Inter-University Centre Split/Berlin, Institute for Eastern European Studies, Free University of Berlin

The PEPPER IV Report:

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

Executive Summary

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Executive Summary

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".

The Summary version of this report is published in French, German and English language and is downloadable on the Inter-University Centre's website at www.intercentar.de together with the extended versions of the PEPPER III and PEPPER IV Reports which are published only in English. For rights of translation or reproduction, applications should be made to the Director of the Inter-University Centre.

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, 10 new EU Member States and 4 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 cooperation with a core-team of experts in the field of Financial Participation, i.e., Milica Uvalić (Perugia University) and Daniel Vaughan-Whitehead (International Labour Organisation). The extended Version of the Report contains 29 country profiles which were compiled by Natalia Spitsa and Stefan Hanisch using information from an international network of legal and economic experts. The European Commission's Directorate General Employment, Industrial Relations and Social Affairs and the Kelso Institute have supported the Benchmarking Project. The editing was supervised by Patricia Hetter Kelso.

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Financial Participation, State Intervention and the Financial Crisis

By the fourth quarter of 2008 the gathering world crisis struck Europe with full force, together with the other national and international financial systems. Confronted with the immense impact of an event widely unanticipated, both international institutions and national governments are now trying to prevent economies from sliding into a long and deep depression. State intervention in the private sector to rescue banks and other financial institutions is taking place on an unprecedented scale.[1] Triggered by the bursting of the American "subprime" bubble, the crisis Europe now confronts threatens not only its entire financial structure but calls the market economy itself into question.

The problem is how to employ these enormous funds, representing public resources, in ways that will contain and hopefully "cure" the crisis. "Socialising losses and privatising profits" is obviously not an acceptable solution. State subsidies should not be used to protect already well capitalised investors from investment risk; when taxpayers' money is involved, average citizens should benefit. In a word, the chosen expedients should tend toward a wider distribution of productive property rather than to accelerate a concentration which once again has proved to be dysfunctional. Here employee ownership and profit sharing, components of the real economy, can make a vital contribution to future economic stability and growth. By raising workers' income in a way that does not increase costs, employee financial participation channels market-sourced income into the pockets of would-be consumers who will use it to buy goods and services. This is especially important inasmuch as the crisis itself partly originates in insufficient consumer purchasing power, a condition intensified by the crisis itself, as the example of the American "subprime crisis" illustrates.

What inflated the "subprime bubble" and what made it burst?

"Subprime mortgage lending" had increased sharply since 2000; in 2005 it was running at about 500 billion USD a year.[2] In their search for new opportunities in the growing financial sector, investment banks began to buy "subprime" mortgages and repackage them for sale as a new financial product, i.e. asset-backed securities, to investors. Thus, in order to diversify the risk and to obtain good ratings, mortgages were bundled, bad "subprime" mortgages being mixed with good ones, and the resulting security (obligation) sliced up into tranches with different returns and risk levels for different investors.[3] The resultant financial products, "Collateralised Debt Obligations" (CDOs), were then sold to institutional clients all over the world. Minimum risk diversification for the investment bank required a certain volume of the mortgage bundles, the larger the better and the more profitable. For this reason investment banks encouraged local banks to lend to marginal debtors, offering these banks the opportunity to unload many of the loans either to private investors in CDOs or on one of the quasi-governmental housing agencies (Fannie Mae, Freddie Mac). The enormous and entirely uncritical absorption of CDOs – in substance nothing other than high risk securities labelled as solid investment and then rated between AAA and B – by the international markets exploded demand. The trade in these assets went far beyond what was

1 In Germany 400 billion Euro; in France 360 billion Euro; in the United Kingdom 550 billion Pounds; and in the United Sates of America 500-700 billion dollars.

2 See "With a pfffffffft or a fizzle" , Nov 8th 2005, The Economist Global Agenda

3 While less risky tranches received proper ratings, i.e., the "good" between AAA and A and the "not so good" between BBB and B the investment bank would retain the worst tranche receiving high interest rates in exchange. Often the ownership of these CDOs was transferred to an offshore shell company, called a "special purpose vehicle", which did not appear on the balance sheet of the bank.

necessary to cover the default risk, as investment banks started to gamble with virtual products, often very highly leveraged.

What made the bubble burst was not the fact that an increasing wave of hundreds and then thousands of small mortgage debtors suddenly started to default. It was rather the failure of the assumption that housing prices would continue to rise. This assumption had been the cornerstone of refinancing the "subprime" debt and the basis for allocating massive amounts of credit to debtors who, under stagnant or decreasing real estate prices, were unable to service these loans. Although the bubble was fuelled by low interest rates, the massive availability of credit and the resulting increase in demand, once housing prices peaked, rising interest rates[4] led to the burst. In brief, the expansion of credit that led to a decade of economic boom was never backed by a real increase in wages, purchasing power or any other factor of real value. The situation of the "working poor" and middle classes was thus unsustainable, based as it was on credit expansion rather than real income growth[5], an expedient which will become increasingly difficult to continue.[6]

Implications of the current crisis for policies supporting the expansion of employee ownership

European workers who may be affected by emergency policies will certainly want to know whether increased participation in ownership of the equity of the companies they work for constitutes a good long-term investment for them and their families, especially under current conditions. Referring to the US example again, Figure 1 shows the development of the Standard & Poor 500 index since 1950.[7] As the figure clearly illustrates, in the last 15 years we have seen two extraordinary speculative bubbles in the equity market, the first beginning in 1995 and ending with the dot-com crash of 2000, the second beginning in 2003. After such a long period of inflated equity prices, the current woes of world stock markets seem to have brought equity prices down to levels that leave them with a price-earning ratio that are actually below historical trends. This is certainly bad news for those who invested during the great bull market period and have seen a disastrous decline in the value of their shares. However, it is very good news for those with funds available to invest now. And so, employees who would benefit from policies implemented now to promote financial participation have much better prospects for appreciable rewards that will be subject to much less instability. Indeed, employee ownership will help stabilize capital markets, a welcome contrast to the destabilizing effect of speculative short term investment.

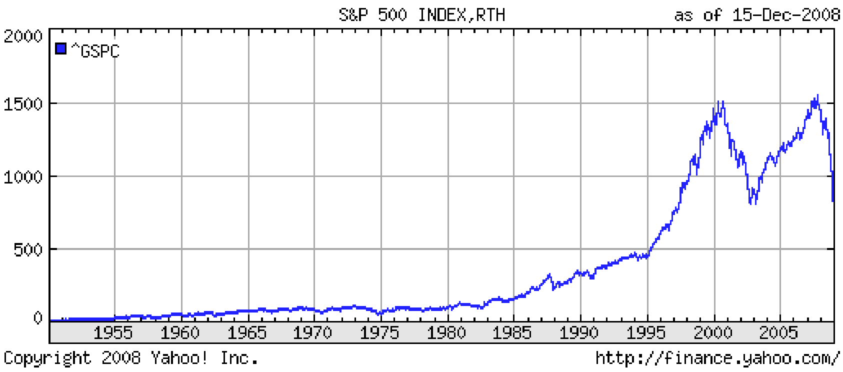

Figure 1. Standard & Poor 500 Index, 1950-2008

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4 Since "subprime lending" usually takes the form of variable-rate, interest-only and negative-amortisation loans, it increases exposure of both debtors and creditors to interest-rate changes.

5 While for the past several years, the inflation-adjusted total pay of the median American worker has not risen, credit card debt has been growing much faster than the economy: More than 8% in last year's third and fourth quarters and over 7% in May. See Geoff Colvin, "The next credit crunch" Fortune Magazine, 20 August 2008.

6 Credit card debt, like mortgage debt, gets bundled, securitised, and sold off by banks. Citigroup, one of America's largest credit card lenders, just reported that it lost 176 mln USD in the 2nd quarter through securitising such debt. With credit card debt getting riskier and banks unable to offload as much of the debt as before credit card issuers will be charging customers higher interest rates have less money to lend to cardholders.

7 The index follows the prices of 500 stocks of large firms traded on the New York Stock Exchange and NASDAQ.

"You either nationalize the banks or you nationalize the mortgages. Otherwise, they´re all toast."[8]

This brings us to the question of the form state intervention should take. The consequences of subsidising the financial sector, for example by "mopping up" toxic CDOs, i.e., buying them with taxpayers' money in order to clean up the balance sheets of banks, are unacceptable because this expedient gives perverse incentives and increases moral hazard by encouraging banks in their irresponsible behaviour. Further, tax revenues should not be used to benefit company shareholders at the expense of workers and the general public. Even though subsidies to bail out shareholders and avoid bankruptcy may indirectly benefit workers and the general public by stabilising the financial system, the long term effect is to further concentrate capital ownership in the hands of a few. Effective nationalisation of failing banks by capital infusion in return for state share ownership may not be as inefficient, but it also concentrates capital ownership, this time in the hands of the state. A better alternative is to increase employee financial participation in the subsidised company 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.

As an illustration of how this could work, consider the following hypothetical situation. Governments could adopt a regulation to the effect that, e.g., at least one-third of any funding that is provided for assistance to a stricken company must be funded through an ESOP-like scheme. If an automobile company or an airline seeks 1 billion Euro in funding, that company would have to adopt an ESOP-like scheme and at least 333 million Euro of the loan would be made to the company's Employee Stock Ownership Plan. The ESOP trust fund would then purchase newly-issued company stock at the value of 333 million Euro from the company. The company in turn would be obligated to make annual tax-deductible contributions to the ESOP trust to enable it to repay its loan over a 10 to 15 year period. Each year as this loan is repaid, a pro rata number of shares of company stock would be released and allocated to the employees. Alternatively, if the state directly purchases equity in a firm, it could insert clauses for their conversion into employee shares at some point in the future. Financing a bailout through an ESOP would increase both employee motivation and productivity as well as purchasing power.[9] Lastly, taxpayer funds are far more likely to be repaid if both management and labour have a vested stake in the success of the enterprise.

8 Nouriel Rubini as quoted by Stephen Mihm in NY Times of August 17, 2008 "Dr. Doom" http://www.nytimes.com/2008/08/17/magazine/17pessimist-t.html?ref=business.

9 An example of this approach is the Regional Rail Reorganization Act of 1973 that Senator Russell Long pushed through the US Congress. It mandated that as a matter of public policy, any federal funding of a "bailout" of private industry should be funded to the maximum extent feasible though the technique of ESOP financing, so that this federal funding would also serve to broaden the ownership of capital rather than to further concentrate it. This policy was followed in the Chrysler bailout, as the Chrysler Loan Guarantee Act of 1980 required the company to establish an ESOP.

Table of Contents

I. The Benchmarking Project, the Indicators Employed and the Current Situation in the EU-27 11
Jens Lowitzsch

1. Introduction 11
a) Recent Initiatives 12
b) To Address Both Challenges … 13
c) …In the Context in the Current Situation in the EU-27 15
2. Responding to the Data Deficit: The Benchmarking Project ...16
a) Aims 16
b) Approach 17
c) Specific Difficulties to be Dealt with 17
3. The Benchmarking Indicators 18
a) Sources 18
b) The Indicators and their Link to the Commission Principles 20
4. Overview of Financial Participation in the EU-27 22

II. Availability of Financial Participation Schemes in the EU Companies 29
Iraj Hashi and Richard Woodward

1. Percentage of Firms Offering Broad-Based Financial Participation to Employees 29
2. Financial Participation Schemes by Size and Sector 30
3. Percentage of Employees Covered 34
4. Percentage of Large (Listed) Firms with Employee Share Plans 36

III. Take-Up Rate of Financial Participation Schemes in the Workforce 37
Iraj Hashi and Richard Woodward

1. Percentage of Employees Participating in Financial Participation Schemes 37
2. Percentage of Employees Participating in Profit-Sharing Schemes with Pre-Defined Formulas on a Regular, Ongoing Basis 39
3. Percentage of Employees Holding Shares in Largest (Listed) Firms 39
4. Conclusions 40

IV. Taxation and Fiscal Support for Financial Participation 42
Jens Lowitzsch and Natalia Spitsa

1. The Problem 42
2. General Taxation of PEPPER Schemes in the EU 43
a) Employee Share Ownership 50
b) Profit-Sharing 52
c) Intermediary Entities 52
3. Specific Tax Incentives for PEPPER Schemes in the EU 53
a) Share-Based Plans 59
b) Stock Options 59
c) Cash-Based Profit-Sharing 60
4. Conclusions 62

V. The Path to a European Regulation 63
Jens Lowitzsch

1. Key Issues and Obstacles to Creating a European Concept 66
a) Focus: Legislating Financial Participation Schemes 66
b) Unanimous Decision vs. Majority Vote 67
c) Different Contexts, Different Approaches – The Building Block Approach 67
2. Options for Creating the Legal Foundations of a European Concept 68

a) Recommendation According to Article 249, Paragraph I, 1 ECT 68
b) Directive Level: Amending Existing European Company Law 69
c) National Level: Building on Existing National Company Law 70

3. Compliance with the Postulates of the European Policy-Makers 74

a) Achieving Competitiveness While Maintaining Diversity 74
b) The Building Block Approach: Meeting Essential Principles … 75
c) … and Overcoming Transnational Obstacles 76

VI. Summary and Recommendations 77

Jens Lowitzsch

1. Promoting PEPPER Schemes at the National Level 78

2. The Building Block Approach: Developing a Common Model for Financial Participation across the EU 79

3. PEPPER Schemes for SMEs: Employee Stock Ownership Plans (ESOPs) 81

4. Promoting PEPPER Schemes through Tax Incentives 83

5. Informing Governments and Policy-Makers about the PEPPER Initiatives 85

Bibliography 86

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). 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 10% to 18% and profit sharing schemes from 19% to 26% (both unweighted country averages). The percentage of company employees taking advantage of these schemes also is growing.

On the other hand, – despite 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 exacerbate this problem in future (for details, see Extended Report, 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, i.e., 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 Commission Recommendation. (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, i.e., 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 companies offer more opportunities for financial participation (CRANET) than employees actually utilize (ECWS). 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 these goals 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.

- Utilize 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 them optional avoids conflict with national law.

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

No cross country data targeting financial participation exists to date. This data vacume 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 the European Parliament recently launched a new initiative, manifested in the opinion of the Economic and Social Committee of 26 February 2003,[1] on the Commission communication "on a framework for the promotion of employee financial participation".[2] The European Parliament called on the Commission to submit studies on the issues raised in its Resolution of 5 June 2003[3]. 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 Plans). In his foreword to the study published in response to this request[4], the President of the European Parliament, Hans-Gert Pöttering, stresses 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.

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

2 COM (2002) 364 Final.

3 P5-TA (2003) 0253.

4 "Financial Participation for a New Social Europe" by *J. Lowitzsch et al.*, Berlin/Paris/Brussels 2008; the bookwas distributed in the European Parliament in French, German and English language.

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 […]." In 2006, in his foreword to the PEPPER III Report[5], 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.[6]

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, 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 initiatives[7] the latter has been fundamentally changing the "world of work" (see Extended Report, Part 3, Chapter II) leading to a growing demand for flexibility at the level of the individual firm.

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 Extended Report, 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, i.e., in profits and ownership stakes in European enterprises.

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.[8] The Commission's new Flexicurity approach[9] also looks at flexibility in terms of enhanced mobility in the labour market and in work organisa-

5 *J. Lowitzsch* , "The PEPPER III Report – Promotion of Employee Participation in Profits and Enterprise Results in the New Member and Candidate Countries of the European Union", Berlin 2006.

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

7 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 "Financial Participation for a New Social Europe" by *J. Lowitzsch et al,* Berlin/ Paris/Brussels 2008.

8 The European commission in its Joint Employment Report addresses this issue of flexibility, calling for an adequate flexibility for both workers and employers (EC, 2006).

9 As defined in the recent EC Communication "Towards Common Principles of Flexicurity: More and better jobs through flexibility and security", COM (2007) Final (27-6-2007).

tion. Table 1 contains a typology of work flexibility. Locational flexibility (or flexibility of place)[10] was added to the classical types of flexibility[11], i.e., 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 firm (as, e.g., in the case of outsourcing) or to its ability to 'expel' workers and thereby 'externalise' them.

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 ➢ 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.

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.[12] 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 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 Extended Report, Part 3, Chapter II).

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

10 See C. Wallace "Work flexibility in eight European countries: A cross national comparison", Sociological Series 60, Vienna, Institute for Advanced Studies, 2003.

11 The definition of flexibility proposed by *J. Atkinson* and *N. Meager* in 1986 distinguishes external numerical flexibility (contractual), internal numerical flexibility (working time), functional flexibility (organisational) and financial flexibility (wages).

12 *H. Chung, M. Kerkhoffs, P. Ester*, "Working time flexibility in European companies" European Foundation for the Improvement of Working and Living Conditions, Dublin 2007.

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[13] 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, more than 19% 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, 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.[14] 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 for PEPPER schemes, which in turn has spread their practice. This suggests a clear link between national attitudes, legislation and diffusion (see Extended Report, 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 countries[15] (see the PEPPER III Report). Very few laws specifically address employee financial participation, and these refer almost exclusively to employee share ownership[16]; legislation on profit sharing is rare[17]. 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 incidence of 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

13 While from 2003 until 2007 corporate and capital income rose by 37.6 per cent, the average employee income increased only by 4.3 per cent, said Minister of Finance Peer Steinbrück of Germany, cited "Mitarbeiter sollen am Unternehmenserfolg teilhaben" Die Welt Online, 27 August 2008.

14 Profit-sharing bonuses have increased from 3.1% in 1996 to 4.5% in 2003 of total pay, while "participation" schemes from 3.8% to 4.6%.

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

16 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 buy-outs; leasing; mass privatisation, and ESOPs and ESOP-type schemes.

17 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.

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.[18] 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.

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, 10 New Member States /4 Candidate Countries), and utilizes 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, i.e., 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

18 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).

PEPPER reports. It digests their results and data from previous studies (EWCS, Eiro, CRANET, EFES).[19] 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 (i.e., between PEPPER I, II and III) that currently prevent a full profiling of financial participation policy and practice;
- 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; the PEPPER IV Report was presented in Brussels and in Strasbourg to the European Commission and Parliament in May 2008.

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 (i.e. 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 "mini survey" of our project partners, additional indicators were added. For individual country's National Sources (see Extended Report, 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 ex-

[19] 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).

perts had classified at the end of 2003.[20] 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.

3. The Benchmarking Indicators[21]

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 firm performance[22], 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 employees[23] undertaken by the Cranfield School of Management (Cranfield University, U.K.) 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 FP 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).[24] Because of the postal nature of the survey, the response rate is rather low (16% 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.[25] 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

20 Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, December 2003.

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

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

23 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.

24 The number of companies in the countries of interest to this study was 5214.

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

FP in all member and candidate countries of the European Union, we undertook mini-surveys in seven of the missing countries (Latvia, Lithuania, Malta, Poland, Portugal, Romania and Croatia).[26] The mini-surveys consisted of a smaller number of firms in each country 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.[27] It is essential to note that the CRANET Survey does not indicate the incidence of FP schemes in companies but only their availability. Furthermore, for the purpose of this research, we have been concerned with broad-based FP schemes (i.e., schemes covering more than 50% of employees) in private sector companies only, as profit sharing or share ownership are largely not applicable to public sector organizations (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% in 2005)[28]. As with the CRANET Survey, only a small part of this investigation is related to FP. The previous round of this survey took place in two waves – in 2000 for the EU15 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 FP 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 FP 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.[29]

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26 Another survey is currently underway in Ireland (expected to produce comparable information). The mini-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 excluded from the benchmarking exercise altogether. Ireland was of course included in the 1999 CRANET.

27 The planned number of firms in each of these counties was 100 in larger and 50 in smaller counties, 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.

28 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.

29 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'.

(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 of this database consists of all listed companies with a market capitalisation of at least 200 million Euros and large non-listed employee owned companies (those employing more than 100 people with employees owning more than 50% of shares). The former group consists of 2270 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%) 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 sets 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'[30]. 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 (manages and three non-managerial groups). In terms of the all-employees criterion, the assumption is that organisations that

[30] COM (2002) 364 Final, 5 July 2002, pp. 3, 10.

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 4th EWCS asks whether 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.[31] 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 profit sharing; **EA** in favour; **[B]** Since 1982, legislation for ESO; amendment 1991; since 1999 legislation for stock options; since 2001 new law on ESO and PS.	**All plans:** EmpC max.20% of after tax profit / year; max.10% of total gross salary; **ESO:** NCL - discounted ES in JSC, financing by firm possible; in capital increases: max. 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 employee participation; **[B]** Employee Funds discus-sed in 70s/80s, PS popular; later support for ESO and SO; in 2000s Government support for share-based schemes.	**ESO:** NCL - ES in JSC: discounted, max. 10% of salary/year, 7-year holding period, free max. 8,000 DKK/year; 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; **PS:** NCL - SPS; NTL - max. 10% of annual salary; **SO:** NTL - broad-based max. DKK	2005 Cranet: **ESO** 36%, **PS** 7.3%; 2005 EWCS: **ESO** 2.4%, **PS** 6.4%; **SO** 2005 Cranet: 2%; EU-Report 2003: 20% of 500 largest firms by 1999, 1/3 of quoted firms 2000.

31 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
		8000, 5-year holding period; individual max. 10% of annual salary or max. 15% difference exercise price / market price.	
Germany	**[A] TU** sceptical / partly hostile because of “double risk”; **EA** support individual firms **[B]** Traditional focus on savings plans (total capital higher than that of ES-firm plans); FP since 2006 on political agenda of all parties.	**ESO:** NCL - discounted ES in JSC, financing by firm possible; state savings bonus of 18% of max. 400 EUR (72 EUR/year) invested in employer stock; no tax / SSC on max. 135 EUR / year employer matching contribution; **PS:** None **SO:** NCL - in capital increase, nominal amount restricted to 10%, that of increase to 50% of equity capital.	2005 Cranet: **ESO** 11%; **PS** 45%; 2005 EWCS: **ESO** 0.8%,**PS** 5.3%; 2005 IAB: **ESO** 3%, **PS** 12%; 2003 WSI: **PS** in 1/3 of firms; **ESO:** 2006 AGP, 3,000 firms, 2.3 mln. empl., 19 bln. EUR; **SO:** EU-Report 2003, in over 2/3 of DAX-listed firms.
Greece	**[A] TU** moved from scepticism to support in 1980s; **EA** indifferent, low priority not a current topic; **[B]** Some regulations on CPS (1984) and ESO (1987); since 1999 more attention on SO; not a current issue.	**ESO:** NCL – ES in JSC discounted or free; within capital increase for 3years not transferable, up to 20% of annual profit; NTL -no PIT/SSC on benefit; **SO:** NCL - free/discounted; NTL - taxable at exercise; tax exempt if qualified plan; **PS:** NTL - max 15% of company profits, 25% of employees’ gross salary; no PIT, but SSC.	2005 Cranet: **ESO** 23,6%; **PS** 9.4%; 2005 EWCS: **ESO** 1%, **PS** 2.8%; **SO:** 2005 Cranet 2%; **SO** EU-Report 2003: only a limited number of firms.
Spain	**[A]** Low priority: **TU** oppose income flexibility; **EA** ambivalent, fear information disclosure requirements; **[B]** Long tradition of social eco-nomy: COOPs (new law 1997) and **EBO**; **PS** supported in 1994 then shift to **ESO/SO**; active support.	**ESO:** NCL - ES/SO in JSC, financing by firm possible; NTL - tax benefits on PIT after 3-year holding period; **PS:** NLL; **SO**: NTL - after 2-year holding period 40% reduction of taxed plan benefit; **EBO:** ‘Workers Companies’ with more than 51% ESO, 10-25% of profits in Reserve Fund; NTL - if 25% reserve, tax exempt from capital transfer tax; tax on formation/capital increase, notary fees.	2005 Cranet: **ESO** 5.7%, **PS** 17%; 2005 EWCS: **ESO** 0.5%, **PS** 6.4%; **ESO**: 2003 CNMV 20% of large firms with share purchase plans; **SO:** 2005 Cranet: 19%; EU-Report 2003: plans in 40 firms of which 1/2 in IBEX 35; **EBO:** 2003 Heissmann, appr. 15.000 ‘Workers Companies’.
France	**[A] TU** show mixed attitudes: sceptical but actively invol-ved, favour if not substitute to pay; **EA** generally in favour, esp. if voluntary; **[B] PS/ESO** strong continuous support since 1959; also in privatisations; climate FP-friendly, focused policy.	**ESO:** PrivL - 5% ES-reserve, max.20% dis-count; NCL - discounted ES in JSC, finan-cing by firm possible, also capital increase; Save-as-you-earn schemes; NTL - flat rate tax of 7.6% and 10% on returns, no SSC; **SO:** NCL - capital increase; NTL - tax on exer-cise gain 26-30% after 4year 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 firm savings-scheme/fund after 5 year holding period.	2005 Cranet: **ESO** 34%, **PS** 92%; 2005EWCS: **ESO** 5.3%,**PS** 12%; 2004 FONDACT: DPS covered 53% of non-agriculture private sector firms employees (i.e. 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.

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
Ireland	**[A] EA** strong support; **TU** support if financial and intrin-sic reward to employees; managers / employees pragmatically motivated; Lobby groups / Institutions e.g. banks for **ESO;** **[B]** Support in privati-sation; improvements in 1995 and 1997; promot-ing voluntary adoption of SPS, e.g. Approved Profit-Sharing Scheme (APSS).	**ESO:** PrivL - 14.9% ESOT-stock paid for by loan/by state; NCL - ES/SPS in JSC, finan-cing by firm possible; NTL - New Shares: limi-ted PIT tax base deduc-tion for Empl., 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 in-centives 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, recent-ly interested in topic **/ EA** mostly supportive; **[B]** Trilateral agreement 1993 supported **PS**; then shift to support **ESO/SO**; recently discussed on political agenda.	**ESO:** CivC - discounted ES in JSC, fi-nancing by firm possible; in capital in-creases deviation from pre-emption rights and preferential "ES" possible; NTL - PIT exemption up to max 2,065 EUR after 3-year holding period; **PS:** NCL - no SSC on max. 5% of total pay; **SO:** NTL - PIT exemption up to max 2,065 EUR after 3-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, approx. 6% of employees involved.
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 firm 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, esti-mates 25% of firms - mainly financial sector; **ESO:** n. a.
Nether-lands	**[A] TU/EA** generally in favour; **TU** support if supplement to pay, prefer PS to ESO; **[B]** Traditional focus on savings plans; sup-port for SO in 2003.	**ESO:** NCL - ES in JSC, financing by firm 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; **IEnt:** Qualified Savings Funds.	2005 Cranet: **ESO** 20%, **PS** 44.8%; 2005 EWCS: **ESO** 1.5%, **PS** 13.8%; **PS:** 3 Mln. participants in 2000; **SO:** 2005 Cranet 4%; EU-Report 2003, more than 80% of all listed firms.
Austria	**[A] TU/EA** currently support FP and cooper-ate; diffe-rent 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; fi-nancing by firm possible; NTL - PIT/SSC allowance for benefit; CGT or ½PIT for dividends; tax exemption for share sale gain; **IEnt:** NCL - Empl. Foundation: EmpC buys own stock, sheltered in IEnt, divi-dends paid out; NTL - EmpC: contribu-tion to IEnt, setting-up/ operation cost deductible; IEnt: tax allowance on contri-butions; Empl.: CGT on dividends;	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%

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
		SO: NCL - capital increase: nominal amount max.10%, increase max.50% of equity capital; max.20% of equity capital for total amount of shares receivable; NTL - 10% of benefit/year, max.50% of total benefit tax free and carry forward of taxation for the remaining amount; **PS:** None	
Portugal	**[A] TU/EA** Indifferent, low priority: **TU** prefer PS to SO; **[B] ESO** mainly supported in Privatisation, esp. around 1997; not on the Agenda; FP is generally ignored.	**ESO:** PrivL - discounted ES; NCL - ES in JSC, financing by firm possible; in capital in-crease: suspension of pre-emptive right of shareholders for "social reasons" possible; **PS:** NLL - not remuneration, no SSC; **SO**: NTL – 50% of share sale gain liable to PIT.	2008 PEPPERIV: **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.
Finland	**[A] TU / EA** generally support FP, especially desire to improve the environment for personnel funds; other forms not discussed; **[B]** Discussions on FP since the 1970s; 1989 law on Personnel Funds (major form until now).	**ESO:** NTL - discount tax free, no SSC; tax relief for dividends; **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%/year can be withdrawn; NTL - 20% of payments to employee tax free; earnings of fund tax free.	2005 Cranet: **ESO** 14%, **PS** 66%; 2005 EWCS: **ESO** 0.7%, **PS** 11%; **PS:** 2007 54 Personnel Funds with 126,000 members; **SO:** 2005 Cranet 5%; 2003 EU-Report: 84% of companies listed at Helsinki Stock Exchange.
Sweden	**[A] TU** neutral / opposed, advocated Wage Earners' Funds; **EA** favour PS for wage flexibility, but no active support; **[B]** From 1992–97 tax incentives for PS in firms; since then no support.	**ESO:** NCL - ES in JSC, financing by firm possible; in capital increase suspension of pre-emptive right of shareholders possible; **PS:** Cash-based none; NCL - share-based "Profit-Sharing Foundations": 1/3 of emplo-yees on similar terms, after dissolution assets to be distributed; NTL - for the employer 24.26% payroll tax instead of 32.28% SSC; **SO:** None.	2005 Cranet: **ESO** 16%, **PS** 26%; 2005 EWCS: **ESO** 1.6%, **PS** 15%; **PS:** 2003 Heissmann: 15%; Wage Earners' Funds created in 1983 were abolished in 1991.
UK	**[A]** Climate FP friendly and supportive; **TU** involved, but reservations: prefer SO to PS; **EA** positive, favour flexibility with regard to form of schemes; employees interested; **[B]** Long tradition of FP, esp. ESO and ESOP; now more active support for SO i.e. SAYE and Sharesave; 2000 new of Enterprise Management Incentives EMI; very little participation in decision-making.	**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; **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 - Empl. Benefit Trust); **ESOP:** NCL - max. £ 125/month shares for pre-tax salary in Trust, EmpC max.2 matching shares / share worth max. £ 3,000/year; NTL - shares exempt from income tax and SSC after 5 years; EmpC contribution to trust tax deductible; **PS:** NTL - approved PS; tax benefits abolished in 2002.	2005 Cranet: **ESO** 19%, **PS** 13%; 2005 EWCS: **ESO** 1.9%, **PS** 6.4%; 2006 ifsProShare: **ESO/ SO** approved plans in 5,000 firms, some with **ESOP**s; SIP in 830 firms; **SPS:** 2002 1 Mln. empl. under approved schemes, average/ head less than £ 700; **SO:** 2005 Cranet: 2%; 2006 ifsProShare: Savings-Related Plans in 1,300 firms, 2.6 mln. empl.; Company Plans in 3,000 firms; EMI in 3,000 firms.

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 Empl.
Bulgaria	**[A] TU** open to FP, **EA** indifferent; not a current topic on either of their agendas; **[B] ESO** strong support 1997-2000 since then ignored; in 2002 PrivL incentives abolished; FP gen. 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-Priv, 4-5% Cash-Priv; 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 firm 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 firm 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 privatis. 20%) of firms majority empl.-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 FP friendly but lack of concrete economic policy decisions.	**ESO:** PrivL - preferential sale; discount max. 10% firms assets and 150% of annual min. pay, instalments; Decree "*Egzisztencia*" Credit; NCL - specific "ES" in JSC, discounted / free, max. 15% of equity capital, financing by firm possible; since 2003 tax-qualified stock plans, first 0.5 mln. HUF free, then 20% tax, 3-year holding period; **SO:** NTL – PIT base is value at exercise; **ESOP:** ESOP-Law 1992; preferential credit; corporate tax exempt until end 1996; contribution to Plan max. 20% tax deductible; tax base lowered; **PS:** None.	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; **SO:** 2005Cranet 27%.
Latvia	**[A] TU / EA** indifferent to FP, not a current topic on their agendas; **[B]** Little support for **ESO** in PrivL; FP so far ignored.	**ESO:** PrivL - max. 20% ES; specific "ES" in state / public firms; NCL - preferential ES in JSC free / discounted, in capital in-creases max. 10% of equity capital non-voting stock; **PS:** None.	2005 EWCS: **ESO** 0.6%,**PS** 8.5%; **ESO:** PrivL 110.6 mln. vouchers to 2.5 mln. people; AI, 1999 16% of 915 firms dominant ESO but falling over time; **PS:** AI, 7% of firms; mostly IT, consulting, real estate.

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 Empl.
Lithua-nia	**[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 Par-liament and Govern-ment.	**ESO:** PrivL - 5%ES deferred paym. max.5 years; NCL - in corporations ES for 3 years non transferable/non voting, financing by firm possible; NTL - uniform 15% dividend tax; after holding period profits from sale of shares not taxed; **PS:** None.	2008 PEPPERIV: **ESO** 4%, **PS** 36%; 2005EWCS: **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.
Malta	**[A] TU** support schemes in practice; FP not a current topic in national tripartite dia-logue; **[B]** FP collateral effect of nationalisation (80's) and privatisation (90's) not a current issue.	**ESO:** NCL – ES in corporations, exempt from prospectus/investment rules; max. 10% discount, financing by firm possible; NTL - SO only taxable at exercise; **ESOP:** Trust Act refers to FP; taxed 15% interest / 10% investment; **PS:** mentioned in NLL.	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 (Ship-yard 1,761 employees); private (foreign) firms, mostly reserved for management.
Romania	**[A] TU** support indiv. cases; **EA** avoid topic; Tripartite council tack-led FP sporadically; **[B] ESO** supported until 1997 esp. **MEBO**; then support declined; current government gives little support and has other priorities.	**ESO:** PrivL - aim 30% of privatised assets Vouchers/ES; Vouchers free; 10% discount ES; NCL - ES in JSC, financing by firm possible; NTL - 10% dividend tax; **ESOP:** PrivL on Empl. Associations; leveraged transaction, preferential credit, max. interest rate 10%; **PS:** Ordinance – CPS compulsory in State/Municipal firms.	2008 PEPPERIV: **ESO** 6%, **PS** 42%: 2005EWCS: **ESO** 1.6%, **PS** 5%; **ESO:** ES 10% of shares issued at privatisation, decreasing;; **ESOP:** 1998 1/3 priv., most frequently used single method 2000: 2,632 firms, average 65% ESO, 1,652 majority ESO; **PS:** estimated 1.2 mln. empl in public sector covered.
Poland	**[A] TU/EA** indifferent to FP; managers / em-ployees pragmatically motivated; Lobby groups / Institutions e.g. banks for **ESO;** **[B]** FP Supported in early privatisation pe-riod; **ESO** in most privatisations, since mid-90's more and more ignored; **PS** in-creased emphasis in the context of collective bargaining agreements.	**ESO:** PrivL - 15% ES for free, 2 years non transferable, max. value 18 month min. pay, *National Investment Funds* 1995 (NIF), shares for symbolic fee; NCL - ES/SPS in JSC, financing by firm possible; NTL - uniform 15% dividend tax; **EBO:** PrivL - *Leverage Lease Buy-Out (LLBO)*, anticipated ownership trans-fer possible; interest 50% of refinance rate; interest part of lease payments are costs; Insolvency Law - buy-out right; **PS:** NCL - CPS/SPS in JSC.	2008 PEPPERIV: **ESO** 40%, **PS** 26%; 2005EWCS: **ESO** 0.7%, **PS** 5%; **ESO:** low and declining; AI in privatised firms, 2000 ca. 11.4% (1998 12.7%); NIF adult citizens 1 share in 15 funds; **EBO:** LLBO 2002 1/3 of priva-tisa-tions, most frequently used sin-gle method, 1,335 firms em-ploying 162,000, 14% over 250 empl; **PS:** AI, limited to management.
Slovakia	**[A] TU / EA** indiffer-ent to FP, not a current topic on their agendas; **[B] ESOP** discussed in 1990; **EBO** concept failed 1995; FP now generally ignored.	**ESO:** NCL - discounted ES and SPS in JSC; max.70% discount/ financing by firm possible; **PS:** NCL - CPS/SPS in JSC.	2005 Cranet: **ESO** 12.7%, **PS** 17%; 2005 EWCS: **ESO** 2.3%, **PS** 28%; **SO:** 2005 Cranet 10%; **ESO:** Insignificant; AI, banking sector / new privatisations; **EBO:** AI, in privatisation, usually management-led.

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 Empl.
Slovenia	**[A] TU/EA** very supportive to FP; Employee Ownership Ass. lobbies legislation; active support by Works Councils / Managers Ass.; **[B]** Strong political support to FP; draft laws 1997/2005 in parliament rejected; new Law on FP in 2008.	**All Schemes:** since 2008 70% tax relief for PS and ESO with 1-year holding period (100% relief with >3-year); max. 20% profits or 10% total salaries/year and max. 5,000 EUR / employee; **ESO:** PrivL - max. 20% ES for Vouchers; Vouchers free, shares for overdue claims; NCL - ES/SPS in corporations; discount / financing by firm possible; **EBO:** max. 40%, shares 4 years non- transferable; Worker association proxy organisation under Takeover Law; **PS:** PrivL - SPS in internal buy-out.	2005 Cranet: **ESO** 14%, **PS** 20%; 2005 EWCS: **ESO** 2.6%,**PS** 18%; **ESO/EBO:** 90% of privatised firms; CS 1998 60% majority. ESO while only 23% of capital (2004 18% strong decline); **PS:** CS, in statutes of 32% of firms, but unexploited in 22%; for board members 20% of listed firms; **SO:** 2005 Cranet 4%.
Croatia	**[A] TU** recently promote **ESO** in revision of privatisation; **EA** indifferent to FP; long tradition of Self-management; **[B] ESO** supported until 1995, since then FP ignored; ESOPs planned in new PrivL.	**ESO:** NCL - ES in JSC financing by firm possible; NTL - Dividends tax exempt; profits from sale of shares not taxed; **ESOP:** general rules of NCL apply; **PS:** None.	2008 PEPPERIV: **ESO** 34%, **PS** 29%; **ESO:** 2005 more than 10% of value of privatised firms (1996 20%); 2004 12% firms with majority ESO; **ESOP:** Survey evidence, ESOP elements in 9,4% of firms (52 out of 552), completed ESOP approx. in 1/4 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 firm profits/contributions; **PS:** NCL / CivC both CPS and SPS; max. 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, 1case 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 as 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 empl.); 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 Buy-out, 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 Buy-out; EmpC = Employer Company; ES = Employee Shares; ESO = Employee Share Ownership; ESOP = Employee Share Ownership Plan; FP = Financial Participation; IEnt = Intermediary Entities; JSC = Joint Stock Companies; MEBO = Management-Employee Buy-out; NCL = National Company Law; NLL = National Labour Legislation; NTL = National Tax Legislation; PIT = Personal Income Tax; PrivL = Privatisation Legislation; PS = Profit-sharing; 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

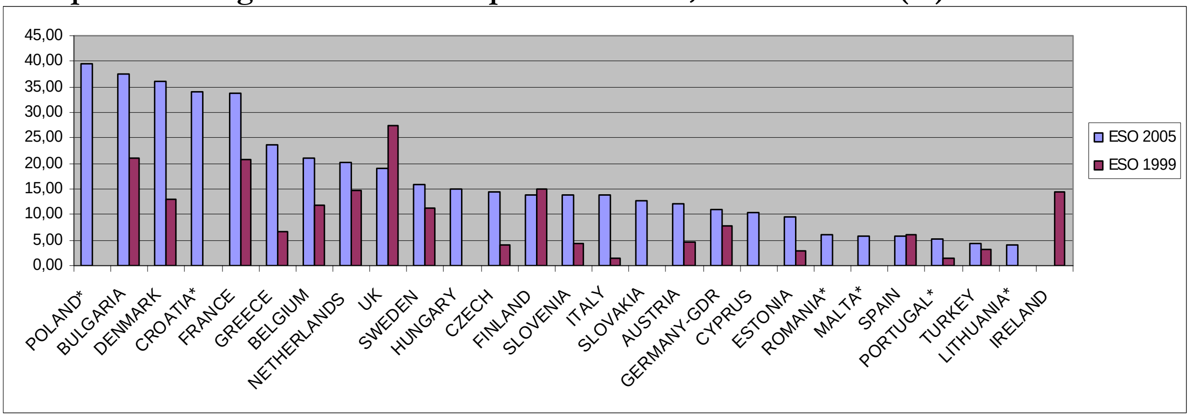
1. Percentage of Firms Offering Broad-Based Financial Participation to Employees

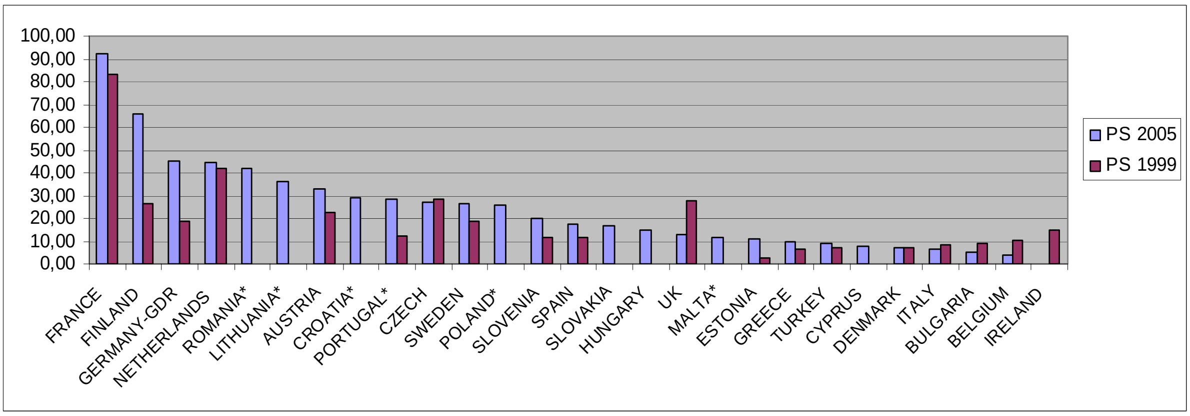
We begin with a look at broad-based employee share ownership (ESO) plans on the basis of data from the CRANET survey of companies (supplemented with data we collected in an independent mini-survey). Figure 1 shows the percentages of companies with broad-based ESO and profit sharing plans in 1999 and 2005 in 26 European countries (including six in which mini-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 unweighted average for all countries grew from 10 to 18%). If we look at the five leading countries in 2005 (with shares ranging from 33 to 40%), 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.

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 unweighted average for all countries grew from 19 to 25%. 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%; for PS from under 4 to over 92%). 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%. The lowest-ranked countries (with coverage under 10%), in ascending order, are Belgium, Bulgaria, Italy, Denmark, Cyprus, and Turkey.

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 firm's business; thus, there is no correlation between the two schemes.

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





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

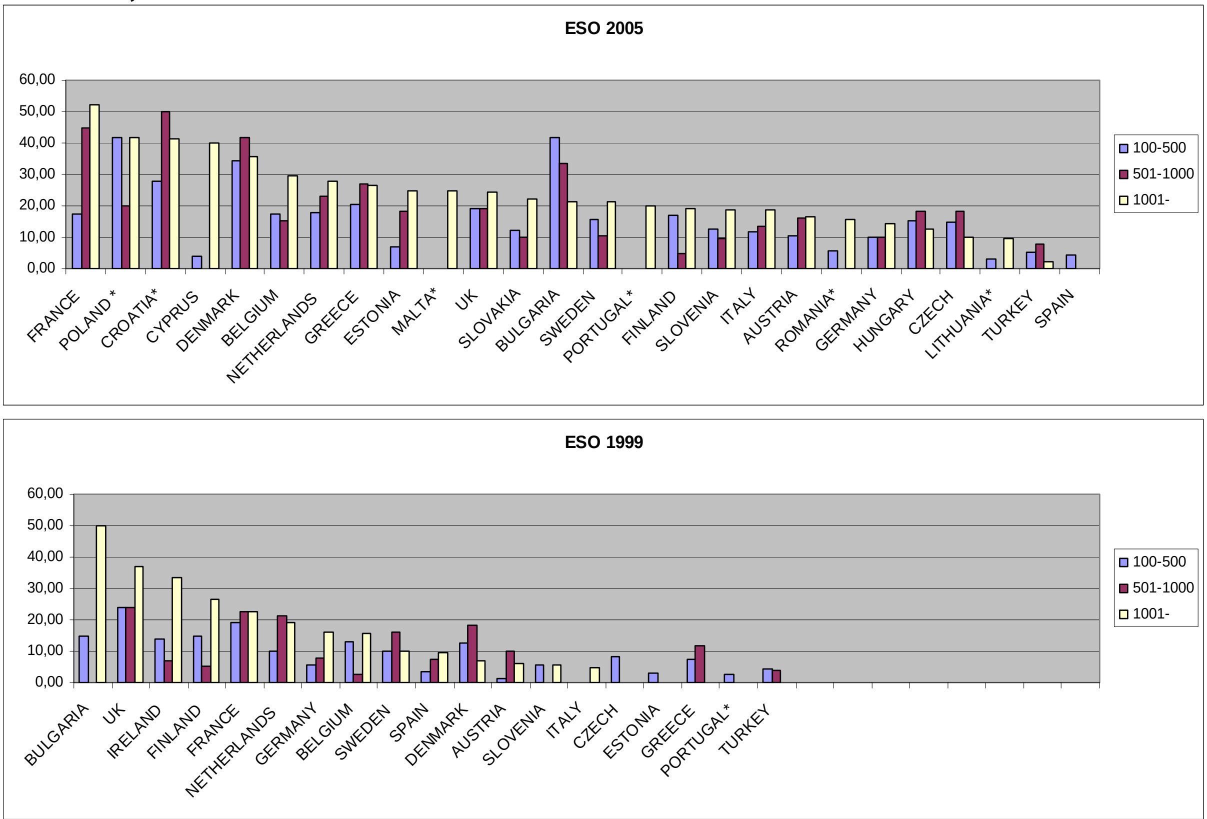
2. Financial Participation Schemes by Size and Sector

We are also interested in how employee financial participation might differ across firms with respect to firm 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 (501-1000 employees) and very large (1001 or more employees). For each country, we have calculated the proportion of firms in each size group offering an FP scheme. In general, it seems that both forms of employee participation are more prevalent in large and very large companies.

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), and in Poland and Bulgaria, where the medium-sized firms have the highest incidence of ESO. The situation was fairly similar in 1999.

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)

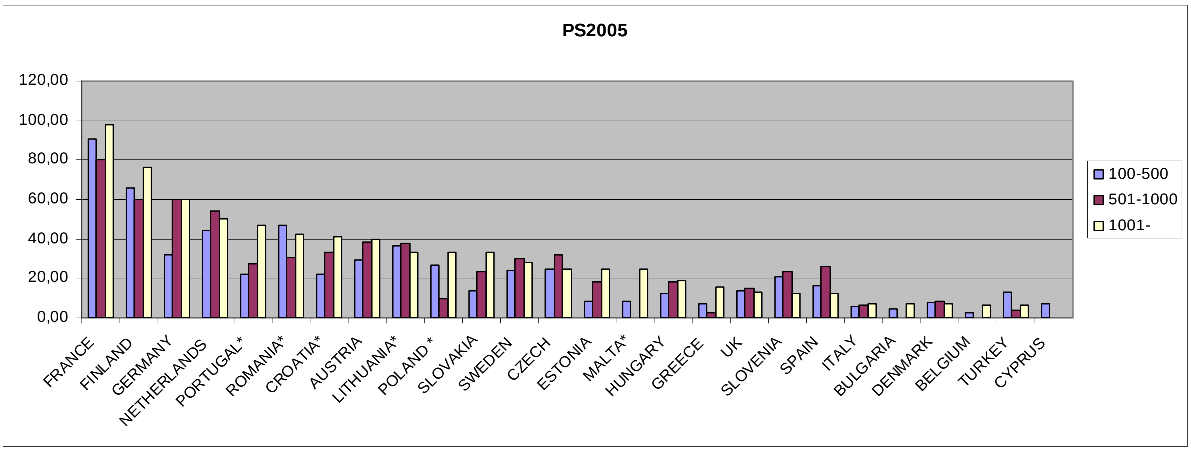
Figure 3 shows the data for PS. There is a much more even distribution across size classes here than in the case of ESO, although here again we see a prevalence (albeit a mild one) of the largest size firms. This situation appears to have changed little between 1999 and 2005.

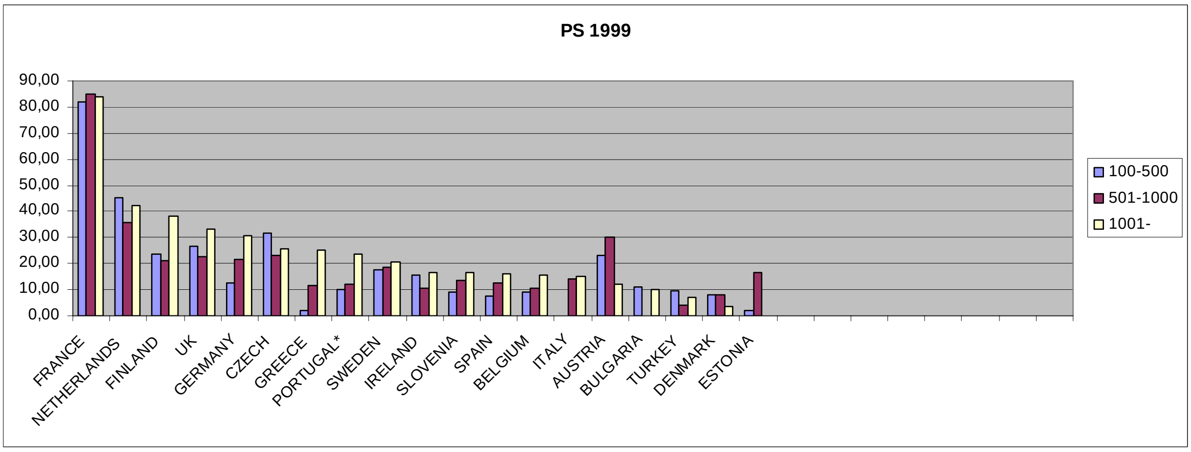
We present a sectoral breakdown of FP schemes in Figures 4 and 5, classifying firms into one of three main sectors: primary (agriculture and extractive industries), secondary (manufacturing), and tertiary (services). For 2005, we see a high average rate of incidence of both ESO and PS in the primary sector. However, this is mostly likely a statistical artifact due to the very small percentage of firms in the sample from that sector[32], and we see no such pattern for the 1999 data. The really interesting differences would be between the manufacturing (secondary)

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

and service (tertiary) sectors in which the vast bulk of the workforce in a modern economy is found.

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





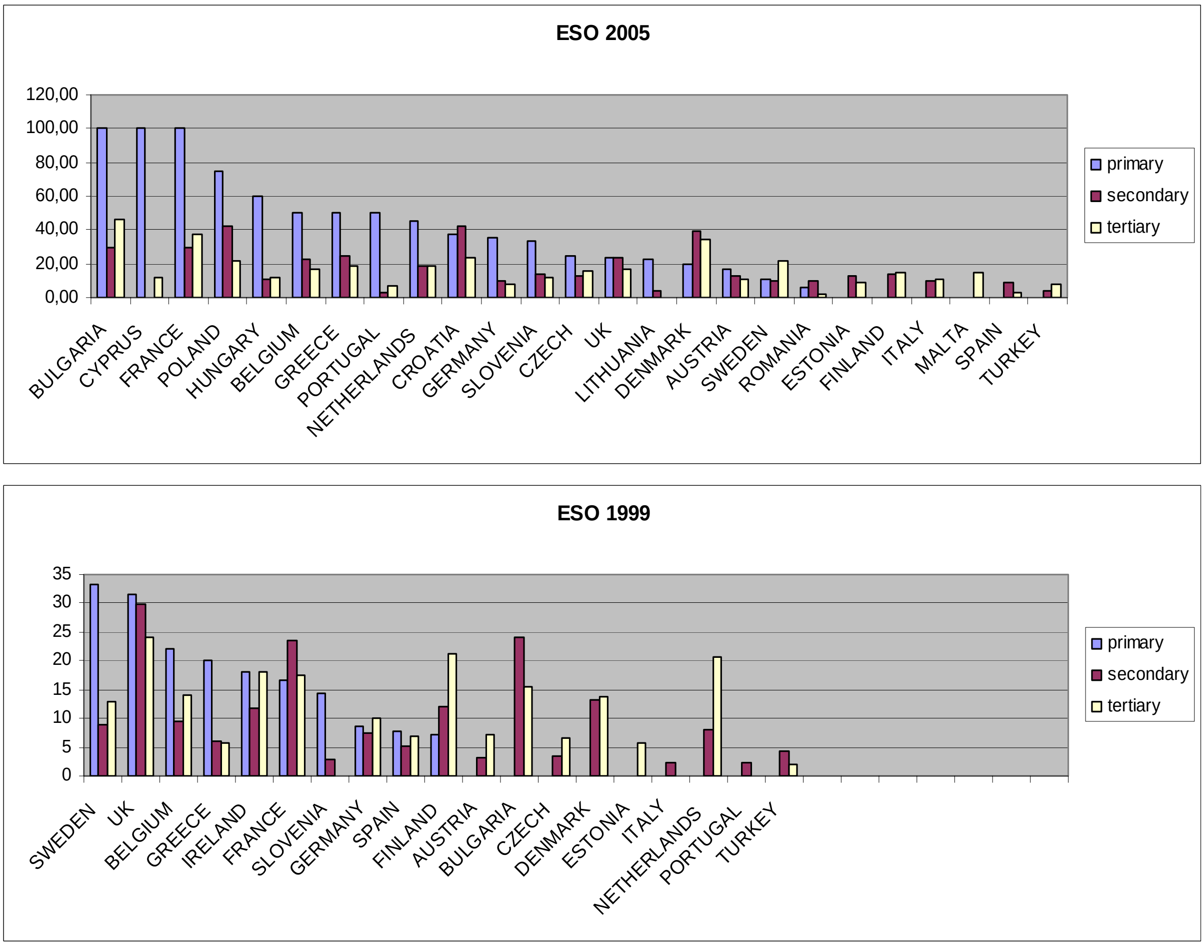
Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania - for 2007)

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 Sweden[33]. 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

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

drops in the share of firms offering ESO schemes in all sectors in the UK (which can also be seen in Figure 1).

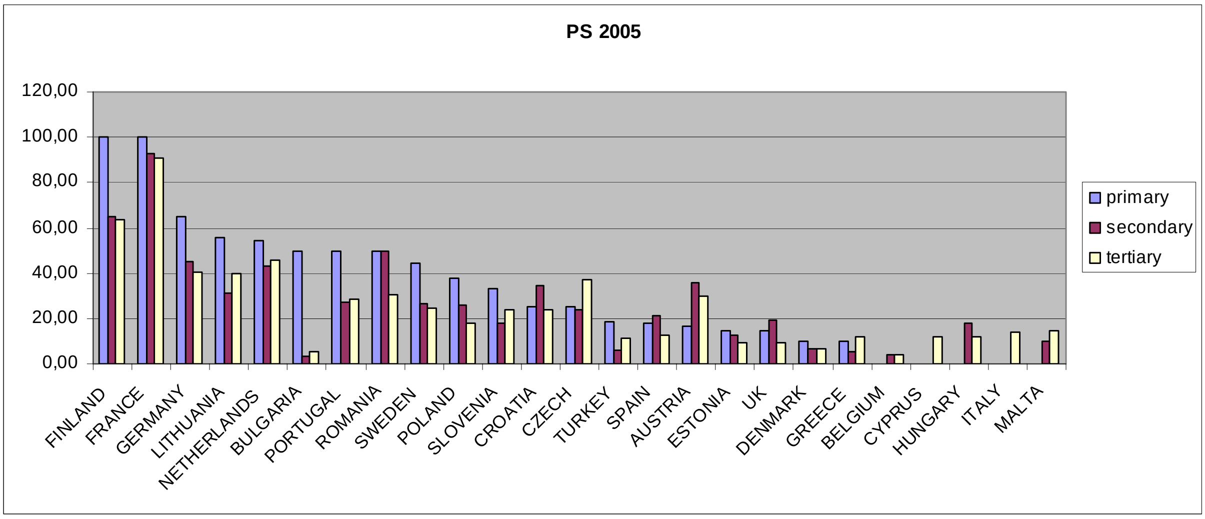
Figure 4. Percentage of firms in each sector offering employee share ownership schemes, 1999 and 2005

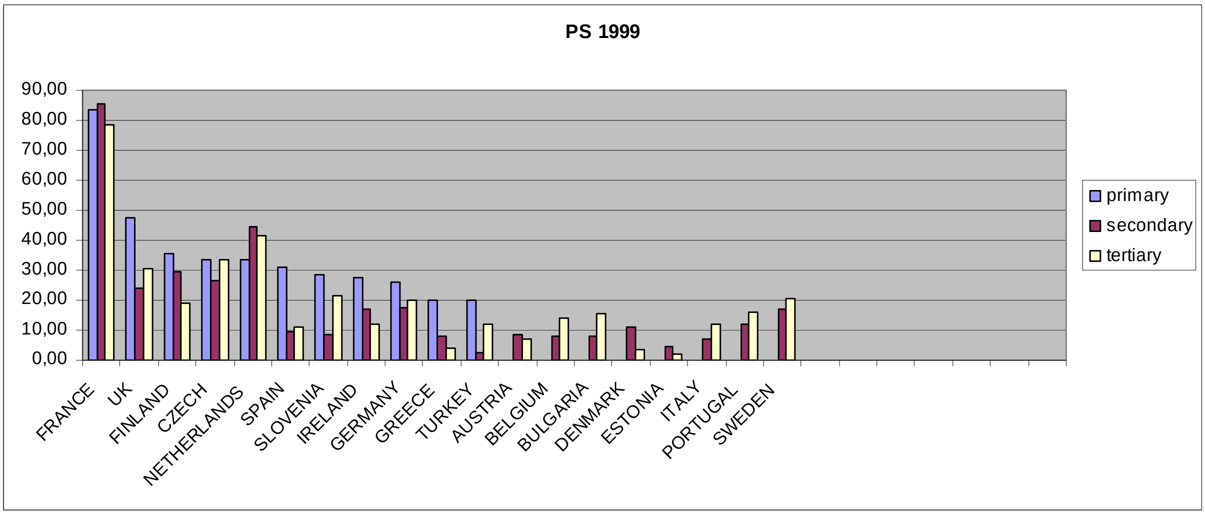


Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania – for 2007)

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 Covered[34]

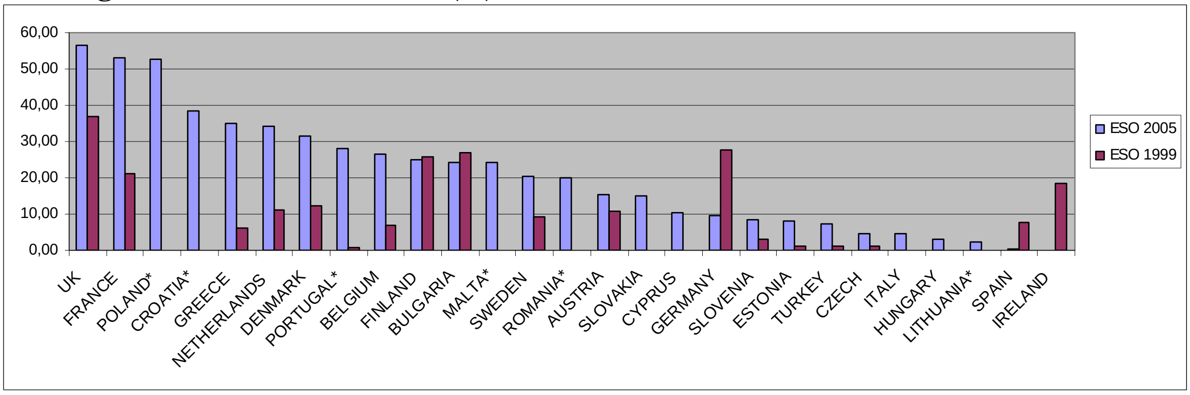
Next, we consider the share of employees in the sample covered by ESO and PS plans. This is an indicator of the extent to which broad-based employee financial participation plans have been adopted in each country. We present the data on this indicator in Figure 6.

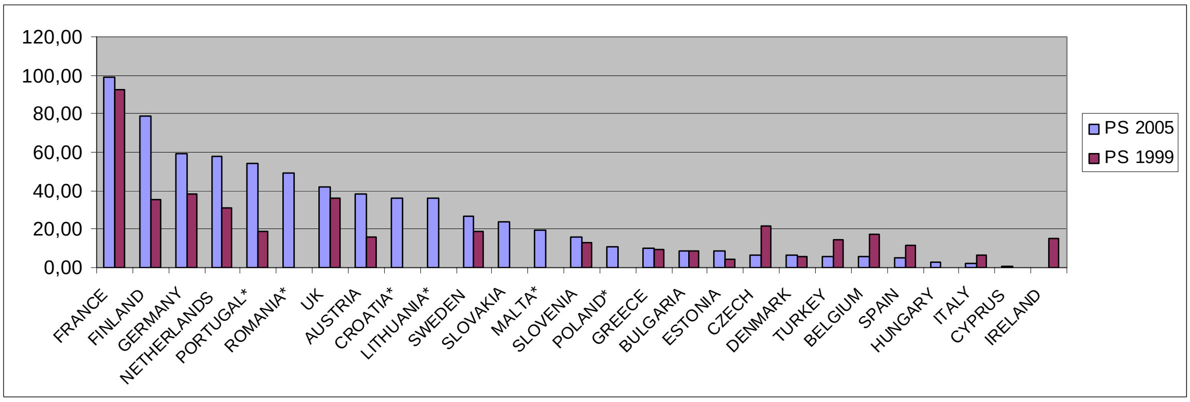
[34] The questionnaire contains questions on the proportion of different categories of employees (managers, professionals, administrative and manual) to whom FP plans are offered and on the share of these different categories in the total workforce of the company. This allows us to calculate the number 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 unweighted country average grew from 12 to 18% between 1999 and 2005). The three leaders (with employee coverage averaging over 50%) are the UK, France and Poland. There is a fairly long tail of low-ranked countries (with coverage averaging under 10%). 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 unweighted average for all countries rose from 19 to 24% between 1999 and 2005). Here again we have a much wider range, from 100% in France down to under 1% in Cyprus, and again we have a long tail of low-ranked countries. After France, other leading countries (with over 50%) are (in descending order): Finland, Germany, the Netherlands, and Portugal (Romania is just under 50%).

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





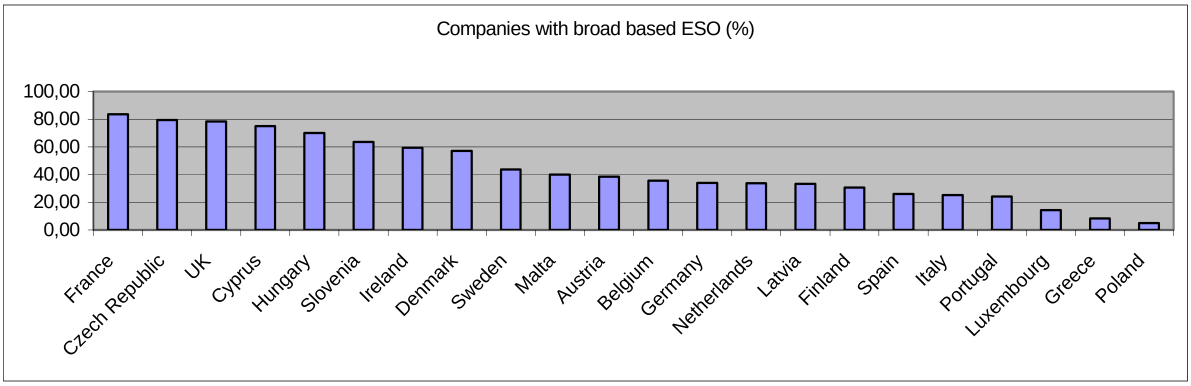
Source: CRANET data and own survey (Croatia, Lithuania, Malta, Poland, Portugal, Romania - for 2007)

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% and are therefore not included in the figure.)

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 mini-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).

Figure 7. Proportion of large EU companies with ESO schemes, 2007 (%)



Source: EFES

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.[35]

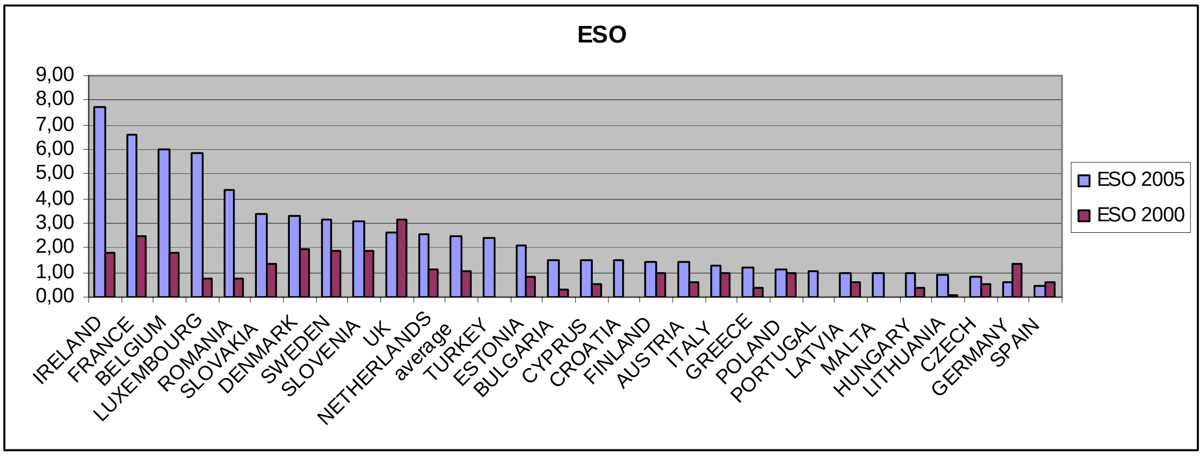
For ESO schemes, as in the case of the CRANET, we see growth in almost all countries (the unweighted average for all countries rose from 1.0% to 2.4%). The exceptions were the UK, Germany, and Spain (the UK and Spain saw declines in both the CRANET and EWCS surveys). The top countries (with participation rates over 5%) 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%), in ascending order, were: Spain, Malta, Latvia, Finland, Poland, Germany, Portugal, Lithuania, Greece, and Hungary (Spain and Lithuania ranked similarly low in both surveys; the low ranking of Portugal again confirms the low incidence of ESO in the Baltic and Iberian countries). We see strongly contrasting figures for Poland, which ranks highest in the mini-survey data and relatively low in the EWCS survey (and also very low in the EFES survey).

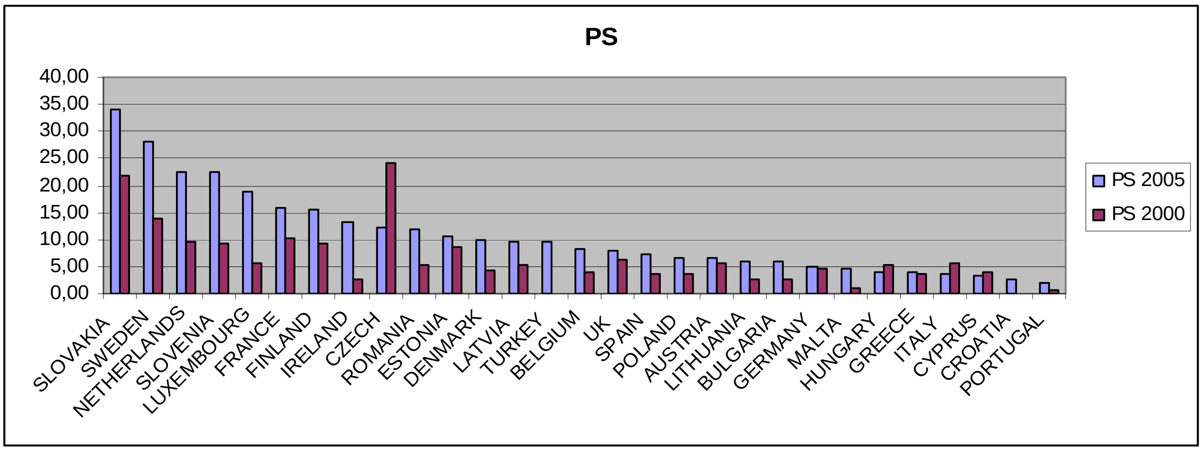
Turning to PS schemes, again as in CRANET, we see a much higher incidence than in the case of ESO (for ESO, the 2005 unweighted average for all countries was 2.4%, for PS 10.8, and the range for ESO was 0.5-7.7, whereas for PS it was 2.1-33.9). As in CRANET, we see growth in almost all countries (the unweighted average rose from 6.8% to 10.8%). 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%), in descending order, were: Slovakia, Sweden, the Netherlands, Slovenia, Luxembourg, France, Finland, Ireland, the Czech Republic, and Romania (with France, the Netherlands Finland and Romania ranking high in both the CRANET and EWCS surveys). The lowest-ranked countries (with participation rates under 3.5%), in ascending order, were: Portugal, Croatia, Cyprus, Italy, Greece, Hungary, Malta and Germany (Turkey, Cyprus, Greece and

35 The earlier survey was done in two stages: EU15 in 2000 and accession and other countries in 2001.

Italy ranked poorly 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 (%)





Source: EWCS

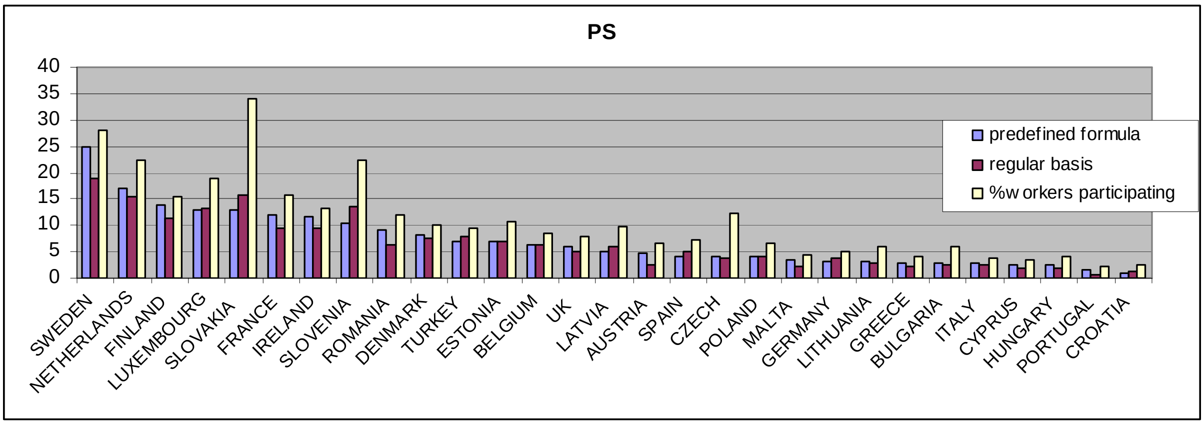
We also see high rates of ESO and PS for two countries for which recent CRANET data were not available: Luxembourg and Ireland. It must be remembered that the EWCS data does not distinguish broad and narrow schemes and, therefore, the high take-up rate of any scheme may only reflect the presence of share-based 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 in such schemes), 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, i.e. Slovakia and Czech Republic) as profit sharing. Using a strict definition of profit sharing, we see that in the best cases approximately 20% 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 mini-survey here is basically the same as it was there.

Figure 9. Profit sharing in 2005: A closer look



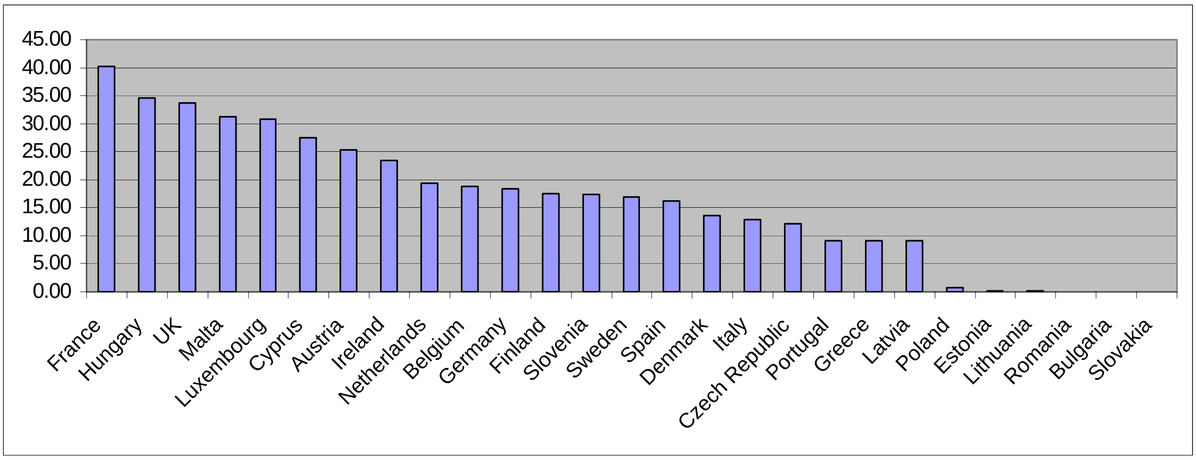
Source: EWCS

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 – i.e., 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% of the total workforce is actually participating in ESO plans (15.05% 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 section II. 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 (like those of CRANET and EFES) and surveys of individuals in the workforce (like the EWCS survey), it seems that FP 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 county'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 the privatisation programmes, have survived in some counties like Poland but gradually weakened in other countries in the process of secondary privatisation.

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 schemes than others, notably the Iberian Peninsula, the Baltic States, and the south-eastern corner of Europe (including Greece, Turkey and Cyprus). On the other hand, the data examined here seem to indicate that a West-East divide (i.e., significant differences between the old EU-15 member states on the one hand, and at least some of the 10 post-Communist 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.

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.[36] 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.[37] 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.[38]

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

36 Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, December 2003, p. 43 et seq. on obstacles to exportation.

37 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.

38 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.

whether some tax incentives are more effective than others irrespective of the country where they are offered.

A useful criterion for measuring the efficiency of tax incentives is the increase in the number of a specific form of employee financial participation immediately after a certain tax incentive is 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.[39] Moreover, potential harmonisation in this area is restricted by Art. 5 (2) ECT. On the one hand, the European Commission supports competition of direct taxes[40], 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 recognizes the importance of preventing unfair tax competition, especially in the area of corporate taxation.[41] 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

[39] 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.

[40] See COM (1980), 139; H. Weber-Grellet (2005): Europäisches Steuerrecht, München, p. 28, 152.

[41] 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, Heinrich (2005): Europäisches Steuerrecht, München, p. 163.

(CCCTB).[42] However, even if the CCCTB should be introduced in all member states, it will not apply to enterprises having no cross-border activities.[43]

Nevertheless, international tax competition is exerting considerable pressure, especially on corporate income tax rates, since the U.S. 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[44] (with some exceptions, e.g., France), and from capital to labour.[45] 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.[46] 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.[47] 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).[48] Dual tax systems represented, e.g., 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

42 See COM (2001) 582 of 23.10.2001; COM (2003) 726 of 24.11.2003; CCCTB/WP/046 of 12.12.2006; COM/2007/223 of 02.05.2007; 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 this case. The EU Tax Commissioner declared that the initiative can, if necessary, be implemented by eight member states through enhanced cooperation.

43 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 (2007): Einheitliche Bemessungsgrundlage der Körperschaftssteuer in der Europäischen Union, in: Monatsbericht des BMF, April 2007, p. 73.

44 See OECD (2005): Tax Policy Reform Conclusions, OECD Centre for Tax Policy and Administration, p. 6.

45 See Weber-Grellet, Heinrich (2005): Europäisches Steuerrecht, München, 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, Steffen (2004): Wer regiert in der Steuerpolitik?, Frankfurt am Main, New York, p. 35).

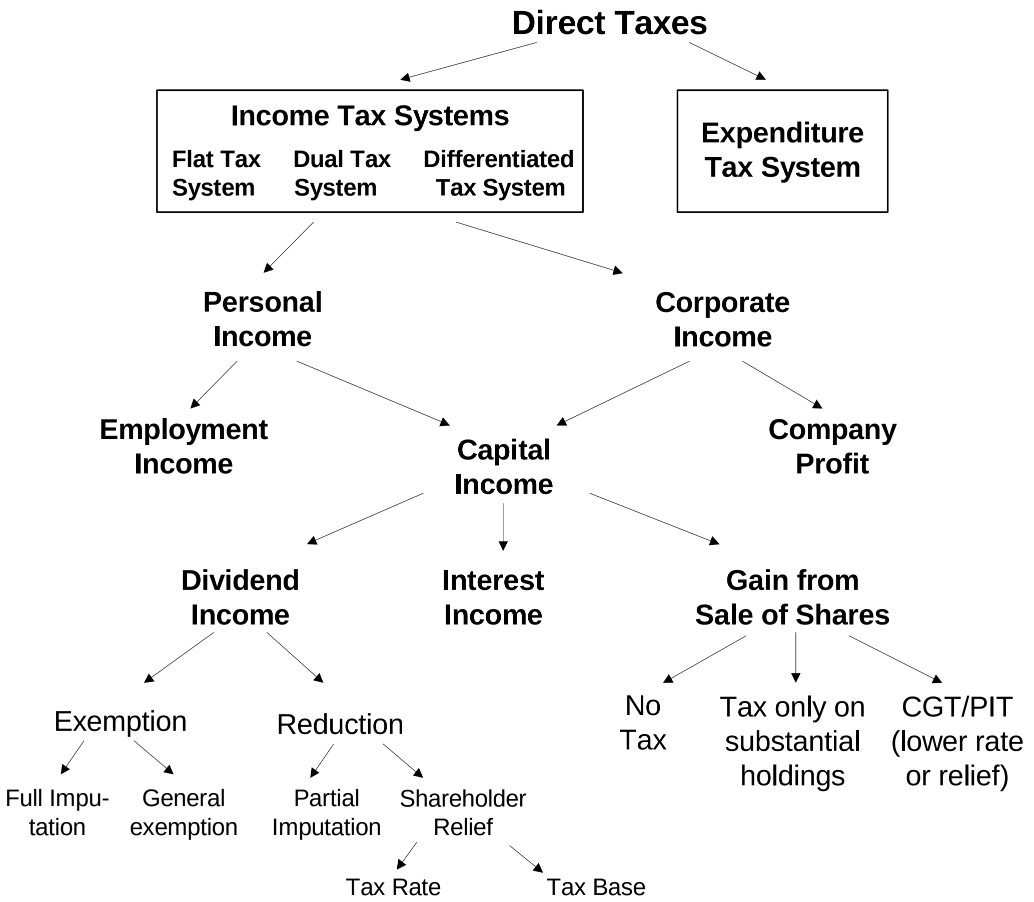
46 See OECD (2005): Tax Policy Reform Conclusions, OECD Centre for Tax Policy and Administration, p. 6.

47 However, Croatia has had an expenditure tax system from 1994 till 2000. I. a. 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.

48 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.

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 EU member states are different and none of the prevailling systems can be considered the best objectively.[49]

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. 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, e. g., Ireland, Latvia, Romania) are generally unfavourable.[50] Partial imputation generally

49 Most Western European countries cannot introduce a flat tax system because of the potential loss of revenue (see for Italy OECD (2005): Tax Policy Reforms in Italy, OECD Centre for Tax Policy and Administration, p. 4).

50 However, it depends on the personal income tax rate. I. a. the income tax rates in Ireland, Latvia and Romania are relatively low.

leads to a higher tax burden at shareholder level than full imputation and shareholder-relief[51] 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.[52] The best system for share-based plans is undoubtedly one that exempts dividend income from taxation by law (e.g., Croatia, Cyprus, Estonia, Greece, Slovakia) or through full imputation (e. g., 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 (e.g., Belgium, Portugal, Cyprus, partially Bulgaria, Malta); taxation only on substantial holdings (defined differently in different countries, e.g., 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 contributions[53] can either reduce the tax base of corporate and personal income tax or be calculated on after tax income (e.g., 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 below.

51 See Spengel, Christoph (2003): Internationale Unternehmensbesteuerung in der Europäischen Union, Düsseldorf, p. 23.

52 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, Christoph (2003): Internationale Unternehmensbesteuerung in der Europäischen Union, Düsseldorf, p. 25.

53 Whether social security is levied as a tax, e.g., 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.

Table 4. General taxation and compulsory social security contributions

	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	Emp.: overall rate 13,07% EmpC: overall rate 35%
Bulgaria	Shareholder Relief: reduced tax rate	10%	7%,	shares of public companies listed at Bulgarian Stock Exchange 0%	Progressive 20-24%, voluntary SSC deductible	Emp.: (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	Emp.: 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	Emp.: 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	Emp.: (cumulative) 12.5% EmpC: (cumulative) 35%
Denmark	Shareholder Relief: reduced tax rate	28%	28% Share Income Tax up to DKK 44300, 43% above; not for professional traders	28-43%	Progressive 5-26.5% central+29-35% sub-central; ceiling 59%	Emp.: 8% labour market tax EmpC: 0%
Germany	Shareholder Relief: reduced tax base	38.7%	General PIT + soli-darity surcharge 5.5%; tax base reduced to 50% of the dividend	0% for small long-term holdings; for substantial shareholdings General PIT on difference	Progressive 15-45.4% +solidarity surcharge 5.5%; limited by an absolute amount; pension and	Emp.: (average) 13-21.4% EmpC: (average) 20.5% Both limited by an absolute amount

[54] Data on corporate tax for 2007 are presented in the report of the German Federal Ministry of Finance of April 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: 20.07.2007.

[56] Data on capital gains taxation from the database at <http://www.deloittetaxguides.com>, Log-in: 20.07.2007.

[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: 20.06.2007.

[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: 20.06.2007.

	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]
			income (half-income system); no SSC	between 50% of proceeds and 50% of acquisition costs	health care contributions partly deductible	
Estonia	Tax exemption for shareholders ; exemption of retained profits from corporate tax	22% on distributed pro-fits	0%	General PIT	flat 22%; mandatory SSC deductible	Emp: 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	Emp.: 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, other-wise general PIT	15-45% savings income deductible	Emp.: 16.35% EmpC: 30.6%
France	Partial Imputation	34.4%	General PIT with tax credit of 40% + social levies (CRDS, CSG) - 11%	CGT 16%; on stock options 30-40%	Progressive 5,5-40%	Emp.: (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	Emp: 17% limited by an absolute amount EmpC: 32+ health care contribution
Ireland	Classical system	12.5%	20%	20%	Progressive 20-42%; voluntary SSC deductible	Emp.: 2-6% EmpC: 8.5-10.75%
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	Emp.: (cumulative) 9.2-10.2% EmpC: (cumulative) 32.08%
Latvia	Classical system	15%	General PIT	General PIT	Flat 25%	Emp.: overall rate 9%; EmpC: overall rate 24.09%, both from after-tax income

	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]
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%	Emp.: 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 ½ PIT rate for long-term holdings	Progressive 8-38%	Emp.: 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%	Emp.: 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%	Emp.: 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	Emp.: (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%	Emp.: average 22.2%; EmpC: average 20.6%
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%	Emp.: 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	Emp.: (cumulative) 17% EmpC: (cumulative) 30.35-31.35%
Slovakia	Dividend tax exemption for shareholders	19%	0%	General PIT	Flat 19%	Emp.: 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	Emp.: 22,1% EmpC: 16.1%

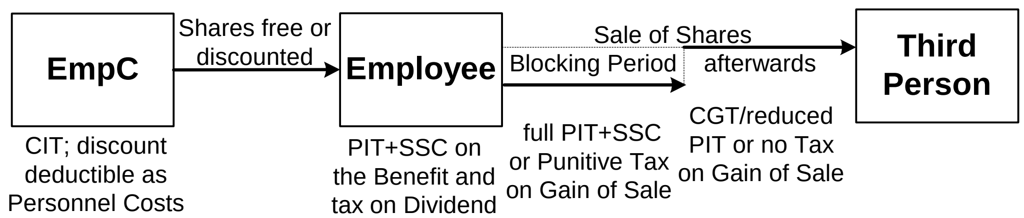
	Type of dividend treatment	CIT[54]	Taxation of dividends at shareholder level[55]	Taxation of share sale at shareholder level[56]	PIT[57]	Compulsory SSC[58]
Finland	Full Imputation	26%	"Investment Tax" 28%; generally no SSC	28%	Progressive 9-32% central+ 18,46% (average) sub-central; SSC deductible	Emp.: (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	Emp.: 7% EmpC: 32.28%
Turkey	Partial imputation	20%	15%; imputation credit of 50%	0% if held more than 4 years, otherwise general PIT	Progressive 15-35%	Emp.: 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%	Emp.: 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.

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"[59] is used as a vehicle. The 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

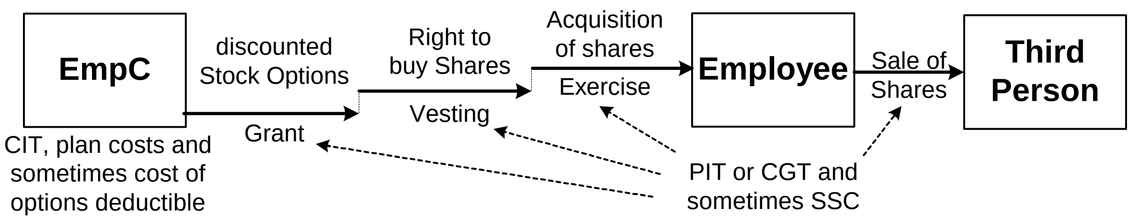


[59] The generic term used for intermediary companies, funds with a separate legal personality and trusts (in common law countries UK, Ireland and Malta), which accumulate distributed profits, hold, allocate and transfer shares, options or certificates of the employer company for employees, sometimes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

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.[60] 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.[61] 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 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.



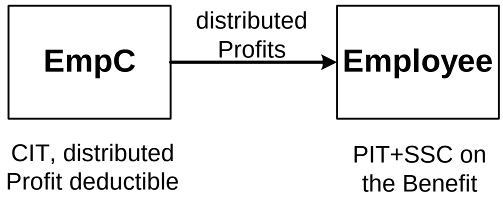
Upfront taxation at grant is connected with considerable risks, so that special tax relief such as reduced tax rate or tax base and exemption from social security contributions are necessary as compensation. Although it could be argued that stock option benefits should be considered as capital gains, 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, e.g., Belgium). In some

60 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.

61 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.

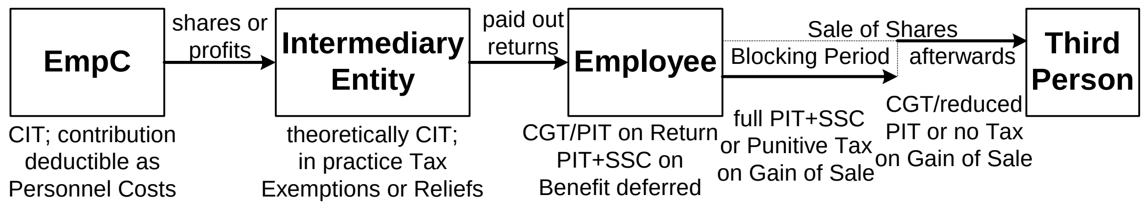
countries (e.g., Denmark, Ireland, Luxembourg, Portugal), both the employer company and the employee are exempted from social security contributions.[62]

b) 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



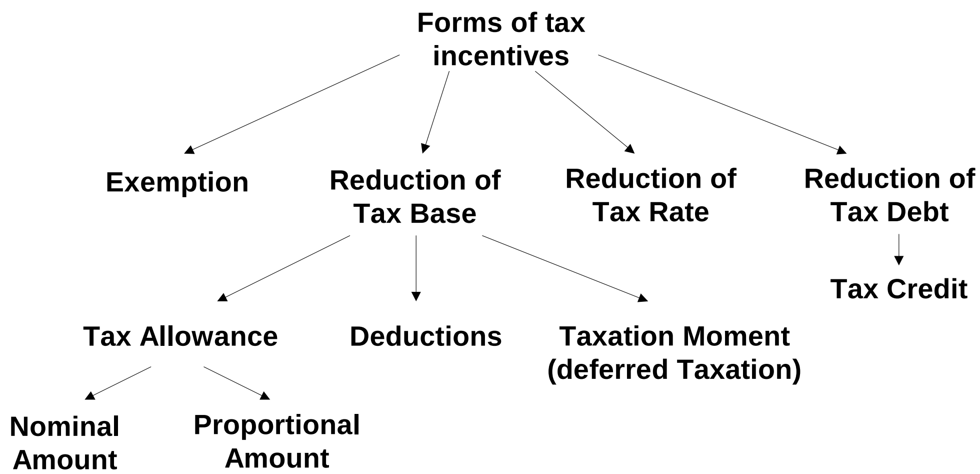
Share ownership plans and profit-sharing plans using a vehicle for the holding of shares and the investment of accumulated funds exist in many varieties in different EU member states, especially because of substantial differences in company law. However, there is a similar basic logic: the employer company 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 (e.g., deferred taxation of the benefit), which in most cases are granted.

62 For details see EC (2003), Stock Options; PriceWaterhouseCoopers (2002): Employee Stock Options in the EU and the USA, London.

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.[63] 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 level of general taxation limits their impact.[64] Therefore the different instruments used to create specific tax incentives are important. Incentives may take the different forms diagrammed below.

Figure 12. 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 cate-

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63 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), Corporate and Indirect Tax Rate Survey 2007, p.15.

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

gories of income, are seldom utilised.[65] 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.[66] 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.[67] 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.

Table 5. Tax incentives for employee financial participation

Country	Employee	Employer Company
Austria **ESO**	**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 7th 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 annually p. p. tax free; if more CGT; dividends on shares tax free.
PS	**General:** No; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.
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	**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

65 See Spengel, Christoph (2003): Internationale Unternehmensbesteuerung in der Europäischen Union, Düsseldorf, p. 28.

66 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, Christoph (2003): Internationale Unternehmensbesteuerung in der Europäischen Union, Düsseldorf, p. 29.

67 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, Klaus, Lang, Joachim (eds) (2005): Steuerrecht, 18. Aufl., Köln, p. 799, p. 802.

Country	Employee	Employer Company
	(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.	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 years 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 years 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.
Finland **ESO**	**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 years blocking period.	**General:** No; **IntE:** EmpC: no CIT, no SSC on profits transferred to IntE; IntE: earnings tax free.
France **ESO**	**ES:** No; **SO:** No; **IntE:** Do not exist.	**ES:** Training of employees on EFP: tax relief Euro 75 per hour p.p. up to Euro 5,000 per company for 2 years (2007); **SO:** No; **IntE:** Do not exist.
PS	**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; **IntE:** Since 1986/1994 (PEE - short-term savings plan): no PIT, no SSC, flat tax of 7.6% if blocking period 5	**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

Country	Employee	Employer Company
	years and EmpC match does not exceed the ceiling; Since 2001: (PPESV - long-term savings plan): like short-term, but blocking period 10 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%.	paid out during blocking period; **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 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%.
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 years 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 years blocking period; Dividends: tax on movable assets (10%); **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; **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT, no SSC; **SO:** (1) No; (2) Costs of distributed shares deductible from tax base of CIT; **IntE:** Do not exist.
PS	**General:** (only for JSC, usually cash-based) no PIT, but SSC on benefit if not exceeding 25% of annual gross salary; **IntE:** Do not exist.	**General:** Distributed amount deductible from tax base of CIT, but SSC; **IntE:** Do not exist.
Hungary **ESO**	**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; **SO:** Since 2003 "Approved Employee Securities Benefit Programme": incentives as for **ES**; **IntE:** Since 1992 ESOP: no PIT on shares transferred via ESOP; contributions to ESOP deductible from tax base of PIT.	**ES:** No; **SO:** No; **IntE:** Contributions to ESOP deductible from tax base of CIT.
PS	**General:** No; **IntE:** Do not exist.	**General:** No; **IntE:** Do not exist.
Ireland **ESO**	**ES:** (1) Purchase of new shares: at sale of shares no PIT, no SSC, only CGT on issue price, if full price paid, 3 years 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 years blocking period; **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 years blocking period, plan approved by tax authorities; **IntE:** ESOT enjoy incentives only if combined with APPS (see below).	**ES:** (1) No SSC; (2) No; **SO:** (1) No SSC; (2) No SSC; **IntE:** ESOT enjoy incentives only if combined with APPS (see below).

Country	Employee	Employer Company
PS	**General:** No; **IntE:** (1) Since 1986 APSS: no PIT, no SSC on benefit not exceeding Euro 12,700, if plan broad-based, 3 years 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.	**General:** No; **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.
Italy ESO	**ES:** Since 1999: no PIT, no SSC on benefit up to Euro 2,066; no SSC (since 2006) if 3 years blocking period **SO:** Since 1999: no PIT, no SSC up to Euro 2,066, if 5 years 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; **IntE:** Do not exist.	**ES:** Discount deductible from tax base of CIT; **SO:** No; **IntE:** Do not exist.
PS	**General:** Since 2007: 23% deduction of PIT up to Euro 350 annually, no SSC; **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 ESO	**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 years 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.
Poland ESO	**ES:** No; **SO:** No; **IntE:** Do not exist.	**ES:** *Leverage Lease Buy-Out (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 ESO	**ES:** No; **SO:** No SSC; **IntE:** Do not exist.	**ES:** No; **SO:** No SSC; **IntE:** Do not exist.
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 ESO	**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.

Country	Employee	Employer Company
Spain **ESO**	**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 years 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; **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; **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.
UK **ESO**	**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 years 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 tax analysis: employee share ownership plans and share-based profit-sharing plans belong to the first category (with certain specific features of indirect plans), stock option plans to the second category, and cash-based profit-sharing plans to the third category.

a) Share-Based Plans

Tax incentives in most countries apply to direct share-based plans, share-ownership as well as profit-sharing. The most common pre-condition is a blocking period between one and seven years, the most common being 5 years (e.g., 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 (e.g., Austria, Finland, France, Ireland, UK). In some cases, tax incentives apply only if the primary plan is linked to a savings contract or scheme (e.g., France, the Netherlands). In many countries, tax incentives apply only if the plan is broad-based (e.g. 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 (e.g. Denmark). In some countries, where the plans are pre-defined in the law, approval of tax authorities is necessary (e.g. 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 135 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% in Denmark and in Finland for direct share ownership plans and 20% 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 (e.g., 15% in Belgium, 7.6% 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 (e.g., 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 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% on the benefit and of 10% on the dividends, which also apply to employees. Specific tax incentives exist for intermediary entities in indirect plans: all earnings (e.g., Finland) or at least a certain amount of contributions and dividends (e.g., 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 (e.g., Belgium, UK, Ireland); restrictions on the difference between the market price of underlying shares and the exercise price (e.g., Belgium, Denmark, Ireland, UK, Austria); the existence of a broad-based plan (e.g., Austria, Denmark, Ireland, UK), and approval by the tax authorities (e.g., 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 (e.g., 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, e.g., Denmark, Hungary, or much higher, e.g., CSOP (GBP 30,000) and EMI (GBP 100,000!) in the UK. Such forms as deferred taxation (e.g. Austria) or taxation at grant (e.g. 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.

Two general principles and several conclusions 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 (e.g., profit-sharing plans in Austria and Germany) sometimes have a higher incidence than those with tax incentives (e.g., share ownership plans in Austria and Germany).[68] Therefore tax incentives are not to be considered a prerequisite to the development of financial participation. Furthermore, in low-tax countries (e.g., Ireland), tax incentives are less important and, in any case, cannot be as large as in high-tax countries.[69]

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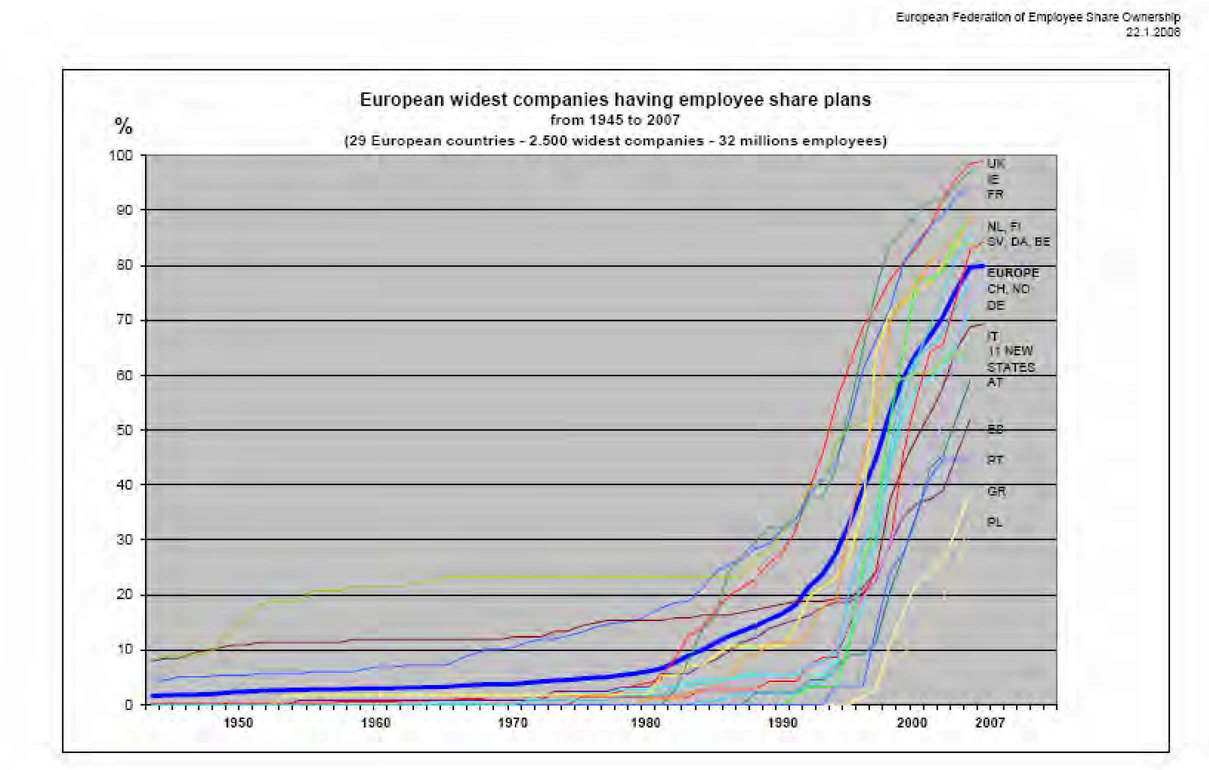
68 In Austria, only 8% of enterprises and 6% of the workforce participated in employee share ownership plans in 2005, tax incentives for which were introduced in 2001, whereas 25% of enterprises operated profit-sharing plans without tax incentives (see Kronberger, Ralf, Leitsmüller, Heinz, Rauner, Alexander (eds) (2007): Mitarbeiterbeteiligung in Österreich, Wien, pp. 11, 17, 162). In Germany, 2.4% of enterprises had an employee share ownership plan in 2001, supported by (marginal) tax incentives, whereas at the same time 8.7% of enterprises operated profit-sharing plans without tax incentives (see Würz, Stefan (ed.) (2003): European Stock-Taking on Models of Employee Financial Participation, Results of ten European Case Studies, Wiesbaden, p. 59).

69 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%), whereas personal income tax is close to the EU average (20-42%). 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).

➢ Tax incentives effectively promote the spread of financial participation

Countries with a long tradition of employee financial participation (e.g., UK, France)[70] universally confirm this experience, but so do countries where tax incentives are quite recent, e.g., Austria,[71] where a substantial increase has been observed, even though total numbers are still relatively low.

Figure 13. European largest companies having employee share plans



According to the graph by EFES (see Figure 13 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

[70] 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: 20.07.2007.

[71] In Austria, only 8% of employee financial participation plans were implemented before first tax incentives were introduced in 1993, while 45% of plans were introduced in four years after more substantial tax incentives became effective in 2001 (see Kronberger, Ralf, Leitsmüller, Heinz, Rauner, Alexander (eds) (2007): Mitarbeiterbeteiligung in Österreich, Wien, p. 32).

most countries, the angle of the graph representing increase becomes steeper following the years in which tax incentives were introduced (e.g. 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 (e.g. 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.

4. 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 (e.g., France, Belgium, UK, Ireland, Finland),
- levying a capital gains tax (e.g., UK, for dividends Belgium),
- levying a special low tax (e.g., France) in lieu of personal income tax, and
- tax allowances for personal income tax (e.g., 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 (e.g., 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 (e.g., in Greece) for cash-based profit-sharing and in Germany and Belgium for schemes of all types.[72] 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[73]: 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. Harmonisation 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 (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 acquisition[74] 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, e.g., 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. Coun-

72 See EC (2003), Cross-border obstacles, p. 17, 24.

73 See EC (2003), Stock Options, p. 42, 43.

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

tries 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.

V. 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.[75] 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 Article 17 of the Charter.[76] 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 1992[77] and in Part 7-II of the Action Programme for Implementing the Community Charter of the Fundamental Social Rights of Workers.[78] 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 Article 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.[79] In summary, the community law appears deficient in regard to employee participation in general, and financial participation in particular.

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75 One reason is that Article 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.

76 Nevertheless the Charter as a mere list of policies is not genuine *jus cogens* and thus has no *res judicata* effect.

77 Concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation), 92/443/EEC, *Official* Journal L 245 , 26/08/1992 p. 53-55 .

78 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.

79 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.

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-jurisdictional framework. In its communication[80] 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 U.S., 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,[81] are transfers of businesses to employees as a way to facilitate business succession in SMEs.[82]
- 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.[83]

80 COM(2002)364 Final, 5 July 2002, p. 3 and 10.

81 On the transfer of small and medium-sized enterprises, 94/1069/EEC, with explanatory note, Official Journal No C 400, 31. 12. 1994, p. 1.

82 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", 2003.

83 See *A. Pendleton, et al.*, "Employee Share Ownership and Profit-Sharing in the European Union", European Foundation for the Improvement of Living and Working Conditions, 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 limited number of cases, recently extended by the Treaty of Nice.[84] 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 (Article 18 ECT) and industrial policy (Article 157 ECT). As to taxation (Articles 93, 94 and 175 ECT), however, the requirement of unanimity for all measures is maintained across the board. In the field of social policy (Articles 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.[85] 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.[86]

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.[87] Since community law would be equally binding, a supranational compromise can encompass only the smallest common features of the diverse national regulations.[88] 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.[89] Thus, provided that they are granted voluntarily on the national level, a supranational concept can offer a variety of incentives from which to choose.

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84 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.

85 This "bridge" cannot, however, be used for social security.

86 E.g., 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 *A. Pendleton / E. Poutsma,* "Financial participation: The role of governments and social partners", European Foundation for the Improvement of Living and Working Conditions, Dublin 2004.

87 As, for example, the German "Mitbestimmung" and the Works Councils in France and the Netherlands.

88 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.

89 A rare exception exists in France where enterprises with more than 50 employees are required to establish a participation fund. See "PEPPER II Report", 1997; KOM(96)0697, C4-0019/97, p.19-20.

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.[90] Combining them in a single program with alternative options leads to a "Building Block Approach", with the different elements being mutually complementary.[91]

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, e.g., the United Kingdom and Ireland.[92] 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.[93] Furthermore, it can be used to refinance outstanding debt, to repurchase shares from departing plan participants, or to finance the acquisition of productive assets.[94] 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.

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90 Compare *White and Case*, "The European Company Statute", 2001, p. 4.

91 For a detailed technical description of the different mechanisms and schemes see *J. Lowitzsch et al.* "Financial Participation for a New Social Europe", Berlin/Paris/Brussels 2008.

92 For Ireland, see *J. Shanahan* and *L. Hennessy*, "Underpinning Partnership at the Workplace – An MSF Guide to Profit Sharing, ESOPs and Equity Participation", Dublin, 1998, p. 9.

93 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", 2003.

94 From an entrepreneurial point of view, see *D. Ackermann*, "How to Cash Out Tax-Free, Yet Keep Your Business . . . ESOPs – A Practical Guide for Business Owners and Their Advisors", Conference Paper for the National Center for Employee Ownership, San Francisco, California, 2002.

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.[95] 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 companies 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 Statute[96] (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.[97] 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,[98] 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:

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95 *High Level Group of Independent Experts*, "Report on cross-border obstacles to financial participation of employees for companies having a transnational dimension", Brussels, December 2003, p. 52ff.

96 Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE); OJ, L 294/1.

97 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.

98 Here it is the result of negotiations between employer and employee representatives.

- 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 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.[99]

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 i.e., the second Council Directive on Company Law 77/91/EEC, dating back to 13 December 1976. Arts. 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.[100]

Member States may lift the limit of the nominal value of the acquired shares of 10% 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, 31, 36, 37, 38 and 39 for

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99 "Employee Stock Options: The Legal and Administrative Environment for Employee Stock Options in the EU", European Commission Enterprise Directorate-General, 2003.

100 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.

companies under a special law issuing collectively held workers' shares, has not been used except in the case of France[101].

As the table 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.

Table 6. Implementation of the 2nd 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	5years not transferable, limit: 20% of equity capital; max. 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 firm 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 (2/3 of votes and equity capital) for benefit of empl.
Germany	Without decision of General Assembly; also (former) empl. 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

[101] 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 empl. 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 firm 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
Portugal	Not specific for employees, generally possible, if partnership contract does	Also to employees of affiliated firms; liquid assets mustn't become less than subscribed	General Assembly may limit/abolish pre-emptive right of shareholders for "social reasons"	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
	not provide for anything else	capital plus not distributable reserves		
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; min.1/2of firms empl. 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 spec. for empl., generally possible	No	No	No
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 max. 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

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
Lithuania	Not specific for employees, generally possible	Advance funds or loan paid back by deductions from employees' salary	Non-voting shares for max. 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 empl..; 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 max. 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

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".[102] Our proposed European Concept refers – as does the Commission

102 See point 1.5 of the Presidency Conclusions of the Lisbon European Council (23-24.3.2000).

– particularly to the experience in the U.S. 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"[103]. 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 (e.g., 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.
- In countries with an Anglo-American tradition, e.g., 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).

[103] Commission communication seeking "a framework for the promotion of employee financial participation", COM(2002)364 Final, 5 July 2002, pp. 3 and 10.

- 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, e.g., 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[104] 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, e.g., 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.

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[104] Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, December 2003, p. 17ff.

VI. Summary and Recommendations

Jens Lowitzsch

The PEPPER IV Report presents conclusive evidence, that regardless of data source, 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. 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 of 10% to 18% and profit sharing schemes from 19% to 26% (both unweighted country averages). On the other hand, – despite 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 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 to the role of employees. There are important differences between the former socialist countries and the mature market economies of the EU-15 and also 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 is due to 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 constitute 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 by financial assistance. This phenomenon has its roots in the second Council Directive on Company Law[105] 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 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 a general, posi-

105 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, IV 3).

tive shift in attitude could be observed though, 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 evidence[106] shows that financial participation can substantially benefit not only employees but also business enterprises and the national economy. This potential, however, remains largely under-utilized 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 providing for 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.

- **Profit-sharing: Strengthen incentives and increase productivity**

Profit sharing, in particular, despite its limited diffusion in the newcomers from Central and Eastern Europe[107], is likely to become far more relevant in these countries, stimulated by the

106 Financial participation has been statistically linked with greater productivity and with higher profits (profit-sharing, Festing et al., 1999; share ownership, Blasi et al., (2004)). Furthermore, these effects appear to be strengthened by the presence of other kinds of employee involvement (Kim, 1998).

107 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 la-

rich experience with these schemes in the EU-15. The need to strengthen incentives and increase workers productivity in the future should generate more favourable attitudes towards flexible remuneration schemes such as profit-sharing. Furthermore, profit-sharing enhances loyalty and motivation among employees by ensuring them employment security in exchange for wage flexibility. Both effects may help to encourage employers to utilize wages rather than employment as the instrument of flexibility. This, in turn, would discourage higher turnover in the labour markets, and contribute to greater employment stability.

- **Internal versus external flexibility: Profit-sharing and flexicurity**

The public authorities' desire to reduce unemployment figures 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 are an element of 'internal flexibility' that allows wages to go down in a period of economic downturn and help the employing company to keep its margins – by automatically decreasing its labour costs – without having to reduce its labour force. Several studies have shown that profit-sharing could bring wage flexibility and employment stability. This is in line with the common principles of "flexicurity" retained by European Commission and Council, such as 'a better balance between external and internal flexibility', 'a climate of trust and dialogue' and 'a better workers' adaptability capacity'. Thus, especially against the background of the changes of the world of work and as a means of achieving internal flexibility (as opposed to external flexibility) profit-sharing can play an important role in the flexicurity approach.

2. The Building Block Approach: Developing a Common Model for Financial Participation across the EU

The "Building Block Approach" as an open platform model ideally responds to the need for developing schemes at the European level in order to support financial participation more actively and to overcome national differences in taxation policy. At the same time, such a framework, while providing a broader incentive system, delineates what companies may do without inviting sanctions from regulatory, legal and taxation authorities.

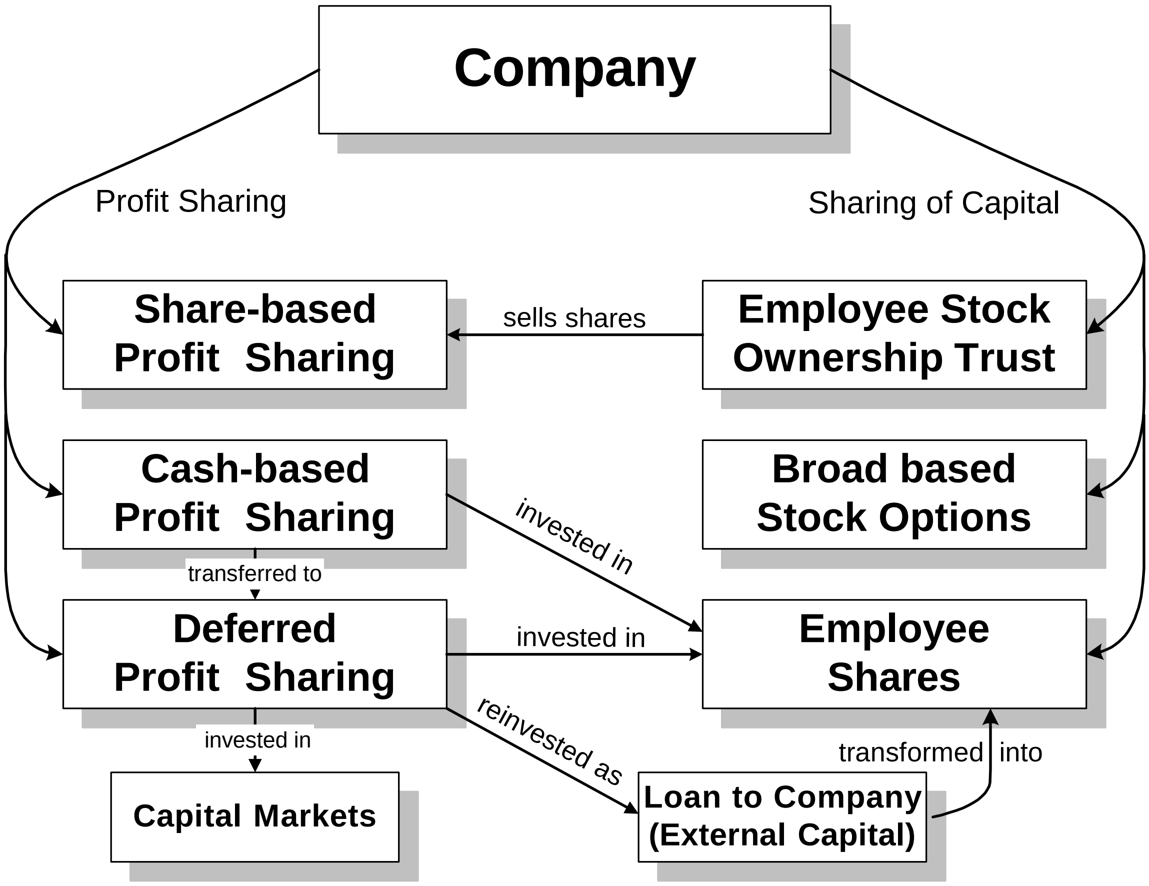
- **Providing a broad incentive system with flexible solutions**

A European model must be compatible with those already established 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, e.g., the United Kingdom and Ireland, but also in some transition countries, such as Hungary, Croatia and Romania, ESOP-models are to be 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:[108] (1) Profit Sharing (Cash-Based, Deferred and Share-Based); (2) Em-

bour 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.

108 For a detailed technical description of the different mechanisms and schemes see *J. Lowitzsch et al.* "Financial Participation for a New Social Europe", Berlin/Paris/Brussels 2008..

ployee 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 consisting 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 from the European Platform drawn up in the Recommendation as equivalent to a plan drawn up under its own laws and provide equivalent benefits. This sets up a distinct legal entity for the chosen Building Block for companies to refer to throughout those countries that decide on recognition.

➢ **Building on existing national legislation originating in the acquis**

Given the above described difficulties in arriving at a supranational compromise, 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 i.e., 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 (e.g., 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 (i.e., direct contributions from the employer company), the ESOP can obtain financing from such different sources as: (I) a loan from the employer company, a selling shareholder or a financial institution such as a bank; (II) dividend earnings; (III) sale of shares to its related share-based profit-sharing scheme; and (IV) 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 allot part of their wealth into the shares of their own companies rather than those of other companies, resulting in concentrated rather than diversified 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 an additional benefit to basic wages. The employee's salary remains unaffected. Furthermore, ESOPs make employees more motivated and productive while at the same time making enterprises more competitive.[109] Finally, there is an additional advantage to the company: shares are not sold to outsiders; thus there is no risk of loss of control and the company remains local. As such ESOPs could be an important tool for solving the problems of business succession in family-owned enterprises, strengthening bonds between enterprise and community, while keeping jobs local and more wage income spent at home.

- **Heads of family enterprises will be retiring en masse in the next ten years**

A recent Commission Communication from 2006[110] 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)

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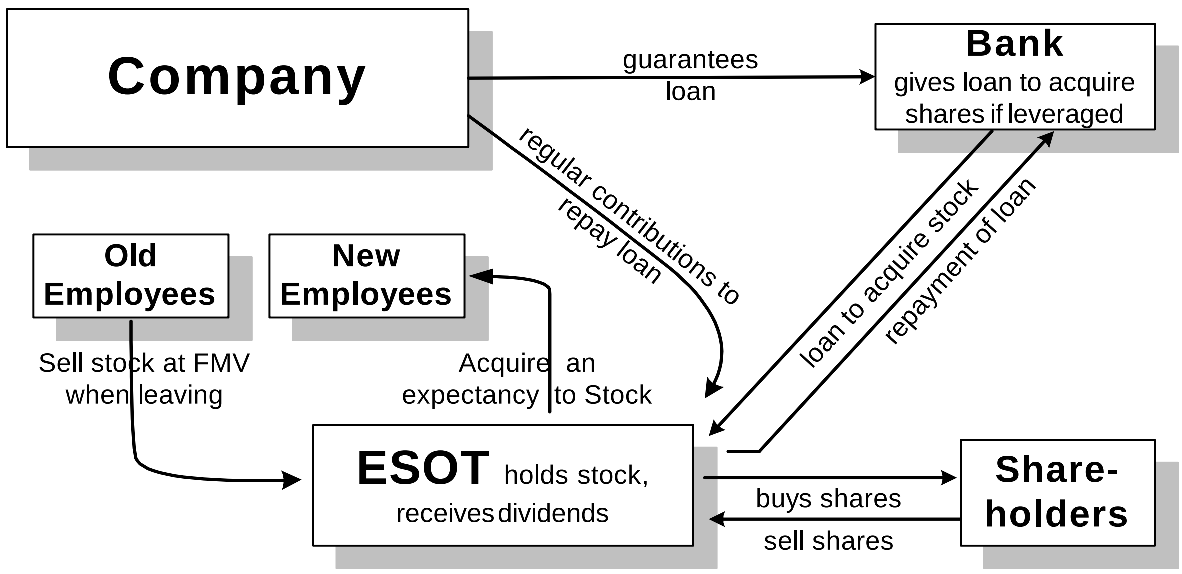
109 For a recent, comprehensive overview of the positive economic evidence (esp. for ESOPs) see *J. R. Blasi, D. Kruse, A.* Bernstein, "In the Company of Owners", Basic Books, New York 2003; they find an average increase of productivity level by about 4%, of total shareholder returns by about 2% and of profit levels by about 14% compared to firms without PEPPER schemes.

110 Implementing the Lisbon Community Programme for Growth and Jobs, on the Transfer of Businesses – Continuity through a new beginning, from 14.03.2006 COM (2006) 117 final.

businesses and will profoundly affect the European Community itself. This field of action has been highlighted as one of the main objectives of the Council Recommendation of 7 December 1994[111] and recently by the European Commission, explicitly stressing 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 buy-out 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 buy-out one or more shareholders while permitting other shareholders to retain their equity position. This is one of its major advantages 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 ESOT 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 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.



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

111 On the transfer of small and medium-sized enterprises, 94/1069/EEC, with explanatory note, Official Journal No C 400, 31. 12. 1994, p. 1; reiterated in the Communication from the Commission on the transfer of small and medium-sized enterprises, OJ C 93, 28.3.1998.

group.[112] As a trusteed plan, the ESOP is designed to separate control over the shares in the trust from the "beneficial owners". The trustee exercises the voting rights while the employees are the financial beneficiaries of the trust. 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 of gradually cashing out without giving up immediate control.[113]

- **ESOP as an alternate leveraged buy-out tool**

The growing number of Private Equity firms targeting Europe's small and medium-sized enterprises[114] makes a comparison of an alternate leveraged buy-out tool of immediate strategic importance. This alternate vehicle is the Employee Stock Ownership Plan. Although the ESOP and the Private Equity fund have some features in common[115], the two markedly differ in one crucial respect: they benefit different constituencies and have different economic and social effects. The Private Equity buy-out 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 buy-out 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 buy-out is a short-term transaction aiming 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-capitalized, 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 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

112 The ESOP may also be used to buy out dissident shareholders.

113 Once the loan is paid off, of course, most companies make some arrangement for the presence of employee representatives on the plan committee.

114 The part of LBOs in the total funds raised in Europe reached over 68% in 2005. In contrast the amount of venture capital investments only represents 5%. See "Hedge Funds and Private Equity - a Critical Analysis", PSE Socialist Group in the European Parliament, 2007, p. 69.

115 The ESOP, invented in 1956, is the prototype leveraged buy-out; the Private Equity form originated in the seventies to utilize tax advantages which the U.S. Congress had passed to encourage the ESOP.

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.

- **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 the positive impact of tax incentives.

- **Tax incentives should (and in most countries do) target those taxes which constitute the heaviest burden in the national taxation system.**

Usually these are the progressive personal income tax and social security. Many countries therefore provide: (1) exemptions from social security contributions for certain plans (e.g., France, Belgium, UK, Ireland, Finland); (2) levying a capital gains tax (e.g., UK, for dividends Belgium); (3) levying a special low tax (e.g., France) in lieu of personal income tax, and (4) tax allowances for personal income tax (e.g., 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 acquisition[116] 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.

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

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 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 a 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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