
European Works Councils: an assessment of their social welfare impact

Sigurt Vitols

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europaen handelsunion institutt

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Foreword

Today more than 12,000 members of more than 850 European Works Council (EWCs) help to invigorate the democratic infrastructure of European civil society. EWCs represent an element of the European social architecture. Moreover, in advanced cases, they encourage and support a collaborative style of company management that benefits from the institutionalised organisation of labour voice at trans-national level.

EWCs have thus become an aspect of good business management practice and have, within a comparatively short period, acquired a crucial position in the architecture of companies and in the European model of corporate governance. At their most advanced, they are recognised as an integral part of the corporate structure that is essential for the successful and sustainable management of a company and their existence benefits all stakeholders, even though the legal foundation for these model solutions is currently very weak, especially in regard to cross-border issues. The strengthening of social dialogue at company level has further promoted the role of EWCs. Thanks to a joint effort by all parties involved in EWC activities, social relations have been stabilised, particularly at the most difficult times represented by restructuring, relocation and the plant closures associated with these developments.

From a trade union standpoint, the contribution of EWCs remarkably combines benefits that are both economic and social. Employees and employers share an interest in promoting an ongoing process of innovation in companies in order to improve their efficiency and competitiveness. For success in this respect, companies need the commitment and skills of their employees. The recent recast of the EWC directive has strengthened the legal position of EWCs and will help to foster the positive economic and social role that EWCs play. It combines the goal of realising the fundamental right of European citizens to be informed and consulted at their workplaces with the goal of promoting the competitiveness of European-based companies.

In this short study Sigurt Vitols follows this line of thought by providing evidence of what he calls the 'social welfare effects' of EWCs. He shows how the investigation of quantitative data can contribute to an understanding of some of the benefits of EWCs as an institution for employee involvement in an economic and social setting.

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May 2009

1. Introduction

In 1994 the adoption of Council Directive 94/45/EC established a right for workers in multinational companies in the European Union to form cross-border organs for collective representation with information and consultation rights vis-à-vis management (European Works Councils or EWCs). In February 2008 the European Commission responded to the long-standing demand for a strengthening of the rights of EWCs with the opening of the second round of consultations on the revision of the EWC directive.¹ Following decisions by the European Council in December 2008 and subsequently by the European Parliament, the EWC directive will be substantially strengthened on a number of points (Jagodzinski 2009). A key point for consideration in the current debate on revision is the economic and social impact of existing EWCs as well as the potential impact of strengthening the rights of these EWCs. Supporters claimed that strengthening the directive would support the fundamental right of workers in the EU to information on and participation in important corporate decisions affecting their lives.² Opponents claimed that EWCs result in significant costs for companies without commensurate benefits.

This paper applies a social welfare approach to the question by analyzing the impact of EWCs on four different groups: shareholders, creditors, managers and employees. It argues that EWCs are a clear net benefit (Pareto improvement) for the European Union: there appear to be no significant negative impacts on shareholders and creditors but there are clear positive benefits for employees and managers. Furthermore, a revision of the directive through strengthening EWC rights could have a net positive impact from a social welfare point of view.

The paper starts with an overview of the social welfare approach. It then reviews evidence that EWCs do not have a negative impact on shareholders and creditors but are viewed positively by worker representatives and managers.

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1. COM (2008) 419 final of 7.2.2008
 2. Therefore, the ETUI compiled a 'EWC Memorandum' containing brief summaries of research on EWCs and underlining the need for reviewing and revising the legal provisions: European Works Councils – Essential for fostering success of the European way of strong democracy, social cohesion and sustainable economy. Academics want to see progress in European legislation. Brussels: ETUI, 2008, downloadable under: <http://www.etui-rehs.org/en/Events/Past-events/2008/September-8-Brussels-EWC-memorandum>

Finally, drawing on studies of the economic impact of works councils in Germany, the paper suggests that the strengthening of EWCs through a recast of the EWC directive could have a net positive impact from a social welfare point of view.

2. The social welfare approach and EWCs

The basic core of the social welfare approach is the idea that the impact of institutions and policies should always be evaluated in terms of their effects on different individuals or, from an aggregated perspective, different groups (Arrow 1951; O'Connell 1982). Looking at the problem from a group perspective, in principle there can be four different types of impact of a policy change from a social welfare point of view:

1. no change (no net negative or positive effects for all groups)
2. Pareto improvement (at least one group experiences a welfare improvement, and no group experiences a worsening)
3. Pareto decrease (at least one group experiences a welfare decrease, and no group experiences an improvement)
4. mixed impact (at least one group experiences a welfare improvement and at least one group experiences a welfare decrease)

The first three are in principle 'easy cases' for public policy in the sense that for case 1 there is no strong case for a policy change, case 2 offers clear support for the policy change, and case 3 a strong argument against the policy change. Case 4 is a much more difficult case to judge, whereby a political decision over whether or not to make the policy change may involve a 'side payment' (i.e. compensating resources or concessions on another issue) to the losing group(s).

Looking at the case of EWCs, at least four groups can be identified as key stakeholders who should be included in the social welfare analysis: employees, managers, shareholders and creditors.³ The type of impact that EWCs might have which could affect the welfare of these different groups includes:

3. In principle other stakeholder groups that could be included in the analysis are: communities in which the company is located, consumers and suppliers. However, data on the impact of EWCs on these groups is more difficult to collect.

- **Employees** – the welfare impact of the policy change is judged in terms of subjective evaluations of inclusion/participation, wages and working conditions, job security, career prospects, etc.
- **Managers** – the welfare impact of a policy change is judged by its impact on the ease or difficulty of operating the company across national borders, of forging a company-wide corporate identity and of other key management tasks, etc.
- **Shareholders** – the welfare impact of a policy change would be judged through its impact on profitability and the stock market value of the company, etc.
- **Creditors** – the welfare impact of a policy change would be judged through its impact on the probability of default on debt payments, e.g. through changes in the overall debt level or in the profit rate.

From a social welfare point of view, the public policy case for EWCs (and for the strengthening of the EWC directive) is clear if there is an increase in the welfare of at least one of these groups without a decrease in the utility of any of the other groups.

In the following sections it will be shown that the available evidence supports the view that EWCs lead to a net welfare improvement. Furthermore, evidence on the impact of strong worker participation in Germany suggests that the recast directive should not lead to negative impacts for shareholders, creditors or managers and should have positive impacts for employees, i.e. a net welfare improvement.

3. Measuring the welfare effects

3.1 Impact of EWCs on shareholders and creditors

In order to determine the impact of EWCs on the welfare of shareholders and creditors, an econometric analysis of the largest 600 listed European companies was performed (DJ Stoxx 600).⁴ Data were gathered on key variables from these companies' financial statements for as many of the years between 2002 and 2007 as were available, on their total stock market valuation at year-end between 2002 and 2007, and on structural variables such as main sector of activity, headquarters country and number of employees.

As a second step, on the basis of the ETUI data base on EWCs, a sub-sample of companies eligible for worker representation through an EWC was identified.⁵ In all, 390 companies in the sample were in principle eligible for EWC representation. Of these companies, 233 (i.e. roughly 60 percent) actually have an EWC, i.e. much higher than the 35 percent coverage rate which is frequently cited for all eligible companies. A variable was constructed measuring the presence or absence of an EWC at each of the 390 companies. This dummy variable was coded with a '1' if an EWC exists at the company, and with a '0' in the absence of an EWC.

As a final step, an econometric test in the form of a multivariate regression analysis was run in order to determine what, if any, impact the presence of an EWC has on shareholder and creditor welfare. In principle, three different types of outcome are possible:

- No significant impact
- Significant negative impact
- Significant positive impact

4. The STOXX 600 composition from June 2008 was used. For a description of this index and its components see http://www.stoxx.com/indices/index_information.html?symbol=SXXP

5. These companies include all companies that have at least 1000 employees overall and at least 150 employees in each of at least two countries covered by the EWC directive.

The impact of the presence of an EWC on the following types of performance was measured:

- Return on Assets (**ROA**), i.e. net income over the business year divided by total firm assets at the beginning of the business year
- Return on Equity (**ROE**), i.e. net income over the business year divided by shareholder equity at the beginning of the business year
- **LEVERAGE**, defined as the sum of short- and long-term debt divided by the total assets of the company
- Market to Book (**MTOB**) ratio, i.e. the total market value of shares outstanding divided by the book value of the firm (shareholder equity)

In other words, the two most common measures of operative performance, one common measure of probability of debt payment and one of the most common measures of stock market valuation were used.

The following control variables were also included, since they are often thought of as key variables which can also influence profitability and market valuation:

- **sale** – total sales during the business year – this is included since the size of a company frequently has an impact on performance measures.
- **s10 to s96** – dummy variables for main sector of activity (2-digit SIC industry) – e.g. s10 is coded 1 when the company's main activity is in SIC 10, or 0 otherwise. S60 serves as the benchmark, i.e. there is no dummy for these companies. In all 55 industries at the 2-digit SIC level were represented in the sample.
- **c1 to c17** – country dummy variables included to control for country effects. In all, companies from 18 countries are included in the STOXX 600 index. Great Britain serves as the 'default' country (i.e. no dummy variable is included for Great Britain).

The results of the regression analysis are given in Tables 1–4 in the next pages. The first step in interpreting the analysis is to look at the values in the column **P>|t|**, which are used to a guide to whether the variable in question appears to be a significant influence on the dependent variable (variable to be explained). With a sample of this size a common cut-off level for this column would be 0.050, i.e. if the value in this column to the left of **ewc** is below 0.050 we interpret the presence of an EWC as a significant determinant of the dependent variable. When the value 0.050 is chosen we can say that the variable is significant, with at least 95 percent probability that the statement is correct.

If this variable satisfies the criterion for significance, step two would be to look at the value for the variable in the column **Coef**. If the value is positive,

Table 1 Effect of EWC presence on return on assets (ROA)

Random-effects GLS regression		Number of obs	=	982		
Group variable: nmbr		Number of groups	=	377		
R-sq:	within	=	0.1335	Obs per group: min	=	1
	between	=	0.4257	avg	=	2.6
	overall	=	0.3760	max	=	4
Random effects u_i ~ Gaussian		Wald chi2(72)	=	317.40		
corr(u_i, X) = 0 (assumed)		Prob > chi2	=	0.0000		

roa	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
ewc	-.0074867	.0061128	-1.22	0.221	-.0194675	.0044941
sale	-6.07e-08	7.46e-08	-0.81	0.415	-2.07e-07	8.54e-08
y2007	.0029771	.0023496	1.27	0.205	-.001628	.0075822
y2005	-.0098458	.0025104	-3.92	0.000	-.014766	-.0049256
y2004	-.0161595	.00218	-7.41	0.000	-.0204323	-.0118867
_cons	.0281972	.0105744	2.67	0.008	.0074717	.0489227

country dummy variables – significant

industry dummy variables - significant

sigma_u	.04120292	
sigma_e	.02394028	
rho	.74760761	(fraction of variance due to u_i)

Table 2 Effect of EWC presence on return on equity (ROE)

Random-effects GLS regression		Number of obs	=	982		
Group variable: nmbr		Number of groups	=	377		
R-sq:	within	=	0.0950	Obs per group: min	=	1
	between	=	0.3152	avg	=	2.6
	overall	=	0.2637	max	=	4
Random effects u_i ~ Gaussian		Wald chi2(72)	=	205.75		
corr(u_i, X) = 0 (assumed)		Prob > chi2	=	0.0000		

roe	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
ewc	-.0215325	.0173963	-1.24	0.216	-.0556287	.0125637
sale	-8.17e-08	2.27e-07	-0.36	0.719	-5.26e-07	3.63e-07
y2007	-.0081755	.0089605	-0.91	0.362	-.0257376	.0093867
y2005	-.037668	.0095909	-3.93	0.000	-.0564658	-.0188702
y2004	-.0593453	.0083008	-7.15	0.000	-.0756146	-.043076
_cons	.2518281	.0304183	8.28	0.000	.1922094	.3114468

country dummy variables – significant

industry dummy variables - significant

sigma_u	.10880767	
sigma_e	.09188953	
rho	.58370206	(fraction of variance due to u_i)

Table 3 Effect of EWC presence on market-to-book ratio (MTOB)

Random-effects GLS regression		Number of obs	=	859
Group variable: nmbr		Number of groups	=	353
R-sq:	within	=	0.0021	
	between	=	0.1069	
	overall	=	0.0442	
Random effects u_i		~ Gaussian	Wald chi2(69)	= 33.32
corr(u_i, X)=		0 (assumed)	Prob > chi2	= 0.9999

mtob	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
ewc	-2.474164	2.305569	-1.07	0.283	-6.992995	2.044668
sale	-.000031	.0000308	-1.01	0.314	-.0000913	.0000293
y2007	-1.034869	2.044586	-0.51	0.613	-5.042183	2.972445
y2005	-.4646713	2.336806	-0.20	0.842	-5.044727	4.115384
y2004	-1.92918	2.022937	-0.95	0.340	-5.894064	2.035704
_cons	3.01711	4.001443	0.75	0.451	-4.825574	10.85979

country dummy variables – significant

industry dummy variables – significant

sigma_u	6.7020765	
sigma_e	21.395778	
rho	.08935366	(fraction of variance due to u_i)

Table 4 Effect of EWC presence on leverage

Random-effects GLS regression		Number of obs	=	975
Group variable: nmbr		Number of groups	=	376
R-sq:	within	=	0.0163	
	between	=	0.4269	
	overall	=	0.3667	
Random effects u_i		~ Gaussian	Wald chi2(72)	= 236.58
corr(u_i, X)=		0 (assumed)	Prob > chi2	= 0.0000

leverage	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
ewc	-.0099472	.0155538	-0.64	0.522	-.0404321	.0205377
sale	2.42e-07	1.86e-07	1.30	0.193	-1.22e-07	6.05e-07
y2007	.0068193	.0055408	1.23	0.218	-.0040405	.0176791
y2005	.012349	.0059141	2.09	0.037	.0007576	.0239403
y2004	.0145339	.0051447	2.83	0.005	.0044504	.0246174
_cons	.3301205	.0268244	12.31	0.000	.2775456	.3826954

country dummy variables – significant

industry dummy variables – significant

sigma_u	.10566395	
sigma_e	.05588882	
rho	.78139239	(fraction of variance due to u_i)

then this variable is taken to be a significant positive influence on the dependent variable. If this is negative, it is taken to have a significant negative influence on the dependent variable. The size of the coefficients also indicates how strong the positive or negative influence is.

Since in all four regression models the variable **ewc** had a value in the column $P > |t|$ that was not below 0.05, the conclusion is that the presence of a EWC does not have a significant effect on **ROA**, **ROE**, **LEVERAGE** or **MTOB**. As a result, it was unnecessary to take the analysis further to step two.⁶

In conclusion, the results of the regression analyses performed here do not suggest that the presence of an EWC has any negative effects on either shareholder or creditor welfare. Negative effects for shareholders would be indicated by a coefficient for the EWC variable which is both negative and significant in the regression equation with the dependent variable **MTOB** (ratio of stock market valuation to book value of company). Such a result would indicate that EWCs have a negative impact on the stock market value of companies, which would clearly be detrimental for shareholders. Negative effects for creditors would be indicated by a coefficient for the EWC variable that is positive and significant in the regression equation with the dependent variable **LEVERAGE** (the ratio of the debt level to the total assets of the company), since this would indicate that EWCs are associated with a higher level of debt in companies. This would have a negative welfare impact on creditors, since a higher debt level is associated with a greater probability that a company will not be able to meet debt repayment obligations. Finally, negative and significant coefficients for the EWC variable in either of the two regression equations with the dependent variables **ROA** (return on assets) and **ROE** (return on equity) would suggest negative welfare effects for both shareholders and creditors. Such a result would indicate that EWCs are associated with lower levels of profitability, which generally would have an adverse impact on both company stock value and the ability to repay debt. Since the coefficient for the EWC variable was not significant in any of the four regression equations, there is no evidence of a negative welfare effect of EWCs on either shareholders or creditors.

3.2 Welfare impact of EWCs on managers

The management perspective is a relatively neglected area in the research on EWCs (Müller and Hoffmann 2001). Two studies carried out by the author were designed to help fill this gap in the literature (Vitols 2001; Vitols 2006a). Both of these studies were based on postal questionnaires of top managers (ei-

6. In addition to the random effects (RE) model, fixed effects (FE) and ordinary least squares (OLS) models were also tested. For each dependent variable the Hausman test and the Breusch and Pagan Lagrangian multiplier test indicated that the RE model was appropriate.

ther human resource directors or CEOs) at a large sample of European companies with EWCs.⁷ In addition, in-depth interviews with a smaller number of managers were carried out. Both studies focused on the challenges that managers face in running multinational companies and on the experiences that they had with EWCs in dealing with these challenges.

The response of managers showed that corporations overall are faced with a number of key challenges when they expand across national borders – how do they integrate diverse national cultures and industrial relations practices? How can they create a common corporate identity, especially when workplaces in other countries are acquired? How can they see that minimum standards for labour practices are implemented outside the home country? How can they ensure a good flow of information from the workforce in different countries directly to top management?

In general, managers had a favourable view of EWCs, and many wished that EWCs could play a stronger and more confident role in helping management meet these challenges. Furthermore, EWCs perform functions that are difficult to fulfil at the national level in MNCs. In particular, EWCs serve as a platform for discussions between workers and management which may be difficult at the national level, due to fragmentation or to adversarial industrial relations traditions.

The most common issues that are discussed concern the company's financial situation (see Table 5). However, other important issues dealing with corporate culture are also increasingly being discussed in EWCs. Company values and/or mission statements had been discussed in 69 percent and CSR in 62 percent at recent meetings of the EWCs surveyed. Issues like cross-border re-

Table 5 Topics most frequently discussed at recent EWC meetings

Topic discussed	% of EWCs
Company's financial situation	99
Corporate values/mission	69
Acquisitions and mergers	68
Plant cutbacks or closures	66
CSR/Sustainability	62
Process innovation	60
Product innovation	49

Source: Vitols, S. (2006a).

7. In the first study, commissioned by the Forum Mitbestimmung und Unternehmen, a joint project of the Bertelsmann Foundation and the Hans Böckler Foundation, all of the STOXX 600 companies with an EWC were surveyed. In the second study, all European companies with an EWC were included.

locations and benchmarking plant performance across borders are also increasingly being discussed in EWCs.

Although there is a diversity of management opinion regarding the effect of EWCs on their companies, in general the assessment is positive (see Table 6). 67 percent of managers thought that EWCs improved communications with employees ‘somewhat’ or ‘significantly’, versus only 2 percent who thought that communications worsened. Almost two thirds felt that employee commitment improved, and none thought that there was a negative impact in this area. 37 percent believe that the effectiveness of implementation of management decisions was improved through the EWC versus only 3 percent believing the contrary. Only in the case of ‘speed of decision making’ was there a balance of positive and negative opinions – however the clear majority (82 %) felt that altogether there was no significant impact here.

Table 6 Percentage of managers believing that EWCs have a positive/negative impact

Impact of EWC on:	Positive	Negative
Communication with employees	67	2
Employee commitment to company objectives	62	0
Effectiveness of implementation of management decisions	37	3
Speed of decision-making in the company	10	9

Source: Vitols, S. (2006a).

In conclusion, most managers feel that EWCs serve as a valuable platform for discussing important issues dealing with corporate culture and cross-border company developments. Most managers also feel that EWCs play a positive role in improving communication with employees, increasing employee commitment to company objectives and improving the effectiveness of implementation of management decisions. In short, from the point of view of managers as a group, EWCs result in a net welfare increase for themselves.

3.3 Welfare impact on employees

Numerous surveys indicate strong support from workers for worker participation. This support comes from both direct support for participation and inclusion as a value in and of itself, as well as the indirect benefits that participation can bring in terms of an improved work environment, increasing feelings of job security, etc. Furthermore, surveys show that there may be a large unfulfilled ‘representation gap’, where workers are not collectively represented but desire such representation. In such cases, the absence of arrangements for collective representation is an indication of formidable barriers to organization or of management resistance.

The most extensive survey that has been conducted in this regard is the study *What Workers Want*, carried out by Freeman and Rogers (2006). This is particularly informative since it was carried out in the US, a country where collective representation of workers plays a particularly weak role. Opponents of trade unions in the US frequently cite strong individualistic values in the national culture as a reason for weak collective representation. The survey shows that 87 percent of US workers desire collective representation bodies that are somewhat or strongly independent of management (p. 175). US workers are also open to different kinds of collective representation other than traditional unionism, such as elected committees of worker representatives that negotiate with management on specific issues such as health and safety.

A comparative analytical report for the European Foundation also shows similar strong support for worker participation in worker satisfaction surveys (Cabrita and Perista 2006). Surveys from Spain, Finland and the Czech Republic show that job satisfaction increases with worker participation or involvement in the organization where they work. Two thirds of workers totally agreeing with the statement that they have the possibility of participating in working decisions were very satisfied with their job versus only 23 percent of those who totally disagree with this statement. In the Czech Republic, 81 percent of workers who feel encouraged to come up with new and better ways of doing things are satisfied with their work, as opposed to only 34 percent of workers who do not feel encouraged to do so.

A large-scale survey commissioned by the Hans Böckler Foundation also found overwhelming support for worker participation in Germany. In all 1007 persons were surveyed in August 2006 by TNS Emnid. According to this survey, 83 percent of respondents claimed that the German model of worker participation had proved itself, and should therefore be preserved. Even more persons (88 percent) claimed that worker participation is necessary (Hans Böckler Foundation 2006:4).

Surveys conducted by Jeremy Waddington show that EWCs are found useful by the large majority of worker representatives, but that these worker representatives want a stronger and more reliable role for these EWCs (Waddington 2003: 303-325; Waddington 2006: 681-708). 88 percent of EWC representatives claimed that they received helpful information on the economic and social situation of their company and 84 percent that they received helpful information on the company's strategy and investment plan.

In summary, surveys show that the large majority of workers support collective representation, even in countries where this tradition is weakly developed. EWCs can help fill this need for collective representation. Worker representatives on EWCs generally report that they receive helpful information on company finances, strategy and other topics, but that they wish for a stronger role for EWCs in this process. From this perspective, the foundation of more EWCs and the extension of their rights would have a net positive impact on workers' welfare from a social welfare point of view.

4. Conclusions

In order to measure the potential welfare impact of a strengthening of the EWC directive, one needs to distinguish between two different effects: 1) increasing the number of EWCs, since fewer companies have EWCs than are eligible under the EWC directive, and 2) increasing the strength of information, participation and codetermination rights of the EWCs.

From the evidence presented in section 3 it is clear that the welfare impact of strengthening the directive with respect to the first effect would be net positive, in the sense that the shareholders and creditors of companies at which a new EWC is founded would not be negatively impacted and employees and managers would enjoy a net increase in welfare. Hence there would seem to be good reasons to extend the impact of EWCs.

Regarding the second effect (strengthening information, consultation and codetermination rights of existing EWCs), there is evidence on the welfare impact of workers' participation in Germany where these rights are considerably stronger than under the current EWC legislation. Strengthening these rights would therefore help move EWCs in the direction of current German practice.

Recent summaries of the impact of worker participation at the plant level (through works councils) are provided by Addison (2004) and Jirjahn (2006). Important conclusions of these studies are:

- with the improvement of the data on works councils, as well as the econometric methodology used, the current generation of studies show an overall positive impact of works councils on company performance
- in particular productivity is significantly higher in plants with works councils than in plants without such bodies – this effect is estimated to be as high as 30 per cent
- workers benefit from reduced fluctuation and increased training.

Almost all recent studies of worker participation at the board level in Germany also show that strong worker rights do not lead to reduced company performance, and thus do not have negative welfare effects for shareholders and creditors (Jirjahn 2006: 215-226 ; Vitols 2006b).

This paper has presented a conceptual approach to evaluating the impact of revising the EWC directive (social welfare approach) and argued that the available evidence shows that:

- EWCs have no negative impact on shareholders or creditors
- EWCs have a positive welfare effect for workers and managers
- EWCs therefore have a net positive social welfare effect

The recent revision of the EWC directive should therefore have a net positive welfare effect for the EU in the sense of enabling the founding of more EWCs.

Furthermore, a review of econometric evidence on the impact of worker participation in Germany suggests that the strengthening of EWCs' rights of information, consultation and codetermination can also be expected to have a net positive social welfare effect.

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