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The ‘strategic discrimination’ of works councilors in Germany: new evidence of the demise of a model?

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Clément Brébion

(Paris School of Economics)

**Abstract**

This paper estimates the impact of works council membership on wages in Germany between 2001 and 2015. It falls within a stream of research on collective organisations which has moved the focus away from the perspective of covered firms and their average worker to concentrate on the actors leading the negotiations (Breda, 2014). To my knowledge this is the first analysis of non-unionized form of representation taking this orientation. In a generalized context of decentralization of collective bargaining, shop-floor delegates are gaining in power and therefore in strategic importance for both the employers and the employees. Their career evolution therefore has a revealing role of the ‘black box’ of, increasingly, the new core of collective bargaining. The case of Germany is chosen because both national and foreign economic actors have steadily been praising its traditional dual model of industrial relations for the cooperative feature it entails at the shop floor. Yet, as discussed in the paper, it has strongly changed since the German reunification and it is expected that the nature of employer-employee relations also evolved since then.

The main model of identification is an OLS with time and individual fixed effects led on a subsample of the German Socio-Economic Panel. I find that, for individuals switching status, being a works councilor increases the hourly gross wage by about 5% in the manufacturing sector while a penalty of 4% is evidenced in the private service sectors. Causality is ensured by verifying that wage pre-trends do not differ between the treated and the control groups. I finally bring elements suggesting that the (dis-)advantage of works councilors is mostly experienced by politically involved representatives in both sectors. Bringing back the context, I explain why this may evidence a strategic behavior of rational employers. 2

**Introduction**

“The main body of research on work councils has been conducted on a collective institutional level, neglecting work council members at an individual level. In times of changing industrial relations, the importance of work councils in management decision making has risen steadily and thus further research of its members is required.” (Störmer, 2010, p. 244)

Depending on the national institutions, two types of elected actors can represent the labour force at the shop floor: union delegates and works councillors. The former take part in collective bargaining and act on behalf of a union which dimensions and preferences exceed the scope of the firm. The latter do not report their decisions before such a superseding organization, they can only sign firm-level agreements and their objectives are expectedly shaped according to the sole conditions applying within the company. Despite the large variety of their responsibilities according to the national institutional frameworks, a common trend with regards to their functions can be evidenced (Baccaro and Howell, 2011). In a generalized context of decentralization of collective bargaining, nearly everywhere, works councillors and union delegates have been gaining in powers. As a result, employers and shop-floor representatives are increasingly entitled to negotiate issues of strategic importance for the firm.

The economic literature has been prolix on the causes and effects of the existence of firm-level negotiating organisations from the perspective of covered firms and their average worker. Yet, very little is known on how the representatives themselves fare within the covered firms despite their increasing strategic importance for both employers and employees. In my knowledge there is only one stream of research dealing with the issue (Bourdieu and Breda, 2016; Breda, 2014). It focuses on union delegates in France and evidences that the position leads to an average wage penalty of about 10%. The authors suggest that the link is causal and could explain why few are the workers running for these positions. More generally, in a context of decentralization of the bargaining process, such pieces of work are likely to play a revealing role on the ‘black box’ of collective bargaining at the firm level.

It takes special importance to examine the influence of mandates on careers at the firm level in Germany. The traditional German model of industrial relations relies on two mainstays: collective bargaining at the branch-level between unions and employers’ associations and plant-level codetermination involving managers and works councillors. It is renowned for the cooperative feature it entails at the shop floor and the strong propensity of both national and foreign economic actors to praise it has remained much steady over time. In particular, entitled with the strongest codetermination rights in the West, and released from negotiations over distributional topics by the branch-level bargaining institution, German works councils are often considered as the most promising collective organisation in terms of rent generation. Yet, while at first glance the structure of the German dual system of industrial relations has remained relatively stable over time, its content has in fact much evolved since the reunification. In particular, Kinderman (2005) has highlighted the “employers’ [attempts] to subvert existing institutions from without (politically) and from within (in the industrial relations realm)”. The extent to which the cooperative feature of the 3

traditional model and, at its core, the ability of works councils to generate rents still apply today is therefore not as straight-forward as usually assumed by many scholars and in the public discourse.

In this paper, I therefore turn the light towards the fate of works councilors in Germany. I use data from the German Socio-Economic Panel (GSOEP) to assess the impact of works council membership on earnings in the country between 2001 and 2015. Thereby, I fill a hole in the economic literature and I bring elements from the firm level on the demise of the cooperative model of industrial relations of reference (Hall and Soskice, 2001) in a global context of increasing strategic importance of shop-floor bargaining. The baseline regression is an OLS model with individual and time fixed effects which controls for union membership. It shows that, for individuals switching status, works council membership increases the hourly gross wage by about 5% in the manufacturing sector while a penalty of 4% is evidenced in the private service sectors. The causality of these results is tested by checking that trends in wage preceding elections do not differ between ‘works councillors to be’ and their colleagues. A series of robustness checks of these results is provided. Bringing back the context, I build on Breda (2014) and Bourdieu and Breda (2016) and suggest that the results may be explained by strategic behaviours of rational employers in both sectors. A last result showing that wage (dis-)advantage mostly affects politically involved works councillors brings final statistical elements in favour of this interpretation.

The text is organized as follows. I first review the economic literature on the impacts of collective organisations on covered firms and workers. Second, I describe the evolution of the German institutional context since reunification. After giving some details on the GSOEP database and providing some descriptive statistics, I then turn to regressions where I evidence a differentiated premium of works council membership according to the sector. I finish by bringing some elements of proof on the strategic discrimination that, I claim, is likely to be playing in both the private service sectors and the manufacturing sector.

**1. The economic literature**

**1.1 A literature on collective organisations traditionally limited to the estimation of their impacts on covered firms and workers**

Economic research on collective organisations has chiefly worked at disentangling their impact on employment, working conditions and performance in covered firms. Until the mid to late 1980s, it mostly dealt with unionized forms of representation. The traditional neoclassical models on the matter emerged in the lines of Dunlop’s article (1944) which treats unions per the model of firm monopolies. In this view, unions would alter the optimal frictionless equilibrium by negotiating higher wage levels than the competitive one, thereby leading firms to respond with a drop in both employment and production. Departing from the sole rent-seeking feature of unions, a few streams of research emerged in the late 1970s. The first one builds on Freeman (1976) who applied Hirschman’s exit-voice model (1970) – then completed by Bajoit (1988) – to the unionized world. It deals with asymmetry of information regarding the satisfaction of employees with their working 4

environment. According to this stream of research, an agent can react to dissatisfaction with her working conditions in four different ways: ‘exit’, ‘apathy or neglect’, ‘loyalty’ and ‘voice’. In the first case, she decides to leave the firm. In the second, she remains in the firm but shirks. When loyal, the agent keeps on believing in the employer and keeps her dissatisfaction to herself. In the last case, she decides to discuss over the source of dissatisfaction with her employer. In this stream of research, management is willing to see workers remain in the firm and be involved in their job. Yet they are unable to precisely observe workers’ ‘mood’ and productivity. The two first options are therefore clearly under-optimal for such employers. ‘Loyalty’ and ‘voice’ ensure satisfactory levels of cooperation. Yet, the former may not be a long-lasting equilibrium if the employer is not aware of the source of discontent while the latter eases his task of dealing with it. By easing ‘voice’ response to job dissatisfaction, the presence of union representatives therefore decreases asymmetries of information in the firm. Unions are then likely to limit turnover, thereby reducing hiring and training costs and increasing firm-specific investment from both sides. Another way for unions to benefit the firm could also stem from an increase in the completeness of contracts. In short, unions may have the ability to control that both employers and employees act for the best of the firm rather than their sole interests (see Pencavel, 1977, p. 139).

The rising theoretical recognition of unions’ capacity to generate rents opened the way for two vivid streams of research. First, a vast amount of empirical papers has tried to disentangle which of the rent-seeking or rent-generating sides of unions dominates in covered firms by estimating unions’ impact on wages, employment or working conditions1. Second, it renewed scholars’ interest in works councils. Once again, two main features differentiate works councils from plant-level unions. First, whereas shop-floor unions’ preferences are somehow shaped in relation with greater-scale organisations (think of union federations or confederations), works councils’ objectives are solely turned towards the plant. Second, their entitlements differ. As stated by Freeman and Lazear (1995, p. 29), “in contrast to plant-level unions, councils cannot call strikes nor negotiate wages […]. Their function, often specified in legislation, is to foster labor and management cooperation with the goal of increasing the size of the enterprise ‘pie’”. It is this latter feature which raised scholars’ attention. Works councils can sign plant-level agreements – which pertain to the sphere of co-determination – and have no say over collective bargaining agreements (CBAs) in which strategic distributional topics such as wages are dealt. Unions at the plant, industrial or multi-industrial/national levels represent the labour force on these matters. In all institutional frameworks, even though works councils still have some capacity to bargain over distributional topics (see part 2), they therefore have much weaker leeway to do so than unions. In other words, their ability to seek rents is limited while legislations provide them with tools to achieve their specific goal of generating rents. At a time of deunionisation and in a context of absence of consensus regarding the economic benefits of unions, works councils therefore appeared as a possible source of welfare gains. It opened the way for empirical research on the matter.

1 Detailing these results is out of the paper scope. For a review, see for instance Benett and Kaufman (2007).

Since FitzRoy and Kraft’s seminal series of papers (1990, 1987; 1985), the empirical research on works councils’ impact on firm performance has mostly focused on Germany. Indeed, in the traditional German model of industrial relations, CBAs on most strategic issues (including wages) are relegated to the branch level hence, expectedly, limiting conflict at the shop floor (see part 2 and box 1). Moreover, German works councils benefit from the largest ‘co-determination rights’ in the 5

Western world. For these two reasons, it is expected that the welfare gains induced by works councils will be maximized in this country. In what follows, I provide more details on the impact of works councils on different outcomes in Germany according to the literature.

As for the impact of works councils on firm performance, Addison et al (2004) exhibit a range of three groups of papers in their metadata analysis. The first one includes studies with representative databases of specific sectors in the early 1990s or before. The second one builds on representative surveys of the whole private sector in the 1990s. The third one is more recent and based on administrative data. They show that the estimation of works council impact on firm performance varies according to the type of studies: respectively mostly negative, positive and ambiguous (though positive if anything). The explanation would stem from differences in sample size, underlying populations and in the coverage of CBA. In their words, “the jury is still out today” (ibid:236). Note that the third type of studies has expanded since then; the impact in the 2000s seems unambiguously positive (Addison et al., 2006; Brändle, 2017; Jirjahn and Mueller, 2012; Wagner, 2008).

Works council coverage is then associated with larger wages (about +20%, Addison et al., 2001; Ellguth et al., 2014). Yet the causal impact is not clear-cut. Addison et al (2001) and Kraft and Lang (Kraft and Lang, 2008) find no effect, whereas Addison et al (2010) and Brandle (2017) observe a positive impact of about 6 to 8%. Broadly, two methods are privileged in the literature: bivariate probits and difference-in-difference methods. These methods are limited: it is known that bivariate probits are very unstable if the binormality of residuals is not respected – which is very rarely tested – and difference-in-difference methods do not take into account spatial correlation. More generally, treating the endogeneity of firms setting up a works council proves particularly difficult, especially since the selection into collective bargaining coverage should also be addressed at the same time given that some interaction effects between the two institutions may be playing.

Thus, Freeman and Lazear (1995) first stated that works councils were more likely to work with management to increase the joint-surplus when sharing rules have been decided upon by collective actors (i.e. when firms are covered by CBAs). For Hübler and Jirjahn (2003, p. 474), CBAs do not actually give rules for “dividing firm surplus”. In their opinion, the key element in industry-level bargaining is rather the possibility for firms to refer to business associations’ experts when needed, and, in particular, in the case of lawsuits. As such, “the opportunities for a council to obtain employer concessions on wages by withholding cooperation in areas where it has codetermination rights are more restricted in covered establishments” (ibid). Empirically, Hübler and Jirjahn observe positive impacts of works councils on wages and productivity, but the former is stronger in uncovered firms while the second is stronger in covered firms. This result has largely been discussed since then. Brandle (2017) and Mueller (2011) obtain similar results on the productivity outcome. But, as for wages, Gerlach and Meyer (2010) replicate Hübler and Jirjahn’s work with administrative data in the same region and find opposite results. Gürtzen (2006) also finds a stronger impact of works council in covered firms while Addison et al (2010) and Brandle (2017) do not observe any significant difference based on the presence of a works council. In a later paper, Jirjahn explains these ambiguous results as follows: CBAs “can have two moderating influences. First, as in Hübler and Jirjahn’s model, collective bargaining coverage limits the opportunities of a works council to engage in rent-seeking activities. Second, collective bargaining coverage increases the effectiveness of the work practices negotiated between works council and employer [and therefore the rent to be shared]” (Jirjahn, 2014, p. 3). Both push towards an increase in productivity but they go in opposite directions as for 6

wages (respectively negative and positive). Jirjahn therefore considers that depending on the sample and on the years, results may differ.

Results of the interaction between works council coverage and the existence or the use of derogations to CBAs are less ambiguous. According to Ellguth et al. (2014), of all firms covered by an industry-level CBA, 39% of those with a works council are bound to opening clauses against 21% for those with no works council. In both cases, about half of them use these clauses. This figure reflects the fact that opening clauses are not solely ‘austerity measures’ – which works council would be expected to limit – but also some ‘stepping stones’ changes in order to boost firms’ competitiveness. As for the impact on wages, the existence of opening clause is associated with a rise in wages which is canceled by their use in firms with no works council but not in those with a works council (with a lesser degree of significance, Brandle (2017) finds this same latter result). Note that in Ellguth et al’s views (2014, p. 105), “these results should not be interpreted as sheer rent-seeking actions because it may also be true that works councils offer alternative or even better and more sustainable solutions to economic problems than simple wage reductions”.

**1.2 The case for a focus on works councilors’ wage in the German context**

What are the main take-home points of the aforementioned literature? First, plant-level organizations entail both a rent-seeking and a rent-generating features. As such, their impact on firm performance, working conditions or wages is not clear-cut. Second, the balance between these two ‘faces’ is expectedly dependant on the quality of the representatives’ relations with the managers. Cooperative relations are likely to enhance the organisation’s capacity to generate rents, conflicting ones are expected to deter it and, conversely, to foster the dominance of its rent-seeking side. Third, in this respect, the correlation between the ability to seek rents or to generate rents is expected to be negative. In particular, larger entitlements to bargain over distributional topics are likely to create conflict between the two parties, to limit the cooperative nature of their relations and therefore to deter the organisation’s ability to generate rents. As a result, existence of collective agreements at an upper scale matters. Employer-employee relations at the shop floor are likely to be the most cooperative in institutional frameworks with a large coverage and centralization of the collective bargaining. In these lines, the decentralization of collective bargaining undergoing in the OECD is expected to count (see box 2). Fourth, institutional rules entitle works councils to fewer bargaining rights over distributional topics and provide them with more specific tools to increase the enterprise ‘pie’ than unions. They are therefore likely to tip the balance towards rent-generation more strongly for works councils than for unions. Fifth, resulting from these first four elements, works councils are expected to have the largest ability to generate rents in Germany where the traditional model of industrial relations equips the organisation with the strongest co-determination rights and have industrial-level collective bargaining predominate on distributional questions.

These elements urge to open the black-box of plant-level bargaining and to turn an eye towards the relations between employers and representatives; this, especially in the case of German works councillors. Very little has been done on the matter. In 2010, Stormer stated “the main body of research on works councils has been conducted on a collective institutional level, neglecting works council members at an individual level” (Störmer, 2010, p. 244). Similarly, in 2014, Breda wrote: 7

“there is no quantitative economic paper in French or English dealing with the role of union leaders, either at the level of the firm or at the national level” (Breda, 2014, p. 6). To my knowledge, the only research dealing with workers’ representatives at the individual level is the French stream of research led by Breda (2014) and Bourdieu and Breda (2016). They turn the light towards union delegates and show that they are at risk of “strategic discrimination”. Breda (2014) elaborates the following reasoning. Shop-floor representatives play two bargaining games at once with their employer: one through their mandate on behalf of their colleagues, another one regarding their own career evolution (promotions, working conditions, etc) like any other employee. As a result, “two Nash equilibria can result from the interaction between the union representative and his employer” (Breda, 2014, p. 6). The first one is a cooperative equilibrium, where the representative trades laxity in her positions as elected delegate against special improvements in her working conditions – relatively to her colleagues. Conversely, a non-cooperative equilibrium will stem when the representative strongly negotiates for her colleagues. In this latter case, her employer could ensure that the delegate’s career stagnate to deter further union activism in the firm. Turning to empirics, Breda (2014) and Bourdieu and Breda (2016) find an average wage penalty of about 10% for union delegates which is positively correlated with the vehemence of the union to which they are affiliated. Bourdieu and Breda suggests that the penalty would stem from a smaller likelihood to be promoted. On these lines, they conclude to some ‘strategic discrimination’ from the employer’s part.

I apply the same reasoning to the case of German works councillors. According to the aforementioned elements, one would expect the traditional German model of industrial relations to protect works councillors from such risks of ‘strategic discrimination’. Yet the model has largely evolved and the extent to which this prevision still applies to contemporary Germany is not clear-cut. After exposing in more details its functioning, I describe the evolutions undergone by the traditional German model of industrial relations. I then turn to the data and estimations. 8

**Box 1 : Quality of the employer-employee relations in the OECD countries**

As suggested above, the nature of the relations between employers and employee’s representatives may affect the risk to encounter cases of strategic discrimination. I use here the Global Competitiveness Index Historical Dataset from the World Economic Forum which allows me to classify OECD countries per the quality of the labor-employer relations from the employers’ view. Figure 3 displays the classification according to the 2007-2017 average of this index.

0.00

1.00

2.00

3.00

4.00

5.00

6.00

7.00

France

Korea, Rep.

Italy

Greece

Turkey

Spain

Slovenia

Poland

Slovak Republic

Portugal

Hungary

Belgium

Latvia

Mexico

Australia

Chile

Czech Republic

Israel

United States

Estonia

Canada

Germany

United Kingdom

Finland

Ireland

New Zealand

Luxembourg

Iceland

Netherlands

Sweden

Japan

Austria

Norway

Denmark

Switzerland

**Figure 3 - Cooperation in labor-employer relations in the OECD countries Averaged over 2007-2017**

Germany ranks in the second third while France is last on this scale. Cases of strategic discrimination are therefore expected to be weaker in Germany than in what Breda (2014) and Breda and Bourdieu (2016) found for France.

Source : World Economic Forum - The Global Competitiveness Index Historical Dataset Note : Self-declared estimation based on the question : “In your country, how do you characterize labor-employer relations?” [1 = generally confrontational; 7 = generally cooperative] 9 Box 2: The decentralization of collective wage bargaining and the rising strategic importance of shop-floor representatives for the firm. Box 2: The decentralization of collective wage bargaining and the rising strategic importance of shop-floor representatives for the firm.

**Box 2: The decentralization of collective wage bargaining and the rising strategic importance of shop-floor representatives for the firm.**

In this section, I use Visser’s database on the Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts (ICTWSS, Visser, 2015) to evidence the generalized process of decentralization of collective wage bargaining. Employer(s)-employees collective bargaining over key issues such as wages can take place at three different levels according to the national institutional framework: national/cross-industrial, industrial or company/establishment. The more centralized – i.e. the higher up on the scale – collective bargaining is, the more encompassing agreements are in terms of employees. To the extreme, workers’ representatives (unions) negotiate with employers’ associations for the whole workforce.

The ICTWSS database includes a ‘country × year’ index accounting for the level at which most bargaining takes place according to the following scale: 1 for predominant shop-floor bargaining, 3 for industry-level dominance, 5 for national or cross-industry dominance; 2 and 4 accounts for intermediate situations2. Figure 1 displays the yearly average, bottom and top deciles of this index over the 25 OECD countries for which the data is available between 1975 and 2014. It evidences a clear trend of collective bargaining towards the firm level over the period and a decreasing spread in the late 2000s.

2 A given level predominates if it accounts for at least two-thirds of the total bargaining coverage rate in terms of employees covered.

Importantly, Figure 1 gives no information on the extent to which CBAs apply such as signed at the predominant level. In many instances, actual wages deviate from the ones agreed on. Think for instance of additional local bargaining, derogation or open clauses, etc.. Visser therefore calculates a summary measure accounting for the *actual* level of centralization of wage bargaining. The measure takes simultaneously into consideration: the predominant level of wage bargaining, the frequency or scope of additional enterprise bargaining, the formality of additional enterprise bargaining and its control by union bodies, the ease to derogate from the hierarchy of norms and the existence of opening clauses. Displayed in Figure 2, the updated index shows an even stronger trend towards decentralization of collective bargaining.

Explaining this generalized trend goes beyond the scope of this work (see for example Baccaro and Howell, 2011; Visser, 2016; part 2.2.1 for Germany). What imports here is that, in countries where the legislation entitles workers to elect representatives at the firm level, decentralization of collective bargaining changes their role and is likely to foster their strategic importance for both the employers and employees. With increasing rights to negotiate with employees’ delegates in the firm over encompassing issues, employers are likely to pay stronger attention to the composition of works councils and union delegations. 10

**2 The institutional context**

Germany has long been considered an economy where a widespread dual system of industrial relations relying on both branch-level and firm-level coordination ensured a peaceful coordination between employers and employees favourable to rent generation. I first describe the traditional structure of bargaining before highlighting how it recently evolved.

**2.1 The two pillars of the traditional German model of industrial relations**

Modern industrial relations in Germany are structured around two pillars (re)institutionalized by the 1949 Collective Bargaining Act and the 1952 Works Constitution Act. The first pillar consists in industry-wide regional (or sectoral) collective bargaining taking place every four years between trade unions and business’ associations. It typically includes questions of wages, working conditions, working time and job classifications. While the agreements reached by these bodies legally apply to unionized workers in the firms with a membership in the association who stroke the deal, they are generally applied to non-unionized colleagues within these companies. Conversely, they are rarely extended to the whole sector: in 2009, only 1.5% of all sectoral agreements had been so (Addison et al., 2017, p. 30). Importantly, unions are not entitled to call for strikes outside of these four-year rounds. Finally, note that collective agreements can also be struck at the firm-level between unions and a company, even though this possibility is barely used.

The second pillar consists in firm-level bargaining between employers and works councils. When referred to by the workers, employers are required by law to facilitate the constitution of a works council and to bear its costs – including the cost of the elections, works councillors’ wage and training, the cost for premises and material facilities (2001 Works Constitution Act (WCA) (sections 20 & 40)) – in private firms with at least five permanent employees. There are also works councils in the public sector (“Personalrat”) but with “somewhat fewer powers” (Müller-Jentsch, 1995). Professional elections take place every four years. As previously mentioned, legally, works councils can only strike deals on issues that “have [not] been fixed or are [not] normally fixed by collective agreement” (WCA Section 77-3). This can include pay systems, working time, holidays and social issues, but in the end, they have little rights over distributional issues (wages3 …). Thus, according to Müller-Jentsch (1995, p. 60), “the potential for works council intervention in managerial decision decreases with the proximity to essential business decisions”. Confined to the less conflicting questions of personal and social matters rather than to financial and economic decisions, they are expected to smooth relations between labour and employers at the plant-level. Thus, the WCA (section 2) states that works councils should cooperate with management “in a spirit of mutual trust […] for the good of the employees and of the establishment”. Both should therefore “refrain from activities that interfere with operations or imperil the peace in the establishment” (section 74). Nevertheless, works council’s powers should not be underestimated. They do benefit from extensive information on the firm’s strategic orientations, they are very well represented in the supervisory

3 Even though they can indirectly influence earnings via wage classification or by negotiating wage premiums (Ellguth et al, 2014:106). See Müller-Jentsch (1995:59-60) for an extensive description of the works council’s participation rights. 11

board4 and, for instance, have a veto right on some individual staff movements as well as co-determination rights on overtime and plans of reduced working time. Even though they cannot call for a strike, these entitlements provide them with some power resources to use over disagreements with the management. Note that, since 1989, the executive staff is entitled to set up separate representative committees (Müller-Jentsch, 1995, p. 61) – though joint-elections remain possible.

4 E.g. half of the seats in the coal and steel industry, half minus one seat in other firms with more than 2.000 employees, a third in those with 500 to 2000 employees.

5 This was their actual primer responsibility when they were legally established in the Weimar Republic (Müller-Jentsch, 1995:53-54)

The two pillars are not fully independent for two reasons. First, when a collective agreement is reached, works councils are in charge of checking its application in the signatory firm(s)5. Second, works councils depend *de facto* on unions: the latter supplies the former with expertise and about two thirds of works councillors are union members (slowly decreasing).

**2.2 A departure from this theoretical case**

As previously mentioned, the traditional German model of industrial relations has been praised by both national and foreign actors. It is deemed to concentrate the conflicting questions at the branch level to ensure that works councils – entitled with strong codetermination rights – maximize their capacity to generate rents in a cooperative atmosphere at the firm level. Yet industrial relations have largely departed from this equilibrium since the 1970s.

**2.2.1 A system under pressure**

For several reasons, the collective feature of German Industrial Relations has been under pressure since the 1970s. First, the financialization of the economy has emphasized shorter-term objectives per the shareholders’ interests. As a consequence, longer-run goals relying on stakeholders cooperation has come to secondary importance (Goyer, 2007). Second, the long-run trend of industrial and occupational restructuring has increased the interest for flexibility which is easier to reach at the level of the plant than at the branch level (Haipeter, 2011a, p. 176). Third, in the aftermath of the reunification, the difficulties endured by East-German firms limited companies’ ability to engage under common collective agreements with the West. Since then, West-German firms have been taking advantage of an increasing room for maneuver due to the credible threat of shifting production to the East (both Eastern Germany and Eastern Europe) at a time when rates of unionization were decreasing. Last, the privatization of former public services has provided more space for retrenchment of collective bargaining agreements (ibid).

Accordingly, employers have increasingly got interest in bringing the core of industrial relations from the industrial or regional level back to the shop floor and growing power resources to do so. As a result, both an internal and external erosion of the traditional German model of industrial relations have materialized. 12

**2.2.2 Internal discrepancies from the traditional model of IR.**

**2.2.2.1 ‘Wildcat cooperation’ : works councils illegal deals in firms covered by CBA**

In the pure traditional model described above6 any workplace agreement between an employer and his works council to deviate from the collective agreement to the disadvantage of employees is null and void (Weiss and Schmidt, 2007). Yet, “it has long been recognized […] that the contents of works agreements negotiated between establishments and their work councils have in practice ranged much beyond the terms fixed by the law” (Addison et al., 2017, p. 4). Thus, according to Müller-Jentsch (Müller-Jentsch, 1995, p. 62), “during the 1960s and 1970s it was usual for works councils in large companies to negotiate informally with management about additional wage increases after conclusion of an industry-wide wage agreement, although this practice was not authorized by the law”. In his 1980 paper, Witte finds that 85% of the large manufacturing firms had signed works agreements with their works council exceeding their legal rights to co-determination. This feature strengthened through the 1980s and 1990s. Normally in charge of ensuring that collective agreements are applied in their establishment, works councils have largely engaged in ‘wildcat cooperation’ with employers against the credible threat of outsourcing.

6 I.e. in the absence of clauses at the collective level, see hereafter.

7 Following Bellmann et al (2008, p. 534) I use the term ‘job alliance’ for “all types of company-specific deviations from a collective contract”

This feature highlights the strategic importance of works councillors for the firm. ‘Wildcat cooperation’ is increasingly taking place against downward pressure on employment. It therefore consists in trading negative components for the workforce against an increase in job security. An instance of circumvolution of the legal issue for works councils and employers is to turn a blind eye on employers’ non-respect of collective agreements or to bargain over “amendments to every single individual employment contracts” (ibid).

**2.2.2.2 ‘Organised’ erosion : the growing number and use of derogations**

To limit the recourse to these strategies and accommodate with firms’ claims for flexibility rather than a ‘one fits all’ approach in a context of downward pressure on membership rates, employers’ associations and unions have been constrained to engage with innovative institutional designs. They include some ‘job alliances’7 allowing for some derogations to the hierarchy of legislation which normally prevents plant agreements to be worse off than branch ones for employees. They are of several types.

First set up at the time of the reunification, ‘hardship clauses’ applied to the case of firms’ economic distress in Eastern Germany. Generalized to the West under the name of “restructuring clauses”, they entitle an employer and a works council to sign agreements on the condition that the collective organisations have ratified the clause. Note that these latter have a right to ask for detailed economic information to make sure that the deal is indeed necessary and helpful for the company’s recovery. 13

‘Opening clauses’ consist as well in branch-level agreements between unions and employers’ associations to let local actors bargain over topics which do normally not lie in their reserved area, including the possibility to deviate from the existing collective agreement. But here, the clauses can be subject to an explicit goal of competitiveness increase, a commitment to innovation or, more broadly, to upcoming investments. Depending on the collective agreement, the firm may have to justify its position against the collective actors or not. Yet when it is the case, the requirements are lighter than for hardship clauses (Silvia and Schroeder, 2007, p. 1452). According to Brändle (2013), while opt-out clauses on working time were more numerous in the 1990s, the ones on earnings are most frequent nowadays. For an opening clause to be used in a firm, the management and the workforce or the works council have to come to an agreement on the issue. The ‘job alliance’ is therefore often reached against some explicit pledges from the employers’ part to protect employment or to engage in investment programs. According to Seifert and Massa-Wirth (2005), 87% of all job alliances involved concessions from management in 2003. In this case, ‘job alliances’ are generally branded ‘company-level pacts’ or ‘pacts for employment and competitiveness’ (PEC hereafter). Note that PECs do not necessitate the existence of a works council in the firm since the workforce can be directly consulted.

A third innovative institutional design is the development of the OT (Ohne Tarifbindung) membership. This new type of affiliation provides a firm the traditional services of an employers’ association but does not compel it to apply the collective agreements. Note that the capacity for an employer to have recourse to this form of affiliation relies on the lack of power resource of the industrial union to oppose it. As such, it is mostly taken up by small and medium-sized firms where unionization is the weakest (Haipeter, 2011a, p. 182).

The trend goes towards a strong development of these designs. Addison et al. (2017, p. 46) observes that PEC covered 15.0% of German employees in 2009 against 13.7% in 2006, that 52.7% of all employees covered by a collective agreement worked in firms entitled to use opening clauses in 2011 against 39.7% in 2005 and that respectively 77.0% and 52.9% of them worked in establishments which did use a clause.

These institutional innovations displace the core of industrial relations from the branch to the firm. As such, they strengthen the importance of works councils both positively and negatively. Positively first, because, in the aforementioned cases, works councillors cannot rely on the mandatory character of branch regulations anymore and therefore have to engage in bargaining over broader issues than in the traditional model. As a result, their claims have gained in strategic importance and the management has increasing incentives to take actions to privilege more peaceful members against radical ones at election time. Negatively then because management’s utility may be positively associated with the absence of a works council. Hardship clauses, opening clauses and PECs can be used in the absence of a works council by bargaining directly with the workforce. This is most frequently the case in terms of establishment numbers the pattern – though not in terms of employees – and the trend is clearly positive (Addison et al., 2017, p. 46)8. It is known that works

8 Thus, counter intuitively, “there is little indication that the pronounced increase in the use of opening clauses has stimulated works councils since their relative incidence is little affected by activation or nonactivation. And, as far as pacts [CPLs] are concerned, although works councils are even more dominant […], their incidence has unambiguously declined both in employee and employer shares”. 14

councillors are more unionized than the average worker (respectively about 60% and less than 20%9) and therefore may be more exigent in the concessions demanded from the management. As a result, employers may be tempted to avoid the creation of a works council when inexistent in the firm or to undermine its continuation when pre-existent in the establishment. OT affiliations are exemplary of this latter case. They prevent firm-members from benefitting from the smoothing feature of the traditional collective model. By not taking part in branch collective bargaining, the firm exposes itself to local strikes triggered by a union willing to enact collective firm-level agreements. As such, one would expect employers benefitting from OT membership to be harsher against unionized workers – whose leaders are often works councillors – than firms with the traditional membership.

9 Addison et al (2006 :7) ; same in my data.

10 The figure comes from the IAB Establishment panel which was first introduced in 1993 but included Eastern Germany only by 1996.

11 Note the spread among services: the banking and insurance sector is widely covered whereas industrial services are at the opposite of the spectrum. Note that none of these sectors exhibit a significative trend between 2001 and 2008.

**2.2.3 External discrepancies : Incidence of works councils and coverage of collective bargaining**

The traditional dual system of industrial relations is not anymore the rule in Germany. To a certain extent this has never been the case. According to the Codetermination Commission (1998) cited in Addison et al (2004, pp. 401–402), in 1984, more than a third of all German employees were not working in a firm with a works council. In the private sector, the figure was of about a half and was even larger for small firms and in the service sector. To a lower extent, this also applied to branch collective bargaining since about 20% of all German employees were not covered in 1980. Despite these figures, the traditional model still occupied a central position until the mid-1980s because non-covered firms often used the standards set up in the collective agreements as reference points (even though a mitigation by sector would be necessary).

The external erosion has deepened concomitantly to the aforementioned internal erosion. Accordingly, nowadays, of all German employees working in firms with five or more employees, only less than half is represented by a works council and about 60% is covered by collective bargaining. In the end, only 40% is benefitting from both mainstays of the traditional German model of industrial relations (Oberfichtner and Schnabel, 2017, p. 22). Moreover, company and establishments agreements in non-covered firms decreasingly take industrial collective agreements as a baseline (Haipeter, 2011a). The gap with covered firms is therefore strengthening.

This process of external erosion has not affected all firms similarly. In 199610, works council and collective bargaining agreements were already more frequent in the manufacturing sector, the public sector and in large firms overall. But the difference got stronger since then. As for collective bargaining coverage, the drop is negatively correlated with the establishment size and is stronger in services11 than in the manufacturing sector while the public sector was not affected (in relation to the respective situations in 1996). The trend is the same regarding works council coverage. For our case, we should keep in mind that a lower incidence of works council and a stronger trend towards external erosion is likely to evidence a stronger opposition of employers against these institutions. 15

**3 Data**

The estimations are led on different sub-samples of the German Socio-Economic Panel (GSOEP). The database is a yearly survey representative at the household and the individual levels (Haisken-DeNew and Frick, 2005). To my knowledge, it is the only database combining information on wages and works councilor membership in Germany. Note that there is no firm-identifier in the panel.

The availability of the main variables of interest in the German Socio-Economic panel according to the wave is displayed in table 1. Respondents are surveyed about their status of works councilor in 2001, 2003, 2006, 2007, 2011 and 2015. I therefore only use these waves. Next, in what follows, the goal is to estimate the importance of the causal (dis-)advantage of being a works councilor in terms of wage. As previously mentioned, employees working in firms covered with works councils are a minority and differ from the rest of the workforce on different observables (see part 4 and table 4 in appendix). It can therefore be expected that they also differ on a number of non-observables. As a result, Information on works council coverage being only available in 2001, 2006, 2011 and 2016, I drop observations from agents working in non-covered firms in the first three of these waves. To limit the full loss of the waves 2003, 2007 and 2015, I assume that, if a firm has not changed status between two consecutive waves with coverage information (e.g. between 2001 and 2006), it has experienced no variation on the matter in the meanwhile. Among the agents exhibiting such sequence of status as for their firm, I therefore approximate the works council status in 2003 (resp. 2007, 2015) by the one applying in 2001 and 2006 (resp. 2006 and 2011, 2011 and 2016) if the person did not change firm in-between. The recoding procedure seems legit since works councils elections normally take place once every four years. Note that some robustness checks are led in part 5 using two alternative samples built without this assumption. Finally, it is known that about two thirds of the works councilors are unionized. The impact of the two variables should therefore be disentangled. Information on union status is given in all years of interest but 2006. For the respondents who answered both in 2006 and 2007 and who did not change firm in-between, I therefore assign to the 2006 wave the same union status as in 200712. The other observations in 2006 are dropped.

12 I restrict the recodification to respondents who did not switch firm on the rational that union status is associated both with the job and the industry.

13 It can be shown that yearly union status change is normally of about 5% in the sample.

These procedures bias the sample towards longer seniority. It should not be problematic for the results, especially given that works councilors already tend to have longer seniority than average. The procedure is also likely to add some noise, especially given the 2006 recoding on union status13. In the end, I can infer the works council status for about 40% of the respondents in waves 2003, 2007 and 2015. Among this population, about 75% works in a covered firm against 65% in other waves. The difference likely stems from the stronger stability of works councilors in their job. Note that the share of works councilors among covered firm in the final sample (see hereafter) is of about 7.8% similarly in each wave (year-to-year ttests show no difference in the yearly share of WC members at the 10% level).

Once the recoding procedure done, I further restrict the sample to full-time workers (i.e. between 30 and 60 working hours per week), aged between 20 and 64 and employed on open-ended contracts in firms with more than 5 employees. Civil servants are dropped as well as apprentices and interns, 16

voluntary workers, militaries and workers of the agricultural sector. At that point, the sample therefore includes 12 985 person-time observations with an average of 2.15 observations per person. Because I use models with individual fixed effects, I drop individuals with only one observation. The final unbalanced panel therefore includes 9769 observations from 2835 respondents. On average, a respondent is observed 3.45 times over 7.3 years (corresponding to the time span between the first and last observations).

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| The main dependent variable is the logarithm of the hourly gross wage. It is calculated using the answers to the questions "How high was your income from employment last month?” and “how many hours [per week] do your actual working-hours consist of including possible over-time”. It consists in taking the log of the ratio between the first and the second answer – the latter multiplied by 4.3. Robustness checks will separately be displayed on the gross monthly wage and the actual number of hours. In each wave, I finally trim the bottom and top 1% of the distribution of the gross hourly wage. **Table 1 : Availability of the main variables of interest in the German Socio-Economic Panel according to the wave** | | | | | | | | | | | | | | | |
| **2001** | **2003** | | | **2006** | | | **2007** | | **2011** | | | **2015** | | | **2016** |
| **Coverage status of the firm** | | |  | | |  | | | |  | | |  | | |
| **Works council membership** |  | | |  | | |  | |  | | |  | | |  |
| **Union membership** | |  | | |  | | |  | | |  | | |  | |