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Explaining managerial and employee attitudes to industrial democracy: the role of the endowment effect

Introduction

As a staple component of the post-war settlement characterised by social democracy, industrial democracy has been under attack and on the retreat in the neo-liberal era. Defined as both formalised systems of workplace and extra-workplace regulation by which workers can exercise influence on organisational decision-making in terms of processes and outcomes, industrial democracy has experienced abolition and erosion, with employers supplanting forms of worker participation in decision-making with mere employee involvement. This extends from erosion in Germany with its system of co-determination comprised of works councils and worker directors to abolition in Britain with its experiments with worker directors, and covers means which are of a statutory and voluntary basis.

This article advances a defence of industrial democracy in a novel way, namely, by using a core empirical finding from behavioural economics called the endowment effect. This effect refers to the human tendency to value items more 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 previously via contract or statute. So, in essence and according to this insight from behavioural economics, if employers were not endowed with this right to manage, they would be less keen on acquiring it than they are to retain it. Likewise, if employees were endowed with participation rights in organisational decision-making, they would be keener to retain such rights than are to acquire them. The effect prompts the employer to value the right to manage more highly, covet it more zealously, and defend it more

vigorously. As such, employers are much more likely to seek to erode and abolish existing practices of industrial democracy as well as resist the creation of new practices of industrial democracy. Consequently, this empirically-derived insight from behavioural economics helps explain why both managerial resistance to acceding to industrial democracy and worker reluctance to campaign for industrial democracy are more marked than might otherwise be expected.

This article also provides a novel defence of the moral justification for industrial democracy by way of exploring two of the most significant theorised objections to industrial democracy from a neo-liberal perspective. The first concerns the defence of the right to manage as freely chosen by employees and employers alike while the second concerns the right to manage as being the most efficient, lowest transaction cost mode of employee governance. The focus of the article then turns to the characteristics of, and extensive evidence for, the endowment effect. Given this effect, we then challenge whether an unfettered right to manage is the preferred employment governance form for either employees or even employers. We further question whether the right to manage is usually, let alone necessarily, efficient. The novelty in approaching a defence of industrial democracy in this particular way is to eschew starting with the traditional multi-faceted arguments of the proponents for industrial democracy concerning aspects of democratic process, equity outcomes for distributing surplus, legitimation of organisational decisions and efficiency gains through productivity coalitions (known as mutual gains). Rather, it is to respond firstly and directly to the arguments against industrial democracy in order to reveal and interrogate the core salient issues. This method has, we believe, greater potential for illumination because it engages more forcefully with the critics of industrial democracy than an espousal of industrial democracy would.

Objections to industrial democracy

The first objection to arguments for industrial democracy is that unmitigated authority-based relations are chosen by the two parties rather than imposed by law-makers, and therefore the employee's choices still govern his or her actions (Maitland 1989). In this view, there is no loss of employee freedom. Why? The right to manage is only a default term, with a gap-filling function in employment contracts (Sunstein 2002). It only affords employers the authority to make decisions when a contentious issue is not covered by an employment contract. The right to manage assigns the employer no property entitlements, which would serve as the basis for an inalienable right to command (Demsetz 1972). On the contrary, parties are free to bargain around the default and settle on alternative rules and duties in contracts. 'The right or duty specified in a default rule 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. If the parties have negotiated unmitigated authority-based relationships in practice, it must be because they prefer them (Maitland 1989). It suggests that the employer has a stronger preference for an authority relationship than the employee has for the alternative, and is prepared to make contractual concessions to secure that outcome (Maitland 1989). In this view, the employee's choices still govern the employee's actions, but at the stage of contract negotiation.

The second associated objection is that unmitigated authority relations in employment are efficient and hence limitations on the employee's freedom are justified on utilitarian grounds. 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, absent major transaction costs (Coase 1960). The two parties should bargain towards the right's 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 employer and employee would bargain over the right to manage and settle on the most efficient outcome 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 firms. 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). In contrast, market governance via the mutual performance obligations specified in contract is rigid and cumbersome, requiring either complicated, contingent terms to cope with uncertainty or recurrent negotiation (Williamson 1985).

The endowment effect

We contest both of 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 of valuing things more when they possess them. Individuals will normally demand a higher price to sell an object already owned than they will spend to purchase the same object. The effect means that the willingness-to-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 objects 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 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 object valuations.

Later contributions broadened the concept's allocation beyond goods to legal rights, including default rights (see, for example, Marcin and Nicklish 2014). The right to manage – universal under capitalism – *endows* employers with the default authority to determine all terms and conditions not established previously via contract or statute. On the one hand, current employers are likely to highly value independent management, if only because they have long been endowed with it. 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 is 'sticky'. Party 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, they would be keener to retain such rights than they currently are to acquire them. The effect prompts the employer to value the right to manage more highly, covet it more zealously, and defend it more vigorously. The effect is consistent with recent German evidence (Jirjahn and Mohrenweiser 2015), that owner-managers, in particular, oppose relinquishing authority to newly introduced works councils, even where works councils ordinarily improve profits

Intellectual context of argument

There is a long-standing ethical justification for *political* democracy (Bacharach 1969; Dahl 1970; Holmes 1988) which can be used as the basis for justifying *industrial* democracy (Archer 1997 2010; Budd, 2004; Cole 1920; Dahl 1985; Gross 1999). The focus is on making organisational decisions compatible with the freedom of individual employees by providing employees with an opportunity to influence those decisions. Though 'freedom' has many meanings, it is ultimately based on one

fundamental idea: 'an individual can only be free to the extent that his or her [freely made] choices govern (or determine) his or her actions' (Archer 2010:590). When human goals are pursued individually, protecting and respecting individual freedom is generally unproblematic, unless the freedom of others is infringed. However, human goals are often best achieved collectively through organisations, creating a potentially serious problem for individual freedom. Organisations necessarily make decisions with consequences for individuals and their subsequent latitude for making choices. Freedom can only be safeguarded by ensuring that affected individuals have some control or influence over organisational decisions. In that way, the organisation's decisions are rendered more consistent with the decisions which would otherwise have been made by affected individuals. Similar versions of this 'all-affected principle' exist in many scholars' writings as the moral basis of both political (Bacharach 1969; Dahl 1970; Holmes 1988; Lindsay 1962) and industrial democracy (Archer 1995, 2010; Budd 2004; Cole 1920; Dahl 1985; Gross 1999).

Stakeholder theorists have similarly argued that control over firms should belong to stakeholder groups, comprised of, for example, employees, customers, creditors, and suppliers. The core idea is that all who are affected by how the firm operates and what it produces should have some influence on how it is run (Gibson 2000; Fassin 2009; Hasnas 2013). The case for a stakeholder approach has been advanced by Budd (2004:191) who suggests a meta-paradigm which defines the parameters of an industrial relations field, with efficiency and voice and equity as the key objectives. As he argues, the standard narrow HRM focus on efficiency must be balanced by industrial relations' normative insistence on employees' entitlement to fair treatment and the opportunity to have a meaningful input into decisions. Equally, Ghoshal (2005:76-7) provided a trenchant critique of the shareholder model and the reliance on ideologically inspired amoral themes which have actively freed managers from any sense of moral responsibility. He charged (2005:80): 'We know that the value a company creates is produced through a combination of resources contributed by different constituencies: employees, including managers, contribute their human capital, for example while shareholders

contribute financial capital. If the value creation is achieved by combining the resources of both employees and shareholders, why should the value distribution only favour the latter? Why must the mainstream of our theory be premised on maximizing the returns to just one of these contributors?’

Control over an organisation can be exercised directly or indirectly (Ellerman 1990). Direct control occurs when affected parties make organisational decisions themselves or appoint/elect a representative to make them on their behalf. Owner-managers exemplify the first type of direct control; shareholders who elect a board of directors which appoints a Chief Executive Officer exemplify the second. Indirect control occurs when affected parties’ actions pressure organisations into modifying decisions by altering the feasibility of different decision options. Most commonly, indirect control is exercised through exit or threatened exit: the severing of ties with the organisation. For example, customers exert indirect control over organisational decisions when they switch their purchases to a competitor. Workers can similarly threaten to quit as in the exit-voice model (Hirschman, 1970) Indirect control (or pressure) can also be exerted in other ways from threats of effort withdrawal to sabotage and theft, though these are likely to vary considerably in effectiveness and risk management retaliation.

Archer (2010) argued direct control should rest with those subjected to the organisation’s authority, just as in a political democracy (Bacharach 1969; Dahl 1970; Holmes 1988). When individuals become subject to an authority, they relinquish the right to make decisions in accordance with their own choices. Instead, the authority’s choices govern subjects’ actions, rather than the subjects’ own preferences or judgments (Green 1988; Raz 1986). The individual loses his or her freedom to act in those domains where authority is exercised. In contrast, Archer (2010) argued indirect control, chiefly via exit, is the appropriate form of control for affected non-subjects. Non-subjects, by definition, are not under the organisation’s authority and so maintain their freedom to make

decisions, even though they might be adversely affected by organisational choices. Direct control is inappropriate for non-subjects for two reasons. First, indirect control is generally sufficient for them to protect their freedom; exit is often an effective way of releasing them from the organisation's effects: imagine a customer who transfers his or her patronage. Second, direct control would unjustifiably empower non-subjects to make decisions which bind the organisation's subjects but not its non-subjects (Archer 2010).

In the employment context, the employer's right to manage, grounded in the employee's duty to obey in the English common law countries, places the employee under the employer's authority. The employer's authority over work necessarily means authority over the worker, since labour cannot be disembodied from the labourer (Marx 1976; Polanyi 1957). Employees are the subjects of the employer. In work-related matters, what the employer allows, subject to certain legal constraints, determines what happens to employees and their employment. Moreover, ultimate authority over employees still lies with the employer, even for professionals and others who customarily enjoy wider discretion at work. Archer (2010) therefore argues that employees should have some direct control over management decisions. As Kahn-Freund argued the contract of employment enshrines a hierarchical power relationship 'in its inception it is an act of submission, in its operation it is a condition of subordination, however much the submission and the subordination may be concealed by that indispensable fiction of the legal mind known as the contract of employment' (Kahn-Freund 1983: 18).

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, 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 evolutionary accounts of attachment as the effect's basis. One focuses on trading as a potentially perilous activity for most of human history, especially when it involves strangers (Jones and Brosnan 2008). In this context, the endowment effect is seen as an environmental adaptation, arising via processes of natural selection (Jones and Brosnan 2008: 1960). Another complementary, evolutionary account for an attachment-based endowment effect focuses on the survival advantages of territoriality as an adaptation to the environment (Gintis 2007; Smith 1976). The territorial incumbent values 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 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 (2010) even argues that this evolutionary endowment effect led to the emergence of self-enforced property rights, which pre-dated the development of contracts, courts, police, and other state organs.

Endowment effect empirical evidence

Evidence for the endowment effect is well-founded. Three different meta-analyses find evidence in a consistent 'offer-asking' gap between WTA and WTP prices (Horowitz and McConnell 2002; Sayman and Onculer 2005; 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) previously argued. 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). 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).

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 price (WTA) to surrender a right, when it is the default, than offers (WTP) to pay, when it is not. 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).

Schwab's (1988) study of labour negotiations was one of the first to illustrate aspects of an endowment effect in a default rule. In this case, 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 the other group. 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.

Johnson *et al.* (1993) asked 136 university staff to tell them what the right to sue was worth in three different default rule conditions, involving a hypothetical car insurance purchase. Subjects were assigned to one of three groups. The default term for one group was an unlimited right to sue. For another, it was a limited right to sue. No default was provided for the final group. Participants were asked to indicate whether they preferred a full right to sue or a limited right. The full-right group was told they could either retain the full-right or relinquish it for a 10% premium decrease. The limited-right group was told they could either retain the limited-right or acquire the full-right for an 11% premium increase. The defaults were 'sticky' in both instances: 53% of subjects in the full-right

group opted to stay with this default; 23% of those in the limited-right group opted to acquire the full-right, when it was not the default. Full-right subjects who chose to retain their default were asked how much of a premium decrease they would require to switch to the limited-right policy. Likewise, limited-right subjects who chose to retain their default were asked how much of a premium increase they would be prepared to pay to switch to the full-right policy. The results revealed a substantial 'offer-asking' gap for the full-right policy: the full-right subjects were prepared to pay an insurance premium of 32% to retain the policy (WTA price), but the limited-right subjects were prepared to pay an insurance premium of only 8% (WTP price) to acquire it (Johnson *et al.*, 1993: 47).

These findings mirror those in real-world car insurance purchases. In the 1990s, the legal default in Pennsylvania was the full right to sue, whereas in New Jersey it was the limited right to sue. In both states, the default was 'sticky': 80% of New Jersey consumers stayed with the limited right default; 75% of Pennsylvania consumers stayed with the full right default (Millon 1998:1014). Pennsylvania consumers valued the full right to sue more because it was their default rule. The same was true for the limited right to sue in New Jersey (Millon 1998).

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 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 would suggest that the multi-faceted, open-ended complexity of the right to manage and the lack of readily available, obvious alternatives are likely to increase its perceived value to management.

Implications of the endowment effect for the first objection

The first objection to the case for industrial democracy, articulated earlier, is that authority-based relations are chosen by the two parties, and so the employee's choices still govern his or her actions. 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 not independent of initial endowments. Hence, current employers are likely to prefer the right to manage.

The evidence still indicates that employees generally prefer some voice in workplace decisions affecting their work and personal lives (McCabe and Rabil 2002:16). Freeman and Rogers (2006:41, 48-49), reporting results from various Gallup polls, found that a majority of US workers (63%) wanted more influence in managerial decision-making and this was true for issues as diverse as benefits (60%), departmental work goals (55%), and training (62%). Moreover, 85% favoured workplace committees to monitor employer compliance with labour regulations, and 87% favoured being represented by a work organisation with at least some independence from management (Freeman and Rogers 2006:137, 147). In the richer Anglophone countries, many more workers also want union representation than actually have it. Bryson *et al.* (2005:165-166) found that approximately 50% of workers in Britain, Canada, and the US wanted union representation, and that the gap between those wanting and actually having representation was 36%, 44% and 42% for youths and 11%, 12% and 37% for adults in each country, respectively. Similarly, Haynes *et al.* (2004: 238) found that slightly less than half New Zealand workers in their survey wanted union representation. In addition, Freeman and Rogers (2006: 20) showed that roughly 60% of US workers had approved of unions over the previous two decades. Their own Worker Representation and Participation Survey (WRPS) showed that 32% of non-union workers would vote for a union if given

the opportunity (Freeman and Rogers 2006:69). This referred to as the ‘representation gap’ (Towers 1997).

Certainly, the findings described above suggest that employees don’t have *overriding* preferences for a strong unilateral right to manage, even in the presence of an endowment effect favouring it. If circumstances were reversed, with employees having the residual right to determine any term or condition not in the contract, the preferences for more employee voice would be even stronger and more widely held. The endowment effect, generated by having a ‘voice’ in making decisions, would prompt employees to value this option even more. A reversal of the right to manage would also render employers more open and relaxed about sharing ‘voice’ with employees. The empirical evidence is broadly consistent with these predictions. 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). Likewise, the experience of participating in management decisions increases employees’ desire for involvement (Mason 1982; Sobel 1993), most notably in cooperatives (Harnecker 2007).¹ In both cases, works councils, specifically, and worker participation, more generally, have become part of the *endowed* decision-making apparatus after a period of some use. 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 the final word on what the parties want. It certainly doesn’t mean that employees fully consent to being governed unilaterally.

Implications of the endowment effect for the second objection

¹ Given the endowment effect, these findings are entirely consistent with managerial resistance to works councils in the initial stages and a lack of employee enthusiasm for participation in its absence.

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, we would expect them to value it much less. The same applies in reverse to presently 'un-endowed' employees. 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.

The efficiency of an untrammelled right to manage can be further questioned, on the basis of meta-studies of employee voice and empowerment, which suggest that the effects, both for employers and employees, are generally positive across a range of variables likely to be important to organizational efficiency (see, for example, Pereira and Osburn 2007; Seibert *et al.* 2011; Spector, 1986; Maynard *et al.* 2012). Meta-studies also suggest that independent employee representation has positive performance impacts (see, for example, Doucouliagos 1995; Doucouliagos and Laroche 2003). In a review of empirical literature published after Levine and Tyson's (1990) earlier review, Marsden and Canibano (2010) found that the optimal level of employee voice, though likely to vary across employers, industries, and occupations, isn't zero.

The consensus among experts is also that the European model of industrial democracy also 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). Recent econometric research has linked works councils, specifically, to a range of positive organizational outcomes, including lower staff turnover (Frick, 2007), higher productivity (Addison *et al.* 2001; Huebler and Jirjahn 2003; Wagner 2008) and higher profitability (Mohrenweiser and Zwick 2009; Mueller 2011; Zwick 2007). 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. Osterloh *et al.* (2011:339) further 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.’² However, the central point is not that worker participation, generally, and industrial democracy, more specifically, are more efficient than a pure form of hierarchical governance. Rather, the clear lesson from the empirical evidence is that a right to manage cannot be easily defended on utilitarian grounds as always, or even usually, economically optimal. Surely, that would suggest that the ethical case for industrial democracy takes priority.

Conclusion

We have argued that employers’ opposition, as well as that of their managers, to industrial democracy derives in part from the endowment effect. In other words, preferences for industrial

² 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.

democracy are strongly influenced by the current endowment situation, which strongly favours maximisation of the managerial prerogative. 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 objections to industrial democracy challenged here, using the endowment effect, are not supported. Streeck (2004:426) has similarly held that conventional economic explanations of management opposition to co-determination and other labour reforms are overly rational, in assuming that individual agents have ‘vastly exaggerated (mental) capacities ...’. Streeck (1997; 2004) has argued, more generally, that external constraints on 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. Hence, if industrial democracy is to experience a renaissance, in Europe and elsewhere, it needs strong support via state intervention, which is currently conspicuously absent and viewed as undesirable in mainstream political discourse. Industrial democracy is unlikely to be widely adopted on a voluntary basis in any country, as long as the right to manage is the default. Indeed, historical experience – like that of the inter-war years - suggests management is only prepared to share power when that power is under threat (see Ramsay 1977 contra Marchington *et al.* 1992), and many would appear to believe that we do not live in such times for the foreseeable future. Nonetheless, reducing resistance to proposals for change could help to be addressed through both political/normative and legislative means. At the political level, advocates of co-determination’s benefits might find this article’s arguments useful in the current context, in which political rhetoric about the negative effects of regulating small and medium sized enterprises has dominated and 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). Perhaps the timing is right for a new agenda. Hyman (2015:18) argues 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 industrial democracy.

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