COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMISSION STAFF WORKING PAPER

Financial participation of employees in the European Union

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CONTENTS

1. Purpose

The Social Policy Agenda adopted by the European Commission on 28 June 2000 states (point 4.1.2.2) that a communication on financial participation and an action plan will be prepared in 2001.

In accordance with the approach and outlook set out in the Agenda and in the wake of the European Commission's Pepper I[1] and Pepper II[2] reports and the Council Recommendation[3] of 1992 (see paragraph II.2 below) , the purpose of **this working paper** is to promote a preliminary consultation and relaunch the debate on financial participation at European level, associating all the players concerned: the Member States, the Community institutions, the social partners, companies and the associations working on the promotion of financial participation.

The Commission will take account of the responses it receives when adopting its communication on financial participation and accompanying action plan.

To facilitate and organise the consultation process, the Commission proposes to focus on three main strands:

- identifying the general principles underpinning national policies,
- addressing the transnational barriers; these relate essentially to tax, the social and cultural environment, and (differing) social security contributions,
- establishing a series of Community measures to improve understanding of the different financial participation systems, including discussions on practices and policies in the Member States and drawing the mutual lessons to be learned therefrom, and to enhance the capacity of the parties concerned to deal with financial participation efficiently, in particular through European Union networks and by promoting dialogue with all the players.

2. Context

2.1 What is financial participation?

The purpose of financial participation is to associate a company's employees in its profits and/or results. Financial participation schemes can take different forms. They may apply to senior managers or to all staff.

The Commission is interested in particular in the schemes that apply to all a company's workers or, at any rate, to the great majority.

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1 Supplement 3/91, Social Europe.

2 COM(96) 697.

3 92/443/EEC.

This paper classifies such schemes under three headings: profit sharing, share ownership and share options.

Profit sharing implies the sharing of profits by providers of both capital and labour, by giving employees, in addition to a fixed wage, a variable income directly linked to profits or some other measure of enterprise results.

Employee share ownership provides for employee participation in enterprise results in an indirect way, i.e. on the basis of participation in ownership, either by receiving dividends, or the appreciation of employee-owned capital after the selling of the shares, or a combination of the two.

Share options give employees an option to buy company shares at a certain price (normally at or below the market price at the time the option is granted) for a specified period of time. In the past, schemes have been targeted mainly at senior management, but they are increasingly being opened up to a wider group or even to all employees.

2.2 European Community policy on financial participation

The Commission has been carrying out work on financial participation since the late eighties. The social action programme (1989–1992) which followed up the Community Charter on the Fundamental Social Rights of Workers solemnly adopted by the Heads of State or Government in Strasbourg on 9 December 1989 envisaged the adoption of a Community instrument on financial participation.

In 1991 the Commission adopted a report on the “Promotion of employee participation in profits and enterprise results” known as the Pepper I report. On 27 July 1992 a Council Recommendation was adopted on the basis of this report, .

The Recommendation invites the Member States to:

- acknowledge the potential benefits of wider use, individually or collectively, of a broad variety of schemes to increase the participation by employees in profits and enterprise results either by means of profit-sharing, or through employee share-ownership or by a combination of both;
- take account of the role and responsibility of the social partners in this context, in accordance with national law and/or practice.

The Council Recommendation made provision for the Commission to present a new Pepper report on its application to the European Parliament, the Council and the Economic and Social Committee.

The Pepper II report was drawn up on the basis of information supplied by the Member States and adopted by the Commission in January 1997.

It focused on two major aspects:

- an overview of the ways the Member States have promoted participation by employees in profits and enterprise results since 1991, following the adoption of the Council Recommendation of 1992;

- identification of the general principles which should be taken on board and promoted by the Member States and the social partners to boost the promotion of financial participation schemes.

The following conclusions were drawn on the first aspect:

- worker participation in company profits is associated with higher productivity levels in every case, regardless of methods, model specification and data used. The development of financial participation schemes is strongly influenced by government action, particularly when tax incentives are made available;
- however, no great change was noted in the Member States' general approach to Pepper schemes;
- France and the United Kingdom have a long tradition of financial participation; in Ireland, Finland and the Netherlands government support increased, while in Germany, Spain and Italy, calls had been made on the social partners to promote financial participation schemes in the context of their bargaining;
- in all the other Member States, the Pepper systems had been discussed, but received little or no government support;
- active campaigns to promote financial participation had been organised in some Member States, notably France, Finland, Ireland, the Netherlands and the United Kingdom.

As for the second essential aspect of the Pepper report, the Commission proposed to the Member States and the social partners a series of general principles designed to encourage financial participation. They aimed in particular to promote the development of a national legislative framework, to extend conditions for admission to financial participation schemes and to incorporate them into employee participation plans within companies.

The European Parliament adopted a Resolution (rapporteur Ms Marie-Thérèse Hermange) on the Commission's Pepper II report in January 1998. Parliament welcomed the document; however, with a view to the recommendations of the Pepper reports and the Council Recommendation of 1992 being taken on board on a greater scale by the Member States, it made a number of calls on the Commission, the Member States and the social partners.

It requested the Commission in particular to promote the exchange of information and best practice at transnational level, to study the impact of financial participation schemes on employment and wage flexibility, and to develop pilot projects for financial participation in public undertakings in the CEECs in connection with privatisation.

It recommended that the Member States develop framework legislation including tax incentives and extend eligibility for financial participation schemes to all categories of employees. It also called on both sides of industry at national and European level to organise information campaigns and encourage Pepper options as a feature of collective bargaining.

In the wake of the Pepper II report and Parliament's Resolution, the Commission granted assistance for a study[4] in 2000 on the objectives of companies and the obstacles they encounter when attempting to apply their financial participation schemes in other Member States. The conclusions of the study are based on the results of a survey covering 500 business in 14 European countries.

The study found that the most important objectives of companies in establishing financial participation plans were to encourage employees to take a greater interest in the success of the company, to create a feeling of belonging to one company and to encourage greater alignment of employees' interests with those of shareholders.

However, as regards the barriers that companies come up against when they wish to export their financial participation plans to other Member States, it appears that the greatest difficulties are connected with the extremely different institutional frameworks (legal and tax rules, law on securities, labour law, social security), different environments and cultural and historical traditions in relation to financial participation and also different industrial relations practices.

2.3 Link between financial participation and other European Union decisions and policies

The question of financial participation naturally comes up in the context of other Community initiatives, notably:

- *Broad Economic Policy Guidelines*

  The 2000 Broad Economic Policy Guidelines, adopted by the Economic and Financial Affairs Council on 19 June 2000,[5] stressed the importance of speeding up "actions to promote employee ownership schemes" with a view to promoting capital markets. In that context, the promotion of financial participation forms part of the structural reforms aimed at improving potential for growth, employment and social cohesion.

- *Communication on risk capital: a key to job creation in the European Union*[6]

  This Commission communication underlines the need to develop risk capital markets and establish, on the US model, a genuine pan-European risk capital market.

  It points out that "financial participation schemes have played an important role in helping to stimulate the growth of new, dynamic companies. In particular, they have enabled individual employees to build up capital to start up their own entrepreneurial activities and involved employees in the development and well-being of the company (helping to promote stakeholding and an entrepreneurial spirit)".

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[4] A company perspective on financial participation in the European Union: objectives and obstacles, Catholic University of Brussels.

[5] European Economy. Main Edition. No 70.200.

[6] SEC(1998) 552.

Following on from this, financial participation clearly creates a direct link between the entrepreneurship and adaptability pillars of the employment strategy.

- *Company taxation*

  In response to the request made at the Vienna European Council in December 1998, the Commission will publish by September a study on company taxation including a detailed review of the transnational problems connected with taxing share options and share purchase.

- *Modernisation of work organisation*

  Financial participation is now referred to in the broader context of modernising work organisation. Both in the Green Paper "Partnership for a new organisation of work"[7] of April 1997 and in the follow-up communication of November 1998[8], it was stressed in particular that the social partners could make progress in this area.

  Greater emphasis has been placed on the modernisation and organisation of work following the launching of the social-partner consultation process on the subject on 20 June 2000.

3. Added value of Community action: bases and compliance with the principles of subsidiarity and proportionality

There are a number of good reasons for promoting, at Community level, more extensive use of financial participation schemes within the European Union, notably:

- *Results of the special summit of Heads of State or Government, Lisbon, 23 and 24 March 2000*

  In Lisbon, the Heads of State or Government set a new strategic goal for the European Union: “to become 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”. Numerous studies have concluded that financial participation schemes are in all cases associated with higher productivity levels. Economic literature and theoretical and empirical studies have, moreover, identified a number of potential advantages in the different financial participation systems:

  - greater worker involvement, also thanks to a greater feeling of belonging to one company, and therefore stronger motivation to improve enterprise results; productivity is raised and social tension is usually reduced;
  - greater employee loyalty, sought in particular by high-tech companies;
  - businesses offering shares (or share purchase options) may not need to reduce their investment capacity;
  - improved competitiveness and job creation in companies;

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7 COM(97) 128.

8 COM(98) 592.

- financial participation by workers demands substantial transparency in company management; this is fully in line with the new governance culture and with the social responsibility of businesses;
- greater alignment of employees' interests with those of shareholders.

However, financial participation is more highly developed and more frequently practised in the United States than in Europe. Promoting and building up financial participation systems for employees in Europe would therefore seem highly desirable and likely to reinforce competitiveness. Financial participation could accordingly contribute to attainment of the Lisbon objectives.

The Lisbon Summit consolidated further the Luxembourg employment strategy whose guidelines (under the entrepreneurship pillar) stress the need to develop risk capital markets.

➢ *The general principles set forth in the Pepper reports have not been adequately incorporated into national policies*

Some Member States have not really done anything to change their national policies on financial participation in the light of the principal conclusions of Pepper II. A new dynamic, not yet sufficiently solid however, is clearly gaining momentum in Europe.

More Member States are displaying willingness to meet companies' needs — on the employers' side and also on the employees' side — to apply financial participation schemes that are competitive vis-à-vis those of certain third-country businesses, and the Member States are increasingly taking this factor into account in their action and national debates.

A brief overview of the situation in the Member States, in the light of the Pepper II conclusions, highlights the following:

- France and the United Kingdom still lead the way; on 19 February 2001 France adopted a new law[9] which refined the employee savings tool, while in 2000 the United Kingdom introduced measures[10] which provided new tax incentives for specific types of businesses;
- in Ireland, boosting financial participation is one of the priorities of the employment partnership[11] adopted in 2000 by the government, the social partners and the non-governmental organisations. The case of Ireland is interesting for it demonstrates that an effective social partnership between all the players concerned can give rise to collective commitments;
- in the Netherlands and Finland, government support for financial participation has increased over the years and the social partners have become more interested and active;

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9 Law 2001-152 of 19 February 2001 on employee savings, JO 43 of 20 February 2001.

10 Finance Act 2000.

11 Programme for Prosperity and Fairness 2000.

- new proposals and fresh discussions are being launched in Germany (notably in the context of social protection reform) and in Austria and Italy (where an expert group of social partners recently put forward a draft law on the introduction of tax incentives for financial participation);
- in June 2001, Belgium adopted a framework law[12] which introduced tax incentives for the first time. The framework law draws on the principles laid down by the Commission in its Pepper reports.

➢ *Transnational obstacles*

This is the most sensitive aspect, as already pointed out in the Pepper reports and the Council Recommendation. Transnational barriers are preventing wider dissemination of financial participation schemes in Europe.

There are three main types of transnational obstacles:

- tax differences between Member States may, broadly speaking, constitute barriers to worker mobility; workers may find that such differences distort the single market, particularly where, in moving from one Member State to another, they could be taxed twice. For example, each time an employee is expatriated by his employer to another Member State the stock options he holds will be subject to different tax regimes. One of the major differences between the Member States is the timing of taxation (e.g., taxation at grant, taxation when the option vests, taxation at the exercise of a stock option). Furthermore, the free movement of capital could be hindered where the domestic taxation rules do not put employees of enterprises in other Member States on the same footing as employees of domestic enterprises. Without objective justification, additional tax or compliance burdens may also be assessed as tax barriers. Tax incentives can play a valuable role, but it should be stressed that Member States have to comply with the State aids rules on direct taxation;

- differences between the Member States as regards compulsory social security contributions on income from financial participation;

- social and cultural barriers: these concern the differing traditions which are less or more favourable to financial participation in the Member States. In some Member States, giving employees a financial stake in the business for which they work is alien to their traditions and industrial relations system. Specialists in this area also refer to "a cultural problem" in relation to financial participation. They stress that the distrust displayed by many employees in financial participation schemes can be put down to a lack of information. This "cultural deficit" is very probably also found among entrepreneurs, above all among SME managers in more traditional industries who would have much to gain if they were more aware of the facts.

The effects of these obstacles are beginning to weigh more heavily on companies operating in the single European market. It would obviously be more logical and easier for such companies to set up one and the same financial participation scheme for all the subsidiaries in a group, with a few national adjustments. In some cases that

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[12] Belgian law on schemes for worker participation in company capital and profits: *Moniteur belge* of 9 June 2001.

appears feasible. In others, however, companies frequently have to redesign and reconstruct their financial participation schemes for their subsidiaries operating in different Member States. They are therefore unable to set up a corporate scheme. This has a twofold disadvantage: on the one hand, it gives rise to significant costs in administration and resources and on the other, they are unable to retain their staff — above all the high-calibre employees in whom they are most interested — for they are ready to move and leave Europe for offers from the US.

Furthermore, given that they cannot run a corporate scheme, they have difficulty in refining pay systems; this is clearly an obstacle when a firm wants to create an enterprise culture following a merger or take-over. Not only are SMEs (notably, start-ups) increasingly having to tackle this problem, but also major groups.

On this point, the interests of employers and employees converge: employees would also like to be entitled to join share ownership schemes covering an entire group. Such issues are often raised nowadays at company level, above all in the works councils of European-scale groups.

- *Lack of information on financial participation schemes in the European Union*

  A number of studies have come to the broad conclusion that Member States and companies alike are unaware of experiences with financial participation in other Member States: hence, the added value of a European initiative aimed at filling this information gap at transnational level.

  In the light of the foregoing and in accordance with the principles of subsidiarity and proportionality set out in Article 5 of the Treaty, promotion of financial participation cannot be achieved adequately by the Member States on an individual basis; the reasons include the need for multilateral partnerships, transnational information exchanges and the dissemination of best practice at Community level. The transnational nature of certain obstacles to the development of financial participation within companies operating in more than one Member State is also an argument for a Community approach.

4. The three strands of consultation: general principles, transnational barriers and Community measures

Via this consultation paper the Commission is consulting all the parties concerned on all aspects of financial participation. However, it would request them to focus on the three following strands:

4.1 General principles

The Commission's two Pepper reports and the Council Recommendation identify certain general principles for financial participation. The Commission takes the view that broad consensus has been attained on them and they are increasingly providing inspiration for further legislation introduced in the Member States.

These general principles are set out below.

Voluntary participation
Financial participation schemes should be introduced voluntarily at company (or company group) level. Employees, for their part, are naturally not obliged to join them. Such schemes may be introduced on the basis of legislation or possibly of existing collective agreements.

Extending the benefits of financial participation to all employees
Access to share-ownership schemes should be open to all a firm's employees, including part-time, fixed-term and temporary employees. In addition, it is necessary to avoid all discrimination on grounds of gender, race or ethnic origin, religion or belief, disability, age or sexual orientation.

Predefined formula
The rules on financial participation in companies should be based on a predefined formula clearly linked to enterprise results. The rules should also establish the start of each reference period and the formula used to calculate the sums allocated to the employees.

Regularity
If financial participation schemes are to be truly effective, they should be applied on a regular basis to ensure a certain continuity.

Clarity and transparency in financial participation schemes
Priority should be given to clear, comprehensible plans, with emphasis on transparency for employees.

Avoiding unreasonable risk for employees
Employees should be warned, in the interests of transparency, of the risks of financial participation resulting from fluctuations in income from schemes or from limited diversification of investments.

Distinction between wages and salaries and income from financial participation schemes
Financial participation is no substitute for pay. It fulfils a complementary role, particularly where worldwide competition makes it difficult to raise salaries above those of competing firms.
Accordingly, the introduction of financial participation should be no barrier to the conclusion of collective wage agreements.
Moreover, it is necessary to make it very clear, in legal terms, whether income from financial participation schemes is exempt from certain charges and contributions which are sometimes levied.

4.2 Transnational barriers

Of the three types of obstacles to the growth of financial participation mentioned earlier, the Community takes the view that the first two, connected with differences in national incentives, particularly tax incentives, and the lack of legal clarity about payment of social security contributions on income from financial participation may require specific, targeted measures at Community level.

Differences in incentives, and the lack of them in certain Member States, will not be ironed out unless we organise gradual convergence between the national systems.

Such a convergence process could be facilitated by machinery, coordinated by the Commission, for the exchange of information, definition of common objectives and regular follow-up on the progress achieved by the Member States.

4.3 Community-level actions to promote financial participation

A number of actions can be taken within a transnational framework with a view to the aim of more extensive application of financial participation within the European Union. These could constitute the basis for an action plan to accompany the communication on financial participation with the objective, in particular, of encouraging introduction (or refinement) at national level of the general principles proposed by the Commission and dealing with the transnational obstacles referred to earlier.

In the run-up to European enlargement, the Commission might also promote measures in the candidate countries.

5. Conclusions and subject-matter of the consultation

The Commission firmly believes that only by raising awareness and achieving genuine commitment among all the parties concerned will it be possible to give impetus to the debate on financial participation at European level.
It accordingly requests the Member States, the Community institutions, the social partners, businesses, specialists in the field and all parties concerned to contribute to this consultation and convey their reactions.

The Commission would like, in particular, to receive contributions on the three basic strands of the consultation paper: the general principles, transnational barriers and Community measures.

The considerations and reactions of the parties concerned may also include responses to the following questions:

- should we plan for a Community initiative on financial participation?

- is it necessary to lay down general principles at European level - and if so, what principles - to encourage greater and more efficient recourse to financial participation schemes within the European Union?

- what measures, at Community level, should the Commission include in its communication and, more particularly, in its action plan?

- are the obstacles identified the most important ones and are there others?

- should other strands be added to the three main strands identified in the Commission's consultation paper? If so, what strands?

Comments may be sent in writing until 30 October 2001 to the following address:

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Directorate-General for Employment
Rue de la Loi, 200
B–1049 Brussels

Comments may also be sent by electronic mail.