Beware, union on board? Why Germany's worker directors need to justify their jobs

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For Klaus Bräunig the next few months represent a tough, even treacherous, journey. A toplobbyist with Germany's main industry federation, he is charged with negotiating what he calls one of Germany's "most dangerous political minefields". His objective: to reduce the power of workers and trade unionists over corporate decision-making.

Chancellor Angela Merkel is due today to enter the same difficult terrain when she addresses 900 labour officials and politicians in a Berlin hotel on the future of co-determination, the system of worker representation that gives German employees more direct influence over corporate strategy than any other advanced economy.

Ms Merkel knows it will not be easy. In May she was jeered by trade unionists when she called for reform of what Germans call *Mitbestimmung*. Aware that a wrong move could spark labour unrest and tensions with the Social Democrats, coalition partner of her Christian Democrats, she will praise the system as a pillar of "Deutschland AG" that over decades has remained standing while other elements of Germany's postwar economic model have crumbled away.

But a renewed call for change is also likely, arguing that Germany's recent wave of economic reforms must be extended to co-determination if its companies are to remain competitive.

Pressure for change is coming from other quarters too. For the first time since co-determination was made mandatory in large companies 30 years ago, a high-level commission is due in November to report to the government on the merits of giving union officials and works councillors seats on the top-tier supervisory boards of some 2,700 companies including global players such as DaimlerChrysler, Siemens and Deutsche Bank. Jürgen Thumann, Mr Bräunig's boss at the BDI industry federation and a member of the commission, is leading the charge by German and international lobby groups for radical reforms that, they argue, would cut costs, speed decision-making and make companies more agile in operating across the European Union and beyond.

Co-determination should be voluntary, they argue, with at most one-third of seats reserved for labour advocates rather than as many as half, as at present. Unions, also on the commission, reject such changes and favour extending Mitbestimmung or retaining the status quo.

While co-determination exists in some form on the national law books of 18 of the EU's 25 member states, Germany's system is the most extensive, so events this autumn are being watched closely. Changes could reshape European corporate governance standards and affect foreign companies' investment decisions.

Mr Bräunig is upbeat about his difficult mission. "We have a strong case to make," he says.

Yet he appears set to fail. The commission may suggest modest reforms butit is unlikely to muster enough support to disturb the intricate web of shared interests - some organisational, some financial - that through co-determination link employee representatives, trade unionists, personnel managers and company executives.

As such, the struggle to modernise Mitbestimmung also highlights the difficulty of reforming the corporatist approach to economic decision-making that, for better or worse, has characterised Germany's postwar history.

Mitbestimmung started during Germany's economic re-emergence after the second world war, with a series of laws culminating in a 1976 decree that aimed to create deep roots for business in society.

The most extensive participation rights exist for staff in companies with more than 2,000 employees: these must allocate half the seats to worker representatives. A total of 5,142 such representatives - including around 1,700 union officials - occupy such posts in 729 companies. Around 30 per centof these are subsidiaries of foreign companies (see chart). A further 2,000 companies with between 500 and 2,000 staff allocate one-third of their boardseats to employee representatives.

The influence exerted by these office holders, for instance on investment decisions, is the immediate reason why, for Germany's unions, the battle for co-determination is one that cannot be lost. Hit recently by falling membership and weakening industrial relations power, unions have come to rely on co-determination - both in supervisory boards and factory-level works councils - as a key institutional prop. Membership of unions belonging to the DGB national federation has fallen by 27 per cent in the last decade, from 9.35m in 1995 to 6.78m.

Moreover, Thomas Otto, an expert on co-determination at the IG Metall engineering union, argues that weakening the system would increase pressure on other labour relations forums, in particular on sector-wide collective bargaining. "This could lead to higher wage demands," he says.

Yet, vitally, board seats for workers have also become an established factor in the power plays between employee representatives and senior managers within companies. It is one of the tasks of supervisory boards formally to appoint CEOs and other executives and to agree their salaries and perks. This gives worker representatives power to demand trade-offs.

Unsurprisingly, this is an area few corporate executives want to talk about openly. A general sensitivity in business over co-determination means companies rarely go beyond platitudes in their formal comments on the system.

Confronted on this, Mr Bräunig is frank. "Does it really surprise you?" he counters. "Executive board members have their [employment] contracts signed off by the employee representatives on supervisory boards. Besides that, no company wants to criticise Mitbestimmung in public, as this will increase tensions within the company. That damages business."

When they do break cover, comments by current - or more commonly, former - executives are often explosive. Speaking at a small expert gathering in January, Manfred Gentz, former finance director at DaimlerChrysler, admits it is "politically incorrect in Germany to criticise co-determination".

Mr Gentz, who was also the car company's personnel chief for nine years and is now president of Germany's international chamber of commerce, complained that co-determination made managers less willing to take tough, unpopular decisions and more likely to make trade-offs. Supervisory board support for the performance-related pay of executives would be traded with cash bonuses for the workforce, or the appointment of a new top executive would be linked to job security pledges for employees, he says.

In extreme cases, this can lead to charges of corruption, as in a scandal last year at Volkswagen, where managers paid works councillors for exotic holidays and prostitutes. But, Mr Gentz implied, VW is not so unusual. "Aren't there the seeds [of such practices] in nearly all companies?"

The unions argue that what happened at VW, and reports of dealmaking by supervisory board members elsewhere in the country, are isolated cases. And for them, there is another reason to defend the system's reputation: money. Employee representatives on supervisory boards receive the same, often generous, company allowances as the other board members. But, under a system unique to Germany, the labour advocates are expected to transfer the bulk of that money to an independent union-oriented foundation.

What started modestly decades ago has turned into a minor gold mine as payments for board members have spiralled. Average annual allowances for supervisory directors in companies with more than 2,000 staff are between €25,000 and €30,000, Mr Otto says, adding that "payments of over €100,000 are also not uncommon".

Trade union-backed board members can retain only around 10 per cent of this money. "We don't want careerist motivations driving people to take these seats," says Mr Otto.

Prime recipient of the rest is the Düsseldorf-based HBS, a foundation named after Hans Böckler, a former German union leader. It received €27m in board allowances last year - an 85 per cent increase on the amount transferred a decade earlier. HBS in turn provides unions with extensive research on employment and wage bargaining trends, plus advice and campaign materials on co-determination.

The money is useful - but also politically charged. Since the foundation's resources come originally from companies, "we have to be careful that the charge does not arise of being financed by our opponents", says Lothar Schröder, executive board member for co-determination at Verdi, the services trade union. He stresses the HBS's charitable status but does not deny that the foundation - whose governing board is led by Michael Sommer, DGB chairman - is "politically close to the unions".

Some in business argue that, since falling membership has in many unions triggered financial cuts and job losses, this extra pot of money - totalling more than €210m since 1995 - plays a role in the unions' strong defence of co-determination. As Jürgen Kurz of the DSW shareholders' pressure group says: "It's certainly ironic that companies are financing their sworn enemies. This money is one reason why unions don't want to change Mitbestimmung."

Labour officials flatly deny any connection, noting with some justification that the budgets of unions - such as Verdi's annual membership revenues of €400m - are large compared with the HBS donations. Mr Schröder even complains it is "completely false" to merely suggest that the HBS funds influence union views on co-determination.

Another senior union official, requesting anonymity, says: "Of course the work of the HBS is politically important and we would be sorry if the €27m was not there. But this is additional money, outside mainstream union work. It is perhaps one factor in our broad context on co-determination, but plays no direct role in our views on why the system should be retained."

Yet a new trend is also relevant. Verdi last year started instructing its 1,500 members on supervisory boards that, because HBS had enough money, they should transfer 20 per cent of their previous HBS donations to the Hamburg-based GPB, a charitable foundation linked with the union.

The GPB, which received €1.6m in supervisory board allowances last year, educates members on pro-union and anti-globalisation themes. Mr Schröder says the GPB does "good work" that could not be provided by Verdi because of the ongoing "membership losses and savings measures". Verdi's move, which one insider says was "controversial within the union movement", could be copied by other unions, according to the DGB.

This web of interests supporting Mitbestimmung may make change unlikely but experts such as Horst-Udo Niedenhoff of the business-aligned IW economic think-tank say reforms must come eventually. If not, companies will increasingly find ways to avoid co-determination by registering abroad or in Germany under special legal forms, he argues. "With their blocking tactics unions are doing long-term damage to the German economy," he says.

Independent researchers are less sure. Sigurt Vitols of Berlin's WZB social studies institute says that, based on his recent review of studies on the impact of co-determination, "there is no clear empirical evidence that the system is bad for business performance - and companies know that".

Michel Goyer of the UK's Warwick Business School argues that, if the German government's aim is to help companies operate more effectively across Europe, tax and other changes might be more important than reforms to co-determination. The latter would "be one factor, but not a decisive one".

Even Kurt Biedenkopf, chairman of the co-determination commission, who refuses to talk in detail until his report is finished, has signalled that only marginal changes are likely, such as to give overseas employees of German companies a say in the process.

Such modest reforms would be bad news for Mr Bräunig as he attempts to make the case for change. This particular minefield is likely to remain treacherous for some time yet.