

Hans G. Nutzinger
Jürgen Backhaus (Eds.)

Codetermination

A Discussion of Different Approaches

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Prof. Dr. Hans G. Nutzinger
Department of Economics
University of Kassel
Nora-Platiel-Str. 4
D-3500 Kassel, FRG

Prof. Dr. Jürgen Backhaus
Faculty of Economics and
Business Administration
University of Limburg at Maastricht
P.O. Box 616
NL-6200 MD Maastricht, The Netherlands



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CONTENTS

1.	Editors' Introduction Jürgen Backhaus and Hans G. Nutzinger	1
2.	Participation and Codetermination in a Perfect and Imperfect World Thomas Eger and Peter Weise	11
3.	Comment Felix R. FitzRoy	37
4.	A General Model of Codetermination Eirik G. Furubotn	41
5.	Comment Hans G. Monissen and Ekkehard Wenger	73
6.	Codetermination, Collective Bargaining, Commitment, and Sequential Games Roger A. McCain	103
7.	Comment Ekkehart Schlicht	129
8.	The Impact of Industrial Policy and Structural Changes on Codetermination in the German Steel Industry Alfred L. Thimm	135
9.	Comment Kurt W. Rothschild	157
10.	Codetermination in West Germany: Institutions and Experiences Hans G. Nutzinger	163
11.	Comment Derek C. Jones	191
12.	Institutional Reform: The Future of Codetermination Klaus Bartölke and Ekkehard Kappler (in collaboration with John G. Slade)	199
13.	Comment Warren J. Samuels	223

14. Workers' Participation Stimulated by the Economic Failure of Traditional Organization An Analysis of Some Recent Institutional Development Jürgen Backhaus	229
15. Comment Frank H. Stephen	269
16. Empirical Studies on Codetermination: A Selective Survey and Research Design Kornelius Kraft	277
17. About the Authors	299
18. Name Index	301
19. Subject Index	305

**CODETERMINATION, COLLECTIVE BARGAINING, COMMITMENT,
AND SEQUENTIAL GAMES: Comment**

by

Ekkehart Schlicht

Codetermination and collective bargaining are distinguished, according to McCain, by the existence of certain management prerogatives in the latter. These create first mover advantages (Schelling 1960), which explains why capital favors collective bargaining over codetermination. Furthermore, these first mover advantages create inefficiencies of the prisoners' dilemma type: management will take into account that its decisions, regarding investment projects, for instance, might improve the bargaining position of labor and will be exploited by labor accordingly. These positional shifts might lead to socially inefficient decisions, that is, to Pareto inferior outcomes. Although repeated negotiations might lead to implicit or explicit cooperative agreements avoiding these inefficiencies, collective bargaining is vulnerable in this sense, and codetermination is more favourable to cooperative solutions since bargaining involves all alternatives from the outset here, and prerogatives leading to those prisoners' dilemma type of inefficiencies are absent.

That is the argument in favor of codetermination forwarded by McCain. My role, as a commentator, is to raise points of criticism, and I shall try to do so, although I feel uneasy because McCain's case is well-taken.

I submit, hence, that McCain's argument in favor of codetermination unduly neglects possible inefficiencies of codetermination both on the firm level and on the level of the industry, and that collective bargaining might prove superior in spite of some shortcomings.

1. Transaction Costs Under Alternative Arrangements

My first observation is that the firm's constitution does not effect efficiency if behavior can be observed and transaction costs are neglected: collective bargaining, codetermination, or untrammelled capitalism describe different assignments of decision rights among employers, employees, and unions. If the parties involved can enter binding contracts, all inefficiencies can be

contracted away quite independently of which assignment of decision rights prevails, and efficiency arguments cannot be decisive with regard to constitutional choices. This is simply the Coase Theorem applied to the issue of industrial democracy.

As long as behavior (or its consequences) can be observed, explicit or implicit contracts can be rendered viable by introducing suitable self-imposed penalties in the case of fraud.¹ But bargaining, the introduction of penalties, arbitration boards, and so forth, introduce transaction costs. Hence, for efficiency, the constitution of firms is to be chosen such that it minimizes transaction costs. Industry-wide collective bargaining emerges as the natural systems solution to problems that are similar across firms, whether codetermination or untrammelled capitalism prevails initially: it solves problems generated by mobility costs, ex post small numbers, idiosyncrasies, etc., that can only be partially resolved by the market or other institutions.² Hence the issue between codetermination and collective bargaining is not necessarily the issue between cooperative and noncooperative games as McCain puts it; it might be the issue between different games involving different bargaining costs, which can be played both cooperatively or non-cooperatively.

As he admits, cooperation is possible and rational³ under codetermination and collective bargaining, since both involve repeated negotiations. Both arrangements will lead to efficient outcomes by the same argument. It might even be argued that collective bargaining is superior to codetermination since the time horizon of the union is longer than the time horizon of the worker because the worker changes firms more frequently than the union (I presume here industry-wide unions). Furthermore, industry-wide collective bargaining saves on bargaining costs. In Germany we observe, for instance, that strikes are restricted to a sample of firms although the dispute concerns the entire industry. Under codetermination, strikes or strike-equivalents are necessary within each firm to achieve the same result, that is, to witness the degree of determination of labor should the employers anticipate it incorrectly. But as long as these informational deficiencies are absent, and given rational behavior, strikes and lockouts will not occur under either codetermination or collective bargaining: they are simply threats for achieving better bargaining results, and similar threats - equivalents of strikes and lockouts - will emerge under codetermination as levers for achieving a strong position in bargaining. Indeed,

those threats may cause more harm under codetermination because they might destroy the spirit of cooperation. Conflicts ought to be channelled institutionally in order to minimize their moral havoc, and collective bargaining is not too bad in this respect. Codetermination, however, might require a certain dose of profit sharing to mitigate conflicts of interest.

All this qualifies McCain's argument insofar as he assumes that strikes will occur under collective bargaining but not under codetermination. That assumption gives an undeserved advantage to codetermination from the outset.

2. The Spreading of Welfare

Codetermination means that, within each firm, only the incumbent workers have a say. Hence decisions will be twisted in favor of the employed, neglecting the wishes of the unemployed. If there is a trade-off between higher wages for the incumbent workers or higher employment, decisions will be biased against additional employment, which implies inefficiencies as well as severe injustice to outside workers - whether unemployed or employed under bad conditions elsewhere. In other words, codetermination of industry, considered as a system, lacks the dispersive forces spreading welfare gains throughout the system which are provided under untrammelled capitalism by perfect mobility and utility taking of labor. In view of the increasing impediments to mobility - through various specificities, idiosyncrasies and ex post small numbers - those welfare-spreading forces are paralyzed, however, and untrammelled capitalism tends to run into similar problems. Industry-wide collective bargaining might be viewed as a provisional solution here as long as no institutions and incentive structures are created which lead to an adequate spreading of welfare gains under codetermination, and to avoiding those inefficiencies generated by neglecting the interests of non-incumbents.

3. Miscellaneous Remarks

Let me add, however, some more general remarks regarding McCain's analysis.

I doubt that we should rely too much on game theory and related rationality concepts since experiments suggest that people behave quite differently from what game theory predicts in many instances, pursuing heuristic strategies, looking for focal points, etc.⁴ Analytically, this difficulty is reflected by arguments such as "cooperation is more likely" under codetermination (McCain). Strictly speaking that argument refers to a behavioral game theory that is still lacking - it has no place in a theory where people are held to behave rationally with probability one.

Furthermore, we should take the specificity problem much more seriously: investment in specific machinery as well as investment in the acquisition of specific skills is to be protected, and granting prerogatives to those who have made these commitments might serve this end.⁵ Emphasizing the specificity problem in this context interlinks the issue of codetermination with the issue of labor specificity and introduces further complications without solving any other problems, of course.

Footnotes:

1 If behavior cannot be observed, adequate incentives are to be provided anyhow, and cooperative solutions in the bargaining sense are impossible. Prerogatives with regard to these activities as well as noncooperation are unavoidable from the outset here.

2 See Williamson (1975, ch. 4).

3 Selten's (1978) "induction argument" renders all finite games of conflict noncooperative, and the game-theoretic proposals for explaining cooperation as rational, which McCain cites, introduce elements of irrationality. Hence there are some analytical problems involved here, but introducing credible commitments through self-imposed penalties might solve some of these problems.

4 See Selten and Stoecker.

5 Alchian (1984).

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- Williamson, O.E. (1975), *Markets and Hierarchies*. New York: *The Free Press*.

ABOUT THE AUTHORS

Backhaus, Jürgen, born 1950, Dr. rer. pol. et Lic. jur., Professor of Public Economics at the University of Limburg at Maastricht (Netherlands). Main fields: public finance, the economics of firms with labor participation, law and economics.

Bartölke, Klaus, born 1949, Dr. rer. pol., Professor of Business Administration at the University of Wuppertal (W. Germany). Main fields: Management, personnel, organization, industrial democracy.

Eger, Thomas, born 1949, Dr. rer. pol., Assistant Professor, Department of Economics, University Kassel (W. Germany). Main fields: comparative economic systems, economic analysis of law.

FitzRoy, Felix, born 1938, Dr. rer. pol. Senior Research Fellow at the International Institut of Management, Science Center, Berlin (W. Germany). Main fields: industrial organization, economics of participation.

Furubotn, Eirik G., Ph. D. in economics, James L. West Professor, University of Texas at Arlington. Main fields: general economic theory, comparative economic systems, theory of the firm, property rights analysis.

Jones, Derek C., born 1946, Ph.D. in economics, Professor of Economics at Hamilton College, Clinton, N.Y. Main field of research: empirical analysis of participatory and labor managed firms.

Kappler, Ekkehard, born 1940, Dr. oec. publ., Professor of Business Administration, University of Witten-Herdecke (W. Germany). Main fields: management, organization, codetermination, economic methodology.

Kraft, Kornelius, born 1955, Dr. rer. pol., Assistant Professor, Department of Economics, University of Kassel (W. Germany). Main fields: labor economics, health economics, industrial economics.

McCain, Roger A., born 1942, Ph. D. in economics, Professor of Economics at Fordham University, New York City. Main fields: worker participation in management, rationality in macroeconomics, economics of the arts.

Monissen, Hans Georg, born 1937, Dr. rer. pol., Professor of Economics, University of Würzburg (W. Germany). Main fields: economic policy, macroeconomics.

Nutzinger, Hans G., born 1945, Dr. rer. pol., Professor of Economics, University of Kassel (W. Germany). Main fields: theory of the firm, codetermination, and environmental economics.

Rothschild, Kurt W., born 1914, Dr. jur., Emeritus Professor of Economics, University of Linz (Austria). Main fields: general economic theory, labor economics, economic forecasting, economic development, and international trade.

Samuels, Warren J., born 1933, Ph. D. in economics, Professor of Economics, Michigan State University, East Lansing, Michigan. Main fields: law and economics of property, genesis of modern economics.

Schlicht, Ekkehart, born 1945, Dr. rer. pol., Professor of Economic Theory, Darmstadt Institute of Technology (W. Germany). Main fields: labor economics, psychology and economics.

Stephen, Frank H., born 1946, Ph. D. in economics, Reader in Economics, University of Strathclyde (Scotland). Main fields: economics of participation, law and economics.

Thimm, Alfred L., born 1923, Ph. D. in economics, Professor of Economics, University of Vermont. Main fields: codetermination, dynamic planning models.

Weise, Peter, born 1941, Dr. rer. pol., Professor of Economics, University of Kassel (W. Germany). Main field: microeconomics.

Wenger, Ekkehard, born 1952, Dr. rer. pol., Professor of Business Economics, University of Würzburg (W. Germany). Main fields: organization, finance, and labor markets.

NAME INDEX

- Alchian, A.A. 23, 34, 41, 48,
68, 71, 72, 93, 101, 133,
134, 237, 238, 246, 247,
256, 264, 266, 273, 275,
278, 288, 297
- Aleman, U. 199, 220
- Aoki, M. 243, 245, 264, 266,
271-273, 275
- Arrow, K.J. 6, 31, 34, 37,
243
- Aumann, Ch. 215, 220
- Aumann, R.J. 115, 126, 127
- Averch, H. 112, 127
- Axelrod, R. 32, 34
- Azariadis, C. 246, 266, 295,
297
- Backhaus, J. 3, 7-10, 33-35,
171, 187, 229, 264, 266,
269-274, 295
- Bahrtdt, H.P. 185, 186, 189,
- Baily, M.N. 125, 127, 295, 297
- Barthel, E. 295, 297
- Bartölke, K. 3, 7, 8, 199, 214,
220, 221
- Batstone, E. 265, 266
- Bauer, O. 98, 101
- Baumol, W.J. 256, 265, 266
- Becker, G.S. 243
- Bell, D. 152, 156
- Benelli, G. 180, 186, 187,
288-291, 295, 297
- Berle, 37
- Beuthien, V. 86, 101
- Biedenkopf, K. 168, 171,
175-177, 186, 187, 194
- Biehler, H. 31, 34
- Bismarck, O. 165
- Blau, F.D. 69, 92, 101
- Blauner, 69
- Blum, A.A. 220
- Blume, O. 175, 187
- Blumschein, H. 213, 220, 221
- Blumenthal, M.W. 180, 187
- Bonus, H. 264, 266
- Bosch, R. 189
- Brandes, W. 31, 34
- Brandt, W. 142
- Breton, A. 265, 266
- Brinkmann-Herz, D. 186, 187
- Buchanan, J.M. 81, 101, 264,
266
- Bullock, A. 194, 196, 197,
249, 259, 262-264
- Buttler, F. 31, 34
- Cable, J. 69, 71, 180, 185,
187
- Carson, R.G. 114, 127
- Chandler, A.D. 233, 266
- Chmielewicz, K. 212, 213, 220
- Coase, R.H. 3, 4, 9, 10, 31,
34, 74-76, 101, 235, 255,
265, 266
- Coddington, A. 127
- Cohen, L.R. 238, 239
- Coleman, J. 31, 34
- Conrad, K. 294, 296
- Conrad, W. 206, 220
- Crawford, R.A. 273, 275
- Dahrendorf, R. 187
- Davidson, R. 293, 297
- De Alessi, L. 32, 34, 97
- Debreu, G. 6, 31, 34, 37
- Defourny, J. 191, 196, 197
- Demsetz, H. 23, 34, 41, 68,
72, 101, 237, 238, 246,
247, 256, 264, 266
- Dey, G. 215, 220
- Diamant, A. 206, 220
- Diefenbacher, H. 34, 179,
185-189, 199, 221, 298,
- Dikau, J. 295, 297
- Downs, A. 87, 101
- Drèze, J.H. 17, 34
- Edwards, R. 31, 32, 34
- Eger, T. 2, 6, 9-11, 26, 31,
34, 37, 38, 295, 297
- Eich, R.A. 97, 101
- Elias, N. 32, 34
- Emery, F. 27, 29, 32-34
- Enke, H. 31, 35
- Eschweiler, W. 220
- Espinosa, J. 196, 197
- Estrin, S. 191-193, 196, 197
- Faith, R.L. 81, 101, 128,
- Fama, E. 245
- Fees, W. 282, 292, 298
- Ferner, A. 265, 266
- Fisher, G.R. 295, 297
- FitzRoy, F.R. 6, 17, 31, 35,
37, 69, 71, 180, 185, 187,
288, 295-296
- Flechsenger, D. 220
- Francis, A. 31, 36
- Freeman, R.B. 92, 101, 264,
266
- Friedman, M. 37
- Furubotn, E.G. 2-4, 31, 35,
41, 68, 69, 71-73, 77, 86,
88, 90, 101, 103, 106, 119
127, 138, 153, 154, 234,
266, 288, 295-298
- Garson, G.D. 206, 220, 221
- Gerl, K. 219, 221
- Gerlach, K. 31, 34
- Gerum, E. 97, 102, 210, 221,
282, 298

- Gessner, V. 85, 97, 101
 Görg, A. 98, 101
 Götze, G. 138
 Goldenberg, V.P. 270, 272, 273, 275
 Grebing, H. 185, 188
 Grub, V. 86, 100
 Gutches, J.F. 249, 264, 266

 Hacker, W. 102
 Hahn, F. 31, 34
 Hahrendorf, R. 138
 Harsanyi, J.C. 111, 127
 Hart, O.D. 77, 101
 Hartman, H. 177, 188
 Hausman, J.A. 293, 298
 Hayek, F.A. 37
 Henderson, J.M. 231, 267
 Hetzler, H.W. 206, 221
 Hirschman, A.O. 31, 35, 181
 Hofmann, W. 220
 Hofstädter, D. 115, 117, 127
 Horkheimer, M. 218, 221

 Issing, O. 264, 266

 Jensen, M.C. 69, 71, 186, 188
 Jeske, J.J. 155, 156
 Johnson, L. 112, 127
 Jones, D.C. 8, 71, 189, 191-193, 195, 197, 299
 Jürgensen, H. 282, 298

 Kahn, L.M. 92, 101
 Kappler, E. 3, 7, 8, 199, 213, 221
 Kirsch, W. 177, 179, 188, 213, 221, 279, 281, 282, 292, 298
 Kißler, L. 185, 188
 Klein, B. 273, 275
 Kleinmeyer, V. 31
 Kmenta, J. 286, 298
 Knight, F.H. 238, 267
 Knuth, M. 179, 188
 Kochs, M. 219
 Kohl, H. 154
 Kotthoff, H. 173, 179, 185, 188
 Kraft, K. 3, 8, 177, 277, 296, 297
 Kraft, M. 31
 Kreps, D.M. 126, 127
 Kristol, I. 152, 156
 Kuda, R. 185, 189
 Kuebler, F. 250, 264, 267
 Kuhn, H.W. 126, 127

 Lachmann, L.M. 252, 253, 265, 267
 Lafontaine, O. 154
 Laske, S. 221
 Lave, L. 126, 127
 Leibenstein, H. 32, 35, 264, 267

 Leipold, H. 102
 Liepmann, P. 31, 34
 Lind, 243
 Loderer, C. 180, 186, 187, 288, 295, 297
 Luce, 127
 Luksch-Eger, M. 31
 Lutticke, D. 31
 Lutz, M. 69, 71
 Lux, K. 69, 71
 Lys, T. 180, 184, 187, 288, 295, 297

 Machlup, F. 231, 264, 267
 McGregor, I. 146, 155, 156
 Macneil, I.R. 272, 273, 275
 Maletzki, I. 220
 Manne, H. 233, 267
 Marglin, S. 31, 35
 Marx, K. 32, 35
 Maslow, 69
 McAleer, M. 295, 297
 McCain, R.A. 2, 4, 5, 24, 33, 35, 69, 71, 103, 104, 106, 110, 114, 125, 127, 129-133, 277, 298
 McKinnon, J. 295, 297
 Meade, J.C. 152, 156
 Means, 37
 Meckling, W.H. 69, 186, 188
 Medoff, J. 264, 266
 Michaelis, E. 295, 298
 Milgrom, P. 126, 127
 Miller, M. 295, 298
 Modigliani, F. 295, 298
 Monissen, H.G. 3, 4, 9, 10, 72, 73, 93, 102, 175, 185, 186, 188
 Mueller, D.C. 17, 31, 35, 69, 71, 288, 297
 Murrighan, J. 271, 275
 Muszynski, B. 4, 10, 173, 185, 188, 199, 221

 Nagel, B. 184
 Nash, J. 37, 111, 121, 127
 Nell-Breuning, O. 28, 32, 33, 35
 Neuloh, O. 186, 188
 Neumann, M. 102, 299
 Newman, P. 221
 Nidenhoff, H.U. 172, 177, 185, 189, 202-204, 221
 Nieder, P. 221
 Nutzinger, H.G. 3, 8-10, 29, 34, 35, 163, 179, 185, 187-189, 191-195, 266, 295, 298

 Oi, W.Y. 69, 71
 Okun, A. 110, 127
 Olson, M. 104, 128
 Oppenheimer, F. 31
 Ott, C. 33, 35

- Palgi, M. 220
 Pareto, V. 6, 15, 37, 43, 46,
 60, 68, 74-77, 86, 87, 104,
 106, 114, 115, 118, 119,
 129, 269, 270
 Paul, E. 189
 Paul, G. 213, 219, 221
 Pejovich, S. 10, 31, 35, 102,
 106, 127, 188, 266, 295,
 298
 Pen, J. 111, 121, 128
 Picot, A. 295, 298
 Pirker, T. 185, 186, 189
 Plett, K. 85, 97, 101
 Pöhler, W. 33, 36
 Poole, M. 199, 221
 Popitz, H. 185, 186, 189
 Potthoff, E. 31, 36
 Praeger, C.M. 214, 221
 Preiser, E. 31, 36
 Prosi, G. 31, 36

 Quandt, R.E. 231, 267

 Reuter, E. 94, 102
 Reynolds, L.G. 99, 102
 Richter, B. 282, 298
 Roberts, B.C. 221
 Roberts, J. 126, 127
 Robertson, D.H. 235, 267
 Roger, A. 127
 Rosen, S. 295, 298
 Rosner, M. 229
 Roth, A. 271, 275
 Rothschild, K.W. 7, 8, 157
 Rubinstein, 271, 275
 Ruthers, B. 102

 Samuels, W.J. 8, 223, 228, 270,
 275
 Scarf, H. 31, 34
 Schank, G. 179, 188
 Schelling, T.C. 129, 134
 Schienstock, G. 206, 221
 Schlicht, E. 5, 129, 295, 298
 Schlochauer, U. 98, 102
 Schmid, A.A. 228, 275
 Schmidt, W. 250, 264, 267
 Schneider, D. 185, 189
 Schneider, H. 88, 102
 Scholl, W. 189, 213, 219, 221,
 279, 281, 282, 292, 298
 Scholten, U. 185, 188
 Schotter, A. 32, 36
 Schüller, A. 31, 36, 102
 Schulmeister, O. 138
 Selten, R. 116-118, 126, 128,
 133, 134
 Shaffner, J.D. 228
 Shuchman, A. 161
 Simitis, S. 250, 264, 267
 Simon, H.A. 17, 36
 Wintrobe, R. 265, 266

 Slade, J.G. 199
 Smith, A. 236, 237
 Solo, R.A. 228
 Spence, 234
 Spieker, W. 97, 102
 Staehle, W.H. 220
 Stein, G. 159
 Steinherr, A. 69, 71
 Steinmann, H. 97, 102, 210,
 221, 282, 283, 292, 298
 Stephen, F.H. 269, 275
 Stoecker, R. 133, 134
 Stoll, E. 220
 Streeck, W. 32, 36
 Streim, H. 98, 102
 Stützel, W. 32, 36
 Svejnar, J. 68, 69, 71, 111,
 121, 128, 180, 186, 189,
 192, 193, 196, 197, 283-
 287, 290, 291, 295, 298,
 299

 Taft, P. 99, 102
 Telser, 118, 126
 Terry, M. 265, 266
 Tesch, E. 154
 Teuteberg, H.J. 171, 185, 189
 Theisen, 185
 Thimm, A.L. 3, 7, 9, 10, 135,
 152-160, 181, 185, 189
 Thompson, E. 128
 Thorsrud, E. 27, 29, 32-34
 Thurow, L. 150
 Tinnin, D. 153, 156
 Tucker, A.W. 127
 Tullock, G. 254, 264-266
 Turk, J. 31, 35

 Vanberg, V. 31, 36
 Viner, J. 185
 Vogt, W. 31, 36, 86, 97, 102
 Voigt, F. 175, 190

 Wachter, H. 199, 221
 Wagner, B. 220
 Waniski, J. 152
 Weddigen, W. 175, 185, 180
 Weise, P. 3, 6, 11, 26, 31,
 34, 37, 38, 98, 102, 295,
 297
 Weitzman, M.L. 135, 152, 156
 Weizsäcker, C.C. 282, 295,
 298
 Wenger, E. 3, 4, 72, 90, 91,
 97, 98, 102
 Wiggins, S.N. 69, 71, 77, 86,
 88, 90
 Williamson, O.E. 17, 37, 65,
 69, 71, 133, 134, 264, 269,
 271, 275
 Willman, P. 31, 35
 Wilson, R. 126, 127

Witte, E. 139, 153-156, 177,
179, 190, 279-282, 292, 295,
299

Woll, A. 102

Woodbury, S.A. 228

Zeuthen, F. 111, 128

Zimbalist, A. 196, 197

SUBJECT INDEX

- accumulation 3, 86, 215
- allocation 26, 31, 73, 77, 83, 94
 - efficient - 24
 - optimal - 14, 15, 80
- American Airlines 98
- ARBED-Saarstahl 7, 138, 142-147, 158
- Arrow-Debreu economy 37
- Austria 6, 143, 147, 164, 290
- asymmetry 237
- authority 75, 76, 176, 231, 233
- automatization 216, 248
- automobil plant(VW Kassel) 171, 177
- autonomy 225
- bargaining 132
 - bilateral - 66
 - theory - 110, 113, 120, 124
 - wage - 111
- barriers 253
 - institutional - 87
- behavior 4, 5, 25, 26, 41, 45, 54, 58, 66, 79, 116, 128, 129, 132, 135, 229, 230, 240, 244, 250, 255, 280
 - bureaucratic - 253
 - cooperative - 27, 177, 241, 242
 - of enterprise 230
 - rational - 22
- Biedenkopf Report 167, 170, 175, 176
- blue-collar workers 202, 203
- board of directors 69, 70, 72, 90, 119, 277
- Brazil 144
- Bullock Report 193, 248
- capital 3, 14, 19, 26, 95, 106, 109, 168, 223, 232, 233, 252, 269
 - owner 23, 25, 27, 32
 - real - 18
- capitalism 5, 25, 29, 37, 102, 130, 226
- choice 256
 - collective - 118
 - economic - 235
- Christian Democratic Union (CDU) 142, 151, 206, 213
- Christian Social Union (CSU) 206, 213
- coalition 46, 49, 51, 54, 60, 66, 67, 69, 70, 74, 204, 206
- Coase Theorem 73, 129
- Cobb-Douglas production function 285, 291
- Codetermination Act 97
- Codetermination Law 135, 162, 165, 167, 176, 177, 180, 201, 203, 278, 281, 286, 289
- collective action 91, 92, 179
- collective bargaining 4-6, 25, 86, 90, 92, 93, 102-104, 107, 114, 117, 119, 128-130, 179, 203-205, 208, 209, 224, 228, 233, 250, 256, 259, 269
- communication 21, 27
- compensation 96, 272
- competition 13, 15, 37, 38, 72, 80, 96, 159, 253
 - perfect - 284
- concentration 17
- Concerted Action 141, 153
- contract(s) 13, 17, 20, 27, 46, 56, 66, 69, 73, 82, 86, 128, 234, 235, 245, 246, 271, 288
 - labor 74, 75, 94, 232
 - long-term - 59
- control 23, 26, 32, 173, 225, 228, 233, 255
 - hierarchical - 22, 103
- Control Council Law 199
- cooperation 4, 7, 117, 119, 122, 130, 131, 150, 164, 166, 173, 184, 243, 250, 271
- correlation 280
- corruption 93
- cost-benefit analysis 102
- costs 72, 80, 98, 228, 232, 269
 - informational and contracting - 37, 77
 - opportunity - 52, 72, 83, 124
 - organizational - 24
 - social - 82
 - transaction - 3, 6, 41, 46, 68, 69, 75, 77, 86, 105, 123, 128, 129, 234
- decentralization 37, 231
- decision(s) 5, 6, 25, 54, 72, 87, 104, 105, 170, 175, 198, 201, 223, 248, 256, 281, 282
- entrepreneurial - 6
- financial - 287, 288
- managerial - 102, 134, 158
- optimal - 26
- democracy 11, 16, 29, 223, 259
 - economic - 165, 223, 226
 - industrial - 43, 45, 55, 65, 70, 77, 103, 129, 202

- distribution 89, 93
 diversification 87
 dynamic capitalistic market
 environment 73
- Eastern Airlines 90
 economic theory 86, 103, 104,
 124
 EEC 139, 141, 144, 147
 efficiency 4, 7, 31, 44, 60,
 64, 73, 80, 83, 102, 105,
 119, 121, 142, 157, 228,
 248, 255, 269
 allocativ - 4, 67, 74
 in - 6, 16, 18, 21, 25, 28,
 91, 128
 Pareto - 15, 74, 118
- EFTA 139
 electrotechnical plant
 (AEG Kassel) 171, 177
 employee 5, 21, 24, 26, 28, 29,
 46, 49, 61, 72, 76, 85, 88,
 92, 107, 114, 128, 140, 146,
 201, 203, 210, 238, 269, 279
 employment 6, 13
 un - 31, 123, 157, 168, 212
 enterprise 88, 142, 148, 154,
 166, 169, 172, 231, 235
 capitalist - 23, 31, 32, 94
 one-person - 26
 public - 207
 entrepreneur 17, 28, 33, 81,
 140, 230, 231, 234, 235
 environment 17
 equilibrium 15, 37, 56, 58,
 110, 115
 - price 15
 - theory 25, 31
 Europe 1, 38, 144, 145, 229,
 246
 European Community 97
 evaluation 102, 170
 social - 79
 executive board 85
 "exit" 29, 31, 33
 - cost 23
 externalities 6, 229, 255
 internalizing - 6
- factor price 8
 Federal Republic of
 Germany 4, 6, 86, 90, 93,
 98, 123, 134, 138, 144, 145,
 156, 162, 190, 198, 200,
 209, 211, 258, 276
 firm 1, 2, 5, 14, 18, 19, 22,
 27, 84, 87, 130, 228, 229,
 237, 243
 capitalist - 1, 19, 41, 45,
 103, 123
 theory of the - 230, 245,
 246, 268
 Yugoslavia - 84
- flexibility 158, 247
 France 134, 144, 163, 193
 free market economy 29
 freedom 158
- game(s) 4, 113, 115, 117, 120
 132
 bargaining - 58
 cooperative - 4, 114, 242
 sequential - 102, 128
 sub - 115
 German Labor Federation
 (DGB) 135, 136, 137, 141,
 149, 207, 210
 German labor front 165
 German mining and steel
 industries 93, 134, 257
 German Steel Strike 154
 German Supreme Court 137
 government 7
 Great Britain 147, 163
- hierarchy 7, 65, 69, 72, 210,
 211, 228, 237
 Hoesch 139, 148, 152
 household 247
 human capital 3, 4, 17, 18,
 20, 38, 60, 67, 82, 87,
 88, 94, 95, 242-244, 252,
 253-257
 firm-specific - 6, 46, 72,
 73, 77, 79, 83, 92, 268
 humanity 11, 16
- IG Metall 146
 imperfections 73
 income 13, 14, 58, 82, 94,
 212, 233
 non-pecuniary - 13, 14
 pecuniary - 13, 14
 India 144
 industrial policy 134, 135,
 138, 142, 156
 industrialization 23, 151,
 163
 industry 5, 128, 137, 169,
 202, 207, 245, 283
 steel - 7, 139, 140, 146,
 152, 157
 information 21, 27
 asymmetrical - 24, 25, 45
 monopolized - 27
 innovation 27, 81, 102, 123,
 229
 labor-saving - 173
 technical - 62, 173, 213,
 216
 institution 4, 129, 162, 182,
 190, 234
 efficiency of - 102
 social - 241

- intervention 96
- investment 1-6 58, 69, 79, 82, 94, 95, 105, 112, 253, 273, 288
 - firm-specific - 1, 43, 45, 47, 48, 53, 57, 61, 62, 66, 69, 70
 - joint - 47, 54, 55, 60, 65, 70, 73
 - labor-saving 79, 81
 - policy 280
- Italy 140
- Japan 134, 179
- Japanese labour relations 38
- job security 43, 46, 48, 55, 59, 62, 272
- joint-stock company 200, 208, 214
- justification 6
- KloECKner 139, 148
- knowledge
 - technical - 13
- Korea 144
- Krupp 139, 148, 152
- labor director 166, 256, 257
- labor input 21, 22
- labor turnover 61
- law 85, 98, 198
 - corporation - 97
 - labor - 171
 - social - 171
- layoff 246, 247
- legislation 87, 137
- Liberal Party 168, 203, 206, 213
- liberty 86
- life-cycle 83, 91, 94
- lockouts 5, 129
- low-cost loans 68
- Luxembourg 146, 153
- management 3-5, 22, 23, 27, 33, 61, 72, 77, 93, 123, 166, 233, 248, 278
 - function of 17
 - supervision of - 4
- marginal rate of substitution 24
- market 1, 26, 30, 129, 245, 252, 268
 - futures - 20
 - labor - 13, 94, 109, 124, 134, 177, 225, 228, 273
 - stock - 28
- mechanism 12, 16, 29, 31
 - market - 12, 16, 30
 - price - 12, 16, 31
- micro-economic theory 233
- mobility 6, 21, 42, 45, 46, 63, 69, 84, 88
 - factor - 179
 - labor - 89
- monopoly rent 26
- Montan Codetermination 97, 140, 146
 - Law 136
- Montan Industry 136, 140
- moral hazard 247
- Nash equilibria 37
- National Assembly of Frankfurt 164
- neoclassical system 12, 15-17, 42, 45, 66, 69, 229, 244, 272, 273
- North America 139
- OECD 135, 290
- organization 3, 16, 27, 28, 31, 37, 54, 81, 222, 228
 - capitalist work - 6
 - social - 16
 - traditional - 253, 268
- Pareto-improvements 66, 68
 - efficient 86, 87, 268
- payouts 5
- Personnel Representation
 - Law 213
- philosophies
 - managerial - 198
- planing 90, 208
 - long-term - 88
- Plant Constitution Act 97
- pluralization 226
- Post Office Unions 259
- power 18, 21, 25, 32, 76
 - bargaining - 76, 112, 114, 279
 - labour - 19
- price-theory 79
 - mechanism 242
 - shadow - 123
- Prisoner's Dilemma 23, 24, 113, 114, 116, 118, 128, 241
- process 4, 11, 18, 48, 72, 243
 - economic - 178
 - evolutionary - 217
 - intra-firm - 28, 229
 - learning - 27
- production function 112, 124, 191
- productivity 22, 24, 111, 119, 158, 179, 193, 246, 248, 276, 282, 284, 292
 - marginal - 14, 19, 21, 26
- profit 13, 14, 23, 24, 46, 59, 64, 88, 243, 276
 - technological - 14
 - sharing - 38, 61
- profitability 282

- portfolio 71
- property rights 3, 41, 44, 66, 68, 69, 73, 158, 163, 179, 190, 254, 287, 289
- protection 81, 85, 91, 93, 94, 247
- qualification 14
 - of representatives 211
 - firm-specific - 19, 20
- quality circles 65, 210
- quasi-rents 46, 73, 76, 77, 80, 81, 85, 87, 88, 91-95, 110, 111
- rationalization 216
- redistribution 3, 72
- regulations 8, 68, 172
 - informal - 180
- rents 74, 76, 271
 - cooperative 76
 - specific 80
- resources 14-18, 29, 31, 49, 60, 67, 194
- restrictions 73, 74, 86, 96, 99, 165, 215, 284
 - contractual - 75
- revolution
 - bourgeois - 108
- rights 3, 4, 6, 25, 73, 81, 84, 87, 166, 210, 211, 224, 245
 - codetermination - 181
 - decision - 27, 28, 72, 74, 75
 - information - 88, 89, 200, 202
 - participation - 276, 282
- rigidity 135
 - wage - 138
- risk 50, 58, 63, 66, 69, 73, 74, 82, 83, 87, 89, 94, 124, 233, 234, 237, 242
- salary scales 271
- scientists 8, 191, 217, 223
- Scotland 143
- "Scrooge McDuck-economy" 15
- second-best results 44
- segmentation of labour
 - market 31
- shareholder 37, 200, 201, 204, 233, 250, 251, 271, 273
- Social Democrats (SPD) 135, 137, 141, 147, 151, 199, 203, 212
- social interaction 122
- social rate of return 106
- social welfare function 113
- socioeconomic experiments 84
- sociology 31
- specification 22
- statistics 21
- steel and coal industry 136
- stock company 277, 293
- stockholder 46, 49, 56, 66, 70, 74, 83, 85, 89, 91-95, 137, 140, 146, 152, 242, 253
- strategy 2, 3, 87, 114-116, 244
 - managerial - 46
- strike 5, 6, 96, 109, 110, 129, 130, 152, 158, 179, 209
- structures 28
 - organizational - 11
 - orthodox - 54
- subgoal pursuit 232
- supervisory board 27, 32, 84, 85, 97, 136, 137, 140, 152, 166-168, 172, 183, 200, 201, 203, 205, 208, 215, 248-250, 278, 279, 290
- Sweden 143, 147
- Taiwan 144
- tariff-protection 68, 144
- technology 27, 64, 81, 86, 93, 151, 192, 202, 216, 230, 256, 257
 - labor-saving 86
- Texas school 102, 119, 123
- Thyssen 139, 148, 152
- trade-off 228
- transaction 235, 268
- trust 27, 208, 209
- uncertainty 45, 50, 59, 73, 91, 240
- union 7, 55, 57, 90, 92, 93, 98, 99, 118, 128, 129, 134, 136, 140, 146, 151, 165, 168, 172, 176, 203, 206, 209, 211-213, 233, 248, 278
 - labor - 198, 199
- United States 1, 37, 90, 92, 97, 98, 123, 134, 163, 179, 229, 246, 257
- utility 107-109, 117, 120, 121, 124, 230
- "voice" 30, 31
- wage 5, 82, 89, 93, 231, 276, 282
 - contractual - 42
 - payments 56
 - rate 13, 81
 - setting 88
- welfare 19, 22, 23, 37, 43, 69, 130, 270, 277
 - state 137
- white-collar workers 202, 204
- Wirtschafts- und Sozialwissenschaftliches Institut (WSJ) 207

"work quality" 23, 27
work times
 flexible - 22
working conditions 13, 22, 23,
 26, 27, 177
Works Constitution Act 284, 285
Works Constitutions Law 166-168,
 177
Works Council Law 165
World War I 98, 143, 164
World War II 199, 201

Yugoslavia 26, 225

