Codetermination enters the American political debate

By George Tyler

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Three senators have introduced unprecedented legislation mandating that employee representatives must comprise one-third of Boards of Directors at publicly-listed US corporations. Upgraded corporate governance with codetermination is an unfamiliar concept to most Americans. Its appearance acknowledges the weakness of conventional tools to end wage stagnation. And it reflects frustration by Democratic senators Tammy Baldwin, Elizabeth Warren and Brian Schatz at the failure of the Obama administration and predecessors to end that stagnation – a failure so spectacularly exploited by Donald Trump.

American democracy is under threat from within because the ballast provided by a moderate middle class has eroded. While fake news plagues democracy in both Europe and America, the dangers are far greater in the latter, compounded by decades of economic stagnation. That is why frustrated Americans turned to Trump even as Dutch, German and French voters overwhelming rejected homegrown demagogic candidates. The difference is critically due to the widespread European upgrading of corporate governance with codetermination – now practiced in 19 of the EU-28 nations.

Codetermination's fruits

Wages: American executive suites, conservative economists and Republicans blame globalization and technology change for stagnant domestic wages when the primary culprit is the absence of codetermination at US firms. After all, German, Scandinavian and other northern European firms have faced the same globalization and technology challenges as US firms. Even so, they have steadily raised wages for decades by about 1 percent annually in real terms, leapfrogging flat US wages in the process. As documented by the US Conference Board, for instance, labor compensation per hour in the capstone manufacturing sectors in seven northern European nations such as Germany is now higher than in the US.

Job Offshoring: Trump successfully exploited the malevolent tradition of US firms in aggressively offshoring high paying jobs to Mexico, China and the like. That contrasts starkly with the policy of codetermination enterprises. The consulting firm EY (Ernst & Young) in 2016 examined the job creation profile of firms comprising the blue chip German DAX 30 stock index, all of which have codetermination governance structures. The increase in foreign sales of these firms (28 percent) during the study period 2011-2015 considerably outpaced their creation of foreign jobs (8 percent). The difference was made up by adding jobs and productivity-enhancing investment at home to service export markets. That is why domestic German employment at these huge firms grew by more (6 percent) than their rise in domestic sales (5 percent). This domestic orientation is the precise opposite of policies pursued by American firms. A *Wall Street Journal* analysis covering the period 2000 to 2009 found that American multinational firms eliminated a net of 2.9 million domestic jobs while adding a net of 2.4m jobs abroad. A second study by Tax Analysts found that U.S. multinationals cut a net 1.9m domestic jobs during this period while adding a net 2.35m jobs abroad.

Investment Rates: Codetermination Boards of Directors set enterprise investment policy, executive compensation and the like – avoiding the pathology of American executives diverting cash flow from wages and R&D to narcissistically fund stock buybacks. That is why investment rates at European nonfinancial enterprises are higher than for American firms. An analysis of German firms for the Berlin Social Science Center (WZB) in 2016 found that the capital investment ratio (investment in long-lived durable goods) of codetermination firms was twice that of firms whose Boards of Directors contained only shareholder representatives. Indeed, the only American firms that mimic the superior investment profile of European codetermination firms are privately-held. Their investment rates (measured as shares of enterprise assets) are 2.5 times greater than rates at publicly-held U.S. firms (10 percent vs. 4 percent).

Higher Shareholder Returns: Greater investment translates to more competitive enterprises. That explains the findings by American economists that financial markets reward share prices of firms with codetermination governance structures with higher Tobin Q's (market value divided by replacement book value of assets).

Will Americans Accept Codetermination?

Codetermination influences the allocation of gains from economic growth, one of the most fundamental struggles in human society. American advocates must overcome opposition from executive suites and their Republican Party allies who argue that codetermination harms corporate efficiency. In reality, evidence from Germany and elsewhere documents that it reduces executive compensation while enhancing enterprise performance and shareholder returns. And Americans have responded. Indeed, an April 2018 survey found that, once familiarized with codetermination, a majority of American respondents support the concept; indeed, they favored it by a margin of well over 2:1 (53% vs. 22%).

Baldwin, Warren, Schatz and other advocates will do well to recall that the American economic deterioration of the 1930s was remedied in part by adopting innovative public policies from other democracies, including minimum wages and social security. To Americans of the day, those borrowed policies were as unfamiliar as the concept of codetermination is to Americans now. And, like them, the practice of codetermination has a long history abroad as a successful policy to reduce income disparities, strengthen local communities, improve job security and grow real wages. It is *the* central element in the ability of powerful capitalist economies such as Germany over the last 3-4 decades to achieving broadly based income growth at the same time that American income disparities have widened and wages stagnated. Adopting codetermination will enable American capitalism to attain the goal set forth by Adam Smith in his 1776 *Wealth of Nations* as a device to create rising prosperity widely shared.