

Business and the development of job security regulations: the case of Germany

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This article examines the role of business in the historical development of job security regulations in Germany from their creation in the inter-war period to the dawn of the crisis of the 'German Model' in the 1990s. It contrasts a *varieties of capitalism perspective*, which views business as a protagonist, or at the very least a consenter, in the development of job security regulations, with a *conflict-oriented perspective*, which has the labour movement as the protagonist and business as an antagonist in the development of job security regulations. The empirical analysis is based on primary and secondary sources and shows that German employers have never favoured strict over flexible job security regulations. Quite the contrary, high levels of job security regulations were forced upon employers during periods of business weakness by a radicalized labour movement in the aftermath of both World Wars.

Keywords: labor law, job security regulations, Germany, institutional change, varieties of capitalism, power resources, industrial relations

JEL classification: K31 law and economics: labor law, N34 economic history: labor and consumers, welfare etc., N44 economic history: government, law, regulation etc

1. Introduction

This article examines the role of business in the historical development of job security regulations (JSRs) in Germany since the First World War (WWI). JSRs are understood as restrictions placed on the ability of employers to use labour (Addison and Teixeira, 2003, p. 85). More precisely, we define JSRs as numerical flexibility which denotes the managerial capacity to dismiss employees to allow for downsizing, or to replace workers and use new forms of employment—such as temporary work—when hiring new

workers (Regini, 2000, p. 16). The focus on numerical flexibility, rather than other forms of flexibility, is due to the prominence of hiring and firing restrictions in the current reform discussions. As argued by Blanchard and Tirole (2003, p. 2), there is no labour market institution more controversial than the laws and regulations governing dismissals.

JSRs have an odd place in the literature. On the one hand, they have been blamed for the inferior labour market performance of Continental European countries (Blanchard and Wolfers, 2000) and accused of benefiting labour market insiders, whilst hurting the weakest in the labour market (Lindbeck and Snower, 1988). On the other hand, they are identified as essential forms of social protection, especially in Continental Europe (Bonoli, 2003), and are said to provide incentives to workers to invest in skills (Estevez-Abe *et al.*, 2001) and to positively influence worker morale and cooperation (Streeck, 1991). The latter two characteristics are of particular importance, as they imply that employers might have cause to support JSRs.

The varieties of capitalism (VoC) literature in particular has argued that business may benefit from welfare state and labour market institutions such as JSRs and unemployment insurance (Estevez-Abe *et al.*, 2001; Wood, 2001a; Mares, 2003). It is argued that employers might start considering certain institutions beneficial, as they help fortify high-skill economies. For example, Mares (2003) analyses the role of business in the historical development of unemployment insurance in France and Germany and shows that rather than opposing the introduction and expansion of unemployment insurance, employers played a central and supportive role in welfare state development. In a similar vein, Wood (2001a, p. 378; 2001b, pp. 251–253) argues that business in coordinated market economies supports JSRs.

In this article we add to the literature by analysing the role of business in the historical development of JSRs in Germany. We focus on Germany for two reasons. First, the VoC literature has identified JSRs as one of the most central labour market institutions of coordinated market economies (Crouch *et al.*, 1999, pp. 32–34; Estevez-Abe *et al.*, 2001, p. 150; Wood, 2001a, p. 378; Kitschelt, 2006, p. 414). To our knowledge, however, only Emmenegger (2010a–c) has examined the role of business in the historical development of JSRs. So although JSRs are at the centre of the VoC approach, we still know very little about their historical development. Second, existing research has yet to provide any support to the claims raised by the VoC literature. Based on case studies of the historical development of JSRs in Denmark, Italy, Sweden and Switzerland, Emmenegger (2010b, c) and Bonoli and Emmenegger (2010) conclude that high levels of JSRs are not the result of business interests but are forced upon employers by radicalized labour movements. However, the case studies fail to include

Germany, where business support for JSRs can most likely be expected.¹ Thus, if business is sometimes indeed a protagonist, or at least a consenter (Korpi, 2006), in JSRs development, we should be able to observe it in Germany.

This article provides the first detailed description of the historical development of JSRs in Germany. We demonstrate that German business has never played a pro-active role in the expansion of JSRs and that the regulations have become more restrictive each time the German labour movement has faced enfeebled employers, who had to consent to more restrictions in order to avoid far worse alternatives. Thus, the German case does not lend any support to claims raised by parts of the VoC literature that business in coordinated market economies supports the development of JSRs.

The article is structured as follows. We first review the literature on business interest in JSRs. Subsequently, we discuss the milestones in the historical development of JSRs in Germany. In part 4 we provide a detailed case study of the role of German business, with a particular focus on the role of export-oriented, skill-intensive manufacturers and their associations, during the most important reforms of JSRs. The final section concludes.

2. Business and job security regulations

Following Korpi (2006, p. 182), we distinguish between three different theoretical perspectives to discuss employers' preferences for JSRs. First, employer-centred, intelligent design perspectives expect employers to be protagonists in the development of JSRs. Second, evolutionary approaches highlight how employers adapt their strategies and preferences after JSRs are in place and how employers become involved in the subsequent stages of policy-making (consenters in Korpi's terminology). Finally, power-oriented approaches argue that political constraints have forced employers to accept JSRs and that despite the existence of wide-ranging JSRs, employers continue to oppose further expansion (antagonists).

Intelligent design approaches stress the functional role of JSRs in different VoC. In these approaches JSRs play a particularly important role in systems of skill provision. Coordinated market economies, such as those found in Germany, need a work force with both firm- and industry-specific skills in diversified quality production (Estevez-Abe *et al.*, 2001, p. 149). However, specific skills are a risky investment for workers because these skills are often not transferable to new jobs. Thus, workers are often reluctant to invest in specific skills

¹Italy is not a coordinated market economy. Job security regulations are often considered to be more important in Continental European than in Nordic coordinated market economies. Switzerland is not a very typical coordinated market economy and is often described as a hybrid between a liberal and a coordinated market economy.

when the institutional framework fails to guarantee a return on their educational investment. Workers instead prefer investing in transferable, general skills. [Estevez-Abe et al. \(2001, p. 150\)](#) identify three main institutional guarantees that protect workers' investments in specific skills: employment protection, unemployment protection and wage protection. Employment protection is what we here refer to as JSRs.²

Employers in coordinated market economies view JSRs as necessary prerequisites for their particular product market strategies, which depend on specific skills. Consequently, 'a rational employer who is interested in specific skills will support policies that ensure adequate return for workers who make investments in those skills' ([Estevez-Abe et al., 2001, p. 160](#)). In countries with an 'industry-specific, firm-specific skill mix', such as Germany, employers are thus expected to support JSRs ([Estevez-Abe et al., 2001, pp. 150, 154](#)). As they argue:

Employers who rely on specific skills to compete effectively in international markets therefore *need to institutionalize* some sort of guarantee to insure workers against potential risks. Without implicit agreements for long-term employment and real wage stability, their specific skills will be undersupplied. Employers' promises are not, however, sufficiently credible by themselves. This is why *social protection as government policy* becomes critical. ([Estevez-Abe et al., 2001, p. 145](#), emphasis added)

Thus, social protection as government policy is needed in order to help avoid market failures. Among the main beneficiaries of these policies are employers because 'employment and income protection can be seen as efforts to *increase* workers' dependence on particular employers' ([Estevez-Abe et al., 2001, p. 181](#), emphasis in original). But to what extent is this outcome intentional? Put differently, to what extent do employers *consciously* push for stricter JSRs? The VoC

²[Estevez-Abe et al. \(2001, p. 150\)](#) argue that 'the higher the employment protection, the less likely that a worker will be laid off even during economic downturns'. They use the OECD EPL indicator to operationalize employment protection and write that the OECD EPL indicator is an 'index of the "restrictiveness" of individual hiring and firing rules contained in legislation and collective agreements' ([Estevez-Abe et al. 2001, p. 165](#)). [Iversen \(2006, p. 441\)](#) downplays the role of JSRs and argues that not only JSRs but also 'public benefits of all sorts' reduce the variability of expected future income. He refutes Kitschelt's assertion ([2006, p. 414](#)) that skill specificity should be a particularly strong predictor for a preference for JSRs. However, Iversen's rebuttal is inconsistent. On the one hand, in [Estevez-Abe et al. \(2001\)](#) the focus is clearly on JSRs (next to unemployment and wage protection) and not on all sorts of public benefits. Similarly, [Crouch et al. \(1999, pp. 32–34\)](#) consider JSRs the core of the 'institutions for skill thesis'. On the other hand, even if the argument also applies to all sorts of public benefits, it does not explain why [Kitschelt \(2006, p. 414\)](#) and [Emmenegger \(2009\)](#) find particularly weak evidence for a relationship between skill specificity and support for JSRs.

approach in general is underspecified with regard to this question. However, since Estevez-Abe *et al.* (2001, p. 181) argue that ‘social protection often stems from the strength rather than the weakness of employers’, it is fair to assume that they hypothesize some form of intentionality.³

We acknowledge that Estevez-Abe *et al.* (2001, p. 147) explicitly state that their model is not a study of institutional origins. However, in subsequent contributions this qualification has been abandoned. Iversen and Soskice (2009, pp. 480–482) explicitly discuss the origins of VoC at the end of the nineteenth century. They argue that ‘given that collective action is possible, both employers and unions have incentives to *develop* a coordinated solution to specific skill formation and workplace cooperation’ (Iversen and Soskice, 2009, p. 481, emphasis added). In addition, Cusack *et al.* (2007, p. 378) observe that distinct capitalisms had already appeared in the nineteenth century—well before the first German laws restricted the employers’ right to hire and fire at will (which appeared in 1920). Moreover, the very same processes that Cusack *et al.* (2007, p. 377) identify as the ones pushing German employers to support a proportional representation electoral system in 1919 (preservation of the negotiated form of skill formation and labour market regulation in the face of nationalization and industrialization processes) should have also made them support the 1920 Works Council Act (the first attempt to establish a general and substantial regulation of job security).

Evolutionary approaches criticize intelligent design approaches for their functionalist bias. Hall and Thelen (2009, p. 14) ‘think it dangerous to assume that the institutions of the political economy were originally created to serve the interests they advance at much later periods of time’. Rather, labour market institutions are the outcome of political struggles between different interest groups. However, once these institutions are in place, employers adapt their production strategies around them. These adaptations ultimately lead some employers to change their labour market policy preferences.

In fact, employers may start supporting policies and institutions that they initially opposed. Having accommodated their practices, they adopt production strategies that increasingly rely on these policies and institutions (e.g. long-term employment relationships). For instance, Hall and Thelen (2009, p. 14) argue that ‘the current effects of an institution may help to explain contemporary support for it but can explain the origins of an institution only rarely’. In a similar vein, Hassel (2007, p. 255) argues that ‘business largely does not want to abandon existing labour market institutions, preferring instead to push for changes that make institutions work in their favour’.

³It should also be noted that Estevez-Abe *et al.* (2001, p. 182) explicitly ask for a test of whether employer preferences conform to the predictions of their theory.

Evolutionary approaches have rarely focused on JSRs. Rather, authors in this tradition have concentrated on collective bargaining, training regimes and unemployment insurance (cf. Thelen, 2004; Hassel, 2007; Hall and Thelen, 2009). To our knowledge, only Wood (2001a, b) has discussed the role of employers in the development of JSRs. He stresses that even though statutory limits to hire and fire at will constrain employers' managerial freedom, employers actually start supporting these restrictions—once they have been implemented—because they help solve collective action problems. He concludes that in countries like Germany, 'where firms are keen to cultivate implicit long-term contracts with skilled-employees, employers will support strong statutory employment protection' (Wood, 2001a, p. 378).

Employers may begin to look upon JSRs more favourably for two reasons. First, adapting their production strategies to the new regulatory environment, employers are forced to make costly investments. However, once these investments have been made, employers have an interest in protecting their investments (a new adaptation of the production strategy would again be costly) and in making sure that their competitors have to make the same investments (to avoid undercutting).

Second, labour market institutions that were not created with economic efficiency in mind may turn out to be a source of superior economic performance and competitiveness (Streeck, 2004, p. 426). 'Beneficial constraints' (Streeck, 1997), such as JSRs, make a low-cost, mass production strategy unfeasible and force firms to adopt a high-quality production strategy. According to Streeck (1991, p. 52) JSRs compel 'employers to keep more employees on their payroll for a longer time than many might be inclined to'. To compensate for this lack of external flexibility, however, firms increase internal flexibility by investing in training and retraining, which leads to a more productive workforce. Workers who feel secure in their jobs and easily identify with their employer will more readily embrace any technological change. In addition, a 'cooperative attitude' will arise among workers, easing a decentralization of responsibilities (Streeck, 1991, p. 52). Consequently, 'beneficial constraints' might even create a comparative advantage over competitors from different regulatory regimes.

Scholars relying on power-oriented approaches of institutional change do not expect employers to support restrictive JSRs. These approaches focus on distributive conflicts between actors and use power as the central explanatory variable. In this perspective, social policy institutions reflect the relative strength of capital and labour (Huber and Stephens, 2001; Hacker and Pierson, 2002; Korpi, 2006). Hence, institutions are the outcome of distributional struggles and determined by the capacity of each party to mobilize power resources in order to push through its own preferences. Employers are unlikely to support JSRs because these regulations circumscribe their managerial prerogative to hire and fire at

will and weaken their bargaining position vis-à-vis labour (Lindbeck and Snower, 1988).

The power resources literature is very explicit with regard to the importance of JSRs in class relationships. Korpi (1983, p. 17) argues that the system of wage labour leads to relationships of authority and subordination among people and creates the basis for class divisions. The subordination of the working class, however, can be scaled down by restricting the prerogatives of capital through legislation or collective bargaining—for instance by preventing management from arbitrarily employing and dismissing staff (Korpi, 1978, p. 326). Other authors argue that the labour movement is generally more supportive of market restricting regulatory policies such as JSRs (Botero *et al.*, 2004, pp. 1343–1344); while Rueda (2005, p. 62) argues that the labour movement's support for JSRs reflects its core constituency, which predominantly consists of workers with an interest in policies that protect their current labour market position.

Power-oriented approaches do not rule out the possibility that employers sometimes use long-term employment relationships to encourage workplace-specific skill formation. In many firms, lifetime employment is granted to the core workforce, on whose skills employers depend.⁴ Such paternalistic job-security policies can be very useful for cultivating worker loyalty. The crucial point is that employers do not oppose long-term employment relationships as long as it is their prerogative to grant it. The advantages of such policies are, however, lost if turned from a privilege into a legal right (Busemeyer, 2009).

Thus, scholars using power-oriented approaches expect the labour movement to push for restrictive JSRs, whilst they expect business to oppose any JSRs. This view implies that JSRs become more restrictive during labour movement dominance—for example, during the years preceding the first oil price crisis (Pizzorno, 1978)—and that business will attempt to dismantle JSRs when the employers' position becomes stronger than the labour movement's—for example, as a result of globalization.

The three theoretical perspectives offer conflicting hypotheses regarding the role of business in the development of JSRs in Germany. The employer-centred, intelligent-design approaches hypothesize that employers support the introduction and expansion of JSRs. Evolutionary approaches hypothesize that employers will initially oppose the introduction of JSRs, but opposition gradually abates. Finally, power-oriented approaches hypothesize the expansion of JSRs in periods of labour movement dominance and their retrenchment in periods of business dominance.

⁴The prime example is Japan, but there are also examples from the USA (IBM, General Motors) and Germany (Daimler). We thank Wolfgang Streeck for pointing this out.

We aim to test the three hypotheses by tracing the historical development of JSRs in Germany from the inter-war period, in which the first important acts were passed, to the dawn of the crisis of the ‘German Model’ in the 1990s. Our focus on this period is for theoretical and pragmatic reasons. First, business support for JSRs is more likely to be observed before the ‘age of neoliberalism’. Second, discussions of the development of JSRs in Germany after 1990 are already available (e.g. [Kinderman, 2005](#); [Eichhorst and Marx, 2011](#)) and provide no evidence for business support for JSRs.

3. The development of job security regulations in Germany: periods and events

There are five decisive periods in the historical development of JSRs (see [Table 1](#)). The Works Councils Act (*Betriebsrätegesetz*, BRG) of 1920 represents the first attempt to establish general and substantial regulation in this area. Its emergence was followed by a period of economic turmoil during the Weimar Republic that continued with the rise of National Socialism, which prevented ‘normal’ institutional development.

Table 1 Main periods in the historical development of job security regulations in Germany

Period	Main institutional developments and legal changes
–1914	Liberal regime: virtually no restrictions on the freedom to dismiss
1920	Emergence of JSR in the Works Councils Act: employees could appeal to works council against dismissal if it was based on invalid reasons (e.g. not related to personal conduct or the situation of the enterprise, but was based on religion, political affiliation etc.) (Section 84). If the plea was considered legitimate and conciliation had failed, the case could be brought to court (Section 86). Judicial verification of the appeal did not make the dismissal null and void. If employer refused to reemploy, the worker was entitled to compensation. Severance pay (Section 87) was the monthly salary multiplied by years of tenure (up to a maximum of half of the annual salary).
1933–1945	Period of economic and political turmoil: no ‘normal’ institutional development. State directed the allocation and price of labour
1951	Restoration and expansion in the Dismissal Protection Act: dismissal in exceptional cases only (Section 1), individual right to appeal (Section 3) applicable for companies with six or more employees (Section 21), social selection criteria (Section 1), right to re-employment (Section 7), severance pay up to a maximum of one annual salary (Section 8).
1951–1970s	Stability in the context of strong economic growth, full employment and labour shortage. Incremental emergence of agency work (regulated in the Manpower Act of 1973). The 1972 Works Constitution Act did not lead to significant changes.
1980s	Marginal reform in the Employment Promotion Act (1985): fixed-term contracts without valid reasons up to 18 months, agency work assignments up to 6 months

Only in the stable democratic environment following the Second World War (WWII) were social partners able to resume JSRs negotiations. The post-war period can be divided into three intervals: the restoration of market-oriented regulations in the 1950s, which witnessed a significant expansion of protection; a rather long period of stability up to the late 1970s, which did not lead to significant changes—despite the 1972 Works Constitution Act (*Betriebsverfassungsgesetz*, BVG); and the emergence of a two-tier reform trajectory in the 1980s.

JSRs have experienced various developments over the course of modern German history. The majority of European countries in the nineteenth century, including Germany, did not impose any significant statutory constraints on the right to dismiss. Employers and employees were considered equal parties to a civil contract, which could, in principle, be unilaterally terminated at any time (Hepple, 1986). The BRG was the first law to stipulate that the right to dismiss was conditional upon valid reasons. Although it is historically important as a ‘Trojan Horse in the citadel of employers’ discretionary right to dismiss’ (Vogel-Polsky, 1986, p. 189), in practice, protection on the basis of the BRG was limited: it only applied to companies with works councils, which were only compulsory for firms with more than 20 employees. Not only did this mean that an enormous share of the workforce was excluded (Nikisch, 1951), there was also no individual right to have your case heard in court. This channel depended on the consent of works councils (Feig and Sitzler, 1928, p. 226). A further limitation was the absence of compulsory reinstatement. Since employers always had the choice between re-employment and financial compensation, the freedom to dismiss was hardly circumscribed. Given the very modest level of severance pay, statutory financial compensation was in most cases perceived as insufficient protection against poverty in the case of unemployment (Hueck, 1954, p. 17).

The National Socialists introduced the next major change in JSRs. The 1934 Act on the Order of National Labour (*Gesetz zur Ordnung der nationalen Arbeit*, AOG) laid the foundation for labour law under the Nazi regime. In effect, however, a state-directed system was implemented in which the allocation and price of labour were no longer market determined. From 1939 dismissals or job changes required the blessing of the public employment service.

After the war, German labour law turned into an overly complex and fragmented mixture of transitory regulations, improvised jurisdiction and legislation at the state level. In the face of mass unemployment and impoverishment, the AOG was abolished later than most other acts of the Nazi period. After 1947 job security was regulated either at the state level or not at all. In the British zone judges used civil code provisions to create a rather strict system of dismissal protection (Nikisch, 1951; Fiedler, 2006). Similarly, the restrictions on labour allocation introduced by the Nazi regime which required job changes to be

approved by the employment office remained in place until the foundation of the Federal Republic of Germany in 1949 (Göller, 1974).

Uniform regulation was restored with the 1951 Dismissal Protection Act (*Kündigungsschutzgesetz*, KSchG). The KSchG contained core elements of the BRG, but significantly expanded protection compared with the pre-war level. Contrary to the BRG and AOG, the KSchG was not based on the concept that employers had the freedom to dismiss. The law instead acknowledged that workers had, in principle, the right to keep their jobs—only dismissals due to special reasons were considered acceptable (e.g. employee conduct or urgent business requirements). Especially in the case of urgent business requirements, the KSchG went beyond the BRG, as the employer had first to consider far-reaching organizational measures to avoid job losses before dismissing any employees (Hueck, 1954, p. 57). The KSchG also introduced social selection criteria, which substantially constrained the employers' right to decide whom to dismiss. The employer's choice of either compensation or re-employment had not been completely abolished, but it had been significantly restricted. Employers now had to prove that there were compelling reasons preventing re-employment. Opting for compensation was further complicated by employers not knowing in advance the amount of severance pay (Nikisch, 1951). With a maximum of 1-year's salary, severance pay under the KSchG was significantly higher than under the BRG. Further important innovations were the individual right to object to dismissals (no longer dependent on the works council's approval) and a wider application of the law (to employers with six workers and more). Thus, the KSchG significantly enhanced the protective function of German labour law, and its introduction was followed by a long period of institutional stability.

Unlike many other Western European countries, JSRs in Germany did not become significantly more restrictive in the early 1970s (Emmenegger, 2010a). Although German trade unions fervently pushed for more restrictions, the BVG granted works councils the right only to postpone dismissals, not to veto them. The regulation of permanent contracts introduced by the KSchG in 1951 is still largely valid. In contrast, major reforms of the regulation of temporary employment have resulted in a two-tier labour market, with a well-protected core of labour market insiders and a periphery of less protected labour market outsiders. The most important step in this respect was the 1985 Employment Promotion Act (*Beschäftigungsförderungsgesetz*, BFG), which allowed for the first time the use of fixed-term contracts without valid reasons (up to 18 months) and increased the maximum duration of agency workers' assignments to 6 months.

4. Business and the historical development of job security regulations

4.1 *Inter-war period and the 1920 Works Councils Act*

Prior to WWI, dominant elites (including employer associations) had an antagonistic relationship with the unions. The constitution did not allow for adequate political participation of the growing group of wage labourers, and their organizations were exposed to repression. Backed by an authoritarian state, employers dominated industrial relations and aggressively restricted the activities of organized labour. The degree of confrontation varied widely: heavy industry and large landowners rejected cooperation, but the 'new industries', with their highly trained and therefore more powerful workforce, had to be more open-minded (Feldman, 1984, p. 102; Herrigel, 1996). Nonetheless, organized labour had few possibilities to achieve progress in social policy and labour law.

The collapse of the German empire dramatically changed this balance of power. Maintaining armament industries placed the regime under increasing difficulty during WWI. Combined with a severe shortage of labour, the unions now found themselves in an extremely powerful position. In 1916 the state was forced to intervene in the labour market in order to concentrate employment in arms production (*Hilfsdienstgesetz*). Labour market participation was made compulsory for men between the ages of 17 and 60, and a change of job was prohibited in 'war-relevant' industries. For fear of labour disputes the state acquiesced to major concessions for the unions and Social Democrats, including the acceptance of unions as representatives of the workforce and the creation of worker and arbitration committees in enterprises producing important goods for the war. The result was a milestone for unions, with a lasting influence beyond its immediate impact on the wartime labour market (Ambrosius, 2005, p. 301; Bieber, 1981).

In the revolutionary period after the collapse of the German empire, the window of opportunity for social policy progress was wide open. Afraid of radical socialist forces pursuing the abolition of the free-market economy, employers teamed up with moderate unions in a corporatist agreement (*Stinnes-Legien-Abkommen*). At first, cooperation was fostered by the desire to escape state intervention, which had grown during the war. However, the actual character of the agreement was strongly influenced by the threat of a socialist revolution and employers' fear of losing their property (Feldman, 1984, p. 123). In a bipartite body—the Central Work Association (*Zentralarbeitsgemeinschaft*)—unions were able to take advantage of the employers' weakness and expand on the achievements made during WWI. Their influence increased even more when the new democratic system brought a Social Democratic government into office in 1919, allowing for a whole series of changes in the field of social policy and

industrial relations (Bieber, 1998, p. 51). Among the achievements of this short period were the 8-hour workday and the right to negotiate collective agreements.

Three further facts illustrate the unions' rapidly growing influence in the early Weimar Republic. Between 1913 and 1919 the number of union members grew from below three to more than eight and a half million (Schneider, 1989, p. 494). In addition, collective bargaining coverage was 10 times higher in the 1920s than in 1914, while labour's share of national income rose from 45 to around 60% (Abelshauser, 1987a, p. 25). The situation rapidly turned sour for the unions towards the end of the 1920s, with many prior achievements being revoked. However, the first important step in the historical development of JSRs in Germany—the BRG—took place in this relatively short period of tumbling employer strength and labour movement radicalization.

How did the employers react to the proposed BRG under these conditions? The negotiations reveal that their willingness to cooperate was the result of a defensive strategy to avoid revolutionary tendencies. Employers largely upheld an anti-union stance and did everything they could to lobby against the BRG. The general opposition was also directed at the proposed role of works councils in personnel policies (Wolff-Rohé, 2001, p. 134). Employers insisted on liberal regulation, and the restrictions were perceived as unacceptable interventions in their managerial prerogatives. For example, they opposed plans to include social selection criteria such as tenure, arguing that such regulations would hamper production (Hueck, 1954). The peak association of the German industry (*Reichsverband der Deutschen Industrie*, RDI) organized protest meetings expressing their emphatic opposition (RDI, 1919, 1920). The RDI unanimously adopted a resolution stating:

Above all, the prospective influence of works councils on the management, its right of codetermination in hiring and dismissals [...] is so dangerous for the management, order and performance of establishments, and thereby so devastating for the entire German economy, that the proposal must under no circumstance become law. (RDI, 1919, p. 17, own translation)

In spite of this and similar reactions, the political constellation, i.e. business weakness and labour strength, did not allow employers to prevent the implementation of the BRG.⁵

Of course, industrial employers had very heterogeneous interests, and decision-making within the RDI was characterized by sectoral as well as geographical cleavages. However, skill-intensive industries (e.g. producers of

⁵For further information on the far-reaching attempts of the RDI to influence parliamentary decision making, see Wolff-Rohé (2001, pp. 136–139).

machinery, chemicals and electronics) were clearly dominant and played a decisive role in the RDI (Feldman, 1984, p. 127).⁶ This suggests that those manufacturers who according to the VoC literature should be most interested in labour market complementarities were in fact unsupportive of JSRs.

To fully appreciate the impact of WWI on German labour law, it is imperative to take into consideration that some hallmarks of the system originate from war-related state interventions. After 1918 Germany faced the challenge of integrating soldiers, refugees and workers from arms production into the peacetime labour market. Against the background of imminent mass unemployment and a scarcity of basic goods, intervention appeared necessary in order to avoid social disaster and political destabilization (Ambrosius, 2005, p. 310). The 1920 Demobilisation Act (*Demobilmachungsverordnung*) was to tackle this problem. Two of its elements are particularly interesting. First, the principle of last resort stipulated that dismissals were only justified if a reduction in working-time was unfeasible. Second, the idea of social selection was introduced, i.e. age, tenure and family situation had to be considered when deciding which employees to dismiss. Although employers could successfully lobby against plans to make these achievements permanent (Hueck, 1954, p. 14), they had a lasting influence on further legal development. For instance, social selection criteria were considered in the jurisprudence of the Weimar Republic and eventually taken up in the KSchG of 1951 (Göller, 1974, pp. 54–62).

The bottom line is that WWI served as a driving force for social policy expansion and for the development of labour law in particular. Virtually all of the innovations of the Weimar Republic can be traced back to the war and its consequences (Abelshauser, 1987a, p. 15)—be it in the form of authoritative interventions or its impact on the power distribution between the social partners. The BRG was negotiated in a relatively short period, in which exceptional factors shifted the balance of power in favour of unions, and this asymmetry biased the original compromise on JSRs.

Given the opposition of the German industry to the BRG, historical evidence seems to lend support to the conflict-oriented perspective—at least in the early stages. What does this result mean for the notion that complementarities surrounding skill formation are the crucial explanatory variable? The temporal order of the German development casts doubt on the VoC argument. As Cusack *et al.* (2007) acknowledge, an industrial pattern of diversified quality production had already emerged in the late nineteenth century (Abelshauser, 2004, pp. 28–44). ‘New’ industries, such as machinery or chemicals, drove Germany’s pre-WWI export boom, with highly skilled workforces being a major competitive

⁶Skill-intensive industries and especially large manufacturers, such as Siemens, Bosch and Carl Zeiss, controlled the RDI’s governing body (Wolff-Rohé, 2001, pp. 68–69).

advantage (Pierenkemper and Tilly, 2004, pp. 145–149). To satisfy their demand for skilled workers, many large companies employed segmentalist strategies, including in-house training and firm-based social policy, to ensure loyalty (Adelmann, 1979). Hence, the diversified quality production model worked for a long time without JSRs, and it is therefore more than plausible that the German industry was reluctant to endorse the Works Council Act in 1920. However, it is important to note that in the Weimar Republic, the topic of skill creation became more pressing in some industries than in others. Due to international competition and the limited price-competitiveness of German production, many manufacturers were forced to go ‘up-market’ in order to maintain their export share. This demanded an ever-stronger focus on quality-competitiveness. Moreover, the artisanal sector, which traditionally trained workers for industry, became less and less capable of satisfying the growing demand for skills—both in terms of quantity and quality (Herrigel, 1996; Thelen, 2004). It is conceivable that this development made employers embrace JSRs as a means to attract more specific skill investments from workers.

As Thelen (2004) observes, some skill-oriented industries in this period sought mechanisms to strengthen training. However, this mainly meant certification rights or standardization—not JSRs.⁷ A major concern was creating a framework that reduced disincentives for employers (e.g. by impeding poaching) rather than for workers. As illustrated by the significant lack of apprenticeship places in the entire Weimar period, attracting trainees willing to invest in skills was not the greatest issue. Accordingly, institutions were required that could strengthen employers’ engagement in training (Thelen, 2004, p. 70). Against this background of labour market conditions, JSRs could contribute only very little to intensifying training.

4.2 *Post-war years and the 1951 Dismissal Protection Act*

At first sight, the process of labour law innovation after WWII differed in many ways from the implementation of the BRG. The KSchG serves as a prime example of corporatist social policy-making, as it was based on an agreement between employers and unions (the ‘*Hattenheimer Gespräche*’ in early 1950). In the following year parliament passed the draft with only minor changes. Thus, the KSchG reform lacked the conflict-laden character of the BRG introduction in 1920 and proceeded more consensually. The question is whether employers turned from veto players into proponents of JSRs or whether they consented for strategic reasons.

⁷As Busemeyer (2009) notes, the certification of skills is the crucial factor determining the portability of skills.

Many employers were dissatisfied with post-war regulatory circumstances. Dismissals required a pre-emptive check by the public employment office, which—at least in the perception of employers—favoured labour market policy concerns over firm interests (*Zentralsekretariat der Arbeitgeber des vereinigten Wirtschaftsgebietes, 1948b*, pp. 3–6). The increased importance of courts, whose decisions on dismissals tended to be rather restrictive, created legal uncertainty. In some parts of the French and American zones, new laws with very rigid provisions concerning dismissals were implemented (*Hueck, 1954*, p. 18; *Nikisch, 1951*). As a consequence of the chaotic post-war situation, employers faced strong short-term incentives to reach a homogeneous and predictable legal basis for dismissals, which would once again render the free allocation of labour possible. Thus, employers had a strong incentive to enter into negotiations with unions about JSRs.

To understand the employers' willingness to cooperate with unions in formulating a draft law, other alternatives available at that time need to be considered. After 1945 unions were quickly able to organize themselves and regain their capacity to act. The common experience of emigration, resistance and terror helped overcome the old fragmentation of the union movement (*Rosenberg, 1948*). From the start Western allies considered the unions a legitimate force in the democratic reconstruction; whilst political parties, as well as employer associations, were regarded more sceptically (*Mielke, 1990; Barthel, 1999*). This left the unions in a very powerful position after the war, particularly after the foundation of a unified peak organization (*Deutscher Gewerkschaftsbund, DGB*) in 1949. By 1948 union density had already reached 42% in the British zone, and 38 and 30% in the American and French zones, respectively (*Schneider, 1989*, p. 241).

These developments were reflected in an aggressive anti-capitalist agenda. Radicalized by experiences of the war, the DGB embraced an antagonistic position towards employer associations, especially in the field of codetermination. More redistribution, elements of central planning and the nationalization of key industries were all requested (*DGB, 1950*, pp. 318–326). This anti-capitalist attitude was also shared by the two largest political parties: the Social Democratic Party (SPD) and—at least in its early years—the Christian-Democratic Union (CDU).

Internal documents show that the common perception of employers at that time was one of unions focused on the abolition of the freedom to hire and fire. The employment relationship would then lose its contractual nature and become irrevocable (*Sozialpolitische Arbeitsgemeinschaft der Arbeitgeber, 1949b*). Moreover, both major political parties supported the strict regulation of dismissals. In its 1949 programme the CDU demanded increased protection—with dismissals as option of last resort only—while the SPD still favoured the idea of a centrally planned economy (*Richardi, 2001*, p. 169).

Hence, a broad political consensus supported more restrictive JSRs compared with the pre-war era. Employers had to consider the prevalent market scepticism when negotiating basic organizational principles of the new economic system. Legitimizing the new order and thereby ensuring support and stability was an important feature of the employers' lobbying strategy. Radical demands were considered neither feasible nor appropriate.

Evidence suggests that employers maintained a preference for flexible regulation. They firmly rejected plans aiming at quasi-lifetime employment and insisted on their right to choose between compensation and re-employment (Siebrecht, 1951). The employer peak association (*Bundesvereinigung der Deutschen Arbeitgeberverbände*, BDA), which conducted negotiations with unions on JSRs, took the position that it was of the utmost interest to defend the conception of the employment relationship as a 'voluntary and terminable contract' (*Sozialpolitische Arbeitsgemeinschaft der Arbeitgeber*, 1949*b, c*). An initial employer draft of 1948 (*Zentralsekretariat der Arbeitgeber des vereinigten Wirtschaftsgebietes*, 1948*a*) was still strongly oriented towards the rudimentary design of the BRG—especially as far as reasons for justified dismissals were concerned. Concerning severance pay, employers suggested returning to the levels of the BRG and objected plans to increase it (see also *Sozialpolitische Arbeitsgemeinschaft der Arbeitgeber*, 1949*a*). Further contentious points were the size threshold of firms subject to the new law and the probationary period. After 'long and tough negotiations', the Hattenheim agreement was seen as a compromise, which in many ways went beyond the initial employer position (*Vereinigung der Arbeitgeberverbände*, 1950, p. 5). However, as it successfully upheld the basic principles of private law and contractual freedom, it was considered 'acceptable for business' (*Vereinigung der Arbeitgeberverbände*, 1950, p. 8).

Thus, even in the post-war period, employers tried to keep JSRs as flexible as possible. There is no evidence suggesting that the employers' position was influenced by considerations related to institutional complementarities, as assumed by the VoC approach. Rather, the Hattenheim agreement was perceived as a far-reaching concession that was unavoidable given the political constellation. It was preferred to the extremely unsatisfying status quo and radical union plans (which had some political support and realistic chances to be implemented).

4.3 *Institutional stability and the 1972 Works Constitution Act*

While many institutions of the German employment model reflect the exceptional character of the post-war economy, i.e. catch-up growth and skill shortage (Pierenkemper, 2009), the economic context certainly did not favour the mutual consent on the development of JSRs. Between 1948 and 1951 the German economy experienced an economic crisis. At the time of the Hattenheim

agreement, the unemployment rate was 12.2% (Abelshauser, 1987b, p. 78). As long as migration from the German Democratic Republic (and former German areas in Poland and what was then Czechoslovakia) contributed to labour supply, a shortage of manpower was not a problem in West Germany (Eichengreen, 2008). Therefore, the KSchG should not be attributed to favourable economic circumstances but to the political factors presented above.

However, the boom of the 1950s and 1960s helped stabilize the new institution. JSRs produced few adverse effects for a German economy with high economic growth and full employment. These circumstances were, however, temporary. Germany's 'economic miracle' benefited from two factors related to the war, and both implied return to normality in the medium term. First, mechanisms of catch-up and convergence drove economic recovery, but rebuilding the capital stock and closing the productivity gap with the USA were soon exhausted as sources of growth. Second, German production was specialized in goods that were required for reconstruction in other countries. The wartime economy had been heavily oriented towards products such as machinery and metals. After the war Germany had the skills and the infrastructure available to export these highly demanded capital goods (Eichengreen, 2008; Abelshauser, 2004, pp. 48–50). This advantage disappeared once growth became increasingly based on service sector expansion.

With the return of normal growth rates and business cycles, the institutional setting biased towards union interests began to become an issue of great controversy. A 1976 survey, conducted by the Association of German Chambers of Industry and Commerce (then *Deutscher Industrie- und Handelstag*, DIHT, now *Deutscher Industrie- und Handelskammertag*, DIHK) for the Council of Economic Experts (*Sachverständigenrat*), indicated that industrial employers increasingly perceived JSRs as a problem. Asked about the most important obstacles to job creation, cautious business expectations, rationalization and wage pressure dominated, but in almost a quarter of the cases JSRs were identified as important obstacles (*Sachverständigenrat*, 1976, p. 208). In some typical high-skill industries, such as machinery, fine mechanics and metals, there was an above-average share of employers who viewed JSRs as the most important obstacle (DIHT, 1977a, p. 58). Accordingly, representatives of the industry started to complain about a lack of flexibility in personnel policies and 'interminable' employment relationships (DIHT, 1977b, p. 28).

Yet for the time being, this altered perception did not translate into strong reform pressure.⁸ After the golden age had cushioned the conflict between capital and labour for two decades, it turned out that there was little leeway to

⁸Quite the contrary, the 1969 Employment Promotion Act improved the protection in the case of mass layoffs.

reverse the development of JSRs. The institution was already producing the typical positive feedback effects for an important voting bloc. The high popularity of JSRs among labour market insiders and union resistance to any liberalizing changes created strong barriers to reform. In fact, unions interpreted the rise of unemployment in the 1970s as an indicator of a lack of protection (IG Metall, 1978). In a draft labour code the DGB practically demanded the abolishment of the freedom to dismiss by giving works councils an effective veto right and creating obligatory severance pay (DGB, 1977, pp. 177–178). In the 1970s unions were relatively influential, with approximately 7.5 million members and close ties to the Social-Liberal coalition (1969–1982). Moreover, in the mid-1970s more than half of the members of parliament were DGB members (Beyme, 1990, p. 368).

Although employers still preferred a more flexible design of dismissal protection, the political situation did not leave any scope for deregulation. The BDA fought the union draft labour code and campaigned for the principle of ‘freedom of contract’ in the employment relationship (BDA, 1978; Kittner, 1988, p. 755). However, rather than promoting liberal reforms, employers were once again in a defensive position, trying to avoid further tightening of regulations.

Damage control became particularly important during the negotiations on the 1972 Works Constitution Act. Echoing an old union demand, the Social Democratic chancellor, Willy Brandt, argued in his government declaration in 1969 that Germany should ‘risk more democracy’, also with regard to the role of works councils. The subsequent draft law incorporated most union demands and was passed by the Social-Liberal majority, despite vehement opposition from employers (Milert and Tschirbs, 1991, p. 80). Even though the Works Constitution Act introduced far-reaching changes, it did not significantly increase the protection against dismissals. It gave works councils the right to demand a social plan (which may cover severance pay, the order of redundancies and social selection criteria) and to postpone dismissals. However—and much to the union’s chagrin—it failed to give works councils the right to veto dismissals.

Against this background, it is not surprising that the employers’ desire for more flexibility started with a very typical, but often neglected, mechanism: defection from the institution at the micro-level by creatively ‘working around’ it—a process which Streeck and Thelen (2005) refer to as ‘displacement’. In the 1960s employers had started to increase external flexibility by supplementing their core workforce with a marginal tier of agency workers, who could be used to handle production peaks. This option, initially offered by Swiss temporary work agencies, was deemed illegal, as it violated the state’s placement monopoly, but was eventually legalized by the Federal Constitutional Court in 1967 (Mayer, 1986). The subsequent agency work boom, especially in

construction and the metal industry, led to union protests, which considered this practice a ‘slave trade’ (Holst *et al.*, 2008). Nonetheless, in 1972 the SPD-led coalition decided to legalize and regulate agency work in order to restrict deviation from standard employment.

4.4 *The emergence of a two-tier system and the 1985 Employment Promotion Act*

Opportunities for deregulation increased with the change of government in 1982. Against the background of structural unemployment, the new centre-right coalition was more receptive to calls for increased flexibility. After employers had been on the defensive in the late 1970s, they now pressed their claim. Under the banner of ‘more market—less state’, the powerful Federation of German Industries (*Bundesverband der Deutschen Industrie*, BDI) explicitly demanded JSRs reform (BDI, 1984, pp. 24–25).

In line with these demands and with the international trend towards supply-side economics, deregulation of hiring barriers appeared on the political agenda (Schmid and Oschmiansky, 2005). The first tangible result of this paradigm change was the 1985 Employment Promotion Act. The BDI and BDA took a clear stance in the reform discussion. They welcomed the flexibilization of temporary contracts, which they had previously suggested; moreover, employers successfully influenced the legislative process. Their demands to increase maximum duration to 18 months and to allow fixed-term contracts for all newly hired employees (BDA, 1985a, p. 11) were implemented. The Act was, however, only seen as ‘one step in the right direction’, and was supposed to be accompanied by more far-reaching measures, especially with regard to permanent contracts (BDA, 1985a, p. XIII; 1985b, p. 29; BDI, 1988, p. 72). As the BDI put it: ‘The deregulation of employment barriers has to be continued vigorously. This includes in particular social compensation plans for collective redundancies and the overly complex regulation of job security’ (BDI, 1990, p. 65, own translation).

However, this more ambitious reform agenda failed due to contradictory forces in the governing coalition. While the liberal Free Democratic Party supported employer demands, members of the CDU left wing rejected further deregulation. The Employment Promotion Act had already led to strong protest by the SPD and unions against a perceived undermining of JSRs (Schmid and Oschmiansky, 2005). Losses in the 1987 elections were interpreted as a punishment for far too extensive social cutbacks. As a result, the CDU closed the window of opportunity for further JSRs reforms.

The liberal turn, which was rather modest by international standards, as exemplified by the 1985 act, illustrates the limits of the politically feasible extent of deregulation at that time. Yet legal change was consequential. Between 1984 and

1986 the share of fixed-term contracts as a percentage of total employment rose from 4 to more than 8% (Schmid and Oschmiansky, 2005, p. 251). Beyond this immediate effect, the Employment Promotion Act can be seen as a starting point for further incremental change. The following two decades witnessed a successive liberalization of temporary contracts and a continually growing share of workers in this segment. This development serves as an illustrative example for the mechanism of incremental institutional change, which over time produced the very flexible arrangements of today (Eichhorst and Marx, 2011).

4.5 *Development of employer attitudes after 1990*

The negative attitude of employers towards JSRs has, if anything, increased over the past two decades. In 1996 the government under Helmut Kohl eventually implemented a modest deregulation of dismissal protection for regular workers, which was welcomed by employers as part of an ‘important and necessary step towards greater individual freedom and self-responsibility’ (BDI, 1998, p. 74, own translation). In the late 1990s the employer association of the metal and electrical industry (*Gesamtmetall*) founded a very active public relations agency to promote welfare and labour market reform (*Initiative Neue Soziale Marktwirtschaft*). One of the main topics was the deregulation of the labour market (Kinderman, 2005, p. 439).

Since then reform of JSRs has remained an important topic on the agenda of business and employer associations, which has been confirmed by survey results. A survey conducted by the DIHK in 2009 showed that almost half of German employers see deregulation of JSRs as an important step to boost job creation (DIHK, 2009). It was regarded as equally important as the reduction in non-wage labour costs and much more important than wage moderation—both prominent employer demands. The negative attitude towards JSRs was even more pronounced for sub-sectors that should appreciate them according to the VoC literature. In the export-oriented industry, which is strongly exposed to economic fluctuations, the results showed a clear majority in favour of easing JSRs. The DIHK’s reform demands are anything but moderate. The specific demands are to raise the firm-size threshold for which dismissal protection applies from just above 11–20 employees and to allow dismissals for economic reasons if compensation is paid. Both measures would practically abolish dismissal protection.

5. Conclusions

What role did business play in the historical development of JSRs in Germany? We have identified four crucial moments with long-lasting effects in the

development of JSRs. During two crucial moments, JSRs have become more restrictive (1920 Works Councils Act and 1951 Dismissal Protection Act). In both cases exceptional circumstances related to both World Wars hampered the ability of employers to resist demands for stronger protection (which, we argue, would have better reflected their actual preferences). Far-reaching concessions were necessary in order to avert—from an employers' point of view—even worse outcomes. During two other crucial moments, further restrictions were avoided (1972 Works Constitution Act), and the first elements of a two-tier labour market were introduced (1985 Employment Promotion Act). In the latter two cases German business was not delegitimized by its involvement in war activities and consequently was able to use all its power resources to influence the political outcome. However, in the German polity, wholesale deregulation of labour law against the will of trade unions was not possible, and, as a consequence, despite considerable power resources, German business could not undo the previous extension of JSRs.⁹ In sum, our findings do not lend any support to claims raised by parts of the VoC literature that business in coordinated market economies pushes for strict JSRs (intelligent design perspective) or starts supporting these restrictions once they have been implemented (evolutionary perspective).

Hence, German JSRs are somewhat 'biased' in favour of employee interests. In the 1950 and 1960s, the 'golden' decades following WWII, this did not matter much. However, the rigidity caused by JSRs was felt in the 1970 and 1980s, when economic growth turned sluggish. Although by then, the institution was 'locked-in', and German business had to deal with the adverse effects of a labour market institution that they would not have accepted in that form under less critical circumstances.

By no means should these results be understood to mean that unions have dominated industrial relations for the past 90 years. Quite the contrary—during the 1920s, as well as more recently, unions struggled with a significant loss of influence. The crucial point is that the relatively short periods of labour strength coincided with the formative compromises in the realm of JSRs, and that these compromises had a lasting influence. This is in line with the mainstream path dependency argument that it is easier to expand the welfare state than to cut it back.

Our findings can also be read as evidence supporting the notion of endogenous institutional change and the importance of 'foundational conflicts' (Koreh

⁹Our findings echo the conclusions by Paster (2009). He finds that employers' strategic responses to the political power structure—rather than economic efficiency benefits derived by specific types of firms—can explain the position of organized business in the formation of market-correcting industrial relations and welfare state institutions in Germany from the 1880s to the 1990s.

and Shalev, 2009). Accordingly, the deregulation of the German labour market starting in the 1980s cannot be ascribed to exogenous factors alone. Deindustrialization and international competition certainly contributed to this development by increasing pressure on labour costs. However, the reasons for change can at least partly be traced back to the initial design of JSRs. As we have shown, main agents of change were the ‘losers’ of the initial negotiations. As business regained power, it started to challenge the historically biased, and thus fragile, post-war compromise on JSRs.

With regard to the VoC literature, we find German employers have never preferred strict JSRs to the more flexible kind. Moreover, at no point has the subject of skill formation been mentioned as an important issue for the development of JSRs. This does not imply that the constraints created by JSRs cannot be beneficial (Streeck, 1997). It is rather likely that JSRs are less harmful in specific skills regimes with mutual interests in long-term employment relationships than in liberal market economies with more dynamic labour markets. Moreover, our analysis should not be regarded as evidence of employers in coordinated market economies not supporting any form of social protection. However, as far as JSRs are concerned, we believe that the VoC approach overemphasizes their functional importance for human capital investments.

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