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Works Councils

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Abstract

This chapter reviews the economic effects of employee representation with statutory consultation and information rights at the workplace, the works councils. The chapter summarises the international literature which is heavily skewed towards the German case. This review focuses, first, on the mechanisms that enable the productivity enhancing role of works councils. Second, the review discusses the context factors that hamper or facilitate the productivity enhancing role of works councils. The chapter will start discussing the economic consequences of German works councils and then review the evidence obtained from other countries.

Keywords: works councils, codetermination, consultation, productivity, management practices

JEL classification: J53, M54, J50

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Introduction

Works councils are institutionalised bodies of representative communication between a single employer and the employees of a workplace (Rogers and Streeck 1995) with statutory rights for information and consultation. The statutory rights make works councils, as discussed in this chapter, unique and different from other forms of employee involvement and participation. Employee representation via works councils has a long tradition in countries like Austria, Germany, and the Netherlands and has been introduced in EU countries following an EU framework Directive (ICE Directive) in 2002¹. The ICE directive established minimal requirements for informing and consulting employees and the implementation of the directive took the national tradition and industrial relations systems into account leading to a variety of works council types across the EU (Hall 2006). Outside Europe, works councils with statutory rights play a role in the industrial relations for example in South Korea.

Works councils are distinct from unions. Works councils focus on participating in management decisions and are, by law, neither allowed to bargain about wages nor to strike, two areas which are reserved for unions. Works councils represent the entire workforce of a plant, establishment, or workplace² not members which is typically ensured by works council elections every few years. Works councils are also distinct from board-level representation where employee representatives have a seat on company boards (Gregoric 2022). Works councils are also distinct from management-led involvement practices because works councils are established on the initiative of employees, and they can enforce their rights using legal actions. Requiring an employee initiative to establish a works council also implies that eligible firms might not have a works council.

This review summarises quantitative empirical studies about the economic effects of works councils on firm and employee outcomes. The review starts clarifying the statutory rights and theoretical mechanisms. Because the current empirical evidence is predominantly based on the German case, the review briefly summarises the empirical evidence about the effects of works councils in Germany on productivity, wages, and profitability for which Addison (2009), Jirjahn and Smith (2018), or Schnabel, (2020) provide a more in-depth discussion. The review focusses on the mechanisms that enable works councils to improve productivity and starts discussing productivity enhancing work practices that works councils can initiate, influence, and facilitate to implement and to sustain. Then, the review discusses moderating factors influencing the functioning of works councils, such as the willingness of managers and works councillors to cooperate, the ownership structure, and the broader industrial relations environment. Finally, the review discusses the economic effects of works councils in other European and non-European countries and concludes with areas for future research.

Statutory information, consultation, and co-determination rights

This section describes the obligations and rights that are typical for works councils across countries, the additional rights that are only available to works councils in a few countries and key relations to the broader industrial relations environment. As a note of caution, this section illustrates similarities and differences between industrial relations systems across countries regarding works councils in order to understand the empirical studies. It is not meant as a comprehensive discussion of differences

¹ Works councils under the 2002 ICE directive are distinct from European Works Councils, which apply to the company not the establishment-level and require that a company employs more than 1000 employees in the EU with more than 150 in at least two member states. This chapter focusses on workplace-level not company-level representation.

² The review will use the terms firm, establishment, workplace, and plant to refer to the organisational entity in which works councils can be established.

in industrial relations between countries (see Visser 2009 or Sanz de Miguel et al. 2020, for a classification of industrial relations systems in Europe).

The first distinctive characteristic of works councils is the legal obligation to work in cooperation with the management at the workplace. For example, the EU framework directive 2002/14 states that information and consultation shall promote mutual trust and strengthen the social dialogue. Article 1(3) requires employer and works councillors to “work in a spirit of cooperation and with due regard for their reciprocal rights and obligations, taking into account the interests both of the undertaking or establishment and of the employees”. Hence, works council legislation focusses on fostering the social dialogue and cooperative employment relations at the workplace.

The second distinctive characteristic is the statutory right for information and consultation. The rights can be enforced and are usually regulated by national law whereby the legally defined areas vary substantially across countries. Information rights typically cover recent and probable developments of the establishment’s activities and the economic situation. Consultation is defined as an exchange of views and establishing a dialogue between the employer and the works council. Consultation rights typically focus on the situation, structure, and probable development of employment, on decisions that probably lead to substantial changes in the organisation of work, and on contractual relations where employment is threatened. In case of a lack of consultation in relevant matters, arbitration tribunals or courts settle disputes between management and works council. Hence, information and consultation rights provide employees with a strong voice in management policies affecting employment and increase employees bargaining power.

A key aspect differentiating works councils across countries is additional codetermination rights. While consultation rights require management to listen to the views of employee representatives but leave the final decision to managers, co-determination rights require a mutual consent between management and works council, meaning the works councils can effectively veto management decisions in specific areas. In Germany, for example, co-determination rights cover areas such as working-time arrangements, technical devices to monitor employees, payment principles and health and safety arrangements. Codetermination rights exist in several countries with a tradition in works councils preceding the EU directive, most notably Austria, Germany, and the Netherlands but also in Czechia, Hungary, and Slovenia. Codetermination rights even in narrowly defined areas give works councils more bargaining power than consultation rights as the stance of the works council cannot be overturned by management.

The second aspect that distinguishes works councils across countries is the broader industrial relation environment. The EU’s ICE framework directive sets minimum requirements for national legislation that should be adopted to fit and embed works councils in a historically developed national system of industrial relations. In many European countries, union representatives at the workplace have fulfilled the role of works councils for decades, such as in Northern European countries with their long tradition of cooperative industrial relations based on unions. Hence, workplace unions or workplace union representatives are often intertwined with the workplace information and consultation bodies introduced or amended in the aftermath of the ICE directive. Industrial relations may have been traditionally cooperative in Northern Europe but have been less cooperative in many Southern European countries (Visser 2009). Such tradition between cooperation and conflict adds another layer in comparing the economic effect of works councils across countries. The interdependence between unions and works councils and the traditional attitude of unions and employers towards each other makes comparing works councils across countries challenging. The depth of works council rights and the role of unions in the broader industrial relations environment creates a wide variety of works council types across countries.

Finally, employees can establish a works council in workplaces above a legally defined number of employees at the workplace. The EU directive sets the threshold at 50 employees, but the threshold is lower in several countries, for example 5 full-time employees in Germany.

Theory

This section reviews three main theoretical frameworks to predict the effects of works councils on firm outcomes such as productivity, wages, management practices, innovation, profitability, and growth: the collective voice, incomplete contracts, and rent redistribution.

a) Collective voice theory

Collective voice theory postulates that works councils can aggregate employees' preferences and communicate effectively with management in order to improve personnel policy (Freeman and Medoff 1984). Raising voice over working conditions or procedural justice provides employees with an alternative to leaving the firm or withdrawing commitment and motivation. However, raising voice individually can result in sanctions by the employer. Hence, a collective voice institution may be required to protect employees from the risk of retaliation by managers. For example, Aghion and Hermalin (1990) argue that articulating individual preferences for family friendly practices might signal higher use of such practices, resulting in lower career opportunities. Work practices and working conditions are public goods at the workplace in the sense of non-rivalry in use but with individual costs for voice. Collective voice institutions can compile employees' preferences and perceptions regarding work practices, working conditions and organisational procedures. In contrast, such information cannot be efficiently collected in exit interviews because of selective responses. By collecting employees' views and experiences, collective voice can reduce information asymmetries between employer and employees about preferences and organisational processes and can lead to more efficiency. By providing a mechanism to solve discontent and to gather reliable information about inefficiencies and public goods, collective voice can reduce employee turnover leading to fewer interruption at work and to lower replacement costs leading to higher productivity and profits (Freeman and Medoff 1984). Reduced employee turnover also increases the return period of investments in firm-specific skills, making such investments more likely. Skill investments can also increase productivity.

Collective voice improves the communication between employees and employers under two conditions. First, the works council needs to represent all parts of the workforce to effectively communicate between a diverse workforce and the management. Representation of minority groups can be an issue. Second, a cooperative attitude of works councillors and of managers, working together to identify information asymmetries and improve working conditions, is a crucial precondition for the effectiveness of collective voice bodies such as works councils.

b) Incomplete contracts

Incomplete employment contract theory postulates that the statutory rights of works councils are the condition to provide a safeguarding function for employees (Smith 1991, 2006; Kaufman and Levine 2000). Incomplete or implicit contracts emphasize that explicit employment contracts cannot perfectly govern an employment relationship because several obligations and expectations of both parties are diffuse and impossible to be written in an employment contract (Hogan 2001). For example, employees might invest time and effort in the employment relationship, trusting that the employer rewards the effort with higher pay or job security. The employer, however, might be tempted to renege on promises made without facing the explicit requirement to compensate the employee. Moreover, line managers retain discretion over information processing, task assignment, and

performance appraisals. They might use the discretion to hoard responsibility and authority, pursue individual over company goals, take credit for subordinate's accomplishments, and reward preferred subordinates (Smith 1991). Such employer and manager opportunism represents a hold-up problem when employers favour short-term gains over long-term cooperation by reneging on promises after employees made investments (Smith 2006). If employees expect such actions, they might withhold cooperation, reduce effort, refuse to invest in firm-specific skills and withhold information, particularly information that might improve productivity but can also be used to increase production norms or lead to redundancies (Jirjahn 2017). Even if employers do not plan to renege on promises, they might not be able to credibly commit that they will not, and employees might therefore withhold cooperation. Such employer commitment problems can undermine cooperation.

To overcome employer opportunism and the employer commitment problem, works councils can use their statutory rights to stipulate policing and monitoring of implicit arrangements. The statutory rights enable works councils to monitor those in positions of power to ensure that their self-interest does not threaten the collective interest (Dow 1987). Moreover, statutory rights require consultation with or the consent of the works councils to change work arrangements. Works councils can negotiate fair practices and policies and monitor the implementation as agreed upon. Thereby, works councils become a workplace institution that provides a safeguarding or insurance function for employees against employer opportunism and solve the employer commitment problem. In other words, works councils can mitigate organisational failures (Jirjahn and Smith 2018). Furthermore, information rights can moderate worker demand in tough times because the works council can credibly verify management claims about the financial and economic situation of the firm and thereby convince employees to increase their effort (Freeman and Lazear 1995).

Advocates of the necessity of statutory rights for works councils point out that only robust statutory rights can overcome managerial opportunism and provide an effective employer commitment device because managers cannot easily overturn work arrangements without the consent of the works council (Smith 2006). The statutory rights are necessary because a pure reputation mechanism is depending on unambiguous contractual terms and on the ability of the wider community to observe compliance (Lorenz 1999). However, obligations and expectations in employment relations are often diffuse and intangible by nature, relying on the mutual believe in good and honest intentions of the other side. Such diffuse obligations, as proposed in gift exchange (Akerlof 1982) and social exchange arguments (Cropanzano and Mitchell 2005) can generate the hold-up problem. The hold-up problem can be unintentionally caused by changes in management when new managers are not bound to verbal promises of previous managers or intentionally by opportunistic managers exploiting short-term gains.

The safeguarding function of works councils can increase the acceptance of managerial decisions, particularly in situations characterized by ambiguity and lack of transparency (Jirjahn and Smith 2018). The fall-back option of statutory rights can increase trust of employees in managerial decisions and actions and thereby encourage employees to invest in firm-specific skills, share innovative ideas about product, services, production, and organisational processes and increase effort all of which lead to higher productivity. Trust in managerial decisions develops as a consequence of statutory rights safeguarding employees.

c) Rent redistribution

Information, consultation, and co-determination increase employees bargaining power and thereby involve direct and indirect wage costs. Direct wage costs can result in works councils using their bargaining power to redistribute rents from the employer to the employee side (Freeman and Lazear

1995). Even if works councils are not allowed to bargain about pay, they can increase pay by negotiating to classify employees into higher pay grades. Moreover, because works councils protect employees from being dismissed, employers might choose to pay efficiency wages to incentivize employees to exert effort. Finally, works councillors receive a salary when negotiating on behalf of employees. Indirect wage costs can result from negotiations and more formalised procedures that require additional time and resources, for example, when policy documents need to be prepared, meetings and negotiations held, and formalised processes implemented. Moreover, formalised procedures such as appraisals might need to be documented requiring additional time from line managers. All of this results in additional time and resources which affects the firms wage bill.

Works councils increase employees bargaining power based on the information, consultation, and codetermination rights. These rights help employee representatives to understand and assess the financial and economic situation of the firm. This can lead to employee concessions in hard times but works councils might also use their rights to demand better working conditions in good times (Freeman and Lazear 1995). Works councils can use their bargaining power to negotiate concessions in working conditions that are not matched by increasing productivity and they can use co-determination rights as bargaining leverage to obtain concessions in areas without statutory power.

Taken all together, works councils can improve the firm performance but also increase the wage costs. Whether the productivity enhancement via voice and safeguarding dominates the rent redistribution effect or vice versa is an empirical question.

Empirical patterns for Germany: productivity, costs, and profitability

The review will only briefly summarise the effects of German works councils on productivity, wages, and profitability. In-depth reviews about these effects provide Addison (2009), Jirjahn and Smith (2018), and Schnabel (2020). It is also important to note that most investigations on works councils are within-country studies. This holds for Germany where works councils are mandatory, but not automatic because the introduction of a works council depends on the workforce of an establishment. Hence, works councils are not present in all eligible establishments. This allows comparing establishments with and without a works council.

a) Productivity

Most empirical studies find a positive effect of works councils on establishment productivity in Germany (Addison et al. 2000; Addison et al. 2001; Frick and Möller 2003; Hübler and Jirjahn 2003; Zwick 2004b; Addison et al. 2006; Wagner et al. 2006; Renaud 2008; Müller 2012; Jirjahn and Müller 2014; Müller 2015; Brändle 2017; Broszeit et al. 2019; Mohrenweiser 2021; Müller and Neuschäfer 2021). These studies use a value-added based productivity measure, and the point estimates vary between about eleven percent (Brändle 2017) and 84 percent (Zwick 2004b) with the majority of estimates between 12 and 25 percent. The significant positive works council coefficient holds for East and West Germany and for manufacturing and service industries. Nevertheless, some older empirical studies find insignificant or negative effects as summarised and discussed in Addison (2009).

In small firms, the works council effect on productivity appears to be less strong. For firms with 21-100 employees, Addison et al. (2001, 2006) estimate insignificant while Jirjahn (2003), Wagner (2008) and Jirjahn and Müller (2014) report significant positive but much smaller effects than in the overall sample. Moreover, estimates for the firm size classes of 50-249 employees (Broszeit et al. 2019; Mohrenweiser 2021) and 21-300 employees (Müller 2012, 2015) are significant positive, but the works council coefficient is about half the size in smaller firms than in estimations with all firms, with Jirjahn (2003) being the exception. The smaller influence of works councils on productivity in smaller firms

can be attributed, first, to the lower relevance of collective voice in smaller firms because managers are more likely to be able to communicate directly with all employees. Second, governance and agency problems increase in firm size making the safeguarding function of works councils more relevant in larger firms.

The positive effect of works councils on productivity holds when controlling for various HR practices (Zwick 2004b; Broszeit et al. 2019). In contrast the works council becomes insignificant in Stettes (2010) who controls for HR practices, several incentive schemes, and alternative forms of representation. Nevertheless, potential complementary effects between HR practices and works councils have not been analysed yet.

Finally, Stettes (2010) and Müller (2015) estimate productivity effects for works councils across the productivity distribution. While Stettes (2010) finds positive works council effects in smaller deciles and a negative effect in the 9th decile, Müller (2015) estimates positive effects across the distribution but also estimates larger effects at the lower deciles.

b) Wages and costs

Works council firms pay higher wages than firms without a works council (Hübler and Jirjahn 2003, Gürtzgen 2009; Addison et al. 2010; Ellguth et al. 2014; Brändle 2017; Hirsch and Müller 2020; Müller and Neuschäfer 2021). The estimates of the work council wage premium range between 5 per cent (Hirsch and Müller 2020) and 22.5 percent (Ellguth et al. 2014), with positive effects across all groups of employees and all quantiles (Addison et al. 2010). The higher wages for works council firms can be attributed to the bargaining power of works council, for example by classifying employees into higher pay grades and by more incentive pay. Works council plants also seem to attract employees with higher quality (Müller and Neuschäfer 2021). Moreover, Hirsch and Müller (2020) conclude that works councils are more likely to bargain over a minimum level of wages rather than over their share in the plant's quasi rent. Finally, in line with the positive wage premium, firms with a works council are more likely to report higher labour costs than firms without a works council (Pfeifer 2014a).

Works councils can increase the indirect wage costs because negotiations in areas in which works councils have consultation and co-determination rights can lead to more formalised procedures. Such formalised procedures are typically written down in work agreements. HR managers assess that 74 percent of these arrangements increase flexibility but 21 percent state that work arrangements lead to more rigidity (Nienhüser 2009).

c) Profitability

The effect of works councils on profitability is theoretically ambiguous and empirical studies report opposing effects. The opposing effects, however, depend on the definition of the dependent variable. Studies using a subjective evaluation of managers about profitability typically estimate a negative effect of works councils on profitability (Addison et al. 2001; Dilger 2006; Müller 2011; Mohrenweiser 2021). In contrast, studies using a more objective measure based on the log of value added minus the wage costs typically estimate a positive effect of works councils on profitability (Müller 2011; Mohrenweiser 2021, Müller and Neuschäfer 2021). The estimated effects of works councils on objective profitability measures range between four percent (Mohrenweiser 2021) and 18 percent (Müller and Neuschäfer 2021). The positive effect of works councils on objective profitability measures is driven by works council firms that are simultaneously covered by a collective bargaining agreement (Hübler 2003, Müller 2011).

The data pattern – significant negative effect of works council on subjective but significant positive effect of works councils on objective profitability measures – holds for a variety of subjective

performance metrics across databases (Mohrenweiser 2021). The pattern might result from missing reference points in several subjective performance questions (Müller 2011) and that subjective performance measures might be understood as after-tax assessments while objective performance measures are before-tax assessments (Mohrenweiser 2021).

d) Employment growth

Employment growth is an indicator of whether works councils drive or hamper businesses. The empirical evidence is mixed. Addison and Teixeira (2006) and Brändle and Goerke (2018) find a negative effect of works councils on employment growth while Jirjahn (2010) and Gralla and Kraft (2018) estimate an insignificant effect. The insignificant effect turns positive in an IV estimation in Jirjahn (2010) who interprets the result as an indication of a downward bias because firms in economic difficulties have a higher probability of having a works council.

The works council life cycle

Empirical studies on the effects of works councils on productivity, wages, and profitability need to address the potential endogeneity of the works council status. The works council coefficient can be biased if works councils are either more likely to be established in high or in low productivity firms. Similarly, the estimates would be biased if works councils drive low productivity firms out of business or if works councils help low productivity firms to survive which would not otherwise. Such selection into or out of the works council status could generate an over- or underestimation of the true effect of works councils on productivity, wages, and profitability. However, performance improvements might also not immediately emerge when a works council has been established but evolve over time, an effect which is called works council learning. In addition to understanding the direction of the bias of productivity, wages, and profitability estimations, analysing the establishment of works councils, the survival of works councils, plant closures and works council learning can also reveal further insights into the collective voice, safeguarding, and rent redistribution role of works councils.

a) What triggers the establishment of a works council?

Works councils can only be established by employees and not by managers. Hence, the circumstances of establishing a works council can reveal if works councils are predominantly a voice and safeguarding institution or an institution to increase the rent of employees. The voice and safeguarding function as motivation to establish a works council is supported if employees are more likely to establish a works council in low productivity firms or downsizing firms in which jobs and thereby firm-specific human capital investments are at risk. In this case, the works council effect on productivity would be underestimated. The rent redistribution argument is supported if employees are more likely to establish a works council in high productivity firms with a large surplus that can be redistributed to employees. Consequently, productivity estimations would be upward biased (Jirjahn 2009).

The empirical evidence is leaning more towards the voice and safeguarding argument. Employment growth and an expansive market strategy is negatively while poor sales are positively associated with the establishment of a works council (Jirjahn 2009). In such circumstances, the statutory consultation and codetermination rights of works councils can provide a safeguarding mechanism against changes of implicit arrangements. Similarly, firms with a new works council have a lower probability of a good profit situation (Kraft and Lang 2008). Moreover, a higher average tenure and higher average wage level of employees in firms with newly established works councils indicate that employees have more to lose when the firm downsizes (Oberfichtner 2019). Moreover, establishing a works council is more likely during major restructurings, outsourcing, mergers, and acquisitions, all of which can increase the uncertainty of employees about the future of jobs and firm-specific human capital investments

(Mohrenweiser et al. 2012). In such circumstance, works councils can provide a safeguarding mechanism to protect employees' rents but also give a voice in a restructuring process. Nevertheless, in rare cases managers with positive experience with works councils in previous jobs encourage and facilitate establishing a works council, indicating an expected performance enhancing role of works councils (Mohrenweiser et al. 2012).

In contrast to these studies indicating defensive reasons for establishing a works council, Beckmann et al. (2010) find support for the rent redistribution hypothesis showing that a higher productivity is positively associated with the introduction of a works council. In contrast, Müller and Neuschäffer (2021) show that the productivity and profitability decreased in the years before a works council is established, a pattern that is more aligned with the voice and safeguarding argument. They also show that firms establishing a works council have the same average quality of employees before and at the time of the establishment of the works council compared with firms without a works council. Hence, the circumstances of establishing a works council point to an underestimation of the productivity premium of works councils and support the voice and safeguarding function of works councils as the dominant driver for employees to establish a works council.

b) Survival of newly established works councils

Establishing a works council changes the power balance within firms as works councils need to be consulted or give their consent to implement or change policies and procedures. Hence, attempts to establish a works council are frequently met by resistance from managers (Artus et al. 2016; Harcourt et al. 2020) particularly owner managers (Jirjahn and Mohrenweiser 2016). Resistance against works councils does not stop after the works council has been established, the initial years of a works council are characterised by conflicts between management and works councils which manifests in a higher likelihood of tense employment relations in firms with newly established works councils (Jirjahn et al. 2011). Consequently, about 40 percent of newly established works councils do not survive the first two years and are abolished quickly (Jirjahn and Mohrenweiser 2016). The probability of abolishing a works council decreases in firm size but is higher for high-tech establishments (Addison et al. 2013). If an owner manages the firm, the probability of establishing a works council is lower and the probability of survival is lower even if conditioned on established works councils (Jirjahn and Mohrenweiser 2016). Owner managers seem to highly value decision autonomy, or the right to manage. They are more likely to be prepared to trade productivity or profitability of their firm – which might result from effective codetermination – with decision power as codetermination limits managerial discretion to manage (Jirjahn and Mohrenweiser 2016). In a similar manner, Harcourt et al. (2020) postulate that hired managers in firms without a works council highly value their right-to-manage and their authority to determine implicit terms and conditions of employment relations.

c) Works council learning

The initial years of a works council are more likely to be characterised by tense employment relations and conflicts while the influence of works councils on management policies and practices is initially limited (Jirjahn et al. 2011). The statutory rights require that the works council needs to be informed, consulted, and give their consent to changes in policies and practices. But works councillors need to learn the skills to understand and negotiate establishment policies and procedures. They also need some time to accommodate into the new role and understand their rights, bargaining position and negotiation options. Similarly, managers need to understand and accept that they cannot make decision unilaterally anymore and share their rationale for decisions. Some managers might find it hard to accept that works councillors monitor their actions. Consequently, conflicts between works council and managers are more likely in the first years of a works council's existence but then gradually

decrease over time (Jirjahn et al. 2011). Both works council and management need time, discussions and probably conflicts before settling into efficient routines and developing a cooperative and trustful relationship. Simultaneously, works councils become more involved in decisions in which they have no statutory rights several years after the works council had been established (Jirjahn et al. 2011).

With cooperative employment relations evolving slowly over several years, information asymmetries might only slowly diminish. Consequently, employee turnover decreases slowly after the establishment of a works council and the productivity premium of works councils emerges slowly over the age of the works council (Jirjahn et al. 2011). A productivity premium can be identified after 7-10 years. However, smaller firms with less than 100 employees are more likely to face a dip in productivity in the initial years of a works council before levelling the pre-works council productivity after about five years compared with firms without a works council (Müller and Stegmeier 2017). Finally, employee quality steadily increases in the first years of the works council life even if employee quality is similar at the time of establishing the works council. The increasing employee quality can at least partially be explained with new employees having a higher quality (Müller and Neuschäffler 2021). Altogether, cooperative employment relations need time to evolve after the establishment of a works council and productivity enhancing effects need time to emerge.

d) Firm closure

In addition to the selective establishing of works councils, differences in firm closure between firms with and without a works council can bias the productivity, wages, and profitability estimations. Works councils might drive low productivity firms out of business because their demands increase wage costs, makes firms more inflexible and resistant to change. On the contrary, works councils might help low productivity firms to survive which otherwise would not because employees can increase their efforts or consent to wage cuts and reorganisations if the works council can credibly confirm a dire economic situation of a firm.

The empirical evidence is mixed. Addison et al. (2004) show that works councils are associated with a higher probability of closure, however, this effect is mainly driven by firms that are not covered by a collective bargaining agreement and employ less than 50 employees. On the contrary, Jirjahn (2012) finds an insignificant effect of works councils on establishment closure. However, single establishment firms with a works council that are not covered by a collective agreement have a higher likelihood of closure than single site firms with a collective agreement. The fact that uncovered firms with a works council are more likely to close than works council firms covered by a collective bargaining agreement might indicate that a collective agreement disciplines works councils and makes them less likely to engage in rent redistribution activities (Addison et al. 2004) or more likely to support productivity enhancing work practices.

Mediating factors for enhancing productivity

Works councils are more likely to be established as a defensive mechanism in times of uncertainty and a productivity premium emerges over the age of a works council. This leads to the question about the sources of the productivity increase. Works councils might provide information about training needs of employees resulting in a training programme. Works councils can also increase employees' trust in managerial decisions by providing a safeguarding mechanism which reduces employees' resistance to change. Thereby, works councils might initiate or facilitate the introduction of productivity enhancing work practices which the management has not implemented yet. This section summarises empirical

studies investigating whether works council are more likely to be associated with productivity enhancing work practices³.

a) Reducing employee turnover

A lower employee turnover can increase productivity because of less disruption in the organisation and reduced replacement costs. Employees should be more likely to stay in works council firms given the collective voice and safeguarding function of works councils. However, a lower intention to quit might also result from rent redistribution if higher pay and benefits reduce the outside options of dissatisfied employees who consequently stay. To distinguish between voice/ safeguarding and rent redistribution, the section focusses on empirical studies that control for wages. Analysing the voluntary employee turnover - or quit rate - at the employee-level, Grund et al. (2016) estimate a 1.2 percentage point and Hirsch et al. (2010)⁴ a 1.4 percentage point lower quit rate for employees working in firms with a works council compared with employees in firms without a works council. At the firm-level, Pfeifer (2011a) estimates a 7.6 percentage points lower quit rate for works council firms. This effect is largely driven by firms covered by a collective agreement indicating fewer distributional conflicts. Adam (2019) finds the same pattern and no indication of rent redistribution. Hence, the voice and safeguarding function seems to dominate rent redistribution function.

Besides quits, works councils can affect dismissals because a firm needs the consent of the works council to dismiss or lay-off employees. The dismissal rate in works council firms is about one percentage point lower than in firms without a works council but not for unskilled or managerial employees for whom the works council effect is insignificant but still negative (Grund et al. 2016)⁵. Furthermore, in a temporary crisis situation such as the Covid pandemic, works council firms recorded a lower dismissal rate than firms without a works council indicating that works councils prioritise job security measures (Fackler et al. 2021).

Furthermore, works councils have a say about severance pay for dismissed employees. Works council firms are 16.4 percentage points more likely to pay severance pay if a plant closes but 9.3 percentage points less likely to pay severance pay if only one employee is dismissed which is substantial given that severance pay is reported in less than a fifth of firms (Grund and Martin 2021). This indicates that works councils do not provide a blank protection for every employee but protect the interest of the majority of employees if a good dismissal reason exists.

Consequently, managers in works council firms are less likely to regard the quit rate as a problem, a result driven by cooperative works councils (Pfeifer 2014a). As a result of lower employee turnover rates, employees in firms with a works council have a longer tenure (Boockmann and Steffes 2011) and are more likely to receive seniority pay (Zwick 2011) than employees in firms without a works council.

b) Recruitment and selection

A firm with lower quit and dismissal rates needs to be more diligent in hiring new staff as recruitment mistakes become more expensive. Works council firms hire fewer employees than comparable firms

³ Unfortunately, mediating studies are not available yet. Understanding productivity enhancing work practices as a mediating pathway to higher productivity requires two casual effects: first, works councils cause the introduction of productivity enhancing work practices and, second these work practices cause, consequently, a higher productivity.

⁴ Hirsch et al. (2010) analyse separation rates, employees who join another firm without an unemployment spell and argue that immediate employment transitions are likely to be voluntary.

⁵ Gralla and Kraft (2018) also find a negative impact of works councils on dismissals.

without a works council (Addison et al. 2001; Gralla and Kraft 2018). Before establishing a works council, works council firms have a comparable hiring rate than firms without a works council but after establishing a works council the share of newly hired staff on all employees decreases (Gralla and Kraft 2018).

In addition, works council firms take more time to select candidates. Firms with a works council take 15.6 percent more time to screen non-managerial candidates than firm without a works council and 13 percent more time to screen managerial candidates (Jirjahn and Mohrenweiser 2019). This can either demonstrate that works councils formalise the selection process or that firms become more diligent selecting the right candidate.

While I am not aware of any study analysing whether a works council increases the pool of potential candidates (recruitment), Backes-Gellner and Tuor (2010) investigate the signalling value of a works council on vacancy rates. They show that firms with a works council have a lower vacancy rate than firms without a works council and interpret the findings as an example of employer signalling of superior work climate and working conditions. Because candidates cannot observe the work climate and working conditions when applying, they rely on signals that are related to such factors but expensive for a firm to imitate such as works councils.

c) Upskilling, further training and apprenticeship

Skill investments can increase productivity but further training investments also provide a compelling case to understand codetermination because firm-specific training can lead to a hold-up problem. The hold-up problem arises if employees invest in skills that are only valuable at the current employer trusting to be rewarded with higher pay or promotions after the skill investments. The managers, however, can revoke their part of the bargain for short-term benefits and the employee has no chance to retrieve the training investments with a better position elsewhere because of the firm-specific nature of the skill investment. Hence, employees might be reluctant to make such investments if they do not trust the management. The safeguarding function of works councils can overcome such trust problem (Smith 1991, 2006). Employees might be more willing to engage in firm-specific skills training if the perceived job security increases and the working conditions improve because of the voice and safeguarding role of works councils.

Beyond that, works councils can directly influence training policies because the Works Council Act (WCA) gives works councils direct consultation and codetermination rights regarding training needs and about duration, timing, and content of training practices (Stegmaier 2012). These specific statutory rights complement the role of works councils to reduce information asymmetries. This might enable works councils to push for a more targeted training approach by identifying training needs that have a stronger impact on skill improvements linked to productivity. The employer might also be more likely to invest in training because decreasing employee turnover and increasing tenure also reduces the employers' risk of investments in skills because the expected return period increases.

Consequently, works councils are associated with a higher probability of firm-sponsored training and a higher training intensity, the number of trained employees on all employees (Zwick 2005; Bellmann and Ellguth 2006; Görlitz and Stibale 2011; Stegmaier 2012; Heywood et al. 2020; Lammers et al. 2021). The exception is Zwick (2004a; 2006) who estimates an insignificant works council coefficient on training intensity. Moreover, Stegmaier (2012) shows that the positive effect of works councils on training intensity is driven by small firms and Lammers et al. (2021) that works councils have a stronger effect on training in low-tech industries and for unskilled workers.

Employees in works council firms are also less likely to pay for their training costs partly or in full. At the same time, works council firms are more likely to have reimbursement clauses in case employees leave the firm shortly after training, indicating that the protection of interests goes both ways (Lehmann 2011). Finally, Zwick (2008) estimates that external training courses and internal training are more prevalent in works council firms and that external and internal training courses lead to higher productivity in firms with a works council but not in firms without a works council. Altogether, this suggests that the voice and safeguarding function of works councils increase the provision of training within firms and also contribute to stronger productivity effect of training.

Apprenticeship training offers an additional perspective on firms training investments because legally mandated corporate governance structures within firms are crucial factors in the formation and development of vocational skills (Busemeyer et al. 2012). The WCA awards works councils monitoring rights about apprenticeship training. Works council firms are more likely to be high quality training firms than firms without a works council. They invest more in the training of apprentices and pay higher apprentice wages (Kriechel et al. 2014). Works council firms also report fewer illness-related absences of apprentices than firms without a works council (Koch et al. 2019; Pfeifer 2020) indicating higher well-being or better working conditions. Works council firms are also more engaged in the community, cooperating with schools and cooperating with other firms (Koch et al. 2019). Consequently, works council firms have a higher retention rate, the proportion of apprentices that stay in the firm after training, a precondition that firms can benefit from skill investments during apprenticeship training (Mohrenweiser and Backes-Gellner 2010; Kriechel et al. 2014).

d) Monitoring, appraisals, and incentive pay

Monitoring devices and incentive pay schemes can increase productivity and are also examples in which works councils can provide safeguarding mechanisms against employer and supervisor opportunism. Beyond that, the WCA grants works councils codetermination rights on the introduction and application of devices to monitor the behaviour and performance of employees as well as for changes in incentive pay schemes.

Works council firms are more likely to use written performance evaluations than firms without a works council (Heywood and Jirjahn 2014; Heywood et al. 2017; Grund et al. 2020), particularly if the performance appraisal is linked to an annual bonus. On the contrary, they are less likely to have performance appraisals linked to future wage rises (Grund et al. 2020). Written appraisals highlight that works councils increase not only the use of appraisals but applying appraisals in a consistent and regulated manner, in which works councils might govern the regulation, monitoring and grievance procedures. The codetermination rights also help preventing the employer from unilaterally altering the payment terms associated with appraisals. Hence, Heywood and Jirjahn (2014) stress that a works council can help ensuring that any plan is implemented as agreed upon. Thereby, works councils can contribute to procedural fairness by helping to set clear performance standards and make performance appraisals more transparent.

Works councils are positively associated with piece rate payments in manufacturing industries, but this positive association can only be found in firms covered by a collective bargaining agreement (Heywood et al. 1998). Heywood and Jirjahn (2002) confirm this pattern for individual and group-based piece rates. They explain this finding with the role of perceived fairness in remuneration and argue that collective agreements have an implicit profit-sharing function by reducing wage dispersion. But lower wage dispersion simultaneously reduces output fairness. Hence, works councils are more likely to implement policies to increase output fairness and thereby increase productivity.

Works council also play a role in pay schemes such as profit sharing and employee share ownership. Works councils can monitor the accounting of profits and participate in decisions that influence the financial performance of the establishment (Heywood and Jirjahn 2014). Works councils are positively associated with profit sharing (Heywood and Jirjahn 2002; 2014) and employee share ownership schemes (Heywood and Jirjahn 2014). The interpretation of such plant-level pay-schemes is debated. These schemes might be seen as sharing the joint surplus between shareholders and employees rather than providing individual incentives because of the free-riding problem in large groups. However, plant-level pay-schemes have substantial productivity effects indicating an incentive effect.

Works councils are not only positively associated with the incidence and intensity of performance pay but also managers in works council firms are more likely to perceive performance pay, and profit sharing as well-suited instruments to motivate employees than managers in firms without a works council (Jirjahn 2018). Hence, the safeguarding function of works councils might increase employees' trust in policies and procedures, and thereby, the acceptance of monitoring and performance-based pay. Döllgast (2008) also describes that works councils use their co-determination rights on monitoring to ensure that monitoring is used to develop rather than punish employees.

e) Innovation and investments

Innovations can increase productivity but are also prime examples where the safeguarding function of works councils can improve the willingness of employees to collaborate and share innovative ideas. Particularly incremental innovations might not only increase efficiency but also reduce employment. Nevertheless, works councils increase the likelihood of incremental but not radical innovations (Jirjahn and Kraft 2011, Kraft and Lammers 2019), which is mainly driven by works council firms that are also covered by a collective bargaining agreement (Addison et al. 2017). Askilden et al. (2006) also find a positive relation between works councils and product innovation. The safeguarding function of works councils seems to improve the cooperation and information sharing which is required for innovative activities.

The impact of works councils on investments is theoretically ambiguous. Works councils might inhibit investments in physical capital if the employer expects an excessive rent seeking of works councils that reduce the return of investment below the opportunity costs. On the contrary, the productivity enhancing-role of works councils might increase the return of investments because it facilitates complementary practices such as incentive schemes, training or work re-organisation. However, Hübler (2003) and Addison et al. (2007) cannot identify any association between a works council and any type of investments in physical capital.

f) Working time arrangements

Managers see working-time arrangements as the most important work agreement with the works council (Nienhüser 2009). While collective bargaining agreements cover the contractual working hours and overtime pay-rates on the sectoral-level, the WCA gives works councils codetermination rights for specific working time arrangements. The statutory co-determination rights combined with the voice role of works council to articulate employee preferences make them an important institutional player in any kind of working time matters including contractual working hours, overtime, shift work, holiday, and flexible working time arrangements.

Works council firms have lower contractual working hours than firms without a works council and are more likely to offer compensatory time off rather than overtime pay to compensate employees for extra work (Promberger and Ellguth 2007) indicating that employees prefer to substitute leisure for labour rather than increasing their income. However, firms with and without a works council do not

differ in the incidence of overtime (Promberger and Ellguth 2007; Jirjhan 2008). Regarding overtime intensity, Promberger and Ellguth (2007) find fewer overtime hours in works council firms for service and manufacturing firms while Jirjahn (2008) finds no difference for manufacturing firms⁶. Similarly, Kraft and Lang (2008) cannot identify that the introduction of a works council changes the overtime hours.

If works councils can effectively articulate the preferences of employees, works councils might push for different overtime policies depending on the contractual working hours in an establishment. Works councils reduce the overtime incidence and intensity for employees working on a 40-hour contract while works councils increase overtime incidence and intensity if an employee has a 35-hours contract. This pattern remains significant for employees who moved into works council firms (Gralla et al. 2017). That overtime use depends on the contractual working hours shows that works councils adjust their bargaining position on employee preferences for income or leisure.

While overtime is used to adapt to short-term fluctuations in demand, establishments can adjust to medium-term fluctuation in demand by adding or skipping a work shift. Works councils are positively associated with the incidence and intensity of shift work (Jirjahn 2008). Shift work touches not only on working time preferences but might also create health problems for employees and can thereby trigger the safeguarding function of works councils to negotiate compensatory practices.

Holidays are another part of working-time arrangements. The number of holidays per employee is either regulated by collective bargaining agreements or in absence by law. However, employees are entitled but not required to take paid leave. A firm culture might even set a norm against taking holidays and line managers might request taking fewer holidays than entitled to. Here, works council can increase employees' awareness that they are entitled to take holidays and put procedures in place that encourage employees to take holidays. Moreover, the safeguarding function and increased job security provided by works councils might persuade employees to take paid holidays (Goerke and Jeworrek 2021). Employees in works council firms are more likely to use more of the entitled vacation days than employees in firm without a works council. This result holds for several sub-groups except for women because women are more likely to use their vacation entitlement. In addition, employees in firms with a works council enjoy more vacation days (Goerke and Jeworrek 2021).

Finally, flexible working-time arrangements can help employees to balance work and private life via flexible working time and flexible workspace opportunities. Works council firms are more likely to provide flexible work schedules for employees with care responsibilities such as flexible working time, working time accounts, telecommuting, and home office (Jirjahn and Mohrenweiser 2021). Moreover, works council firms are more likely to use flexible working time accounts, in which employees work more hours during times of high demand and fewer hours during times of low demand (Promberger and Ellguth 2007).

g) Health and safety

The voice function of works councils can convey employees' preferences for health and safety practices that go beyond law. In contrast, firms have usually a low incentive to invest in technologies to internalise external costs for additional health and safety measures. Works council firms have significantly more health practices than firms without a works council, particularly practices that primarily aim to improve the information flow such as sickness analysis or health surveys (Jirjahn et al.

⁶ Promberger and Ellguth (2007) do not control for the wage level while Jirjahn (2008) controls for several wage components. A higher wage level might stimulate employees to substitute income for leisure rather than increase their income.

2022). This might suggest that works councils are particularly effective communicators of hazardous or unsafe work condition. They might have the resources to understand and compare potentially hazardous conditions with industry standards. However, works councils might also request more than optimal health practices aiming to improve employee well-being.

Works councils have also a positive impact on investments in purification and waste technologies that reduce workplace hazards, but also benefit the local community and thereby the families and environment where employees are living (Askilden et al. 2006). Firms have a low incentive to internalise these costs but works councils can use their codetermination rights on health and safety policies to push for higher investments in green technologies to mitigate workplace hazards. In contrast, works councils are not associated with investments in green products which are not directly related to health and safety risks in the production process and are not benefiting the local community (Askilden et al. 2006). This underlines that works councils represent the interest of employees but do not push for a society-wide green policy agenda.

h) Absence

Absence can also be interpreted as an expression of preferences, and a response to working conditions. While presentism, coming to work despite being sick, shows an overcommitment to work, absenteeism, being absent even for minor sickness, indicates a low commitment. Employers might have strong norms and procedures in place to avert absenteeism but also to foster presentism to prevent work disruptions. In these cases, works councils can provide a safeguarding mechanism against actions to enforce such norms. Hence, employees might feel more protected to stay at home if they feel sick (Arnold et al. 2018). Moreover, works councils are able to improve the working conditions, health and safety standards in a way that reduces physical and mental health problems (Jirjahn et al. 2022) resulting in fewer absence. Employees in firms with a works council are three percentage points more likely to be off sick during a year and have one day more sick absence over a calendar year. This pattern holds for employees moving into firms with a works council (Arnold et al. 2018). At the establishment-level, works councils are associated with more absence days among all employees (Heywood and Jirjahn 2004). Consequently, firms with a works council are more likely to report problems because of high absence rates (Pfeifer 2014a).

i) Equality practices and equal pay

Works councils might only advocate the interests of their main electorate and not lobby to implement equality policies for minority groups at the workplace (Freeman and Lazear 1995). Analysing equality policies enables understanding whether works councils can effectively represent minority groups amongst the workforce. Proportional representation can overcome the minority representation problem. Proportional representation of women in a works council is required in the WCA but it remains an empirical question if works councils also push for gender equality practices, particularly in male-dominated firms.

Works councils increase the likelihood of gender equality practices such as mentoring, quotas for women in leadership positions, and action plans for women (Jirjahn and Mohrenweiser 2021). Moreover, Heywood and Jirjahn (2009) show that a higher share of women amongst the workforce is associated with a higher probability of childcare support, working time and job design policies supporting women. This confirms the view of Budd and Mumford (2004) that employee representation and provision of family-friendly practices should be stronger in workplaces with high shares of women because works councils focus on the majority employee group.

Finally, works councils are associated with a higher probability of family-friendly practices such as support of child-care and support for caring for relatives (Heywood and Jirjahn 2009; Jirjahn and Mohrenweiser 2021). An under-provision of family-friendly practices can be a result of incomplete information about employees' preferences, employer commitment problems and supervisor opportunism at various layers of hierarchy. The works council effect on these practices is entirely driven by firms that are also covered by a sectoral collective bargaining contract (Jirjahn and Mohrenweiser 2021).

Equality practices should also be reflected in wage policies and a more equal distribution of pay. Works councils are associated with a smaller wage variance within the firm (Hübler and Meyer 2001; Jirjahn and Kraft 2010; Hirsch and Müller 2020) and works councils did not contribute to the rising wage variance in Germany over the last decades (Baumgarten et al. 2020). On the contrary, the findings for works councils on the gender pay gap is mixed. Heinze and Wolf (2010) and Addison et al. (2010) find a lower gender wage gap for works council firms while Oberfichtner et al. (2020) cannot identify an effect of works councils on the gender pay gap.

j) Fairness perception, commitment, and job satisfaction

HR practices such as performance pay, appraisal procedures, and equality practices should increase employees' fairness perceptions and attitudes which is the way that employees feel about job tasks, working conditions, and compensation. Attitudes such as engagement and commitment can lead to higher performance (Stanley and Meyer 2016).

Employees in firms with a works council are more likely to perceive their payment as fair than employees in firms without a works council. This relation is weaker if an employee receives higher wages (Pfeifer 2014a). Hence, despite that works councils increase the use of incentive pay schemes and thereby potentially increasing the wage inequality within a firm, negotiating the rules and procedures that govern performance pay and appraisals may lead to an increased perception of fair payment. In contrast, Mohrenweiser and Pfeifer (2019) did not find a significant difference in distributional fairness perceptions between employees in firms with and without a works council.

Managers in firms with a works council report fewer problems with staff motivation than in firms without a works council (Pfeifer 2014b). Employees in works council firms also have a higher affective commitment, reflecting the emotional ties an employee develops with the organization primarily via positive work experiences (Grund and Titz 2021). Affective commitment also leads to lower intentions to leave an organisation and ultimately to lower quit rates (Stanley and Meyer 2016), a relation that seems reasonable given the evidence that works councils are related to lower quit rates (Pfeifer 2011a; Grund et al. 2016). Nevertheless, the attitudes and perceptions of employees within works council firms have not been conclusively investigated so far.

In contrast, the job satisfaction of employees, the general assessment that an employee makes about the job or job situation, has been more intensively studied. Employees in works council firms report an insignificant lower (Grund and Schmitt 2013; Bellmann et al. 2019; Mohrenweiser and Pfeifer 2019) or significant lower job satisfaction than employees in firms without a works council (Jirjahn and Tsertsvadze 2006). This mirrors the union and job satisfaction literature (Artz and Heywood 2021) which argues that unionised workplaces have higher earnings, benefits, more transparent procedures, and lower wage inequality, all of which are typically associated with higher job satisfaction. But because works councils provide an effective grievance mechanism, discontented employees might be more likely to stay despite being dissatisfied but who would have left otherwise (Clark et al. 2008; Artz and Heywood 2021). However, employees who move from a firm without a works council into a firm with a works council do not experience any change in job satisfaction (Grund and Schmitt 2013).

The association between works councils and job satisfaction is negative for managers and part-time employees while full-time blue-collar workers are positively associated (Jirjahn and Tsertsvadze 2006). Works councils might campaign primarily for full-time employees while part-time employees have a lower incentive to engage with the works council. Part-time employees might have time constraints attending relevant meetings and are also less affected by managerial decisions (Jirjahn and Tsertsvadze 2006). In contrast, Bellmann et al. (2019) find a significant positive association between a works council firm and job satisfaction when aggregating individual job satisfaction on the firm-level.

Moderating factors supporting the productivity enhancing effects of works councils

Context factors such as being covered by a collective agreement can facilitate or hamper the effect of works councils on productivity, wages, and profits. Works councils cannot directly influence these context factors, at least in the short run. The section will discuss three context factors as moderators: the willingness of managers and works councillors to cooperate, the ownership structure of the firm and the broader industrial relation environment.

a) Managers and works councillor's willingness to cooperate

The willingness of employees and managers to cooperate is a key assumption in collective voice models to trigger performance gains. The WCA also requires employers and works councillors to work in a spirit of cooperation. This seems to be the case in the majority of firms, even with different definitions to assess cooperative employment relations (Nienhüser 2005; Dilger 2006; Jirjahn and Smith 2006; Pfeifer 2011b; Nienhüser and Hossfeld 2011, Backes-Gellner et al. 2015). The proportion of adversarial employment relations vary between 3.2 percent (Pfeifer 2011b) and 14.8 percent of all firms with a works council (Jirjahn and Smith 2006). However, works councillors are typically less favourable than managers in assessing an employment relationship as cooperative (Dilger 2006; Nienhüser and Hossfeld 2011; Addison and Teixeira 2020).

Productivity enhancing work practices such as piece rates, bonus pay, and employer provided further training are more likely under cooperative than non-cooperative works councils. Cooperative employment relations are more likely the higher the share of high-skilled employees, the lower the proportion of part-time employees and in firms without an active owner (Jirjahn and Smith 2006). The probability of uncooperative employment relations between management and works council decreases in the first years of the lifetime of a works council, supporting the idea that both sides learn to discuss and settle their conflicts over time (Jirjahn et al. 2011). Moreover, the stronger the support for the works council amongst the workforce, the higher the likelihood that the works council has a strong influence on decisions and the lower the likelihood of uncooperative relations between works council and management (Jirjahn et al. 2011). A works council with strong support amongst the workforce is more likely to represent the workforce preferences and to be an effective communicator, both of which are crucial assumptions that collective voice can improve productivity.

Work arrangements are the key outcome of negotiations between the works council and management and are formalised regulations that govern the policies and practices within firms. Managers evaluate that work arrangements increase flexibility if the works council is perceived to be cooperative while a non-cooperative works council increases the rigidity of work arrangements (Nienhüser 2009). Consequently, cooperative works councils are associated with a higher productivity but uncooperative works councils with higher wages per employee (Pfeifer 2011b). Moreover, works council firms have a higher likelihood of closure if management takes decisions usually against the point of view of works council (Addison et al. 2019). This type of works council is also associated with a higher probability of low motivation amongst staff compared with cooperative works councils (Pfeifer 2014a). Hence, these

studies indicate that more cooperative employment relations are associated with a higher likelihood of productivity enhancing work practices and higher productivity.

b) Ownership structure

Decision making processes in firms depend on the governance structure of the firm which is influenced by the legal form and ownership of the firm. Works councils influence decision making in firms and particularly codetermination rights limit the right to manage of owners and managers. Managers with a strong preference for authority are more likely to oppose codetermination and cooperation with the works council. Moreover, the management style in foreign-owned multinationals might generate additional tensions if foreign-owned multinationals are not familiar with the cooperative German system of industrial relations.

Owner managers are more likely to oppose codetermination than employed managers because they do not only receive utility from being independent at the workplace but also from 'consuming' dominance over managers and employees. They gain utility from being the ultimate boss within an establishment (Jirjahn and Mohrenweiser 2016). Because codetermination restricts the right to manage and the authority to determine implicit terms and conditions, codetermination reduces the utility of owner managers and makes them more likely to oppose codetermination. Consequently, owner managed firms have a lower probability to have a works council (Gerner et al. 2019; Kölling and Schnabel 2022) which holds for firms entirely run by the owner family and firms with executives consisting of the owner family and hired managers (Kölling and Schnabel 2022). In addition, establishments with an owner-managers have a lower likelihood to introduce a works council and a lower likelihood that the works council survives (Jirjahn and Mohrenweiser 2016). Finally, works councils in owner-managed firms have less influence on decisions that go beyond the statutory rights and a higher likelihood of uncooperative employment relations (Jirjahn et al. 2011).

A foreign owner might be less familiar with the German system of co-determination that requires a high degree of cooperation between management and employees than a domestic owner. Works councils requesting a say in establishment policies might not fit into the management style, organisational procedures, and authority structure of foreign-owned multinational corporations. Consequently, foreign-owned firms with a works council are less likely to report cooperative employment relations, indicating a higher level of conflict at the workplace (Dill and Jirjahn 2017). Hence, a works council in a subsidiary of a foreign-owned multinational company might be less effective in reducing information asymmetries. Moreover, foreign-owned multinational companies might also be more likely to threaten transferring production abroad and have a stronger shareholder value orientation implying a shorter time horizon, all of which lowers the opportunities of works councils to limit employer opportunism (Jirjahn and Müller 2014). Consequently, foreign-owned firms with a works council are less likely to have formal performance appraisal procedures, profit sharing and employee share ownership, all of which are incentive practices that increase employee productivity (Heywood and Jirjahn 2014). As a result, even if foreign-owned firms are more productive than domestic firms, the interaction of works councils and foreign-owned firms significantly reduces this advantage (Jirjahn and Müller 2014).

c) Moderation by the broader industrial relations environment

The broader industrial relation environment mostly refers to the interdependence between works councils and unions. In Germany, unions but not works councils bargain about wages, with about 44 percent of establishments covered by a sectoral-agreement and about 8 percent by a firm-level agreement (Bossler 2019). Sectoral union wage bargaining moderates the impact of works councils on productivity by limiting distributional conflicts. If distributional conflicts are solved outside the firm,

employment relations are more likely to be cooperative and geared towards productivity enhancement (Hübler and Jirjahn 2003). Consequently, firms with a collective bargaining agreement and a works council are associated with a higher productivity than works council firms that are not covered by a collective agreement (Hübler and Jirjahn 2003; Hübler 2003; Wagner et al. 2006; Wagner 2008; Jirjahn and Müller 2014; Brändle 2017). This holds mainly for sectoral-level bargaining but not for firm-level bargaining (Jirjahn and Müller 2014). Accordingly, works council firms that are also covered by a collective bargaining agreement are associated with lower quit rates (Pfeifer 2011b), a higher use of piece rates, bonus pay, profit sharing (Heywood and Jirjahn 2002), and equality practices (Jirjahn and Mohrenweiser 2021) than works council firms without a collective bargaining agreement.

The evidence regarding the moderating effect of union wage bargaining in wage estimations is mixed, ranging between significant negative (Hübler and Jirjahn 2003) and insignificant (Brändle 2017) to significant positive (Addison et al. 2010; Müller and Neuschäffer 2021). This variety of point estimates can be explained by two counteracting effects. On the one side, works councils in firms that are not covered by a collective agreement focus more on distributional policies impacting wages (Hübler and Jirjahn 2003). On the other, wages in works council firms might be higher because employees and employers share the surplus of the productivity enhancing role of works councils. The productivity enhancing effect might be stronger in firms covered by a collective agreement because unions provide training and legal advice for works councillors (Jirjahn 2017), increasing the awareness of statutory rights and improving the skills in negotiating and monitoring work arrangements. Competent works councillors are seen as a key factor of effective codetermination by managers (Garcia et al. 2017). However, unions and works councils are formally independent but many works councillors are also union members (Goerke and Pannenberg 2007; Behrens 2009).

Finally, works councils are only associated with higher profits when covered by a collective bargaining agreement (Hübler 2003; Müller 2011). Finally, Jirjahn (2012) finds a negative interaction effect between works council and collective agreement for establishment closures while Addison et al. (2004) find an insignificant interaction effect.

Evidence for other countries

The scope of statutory rights of works councils differs substantially between countries. Like Germany, some countries grant works councils additional codetermination rights or veto power over managerial decisions in narrowly defined areas which increase the bargaining power of works councils. Furthermore, works councils are embedded in a national industrial relations system with a unique interdependency between works councils and workplace, sector, or national unions; and a specific tradition of labour-manager cooperation. Particularly these factors, additional codetermination rights, interdependence with unions, and tradition of employer-employee cooperation led to a variety of types of works councils across countries. Analysing this variety enables additional insights in the theoretical mechanisms how works councils can influence firm outputs. The section firstly summarises studies that analyse the economic impact of works council on firm performance. Second, it summarises empirical studies that investigate the varying influence of types of works councils on decisions and employment relations within firms. Third, the section discusses studies investigating the impact of works councils on employee outcomes.

a) Works councils and firm performance

The number of empirical studies about the economic influence of works councils on firm outcomes outside Germany is scarce and covers only a handful of countries. In France, works councils have no significant effect on total factor productivity in estimations with all firms, but the works council

coefficient turns significant negative in small establishments (Fairris and Askenazy 2010). France is typically seen as a country with adversarial labour management relations (Lorenz 1995; Bryson et al. 2011).

For Belgium, van den Berg et al. (2017) find a positive effect of works councils on productivity (value added per employee) but not on profitability (return on investment). The interaction between works councils and unions is insignificant. Belgian works councils are dominated by unions and consist of employer and employee delegates. However, Belgian works councils have the right to be assisted by an external auditor, who can improve the competence of works councils in negotiations (van den Berg et al. 2017).

In Finland, works councils appear to have no significant effect on productivity and profitability (Keskinen 2018; Harju et al. 2021). However, Keskinen (2018) finds a lower employment growth, fewer new employees and fewer employees leaving in works council firms while Harju et al. (2021) cannot identify an effect on separation rates. Both studies use the reduction of the legal threshold for works councils from 30 to 20 employees in 2008 to identify the causal effect of works councils on firm outcomes. Both studies assume that all newly eligible firms establish a works council over the observation period which is a strong assumption although a high proportion of eligible Finish firms had a works council pre-2008. Nevertheless, smaller firms have a lower likelihood to have a works council and works councils need time before they function effectively. Hence, the insignificant effects might be explained by few compliers (Keskinen 2018). The Finish system of employment relation belongs to the cooperative Nordic tradition and information and consultation rights for works councils predate the ICE framework directive.

Finally, Jäger et al. (2022) analyse the introduction and expansion of establishment-level consultation and codetermination rights between 1960 and 2019 in Austria, Belgium, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, the Netherlands, Norway, Sweden, Switzerland, and the UK. They cannot identify significant effects of changes in the legislation on aggregated economic outcomes such as wage growth, labour share, productivity growth, capital formation, and GDP growth. The research design also assumes that all eligible firms introduce or expand codetermination following a legal change. The proportion of compliers is unclear but might be small because the works council incidence is usually rather small in newly eligible firms and in small firms. The study, however, comprises a wide range of industrial relation traditions – between cooperative and adversarial – and the introduction and expansion of consultation and codetermination rights.

In contrast to these studies which use objective measures for firm performance, studies using a subjective measure of firm performance find significant negative effects of works councils on productivity and profitability for European countries (van den Berg et al. 2013; Addison et al. 2020). The subjective performance measures are based on the assessment of managers on a Likert scale, for example on the financial situation of the establishment. This data pattern, a significant negative coefficient of works councils on subjective performance assessments but an insignificant effect on an objective measure resembles the findings for Germany. This pattern is probably affected by a missing reference category in the survey questions and the difference between before (value added based measures) and after-tax evaluations (subjective questions) as discussed in Mohrenweiser (2021).

b) Types of works councils: decision processes, HR policies, and practices

A substantial literature outside Germany focusses on understanding the impact of works councils on decision-making at the workplace and emphasises the consequences of different types of works councils on firm outcomes. This is not only relevant to understand the voice and safeguarding functions of works councils but also to understand the role of legislation for industrial democracy.

Legislation for consultation and information of employees is in itself no guarantee that employees will actually play a role in the decision-making process. Employees will probably have a limited influence if managers are hostile to employee participation (Franca and Pahor 2014). Consultation rights can also be interpreted differently. Managers tend to be more likely to consult employees about how to implement a decision and not whether the decision should be taken at all (Marginson et al. 2004). Managers might also be more likely to support employee participation as long as works councils do not interfere too much in decision-making.

In South Korea, the influence of works councils on establishment policies varies considerably. If managers and works councillors alike assess that the works council is effective, the works council has more influence on a number of HR practices and is associated with higher labour productivity compared to ineffective works councils (Kleiner and Lee 1997; Kato et al. 2005). South Korean works councils consist of employee and employer representatives and are intertwined with unions if unions are present at the workplace (Kleiner and Lee 1997). These findings indicate that not participation rights itself but the effective cooperation between works councils and management might result in more influence of employees in decisions and in higher productivity.

A similar conclusion can be drawn from a couple of Dutch studies. Dutch managers report a higher economic position if managers and works councillors accept or search for compromises and if works councils are involved early in the decision-making process. On the contrary, works councils that are seen as unnecessarily delaying decisions are not associated with the economic position of the firm (van den Berg et al. 2011a). Moreover, managers perceive the works council as more efficient if the works council enhances the acceptance of management decisions by staff, and if the works council is willing to cooperate (Wigboldus et al. 2016). Dutch works councils have tradition of codetermination rights that predate the ICE directive (van den Berg et al. 2011b).

In contrast, Belgium firms that involve the works council early in the decision process have a significantly lower subjective productivity than firms involving works councils late. In small firms, subjective productivity is higher if the works council is not substantially involved in decisions. However, the scope of works councils influence is not associated with productivity (van den Berg et al. 2018). Belgian works councils have no codetermination rights, consist of employer and employee delegates, and are dominated by unions (van den Berg et al. 2017).

The South Korean and Dutch findings indicate that not the pure existence of a works council but effective cooperation between works council and management and effective communication between works council and workforce can lead to superior performance. In contrast, the Belgian findings show that late or no involvement of the works council is beneficial for productivity. It remains an open question whether different labour management tradition, differences in the rights of works councils, or the measurement of the performance variables drive the opposing the findings.

The impact of works councils on firm decisions has also been analysed in a couple of studies for Central and Eastern European countries. Several Central and Eastern European countries ⁷ have codetermination rights in specific areas owing to a transformation to the market system in the early 1990's that was oriented toward the Austrian and German model. Nevertheless, managers in works council firms in Central and Eastern European countries are less likely to consult employee representatives about changes in remuneration, organisation of work, working-time arrangements and restructuring than managers in Western European countries (Oertel et al. 2016). However, the more employees in Central and Eastern European countries are interest in participation in decision

⁷ These are Croatia, Czechia, Lithuania, Hungary, Romania, Slovakia, and Slovenia (Prouska et al. 2022).

making, the more the works council is involved in decisions within the firm (Prouska et al. 2022). Moreover, managers have a more favourable opinion about employee participation in decision making in Slovenian firms with a works council than in firms without a works council (Franca and Pahor 2014). Managers in firms with a works council in Slovenia and Croatia are more likely to see works councils as an effective tool for downward communication with the workforce than Austrian and German managers while Slovakian managers scored similar to Austrian and German managers. Moreover, a higher union density within firms is associated with a more positive assessment of works councils for effective downward communication (Croucher et al. 2022). These findings suggest that codetermination rights alone are not a guarantee for employee participation but that a corporate culture towards participation in decision making is a relevant precondition for the influence of works council on decision making.

Cooperation between managers and employees is driven by perceived trustworthiness (Garcia et al. 2017). Consequently, trust between management and works council is the main driver for managers to assess a good economic situation and a high subjective labour productivity in firms with a works council in several European countries (Addison and Teixeira 2020). This finding highlights the relevance of trust in employment relations within a firm as a precondition for beneficial economic outcomes aligning with the voice and safeguarding function of works councils. However, managers in European firms have typically more trust in works councillors than vice versa, similarly to the results in Germany (Addison and Teixeira 2020). Kerkhof et al. (2003) explain this phenomenon in a study of Dutch works councils with differences in the understanding of trust between management and works councillors. Managers are more likely to assess trust in works councillors based on outcomes in past negotiations while works councillors are more likely to assess their trust on the relation between management and works council and on how they are treated by managers in negotiations. Because relational trust needs longer to develop, works councillors are less likely to report trustful employment relations than managers (Kerkhof et al. 2003).

More generally, Lorenz (1995) explains the failure of the French codetermination laws that have been introduced in the 1980 and early 1990 with mistrust and a defensive strategy of French unions and employers alike. In negotiations, both parties had been looking for their advantage rather than the joint surplus. He also highlights that the cooperative employment relations culture in Germany took several decades to emerge. Hence, attitudes and beliefs of employers and unions can be serious obstacles to the effectiveness of legislation for works councils (Lorenz 1995). Consequently, Jäger et al. (2022) finds a higher quality of employment relations, measured as a lower probability of strikes and a more favourable evaluation of a cooperative working climate by managers, in firms across Europe as a consequence of the introduction and expansion of codetermination rights.

Beyond trust, the competence of works councillors in understanding management practices and workplace regulations is a key factor for the influence of works councils on decisions. If managers perceive works councillors as more competent, the influence of the works council on firm decisions is stronger across eleven European countries (Garcia et al. 2017). Works councillors might have limited power in negotiations with management when they are not seen as competent counterparts regardless of statutory rights. Interestingly, managers in German firms report that works councils have more influence on decisions than works councils in other European countries (Pender et al. 2018). This might be a consequence of learning or a more structured training of works councillors in Germany.

Beyond that, the impact of works councils on productivity enhancing work practices has been analysed in Cyprus, Ireland, Poland and the UK, countries that had no general statutory employee information and consultation system before the implementation of the ICE directive. Flexible working time arrangements in eligible firms increased in these countries after the implementation of the ICE

directive (Burdin and Perotin 2019). Moreover, French works council firms offer significantly more job autonomy than French firms without a works council (Fairris and Askenazy 2010).

c) Works councils and employee outcomes

Works councils can also impact employee outcomes, but the theoretical predictions are ambiguous. Regarding employee retention, Forth et al. (2017) find a more strained work climate but also fewer retention problems in European firms that have both union coverage and a works council but not if a works council alone is present. Forth et al. (2017) interpret these findings as support for the collective voice model where voice-induced complaining puts a strain on work climate and strengthen the bargaining power of employees, resulting in a negative association of worker representation with both work climate and voluntary quit rates. Addison and Teixeira (2019) use the same data but cannot find a significant effect of works councils on retention problems but confirm the negative effect on a good work climate. Moreover, they find a negative association of works councils with a low level of absenteeism and no effect on staff motivation. Their results are driven by Austria, Germany, and the Netherlands, countries with a long tradition of strong codetermination rights. The findings are at least in contrast to the evidence provided by studies for Germany (Grund et al. 2016; Jirjahn 2018). Finally, joint consultation committees in the United Kingdom have a positive effect on job satisfaction. The effect is stronger if the firm has also high-involvement work practices in place and has a union representation (Gomez et al. 2019).

These studies show a mixed impact of works councils on employee retention and employee attitudes. However, the number of studies is still limited, and more evidence is needed to assess the impact of works councils on employee outcomes. In particular, the evidence is limited given the variety in works council rights, interdependencies with unions and the variety in cooperative and adversarial tradition of employment relations across countries.

Conclusions

The review focusses on mechanisms that enable works councils to improve firm productivity and on context factors that facilitate or hamper the economic effects of works councils. The empirical evidence in Germany points towards a productivity enhancing role of works councils together with higher wages and higher profitability in works council than firms without a works council. On the contrary, the international empirical evidence points towards an insignificant effect of works councils on productivity and profitability but the number of studies outside Germany is still small given the variety of industrial relations systems in which works councils operate.

Works councils in Germany reduce employee turnover and are associated with a number of performance-enhancing work practices such as training, incentive pay, structured appraisal methods, more diligent selection procedures, health, and equality practices. Most of these practices are more likely if the firm is simultaneously covered by a sectoral collective bargaining agreement and consequently, the productivity effects are stronger in works council firms covered by a sectoral agreement. The positive effects of works councils on productivity in Germany can neither be explained by firm closures, nor that works council are more likely to be established in high-productivity firms. In contrast, the evidence suggests that works councils are established as a defensive mechanism in times of economic trouble and uncertainty. Hence, the estimated productivity effects are, if at all, underestimated. Nevertheless, the initial years of a works council witness a higher likelihood of conflicts between works council and management, but conflicts ease over time and more cooperative employment relations emerge. Consequently, a productivity premium can be identified several years after the works council has been established.

Works councils seem to use their rights to monitor and police arrangements that govern performance enhancing work practices and thereby provide a safeguarding mechanism against employer opportunism or provide an effective mechanism for employer commitment. They can also provide a voice for employees and an effective communication channel to the workforce which increases the acceptance of and trust in managerial decisions. Particularly the empirical literature outside Germany emphasises that works councils have a variety of de-facto power in decision making regardless of de-jure rights and that this variety might explain whether works councils are associated with higher productivity or not. It points towards the relevance of trust between managers and works councillors as a precondition for beneficial economic outcomes. Nevertheless, this literature is still emerging and is mostly based on cross-section surveys, subjective assessments of firm performance and studies in a limited number of countries.

Even if the review discusses work practices as mediating factors to explain the productivity enhancing effects of works councils, the presented evidence does not allow to conclude that works councils cause the introduction of performance enhancing work practices. Indeed, many firms experiment, introduce, and terminate work practices frequently (Chi et al. 2011; Wilkinson and Mowbray 2019) and works councils might play a vital part in the successful implementation of performance enhancing work practices. For example, employees might be suspicious regarding new performance pay rules if they suspect increasing norms as the sole motivation behind the practice and therefore withhold effort contradicting the incentive effect of performance pay. In such a case, works councils can negotiate performance pay policies that address employees concerns and thereby increase the acceptance or perceived fairness of performance pay policies. Hence, works councils might be associated with the introduction of sustainable performance-enhancing work practices. Moreover, managers might be more likely to introduce performance enhancing work practices because they fear that works councils might redistribute rents and try to offset rent share losses by experimenting with high-performance work practices. On the contrary, works councils might also - exclusively or additionally - improve the efficacy of work practices but have no share in the introduction. Hence, works councils moderate the effect of management practices on firm performance. For example, works councils can provide information for a more targeted training approach in a firm with a history of employer-provided training but the more targeted training approach consequently increases productivity. Hence, works councils might improve the efficacy of performance enhancing work practices. Distinguishing the role of works councils in the introduction and/or efficacy of work practices has not been touched yet.

Related is the question how works councils perform compared to management-led involvement practices. Management-led involvement practices include consultation and information sharing practices but also team or job autonomy. Involvement practices are associated with higher performance (Bryson et al. 2005) and form an integral part of high-performance-work systems which are associated with higher performance (Combs et al. 2006). Involvement practices which are not backed by statutory rights offer managers more leeway in decision-making than works councils, but they provide no safeguarding mechanisms for employees. Instead, they rely on mutual trust and reciprocal behaviour of employees and managers to work effectively. Hence, comparing involvement practices with works councils and investigating complementarity and substitution between them might allow to identify the conditions when statutory rights and thereby government regulation of employment relations is beneficial for firm, employee, and societal outcomes.

Finally, changes in the nature of work constitute new challenges for works councils because it increases pressure on businesses to adapt and change their business model. Digital technologies facilitate monitoring of employees which can undermine trust and cooperation and increase chances for employer opportunism. Simultaneously, digital technologies present opportunities for productivity

enhancement. Hence, works councils might play an important part in implementing digital technologies at the workplace either by hampering the introduction as a defensive mechanism or by ensuring that the trust threatening aspect does not dominate the performance enhancing effect. It remains an open question if works councils can provide a flexible mechanism to respond to adaptation pressure and get employees on board for changes in the organisation of work or if they respond defensively generating more rigid conditions for firms to deal with.

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