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East-West Integration and the Changing German Production Regime: A Firm-Centered Approach

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Abstract

With the opening of Central Eastern Europe German firms have gained access to low labor costs in close geographical proximity. Intense debate about the impact this has had on the "German model" of capitalism has ensued. This paper argues that, in fact, production shifts are taking place in which cost-cutting motives are an important guideline. German firms, however, hesitate to aggressively utilize this new option in their internal domestic labor policy. Rather, firms tend to avoid confrontations with their employees on "job exports". The necessity of collaboration on both sides of the border, the relative strength of workers in the domestic high-quality production system, and the constraints of industrial relations provide explanations for the moderate behavior. So far, the outcome of the bargained reorganization is that firms gain more labor flexibility, performance-related differentiation, and labor-cost rationalization without challenging the institutionalized long-term employment commitments for their core workforce.

Introduction

The opening of Central and Eastern Europe after 1989 has created a new opportunity for German firms similar to those of firms in the United States. They gained access to huge resources of cheap labor in geographical proximity. This ”tremendous opportunity,” as Lester Thurow (1999) puts it, to move labor-intensive production toward Central and Eastern Europe raises two questions which I will discuss in this paper: First, why do German firms move production into their neighboring countries—how important are cost-cutting motives for them? Second, have German firms exploited the new opportunity to break with social rules in their corporations at home that has so long prevented them from exploiting large wage differentials to the extent practiced by Anglo-Saxon firms? Do German firms use the new opportunities to impose changes on the basic rules and practices of the ”German model,” shifting toward the liberal, Anglo-Saxon market model?

Lester Thurow has little doubt that German firms have to behave in this way. Other observers point out that firms can utilize the new opportunity to extort concessions form their employees even when they do not plan to shift production in the neighboring countries. Yet, the debate on institutional convergence and national diversity of capitalism provides also a different view. David Soskice and Peter Hall (1999) argue that firms develop distinctive corporate strategies and organization to capitalize on the institutions in which they are embedded. Hence, it is far from clear that firms from different institutional backgrounds would react to similar opportunities in the same way.

Soskice and Hall characterize the German institutional framework in four dimensions or institutional spheres: 1) a financial and corporate system that allows long-term financing of firms. Stable cross-company-shareholding, close relations to a main bank and a legally institutionalized role for employees in the supervisory boards of large firms are key parts of this system; 2) industrial relations, in which collective bargaining equalize wages and labor regulations on the industrial level. In addition, strong co-determination gives works councils at firm-level considerable authority over lay-offs and working conditions. This makes lay-offs difficult but encourages employees to invest in firm-specific skills, while fostering loyalty and extra efforts; 3) the educational and training system results in encompassing initial vocational training of young people, in which organized businesses and/or individual firms are closely involved. It provides firms with highly-skilled and specialized labor; and 4) there is an institutional intercompany system that enables substantial cooperation to take place between firms with regard to innovation and setting of industrial standards (Soskice 1999).

In fact, based on this ”production regime” many German firms quite successfully competed with lower cost competitors in the 1980s. They moved into upper-end market segments with high-quality production and rising capital intensity. Small and medium-sized firms often further cultivated existing specialized niches, while large firms combined mass production with high-quality standards, increasing model variation and frequent incremental technical improvements. The underlying assumption behind this correlation between corporate

strategy and institutional framework is that German firms depend less on low-cost labor than their U.S. counterparts. Hence, German firms have less reason to move their activities out of the national economy even when faced with new access to low-cost labor. Consequently, lower labor costs in close spatial proximity appears far less challenging for the high-wage, high-regulate system.

I argue in this paper that German firms have strong motivations to shift production to Central and Eastern Europe. Firms are interested in Central and Eastern Europe as an emerging market and as an opportunity for cost cutting. Those firms—mainly from mature industries— have more and more problems with a home-based production strategy, which avoids international competition by moving in upper-end product markets and increasing capital intensity. However at least until now, German firms have not utilized this ongoing cross-border reorganization for aggressive dismantling strategies of the labor-related parts of the German production regime. This does not mean that firms did not exert increasing pressure on the domestic workforce and their interest representatives in the '90s. But large firms in particular focused above all on more flexibility of this production regime and for rationalization of its costs. The outcomes so far are heavily shaped by the institutional logic of this framework.

I outline this argument in three steps. First, I briefly describe the methodology of my analysis on which this paper is based. In section two and three, I will show that cost-issues are important motives for production shifts into this region and that this is linked to the limits of the mainly home-based, export-oriented high-quality production system of German firms in the 1990s. In section four, I identify strategies of cross-border corporate reorganization that can be partly interpreted as a response to the limits of this production system. As cross-border reorganization I term the process in which firms arrange or rearrange different corporate units and functions across a border that leads to new labor divisions and specialization. Finally in section five, I show why German firms hesitate to dismantle the labor-related parts of the German production regime and what their alternative strategies are.

Firm-Level Analysis

The principal methodology of this research is a firm-level analysis. Between December 1998 and August 1999, I surveyed 30 German firms that have or have tried to establish production capacities in the form of subsidiaries, participation in existing firms or joint ventures in Poland and the Czech Republic (three firms from my sample eventually gave up their production facilities in these neighboring countries). I conducted 55 confidential interviews (each two hours and more in length) with leading executives or company-owners. Also included in this study are interviews with works councils, union leaders and consultants in intermediary organizations. Beyond the interviews I visited factories and collected firm-data (internal statistics, annual reports from the last ten years, press releases or other available articles about the selected firms between 1989 and 2000).

The firm sample was not designed to be representative. It was designed to comprise a range of different kinds

of corporate strategies and reorganization patterns practiced by German firms across the border. Four criteria guided the clustering:

a) A first criterion is firm size. The geographical proximity of Poland and the Czech Republic attracts firms with different resources and international experiences. Investment in both countries is not only the domain of large firms. Many small firms are encouraged to look abroad. Thus, I strove to include firms of different sizes. Eleven of the 30 surveyed firms have a group size (including their new Polish or Czech plants) with fewer than 1,000 employees. Nineteen firms have more than 1,000 employees and among them are three multinational companies with more than 20,000 employees. Four of the large firms have invested in both countries. Nine firms have also invested in production capacities elsewhere in Central and Eastern Europe (namely Romania, Hungary and/or Russia).

b) The second criterion was that the firms should belong to industries where—at least theoretically—both market-access and cost-cutting strategies might be relevant. Industries with dependence to the regional markets in the host countries (like the basic food industry) were excluded, since little reorganization on German side is likely to occur. At the same time, the selected firms should belong to industries that are relevant German investors in either country. Since in both countries the transportation equipment industry is a major foreign direct investor this industry receives high attention in my research, too. In the Czech Republic transportation equipment industry is the major foreign direct investor. In Poland this industry ranks closely behind the food and tobacco industry. Other important investing industries are the metalworking and electrical industry in general, the chemical industry (i.e. the those part which produces mainly consumer goods), furniture and textile.[1] According to these guidelines, the following industry-mix was selected:

Table 1: Branch origin of Surveyed Firms

Industries	Firms	In the Czech Rep.	In Poland
Transport equipment	11	6	5
Metal products and electrical machinery	11	7	3
Chemical and rubber products	3	2	1
Other consumer goods	5	2	3
Total	30	18	12

c) A further hypothesis is that the geographical distance between German firms and the selected location in Poland or the Czech Republic indicates differences in corporate strategies and organization. Referring to this spatial dimension, the sample consists of German firms that are both near the Polish or Czech border and those located in German industrial centers further away from the border. As a result, eight firm headquarters are located in Bavaria, near the Czech border, and four firms are located in Saxony near the

[1] See Zemplinerova 1998, Witkowska 1997, Czechinvest, fact-sheet no 2, PAIZ 1999.

Czech and Polish border. Seven firms are located in northern Germany (including Lower Saxony). Another seven firms come from North-Rhine Westphalia, and three are located in the southern part of Germany, all seventeen being far from the border.

d) Finally, I am interested in different forms of capital involvement (subsidiaries, participation and joint ventures). The assumption here is that shared corporate control of existing enterprises leads to different corporate strategies and outcomes to investments in which no transformation of the existing organizational structures and workforce occurs (so called green field investment in contrast to brown field).[2] Yet to find actual joint ventures turned out to be difficult. After a short period in the early 1990s, most German firms strove to get full ownership control. Therefore, the overwhelming majority of my sample represents firms with wholly owned subsidiaries. Twelve of the large firms followed this path, and almost all small and medium-sized firms control their Czech or Polish plants. Five large firms have started with a minority of the stock but raised their shares to majority control of up to 70 percent (and more) of the stock. Just one firm (a latecomer among the investors) controls less then 50 percent. Nine of the eleven small and medium-sized firms decided for green field investments. Eleven of the nineteen large firms did the same. Nine large and only one small firm took over an existing organization (brown field).

Motives: Cost Cutting and New Product Markets

In 1998, Western industrial countries attracted 87.7 percent of Germany's rapidly growing direct investment (mainly Western Europe and the U.S.). Developing countries amounted to 6.6 percent, the countries in transition (Central and Eastern Europe) accounted for 5.7 percent, Asia for 4 percent and Latin America for 2.5 percent (BMWi 1999). Both the high share of investment in other Western industrial countries and the high amount of investments in the service sector indicate that market motives continue to determine German business activities abroad.[3] Yet also the flow of investment into Central and Eastern Europe continued to rise. In 1998 and even earlier in 1996, Poland ranked fifth among the host countries for German direct investment, while the Czech Republic held the tenth position (BMWi 1999, 1997). According to a survey of the U.S. consulting firm A.T. Kearney, Poland is the third most interesting place for German investors, followed by the Czech Republic (fifth rank) and Hungary in the tenth position (FAZ 2/23/2000). This makes Germany the largest single investor in Central and Eastern Europe (see Table A).

In all of these countries the manufacturing sector figures prominently as a target for foreign direct investment (PAIZ 1999, Czechinvest 1999). Therefore macroeconomic analyses of investment outflows indicate that cost-

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[2] Green field investment in the former Soviet block states mostly means that part of a state enterprise are bought (estate and buildings). Even part of the work force and few local managers were hired. Yet, foreign investors create their own, new corporate organization instead of taking over an existing one (brown field).

[3] See Kaufmann/Menke 1997: 94ff.; Härtel/Jungnickel 1996, Morsink 1998: 151, Deutsche Bundesbank 1997, ifo Institut 1996.

cutting motives are driving the rising interest in Central and Eastern Europe.[4] The existing surveys of firms on this issue, however, are not of one mind. DOWC Ost-West-Consult, a subsidiary of the Dresdner Bank, for instance, has surveyed 500 firms, 80 percent of the 150 responding firms report the desire to gain market access as their most important motive for investment in Central and Eastern Europe. 48 percent report protection and expansion of their market shares as investment motives (though that might also refer to benefits of mixed price calculation to compete on Western markets), and only 41 percent note labor costs as a motive. Most of the surveyed firms were small and medium-sized (DOWC 1994: 17-19). In a survey of the German *Genossenschaftsbank*, the interest in the new product market also top the list, yet the authors note that labor cost motives are more relevant for small firms than for large ones (DG Bank 1996).[5] In other surveys, market and labor cost motives share similar importance. Sometimes market motives figure prominently in German outward investments (Beyfuß 1996) while at other times labor costs are on top (ZVEI 1995, VBM 1995, VDMA 1997).

Yet there appears to exist different preferences in different industries. Especially in the metalworking and electrical industries cost cutting is more relevant than in others. Moreover, these industries are very important investors in the Polish and Czech manufacturing sector. In addition, shifts in motivation seem to depend on the geographic distance to Western Europe and the size of the host country markets. Cutting labor costs is a prominent motive of German firms investing in the Czech Republic; direct investment in Russia is seen first of all as a way to get access to the huge and distant Russian market (Beyfuß 1996: 28-29). Also the size of Poland seems to be more attractive for firms with market interests than the small Central European countries.[6]

My firm-level analysis reflects both the high dynamic in the internationalization of production in the 1990s as well as the increasing concern to cut costs by moving production abroad. This is not exclusively but mainly related to the nearby eastern neighbors. For almost all firms with a group size of less than 1,000 employees, investments in Poland or the Czech Republic represent the first step in the internationalization of production. Most of the large firms already had outward production in the '70s or '80s (13 of 19 firms). Yet, this shift of production focused with few exceptions on gaining market access. Typical for the 1980s was that a wider range of large firms shipped production abroad. The U.S., East Asia and China became targets for such activities along with Western Europe. Joint ventures and acquisitions of existing firms were usually used to gain access to regional markets. Often these projects did not live up to expectations. Most of the surveyed firms with production facilities in the U.S. or Asia passed through an expensive and time-consuming learning process before seeing positive results. The growth rates on these markets were slow.

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[4] Beyfuß 1996: 6-13, Härtel/Jungnickel 1996: 20-28, Bundesbank 1997.

[5] See also Meyer 1995.

[6] See Deutsch-Polnische Industrie- und Handelskammer 1998, Jaworek 1999: 150, Kaufmann/Menke 1997. The differences in outcomes have also methodological reasons which I cannot debate in this paper. All surveys are highly selective, and they often include more or less random clusters of investors including services/sales and production.

Until the end of the 1980s, even the large firms studied remained highly home-based in their production, in spite of the rising number of production capacities abroad. This began to change in the 1990s when firms started to systematically expand their foreign direct investments. Still, at the end of the 1980s almost all studied firms had more than 60 percent of their workforce at home. The domestic workforce of only one chemical firm amounted to a share below 50 percent. At the end of the 1990s the share of the domestic workforce declined in every case by ten percent at least. In nine large firms the share dropped below 50 percent (seven firms had a share of the domestic workforce around 40 percent and less), three firms had reduced the share of the domestic workforce below 60 percent. Meanwhile, most of the small firms retained a share above 60 percent.

At first glance, my firm-level analysis confirms those surveys that have revealed a sharp difference in motives between the small and medium-sized firms on the one hand, and the large ones on the other. Around one-third, i.e. 12 of the surveyed 30 firms, established production capacities in the Czech Republic or Poland in order to benefit exclusively from lower (labor) costs (Table 2). Among them are eight firms of this group that have less than 1,000 employees, and only four large firms that have established at least one location just for cost-cutting motives. A majority of the studied large firms, namely 15 out of 19, report a strategic interest in the emerging Central and East European markets. However, ten of those large 15 firms are concerned about cost benefits as well and they pursue mixed strategies. In fact, nine large firms were so strongly oriented toward cost cutting that this motive determined their whole corporate strategy and organization in Poland and the Czech Republic. Investments in production, logistic solutions for re-export, quality control and other production-related issues were clearly a priority. In other words, the corporation abroad was mainly designed to respond to Western or world market demands, while corporate strategies and capacities to develop the regional market were far less established. Hence, a closer examination of investment motives reveals that also among the large firms, a majority intended to reduce costs in order to compete in Western markets when they invested in the Czech Republic and Poland.

Table 2: Investment Motives of German Firms in Poland and the Czech Republic (n=30)

Firm Size (Group)	*Market Motive*	*Mixed Motives*		*Cost Motives*	*Other Motives*
		with dominant market interest	*with dominant cost interest*		
< 1000	---	**1**	**1**	**8**	**1**
In					
Czech R.	---	1	1	6	1
Poland	---	---	---	2	---
> 1000	**5**	**1**	**9**	**4**	**---**
In					
Czech R.	1	---	5	3	---
Poland	4	1	4	1	---
Total	**5**	**2**	**10**	**12**	**1**

There seems to be a greater interest in the Polish market than in the market of the Czech Republic. After the high expectation that this investment would create ”footholds” in the East European (GUS) market, the size of the domestic market became more crucial for market-oriented strategies.

In sum, small and medium-sized firms tend to use a low-cost strategy exclusively, while the majority of firms with more than 1,000 employees pursue a mixture of market-expansion and cost-cutting measures for products offered on Western markets. While the spatial proximity has encouraged small and medium-sized firms to manufacture abroad, large firms are tempted to combine their market interests with cost-cutting strategies at home. In either case, cross-border reorganization is taking place.

Driving Forces: Limits of Home-Based High-Quality Production

The deep recession of 1992/93 turned out to be an important catalyst for German outward investments. During this crisis 13 studied firms suffered heavy losses in important parts of their industrial business (4 small and medium-sized companies, SMC). Two-thirds of the firms reduced their domestic employment (16 large firms, 5 SMC). Moreover, the recovery of orders by the firms occurred much faster than the recovery of the profit margins. Meanwhile, the industrial fluctuation—especially in the metalworking and electrical industries—remained hard to predict.

The problems were twofold: On the one hand, firms were faced with growing international price competition in their traditional domestic and West European markets. Moreover, after the crises, customers became more price conscious and began to calculate harder if they should buy, for instance, expensive specialized equipment instead of limiting themselves to standardized solutions. This contributed to the pressure on the mainly home-based high-quality production that offset higher labor costs by doing business in higher price markets and by increasing capital intensity. On the other hand, the potential growth markets for the German firms, like the

emerging markets or the U.S. market, were even more price-sensitive than the Western European market. Many producers, therefore, faced the situation that a market-expansion strategy by exporting ”Made in Germany” products was not only hampered by local content obligations and other market restrictions but also by high production costs.

Still, there was additional pressure to move to Central and Eastern Europe. First, large firms often persuaded or forced their suppliers to follow them into Central and Eastern Europe. A well-known example of this kind of vertical interdependence is the engagement of the German automobile producer Volkswagen in the Czech Republic. In the early 1990s, Volkswagen began systematically to demand that key suppliers settle down in the countries where Volkswagen plants are located.[7] In the case of the joint venture with the Czech automobile firm Skoda, a high share of local supplies were part of the contract with the Czech government who feared that Volkswagen would desert the domestic suppliers of Skoda. Yet Volkswagen also urged its own German suppliers to follow the company because they could use the lower wage scales in the Czech Republic to scale down their prices. In my sample, all seven suppliers of the vehicle industry found their way into Poland or the Czech Republic because of this pressure. And one can find similar developments in other industries like the packaging industry that accompanied their traditional customers abroad. Sometimes investors coordinate their orders to raise incentives for joint suppliers to follow them. Sometimes large firms even sent their suppliers or subcontractors as ”pioneers” into this region, allowing them to take more time for their decision and to test the new field.

Second, once firms began to offer ”mixed prices” calculated on German and low-cost wages, customers also learned to demand similar prices from the competitors of those firms. Facing price drops, competitors were challenged to either enhance their productivity by further rationalization and automatization or to shift production abroad as well. In other words, the ”pioneers” of shipping production abroad raised the incentives and increased pressure for latecomers.

A third pressure could be observed in very large firms. In the second part of the 1990s, the front-runners of internationalization successfully established a profit-oriented management style. The salaries and carriers of executives were linked to stipulated profit margins based on available market data, the performance of publicly traded competitors and the business outlook of the particular industry. This institutional change also began to influence the decision making-process about what should be kept at home and what would be better produced in a lower-cost country. Yet, it is important to note that there are huge differences in how far large firms pushed themselves in this direction. Small and medium-sized firms appeared even less inclined to imitate the ”pioneers” among the large firms.

In sum, the increasing interest of German firms in cross-border reorganization in the 1990s was not only triggered by new opportunities in Central and Eastern Europe. The recession in the early 1990s and its aftermath revealed the limits of a high-quality, home-based production in mature German industries that up

[7] See for the Czech Republic Dörr/Kessel 1999.

until that point had offset growing international price competition by moving upmarket. Once underway, additional pressure accelerated cross-border reorganization.

Strategies of Cross-Border Reorganization

Five strategies of cross-border reorganization between German firms and their Polish and Czech plants were identified. Since especially large firms have often more than one motive to invest in both countries, they often combine different strategies (see Table B).

The first strategy is the extended workbench. Labor-intensive and low-skilled operations were cut out of the existing production processes of German plants and moved across the border. Outside of Germany, the semi-finished products were assembled or completed with low-tech machinery and often subsequently re-exported. The management boards of such workbenches were small. Sometimes this pattern is compared with the U.S. assembly industry along the northern Mexican border (Pavílnek and Smith 1998). Yet unlike U.S. ”maquiladoras” the main investors in Czech and Polish extended work benches were small and medium-sized firms. Nine of the eleven small and medium-sized firms in my sample pursued this strategy. Only five large firms used this approach in one of their Czech or Polish production locations.

The next strategy can be identified as vertical reintegration. Vertical reintegration is an approach for large firms with complex products that invested in existing Polish or Czech enterprises (brown field investments). In the late 1980s and in the early 1990s, large firms began to reduce costs by outsourcing parts of their value-added production chain. At the beginning, this production was shifted toward nearby domestic suppliers. Later, companies tried to move the less sophisticated components toward Central and Eastern Europe. Sometimes those components were first given to subcontractors abroad but then reintegrated in wholly owned subsidiaries. So firms exploited the cost advantage and organized their demands without worrying about unintentionally strengthening their supplier. Vertical integration is not a strategy that determines a whole plant. In all six cases I found it was combined with other strategies.

The third strategy I have called the ”made-by” strategy.[8] Companies not only shift some labor-intensive work places across the border, but also complete the manufacturing process for complex components and products. The brand name of the German firms guarantees that high quality standards are met. They do this chiefly with German or German/Western ”socialized” expatriates[9], fast implementation of new concepts of quality control, and high capital investments in quality-sensitive operations. Because of this orientation toward high quality local content remains low and the supply is focused on low-tech components. Yet this is not necessarily a permanent arrangement. On the contrary, firms try to find regional suppliers or raise their local content successively through German suppliers who have settled in Poland or the Czech Republic. Also in other respects ”made by” is a dynamic pattern that often starts as an extended workbench but, if successful

[8] I have borrowed this term from Suzanne Bergers and Richard K. Lesters "Made by Hongkong."

[9] In Poland such expatriates are often former Polish emigrants who had left Poland in the time of the Martial Law in the ‘80s.

leads to the addition of further production and functions. In the end, even newly developed products can be shifted abroad when profit margins are too low in Germany. Consequently, the studied plants became partly responsible for the product, receiving a larger number of qualified jobs in quality control, purchasing, development and construction. ”Made-by” often included both labor-intensive work and higher skilled or capital-intensive work. Therefore, firms favored brown field investment where they obtained easy access to experienced and skilled workers. Five firms in the study were moving in this direction. In two cases this was directly combined with regional market interests. These are two engineering firms, which produce their basic machines in their Czech and Polish plants—the basic machine includes the complete machinery without the electronic installation, hydraulics and the customized configuration of the machine tools. At the same time the existing program for the standardized (complete) machines of the Polish and Czech firms was continued and modernized.

The fourth cross-border reorganization concept represents the ”two-brands” strategy that Volkswagen had developed for its Czech Skoda-enterprise.[10] This strategy was adapted by other vehicle producers, and can also be found in other industries. Five large firms in my sample are moving in this direction. The core idea is that the investor combines high-quality and high-price products with products for a lower-price segment for both the Central/East European and the West European markets. Sometimes, lower-price products were still manufactured by the German firm at home but came under enormous price competition. In other cases, German firms had already given up lower-price markets when they moved further upmarket in higher price and quality segments. Unlike the ”made by” strategy, the Czech or Polish companies produced under their own brand name. Mostly, this is the traditional brand name of the firm, which was taken over. Yet, I have also found three examples of green field investments where a new ”second-brand” was created. The ”two-brands” strategy implies that at least part of the marketing and sales is located in the host countries. In a few cases companies have located some research and development functions as well.

The fifth pattern can be described as follow-up reorganization when large firms build and rebuild their international production networks. This pattern has nothing to do with production shifts motivated by cost cutting, and it cannot be traced back to the limits of the German high-quality production system. Cross-border reorganization occurs when the demands of customers undergo change. With the implementation of the platform-strategy by Volkswagen in the mid-1990s, for instance, different new automobile models were constructed on one basic construction (platform). Suppliers, who initially moved to the Czech Republic exclusively to fill Skoda orders, now deliver to other European Volkswagen plants as well. Firms were thus forced to adjust their internal labor division that in the initial period of expansion had often been simply designed as a ”one order-one factory” (which lasted as long as a certain automobile model was produced). Changing market conditions can also trigger follow-up reorganization as well as changes in the political-

[10] Constanze Kurz and Volker Wittke called this type of cross-border reorganization ”complementary specialization” because those products supplement the bottom part of the product range of the western manufacturers (1999: 83). Since the ”made by” strategy is a sort of complementary specialization, too, I prefer the term coined by the firms themselves to describe this strategy.

institutional conditions (for instance, diminishing toll duties within Europe and between EU and Central and Eastern Europe). It is important to note that Polish and Czech plants have a quite good position in the follow-up cross-border reorganization because of their lower labor costs, qualified workforce, their relatively modern equipment and good logistical position within Europe.

Bargained Reorganization

We have, in sum, seen that German firms do use the new opportunities in Central and Eastern Europe to reorganize their production structures. Moreover, we have seen that cost cutting is important in this respect. The patterns of cross-border reorganization do at least in part react to the constraints of the major home-based, high-quality production that most observers in the 1980s perceived as a great success. The absolute decline of the domestic workforce especially in the large firms studied emphasizes that a serious redefinition of corporate strategy and organization is under way. Eleven out of 18 large firms had fewer domestic employees at the end of the 1990s than at the beginning of that decade, while subsequent growth took place abroad.

Have German firms utilized lower wages and labor regulation in Central and Eastern Europe for frontal assaults on the labor-related part of the domestic German production regime? My answer is no. Rather, firms tried to avoid situations in which lay-offs at home were directly linked to production shifts abroad. Often they have staggered workforce reduction so as to exploit ”natural” fluctuations—due, for example, to retirement—or workforce in peripheral plants was reduced. Firms also compensated for lost jobs by adding new ones for products in higher priced market segments for which at least part of the existing workforce was retrained. Severe cuts were mostly undertaken during the crisis in the early 1990s that can be traced back to general economic problems rather than to production shifts. The realized growth abroad may have worried the domestic workforce but it has not touched them immediately. In short, managers and owners showed little propensity to play hardball with their works councils and workforce on this issue.

Few companies decided to move their entire production abroad, while the headquarters, R&D, service and marketing/sales remained in Germany. One instructive example is a Bavarian family firm that was bought by a large U.S. company in the early 1990s. Let me outline this case briefly:

The U.S. company, in fact, tried to dismantle the German model. One of the first measures was to quit the employer's association. The works council's response to this was to force the company to accept a firm-based, individual contract that contained the main tenets of the industry-wide contract (including the 35-hour week of the metalworking industry). In the mid-1990s, the company began to shift production toward a German subcontractor in the Czech Republic. Three years later, the company decided to close the German production completely and to establish a wholly owned manufacturing subsidiary in the Czech Republic where they had bought an old industrial complex planned to set shop. Only marketing/sales, R&D and a small headquarters were to remain in Germany. The Czech government promoted this investment with tax advantages and

subsidies for a training program. But the German works council fought back. Its members pointed to opportunities for rationalization and argued that the risks and costs of the decision had been underestimated. The employees demonstrated, and the city government became involved. The major arena for bargaining, however, was the supervisory board in which, according to German law, works councils and the unions are regular members. The American executive president agreed to call for a second opinion by an external consulting company. The works council also received some funding from the company to hire a consulting firm of their choice. As a result, the German firm had exactly one year to reorganize itself, to introduce new organizational concepts and to reduce product variation. At the years end, the final decision would be made. In addition, the management of the German firm was replaced and a further drop in employment was announced. The works council and the union, however, could prevent wage cuts and the abolishment of the 35-hour week. Moreover, the American management agreed to establish a so called ”employment company” (*Beschäftigungsgesellschaft*) for those who lost their job and could not immediately find a new one. This ”employment company” had already become a model for other German works councils of the U.S. parent company. Finally, it was determined that instead of the moving German production, a British unit of the parent company would be moved to the Czech Republic.

This example illuminates that the German works councils in cooperation with unions are still powerful enough to impose bargaining upon cross-border reorganization. The U.S. managers acknowledged the faults of their original concept. But they also noted that they depended on the German employees for the success of new production facilities in the neighboring country.

Managers are even more aware of such dependence when they do not plan a radical shift of production abroad since they see no necessity to do so or consider it as too risky. In these cases, we can observe a further upgrading of the (remaining) German production to highly specialized, skill intensive or innovative products with better profit margins. In capital-intensive production systems the shift of technical equipment abroad also elicits upgrading in skills because it is replaced more quickly by the most advanced automated technologies.

In addition, during the 1990s many firms adapted new organizational concepts like short-term delivery (just-in-time), team work or total quality control where quality control was widely integrated into the production itself. Such concepts make the production system even more vulnerable to industrial strife.[11] Although works councils and employees cannot really block cross-border reorganization, they can still turn the firms' interest in cooperative relations into bargaining power (see also Dörre 1999). At least for large companies, cooperation with the workforce is still heavily embedded in the formal structure of the German industrial relation system, with entrenched works councils and a strong union presence. This is certainly one reason why in spite of increasing tensions the large firms I studied did not seriously undertake efforts to abolish collective agreements or to withdraw from the bargaining table with the unions. They took into account instead that

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[11] Kathleen Thelen explains by way of the vulnerability of the new organizational concepts why German firms have been unwilling so far to break with the institution of collective industrial-wide bargaining (Thelen and Kume 1999, Thelen 2000). This argument is similar to mine.

small and medium-sized firms get increasingly upset by the large firm dominated policy of employer's associations.

In very large firms the strong position of German works councils and unions actually encourages cooperative labor relations in the Czech and Polish plants. If we look at Table C the large firms do not show a single response as to how they deal with interest representation. Some of them have strong non-cooperative attitudes; others have even accepted workers' representatives at their supervisory boards when they do not have to. That is the case in Poland where no such rule exists. Yet, what we can observe is that the cooperative pattern is more stable in very large firms. I argue that this is linked to the strong position of works councils and unions within large German industrial firms and their capability to establish cross-border exchange on their own. Though the interests of employees on both sides are different in important respects, this exchange supports the organization of collective bargaining and encourages workers' representative to address demands. In one case the firm-level union even prevailed in determining conditions of German works councils in large firms. They negotiated exemptions from their regular work hours. Yet it must be also noted that for workers' representatives in very large firms it is easier to develop and stabilize cross-border relations than in smaller companies. Large firms provide more personnel and material resources (for instance, addressing issues like language gaps). They can also take advantage of the new concept of European Works Councils. Though the influence of this committee is limited, it provides a platform for cross-border communication among workers' representatives in which Czech or Polish representatives have been included. Finally, large firms are much more in the public eye and therefore more sensitive to issues that can ruin their reputation, especially when such incidents can easily be communicated across the border.

In other words, the way in which especially large firms cope with the new challenges and opportunities in the 1990s does not focus on a radical model shift in labor relations toward the Anglo-Saxon liberal market model. Where does the pressure of firms go? Three areas are important here:

a) The strongest pressure that firms exerted on the labor-related parts of the German production regime in the '90s was pressure on greater labor flexibility that would help them to adapt to the more volatile market fluctuations. The range of solutions has in common: They aim to allow more institutional flexibility without challenging the fundamentals of the long-term employment commitment between employers and the core workforce. So firms have attained greater hire and fire flexibility through increased use of temporary workforce *(Leiharbeit/ befristete Einstellungen*) that can be easily laid off again. Another way to gain more labor flexibility is the increase in working-time flexibility. The most important innovation here are the so called "working-time accounts" *(Arbeitszeitkonten)* which were implemented in most of the studied large firms in the 1990s. "Working-time accounts" mean that employees work longer in peak times than the official working hours and this often implies that they need to work also on Saturdays. The over-time is not paid, instead the hours are saved in this "time account", from which during a whole year employers and employees can "draw" hours for slower periods of production or for taking a day off. In addition, part-time work and early retirement for older employees lets firms renew their workforce without growth and without challenging the long-term employment commitment. Here the German welfare state comes in as a direct supporter that has to take over part of the cost of such solutions. But that is another story.

b) Firms also began to cut their expenditures for which they were not contractually or legally obliged. "Working-time accounts" play a role here because, for instance, workers give up overtime earnings. Another strategy is to reduce the core workforce by outsourcing to subcontractors. In this way, part of their former workforce is excluded from the higher protection and wage standards within the firm. Important targets of

labor-cost rationalization are also pension plans and expenditures for vocational training. Many large firms began to reduce the number of trainees. This did not imply, however, that they intended to dismantle the in-house system of vocational training. In fact, large firms have become heavily engaged in modernization of the professions offered by the vocational system to young people. Moreover, even at the end of the 1990s, annual reports of firms in my sample, as with manufacturing industries in general, provide more young people with apprenticeships than they can employ afterwards (see also Baethge 2000). This over-production is sometimes a direct outcome of collective bargaining agreements but it is also part of the firm symbolic management demonstrating "social responsibility" and optimistic business outlooks. If large firms sign contracts to safeguard existing domestic production locations (*Standortsicherungsverträge*) with unions and works councils, vocational training is always a key issue. In return for substantial annual savings of personnel expenses which are achieved through cuts in the voluntary benefits granted by the company, firms give usually three time-limited guaranties: employment guarantees**,** promises of capital expenditures or R&D spending in Germany and commitments to train more young people in their vocational training facilities than the company actually needs.[12]

c) Finally, firms began to establish systems that linked salaries more directly to the earnings of the company. The new incentive systems are targeted mainly at executives and management staff who are not included in collective agreements. The industrial-wide collective wage agreements constrain the introduction of such firm-level methods for wage earners. Yet there are also tendencies to link a larger part of the wages to firms' performance, i.e. some large firms restructured their system of additional pay components in excess of the collectively agreed rates in the ´90s, to allow greater performance-related differentiation in pay levels. It will be a crucial question for the future as to what extent and how wage earners will be included into a more profit-oriented incentive system; or vice versa, which consequences it would have for the social constitution of corporations when only some groups of the employees are involved in such a system.

Conclusion

To summarize my argument, there is enough evidence indicating that German firms do not simply expand their corporations and business into Central and Eastern Europe markets. Cross-border corporate reorganization is taking place in which cost-cutting motives are an important guideline. The conjunction of spatial proximity and low labor costs clearly foster this type of reorganization. Firms do not just take advantage from the new opportunity. Cross-border reorganization is also a response to the limits of the adjustment strategy in the ´80s, characterized by a mainly home-based production system, which serves the German quality-sensitive market and exports finished goods to Western Europe and the rest of the world. Outward investment has been part of this system since the 1950s. Yet they tended to stimulate further exports

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[12] Working time flexibilization for operational reasons are also part of the agreements.

from the German parent companies and therefore to maintain domestic employment, which is not for sure anymore.

German firms hesitate to utilize the low cost option in proximity aggressively in their internal labor policy at home. Rather, they tend to avoid confrontations with their employees on production shifts. The necessity of collaboration between both sides of the border, the relative strength of workers in the domestic high-quality production system and the constraints of the industrial relations system provide explanations for this rather moderate behavior. In other words, exploiting the new opportunities in order to impose changes on the basic rules and practices of the "German model," shifting toward the liberal, Anglo-Saxon market model is still pretty risky for manufacturers in mature industries (whatever individual preferences might be). This keeps firms behind the bargaining table in spite of the greater asymmetry in labor relations caused by higher capital mobility. The outcomes of the bargained reorganization so far is that firms gain more labor flexibility, performance-related differentiation and labor-cost rationalization without challenging the long-term employment commitments, institutionalized in the German production regime. A well-known consequence of this kind of adaptation is that it protects mainly the existing and shrinking core workforce.

Appendix

Table A: Direct investment of the 14 industrial countries in selected countries in transition*

Item	1990	1991	1992	1993	1994	1995	1996	1997	1990-97
Total (in US$ billion	0.9	1.8	3.0	4.9	4.2	9.2	7.0	5.8	36.7
Shares of individual countries (in %)									
Germany	17.8	14.0	35.0	29.6	45.1	30.1	(50.7)	(41.5)	(36.8)
United States	16.9	11.7	15.7	25.1	12.1	14.5	.	.	.
Austria	43.0	27.6	15.1	10.6	10.2	6.7	(5.0)	(14.8)	(11.1)
France	5.0	11.7	11.3	5.8	5.9	14.4	(10.9)	(15.1)	(11.1)
United Kingdom	0.2	0.3	1.9	0.7	4.8	0.9	(2.8)	.	.

* For 1997 no data for the United States and United Kingdom. The percentages in brackets were calculates without these data and are therefore distorted upwards.

Source: Deutsche Bundesbank, Monthly Report, October 1999

Table B: Gross-Border Activities and Labor Demands of 18 Large German Manufacturers in Poland and the Czech Republic

Firm Code	Firm size	Mix of Strategies	Labor or Capital Intensive	Brown or Green Field Investment	Skill-Demands on Shop-Floor	Dominant Gender on Shop-Floor
B/P	1,100	Reintegration, market expansion	Labor	Green	Skilled	Male
N/T	1,200	Made by/ market expansion	Mix	Brown	Highly skilled	Male
G/T	1,700	Extended workbench, market expansion	Labor	Green	Unskilled	Male
H/P	2,000	Two-brands, expansion	Labor	Green	Skilled	Male
D/T	2,500	Extended workbench, market expansion, follow-up reorg.	Labor	Brown/green	Unskilled/ semi-skilled	Mixed
E/T	3,000	Extended workbench, market expansion, follow-up reorg.	Labor	Green	Unskilled	Female
A/P	3,400	Made by/ two brands	Mix	Brown	Highly skilled	Male
F/T	5,000	Reintegration, made by, little local market	Labor	Brown	Skilled	Male
B/T	6,000	Two-brands	Labor	Green	Semi-skilled	Mixed
E/P	6,000	Extended workbench	Labor	Green	Unskilled	Female
J/P	6,000	Made by, growing interest in market expansion	Labor	Brown	Mixed	Mixed
K/P	7,500	Market expansion with local brands	Capital	Green	Unskilled	Mixed
L/P	11,000	Market expansion with local and international brands, follow-up reorg.	Capital	Brown	Unskilled	Mixed
C/T	15,500	Market expansion/ follow-up reorg.	Capital	Green	Unskilled work besides high skilled jobs for technicians	Male
D/P	17,000	Market expansion	Capital	Brown	Unskilled	Mixed
A/T	<20,000	In different locations: made by, reintegration, extended workbench, market expansion	Mixed and labor	Brown/ green	Skilled/ unskilled	Mixed
F/P	<20,000	Reintegration, market expansion, in other places: two brands and made by	Labor and capital	Green and brown	Skilled	Male
G/P	<20,000	Market expansion, extended workbench, shift toward two brands	Labor	Green	Skilled	Male

Table C: Industrial Relations of 18 Large German Manufacturers in Poland and the Czech Republic

Firm Code	Firm Size	Size of the Sample-Company in the Host Countries	Brown or Green field Investment	Works Councils at home (WC), Whole German Company Works Councils (GCW), Euro Works Councils (EWC)	Enterprise Unions in the Host Countries	Acceptance of Trade Unions Outside of the Firm as Partner by Local Management	Frequent Wage Bargaining	Regular Cross-Border Consultations Among Workers' Representatives
B/P	1,100	150	Green	WC	Yes	Cooperative	First time	----
N/T	1,200	800	Brown	WC	Non-union form of representation	Coop., but owner intervened	----	----
G/T	1,700	300	Green	WC, GCW	Yes	Coop.	Yes	----
H/P	2,000	390	Green	WC, GCW	Yes	Non-coop.	Non-regular	----
D/T	2,500	700	Brown/Gree n	WC, GCW	----	Non-coop.	----	----
E/T	3,000	650	Green	WC, GCW	----	Non-coop.	Yes	----
A/P	3,400	470	Brown	WC, GCW	Yes	Coop.	Yes	----
F/T	5,000**	580	Brown	WC, GCW, ECW	Yes	Non-coop.	Yes	Yes
B/T	6,000	500	Green	WC, GCW	----	Non-coop.	----	----
E/P	6,000	2,500	Green	WC	Yes	Coop.	Yes	----
J/P	6,000	920*	Brown	WC, GCW	Yes	Coop.	Yes	----
K/P	7,500	200	Green	WC, GCW	Yes	Non-coop.	----	----
L/P	11,000	1,500	Brown	WC, GCW (including representatives of the host country	Yes	Coop.	Yes	Yes
C/T	15,500	300	Green	WC, GCW	Yes	Non-coop.	Yes	----
D/P	17,000	480	Brown	WC, GCW, ECW	Yes	Coop.	Yes	----
A/T	<20,000	1,700*	Brown	WC, GCW, ECW	Yes	Coop.	Yes	Yes
F/P	<20,000	2,400*	Green	WC, GCW, ECW	Yes	Coop.	Yes	Yes
G/P	<20,000	300	Green	WC, GCW, informal European meetings	Yes	Coop.	Yes	Yes

* The parent companies of those firms have more than one manufacturing company in Poland or/and the Czech Republic. Hence the number of employees is actual higher, shadowed firms have Polish or Czech managers as leading executives.
** This German company became part of a foreign multinational enterprise in the ‘90s.

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