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I. Introduction

Part of the success of the employee stock ownership plan(ESOP) concept stems from the steady support it has received from both sides of the political spectrum. Such political strangers as Walter Reuther and Ronald Reagan have supported expanded employee ownership of employer stock.[1] The theoretical background combines commitments to free enterprise and more equitable distribution of corporate ownership. Since 1973, when Senator Russell Long (D Louisiana, retired) introduced the first of a continuing series of legislative initiatives favorable to ESOPs, the establishment of ESOPs has grown rapidly. By the end of 1985 there were approximately 7,400 ESOPs covering some 7.4 million employees.[2] 550 companies adopted ESOPs during 1985 alone.[3] Most companies with significant employee ownership are medium to small sized, such as Hallmark Cards or Eastern Airlines.[4] Larger companies such as ATT, GM, and Exxon, however, have also distributed some shares to employees through ESOPs.[5]

The extraordinary growth of ESOPs has generated interest in exporting the

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1. *The 1967 Economic Report of the President: Hearings Before the Joint Economic Committee*, 90th Cong., 1st sess. 774 of part 4 (1967); Ronald Reagan, Speech to the American Legion, *reproduced in* The Washington Post, Feb. 23, 1983, at 12.

2. Pens. Plan Guide(CCH), No. 589, at 2 (July 3, 1986), from data compiled by the National Center for Employee Ownership.

3. *Id.*

4. Eastern Airlines has 37,100 employees, and is 25 percent employee owned; Hallmark has 10,000 employees, and is 65 percent employee owned. Employee Ownership, newsletter of the National Center for Employee Ownership, May/June 1986.

5. N. Kurland, The Future of the Multinational Corporation: Who Will Own It? Unpublished paper for the International Congress on Technology and Technology Exchange, Pittsburgh, May 4, 1982 (available through the office of the Mich. Y.B. of Int'l Legal Stud.).

idea overseas. As part of the Carribbean Basin Initiative, President Reagan appointed a task force to study the prospects for ESOPs in Central America and the Carribbean. The task force released a report with encouraging recommendations to the President and Congress in October of 1986.[6]

This note presents the case for adapting ESOPs to the operations of U.S. multinational enterprises (MNEs) in Central America. It argues that the U.S. as home country, host countries in Central America, MNEs, and their employees all can benefit by cooperating to produce more democratic ownership and participation in MNEs through ESOPs. Widespread employee ownership would also represent progress on some of the more general problems associated with underdeveloped economies.

Part II of this note explains the relevance of using U.S. direct investment in Central America as a starting point for encouraging employee ownership. Part III describes the essential legal framework of the ESOP in the U.S., providing a framework from which to adapt the ESOP to other countries. Part IV argues that all parties paricipating in this form of expanded ownership will realize significant short and long-term benefits, but points out some problems of transferring ESOPs, a U.S. legal innovation, to different cultural and business environments. Part V presents some of the legal and economic issues of adapting ESOPs, and suggests two possibilities for implementing a program of expanded employee ownership.

II. Central America and U.S. MNEs

Although the idea of exporting the ESOP should by no means be limited, U.S. direct investment in Central America makes a sensible starting point for several reasons. First, the interest that both the Administration and Congress have expressed in democratic ownership raises excellent prospects for concrete foreign policy legislation supporting the concept.[7] Economic and political relations between the U.S. and Central America are critical for both parties, and their mutual long term interests certainly lie in improving them.[8]

Second, although new investment and returns on existing investment have fallen off high levels achieved during economic growth in the seventies, U.S. investment in Latin America is still very important to the region. U.S. companies

6. Presidential Task Force on Project Economic Justice, High Road to Economic Justice (October 1986) [hereinafter Presidential Task Force], available through the Center for Economic and Social Justice, Wash. D.C. The Task Force report is a thoughtful and comprehensive analysis focusing on the possibilities for 'privatizing'economies dominated by inefficient state participation by means of ESOPs and debt-for-equity swaps. Although many of the issues are the same, this note concentrates on U.S. direct investments rather than domestic private or state owned firms in Central America.

7. H.R. Con. Res. 31, 99th Cong., 1st Sess. (1985).

8. *See generally*, W. LaFeber, Inevitable Revolutions: The United States in Central America (1984).

remain the dominant foreign investors in Latin America as a whole, and earn a high rate of return on investments there.[9] Moreover, while foreign firms continue to compete to invest, the developing countries' positions on foreign investment have shifted from stricter regulation to a more flexible policy as part of a competition to attract investment.[10] The business expertise and investment capital MNEs can provide, combined with cheap labor and resources from the host country still create a strong incentive to foreign investment. Especially now, given the recessed economies and huge foreign debts of many developing nations, MNEs take on added importance as engines for development and partial cures for balance of payments ills.

Third, the great potential within MNEs to enhance development in Central America has not been realized. The image of U.S. MNEs has been of powerful and tightly managed companies whose presence benefits a concentrated group of owners or host country elites. Relations between domestic labor, MNEs, and host governments have often been combative and unproductive.[11] Despite the long-standing U.S. policy of development through foreign investment there has been little improvment (if not actual deterioration) in the economic structure of Central American countries.[12]

Nevertheless, direct foreign investment is here to stay and does create some substantial benefits.[13] An International Labor Organization study concluded that even capital intensive foreign investment provides significant employment effects through business linkages.[14] In Latin America as a whole, direct employment created by MNEs grew more rapidly in the years 1960-1977 than in any other developing region. In Mexico MNEs are estimated to employ 20 to 30 percent of manufacturing workers.[15] Add to this the domestic labor employed in U.S. agribusiness or service firms, and the great potential of equity distribution through ESOPs is plain.

9. R. RAMSARAN, US INVESTMENTS IN LATIN AMERICA AND THE CARRIBBEAN 101–3 (1985).

10. Levinson, *Yanqui Come Back!*, ACROSS THE BOARD, October 1986, at 22.

11. Some contributing examples are the United Fruit Company in Central America, and ITT and the Anaconda and Kennecott copper companies in Chile. They are perceived as having corrupted local leaders and having interfered in host politics in an exercise of greed and exploitation. The point is not to pass judgment on these allegations. Whether there is a factual basis for the worst images of multinationals in Central America their relations could be improved and situations like those mentioned may be avoided.

12. *See* RAMSARAN, *supra* note 9, at 108–9, 178–87.

13. It is beyond the scope of this note to take sides in the academic debate on issues such as the net balance of payments effect of foreign investment, net social costs or benefits. *See, e.g.*, C. F. BERGSTEN ET AL., AMERICAN MULTINATIONALS AND AMERICAN INTERESTS, 354–368 (1978) [hereinafter BERGSTEN]. The proposal of this note would shift the evaluation more in favor of multinational corporations. BERGSTEN, *id.*, or R. VERNON, STORM OVER THE MULTINATIONALS (1977), outline the broad issues in foreign direct investment.

14. INTERNATIONAL LABOR ORGANIZATION, EMPLOYMENT EFFECTS OF MULTINATIONAL ENTERPRISES IN DEVELOPING COUNTRIES 56–76, 114 (1981).

15. *Id.* at 112–13.

Finally, although labor unions are generally weak, suppressed, or controlled in Central America there are incipient movements for worker ownership and participation. One such movement is the *solidarista* phenomenon originated in Costa Rica. *Solidaristas* are employee associations funded by employee contributions and employer matching funds which create credit for employee purchases of employer stock or other investments. *Solidaristas* now involve almost all U.S. MNEs in Costa Rica and typically own 10–20 percent of employer stock.[16] The movement has spread to Guatemala and is present in Honduras and El Salvador, totaling over 1000 associations covering more than 140,000 employees.[17] MNEs with some degree of employee ownership in Guatemala or Costa Rica include Delmonte, Firestone, IBM, and Ramada Inns.[18] These developments of worker ownership and participation have occurred without any of the tax incentives which favor ESOPs in the U.S. One can imagine the redoubled growth of distributed ownership if key elements of the favorable U.S. legal environment could be duplicated or substituted in Central America.

III. ESOPs in the United States

Lawyers working with ESOPs in the U.S. must be highly specialized. They confront a maze of statutes and regulations involving the Employee Retirement Income Security Act (ERISA), the Internal Revenue Service (IRS), the Securities and Exchange Commission, and the Department of Labor. Fortunately, the ESOP can be reduced to some basic elements, and in streamlined form should be easily adaptable to the various tax, labor, corporation, and foreign investment laws in Central America.[19] Set forth below is the essential structure of the leveraged ESOP:[20]

1) A trust is set up for the employees and obtains a loan guaranteed by the corporation to purchase presently owned employer securities or new issues.

2) The stocks are held in a suspense account as collateral for the loan until the loan is repaid from employer contributions or other sources. Stocks are then freed and allocated to individual accounts according to flexible formulas based on pay and/or service length, or per capita methods.

16. Winsor, *The Solidarista Movement: Labor Economics for Democracy*, 9 The Washington Quarterly 177 (September 1986).

17. *Id.* at 177–78.

18. *Id.* at 180. *See also* J. Recinos et al., Statement of Purpose of the Solidarity Union of Guatemala: The Philosophy and Objectives of the Business Executives, Corporate Owners and Workers Solidarity Alliance of Guatemala (unpublished, available through the office of Mich Y.B. of Int'l Legal Stud.).

19. An excellent discussion of ESOPs, heavily relied on here, is Wehyer & Knopff, The ESOP (1986).

20. *Id.* at 29–35.

3) The account vests to employees, much as in any pension plan, according to certain schedules. Dividends, if available, may be distributed immediately or left in the individual account. Unallocated dividends may be used to repay the loan or be invested.

4) Plan participants are entitled to begin receiving distribution of account balances five years after termination of employment. Where stock is not a registration type security (not readily tradeable) employees may "put" the stock back to the employer for a fair price.

The essence of the ESOP is employee access to corporate credit which provides the opportunity for expanded ownership by employees without requiring their financial contribution or risk.[21] Although ESOPs make excellent complements to worker participation systems, the law does not require direct employee participation in management. In large, publicly held corporations, allocated ESOP stock must generally be voted as directed by the employees, and unallocated stock must be voted in the interests of the employees by the plan administrator(s).[22] Where stock is not readily tradeable, voting rights must be passed through to individual employees on major actions such as mergers or consolidations, recapitalization, liquidation, dissolution, sale of substantial assets, or such other actions requiring more than a majority as are enumerated in the bylaws.[23] The employer may still structure the desired degree of employee input into everyday business decisions. The percentage of outstanding stock held in an ESOP can also be set by the employer. No minimums or maximums apply.[24] However, an ESOP may only hold "qualifying" employer securities.[25]

ESOPs are implemented in the U.S. for many different reasons. Boards of directors, of course, do not set them up solely out of a concern for economic justice. ESOPs have been used to raise finances, as a defense to takeovers, or as a favorable method for owners of close corporations to retire their interest. Employees desiring a chance to save their failing company have used ESOPs as a leveraged buyout mechanism.[26] But the driving force behind the proliferation of ESOPs is the favorable tax treatment begun in 1973. [27] Moreover, ESOPs have remained relatively unscathed by the 1986 Tax Reform Act, unlike many other

21. ESOP creditors can only reach the following trust holdings: (1) loan collateral; (2) employer contributions; and (3) earnings derived from (1) and (2). Treas. Reg. § 54.4975-7(b)(5) (1986).

22. I.R.C. §§ 409(e), 4975(e)(7) (1987).

23. I.R.C. §§ 401(a)(22), 409(e) (1987); WEHYER & KNOPFF, *supra* note 19, paragraph 4.15.

h 24. WEHYER & KNOPFF, *supra* note 19, at 238–40.

25. Defined in I.R.C. § 401(9) so as to protect the central purpose of the ESOP trust of investing in employer stock for the benefit of the employees. Treas. Reg. & 54.4975-11 (1986) gives a general definition of ESOPs and their requirements.

26. WEHYER & KNOPFF, *supra* note 19, at 12–20.

27. *Id.*, paragraphs 1.02, 1.11. These passages describe the legislative history and some of the important tax incentives of ESOPs.

pension or profit sharing devices. The following is a list of some key tax advantages for ESOPs:

1) The ESOP trust itself is tax exempt if a qualified ESOP is maintained under ERISA. Employee accounts are untaxed until distributed.[28]

2) Employer contributions to repay the loan are treated as a deductible employee benefit expense. Other contributions may be deductible up to a relatively high percentage of the total compensation of plan participants.[29]

3) Commercial lenders to an ESOP may deduct 50 percent of the interest proceeds.[30] Thus, loans to an ESOP may often be extended at below market rates.

4) Sellers of stock to an ESOP may defer taxation of the proceeds by reinvesting in the stock of another U.S. company.[31]

5) The corporation may deduct cash dividends paid to participants; there is no "double taxation" of corporate profits at the corporate and individual level.[32]

To accompany these generous tax incentives, and other less crucial advantages for ESOPs, the IRS, the Department of Labor, and the SEC combine to check potential abuses and to ensure that ESOPs are maintained prudently and fairly for the "exclusive benefit" of employees under the extensive regulation of ERISA.[33] Chiefly, to be eligible for any tax benefits an ESOP must represent a fair cross-section of employees. It must not discriminate in favor of highly compensated employees in participation or benefits.[34]

Naturally, the IRS can recover improperly obtained tax benefits if a plan has become unqualified, but other enforcement mechanisms affect ESOPs more immediately. Plan administrators or hothers who may be defined as ESOP fiduciaries are subject to a duty to protect the interests of employees.[35] Recent developments in the courts have put serious emphasis on this duty.[36] There are

28. I.R.C. §§ 401(k), 4975(e)(7) (1987). Tax deferral for employees is given in §§ 402(9), 401(a)(23).

29. I.R.C. § 404(a) and (k) (1987).

30. I.R.C. § 133 (1987).

31. I.R.C. § 1042 (1987).

32. I.R.C. § 404(k) (1987).

33. I.R.C. § 401(a) (1987) covers qualified employee plans generally.

34. Participation requirements for qualified plans are given in I.R.C. §§ 401, 410, 411, 415 (1987). "Top heavy" plans — those which may discriminate in favor of more highly compensated employees — are governed by I.R.C. § 416 (1987).

35. Employee Retirement Income Security Act of 1974, §§ 3(21)(A), 404(a)(1)(B) and (C), 29 U.S.C. Ch. 18, (1982, Supp. 1986) [hereinafter ERISA]. Plan participants can sue for fiduciary breaches, ERISA § 502(a)(2).

36. Donovan v. Bierwirth, 538 F. Supp. 463 (E.D.N.Y. 1981), *cert. den.*, 459 U.S. 1069 (1982), *aff'd and modified*, 680 F.2d 263 (2d Cir. 1982), *rev'd and remanded*, 754 F.2d 1049 (2d Cir. 1985) (breaches of duty in voting employee stock); *see also*, *Suit Against Magazine Highlights Debate on Valuing Employee Owned Companies*, Wall St. J., Sept. 16, 1986, at 31, col. 4.

detailed reporting requirements to the IRS and the Department of Labor[37] and potential registration requirements under the securities laws of 1933 and 1934. Importantly, employees must receive an explanation of the plan and what their participation means in language calculated to be understood. Employees also have the right to some information on demand.[38]

These last basic regulations are probably more essential for adapting ESOPs to multinational operations than the tax incentives. In other legal systems, different tax or non-tax incentives may be packaged so as to replace the U.S. incentives, but the fiduciary and reporting requirements should remain strong to protect the employees. Nevertheless, it should not be difficult to simulate U.S. treatment of ESOPs as pension or profit sharing plans or deferred compensation mechanisms within the existing tax structure of other countries.[39]

IV. Benefits for all Parties in the MNE Scenario

Adapting the ESOP to U.S. MNEs in Central America would serve the best long term interests of everyone. There are costs associated with such a program, but in a carefully designed plan the benefits should outweigh the costs for each actor. This is best seen by viewing the possibilities from each perspective.

A. Host Countries

Before analyzing the host country benefits, it should be noted that the argument of benefits from employee ownership presumes a nationalistic definition of the broad interests developing countries have vis-a-vis foreign investment. The dual economies associated with developing countries present a potential political problem because they can create a class of local elites whose interests are more closely allied with those of the foreign investors. A concentrated, modernized enclave may develop in the urban centers around capital investment while the peripheral sectors languish.[40]

37. The IRS requires registration documents from all plans, I.R.C. § 6057 (1987), and detailed annual reports of the finances of the plan and its operations, I.R.C. § 6058(a) (1987). The Department of Labor requires an updated plan description, ERISA § 101(b) and 104(a)(1)(B), annual reports, ERISA § 103, and a copy of the summary plan description given employees, ERISA § 104(a)(1)(C). Additionally, documents and reports filed with the IRS and DOL may have to be available for public inspection, I.R.C. § 6104(a)(1)(B) and (C). Penalties may be assessed for failure to comply with reporting and disclosure requirements, ERISA § 501.

38. Plan participants must have a summary description of the plan, ERISA § 104(a) and (b), and a statement of their rights under the plan, ERISA § 104(c). On request, participants may obtain copies of the plan documents such as the complete description or the trust agreement, ERISA § 104(b)(4).

39. This is taken up more fully in part V.

40. Prebisch, *A Critique of Peripheral Capitalism*, 9 CEPAL Review (1st half), 60–76 (1976); J. Nelson, Access to Power 24–33 (1979) (analyzing the dual economy). The characteristic effects of a modern developing sector vary with each country's political and economic history; Jackman, *Dependence on Foreign Investment*, 34 World Politics 175 (1982).

Developing countries have recognized these issues and have begun to seek to answer some of their specific needs, defined in more nationalistic terms, through bargaining with foreign investors in each case.[41] Though there is tremendous diversity in developing country characteristics, developing and developed countries have evidenced a reasonable consensus on the proper role of MNEs with respect to host countries.[42]

With a host country perspective having been identified, the most salient benefit of ESOPs for host countries would be some reduction in the concentration of ownership and the staggering income disparities so prevalent in Central American economies.[43] Currently, only the government or wealthy elites can afford ownership in MNEs. Even where employees represent a small percentage of the total labor force, as a new class of owners of income producing assets they would represent a significant change in the structure of underdeveloped economies.

Furthermore, ownership expanding mechanisms such as the ESOP fit well within the general theme of decreasing the income gap in Central American economies. An ESOP is a method of distributing future wealth, not redistributing currently held wealth, as in land reform programs so often stalled in Central America.[44] As such, an ESOP program would be more palatable to the wealthy elites. Similarly, since the program would be directed initially at MNEs, host governments subject to criticisms of foreign domination and exploitation, yet in great need of the capital and expertise MNEs can provide, would find the policy more politically feasible. In addition to this softened perception of foreign investment, employee ownership could create a new political constituency for programs aimed at the income gap.

Host countries have also sought to extract maximum employment benefits from MNEs. One goal is the creation of a larger, more skilled class of labor by means of local hiring and training requirements for MNEs. MNEs have been willing to cooperate with these requirements in the interest of efficient operations in the local business environment.[45] Access to ownership for these employees would create more ties to the host economy, serving the preference for integrated development over MNE enclaves. The pension and profit sharing elements of an ESOP are consonant with the goal of improving the quality of the labor force.

To the extent that a company is successful and an ESOP prospers, two benefits may be realized. ESOPs could help supply savings for investment in more employer securities or in other outlets, much as solidaristas do.[46] Gains in work-

41. BERGSTEN, *supra* note 13, at 369–81.

42. U.N. CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS (draft), U.N. Doc E/C.10/1982/6 of June 5, 1982, Annex. at 192 [hereinafter U.N. CODE].

43. During 1960-1975, a period of relatively high GNP growth, income distribution worsened in Latin American countries. RAMSARAN, *supra* note 9, at 27.

44. For one country's case, *see* E. BALOYRA, EL SALVADOR IN TRANSITION, 102–04,138–9 (1982).

45. I.L.O, *supra* note 14, at 113.

46. Winsor, *supra* note 16, at 181.

ers' income would help support strong consumer demand, which is vital to further development.

Another route to integrating and controlling foreign investment is a local ownership requirement. The most well known example is probably Mexico's widely emulated "mexicanization law," requiring majority local ownership in most foreign direct investments.[47] The purpose of local ownership is to prevent de-nationalization of the economy and ensure that local interests are represented in MNEs. These goals have often been frustrated because, as noted earlier, local owners may have a closer allegiance to the company's interest than the national interest.[48] Or, where local owners might represent countervailing interests to the MNEs worldwide profit motive, companies have evaded the law through sham stockholders or other means.[49]

Host countries could improve the performance of local ownership requirements by allowing foreign investors to satisfy them with effective ESOPs. Worker participation in everyday management could still be at the discretion of the company, although it should be encouraged. Such employee owned stock, however, makes the company accountable to the workers on major issues such as substantial sales of assets, liquidation, or merger by means of the fiduciary duty to stockholders or employee voting rights. Without effective unions or plant-closing legislation, a shutdown or liquidation by an MNE without warning can have disastrous effects on the employees and local community. An ESOP would at least ensure that employee interests are a factor, and if it held a substantial portion of stock, the employees might be able to veto unfavorable proposals. Finally, if reporting requirements similar to those imposed under U.S. law were adopted, host countries could more easily police local ownership.

B. United States as Home Country

The worldwide activities of U.S. corporations have important effects on trade policy, foreign relations, and ultimately the domestic economy. Yet U.S. response to these forces has lagged considerably behind their appearance. U.S. multinationals have been encouraged to carry out their investments without being accountable on many issues to the home country. U.S. policy has not presented a coherent treatment, and has mainly been confined to taxation and protection of U.S. investments.[50] The Foreign Corrupt Practices Act[51] is one attempt to influ-

47. *Ley Para Promover la Inversion Mexicana y Regular la Inversion Extranjera*, 317 D.O. 5, March 9, 1973 (Law to Promote Mexican Investment and Regulate Foreign Investment).

48. Vernon, *supra* note 13, at 168–70.

49. R. Tancer, *Regulating Foreign Investment in the Seventies: The Mexican Approach*, in THE FUTURE OF MEXICO, 197–206 (Kaslow ed. 1976).

50. BERGSTEN, *supra* note 13, at 22–31. The authors also discuss the history of U.S. policy, and conclude that more careful consideration of foreign investment effects on the security and welfare interests of the U.S. and host countries is called for. *Id.* at 309–14.

51. 15 U.S.C. §§ 78dd-1 and 78dd-2 (1982). This act penalizes certain illicit activities of U.S. corporations abroad, including their employees and agents, such as bribing government officials.

ence MNE activity, but the U.S. needs to become more involved in the investment process.

A significant step toward greater involvement would be active encouragement of employee ownership of U.S. companies abroad. Such a program would demonstrate real commitment to the longstanding U.S. development rhetoric of free enterprise and democratic principles. Past policy and the present Carribbean Basin Initiative have been justifiably criticized for placing development issues in the context of East-West relations and failing to recognize the need for real structural reforms in the economies and attention to basic needs. The benefits of U.S. style modernization have not trickled down.[52]

Overall, developing countries have perceived similar economic policies thrust on them by the member nations of the Organization for Economic Cooperation and Development (OECD) and international financial institutions as paternalistic and somewhat hypocritical.[53] Putting its own house in order first by encouraging ESOPs in MNEs abroad, the U.S. could begin to remedy policy failures and lost credibility.

Charles Kindleberger pointed out that the challenges of the global economy call for leadership and recognition of long-term interests. While the U.S. is no longer the dominant economy, he sees it as the best choice to assume that leadership.[54] With this particular program of encouraging employee ownership the U.S. might provide an example of sound foreign policy for other developed countries.

The debt crisis, East-West security issues, and the mutual need for strong and stable trading partners have created a special interdependence between the U.S. and Central American nations. Yet few would describe Central America as a shining example of U.S. foreign policy. For instance, on the mainland as well as in the Carribbean there have been a series of heavy handed and belated attempts at quick military solutions to problems with deeper roots: Guatemala (1954), Cuba (1961), the Dominican Republic (1965), Grenada (1983), and currently Nicaragua and El Salvador. ESOPs in U.S. MNEs could be part of a more patient alternative policy with greater respect for self-determined development in Central America. Steps the U.S. might undertake to promote this are discussed in Part V.

C. MNEs

Companies establishing ESOPs would be giving up some managerial control and profits, while incurring the administrative costs of setting up and maintaining

52. RAMSARAN, *supra* note 9, at 100, 108, 178–87.

53. R. HANSEN, BEYOND THE NORTH-SOUTH STALEMATE, 7–8,27,47–52 (1979). Hansen analyzes developed and developing country relations in the context of the world political system.

54. Kindleberger, *Dominance and Leadership in the International Economy*, 25(2) INT'L STUD. Q. 242 (1981).

a qualified plan. These disadvantages must be partly overcome by incentives such as those under U.S. tax law.[55] However, an ESOP can buy a multinational enough significant benefits, aside from those which incentives give, to make it a productive investment. In addition to the finances raised from a sale of stock, the company can achieve better labor relations through more involved, satisfied and productive workers, and improved status with host countries.

Since the success of an ESOP depends on profits, the participating employees have a real stake in the success of the company. In the U.S. there have been spectacular examples of productivity and profitability gains after ESOPs with substantial shares were instituted.[56] They also have the potential of improving labor relations and worker satisfaction as *solidaristas* do.[57] In the U.S., managers often cite the motivation of employees as a primary rationale for ESOPs.[58] These could be tremendously significant benefits to MNEs.

Two cautionary notes are in order, however. First, the overall evidence for increased productivity and worker satisfaction is somewhat inconclusive. Some studies support these benefits in the context of employee ownership.[59] Other studies have found no such connection but suggest that the missing variable may be a degree of worker participation in management decisions, or a more than trivial degree of ownership.[60]

Second, there should be a close examination of the differences in culture and labor structure. A simple transfer of worker ownership or participation models developed in one country to a different country may not result in any of the same benefits.[61] Specifically, the U.S. labor force is generally more educated and more sophisticated about employee benefits than are the labor forces of Central America. Motivation and satisfaction in these workers may depend partly on the company's ability to fully disclose to the rank and file employees what the ESOP means for them and how it works. Thus, the extensive disclosure requirements in U.S. law for the education and protection of employees take on added significance in the MNE setting.

55. They need not necessarily be tax incentives; waivers of certain restrictions on foreign investment or trade incentives could be just as effective.

56. Presidential Task Force, *supra* note 6, at 72–4.

57. Winsor, *supra* note 16, at 181.

58. WEHYER & KNOPFF, *supra* note 19, at 16.

59. ESOP companies in similar sized firms and industries are one and a half times more profitable than other firms. M. Quarri, *Employee Ownership and Corporate Performance*, unpublished study available through the National Center for Employee Ownership (1986). Worker satisfaction and productivity are related to ESOP contributions and the commitment of the company to worker ownership. *Employee Ownership*, unpublished study by the University of Michigan Survey Research Center (1980).

60. Sockell, *Attitudes, Behaviors, and Employee Ownership*, 24(1) INDUS. REL. 130 (1985); Long, *Worker Ownership and Job Attitudes*, 21 INDUS. REL. 196 (1984).

61. Levitan & Werneke, *Worker Participation and Productivity Change*, 28 MONTHLY LAB. REV. 28 (1984).

The response of Central American labor to employee ownership diminishes these two concerns somewhat. The *solidarista* movement is one indication of an environment ripe for modified ESOPs. In particular, there is the dramatic example of *La Perla* coffee plantation in Guatemala. Beset by guerillas and on the brink of failure, the owners set up an ESOP under the auspices of a *solidarista* association. In 1984, after the first allocations of shares (40 percent ownership) production increased nearly two-fold, and prospects for the future are excellent. Worker ownership is a powerful enough idea that some of the guerillas have defected to the plantation, and plantation workers have taken up arms to defend their interests.[62]

An additional benefit of local ownership, especially of a kind making a unique contribution like an ESOP, is the harmonization of relations with the government and reduction of risks of unfavorable reactions to foreign investment.[63] The effort multinationals spend on political risk evaluation and the growth of overseas investment insurance indicate that unpredictable host country policies are one of the greatest concerns of MNEs.[64] In most circumstances host countries should be more reluctant to expropriate a multinational with a significant element of local ownership through an ESOP. Even less severe policies affecting the profitability of an MNE would damage the interests of domestic employee owners.

In the actual event of expropriation and compensation proceedings, contributions to the host country made through an ESOP could result in more favorable valuations of the investment. If MNEs can present a less clearly foreign intrusion into their hosts overall—if they are seen as less of a de-nationalization or exploitation threat—their investments should receive more favorable treatment. Finally, to the degree that MNEs are able to accomplish these objectives they may reduce their overseas investment insurance costs.

Elsewhere in the Michigan Yearbook of International Legal Studies, Kojo Yelpaala has described the internalization theory of why MNEs invest abroad. He argues that legislation targeting MNEs must take account of the desire of MNEs to obtain control over all factors affecting marketing and production in their business. With such control, MNEs can shift aspects of their operations among countries to maintain a smooth business despite the vagaries of the world economy or host government policies creating "market imperfections."[65] For example, if the costs of labor go up in one country, or even the predictability of those

62. England, *Peasants Fight and Buy Stock to Save Beleaguered Plantation*, INSIGHT (June 16, 1986) at 33, col. 1, *reprinted in* Presidential Task Force, *supra* note 6, appendix D.

63. *See* M. BROOKE & H. L. REMMERS, THE STRATEGY OF THE MULTINATIONAL ENTERPRISE 235–240 (1978).

64. *See* M. Levinson, *Where's the Next Revolution*, ACROSS THE BOARD, Jan. 1986, at 40.

65. Yelpaala, *The Impact of Industrial Legislation on the Behavior of Multinational Enterprises and Labor in the Industrializing Countries of East and Southeast Asia*, 6 MICH.Y.B. INT'L LEGAL STUD. 383, 395–6 (1986). *See also*, P. BUCKLEY AND M. CASSON, THE ECONOMIC THEORY OF THE MULTINATIONAL ENTERPRISE 9–14 (1985).

costs, a multinational may respond by shifting that factor of production elsewhere.

It follows that local ownership, especially in an ESOP, would put some outer limits on the flexibility MNEs enjoy. Indeed, this is part of the advantage to the other actors. Nevertheless, there is a trend toward greater local ownership.[66] ESOPs should not affect this trend, nor deter investment for the following reasons. An MNE will still retain control over the costs associated with an ESOP. Unlike a minimum wage law, or employment insurance, or even a defined benefit pension plan, ESOPs do not raise the fixed costs of labor. The cost is variable aside from the minor administrative expenses. There is no minimum contribution requirement. If in one year there are no profits, there need not be contributions. Or if in another year the company needs capital for expansion, it need not contribute.[67]

In summary, MNEs with ownership by local employees will be giving up some control. But the internalization theory supports the view that MNEs would generally trade such control for the benefits of harmonious relations with the host country and labor force.

D. Local Workers

The rank and file employees of MNEs are often left out of the development equation. Or worse, they are subjected to repression of collective action or wage freezes in the interests of industrialization.[68] The benefits of ownership, shareholder rights, and worker satisfaction have already been noted in the context of host country and MNE interests. In the long run, ESOP beneficiaries might not be the only workers aided by the process. A growing class of more sophisticated employee-owners might obtain political power to bargain for the welfare of other workers, especially those in the poor agricultural sector. Prospects for this, however, would vary greatly with the local political structure.[69]

An episode in Honduras illustrates the more concrete significance of employees' equity in their company. A Central American ladies garment manufacturer

66. BROOKE & REMMERS, *supra* note 62, at 235–40. This passage also treats some of the variables affecting the costs of local ownership.

67. The lack of a contribution requirement is at once a strength and a weakness of this proposal. If an ESOP fails to succeed for lack of profits or whatever reason, the employees are left with nothing except contributions they may have made or vested benefits. For a company not realizing enough profits, default on the loan would probably mean that the secured creditor becomes the stock owner. Incentives for the maintenance of ESOPs by profitable companies can ensure that plan failure is not a problem in practice.

68. *See, e.g.*, B. KADAR, PROBLEMS OF ECONOMIC GROWTH IN LATIN AMERICA 195, 212–13 (1980); Villegas, *The Philippine Labor Code and Industrial Workers*, 44 (nos 1–4) PHIL. SOC. SCI. AND HUMANITIES REV. 75 (1980).

69. NELSON, *supra* note 39, at 125-67, 318-26. This is an in-depth analysis of the political prospects for urban lower classes in developing countries.

known for an anti-labor posture suddenly shut down and abandoned a factory employing some 289 Honduran women. This followed a history of similar actions elsewhere in Central America where there was the prospect of dealing with organizing labor interests. Those employees applied their equity in the company to obtain the machinery and other productive assets. They were able to establish a worker-managed enterprise jointly with the Honduran Port Authority which manages the free trade zone. For many of the women this venture has offset some of the devastation of lost jobs where there are few other employment prospects. The cooperative faces some difficulties, international marketing for example, but these women now have an opportunity to take charge of their fate.[70]

In conclusion, ESOPs should not be construed as a substitute for unions, unemployment insurance, job safety laws, or other worker benefits which may be necessary and feasible. Even in developing countries which have laws protecting labor, companies are often able to evade them.[71] Rather, employee ownership should be a component of an overall drive to improve the status of labor in developing countries. The determination and ability of the Honduran women illustrates the great potential for employee ownership to benefit labor.

E. The International Perspective

Various country factions still debate some aspects of the proper treatment of MNEs, notably the applicable law for compensation of expropriated assets. Even so, the ESOP proposal outlined here coincides with many of the settled objectives for MNEs expressed in the *U.N. Code of Conduct on Transnational Corporations*. The Code calls for cooperation between host countries and MNEs to maximize "their contributions to the development process" and establish "mutually beneficial relations."[72] On the issue of ownership the Code provides that:

> "Transnational corporations shall/should co-operate with Governments and nationals of the countries in which they operate in the implementation of national objectives for local equity participation and for the effective exercise of control by local partners. . . ."[73]

Furthermore, the Code provides that MNEs should enhance the effective participation of local personnel in decision-making and contribute to the economic and social development of the host.[74] Additionally, the Code describes disclosure requirements of financial data and operations to the host government and labor more extensive than those that might be required for an ESOP.[75] Therefore,

70. Street, *Multinationals Square Off Against Central American Workers*, BUS AND SOC'Y REV., wntr., 1985 at 45–49.

71. NELSON, *supra* note 39, at 31–33.

72. U.N. CODE, *supra* note 41, paragraph 9 at 194.

73. *Id.*, paragraph 23, at 196.

74. *Id.*, paragraphs 21, 24, at 196.

75. *Id.*, paragraphs 44, 45, at 200–01. *Seehalso*, R. BLANPLAIN, THE OECD GUIDELINES (1983) on the developed countries' policies and practices with respect to MNEs and their labor.

expanded employee ownership in MNEs should draw support throughout the international community.

V. Implementation

Sweeping national legislation of the type in the U.S. favoring ESOPs is unlikely in Central American nations until a few successful examples are carried out. Currently, numerous factors would affect the feasibility of implementation and structure of the plan in any given case. Even the new U.S. corporate tax rates enacted in 1986 may affect foreign investment decisions.[76] Moreover, the legal systems of Central America, though based on civil law, are by no means homogeneous. Varying tax, labor, corporate, or foreign investment laws will all raise different considerations with respect to ESOP type mechanisms. A consideration of all these factors is beyond the scope of this note. Ultimately, the relative bargaining powers of the home country, the host country, and the MNE would determine the outcome in each case as they each strive to tailor the ESOP to the local environment and to their best advantage.[77] Therefore, this section is limited to pointing out some more general problems and possibilities for implementation.

A. Preliminary Considerations

A basic requirement for setting up a successful ESOP is that there be taxable profits. A review of the recessed economies in Central America could lead one to conclude that MNEs are not doing well enough to consider new proposals based on profits.[78] Closer examination reveals that U.S. firms continue to realize healthy returns on investment in Central America, especially in manufacturing.[79] Despite the strong dollar, many U.S. multinationals are realizing substantial profits abroad, including profits from Latin America.[80]

A second less significant issue is the lack of the beneficial ownership of property concept in civil law countries. If a trust for employees cannot be worked into the local law then the gradual steps of ownership in an ESOP (suspense account, allocation, vesting, distribution) and their attendant legal rights will have to be replaced by some other legal technique. This is not an insurmountable obstacle. Civil law countries have developed contractual or corporate means of accomplishing similar results.[81]

76. *Tax Bill May Force New Practices Abroad*, Wall St. J., Aug. 22, 1986, at 18, col. 1.

77. An interesting statistical study of bargaining power between host countries and MNEs is found in LeCraw, *Bargaining Power, Ownership, and Profitability of Transnational Corporations in Developing Countries*, 15 J. of Int'l Bus. Stud. 27 (1984).

78. *Cf., e.g.*, Baird, *Survival Strategies for Latin America*, Institutional Investor Oct., 1983, 283–91.

79. Ramsaran, *supra* note 9, at 102–3.

80. Pearson, *Strong Dollar or No, There's Money to be Made Abroad*, Business Week, March 22, 1985, at 155–62.

81. Interview with Peter Behrens, Professor of Law, Max Planck Institut, Hamburg, in Ann Arbor (March 10, 1987).

B. United States Options

The simplest method of introducing ESOPs to Central America would be to extend the coverage of U.S. qualified plans to affiliates in Central America. For U.S. citizens working in branch offices, divisions or subsidiaries, the affiliated employer test of ERISA may require this coverage to qualify the parent company's plan.[82] A U.S. plan may then be used to cover the foreign employees as well without being disqualified.[83] With the U.S. having effectively subsidized the costs of regulating the plan, it only remains to the host country to coordinate its tax treatment of the plan. For instance, company contributions to the plan should be deductible but not taxed as income to the employees until actually received.

Short of extending U.S. plan coverage, there are other important options for U.S. encouragement of employee ownership. First, trade policies could target MNEs exporting to the U.S. and having significant employee equity for preferential treatment. Tariffs, quotas, or other trade barriers should be relaxed in such circumstances. Second, banks extending loans to ESOPs overseas should receive the 50 percent interest earning exclusion they have for U.S. plans. Third, multilateral lending institutions in which the U.S. participates, such as the Inter-American Development Bank, should provide loans to ESOPs or help to guarantee private loans to ESOPs.[84] Finally, repatriated profits from MNEs with ESOPs might be extended the same tax treatment as if the companies were in the U.S.

C. Host Country Options

Developing countries should concentrate initially on the companies against which they have the greatest bargaining power, preferably in the export sector where foreign investment is concentrated. One method of duplicating the key protections in U.S. law and extending comparable tax incentives would be by contract. The multinational, probably already experienced in U.S. employee benefits law, would agree to maintain a qualified plan on the basis of streamlined U.S. law incorporated into the contract. The host country would promise to waive or alter local laws which could weigh against the plan and provide any other necessary incentives. Failure to maintain the plan, except for excusable economic reasons, would be a breach of the contract and entitle either the government or the employees to sue for restitution or other damages. Back taxes could be one measure of damages.

There are precedents for these kind of special legal arrangements with MNEs

82. I.R.C. § 414 (1987).

83. I.R.C. §§ 406,407,414 (1987). There is a brief but thorough discussion of this in Klein, *Use of U.S. Qualified Retirement Plans Outside the U.S.*, 12 INT'L TAX J. 63 (1986). Under this scheme foreign employees could obtain ownership of parent company stock: this would be an interesting and dramatic development in the matter of international securities.

84. Presidential Task Force, *supra* note 6, 79–87, makes these recommendations and others.

in the form of export processing zones, also called offshore manufacturing, or free trade areas. The controversial *maquiladoras* in Mexico are a notable example of this phenomenon. Typically, the host country makes certain requirements of companies wishing to export in the zone such as setting a high percentage of exported products, or repatriating a low percentage of profits. The firm gains a sort of legal bubble in which to operate free of export duties or regulations normally applied to foreign investment.[85] Offshore business can earn foreign currency and provide something of a quick fix for balance of payments troubles. More benefits along the lines of integrated development objectives could be obtained by including ESOPs in the legal package.

A brief look at Mexican tax laws demonstrates some of the adaptations host countries may make especially for ESOPs. Mexico requires employers to contribute eight percent of before tax profits to employees. Those contributions are non-deductible, and taxed to the recipient.[86] However, contributions to employee "savings funds" are nontaxable to the employee and deductible by the employer up to 13 percent of salary.[87] An ESOP could be worked into this structure by treating it as a savings fund for the employees and retaining the profit sharing requirement, while allowing an income tax deduction for contributed profits. Mexico also has a withholding tax of 55 percent on dividends as an advance payment of income tax[88] that could be waived for dividends paid into the ESOP.

Although, as mentioned, there may also be labor laws or corporate laws which affect the adaptation of the ESOP in Mexico or in other countries, the basic ESOP is a flexible instrument that lends itself to adaptation in many legal systems.[89]

VI. Conclusion

The establishment of a few successful ESOPs in Central America would be but a small step in gradual and steady progress toward the resolution of problems discussed throughout this note. Yet the potential of the concept is broad. Employee ownership could expand to the MNEs of other host countries or to domestic firms. Consider the rest of Latin America — especially Argentina and Brazil, laden with foreign investment — and the developing world. Even Israel and the United Kingdom have shown interest in employee ownership.[90]

85. Moreno, *Mexican Law on In-Bond Processing Plants*, in 1 Doing Business in Mexico Ch. 33, (Matthew Bender, 1987). *See generally*, A. Basile & D. Germidis, Investing in Free Export Processing Zones (OECD Development Centre Studies 1984).

86. 3 Int'l Tax and Bus. Service (Deloitte, Haskins and Sells), *Mexico* paragraph 7.18 at 30 (1986).

87. *Id.*, paragraph 10.07 at 38.

88. *Id.*, paragraph 5.03 at 19.

89. The author wishes to acknowledge the invaluable assistance of Norm Kurland of Equity Expansion International in the analysis of the essential requirements for adapting the ESOP.

90. *ESOP Report*, ESOP Association, Nov/Dec 1985, at 3.

There are still pressing issues with respect to MNEs which ESOPs would not affect: these include transfer pricing and appropriate technologies or products for underdeveloped economies. Basic human needs, sovereign debt, declining terms of trade, and dependence on primary exports will still trouble developing countries. These distressing issues should not diminish the potential accomplishments of an expanded ownership program. Dealing with foreign investment need not be a zero-sum game. As a cooperative and mutually beneficial approach, ESOPs would be likely to have lasting effects. Perhaps success in this area could create the optimism and cooperation needed to effectively address other development problems.