» Opinion

Minimum Wages Threaten Jobs

Klaus F. Zimmermann

In Germany, legal minimum wages are currently in effect only for the construction industry, which is covered by the Law on the Posting of Workers *(Arbeitnehmerentsendegesetz)*. Recently, however, the Federal Government has announced that it will consider reform proposals to extend these minimum wage regulations to other industries as well. Although it remains unclear how this would be done, it is conceivable that the above-mentioned law would be used to declare collective agreements including minimum wages as binding for the entire industry. Cleaning contractors and temp agencies, for instance, will likely be subject to this form of regulation in the near future. Another option would be to adopt minimum wage laws, such as in the United States and a number of European countries, which would apply to all industries nationwide.

What prompts the government to interfere with the market mechanism – and even with the constitutionally guaranteed collective bargaining autonomy – in such a drastic way? Among the main driving forces are social policy considerations. Labor is supposed to provide an income above the poverty level. This argument fails to recognize, however, that many low-paid jobs are not the single source of household income, but merely a form of additional earnings. Another goal is to prevent foreign firms from easy market access. This was the main reason behind the introduction of minimum wages in the construction industry. What this all boils down to is a simple form of protectionism: By impeding competition, prices are kept artificially high. As a consequence, potential gains in purchasing power, which would stimulate demand, are not realized. And, possibly even worse, firms lack an important incentive to innovate.

Existing scientific analyses of other countries with minimum wage laws provide ambiguous results as to whether minimum wages have positive or detrimental effects on employment. Due to limited data and methodological problems, most of these studies are not sufficiently compelling. In any case, they cannot be taken as evidence that an introduction of minimum wages in Germany would not harm the economy. The same applies to the argument that minimum wages would not have any negative employment effect because they also exist in countries with more favorable labor market trends. Any comparison of this sort would need to take into account that Germany's entire labor and social policy framework differs substantially from that of other nations. In contrast to the Anglo-Saxon countries, for instance, Germany has a generous welfare state system that offers few incentives to take up low-paid employment. This means that minimum wages in Germany would need to be relatively high in order to attract people from welfare to work. This would not just make existing jobs in the low-wage sector more expensive, but it would cause a domino effect across the wage distribution: Better qualified workers would also demand higher wages in order to re-establish the previous wage differential. The skilled trades would be affected just as well as providers of simple services – and basically all labor-intensive industries, in which firms can respond to higher wages only by raising prices. Given that domestic demand in Germany is chronically weak in these sectors, it would be unrealistic to believe that higher prices can actually be achieved in the market. The more likely consequence would be a reduced supply of goods and services, which would result in higher unemployment.

As well-meaning as the introduction of nationally binding minimum wages may be in terms of social policy goals, policymakers should be aware that they are contemplating a dangerous field experiment. The high unemployment rate of low-skilled workers in Germany – and the enormous gap between the employment prospects of different skill groups – is virtually unparalleled in the industrialized world. This is why Germany needs more jobs in the low-wage sector rather than a minimum wage.

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