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2 The flexibilisation of German industrial relations[1]

Lucio Baccaro
Max Planck Institute for the Study of Societies and University of Geneva

Until few years ago, German industrial relations were regarded as a key contributor to the country's seeming ability to reconcile equity and efficiency. They acted, it was argued, as "beneficial constraints" (Streeck 1997), by making it difficult for companies to take the low road of cost competition and by forcing them instead – perhaps against their own inclination – to innovate and upgrade.

The argument of this chapter is that from the 1990s onwards, Germany's industrial relations institutions have become much less constraining. In particular, industry-level bargaining, while remaining the prevalent level of bargaining in Germany, has seen a severe erosion of coverage and has become considerably less encompassing and rigid than it was 20 years ago. Simultaneously, union density has declined steadily, and faster than in less institutionally dense English-speaking countries. While the coverage of works councils has held up better than union density, it has become more difficult for unions to control the propensity of workplace representation structures to exchange derogation of industry standards for the promise of employment security.

The flexibilisation of industrial relations institutions has overlapped in time (and plausibly produced) a tendency of real wages to grow more slowly than labour productivity in almost all sectors. Wage moderation, in turn, combined with the inability of Eurozone partners to adjust their nominal exchange rates vis-à-vis Germany, has stimulated exports while simultaneously depressing imports. In other words, the

1 This chapter draws on two publications, both coauthored with Chiara Benassi: Baccaro and Benassi (2017), Baccaro and Howell (2017: Chapter 5), and on the literature cited therein.

flexibilisation of industrial relations has contributed to the entrenchment of the German export-led growth model in the 15 years before the Global Crisis.

Institutional rigidities

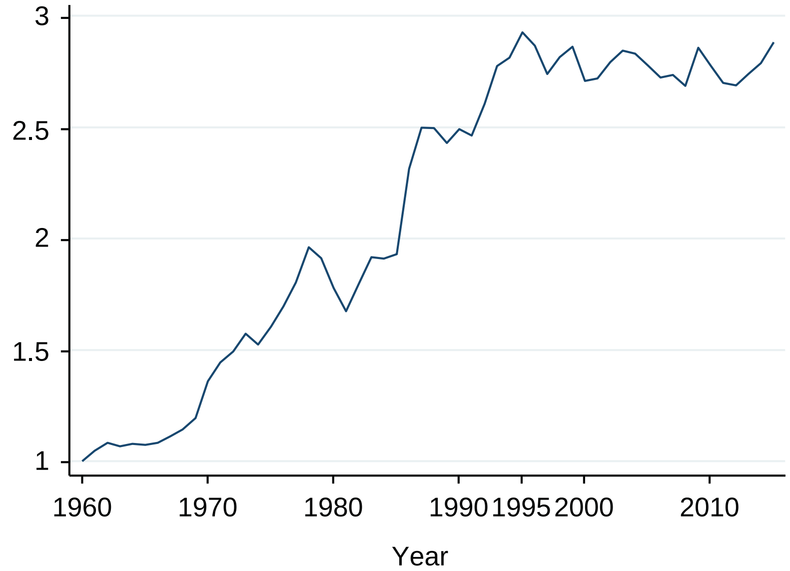
The German model of textbook fame was a fairly rigid system. Employer discretion in hiring and firing was limited by high levels of employment protection. The ability of firms to adapt wage rates to local labour and product market conditions was constrained by industry-level collective bargaining. At the workplace level, every major change had to be negotiated, even though relationships between management and works councils were mostly cooperative.

According to Wolfgang Streeck (1997), Germany's institutional rigidities, far from being a hindrance for firm competitiveness, were a source of dynamic efficiency. Institutions simultaneously constrained and enabled German employers, pushing them towards competitive strategies they may have not adopted if left on their own. Unable to compete on costs due to the presence of strong unions and encompassing industrial relations institutions, firms were encouraged to boost their quality and productivity levels by investing in worker skills, technology, and innovation. This allowed German firms to successfully weather competition from new Asian competitors in the 1980s.

The German production regime, referred to as diversified quality production (DQP) (Sorge and Streeck 1987), depended crucially on employers being unable to escape the regulatory reach of national institutions, and on product demand being only moderately price elastic.

Consistent with DQP upgrading, Figure 1 shows that the ratio of export prices to import prices for German goods increased pretty much continuously from 1960 to 1995. However, the ratio stagnated afterwards. A plausible interpretation is that more intense competition led German export-oriented firms to seek a relaxation of institutional rigidities; this in turn may have reduced firm incentives to move upmarket.

Figure 1 Ratio of exports to import prices for German goods



Source: AMECO database

The trajectory of change

After reunification, German manufacturing firms had a cost problem, which reduced their ability to compete internationally. Foreign producers seemed to have developed an ability to produce with similar levels of quality, but at slightly more convenient prices. In addition, the need to finance the costs of unification had led to increased social security contributions and higher labour costs overall. The response to the cost problem was an employer offensive, which ended up undermining many of DQP's beneficial constraints.

In the 1990s, manufacturing firms (primarily, but not exclusively, those based in the new *Laender*) began leaving the employer association to avoid being bound by the industry-level contract and associated wage provisions. In response, employer associations introduced the option of membership without having to apply the industry contract. This move stemmed the haemorrhage, but reduced employers' capacity for coordination. Additional cost reductions were obtained by outsourcing non-essential services (e.g. janitorial and food services) to firms applying less expensive contracts than the metalworking contract. In addition, large firms used their market power to squeeze the profit margins of domestic suppliers, creating further incentives for these firms to seek respite outside the scope of industry bargaining.

Furthermore, large firms restructured and internationalised their supply chains, offshoring especially (but not exclusively) the more labour-intensive phases, to former communist countries.

Only a minority of German manufacturing companies engaged in offshoring (Kinkel and Lay 2003). Nonetheless, the credible threat of offshoring increased the workers' willingness to make concessions in order to avoid firm relocation. The 1990s and afterwards saw a wave of concessionary bargaining at the workplace level, exchanging 'opening clauses' for the promise of job security.

Attempts were made in 1995 and 1998 to address the cost problem through national-level 'social pacts', but they essentially failed. In response, the government decided to proceed unilaterally. The Hartz reforms worsened the fall-back option for workers in case of redundancies and increased their willingness to make concessions even further (Rebien and Kettner 2011).

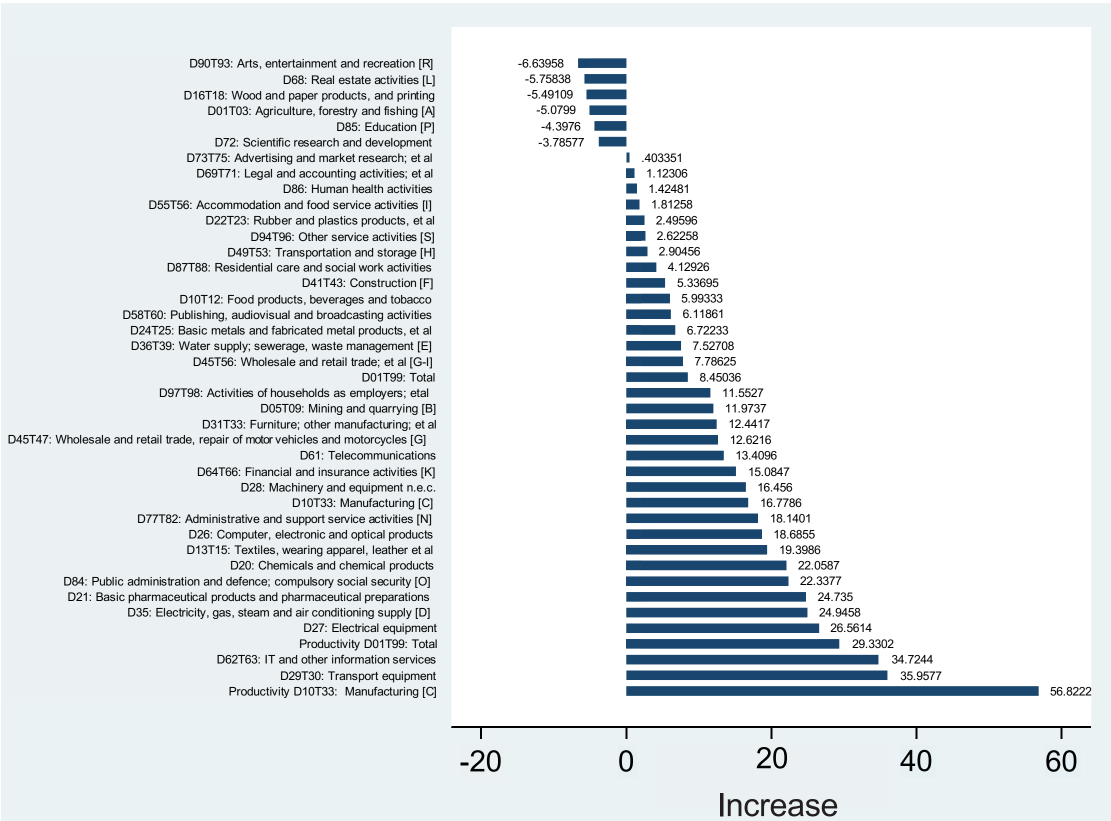
However, the trend of wage moderation had begun before the introduction of the Hartz reforms. Furthermore, wage moderation was not just a peculiarity of the service sector, the sector most affected by the Hartz reforms, but also (albeit to a lesser extent) of the manufacturing sector.

A flexibilised German model

Because of the above trends, sectoral bargaining coverage declined steeply in both manufacturing and services: from 80.3% (1995) to 50.4% (2013) in manufacturing and from 71.1% to 45.2% in services. The decline of industry-level bargaining was not counterbalanced by an increase in company-level agreements. The coverage rate of company bargaining slightly increased in manufacturing but halved in services. The sectoral coverage rate of establishments fell from 63.2% to 26.9% in manufacturing, and from 56.7% to 32.4% in services. Furthermore, between 2005 and 2007 (the two years for which data are available) over 20% of the manufacturing establishments covered by sectoral agreements made use of opening clauses. Overall, industry-level bargaining is still the main type of bargaining in Germany, but is now much less encompassing than in the past.

The softening of industry-level agreement has undermined the ability of collective-bargaining institutions to redistribute productivity gains across sectors. In the heyday of the rigid German model of industrial relations, unions in high-productivity sectors such as metalworking would target the economy-wide rate of productivity growth to allow wages in low-productivity sectors to grow faster than their (stagnant) sectoral productivity. This stimulated household consumption and domestic demand. The collective bargaining system no longer plays this redistributive role, and sectoral differentials have widened. In particular, between 1991 and 2007 real wage growth in manufacturing was much greater than in low-end services such as hotels and restaurants.

Figure 2 Changes in real wages per hour worked by employees and in labour productivity, 1995-2014



Notes: Wages are deflated with the CPI; labour productivity measured by value added volume per hour worked by employees.
Source: OECD STAN Database

Wage moderation has been a generalised phenomenon, cutting across private and public sectors, manufacturing and services. Figure 2 reports real wage increases for a number of sectors, and compares them with productivity increases in the manufacturing sector and in the economy as a whole. Only in two sectors – transportation equipment and IT and other information services – did real wages exceed national productivity (but not manufacturing productivity, which was much higher); in all other sectors, they were well below. Real wage growth was negative in the education sector, and only marginally positive in the health sector, in the hospitality industry, and in construction.

Based on these trends, it is not surprising that the contribution of household consumption to German growth was negligible between 1994 and 2007. After the crisis, the German growth model rebalanced in part and household consumption became a more important driver of growth. Institutional innovations like the introduction of the minimum wage go in the direction of rebalancing. However, the fundamentally export-led nature of the model did not change, as demonstrated by the very large current account surplus.

Overall, the liberalisation of industrial relations and associated wage moderation seems to have boosted the cost competitiveness of the German economy. This has stimulated exports and, perhaps more importantly, depressed imports through the stagnation of domestic demand.

However, it has also eliminated an important productivity whip, which once forced companies to innovate and upgrade in order to remain competitive. The price for the relaxation of beneficial constraints may have to be paid in the future.

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About the author

Lucio Baccaro is Director at the Max Planck Institute for the Study of Societies in Cologne, and professor of sociology at the University of Geneva. He is the author of *Trajectories of Neoliberal Transformation: European Industrial Relations since the 1970s* with Chris Howell (2017).