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Why Are German Employers Associations Declining?

Arguments and Evidence

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Considerable progress has been made during the past two decades in conceptualizing dynamics within German employers associations—in particular, explanations for declines in density—and the impact on the economy. The verification has not kept pace with theorization, however. This article provides empirics. The analysis confirms earlier conclusions that the interests of large and small employers have increasingly diverged since the mid-1980s. In contrast to the conventional wisdom, however, the authors find that organized labor has not contributed to the cost pressures that have prompted many small- and medium-sized enterprises to leave employers associations. The article also explores employers associations' response to a more challenging environment in light of the "varieties of capitalism" literature. The decision of several German employers associations to offer different classes of membership has qualitatively expanded subnational variety within the German variety of capitalism

Keywords: *labor–management relations; collective bargaining; market structure; firm strategy; other economic systems; legal institutions*

Employers associations (*Arbeitgeberverbände*) rank among the most important institutions in the German economy. They have been instrumental in creating and preserving the famous postwar social partnership between German labor and management that has minimized industrial conflict and brought stability to German industrial relations. In particular, the high density of employers associations in terms of employment has been

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crucial in extending the coverage of collective agreements far beyond what trade unions acting alone could ever have accomplished. German employers associations have nonetheless been shrinking for two decades. In particular, the membership rates of small- and medium-sized enterprises (SMEs) have fallen off precipitously. Efforts to stem the deterioration have thus far proved unsuccessful. The decline has become so pronounced that the capacity of German employers associations to continue to play their traditional stabilizing role has come into question.

This article investigates the causes and implications of the decline of German employers associations. It extends and refines the standard account for the decline, which argues that employers associations have responded to the increased sensitivity of their member firms to industrial action as a result of globalization by acquiescing to more generous collective bargaining agreements. This acquiescence according to the conventional wisdom has opened a gulf between the large internationally oriented manufacturers, which can afford the higher labor costs, and their smaller suppliers, which cannot (e.g., Thelen & van Wijnbergen, 2003).

Data substantiate some parts of the standard account but not others. Since the 1980s, German employers have indeed become much less prone to resort to lockouts and other aggressive tactics in labor disputes. The gap between large and small employers has widened. Large firms have squeezed their smaller suppliers far more aggressively to attain price cuts. Small enterprises have responded by dropping out of employers associations. In contrast to the conventional wisdom, however, we find that organized labor has not contributed to the cost pressures that have prompted many SMEs to leave employers associations. Increases in compensation have actually become progressively smaller during the past 25 years and compensation expenses as a share of total costs have shrunk dramatically.

Still, the flight of SMEs from employers associations has prompted these organizations to experiment with restructuring and even redefining their mission. The article examines the content, efficacy, and implications of these efforts. It concludes with a brief discussion of the implications of this analysis for the “varieties of capitalism” (VoC) literature.

Previous Research on German Employers Associations

Before the 1990s, employers associations were “chronically unexplored” (Abromeit, 1987, p. 417) and “disproportionately disregarded” (Traxler, 1985,

p. 51) in academic literature. Much has changed since then. Upheaval within the economies of numerous high-income countries highlighted the role of employers and their associations. Newer investigations of the formation of the welfare state and collective bargaining regimes during the 20th century moved beyond simplistic one-sided analyses to “bring capital back in” to the picture in a much more nuanced and sophisticated fashion (e.g., Swenson, 1989). Thelen and van Wijnbergen (2003) identify two schools within this literature. The first argues that transnational economic integration is producing convergence around a deregulated neoliberal Anglo-Saxon model (e.g., Friedman, 2005; Katz & Darbishire, 1999). This perspective sees little place in contemporary economies for institutions that have traditionally mediated markets, such as employers associations and trade unions.

The second school asserts that stable market niches within the world economy and multiple equilibria regarding institutional arrangements permit VoC to coexist (e.g., Hall & Soskice, 2001). Some countries configure their “national institutional framework of incentives and constraints” to focus on low-end mass production, whereas others concentrate on making quality high-end products (Soskice, 1999, p. 102). The latter maintain “coordinated market economies,” in which employers associations and other intermediary institutions play an active role in mitigating market failures that must be resolved for this approach to pay off in practice (e.g., the underprovision of skills). Proponents of the VoC approach claim that deepening globalization is far more likely to sharpen cross-national differences and shore up existing national models than to promote convergence, because the transnational integration of markets increases the number of viable niches available for high-end production.

Most scholars of German political economy have shown considerable sympathy for the VoC school (e.g., Fichter, Wever, & Turner, 2001; Schroeder, 2000; Traxler, 2004). Yet others noted deterioration in the membership and density of German employers associations that ultimately proved too large and persistent to dismiss (e.g., Silvia, 1997). Some scholars have attempted to deepen our understanding of national production regimes through analyses of individual cases. Germany has been a frequent subject of these studies, because scholars have identified it as an exemplar of a coordinated market economy. Much of this research has focused on German employers associations, because they play a central role in regulating the German economy and they have been experiencing difficulties of late. Thelen and van Wijnbergen (2003) have presented the most sophisticated analysis accounting for the membership decline in employers associations.

As a result, their analysis has become the conventional wisdom. Thelen and van Wijnbergen base their analysis on a case study of how *Industriegewerkschaft Metall* (IG Metall, Industrial Union of Metalworkers) was able to win a 1995 strike despite declining membership and Germany's increased international economic integration. Along the way, they address "characteristic blind spots" in the VoC approach, in particular, a tendency "to see all feedback as operating to sustain and reproduce existing systems" (p. 860).

Thelen and van Wijnbergen (2003) argue that globalization splits the German employers camp into two groups: larger, export-oriented firms, and smaller enterprises that serve primarily as suppliers to those large firms. According to Thelen and van Wijnbergen, greater transnational economic integration renders the export-oriented firms more vulnerable to economic disruption than they had been in the past. Their supply and sales chains have become considerably longer and they increasingly face formidable competition from foreign rivals both at home and abroad. Large, export-oriented firms are therefore far less willing to engage in industrial conflict, because the disruptions entailed have become larger and more costly in terms of lost market share than they were decades ago. The result, Thelen and van Wijnbergen assert, is that the large firms have increasingly influenced employers associations, which negotiate compensation rates for most of the German economy, to accept hefty hikes to avoid production shutdowns.

Thelen and van Wijnbergen (2003) maintain that the larger and more sophisticated German firms have responded to the acceleration in compensation costs by undertaking a thoroughgoing restructuring to ratchet up productivity growth. Smaller firms, in contrast, do not have the capacity to do the same because they lack the resources and economies of scale to restructure. This, according to Thelen and van Wijnbergen, has produced a vicious cycle within German employers associations. SMEs that cannot adjust shirk membership in employers associations. After each new expansive wage settlement, a fresh wave of cost-sensitive SMEs quit their associations to cut costs, which leaves a greater proportion of larger, more conflict adverse and cost sensitive firms in the associations.

The strength of Thelen and van Wijnbergen's (2003) study is the analytics. These studies deploy stylized institutionalist arguments, at times supplemented with a rational-choice approach, to elucidate their claims. The weakness, however, is the empirics. This approach provides us with no systematic evidence. In some instances (e.g., wage developments), single anecdotes are provided that are not representative of the longer trend (e.g., the 1995 metal-industry strike). In other cases, no evidence at all is given (e.g., productivity trends). Other scholars making similar arguments share

this shortcoming (e.g., Streeck & Hassel, 2003/2004). This failure to use aggregate data is in part understandable. Employers associations are not mass organizations. They tend to keep organizational data and internal communications confidential. Still, there are relevant aggregate data available on compensation and productivity that even the more sophisticated studies of German employers associations have not used. This article takes the extra step of using available data to test the claims of the existing literature. Our contribution can thus be read as a refinement of the Thelen and van Wijnbergen analysis, that is, it is an empirical evaluation of their analytical points. We find that some of their assertions stand, but others do not. On one hand, data confirm the bifurcation within the employers camp and the increased reluctance of German firms to use lockouts. On the other hand, our empirical analysis shows real compensation growth has been flagging for some time in Germany and productivity developments have been at best mixed.

Our findings lead us to reformulate our understanding of the dynamics of the German economy. Large export-oriented firms are actually still getting the labor quiescence and relative wage restraint that they want from employers–association membership. They have maintained profitability by rationalizing production and squeezing their suppliers. As a result, big manufacturers have not fled from employers associations. Small enterprises, in contrast, have found it increasingly difficult since the mid-1980s to maintain their memberships in employers associations and remain profitable because of the aggressive tactics of their larger customers, so many have dropped out of the employers associations. Another crucial difference distinguishing our analysis is the role of trade unions. Thelen and van Wijnbergen (2003) infer from their model that the increased sensitivity and vulnerability of large German companies to industrial action have enhanced organized labor's immediate leverage in collective bargaining, which has exacerbated cost pressures for German firms. The evidence, however, does not support this claim. Mean wage increases have been shrinking in Germany since the 1960s—both in the metals sector and in the German economy as a whole—with the sharpest drop coming precisely when Thelen and van Wijnbergen see cost pressures increasing (i.e., the 1980s). In other words, trade unions, if anything, have lost ground as a result of the recent developments in the German economy.

To assess the merit of our claims versus those of others regarding the causes and consequences of change within German employers associations, it is essential first to understand the profile of German employers associations and their economic, legal, and political environment. The following section provides this context.

A Profile of German Employers Associations

The structure and approach of German employers associations have evolved significantly since their founding in the late 19th century. Firms established employers associations initially as antiunion organizations (*Gegenverbände*). The associations did not engage in collective bargaining but instead maintained blacklists of prounion workers and coordinated lockouts. They maintained discipline among members by fining firms that poached business away from struck firms or hired workers on strike elsewhere. Coordinating strategy and tactics through employers associations gave firms more power in the labor market. It also contributed to centralizing and to routinizing industrial relations by taking decisions away from individual firms and placing them under the purview of collective actors (Leckebusch, 1966).

During and after the First World War, trade unions gained more rights. Employers associations adjusted in response, taking on a number of new tasks, including political lobbying and regional collective bargaining at the sectoral level. Some German employers associations also continued to help firms avoid unions during the interwar years. The National Socialists gradually stripped employers associations of autonomy, reducing them to subordinate bodies under the Nazi state. After the Second World War, German business gradually reconstructed a new network of business associations that came largely to resemble a rationalized version of the interwar structures. The legacy of business collaboration and trade union suppression under National Socialism tainted union avoidance as a tactic. The new basic law protected the right to organize. Legislation and court rulings promoted autonomous collective bargaining between trade unions and employers associations. As a result, employers associations assisted firms with collective bargaining rather than union avoidance (Erdmann, 1966).

There are nearly 1,000 employers associations in Germany today, most of them regional organizations covering a single sector. The vast majority of these belong to the national federation for their sector, such as the General Association of Metal-Industry Employers Associations (*Gesamtverband der metallindustriellen Arbeitgeberverbände*, Gesamtmetall) and the Federal Employers association of the Chemical Industry (*Bundesarbeitgeberverband Chemie*, BAVC). Fifty-four sectoral federations belong to the peak organization of employers associations, the Federal Organization of German Employers associations (*Bundesvereinigung der Deutschen Arbeitgeberverbände*, BDA). The internal structure of employers associations resembles that of the unions, but their size does not. The collective bargaining department is

most important. Other departments are typically international relations, labor law, media relations, research, personnel policy, social policy, and training. The staff of most regional employers associations and sectoral federations ranges between 2 and 20. Trade unions have many times that number (Plumpe, 1996).

Recruitment is rarely an easy task for any voluntary membership-based organization, and employers associations are no exception. Employers associations confront organizational challenges that trade unions do not. The membership of employers associations is extremely heterogeneous, ranging from small enterprises to transnational giants. As a result, the objectives and resources of member firms vary widely. Many members of employers associations are highly intertwined economically. Some are economic competitors; many buy from or sell to other association members. Nonetheless, employers-association members place a high value on preserving autonomy. These vast differences in the size, resources, and objectives of member firms make it difficult for employers associations to reach common positions and to pursue them with consistency and discipline. Economic hard times and ideological differences accentuate the divisions.

Employers-association officials have learned to attract and to retain heterogeneous firms by providing selective incentives, such as legal services, personnel advice, strike insurance, and lobbying. Membership in employers associations has also provided individual employers with an invaluable social network for finding and keeping business. These selective incentives have traditionally helped employers associations both to bind companies closer to their associations and to strengthen the associations vis-à-vis individual member firms. The most important single product that German employers associations have traditionally provided is the regionwide sectoral collective bargaining agreement (*Flächentarifvertrag*). Regionwide agreements reduce transaction costs for individual firms by eliminating the need to retain staff skilled in labor negotiations. They also have reshaped the German labor market by dampening competition on the basis of labor costs within sectors (Traxler, 1986).

A regionwide sectoral collective bargaining agreement is only effective when it covers firms that account for the preponderance of employment under its jurisdiction. The degree of coverage, which is known by the technical term *density* in industrial relations circles, therefore provides us with an assessment of the power of employers associations. It serves as the dependent variable for most investigations of German employers associations, including this one. The following section discusses density trends in Germany.

German Employers Association Density

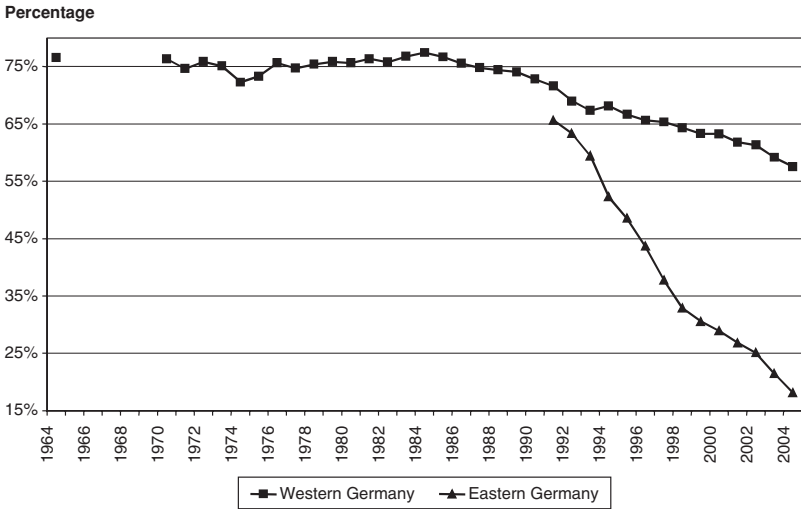
An important indicator of the influence of the employers associations on labor market policy is density in terms of employment (i.e., the share of the labor force that works for enterprises that are members of employers associations). Unfortunately, these data are not readily available for the whole economy. Only one sectoral federation of employers associations, *Gesamtmittel*, has regularly released annual information about its membership. Scholars have traditionally used the data from the metals sector to gauge trends in employers association density for the German economy as a whole. This measure is by no means perfect. Still, a good case can be made for using the data from the metal industry employers associations as a surrogate because the sector remains at the heart of the German economy and it has a broad mix of firms ranging from small shops to transnational giants. A comparison by Völkl (2002) of employers associations across sectors supports this practice. It finds variation in the membership trends of employers associations across sectors but places the metal industry in a middle range. Still, because our evidence is just from the metalworking industry, we can only confidently make claims about that sector.

Density gauges the coverage of employers associations. Employment density measures the share of employees at member firms of employers associations as a percentage of total employment. Before German unification, density in terms of employment of the Western German metals industry remained remarkably stable, fluctuating only within a few percentage points of 75% during the first 25 years for which we have data (see Figure 1). Two trends in reunification density data stand out. First, employers association density slopes upward slightly for 10 years starting in 1974 and begins to fall off in the second half of the 1980s (*Gesamtmittel*).

Since the mid-1980s, the employment density of the Western German metal industry employers associations fell by almost twenty percentage points, from 77.4% in 1984 to 57.6% in 2004. The trend in Eastern Germany has been even more dramatic. In 1991, the first full year of postwar German unity, employment density of the Eastern German metal industry employers associations stood at 65.7%. This figure was not that different from Western density at the time, which was 71.6%. A gap quickly opened up, however. In 1995, the employment density of the Eastern German metals sector had fallen below 50%; in 1997, it slipped below 40%; in 2000, it dropped below 30%; and by 2004, it had reached 18.1% (see Figure 1).

A cyclical explanation can be ruled out; the data for both Eastern and Western Germany show a steady decline independent of cyclical economic

Figure 1
German Metals Industry Employers Association Density
in Terms of Employment



Source: Gesamtmetall (1980-2006).

developments (Schroeder & Ruppert, 1996). The metals sector is by no means the exception in Eastern Germany. The Berlin-based economic research institute, *Deutsches Institut für Wirtschaftsforschung* (DIW), undertook a survey of density in terms of employment for employers associations in all manufacturing sectors of Eastern Germany. These data track closely with those for the metals sector. DIW found employment densities of 76% at the end of 1993, 45% in early 1998, and 34% in the middle of 2000 (Deutscher Gewerkschaftsbund, 2001).

What has been the impact of the declining density of German employers associations? Regionwide collective bargaining agreements determine compensation for a significantly smaller share of German employees today than they did 30 years ago. Between the 1970s and 1995, the coverage of regionwide collective agreements in Western Germany fell from roughly 80% to 72% of all employees. Since 1995, the slide has continued. By 2003, regionwide contracts set compensation for only 62% of the Western workforce (Institut für Arbeitsmarkt- und Berufsforschung, 1993-2005).

Some firms that have left their sector's employers association have negotiated single-firm contract with a trade union, which are known as "house" agreements in Germany. The unions typically take great pains to ensure that the contents of a house contract are by and large the same as the regionwide agreement. Still, managers at some enterprises prefer house agreements for several reasons. House agreements can be tailored at the margins to match a firm's specific needs. Firms with house agreements do not have to pay employers association dues and are not dragged into industrial disputes over a regionwide contract. A house agreement also has inherent disadvantages. Firms face unions alone in collective bargaining. They must undertake negotiations themselves and have no strike insurance (Schroeder, 1995). Although the number of house agreements has increased markedly since 1990, the share of employees covered by them in Western Germany has actually waned, falling from 10.4% to 8% between 1995 and 2003. The number of house agreements has stayed roughly constant in Eastern Germany. So one cannot conclude that house contracts have filled the void created by the decline in coverage of regionwide agreements.

Combining the data on regionwide and house collective agreements shows that the reach of collective bargaining in Western Germany has slipped from approximately 90% of the workforce during the heyday of the 1970s to 70% today. Coverage still remains relatively even. In Western Germany, a majority of the employees are essentially under the same collective agreement in most regions and sectors. An exception in Western Germany is business services. Coverage in this sector has dropped to 35% of the workforce (Ellguth & Kohaut, 2004).

The Eastern German record resembles the West, but the swing has been more pronounced. The coverage of regionwide agreements has shrunk faster and farther. In the first few years after German unification in 1990, regionwide agreements set compensation for roughly four fifths of Eastern German employees, just as they had in Western Germany up to the early 1980s. The firms under the control of the *Treuhandanstalt* (THA, Trust Holding Agency), which was a public entity established to manage the economic assets of the former German Democratic Republic until they were sold off, routinely joined employers associations. The THA liquidated most of its holdings within 5 years. Many of the new private owners failed to maintain memberships in employers associations. As a result, the share of the Eastern German labor force covered by a regionwide collective agreement in 1996 fell to 56.2% and continued to decline, reaching 43% in 2003. The share of employees covered by house agreements since unification has always been higher in Eastern Germany. In 1996, this figure amounted to 17.2%. By 2003, however,

it had fallen to 11%, despite an increase in the actual number of contracts. Between 1996 and 2003, the combined coverage of regionwide and house agreements in Eastern Germany fell from 73.4% to 54%.

Membership declines among employers associations have resulted in German employers associations' losing their capacity to carry out their core mission, namely, the determination of compensation in the labor market. In both Eastern and Western Germany, the percentage of wages set through collective bargaining has fallen by roughly twenty percentage points from the peak level. Why have these declines taken place?

Why Has German Employers Association Density Declined?

Thelen and van Wijnbergen claim that acceleration in the growth of compensation starting in the 1980s has been the cause of the declining density of German employers associations. An examination of compensation trends shows the opposite, however. Mean annual change in real hourly income in both the German economy as a whole and in the Western German metal-working sector has grown smaller in each successive decade since the 1960s (see Table 1). As a result, personnel costs have progressively become relatively easier for firms to bear, not harder. Western German personnel costs calculated as a percentage of total sales have declined from 33.5% in 1974 to 22.2% in 2004. Eastern German labor costs fell even farther, dropping from the equivalent of 40.9% of total sales in 1992 to 20.9% in 2004 (Gesamtmetall). Something else besides a surge in labor costs must be causing the decline in employment density of German employers associations.

Productivity data provide a clue, although the developments are not uniform. For the German economy as a whole, the pattern of productivity growth tracks with that of income, which is to be expected. Productivity has increased in Germany during the past 45 years but at an increasingly slower pace (Table 1). The 1990 to 1999 period stands out as a marginal exception, but it can readily be explained by the surge in Eastern German productivity immediately following German unification. New investment, wholesale rationalization of the formerly planned economy, and a massive contraction of the labor market produced a significant temporary acceleration in Eastern German productivity growth, which briefly lifted overall Germany productivity growth as well. The dominant trend of decelerating productivity growth for the German economy as a whole resumes in the subsequent period. It is important to note that the pattern of productivity growth differs

Table 1
German Hourly Income and Productivity
Developments (in Percentages)

Period	Mean Annual Change in Real Hourly Income		Mean Annual Change in Gross Domestic Product per Hour Worked (Productivity)	
	Germany	Western Metalworking	Germany	Metalworking
1961 to 1969	5.3	5.6	4.8	
1970 to 1979	3.6	3.7	4.0	4.6
1980 to 1989	1.4	1.7	2.0	2.9
1990 to 1999	1.2 ^a	1.6	2.7 ^a	4.8 ^a
2000 to 2004	0.6	0.6	1.5	3.9

a. United Germany as of 1991.

Source: Gesamtmetall (2006); Organization for Economic Cooperation and Development (2004, 2006).

for the metalworking sector. Metalworking productivity decelerates along with the national pattern (although at a slightly higher average rate) during the 1980s (Table 1) but breaks with the national trend thereafter. Metalworking productivity growth rebounds dramatically in the 1990 to 1999 period and then settles in the subsequent period at a rate substantially higher than productivity growth for Germany as a whole (3.9% vs. 1.5%).

The recent acceleration in productivity combined with moderation of income growth in the metalworking sector explains why labor costs as a percentage of total sales have dropped precipitously, particularly during the past decade. In other words, the data show that cost pressures owing to wages have become increasingly less severe in recent years. The picture for the German economy as a whole is neutral regarding cost pressures owing to labor. Productivity increases have tailed off, but so has income growth. The data do not support the causal chain theorized by Thelen and van Wijnbergen. What then has caused the decline in employer association density?

Alternative Explanations for the Decline in German Employers Association Density

Several explanations have been proffered for the decline in employers association density. Some of the broader explanations, such as generational

change, can be dismissed out of hand because they cannot explain the divergence between large and small enterprises in the propensity to belong to an employers association. Three potential explanations do exist that are consistent with the data: (a) divisive pressure of greater global competition on German manufacturing, (b) changes in firm size, and (c) poor provision of employers association services to SMEs. We will discuss each in turn.

Divisive Pressure of Greater Global Competition on German Manufacturing

Germany's original equipment manufacturers (OEMs)—that is, the predominantly large firms that assemble manufactured goods—first began to face significant competition from East Asia at home and in third-country markets in the late 1970s and early 1980s. They responded by borrowing production techniques from Japan—such as just-in-time parts delivery and continuous improvement (*kanban*)—that put unprecedented quality and price pressures on their parts suppliers (Silvia, 1988). This trend hit small suppliers particularly hard because most did not have the depth to adjust easily.

One man came to personify this development: José Ignacio López de Arriortua. Ignacio López served as head of purchasing for the German unit of General Motors, OPEL, in 1986. López quickly moved up, becoming the purchasing chief for General Motors Europe from 1987 to 1992. He held the comparable position at Volkswagen from 1993 to 1996. López's technique was simple. Each time he negotiated a new contract, he demanded that the supplier cut prices by at least 25%. Any firms failing to comply would lose the business. This aggressive approach became known as the "López effect." The López effect spread quickly throughout the European and eventually North American manufacturing sector, but it remained especially pronounced in the automobile industry. It persists today. Parts suppliers complain that a second wave of across-the-board double-digit price cuts is currently under way. Profitability in terms of sales among German automobile parts suppliers has deteriorated during the decades. Lately, parts supplier profitability has failed to break the 5% mark. This pressure on parts suppliers has bifurcated the German automobile industry. The return on investment for the OEMs has been double that of the suppliers, and the gap between the two has continued to widen. European OEMs have also managed to maintain profitability far more successfully than their Japanese and North American competitors. In 2001, for example, the cash flow return on invested capital was 8.9% for European automobile producers. Their Japanese and North American counterparts earned only 6.3% and

3.5%, respectively. Small suppliers responded to these pressures by looking for ways to cut costs that were previously unthinkable; this included dropping membership in employers associations (A. T. Kearney, 2002; Kinkel & Lay, 2004; Moffett & Youngdahl, 1998).

The deterioration of the economic environment for German supplier firms because OEMs greatly intensified cost and quality pressures in the wake of globalization is the main explanation for the overall decline of membership in German employers associations and the disproportionately large drop in SME density. The timing of the intensification of economic pressure on suppliers is consistent with the flight from employers associations, which also begins in the latter half of the 1980s. A *Gesamtmittel* investigation indicates that cost pressures are the principal cause of flight from its member associations. It reported that roughly half of all the firms that left a metal industry employers association in the period under investigation (i.e., 2002 to 2005) did so because of cost pressures. The other half left because of either insolvency or a merger (both of which in many instances may also be at least in part a product of price pressures). The explanation is also in step with the data on wages and productivity (Roth, 2006; Silvia, 1999).

Secondary explanations help to account for some dimensions of declining density in German employers associations that the divisive pressures of globalization on German manufacturing alone cannot. Let us now turn to these.

Changes in Firm Size

The changing demographics of German business also help to account for the decline in employers association density throughout Germany, but it is a particularly important explanation for the disproportionately large decline in Eastern Germany. Smaller firms have always had a lower propensity to join employers associations, so a decline in median firm size would reduce density in terms of employment. Data reveal a shift toward smaller firms. From 1991 to 1999, employment at Western German firms with fewer than 20 employees expanded by 600,000 (from 5.1 to 5.7 million), but the number of jobs fell by 1.4 million (from 17.1 to 15.7 million) at firms employing 20 or more people (Organization for Economic Cooperation and Development, 2002). The dismantling of and privatization of the Eastern German economy during the 1990s reduced the proportion of the workforce employed at large workplaces far below that of Western Germany. This is precisely when employers association density in terms of

employment fell precipitously in Eastern Germany (see Figure 1). One might think that the divergence between Eastern and Western employers association densities would be the product of the very different economic and historical trajectories of the two regions, but empirical analysis shows otherwise. Schroeder and Ruppert (1996) found that Eastern and Western German firms of the same size had the same propensity to join employers associations. In other words, the gap in firm density between Eastern and Western Germany is largely the product of the dearth of large workplaces in the East rather than differences in acculturation or conditions on the ground (Schroeder, 2000).

Poor Provision of Employer–Association Services to SMEs

Case studies and interviews show a belief among rising numbers of owners and managers of small businesses that employers associations are not sufficiently considering the specific interests of SMEs, particularly in comparison to the concerns of the larger members (e.g., Max-Planck-Institut für Gesellschaftsforschung, 2002). Research has not yet indicated whether this belief is simply a manifestation of divisive pressures within German manufacturing (which was discussed above), or service provision has actually deteriorated, or SMEs are asking for new services that the employers associations have been slow to provide.

Summary of Explanations for the Decline of German Employers Associations

It is important at this juncture to distinguish briefly between our explanation and the claims of the conventional wisdom for the decline of German employers associations, because they are subtle yet significant. The Thelen and van Wijnbergen (2003) explanation asserts that German trade unions have exploited a greater sensitivity and vulnerability of larger transnational firms that is a product of greater global competition to extract additional monopoly rents from German firms. Large companies have been able to adjust relatively easily, but the SMEs have not, prompting small enterprises to flee employers associations in an effort to cut costs. The weakness of this explanation is that it is inconsistent with the data on wage increases, which have grown more moderate with time and thus show no evidence of greater rents accruing to union members. Our explanation is more direct. Large internationally active firms have shifted costs onto SMEs, taking advantage

of their market power. Increasing numbers of SMEs have reacted by fleeing employers associations to reduce their own costs. The unions are not beneficiaries of these developments. To the contrary, they have found their ability to improve compensation diminished.

The changing environment does raise an additional question, which we have yet to address: How have German employers associations responded to membership decline, a deterioration in solidarity among employers, and the new challenging demands of individual firms? The next section provides an overview.

The Impact of Declining German Employers Association Density

The data on compensation presented above show that declining density has not thus far weakened German employers associations in collective bargaining, but there is strong evidence that declining density has effectively removed one of the most controversial tactics from the repertoire of German employers—namely, the lockout. The lockout has a long tradition in German industrial relations. Employers and their associations frequently resorted to lockouts in the 19th and early 20th centuries to raise the cost of strikes for workers and their unions. At times, the lockout was even used to break unions.

The Nazis eliminated autonomous collective bargaining, so there was no need for lockouts while they were in power. Employers were slow to revive the controversial tactic in the immediate postwar years, because they wished to demonstrate that a mixed capitalist economy was superior to Soviet-style central planning and to restore the business community's reputation following their collaboration with Nazism (see Table 2). In the early 1960s, however, aggressive new leaders among the ranks of the employers revived the lockout as a weapon in industrial disputes. Employers associations began to expel firms that refused to participate in lockouts. Expulsion from an employers association was a serious punishment in the 1960s. It deprived an expelled employer of participation in the association's collective bargaining deliberations; strike insurance; opportunities to serve on tripartite quasi-governmental bodies; and assistance when dealing with banks, other businesses, and government officials. Expelled employers were also shunned in the business community (Noé, 1970). The get-tough policy yielded results. From 1960 to 1969, for every 100 striking workers, 37.8 were locked out; and for every 100 workdays lost because workers were on strike, 43.4 were lost because workers were locked out. Employers continued to use the lockout regularly during the 1970s and 1980s. The ratio of locked-out employees

Table 2
Use of the Lockout in German Industrial Relations

Period	Striking and Locked-Out Employees ^a	Locked-Out Employees ^a	Locked Out as a Percentage of Total Striking and Locked-Out Employees	Working Days Lost Because of Strikes and Lockouts ^a	Working Days Lost Because of Lockouts ^a	Lockout Days as a Percentage of Total Days Lost
1950 to 1959	1,395,898	38,238	2.7%	9,831,075	791,183	8.05%
1960 to 1969	815,967	308,717	37.83%	3,157,249	1,371,377	43.44%
1970 to 1979	1,982,781	679,278	34.26%	11,647,753	6,224,646	53.44%
1980 to 1989	1,395,903	172,119	12.33%	6,098,410	2,698,875	44.26%
1990 to 1999	2,151,507	275	0.01%	3,378,265	2,591	0.08%

a. Actual participating and affected workers and actual lost working days without double counting.
Source: Bundesagentur für Arbeit (2004); Statistisches Bundesamt (2006).

to strikers began to wane during the 1980s, but the ratio of lost days owing to lockouts versus strikes remained high, reaching 44.3%.

During the 1980s, leading German firms began to adopt new manufacturing methods imported principally from Japan, such as just-in-time parts delivery and lean production in response to intensifying international competition. The new techniques cut costs and enhanced quality, but they simultaneously increased the speed and intensity of a strike's impact on production. As quality became ever more crucial to success in international markets, German workplace managers increasingly came to value a close, cooperative relationship with their employees. Nothing poisoned plant relations more than a lockout. Consequently, local managers increasingly began to resist demands by their employers associations to lock out employees. On the other side of the coin, the value of joining an employers association had waned since the 1960s. Firms were increasingly relying on in-house personnel service and legal advice. Direct connections with politicians and other businesses had become far more common. Shunning lost much of its impact, because most local business communities had become far less close knit (Silvia, 1988).

Because many German firms were already questioning the value of membership in an employers association, the threat of expulsion lost much of its disciplinary power. As a result of the sharp changes in the economic and social landscape discussed above, employers associations all but abandoned the lockout in the 1990s. During the 1960s, 1970s, and 1980s, German employers locked out at least 100,000 employees (see Table 2). German firms only locked out 275 workers during the entire decade of the 1990s, even though the number of strikers for the decade exceeded 2 million, which was an all-time high. The share of locked-out employees calculated against the total number of striking and locked-out employees fell to an astounding 0.01%. Days lost owing to lockouts as a percentage of lost days because of strikes and lockouts dropped to an equally astounding 0.08%.

The terrain for German employers associations has shifted considerably. Declining density and the loss of one of the traditionally most powerful weapons in their arsenal poses an unprecedented challenge to their place in the German economy. How have they responded?

Employers Association Responses

German employers associations have reacted to falling membership the way that any business would respond to declining sales. They have been

altering their existing product to bring it more in line with perceived customer needs and have been developing new offerings. The imperatives of organizational survival have generated tremendous pressure to depart from fealty to past practice, although vested interests both inside and outside of the associations have resisted even sound reforms for particular reasons. On the other hand, some caution is warranted. Rash or ill-conceived innovations could even hasten decline, because they would alienate existing members while failing to attract new ones. Experimentation by German employers associations began incrementally, but it has accelerated in recent years, because the smaller steps have not staunched membership loss.

Hardship and Opening Clauses

Starting in the 1990s, German employers associations have strived on the behalf of their members to depart from a “one size fits all” approach and to make regionwide collective agreements more flexible. Specifically, many employers associations have successfully inserted “opening clauses” (*Öffnungsklauseln*) and “hardship clauses” (*Härtefallklauseln* or *HärteklauseIn*) into collective agreements to provide greater flexibility at the level of the workplace for the determination of compensation. Both are types of escape clauses, which give the manager and works council at an individual workplace the option of developing abrogations of a regionwide collective agreement. The differences between the two are subtle yet significant. Many do not use the terms consistently, however, which creates some confusion. Hardship clauses are specifically intended for firms experiencing serious economic difficulty. To qualify for a hardship clause, a firm must open its books completely to union representatives to demonstrate true need. As a rule, hardship clauses require both the employers association and the trade union with jurisdiction over the workplace in question to ratify any agreement reached by workplace management and the works council before it can go into effect. Firms that are only temporarily experiencing difficulties but are otherwise sound are the ones most likely to receive approval to use a hardship clause at one or more workplaces. In contrast, the collective bargaining parties usually do not approve contractual abrogations for firms that are performing so badly that even temporary cuts in compensation will not save them, because propping up hopeless enterprises can force other companies on the margins out of business.

Opening clauses are more general and are not just for firms in economic trouble. The principal purpose of opening clauses is to increase flexibility in the German labor market. Firms wishing to invoke an opening clause

usually must provide some economic justification, but they typically do not have to open their books. Most opening clauses also require the collective bargaining parties to ratify an abrogation before it can go into effect, but a few do not. The majority of opening clauses in current contracts permit greater flexibility in weekly working time, or temporary reductions in wages and benefits either for new hires to promote employment or for the whole workforce to avoid layoffs. Opening clauses may also be used to permit practices such as performance-based pay and lower compensation scales for small enterprises (Bundesministerium für Wirtschaft und Arbeit, 2004).

Hardship and opening clauses have spread relatively quickly to collective agreements throughout the German economy, and workplaces are using them. Bispinck and Schulten (2003) estimate that one third of all workplaces in the private sector have individual agreements that diverge from the regionwide contract. Most employers have nonetheless found these escape clauses to be an insufficient solution to their business's problems, because they are intended for firms in economic distress. As a result, employers associations have worked on additional alternatives.

A Quick Notice

In the late 1980s and early 1990s, increasing numbers of managers from firms leaving employers associations said they were doing so because they feared getting trapped in a bad contract. German law requires any company that leaves an employers association to continue to adhere to all contracts signed by that association when the company was still a member until those contracts expire. For example, if an employers association approved a 2-year wage agreement and a member firm quit the association on the following day, the member firm would still be legally obligated to pay the contractual rates for the 2 years that the contract is in force, even though the firm is no longer a member of the employers association. Managers particularly worried about costs have been leaving their employers association in increasing numbers when a union puts a high initial demand on the table, even though the final agreement may ultimately amount to only a small fraction of the initial demand.

In response, a few employers associations have begun to offer something called "quick notice." Before the introduction of quick notice, it took several weeks at a minimum for a firm to leave an employers association. Employers associations with quick notice allow member firms to leave the association immediately whenever they wish, simply by sending the association a postmarked letter to that effect. This way, nervous managers are

able to let negotiations unfold considerably further without the fear of being locked into an expensive contract. In many instances, firms can even withdraw during the period after a provisional agreement has been reached but before the employers association has officially ratified it, because the agreement is not yet legally binding. Quick notice has alleviated some of the anxiety of nervous managers about being trapped in a bad contract, but it has not arrested the employers associations' membership slide. Few of the firms that have the option of using quick notice have actually used it and the membership declines of employers associations that have quick notice are not noticeably less than those that do.

Ohne Tarifbindung Membership

A more radical response by employers associations to dissatisfaction and flight has been to offer a whole new form of affiliation called membership "without collective bargaining ties" (in German, *ohne Tarifbindung*, or OT). OT members are not involved in the collective bargaining activities of their employers association but may avail themselves of the association's legal, lobbying, and personnel services. OT members are not obliged to pay the wages and benefits spelled out in the regional collective agreement of their employers association. Unlike full members, however, OT members are not shielded from union efforts to obtain a house collective agreement directly from them, which could include a strike. OT members typically pay lower dues but are not eligible to collect strike insurance from an employers association.

OT membership is widespread in the metals, plastics, textiles, and wood-working industries. It is particularly popular among small firms. Slightly more than one quarter of the member firms in the metalworking industry have an OT membership. These firms employ one tenth of the workers in the sector. Fully one third of the 1,500 firms in textile employers associations are OT members. In Eastern Germany, a majority of the members in many regional employers associations have OT status (Hauschild, 2006).

OT membership accomplishes several objectives for employers associations. It provides an alternative to quitting an employers association for disgruntled members, particularly those firms upset by the results of a specific collective agreement or fearful of an upcoming bargaining round. OT membership permits the employers-association officials to stay in touch with the managers of firms that otherwise would have left altogether and to continue to collect at least some dues from them. The existence of the OT option also gives employers associations more leverage in collective negotiations,

because they can argue that a costly settlement will lead more firms to switch to OT membership.

On the other hand, OT membership is not without its risks for employers associations. Offering OT membership could prompt many current full members to switch, which could cause a financial crisis (because full dues are significantly higher) and even undermine the viability of regional collective agreements. The provision of OT services in addition to the regular ones and the complexities of managing two types of memberships would also increase costs. Moreover, if a majority of the membership in terms of employment in an individual German employers association changed their affiliations to the OT variety, many privileges and protections provided to employers associations under German law would fall away. The association could lose its tax-exempt status, because the primary activity of the association would be a profit-making venture—namely, personnel consulting rather than collective bargaining.

Employers associations are nonetheless attracted to this new form of organization, because it may be the key to their survival in a bifurcated economic environment. Regional affiliates of metal industry employers associations in Baden-Württemberg, Hesse, and Eastern Germany pioneered OT membership in the late 1990s as an alternative to full membership. They did so with reluctance and even embarrassment. For decades, the principal task of employers associations has been negotiating regionwide collective bargaining contracts. The resort to OT membership could be perceived as an admission of failure. The employers associations in the textile and woodworking sectors were the first to permit OT memberships. Small employers comprise a much larger share of the membership in these sectors. As a result, recruitment and retention of members has always been more challenging. The intensification of transnational competition since the 1970s took a heavy toll on membership in the two sectors. Desperate officials in the two associations relented and decided to permit OT membership (Schroeder, 1999).

Initially, the peak confederation in the metalworking sector, Gesamtmetall, also reluctantly tolerated OT membership arrangements among its regional affiliates, primarily because it was not in a strong enough position to mete out effective discipline to stop it. This changed in 2005 when Gesamtmetall's leadership decided to fully embrace OT membership. In March of that year, Gesamtmetall picked a 39-year-old lawyer who had been chief of personnel at the Knorr brake company by the name of Eva Maria Kunstmann to become the new director-general of the organization. A month later, Gesamtmetall explicitly sanctioned OT membership as an alternative to the traditional form. Gesamtmetall adopted a new mission statement announcing

this transformation explicitly as its first point. At the top of Gesamtmetall's Web page, it currently reads "The Peak Association for Enterprises bound and unbound by collective bargaining."

It remains to be seen whether a tipping point exists at which a flight out of full membership undermines the viability of the regionwide collective agreements that cover full members in German employers associations. It is far from certain that employers associations would survive if bargaining shifted to the company level because the main reason most individual firms have traditionally joined an employers association—the provision of collective security in industrial disputes—would disappear. None of these measures has so far stopped the slide of German employers associations. They nonetheless represent a reconstruction of German capitalism that has implications for how we understand the political economy of high-income countries.

Implications of Findings for VoC Literature

The results of this research also have implications for the VoC literature. The VoC school emphasizes the differences in national models of capitalism but ironically underplays heterogeneity within individual countries (e.g., Hall & Soskice, 2001). Recent developments in the German case show increasing fragmentation between manufacturers and suppliers. German manufacturers have been able to retain much of the so-called German model. They have only been able to do so, however, by forcing parts suppliers to abandon large pieces of it. Similar gulfs have opened up within the German economy between services and manufacturing and between the public and private sectors, resulting in variety within the VoC. The coordination of capitalism reached unprecedented levels in some sectors, such as the chemical industry, whereas it has broken down in others, such as construction, depending on economic conditions and political economic dynamics within individual sectors. Other industries, such as metalworking, have divides within the sector itself.

This increasing heterogeneity in production strategies and labor practices makes the task of interest groups exceedingly problematic, because it has become increasingly difficult to find a common denominator among members. Some, such as Gesamtmetall and the employers associations in the textile and woodworking industries, are experimenting with two-tiered memberships to remain attractive both to firms producing within the confines of the traditional German coordinated market economy and to those

that are experimenting with a more liberal approach. It remains too soon to tell whether two-tiered membership (or any other approach) will successfully bridge the gaps that have opened up. Increasing heterogeneity also poses a challenge to the VoC scholars, because their theoretical framework identifies distinct homogeneous “production regimes” that are “primarily defined at the national level” as the principal explanation for the rise and persistence of cross-national variation in capitalism (Soskice, 1999, pp. 101-101). Some VoC scholars have even argued that greater transnational economic integration will lead to an intensification rather than a diminution of reliance on a dominant national model, such as “diversified quality production” in Germany (e.g., Soskice, 1999, p. 134). Yet the evidence indicates the contrary.

Conclusion

The conventional wisdom on German employers associations is accurate regarding the virtual abandonment of lockouts and the bifurcated membership trend within German employers associations. Small firms are shirking membership. Large firms are not. The conventional view’s explanation (i.e., trade unions taking advantage of the greater vulnerability of large internationally oriented firms to run up labor costs) finds no evidential support. German wage increases have become increasingly moderate through successive decades. Cost pressures on small firms have been coming from a different source. German multinational enterprises have been increasingly aggressive in shifting costs onto the smaller domestic suppliers to strengthen their position in international markets. Evidence from the metals industry shows that the OEMs’ strategy has worked for them but to the detriment of both the suppliers and the employers associations. German trade unions are neither the motor nor a beneficiary of these developments. These trends have instead weakened organized labor’s collective bargaining clout.

The decision of growing numbers of German employers associations to accept multiple forms of membership, including some that do not include collective bargaining, demonstrates a rise in fragmentation and heterogeneity within the German economy. The VoC school, which relies heavily on distinct national regimes of accumulation to explain the persistence of national models of capitalism, cannot account for the fragmentation. In other words, we are beginning to see increasing variety within national VoC. An explanation for the rise of fragmentation supported by evidence appears to be a fruitful avenue for future research.

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