



Socially - optimal level of co-determination of labor and the European directive on workers' councils

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Abstract

In the past employee interest and influence have been presented mainly through trade unions and collective bargaining (economic regulation). Socially optimal levels of co-determination may be prevented by the existence of high fixed costs of establishing councils. Job security can resolve the adverse selection problem and raise economic efficiency i.e. worker or agent will work efficiently or *socially optimal*. Co-determination reinforces well functioning social democracy, recent studies discover that consultation and participation increase than innovativeness of the company. The US and EU approach to employment are different under common and civil law, that differ in many ways. The US employment –at- will is liberal individualist model, laissez-faire approach and any regulation is considered to be potentially welfare reducing. And mandatory employment rights model; EU model that seeks it's rationale in the previously mentioned market failures (agency problems, hold-up problems) caused by asymmetric information and incomplete employment contracts, and the presence of monopolies, monopsonies that reduce workers mobility. Harmonious relations between" social partners" – labor and management are the aim of the European Work Council directive. European law continues to focus on workers and shareholders interest.

Key words: Asymmetric informations, European model, Employee councils, Co-determination, European Work Council Directive

In the past employee interest and influence have been presented mainly through trade unions and collective bargaining (economic regulation). Mandatory introduction of the European model –statutory support for the employee rights to information consultation, and joint decision making through voluntary work councils ⁽¹⁾ (work regulation) raises questions about what should be the objective, extent and form of employee access to and influence on decision making within the firm. ⁽²⁾.Freeman and Lazear (1995) findings suggest that neither workers neither employers' have incentives to voluntary create work councils. The distributional effect will lead workers to demand degree of empowerment that exceeds social optimum. Socially optimal levels of co-determination may be prevented by the existence of high fixed costs of establishing councils ⁽³⁾ As Fitz Roy and Kraft (2005) show the effect on co-determination on productivity, job satisfaction variable and efficiency ⁽⁴⁾. Information is the basic resource in decision making (Gospel, Willman 2004).There exists pervasive asymmetry of information between the employer and employee. Economic value of the council can be modelled as communicator from management to workers. There is a social benefit from good information that maximizes the utility of employees and employers. Full information disclosure will enable workers to respond flexibility whether firm is in a good or bad state ⁽⁵⁾. Expected utility of workers; working independently of the state of the firm (good or bad) i.e. just working normally is given ⁽⁶⁾ $EU_N = pU_N + (1-p)U_0$.Alternatively if workers are indifferent between N and F(Normal and Fast) it is defined p^* probability as $p^* = (U_F - U_0) / (U_N - U_0)$
 p^* lies between 0 and 1 since $U_0 < U_F < U_N$. Exchange of information is legally mandated, work councils can enhance the flow of information from workers to management. Joint consultation becomes communication vehicle for management to provide general information about the state of the organization. Employee councils have been introduced to a large number of organizations not just to integrate consultative and negotiating process but to do “employee” rather than “union” presentation. Increasing size of the employee council can improve accuracy of information, work councils’ improve enterprise surplus when they have limited and definite power in the enterprise. Information obtained by the union sets must yield higher joint surplus than the information’s provided in the disjointed sets. Work councils, are mandated rights over the level of employment, employee surplus division, working conditions. On long run this increases the level of job-security. Job-security is higher valued work-outcome by the workers according to the study of Clark (2005). Job security can resolve the adverse selection problem and raise economic efficiency i.e. worker or agent will work efficiently or *socially*

¹ Works constitution act 1952 and 1972 for work councils in private sector and The personnel representation Act 1974 extended this to public sector enterprises

² See Appendix 1 Section A ; Table 1 tow way channel work council and trade union

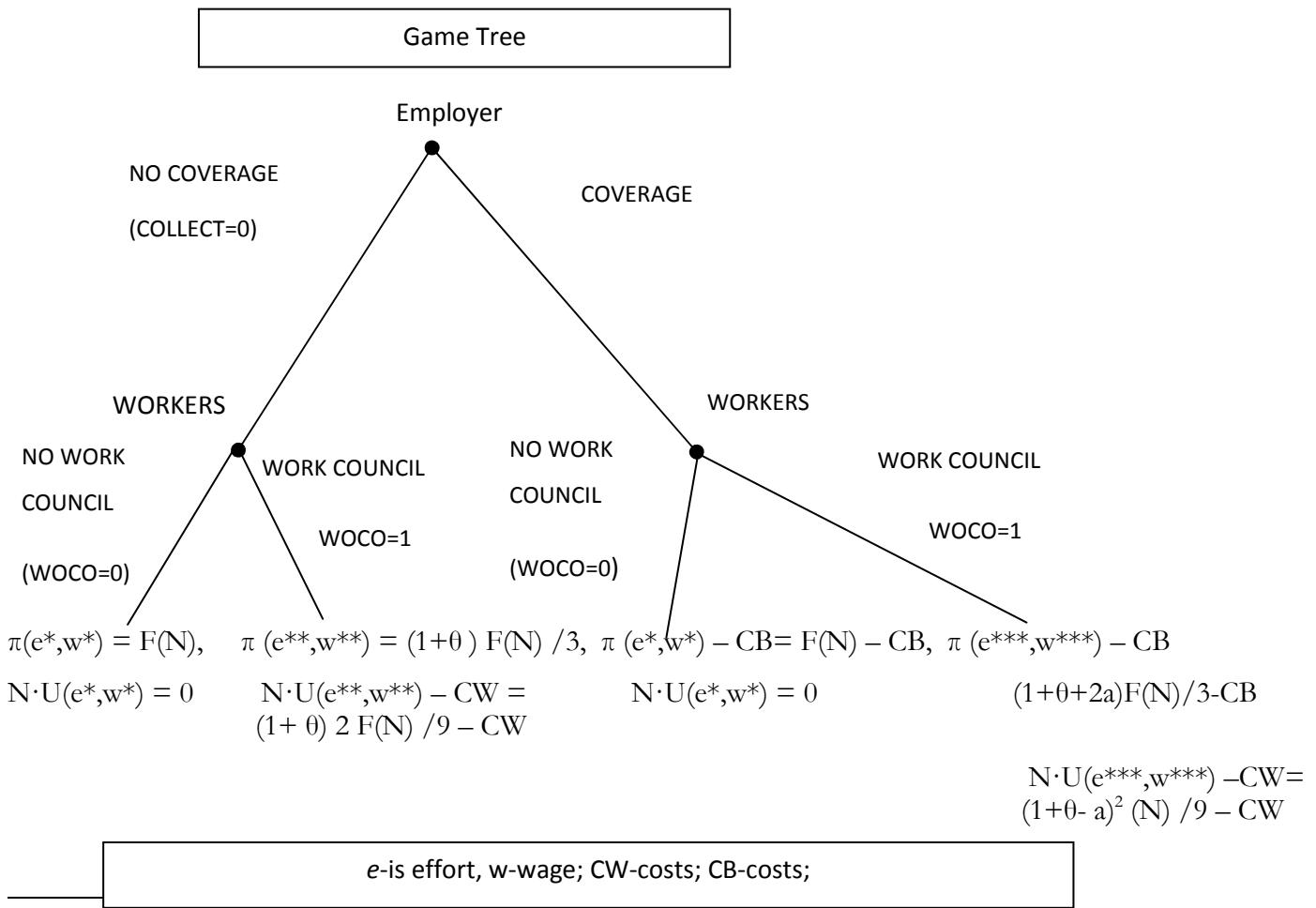
³ See Appendix 1 Section B ; Firm A weak council ; Firm B no council

⁴ See Appendix 1 Section C ; Table 2 Co-determined third parity so-determined and non-codetermined firms and Section D Table 3 Cobb Douglas production function

⁵ See Appendix 1 Section E Gains from information disclosure as a function of p

⁶ P % of the time workers are right working normally N and receive utility U_N while $(1-P)$ % of the time they are wrong and receive utility U_0

optimal (Akerlof, 1976). Which will reduce the opportunistic or *dysfunctional behaviour*. Results from an empirical study of (Bauer T. 2004) showed that opportunity to participate in decision making, communication with co-workers have positive impact on the welfare of the employees. What makes the contracts incomplete is the long-run relationship between principal and agent and element of uncertainty and risk in the relation. If contracts are incomplete allocating some control rights to employees may be optimal, as they may be willing to develop firms' specific capital. And on the long run monitoring costs cumulative increase; that is why job security legislation should be self-enforcing in other words there will be low cost for litigation. Collective bargaining is based on the manifestation of power and counter power between employer association and trade union. Co-determination requires limitation of managerial discretion to manage. However some limitation should be placed on the power of work councils (Freeman Lazear 1995) . Employee consultation it is legally required, communication through joint consultative or works committee on average is increasing(downward and upward communication)⁷. Geary distinguishes between *consultative* participation upward communication and *delegative* participation i.e. participation designed into peoples' jobs. Co-determination reinforces well functioning social democracy, recent studies discover that consultation and participation increase than innovativeness of the company. The study by Hubler and Jirjahn(2003) showed that the presence of work councils exerts positive impact on productivity within the covered industrial relations regime.



⁷ See Appendix 1 Section F Table 4 Change in communication through representative staff bodies over the previous three years

The employer will be a member of an employers' association if the cost of coverage the collective agreement are offset by the advantage of discouraging the rent seeking behaviour of the work council. A study of Mizrahi, Shlomo (2002) argues that firms efficiency, stability and workers participation can be achieved through participatory decision rules therefore government intervention is considered to be marginal throughout. Relying on the rationales developed by the new-institutional economics long-run relationships between employer and employees are essential for the firms' existence and stability. This explains the advantages of the social contract although *efficiency* in the market can be achieved without it but under assumption of perfect competition in the market. The firms in capitalist market economies face profit maximising constraint, and high involvement of employees to increase their share in the firm's surplus, leading to inefficiency. From managerial perspective there is optimal level of involvement which is not always must be maximum level of involvement (Mizrahi, 2002). Economic studies show that economic benefits tend to be higher; the higher the level of participation and where there is financial participation through profit sharing and or ownership stakes (Hodgson Jones). Employment law is often labelled as either *individual* i.e the law relating to the employee-employer relationship, or *collective* i.e. relationship between employee, employer and third party, trade union (Hardy, Upex, 2006). The US and EU approach to employment are different under common and civil law, that differ in many ways. The US employment –at- will is liberal individualist model, laissez-faire approach and any regulation is considered to be potentially welfare reducing (Adnett, Hardy, 2005). And mandatory employment rights model; EU model that seeks its rationale in the previously mentioned market failures (agency problems, hold-up problems) caused by asymmetric information and incomplete employment contracts, and the presence of monopolies monopsonies that reduce workers mobility. Sources of the law in US/UK are essentially legislation and case law while in EU there are treaty provisions, directives and regulations regulating the labour law of the member states. In the common law countries the contract of employment about the individual bargaining between employer and employee is the core of the employment relationship (Osman, Chris 2001). Civil law jurisdictions are somewhat different, employment relationship are regulated by labour code (France) or collective agreements, that contrary to market – oriented US model, create neo-corporatist European Social model that establishes diverse non-waivable worker rights. According to common law employer can be dismissed without reason and has no protection against it (Robinson, Fox, 1985). In EU all the member states have the level of protection or eligibility if the dismissal is unfair. Corporatist contest the argument that job security legislation and centralized co-ordinated bargaining produces hysteresis i.e. downward inflexibility (the Beveridge curve) in the relationship between vacancies and unemployment. Some suggest that deregulatory pressures are inevitable in the labour market, reflecting the changes in the industrial organization, implying looser organization and dualism, between a protected core of multiskilled employees and adjustable periphery of contract workers and an adjustable periphery of contract workers in an era of post-Fordist flexibility (Rhodes, 1992). Most EU legislation that affects employment law is introduced in the form of directives. Directives are legislative instruments that require member state to translate the contents of the directive into national law (Lewis, Sargeant, 2000). European Work

Council Directive (EWC)⁸ gave embodiment of the European model of representation that covers transnational companies that work in EU. The directive's basic requirement is am establishment of a procedure for information and consultation between workers and the firm (Hogler, 1996). Directive avoids any linkage between trade unions and representation. Even though directive is transnational in its scope, it contemplates decentralized schemes by which parties can make local agreements to satisfy the law. Directive's policy rationale derives from the social charter, social interest are indispensable adjunct to economic project. Social charter previously was considered important for workers' rights protection (Teague, 1993). Central of this philosophy is the theme of partnership that is meant to encourage employee commitment, epitomized in German Co-determination Act (1976), (Morley, Guinnigle, Collings, 2006). Employee rights ,do not include workers right to engage in collective bargaining with the employer. Those are the instructive comparisons between US and EU law that can be drawn. Harmonious relations between "social partners" – labour and management are the aim of the directive. All member states should provide appropriate measures in a case of failure to comply with this directive by ensuring administrative and judicial procedures. The key feature of the legislative strategy behind the transnational character that transnational character of the bodies that directive promotes has enabled commission to apply the principle of mutual recognition of member states existing national systems of employee representation (Hall, 1992). Workplace democracy has impact upon economic efficiency which is in line with the Lisbon Strategy (2000) and social agenda of establishing interaction between economic employment and social policy. The system of codetermination restricts freedom of establishment of foreign corporations; this restriction is justified under imperative requirements doctrine. European law continues to focus on workers and shareholders interest.

⁸ COUNCIL DIRECTIVE 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees

Appendix 1 Section A

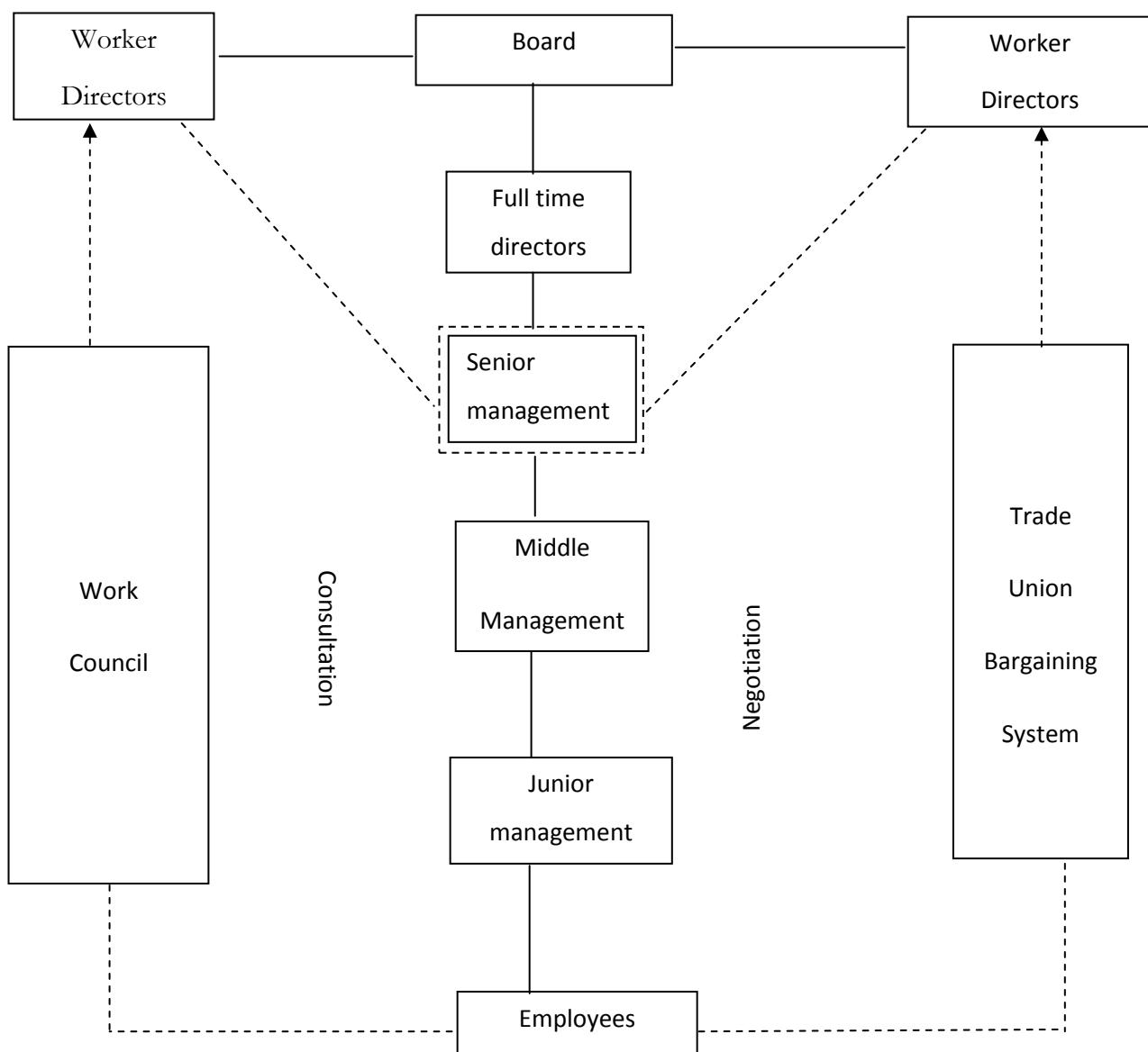


Table 1 Channels of presentation; two channels work council and Trade Union

Appendix 1 Section B

A

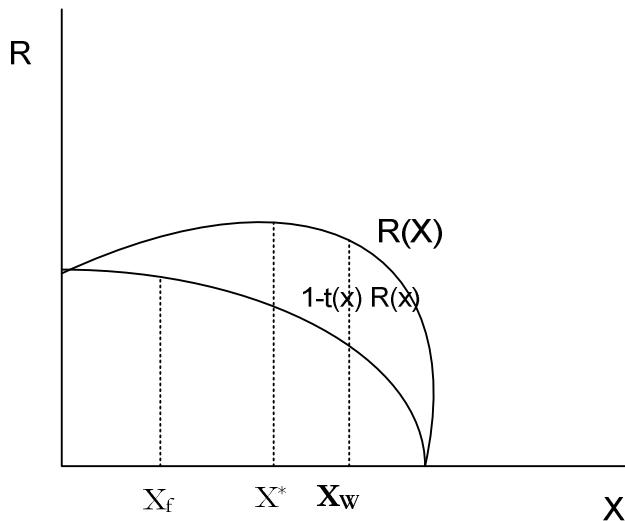
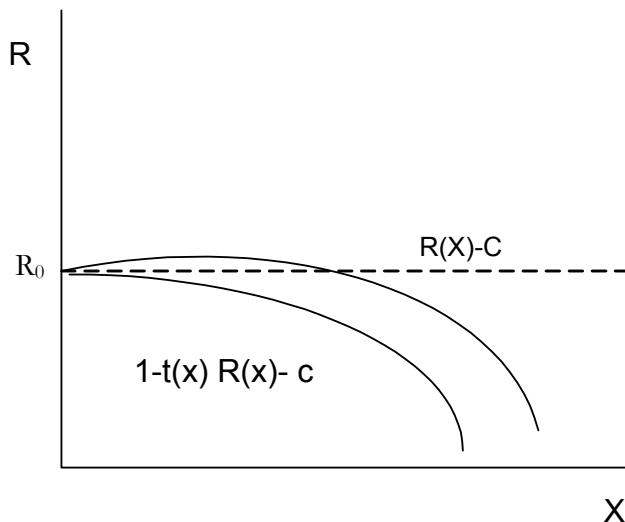


Fig 1 A firm establishes weak council X^* is social optimum that maximizes joint surplus, workers will choose X_w , short changing the interest of capital.

B



B Firm establishes no council; here C denotes fixed costs to works councils- time and preparation for the elections

Appendix 1 Section C Table 2 Co-determined third parity so-determined and non-codetermined firms

Descriptive statistics 1972-1976 and 1981-1985			
Variable	Co-determined firms (N=65)	Third parity co-determined firms (N=61)	Non co-determined firms (N=53)
1972-1976 COD =1 if employment is > 2000	1	0	0
LABOUR Number of employees	17586 (26926)	1137 (547)	321 (126)
Capital Total capital stock in TDM (thpousands of deutche marks)	1320188 (2187755)	65906 (40753)	16949 (12092)
MAT material input in TDM	963477 (1631943)	46217 (51503)	14674 (10618)
SALES total volume in TDM	1879424 (3096734)	95906 (64853)	28248 (16677)
OVER Average number of overtime hours per week and worker at industry level	2.30 (0.94)	2.44 (1.03)	2.57 (1.20)
CONC percentage market share of the six largest firms in the industry	33.58 (18.88)	22.80 (15.06)	21.65 (16.72)
IMP (value of imported goods relative to/total production)	0.17 (0.11)	0.19 (0.12)	0.22 (0.17)
EXP(value of exported goods to total sales volume)	0.33 (0.10)	0.30 (0.06)	0.30 (0.12)
1981-1985 COD =1 if employment is > 2000	1	0	0
LABOUR Number of employees	18918 (37834)	1100 (450)	315 (117)
Capital Total capital stock in TDM (thpousands of deutche marks)	2246018 (3865700)	117990 (89117)	28904 (22076)
MAT material input in TDM	2082503 (3862749)	90468 (98639)	30746 (43039)
SALES total volume in TDM	3729622 (6706128)	175726 (130640)	53270 (48942)
OVER Average number of overtime hours per week and worker at industry level	1.43 (0.59)	1.57 (0.63)	1.71 (0.79)
CONC percentage market share of the six largest firms in the industry	33.43 (18.65)	23.55 (15.37)	23.30 (16.95)

IMP (value of imported goods relative to/total production)	0.25 (0.16)	0.28 (0.19)	0.34 (0.22)
EXP(value of exported goods to total sales volume)	0.44 (0.17)	0.42 (0.18)	0.42 (0.18)
mean values (standard deviation in parentheses)			

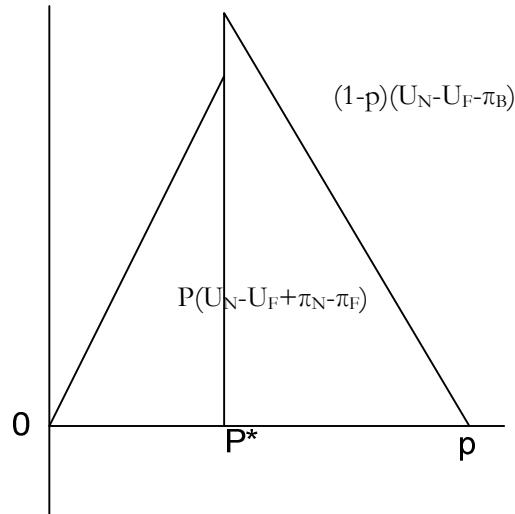
Appendix 1 Section D Table 3 Cobb-Douglas Production function

Cobb-Douglas Production function		
	<i>Hausmann Taylor</i> 1972-76	<i>Random effects</i> 1972-76
<i>Period variable</i>	<i>1981-85</i>	<i>1981-85</i>
Constant variable	3.17 (11.12)	2.51 (20.42)
COD	0.24 (4.06)	0.005 (0.22)
COD 80	0.06 (3.48)	0.04 (2.84)
lnN	0.27 (6.49)	0.29 (14.11)
lnK	0.27 (5.82)	0.27 (8.12)
lnMAT	0.32 (5.51)	0.37 (8.48)
IMP	-0.13 (-1.15)	-0.21 (-2.33)
EXP	0.20 (2.54)	0.25 (3.25)
OVER	-0.0003 (-0.03)	0.006 (0.51)
CONC	-0.0003 (-0.10)	0.0001 (0.06)
R^2		0.998
chi-square(p-value)	4.17 (0.999)	
Hausman test on Hausman–Taylor–RE versus Within Estimation of all time-varying variables		

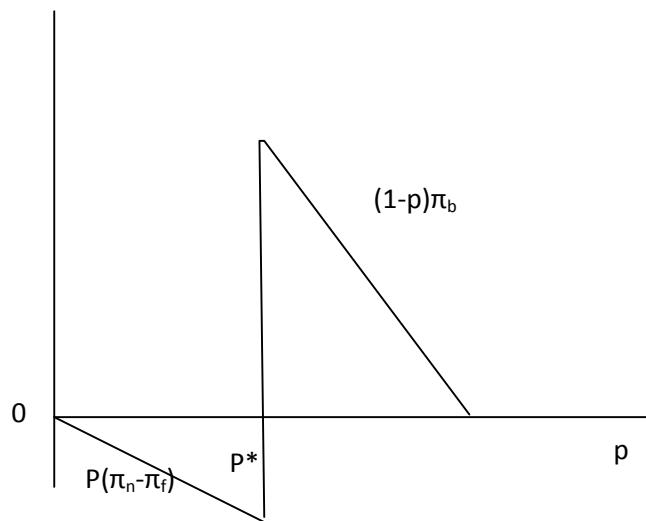
Notes: t-values (respectively probability value for the chi^2 statistic) in brackets,
n=1630, 179 firms, time dummies not reported.

This table shows that the sign on the co-determination variable is positive and statistically significant and his economic influence on the productivity and efficiency is also significant.

Appendix 1 Section E figure 3 and figure 4 Social and employee gains



A. Social Gains



B. Employer gains

Appendix 1 Section F, Table 4 Change in communication through representative staff bodies over the previous three years

Country	Increased	Same	Decreased	Not Used
UK	25.3	42.0	4.6	28.1
France	15.3	75.9	5.1	3.6
Germany	17.1	67.9	6.5	8.5
Sweden	22.6	63.3	7.3	6.7
Spain	28.8	56.9	2.6	11.8
Denmark	37.0	46.3	4.2	12.5
the Netherlands	35.0	49.9	6.9	8.2
Italy	24.3	57.0	9.3	9.3
Norway	5.4	32.3	58.6	3.8
Switzerland	17.8	34.9	3.6	43.6
Turkey	11.9	41.5	5.1	41.5
Finland	34.7	57.3	5.2	2.8
Greece	10.6	47.5	2.1	39.7
Austria	19.4	66.0	7.8	6.7
Belgium	18.8	54.6	8.3	18.3
Australia	9.4	37.7	9.4	43.5
New Zealand	14.4	46.4	3.2	36.0
the USA	11.4	30.6	2.3	55.7
Canada	20.2	47.8	3.9	28.2
Slovakia	15.7	42.7	2.0	39.6

Source: Cranet data(2004)

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