

**Using the endowment effect to explain managerial resistance towards co-determination:  
implications for employment relations from the German case**

**Abstract**

This article provides an innovative defence of co-determination by way of exploring two of the most significant theorised objections to it from neo-liberal and libertarian perspectives, namely, the defence of the right to manage as freely chosen by employees and employers alike, and the right to manage being the most efficient, lowest transaction cost mode of employee governance. Instead, we focus upon management preference emanating from the endowment effect, and manifested in management style and ideology, as a more credible explanation for management's support for its prerogative to manage. The endowment effect prompts both strong employer and manager objections to co-determination and weak employee willingness to seek it because humans place more value upon items currently in their possession than upon those they do not possess. We explore this argument by examining the experience of co-determination in Germany. The significance of our argument lies in identifying managerial preference as the key variable to be challenged and changed in order to pacify management opposition to co-determination through political, ideological and institutional means.

**Key words**

Employment relations, corporate governance, managerial behaviour, Germany

## Introduction

Co-determination has been a staple and statutory component of social democratic settlements in northern European countries like Austria, Denmark, Finland, Germany, Netherlands, Norway and Sweden. Yet, it has been under attack and on the retreat in the neo-liberal era, where libertarianism has provided intellectual and political succour. In the Nordic countries, co-determination takes the form of company board-level worker representation. In the Germanic (Austria, Germany, Netherlands) mould, co-determination also includes a system of works councils so that there is a 'thicker' form of regulation of employment relations. Under Germanic co-determination, workers can then seek to exert influence upon organisational decision-making in terms of its processes and outcomes in a way which is not usually possible under collective bargaining, producing a form of 'partial participation' in terms of Pateman's (1970) threefold schema. Not only is collective bargaining normally focused upon the more immediate terms and conditions of employment (like wages and conditions) but it is also usually reactive in nature, responding to management initiatives. By contrast, Germanic co-determination offers the possibility of influencing organisational decision-making at a far earlier stage and in a strategic way through board-level representation and through works councils with their rights of consultation and veto. Consequently, this form of co-determination represents a curtailment of managerial prerogative, where the interests of capital and labour diverge. Indeed, Frege (2002:222-223) postulated: 'Interest representation through collective bargaining does not in itself challenge the managerial right to manage. It is based on the manifestation of power and counter-power, and not on legislative rights. Interest representation through codetermination, on the other hand, requires the limitation of managerial discretion to manage.' But in the last thirty years, co-determination has experienced significant decline through employers' strategies of avoidance and attrition, with many employers supplanting it with employee involvement or straightforward unilateralism. This represents the re-assertion of their managerial prerogative.

In the context of this avoidance and attrition, the purpose of this article, through deploying the example of Germany, is to mount a novel defence of co-determination by using core empirical findings from behavioural economics on the 'endowment effect'. This refers to the human tendency to value items (and legal rights) more highly when they are already in possession than before possession arises or in the absence of possession. This tendency is sometimes also referred to as 'loss aversion'. Applied to employment relations, management's right to manage endows employers with the default authority to determine all terms and conditions not established via contract or statute. Thus, if employers were not endowed with this right to manage, they would be less keen to acquire it than retain it. The effect prompts employers to then value the right to manage more highly, covet it more zealously, and defend it more vigorously. As such, employers are likely to seek to erode and evade existing co-determination as well as resist newly established co-determination. Consequently, this empirically-derived insight from behavioural economics helps explain why managerial resistance to acceding to co-determination and worker reluctance to campaign for co-determination are more marked than might otherwise be expected, especially when recent research suggests that firms with co-determination are more profitable than those without (Mueller 2011).

This article also then provides an innovative defence of the moral justification for co-determination by way of exploring two of the most significant theorised objections to it from a neo-liberal perspective and where libertarianism has therein had an important influence. The first objection concerns the defence of the right to manage as freely chosen by employees and employers alike, while the second concerns the right to manage being the most efficient, lowest transaction cost mode of employee governance. By contrast, we focus upon the issue of management preference - manifested in style and strategy and found within an overall worldview or ideology - as a more credible explanation for management's support for its prerogative to manage than either a freely chosen human order or simple profit maximisation. The significance of this is in identifying

managerial preference as the key variable to be challenged and changed in order to pacify management opposition to co-determination through political, ideological and institutional means.

The originality in defending co-determination in this way can also be found in eschewing the traditional arguments of its proponents in terms of democratic process, equity outcomes for distributing surplus, legitimisation of organisational decisions and efficiency gains through productivity coalitions (known as 'mutual gains'). Rather, we respond firstly and directly to the arguments against co-determination in order to reveal and interrogate the core issues at hand. This method has, we believe, greater purchase for illumination because it engages more forcefully with the critics of co-determination than any espousal of arguments for industrial democracy does.

This article proceeds by examining the two key neo-liberal arguments against co-determination. From here, it lays out an explanation of the endowment effect, its empirical basis and its implications for refuting the two neo-liberal arguments against co-determination. The article then examines the endowment effect in relation to the 'right to manage' as a default. Following this, the article introduces the case of German co-determination, firstly, covering its erosion and eclipse as a result of employer resistance before, secondly, examining the implications of the endowment effect for the two neo-liberal objections. The article finishes by discussing the research and political implications of its conclusions.

### **Objections to co-determination**

The first objection to legislated co-determination is that unmitigated authority-based relations, inherent to managerial prerogative, are freely chosen by the two parties, capital and labour, rather than imposed by law-makers (Maitland 1989). It follows that, if the parties wanted co-determination, they would have voluntarily negotiated such an arrangement for themselves. They

would not need the state to force it upon them via legislation. Instead, in the absence of legislative support for co-determination, both sides virtually always negotiate arrangements that continue to recognise management's unilateral right to manage.

The right to manage, or managerial prerogative, assigns the employer no property entitlements, which would serve as the basis for an inalienable right to command (Demsetz 1972). The right to manage is only a common law default term, the mirror of the employee's duty to obey, with a gap-filling function in employment contracts (Sunstein 2002). Hence, it only affords employers the authority to unilaterally make decisions when a contentious issue is not covered by an employment contract. The parties remain free to bargain around the default and settle on alternative rules and duties in the contract, as with a co-determination arrangement. 'The right or duty specified in a default rule, such as the right to manage, becomes effective ... only by mutual agreement, and ... the party burdened by the right (or the absence of it) must agree to take up the burden ...' (Millon 1998:1010). '[S]uch rules do not determine the outcome of the bargaining process because the parties are free to substitute an alternative to the default rule' (Millon 1998:1004). Neither do they confer wealth on the party favoured by the default: a non-favoured party can demand concessions in other contractual terms as the price of securing their consent to a default beneficial to the other party (Millon 1998). Thus, the central premise is that there is no inherent authority in the employment relationship. The parties are free to negotiate whatever relationship they prefer, including co-determination. If the parties have negotiated unmitigated authority-based relationships in practice, it must be because they prefer them (Maitland 1989). This suggests that the employer has a stronger preference for managerial prerogative than the employee has for the alternative, and is prepared to make contractual concessions to secure that outcome (Maitland 1989).

The second and associated objection to legislated co-determination is that managerial prerogative is efficient. Why? The Coase Theorem posits that the initial allocation of a property right between two

parties is irrelevant to such a right's final allocation, in the absence of major transaction costs (Coase 1960). As a result, the fact that the right to manage is the default should make no difference to whatever decision-making arrangements are eventually established. The two parties, capital and labour, should bargain towards the right's most efficient allocation, with the party who values it most (e.g., derives the greatest output or utility from it) prepared to pay the other to acquire it, leaving both better off. Hence, the Theorem predicts that the two parties would bargain over the right to manage and settle on the most efficient decision-making arrangement for their relationship. The fact that the right to manage invariably stays with management suggests that hierarchical authority is the most efficient form of governance. Indeed, Coase (1937) famously argued that the lower transaction costs of hierarchical governance, in relation to market governance via contracting out, explained why work was mainly organised into hierarchically-organized forms. Hierarchical governance of the employment relation provides flexibility in an uncertain world by empowering employers to constantly adapt employees' terms and conditions to new circumstances (Williamson 1985).

### **The endowment effect**

We contest both these objections, on the basis of the empirically validated endowment effect, a term initially coined by Thaler (1980), to refer to the tendency people show to value items or objects (or rights) more when they possess them. Thus, individuals will normally demand a higher price – like a monetary value - to sell an item (or right) they already own than they will spend to purchase the same object (or right) when they do not yet possess it.<sup>1</sup> The effect means that the willingness-to-

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<sup>1</sup> It may appear difficult to untangle how capitalists could become employers in the capitalist epoch without acquiring the right to use wage-labour as they see fit, that is, acquire the managerial prerogative. Yet, being an employer and having the right to manage were not historically inextricably linked. The putting out system, use of gangmasters (for unskilled and sem-skilled labour) and reliance upon craftsmen and tradesmen (with master craftsmen and tradesman in charge) were just some of the examples of forms of subcontracting based upon a market, and not employment,

accept (WTA) price is higher than the willingness-to-pay (WTP) price, producing an 'offer-asking' price gap (Kennedy 1981). It has three key implications that run counter to the Coase Theorem (Korobkin 2013). First, valuations depend heavily on whether one owns or possesses the items or objects (rights) in question. Second, the 'offer-asking' price gap decreases transactions between sellers and buyers because the former typically want higher prices than the latter are prepared to pay. Third, with little trading, initial goods (rights) allocations tend to 'stick': final allocations are, therefore, similar to initial allocations. The parties do not necessarily bargain toward one outcome, and no one outcome stands out as obviously efficient, given the variation in item or object (right) valuations. Later contributions broadened the endowment effect's application beyond goods to legal rights, including default rights (see, for example, Marcin and Nicklish 2014). It follows that the right to manage - universal under capitalism - endows employers, at first instance, with the default authority via managerial prerogative to determine all terms and conditions not established previously by contract or statute. So, on the one hand, employers are likely to highly value the right to manage, if only because they have long been endowed with it. And, on the other, employees are unlikely to value the right so highly, not having been endowed with it. Therefore, it is unlikely to be traded away and remains 'sticky', in the sense of invariably staying with the employer. It also follows that each party's preferences with respect to the default right to manage are highly context dependent. Thus, if employers were not endowed with the right to manage, they would be less keen on acquiring it than they currently are on retaining it. Likewise, if employees were endowed with participation rights in management decisions from the first, they would be keener to retain such rights than they currently are to acquire them.<sup>2</sup> The endowment effect prompts the employer to

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relationship. Over time, these were superseded by the establishment of hierarchical employment relations within the factory system. But even in this stage of capitalism, over and above hiring and firing, the managerial prerogative had to be created over issues pertaining, *inter alia*, to labour time (establishing the working day), property rights (stopping pilfering) and turning labour time into labour power.

<sup>2</sup> We do not examine the relative propensity of employees to create works councils in terms of the endowment effect although studies are at hand to do so (see, for example, Oberfichtner 2016 for a

value the right to manage more highly, covet it more zealously, and defend it more vigorously. The implications of the endowment effect for managerial prerogative, in relation to both management preferences and efficiency, are explored later in this article.

### **Explaining the endowment effect**

The endowment effect's leading explanation is loss aversion, the idea that 'losses loom larger than equally-sized gains' in people's minds, with losses and gains considered in relation to a reference point (Ericson and Fuster 2013:8). A reference point is typically defined in terms of the *status quo*, including currently endowed rights and entitlements as well as objects. Overall utility is greatly affected by changes in relation to this reference point, with losses typically having twice the impact of equivalent gains, as measured in the 'offer-asking' price gap (Rabin 1998). Nevertheless, loss aversion is at best an incomplete theory, describing how the effect operates, without explaining its ultimate cause (Jones and Brosnan 2008; Korobkin 2013). Loss aversion is often attributed to a deeper phenomenon, the theory of *attachment* to possessions (Korobkin 2013). This is '... the feeling of possessiveness and of being psychologically tied to an object', the feeling that it is 'mine' (Pierce *et al.* 2001: 299). It typically arises via one or more of three routes: control over the object via possession; familiarity with it via actual (or even imagined) use over time; and association of the self with the object via investment of time and effort to create, develop, and change it (Pierce *et al.*, 2001; 2003).

Some scholars have proposed and tested an evolutionary account of attachment as the effect's basis. This evolutionary account has also been used to explain the origins of property rights in law (Krier 2009). It focuses on the survival advantages of territoriality as an adaptation to the

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summary of extant research and his own original research). These highlight the importance of plant size and existing collective agreements.



environment (Gintis 2007; Smith 1976). The territorial incumbent values, and is, therefore, more willing to fight to defend property he or she possesses (or owns) more than any challenger of the same species. Self-enforcement of property rights thus provides considerable security of tenure, affording any species the time to use and develop a property for food, shelter, or mating. This endowment effect has been observed in many species, for properties as diverse as hives, nests, burrows, dams, and webs (Gintis 2007). It has also been found in human toddlers, in their aggressive willingness to defend what's 'mine' (Furby 1980). The endowment effect would have given early humans and other species major survival advantages in retaining and developing their property, ensuring that those members of the species who demonstrated the effect were more likely to survive, via the processes of natural selection, than others who did not (Gintis 2007; Jones and Brosnan 2008; Smith 1976). Krier (2009) argues that this evolutionary endowment effect led to the emergence of self-enforced property rights, which pre-dated, but were later reflected in, the development of contracts, courts, police, and other state agencies. Managerial prerogative also relates strongly to the control over, and use of, property, and thus an endowment effect predicated on territoriality would appear especially germane.

### **Endowment effect empirical evidence**

The endowment effect is well-founded in evidence. Three different meta-analyses find evidence of a consistent 'offer-asking' gap between WTA and WTP prices (Horowitz and McConnell 2002; Sayman and Onculer 2005; Tuncel and Hammitt 2014). In other words, humans (and many other species as well) more heavily value objects they already possess than those they do not. The meta-studies indicate that the 'offer-asking' price gap is largest for complex goods and entitlements that are rare or unique and have no close market substitutes (Tuncel and Hammitt 2014). The gap also tends to be large for goods created, developed, or modified by owners, the so-called 'IKEA' effect (Norton *et al.*

2012).<sup>3</sup> The gap is smaller for ordinary private goods which are easy to purchase and/or widely available, and non-existent for tokens redeemable for cash (Horowitz and McConnell 2002; Tuncel and Hammitt 2014). Tuncel and Hammitt's (2014) meta-study shows that this gap is not the product of weak experimental or survey methods as Plott and Zeiler (2005; 2007; 2011) earlier argued.

The endowment effect has been found in many work and employment-related contexts. For example, studies reveal that negotiators are more demanding and less compromising, when they construe bargaining as a loss of an object already possessed than as a potential gain of an object possessed by the other party (see, for example, Neale and Bazerman, 1998). In another study, factory workers worked harder to retain a provisional bonus that was 'lost' if they did not achieve certain performance standards than they did to 'gain' the same bonus if they did achieve the same performance standards (Hossain and List 2012). Likewise, teachers who 'lost' an incentive if their students did not perform had students with higher math test scores, whereas those who 'gained' an incentive if their students did perform had students whose test scores were unchanged (Fryer *et al.* 2012).

### **Defaults and the endowment effect**

Defaults, such as the right to manage, also generate endowment effects. Although defaults do not directly assign property entitlements to parties, and parties may negotiate substitutes for such rules (Demsetz 1972), people act as if the party favoured by a given default actually 'owns' the right embodied in the rule (Millon 1998). Consequently, a party typically demands a higher acceptable price to surrender a right, when it is the default, than is willing to offer to pay for the right when it is

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<sup>3</sup> Norton *et al.* (2012) coined the term 'IKEA effect' to describe their empirical finding that self-assembly of simple products, such as Lego figures, IKEA furniture, and origami animals, increased product valuations. For instance, subjects were willing to pay 60% more for their own successfully self-assembled IKEA furniture than for the same furniture, pre-assembled.

not the default. Since the default's 'owners' are normally unwilling to sell at prices offered by 'non-owners', defaults tend to 'stick' in ways comparable to property endowments. When parties negotiate around the default, 'non-owners' must normally make concessions and, thereby, effectively transfer wealth to the 'owning' party. In contrast, when parties stay with the default, as they usually do, the 'owning' party is not required to make concessions. So, in practice, default rules are not neutral (Marcin and Nicklisch 2014). Here, we review three empirical studies on the matter to help contextualise and explain the relationship between the endowment effect and different default situations.

In Schwab's (1988) study, the default rule forbade the employer from transferring work from a union to a non-union facility for one group of negotiators, but allowed the transfer for another group of negotiators. The choice of default rule had strong distributive effects: union teams generally negotiated more favourable contracts, in terms of points, in the presence of the no-transfer default than the alternative, with the reverse being true for the management teams. Both union and management teams '... acted as if they must purchase the right when the legal presumption favoured the other party ...' (Schwab, 1988:254). Nevertheless, unlike later studies, Schwab's research failed to reveal any impact of the choice of default rule on final settlement outcomes; the default rule was not especially 'sticky'. Further, he did not explicitly measure the 'offer-asking' price gap.

In the second salient study, Johnson *et al.* (1993) asked 136 university staff to value what the right to sue was worth in three different default rule conditions (unlimited right to sue, limited right to sue, no default right to sue) involving a hypothetical car insurance purchase. Participants were asked to indicate whether they preferred a full or limited right. The full-right group was told they could retain the full-right or relinquish it for a 10% premium decrease. The limited-right group was told they could retain the limited-right or, alternately, acquire the full-right for an 11% premium increase. The

defaults were 'sticky' in both instances: 53% in the full-right group opted to stay with this default while 23% in the limited-right group opted to acquire the full-right. Those in the full-right group who retained their default were asked how much of a premium decrease they would require to switch to the limited-right. Likewise, those in the limited-right group who retained their default were asked how much of a premium increase they would be prepared to pay to switch to the full-right. The results revealed a substantial 'offer-asking' gap for the full-right policy: those in the full-right group were prepared to pay an insurance premium of 32% to retain the policy, but those in the limited-right group were only prepared to pay an insurance premium of 8% to acquire it. These findings mirror those in actual car insurance purchases (Millon 1998), showing consumers valued the full right to sue more because it was their default rule. The same was true for the limited right to sue.

Lastly, Korobkin (1998) asked law students to pretend to be lawyers advising a courier company about contract terms regarding liabilities for lost or damaged packages and/or delayed delivery. They were asked how much they would advise the courier company to pay (in terms of price hikes or discounts to the customer) to switch from the relevant default rule to the other liability rule. The results revealed a substantial 'offer-asking' price gap consistent with an endowment effect. For instance, students in the limited-liability group recommended the company demand a minimum amount (\$7 per package) to sacrifice the limited-liability default rule while those in the full-liability group suggested the company offer a maximum amount (\$4.5) per package to obtain the limited-liability term. The majority in both conditions recommended that the company 'stick' with the *status quo*, the existing default (Korobkin 1998:639). Marcin and Nicklisch (2014) replicated much of Korobkin's experiment, involving contrasts between full-liability and limited-liability default rules, but with better methodological design features. Significant 'offer-asking' gaps were consistently estimated (Marcin and Nicklisch, 2014:5,18). Variations in method and subjects' experience appear to make little difference to the size of the gap.

The right to manage is likely to generate even larger endowment effects than those reviewed above, because it is a *process* default that outlines a default means for determining any and all terms not specified in the employment contract or outlined in statute. It potentially applies to a vast range of issues and circumstances. By contrast, a *content* default (e.g., the limited liability of the courier company), relating to just one issue, is much more specific and can be relatively easily replaced with a single contract term of a few lines at most. Results from Tuncel and Hammitt's (2014) meta-study suggest that the multi-faceted, open-ended complexity of the right to manage and the lack of readily available, obvious substitutes are likely to increase its perceived value to management in an endowment situation as compared to a non-endowment situation.

### **Co-determination in Germany**

We now turn to applying the endowment effect for managerial prerogative to the case of co-determination. We focus our attention upon the German system of co-determination, given not only Germany's relatively large population and economic dominance of post-war Europe but also because i) the German version of co-determination represents one of the most comprehensive and advanced extant systems of industrial democracy; ii) while the element of the works council is absent in the Nordic countries, it has become the key part of the German co-determination system (Müller-Jentsch 2003:44) and offers the more potent challenge to managerial prerogative; and iii) the German system has experienced the greatest erosion.<sup>4</sup> Co-determination in Germany is buttressed by wage and condition setting agreements based on sector and state regions that have legal underpinnings. Together, these components form an overall industrial relations framework. Both components have experienced a widely recognised period of decline in coverage and influence

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<sup>4</sup> The significance of German co-determination can also be found in interest in it from outside Germany in terms of providing an exemplar to follow – for example, in Britain (see Hutton 1995, 1997), the US (see Turner 1997, 1998) and in South Africa in the late 1980s and early 1990s (see Barchiesi 1998 and Buhlungu 1999).

in the last thirty years after a long period of stability and strength (Addison *et al.* 2017, Doellgast and Greer 2007, Gall 1997, Hassel 1999, 2002).<sup>5</sup> For our purposes, it is critical to establish that the erosion of co-determination is a result of employer and management, and not worker, union, or even (independent) state antipathy. Co-determination has remained relatively stable and resilient within the declining manufacturing sector, although even here foreign capital has shown resistance (Schmitt 2003, Williams and Geppert 2006). Frege (2003) summarised extant research highlighting attrition in the role and power of works councils. However, the crucial source of the systemic erosion, according to Hassel (1999, 2002), has been the inability of co-determination to establish itself in the growing private services sector, whether with domestic or foreign capital, and where new establishments are created (see Addison *et al.* 2013). This inability has been largely the result of (active) employer resistance and is most graphically illustrated by the behaviour of the likes of Aldi, Lidl, Schlecker and McDonald's (see, for example, Royle 1998, 2003). It should also be noted that employer antipathy is often passively realised because of an insufficient worker mandate, especially in smaller enterprises, often as a result of low and falling union membership. Overall, in the private sector in 2013, only 9% of eligible workplaces had a works council in the former West Germany (10% in the former East Germany) covering 43% of employees in the West and 35% in the East (Ellguth and Kohaut 2014). In workplaces with more than 500 employees, 87% had works councils in the West and 89% in the East (Ellguth and Kohaut 2014). These figures were essentially unchanged for the first half of the 2010s (Ellguth and Kohaut 2011, 2015). In the public sector, a weaker form of enterprise co-determination exists through staff councils. In these workplaces, managerial prerogative has been extended at the expense of the influence of workers and their unions (Keller 2011). Although there have been changes to the law governing co-determination since the last

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<sup>5</sup> Some like Klikauer (2002) and Frege (2002, 2003), respectively, have contested the extent of the erosion with regard to the German system of industrial relations and the works council element of co-determination.

major law in 1976, fundamental amendments have not occurred. Consequently, the state has not initiated a process of erosion through legislative means.

### **Implications of the endowment effect for the first objection**

The first objection to co-determination, articulated earlier, is that authority-based relations, inherent to the right to manage, are chosen by the two parties. The 'stickiness' of the right to manage default in practice, in remaining with management, therefore reflects what the parties want. The assumption is that the default has neutral effects on party preferences. However, several meta-studies (Horowitz and McConnell 2002; Sayman and Onculer 2005; Tuncel and Hammitt 2014) show that preferences are generally not independent of endowments. What holds true generally almost certainly holds true for managers specifically.

Turning to Germany, workplaces there do not have works councils from the outset. Thus, the initial endowment situation at shop-floor level is one where managers exercise relatively unimpeded authority, subject only to statutes and collective agreements. The *Works Constitution Act 1976* entitles employees in all German establishments with five or more employees to have a works council on employee request. However, works councils in Germany critically depend on employer support to succeed, but that support is frequently absent, especially in the early stages (Backes-Gellner *et al.* 2015; Jirjahn 2003; Jirjahn and Smith 2005; Pfeifer 2011, 2014). The country's *Works Constitution Act 1976* officially prohibits managers from obstructing works councils, harassing, intimidating, or dismissing councillors, and interfering with elections, but studies show that managerial hostility is common and can discourage employees from establishing a new works council and compel them to withdraw from, and/or dissolve, an existing one. When opposition occurs, works councils in Germany can find it difficult to make and/or implement decisions, and councillors can find it hard to cope with the pressure (Bormann 2007; Polzer and Helm 2000,

Rheinisches Journalistinnenbuero 1987; Rudolph and Wassermann 1996). Such hostility helps explain why 40 percent of works councils in Germany are discontinued within the first two years (Jirjahn and Mohrenweiser 2015).

Evidence from Germany also indicates that resistance to works councils is much stronger in owner-managed than in professionally-managed firms. Owner-managed firms are more likely to suppress works councils (Behrens and Dribbusch 2014) and ensure that they have less influence over decisions (Jirjahn *et al.* 2011). Most importantly, the odds of a works council being introduced are more than 40 percent lower, and the odds of a recently adopted works council being dissolved are nearly 200 percent higher, in owner-managed firms (Jirjahn and Mohrenweiser 2015: 13). As Jirjahn and Mohrenweiser (2015) point out, this was the case even where works councils improved profitability. There is also evidence that managerial attitudes to co-determination can, and do, soften substantially over time. For instance, most executives at larger German firms, who have experienced co-determination at first-hand, accept and support the existence of labour directors (Paster 2011). In such cases, works councils have become part of the *endowed* decision-making apparatus after a period of some use.

Findings of management resistance to works councils in Germany are consistent with Fehr *et al.* (2013), who showed that principals retain authority in an agency relationship, even when they would profit from greater power-sharing. The traditional explanation for such behaviour is management's 'taste for power', where decision-making rights are viewed as having their own intrinsic value (Bartling *et al.* 2014). We argue that such tastes derive, at least partly, from an endowment effect, acutely manifested at the early stages of establishing a works council, when power is first shared with workers. Moreover, owner-managers, with even stronger attachment to the firm, experience this endowment effect even more strongly. Once power-sharing becomes routinised, the sense of loss subsides and managements gradually come to accept the new endowment situation, with co-



determination as the *status quo* for their reference point. Such contexts provide the opportunity for capital to accept co-determination as a positive-sum game with institutionalised 'mutual gains'.

Overall, the logic of the endowment effect and associated empirical evidence suggest that preferences are very malleable and highly context dependent. It follows that the failure of employers and employees to negotiate around the right to manage should not be construed as what management wants, or is prepared to accept, in all situations and forever. These are likely to be influenced by initial endowments.

### **Implications of the endowment effect for the second objection**

The fact that the right to manage default is retained and defended by employers, and not usually coveted by employees, does not necessarily mean that it is efficient. According to Coase (1960), the party with the more efficient use of a given right (or resource or entitlement) should be prepared to pay more to acquire it. However, the endowment effect necessarily means that WTP and WTA prices differ: how much each party is prepared to pay depends upon whether that party is currently endowed with the default (Sunstein 2002). If employers were not endowed with the right to manage, we would expect them to value it much less. Thus, the parties' willingness-to-pay, as expressed via their WTA or WTP prices, is unlikely to reliably indicate what is efficient. In particular, a comparison of the employer's WTA price with the employee's WTP price is unlikely to reveal which party truly values the default more.

Both theory and evidence cast serious doubt on whether managerial opposition to co-determination is efficient and thus rational, in terms of the Coase Theorem. Thus, recent econometric research regarding Germany has linked works councils, specifically, to a range of positive organizational outcomes, including lower staff turnover (Frick 2007), higher productivity (Brändle 2017; Hübler

2015; Jirjahn and Muller 2014; Muller 2012, 2015) and higher profitability (Mohrenweiser and Zwick 2009; Mueller 2011; Zwick 2007). Most importantly, the overall effect of works councils on profit is positive across large samples of companies (Mohrenweiser and Zwick 2009; Mueller 2011). Although some earlier studies showed a negative link with profitability, Mueller (2011) attributes such results to the use of data on managerial opinions or impressions; using actual profit data, he shows that the link is, indeed, positive. Moreover, Müller and Stegmaier (2017) discerned a number of reasons for managerial resistance to works councils in Germany, such as entrepreneurial freedom and short-termism, that are consistent with the endowment effect. Surveying the wider European terrain, Osterloh *et al.* (2011:339) found that countries with 'far-reaching co-determination laws generally had better economic performance in terms of employment, labour productivity, research investment, and labour peace.'<sup>6</sup>

Co-determination generally contributes positively to firm performance in two important ways (Freeman and Lazear 1995). First, co-determination's institutions provide fora for the exchange of ideas and information, enabling managers to explain and canvas support for their plans and decisions while workers voice their feedback and have the opportunity to propose their own ideas and initiatives. Second, the experience of joint decision-making provides capital and labour with opportunities to build a better, more trusting, more cooperative, and ultimately more productive relationship as explicitly envisaged at the beginning of successive iterations of the German *Betriebsverfassungsgesetz* (*Works Constitution Act*). However, the central point is not that codetermination is always more efficient than a pure form of hierarchical governance. Rather, the clear lesson from theory and evidence is that a right to manage cannot be easily defended on utilitarian grounds as always, or even usually, economically optimal.

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<sup>6</sup> European countries have, in the post-Global Financial Crisis period, nevertheless struggled with economic problems, such as unemployment and low growth. These have chiefly emanated from the contractionary effects of budgetary austerity, most dramatically in Greece, as well as the difficulties of regaining export competitiveness because of common adoption of the Euro.

## Conclusions

Using the case of Germany, we have argued that managerial opposition to co-determination derives, in considerable part, from the endowment effect. Thus, management preferences for or against co-determination are strongly influenced by the current endowment situation, which strongly favours managerial prerogative as the default, and so any systemic infringement of this default like co-determination is likely to be viewed as an attempt to revoke this right. Moreover, attachment to this *status quo* is likely to be more a function of loss aversion in conditions of uncertainty than a genuine, independent choice of a more efficient or harmonious relationship. Thus, the two neo-liberal objections to co-determination are fundamentally flawed, failing to account for how human beings actually think and behave. Deploying these insights from behavioural economics provides a more robust explanation of management's attachment to its prerogative than those that focus upon the factors like unitarist ideology. Indeed, such accounts could be understood as the product of the endowment effect, rather than separate competing explanations of managerial behaviour.

Profit maximisation also provides a poor explanation for managerial opposition to co-determination. Profit maximisation is a seemingly simple matter, in principle, but a complex goal to pursue in practice (Müller and Stegmaier 2017). Markets are characterised by uncertain prices and quantities for both inputs and outputs; workers have uncertain actual and potential performance characteristics when first hired; and firms are characterised by a diverse range of specialist workers and managers, often in different departments (e.g., accounting and finance, investment and planning, operations and production, purchasing, marketing and sales etc.). Each specialist function is but part of an overall, complex social process, with some functions nearer the point where surplus value (profit) is realised than others. So, line managers in, say, production cannot with any certainty ensure that increased productivity will bring about increased profitability. Moreover, each

department or function has an internal hierarchy, again placing the bulk of managers further away from responsibility for profit realisation. This suggests that managers have other objectives that are more short- and medium-term in nature and, at best, many are imperfect cyphers for profitability. This is all the more true in non-profit organisations. Streeck (1997, 2004) has not only held that conventional economic explanations of management opposition to co-determination and other labour reforms are overly rational but that external constraints upon managers can be beneficial, citing examples of legislative (and social) changes, which were initially rejected by employers, but later transformed into sources of competitive advantage.

For researchers of employment relations, the main implication of these conclusions is that management, as the primary agent within the employment relationship under capitalism, should be seen as being less offensive, more reactive and less innovative than is generally held to be the case in regard of having the power of initiative that stems from the right to manage (contra unions being perceived to be secondary agents and, thus, primarily defensive and reactive). This focus upon power, particularly through the power of initiative and combining aspects of all three dimensions of power - coercive force, agenda-setting and defining interests (Lukes 1974, 2005), suggests that to more fully study and understand the motivations behind management actions requires that the defence of power - and defence of the power to act – be put on a more equal footing alongside the other key salient meta-aspects, namely, ideology and material interests, when researching employment relations.

In policy terms, if co-determination is to experience a renaissance in some countries or be initiated for the first time in others, it needs strong support via state intervention, which is currently conspicuously absent and viewed as somewhat undesirable in much mainstream political discourse. Co-determination is unlikely to be widely adopted on a voluntary basis in any country, as long as the right to manage is the default. The case of Britain is illustrative. Then British Prime Minister, Theresa

May, announced in 2016 her plan to legislate for the creation of a single worker director in each large company. This plan was shelved within six months following lobbying from employers and replaced by a government policy of allowing companies to facilitate the representation of employee interests at board level in whatever manner they saw fit. Following this reversal just four companies created worker directors, adding to the one already existing company and only a dozen companies have appointed non-executive directors to represent employees' interests. Indeed, the longer historical record - like that of the inter-war years - suggests management is only prepared to make concessions to ultimately try to preserve its power and authority when under pressure from workers (see Ramsay 1977 contra Marchington *et al.* 1992), and many believe that we will not live in such times for the foreseeable future. Nonetheless, reducing resistance to proposals for change could be addressed through both political/normative and legislative means. At the political level, advocates of co-determination's benefits might find our conclusion useful in the current context, in which political rhetoric about the negative effects of regulating small- and medium-sized enterprises has primarily informed the deregulation of labour law (Schömann 2015). Indeed, Streeck (1997; 2004) draws attention to a need for 'educating capitalists' on the benefits of co-determination. In legal terms, the German *Works Constitution Act* and its equivalents in other countries need to provide more support for those attempting to initiate a works council. They also need more effective penalties against those who defy existing legal provisions that forbid employer interference at the formation stage. Such regulation should minimise employer opposition (Backes-Gellner *et al.* 2015).

Despite the continued domination of neo-liberalism, conceivably, the timing is now right for a new agenda to emerge. Hyman (2015:18) argued after the global financial crisis there has been much discussion of the deficiencies in existing systems of corporate governance, particularly as the liberalization of global financial transactions has made 'shareholder value' the overriding corporate goal even in 'coordinated' market economies. This, perhaps, opens the door to corporate social responsibility extending its remit to taking on board the merits of the case for co-determination. An

example of this comes not just from US Senator Bernie Sanders, the perennial social democratic contender for the Democratic presidential nomination but also from US Senator, former legal scholar and mainstream contender for the Democratic nomination for the 2020 presidential election, Elizabeth Warren. Her 2018 *Accountable Capitalism Bill* laid before the United States Congress stipulates that employees elect 40% of board of directors of any corporation with over \$1 billion in tax receipts.

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