THE PARADOX OF GLOBALIZATION
Labor Relations in Germany and Beyond

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What is the impact of globalization on labor in the advanced industrial countries? One body of work holds that globalization pushes all countries toward neoliberalism; another argues that the impact of globalization will vary according to prevailing institutional arrangements and predicts continued divergence between the so-called liberal and coordinated market economies. In an analysis of the German case that combines case-study and formal-modeling methods, we refute the first, neoliberal convergence, theory, showing that globalization in some ways empowers unions by rendering employers extremely vulnerable to industrial unrest. Furthermore, we suggest some revisions to the second, varieties of capitalism, perspective. We show that, in Germany, employers' increased vulnerability to conflict has shored up centralized bargaining arrangements in the short run, but at the same time, has also set in motion feedback effects that are deeply destabilizing to the system in the longer term.

Keywords: *globalization; industrial relations; labor politics; advanced industrial countries; Germany; analytic narrative*

What is the impact of globalization on labor in the advanced industrial countries? There are conflicting views. One body of work holds that globalization pushes all countries toward neoliberalism and deregulation, encouraging firms to lower labor costs and increase labor market flexibility while undermining the power of unions to prevent these (Kapstein, 1996; Katz & Darbishire, 1999; Ross & Martin, 1999). Another literature argues that the impact of globalization will vary considerably according to the insti-

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tutional arrangements within each country that influence employer strategies and interests, producing more neoliberalism in the so-called liberal market economies but not in the coordinated market economies where firms have a stake in preventing deregulation (see, especially, Hall & Soskice, 2001).

This article refutes the first (*neoliberal offensive*) thesis and embraces but also refines the alternative (*varieties of capitalism*) thesis. Our analysis focuses on Germany, a critical case in this literature, not least because proponents of both perspectives have offered it as a prime example of their preferred line of argument. Scholars embracing the neoliberal offensive position can point to a number of serious destabilizing trends over the past decade in Germany's relatively centralized collective bargaining institutions.[1] Representatives of the varieties of capitalism perspective, by contrast, have been impressed with the resiliency of formal bargaining institutions in the face of intense market pressures and unification. Our analysis employs a combination of comparatively informed case analysis and formal modeling to explore the specific blind spots of each perspective as it approaches the German case. On this basis, we then develop an alternative explanation for that case and derive a series of hypotheses to guide the analysis of labor in other developed democracies as well.

Specifically, we argue that the focus of the neoliberal offensive thesis on how capital mobility strengthens employers against labor has completely obscured aspects of globalization that have very different implications for labor relations than those predicted. Where, as in Germany, employers are heavily invested in competitive strategies that rely on high quality and often just-in-time production, employers are more dependent than ever on stable relations with labor at the plant level and more vulnerable to overt industrial strife (Thelen, 2000; Thelen & Kume, 1999). In line with the varieties of capitalism perspective, we argue that the stability of centralized bargaining to date can be traced back in no small part to employers' continuing interest in institutions that have traditionally guaranteed a high degree of peace and predictability on the shop floor.

However, the varieties of capitalism literature has its own characteristic blind spots. In particular, this literature tends to see all feedback as operating to sustain and reproduce the existing system. By contrast, our analysis shows that the results of some recent collective bargaining rounds in the metalworking industry, in which the employers association went to some lengths to avoid conflict with the union, have had "feedback effects" that are deeply destabilizing in the medium and longer term. The most destabilizing forces go back to a growing divide within the employers association itself: The intensification of cooperation within a shrinking core of firms has driven a narrowing of the coverage of German collective bargaining institutions that threatens the stability of the system as a whole (Thelen & Kume, 1999).

We develop this argument in three steps. The first section focuses on the neoliberal offensive thesis. It provides an account of a number of developments in Germany that appear anomalous in light of theories emphasizing a struggle between emboldened employers seeking deregulation and weakened union defenses. In particular, we cite several recent collective bargaining rounds that featured surprising displays of labor strength in a period generally seen as favoring capital. We trace union victories in these conflicts back to employers' heightened vulnerability to industrial strife. The second section goes on to address the varieties of capitalism perspective. Here we show that these union victories over disorganized employers—far from shoring up the system—"feed back" in ways that complicate coordination on both the employer and the union sides and, in so doing, threaten the long term stability of the system as a whole. A final section reflects on the strengths and weaknesses of the type of analytic narrative strategy employed in this article and suggests a number of hypotheses to guide further research.

SORTING OUT ELEMENTS OF STABILITY AND CHANGE IN GERMAN INDUSTRIAL RELATIONS

Students of industrial relations in the developed democracies have devoted considerable attention to the ways in which globalization has generated new pressures for deregulation. Although almost no one is predicting a complete convergence of Europe's more centralized labor relations systems on the U.S. model, the idea of a broad neoliberal offensive against rigid centralized bargaining arrangements remains prominent and viable. Proponents of this thesis in the German context can cite some significant new developments that appear to strongly support a pessimistic prognosis for centralized bargaining there (Fichter, 1997; Flecker & Schulten, 1999; Mahnkopf, 1991). German business leaders and politicians have clearly become more critical than ever before of traditional bargaining arrangements; for instance, in February 2000, the presidents of the country's four most important peak employer associations signed a letter calling for changes in the collective bargaining law to allow more local flexibility. Their demands were backed up by the business-oriented Free Democratic Party, which put forth even more radical proposals, including changes in the Works Constitution Act.[2]

Beyond the rhetoric, the past years have also seen sobering trends toward an overall shrinkage in collective bargaining coverage as a significant number of firms have decided to go their own way by giving up their membership in the industry associations that negotiate industry-wide agreements with the union. Available evidence suggests that coverage rates have fallen off from the previous level of about two thirds of all German firms to about 50% of companies in the West and only 25% of companies in the East.[3] Beyond the formal defections from the employers associations, there is also the problem of firms undercutting industry agreements unofficially, a problem that is again more severe in the East but growing in the West as well. Overall, the best available evidence suggests that about 15% of firms (lower in the West, higher in the East) either *sometimes* or *often* contravene collective bargaining agreements.[4] No wonder some of the most astute observers of German industrial relations have begun to question the sustainability of the German model.

However, there have been other developments in Germany that appear to be completely anomalous from the perspective of the neoliberal offensive thesis. In particular, the late 1990s featured a series of collective bargaining rounds in which key unions prevailed over increasingly timid and disorganized employers associations.[5] A 1995 conflict in the Bavarian metalworking industry ended in a virtually complete victory for the union, as individual employers began to openly side with their workers and against the employers association, making it impossible for the latter to follow through with a planned lockout. The next year, a conflict over sick pay followed a similar trajectory, and a breakdown in employer solidarity led to a compromise that reinstated the union's main demand. Again in 1998, the threat of a strike in the steel industry in Eastern Germany brought about a rapid disintegration of solidarity among employers as the leading companies rejected a hard line position and insisted instead on a negotiated settlement.[6] And finally, the 1999 wage round in the metalworking industries ended in a settlement that the employers association (*Gesamtmetall*) complained was forced on them by union "blackmail" in the form of strike threats.

Examples such as these confront us with a puzzle: If globalization has rendered capital so strong and labor so weak, why were German employers so helpless and lost when the time came to negotiate with the unions? Why couldn't they translate the power that globalization presumably confers to them into collective bargaining victories? Most of the existing literature on industrial relations paints a picture with labor on the defensive and employers wringing concessions out of unions against a threat to locate production elsewhere. But in the bargaining rounds cited above, it was employers not unions who were complaining about extortion and blackmailing. Why the apparent role reversal?

These are not questions that can be answered from within the dominant neoliberal offensive paradigm. To answer them requires that we confront an alternative aspect of globalization that such theories have largely ignored. The bargaining rounds sketched out above reveal a very different face both to globalization and to the strains in centralized bargaining in Germany. The key to understanding these developments is to take into account the way in which globalization has vastly increased the vulnerability of individual firms to industrial strife, which in turn has enormously complicated coordination within overarching employers associations over the appropriate response to union demands, qualitative or quantitative, in the context of collective bargaining rounds.

Whereas in the past, companies were willing to be mobilized for extended struggle with the union in collective bargaining rounds, employers are increasingly finding that interruptions in production now have consequences that cannot be made up. Firms that are part of sprawling (often cross-national) production networks and producing on a just-in-time basis correctly fear that disruptions in production could result in the loss of whole markets. As one employer put it, “You return to find your market occupied.” Likewise, companies that compete on the basis of high quality and reliability are loath to have industry-wide or national conflicts played out in their plants. In each and every one of the examples cited above, the employers association found it impossible to muster the support of core firms to respond to the threat of a strike by the union with the prospect of a sustained industrial conflict supported by its members. The 1990s thus saw a dramatic new development in German industrial relations—a marked decline in employer solidarity and with that, the decline of their most powerful weapon, the lockout (Thelen & Kume, 1999).

REDEFINING INDUSTRIAL PARITY IN COLLECTIVE BARGAINING

Our thesis is that global competitive pressures have given rise to a new schism in employer interests that is undermining employer solidarity in the context of centralized collective bargaining with unions. In the past, core firms within the employers association prioritized achieving moderate collective bargaining settlements over maintaining labor peace. If necessary, they were willing to sustain prolonged conflict and support the employers association in locking out their own workers to force the trade unions to moderate their demands. As global competitive pressures have increased the cost of industrial conflict, a growing number of key employers now prioritize maintaining labor peace. Firms whose production strategies have rendered them very vulnerable to work stoppages would rather settle for somewhat more expensive contracts than face industrial conflicts at their plants.

However, other firms are in a very different situation, as a result of different, more conventionally understood effects of global pressures on them. Companies in which labor costs are a major factor in production are in many cases experiencing increased wage competition from foreign markets. Such firms have relatively little room to avert the cost of higher collective bargaining agreements by increasing flexibility. If push comes to shove, they would want to emphasize a moderate settlement over maintaining labor peace and thus prefer that the employers association resort to a lockout to force the unions to reduce their demands.

The divergence of interests laid bare by global competitive pressures introduces important complications into the calculus of both employer associations and unions as they formulate their positions in collective bargaining rounds. In particular, such rounds increasingly take place under conditions in which the ability of the employers association to muster solidarity for a lockout is seriously compromised. In collective bargaining, trade unions must now make their initial wage demands under the pressure of the resulting higher expectations on the part of their membership.[7]

It is reasonable to assume that a union would choose to settle for more moderate wage increases when it is obvious to both leaders and members that the cost of a strike is high (in other words, when a strike is likely to be answered by a lockout and thus result in a full-blown, protracted conflict) but would be under pressure from members to hold out for higher wage increases when it is unlikely that a strike will be answered by a lockout (in other words, when the employers association prioritizes labor peace). Thus the union's behavior depends on its belief about whether the employers association will be able to resort to a lockout in case of conflict.

Bargaining starts with a union's demand for higher wages. If the employers association accepts this demand, labor peace is preserved but at the price of paying higher wages (HWLP). If the employers association rejects the initial demand for higher wages, the union can choose to accept this and settle for a more moderate agreement, in which case labor peace is also preserved (MWLP), or the union can choose to respond to the employers' rejection by calling a strike. If the union calls a strike (partial conflict), the employers association has to decide whether to settle immediately and pay the higher wages as part of the settlement (HWPC), or to respond to the strike with a call for a lockout to extract a more moderate settlement, in which case a full-blown industrial conflict ensues (IC).

Based on this picture of preferences and sequencing, the interactions between the employers association and the trade union during a collective bargaining round can be written as an extensive form game, where λ denotes

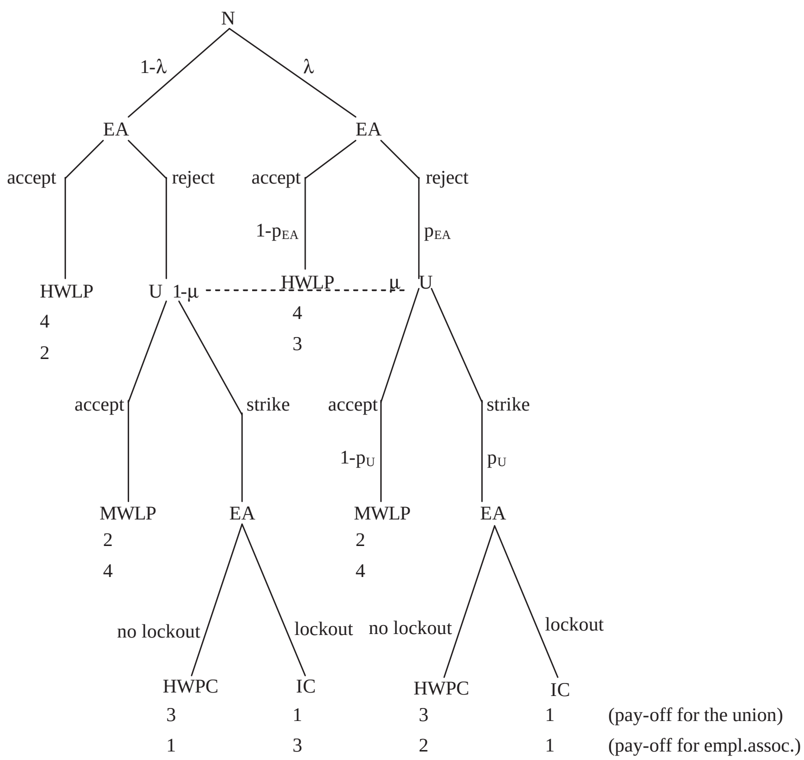

Figure 1. **Extensive form game on collective bargaining between an employers association (EA) and union (U) with incomplete information on the union's side about the employers' preferences.**

the probability that the employers association is conflict averse, which is to say, unable to muster the solidarity for a lockout. In the right branch of Figure 1, the employers association prioritizes labor peace over moderate settlements; that is, it does not receive support from member firms to lock out. In the left branch, the employers association emphasizes moderate wage settlements over labor peace; that is, its member firms are willing to back up a tough bargaining stance with a lockout. At the start of the game, nature determines whether the employers association prioritizes labor peace or a moderate settlement.

Equilibria of the Game and Properties of the Solution

We proceed under the assumption that the game is played period by period by the union and the employers association.[8] To solve the game, call μ the beliefs of the union, which is the probability it assigns that an employers association that has rejected the initial wage demand is conflict averse and therefore will not respond to a strike with a lockout. It can be shown that the game has two equilibria, depending on the likelihood that the employers association is not prepared to engage eventually in an industrial conflict (λ):

Proposition 1 (equilibria of the game). There exists a threshold value μ^* such that, where there is a high likelihood that an employers association is unable to muster the solidarity for a lockout ($\lambda > \mu^*$), the equilibrium will be in mixed strategies, with the employers association sometimes engaging in "bluffing" by rejecting a union's demand for higher wages in the hope the union will abandon its demand and not strike. Conversely, if it is likely that the employers association will be able to lockout ($\lambda < \mu^*$), the equilibrium of the game is in pure strategies, with employers always rejecting high settlements in the confidence that the union will not confront them.

Ironically, before globalization increased the cost of industrial conflict to core firms within the employers association (and increased the cost of high wages for others), employers did not really face a trade-off between labor peace and a moderate settlement as the ability to credibly threaten a lockout was often sufficient to obtain both. Interests among employers converged, and the employers association could rely on its members' solidarity in case of a lockout.

From here, we focus on the mixed strategy equilibrium because we are interested in studying how the employers association's declining ability to muster the solidarity for a lockout affects bargaining between unions and employers.

Proposition 2 (increased labor peace). As the cost to individual firms of a lockout increases (as measured by the probability that the employers association will not resort to a lockout, λ), the likelihood that the employers association initially accepts the union's demand for higher wages increases. This increases labor peace, as the frequency of strikes and of lockouts decreases. Indeed, there are two effects, one direct and one indirect, that affect the changing frequency of high wage settlements, strikes, and lockouts when the cost to individual firms of a lockout increases. The increase in λ—itself due to some employers simply being less able to sustain industrial conflict and thus less willing to lockout—results directly in a decrease in the number of lockouts, an increase in the number of higher wage settlements, and a decrease in the number of strikes. But this is compounded by an indirect effect: Because employers realize that the union knows they are less likely to lockout, they will be compelled to bluff less in instances in which, otherwise, they might have been able to obtain a more moderate wage settlement because of the union's fear of being confronted with a resolute employers association.

SUMMING UP THE ARGUMENT SO FAR

Beginning with the premise of firms' enhanced interests in industrial peace and working from there through the implications of this for the interaction between an employers association and a union in collective bargaining, we gain insights into developments in Germany that are otherwise hard to reconcile with the dominant view of a neoliberal offensive against labor. The alternative perspective outlined above explains why, in a period characterized as one of extreme labor weakness, employers have nonetheless found themselves signing wage deals that they themselves characterize as disastrous and catastrophic.[9] The key to understanding this puzzle is that the strong aversion to conflict on the part of core firms makes it nearly impossible for the employers association to answer union strike calls with even a credible threat of a lockout.

Our analysis thus provides a better account of the resilience of the German system to date than the neoliberal offensive argument, which attributes this mostly to inertia or institutional "stickiness" and predicts further erosion if not a more dramatic breakdown. By contrast, our analysis draws attention to the significant contributions that centralized collective bargaining makes for employers, for example, by regulating industrial conflict and guaranteeing predictability and peace at the plant level. Put simply, the system secures the labor peace that some employers are clamoring for more than ever. At the same time, our explanation accounts for significant events (union victories in collective bargaining) that appear completely anomalous in light of the neoliberal offensive thesis. In our account, we can see that these events go back in a straightforward way to an erosion of employer solidarity in the context of globalization's very differential effects in terms of firm sensitivity to the labor peace or wage moderation trade-off.

But these interim conclusions suggest further puzzles and anomalies. In particular, if the conventional wisdom were correct that the main source of instability of the German system is union weakness in the face of a neoliberal offensive by employers, then the strength of unions in industrial conflicts noted above would be very good news for unions. However, what we observe in Germany are not expressions of satisfaction but rather of deep concern on the part of unions who worry very much about the weakness of the employers associations with whom they negotiate. But why should they care? If the biggest challenge to centralized bargaining were the inability of unions to defend it against employer aggression, then union strength in negotiations with employers should shore up these institutions. Why should unions worry about employer weakness? The following section addresses this question. It examines the feedback effects set in motion by union victories over disorganized employers and casts doubt on the idea that such developments shore up the system, suggesting on the contrary that they are deeply destabilizing to traditional centralized bargaining institutions in the medium to longer term.

FEEDBACK EFFECTS AND THE REAL SOURCE OF INSTABILITY IN GERMAN INDUSTRIAL RELATIONS

An alternative to the neoliberal offensive thesis can be found in a growing literature on varieties of capitalism (see, especially, Hall & Soskice, 2001). This literature argues strongly against the idea that political economic institutions in the advanced industrial countries will converge on a neoliberal model. Far from universally embracing deregulation, employers in the developed democracies will seek to confront new market challenges by building on and deepening previous sources of comparative institutional advantage. Thus whereas employers in liberal market economies like the United States and the United Kingdom may well seek deregulation in industrial relations, employers in coordinated market economies like Germany will not turn away from traditional arrangements, because the strategies they have developed in the market rely on the wage moderation and labor peace that centralized bargaining has traditionally provided. Much evidence supports the idea that employer interests vary in important ways cross-nationally and particularly across these two broad types of political economies (Thelen, 2001).

The varieties of capitalism literature therefore usefully draws attention to the ways in which employers themselves have become invested in various institutions (including centralized bargaining) and—against the neoliberal offensive thesis—in fact support continued centralization. Given this emphasis, the theory predicts continued stability and, in the case of Germany, continued centralization as well. To the extent that the theory sees employers as supportive of and indeed dependent on existing institutions, all feedback within the system is, so to speak, positive and supports the existing system.

However, as we have seen, there are serious strains in the German system at present, strains that tend to be completely blended out in the varieties of capitalism perspective. The problem, as we see it, is that this framework builds on a highly aggregated notion of “employer interests” (for a general discussion, see Thelen, 2002). As we observed, there are important divisions running through key employers associations such as Gesamtmetall that are activated and indeed exacerbated by the trends just described. The problem of declining membership cited at the outset is closely related to the solidarity problems that the employers association for metalworking has been experiencing in recent collective bargaining rounds. The instabilities in the system go back to a growing gap within Gesamtmetall itself—between the firms that remain heavily invested in traditional institutions and are willing to pay almost any price to preserve labor peace and the growing number of companies for whom defecting from the employers association appears to offer relief from high settlements.[10]

For these latter firms, the cost of retaining membership in the employers association—including the obligation to accept a high settlement (C) multiplied by the probability of a high settlement being the outcome of collective bargaining (ρ)—may outweigh the benefits of membership (B), which include but are not limited to the benefits of labor peace. For each firm i, there exists a threshold value ($\tau_i = B_i / C_i$) such that if $\rho > \tau_i$, the firm defects from the association. In other words, this cost-benefit calculus determines a firm’s tolerance for high wages—or conversely, its aversion to conflict. Because the stance of the employers association in collective bargaining is a function of its members’ interests, defections from the employers association following any given collective bargaining round affect the association’s strategic strength at the start of the subsequent round. If the firms that are unwilling to tolerate higher settlements defect, the employers association as a collective will be more willing to accept higher wages during the next collective bargaining round. In particular, we assume that the inability to resort to a lockout by the employers association λ_{t+1} is determined by the mean tolerance for higher wages of the employers who remain members after evaluating the outcome of the previous collective bargaining round.

We can now state as a second result of our analysis:

Proposition 3 (realignment of the system of industrial relations). Suppose that for at least some employers $C_i > B_i$ (i.e., $\tau_i < \rho$), then an increase in the aversion to conflict of some but not all employers—which results in an increase in their tolerance for higher settlements (τ)—leads to a destabilization of the system of industrial relations. As some members of the employers association become increasingly averse to conflict, resulting in a less resolute stance of the employers association and hence an increased likelihood of higher settlements, the members for whom a high settlement is unpalatable start to defect from the association. This further weakens the position of the employers association, and hence, increases the likelihood of higher settlements ultimately leading to more defections. This spiral of defections continues until no member firm with a low tolerance for high settlements (i.e., hard-liners for whom $C_i > B_i$) remains a member of the association.

In the analysis outlined above, we have focused on an aspect of globalization that has previously been understudied, namely employers' increased vulnerability to production stoppages and industrial conflict. However, as we noted before, increased competition from foreign markets at the same time puts pressure on other employers to cut labor costs. It should be clear that this second, more conventional effect of global competitive pressures compounds the dynamic developments we have outlined, by simultaneously decreasing τ and accelerating the defections by employers desperate to cut a more moderate wage deal. Thus the prevalence of industrial peace that, as Proposition 2 shows, ensues as a result of the increase in τ^*, is accompanied by increasing disarray in the employers association, as some employers start to defect from the uniform wage deal.

THE DILEMMA FOR EMPLOYERS . . .

The crux of the problem in the German industrial relations system poses a real dilemma. The German collective bargaining system continues to command the strong support of a significant core of firms that rely heavily on labor peace and prioritize this over wage moderation.[11] Other companies, however, are coming to the conclusion they cannot keep up in terms of the costs of collective contracts that are increasingly oriented around the strongest and most conflict-averse firms. In a perverse twist of the usual rhetoric that accompanies collective bargaining rounds, in the late 1990s Gesamtmetall no longer met union threats of a strike with the traditional counterthreat of a lockout but rather with the threat that if the union persists, the employers association will simply fall apart—leaving the union no one with whom to bargain.[12]

Of course employers associations in Germany always had to deal with divergent interests of highly heterogeneous membership bases. In the past, the German system allowed for a significant degree of wage flexibility across firms. Industry-wide settlements did not exhaust the capacity of the strongest firms to pay; these companies signed on to the agreement but "topped it up" with additional benefits at the plant level (to be able to recruit the best workers). However, the available evidence suggests that this form of flexibility has been reduced in recent years. On the basis of a survey of nearly 8,000 firms (East and West), Bellmann, Kohaut, and Schnabel (1998) show that the percentage of firms paying wage increases over the collective bargain has dropped from 60.6% in 1993 to 48.9% in 1997. Among those firms paying higher, the amounts they are paying in excess of the negotiated increases has also fallen by two percentage points (averaging across all firms) over those 4 years (Bellmann, Kohaut, & Schnabel, 1998). This reduction in wage drift suggests that industry-wide contracts are increasingly exhausting the capacity of the strongest firms to pay, which in turn means that the weaker firms are now forced to pay wages much closer than before to those of the strongest companies (Hassel, 1999; Hassel & Schulten, 1998).[13] These trends have heightened the dilemmas that employers associations like Gesamtmetall now face.

. . . AND FOR UNIONS

The dilemmas faced by unions are in some ways even more intense and unprecedented, as these same trends produce feedback effects on the labor side that also complicate enormously the problems of coordination within unions such as the metalworkers, IG Metall. It is clear that the labor unions face a trade-off between a short-run collective bargaining gain and a long-run decrease in the coverage of the uniform contracts resulting from defections from the employers associations. In the German case, there is ample evidence that the unions are fully aware of this trade-off but quite constrained by the dilemmas they face in attempting to confront the long-term problems.[14] Where union members in some firms would be more than happy to take the higher wages that these firms are willing to pay, union leaders and members in the other firms can be expected to be more concerned with the resulting decrease in the coverage of collective bargaining contracts (and with that, expected lower wage deals outside the industry framework for the workers, as well as potential membership losses for the union).

Of course, unions like the IG Metall—large organizations featuring a highly diverse membership base—have always had to deal with tensions among workers in more and less dynamic plants and sectors. But it appears that the dilemma for the union presents itself more starkly today than in the past; in particular, the decline of the lockout reduces the external pressure on the union to moderate its collective bargaining demands. It should be obvious that a powerful (and unified) opponent is immensely helpful to union leaders who need to maintain solidarity among workers of different skill levels who are employed in firms experiencing quite different economic pressures. Without an effective counterforce pushing against it, the union faces a more difficult task in trying to achieve an internal consensus.

Germany's unions (and particularly the pattern-setting metalworkers union) have recently come under fire for their hesitating and at times seemingly contradictory strategic course. Overtures and signals by the IG Metall of willingness to accept some trade-off between wage restraint and employment are followed by determined calls for an end to moderation (*Ende der Bescheidenheit*). Our analysis provides some insights into this seemingly erratic course. Union leaders may well be quite willing to agree to more moderate wage deals (or more likely, to accept greater differentiation in industry-wide deals along other dimensions such as working times). However, lacking a strong and coherent counterpart on the employer side, such concessions are becoming harder to sell internally. Indeed, every movement in that direction exposes the union leadership to a challenge from internal opponents who favor a more hardline approach and push for a more aggressive stand by the union. Thus the dynamics described above between unions and employers in collective bargaining complicate internal union politics in ways that make it hard to break the cycle. If anything, the split on the employer side has opened up a gap within the union that further fuels the negative feedback mechanisms noted above (see the middle box at the left in Figure 2).

In sum, in the past, large, highly unionized firms were willing to bear the costs of a strike/lockout to achieve moderation in wage increases—results that of course benefited all firms. In the 1990s, and for the reasons elaborated above, many of these firms increasingly prioritize labor peace over wage moderation. Their views tend to prevail within the employers associations because these are precisely the firms to which the association looks to carry them through a conflict with the union. The unwillingness of these firms to perform the role traditionally assigned to them has led to a situation in which the agreed wage increases are now closer to the upper limit of what they can afford. Other firms, which have traditionally benefited from a system in which they got wage moderation without having to fight for it, are defecting at an increasing rate as a result. These defections, in turn, feed back in ways that further destabilize the bargaining system as, over time, contracts come to cover an increasingly narrow group of firms.

REFLECTIONS, METHODOLOGICAL AND COMPARATIVE, ON THE GERMAN CASE

The analysis presented above combines elements of a comparatively informed case study with formal modeling; it amounts to what is currently traveling under the label of an analytic narrative (Bates, Greif, Levi, Rosenthal, & Weingast, 1998). In this section we reflect briefly on what this

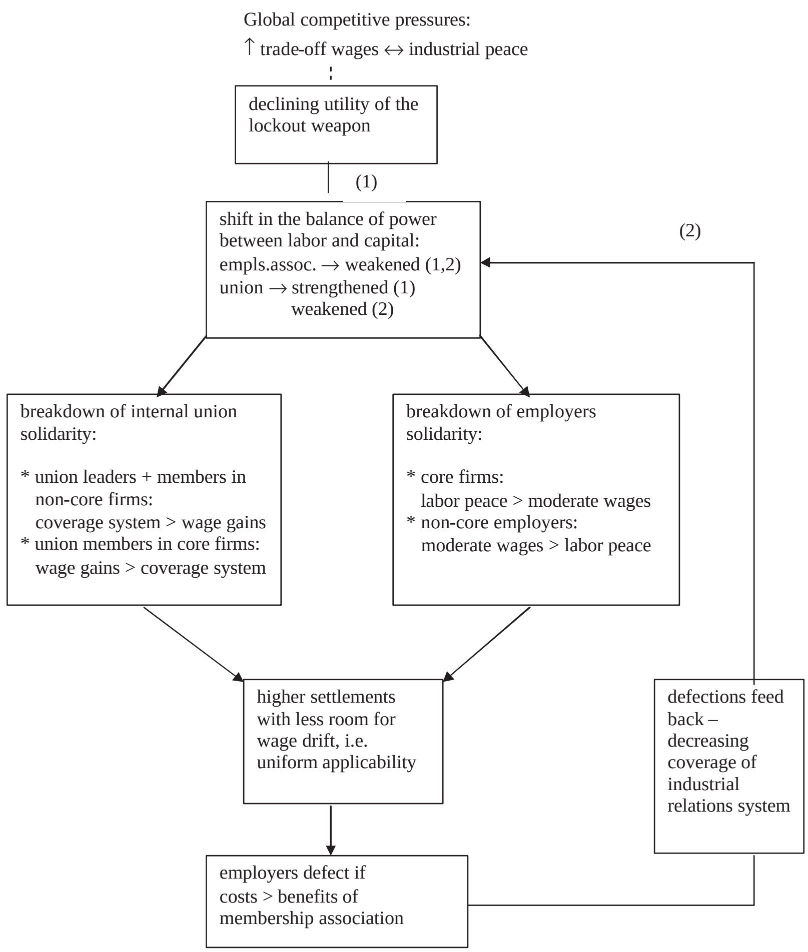

Figure 2. **The dynamic effect of an exogenous change in the utility of a lockout on the system of industrial relations.**

type of analysis yields and what it lacks. First to what it has yielded: We have presented an analysis of recent events in Germany that we think better fits the empirical record than two rival hypotheses against which we have measured our own claims, namely, the neoliberal offensive argument and the employer interest argument derived from the varieties of capitalism literature. In setting our own argument against these prominent alternatives, we have addressed one of the main criticisms (and a valid one) leveled against other analyses in the analytic narrative vein that mostly focus on modeling their preferred account of the outcome in question without considering explicitly how it "stacks up" against alternative hypotheses (see, especially, Mahoney, 2000).

This is an important first step but not the whole story. The real test of the argument that we have presented also requires that we extend the analysis to new events and phenomena that we have not considered in the formulation of the model itself. Mahoney (2000) has argued that there are two different ways to test an analytic narrative focusing on a single case. One way is to generate predictions from the case at hand that can be tested against empirical developments or additional evidence from that same case. Alternatively, one can expand the scope conditions that define the case at hand, generating new hypotheses based on changes in the assumptions that went into the specification of the first case. Thus moving from narrow to the broad, we turn to a series of hypotheses, regarding the German case and beyond, that emerge from our analysis and that might provide the foundation for further research.

Hypothesis 1: Firms that are most likely to defect from the associations will be those that, first, are less vulnerable to work stoppages than other members, and second, are more labor-intensive than other member firms (or for that matter, any other factor that affects the way a firm weighs the trade-off between the cost of industrial conflict and the level of wage settlement).

If our model is correct, then prominent claims that the source of fragmentation in German employers associations is a matter of firm size (small versus large firms) are either wrong or spurious. Until recently, most observers had assumed that small firms were the most likely to opt out of the system (Kohaut & Schnabel, 1999; Schnabel & Wagner, 1996; Thelen & Kume, 1999). By contrast, our argument suggests that the key cleavages that run through the employers associations are based not on size per se but rather on differences in production strategies that determine the threshold for conflict within particular firms. In other words, our alternative perspective draws attention to the trade-offs that individual firms face—that is, the changing cost of industrial conflict relative to more expensive collective bargaining settlements, which can vary substantially across firms of the same size, depending on the percent of labor costs in total production.

Sorting out the relative effects of firm size and production strategy will require more fine-grained survey research than is currently available. However, in the meantime, some evidence has emerged that lends credibility to our claim. For example, although it is certainly the case that firm size is an important factor in determining whether a firm is likely to be a member of an employers association in the first place,[15] data relating a firm's size to its propensity to leave the association are far less conclusive.[16]

This focus on the changing cost of conflict may also account for another surprising finding from the empirical analysis of firm defections in Germany. Initially, it was thought that supplier firms would be under tremendous cost pressure and therefore defect from employers associations at a higher rate than other firms do, but this hypothesis has not been borne out by empirical studies (e.g., Schroeder & Ruppert, 1996a; Schroeder & Ruppert, 1996b). Our analysis suggests an answer. In the context of tightly coupled, just-in-time production, supplier firms have an especially keen interest in uninterrupted production and thus have good reasons to stay in employers associations that increasingly prioritize labor peace.

Hypothesis 2: The more heterogeneous the membership in an employers association, the greater the centrifugal tensions it is likely to be experiencing in the face of the dual strains of globalization that we have identified.

Our analysis has focused almost entirely on developments in the metalworking sector, an emphasis that seems justified in terms of the key (pattern-setting) role that this sector has traditionally played within the system of industrial relations in Germany as a whole. However, the logic of our argument allows us to extend it beyond the case at hand. It is easy to see why the centrifugal dynamics we have described will be most intense in employers associations that represent a very heterogeneous membership like the metalworking sector. An association representing a homogeneous membership, that is, whose member firms have a similar threshold for tolerating higher wages or conflict, will either take a consistently harder line (if the firms are willing to bear the conflict to secure moderate wages) or will buy the labor peace their members prefer (if they are not). In an employers association representing a very diverse membership, by contrast, centrifugal pressures emanate precisely from the fact that some member firms have a substantially different cost-benefit calculus from others.

Here again, further research is needed but the general line of argument seems consistent with what we know about developments across sectors in Germany. The strains we have described (including formal and informal defections) are strongest in the metalworking industry where the employers association (Gesamtmetall) represents a very diverse group of firms in terms of production methods and market position. These same trends are much less evident in other sectors, for example, in the chemical industry where the employers association is dominated by a few big firms that have almost identical production structures. In fact, in Germany, the first and most controversial moves to allow greater leeway for local bargaining were conceded in the chemical industry, and it has come as a surprise to many that these provisions have simply not been taken up by very many firms in that sector.[17] Our analysis provides an explanation that links this outcome to the different structure of the chemical industry, where conflicts among firms with different thresholds for conflict are not as likely to emerge as in metalworking.

Hypothesis 3: Centrifugal pressures on the system of industrial relations, similar to those observed in the German case, should be seen in other countries where collective bargaining is centralized at the industry or national level and where a majority or significant minority of firms are pursuing similar high-quality strategies as in Germany.

The class of countries to which our line of analysis applies would thus be the countries categorized in the varieties of capitalism literature as the coordinated market economies (Hall & Soskice, 2001). We should be clear that although the general trends are similar, the assumptions in the model would have to be adjusted to account for the details of individual cases, for example, differences in the legal framework within which collective bargaining is embedded.

Extending the logic of our analysis, it should be the case that the strains we observe in centralized bargaining systems would be worse in systems governed by the principle of collective bargaining autonomy rather than compulsory state mediation. This is because the inability of employers to forge an internal consensus (which in turn translates into problems of maintaining solidarity within unions as well) could be compensated by the threat of direct state intervention to impose a collective bargaining outcome on both parties. Here the comparison between Sweden and Germany on one hand, and Denmark and Norway on the other, would be instructive. In Sweden too, there have been new tensions within and realignments across previously stable employer associations over the past 15 years (Iversen, 1996; Pontusson & Swenson, 1996). In that country, the mid-1990s witnessed a similar display of employer disarray in the context of industrial strife (overtime bans and strike threats). In this case, unions and employer associations across the private sector responded to these developments by jointly undertaking measures to strengthen voluntary mediation as an alternative to industrial conflict (Thelen, 2001, pp. 87-88).[18]

Again extending the analysis of the German case to other countries, we should find that centrifugal pressures on the labor side are worse where union organization is disproportionately concentrated in the core firms (conflict-averse and willing/able to pay a high price for labor peace). This factor would distinguish the German and the Swedish unions, where the latter organize an overall much larger percentage of all workers across all types of firms. Where, as in Germany, unions organize a smaller percentage of workers, and with membership concentrated in core firms, there is a much greater danger of fragmentation of the labor movement into "clientelistic" or insider-oriented organizations who specialize in interest representation for workers in core firms rather than uniform coverage.

CONCLUSION

The foregoing analysis helps to make sense of the paradoxes in contemporary German industrial relations. In doing so, our analysis puts in an entirely different light the task facing German unions in an era of globalization. The conventional literature tends to adopt a zero-sum view of power relations between unions and employers, that is, a relative gain in the strength of one comes at the expense of the other. As we have seen, most analyses see the stability of centralized bargaining as hinging crucially on labor's strength and ability to defend traditional practices against employers. By contrast, our analysis of the German case shows that the strength of organized labor and that of employers rise and fall together (Swenson, 1991). Weakness and disorganization on the employers' side may allow German unions to prevail in the short term, that is, in specific labor disputes. However, these victories have set in motion dynamics that weaken the labor movement by prompting firm defections and narrowing the coverage of collective contracts. No wonder, then, that German unions are not celebrating the current disarray among employers but rather urgently calling on the associations to get their houses in order.

NOTES

1. The German system of collective bargaining features coordinated industry-level bargaining under the leadership of the pivotal metalworking sector.
2. See Schulten (2000).
3. See Schulten (1999a).
4. See Schulten (2001).
5. A full recounting of the episodes below, to which we can only allude here, can be found in Thelen (2000).
6. See Schulten (1998).
7. On internal union politics and wage setting, see also Streeck (1994, p. 126).

8 In particular, a firm's decision to defect from the employers association is taken without considering the impact of this action on cohesion within the association or on future bargaining. These considerations will not enter into the strategic calculations of individual firms, given their small size relative to the association's membership as a whole. We later discuss the implications of relaxing the assumption of myopic bargaining on the union side.

9. *Frankfurter Allgemeine Zeitung*, April 4, 1995; see also Schulten (1998).

10. This section elaborates and refines dynamics identified in Thelen and Kume (1999, pp. 487-492, 497-498).

11. It is possible that some of these firms may have exercised certain exit options already, for example, relocating abroad those elements of production that do not rely on the German infrastructure for their success.

12. Wolfgang Schroeder (1995) and Klaus Lang (1999) note that the employers have begun to use this threat strategically to put pressure on the unions to moderate their wage demands, attempting in effect to hold the unions responsible for membership flight from the association. See also *Handelsblatt*, March 24, 1999.

13. This appears to be one of the reasons why, against the trend in most other advanced industrial countries, wage inequality in Germany has been declining not increasing. We thank Jim Mosher for suggesting this to us.

14. Thus, for example, IG Metall worries publicly about the weakness of the employers associations and quite correctly views employer weakness as one of labor's most pressing problems. See, for example, the comments by the union's leader, Klaus Zwickel, in *Handelsblatt*, March 24, 1999, which argue that the union wants strong associations that are able to bring "strays" back into line.

15. Kohaut and Schnabel (1999) present the relevant data. Among the smallest firms (1-4 employees) only 34.5% and 17.4% of firms (West and East, respectively) are part of the industry-wide bargain. This figure rises with increasing firm size. Among the largest firms (1,000+ employees), 79.1% (West) and 81.5% (East) belong to the association.

16. In a study of membership defections from four representative regional employers associations, Schroeder and Ruppert (1996a) find little support for the thesis that mainly small firms leave the fold. They find instead that defections are more common among medium-sized firms (between 100-499 and 500-999 employees) (pp. 12-14).

17. See Schulten (1999b).

18. See Ahlberg (1997).

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