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Politically Demanding, Economically Perilous —Germany Considers Minimum Wages

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The expansion of the low-wage sector in the last decade has helped Germany tackle persistent unemployment. The price has been not only rising social problems but the discontent of its neighbours who are unable to compete with Germany's wage policy and concerned about macroeconomic imbalances in the eurozone. The next government now looks likely to introduce a statutory minimum wage. The economic effects of this measure are highly unpredictable. They may also trigger a debate about the eurozone-wide coordination of national wage policies.

Germany has been traditionally a country with very high wages. In 2012, the gross average hourly wage in the private sector amounted to €31, roughly a third more than the EU-average. But there are some new associations with that image, particularly for Germany's western neighbours, which see it as a country with so called social dumping and low cost competition. Belgium identifies pay for German meat workers as a threat to its meat industry. Those workers are paid up to €3–4 per hour—some €10 less than in Belgium where companies must obey rules on minimum wages. In April, the government in Brussels therefore filed a complaint against Germany with the European Commission for contravening EU competition rules. Its concerns are echoed by French officials. They accuse Germany of "unfair competition," warning that its policies might weaken its partners and cause deeper macroeconomic imbalances in the eurozone.

This disparity in perception of the German labour market is not an accident. The Federal Republic has been able to maintain collective bargaining between sector trade unions and employers' organisations, which guarantees high wages for those employed on full contracts. But at the same time, the labour market and social reforms of Gerhard Schröder's government created space for the flexible employment sector, one with no bottom level for wages. Moreover, the new system was subsidised by the state: people who accepted very low wages still enjoyed financial support actually intended for the unemployed. Meanwhile, most European states have extended their minimum-wage regulations. It is hardly surprising that their companies have started to complain about a "cheap" Germany.

The reforms in Germany, though, are considered to have been a success since they helped to reduce unemployment among the low-skilled and brought the economy close to full-employment status. However, they have come at a cost. It is not simply the problem that those on flexible contracts with low wages may fall into poverty but the apparent persistence of the problem. They do not have the means to invest in their skills in order to switch to higher wage employment. Moreover, since they receive such low pay that they make no social system contributions, they will not be able to save enough from their current pay checks for retirement. The permissive regulations have led in some cases to abuse, with media recently reporting about hourly salaries of €1.59 in eastern Germany or on the drastically low labour conditions of immigrants from Romania and Bulgaria in the food industry. There are also doubts about the macroeconomic effects for Germany. Nobody really knows to what extent these low-wage jobs crowd out regular jobs. But if this effect is big enough, it is time to worry about the sustainability of private consumption—the most important driver of the domestic economy.

These concerns, therefore, have been fuel for the idea of a statutory minimum wage. It has a growing number of supporters, up to 83% of citizens according to a spring 2013 survey. During the election campaign, the Social-Democratic Party (SPD) and Greens were willing to exploit this potential, proposing €8.50 per hour. The Christian-

Democratic Union (CDU) and even the Democratic Party of Freedom (FDP), although very sceptical, refrained from attacking it openly. It seems highly likely that a minimum wage will be introduced under any new coalition. The SPD will insist on this concession, particularly after giving up on a rise in marginal income taxes as a central part of their election programme.

A Minimum Wage—A Maximum Risk? Economists are not convinced about the advantages of introducing a minimum wage. It is estimated that about 5.6 million workers, or around 17% of all those employed (up to 25% in the east), would receive a pay rise after the introduction of a minimum wage of €8.50. Rising labour costs and the higher prices that may follow for many services are rather unavoidable. It cannot be excluded that this effect will spread throughout the high-wage, export-oriented sectors, weakening the competitiveness of the country. Most of the fears about a minimum wage concern employment rates. Even if companies do not fire workers whose pay would rise to the minimum wage, they might stop hiring new ones, making the ongoing fight against unemployment much more difficult. Many jobs, particularly in the service sector, could become informal and enlarge the already large black market, estimated to be €340.3 billion. In sum, low-skilled workers may become victims, not winners of the new regulations.

Facing these doubts, a rising number of experts and politicians have been calling for a softer version of the proposed minimum wage. The CDU/CSU would try to marry it with the existing system of collective bargaining. Trade unions and employer organisations would be responsible for setting up the "lowest boundaries" in their sectors, according to the regions in which they operate, the skill profiles of the employees, as well as their age, seniority, and other factors. This solution could indeed minimise many risks connected with the introduction of minimum wages, but it creates new ones, such as the risk of decreased competition. When Deutsche Post and its trade unions enforced a relatively high minimum wage of €9.80 per hour for all companies in the postal sector, small low-cost providers such as PIN Mail AG, successfully challenged it in the courts as an attempt to crowd them out of the market.

An alternative for shifting more responsibility to collective bargaining could be a separate, independent body, most probably a tripartite commission composed of the government, trade unions and employer organisations. An open question is if this body would set up one, universal minimum wage level for the whole economy or if it would differentiate between jobs. The first option carries with it the risk of overshooting, with all the possible negative effects on employment and competitiveness. The second means a complicated decision-making process and political struggles. In the past, similar initiatives dealing with macroeconomic policy and labour market issues, both started with the blessing of the SPD, failed in an atmosphere of deep conflict between the trade unions and employers.

Consequences for Europe and Poland. The introduction of a minimum wage will be difficult for Germany, but would also have some implications for the eurozone and the EU. In the most positive scenario (rising domestic consumption, higher GDP, and no negative effects on competitiveness and employment), neighbouring countries can hope for an expansion of German demand and even a reduction in the current-account imbalances within the eurozone. Yet, even in this scenario, other potential effects are ambiguous at best. Higher employment costs may spur German businesses to shift production to cheaper destinations. This might mean to Spain, Portugal, Greece or Poland, but it might also mean countries farther away, such as China, potentially damaging the position of such countries as Poland in the regional supply chain. Any boom in services in the regions along the German border cannot outweigh this risk. In a mostly negative scenario, Germany would lose its cost-competitiveness and face higher unemployment. Hopes that German demand would boost exports from other European economies would then remain unfulfilled, and other governments would be faced with a politically gridlocked Berlin dealing with domestic populism.

There is a broader implication, too. The German wage restraint of the last decade has become a suggested recipe for crisis-ridden countries. If they were to follow this course, they could become more competitive, scale down consumption and thereby balance their current accounts. Proponents of Keynesian solutions to the current crisis—strong in France, southern Europe, and the left in the Bundestag, counter that wage restraint would start a race to the bottom, with massive effects on living standards without necessarily bringing about a more competitive and balanced eurozone. In their opinion, deeper coordination of national wage policies would serve as a better adjustment tool. Public debts cannot increase and the ECB can hardly make access to already cheap money cheaper, but coordinated action on wage adjustments could bring some movement in the eurozone economy. This expansive option would mean that not only must statutory national minimum wages be introduced but also "steerable" wage bargaining systems include strong organisations of employees and employers or a government able to intervene in this area.

Putting this new Keynesian agenda on the negotiating table in the eurozone will be an uncomfortable issue for Poland. First, it would become another point on an already long list of corrections of the eurozone, making the decision to join quickly more difficult and strengthening proponents of a euro-referendum in the country. Second, conducting joint wage policy would be a risky experiment for Poland. Its competitiveness is still based on its low costs of labour and relative flexibility. It has a minimum wage, but its application is almost incidental and the possibilities to bypass it almost unlimited. Worse, Poland has a very weak system of collective bargaining: the tripartite commission model is often considered inefficient, unions are only strong in the public sector and large companies, and the SME sector having only experience with individualised and extremely decentralised wage bargaining. With such a model, any experiment with Europe-wide coordination of wage policies is hardly imaginable.