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## A Cartel Analysis of the German Labor Institutions and Its Implications for Labor Market Reforms

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**651**

**Justus Haucap  
Uwe Pauly  
Christian Wey**

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**Berlin, December 2006**

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## **Discussion Papers 651**

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### **A Cartel Analysis of the German Labor Institutions and Its Implications for Labor Market Reforms\***

Berlin, December 2006

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# **A Cartel Analysis of the German Labor Institutions and Its Implications for Labor Market Reforms**

by Justus Haucap, Uwe Pauly and Christian Wey

## **Abstract:**

In this paper we apply standard cartel theory to identify the major institutional stabilizers of Germany's area tariff system of collective bargaining between a single industry union and the industry's employers association. Our cartel analysis allows us to demonstrate that recent labor policy reforms that intend to make labor markets more "flexible" further serve to stabilize the labor cartel while other pro-competitive proposals have failed. We argue that the pro-competitive recommendations failed exactly because of their destabilizing effects on *insiders'* incentives to stay in the labor cartel. We propose regulatory measures for injecting competition into Germany's labor markets that focus on the creation of new options for firms and workers *outside* the existing area tariff system; in particular, by liberalizing existing barriers for the establishment of a fully tariff-enabled union. Such an endeavor must go hand in hand with the institutionalization of a competition policy framework for labor market disputes as any destabilizing policy inevitably provokes counter measures of the incumbent labor cartel so as to protect their dominance vis-à-vis outsider competition.

**Keywords:** Union, Collective Bargaining, Cartel Stability, Labor Market Reforms

**JEL classification:** J52, K31, L12

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## 1 Introduction

In this paper we argue that the German labor regulations and legal practices that enforce these regulations can best be understood as devices to suppress competition on the labor supply-side to the maximum possible extent. The so-called *Flächentarifsystem* or “area tariff system” (henceforth: ATS) consists of a *single* industry union and one employers’ association which represents the vast majority of the firms in the industry. Both parties determine the wages and overall employment conditions by signing an area tariff agreement (*Flächentarifvertrag*). While these tariff contracts are formally binding only for all employees employed by the member firms of the employer’s association, their coverage typically extends to almost all employees in the industry.<sup>1</sup>

Germany’s labor laws and institutions do not only encourage unionization and collective bargaining. In many other countries the cartelization effects of such labor legislation is confined to an individual employer’s premises, so that industry-wide collective bargaining is rather exceptional (for seminal cartel analyses of the US labor laws, see Chamberlin [1963] and Posner [1984]). In contrast, in Germany, the “one-union” principle has been realized, so that uncontested union monopoly power and industry-wide tariff agreements are the rule. As our cartel analysis will reveal, the reason for this outcome is that significant parts of the German labor institutions serve to facilitate the cartelization of the *entire* labor supply within the hand of a single industry union, both by discouraging employers and employees of the industry to exit the cartel and by fighting off outsider competition at the individual and the collective contracting level.

This kind of extreme pro-monopoly orientation of the German labor law is opposite to the widely acknowledged antitrust principles that serve to ensure competitive structures and efficiency in goods and service markets. The effects of labor cartels are quite similar to cartels between sellers of goods and services, though: they both serve to raise the price above levels

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<sup>1</sup> Because of space constraints, we will not analyze recent developments towards a more segmented labor market in Germany with a considerable amount of employment channeled through temporary work agencies. The law for employment agencies (*Arbeitnehmerüberlassungsgesetz*) was liberalized in 2003 regarding the principle of equal working conditions (*Gleichbehandlungsgrundsatz*) which does not apply anymore if the employment agency or the respective employers’ association succeeds in striking a new collective sector contract (*Branchentarifvertrag*). Quite interestingly, a couple of such collective contracts have been concluded since then, not only with the monopoly unions of the *Deutsche Gewerkschaftsbund* (DGB) but also with the unions of its (*only*) rival, the *Christlicher Gewerkschaftsbund* (CGB) (for a preliminary study of this very recent phenomenon, see Antoni and Jahn [2006a,b]).



that would prevail under conditions of competition.<sup>2</sup> As a consequence, supply becomes rationed which is – in labor market terms – equivalent to persistent unemployment. And indeed, Germany's unemployment rate consistently ranges at the top among the industrialized economies. According to Eurostat [2006], the unemployment rate for July 2006 has been 8.2% in Germany, while it came down to 3–5% in many other countries like the US, Netherlands, or Denmark to provide some examples. Moreover, the number of long-term unemployed is continuously increasing and increasing youth unemployment has become a major political concern (see OECD [2003], Sachverständigenrat [2006]).<sup>3</sup>

However, while seller cartels have to be self-enforcing, and therefore, must rely on some (often imperfect) sort of market-based enforcement mechanism, the German labor cartel does not suffer from such incentive problems. In fact, our cartel analysis reveals that the German labor law, and complementary legal practices, have yarned a dense net of institutional stabilizers around the ATS. As a consequence, and in sharp contrast to more conventional product market cartels, the ATS has been surprisingly stable since its emergence after the Second World War.

Our main objective in this paper is to apply standard cartel theory to identify the major institutional stabilizers of the German labor cartel. Our cartel analysis allows us to demonstrate that recent labor policy changes that intend to make labor markets more “flexible” further serve to stabilize the labor cartel while other pro-competitive proposals (which have been wrongly framed as “flexibility” measures) have failed. We argue that the latter pro-competitive recommendations failed exactly because of their destabilizing effects. Finally, we propose regulatory measures for injecting competition into Germany's labor markets. Such an endeavor must, however, go hand in hand with the institutionalization of a competition policy frame-

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<sup>2</sup> Under fairly general conditions, prices above competitive levels lower overall social welfare. Some economists and industrial sociologists, among others, have developed several “efficiency” arguments in favor of labor cartelization and related stabilizing labor laws, as e.g., dismissal protection laws (for summaries of those undertakings, see e.g., Müller-Jentsch [1983, 1986], Deregulierungskommission [1991], Berthold and Hank [1999], or Engel [2000] which focus on the debate in Germany, and Posner [1984] which summarizes the debate in the US).

<sup>3</sup> The real extent of unemployment in Germany is in fact much larger. For example, the German Council of Economic Advisors has consistently reported a hidden unemployment of around 1.2 million persons (see Sachverständigenrat [2005, p. 130]). The *Institut für Arbeitsmarkt- und Beschäftigungsforschung* (IAB) which is a subsidiary of the *Bundesagentur für Arbeit* (formerly, *Bundesanstalt für Arbeit*) reports for 2002 an employment gap (*Arbeitsmarktlücke*) of around 6.7 million unemployed persons which consists of 4.1 million registered unemployed, 1.7 million hidden unemployed, and 1.0 million persons who are participating in governmental employment promotion programs (see Bach and Spitznagel [2003, p. 7, Table 1]). These numbers give rise to a rate of below capacity employment (*Unterbeschäftigungsquote*) of 14.9% in 2002, a number much higher than the officially reported unemployment rate of 10.8% for that year. It is noteworthy though that the IAB numbers still tend to underestimate the real extent of the unemployment misery in Germany, as for example, the extensive use of early retirement programs is not taken into account.

work for labor market disputes as any destabilizing policy inevitably provokes counter measures of the incumbent monopoly unions so as to protect their dominance vis-à-vis outsider competition. Without accomplishing an institutional framework that allows for a balanced reasoning between pro-union objectives and antitrust objectives, any policy proposal aiming for more decentralized governance of employment relationships is doomed to fail. As a consequence, we propose drastic institutional changes in the legal environment which are more conducive to a rule of reason approach and which stand in sharp contrast to the current approach that is per se pro-monopoly oriented.

The remainder of this paper is organized as follows: Section 2 provides a brief overview over the ATS before section 3 reconciles the cartel analysis of the German labor market. Section 4 analyzes the effects of recent labor reform proposals and discusses various elements that a working competition order for the labor market would need to have. Section 5 summarizes and concludes.

## **2 Collective Wage Bargaining in Germany**

In Germany, wage tariff profiles and overall work conditions are, for the overwhelming majority of all workers, (still) negotiated on a bilateral basis between industry unions and the according industry employers' associations. In principle, the resulting area tariff contracts serve as a minimum standard for all employees in a given region under the so-called area tariff system (ATS). The centralized ATS is complemented with firm-level agreements which regulate the detailed employment of workers at their workplaces.<sup>4</sup>

While the percentage of employees covered under the ATS has been declining by 9.4 percent in West Germany and by 10.8 percent in East Germany between 1995 and 2000 (see Kohaut and Schnabel [2003a]), the overwhelming majority of blue-collar employees is still paid wages equal to or even higher than the wages negotiated at the centralized level, even though more and more firms have been "escaping" from the collective agreements by leaving their employers' associations, especially in East Germany (see Kohaut and Schnabel [2003b]). In general though, competition still plays a very limited role, as competition through either indi-

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<sup>4</sup> For a detailed description of the ATS, its emergence, and its legal foundations, see Pauly [2005] and Haucap, Pauly and Wey [2006].

vidually negotiated labor contracts or alternative collective wage agreements is only slowly developing.

Collective bargaining and the right to form coalitions in the labor market are constitutionally protected in Germany by Article 9 of the Germany constitution (*Grundgesetz*). That means, as in many other countries (such as the USA), labor market cartels are legalized in Germany. Put differently, the labor market is exempted from competition law. The underlying idea is that workers need to be protected, as employers are assumed to have significantly more bargaining power so that they can and will impose unfavorable (and unfair) conditions upon their employees. Hence, the constitution allows for the formation of labor unions that ought to have some countervailing power.

In addition, collective bargaining is regulated through the law concerning tariff agreements, the *Tarifvertragsgesetz* (TVG), which is the explicit legal basis of the ATS in Germany, and the law concerning corporate constitutions, the *Betriebsverfassungsgesetz* (BetrVG), which regulates firm-level codetermination rights and proceedings. As we will discuss in the next section, various provisions in these two laws help stabilizing the ATS.

### 3 Cartel Stability

While labor market cartels are exempted from competition law and legalized through the constitution in Germany, it is well known from economic theory that the pure authorization of a cartel is not sufficient for guaranteeing the cartel's stability against either deviation by insiders or competition from outside (see Selten [1973], Philips [1995]). In fact, cartels are rarely stable if the number of market participants is very large, which is typically the case in most labor markets. Of course, this insight is by no means new (see Liefmann [1927], Stigler [1964] or Selten [1973]), but it implies that the ATS cannot be a direct result of the constitutional freedom to form coalitions in the labor market alone.

In theory, the ATS should be destabilized by incentives on both the employers' and the employees' side to undercut the collective tariff agreement. Quite generally, firms can improve their competitiveness by paying wage rates below the standard wage. Similarly, unemployed workers who are not able to find a job at the conditions negotiated under the ATS should rather prefer a lower paying job over no job at all and, therefore, also accept job offers at wages below the centrally negotiated rate. Hence, consistently high unemployment rates in

Germany and ever increasing international competition in almost all segments of the German economy should undermine the ATS. However, this is not quite yet the case: Almost 90 percent of all employer-employee-relationships are still governed by tariff agreements concluded between industry unions and employers' associations (see Franz [2003, p. 247]). The answer to the question why labor market competition is only emerging so slowly is, of course, that the institutional framework governing the German labor market, first penalizes firms' exit from the ATS, and second, rewards firms' entry into the ATS and, thereby stabilizing the wage cartel. We first summarize the legal provisions which provide incentives to abstain from exiting the ATS.<sup>5</sup>

1. It is virtually impossible for a member firm of the employers' association to negotiate a lower wage than the collectively negotiated industry-wide wage with non-unionized workers. A non-unionized worker cannot commit not to join the union after being hired (Kissel [2002, p. 46]). Therefore, a worker can always become a union member, in which case § 4 TVG requires the employer to immediately pay the tariff wage. Recognizing Germany's restrictive "dismissal protection law" (*Kündigungsschutzgesetz*) and the "law regarding part-time work and temporary labor contracts" (*Gesetz über Teilzeitarbeit und befristete Arbeitsverträge*) we obtain the result that any discrimination between workers by a tariff bound employer is not a real option.<sup>6</sup>
2. Termination of membership in the employers' association in order to escape the ATS is made unattractive through the following provisions: *First*, the "continuity principle" (*Fortgeltung*) of § 3 (3) TVG bounds the employer to centrally negotiated agreements until these agreements expire.<sup>7</sup> *Second*, the continuity principle does not only apply to the labor contracts that exist when the firm leaves the employers' association, but also to all new labor contracts concluded within the life-span of the existing centrally negotiated

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<sup>5</sup> See Haucap, Pauly and Wey [2006] for a more comprehensive analysis.

<sup>6</sup> There are additional reasons for the absence of discrimination between organized and non-organized workers: i) Industry-wide tariff agreements may provide for "outsider clauses" (*Außenseiterklauseln*) which require member firms not to discriminate; ii) works councils have a veto right concerning the hiring of new workers whenever this is disadvantageous for the established workers already employed by the firm (§ 99 (2) BetrVG) or whenever this violates agreed hiring rules (§ 95 BetrVG) or equal treatment rules (§ 87(1) BetrVG); iii) firms may want to pay tariff wages "voluntarily" to non-unionized workers in order to prevent them from becoming unionized.

<sup>7</sup> While wage-agreements typically do not last longer than two years, other non-wage-agreements have a life-span of up to ten years. Some non-wage agreements about working conditions (so-called *Manteltarifverträge*) do not even specify an expiry date.

agreements.<sup>8</sup> *Third*, the “right of continuance” (*Nachwirkung*), laid down in § 4 (5) TVG, constrains the deviating employer in re-writing its labor contracts, as all labor contracts concluded before the end of the continuity term have to adhere at least to the then valid tariff-conditions for an unlimited period of time.

3. Coverage extension rules can be employed to rule out any undercutting of centrally negotiated tariff agreements even vis-à-vis non-unionized workers.<sup>9</sup>
4. The deviating firm loses its protection against strikes over the duration of the centrally negotiated tariff agreement, as the union’s “peace keeping duty” (*Friedenspflicht*) only applies to member firms of the employers’ association.<sup>10</sup>

Hence, the short run gains of leaving the employers’ association in order to achieve a competitive advantage by negotiating lower wage contracts are virtually nil. We now turn to provisions which draw outsider firms into the ATS:

1. The outsider cannot strike a collective agreement with a union other than the incumbent monopoly union. Given that an individual employer cannot negotiate a better deal than the employers’ association, the outside firm is left with the only remaining option to rely exclusively on individual contracting. In the latter case, the firm operates under the constant threat of a strike.
2. Application of the AVE would require the outsider firm to pay the tariff wage anyway.

A main question, however, remains, how does it come that there is virtually no union competition so that firms outside the ATS cannot strike a collective agreement with a union other than the monopoly union? Following our previous analysis of the cartelizing effects of Germany’ labor laws we can identify, again, legal constraints that effectively restrict the possibility to form competing unions with the right to negotiate collective wage agreements (*Tariff-fähigkeit*); in particular:<sup>11</sup>

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<sup>8</sup> Strictly speaking, after having terminated membership in the employer association, only new labor contracts with union members have to adhere to the tariff agreements which are in force. However, as explained above, the scope for discrimination between organized and non-organized workers is quite small.

<sup>9</sup> For a description and analysis of coverage extension rules in Germany, see Meyer [1992] and Haucap, Pauly and Wey [2000, 2001] for an economic analysis.

<sup>10</sup> The deviant firm is also excluded from the strike insurance system (*Gefahrengemeinschaft*) which the employers’ associations provide for their member firms.

<sup>11</sup> See, e.g., Reuter [1995], Rieble [1996], and Kissel [2002] for the requirements a tariff enabled union must fulfill according to legal practice.

1. “Interplant requirement”: The union must not only operate at one plant exclusively but it has to present workers’ interests at many plants.
2. “Mightiness requirement”: The workers’ association must be mighty. According to the Federal Labor Court one indicator for “mightiness” is whether the union has already concluded collective wage agreements in the past. Moreover, the existence of a powerful incumbent union has been used as evidence that a new union is not mighty.<sup>12</sup>

Obviously, a new union can hardly refer to collective contracting in the past, as mightiness is a prerequisite for the legal right to conclude collective wage agreements. This means that a new union has to attempt to square the circle: The right to collective bargaining cannot be obtained without a union being sufficiently mighty, while one indicator for a union’s mightiness is it having concluded collective agreements in the past. The interplant requirement explicitly excludes a firm’s workforce (or an alternative organization such as the works council) from negotiating a collective agreement with their employer, even when the firm faces bankruptcy and a lower firm-specific wage would save the firm. Consequently, one can conclude that the existing legal practice virtually excludes the creation and appearance of any new union with a right to engage in collective bargaining (also see Kissel [2002, p. 105]).

To summarize, our analysis shows that on the one hand legal provisions make it less attractive for firms to leave the employers’ association, as the benefits of exit are reduced by law, and on the other hand there are costs of operating outside the ATS which, taken together, make exit from the ATS less attractive for firms and draw outsiders into the employers’ association.

## **4 Competition Policy in the Labor Market**

One common (and steadily repeated) policy recommendation on how to reduce unemployment in Germany is to make wage rates more flexible so that local and firm-specific conditions can be reflected more accurately in the wage rates (see, e.g., Donges [1992], OECD [1996], Siebert [1997], Sachverständigenrat [2002]). Put differently, it is suggested that wages should be allowed to differ to a greater extent between firms than today.

Today tariff area agreements usually specify minimum standards and do not take into account firm specific conditions. Due to the principle of advantageousness (*Günstigkeitsprinzip*) there

is no scope for agreeing on lower wage rates at the firm level.<sup>13</sup> Hence, most of the reform proposals aim at the “localization” of wage negotiations (see Bahnmüller [2001]), which can, in principle, be implemented within the ATS through so-called opening clauses which may require the consent of central instances. In these cases, the central bargaining parties agree on wage corridors within which individual firms can deviate towards lower wage rates. The extent of firm specific wage differentiation, however, remains under the control of the labor market cartel, so that wage differentiation can be understood as being analogous to input price discrimination under monopoly. Less productive firms are expected to be granted wage concessions (lower wage rates) under this regime when compared to firms with higher productivity levels which will face higher wage demands. For the ATS, such rules have a stabilizing function as they allow for monopolistic wage discrimination, and hence, help to prevent decentralized wage setting outside the labor market cartel’s control (i.e., the so-called *Tarifflucht*).<sup>14</sup>

In contrast to flexibility reform proposals *within* the labor market cartel, alternative reform proposals call for the introduction of competition into the labor market by truly decentralizing wage negotiations. Interferences by central instances of the labor cartel are invalid under such a scenario, so that competition between *independent* union-employers relationships within the same industry would emerge. These reform proposals will reduce the involved parties’ market power and would imply a fundamental change of the German labor market framework. For example, the Wissenschaftliche Beirat [2004] has proposed a strong version of an opening clause that features more wage-setting competencies for works councils. Quite clearly, such a proposal may have strong de-stabilizing effects as it would introduce the possibility of non-cooperative “best-response” strategies at the firm level, even if one allows for the fact that works councils are typically run by (union-trained) organized workers (which is, in turn, a result of the works council formation process as prescribed by the *Betriebsverfassungsgesetz*). Not surprisingly, such an ambitious proposal has not been implemented so far.

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<sup>12</sup> See Haucap, Pauly, and Wey [2006, pp. 366–367] for an account of labor court rulings against the *Christliche Gewerkschaft Metall* which is the only existing competitor of the *IG Metall*.

<sup>13</sup> Tariff area agreements usually specify different wage rates for different qualifications. Hence, there is some limited scope for grouping employees into lower qualification classes, but this grouping is monitored by the firm’s works council.

<sup>14</sup> The effects of a flexibility policy *within* the ATS on employment and social welfare are ambiguous when compared with alternative structures of unionism (see Haucap and Wey [2004]).

The important message is that introducing more “*flexibility*” into Germany’s labor market can have very different implications for the stability of the German labor cartel. While the introduction of flexibility *within* the ATS strengthens the bargaining parties’ market power vis-à-vis potential outside competitors, the introduction of true competition through decentralized bargaining reduces market power by facilitating market entry through market liberalization.

Since the German constitution guarantees the right to form coalitions and since collective bargaining saves transaction costs, the formation of collective labor unions cannot be prevented altogether. This has also been recognized by legal scholars such as Rieble [1996, p. 540] who writes (translated by the authors): “A labor market competition order primarily has to regulate collective competition regarding tariffs and labor conflicts.”

It is mainly outsider competition in the form of new unions who have to be protected against anticompetitive practices by the incumbent labor monopolist. As individual firms already have the right to negotiate collective wage agreements once they have left “their” employers’ association, competition on the employers’ side can slowly emerge, even if the continuity principle and the right of continuance are not removed. However, as explained above, it is extremely difficult for competing worker associations to obtain the right to negotiate collective wage agreements today. To facilitate competition between unions, especially the mightiness requirement and the interplant requirement described above need to be abolished to break the incumbent union’s market power.

Therefore, regulatory reforms of the labor market that aim at introducing competitive collective bargaining have to deal with two related issues. *Firstly*, barriers to entry for new collective bargaining parties have to be removed. This also involves the reduction of switching costs, i.e. firms and employees must have the opportunity to terminate existing agreements and conclude new agreements. *Secondly*, once the entry barriers have been removed, anticompetitive behavior by incumbent collective bargaining parties has to be prevented by appropriate measures. Incumbent monopolies and established cartels usually have the ability and also the incentives to drive new entrants off the market in order to prevent competition.<sup>15</sup> As Simon (1944, p. 6) has put it quite bluntly in this context, “monopoly power must be abused. It has no use save abuse.”

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<sup>15</sup> It is well-known that the rent-seeking incentive of an incumbent monopolist may very well lead to much higher welfare losses than the mere exercise of monopoly power would suggest. While in the latter case the welfare loss



Turning to the first point, there are a number of barriers for firms or alternative employers' associations which prevent them from negotiating separate collective wage agreements. First, the principle of advantageousness and restrictions on works councils' ability to engage in collective negotiations (§ 77 (3) *Betriebsverfassungsgesetz*) as well as continuation clauses (§3 (3) and § 4 (5) *Tarifvertragsgesetz*) make it unattractive to leave the ATS. Second, coverage extension rules (§ 5 (1) *Tarifvertragsgesetz*) and the absence of *competing unions* tend to draw outsiders into the ATS. On the union's side the mightiness criterion and the interplant requirement need to be removed to facilitate competition between unions.<sup>16</sup>

Turning to the second point, strike activities by incumbent unions need to be regulated with a competition policy perspective. As the history of labor market disputes reveals, strategic strikes were commonly used to discipline other workforces or firms that try to escape the labor cartel.<sup>17</sup> The history of collective labor relations and cartelization more generally, teaches us that the main problem of introducing competition consists in the use of coercion, force and exclusionary arrangements so as to fight off outsider competition both by deviating employers and by rival unions (see, e.g., Chamberlin [1964]). Currently, labor law is primarily tailored for the regulation of strike activity between central unions and central employers' associations where competition between independent collective agreements is virtually absent. Therefore, regulations on strategic strike activities that aim at disciplining outsiders are (understandably, given the current system) not in force. Within the ATS strikes serve to strengthen the union's bargaining position in a bilateral bargaining game. In contrast, in a decentralized wage bargaining system strikes can also serve to discipline competing unions or deviating employers so that more strike activities can be expected.<sup>18</sup> For example, so-called secondary strikes have been a common tactic of unions to harm competing outsiders in case of deviating behavior either by forcing boycotts of essential customers or suppliers. Interestingly, to our best knowledge, in Germany's highly cartelized labor markets secondary strikes have not been used. A commonly held view among German labor lawyers is that secondary

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is limited to the Harberger triangle, in the former case the entire present value of the monopoly profit stream is at stake (see, e.g., Philips [1995]).

<sup>16</sup> At the individual level so-called yellow-dog contracts are illegal which would allow a worker to commit not to join the union after being hired. Quite obviously, together with Germany's strict dismissal protection law, these rules deprive individuals from the opportunity to compete against the labor cartel.

<sup>17</sup> See, for example, Judge Pitney's summary of the US Duplex case of 1913 documented in Berman [1930, p. 104].

<sup>18</sup> Accordingly, Posner (2003) concludes that the US labor law can be interpreted as a "peacemaker" that reduced the exercise of force – in particular, strikes, boycotts, and lockouts – by the collective bargaining parties.

strikes are illegal. Needless to say, that there has also been no pressing need to apply such crude of forcing measures in Germany, and it remains to see how labor lawyers will deal with such activities in the future under an environment which backs decentralized, and hence, competitive collective labor agreements.<sup>19</sup>

Any labor policy proposal that tends to favor a break-up of the ATS has to go hand in hand with a proposal for an institutional framework that will deal with the unavoidable conflicts a decentralized and hence more competitive labor market system must provoke; as e.g., secondary strikes, picketing and forced boycotts by the dominant union to protect its monopoly power. To resolve such disputes in a way that allows to trade-off pro-union objectives and opposing antitrust rules an appropriate court system is needed.

The current labor court system is, however, not well equipped to allow for such a more balanced approach. The nomination of labor courts is done in good understanding with the monopoly unions and the employers' associations (see Pauly [2005, p. 104f.]), so that the "labor jurisdiction law" (*Arbeitsgerichtsbarkeitsgesetz*) guarantees the influence of the labor cartel on labor courts' composition. Moreover, labor courts' strict orientation towards an unconditional support of monopoly unionism (as exemplified by its very restrictive approval of the union status) makes it unlikely that the current labor court system will protect the outsider rights in an adequate way. As has been pointed out by Posner [1984] for the National Labor Relations Boards in the US that displaced the common law system there, the labor court system can be interpreted by its very existence to function as a major force in executing the stabilizing effects of the labor laws.

However, the US case is also instructive for the realization of labor market policies that intend to strengthen competition, as union-employer contracts that aim at forcing other businesses to join the collective agreement may fall under the domain of antitrust laws (see Sullivan and Grimes [2000, pp. 716–727] for a delineation of the labor exemption in US antitrust law). The US case, therefore, highlights the role of competition policy to safeguard a more decentralized labor system by appropriate competition rules. Put differently, decentralizing labor market reforms need *both*: antitrust laws *and* an appropriate legal environment.

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<sup>19</sup> Recently, Germany's most powerful industry union *IG Metall* has reverted to a tactic which comes close to a call for a secondary strike. Precisely, the *IG Metall* pushed hard to persuade employers to boycott a collective agreement between the Employers' Association of Northern Bavarian Work Agencies (*Interessengemeinschaft Nordbayerischer Zeitarbeitsunternehmen – INZ*) and the *Christlicher Gewerkschaftsbund* (CGB). The respective

## 5 Conclusions

We have shown that standard cartel theory provides a parsimonious way to explain the functioning of the major labor institutions and the causes of uncontested union monopoly power in Germany. Those institutions serve to facilitate the cartel agreements between industry unions and employers' associations by effectively protecting the cartel against deviant behavior of insiders as well as from outsider competition, in particular, in the form of rival unions.

We have argued that recent labor market reforms that intend to make the ATS more "flexible" can be split into stabilizing reforms (in particular, opening clauses within the ATS) and reforms which introduce competition in the labor market. Only the former proposals have been successful so far, while truly liberalizing proposals have failed. As the latter proposals have been lacking a vision of how to deal with the arising conflicts and disputes, such proposals are not really convincing. Instead, any attempt to introduce competition into the German labor market must deliver a convincing answer to the question of how to deal with the arising re-monopolizing strategies (in particular, strikes and the use of force as well as exclusionary arrangements). From this perspective, the current labor court system appears to be a major barrier of change which has to be displaced by a new jurisdiction that trades off the constitutionally guaranteed right to form labor coalitions against the adverse effects cartels and abuse of monopoly power must evoke. In short: A more *reasonable* approach within the legal environment for the labor market is badly needed.

Moreover, we have distinguished labor market liberalization strategies into two categories: Firstly, those policies that directly aim at breaking up the existing ATS by making deviant behavior of *insiders* more attractive, and secondly, labor reform proposals that allow for new options of collective agreements among *outsiders*, while leaving the status quo of the cartel participants untouched. Most proposals fall into the first category, as e.g., strong opening clauses and the attenuation of the principle of advantageousness *within* the ATS as well as attempts to enable works councils to strike collective labor contracts, again, *within* the ATS. Similar effects emanate from proposals that soften continuation clauses and the dismissal protection law. It is not surprising that all those proposals (which failed) have received a maximum of political opposition. The liberalization of Germany's labor market can be achie-

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collective agreement was banned by leading union official, Reinhard Dombre, as a "dirty trick with questionable associations" (see the official website of the Deutsche Gewerkschaftsbund: <http://www.dgb.de>).

ved without unsurmountable political opposition, if policy proposals gain momentum which fall into the second category.<sup>20</sup> New options for firms and workers *outside* the existing ATS can be created by liberalizing existing barriers to entry for the establishment of a fully tariff-enabled union.<sup>21</sup> Such a new option will also provide additional incentives for insider firms to leave the ATS, so that the German labor cartel may very well vaporize in the not to far future.

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<sup>20</sup> While we did not analyze recent trends in the temporary work market in Germany, we feel that liberalization appears to be quite successful here, exactly because a *new market* has been unlocked by liberalizing laws (see Footnote 1) so that vested interests, and hence, political opposition were presumably minimal in that case.

<sup>21</sup> Creating new options for outsiders comes closest to a pareto-improvement (at least in the short run, when we abstract from competition effects) which, by definition, should minimize the incumbent labor cartel's protest.

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