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The Decreasing Returns of Social Compromise: The Role of Business in the Transformation of the German Welfare State

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Abstract

Inspired by the 'Varieties of Capitalism' (VoC) approach, recent studies challenged the conventional understanding of business as opposed to labour-friendly social policies. This paper analyses changes in employer support for social policy using Germany as a crucial case. The paper finds that employers came to support labour-friendly social policies in the post-war period, in line with predictions by the VoC literature. From the 1990s onwards, though, employers became protagonists of institutional change, rather than stability, a finding that contrasts with expectations in the VoC literature. The paper develops the argument that decreasing returns and negative feedback effects of existing institutional practices explain the erosion of employer support. This suggests that business adaptation to institutional constraints does not necessarily result in a sustainable institutional equilibrium, but may, to the contrary, produce negative feedback effects in other areas that erode business support.

The role of employer interests in explaining institutional stability and change in collective bargaining and welfare state institutions has become a key theme in political economy in recent years. Do interests by employers in the continuation of existing institutional settings help to explain their stability in a period of globalisation? Inspired by the 'Varieties of Capitalism' (VoC) approach by Hall and Soskice,[i] some studies suggest yes.[ii] These studies suggest that the stability of collective bargaining and welfare state institutions in 'coordinated market economies' rests in part on employer interests in their survival. According to this argument, the collective bargaining and welfare state institutions characteristic of 'coordinated market economies' provide competitive advantages to the predominant types of firms. Firms build their production strategies around these institutions and, thereby, become dependent on them. This, in turn, provides firms with an interest in the survival of these institutions. This raises the question: To what extent do dominant business interest groups in 'coordinated market economies' today oppose attempts by governments or other actors to liberalise labour markets and retrench welfare state programs?

This paper addresses this question through a detailed examination of the German case. The paper focuses on attitudes by German business federations towards two sets of institutions: collective bargaining and welfare state programs. These two sets of institutions belong to the core of what in political economy is known as the German model of capitalism.[iii] The paper chooses Germany as a *crucial case* because this country is a paradigm case of a 'coordinated market economy', a type of economy that is characterised by institutional complementarities that benefit predominant types of firms, in particular firms that rely on high-skill/high-quality production.[iv] According to the VoC approach, welfare state and collective bargaining institutions are part of a wider regulatory regime that firms in coordinated market economies

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benefit from. Among the benefits the VoC literature ascribes to collective bargaining and welfare state institutions are workforce collaboration, social peace and investments in industry-specific skills.[v] As Hall and Soskice argue, business in coordinated market economies like Germany should thus oppose deregulatory reforms that undermine these competitive advantages.[vi] Germany constitutes a crucial case for this theoretical debate, because it is a case where we can expect business to be most likely to oppose reforms deregulating labour markets and social protection.

In contrast to these expectations in the VoC literature, some studies have identified an erosion of employer support for collective bargaining and welfare state institutions. Daniel Kinderman for instance has found that 'German employers desire deregulation and liberalisation — a move towards a Liberal Market Economy.'[vii] In a similar way, Georg Menz has found that German employers during the 1990s have 'lost faith in the Rhineland model.'[viii] Menz shows that employers started to take more bellicose stances, pushing for liberalising policy reforms and a decentralisation of collective bargaining functions. Menz identifies employers as a driving force behind a turn in public discourse to market liberalisation. Business campaigns intended 'to de-legitimise the post-war consensus, questioning labour market regulation, the scope of the welfare state, and tax levels in light of the purported need to render the country an attractive site for investment and production.'[ix] In a similar way, Damian Raess finds that German firms became transformative actors. Raess argues that 'large firms [decided to] withdraw their long-held support to the system of industry-wide collective agreements.'[x]

While these studies provide evidence for a turn by employers towards market liberalisation, we still know little *why* this shift occurred. This paper intends to contribute to the debate about the role of employer interests in welfare state reform by offering a new explanation that links the erosion of employer support for institutions of social compromise to negative feedback effects produced by these institutions. The purpose of the paper is twofold: First, the paper documents changes in the policy positions of German employers since the early 1990s. The paper provides evidence that there has been an erosion of employer support for welfare state institutions and bargaining institutions in some respects, but not in others.

Second, the paper relates this partial erosion to negative feedback effects generated by the German welfare state, most importantly, the rise in non-wage labour costs. The paper shows that the erosion of employer support for welfare state institutions is motivated by rises in non-wage labour costs. Attacks by the employer federation (BDA) focused on those aspects of the German welfare model that contributed most to higher non-wage labour costs, in particular social insurance. Reform demands by the employer federation focused on cutting non-wage labour costs, while maintaining the basic institutional framework. At the same time, employers continue to accept institutions that do not raise labour costs, like the works councils. As the rise in non-wage labour costs is partly the result of employers own past institutional practices - like practices of labour shedding backed by social policy - the erosion of employer support for social policy is thus largely an endogenous process.

The structure of the paper is as follows: The paper first presents the theoretical argument in more detail. Subsequent sections analyse changes in employer attitudes towards practices of consensual policy-making, towards welfare state institutions, and towards bargaining institutions. Part five discusses the reasons for employers' turn toward market liberalisation. A final section concludes.

THEORY: NEGATIVE FEEDBACK EFFECTS AND EMPLOYER SUPPORT FOR LIBERALISATION

The erosion of employer support for collective bargaining and welfare state institutions results from negative feedback effects of employers' own past institutional practices. The negative feedback effects of the so-called Bismarckian welfare state model on non-wage labour costs are well documented in the literature on welfare state reform: In a context of rising unemployment, countries with a Bismarckian welfare model did in the past often use social policy to reduce labour supply. Relying on payroll taxes, these welfare states generated ever higher non-wage labour costs, which, in turn, had negative effects on levels of employment.[xi] Employers played an important role in this development: By using social policy, many firms managed to shed labour peacefully, while, at the same time, they could externalise the costs of this practice to the economy at large. In particular large firms practiced this strategy of labour shedding-cum-social pacification, using, for instance, various options for early retirement to reduce and restructure their workforce.

Building on this insight, some have argued that predominant types of employers in Bismarckian welfare states will defend social policies that facilitate labour shedding. [xii] According to this argument, employer interests in Bismarckian welfare states are thus an obstacle to cost-cutting reforms. Isabela Mares, for instance, has argued that, in the early stages of policy development, 'individual firms were the primary driving force in the development of early retirement.'[xiii] The evidence presented in this paper shows that in the case of Germany this argument holds for the post-war period up to the 1980s. From the 1990s onward, however, employer associations became increasingly critical of generous social policy.[xiv] In short, employers today act as forces of institutional change, rather than stability.

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This change in employer positions results, in part, from the negative feedback effects of employers' own past practices of labour shedding-cum-social pacification, which made it increasingly difficult for them to externalise costs to the state. For a while, employers supported a policy of welfare expansion because it allowed them to externalise the costs of peaceful labour shedding to the state. In the longer run though, the secular rise in non-wage labour costs associated with the strategy of labour shedding-cum-social pacification meant that these costs had to be borne by employers themselves. While large firms were the main practitioners of labour shedding-cum-social pacification, the costs of these practices had to be borne by the business community at large. In particular small firms, which are less able to use social policy to facilitate peaceful labour shedding, began to demand a policy shift. As a result, support by employer associations for costly bargaining and welfare state institutions eroded. Employers' turn towards market liberalisation and welfare cutbacks in the 1990s is thus to a considerable extent a response to endogenously created problems.

The paper builds on the concepts of positive and negative feedback effects, developed in the historical-institutionalist literature, to theorise this development.[xv] Building on the role of positive feedback effects, the VoC-inspired literature on employer preferences emphasises the role of employers as a source of institutional stability, rather than change.[xvi] These positive feedback effects are the result of adjustment by individual firms to institutional constraints: Having adjusted successfully to institutional constraints, firms will come to depend on their continuation, as their production strategies rely on these constraints.[xvii] However, as Hermann Schwartz,[xviii] Wolfgang Streeck,[xix] Christine Trampusch,[xx], Kent Weaver,[xxi] and others have argued negative feedback effects and decreasing returns may be of equal importance in politics. Following these studies, I argue in this paper that the erosion of employer support for collective bargaining and welfare state institutions results from shifts in the balance between positive and negative feedback effects. In the post-war period institutional practices helped firms to secure social peace (positive feedback effect) and, as a consequence, allowed them to support bargaining and welfare state institutions. From the 1990s onward, though, the concomitant rise in non-wage labour costs (negative feedback effect) that resulted from these practices turns employers into protagonists of market liberalisation. In short, negative feedback effects have come to outweigh positive feedback effects.

By looking at the balance of positive and negative feedback effects, the paper suggests, we can move beyond static conceptions of institutional stability. While positive feedback effects did indeed lead employers in the post-war period to support social policies and bargaining institutions, these same policies and institutional practices did in the longer run create negative consequences for them. As a result, the economic efficiency effects created by these practices did not lead to an institutional equilibrium, but, instead, generated new, unintended, problems that, in the long run, undermined the same institutional setting they supported in the short to medium run.

The conception of employer interests used in this paper is a *multi-dimensional* one. Two interest dimensions shape employer positions towards collective bargaining and welfare state institutions. The first dimension is an interest in social peace and workforce cooperation. Collective bargaining and welfare state institutions support this interest. The second dimension is the labour cost dimension, employers' interest in keeping labour costs low. These two dimensions are often at odds with each other. Institutions that promote social peace often contribute to higher labour costs. How the resulting tensions play out changes over time in response to changes in the balance of positive and negative feedback effects.

Changes in the way employers balance their conflicting interest dimensions are the basis for the observed changes in employer positions. During the post-war period high levels of economic growth and rising labour productivity allowed firms to de-prioritise the labour cost dimension, while at the same time the strength of the labour unions made social peace an important goal. Over time, the secular rise in non-wage labour costs, together with the parallel intensification of international cost competition, raised the salience of the labour costs dimension. At the same time improved possibilities due to globalisation to relocate to lower-cost areas have reduced the pressure on employers to make concessions in turn for social peace. Endogenously created problems did interact with exogenous changes to bring about the erosion of employer support for collective bargaining and welfare state institutions analysed in this paper.

The account of the role of employers in the politics of welfare state and bargaining reforms presented in this paper differs from efficiency-theoretic accounts informed by the VoC approach. These accounts emphasise the role of employer interests in sustaining the institutions characteristic of the German political economy. Referring to institutions for cross-class cooperation, Peter Hall, for instance, argues that '[t]he stance taken by producer groups…explains some of the resilience of VoC….Firms were reluctant to endorse institutional reforms that threatened the viability of corporate strategies in which they had made major investments.'[xxii] In contrast to VoC-inspired accounts, the account presented in this paper suggests that German employer associations became advocates of labour market liberalisation and welfare state retrenchment as the returns of the institutional practices they had relied upon in the past became exhausted.

EMPLOYERS AND SOCIAL COMPROMISE

Starting with the early 1990s, employers began to advocate a gradual liberalisation of labour market and social policy arrangements. Rather than defending existing policies and institutions against liberalising reform initiatives by governments or pro-market parties, they became active protagonists of market liberalisation. Together with the pro-business Free Democrats (FDP), employer associations belong today to the most pro-market actors in Germany. The type of liberalisation employers advocate today is one of gradual reform within existing institutions, rather than a wholesale shift to a liberal market economy or an Anglo-American model. To reduce labour costs, they call for far-reaching welfare cuts and a greater role for private welfare provisions, though without demanding the outright abolition of Bismarckian social insurance programs. They push for decentralisation and flexibilisation within collective agreements and labour law, but without trying to dismantle bargaining institutions and labour market regulations altogether. This means that employers neither defend the existing system against liberalising reform plans by other actors, as VoC-inspired efficiency-theoretical arguments predict, nor do they push for its outright dismantling. Instead, they push for gradual liberalising reforms within the existing institutional setting.

Employers' shift to market liberalisation took place at the collective as well as on the individual level: On the collective level, employer associations make more assertive demands for welfare state retrenchment and labour market liberalisation. These demands are often articulated through public campaigning and the media. On the individual level, a considerable share of firms has left sectoral bargaining, as shown below (Figure 2). As a result, collective bargaining coverage has eroded considerably since the early 1990s.[xxiii] Together, the erosion of bargaining coverage and calls for welfare cutbacks and labour market liberalisation indicate a rising dissatisfaction among firms with the policies that characterise the German model of capitalism.

Parallel to this move towards more liberal policy demands, employer support for consensual forms of policy-making eroded. The Federation of German Industry (BDI), in particular, began to take more confrontational stances. Unlike the national employer federation BDA, the BDI is not constrained by the need to cooperate with unions, and therefore can afford to be more upfront in its stances. Former BDI president Tyll Necker publicly denounced social compromise as an ineffective way of reforming the economy:

> A point has been reached when a politics of compromise at any price can no longer be sustained. The decisive question is not "what will appease the unions" but "what will combat unemployment"…When necessary, one must be prepared for confrontation.[xxiv]

Similarly, Necker's successor as president of the BDI, Hans-Olaf Henkel campaigned in the media for a turn away from social compromise to enable liberalisation:

> The consensus model is yesterday's model. Everywhere in the world people are recognising that the principle of subsidiarity should also apply within the economy. In Eastern Germany firms are violating collective agreements everywhere. Without these violations the situation in the East would be even worse. I consider these violations not as disastrous, but as exemplary… In Germany we have too many Round Tables and too few quick and hard-edged decisions.[xxv]

While the BDI has always taken less accommodating and more radical stances than the BDA, the differences between the two federations are essentially differences in style, rather than differences in policy substance. Their dissatisfaction with consensual politics is motivated by their perception of a lack of progress of liberalising reforms, which they attribute to the consensualism of German politics.

Use of Public Campaigning to Promote Liberalisation

Employers' dissatisfaction with the slow progress of liberalising reforms is also evident in their intensification of public campaigning. During the post-war period, the business federations relied predominantly on participation in corporatist bodies and good contacts to government policy-makers to promote their interests. Public campaigning did, in general, not play an important role. Today, employers do increasingly consider corporatist forms of policy-making as ill-suited to achieve their goals, and turn to public campaigning instead. These campaigns aim primarily at labour market liberalisation and reductions in non-wage labour costs. They build on the so-called *Standortdebatte* ('competitiveness debate') and use this debate to impress the need for welfare retrenchment and labour market liberalisation to the public.

Probably the most prominent and influential of these campaigns is the so-called '*Initiative New Social Market Economy*' (INSM). The INSM was initiated in 1999 by the national employer federation for the metalworking sector, *Gesamtmetall*, which also funds the campaign. The declared goal of the campaign is to shift public opinion in favour of market-liberalisation.[xxvi] The supervisory board of the campaign is dominated by representatives of *Gesamtmetall* and other business associations.[xxvii] Despite its dependence on business funding, it presents itself to the public as an independent, non-partisan and experts-based organisation.

Its messages focus on the need for market-oriented reforms. The initiative's understanding of the 'social market economy' is inspired by the thinking of ordo-liberals of the post-war period,[xxviii] in particular by the former CDU Minister of Economics *Ludwig Erhard* (1949-1963).[xxix] The core doctrine of this school of thought is that free market competition is the best way to achieve social justice. State regulation is needed, but should serve to enable and promote free market competition, not to constrain it.[xxx] Although the social market economy has since remained a vaguely defined concept, meaning very different things to different people, it has become akin to a foundational myth for the post-war political-economic order and is frequently evoked in political discourse.[xxxi] The INSM links its campaign to the favourable

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normative connotations that this concept enjoys in public discourse, even though the campaign is pushing for a more market liberal type of economy.

Gesamtmetall's sponsoring of INSM indicates an intensified dissatisfaction among its members with the existing system of political-economic regulation. The decision to found INSM was made after opinion polls had shown that large parts of the population supported a generous welfare state and opposed market-oriented reforms.[xxxii] *Gesamtmetall* mandated INSM to conduct public campaigns with a view to produce a long-term change in public opinion in favour of market-oriented reforms.[xxxiii] Even though the policy statements of INSM often remain vague, their general orientation is clear: reducing the size of the welfare state, cutting payroll and other taxes, and liberalising economic regulations. In short, employers' turn to public campaigning for market-oriented reforms indicates that they have become protagonists of institutional change, rather than defenders of the existing institutional setting against reform plans by neo-liberal governments or parties.

EMPLOYERS AND WELFARE STATE REFORM

In the field of welfare state politics, the containment of social expenditures, and thus labour costs, became the paramount priority of employers in the 1990s. In response to de-industrialisation in East Germany after unification, governments greatly extended the usage of social programs to deal with mass lay-offs. Unemployment insurance and early retirement, in particular, were used on a massive scale to cushion the effects of economic restructuring in East Germany.[xxxiv] In addition, the government widely applied active labour market policy measures, like job creation programs, in the initial years after unificiation. In 1992, social expenditures in the East amounted to 66 per cent of its GDP.[xxxv] In short, large-scale financial transfers from the West to the East were used to cushion the social consequences of economic transformation. Thereby, the policy of labour shedding-cum-social pacification, developed in West Germany in the mid-1970s, became extended to the East. In addition to greater numbers of benefit recipients also in the West, this contributed to a sustained rise in non-wage labour costs (see Table 1 below).

[TABLE 1 ABOUT HERE]

In response, reducing non-wage labour costs became the paramount political concern of business during the 1990s. Under pressure from international cost competition and rising labour costs at home, they became increasingly vocal in pushing for cost containment and benefit cuts. Policy statements by business representatives in the media as well as reform proposals by the business federations became single-mindedly focused on the goal of cost reductions, as shown in more detail below.[xxxvi] They demanded, inter alia, substantial cuts in benefit levels, lower payroll taxes, a lowering of business taxes, and a greater role for private welfare. Associations representing small- and medium sized firms were particularly vocal in pushing for reforms. On February 10th, 2003, the German Confederation of Skilled Crafts (*Zentralverband deutsches Handwerk,* ZDH) organised countrywide rallies against government policies, the first major political rally by businesspeople in the Federal Republic. About 10,000 businesspeople attended the rally in Berlin, about 14,000 in Munich. Participants' main demands were lower taxes, lower payroll taxes and less bureaucracy.[xxxvii] In short, the high level of non-wage labour costs has become one of the most salient political issues for employers today. This holds in particular, but not only, for small- and medium-sized firms.

Surveys data of individual business executives confirms the finding of business discontent with high non-wage labour costs. A survey conducted by the *Handelsblatt* newspaper in 2005 (n=845) found that business executives consider the reduction of non-wage labour costs as their top political priority, followed by liberalisation of dismissal protection. Small minorities only consider workforce skills and wage levels as issues of political priority[xxxviii] (see Figure 1 below). Another survey conducted by the same newspaper two years earlier provided similar results: Again, reduction of non-wage labour costs was the item mentioned most frequently (66 per cent), followed by liberalisation of dismissal protection (43 per cent).[xxxix] Another survey, conducted in 2005 among medium-sized firms by *manager magazin*, found that 82 per cent of executives consider the level of non-wage labour costs as having a negative impact on the performance of their firm. Non-wage labour costs was among the most frequently mentioned items in this survey, together with taxation (82 per cent), bureaucracy (84 per cent) and pricing pressure (93 per cent).[xl] In short, survey data for both, small and large firms, confirm that the rise in non-wage labour costs has become a major concern for business.

[FIGURE 1 ABOUT HERE]

The views by individual business executives are reflected in changing policy positions by the national employer federation (BDA). Its changing positions toward early retirement are a case in point. While the BDA supported various forms of early retirement in the past,[xli] it is now campaigning against them.[xlii] In 2008, for instance, BDA president Dieter Hundt, responded to SPD proposals for extending certain early retirement provisions by saying that:

> We can no longer continue to push out of their jobs healthy employees in their prime. … Every Euro that is used for meaningless early retirement reduces the scope for wage increases and reductions in payroll taxes.[xliii]

This position is in marked contrast to earlier employer support for early retirement schemes. The BDA, dominated by large firms, had endorsed early retirement schemes in the 1980s and up to the mid-1990s.[xliv] In 1984, for instance, BDA executive director Ernst-Gerhard Erdmann argued that early retirement schemes would be justified, even if only as a temporary measure, to improve the job chances of younger workers. [xlv] Even as late as 1995, the BDA was critical of government initiatives to restrict access to certain early retirement schemes, arguing that such restrictions would lead to union resistance against lay-offs.[xlvi] Under pressure from smaller firms, who make less use of early retirement, the BDA eventually conducted an about-turn.

The change in employer positions is visible also in many policy manifestos published by the BDA from the mid-1990s onwards. These documents are single-mindedly aimed at reducing welfare state expenditures.[xlvii] Employer proposals do not entail a full-sale switch to a residual or liberal type of welfare state, though. Instead, they aim at a substantially down-sized and less redistributive version of a Bismarckian welfare system. Social insurance programs should remain financed primarily by payroll taxes, benefits should remain earnings-related and programs should continue to be administrated by the social partners. Yet, benefit levels should be substantially lower than today. Employer associations want to achieve far-reaching cost reductions within the framework of the Bismarckian welfare state, that is, without radical changes to the formal institutional framework.

To take an example, in 1998, the BDA published a social policy manifesto, entitled '*Social Policy for more Competitiveness and Employment.*'[xlviii] There, the BDA demanded that the ambitions of the welfare state should be reduced from providing income maintenance benefits (*Lebensstandardsicherung*) to providing only a minimum level of protection (*Basissicherung*), to reduce non-wage labour costs.[xlix] Moreover, the BDA demanded deregulation in labour law and in collective agreements.[l] Wage bargaining functions should be decentralised, with more scope given to bargaining at the plant level, with greater differentiation of wages to allow the growth of a low wage sector, and with sectoral agreements being transformed into 'framework agreements', which define minimum standards, rather than actual conditions.[li]

Subsequent manifestos, entitled *Promoting Growth and Employment*[lii] and *Principles for a Reorientation of Social Insurance,*[liii] again emphasised cost-cutting welfare reforms to maintain international competitiveness. This time, a shift in the financing of health care and long-term care insurance away from payroll taxes is also advocated, unlike in the previous manifestos.[liv] Financing of these two programs should be changed to earnings-independent insurance premiums paid by the individual. Moreover, health care and long-term care insurance should provide only primary services, patient co-payments should be extended and market mechanisms of governance should be strengthened.[lv] The principle of mandatory coverage in social insurance should be maintained, though, to avoid adverse selection problems.[lvi] Redistributive elements within the social insurance system should be systematically eliminated.[lvii] In pensions and unemployment insurance, benefits should be made more strictly earnings-related (actuarial) to maintain work incentives.[lviii] The duration of unemployment insurance benefits should be shortened further.[lix]

Notably, positive effects of social policies on economic competitiveness are not mentioned in these BDA policy manifestos. In contrast to what VoC-inspired efficiency-theoretic models predict, the BDA argues that high non-wage labour costs, caused by high levels of social spending, have a *negative* effect on work incentives because high non-wage labour costs reduce the relative net salary of employees, and thereby make it less attractive to work and to invest in skills.[lx]

EMPLOYERS AND INDUSTRIAL RELATIONS INSTITUTIONS

Parallel to the erosion of employer support for social policy programs, employers became also increasingly dissatisfied with bargaining institutions. While firms need to put up with non-wage labour costs, they can reduce their wage costs by leaving sectoral bargaining institutions. This is what many firms, in particular smaller ones, did. Coverage of firms by sectoral bargaining institutions declined considerably since the early 1990s. In 2006, 57 per cent of all West German workers, working in 37 per cent of all West German plants, were still covered by sectoral collective agreements. This equals a decline of about 15 per cent compared to the mid-1990s (see Figure 2 below). Coverage by works councils declined as well, although less dramatically. According to a study by Ellgut, coverage by works councils in the West declined from 50 per cent in 1996 to 46 per cent in 2005.[lxi]

[FIGURE 2 ABOUT HERE]

The erosion of employer support for collective bargaining institutions indicates a historical turning point. During the post-war period employers came to value bargaining institutions for their contribution to social peace. They abandoned their earlier reservation towards cooperation with unions, characteristic for the Wilhelmine Empire and the Weimar period, and came to genuinely support institutions collective bargaining and works councils. Since the 1990s, however, a rising share of firms has left sectoral bargaining. The turn against collective bargaining today is rooted not in hostility towards unions, as in the Nineteenth century. It is rooted instead in dissatisfaction with the economic outcomes produced by the existing bargaining institutions, in particular high and rigid labour costs and working time regulations. Collective bargaining helped employers to secure social peace and cooperative workforce relations, but at the same time raised labour costs and regulated working conditions to an extent that an increasing number of firms today consider unbearable.

Exit from sectoral bargaining is widespread in particular among smaller firms. Smaller firms tend to face stiffer competitive conditions than large firms. This is partly because they often are suppliers to larger manufacturers. The manufacturers pass on cost pressures to their suppliers, while suppliers are unable to pass on pressure further. Being covered by the same sectoral wage agreements as the large manufacturers, small suppliers face increasing difficulties in complying with agreements.[lxii] Smaller firms are thus those who perceive sectoral agreements as most burdensome. They tend to abandon sectoral bargaining, while larger firms prefer to reform the bargaining system instead of dismantling it. Their better competitive position and better capacities to make use of decentralised and flexibilised arrangements, combined with higher union strength in their firms, allows large firms to continue to prioritise social peace over cost reductions.[lxiii] Smaller firms in contrast tend to prioritise labour cost reductions over social peace, also because union strength and strike risks are often lower among smaller firms.

Employer associations have responded to member exit from sectoral bargaining institutions in two ways: First, by creating opt-out possibilities for their members, and second by aiming to transform sectoral agreements into so called framework agreements. First, associations allowed dissatisfied members to opt-out from bargaining coverage by establishing new categories of membership (so called OT memberships). In metalworking, the largest industrial sector, about one quarter of all organised firms opted out from bargaining. These firms employ about 10 per cent of all employees.[lxiv] In effect, these opt-out options mean that employer associations had to accept the erosion of sectoral bargaining institutions, even though this undermines their own role as bargaining partners.[lxv] Some associations in Eastern Germany even actively encouraged their members to opt out from bargaining institutions. The president of the Association of Saxon Metal Employers (VSME), Bodo Finger, for instance, declared in 2007 that '[a]bout 93 per cent of our firms live in a world without sectoral collective agreements and are very successful by doing so, as the growth in turnover, exports and jobs proves.'[lxvi] In general, though, employer associations were forced to accept a decline in bargaining coverage, rather than having actively promoted it.

Second, employer associations aim to transform sectoral agreements into so called framework agreements. These are agreements that set guidelines for plant-level negotiations, rather than directly determining wages and working conditions. This approach appears to be in line with the preferences of a large share of their members. According to a Handelsblatt survey, 19 per cent of all business executives want sectoral bargaining to be abolished and to be fully replaced by plant-level bargaining. The vast majority though, 72 per cent, want sectoral agreements to be transformed into framework agreements. 8 per cent only want the bargaining system to remain as it is. Dissatisfaction is particularly widespread in those sectors that long belonged to the core of the German model of industrial relations. In metalworking and electric engineering, 26 per cent of all firms want sectoral wage agreements to be abolished, compared to the 19 per cent on average.[lxvii] This indicates that pressures for change are not coming merely from the margins of the economy, but from core sectors instead. In short, the data show that employers neither want to dismantle sectoral bargaining, nor do they defend it against liberalising challenges. Instead, they promote its liberalisation within the existing formal institutional framework. They want sectoral agreements to become framework agreements setting broad parameters for plant-level bargaining.

A forerunner to framework agreements was the introduction of so called hardship clauses that spread throughout the economy in the 1990s. About one third of all covered firms make use of such locally bargained deviations from sectoral agreements.[lxviii] These clauses allow local management and works councils to negotiate deviations from sectoral agreements.

Often, such local deviations were exchanged for job or investment guarantees by management.[lxix] Concessions by the local workforce typically concerned issues of working time flexibility, lower compensation for overtime work, or temporary undercutting of sectoral wage standards.[lxx] The fact that employers today call for the general usage of framework agreements shows that decentralisation is not anymore seen as an emergency measure limited to firms that face exceptional difficulties. Instead, hardship clauses appear to have been a step towards a general transformation of the bargaining system. In effect, these decentralising steps amount to substantial liberalisation. Decentralised bargaining is more subject to market forces than nationally coordinated bargaining, because the threat of relocation of production is greater at the firm level than at the national level, thus exposing labour to greater market pressures.

In short, pressure from members led employer associations to push for a liberalisation of the existing bargaining framework. They do not defend the existing system against liberalising changes, nor do they push for its outright dismantling. Instead, they aim at liberalisation within existing institutions. The erosion of employer support for bargaining institutions parallels developments in welfare state politics, where employer support for generous social programs eroded during the 1990s. In both fields, employers turned into protagonists of a gradual, but none the less transformative, change into a more liberal direction.

DISCUSSION: WHAT EXPLAINS EMPLOYERS TURN TO LIBERALISATION?

The erosion of support for collective bargaining and welfare state institutions indicates that employers today are protagonists of liberalisation, meaning a shift of the German labour market and welfare state model into a liberal direction. Employers do not want to abolish labour market and welfare state institutions; they aim for a gradual, but nevertheless far-reaching, liberalisation of existing policies and institutions. This position - neither outright opposition to nor defence of the status quo but instead liberalisation – results from a complex interaction of conflicting interest dimensions, as well as adjustments to political constraints.

Collective bargaining and welfare state institutions create benefits as well as costs for employers. On the benefit side, they contribute to workforce cooperation and facilitate peaceful labour shedding. On the cost side, they raise labour costs. The balance between these two sides is not static, it changes over time. It changes because of positive and negative feedback effects. Positive feedback effects result from firms adjusting their human resource strategies to the institutional environment. In the post-war period firms learned to make use of social policies to facilitate restructuring by way of a strategy of labour shedding-cum-social pacification. They used provisions in collective agreements and social policies, like early retirement and long-term unemployment benefits, to facilitate peaceful labour shedding.

In the short run, this strategy of labour shedding-cum social pacification shored up employer support for social policy. In the longer run, though, this practice turned out as a mixed blessing for business. The secular rise in non-wage labour costs became its Achilles' heel. This rise eventually resulted in a paradigm change regarding the way employers perceive their own interests. This change is visible in both areas analysed in this paper: social policy and industrial relations. Under the pressure from discontent members, employer associations abandoned their tacit consent to generous social protection. From the 1990s onward, employer associations greatly intensified their public campaigning for welfare retrenchment, evident in campaigns such as the pro-market INSM. In industrial relations, a considerable number of firms, mostly smaller ones, responded to rising labour costs by leaving sectoral bargaining institutions, as this is one of the few ways available to firms to reduce their labour costs. To deal with member defections, employer associations were forced to introduce opt-out possibilities and transform sectoral agreements into so called framework agreements, even though this clearly undermined their own role in the regulation of labour markets.

Discontent with social policies and bargaining institutions is particularly strong, but not limited to, small and medium-sized firms. For various reasons, smaller firms were less capable to make use of labour shedding-cum-social pacification strategies than large firms. One reason for this is that they could not afford the co-payments necessary to use certain social programs. Therefore they are also less willing to bear the costs of these programs, which are borne by all firms through higher payroll taxes. However, as the survey results presented show discontent with high labour costs and bargaining institutions is not limited to small firms. The BDA, dominated by large firms, also turned towards welfare retrenchment in the 1990s. While in the past the BDA had endorsed early retirement, for instance, it is today campaigning for a closure of early retirement pathways, despite the fact that its larger members had made extensive use of such provisions in the past. The funding of the pro-market INSM campaign by the employer federation of the metalworking sector (*Gesamtmetall*), long considered the core of the German model, also indicates that discontent goes far beyond small firms or peripheral sectors.

CONCLUSIONS

On balance, employers today are forces of change in welfare state politics, rather than stability. Employers' turn to market liberalisation resulted from negative feedback effects of existing institutional practices of social compromise and social pacification. These negative feedback effects take the form of a sustained rise in labour costs. This development is part of what Streeck has called the *self-undermining of the institutions* of the German political economy.[lxxi] Institutional practices that initially shored up employer support for social policy programs and bargaining institutions over time came to erode employer support, due to their unintended and unforeseen effects on labour costs. The self-interested usage of bargaining and welfare state institutions by firms did in the long run not lead to a political equilibrium of cross-class consensus. Instead, the problems it created led to a liberalising counter-movement.

The argument presented in this paper points us also to the need to move beyond a dichotomous understanding of bargaining and welfare state institutions in coordinated market economies as being either an asset or a burden to business. They are both. Yet, the balance between the two has changed over time, as the effects of institutional practices on firms change over time. This explains why employers today do not advocate the outright dismantling of bargaining and welfare state institutions, but their liberalisation. The positive feedback effects continue to exist, bargaining and welfare state institutions continue to contribute to social peace. Employers do not want to sacrifice that. However, the importance of these benefits has declined relative to their costs.

While VoC-inspired accounts of employer interests are right that firms in a coordinated market economy like Germany derive benefits from bargaining and welfare state institutions, these same institutional practices also come with costs to business. The findings in this paper suggest that the capacity of firms to use social policy and bargaining institutions as a resource in solving problems of personnel management did not result in sustained business support, but did instead create new and unforeseen problems for firms in other areas, in particular in terms of labour costs, that undermined institutional stability. These unintended and unforeseen problems did in the long run also undermine the very cross-class basis of support that these practices of social compromise could temporarily rely upon. The result is an increasingly fragile social compromise, and a need for re-negotiation.

Contrary to efficiency-theoretic accounts that see business interests in coordinated market economies as a source of institutional stability, this paper contends that economic benefits to firms cannot serve as the primary component of an explanation of the stability of CME-type social policies and industrial relations institutions. Existing efficiency-theoretic accounts of employer preferences, while pointing rightly to the benefits of cross-class cooperation to employers, tend to neglect the negative feedback effects that undermine social policy-backed forms of cross-class cooperation. Integrating positive and negative feedback effects of institutional arrangements in a dynamic way allows us to better understand the tensions and balancing acts that will inform also the political compromises upon which the future sustainability of non-liberal types of economic institutions rests.

NOTES

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