

I *Introduction*

In this essay I wish to explore the intersection of two broad issues. The first is the general trend towards the merger of labour law and corporation law, and in particular the increasing attention being given to mechanisms for direct worker participation in corporate governance. The second is the much-neglected but very important role that collective choice mechanisms play in corporate governance.

II *The merger of corporate law and labour law*

In the United States, labour law and corporate law have long been radically separated both in practice and in scholarship. Today, however, there is growing consensus that, whatever may have been true in the past, this split is no longer desirable.

The model of labour law embodied in the National Labor Relations Act of 1935, with its rigid separation of workers from employers and its highly adversarial bargaining procedures, is now losing its legitimacy among scholars just as it is being abandoned in the workplace. In the 1950s, roughly 40 per cent of private sector workers were represented by unions formed under that Act; today, the figure is only about 15 per cent and continues to decline.¹ Many analysts feel that the resulting vacuum is undesirable and that alternative mechanisms should be developed to assure efficiency and equity in the relations between workers and the firms that employ them.² The mechanisms that receive most attention in this regard commonly involve some form of direct representation of

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1 Paul Weiler *Governing the Workplace* (1990) 9-10

2 For a particularly thorough and thoughtful analysis, see Weiler, *supra*.

workers in corporate governance.³ As a consequence, corporate law and labour law are likely to become increasingly merged in years to come. Nor is this trend unique to the United States: indeed, most other developed countries have already gone further in that direction.

Germany, in particular, has long been in the vanguard in this respect. It began enacting legislation along these lines in the nineteenth century, and today it has a far more extensive system of worker participation in corporate governance than any other industrialized nation. Consequently, it is natural to turn to Germany to see what can be learned about alternative mechanisms for worker participation, and in this essay I shall focus on the German experience, together with the American experience, for my examples.

This conference is concerned with what 'the classical theory' of the firm can teach us about the interests of stakeholders such as workers. When it comes to economic analysis, 'the classical theory' is today of course the *neoclassical* theory of the firm and its recent outgrowths. Therefore, in exploring worker participation, it is appropriate to ask what that body of theory can tell us. In approaching this issue I want to focus on one particular aspect of the theory of the firm that has remained notably underdeveloped, but that has great promise in general and seems particularly important in understanding worker participation. I have in mind here the political character of the firm.

III *Studying the political character of the firm*

Over the past thirty years there has emerged an extensive and sophisticated literature on the economics of corporate law. The evolution of that literature has largely mirrored the evolution of the growing literature in economics on the internal organization of the firm. Very broadly speaking, there have been three important methodological developments, in successive stages.

First, the literature focused heavily on the difficulties that owners experience in policing managers. This body of work began with the managerial theories of the firm offered in the 1960s, in which the principal focus was on what managers do with the freedom they have from shareholder control. Subsequently, in the 1970s, the issue was then pursued in the principal-agent literature, which focused on the reasons why

³ Examples are proposed worker representatives on the board of directors, full worker ownership, ESOPs, company-sponsored unions, and Paul Weiler's employee participation committees.

control by owners is weak and on the mechanisms that can be designed to confine managerial opportunism. Among the important legal applications has been the extensive discussion of the market for corporate control and its regulation.

Second, beginning in the early 1970s there developed the analysis of transaction-specific investments and their importance for contracting – a development associated closely with the work of Oliver Williamson. The principal contribution to law has been a more subtle understanding of long-term contracting, the structure of ownership, and associated anti-trust issues.

Third, since the late 1970s there has been rapid development in the theory of non-cooperative games. On the legal side, that work has been employed to explore such phenomena as labour negotiations, predatory pricing, and hostile takeovers.

All of this literature focuses primarily on situations in which there are only two parties to a transaction. Yet there are many situations in which there are many more than two participants simultaneously involved in intra-firm decision-making. This is true, in particular, whenever a decision is made through a collective choice mechanism such as voting. And there is in fact a great deal of voting in corporate enterprise. Voting is employed whenever a corporation's shareholders choose the firm's directors or approve fundamental corporate changes such as merger or dissolution. It is also the mechanism routinely employed for making decisions within the corporate board itself. On the labour side, in turn, voting is used when workers elect union officials or works council representatives, or when they must exercise their choice as a group on basic issues such as calling for a strike.

In short, corporations are, by their very nature as *corporate* (which is to say, collective) institutions, also political institutions. Consequently, corporate decision-making often has an important political dimension. And this means, in turn, that corporate decision-making involves complexities that go well beyond the types of strategic behaviour involved in simple two-party bargaining.

Literature on the organization of the firm has so far tended to neglect these political dimensions of the firm. There is remarkably little systematic examination of the characteristics of the various types of collective choice mechanisms that business firms employ, including the costs those mechanisms involve and the efficiency of the decisions they yield.

This may be because, if one focuses only on *shareholder* decision-making, it is often possible to ignore these political issues. Shareholders have highly homogeneous interests with respect to most corporate decisions: they all basically want to maximize the net present value of

future distributions. Shareholders may, to be sure, differ among themselves concerning some issues, such as distributions of earnings that will affect them differently depending on their personal tax status. Where such divergences in interest are potentially serious, however, they can often be muted or avoided if the shareholders simply sort themselves out among firms, or invest in different types of securities, according to their differing financial needs.

More serious conflicts can arise among a firm's shareholders where some but not all of them also have some other transactional relationship with the firm – or example, as suppliers, salaried officers, customers, or holders of debt securities. Indeed, in the United States much of corporate law is concerned with managing these conflicts. (Most of the rest is concerned with constraining managerial opportunism vis-à-vis the firm's owners in general – that is, with the basic agency problem.) But these conflicts usually involve only two discreet groups of shareholders – for example, the controlling shareholders versus the minority, the shareholders who are paid officers of the firm versus those who are not, or the shareholders who have inside information versus those who lack it. Therefore, these conflicts do not really involve a problem of *collective* choice, but rather just conventional two-party bargaining. Moreover, in such situations it is often possible for the parties, or a court that reviews their behaviour, to use some relatively clear and objective criterion – such as an appraisal of stock values based on projected future earnings – to place boundaries on the range of acceptable outcomes, and in particular to constrain opportunism. As a result, to date it has been relatively easy to neglect the political character of the firm.

To be sure, there is reason to believe that, in American corporate law, problems of intra-shareholder politics will become more complex in the future. Now that hostile takeovers are no longer popular, there is renewed interest in actively using shareholder voting – which is to say, proxy fights – as a means of controlling corporate managers. And this means that the interests and judgments of a large group of shareholders – including a growing number of sophisticated institutional investors who may have differing theories about what is appropriate for corporate management, and who may want their own representation on a corporation's board – may have to be aggregated for purposes of making a single decision. But I shall leave it others to deal with the problems of involving investors more actively in corporate governance. Rather, I want to focus here on problems of collective choice involving workers.

Much of the scholarly work that has been done to date on worker participation, and particularly the theoretical work, has tended to assume

that workers are a homogeneous group who have clearly defined interests vis-à-vis shareholders.⁴ For some purposes this is a reasonable simplification. As a general matter, however, it is obvious that workers often have widely diverging interests. More particularly, different groups of workers within a firm will often be affected differently by any given decision that is made by the firm, and thus will have different preferences about the outcome to be chosen. For example, when it comes to designing a pension plan or determining the probability that workers will be laid off, older workers are likely to have much different preferences than do younger workers. Similarly, there will be important questions of firm policy on which workers are likely to differ according to their gender, their age, their health, their family's mobility, the particular plant they work in, or whether they are blue collar or white collar. Moreover, in contrast to the situation with shareholders, there is often no simple objective standard that the parties themselves, or a court or other third party, can employ to place tight boundaries on the range of solutions that is acceptable when workers' interests differ along such lines.

These problems are substantially aggravated when workers and shareholders are brought together to share power in the same decision-making body, such as the corporate board of directors. However radically workers may differ in interest among themselves, in general there will of course be even greater differences of interest between workers and investors.

It follows that, as workers become more directly involved in corporate decision-making, the characteristics of alternative collective choice mechanisms, both in terms of the ways that they resolve conflicts and aggregate preferences and in terms of their transactions costs, will become increasingly important as a matter of policy and, in particular, as a matter of law. For it is through law that we will decide what kinds of decision-making mechanisms corporations may or must employ, and it is through law that society must resolve the conflicts that those mechanisms cannot decide.

⁴ See, for example, the essays collected in H. Nutzinger and J. Backhaus *Codetermination: A Discussion of Different Approaches* (1989). In his own contribution to that volume, Backhaus explicitly acknowledges this limitation, offering the qualification that his analysis is based 'on the somewhat counterfactual assumption that labour and capital representatives each form homogeneous groups.' Jürgen Backhaus 'Workers' Participation Stimulated by the Economic Failure of Traditional Organization: An Analysis of Some Recent Institutional Developments' *ibid.* 229, 250

In seeking to expand the theory of the firm to incorporate a more sophisticated view of the properties of collective choice mechanisms, it is natural to turn to political theory. And in fact contemporary political theory has recently begun to focus with some care on the properties of collective choice mechanisms. In the wake of Arrow's seminal work four decades ago there developed a substantial literature describing the pathologies to which collective choice mechanisms are subject. More recently, over roughly the past decade and a half, the literature has begun to look more closely at the types of institutions and rules that have evolved in various settings to constrain those pathologies. For applications, however, the literature has focused principally on governmental institutions, and in particular on the characteristics of the US federal legislature. While there are useful parallels between those institutions and the types of collective choice mechanisms employed in private firms, there is also much that is unique in the latter. Consequently, there remains much work to be done in extending the theory of the firm to encompass problems of collective choice.

In contrast, there is a special advantage to studying collective mechanisms in the corporate context. Since there are so many private firms in the economy, and since these firms operate in competitive markets, the structures that they employ are subject to market selection. The invisible hand will tend to punish those firms that choose inefficient choice mechanisms and reward those that choose efficient ones. Consequently, we can gain some insight into the relative efficiency of different mechanisms simply by seeing which institutions survive in the long run and which do not. Of course, in applying such a survivorship test we must be careful. Regulation can strongly bias market outcomes, and the market itself can sometimes operate slowly and capriciously in selecting institutional forms.

In an effort to emphasize the importance of the problem of collective choice, to point to some particular issues worth studying, and to suggest a few tentative conclusions, I shall briefly survey here the principal devices that have been used to date to provide for worker participation in corporate decision-making, focusing in each case on the properties of the device as a collective choice mechanism. In particular, I shall examine, in turn, full worker ownership, partial worker ownership, board-level representation, unions, and works councils. In undertaking this survey I shall make little effort to be methodologically rigorous. Rather, since my principal object here is only to raise issues and not to resolve them, I shall indulge in rather casual and speculative theorizing and empiricism. And, as already suggested, for examples I shall confine myself largely to the United States and Germany.

IV *Full worker ownership*

I begin with full worker ownership because this is the subject on which my own work has concentrated most heavily and because I believe that it most clearly frames the issues and evidence.⁵

In developed market economies, and particularly in the United States, there is a surprisingly large amount of worker-owned enterprise. Most of these firms are in the service sector, where they are particularly common in professional services such as law, accounting, and investment banking. There are, however, a few prominent examples in the industrial sector as well.

Worker-owned firms have some potentially important efficiency advantages vis-à-vis investor-owned firms in which workers are simply hired on a contractual basis. First, worker ownership can improve incentives for productivity, both because it gives each worker a personal share in the returns from her own work and, perhaps more importantly, because it gives workers an incentive to monitor their fellow workers. Second, it reduces the firm's incentive to exploit workers if they become locked in to the firm over time by making personal and professional investments that are firm-specific. Third, it removes incentives for strategic behaviour in wage bargaining. Fourth, it allows easier and more credible communication of worker preferences to management. Fifth, it inclines the firm to respond to the preferences of the average worker rather than, as in a firm that simply hires workers on the market, the preferences of the marginal worker. Sixth, it promises to reduce agency costs since workers are likely to be in a better position to monitor managers than are shareholders. Seventh, and last, worker ownership yields workers whatever satisfaction they derive directly just from participating in the process of governance or having a greater sense of personal control.

Nonetheless, worker ownership also has some obvious disadvantages. One is poor capital liquidity for both workers and the firm. A second is poor allocation of risk. A third, and the one of most importance to us here, is a potential increase in the costs of firm decision-making. The latter costs include both the transaction costs of the decision-making

5 Henry Hansmann 'When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy' (1990) 99 *Yale LJ* 1749-1816; Henry Hansmann 'The Viability of Worker Ownership: An Economic Perspective on the Political Structure of the Firm' in M. Aoki, B. Gustafsson, and O. Williamson (eds) *The Firm as a Nexus of Treaties* (1990); Henry Hansmann 'Ownership of the Firm' (1988) 4 *J of Law, Econ. & Org.* 267-304

process itself (such as attending meetings or acquiring information) and the costs engendered by substantively inefficient decisions.

If we examine the types of firms and industries in which we do and do not find worker ownership, we can draw some important inferences about the relative magnitudes of these different costs and benefits of worker ownership, and about the costs of collective choice in particular. Broadly speaking, two general observations can be made. First, worker ownership tends to arise only where there is extreme homogeneity of interest among the workers involved. No matter how large the potential benefits of worker ownership may seem in any given setting, it rarely appears if the workers who would share ownership have diverse interests in the firm. Second, where there is substantial homogeneity of interest among the workers involved, worker ownership is surprisingly common. The other costs associated with worker ownership – in particular, poor diversification of risk and the difficulty of assembling capital – do not appear to be particularly serious.

I shall not try to summarize the evidence for these conclusions here. An example, however, may help to clarify the issues involved. Consider, therefore, the recent takeover effort directed at United Air Lines by its pilots. The 7,000 pilots involved in that attempted takeover are precisely the type of workers for whom worker ownership has commonly proven successful – namely, a class of workers who all perform very similar jobs and occupy a single horizontal stratum within the firm, with one member of the class rarely supervising another. In short, there is very little vertical or horizontal division of labour among the workers involved. Indeed, driver-owned transportation firms are quite common throughout the world. Workers such as United's pilots, by virtue of the jobs they perform, all have very similar interests in the firm in the sense that they are all likely to be affected more or less the same way by nearly any decision that the company makes. Consequently, collective decision-making among this group of workers is potentially quite unproblematic. And apparently this is an important reason why such firms are viable.

Indeed, the pilots at United Air Lines came very close to mounting a successful takeover. At least for the first round of bidding they were able, evidently with little difficulty, to obtain the necessary capital to finance the acquisition. It was, instead, intense opposition from other employees – in particular, the airline's mechanics and their union – that was evidently in large part responsible for the failure of the bid. In an effort to resolve the conflict, the pilots ultimately included both the mechanics and the airline's flight attendants among the employees who would share ownership. This latter bid quickly collapsed, however. And, indeed, the effort was probably doomed in any event. For while the pilots alone could

probably have governed the firm successfully, from the observed record of worker ownership in general it seems very unlikely that shared governance among the three different groups of workers would have proven viable.

In sum, worker ownership appears viable if, but only if, the workers sharing ownership have highly homogeneous interests.

From what we know of public choice theory, however, strong homogeneity of interest is not in itself sufficient to eliminate the pathologies of collective choice mechanisms. If the choice set is sufficiently large, for example, then majority rule may not yield a stable equilibrium even if preferences are only very slightly heterogeneous. To take a mundane example, if a majority of the pilots in a pilot-owned airline have brown eyes, they might decide to vote for a policy under which brown-eyed pilots get paid fifty per cent more than do blue-eyed pilots. But then, if the pilots over five feet ten inches in height form a majority, they might in turn vote for a policy in which pilots over five feet ten get paid sixty per cent more than do shorter pilots. And so forth. Thus if, as the evidence suggests, substantial (but of course never complete) homogeneity of interest is sufficient to reduce considerably the costs of collective decision-making, there must be some special reason why this is so.

One likely possibility is that homogeneity of interest serves to limit substantially the range of possible outcomes from which the mechanisms for collective choice can select. Where there is substantial perceived homogeneity of interest, as where all workers have essentially the same role within the firm, socially shared norms of fairness, as well as the fiduciary rules that a reviewing court will enforce, are likely to rule out of bounds all but a relatively narrow range of possible outcomes – that is, to constrain substantially the size and dimensionality of the available choice set. Thus, neither conventional morality nor the courts may sanction a system in which pilots with brown eyes get paid more than do those with blue eyes.⁶

6 Of course, homogeneity is in important respects a social construct. Consequently, what passes for homogeneity in one setting may not in another. There was a long period in which it would have been both morally and legally acceptable in the United States for pilots with white skin to be paid more than pilots with black skin. Heterogeneity of this sort may be sufficient to defeat worker ownership even where the workers involved all have essentially the same job in the firm. There is reason to believe, for example, that an important reason why farmer-owned marketing cooperatives are much less common in tobacco than in other crops is that there is much more racial diversity among tobacco farmers than among other types of farmers. Among the important projects facing us in improving our understanding of governance structures is to understand better what forms and degrees of

It may also be significant in this regard that many worker-owned firms effectively give members the right of exit at will on reasonable terms – something that investor-owned firms seldom do. For example, in the many firms of service professionals that are formed as partnerships, each member has the right to leave the firm and not only take her own human capital with her but also demand an accounting for her share of the firm's value. By giving each worker-owner a position beyond which she cannot be oppressed or exploited, this device further constrains the choice set for the firm as a whole.

Similarly, worker-owned firms often adopt, as a more or less constitutional matter, general allocative rules that have the effect of reducing the degree of potential conflict in collective decision-making – further reducing, as it were, the size of the decision space – and that are hard to explain on other grounds. These include, for example, rotation of jobs as well as schemes to apportion earnings equally or by some other clear and objective formula.

Worker-owned firms also commonly employ various devices that are evidently designed specifically to dampen the intensity and volatility of partisanship. One is to have directors serve long terms and not be removable except for cause, as is done in the famous complex of worker cooperatives at Mondragon in Spain. Another is to give outsiders the right to intervene when internal decision-making produces inefficient results. For example, the central bank at Mondragon can step in and take over management if the elected management gets into difficulty. The important role of the communist and socialist parties in Italian worker cooperatives may be another example.

Another common approach is to structure governance so that a substantial fraction of the firm's directors must be outsiders, so that no policy can be adopted without either the concurrence of the outsiders or else near unanimity among the insiders. The Weirton Steel Company in West Virginia, which was purchased by its workers in the early 1980s, offers an example, as does the structure proposed for the board of directors in the pilots' proposed takeover of United Air Lines. An extreme form of such devices is to be found in those firms in which the whole board not only consists of outsiders but is self-appointing and simply charged with managing the firm as fiduciaries *on behalf of* the workers rather than being elected by them. This is the situation, for example, in most of the large firms termed 'worker cooperatives' in Britain.

homogeneity are important in determining the efficacy of alternative governance mechanisms. I offer here only the crude general observation that *some* substantial degree of homogeneity of interest appears to be important in making worker governance viable.

Indeed, it is arguable that worker ownership generally serves just to insure that a firm's workers *as a whole* are not exploited by the firm, and not to provide a means for truly effective worker participation and representation. To the extent that worker ownership *does* lead to improvements in worker participation in firm decision-making, these benefits may principally come, not directly through worker election of the board of directors, but rather in the encouragement that worker ownership gives the firm to set up other forms of worker consultation such as works councils and quality circles.

It would be easier to draw definite conclusions here if we had better studies of the way that decision-making actually occurs in worker-owned firms. So far, there is remarkably little systematic, or even anecdotal, information available along these lines. For example, although there are tens of thousands of large firms of service professionals in the United States, we still know very little about the way in which power is actually exercised in such firms. Even Mondragon has not been the subject of a close analysis of collective decision-making.

V *Partial worker ownership*

In the United States there are many firms in which workers have obtained a substantial *partial* ownership interest. The principal vehicle for this has been the employee stock ownership plan, or ESOP. This is, in effect, a pension plan that invests exclusively in the stock of the employing firm. There are perhaps 10,000 firms with such plans in the United States today, including 500 to 1,000 in which the plan owns a majority of the firm's equity stock.

One of the most striking facts about such plans, for present purposes, is that they have brought very little worker participation in governance. It is difficult to identify a single firm in which the workers elect a majority of the board of directors, and indeed there appear to be only a few of these firms in which there are any worker directors at all. Various factors are responsible for this outcome. One is that, in closely held firms, the trustee of the pension plan often has the authority to vote the stock on behalf of the workers, and the trustee is commonly appointed by the firm's management. Another is that cumulative voting for directors is unusual among American corporations, so that minority or unorganized shareholders often go unrepresented.

The principal interest in ESOPs has come, not from workers, but rather from investors, managers, investment bankers, and banks. And these are in fact the groups whose interests the ESOPs appear largely designed to serve. Thus it is not surprising that ESOPs involve little worker participation in governance. Nonetheless, given that the instrument exists, and

that it benefits from large tax subsidies, it is striking that it has been so little used for securing greater worker participation.

It may be that this is, in effect, a tacit admission by all involved that partial share ownership is a poor basis on which to build worker participation. Workers, in voting their stock, have interests that clearly conflict with those of non-worker shareholders. Moreover, an ESOP must by law extend to all workers, and a substantial fraction of all ESOP stock is in the hands of white-collar and managerial employees. Any election to the board – such as might follow from cumulative voting – would therefore raise questions of just *which* workers were being represented. In a firm with a union, for example, would the employee-elected directors end up representing the unionized or the non-unionized employees? Without more refined means for electing directors from the workers by class of employees, it is not clear how representative of the workforce as a whole the worker directors would actually be. This is not to say that these issues could not be worked out. But so far they have not been. And, in the meantime, all involved seem simply to have decided that using ESOPs to provide for board representation by workers is not worth pursuing. Perhaps this is also further recognition that, as our previous discussion of full worker ownership suggests, even if the worker-elected directors *were* representative of the workers, there would still be serious problems in group decision-making.

VI *Worker representation on corporate boards*

German-style co-determination – by which I mean the large representation on a corporation's supervisory board to which German workers are entitled under the 1951 coal and steel legislation and under the more general legislation adopted in 1952 and 1976 – has roughly the opposite characteristics from ESOPs. It provides for substantial worker participation in corporate governance but requires no equity investment and offers no direct participation in net earnings. The resulting legal structure is unusual but by no means unprecedented, even if viewed in terms of American law and institutions. Translated into American law, a co-determined firm combines elements of a business corporation, a cooperative corporation, a non-profit corporation, and a partnership. If one had to offer a brief description of the resulting structure in traditional terms, one would say that it yields, at least formally, a firm that has roughly the character of a hybrid producers' cooperative, with suppliers of both labour and capital sharing ownership.

If all workers were homogeneous, and if the workers had complete parity on the corporation's board, then we would have a structure

roughly like a two-person partnership, in which the two parties must continually bargain between themselves over all relevant matters concerning the operation of the firm. It would also have something of the character of ordinary collective bargaining, except that it would have the advantage that information would be fully shared and that the terms of the agreement might be more easily adjusted as time goes along.⁷

Such a structure is, arguably, roughly what we see in the German coal and steel industry. The worker representatives there have been granted substantial parity on the board of directors. Moreover, the worker representatives arguably reflect a substantial homogeneity of interest induced by the heavily blue-collar nature of the work and, probably much more importantly, by the substantial role given to the union in representing the workers on the board – since the highly centralized structure of union authority in Germany presumably tends to yield a common policy for the worker representatives vis-à-vis the investor representatives on the boards in these firms. Or, to put the issue the other way around, without a strong role for the union, full parity for the worker representatives might either yield substantial instability, as different groups of worker representatives sided with the shareholder representatives at different times, or else just reduce the worker representatives to impotence and leave most decisions to be made, in effect, by the shareholder representatives alone.

In those industries covered by the Co-Determination Act of 1976 (namely, all firms outside of coal and steel in which there are more than 2,000 employees), it seems likely that the workforce itself is often less homogeneous than it is in iron and steel. But more importantly, the unions have not been given as large a role in the process of selecting worker representatives to the supervisory board. As a result, the worker representatives on the board represent constituencies with diverse interests. The mandated representation system for the workers reinforces this, since it requires that there be included, among the worker representatives, at least one representative from each of three classes of workers: wage earners, salaried employees, and managerial employees. It follows that there is a potential threat that politics at the board level, both among workers and between workers and shareholders, could yield instability and inefficiency.

A variety of devices, however, seem well designed to prevent that result. The first and most important of these devices is the lack of full

⁷ This is roughly the (stylized) characterization offered in Jürgen Backhaus, *supra* note 2.

parity for labour on the board: if there is deadlock between the worker and the shareholder representatives, a casting vote is effectively granted the shareholder representatives. Second, there is the dual board structure in Germany in which the higher 'supervisory' board, on which the worker representatives sit, is distant from all but the broadest decisions of policy. Third, there is the provision for separate managerial representatives among the employee representatives, with the result that one or more of the worker representatives is often likely to side with the shareholder representatives. Fourth, and finally, the matters of most direct importance to workers are not decided at the level of the supervisory board. Rather, either they are decided higher up, at the industry level, through collective bargaining between the unions and the employers' associations, or they are decided at a lower level in dealings between the firm's management and the works councils. As a consequence, the board is not used for making the particular types of decisions where workers and shareholders have the most strongly conflicting interests, and where the workers have the most strongly conflicting interests among themselves.

Indeed, it appears that co-determination has not had a substantial impact on firm decision-making at the board level, which continues to be dominated by shareholder interests in firms outside the iron and steel industry. Rather, the worker representatives to the supervisory board arguably play a largely informational role, providing a credible source of information from the firm to the workers (and vice versa) in support of the workers engaged in conducting union bargaining and in the works councils, where the real worker influence takes place. This suggests, in turn, that there may not be much difference between the regime imposed on those firms covered by the 1976 law and the smaller firms still covered by the 1952 law, which provides for only one-third of the directors to be worker representatives, and indeed that both these systems may be little different in practice from the regimes imposed in the Scandinavian countries and elsewhere, under which workers have the right only to elect between one and three members to the board.

VII *Unions*

Unions are potentially subject to many of the same electoral pathologies that might affect worker-owned firms or co-determined firms. Therefore we might also expect to discover among unions various institutions that have arisen to constrain these tendencies.

In American unionism, there are some obvious institutions of this sort. To begin with, unions are confined to representing only employees who

have no supervisory responsibilities – which means that in most basic industries they are largely confined to representing blue-collar employees, while in service enterprise they largely represent clerical employees. This immediately imposes a substantial degree of homogeneity on the interests of the workers that the unions represent.

Second, companies are required by law to bargain with unions only over a limited range of issues, including principally wages and other immediate conditions of employment. This means that many issues that might divide the workforce, such as plant closings, are not likely to be subject to collective bargaining, and hence will not stress the internal politics of unions.

Third, American unions have traditionally been relatively oligarchic and undemocratic. While this has generally been deplored by commentators, it may at least serve the functional purpose of avoiding some of the pitfalls of the democratic process.

Fourth, as we have already noted, unions in America represent only a small and declining fraction of the workforce. Among the reasons for this decline may in fact be the increasing heterogeneity of the workforce. When the typical worker was a relatively uneducated white male engaged in unskilled or semi-skilled labour, it may have been much easier for a single union to represent his interests. With better education and greater heterogeneity, internal union politics are likely to become more participatory and more complex. And, ironically, this very increase in participation may make unions less viable, for the reasons we have been discussing here.

The substantially greater share of the labour market represented by unions in Germany is perhaps in part a consequence of the ways in which they differ in these respects from American unions.

First, the relatively high percentage of the German workforce that remains in basic manufacturing may be important here, if in fact workers in such industries tend to have more homogeneous interests.

Second, German unions play less of a role in determining the precise terms offered workers at individual firms than do American unions. Much of the detail is left to be worked out at the level of the firm or the plant through the works councils. The unions can therefore simply represent workers where their interests have most in common.

Third, both unions and collective bargaining in Germany are highly centralized. At the same time, German unions, in contrast to American unions, play only a modest direct representation function at the shop floor level, which is often handled instead – to the extent that it is handled at all – by the works councils. This pattern of organization presumably reinforces the oligarchic character of the

unions and hence insulates them further from the potential stresses of worker politics.

Fourth, Germany does not have the closed shop. Consequently, workers who sharply disagree with a union's positions can join another union or not join any union at all. In the United States, in contrast, a union must endeavour to represent *all* of a firm's workers who fall within its jurisdiction.

VIII *Works councils*

Under legislation adopted in 1972, all German firms with at least five employees are required to have one or more works councils, elected by the firm's employees, to represent the employees' interests. This legislation builds on a series of earlier enactments concerning employee committees that reach as far back as the nineteenth century. The works councils are the feature of German institutions that are most at variance with those in the United States. As with the German unions, the comprehensive character of the works councils is impressive; eighty per cent of workers are represented by them.

As with the other forms of worker participation surveyed here, however, the works councils have a variety of features that seem well designed to mute the electoral process.⁸

First, the law provides that the works council representatives are to be elected according to constituencies. There is a separate council for each plant. While there is provision for higher-level works councils to be formed in multi-plant firms, such councils have seldom been formed.⁹ Salaried and wage (white-collar and blue-collar) employees are to elect representatives separately, with the numbers of each established by a statutory formula. And male and female employees are also intended to be represented proportionately. Taken together, these provisions substantially circumscribe the scope of politics in choosing representatives. Further, by having a separate works council for each place of work, the law removes an important source of diversity of interest among the members of each council.

8 The basic legal structure of the German works councils is surveyed in Walter Kovenbach *Employee Councils in European Companies* (1978) 109-44. For detailed case studies of the ways in which works councils actually operate in a broad range of firms of different sizes in different industries, see Karen Williams *Industrial Relations and the German Model* (1988).

9 P. Hanau 'Federal Republic of Germany' in Kolvenbach (ed.) *Handbook on European Co-Determination* (1968)

There are also various devices through which works council members are insulated from the immediate influence of the workers they are supposed to represent. Council members are elected for three-year terms and cannot be removed except for cause. The unions play a large role in nominating representatives, and often have substantial influence over their policies. At the same time, works council members are prohibited from participating actively in union-type activities such as organizing workers for action against the employer.

For these reasons, presumably, there is relatively little consultation between works council representatives and the workers on the shop floor, and the works councils do not 'represent' the workers in any very direct sense. Indeed, it has been suggested that German works councils would risk becoming the complete captives of the employers were it not for the union role in choosing and advising the participants in the councils.¹⁰ Yet even the unions themselves, in comparison with their American counterparts, have relatively little direct contact with workers on the shop floor. Rather, as we have already noted, authority in the unions flows largely from the top down.

When we turn to the works councils' actual participation in corporate decision-making, we see that there is little effort to employ voting or other related collective choice mechanisms. In contrast to the supervisory board, where workers and shareholders both have representatives who are expected to vote as a group in making decisions, a works council has only worker representatives and the council is expected to bargain as a single entity with management. The works council is assigned by law various issues on which it has a veto over the firm's decisions; if an agreement with management cannot be reached, issues are to be resolved by arbitration.

IX *Conclusion*

Any system of law that governs worker-shareholder relationships must seek to aggregate preferences in a fashion that economizes on transaction costs while yielding substantive decisions that are both fair and efficient. The German system of corporate law and labour law, which I have chosen to focus on here, may or may not represent a good model for other countries such as the United States to imitate. But it is almost certainly true that any successful approach must, like the German system,

¹⁰ Clyde Summers 'An American Perspective on the German Model of Worker Participation' (1987) 8 *Comp. Labor Lj* 333-55 at 351, 353

involve a complex set of institutions that is highly articulated and interconnected, with checks and balances designed not just to activate worker participation but also to place substantial restraints on the play of intra-firm politics.

We are just beginning to develop the theory and evidence necessary to analyse the properties of the alternative collective choice mechanisms that are available for these purposes. The further refinement of those tools and their integration into the theory of the firm are important items on the agenda for both lawyers and social scientists, since the available evidence suggests strongly that the properties of collective choice mechanisms place important practical limits on the available forms for enterprise organization.