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## Profit Sharing in Mexico

JOHN W. SCHMITZ\*

Concepts of profit sharing vary almost without limit, differing from contract to contract and from country to country. The concepts range from the extreme of the U.S.,<sup>1</sup> where no profit sharing is required, to the extreme of Peru,<sup>2</sup> where the government wants workers to own a third of all private enterprises. Until fairly recently, Mexico could be considered to be somewhere in the middle of this spectrum.

The 1917 Mexican Constitution provided for mandatory profit sharing, but, until 1962, no federal legislation was passed to implement this provision. Therefore, what profit sharing did exist depended primarily on private contracts and collective bargaining agreements.<sup>3</sup> The 1962 law, opposed by socialists for fear it would weaken worker opposition to the capitalist system,<sup>4</sup> changed this situation. By requiring that all business enterprises distribute a portion of their after tax profits to their employees on an annual basis,<sup>5</sup> it effected a distribution of profits ranging from 2.8 to 12.6 percent of a firm's net income.<sup>6</sup> Eventually, this inconsistency prompted the enact-

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1. In the United States, profit sharing is based on contractual agreements between employer and employee. On profit sharing in the United States, see P. Drucker, *Management*, at 190-1, 292-5 (1974); B. Metzger, *Profit Sharing In Perspective* (Profit Sharing Research Foundation ed. 1966); B. Metzger, *Profit Sharing in 38 Large Companies* (1976); Bergman, *Pension, Profit-Sharing Plans, Etc. — Selection*, 205-3rd T.M.; Sollee and Shapiro, (*ERISA*) — *Profit Sharing Plans — Qualification*, 310 T.M.; Hancock, *Planning and Drafting Qualified Profit Sharing Plans*, 25 *Bus. Law.* 1561 (1970); Miller, *Primer on Pension and Profit Sharing Plans — a Perspective for the General Practitioner*, 27 *Bus. Law.* 451 (1972); Savitz, *Profit Sharing Primer*, 14 *Prac. Law.* 49 (1968); and Stewart & Haines, *Employee Benefit Plans*, 23 *Rutgers L. Rev.* 681 (1969).

2. In Peru, profit sharing is strictly mandatory, based on supplementary legislation to Article 45 of the Peruvian Constitution, which now obligates all private companies to give certain workers 15 percent of net profits, plus representation on the board of directors, in addition to the 10 percent of net profits that goes to all workers as ordinary profit sharing. Decree 21,789, issued February 2, 1977.

3. See discussion on pages 12-19, *infra*, concerning the history of profit sharing in Mexico.

4. Lecture given by Alejandro Ogarrío, Member of the National Commission for the Fixing of Minimum Wages, at the Escuela Libre de Derecho in Mexico City on July 6, 1977.

5. Decree published in the *Diario Oficial* of November 21, 1962.

6. Hoagland, *Company Formation in Mexico*, at D-25 (1972).

ment of a flat rate of 8 percent<sup>7</sup> that today establishes Mexico as one of the nations most committed to the idea of profit sharing.

Recent legislation,<sup>8</sup> dealing with the related concept of worker control, confirms this view. The legislation departs drastically from traditional property concepts, creating a new form of economic organization, the *sociedad de solidaridad social* (social solidarity society), composed solely of workers, exercising complete control, benefiting from all the profits, and striving to achieve a number of social goals. The assets of a *sociedad* are of a "collective nature."<sup>9</sup> The assets may initially consist of contributions made by members or by official institutions, persons or corporations not belonging to the *sociedad*, and the assets may be increased by purchases of necessary goods (financed, if necessary, by loans from national credit institutions, which are obligated to give preference to a *sociedad*)<sup>10</sup>, but once the assets are acquired, they are irrevocably devoted toward serving the *sociedad's* social purposes.<sup>11</sup>

These purposes are set by law. They are: (1) The creation of jobs; (2) the conservation and improvement of the environment; (3) the rational exploitation of natural resources; (4) the production, industrialization and marketing of necessary goods and services; (5) the education of *sociedad* members and their families; (6) the improvement of the members' standard of living; (7) the affirmation of national civic values; (8) the defense of Mexico's political, cultural and economic independence; and (9) the practice of social solidarity.<sup>12</sup> What these purposes indicate is the formation of an entity far more similar to the Peruvian *comunidad industrial* than to the traditional capitalist enterprise, characterized by single-minded devotion to one goal: profit maximization. These purposes, when viewed in light of other provisions governing the *sociedad de solidaridad social*,<sup>13</sup> may indeed indicate the eventual destruction of the concept of private property in Mexico and the dawning of a new economic system.

7. Resolución de la Segunda Comisión Nacional para la Participación de los Trabajadores en las Utilidades de las Empresas, article 1, as published in the *Diario Oficial* of October 14, 1974.

8. Ley de Sociedades de Solidaridad Social, as published in the *Diario Oficial* of May 27, 1976.

9. *Id.*, art. 1.

10. *Id.*, art. 37.

11. *Id.*, art. 10.

12. *Id.*, art. 2.

13. An example is art. 30 which raises the possibility that a worker may be permitted to benefit from the *sociedad's* profits only while he is in the organization, thus requiring him to forfeit his investment to the state upon his departure. See, *Bus. Latin Am.*, June 23, 1976, at 194.

Presently, of course, this does not seem likely to occur.<sup>14</sup> However, the private sector in Mexico fears that *sociedades de solidaridad social* may gradually be used to destroy private business.<sup>15</sup> It fears that industrial enterprises run by workers may be used as a new form of unfair competition, based on special privileges granted by the federal government, namely, the assured preferential access to local credit,<sup>16</sup> the potential exemption from social security payments,<sup>17</sup> and the possible receipt of federal subsidies. The result of such a policy may be the same as the result of Peru's six-year effort to achieve 50 percent worker ownership of all private enterprises: total discouragement of private sector investment initiative and, because of insufficient individual incentives, worker dissatisfaction.<sup>18</sup>

This article avoids supporting such a pessimistic view of the eventual effect of the law creating the *sociedades de solidaridad social*. It instead attempts to treat profit sharing optimistically. First, it examines the philosophy of profit sharing, revealing the high and potentially realistic hopes that scholars and politicians have for profit sharing, so as to indicate that mandatory profit sharing may benefit private enterprise as well as the labor force, rather than operate as a discouragement to investment. Second, it examines the legal history of profit sharing in Mexico, indicating that worker participation has deep roots in the Mexican system. Third, it examines the Mexican law of profit sharing as it exists today, providing for the investor a guide to determining the exact impact that this legislation will have on any enterprise, and offering to the student of labor relations an introduction to several novel ideas on how to implement the goals of profit sharing. Finally, this article attempts to determine the implications of Mexico's legislation, not only for Mexico, but also for the investor, for the worker, and for the other countries interested in worker participation.

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14. One observer stated that the enactment of the law on *sociedades de solidaridad social* is another example of "the Mexican government's habit of passing damaging legislation, letting it lie dormant for a while and then uncorking it for some specific purpose at a chosen time." *Bus. Latin Am.*, June 23, 1976, at 194.

15. *Bus. Latin Am.*, *supra* note 14.

16. *Ley de Sociedades de Solidaridad Social*, *supra* note 8, art. 37.

17. *Id.*, art. 35.

18. *See Bus. Latin Am.*, February 16, 1977, at 49.

## I. THE PHILOSOPHY OF PROFIT SHARING

The political rhetoric in Mexico refrains from characterizing profit sharing as more than a means of income redistribution.<sup>19</sup> Yet the writings of Mexican scholars reveal that Mexico's leaders may well believe that profit sharing is indeed something more, perhaps even something revolutionary.<sup>20</sup>

The leading scholar on the subject, Alfonso Álvarez Friscione, lists the following benefits to be derived from profit sharing. For the worker he sees it as supplementing a salary, encouraging saving, providing security, and aiding emotional well-being. For the businessman he sees it as improving the effort of the workers and insuring the workers' loyalty to the enterprise. For the business itself he sees it as increasing productivity, encouraging unity, complementing wages and salaries, and thereby bettering relations between the workers and their employers. Finally, for society he sees it as providing the best means to share the national wealth, avoiding strikes, diminishing social conflicts, stopping the war between classes, and preventing the rise of a communistic or totalitarian regime. Álvarez also contends that profit sharing serves to give workers a greater sense of their own dignity.<sup>21</sup>

Álvarez, in arguing that profit sharing may even be revolutionary, notes that there are three forms of capitalism: the traditional type, where the law of supply and demand controls the relationship between employer and employee; the U.S. type, where the state effectively balances the bargaining power of both; and the experimental type, where individual businesses, particularly in the United States and Germany, attempt to act on their own to make the relationship between employer and employee more equitable.<sup>22</sup> In the first, workers are bought as if they were products and are assigned

19. However, Luis Echeverría Alvarez, the recent President of Mexico, stated that, "I exhort the workers to contribute with greater eagerness to national progress and to always defend their rights with energy and integrity. I exhort the businessmen, equally, to prove, every day, their determination to promote, in liberty, an order more just for all . . . . Arduous are the works that await us." But with its footing in justice, "production must increase. The fruits of the wealth generated by all must, (instead of) expanding differences between compatriots, impel, by means of an expanded popular consumption and a balanced popular system of finance, the development of the country." Speech presented before the Second National Commission on the Participation of the Workers in the Profits of Business Enterprises, October 14, 1974.

20. The most important works by Mexican scholars on profit sharing include: A. Álvarez Friscione, *La Participación de Utilidades* (1976); B. Cavazos Flores, *El Derecho del Trabajo en la Teoría y en la Práctica* 89-158 (1972); M. de la Cueva, *Derecho Mexicano del Trabajo*, Volume I 677-693 (1974); M. de la Cueva, *El Nuevo Derecho Mexicano del Trabajo* 320-339 (1974); E. Guerrero, *Manual de Derecho del Trabajo* 159-183 (1973); B. Margain Hugo, *Reparto de Utilidades* (1964); F. Padilla G. & F. Lerdo de Tejada, *La Participación de Utilidades en la Nueva Ley Federal del Trabajo* (1972); and L. Recasens Siches, *Aspectos Sociológicos de la Participación de Utilidades* (1963).

21. A. Álvarez Friscione, *supra* note 20, at 663.

22. *Id.* at 123-24.

limited functions in the overall production. In the second, workers are afforded a greater status and are seen as integral to production. In the third, the personality of the worker is taken into account, raising his status still further, recognizing him not only as a collaborator in a business effort, but also as a human being. It is this third type that Alvérez says could be the basis of a new economic system.<sup>23</sup>

Alvérez states that an enterprise must function as “an association of persons,” in which each worker cooperates fully with all his spiritual and physical effort to achieve the greatest possible success in an atmosphere of confidence and friendship, of mutual identification and common purpose.<sup>24</sup> This is a vision of an effective association between capital and labor that gives rise to “a new economic science, that centers the economy on the concept of man as a being with moral dignity.”<sup>25</sup> In practical terms this means that, “Profit sharing can and must be an essential part of a new economic system”<sup>26</sup> that will triumph over the old promises of individualism and the false hopes of collectivism, both of which have brought misery, depression, and even enslavement of workers.<sup>27</sup>

If used properly, it can be a mechanism to effect social peace in both a material and spiritual sense. It could virtually eliminate obvious hindrances to production — lockouts, strikes, etc. — and could also work to eliminate the less obvious state of tension that perpetually exists in most employer-employee relations. Not all conflict could be eliminated, of course, since conflict is inherent to the human condition. But, says Alvérez, profit sharing does considerably improve social relations in business enterprises, as indicated by the successful profit sharing plans carried out in Switzerland, the United States, Germany, and other countries.<sup>28</sup>

The unions, of course, have often fought profit sharing for fear it will weaken the will of the working class to continue the traditional fight against the owners of production.<sup>29</sup> The unions also have feared that profit sharing would compromise the right to strike, or that it would be an excuse by which salaries would be diminished. In fact, one scholar argued that profit sharing in any form should be resisted, because it could become so important as to replace wages and thereby put workers in a highly insecure position.<sup>30</sup> Another scholar simply called the entire idea of profit sharing unjust, since a worker in one factory with poor facilities or poor management could per-

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23. *Id.* at 179.

24. *Id.* at 124.

25. *Id.*

26. *Id.* at 179.

27. *Id.* at 180.

28. *Id.* at 181.

29. *Id.* at 653.

30. *Id.*

form the same services as a worker in another factory with better facilities or better management, yet receive a smaller sum as profits, or no profits at all, due solely to the place of his employment.<sup>31</sup>

Alvírez answers these objections by stating that even if these objections proved to have foundation, profit sharing should nevertheless proceed to be implemented because its advantages far outweigh its disadvantages.<sup>32</sup> Instead of placating the unions' fears, he contends that, in passing and implementing profit sharing legislation, the state does not interfere in industrial relations solely for the workers' benefit. Going beyond what the politicians have attributed to profit sharing, (namely the potential for providing a better means for income redistribution and a more secure foundation for balanced economic development) Alvírez argues that labor legislation has a purpose that is more lofty and moral than the granting of benefits to one group in society at the expense of the other. He contends that, instead of offering an unearned increment to employees' income, labor legislation should be directed toward protecting the spirit of industry by serving the reasonable interests of capital while augmenting workers' wages.<sup>33</sup>

Although not reflected for the most part in the nation's political rhetoric, this philosophy, which has its roots in teachings of the Catholic Church, as well as in the experiences of private industry, may inspire Mexico's political leaders to actually build, as Echeverría said, "an order more just for all."<sup>34</sup> Yet this philosophy, as best expressed by Alvírez, may be just as likely to inspire radical changes in the Mexican system, such as those made possible by the institution of the *sociedad de solidaridad social*, which would be detrimental to the interests of capital and therefore, as Alvírez argues, counterproductive for labor as well as capital.<sup>35</sup> However, to twist the philosophy of profit sharing in such a manner would undermine the achievement of the historical goals of profit sharing in Mexico.

## II. THE HISTORY OF PROFIT SHARING

In 1856, it was said before the commission charged with writing a new Constitution for Mexico that, "The true social problem is how to emancipate the day-labourers from the capitalists. The solution is very simple: convert work into capital. This operation, demanded by justice, will assure to the day-labourer not only the salary that corresponds to his subsistence but rather the right to divide proportionately the profits with their employers."<sup>36</sup>

31. *Id.*

32. *Id.* at 187.

33. *Id.* at 187-88.

34. See note 19 *supra*, and accompanying text.

35. A. Alvírez Friscione, *supra* note 20, at 188.

36. *Id.* at 251. On the commission see F. Zarco, *Historia del Congreso Constituyente de 1856*.

This statement did not convince the commission that profit sharing should be incorporated as a basic principle of the new Mexican system, but it was duly noted as the first significant expression of the idea that labor relations could be improved through profit sharing. Whatever influence the statement may have had is unclear. Yet it does appear to outline the thinking of Antonio Sarabia, who proposed in 1914 that a Regulatory Law to Article Five of the Constitution of 1857 be adopted, a law which would assure that fifty percent of the profits of most enterprises be distributed to the workers.<sup>37</sup> Unlike the statement of 1856, this proposal had a tangible effect. Along with other less extreme proposals, it foreshadowed the enactment of the first legal provisions on profit sharing in Mexico, Sections VI and IX of Article 123 of the Constitution of 1917.<sup>38</sup> These provisions did not constitute the all-encompassing piece of legislation that the advocates of profit sharing had envisioned, for they required complementary state legislation to be effective, but they did form a solid basis for future efforts to implement more ambitious profit sharing plans.

Some states did not pass the necessary complementary legislation and others passed legislation which implemented Article 123, but which did not give effect to the profit sharing provisions. These states included Chiapa, Durango, Guerrero, Hidalgo, México, Morelos, Nuevo León, San Luis Potosí, Tlaxcala, and the Federal District.<sup>39</sup> The other states enacted various provisions, differing considerably in their scope. Sonora and Sinaloa, for example, misinterpreting profit sharing as merely a means to augment wages, stipulated that a worker must be allowed an annual bonus equivalent to an extra month's pay.<sup>40</sup> Colima and Jalisco, on the other hand, promulgated laws which provided that three percent of the profits of agricultural enterprises and five to ten percent of the profits of industrial enterprises must go to the businesses' employees.<sup>41</sup> Another version of the original Constitutional provisions was found in Oaxaca and Chihuahua, where any profits exceeding a twenty percent annual rate of return were distributable to the workers, yet the amount distributed could not exceed ten percent nor be less than five percent of the workers' salaries.<sup>42</sup> However, all of these different provisions did have one thing in common. They had insufficient time in which to prove themselves, since all state labor laws became ineffective in 1929, when the federal government assumed complete authority over any matter concerning labor.<sup>43</sup>

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37. *Id.* at 253.

38. *Id.* at 254.

39. *Id.* at 261.

40. *Id.* at 262.

41. *Id.* at 263.

42. *Id.* at 264.

43. See Demeure, *Labor Legislation Considerations for American Companies Investing in Mexico and South America*.

The political and legal status of profit sharing was brought into question as the process of federalization occurred, because no federal statute was passed to take the place of those state statutes that had implemented profit sharing. The Constitution established that there was a right to profit sharing, but it was now questionable whether this right was enforceable. The Supreme Court, in the case of *Cervecería Moctezuma, S. A.*, held that it was not, absent some federal legislation, giving effect to the Constitutional provision.<sup>44</sup>

This decision settled the legal status of profit sharing for a considerable period of time, during which the political status of profit sharing was constantly changing. Union support for the necessary federal legislation, although initially nonexistent, gradually increased, giving rise to occasional outbursts of strong backing, as evidenced by the demands in 1949 for fifty percent worker participation in the profits of certain enterprises.<sup>45</sup> Some members of the labor movement even thought "that labor leaders or labor councils might participate in the governing of an enterprise."<sup>46</sup>

Not until 1961, however, does it appear that union support for profit sharing was solidly and consistently expressed. In December of that year, President Adolfo López Mateos proclaimed that profit sharing should be implemented by the federal government. He requested that Congress pass a Constitutional reform, establishing a "National Commission, consisting of representatives of the workers, of the owners, and of the government, to set the percentage of profits that should be shared among the workers."<sup>47</sup> He specified that this reform should not compel new businesses to share their profits, nor compel other businesses to do so when the National Commission deems them to be unsuitable for profit sharing. In a final note, he emphasized that, "The right of the workers to participate in profits does not imply authority to intervene in the direction or administration of enterprises."<sup>48</sup>

On November 20, 1962, these recommendations were made law, and on December 31, 1962, a national system of profit sharing was established.<sup>49</sup> This reform of the federal labor law provided that the percentage of profits to be shared must be set by the National Commission in recognition of the condition of the national economy, the necessity of industrial development, the right of capital to obtain a reasonable return, and the desirability of en-

44. XII *Semanario Judicial de la Federación* 753 (1923).

45. A. Álvarez Friscione, *supra* note 20, at 268.

46. L. Padgett, *The Mexican Political System* 170 (1966).

47. Iniciativa de Reformas a las Fracciones II, III, VI, IX, XXI, XXII y XXXI del Inciso "A" del Artículo 123 de la Constitución General de la República, *Diario Oficial*, December 27, 1961.

48. *Id.*

49. Poder Ejecutivo, *Diario Oficial*, November 21, 1962.

couraging reinvestment;<sup>50</sup> that the amount labeled as profits for the purpose of effecting worker participation was to be the same as that reported for income tax purposes;<sup>51</sup> and that the amount distributable to the workers was to be divided into two parts, one going to each worker equally and the other according to their respective salaries.<sup>52</sup> All enterprises were subject to this system, except for the following: (1) Newly created enterprises, during the first two years of operation; (2) newly created enterprises developing a new product, during the first four years of production; (3) enterprises dedicated to exploitation of natural resources, during the period of exploration; (4) charities; (5) the Mexican Institute of Social Security, (6) public decentralized institutions which have cultural or socially benevolent purposes; and (7) other enterprises which have less than a certain amount of capital.<sup>53</sup> All workers were subject to the system, except for the following: (1) directors, (2) administrators, (3) general managers, (4) apprentices, and (5) domestic workers.<sup>54</sup> The law also stipulated that no worker was to receive an amount of profits in excess of one month's salary,<sup>55</sup> and that no worker was to participate in the losses of any company.<sup>56</sup>

Generally, the workers were entitled to twenty percent of the distributable net profits of the firm where they worked.<sup>57</sup> What was distributable was determined by establishing the book income for the year, adding the provisions for capital and liability reserves, plus any provisions for the increase of reserves for uncollectable accounts, and deducting the income tax liability for that year and for any previous years.<sup>58</sup> Thirty percent of the resulting sum was then subtracted in order to allow invested capital a reasonable return and to stimulate reinvestment.<sup>59</sup> An additional percentage, determined by the difference between the amount of the respective company's invested capital and the amount of its annual payroll, was also subtracted, so as to compensate capital and labor according to their in-

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50. Reformas y Adiciones a la Ley Federal del Trabajo, *Diario Oficial*, December 31, 1962.

51. *Id.*, art. 100-H.

52. *Id.*, art. 100-M.

53. *Id.*, art. 100-P.

54. *Id.*, art. 100-Q I, V.

55. *Id.*, art. 100-Q II.

56. *Id.*, art. 100-R.

57. Resolución Aprobada por la Comisión Nacional para la Participación de los Trabajadores en las Utilidades de las Empresas, art. 1, *Diario Oficial*, December 13, 1963.

58. *Id.*, art. 6 I.

59. *Id.*, art. 6 II

dividual contribution to the production of profits.<sup>60</sup> For example, if a business enterprise had capital worth less than twice the value of the labor contributed, it could deduct an additional ten percent. However, if the relative contribution of capital was greater, the deduction was greater, increasing gradually to a maximum deduction of eighty percent, when the capital was equivalent to more than thirty times the value of the labor contributed.<sup>61</sup>

In any company, the accuracy of the above calculations could be challenged by a majority of the workers or by their union through the filing

60. *Id.*, Provision 65. With respect to this provision, Padgett, *supra* note 46, makes the following observation:

"The important fact to remember from the standpoints both of foreign and domestic firms is that the law makes allowances for taxes which the company must pay and also for opportunities for reinvestment on the part of the company. The Mexicans stress that one of the major reasons why such plans have failed or have not done well in Venezuela, Peru, Colombia, Chile, and Argentina is that the importance of reinvestment needs has not been recognized in the legislation in those countries. Clearly, Mexican policy-makers expect to take some of the pressure off themselves through this law, feeling that it is just one less thing which Communists can offer in the way of distribution of wealth."

61. *Id.*, Provision 66. An example of the entire computation, expressed in Mexican pesos, of the employees' profit participation was provided in Arthur Andersen & Co., *Tax and Trade Guide* — Mexico 113-14 (1972), as follows:

1. Net income after actual corporate income tax payable (before profit sharing provision).....		1,800,000
2. Add nondeductible items (provisions for liability reserves, provision to reserve for uncollectible accounts, etc.) .....		200,000
3. Base net income .....		2,000,000
4. Less 30% of line 3 .....		600,000
5. 70% of base net income .....		1,400,000
6. Less adjustment factor:		
6A Invested capital.....	10,000,000	
6B Total annual payroll.....	3,250,000	
Capital/payroll ratio (line 6A over line 6B).....		3.07
Computation based on the table of Appendix F [below]		
on 3.0	15.00%	
on 0.07	.35	
	15.35%	
15.35% of line 5.....		214,900
7. Net income subject to employees' participation.....		1,185,100
8. Amount due to employees (20% of line 7).....		237,020
9. Percentage of net profits before profit participation (line 8 over line 1).....		13.17%
10. Percentage of base net income (line 8 over line 3).....		11.85%

of a formal objection with the *Secretaría de Hacienda y Crédito Público* (the Treasury Department) within thirty days after the company had made available to them its annual income tax return.<sup>62</sup> If the *Secretaría* rendered a final decision, the workers were prohibited from taking further legal action against the company on the subject of the dispute.<sup>63</sup> Their initial legal action did not, however, prevent them from demanding payment of the agreed upon minimum share, which was due within sixty days after the date set for payment of the company's annual income tax.<sup>64</sup> Nor were the workers forestalled from making profit sharing the subject of collective bargaining.<sup>65</sup>

Yet the workers found that their real objections to the operation of the profit sharing system could not be handled through collective bargaining, nor through the filing of a formal complaint with the *Secretaría*. Their real objections centered on the nature of the system, which they felt slighted their

## Appendix F

TABLE FOR DETERMINING PERCENTAGE DEDUCTION  
APPLICABLE TO 70% OF BASE NET INCOME FOR  
PURPOSES OF EMPLOYEE PROFIT SHARING

Factor for Comparison of Capital and Annual Payroll		Percentage Deduction Applicable to 70% of Base Net Income	
From	To	Percentage Applicable to Lower Limit	Number to be Applicable to Excess Over Lower Limit
0	2.0	10	—
2	2.9	10	5.0
3	3.9	15	5.0
4	4.9	20	5.0
5	5.9	25	5.0
6	6.9	30	5.0
7	7.9	35	5.0
8	8.9	40	5.0
9	9.9	45	5.0
10	11.9	50	2.5
12	13.9	55	2.5
14	15.9	60	2.5
16	19.9	65	1.2
20	24.9	70	1.0
25	29.9	75	1.0
30 and above		80	

In determining the ratio of capital to labor, branches of foreign companies were apparently treated less favorably than Mexican firms, according to Hoagland, *supra* note 6, at D-25.

62. Reformas y Adiciones a la Ley Federal del Trabajo, *supra* note 50, Article 100-K II.

63. *Id.*, art. 100-K III.

64. *Id.*, art. 100-L.

65. No provision in the law prevented them from doing so under any condition. See art. 450, section V of Labor Law.

interests through the application of a complicated, one-sided formula. Apparently, many workers did not initially understand how their share of the profits was to be computed. They expected to receive twenty percent of the net profits and were surprised to learn that, once all the calculations were made, only a small fraction of the net profits was actually distributable.<sup>66</sup> They were also shocked that the basic percentage could be reduced if the earnings of their company dropped below a certain level.<sup>67</sup>

Employers were generally pleased with the early operation of the profit sharing system, questioning only its denial of an income tax deduction for the profits that were shared.<sup>68</sup> But workers severely criticized the system for allowing employers to mock the right of worker participation. In 1964, for example, the head of one major union charged that of the 4,000 firms originally affected by the profit sharing law, 3,000 failed to act in good faith in carrying out their obligations.<sup>69</sup> Others cited the small amount of profits shared as proof of the system's inadequacy.<sup>70</sup>

Ten years' experience with the system did not alter their disillusionment. In 1973, workers still complained about employers' lack of good faith, alleging that the manner in which the system operated allowed employers to understate their profits.<sup>71</sup> Criticizing in particular the restrictiveness the National Commission placed on the obtaining of information to verify employers' reports,<sup>72</sup> workers charged that, because of the Commission's bureaucratic sluggishness and its marked indifference to the workers' position, the system was inefficient and ineffective.<sup>73</sup> They said that, for most workers, profit sharing was "pure theory",<sup>74</sup> as indicated by the fact that of the 25,000 companies sharing their profits in 1973, 400 paid sixty-five percent of all the profits distributed.<sup>75</sup> They recommended that the complicated profit sharing formula be eliminated, simplifying the system so that workers could better protect their rights.<sup>76</sup>

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66. Employees usually received from two to six percent of net profits. A. Álvarez Friscione, *supra* note 30, at 486.

67. *Excélsior*, June 27, 1964.

68. *See, e.g.*, the following cases before the Tribunal Fiscal: Juicio 3861/64, Sentencia de la Primera Sala, January 11, 1965; and Juicio 1727/68, Resolución de la Séptima Sala, July 27, 1968. *See also*, Amparo Directo DA-354/75, September 23, 1975.

69. *Excélsior*, June 6, 1964.

70. *See Padgett, supra* note 46, at 173-75. From 1965 to 1970, profit sharing generally amounted to less than two weeks' pay for each employee each year, or between 360 to 640 pesos per person annually. A. Álvarez Friscione, *supra* note 20, at 560.

71. *Excélsior*, November 6, 1973; *El Sol*, November 6, 1973; and *Excélsior*, November 14, 1973.

72. *Ultimas Noticias*, November 14, 1973.

73. *Id.*

74. *Excélsior*, November 14, 1973.

75. *Id.*

76. *Engrane*, February 1, 1973.

Employers, on the other hand, instead of criticizing the system, argued that it was achieving all of its objectives. They continued to protest the "unconstitutionality" of disallowing the deductability of profit sharing for income tax purposes,<sup>77</sup> yet praised profit sharing itself as an incentive that was helping businesses to operate with greater efficiency, to increase productivity, and to produce larger profits. According to them, the system, besides aiding the national economy, was insuring social justice.<sup>78</sup>

They denied that businesses were avoiding compliance with the system. They found it commendable that 400 of the nation's companies distributed sixty-five percent of the profits in which workers shared. They indicated that the 400 companies were highly labor-intensive and were paying eighty percent of their profits to their employees, while other businesses paid as little as ten percent because of their relatively greater amount of invested capital.<sup>79</sup> They objected to simplifying the system, feeling that simplification would only produce inequity.<sup>80</sup> They also objected to workers' attempts to examine their books, arguing that such examinations would interfere in the conduct of their business and put company secrets into the hands of third parties.<sup>81</sup> In short, they defended the status quo completely.

However, despite the employers' arguments, the strength of the workers' basic objections to the system succeeded in altering the status quo. In 1974, the law was changed.

### III. THE LAW OF PROFIT SHARING

The new law entered into effect on October 15, 1974. In its preamble it stated that profit sharing constitutes a valuable means of achieving equilibrium between the factors of production and recognizing the contribution of labor to business enterprises.<sup>82</sup> It also stated that profit sharing is an important incentive for workers since it enables them to raise their standard of living and achieve a more equitable distribution of the national wealth,<sup>83</sup> and that, by stimulating productivity, profit sharing is a vital factor in the successful conduct of business.<sup>84</sup>

In view of the studies that had been conducted on the system of profit sharing in its ten years of operation, the new law modified the system in two fundamental respects. It made one percentage rate applicable to all com-

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77. *El Heraldo*, December 3, 1973.

78. *Excelsior*, November 24, 1973.

79. *Excelsior*, November 13, 1973.

80. *Excelsior*, November 16, 1973.

81. *Excelsior*, November 17, 1973.

82. Resolución de la Comisión Nacional para la Participación de los Trabajadores en las Utilidades de las Empresas, Provision 2, *Diario Oficial*, October 14, 1974.

83. *Id.*, Provision 3.

84. *Id.*, Provision 4.

panies,<sup>85</sup> regardless of the amount of their income, providing that they were not one of the companies that was exempt from the law's application.<sup>86</sup> And it eliminated the deductions that had previously been allowed to reflect the ratio of capital to labor and to acknowledge the need for a reasonable rate of return.<sup>87</sup> In so doing, the law eliminated the complicated calculations of which the workers had complained.

The law provided that workers would participate in the profits of the companies where they work at the flat rate of eight percent,<sup>88</sup> without any deductions whatsoever for their employers.<sup>89</sup> The new formula for determining the amount of distributable net profits was therefore the following: the company's annual income, as determined by the Income Tax Law,<sup>90</sup> less their expenses, times eight percent. If a company's annual income was impossible to determine, then it could be estimated, just as it would be for the payment of income tax.<sup>91</sup>

The companies that were obligated to share their profits were broadly defined as "all the economic units of production or distribution of goods or services, in accord with the Federal Labor Law, . . . that have workers in their service."<sup>92</sup> But, in practice, the same companies that had been excluded from the application of the prior profit sharing law were excluded from the application of the new law.<sup>93</sup>

Also as before were the limitations on the amount of profits which could be shared. Workers whose income was derived exclusively from the rendering of their services, or was derived from the production of rents or the collection of interest, were limited to a share that did not exceed the amount of one month's salary.<sup>94</sup> Directors, general managers and administrators were excluded from participation entirely.<sup>95</sup>

The payment of profit sharing to employees continued to be a non-deductible expense for income tax purposes. As under the prior law, employers were also penalized by the provision which prohibited reducing profits by the losses of previous years.<sup>96</sup>

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85. *Id.*, Provisions 12, 13.

86. *Id.*, art. 2, 12.

87. *Id.*, Provision 6.

88. *Id.*, art. 1.

89. *Id.*

90. *Id.*, art. 3.

91. *Id.*, art. 5, 6, & 9.

92. *Id.*, art. 2.

93. See note 53 *supra*, and accompanying text.

94. Resolución, *supra* note 82, art. 7.

95. See note 54 *supra*, and accompanying text.

96. Resolución, *supra* note 82, art. 10.

Under the new law, the National Commission retained the right to fix and revise the percentage of profits that are distributable.<sup>97</sup> It also maintained the authority to conduct investigations and to undertake the studies necessary to ascertain the general conditions of the national economy.<sup>98</sup> In addition, it remained obligated to act in recognition of the necessity of promoting the nation's industrial development, a reasonable rate of return on capital, and the reinvestment of capital in profit sharing enterprises.<sup>99</sup>

The procedure for filing complaints against employers remained the same under the new law,<sup>100</sup> and the right to strike for failure to properly share profits was reaffirmed.<sup>101</sup>

The portion of profits that were distributable continued to be divided into two parts, one to be paid in view of the respective salaries earned by each employee and the other to be paid to all employees on an equal basis, taking into consideration the number of days during which each employee had worked.<sup>102</sup>

The new law did not clearly state that profit sharing did not give workers the right to participate in the administration of their company. However, the absence of a statement to this effect could not be interpreted to mean that workers may demand such a right by virtue of the new law, since the profit sharing system is clearly based on the absence of this right.

What the new law may imply, however, is a decreasing emphasis on allowing a reasonable rate of return and stimulating reinvestment. The deduction which had been designed to serve these purposes was eliminated in favor of affording workers greater simplicity in the determination of their share of profits. The new law states that the National Commission continues to be obligated to act in light of these purposes, yet it is questionable whether the Commission does so now, after having shown that it does not consider it of primary importance that these goals be served.

The failure to distinguish between the different types of companies also indicates that the Commission has chosen to opt for improving the procedural aspect of the profit sharing system, rather than make the distinctions that are necessary to assure that capital and labor are compensated according to their respective contributions. This emphasis on speed and ease of application of the law's provisions should be reflected in the Commission's actions. It should be noted, however, that although the new law may

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97. *Id.*, Provision 5.

98. *Id.*, Provision 6.

99. *Id.*

100. See notes 62 & 63 *supra*, and accompanying text.

101. See art. 450, Section V of the New Federal Labor Law, and E. Guerrero, *supra* note 20, at 353.

102. See note 52 *supra*, and accompanying text.

facilitate ease of calculation and thereby speed up the procedure for the settlement of disputes, the Commission did not deem it necessary to alter the procedure drastically. It remains as restrictive as before. Workers were not given the right to obtain more information on their company's performance so as to allow them to better verify the annual income statements. The Commission is therefore not likely to render much more assistance to workers under the new law than it did under the old.

The impact of the changes in the law is likely to be perceived most readily in the capital intensive industries. Since the ratio of capital to labor is no longer recognized, workers in capital intensive industries may receive an exceptionally large share of the profits, with the consequent disallowance of a reasonable rate of return and the eventual discouragement of reinvestment. Other industries are not as greatly affected by the new law. "Companies having relatively substantial salary and wage costs were paying profit sharing equivalent to around 7.5 percent of their pre-tax profits under the former regulations."<sup>103</sup> It is insignificant that they now pay eight percent, yet for the capital intensive industries, accustomed to paying two to six percent, the impact of the eight percent rate is considerable.

However, even for these industries, it is encouraging that, in general, profit sharing does not appear to inhibit the reinvestment of capital. Statistics compiled by the Congress of Labor show that in 1965, there were 6,642 enterprises that shared their profits. In that year, 636,000 workers benefited from profit sharing. In 1970, there were 36,000 enterprises participating in the system — six times more than in 1965. The number of workers benefited increased to 2,100,000 by 1970 — or three times more than in 1965. During this period, although the amount received by each worker remained virtually the same, the total amount of profits shared increased from 407,000,000 to 1,312,000,000 pesos. And, while this increase was occurring, the total amount of capital reinvested also tripled. In 1965, the capital in the enterprises sharing their profits was valued at 35,500,000,000 pesos. By 1970, this figure increased to 118,000,000,000. Similar statistics on the impact of the new law are not available, but since the flat rate of eight percent is approximately the same as the effective rate before the new law's enactment, there is no reason to expect that the current effect of profit sharing on reinvestment would, for most industries, be substantially different than before.<sup>104</sup>

Unfortunately, however, the above statistics do not measure the success of the profit sharing system. Avoiding the discouragement of reinvestment is not a standard by which profit sharing may be evaluated, for the concept of profit sharing has established for itself other tangible and intangible stan-

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103. Price Waterhouse, *Doing Business in Mexico* 60-61 (1975)

104. A. Alvarez Friscione, *supra* note 20, at 560.

dards by which it must be judged. Recall that profit sharing is designed to supplement employees' income and to offer them added incentive; and it is supposed to increase the well-being of the worker and, by lessening industrial tensions, the well-being of society; it is intended to foster productivity through a new cooperation between capital and labor. The new law on profit sharing must be evaluated according to the extent to which it achieves these and many other goals. It must be judged against the promises made by the philosophy of profit sharing in Mexico.

#### IV. CONCLUSION

The Mexican philosophy of profit sharing is realistic. Profit sharing can benefit both labor and capital, as Alvérez contends. But it is a concept which can be easily misinterpreted, as the state laws implementing Article 123 indicate. It is a concept which, in practice, can be too severely restricted, as, for example, is the case when a worker is allowed to share in profits only to the extent of a portion of his annual salary, or when a worker is allowed to share in the benefits of an enterprise, without having to share any of the risks. It is also a concept which can be too severely extended, as is the case with the *sociedad de solidaridad social*, which permits labor to benefit at the expense of capital, even to the extent of compromising the fundamental right to hold private property.

Profit sharing in Mexico should not assume these extreme forms, which are plainly contrary to the rationale underlying worker participation. The National Commission on profit sharing pinpointed the primary characteristics of an ideal system of profit sharing: (1) the system should recognize that capital and labor both contribute to the production of profits, (2) the system should view profits as being distinguished from salaries and wages, and therefore (3) the system should make workers "participants in the profits of the businesses where they work, from the precise moment in which profits are generated, without placing importance on the amount of same."<sup>105</sup> Any other application of the concept of profit sharing would destroy "the roots of the constitutional institution" and, "as has happened in other places when the theory of profit sharing has not been recognized in its purity and an inoperative substitute has been established," would negate a right of great importance.<sup>106</sup> Mexico should take the Commission's advice.

Mexico may be the nation that has best articulated the philosophy of profit sharing. Yet, despite all that has been said about distinguishing between the sharing of profits and the payment of wages, profit sharing in Mexico is little more than a wage supplement. It is an expected annual bonus,

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105. Resolución Aprobada por la Primera Comisión Nacional para la Participación de los Trabajadores en las Utilidades, Provision 27, *Diario Oficial*, December 13, 1963.

106. *Id.*

bearing a tangential relationship to the effort of the individual worker, providing some added incentive, but not enough to allow those intangible goals of profit sharing — a tremendous reduction of conflict in industrial relations and a notable increase in the workers' sense of dignity — to be achieved. Profit sharing in Mexico should instead encourage participation between labor and capital in all areas of industrial relations, particularly in risk-taking and in decision-making. It should make workers participants in the profits of their enterprises at the precise moment the profits are realized, "without placing importance on the amount of same,"<sup>107</sup> tying an immediate and unlimited benefit to the effort of each worker. It should undergo radical change, because, as is, it is an "inoperative substitute"<sup>108</sup> for the pure concept of profit sharing that Mexico has accepted in theory, yet rejected in practice.

At present, the practice of profit sharing in Mexico may be seen by the investor as meaning only an additional tax or another cost of business. By the worker it may be seen as meaning a welcome supplement to one's income, but no more. By the student of industrial relations it may be seen as meaning a novel, yet limited, attempt to improve the position of labor. However, all could find something of significant importance in the Mexican philosophy that gave rise to this uninspiring reality. The Mexican philosophy of profit sharing offers a glimpse of what could be, not only for Mexico, but for all the countries that are experimenting with worker participation.

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107. *Id.*

108. *Id.*