹¹¹



In January 2005, out of a sample of 722 firms, 19 or 2.63 per cent were (partly) employee-owned with a share ownership ranging from 20 to 100 per cent (Jones et al., 2005). Profit-sharing is rare in Estonia, but other forms of monetary incentive schemes are used in more than 50 per cent of cases (Mygind, 2002). Some information on profit-sharing in Estonia was found in the Estonian management survey (1997/98), with only 13 instances or 5.9 per cent being reported out of a sample of 220 firms.

1. General Attitude

Currently, social partners are represented by the Confederation of Estonian Trade Unions and the Estonian Employers' Confederation. They do not have equal power; the trade unions traditionally are the weaker party. Recent debates between social partners on employee participation were triggered by the necessity to transform the *aquis communautaire* into Estonian law. The government is waiting for a trade union initiative, but the trade

¹¹¹ According to an overview of the distribution of ownership in a sample of 666 Estonian enterprises.

unions are in no hurry to comply. PEPPER schemes have not been on Parliament's political agenda. Only one political party has addressed this issue: the Social Democratic Party. These circumstances make it unlikely that Estonia will adopt new legal regulations on employee participation soon.

2. Legal and Fiscal Framework

No specific legislation on any PEPPER scheme in Estonia exists at present. The legal framework neither creates nor prevents incentives for the development of PEPPER schemes.

a) Share Ownership

Privatisation (1990, abolished in 1993) – Semi-private forms of business ownership ('people's enterprises' and leased enterprises) introduced in the early stage of privatisation under Soviet law (and later legalised under Estonian law), in particular leased enterprises, are assumed to have been a major source of employee ownership in Estonia. In the privatisation of small and medium-sized enterprises, employees were given a pre-emptive right to buy the enterprise at the initial price. By 1993, when all privileges were abolished, small enterprise privatisation was almost complete; an estimated 80 per cent of enterprises had been taken over by insiders. The privatisation programme for large enterprises was finally adopted in 1993. Following the German Treuhand model, it contained no preferential rights for employees. Employee ownership of shares in enterprises purchased during privatisation is decreasing. Enterprises in the energy sector, as well as public utilities, are still partially state-owned; they could be put up for sale in the future. The current Privatisation Law offers no privileges to employees or other potential buyers. The few privileges employees had under Estonian law were abolished as early as 1993.¹¹²

Private Companies – Estonian Commercial Law contains no special rules on profit-sharing or on employee share ownership with respect to acquisition, limitations on the number of shares, or issuance of employee stock for any specific undertaking; general rules therefore apply. Some employees still hold shares purchased during privatisation and thus have the rights attached to these securities according to the Commercial Code (CC) and Securities Market Law (SML). Since employees who became shareholders often acquired minority shares in newly founded limited liability companies and joint-stock companies during early privatisation, provisions concerning the rights of minority shareholders and shares acquired during this period are important.¹¹³ If securities issued by a company are

¹¹² Initially, pre-emptive rights, which often also led to the possibility of buying assets or shares under value, were the most popular mechanism. With regard to privatisation in the industrial sector, most influential political forces were opposed to buyouts by employees.

¹¹³ Pursuant to §§ 515 (1) and (2) CC, rights attached to shares issued before 1 September 1995 which do not comply with the provisions of the Commercial Code remain valid, whereas rights not attached to shares are void. Minority shareholders of a joint-stock company can be bought out by a majority shareholder holding at least 9/10 of the shares upon resolution of the general meeting with at least 95 per cent of the votes represented by all shares; in this case a fair compensation to minority shareholders is secured by the provisions regarding takeover bids (§§ 363 2 (2) and 363 7 (1) CC) and the right to lodge

offered solely to its employees or managers, the prospectus need not be made public and registered (§ 17 (1) 2) SML). Consequently employees and management are not entitled to compensation pursuant to § 25 SML on losses resulting from the volatility of acquired securities.¹¹⁴ Furthermore, if a company provides investment services solely to its employees and management, it does not have to be registered as an investment company (§ 42 (1) SML). Thus it can conduct investment activities without a licence (§§ 48 ff., SML). It is not obliged to report transactions (§ 91 SML) or to have additional reserve and risk funds (§§ 93 ff., SML), nor are there additional requirements for managers (§ 79 SML).

b) Profit-Sharing

Special legislation on profit-sharing with regard to employees does not exist; therefore, there are neither direct incentives nor direct restrictions. For employees it is preferable to receive distributed profits under a corresponding scheme rather than as wages/salaries since they do not have to pay income tax on profits or dividends. Nevertheless, the resident company pays income tax at the rate of 22 per cent on distributed profits (§ (4) IITL), whether the distribution is monetary or non-monetary (§ 50 IITL); this is a disincentive for profit-sharing.

c) Participation in Decision-Making

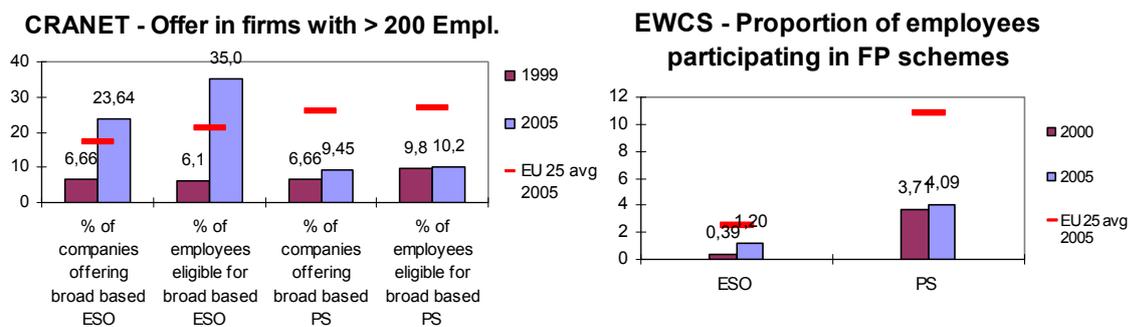
Although Estonian company law is so strongly influenced by German law that rulings by German courts can be used to interpret provisions of the Estonian CC, special rules on the participation of employees in management and decision-making contained in a special German law (*Betriebsverfassungsgesetz*) were not considered by the Estonian law-makers. If employees are also shareholders, they have voting rights in each company form, although they generally have no influence on resolutions of the general meeting since they are, in most cases, minority shareholders.

a claim with a court (§§ 363 8 (2) and (3) CC). Minority shareholders have no corresponding sell-out right, that is, they cannot demand that the majority shareholder buy their shares if they wish to sell them.

¹¹⁴ This seems to be justified since management and employees might have insider knowledge, but it could be argued that employees, unlike managers, do not necessarily have full information as to the financial situation of the company. Notably, employees are not deemed insiders, but rather as third persons who could receive information from insiders, under the same law (§ 191 (1), (3) SML).

IX. Greece

The first tax incentives for employee financial participation plans were introduced as early as 1974. Legislation broadened tax incentives in 1980 and 1987. Currently in place are special regulatory laws and tax incentives covering cash-based profit-sharing, employee share ownership and certain types of stock option plans. Although employee financial participation plans are still not widespread, they have been on the increase since the beginning of the current decade, especially executive stock option plans. Thirteen percent of companies listed on the Athens Stock Exchange offered stock option plans in 2007, mainly to executives. 30,000 persons (1.8 per cent of employees) participated in these plans (Ioannou, 2008).



The EU High Level Group of Independent Experts (European Commission, 2003a, p. 32). found that the limited spread of employee financial participation plans, despite tax incentives, was attributable to the complexity and restrictions of the regulations. Tax incentives are indeed restricted to joint-stock companies (anonimes etairies). However, the number of such companies in Greece is quite high (16,767 companies in 2007), with the majority of them being SMEs. The complexity of the regulations arises from the fact that the provisions on tax incentives are dispersed through many different pieces of legislation. Another important factor inhibiting the spread of employee financial participation is the reluctant attitude of social partners at the company level, although social partners at the national level view the issue more positively.

1. General Attitude

The government generally supports PEPPER schemes by initiating and implementing tax incentives for specific types of plans. Employer associations were not initially interested in employee financial participation. Trade unions (that is, the General Confederation of

Greek Workers and public sector unions), originally strongly opposed, have accepted financial participation since the beginning of the 1990s. Attitudes of both social partners have become more favourable since the beginning of the present decade. Facilitation of PEPPER schemes has been on the national collective bargaining agenda. In the current round of collective bargaining (2008), both social partners made facilitation of employee financial partnership an issue to be included in the agreement. However, this agreement requires government ratification to become applicable at the company level.

2. Legal and Fiscal Framework

Special legislation, including tax incentives, exists for cash-based profit-sharing, employee share ownership and stock option plans.

a) Share Ownership

Both share ownership and stock option plans enjoy tax incentives under certain conditions.

Share Ownership Plans – Since 1987, joint-stock companies have been allowed to acquire their own shares in order to distribute them to employees. If these shares are purchased on the public market, up to 10 per cent of equity capital can be distributed; the distribution must be made within 12 months. If the shares for distribution are to be issued in the course of a capital increase, up to 20 per cent of the annual profit can be distributed; the shares must be blocked for three years unless the general meeting provides otherwise. If these pre-conditions are satisfied, the employee is not subject to either personal income tax or social security contributions on the benefit, but is liable to the tax on movable assets (10 per cent) on dividend or interest payments. The employer company can deduct the distributed amount from the tax base of the corporate income tax. According to the Circular of the Ministry of Finance of 2000, gift tax applies to the employee's benefit rather than personal income tax. When the shares are sold, only the transfer tax is applicable; companies often offer shares to employees at a reduced price in order to overcome opposition to privatisation.

Stock Option Plans – Stock Option Plans are divided into qualified plans under the Law 2971/1999 and non-qualified plans under the Presidential Decree 30/1988. In qualified plans, the shares to satisfy the claims of option owners at exercise are issued in a qualified capital increase whereby the number of shares should not exceed one tenth of shares already outstanding. In such plans, employees are not subject to taxation at grant or exercise or liable for social security contributions; the employer company, however, cannot deduct the cost of the shares. In non-qualified plans, shares to satisfy the claims of option owners at exercise are purchased on the public market. Under these plans, employees are generally subject to personal income tax and social security contributions, but the local tax office can levy a gift tax instead of the personal income tax if 'the benefit derived exceeded the proper measure'. The employer company can deduct the value of distributed shares as personnel costs. Because there has been a substantial increase in the number of executive

stock option plans since the year 2000 and the benefit of the executives usually exceeded 50 per cent, the government is considering much higher tax rates (40 per cent) in such cases.

b) Profit-Sharing

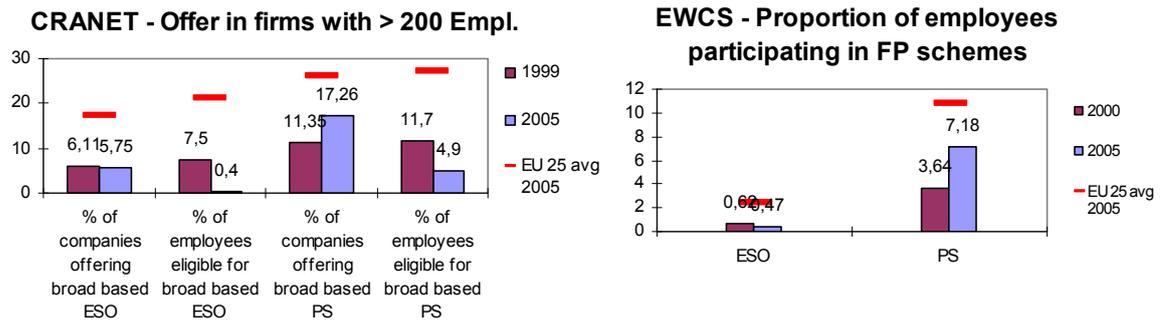
Profit-sharing plans are predominantly cash-based and linked to tax incentives. The company is allowed to distribute 15 per cent of annual net profits to employees. Each employee can receive up to 25 per cent of annual gross salary as his profit share. The company must submit a list of beneficiaries, with amounts payable to each individual employee, to the workers' council within one month of approval by the general meeting. However, it must be noted that only a small number of companies have workers' councils; when they exist, they must be informed, but their approval is not required. In practice, no case is known where this pre-condition became a problem. If these pre-conditions are met, the employee is exempt from income tax, but subject to social security contributions on the profit share amount. Profit-sharing distributions are exempt from the corporate income tax, but social security contributions are not.

c) Participation in Decision-Making

There is no direct connection between participation in decision-making and financial participation of employees. In particular, financial participation plans cannot extend existing rights with regard to participation in decision-making. The employees in the 'socialised sector' (for example, public utilities and transport), where two levels of employee representation are compulsory for companies under state control (representative assembly of social control setting broad policy objectives: one third employees, one third board of directors, one third elected by employees) might have influenced the introduction and design of financial participation plans but did not choose to do so.

X. Spain

Employee financial participation in Spain typically takes two forms: ‘Workers’ Companies’ (Sociedades Laborales), which combine employee share ownership with decision-making rights, and profit-sharing. In recent years the number of Workers’ Companies and of their employees (approximately 20,000 enterprises in 2007, employing 125,000 workers) have shown steady growth at higher rates (see CONFESAL, 2006, p. 6) than conventional companies, indicating the success of this form of financial participation. Profit-sharing plans are mainly cash-based. According to a Ministry of Labour and Social Affairs survey in 2006, 18.8 per cent of private sector employees participate in some kind of profit-sharing in their workplace.¹¹⁵ There are relatively few employee share ownership and stock option plans; these are mainly found in large multinational companies and often limited to the executives. Tax incentives for share purchase plans, however, introduced in 2003, could encourage employee share ownership to spread.



1. General Attitude

Under the Spanish Constitution, the government is obliged to take an active role in facilitating access of employees to ownership of productive assets. Both major political parties the right wing PP and the left wing PSOE are in favour of the concept of Workers’ Companies (Sociedades Laborales). The present government supported employee financial participation with tax incentives for Workers’ Companies and employee share ownership schemes. The employer associations are careful not to promote plans limited to executives only, as in the past stock options adversely affected the financial markets, caused political friction and left a negative image generally. Nevertheless, they do not actively support

¹¹⁵ The overall figure for Spanish employees, including management and co-operatives is 23.7 per cent. Genuine profit-sharing plans and performance-related pay not connected to financial indicators are not clearly differentiated, so that it is not clear whether this data reflects the incidence of profit-sharing correctly.

broad-based plans. Trade unions accept financial participation plans only if they are on top of regular wages. Associations which lobby to protect the advantages gained by companies practicing financial participation exist on both the regional and company level (for example, MCC, Confesal, CEPES, Federaciones de Cooperativas). In 2008 (responding to a proposal by Confesal), a modification of the Law on Workers' Companies to eliminate some restrictive prerequisites, thereby making this type of company more like a normal company with standard labour relations, is under consideration.

2. Legal and Fiscal Framework

Workers' companies are governed by the Law on Workers' Companies of 1986, substantially amended in 1997. There is no special regulation pertaining to profit-sharing.

a) Share Ownership

Workers' Companies constitute the typically Spanish form of employee share ownership. In addition, some listed companies implement stock option plans (although often for executives only), whereas in non-listed companies share purchase plans are practised. Most recently tax incentives for employee share ownership and stock option plans with regard to income tax liability were introduced by the Law on Stock Ownership Incentives 46/02 of 18 December 2002, effective 1 January 2003.

Workers' Companies (Sociedades Laborales) can be founded as a workers' company or become a workers' company by changing their corporate form. Since 1997, there are two forms: Sociedad Anónima Laboral (SAL) with minimum equity capital of Euro 60,000 and Sociedad Limitada Laboral (SLL) with minimum equity capital of Euro 3,000. The majority of shares must be held by the employees, but individual employees may not hold more than one-third of the capital. The articles of association must contain regulations on transfer of shares when an employee shareholder leaves the company. Each workers' company must establish a special fund for the compensation of losses amounting to 20 per cent of its profits (compulsory 10 per cent for normal companies and additional 10 per cent for workers' companies). The remaining 80 per cent of the profits can be distributed between the members of the workers' company or attributed to a voluntary reserve to increase the company's own capital and thus the value of its shares. If the compensation fund amounts to 25 per cent of annual profits the company benefits from a 99 per cent tax exemption from capital transfer tax (this affects primarily acquisitions of real estate by the workers' company). Persons that wish to join a workers' company have the possibility to receive the unemployment security payments they are entitled to as a single flat payment (instead of monthly payments for the duration of unemployment) conditional on contributing the sums to the capital of the workers' company. Furthermore, workers' companies are exempted from: (1) taxes in connection with company formation and capital increases (additional to a tax credit of 99 per cent of taxes connected with transfer of shares to employees); (2) notarial deeds on transfers to the company as well as notarial deeds on bond debts and debenture bonds. These incentives only apply to the setting up of the workers' company (that is, they do not affect personal income tax liabil-

ity, etc.). The Law on Workers' Companies details special labour regulations (for example, on allocation of working time between employee shareholders and other employees). The federal Labour Ministry and municipalities exercise control over the workers' co-operatives.

Share Ownership Plans (Share Purchase Plans) have enjoyed tax incentives under certain conditions since 1996 which were specified in law RD 214/1999 and extended in 2003. Shares are excluded from income tax assessment under the following conditions: (1) the market value of the benefit at the time of acquisition does not exceed Euro 12,000 p.a., (2) shares are offered within the framework of a regular compensation plan (but not necessarily of a broad-based plan), (3) each employee and his family members own not more than 5 per cent of the equity capital and (4) the shares are blocked for 3 years, tax incentives apply. Shares given to employees under these circumstances will not be considered as payments in kind.¹¹⁶ No tax incentives apply to dividends, but at sale of shares a flat tax of 15 per cent instead of the personal income tax is imposed on the employee. Furthermore, for New Company Limited Partnership (SLNE) a mechanism providing an incentive for employee savings in order to acquire shares or holdings in the employing company, a 'company savings account' was introduced in 2003.¹¹⁷

Stock Option Plans are also linked to tax incentives as of 2003. If the vesting period does not exceed two years and options are not granted annually, a 40 per cent personal income tax allowance (limited by the annual medium wage determined by law multiplied by the number of years before vesting) applies. If the shares cannot be sold within three years after the option grant and the plan includes all employees on equal terms, the amount of the tax allowance and the ceiling are doubled. Approximately 40 listed companies operated stock option plans in 2003.¹¹⁸

b) Profit-Sharing

Since the 1994 reform of the Labour Market Law 11/1994 mentions the use of bonuses connected to the results and situation of the enterprise. Both cash-based and share-based profit-sharing plans are found, but cash-based profit-sharing prevails. In many cases, profit-sharing plans contain financial indicators as well as performance-related indicators, so that they cannot be considered as genuine profit-sharing plans. Some share-based plans ('performance shares') are linked to financial indicators, such as BPA, RTA, etc. Stock appreciation rights, that is, payment in cash or transfer of shares connected to the increase in the share value at the end of a determined period, are sometimes granted, but rarely.

¹¹⁶ However, it should be made clear that such a distinction refers to taxation only. In labour law terms, shares are payments in kind and, therefore, their value cannot amount to more than 30 per cent of the wage. Payments in kind have an exceptional character and their establishment is only admissible if there is a law, a collective agreement or a pact between the parties authorising it; it can never be unilaterally imposed by the employer. See Poutsma (2001), p. 82.

¹¹⁷ By Decree Law 2/2003 from April 25 regarding economic reform measures; however, this mechanism has not yet been extended to Workers' Companies as postulated by CONFESAL in 2006.

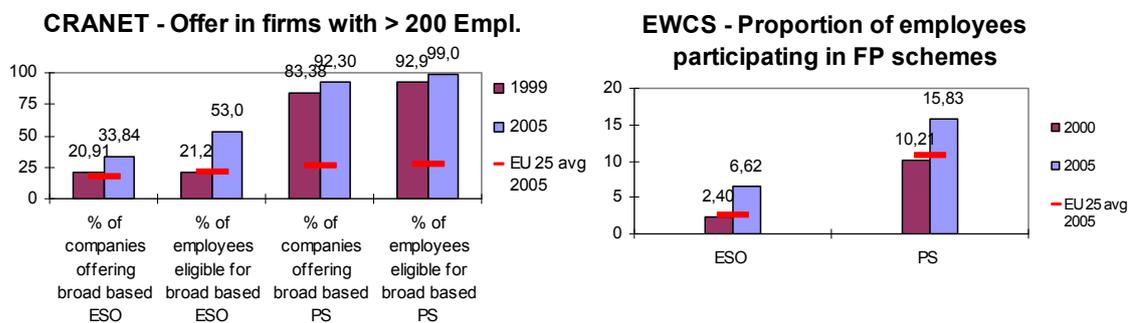
¹¹⁸ EU Report on Stock Option Plans (European Commission, 2003c). Note that these figures include executive plans.

c) Participation in Decision-Making

Employee share ownership in Workers' Companies is directly linked to participation in decision-making. The board of directors cannot decide on liquidation, capital increase or reduction or board composition without general assembly consent. Each member of the workers' company has the right to be a candidate for election to the governing bodies of the company. In other plans, there is no direct connection between participation in decision-making and employee financial participation; in particular, financial participation plans cannot extend the existing rights pertaining to participation in decision-making.

XI. France

France has a relatively long tradition of employee financial participation, especially different forms of profit-sharing and collective savings plans. The first profit-sharing plans (so-called *intéressement*) were introduced in 1959, but they did not become wide-spread until substantial tax incentives were introduced and restrictions abolished in 1986. A second type of profit-sharing plans (*participation*) introduced in 1967 were compulsory for all companies with more than 100 employees, a number reduced to 50 employees in 1986. Additionally in 1967, tax incentives were introduced for profit-sharing and the first short-term savings plans (*Plan d'Épargne d'Entreprise (PEE)*) were adopted. Important improvements were enacted in 1994 for all types of plans. The most recent employee financial participation plan is the long-term savings plan (*Plan d'Épargne-Retraite Collectif (PERCO)* introduced as *Plan Partenarial d'Épargne Salarial Volontaire (PPESV)* in 2001 and renamed in 2003) designed to facilitate voluntary savings for retirement. Stock option plans were first introduced only for listed domestic companies in 1970 and extended to unlisted and foreign companies in 1987. Although the taxation of these plans became more favourable in 1996, they are still prevalingly used by executives and seldom broad-based.



Currently, four basic plans are the most common: voluntary profit-sharing (*intéressement*), compulsory profit-sharing (*participation*), short-term savings plans (*Plan d'Épargne d'Entreprise (PEE)*) and long-term savings plans (*Plan d'Épargne Retraite Collectif (PERCO)*). Whereas 'participation' is compulsory for all companies with 50 or more employees, the other plans are voluntary. All these plans are traditionally classified as profit-sharing plans, although 'intéressement' can be linked to indicators other than profit or to non-financial indicators and savings plans are more a financial vehicle for profit-sharing than genuine profit-sharing plans. The traditional classification is followed here but with the above reservations. Shares can be transferred to employees directly for free or at a discount, but distinctive share ownership plans are seldom. Employee share ownership generally emerges from profit-sharing plans when profit shares, employee earnings or employers' matching amounts are invested in company shares. For this reason, statistical data are only available for profit-sharing plans (which have to be registered with the Ministry of Labour) and not for employee share ownership.

According to the data of the Association Francaise de Gestion (AFG), two-thirds of large companies operated profit-sharing plans with 10.3 million beneficiaries in 2006. In this year, the total amount of funds allocated in profit-sharing plans was Euro 12.9 billion, of which Euro 5.8 billion were held in ‘participation’ profit-sharing plans, Euro 2.5 billion in ‘intéressement’ profit-sharing plans, Euro 2.9 billion were voluntary payments of employees, and Euro 1.7 billion were matching payments by the employing company to PEE and PERCO. The cumulative value of assets (including funds invested in 2006, value of the remaining assets and capital gains from these assets) was Euro 82.4 billion, which is 19 per cent more than 2005. In 2006, 52 per cent of assets from funds were invested in company shares, so it seems that employee share ownership is increasing, although the share of employees in most companies is still less than 3 per cent.

1. General Attitude

Successive governments have been developing employee financial participation schemes for the last 40 years. Legislation had to become more complex in order to prevent discrimination of lower-ranking employees in relation to management, on the one hand, and to prevent employee abuse of these schemes to avoid taxes, on the other hand. The main political goals are more equal distribution of wealth through participation in enterprise results, enhancing purchase power and solving social security problems, especially pensions.

The employers’ associations support voluntary plans as these allow more flexibility in the planning of labour costs; they strongly oppose compulsory schemes, although they are compelled to implement them. Employers also support the development of savings plans and advocate the view that these should be closely connected to pension plans and even replace them. The trade unions generally support all schemes that do not lead to a reduction of cash pay. If employee assets are to be invested, the trade unions advocate diversification on the grounds of less risk rather than investment in the employer company’s shares. They oppose using the savings plans to reduce or replace pensions.

2. Legal and Fiscal Framework

The major employee financial participation plans ‘intéressement’ profit-sharing, ‘participation’ profit-sharing, short term savings plans (Plan d’Epargne d’Enterprise (PEE)) and long-term savings plans (Plan d’Epargne-Retraite Collectif (PERCO))¹¹⁹ were introduced by various laws (that is, Law on Profit-Sharing of 1959, Law on Compulsory Profit-Sharing of 1967, Law on Employee Savings Plans of 1967) which have been amended many times, most recently by the Law of 31 December 2006 and the Law of 4 December

¹¹⁹ This plan evolved from the Plan Partenarial d’Epargne Salarial Volontaire (PPESV) and may be set up as an inter-enterprise (PERCOI) or branch (PERCOB) plan.

2008. Irrespective of the type of plan, an employee starting to work for the company must be informed of the plans in operation and the pre-conditions of participation. Company training of employees on financial participation issues is linked to tax incentives. The tax relief for the employer company is Euro 75 for one hour training of the employee, but not more than Euro 5,000 per company for two years.

As confirmed by the 2006 amendment, plans have to be approved by the Ministry of Labour prior to introduction. If the state authority submits no objections within four months of submission of the agreement by the employer company, the plan is deemed approved. However, this provision does not protect the employer company, should the competent state authority contest the plan implementation.

a) Share Ownership

As explained above, no special share ownership plans are common; share ownership is generally acquired by means of profit-sharing plans. However, it is possible to transfer free shares to employees; since 2006 such transfers are without a holding period and with a vesting period of four years. In short term savings plans it is possible to offer employees to subscribe to a capital increasing at a subscription price with up to 20 per cent discount of the fair market value using their savings and company matching contributions. In privatisation, 5 per cent of shares are reserved for employees and can be offered at a discount of up to 20 per cent of fair market value.

b) Profit-Sharing

As explained above, all major plans are broadly regarded as profit-sharing plans. An employee may participate in different types of plans at the same time if several plans are offered by the company. The combination of different plans is advantageous from the viewpoint of taxation and, therefore, quite common. Profit-sharing accumulations can be transferred to PEE or PERCO as well as - for profit-sharing only - to a special blocked account in the companies' accountancy. Since 2006, it is prescribed by law that the company must introduce PEE if it operates a profit-sharing plan (participation) and must introduce PERCO if it has been operating PEE for more than five years.

'Participation' profit-sharing plans are compulsory; the other three plans are voluntary. Profit-sharing, both 'intéressement' and 'participation', as well as PERCO can be introduced only on the basis of an agreement with employee representatives, whereas PEE may also be based on a unilateral decision of the employer company. All plans must be broad-based (that is, apply to all employees, with the exception of those with less than three months of service). A blocking period of five years (profit-sharing, PEE) or until retirement (PERCO) is compulsory and linked to substantial tax incentives, which generally include exemption from personal income tax and social security contributions and imposition of special social contributions of 7.6 per cent for both employees and the employer company and on returns of 10 per cent. The blocking period expires under certain personal circumstances of employees (death, disability, cessation of employment, insolvency, marriage, birth of a third child, divorce while keeping custody of at least one child, purchase of a principal residence, founding or acquisition of an enterprise by the employee).

Invested employee earnings and matching amounts of the employer company must be, and employee profit shares can be, transferred to mutual funds (FCPE), usually managed by assets management firms, that is branches of banks or insurance companies which invest the assets in shares or bonds of the employer company or of several different companies. FCPEs are usually at enterprise level (whereas special rules apply to SMEs), they may be either diversified or non-diversified and while the company must offer the former the latter is optional. If the employer company is not listed, the FCPE is obliged to invest one-third of assets in marketable shares or bonds, unless the company buys back 10 per cent of its own shares or all assets belong to employees planning to participate in a leveraged buyout. After the blocking period expires, the accumulated assets are paid out as a lump sum (all plans) or an annuity (only PEE and PERCO).

Table 7. Composition of the Diversified FCPE

(Limitations for certain types of assets / issuers in per cent of total value of the FCPE)

| | |
|---|--|
| maximum 33 per cent (0 per cent for multi-non-listed SME fund) qualified assets of enterprise / group that grant their employees contributions in order to acquire shares in the FCPE | minimum 66 per cent (100 per cent for multi-non-listed SME fund) other qualified assets / investments: <ul style="list-style-type: none"> – maximum 5 per cent of each issuer / investment fund – maximum 10 per cent of diversified investment fund investing in employer company |
|---|--|

Table 8. Composition of the Non-Diversified FCPE

(Limitations for certain types of assets / issuers in per cent of total value of the FCPE)

| | |
|---|---|
| minimum 33 per cent up to 100 per cent (maximum 66 per cent for non-listed SME fund) qualified assets of enterprise / group that grant their employees contributions in order to acquire shares in the FCPE | maximum 66 per cent (minimum 33 per cent for non-listed SME fund) other qualified assets / investments maximum 5 per cent of each issuer / investment fund |
|---|---|

In the following, individual plans are presented:

Compulsory Profit-Sharing (participation) is compulsory in all companies with 50 or more employees, while voluntary in smaller companies. However, not all such companies have introduced profit-sharing plans in practice, especially if they cannot pay the minimum amount of profit share due to plan participants according to the compulsory formula given the financial results. The compulsory formula for the special profit-sharing reserve is as follows: $0.5 \times (\text{net profit} - 5 \text{ per cent of share capital}) \times \text{total wage bill/value added}$. In addition, an additional bonus (the so-called ‘working dividend’) can be paid according to the general rules of the company’s profit-sharing plan if profits are substantially higher than expected. The maximum annual amount per employee is equivalent to 75 per cent of the annual ceiling for the calculation of social contributions, for example, for 2009 Euro 25,731. The plan can be introduced on the basis of an agreement with the trade unions or with the workers’ council or with the approval of a two-thirds majority of employees. Since 2006, profit-sharing became a compulsory part of collective agreements of the economic sectors which then may be applied to individual companies on a volun-

tary basis. Since the 2008 amendment each year employees may opt to have their profit share paid out for the current year. If they do not, their profit share is automatically deferred and, during the blocking period, transferred either to a special blocked account in the accountancy of the company (CCB) or to a mutual fund (FCPE). If deferred, the benefit is exempted from personal income tax and regular social security contributions; a 2 per cent social tax for employers and a flat social contribution of 7.5 per cent plus 0.5 per cent (total 8 per cent) on 97 per cent of the employees contributions apply instead. The interest or returns are subject to a special social contribution of 10 per cent and, if paid out during the blocking period, income tax (if the interest or returns are accumulated, they are exempt from income taxation).

Voluntary Profit-Sharing (intéressement) is voluntary and its formula is free. It can be linked to indicators other than profit, such as reduction of losses, fewer work injuries or other performance-related indicators, but it is usually based on financial indicators. The maximum amount is the same as for the profit-sharing plan. It is introduced by a three-year agreement with the trade unions or the workers' council, which is not automatically renewable, or on the basis of approval by two-thirds of all employees. The amount normally is paid out to the employee immediately and is then exempt from social security contributions (except the special flat social contribution of 7.5 per cent), but subject to full personal income tax. However, if the profit share is invested for more than five years in a company savings plan (PEE) or until retirement in a long-term savings plans (PERCO) income tax exemption applies and the fiscal treatment is as described above.

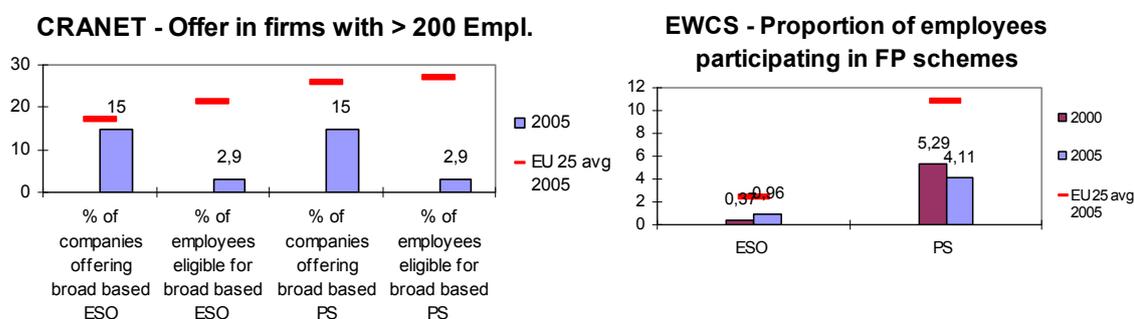
Savings plans (PEE, PERCO) are voluntary and their formula is free. The holding period is five years for PEE and until retirement for PERCO. An employee can transfer part of his earnings and/or his profit share up to a ceiling of the total amount of 25 per cent of his gross earnings to the savings plan. The company is entitled (but not obliged) to match the employee contribution with an amount up to three times higher. The maximum matching amount (abondement) was originally expressed in absolute figures, but, since 2006, it is expressed as a proportion of the annual social security ceiling. The maximum matching amount is higher for the investment in company shares than for diversified investment, and higher for PERCO (approximately Euro 6,000) than for PEE (approximately Euro 3,000) and may reach up to approximately Euro 9,000 cumulative. The matching amount is generally exempted from personal income tax and social security contributions, but is subject to a special social contribution of 7.5 per cent. However, the amount of the matching contribution exceeding the ceiling for PEE in PERCO is subject to an 8.2 per cent flat tax, and the amount exceeding the ceiling for PERCO is subject to full personal income tax and social security contributions for the employee and the employer company. As above the tax on interest and returns is a flat tax of 10 per cent. After the blocking period expires, the amount may remain in the PEE/PERCO with the same fiscal advantages, can be paid as a lump sum or an annuity or invested elsewhere, for example. In large companies, leveraged savings plans are frequent; furthermore employees can use an interest free bank loan in order to purchase up to ten times more shares than with their own earnings against a share in capital gains.

c) Participation in Decision-Making

Most major employee financial participation plans can be introduced only on the basis of an agreement with the trade unions or the workers' council, so that employee representatives generally participate in negotiations on the design of the plans. In addition, the workers' council is usually consulted before the agreement is signed and informed of the implementation of profit-sharing plans, both 'intéressement' and 'participation'. For savings plans, a special supervisory body elected by the workers' council must be consulted and informed. Mutual funds are managed by a supervisory board consisting of one-half employee representatives, elected by the workers' council for two years, and one-half employer representatives. If the assets are invested in company shares, the chairman must be an employee representative. In practice, this body is inefficient, since the management decisions are taken at face value by the bank or insurance company and generally accepted by the supervisory board. If employees own more than 3 per cent of the equity capital of a listed company, they must have at least one representative on the company board who must be elected. The mandate of the representative ends upon cessation of employment. All companies have to amend their statutes accordingly at the first extraordinary meeting after the publication of the law. However, this provision does not play a major role in practice, since employees have a larger share in a very small number of companies.

XII. Hungary

Employee ownership has been the main form of financial participation in Hungary. It has been variously structured to include employee acquisition of state assets on preferential terms during the first wave of privatisation, employee share ownership as a part of external privatisation, long-term incentive plans, and stock options. In the first stages of privatisation, the most prevalent form of employee ownership was the Hungarian Employee Share Ownership Programme, modelled on the US ESOP. Although briefly popular as a quick expedient for getting assets into the hands of company employees, now that privatisation is over, the number of ESOP companies is on the decline. Except for the Approved Employee Securities Benefit Programme, introduced by tax laws in 2003, the other PEPPER schemes, including profit-sharing, are found only to a limited extent. Having little support in official economic policy, they are not formally registered or reported. As for profit-sharing, according to Hewitt Associates¹²⁰, eight out of ten Hungarian enterprises utilise short-term incentives that go beyond the simple sales premium. Of these, 20 per cent use profit-sharing; most (67 per cent) base profit shares on the employee's status in the hierarchy, but many (23 per cent) set other criteria as well. According to the survey, however, only 10 per cent of employees entitled to a profit share actually receive one.



1. General Attitude

Trade unions at the national level actively promoted employee ownership in various forms. Local trade unions, however, often took a surprisingly passive stand, declaring their interest in employee buyouts but taking no role in organising the procedure. Other local trade unions actively lobbied for preferential shares and also ESOP buyouts. In addition to influencing privatisation decisions, unions usually had at least one of their leaders

¹²⁰ The incentive systems of 50 companies were surveyed in 2003, the majority of which were large ones in terms of sales and number of employees.

as a member of the organising committee and the ESOP trust. Employees and their trade union representatives regarded the ESOP and other buyout schemes as tools for preserving jobs. Since the end of privatisation in 1998, lobbyists have fought, so far with little success, to gain political support and financial incentives for extending the use of ESOPs beyond the privatisation process, and to make use of this technique in cases of liquidation. Another important effort of lobbyists was to amend ESOP and tax laws to protect existing ESOPs from an unfavourable economic environment. To summarise, Hungary has no focused policy on employee ownership. Although political parties on both left and right declare their commitment in the past as well as most recently, the principle has yet to be translated into economic policy.

2. Legal and Fiscal Framework

The legal framework of employee financial participation includes both profit-sharing and employee share ownership. However, no specific legal or tax incentives for profit-sharing are granted either to employer or employee. Company law explicitly regulates employee shares, including stock options. Recently an Approved Employee Securities Benefit Programme with specific incentives has been introduced.

a) Share Ownership

Employee privatisation on preferential terms (1991, 1995, 2007) – The privatisation law of 1991 contained various preferential privatisation techniques. In 1995 a new Law on Privatisation, still in force, reduced some allowances for employees, but offered at the same time new forms and techniques, that is, privatisation on deferred terms, employee privatisation on preferential terms, *‘Egzisztencia’* credit, and ESOPs.¹²¹ In 2007 the Law on Privatisation was superseded by the Law on State Property¹²² which, however, preserved the described incentive system. Privatisation offers three financial techniques for acquiring employee ownership on preferential terms: (1) price reduction, (2) purchase by instalment, and (3) purchase on credit. Thus a discount of up to 150 per cent of the annual minimum salary is possible. However, the nominal value of shares thus acquired may not exceed 15 per cent of the company’s registered capital nor the discount granted exceed 50 per cent of the purchase price. In the event of paying the discounted price in installments, except if sold within the framework of an ESOP (see below), a down payment of fifteen per cent is required in cash, upon which payment of the remainder may be deferred for a period of up to three years at the prevailing interest rate charged on public debts. Further, Hungarian citizens may take up to 50 per cent of the property that they wish to acquire, up to a

¹²¹ Law XXXIX of 1995 on the Realisation of Entrepreneurial Property in State Ownership; Governmental Decree No. 28 of 1991 on *‘Egzisztencia’* Credit and Deferred Payments Benefits (see below).

¹²² Law CVI of 2007 on State Property in force since 1 January 2008.

maximum of HUF 50 million, as an *'Egisztencia' credit*, regardless of the number of buyers.¹²³

Employee stock ownership programme (1992, 2003, 2007) – In Hungary the US ESOP system strongly influenced the law regulating the establishment and functioning of ESOPs.¹²⁴ Basically, the Hungarian ESOP followed the American 'trust' model. However, there is a major difference between the two systems: while the Hungarian ESOP is a privatisation vehicle with the organisation ceasing to exist as soon as all the securities are paid for and their ownership transferred to the employees, the US ESOP continues to administer the securities of employees.¹²⁵ The Hungarian ESOP is an independent legal entity; so-called 'privatisation' and 'non-privatisation' ESOPs exist. In the case of the former, the ESOP buys the property of the State Property Agency or of municipalities; there are incentives attached to this form. In the latter case, shares or business shares not at the disposal of the State Property Agency are sold, for example, already existing securities or securities issued in connection with capital increase. The only difference between the two forms is that there are no specific incentives encouraging companies or employees to establish non-privatisation ESOPs. If the employees decide that the ESOP should remain in place, regulations for the period after repayment (for example, rules for marketing shares) must be developed.¹²⁶ The ESOP is fully liable for its obligations. Members of the ESOP are not liable for its debts except for the securities already allocated to them. Until the shares are transferred to the plan participants the ESOP owns the shares. As for the exercise of property rights, participants have voting rights in proportion to their registered shares, but only up to a maximum of 5 per cent of the property acquired by the ESOP.

Tax exemptions for *'privatisation' ESOPs* allow the company to offer tax allowances for property sold to the ESOP as prescribed by the Corporate Tax Law. Accordingly, the company may deduct up to 20 per cent of the amount paid to the ESOP from its tax base. ESOPs were not subject to corporate profit tax until 31 December 1996. However, after that date, the income of ESOP falls under the rules of the Law on Corporate Tax and Dividend Tax, and, accordingly, 16 per cent tax is paid on their taxable income.¹²⁷ According to Personal Income Tax Law, securities transferred from the company to employees

¹²³ Section 58 (3) of Law XXXIX of 1995 on Realisation of Entrepreneurial Property in State Ownership. This rule applies to ESOP credits as well.

¹²⁴ Regulated by Law XLIV of 1992 on Employee Share Ownership Programme, which entered into force on 14 July 1992, amended with Law CXIX of 2003 and Articles 38-42 of Law CVI of 2007 on State Property.

¹²⁵ Another difference between the American and Hungarian regulation was that under the 1992 ESOP Law there were no 'fairness' rules (this led to disproportionately large manager ownership); however, this was changed with the 2003 Amendments.

¹²⁶ In absence of such legal regulations, the majority of ESOP organisations ceased to exist after the loans were repaid. Moreover, the established forms of operating the asset (for example setting up a limited company) involve considerable costs. See Boda et al. (2006).

¹²⁷ Two special rules apply in calculating the ESOP tax base: (1) the tax base should be reduced by the amounts paid by private persons as their own contribution to the ESOP and by the amounts of subsidy paid by other private or legal persons or by the employer company (under general rules these amounts would have been considered income); (2) at the same time, the tax base must be increased by the acquisition value of the shares given to the ESOP participants (under general rules this amount would be accounted among expenditures, thus reducing the profit).

are tax free since they are not considered income; however, when the employee sells these shares, the proceeds are taxed at the capital gain rate of 20 per cent.¹²⁸

Private Companies (1988) – Employees’ shares, first introduced by the Law on Business Associations of 1988, still exist under the current law. They are registered shares and can be issued free of charge or at a reduced price in accordance with the provisions of the Articles of Association of the joint-stock company, for example, in the context of a Long-Term Incentive Plan or a broad-based Stock Option Plan. Employees’ shares may be issued in conjunction with a simultaneous share capital increase of the joint-stock company, up to a maximum of 15 per cent of the increased share capital. A joint-stock company may pass a resolution entitling employee held shares to dividends from after-tax profits to be distributed amongst shareholders prior to the shares belonging to other categories or classes of shares, but following shares granting preferred dividends. In the event the employee dies or terminates his or her employment, except in the case of retirement, his or her heir or the employer has the right to transfer the employee’s shares to other company employees within six months.¹²⁹ The employer company can distribute them free or at a discounted price, making this form of financial participation very attractive to employees. However, this form of share acquisition enjoys no tax incentives. Since 1 January 2003, income received in the form of securities is no longer regarded as an allowance in kind.¹³⁰ Thus, in the case of employees’ shares, the difference between the purchase price and the sale price is subject to personal income tax.

Approved Employee Securities Benefit Programme (2003) – At the beginning of 2003, new legislation¹³¹ came into effect allowing companies to set up state-recognised, tax-qualified stock plans. The organiser of an Employee Securities Benefit Programme has to submit an application for its recognition to the Ministry of Finance which informs the relevant tax authorities of its decision. To be approved, the programme must comply with certain proscribed conditions, for example, only securities issued by the applicant company or by its majority shareholder may be offered in the programme; statutory threshold levels of at least 10 per cent employee participation and a management share of less than 25 per cent representing less than 50 per cent of total share value. At the time of sale, the employee is taxed on the spread between exercise price and sale price. This capital gain is

¹²⁸ See Section 18 (4) of Law XLIV of 1992 on Employee Share Ownership Programme and Section 66 of Law CXVII of 1995 on Personal Income Tax; Securities acquired from already taxed personal income of the participant of the programme are not taxable.

¹²⁹ If this deadline expires without success, at the first shareholders’ meeting thereafter the company shall withdraw the employees’ shares in question with a corresponding reduction in its share capital, or shall decide to sell such shares after transforming them into ordinary, preference or interest-bearing shares.

¹³⁰ The applicable rules of taxation are determined by the legal relationship between the private person and the provider. In the case of securities provided by employer to employee, such income is considered as income from employment, and the pertinent tax rules have to be applied. See Informant of the Tax and Financial Control Administration (APEH) on the Rules on Securities Allowance in Force from 1 January 2003. Source: Hungarian CD Jogtar (28 February 2005).

¹³¹ Law CXVII of 1995 on Personal Income Tax; Decree of the Ministry of Finance No. 5 of 2003 on the Procedure of Registration of Approved Employee Securities Benefit Programme, and on the Rate of Administration Service Fee for the Initiation of the Procedure.

taxed at 20 per cent, separately from other income.¹³² Companies have no withholding or reporting obligations in connection with employee stock option or purchase plans. The first HUF 500,000 of the shares that have met vesting requirements are not taxable at exercise or vesting. Any shares deemed non-qualified are taxed as normal employment income (progressive scale from 18 to 38 per cent). Vested shares must be held in a security account overseen by a trustee during an obligatory three year vesting period which ends on 31 December of the second year after the securities have been acquired. At the end of the vesting period, employee shareholders enjoy the same rights as any other shareholder of the same class. The most recent amendment of the Law on Personal Income Tax (Act LXI of 2006) stipulates that gains of all share purchases and similar transactions should be added up in the given tax year and that in calculating the tax base, instead of the nominal value at the time of allocating the share option, the actual value at the time of purchase is the relevant number, not the nominal value at the time of allocation. At the same time, according to the interpretation of the officers at the Ministry of Finance, the amendment abolished the blocking period.

b) Profit-Sharing

Except for section 5 of the Labour Code, stating that an employer may grant any benefit to its employees if it is provided in a non-discriminatory manner, no regulations exist. There are neither tax allowances nor other incentives for profit-sharing; any kind of benefit paid to employees falls under the Personal Income Tax Law and there is no allowance for employers.

c) Participation in Decision-Making

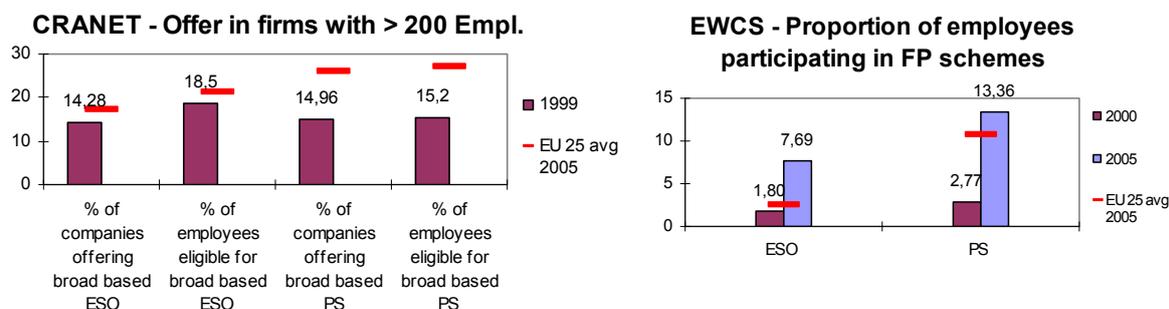
Employee representatives make up one third of the supervisory board in companies with more than 200 employees. In companies with more than 200 employees having a two-tier board system (both a supervisory and a management board), the works council has the right to nominate one third of the members of the supervisory board. In companies with a single-tier board system (only a board of directors), employee participation at the board level must be regulated by an agreement between the works council and the company. This is a new development (prior to the 2006 legislation only two-tier board structures were possible), and it represents a potential weakening of employee representation at the board level, since there are no minimum requirements. Furthermore, Article 42 of the Law on State Property requires, that prior to adopting a decision concerning the sale of an enterprise under majority state ownership, the employees' representatives must be informed about any possible opportunities regarding the acquisition of ownership by the employees. Workplace representation in Hungary is provided by both local trade unions and (since 1992) elected works councils, with the balance between the two varying over time. After legal amendments initiated by the socialist government elected in 2002, only the union has the right to negotiate collective agreements.

¹³² While personal income tax is payable because the shares are regarded as earned income, no social security contribution must be paid (earlier share benefits were regarded as in-kind benefits, belonging to the highest income tax bracket (44 per cent), and the social security contribution was also payable).

XIII. Ireland

Although employee financial participation has been discussed in Ireland since the mid-1970s, not until 1982 was the first tax incentivised plan introduced (Approved Profit-Sharing Scheme/APSS). Additional tax incentives came in 1986. During the tax reform of 1997, additional plans (Approved Savings-Related Share Option Scheme/SAYE and Employee Share Ownership Trust/ESOT) were added. In 2001 another plan (Approved Share Option Scheme/APOS) was approved.

There are now six share-based plans linked to tax incentives – the four approved schemes enumerated above plus the purchase of new shares and restricted stock schemes. In addition there is an unapproved stock option plan. According to statistics provided by the Irish Business and Employers Confederation (IBEC), in 2002 there were in operation 400 APSS plans, 15 APOS plans and 90 SAYE plans with 140,000 employees. Whereas the number of new schemes has declined after 2001, it has been increasing again since 2004. In 2008, 10 per cent of the private sector workforce (estimated 135,000 employees) participated in 500 APSS schemes according to the Irish ProShare Association Revenue Review of APSS. Although there were only 125 SAYE plans in 2008, they seem to be the most popular judging by the number of participating employees. Many companies combine several approved plans and also operate unapproved ones (no statistics are available). The majority of plans are found in listed multinational companies.



1. General Attitude

Employee financial participation, especially share ownership, has been supported by successive governments, as a means of aligning the interests of employees with employers and making retirement more secure. However, it has not been linked with pension policy so far. Employee Financial Involvement (EFI) is addressed in national economic programmes and in national wage agreements, but is regulated only by local collective agreements or by in-house agreements.

Since the beginning of the 1980s, the Irish Business and Employers' Confederation (IBEC) has supported tax-efficient share schemes and regard them as a key element in recruiting and retaining personnel, but only if they remain voluntary. The Irish ProShare Association, which promotes and conducts research on employee financial participation, was founded by IBEC. Trade unions also support those financial participation plans which provide explicit financial rewards as well as a sense of participation. Representatives of both employers and trade unions support partnership initiatives at the enterprise level.

2. Legal and Fiscal Framework

Employee financial participation plans fall into two categories: either they are approved or unapproved. Plans introduced under the annual finance acts and approved by and registered with the Inland Revenue enjoy tax advantages as well as exemption from PRSI (compulsory social security contributions), which especially benefit employees. Unapproved plans may be designed and introduced at the employer company's discretion but receive no specific tax advantages. Approved plans must be designed in accord with legal specifications whereas unapproved plans enjoy more flexibility. Under current legislation, all approved plans (and typically unapproved plans as well) are share-based, including profit-sharing, share ownership and stock option plans. Tax incentives for approved plans are governed by the Taxes Consolidation Act of 1997, as amended (Part 17, Schedules 11, 12, 12A, 12B and 12C). Unapproved plans are used for granting shares or options to individual employees, where the company does not operate an approved scheme or where the company wishes to award shares in excess of the amount that can attract favourable tax treatment or in contravention of the rules of any of the approved schemes. Unapproved plans are usually combined with approved plans.

a) Share Ownership

An approved share ownership plan (purchase of new shares) as well as three stock option plans (SAYE, APOS and restricted stock) are supported by tax incentives. There is also an unapproved stock option plan which exempts employees from PRSI contributions but imposes the full personal income tax at exercise.

Share Ownership Plans – Purchase of New Shares: If employees pay full price for newly issued shares and hold them for three years, the subscription cost (subject to a lifetime ceiling of Euro 6,350 as of 2006) is exempt from both personal income taxes and PRSI. A capital gains tax is based on the issue price. The employer company is also exempt from PRSI. In a *Restricted Stock Scheme*, participants are given a future interest in shares, subject to certain restrictions. On shares held for at least one year, the employee may deduct a specific percentage of the benefit from the personal income tax base (from 10 per cent for one year to 55 per cent for more than five years).

Approved Stock Option Plans – The *Approved Savings-Related Share Option Scheme*

(*SAYE*), introduced by the Finance Act of 1999, is currently the most popular plan judging by the number of participants relative to the number of companies operating such schemes. It must be open to all employees on similar terms, with possible exception of employees with less than three years of service. The plan is structured as follows: the employee make a save-as-you-earn (*SAYE*) contract with a bank, agreeing to save a specified monthly amount (Euro 12 to 500) through deductions from after-tax remuneration for a period of three or five years service (In the five year plan the monies saved can be left on deposit with the financial institution for a further two years), while the employer corporation grants him share options for the maximum number of shares his *SAYE* savings will be able to buy at the exercise price. The *SAYE* contract always includes a tax-free bonus to be awarded at completion, the amount depending on the term. The exercise price may be up to 25 per cent lower than the market value of the shares at the time of grant. At maturity of the *SAYE* contract, the employee may choose to exercise the option, selling or retaining the shares, or to receive the savings and bonus in cash. These requirements fulfilled, the employee is exempt from the personal income tax at the time of grant or exercise; the capital gains tax, however, is levied at the time of sale. Neither the employee nor employer must pay PRSI.

The *Approved Share Option Scheme (APOS)* was introduced in the Finance Act of 2001.

Eligibility requirements are the same as for the share option scheme described above. It is further required that at least 70 per cent of options are transferred to the broad-based plan; shares may not be sold within three years of grant. These requirements fulfilled, the employee is exempt from the personal income tax at grant or exercise; at sale, the capital gains tax must be paid on the difference between proceeds and option price. Neither the employer company nor the employee is liable for PRSI.

b) Profit-Sharing

The oldest form of financial participation is the approved profit-sharing, introduced in 1982. It is a share-based leveraged profit-sharing plan. Cash-based and/or direct share-based profit-sharing plans are also possible, but have no tax advantages. Individual gain-sharing based on performance-related indicators, promoted by the government since 2000, may be more widespread than cash-based profit-sharing.

Approved Profit-Sharing Scheme (APSS) – The APSS must apply to all employees on similar terms, with the possible exception of those having less than three years service. Any shares allocated under APSS cannot be subject to restrictions other than restrictions which apply to all shares of the same class. An exception to the general rule on restrictions exists, when the company's articles of association require an employee or director to dispose of his/her shares on leaving the company.¹³³ Employee shares are held in trust and cannot be withdrawn for two years; not until the third year do tax incentives apply. The trust must allocate the shares to the employees within 18 months and subsequently is not held liable for the tax on dividends. Employee benefits of up to Euro 12,700 (2006)

¹³³ This provision could prove to be an obstacle to introducing these plans in non-listed companies if the employees – unlike shareholders who are not employees – have to sell the shares to the company after leaving, which in turn might create tax complications arising from the obligatory sale.

are exempt from both income taxes and PRSI contributions. If the shares are sold during the blocking period, the employee is liable to personal income tax on the lesser amount of the market value of the shares or the proceeds of sale. Shares sold after the blocking period are subject only to the capital gains tax.

Subsidiary schemes to APSS are the *'relinquished salary' scheme*, where the employee is allowed to deduct up to 7.5 per cent of his base pre-tax salary to increase his share-based profit-sharing, and the employer matching scheme (so-called *BOGOF*, that is, *buy-one-get-one-free*), where the employee buys shares with his after-tax income and the employer matches his purchases. The employing company can deduct costs of setting up and operation of the plan and costs of providing shares to employees, and it is not liable to PRSI.

Employee Stock Ownership Trust (ESOT) – Since 1997 the APSS has been allowed to combine with an ESOT, similar to the American Employee Stock Ownership Plan (ESOP). In contrast to the APSS trust, the ESOT is empowered to hold shares for 20 years; it may also borrow funds and sell shares. The trust pays no tax on dividends used for specified purposes (for example, acquiring shares, repaying loans, etc.). Shares transferred to the ESOT must be common shares, fully paid for and irredeemable. There are three types of trust structure permitted: single trustee; majority of trustees are employees; and equal employee/company representation plus an independent trustee. On shares not transferred directly to employees but first to the APSS trust, tax incentives for APSS apply. The ESOT is not subject to capital gains tax on disposal of shares provided the proceeds are used for specified purposes. The ESOT was widely used for privatisation of state-owned enterprise. Usually 14.9 per cent of the equity capital of the company undergoing privatisation was accumulated in the ESOT for employees. Shares were typically acquired by a combination of loans and a direct state grant, in exchange for productivity concessions and the agreement of trade unions to privatise. A well known example is the Eircom ESOP whereby the employees own 35 per cent of the shares through an ESOT which has a representative on the board of the now privatised company.

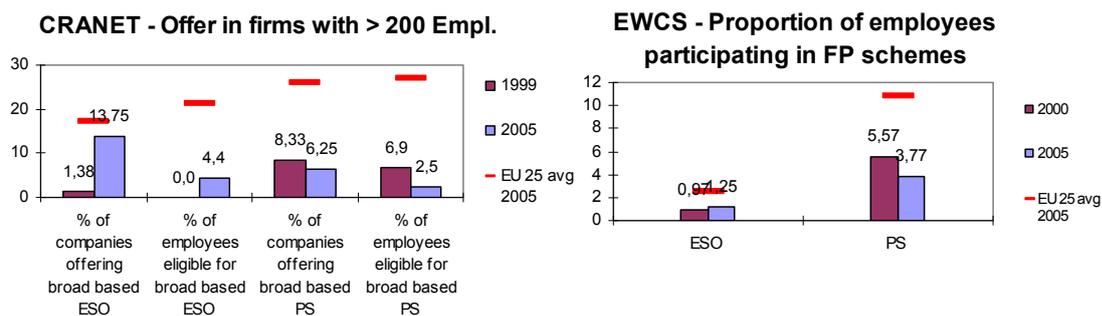
c) Participation in Decision-Making

Participation in decision-making and financial participation have no direct connection, nor can existing decision-making rights be extended by a financial participation plan. General provisions of labour law, such as equal pay and prohibition of discrimination, also apply. Employee representatives in Ireland's single-tier boards are only found in the state-owned sector, where they normally account for a third of the total. Privatisation has cut the number of companies covered and the process is continuing. There is no statutory system for workplace representation in Ireland. Those who work in unionised workplaces – about half of the entire workforce – have representation through the union. New procedures have been introduced as a result of the EU directive on information and consultation, but they may not make much difference. National pay pacts have provided a framework for bargaining in Ireland since 1987. Agreed between the unions, employers and government, they are not legally binding, but have been widely observed.

XIV. Italy

Financial participation in Italy has emerged particularly since the mid-1980s, with the development of company level bargaining agreements. This development took place at a time when companies were restructuring their production processes and redesigning human resource management; labour unions, seeking more power and legitimacy, saw to it that workers had an important role in shaping these agreements at the company level.

The most important form of employee financial participation used to be profit-sharing but recently employee ownership has been catching up. The Italian privatisation process, implemented on a large scale since the 1990s, had no significant impact on employee ownership. Workers co-operatives, on the other hand, have significant importance in the commercial sector, as well as a long historical tradition. Tax incentives for employee financial participation were introduced in the late 1990s; unlike in most other countries they regard also smaller firms, that is, limited liability companies.



1. General Attitude

Under the Tripartite Agreement of 1993¹³⁴, new rules on decentralised bargaining and income policy were adopted. Although this had a positive effect on the introduction of PEPPER schemes, corresponding tax incentives for promoting employee financial participation were not introduced until 1997; the emphasis as placed on achieving macro-economic benefits through linking pay to performance, especially to check wage inflation. Promoting a new environment of participation at the micro-economic level was less relevant. It is difficult to evaluate what impact the bargaining rules of the 1993 agreement had on the spread of employee financial participation in Italy; regularly published official data on the incidence of these plans is lacking. Recently, however, a renewed interest in this issue has stimulated new proposals to make compensation schemes more flexible and to

¹³⁴ 'Protocollo sulla politica dei redditi e dell'occupazione, sugli assetti contrattuali, sulle politiche del lavoro e sul sostegno al sistema produttivo' of 13 July 1993.

increase tax incentives. This government initiative, supported by both, unions and employers' representatives, confirmed by Law No. 126/2008 was extended in the 2009 budget.

Trade unions and employer representatives alike have mixed views of financial participation. Trade unions agreed in principle on the positive effects of profit-sharing but were divided over employee share ownership schemes. Of the major trade unions, CISL is in favour of share schemes, regarding them as a means to expand participation in decision-making; UIL, on the other hand, believes it not the function of trade unions to promote share ownership. CGIL, however, is traditionally opposed to share schemes; its position is that employee financial participation is better realised through special complementary funds ('Fondi di previdenza complementare'). Employer associations were similarly divided. Confindustria wants to leave the matter entirely to individual enterprises without taking a stand. The organisations representing SMEs (Confartigianato, Confcommercio) are more open to financial participation if it takes the form of funds to promote regional development of SMEs. However, in the context of a new legislative initiative in 2009 these positions are being reevaluated.

In summary, the political situation in Italy is in a state of evolution. All political parties agree on introducing fiscal incentives (namely, tax reduction) to encourage company-level agreements linking increases in remuneration to increased productivity. This principle was mentioned in the tripartite agreement of 23 July 2007; although not yet implemented, it is expected to decrease the tax burden on remuneration made in the form of profit-sharing. Despite increased interest in this subject, other kinds of participation, for example, employee shareholding, do not have the unanimous support of employer associations and trade unions.

2. Legal and Fiscal Framework

Although Art. 47 of the Italian Constitution recognises the right of workers to have access to share investments in the main production industries, legislative support of employee financial participation is comparatively underdeveloped (compare Pendleton and Poutsma 2004, p. 12). Special legislation, including tax incentives, exists for profit-sharing, employee share ownership and stock option plans.

a) Share Ownership

Pursuant to the Law No. 262 of 28 December 2005, quoted companies that intend to provide share or stock-option plans to employees, directors or consultants need the approval by the shareholder meeting; they also must communicate information on the plan to both Consob (the Italian Securities and Exchange Commission) and to the public. In general the sale gain is taxed with 12.5 CGT instead of 40 per cent provided that the transfer regards less than 2 per cent of the votes or 5 per cent of the capital in quoted companies or respectively less than 20 per cent of the votes or 25 per cent of the capital

in non-quoted companies; in cases of losses the amount can be carried forward as a tax credit.

Share Plans – The Italian Civil Code (hereinafter referred to as CC) regulates discounted employee shares in joint-stock companies with a holding period of 3-5 years.¹³⁵ According to Art. 2441 CC, the pre-emptive right of shareholders can be suspended for up to 25 per cent of newly issued shares by majority vote of the general assembly if these shares are to be transferred to employees; for more than 25 per cent, majority shareholder vote is required. To facilitate the acquisition of shares by employees, the law permits a company to advance funds and to make and secure loans, with a view to acquisition by employees of the company, conditional that this ‘financial assistance’ is within the limits of distributable reserves (Art 2358 CC). Furthermore, Art. 2349 and 2351 CC permit the issuing of special ‘employee shares’ in capital increases with specific rules for form, tradability and rights (see below c)). Since 1999 pursuant to Decree Law 505/99 free shares are not considered income and exempted from personal income tax and social security contributions up to a threshold of Euro 2.066. According to Art. 51 of the Income Tax Law (hereinafter referred to as IITL), the tax exemption is linked to a blocking period of three years. However, no blocking period has to be observed if the shares are transferred *ex lege* (Tax Agency decision No. 97 of 25 July 2005).

Privatisation – Pursuant to § 381 of the Law No. 266 of 23 December 2005, the by-laws of companies in which the State has a significant ownership position may foresee special financial instruments or categories of shares, to be offered free to all shareholders, or in the case of specific shareholders for the payment of compensation in order to facilitate the privatisation process.

Stock Option Plans – Specific rules regarding stock option plans were introduced in 1997 under Art. 48 para. 2 g) and g-bis) IITL as amended by the Decree Law 314/97. Decree Law 505/99 exempted the increase in value between grant and exercise of the option from social security contributions and personal income tax with new conditions for the tax exemption introduced by Decree Law No. 262 of 3 October 2006 (the so-called ‘Financial Law’ converted into Law No. 286/2006): (1) minimum vesting period of three years from when they are assigned; (2) at the moment when the employee exercises the option or the share is accrued, the company is listed on the market¹³⁶; (3) a minimum holding period of five years from date of exercise, for shares representing the difference between the value of the shares at grant and the amount provided by the employee. Nevertheless, the exemption from PIT was cancelled by Decree Law No. 112/2008 and Law No. 113/2008.

Limited Liability Companies (SRL) – While a share in a SRL transferred as remuneration is subject to corporate income tax at company level, a free share is exempt from tax and social security contributions up to an amount of Euro 7.500 (2009) with the notary fees borne by the employer.

¹³⁵ However, pursuant to Law No. 112/08 the value of the discount is deemed income and subject to personal income tax and social security contributions accordingly; the same applies to shares transferred in lieu of remuneration.

¹³⁶ This condition substantially reduces the possibility of exemption from ordinary taxation for a large number of employees, considering that the number of companies listed on the market is rather low.

b) Profit-Sharing

Rules for profit-sharing are determined by collective bargaining at the company level. Tax incentives for profit-sharing were introduced by the Decree Law No. 67 of March 1997 allowing a partial tax exemption for employers' contributions up to 1 per cent of the payroll; this percentage was subsequently increased to 3 per cent.¹³⁷ Further, a 10 per cent 'compulsory solidarity contribution', substituting for the general social security contribution, was introduced. Although the new Law No. 247/2007 increased the tax exemption for employer contributions to a maximum of 5 per cent the Inter-ministerial decree of 7 May 2008 set a ceiling of 3 per cent. The employer benefits from a 25 per cent reduction in social security contributions. The employee is exempted from social security contributions, which the state covers in order not to reduce the initial contribution. The ceiling of the annual maximum value of the bonus rose from Euro 3.000 to Euro 6.000 with the income ceiling for eligibility for incentives fixed at Euro 35,900 annually.

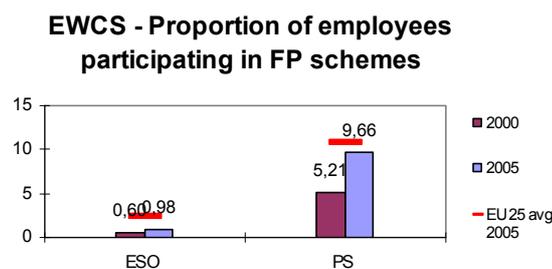
c) Participation in Decision-Making

Employee financial participation is generally not linked to the extension of the existing participation rights in decision-making. A rare exemption is Art. 2351 CC: it stipulates that shareholders of specific 'employee shares' can be granted the right to nominate a representative to the management or supervisory board under the company's articles of association. Nevertheless, Art. 2351, introduced with the 2003 reform of the Civil Code has not been used to date. Although Art. 46 of the Italian Constitution recognises the right of workers to 'co-operate in the running of the companies in a manner and within the limits defined by the law', this regulation was never transformed in special laws. However, Law No. 300/70 guarantees the freedom of trade unions and the right to be represented. The so-called 'Intesa Quadro' between the major trade unions CGIL, CISL and UIL of 1 March 1991 introduces an organ of union representatives (RSU, rappresentanze sindacali unitarie) which may be set up in any company with more than 15 employees and has the right to represent workers, inter alia in collective bargaining. Information rights (for example, about investment, planning, production, forecasts, technological changes) and consultation rights (for example, on internal work rules and the working environment) are defined in collective bargaining contracts. The recent transposition of the European Directives on Information and Consultation rights (Decree Law 25/2007) into national law extends and strengthens the effectiveness of these rights in all companies employing more than 50 employees.

¹³⁷ In 1998, the share of the flexible wage exempted from payment of social security contributions was raised to 2 per cent and in 1999 the tax relief was re-determined to a maximum of 3 per cent.

XV. Latvia

Employees financial participation in Latvia may be summarised as poorly developed and on the decline. During the transition period, privatisation shaped the environment for employee financial participation and influenced the current state of employee share ownership and profit-sharing. However, the transition process only resulted in a low level of employee financial participation. By the end of 1998, shares with the nominal value of LVL 27 million, amounting to 13.56 per cent of total shares, had been sold for vouchers to 25,611 employees and former employees of the companies. During the period 1997-1999, employee and former employee ownership decreased by 19.2 per cent and 23.3 per cent.¹³⁸ Profit-sharing is reported in only 7 per cent of 167 enterprises responding to a 1997 management survey, but five out of 28 enterprises had majority employee ownership.



1. General Attitude

Trade unions are quite weak; the current rate of unionisation in Latvia is 18 per cent. The Free Trade Union Confederation of Latvia (FTUC) is the biggest non-governmental organisation in Latvia; it protects the interests of employees who are trade union members at branch and inter-branch levels, and represents 25 organisations. Financial participation of employees is currently not on the trade unions' agenda. Employers are represented by the Latvian Employer's Confederation (LEC), which considers the issue of financial participation of employees is outside the Confederation's area of expertise. The government is not concerned with employee financial participation; its priority is employment. The Ministry of Social Affairs concentrates its activities on solving problems related to increases in the minimum wage and unemployment allowances. Nor is employee participation on the political agenda of Parliament. Recently, however, political parties and policy makers have shown a growing interest in this issue.

¹³⁸ According to another study based upon responses from 915 enterprises specifying their ownership structure for 1997, 1998 and 1999 (Jones and Mygind, 2005).

2. Legal and Fiscal Framework

Both employee share ownership and profit-sharing are found in Latvian companies and are directly or indirectly regulated by legislation. Although there is no special legal regulation of profit-sharing, several pieces of legislation relate to employee share ownership. Regulation in this area has not been systematic, so existing legislation partly creates incentives and partly inhibits these schemes.

a) Share Ownership

Privatisation – Small privatisation started in November 1991 in accordance with the Law on the Privatisation of Objects of Trade, Catering and Services. Local privatisation commissions decided the privatisation method, initial price, etc. Potential privatisation methods were sale to employees, auctions to a selected group, open auctions, and sale to a selected buyer. Buyers had to be Latvian citizens or to have been residents of Latvia for at least 16 years.¹³⁹ Large privatisation of state-owned property and land was and still is being carried out by the Latvian Privatisation Agency. Although in an advanced stage, the privatisation process is not yet completed, so that it remains possible for employees to acquire shares under the Law on the Privatisation of Objects owned by the state or a municipality and the Law on the Reorganisation of State and Municipal Enterprises in Corporations (RL). Shares of state owned corporations can be sold to employees, in the course of privatisation, at a price even lower than the nominal value of such shares. However, the shares to be sold to the employees cannot exceed 20 per cent of the share capital of the particular company (Art. 57 RL). If municipal objects are privatised by restructuring, the privatisation plan must contain a clause stating how many shares will be sold to employees, as well as the discount if such is applicable according to law (Art. 40.2.5 RL). The 20 per cent limit on employee share privatisation seems to be a limitation of rights rather than an entitlement, due to the fact that there is no clear legal obligation to offer any shares whatsoever to employees in a particular privatisation case.

State or municipal owned companies (2001) – According to the Law on State and Municipal Corporations, the government of Latvia or the respective municipal authority decides in which state or municipal company employee shares can be issued (Art. 68 (1), (2)). Employee shares can only be owned by employees and board members. If employment is terminated, or the board member leaves office, the employee's shares are transferred back to the company. This is one of the exceptions when a company is allowed to acquire its own stock (Art. 70). Employee stock acquired by the company must be transferred to employees within six months. Shares not transferred within the prescribed time period will be cancelled and the share capital decreased accordingly (Art. 71 (1), (2)).

Private Companies (2004) – For a limited liability company, there are no special legal regulations on employee share ownership so general rules apply. By contrast, a joint-stock company may issue shares which can be acquired by employees in the broad sense, that is,

¹³⁹ Decrees of 1992/93 included a list, proposed by the sector Ministries, of 579 medium and large enterprises to be privatised. Four hundred of these enterprises were to be public offerings, and an additional 147 were to be leased with the option to buy; later this list was expanded to 712 enterprises.

including managers (Art. 255 (1) Commercial Law (CL). Employee stock shall be issued only on account of the net profit of the company, and the total value of employee stock should not exceed 10 per cent of the registered company's equity capital (Art. 255 (4) CL). Another limitation concerning employee stock is the requirement that the company's own capital not become less than the registered capital (Art. 255 (5) CL). No voting right and right to liquidation quotas are attached to employee stock issued according to Art. 255 CL.¹⁴⁰ Such stocks can be freely sold if the Articles of Association do not provide otherwise (Art. 255 (7) CL).

b) Profit-Sharing

There are no legal limitations or regulations pertaining to profit-sharing. Salaries may be made dependent upon company profit and benefits may be provided in the form of premiums or in other forms directly linked to the profits of a particular company. However, all benefits are subject to a personal income tax of 25 per cent. This reduces the incentive to provide additional benefits since the benefits of profit-sharing are 25 per cent less than they would be on dividends paid to employee shareholders; dividends are not subject to tax.

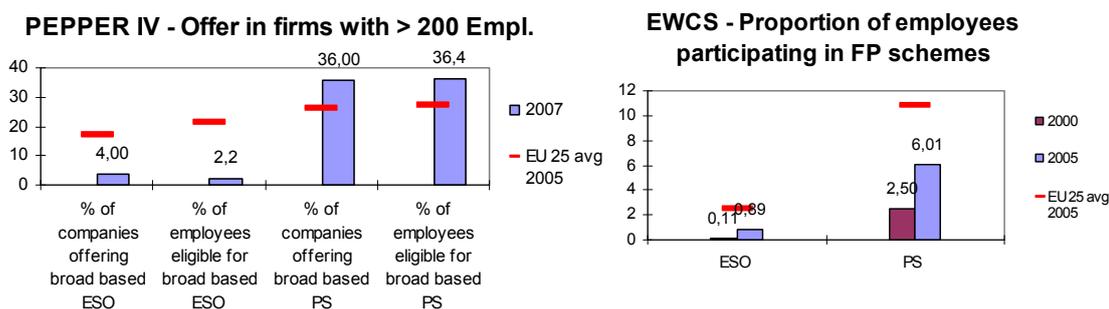
c) Participation in Decision-Making

There is no statutory employee representation at the board level in Latvia. The main form of workplace representation in Latvia is through the unions, but since the revised Labour Law (LL) came into effect on 1 June 2002, it has also been possible to elect 'authorised employee representatives' (Art. 10 (1) LL). Both are involved in information and consultation and both can be involved in collective bargaining, although non-union representatives can only negotiate if there is no union (see Art. 18 (1) LL). The employer shall consult with employee representatives on issues that may affect the interests of employees, in particular decisions which may substantially affect work remuneration, working conditions and employment (Art. 11 (1) 2) LL).

¹⁴⁰ Employee stock issued by a private joint-stock company according to Art. 255 CL should be differentiated from the stock acquired by employees in the course of privatisation. Limitations attached to employee stock according to Art. 255 CL, in particular lack of voting rights, do not apply to privatisation stock.

XVI. Lithuania

After Lithuania regained independence, employee ownership was used to implement privatisation. In the initial stage 1991-1995, employee buyouts at a discount, combined with the extensive use of vouchers by employees and leasing with the option to buy, resulted in a high percentage of employee majority ownership. By 1994, fewer than 5 per cent of privatised firms in the programme implementing the Law on the Initial Privatisation of State-owned Property (LIPSP) had no employee ownership, while the percentage of enterprises where employees had taken over most of the privatised assets increased from 3 per cent in 1991-1992, to 65 per cent in 1993 and 92 per cent in 1994-1995 (Privatisation Department at the Ministry of Economics). Since most of the preferential rights of employees were abolished in 1995, employee ownership began to decline, and ownership is now mainly in the hands of management and outsiders.¹⁴¹ No data is available on profit-sharing. At present in Lithuania, financial participation tends to be viewed as an incentive for motivating managers, initiated by managers and current owners of companies.



1. General Attitude

Trade unions are organised through the Lithuanian Trade Union 'Solidarumas', the Lithuanian Labour Federation and the Lithuanian Trade Union Confederation, the latter being the largest and strongest union with over 120,000 members. In the early stage of transition, unions promoted employee ownership and actively contributed to place EO on

¹⁴¹ A manager survey conducted in spring 2000 provides information on ownership at the time of privatisation or start-up as a new company for the years 1993, 1996, 1999 and spring 2000 with 405 respondents (for details, see Lowitzsch, 2006, pp. 199, 205, Table 4). In 1993, approximately 50 per cent of employees were owners in the sample of responding enterprises. However, that proportion fell to about one third in 1999. Not surprisingly, the proportion of employee owners was highest in employee-owned enterprises, but here also the proportion of owners fell from 76 per cent in 1993 to 66 per cent in 1999.

the Lithuanian privatisation agenda. The general objective of trade unions is higher wages for employees while associating employee ownership with an increase in company profitability. Although no particular actions concerning employee financial participation are presently on the Confederation's agenda, this issue could garner support if any industrial trade union made a proposal. Employers are organised within the Lithuanian Confederation of Industrialists, which actively promotes the interests of large businesses and in the Lithuanian Employers' Confederation; the question of employee financial participation has not been addressed by either of them. While the former has no official position on this issue, it supports initiatives of individual enterprises. Recently, employers have been paying more attention to employee motivation, for example, through financial incentives; this interest is prompted by the emigration of skilled workers, a growing problem. The coalition parties which came into power in 2004, including the Social Democrats (LSDP), the New Union (Social Liberals) and the newly established Labour party (DP), do not mention financial participation in their official programmes. Their focus is on increasing social guarantees and reducing poverty and unemployment.

2. Legal and Fiscal Framework

Employee financial participation is only slightly regulated. Current legal regulations neither contain special provisions on PEPPER schemes nor provide companies with incentives to introduce them.

a) Share Ownership

Privatisation (1991, abolished 1995, 1997) – The first stage of privatisation started when the Law on the Initial Privatisation of State-owned Property of 1991 with the agent of the rapid privatisation in Lithuania being the voucher scheme.¹⁴² Employees had the opportunity to buy a certain percentage of shares in the first round of auctions at lower rates before most of the remaining shares were sold in public offerings in later rounds. The percentage of shares available for employees was increased from 10 per cent in 1991 to 30 per cent in 1992 and to 50 per cent after the former Communist Party came into power in early 1993. The additional 20 per cent shares reserved for employees after 1993 did not initially include voting rights; later the general meeting could convert these shares into regular voting shares. The second stage of privatisation was based upon a new Law on Privatisation of State-owned and Municipal Property of 4 July 1995 which aimed at the sale of residual shares and some of the very large companies, including public utilities and infrastructure enterprises and abolished Vouchers; only cash privatisation was permissible. The third Law on Privatisation, still effective, was adopted on 11 April 1997. Privatisation of the majority of enterprises in Lithuania is now complete. However, privatisation is still

¹⁴² Vouchers and cash quotas were only given to residents and had limited transferability (to relatives, later they could be used in exchange for outstanding housing loans).

possible and the respective legal regulations are still in force.¹⁴³ The current Law on Privatisation contains no significant preferential rights for employees in the privatisation process. However, if shares are privatised by public tender, employees can be offered up to 5 per cent of the state-owned shares at par value. This provision does not apply to enterprises under state control or to enterprises in which employees have already acquired shares of their employer enterprises under other laws (Art. 16 (3)). If shares are offered at a public tender or by direct negotiation, the final payment can be postponed for five years in the case of employees (Art. 20 (3)).

Private Companies (1995, 2003) – In the course of capital increase, corporations (joint-stock companies as well as limited liability companies) can issue employee shares after all shares subscribed at the time of incorporation have been paid for (Art. 43 Law on Companies¹⁴⁴, hereinafter referred to as CL). The CL sets no maximum percentage on these new employee shares. They are to be distributed among all employees wishing to purchase them, except for management (Art. 43 (2) CL). A restriction period of not longer than three years must be determined within which employee shares can be sold only to other employees (Art. 43 (3) CL). During this period employee shares are not only of limited tradability, but also non-voting (Art. 43 (3.3) CL), although employee shares are ordinary shares (Art. 43 (1.1) CL). Art. 43 (5) CL stipulates that an employee must pay for subscribed employee shares before the restriction period for the transfer of shares expires. The first payment should be made in cash within a short period; further instalments can be deducted from the employee's salary upon application of the employee. The corporation may not exact pressure on employees to force them to purchase shares or to pay for shares by salary deductions (Art. 43 (4) CL). After the restriction period for the transfer of shares expires, employee shares become ordinary shares and can be sold to third parties not company employees (Art. 43 (3) CL). Since most employees are minority shareholders, provisions on the protection of minority shareholders apply.

b) Profit-Sharing

There are no specific regulations on sharing profits with employees. Since companies pay income tax on dividends, this is viewed as an expensive method of profit distribution; therefore priority is given to share buyback schemes. Employee monetary incentive schemes used in companies include payments of premiums and bonuses, in some cases related to company turnover and profits. Bonuses have tax advantages, since they are not double taxed as dividends are (firstly at corporate profit tax rate, secondly at income tax rate), but taxed only as income for individuals (33 per cent).

¹⁴³ The most important of these are the Law on Privatisation of State Property and Property of Municipalities of 11 April 1997 as amended (hereinafter referred to as PL), the Law on Securities Market of 16 January 1996 as amended, and the Law on the State Property Fund of 11 April 1997 as amended.

¹⁴⁴ Law on Companies from 11 December 2003, No. IX-1889 (Valstybės žinios 2003, No. 123–5574) as amended; according to CL, shareholders have the pre-emptive right to acquire shares or convertible debentures issued by the company, unless the general meeting decides to withdraw the pre-emptive right for all shareholders.

c) Participation in Decision-Making

According to the Labour Code¹⁴⁵ (hereinafter referred to as LC), employees may be represented and protected by trade unions or by work councils (Art. 19 (1) LC).¹⁴⁶ The work council should include representatives of all employees. A trade union, however, can be established by a small number of employees in an enterprise. The works council may be elected only when there is no local trade union and if the staff meeting has not transferred the function of employee representation to the sectoral trade union. The trade unions or works councils have the right to negotiate collective bargaining agreements, to participate in information and consultation procedures, to approve internal work regulation in the enterprise. There is no rules on participation in the management or supervisory boards.

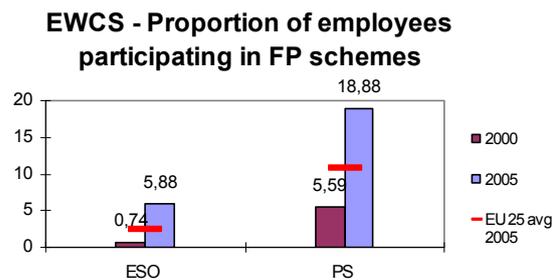
¹⁴⁵ From 4 June 2002, No. IX-926 (Valstybės žinios 2002, No. 64-2569) as amended.

¹⁴⁶ Where an enterprise, agency or organisation has no functioning trade union and if the staff meeting has not transferred the function of employee representation and protection to the trade union of the appropriate sector of economic activity, the employees shall be represented by the work council elected by secret ballot at the general meeting of the staff (Art. 19 (1); 21 (2) LC).

XVII. Luxembourg

Few employee financial participation plans exist, mainly in multinational companies in the financial sector. Presumably the most common form is cash-based profit-sharing; the data, however, is unreliable inasmuch as the widely used bonus plans ('gratification') are generally unrelated to profits or other financial indicators and therefore are not genuine profit-sharing plans. Share ownership and stock option plans are few and very seldom broad-based.

According to a recent cross-country study, the percentage of enterprises offering various forms of financial participation plans in 2005 was as follows: employee share ownership plans, 3.9 per cent, and profit-sharing plans, 13.7 per cent (EWCS). Approximately 25 per cent of companies offered stock option plans in 2003 (EU Report on Stock Option Plans). Please note that these figures include executive plans.



1. General Attitude

Government interest in employee financial participation dates from the beginning of the 1990s. At that time, policy makers were especially advocating voluntary profit-sharing, with the proviso that it should not be made a part of collective agreements. Nevertheless, no concrete policy measures were adopted and in recent years the issue has not been broached. Employers' associations (organised in the Union des Entreprises Luxembourgeoises, UEL) were generally opposed to financial participation schemes, preferring other flexible pay models, however, they have not recently taken a position. The two major trade unions, the Onofhängege Gewerkschaftsbond Lëtzebuerg (OGBL) and the Lëtzebuerger Chrëschtliche Gewerkschaftsbond (LCGB), were sceptical about employee financial participation, fearing loss of control over the collective bargaining process. Nevertheless, some collective agreements have included elements of profit-sharing.

2. Legal and Fiscal Framework

No special legislation or tax incentives exist for any form of employee financial participation.

a) Profit-Sharing

Cash-based profit-sharing is supposed to be the most common form. This is difficult to distinguish, however, from the commonly practiced bonus plan (gratification), which is unrelated to financial indicators. Nevertheless, incidental evidence suggests that sometimes collective agreements link this ‘gratification’ to company profits. Since collective agreements, except for those declared binding for subsidiaries, are not public, it is difficult to quantify this phenomenon. An exception is the collective agreement for the banking sector. We may conclude that genuine cash-based profit-sharing plans, especially broad-based ones, will be very rare.

b) Share Ownership

Broad-based share ownership and stock option plans, if any, exist in very few large multinational companies. There is no special legislation on these types of plans. Stock option plans can be divided into potential options (not tradable at grant) and tradable options (tradable at grant). Tradable options for employees are very rare. The employee is subject to personal income tax at exercise, but exempt from social security contributions. The employing company can deduct the costs of the plan and is exempt from social security contributions.

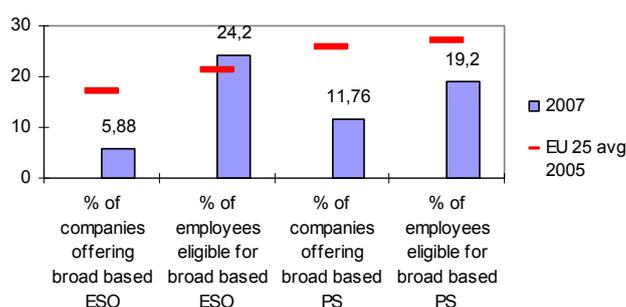
c) Participation in Decision-Making

There is no direct connection between participation in decision-making and financial participation of employees; in particular, financial participation plans cannot extend existing rights pertaining to participation in decision-making. In companies with compulsory employee representation on the board (pursuant to Art. L. 426-1 of the Labour Code in state companies and companies with more than 1,000 employees), employee representatives may initiate and influence the design of financial participation plans.

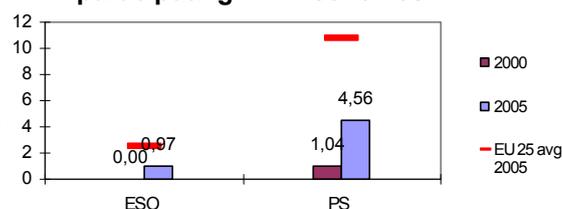
XVIII. Malta

In spite of a strong historical link to the United Kingdom, the source of much of the law on Companies and Employment, in practice employee financial participation is not well developed in Malta, being neither well diffused nor enjoying much political support. The ramifications of the nationalisation programme in the 1970s and the privatisation drive of the 1990s had the unintended consequences of introducing employee financial participation in some larger firms first. However, privatisation cannot be said to have been auspicious for workers' participation. The largest schemes in operation at two previous state owned enterprises are share ownership schemes; profit-sharing is rare. Most of the firms which operate financial participation schemes have a unionised work force with trade union support.

PEPPER IV - Offer in firms with > 200 Empl.



EWCS - Proportion of employees participating in FP schemes



1. General Attitude

The government policies that actually triggered the largest PEPPER schemes in practice were not focused upon employee financial participation but produced it rather as a side effect. Between 1971 and 1987 the newly elected government of the Malta Labour Party (MLP) embarked upon a programme of nationalisation as part of the de-colonialisation process, seven years after attaining political independence. The banking sector, at that time dominated by two major banks, was one of the nationalisation targets. The winding up of a 'widow and orphans' fund in operation in these banks prior to nationalisation resulted in the creation of a number of shares for the employees of one of these banks. The privatisation programme of 1990 adopted by the Nationalist Party (NP), in power since 1987, also had the unintended consequence of introducing employee financial participation schemes in the banking sector. Reversing the process of nationalisation begun by the previous administration, the government divested itself of several entities in which it was a majority shareholder. A side effect of this privatisation process was the creation of a trust fund for the benefit of employees in one of the banks.

Despite the social partners' apparent lack of enthusiasm, trade unions have supported all the schemes that were proposed, putting them into practice and actively participating in their administration. With no collective bargaining at the sectoral level, it is easier for Maltese trade unions to support such schemes in practice. The most active trade union in this area is the Malta Union of Bank Employees. This arises from the fact that the two major banks, where the union is heavily represented, were the targets of both the aforementioned nationalisation and privatisation programmes. The general trade unions, that is, General Workers Union, the island's largest union, and the Union of United Workers, were also involved in prolonged discussions with the Government about the introduction and implementation of a public sector scheme which gave employees the opportunity to set up co-operatives and submit tenders for work contracts. PEPPER schemes have never been prominently featured on the agendas of the two major political parties. The present NP government, while rather passive, is not adverse to financial participation.

2. Legal and Fiscal Framework

Maltese law tends to refer to employee participation schemes indirectly; it tacitly recognises that Maltese firms may put such schemes in place (by means of private or collective agreements), rather than establishing a formal framework for their establishment or creating any significant fiscal or other incentives. However, Maltese law does provide a legal instrument for ESOPs, namely the trust vehicle. Tax incentives for financial participation schemes are few.

a) Share Ownership

Privatisation (1990) – The privatisation drive which the Nationalist Party embarked upon in the early 1990s resulted in a share ownership scheme being put into place for the employees of two formerly para-statal entities¹⁴⁷ which were partially privatised.¹⁴⁸ However, these schemes had no statutory basis; they were set up and regulated by means of private agreements (both individual contracts and collective agreements) between the newly privatised companies and their employees. Interestingly, the statutes of two as yet un-privatised utility providers, the Enemalta Corporation¹⁴⁹ and the Water Services Corporation,¹⁵⁰ explicitly permit the *'establishment, by the Corporation [...] of schemes or incentives related to productivity or performance.'*

Private Companies (2004) – There is no statutory framework for either share ownership or share option schemes. Maltese law does not regulate the exact conditions under which

¹⁴⁷ By virtue of their nationalisation these two banks had become para-statal entities (independent statutory bodies within the realm of the public sector).

¹⁴⁸ This was a trust fund, set up on behalf of employees, in the Bank of Valletta, a formerly state owned bank, and in Maltacom, a state owned telecommunication enterprise.

¹⁴⁹ Enemalta Corporation Act, 1977 (Chapter 272 of the Laws of Malta).

¹⁵⁰ Water Services Corporation, 1991 (Chapter 355 of the Laws of Malta).

share option schemes may be offered. It is left to individual companies to create their own schemes based on general company and civil law principles. Provided that a company is empowered by its Memorandum and Articles of Association to implement employee financial participation schemes, employers wishing to adopt one of the two types of schemes can enter into private or collective agreements with their employees, setting out the scope, terms and conditions. Where the employer company is itself the issuer of the shares to be offered to its employees, it is not considered to be providing an investment service subject to the Investment Services Act 1994 (IS Act).

Shares must be allocated to employees in accordance with the general rules set forth in the Companies Act 1995 (CA). As a general rule, the CA prohibits a company from acquiring its own shares (Art. 105 para. 1 CA) or the shares of its parent company (Art. 110 para. 1 a) CA), or providing financial assistance for the purchase of either (Art. 110 para. 1 lit. b) CA). However, Art. 106 para. 4 CA and Art. 110 para. 2 CA make an exception to this general rule allowing a company to both acquire its own shares or those of its parent and to provide financial assistance in order to facilitate the acquisition of shares by or for its own employees or the employees of a company of the same group. It should also be noted that the CA generally allows companies to offer their shares at a discount or pay a commission to anyone subscribing or agreeing to subscribe to company shares. This may also apply where shares are offered to employees at a discount in a corporate share ownership scheme. In this context the CA does not differentiate between discounted shares offered to employees or to third parties.¹⁵¹ Tax law, on the other hand, offers no significant tax incentives for these schemes. As for stock options, it offers certain minor incentives. Under the Fringe Benefit Rules issued under the Income Tax Act,¹⁵² share options are taxable only upon exercise.¹⁵³

Employee Share Ownership Plans (ESOPs) – Maltese law contains no specific legislation on ESOPs. Recent Trust legislation,¹⁵⁴ inspired by Jersey legislation, has seamlessly integrated the UK common law concept of trusts into Maltese law. A Trust can take many forms, and although the concept originated in the UK, trusts are not exclusive to countries that follow the common law tradition. One of these civil law countries is Malta which, through the Trusts and Trustees Act 1988, as amended in 2004 (Trusts Act), allows Maltese individuals and companies both to found and be a beneficiary in trusts regulated by Maltese law. The Trusts Act does in fact contain an explicit reference to ‘employee benefit or retirement schemes or arrangements’ as forming the basis of a Trust. Although traditionally used for hedge funds, the ‘Collective Investment Scheme’ (CIS) may also be the basis for an ESOP.¹⁵⁵ With regard to the taxation of ESOPs which fall

¹⁵¹ Consequently, the following conditions apply across the board: (i) authority for the making of discounts must be given by the company’s Memorandum and Articles of Association, (ii) the discount must not exceed 10 per cent of the issue price or as prescribed by the Memorandum and Articles, whichever is less, (iii) the amount or rate of discount must be made public, and (iv) in no event may the value of the shares be reduced to below their nominal value as a result of such a discount.

¹⁵² Legal Notice 125 of 2001.

¹⁵³ Rule 36 of the Fringe Benefit Rules (LN. 125 of 2001).

¹⁵⁴ The Trusts and Trustees Act, 1988 (Chapter 331 of the Laws of Malta)

¹⁵⁵ ‘Collective Investment Scheme’ defined in Art. 2 IS Act is any scheme which aims at ‘collective investment of capital acquired by means of an offer of units for subscription, sale or exchange’. It must operate according to the principle of risk spreading and either (i) the contributions of the participants and

within the definition of CISs, unfortunately the Income Tax Act 1948 does not distinguish between exempted and non-exempted CISs; therefore the income from CIS ESOPs will be taxable at the normal rate. For taxation purposes, a CIS is treated as a prescribed fund. Investment income, as defined in the Income Tax Act 1948, which is received by a prescribed fund, is subject to a withholding tax of 15 per cent on bank interest and 10 per cent on investment income from other sources. Other income and capital gains remain exempt for prescribed funds. When Maltese resident participants of the CIS (the employees) redeem, liquidate or cancel their units in the CIS, they are not subject to a second withholding tax.

b) Profit-Sharing

Maltese employment law considers profit-sharing arrangements between employers and employees as forming part of the employee's wage. Maltese labour legislation also recognises service contracts in which remuneration is solely in the form of a commission or a share of the employer's profits,¹⁵⁶ although these are rarely found in practice. This treatment as a 'wage' implies that any share of the profits will be computed together with the employee's salary for the purposes of the imposition of income tax.

c) Participation in Decision-Making

There are no general statutory arrangements for board level representation in Malta. Employee representatives in companies at board level are only found in the state-owned and recently privatised sector, and even here they are becoming less common. In Malta it is the union, provided it is recognised (that is, the employer agrees to negotiate with it), that normally represents the employee at workplace level. Although EU directives have led to new arrangements for non-unionised employees, these do not seem to have been implemented to any extent. 2006 legislation, requiring the setting up of information and consultation structures, applied to companies with 150 or more employees from January 2006, and to companies with 100 or more employees from March 2007. From March 2008 on, it applies to companies with 50 or more employees. The key level for collective bargaining is the company level. There is also protection for those not covered by collective bargaining through a series of wage orders for specific industries that set minimum terms.

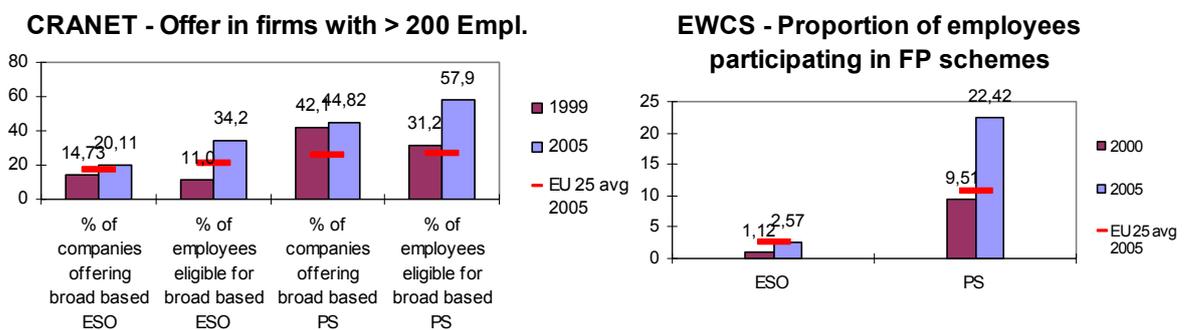
the profits or income out of which payments are to be made to them are pooled; or (ii) at the request of the holders, units are or are to be re-purchased or redeemed out of the assets of the scheme or arrangement, continuously or in blocks at short intervals; or (iii) units are, or have been, or will be issued continuously or in blocks at short intervals.

¹⁵⁶ Art. 22 (3) and Art. 36 (13) Employment and Industrial Relations Act, 2002.

XIX. Netherlands

Employee financial participation schemes were introduced in the 1950s on behalf of expatriate executives from the United States. Many plans, especially share ownership and stock option plans, are still limited to top management. Savings plans combined with profit-sharing or employee share ownership plans, generally broad-based, have been implemented since the 1970s. The combination of profit-sharing and share ownership plans with savings plans is most common in the Netherlands and thus may be considered typical.

A long-term study of the development of employee financial participation from 1996-2001 found that the number of enterprises with employee financial participation schemes more than doubled during that time period, from four percent to nine percent. Although these figures include executive plans, a trend could be observed: executive plans had decreased in number, while broad-based plans had increased (Poutsma and Van den Tillaart, 1996; Stikkelbroeck, 2001). Profit-sharing plans showed only a five percent rise during the same period. The assumption was that this form of financial participation had peaked.



More recently, a study of employee financial participation in companies listed on the Amsterdam Stock Exchange showed that 62.5 per cent of AEX companies offered such plans (Beursken, 2007). Stock option plans, offered by 41.7 per cent of the AEX companies, were the most popular. These figures, however, also include executive plans. New nationwide statistics on various kinds of employee financial participation plans are currently being prepared by the Netherlands Participatie Instituut, but as of March 2009 they had not been published.

1. General Attitude

Employers' associations traditionally backed only the management model; recently, however, they have begun also to favour broad-based plans for reasons pertaining to employee motivation. Ordinarily there is no connection between share ownership and business form. An exception is the small family enterprise whose owners generally oppose employee share ownership because they fear loss of control. Trade unions, which generally have been opposed to employee financial participation, recently have declared their support for broad-based plans on condition that no substitution for regular remuneration will be required. In 2001, the trade unions began a discussion on whether profit-sharing and broad-based stock option plans should be included in collective bargaining agreements. This proposal, however, has not been accepted.

The government has given little support to employee financial participation of late, having concluded that such plans, especially the most prevalent limited to executives only, do not contribute to a more equitable distribution of wealth.

2. Legal and Fiscal Framework

When combined with savings plans profit-sharing or employee share ownership plans benefit specific tax incentives; for this reason this combination is the most typical form of employee financial participation. In 1994, legislation on deferred profit-sharing, cash-based profit-sharing and stock options was enacted.

a) Share Ownership

Share Ownership Plans – Although public companies (Namloze Venootschap) may transfer shares directly, limited companies (Besloten Venootschap) must utilise an intermediary because share transfer for them can be made only by means of a notarial deed. The intermediary chosen for this purpose is usually a foundation (Stichting Administratie Kantoor, SAK). It owns the employee shares, exercises voting rights and transfers depository receipts of shares to the employee shareholders. Other business forms can also be used as intermediaries. Tax incentives do not apply to share ownership not combined with a savings plan. Under a savings plan, an employee may save from his pre-tax salary a legally specified maximum amount (Euro 613 in 2008). However, if savings are converted into shares, the annual maximum allowance is doubled (Euro 1,226 in 2008).

Stock Option Plans – Stock option plans were originally limited to executives, but there has been an increase in the number of broad-based plans since the beginning of the 1990s. Options may be conditional (for example, subject to a vesting period or a performance-related proviso) or they may be unconditional (that is, tradable at grant). Specific

rules regarding the moment of taxation introduced in 2001¹⁵⁷ and respective tax incentives were recently abolished so that taxes are now to be paid at exercise only.

b) Profit-Sharing

Profit-sharing is found in both cash-based and share-based forms. Since 2003, tax incentives for profit-sharing plans depend on their being combined with a savings plan. The general rules governing savings plans and corresponding tax incentives, discussed under share ownership above, also apply to profit-sharing plans. Additionally, under plans which include at least 75 per cent of employees, with employee shares being held in the savings plan for four years, a 15-per-cent flat tax is paid at exit in lieu of personal income tax and social security contribution. Under certain circumstances, the four-year blocking period is waived (for example, if the employee buys a principal residence, starts a new business, or takes a sabbatical or educational leave of absence).

c) Participation in Decision-Making

There is no direct connection between participation in decision-making and employee financial participation. The latter plans are specifically enjoined from extending those participation rights already in force. Moreover, employee financial participation is generally not a part of collective agreements. Companies with a workers' council (compulsory in all firms with more than 100 employees) must obtain council approval for any amendments made in the 'system of remuneration'; broad-based employee financial participation plans are regarded as a part of this system. However, no approval of the workers' council is required in the case of 'discretionary plans', that is, plans restricted to management only.

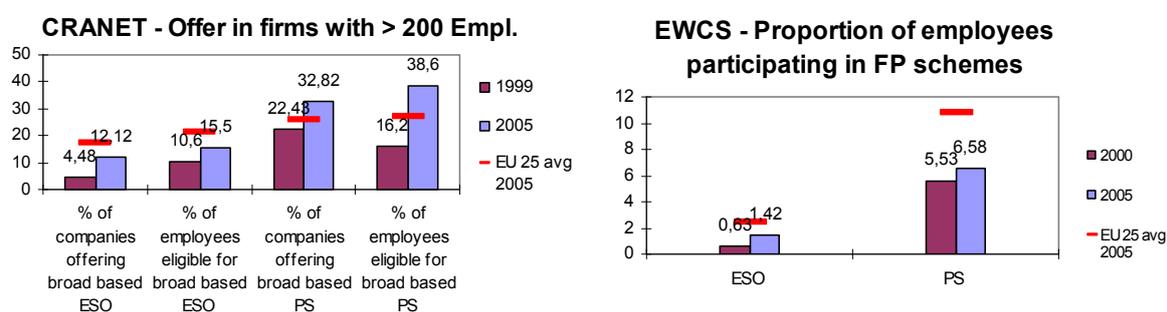
¹⁵⁷ As of 2001, the employee could choose between one of two tax alternatives: unconditional options could be taxed at grant and conditional options at vesting, with no tax liability at the moment of exercise if held for more than three years, or tax could be imposed at exercise on the total capital gain.

XX. Austria

Recent measures promoting employee financial participation focus on share ownership. Currently eight percent of enterprises, mostly listed joint-stock companies, have introduced employee share ownership plans; through these, 160,000 individuals, or six percent of the Austrian work force, own an average of five percent or less of shares in their employer firms (Kronberger et al., 2007, pp. 11, 67). Leveraged employee ownership plans (similar to ESOPs), using different forms of foundations as a vehicle, were introduced in connection with privatisation.

The total number of financial participation plans, although still relatively small, has increased significantly since 2001 in response to the introduction of tax incentives. Only eight percent of plans currently active were established prior to 1990; 48 per cent date between 1990 and 2000, and 45 per cent after 2000 (Veveřa, 2005, pp. 54).

Stock option plans, generally not broad-based, have been implemented in one percent of enterprises. Profit-sharing plans are found in 25 per cent of enterprises, mostly small and medium-sized trade companies (Kronberger et al., 2007, p. 17).



1. General Attitude

By the end of the 1990s, the government had become more supportive of employee financial participation. Behind this change in attitude were such factors as increasing competition with Eastern European economies, promotion of employee participation by the EU, and impending privatisation of several large state-owned companies (for example voestalpine AG, Vienna Airport, Saline AG, AMAG, AUA, OMV). Both the trade unions and employers' associations strongly support employee financial participation and co-operate with each other in this area.

After tax incentives were introduced in 2001, the Federal Workers' Chamber (BAK) and the Austrian Economic Chamber (WKÖ), in co-operation with the University for Applied Science Wiener Neustadt, conducted a study (2005) of the effects of financial participation on enterprise results and employee attitudes in individual companies. This study

found that 80 per cent of employer companies and workers' councils in firms which have employee financial participation plans are satisfied with the results, while 71 per cent of enterprises without such plans would introduce them if the legal framework were improved (Kronberger et al., 2007, pp. 10, 16). In their proposals for reforming the legal framework, representatives of both employers and employees focus in part on the same issues: introduction of tax incentives for employee participants of profit-sharing schemes, higher tax incentives for participants in employee share ownership schemes, and more incentives to encourage small and middle-sized companies to introduce employee ownership schemes, especially leveraged ones similar to the ESOP.

The only controversial issue is whether employee financial participation should include a role in decision-making. Trade unions are critical of models which subject employees to risk, as with non-voting employee shares, without granting corresponding rights; they also object to schemes that benefit only management, for example, stock options. Since labour law already requires employee participation in decision-making, this issue only affects small enterprises without workers' councils.

2. Legal and Fiscal Framework

The incidence of various models of employee financial participation depends on the business form. Share ownership plans are introduced in: quoted joint-stock companies (AG), 45 per cent; co-operatives (Genossenschaft), foundations (Stiftung), registered associations (eingetragener Verein), 50 per cent; limited liability companies (GmbH), 6 per cent; they do not exist in partnerships (OHG, KG, OEG, KEG, GbR) (Kronberger et al., 2007, p. 17). An absolute obstacle to employee share ownership in partnerships is the institute of co-ownership under the Austrian company law; this institute is typical of Germanic legal systems. Other obstacles to the spread of employee share ownership plans in limited liability companies include the strong position shareholders enjoy vis-à-vis management, the transfer of share ownership only by notarial deed, and the absolute prohibition against a company acquiring its own shares.

Employee share ownership is based on a direct participation model in 21 per cent of enterprises (Kronberger et al., 2007, p. 57). Leveraged models are less common due to high costs and complex administration; they are found in large publicly-quoted joint-stock companies, especially those created by privatisation. Profit-sharing plans are found in every third limited liability company and every second private joint-stock company (Kronberger et al., 2007, p. 53).

The law on Capital Market Offensive of 5 January 2001 introduced tax incentives for employee share ownership schemes by amending the Income Tax Law (hereinafter referred to as 'ITL') and the Capital Tax Law (hereinafter referred to as 'CTL').

a) Share Ownership

Employee share ownership plans are mainly based on direct share transfer. However, leveraged share ownership plans and stock option plans have become more widespread since 2001.

Direct Share Ownership Plans – A joint-stock company is generally prohibited from acquiring its own stock, but this does not apply to employee shares (§ 65 para. 1 no. 4 of the Law on Joint-Stock Companies, hereinafter ‘JSCL’). A resolution of the general meeting is required to introduce such employee shares which remains in effect for 18 months. Transfer of shares to employees in connection with a capital increase, excluding pre-emptive rights of existing shareholders, is possible if the resolution of the general meeting on the capital increase makes this exclusion (§§ 65 para. 2a, 153 para. 5 JSCL). No period for the transfer of shares to employees is specified in the JSCL, but this transfer must take place immediately after issue to comply with company law. Current and retired employees of the employer company and of affiliated companies may participate in an employee share ownership plan (§ 15 JSCL). The definition of affiliated companies was extended in 2005: companies affiliated within the economic sector under the company law and also companies which are members of an association in liability (according to § 30 para. 2a of the Federal Law on Competition) are also deemed to be affiliated.

A blocking period for the transfer of employee shares is not prescribed, but shares are usually held for at least five years for tax purposes. Pursuant to § 3 para. 1 no. 15(b) IITL and § 49 para. 3 no. 18(c) of the Law on Social Security Contributions, a tax and social security allowance of up to Euro 1,460 applies to the benefit from the transfer of discounted shares if the shares are held for at least five years, the plan is broad-based, and shares are held by the employees but deposited with a domestic credit institution or a fiduciary which administrates the shares and exercises voting rights according to the employee’s instructions. This tax allowance applies only to current employees of a domestic or foreign employing company or an affiliated company. The employer company is also exempted from the obligation to pay social security contributions in this case. The employers’ associations, trade unions and the legal literature all object that the tax allowance is too low and advocate an increase of up to Euro 5,000. Taxation of dividends on employee shares depends on the economic ownership. If the employee has the economic ownership of shares, the capital yields tax or, upon application of the employee, half of the personal income tax, is imposed (dividends on shares of foreign companies are always taxed at half of the personal income tax) (§ 37 para. 4 IITL). If the employee is not the owner (for example, if the employing company may buy the shares back at will or if the shares must be returned at termination of the employment contract), full personal income tax and social security contributions are imposed.

Leveraged Share Ownership Plans – By the Law on Capital Market Offensive of 5 January 2001, the IITL was amended also in relation to the taxation of private foundations. In view of prospective privatisation of large state companies, a model for ‘strategic ownership’ of employees had to be developed. An already existing business form, the private foundation, was chosen to serve as the vehicle of the leveraged employee share ownership plans. Whereas many large privatised enterprises use a private foundation under the Law on Private Foundations as an intermediary company (for example voestalpine AG, Saline AG, AMAG), some utilise a new form ‘employee participation foundation’ (Belegschafts-

beteiligungsstiftung) defined in § 4 para. 11 no. 1(c) IITL (for example Vienna Airport).¹⁵⁸ The foundation holds and purchases the shares, exercises voting rights, and transfers returns to the employees.¹⁵⁹ In contrast to direct employee share ownership plans, the beneficiaries of leveraged plans enjoying tax concessions can also be retired employees and family members (spouses, children) of employees. A foundation can only be used for shares of domestic companies; the definition of affiliated companies in connection with the foundation was not extended in 2005.

The value of its own shares or money for purchasing shares transferred to the foundation as well as the costs of establishing and operating the foundation can be deducted from the tax base of the corporate income tax by the employer company. The foundation distributes the amount of contribution by the employer company over nine financial years, and 1,460 Euro per employee per annum is tax free (§ 13 para. 1 last sentence CTL). Dividends on shares held by the foundation are also tax exempt (§ 10 para. 1 CTL). However, the capital gains tax is imposed on contributions used for administration. The employee pays a capital gains tax on returns transferred by the foundation of up to 1,460 Euro and full personal income tax, but no social security contributions on the amount in excess thereof.

Stock Option Plans – Stock option plans are generally limited to management. Executive officers and members of the management bodies of joint-stock companies are allowed to acquire shares through stock options if the shares constitute not more than 20 per cent of equity capital (§ 159 para. 5 Law on Joint-Stock Companies). However, a small number of broad-based stock option plans are also found. Taxation of stock options for employees depends on economic ownership. At the time economic ownership is transferred, the shares become taxable. The criteria for economic ownership are the relationship and tradability of options. According to § 3 para. 1 no. 15 (c) IITL, 10 per cent in one year and 50 per cent of the difference between the value of the underlying share at exercise of the option and the value of the underlying share at grant of the option are tax exempt if certain pre-conditions are met: the options must be non-tradable, the plan must be broad-based, and the value of the underlying shares at grant must not exceed 36,400 Euro. If options are deposited with a domestic credit institution or with a fiduciary, taxation of the remaining amount can be deferred until the acquired share is sold or the employment contract terminated, up to the seventh year following the option grant. The employer company can deduct the cost of shares.

¹⁵⁸ In literature it is objected that the economic activities of foundations are restricted by law so that it cannot create reserves and make investments. In addition, this form cannot be utilised by small companies due to administrative complexity and prohibitive costs, therefore they use business forms as associations (Vereine), trusts (Treuhandschaften) and partnerships under civil law (GbR) instead.

¹⁵⁹ In some companies, the shares are possessed by employees, whereas the foundation only accumulates and exercises the voting rights. In such cases, the taxation is different.

b) Profit-Sharing

Although there are no tax incentives, profit-sharing schemes are relatively widespread, especially in small corporations. Most are cash-based and take into consideration such factors as turnover, EBIT, cash flow, etc., alone or in combination, and not necessarily balance sheet profit (Kronberger et al., 2007, pp. 51). A profit-sharing plan may be introduced through a collective agreement, an in-house agreement, or an employment contract. However, an in-house agreement can regulate the pre-conditions, factors, calculation methods and form of payment (§ 97 para. 1 line 16 of the Law on Employment Contracts, hereinafter referred to as ‘LEC’) only if the factor to which the plan refers also considers the expenditure of the enterprise.¹⁶⁰ A plan not regulated by an in-house agreement is usually based on individual employment contracts whose content is not restricted in this respect. A participating employee is entitled to examine the basis of his share calculation in the books (§ 14 of the Law on Employees). If the plan originates in a collective agreement, the workers’ council is also entitled to examine the calculation basis, but not documents on individual wage payments (§ 89 of the LEC).

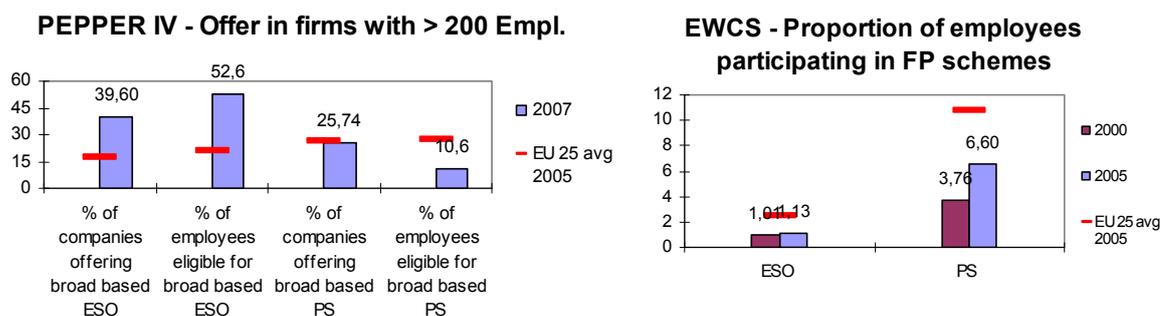
c) Participation in Decision-Making

Under labour law, co-determination and participation rights of employees through their representatives are traditionally well developed. Employees send members to the supervisory board (§ 110 para. 1, 5 LEC) and are represented by the workers’ council. There is generally no direct connection between participation in decision-making and financial participation of employees; in particular, financial participation plans cannot extend existing rights in connection with participation in decision-making. However, the employees in their capacity as shareholders can take substantial influence on important decisions of the general meeting (for example exercise the squeeze-out right) and be represented in the supervisory council if their cumulative share is at least 10 per cent. Certain aspects of financial participation plans can be regulated by a collective agreement and/or an in-house agreement; in this case, employees’ representatives participate in negotiations and decisions. The following rights of the workers’ council can be connected to financial participation: right to information (§§ 91, 92 LEC), right to consultation in the case of operational changes (§ 109 LEC), and right to demand elimination of faults (in this context all circumstances of financial participation detrimental to employees; see § 90 para. 1 LEC). Only 17 per cent of enterprises operating financial participation plans indicated problems in connection with decision-making (Kronberger et al., 2007, p. 61). In general, problems arise only in small enterprises which do not have a workers’ council.

¹⁶⁰ This means that plans relating to turnover as a factor cannot be regulated by an in-house agreement.

XXI. Poland

The most significant form of employee financial participation in Poland today is employee ownership. Poland's privatisation programme was characterised by significant incentives for employee participation, especially in firms privatised by leasing and transformed into so-called employee companies (*spółki pracownicze*). Ownership structures in these companies have, on the whole, been relatively stable, with non-managerial employees retaining, on average, a significant portion of enterprise shares. Research conducted in the late 1990s from a sample of 110 employee-leased companies privatised between 1990 and 1996 showed that on average the share of non-managerial employees in ownership decreased from 58.7 per cent immediately after privatisation to 31.5 per cent in 1999. Approximately 32 per cent of leasing-privatised firms were still majority-owned by non-managerial employees by mid-1999. Over time, more and more shares were also found in the hands of outsiders (probably due largely to retention of shares by people whose employment relationship with the company ceased for whatever reason), while the presence of strategic outside investors (including foreign investors) had begun to be felt in a minority of firms by the end of the last decade (see Lowitzsch, 2006, p. 237, Table 3). Less significant forms of minority employee share ownership emerged from privatisation methods other than leasing. Insiders possessed only 12.7 per cent of shares at the beginning of 1998, and this fell to 11.4 per cent two years later. Although, all current forms of financial participation may also be used in employee compensation schemes outside of privatisation, there are no tax incentives to encourage this.



1. General Attitude

No interest in further development of PEPPER schemes can be observed either in political or trade union circles. With regard to PEPPER schemes and other forms of workers' participation, the positions of trade unions like *Solidarność* were and still are inconsistent and often ambiguous. Institutions created to support employee-owned firms in Poland include the Union for Employee Ownership (*Unia Własności Pracowniczej*), the All-Poland

Chamber of Employee-Owned Companies (*Ogólnopolska Izba Gospodarcza Spółek Pracowniczych*) in Poznań, and the Gdańsk Employee Ownership Bank (*Bank Własności Pracowniczej SA w Gdańsku*); however, their role in employee-led privatisation in Poland was very limited. As of early 1996, the Union for Employee Ownership, founded in the autumn of 1990, had only 76 member firms, some of which were still state-owned.

Clearly, since the mid-1990s, the main, openly declared objective of privatisation policy has been to maximise revenues; therefore, all but the smallest state enterprises are to be privatised by commercial methods, despite the fact that employee-owned firms were often the most successful. Moreover, policy makers have encouraged enterprises being commercially privatised to seek outside investors; for this purpose, a clause was included in the 1996 Privatisation Law requiring at least 20 per cent of the shares of a leasing company to be purchased by persons not employed by the company. 100 per cent management-employee buyouts were thus made difficult. Policy makers provided no incentives for the extension of employee financial participation other than through privatisation schemes. However, most recently the topic has returned to the political debate.

2. Legal and Fiscal Framework

In Poland the legal framework provides various forms of PEPPER schemes, embracing on the one hand share ownership and profit-sharing, and on the other the private sector as well as enterprises undergoing privatisation. However, no incentives have been provided by policy makers for the extension of PEPPER schemes. All forms of participation are available for use in employee compensation schemes, although there are no tax incentives to do so.

a) Share Ownership

'Employee Companies' (1990, 1996) – So-called employee companies emerged from Leverage-Lease-Buyout (LLBO) privatisation. This is one form of so-called liquidation privatisation introduced in 1990 which according to Art. 39 of the Law on Commercialisation and Privatisation (PrivL¹⁶¹) since 1997 requires: relatively good financial and market conditions; no requirement for substantial investment to modernise, replace, develop equipment, etc; a yearly turnover of up to Euro 6 million; a maximum of Euro 2 million of equity consisting of two enterprise funds; willingness of management and employees to assume the financial risk involved in undertaking a common investment (including third parties). A newly established private company concludes an agreement with the State Treasury to lease the assets of the state enterprise for a maximum period of 15 years.¹⁶²

¹⁶¹ Of 30 August 1996, Dz. U. No. 118, Pos. 561, re-published in Dz. U. 2002 No. 171, Pos. 1397, No. 240, Pos. 2055, with subsequent amendments.

¹⁶² Until 2002 Art. 52 para. 1 PrivL foresaw a maximum of 10 years; the legal regulations for LLBOs are to be found in Art. 39 para. 1 No. 3 and 50 to 54 PrivL; it is reserved exclusively for Polish nationals and as an exception also legal persons (Art. 51, para. 1 No. 2 PrivL).

The interest payment was set at 30 per cent (75 per cent of 40 per cent) if the central bank refinance rate exceeded 40 per cent; in 1993 this was lowered to 50 per cent of the refinance rate.¹⁶³ Moreover, a leased company can apply to its founding organ for a reduction of interest payments owed as a result of postponements during the first two years of the leasing period if its investment expenditures out of profits amount to at least 50 per cent of its net profit. Finally, the corporate income tax law allows firms to include the interest portion of their lease payments as costs, thus reducing their tax liability. The new privatisation law in 1996 additionally leveraged the financial lease contracts in order to enhance the credit-worthiness of employee-leased firms applying for bank loans. Art. 52 PrivL makes it possible for full ownership to be acquired before the end of the contract if one-third of total leasing rates have been paid, provided that the balance sheet for the second business year of the company has been approved. If more than half of the total leasing rates have been paid, the blocking period is cut in half. Because of conditions on the Polish credit-market, this regulation has become very important in practice.¹⁶⁴

Employee shares in Capital Privatisation (1990, 1997) – According to Art. 36 pp. of the new PrivL, which came into force in early 1997, employees can acquire 15 per cent of shares for free, with the restriction that these shares be exempt from free trade for two years, and for three years in the case of employees elected to the management board. Generally, they are required to enter their claim six months before the company is registering since the right expires otherwise; the right is also good for six months after sale of the first share. Shares are allocated in groups made up according to length of employment in the enterprise. The total value of allocated shares under these claims may not exceed the sum of the average salary in the public sector for 18 months, multiplied by the number of employees acquiring shares. This rule applies not only to commercialised companies undergoing capital privatisation and those included in the Mass Privatisation Programme, it was also extended to include 15 per cent employee participation in a ‘direct privatisation’ transaction involving sale of an enterprise as a going concern, as well as in kind contributions of an enterprise (Art. 48 para. 3, Art. 49 para. 4 PrivL). The only other exception is commercialisation via debt-to-equity-swaps.

Private Companies (2003) – In an exception from the general prohibition against acquiring its own stock, Art. 362 para. 1 of the Commercial Companies Code (CCC) permits a company to acquire its own shares in order to offer them to current employees, retired employees of the company, or employees of an affiliated company contingent upon a business relationship of at least three years.¹⁶⁵ In this case, Art. 393 No 6 CCC requires a decision by the general shareholders assembly and Art. 363 para. 3 CCC states that the shares shall be transferred to the employees within 12 of acquisition. Acquisition of the company’s own shares in this case is subject to the provisions that the total nominal share

¹⁶³ Ordinance of the Minister of Finance of 13 May 1993, M. P. 1993 No. 26, Pos. 274, altering that of 7 May 1991, M. P. 1991 No. 18, Pos. 123.

¹⁶⁴ Furthermore Art. 54 PrivL foresees the possibility to regulate the specific conditions of such leverage by Ordinance of the Council of Ministers including the possibility to reduce the threshold of paying 20 per cent of the net value of the object of the lease stated in Art. 51 para. 1 No. 3 PrivL to 15 per cent. In this context Art. 64 PrivL granted existing Employees Companies the right to renegotiate their contracts within 3 months of the Ordinance coming into power.

¹⁶⁵ This regulation had its origin in the harmonisation with the *acquis communautaire*, that is, the implementation of the Second Council Directive of 1976 (77/91/EEC; OJ L 26, 31.1.1977, p. 1).

value may not exceed the value of 10 per cent of the enterprise's equity capital, and that the purchase price, together with the transaction cost, may not be higher than the reserve set aside from the company's own profits (Art. 348 para. 1 CCC).¹⁶⁶ Additionally, under current legislation, joint-stock companies may issue new shares to be transferred to employees in the context of so-called conditional capital increases, with Art. 448 para. 2 No. 2 CCC expressly referring to the possibility of transferring shares to employees to satisfy previously acquired claims from profit-sharing. A prerequisite to this form of capital increase is that the employees are identified in the decision made by the general shareholders assembly on the capital increase.¹⁶⁷ A companion regulation is Art. 442 para. 1 CCC, which stipulates the possibility of capital increases financed by the company's own capital, referring to Art. 348 para. 1 CCC concerning reserves made from the company's own profits. In order to facilitate the acquisition of shares by employees, under Art. 345 para. 2 of the CCC, the legislature has made an exception to the general prohibition against leveraging acquisition of its own stock. Thus, conditional upon the creation of a corresponding reserve (Art. 348 para. 1 CCC), the company may advance funds, make loans, and provide security in order to expedite the acquisition of its stock by its on employees or those of an affiliated company.

Stock Options – Employees may receive stock options, regular or on a privileged basis (at below-par prices or free of charge) although there is no specific regulation to this effect.

Pre-emptive Right of Purchase of an Enterprise under Insolvency Law (2003) – The Insolvency and Reorganisation Law (IRL) of 2003, a completely new version of Polish insolvency law¹⁶⁸ provides a contingent possibility for setting up 'employee companies' in the context of a liquidation procedure. If the sale of the debtor's business as one or several functioning units is impossible, then each asset is to be publicly auctioned by the administrator, under supervision of the judge-commissioner. If assets are not sold at a public auction or the judge-commissioner does not accept the offer, he can order a second auction, or can determine the minimum price and conditions of sale and allow the administrator to find a purchaser or to sell assets free of procedural restrictions (to be approved by the creditors' committee). In this case, a commercial company founded by at least half of the debtor enterprise's employees and with the participation of the Treasury has a pre-emptive right of purchase of the enterprise or functioning enterprise units (Art. 324 IRL).

¹⁶⁶ Art. 347 para. 3 and 348 para. 1 CCC provide the possibility to allocate enterprise profits to special funds while not paying them out as dividends to shareholders, thus allow share based profit-sharing.

¹⁶⁷ The issuance of shares to be acquired by employees in this case shall not be considered as a public offering but as a 'private subscription' (Art. 431 para. 2 No. 1 CCC).

¹⁶⁸ Dz. U. 2003 No. 60, Pos. 535. For a detailed analysis of the new law see Zedler (2003).

b) Profit-Sharing

The possibility of implementing profit-sharing as a form of remuneration in addition to wage systems and directly linked to enterprise profits is stipulated in Art. 347 para. 3 and 348 para. 1 CCC for joint-stock companies (*tantiema*).¹⁶⁹ Furthermore, as already mentioned, share-based profit-sharing is regulated in the context of conditional capital increases under Art. 448 CCC, which mentions the possibility of transferring shares to employees, especially in cases where they have acquired claims from profit-sharing. The general type of scheme linked to enterprise results is referred to in Polish as a ‘*bonus*’ but has no legal foundations. Other practices presently sanctioned by law are compensation forms linked to an employee’s individual results (gain-sharing); these are not generally linked to enterprise results and thus do not constitute a PEPPER scheme.¹⁷⁰

c) Participation in Decision-Making

Codetermination at the strategic level takes the form of obligatory representation of employees on the supervisory boards of commercialised companies of, initially, two-fifths of the members and, from the moment the state ceases to own 100 per cent of the shares, one-third (Art. 14 PrivL). Furthermore Art. 11, 12, 60 PrivL provide a detailed procedure for the election and qualification of representatives, while Art. 15 PrivL protects their employment contract for the duration of their term and the year following. A new feature in the context of ‘social compensation’ is the participation of an employee representative on the executive boards of privatised enterprises employing more than 500 employees (Art. 16 PrivL). Outside privatisation, development of participation in decision-making has been very limited, even in companies where employees have significant share accounts. Poland is still dominated by an elitist and managerial corporate culture which minimises opportunities for participation. Almost all progress made in the area of participation in decision-making in Poland may be attributed to the European Union.

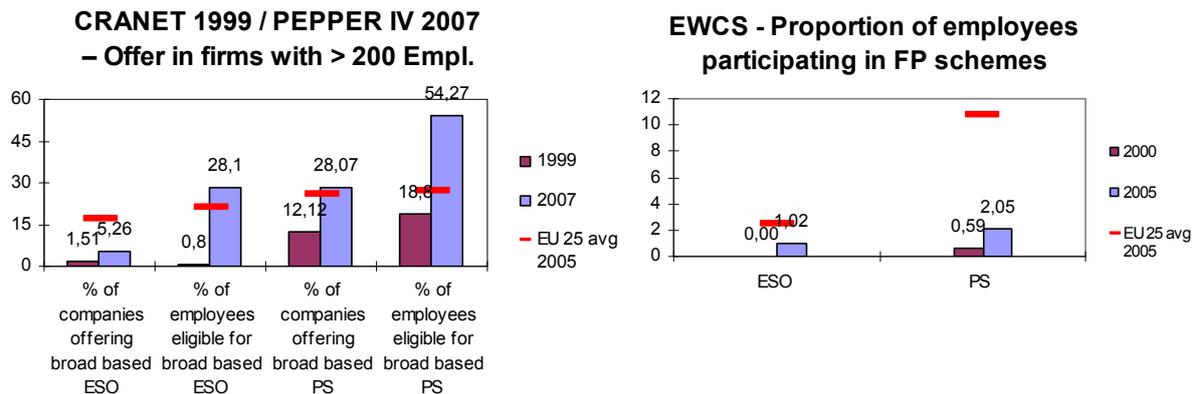
Although the development of both direct and indirect (representational) employee participation in decision-making in employee-owned companies seems rather low, there are signs that some potential for genuine employee involvement could be latent in these firms. In many Polish employee-owned companies, for example, no dividends have been paid out, even after two or three years as a private company, because of decisions to plough back profits into investment or to not pay dividends until the lease is paid off. That employee shareholders can be convinced to vote in favour of such ‘austerity’ plans is evidence that the entrepreneurial attitudes characteristic of genuine ownership and participation may be present amongst the work forces of certain employee-owned companies.

¹⁶⁹ See decision of the Supreme Court of 5 May 1992, I PZP 23/92, Bibl. Prac. No. 25, p. 96.

¹⁷⁰ Such as other forms of remuneration, for example, gratifications (*gratyfikacja*, *nagrody*, *nagrody jubileuszowy*), thirteenth salary, commissions (*provizja*; used frequently, if not universally, in the case of sales force employees) and various types of bonus schemes. For details, see Ciupa (2001); ‘*Premie i nagrody dla pracowników*’, *Rzeczpospolita* of 3 Oct. 2005.

XXII. Portugal

No tradition of employee financial participation has emerged in Portugal for reasons both historical and economic. The Portuguese economy is still based on small companies under continuous family ownership; these owners are reluctant to granting participation rights to employees. Moreover, flexibility in employment and labour costs as well as relatively low unemployment have been achieved independently. Employee share ownership and stock option plans were promoted in connection with privatisation in the 1990s after the French example. However, this did not lead to any substantial increase in employee share ownership because a significant number of employees, prior to the share transfer, had signed contracts waiving their rights and agreeing to sell their shares immediately after the end of the blocking period. Currently, only a few plans are operated by large multinational companies primarily in the financial and insurance sector; the majority of these are cash-based profit-sharing plans; however, single cases of employee share ownership as well as stock option plans do occur (for example, Siemens, EDP, Portugal Telecom, Cimpor).



1. General Attitude

The government is indifferent to employee financial participation. Nor are employer associations interested since wage flexibility has been achieved by other means. Initially, the trade unions were suspicious of financial participation, but they have changed their attitude since 1988 and now try to promote it. However, this is true only of independent trade unions, for example, SIMA (Sindicato das Industrias Metalurgicas e Afins), which has proposed to include financial participation in collective agreements. The largest trade unions, UGT (Uniao Geral de Trabalhadores) and CGTP (Confederacao Geral de Trabalhadores), generally do not support such initiatives.

2. Legal and Fiscal Framework

A small number of financial participation plans are operated primarily by large companies in the financial and insurance sector; many of these plans are limited to executives. Cash-based profit-sharing schemes predominate.

a) Share Ownership

The number of share ownership and stock option plans is very small, executive plans included. The existing plans are purported to be modeled on similar plans in the UK and Ireland.

Share Ownership Plans – Share Ownership Plans were used on a larger scale in the privatisation process between 1989 and 1998. According to Art. 10 and 12 of the Framework Privatisation Law of 1990, a certain percentage of the capital reserved for acquisition or subscription had to be reserved for current employees and, if employed by the company for more than three years and not dismissed as a result of a disciplinary proceeding, for former employees as well; the blocking period was for two years. As to privatisation of individual companies, special laws containing specific conditions (for example, the relation of pre-emption rights of employees to pre-emption rights of other individuals), in compliance with the Framework Privatisation Law, were enacted. The employees had to pay a certain price determined by the Minister of Finance. On shares held for at least two years, gains in share value were not taxed. In addition, employees enjoyed tax incentives if they purchased shares offered for public sale by the state; they could deduct up to 30 per cent of total taxable income, up to a fixed amount.

Stock Option Plans – Stock Option Plans are often limited to executives. Since the total number of stock option plans, including executive plans, is very small, the number of broad-based stock option plans will probably be fewer than ten. There are no special rules on taxation of stock options in financial participation plans for employees; employee stock options, like other types of stock options, are subject to the personal income tax at the time exercised, and no social security contributions need be paid.

b) Profit-Sharing

Both cash-based and share-based profit-sharing schemes exist, with the percentage of cash-based profit-sharing schemes being much higher. Profits allocated to employees are usually transferred immediately, but under certain conditions can be blocked for one to two years. Conditions are determined at the company level. Since 1969, the profit share of the employee has not been treated as remuneration, exempting employees from personal income taxes and social security contributions on this amount (Art. 261 of the Labour Code). However, the profit share must be based on an individual agreement covering a specific period, otherwise it will be fully taxable. The employer company can deduct distributed profit transferred to the employees.

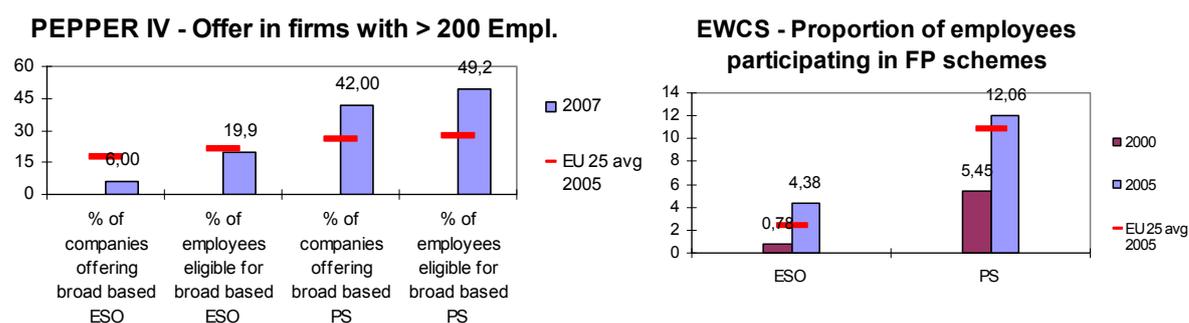
c) Participation in Decision-Making

No direct connection exists between participation in decision-making and employee financial participation; in particular, financial participation plans may not extend the existing rights in connection with participation in decision-making. Financial participation is not a part of collective agreements, although the trade unions have proposed including such schemes on several occasions. Employee representation on the executive and supervisory boards is prescribed by law in certain public companies, but not often implemented in practice. Although consultations on financial participation plans are not compulsory, they sometimes take place, especially in the case of profit-sharing plans, to improve the design.

XXIII. Romania

Employee financial participation in Romania is a relatively new idea, as distinguished from various pseudo schemes attempted under the communist regime. PEPPER schemes emerged during early stage privatisation; at that time voucher privatisation and insider privatisation via an ESOP-like scheme were the two main privatisation methods. The most prevalent form is employee share ownership, mainly through ESOP-like schemes. It is estimated that by the end of 1998, over a third of all industrial firms in the State Ownership Fund had undergone ESOP privatisation, with an average employee ownership of 65 per cent and a median of 71 per cent; in addition, ESOP participants made up the largest owner group in one-fourth of Romanian privatised firms, making this method the country's most important tool for state ownership divestment (Earle and Telegdy, 2002; World Bank, 2004; compare also to Lowitzsch, 2006, pp. 251, Tables 1-3). Nevertheless, after more than ten years of transition, only 40 per cent of large enterprises and about two-thirds of medium-size enterprises have been privatised. The number of state-owned or state-controlled firms in Romania remains larger than that total in the other Central and Eastern European countries combined.¹⁷¹

Since 2001 cash-based profit-sharing, known as 'The Fund of Employee Profit Participation', has been compulsory in companies and in autonomous bodies where the state is the sole or majority owner. At a national level, net profits directly paid to employees in 2003 was about 2.2 per cent on average, while 70.3 per cent was distributed from salary funds, including premiums and benefits.¹⁷² Although the number of profit-sharing firms is still limited, their number is gradually increasing.



¹⁷¹ World Bank data from 2004, at the end of 2003 there were about 1,300 state-owned enterprises and another 600 enterprises de facto under state control.

¹⁷² Although compulsory, interview evidence reported, that in practice it is seldom applied and, if applied, concerns a rather small number of employees.

1. General Attitude

While employees are represented by a considerable number of large trade union confederations, employers' associations – eleven of them registered – are even more fragmented. In privatisation of utilities and the oil and gas industry, employees often have purchased shares through trade unions, since the unions, being very strong in these sectors, have substantial influence, including the right to appoint at least one member to the boards of administration. In some cases (for example, the sale of 8 per cent of the social capital of the PETROM Company, representing a total value of about Euro 200 million) the trade unions tried to have the relevant law amended to make employees' associations controlled by the trade unions become the purchasers of the offered shares rather than individual employees. Such cases illustrate that the interests of trade unions and their legal representatives are not necessarily in line with the interests of individual employees, and that sometimes trade unions try to achieve their goals at the expense of employees' rights. Trade unions have a very strong position in the tripartite council (National Social and Economic Council), which also includes the government and the employers' associations. Employers' associations have not yet addressed the issue of financial participation of employees. However, according to Article 104 of the Collective Labour Contract concluded at the national level for the years 2007-2010, employers and trade unions committed to mutual information concerning changes in the property form of their companies and to sustain the participation of employees' associations in their privatisation. Well known examples of ESOP associations founded in 2008, are that of SC Oltchim MBO gathering 2000 employees from OLTCHIM SA – more than half of the number of whole employees – and that in Electrica SA acquiring 10 per cent of the employer company.

At present, employee financial participation is of little interest to either the government or political parties. The last significant commitment by policy makers was in 2001 when the aforementioned compulsory cash-based profit-sharing scheme, 'The Fund of Employee Profit Participation', was introduced. Only one aspect of financial participation of employees is currently being addressed by the government, namely the sale of minority shares to employees in public enterprises now in the process of privatisation; these include utilities (or the so-called *Régies autonomes*), oil and gas, banks, as well as state companies. However, since economic privatisation policy was recently changed to favour sales to strategic outside investors, including foreign investors, government support is expected to be on the decline. In some of these privatisation cases, trade unionists and representatives of political parties are suspected of engaging in insider deals and corrupt practices at the expense of employees; therefore the general public has little confidence in government support of employee financial participation.

2. Legal and Fiscal Framework

Romanian law lacks a systematic legal framework for regulating employee financial participation. However, several laws passed in conjunction with the privatisation process influenced the extent to which the concept of employee financial participation has spread,

with mass privatisation and an ESOP scheme being the major forms. The only legal regulations of profit-sharing concern a compulsory scheme in (majority) state owned companies to which National Labour Collective Agreements apply.

a) Share Ownership

Privatisation (1991, 1995, 1999) – The Romanian Privatisation Law 58/1991 decreed that 30 per cent of shares be free shares transferred under alternate privatisation methods, mainly through vouchers and contained regulations on preferential treatment for employees and management in the sale of shares through the national Privatisation Agency. According to Art. 48 of Law 58/1991, employees (including management) of the relevant enterprise had a pre-emptive right to purchase the offered shares on preferential terms. In a fixed price sale, the ‘insider share price’ had to be 10 per cent lower than the public price; in the case of a sale by competitive bidding, the insider offer had to be accepted by the Privatisation Agency as long as the offered price was not lower than 90 per cent of the highest public bid. This preferential treatment was extended to the direct sale procedure, where the insider offer had to be accepted by the Privatisation Agency in the event of an equal negotiation offer from other interested parties. The 30 per cent quota was reaffirmed by Law 55/1995 on the Acceleration of the Privatisation Process; the privatisation agency compiling a list of suitable enterprises issued the so called ‘nominal value vouchers for privatisation’ to be distributed amongst the resident population that had not made full use of their property vouchers received according to Law 58/1991. This new law contained the first real incentive for employee financial participation in voucher privatisation. While members of the general public who owned the nominal value vouchers could exchange their vouchers only for shares of companies chosen from the privatisation agency’s list of suitable enterprises, Art. 5 offered employees, former employees (pensioners or the unemployed) and managers the same opportunity to acquire shares of non-listed companies.

Employee Stock Ownership Plans (1992, 1994, 1997, 2002) – ESOP associations stem from Rule 1/1992 on the Standard Procedure for the Privatisation of Small Enterprises by the Sale of Shares in force as of January 1993. Although focused on the privatisation of so-called ‘small enterprises’ with not more than 50 employees, this regulation defines insider privatisation via an ESOP-like scheme implemented by means of direct negotiations with interested employees and managers as the standard privatisation procedure. However, the shares were not acquired directly by participating employees but by an incorporated association of share owners ruled by Law 77/1994 allowing employees and the management of partly or fully state-owned enterprises earmarked for full or partial privatisation to establish ESOP associations.¹⁷³ Until 2002, only one ESOP association could be established in each enterprise to be privatised, eliminating the possibility of competition between associations over the purchase of one specific enterprise. Membership in the

¹⁷³ Law on Associations of Employees and Members of the Management in Companies in the Privatisation Process, establishing so-called management and employee associations (‘asociația salariaților și membrilor conducerii’). When voucher privatisation came to an end Emergency Ordinance 88/1997 defined a rough legal framework for the employee shareholder associations and referring for the details to the general legal provisions governing associations and foundations; the Ordinance was subsequently changed by Law No. 137/2002 concerning some measures to forward privatisation.

ESOP association, while voluntary, was a precondition for making use of the advantages and rights. The law prescribes that a minimum of 30 per cent of the total number of employees and management staff must participate in establishing the ESOP association. The employing enterprise is obliged to disclose all relevant commercial and financial information to the association's founding committee; it must also bear the costs of a preliminary feasibility study. The ESOP association buys and administers the shares for its members. Membership is open to employees with open-ended labour contracts for at least half-time employment (since 2002 also to fixed-term employees and to pensioners), to members of the management of the employer company and former employees, both unemployed and pensioners.

The association's main decision-making body is the general meeting in which each member has one vote. The general meeting adopts the ESOP association's Articles of Association which must contain strict rules on the distribution of shares purchased. With the share not being acquired directly by employees and management, but the intermediary ESOP association, with an autonomous legal personality, participation in decision-making therefore depends upon the decision-making procedure within the association and how members' decisions are transmitted to the shareholders' meeting. The ESOP association may also purchase shares on behalf of individual members. In this case the shares are distributed directly to and administered by the members themselves once they fully pay for the shares either with cash or privatisation vouchers. The main advantage of buying shares through the ESOP association is the use of the credit offered either by the Privatisation Agency itself or by external banks. Shares bought under the name of the association are not vested directly to individual members, but retained by the association until they are entirely paid for, serving as credit securities during this period. ESOP associations' members have pre-emptive rights to the unvested shares, on the basis of length of employment, company position and salary. If the members do not exercise their pre-emptive rights, these shares may be distributed to new employees. When all shares are distributed to its members, the association must be dissolved. Law 77/1994 additionally offers preferential instalment options¹⁷⁴ for shares purchased by ESOP associations. This involves a low advance payment, complemented by a minimum repayment period of five years and a maximum interest rate of 10 per cent per year. Given the high inflation rate that obtained during the 1990s, this interest rate limit turned out to be remarkably advantageous.

Private Companies – The legal framework established by Romanian company law is defined by Law 31/1990 on companies, republished in 2004. Romania has only made partial use of the tools/exceptions offered by the Second Council Directive 77/91/EEC of 13 December 1976 to promote employee financial participation by means of corporate legislation. Regarding permission to acquire the companies' own shares for its employees Art. 103 Law on Companies offers an exception to the restrictive general rule for such transfer which requires a decision of the shareholders' meeting in the case of the acquisition of shares for the employees of the company. The second exception is Art. 106 para. 2 Law on Companies, that is, the encouragement of share acquisitions by employees by permission to advance funds and to make or secure loans for this purpose.

¹⁷⁴ Regarding Art. 52 of Law 77/1994 the Privatisation Agency is bound by these conditions. Furthermore, the Agency has to accept a certain amount of privatisation vouchers (property vouchers) in exchange for the shares to be transferred.

b) Profit-Sharing

In 2001 the government passed Ordinance 64/2001¹⁷⁵ covering state or municipal enterprises whose legal form is prescribed by Law 31/1990 on Trading Companies, with the state as single or majority owner, or in a specific legal structure which is still widely used by public utilities ('regiã autonoma', governed by specific regulations). The ordinance regulates the details of profit distribution, such as reserve funds, payouts to owners and the coverage of losses from previous years. In Art. 1 lit. e), the ordinance also contains a provision which sets the maximum payout rate for employee profit-sharing at 10 per cent of the overall profit of the enterprise (10 per cent in the case of companies, or 5 per cent in the case of autonomous bodies, depending upon employees' performance and contribution to the financial results).¹⁷⁶ There is no current provision regarding a minimum rate; it should be noted that the number of state firms actually making a profit is still low. Nevertheless, Ordinance 64/2001 is one of the few laws expressly dealing with the issue of employee profit-sharing. Against the background of the pronounced encouragement of ESOP privatisation schemes, profit-sharing in companies privatised through this method should be widespread, as a side effect of share ownership. Since ESOP privatisation policy particularly favoured the sale of smaller enterprises to employees and management, profit-sharing schemes should be over-represented in the sector of small and medium sized firms.

c) Participation in Decision-Making

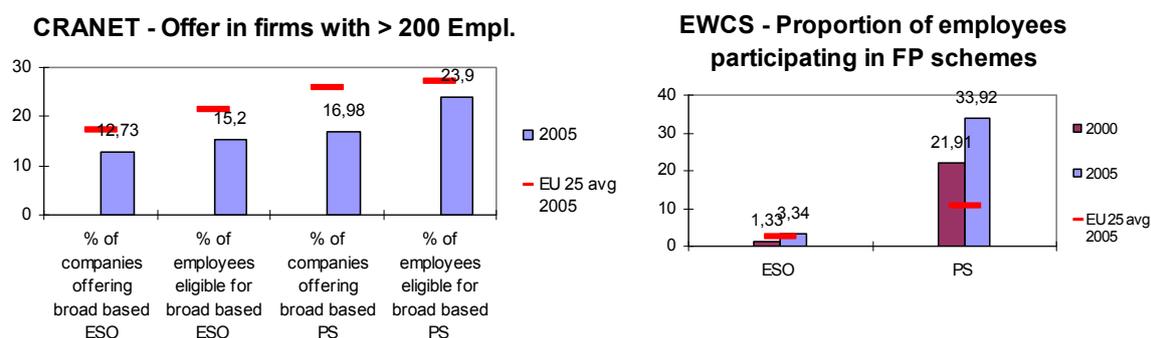
While legislation before 1990 emphasised employee participation in decision-making excessively way, the privatisation laws passed since 1990 contain no special regulations on this issue. The notion of employees' co-determination, as in German law, was not introduced. The Company Law does not provide any legal means for the privileged participation of employees in decision-making. However, it does contain various provisions protecting the interests of minority shareholders. The new Labour Code of 2003, as well as the nation-wide collective agreement with trade unions for the period 2007-2010, contain regulations for some compulsory consultation procedures if management is planning any changes in labour conditions.

¹⁷⁵ On the Repartition of Profits Obtained by State and Municipal Companies with the State as Single or Majority Owner (M. Of. No. 536/2001 as amended) abrogating earlier regulations, for example, Ordinance 23/1996 on the same issue.

¹⁷⁶ Supplemented by Governmental Disposition No. 29 of 25 February 2002 for the approval of the explanatory note regarding the establishing of the amounts making the object of the profit repartition conforming to the Governmental Ordinance No. 64/2001 and their reflection in bookkeeping (M. Of. No. 157/2002).

XXIV. Slovakia

Despite political declarations in the mid-1990s, PEPPER schemes have made little progress in Slovakia, while financial participation remains marginal. The environment for employee participation has been generally more favourable than in the Czech Republic due to a major difference in the privatisation plan of Slovakia revised after the split from Czechoslovakia in December 1992. Starting with a focused policy favouring the voucher scheme, the new government switched to traditional privatisation methods – trade sales in particular but also insider privatisation – in its second privatisation wave. The populist government in the mid-1990s used employee shares in conjunction with managerial types of privatisation to facilitate property transfer to members of their party. However, the subsequent reformist government abolished this system; from 1998 on, the *Dzurinda* government focused on revenue-oriented privatisation of the remaining state enterprises, which included telecommunications, gas utilities and large banks. The private ownership structure which emerged from this point is totally dominated by external or managerial ownership.



Note to the reader: The high ranking of Slovakia in the EWCS chart is very surprising, and we suspect that this may be due to the misunderstandings about the nature of profit-sharing schemes and the mistaken treatment of some bonuses as profit-sharing.

1. General Attitude

The general attitudes towards employee participation, current and past, can be summed up as ‘unsuitable for Slovak economics’. External ownership is the preferred form of ownership; no incentives to encourage other forms or employee participation are provided. A survey of past and recent literature on enterprise sector development and corporate governance in Slovakia reveals no professional or public interest in employee participation. Moreover, there is no mention of insider shares; at best managerial ownership and buyouts are dealt with. In general, attitudes toward employee participation are similar to those in the Czech Republic.

Trade unions on the whole also seem indifferent. The only document on the website of the Confederation of Trade Unions of the Slovak Republic that mentions employee shares is concerned with social dialogue, not shares as a form of corporate governance; the reference is merely casual, with no apparent implication. Today, political parties seem to ignore this issue, except for the Communist party which explicitly mentions employee shares in a 1994 programme which has not since been modified. Based upon partly anecdotal pieces of evidence, we conclude that the probability that employee shares will become a focal issue of government economic policy in the near future is low; the subject seems of interest only to the far left of the political spectrum and of no concern to trade unions, government or the general public. High unemployment may be the explanation.

2. Legal and Fiscal Framework

Under present Slovak law, which is similar to the Czech Republic, there is no specific employee financial participation programme or any particular law or regulation pertaining to any specific PEPPER scheme. The only form of employee participation in the ownership structure of corporations covered by general laws have been a few regulations on the acquisition of shares by employees and profit-sharing in joint-stock companies.

a) Share Ownership

Privatisation (1995, abolished 1996) – The Slovak Republic National Council Act No. 192/1995 was the basic legal act, which accelerated direct sales primarily, while at the same time subsidising domestic entrepreneurs and enabling them to participate in the privatisation process under favourable conditions. Direct sales were to be used to compel employee ownership, obliging the transferee either to issue employee shares that accounted for 10 per cent of the companies' equity capital, or to enable employees to acquire at least a one third¹⁷⁷ stake in the transferees' equity. Instalment payments scheduled for 5-10 years with the first instalment at about 20 per cent of the purchase price were foreseen in order to off-set the domestic financial capital shortage.

Private Companies (1989, 2001, 2004) – In 2001 the concept of genuine 'employee shares' as a special type of share was abolished in favour of an option allowing joint-stock companies to include rules in their statutes which allow their employees to buy company shares at a discount. According to § 768c, para. 17, Commercial Code (CC), previously issued 'employee shares' had to be converted into regular shares by a decision of the general shareholders assembly by January 2004. In case the conversion requirement was not met, § 768c, para. 14, CC stipulates the possibility of liquidation of the company by court decision. § 204, para. 4, CC introduced the possibility of employees acquiring shares on preferential conditions to replace 'employee shares'. The general prohibition against a

¹⁷⁷ A twist appeared in this year, when all the privatised firms were required to issue 34 per cent of their share capital in employee shares: This requirement was abolished within half a year and the privatisation law then only mentioned an option to issue employee shares, not a requirement to do so.

company acquiring its own stock, regulated in §§ 161a and 161 f CC, is in principle an obstacle to the introduction of employee shares. However, the corporate charter can permit (pursuant to the rules laid down in § 161 a para. 2 lit. a) CC, introduced in 2004) a company to acquire its own stock for the purpose of transfer to its employees; such shares must be transferred within 12 months of acquisition by the company. Under current legislation, joint-stock companies may issue new shares which grant employees favourable conditions in the context of so-called mixed capital increases (according to § 209a para. 1 CC), that is, the capital increase of a company issuing new stock financed by the company's own capital. According to § 204 para. 4, the general shareholders assembly can authorise the offer of a certain number of those shares to employees at a lower price than the offering price, with the difference paid from the company's own resources.

In order to facilitate share acquisition by employees, legislation allows a company to fully pay for the stock acquired by its employees. § 204 para. 4 CC states that a prerequisite to the preferential conditions for the purchase of shares by employees is that the overall value of the granted discount for the issued shares has to be covered by the company's own resources. The terms will be decided by the general shareholders meeting. In the case of the mixed capital increase previously mentioned, applying § 204 para. 2 CC, and in analogy to § 209a para. 3 and 5 CC, the total discount may amount to 70 per cent of the share price provided that the remaining 30 per cent is paid by the employees at the moment of the transaction, unless the down payment for the acquisition is financed otherwise. In fact, § 161e para 2 CC, introduced in 2004, contains an additional regulation permitting the company, an exception to the general prohibition against leveraging the acquisition of own its stock, to do this in order to facilitate the acquisition of shares by its employees. The company may make loans to employees for the purpose of acquiring newly issued shares or in order to buy them from third persons; also to guarantee such loans from third persons provided that this does not endanger the company's own funds. Thus a company may enable its employees to acquire company shares by discounting the purchase price, by providing credit and financing, by acting as guarantor, or by a combination of all three preferential conditions.

b) Profit-Sharing

Nothing in the Slovak legal system prohibits companies from sharing profits with their employees. The only explicit regulation is provided in § 178 para. 4 CC which states that, in accordance with the corporate charter, employees may be entitled to a share in the company's profits (cash-based profit-sharing). Either the corporate charter or the general shareholders meeting may also stipulate that profits allocated to the employees be used exclusively to purchase shares on preferential conditions, or to make up the discount granted to employees in such a purchase (share-based profit-sharing). Further, share-based profit-sharing is mentioned in the context of capital increases. As a rule, a capital increase requires the decision of the general shareholders assembly, but § 210 CC, in accordance with the corporate charter, allows delegation to the management board. § 210 para. 4 CC regulates a capital increase through issuance of the shares to be transferred to employees on preferential conditions. This possibility is especially emphasised in the case where the general shareholders assembly has previously decided that the part of the profits that it allocates to employees is used exclusively to purchase these shares. All those benefits will be subject to personal income tax of 19 per cent.

c) Participation in Decision-Making

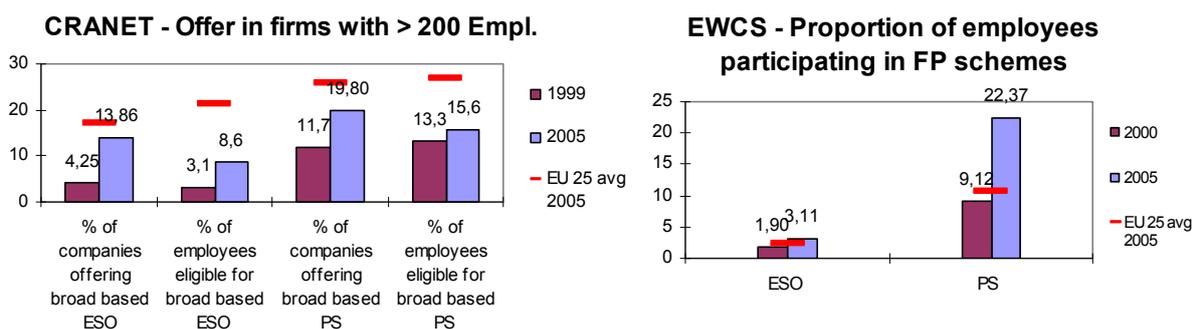
According to § 200 of the Slovak CC, joint-stock companies (similar remnant as in the Czech case due to common initial conditions) with more than 50 employees must have one third representation of employee-delegated members on the supervisory board. There are no special rules for participation of employees in decision-making with regard to PEPPER schemes or privatisation matters. With regard to employee shareholding the general rules of the Commercial Code concerning shareholders rights apply.¹⁷⁸

¹⁷⁸ For limited liability companies see §§ 114, 122, 123, 125 ff., for joint-stock companies see §§ 178, 179, 180 ff. CC.

XXV. Slovenia

Slovenia has a long tradition of employee participation, starting with employee self-management in the 1950s. The strong tradition of employee involvement in corporate affairs is reflected in both the Slovenian model of privatisation and in the development of Slovenian company law. Furthermore, in contrast to other Eastern European countries, Slovenia has retained relatively strong political support for the financial participation of employees up to the present time, with draft laws being presented in 1997, 2002 and 2005. Although Parliament did not pass any of the draft laws, supporters of financial participation have established associations to promote a legal framework. Their efforts finally led to success: on 29 February 2008, the Law on Employee Share Ownership and Financial Participation was adopted by the Parliament.

Damijan et al. (2004) reported that insider ownership decreased by more than 10 per cent in the period 1998-2002 (from 38.52 per cent to 26.17 per cent). The number of firms predominantly owned by employees (managers excluded) declined from 74 to 26. Of these firms, 10 per cent had no employee owners; in 25 per cent employees held less than 5 per cent of shares, while in half of the sample, the aggregate level of employee ownership did not exceed 18.4 per cent. There were only 25 per cent of firms in the sample with employee ownership exceeding 40 per cent of company capital. By contrast, profit-sharing schemes are rare. Kanjuc-Mrčela (2002) finds that only about 7 per cent of the 41 largest Slovenian firms have actually constituted a 'fund of own shares' in order to remunerate their employees. About 32 per cent of the firms introduced the possibility of employee profit-sharing in their Articles of Association. This possibility, however, often remains unexploited (in 22 per cent of firms in the sample).



1. General Attitude

Debates over the establishment and continuance of employee ownership and other forms of financial participation began in the early 1990s. In 1995 a group of enterprise representatives, union representatives, journalists and academics established the DEZAP (Em-

mployee Ownership Association). DEZAP's main task is to encourage employee ownership in Slovenia – its inception, growth and effectiveness. In pursuit of these objectives, the Association promotes the adoption of suitable legislation on employee ownership, provides professional assistance to and training and education of employee owners, develops networks of employee-owned firms, and promotes co-operation with other firms and international organisations. A similar organisation, the Association of Works Councils (Studio Participatis), currently consisting of 100 members, supports all forms of employee participation.¹⁷⁹ Trade unions, however, have varying views. For example, they opposed the 1997 profit-sharing law because it linked the introduction of profit-sharing with wage concessions, a connection which explained why the law was rejected. Finally, the promotion of employee financial participation, for example, by tax allowances, is one of the stated objectives of the Slovenian Association of Managers for 2005 (Združenje Manager).¹⁸⁰

Tax issues were the main obstacle to the adoption of the Law on Employee Financial Participation in 1997. In October 2002 the Slovenian Economic Ministry established an expert group to prepare the regulations on employee share ownership and other forms of financial participation. A new draft Law on Employee Financial Participation, submitted to Parliament by the Social Democrats in 2005, was rejected. These draft laws made employee financial participation plans compulsory; consequently employer groups strongly opposed these laws, all of which were proposed by centre-left governments. The 2006 draft law, however, was prepared by the first centre-right government in co-operation with the social partners and agreed upon in the Economic Social Council in December 2007. This draft law was adopted by the Parliament on 29 February 2008.

2. Legal and Fiscal Framework

The new Law of 29 February 2008, which took effect in April 2008, regulates share ownership and share-based profit-sharing plans (though not stock option plans) and offers strong tax incentives for the schemes eligible. However, the Ministry of Finance has yet to issue the Order authorising these incentives. When the Order is issued, interested companies will be obliged to register with the Ministry to become eligible for tax incentives. However, privatisation law, on the basis of which employee ownership first emerged in Slovenia, and general company law contain regulations with regard to Financial Participation.

a) Share Ownership

Privatisation (1993, 1997) – Privatisation was introduced by the Law on Ownership Transformation of 1992¹⁸¹ (hereinafter referred to as LOT), which authorised the sale of

¹⁷⁹ <<http://www.delavska-participacija.com>>.

¹⁸⁰ <<http://www.zdruzenje-manager.si>>.

¹⁸¹ Of 5 December 1992, OG RS 55/1992, as amended. However, a special form of participation of workers was already regulated by Art. 168 Company Law as amended in August 1990 (labelled 'the begin-

companies and social capital to workers or third parties, and defined a special form of workers' participation in social capital. Companies under social ownership were transformed¹⁸² into corporations and issued shares in the amount of the value of the social capital. The shares could be distributed or sold internally, sold to outsiders, and assets sold to outsiders. The LOT provided for the mandatory distribution of 40 per cent of the social capital to different funds (10 per cent to the Pension Fund, 10 per cent to the Restitution fund¹⁸³ and 20 per cent to the Development Fund for subsequent sale to Privatisation Investment Funds). The firms were then entitled to distribute (in exchange for employee vouchers) up to 20 per cent of ordinary shares amongst current and former employees, including retired employees. Registered shares obtained by workers could not be transferred for a period of two years after the issue date, except as an inheritance. In practice, however, employees found ways to sell their shares before this period was up, and many sold them immediately.

Furthermore, companies had discretion over the allocation of the remaining 40 per cent of their capital (after the distribution of 40 per cent to various funds and 20 per cent to inside owners); they could either sell to insiders (internal buyouts) or outsiders (outside privatisation). In an internal buyout, workers could buy shares with the profits of the companies owned by participants in the internal sale programme, as well as with their salaries or other sources. The workers could also obtain a part of the shares to satisfy salary claims or other legitimate claims against the company. Further, the option of the so-called 1/5 company model was introduced in order to support employee participation in ownership. For privatisation purposes, Slovenian citizens were granted vouchers; the value of vouchers granted to each individual depended upon the length of employment (Art. 31 LOT). Vouchers could be used to obtain shares in the employer company within the limitations of internal distribution (the initial 20 per cent), to obtain shares of Privatisation Investment Funds, to purchase shares of other companies privatised by public sale, and to purchase shares or other property of the Republic of Slovenia and state-owned companies offered to the public in return for vouchers (in the latter case, vouchers could not be freely traded).

Certain measures were taken to preserve employee ownership after privatisation, beginning with the two-year restrictions on trading shares gained from internal distribution (respectively four years for the case of an internal buyout). To prevent decline in employee ownership, some firms decided to limit trading by internal acts, namely through 'shareholder agreements' prohibiting the sale of employee shares to outsiders and providing for employee representation of employees in the company's decision-making process. However, shareholder agreements proved easy to abandon and difficult to administer (Mrčela, 2002). Upon the proposition of DEZAP, the Slovenian Chamber of Commerce

ning of capitalism'), which authorised the managing body of socially-owned companies and public companies to offer the employees the possibility to buy the assets of the company under the conditions defined in the Articles of Association.

¹⁸² The LOT emphasised ownership transformation rather than privatisation, which, nevertheless, was the final goal of the law. Transformation was the interim stage, allowing for the acquisition of ownership by workers and other Slovenian citizens of existing social capital (public funds).

¹⁸³ The Slovenian Restitution or Compensation Fund has to issue debenture bonds to re-privatisation claimants who did not get their nationalised property returned in kind. The Slovenian Compensation Fund obtained funds from the non-distributed public funds.

and the Association of Free Trade Unions, an amendment was introduced to the Take-over Law of 1997; this provided for the possibility of an institutional organisation of inside owners in the company's Workers Associations and exempted them from public bids (Art. 81). By the amendment to the Take-Over Law, Worker Associations became professional proxy organisations and, as such, had to act in accordance with the Takeover Law (Art. 298) and the provisions of the Company Law. The earlier laws regulating transformation and privatisation, although not abolished, are no longer in practice since privatisation is generally complete.

Private Companies (2004, 2008) – The transposition of the Second Council Directive 77/91/EEC of 13 December 1976 into Slovenian CL 2004, allowed companies to buy their own shares up to 10 per cent of the subscribed capital for distribution to their own employees and employees of associated companies within a one-year period (Art. 240 CL). This provision applies to both joint-stock companies and limited liability companies; tradability is unrestricted for shares thus acquired. Further, Art. 241 CA allows companies to advance funds, make loans, and provide security for the acquisition of company shares by their own employees or employees of an associate company. Pursuant to Art. 318 CL, part of the profit can be distributed to employees in the form of new shares if the general meeting so decides.

Under the new Law of 29 February 2008, employees are granted a 70-per-cent tax relief on distributed shares held for one year, and a 100 per cent tax relief on shares held three years, up to an annual maximum of Euro 5,000. In addition, no social security contributions are imposed on the benefit. In the original draft law, only employees covered by collective agreements, that is, with the exception of management and other key personnel under individual contract, were eligible for tax incentives. However, the version of the Law finally adopted includes all personnel categories, but only for a limited amount. The annual amount for financial participation may not exceed 20 per cent of company profit or 10 per cent of the employees' total gross salary. The employer company may deduct the value of distributed shares from the corporate income tax base.

b) Profit-Sharing (1993, 1993)

The new Law of 29 February 2008 also applies to share-based but not cash-based profit-sharing. The rules of the Law explained in the section on share ownership also apply to share-based profit-sharing. Further, general provisions of company law may also apply. In Art. 228, the new CL of 1993 regulates the use of net profit. This profit must primarily be used for covering losses and creating legal and statutory reserves. The remaining net profit not exceeding 50 per cent may be used for other reserves; if the Articles of Association so provide, a part may be distributed to employees and members of the management and supervisory boards.¹⁸⁴ These matters are decided by the general meeting in determining distribution of profit. In summary, the CL makes profit-sharing possible provided that there is enough profit to cover losses, legal and statutory reserves, that the Articles of Association allow some use of profits for employees, and that the general meeting ap-

¹⁸⁴ Only the Articles of Association can grant members of the management board the right to participate in profit-sharing in recognition of their work contributions (Art. 252 (1) CL).

proves the decision.¹⁸⁵ The participation amount is usually determined as a percentage of the annual profit of the company.

c) Participation in Decision-Making

Art. 75 of the Constitution specifies the terms and conditions of employee participation in management. It was implemented by the special Law on Workers' Participation in Management of 1993¹⁸⁶, which regulates workers' participation in the management of economic units regardless of ownership form, including co-operatives.¹⁸⁷ According to this law, workers may participate in management by submitting initiatives, by demanding information, by consultations with their employer, and by participation in decision-making, including the right to reject employers' decisions. In particular, workers are entitled to nominate from one third to one half of supervisory board members and, in firms with more than 500 employees, one member of the management board. Since employees who obtained shares in the course of privatisation are as a rule minority shareholders, special provisions of the CL on the protection of minority shareholders apply. These special rights relate to the general meeting, the right to information, the right to examine the books, and the right to lodge a complaint against the decisions of the general meeting. On the other hand, these rights do not include the right to replace management.

¹⁸⁵ It is also possible that participation in profits is defined by the meeting of shareholders (Art. 276 CL), but, by systematic interpretation of special provisions in conjunction with general provisions, it can also be concluded that in this case the general meeting has to amend the Articles of Association.

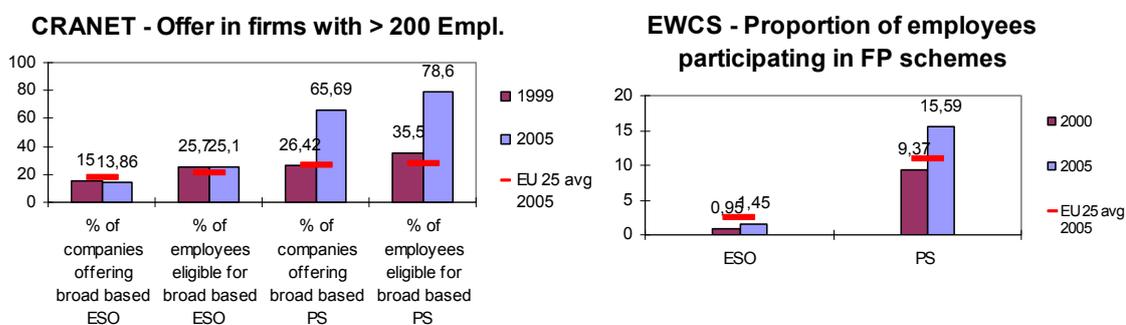
¹⁸⁶ Of 6 August 1993, OG RS 42/1993, as amended.

¹⁸⁷ Individual specific provisions on employees' co-management are integrated into the special laws for different economic sectors, for example, the Energy Law, Banks and Savings Banks Law, Insurance Company Law.

XXVI. Finland

Personnel funds are the only form of financial participation to enjoy fiscal incentives and the support of the social partners. In 1989, the Council of State appointed a committee to find new forms of co-operation for enhancing economic democracy, competitiveness and productivity. A draft law in 1987¹⁸⁸ proposed voluntary personnel funds as a key element. The funds were to encourage efficiency at the company level, ‘innovations’ at all levels, and a balanced division of decision-making and responsibilities. The law, enacted in 1989 (814/1989), immediately attracted great attention. The majority of the funds in place today were established then. A total of 82 funds have been established between 1990 and April 2007, of which 28 have been closed down.

There are now 54 operating personnel funds with about 126,000 members covering over five percent of the workforce. It is not clear why the number of funds is not higher. The Ministry of Labour made a study (1999) of the funds which had closed down. In ten companies out of 13 the closure was due to changes in the company structure, for example, mergers and acquisitions. Another cause was a shift towards performance-related pay (two cases in the forest industry). Since the recession in the mid 1990s only a few funds have been established each year; recently their popularity has increased though. Interest in personnel funds has recently grown, in 2005 eight new funds were registered, more than in any other year since 1991.



¹⁸⁸ First official discussions about employee wage earner funds (as they were called at the time) took place in 1981 at Trade Union Organisations general meeting. The idea of wage earner funds in Finland was attributable to the model of collective wage earner funds developed in Sweden by Rudolf Meidner. The US ESOP was also a source of inspiration.

1. General Attitude

Until recently, personnel funds were the only subject discussed by the social partners. Personnel funds were promoted by both, employee associations (for example, Central Organisation of Finnish Trade Unions (SAK), the Finnish Confederation of Salaried Employees (STTK), and the Confederation of Unions for Professional and Managerial Staff (AKAVA)) and employer associations (for example, Confederation of Finnish Industries (EK), Commission for Local Authority Employers (KT) and the State Employer's Office) as well as the government.¹⁸⁹

However, the interest in financial participation is growing; social partners improve organisational and pay flexibility; the current government and social partners regard personnel funds as a good instrument for achieving flexibility. At present these parties are discussing methods to facilitate and promote the use of personnel funds. Current incentives for both employees and employers do not seem to enhance their use as much as intended though. Options and share ownership are not viewed as proper subjects for collective bargaining. Some employee associations would like profit-sharing or performance-based pay to be subject to collective wage bargaining negotiations. The employers associations think that the companies should have the flexibility to unilaterally decide whether such pay forms should be used.

2. Legal and Fiscal Framework

a) Share Ownership

Personnel funds may sometimes be considered to be employee ownership when fund assets are invested in the company. Here, however, they are defined as profit-sharing.

Employee shares - Companies may transfer shares to employees at a favourable price. The benefit is tax free if the discount is up to 10 per cent below the current price and the majority of employees have access to the plan (§ 66 para. 1 of the Income Tax Law). 30 per cent of dividends from public companies are tax free, and 70 per cent are taxed as capital income. The company withholds 19 per cent in tax from payments to the employees; employees can deduct this tax from the personal income tax base. Dividends of private companies are tax free if earnings per share are less than 9 per cent and the total amount of earnings does not exceed Euro 90,000; otherwise, they are taxed as dividends of public companies.

Stock options¹⁹⁰ - The first stock option plans in publicly traded companies in Finland were launched in 1987. A large increase has been observed between 1998-2000, when the stock market was at record highs. The majority of option schemes are used in publicly

¹⁸⁹ In 2007/08 the Centre party held the majority of seats in parliament and was the ruling majority, together with the Coalition party, whereas the Social Democratic party is in opposition

¹⁹⁰ Based on the data from the doctoral thesis of Mäkinen (2007) and Kalmi (2005).

traded companies and in companies that are preparing for initial public offering. The schemes are either broad-based or selective. Broad-based schemes include all employees or at least the majority, while selected schemes are mostly for the management. Broad-based schemes became popular in 1998-2000, but their popularity has waned. The Law on Joint-Stock Companies (624/2006) requires companies to report all relevant conditions and changes in their stock option schemes to shareholders. Generally in Finland stock options are either given for free or in exchange for a loan to the company which is usually to be repaid in one to three years. Options typically can be exercised two to four years after grant. The exercise period may extend from a few months to a few years. The share price is usually set to correspond to the price at the time of grant. Stock options are taxed as earned income. The employer pays social security contributions.

b) Profit-sharing

Personnel Funds – Personnel funds have been the most frequent form of employee financial participation since 1990. The Law on Personnel Funds (814/1989) was issued 15 September 1989 and amended several times thereafter. The personnel funds are deferred profit-sharing plans allowing investment in the equity of the employer company and thus involving an element of employee share ownership.¹⁹¹ Annual payments to the fund should be (at least up to 50 per cent) accumulated from company profits. The employer retains the right to choose the criteria for profit-related payments, but these must be fixed, typically, a year in advance.¹⁹² The funds are established on the basis of company-level agreements, prerequisite is that a company has at least 30 employees.¹⁹³ The law requires all employees to be included in the plan; only senior management may be excluded. A personnel fund is registered with the Ministry of Labour and is a legal entity in its own right. However, it may engage only in the activities determined by the Personnel Funds Law (814/1989). The funds invest their assets either in shares of the employer company or other companies, in investment funds, bonds or bank accounts. These investments multiply the financial returns of the employees beyond company profits.

The assets in the personnel fund are allotted to individual accounts. The shares are generally distributed to employees either in relation to base pay or to hours worked. Individual accounts are blocked for the first five years of participation. After that, a member can withdraw up to 15 per cent of the value of his accumulated fund share. At retirement, the employee is entitled to withdraw the value of the fund share either immediately or in instalments within four years. The law requires the fund to provide each employee with information about his account at least once a year by letter. Personnel funds enjoy several tax advantages. For employees, 20 per cent of the pay-outs from the fund are tax free (§ 65 of the Income Tax Law). The fund pays no taxes on its earnings (§ 20 Income Tax Law). The employer company is not liable to social security contributions, and can deduct profits contributed to the fund as professional expenses from the corporate tax base (§ 8

¹⁹¹ The discussion draws from Vartiainen and Sweins (2002) and Sweins (2004).

¹⁹² It is possible to use other measures of efficiency, for example, quality or physical productivity. At the present time companies do not, however, utilise this alternative to any extent.

¹⁹³ Personnel funds are established by a collective decision of employees and two-thirds of all personnel groups must support the establishment of the fund. In the case of corporate groups there can also be a joint funds for all member companies.

Corporate Tax Law). Since 1999 (amendment 344/99) allowed the funds also to be established in civil service departments and in state owned companies. In lieu of profit, the government offices use measures of performance. In 2000 (amendment 1145/99), the law was changed to allow employees to withdraw their share in cash if it is permitted by personnel fund regulations. Internationalisation and globalisation led to a change that also allowed Finnish international companies to extend profit-sharing plans, including personnel funds, to its subsidiaries abroad (amendment 499/2002).

Even though Finnish personnel funds were inspired by Swedish wage-earner funds and US employee stock ownership plans, important differences exist between these schemes. Neither Employee Share Ownership Plans (ESOPs) nor wage-earner funds (WEFs) are profit-sharing schemes. In ESOPs, the trust acquires shares with borrowed capital, and in WEFs with the government assistance.¹⁹⁴ Whereas personnel funds typically distribute their shareholdings quite widely and invest also in other securities, employee share ownership plans invest only in their own company. The main difference between personnel funds and wage-earner funds is that the former are completely voluntary and operate at the level of the company, whereas the latter operated at the national level for the benefit of the entire workforce. In the design of Finnish personnel funds, the employers explicitly wanted to avoid the Swedish obligatory model.

Performance-related pay – Neither legislation nor incentives for performance related pay exist. Performance related pay may be paid from company profit or from budgeted money or it may be a mixture of both. Plans may be related both to individual (gain-sharing) performance as well as collective performance (profit-sharing). Of those employees belonging through the employer to the Confederation of Finnish Industries (EK) 52 per cent are participating in some performance related pay scheme. This concerns about 500,000 employees. Performance related pay that is other than personnel fund is used in one third of the companies. EK estimate that in the whole private sector (also not members) there were 46 per cent of the employees joining the performance related pay schemes. There are differences between sectors and personnel groups. The pay schemes are usually covering the whole workforce, but they may cover only a part of the workforce. PRP was more common in the industry sector (69 per cent) than in the service sector (44 per cent) or building sector (40 per cent).

c) Participation in Decision-Making

Financial participation is generally not linked to the extension of participation in decision-making. While wage increases are subject to collective agreement, companies may adopt profit-sharing and other performance-based payments independently without negotiations.¹⁹⁵ However, financial participation in form of personnel funds which is the most common form in Finland requires the consent of two thirds of employees to establish or

¹⁹⁴ See Blasi and Kruse (1991) for a description on ESOPs and Whyman (2004) for a recent account on WEFs.

¹⁹⁵ The unionisation rate in Finland is around 70 to 80 per cent; about 90 per cent of all wage and salary earners are covered by collective bargaining agreements. A few collective agreements, however, have included negotiation on performance based pay.

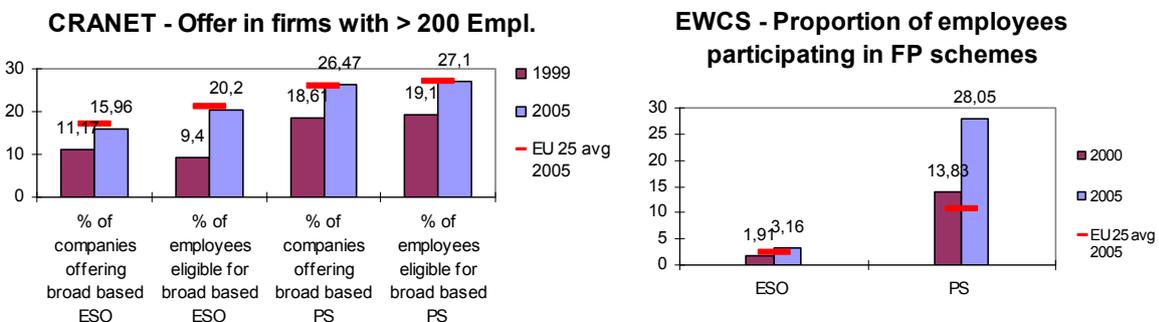
to dissolve a fund pursuant to § 9 Personnel Funds Law (814/1989).¹⁹⁶ Co-determination, employees' representation on the supervisory board is prescribed in the law 725/1990 (Finnish companies) and in 758/2004 (Societas Europaea and European co-operatives). In companies with over 150 employees, the employees have a right to elect representatives in the company management, that is one-fourth of the members of – depending on the company type – the supervisory board, the board of directors or management groups. There is no data available for how many companies have employees in the supervisory board.

¹⁹⁶ One of the prerequisites for a personnel fund is a profit bonus system decided by the employer. An eventual decision on establishing a personnel fund shall be preceded by a procedure of information and consultation in accordance with § 19 Co-operation Law 334/2007.

XXVII. Sweden

There is no specific system for direct promotion of employees' financial participation in profits or shares in Sweden, despite the fact that discussions about financial participation that is wage earner funds started in Sweden already at the beginning of the 1960s. The Law on Wage Earner Funds was enacted in 1983¹⁹⁷, whereby the majority of their assets were placed in shares of large companies. The obligation to make contributions to the funds was abolished in 1990.¹⁹⁸ There are no common definitions of different pay systems in Sweden, which makes comparisons difficult. There are no statistics on how many companies use financial participation. In Sweden, there is no particular national promotion for financial participation. One of the main thoughts behind the taxation reform in the late 1990s was that all different sources of work income should be handled in the same way, and therefore there are no income tax reliefs for the employees.

Profit-sharing foundations are used, but the extent is unknown because they are not registered with any authority. Performance-based pay is used in several companies and the collective agreements leave place for them. Performance based pay is based both on collective and individual results. It is not possible to distinguish, how many of these plans actually are profit-sharing plans.



¹⁹⁷ At that time, there were only discussions inside the Central Organisation of Trade Unions (LO). A workgroup around Rudolf Meidner proposed that 20 per cent of the profit in companies with over 100 workers should be invested in wage earner funds. Approximately 60 per cent of all employees in Sweden worked in such companies. The profits of these companies made up about 80 per cent of the profits in the whole country. The proposal was to create five regional wage earner funds which would be coordinated with the employment pension funds. Nevertheless, the law was different from the initial proposal. The funds got their assets from 20 per cent tax on the company real profit and from an increase in pension contribution. The public sector also participated in the funds.

¹⁹⁸ In 1991, the political right wing won the elections and started to close down wage earner funds. The draft law brought into the Parliament stipulated that the existing funds should be closed down and no new funds should be established. The accumulated capital of SEK 22 billion in shares was intended to be used to enhance private ownership and savings, but this proposition was rejected, since it would lead to volatility of financial markets. The government decided that 10 billion would be invested in research promotion and the remaining amount in subsidies for pension schemes.

One study shows that 19 per cent of the employees were involved in broad-based profit-sharing plans and 12 per cent in broad-based share ownership plans in 1998 and the number seems to have increased since.¹⁹⁹ The Swedish Trade Union Confederation's studies show large differences between different groups. In 1998, profit-sharing was most common among younger employees in the private sector with a full-time job and highly paid men working in the industry sector.

1. General Attitude

Employer associations regard financial participation as a good method of attaining increased flexibility in labour costs, depending on the success of individual firms. Because trade unions fear that financial participation will become a part of basic remuneration and affect regular raises in pay their view is neutral and sometimes negative. In practice, financial participation remains a local issue, while the national associations are more concerned with the taxation issues of financial participation as they affect their respective constituencies, for example, for employers the Confederation of Swedish Enterprises and for employees the Landsorganisationen (LO), the Swedish Confederation of Professional Associations (SACO), and the Swedish Trade Union Confederation (TCO). Government has little interest in financial participation and engages in no direct promotion. The government view is that employment income from different sources should be taxed at the same rate. The history of wage earner funds may still affect the debate on financial participation.

2. Legal and Fiscal Framework

a) Share Ownership

Employee Shares – The employer may offer stock purchase programmes to the employees at a discount price, but no incentives are available. Employees pay income tax on the difference between the discount and the market price, while the employer pays social security contributions at the time of grant if the grant price is below market. Future gains are taxed as capital income.

Stock options – Stock option programmes became more common in Sweden during the 1990s. One of the reasons was that generally tax is paid on capital income which is lower than that on income of employment. Nevertheless, employee stock options are not considered as financial instruments and thus, taxation is not as favourable as for other options. The employer has no contributions at time of grant; social security contributions are

¹⁹⁹ Würz (ed.) (2003), p. 116-128; on the general value and background of employee financial participation in Sweden.

paid at time of exercise.²⁰⁰ Likewise employees are not taxed at time of grant. At the time of exercise the difference between the market price and the exercise price of the shares is taxed as income of employment and social security contributions are due; future gains are taxed as capital income (§ 12 of the Income Tax Law 1999/1299). Employee stock options usually have the following characteristics: only available to employees within a company or group, granted for free with an exercise period of five to ten years, not portable if the employee leaves the company.

b) Profit-Sharing

Cash-based profit-sharing exists but remains unregulated by law. No incentives exist for cash bonuses. No statistics on profit-sharing are available.

Profit-Sharing Foundations – Although legally possible since 1962 (Law 1962/381), the first profit-sharing foundations in Sweden were established a decade later. A profit-sharing foundation is an entity for the benefit of employees, to which the employer company contributes a percentage of company profit and which is governed in accordance with legally defined principles. If the company decides to create a profit-sharing foundation, the employees, often through union representatives, establish the foundation and determine its charter, including the provision on how the contributions are to be invested. In listed companies, the assets are often partially invested in company shares. A profit-sharing foundation must fulfil certain requirements under the Law 1990/659. Employer contributions should represent a reward to employees for improving their performance. At least one-third of the employees must participate. Profit-sharing contributions are to be vested for at least three years. Terms and conditions must equally apply to all participants. When the foundation is terminated, its assets must be distributed directly to the employee participants, not to the company. The purpose of the foundation is to administer the allocated assets according to specific directions of its charter.

Employer contributions to the foundation were once exempt from social security contributions and payroll tax (1992-1997). This probably influenced the number of new funds. Today the employer pays a payroll tax of 24.26 per cent on contributions at the time they are made (Law 1996/97:21 s. 25) in lieu of a social security contribution of 32.28 per cent which is paid on wages. No tax incentives are given to employees; they pay taxes on income attributed to employment service at the time their trust accounts are distributed. The foundation pays capital tax 1.5 per cent on its assets (§ 20 of the Law on Governmental Capital Tax 1997:323). Since there is no systematic registration of profit-sharing foundations, it is impossible to know the extent of use or number. The most famous profit-sharing foundation in Sweden is that of Handelsbanken, called Oktogonen, enacted in 1973. Every year since then, except for 1992, Handelsbanken has contributed a part of its profit to the foundation. Shares are divided equally among employees, and the employee collects his or her payments at the age of 60. The foundation was Handelsbanken's largest shareholder in 2004, owning 10.1 per cent of the voting shares and 9.6 per cent of the capital. One third of foundation assets was invested in Handelsbanken shares, and the remainder was invested in the shares of publicly traded companies.

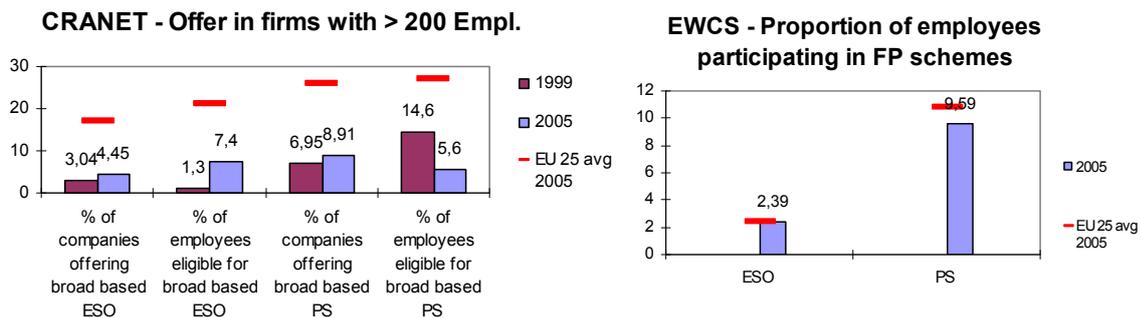
²⁰⁰ This may involve the risk of large social security contributions for the employer in the future.

c) Participation in Decision-Making

Employee financial participation is not connected to participation in decision-making. The extensive co-determination, representation and consultation rights of employees, mainly through trade union representatives, are governed by the Law on Board Representation (1987/1245) and the Law on Co-determination at Work (MBL 1976/580). The Act on Board Representation gives the local trade union the right to appoint two representatives to the board of directors if the company has at least 25 employees. If the company has at least 1,000 employees and operates in several industries or business sectors, the trade union has the right to appoint three board representatives. Under the Act on Co-determination at Work all important matters concerning the relation between employer and employees' organisations shall be determined by negotiation. The employee is always represented by the trade union organisation that has the right to negotiate. In the case of the employer, the right of negotiation may be exercised either by an employers' organisation or by the individual employer.

XXVIII. Turkey

On the whole, financial participation of employees has played a limited role in Turkey. Share ownership schemes have been implemented mostly in the context of privatisation and in multinational companies, while profit-sharing is found in private companies. Employees of many privatised enterprises have become share owners with incentives such as discounts, payment by instalments and loans being used. Anecdotal evidence has been found for the presence of ESOP-like schemes based upon associations and foundations which hold the shares of the employer company (for example, Adana Kağıt Torba Sanayii T.A.Ş. and Teletaş Telekomünikasyon Endüstri Ticaret A.Ş.) on behalf of employees, who acquire shares from contributions of company profit. The legal framework contains no special regulations concerning PEPPER schemes and some even inhibit their further development, although reforms of the Commercial Code are underway. Except for the tax deductibility of employers' contributions and specific tax exempt associations and foundations, there are no direct incentives for setting up PEPPER schemes.



According to a 2007 study of corporate governance in publicly traded Turkish companies, 3 to 4 per cent have employee share ownership programs, and 15 per cent have employee pension funds and other funds or foundations for retirement or unemployment insurance. Over 20 per cent of the companies have profit-sharing, though no distinction is made between broad-based schemes and those restricted to management (board members) (Küçükçolak and Özer, 2007, p. 5, p. 12: Table 7).²⁰¹

²⁰¹ The data results from a questionnaire based on the practices of corporate governance principles by the respondents, namely the Istanbul Stock Exchange (ISE) member firms and companies listed on the ISE, and a statistical evaluation of the findings. 115 members firms out of 205 and 243 ISE companies out of 308 were included.

1. General Attitude

Employee financial participation is not currently an issue for trade unions; their positions are inconsistent, probably due to lack of knowledge about the schemes available. Their attitude, however, can be described as generally positive, considering that, if the government would establish a consistent legal framework, employee ownership could benefit not only employees, but also the economy. On a national level, employees are represented by the Confederation of Rights of Turkish Workers' Trade Unions (Hak İş), the Confederation of Turkish Workers' Trade Unions (Türk İş) as well as the Confederation of Revolutionary Workers' Trade Unions (DISK). During the discussion of the Tax Reform of 1968, the Conservative Hak-İş had a more positive attitude towards employee participation than did the Türk-İş. Employers, generally, present themselves as opposed to employee participation, in particular to participation in decision-making and employee ownership, and most collective agreements are influenced by this attitude. They are, primarily, represented by the Turkish Industrialists' and Businessmen' Association (TÜSİAD) as well as by the Turkish Confederation of Employers' Associations (TİSK). However, according to a report of the TÜSİAD, participation of employees in privatisation is considered a positive factor in broadening income distribution and avoiding labour disputes (TÜSİAD, 2002; Gürol, 1994, p. 95). According to a survey conducted by the Capital Markets Board of Turkey in 2004²⁰² among the companies listed at the Istanbul Stock Exchange (ISE), 56 per cent of the responding companies were in favour of employee participation in the management of the company. Employee participation has been discussed by academics, politicians and trade unions since the tax reform of 1968.

The 58th Government (Justice and Development Party) in its instant action plan of 2002 encourages Turkish citizens working abroad to invest their savings in the privatisation of Turkish enterprises. According to the party programme, the intention is for companies subject to privatisation to be primarily offered to employees, along with certain other target groups. Accordingly, the Privatisation Law was amended by Law No. 4971 in 2003 to stipulate that employees can participate in privatisations conducted by public offers.

2. Legal and Fiscal Framework

Employee financial participation is covered by different laws; the recognised forms are profit-sharing, stock options and, to a limited extent, employee share ownership. Legislation permits employee share ownership in joint-stock companies during privatisation and in private companies through setting up welfare funds and mutual assistance funds for their employees' benefit. Except for tax deductibility on employers' contributions to special tax exempt associations and foundations, there are no direct incentives for PEPPER schemes.

²⁰² Survey on the Implementation of Corporate Governance Principles conducted by CMB of Turkey in 2004; 249 companies out of 303 responded to the survey.

a) Share Ownership

Privatisation (1984, 1994, 2003) – The privatisation programme in Turkey was initiated in 1983. Privileges for employees in connection with privatisation were introduced by Decree No. 18514 of the Public Participation Fund of 13 September 1984, regulating administration, usage and other issues. This decree allowed employees as well as the local citizenry to be included in the case of share sales.²⁰³ According to Decision No. 54 of the Housing Development and Public Participation Board of 30 April 1987, shares of enterprises to be privatised should primarily be offered to employees, local residents, and Turkish citizens working abroad. Pursuant to Art. 18 of the Privatisation Law²⁰⁴, privatisation could be conducted by sale, lease, the granting of operational rights, the establishment of property rights other than ownership, profit-sharing, and other legal dispositions depending upon the nature of the business. In the context of a share deal, the sale of shares to employees is expressly regulated and, depending upon the privatisation decision in each individual case, employees may be entitled to purchase shares at a discount and/or in instalments. Furthermore, Law No. 4971 of 15 August 2003 amended some laws and the decree law on the establishment and duties of the General Directorate of the National Lottery Administration, amending Art. 7 of the Privatisation Law to stipulate that employees can participate in privatisations conducted by public offer. In this context the possibility of granting credit to employees from funds of foundations set up by the employer company (see below ESOPs) according to Art. 468 and 469 of the Turkish Commercial Code²⁰⁵ (hereinafter referred to as CC) is important. Thus, acquisition on preferential terms, such as deferred payment in instalments, credit from established foundations and discounted prices, are amongst the possible incentives stipulated by privatisation legislation in order to leverage employee ownership in privatisation.

Private Companies (2003) – Turkish commercial law does not contain special rules for any business form on employee share ownership respecting share acquisition, limitation of the number of shares or the issuance of employee stock; therefore general rules apply. Nevertheless, the Corporate Governance Principles of June 2003 which are recommended by the Capital Market Board for adoption by individual listed companies do promote PEPPER schemes. Generally, corporations are not allowed to acquire their own stock (Art. 329 CC) and unlike regulations in other countries, exceptions from this general rule do not include special rules on employees' shares.²⁰⁶ Thus, even if freely disposable equity of the amount necessary for this purpose is available, Art. 329 CC is an obstacle to all schemes that enable employees to acquire shares if part of the price or the whole price of the stocks is paid for by the company (for example, acquisition below market price, free shares, premium, bonus, etc.). However, there is no restriction on offering shares to em-

²⁰³ In 1984 the first related Law No. 2983 was enacted, followed by Law No. 3291 in 1986. See <http://www.oib.gov.tr/baskanlik/yasal_cerceve_eng.htm>.

²⁰⁴ Law No. 4046 on the Implementation of Privatisation of 27 November 1994 as published in the Official Gazette No. 22124 on 27 November 1994 and most recently amended by Law No. 5398 of 3 July 2005 published in the Official Gazette No. 25882 on 21 July 2005.

²⁰⁵ Law No. 6762 dated 29 June 1956, enacted on 2 July 1956, published in the Official Gazette No. 9353 on 9 July 1956.

²⁰⁶ Art. 329 CC widening the exceptions is under consideration. In parallel the Capital Markets Law is subject to an amendment and in this case acquisition of own shares with the object to give them to their employees including by publicly held joint-stock companies is apparently under consideration.

employees on favourable conditions in the course of a capital increase provided that the price is not lower than the nominal value (Art. 286 CC). Furthermore, according to Art. 14/A of Capital Market Law, if the company's Articles of Association permit, publicly held joint-stock corporations may issue and offer to the public preferred non-voting shares. A foreign multinational company wishing to implement a financial participation plan for employees working in a subsidiary or companies of the same group in Turkey in accordance with the rules of the home country, must register the plan with the Capital Markets Board of Turkey, which will evaluate the application and approve or reject it. The sale should be conducted through an intermediary institution, for example, a bank, special financial institution or brokerage house.

Employee Stock Ownership Plans (ESOP) – Although genuine ESOPs have not been implemented in Turkey, ESOP-like schemes have been found. These are based upon associations or foundations which collectively hold the employer company's shares on behalf of employees, with the employer company making contributions from company profits to facilitate their acquisition. Pursuant to Art. 468 (1) CC, funds allocated for assistance to employees shall be set aside from the property of the company, and a foundation can be set up in accordance with the provisions of the civil law with the funds serving as its assets.²⁰⁷ As such, welfare funds or mutual assistance funds created for the benefit of employees are allocated to the foundation (or association) which in turn can invest in the stocks or other securities of the founding company. Thus the provisions of Art. 468 (1) and 469 (3) CC make it possible to overcome the constraints of Art. 329 CC which prohibits a company from acquiring its own shares. Further, the foundation deed may provide that the property of the foundation shall consist of a debt to the company, making it possible to finance the acquisition of shares by employees on credit. According to Art. 469 (3) CC, even if the Articles of Association contain no specific provision, the General Assembly can decide to set aside funds to establish assistance funds for employees. After setting up a foundation or other organisation for the benefit of employees, the founder company can provide resources either from profits on the basis of a General Assembly resolution or from optional reserves for social purposes. As a rule, allocations are to be regulated by the provisions on assistance funds in the Articles of Association. Employers' contributions to foundations (associations, etc.) that have been granted tax exemption by the Council of Ministers are tax deductible up to a maximum of 5 per cent of the current year's profit. Employees can also make individual contributions.

b) Profit-Sharing

Art. 323 of the Code of Obligations authorises any agreement that grants a share in profit to employees in addition to their basic fixed wage. In publicly-held joint-stock companies this may apply only if authorised by the Articles of Association (Art. 7 of a Communiqué of the Capital Markets Board of Turkey²⁰⁸ hereinafter referred to as DivComm). Joint-

²⁰⁷ In accordance with Art. 468 I and 469 III other than the aforementioned vehicle of a foundation also an association, a co-operative, a corporation or any other organisation for the benefit of employees may be used.

²⁰⁸ On Principles Regarding Distribution of Dividends and Interim Dividends to be Followed by Publicly Held Joint-stock Corporations Subject to Capital Market Law; Serial: IV, No. 27 published in the Official Gazette No. 24582 dated 13 November 2001, see Art. 8.

stock companies must retain 10 per cent of the net profit each year as a reserve until it equals 20 per cent of the capital ('first allocation', Art. 466 (1) CC). If dividends to shareholders exceed 5 per cent of the annual profit or if profit is not distributed as an entitlement from holding shares, for example, to employees, foundations, or company management, then an additional 10 per cent of the amount of profit to be distributed must be retained as a 'second allocation'. Joint-stock corporations with shares not traded on the stock exchange are required to distribute the first dividend principally in cash. However, companies not exempt from independent auditing²⁰⁹ can distribute the first dividend in cash and/or in the form of bonus shares (share-based profit-sharing). Corporations which partly or wholly prefer to distribute the first dividend in the form of share-based profit-sharing are required to obtain shareholder approval. Dividends of shareholders who did not exercise this right or had no opportunity to do so are paid in cash. In cases of making donations or distributing profit shares to foundations (see foundations discussed earlier in the ESOP section) another Communiqué of the Capital Markets Board of Turkey²¹⁰ further requires that these payments should not result in 'inconsistent' transactions²¹¹; that information on the donations needs to be given to shareholders at the General Assembly, and that all necessary information must be disclosed and published in the ISE Daily Bulletin.²¹²

c) Participation in Decision-Making

Turkish companies are not required to include employees in the corporate governance process, and there is no obligatory regulation on participation of employees in the management of the company. However, roughly one-third of traded companies do have a program for the participation of employees in management (Küçükçolak and Özer, 2007, p. 9: Table 3, p. 12: Table 7). The Capital Markets Board of Turkey Principles recommend that companies establish mechanisms and models to encourage stakeholders' participation in management, while giving priority to employees but without hindrance to company operations.

²⁰⁹ In accordance with Art. 3 (a) DivComm of the Communiqué on Principles Regarding Exemption Requirements for Issuers and Removal from the Board's Register Serial: IV, No. 9 published in the Official Gazette No. 22154 on 27 December 1994.

²¹⁰ Communiqué on Principles and Rules on Financial Statements and Reports in Capital Markets Serial: XI, No. 1 published in the Official Gazette No. 20064 on 29 January 1989.

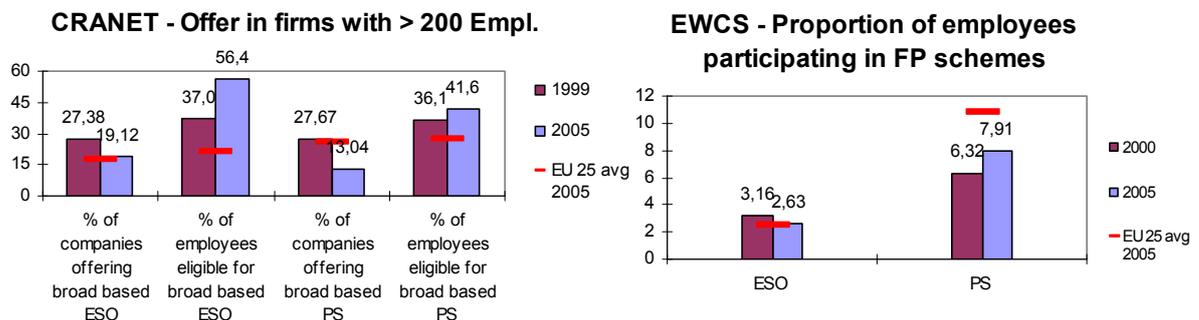
²¹¹ Defined by Art. 15 (6) Capital Market Law: in the case of transactions with another enterprise or individual with whom there is a direct or indirect management, administrative, supervisory, or ownership relationship, publicly held joint-stock corporations shall not impair their profits and/or assets by engaging in deceitful transactions such as by applying a price, fee or value clearly inconsistent with similar transactions with unrelated third parties.

²¹² According to Communiqué on Public Disclosure of Material Events Serial: VIII, No. 20 published in the Official Gazette No. 21629 on 6 July 1993, amended with Serial: VIII, No. 39 published in the Official Gazette No. 25174 on 20 July 2003.

XXIX. United Kingdom

Profit-sharing plans first appeared in the UK at the end of the 19th century, while employee share ownership plans were introduced in the 1950s. These plans, however, remained small in number until the introduction of tax incentives in 1978. Approximately 5,000 companies currently maintain Inland Revenue-approved employee financial participation schemes.²¹³ With the abolishment of the last approved profit-sharing plan (Profit-Related Pay (PRP) or Approved Profit-Sharing Scheme (APS)) in 2002, the remaining approved plans, as well as numerous unapproved plans, are all share-based.

Approved plans operated in a 2006 breakdown as follows: Share Incentive Plans (SIP) - 830 (IR tax cost GBP 320 million); Savings-Related Share Option Schemes (SRSO), Sharesave or SAYE Schemes - 960 with approximately two million employees (IR tax cost GBP 412 million); Company Share Option Plans (CSOP) – 3,030 but with many fewer employees than SRSO (IR tax cost GBP 205 million), and Enterprise Management Incentives (EMI) - 2,570 with 27,000 employees (IT tax cost GBP 170 million).²¹⁴



Many companies combine several approved plans and also operate unapproved plans. (No statistics available.) Since approved plans are based on long-term holding and withdrawals which are not reported to HM Revenue and Customs, it is impossible to determine the exact number of employees participating in plans at a given moment.

²¹³ <www.ifsproshare.org>, Log-in: 19 October 2007.

²¹⁴ <www.hmrc.gov.uk/stats/emp_share_schemes/menu.htm>, Log-in: 9 October 2007. The difference between the data in the comparative tables and in the country profile is attributable to the last update of statistics by the HM Revenue and Customs. The costs of the plan are comprised of tax losses and National Insurance Contribution (NIC) losses.

1. General Attitude

The Confederacy of British Industry (CBI) and other employers' organisations generally support the employee participation plans proposed by the government, especially employee share ownership plans, but they have also criticised some approved plans for lack of flexibility. The government responded to this criticism by introducing the more flexible Share Incentive Plan. The CBI also set up a special task force to discover why employee shareholding has been declining since the 1990s. The government used these research findings to design new employee financial plans to reverse this decline. Trade unions over the years have taken a dim view of employee financial participation on the grounds that it would undermine the traditional collective bargaining process. This was their reason for strong past opposition to Profit-Related Pay Schemes. Recently, however, they have changed their attitude. The Trades Union Congress (TUC) has declared itself in support of employee financial participation schemes that are broad-based, and if both employees and employee representatives are consulted before introduction. Recently some trade unions have themselves proposed new schemes of financial participation.

Successive governments have committed themselves to supporting employee financial participation plans and promoting widespread share ownership for reasons both ideological and pragmatic. These include making enterprise more democratic, developing financial markets and fostering social welfare. The present government, together with the London Stock Exchange and a consortium of major companies, were the original founders of IfsProShare. This is an independent organisation which promotes wider share ownership and financial education. It still plays an important role in promoting the interests of companies having financial participation plans, disseminating information on best practices and consulting with companies interested in setting up such plans.

2. Legal and Fiscal Framework

All employee financial participation plans fall into one of two categories: approved by the Inland Revenue or not approved. Plans introduced under the annual Finance Acts must be approved by and registered with Inland Revenue; they enjoy substantial tax and NIC exemptions, enumerated in the Income and Corporation Taxes Acts, especially for employees. Unapproved plans may be introduced at the employer's discretion, but receive no special tax incentives. Approved plans must conform to law; unapproved plans are more flexible. Under current legislation, all approved plans (and typical unapproved ones as well) are employee share ownership plans. Unapproved plans are used for granting shares, options or cash equivalents that exceed legal maximums to individual employees or to employees not UK tax subjects. Unapproved plans are usually combined with approved plans. It is also possible to design a hybrid model containing provisions both approved and unapproved.

a) Share Ownership

Share ownership plans may be approved or unapproved. Under current legislation there are four approved plans, one direct share ownership plan with several modifications, SIP and three stock option plans (SRSO, CSOP and EMI). SIP and SRSO are broad-based, while CSOP and EMI may be restricted. Although not regulated, some forms of unapproved schemes are quite widespread: Long-Term Incentive Plans (LTIP), restricted Shares Plans and Unapproved Option Plans. Whereas LTIP and Restricted Shares Plans are predominantly confined to executives, Unapproved Option Plans are often broad-based complements to an approved plan. The following section will cover only approved plans.

Inland Revenue Approved Share Ownership Plan – The *Share Incentive Plan (SIP)* was introduced under the Finance Act of 2000 to replace the PRP on which it is partially modeled. Several possible modifications make it more flexible than earlier plans; also longer holding periods discourage tax evasion. The employer company sets up a trust to serve as an intermediary in allocating shares to employees. The share may be allocated without cost (‘free shares’), at a discount, or at full price (‘partnership shares’); also the employer may match the employee’s partnership shares (‘matching shares’). Dividends paid on all shares may be reinvested in additional shares (‘dividend shares’). Each plan modification is subject to specific requirements which, if met, confer substantial tax advantages on both employees and the employer company. These generally take the form of exemption from both the personal income tax and national insurance contributions. The plan must include all employees, with the possible exclusion of those employed less than 18 months, and the same general provisions must apply to all participants. Tax exemptions are valid for all versions of the plan after the shares have been held for five years, or earlier if the employee terminates his employment on account of injury, disability, redundancy, retirement or death; also if transferred under the Transfer of Undertaking (Protecting of Employment) Regulations of 1981, or on the employer company ceasing to be an associated company. Shares sold immediately after withdrawal are exempt from a capital gains tax. Regulations specific to each plan are as follows:

Free shares cannot be withdrawn from the trust during a holding period of three to five years. However, if the employee withdraws the shares or his or her employment ceases between the third and fifth year for reasons other than above, personal income tax and national security contributions are payable on the lesser of market value on the award date and the market value on the withdrawal/cessation date. If the employment ceases for other than the stated reasons before the end of the three year holding period, full personal income tax and national security contributions are imposed. An employee share in the plan is limited to GBP 3,000 per annum.

Partnership shares are purchased by the trust from a part of the employee’s pre-tax remuneration according to the employee’s agreement with the employer company. The shares are purchased either within 30 days of pay deduction or at the end of a specified accumulation period of up to 12 months. If the latter, the share price is the lowest market price of the period. An employee is limited to GBP 1,500 per annum. After the five-year holding period or termination of employment for the given reasons, the employee is exempted from personal income tax, and the employer exempt from national security contributions. However, the employee is only exempted from paying national security contributions if his total earnings fall below the ceiling on national security contributions. If the employee

withdraws the shares or his employment ends for a reason other than those stated between the third and fifth year, personal income tax and national security contributions are exacted on the lesser of the amount of the employee contributions for purchase and the market value of shares on the date of withdrawal/cessation.

Matching shares can be offered by the employer company up to two matching shares for each partnership share. These are allocated to the employee on the same day as partnership shares are acquired. The holding period is the same for matching shares as for free shares.

Up to GBP 1,500 of dividends per annum can be used to purchase *dividend shares*. The general holding period for dividend shares is three years. If these shares are withdrawn or employment ends for other than stated reasons within five years of their acquisition, the employee is liable for personal income tax on the dividends used to purchase the shares. However, there is no liability for national insurance contributions.

Inland Revenue Approved Stock Option Plans – *Savings-Related Share Option Scheme (SRSO) or Sharesave or SAYE Scheme*, introduced by the Finance Act 1980, is currently the most popular plan judged by the number of participants. It must apply to all employees, except possibly those with relatively short service. The basic structure of the plan is as follows: the employee enters into a Save-as-you-earn (SAYE) contract with a designated bank or building society, agreeing to save a specified monthly amount (GBP 5 to 250) by deduction from after-tax remuneration for 3, 5 or 7 years and the employer company grants him share options for the maximum number of shares he will be able to purchase at the exercise price with his SAYE savings. The SAYE contract always includes a tax-free bonus added to savings on completion, the amount depending on the term of the contract and the rates are set by the Treasury. The share exercise price can be up to 20 per cent under the market value of the underlying shares at the time of the grant. At maturity of the SAYE contract, the employee is entitled to choose whether to exercise the option and retain or sell the shares or take the savings and bonus in cash. These requirements fulfilled, the employee is not liable for personal income tax at grant or exercise. However, he must pay capital gains tax on the sale of shares.

Company Share Ownership Plan (CSOP) was introduced in 1984 as Discretionary Share Option Scheme (DSOP) and re-launched in 1996 under the current name with amended requirements. It is a discretionary plan which is often limited to the executives but can also be broad-based. It is often connected to performance results, that is, a certain goal must be reached before the option can be exercised. The following requirements also apply: the value²¹⁵ of outstanding options per employee must not exceed GBP 30,000 at grant; the exercise price may not be less than market value at grant; the exercise period may not be shorter than three nor longer than ten years after grant.²¹⁶ These requirements fulfilled, the employee is not liable for personal income tax at grant or exercise.

Enterprise Management Incentives (EMI) was introduced by the Finance Act 2000 in order to help small, higher risk companies to recruit and retain highly qualified employees. It ap-

²¹⁵ The value is equal to the number of shares multiplied by the exercise price.

²¹⁶ Before 2003, an additional requirement had to be fulfilled: the exercise period had to be not less than 3 years after any previous tax-free exercise. This requirement was abolished.

plies to companies with gross assets of less than GBP 30 million.²¹⁷ The plan can be selective. Approval of the Inland Revenue is not required, but it must be notified of each stock option grant under EMI within 92 days. Options granted must not exceed a total market value of GBP 120,000 per employee or GBP 3 million for the company. These requirements fulfilled, neither employees nor the employer company are subject to personal income tax or national insurance contributions at grant or exercise. However, they must pay capital gains tax at the sale of shares.

b) Profit-Sharing

At present there are no approved or conventional unapproved financial participation plans in the form of profit-sharing plans. However, a few unapproved bonus schemes might be both broad-based and profit-connected; if so, they could be considered as cash-based profit-sharing plans. There used to be an approved profit-sharing plan - Profit-Related Pay (PRP) or Approved Profit-Sharing (APS) - which was exceedingly popular until terminated in 2003.²¹⁸ There were 14,275 of these plans in 1998, covering 4.6 million employees. The plan, however, was mainly used as a means of avoiding taxation. Since it did not lead to a wider employee shareholder base, while causing heavy tax loss, the government phased it out in 1999, and completely abolished it in 2002. It was replaced with the SIP. Some employees, however, may have yet to withdraw their shares from the earlier plan.

c) Participation in Decision-Making

There is no direct connection between participation in decision-making and employee financial participation; in particular, financial participation plans cannot extend existing rights in decision-making. General provisions of labour law, for example, equal pay and prohibition of discrimination, also apply to financial participation plans.

²¹⁷ Originally, the volume of assets was GBP 15 million (until 2003), but it was considered necessary to substantially increase it.

²¹⁸ This plan was a broad-based deferred share-based profit-sharing plan introduced in 1978. The employing company had to set up a trust and pay contributions, so that the trustees were enabled to purchase shares of the company to be attributed to employees. The employees were not entitled to withdraw the shares within two years; if the shares were withdrawn after three years, no personal income tax was to be paid on the benefit. The participation of an employee connected with tax relief was limited to 10 per cent of the earnings or GBP 3,000.

Part 3

Comments on the Benchmarking Results

I. Lessons from PEPPER I to PEPPER IV

Milica Uvalić

1. Introduction

'Financial participation' refers to various forms of participation of employees in enterprise results. It includes two main types of schemes: (1) profit-sharing, namely the sharing of profits by the 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, which is paid either in cash or in enterprise shares; and (2) employee share ownership, including Employee Stock Ownership Plans (ESOPs), which assures employees an additional source of income related to enterprises results, either through dividends and/or the appreciation of employee-owned capital (Uvalić, 1991, p. 10). Over the last twenty years, the term has been used to distinguish these forms of employee participation from the more traditional forms which enable the participation of employees in decision-making, either through workers councils or co-determination on company boards (such as the most well-known system of Mitbestimmung in Germany). In 1990, a

new abbreviation was also born to cover the various forms of financial participation, namely PEPPER – Participation of Employees in Profits and Enterprise Results.²¹⁹

It is worth recalling that employee financial participation has been on the agenda of the European Union (EU) for almost two decades. In 1989, the Commission of the European Communities (CEC) decided to include employee financial participation among the priority objectives of its Action Programme for the implementation of the Community Charter of Basic Social Rights of Workers (European Commission, 1989). This initiative led to the preparation of the first PEPPER Report (Uvalić, 1991), reviewing the experience with employee financial participation in the then twelve EU Member States. On the basis of the PEPPER Report, the EU Commission prepared a Recommendation on PEPPER which was adopted by the European Council in July 1992 (see footnote 1), inviting Member States to facilitate the spreading of PEPPER schemes in practice. The information on individual EU countries experiences' was updated in the Commission's PEPPER II Report (see European Commission, 1997). These first two PEPPER Reports described the variety of employee financial participation schemes that have developed in the EU Member States (the EU-12 and EU-15 respectively). More recently, the PEPPER III Report (Lowitzsch, 2006) extended the previous two reports to describe the experience with the application of financial participation schemes in fourteen countries - the twelve new EU Member States that entered the EU in 2004 and 2006, and the two candidate countries. Finally, the PEPPER IV Report with its 'benchmarking exercise' gives the most recent assessment of financial participation in the whole EU, reporting for the first time comparable empirical data for all the EU-27 Member States and two candidate countries (Croatia and Turkey). From a historical perspective, it should be stressed that the general environment for the development of financial participation has been very different in the older with respect to the younger EU Member States. This is why it seems important to share the rich experience gained with PEPPER schemes in the EU-15 with the new and incoming EU Member States. Due to the specific pre-1989 socialist legacy, PEPPER schemes of the type known in the developed market economies have had no tradition in Central and Eastern Europe. As illustrated in the PEPPER III Report, employee share-ownership has been the prevalent type of scheme implemented during the 1990s, and this for very different reasons than those which have motivated the introduction of schemes in some of the older EU Member States. This renders the task of diffusing information on employee financial participation from the older towards the new EU Member States even more important.

This chapter aims to discuss some of the main lessons to be drawn from the experience with employee financial participation accumulated in the European Union over the last several decades. In what follows, the principle reasons why employee financial participation has been promoted are briefly recalled (section 2). Next, the main characteristics of PEPPER schemes, as reported in the PEPPER I through PEPPER IV Reports, therefore the experience of both the old and the new EU Member States and candidate countries, are examined (section 3). It ends with a few concluding remarks regarding the general framework of PEPPER schemes in the EU (section 4).

²¹⁹ The acronym PEPPER was proposed by Mario Nuti at the Workshop on Employee Financial Participation held in 1990 at the European University Institute in Florence.

2. Why promote PEPPER?

Government policies promoting PEPPER schemes have usually been motivated by the desire to introduce greater flexibility in payments systems and by commitments to a property-owning democracy and peoples' capitalism, as was the case in the UK in the 1980s. The deeper motives for promoting PEPPER schemes, however, are found in the rich theoretical literature on the potential benefits of employee participation in enterprise results.²²⁰ The theoretical arguments in favour of employee financial participation are based on two main groups of positive effects which are expected from such schemes.

First, employee financial participation is likely to improve workers' incentives. The change from a rigid system of guaranteed wages in which rewards are independent of effort, to a system which provides employees with a part of income directly linked to enterprise performance, will increase individual motivation and commitment, and will provide for greater identification of employees with the interests of their company, thus resulting in higher labour productivity and improved overall enterprise efficiency. In the case of employee ownership schemes, employees will be more interested in enterprise performance if they receive dividends or can gain from the appraisal of the value of their shares (Uvalić, 1991).

Second, financial participation schemes provide more flexible systems of remuneration, since a part of employee earnings is variable and depends directly on enterprise performance. More flexible remuneration is expected to enable more flexible employment policies, and as such could contribute to lower unemployment. In the case of employee share-ownership, enterprises may also be able to offer lower wages, since workers will be receiving a part of their income as shareholders; the wage that management must offer workers to persuade them to accept it will be lower if employees are likely to lose capital gains and dividends by rejecting the wage offer. Wage moderation may in turn lead to less variable employment policies, which can lower the risk of unemployment.

There is also a more practical reason for promoting employee financial participation in the EU. Since PEPPER schemes were more diffused, in the 1980s and the 1990s, in the two countries which are the EU's main competitors - the United States and Japan - their wider use in the EU Member States is considered a potential source of increasing EU competitiveness. Although more recent estimates suggest that there may be more schemes in the EU than elsewhere (see Pérotin and Robinson, 2003), this argument has not lost its relevance. In view of the EU objectives laid down at the Lisbon (2000) and Barcelona (2002) European Councils, of making the EU the most competitive and dynamic knowledge-based economy in the world, any scheme that has the potential of contributing to increasing enterprise competitiveness in the EU Member States is clearly of paramount importance.

²²⁰ There is an enormous literature on these arguments. For a survey, see Bartlett and Uvalić (1986), Bonin and Putterman (1987) or Uvalić (1991).

3. From PEPPER I to PEPPER IV

We will point to some main lessons to be drawn from the long experience with employee financial participation in the EU. As in the PEPPER reports, we will focus on four main issues: (1) the general attitude of the government and social partners towards PEPPER schemes; (2) the existing legislative framework; (3) diffusion of PEPPER schemes; and (4) evidence on their effects. The very different political, economic and historical context before 1989 in Western and Eastern Europe has fundamentally influenced all relevant issues regarding PEPPER ever since. This is why these issues will be discussed separately for the old and the new EU Member States.

a) General Attitudes

In the older EU Member States, we find a variety of positions of governments, trade unions, and employers associations on PEPPER. Whereas in countries such as France and the UK, PEPPER schemes have had a very long tradition and have been supported by specific legislation as well as fiscal incentives, this has not been the case in many other EU countries. One of the most intriguing questions, therefore, is why in many EU countries there has been lack of support of PEPPER schemes by governments and/or social partners.

There are essentially two groups of reasons why financial participation has not been actively promoted in individual EU countries. The first reason is simple, as it derives from the lack of interest, and the consequent absence of any position (in favour or against) employee financial participation. The second reason is more complex and derives from the very different understandings of the potential benefits and risks of financial participation schemes, as will be briefly illustrated below.

There is an enormous heterogeneity of views of governments, trade unions, and employers associations, some fiercely against and others in favour of financial participation. Traditionally, the strongest opponents of PEPPER schemes in several Western European countries have been the trade unions, though for different reasons in the various national contexts. Trade unions have opposed financial participation because they feared that it would provoke more inequality in workers earnings, or because of the dual risk involved of workers losing both their jobs and savings in case of enterprise closures. In countries like France or Germany, some trade unions have been strongly opposed to primarily employee capital ownership, regarding radical changes in the economic system the only way to secure a more equal distribution of wealth. In France and in the UK, not only trade unions but also parties to the left have strongly opposed financial participation because it was the conservative governments in both countries that have promoted PEPPER schemes and have pushed for the adoption of specific legislation. In many other EU countries trade unions have accepted PEPPER, but have argued that schemes must remain outside the framework of collective bargaining and must represent an addition, and not a substitute, to wages.

The rethorics has increasingly changed in recent years. Contrary to the situation in the late 1980s, today many trade unions recognise that capital and labour may pursue similar interests. It has become acknowledged that employee financial participation can strengthen

workers incentives, improve intra-firm human relations, and increase wage flexibility. In France in recent years, the political forces to the left have, for the first time, legitimised PEPPER schemes, recognising they can provide a better division of value-added in the interest of the labour force without loss of competitiveness of the enterprise, thanks to the variable nature of profit-related bonuses and their exemption from social security contributions. Financial participation is sometimes also regarded as an important instrument for enriching the social contract and social dialogue. PEPPER schemes are viewed as a means to increase employee remuneration and redistribute power in their favour.

Regarding the position of employers associations in the older EU Member States, they have usually supported voluntary PEPPER schemes and opposed any binding arrangements. Some employers associations have also argued for the introduction of tax incentives, considering PEPPER schemes an important instrument for improving employee motivation and commitment. Employers confederations most frequently accept financial participation, regarding it a means for obtaining a closer identification of employees with their enterprise, offering workers a personal stake in their company, and increasing intra-enterprise co-operation. There are, however, employers associations which do not actually have a concrete standpoint on PEPPER, primarily in those EU countries where financial participation has not been very widespread.

In many old EU Member States, PEPPER schemes have become part of a new culture of industrial relations based on innovative managerial strategies and more flexible remuneration policies. There has been an unusual convergence of economic thought from opposite ends of the political spectrum. On the left, with the collapse of state socialism as an economic ideal, workplace democracy has emerged as the principal institutional reform that commands widespread support among critics of capitalism; employee control of enterprises, it is hoped, will succeed where state control has failed in equalising power and wealth and in decreasing worker alienation and exploitation. On the right, in turn, there has been an increased discouragement with the efficiency of traditional forms of labour-management relations, and in search of an alternative, many have turned to employee ownership (Hansmann, 1990, p. 1751). Minority employee ownership within traditional firms has thus been accepted by both left and right-wing political parties, including many trade unions which have traditionally opposed it. Its advantages are particularly stressed within the context of property owning democracy, which ought to ensure more widespread ownership than traditional capitalism.

Passing to the new EU Member States, the general attitudes towards PEPPER schemes of governments and the social partners are remarkably different than in the older EU countries, particularly in the countries from Central and Southeast Europe (CSEE). The general attitudes towards PEPPER schemes have been strongly influenced by the legacies inherited from the communist times and the priorities imposed by the post-1989 transition to multiparty democracy and market economy. The specific political and economic system that existed before 1989 in the CSEE countries has also crucially shaped a number of important institutions, including trade unions and employers associations. Thus during communism, the political influence, bargaining power and role of trade unions and employers associations were marginal; although there was practically a 100 per cent rate of workers unionisation in most CSEE countries, this had little meaning since trade unions did not have any power to influence wage levels or other issues regarding working conditions.

As part of the historical turn in 1989, a radical transformation of institutions such as trade unions and employers associations has also taken place throughout CSEE. However, these changes have most frequently led to the adoption of a hyper-liberal economic and social model, with particularly flexible labour markets, weak trade unions and scarce diffusion of collective bargaining (see Nuti, 2007). Thus the model of industrial relations adopted in CSEE resembles primarily the UK model; in practically all CSEE countries except Slovenia, less than 50 per cent of workers are covered by collective bargaining and only a small percentage of the workforce is unionised.

This background in part explains the lack of interest for employee financial participation in the new EU Member States from CSEE. The various forms of employee participation, whether in decision-making or in financial results, are frequently viewed as not fitting into the new model of liberal social and industrial relations. Employee financial participation is erroneously regarded as a leftist idea and related to the concept of self-management and workers management rights that existed in pre-1989 Yugoslavia, Poland and Hungary. The word ‘participation’ is most frequently misinterpreted and its promotion confused with the desire to re-introduce outdated concepts and practices which have long been abandoned. Consequently, employee financial participation has hardly ever appeared on trade union’s policy agenda, only in a few CSEE countries have trade unions actually promoted employee ownership within the privatisation process, and they have not developed institutions to protect employee shareholders. Trade unions have been particularly critical about profit-sharing, since the deep economic crisis which accompanied the transition has clearly not favoured the introduction of profit-sharing. The fall in living standards has led workers to primarily claim higher basic wage increases, rather than flexible profit-sharing bonuses.

As to employers associations in the CSEE countries, their position on PEPPER has been passive and in most countries has not yet developed into a clear official standpoint. Though this seems to be the prevalent case, there are exceptions, such as the employers association in Slovenia which recently has been trying to obtain tax concessions from the government for enterprises implementing financial participation.

The main conclusion that can be drawn from the ongoing analysis is that in both Western and Eastern Europe arguments advanced against employee financial participation have been prevalently political in nature. However, the reasons for rejecting financial participation in the former communist countries are entirely different than those encountered in the older EU Member States. In the CSEE countries, the rejection derives primarily from a basic misunderstanding regarding the nature of PEPPER schemes.

b) Legislation

The experience with profit-sharing and employee share-ownership in the older EU Member States clearly confirms that schemes have been most diffused in those countries where concrete legislative measures have been introduced to support them (for example, in France, the UK or Ireland). The lack of specific legal provisions on employee financial participation, which would provide a different fiscal treatment or other type of incentive, seems to have been a major obstacle for its introduction.

This has also been the case in the CSEE countries, as illustrated in the PEPPER III Report (see Lowitzsch, 2006). Given the lack of more general support for financial participation

in the CSEE countries, if we exclude privatisation laws which have favoured the acquisition of shares by employed workers, there have been limited cases of legislation promoting PEPPER schemes. Those countries with privatisation laws envisaging the sale of shares at privileged terms to insiders have also been the countries that ended up having a substantial number of firms owned by employed workers and managers (for example Poland or Slovenia). The existence of privatisation laws favouring acquisitions by employees at privileged conditions has been fundamental for the diffusion of employee share-ownership throughout CSEE.

The findings of all the PEPPER Reports have suggested that there are not many legal obstacles for the introduction of financial participation schemes in the EU. However, the adoption of a framework law promoting PEPPER has always proved useful, as it has offered the general legal framework to guide enterprises in their adoption of financial participation. One of the main lessons of the PEPPER Reports is that specific legislation on PEPPER is important. Although there have been cases where financial participation schemes have been applied by enterprises even without legislation on PEPPER (as for example in Italy), the experience accumulated so far in the majority of EU countries suggests that the adoption of schemes has been greatly facilitated if there were concrete laws to promote them. Employee ownership and profit-sharing have spread particularly in those countries where there were laws to promote and support them – as in France and the United Kingdom, or in Poland and Slovenia.

c) Diffusion

In the older EU Member States, a favourable general attitude within a given national framework has usually led to some supportive legislation on PEPPER, and this has clearly facilitated the spreading of schemes in practice. This has been the case in all EU countries where PEPPER schemes have been rather diffused, such as in France and the UK, suggesting a clear link between general attitudes, favourable legislation, and diffusion of schemes in practice. In the four largest EU countries, around 19 per cent of private sector employees are covered by some form of financial participation (Pérotin and Robinson, 2003). It is interesting to note that in France, the country where PEPPER schemes have had the longest tradition, in recent years the share of variable pay has increased,²²¹ confirming a tendency to pay increases in workers income increasingly through variable remuneration.

In the CSEE countries the situation is quite different. As illustrated in the PEPPER III Report (Lowitzsch, 2006), it is primarily thanks to the privatisation of many state-owned firms in the 1990s that we have seen widespread employee share ownership in most CSEE countries (all except the Czech and Slovak Republics). The fact that employees were frequently offered privileged conditions for buying shares of the enterprise of employment was not determined by convictions of employee ownership being an instrument to strengthen incentives, but because this method of privatisation was chosen by default. In the absence of other potential buyers, sales of enterprise shares to insiders was a frequently used method in many countries, leading to a number of employees becoming

²²¹ Profit-sharing bonuses have increased from 3.1 per cent in 1996 to 4.5 per cent in 2003 of total pay, while ‘participation’ schemes from 3.8 to 4.6 per cent.

shareholders of their company. Moreover, in most CSEE countries, the importance of employee shareholding has substantially declined over time, as workers chose to sell their shares to external owners upon expiry of the imposed time limits. Since the mid-1990s, the general trend has been a decline in both the share of employee ownership within firms, and in the number of employee-owned firms. Dominant employee ownership has survived in a relatively small number of firms, although most CSEE countries still have a number of firms with some proportion of employee-owned shares.

The PEPPER III Report has also shown that there has been little profit-sharing in the new EU Member States. Although company laws in most CSEE countries do envisage the possibility for firms to introduce some form of profit-sharing, in practice it seems that this possibility has been used only in some countries. Where implemented in CSEE, profit-sharing has been introduced on a purely ad hoc basis, rather than in a systematic way assuring regularity in its application (as for example in France).

Some of these trends are confirmed by the most recent data provided in the PEPPER IV Report (see Lowitzsch et al., 2008). The PEPPER IV Report has tried to fill some of the gaps which derive from unsatisfactory general statistics on the application of PEPPER schemes in the EU Member States. Given that national statistics on the diffusion of PEPPER in individual countries are generally poor (with the exception of a few countries like the UK and France), whereas sources such as CRANET or the European Working Conditions Survey (EWCS) are very broad international surveys, which include only some questions focusing specifically on financial participation and do not cover all EU countries, the PEPPER IV Report has tried to compare all available data on financial participation and to collect comparable indicators for those EU Member States for which data were not provided elsewhere.

Although the results reported in the PEPPER IV Report confirm some of the findings of the previous PEPPER Reports, there are two important and surprising differences: (1) regardless of the data source, we find conclusive evidence, that the past decade has seen a significant expansion of employee financial participation in Europe; (2) the data examined seem to indicate that a West-East divide is less significant than one might have anticipated. Broad-based share ownership schemes increased between 1999 and 2005 in the old EU-15 from an average of 13 to 17 per cent and in the new EU-12 from an average of 10 to 23 per cent; a slightly different picture results for profit-sharing schemes though, which increased in the old EU-15 from 29 to 36 per cent and in the new EU-12 from an average of 19 to 26 per cent (all weighted country averages for the countries from both samples).

Among the many findings is that in 2005, broad-based employee share ownership was very frequently present in large firms in countries such as Poland, Bulgaria, Denmark, Croatia and France, whereas profit-sharing was diffused primarily in France, Finland and Germany. Interestingly, some of the desirable characteristics of profit-sharing – that it is paid on a regular basis and according to a predefined formula – were found to be frequently absent in many enterprises introducing profit-sharing.

d) Empirical evidence

The main conclusion that can be drawn from existing empirical evidence from both the old and the new EU Member States is that no straightforward generalisations are possible regarding the effects of PEPPER. There is ample evidence from western market econo-

mies that employee share-ownership and profit-sharing have had positive effects on workers incentives and productivity (see for example Blinder (ed.), 1990). The evidence from CSEE countries is of more recent origin, it is much more limited, and it is almost exclusively based on the experience with employee share ownership. There have been studies on some CSEE countries – including the Baltic countries, Poland, Hungary and Slovenia - indicating that the post-privatisation performance of employee-owned firms has been similar to that of other types of firms (see Uvalić and Vaughan-Whitehead, 1997), though there have also been other studies reporting less optimistic results (for a broad survey, see Djankov and Murrell, 2002). New empirical evidence is clearly needed from both the old and the new EU Member States before further conclusions can be drawn.

4. Concluding Remarks

The ongoing analysis allows us to point to the main differences between the experience with employee financial participation in the older EU Member States from Western Europe, and the younger EU Member States from Central and Southeast Europe. These key differences are summarised in Table 9.

Table 9. Main differences in PEPPER across the European Union

| Old Member States (West) | New Member States (East) |
|---|--|
| Long tradition (since the 1950s) | A recent phenomenon (1990s) |
| Variety of different forms (PS, ESO, ESOPs) | Almost exclusively ESO, through privatisation |
| Actively promoted in a number of countries, also on a continuous basis (regularity) | Only ESO promoted, but as a one-off measure (through privatisation) Profit-sharing either not considered, viewed with suspicion, or introduced on an ad hoc basis (no regularity) |
| Advantages seem to have outweighed the disadvantages | Empirical evidence inconclusive, still very limited and prevalently on ESO |

Source: table compiled by the author.

Returning to the question posed initially - how to explain the lack of general support for PEPPER by governments, trade unions and employers associations, and the corresponding absence of supportive legislation which also explains the limited diffusion of PEPPER schemes in many EU countries - three groups of factors seem important:

- Lack of information: in many EU countries, little is known about the positive experiences gained with PEPPER in France, the UK, or elsewhere;

- Rejection of PEPPER on ideological grounds: PEPPER is confused with leftist ideas such as self-management, and is not considered or acknowledged as part of modern managerial practices;
- Economic conditions in the new EU Member States have not facilitated the introduction of PEPPER schemes, thus favouring the standard wage employment contract.

It is important to remove the ideological barriers to the diffusion of PEPPER schemes, also by facilitating the spread of general information about successful examples of implementation of financial participation. The EU could play an important role in this regard, by continuing to promote employee financial participation in the now enlarged EU, as a follow-up of its earlier initiatives in this area. By informing governments and policy makers in the new Member States and candidate countries of its various PEPPER initiatives, by reporting on the rich experience gained in many EU countries reported in the PEPPER I to PEPPER IV Reports, and by indicating the positive effects such schemes have had in a variety of national settings, such action could contribute to a more widespread diffusion of employee financial participation in the enlarged EU.

In choosing the most appropriate PEPPER schemes, enterprises throughout the EU have numerous options available – from profit-sharing schemes in cash or in shares, to various forms of employee ownership, including Employee Stock Ownership Plans. These various types of PEPPER schemes could interact and be implemented simultaneously, depending on the specific needs and context.

However, since the success of PEPPER schemes can depend on certain key features, the experience accumulated in the older EU Member States should probably be taken into account. In the first PEPPER Report it was recommended to adopt schemes of a certain type, with some key characteristics (Uvalić, 1991, pp. 194-196). The ten general characteristics of financial participation that were recommended in the PEPPER I Report, which were subsequently also adopted in the European Council 1992 Recommendation on PEPPER (see footnote 1), are therefore worth recalling again:

- (1) Regularity in application: PEPPER schemes ought to be applied by enterprises on a regular basis;
- (2) Pre-determined formula: Employee benefits from PEPPER ought to be calculated according to a predetermined formula;
- (3) Supplement to wages: Employee benefits from PEPPER must represent an addition and not a substitute to wages;
- (4) Calculation of employee benefits: The amount which employees receive on the basis of PEPPER should not be fixed in advance but ought to be variable, linked to some measure of enterprise performance;
- (5) Beneficiaries: PEPPER should benefit primarily employees, and ought to be made available to all or the larger part of employees
- (6) Enterprise type: PEPPER should be applied in all types of enterprises, both private and public;
- (7) Enterprise size: PEPPER should be applied in all enterprises irrespective of size; sufficient opportunities ought to be created for bringing schemes within the reach of small and medium-sized firms;

- (8) Simplicity: It is advisable to avoid PEPPER schemes of a very complex nature;
- (9) Employee information and education: For the success of any type of PEPPER scheme, it is important to supply adequate information to all employees concerned;
- (10) Voluntary nature of PEPPER schemes: Participation in PEPPER schemes should not be imposed either on companies nor on employees.

These are some of the main elements to be taken into account when applying employee financial participation schemes in the future, in line with the European Council's Recommendations on PEPPER adopted in 1992 (see footnote 1).

II. Financial Participation and the Work Challenges of the 21st Century

Daniel Vaughan-Whitehead

1. Introduction

The copious studies of workers' financial participation certainly have helped to better identify both the scope and incidence of the various forms of workers' participation in enterprises' profits and results. They also have helped policy makers to better identify the potential benefits and potential risks these schemes involve. In particular, they have led European institutions (notably the European Commission and the European parliament) to come out in favour of financial participation, an action that prompted more governments in the EU to introduce these motivational schemes.

Now, however, workers' financial participation seems to have arrived at an important cross road. PEPPER III has disclosed how poorly supported financial participation schemes are in the 12 new EU Member States. But beyond this, financial participation has to be reconciled with a new international environment and a new world of work that is radically changing not only in the new EU Member States but in Europe as a whole. While many studies on financial participation have focused on the economic impact of these schemes, our proposals have a broader purpose. We must more precisely define the new context in which financial participation now has to evolve. This will allow us to identify on the one hand new obstacles that may limit recourse to financial participation schemes and, on the other hand, new challenges that may encourage them in future. Our analysis concerns the two main forms of financial participation schemes, profit-sharing and employee ownership, formulated on two main questions: Will profit-sharing remain an important wage mechanism and which elements in the new world of work in Europe could eventually modify its scope and incidence? Will employee ownership schemes continue to attract both employers and employees in a labour market undergoing constant change?

The following sections present some of the main trends in policy issues, globalisation and changing work patterns which we believe may variously influence the development of financial participation schemes (see summary in Table 10). This overview will allow us to discuss some of the challenges that must be faced.

Table 10. The new world of work and the new obstacles and opportunities for Financial Participation (FP), Profit-Sharing (PS) and Employee Ownership (EO) Schemes

| The 10 new work challenges | Obstacles to PS and EO development | Opportunities for PS and EO development |
|---|---|---|
| Feature 1. – Deregulation of the labour market – Tax incentives mainly related to job creation | Less (legal and tax) incentives for promoting PS or/and EO | Governments and employers could be more keen on providing incentives if the advantages of PS and/or EO were made better known |
| Feature 2. External flexibility prevailing | – Wage flexibility less attractive than employment flexibility – High employee turnover is a disincentive to PS and EO at the enterprise level | – Negative effects of external flexibility may highlight the benefits of internal flexibility (with PS and EO representing key policy tools) – FP to be integrated in flexicurity agenda |
| Feature 3. Increased recourse to atypical work contracts | – Fragmented labour force not favourable to PS and EO schemes – Higher fraction of the labour force not covered by FP | PS or/and EO for all may offer an opportunity to overcome dual labour force |
| Feature 4. – Along globalisation unequal distribution of growth – Wage moderation – Wages often a residual payment along supply chain | – Compressed wages do not leave much room for PS; – EO more risky investment because of profits more volatile and less dependent on workers' efforts | – PS could offer a means to better redistribute part of the profits to the workers – EO could motivate workers in global operations if complementary and not a substitute to basic wage. – Both schemes would help workers to better benefit from global growth |
| Feature 5. – Increased number of low wage earners and of working poor – Increased wage disparity | – Workers look for basic wage increases rather than FP – Look for immediate return and not long term EO – Lack of trust in these schemes because of declining living standards and purchasing power | – In a context of low pay, PS could provide a useful tool for automatically increasing wages when and where profits increase – EO could act as useful complementary pay if investment in EO not coming from basic wage (but from PS for example or savings plans) |
| Feature 6. – Outsourcing and recourse to migrants to reduce labour costs – Greater volatility of profits | – Main aim is to reduce costs so employers generally not keen to implement PS – Workers should be aware of EO risks and decide accordingly – Higher labour force turnover not favourable to FP | – PS and EO could prove to better motivate the labour force (skilled and unskilled) – PS and EO would help ensure a climate of trust and dialogue (one of the flexicurity common principles) – These schemes should be applied to all |
| Feature 7. Longer working hours as source of workers' additional income | – PS neglected by the workers (and the employer) for improving workers' income – EO not leading to immediate cash income | – PS could be related to hours worked – FP could improve work intensity without de-motivating workers – Longer working hours is rather an element of internal flexibility (so could be combined with profit-sharing) |

| The 10 new work challenges | Obstacles to PS and EO development | Opportunities for PS and EO development |
|---|--|---|
| Feature 8. Changes in work organisation with increased shift work and unsocial hours | Creates differences between the employees (between those who work unsocial hours and those who do not), thus not optimal for FP development | <ul style="list-style-type: none"> – FP schemes could take into account such organisational changes – FP could help motivate workers toward new work organisation – Workers could better accept unsocial hours if sharing companies' profits and capital |
| Feature 9. <ul style="list-style-type: none"> – New types of jobs in services (home care for elderly people, telework, self-employment etc.) | <ul style="list-style-type: none"> – New relationship 'worker-client' (replacing 'worker-employer') for which PS and EO are less applicable – An increasing per cent of labour force will be excluded from PS/EO (self-employed, etc.) | <ul style="list-style-type: none"> – The challenge is to identify ways to introduce FP in these new types of services – FP continues to be promoted in large firms – FP could also become an important tool in SMEs to motivate the labour force |
| <ul style="list-style-type: none"> – New types of workers | <ul style="list-style-type: none"> – Migrant workers, interim agency workers, who are generally under different work and employment conditions | <ul style="list-style-type: none"> – PS and EO could be applied to all these workers if employer willing – Would reduce labour force fragmentation |
| Feature 10. Weakening social dialogue | <ul style="list-style-type: none"> – More difficult to distinguish PS and wage bargaining – Employers tempted to use it as a substitute for basic wage increases – Trade unions more reluctant to implement PS | <ul style="list-style-type: none"> – PS may play an important role in wage bargaining provided that risk of income loss for workers is avoided or limited – EO should be kept separate from wage bargaining to provide additional source of income |

Source: table compiled by the author.

2. Policy Issues: The Challenges for Financial Participation

a) Toward a Shrinking Number of Incentives Provided by Public Authorities?

As emphasised in several EC reports, government initiatives for promoting financial participation schemes are essential to their growth. It is significant that these schemes are most fully developed in France and the UK where specific government legislation has long promoted them.

For this reason the European Commission advised governments (European Commission, 2002) to utilise all available means to induce enterprises to offer financial participation. Three principle means can be distinguished:

- A legal framework that enables enterprises to implement²²² and promote such schemes;
- Tax incentives, generally granted to both employers and workers, have proven to be an effective policy tool;
- A general publicity campaign to promote these schemes has been organised to ensure the success and widespread implementation of the above two means.

However, conditions in the EU over the past decade have not seemed favourable to these three types of government initiatives. High unemployment rates in the 1990s led most governments to put unemployment at the core of their agendas. The present world financial crisis may intensify this emphasis. Tax incentives were mainly channelled to enterprises, usually SMEs, which could create new jobs. Limited economic growth, or even recession, also caused governments to impose new restrictions on the use of tax incentives. The legislative route presents difficulties first at the EU level since the European Commission decreed that no new legislation, especially social legislation, should be adopted at the EU level (Verheugen, 2005). Also national Member States may be reluctant to adopt new legislation (although experience so far is rather mixed, see Part 1, Chapter I, Table 2) but instead focus on reducing labour market regulations in the hope that greater freedom to hire and fire will induce enterprises to create more jobs and make the labour market more flexible. Actually, new labour legislation is generally put in place in order to modify hiring and firing conditions or to encourage new forms of atypical employment. New labour law is thus directed more toward deregulation than ‘protecting’ workers.

At the same time, however, a too-extreme shift toward external flexibility has led to new legislation intended to ‘re-protect’ the workers, for example, the recent UK legislation amending the use of interim agency operations with migrant workers and to curtail abuses of the ‘gang-master’ system. Similarly, in the last few years several national governments have introduced (UK, Ireland, Cyprus) or are discussing the possible introduction (Germany) of a national statutory minimum wage to avoid ‘social dumping’ resulting from migrant workers accepting lower wages and working conditions. In the same vein, national governments could further encourage financial participation either through labour law or tax and company laws intended to compensate for adverse effects on workers’ motivation occasioned by greater work intensity, unsocial hours, or atypical forms of contract. Financial participation, by covering all employees, could also help avoid a labour force divided between permanent and temporary workers. All workers would be concerned with the financial health of their employer company, even on a short-term basis. This new context could thus be favourable for governments’ initiatives to develop financial participation schemes.

b) Internal vs. External Flexibility or Toward a More Complex Structure?

Government’s interest in curbing unemployment has led them to favour the process of entry and exit from the labour market and the promotion of an ‘external flexibility’ model. Profit-sharing schemes do largely constitute an element of ‘internal flexibility’ by allowing

²²² In France for example the deferred profit-sharing law does also provide a concrete formula to be followed by all enterprises with more than 50 employees.

wage decreases during periods of economic downturn, thus enabling the employer to keep within his margins by automatically decreasing labour costs without reducing the labour force. Several studies have shown that profit-sharing could contribute to wage flexibility and employment stability, thus improving human capital and worker motivation. Public incentives to use employment rather than wages as the flexibility route may lead to higher labour turnover and thus greater employment instability. This high labour turnover is contrary to the original goals of profit-sharing, which were to foster loyalty and motivation amongst employees by offering employment stability in exchange for wage flexibility. Current employment policy may thus be interpreted as unfavourable not only to profit-sharing but also to employee ownership schemes as a means to create a long-term partnership between labour and capital. Policy makers have also resorted to longer working hours, an element of internal, not external flexibility. Consequently, the policy framework is more complex than anticipated.

Financial participation could have an important role to play in this context. First it could compensate for some of the negative effects of external flexibility on worker motivation, and second it could moderate such changes in work organisation as longer working hours, unsocial hours, and shift work. Financial participation could, for example, be integrated into the flexicurity debates which are specifically directed toward helping employers to improve their employment and investment environment while at the same time helping workers to protect their basic interests. In short, financial participation schemes could precisely assist in the implementation of many of the common principles of flexicurity supported by the heads of states and governments of the EU Member States, for example, ‘a better balance between external and internal flexibility’, ‘a climate of trust and dialogue’, and ‘a better workers’ adaptability capacity’ (European Commission, 2007).

c) Increased Recourse to Atypical Work Contracts

In the attempt to ‘deregulate’ labour markets, many EU governments promoted various forms of atypical employment: fixed-term contracts, part-time work, employment through interim agencies and, a category which calls for particularly careful analysis, self-employment. Most employers’ federations had been pleading for years for more flexible labour contracts.

While open-ended contracts are still most common, the growing use of fixed-term contracts affects the majority of EU countries. First, **fixed-term employment** increased from 12.1 per cent of total employment in 1998 to 14.2 per cent in 2005 in the EU-25.²²³ Another form of temporary work particularly worth considering is **agency work**.²²⁴ Temporary agency work remains a new form of employment in most eastern European Member States. This is often attributed to usage of other forms of irregular contract, particularly ‘self-employment’ (employment on the basis of civil contracts rather than employment contracts). However, agency work is on the rise. **Part-time contracts** may also offer an additional source of flexibility. In some countries this variation has been developed as a

²²³ It became even more widespread in the 12 new Member States, with a percentage of 15.6 compared to 14.0 per cent in the EU-15.

²²⁴ Agency work is most prevalent in the UK, then in Luxembourg, the Netherlands and France, followed by Belgium, Denmark and Finland.

flexible arrangement to ameliorate labour market conditions. Part-time work has increased in most EU countries, rising from 15.8 per cent of total employment in 1998 (EU-25 average) to 18.4 per cent in 2005 in the EU-25.²²⁵ Finally, **self-employment** is a very heterogeneous category.²²⁶ Globally, it has increased slightly but steadily over the last decade, representing 10.3 per cent of total employment in 2005 in the EU-25. Case studies show that this type of self-employment often includes regular employees who have been requested by their employer to shift from a regular employment contract to a self-employment contract, usually in an attempt to avoid social contributions and taxes. This is also the case in construction, which in many countries represents the second largest proportion of self-employed workers after agriculture. The European Commission expressed its concerns over this problem in a recent report on free movement of workers across the enlarged EU: ‘The problem of persons posing falsely as self-employed workers to circumvent the law should be dealt with by Member States’ (European Commission, 2006).

This review has shown an increase in all kinds of non-standard contracts. While continuing to affect a minority of workers, quantitatively as well as structurally, this has become a major feature of the labour market. It is clearly influencing the development of a financial participation adapted to a core rather than a peripheral labour force. One of the basic principles of profit-sharing and employee ownership is in fact the inclusion of all employees, not only those comprising the core. A greater fragmentation of the labour force thus makes the implementation of such a basic principle more difficult. It may prove difficult, and even inefficient, to cover self-employed workers or even those on stand-by projects. The latter, due to their disadvantaged employment status, clearly are less concerned with the company’s profitability.

On the other hand, profit-sharing and employee ownership extended to all employees may offer an opportunity to overcome tensions within this dual labour force. Despite different employment status and wage treatment, all workers employed by the company could feel committed to the enterprise through some sort of financial participation schemes together with other participatory practices (for instance in decision-making). Extending financial participation to atypical forms of contract may thus represent a future challenge having many potential positive effects on the social climate, worker motivation, and productivity.

3. Impact of Globalisation

a) Unfavourable Distribution of Economic Growth

Another factor that may influence the growth of financial participation schemes has to do with wage developments and, more generally, the redistribution of growth. First the redis-

²²⁵ Part-time work may be a positive choice, mainly for the purpose of finding a better balance between work and family. In some cases, however, it is imposed. We can observe an increase in the percentage of ‘involuntary’ part-time workers (Eyraud and Vaughan-Whitehead, 2007).

²²⁶ The self employed can be employers (self-employed with employees) or individual workers under a self-employment contract (self-employed without employees).

tribution of economic growth is found to be increasingly unequal along the course of globalisation. Higher economic growth experienced in several countries does not seem to automatically translate into a higher share of wages in GDP.²²⁷ On the contrary, this **wage share has declined** rapidly in fast-growing countries, for example, Brazil, Republic of Korea, South Africa and China. It has also declined significantly in the United States, Canada and Japan. According to OECD (2006, p. 186): ‘nominal wage growth (in Member States) has fallen well short of increases in productivity for several years, driving the share of national income to a low level. Wage moderation appears to be an international phenomenon.’ The wage share has also fallen in Europe, as shown in a recent comparative study conducted by the European Commission (European Commission, 2007c). After increasing in the EU during the 1960s and the first half of the 1970s, peaking at 69.9 per cent of GDP in 1975, the wage share began to gradually decline, reaching a low of 57.8 per cent of GDP in 2006. Since a downward trend is also observed in the 12 new EU Member States, their recent membership is not expected to significantly alter the overall trend.

Economists take the view that such evolution of the wage share depends on **two main factors**: first the evolution in the ratio of capital to labour, mainly due to technological and sectoral changes, for example, new technologies replacing middle-income workers or the growth of banks and financial companies. The increasing **capital-labour ratio** could also result from a general decline in the number of employees due to restructuring. The second factor goes beyond the capital-labour ratio arising from the fact that the rate of return to capital could grow faster than the rate of return to labour. And indeed in some countries a declining **ratio of wages to profits** has been observed, for example, in China, but also in industrialised countries like Austria, Canada, Australia,²²⁸ as well as several Central and Eastern European countries which have also experienced some wage moderation. More generally we also witness a disconnection between the evolution of wages and productivity, developments which normally should go hand in hand. Financial participation may help to rebuild this relationship essential not only for social peace but also for economic growth.

In EU countries in particular, **wage moderation** represents an important trend in the new world of work. In Spain, for instance, wage moderation, backed by the two major Spanish trade union federations, is seen by many analysts as a key element in the huge growth in employment that country has experienced. The same logic underlies concessionary bargaining. As for flexible working time, whether at the central level as in Ireland or in the process of decentralising collective bargaining, there are many examples of concessionary bargaining moderating, freezing or even decreasing wages.²²⁹

²²⁷ The wage share is an indicator of the distribution of income between capital and labour. It represents the ratio between the total compensation of employees (according to the system of national accounts) and gross domestic product (either at market prices or factor cost).

²²⁸ Authors' own calculations.

²²⁹ Even in Denmark, where concessionary bargaining is limited, there are examples of major wage concessions as, for example, for SAS Ground Service in February 2005 or in one of the Tulip Slaughter Houses in Ringster in December 2004, where 300 workers had to accept wages 15 per cent below the industry level to keep their jobs.

Against this background, both profit-sharing and employee ownership may help to better distribute the fruits of economic growth. It is precisely the rising return on capital that makes co-ownership more attractive and as such may provide alternative ways to generate a better distribution of company profits and growth. Promoting worker participation in enterprise profits and capital ownership may be part (by allowing workers to become owners or to share profits) of a re-distributional policy agenda. Of course the way these schemes are implemented will have different effects on inequalities, that is, between a financial participation scheme offered equally to all employees, of whatever position and background, and one that offers more opportunities and benefits to managerial employees.

b) The Incidence of Low Pay and Working Poor

In the context of wage moderation, the increased proportion of low-paid workers (wages below 60 per cent of the median wage) and the phenomenon of the working poor have attracted the attention of both policy makers and the media. This is another factor that influences the latitude left for financial participation schemes to develop. The European Commission reports more than 8 million working poor in the former EU-15. This number would probably double (no calculation seems to have been made yet on EU-27) were the 12 new EU Member States counted. The majority of low-wage economies (above 30 per cent of employees paid a wage under 60 per cent of the median wage) are in the 12 new EU Member States, except for Portugal and the UK (32.2 per cent), while the highest wage economies (under 15 per cent) are from the original; EU-15: Denmark, Italy, Belgium, Finland and Sweden.

The low-pay-working-poor phenomenon obviously affects the development of financial participation. Good evidence of this is provided by the experience of Central and Eastern European. The very low wage rates that prevailed during the first years of transition obviously motivated workers to seek immediate wage increases rather than a deferred share in hypothetical profits. This low purchasing power level also explains the progressive dilution of employee ownership caused by workers selling their shares for cash over the transition despite the fact that this form of property had become, by default, one of the most important privatisation tools (Uvalic and Vaughan-Whitehead, 1997). This also largely explains the weak development of profit-sharing in these countries (Lowitzsch, 2006; European Commission 2006).

Although this situation may change over time as wages and living standards catch up, wage moderation may remain on the policy agenda of former EU-15 countries, affecting the number of low wage workers. The challenge here is for financial participation to help reduce the number of low wage workers by providing wage increases and dividends when feasible.

It is encouraging to observe that financial participation schemes after their growth in the 1990s have gained ground. Profit-sharing schemes not only maintained a significant position in countries like France and the UK where they were most developed, but also gradually expanded in other EU countries as well, that is, Greece and Spain (see data on financial participation in this volume). Recently Slovenia also introduced new legislation to encourage profit-sharing schemes. This trend also holds true for employee ownership, with more large enterprises embracing employee ownership over time (European Federa-

tion of Employee Share Ownership, 2008). Employee ownership is definitely a valuable tool in income and asset formation. But it confronts two challenges. First, it needs to extend these schemes beyond managers and high-level employees so as to include all employees; second, it needs to encourage small and medium enterprises to utilise employee ownership schemes.

c) A Race to the Bottom through Outsourcing and Migrant Workers

Globalisation constantly pressures enterprises to lower wage costs. This has caused many of them to resort either to outsourcing or to utilise lower-wage migrant workers. This outsourcing policy clearly constitutes an extreme attempt to achieve external flexibility, thereby reinforcing the trends earlier described. Since their main objective is to reduce costs, employers may generally not be keen on implementing profit-sharing, which is a radically different concept not directly related to cost reduction. We have earlier discussed the difficulties attending the use of profit-sharing among sub-contractors; the small margin left to them by the buyers makes wages treated more as a residual payment rather than as a primary built-in cost. However, this would not keep employers from utilising profit-sharing or employee ownership schemes to motivate their home-country workforce, which is generally more highly skilled.

In fact, profit-sharing does not conflict with the employer's pursuit of greater competitiveness because of its motivational effect on both skilled and unskilled employees. Moreover, it constitutes one way to keep wage costs flexible, thus providing a possible alternative to outsourcing. The problem is that we are now experiencing a race to the bottom in terms of labour costs, with China's low labour costs in the lead, which home-country workers are almost certain eventually to lose because of their inability to continuously lower their wage claims. The co-existence of migrant workers with local workers in a company capable of providing financial participation for both groups could present an interesting alternative in terms of competitiveness. By welcoming migrant workers from new EU Member States, Britain has shown that this can result in a dynamic economy whose labour costs remain competitive while its technological and quality contents are progressively upgraded.

At the same time, the increased volatility and internationalisation of profits is working against the transparency of profit-sharing and employee ownership schemes which the literature advocates. Profits seem to have become dependent on a much larger spectrum of policies: capital investment, marketing, diversification of products and activities, in addition to outsourcing, none of which the workers can influence much. Even in this context, however, financial participation, employee ownership in particular, may represent a way to motivate workers within a company's global operations. It would equally help to share more of the fruits of global economic growth with employees.

4. Structural Changes in the World of Work

a) Changing Patterns of Work: New Types of Jobs and Workers

The changes taking place in production of goods and services also affect the scope of financial participation. In most European countries over the last decade manufacturing activities have declined while the service sector has grown. There is significant current growth in such new types of services as home care for elders or children, as well as teleworking. Home services in particular are expected to undergo continuous expansion as the work force ages and life expectancy increases; they have introduced, however, a radically different relationship between the employee or a group of employees and the employer, since the employer may now be an individual client. This type of relationship clearly makes it difficult to measure individual and collective performance and renders financial participation more difficult to apply. The increase in very small enterprises also introduces a new context for implementing workers' financial participation schemes.

At the same time, firms in more traditional areas are becoming 'entrepreneurs' and less and less 'employers'. They try, for instance, to limit their core workforce and to develop subcontracting and other new forms of commercial relations (with individuals, other firms or organisations) in order to shift the risk of the employment relationship to the employees themselves or to other firms and organisations. These changes make the concept of 'employer', normally the entity implementing and monitoring a financial participation scheme, more difficult to define. As a consequence, financial participation schemes may become less relevant as a management or human resources tool.

The challenge here is to study the potential development and effects of financial participation schemes in this new type of service employment. At the same time, financial participation schemes should find a role in the development of small and medium enterprises in the new service area. Finally, both profit-sharing and employee ownership could be efficiently applied to new categories of workers such as migrant workers and interim-agency workers in order to ensure efficient integration and motivation in their work environment. This would help reduce the current gap between this expanding part of the labour force and more permanent employees, thus limiting the potential conflicts and productivity loss that these developments could generate.

b) The Structural Weakening of Social Dialogue

Financial participation prospects should also be viewed within the context of current social dialogue notably dominated by the continuous decline in trade union membership, decentralisation of wage bargaining, wage moderation through flexibility (or 'flexicurity'), tradeoffs at the company level, and stronger bargaining power of employers through outsourcing and migrant labour. This trend is even more striking in the new EU Member States, where trade union membership as well as collective bargaining coverage, already very low at both the branch and enterprise levels, continue to decline.

When and wherever they are involved in decentralised bargaining, trade unions are generally pushed by the employers to negotiate new types of trade-offs, such as wage increases in return for longer working hours, wage cuts for maintaining employment, etc. In a con-

text of wage moderation and wage concessions at enterprise level, trade unions may fear that financial participation schemes will be used as a substitute for rather than as a complement to regular wage increases ordinarily negotiated through collective bargaining. A distinction between financial participation, particularly profit-sharing, and wage bargaining thus becomes essential to gain trade union support. Here national experiences are very diverse. In some countries, for example, France, profit-sharing is in addition to wage increases bargained at the company level and thus has a positive impact on social dialogue concerning wages. In other countries, for example, the UK, profit-sharing has been a substitute for wage increases, a deviation that clearly explains trade union opposition to schemes of this type. The experience of Brazil, a non-EU country, is particularly interesting. Here the opportunity for social partners to negotiate profit-sharing schemes at the enterprise level has led to an unprecedented development of collective bargaining agreements.

This new world of work is clearly changing trade union priorities. In response to the continuous decline in membership, trade unions are trying to promote negotiations, mainly at the national (or possibly sectorial) level, on such issues as wage increases. Trade unions are increasingly suspicious of all systems implemented at enterprise level to which they do not consent. Thus trade unions have recently pushed for minimum wage settlements and wage negotiations on average wage or hourly wage increases to be decided at the national level; also for the generalisation of the extension clause, which, for example, allows a collective agreement reached at the sectorial level to be generalised to include all companies and workers in that sector, even companies that have not signed the collective agreement. Paradoxically, this move may further decrease both the power of collective bargaining and of trade unions at the local level.

Granting the difficulties confronting organised labour, trade unions might also consider the benefits they could obtain from reinvigorating their activities at the local level. In this effort, financial participation schemes may also offer them the opportunity to actually increase total worker remuneration packages despite wage moderation. By providing new tradeoffs in the flexicurity arena, financial participation could help trade unions work their way through the wage moderation era.

5. Concluding Remarks

Workers' financial participation has remained on the EC policy agenda for years (see PEPPER I, II and III Reports). Multiple studies have emphasised the positive economic and social effects of these kinds of schemes. As the EC itself emphasised, 'Financial participation is one important element that may contribute to EU countries' competitiveness while preserving its social cohesion.' (European Commission, 2002). European Commission reports also described as 'disappointing the low use of these schemes considering their importance for productivity, wage flexibility, employment and employees' involvement'; before insisting that 'the development of financial participation schemes is strongly influenced by government action, in particular by the availability of tax incentives' (European Commission, 1997).

On one hand, many governments in the EU have continued to develop financial participation schemes (see Part 2, Country Profiles, in this volume). On the other hand, however, rapid changes in the world of work may curtail the utilisation of financial participation. There is an urgent need to rethink the role of financial participation within this new environment, especially in light of the fact that the most recent labour market developments, as shown here, are not always favourable to extending financial participation to a large portion of the work force.

More specifically, the priority most European governments have given to less regulation, especially through removing all barriers to hiring and firing, has obviously put more emphasis on **external** flexibility, that is, employment adaptability. As a result, **internal** flexibility (based on employment stability in order to maintain labour force motivation and skills, mainly through either greater pay flexibility, which profit-sharing schemes can help achieve, or through workers' motivation which employee ownership can enhance) is less seen as a priority policy option.

The world of work, however, is complex and continuously evolving. Not only are new forms of work organisation emerging, for example, atypical forms of work or the utilisation of shift work and unsocial hours, but working hours also are tending to increase, an element that may be more related to internal than external flexibility. There is no doubt that financial participation is called upon to adapt to this complex and changing world of work, first to accommodate the changes in work organisation, but quite as importantly, to motivate a labour force increasingly dominated by wage moderation, sometimes extreme, and casualisation of the employment relationship.

Globalisation is also challenging financial participation in its current form. Employers have increased external flexibility even further through a more systematic recourse to outsourcing or the employment of migrant labour. Wage developments described in this paper confirm the employers' success in minimising wage costs, widening an already unequal distribution of growth between wages and profits, and a general move toward wage moderation in almost all European countries, a development that has helped increase the proportion of low paid and working poor. Trade unions seem to be rather powerless in this context of ongoing membership decline and the shrinking coverage of collective bargainings.

Moreover, increased recourse to atypical contract forms such as fixed term contracts, self-employment, and interim agency work have further fragmented the labour force, while fostering the development of atypical working time arrangements such as shift-work or week-end work. The development of financial participation is complicated by these developments as well as the recent growth of new types of services, for example, home care for the elderly, which modify the traditional employer-employee relationship.

On the positive side, financial participation may offer policy makers a means of countering some of the effects of globalisation, particularly the continuous decline of the wage share in economic growth. Profit-sharing and employee ownership could be used to correct this imbalance and ensure employees a fair share in economic growth. Distributing a part of a company's profits or dividends to its workers links employee income to work performance. Linking wages to the companies' profits or capital may also be a way to integrate home-country employees into their company's global operations.

Both employers and public authorities need to be reminded of the contributions profit-sharing and employee ownership can make to worker motivation, human capital investment, and enhanced productivity. These schemes also could counter some of the negative effects of current economic trends, that is, the extreme use of external flexibility and outsourcing, affecting the vulnerability of workers, overall quality of jobs and long-term growth from the (Eyraud and Vaughan-Whitehead, 2007).

Extended to all types of employees, financial participation could also help limit the devastating effects of the emergence of a dual labour force, and provide a way to reduce the gap between permanent workers and more insecure workers (such as migrant and interim-agency workers).

Moreover, if the traditional routes for promoting financial participation schemes, for example, legislation or tax policy, have become more difficult, other routes must be investigated. Financial participation schemes should be made part of the corporate social responsibility agenda. It might further be promoted by coordinating the approaches of EU agents, for example, through the open method of coordination (that is, a better exchange of practices and benchmarking).

At the same time should not financial participation schemes be made a part of social dialogue and collective bargaining at the decentralised level? As a start, that could be discussed within the current flexicurity negotiations at company level. In addition, since many economic and social issues, including wage policy, are now negotiated in many countries in tripartite discussions at the national level, often leading to tripartite or economic and social pacts, the time has come to add financial participation to the tripartite agenda as a policy tool and to discuss how its different forms may contribute to general economic and social goals.

Obviously some of the obstacles to financial participation identified in this article, for example, organisational changes, recourse to additional working hours or atypical work contracts, are not entirely new phenomena. What is new, however, is globalisation and internationalisation in which financial participation now must operate and which has brought new systematic types of business models such as outsourcing, minimisation of wage costs, dominance of external flexibility through labour deregulation and more freedom to hire and fire workers. Both the new employers' vulnerability to international competition and the new strategies of the trade unions, for instance a return to centralised wage-fixing to avoid risky tradeoffs at company level, have to be taken into account as well.

Financial participation must be reconsidered in this new work environment if it is to develop further. Otherwise it will not be able to serve as a policy tool to address some of the major issues brought by globalisation in terms of wage disparity, poverty, and uneven distribution of the fruits of economic growth.

III. The Path to a European Regulation

Jens Lowitzsch

The basic conception of civil society as a society of private property owners has not (yet) been sufficiently recognised in European law.²³⁰ Since the adoption of the European Charter of Fundamental Rights (as part of the Treaty of Nice in 2001) ownership has been more precisely defined in Art. 17 of the Charter. But not until the ratification of the European Reform Treaty and the inclusion of the European Charter of Fundamental Rights as part of it will the Charter become binding European Law.

So far the only explicit support for a framework for financial participation is to be found in the Council Recommendation of 27 July 1992²³¹ and in Part 7-II of the Action Programme for Implementing the Community Charter of the Fundamental Social Rights of Workers.²³² Title XI (Social Politics) of the additional protocol of the European Human Rights Convention of 1952, however, contains no recognition of the financial participation of employees. It merely states principles of protection of labour, equal opportunities and co-determination, although Art. 139 (former 118b) ECT permits agreements between social partners on a community level. A rare exception to the general silence is the second Council Directive on Company Law.²³³ In summary, the community law appears deficient in regard to employee participation in general, and financial participation in particular.

1. Key Issues and Obstacles to Creating a European Concept

The American experience in institutionalising techniques for broadening the ownership of capital, valid in all of the 50 American states, provides a model for such a trans-

²³⁰ One reason is that Art. 295 (former 222) of the Treaty of Amsterdam excludes private property as a legal institution from the law of European contracts. But de facto the treaties do deal with the subject of private property, especially by regulating derived rights and related areas.

²³¹ Concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation), 92/443/EEC, *Official Journal* L 245, 26 August 1992, p. 53-55.

²³² The Charter of 9 December 1989, which was also signed by the United Kingdom in 1998, is neither a binding legal act nor is it a treaty among the signatory states. It is merely a solemn declaration which should nonetheless serve as an aid to the interpretation of the provisions of the EC Treaty, since it reflects views and traditions common to the Member States and represents a declaration of basic principles which the EU and its Member States intend to respect. Together with the Action Programme, which has also been approved by the Heads of State or Government, it is therefore used by the Commission as a basis for justifying many of the Directives it proposes.

²³³ See Art. 19 para. 3, 23 para. 2, 41, para. 1 and 2 of the Directive, 77/91/EEC, dating back to 13 December 1976 which allow derogations from the European legal framework for Joint-stock Companies designed to encourage the financial participation of employees.

jurisdictional framework. In its communication²³⁴ the Commission refers to this experience by stressing the ‘important impact financial participation can have in terms of economic growth, fostering industrial change and making sure that all workers participate in this growing prosperity’. Furthermore, the Commission states that ‘especially when compared to the experiences in the US, there exists still a huge, largely unused potential for the further development of financial participation as part of an overall strategy aimed towards stimulating the growth of new, dynamic companies’. Two relevant issues are currently under consideration in the European Union:

- Can broadened ownership of capital through ESOPs or similar vehicles help EU companies become more competitive in the world market? One field of action already identified in this context, in the Council Recommendation of 7 December 1994,²³⁵ are transfers of businesses to employees as a way to facilitate business succession in SMEs.²³⁶
- Assuming that broadened ownership of capital is desirable from a social and economic standpoint, what is the best way to amend legal structures in the EU so as to create a legal foundation for employee share ownership as part of property rights legislation, and thus the ‘acquis communautaire’ itself?

a) Focus: Legislating Financial Participation Schemes

Although tax incentives are the most common way of encouraging financial participation schemes, a common European legal framework imposing such tax incentives would collide with the national legislative sovereignty over taxation. Under the European Union each Member State retains exclusive power over all matters involving taxation; any Directive involving taxation requires the unanimous consent of the Member States. Therefore a European approach to the problem must provide a broad incentive system going beyond the classical instruments of tax legislation. Establishing such schemes through legislation is of primary importance, as it gives companies a distinct legal entity and provides them with a clear framework for company decisions and actions. At the same time, establishing a legal framework delineates what is possible for companies without inviting sanctions from regulatory, legal or taxation authorities (see Pendleton et al., 2001, p. 9).

b) Unanimous Decision vs. Majority Vote

Diverse national approaches to both financial participation and participation in decision-making constitute further impediments to change. For obvious reasons, it is very difficult to reach a unanimous supranational compromise either in the Commission or in the Council. The law of European Treaties in general permits majority vote decisions in a

²³⁴ COM (2002) 364 Final, 5 July 2002, pp. 3, 10.

²³⁵ On the transfer of small and medium-sized enterprises, 94/1069/EEC, with explanatory note, Official Journal No. C 400, 31 December 1994, p. 1.

²³⁶ One of the key areas defined in the Final Report of the MAP 2002 Project, *European Commission Enterprise Directorate-General*, ‘Transfer of Businesses – Continuity Through a New Beginning’ (European Commission, 2003b).

limited number of cases, recently extended by the Treaty of Nice.²³⁷ No less than 27 provisions have been changed completely or partly from unanimity to qualified majority voting, among them measures to facilitate freedom of movement for the citizens of the Union (Art. 18 ECT) and industrial policy (Art. 157 ECT). As to taxation (Art. 93, 94 and 175 ECT), however, the requirement of unanimity for all measures is maintained across the board. In the field of social policy (Art. 42 and 137 ECT), despite maintenance of the status quo, the Council, acting in unanimity, can make the co-decision procedure applicable to those areas of social policy which are currently still subject to the rule of unanimity.²³⁸ Therefore the search for a legal foundation at the Directive level has to focus on those 'majority vote' regulations if it is to be successful. This is further true because the position of the governments in relation to the social partners, their role in society, and their relation to each other varies significantly in the different member countries.²³⁹

c) Different Contexts, Different Approaches – The Building Block Approach

A strict distinction concerning suitable options and legal procedure to create solutions at the European level has to be made between participation in decision-making and financial participation of employees. Participation in decision-making, whatever its form at the national level, is as a rule obligatory for enterprises in the given country.²⁴⁰ Since community law would be equally binding, a supranational compromise can encompass only the smallest common features of the diverse national regulations.²⁴¹ Financial participation on the other hand is traditionally an optional instrument for improving company performance and corporate governance; enterprises are therefore free to introduce financial participation schemes.²⁴² Thus, provided that they are granted voluntarily on the national level, a supranational concept can offer a variety of incentives from which to choose.

A European Regulation should thus encompass a broad incentive system which provides different and flexible solutions, compatible with those already established in the Member States. An adaptable scheme can provide for a solution suitable for use throughout the European Union, comprising best practises of national legislation and customs (compare White and Case, 2001, p. 4). Combining them in a single program with alternative options

²³⁷ The Treaty of Nice has extended the scope of co-decision. This procedure will be applicable to seven provisions which change over from unanimity to qualified majority voting (Articles 13, 62, 63, 65, 157, 159 and 191; for Article 161, the Treaty stipulates assent). Accordingly, most of the legislative measures which, after the Treaty of Nice, require a decision from the Council acting by qualified majority will be decided via the co-decision procedure.

²³⁸ This 'bridge' cannot, however, be used for social security.

²³⁹ For example, the consensual continental contrasts with the Anglo-American confrontational model; likewise the strong position of the state in France contrasts with the powerful role of the German 'Tarifpartner' (collective bargaining parties, such as trade unions and employer associations) (see Pendleton and Poutsma, 2004).

²⁴⁰ As, for example, the German 'Mitbestimmung' and the Works Councils in France and the Netherlands.

²⁴¹ This problem is well illustrated by the prolonged controversy over the so called European Workers Council, and as a consequence the rather minimal compromise of the regulation in the European Company Statute.

²⁴² A rare exception exists in France where enterprises with more than 50 employees are required to establish a participation fund. See European Commission (1997), p. 19-20.

leads to a ‘Building Block Approach’, with the different elements being mutually complementary.²⁴³

These building blocks consist of the following three basic elements:

- Profit-Sharing (cash-based, deferred and share-based);
- Individual Employee Shareholding (stock options and employee shares);
- Employee Stock Ownership Plans (ESOPs) as collective schemes.

While profit-sharing schemes, stock options and employee shares are relatively widespread in the European Union, Employee Stock Ownership Plans (ESOPs) are predominantly to be found in countries with an Anglo-American tradition, for example, the United Kingdom and Ireland.²⁴⁴ Originated in the United States as a technique of corporate finance, the ESOP, using borrowed funds on a leveraged basis, has the capacity to create substantial employee ownership and can be used to finance ownership succession plans, an important feature, especially for European SMEs.²⁴⁵ Furthermore, it can be used to refinance outstanding debt, to repurchase shares from departing plan participants, or to finance the acquisition of productive assets.²⁴⁶ The last two functions are also both possible on an unleveraged basis. In the unleveraged case, of course, less stock can be acquired in any given transaction.

2. Options for Creating the Legal Foundations of a European Concept

a) Recommendation According to Article 249, Paragraph I, 1 ECT

The European Concept could be framed as a Recommendation according to Article 249, paragraph I, 1 ECT. The downside of such a solution, however, is that Recommendations according to Article 249, sentence 5, ECT are not legally binding and thus implementation in the Member States would be far from certain. On the other hand, legislation of such schemes in any form whatsoever is a major step forward, as it sets up a distinct legal entity for companies to refer to and provides a framework for company decisions and actions in those countries that approve the European Concept.

One possible solution to the problem of national implementation would be a recognition procedure by Member States for financial participation similar to that proposed by the High Level Group of Independent Experts (European Commission, 2003a, pp. 52). As a result of this procedure, single Member States would recognise single elements from the European Concept drawn up in the Recommendation as equivalent to a plan drawn up under its own laws and provide equivalent benefits. In this way they would provide com-

²⁴³ For a detailed technical description of the different mechanisms and schemes see Lowitzsch et al. (2008).

²⁴⁴ For Ireland, see Shanahan and Hennessy (1998), p. 9.

²⁴⁵ One of the key areas defined in European Commission (2003b).

²⁴⁶ From an entrepreneurial point of view, see Ackermann (2002).

panies operating under their legislation with a legal framework that delineates what is possible without invoking sanctions from regulatory, legal and taxation authorities. Recognition is nonetheless a major step and would require considerable co-operation between the Member States and the Commission.

b) Directive Level: Amending Existing European Company Law

Considering the difficulties in passing and implementing European Directives, especially in sensitive areas where unanimous decisions may be required, it seems preferable to amend existing European legislation. Since employee share ownership fits into the framework of company law, rules to implement it could be proposed as an amendment of the ‘European Company’ legislation. Like the European Company Statute²⁴⁷ (ECS), which provides an option for forming a supranational company, there could be an amendment to the ECS permitting such companies to create ‘European Employee Shareholding’ as an option.²⁴⁸ This option could be easily extended to other companies which do not fall under the ECS, provided that national legislation would then be adapted to the requirements of the supranational statute.

The EU Member States would have an incentive to implement legal rules pertaining to the ‘European Employee Shareholding Statute’ as an amendment to the ECS, choosing from a variety of incentives, possibly including tax breaks as well as other preferential treatment:

- Unlike the supplementary rules to the ECS concerning participation in decision-making, those on ‘European Employee Shareholding’ would be totally voluntary; they would apply only if the company decides to adopt one of the existing models of financial participation.
- As in the case of the supplementary rules to the ECS on participation in decision-making,²⁴⁹ the scheme would be, at first hand, proposed by the employers to their employees; in other words, a negotiated proposition. If the proposed scheme does not correspond to a catalogue of minimum requirements, or the parties so decide, a statutory set of standard rules would apply as a ‘safe harbour’.

The mechanism of the ‘default standard rules’ concerning participation in decision-making, foreseen in the ECS for resolving potential conflict while at the same time not imposing a solution, would even be suitable in the field of financial participation:

- As for the ‘standard rules’ for private and/or unlisted SMEs, an ESOP-trust would be feasible since it may provide a relatively non-controversial solution to the question of

²⁴⁷ Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE); OJ, L 294/1.

²⁴⁸ As proposed in the report of the Committee on Employment and Social Affairs of 5 May 2003 (A5-0150/2003), p 11 and 14 and expressed in the European Parliament Resolution of 5 June 2003 (P5-TA (2003) 0253), 31. IV; like the Council Directive 2001/86/EC of 8 October 2001, ‘supplementing the Statute for a European company with regard to the involvement of employees’ but with regard to financial participation.

²⁴⁹ Here it is the result of negotiations between employer and employee representatives.

employee voting rights and may buffer potential risk more easily, while at the same time solving the problem of business succession.

- As for the ‘standard rules’ for quoted medium-sized and large enterprises, a restricted broad-based employee stock option or stock purchase scheme (as practised in the United Kingdom) seems to be feasible since there has already been substantial development in European harmonisation on the one hand (see below), and a remarkable initiative put forward by the Enterprise Directorate-General on the other (European Commission, 2003c).

c) National Level: Building on Existing National Company Law

Given the above described difficulties in arriving at a supranational compromise either in the Commission or in the Council, in order to reach a regulation at the Supranational level, the simplest solution is to build on existing national legislation originating in the *Acquis Communautaire*. A rare example of such legal ‘common ground’ are some of the national rules on listed and unlisted joint-stock companies originating in the implementation of European Law that is, the second Council Directive on Company Law 77/91/EEC, dating back to 13 December 1976. Art. 19 para. 3, 23 para. 2 and 41, para. 1 and 2 of the Directive allow Member States to deviate from the European legal framework of joint-stock companies in order to encourage employee financial participation. Although primarily referring to share ownership schemes these – optional – regulations also leave room for combination with profit-sharing schemes.

Art. 19 para. 3 allows Member States to deviate from the restrictive rules governing exemptions from the general prohibition against a company acquiring its own stock. When the shares acquired by the company are earmarked for distribution to that company’s employees or to the employees of an associate company, a general shareholders assembly decision is not obligatory although such shares must be distributed within 12 months of acquisition.²⁵⁰

Member States may lift the limit of the nominal value of the acquired shares of 10 per cent of the subscribed capital (including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company’s behalf) though, according to Art. 41 para. 1.

As an exception to the general prohibition against a company leveraging the acquisition of its own shares, Art. 23 para. 2 allows Member States to permit companies to advance funds, make loans, and provide security (financial assistance), with the intention of selling these shares to company employees. Art. 41 para. 1 further allows for deviations from general rules and restrictions to encourage employee financial participation during the process of raising additional capital. An example is the financing of the share issue from the companies’ own funds or through a profit-sharing scheme. Finally, the opening clause of Art. 41 para. 2 of the Directive providing for the possibility of suspension of Arts. 30,

²⁵⁰ The general rules that (i) require that the acquisitions may not have the effect of reducing the net assets below the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes and (ii) require that only fully paid-up shares may be included in the transaction still apply across the board.

31, 36, 37, 38 and 39 for companies under a special law issuing collectively held workers' shares, has not been used except in the case of France²⁵¹.

Table 11. Implementation of the Second Council Directive on Company Law 77/91/EEC

| Country | Art. 19 III permission to acquire companies own shares for its employees | Art. 23 permission to advance funds, make loans, provide security (financial assistance), with a view to acquisition | Art. 41 I derogation to encourage financial participation in case of capital increases | Other general provisions in Company Law to promote financial participation |
|----------------|---|--|---|--|
| EU-15 | | | | |
| Belgium | Without decision of General Assembly | Value of financial assistance within distributable reserves; net assets mustn't become less than subscribed capital; also firms founded by employees who hold more than 50% of voting rights | 5 years not transferable, limit: 20% of equity capital; up to 20% discount | No |
| Denmark | Limit: equity capital exceeds distributional dividend; share capital less own shares held must amount to not less than DKK 500,000 | If qualified stock purchase plan; also acquisition from employees; to extent that shareholders' equity in company exceeds amount of not distributable dividends | According to Articles of Association issue of new/bonus shares; also subsidiary employees; authorisation up to 5 years each; also other than by cash payment | Deviation from subscription/pre-emption rights by decision of General Assembly (two thirds of votes and equity capital) for benefit of employees |
| Germany | Without decision of General Assembly; also (former) employees or of affiliated firms; reserve fund necessary without reducing equity capital or reserve funds | Yes | Stock options for firms/affiliated firms employees; General Assembly decision; nominal amount of options restricted to 10%, that of increase to 50% of equity capital | In firms with individual share certificates number of shares to be increased to the same extent as equity capital is increased |
| Greece | Also personnel of ancillary firms | No | Shares / stock options, free / discounted; 3 years not transferable without General Assembly approval | No |
| Spain | Also for stock options | Yes | No | No |

²⁵¹ See Art. L.225-259 to L.225-270 of the French Commercial Code: Employee shares collectively owned by paid personnel in a workers' commercial co-operative.

| Country | Art. 19 III permission to acquire companies own shares for its employees | Art. 23 permission to advance funds, make loans, provide security (financial assistance), with a view to acquisition | Art. 41 I derogation to encourage financial participation in case of capital Increases | Other general provisions in Company Law to promote financial participation |
|-------------|---|--|---|--|
| France | In context of share-based profit-sharing scheme, share savings plan or stock option scheme | Also in subsidiaries or companies included in a group savings scheme | For all schemes; General Assembly decision required; no public offering; | Employee stock options; Share-based deferred profit-sharing; Save-as-you-earn schemes |
| Ireland | Not specific for employees, generally possible | Firm / group firm; provision of money / loans under share scheme; present / former employees and members of families | No | Finance Acts: Share-based profit-sharing; Save-as-you-earn / Share purchase schemes |
| Italy | No | Value of financial assistance within distributable reserves | Pre-emptive right of shareholders can be suspended for up to 25% of new shares with majority General Assembly vote; more than 25% require majority of capital held | Special 'Employees shares' can be issued in capital increase with specific rules for form, tradability and rights |
| Luxembourg | As minimum requirements of Directive | Limit: net assets of company not lower than amount of subscribed capital plus reserves | No | No |
| Netherlands | Also employees of group firm; without decision of General Assembly, if Articles provide; equity capital reduced by acquisition price not less than amount paid for shares plus reserve funds | Yes (but restrictions for closed JSC) | No | No |
| Austria | Also employees of affiliated firms; reserve fund for own shares to be established without reducing of equity capital or other reserve funds; Stock options without decision of General Assembly, but consent of supervisory board | No | Stock options for firms /affiliated firms employees; General Assembly decision; nominal amount of options restricted to 10%, that of increase to 50% of equity capital ; limit of 20% of equity capital for total amount of shares receivable | In firms with individual share certificates the number of shares has to be increased to the same extent as equity capital is increased |

| Country | Art. 19 III permission to acquire companies own shares for its employees | Art. 23 permission to advance funds, make loans, provide security (financial assistance), with a view to acquisition | Art. 41 I derogation to encourage financial participation in case of capital Increases | Other general provisions in Company Law to promote financial participation |
|-----------------|--|--|---|---|
| Portugal | Not specific for employees, generally possible, if partnership contract does not provide for anything else | Also to employees of affiliated firms; liquid assets mustn't become less than subscribed capital plus not distributable reserves | General Assembly may limit/abolish pre-emptive right of shareholders for 'social reasons' | No |
| Finland | Not specific for employees, generally possible | Yes, if interest rate is less than the reference interest rate, difference is taxable benefit and subject to social tax | No special regulation with a view to employees | Act on Personnel Funds |
| Sweden | Not specific for employees, generally possible | employees of firm/group firm; total value limited; at least 50% of firms' employees covered; advance/loan to be repaid within 5 years | General Assembly can suspend shareholders pre-emptive right of; also group firm; also wife / husband / children | No |
| UK | Not specific for employees, generally possible | Firm/group firm; provision of money / loans under share scheme; present/former employees/ family members; net assets mustn't become less than subscribed capital; value of financial assistance within distributable reserves; | No | Finance Acts: Share-based profit-sharing; Save-as-you-earn / Share purchase schemes |

New Members

| | | | | |
|-----------------------|--|--|--|--|
| Bulgaria | Not specific for employees, generally possible | No | No | No |
| Cyprus | Without decision of General Assembly | Advance funds and make loans to employees | No | No |
| Czech Republic | Without General Assembly decision provided for reserve | In accordance with Articles of Association | Financing from company profits or profit-sharing; not considered public offering | Discount limit: 5% of equity capital, covered by firms own resources |
| Estonia | Not specifically for employees, generally possible | No | No | No |

| Country | Art. 19 III permission to acquire companies own shares for its employees | Art. 23 permission to advance funds, make loans, provide security (financial assistance), with a view to acquisition | Art. 41 I derogation to encourage financial participation in case of capital Increases | Other general provisions in Company Law to promote financial participation |
|----------------------------|---|---|---|---|
| Hungary | Not specific for employees, generally possible | Also employees of controlled firms or organisations founded by employees | Both, free / discounted special 'Employee Shares', not considered public offering | Spec. free/discounted 'Employee Shares'; limit: 15% equity capital; not transferable; obligation to sell back |
| Latvia | Firm may fully pay up stock, not transferable; for up to 6 months | No | Non-voting shares, max 10% of equity capital, covered by firms profit; no public offering | 'Employee shares' in municipal/state firms; not transferable; obligation to sell back |
| Lithuania | Not specific for employees, generally possible | Advance funds or loan paid back by deductions from employees' salary | Non-voting shares for up to 3-year period in which share sale only to other employees | No |
| Malta | Without decision of General Assembly | For employees of firm/ group firm; provided it does not endanger firms own funds | No | Free/discounted shares of mother firm for employees; no prospectus needed |
| Poland | Also retired employees/ affiliated firms; reserve needed | Reserve needed, also employees of affiliated companies | Financing from firms' profits / profit-sharing; not considered public offering | No |
| Romania | Financed by profits and/or distributable reserves | Yes | No | No |
| Slovak Republic | In accordance with Articles of Association | Provided it does not endanger company's own funds | By General Assembly decision | Discounted share offers, discount up to 70% covered by firms' own resources |
| Slovenia | Also retired employees and of associate firms | Also employees of associate companies | Financing from profit-sharing possible | No |
| Candidate Countries | | | | |
| Croatia | Also employees of associated firms; reserve from profits needed | Reserve needed; must not endanger equity capital | Among others to fulfil employees' claims to acquire shares | No |
| Turkey | Not specific for employees, generally possible | No | No | No |

As the table above illustrates, a surprisingly large majority of Member States have adopted national legislation permitting a company to acquire its own shares in order to transfer them to its employees (implemented in 17, possible in 25), and to facilitate this acquisition by financial assistance (implemented in 23). Despite the fact that this legislation has rarely been used in some countries, the existence of corresponding regulations across the EU may serve as a foundation for a European concept.

3. Compliance with the Postulates of the European Policy Makers

a) Achieving Competitiveness While Maintaining Diversity

Financial participation of employees is closely linked to the objectives of the Lisbon summit for making the European economy ‘the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’.²⁵² Our proposed European Concept refers – as does the Commission – particularly to the experience in the US that demonstrates the impact such a model can have ‘in terms of economic growth, fostering industrial change and making sure that all workers participate in this growing prosperity’²⁵³. Therefore, in order to harness the potential – still largely unexploited in Europe – of the further development of financial participation as part of an overall strategy for stimulating the growth of new, dynamic companies as the Commission requires, we advocate the development of ESOPs.

Although the thesis that democracy requires a broad distribution of wealth is widely accepted, present social policy has not yet responded to the growing concentration of wealth; no regulations have come into force either at a national or a European level. Social attention so far has been focused on the growing wealth of the few (for example, anti-monopoly legislation). Given this context, an open, modular concept ideally responds to the need for developing regulations at the supranational level in order to support financial participation more actively and to overcome national differences in taxation policy. At the same time, such a legal framework, while providing a broader incentive system, delineates what companies may do without inviting sanctions from regulatory, legal and taxation authorities.

A legal foundation at the European level has to focus on ‘majority vote’ regulations if it is to be successful. Thus it should encompass a broad incentive system which provides different and flexible solutions compatible with those already established in the Member States:

- Relatively widespread in the European Union are profit-sharing schemes, stock options and employee shares.

²⁵² See point 1.5 of the Presidency Conclusions of the Lisbon European Council (No. 23 of 24 March 2000).

²⁵³ Commission communication seeking ‘a framework for the promotion of employee financial participation’, COM (2002) 364 Final, 5 July 2002, pp. 3, 10.

- In countries with an Anglo-American tradition, for example, the United Kingdom and Ireland, ESOPs are also to be found;
- Central and Eastern European countries have developed share ownership systems (rather than profit-sharing schemes) with shares being distributed for free or sold at the market price or under preferential conditions.

The apparent difference in legal and political priorities between East and West is due to the fact that the first priority of post-socialist legislators is to change the socialist economic system through privatisation and re-privatisation. Therefore the development of these schemes does not necessarily constitute a progressive evolution of their pay system or their work organisation process.

The Building Block Approach reflects this diversity, while opening national practise to new forms of financial participation.

b) The Building Block Approach: Meeting Essential Principles...

The proposed Building Block Approach fully complies with the essential principles of financial participation schemes which the Commission sets forth in the cited Communication:

- All elements of the building blocks are voluntary for both enterprises and employees (this does not, however, conflict with the French compulsory regulations at the national level).
- The building blocks can be put together in any combination depending on the specific needs of the given enterprise so as to produce individually tailored, clear and comprehensible plans.
- Discrimination, for example, against part-time workers or women, would exclude any national company scheme from being integrated into the supranational European Concept.
- The proposed share ownership schemes that have been established in the United States and the United Kingdom for decades include adequate training programs and educational materials which allow employees to assess the nature and details of the schemes.
- Unreasonable risks for employees are buffered by the diversity of the concept. The dissemination practices for employee information aim at, among other objectives, raising the awareness of the risks of financial participation resulting from fluctuations in income or from limited diversification of investments.
- By collecting the best practise of national legislation and customs, the rules on financial participation at the company level are based on a predefined formula clearly linked to enterprise results.
- Each building block is a complement to, not a substitute for, existing pay systems.
- It is the explicit aim of the Building Block Approach to be used throughout the European Union and as such to be compatible with worker mobility both internationally and between enterprises.

c) ...and Overcoming Transnational Obstacles

At the same time, the Building Block Approach seeks to address transnational obstacles identified by the Commission and Parliament (European Commission, 2003a, pp. 17) as imposing barriers to the development of a European model and to cross-border plans for financial participation:

- By providing a broad incentive system going beyond the classical instruments of tax legislation, the modular approach neither relies on nor excludes tax incentives.
- In spite of the difficulty of implementing tax incentives, these still remain a powerful tool for enhancing and broadening financial participation. They could be voluntarily granted by countries singly or in groups, creating in the process an increasingly favourable environment. The pro-activism of countries with an advanced tradition like France or the United Kingdom would at the same time encourage others to emulate them.
- The PEPPER IV benchmarking across the EU provides the first ever complete overview of employee participation in all member and candidate countries of the European Union and thus facilitates the avoidance of transnational obstacles, for example, blocking periods when employees may not dispose of their shares.
- Our project, by providing information in a systematic way with reference to the experience of the EU-15, is also helping to overcome the cultural differences in the social partnership as well as raising the new member countries' awareness of employees.

IV. Summary and Recommendations

Jens Lowitzsch

The PEPPER IV Report presents conclusive evidence, regardless of data source, that the past decade has seen a significant expansion of employee financial participation in Europe. This is true of both profit-sharing and employee share ownership, although profit-sharing is more widespread. Against the background of the different genesis of PEPPER schemes in the old and the new EU member countries it is surprising, that the data examined seem to indicate that a West-East divide exists only with regard to profit-sharing. Throughout the European Union, the percentage of enterprises offering various PEPPER schemes is on the rise. Between 1999 and 2005, broad-based share ownership schemes increased from an average of 13 to 18 per cent and profit-sharing schemes from 29 to 35 per cent (weighted country averages for all countries included in both samples). On the other hand, despite this positive trend it seems that financial participation has been extended to a significant proportion of the working population in only a handful of countries.

Analysis of the legislative framework in the 27 EU members and the two candidate countries has shown that PEPPER schemes vary widely, reflecting the recent history of the countries under consideration and their different approaches and attitudes toward the role of employees. There are important differences between the former socialist countries and the mature market economies of the EU-15, and within the former group between those in which employees enjoyed a privileged position (such as the former Yugoslavia and Poland) and those which were managed along the more orthodox Soviet model (such as Czechoslovakia). The apparent difference in legal and political priorities between East and West stems from the fact that the first priority of post-socialist legislators was to change the socialist economic system through privatisation and re-privatisation; thus the development of PEPPER schemes does not necessarily represent a progressive evolution of their pay system or their work organisation process, as it does in the EU-15. A rare exception of legislation found in the majority of the countries under consideration are rules permitting joint-stock companies to acquire their own shares in order to transfer them to their employees, and to facilitate this acquisition with financial assistance. This phenomenon has its roots in the Second Council Directive on Company Law²⁵⁴ and in the new Member States, as part of the *acquis communautaire*, corresponding legislation was adopted in the context of accession to the EU.

In the past the comparative analysis of the general attitude of governments and social partners has shown a lack of concrete policy measures supporting PEPPER schemes, and

²⁵⁴ See Art. 19 para. 3, 23 para. 2, 41, para. 1 and 2 of the Directive 77/91/EEC, dating back to 13 December 1976 which allow derogations from the European legal framework for joint-stock companies designed to encourage the financial participation of employees (see Part 3, Chapter IV, Section 3).

limited interest both by trade unions and employers organisations in about half of the countries. Instead of being actively promoted as in some old EU Member States, employee financial participation in the new member countries has (with some exceptions) most frequently not been considered, or has been viewed with suspicion. During the last decade across the EU, however, a general, positive shift in attitude could be observed, with the number of passive countries decreasing to about a third.

On the basis of these principal findings of the PEPPER IV Report suggestions for future initiatives which could contribute to a more widespread diffusion of employee financial participation in the enlarged EU are being made to the EU Member States as well as to the Commission.

1. Promoting PEPPER Schemes at the National Level

A growing body of empirical evidence²⁵⁵ shows that financial participation can substantially benefit not only employees but also business enterprises and the national economy. This potential, however, remains largely under-utilised in most Member States, while financial participation within the EU itself is unevenly diffused

– **The challenge: Legislating PEPPER Schemes**

In conformity with much of the Western experience, a major obstacle to introducing employee financial participation in the new member countries is the lack of specific legal provisions on employee financial participation offering specific fiscal incentives to encourage it. The absence of specific legal provisions may also account for the decrease in financial participation in those countries which earlier utilised it as a tool of privatisation. Western experience shows that profit-sharing and employee share ownership are most prevalent in those countries which have legislated PEPPER schemes and offer a variety of well-designed tax incentives that encourage its use and spread. Therefore, the promotion of PEPPER schemes in new member and candidate states might well begin with action in the policy area.

– **Share Ownership Schemes: Developing a long-term perspective**

Given the prevailing economic conditions in Central and South Eastern Europe, the new member and candidate countries could discover that financial participation is even more important to them than to the EU-15. Although these countries introduced share ownership as a one-time incentive to employees during privatisation, they did not follow up with policies and measures that would make employee share ownership a permanent component of their new private property, free market economies. By contrast, a number of Western governments, as well as the EU itself, have actively promoted employee financial participation precisely because of its beneficial long-range effects.

²⁵⁵ Financial participation has been statistically linked with greater productivity and with higher profits (profit-sharing, see Festing et al., 1999; share ownership, see Blasi et al., 2003). Furthermore, these effects appear to be strengthened by the presence of other kinds of employee involvement (Kim, 1998).

– **Profit-sharing: Strengthen incentives and increase productivity**

Profit-sharing in particular, despite its limited diffusion in the new Member States in Central and Eastern Europe²⁵⁶, is likely to play a more prominent role in these countries, stimulated by the rich experience of the EU-15 with these schemes. The need to strengthen incentives and increase worker productivity in the future should generate more favourable attitudes towards flexible remuneration schemes like profit-sharing. Furthermore, profit-sharing enhances loyalty and motivation among employees by ensuring them employment security in exchange for wage flexibility.

– **Internal versus external flexibility: Profit-sharing and flexicurity**

The political desire to reduce unemployment figures has led government to favour the process of entry and exit from the labour market and an ‘external flexibility’ model. Profit-sharing schemes are an element of ‘internal flexibility’ that allows wages to fall in a period of economic downturn thus allowing the employer company to maintain its margins by automatically decreasing its labour costs without reducing its labour force. Several studies show that profit-sharing can provide wage flexibility and employment stability. This is in line with the common principles of ‘flexicurity’ sustained by the European Commission and Council, among them ‘a better balance between external and internal flexibility’, ‘a climate of trust and dialogue’ and ‘a better workers’ adaptability capacity’. Thus, especially given the changes occurring in the world of work and the need to achieve internal flexibility (as opposed to external flexibility), profit-sharing can play an important role in the flexicurity approach.

– **Financial crisis, state intervention and participation**

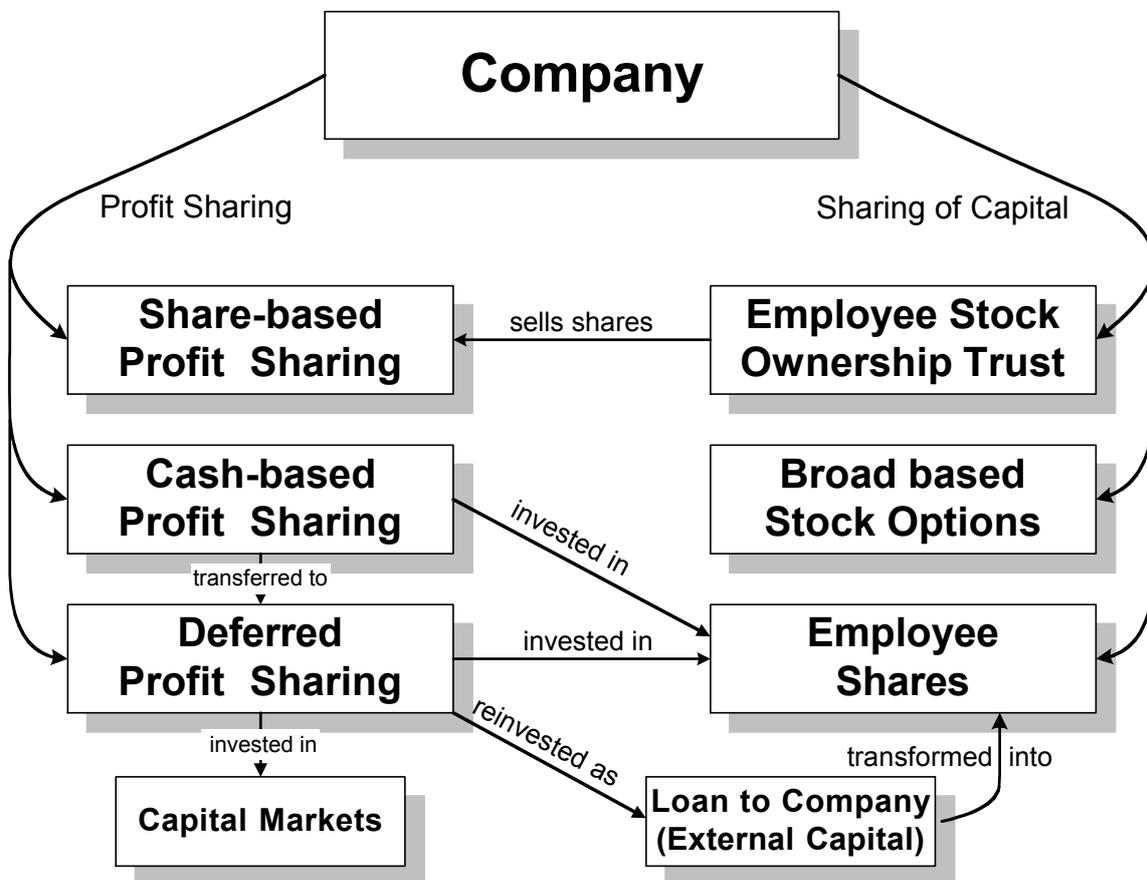
‘As we have been witnessing since late 2008, employees often bear much more than just a fair share of the pain in an economic downturn. Tools allowing them to share the gain when the financial results of their employer are growing are, apart from all other aspects, part of a basic fairness in the relationship between employer and employee. The development of such mechanisms therefore needs to continue’ (see foreword to this volume by Jean-Claude Juncker). In the context of the massive and unprecedented state intervention, one solution could be to increase employee financial participation in subsidised companies as a quid pro quo for state help. Subsidies to prevent bankruptcy as well as those that aim at stimulating the economy may, for example, be channelled through an Employee Stock Ownership Plan (ESOP) or a similar scheme. Furthermore, banks that receive state guarantees could be obliged to support financial participation of employees through their lending activities, for example, financing employee buyouts.

²⁵⁶ In the early 1990s, the general economic conditions – recessionary trends, falling wages, low or negative profits – have not favoured the adoption of profit-related remuneration schemes. Changes in the area of labour relations have usually provided laws based on the standard wage employment contract, which together with rigid tax provisions, do not allow much flexibility in payments systems.

2. The Building Block Approach: Developing a Common Model for Financial Participation across the EU

The 'Building Block Approach' as a flexible platform model ideally meets the need to developing schemes at the European level in order to more actively support financial participation and overcome national differences in taxation policy. At the same time this framework both provides a broader incentive system and delineates what companies may do without inviting sanctions from regulatory, legal and taxation authorities.

Figure 18. The Building Block Approach



– Providing a broad incentive system with flexible solutions

A European model must be compatible with those existing models in the Member States. Relatively widespread in the EU-15 are profit-sharing schemes, stock options and employee shares. In countries with an Anglo-American tradition, for example, the United Kingdom and Ireland, but also in some transition countries, such as Hungary, Croatia and Romania, ESOP models are also found. The Building Block Approach reflects this diversity, while opening national practise to new forms of financial participation. The building

blocks consist of the three basic PEPPER elements:²⁵⁷ (1) Profit-Sharing (Cash-Based, Deferred and Share-Based); (2) Employee Share-holding (Stock Options and Employee Shares); (3) Employee Stock Ownership Plans as Collective Schemes.

– **A future EU Recommendation: Implementing the legal foundations of a European Model**

The European Platform composed of the proposed Building Blocks could be framed as a Recommendation addressing the problem of national implementation by a recognition procedure by Member States. As a result of this procedure, each Member State would recognise individual elements of the European Platform as drawn up in the Recommendation to be the equivalent of a plan drawn up under its own laws and conferring equivalent benefits. This establishes a distinct legal entity for the chosen Building Block which companies in those countries that decide on recognition can refer to.

– **Building on existing national legislation originating in the *acquis***

Given the above described difficulties in arriving at a supranational compromise, the shortest path to a regulation at the supranational level, the simplest solution is to build on existing national legislation originating in the *acquis communautaire*. A rare example of such legal ‘common ground’ is found in some of the national rules on listed and unlisted joint-stock companies originating in the implementation of European Law, that is, the Second Council Directive on Company Law 77/91/EEC. Further investigation of other common existing regulations in this field is needed.

3. PEPPER Schemes for SMEs: Employee Stock Ownership Plans (ESOPs)

In addition to well known forms of financial participation (for example, employee shares and profit-sharing), the Building Block Approach introduces a lesser known but flexible form of collective share ownership: the ESOP. While, for example, share-based profit-sharing schemes have only one source of funds (that is, direct contributions from the employer company), the ESOP can obtain financing from such different sources as: (1) a loan from the employer company, a selling shareholder or a financial institution such as a bank; (2) dividend earnings; (3) sale of shares to its related share-based profit-sharing scheme; and (4) contributions from the employer company.

While share ownership generally involves additional risk for employees, the ESOP avoids this consequence. Although employees, as in other share ownership schemes, are encouraged to invest a part of their wealth in shares of their own companies rather than in those of other companies, thus concentrating rather than diversifying risk, there is this fundamental difference: ESOP debt is funded by appropriately timed contributions from the company to a employee trust (ESOT). Thus the scheme provides a benefit additional to basic wages. The employee’s salary is unaffected. Further, ESOPs motivate employees to

²⁵⁷ For a detailed technical description of the different mechanisms and schemes, see Lowitzsch et al. (2008).

become more productive, while at the same time making enterprises more competitive.²⁵⁸ Finally, there is an additional advantage to the company: shares are not sold to outsiders; thus there is no risk of loss of control while the company itself remains local. This makes ESOPs an important tool for solving the problems of business succession in family-owned enterprises, one that strengthens bonds between enterprise and community, keeping jobs local and resulting in more wage income being spent at home.

– **Heads of family enterprises will be retiring en masse in the next ten years**

A recent Commission Communication from 2006²⁵⁹ stated that with the aging of Europe's population, 'one third of EU entrepreneurs, mainly those running family enterprises, will withdraw within the next ten years'. This portends an enormous increase in business transfer activity which could affect up to 690,000 small and medium-sized enterprises and 2.8 million jobs *every year*. It is anticipated that as a consequence of the new forms of business finance now coming into use, transfers within the family will decrease, while sales to outside buyers will rise. The entrance of international investors into what used to be primarily domestic markets will broaden the range of potential buyers for European small and medium-sized enterprises. This process is likely to threaten the successful regional structure of European (family-owned) businesses and will profoundly affect the European Community itself. This field of action was highlighted as a main objective of the Council Recommendation of 7 December 1994²⁶⁰. Recently the European Commission stressed the importance of ownership transfers to employees as a specific measure for facilitating business succession in SMEs.

– **ESOP as a vehicle for business succession**

A full or partial ESOP buyout provides an ideal vehicle to facilitate transitions in ownership and management of closely-held companies. The ESOP creates a market for retiring shareholders' shares, which is of major importance to unlisted SMEs having no other ready source of liquidity. ESOPs may easily buyout one or more shareholders while permitting other shareholders to retain their equity position. This is a major advantage from the shareholders' perspective. At the same time, ESOPs give business owners the opportunity to diversify their investment portfolios without the costly process of going public. Furthermore, there is no dilution in equity per share of current stockholders since no new shares are issued and all shares are bought at fair market value. If the ESOP borrows money to buy shares, the company repays the loan by combining any dividend income of the trust with its own tax-deductible contributions to the plan. As the loan is repaid, a number of shares equal to the percentage of the loan repaid that year is allocated to employee accounts, usually on the basis of relative compensation. In this way the ESOP creates a market for retiring shareholders' shares at a price acceptable to the owner - a market

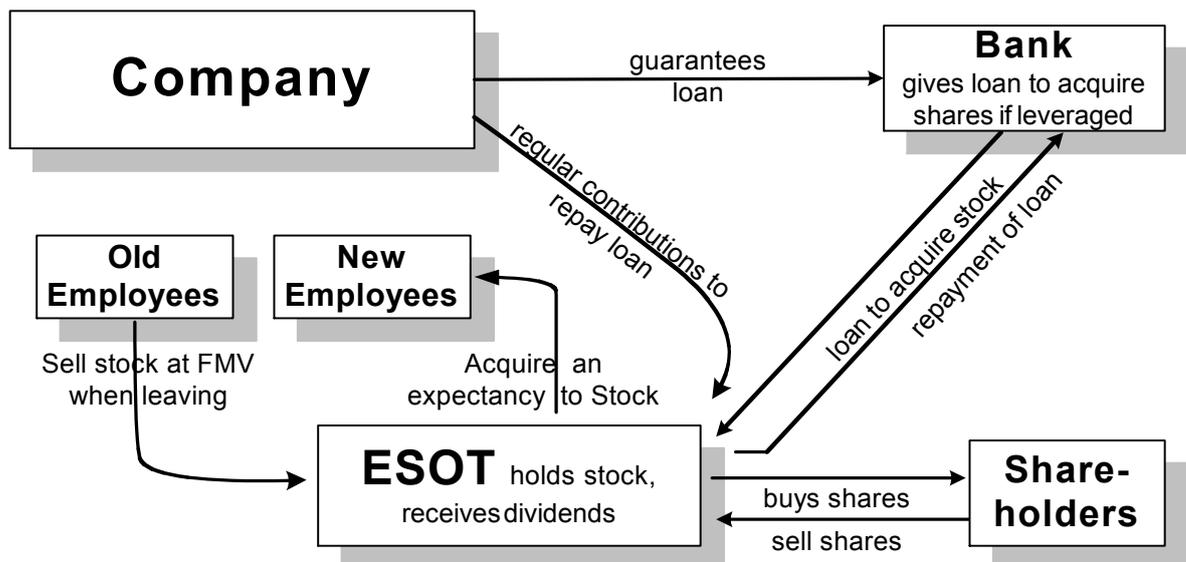
²⁵⁸ For a recent, comprehensive overview of the positive economic evidence (in particular for ESOPs) see Blasi et al. (2003); they find an average increase of productivity level by about 4 per cent, of total shareholder returns by about 2 per cent and of profit levels by about 14 per cent compared to firms without PEPPER schemes.

²⁵⁹ Implementing the Lisbon Community Programme for Growth and Jobs, on the Transfer of Businesses – Continuity through a new beginning, from 14 March 2006, COM (2006) 117 Final.

²⁶⁰ On the transfer of small and medium-sized enterprises, 94/1069/EEC, with explanatory note, Official Journal No. C 400, 31 December 1994, p. 1; reiterated in the Communication from the Commission on the transfer of small and medium-sized enterprises, OJ C 93, 28 March 1998.

which otherwise might not exist. At the same time, when a change of control is appropriate, ownership is transferred to motivated employees who have a vital interest in the company's long-term success.

Figure 19. ESOP as a vehicle for business succession



Thus the ESOP may be an attractive alternative to selling the business to outsiders, especially when there is a desire to keep control of the business within a family or a key-employee group.²⁶¹ As a trustee plan, the ESOP is designed to separate control over the shares in the trust from the 'beneficial owners'. The trustee exercises voting rights while the employees are the financial beneficiaries. The trustee may, in fact, be the very person who has just sold some or all of his shares to the trust. For smaller firms especially, it is much easier to contemplate a gradual transfer of ownership by creating a market for the shares of those who wish to sell at the present moment, while enabling those who wish to hold their shares to retain their equity interest permanently or at least until some later date. The result is the opportunity to gradually cash out without giving up immediate control.²⁶²

– ESOP as an alternate leveraged buyout tool

The growing number of Private Equity firms targeting Europe's small and medium-sized enterprises²⁶³ makes a comparison of an alternate leveraged buyout tool of immediate strategic importance. This alternate vehicle is the Employee Stock Ownership Plan. Al-

²⁶¹ The ESOP may also be used to buy out dissident shareholders.

²⁶² Once the loan is paid off, of course, most companies make some arrangement for the presence of employee representatives on the plan committee.

²⁶³ The part of LBOs in the total funds raised in Europe reached over 68 per cent in 2005. In contrast the amount of venture capital investments only represents 5 per cent (see PSE Socialist Group in the European Parliament, 2007, p. 69).

though the ESOP and the Private Equity fund have some features in common²⁶⁴, the two markedly differ in one crucial respect: they benefit different constituencies and have different economic and social effects. The Private Equity buyout concentrates ownership of productive enterprises and the income they produce, while the ESOP broadens both the economy's ownership base and the distribution of income. The Private Equity buyout increases the wealth of its own narrow constituency, while the ESOP improves the material well-being and economic security of working people and their families. The Private Equity buyout is a short-term transaction aimed at restructuring and selling the target company to a third party that, in turn, may be just another Private Equity Fund. The ESOP is a long-term commitment which ensures the continuity of the enterprise.

Quick profits for a few investment consortiums whose participants are already well-capitalised, or incomes rising over time for employees motivated by the ESOP to make their enterprises more profitable and competitive? This is the choice confronting the European Union as it prepares for a massive transformation of ownership of the business enterprises that generate its economic prosperity.

4. Promoting PEPPER Schemes through Tax Incentives

In spite of the difficulty of implementation at the European level (due to the exclusive jurisdiction of national legislation over tax law), tax incentives remain powerful tools for enhancing and broadening financial participation. This is especially true when they remain optional for the member countries and not subject to a unanimous vote of approval. Countries could voluntarily offer tax incentives singly or in groups. Such a step would create an increasingly favourable environment where countries having an advanced tradition, such as France or the United Kingdom, would encourage emulation. Optional preferential treatment as part of the Building Block Approach requires distinguishing between profit-sharing schemes, share ownership schemes and employee stock ownership plans.

- **Tax incentives are not a prerequisite to PEPPER schemes but they effectively promote financial participation where they exist**

On the one hand, financial participation schemes without tax incentives sometimes may have a higher incidence than those with tax incentives. Therefore tax incentives are not to be considered a prerequisite to the development of financial participation. On the other hand, the experience of countries with a long tradition of employee financial participation as well as that of countries where tax incentives are quite recent, universally confirm their positive impact.

²⁶⁴ The ESOP, invented in 1956, is the prototype leveraged buyout; the Private Equity form originated in the seventies to utilise tax advantages which the US Congress had passed to encourage the ESOP.

- **Tax incentives should (and in most countries do) target those taxes which constitute the heaviest burden in the national taxation system**

The heaviest taxes are usually the progressive personal income tax and social security contributions. Many countries therefore provide: (1) exemptions from social security contributions for certain plans (for example, France, Belgium, UK, Ireland, Finland); (2) levying a capital gains tax (for example, UK and on dividends Belgium); (3) levying a special low tax (for example, France) in lieu of personal income tax, and (4) tax allowances for personal income tax (for example, Austria, Finland, Ireland).

- **Some forms of tax incentives are more favourable for certain types of plans and also lead to higher efficiency**

For share ownership and stock options as far as benefit taxation is concerned: generous valuation rules combined with a favourable taxation moment (often linked to holding period), and, if possible, exemption from SSC for both the employer company and the employee.

For dividends and sale of shares: a special tax rate or capital gains tax in lieu of personal income tax and, if necessary, exemption from SSC.

For ESOPs and Intermediary Entities: exemptions from income tax on share acquisition²⁶⁵ or on share sale if the profit is realised after a holding period or within a retirement program; the company may qualify for tax relief on both interest and principal payments on the loan; sale of stock to an ESOP on a tax-deferred basis if the proceeds of the sale are reinvested in securities of other domestic corporations (tax-free rollover).

For profit-sharing: a special tax rate in lieu of the progressive personal income tax as well as exemption from SSC for both the employer company and the employee.

5. Informing Governments and Policy Makers about the PEPPER Initiatives

The development of financial participation schemes across the EU is strongly influenced by national policies, in particular by the availability of an appropriate legal framework, tax incentives and other financial advantages. As a result, different laws and sometimes mandatory rules in different countries often require specific forms of financial participation, forcing companies to tailor the design of an international plan accordingly. Here the EU has an important role to play in promoting employee financial participation throughout the newly-enlarged EU. It could disseminate information and proposals on this subject as a continuation of earlier initiatives in this area.

In line with prior Commission activities, a Community initiative should launch an EU-wide, comparative, focused survey of financial participation. Since no cross-country data focussed on financial participation is available at present, the PEPPER IV benchmarking

²⁶⁵ In Ireland this is the case only where the ESOP comprises an ESOT working in tandem with an Approved Profit Sharing Scheme.

is a compromise intended to cope with the existing data deficit without undertaking a new survey. There were inconsistencies between different data sources which showed different scales of financial participation, for example, a much larger offer (CRANET) than the actual take-up rate by employees (EWCS). This discrepancy in the cross country data can probably be attributed to diverse definitions and methodologies employed as well as a diverse emphasis of the surveys. To facilitate a discussion of individual country scores on different indicators vis-à-vis comparable scores of other EU members, and to obtain a reliable overall picture, a more comprehensive and consistent data base is indispensable. The Commission should support additional research specifically designed to fill this gap.

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The PEPPER IV Report presents conclusive evidence, regardless of data source, that the past decade has seen a significant expansion of employee financial participation in Europe. This is true of both profit-sharing and employee share ownership, although profit-sharing is more widespread. Against the background of the different genesis of PEPPER schemes in the old and the new EU Member States it is surprising, that the data examined seem to indicate that a West-East divide exists only with regard to profit-sharing.

Throughout the European Union, the percentage of enterprises offering various PEPPER schemes is on the rise. Between 1999 and 2005, broad-based share ownership schemes increased from an average of 13 to 18 per cent and profit-sharing schemes from 29 to 35 per cent (both weighted country averages for all countries included in both samples). On the other hand, despite this positive trend it seems that financial participation has been extended to a significant proportion of the working population in only a handful of countries.

This Report summarises and updates the previous PEPPER reports. It is the result of the Commission funded project 'Assessing and Benchmarking FP in the EU 27' which closes the gap between PEPPER I/II (1991: EU-12 / 1997: EU-15) and PEPPER III (2006: ten new Member States and four candidates). It implements benchmarking indicators developed by the European Foundation for the Improvement of Working and Living Conditions in all 27 EU Member States and candidate countries.

The Report is divided into three parts. The first consists of an overview of the benchmarking project and the current situation in the countries under consideration, a presentation and discussion of the benchmarking results as well as an analysis of the fiscal framework and tax incentives in the EU-27. The second part provides country profiles, each covering the attitudes of social partners and government policies, the legal foundations for different schemes and, where available, the incentives for their application. The third part summarises the experience of employee financial participation in Western and Eastern Europe, its role in the changing world of work in the 21st century and its relevance in the context of the European integration process. Finally recommendations and suggestions for further initiatives are made.