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**Employee Relations in Germany in
Transition: A Path Dependent Trajectory of
Change?**

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Abstract

The paper discusses whether in view of the accumulated contextual pressures the evolving new German employee relations model will resemble a more flexible version of the current one or whether it will emerge as an “Anglo-Saxonised” German model. It ascertains that despite the current contestation of the German model, erosion tendencies, though not negligible, are not as widespread as is often assumed and that far reaching reforms along neo-liberal lines are not desirable in the German context. It is suggested that a large proportion of German employers have a vested interest in maintaining the fundamentals of the current system. Proposes a path dependent reform trajectory internal to the system. The paper shows that the series of reforms carried-out so far has been accomplished within the parameters of the existing system, taking the form of regulated flexibility and centrally co-ordinated decentralisation. It ascertains that the German model is more adaptable and more flexible than its actual reputation, allowing companies to operate with more flexible collective employee relations’ responses. Yet, evidence suggests that firms are already under-utilising the broadened framework. Nevertheless, the author predicts a continuation of the reform process and an emerging new flexible German employee relations model that remains essentially a collective one.

Keywords: Deregulation, Decentralisation, Employee Relations, Flexibility, Germany.

Introduction

Against the background of heightened international competition, global shifts in production, ongoing structural change and the problems of German unification, one of the most controversial issues in the industrial relations (IR) literature is whether the German model of employee relations (ER) with its emphasis on collective ER will retain its national distinctiveness by arresting these pressures in a path dependent trajectory of institutional and regulatory change (e.g. Lane, 1995, Whitley and Kristensen, 1996). Alternatively, whether these pressures will lead to the disintegration of the tightly regulated and densely institutionalised German model and its convergence to the orthodox deregulated market-led Anglo-Saxon model with its emphasis on individualistic ER (e.g. Streeck, 1997).

Since the early 1990s the general consensus among German employers regarding the advantages of the German model with its proven track record seems to have gradually weakened and subsequent erosion tendencies have increasingly contested the German model. According to a number of commentators, the German model, which has been extremely successful in the past, has outlived its usefulness and will be swept away in the new millennium unless it is substantially overhauled by far reaching reforms along neo-liberal lines in order to cater for the greater and more diverse flexibility requirements of an increasingly heterogeneous German business community (Berthold, 1995; Goldman Sachs, 1997). Others, however, suggest that such an assessment overlooks the inherent internal flexible adaptation potential of the German model to accommodate change within the parameters of the current system (Heise, 1999, Locke, *et al.*, 1995). The aim of this article is to shed light on the unresolved question of whether the evolving new German model of ER will resemble a more flexible version of the current one or whether it will emerge as an “Anglo-Saxonised” German model.

After setting out the salient characteristics of the German model and accounting for its past success, the paper presents the major criticism of the German model. Based on the available evidence, the paper goes on to assess whether the erosion of the main institutional pillars is actually as widespread as is often assumed. Thereafter follows

an evaluation of possible reform trajectories as to their feasibility and desirability within the specific German context. Based on these findings, the paper analyses the nature and extent of the reforms carried out so far. Next, it assesses in how far companies have actually implemented the provisions of these reforms. The concluding section draws together the main findings and maps out the possible future direction of the emerging new German ER model. The paper focuses on the link between labour market institutions and regulations and the micro level and sets aside the link to macro developments.

Main Characteristics and Track Record of the German Model

The high degree of regulation and the encompassing institutional infrastructure have imposed a uniform set of arrangements on companies but at the same time provided an incentive structure for employers to accept institutional constraints (Lane, 1995; Soskice, 1994). Key elements of the German model of labour relations to which a large proportion of companies subscribe are the centrally co-ordinated sectoral collective bargaining system and labour representation at domestic level via the works council system, equipped with statutory information, consultation and co-determination rights. The traditional German approach to ER has also been underwritten by strong labour market legislation, the close ties between companies and banks, the comprehensive vocational education and training (VET) system, as well as the relatively elaborate welfare system. The particular balance of constraints and incentives generated by this interactive institutional infrastructure has resulted in a path of upmarket restructuring across a large section of German industry (Lane, 1995; Streeck, 1992). It constrained companies from effectively operating in price competitive markets by foreclosing a low cost adjustment route. At the same time, it forced and enabled companies in the manufacturing sector in general, and the large export industries in particular, to shift towards non-price competitive markets by adopting a diversified quality production (DQP) strategy and compete on a high skills/high productivity/high value added basis.

Traditionally, collective bargaining has taken place between strong collectivist unions and employers' associations. The pilot function of the metalworking sector settlements (covering a substantial part of the German export industries), in combination with the co-ordination capacities of the peak organisations of capital and labour, led to the particular German form of pattern bargaining. This created "solidaristic" settlements, producing a high degree of standardisation of wages and conditions, as well as ensuring that wage increases in the metalworking sector were spread relatively evenly across the different industries in the economy. In contrast to a decentralised bargaining system the unitary nature of the German system may have produced less wage flexibility at the micro level. Some degree of wage structure flexibility nonetheless exists in terms of wage differentiation between regions and bargaining sectors, as well as inter and intra-sectoral differentiation according to labour qualification and skills (Tüselmann, 1996a). There is traditionally no differentiation between individual companies within a bargaining sector since the sectoral accords apply to companies of different sizes, cost structures, technology, capital intensity and global exposure. Indeed, the nature of the collective bargaining system might have kept wages higher and the wage spread lower than the labour market might have determined. Moreover, collective agreements set a *de facto* minimum floor, preventing downwards pressure on pay rates and conditions, thus taking wages and conditions largely out of competition, since the law makes it illegal to undercut the provisions in the accords, unless they contain an explicit opening clause. In effect, this acted as a barrier to low wage adjustment, thereby forcing companies to orient themselves towards non-price competitive markets and adopt a strategy of up-skilling to sustain high and relatively even wage levels (Streeck, 1992). In turn, this required large-scale recurrent investment in training and retraining in order to match labour productivity with the largely externally (high) fixed cost of labour. Here, the combination of (i) the ability of the bargaining system to overcome externalities connected to training; (ii) the comprehensive and extensive VET system supplying a large pool of qualified labour (iii); the close links between companies and banks shaping management orientation towards long term investment perspectives, facilitated the high investment in human capital and technology in the majority of German firms. In turn, this led to a high degree of functional flexibility, enabling the adoption of a DQP strategy (Tüselmann, 1996b).

Furthermore, strong employment protection legislation and the associated high costs of dismissals created external labour market rigidities. To compensate, companies were induced to seek high degrees of internal flexibility by developing large and stable internal labour markets, which further encouraged them to invest in training and achieve high levels of functional flexibility. This resulted in long term employment relationships. At the domestic level, the works council system has developed into the pivotal institution of the collective voice mechanism in German employee relations. Despite the statutory participation rights of works councils curtailing the scope for unilateral management decisions and strategic choice, works council/management relations have developed into a consensual, high trust/low conflict relationship. Works councils having taken on a co-management role and they have operated as joint problem solving bodies by finely balancing their representative and co-operative functions (Jacobi, *et al.*, 1998). However, the positive experience of the German works council system is largely contingent on the external guarantees and features of the wider German IR context within which it embedded. For example, the external collective bargaining system detaches management - works council relations from the conflict over wider issues of income distribution.

This interdependent regulatory and institutional configuration which has facilitated a high degree of functional flexibility, but constrained the pursuit of high degrees of numerical and financial flexibility across a broad spectrum of German industries seems to have resulted in a high wage/high productivity/high value added/high investment matrix (Streeck 1987). The German collective approach to ER with its emphasis on long term perspectives, co-operation, consensus and the enhancement of joint benefits seems to be both the result as well as the underwriter of this matrix. Additionally, the German model possesses an inherent internal reform potential to accommodate change in an incremental, negotiated and consensual manner within the parameters of the existing system.

Pressures for Change

Since the early 1990s the consensus as to the benefits of the traditional collective German approach seems to have gradually weakened. The culmination of accumulated contextual pressures and new challenges, such as heightened international competition, global shifts in production, ongoing structural and technological change, as well as the problems of unification are contesting the adaptation potential of the German model. With increased international competition also affecting less price sensitive markets, German manufacturing companies are no longer able to insulate themselves from price competition. Yet, firms in western Germany have to bear the highest labour costs in the industrialised world. Labour productivity, though high, proved insufficient to compensate for the labour cost disadvantage, leading to German companies experiencing one of the highest unit labour costs in the industrialised world (IW, 2000a). Too high wage settlements in the 1990s are often quoted as a main contributor (Berthold, 1995; IW 1999a) In wake of German unification, the collective agreements on rapid wage convergence to the western level left the eastern region grossly non-competitive. Because of the large gap between labour cost and labour productivity, unit labour costs were significantly above the already high western ones in the immediate post unification period (Deutsche Bundesbank, 1997).

Apart from connecting the pay bargaining system with the labour cost disadvantage, nearly every aspect of the German model is subject to criticism. As a result of the progressive reduction of collectively agreed working hours, western German companies have now to contend with the shortest working times in the industrialised world. Coupled with working time laws and collective agreements, which traditionally constrained companies pursuit of high degrees of temporal flexibility and flexible working time arrangements, this has produced a comparatively low degree of plant utilisation and high unit capital costs (European Commission, 1994). Additionally, this has impeded temporal flexibility in terms of synchronisation between fluctuations in the business cycle and working hours. Strong employment protection legislation and restrictive laws on the conclusion of atypical contract largely foreclosed the use of external numerical flexibility to respond to fluctuations in demand, thereby increasing costs by carrying excess labour. The unitary and uniform character of the wage formation system is thought to have led to wage

settlements and structures that provided too little inter and intra-industry differentiation. This is believed to reflect inadequately the differing flexibility requirements of individual companies in light of the sharp intensification of international competition for companies operating in price competitive markets and the structural shift from manufacturing to the service sector (Kroker, 1995; Siebert, 1996). In the growing service sector, companies may require higher degrees of temporal and numerical flexibility, as well as more a more differentiated wage structure to reflect the relative importance of lower skilled jobs in this diverse sector.

Erosion of the German Model: Myth and Reality

The upshot of the above developments is assumed to have led to a serious erosion of all the main institutional pillars of the German model (Hassel, 1999; Schnabel, 1998; Wirtschaftswoche, 1995). According to such commentators, there has been a wave of resignations from employers associations, a large decline in the importance of sectoral bargaining, a steep increase in company level bargaining, a declining works council ratio and a steadily increasing incidence of disorganised decentralisation, whereby employers which remain in sectoral bargaining structures violate the provisions in the collective agreements.

However, on closer inspection it appears that pressures and erosion, though not negligible, are by no means as overwhelming as often portrayed. It would be misleading to attribute the surge in western German labour costs in the 1990s (apart from the wage settlements in the immediate post unification period) mainly to the German wage formation system. The main reason for the increase was not so much the disproportionate growth in direct wage costs as compared to other main industrial countries, but rather the faster rise in non-wage labour costs, especially the increasing social security element, rather than the collectively agreed pay supplements (IW, 2000b). Indeed, throughout the 1990s, wage restraint continued to be an essential feature of the German model, with wage increases being generally below the so-called 'cost-neutral margin of distribution' - which is the increase in inflation plus the increase in labour productivity (Heise, 1999). In eastern Germany, the unit labour

cost disadvantage has continually been reduced, partly because of rationalisation and the revision of the wage convergence agreements, although they are still above those in western Germany (IW 1999b)

There are no official statistics on the coverage rate of the major IR institutions, making it impossible to exactly quantify the degree of erosion. However, on balance, the various studies suggest that membership to employers' associations may have fallen between 8 and 12 percentage points in the private sector in western Germany since the early 1990s (Hassel, 1999; Schulten and Zagelmeyer, 1998). This institution nonetheless remains relatively encompassing with around three quarters of companies still subscribing to employers associations by the end of the 1990s (EIRR, 2000). Accordingly, the percentage of companies subject to sectoral bargaining accord decreased, though these still applied to over two-thirds of west German employees in 1999 (EIRR, 2000). Despite the number of company level agreements having doubled in the 1990/99 period (IW, 2000c), their relative importance should not overrated. The growth was mainly accounted for by SMEs and company level agreements covered under 8 per cent of all private sector employees in 1999 (IW, 2000c). A growing incidence of companies concluding individual agreements with employees also accounts for the decline in the coverage rate of sectoral agreements (Schnabel, 1998). However, the main reason for the decline in membership of employers' association and the coverage of sectoral accords lies not in a wave of resignations from employers' associations but can mainly be explained by newly established companies, many of which are service sector companies and often relatively small in size, having not joined employers' associations (IAB, 1998). This also explains a decreasing works council ratio, albeit around two-thirds of employees still work in establishments which have this collective voice mechanism (Addison, *et al.*, 1998). Additionally, every second firm which withdrew from the sectoral bargaining structure and opted for company level bargaining rejoined their respective employers' association after one year (IW, 1999c). It should be noted that companies which withdrew from employers' associations account for just 4 per cent of the dependent labour force in western Germany (Schulten and Zagelmeyer, 1998).

In summary, it would appear that the main pillars of the German model remain relatively encompassing and the overwhelming majority of companies who subscribe

to them are not abandoning them, but newly founded companies, especially in the service sector are not subscribing to them. With the lower degree of collective arrangements in the service sector not being a German specific, but an international development, a certain decline in the importance of the collective ER institutions in the German economy (like in other developed countries) is more or less expected in line with of the growth of the service sector. Rather than employers being dissatisfied with the German model, the structural shift seems to be the main explanatory factor, negating to a large extent the notion that German firms are withdrawing from the system *en masse*.

Notwithstanding the above, there has been a growing incidence of disorganised decentralisation since the early 1990s, whereby employers who subscribe to the sectoral bargaining system undercut the provisions in collective agreements (despite being illegal), either unilaterally or in co-operation with works councils (Bispinck, 1998; Jacobi, et.al. 1998), thereby exerting considerable pressure onto the sectoral parties to arrest this trend in the form of organised decentralisation. In west Germany, this development relates mainly to issues of working time flexibility, but is also becoming more prominent in relation to pay, with the latter being accounted for mainly by SMEs. Yet, larger German companies are also increasingly securing such deals with their works councils by inserting the strategic use of DFI and the threat of locational flexibility in the management/works council relationship (Mueller, 1996). Furthermore, erosion tendencies are more prominent in east Germany than in the western region (e.g. Schmidt, 1998, *Wirtschaftswoche*, 1995). A considerable number of companies have either not joined or withdrawn from the sectoral bargaining structures and in those that remain within these structures, disorganised decentralisation, especially in relation to pay, is substantially more pronounced than in west Germany. There may be a danger that this feeds back to the western region, thereby potentially undermining the system as whole.

Trajectory of Change

Although the need for reforms is widely accepted, the unresolved issue is how and to what extent to reform a model that has proven extremely successful in the past without losing its advantages. Indeed, the real issue is not one of a duality of choice between preserving the *status quo* and far reaching deregulation/decentralisation measures along the lines of the market-led Anglo-Saxon model. This is true particularly true when it is considered that it is impossible to provide a framework within which companies in all types of markets, industries and sectors can operate under optimal conditions (see McDonald and Tüselmann, 1998). In fact, Anglo-Saxon style reforms may prove detrimental in the German context. Far reaching deregulation and decentralisation measures may perhaps improve the conditions for companies which operate in price sensitive markets by considerably enhancing the scope to achieve high degrees of numerical and pay flexibility, but this may destroy the very incentive structure that forced and enabled a large section of German industry to effectively compete in less price sensitive markets on a high value added, high productivity, high skills bases, underpinned by high degrees of functional flexibility. This is contingent on the particular configuration of certain rigidities, such as strong employment protection laws, a relatively undifferentiated wage structure and pay settlements. Thus, a large proportion of German employers actually has a vested interest in maintaining the fundamentals of the German model. The elimination of these rigidities may lead to widespread opportunistic behaviour and opening the floodgates to a low cost adjustment route which in the long run propel the German high wage/high value added/high productivity/high investment matrix to a low wage/low value added/low productivity/low investment matrix.

Nevertheless, it should be possible to broaden the scope for differentiation; numerical, temporal and pay flexibility and widening the margin for company specific solutions to a certain extent without endangering the basis of the German model. This implies a trajectory of internal reforms within the parameters of adaptation potential of the current system, taking the form of regulated flexibility and centrally co-ordinated decentralisation. This would allow companies to operate with a more flexible collective ER approach. The framework for numerical flexibility may be broadened somewhat without a significant curtailment of the employment protection regulations by liberalising the conclusion of atypical contracts. At the

same time, safeguards need to be included to limit the possibility of utilising such contracts as a means of circumventing dismissal protection legislation. In contrast, it should be possible to widen considerably the scope for working time flexibility, as long as sectoral agreements continue to set the minima within which management and works councils can negotiate company specific solutions. Temporal flexibility is another source of internal flexibility and is therefore complementary to the high degree of functional flexibility found in many German companies.

Yet, far reaching reforms to the wage formation system (the core of German industrial relations), whereby the feasible space for the pursuit of high degrees of financial flexibility is substantially enlarged, is not a viable alternative in the German context. The radical decentralisation option of a full-scale move to company/establishment level bargaining would undermine the incentive structure that has underpinned the widespread upmarket restructuring across a broad spectrum of industries. In any case, a general move to company/establishment bargaining would be accompanied by a shift in relative bargaining power between the parties to the disadvantage of employers and SMEs especially, since they would have to negotiate with unions that are organised on a sectoral basis. Amending the law to allow works councils to engage in pay bargaining would destroy the harmonious high trust/low conflict relationship between management and work councils, since this is largely the result of their relations being detached from the wider issues of income distribution.

The bulk of German employers actually have a vested interest in maintaining the fundamentals of the current system. Because of the pilot function of the metalworking sector, the anti-inflation stance of the Bundesbank and the co-ordination capacities of the peak organisations of labour and capital, the settlements in the engineering sector are generally in line with the existing rate of inflation and *economy wide* productivity growth¹. With labour productivity generally being higher in most export industries compared to manufacturing as a whole and with labour productivity growth in manufacturing generally being above economy wide labour productivity growth (Heise, 1999; Hof, 1995), wage restraint is a an essential feature

¹ With the European Central Bank having taken over responsibility for monetary policy, it may be somewhat questionable whether the effect on collective bargaining in Germany may be as strong as under the Bundesbank reign.

of the system. This wage restraint works obviously to the advantage of a large proportion of German employers, over and above the benefits of lower bargaining, conflict and transaction costs when compared to a decentralised bargaining situation. Furthermore, independent of industry and sector, sectoral agreements reflect average productivity and profitability of all firms in the bargaining sector, thus rewarding firms with above average productivity. Both lines of argument explain why the majority of firms have a vested interest in having large parts of pay determined outside the company level. This is particularly true against the background of the large proportion of high skills/high productivity workers in many German companies. These employees have substantial bargaining power. By determining a large part of pay externally, the sectoral bargaining system prevents the appropriation of quasi-rents by employees. Decentralisation in relation to pay would need to be closely defined so that it is not too extensive in scope and includes safeguards to prevent opportunistic behaviour by individual firms and widespread low wage cost adjustment strategies, which would undermine the incentives to compete on high skills/high productivity/high value added basis.

In sum, reforms would need to strike a subtle balance between making the German model more flexible, thus allowing more differentiated solutions in accordance with the specific needs of companies, whilst maintaining the fundamentals and advantages of the current system. Consequently, such a reform path implies that there are limits to greater flexibility in the German context.

The Reform Process

The assessment of the series of reforms throughout the 1990s shows that by the new Millennium the German model appears to be more adaptable and more flexible than its actual reputation. In relation to numerical flexibility, deregulation by the state has been modest (for an overview see e.g. Heise, 2000; Tüselmann, 1996a). Despite

some easing of redundancy provisions, government deregulation measures have not led to significant curtailment of the General Dismissal Protection Act. However, the scope for flexible staffing has been improved by the liberalisation of the conclusion of fixed term contracts² and the relaxation of regulations on work through temporary work agencies. However, at the same time, safeguards were included to limit the possibility of utilising such atypical employment as a means of circumventing dismissal protection legislation. Legislation concerning part-time employment was aimed at enhancing the conditions for the uptake of part-time jobs by improving social security provision, rather than using deregulation measures. In fact, all these measures took the form of regulated flexibility and have not impaired the configuration of rigidities, which underpin the widespread pursuit of high skill/high productivity/high value added approaches in Germany. Companies in less price sensitive markets, but where there has been an increase in the competitive environment, should be able to enhance numerical flexibility via flexible staffing at the edges of their internal labour markets without undermining the incentive structure for pursuing high degrees of functional flexibility. The flexibility requirements of companies operating in price competitive markets and the service sector should have been met to some extent.

The new Working Time Law, which replaced the outdated and restrictive Working Time Order of 1938 has considerably broadened the framework for flexible working time arrangements and has given the social partners a wide margin of manoeuvre. Indeed, the flexibilisation of the sectoral bargaining system has been given a substantial boost by the various agreements on flexible working hours during the 1990s (for an overview of the reforms see e.g. Tüselmann and Heise, 2000; WSI, 1998). Over recent years, it has become commonplace for collective agreements on working time to include opening clauses that allow the local level parties to deviate from the collectively agreed provisions in order to reflect the specific needs of individual companies/establishments. Notwithstanding inter-sectoral differences, many collective agreements allow for the annualization of working time, variation and differentiation between companies, plants/branches, employee groups, etc. This

² The legislation for the liberalisation of fixed term contracts runs out by end of the year 2000 and no extension has been agreed to as yet.

has been achieved by means such as work-sharing agreements (e.g. banking, printing, steel and metalworking industries), working time corridors (e.g. insurance, textile, western German chemical and eastern German synthetics industries), the extension of standard working time (subject to upper limits) (e.g., metalworking industries) and increasing the averaging-out period for the unequal distribution of working time. Many collective accords now also allow for individual time-banking and in several industries additional flexibility exists, such as the inclusion of Saturdays in the calculation of the normal working time.

So far, the reforms have been achieved within the adaptation potential of the existing collective bargaining system, taking the form of centrally controlled decentralisation. The sectoral level parties determine the extent, limits and implementation procedures, within which domestic level parties can negotiate company/establishment specific solutions. The expanded range for temporal flexibility should enable companies in all types of markets, industries and sectors to operate with a lower cost base at the German location. It allows for quicker response to fluctuations in demand and a better synchronisation between business cycle developments and working time without having to resort to more expensive options, such as lay-offs, overtime and short-time working. Indeed, a higher degree of temporal flexibility should reduce the need for high levels of numerical flexibility to meet companies' short-term flexibility requirements. Furthermore, companies can improve long-term competitiveness by reducing capital unit costs via more flexible working time arrangements, which allows for the de-coupling of individual working time and plant operation time/opening hours.

In contrast to working time flexibility, reforms in pay bargaining, though gaining momentum, have generally been more selective, more closely defined, less extensive in scope, provided greater control for the central level parties and are more likely to include safeguards to circumvent widespread opportunistic behaviour (for an overview of the reforms see e.g. Schnabel, 1998, Tüselmann and Heise, 2000). As outlined before, an overly broad scope for pay differentiation and flexibility may not be desirable in the German context. Nevertheless, throughout the 1990s, progress has been made in inter-sectoral and intra-sectoral horizontal differentiation, as well as in vertical differentiation in terms of wage structure flexibility. There has been a

widening of the wage spread since the mid 1990s with pay accords producing a wider differential in collectively agreed pay increases and supplements between the bargaining sector. Although the pilot function of the metalworking sector seems still to be intact, the margin of fluctuation around the pilot settlements has widened somewhat recently (WSI 2000), thereby producing pay increases which are more sensitive to the different economic conditions among the different industries in the economy. Wage structure flexibility has been increased in several bargaining sectors (e.g. chemical, paper, construction industries), incorporating additional rates at the bottom of the pay scale or lower starting salaries for new labour market entrants and the long term unemployed.

However, the main emphasis in the reform process has been to incorporate opening clauses in the sectoral accords, increasing intra-sectoral differentiation. The different types of opening clauses allow companies to conclude agreements with the works councils to postpone, waive or lower collectively agreed pay rates or supplements for a limited period of time and to a certain extent. Some opening clauses are explicitly linked to companies experiencing severe economic difficulties, such as the hardship clauses in the plastics and travel industries, the eastern German steel and metalworking industries and the western German paper industry. However, opening clauses that are not explicitly linked to the potential threat of bankruptcy have become more common over recent years. Opening clauses are either conditional ones, whereby agreements between works councils and management require the consent of the sectoral parties (e.g. western German chemical industry and eastern German construction industry) or unconditional ones where no consent is needed. Many of both types of opening clause contain provisions for job security and/or require an undertaking by the employer to improve competitiveness at the German location. Furthermore, in several bargaining sectors, small company clauses have been agreed, such as in the eastern German retailing and wholesaling industries and the western German brewery industry. These clauses provide for agreements between management and works councils in companies below a certain size threshold to undercut collectively agreed provisions.

These reforms have made the sectoral pay agreements more flexible by providing greater inter-company differentiation within bargaining sectors and by widening the

space for firms to create downwards pay flexibility. So far, decentralisation has been embedded within the existing structure of the system. The conflict over wider issues of income distribution is still conducted at central level, with collective agreements continuing to set minimum conditions, while at the same time broadening the framework for company specific solutions without undermining the incentive structure for the pursuit of high skills/high productivity approaches.

Implementation Record of the Reforms

However, the available evidence on the implementation of the reforms suggests that companies, despite calls for further reforms, are only making limited use of the existing broadened framework for differentiation and flexibility. Once sectoral and socio-economic developments and business cycle developments are discounted, the diffusion effect of the reforms appears smaller than might have been anticipated. Despite a marginal increase, fixed term employment has remained relatively stable since the mid 1980s and still lies below the EU average (IW, 2000d). Interestingly, by the year 2000, the share of fixed term contracts on all employment contracts is lower in a number of the service sector industries, such as banking and insurance or other business services compared to the average share of the private sector as a whole (IW, 2000d). Although experiencing a dynamic growth rate, studies suggest that the level of part-time employment remains below its full potential (e.g. McKinsey, 1994). Additionally, compared to the share of part-time employment in other OECD countries, Germany occupies only a middle position (OECD, 2000).

It is impossible to ascertain exactly the uptake of the opening clauses in the sectoral agreements on pay and working time flexibility because of the lack of comprehensive data. However, there are indications that fewer companies than expected are making full use them (see e.g. Handelsblatt, 1997; Gewerkschaftliche Umschau, 1997; Tüselmann, 1996b, WSI, 1998). For example, just 5 per cent of chemical companies which are subject to the sectoral accords have implemented of the provision on a working time corridor, less than 10 per cent of companies in the metalworking sector seem to have implemented the work-sharing agreements and just 3 per cent of

chemical firms are estimated to utilise the pay corridor provisions or the lower starting salary provisions.

One explanation offered for the under-utilised framework is that the scope has not been broadened enough (Hassel, 1999). Another reason put forward is that increased information and transaction costs arising from the complexities of the implementation and adaptation provisions in the sectoral accords may outweigh the benefits of greater flexibility, especially for SMEs (Schnabel, 1995). Both lines of arguments may partially explain the increase in informal flexibility via disorganised decentralisation despite the broadened formal scope for differentiation and flexibility. Alternatively, in light of the high degree of functional flexibility in many German firms, the current provisions might already be more than sufficient to cater for the flexibility requirements of a large section of German companies. In this context the need for further reforms seems somewhat debatable. Notwithstanding this conclusion, the growing incidence of disorganised decentralisation and informal flexibility will probably lead to a further broadening of the formal framework since the sectoral parties are anxious to arrest this trend within the parameters of the current system.

Conclusions

Despite the problems in the German ER model, it is not on the brink of collapse. These problems are not negligible, but they are by no means as overwhelming as often portrayed. Although there is a decline in the coverage rate of the main ER institutions (albeit still remaining relatively encompassing), the decline is largely due to structural shifts rather than a widespread withdrawal from the German model. However, a growing incidence of disorganised decentralisation and informal flexibility, as well as the situation in East Germany are contesting the German model.

Although the need for reforms is widely accepted, the foregoing analyses has shown that many German employers have actually a vested interest in maintaining the

fundamentals of the current model and that far reaching deregulation and decentralisation measures along the lines of the market-led Anglo-Saxon model are not a viable option in the German context. This would destroy the very incentive structure that underpins the high skills/high productivity/high value added approaches found in many German companies, particularly in the export industries, since this is dependent on the particular configuration of regulatory and institutional rigidities created by the German system. Yet, it should be possible to make the German model more flexible and provide a wider margin for company specific solutions without endangering the fundamentals of the German model. This could be achieved by a path dependent reform trajectory within the parameters of the adaptation potential of the current system, taking the form of regulated flexibility and centrally controlled decentralisation in order to better reflect the differing flexibility requirements of an increasingly diverse German business community.

Indeed, the assessment of the reforms carried out so far has revealed that these have been accomplished within the parameters of the existing system and that the reform process seems actually more advanced than frequently assumed. This indicates that the German model is more adaptable and more flexible than its actual reputation, allowing companies to operate with more flexible collective ER responses. Nevertheless, evidence on the implementation of these reforms at the company level suggests that firms are already under-utilising the enhanced framework for differentiation, flexibility and strategic choice. This perhaps suggests that the reforms so far are either already more than sufficient to cater for the flexibility requirements of a large section of German companies, or have not been broad enough in scope and have therefore led to disorganised decentralisation and the pursuit of informal flexibility.

Notwithstanding the under-utilised framework, the reform process is set to continue. However, this raises the question how far it should go and where to draw the line to stop it from threatening the existence of the current model. In light of the impossibility of providing a framework whereby companies in all types of markets, industries and sectors can operate under optimal conditions, the limits of a path dependent reform process will be reached when it starts to undermine the incentive structure that enables a large section of Germany industry to compete effectively in

less price sensitive markets with a DQP strategy. This therefore rules out “Anglo-Saxonisation” style measures. Because of the continuing pressures of disorganised decentralisation and informal flexibility such an outcome may not seem entirely clear at this particular juncture of time. Nevertheless, the emerging flexible German ER model, should be able to embrace the service sector and the eastern German business community to a greater extent, whilst at the same time leaving the incentive structure for its core constituency intact, i.e. the western German manufacturing sector, in general, and the large export industries, which continue to be the backbone of the German economy, in particular. There are strong grounds to assume that past success will set the future direction of the evolving new German ER model, by striking a subtle balance between change and continuity.

To further substantiate these conjectures, future research needs to obtain a more comprehensive empirical picture of the erosion tendencies, especially in eastern Germany, and the implementation of reforms at the micro level. Furthermore, cross-national research needs to assess the findings and arguments of this paper in light of the experience in other countries, such as the Netherlands and Sweden. Additionally the findings and arguments of the paper need to be integrated into the theoretical frameworks and empirical evidence of the different strands of the convergence debate.

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