6. Industrial democracy and inequality

Author

Simon Deakin
Codetermination laws, in common with labour laws more generally, have stood still in the past two decades, while shareholder protection standards have seen a significant boost. The playing field, far from being level, has been tilted in favour of capital. This is leading to an unbalanced economy, with detrimental effects on social cohesion.

Simon Deakin
Introduction

What is the contribution of labour laws to democracy in the workplace and wider society? What are the economic and social impacts of laws promoting worker voice and participation? Until recently, these questions generated a good deal of theoretical and normative argument but little by way of systematic analysis, as evidence was lacking.

This is now changing as a result of the greater availability of cross-national data on legal institutions and their operation in labour and capital markets. This chapter reviews evidence from the Cambridge Leximetric Database (Deakin et al. 2017), a uniquely extensive resource which tracks developments in labour laws over several decades and has recently been updated to include 2020.

New evidence from the database has shed light on the relationship between industrial democracy and inequality. While improvements to workers’ codetermination and related representation rights began to plateau across EU Member States after 1990, the rights of shareholders were significantly strengthened. This means that, relative to the protection given to the interests of shareholders within managerial decision-making, that given to workers’ interests underwent a marked decline.

This trend is related to the increased share of corporate earnings diverted into dividends and share buy-backs at the expense of wages. There is no evidence that this benefits productivity or innovation in any way – if anything, the opposite is true.
Developments in laws governing worker voice and participation

Laws relating to worker participation in decision-making within the enterprise take two forms. On the one hand are laws which give workers the right to elect or nominate representatives to company boards or equivalent decision-making bodies. On the other are laws which require management to inform or consult with employee representatives on matters of workplace organisation. Sometimes workers are given co-decision or veto rights over management decisions. In certain countries, employees are represented through works councils or enterprise committees elected by the workforce of the relevant unit (plant, company or corporate group); in others, consultation and co-decision rights are vested in trade unions. Specific rules may apply to multinational companies, as in the case, for instance, of those falling under the ambit of the European Works Council Directive. Both types of laws are commonly referred to under the general heading of ‘codetermination’, although they have different functions and operate at different levels. Board-level codetermination gives worker representatives a say in issues of corporate strategy, while codetermination via works councils or trade unions allows workers a voice in the running of the enterprise.

Codetermination has a long history in Europe. Antecedents of current arrangements can be found in some countries, most notably Germany, as early as the turn of the twentieth century. After World War Two, codetermination laws were passed for the first time in several European countries and significantly strengthened in others. This was done in order to democratise the operation of industry and to avoid concentrations of economic and political power of the kind which were thought to have aided the rise of authoritarian regimes in the inter-war years (McGaughey 2016).

Numerous initiatives in worker participation in management decision-making were developed on either side of the post-war divide between market and non-market (or ‘state socialist’) systems. After 1989, laws that had been passed to promote worker voice in some former state socialist systems were retained, with modifications, in the transition to a market economy (this was the case, for example, in Czechia, Estonia, Latvia, Lithuania, Poland, Slovakia and Hungary). In others, where institutions for worker participation had atrophied by the end of the 1980s (as in the case of the then Federal Socialist Republic of Yugoslavia), the transition from a planned to a market economy was the occasion for the introduction of fresh legal mandates for codetermination at board and/or workplace level (as in Slovenia in 1993 and Croatia in 1995, 2001 and 2009). A number of EU-level initiatives, including the European Works Councils Directive (in its original form dating from 1994), the Directive on information and consultation of employees (2002), and the Council Directive supplementing the Statute for a European Company with regard to the involvement of employees (2001), stimulated developments at national level during these years.

Table 6.1 provides summary information on codetermination laws in force in the current EU27 and EEA Member States, plus Switzerland and the United Kingdom, during the period 1970 to 2020. Figure 6.1 shows overall trends, using data from the Centre for Business Research Labour Regulation Index (the ‘CBR-LRI’, which is part of the wider Cambridge Leximetric Database). The CBR-LRI captures not just the adoption of a law but the degree to which it is protective of workers. It contains 40 indicators altogether, grouped into five sub-indices which code for the law governing the employment relationship, working time, dismissal, employee representation, and industrial action. The codetermination indicators are part of the sub-index on employee representation.

The ‘codetermined board’ indicator assigns a higher score to a law according to how far it provides for mandatory election or nomination of worker directors. In the case of the ‘works council’ indicator, a higher value on a 0-1 scale is assigned to laws mandating a works council or enterprise committee with statutory powers of consultation and decision rights; lower values are assigned to laws which provide for standing bodies with fewer powers, or for...
### Table 6.1 Codetermination laws in European countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Description</th>
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<tbody>
<tr>
<td>Austria</td>
<td>Legislation dating from 1975 makes provision for worker representation (one third) on the supervisory boards of large undertakings. The codetermination law also provides works councils with extensive participation and co-determination rights.</td>
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<tr>
<td>Belgium</td>
<td>There is no legal provision for worker representation on company boards and it does not occur in practice outside a few state enterprises. Works council powers derive from laws dating back to 1948, and related trade union functions are set out in a series of collective agreements from 1971.</td>
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<tr>
<td>Croatia</td>
<td>Provision for a single worker director to serve on the supervisory boards of certain state-owned and large companies was introduced in 2001 and strengthened in 2004 and 2009. Consultation of employees with respect to redundancy was introduced in 1992; since 1995, legislation provides for works councils with a range of co-decision and consultation rights.</td>
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<tr>
<td>Cyprus</td>
<td>There is no legal right to worker representation on boards. There is no general provision for works councils. Rights to information and consultation over collective redundancies were implemented in 2005.</td>
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<tr>
<td>Czechia</td>
<td>Under a law dating back to 1990, employees have the right to elect one third of the members of the supervisory board in larger companies; from 2014 this only applied to the public sector, but a law passed in 2017 (effective from 2019) restores the right to companies employing more than 500 full-time employees. From 1990 employees have had the right to be informed and consulted on a range of workplace matters, either through a trade union, a works council or a statutory health and safety representative body.</td>
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<tr>
<td>Denmark</td>
<td>Workers have had the legal right to board-level representation in enterprises employing 35 or more employees since the passage of the Companies Act in 1973. Cooperation committees in firms employing 35 or more employees are set up under provisions of collective agreements; they have information and consultation rights but not a veto right.</td>
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<tr>
<td>Estonia</td>
<td>There are no board-level codetermination rights. Rights to information and joint decision-making through workers’ councils date back to the labour code inherited from Soviet law; in 1993 workers’ representatives were granted statutory rights to information and consultation on workplace issues, and in 2003 veto rights with respect to collective dismissals.</td>
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<tr>
<td>Finland</td>
<td>A 1990 law granted workers in organisations with over 150 employees the right to participate in management decision-making, with the method to be agreed by the concerned parties; employee representatives have the same rights and privileges as company directors. Since 1978, legislation has provided for trade union representatives to have information and consultation rights in companies with 30 or more employees (20 or more since 2007) and co-decision-making rights in relation to specified matters.</td>
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<tr>
<td>France</td>
<td>From 1982, representatives of enterprise committees had the right to participate in board meetings and from 1986, legislation provided for employee directors elected by the workforce to be allotted between a quarter and a third of seats on the boards of public limited companies. In 2013, board-level representation became mandatory in all companies employing 10,000 employees worldwide or 5,000 in France. There has been statutory provision for workplace representatives since 1936 and for enterprise committees since 1945, with the law strengthened in 1966, 1982 and 2002; consultation structures were streamlined in 2016.</td>
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<tr>
<td>Germany</td>
<td>Legislation of 1951 provided that half the members of the supervisory boards of coal and steel companies should be employee-nominated, and in 1952 a norm of one third representation was established for companies in other industries, with exceptions for some companies employing fewer than 500 employees. Currently, the norm is half-employee board membership in companies of more than 2,000 employees (Codetermination Act 1976) and one third in those with more than 500 (One Third Participation Act 2004). Works councils were granted joint decision-making powers in legislation of 1952, which were extended in 1972; they include a right to be informed, and in some instances to veto, dismissals.</td>
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<tr>
<td>Greece</td>
<td>There is no general provision for mandatory worker representation on boards; one third of the directors in some state-owned enterprises must be elected by the workforce. Legislation of 1988 provides for works councils in enterprises with 50 or more employees; their role is said to be participatory and consultative and must not prejudice the operation of trade unions.</td>
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<tr>
<td>Hungary</td>
<td>Under a law of 1951, works councils had the right to nominate one third of supervisory board members in companies with two-tier boards and 200 or more employees. Board-level representation has been mandatory since 2006, unless waived by the works council. Legislation from 1957 set out certain rights of codetermination and the labour code of 1992 provided for information and consultation and also for veto rights in relation to major workplace changes; the 2012 code refers to consultation but not to veto.</td>
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<tr>
<td>Country</td>
<td>Relevant Legal Provisions</td>
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<tr>
<td>Iceland</td>
<td>There are no provisions for board-level representation of employees.</td>
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<tr>
<td>Ireland</td>
<td>Under law dating from 1977, larger state-owned enterprises can provide for up to a third of the board to be worker representatives, but there is no general right to board-level representation.</td>
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<tr>
<td>Italy</td>
<td>There is no legal right to board membership or representation for workers.</td>
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<tr>
<td>Latvia</td>
<td>There is no provision for board-level codetermination.</td>
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<tr>
<td>Lithuania</td>
<td>The 2004 labour code referred to a right of employee representation in enterprise management, but was not strictly binding; the law was revoked in 2008.</td>
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<tr>
<td>Luxembourg</td>
<td>Since 1974 legislation has provided for one-third worker representation on boards of companies with 1,000 or more employees.</td>
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<tr>
<td>Malta</td>
<td>Since 2006, workers in larger companies who are not represented by a trade union have had the right to elect their own representatives, who enjoy consultation and information rights in line with those of trade unions; from 2008, these information and consultation rights apply in companies of 50 or more employees.</td>
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<tr>
<td>Netherlands</td>
<td>From 1971 the works council had the right to be informed on the nomination or the dismissal of a board member, and from 1979 to be consulted; since 2004 the works council has had the right to nominate up to a third of the members of the supervisory board in larger companies.</td>
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<tr>
<td>Norway</td>
<td>Since 1973 legislation has provided for one-third of the directors of companies with 30 or more employees to be elected by the workforce.</td>
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<tr>
<td>Poland</td>
<td>Legislation from 1981 provides for a right to board-level participation in state-owned and formerly state-owned companies.</td>
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<tr>
<td>Portugal</td>
<td>The 1976 Constitution provides for the election of worker representatives to company boards, and legislation from 1979 confers the right of works councils to elect board-level representatives, with numbers to be determined by the employer.</td>
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<tr>
<td>Romania</td>
<td>Legislation of 1991 gives trade unions a right to be invited to board meetings in order to discuss work-related matters but there is no right to nominate or elect worker directors.</td>
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<tr>
<td>Country</td>
<td>Description</td>
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<tr>
<td>Slovakia</td>
<td>At least half of the seats on the supervisory board of private-sector companies employing 50 employees or more are set aside for representatives of the workforce. The 1965 labour code provided for participation rights for all workers, primarily through trade unions, and the 1993 Constitution includes a right of participation in the running of the enterprise; since 2002, works councils have been accorded information and consultation rights in workplaces without a trade union.</td>
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<tr>
<td>Slovenia</td>
<td>The 1991 Constitution contained a right of employee participation in the management of the enterprise and a 1993 law provides for board-level representation in companies with 50 or more employees, subject to an assets threshold. Prior to 1993, codetermination was supported by the constitutional right to participate in management; in 1993 a works council law was introduced.</td>
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<tr>
<td>Spain</td>
<td>A law of 1962, repealed in 1980, provided for employee participation at board level in public-sector enterprises and larger private-sector firms; since then, there has been no legally mandated board-level representation for workers, although in some sectors employee participation at board level has been achieved through collective bargaining. A law of 1971 provided for the establishment of works councils and their information and consultation rights were extended in 1973 and 1980; there is no co-decision right.</td>
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<tr>
<td>Sweden</td>
<td>A right of employee participation at board level was first established in 1972 and extended by later legislation, most recently in 1987. Codetermination, dating from a 1976 law, is based on the employer’s duty to negotiate and consult with the trade union on changes in the activities of the enterprise and on major changes affecting the company.</td>
</tr>
<tr>
<td>Switzerland</td>
<td>There is no provision for board-level codetermination. A law of 1993 provides for information and consultation rights and for an enterprise committee in enterprises above a certain size.</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>There is no legal requirement for worker-elected directors. Changes made to the Corporate Governance Code in 2018 now mean that listed companies must have either a worker director, a non-executive director with designated responsibilities for the workforce, or an advisory panel. They may also adopt alternative arrangements if they can explain and justify doing so. Take-up of the worker director option is therefore effectively voluntary. There is no legal requirement for works councils or similar standing bodies of employee representatives. Information and consultation rights have been enacted in the light of the requirements of relevant EU directives; there is no veto or co-decision right.</td>
</tr>
</tbody>
</table>

Source: Cambridge Leximetric Database (Deakin et al. 2016).

Figure 6.1 **Trends in selected codetermination laws (1970-2020)**

- Codetermined board
- Works council

Note: Scores are normalised on a 0-1 scale as shown in the vertical axis. A higher score indicates an increased level of worker protection. For further explanation of the coding method see Deakin et al. (2016).

Source: CBR Leximetric Database (Deakin et al. 2016), updated to 2020.

information and consultation rights of the kind which operate with respect to specific issues including collective redundancies, transfers of undertakings, and occupational health and safety.

Figure 6.1 shows that the 1970s was a period during which codetermination laws of both kinds were significantly strengthened, in the sense of becoming more worker-protective, across Europe. A further strengthening can be observed in the early 1990s and then again in the mid-2000s. The trend has been more or less stable since that point, indicating that codetermination is not one of the areas of labour law impacted by deregulatory reforms associated with the global financial crisis of 2008-9 and the resulting period of ‘structural adjustment’. On the contrary: in the past decade laws enhancing board-level representation of workers have been enacted in France (2013) and Czechia (2017), while workplace-level codetermination rights have recently been strengthened in Lithuania (2016).
Trends in shareholder protection

If the general picture with respect to codetermination laws is one of a wave of pro-worker legislation in the 1970s followed by a period of relative stability since then, this must be set against trends in laws relating to shareholder rights. Since the early 1990s there has been a significant rate of increase in the adoption of laws promoting shareholder voice within corporate governance. These are laws which empower shareholders to hold managers to account and in practice tend to put them under pressure to prioritise the interests of shareholders over those of other corporate constituencies, including workers. They apply with particular force in the listed company sector, which substantially overlaps with the larger enterprises where laws on board-level codetermination mostly operate. This strengthening of shareholder influence can be expected to offset the influence which workers might seek leverage over corporate management with the help of codetermination laws.

Figure 6.2  Trends in shareholder protection laws (1990-2013)

Note: Scores are normalised on a 0-1 scale as shown in the vertical axis. A higher score indicates an increased level of shareholder protection. For further explanation of the coding method see Dukin et al. (2016). SPI stands for Shareholder Protection Index. Source: Cambridge Leximetric Database (Dukin et al. 2016).
Part of the Cambridge Leximetric Database codes for changes in company law uses a methodology similar to that used to construct data on labour law. The CBR Shareholder Protection Index (CBR-SPI) is made up of ten indicators of shareholder rights. The SPI does not currently code for all European countries as the LRI does, and is only available for the years 1990-2013. The country coverage is nonetheless broadly representative of legal changes in the European region as it includes economies with a long history of financial development (France, Germany, Italy, Spain, Sweden, Switzerland and the UK) as well as a number of countries whose financial markets were initially less well developed but experienced rapid growth from the starting point of the economic transition of the early 1990s (Czechia, Estonia, Latvia, Lithuania, and Slovenia). The time period captures the most significant changes made to corporate governance laws over the past two decades.

Figure 6.2 illustrates country-level trends in the SPI. There has been a consistent and steady rise in levels of shareholder protection across virtually all countries in the period covered by the index, with increases particularly marked from around 2000.

Some of the indicators in the SPI are concerned with the extent to which the law protects the rights of minority or retail investors against majority shareholders. Others are relevant to shareholder-worker conflicts since they code for the protection given by the law to the pursuit of shareholder value over other goals or objectives of management, such as preserving employment or maintaining the enterprise as a going concern for the benefit of all stakeholders. Two variables in the SPI are of particular relevance in the present context: these code, respectively, for laws and regulations which either require or ‘nudge’ companies to appoint independent directors to boards (the ‘independent board indicator’), and which govern the conditions under which takeover bids are conducted (the ‘takeover bid indicator’).

The independent board indicator captures the degree to which laws or regulations require the appointment of directors who are external to the company’s management or wider workforce. Although, in principle, independent or non-executive directors owe the same set of fiduciary duties to the company as other directors, and are not bound to prioritise shareholders’ concerns above the wider corporate interest, there is evidence that, as a matter of practice, such directors tend to see themselves as tasked with defending shareholders’ rights against those of managers and, relatedly, of the workforce, particularly when a change of control or takeover bid is being considered (Deakin 2013). This indicator assigns a higher score depending on the proportion of board members who must be external or independent in this sense (in practice, this ranges from a single director in some countries to a third or half of the board in others).

Relatedly, the takeover indicator captures the role of laws and regulations which seek to ensure that shareholders’ interests are fully reflected in boards’ responses to takeover bids. It assigns a higher score to laws and regulations which require a bidder to purchase the entire share capital of the target company once their share of the voting equity exceeds a certain threshold, and to offer to purchase the remaining shares for at least the price they have already paid to take a controlling or influencing stake. This ‘mandatory bid’ rule is intended to protect minority shareholders by guaranteeing that they will benefit from the ‘premium’ the bidder pays to take control of the target company. It also has the effect of increasing the pressure on bidders to finance the costs of a takeover through post-bid asset sales and enterprise restrucutrings.

Because takeovers tend to lead to asset disposals and reorganisation, laws and regulations which empower shareholders when a change of corporate control is being considered can put workers’ interests at risk. Hostile bids for listed companies are comparatively rare events even in those countries, such as the US and UK, which have a relatively high incidence of them. However, the presence of a pro-shareholder takeover law has been shown to encourage certain forms of shareholder activism, including activist hedge fund interventions, and certain types of change of control transaction, including private equity-led buyouts, which have become relatively common occurrences in financial markets in Europe, following a trend which began in the US and has since spread worldwide (Deakin 2013).

Hedge fund activism is associated with rising payouts to shareholders in the form of dividends and share repurchases, while private equity-led buyouts enable shareholders to ‘cash out’ their gains and to shift the resulting costs on to firms in the form of debt. There is evidence in both cases that gains to shareholders translate into losses for workers in the form of redundancies, wage cuts, deteriorating terms and conditions of employment, and a rising incidence of precarious work (Deakin 2013).
At the start of the covered period (1990-2013), none of the countries coded in the SPI dataset had rules on independent boards. By the end of it, a norm had been established that half or more of the members of the board of a listed company should be independent, either as a matter of law or via standards set out in corporate governance codes in Czechia (2008), Cyprus (2010), Estonia (2006), France (2003), the Netherlands (2004), Poland (2002), Slovenia (2009), Sweden (2008), Switzerland (2002) and the UK (2004). The norm became one third independent membership in Belgium (2004), Italy (2013) and Spain (2003).

With respect to the mandatory bid rule, norms requiring a bidder to purchase the share capital of the target company in its entirety once they acquired either a certain threshold (which can be as low as 30%, as in the long-standing UK rule) or a controlling interest (equivalent to 50% of voting stock) were established in Belgium (1989), Cyprus (2007), Czechia (1996), France (1989), Estonia (2002), Germany (2001), Italy (2008), Latvia (2006), Lithuania (2006), the Netherlands (2006), Poland (1991), Slovenia (1997), Spain (1991), Sweden (1999), and Switzerland (1997). In a number of cases these legal changes were initiated by way of response to the adoption of the Thirteenth Company Law Directive (2004), which requires EU Member States to adopt a version of the mandatory bid rule.

Figure 6.3 compares the rate of increase in the two codetermination indicators with the independent director and takeover bid indicators over the period between 1990 and 2013 for those countries coded in both the LRI and the SPI. The first two indicators increased relatively slowly, the latter two more rapidly.

Put another way, what Figure 6.3 shows is that, while the evolution of workers’ codetermination and related representation rights plateaued from 1990 onwards, the rights of shareholders were significantly enhanced. Therefore, relative to the protection given to the interests of shareholders within managerial decision-making, that given to workers’ interests underwent a marked decline after 1990.
Impacts on inequality

Research has shown that income and wealth inequalities in industrialised economies peaked in the second decade of the 20th century before undergoing a decades-long decline which, however, went into reverse in the US from the 1970s and in Europe from the 1980s (Atkinson 2015; Milanovic 2016; Palma 2011, 2019a, 2019b; Piketty 2014, 2019). Piketty’s (2014) explanation for this pattern is that in a market economy there is an inherent tendency for the rate of return on capital to exceed the growth rate of the economy. Inequality declined in the middle decades of the twentieth century, he argues, as a result of the destruction of rentier wealth brought about by the two world wars and the great depression. In the final decades of the twentieth century, returns to capital revived during a period when economic growth was slowing, as a result of reduced population growth and a productivity slowdown.

If Piketty (2014) is right, the contribution of labour and company laws to inequality trends can be expected to be relatively insignificant. Legal changes will not have much impact on wider developments in the economy, which have technological and demographic origins. The law may, at best, reflect these deep-rooted tendencies; it can reinforce but not fundamentally divert them.

On the other hand, there is evidence to suggest that the steep rate of increase in shareholder rights from the 1990s onwards, during a period when employment rights had reached a plateau, has indeed impacted inequality trends. In the middle decades of the twentieth century, the ‘labour share’, which measures returns to wages and salaries, was stable at around 65% of national income in most industrial economies. Since 1990 it has fallen by around 5% in the UK, France, Germany, Canada, and Japan and, by over 10% in the US, Korea, Spain and Italy (ILO and OECD 2015). As the labour share has been falling, the capital share, which measures returns to investments and property, has risen (in national accounting terms the labour share and capital share together represent a unity, so that as one goes down the other goes up). Sjöberg (2009) shows that increases in shareholder rights, as measured by the World Bank’s Doing Business reports, are correlated with a rise in the capital share, while Ferguson et al. (2017) show that increased legal protection for shareholders, as measured by the Cambridge index (SPI), is correlated with a range of health inequalities, including rising child mortality rates in lower income groups.

Adams et al. (2019), meanwhile, using the Cambridge index (LRI), show that improvements in workers’ rights (including the two codetermination indicators) are correlated with rises in the labour share. This finding implies that while the labour share has been falling more or less consistently throughout the period covered by the part of the LRI index they analysed (1990-2013), it would have fallen even further had it not been for the labour laws enacted to protect workers’ rights. Palma (2019a, 2019b) shows that the stagnation of wages relative to labour output which can be observed in industrial economies from the early 1980s can be traced back to institutional changes permitting shareholders to extract higher returns (including the lifting of legal restrictions on share buy-backs which began in the UK and US in the 1980s; see also ETUI and ETUC 2020: 115) at the same time as institutional protections for collective bargaining were being weakened (ETUI and ETUC 2015: 48).

We know from Piketty’s research (2014, 2019) that most households in the wealthiest decile owe their position to the returns on labour captured by very highly paid professionals and managers, in particular those working in the financial sector. However, when it comes to the wealthiest 1% and 0.1% of households, where the observed increase in inequality becomes exponentially large, returns to capital (in the form of income from dividends and rents) matter more than those to labour (wages and salaries). It is likely that laws which strengthen capital rights relative to labour rights – the broad pattern in Europe, as we have seen, since 1990 – are driving at least part of this outcome (Deakin 2021; ETUI and ETUC 2015: 67 ff.).

High and rising levels of inequality may be the result of exponential returns to those with capital rights at the very top of the income scale, but they have effects beyond the top 0.1% or 1% of households. Epidemiological research shows that relative differences in income and status are correlated with measures of social wellbeing, including infant mortality, obesity, mental illness, educational performance, teenage motherhood, and homicide, across all income groups (Wilkinson and Pickett, 2008). It would seem that ‘everything else being equal, it is better to live in a more equal society’ even for those in the ‘richer part of society’ (Baumard 2016: 1137).

From a health perspective, it is better for everyone, including the rich, to live in a more equal society.
Impacts on investment, innovation, productivity and employment

If it were possible to reverse all or part of the increase in inequality through changes to labour and corporate laws, would this not come at the cost of economic performance? The idea of the ‘big trade-off’ between equality and efficiency (Okun [1967] 2015) may be a plausible position for some, and one which until recently probably represented a consensus view among European policymakers. However, it is increasingly being questioned as new evidence comes to light on how laws and institutions shape outcomes in labour and capital markets.

In this respect, an advantage of the Cambridge database is that it provides a longer time series and more extensive coverage by subject matter than alternatives, such as the OECD Employment Protection Indicators and World Bank Doing Business reports. This is important because the economic impacts of changes in labour laws can be expected to differ over the time scale being considered.

In the short run, laws strengthening worker protection impose costs on firms which may lead them to defer hirings or make redundancies in order to avoid future liabilities. In the medium to long term, however, the same laws, by making labour relatively more expensive compared to capital, may induce firms to spend more on training, thereby improving labour quality, and to invest in capital goods and organisational improvements, thereby enhancing productivity and profitability. This phenomenon has been called the ‘beneficial constraint’ effect (Streeck 1997). Laws which weaken labour by comparison to capital can be expected to have the inverse effect: a short-term rise in employment is likely to be offset by long-run declines in productivity and, ultimately, in the quality of services and products supplied by firms.

In the most comprehensive study so far undertaken using the LRI dataset, Adams et al. find evidence of the ‘beneficial constraint’ effect. In a panel data analysis of all 117 countries in the dataset covering the period 1990 to 2013, they find that increases in worker protection (including codetermination laws) are correlated with short-term increases in unemployment, which are then offset by gains in labour force participation and employment and by a fall in unemployment over the longer term. While their study does not find a statistically significant relationship between labour laws and productivity, a separate study by Deakin, Malmberg and Sarkar (2014) finds a positive correlation between the employment representation index (which includes the two codetermination variables) and productivity, as well as employment and the labour share, in a smaller sample of industrialised countries (France, Germany, Sweden, the UK and the US). Research by the ETUI on the topic also demonstrates that countries that rate higher in the European Participation Index tend to have a higher labour share in their GDP (ETUI and ETUC 2020: 155).

Labour laws also appear to be positively correlated, and shareholder protection negatively correlated, with innovation. A study by Acharya, Baghai and Subramanian (2014a), using the ‘dismissal’ sub-index of the LRI, reports a positive correlation between employment protection and innovation, as measured by patenting activity, in a sample of industrialised countries (France, Germany, the US and the UK). They attribute this to the greater willingness of workers to share knowledge with managers in countries with strong dismissal protection laws. Replicating their approach in a study of state-level employment laws in the US, they find that improvements to dismissal protection are correlated not just with a higher incidence of patenting by firms, but by an increase in the number of start-ups and a rise in the number of employees in high-tech firms in regions such as Silicon Valley (Acharya et al. 2014b). Conversely, a study by Belloc (2013), using the Cambridge SPI dataset, reports a negative correlation between innovation and shareholder rights. This result is explained by the role of investor-friendly legislation in enhancing the power shareholders have over managers to extract value from the firm over the short term, at the expense of its long-term development.

An influential argument for weakening labour laws is that worker protections deter investment in firms (Besley and Burgess 2004); conversely, strengthening shareholders’ rights...
is assumed to improve the supply of capital to the productive sector (La Porta et al. 1998). In the context of codetermination, the opposite may well be the case. Jäger et al. (2021) find that German firms that are beyond the scope of board-level codetermination laws have reduced capital intensity by comparison to those subject to joint governance by employees and shareholders, a result consistent with the ‘beneficial constraint’ effect.

More generally, it would seem that a significant part of the value released through dividends and share buy-backs during the period of the strengthening of shareholder rights since 2000 has not been finding its way into productive investment. Recent research shows that as a result of investor pressure, dividend payouts in companies have increased to over 50% of profits in recent years (since 2010) which has resulted in an increased financial vulnerability of companies and consequent increased risk of job losses, as well as a deterioration of working conditions during the Covid-19 crisis (ETUI and ETUC 2020: 156). Much of this capital flow from dividends and buyback has been diverted into property and financial assets. In 2015 the ILO and OECD jointly produced an analysis which showed that investment as a proportion of GDP in industrialised economies had been static between 2000 and 2007 and began to fall in 2008, even as the capital share was rising. The analysis concluded that ‘in developed economies, the shift in income away from labour towards capital has not produced the expected results on investment’ (ILO and OECD 2015: 12). And making labour cheap by comparison to capital has other detrimental effects: for example, the phenomenon of ‘capital shallowing’, identified with labour replacing capital, is associated with the productivity slowdown which a number of European countries experienced in the wake of the 2008 financial crisis (Pessoa and van Reenan 2014).
Conclusion

Laws supporting democracy at work have a long history in Europe, and in recent decades have been strengthened in several countries. In supporting workers’ codetermination rights, labour laws can contribute not just to greater equality, as measured by labour’s share of national income, but also improved productivity and innovation, thus leading to higher employment.

The beneficial effects of codetermination laws are, however, increasingly being offset by laws and corporate governance standards empowering shareholders. Since the early 1990s, changes to company law across Europe have brought about a major shift in board structures, emphasising the role of independent directors in holding managers to account on behalf of shareholders. Laws and regulations designed to facilitate takeover bids have further shifted the balance of power within firms towards financial interests, putting jobs and wages at risk.

Newly available data, analysed in this chapter, has clarified what is at stake in the interaction between codetermination laws and corporate governance standards. Codetermination laws, in common with labour laws more generally, have stood still in the past two decades, while shareholder protection standards have seen a significant boost. The playing field, far from being level, has been tilted in favour of capital. This is leading to an unbalanced economy, with detrimental effects on social cohesion. These developments, however, are neither inevitable nor irreversible, but can be addressed with the right laws and policies.
References


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