

# **Incomes Policy in Germany and Partial Decentralization of Collective Bargaining**

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## **1. Introduction**

This paper firstly analyzes the decline of collective bargaining and the onset of decentralized wage bargaining. Secondly, political and economic factors for the setup of an official incomes policy, its principal objectives and economic approaches, diverging between unions and employers' associations, as well as the ultimate failure are discussed. Thirdly, it is elaborated that after the demise of official incomes policy the decentralization of wage determination proceeded and flexible wage bargaining at the level of establishment, incorporating elements of the former official incomes policy, strongly expanded. Empirical results of this institutional turning point, including severe shortcoming, are pointed out.

## **2. Declining Collective Bargaining and the Onset of Decentralization**

Subject to some data restrictions the trends are presented for periods till the last decade of 2000 and the second decade of the 21<sup>st</sup> century.

Net union density (without retiree members) of the DGB-unions (unions affiliated with the German Federation of Unions – DGB) declined from 27.3 (1980) to 17.2 (2000) and to 12.9 per cent (2011). Union density in Germany was one of the lowest of the EU countries in 2010 (Ebbinghaus, Göbel 2014, 216 and 230).

A similar trend is detectable in the German Employers' Associations (BDA and subgroups) with especially small and medium-sized firms leaving or not joining the associations. In the Metal Employers' Associations of West Germany, for example, the percentage of membership firms declined from approximately 56 (1984) to 41 (1994) and to 18 (2011) (Schroeder, Sylvia 2014, 354).

The coverage of sectoral bargaining fell from 1996 with 68 (43) per cent of all employees in the private sectors of the economy in West (East)

Germany to 2000 with 60 (39) and to 47 (29) per cent in 2014, respectively (Ellguth, Kohaut 2015, 293). The sectoral spread of collective bargaining coverage in 2010 varies widely, ranging from 69 per cent in chemicals to 15 per cent in IT-services. 20 per cent of employees in small companies (10-49 employees) are covered by collective contracts, whereas the corresponding percentage amounts to 86 in companies larger than 1000 employees (Statistisches Bundesamt 2013). Average wages are highest in firms with sectoral contracts, followed by companies with an orientation towards sectoral collective wages and finally by their non-orientating counterparts (Addison 2012).

From 1996 to 2014 works councils existed in about 10 per cent of firms without a detectable trend. However, the percentage of all employees in firms with a works council and a sectoral collective agreement in West (East) Germany declined from 1996 41 (29) to 2000 37 (25) and to 28 (15) in 2014 (Ellguth, Kohaut 2015, 296). The percentages are substantially higher for large companies with more than 500 employees (Ellguth 2004, 166).

The basic trends of an erosion of collective bargaining were already quite striking before 1998, the year of the introduction of the second version of incomes policy in Germany, and they proceeded unabatedly after the turn of the century.

In addition, this development was accompanied by steps towards a partial decentralization of collective bargaining. With high and persistent unemployment in West Germany the metal workers' union (IGM) in 1984 started a long national strike for a reduction of weekly working time from 40 to 35 hours with full income compensation in order to redistribute working hours across more employees and thus reduce unemployment (Giersch, Paqué, Schmieding 1992, 215). Finally, a compromise incorporated two elements: a gradual introduction of a working week of 35 hours and "opening clauses for working time" (OC\_WT) for flexibility at the company level to be negotiated by *the employer and the works council*. After 1992, in a very severe recession large companies negotiated with works councils and the consent of trade unions cost-cutting measures, such as working time reductions without wage compensation, and employment guarantees (Rehder 2003, 116).

In this period the government and the two bargaining partners agreed to transfer the basic labor market institutions to the Eastern part of the country and the unions specified rapid annual wage increases to attain Western wages. Unemployment attained unsustainable levels and the hiatus between wages and labor productivity increased. Employers demanded “opening clauses for employment and competitiveness” (OC\_EC) in collective contracts in the East that would allow *firms with the consent of their employees or the works council* to pay wages below the standards of the collective wage agreement, increasing the likelihood of the survival of firms and stabilizing employment. Reluctantly, the unions gave in, fearing that this new type of opening clauses might spill over to the West.

### **3. Second Version of Incomes Policy: Alliance for Employment, Training and Competitiveness (1998 – 2003)**

21 years after the termination of the Concerted Action (1967-1977), the first version of incomes policy in Germany (Ulman, Flanagan 1971; Flanagan, Soskice, Ulman 1983), the second version of incomes policy was established by the newly elected coalition government of the Social Democratic and Green Parties (Centre/Green) in a period of high rates of unemployment. Several factors might have contributed to this decision.

First, against the background of stagnating and declining employment, IGM and DGB launched an initiative in 1995 for an improvement of employment. The issues were discussed in a forum for non-binding debates between the government, unions and employers’ associations (Bispinck, Schulten 2000, 6). After the Centre/Right coalition enacted fiscal spending cuts in the area of social policy, the unions terminated their participation. Second, the idea of a social pact at the national level was adopted by the Social Democratic Party, strongly supported by unions in the election campaign. Third, the major components of the German system of industrial relation, i.e. works councils (co-determination), collective agreements, unions and employers’ associations are declining, the decline, however, is much less pronounced in large companies. They are characterized by stable union density rates, and high rates of coverage by collective agreements and works councils and they try to use wage cuts by reducing voluntary bonuses (Hassel 1999, 502). As large companies play important roles in

the employers' associations they have an incentive to participate in an Alliance that might lead to more moderate wage hikes and reduced unemployment.

The Alliance was chaired by the Chancellor and composed of the major business organizations and the most important sectoral unions. After the first meeting of the Alliance a joint consensual statement declared the reduction of high unemployment as the most serious challenge requiring a permanent cooperation between the state, unions and employers (Arlt, Nehls 1999, 262-264). Subsequently, unions (DGB) and employers' associations agreed in a joint paper on the preferred use of productivity increases for employment expansion, the reduction of working time for additional jobs and an extension of working time accounts (OC\_WT).

Despite this compromise the main focuses of unions and employers' associations differed. Unions generally preferred working time reductions in order to redistribute the available volume of work without income cuts and/or an extension of early retirement, while the employers' associations opted strongly for wage settlements below productivity increases. However, in the bargaining round for 2000 and 2001 the chemical workers union (IGBCE), referring explicitly to Alliance's employment-oriented collective bargaining policy, exceptionally took the wage-leader function and settled for moderate wage increases. The public reaction to the chemical agreement was very positive, influenced the negotiations of IGM and led to moderate wage increases in this sector (Bispinck, Schulten 2000, 20 f.).

During this bargaining round unemployment declined and wages rose moderately. With the onset of recession in 2002 the still high unemployment stagnated and began to rise again. The results of collective bargaining were criticized by IGM members, who began a series of short strikes and initiated a harsh debate about the Alliance and the participation of unions in the tripartite institution. The ensuing contractual wage increases for 2003 and 2004 were generally regarded as excessive. Apparently, for the strategy and actions of German unions fairness and equity are more important tenets than a reduction of unemployment (Ulman, Gerlach, Giuliano 2005, 9).

With collective bargaining policy as a taboo topic for unions, a gradual phasing-out of the Alliance was unavoidable. After the reelection of the

Centre/Green coalition in 2002, the Chancellor dissolved the Alliance and abrogated the second German attempt for an official incomes policy.

#### **4. Proceeding Decentralization of Wage Determination**

The main indicators of collective bargaining – net union density, membership in employers' associations, coverage by sectoral collective wage agreements, the proportion of employees in firms with a works council and a sectoral collective wage agreement – continued to shrink after the turn of the century, as shown previously. The decline was very severe in East Germany and in general did not affect large companies.

After the demise of the "Alliance" and with high and rising unemployment rates, "opening clauses for employment and competitiveness" (OC\_EC) were established in West Germany. In a very important treaty, concluded in the engineering industry in 2004, IGM and the employers' association agreed on a regulated firm-level bargaining between management and the works council with initially stringent supervisory rights of unions and employers' associations. On the one hand this treaty debilitated the institutional governance of the labor market by the traditional bargaining partners, exposing it more strongly to market forces. On the other hand and especially in the core of the German economy the bargaining partners – management and works councils – compromised: workers accepted pay cuts, extended working time and more flexible working arrangements, while management promised investments, guaranteed production at the location of the firm and employment, and abstained from dismissals.

In 2011, 28 (16) per cent of employees with a collective contract in the private sector are employed in establishments with an OC\_WT (OC\_EC). The percentages increase with plant-size and the two versions of alliances coexist in many firms (Ellguth, Kohaut 2014, 442).

In the first decade of the 21<sup>st</sup> century six independent occupational unions were founded with about 200 000 members (Lesch 2008, 146), organizing qualified employees and competing with unions of the DGB. Their threats and frequent strikes are very successful in attaining higher wages, counteracting the flat wage structure in collective wage agreements (Schroeder, Kalass, Greef 2011, 92). The debut of

occupational unions leads to an additional decentralization and fragmentation of the German system of collective wage contacts.

Reforms of the supply-side of the labor market accelerated fragmentation and the partial erosion of collective bargaining. The basic proposals of the Hartz-Commission were implemented between 2003 and 2005, directly after and as a response to the failure of the “Alliance”. Hartz-activation policy tightened the rules for the unemployed to accept job offers. The Hartz welfare reforms cut the duration of unemployment insurance benefits (UB I). The merger of social assistance with the assistance for long-term unemployment into a single flat rate and means-tested benefit generated a general minimum income support with strong activation requests (UB II). These policy changes augmented labor supply for low-wage jobs.

In the course of the Hartz-reforms various types of atypical employment were deregulated. Fixed-term contracts were generally available for firms up to two years. Agency (temporary) work was completely deregulated. Especially in the core economy works councils and management welcomed the numerical flexibility provided by agency workers as they supported job stability for the core workers. Finally, the Hartz-reforms adopted, modified and raised the attractiveness of marginal employment (mini-jobs).

Summarizing, these developments led to an increasing fragmentation and heterogeneity of the labor market and the labor force. Wage-setting at the individual level became much more wide-spread. Due to the increasing availability and use of opening clauses the role of firm-level works councils in bargaining was strengthened relative to unions (Carlin, Hassel, Martin, Soskice 2015, 83; Dustmann, Fitzenberger, Schönberg, Spitz-Oener 2014). The activation policy for labor supply and the partial deregulation of atypical forms of labor contributed to the acceptance of low-wage jobs. In addition, the fiscal deficit rules of the “Stability and Growth Pact” in the Euro zone limit the application of fiscal policy, whereas the monetary policy of the ECB regulates the inflation rate in the Euro zone, not only in Germany. While these institutional changes further weakened the case for official incomes policies, they simultaneously supported the transfer and imitation of some of their elements like bargaining over wages and employment to the microeconomic level.

## **5. Flexible Lower-Level Bargaining: Empirical Results**

The prior argumentation raises two questions. First, why is core of the German economy composed of larger and middle-sized firms in manufacturing, banking, finance, insurance and energy with sectoral collective bargaining and works councils, although benefitting from partial decentralization, reluctant to advocate a cancellation of the system of sectoral collective bargaining (Thelen 2000). Freeman and Lazear (1995, 49) show that “works councils are most likely to improve enterprise surplus when they have limited but definite power in the enterprise”. This encourages works councils to focus first and foremost on improving the operation of the workplace, on enhancing productivity and on reducing quits and dismissals. A high proportion of the wage bundle is determined by sectoral collective contracts and larger firms, in accordance with works councils, usually raise the remuneration. In periods requiring employment stabilization and an improvement of competitiveness firms can still use sectoral collective wages as a benchmark and bargain with works councils over reductions of ‘extra pay’ and within the framework of “opening clauses” of undercutting the benchmark. Empirical results for Germany support this analysis. Compared to uncovered establishments the impact of works councils on wages is less strong in covered plants and their productivity enhancing effects are more likely in establishments with a collective wage contract (Hübler, Jirjahn 2003).

The second question concerns the economic effects of opening clauses (OC). OC\_WT are a compromise between management and works councils. They increase productivity and lead to a reduced fluctuation of workers. Wages and profits do not fall (Bellmann, Hübler 2015).

Slightly more than 50 per cent of OC\_EC are concluded in economically critical phases of an establishment, whereas the remaining OC\_EC intend to strengthen the future competitiveness of their plants starting from their still satisfactory economic condition (Hübler 2005, Hübler 2006a, Hübler 2006b, Bellmann, Gerlach, Meyer 2008). The probability of a stable or rising employment is on average significantly higher in plants introducing them in an acceptable economic condition with the goal of improving competitiveness than in establishments in an already

critical phase. Trustful relationships between the bargaining partners are a significant ingredient of their success.

In addition, a recent study of the effects of OC\_EC on employment in the severe economic crisis (2008/2009) shows that in establishments affected by the crisis the existence of an OC\_EC supported the stabilization of employment (Bellmann, Gerner 2012).

In summary and with some caveats, the current empirical results show that opening clauses stabilize and stimulate employment, sometimes with wage moderation and particularly in larger companies.

The new institutional set-up is correlated with an extreme increase of wage inequality. Germany now belongs to the group with the most pronounced earnings inequality in Europe (Rhein 2013). The increase of real mean wages was very modest in the period after 1995, whereas wage inequality rose very strongly. Real wages at the 15<sup>th</sup> percentile declined dramatically, at the median they started to fall after 2000, and at the 85 percentile they continued to rise after 1995. The decline of union coverage and the decentralization of collective agreements as important elements of the remarkable change of wage inequality, however, vary between the studies (Antonczyk, Fitzenberger, Sommerfeld 2010; Card, Heining, Kline 2013; Dustmann, Ludsteck, Schönberg 2009).

## **6. Conclusion**

After 2004, with modestly rising real wages the development of employment and labor productivity was more advantageous in Germany than in most other countries of the Euro zone (Dustmann et al. 2014, 170; Thimann 2015, 145). The ongoing decentralization of wage determination and flexible lower-level bargaining were the principal driving forces of this process. A large part of total employment is relegated to competitive labor markets. "Opening clauses" (OC) are important elements of the new focus of collective bargaining, mimicking to some degree past incomes policies. The case for official incomes policy became much weaker. However, the stability and future prospects of this development are at risk, since works councils tend to foster the stabilization and growth of employment in conjunction with a sectoral collective wage contract. This side condition is weakening.

This paper has intended to show the significant role of works councils in the resurgence of the German economy. Works councilors are not necessarily union members, although many are. They have a margin of independence from the unions and often act for the benefits of firms. As workers generally desire more voice and influence in firms and at the work place (Addison 2014, 8) these insights might be of some importance for the US.

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