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INTRODUCTION TO THE DIFFERENT SYSTEMS OF PROFIT SHARING, CAPITAL SHARING AND INVESTMENT WAGE*

Francine VAN DEN BULCKE

Francine Van Den Bulcke has a doctor's degree in Economics of the University of Ghent, and is assistant lecturer in microeconomics at UFSAL, Brussels. Her research activities lie mainly in the field of income and wealth policy and industrial relations.

Summary

Different goals and motives have played a role in advocating worker participation in profits and capital formation of industry in Europe since the end of the fifties, beginning of the sixties. They have resulted in a wide variety of proposals, plans and applications between countries and companies.
Recently several European governments have shown a renewed interest in financial participation for workers, which has become a widely discussed topic between employers, trade unions and political parties.
In this paper we classify and briefly analyse the different schemes, according to their principal characteristics and signification in labour relations today.

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1. INTRODUCTION

Participation of workers in the profits and capital formation of industry, either through systems of profit sharing, capital growth sharing or investment wage has been a major concern of trade unions, political parties and governments in Europe since the end of the 1950's and the beginning of the 1960's. Many proposals and plans have been developed which aim to introduce such schemes through collective bargaining or by law, in order to cover a wide range of companies to the benefit of as many employees as possible (or even the whole work force).

In contrast to the U.S. where they are very widespread and generally accepted on a voluntary basis, profit sharing and employee shareholding have in Europe been advocated as instruments of government policy to stimulate (long term) workers' savings and worker asset formation. Their main objective is to contribute to a more equitable distribution of income and wealth, especially of productive ownership (a property owning democracy, Meade).

The rationale behind these proposals is that as a matter of justice, employees should receive a fair part of the profits that they help generate, the wealth they help create.

Although plans and proposals outnumber applications by far, in several European countries today some or other form of financial participation has been put into practice, either imposed by legislation or encouraged by fiscal measures. However, in other countries which have tried to do so, bills have had to be withdrawn under strong pressure from employers and because of political opposition.

As a result of the worsening economic situation in most EEC countries since the mid-seventies, trade unions, political and social parties have lost interest in capital sharing schemes, economic democracy and problems of wealth distribution in general. Priority has been given to the unemployment problem. Measures to reduce unemployment such as reduction of working hours, work sharing have undoubtedly become the most discussed topics in industrial relations during the past years. Job bargaining became more important to trade unions than wage bargaining.

However, since governments have proclaimed a policy of wage restraint at the end of the seventies and into the eighties to reduce labour costs and stimulate investment and employment, profit sharing and investment wage have received renewed attention from trade unions as a compensation for moderating their wage demands. Collective worker funds or investment funds administered by trade unions and government officials

have appeared in the meantime to be an attractive way to control and stimulate work creating investments.

The renewed interest in financial participation in recent years in Europe has also been inspired by employers and liberally oriented governments. They see profit sharing and investment wage as an effective way to bring more flexibility and differentiation into the wage system, which they believe can create more effective labour market conditions and will stimulate employment and economic recovery.

According to these ideas, as recently developed by Meade and Weitzman, profit sharing schemes are in the first place instruments of a new wage policy to combat stagflation, rather than instruments of wealth distribution.

In this new wage system, as strongly defended by Weitzman in the *Share Economy* (1984), a fixed wage basis should be supplemented by a variable part, according to the financial results or the economic performance of the firm (as is the case in Japan). According to Meade (1982) profit sharing, next to worker cooperatives and partnerships in which workers will partly bear the capital risk, should be part of a new approach to wage policy.

2. GOALS

Different goals and objectives have thus played a role in the promotion and realisation of the different types of financial participation of workers in undertakings.

As already stated, the main goal, especially in Germany and the Netherlands, has been for years the *uneven distribution of income and wealth.* The origin goes back to the economic policy in the period of reconstruction after the war, which favoured capital formation out of retained profits, by wage restraint and fiscal measures.

As it was recognized that a policy of merely subsidizing savings and wealth accumulation on a voluntary basis out of wage income by premiums and tax concessions, cannot contribute to a fairer distribution of productive wealth, compulsory saving out of company profits (capital growth sharing) or out of an additional wage increase (investment wage) was viewed as a much fairer and more effective solution.

By means of the well-known Capital Formation Laws (1965, 1970), the concept of an investment wage has been introduced on a wide scale

through collective bargaining in West Germany. Contributions paid by the employer, on behalf of the employees, eventually supplemented by the workers' own savings, are subsidized by the government, provided they are used for approved savings during a certain period of time. These laws contributed to a considerable extent to a rise in workers' savings in Germany. A similar system of investment wage has been made possible in the Netherlands, but has only been negotiated in a few industries (1972). The increase of long term workers' savings and productive investment, in order to contribute to *economic growth,* has indeed been another goal pursued by governments with capital sharing schemes. Indeed, as the funds accumulated by profit sharing, are reserved *to finance productive investment,* they can further play a role in the recent need *to increase and spread the supply of risk capital* in industry. Thus they can stimulate workers' savings not only in a quantitative, but – as became more urgent in economic recession – also in a qualitative way.

Next to the spread of profits, wealth and ownership of shares, a main concern of trade unions, especially in the Scandinavian countries, is the *concentration of power,* as connected with the ownership of productive property. According to this vision co-determination rights should be inherent to the securities or funds workers receive out of profit sharing or investment wage. This is, however, not a general point of view in the trade union movement. For German trade unions it is essential to make a clear distinction between worker participation (Mitbestimmung, industrial democracy) and financial participation of workers (economic democracy).

During the seventies social-democratic parties especially and trade unions claimed the establishment of collective investment funds, that would collect, control and invest the capital workers are entitled to under capital sharing systems. They are looked upon as an appropriate answer and counterbalance to the concentration of productive and economic power in the economy.

So far – with the exception of Sweden – all proposals and attempts to introduce such schemes by law have failed: this was the case in Denmark (1973), Great Britain (1973), Germany (1974), and the Netherlands (1976-1980). Indeed, after years of political debate, such funds were established at last in Sweden in 1984. In contrast to profit sharing schemes on a company level, as have been implemented by law for companies of a certain size in France since 1968, these collective or supra-national schemes rather favour collective workers' savings, and collective ownership in the economy, instead of individual workers' savings or ownership.

Other goals are in the field of *stabilisation policy* and *incomes policy* focused on *economic recovery.* Capital growth sharing and investment wage instead of nominal wage increases can combat inflation, and meanwhile improve the material and immaterial position of wage earners in firms and in society. Their contribution to economic recovery lies in their ability to mitigate nominal wage increases, to stimulate the supply of risk capital and to bring *incentives* to workers (which will increase productivity and profits, in which they can share).

These different goals and motives varying in importance between countries, interested parties and in time, account for a wide variety of schemes. It therefore makes little sense to start a discussion for or against the participation of workers in profits and capital of industry, when it is first not made clear which system is envisioned.

3. AN OVERVIEW OF THE DIFFERENT SYSTEMS OF CAPITAL SHARING

3.1. Profit sharing

Profit sharing can be defined as each system that gives workers, because of their labour relation to the company, a right to share in the profits of the company.

According to such schemes employees receive a bonus based on a formula strictly related to profits. Differences occur in how the profits should be calculated: should workers receive a part in the gross or net profits, pre- or post-tax profits, or excess profits? Several formulae are of course possible. The most common is that workers only receive a share of profits, if these have exceeded a defined threshold, which can be a fixed sum, or a percentage return on capital employed (Bell, p. 7).

The idea of profit sharing is certainly not new. It goes back to the 19th century. Traditionally it merely intends to be a variable part of the wage, depending on the economic results of the financial year, paid in cash and freely available to the worker. The first experiments with profit sharing and employee shareholding were inspired by the ideas of the French socialist school (St. Simon, Proudhon, Blanqui, Fourier), and some famous 19th century economists such as J.S. Mill, A. Marshall and Von Thünen. As they advocated worker cooperative enterprises, they can be seen as precursors of the ideas of participation and co-partnership. The concept of profit sharing was only realised to a limited extent in the

previous century in France, Great Britain and the U.S. It became, however, very popular in the U.S. after World War II. More and more American employers introduced such schemes for their employees as a way to improve productivity and efficiency and to improve their relations with their employees, thus to achieve management objectives.

Deferred profit sharing plans became more widespread than cash plans, because of favourable tax provisions and their use as pension funds in firms. Under such plans, the bonus paid to workers is transferred into trusts, that invest the money on their behalf, often during the whole period of employment in the company. Next to company savings plans or thrift plans these deferred profit sharing plans have played a major role in the success of employee shareholding in the U.S. Today, according to estimates some 15% of U.S. firms run some kind of profit sharing scheme, which covers some 20% of the work force in the private sector (Remus, p. 12-13).

Although several European companies also practise some form of profit sharing and employee shareholding the concept did not receive much attention in Europe, until governments became interested. Profit sharing was and still is considered in Europe as some romantic idea of employers, and not as a serious issue in labour relations. Besides, European trade unions have always been opposed to individual profit sharing schemes, introduced on a voluntary basis, on the instigation of the employer, because they are seen as a threat to the solidarity and the uniformity of the wage system, and are in conflict with their wage policy.

In West Germany and the Netherlands the government has recognized these schemes as a way to stimulate savings and has tried to integrate them into a broader policy of asset formation and distribution of wealth.

In France it was De Gaulle who saw in the participation of wage earners in the profits and the capital growth of firms, the way to a better cooperation between labour and capital in companies and more worker influence in industry. Profit sharing and employee shareholding were introduced by law in France for companies of a certain size in 1968.

Ideological and socio-political considerations played a major role indeed in several European countries in the promotion of the idea of financial participation, while management objectives clearly prevail in the U.S. In Europe, the idea of capital sharing and economic democracy has often been advocated as a form of modern welfare capitalism, even as an alternative between socialism and capitalism (Öhman, p. 2). As a consequence, in Europe profit sharing is seen more as an inherent right of workers to the results of their productive efforts, while in the U.S. rather as a gift of the employer.

3.2. Capital growth sharing

Capital growth sharing is a term used in Europe to identify those profit sharing schemes by which workers receive some share in the total «surplus» profits of the firm (excess profit sharing). «Surplus» means those profits remaining after deduction from gross profits of such items as taxes, depreciation, interest and a «reasonable» return on capital employed. According to some authors the term should be restricted to those types of plans that attribute to workers a share in the retained part of excess profits, used for selffinance.

Indeed, according to the early philosophy behind the idea of capital growth sharing, as it emerged especially in West Germany and the Netherlands, workers should participate in the retained profits of companies, because these have played a major role in the unequal distribution of productive wealth since World War II. This implies the necessity of attributing shares or share certificates to workers, instead of cash, which are not redeemable for a certain period of time. In general, the term capital growth sharing has become widely used to indicate those schemes by which workers share in total or net profits, provided the funds are invested in a productive way, either inside or outside the firm, and frozen during a fixed period of time (e.g. 2 to 5 years).

3.3. Investment wage

According to investment wage schemes, part of the wage or the wage increase is not paid in cash but reserved for the financing of productive investments. This can be a percentage of the total wage bill, which is then divided according to a certain ratio between all employees, a percentage of the individual wage, or a lump sum payment above the normal wage.

As the concept of investment wage was first developed in Germany in the 1950's and 60's, it was intended as an additional wage increase, negotiated or fixed by law, paid by the employer in some form of approved saving or to an investment fund. As an additional wage, it is financed out of company profits as in the case of profit sharing. According to more recent proposals, however, even by trade unions (the Netherlands) the investment wage should be freely negotiated through collective bargaining within the normal scope of wage increases, and according to some even at the expense of the normal wage. Because it guarantees to all workers a fixed payment, irrespective of company profits, it is often preferred to profit sharing or seen as a substitute for profit sharing into non-profit sectors of the economy.

3.4. Preferential purchases or free distribution of shares

Profit sharing and investment wage schemes are, of course, not the only ways to stimulate employee shareholding. Preferential purchase or free distribution of shares are another type of schemes favoured by governments in different countries such as France, the U.K., Denmark. This can occur by providing financial aid for employees to buy shares at current market prices, by granting purchase options valid for a specified period, or by purchasing on the basis of a price fixed in advance (stock-option plans). Because such schemes are only practicable in a limited number of companies, and are in many cases restricted to management, their interest is more in the field of motivation of employees, rather than workers' asset formation ([8], p. 7-8; [9], p. 1-2).

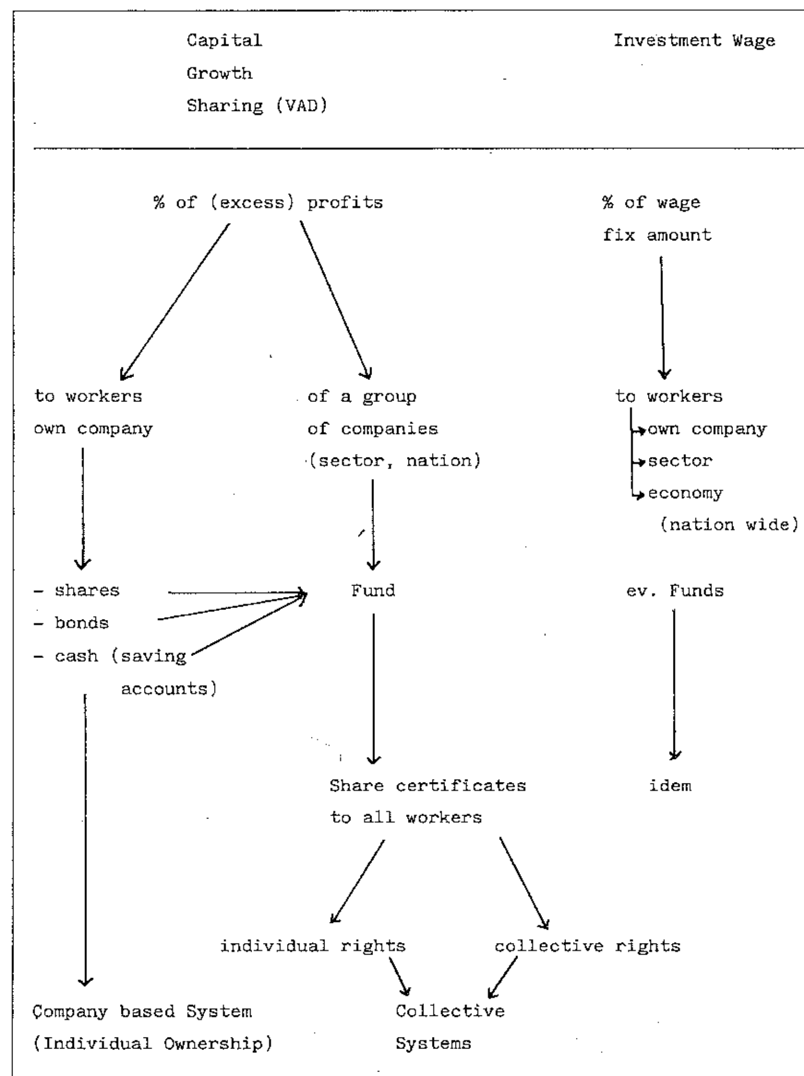
4. CLASSIFICATION OF SCHEMES

As already stated, the different goals and motives that are pursued by profit and capital sharing plans are reflected in a wide variety of schemes, with often very distinct features and consequences.

The main differences concern the calculation basis (wage or profits, what profits?), the way and level of organisation (company, sector, the economy), the type of securities workers receive, or the way their capital is invested (in or outside their own company, use of investment funds).

An important distinction can be made between *company- or enterprise-based systems,* by which workers are entitled to share in the profits or capital of their own company, and *supra-industrial or collective systems,* by which workers collectively share in the capital formation or capital growth of a group of companies, organized on sectoral, regional or national level (scheme 1).

Scheme 1: Classification of capital sharing schemes



In these latter cases, collective or centralised funds act as intermediaries in collecting, controlling and investing the workers' capital on their behalf. The advantage, from the point of view of distribution of ownership, is that all employees, even those in low- or non-profit making companies and sectors of the economy benefit from the schemes, as in the case of investment wages. These plans have especially been advocated by trade unions as alternatives to company-affiliated systems to give labour a share in the capital gains accruing to stockholders, and co-determination rights inherent to stock ownership. They can either be financed by companies contributing a fraction of their profits or wage bill or both, in the form of corporate stock, or in cash, provided they are transfered to investment funds. The fund itself, belonging to all employees, should issue non-negotiable fund certificates to workers, only redeemable after a certain period of time.

Within those two different approaches of capital sharing many more constructions are possible. These can be illustrated by the following classification, according to the different characteristics of the plans [1] (scheme 2).

The distributional impact of the plans, as well as their economic consequences will, of course, strongly depend on their specific construction. However, practical and political considerations will undoubtedly also influence the choice of a particular type of plan.

The most *controversial issues* concern questions such as:

- Should profit sharing or investment wage be voluntary or compulsory for the companies and the workers? In other words: should they be left to the initiative of the employer, or should government impose such schemes by law, or just create a flexible legal and fiscal framework in order to stimulate the introduction of capital sharing?
- Should the schemes be company-affiliated with the possibility of investing the workers' capital within the company as an incentive to the workers, but leaving them with a double risk (of losing their job and their capital)? Or is it better to spread risks by pooling the funds outside the company, but with the disadvantage of draining liquidity and financing capital from the firm?

(1) For a more detailed analysis, see Van Den Bulcke, part I.

Scheme 2: General characteristics of capital sharing schemes

	Capital growth sharing	Investment Wage
Calculation basis	% of profits	% of wage
Way of Introduction + Workers covered	- company agreements - collective agreements - law	- firm - industry - economy
Range of companies	- individual companies - sector or industry - all of a certain size	- individual companies - sector or industry - all (and public sector)
Membership	voluntary or compulsory	
Type of securites	- shares - shares or bonds - any	- shares - shares or bonds - any - approved savings
Worker choice of savings options	/	/
Freezing period	/	/
Investment and control of securities	- financial institutions - investment funds (wage earners' funds)	
Government tax concessions	- to companies - to workers	

- Should supra-industrial or nation-wide systems be preferred because they provide an equal access to productive ownership for all wage-earners, but with the disadvantage of a relatively small quantitative impact? Should enterprise-based systems be encouraged by tax concessions in high profit sectors of the economy, at the expense of all tax payers?
- Should workers have free choice of savings or can payment and investment of the wage-earner part only occur in quite specified ways (shares, bonds)?
- Should co-determination rights be inherent in employee shareholding? If so, should voting rights be directly exercised by the employees, or by their representatives in the fund?
- Should the funds be constructed at the national or regional level, or rather be branch-oriented, as was proposed during recent years in West-Germany and the Netherlands?

When we consider the proposals and realisations that have emanated in the past decades, several different trends can be distinguished. During the fifties and sixties profit sharing schemes on company level or investment wages introduced by collective agreements were mostly aimed for. Because of the unequalities created by this approach, collective systems or the introduction of an investment wage by law accessible to all workers, were claimed in most European countries, with the exception of France, during the seventies. During the 1980's, together with the increase in profits and a general call for more flexibility in labour market conditions, schemes on a company level, possibly as a result of collective agreements on sectoral level, have again become sought after. In the meantime it has also been proved that only when governments provide the necessary legal and fiscal instruments or framework to facilitate the introduction of such schemes, these will be applied on a wider scale. Great Britain can be mentioned as an example.

In Belgium the issue of profit sharing and employee shareholding has received attention from employers and the government only during the past few years. Since initiatives have been taken on both sides the stimulation of financial participation in Belgian companies has also become a widely discussed topic. We are convinced that the discussion whether and how to introduce profit sharing schemes, can benefit from the experiences of countries which have already introduced these systems or which have been considering such schemes for a long time.

In a next contribution we will therefore examine the realisations and experiences with profit sharing, employee capital sharing and related systems in various European countries.

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