» Opinion

False Hopes in Germany's Minimum Wage

Klaus F. Zimmermann

The new German government coalition is planning the phased introduction of a national minimum wage of 8.50 euros per hour. This is a bold move placing Germany among the world leaders in terms of government-mandated minimum wages. A simulation based on data from the German Socio-economic Panel (GSOEP) shows that 4.5 million people – 15 percent of all employees in Germany – would be affected. Most young workers under 25 years of age fall below this threshold. In all of Europe, only France has a higher minimum wage of EUR 9.43. Notably, this is the country where youth unemployment soared to almost 26 percent at the end of 2012.

The markets will have a hard time adapting to this new situation. Many sectors currently have collective wage agreements below the planned minimum. Moreover, income support schemes in Germany are highly complex. Given the constitutional guarantee against poverty, low wage earners are entitled to wage subsidies supplementing their labor income. For those who are not employed, basic income support under the "Hartz IV" legislation is available. As Germany has no experience at all with a national minimum wage, the country is treading new ground – which, if anything, will provide economic research with lots of material for new studies.

In the international research and policy community, the German plans have caused some astonishment. To be sure, many countries have a minimum wage – but on a much lower level, where the damage it can do is limited. The U.S. minimum wage of 7.25 dollars, for example, is equivalent to about five euros. Fewer than three percent of U.S. workers fall into this category. People like Paul Krugman, who favor raising the minimum wage to stimulate the U.S. economy, will certainly applaud the German minimum wage as a means to strengthen mass purchasing power. This could then be viewed as Germany's contribution to boosting domestic consumption so that rising imports would reduce the country's large trade surplus, thus silencing criticism of the German export miracle.

But it is much more likely that a large share of new jobs in the low-wage sector, which have been created over the past years, will disappear again before long. This would undermine the recently achieved flexibility of the German labor market, which is owed in part to various forms of marginal employment. It is important to note that job losses are not necessarily confined to those who currently earn less than the planned minimum wage. If firms face lower demand for their products after raising prices in response to higher labor costs, they may also resort to laying off low-skilled employees who work in regular full-time jobs above the minimum wage.

Low-wage earners in Germany are not typically low-skilled. Most of them are not the sole earners in their family, nor do they live in households with a high risk of poverty. Therefore, contrary to what the minimum wage movement has been propagating, minimum wages are not an appropriate instrument for redistribution. Studies have shown that the introduction of a minimum wage in Germany would fail to make household incomes more "socially just."

Since the situation of low-income households is unlikely to improve as a result of the minimum wage, there will be no boost in consumption and, accordingly, no rise in imports. The minimum wage will further diminish the role of unions, who lose an incentive to fight for the interests of workers in the absence of government intervention. What remains is the self-congratulatory mood among policymakers who feel they have "done the right thing."

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