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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

***Profit-Sharing In France--
Small Benefits From A Grand Design?***

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
December 1970

INTELLIGENCE MEMORANDUM

Profit-Sharing In France -- Small Benefits From A Grand Design?

Introduction

General De Gaulle's attempts to reform the French economy were based in large measure on his vision of a "third way" to harmonize relations between labor and capital. A key feature of De Gaulle's concept was *interessement*, or worker participation in enterprises. Profit-sharing, a major step toward such participation, was decreed in 1967. The extent and effects of profit-sharing are important elements in assessing the stability of relations between labor and capital, and ultimately the permanence of De Gaulle's imprint on the economy.

This memorandum describes the evolution of French profit-sharing plans, from De Gaulle's initial reform efforts following World War II to the profit-sharing law implemented in 1968. The application of the law and the effects of profit-sharing on business profits, workers' incomes, and government revenue are discussed. Finally, the more general economic effects of French profit-sharing plans are assessed. The arithmetic of profit-sharing is included in the Appendix.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of National Estimates and the Office of Current Intelligence.

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Worker Participation -- De Gaulle's "Third Way"

1. The roots of worker participation in France go back at least to the immediate post-war period when General De Gaulle, in an effort to undermine Communist influence within the French working class, stated that the first order of business for the provisional government was to show workers they would not only play an active role constructing a new, unified French society but would also share the benefits resulting from its creation. Labor relations in France have had a stormy history. Bitter strikes and violent confrontations rather than collective bargaining traditionally have characterized the almost feudal state of French labor-management relations. As a result, the working class has been relatively poor, alienated from management and largely alienated from the rest of society, and politically oriented to the left.

2. De Gaulle's early post-war measures were limited mainly to nationalizing enterprises in certain key sectors and establishing an extensive social welfare system. The General, however, never lost sight of his ultimate objective of a "third way" -- a visionary blend of capital and labor which he termed "pancapitalism." Pancapitalism would adopt the positive features of both Communism and capitalism, but would discard the authoritative, inefficient features of the former and the materialistic, dehumanizing aspects of the latter.

3. After returning to power in 1959, De Gaulle instituted a voluntary profit-sharing system for workers. This effort, which foreshadowed the present profit-sharing scheme, had little success. Labor exhibited an almost total lack of interest, and employers were reluctant to conclude agreements with the "most representative" employee union -- often the Communist-dominated General Confederation of Labor (CGT). Later, in 1965, the National Assembly adopted the so-called Vallon Amendment, committing the government to prepare legislation granting workers the right to a share in increased net worth resulting from a firm investing retained earnings.

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4. Partisans of the Vallon Amendment argued that only by giving workers some proprietary interest would it be possible to supplant the French workers' feeling of being exploited by their employers. Prime Minister Pompidou and the Minister of Economy and Finance Debre reportedly were unenthusiastic about the idea, and in 1966 a government-appointed committee reported that "the time is inopportune for such reforms."* Workers also showed little interest. Only De Gaulle's interest kept the idea alive.

5. In the spring of 1967 De Gaulle asked for emergency powers to reorganize the social insurance system and to introduce participation of wage earners in enterprises which practice self-financing. At that time most observers felt that any measure adopted by the government would provide inducements for firms adopting profit-sharing plans but that such plans would be obligatory only after several years. In mid-July, however, De Gaulle announced his decision that the new system would be mandatory immediately, at least for large firms. The profit-sharing decree was issued in August 1967, but it was not implemented at that time. Instead, the final decisions on exact forms of participation were put off until the following year.

The Beneficiaries Disapprove

6. Labor and management representatives were almost unanimously hostile to the initial profit-sharing law. Although profit-sharing schemes have been in force for many years in a number of countries, labor unions traditionally have been cool to participation plans. They usually hold that the best way for workers to share in business earnings is by obtaining the highest wage rates and best working conditions that the enterprise can afford. The unions also have suggested that profit-sharing would give firms reason to hold down wage increases. All of these arguments were

* *The time was more opportune than the committee thought; less than two years later the French economy came to a grinding halt as workers joined students in a massive general strike.*

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loudly advanced in opposition to the French profit-sharing scheme.

7. Management's fears also were volubly expressed. Employers saw profit-sharing as one more threat to the already low profit margins of French enterprises. They also feared that this would mean increased bargaining strength of French labor and a concomitant weakening of employers' managerial prerogatives. Management representatives were indignant at the obligatory nature of the decree.

8. It was only a matter of weeks, however, before the wave of criticism receded. Both sides quickly realized that the ordinance -- sweetened by several amendments -- was not all that far reaching. Several examples of the effects of profit-sharing appeared in the press, showing that many firms, whose profits fall below 5% of net worth, would not have to distribute any profits to workers. Moreover, the provision to provide tax credits for firms participating in profit-sharing dissipated most of the remaining fears and criticisms of management.

9. The riots and general strikes in May and June 1968 put participation and the need for extensive reforms back into the spotlight. Following the crisis and the announcement of reforms designed to promote participation in every branch of French life, including industry, speculation again arose concerning the extension of the provisions of the profit-sharing law. The most radical proposal came from Minister of Justice Capitant, who advocated introducing a new type of enterprise, jointly directed by representatives of labor, management, and shareholders.

10. Management spokesmen quickly claimed that Capitant's proposals implied "sovietizing" French industry. The French National Employers' Council (Patronat) expressed vigorous opposition and asserted that "if translated into law, these proposals can only destroy efficiency and ruin the national economy. Efficiency requires unity of control by the head of the enterprise, who owns it or is responsible to the shareholders." In the face of this opposition, President De Gaulle

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and his Prime Minister, Couve de Murville, quickly repudiated much in Capitant's statements. In July 1968 they stated that the government saw worker participation less in terms of profit-sharing (emphasized by Capitant and by the decree issued 11 months before) than in terms of restructuring labor-management relations within enterprises. The purposes of the reform were to organize "regular participation by all employees in the process of fact-finding, inquiry, and discussion leading up to the main decisions," and to apply recent regulations on participation to such matters as gains in productivity and the sharing of increases in assets. These statements represented a significant lowering of De Gaulle's goals for a "third way." Still, the profit-sharing law was to be implemented -- although not as quickly nor as completely as was originally thought (or feared).

The French Profit-Sharing Law and Its Application

11. The profit-sharing law of 1967* is (at least rhetorically) the first stage of a "three-stage rocket," designed to enmesh French workers in the web of *interessement*.** Stage one, profit-sharing, involves giving workers a financial interest in the success of the companies for which they work. Stage two, shareholding, is designed to allow the worker actual part ownership. This stage is exemplified by the distribution of company stock at the nationalized Renault plants. The stock, representing 25% of Renault's assets and valued at about $50 million, will be given to

* *Ordinance No. 67-693*, Participation by Employees in the Benefits Resulting from Industrial Expansion, *17 August 1967*.

** *The "three-stage rocket" became part of the government's rhetoric after it became clear what direction the implementation of profit-sharing was taking. Stage two -- the distribution of company stock -- is presently one of the options available to firms under the profit-sharing law. However, very few contracts have been signed utilizing this option. Pompidou, who appears to favor the shareholding idea, has praised it as a higher, more advanced form of participation.*

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all workers who have been at these plants for five years or more. If the plan proves successful at Renault, the government is hoping to apply shareholding to other state-owned non-monopolistic companies, an obvious example being clearing banks. The government will encourage private concerns to follow its example. A high official in the Ministry of Labor, Dechartre, has stated that shareholding may even be enforced by law -- just as profit-sharing, which from 1959 to 1967 was only encouraged by fiscal advantages, has now become a legal obligation. Stage three involves granting responsibility to the French worker. Industrial organization is to reach a level where a worker is no longer "hired" by a company but is "associated" with it -- whatever this may mean.

12. The French profit-sharing law now makes it compulsory for wage earners to share in the "excess profits" of any enterprise, public or private, that normally employs more than 100 workers. One underlying idea is that, whenever an employer uses the need to plow back profits as a reason for refusing wage increases, the workers have a certain claim on the resulting increase in assets. In the words of the ordinance, workers acquire a "new right" based on the principle that "progress, being achieved by all, must be for the benefit of all, meaning that all must share in the ensuing increase in assets." According to the Report of the President of the Republic accompanying the ordinance, the requirement "is designed to promote economic efficiency and progress, increase the investment capacity of enterprises, foster saving and encourage the establishment of a new relationship between employees and employers."

13. The workers' share of company profits is calculated by adjusting net profits after deducting the 50% corporate profits tax. (For details of the calculation, see the Appendix.) In brief, profits equal to 5% of net worth are first set aside from after-tax profits for payment of dividends. "Labor's share" of the remaining profits is then determined according to the proportion of the wage bill to total production costs. The amount of shared profits accruing to the workers

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is then one-half of this amount. Management, however, gets at least part of this money back in the form of a tax credit. The workers' share of profits is deductible from taxable income, and management has the option of investment up to this amount from its retained earnings on a tax deductible basis. Thus the tax saving may approach or even equal the additional labor cost.

14. The lack of clarity in the French profit-sharing law, the many options and provisions applicable to different firms, the traditional reticence of the French to disclose business accounts, and -- most important -- the year-to-year variations in business profits, all preclude accurate calculations of the effects of profit-sharing on the individual firm or on the economy as a whole. In the following example, however, we suggest the effects of profit-sharing on a "typical" French corporation. Three assumptions are made:

a. Capital coefficient (ratio of net worth to production costs): 1.0

This is the most important assumption; net worth is the base on which the 5% "prior return" is calculated before the distribution of profits. Unfortunately this assumption is also the most tenuous. The ratio varies widely, from less than 0.5 (for a firm with few assets but high turnover) to over 2.0.

b. After-tax profits as a percent of net worth: 10%

The rate of return on capital obviously varies widely from firm to firm, industry to industry, and year to year. The average profit of 10% on capital per year is too high for 1967 and 1968, but may be fairly accurate for large firms in 1969 and 1970.

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c. Labor coefficient (ratio of labor costs to total production costs): 0.6

A labor coefficient of 0.6 is fairly representative; the ratio generally falls in the range between 0.4 and 0.7.

Assuming that this "typical" corporation takes advantage of the tax credits allowed it, profit-sharing as a percent of wage costs (the effective wage increase) would be 2.5%, and profit-sharing as a percent of net profits would be 15%. (For calculations, see the Appendix.)

15. To illustrate the range of effects when alternative values for (1) return to capital and (2) the capital coefficient are considered, we calculated the matrix in the table. The labor coefficient was held constant at 0.6.* Within this matrix, figures in the top row (profit-sharing revenue as a percent of the net after-tax profit), opposite each alternative return to capital, show the calculated shared profit as a percent of net profit; the figures in the middle row (profit-sharing revenue as a percent of total wages) show shared profit as a percent of total wages (thus, the equivalent percentage increase in the average worker's wage); figures in the bottom row (equivalent tax rate) show the effective tax rate on the corporation. We also assumed the corporation is in at least its second year of profit-sharing. The full effects of tax credits on profit-sharing

* *Because of the application of the labor coefficient before profits are distributed to labor, the intensity of labor in a firm has no effect on the ratio of shared profit to total wages. It does not, therefore, affect the workers. However, the labor coefficient does have a direct effect on the accounts of the firm. As the labor coefficient rises, profit-sharing as a percent of net profits rises also, but the firm's tax credit for investment increases at the same time in an equal amount. The effect of varying the labor coefficient, given full utilization of the provisions of the law, is therefore marginal.*

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Hypothetical Results of Profit-Sharing Under Various Assumptions

After-Tax Return to Capital (Percent)	Three Major Results	Capital Coefficient		
		0.5	1.0	2.0
5	a/	0	0	0
	b/	0	0	0
	c/	50.0	50.0	50.0
10	a/	15.0	15.0	15.0
	b/	1.25	2.5 d/	5.0
	c/	42.5	42.5	42.5
15	a/	20.0	20.0	20.0
	b/	2.5	5.0	10.0
	c/	40.0	40.0	40.0
20	a/	22.5	22.5	22.5
	b/	3.75	7.5	15.0
	c/	38.75	38.75	38.75

a. Profit-sharing revenue as a percent of net after-tax profit.
b. Profit-sharing revenue as a percent of total wages.
c. Effective tax rate.
d. Results for "typical" corporation in Appendix.

and investment are thus included. The results of these calculations indicate that the French government's prediction of an effective wage increase of 10% (as a result of profit-sharing) probably is overly optimistic.*

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* *The figures in the middle row indicate that a combination of an abnormally high after-tax return and a relatively high capital coefficient is necessary to achieve an effective wage increase of 10%. It is likely that this combination will occur in only a few situations.*

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Methods of Distributing Profits

16. Three basic methods were outlined in the ordinance under which that part of the company's profits constituting the addition to the workers' reserve would be set aside for the employees: (1) shareholding, (2) company investment funds, and (3) labor-management mutual funds. If labor and management could not agree to the use of one of these options in a specified time, the second -- a company investment fund -- would have to be used. Regardless of the option, no cash would be paid the workers when profits were distributed. Instead, they would receive a claim, redeemable after five years.

17. Under the first option, the company would distribute shares or fractional shares of its stock to the workers, who thereby would become part owners of the firm. The stock could come either from a new issue or from treasury stock (a supplementary decree allowed French firms to buy up to 10% of their own shares on the Bourse). Workers receiving stock under this option must retain it for five years. If they want to sell after this period, the stock must be sold to the firm or a fellow worker.* Under the second option, a special investment fund would be established and the employees would acquire creditor status against the enterprise equal to the amount of shared profit. In practice this fund has usually taken the form of blocked, or frozen, accounts.

18. The third option, providing for a type of mutual fund jointly regulated by representatives of labor and management, is difficult to interpret -- even after the issuance of a supplementary decree. Presumably, a board composed of labor and management representatives will establish an investment portfolio or turn the funds over to an established investment corporation. If the fund is managed within the firm, the investment board may include in its portfolio stock of that firm,

* *The government, however, is considering a proposal allowing firms to set up stock option plans which would give the workers greater freedom of disposal of their shares.*

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medium-term loans to the firm, or issues purchased in the market. When such funds are reinvested in the firm, they may be used only for the purpose of capital formation. As yet little information is available concerning the actual application of this option.

Economic Effects

19. The most significant economic aspect of the French profit-sharing law is the tax credit available to the firm. The law was designed to encourage enterprise investment from retained earnings. As shown in the Appendix, if a company exercises its investment option, the effect is equivalent to transferring the entire cost of the program to the French Treasury.* If the enterprise does not invest an equal amount (as in the last column of the Appendix table), the cost of the program is shared by the government and the firm.

20. The law also was designed to allow enterprises limited access to funds placed in the workers' reserve. However, some of the various options available to utilize the workers' reserve effectively block the company's access to these funds. For example, the second option was designed specifically to increase a firm's opportunities for obtaining investment funds, but in practice this method of profit-sharing usually has taken the form of frozen accounts controlled by the workers. The same is true to a lesser extent for the mutual fund option. In this case, the firm may be but one of several recipients of the funds allocated by the investment board. Even for the economy as a whole, there is no guarantee that the funds in the workers' reserves will find their way into productive investment.

21. For the worker, it appears at first glance that participation in profit-sharing creates a

* *When the firm invests retained earnings in an amount matching the transfer to the workers' reserve, the firm's net profit after taxes for the second (or subsequent) year of profit-sharing is unaffected by profit-sharing because the tax saving is equal to the share of profits credited to the workers.*

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cost-free increase in his present and future income. That is, he is given some type of interest- or dividend-bearing certificate redeemable in five years. Unless profit-sharing decreases the firm's ability to increase wage rates (wage increases averaging over 10% annually in the past three years have done much to dispel this fear), the worker's present income should be increased by the return paid on his share, and his future income should be increased by the cash payment he receives when he sells his stock or redeems his debt instrument. However, the government's loss in corporate income tax revenue must be replaced largely by increases in other receipts. Because the French tax system is highly regressive, with direct and indirect taxes on consumption providing the bulk of tax revenues, the net economic gain accruing to workers will be substantially smaller than the nominal increases in income that result from profit-sharing.

Preliminary Results

22. In October 1970 the Ministry of Labor published incomplete but useful statistical information concerning the results of implementing the profit-sharing law. When the profit-sharing legislation was enacted in 1967, approximately 10,000 enterprises employing 5 million workers were expected to proceed with intra-firm negotiations leading to adopting profit-sharing plans. According to the Ministry of Labor, over 6,200 enterprises and 2.7 million workers are now covered by profit-sharing plans. More than two-thirds of the profit-sharing contracts were concluded by companies employing under 500 workers. Although the legislation is compulsory only for enterprises with more than 100 employees, over 10% of the signatory enterprises had smaller work forces.

23. Although over half of the enterprises covered by the law have now concluded contracts, the degree of implementation varies widely by industrial sector. The bulk of the contracts (86%) are concentrated in the construction and public works industries. Other sectors, in declining order, are mechanical and electrical industries, commerce, textiles, financial institutions, and agricultural and food processing

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industries. No contracts have yet been signed in the metal processing sector.

24. Of the three methods under which shared profits could be made available to employees -- shareholding, company investment funds, and labor-management mutual funds -- two were highly preferred. The second option -- a special investment fund within the company -- was selected in 56% of the contracts.* Forty-three percent of the contracts chose the third option, for investment funds jointly regulated by labor and management. Less than 1% of the contracts adopted involved allocating company shares to employees, demonstrating French labor's lack of interest in shareholding plans.

25. Since the initial decree in 1967 and the final passage of the profit-sharing bill in 1968, much of the criticism voiced by both labor and management has evaporated. The big labor unions appear to have accepted the principle, or at least the inevitability, of participation through profit-sharing. At the same time, the industrialists, who at first cried out against "sovietizing" French industry, now recognize certain positive qualities in the system. Both managers and stockholders now admit -- albeit reluctantly -- that profit-sharing may increase the amount of investment funds available to the firm without reducing after-tax profits. Also, it now appears that profit-sharing will involve little or no dilution of managerial control.

26. The number of profit-sharing contracts continues to increase, and workers' reserves are being created. However, the question remains: will profit-sharing as now practiced in France have any significant economic effects? The answer

* *This form of profit-sharing is favored by the CGT. In 1968 the CGT obtained 55% of the votes in enterprise committee elections and was thus the dominant voice in the "company works councils" that represented labor in most of the profit-sharing contracts. The Communist-dominated union finds this the least odious form of participation -- that is, it provides the smallest chance for the corruption of French workers by "capitalist greed."*

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will depend primarily on three factors: (1) the extent of future implementation, (2) future profit margins of French industry, and (3) the extent to which enterprises can -- and if they can, will -- take advantage of fiscal benefits in order to increase investment in plant and equipment.

27. Preliminary and tentative information indicates that in 1969, with approximately half the plan implemented, a little over $100 million in profit-sharing revenue was distributed (an average of $50 for each of the approximately 2 million recipients, less than 2% of total wages paid these workers). At most, the increase in funds available for investment in 1970 as a result of profit-sharing could amount to $200 million.* Although this sum appears large, it would represent less than 1% of total net business investment. And, again assuming that French enterprises fully exercised their option to invest and receive a tax credit in corresponding amount, the French government's tax loss of approximately $100 million would be less than 0.5% of total government receipts. Therefore, even under these most optimistic (and unlikely) assumptions, French profit-sharing in 1969 was relatively insignificant in terms of workers' incomes, business investment, and lost tax revenue.

* *The conditions necessary to maximize the amount available are (1) all funds in the workers' reserves are invested, (2) each distributing firm matches its contribution to the workers' reserve with funds earmarked for investment, and (3) an amount equal to the special investment provision would not be invested without the tax credit.*

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Conclusions

28. The storm of criticism aroused by the profit-sharing law has receded. The polemics that emanated from both labor and management have been replaced, not by approval of the law but by widespread apathy toward profit-sharing. Although industrial reform, achieved through greater worker participation in French enterprises, remains a key aspect of Gaullist economic doctrine as interpreted by Pompidou, the government's enthusiasm and roseate predictions now appear somewhat forced.

29. It is unlikely that profit-sharing, even when fully implemented, will provide an important source of investment capital; it also is unlikely that it will affect significantly workers' incomes or labor productivity. However, in a country where labor-management relations traditionally have been riven with mutual distrust and where the mechanism of collective bargaining is almost unknown, the impact of profit-sharing may transcend direct economic effects. Labor-management negotiations leading to profit-sharing contracts, as well as labor's limited but important role in managing the resulting workers' reserves, are giving the French worker some sense of involvement in enterprise affairs. Although it is impossible to predict whether a lasting improvement in French labor relations will result from profit-sharing, government efforts to increase worker participation can be given some credit for the present quiet on the French labor front.

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APPENDIX

The Arithmetic of Profit-Sharing

At the end of its financial year, a "typical" company covered by a profit-sharing scheme credits a special section in its accounts with the share of profits accruing to the workers. This share is calculated first by taking the net profit (after deduction of corporate taxation at a rate of 50%) and subtracting a priority charge equal to 5% of capital for dividend purposes. Then, in a separate calculation, the company's wage bill is divided by a concept known as the total value added, which is basically total production costs (total labor costs, duties and taxes with the exception of turnover taxes, financing costs, amortization allowances, mandatory contingency funds, and dividends). The result of the second operation is then multiplied by the first and *half* the resulting amount is credited to the employees. For a "typical" corporation (in which net worth is approximately equal to total production costs, net profits are 10% of net worth, and labor costs represent 60% of total production costs), the calculations for the first and second years of profit-sharing are given in the accompanying table.

In the first year of profit-sharing (1969 in the table), the corporation receives no tax credits and must finance the entire cost of profit-sharing from its after-tax profits. The amount available for additions to reserves, dividends, and the like, is thus reduced by the full amount of the workers' reserve. If the corporation in the second year uses its investment option (see the table), the corporation is only marginally affected by profit-sharing. In 1968 the corporation's before-tax profits are $200,000, taxes are $100,000, and after-tax profits are $100,000. In the second year of profit-sharing, assuming the corporation invests an amount equal to 1969 profit-sharing, before-tax profits are still $200,000 but corporate taxes are now only $85,000. After-tax profits thus are $115,000, of

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which $15,000 must be subtracted for profit-sharing. The arithmetic of the French profit-sharing law thus leaves the corporation with the same *net* after-tax profits of $100,000, and the cost of profit-sharing is wholly transferred to the government. If the corporation does not utilize its investment option (see the table), the cost of the program is shared by the corporation and the Treasury.

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Calculations of Profit-Sharing for a "Typical" Corporation

	1968	1969	1970	
	Before Profit-Sharing	First Year	Investment Option Used in 1969	Investment Option Not Used in 1969
	Thousand US $			
1. Total production costs	1,000	1,000	1,000	1,000
2. Total wage costs	600	600	600	600
3. Labor coefficient (line 2 : line 1)	0.6	0.6	0.6	0.6
4. Owned capital (net worth -- stock outstanding plus reserves)	1,000	1,000	1,000	1,000
5. Net profit before tax	200	200	200	200
6. Prior return to capital (5% of line 4)	50	50	50	50
7. Before-tax profits less previous year's profit-sharing (line 5 - line 13)	200	200	185	185
8. Taxable profits (line 7 - line 14 of the previous year)	200	200	170	185
9. Corporate profit tax (50% of line 8)	100	100	85	92.50
10. Net after-tax profits (line 8 + line 14 - line 9)	100	100	100	92.50
11. Profit available for sharing (line 10 - line 6)	a/	50	50	42.50
12. Labor's share of profits (line 11 x line 3)	a/	30	30	25.50
13. Addition to workers' reserve (½ of line 12)	a/	15	15	12.75
14. Investment provision (maximum permitted: line 13)	a/	15	15	12.75
	Percent			
15. Profit-sharing as a percent of wage costs (line 13 : line 2)	a/	2.5	2.5	2.12
16. Effective tax rate (line 9 : line 5)	50.0	50.0	42.5	46.25
17. Profit-sharing as a percent of net after-tax profits (line 13 : line 10)	a/	15.0	15.0	13.78

a. Not applicable.

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