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Changes in the system or change of system?
The national employment model of Germany

First draft

Please do not quote

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1 Introduction

For a long time Germany and Japan had been regarded as successful models for coordinated and trust based varieties of capitalism since their economies seemingly performed better than the economies of the predominantly market led economies. By the late 1990s the picture has changed. The market led economies of the US and UK had recovered and the German and Japanese economies were widely perceived to be in difficulties. The advocates of unregulated capitalism now make the case that the market led economies with its commitment to labour market flexibility through job insecurity, weak trade unions, a lean welfare state, and large differentials in pay are more likely to flourish and that there is no practicable alternative to the market model in the long run.

Over the last decades we could observe an astonishing number of upward and downward careers of national models of capitalism. Often the celebrated best performing models already show signs of a coming economic and institutional crisis while models in deep crisis are being substantially reformed and might regain the capacity to prosper again. There are reasons to believe that models of capitalism have always been developed within a specific economic and social environment and that a changing environment requires substantial reforms which often are only possible in a deep crisis. In addition the reasons for the crisis of an economy might not lay in the specific institutional setting of the economy but in external shocks or in the macroeconomic policy which not necessarily is closely linked with a specific model. There is always the possibility that the success or the crisis of a specific model of capitalism is not the result of specific institutional structures but of specific macroeconomic policies or external shocks. The literature on models of capitalism tends to neglect the impact of macroeconomic conditions.

Therefore we feel the need to be cautious with a prognosis of the end of the German model without a careful analysis of all the reasons of its present low growth rates and an understanding of its capacity to adjust to a new environment. The German model as one prominent model of the Rhenish Capitalism (Albert 1996) has been termed as “diversified quality production” (Streeck 1992) based on a “high skill equilibrium” (Finegold/Soskice 1988). Trust relationships between the main actors are said to facilitate long-term relationships and decisions. These „trust-relationships are anchored either in intra-capital relationships (with the emphasis on cooperation between large German companies, between German industry and German banks, and between small and large German capital) or in capital-labour relationships in a sweep of enthusiasm which moves from advocates of social market economies to enthusiasts for the ‘beneficial constraints’ imposed on German capital by strong labour unions” (Coates 2000: 64). The trust relationships are reproduced through the following mechanism:  

The structure of corporate governance: Long term decision making has been encouraged by stable ownership of German companies. Companies do not often change hands. Many companies continue to be privately held and only a small proportion of the productive capital is traded (Streeck 1997). Through the system of codetermination decisions are continuously negotiated. The firms are social institutions in which risks and benefits between and within the groups including the employees are mutualized (Albert, Gonenc 1996: 276). Finally the managerial elites are selected from within the companies and their careers are linked with the long-term performance of the company. Within each industry German companies compete in the product market but cooperate in dense networks (chambers, employers’ organizations, various organizations of engineers) at local, regional and national level in setting technical standards and diffuse innovations.
The special role of German banks: the banks own substantial amounts of industrial shares, they are represented at the supervisory boards of most big companies and control proxy votes for shares deposited with them by customers. Small and medium sized companies, the famous “Mittelstand”, enjoy the capacity to raise long-term loans from a differentiated set of regional, municipal and cooperative banks at low costs. The long-term banking encourages industrialists to take a longer view (Coates 2000: 173) and encourages banks not to speculate with the stock. Contrary to the UK where the banking system for its survival has not been dependent on the health of the local manufacturing the German banks are deeply linked with the manufacturing companies.

The dual system of apprenticeships: The German workforce is highly skilled because companies train a substantial proportion of young people in the apprenticeship system. The training takes place in recognized occupations for which formal standards are developed by the unions and employers organization who are the main promoters of the system. The training standards and the existence of occupational labour markets are a powerful instrument of the diffusion of new technologies and forms of work organization across the economy, including small and medium sized companies. In many occupations training yields only returns over the long term. Therefore the high average tenure of employees and the long-term orientation of the management is one of the conditions of the German “skill machine” (Culpepper/ Finegold 1999).

The system of industrial relations: The industry wide collective bargaining operated by strong unions and employers organization takes wages out of the competition and forces employers to increase productivity and to concentrate on quality production where price-competition is less intensive. The collective agreements and the German labour law are limiting external mobility of the companies. Internal flexibility based on non-Tayloristic work organization has been developed to compensate these constraints. Employment security is improving motivation and cooperation within companies. Employees have a strong voice within the company which makes it possible to negotiate for longer-term benefits. “Codetermination thus insulates both management and labor from opportunistic pressures” (Streeck 1992: 32-4).

The welfare system: Most employees are covered by mandatory state regulated age, sickness, accident and unemployment insurances which guarantee comparable high replacement rates and a good quality of welfare services. The contribution based welfare system increases indirect labour costs but it reduces transaction cost for companies which do not have to find firm specific solutions. The portable benefits also reduce the costs of external mobility which is one important condition of functioning occupational labour markets. The welfare state together with the labour law and collective agreements were regarded as the major instruments for the de-commodification of labour in Germany.

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1 The German „Mittelstand“ comprises also big family owned companies with up to 5 000 - 10 000 employees which might even be world leaders in specific product markets. The term “Mittelstand” refers to locally based family enterprises irrespectively how big they are and underlines the contrast to anonymous stockholding companies.

2 Polanyi (1944) coined the term ‘decommodification’ to describe the protection of labour from the vagaries of the market, so that its very nature as a commodity was restricted. In a market economy, however, complete decommodification is impossible. The most that can be done – and this is what is meant by the term – is to build in buffers between the market and employment relationships that guarantee workers an income, at least for a transitional period, even when they are not working because of illness, accident, unemployment, short-time working etc. At the same time, employees’ capacity for work is maintained over the long term by offering them protection against excessive demands. Social protection and the constraining of corporate decision-making by rules (e.g. dismissal protection) increased workers’ bargaining power in the labour market and enabled them to obtain for themselves a share of the increase in economic productivity.
Based on these institutions the German manufacturing industry specialized on high quality products and achieved high export surpluses. One group of scholars argue that the German production model is in a deep crisis. Kitschelt/ Streeck see Germany in a “high equilibrium trap” (2004: 1) since the markets for high price quality products are shrinking due to increased international cost competition. In addition they argue that German institutions favour incremental innovation and are to slow to response the new and highly uncertain demands of a changed world (2004: 3). It is also argued that the German economy has become too dependent on old industries, like the automobile and machine tool industries, and is lagging behind in developing new industries and the service sector. Others authors see the stability of employer organization and unions crumbling which were the main actors organising the consensus within the old model. Another group of scholars seems to be more optimistic. Carlin/Soskice underline that “Germany remains the exporting powerhouse of Western Europe“(1997). Culpepper (1999: 359) found only little support for potential threats to the high skill equilibrium.

Strikingly enough in large parts of the literature on the German production model it is taken for granted that it is possible to take a particular section of the economy as the whole. It is implicitly assumed that other parts of the economy are structured in the same way as the manufacturing industry without explaining why this is the case. To understand the German Model of capitalism and its changes it is necessary to analyse, if this implicit assumption is empirically founded. To simplify our argument we differentiate the economy in three big segments (Figure 1.1; see Annex for definitions):

- First, the industrial segment including production-related services, to which we give here the label “production”;
- Second, the distributive and consumption services (“consumption and distribution”), and
- Third, the large range of public and social services concerning basic needs of societal provision, including education, health and care (“provision”).

In fact there are good reasons to believe that in the past the two other segments were structured in a similar way as the industrial segment: Firstly the functional equivalent to the stable ownership in the industrial segment was the strong role of the public service in the distributive (water, energy, transport, post, telecommunication) and in the social services (health, education and training). Secondly the common bond of national wide institutions (labour law, welfare regime, codetermination, dual system of apprenticeship, industry-wide collective bargaining) was strong. Thirdly where the unions and employers were too weak to follow the other sector special mechanism for this weaker sector were invented like the extension of collective agreements. Fourthly the manufacturing sector played the role of a pace-maker for some decades. The unions and employer organizations were stronger in the manufacturing industry than in the other sectors. The pattern agreements of the IG Metall set the pace for the rest of the economy and many collective agreements of the manufacturing sector were later generalized by law. To play this role of a pace maker the unions had to orientate their wage policy on the productivity increases in the whole economy and not on sector specific developments. Fifthly the high economic growth in the post war-period linked with continuous labour shortages made it easier for unions to improve labour standards also in labour intensive industries with weak unions like in the food industry, in retail trade or in hotels and restaurants.
Today, however, the links between the institutional structures of the industrial segment and the two segments are getting loose and the industrial segment in itself is becoming more heterogeneous. With the expansion of the service sector and the increase of the female employment rate it becomes more visible that the German employment system has been designed for the male breadwinner.

Those authors who compared welfare regimes were much less enthusiastic about Germany as the analysts of the production model. Esping-Andersen (1990) took Germany as the example of a conservative corporatist welfare system which reinforces gender divisions and the difference between high and low status workers in the labour market. The German welfare state does not provide enough public services for children or elderly care but supports unpaid household work by the provision of transfer payments. Housewives have mainly access to welfare payment through their position as dependants of their insured spouses. Marginal part-timers do not loose their entitlements as dependants. This explains the time-lag in the increase of female employment rates, the high proportion of female marginal part-time work and the decline of birth rates with the increase of female employment rates in Germany. It has also been argued that the German welfare regime with its high subsidies of unpaid housework does not fully exploit the possibilities to create jobs in the service sector which partly explains the
German “service gap” (Bosch 2001, Bosch/Wagner 2005). So with the growth of the service sector the German welfare regime works as a “built-in-deregulator” of the standard employment relationship while the reformed Scandinavian welfare states works as a “built-in-stabilizer” of the employment model of a more flexible standard employment relationship which reduces gender divisions (Bosch 2004).

In addition it cannot be taken for granted anymore that collective agreements in the manufacturing sector are followed in other sectors. The privatization of public utilities and of many social services have created new sector specific models of cost competition in which collectively agreed wages do not serve any more as a floor. The state does not intervene anymore to stabilize minimum wages as in the past but increases instead the pressures on unemployed to accept lower wages. Basic institutions like the industry-wide bargaining are eroding in many industries and the state seems less and less willing to guarantee minimum labour standards. Employers who joined the employers associations in the past because they were afraid to negotiate with strong union without external support are losing this fear and leave and others of newly founded enterprises are not joining the employer associations. The instability of the employers association is regarded as the Achilles heel of the German system of industrial relations.

The instability of the German model cannot be understood without taking into account the external shock of the German unification and policy changes. The system of industry wide bargaining with similar wages in an industry has been grown in West-Germany over many decades. Companies had time to adjust their productivity levels. East German companies were not given that time and found themselves not in a fast growing economy as the West-German companies after the war but in sharp competition with highly productive West-German and foreign companies. The pressure on wages was also fuelled by the surplus in labour supply due to the substantial increase of unemployment after the breakdown of the East-German economy. The regional divisions especially between East- and West-Germany have not diminished in spite of high subsidies of the east-German economy. This puts the German employment model which was characterized by homogenous labour standards within industries and across the regions under stress. In addition the public budgets were hollowed out by high transfers from West to East-Germany and by several tax-reforms. Since deficit spending was limited by the Maastricht-criteria public investments and welfare payments were cut down. As a result the German economy was growing slower than the rest of the EU since the mid 90’s.

It remains open if the present fragility of many institutions is a temporary phenomenon which will disappear as soon as unemployment goes down and the East-Germany has reached West-German productivity levels or if the German employment model will be replaced by a dual economy with an “East-German Mezzogiorno” and a reformed West-German Model or if the consequences of the unification have the potential to destroy the model of coordinated capitalism at all. Five years ago we were still confident that the main actors were trying to reform the German model. Today we see that basic pillars of the German model have been demolished and that major actors within the employer associations, the conservative and liberal parties and even influential factions within the green and social-democratic party want a change towards a more market-led system. Ironically the German system seems to be most resistant to reforms where the reforms are most needed. The tax and welfare systems still follow the traditional breadwinner-model and major actors either do not have the courage to change it or clinch to the old model.

In the following we will analyse the recent changes and will try to find some answers to the question in which direction the German model has developed. To do this we will first analyze the economic development and the economic policy in the last 15 years (2.1). Then we will
analyse changes in basic institutions of the German model. We will start with the corporate governance (2.2) and the organisation of the production process (2.3). After that we will look at the training system (2.4), the industrial relations (2.5) and the employment system (2.6) which includes the gender regime.
2 Drivers for change. Political and economic organisation

2.1 Changes in economic and political conditions. Role of major actors

At the beginning of the 1980s, after the Kohl government had come to power, it was a widely shared belief in Germany that the new government would try to follow the general route towards a more deregulated economy, paved by the US and British governments, and curb both the welfare state and union power. In fact these had been the core ideas of a manifesto of a leading liberal politician (Lambsdorff 1982) which heralded the break-up of the Socialdemocratic-Liberal coalition in 1982 and gave way to the alliance of the Liberals with Helmut Kohl’s Christian-Democratic party that lasted until 1998. The German word *Wende* (turn), which became a major symbol in German political rhetoric in 1989/1990, had its forerunner in West-German politics in the mid-1980s when the chancellor prescribed a “mental and moral turn” towards an effort-oriented, rather than what he saw as an entitlement-oriented, general attitude in Germany. True, in the course of that decade, his government executed various cuts to welfare state benefits and increased its pressure on the unions. Moreover, business began its large move to the redistribution of income aiming at reversing the shifts between wages and profits stemming from the 1970s. All in all, however, “market-oriented and deregulatory policies were clearly less pronounced in Germany than in some other countries or failed because of the resistance of unions and the political opposition” (Beck at al. 2005: 4). It was not before the German unification that the German economy and its major actors slid, or drove, into a truly crucial phase for the country’s employment model.

In what follows, the major characteristics of the economic development, the macroeconomic strategy and the shifts in the roles and orientations of major actors will be outlined, some of them just briefly as they will be described in greater detail in later sections: the sluggish growth of the economy and its interaction with the German unification, the predominance of export orientation throughout the economic and political elite, the focus of both the Kohl and the Schröder governments on reducing revenues and expenditures at once in their fiscal, social and labour market policies, and the fundamental shift in the balance of power within the system of industrial relations.

2.1.1 The economic implications of the German unification

After a gradual decline in growth rates and a gradual increase in unemployment rates over the last three decades, the average annual real GDP growth from 1991 to 2003 was at 1.5%, which was well below the OECD average of 2.5% (OECD 2005). The sluggish growth of the German economy had far-reaching consequences for the country's employment situation. The 1990s exhibited a boost in unemployment, exceeding considerably the step-by step increase experienced so far (Figure 2.1).

While employment in the EU15 without Germany grew by 16.5% (+ 17.5 million) between 1992 and 2003, employment in Germany decreased by 2% (- 0.7 million). The greater part of this decline was attributable to the breakdown of large areas of the East German labour market. Unlike the general trend female employment in Western Germany continued to rise, which was, however, partly linked to an increase in indirectly subsidised “mini jobs” (see below, chapter 2.6).

Germany’s unemployment rate, which was in 1992 with 6.4% far below the EU15 average of 10.1%, increased to 9.6% in 2003, thus overtaking the EU 15 average of 8.1% (European Commission 2004a). This had also a marked impact on the country’s GDP per inhabitant which slumped from 122% in 1995 to 109% of the EU 25 (!) average in 2004, which corresponds almost exactly to the EU 15 level (Eurostat Structural Indicators).
The single most important factor to explain this unfavourable situation are the economic problems entailed by the German unification. The economic incorporation of Eastern Germany into the larger Federal Republic started with the one-to-one conversion of the East German mark into DM in 1991. This big bang corresponded to a revaluation of the East German currency by more than 100% which turned the East German economy uncompetitive overnight. The revaluation shock initiated rapid wage increases (by and large agreed between the trade unions and West German firms and state run holdings in Eastern Germany), which entailed a boost in wage piece costs by more than 50% within the first three years after unification, compared to roughly 10% in the West (Flasbeck/Spiecker 2001: 73). As a consequence, a large process of de-industrialisation began, followed by a loss of about 4 million out of 9.8 million jobs. In 2004, according to national definitions, the average unemployment rate in Eastern Germany was at 18.5%, compared to 8.5% in the Western part of the country. Today, the ratio between registered unemployed and jobs offered is at 36:1 in the East, in comparison with 12:1 in the West (Bofinger 2005: 59).

Moreover, a process of migration primarily of younger and high skilled workers to Western Germany (in particular to Southern regions) began which reduced the population in Eastern Germany to 15.1 million, compared to the 16.4 million people who had lived in the former GDR in 1989. As a result, the East German economy has been weakened by a loss of human capital and, in the medium term, may have to reckon with shortages of skilled labour.

At the very beginning of this process the West German economy benefited strongly from the unification boom, as did, though to a lesser extent, some other nations with high exports into Germany. After that initial boost, however, the West German economy slid into a business slump (or was pushed into it by Deutsche Bundesbank, as critics argued), whereas the Eastern part exhibited high growth rates based on massive public investments (construction) and important public subsidies for private investments. Once these supportive actions diminished, what remained as major engines for self dependent growth proved as insufficient, and from 1997 growth rates in the West began to exceed those in the East.

The initial economic successes have now been more than offset by the growth lost as a result of, first, the severe slump of the construction industry (which accounts for a third of the growth lag between Germany and the EU average, according to EU estimations; Bofinger 2005: 57), and second, to the transfers which continue to be of supreme importance for the East German economy (Table 2.1). About half of these transfers get effective at West German
or foreign suppliers, i.e. the contribution to home grown added value is comparatively weak (Lehmann et al. 2005).

To some extent these transfers may be regarded as built-in stabilisers. In the longer run, however, they have had a deep impact on the situation of the state and social security budgets in Germany. As great parts of these transfers have been paid out of social security contributions, the share of social security contributions in GDP was boosted from 15% in 1990 to 18.5% in 1997. Simultaneously, public deficits which amounted to 41% of GDP in 1989 surged to 63% in 1998 (Bofinger 2005: 67). The political conclusions drawn by German governments from this problematic, however, were not related to its causes rather than to an alleged overall “reform deadlock” in Germany which should be overcome by the dual strategy of public savings and reductions of social security expenditures.

Table 2.1: Net transfers from Western to Eastern Germany (2003)

<table>
<thead>
<tr>
<th>Net transfers ...</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>... as percentage of West German GDP</td>
<td>4</td>
</tr>
<tr>
<td>... as percentage of East German GDP</td>
<td>32</td>
</tr>
<tr>
<td>... as percentage of East German domestic demand</td>
<td>22</td>
</tr>
</tbody>
</table>


Just as important as these direct effects of the economic approach to unification are its indirect effects. The first one is the changing balance of power on the labour market which reflects in the rapidly growing difficulties for the trade unions and in the weak, and even further weakening, basis of collective bargaining in East Germany (aspects which will be described in greater detail in later sections). The second symptom of indirect repercussions is a delay of institutional reforms in Germany as you won’t criticise what you sell. The one-to-one transfer of the West German system to East Germany reinforced the postponement of long overdue reforms of many West German institutions, for example in family, labour-market, collective bargaining and education policies, which had already been discussed in the 1980s. In the course of this institutional transfer, West German institutions were presented as being so superior that, similarly to what happened with colonial powers, the process led to structural conservatism and a backlog of reforms that must now be laboriously resolved.

The economic problems associated with unification have been, and still are, linked with the one-sided approach of the German governments and the economic establishment to the export-oriented industries as the one and only growth engine of the country.

2.1.2 “Production site Germany”

The unification boom at the beginning of the 1990s was accompanied by a certain increase in inflation rates, which induced the Deutsche Bundesbank to a radically high interest rate policy, with side-effects not only on the German business cycle but also on other European countries. Further, this policy prompted a series of revaluations of the Deutsche Mark between 1992 and 1995 which raised the cost level of German manufacturing compared with the rest of the world by about 13% (Bofinger 2005: 78). Export-oriented industries, such as automotive, were particularly affected while already having slid into a critical situation in the 1980s (Jürgens 2004: 415; see chapter 2.3).

Thus, while any potential inflationary dangers were suppressed effectively, the German economy had a difficult start into the second half of the 1990s with a combination of sluggish growth, high unemployment, deteriorated international cost competitiveness, and high burdens on state budgets. This was when the alleged need for a fundamental improvement, if not renewal, of Germany as a production site or “location of industry” was put on the agenda of
politics, economics, and particularly in the media, with top priority. Germany was to be fitted for the world markets, the whole country with all its aspects of economic and social life was to be focused on the need to improve international competitiveness.

Basically, this economic strategy had its roots in earlier decades, namely in the 1980s when not only the Bundesbank, as usual, but also fiscal policy of the Federal Government increasingly tended to “refuse to take on responsibility for employment, thus urging trade unions, or collective bargaining, into the provision for high employment by means of general wage moderation” (Flassbeck/Spiecker 2001: 123). In the mid-1990s at the latest it had become clear that the tide had definitely turned for that matter. After their earlier short attempts to take advantage of the unification boom and to attain a rapid East-West alignment of wages, the trade unions were forced into a moderate wage policy from the mid-1990s onwards (Figure 2.2).

Figure 2.2: GDP and wages 1991-2004, Germany (1991 = 100)

Key: 1) GDP (nominal); 2) Gross wages per worker; 3) Net wages per worker; 4) GDP (real); 5) Net real wages per worker
Source: Federal Ministry for Health and Social Security

It is true that the average wages in Germany are still high by Euro-Zone standards, but the German economy has lost its leading position for that matter (Table 2.2).

Table 2.2: Gross wages per hour (manufacturing and services; Euro-Zone)

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>20,30</td>
<td>24,10</td>
</tr>
<tr>
<td>Belgium</td>
<td>22,10</td>
<td>26,50*</td>
</tr>
<tr>
<td>France</td>
<td>19,50</td>
<td>24,90</td>
</tr>
<tr>
<td>Netherlands</td>
<td>17,70</td>
<td>24,30</td>
</tr>
<tr>
<td>Austria</td>
<td>17,30</td>
<td>20,20</td>
</tr>
<tr>
<td>Finland</td>
<td>16,20</td>
<td>20,90</td>
</tr>
<tr>
<td>Italy</td>
<td>14,80</td>
<td>18,40</td>
</tr>
<tr>
<td>Spain</td>
<td>11,90</td>
<td>15,80</td>
</tr>
<tr>
<td>Greece</td>
<td>6,10</td>
<td>10,70</td>
</tr>
</tbody>
</table>

* 2002
Source: Horn et al. (2005)
Moreover, the pace of wage growth in Germany was so slow that it could not even make up for the inflation rate. Though inflation was well below EU average real wages dropped between 1995 and 2004 (Figure 2.3).

**Figure 2.3: Average annual growth of real wages* in the EU 15 and EU 25 (1995-2004, %)**

<table>
<thead>
<tr>
<th>Alte EU-Staaten</th>
<th>Neue EU-Staaten</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schweden</td>
<td>25.4</td>
</tr>
<tr>
<td>Großbritannien</td>
<td>25.2</td>
</tr>
<tr>
<td>Irland</td>
<td>19.4</td>
</tr>
<tr>
<td>Portugal</td>
<td>17.8</td>
</tr>
<tr>
<td>Dänemark</td>
<td>15.6</td>
</tr>
<tr>
<td>Niederlanden</td>
<td>11.9</td>
</tr>
<tr>
<td>Luxemburg</td>
<td>10.1</td>
</tr>
<tr>
<td>Finnland</td>
<td>9.3</td>
</tr>
<tr>
<td>Frankreich</td>
<td>8.4</td>
</tr>
<tr>
<td>EU 15</td>
<td>7.4</td>
</tr>
<tr>
<td>Belgien</td>
<td>6.4</td>
</tr>
<tr>
<td>Spanien</td>
<td>5.4</td>
</tr>
<tr>
<td>Österreich</td>
<td>2.8</td>
</tr>
<tr>
<td>Italien</td>
<td>2.0</td>
</tr>
</tbody>
</table>

*Changes per capita, private consumption deflator  

As a result of wage moderation, the unit labour costs as an indicator for an economy’s international cost competitiveness have been rising at a significantly slower pace than in all other major advanced economies with the exception of Japan (DIW 2004). Between 1999Q1 to 2005Q1, the rate in Germany was at 1.7%, as compared to 10.6% in the Euro-Zone (Horn et al. 2005). The policy of the European Central Bank, which appears to be by and large a continuation of the Bundesbank policy on the Eurozone level, proves to be crucial for that matter. Under the new conditions of the single Euro currency and equal nominal short-term interest rates in the Eurozone, the combination of low inflation rates and stagnation of real wages has, on the one hand, led to a rise in real interest rates in Germany. On the other hand, as the German Council of Economic Experts (SVR 2004) pointed out in its report for 2004/2005, “this change in the relative national price level led to a market cumulative real effective depreciation against other countries amounting to 5 per cent. A comparison of the respective change in the relative effective exchange rate with the export growth of the individual countries in a cross-section analysis produces a significant negative correlation”. Bluntly, it has been very much a beggar-my-neighbour-policy which had worked well for a small country like the Netherlands in the 1980s (which was the kept silent economic core of the Dutch miracle of that time) but is inappropriate for a larger economy like the German. Hence the first, and predominant, effect of wage stagnation has been the persistent stagnation of domestic demand with its depressant effects on investments and growth (Figure 2.4). For the last couple of years Germany has not been far from the edge of deflation.
In contrast, for the first time since 1992, the German economy regained its position as the world export leader in 2003 with a roughly 10% share in world exports. The soaring exports covered not only traditional areas such as Western Europe and the USA, but included the fast growing markets of central and Eastern Europe. From 1993 to 2003, exports from Germany into the EU accession states (CEE) grew faster than imports from these countries into Germany; Germany has maintained its status as a net exporting economy vis-à-vis this region (Knogler 2005: 14). In conjunction with export growth, big German firms are transforming themselves into “global players”. Behind the smokescreen of the mainstream economic discourse reflected in the media, describing Germany as the “sick man of Europe” (Sinn 2004) and a major “exporter of jobs, rather than goods”, to Eastern Europe, German firms are integrating CEE countries, along with countries in other parts of the world, into their transnational manufacturing networks (Klobes 2005). Still, as a business newspaper commentator put it in a nutshell (Handelsblatt, 4/8/2005), “the firms are marching ahead and the economy is lagging behind”.

However, in medium-sized and large economies net exports can never outweigh a lack in domestic demand (Horn 2005). This is very well reflected in the contrasting pictures of Germany and some other countries, including the UK, whose economic performance in recent years benefited very much from implicitly Keynesian oriented fiscal and Central Bank policies, rather than deregulated labour markets (Volz 2003; Edmonds/Glyn 2005; Figure 2.5).
Irrespective the obvious flaws of the predominant economic strategy over the last few years the alertness in German mass media, mainstream academia and business discourse continues to be focused on the international labour cost competitiveness of “location Germany”. The majority of German economists (e.g. Siebert 1998 and Sinn 2004), but also international observers (OECD 2004), see the causes of high unemployment in Germany as lying exclusively in the allegedly too high wages, welfare benefits and taxes, and in the supposedly inadequate flexibility of the German labour market. Hence, not surprisingly, all governments over the last 15 years have complied to mainstream thinking and have contributed actively to the growing gap between export strengths and domestic weakness of the economy. Moreover, they have made the situation even more complicated by a series of political steps that contributed to what can be called a gradual impoverishment of the state.

2.1.3 Running the state dry

The overall strategy of the German governments over the last decade, with the short interruption of the very first months of the red-green coalition in power in 1998/1999, has been to try to save, rather than grow, out of budget deficits (Horn 2005: 158). From 1999 on, even more rigorously put on the agenda than under the preceding conservative coalition, the main objectives of federal fiscal policy have been

- the reduction of public deficits via expenditure cuts,
- the fostering of private investments and consumption by tax cuts, accompanied by
- a reduction of wage fringe costs for employers (unemployment insurance, health care, old-age pensions).

This triple objective continues to be unanimously supported, as an objective, by the overwhelming majority of the political, economic and media establishment of the country. It has to be noted, however, that in contrast to a widely shared belief in Germany, the total tax burden in % of GDP in Germany is slightly lower than on EU-25 average (40.2% compared to
40.4 % in 2002). In 2002, taxes amounted for 23.2% of GDP compared to 27.4% in the EU-25, whereas social security contributions lay roughly 4%-points above the EU average (European Commission 2004b).

The Maastricht treaty and the introduction of the Euro played, and are still playing, a significant role in the German public discourse for that matter. Obviously the Maastricht criteria were born under the assistance, if not by the initiative, of the German government. It did not take long until these criteria proved to be a “self-tailored straightjacket” (Bofinger 2005: 91) for the German state and economy. However, despite various debates on the rationale of these criteria within the EU and, to a lesser extent, also in Germany they continue to be one of the major justifications for the fiscal strategy of the Federal Government.

Rather than responding to the lack of private investments and consumption by an increase in public investments, German economic policy preferred the opposite. From 1991 to 1998, i.e. under the conservative government, public gross investments by federal, regional and local authorities were reduced from 40 to 35 billion € per year and were driven further down by the red-green coalition to 32 billion € in 2003 – an overall cut by 20% (numbers not corrected for inflation rate; Mosebach 2005: 167). The share of public investments in GDP, which were at 4.8% in 1970, dropped to 1.7% in 2001, thus reaching an all-time low in the history of the Federal Republic (ver.di 2003). Of particular importance for local and regional businesses and SMEs are public investments of local authorities, which from 1996 to 2003 were cut by 13% in the Western and by 35% in the Eastern part of the country (Vesper 2004).

Obviously the strategy of curbing public expenditures affected large parts of services delivered by the state rather far beyond investments and was linked with a wide range of privatisation activities. Changes in ownership at German Rail, Post and Telecom accounted for a drop in staff numbers in the civil service by roughly 1 million (ver.di 2003). Most importantly, however, the austerity in public spending prevented the state from extending services where this would have been in line with objectives in other policy areas. A notable example for this conflict of aims was the reluctance from major investments into childcare services and full-time schools which has become a major topic in public debates only recently.

Parallel to expenditure cuts, a series of tax cuts were to boost private investments and consumption. The incomplete list of these actions includes (1) the abolishment of a wealth tax, (2) the abolishment of a local capital tax (these two measures were taken by the Kohl government, the following by the Red-Green government), (3) reductions of the corporate income tax in several steps, (4) tax exemptions on gains for companies selling capital stocks of other companies, (5) reductions of the income tax in several steps (with progressive relief relative to the income level) (BMF 2004).³

Obviously neither the relief for private consumers nor the one for businesses could outweigh the aforementioned stagnation of purchasing power. Moreover, parallel to the first step of income tax relief, various changes in the social security system imposed additional charges on lower and intermediate income groups that compensated for a great deal of the income tax relieves. It is a widely shared view that the income tax reform “fulminated”, for that matter.

Next to boost private consumption and investments, a second explicit major objective of various tax reforms was to turn corporate taxation internationally more competitive. However, the need for this move is controversial as critics point at Eurostat estimations on implicit capital income taxation that exhibit a below EU average effective taxation in Germany (Table 2.3; see Schratzenstaller 2004 for a review of the debate).

³ The tax reforms did not include changes the splitting principle in the income tax system which continues to be a major implicit subsidy for the male breadwinner model (see chapter 2.6).
Table 2.3: Implicit tax rate on capital income in the European Union, 1995-2001 (in %)

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* 1999 to 1995, ** 2000 to 1995
1) Calculated with a simplified denominator due to lack of full sectoral accounts data
2) Denominator including net reinvested earnings on foreign direct investment

Source: Eurostat (2003): 97

The only explicit objective of the tax reforms which has been achieved undoubtedly is the drop in tax revenues which amounted to more than 5% in 2001 and 2002 (BMF 2005). Other, distributive, effects of the tax reforms may be as important in a long term perspective. All tax payers have been relieved by the income tax cuts, but relief is greatest for high income earners (the highest tax rate has been reduced from 53% in 1999 to 42% in 2005). Moreover, the relative weights of income, consumer and corporate taxes have shifted markedly. In the long run, between 1970 and 2003, the share of income and consumer taxes in total tax revenues rose from 69% to 85%, whereas the share of corporate taxes dropped from 31% to 15% (Böf-inger 2005: 44). At the first instance, the changes in the corporate income taxes triggered a virtual breakdown of tax revenues from large companies (Figure 2.6).

Figure 2.6: Shares of wage tax* and taxes on profits and wealth as of total tax revenue

* pay-as-you-earn tax (dotted line)
Amongst these reforms, the tax exemptions conceded to companies selling capital stocks of other companies proved to be of particular importance. By way of example, the exemption from taxes covered companies such as Deutsche Bank that accounted for capital gains of 2.3 billion € in their balance sheet for the first half of 2002 (Mosebach 2005: 169). The tax exemption induced a landslide of shares sales by banks, insurances and other big companies which, in conjunction with the outcomes of a series of other legislative measures, marked the “erosion of Deutschland AG’s pillars” (Kellermann 2005: 120; see section 2.2).

The strive for the weakening of the revenue basis of the state has had fundamental impacts on the whole of the German employment model. The first one, which has already been mentioned, is the curb on public investments and public (or fiscally subsidised) services. The strategic importance of the widening gap between needs and provisions is obvious. One example which has gained greater attention recently is what may be called a massive “underinvestment” into child care, schooling, and elderly care (underinvestment both in financial terms and public awareness / intellectual efforts).

A second, hardly noticed impact of the fiscal strategy outlined here is a squeeze of the revenue bases of the intermediate (regional) and local levels of the state that have little room for manoeuvre with respect to their own revenues. The narrowing of the tax basis is most effective here and the effects go beyond short or mid-term cuts of expenditures (as mentioned earlier by the example of dramatic curbs on local investments). One strategic implication is the drive on the regional level (Länder), irrespective the political colour of their governments, to curb staff costs radically. This led to the recent break-up of the association of public employers and an ongoing open conflict between the Länder and the ver.di trade union over terms and conditions, including working-time which was unilaterally boosted by up to 3.5 hours per week (from the initial 38.5 hrs/week). Thus the tax policy of the federal government, though supposedly not intended, provoked a severe blow for the industrial relations system in general.

The policy of running the state dry has, thirdly, a strategically important implication for the social security system and the welfare state. It is true the main pillar of this system, in terms of revenues, are the social security contributions. However, as indicated above, revenues have got under the dual pressure of high unemployment and moderate nominal wage increases, whereas expenditures continue to be pushed by the unification-triggered transfer payments. Moreover, Federal government grants to the unemployment insurance and the old-age pension system are an indispensable part of their revenues. The narrowing of the tax basis exerts pressure on these grants as on many other expenditures, thus forwarding the pressure to the social security budgets. Hence, the strive for curbing the expenditures on old-age pensions, health and unemployment benefits is led by the dual motivation of relieving employers from wage fringe costs and avoiding extra burdens for the federal budget once the revenues of these systems are cut.

The macroeconomic trends and political choices outlined here are crucial parts of the background for both the major changes in the social security system and the changes in the industrial relations system which will be described in greater detail in later chapters of the present report. In what follows we give just a rough overview.

2.1.4 The “conversion of the welfare state”

Unlike many other European countries the German welfare system is very much contribution-based, rather than tax-based. With some exceptions, the revenues of the system come in equal parts from employers and employees. Neither self-employed nor civil servants have contributed, whereas spouses without own income out of gainful employment benefit from the contribution paid by the family breadwinner. It has to be noted that there are major payments
from the state into the old-age pension system and into the unemployment insurance. The bulk of the budgets of the welfare systems, however, is contribution-based.

Over the 1990s, total social protection expenditures in Germany increased roughly by 2 percentage points (from 27.6% in 1992 to 29.8% in 2001). Most of the rise was attributable to old-age and disability pensions, and to family benefits (European Commission 2005b: 108). Some of this rise was covered by taxes, but due to the architecture of the system most of it is reflected in the social security contributions. The contribution rate (excluding accident insurance) as of gross wages was at 42% in 2003, compared to 36.8% in 1991 (Streeck/Trampusch 2005).

Not surprisingly, this rise has become one of the major issues in the debate on labour market problems in Germany. The predominant feeling in politics, media and academia is that bringing the contribution rate down is one major, maybe even the most important remedy against unemployment, with particular importance for a boost in labour-cost sensitive service jobs. In the long run, additional pressure on these so-called non-wage labour costs is attributed to demographic changes. As a consequence, the red-green government in its approach to labour market and welfare state reforms focused on the issue of non-wage labour costs.

At an early stage of the red-green coalition, bold action was taken to lower the old-age pension contributions by creating a new tax on energy consumption (Ökosteuer) whose revenues are serving as a supplement to the state’s grants to the pension system. The rationale of this tax was a reshuffle of the revenue base of the old-age pension system, rather than a cut in expenditures. This is what made the new tax highly controversial with employers organisations and the parliamentary opposition, in spite of its doubtless success, as far as the relief in non-wage labour costs is concerned. Thus, government did not go further down this road. Other than previously planned, the environment tax was just maintained, rather than extended. As a consequence, attention was focused on the expenditure side of the old-age pension and other parts of the social security system.

The overall rationale now is, bluntly, if non-wage labour costs are to be reduced, expenditures have to be cut. In 2003, the government declared in its “Agenda 2010” the need for a “conversion” (Umbau) of the welfare state, geared to making the welfare state “affordable” in the future. The most important elements shall be briefly summarised here, some aspects will be taken up in other parts of the present report.

One set of measures addresses the old-age pension system. The first major element, which was already started before the “Agenda 2010”, is the build-up of a supplementary capital-based old-age insurance whose contributions are paid by the persons insured (i.e. no more

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4 It is beyond the scope of the present report to discuss details of pension reforms. It should be noted, however, that the implications of demographic changes are far from being clear. It is true that they entail major distributional challenges, irrespective the type of old-age pension system. The strains they exert on the pay-as-you-go system, however, depend very much on future employment rates (Weller 2004). Moreover, in the German context, some particular aspects are worth mentioning. First, the overall wage costs of companies, including the rising social security contributions, have lagged behind the productivity increases over the last 20 years (Flassbeck/Spiecker 2001: 128). Second, over the last three decades the periodic leaps of social security contributions were very much a step-by-step growth following each major boost in the level of unemployment, so there may further inquiry needed into what are causes and what are effects. Third, the revenues of the social security system have got under the dual pressure of high unemployment and moderate nominal wage increases, i.e. a narrowing revenue base, whereas expenditures continue to be pushed by high unemployment and by the transfer payments to Eastern Germany. Fourth, this latter aspect is one of example for so-called non-actuarial benefits from the social security system, i.e. various benefits from the system are not directly related to the rationale of the revenues (next to the transfers mentioned, one of the most powerful cost drivers for that matter are the derived benefits of inactive spouses).
contributions from the employers) but subsidised by the state. This element of capital-based privatisation in the public old-age pension system is supplemented by the promotion of private old-age insurances by means of “wages transformed by the employer”, i.e. direct payments by the employer of a certain share of the wage before taxes and contributions into a private pension insurance. In this system, the subsidy of the state is indirect because taxes (and contributions) are postponed into a stage of life when most people have lower incomes than in their active phase.

Following the “Agenda 2010”, the other important changes in the old-age pension system have been various changes in the so-called “pension formula” which affect the ratio between rises in pensions and rises in wages, at the expense of pensions (Steffen 2002). Given the slow wage growth most pensions have stagnated over the last few years (actual pension cuts are banned by law), but many pensioners had to face additional burdens triggered by other legal changes.

Further steps under scrutiny, as being proposed by a government commission on the long-term safeguarding of the social security system, include a raise in the age of entry into old-age pensions from 65 to 67 years (BMGS 2003).

The second set of measures addresses the health insurance system. The first reform package included, next to a wide range of changes in the functioning of the social health insurance organisations, various cuts in entitlements, a one-sided relief of employers from certain parts of the contributions, and a general fee for the consultation of doctors. Two years after the reform its impact on health insurance contributions is unclear and controversial.

The third set of measures aims at the “reform of the labour market”. As the Federal Government, in its overall employment strategy outlined above, sees its room for manoeuvre basically limited to supply-side measures and tax cuts to support private consumption, rather than macroeconomic stimuli, it is obvious that the major approach to tackle unemployment must be focused on the “flexibility” of the labour market. The basic rationale is to induce unemployed to take on jobs, if there are any, to the conditions offered. The core element of the four acts on “modern labour-market services” (the so-called Hartz-Reform) is the merger of previously separated systems of unemployment benefit and supplementary benefits (means-tested basic social welfare). Since January 2005, persons unemployed for one year who are capable of working are entitled only to means-tested transfer payments at roughly the level of social welfare (€345 in West Germany and €331 in East Germany, plus housing costs). Further supplements are payable for family members. Personal assets above a certain permitted limit are set off against the benefits, which obviously conflicts with the overall strive for greater private capital-based pension insurance, as critics argue.

Since the reform entails in many cases substantial reductions in transfer payments, pressure on the unemployed to take on any job offered increases. Moreover, the criteria for the acceptability of a job have been markedly tightened up. This applies both to the requirements in terms of regional mobility and the pressure to accept a job below one’s own skills level. In principle, all jobs are now acceptable – even if the income that can be earned in them barely exceeds the entitlement to transfer payments. Payment below collectively agreed levels (up to 30% less) must also be accepted.

2.1.5 Conflicting objectives

Next to the labour market reforms and the other two sets of measures aiming at expenditure and contribution cuts in the social security system, there were various other important labour market related measures taken which served different aims, thus partly contributing to a rise in conflicts of aims in labour market oriented policies. All in all, politics are actively contributing to growing inconsistencies in the employment system.
One major reform aimed at the boost of “mini jobs”, i.e. marginal part-time with reduced social security contributions, in order to promote (in particular low-wage) work in the service sector (for details also on what follows see chapter 2.6). As the boost actually happened it could be assumed that this was the biggest obvious success on the road to more employment by means of lower non-wage labour costs. However, the effects on the expenditure side of the old-age pension system tend to be negative. Moreover, the single largest clientele of this measure are married women who benefit from the derived benefits of their husbands, which is very much in line with the male breadwinner centred architecture of the German welfare state. On the other hand, however, various other measures taken aimed at fostering standard employment of women, in particular by introducing an entitlement to switch from full-time to part-time (and a much weaker entitlement to switch in the opposite direction), gradual improvements as to the provision of childcare facilities, and other steps.

Another inconsistency is emerging in the labour law, concerning the legal position of works councils and of collective bargaining as major pillars of the industrial relations system (for what follows, see chapter 2.5). A reform of the Works Constitution Act improved the possibility for employees in small establishments to vote a works council, an important reform given the increasing importance of smaller establishment sizes. Further, in the course of the negotiations on a legal form for cross-national firms in Europe (“Societas Europaea” / SE), the German government defended successfully the right to co-determination according to German law within a broader European legal framework (BMGS 2005). In contrast to these measures geared to stabilise one of the cornerstones of the German employment model, the predominance of industry-wide collective bargaining over internal agreements between management and works councils, a basic feature of German labour law, is being challenged. The federal chancellor, in his 2003 “Agenda 2010” programme, announced the break-up of this legal predominance if trade unions (and employers) were not prepared to more “flexibility” at the local level (see chapter 2.5). As collective bargaining is very flexible indeed, the matter was dropped by the government. However, the subject had been on the Liberal and Christian-Democratic agenda already and is being announced as one of the first measures to be taken in the case of a black-yellow takeover.

2.1.6 Major actors striving for dismantling the cornerstones?

As the present overview on the economic changes over the last 15 years suggests, the political arena relative to the German employment model has changed fundamentally. As far as the future of the model is concerned, this is an obviously important aspect. What counts for the future is not just the actual strengths and weaknesses of the employment model, but also how major actors perceive these strengths and weaknesses, and discuss them in the public sphere.

Undoubtedly, leading actors do no longer support the model, some of them fight openly for its dismantling. Important pressure groups have gained supremacy in the media for that matter over the last decade. These include large foundations and efficient campaigns (such as the “Initiative for a New Social Market Economy”, c.f. Speth 2004) as well as major management consultancies that have been core actors in the labour market reforms of the Red-Green coalition. Both the Schröder government and the leadership of the Christian-Democratic Party are partly following, partly driving the mainstream in a more improvising manner rather than led by strategic guidelines (Geyer et al. 2005). The membership of their parties, similar to large parts of the population, are driven more by a lack of obvious alternatives rather than conviction to follow that road. As a consequence, the political scene and the party system have lost a great deal of their stability of the past.

One important aspect of this change has been that the political elite contributes (unwillingly as may be assumed) to a deterioration of the economic problems, in particular to the weakness
of the domestic market and to the strategic underinvestment into social and educational services. This continues to provide a platform for economic opinion leaders to prescribe a cure for the “sick man of Europe” which does not help, and as a consequence to urge for raising the dose rate. The continuously high unemployment is the impressive background for the fuelling of a crisis mentality in a wider public.

Strikingly enough, no major force amongst the political and economic establishment has focused on a revitalisation of the traditional strengths of the German production and employment model. This has left the trade unions as the only advocates of revitalisation, but they have hardly succeeded so far in getting out of the corner of the alleged “defenders of the old days”. Obviously revitalisation would require reforms. However, for the time being, the term “reform” has changed sides in Germany.
2.2 Corporate Governance

2.2.1 German Model of Corporate Governance and the Bank-Based Financial System

From the outset of comparative research on capitalist economies the particular system of corporate governance and finance was regarded as a main characteristic of what was called later the German model of capitalism. Already Shonefield has emphasised the important role banks played in the long-term coordination of information and business interests and in monitoring and protecting industrial enterprises (Shonefiled 1968, 292 ff.). Also the concept of diversified quality production developed in the 1980s to describe the particular German way of transforming the production regime towards forms of flexible production rests at least implicitly on the assumption that companies could build their strategies on long-term financial resources (Streeck 1992: 32). The role of corporate governance and finance again was recognized explicitly in the debate about the ‘varieties of capitalism’ as one of the five central institutional pillars forming the environment for companies to solve their coordination problems. In this view, the ‘comparative institutional advantages’ of ‘coordinated market economies’ like the German one rest indispensably on the provision of so called ‘patient capital’ by the banks, an internal form of monitoring within personal networks based on privileged information and on a structure of mutual investments between banks and industry (Hall/Soskice: 22).

This view of the German system of corporate governance is shaped by the historical experience of its functioning up to the 1990s. From then on changes in the institutional structures and the strategic orientations of the key actors can be observed that can be interpreted as a renunciation of the system path. Until the 1990s the system of corporate governance was composed of at least five basis features (Höpner 2003: 24).

A stable structure of shareholders: The share of widespread shareholdings accounted for about one third of all shareholdings and therefore was quite small. Banks, industrial enterprises, family owners and public authorities played an important role as shareholders and pursued long-term strategic interests.

The big banks: The big banks carried out a multiple function forming house banks, being shareholders, creditors, proxy shareholders of small shareholders and monitoring agents within the supervisory boards of the companies. So banks have both provided long-term capital for industrial enterprises and monitored the board of directors.

Codetermination: Employee representatives have codetermination rights regarding their presence on the supervisory boards. As defined in different laws, employee representatives have one third of the seats on the board in companies from 500 to 2000 employees and half of the seats in joint stock companies with more than 2000 employees. In the last case the chairman of the board as a representative of the shareholders has a double voting right. Full parity codetermination exists in the coal and steel industry.

Weak outside monitoring: Monitoring by outsiders was only weakly developed. The transparency of information for external shareholders was low, because according to the German Commercial Code (Handelsgesetzbuch) the companies were allowed to use certain options for balancing like setting aside reserves. Also restrictions of voting rights existed like upper limits for voting rights or multiple voting rights, and banks could use proxy votes.

Management: German top managers usually featured long-term commitments with their companies. They often had a background formed by technical qualifications. Partly they were recruited from the employees of the companies.
The German system of corporate governance encouraged a long-term orientation of enterprise strategies focused more on the long-term growth and profitability of the firm than on the short-term economic results. The main reason for these orientations was the absence of a market for corporate control typical for the Anglo-Saxon economies which was prevented by the institutional framework described above and which encouraged patient capital and long-term relationships.

Two often neglected but very important features of the German system of governance and finance till the 1990s were the financing of the small and medium-sized enterprises (SMEs, also called the Mittelstand in Germany) on the one and the public ownership of important service providers on the other hand. The SMEs usually are family owned and not organised in the legal form of a joint-stock company. Both employee interests and the interests of other industrial enterprises are of less relevance for their governance as it is known from the joint-stock companies. But similar to the big joint-stock companies banks played an indispensable role for company finance as house banks providing patient and long-term capital. Therefore, their strategic function as creditors allowed the banks to gain influence and to monitor business practices also in the small and medium-size companies. Small firm lending was a business especially of the savings and cooperative banks. The second important feature is the public ownership of important service enterprises like post, telecommunications, railway, public banks and the large public ownership in services like health, energy, or water supply. These service enterprises or sectors were endowed with long term capital by the public authorities and very often, like post and telecommunication, regulated in a corporatist way between different interest groups (Lüthje 1997). Public ownership implied that these areas were closed for the access of private capital and hence for the interests of private shareholders.

To understand the German system of corporate finance it is important to have a closer look at the structure of the German financial system that was diverging in several aspects from the systems of other advances capitalist economies. The German “bank-based system” (Zysman 1983) was characterised by at least three distinctive features (Deeg 1999). The first feature is the central role of banks as intermediaries of all kinds of financial transactions, compared to the relatively minor importance of stock markets both for corporate finance and for the asset decisions of the private households. The second feature is the universal form German banks typically developed. As universal banks they were active both in deposit and credit business. The third feature, finally, is the competition between different banking groups. In the course of history three different groups of banks developed in the German economy, the private banks, the public owned savings banks which have the largest market share of the groups in commercial lending and the cooperative banks owned by their members. Starting from different origins, these groups have developed similar structures and business areas and therefore have become direct competitors. As a result of ownership structure and public mandates, savings banks and cooperative banks play a decisive role in capital lending for SMEs.

Vitols (2003: 245 ff.) points out the fact that the analysis of the German systems of corporate governance and finance also has to take into account some general conditions that have facilitated its development in the post-war period and its smooth functioning until the 1980s and 1990s. They consisted of a) a high demand for financial resources especially of the SMEs in the reconstruction period; b) relatively low inequalities of income distribution and a relatively high preference of the households for saving in assets with low risk; c) excesses or at least low debts of the public households; and d) pay-as-you-go public pension systems, accompanied by company pension systems based on the reinvestment of money within the company. These conditions have framed an environment that restricted the development and growth of stock markets.
2.2.2 Changes of the German Model

The patterns of the German model described above have gone through severe changes in the course of the last 10-15 years. On the one hand, some of the basic pillars of the system seem to tumble down, whereas on the other hand the role of capital markets and of mechanisms of external control is strengthened. All in all, the change of corporate governance and finance can be partitioned in four different but mutual dependent strands of development.

The first strand concerns the general framework of the system of corporate governance which has changed considerably. One element of change was that companies have developed strong capacities for internal finance, so that the demand for external finance by banks was declining. Furthermore, in the course of liberalisation of the financial markets, big joint-stock companies were able to open up cheaper sources of finance. Another element of change consisted of the growing public debts that were accumulated especially in the course of financing the German unification since 1990. These debts could be financed by rent seeking international financial capital. A third element is a slight trend of greater wage dispersion, coupled with a shift of household preferences towards more risky assets and therefore towards the use of the financial markets in the savings portfolios of households. Finally it has to be mentioned that a capitalized pension system was introduced by the German government in 2001 additional to the pay-as-you-go system, justified with the development of demography and claimed by the insurance companies hoping for the creation of a new product market. This pension system is likely to strengthen the role and volume of the capital markets and their actors (see Vitols 2003: 245-47)

A further element of changing general conditions is the privatisation of former state companies (Table 2.4). Very important in this respect was the privatisation of the post, which was split up into the post in a narrower sense on the one and the telecommunication on the other hand. Both were transformed after several steps of privatisation into joint stock companies. This process was coupled with a marketing initiative by the federal government to enhance the popularity of the stock markets for the asset decisions of the private households, contributing decisively to the stock market boom at the turning of the century. Privatisation also becomes more and more important in other, former exclusively public service areas like railway or health and the services former offered only by the municipal utilities like public transport or water supply. The transformation of the railway company into a joint stock company is planned, some hospitals are privatised and more and municipal services are opened for competition (e.g. public transport), often with competitors not subject to collective bargaining agreements, and for acquisition (e.g. local authorities rent their water supply to financial investors). Therefore, the former decoupled public sector is re-coupled more and more to the financial system in the form of strengthening of the financial markets and of its opening to the interests of private financial shareholders.
### Table 2.4: Enterprises in Public Ownership

<table>
<thead>
<tr>
<th>Enterprises</th>
<th>Year of Privatisation</th>
<th>Highest share of public ownership in %</th>
<th>Shares in 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deutsche Bahn</td>
<td>Planned</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Deutsche Post</td>
<td>2000</td>
<td>100</td>
<td>69.0</td>
</tr>
<tr>
<td>Deutsche Telekom</td>
<td>1995/1996</td>
<td>100</td>
<td>73.0</td>
</tr>
<tr>
<td>Lufthansa</td>
<td>1965-1998</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Preussag</td>
<td>1959</td>
<td>100</td>
<td>33.0</td>
</tr>
<tr>
<td>Salzgitter</td>
<td>1990-1998</td>
<td>100</td>
<td>40.0</td>
</tr>
<tr>
<td>RWE</td>
<td>1998</td>
<td>57.0</td>
<td>25.0</td>
</tr>
<tr>
<td>VEBA</td>
<td>1965-1987</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>VIAG</td>
<td>1986-1988</td>
<td>100</td>
<td>32.6</td>
</tr>
</tbody>
</table>

Source: Zugehör 2003: 72

State authorities are not only important for the change of the financial system with respect to privatisation, but also with respect to legislation. This is the second strand of development. Since the 1990s a number of laws were passed by the federal government concerning the functioning of the financial markets (Ordnungspolitik) and aimed to strengthen the role of the capital market as a financial institution. Worth to be mentioned are especially the following (see Vitols 2003: 252 ff.; Jackson 2003: 270 ff.).

The Financial Markets Promotion Laws (Finanzmarktförderungsgesetze): Since 1994 four such laws were passed, creating new rules and structures for the German financial market. Most important elements of the laws are the creation of an independent regulatory agency (the Bundesaufsichtsamt für Wertpapierhandel) and of rules for dealing with insider information with potential impacts on security prices. Today the BfW has merged with two other regulatory agencies to the Bundesanstalt für Finanzdienstleistungen (BaFin) also responsible for the insurance and credit markets.

The Law on Control and Transparency in Corporations (Gesetz zur Kontrolle und Transparenz in Unternehmensbereich, KonTrag): This law was designed to improve the attraction and transparency of German joint-stock-companies for the international capital markets. Auditor independence was strengthened by requiring its appointment by the supervisory board, and both multiple supervisory board memberships and ownership stakes exceeding 5% of the stock have to be disclosed. Also the restrictions on voting rights like multiple voting rights and upper limits of voting rights were prohibited. Furthermore, banks are no longer allowed to use proxy votes if their own shareholding exceeds 5% of the company stock, and former restrictions on share buybacks and stock options were abandoned. In the Law on Facilitation of Borrowing of Capital (Kapitalaufnahme erleichterungsgesetz) joint stock compa-
The tax laws: Also tax laws were used to strengthen the role of the financial markets. In 2002, the red-green coalition in federal government decided tax exemptions on gains for companies selling capital stocks of other companies. Before that high taxes have hindered sales of large shares. Now banks have strong incentives to reduce their stakes without tax discount on their gains made by selling stocks. Although topical data is not available, from our knowledge of the annual business reports of the big banks they have used the new law for a boosted selling of their stocks, thereby weakening the traditional long-term personal ties with industrial enterprises by reducing their seats in the supervisory boards (and their role as chairmen of the supervisory boards).

European law: The development of the German financial markets is also deeply influenced by the European law, at least in two respects. The first one is the European competition law and the clause that the liability public authorities traditionally assumed for the savings banks has to be broken off. One of the consequences of this regulation that becomes effective in 2005 is that the costs of refinancing for the savings banks are increasing, depending on the assessments of the international rating agencies and making credits dearer for the SMEs as the most important client group of the savings banks (Financial Times Deutschland, 18.07.2005). Another consequence is the debate that develops now about the privatisation of savings banks. One attempt in the eastern Länder failed some months ago, but in Berlin the legal preconditions are already created to sell the public Berlin Bank Society (Berliner Bankgesellschaft) to a private investor. The possible consequences of a privatisation are serious, as examples like Great Britain show, where an undersupply of banking services hurts SMEs and households and savings banks are not able to fulfil the important functions regarding the promotion of economic and regional development especially in weaker developed regions known form countries with public savings banks (Gärtner 2003: 127 ff.). The second impact of European law concerns the discussion about the legal norms for a European corporation, which will have consequences for the structure of the supervisory board and its role in monitoring the board of directors and in creating an important level of codetermination of employee representatives. The current state of affairs is marked by the decision of the Nizza summit in 2000 to create a European norm only for multinational enterprises and to make the social partners responsible for negotiating specific rules of codetermination; if these negotiations fail, the highest applicable law remains in force.

The third important strand of development is marked by deep changes in organisation and strategies of the banks that occurred during the last 15 years especially in the big banks, but to a lesser degree also in the banks of the other banking groups. An important consequence of these changes for the big banks is the abandonment of their traditional role as house banks and the attempt to replace this by a new role as investment banks. In this respect, at least four points are worth mentioning (see also Deeg 2005; Haipeter 2004). The first one is the fact that in the 1990s ‘Lean Banking’ has become the central principle of reorganisation in the German banking industry. In the meantime, in each of the banking groups the automation of services, the reduction of branch density, the centralisation and outsourcing of back-office functions and the segmentation of the retail channel according to customer groups are common standard. Secondly, the banks are now organised along divisions that are monitored as profit centres and that are separating the retail trade, the business clients and the investment banking. Thirdly, in the big banks the separating into divisions goes hand in hand with an orientation of company strategy on shareholder value, also described as a financialisation of corporate governance. Because of its high profitability in the 1990s, for the time being the
investment banking division gained weight strongly, whereas the traditional retail banking was partly neglected by the big banks, leaving an open space filled in by the savings and cooperative banks. Fourthly, the new orientation towards investment banking was one of the main motives for the German big banks to claim a strengthening of the financial market by institutional reforms in the German financial system. It is also the main reason to explain why the German big banks have sold great parts of their shares in industrial companies and why they are abandoning their role as house banks and why their representatives are giving up their role as chairman on the supervisory boards (see figure 2.7). Long-term financial and personal relationships in the sense of a house bank are not compatible with the role of a neutral investment bank (see also Beyer 2003: 126).

Figure 2.7: Origin of Chairmen of Supervisory Boards in 40 Enterprises 1990-1999

Source: Höpner 2003: 138

The developments described above were characterised as a ‘bifurcation’ of the German financial system (Deeg 2005: 169), leading to the creation of two subsystems, one consisting of big banks accompanying the capital market transactions of big firms, the other composed of the savings and cooperative banks functioning as creditors for the large SME sector. It is worth doubting whether this bifurcated system will remain stable in the future, regarding both the crisis of investment banking divisions of most of the big banks and the dangers of privatisation of the savings banks.

The fourth strand of development finally is the change in corporate governance, which is to a great extent a consequence of the three other strands. This change can be assessed as a break in the path development of the German system of corporate governance. Whether this has to be interpreted as an Anglo-Saxonisation of the system or as a hybridisation based on the interaction of shareholder value on the one and codetermination on the other hand has to remain an open question (see the discussion in Höpner et al. 2005; Jackson 2005). But that a fundamental change has taken place is hard to deny. The main changes can be summarised in the following points (see also Höpner 2003; Jackson 2005).
Privatised former public owned companies are using shareholder value management as an instrument for a radical restructuring to strengthen competitiveness, thereby becoming part of the avant-garde of shareholder value management.

Shareholders are gaining influence. The structure of widespread shareholdings is changing, characterised by the increasing importance of German and international institutional investors. Shareholder pressure is strong in cases of a high share of widespread shareholdings and in cases of diversified enterprises which have to withstand a conglomerate discount on the stock markets and therefore have incentives for a reduction on core competencies.

Because of the withdrawal of the big banks from industry shareholding, the protection against hostile takeovers is decreasing. As some cases show, big banks now are no longer functioning as barriers against but as promoters of hostile takeovers (see Höpner/Jackson 2003: 160 ff.).

The personnel structure of top management is changing. The constancy of membership in the firm is decreasing, and the share of academics with a specialisation in finance is increasing (see figure 2.8). Furthermore, variable elements of pay based on short term performance indicators are gaining importance. As one consequence, a market for top managers has emerged, and top managers have incentives to develop short-term orientations.

Figure 2.8: Career Paths of Chairmen of Boards of Directors of 40 Enterprises, 1990-1996

Like in the big banks also in the non-financial corporations a financialisation of corporate governance can be observed. Indicators of financialisation are the divisionalisation of company structures, the steering and monitoring of the divisions by financial targets (return on equity), the concentration on core competencies yielding high returns and the outsourcing of other business areas.
2.3 Organisation of the production process

In the following section, we will illustrate the thesis of a ‘silent revolution’ in the organisational structures in German industry that has taken place during the last one and a half decades. These changes can be interpreted as a consequence of a structural dissolution of formerly integrated combine production units and transforming them into a value chain-oriented production (‘from customer to customer’) in many areas of production. The functional orientation of the former structures was tackled, and companies increased their internal numeric and functional flexibility by a set of measures applied. This has some implications for the workforce in the companies and for management, as well.

When talking about “the” German production model which is still very much oriented towards “Diversified Quality Production” (DQP), we should keep in mind that there is no single system or rule to describe it. At least the differences between car manufacturing, engine building industry, and chemical industry seem to grow. Accordingly, the following descriptions provide some unavoidable simplification in order to highlight the shift towards a different “hybrid” production model that has adapted elements of the lean production concept in a certain German way.

2.3.1 Patterns of work organisation in Germany until the 1980s

The aforementioned DQP model has been emphasising the high degree of quality of the products delivered by many German firms in the 1980s. “German companies tended to produce higher-quality products which they sold at higher prices, not only in the well known cases of the automobile and machine tools industry, but also in industries such as textiles, precision engineering and food processing” (Jürgens 2004, 415) Obviously, emphasising high-quality niche markets has been guaranteeing a profitable basis. Accordingly, work organisation and organisational structures in many German companies were primarily directed to fit for a specific market situation which is characterised by relatively stable and supplier dominated market conditions.

Several elements of this production model can be highlighted. In these years, **functional company structures** were quite common even in very large companies in Germany. With respect to the DQP thesis it is astonishing, that market-directed (“divisional”) organisation structures of the firm have been introduced very reluctantly.⁵ Co-ordination was provided through strictly kept hierarchies, and the separation of planning and execution was state of the art in many organisations (cf. o.A. 1951). Work scheduling e.g. has always been a task of a specialised department (“Arbeitsvorbereitung”) regularly provided by former production workers who were trained in time and motion studies disseminated by the German REFA association.⁶ As an effect of these organisational measures, companies tended to be fairly bureaucratic and inflexible while emphasising rationalisation gains on a workplace level and ‘perfect’ planning.

This was even fostered by the fact that many German companies had developed an **integrated approach to production** – the degree of internally produced value added was fairly high.

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⁵ For the late 1980’s, it is estimated that approx. 40% of the companies with 100-1000 employees and approx. 50% of the firms with >1000 employees had a divisional structure (Vahlens Kompendium 1990, 154).

⁶ Professional associations like REFA contributed to the dissemination of these concepts. REFA (abbrev. for the “Reichsausschuß für Arbeitszeitermittlung” [Imperial Committee for the Definition of Working Times], today: “REFA - Verband für Arbeitsstudien und Betriebsorganisation” [Association for Workstudies and Factory Organisation]) has been founded by the Confederation of Metal Industry and the German Association of Engineers in 1921. (cf. Raehlmann 1991, 507)
Especially the large companies were covering many production stages as well as production related service tasks due to the fact that a dependence on external supply would have caused risks as long as infrastructure and supply chains could not be adequately managed. (Lutz 1984) Furthermore, for the chemical industry, there was a tradition of large integrated production units continuously providing several semi-products for different product lines (pharma products, colours, plastics, pesticides etc.) and thus gaining competitive advantages in production. (Kern/Schumann 1984)

Beyond that, companies tended to develop stable supplier relations in order to guarantee safety in materials supply and to avoid production stops. Additionally, large internal buffers assured a continuous supply of material for production but, at the same time, causing a high degree of fixed capital. With this approach, many companies were able to react to market demands in short terms – functional production units were applied (“Werkstattfertigung”) in order to enable economies of scale as far as possible. Summing up these aspects, we can say that the core of the rationalisation efforts was directed to a specialisation on the workplace level based on skilled and experienced work and improved planning. (cf. o.A. 1951)

Even though high quality was a core element of the market strategy, the basic idea to reach quality production was based on a strong emphasis on technical solutions (sometimes criticised as “over-engineering”), on the most advanced production technology applied, and on quality control. Thus production could provide high quality products – but comparatively much waste as well. The need to check and filter waste at the end of production or manufacturing has caused an additional amount of work – e.g. the quality control itself and repair work. An integrated approach – delegating quality responsibilities to the workplace and enabling employees to improve – had not been developed in Germany as was in Japan. (cf. below).

Concerning the social structure of the company, Germany establishments tended to have a low differentiation of workforce into ‘core staff’ and ‘peripheral staff’ with an emphasis on long lasting employment relations (for tenure data cf. Chapter 2.6). Even handicapped people could shift over to less exhausting tasks or units inside the same company (internal transport, security/gate control e.g.). Some implications of long term employment need to be mentioned: Firstly, long term employment is providing a basis for a good knowledge of processes and people in the company. Commitment and identification tends to be higher than in a short term employment contract. Additionally, long term employment regularly meant that people were working in the same department or even at the same machine for a long time. By getting experienced and familiar with machinery and material, even unskilled employees were enabled to an on-the-job specialisation on certain processes. This has opened a career path even for employees with a low formal qualification (semi-skilled workers) based on experience in technical process know-how. Furthermore, concerning internal mobility, for blue collar workers, there were different career paths into white collar jobs associated with long term employment – with an additional qualification step and work experience, they could become e.g. “Meister” (head of a technical sub-department or unit) or shift over to operations scheduling in the planning department (“Arbeitsvorbereitung”).

But it needs to be emphasised that the DQP strategy has been relying on occupation-based qualified work (cf. Chapter 2.4) – a formal degree of qualification between semi-skilled work and academic professions which you receive after a three years apprenticeship. This is a core element for guaranteeing the functional flexibility and performance of the companies. Skilled workers were applicable for different tasks without a long preparatory training necessary. It was a common practice that apprentices were given an unlimited contract after their examinations and then worked in the company for many years. The combination of technical
skills, adaptation to and knowledge of the company, and long term job security with different career paths available has led to a high attractiveness of skilled qualified work.

**Management styles** and adequate patterns in hierarchy were developed. There was a tendency towards directive and face-to-face control. The responsibilities were defined along functional and hierarchical boundaries. As a management concept, the “Harzburger Modell” of management was developed by the Training Academy of the German Confederation of Employers focusing on the structured delegation of decisions and tasks from ‘upper’ management to ‘lower’. In it, tasks and responsibilities are clearly defined and made explicit. In this sense, the “Harzburger Modell” was a means for top management to keep control on the company by avoiding a decision overload at the same time.\(^7\)

As a final aspect of work organisation, **working time patterns** were applied in a way that overtime and numerical flexibility was comparatively expensive for the companies. Fixed times for come and leave characterised the standard shift systems applied. In many companies, performance based wage systems were applied based on time and motion based optimising of single production steps (cf. o.A. 1951). Furthermore, the negotiated overtime premium in the regional sector wage contracts was an incentive to work longer for the employees while, at the same time, companies were able to avoid an extension of the workforce in periods of high demands of work capacity. The numerical flexibility available at that time has caused additional costs.

### 2.3.2 Crisis of the Model – adopting elements of the Lean Production concept as a remedy

German companies had obviously been successful in a market environment characterised by a strong position of the seller with an emphasis on technology based problem solutions while customer orientation remained limited. During the 1980s, a change of market situation happened because successful competitors emerged on the markets following different market strategies. E.g., the success and the growth of Japanese companies especially in automobile and machine tool industry emphasising high quality, time, and price based competition even in premium markets. In machine tool industry, these companies had a higher productivity and the operating efficiency of their standard machines turned out to be a danger for the ‘over-engineered’ machines of their German competitors. In automobile, the Japanese manufacturers had initiated far-reaching efforts to improve quality and to speed-up their time-to-market with new products while reducing internally produced value added and fixed capital. (cf. Jürgens/Naschold 1994, 241ff.) This became a major challenge to German export oriented industry as well as on the internal German market. At the same time, German companies had to face increasing quality problems and comparatively high costs (esp. in the automobile industry). After a less successful efforts to cope with these challenges e.g. by applying a techno-centric approach to new IT-technologies (“Computer integrated manufacturing” – CIM, cf. Scheer 1988) following the idea of a fully automated production line with a ‘deserted shop-floor’ (‘menschenleere Fabrik’), there was a shift towards organisational aspects at the end of the 1980s. These years have been characterised as being the “lost 1980s” of the German production model (“die verlorenen achtziger Jahre”, Jürgens/Naschold 1994, 256).

The inflexibility of internal company structures – characterised by a trend towards bureaucracy, many hierarchy levels, and functional barriers – became increasingly evident in many companies. E.g. in the German automobile industry, costs and speed of internal product de-

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\(^7\) Between 1956 and 1972, approx. 250,000 managers in Germany have been trained by Academy located at Bad Harzburg, to use the “Harzburger Modell”. (Kieser 1993, 92) This is why its influence on management and control structures of German companies can not be overestimated for that period of time.
velopment turned out to be uncompetitive in these years. Concurrent engineering or the pre-
emptive internal coordination of product development and production needs was fairly un-
common in the 1980s. (cf. Jürgens 2004) Formerly successful structures turned out to be ob-
obstacles to a faster reaction to changing market demands and to reach a customer and ser-
vice orientation. Furthermore, there was a growing need to overcome communication barri-
ers imposed by the functional structures. Obviously, the prominence of quality circles and 
project management in these years can be seen as efforts to improve internal communication 
while trying to leave organisational structures untouched in core areas (cf. Breisig 1990a, 
1990b).

In order to regain competitiveness and market positions, the concept of “Lean production” 
(Womack et al. 1991) and “lean management” was widely received in Germany as a model 
for industrial restructuring, even in service sector in Germany. Five aspects related to the 
concept need to be highlighted.

Firstly, companies increasingly reflect and decide about to “make or buy” certain preliminary 
products or supply parts: the question came up whether it is useful to produce all parts by own 
means or to leave it to specialised suppliers. This strategic decision put pressure on internal 
production units by confronting them with market prices. Thus, internal rationalisation and 
cost cutting measures were introduced with a formerly unknown power. In effect, the transfer 
of increasing price and quality competition into the companies has led to a situation that all 
units were continuously checked for costs and profitability. Secondly, lean production is 
emphasising the reduction of buffers and fixed capital. According to the Japanese approach, 
waste and dissipation (‘muda’) has to be avoided whenever this is possible. The most ad-
vanced form of this kind of reduction is implemented in a just-in-time production when only 
the supply of material for the present shift is available and delivered just-in-time by the sup-
plier. Buffers don’t exist any more, here. A third emphasis of Lean Production is on quality. It 
focuses on quality production instead of ex post quality control: the objective is a ‘0-defect’-
production. Furthermore, providing ‘0-defect’ products is a prerequisite to just-in-time-
production and to reduce buffers because only if the supplier would guarantee a 100% quality, 
the final assembly line can do without buffers. A fourth aspect is a market or demand related 
production applied e.g. by the ‘kanban’ principle. The idea behind is that the company will 
only produce what the customer has ordered. The order is initiating a chain of internal ‘de-
mand pulls’ in production to provide the products in time and in quality needed, and it initi-
ates activities to refill a defined supply level at all stages of production. This principle would 
lead to a minimisation of fixed capital when applied. Adopting concepts of lean production 
and implementing these practices in German industry would necessarily lead to different 
management practices as a final aspect. Management and control structures need to be reor-
ganised in order to guarantee the saving of costs and increase of flexibility by delegation of 
competencies to de-central units in charge – at least: in theory (cf. for aspects of task integra-
tion and operative decentralisation Lay/Maloca 2005, Latniak et al. 2002).

What we can see here is a fundamental shift of the rationalisation concepts and practices 
towards an integrated and systemic view on the whole process of production and value gen-
eration. It is obvious that not a single workplace or a single specialisation effort at a single 
point could lead to an improvement of the whole process. Lean production in this sense is an 
effort to optimise the whole value chain “from the customer to the customer” in order to reach 
an integrated – and not only a partial – optimum. First efforts towards this kind of “systemic 
rationalisation” were described for German automobile and automotive industry since the 

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8 Womack et al. (1991) emphasise the resulting vulnerability of lean production systems at this point.
With adopting and adapting these organisational changes since the middle of the 1980s, German industry has partly managed a shift in competition towards volatile markets, even in premium and high quality niches which still are in the focus many German production companies. These markets became hard-fought terrain and the competition is not only driven by quality demands, but by price and delivery time aspects which need to be taken into account in the same way.

2.3.3 Organisational changes towards a “German model of Lean Production”

The organisational changes of the German production model tend to lead to a company structure which is much more directed towards the needs of value generation processes and adapted to the market changes mentioned: A process-oriented structure has been aimed at by many companies. Some of the blueprints of the Japanese Lean model – co-ordination through internal and external supplier relations and a customer-driven logic of production – could not immediately be introduced, but it is evident that selected elements have been adopted in order to become competitive. The emphasis to become leaner has led e.g. to a massive reduction of hierarchies and central units in production within a short time. Comparing 1997 and 1999, we can see that the percentage of companies (producing investment goods) which had reduced hierarchies rose from 37.9% to 65.6%, central departments were resolved in 24.9% in 1997 and in 43% of the companies in 1999 (Latniak et al. 2002, 151). Taking into account that, furthermore, approx. 45% of the companies had introduced a market oriented segmentation of their production in 2001 (Lay/Schirrmeister 2003, 11), there is a strong indication for a turn towards leaner and process oriented organisation structures. Obviously, companies were broadly cutting costs and experimenting with new organisational structures in order to overcome limits of the functional structures they had before.

The shift towards a customer orientation is indicated by several other findings. For all industries, it could be demonstrated that customer and supply relations have been object to changes e.g. in 2001. Concerning sourcing strategies, Alda/Bellmann (2002, 528) could show that approx. 25% of all German companies increased their proportion of internal production while approx. 20% emphasised outsourcing in this year only (!). In production companies, Egggers/Kinkel (2002, 6) revealed similar findings concerning company co-operation in German industry: While 36% of the companies co-operate in order to balance their production capacity, approx. 24% apply cooperative approaches in order to provide an integrated offer (“Systemangebot”). Concerning production, a just-in-time supply to the customer was used by approx. 40% of the companies in 2001 (Lay/Schirrmeister 2003, 11). What we can see here is that sourcing strategies became an important aspect of activities during the 1990s for German industry: optimising customer-supplier relations turned out to be a strategic measure. The companies obviously turned towards diversified sourcing strategies applied at the same time – strategic co-operation (‘co-production’) as well as market based sourcing. Furthermore, these figures are indicating an increasing interaction between customers and suppliers in production which is a necessary effect of closer co-operation. Accordingly, we can see that distribution and services departments cover a comparatively higher amount of jobs in restructured companies (Latniak et al. 2002, 156).

Looking into different production sectors, there are significant differences. Following Jürgens (2004, 419), especially the German car-makers actively promoted the complete restructuring of the industry through outsourcing and ‘modularisation’ of products. Here, ‘modularisation’ is an effort to define larger units of supplier parts (‘modules’) which are delivered as an integral part to the assembly lines. Jürgens noted that the reduction of vertical integration and the modularisation “must have been a matter of urgency for the German car makers”. The degree of vertical integration overall was reduced from around 35% to 25% of internally created value added between 1988 and 1998 “with the most dramatic taking place between 1995 and
This is different for the German engine building industry: The introduction of outsourcing in this sector is comparatively reluctant. The internally produced value added was still approx. 75% in 2001 (Kinkel/Lay 2003, 5). Obviously the diffusion in this sector is comparatively limited due to the fact that technical specialisation and customer oriented development restricted the application of economies of scale (cf. Widmaier 1999). The organisational structures in chemical industries – large combine structures with integrated production units – were completely rebuilt in recent years. The split of Hoechst AG after a period of modularisation (Dormann 1993), the strategic re-orientation of Bayer AG and BASF, and the complete restructuring of pharmaceutical production, “generica” production, and “specialities” production didn’t leave any of the larger production companies untouched. This restructuring process of the branch is still ongoing with severe effects on company structures (ongoing instability). The influence of the changes in corporate governance, financial markets, and tax exemption on gains in selling corporate shares is quite important here (cf. Chapter 2.2).

One of the most striking results on recent organisational changes is the importance of the quality aspects. A different concept of quality has been introduced esp. in automotive production in the late 1980s and early 1990s by fostering ISO 9000ff. certifications as a precondition to remain supplier. It is one of the core areas of activity of the companies meanwhile: 51% of all companies (in West Germany) and 59% (in East Germany) focused on quality aspects in 2001 (Alda/Bellmann 2002, 528). Quality audits by the customers are regular practices in approx. 60% of the companies in production sector. Active measures to improve quality in production processes, as are e.g. quality circles and continuous improvement teams are applied in approx. 50% of the companies. Finally, the EFQM approach to quality production is applied by approx. 18% of the companies in German production in 2001. (Lay/Schirrmeister 2003, 11) Other studies reveal that continuous improvement processes were initiated in 65% of the companies in 2001. (Lay/Eggers 2002, 3) It is quite evident, that meanwhile, the majority of companies are making strong efforts towards an increased quality of products and production. Obviously, integrated quality management approaches are widely applied in German industry.

Concerning the companies’ staff, there is a large group of approx 55% skilled workers in production companies. So, occupation-based skilled work is the backbone of the production, still. But there are slight modifications of the traditional picture. Firstly, there is a comparatively higher amount of academically skilled staff in restructured companies needed. While there are 19% of employees with academic degrees in companies with traditional structures, there were 24% in restructured companies in 1999 (Latniak et al 2002, 155). This can be explained partly by the growing importance of the customer interface where people with academic degrees are partly preferred. It is not clear whether there is a statistical effect of the selective reduction of employees and the companies’ preference of keeping highly qualified staff. The ‘core staff’ is guaranteeing product development and control of the production processes while contract workers or ‘peripheral staff’ is increasingly hired and fired – or none-core assembling and manufacturing is outsourced or transferred abroad (Kinkel/Lay 2004a, b).

As mentioned, the transfer of increasing price and quality competition into the companies has led to a situation that all units were continuously checked for costs and profitability. As a result, secondly, the structure of the wage costs turned out to be a driver for outsourcing specific parts of the production units: According to the regional and sector related wage contracts (“Tarifverträge”), the wages paid for certain additional (‘peripheral’) services in metal and automotive industry (as are e.g. cleaning, security, facility management, factory canteen) were much higher than in cleaning industry, security business etc. (cf. on “beauty contest” in Chapter 2.5) Accordingly, these jobs were outsourced to specialised companies in order to cut (or better control) costs.
These structural changes influenced the skills demand of the companies. This is reflected in the reform of the training ordinances (cf. Chapter 2.5). There is a growing importance of updated technical skills and a broadly based training for reaching a degree of skilled work, thus further guaranteeing the prerequisites of functional flexibility. Along with the increasing interaction between customers and suppliers in the value chain, there is a growing need for knowledge about previous and following steps of production being available at demand. These competencies are prerequisites to be able to find solutions for production problems adapted to customer demands within short time. Furthermore, there is an increasing demand for an improved formal education as prerequisite for skilled work and a complaint of the industry that German apprentices lack basic education competencies. Both these aspects indicate that an increasingly complex value chain needs to be managed and that knowledge on related steps of the process is broadly needed for this purpose.

Concerning management aspects, the new structure is indicating a different model of leadership and control. Firstly, as mentioned, induced by the focus on quality aspects, integrated systems of quality management are a central task of present management activity. As a further indication of a systemic management approach, performance measurement is applied in 84% of the production companies, 28% have joint a benchmarking approach until 1999 (figures provided by the FhG-ISI). In this respect a system approach to management has been substituting the traditional directive way.

Secondly, the former face-to-face oriented control has been complemented by contemporary forms of hierarchical communication. In 1999, 68% of German production companies applied a “Management by Objectives (MbO)” strategy, further 12% of the companies intended to apply it within a short time (Brödner/Lay 2002, 50) – i.e. at the end of the 1990s, the vast majority of the companies had implemented this principle. This may as well be an effect of the reduction of management levels in the companies. Due to this fact, each manager on a hierarchy level tends to be responsible for more people than in former times. Together with the duties induced by the management systems, there is less time left for individual communication and control. MbO is providing a rule structure and a system of delegation suitable for this situation – apart from widely varying practices in the companies (cf. REFA 1994).

Finally, hierarchical career paths and a shift into middle management are increasingly limited for skilled work as a consequence of reduced hierarchy levels. There is no more an immediately coupling of the perspective to proceed towards technical expertise or planning skills with social status, prestige, and salary increase (cf. above). This may lead to difficulties of the ‘new’ model to tie ‘core employees’ to the company for a long time.

Obviously, the companies’ efforts to gain flexibility are not only limited to aspects of work organisation and outsourcing. The extended introduction of flexible working time regulations and flexitime accounts in Germany has been applied to increase numeric flexibility according to changing capacity needs and – in many cases – to reduce costs for overtime (cf. Bosch et al. 2005, 35ff.). The advantages of flexitime accounts for companies and for the employees are evident: While overtime causes paid overtime premium (and short-time work leads to a reduction of wages) the introduction of flexitime accounts introduces a partial decoupling of working time and wages. Companies apply these solutions in order to balance between periods of high and low demand for work capacity without extending costs. The attractiveness of these accounts for employees is very high if there is a valuable influence of the employees on the times of come and leave.

Recent studies (Bauer et al. 2004, 117) reveal that working time accounts with a flexible time scheduling have been gaining importance, increasingly. For all industries and public services, the application rose from 37% to 41% of all companies with a significant increase in larger companies (from 55% to 68% of all companies employing >500 people). It is interesting to
see that the majority of those employees who have a flexitime account and who can actively influence their working time tend to work longer as regulated in their contract (57\%) (Bauer et al. 2004, 102). The reasons are quite striking: otherwise the amount of work couldn’t be managed, problems needed to be solved, or the work output would be inconvenient (loc. cit, 104).

This is sharply contrasting to public complaints about the (supposed) inflexibility of working time regulations in Germany. It is no doubt that there is an internal (functional and numerical) flexibility available in German companies – the interesting point is how this is managed. In this respect, we can conclude that, unlike any other country, companies apply the organisation of working time in order to increase numerical flexibility in Germany. Flexitime accounts are widely used. They serve as an element of increasing numerical flexibility in quality production while, at the same time, they support cutting the costs of employment and overtime. In this respect, it has to be emphasised that concerning the duration of working times, Germany is among those countries with shortest times while it is the leading country in flexibly using them.

2.3.4 Synopsis of the characteristics of “old” and “new” production model

It should be kept in mind that the “new production model” is not a unique one which is followed by the majority of companies in the production sector in the same way. The individual and branch varieties are even increasing as is indicated e.g. by the differences in automotive industry, machine production, and chemical industry. But the strong emphasis on sourcing and co-operation aspects is common to all these sectors. Different elements of the models were applied in different ways but with similar objectives and market orientation. Much of what has been characteristic for the “old” model is still vivid in many companies. The output of change efforts to the organisational structure of companies is a kind of hybrid of both the models (Figure 2.9).

But this kind of re-organisation and structural change of companies and production processes has obviously contributed to ensure the competitiveness – at least – of the export oriented part of German industry. Many companies obviously increased customer orientation, internal numerical and functional flexibility and adapted to changing market needs by a whole set of measures: There is a reduction of functional and hierarchical barriers. Companies are focusing on the improvement of quality production, they are applying mixed sourcing strategies and outsourcing of low value services (thus making use of cost differences), and they have been increasing numerical flexibility by flexitime accounts. Supported by several macro-aspects, these changes have been supporting the ability of German industry to perform as an ‘export champion’ in recent years again.

Seen from a different angle, there is a continuous critique on these changes. There is an ongoing critical German discussion on the stability of a Tayloristic work organisation that has always emphasised the limits of task integration (Lay/Maloca 2005), the slow diffusion of integrated approaches to work structuring (Norhause-Janč/Pekruhl 2001), and the general misuse (Moldsch 2002) or the ‘under-utilisation’ of human resources in a Tayloristic and functionally specialised organisation of the shop-floor (Naschold/Jürgens 1994). Apart of that, there is an indication of increasing psychological strain and stress for the core staff which may reflect the impact of the threat to perform high permanently, of the reduced staff and growing work intensity in many companies, and of growing insecurity whether production will be kept or not. This type of an ‘un-sustainable’ application of human resources may cause a severe problem for the new production model in the long run.
Figure 2.9: Characteristics of “old” and “new” production model

<table>
<thead>
<tr>
<th>“Traditional structure” of work organisation in Germany</th>
<th>“German Lean Model of Production”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stable market situation</td>
<td>increasing price &amp; time &amp; quality based competition</td>
</tr>
<tr>
<td>Functional structure</td>
<td>Process oriented structure</td>
</tr>
<tr>
<td>High degree of internal production of value added</td>
<td>Modular structure along “make or buy” decisions</td>
</tr>
<tr>
<td>Stable sourcing relations – large internal buffers</td>
<td>Selective and strategic sourcing decisions</td>
</tr>
<tr>
<td>Management style based on directive and control in hierarchies</td>
<td>Introduction of integrated management systems,</td>
</tr>
<tr>
<td>Quality guaranteed by intensive control measures ex post</td>
<td>Quality ‘is being produced’ – introduction of integrated quality management systems covering the whole value chain/process chain</td>
</tr>
<tr>
<td>Low differentiation between core staff and peripheral staff</td>
<td>Increasing differentiation between core staff and periphery into differently tied sub-groups of employees</td>
</tr>
<tr>
<td>Occupation-based qualified work (“qualifizierte Facharbeit”) as prerequisite to Diversified Quality Production (DQP) for the core of the staff – low internal mobility</td>
<td>Occupation-based qualified work as prerequisite to DQP but with updated technical skills and broad based training – increasing internal mobility</td>
</tr>
<tr>
<td>Working time patterns with a specific regulation of overtime guaranteeing no extension of the workforce</td>
<td>Broad use of flexitime accounts: numerical flexibility by the application of working time organisation while contractual working times are short</td>
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2.4 Training System

2.4.1 The importance of the dual system of vocational training

In most OECD countries one can observe a rapid expansion of tertiary education since 1990. However, the percentage of graduates in Germany from tertiary education in the younger age cohorts was only 19% in 2000 which is far below the OECD average of 30.3% and the figures of particular countries such as Australia (42%), Finland (41%) and UK (37%). This difference is today more pronounced than in 1990. Between 1990 and 2000 the percentage of graduates from tertiary education grew in Australia by 11%, in UK by 10%, in the USA by 9% but in Germany only by 1% (OECD 2003). The OECD has already criticised the German education and training system because of its comparatively low numbers of university graduates. The German government and many German experts accept this criticism and see here an important barrier in developing new knowledge-intensive industries. The red-green government formulated in their coalition agreement of 2002 the goal that Germany should increase the percentage of graduates from university to the OECD average of 30%.

To understand the German system of education and training it is, however, necessary to include into the analysis not only the general and higher education, but also the vocational training. High percentages of university graduates are not necessary a good indicator for a good performance of the education and training system. If a university diploma is the only way to get access to good jobs, then the number of university students will increase. In Germany young people still seem to have with vocational training an alternative route to good jobs. Today, around 60% of young people (age cohort 16-25 years old) complete a vocational training programme. Most of them (around three quarters) go through the so-called "dual system" of apprenticeship, the others (mainly in health and education occupations) through school-based training which, however, is combined with practical learning at the workplace.

In the dual system the workplace component of training is based on a training contract between the apprentice and a private or public employer. Obligatory occupational school training is provided and funded by the government, while the costs of practical training are usually borne by firms. Thus, the term “dual system” means that apprentices learn in two places which in the ideal case cooperate in organizing the training. The duality is also reflected in the joint funding of the training by the state and the companies.

The proper functioning of the dual system depends on the readiness of firms to provide training. Firms in Germany can be said to have assumed a “social obligation” to offer a training place to all young people seeking one. One question that is constantly being discussed is whether firms, with their particular commercial interests, are actually in a position to take on this social task of being the basic providers of vocational training for young people. The tensions are evident. Firstly, in times of economic crisis, firms seek to reduce costs, and their first target is often training costs. Secondly, firms are always preying to the temptation to cease training and recruit workers already trained by other firms. Finally, as price competition becomes ever fiercer, firms may increasingly adopt a short-term perspective, in which training, which often pays off only in the long term, simply appears to be too costly. A commission set up by the English Ministry of Education to analyze German industrial training was astonished by this attitude. They wrote in one of their reports: "It is difficult to relate all this to British attitudes. UK employers would in general welcome a reduced financial commitment to training" (Studies in Vocational Education and Training 1983, Vol. 3: 11), “They (German employers G.B.) appear anxious to retain as much control as they can over training and are willing to pay for training. In Britain we are faced by a completely contrary position where companies are reluctant to train above the minimum and would welcome increased attention
paid by the schools to preparation for employment, and the specific requirements of individual companies” (Studies in Vocational Education and Training 1983, Vol. 4: 11).

The comparatively high percentage of participation in vocational training is regarded as the main reason for the relative low youth unemployment rate in Germany. The dual system has proved to be an effective mechanism for integrating young people into the labour market in spite of generally high unemployment. Unemployment is not as highly concentrated among young people as in many other countries. In most countries internal labour markets dominate and it is known from segmentation theory that in periods of high unemployment insiders try to protect themselves from outsiders. Obviously young people, who want to enter the labour market, are outsiders and often have to shoulder the main burden of unemployment.

In Germany many jobs, which are held by university graduates in other OECD countries, are occupied by graduates of the dual system of vocational training. The skills structure in the German labour market is less sharply polarised than that, for example, in the USA, In the US around 45% of the employees (1989) only have a high school degree or less while in (West) Germany only 16% of employees had no vocational training (Freeman/Schettkat 1998).

Several comparative studies have shown how work organisation differs in German and North American or British firms, whose skills structures more closely resemble those in their North American counterparts (Prais and Wagner 1983; Wagner and Finegold 1997). These studies also indicate that work organisation in the USA or in UK is more hierarchical. Unlike in Germany supervisors are more likely to be high-school graduates and to have greater responsibility for coordination. The majority of employees in US and UK have had on-the-job training and are often in a position to carry out several activities. Because the range of skills is less broad and because skills are more firm-specific and insufficiently transparent (no certification), they cannot be transferred when employees move to another firm. In contrast, German firms mostly have an "occupational" organizational structure and organisation of work. The organization of operational and work procedures can be arranged so that the resulting work can be mastered by persons with the customary qualification provided by a standardized vocational training (e.g. toolmaker or bank or office clerk). The firm can rely on these workers to carry out all aspects of their tasks according to the standards and routine belonging to their occupations. This minimizes the need for supervision and requires the workforce at all levels to make full use of their knowledge and skills.

One rarely mentioned peculiarity of the German system of vocational training is the wide range of possibilities to acquire additional generally recognized certificates on the top of the certificate from the dual system. Such further certificates allow upward mobility within or across companies. The supervisors and middle managers, who are recruited from the shop floor, have acquired often as part-time students outside working hours an additional certificate (master, technician or the equivalent in the white collar occupations like “Bankfachwirt”). Up to the 1970’s careers, for example, from a bank clerk up to bank director, were not uncommon. Since then the increasing supply of university graduates has changed recruiting patterns of firms and the traditional upward mobility from the dual system ends in middle management. These career possibilities together with a high probability of getting a job are the main reasons why vocational training is still attractive even for school leavers from grammar schools.
2.4.2 Reasons for the crisis of the dual system of vocational training

A few years ago, the advantages of the German system were extolled everywhere. The reason was that the dual system produces a very limited horizontal and vertical division of labour, which gives firms ample flexibility in the use of the skills embodied in its workforce (Lutz 1979). This flexibility used to be held up as the real secret behind German firms’ competitiveness (Streeck 1991). Opinion has now swung against the German system, which contrary to the view of Lutz is seen by some authors as rigid and immovable. German skilled workers, with their sense of professional pride and specialist orientation, are said to be hostile to new forms of work organization with teamwork and flat hierarchies which break down the boundaries between individual occupations (Herrigel, Sabel 1999). Because of the complex system of occupational demarcation, which is still allegedly defended by the trade unions, it is said to be more difficult to introduce new management philosophies in Germany than in the USA or Great Britain. As a result, the competitiveness of German industry is said to be at risk (Sabel 1995). Moreover, the process of adjusting training to new technologies is said to be proceeding much too slowly. Other authors consider the system to be still functional for manufacturing industry, but not for the expanding service sector which, with its large number of small firms, requires more flexible, ad hoc structures rather than traditional bureaucracies (Streeck, Heinze 1999). Yet other authors see signs of erosion from within arguing that firms are not prepared to invest in training because of the increasingly short planning horizon, and that young people themselves are seeking to acquire better academic qualifications which will give them access to better jobs (Geißler 1991).

In fact, every occupational training system outlives its usefulness in periods of rapid structural change, if it does not adapt to that change. Thus the once flourishing vocational training systems in the USA and Great Britain have become less important, because they were established primarily in the craft industries and were unable to gain a sufficient foothold in large manufacturing firms, and none at all in the service sector (Marsden 1995). This adjustment was made successfully in Germany in the past when the dual system was first extended from the handicraft sector to the manufacturing industry and then secondly from blue collar to white collar occupations. The dual system is a regulated training system (Bosch 1993). In times of rapid change, it must be re-regulated if it is not to be eroded.

The major problems of the dual system of vocational training can be summarized as follows:

The declining willingness of firms to train: The share of firms providing training fell from 34.3% of all firms in 1985 to 24.3% in 2002 (BMBF 2004a: 104). In East Germany only 19.5% of the firms are training apprentices (BMBF 2004a: 106) and most training is financed by the state. Some authors argue that the present low demand for new apprentices is only due to low economic growth rates and the special economic problems in East Germany. Other authors see structural changes on the demand side. They argue that the traditional German model is breaking up. The supporting structures of this model were all geared to long-term relationsships in the labour market. With privatization of public services, new forms of short-term governance of companies (shareholder value), the deregulation of labour markets and the weakening of collective bargaining, they argue that short-term thinking becomes dominant amongst employers. Since the net returns of training are only positive in the longer term, this substantially reduces the demand for new apprentices (Bosch 2004a+b). Baethge, Baethge-Kinsky (1998) take it for granted that occupational labour markets have disintegrated because less occupational skills, but more general skills, are required in modern flexible work organization. Author authors see the reason for the low demand for apprentices in increasing costs of the training, since theoretical training in the vocational schools has been extended from one
to two days per week which together with working time reductions has reduced the time apprentices spend in the firm (Wößmann 2004).

The lengthiness of the reform of occupational profiles: With the introduction of new information technologies, the diffusion of new modes of work organization (e.g. lean production) and the expansion of the service sector, it became obvious that the vocational training system was not keeping pace with the rapidly changing economy. The state delegates responsibilities for content of training to the social partners. The reform of training ordinances and the creation of new occupations proofed to be an extremely lengthy procedure. The explanation for this lies in the diverse interests of the various actors involved, which had to be carefully balanced out. On the employers’ side there were, for example, conflicts of interest between large and small firms, as well as between modern and traditional firms. The social partners also had differences of opinion on, among other things, how high and binding the quality standards should be. As well within the trade unions there were differences of opinion between the various occupational groupings, although they were nothing like as significant as in Great Britain or the USA, since the German unions are not organized on the craft principle.

A decreasing attractivity of the dual system to school leavers and employers due to the expansion of tertiary education: With the expansion of tertiary education the dual system might loose the best school leavers. This will especially be the case if upward mobility is limited because higher positions in companies are exclusively reserved to graduates from tertiary education.

An increasing proportion of young people with insufficient reading and numerical skills to be accepted as an apprentice by a firm: It is controversial how big this group is. If you take the young people leaving the lower secondary school (Hauptschule) without a certificate than the Percentage is amounting to 9%. If one takes the PISA-Study than around 22% of young school leavers people do not have sufficient reading and numerical skills. If one takes the young people who do not find an apprenticeship place and attend public financed preparatory courses the percentage amounts to about 20% (Müller-Kohlenerg, Schober, Hilke 2005: 20). The reasons for the increase of school leavers with insufficient skills are seen in the increasing number of school leavers with a migration background and the inability of the highly sectionalized German school system to integrate Migrants and to guarantuee equal chances to pupils with different social background. Germany still does not have comprehensive schools and already at the age of 10 the pupils are distributed to lower and intermediate secondary schools and grammar-schools. Since more and more young pupils go to the intermediate secondary schools and grammar-schools socially disadvantaged pupils are concentrated in the lower secondary schools.

2.4.3 Reform of the dual system

2.4.3.1 Reform of training ordinances

At the beginning of the 1970s most training ordinances dated back to the 1930's. The systematic introduction of new technologies and new organizational principles made traditional trades obsolete. Some traditional craft jobs disappeared, the profiles of many existing occupations overlapped and also traditional occupations were too narrowly defined to allow or promote new forms of work organization requiring multi-skilled workers. The first major wave of new ordinances between 1970 and 1995 saw the revision of virtually all occupations requiring vocational training. In most cases, the revision adhered to four principles. Firstly, different but related occupations were combined. As a result, the number of recognized occu-
pations fell considerably, from 901 in 1950 to 346 in 2005. Secondly, for many of the new occupations, a common phase of basic training during the first year was developed. Specialisation was reserved for the following years. Thirdly, new technologies were included. Fourthly, and finally, teaching methods were changed to better prepare apprentices for flexible work organization by, for example, selecting and designing their own projects.

With the introduction of new information technologies, the diffusion of new modes of work organization (e.g. lean production) and the expansion of the service sector, it became obvious that the vocational training system was not keeping pace with the rapidly changing economy. Revision processes lasting up to seven years meant that, with a training period of 3 years, appropriately trained skilled workers would be coming on to the labour market with a 10-year time-lag. In 1995, the social partners reached agreement on an accelerated procedure for issuing new ordinances. It was decided that the revision of old occupations should last no more than one year, and the creation of new occupations no more than 2 years. Since then, the speed with which new ordinances are issued has increased considerably. Thus between 1996 and February 2005, 64 new occupations have been defined and 190 have been modernised. In 2002 47% apprentices were trained in newly developed occupations or occupations modernised after 1996 (BMBF 2004a: 90). In 2002 116,916 apprentices were trained in one of the new occupations (BMBF 2004a: 93), which cover a broad spectrum of activities. They range from car salesperson, aircraft electronic technician, service employee in air traffic, specialist in system catering, specialist/catering trade and toy maker to two groups of occupations linked to the new information and communications technologies. Critics of the German vocational training system have not yet acknowledged this „revitalisation“.
The new IT Occupations

The new IT Occupations comprise mainly technical and commercial activities that are widespread among both suppliers and users of new information technologies. The occupational profiles, which take account of the needs of both suppliers and users, are intended to create the conditions for optimal collaboration between the two. For all four occupations in this second group, experts compiled a common list of core skills covering electrical engineering, electronics, information technology and management. These core skills account for around one half of the content of the training programmes. The other half is designed to impart specific specialist skills. These four occupations were developed by the social partners in the record time of only nine months. It seems that the graduates from the IT occupations are holding jobs which are held in the UK by graduates from university (Steedmann, Wagner, Foreman 2003) (see figure 2.10).

Figure 2.10: Training Pathways in the German IT-Industry

The IT occupations are the “playing ground” for new ways in linking the vocational training with further training and tertiary education. Unions and employers were aware that school leavers from grammar school could only be attracted, if the new occupations offered possibilities of upward mobility. Since the hierarchies in IT enterprises are flatter than in many other companies further training for the typical middle managers positions like Meister or the Bankfachwirt (similar to Meister in banking) did not seem to offer a solution. Specialisation and upwards mobility to the academic level seemed to be more appropriate and so 29 specialists profiles have been developed. The next step of the reform process is the establishments of new pathways from the technical to the academic level. It is intended to avoid the traditional and lengthy method of requiring those who have completed technical training to start anew at university by recognizing some of the acquired qualifications via credit points.
**Modernization of the metallurgical trades in 2004**

This reforms covers more than a 100 000 new apprentices per year are affected. The former 18 specializations in 5 basics occupations were abolished. Training now only takes place in five occupations (industrial mechanic, plant mechanic, construction mechanic, tool maker, milling machine operator). The schematic division between joint basic training and later specialization has also been abolished. Joint core competencies and occupations specific competencies are learned over the whole duration of training. The training in the vocational school is linked with the projects in the firms and the ‘stretched examination’ will be introduced. Since the skilled trades in a more decentralized work organization are more and more for responsible for quality and environmental management, cost calculation and customer contact, these new competencies belong to the new joint core qualifications. The training is no longer solely subject-oriented but increasingly takes account of actual processes and procedures in the workplace. This means, for example, that electricians and fitters are no longer trained separately but work together in teams on mock or real projects. The examinations no longer focus solely on specialist knowledge but also include projects carried out in the workplace. In the 90s a learning project was understood to be an internal technical project. Today it includes the contact with the customer (which also can be an internal customer). The reform is regarded as a major milestone in safeguarding the competitiveness of the German engineering industry (see figure 2.11).

*Figure 2.11: Comparison of training curricula in the metallurgic trade 1987 and 2004*

Source: VME B-W e.V 2005: 4

It seems fair to say that today the occupational profiles in Germany have been proactively adapted to structural changes and new forms of work organization. What is important to note is that the introduction of the new occupational profiles were only possible after German
companies had changed their work organization. Herigel/Sabel (1999) deeply misunderstood the dual system. In fact they criticised the traditional German functional work organisation in which the dual system was embedded. If apprentices are trained in a functional and hierarchical work organisation they learn how to behave in such an organization. Today they learn how to behave in more decentralised organisation which is organized along business processes.

The dual system has also been expanded to new industries by the creation of new occupations. The strength of the reform is that it did not follow trendy ideas of replacing technical skill by general skills but by combining the learning of both skills. The strength of the reform is also that it combines as in academic education input standards (definition of occupational curricula, qualification of the trainers) with output standards (broad competencies tested in examinations instead of relying only on narrow output indicators as in some competency based systems (for example NVQ in England or in Australia).

2.4.3.2 Increasing the permeability between vocational training and tertiary education

An open question is how the expansion of tertiary education and the introduction of the bachelor and master in all EU-member states (Bologna Process) will affect the vocational training system in Germany. The Bologna process will change tertiary education dramatically in Germany because the traditional diploma (4 years) will be replaced by bachelors with 3 year courses. The traditional differences between universities with the 4 year diploma and the Fachhochschulen (universities of applied sciences) with their 3 year diploma will be abolished. There are good reasons to believe that the number of bachelors will increase and that the bachelors will increasingly compete with the graduates from the master and technician school and its equivalents for the white collar occupations.

Already in the last decade one could observe that the expansion of higher education has blocked traditional careers of graduates from the dual system which might get less attractive to the best school leavers. Many German companies are interested to combine the theoretical at tertiary level with practical learning within companies. Therefore many Fachhochschulen developed in the last years dual study courses. The students were combining study and a shorter apprenticeship in one occupation of the dual system at the same time. Although the work load is much higher for the students they find it attractive because they already have a contract with a company which might facilitate to get a job after the study is completed. In addition some chambers add up theoretical courses to the traditional master and technician course. Their intention is to give their graduates the certificate of a bachelor of applied sciences. The universities and Fachhochschulen try to block the recognition of this certificate because they are afraid to loose their monopoly in tertiary education. A third way of combining the dual system and tertiary education will be developed in the new IT-occupations where in future it should be possible to get the bachelor and masters by collecting credit points in a modularised study.

These are possibilities to link the tertiary education with the vocational training, or speaking in terms of European harmonisation policy the Bologna (tertiary education) with the Copenhagen-Brugge-Process (vocational training). The two today separated systems can be become more permeable by recognizing credit points from the vocational training in tertiary education. It seems also necessary that main actors in Germany become aware of the fact that Germany with its vocational training system does not need the same percentage of students in higher education as countries without such a system. German competitiveness is based on the combination of good academic education linked with a highly skilled workforce below the academic level.
2.4.4 Firms willingness to train

No doubt the percentage of firms training apprentices has declined in Germany. It remains controversial what the reasons are for this decline. We suppose that this development can only be explained by the following reasons: 1) The slow growth of the German economy which means that the firms are recruiting less young people than in periods of higher growth. 2) The catch-up process of the east-German economy has slowed down so that many East German companies are not competitive. 3) The costs of the training for the companies have increased due to the introduction of a second day per week in vocational schools. 4) An increasing number of companies are planning only for the short-Term. 5) The percentage of young people with insufficient reading and numerical skills are increasing. 6) The companies recruit more and more graduates form tertiary education.

If one sees this impressive lists of reasons why the German system of dual vocational training might erode it is astonishing that still more than 60% of young people are going through this system. Figure 2.12 shows that the companies sees are seeing advantages in training young people. Through the work-based training companies get young people with skills they need, even if there are shortages on the labour market; they also avoid cost by selecting the best graduates and by avoiding wrong decisions in recruiting.

*Figure 2.12: Returns of training*

Source: Walden, Beicht, Herget, 2002: 38

Obviously the costs of training and the costs of non-training (recruiting costs of skilled workers from the external labour market) play a major role for companies. Since the apprentices are also performing productive work, the net costs of training are lower than the gross costs. In 2000, the average net cost per year and per apprentice for all firms was 2 448 € per year (10 178 € gross). The gross and net costs vary considerably with size of firm and industry.
Net costs per apprentice in manufacturing and commerce are 3 598 € per year and in the craft sector 1 393 € per year (BMBF 2004a: 1).

If the net costs of training are compared with the costs that a firm providing training subsequently saves relative to a firm that does not provide training, it emerges that it is more costly to recruit staff in the labour market than to provide training (Cramer / Müller 1994). A firm providing training saves itself the cost of training workers recruited in the external labour market and, above all, the costs incurred by making the wrong decisions when recruiting in that market. Training firms and apprentices know each other after the training period, so that the risk of a mistaken selection is eliminated, or is much less than it is for a non-training firm recruiting in the external labour market (Figure 2.12). And, in many cases, the only way a non-training firm can recruit skilled workers in the labour market, or entice them away from other employers, is to offer inducements in the form of higher pay.

However, the utility of training is realized only in the longer term, and is not apparent to firms unless they adopt a longer-term approach to their personnel planning. Since the average tenure has not decreased (See chapter on Employment system) and occupational labour market have not eroded there are still strong incentives of companies to invest in training (Erlinghagen 2004.; Bender/Haas/Klose 1999). How can the increasing employment stability and of vocational labour markets be explained? Clearly it cannot be argued that the flexibility demands on employees have declined. The main reasons are:

German firms have significantly increased the share of well-qualified employees in their workforces. This is because they are better able to cope with rapidly changing market demands and the increasing pace of technical and organisational change if they employ better-trained workers rather than less well-trained ones. A hire and fire policy would be even more expensive with increasingly well-qualified employees than with a less well-qualified workforce.

Occupations have been defined more broadly. Therefore activities can be changed gradually without the changes being recorded in the employment statistics as a change of occupation or being registered as such in surveys.

New occupations are being developed for activities that did not exist in the past (like the IT occupations). The new occupations have led to many firms that had not previously provided training places becoming involved in vocational training. They also helped these companies to adjust their work organization and pay structures along these occupations which reduced transaction costs substantially and also made external mobility for the workers easier.

All these reasons explain why the system has not collapsed. However because of the slow economic growth, the situation in East Germany, the tendency not for all but for some companies to plan only for the short-term and the increase of low skilled school leavers still create substantial tensions in the system with increasing numbers of school leavers waiting as unemployed or in preparatory classes for an apprenticeship. Because of these tensions, the introduction of a training place levy has continuously been debated for years. The levy would be paid by all firms and would be used to defray the costs incurred by firms providing training. A levy of this kind has been introduced in only a few industries (e.g. in the construction industry, where it amounts to 2.8% of the gross wages bill). Employers opposed these proposals, even though those who train would have reduced their financial obligations. Because of the fierce opposition of employers associations to the introduction of a levy system conservative as well as social democratic governments proposed voluntary “training pacts” as an alternative. A first training pact was signed with employer associations in the early 80’s. As it
turned out, firms became more willing to provide training and the number of newly concluded training contracts rose substantially. In 2004 a law on the introduction of a levy system passed the parliament. The red-green government, however, never had the intention of implementing the law. It was only used to put pressure on the employers association to sign a new training pact. However, it is noticeable that the political pressure in 2004 was weaker than in the mid-1980s. In the 80’s employers promised an apprenticeship to each school leaver demanding an apprenticeship place. In 2004 the employers association promised 20,000 new apprenticeship contracts. They made clear that this would not mean an actual increase in demand by 20,000, since some companies might cut down demand. So the 2004 “training pact” was more a sop to the unions than a real obligation for employers. The employers’ associations now represent a still declining share of firms and are therefore finding it very difficult to assume obligations for the whole of the economy. The “membership problem can be seen as the Achilles heel of the German model of industrial relations” (Schroeder 1997: 226), and therefore also of the vocational training system as well.

The unions have sought to check the decline in firms’ willingness to train through collective agreements. Agreements have been concluded in 80 collective bargaining areas, covering 12.4 millions employees and introducing various measures intended to stabilize or increase the number of apprentices. In some industries they accept cuts in the training allowances if companies offer more apprenticeship places.

The companies have reacted on the increasing differentiation of the skills of school leavers. In the past, the vast majority of apprentices were from lower and intermediate secondary schools; very few grammar-school pupils entered the dual system. However, as the share of young people taking the upper secondary leaving certificate (the Abitur, which allows access to university) has increased, so the dual system has become increasingly differentiated. The average age of apprentices rose from 16.6 in 1970 to 19.3 in 2002 (BMBF 2004a: 77). Pupils from all kinds of schools are now entering the dual system. The spectrum now ranges from young people without even the lower secondary leaving certificate to those with the Abitur, who accounted for 13.9% of all apprentices in 2002. Those leaving the lower secondary schools tend to go into the craft sector or agriculture, while those with the Abitur are more likely to opt for the higher technical and commercial occupations. Thus, two-thirds of all those training as bank clerks have the Abitur, while almost two thirds of those training as hairdressers or sales assistants have the lower secondary certificate. At the lower end, the dual system also offers training opportunities to those who have dropped out of the school system. More than 10% of those training as painters and decorators have no school leaving certificate at all. In line with these internal differentiations, the nature of the training provision is also becoming more diverse. The theoretical component for apprentice bank clerks is greater than for fledgling painters and decorators. The differences in attainment levels within the vocational schools are also considerable. There are around 30 000 young people without any school leaving certificate in some form of training. At the upper end, an apprenticeship in the dual system also offers opportunities for promotion in more highly-skilled areas of activity. The state tries to improve the reading and numerical skills of school leavers by financing preparatory courses. This measures are often ineffective because the participants already have lost their motivation during school-time. Experts agree that the preparatory courses itself need to be dualized through a combination of workplace and school based learning.
2.4.5 Summary

Occupational labour markets in Germany have been strengthened by creating broader and more flexible occupational profiles. The inclusion of employees and training experts as well as the social partners in the process of producing new ordinances and revising old ones suggests that this will be the case. They have helped to shape the process, which is in itself one of the preconditions for acceptance. The new and revised occupations themselves are providing the impetus for many firms to change their work organisation. Indeed, it is precisely those firms that are still clinging to the classic hierarchical, execution-oriented forms of work organisation that are being helped by the new forms of training to implement the organisational changes they require. Labour markets that used to be divided by trade or craft are being converted into open occupational labour markets with close cooperation between individual occupations. Such change has made Sabel’s (1995) critique, alluded to above, no longer valid.

The system has succeeded in coming to terms with the structural changes that have taken place over the past 20 years, albeit with a certain time-lag. One unsolved problem of the system of dual vocational training in Germany is the decrease of companies willingness to train. We assume that the willingness will increase when the economy is growing again. Because of increasing costs of training there might be needed new mechanism of cost-sharing by introducing a levy system or New Deals in collective agreements. The other unsolved problem comes from the unclear place of the dual system within the German system of training and education. If the sectionalized school system is preserved, then the system might erode at the lower end, if the permeability to higher education is not improved, then it might erode at the higher end.
2.5 Industrial Relations

2.5.1 Traditional structures of the German system of industrial relations

Duality is without doubt one of the most characteristic features of the German system of industrial relations. Duality means the co-existence of two formally separated levels of regulation and negotiation, one formed by industry-wide collective bargaining, the other by plant-level co-determination. Both levels as “arenas” of conflict (Müller-Jentsch 1995: 13) are characterised by different actors and different products.

In the arena of industry-wide collective bargaining industry unions are negotiating collective bargaining agreements with employers’ associations that are structured like the trade unions around industry lines. The industry-wide collective bargaining takes priority over bargaining on the plant level by management and works councils. Formally, collective bargaining agreements are mandatory only for the members of the respective trade unions working in enterprises that are members of the respective employers’ associations; whereas in practice all employees working in the enterprises organised in the employers’ associations are treated according to the norms of the agreements. Thus, the actual coverage of the agreements is a good deal bigger than its formal coverage, and it is in some ways decoupled from the actual organisational capacity of the trade unions. The reason for this practice is that the employers do not want to give their employees incentives to join a union. Furthermore, collective bargaining agreements can be declared as generally binding by the state for an industry if an agreement already covers 50% or more of the employees in the industry in question and if a collective bargaining committee with representatives of unions and employers’ associations agrees.

The regulations of the collective bargaining agreements, as far as they concerned the central topics of working time and wages, were far reaching in terms of containing encompassing material norms that had to be applied by the companies. The working time regulations for example included very detailed norms concerning not only the length of weekly working time, but also its distribution and position. This does not mean that the system was rigid. At the end of the 1980s about 40,000 collective bargaining agreements existed, which is an indicator for the high degree of differentiation within the system and which is caused by the fact that many agreements only have a regional character or are negotiated with single companies. Within the variety of agreements the agreements of the metalworking industry played a dominant role as leading agreements, forming a logic of pattern bargaining. Pattern bargaining led to similar developments of wages and working conditions between industries, although resting on quite different base levels.

In the arena of plant-level codetermination works councils are negotiating with their management production-related issues and issues that are delegated to them by the collective bargaining agreements or that are simply left open by the collective bargaining agreements. The stipulations of plant-level agreements (Betriebsvereinbarungen) therefore are subordinated to the collective bargaining agreements. The works councils have certain rights of co-determination according to the works constitution act (Betriebsverfassungsgesetz) from 1952, complemented in 2001. They are also committed by law to preserve peace on the shop floor and to pay attention to the well-being of their firm. The co-determination on plant- and company level is complemented by the co-determination on the supervisory board in corporations, following the works-constitution act for corporations from 500 to 2000 members, the co-determination act for corporations with more than 2000 members and the co-determination act for the coal and steel industries, respectively offering different degrees of co-determination.
with full parity co-determination only in the shrinking coal and steel industries (with today less than 300,000 employees, Müller-Jentsch/Ittermann 2000: 208).

The division of work between the two levels is one of the main reasons for the comparably peaceful character of industrial relations in Germany. Concerning the average of strike activity in the years 1970 to 1988, Germany is one of the four countries with the lowest strike activity of all OECD countries (Müller-Jentsch/Ittermann 2000: 248). As labour conflict is restricted to the arena of collective bargaining and within this to certain periods of negotiation – during their term no conflict about collective bargaining agreements is allowed –, the arena of plant-level negotiations is characterized by a peaceful “conflict in partnership” (Müller-Jentsch 1991) between works councils and management.

During their historical development, works councils also have assumed important functions both for the collective bargaining agreements and for the trade unions. Originally designed in the 1950s by a conservative government as a competitive institution for the trade unions on the shop floor, they passed through a conversion of their function (Thelen 2003) and became the most important actors of unions’ shop floor representation. Already at the end of the 1960s the share of works councils not organised in a union fell to under 20%. From then on unions and works councils could be regarded as a “contradictory unity” (Streeck 1979: 250) which was characterised by a division of work that was described as a mutual “service relationship” (Kotthoff 1979: 323). On the one hand, the works council had the function to monitor the application and practice of the collective bargaining agreements within the firms and he was the central actor of the recruitment of members for the unions. On the other hand, the unions offered the works councils help and consultation (and the protection of the collective bargain agreements).

It is important to note that the functioning of the dual system and the interaction of its levels are based on two necessary conditions (see also Müller-Jentsch 1995). The first condition is the high degree of legal regulations compared to other advanced economies. Both collective bargaining and co-determination have a legal foundation, the one based on the law on collective bargaining agreements from 1949 (Tarifvertragsgesetz), the other on the works constitution act from 1952 (Betriebsverfassungsgesetz). By means of the legal foundations not only the existence and the legitimation of unions and works councils as key actors of the system was brought into being, but also norms for topics and processes of negotiation between the actors have been pretended.

The second condition is the existence of encompassing organisations that are able to negotiate industry-wide agreements and that have the power to enforce these agreements for most parts of the industry. One indicator for this capacity is the density of the associations. Union density has never been very high compared to most of the developed capitalist economies except the USA, UK or France. From 1970 to 1995 it stagnated from 33 to 29%, during this period having increased in the seventies up to 36% (Traxler/Blaschke/Kittel 2001: 82). As it was explained above, there is no lineal connection between union density and the coverage of collective bargaining agreements, because the coverage is extended also to non-union members by the employers. So the important indicator is the density of the employers’ associations, because the membership to these associations decides whether an agreement is valid for the employees of a company or not. And concerning this indicator, the density of about 70% at the beginning of the 1990s belonged to the highest compared to other advanced economies (Traxler/Blaschke/Kittel 2001: 94).

This system was highly stable until the beginning of the 1990s. Although some changes have taken place in the 1970s and 1990s, the system was able to absorb them within the existing structures. Furthermore, it seems to be justified to say that the existing structures were a precondition to be able to do this. The most striking example in this respect is the decentralisa-
tion of working time regulation in the course of the steps in working time reduction in the 1980s and early 1990s, which has led to new role of plant-level negotiations (also called “Verbetrieblichung”, Schmidt/Trinczek 1989) within the industrial relations system. When in 1984 the IG Metall succeeded in negotiating the “entrance” to the 35-hours-week, it had to pay for this success by a clause opening the possibility of plant based negotiations about flexible regulations concerning the distribution of working time to a certain degree. This clause in the first years was only rarely used by the employers. But when its usage grew later on, the works councils have soon developed a capacity to negotiate these topics with success and without undermining the collective bargaining norms. In other words, the existence of the dual structure was a precondition for the successful adaptation of this kind of decentralisation, because it allowed a flexible shift in the regulation levels without disturbing the balance between the levels (also Thelen 1991; Wever 1995). But it is also important to note that this flexibility had its limits, and these limits were reached in the course of the changes since the 1990s.

2.5.2 Changes in the system of industrial relations

From the beginning of the 1990s, several changes in the system of industrial relations can be observed that entitle the observer to speak of a renunciation of the development path the system has characterised since the 1950s. Three interlinked strands of development can be distinguished.

2.5.2.1 Collective bargaining

The first strand is concerning collective bargaining. During the 1990s, the scope of decentralisation of the collective bargaining system was enlarged. This process was characterised as a “controlled decentralisation” (Bispinck/Schulten 1999: 198) or as an “organised decentralisation (Traxler 1995: 7) of the collective regulation of working conditions, because it was negotiated and monitored by the associations on the collective bargaining level. What the terms above do not describe properly is the change in the forms and substance of decentralisation that occurred during the 1990s, a change that is able to undermine the basic structures of the collective bargaining system

Speaking of decentralisation one has to differentiate between two forms. One of these forms is the “Verbetrieblichung” in terms of the plant-level definition and concretisation of collective bargaining norms. The most important example of this form is the plant-level negotiation of flexible working-time regulations that are based on framework norms given in the collective bargaining agreements, e.g. limits for fluctuations in the distribution of working times. The other form can be called “opening” of collective bargaining agreements by opening clauses. Opening means the plant-level negotiation about the collective bargaining norms themselves with the objective not of the concretisation but of the shortfall of collective bargaining norms.

The second form of decentralisation, the opening clauses, first emerged as a consequence of the German unification in the metalworking industry. In this industry, the first agreements the collective bargaining parties concluded after unification provided the adjustment of Eastern wage levels to the Western levels. This agreement soon proved to be inaccessible in the course of the restructuring of the East German industry. From then on, many East German employers went on the run to avoid the collective bargaining agreements, and in order to stop the flight, the union IG Metall conceded for the first time the conclusion of hardship clauses opening the possibility to fall short of the norms of the collective bargaining agreements.

This development later has spread to other industries and also to the collective bargaining agreements in West Germany as a result of the pressure of the employers’ associations, them-
selves forced by their members to enhance the bargaining options on plant and enterprise level. At least three motives can be listed why the enterprises were demanding the further decentralisation of collective bargaining: The first one is the intensified competition between different production locations within the companies that is to be used to decrease working standards. The second one are the growing economic difficulties of SME’s, following on the one hand from the intensification of product market competition and on the other hand from problems in external finance by banks that use to allocate credits increasingly restrictive. Finally in the context of shareholder-value management demands on the return on capital are growing, leading to cost cutting strategies within the firms.

In the metalworking industry for example hardship clauses were concluded in the second half of the 1990s. They allowed enterprises to fall short of bargaining norms in cases of severe crises. In the collective bargaining agreement of 2004 a decisive step towards a more general opening was made by offering the possibility for enterprises to fall short of norms independent from their economic situation, just with the obligation to strengthen innovation and to secure employment.

In general, three forms of opening of collective bargaining agreements can be distinguished. The first one is the coordinated decentralisation that is characterised by the obligatory agreement of unions and employers’ associations to plant-level proposals. Most of the opening clauses belong to this form. The second one is the uncoordinated decentralisation giving works councils and managers plenty of rope in negotiating deviances from the industry-wide agreements. This form only exists in a few industries (e.g. the construction industry) or in strongly regulated limits. And the third one is the wild decentralisation based on plant level practices not legitimated by the collective bargaining agreements. In 2004, about 12% of the works councils were admitting these practices (Bispinck 2005: 303). One of the decisive questions for the future of collective bargaining in Germany will be if the associations – and especially the unions – will be able to perform the complicated and resource intensive task to coordinate openings effectively. Not to be forgotten in this context is the dimension of politics. So the conservative party is promising in case of victory in the coming elections the break-up of the priority of collective bargaining agreements over plant-level agreements, which would further undermine the structures of collective bargaining.

At least three further problems of collective bargaining have to be mentioned. One is the competition between different bargaining agreements. By means of outsourcing or other instruments, management increasingly is able to choose between different collective bargaining agreements in terms of a “beauty competition” between regulations. This increases the pressure on the unions to lower working standards. The second problem concerns privatisation and the public authorities. Privatised companies often have to compete with companies not bound to a collective bargaining agreement and therefore claim the lowering of labour standards. The public authorities themselves have to cope with high debts – caused by unification and last but not least by tax reforms – and therefore call for deviations or the lowering of standards, leading also to the dissolving of old coalitions between unions and social democrats (at least insofar they are ministers of finance). The third problem, finally, is that the utilisation of the instrument of declaring collective bargaining agreements generally binding by the state is declining and is no longer functioning as a stabiliser of the system of industrial relations (Kirsch 2003). This has been an important role of this instrument especially in industries, where wages are low, trade unions are comparatively weak and competition between union and non-union firms has endangered the norms of the collective bargaining agreements. One important example of this development is the retail trade, where the declaration was abandoned and therefore collective bargaining agreements lost ground and unions were forced onto defensive.
These problems in mind, the innovations in the bargaining system developed in the last years lurk to be forgotten. These innovations for example concern new framework agreements (Entgeltrahmentarifverträge) in the metal industry or the agreements on further education in the same industry and the chemical industry (for details Bosch 2004). Especially the framework agreements were interpreted as one of the most important innovation projects of the social partners, creating new job classification systems that adapt the classifications to the requirements of innovative forms of work organisation. Three elements are forming the core of these agreements: Former barriers in classification between blue and white collar workers were abolished, cooperation was included as a main indicator for job evaluation and new forms of performance regulation like target agreements were taken up.

2.5.2.2 The decline of the associations

It cannot be denied that the collective bargaining agreements in the meantime have become very flexible forms of regulation enabling companies to bring their individual interests in. So it can be said that problem of collective bargaining agreements is not their lack of flexibility as it is often pretended. On the contrary, there are many hints that in a sense their real problem is the problem of the associations that have to negotiate and enforce them. To begin with the unions, there is no doubt that they are facing a severe crisis. In the last 12 years union density has decreased from more than 36% in 1992 (this figure was positively influenced by the unification effect) to about 24% in 2003 (Streeck/Rehder 2005: S. 52). These are the gross figures including retired members; according to estimations of the net figures only including members in the working age it can be supposed that the density now has fallen below 20%. The results for the unions organised under the umbrella of the DGB which form the core of the German trade union movement are even more disillusioning (see figure 2.13).

Figure 2.13: Organisational Density of the DGB Trade Unions since 1953

DGB-Mitglieder: Members of the Federation of German Trade Unions
Ohne Rentner: Without Pensioners
Jugend: Youth up to 25 Years
Source: Ebbinghaus (2005): 24
Of course it can be argued that in the German system the coverage of collective bargaining is to a certain extent decoupled from the density of the unions, because the validity of the agreements is extended to non-union employees as well. But this is not the whole truth, because the decision of a company to join or not to join the employers’ association depends to a high degree on the question what will happen if the company stays outside the agreement or uses the exit option. The weaker the union in the company, the lower the probability that the union is able to negotiate a bargaining agreement on the base of the industry standards and therefore the lower the probability of disadvantages for the company in the case of exit. To say it the other way round: The more collective bargaining is decentralised, the more important is a strong union presence in the plants to fight for the norms of the collective bargaining agreements, not at least because the presence of unions in the company is important for monitoring the adaptation of the collective bargaining agreements.

At a first sight it is the weakness of the employers’ associations that is the main reason for the decline of the coverage of collective bargaining agreements, because it is the membership in the employers’ associations that defines the coverage of the agreements. From 1995 to 2003 coverage decreased from 72% to 62% relating to the employees and from 53% to 43% relating to the companies (see figure 2.14) (Ellguth/Kohaut 2004).

*Figure 2.14: Development of Collective Bargaining Coverage in the German Economy according to Employees*

The starting point for the decrease of collective bargaining coverage and of the decline in membership of the employers’ associations without doubt was the restructuring crisis of the East German industry (Langer 1994; Ettl/Heikenroth 1996). But in the meantime the phenomenon has encroached also to West Germany, as the example of the employers’ associations in the metal working industry shows (see figure 2.15).
Two main problems for employer loyalty can be identified. The first problem is a growing interest gap between SMEs (small and medium-sized enterprises) and the big companies, fuelled especially by the deterioration of the economic situation of the SMEs on product and financial markets, leading both to an increase in critics about the bargaining agreements and an increase in the use of exit options. The second problem – and this seems to be the decisive one - is the weakness of the unions that are not able to hold these enterprises back, so that the enterprises can exit at low costs.

Some employers’ associations have responded to the problem by the foundation of new associations that do not combine membership with the obligation to adapt the collective bargaining agreement (Verbände ohne Tarifbindung). Although founded as an instrument to overcome the weakness of the employers’ associations, these new associations will intensify the problems of the collective bargaining coverage because they legitimise the exit from collective bargaining (Haipeter/Schilling 2005).

2.5.2.3 Changes in co-determination

Co-determination seems to be quite robust over time. The shares of enterprises with works councils and the share of employees working in enterprises with works councils were rather stable (figure 2.16). Within the works councils, the union density is declining. Already in the second half of the 1980s the share of non-union members increased over 20%, with a rising tendency up to now (Müller-Jentsch/Ittermann: 218).
Changes in co-determination policy over the last 20 years are far-reaching. Central causes are the decentralisation and the opening of collective bargaining agreements. In the course of these developments new bargaining responsibilities are shifted on the shoulders of the works councils. Works councils now not only have to negotiate and monitor the adaptation of the collective bargaining agreements in the plants, they also have to negotiate themselves plant-level variations of bargaining norms and they are confronted with claims to fall short of collective bargaining agreements.

As a consequence, works councils increasingly act as co-managers in their plants and enterprises dealing with questions of employment security and organisational innovation (see Müller-Jentsch 1998). This development can be interpreted as a gain in influence for the works councils, now negotiating with management on policy fields that former were prerogatives of management. But the role of co-management also entails certain problems for the works council. One problem is that of countervailing power. Only works councils with countervailing power are able to negotiate offensive agreements in terms mentioned above. Another problem concerns the legitimation of the works councils towards the employees that emerge if works councils are more and more regarded as a part of management and less as the representatives of the interests of the employees. Against the background of these common trends, a variety of empirical forms of co-determination can be observed, ranging from powerless works councils (mostly in small enterprises or service enterprises) over cooperative social partners to conflict-oriented works-councils, all these forms with different shadings (Kotthoff 1994; Haipeter 2005).

An important example of the new tasks the works councils are confronted with are the alliances for work and employment. They are based on a new form of deal based on the exchange of employment security or investments or other concessions by the employers and concessions concerning wages or working times by the works councils. These agreements can - from the perspective of the works councils - have a defensive character if they are based mainly on wage concessions and an offensive one if they also include the agreements about organisational innovations, investments or steps in training and further training. In 2002 22% of the
works councils have negotiated an alliance for employment with their management (Seifert/Massa-Wirth 2004).

Regarding these developments it has to be kept in mind that the requirements of the new roles the works councils play are very high and it may be doubted if a lot of works councils will be able to fulfil them in the long run. What also may be questioned is the belief that works councils could become new collective bargaining actors if the priority of collective bargaining agreements should be restricted. In this case, they will be fully overtaxed if they do not get the right to exercise industrial conflicts.
2.6 Labour market

2.6.1 Introduction

In this section we will try to analyse the consequences of these developments for the German labour market as far as they can be traced in the data available. The section will direct the attention to four topics of central importance for the German employment system: employment, job stability, low-wage work and the gender regime. Each of these topics will be discussed with respect to its origins caused by institutional changes and changes in policy. Finally we will have a look at the differentiation of the German employment model along the segments we have identified in the introduction to this paper.

2.6.2 Employment

The development of employment is a variable influenced by a variety of factors. One particular factor is the German unification. First of all, in the course of unification labour supply increased fundamentally. In 1990, 63 million West Germans and 16 million East Germans united in a single country. In terms of working population, 10.7 million East Germans aged between 15 and 65 years joined about 44.1 million West Germans in the German labour market (see table 2.5).

In the course of the nineties, East German population decreased quickly from about 16 million people in 1990 to about 13.8 million in 2001. In contrast, the West German population rose at the same time, first of all because there has been a massive emigration from East Germany due to the high unemployment rates in the eastern part of Germany.

Table 2.5: Population indicators, Germany

<table>
<thead>
<tr>
<th>Total population</th>
<th>1985</th>
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<tbody>
<tr>
<td>East Germany (in 1000)</td>
<td>16,644</td>
<td>16,111</td>
<td>15,505</td>
<td>15,405</td>
<td>15,217</td>
<td>13,788</td>
</tr>
<tr>
<td>West Germany (in 1000)</td>
<td>60,975</td>
<td>63,254</td>
<td>66,156</td>
<td>66,647</td>
<td>66,946</td>
<td>68,551</td>
</tr>
<tr>
<td>Total (in 1000)</td>
<td>77,619</td>
<td>79,365</td>
<td>81,661</td>
<td>82,052</td>
<td>82,163</td>
<td>82,339</td>
</tr>
<tr>
<td>Various characteristics</td>
<td>1985</td>
<td>1990</td>
<td>1995</td>
<td>1997</td>
<td>1999</td>
<td>2001</td>
</tr>
<tr>
<td>Women per 100 men</td>
<td>-</td>
<td>-</td>
<td>105.7</td>
<td>105.3</td>
<td>105.1</td>
<td>104.6</td>
</tr>
<tr>
<td>% of high qualified persons</td>
<td>6.3*</td>
<td>7.5**</td>
<td>9.1</td>
<td>10.3***</td>
<td>8.8</td>
<td>8.8</td>
</tr>
<tr>
<td>% of Non-Germans</td>
<td>7.2*</td>
<td>8.2*</td>
<td>8.8</td>
<td>9.0</td>
<td>8.9</td>
<td>8.9</td>
</tr>
<tr>
<td>% of population aged &lt; 15</td>
<td>15.9</td>
<td>16.2</td>
<td>16.2</td>
<td>16.0</td>
<td>15.7</td>
<td>15.3</td>
</tr>
<tr>
<td>% of population aged 65+</td>
<td>14.7</td>
<td>14.9</td>
<td>15.6</td>
<td>15.8</td>
<td>16.2</td>
<td>17.1</td>
</tr>
</tbody>
</table>

Population aged 15-65

<table>
<thead>
<tr>
<th>East Germany (in 1000)</th>
<th>1985</th>
<th>1990</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>West Germany (in 1000)</td>
<td>42,767</td>
<td>44,192</td>
<td>46,106</td>
<td>45,250</td>
<td>45,214</td>
<td>43,729</td>
</tr>
<tr>
<td>Total (in 1000)</td>
<td>-</td>
<td>54,904</td>
<td>55,847</td>
<td>55,993</td>
<td>55,915</td>
<td>55,756</td>
</tr>
</tbody>
</table>

Source: Zuma – Social Indicators *West Germany, **1991, ***1998

East German working population decreased from 10.7 million people in 1990 to 9.6 million in 2001. It can be seen very easily that West German working population grew very fast mostly due to this reason until 1995 (46.1 million). Since then, the working population of West Germany decreased to a 43.7 million people in 2001.

The additional labour supply caused by unification initiated much of the boost in unemployment in the 1990s. At the beginning of the 1990s, the unemployment rate was with 6.4% far below the EU15 average of 10.1%. From then on it increased to 9.6% in 2003, which was above the EU 15 average of 8.1% (European Commission 2004). Noteworthy developments
of unemployment besides the overall increase are the massive rise of men’s unemployment as well as the rise of youth unemployment. While in 1992, 5.1% of men have been unemployed, it nearly doubled to 10.0% in 2003. Youth unemployment rose from 6.2% in 1992 to 11.1% in 2003. Compared to those massive changes the unemployment rate of women remained rather stable (table 2.6).

Table 2.5: Employment indicators, Germany

<table>
<thead>
<tr>
<th>Activity rate</th>
<th>1992</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of population aged 15-64</td>
<td>71.0</td>
<td>70.5</td>
<td>70.6</td>
<td>71.2</td>
<td>71.5</td>
<td>71.5</td>
</tr>
<tr>
<td>% of population aged 15-24</td>
<td>58.1</td>
<td>52.2</td>
<td>49.8</td>
<td>51.6</td>
<td>51.3</td>
<td>49.1</td>
</tr>
<tr>
<td>% of male pop. aged 15-64</td>
<td>80.9</td>
<td>79.6</td>
<td>79.2</td>
<td>79.2</td>
<td>79.0</td>
<td>78.2</td>
</tr>
<tr>
<td>% of female pop. aged 15-64</td>
<td>61.0</td>
<td>61.3</td>
<td>61.8</td>
<td>63.0</td>
<td>63.8</td>
<td>64.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Occupied population</th>
<th>1992</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total (thousands)</td>
<td>37,878</td>
<td>37,382</td>
<td>37,208</td>
<td>38,077</td>
<td>38,917</td>
<td>38,248</td>
</tr>
<tr>
<td>Men (thousands)</td>
<td>22,065</td>
<td>21,562</td>
<td>21,237</td>
<td>21,483</td>
<td>21,732</td>
<td>21,040</td>
</tr>
<tr>
<td>Women (thousands)</td>
<td>15,813</td>
<td>15,820</td>
<td>15,971</td>
<td>16,594</td>
<td>17,185</td>
<td>17,208</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Employment rate</th>
<th>1992</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of population aged 15-64</td>
<td>66.4</td>
<td>64.6</td>
<td>63.7</td>
<td>65.2</td>
<td>65.8</td>
<td>64.8</td>
</tr>
<tr>
<td>% of population aged 15-24</td>
<td>54.4</td>
<td>47.7</td>
<td>44.6</td>
<td>47.2</td>
<td>47.0</td>
<td>44.0</td>
</tr>
<tr>
<td>% of male pop. aged 15-64</td>
<td>76.9</td>
<td>73.3</td>
<td>71.9</td>
<td>72.8</td>
<td>72.8</td>
<td>70.6</td>
</tr>
<tr>
<td>% of female pop. aged 15-64</td>
<td>55.9</td>
<td>55.3</td>
<td>55.3</td>
<td>57.4</td>
<td>58.7</td>
<td>58.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unemployment rate</th>
<th>1992</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment rate (% labour force 15+)</td>
<td>6.4</td>
<td>8.0</td>
<td>9.7</td>
<td>8.4</td>
<td>7.8</td>
<td>9.6</td>
</tr>
<tr>
<td>Youth unemployment rate (% labour force 15-24)</td>
<td>6.2</td>
<td>8.4</td>
<td>10.4</td>
<td>8.8</td>
<td>8.4</td>
<td>11.1</td>
</tr>
<tr>
<td>Unemployment rate men (% labour force 15+)</td>
<td>5.1</td>
<td>7.0</td>
<td>9.1</td>
<td>8.1</td>
<td>7.8</td>
<td>10.0</td>
</tr>
<tr>
<td>Unemployment rate women (% labour force 15+)</td>
<td>8.2</td>
<td>9.4</td>
<td>10.4</td>
<td>8.9</td>
<td>7.9</td>
<td>9.2</td>
</tr>
</tbody>
</table>

Source: Employment in Europe 2004

Regarding the structure of unemployment, other factors besides unification have to be taken into account. One of the main tendencies to be mentioned is the difference in unemployment rates between skilled and unskilled workers. The gap between the unemployment rate of unskilled workers and the general unemployment rate has widened over the years. In 2002, the unemployment rate among low-skill workers stood at 19.8%, about 2.5 times higher than the overall unemployment rate (Figure 2.17). This tendency can be regarded as a reflection of the efforts the enterprises made to enhance their skill base by increasing the shares of skilled workers in their workforces. As mentioned above, the goal of this strategy is to raise the capacity of functional flexibility that enables the enterprises better to react on market fluctuations. We will discuss this further below.
Another important factor to be mentioned concerning the increase in unemployment is the change in personnel policy which can be observed in many enterprises in the course of growing financial pressures. For reasons of cost cutting capacities of personnel are reduced, yielding on the one hand to a decrease in the availability of jobs and on the other hand to an increasing gap between actual working times and working times agreed in the collective bargaining agreements (Figure 2.18) (Haipeter/Lehndorff 2004).

Figure 2.18: Usual and collectively agreed working time in East and West Germany

Sources: BMWA 2004; European Labour Force Survey
2.6.3 Job stability

By changing their structures in the direction of process orientation and functional flexibility, German companies have further strengthened an old comparative advantage they already had developed in the flowering period of DQP, the internal flexibility of production based on multi-functional skills which has been complemented by flexible working time regulations. This strength now seems to rest on a more solid ground. If companies invest in skills and enhance their functional flexibility it can be expected that they also build on long term relationships with their employees. As it was mentioned in the literature on the varieties of capitalism, the investment in skills does not fit well with a high degree of external flexibility which would entail a high fluctuation of skills and poaching between companies.

This is exactly what is reflected in the data available on the development of job tenure in the past. According to these data, job tenure among German employees is considerably higher than in the labour markets of English-speaking countries but lower than in Japan or the Latin countries. Average job tenure was 10.4 years in Germany in 1998, 8.2 years in Great Britain, 6.6 years in the USA, 12.1 years in Italy and 11.6 years in Japan (Auer/Cazes 2000). It is important to mention that the higher job tenure in Germany is not only based on the reorganisation strategies of the companies, but it is also linked to the highly developed regulations on dismissal protection and the effective system of workplace codetermination based on works councils which have in turn a decisive influence for shaping company strategies. The regulations on dismissal protection make dismissals expensive for firms. Consequently, employers have strong incentives to look for alternatives to redundancies within the firm. This is also the course of action the works councils urge employers to take.

Astonishingly, in the German literature it is increasingly taken for granted that the particular combination of stable internal and occupational labour markets has already disintegrated. It is assumed that demands for flexibility have increased to such an extent – as a result of the globalisation of markets, the introduction of new technologies, the shift from large to smaller production units and the development of an increasingly market and customer-driven service economy – that employers increasingly make use of external flexibility and that employees will have to change employer more often than hitherto and will therefore be changing occupation several times in the course of their working lives. If these assumptions about the erosion of internal and occupational labour markets were correct, the consequences for the German labour market model would be far-reaching. Dismissal protection, which encourages internal mobility, would be as obsolete as the vocational training that has existed to date. Occupations would lose their guidance function for training decisions and would therefore not offer secure routes into the future as they have done up to now.

In sharp contrast to this 'risk society' discourse (Beck 1992), empirical research has produced little if any evidence of either a decrease in job stability or an increase in changes of occupation in Germany. In Figure 2.19, the 50 per cent survivor rates9 of the annual survival curves have been used to represent these graphically. The calculation has been differentiated by occupational qualification. As Figure 2.19 shows, the slight decrease in the median duration

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9 Rather than using cross-sectional surveys of actual tenure as a measure, which is affected by variations in hiring activity, continuous event history data should be used to analyse job stability. In Germany, such data are drawn from the register of employment subject to social security contributions and made available as the IAB employment subsample, which presently covers the period from 1975 to 1995 (Bender et al. 2000). Data of this quality make it possible to assess job stability in terms of the survivor rates for individual entry cohorts. Instead of providing snapshots of tenure in current job, survivor analysis focuses on calculating the extent to which each entry cohort is reduced over time through separations. For each entry cohort, a survival curve is calculated, which can be characterised by the number of days that elapse until a certain percentage of the cohort has separated from their job.
of unskilled jobs was more than offset by the increasing stability of the jobs held by those with occupational and academic qualifications. Developments at the macroeconomic level were further influenced by the fact that, in the period under consideration, the share of unskilled workers fell from 32 to 19 per cent.

**Figure 2.19: Median duration of survival in newly entered jobs by level of vocational qualification, West Germany, entry years 1976-1993**

![Graph showing median duration of survival in days for different levels of vocational qualification](image)


The detailed results are just as interesting as the overall figures. It was not just full-time jobs that became more stable, but part-time jobs as well. In smaller establishments particularly, employment stability increased, albeit from a low level. In large establishments with 500 or more employees, on the other hand, job stability declined slightly but from a much higher starting level. Since the share of smaller establishments in total employment increased at the same time, while the share of large establishments declined, the increased stability in smaller establishments more than compensated for the decline in stability in large establishments. When interpreting these results, it has always to be taken into account that the boosting and less stable part of the German labour market, the marginal part-time employment (*geringfügige Beschäftigung*, so-called mini-jobs), is not included in this analysis of job stability. So, though there may be some decrease in job stability at the periphery of the labour market, job tenure in the large core continues to be rather stable.

Regarding job stability it is important to point at a fundamental change within the formal stability of the standard employment relationship. Doogan’s (2001) distinction between “job stability” and “employee insecurity” is also applicable to the German labour market. In this respect one can speak of a “manufactured uncertainty” (op. cit.: 438). This kind of uncertainty below the formal stability of jobs reflected in the data can be attributed to a large extent to the effects of organisational restructuring, especially the new emphasis on internal competition and on coordination following rules of markets. In the consequence, employees are increasingly confronted with market risks and individual working targets, and they continuously have to prove their importance for their business unit. Employees have to cope with a new form of per-
formance pressure based on a fundamental uncertainty about the security of career perspectives as well as of the employment relationship as a whole (see also Dörre 2005).

2.6.4 Low wage work and income inequality

The periphery of the labour market, too, is undergoing important changes. In international comparisons Germany is often classified as a country with low wage dispersion. Compared to the USA and UK, Germany has a relatively equal income structure and a small proportion of low-paid workers (OECD 1996; OECD 1997). The OECD analyses (1996) indicate a reduction in income inequality in Germany (comparison D5/D1) between 1983 and 1993. This makes Germany the only country in which income inequality had lessened. Only in the Scandinavian countries income inequality is even lower. Furthermore, the OECD’s international comparative studies show that the chances of low-paid workers obtaining a better-paid job are higher in Germany than in the United States, a country with more income inequality.

Unfortunately, like most international comparisons, the OECD’s studies relate only to Western Germany and up to the beginning of the 1990s. Since then several developments have taken place that could undermine the traditional picture. One of these developments is the persistent high rate of unemployment that is weakening the trade unions and sending out pressures for low income increases. Another development is the reduction in collective bargaining coverage, boosting the existence of a non-union sector of the economy that formerly had not existed. And finally one of the main objectives of the labour market reforms is to create a sector of low wage employment as an answer to the problem of unemployment.

So the environment for economic actors to develop low wage strategies has improved. Data on low wage work is hardly available. Due to the inadequate nature of the information on low-wage employment in Germany Bosch and Kalina (2005) effected their own calculations. Figure 2.20 provides an overview of the trend over time in the percentage of low-wage workers among employees subject to compulsory social security contributions. In 1975, the percentage of low-wage workers among full-time employees subject to compulsory social security contributions was 16.4%, but by 1994 this figure had decreased to 14%. Since then, however, this percentage has risen again, reaching 16.6% in 2002.

Generally, it proves to be difficult to categorise the level of low-wage employment in Germany in an international comparison. Nevertheless, whereas in most studies the UK and the US have the highest shares of low pay, in the meantime Germany has become one of the leaders on the European continent for that matter. This trend is supported by the boost in “mini-jobs” which was initiated by the labour market reforms. Mini-jobs are mostly used in the service sector, especially for auxiliary jobs such as cleaning in the health sector, in hotels and restaurants, and in the retail trade. Since the threshold for a mini-job was increased from €325 to €400 in 2003, about 400,000 new mini-jobs have been established until June 2004. Altogether, there were 4.8 million mini-jobs in Germany in June 2004 (Schwengler 2004).

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10 With the focus on employees covered by social security the BA-employee panel covers about 80% of all employees. Self-employed and civil servants are not included. The analysis focuses on full-time employees only, which excludes part-time work. Besides this apprentices are excluded.
A central problem of the growing importance of low wage work and of work in non-union sectors are the repercussions on the core sector of stable employment covered by collective bargaining. It is fair to assume that the growth of the low wage sector will have erosive effects for the core sector. Firstly, the binding power of collective bargaining agreements may be reduced. Companies in the union sector have to compete with companies in the non-union sector, thus inducing companies either to claim lower labour standards or to exit from the employers’ associations and thereby to leave the collective bargaining agreements or to source out at least some parts of its production process in order to circumvent the agreements. Secondly, incentives are created for the companies to change strategies. If low wage work becomes increasingly accessible, companies may shift their strategies from the model described above to a model based more on low wage work and external flexibility.

### 2.6.5 Gender Regime

One of the most important developments of the labour market with tremendous effects for the German employment system is the increase in the employment rate of women. Data exhibit a long-term upward trend which, in Western Germany, persisted in the 1990s. In 1992, 55.9% of women between 15 and 64 years were employed. After a slight decrease in 1995 the rate rose to 58.8% in 2003. The fact that this development is merely influenced by cyclical fluctuations is an indicator for the fundamental character of this change both for the German employment system and for the German welfare regime as well.

Most of this increase takes place as part-time work, with growing shares of marginal part-time in recent years. Between 1993 and 2003, the percentage of persons working part-time increased by more than 7 percentage points (table 2.7). While the percentage of women working part-time increased about 10 percentage points reaching nearly 43% in 2003, part-time rates of men more than doubled, but on a very low level. Less than 7% of all men work part-time.
Table 2.6: Part-time rates, Germany

<table>
<thead>
<tr>
<th>Part-time rates</th>
<th>1993</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Women</td>
<td>32.1</td>
<td>33.7</td>
<td>35.3</td>
<td>37.3</td>
<td>39.2</td>
<td>42.7</td>
</tr>
<tr>
<td>Men</td>
<td>3.0</td>
<td>3.6</td>
<td>4.3</td>
<td>4.9</td>
<td>5.3</td>
<td>6.6</td>
</tr>
<tr>
<td>Total</td>
<td>15.2</td>
<td>16.3</td>
<td>17.6</td>
<td>19.3</td>
<td>20.8</td>
<td>22.4</td>
</tr>
</tbody>
</table>

Source: Eurostat – Structural Indicators

Concerning the development of female part-time work differences between East and West Germany have to be taken into account. In 2003, the part-time rate among West German women in employment was 44.7%, compared with 26.6% in East Germany (SVR 2004: 173). 56% of female part-timers in West Germany gave personal or family obligations as reason for not working full-time, while in East Germany 52% of female part-timers stated they had been unable to find full-time jobs (Statistisches Bundesamt 2001: 28). For 2001, separate data are available on mothers with children under 18 years of age. In West Germany, 55% of this group were economically active and of them more than half worked no more than 20 hours per week. In East Germany, on the other hand, the participation rate for women with children was 69% and almost two thirds were working full-time. So in West Germany the participation rate and the volume of work amongst mothers are lower than for all women in working age, whereas in East Germany they are higher (Statistisches Bundesamt 2001: 36). Thus there is a fundamental difference in the level of economic activity among women with children between the 'old' and 'new' parts of the Federal Republic of Germany.

In contrast to other countries such as Sweden or France, Germany belongs to the group of countries where the birth of children leads to a massive reduction of labour supply of mothers. This is true in terms of a medium and long-term withdrawal from gainful employment as well as a medium and long-term change into part-time work (Anxo et al. 2005). Part-time work of women in Germany has its very special function in the life course of women. It plays a dominant role as an access to the labour market for women rather than a substitute for full-time work (Klammer 2005: 309). However, findings of O’Reilly and Bothfeld (2002) suggest that part-time work in Germany is not primarily a basis for full-time work in the future as most female part-timers switch between part-time and no gainful employment at all. This is true especially for women with children and those with low qualification levels.

The background for these distinct features of the German labour market is the traditional welfare regime in Western Germany which is still based on the male breadwinner. Following the characterisation of Esping-Andersen, the German “corporatist” welfare regime is marked not only by the preservation of status differentials but also by the preservation of traditional familyhood. Claims of non-working women on social insurance are derived from their working husbands, family benefits encourage motherhood and family services like day care of children are underdeveloped and left to the capacities of the families (Esping-Andersen 1990).

In contrast to the changing social reality, and also in contrast to various recent measures aiming at certain improvements in the provision of childcare facilities and in the potential to combine parental benefits with part-time work, the basic features of the tax and social security systems still work in favour of the single-breadwinner model (Dingeldey 2001). The introduction of exemption from social security contributions and of flat-rate taxation for marginal part-time time jobs involving less than 15 hours work per week served to mobilise the female

---

11 In the year 2000, only 30% of married couples in West Germany still conformed to the traditional male-breadwinner model; the figure for East Germany was only 19% (Holst/Schupp 2001).
labour force without encroaching on the man's economic supremacy within the family or changing married women's entitlement to social security benefits, which was derived from their husbands' earnings.

As it was mentioned above, the case is different regarding East Germany. In the German Democratic Republic, a high level of labour market participation among women was a fundamental objective of social policy. With lagging labour productivity, high export commitments to other Eastern Bloc countries and a chronic labour shortage, it was economically essential for women to work. A highly developed system of childcare provided at the times required by working parents and, in many cases, at the workplace made it possible for women to work and indeed created work for many women. Low wages made it necessary for both partners to work in order to achieve the desired standard of living. Consequently, the female participation rate was almost as high as that for men and part-time work was low.

Following German unification, East Germany became subject to the entire legal framework of the West German employment regime. Massive deindustrialisation and the transfer of West German employment practices by West German managers led to growing similarities between the employment structures in East and West Germany. Until the year 2000, the employment rates in East and West Germany ended up more or less equal at about 65% (Holst/Schupp 2001; microcensus data). However, this apparent similarity conceals considerable and persistent differences in attitudes to employment. In fact, it is only female employment rates that are similar; participation rates continue to diverge considerably, at 70% in West Germany and 83% in East Germany. The reason for this is that non-employment among East German women tends to take the form of registered unemployment, while non-employed women in West Germany tend to be out of the labour force.12

Yet another reason of the differences between female employment rates in East and West Germany is the major discrepancy in the provision of childcare facilities. The supply of childcare facilities in West Germany is still far below the level of the other Western European countries. At 4%, the share of children under three years of age who attend a nursery is almost negligible (the figure for East Germany is 14%). While it is true that three quarters of West German children over the age of three are in some form of pre-school education (the figure for East Germany is 85%), almost 80% of them attend mornings only (in East Germany, 71% attend all day – Spieß/Büchel/Frick 2002). And to this day, school opening times in West Germany remain concentrated in the morning.

The tension between the growing numbers of increasingly well-qualified women demanding equal participation in economic life and the unchanging institutional environment has given rise to a characteristically West German '1¼ to 1½-earner model'.13 The increasing childlessness among more highly qualified women in particular can be interpreted as a rejection of this

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12 As well as differences in attitudes to paid work, a number of legal factors are at work behind these statistics. East German women who lost their jobs after unification and have not found alternative employment remain entitled to unemployment assistance after they have exhausted their entitlement to unemployment benefit provided that they continue to register as unemployed and their partners earn less or are also unemployed. Jobless West German women in the same situation, whose partners earn more, lose their entitlement to unemployment assistance and then have little incentive to continue to register as unemployed. Alternatively, they may have been out of the labour market for several years while raising their children and have no entitlement to benefit at all.

13 In the year 2000, 30% of married couples in West Germany in which the man was of working age conformed to the 'both economically active/woman in insurable part-time employment' model (= 1½ earners) and 9% to the 'both economically active/woman in marginal part-time employment' model (= 1¼ earners). The corresponding figures for East Germany are 19 and 4% respectively.
employment regime. The unequal distribution of births among the social classes means that the social structure of children in Germany, almost 15% of whom are living in poverty, is considerably less favourable than the social structure of the population as a whole. The OECD's PISA study, which compared the basic competences of 15-year-old schoolchildren in developed countries, showed that the German school system is particularly bad at compensating for educational disadvantages due to family background. When it comes to the reproduction of its human resources, therefore, Germany finds itself in a vicious circle, which could undermine the traditional strengths of its productive system, namely high-quality production based on a skilled labour force.

The effects of the German employment regime and education system are not confined to disadvantaging of women in the labour market and the reproduction of human resources. As Bosch/Wagner (2002) have shown, there is a close connection at the international level between women's employment and the volume of work in services, particularly in social and personal services. Germany's relative underdevelopment in the provision of social and personal/household-related services, which is attributable to its family model and employment regime, is an important factor that helps to explain the country's low level of employment growth (Freeman/Schettkat 1999). The 'service debate' in Germany, however, is focused on the creation of a low-wage sector rather than the development of high added-value societal services.

The position is slowly changing, at least on the ideological level. The notion that children could be cared for all day in public facilities is no longer regarded in the public discourse as an infringement of parents' rights. Unfortunately, this change of attitude coincides with an unfavourable economic situation and with priorities in fiscal policy which make it even more difficult to put the new thinking into practice. All the same, the red/green coalition government has taken two important steps towards reform. As from 2004, the Federal Government has made available 4 billion Euro for the development of provision, as needed, of all-day schools in all regions of Germany. The Law on the expansion of day care (TAG) adopted by the Federal Cabinet in July 2004 provides for Länder and local authorities with responsibility for childcare to expand their provision of day-nursery places and day care for children younger than 3 years as from 2005. The aim is for provision to be expanded sufficiently to meet local needs everywhere by 2010; the number of childcare places for under 3 year old children is set to increase from the current figure for West Germany of some 60,000 to 120,000 by 2006, and to some 230,000 new places by 2010.

2.6.6 The three segments of the employment system

The statistical data not only point to some fundamental changes on the labour market that are coupled with the changes in the German production model. They also give strong hints for our hypothesis that the structures of the employment model are changing in a way that questions the traditional interpretation of the German model and its development. To understand these changes a wider approach is needed that takes notice of the differentiations within the employment model that can be observed today.

Therefore, in what follows we will present a few data which indicate the shifts in the relative importance of different industries. To do so, we come back to the three employment segments defined at the beginning, i.e. “production”, “consumption and distribution” and “provision” (cf. Figure 1.1 and Annex).14 As exhibited in Table 2.8 the production segment continues to

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14 Primary sector is not integrated in this concept of segments because of its negligible importance.
be the largest employment segment in Germany. However, its relative weight dropped, for the benefit of the societal services in the provision segment. In a nutshell, employment in Germany continues to be much more production-centred than most other advanced capitalist economies, but social and educational services are on the rise.

**Table 2.7: Shifts in composition of workforce by employment segments**

<table>
<thead>
<tr>
<th>Year</th>
<th>Production</th>
<th>Consumption / distribution</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>12,619</td>
<td>5,964</td>
<td>6,235</td>
</tr>
<tr>
<td>1995</td>
<td>16,427</td>
<td>8,398</td>
<td>9,790</td>
</tr>
<tr>
<td>2004</td>
<td>15,614</td>
<td>8,268</td>
<td>10,721</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Production</th>
<th>Consumption / distribution</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>50.8</td>
<td>24.0</td>
<td>25.1</td>
</tr>
<tr>
<td>1995</td>
<td>47.5</td>
<td>24.3</td>
<td>28.3</td>
</tr>
<tr>
<td>2004</td>
<td>45.1</td>
<td>23.9</td>
<td>31.0</td>
</tr>
</tbody>
</table>

Note: All numbers in this and the following tables refer to the Federal Republic of Germany (i.e. 1985 West, 1995 and 2004 West and East). Moreover, NACE classifications were changed in 1992. Thus, the numbers presented here serve for a rough estimation of general trends only.
Source: European Labour Force Survey; own portrayal

Major components of the production segment are manufacturing, construction, and various business related services including banks, insurances, R&D and IT. The typical feature for most of these activities used to be high regulative standards as indicated in Figure 1.1 in the introductory chapter. These standards included large parts of the business related services, many of which were provided in-house in large manufacturing companies, which still explains the marked discrepancy between “sectoral” and “functional” tertiarisation in Germany (Bosch/Wagner 2005), apart from traditional business services such as the banking and insurance industries with their own collectively agreed standards. As a consequence the features of the production segment used to be comparatively homogeneous.

**Table 2.8: Structural change within the production segment**

<table>
<thead>
<tr>
<th>Year</th>
<th>Mfg. industry</th>
<th>Construction</th>
<th>Business services</th>
<th>“Production” total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>8,829</td>
<td>1,899</td>
<td>1,891</td>
<td>12,619</td>
</tr>
<tr>
<td>1995</td>
<td>9,539</td>
<td>3,344</td>
<td>3,544</td>
<td>16,427</td>
</tr>
<tr>
<td>2004</td>
<td>8,615</td>
<td>2,468</td>
<td>4,530</td>
<td>15,614</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Mfg. industry</th>
<th>Construction</th>
<th>Business services</th>
<th>“Production” total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>35.6</td>
<td>7.7</td>
<td>7.6</td>
<td>50.8</td>
</tr>
<tr>
<td>1995</td>
<td>27.6</td>
<td>9.7</td>
<td>10.2</td>
<td>47.5</td>
</tr>
<tr>
<td>2004</td>
<td>24.9</td>
<td>7.1</td>
<td>13.1</td>
<td>45.1</td>
</tr>
</tbody>
</table>

Source: European Labour Force Survey; own portrayal

Today, as indicated by table 2.9, the relative importance of the components has changed. The most striking change is the rise in importance of business services as organisationally separated from the manufacturing core. In recent years a great deal of high end business related service activities have been subject to outsourcing and an increasing competition between
independent (both small and large) service providers, including activities such as engineering and IT. The overall importance of these activities is underscored by the rising share of high skilled workers in all “production segment” employees (21.6% in 1995 to 25.3% in 2004 according to the European Labour Force Survey).

The provision employment segment includes the whole range of public and societal services which, other than the private consumption oriented services in the consumption/distribution segment, serve for provision concerning social security, education, health, and public utilities. Obviously this segment with its dominant importance of the state as an employer used to be another stronghold of highly regulated employment conditions, along with manufacturing. However, things are changing rapidly. In the 1990s, the share of employees in public services as of all employees has begun to shrink, whereas the health industry in particular has emerged as the major employment growth engine over the last two decades (Schulz/Leidl/Koenig 2001) (see table2.10).

**Table 2.9: Structural change within the provision segment**

<table>
<thead>
<tr>
<th>Year</th>
<th>Public services (in 1,000)</th>
<th>Education (in 1,000)</th>
<th>Health (in 1,000)</th>
<th>“Provision” total* (in 1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>2,241</td>
<td>1,084</td>
<td>1,333</td>
<td>6,235</td>
</tr>
<tr>
<td>1995</td>
<td>3,145</td>
<td>1,822</td>
<td>3,070</td>
<td>9,790</td>
</tr>
<tr>
<td>2004</td>
<td>2,797</td>
<td>2,023</td>
<td>4,022</td>
<td>10,721</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of employees (in 1,000)</th>
<th>Share in total employment (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>9.1</td>
<td>4.4</td>
</tr>
<tr>
<td>1995</td>
<td>9.1</td>
<td>5.3</td>
</tr>
<tr>
<td>2004</td>
<td>8.1</td>
<td>5.8</td>
</tr>
</tbody>
</table>

* Note: The provision segment includes more industries beyond public services, education, and health. Source: European Labour Force Survey; own portrayal

**Table 2.10: Changes in composition of the workforce**

<table>
<thead>
<tr>
<th>Year</th>
<th>Production</th>
<th>Consumption / distribution</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>7.9</td>
<td>15.8</td>
<td>18.4</td>
</tr>
<tr>
<td>1995</td>
<td>10.1</td>
<td>20.1</td>
<td>23.3</td>
</tr>
<tr>
<td>2004</td>
<td>14.4</td>
<td>28.5</td>
<td>29.6</td>
</tr>
<tr>
<td>1985</td>
<td>27.7</td>
<td>45.0</td>
<td>54.4</td>
</tr>
<tr>
<td>1995</td>
<td>29.3</td>
<td>47.5</td>
<td>59.6</td>
</tr>
<tr>
<td>2004</td>
<td>31.2</td>
<td>48.9</td>
<td>63.0</td>
</tr>
<tr>
<td>1985</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1995</td>
<td>21.6</td>
<td>13.5</td>
<td>38.7</td>
</tr>
<tr>
<td>2004</td>
<td>25.3</td>
<td>13.7</td>
<td>40.1</td>
</tr>
</tbody>
</table>

Source: European Labour Force Survey; own portrayal
Apart from the relative importance of various elements within the employment segments, some major shifts concerning the composition of the workforce are also noteworthy (Table 2.11).

As exhibited in the table, provision as the only growing segment is at the same time the one with the highest shares of women, part-timers and highly qualified workers. As to the part-time work, however, the most important change is observable in the consumption segment. The most notable change concerning the composition of the workforce here is the rise in subsidised marginal part-time work amongst the classical distributive and consumption oriented services such as trade, household activities, and hotels and restaurants with their high shares of low wage female labour. It reflects in the overall numbers for the whole of the consumption segment which indicate an above average rise in the percentage of part-time workers with a simultaneous drop in average working hours of part-timers (table 2.12).

Table 2.11: Working-time changes within the consumption segment

<table>
<thead>
<tr>
<th>Year</th>
<th>Part-time rate (in % of all workers in “consumption”)</th>
<th>Average working-time of part-timers (hrs/week)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>15.8</td>
<td>21.1</td>
</tr>
<tr>
<td>1995</td>
<td>20.1</td>
<td>18.8</td>
</tr>
<tr>
<td>2004</td>
<td>28.5</td>
<td>16.7</td>
</tr>
</tbody>
</table>

Source: European Labour Force Survey; own portrayal

The shifts in relative weights between and within the three interlocking employment segments as well as some major changes in the composition of the workforce indicate the underlying quantitative trends to what will be summarised in the concluding chapter as growing heterogeneities and inconsistencies in the German employment model.
3 Evaluation

“Model status can change rapidly as economic fortunes and international judgements shift” (Fulcher 2005: 190). If one takes a look at the opinion leading discourse about Germany which prevailed until only recently, the German model of production and employment appears to be doomed to fail. Its strengths of past decades are said to be no longer in line with global competition, expectations of both domestic and foreign investors, flexibility needs of businesses, and inter-generational equity in the face of the “demographic time bomb” and public deficits. The country is said to be living beyond its means: wages are too high, working-times too short and too rigid, and the welfare state too expensive. However, a closer look at the economic performance and institutional change over the last one or two decades reveals a much more contradictory picture. As Beck et al. (2005: 225) rightly state, “while there is a discussion about an alleged incrustation of the German model, significant institutional changes and considerable adaptability can be observed. And while there is much lamentation about a decline of the German economy in global competition, Germany is rushing from one export record to the next”.

In fact, as signalled by the export boom, the productive system in German manufacturing is maintaining its progress on the road of “diversified quality production” over a wide range of industries, if fuelled by the need to overcome periodic crises. The structure of labour input is changing constantly for the benefit of skilled and high-skilled workers. The vocational training system continues to hold its dominant role for the provision of qualified labour supply by a series of reforms both following technological change and aiming at a greater functional mobility over the life course of industries and individuals. Pay and status structures in large industries such as metalworking and public services are being reformed fundamentally within the heartland of “incrustation”, that is by the actors of collective bargaining. At the same time, the latter system has gone through a process of decentralisation which may be subject to a debate on whether or not this “flexibilization” heralds vitality or demise, but the potential of the actors to adaptation is beyond doubt. And, last but not least, the welfare state with its pay-as-you-go old-age pension system, social health insurance, as well as the labour law and other institutions continue to provide for a comparatively high level of decommodification of labour which has made up over decades a basic feature of the German employment model.

Yet, the persistent high rate of unemployment is the most disturbing and ever present demonstration that the links between economic competitiveness and institutional adaptability on the one hand and employment, growth and public welfare on the other are not working the way they used to. The cohesion and consistency of the German productive and employment system have got, or are being driven, into disorder. Neither “modification but continuity” nor “general erosion” would be appropriate overall pictures of the German employment model.

In what follows, the observations and findings presented in the above sections will be summarised and drawn together. For this purpose, we are going back to our two major observations in the introductory chapter: First, that it may be misleading to take one particular section of the economy, i.e. the manufacturing industry, as the whole. Rather, it is necessary to analyse whether or not the (mostly implicit) assumptions about the exemplary character of manufacturing for the whole of the employment model are still justified. Our hypothesis was that the links between the production segment and the two other employment segments are getting loose and that the internal structure of the employment segments is becoming more heterogeneous. After we have given, in what follows, an overview on our findings for that matter we will return to our second observation which pointed at a growing inconsistency between different parts of the employment model, most notably between the welfare state and the increasing importance of female labour market participation and of the service sector. The
hypothesis was that these inconsistencies may turn the welfare regime into a ‘built-in deregulator’ of the standard employment relationship.\textsuperscript{15}

3.1 Increasing heterogeneity

As to the first hypothesis, our findings suggest that the cohesion within each of the three interlocking segments of the German production and employment model is declining and, moreover, the bonds between the segments are getting weaker. The main features are exhibited in Figure 3.1, which takes up Figure 1.1 of the introductory chapter.

It is mainly the changes in governance structures and in industrial relations which are pushing the employment model into greater heterogeneity within all three employment segments. In the \textit{production} segment, the manufacturing core, first, has been slimmed down radically over the 1990s in conjunction with major restructuring activities, which contributed, on the one hand, to its persistent international competitiveness. On the other hand, second, this went together with an increasingly important shareholder value orientation amongst top management of large companies, based on changing ownership structures which were boosted by deregulations of the financial markets and accompanying changes in the German tax system conducive to the disentanglement of the “Deutschland AG”. Third, the changes in big business have accelerated the cost pressure on the \textit{Mittelstand}, including an increasingly difficult environment for business finance. Moreover, fourth, \textit{Mittelstand} companies which continue to be a backbone of the engineering industry are becoming interesting for private equity, thus challenging moderate profitability expectations. All these trends hamper long-term management orientations and increase the vulnerability of enterprises.

Hence, in many cases the price for maintaining or regaining competitiveness, sometimes even the survival of manufacturing companies or establishments is downsizing and outsourcing. Thus, the ties between high- and low-value-added sections of the production chain are challenged, which exerts a growing pressure on assembly plants in particular where management increasingly believes in lower labour standards as a means to maintain competitiveness. These changes hamper many firms’ willingness to provide vocational training and exert an enormous pressure on collective bargaining as they contribute to a growing reluctance of SMEs in particular to join employers associations and accept collectively agreed standards. The East-West gap in collective bargaining coverage rates and acceptance of standards is of particular importance not just for the East but also for the West as it makes the Eastern part of the country appear as a forerunner of local, rather than industry-wide, bargaining. Moreover, it has to be reminded that the drop of collective bargaining coverage is not only attributable to industry-related changes but also to explicit political pressures.

Another important driver for heterogeneity in the production segment is the trend to outsourcing of both high and low value-added business related service activities. It is business services in engineering and IT which exhibit the lowest collective bargaining coverage (Ellguth/Kohaut 2004). Though it is true that the IT industry is a milestone for the increasingly rapid adaptation of vocational training to technological and industrial change, there are no overall bargaining structures covering the whole of the industry, and collective bargaining takes place at the company level in most cases, if at all.

On the far end, services such as cleaning and catering which have been outsourced from manufacturing companies have been transferred to the second employment segment (consumption/distribution) with its markedly lower levels in terms and conditions.

\textsuperscript{15} In the present report we have not gone into details of the structure and the problems of the welfare state as this will be subject of the forthcoming part of the analyses of national employment models in the DYNAMO project.
In the consumption and distribution segment, too, changes in ownership and governance structures account for a boost in heterogeneity. The arguably most important change here has been the privatisation of telecommunication services and the emergence of a totally new competitive environment in this industry. Next to telecommunication, large parts of the transport sector were subject to privatisation activities. The long-term effects on the employment model are substantial as both postal and telecom services and public transport used to be major strongholds of highly protected and regulated terms and conditions.
Moreover, wide areas within the consumption/distribution segment, notably the retail trade as its largest industry, have been affected markedly by the weakness of domestic demand in Germany and by the promotion of marginal part-time via the tax and social security system. Labour cost cutting and the boost of marginal part-time imply a trend towards a fragmented workforce as well as increasing difficulties to maintain regulative standards. The generalisation of collective agreements which used to be common practice in the retail trade in earlier decades has become virtually nonexistent.

The provision segment, too, is experiencing major privatisation activities notably in health and care services. Moreover, the cost cutting pressures on these services exerted by the state push for a broad turn towards governance strategies borrowed from private businesses, such as target costing and outsourcing. More general, the politics of running the state dry (c.f. chapter 2.1) have triggered off both major staffing cutbacks in the civil service and a break-up of the associations of public employers in what used to be a heartland of highly regulated terms and conditions and a stronghold of collective bargaining in the German employment model, next to manufacturing. Here, the fact that fragmenting of collective bargaining is partly attributable to explicit political pressures is most obvious.

The trend towards heterogeneity within each of the three employment segments is accompanied by a loss of cohesion between these segments. It is true that the strong ties between the employment segments which could be taken for granted in earlier decades still do exist and have even be renewed in some cases. One important aspect here is the persistently crucial role of the dual system of vocational training which has gone through some major reforms over the last two decades. Another stabilising factor continues to be the Works Constitution Act with, after its latest reform, its reduced company size threshold as to the right to vote a works council. Finally, basic features of labour law, such as dismissal protection, continue to provide for a high degree of employment stability which has for decades been one of the cornerstones of long-term oriented personnel management.

However, some of these regulations are under increasing pressure, and the strength and reliability of some other ties between the employment segments has become considerably weaker in the course of the 1990s. By way of example, dismissal protection has been subject to various zigzag changes over the last few years with a clear tendency to be loosened under a conservative government. The break-up of the legal priority of industry-wide over local collective agreements is another topic on the political agenda. It is a major focus in the short-term action programme of the Liberal and Christian-Democratic parties but already raised, as a choice, by the Social-Democratic government’s “conversion of the welfare state” programme.

In fact, recent and ongoing tax system and welfare state reforms affect the overall cohesion of the national employment model in various ways. Important aspects here are, first, various changes in the tax system mentioned earlier which gave way to and supported the break-up of stable ownership structures and the fragmentation and constant reshuffle of enterprises. Second, the labour market reforms which urge jobseekers into jobs with wages beyond the collectively agreed level, if there is any. Third, standard terms and conditions have got under pressure by the lowering of unemployment benefits for long-term unemployed, thus fostering low wage employment. Fourth, the enhancement of marginal part-time is contributing to the gender-specific segmentation of the labour market and to the fragmentation of the basis for collective regulation of working conditions.

However, it is not just important what has actually been done in politics but also what is neglected to do. A major indicator for this latter aspect are the well known results of the PISA tests which signal a growing gap between the needs and the potentials of a high performance economy in the future. Equally important, and at the very heart of the German employment model, is the discrepancy between the structure of the welfare state and the rise in female
labour market participation. This is where the “built-in deregulators” come into play to which we finally turn.

3.2 Modernisation lag

The most obvious inconsistency which has developed over the last two decades is the widely persistent orientation of the welfare state on the male breadwinner model, which concerns the tax and social security contributions system as well as the benefits and services aspects of the welfare state. This orientation has got into stark contrast to the increasing female labour market participation and, in conjunction with it, the need to develop the service sector. Some symptoms of this inconsistency have begun to get an issue in public debates recently, in particular the low fertility rate in Germany. Other major symptoms, including the gender-specific segmentation of the German labour market with its unusual high rate of marginal part-time have been described in earlier chapters of the present report. Large potentials of qualified labour are wasted or under-used, while the fiscal burdens due to various forms of tax and social security subsidies for the breadwinner model are high. What we are facing here is a modernisation lag which works as a powerful built-in deregulator of the standard employment relationship and a de-stabiliser of the German employment model.

Arguably the strategically most important drawback from this modernisation lag is that it implies a dual ill-allocation: large employment potentials are under-used, and the state is prevented from more substantial investments into the development of societal services (namely health, child and elderly care, and education). Both intellectual and financial investment into education is needed as the present school system is particularly bad at compensating for educational disadvantages due to family background. When it comes to the reproduction of its human resources, therefore, Germany finds itself in a vicious circle, which could undermine the traditional strengths of its productive system, namely high-quality production based on a skilled labour force. The health and care sectors, in turn, have already gained some momentum as job engines, but the societal need, and potentials, of future growth are much higher as is best demonstrated by the comparison of Germany with some other EU economies (Bosch/Wagner 2005).

As far as the German employment model is concerned, an active role of the state for the development of these high added-value services would be of particular importance. Other than many people in Germany are being made believe, there is no automatism that transforms export championship into economic growth and rising rates of employment. Rather, the mobilisation of growth potentials in areas which are crucial for the future development of the society, in line with ongoing changes in the gender contract, depends very much on the assistance of the state, if growing social polarisation is to be avoided (Esping-Andersen 2002). Thus, it could also promote more offensive and open-minded attitudes to structural change in the German public towards flourishing education and care services, in contrast to a prevailing tunnel-vision-like focus on international competitiveness in terms of labour costs in manufacturing.

In fact, it is this tunnel-vision of major actors which aggravates the crisis of the employment model also in the short run. This is most clearly demonstrated by the weakness of domestic demand in conjunction with the economic effects of unification. In contrast to various other countries, including market-centred economies such as the US and the British, there has been virtually no serious growth-oriented macroeconomic initiative of major actors, neither from collective bargaining, nor from the state. The companion of economic stagnation and persistent high levels of unemployment, however, is a reluctance to structural change towards high added-value societal services. The constant almost-stagnation over a rather long period of time has reinforced, oddly enough in a high-performance economy, a defensive attitude
against structural change amongst all major actors: Many large companies are increasingly focussing on lower wages rather than organisational reforms in order to increase competitiveness; trade unions and local works councils see themselves very often in a situation in which ever more important concessions have to be traded against the safeguarding of existing jobs; and as to politics, the policy of running the state dry diminishes the state’s potential to contribute to sustainable reforms of the German employment model.

In a situation of lasting economic stagnation, each challenge to an employment model turns into a threat. As long as major actors tend to increase the dose rate of their medicine, rather than changing the cure, the disease gets even worse, and so does the threat. A turn towards a growth strategy hand in hand with the development of high added-value societal services has not been put on the agenda by any of the major political actors so far.

In this context, the supreme importance of the German unification is clearly visible. Its economic implications induced, or encouraged, policy-makers and other major actors to take actions which endanger the employment model, while freezing outdated structures and obscuring political alternatives. The avoidance of an East German Mezzogiorno is not a matter of just a few years. It takes patient and steady policies focused on the East as well as a healthier economic environment in Germany in general. In the long run, the recovery of Eastern Germany and a renewal of the German employment model may be two sides of the same coin. The question, however, is in which direction this coupling works. One possibility is that fragmented labour standards in Eastern Germany are abused as Trojan horses for the dismantling of the traditional strengths of the German employment model. Another could be a renewal of the employment model based on a development of its strengths, in conjunction with a modernisation of the welfare state for which the public preparedness is stronger in the East than in the West. In spite of the current political mainstream it is not clear which choice will prevail in the long run.

Taking our two strands of argument together, the German employment model is suffering a dual challenge. The first challenge are the growing tensions between ongoing changes in ownership and governance structures geared to short-term profitability, and a set of institutions geared to adaptability by means of stability, rather than short-termism. In spite of some attempts to stabilise the system, the political mainstream over the last few years has turned increasingly towards lessening these tensions by eroding major institutions vital for the German employment model. What major actors neglect to tackle, in turn, is the growing modernisation lag in the welfare state. This second challenge works as a built-in destabiliser of the German employment model. Though public awareness of this problem is rising, there is still reluctance to set major reforms on the political agenda, let alone to put them into practice.
Annex: The three segments of the German Employment Model

Segment 1: Production
Manufacturing (NACE 10 – 44)
Construction (NACE 45)
Financial intermediation (65)
Insurance and pension funding (66)
Activities auxiliary to financial intermediation (67)
Real estate activities (70)
Renting of machinery and equipment without operator (71)
Computer and related activities (72)
Research and development (73)
Other business activities (74)

Segment 2: Consumption and distribution
Sale and maintenance of motor vehicles and motorcycles, retail sale of automotive fuel (50)
Wholesale trade and commission trade (51)
Land transport; transport via pipelines (60)
Water transport (61)
Air transport (62)
Supporting and auxiliary transport activities; activities of travel agencies (63)
Post and telecommunications (64)
Hotels and restaurants (55)
Activities of households (95)

Segment 3: Provision
Public administration and defence; compulsory social security (75)
Education (80)
Human health, veterinary and social work activities (85)
Sewage and refusal disposal, sanitation and similar activities (90)
Activities of membership organisations and church and other religious organisations (excluding social work and sporting activities) (91)
Recreational, cultural and sporting activities (92)
Other service activities (93)

(Excluded: Primary sector (1 – 5); Extra-territorial organisations and bodies (99))
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