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WHAT TRIGGERS THE ESTABLISHMENT OF A WORKS COUNCIL? *

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ABSTRACT

This paper analyses events that trigger the establishment of a works council and the actor or agent who triggers it. The paper extends previous research in two dimensions. First, we examine specific events that motivate workers to establish a works council, such as a change of owner, founding a spin-off, a firm-acquisition or a radical restructuring. These events express risk protection as workers' primary motivation for establishing a works council. Second, we analyse the actor or agent who triggers the establishment of a works council and show that management is involved in one third of all cases and has, in a minority of cases, motivated workers to establish a works council. Managerial involvement in the process of establishment reveals a positive managerial response to worker representation.

JEL Classification: J53, J32, J83, M54

Keywords: co-determination, workers voice, establishment of a works council

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INTRODUCTION

German works councils attract a lot of attention as plant-level worker representation because works councils are generally considered to promote industrial democracy, improve working life and benefit economic performance (Frege 2002, Addison et al. 2004, Addison 2009, Jirjahn 2009). Therefore, the EU's 2002 Information and Consultation of Employees Directive requires similar plant-level employee representations in European countries (Hall 2006). Although a long tradition of research has investigated the determinants and effects of works councils, we do not know much about the reasons and circumstances that trigger the establishment of a works council. This paper examines events that trigger the establishment of a works council and the actor or agent who trigger it.

Previous studies argue that employees establish a works council to limit the opportunistic behaviour of employers (Jirjahn 2009). Because this behaviour more likely occurs during an economic crisis than a boom of the firm, Jirjahn (2009) and Kraft and Lang (2008) show that works councils are likely to be established when a firm faces a poor profit situation and a decline in employment. We extend these previous studies in two dimensions.

First, we derive specific trigger events that motivate workers to establish a works council and that are likely to occur but do not only occur during an economic crisis faced by a firm. The paper shows that a change of the owner increases the probability of establishing a works council. A new owner may mark a change in the working conditions, leadership and compensation schemes of a plant. Workers who worked at a plant because the working conditions and the leadership of the former owner fit their preferences are now unsatisfied and willing to establish a works council. Moreover, founding a spin-off and a radical restructuring can indicate changing working conditions and can threat the security of workplaces, both of which trigger the establishment of a works council. In both situations, works councils are an instrument of risk protection, i.e. the risk of loosing the workplace or deteriorating working conditions. Thus, the result supports and specifies previous findings that works councils protect workers against the risk of employer opportunism; in particular, they overcome information asymmetries, enforce implicit arrangements and enhance workers' bargaining power. While risk protection is the underlying reason for workers to establish a works council, specific events such as an owner change and a restructuring trigger the establishment at a particular time.

Moreover, the paper shows that a firm-acquisition increases the probability of establishing a works council. Here, the buying plant may already have a works council or different working

conditions and cooperative cultures. Such differences between both firms lead to conflicts which cause the establishing of a works council. Furthermore, the panel design of our study shows a clear pattern of newly established works councils over the business cycle after controlling for specific trigger events. Works councils are more likely to be established during a sector-wide economic downturn than a boom.

Second, we examine the actor or agent who triggers the establishment of a works council. Establishing a works council in conjunction with or against the will of the management reveals the managerial attitude and managerial response to worker representation. In particular, previous studies assume, due to the lack of data, that only workers alone establish the works council. On the contrary, we have information about the initiator of the establishing process, and we show that the management is involved in around one third of all cases and has in a minority of cases motivated workers to establish a works council. This finding allows differentiations about the quality of intra-firm industrial relations, specifically, managerial response, which is considered the most important factor in collective voice theory (Freeman and Medoff 1984, Bryson 2004, Addison 2009).

The remainder of this paper is structured as follows: first, we present an overview of institutions, discuss motivations for establishing a works council and derive our main hypotheses (section 2). Then, we describe our data and variables (section 3). Afterwards, we present our results on trigger agents and trigger events (section 4) and then conclude and discuss the generalisation of our results to other countries (section 5).

INSTITUTIONS, THEORY AND HYPOTHESES

Institutional Framework

Works councils' rights are laid down in the Works Constitution Act, stating that councils shall be elected by the workers of firms with five or more employees.[1] Although their creation depends on the initiative of firm's employees, councils are not present in all eligible firms. Works councils have full codetermination rights (participation or veto rights) on a set of issues, including the introduction of new payment methods, overtime work, and the use of technical devices designed to monitor employee performance. They have weaker consultation rights in matters such as changes in equipment and working methods that affect job requirements. Their information rights cover financial and economic matters (Hübler and Jirjahn 2003, Addison 2009).

Even if only workers can establish a works council, case studies show that managers also sometimes motivate workers to establish a works council or that management and workers cooperate in its establishment (Schlömer et al. 2007). Therefore, we discuss the motivation and trigger events for establishing a works council for both agents, the workforce and the management.

Risk Protection as Workers Motivation

For workers, works councils are an instrument to protect workers against employer opportunism, in particular, works councils can discipline managers for breaking implicit arrangements about compensation schemes, working conditions, fringe benefits, cooperative culture and leadership (Smith 1991, Freeman and Lazear 1995, Kaufman and Levine 2000, Jirjahn 2009). Implicit contracts are common in employment relations, which are characterised by information asymmetries (Hogan 2001). Although implicit contracts are usually self-enforcing due to reputation mechanisms, employers and employees may cooperate initially, but the employer may be tempted to renege on the promises made to the employees. Employers can behave opportunistically with respect to information, payment, employment and working conditions (Freeman and Lazear 1995, Ramey and Watson, 1997, Betrand 2004, Jirjahn 2009).

In this framework, each offered job includes an implicit contract about certain working conditions, compensation schemes and a cooperative culture, arrangements that are neither contractible nor enforceable and are therefore implicit. An implicit contract is broken when managers announce lay-offs, cancel fringe benefits or increase the workload, to name a few. Then workers demand an institution that protects their interests which are not legally enforceable. Works councils are an instrument for risk protection because works councils have legal co-determination rights on personnel issues. These statutory rights reduce uncertainty and the risk of arbitrary management decisions, making works councils an instrument to safeguard workers' interests. Legal co-determination rights can discipline managers for breaking the implicit contract.

Managers may have reasonable arguments for cancelling an implicit contract; for instance, competition and innovation force a restructuring, or the economic situation no longer allows paying fringe benefits. However, as long as workers cannot evaluate whether the economic situation requires such concessions by workers or whether managers only want to increase their rent share on workers costs (information asymmetry), workers will be inclined to

establish a works council because works councils have legal access to information on financial and economic matters and legal bargaining power to enforce the implicit contract. Thus, organisational shocks such as a restructuring, a partial plant closure and founding a spin-off are events triggering the establishment of a works council basing on risk protection.

Furthermore, an owner change can break the implicit contract. A new owner can introduce a new cooperative culture, change compensation and working conditions, but the conditions of the former owner fit workers preferences, causing workers to resist these changes. The resentment can lead to the wish of legal co-determination that protects workers' interests. A works council enhances workers' bargaining power and enforces implicit contracts by penalising the firm for breaching the implicit contract. Thus, an owner change can trigger the establishment of a works council basing on risk protection.

These events or organisational shocks likely causes the establishment of a works council, as breaking implicit contracts constitutes a pecuniary or non-pecuniary utility loss for workers. A sufficiently strong utility loss can motivate workers to call for action, as behavioural economists have shown. Because workers value a potential loss higher as a similar gain conditioned to a certain reference point, this so-called loss aversion is more likely to trigger an action than a similar utility gain (Tversky and Kahneman 1991, Kahneman et al. 1991). In our case, customised working conditions are the reference point, and a strong deterioration of working conditions is a reasonable trigger event causing workers to act and establish a works council. Loss aversion can explain why risk protection is a more prevalent motivation than a similar possible wage increase.

Workers demand risk protection when an implicit contract between management and workforce requires renegotiations. Employers likely break an implicit contract when an organisational shock, such as a restructuring, or an owner change occurs. Breaking the implicit contract causes a pecuniary or non-pecuniary utility loss through deteriorating working conditions for instance. This utility loss can trigger the establishment of a works council by workers.

Solving the Commitment Problem as Managerial Motivation

For managers, solving commitment problems is the main advantage of works councils. Even if only workers can legally establish a works council, solving the commitment problem can be a motivation for managers to support the establishment. Commitment problems can arise in a variety of situations. Workers may withhold information about potentially performance-

enhancing innovations when they fear that the employer might use the information about innovations to their disadvantage though actions such as the intensification of the workload or job cuts (Jirjahn et al. 2009). Moreover, employees may refuse concessions even when those concessions may be necessary to overcome a crisis of the firm if employees fear that the employer overstates the crisis to demand greater concessions (Jirjahn and Smith 2006).

Works councils can solve commitment problems and create trustful employment relations and cooperation, which enables effective communication and increases the legitimacy of management decisions (Hall et al. 2007). Therefore, employees are willing to share their ideas for improving the efficiency of production. Furthermore, works councils increase work satisfaction (Cornelissen et al. 2008), which leads to a reduction in quitting. Lower turnover suggests lower hiring and training costs and less disruption in the functioning of works groups. The likelihood that workers and firms remain together for a long period increases the incentive for investments in skills specific to the enterprise, which also raises productivity (Freeman and Medoff 1984).

However, employee involvement gives workers a stronger bargaining position to renegotiate firm's rents. Rent redistribution is the main reason why managers oppose the establishment of a works council, particularly when the expected increase of the rent share for the workforce offsets the expected increase in total rent (Freeman and Lazear 1995). Although works councils have no legal right to strike, it can still increase workers' bargaining power using their veto rights or delaying decisions where participation and consultation rights prevail (Visser 1995, Nienhueser 2009). Moreover, management needs additional time for preparing consultations and persuading works councillors (Hall et al. 2007).

When managers expect that productivity enhancement, due to solving commitment problems, outweigh expected losses, due to rent redistribution and the loss of control in decision making, they support or motivate workers in the establishment of a works council.

DATA AND VARIABLES

Data-Sets

We use two data sources to analyse events that trigger the establishment of a works council and the agent who triggers it. The IfM Bonn Works Council Survey allows in-depth descriptions of the establishing process regarding the trigger event and the agent but does not include questions about these events for firms that did not establish a works council and does

not include a time dimension. We thus turn to the IAB Establishment Panel and estimate the influence of an organisational shock on the probability of establishing a works council.

The IfM Bonn Works Council Survey is a unique cross-section dataset about co-determination in small- and medium-sized companies in Germany. The unique feature of this survey is a set of questions about the establishment of a works council. All firms covered by a works council report the trigger event, trigger agent and year of establishment. The dataset is representative of firms with 20 to 500 employees and was collected by the Small and Medium Size Enterprise Research Institute in 2005 (Institut für Mittelstandsforschung – IfM; for a detailed data description, see Schlömer et al., 2007). Because the survey was collected in 2005, several years after most works council were established, we drop all firms where the manager reports that he or she cannot remember or was not in charge at the time of establishment. Furthermore, we restrict the sample to firms that established their works councils between 2001 and 2005. We draw this sub-sample because these firms also report the number of employees at the time of establishment, which is necessary for subsequent regression analyses. This restriction yields a sample of 60 firms that established a works council between 2001 and 2005.

The IAB Establishment Panel is a representative survey based on a stratified random sample from the population of all German establishments. We use the waves 1999-2007 of this panel in which information about works council status, organisational shocks, and other firm characteristics for each firm are available (for a data description, see Jacobebbinghaus 2008).[2] We match growth data downloaded from the Federal Statistical Office. We drop non-profit and agriculture firms as well as all firms with more than one change in their works council status and all firms that switched from having to not having a works council. Furthermore, we drop all firms with fewer than five employees because of the legal threshold for establishing a works council.

We use the IfM Bonn Works Council Survey for detailed descriptive analyses and the IAB Establishment Panel for our main regressions so that we derive our variables for the latter dataset.

Dependent Variable

We identify all firms that do not have a works council in the previous year but report to be covered by a works council in the following year as newly established works councils. The probability of establishing a works council for a random uncovered firm is around 1 percent.

Even if the establishment of a works council is a rare event, we identify 273 newly established works councils in the IAB Establishment Panel. The control group contains all firms that have not established a works council between two observation periods. Table A2 in the appendix shows descriptive statistics of newly established works councils.

Explanatory Variables:

Several variables capture the trigger events based on risk protection. First, we define a set of dummy variables for organisational shocks that directly influence the security of workplaces, such as a partial plant closure, an outsourcing or a spin-off of a part of the firm. These relatively rare events threaten the workplace security as a part of the implicit contract and therefore should present a strong incentive for workers to establish a works council. Second, a radical reorganisation breaks the implicit contract between workers and management when it entails job cuts and worsens working conditions.

Third, an owner change can threaten the implicit contract when new owners change working conditions but workers stay at the firm because working conditions under the old owner fit their preferences. Moreover, new owners may cut fringe benefits so that workers suspect losing the rents that they have created with their effort to the new owner. We define an owner change when a firm was a single-site firm in the previous year and is a branch of a larger company in the next year.

In addition to these trigger events, we check the determinants of establishing a works council that are used in previous studies. A bad economic perspective lowers profits and can force managers to announce wage cuts and to urge workers to increase their effort, all of which threaten the implicit contract (Jirjahn 2009). Similar to Kraft and Lang (2008) and Jirjahn (2009), we use plant-level employment growth as an indicator for a bad economic situation, defined as the percentage increase or decrease in the previous year employees. In addition, we distinguish between plant-level and sector-level downturn. Because sector-wide downturns are frequently reported in media, workers may react differentially when only the plant or the entire sector faces a downturn. We measure the sector-wide economic situation with the deviation from the mean growth for each sector and year. This variable additionally enables the measurement of the establishment of works councils over the business cycle. A negative deviation from the sectoral mean growth in a particular year should be correlated with a higher probability of establishing a works council. Note that the deviation from sectoral mean

growth is independent of plant-level trigger events, which can occur in good as well as in bad times.

Control Variables

In addition to our variables of key interest, we control for other variables that determine the establishment of a works council (Kraft and Lang 2008, Jirjahn 2009). Firm size may have a positive influence on the establishment of a works council. The number of employees indicates a more complex and hierarchical organisation, where councils mitigate transaction costs. Moreover, the legal rights of works councils are stronger in larger firms, and the stronger rights might increase workers' incentives for establishing a works council (Jirjahn 2009). Furthermore, we include several variables for the composition of the workforce and take into account that different types of workers may differ in their taste for representation. Skilled workers may be more likely to establish a works council than unskilled workers because their firm-specific human-capital investments are threatened by job loss. In contrast, works councils face difficulties in effectively representing part-time employees (Jirjahn and Smith 2006).

Furthermore, variables that influence the coverage of works councils can also influence the establishment; for example, East German firms tend to have a lower probability of coverage, and older firms have a higher probability (Zwick 2004). Moreover, we include a dummy for payment above the collective agreement and the presence of a collective bargaining agreement. Hübler and Jirjahn (2003) show that collective bargaining coverage discourages workers from adopting a council because it limits the scope for plant-level bargaining. Accordingly, firms switching to collective bargaining might discourage workers from establishing a works council. Furthermore, export-oriented firms, a common proxy for international competitiveness, and firms with higher investments per capita, a common proxy for capital stock, usually make higher investments in human capital, which make earning losses larger when leaving the firm (Zwick 2004). Moreover, the legal form and the ownership status of a firm may have an influence on the probability that the management break the implicit contract (Jirjahn 2009).

FINDINGS

Using the IfM Bonn works council survey, we present descriptive evidence about specific trigger events bringing about the establishment of a works council. We then present the agents who triggered the establishment and examine correlations between the two. Afterwards, we turn to the IAB Establishment Panel and analyse the role of these trigger events on the probability of establishing a works council comparing firms that have established a works council with firms that have not.

Trigger Events

The IfM Bonn Works Council Survey asks managers about specific events that triggered the establishment of their works council. Managers report that organisational shocks are a relevant trigger in 43 percent (table 1). The most important organisational shock is a change of the owner (32 percent).[3] Workers thus seem to consider a new owner as a menace to the implicit contract. Workers, for instance, suspect that new owners cut fringe benefits, change working conditions and prefer a new management style, whereby the style and conditions of the former owner fitted workers' preferences.

Moreover, workers require risk protection when an organisational shock affects the security of workplaces, such as when mangers announce a radical reorganisation or a partial plant closure. Workers thus have an even stronger incentive for establishing a works council. These events naturally happen seldom but are frequently identified as trigger events. A partial plant closure triggers the establishment of a works council in 3 percent and a radical restructuring in 15 percent of all cases.[4] Workers are willing to protect their interests, in particular, enforce an implicit contract and reduce information asymmetries, when an organisational shock occurs or the owner changes.

On the contrary, the second category "workers voice" (58 percent) cannot unambiguously be assigned to risk protection. For example, the sub-category "conflicts between management and workers" (10 percent) can either result from risk protection spurred by something like management's plan for cancelling fringe benefits or from workers' strategy for enhancing workers' rent-share. A similar argument holds true for the sub-categories "workers want more codetermination" (18 percent) and "the management knows no reason why workers have established a works council" (27 percent). In contrast, the last sub-category, "new workers with works council experience," means that newly hired employees who previously worked at a firm covered by a works council convinced their co-workers to establish a works council

(13 percent). This category describes a network effect, where the idea of co-determination spreads to other firms in a certain region and industry. This idea is frequently used to instrument works councils in studies of economic effects of works councils (Mueller 2009).

The third category, "managerial communication" (22 percent) refers to answers where the management is explicitly named to be involved in the establishing process. The first sub-category "management demand a fixed representative" (13 percent) suggests that managers demand the council's mediation role. The council's mediation role avoids transaction costs and solves commitment problems. These reasons may also play a role in the second and third sub-categories "managers want to improve productivity and motivation" (13 and 5 percent, respectively). These sub-categories additionally refer to the argument that works councils enhance the size of the enterprise pie.

In addition, the questionnaire allows multiple answers, and one third of the respondents marked off more than one trigger event. For example, 14 of the 35 respondents of "workers voice" also identify the organisational shock of a "new owner" as a specific trigger event. In these cases, an owner change also leads to conflicts between management and workers or the new owner does not know why the workers establish a works council after the owner changes. Such multiple answers support the idea that risk protection spurred by enforcing the implicit contract is a prevalent trigger. Otherwise, the productivity enhancement argument of works councils seems to be a relevant trigger in a minority of cases.

Trigger Agents

Our data additionally allow identifying trigger agents, which provide a more comprehensive insight into the establishing process. Even though only workers can formally establish a works council, managers can support the establishment of a works council. Management support reveals a positive attitude of those mangers towards employee representation. As a result, these works councils should have more positive effects, such as increasing firm-performance and reducing turnover, because managerial response to workers voice is generally considered as a key factor for beneficial employee representation (Freeman and Medoff 1984, Bryson 2004). Managers are involved in the establishment of works councils in about one third of cases (table 2). In these firms, managers actively want to moderate an intra-firm industrial relations change once workers show interest in plant-level codetermination. Furthermore, management itself encourages workers to establish a works council in approximately 7 percent of all cases. Management motivations for establishing worker

representation are described in a case study by Schlömer et al. (2007). They cite a manager who knows the positive effects of a works council, particularly the mediation role of works councillors, from his previous job. To take advantage of worker representatives, he motivates the workforce to establish a works council in his new firm. Nevertheless, workers alone trigger the establishment in the majority of all cases. Our results show that both workforce alone and workforce in conjunction with management are prevalent initiators of council establishment.

We can also calculate descriptive statistics on the trigger events and agents for the entire sample, but the retrospective nature of the questions may cause recall problems for respondents and bias the results. For instance, we can show that the number of firms where managers was involved in the establishment process or have motivated workers to establish the works council significantly increase when the time span between the establishment of the works council and the survey increases. This finding may be a tribute to good employment relations in those firms, where managers cannot imagine that they oppose employee representation.[5]

Associations between Trigger Events and Trigger Agents

In addition, we examine associations between trigger events and agents. Table 3 shows that workers alone are likely to establish a works council if an organisational shock occurs and workers want more voice. On the contrary, table 3 also confirms that managerial involvement is associated with management's demand for a fixed representative and their desire to improve productivity and motivation.

Furthermore, we validate these correlations using a multivariate framework, whereby we control for additional variables that also influence the probability that workers alone establish a works council.[6] Table 4 shows the marginal effects after probit and supports the descriptive findings. The variables of primary interest, an organisational shock and voice requirements, increase the probability that workers alone establish of a works council. An organisational shock increases this probability by 48 percent when we control for managerial attitude towards employee participation at the time of establishment (column 3). Furthermore, a positive managerial attitude decreases the probability that workforce alone calls for election, that is, an increasing probability that managers are involved in the establishment process. However, managerial attitude is highly endogenous and should be interpreted with caution.

All other variables are insignificant when we control for the managerial attitude towards employee representation at the time of establishment.

The IfM Bonn works council survey directly asked managers of firms that have introduced a works council about the trigger event. Unfortunately, this data set includes no information about a change of the owner or a restructuring in firms that have not introduced a works council. We thus turn to the IAB Establishment Panel and analyse the relevance of these trigger events comparing firms that have introduced a works council and that one that have not.

Trigger Events: Comparison to Uncovered Firms

The IAB Establishment Panel defines the trigger events slightly differently. First, the data entail additional categories, outsourcing, firm-acquisition and spin-offs. Second, the definition of the reorganisation differs so that we can only identify when a reorganisation occurs rather than a radical one. Therefore, a larger proportion of firms should report such reorganisation. Third, the data only allow an indirect measure of an owner change. We define an owner change when a firm was a single-site firm in the last year and is now a branch of a company. Note that this definition captures only a part of the owner changes of the IfM Bonn Works Council survey. Additionally, we measure the employment growth, which is identified in previous studies as a prevalent trigger, and the deviation from sectoral mean GDP growth in the previous year, which shows the development of newly established works councils over the business cycle.

Table 5 presents the descriptive statistics of the trigger events in the IAB Establishment Panel. Each organisational shock occurs more frequently in firms with newly established works councils than in a firm without one. For instance, reorganisations occur in 13 percent of all non-treated firms but in 25 percent of the treated firms. Otherwise, a spin-off is seldom founded but occurs 5 times more often in firms with newly established works councils than in firms without one. Similar, a new owner occurs three times and a firm acquisition and outsourcing 2 times more often in firms with newly established works councils than in firms without a works council. Furthermore, works councils are established when the sectoral growth in the preceding year was 0.53 percentage points lower than average.

Table 6 presents the marginal effects of the determinants of establishing a works council after probit. The occurrence of an organisational shock has a significant positive effect on the probability of establishing a works council. The marginal effect is 0.35 percent on all

uncovered firms. This effect has to be compared with the probability of establishing a works council of 1.07 percent, which yield an influence of one third. Moreover, an owner change increases the probability of establishing a works council by 0.8 percent, although we can only indirectly measure a change of the owner in the IAB Establishment Panel. Workers may consider a new owner as a menace to the implicit contract.

Furthermore, we separate the organisational shock in 5 categories (table 7). Three shocks, a spin-off of a part of the firm, an acquisition of another firm and a reorganisation have a positive impact on the probability of establishing a works council. When a plant found a spin-off, the probability of establishing a works council increases by 0.18 percent. Workers in those plants may fear deteriorating working conditions or job cuts when jobs are transferred to a spin-off. Contrary, acquisition of another plant increases the probability of establishing a works council by 0.6 percent. In these cases, the insourced plant may already have a works council which spread to the buying plant. Furthermore, a restructuring increases the probability of establishing a works council by 0.3 percent. When a restructuring causes deteriorating working conditions or job losses, this breach of the implicit contract trigger the establishment of a works council. On the contrary, a partial plant closure and an outsourcing of a part of the firm have no significant effect. Altogether, the results support the hypothesis that risk protection is a prevalent motivation that employees establish a works council and a new owner, firm-acquisition, spin-off and a restructuring trigger the establishment of a works council based on risk protection.

Furthermore, breaking the implicit contract cannot only result from specific organisational shock events; additionally, a bad economic situation may force managers to cut fringe benefits or to demand higher effort levels from workers. We capture this source of breaking the implicit contract on the plant-level and on the sector-level. While plant-level employment changes has no effect after controlling for organisational shocks, the deviation from the average sectoral growth preceding the council's establishment has a significant negative impact on the probability of establishing a works council. This measure takes into account a different economic growth between industries, whereby the average sectoral growth is the reference point. A negative deviation means that the sectoral growth rate is lower than the average of the sector during the last years and, vice versa, a positive deviation represents a higher one. An 1 percent lower than average growth in the previous year increases the probability of establishing a works council by about 0.1 percent. Figure 1 supports this interpretation. In figure 1, we plot the yearly number of newly established works councils and the previous year GDP growth. A higher GDP growth in the previous year is associated with a

lower number of newly established works councils and vice versa.[7] Works councils are more likely established during economic recessions than during boom periods after controlling for explicit organisational shocks.

The control variables have the expected signs. The firm size shows a positive concave shape. An increasing number of employees indicate a more complex and hierarchical organisation in which a higher need of communication increases works council's benefits, such as the mitigation of transaction costs. The finding shows that the increasing coverage of works councils by firm size stems not only from the fact that firms with a works council grow, but also that large uncovered firms are more likely to establish a works council than small uncovered firms. This relation is illustrated in figure 2. The probability of establishing a works council increases from less than a half of a percent in the smallest eligible firms to around 6 percent in firms of around 500 employees. Therefore, larger firms have a higher probability of having a works council, and the remaining uncovered firms have a higher probability of establishing a works council.

Furthermore, the proportion of part-time workers has a negative impact on the probability of establishing a works council, which confirms recent findings that councils face difficulties in effectively representing part-time employees. Moreover, firms covered by a collective agreement are more likely to establish a works council than firms without a collective agreement. Furthermore, limited firms have a positive influence on the probability of establishing a works council, and single site firms have a negative influence. Single-site firms may better reflect workers' interests than multi-site firms because mangers of multi-site firms have to consider different plants. Moreover, East German firms have a lower probability of establishing a works council which coincides with a lower incidence of works councils in East Germany than in West Germany. This finding does not support a convergence of industrial relations in both parts of Germany. Furthermore, the export share of total sales and the level of investment have no influence.

Robustness Checks

We run a series of robustness checks for the estimations of the trigger events using the IAB Establishment Panel. First, we test the influence of all key explanatory variables alone. Second, we repeat the estimation for West Germany only. Both tests confirm our findings. Third, we exclude the reorganisation dummy because this variable has the highest weight in the organisation shock and, more importantly, was not regularly asked in the IAB

Establishment Panel. Even if reorganisations are not asked about regularly, the construction of this question allows interpolation to previous years. Nevertheless, this measure may not be as precise as the others. Therefore, we run all regressions without the reorganisation dummy and get qualitatively and quantitatively similar results.

CONCLUSION AND DISCUSSION

This paper presents evidence for trigger events and trigger agents of establishing a works council. We show that a change of the owner and organisational shocks, such as firm-acquisition, the creation of a spin-off, or a restructuring of the firm, lead to a higher probability of establishing a works council. These trigger events support the story that workers demand works councils as an instrument of risk protection against deteriorating working conditions and to safeguard workplaces. Moreover, these trigger events extend recent findings that financial distress and declining employment causes the establishment of a works council because organisational shocks can occur in good and bad times. However, sector-wide economic downturn still has an effect on the probability of establishing a works council.

Moreover, we show that while the workforce alone is the most frequent trigger agent in about two thirds of all cases, management is involved in the other third and has in a minority of cases motivated workers to establish a works council. When managers are involved in the establishing process, intra-firm industrial relations may exhibit less conflict during and after the establishment of a works council.

Our findings are also relevant for other countries of the European Economic Area (EEA), which following adoption of the EU's 2002 Information and Consultation of Employees Directive (ICE), are now all required to have provisions for the establishment of representative structures for employee information and consultation within national undertakings i.e. at workplace and/or firm level. The rights specified in the Directive differ from the German Works Constitution Act, which provides more robust rights on the timing and quality of information provision, a more rigorous definition of consultation and, in addition, co-determination rights on a range of issues which in effect provide works councils with veto rights on personnel matters. These differences are likely to dilute the extent of the risk protection provided by national legislation introduced under the Directive as compared to Germany, and hence the incentive for workforces to seek the establishment of works council-type arrangements. Moreover, the Directive also provides considerable leeway for individual member states in framing their implementing national legislation (Carley and Hall 2008).

How far the findings of the present study are relevant to other EEA countries can be considered along two dimensions. The first is the robustness of information and consultation rights. Under Austrian and Dutch legislation, for example, these are equivalent to those specified in Germany. The same broadly applies to the rights of local trade organisations within firms under the basic agreements which govern industrial relations in the Nordic countries. In France and Spain, however, statutory consultation rights are weaker than in Germany – hence the rent protection incentive for workforce is reduced. In the UK and Ireland, where universal rights to employee information and consultation were unknown until the coming into force of national legislation implementing the EU directive (Hall 2006), the recent legislation's information rights are less precisely specified than in continental Western and Nordic Europe and consultation rights are weaker. Moreover, framing of the UK regulations leaves open the possibility for management and workforce representatives to negotiate 'private' arrangements outside of the formal procedures of the UK legislation. These so-called 'pre-existing' agreements (Hall 2006) do not necessarily have to meet the information and consultation standards specified in the UK legislation. Nonetheless, even in the UK and Ireland, the weaker consultation rights do not necessarily impinge on the potential for obtaining credible information about economic situation which are necessary to overcome the information asymmetries after an organisational shock. Therefore, a works council basing on the ICE Directive can also be an instrument for risk protection, for example, when the management cancel implicit contracts about fringe benefits or working conditions. Indeed, weaker co-determination rights may result in a weaker incentive for workforces to trigger the establishment of a works council. In other countries, management might be a relatively more prominent trigger agent in establishing a works council (cf. Hall et al. 2007 for the UK). Management incentives for promoting the establishment of works council-type arrangements are likely to be less impacted by these differences. Hence, in countries such as the UK and Ireland, management appears to be a relatively more prominent trigger agent (Hall et al. 2007).

The second dimension is the extent to which rights to information and consultation, and the corresponding works council-type structures, are well established and hence the likely costs and benefits well known to management and workers. In countries such as Germany, where the current legal framework has essentially been in place for more than half a century, then an equilibrium situation prevails. In contrast, where information and consultation rights have only recently been introduced, as in the UK, and a situation of transition prevails, both management and workforces have greater uncertainty about the potential costs and benefits

involved. Equilibrium means here especially that, on the one hand, workers and managers are aware of works councils' statutory rights. These rights are taught in Germany, for example, during the apprenticeship where two thirds of a birth cohort is trained. On the other, unions see works councils as a complementary industrial relation institution in Germany and this mutual recognition evolved over a long period accompanied by an intensive conflict (Mueller-Jentsch 1995). Nevertheless, the role of works councils in a historic developed country specific system of industrial relations is hard to predict and therefore country specific institutions do not allow a direct application of our results.

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Table 1: The Trigger Event for Establishing a Works Council[1]

		Observation	Percent
Organisational Shock		26	43.33
	New Owner	19	31.66
	Partial Plant Closure	2	3.33
	Radical Reorganisation	9	15.00
Workers Voice		35	58.33
	Conflicts between Management and the Workforce	6	10.00
	Workers want More Co-Determination	11	18.33
	New Workers with Works Council Experience	8	13.33
	Management Knows no Reason	16	26.66
Managerial Communication		13	21.66
	Improve Productivity	8	13.33
	Improve Motivation	3	5.00
	Need a Fixed Representative	8	13.33

Sample restriction: 60 firms that have established a works council between 2001 and 2005, answers were given by the managers and multiple answers were possible, source: IfM Bonn Works Council Survey 2005.

Table 2: The Trigger Agent for Establishing a Works Council

	Observations	Percent
Workforce Alone	37	61.67
Management Involved	19	31.67
Management Motivated	4	6.67

Sample restriction: 60 firms that have established a works council between 2001 and 2005, answers were given by managers; Source: IfM Bonn Works Council Survey 2005.

1 The classification in the three groups: managerial communication, workers voice and organisational shock, is based on logical connection, if the management was named in the question or if an organisational shock was asked. This classification cannot be obtained by a factor analyses because the most respondents tick only one possible answer and therefore a factor analyses can only be based on a minor sub-sample.

Table 3: Cross-Tabulation of Trigger Agent and Event Establishing a Works Council

		trigger event					
		Organisational Shock		Workers Voice		Managerial Communication	
trigger agent	Workforce Alone	18	0.42	25	0.58	0	0.00
		0.70		0.72		0.00	
	Management Involved	7	0.26	10	0.37	10	0.37
		0.27		0.28		0.77	
	Management Motivated	1	0.25	0	0.00	3	0.75
		0.03		0.00		0.23	

The trigger event question allowed for multiple answers; in each cell: top left = the number of cases; top right = the percentages of trigger agents (row); bottom left = the percentages of trigger events (column). Sample restriction: 60 firms that have established a works council between 2001 and 2005. Source: IfM Bonn Works Council Survey 2005.

Table 4: Relation between Trigger Agent and Trigger Event, Marginal Effects after Probit.

	Coef.	Z-Value	Coef.	Z-Value	Coef.	Z-Value
Dummy: Organisational Shock			0.3913	2.41 **	0.4773	2.66 **
Dummy: Workers Voice			0.5344	3.12 **	0.4384	2.26 **
Managerial Attitude towards Employee Representation					-0.3230	2.97 ***
Number of Employees	0.0042	1.74 *	0.0053	2.05 **	0.0040	1.45
Squared Number of Employees/1000	-0.0089	1.60	-0.0114	1.92 *	0.0000	1.13
Dummy: Owner-Manager	0.2742	1.66 *	0.2510	1.36	0.2524	1.29
Dummy: Single Site Firm	0.0119	0.08	0.0651	0.38	0.1399	0.78
Dummy: Located in East Germany	0.1809	1.14	0.1594	0.96	0.2467	1.57
Industry Dummies	yes		yes		yes	
Number of Establishments	60		60		60	
LR chi(2)	8.13		20.54		33.57	
Pseudo R^2	0.1018		0.2571		0.4202	
Log Likelihood	-35.87		-29.66		-23.15	

Dependent Variable: One = workforce alone triggers the establishment of the works council, Zero = managerial involvement during the establishing process. Marginal effects are calculated on the mean of the dependent variable. Sample restriction: firms that established a works council between 2001 and 2005; *, **, *** significant on the 10%, 5% or 1% level respectively. Source: IfM Bonn Works Council Survey 2005.

Table 5: Frequents of Trigger Events (IAB Establishment Panel)

	No Works Council	Newly Established Works Council
Organisational Shock	0.1685	0.3029
New Owner	0.0095	0.0293
Deviation from Sectoral Mean Growth	0.0332	-0.5310
Partial Plant Closure	0.0149	0.0147
Spin-off of a Part of the Establishment	0.0086	0.0403
Outsourcing of a Part of the Establishment	0.0048	0.0110
Firm-Acquisition	0.0218	0.0549
Reorganisation	0.1331	0.2518
Number of Observations	25366	274

Source: IAB Establishment Panel 1999-2007.

Table 6: Marginal Effects after Probit Regression of the Probability of Establishing a Works Council

	Coef.	Z-Value	Coef.	Z-Value
Organisational Shock	0.0035	2.82***		
New Owner	0.0082	1.83*		
Deviation from Sectoral Mean Growth	-0.0010	4.38***	-0.0010	4.40***
Firm-level Employment Growth	-0.0071	0.58	-0.0082	0.64
Number of Employees / 1000	0.0213	4.41***	0.0233	4.76***
Squared Numb. of Employees/1000	-0.0032	2.30**	-0.0036	2.53**
Share of Skilled Workers	-0.0019	1.00	-0.0019	1.00
Share of Apprentices	-0.0049	0.99	-0.0050	1.01
Share of Part-time Workers	-0.0063	2.45**	-0.0066	2.56**
Exportshare/ 1000	0.0082	0.28	0.0018	0.06
log(Investment per Capita)	-0.0001	1.01	-0.0001	0.76
Collective Agreement	0.0058	4.80***	0.0059	4.77***
Wages above Collective Level	0.0010	0.82	0.0010	0.83
Old Establishment	-0.0019	1.66	-0.0020	1.71*
Bad Economic Situation	0.00002	0.00	0.0002	0.20
East German Establishment	-0.0027	2.49**	-0.0028	2.52**
Single Site Firm	-0.0052	2.81***	-0.0054	2.92***
Limited Firm	0.0043	2.66***	0.0045	2.77***
Number of Observations	25558		25558	
Prob > chi2	0.0000		0.0000	
Pseudo R2	0.0848		0.0813	

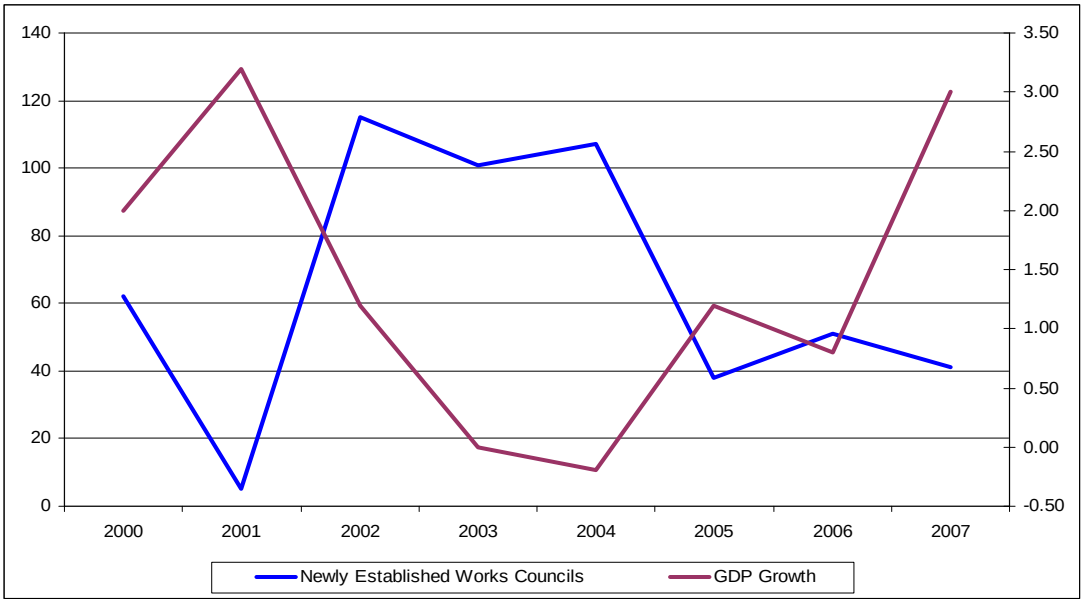
Dependent Variable: One = newly established works council, zero = no works council. Regression includes industry dummies. Standard Errors are clustered on Firm. Marginal effects are calculated on the mean of the dependent variable. Source: IAB Establishment Panel 1999-2007

Table 7: Probit Regression of the Probability of Establishing a Works Council

	Coef.	Z-Value
New Owner	0.0073	1.69*
Deviation from Sectoral Mean Growth	-0.0009	4.37***
Partial Plant Closure	-0.0025	0.81
Spin-off of a Part of the Establishment	0.0018	3.48***
Outsourcing of a Part of the Establishment	0.0043	0.69
Firm-Acquisition	0.0065	2.12**
Reorganisation	0.0031	2.39**
Number of Observations	25558	
Prob > chi2	0.0000	
Pseudo R2	0.0895	

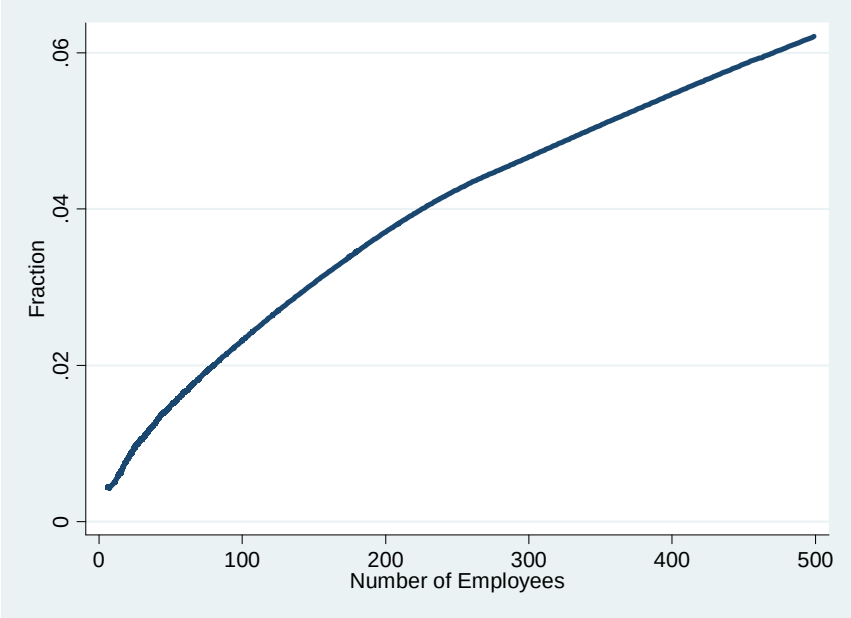
Dependent Variable: One = newly established works council, zero = no works council. The same control variables used as in table 6. Standard Errors are clustered on Establishment. Marginal effects are calculated on the mean of the dependent variable. Source: IAB Establishment Panel 1999-2007

Figure 1: Number of Newly Established Works Councils and the Business Cycle



Source: IAB Establishment Panel 1999-2007 (own calculations), Federal Office of Statistics.

Figure 2: Newly Established Works Council over Firm Size, Unconditioned Locally Weighted Regression



Source: IAB Establishment Panel 1999-2007. Note: The firm-size range is restricted to 500 employees because we observe too few bigger firms which have newly established a works council and therefore this estimator would not appropriate fit the extended firm size range.

APPENDIX

Table A1: Descriptive Statistics for the Estimation Sample of the IAB Establishment Panel.

	Mean	SD
Dependent Variable:		
Dummy: Newly Established Works Council	0.0107	0.1028
Explanatory Variables:		
Dummy: Organisational Shock	0.2337	0.4232
Partly Plant Closure	0.0149	0.1213
Spin-off of a Part of the Establishment	0.0089	0.0941
Outsourcing of a Part of the Establishment	0.0049	0.0699
Deviation from Sectoral Mean Growth	0.0271	2.1808
Firm-Acquisition	0.0222	0.1473
New Owner	0.0097	0.0979
Reorganisation	0.1344	0.3411
Employee Characteristics:		
Share of Apprentices	0.0617	0.0923
Share of Skilled Workers	0.7428	0.2595
Share of Part Time Workers	0.1791	0.2282
Establishment Characteristics:		
Firm-level Employment Growth	0.0024	0.0303
Number of Employees	38.6391	105.9900
Dummy: Collective Bargaining Contract	0.3934	0.4885
Dummy: Payment above Collective Level	0.2764	0.4472
Dummy: Establishment founded before 1989	0.7408	0.4382
Bad Profit Situation	0.3075	0.4615
East German Establishment	0.4500	0.4975
Exportshare	4.7314	14.4388
Log(Investment per Capita)	5.0197	3.7964
Dummy: Limited Firm	0.5895	0.4919
Dummy: Single Site Firm	0.3066	0.4611
Distribution by Industry:		
Cloth and Food Industry	0.0519	0.2219
Timber Industry	0.0536	0.2252
Chemical Industry	0.0453	0.2079
Metal Working Industry	0.0708	0.2566

Continued next page

From previous page		
Automotive Engineering	0.0499	0.2177
Electrical Industry	0.0449	0.2071
Construction	0.1569	0.3637
Wholesale and Retail	0.1806	0.3847
Logistic and Telecommunication	0.0409	0.198
Services for Companies	0.1213	0.3265
Research and IT	0.0291	0.1682
Services for Households	0.0844	0.278
Healthcare and Education	0.0704	0.2558
Number of Establishments	25640	

Table A2: Descriptive Statistics for Firms with newly Established Works Council in the IfM Bonn Works Council Survey (estimation sample at once).

	Mean	SD
Dependent Variables:		
Dummy: Initiator Workforce Alone	0.6167	0.4903
Dummy: Initiator Management Involved	0.3833	0.4903
Trigger Events:		
Workers Voice	0.4333	0.4997
Organisational Shock	0.5833	0.4916
Managerial Attitude towards Formal Employee Representation*	3.1166	1.0591
Firm Characteristics:		
Number of Employees	174	119
Squared Number of Employees	44093	50997
Dummy: Owner is Manager	0.3333	0.4754
Dummy: Single Side Firm	0.3833	0.4903
Dummy: Located in East Germany	0.2500	0.4367
Distribution by Industry:		
Dummy: Manufacturing	0.2000	
Dummy: Construction	0.0833	0.2787
Dummy: Trade	0.0333	0.1810
Dummy: Traffic	0.1000	0.3025
Dummy: Service for Companies	0.4833	0.5039
Dummy: Service for Households	0.1000	0.3025
Number of Observations	60	

* Scale from 1 (very negative attitude) to 5 (very positive attitude).

Table A3: Itemized Answers of Trigger Event to Establish a Works Council

Agent / Event	Total Observation	Workforce Alone	Management Motivated	Management Involved
New Owner	19	14	0	5
Partial Plant Closure	2	2	0	0
Radical Reorganisation	9	6	1	2
To Improve the Productivity	8	0	1	7
To Improve the Motivation	3	0	0	3
Need a Fixed Representative	8	0	2	6
New Workers with Works Council Experience	8	7	0	1
Conflicts between Management and the Workforce	6	5	0	1
Workers want More Co-Determination	11	8	0	3
Management Knows no Reason	16	9	0	7

Total numbers and percentages, multiple answers possible, source: IfM Bonn Works Council Survey 2005.

Endnotes

[1] Works councils are establishment-level employee representation. We use the term firm instead of establishment to avoid misunderstandings to the term establishment of a works council.

[2] Again, we use the term firm instead of establishment to avoid misunderstandings but the analysis is based on the establishment-level.

[3] A change of the owner is more widely defined as in the IAB Establishment Panel and comprise every change of the ownership.

[4] The percentage of each category do not equals the sum of the sub-categories because multiple answers were possible and some respondents identified two sub-categories as trigger events.

[5] Accordingly, Schlömer et al. (2007) cite managers who state, “if works councils do not exist, they have to be invented.”

[6] The definition of all control variables are shown in appendix table A2. All variables are collected in 2005. However, managerial attitude towards employee representation and the establishment size at the time establishment are specifically asked. All other used variables are assumed to be constant over time.

[7] We obtain a similar figure when we plot the year dummies against the number of newly established works councils.