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

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Justus Haucap, Uwe Pauly and Christian Wey*

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Abstract

This paper offers a cartel explanation for the stability of German collective bargaining institutions. We show that a dense net of legal safeguards has been yarned around the wage setting cartel. These measures make deviation by cartel insiders less attractive and simultaneously erect entry barriers for alternative unions. As we argue many recent labor policy measures, which make wages more flexible, serve to further stabilize the labor cartel, while truly pro-competitive proposals have not been implemented exactly because of their destabilizing effects. We propose policy measures that remove entry barriers and facilitate outside competition by alternative collective bargaining organizations.

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1 Introduction

In this paper we argue that many German labor regulations and legal practices that enforce these regulations can best be understood as devices to suppress competition on the labor market 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.[1]

Germany's labor laws and institutions do not only encourage unionization and collective bargaining, but the "one-union" principle has been realized in Germany so that uncontested union monopoly power and industry-wide tariff agreements are the rule. This sharply contrasts with many other countries where the cartelization effects of such labor legislation are 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]).

As our cartel analysis reveals, 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 to exit the cartel and by combating outsider competition at the individual and the collective contracting level.[2]

This kind of extreme pro-monopoly orientation of the German labor law stands in sharp contrast to widely acknowledged antitrust principles which serve to ensure competitive structures and efficiency in other markets, even though the

[1] Due to space constraints, we will not analyze recent developments towards a more segmented labor market in Germany, following the liberalization of the law on employment agencies (*Arbeitnehmerüberlassungsgesetz*) in 2003. Now the principle of equal working conditions (*Gleichbehandlungsgrundsatz*) does not apply anymore if the employment agency or the respective employers' association concludes a new collective sector contract (*Branchentarifvertrag*). Indeed, a small number of such collective contracts have now been concluded, 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], [2006b].

[2] The realization of the one-union principle was a problem in the service sector where industry evolution and market liberalization increasingly blurred the boundaries between service branches. Difficulties in clearly delineating union competencies led to the largest union merger in post-war German history when in March 2001 the five service sector unions (namely, the *Deutsche Angestellten-Gewerkschaft* (DAG), the *Deutsche Postgewerkschaft* (DPG), the *Gewerkschaft Handel, Banken und Versicherungen* (HBV), the *Industriegewerkschaft Medien, Druck und Papier, Publizistik und Kunst* (IG Medien), and the *Gewerkschaft Öffentliche Dienste, Transport und Verkehr* (ÖTV)) merged to form one union *Verdi*; at that time, the largest sector union of the Western World with roughly three million members.

effects of cartelization are quite similar in both the labor market and "ordinary" other markets: Cartels raise prices above competitive levels.[3] 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 has come down to 3–5% in many other countries like the US, the Netherlands, or Denmark to provide some examples.[4]

However, while cartels usually 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 World War II.

The 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 measures that intend to make labor markets more "flexible" further serve to stabilize the labor cartel while other pro-competitive proposals (which have misleadingly been framed as "flexibility" measures) have not been implemented. We argue that the latter pro-competitive recommendations have failed exactly because of their destabilizing effects. Finally, we propose 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 framework 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 an institutional framework that allows for a balanced reasoning between pro-union objectives and antitrust concerns, any policy aiming for a 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.

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[3] Prices above competitive levels reduce social welfare under fairly general conditions. 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).

[4] The true unemployment rate 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 [2006, p. 130]). BACH AND SPITZNAGEL [2003, p. 7, Table 1] even report 1.7 million people in hidden unemployment and 1.0 million people participating in governmental work programs, and these numbers still tend to underestimate the true extent of unemployment in Germany, as the extensive use of early retirement programs is not taken into account.

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 for a working competition order for the labor market. 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 (see KOHAUT AND SCHNABEL [2007]). 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.[5]

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 and even further until 2006 (see KOHAUT AND SCHNABEL [2003a], [2007]), 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], [2007]). In general though, competition still plays a very limited role, as competition through either individually 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 German 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.

[5] For a detailed description of the ATS, its emergence, and its legal foundations, see PAULY [2005] and HAUCAP, PAULY AND WEY [2006].

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] and PHLIPS [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 low wage 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: About 80 percent of all employer-employee-relationships are still directly or indirectly governed by tariff agreements concluded between industry unions and employers' associations (see KOHAUT AND SCHNABEL [2007]). 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, thereby stabilizing the wage cartel. We first summarize the legal provisions which provide incentives to abstain from exiting the ATS.[6]

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.[7]

[6] See HAUCAP, PAULY AND WEY [2006] for a more comprehensive analysis.

[7] 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

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 are being re-newed or expire.[8] *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 agreements.[9] *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.[10]
3. Coverage extension rules can be employed to prevent employers from undercutting centrally negotiated tariff agreements even vis-à-vis non-unionized workers.[11]
4. The deviating firm looses 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.[12]

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.

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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.

[8] 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.

[9] 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, the scope for discrimination between organized and non-organized workers is quite small.

[10] The right of continuance does not apply when new workers are hired.

[11] 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.

[12] The deviant firm is also excluded from the strike insurance system (*Gefahren-gemeinschaft*) which the employers' associations provide for their member firms.

2. Application of coverage extension rules would require the outsider firm to pay the tariff wage anyway.

A main question, however, remains: Why is there virtually no union competition so that firms outside the ATS cannot enter into collective agreement with a union other than the incumbent monopoly union? Following our previous analysis of the cartelizing effects of Germany's labor laws we can identify, again, legal constraints that effectively restrict market entry of competing unions with the right to negotiate collective wage agreements (*Tariffähigkeit*); in particular:[13]

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 to evaluate a union's "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.[14]

These requirements are a result of legal practice and the Federal labor court (*Bundesarbeitsgericht*) has developed a very restrictive interpretation that allowed the incumbents unions (organized in the *Deutsche Gewerkschaftsbund*) to challenge the union status of rival unions successfully in court (see FRANZEN [2001, pp. 6–7]). 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 the right to engage in collective bargaining (also see KISSEL [2002, p. 105] as well as LESCH [2006]).

In addition, five of the DGB member unions have merged into a single large union (*verdi*) in 2001. While some of the five unions were effectively competing before the merger due to overlapping competencies for some firms, the grand merger has not only further reduced actual competition between unions but also reduced the prospect for potential union competition within the current framework. At the same time, however, we have also seen the emergence of two

[13] See, e.g., REUTER [1995], RIEBLE [1996] and KISSEL [2002] for a full description of the requirements a tariff enabled union must fulfill according to legal practice.

[14] 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*.

new unions, which have grown out of former interest groups, such as *Cockpit* (organizing pilots) or *Marburger Bund* (organizing physicians). Both unions only compete at the fringe with existing unions, however, as they organize workers which are complementary to other unionized workers, organized by the DGB, such as flight attendants and nurses. Hence, these new unions hardly compete with existing unions, but rather complement them. Accordingly, there is less resistance from established unions when compared to the formation of truly competing unions such as the *Christliche Gewerkschaft Metall (CGM)* which directly competes with the incumbent *IG Metall*.

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. In addition, there are significant barriers to entry for new unions as it is extremely difficult for a new union to obtain the right to engage in collective bargaining. In consequence, there is very little competition between unions.

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] and 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.[15] 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 that 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,

[15] 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.

and hence, help to prevent decentralized wage setting outside the labor market cartel's control (i.e., the so-called *Tarifflucht*).[16]

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 destabilizing 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 *Betriebsverfassungs-gesetz*). Not surprisingly, such an ambitious proposal has not been implemented so far.

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 (and should not) 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, labor market reforms 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 includes the reduction of

[16] 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]).

switching costs, i.e. firms and employees must be able to terminate existing agreements and conclude new ones. *Secondly*, once 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.[17] As SIMON [1944, p. 6] has put it quite bluntly in this context, "monopoly power must be abused. It has no use save abuse."

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.[18]

Regarding 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 deviate from the labor market cartel.[19] 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 combat outside 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

[17] 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 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., PHLIPS [1995]).

[18] 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.

[19] See, for example, Judge Pitney's summary of the US Duplex case of 1913 documented in BERMAN [1930, p. 104].

can be expected.[20] 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 strikes are illegal. Needless to say, that there has also been no pressing need to apply such crude measures in Germany, and it remains to be seen how jurisprudence will deal with such activities in an environment that facilitates the emergence of decentralized, and hence, competing collective labor agreements.[21]

Any 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. Labor court judges are nominated in close consultation with both incumbent monopoly unions and the employers' associations (see PAULY [2005, p. 104 f.]), 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 outsider rights in an adequate way. As has been pointed out by POSNER [1984] for the National Labor Relations Board 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.

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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[20] 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.

[21] 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 collective agreement was banned by leading union official, Reinhard Dombre, as a "dirty trick with questionable associations" (see the official website of the DGB at http://www.dgb.de).

5 Conclusions

We have shown that standard cartel theory provides a consistent and 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 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 clause within the ATS) and reforms that introduce competition into the labor market. Only the former proposals have been politically successful so far, while truly liberalizing proposals have not been implemented. 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 for policy makers. Any attempt to introduce competition into the German labor market must come with 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 to change. It should be displaced by a new jurisdiction that trades off the constitutionally guaranteed right to form labor coalitions against the adverse effects that cartels and abuse of monopoly power must evoke. In short: A more *reasonable* approach within the legal labor market environment is desperately needed.

Moreover, we have distinguished between two kinds of labor market liberalization strategies: Firstly, some policies directly aim at breaking up the existing ATS by making deviant behavior of *insiders* more attractive, while, secondly, other reform proposals 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. For example, strong opening clauses and the attenuation of the advantageousness principle *within* the ATS would facilitate deviant behavior by cartel insiders. The same holds for the suggestion to enable works councils to conclude 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 have received a maximum of political opposition and have, accordingly, not been implemented. If, however, policy proposals that fall into the second category gain momentum, then the liberalization of Germany's labor market can be achieved without a brute force approach that aims at breaking up the cartel directly.[22] New options for firms and workers *outside* the existing ATS can be created through the removal of existing entry barriers for the establishment of a fully tariff-enabled

[22] 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.

union. Political opposition against new options should be smaller when compared to other proposals, as the creation of such options for outsiders comes closer to a Pareto improvement (at least in the short run when we abstract from competition effects). This should, by definition, reduce the incumbent labor cartel's protests. In the longer run, new options outside the ATS will also provide additional incentives for insider firms to leave the ATS so that the German labor cartel may very well vaporize in the future.[23]

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[23] An additional pro-competitive consequence of lowering entry barriers for new unions is that this threat tends to counter incentives for union mergers, as e.g., the *verdi* mega merger (see Footnote 2).

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