

Do works councils raise or lower firm productivity?

Works councils can have a positive impact on firm productivity, but only when specific conditions are in place

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ELEVATOR PITCH

The German model of co-determination (*Mitbestimmung*) with works councils, in which workers are involved in the management of a company, was a role model for other countries for many years. However, since the 1990s the appeal of works councils has been declining, to the extent that now even employees are sometimes voting against representation. This was recently demonstrated by workers at the Volkswagen factory in Chattanooga, Tennessee, who voted against union representation. An important question for firms and for policymakers is whether the adoption of a works council has a positive influence on a firm's productivity and what the consequences are for a firm's profits.

KEY FINDINGS

Pros

- ⊕ Works councils improve information flows between management and workers.
- ⊕ Works councils lead to a higher investment in firm-specific human capital.
- ⊕ Workers have more influence and control over management decisions and policies of the firm.
- ⊕ More trust is generated between employees and employers and greater job satisfaction developed.

Cons

- ⊖ Costs are incurred by the firm for the paid release of council members from employment.
- ⊖ Works councils can lead to increased regulation and lagged decisions.
- ⊖ Works councils can lead to conflicts between the works council and management.
- ⊖ There is less investment in physical capital.

AUTHOR'S MAIN MESSAGE

Empirical research, particularly from Germany, shows that works councils can have positive productivity effects. On average, however, the effect has been decreasing over the last 20 years and a convergence in productivity is being observed between firms with and without works councils. A positive impact on productivity is more likely to be the case under certain conditions, specifically when: (i) there is a process of collective bargaining; (ii) there are no conflicts of interest between management and works councils; and (iii) co-determination is based primarily on voluntary agreements rather than on legal requirements. Policymakers should provide the necessary resources and appropriate, non-discriminatory incentives in order to encourage this.

