On Contradictions of ‘Low Wage Policies’

The German Example

1 Introduction

State policies directly or indirectly concerning low wages are actually dealing with three different aspects of economic activity, obviously related to each other but nevertheless far from identical:

(1) low (hourly) wages;
(2) small (individual) earnings;
(3) poverty of households despite their engagement in paid work, either during working age or after retirement.

Depending on how the issue is framed, one will arrive at different definitions of the problem, different explanations of its causes and thus at different cures. The separation of the institutions dealing with these different aspects and the disjunction between the respective discourses allows disregarding the contradictions between the respective policies. Against this background, it does not come as a surprise that Germany lacks a coherent ‘policy for low-wage workers’. The case of Germany may be extreme but not unique; it can serve to exemplify contradictions such a policy may face in other countries as well.

The paper is organized along the three fundamental aspects of low wages (2), small earnings (3), and in-work poverty (4). Section 2 begins with the promotion of a low-wage sector and its justifications (2.1), it continues with the empirical proliferation of low wages (2.2), and it finally covers the scattered landscape of wage regulation and the bumpy road toward statutory minimum wages (2.3). Section 3 points out how the German family and employment regime promotes small earnings, particularly for women (3.1), how the ‘activating turn’ in labor market policies reinforces this tendency (3.2), which appear as a writing on the wall for pensions and old-age poverty (Fehler! Verweisquelle konnte nicht gefunden werden.). At the end of the pipe made up of low wages and small earnings, we find in-work poverty (4.1), which is discussed with regard to the 2005 reform of minimum income benefits (from Fehler! Verweisquelle konnte nicht gefunden werden. to 4.2). The Summary and Conclusion (5) puts the three aspects together and points to the consequences that emerge from a comprehensive view.

2 Low wages

2.1 Low wages as a virtue?
Since the early 1970s until 2005, over four full business cycles, German unemployment numbers have shown a staircase-shaped pattern where each recession produced a rise which was only partially compensated during the following upturn. Skill-biased technological change and cyclical selection processes taking effect in each successive round of dismissals and hirings resulted in a concentration of low-skilled workers in the growing stock of the unemployed (Figure 1), and, even more markedly, of the long-term unemployed.

Figure 1: Unemployment rates\(^2\) 1975 to 1998, overall and unskilled

![Unemployment rates graph](image)

Source: Reinberg 1999

Growth in the mismatch between skills demand and skills structure of the workforce was particularly rapid during the 1990s, due to the German unification, advances in globalization and accelerated structural change. Furthermore, due to strong competition on the supply side of the labor market, the skills structure among the employed was more advanced than the jobs structure; in other words, skilled workers displaced unskilled workers in jobs not necessarily requiring completed vocational or academic training. In 2008, jobs not requiring the completion of vocational or academic training still amounted to 21 per cent (Bellmann und Stegmaier 2010, S. 8), whereas only 15.3 per cent of the employed workforce actually had no such training in that year (Bundesagentur für Arbeit - Statistik 2011).

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\(^2\) This is the legally defined German unemployment rate (administrative count) which is different from the ILO definition of unemployment.
As early as 2006, 15.2 per cent of the female and 9.5 per cent of the male active workforce were employed below their skills level, according to a survey of working conditions (Hall 2010).

In this situation, during the 1990s and well into the 2000s, the German unemployment problem appeared as being primarily a problem of the unskilled to many observers (Berthold und Fehn 2000). A dynamic public discourse emerged claiming the necessity to develop a ‘low wage sector’. If jobs were available at wage rates properly reflecting the allegedly low productivity of low-skilled workers, then there would be more demand for low-skilled work (Kommission für Zukunftsfragen der Freistaaten Bayern und Sachsen 1997).

There were different strands of these arguments: In a neo-liberal vein, the argument was in favor of breaking up the structure of collective bargaining (Berthold und Stettes 2000), either by allowing works councils to negotiate local wage deals that would undercut the regionally agreed rates ‘in favor’ of unemployed job applicants, or by requesting trade unions themselves to introduce lower entrance wage categories for these groups. The ‘social-democratic’ version of the argument was about subsidizing employers’ wage costs, or complementing low wages with subsidies paid directly to the employee (‘negative income tax’), or both (Heinze und Streeck 2000).

2.2 Empirical development of the ‘low wage sector’

Despite public talk about a low-wage ‘sector’, wages are, of course, stratified in a continuous way, and any definition of low wage thresholds is purely conventional. According to a widely accepted definition also used by the OECD, wages below two thirds of the median wage are regarded as ‘low wages’.

While the alleged necessity of developing a ‘low-wage sector’ in Germany was still under heated debate, such a sector was actually already existent, and it started expanding – without, at first, any institutional reforms that would have worked in favor of it. Considering hourly wages of all dependent employees (i.e. including part-time workers and very short part-time, the so-called mini jobs – see p. 8), the turn came in 1998 and led from 15 per cent to about 21 per cent in 2006, with a slight decline since then (Figure 2 - Kalina und Weinkopf 2010).³

³ Because of the wide wage gap between East and West Germany, low-wage thresholds and percentages were calculated separately for the two regions, of which the figures reported here for Germany as a whole are weighted averages.
Figure 2: Numbers of low-wage earners (millions), with low-wage thresholds calculated separately for West and East Germany*) for each calendar year

<table>
<thead>
<tr>
<th>Year</th>
<th>Millions</th>
<th>West Germany</th>
<th>East Germany</th>
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<tbody>
<tr>
<td>1995</td>
<td>4.4</td>
<td>5.0</td>
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<td>1996</td>
<td>4.4</td>
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<td>1997</td>
<td>4.3</td>
<td>5.3</td>
<td>5.9</td>
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<td>1998</td>
<td>4.3</td>
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<td>6.1</td>
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<td>1999</td>
<td>5.0</td>
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<td>2000</td>
<td>6.0</td>
<td>6.0</td>
<td>6.4</td>
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<tr>
<td>2001</td>
<td>5.9</td>
<td>5.9</td>
<td>6.3</td>
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<tr>
<td>2002</td>
<td>6.1</td>
<td>5.9</td>
<td>6.6</td>
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<td>2003</td>
<td>6.2</td>
<td>6.1</td>
<td>6.7</td>
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<td>2004</td>
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<td>2005</td>
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<td>2006</td>
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<td>2007</td>
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<tr>
<td>2008</td>
<td>6.6</td>
<td>6.6</td>
<td>7.2</td>
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Source: Kalina und Weinkopf 2010
*) statistical low-wage thresholds (2/3 of the median wage) in 2008: West Germany 9.50 Euros, East Germany 6.87 Euros

Whether the expansion of the low-wage-segment has improved the chances for low-skilled workers of taking up employment, as intended by its proponents, has not yet been seriously investigated. A purely descriptive inspection does not exactly support the view that low-skilled workers would have benefited to great extent. Continuing the time series of Figure 1 shows no sustained improvement in the relative position of the unskilled with regard to unemployment rates, but rather a continued widening of the gap, expressed in Figure 3 as ratios of the unemployment rates of the unskilled and those with certified vocational skills (2-3 years apprenticeship or equivalent). By contrast, focusing on employment rates rather than unemployment rates, the picture is slightly more favorable: The relative employment position of the unskilled has improved since about 1996, with setbacks in the recessions 2001 – 2004 and 2008. The apparent riddle of an increasing skills gap with regard to unemployment and a closing skills gap with regard to employment can be resolved by assuming that unskilled employment growth was fed more from the previously inactive than from the unemployed. If we are to assume a causal relationship with the expansion of low wages at all (which, of course, cannot be established with these descriptive data), then we must conclude that ‘low wage policies’ have not solved the problem that was referred to for their justification.
The growth of the low-wage sector has arguably contributed to overall wage constraint. During the 2000’s, earnings in Germany have declined in real terms, and so has the wage share (Bispinck 2011). Per unit labor costs in Germany have lagged behind major competitors. This has contributed to Germany’s success in exports, but also to the imbalances currently threatening the Euro zone (Hein 2011). With regard to employment, however, it has been argued that Germany’s export boost through wage restraint has created fewer jobs in export-oriented industries than Germany has forgone to create by starving its domestic market (Horn et al. 2010).

It was only until after the labor market reforms culminating in 2005 (see 4.2 for further details) when the public discourse about the ‘low-wage sector’ shifted from treating it as a contested proposition to acknowledging it as a reality and, increasingly, perhaps also a problem.

### 2.3 Wage regulation

Like Austria and the Scandinavian countries, Germany has no universal statutory minimum wage. These countries share a tradition of autonomous wage-setting by the social partners through collective bargaining without interference by the state. In Germany, the autonomy of the social partners in wage-setting is enshrined as a

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4 In order to inspect employment and unemployment in a consistent database, these data were calculated from the German microcensus using ILO definitions. A skills-specific breakdown of the administrative unemployment count gives the impression of a slightly less negative outcome for the unskilled (cf. Möller 2011).
constitutional principle. This tradition explains reluctance to embrace the idea of a universal statutory minimum wage, even among trade unions until not so long ago.

Strictly legally speaking, collective agreements in Germany are only binding between parties who are members of the contracting organizations, i.e. trade unions and employers’ associations. However, employers normally do not discriminate against non-members of trade unions because this would only boost union membership. On the employers’ side, however, membership in the contracting association is crucial for the applicability of the sectoral collective agreements. Employers’ associations have responded to some employers’ reluctance to join by offering a second-tier membership status entitling to the services provided by the association but not implying to become part of the collective agreements. As a consequence, percentages of employees covered by collective agreements have declined considerably (see Figure 4). Coverage in the East has generally been lower, since the system of industrial relations established in West Germany never fully took root in the East after unification. In a way, German unification can be seen as a trigger for the partial erosion of Germany’s collective bargaining system.

Figure 4: Percentages of employees in establishments covered by sectoral/regional collective agreements, 1996 to 2010

Source: Ellguth und Kohaut 2011

It should be noted, however, that coverage by a collective agreement does not automatically preclude wages below the statistical low-wage threshold, nor does non-coverage necessarily imply low wages. About 16 per cent of agreed wage

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There are no ‘closed shops’ in Germany since the free choice to join or not to join a union is a constitutional right of workers.
categories are currently (2011) below the low-wage threshold (Bispinck und WSI-Tarifarchiv 2011) of around 9 Euros per hour established empirically for 2008\(^6\) (Kalina und Weinkopf 2010) – which is not to say, of course, that the same percentage of the workforce would be employed in such categories.

Beyond the immediate coverage of collective agreements, there are four additional ways of wage regulation in Germany. The Collective Bargaining Act (Tarifvertragsgesetz - 1) traditionally foresees a procedure for *erga omnes* rulings: Upon request by either of the collective bargaining parties and with the approval of the Tariff Committee comprised of equal numbers of union and employers’ umbrella organisation representatives, an existing collective agreement already binding employers who employ at least 50 per cent of the workforce concerned can be declared universally binding for the whole sector in question, if this is considered to be in the public interest. The use of the *erga omnes* clause has declined from 5.4 of the collective agreements in 1991 to 1.5 per cent in 2009 (Bispinck 2010), partly due to the resistance by employers’ umbrella organizations even against the declared intentions of the sectoral employers’ associations directly concerned.

In order to circumvent the obstruction of employers’ umbrella organizations, the legislator has introduced *erga omnes* mechanisms of various sort into other laws, like the Posting of Workers Act (2), the Minimum Working Conditions Act (3) and the Temporary Work Agency Act (3). Bound by the tradition of free collective bargaining, the underlying rationale in all these cases has been that first there must be some more or less representative collective agreement which is then extended, via various mechanisms, to become universally binding *only within the respective sector*. Technical variations between the four mechanisms concern thresholds of representativeness of the agreement to be extended and the level of consensus needed to justify government action. The result of these regulations is a variegated patchwork of sectoral minimum wages scattered around the statistical low-wage thresholds. The procedures hitherto available do not provide a solution for situations where there is not any collective agreement to begin with, and they suffer stalemate when there is no consensus between the social partners concerned or wherever quarrels arise on either side about who is legitimately representing a given sector. The paradigm shift from *extending* the results of collective bargaining to *complementing* collective bargaining still has to be made.

### 3 Small earnings

Up to here, this article has dealt with low (hourly) wages, as far as available statistics allow their identification, and not explicitly with small (individual) earnings. Whereas both are obviously related, low wages may nevertheless, to some degree and within legal and physical limits, be compensated by long hours (as is typical for the security services industry), and low earnings may have causes other

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\(^{6}\) This is the benchmark for Germany as a whole, which is used here since some of the collective agreements apply nation-wide. More recent measurements are not available.
than low wages. They might result from unprofitable self-employment, or from dependent part-time employment with short hours. Over the year or over a workers’ career, they might also result from discontinuity of employment.

3.1 Promotion of small earnings in the German employment regime

The German employment regime is rife with institutions and mechanisms that restrict labor market participation and indirectly incentivize small earnings, most of which are related to a ‘conservative’ gender regime modernized only half way:

- In West Germany, i.e. for four fifths of the population, childcare facilities are insufficient so that full labor market participation is extremely difficult for carers of young children. The normal pattern is that mothers interrupt their careers after childbirth, return only part-time and resume working full-time only when their children are well in their teens, or never.

- The social insurance system supports spouses’ non-participation or only marginal participation in the labor market, be they parents or not, by providing derived entitlements to dependents and survivors free of contributions. The tax system works in the same direction by first pooling married couples’ incomes and then applying the tax progression table to half of the family income for each of them separately. This ‘tax splitting’ system provides indirect subsidies to couples with unequal earnings. Together with the social insurance system, it creates high marginal taxation for partners who would expand their labor market participation and earnings.

- ‘Marginal’ part-time employment, since 2003 called ‘mini jobs’, grew out of this system already in the 1960s. Small jobs earning currently no more than 400 Euros per month are exempt from employees’ social insurance contributions, assuming that the worker is already covered through her or his partner, parents or through other systems like students’ health insurance. Income taxation is taken care of by the employer through a flat-rate withholding regardless of the employee’s household income. With a total of 7.4 million mini-jobs and 4.9 million persons working a mini-job as their only job (around 12 per cent of the gainfully employed population, two thirds of them female), the mini-job has become a kind of cornerstone of the German employment system. By its very definition, the mini-job is a low-earnings job, and since its threshold has not been raised since 2003, maximum earnings allowed from mini-jobs have decreased in real terms.

- Although the widespread perception that employment careers have become more volatile and patchwork-like overall is not supported by suitable panel data, this finding does hold true for the low-skilled (Giesecke und Heisig 2010): They are not only threatened by low wages but their annual and life-time earnings are further depressed by more frequent career interruptions after job loss.

All these mechanisms work in gender-specific ways: In practice, low earnings instigated by the employment system are predominantly female earnings. The tendency for ‘small’ jobs is also reflected in statistics of working time: Whereas
Germany’s female employment rate has grown steadily from 2000 to 2009 by almost 9 percentage points, the female full-time equivalent employment rate has actually fallen between 2001 and 2005, and its growth over the whole period was less than 5 percentage points (European Commission, Directorate-General for Employment, Social Affairs & Equal Opportunities 2010, S. 171). In other words, the ‘cake of work’ women are sharing has grown more slowly than the number of women sharing it.

3.2 The role of ‘activating’ labor market policies

The ‘activating’ turn in social policy, and, in particular, in labor market or ‘employment’ policies potentially reinforces the trend towards lower earnings. Criteria for ‘acceptable’ jobs which cannot be refused have been considerably tightened. Since 1997, qualification status is no longer of concern. After a person has been receiving contribution-based unemployment benefits for six months, any job is acceptable paying at least the amount of the benefit, which implies a wage cut of roughly one third compared to the former wage. Unemployed persons lacking (sufficient) unemployment insurance entitlements or having exhausted them and therefore receiving means-tested minimum income benefits (see 4.2 for details) have to accept any job they can physically and mentally perform, regardless of earnings.

Empirical findings, though still incomprehensive, tend to support the view that ‘work first’ policies have contributed to the downgrading of the earnings structure. According to representative surveys, employers have reported that both unemployed job applicants and incumbent workers became more prepared to make concessions about pay and working conditions (Rebien und Kettner 2011). Among the recipients of minimum income benefits who have taken up work, only one third has got an open-ended full-time contract, almost 50 per cent earn less than 7.5 Euros per hour (which is well below the low-wage threshold), and about one quarter have accepted a job below their certified skills level (Achatz und Trappmann 2009). In other words, in the absence of an effective floor for wages and earnings, ‘work first’ policies contribute to the expansion of low wages and small earnings.

4 Poverty despite employment

4.1 In-work poverty at household level

Poverty cannot be linked to low wages or earnings directly since it is not assessed at individual but at household level. Living together with family members can mediate the relationship between earnings and poverty in very diverse ways: It can mean to be saved from poverty by having a better-earning partner, but it can also mean being poor despite individually sufficient earnings because of living with children as a lone parent, or with an unemployed partner.
Table 1: Rates of population at risk of poverty despite being employed at least 6 in 12 months, after social transfers, 2006, selected EU member states

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<th>BE</th>
<th>DE</th>
<th>DK</th>
<th>ES</th>
<th>FR</th>
<th>IT</th>
<th>NL</th>
<th>SE</th>
<th>UK</th>
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</thead>
<tbody>
<tr>
<td>total</td>
<td>6.1</td>
<td>4.3</td>
<td>7.4</td>
<td>4.1</td>
<td>10.7</td>
<td>6.7</td>
<td>9.8</td>
<td>4.6</td>
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</tr>
<tr>
<td>male</td>
<td>6.3</td>
<td>4.4</td>
<td>6.8</td>
<td>4.9</td>
<td>12.0</td>
<td>7.0</td>
<td>11.7</td>
<td>4.6</td>
<td>7.0</td>
<td>8.3</td>
</tr>
<tr>
<td>female</td>
<td>5.7</td>
<td>4.3</td>
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<td>6.9</td>
<td>4.6</td>
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<td>7.7</td>
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Source: Statistisches Bundesamt 2011

According to the latest available figures based on EU-SILC data, German in-work poverty risk rates after social transfers appear quite considerable (Table 1). Furthermore, among the countries selected, Germany is the only one where the poverty risk rate is higher for women than for men. Unfortunately, the available data do not allow disentangling the effects of the gender pay gap, restrained labor market participation of women, and possibly insufficient provisions for lone parents who are, in practice, predominantly female.

4.2 The reformed minimum income benefit system working as a supplement to low earnings

From 2005, two benefits for workless people without unemployment insurance claims were merged into a single new one, called ‘minimum income benefit for jobseekers’ (for details, see Knuth 2007, 2009). Introducing a new gliding scale of disregard for earned income, meant to incentivize taking up employment, was part of the reform. This mechanism of gradual benefit withdrawal works like earned income tax credits in other countries, except that there is no threshold in terms of a minimum of hours or earnings before the subsidy begins. Obviously, here again, there is a mechanism in place that works in favor of accepting low earnings.

After two subsequent amendments which demonstrate the uncertainty about the objectives and mechanisms of such an in-work benefit, the formula of disregard for monthly earned income is currently as follows:

- the first 100 Euros are disregarded completely;
- of the part of earnings that fall between 100 and 1,000 Euros, 20 per cent may be kept by the benefit recipient;
- of the part of earnings between 1,000 and 1,200 Euros (1,500 Euros for persons having to maintain at least one child, only 10 per cent may be kept);
- the part of earnings exceeding 1,200 Euros is fully counted against the benefit which means that in most cases recipience of the benefit will end.

Because of the principle of equal treatment, this provision not only works as an incentive for benefit recipients to take up work even if resulting earnings are insufficient for their families’ needs but also as an invitation to those who already
are low earners or breadwinners of families too large for their earnings capacity to claim benefits. Consequently, the percentage of claimants receiving the benefit despite being engaged in paid work rose from 18 in 2005 to 27 in December, 2008 (Hartmann und Bergdolt 2010), equivalent to 1.3 million persons. In the absence of an effective wage bottom as well as an accepted norm for female labor market participation, in-work benefits will continue to resemble a picture puzzle: What looks like an incentive to take up work and reduce benefit recipiency in one perspective, will appear like a subsidy for wage-dumping, or for optimizing work-leisure-income balances, or for sustaining traditional family models from another perspective.

5 Summary and Conclusions

With a focus on low wages, small earnings and poverty, we see a Germany quite different from how it used to be depicted in international typologies. The ‘co-ordinated economy’ has allowed the development of vast loopholes in which there is no effective wage regulation at all, and employers’ umbrella organizations are obstructing attempts to close such loopholes through erga omnes regulations. Traditionally considered a high-wage/high quality economy, Germany has developed a substantial low-wage segment, and wages have been stagnating overall. Small annual and lifetime earnings have for long been typical for (West) German women, and though family and educational policies have come into motion in recent years, there is not yet an unequivocal strategy for overcoming the ‘conservative’ family model. Poverty, for long considered an impossibility in Germany, has become a reality of which this article only touched the aspect of in-work poverty.

Alleviating in-work poverty through income supplements can be a very costly strategy if the causes for insufficient household income are not addressed or even reinforced. Undoubtedly, low hourly wages are among these causes – however, public discourse tends to disregard the many factors mediating between hourly wages and household poverty, many of which are also causes of poverty by themselves. The German strategy regarding wages, earnings and income in the lower strata of the employment system has been paradoxical and fragmented: For a long time, the growth of a low-wage segment was depicted as desirable for creating or safeguarding jobs for the low-skilled, and overall wage restraint is still seen as a virtue today. The linkages between female employment patterns, wage structures and household poverty are not adequately addressed. When viewing these fields in conjunction, the message is simple and clear: If it is no longer possible for lower-skilled males to earn a ‘family wage’ even at a very moderate living standard, as used to be the case in the ‘golden age’ of Fordism, and if these males are to have families nevertheless, then the mothers of their children must have access to full-time employment and equivalent careers at equal wages, which implies in turn that public childcare must become the norm from a very early age on. The same applies to high-skilled couples who can no longer maintain the living standards they aspire to in single-breadwinner arrangements. But even accepting that family wages are no longer attainable for single earners, there must be a bottom to wages that allows a single full-time worker
to live without supplementary benefits. Only with an effective minimum wage regulation and with an institutional framework that gives wives and mothers both the possibility and the incentive to participate fully in the labor market, supplementing earned incomes where families are still in need and designing such supplements in ways that incentivize employment are good investments and not just sunk costs.

References


Contradictions of ‘low wage policies’


