

**The Centralization of Wage Bargaining Revisited.  
What have we learned?**

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November 2005

A note prepared for a seminar at The European Institute, LSE, in the series  
“Landmarks in the Political Economy of European Integration Revisited”, 28th  
November 2005.

I am most grateful to Christian Spielmann for research assistance. I am also grateful  
to the ESRC for support under the World Economy and Finance Research Programme  
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## Introduction

In our 1988 paper, “Bargaining structure, corporatism, and macroeconomic performance”, Lars Calmfors and I argued that the relationship between wage bargaining and macroeconomic performance might not be monotonic but hump-shaped; that economies with highly centralized and highly de-centralized wage bargaining would perform well, and those in the middle, with only moderately centralized bargaining, would perform worse. We adduced a certain amount of empirical evidence in support of this claim, and also we set out a very simple theoretical model to demonstrate that the hump could emerge under fairly plausible and weak assumptions about the economy.

Since that time, there has been the most extraordinary amount of research into labour markets and macroeconomic performance, and more generally into corporatism. Some of this work followed up and scrutinised claims made in Calmfors and Driffill (1988); some of it followed up other lines of research. Our paper had simply taken up a few of the ideas that were being considered in the 1980s and formalised them, and used them as the basis for some strong empirical predictions. There was a great deal of interest in the 1980s in the effects of unions and bargaining, particularly in the Nordic countries. Flanagan, Soskice, and Ulman’s (1983) book, *Unionism, Economic Stabilization, and Incomes Policy: European Experience* was a very valuable source of information. Mancur Olsons’s (1982) *The Rise and Decline of Nations* was very influential, and had addressed a wide range of issues, of which the effects of powerful unions were just one.

What have we learned about these issues since then?

### A brief review of Calmfors and Driffill (1988)

#### (a) Theory

Our model assumed that all workers were union members, a fixed capital stock, a closed economy, no intermediate goods. (What happens if you start to take all this into account?) It was also completely static, and predicted a relationship between the real wage and employment on the one hand with bargaining structure on the other. It

did not really make predictions about the effects of bargaining structure on inflation or on the flexibility of nominal and real wages in the face of shocks to the economy.

Bargaining structure was assumed to be an exogenous variable. All other things were held constant, such as the tax regime, social security benefits, education and training, the human capital structure of the workforce, industrial relations legislation, and employment-protection legislation. Workers were assumed to be hired and fired as needed; there was no long-term relationship between worker and firm due to firm-specific human capital, insider-versus-outsider issues, or whatever.

The model showed that the non-monotonic relationship between centralization and wage-setting emerged as a theoretical possibility under what, we argued, were plausible assumptions. The key assumption was that at higher levels of aggregation, goods became less and less good substitutes for each other. While individual firms may have faced elastic demand, industries faced less elastic demands for their products, and at the level of the whole economy, the demand for goods was less elastic yet. Thus more centralized unions enjoyed more monopoly power, and will raise wages further. Offsetting this was the factor that when unions raise wages for their members, they also raise the prices of some of the goods they consume. The bigger the union, the stronger this effect, and the less incentive they have therefore to raise wages. The interaction of these two effects may, depending on the elasticities of demand, lead to the non-monotonic relation between the centralization of bargaining on the one hand and real wages and employment on the other.

### **(b) Empirical Analysis**

Our empirical analysis looked at the relationship between indices of centralization and/or coordination of bargaining, on the one hand, and unemployment or a misery index (a combination of unemployment and inflation) on the other. For the most part it was a simple bivariate relationship. No other factors that might have affected macroeconomic performance were considered.

How should corporatism/centralization/coordination of bargaining be defined and measured? We took a narrowly defined measure, arguing that ‘corporatism’ had been defined in many and various different ways, could be taken to include many different factors, some fairly objectively measurable, others more subjective (examples?), and

that there was a danger of circularity. There has been much reconsideration of the definitions and the data since then.

We took an index based on “the extent of inter-union and inter-employer cooperation in wage bargaining with the other side” (CD, 1988, p17). The index was the sum of two elements: the level of coordination within national trade union confederations and within national employer organisations; and the number of existing central union federations and their cooperation, and the number of existing central employer federations and their cooperation. Each index was scored 1, 2, or 3. The ranking that emerged is described in table 5.

### **Empirical Critique and Developments**

The rankings and scores were disputed from the outset, in some cases because they ignored coordination amongst players that was not represented in the visible structures, and in some because they took no account of the influences of other factors like minimum wages, as in France. Switzerland, it was argued, was in fact a neo-corporatist system with heavy involvement of employers’ organizations in policy design and much more coordination than the centralization indices indicated. (Comments following the presentation of the paper in 1988, from Economic Policy.) David Soskice (1991) argued that Japan and Switzerland had not been treated properly, and that when they were treated properly, a linear relationship not a hump emerged. The thrust of his argument was that CD had paid too little attention to the role of coordination among employers organizations, and that too much attention had been paid to the level at which bargains were struck (firm/industry/economy) and too little to the extent of coordination among participants to wage setting across units (again, firms or industries as the case may be). Thus he also revised the relative positions of France, Italy, and the UK. Robert Flanagan (1999) writes that, after using a wide variety of indicators of economic performance and new data on the centralization and coordination of collective bargaining, a 1997 OECD study concluded that there was no evidence to support the Calmfors and Driffill hypothesis in the 1990s.

Nevertheless, Lars Calmfors (2001) reports a number of studies that have found a hump-shaped relationship between centralization or coordination and economic

performance. He reports six studies that show a monotonic relationship, and five with a hump. The average unemployment rate for low and medium relative to high coordination economies is 6.8 and 3.2 percent among the monotonic studies and 4.9 and 6.8 percent among the non-monotonic studies. (The studies he reports are these. Monotonic: Layard *et al*, 1991; Zetterburg, 1995; Scarpetta, 1996; Bleaney, 1996; Elmeskov *et al*, 1996; Nickell and Layard, 1999. Non-monotonic: Zettterburg, 1995; Bleaney, 1996, Scarpetta, 1996; Elmeskov *et al*, 1996 (two entries)). However, all these studies appear to suggest that high coordination leads to lower unemployment than does low coordination.

The more important way in which empirical research in this area has developed is in the direction of considering bargaining structure as not the only but one of many factors that might affect unemployment and other measures of economic performance, and also taking account of dynamics of effects, rather than simply looking a static models. Recent examples in this vein include Nickell, Nunziata and Ochel (2005) and Blanchard (2005). Nickell *et al* consider the evolution of unemployment in the OECD from the 1960s to the 1990s, and allow for the effects of the unemployment benefit system, systems of wage determination, employment protection legislation, labour taxes, and barriers to labour mobility. In addition to these structural variables, which evolve over time, they also allow for the effects of shocks to interact with these structural features. They find that a fall in union density causes a significant fall in unemployment; higher coordination in bargaining reduces unemployment, and the effect of coordination is greater when union density is greater; the effect of coordination is greater when the tax rate on employment is higher. Here then the effect of bargaining comes principally through coordination, and the effect is monotonic. However, they do not look for a non-monotonic effect, so this does not provide very strong evidence against such an effect. This study shows that there is an important effect of bargaining structures when controlling for other influences on unemployment. Bargaining is not the only or principal influence, but it has a clear effect. Employment protection legislation does not appear to raise unemployment. But the replacement ratio, and the duration of benefits have a clear effect. Employment taxes have a positive effect, while labour demand shocks and productivity (tfp) shocks reduce unemployment, and real import price shocks, money supply shocks, and real interest rates increase unemployment.

Blanchard's (2005) account puts rather more weight on real and nominal wage rigidity, on factors affecting flows in the labour market, and on the interaction of shocks and institutions. He in fact expresses a degree of doubt about the amount of information that can be extracted from an exercise like that of Nickell *et al.* ("It is clear however that the number of shocks, institutions, and interactions is sufficiently large that the ability of such panel data regressions to tell us what exact combination of shocks and institutions matter is limited. Such regressions allow us to check for simple and partial correlations; they are unlikely to tell us about which combination of shocks and institutions is responsible for unemployment." page 26.) He actually seems to place little importance on collective bargaining, density, coordination, and so on.

### **Theoretical developments**

Theoretical modelling of the relationship between centralization and unemployment has developed in various directions. Notably, Jean-Pierre Danthine and Jennifer Hunt (1994) argued that openness of the economy would be likely to lower the hump. Greater international competition would reduce the ability of domestic industry unions to raise wages. At the same time the national price level would be less affected by the wage decisions of domestic unions. Alex Cukierman and Francesco Lippi (1999) have explored the interaction of wage determination with central bank independence and monetary policy, and look at implications for both unemployment and inflation.

The concept of corporatism has been discussed and analysed more broadly in books such as those of Matti Pohjola (1992), and Joop Hertog and Coen Teulings (1998). There are many ramifications of the concept. A topic that has been widely taken up in the literature is the implications of centralized bargaining for the distribution of earnings and relative pay of different groups of workers. The compression of differentials, leading to problems in recruiting higher skilled workers, was one of the factors that led the Swedish employers organization to withdraw from centralised bargaining.

There has been a massive rise of research into the relationships between institutions and growth, which may include labour market institutions among the many factors that have affected growth. Finance and growth literature. In a sense, the corporatism/macro performance issue is just one part of this.

### **Changes on the ground**

How have labour markets, and economies more generally, changed since 1988? What has happened to institutions and to macroeconomic performance?

There has been a fall in inflation, and convergence at low inflation rates, as figure 2 shows. Inflation in OECD economies now lies in a range between zero and three percent, roughly speaking, and has done so for the past three or four years.

Unemployment has not converged, of course. It ranges between roughly four and eleven percent (see figure 1). The convergence in inflation results from the current implementation of monetary policy. Independent central banks (starting around 1988) use the short-term interest rate as the policy instrument. The adoption of inflation targeting, or something very close to it, with an inflation target around 2 percent is nearly universal.

The collapse of communism in 1989, and the subsequent opening up of Eastern Europe, has affected some economies greatly. Various Eastern European countries (Estonia, Latvia, Lithuania, Poland, Hungary, the Czech Republic, Slovakia, Slovenia) are now members of the EU. The collapse of Russian economy hit Finland very hard. German unification had a potent effect on Germany. Very high unemployment persists in Eastern Germany (possibly for reasons set out by Driffill and Miller (2003)).

There has been a general downward drift in trade union membership, in coverage of collective bargains, and in the amount of coordination of bargaining among unions. Trade union density fell from 34 percent in 1970 to 21 percent in 2000 (over a weighted average of a constant sample of OECD countries). Coverage has fallen from 45 to 39 percent on the same basis. Centralization of bargaining, on the OECD's measure has fallen notably in Australia, Denmark, New Zealand, Spain, and Sweden, and slightly in one or two other countries. The 'Swedish model' of highly

centralized and coordinated wage setting disintegrated during the 1980s. The Danish approach labelled 'flexicurity' by the OECD has been widely noted. Coordination of bargaining, again on the OECD's measure, has fallen in Australia, Austria (slightly), Denmark (slightly), New Zealand, Portugal (slightly), Spain, Sweden, and the UK (slightly), though there have been increases in Belgium, Italy, and the Netherlands. These changes have accompanied the continued downward drift in the share of employment in manufacturing and other industries in which unions were traditionally strong. Privatisation of public enterprises has weakened unions' grip, as have the growth of service industries, the rise in the employment of women and part-time workers, trends general throughout the OECD.

At the same time the monopoly powers of unions have been weakened by the onward march of globalisation, the continued fall in costs of transport and communication, the advance of IT, the growth of outsourcing of manufacturing and services to emerging markets. The rise of India and China and other emerging markets, all have made for greater competition and undermined the monopoly positions that unions might have exploited. Within the EU, the 'completion' of the Single Market and the introduction of the Euro in January 1999 were intended to increase competition. Openness of economies, as measured by imports and exports relative to GDP, has generally continued to increase.

Public policy has also changed in ways that have weakened union influence. A succession of changes to industrial relations laws in Britain in the 1980s weakened union power: the ban on secondary picketing, the requirement to hold ballots before strikes; the removal of protection from unofficial strikers, employers' freedom not to recognise unions for bargaining. In Britain and a number of other countries, the benefits system has been changed in the direction of lowering replacement rates, limiting the period of availability of benefits, and placing greater pressure on recipients to look for and take jobs. This policy has been pushed in Britain a great deal (harassment of the work-shy). In some countries employment protection legislation has been scaled back, to allow for more temporary employment (OECD Employment Outlook, 2004). Some countries have made more effective use of active labour market policies.



Meanwhile, corporatism is not dead. In Ireland, for example, there has been a succession of tripartite social pacts to limit inflation and promote high employment, sometimes involving the government in offering lower tax rates. The Netherlands' success in returning to lower unemployment has been characterised as partly a success of a corporatist model (Nickell and van Ours, 2000).

Although one should not do it, it is very tempting to look at the scatter diagrams of unemployment plotted against coordination and centralization for the OECD countries, as it done in figures 3 and 4. The data are unemployment averaged over the period 2000-2003 (four annual observations) and the coordination and centralization figures for 2000 (OECD data). What do we find? There are only a few observations with coordination equal to one, two, or three. Most have a value of four, and there is wide variation among them in unemployment rates, from the Netherlands (3%) to Italy (9.4%), though one has to keep in mind that Italy combines the low-unemployment north with the high-unemployment south. The only more coordinated countries are Belgium and Norway on 4.5 and Finland on 5, with very high unemployment, and rather spoiling any hump-shaped pattern. But for all these countries, other factors also affect unemployment. In Finland's case, it may be argued that the country has not fully recovered from the collapse of its markets in the Soviet Union in 1990. Among the 4s, the Netherlands benefits from its cooperative unions and relatively flexible labour markets. Germany's social security system still provides high replacement rates and relatively poor incentives to work. Overall, there is very weak evidence of a non-monotonic relationship between coordination and unemployment. A regression of unemployment on coordination and coordination squared (weighted least squares, with population weights) gives

$$\hat{u}_i = 0.18 + \underset{(s.e.=2.47)}{6.33} (coord) - \underset{(s.e.=0.48)}{1.16} (coord)^2$$

$$R^2 = 0.84$$

and the predicted unemployment rates at these levels of coordination indeed are non-monotonic. These regression results are not to be taken too seriously, it need hardly be said.

The picture is less promising looking at unemployment versus centralization where most countries are given an index of either 2 or 3, and within each category there is a

very wide range of variation. The 2s run from Switzerland (3.2% unemployment) to Italy, and the 3s from the Netherlands to Spain (11.1%). Within each of these centralization categories there are good explanations for the variety of unemployment figures. Nevertheless, running the same regression gives

$$\hat{u} = 0.97 + \underset{(s.e.=1.9)}{5.3} (\text{centralization}) - \underset{(s.e.=0.42)}{0.95} (\text{centralization})^2$$

$$R^2 = 0.87$$

The stability of inflation rates in the last few years (figure 1) may suggest that the unemployment rates averaged over 2000-2003 might be taken as equilibrium rates, reflecting long-run forces, such as the effects of labour market institutions. However, the scatter diagrams of inflation against unemployment show that relative to the past, we have seen in the last five years or so large movements of unemployment against relatively small changes in inflation, as Charles Bean's slides from his comments on Blanchard (2005), reproduced below, show. This rather undermines the notion of the equilibrium unemployment rate, and suggests that there might be further large changes in unemployment without inflation rising. So the status of recent unemployment rates as indicating equilibrium rates is questionable.

## Conclusions

Calmfors and Driffill (1988), in their empirical work, did not take account of other factors than simply centralization of bargaining, such as informal coordination of bargaining across groups, and the density of unions. The simple bivariate relationship was too simple minded. Other factors are important in determining the equilibrium unemployment rate, particularly the benefit and social security system, and active labour market policies. A multivariate analysis is needed, and indeed several have been provided, such as Nickell *et al* (2005). Theoretically, we omitted factors that have subsequently proved to be important, such as openness, and the effects of the macroeconomic policy context on wage setting. There are other factors, which may be important, such as the role of intermediate goods.

Nevertheless, both as a theoretical and an empirical proposition, the non-monotonic relationship between a measure of unions' coordination and unemployment has not

entirely been overturned. Some empirical studies continue to find evidence of it, though quite a few do not, and quite a few do not look for it. Theoretically, the proposition remains intact, although the empirical relevance of the model on which it is based is questionable.

Over the last seventeen years, unions have lost membership, power and influence. The general direction of change has been towards less centralised and slightly less coordinated bargaining. Higher competition in product markets has reduced monopoly power that unions can exploit. Public policies on job protection legislation, on unemployment benefits, and training have been very important in bringing down average unemployment rates in a number of countries.

Much of the academic literature has taken labour market institutions separately, but in view of the vast amount of recent work on institutions on growth and macroeconomic performance, including political institutions and financial markets, perhaps collective bargaining and related matters should be seen as part of broader research on institutions and macroeconomic performance in the medium term and long-term growth. While these institutions have generally been taken as the exogenous variables, they should perhaps also been seen as endogenous.

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## Tables

Table 1

Trade Union Density in %				
	1970	1980	1990	2000
Australia	44	48	40	25
Austria	63	57	47	37
Belgium	41	54	54	56
Canada	32	35	33	28
Denmark	60	79	75	74
Finland	51	69	72	76
France	22	18	10	10
Germany	32	35	31	25
Greece		39	32	27
Iceland		75	88	84
Ireland	53	57	51	38
Italy	37	50	39	35
Japan	35	31	25	22
Luxembourg	47	52	50	34
Netherlands	37	35	25	23
New Zealand	56	69	51	23
Norway	57	58	59	54
Portugal		61	32	24
Spain		7	11	15
Sweden	68	80	80	79
Switzerland	29	31	24	18
UK	45	51	39	31
United States	27	22	15	13
OECD	42	47	42	34 unweighted average
OECD	42	47	42	36 unweighted average (unchanged sample)
OECD	34	32	27	21 weighted average
OECD	34	33	26	21 weighted average (unchanged sample)

Source: OECD Employment Outlook, 2004, chapter 3, table 3.5.

Table 2

<b>Collective Bargaining Coverage in %</b>			
	1980	1990	2000
Australia	80	80	80
Austria	95	95	95
Belgium	90	90	90
Canada	37	38	32
Denmark	70	70	90
Finland	90	90	80
France	80	90	90
Germany	80	80	90
Greece			
Iceland			
Ireland			
Italy	80	80	80
Japan	25	20	15
Luxembourg			60
Netherlands	70	70	80
New Zealand	60	60	25
Norway	70	70	70
Portugal	70	70	80
Spain	60	70	80
Sweden	80	80	90
Switzerland	50	50	40
United Kingdom	70	40	30
United States	26	18	14
OECD unweighted average	67	66	60
OECD unw ave (unch. sample)	67	66	64
OECD weighted average	45	38	35
OECD w. ave (unch sample)	45	44	39

Source: OECD

Table 3 Centralization of Bargaining

	1970-74	1975-79	1980-84	1985-89	1990-94	95-2000
Australia		4	4	4	4	2
Austria		3	3	3	3	3
Belgium		4	3.5	3	3	3
Canada		1	1	1	1	1
Denmark		5	5	3	3	3
Finland		5	5	4	5	5
France		2	2	2	2	2
Germany		3	3	3	3	3
Greece						
Iceland						
Ireland		4	4	1	2.5	4
Italy		2	2	3.5	2	2
Japan		1	1	1	1	1
Luxembourg						
Netherlands		3	3	3	3	3
New Zealand		3	3	3	3	1
Norway		4.5	4.5	3.5	4.5	4.5
Portugal		5	4	3	3	4
Spain		5	4	4	3.5	3
Sweden		5	5	4.5	3	3
Switzerland		3	3	3	3	2
United Kingdom		2	2	1	1	1
United States		1	1	1	1	1

Source: OECD

Table 4 Coordination Index

	1970-74	1975-79	1980-84	1985-1989	1990-94	95-2000
Australia	4	4	4.5	4	2	2
Austria	5	5	4.5	4	4	4
Belgium	4	3.5	4	4	4	4.5
Canada	1	3	1	1	1	1
Denmark	5	5	3	4	3	4
Finland	5	5	4	5	5	5
France	2	2	2	2	2	2
Germany	4	4	4	4	4	4
Greece						
Iceland						
Ireland	4	4	1	2.5	4	4
Italy	2	2	3.5	2	3	4
Japan	4	4	4	4	4	4
Luxembourg						
Netherlands	3	4	4.5	4	4	4
New Zealand	4	4	4	4	1	1
Norway	4.5	4.5	3.5	4.5	4.5	4.5
Portugal	5	4	3	3	4	4
Spain	5	4	4	3.5	3	3
Sweden	4	4	3.5	3	3	3
Switzerland	4	4	4	4	4	4
United Kingdom	3	4	1	1	1	1
United States	1	1	1	1	1	1

Source of data: OECD

Table 5

		Coordination level within central organizations	Existence of central organizations and their cooperation	Total Score
1	Austria	3	3	6
2	Norway	3	2	5
3	Sweden	3	2	5
4	Denmark	3-	2	5-
5	Finland	3-	2	5-
6	Germany	2-	3-	5--
7	Netherlands	2	2+	4+
8	Belgium	2	2	4
9	New Zealand	1	3	4
10	Australia	1	3	4
11	France	1+	2	3+
12	UK	0+	3	3+
13	Italy	1+	2	3+
14	Japan	1	2	3
15	Switzerland	1	2	3
16	US	1	1	2
17	Canada	1	1	2

Source: table A1 from Calmfors and Driffill, 1988. The rankings of countries with equal scores are explained in the appendix of the paper.



## Figures

Figure 1 Unemployment Rates

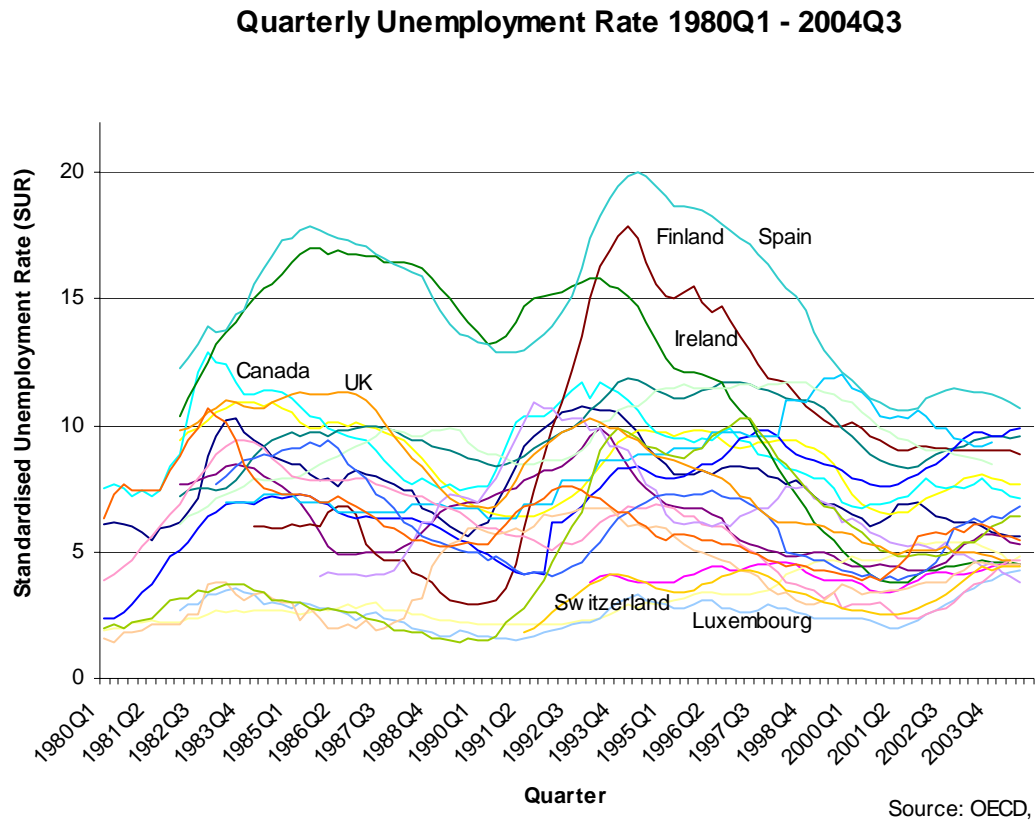


Figure 2 Inflation Rates

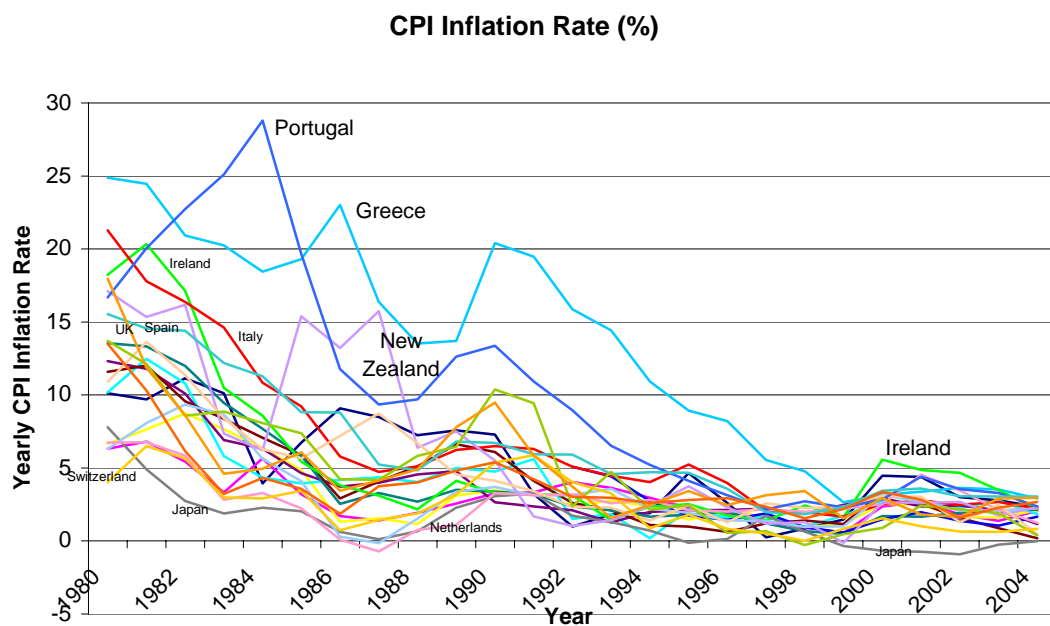


Figure 3 Coordination and Unemployment

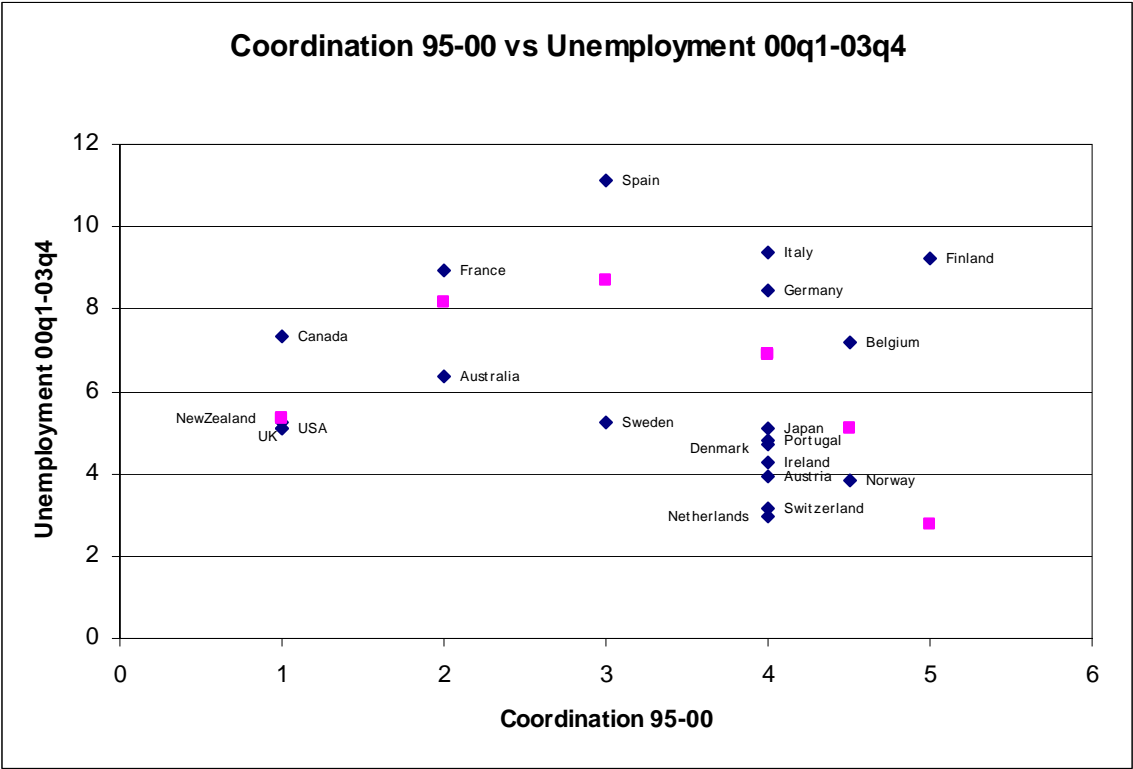


Figure 4  
Centralization and Unemployment

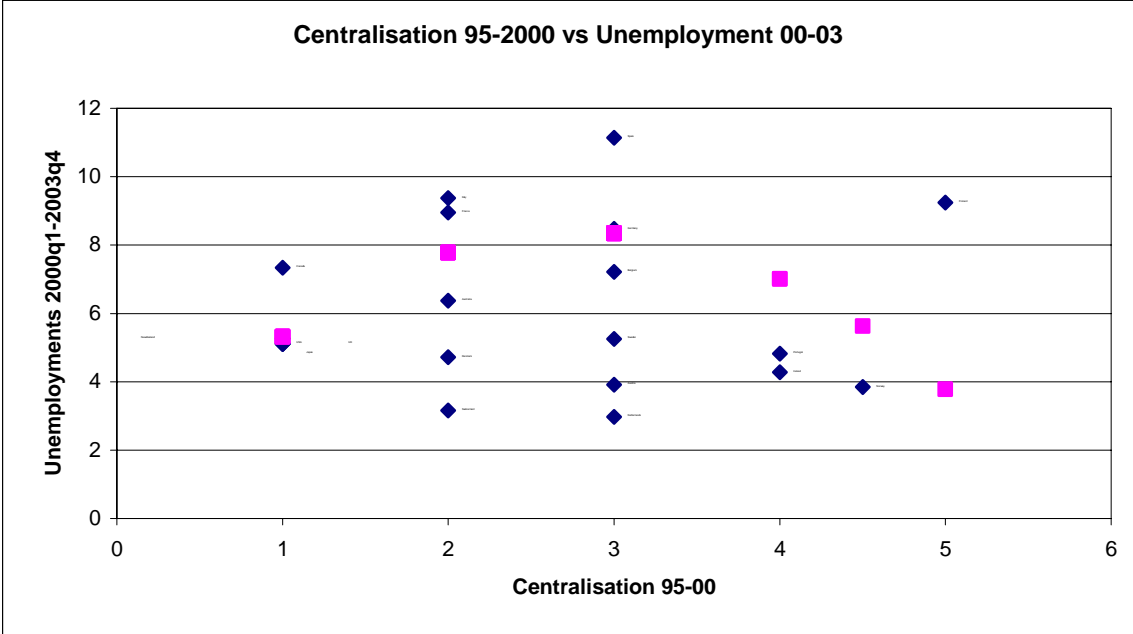


Figure 5 Trade Union Density and Coverage 2000

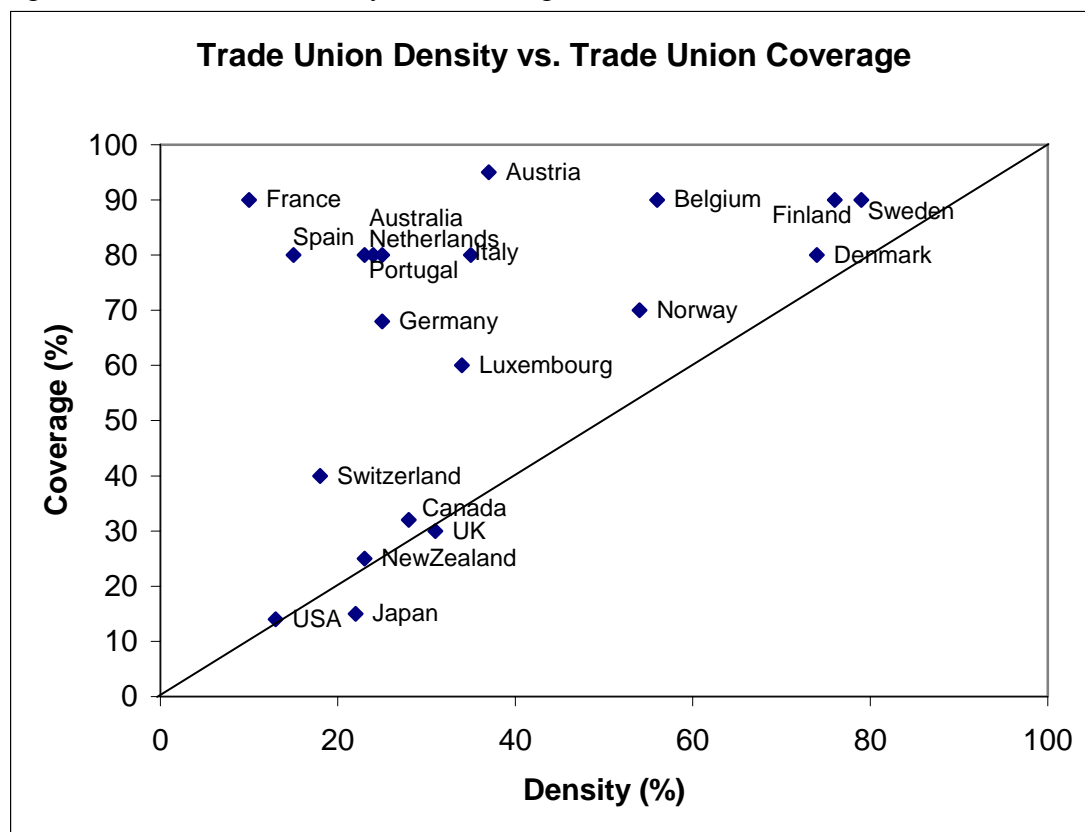


Figure 6. Unemployment and inflation in various countries

Figures reproduced from Charles Bean's comments on Blanchard at the October 2005 Economic Policy Panel meeting

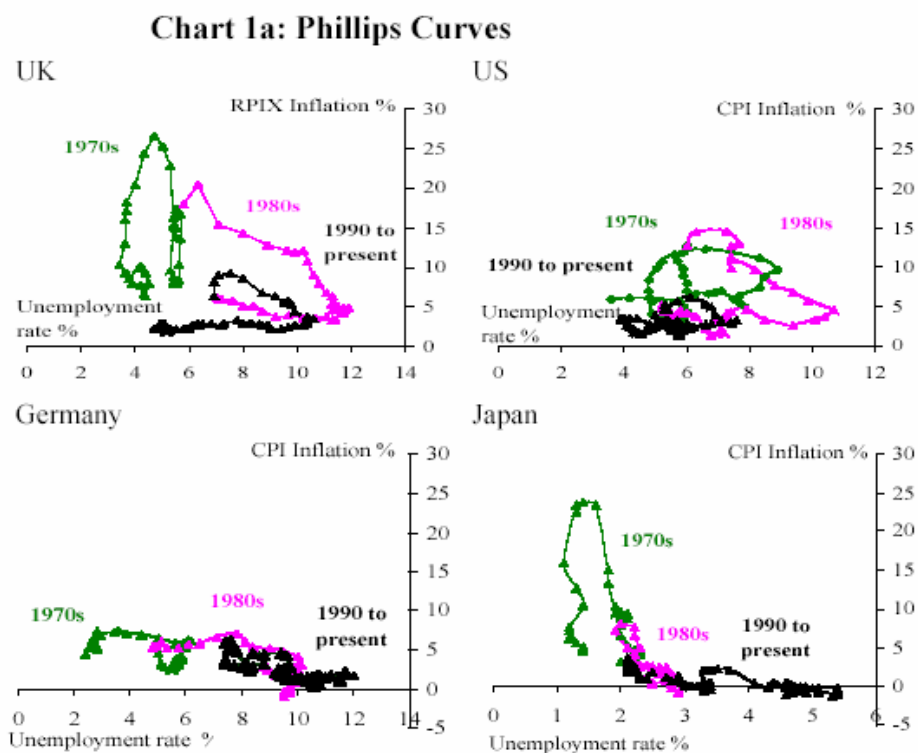
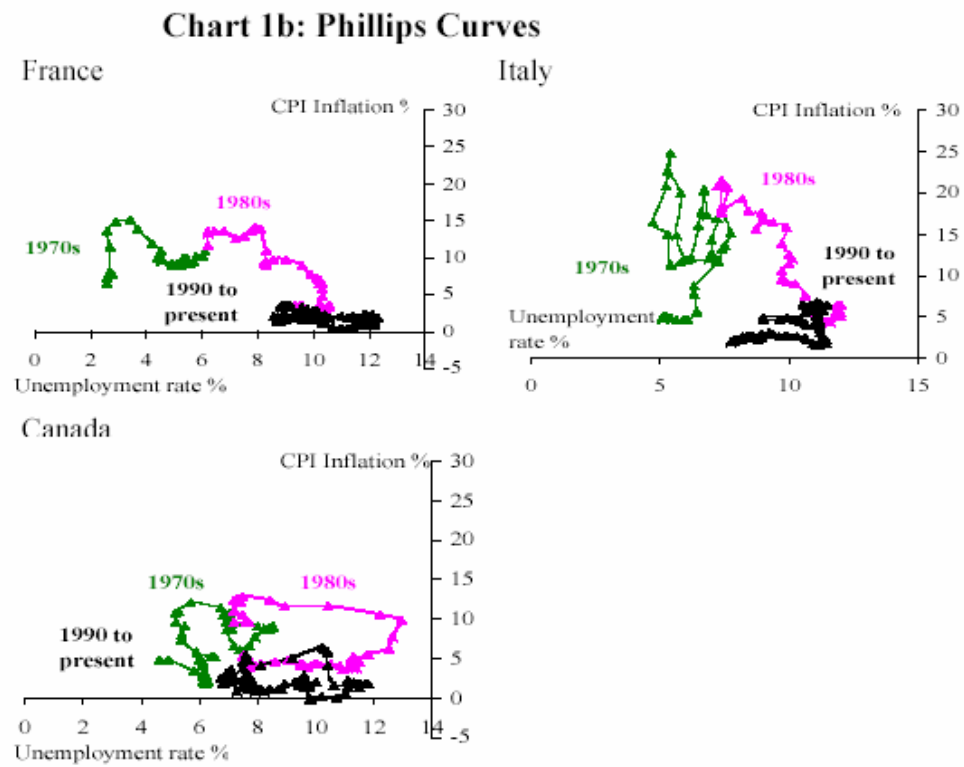


Figure 7. More Phillips curves (from Charles Bean's comments on Blanchard, 2005)



## **Report: Recent Changes in the German Wage Bargaining Process**

Christian Spielmann

Draft: 28.02.05

For decades, wage bargaining in Germany has been at branch/industry level. At the centre of the German bargaining process is the “Flächentarifvertrag” (system of industry-wide collective wage agreements) which regulates the working arrangements for unionised members of certain industry sectors and regions. Recently, there has been a trend towards more flexible lower-level bargaining procedures and some authors argue that the “erosion of the German model<sup>1</sup>” may have already started (see OECD, 2004).

Many of the changes in the wage bargaining process have gone unnoticed partly because trade unions have been supportive and the collective agreements have been pragmatic (Streek and Rehder, 2003).

Both trade union density and coverage have decreased from the 1990s onwards when economic performance was declining. The coverage rate in 2002 was 71% in Western Germany and 56% in the East - around 15% lower than in 1980. This is still very high in comparison with the rest of the world (OECD, 2004). In both, the West and the East, around 40% of the companies which are not tied to the collective wage agreements base their wage decision upon the collective bargaining outcomes.

In Germany the legal framework in which wage decisions are made has remained fairly stable compared to other OECD countries. Coordination and centralisation indicators show the same values over the past 30 years. The “Flächentarifvertrag” is still at the centre of the bargaining process and institutional change in Germany was rather an extension of the existing framework and not a modification (Streek and Rehder, 2003).

These extensions are manifested in two developments. Firstly, company-level alliances for employment and competitiveness (Betriebliche Bündnisse zur Sicherung von Beschäftigung und Wettbewerbsfähigkeit) have emerged. Secondly, contingent pay arrangements have been widely extended.

Trade unions have agreed to make remuneration of unionised labour more variable. In particular, payments are increasingly linked to performance of the individual worker or to the company performance. In addition, employees share the firm’s economic risk by holding capital shares. Remuneration arrangements of this kind have become common. A recent study (Kurdelbusch, 2003) shows that out of 90 major German enterprises, more than half of them had included arrangements like the ones mentioned above in their contracts. Such concessions have reduced the union power but have also prevented a major flight out of the collective bargaining agreements. Hence, trade unions now accept variable pay arrangements but try to regulate their design (Streek and Rehder, 2003).

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<sup>1</sup> Carlin, Wendy / Wikipedia: used in economics to describe post-World War II West Germany's means of using innovative industrial relations, vocational training, and closer relationships between the financial and industrial sectors to cultivate economic prosperity.

“Betriebliche Buendnisse” are company level pacts between the bargaining parties (employer/management and employee/work council) which deviate from the industry wide collective wage agreement. Such pacts can be made in the presence or absence of the affected trade union, which often results in disputes. However, strikes or lock-outs are not permitted. It is usually not possible to take legal actions with respect to the content of such arrangements. However, the code of practice is to treat such arrangements as binding.

Within a company level pact, employees agree to less pay, higher productivity or reallocation of work in exchange of employment securities or if the company binds itself to specific investments.

The law from the mid 1990s regulating the remuneration of unionised workers (Tarifrecht) consists of a ‘favourability principle’. This states that deviations from the “Flaechentarifvertrag” were only allowed if they were in favour of the employee. Hence, most company level pacts were basically a breach of the collective bargaining agreement. However, so-called opening or opt-out clauses (Oeffnungsklausel) were increasingly introduced into the “Flaechentarifvertrag” which legalised the formation of company pacts.

In certain circumstances opt-out rules allow companies to deviate from the “Flaechentarifvertrag” to the detriment of employees. The use and the applicability of such rules have been widened extensively in the past. Recently, about a quarter of the companies with work councils and more than 20 employees have deviated from the collective bargaining arrangements. The majority of such agreements have been concerned with working hour arrangements - but increasingly, remuneration issues are also subject to such agreements (OECD, 2004).

The measures described above can be seen as “conserving” measures. Reforms were made by retaining the predominant role of unions. One can argue that the way, wage bargaining has taken, has even stabilised the system by giving unions new functions. (Streeck and Rehder, 2003). However some tendency of erosion has been seen particularly in East Germany. For example, some firms left or did not join the collective bargaining arrangements (OECD, 2004). Yet, these examples are relatively rare compared to the existence of more flexible bargaining arrangements.

Plant level arrangements in particular have become very common, and many examples can be found.

In 1993, The Volkswagen AG deviated from the collective bargaining agreement and introduced the “4-day-week” without any pay compensation. In return they assured that 30 000 work places had been secured. This pact was agreed by the VW management and the regional leadership of the IG Metall (metal workers trade union). This was particularly striking as the agreement was made in a time where employers demanded longer working hours. Shortly after, similar agreements were made for the mining sector.

Another famous company agreement is VW’s project “5000\*5000” which was settled in 2001 after 2 years of dragging proceedings.

Initially the idea was to create 5000 jobs for three years in two production sites in Lower Saxony (Wolfsburg and Hanover) to build the new VW Van. The contracts should have had fixed remuneration of 5000 DEM. Working hours should have been flexible depending on demand with an upper limit of 48 hours per week and Saturdays would be a normal working day. From the cost side, this would mirror production possibilities VW would have had in other locations such as Portugal. VW threatened to build the production plant in a less cost-intensive environment outside Germany.

The negotiations were carried out between the IG Metall and VW. The union fought heavily against VW's plans accusing them of pay and social dumping which could have serious consequences for collective bargaining standards in Germany. In addition, work councils and union organisations at other automobile producers in Germany feared the erosion of a level playing field within the industry. Politicians and the German public, however, seemed to be highly in favour of VW's plans and hoped for a compromise between IG Metall and the car producer. In June 2001 the negotiators did not reach an agreement. But 10000 unemployed people had already applied for the 5000 jobs under the given conditions, according to VW.

Under the existing political and public pressure, the parties resumed talks soon after and came to an agreement where in a first instance 3500 new jobs were created.

In 2005 a new BMW plant in Leipzig, East Germany, was opened under a company agreement between BMW and the IG Metall. This agreement allows for more flexible working hours depending on the number of orders. The outcome of the negotiations, has in part led to the decision to build the new production site at that particular location, according to BMW. The negotiations have been praised by politicians.

Where trade unions and companies increasingly seem to agree upon the design of company contracts, conflicts at a company level between employees and employers seem to increase.

In 2004, DaimlerChrysler and the IG Metall agreed upon a company contract to save 500 Million Euro but assured certain investments and employment guarantees. Negotiations were highly controversial and even though an agreement was finally reached, the works council did not accept the pact.

Overall, pressure from the government on the trade unions has led to more flexibility and a climate of give-and-take in the German wage bargaining process over the last decade. Opt-out clauses are used more often and unions seem to be increasingly cooperative.

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