

# The minimum wage in Germany five years on

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Toralf Pusch and Arne Heise

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**When the minimum wage was introduced in Germany in 2015, there were febrile forecasts of huge job losses. These have proved minimal—while incomes and consumption have benefitted.**

In the decade following the end of the financial crisis, employment in Germany has been rising every year. Wage growth picked up in its aftermath, even for employees not covered by collective agreements. The largest wage increases, triggered by a minimum wage of €8.50 introduced in 2015, were experienced by employees with low qualifications and employees in eastern Germany. A possible related decline in employment was hardly noticeable. Against this backdrop, it is not surprising that approval ratings for the statutory minimum wage are high and that a debate on raising the minimum to €12 per hour is gaining momentum.



Toralf Pusch

Five years ago, a positive balance on the German minimum wage was anything but certain. At the time, opponents warned loudly against a sharp decline in employment. The German Council of Economic Experts issued an urgent warning and the contributions of the academic economists Andreas Knabe, Ronnie Schöb and Marcel Thum and a second team led by Klaus Zimmermann at the Institute for the Future of Work (IZA) are particularly memorable. Knabe, Schöb and Thum estimated that 425,000 to 910,000 jobs were at risk and the IZA authors predicted the loss of 570,000 jobs. Some earlier forecasts came to even more drastic results (for a minimum wage of €7.50!).



Arne Heise

How is it possible that renowned German economists could end up being so wrong with their forecasts? In a recent article, Oliver Bruttel, Arne Baumann and Matthias Dütsch of the German Minimum Wage Commission point out that the warnings were based on a neoclassical labour-market model, with perfect competition and the (thoroughly controversial) assumption of a high wage elasticity of employment. Alternative models were hardly considered.

Moreover, the forecast results were at odds with international empirical research on the employment effects of minimum wages. Meta-studies evaluating a large number of results from the empirical literature have found these effects to be small or even insignificant.

## **Demand impact**

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One effect of minimum wages which has so far received little attention in the empirical literature is their impact on the demand for goods in the economy. Recently, we have considered these demand effects for the case of Germany. Demand increases can occur, for example, if low earners spend the majority of additional income derived from a minimum wage-related uplift on consumption. This increases the sales of goods by companies affected, directly and indirectly.

On the other hand, the minimum wage has also triggered price increases, which can depress demand. How strongly the demand for goods reacts to price increases is measured by the so-called price elasticity of demand. Our calculation of the price elasticity of products from the low-wage sector is well below 1, meaning that a 1 per cent price increase leads to a demand contraction of less than 1 per cent. In the case of food products, which are comparatively highly affected by the minimum wage and represent a significant share of household expenditure, a low price elasticity is immediately obvious, since the fulfilment of basic needs is likely to be influenced comparatively little by prices.

Presumably, it was this low price elasticity, together with higher consumption from the incomes of low-wage employees, which has led to the very low employment effect of the minimum wage (about 27,000 jobs lost, according to our calculation). How well typical and large low-wage industries could adapt to the minimum wage is also demonstrated by indicators shown in the table below.

## **Share of employees (%) with an hourly wage below €8.50 in 2014 and increases (%) in gross value added before and after the introduction of the minimum wage**

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	Minimum wage share	Change of gross value added	
	2014	2011-14	2014-17
Germany, all sectors	12.6	9.0	11.6
food industry	24.5	8.9	17.3
hotels and restaurants	45.1	11.5	18.3
retail trade	24.6	10.0	19.9

Sources: EU KLEMS (gross value added, nominal values), SOEP v34 (minimum wage share based on contractual working hours information), own calculations

Next to the share of employees with hourly earnings below the minimum wage in 2014, the table also shows the increase in gross value added in the periods before and after its introduction. The choice of the gross-value-added measure was deliberate, since this production value of sectors also includes the resulting income of employees and capital owners (on the distribution side of accounting). Among other things, the self-employed, for example, could experience a loss of income due to higher wages of their employees, which would have a dampening effect on the increase in gross value added.

The data however point in a different direction. In the first three years after the introduction of the minimum wage, gross value added in low-wage industries rose much faster than in the economy as a whole. Beforehand, gross value added increases were roughly in line with overall economic growth. Apparently, companies in industries strongly influenced by the minimum wage have succeeded in generating higher revenues. Next to higher incomes, higher price increases in low-wage industries likely played a role, as pointed out by Bruttel, Baumann and Dütsch.

All in all, the statutory minimum wage in Germany is therefore a success story. A hardly noticeable employment effect was counteracted by significant increases in low-wage earners' remuneration. The relative price increases of a number of goods produced in the low-wage industries appear to be manageable, given a comparatively moderate general rate of price increase. Against this background, there is a general case for making greater use of the scope for raising the statutory minimum wage towards an hourly rate of at least €12.