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ABSTRACT

Employer Preferences and Social Policy: Business and the Development of Job Security Regulations in Germany since World War I*

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 1980s. It contrasts the varieties of capitalism approach, which sees business as protagonists, or at least consenters, in the development of job security regulations with a conflict-oriented approach, which sees the labour movement as protagonists and business as antagonists in the development of job security regulations. The empirical analysis is based on primary and secondary sources and shows that at no point in time German employers preferred strict over flexible job security regulations. Quite the contrary, high levels of job security regulations have been forced upon employers by radicalized labour movements in periods of business weakness in the aftermath of both World Wars.

JEL Classification: K31, N34, N44

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

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1. Introduction

This article examines the role of business in the historical development of job security regulations in Germany since World War I. Job security regulations are understood as restrictions placed on the ability of employers to use labour (Addison and Teixeira 2003: 85). More precisely, we define job security regulations as numerical flexibility, which denotes the managerial capacity to dismiss employees in order to allow for downsizing, or to replace workers and use new forms of employment – such as temporary work – when hiring new workers (Regini 2000: 16). The focus on numerical flexibility, as compared to other forms of flexibility, is due to the prominence of hiring and firing restrictions in ongoing reform discussions. As argued by Blanchard and Tirole (2003: 1), there is no labour market institution more controversial than the set of laws and procedures regulating separations. Furthermore, most research in the social sciences on labour market flexibility focuses on dismissal and hiring restrictions (e.g. Nickell and Layard 1999; Blanchard and Wolfers 2000; Estevez-Abe et al. 2001).

Job security regulations have an odd place in the literature. On the one hand, they have been identified as an important reason for the inferior labour market performance of Continental European countries (Blanchard and Wolfers 2000; Kenworthy 2004) and are argued to benefit labour market insiders, while hurting the weakest in the labour market (Lindbeck and Snower 1988; Rueda 2005). On the other hand, they have been 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 influence worker morale and firm-worker cooperation in a positive way (Streeck 1991; Crouch 2005). Especially these latter points are of importance, as they imply that employers might in fact *support* job security regulations.

The varieties of capitalism (VoC) literature has forcefully argued that business may benefit from welfare state and labour market institutions such as job security regulations (Hall and Soskice 2001; Estevez-Abe et al. 2001; Mares 2003). Thus, while maybe initially opposing the constraints forced upon them, employers might start considering them beneficial (Streeck 1997), as they help fortifying high-skill economies. For example, Mares (2003) has analyzed the role of business interests in the historical development of unemployment insurance in France and Germany and showed that rather than opposing the introduction and expansion of unemployment insurance, employers played a central and supportive role in welfare state development. Similarly, Swenson (2002) and Hall (2007) have demonstrated that business might play a pro-active role in the development of the welfare state in general and labour market policy in particular.

In this article, we add to this literature by analyzing 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 1980s. We focus on job security regulations in Germany for two reasons. Firstly, the VoC literature has identified job security regulations as one of the most central labour market institutions of coordinated market economies (Crouch et al. 1999; Estevez-Abe et al. 2001; Kitschelt 2006). Nevertheless, to our knowledge, only Emmenegger (2010abc) has examined the role of business in the historical development of job security regulations. Thus, although job security regulations are at the centre of the VoC approach, we know very little about their historical development.

Secondly, existing research has not provided support to the claims raised by the VoC literature. Based on case studies of the historical development of job security regulations in Denmark, Italy, Sweden and Switzerland, Emmenegger (2010bc; Bonoli and Emmenegger 2010) concludes that, in contrast to the claims by the VoC literature, high levels of job security regulations are not the result of business interests, but forced upon employers by radicalized

labour movements. However, none of his case studies has covered the German case, which is arguably the most likely case where business support for job security regulations can be expected.[i] Thus, if business is sometimes indeed a protagonist, or at least a consenter (Korpi 2006), in the development of job security regulations, we should be able to observe it in Germany.

This article contributes in two ways to the literature. Firstly, we provide what is, to our knowledge, the first detailed description of the historical development of job security regulations in Germany since World War I. Secondly, we demonstrate that at no point in time, German business played a pro-active role in the expansion of job security regulations. We show that job security regulations have become more restrictive each time the German labour movement was facing enfeebled employers that had to consent to more restrictions in order to avoid – from the employers' point of view – even worse solutions. Thus, the German case does not lend any support to claims raised by the VoC literature that business in coordinated market economies supports the development of job security regulations.

The article is structured as follows. We first review the literature on business interest in job security regulations. Subsequently, we discuss the milestones in the historical development of job security regulations in Germany. In part 4, we provide a detailed case study of the role of German business during the most important reforms of job security regulations from their creation in the inter-war period to the dawn of the crisis of the 'German Model' in the 1980s. A final section concludes.

2. Employer preferences and social policy

The varieties of capitalism (VoC) literature, especially in the version promoted by Hall and Soskice (2001), provides an essentially functionalist perspective on institutional choice and development (Allen 2004). Accordingly, institutions are purposefully designed and stabilized in order to reduce transaction costs or to solve coordination problems. Institutional complementarities are said to stabilize distinct national models. An example of a dense network of interdependent institutions can be found in German manufacturing. Its traditional production model – focusing on customization and quality – strongly relies on human capital investments that, in turn, require complementary institutions such as long-term employment relationships and vocational training.

Job security regulations are, according to the VoC literature, an essential pillar of coordinated market economies such as Germany (Estevez-Abe et al. 2001; Hall and Soskice 2001). These 'beneficial constraints' (Streeck 1997) make a low-cost mass production strategy unfeasible and force firms to adopt a high quality production strategy, as it "compels employers to keep more employees on their payroll for a longer time than many might be inclined to" (Streeck 1991: 52). To compensate for this lack of external flexibility, firms increase internal flexibility by investing in training and retraining, which leads to a more productive work force. Moreover, "high employment security and the resulting identification of workers with the firm not only make for comparatively easy acceptance of technological change, but also help to create and support the cooperative attitudes among workers that are so necessary for flexible decentralisation of competence and responsibility" (Streeck 1991: 52).

From an employee's point of view, job security regulations are the insurance that there will be return on investment in specific skills (Estevez-Abe et al. 2001). In coordinated market economies, employers desire workers with firm- or industry-specific skills, but employees are reluctant to invest in these skills, as they are not easily portable to other firms or industries. Rather, they prefer investing in less risky general skills. Job security regulations, however, are a

way to mitigate these risks, as they guarantee that employees remain in the firm for a long enough period to reap the returns on their investment. Thus, job security regulations have an insurance function and diminish the reluctance of workers to invest in specific skills. As a result, the VoC literature argues, employers learn to appreciate these 'beneficial constraints' as they give them a comparative advantage in some product markets (Hall and Soskice 2001).

While there is a tradition in the VoC literature to treat the emergence of institutions as exogenous (Estevez-Abe et al. 2001; Hall and Thelen 2009), some authors argue that institutional complementarities are purposefully designed to reap the benefits from coordination. In the case of social policy and skill formation, this implies the counter-intuitive notion of employers lobbying for policies or institutions to make a specific production model viable. A well-known example is Mares (2003) who argues that German employers in skill-intensive sectors were supportive of unemployment insurance to reduce disincentives for specific human capital investment.[ii]

Mares' (2003) analysis and the importance of job security regulations in the VoC framework (Estevez-Abe et al. 2001; Kitschelt 2006) imply that business might be similarly supportive of the introduction and expansion of job security regulations. However, this claim has been subject to two recent theoretical criticisms. Firstly, Busemeyer (2009) argues that the VoC literature misconceives the real portability of qualifications. In Germany, certification of skills ensures a high transferability of specific skills, at least within an industry. Moreover, vocational training traditionally provides polyvalent skills, which are often applicable to more than one industry. Hence, the question is not which incentives exist for workers' skill investments, but why firms potentially bear the sunk costs of training. Since factual transferability makes employers, and not workers, vulnerable, the transaction cost problem cannot be solved by job security regulations, but only by mechanisms preventing poaching.

Secondly, Emmenegger (2009) has noted that employers in coordinated market economies are as dependent on workers with (scarce) specific skills as employees are dependent on long-term employment relationships that guarantee a return on skill investments. Put differently, employees with specific skills are difficult to replace and thus not likely to be easily fired. Accordingly, the level of skills is a much better predictor of preferences for job security regulations than skill specificity.

With the VoC argument revisited in this way, complementarities between skill formation and job security regulations provide no plausible reason for German employers to be protagonists in the emergence of job security regulations. However, it is still possible that employers – after having job security regulations forced upon them – learn to appreciate these constraints.

Power-oriented explanations of institutional change and resilience challenge the VoC approach more fundamentally. The power resources approach focuses on distributive conflicts between actors and uses power as the central explanatory variable. In this perspective, social policy institutions reflect the relative strength of capital and labour (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.

The power resources literature has been very explicit about the importance of job security regulations. Korpi (1983: 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 abolishing the managerial prerogative to hire and fire at will (Korpi 1978: 326). In any case, the power resources literature

expects the labour movement to push for restrictive job security regulations, while it expects business to oppose any job security regulations. This view implies that job security regulations become more restrictive during labour movement dominance, for example during the years preceding the first oil price crisis (Pizzorno 1978), while business will attempt to dismantle job security regulations when employers are gaining in strength as compared to the labour movement, for example as a result of globalization.

In sum, the VoC approach and the power resources literature offer conflicting hypotheses with regard to the role of business in the development of job security regulations in coordinated market economies. While the VoC literature, in its most extreme form, hypothesizes that employers support, or at least not oppose, the introduction and expansion of job security regulations, the power resources approach predicts the expansion of job security regulations in periods of labour movement dominance and the retrenchment of job security regulations in periods of business dominance. In the next two sections, we will test these two hypotheses by tracing the historical development of job security regulations in Germany from the interwar period, in which the first important acts have been passed, to the dawn of the crisis of the 'German Model' in the late 1980s. We restrict our focus to the period before the 1990s for theoretical and pragmatic reasons. Firstly, business support for job security regulations is more likely to be observed before the 'age of neoliberalism'. Secondly, discussions of the development of job security regulations in Germany after 1980 are already available (Eichhorst and Marx 2011; Vail 2010) and provide no evidence for business support for job security regulations.

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

The time period covered by this analysis makes it necessary to identify the decisive events or periods in the historical development of job security regulations (see Table 1). Quite clearly, the Works Councils Act (*Betriebsrätegesetz, BRG*) of 1920 represents the first attempt to establish a general and substantial regulation in this area. The emergence of this institution is then followed by a period with various historical anomalies. In the Weimar Republic, economic turmoil and eventually the rise of National Socialism prevented a 'normal' institutional development. It was only after WWII, in a stable democratic environment, that social partners could restart negotiating the regulation of job security. In the post-war period, three periods can be distinguished: the restoration of market-oriented regulations in 1950s (entailing a significant expansion of protection), a rather long period of stability up to the late 1970s culminating into the 1972 Works Constitution Act (*Betriebsverfassungsgesetz, BVG*), which did not lead to significant changes, and, finally, the emergence of a two-tier reform trajectory in the 1980s.

[Table 1]

Before turning to employer attitudes as the core contribution of the paper, the following paragraphs will provide a brief description of how job security regulations developed over time. In the 19th century, Germany – as all other European countries – 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; Stolleis 2001). The BRG for the first time stipulated that the right to dismiss is 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: 189), in practice, protection on the basis of the BRG was limited. Most importantly, it only applied to companies

with works councils, which was only compulsory for firms with more than 20 employees. At that time, this meant excluding an enormous share of the workforce from employment protection (Nikisch 1951). Furthermore, there was no individual right to apply to the court, as appealing against notice depended on the consent of works councils (Feig and Sitzler 1928: 226). Another limitation was the lack 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 (see table 1), statutory financial compensation was in most cases perceived as an insufficient protection against poverty in case of unemployment (Hueck 1954: 17).

The National Socialists introduced the next major change in job security regulations. The 1934 Act on the Order of National Labour (*Gesetz zur Ordnung der nationalen Arbeit, AOG*) laid the foundation for the labour law under the Nazi regime. Practically, however, the regime implemented a state-directed system in which the allocation and price of labour was no longer determined by private actors. From 1939 onwards, dismissals or job changes required a pre-emptive check by the public employment service.

After capitulation, German labour law turned into an overly complex and fragmented mixture of transitory regulations, improvised jurisdiction and legislation at the state (*Länder*) level. For practical reasons in 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 on the state level or not at all, like in the British zone where judges used provisions of the civil code to create a rather strict system of dismissal protection (Nikisch 1951; Fiedler 2006). Similarly, the restrictions on labour allocation, as introduced by the Nazi regime, remained in place until the foundation of the Federal Republic of Germany in 1949, requiring job changes to be approved by the employment office (Göller 1974).

Uniform regulation was restored by the 1951 Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*). The KSchG took up core elements of the BRG, but significantly expanded protection compared to the pre-war level. As opposed to BRG and AOG, the KSchG was no longer based on the idea that employers have the freedom to dismiss. Rather, dismissals were valid as an exception only, while, in principle, it was acknowledged that workers have the right to keep their jobs. Thus, only dismissals due to special reasons were considered acceptable (e.g. reasons related to the conduct of the employee or to urgent business requirements). Especially in the case of urgent business requirements the KSchG went beyond the BRG, as the employer had to first consider far-reaching organizational measures to avoid dismissals before being allowed to dismiss the employees (Hueck 1954: 57). In addition, the KSchG introduced social selection criteria, which substantially constrained the employers' right to decide who to dismiss. The employer's possibility to choose between compensation and re-employment had not been completely abolished, but significantly narrowed, as employers had to prove that there were compelling reasons that rendered continuation of employment impossible. Practically, opting for compensation was further complicated by the fact that employers did not know in advance the level of severance pay (Nikisch 1951). Moreover, with a maximum of one annual 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 works councils agreement) and a wider application of the law (to firms with six workers and more). Altogether, it is safe to say that the KSchG significantly enhanced the protective function of German labour law.

The introduction of the KSchG was followed by a long period of institutional stability. Unlike most other Western European countries (Emmenegger 2010a), job security regulations in Germany have not become much more restrictive in the early 1970s. Although German trade unions fervently pushed for more restrictions, the 1972 Works Constitution Act granted works

councils only the possibility to postpone dismissals, not to veto them. Thus, the regulation of permanent contracts as introduced by the KSchG in 1951 is still largely valid today. In contrast, major reforms of the regulation of temporary employment have contributed to the development of a two-tier labour market with a well protected core of labour market insiders and an inferior segment consisting of less protected labour market outsiders. The most important step in this respect was the Employment Promotion Act of 1985 (*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 six months.

4. Business and the historical development of job security regulations

The following section analyzes the role of business in the historical development of job security regulations. The section is organized according to the crucial periods identified in the previous section.

4.1 Interwar period and the 1920 Works Councils Act

In the German empire, dominant elites (including employer associations) had an antagonistic relationship with unions. The constitution did not allow for an adequate political participation of the growing group of wage labourers and their organizations were exposed to discrimination and repression. Backed by the authoritarian state, employers dominated industrial relations and aggressively contained activities of organized labour. Obviously, the degree of confrontation differed. While heavy industry and large landowners rejected cooperation, the 'new industries' with their highly trained and therefore more powerful workforce had to be more open-minded (Feldman 1984: 102; Herrigel 1996). Nonetheless, organized labour had only few possibilities to achieve progress in social policy or labour law (Saul 1974). The war and the following collapse of the German empire changed dramatically this balance of power.

During WWI, the regime had to maintain its defence production under increasingly difficult conditions, especially a severe shortage of labour. This put unions 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*). For this purpose, labour market participation was made compulsory for men from 17 to 60 years and change of jobs was prohibited in 'war-relevant' industries. As the authorities could not afford to risk a labour dispute, unions and Social Democrats were able to push through major concessions: the acceptance of unions as representatives of the workforce as well as the creation of worker and arbitration committees in enterprises producing important goods for the war. With the fulfilment of these old demands, the act can be seen as milestone for unions, with a lasting influence beyond its immediate impact on the wartime labour market (Ambrosius 2005: 301; Bieber 1981).

In the revolutionary period after the collapse of the empire, the window of opportunity for social policy progress was even more 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 WWI and which was expected to increase during demobilization. But 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: 123). In a bipartite body, the so-called Central Work Association (*Zentralarbeitsgemeinschaft*), unions could take advantage of the employers' weakness and could expand the achievements made during WWI. Their influence even increased 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: 51). Among the achievements of this short period were the eight-hour working day and the right to negotiate collective agreements.

Thus, WWI and the following period fundamentally changed the power balance between employers and unions – at least temporarily. 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: 494). In addition, collective bargaining coverage was ten times higher in the 1920s than in 1914, while labour's share in national income rose from 45 to roughly 60 percent (Abelshauser 1987: 25). Even though the situation rapidly turned to the negative for unions towards the end of the 1920s and prior achievements were revoked, the first important step in the historical development of job security regulations 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 only the result of a defensive strategy to avoid revolutionary tendencies. In fact, 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: 134). Concerning job security regulations, employers insisted on a liberal regulation. The restrictions were perceived as unacceptable interventions in their managerial prerogatives. For example, they opposed plans to include social selection criteria like tenure, arguing that such regulations would hamper productive potentials (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: 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 (on the far-reaching attempts of the RDI to influence parliamentary decision making see Wolff-Rohé 2001: 136-139).

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 machinery, chemicals and electronics) were clearly dominant and played a decisive role in the peak association (Feldman 1984: 127).[iii] This suggests that those manufacturers who according to the VoC literature should be most interested in labour market complementarities were in fact not supportive of job security regulations.

To fully appreciate the impact of WWI on German labour law, it is imperative to take into consideration that some hallmarks of the system directly go back to 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 scarcity of basic goods, intervention appeared necessary in order to avoid social disaster and political destabilization (Ambrosius 2005: 310). In the field of labour law, the 1920 Demobilization Act (*Demobilmachungsverordnung*) was to tackle this problem. Two of its elements are particularly interesting. Firstly, the principle of last resort stipulated that dismissals are only justified if a working-time reduction is unfeasible. Secondly, the idea of social selection was introduced, i.e. age, tenure and family situation had to be considered when deciding on which employees to dismiss. Although employers could

successfully lobby against plans to make these achievements permanent (Hueck 1954: 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: 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 innovations of the Weimar Republic can in some way be traced back to the war and its consequences (Abelshauser 1987: 15), be it in the form of authoritative interventions or via 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. Thus, one can consider the original compromise on job security regulations as being biased by the asymmetric conditions during its formation.

Given the opposition of the German industry to the BRG, historical evidence seems to lend support to the conflict-oriented perspective – at least for this early stage of institutional development. 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. An industrial pattern of diversified quality production emerged already in the 19th century (Abelshauser 2003). The so-called 'new industries' heavily relied on knowledge as a productive factor. 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 dismissal protection and it is therefore more than plausible that the German industry was reluctant to endorse it 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 shares. This demanded an ever-stronger focus on quality-competitiveness. Moreover, the artisanal sector that traditionally trained workers for the 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 therefore conceivable that this development did make employers embrace job security regulations as a means to attract more specific skill investments from workers.

As Thelen (2004) points out, in this period some skill-oriented industries sought mechanisms to strengthen engagement in training. However, this mainly meant certification rights or standardization and not employment protection. In addition, a major concern was to create 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 (Gladen 1979), attracting trainees willing to invest in skills was not the greatest issue. Accordingly, institutions were needed that could strengthen employers' engagement in training (Thelen 2004: 70). Against the background of these labour market conditions, job security regulations could contribute only little to an intensification of 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. In fact, 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 Gespäche*' in early 1950). In the following year, the parliament passed the draft with only minor changes. Thus, the KSchG reform lacked the extremely conflict-laden character of the BRG introduction in 1920 and, by any standards, proceeded more consensually. This

leaves, however, the question open whether employers turned from veto players into proponents of job security regulations or whether they consented out of strategic reasons. To answer this question, the historical context needs to be considered.

After the war, employers were dissatisfied with the regulatory situation. 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: 3-6). The increased importance of courts, whose decisions tended to be rather restrictive on dismissals, created legal uncertainty. In some parts of the French and American zones, new laws with very rigid provisions concerning dismissals were implemented (Hueck 1954: 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 render the free allocation of labour possible again. Thus, employers had a strong incentive to enter into negotiations with unions about job security regulations

To understand the employers' willingness to cooperate with unions in the formulation of the draft law, one has to consider the alternatives at that time. After 1945, unions were quickly able to organize themselves and to regain their capacity to act. The common experience of emigration, resistance and terror helped to overcome the old fragmentation of the union movement (Rosenberg 1948). The Western allies considered the unions from the start as legitimate forces in the democratic reconstruction, while political parties as well as employer associations were seen more sceptical (Mielke 1990; Barthel, 1999). Thus, after the war and particularly after the foundation of a unified peak organization (*Deutscher Gewerkschaftsbund, DGB*) in 1949, the unions were in a very powerful position. By 1948 union density already amounted to 42% in the British zone, and to 38% and 30% in the American and French zones respectively (Schneider 1989: 241).

These developments were reflected in an aggressive anti-capitalist agenda. Radicalized by the 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 socialization of key industries were requested (DGB 1950: 318-326). This anti-capitalist attitude was also shared by the two biggest political parties, the Social Democratic SPD and – at least in its early years – the Christian Democratic CDU.

Concerning labour law, union plans aimed at the abolition of the freedom to hire and fire, at least in the perception of employers as internal documents show. The employment relationship should no longer be terminable and therewith lose its contractual character (Sozialpolitische Arbeitsgemeinschaft der Arbeitgeber 1949b). Moreover, both major political parties supported strict regulation of dismissals. In its 1949 programme, the CDU demanded enhanced protection with dismissals as option of last resort only, while the SPD still favoured the idea of a centrally planned economy (Richardi 2001: 169).

Hence, a broad political consensus supported more restrictive job security regulations as compared to 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 element of the employers' lobbying strategy at that time. Radical demands were considered neither feasible, nor appropriate.

Evidence suggests that employers maintained their preference for flexible regulation. They firmly rejected the 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 about job security regulations, took the position that it was of utmost interest to defend the conception of the employment relationship as a "voluntary and terminable contract" (Sozialpolitische Arbeitsgemeinschaft der Arbeitgeber 1949bc). An initial employer draft of 1948 (Zentralsekretariat der Arbeitgeber des vereinigten Wirtschaftsgebietes 1948a) 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 to go back to the low levels of the BRG and objected plans to increase it (see also Sozialpolitische Arbeitsgemeinschaft der Arbeitgeber 1949a). Further contentious points were the size threshold of firms subject to the new law and the probationary period. After "long and tough negotiations", the agreement of Hattenheim was seen as a compromise, which in many ways went beyond the initial employer position (Vereinigung der Arbeitgeberverbände 1950: 5), but as it successfully upheld the basic principles of private law and contractual freedom – the main demands of the employers – it was considered "acceptable for business" (Vereinigung der Arbeitgeberverbände 1950: 8).

Thus, even in the post-war period, employers tried to keep job security regulations 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 over, on the one hand, an extremely unsatisfying status quo and, on the other hand, 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 did certainly not favour mutual consent on the development of job security regulations. Between 1948 and 1951 the German economy went through an economic crisis. At the time of the Hattenheim negotiations, unemployment amounted to 12.2 percent (Abelshauser 1987: 78). As long as migration from the GDR (and formerly German areas in Poland and Czechoslovakia) contributed to labour supply, manpower shortage was not much of 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 stabilizing the new institution. In a context of high economic growth and full employment, job security regulations produced few adverse effects for the German economy. But obviously, these circumstances were temporary. Germany's 'economic miracle' benefited from two factors related to the war and both implied return to normality in the medium term. Firstly, mechanisms of catch-up and convergence drove economic recovery, but rebuilding the capital stock and closing the productivity gap to the US by adopting new technological or organizational knowledge were soon exhausted as sources of growth. While this applied to all European economies, the German post-war boom was also caused by a second factor. German production was specialized into goods, which were required for the reconstruction in other countries. The wartime economy had been heavily oriented towards products such as machinery and metals. After the war, Germany therefore had the skills and the infrastructure available to export these highly demanded capital goods (Eichengreen 2008; Abelshauser 2004: 48-50). This advantage vanished when 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 (*Deutscher Industrie- und Handelstag, DIHT*) for the Council of Economic Experts (*Sachverständigenrat*), indicates that employers increasingly perceived job security regulations as a problem. Asked about the most important obstacles to job creation, cautious business expectations, rationalization and wage pressure dominate, but already 24 percent of industrial employers considered job security regulations the most or second most important obstacle (Sachverständigenrat 1976: 208). This attitude was particularly widespread among producers of machinery, fine mechanics and metals (DIHT 1977a: 58). Accordingly, representatives of the industry started to complain about a lack of flexibility in personnel policies and "interminable" employment relationships (DIHT 1977b: 28).

Yet, for the time being this changed perception did not translate into strong reform pressure.[iv] After the golden age had cushioned the conflict between capital and labour for two decades, it turned out that there was little leeway left to reverse the development of job security regulations. At this time, the institution already produced typical positive feedback effects for an important voting block. The high popularity of job security regulations among labour market insiders and union resistance to any liberalizing changes created strong reform barriers. Quite the contrary, unions interpreted the rise of unemployment in the 1970s as an indicator for a lack of protection (IG Metall 1978). In a draft labour code, the DGB demanded to practically abolish the freedom to dismiss by giving works councils an effective veto right and to create obligatory severance pay (DGB 1977: 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 the parliament were also DGB members (von Beyme 1990: 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: 755). But rather than promoting liberal reforms, employers were 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 Brandt declared 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 employers' opposition (Milert and Tschirbs 1991: 80). Even though the Works Constitution Act introduced far-reaching changes, it did not significantly increase the protection against dismissals. It gives the 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, much to the union's chagrin, it did not 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 on the micro-level by creatively 'working around' it, a process which Streeck and Thelen (2005) refer to as 'displacement'. Already in the 1960s employers 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 violates 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 "slave trade" (Holst et al. 2008). Nonetheless, in 1972, the SPD-led coalition decided to legalize and regulate agency work in order to restrict defection from standard employment.

4.4 The emergence of a two-tier system and the 1986 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 heading "more market – less state" the powerful Federation of German Industries (*Bundesverband der Deutschen Industrie, BDI*) explicitly demanded the reform of dismissal law (BDI 1984: 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 Employment Promotion Act of 1985. 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: 11) were implemented. The Act was, however, only seen as "one step in the right direction" which should be accompanied by more far-reaching measures, especially with regard to permanent contracts (BDA 1985a: XIII, 1985b: 29; BDI 1988: 72).

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

Hence, the – by international standards modest – liberal turn as exemplified by the 1985 act illustrates the limits of the politically feasible extend 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 four to more than eight percent (Schmid and Oschmiansky 2005: 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 constantly 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).

5. Conclusions

What role did business play in the historical development of job security regulations in Germany? In the preceding pages, we have identified four crucial moments in the development of job security regulations. During two crucial moments, job security regulations have become more restrictive (1920 Works Councils Act and 1951 Dismissal Protection Act). In both cases, exceptional circumstances related to WWI and WWII respectively have hampered the ability of employers to resist demands for stronger protection (which, we argue, would have better reflected their actual preferences). Quite the contrary, 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 could be avoided (1972 Works Constitution Act) or first elements of a two-tier labour market have been introduced (1985 Employment Promotion Act).

In the latter two cases, German business was not delegitimized by its involvement in war activities and consequently 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 is not possible. As a consequence, despite considerable power resources, German business could not undo the previous extension of job security regulations.

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

By no means should these results be read in a way that unions dominated industrial relations for the past 90 years. Quite the contrary, during the 1920s as well as in the more recent history, unions struggled with significant losses of influence. Rather, the crucial point is that the relatively short periods of labour strength coincided with the formative compromises in the realm of job security regulations 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.

These findings imply that flexibilization at the margins of the labour market, which started in the 1980s and continues up to today (Eichhorst and Marx, 2011), cannot be ascribed to exogenous factors only. Deindustrialization and international competition certainly contribute to this development by decreasing demand for some types of jobs. By increasing cost pressure, they might have contributed to pushing employers over the "critical threshold point" (Mahoney 2000: 523) to challenge job security regulations. But change was also endogenous in so far as 'loser' of the initial negotiations (business) started to undermine the status quo (Koreh and Shalev, 2009). Thus, it looks as if job security regulations rest upon a fragile compromise, which is increasingly called into question. The Hattenheim agreement resulted in an asymmetric (employee-friendly) compromise about the fundamental conflict between labour's desire for security and business' desire for freedom. Increasing power resources and cost pressure led business to challenge this compromise, but significant change is difficult to enforce in polities characterized by numerous veto players. As a result, it looks as if German employers adapted their strategy and started lobbying for a two-tier labour market.

With regard to the VoC literature, we would like to note that at no point in time German employers preferred strict over flexible job security regulations. This does not imply that the constraints created by job security regulations cannot be beneficial (Streeck 1997). In fact, we fully agree with the VoC literature that job security regulations are likely 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 read as evidence that employers in coordinated market economies do not support any form of social protection. However, as far as job security regulations are concerned, we believe that the VoC approach vastly overemphasizes their functional importance for human capital investments.

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

Time	Main institutional developments and legal changes
- 1914	**Liberal regime**: virtually no restrictions on the freedom to dismiss
1920	**Emergence** of job security regulations in Works Councils Act: Employees can appeal to works council against notice, if it is based on invalid reasons (e.g. not related to personal conduct or situation of the enterprise, based on religion, political affiliation, etc.) (§84). If the plea is considered legitimate and conciliation fails, the case can be brought to court (§86). Judicial verification of the appeal does not make the notice null and void. If employer rejects re-employment, worker is entitled to compensation. Severance pay (§87): 12^{th} part of monthly wage times years of tenure, maximum half an annual wage.
1951	**Restoration/expansion** in Dismissal Protection Act: dismissal in exceptional cases only (§1), individual right to appeal (§3) applicable for companies with six or more employees (§21), social selection criteria (§1), right to re-employment (§7), severance pay up to one annual wage (§8).
1951 - 1970s	**Stability** in the context of strong economic growth, full employment and labour shortage. Incremental emergence of agency work (regulated in Manpower Act of 1973). The 1972 Works Constitution Act does not lead to significant changes.
1980s	**Marginal reform** in Employment Promotion Act (1985): fixed-term contracts without valid reasons up to 18 months, agency work assignments up to six months.

Endnotes:

[i] Italy is not a coordinated market economy (Hall and Soskice 2001). Hall (2007) and Pontusson (2005) argue that job security regulations are more important in Continental European than Nordic coordinated market economies such as Denmark and Sweden. Switzerland is not a very typical coordinated market economy and often described as a hybrid between a liberal and a coordinated market economy (Trampusch and Mach 2010).

[ii] Mares (2003: 259) qualifies this claim by acknowledging that employers were not agenda setters in the introduction of unemployment insurance.

[iii] Skill-intensive industries and especially large manufacturers such as Siemens, Bosch and Carl Zeiss controlled the RDI's governing body (Wolff-Rohé 2001: 68-69).

[iv] Quite the contrary, the 1969 Employment Promotion Act improved the protection in case of mass dismissals.