



“Summary of article by Richard B. Freeman and Edward P. Lazear: An Economic Analysis of Work Councils” in Frontier Issues in Economic Thought, Volume 4: The Changing Nature of Work. Island Press: Washington DC, 1998. pp. 245-248

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Works councils exist in a variety of forms, but all serve the central function of establishing a group of worker representatives (however selected) who facilitate honest communication between workers and management, and provide workers an avenue for consultation on certain decisions. While this rarely extends to co-determination (the German model being the outstanding exception), the requirement for consultation in itself may be a source of bargaining power.

Works councils may operate as supplements or complements to trade unions. Some firms have supported them as alternatives to unionization. In the United States, in the early part of this century, works councils covered 10 percent of the workforce in several major industries. They quickly lost popularity among managers, or workers, or both, and in the 1920s most vanished from the U.S.; however they continue to play a significant role in Europe.

This article draws on a combination of interviews and abstract modeling techniques to address several questions:

Do councils require external institutional mandating, as in most of Western Europe, or can they be expected to arise from voluntary managerial decision making? When will councils communicate productivity-improving information between workers and firms? What are the benefits and costs of giving councils co-determination rights over some decisions? What can go wrong in a council setting and what arrangements might minimize the risk of poorly functioning councils? [27-8]

WORKS COUNCILS: MANDATED OR VOLUNTARY?

The value of works councils for workers depends importantly on the long-term benefits that result when cooperation and two-way flows of relevant information strengthen the firm and increase its profitability. This value can be reduced if the firm is determined not to share such gains with the workers, or if other changes (such as reduced employment security) shorten the workers' time horizons.

As institutions that give workers power, councils can affect the distribution as well as the amount of the firm's surplus. The greater the power of works councils, the greater will be workers' share of the economic rent, and the greater the likelihood that firms will oppose them. The social

optimum regarding the amount of power given to councils can be expected to lie somewhere lies between the preferences of labor and management. Thus, if works councils are to fulfill their social potential they must be mandated by institutions (presumably government) outside of the firm.

COMMUNICATION

"Management may misinform workers about the situation of the enterprise when it sees workers' gains as owners' losses. Knowing that management can use information strategically, workers may disregard what management says even when it is truthful." [33] Firms are especially likely to be generous with financial information when times are bad and an exceptional work effort is needed for the firm's survival. Because workers may not believe this (a firm could "cry wolf" to motivate workers' efforts simply to increase profits), councils need to be designed to overcome asymmetries in information between labor and management. They also need to overcome differences in education and in "language," to enable the council members especially, but also the rest of the workers, to understand financial and business terms and ways of presenting information, and to communicate, for example, with accountants.

The socially optimal situation produces the maximal average utility for the workers when they have full information about the state of the firm. Full information allows them to respond flexibly by working extra hard in bad times and at a normal pace in good times. The firm's gains from such a situation are, however, less than the overall social gains, so the firm will voluntarily disclose information less frequently than is socially desirable. Hence it may be necessary to mandate councils' access to certain kinds of information -- e.g., the enterprise's financial condition and its business plans -- on a regular basis, not only in times of crisis.

Councils can improve the incentives for workers to provide information, and also affect worker-to-management communication by filtering the information through the workers who are on the councils. However, for workers to communicate truthfully with management they need reassurance that the information they provide will not further empower the firm to resist sharing economic rents. Thus the communication function of works councils will be enhanced when the councils effectively give workers some control over the use of information they provide.

REPRESENTATION ON COUNCILS

Works councils, as forms of representative government, must consider how well the subset of the population (works councilors) reflects the preferences of the whole population (workforce). When there is a large majority on a particular issue a large council is more representative and will communicate preferences more accurately. However, when there is a near-even split of opinion the danger is increased that the council will favor the minority. In fact, there are diminishing returns to increasing council size: adding members improves the accuracy of information from workers when there is a strong, but not overwhelming majority, but adds little accuracy when the workforce is nearly evenly divided or unanimous over an issue.

Different countries and settings have produced a variety of means of filling the council membership. In some cases blue-collar workers may elect white-collar workers as their

representatives. In others (e.g., in Belgium) counselors must be selected from union election slates. A significant issue is how to achieve minority representation on specific issues. Proportional representation is a partial, but imperfect solution; an alternative possibility is to select councilors randomly (like a jury), with the option that a randomly selected delegate have the right to appoint a willing alternate from the same age, gender, or otherwise defined group.

CONSULTATION AND CO-DETERMINATION

An essential feature of works councils is that they possess consultation rights over some categories of firm decisions. This implies a cost to the firm, in preparing for and participating in meetings, as well as through delays in action. However, consultation can increase profitability when workers alone, or the combination of workers and managers talking together, can discover or create solutions to company problems that would not have been found otherwise. "The essence of co-determination is teamwork." [44]

Consultation is not always useful; benefits must be weighed against costs -- especially the costs of delay. Because most managers are keenly aware of these potential costs, outside of Germany co-determination rights are generally accorded only with respects to decisions on which management is likely to be neutral. However, firms may thereby lose important benefits that would come with the enhanced job-security that results from the German-style works council. Additional job security induces workers to take a longer-run view of the firm's prospects: secure workers value company profits because profits reflect future worker compensation. One would expect workers in enterprises with strong works councils to have greater loyalty to their firm than workers in other firms.

Works councils are most likely to increase enterprise surplus when they have limited but real power in the enterprise. Many important questions remain unanswered, but the foregoing analysis suggests the value of paying serious attention to the design of council-type arrangements that might fit decentralized labor systems such as those of the United States or Britain. There are potential net social gains from works councils. To realize these gains, the rules governing councils must be written carefully, creating realistic bounds on the power of both labor and management, and fitting appropriately within the broader labor system.