

## GERMANY: A MIXED BAG FOR PAY RISES IN 2022

Anthony Morlet-Lavidalie

After 2021, a year when wage negotiations were difficult against a backdrop of a fragile and uneven economic recovery, wage increases should be much higher in 2022 but insufficient to compensate workers for high inflation.

The country's most powerful union, IG Metall, has obtained a wage increase which has not been seen in the metalworking sector for 30 years: +6.5%. However, this increase should be put in perspective, since the agreement covers 18 months, bringing the annual growth rate to +4.5% in 2022.

Salary negotiations in Germany are still mostly carried out at a centralised level (by industry or sector). The shift in decentralization in the 1990s mainly enabled enterprises to break out of sectoral agreements in exceptional circumstances (e.g. financial difficulties of enterprises, or unfavourable economic conditions).

The German Trade Union Confederation (DGB), a pillar of German trade unions, centralises the majority of trade union bodies and brings together almost 6 million members. DGB is dominated by two major union powers: IG Metall (metallurgy and textiles) and Ver.Di (transport, trade, banking and insurance).

### GERMANY: LABOUR COST AND WAGES DYNAMIC IN PRIVATE SECTOR

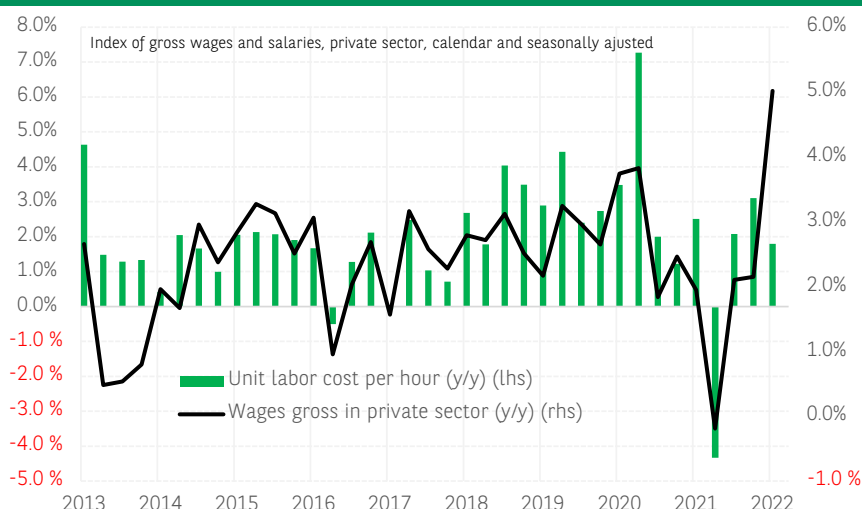


CHART 1

SOURCE: MACROBOND, BUNDESBANK, BNP PARIBAS

Collective bargaining was particularly difficult in 2021 in Germany. Despite the pugnacity of trade unions that negotiated agreements over a long period of time, the unfavourable circumstances linked to the two years of the Covid-19 pandemic prevented wages from growing significantly. On average, negotiated wages have risen by only 1.7%, the lowest since 2006, according to the Hans-Böckler Foundation's Institute of Economic and Social Research (WSI)<sup>1</sup>. This weak dynamic can also be explained by the fact that 2021 was marked by the exceptional distribution of bonuses rather than salary reviews. In a context of uneven economic recovery between sectors, companies preferred to maintain flexibility by awarding employees "Corona bonuses" (*Corona-Prämie*), as WSI called them in its annual report. These one-off bonuses, amounting to a maximum of EUR1,500 per employee, were exempt from tax until March 2022. In practice, the bonuses that were awarded averaged EUR500, ranging from EUR90 in the confectionery industry to EUR 1,300 in the public sector.

### INFLATION SHOULD ERODE EVEN LARGE WAGE INCREASES IN 2022

At the beginning, 2022 should have been a good year for salary negotiations<sup>2</sup>. Provisional agreements for the year were favourable to employees, given the post-Covid recovery and growing tensions in the labour market. WSI's annual report, published at the end of 2021, stated that the context of a « *strong economic recovery and shortages of skilled labour in many sectors would create favourable conditions for substantial salary increases. Employees expect their purchasing power to increase in 2022* ». Several sectors had negotiated significant increases, often complemented by bonuses such as in 2021: accommodation (rise between +4% and 6% depending on grade), transport (from 1.5% to 5%), and construction (+2% to +3%).

<sup>1</sup> Institute for monitoring wage negotiations and minimum wage development in Germany.

<sup>2</sup> Dullien et al. (2021), *Auf Winterpause folgt kräftiges Wachstum: Die konjunkturelle Lage in Deutschland zur Jahreswende 2021/2022*, IMK-Report No. 172, Düsseldorf

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However, the rapid and severe deterioration of the economic environment has set back a large number of trade union organisations. The slowdown in activity will weigh on employees' bargaining power, while they would like to negotiate larger-than-expected salary increases to preserve their purchasing power in the face of inflation, which should reach an annual average of just over 8% in 2022.

After a strike, the most powerful German union, IG Metall, achieved salary increases for metalworkers of +6.5% on 15 June, starting in August over the next 18 months. It follows negotiations in the textile sector where IG Metall obtained a +5.6% increase in wages at the beginning of May. Although this is the biggest rise in 30 years in the metalworking sector, the increase should be seen in perspective, since the agreement covers 18 months, bringing the annual growth rate to +4.5% in 2022. Not forgetting that workers' basic wages did not increase last year as they were offset by bonuses. So, the growth in negotiated wages is not so high as it will be calculated in relation to the base salary which has been unchanged since 2020 (and not in relation to the total compensation which includes the bonuses which were very important last year). And it is important to note that salaries' increases in other sectors are expected to be smaller because IG Metall has more bargaining power than other, smaller trade unions.

## MORE THAN JUST A HELPING HAND, THE HISTORIC RISE IN THE MINIMUM WAGE WILL PRESERVE THE PURCHASING POWER OF THE LOWEST INCOME HOUSEHOLDS

With net purchasing power increasing this year, workers paid the minimum wage or close to it will be an exception. Indeed, they will see their purchasing power improve thanks to the substantial increase in the minimum wage, which will reach EUR12 per hour in October 2022 (chart 2) after an initial increase in July to EUR10.45 per hour, compared with EUR9.82 currently (i.e. an increase in total of 22%).

However, not all salaried employees paid the sectoral minimum wage will be directly affected by this pay rise, given that the minimum wage is already over EUR12 per hour in a certain number of sectors. Nevertheless, the increase in the minimum wage should generate knock-on effects for wages close to the minimum<sup>3</sup> and, therefore, increase the wage of a significant number of employees in the first deciles of income distribution<sup>4</sup>. The sectors that will see their minimum increase are essentially sectors in which the most vulnerable workers are found: temp agencies, cleaning agencies, farming and building trades (chart 3).

## WAGE INCREASES TOO SMALL TO FUEL DOMESTIC INFLATION

Although real wage growth is expected to be negative in 2022, the magnitude of nominal wage increases raises the question whether it could trigger a feedback loop between wages and prices.

Theoretically, to be in line with the European Central Bank's inflation target, nominal wages can increase by +3% per year since the increase in labour productivity (+1% per year on average in the long term) will limit the increase in unit labour costs to +2% per year<sup>5</sup>.

### MINIMUM WAGE IN GERMANY: EVOLUTION SINCE 2015

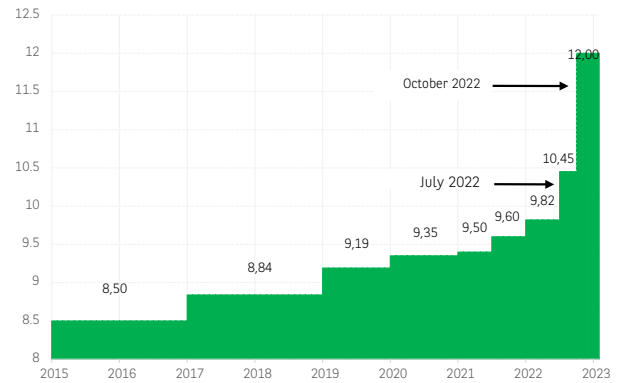


CHART 2

SOURCE: MINDESTLOHNKOMMISSION, WSI, BNP PARIBAS

### SECTORS IMPACTED BY THE INCREASE IN THE MINIMUM WAGE AND SECTORS WHERE THE MINIMA ARE CLOSE

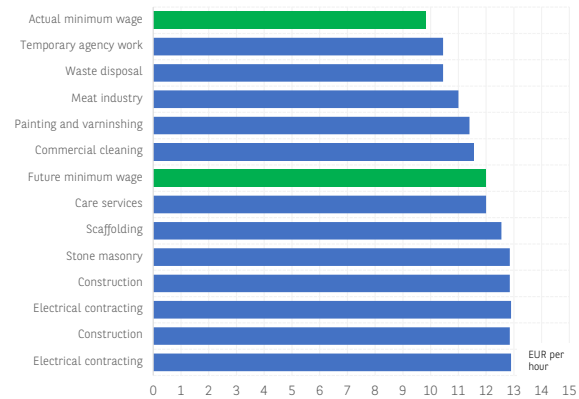


CHART 3

SOURCE: WSI, BNP PARIBAS

In Germany, the salary increases negotiated in 2022 seem high due to a significant base effect: since employees were mainly rewarded through bonuses last year, the salary scales hardly rose in 2021. In fact, part of the wage increases will be eroded by the decrease in bonuses that were paid as an exception last year. Total compensation for employees will therefore increase more moderately in 2022 than what the agreements suggest.

Unit wage costs, which take into account total remuneration and are adjusted for productivity gains, should rise more moderately than wages (in the region of 3% in 2022), thereby limiting the upward pressure on company costs and hence inflation. The data available for Q1 2022 seem to confirm this : while salaries in the private sector increased by +5% y/y, unit wage costs only increased by +1.8% y/y (chart 1).

<sup>3</sup> Studies show, on average, that the knock-on effects can be felt at up to 1.5 to 2 times the minimum wage, but then fall very quickly.  
<sup>4</sup> Koubi et al. (2007), *The short-term effects of the distribution of minimum wage increases in the salary scales of companies with ten or more salaried employees over the period 2000-2005* Dares, *Salaries in France*, Edition 2007; Goarant et al. (2012) *The effects of minimum wage increases on monthly salaries in companies with 10 or more employees from 2006 to 2009*, DARES Working Document; Aeberhardt et al. (2016), *Spillover effect of the Minimum Wage in France: An Unconditional Quantile Regression*, Working Papers, Center for Research in Economics and Statistics.  
<sup>5</sup> The underlying assumption is that companies are able to increase their selling prices with 2% to neutralize the impact of higher unit labour costs on their profit margins.

The negotiating power of employees has shrunk as economic conditions have deteriorated. While they were in a strong position at the end of last year, with forecast GDP growth of over 4%<sup>6</sup>, the drop in activity and profits expected by companies strengthened the bargaining power of employers' unions, leading to less generous agreements. The decline in turnover in many sectors, particularly industrial sectors, has also enabled companies in difficulty to exclude themselves from agreements and to freeze salaries.

It can therefore be concluded that at this stage wage dynamics in Germany are not large enough to fuel cost inflation.

In order to understand the context in which these wage negotiations take place, it is necessary to consider how German trade unions are structured and how wages are set.

## BUILT AND DESIGNED TO COMBAT THE STRUCTURAL DECLINE IN MEMBERSHIP

Historically, the organisation of German trade unions has followed the principle of representation by industry (*Industriegewerkschaft*). As each body defends the interests of employees belonging to the sector it represents, once a sector is big enough to be able to create a trade union organisation, there follows an increase in the number of trade unions. It was a system that continued from the post-war period until the end of the "*Wirtschaftswunder*" (which refers to the strong economic growth after World War II) in West Germany. But then, large organisations gradually suffered from the individualisation of work, which no longer favoured the employees' agreement within a common structure. In other words, trade unions have lost influence because of the change in the structure of the labour market. Workers in industry and agriculture, whose numbers have tended to fall, were strongly represented by trade union organisations, unlike employees working in services. For example, only 2% of IT staff are members of a trade union in Germany<sup>7</sup>.

The increased financial difficulties associated with the sharp decline in the unionization rate in the 1990s led to a weakening of the bargaining power of unions. In response, independent federations began a merger movement to create larger structures capable of retaining significant influence. As the size of the organisation is a decisive factor in negotiating power, in 1996, the building trade union merged with the agricultural, forestry and horticultural federation to create the IG BAU. The following year, the chemicals, mining and tanneries trade unions joined forces to form the IG BCE, and IG Metall (consisting of the steel, wood and plastics sectors) took over the textile trade union. The services sector also experienced massive consolidation under the name Ver.Di in 2001 with the merger of transport, trade, postal, other public services and banking and insurance trade unions.

This movement continued until the vast majority of trade unions became part of the German Trade Union Confederation (DGB), which alone represents almost 6 million trade union members across Germany (*chart 4*). Within DGB, IG Metall and Ver:Di enjoy considerable influence and actually play a dominant role.

NUMBER OF MEMBERS (IN THOUSANDS) OF MEMBER UNIONS OF THE GERMAN TRADE UNION CONFEDERATION (DGB) IN 2018

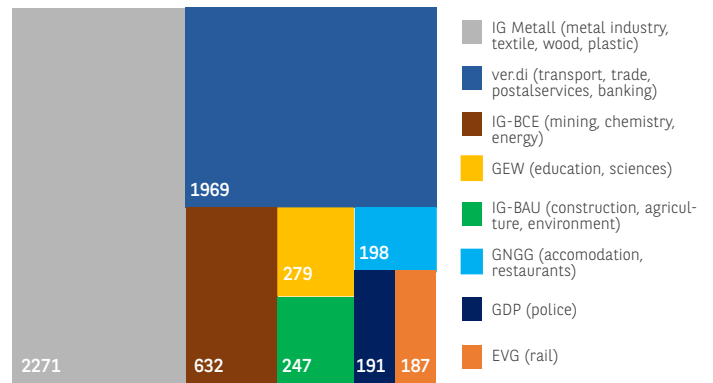


CHART 4

SOURCE: DGB, BNP PARIBAS

## CENTRALISED SALARY NEGOTIATIONS WITH A HEALTHY DOSE OF FLEXIBILITY

In wage negotiations, Germany is characterised by a high degree of centralisation with agreements mostly made at the industry or sector level. Although a decentralisation movement was initiated from the mid-1990s to allow for more negotiation at the company level, sectoral collective bargaining remains by far the main way in which remuneration is set. Trade unions are particularly important as they have a major institutional role which makes them stakeholders in their own right. This joint management implies that they are jointly responsible, in the same way as their employer counterparts and the public authorities, for the economic and social decisions that are taken. Nor do German trade unions generally suffer from ideological opposition. The need and willingness to reach an agreement at the end of each period leaves little room for political demands. This process of setting wages results in a very pronounced culture of compromise in Germany.

Another specific feature of the German model is that it is characterised by greater flexibility compared to other European countries in the application of collective bargaining agreements. Companies can more easily than others ignore certain sectoral agreements if their individual financial situation is difficult or the sector is hit by an economic crisis. This results in temporary pay freezes, for example<sup>8</sup>.

As Germany has a low coverage rate of collective bargaining for a country where the majority of negotiations are centralised (the proportion of employees represented by a union or covered by collective bargaining is just 55%; *chart 5*), Works Councils (*Betriebsrat*) play a leading role in negotiations at company level. Consisting of employees and directors, they allow employees to be represented and defended<sup>9</sup> in the absence of trade union organisations. The latter are experiencing the downward trend in the rate of unionisation, from which Germany, like other industrialised countries, has not escaped (falling from 35% in the early 1980s to 16% in 2019). Empirically, however, the effects of

<sup>6</sup> OECD, Economic Outlook December 2021

<sup>7</sup> IFRI 2007, *Trade unions in France and Germany: Difficult adaptations to changes in society*, Franco-German Visions n° 12.

<sup>8</sup> Jimeno and Thomas (2013), *Collective bargaining, firm heterogeneity and unemployment*, European Economic Review, vol. 59 Elsevier.

<sup>9</sup> Freeman and Lazear (1995), *An economic analysis of works councils* in J Rogers and W Streeck (eds.), *Works Councils: Consultation, Representation, Cooperation in Industrial Relations*, NBER Comparative Labor Markets Series; Freeman et al. 2020 (*Unions raise worker wellbeing*, VoxEU, 11 November).



employees' membership of works councils on wage dynamics are small to non-existent<sup>10</sup>.

Unlike in France, where wage negotiation cycles are codified and must take place every year, wage agreements in Germany are not dictated by regulation. In practice, however, trade union bodies open negotiations every year with the employer at the sector level, and the agreements that are reached often run over the following two years (since the beginning of 2000, the average duration of collective agreements has been 22.3 months). Furthermore, decentralised negotiations at company level are more frequent, as shown by the "Wage Dynamics Network" survey overseen by the European Central Bank and the Bundesbank: 39% of German companies report that base salaries are adjusted more than once a year, and 31% report annual adjustments.

In short, Germany's model is economically and socially rather efficient. It is centralised enough to pursue efficiency, as suggested in the leading literature on the subject<sup>11</sup>, while exercising flexibility clauses that allow companies facing difficulties to exempt themselves from a binding agreement and preserve employment<sup>12</sup>.

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#### RATES OF UNIONIZATION AND COVERAGE OF EMPLOYEES BY COLLECTIVE BARGAINING

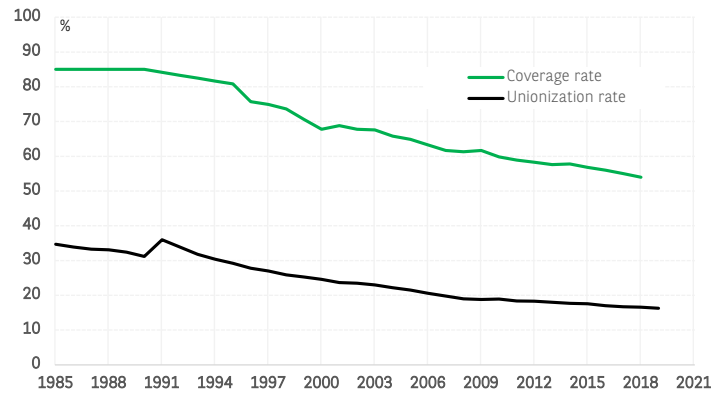


CHART 5

SOURCE: OECD, AIAS, ICTWSS BNP PARIBAS

<sup>10</sup> Blandhol et al. (2020) *Do employees benefit from employee representation on corporate boards?* NBER Working Paper n°28269; Jäger et al. 2021 (*Labor in the boardroom*, Quarterly Journal of Economics 136: 669–725)  
<sup>11</sup> Calmfors and Driffill (1988), *Bargaining structure, corporatism and macroeconomic performance*, *Economic Policy*, vol. 3, n° 6; Cahuc and Zylberberg, 1991 (*Levels of wage negotiations and macroeconomic performance*, *Annals of Economics and Statistics*, n° 23).  
<sup>12</sup> Jimeno and Thomas (2013) *Collective bargaining, firm heterogeneity and unemployment*, *European Economic Review*, vol. 59 Elsevier.



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