

Understanding the German minimum wage

As of 1st of January 2015 a minimum wage has been effective at the German labour market introduced through political decision in the German Parliament. This article explains the background for this fundamental change in the German labour market both in relation to wage formation and in relation to the regulation of the market.



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With the introduction of a statutory minimum wage at a starting rate of 8.50 € per hour worked by January 2015, Germany has undertaken a large-scale policy experiment that continues to raise eyebrows among economists worldwide. This reform is also a departure from a long-established path of not having governmental interference with wage setting, but to rely on autonomous collective bargaining between sectoral employer associations and trade unions. What is behind this?

In July 2014, the German Parliament has passed legislation on a new general statutory minimum wage that has been introduced now. The minimum wage of 8.50 gross per hour only allows for very limited exemptions. Exemptions exist for specific target groups such as for the long-term unemployed when hired initially for up to six months, for seasonal workers and newspaper distributors (only transitory), for young people below the age of 18 as well as for apprentices – irrespective of age – and for students taking internships, the latter for up to three months. The statutory minimum wage is uniform across the country, not taking into account difference in regional wage levels.

Furthermore, if collective agreements with wages below the new minimum wage exist currently, they will remain effective during a two-year transition period until the end of 2016. A bipartite commission consisting of representatives of employer

associations and the trade unions will decide annually on the adjustment of the minimum wage, based on the development of collectively agreed wages observed over a two-year period. This mechanism will be operated for the first time in 2017. Furthermore, the statutory minimum wage is only one element of the recent reform. The extension of collective agreement is facilitated as well.

The statutory minimum wage, also in combination with the easing of collective bargaining extension, is a remarkable step and a major departure from the current system of industrial relations and labor market governance in Germany. For the first time in post-war Germany, this quasi-universal minimum wage will set a general wage floor for all sectors, occupations and regions, with more or less universal coverage kicking in after the transition period.

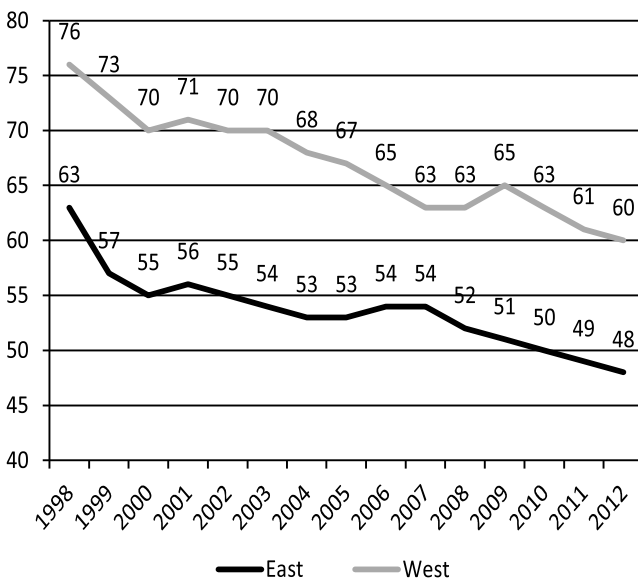
This political decision, supported by the two governing parties, Christian Democrats and Social Democrats, but also by a vast majority of the electorate, can only be understood as a response to the growth of the low-pay sector over the last decade. In fact, the German labor market underwent a massive restructuring since the mid-2000s. This was triggered by a policy package that aimed at reducing unemployment, in particular persistently high long-term unemployment through a couple of related reforms: (a) a stricter activation policy addressing the

NOTE 1 Marginal part-time is part-time work below 400 EUR per month, exempted from employee's social contributions, a special employment type in Germany

unemployed, declaring all jobs to be acceptable to unemployed people on minimum income support, and (b) a liberalization of non-standard contracts such as temporary agency work and marginal part-time jobs.¹

These two elements were supposed to stimulate job creation in areas where the German labor market was perceived to be underperforming, in particular in some areas of the service sector. At the same time a long-term decline of collective bargaining coverage has led to a very limited role of collectively agreed wage scales in many service sectors. This is largely due to a massive decline in trade union membership as well as a certain erosion of membership in sectoral employer associations. In particular in the service sector outside banking, insurance and former or current public employers, bargaining coverage is pretty low.

Figure 1: Collective bargaining coverage, in per cent of all workers



Source: Hans Boeckler Foundation Tarifarchiv.

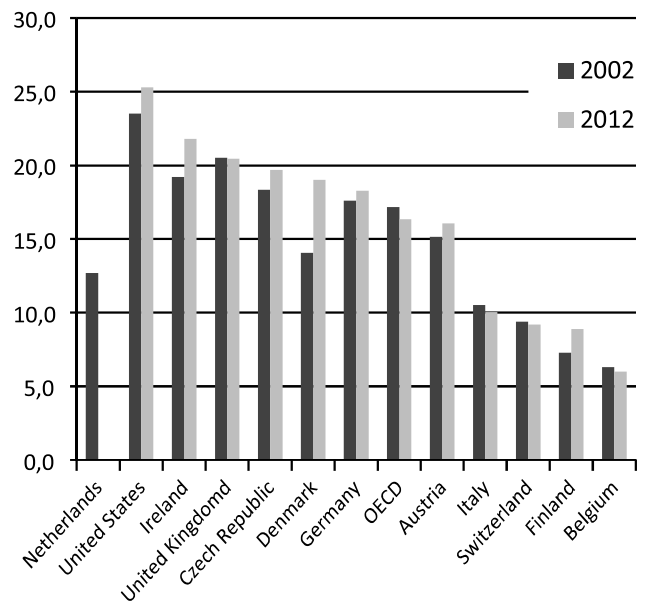
As a consequence of this more flexible institutional set-up of the German labor market, a larger share of workers were employed at a relatively low wage rate. Empirical data on full-time workers show that the low pay sector in Germany, as measured by wages below two thirds of the median has grown significantly and is now one of the largest in Europe. Furthermore, the risk of low pay is higher for workers on non-standard contracts such as marginal part-time work or temporary agency work. Hence, while employment grew significantly, contributing to the expected improvement of the labor market, diversity of pay and other working conditions increased within the German employment system.

Figure 2: Collective bargaining coverage by sector, 2012

	sectoral agreement		company agreement	
	West	East	West	East
Public administration	87	85	11	15
Banking and insurance	79	64	3	1
Energy and infrastructure	75	30	13	30
Construction	70	50	2	4
non-profit organizations	57	29	10	18
Health and education	55	31	8	19
Manufacturing	54	24	10	13
total	53	36	7	12
Business services	46	47	5	7
Logistics	44	16	15	21
Hospitality and other services	42	28	2	4
Wholesale	42	14	5	13
Retail trade	41	33	4	9
Information and communication	20	10	16	17

Source: WSI Tarifarchiv.

Figure 3: Low-pay shares of full-time workers



Source: OECD Employment Outlook 2014.

Figure 4: Low pay by type of job in per cent, 2010

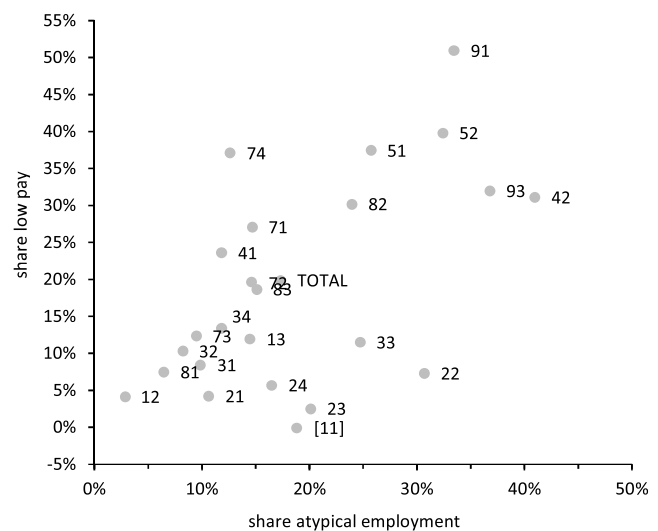
	Total	Standard employment	Non-standard contracts				
			All non-standard contracts	Part-time work	Fixed-term contracts	Marginal part-time work	Temporary agency workers
Total	20.6	10.8	49.8	20.9	33.5	84.3	67.7
Women	26.5	15.1	47.6	19.2	35.5	84.8	72.9
Men	15.8	8.1	53.7	34.3	31.6	83.4	65.4
Less than upper secondary education	52.8	22.7	77.8	44.7	62.2	88.1	85.5
Upper secondary education	17.7	12.1	39.4	17.1	36.2	77.2	57.6
Tertiary education	1.7	0.5	8.3	2.7	5.7	61.4	20.7
Selected occupational groups							
Academic occupations	3.0	1.0	10.5	3.5	5.7	64.9	/
Technicians and equivalent non-tech. occupations	7.6	4.0	24.9	4.7	17.3	68.1	29.2
Office clerks	23.4	10.9	48.1	13.2	39.4	80.3	62.5
Service and sales occupations	42.3	28.4	65.4	30	58.3	88.6	72.1
Crafts	16.1	11.1	48.7	32.6	31.3	81.0	47.6
Machine operators and assemblers	23.7	17.1	60.6	33.2	39.7	89.3	63.0
Labourers	61.5	39.7	79.2	56.3	70.7	90.3	89.2

Source: Federal Statistical Office.

Finally, with respect to employment conditions, atypical work and low pay tend to go together in many occupations, as figure 5 shows. Again, the most affected are mainly those occupations where employment growth was associated with an increased share of atypical contracts (42, 51, 52, 91) and agency assigned work contracts (93).

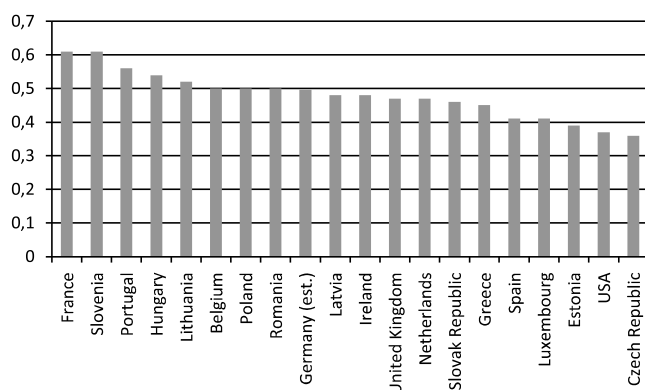
Regarding wage dispersion, the weakness of collective bargaining in the private service sector, in particular in medium- and low-skill occupations, has raised attention of the issue of setting binding minimum wages since the mid-2000s. This was virtually a non-issue for many years as trade unions (and employers) always saw wage bargaining as their genuine responsibility, but faced with increasing low pay and limited capacities to establish collective agreements, the trade unions started to push for a general statutory minimum wage, a political project that is also popular with the majority of German voters. Over the last years and in different government constellations, however, collectively agreed minimum wages in an increasing number of sectors have been made generally binding via existing legislation on the posting of workers or, in the case of agency workers, on the regulation of temporary work agencies. Now, somehow completing this policy shift, Germany has established a binding minimum wage floor for virtually all categories of workers and all sectors for the first time and at a medium level, if compared to other country's minimum wages.

Figure 5: Atypical work and low pay by occupations



Source: SOEP, weighted, dependent employment only, without agriculture (ISCO 61,92) and armed forces (ISCO 01), own calculations. unreliable, number of cases insufficient (<30 cases).

Figure 6: Minimum wage in per cent of median wage of full-time workers, 2013



Source: OECD online database, estimated value for Germany.

From a labour market point of view, a national minimum wage at a moderate level would be feasible without major negative effects on job creation, particularly if it set by an independent committee of experts and accompanied by a regular evaluation of its effects. However, the current government has decided on the level of minimum wage *a priori* and handed over further adjustments to a committee formed by employers' and trade union representatives. Along with the expected interventions into agency work, the relatively high statutory minimum wage will probably be the most important reform breaking with the deregulatory approach adopted about ten years ago. While designed to limit the dispersion of wages and working conditions, the re-regulatory approach may also trigger new forms of circumvention, such as a resort to undocumented overtime or more bogus self-employment¹. This could entail adverse working conditions for those affected. Hence, in line with experiences of the recent past, we also expect creative reactions of employers and employees, at least to some extent, aiming at circumventing the minimum wage or avoiding its direct implications for labor costs and prices, in particular by non-documentation of actual hours worked or by converting dependent employment into (bogus) self-employment. In this respect, the

minimum wage generates substantial challenges regarding the monitoring of hours worked and the real employment status of freelancers, despite an expansion of the staff in charge of supervising the application of the minimum wage.

From an economic perspective, the new minimum wage is likely to put pressure on low-paid jobs, leading most probably to wage and price increases in some cases, but also to job losses in heavily affected occupations and regions. It is expected quite clearly that the statutory minimum wage will particularly affect those parts of the labor market where low pay is widespread and collectively agreed wage settlements to not really matter. Simulations point at a strong employment impact in small companies, in non-standard jobs, in the eastern part of Germany, and in some low- to medium-skilled occupations of the service sector.

In some respects, the German labor market will become more exclusive again, reversing some, but not all of the liberalization of the early 2000s. To some extent there is the risk of potentially returning to a situation with fewer jobs, but less diversity, comparable to the French arrangement where employment of low skilled people in the zone above the minimum wage has to be stabilized by massive subsidies to employers. To stabilize employment in low-skilled service occupations and avoid higher unemployment for the most vulnerable people, hiring benefits to employers or publicly supported employment might become prominent topics for the labor market policy agenda, entailing an even stronger role of government here, but probably quite costly and not particularly effective.

For the sake of evidence-based policymaking, it is necessary to monitor the developments now closely, preparing to evaluate the effects of the new minimum wage on employment, unemployment, wages and other outcomes such as skill formation and productivity independently and timely before deciding on an adjustment of the statutory minimum wage. Yet, the new legislation does not provide for a systematic consideration of evaluation results when making a decision on the adjustment of the minimum wage.

NOTE 1 «bogus» means 'artificial' or abusive forms of self-employment to circumvent the minimum wage as it does not hold for self-employed.