
INFORMATION NOTE

Supplementary note on the minimum wage system in Germany

1. Background

1.1 The Panel on Manpower (the Panel), at its meeting on 20 March 2008, discussed the research paper entitled "Minimum wage system in selected places" prepared by the Research and Library Services Division (RLSD). At the meeting, the Panel requested RLSD to provide supplementary information on the legislation to extend the coverage of specific trades under Germany's minimum wage system. In addition to the requested information, a general account of the minimum wage system in Germany is also provided in this note for facilitating cross reference to the situations in the selected places covered by the research paper.

2. Development of the minimum wage system in Germany

2.1 Germany has no statutory national minimum wage. Nevertheless, there is an established collective bargaining system which enables employers and employees to negotiate and agree on the terms and conditions of employment in a defined scope of application, mostly referring to a sector¹ within a particular region or nationwide. The collective agreements in Germany include mainly wage agreements relating to remuneration and training allowances, and to a lesser extent framework agreements relating to working conditions such as working time and leave periods. Legally binding for members of the signatory parties to the agreement with downward deviation prohibited in principle, a collectively agreed wage rate is *de facto* statutory minimum in the given scope of application.

2.2 The current sector-specific minimum wage system in Germany, predominantly featured by a collective bargaining framework, can be traced back to the first decade of the last century when the relevant legal provisions were first introduced². Following almost two decades of Nazi rule when free trade union and related activities came to a halt, the collective bargaining system was resurrected in the former West Germany by the enactment of the *Collective Agreement Act* in April 1949. The coverage of the collective bargaining system expanded and exceeded 80% of employees in the former West Germany in the 1980s.

¹ Referring to either a sectoral classification or an occupational category straddling through different sectors.

² Including the *Act on Patriotic Services* enacted in 1916 and the *Collective Agreement Ordinance* enacted in 1918.

2.3 After the national unification in October 1990, the collective bargaining system was also extended to the territory of the former East Germany where wages had been basically regulated by the government. However, collective agreements in the eastern part of the unified Germany have not been as popular as in the western part, covering slightly more than half of employees in 2006. Workers in the eastern part of the country face persistently higher unemployment and hence are generally less receptive to collective wage bargaining for fear of being priced out of jobs. This situation, together with the competition pressure exerted by inflow of foreign workers and outward relocation of operation bases by German enterprises, has induced more and more workers in the western part to opt out of the collective bargaining system. In 2006, the coverage of collective agreements dwindled to about two-thirds in western Germany.

2.4 Decentralisation is another noteworthy development of the collective bargaining system over the past decade or so. For the sake of flexibility, it has become more common for individual employers to conclude with employees direct company-level agreements instead of adopting sector-level agreements. There are also increased incidents that at the company level, employers and employees mutually agree on various deviations from certain provisions in the binding sector-level agreements.

2.5 Amidst lesser predominance and decentralisation of the collective bargaining system, the trade unions have turned more active in requesting the government for mandatory extension of collective bargaining coverage to the entirety of selected sectors, which in effect gives rise to sector-specific statutory minimum wages in the sectors concerned. There were a few successful cases in the past few years, though the number of sectors involved has remained limited. Meanwhile, the trade unions have reached consensus in proposing a statutory national minimum wage system. Nonetheless, the idea meets opposition from the employers and the government has reservation about it while public opinions are also divided. Heated public debate is underway, and there is as yet no clear signal on the way forward.

3. Coverage of the minimum wage system

3.1 As employers and employees are free to organise themselves into coalition to engage in collective bargaining, there is virtually no pre-set boundary of minimum wage coverage in terms of age, gender, academic background, skill level, etc. The actual coverage depends on the size of membership for the signatory parties to the relevant collective agreement, and the extent to which the employer voluntarily extends the agreed provisions to non-organised employees. Overall, no systematic pattern of coverage is observed for different sectors and types of workers.

3.2 Although only about a quarter of German employees are trade union members, more than half of them are covered by collective agreements directly and indirectly. In 2006, the shares of employees whose terms and conditions of employment were regulated by collective agreements stood at 65% and 54% respectively in western and eastern Germany. While only unionised workers are in principle protected by collective agreements, it is a common practice for the employers bound by agreements to treat unionised and non-unionised staff equally.

Exemption

3.3 Under the sector-level agreements, individual enterprises are allowed to negotiate further with their employees on upside or downside deviation from the agreed wage rate and provisions on other aspects. Subject to mutual consent, it is lawful to stipulate an opening clause pertaining to a particular term or condition of employment even though it is *prima facie* disadvantageous to the employees. In other words, individual employers may be exempted from offering the collectively agreed minimum wages through the use of an opening clause.

3.4 In any event, most of the collective agreements specify limits to deviations, beyond which approval from signatory parties is necessary. For example, a maximum limit of 10% below the collectively agreed wage level is quite common.

3.5 According to an unofficial estimate³, about 75% of the establishments covered by collective agreements in Germany made use of one or more opening clauses in 2004. Of these establishments, 25% applied an opening clause on cutting entrance pay for newly-hired employees. The corresponding percentages were 22% for reduction or postponement of annual bonuses, 17% for postponement of collectively agreed pay increase, 10% for reduction of collectively agreed basic pay, and 9% for reduction or postponement of holiday pay.

Mandatory extension to sector-wide coverage

3.6 In accordance with Article 5 of the *Collective Agreement Act*, the Ministry of Labour and Social Affairs is empowered to declare a collective agreement generally binding for a sector within the defined territorial scope through the issue of an Order Imposing Extension. The declaration in effect sets the collectively agreed wages as the statutory minimum at the sector level.

³ Works and Staff Council Survey 2004, German Institute for Economics and Social Science (WSI).

3.7 The Ministry usually does not take the initiative to issue an Order Imposing Extension, which rests with application from at least one signatory party to a collective agreement in the first place. Subject to fulfillment of some basic requirements, the application is then vetted by a committee whereby the umbrella organisations of employers and employees are equally represented. This procedure is aimed to uphold public interest by avoiding undue wage pressure and employment impact to other segments of the region. The final decision is made by the Ministry in agreement with the committee, but it is often difficult for the committee to make recommendation because of divided views between the employer and employee representatives. Successful applications have henceforth been limited, especially in relation to wages.

3.8 A new provision introduced by the *Posted Workers Act*⁴ in December 1998 provides a simpler procedure to mandate extension of a collective agreement. Instead of issuing an Order Imposing Extension under the *Collective Agreement Act*, the Ministry is empowered by the *Posted Workers Act* to issue a ministerial directive for the same effect and by similar procedure except that the committee's recommendation is unnecessary. By this means, the Ministry has, since 1999, declared collective agreements generally binding in six sectors nationwide, and handled applications in some other sectors such as postal services⁵, security services, laundry and forestry.

Table 1 – Coverage of the *Posted Workers Act* by sector

Sector	Effective date
Construction	1 September 1999
Roofing	29 August 2005
Painting	29 August 2005
Wrecking	29 August 2005
Industrial cleaning	9 March 2007
Electrical works	17 September 2007

Source: European Industrial Relations Observatory On-line.

⁴ Enacted in February 1996, the *Posted Workers Act* initially provided posted workers (i.e. workers from one European Union member state sent temporarily by their employer to work in another) in the construction sector with protection of German statutory minimum standards in areas such as working time and paid leave. The Act also provided that posted workers should be covered by the same minimum collectively agreed wages and collectively agreed provisions on paid holidays as German workers.

⁵ It was approved by the German Parliament in December 2007 that the Act would also apply to the postal service sector as from 1 January 2008. However, the implementation was put on hold due to legal proceedings pursued by an employer and subsequent court ruling against the implementation in early March 2008.

4. Minimum wage rate

Multitude of collectively agreed wage rates

4.1 In the presence of tens of thousands⁶ of collective agreements, there exists a great diversity of agreed minimum wage rates across different sectors and even companies that can hardly be averaged in absolute terms. Even within the same scope of application, sometimes more than one single minimum wage rate applies to different qualifications and work locations. In three out of the six sectors covered by the *Posted Workers Act*, for example, multiple rates of minimum wages apply with differentials ranging from 8% to 28%.

Table 2 – Minimum wages rates in the six sectors covered by the *Posted Workers Act*

Sector	Western Germany	Eastern Germany
	Hourly rate as at 1 January 2008	
Construction	€10.4/€12.5 ⁽¹⁾ (HK\$111.2/HK\$133.6)	€9.0/€9.8 (HK\$96.2/HK\$104.8)
Roofing	€10.2 (HK\$109.0)	€10.2 (HK\$109.0)
Painting	€7.85/€10.73 (HK\$83.92/HK\$114.70)	€7.15/€9.37 (HK\$76.43/HK\$100.17)
Wrecking	€9.49/€11.60 (HK\$101.45/HK\$124.00)	€8.8/€9.8 (HK\$94.1/HK\$104.8)
Industrial cleaning	€8.15 (HK\$87.12)	€6.58 (HK\$70.34)
Electrical works	€9.4 (HK\$100.5)	€7.9 (HK\$84.5)

Note: (1) The average exchange rate of Euro in 2007 was €1 = HK\$10.69.

Remark: The two wage tiers pertain to higher and lower grades of job requirement.

Source: European Industrial Relations Observatory On-line.

⁶ According to an official estimate, there were about 70 000 registered collective agreements in Germany as at end-2007.

Real value of the minimum wage

4.2 According to the index of collectively agreed wages compiled by the Federal Statistics Office of Germany, the minimum wages of manual workers and non-manual workers in all sectors rose at the average annual rates of 1.9% and 2.0% per annum respectively from 2000 to 2006. These rates were slightly higher than the average annual consumer inflation rate of 1.5% over the same period, implying an increase of around 0.4% – 0.5% per annum for the minimum wages in real terms.

Minimum wage rates relative to the average wage rate

4.3 In the construction sector, the generally binding minimum wage rate under the *Posted Workers Act* amounted to €10.3 (HK\$100.5)⁷ – €12.4 (HK\$121.0) per hour in western Germany and €8.9 (HK\$86.9) – €9 (HK\$87.8) per hour in eastern Germany as at 1 September 2006⁸. These were equivalent to 75% – 90% and 64% – 65% of the average hourly wage of €13.8 (HK\$134.7) in the sector in 2006. Despite the lack of data to allow similar comparison in other sectors, anecdotal evidences show that incidents of actual wages and salaries exceeding the collectively agreed levels are quite common. According to an unofficial estimate⁹, around two-thirds of works councils¹⁰ reported in 2002 that wages and salaries above the collectively agreed rates were paid in their establishments.

4.4 In terms of relativity in wage growth, the index of collectively agreed wages rose at an average annual rate of about 2% from 2000 to 2006. This was slightly faster than the corresponding growth of 1.8% for the average gross hourly wage rate in the manufacturing sector, but was slower than that of 2.7% for the average gross monthly salaries in the combined coverage of the manufacturing, distributive trade, credit and insurance sectors. Conceivably, the divergence was attributable to additional payments over agreed wages in terms of performance-related commissions and profit-related bonuses that were more common in the service sectors than in the manufacturing sector.

⁷ The average exchange rate of Euro against HK dollar in 2006 was €1 = HK\$9.76.

⁸ The minimum hourly wage rates in the construction sector are revised every September. The revision in 2006 pertained to a mild increase of €0.1 (HK\$1.0) for both eastern and western Germany.

⁹ Based on a survey conducted by the German Institute for Economics and Social Science (WSI) in 2002.

¹⁰ In an establishment regularly employing five or more employees, its employees may decide to elect a works council to represent their interests. One of the main tasks for a works council is to monitor the employer's compliance with the applicable collective agreements, but the council is not permitted to engage in collective bargaining directly.

Table 3 – Growth of collectively agreed wages⁽¹⁾ vis-à-vis growth of market wages and consumer inflation

Indicator	2000	2006	Average annual change during 2000-2006 (%)
Index of collectively agreed wages of manual workers (=100 in 2000)	100.0	111.9	1.9
Index of collectively agreed wages of non-manual workers (=100 in 2000)	100.0	112.4	2.0
Consumer price index (=100 in 2005)	92.7	101.6	1.5
Average gross hourly wages in the manufacturing sector	€4.0 ⁽²⁾ (HK\$103.2)	€5.6 ⁽³⁾ (HK\$152.3)	1.8
Average gross monthly earnings in the manufacturing, distributive trade, credit and insurance sectors	€984 (HK\$21,992.1)	€3,510 (HK\$34,257.6)	2.7

Notes: (1) The index is based on selected collective agreements in the manufacturing, wholesale and retail trade, financial intermediation, transport, storage and communications sectors, and the central, regional and local authorities.

(2) The average exchange rate of Euro against HK dollar in 2002 was €1 = HK\$7.37.

(3) The average exchange rate of Euro against HK dollar in 2006 was €1 = HK\$9.76.

Sources: Federal Statistics Office of Germany; Organisation for Economic Co-operation and Development (OECD).

5. Characteristics of minimum wage workers

5.1 According to the Federal Employment Agency of Germany, about 65% of the employees in western Germany and about 54% of the employees in eastern Germany were covered by collective agreements in 2006.

5.2 Most of the major economic sectors, including agriculture, manufacturing, construction and services, witnessed a majority of their employees covered by collective agreements in 2004. Despite more extensive use of company-level agreements in recent years, a majority of such collective agreements remained concluded at the sector level.

5.3 Analysed by firm size, the employees in larger enterprises are more likely to be covered by collective agreements. It was estimated¹¹ that the proportion of enterprises hiring more than 1 000 employees with collective agreements reached 82% – 89% in 2004-2006. This was higher than the corresponding proportions of 57% – 77% for enterprises with 100 – 1 000 employees, and 22% – 48% for enterprises hiring less than 100 employees.

5.4 In a recent study, it is estimated¹² that there are about 1.4 million workers in the six sectors covered by the *Posted Workers Act*. This accounts for about 6% of the employees covered by collective agreements and 4% of the employee population in Germany.

Table 4 – Collective bargaining coverage of employees in 2006 (expressed as % of covered employees to total number of employees)

Sector	Collective agreements concluded at:					
	Sector level		Company level		Combined total	
	West	East	West	East	West	East
Agriculture	55	14	*	*	55	14
Mining and energy	77	48	14	40	91	88
Raw materials processing	59	37	12	11	71	48
Manufacture of investment goods	59	22	10	17	69	39
Manufacture of consumer goods	58	31	9	12	67	43
Construction	73	48	3	7	76	55
Trade and repair	50	31	6	6	56	37
Transport and communications	44	24	15	32	59	56
Finance and insurance	85	72	2	*	87	72
Business services	35	42	8	7	43	49
Other services	56	38	8	15	64	53
Non-profit sectors	53	30	7	28	60	58
Public authorities	87	84	10	14	97	98
Total	57	41	8	13	65	54

Remark: * Insignificant number of cases.

Source: Institute for Employment Research, the Federal Employment Agency of Germany.

¹¹ Based on a survey conducted by the European Commission in its Industrial Relations and Social Dialogue Program during September 2004 – September 2006.

¹² Estimated by European Industrial Relations Observatory On-line in 2007.

6. Process of determining the minimum wage rates

Authority for determining the minimum wage rate

6.1 By virtue of the freedom of association guaranteed by the *German Federal Constitution*¹³, the rights of people to negotiate and conclude collective agreements independently are established.

6.2 The source of law for the collective bargaining system comes from the *Collective Agreement Act* enacted in 1949 and amended in 1969. The Act describes the rights of employers and employees to regulate the terms and conditions of employment on their own respective responsibility and independent of political influence. In other words, both employers and employees possess the autonomy and authority to determine the minimum wages concerning their own interests.

6.3 In practice, a collective bargaining agreement may be concluded on the employees' side by trade unions and on the employers' side either by a single employer or by an employers' association. Although there is no statutory definition of the notions "trade union" and "employers' association", the Federal Labour Court of Germany has established a set of criteria that the parties to collective agreements must fulfill. These criteria cover, *inter alia*, continuity of existence, competence in organisation, independence from political influence, and capability to exert pressure on and resist pressure from the counterpart in the bargaining process.

6.4 On the grounds of public interest, the government possesses the authority to declare a collective agreement generally binding for a given sector within a territorial scope through the issue of an Order Imposing Extension under the *Collective Agreement Act* or a ministerial directive under the *Posted Workers Act*. This places a legal obligation on non-parties in the sector concerned to apply the provisions of the agreement.

Criteria for determining the minimum wage rate

6.5 There are no statutory criteria for determination and adjustment of the minimum wage rate. Normally, the negotiating parties take into account the prevailing inflation, productivity growth and business performance in the bargaining process.

6.6 In deciding whether or not to declare a collectively agreed wage rate or scale generally binding for a sector, the government has to ensure that it is representative enough as a minimum wage indicator in that sector. It is for this reason that the employers bound by the collective agreement must have employed at least 50% of the employees working within the sectoral and geographical scopes relevant to the agreement.

¹³ Article 9 of the Basic Law viz. German Federal Constitution.

Procedure for determining the minimum wage rate

6.7 A collective agreement concluded after the bargaining process must be in writing and the employer side has to place the text of the agreement at the employees' disposal. Every collective agreement should be entered in the register of the Ministry of Labour and Social Affairs.

6.8 Collective agreements are usually concluded for a definite period, say one to two years, and end automatically when this period expires.

6.9 In the event that the bargaining parties are unable to reach an agreement, the arbitration proceedings involving official agencies shall apply, intending to reconcile conflicting interests and avoid industrial action. However, the proceedings are facilitative in nature and no compulsory state arbitration against the will of the parties concerned can be imposed. In other words, the parties concerned have the rights to refuse the proposal in the arbitration process.

6.10 If any one signatory party to an existing collective agreement seeks a mandatory sector-wide extension of its coverage, the party should apply to the Ministry of Labour and Social Affairs for declaration. The party is free to apply for either an Order Imposing Extension under the *Collective Agreement Act* or a ministerial directive under the *Posted Workers Act*. In both cases, the agreement in case must have already covered at least 50% of the employees in the defined scope of application. Prior to the Ministry's final decision which takes public interest into account, the request for an Order Imposing Extension requires the approval by a majority of at least four votes in a committee of six members comprising three representatives each from the umbrella organisations of employers and employees¹⁴. This requirement is unnecessary in seeking declaration through a ministerial directive under the *Posted Workers Act*.

7. Enforcement and penalty

Enforcement

7.1 The enforcement mechanism for regulations governing wage-setting through collective bargaining primarily relies on self-reporting by the stakeholders to protect their own interests and subsequent legal proceedings for valid litigations. The government does not perform a proactive role in monitoring due to practical difficulties arising from massive collective agreements with diverse structures and specifications. It is only for the six sectors covered by the *Posted Workers Act* that the customs authority regularly inspects against illegal employment of foreign workers and non-compliance with the statutory sector-specific minimum wages.

¹⁴ The umbrella organisations refer to the National Union of German Employer Associations on the employer side and the Confederation of German Trade Unions on the employee side. Three representatives together with at least three replacements on each side are nominated by the two organisations respectively and then appointed by the Ministry of Labour and Social Affairs. For the sake of neutrality, the representatives handling an application must not come from the sector that the collective agreement is involved in. In the event of such coincidence, the participation shall be taken up by the replacement representatives in other sectors.

7.2 Once concluded, a collective bargaining agreement is legally binding for all members of the signatory parties on the employer and employee sides. Without opening clauses mutually agreed, it is unlawful for an employer bound by the agreement to offer wages and other employment terms which are less favourable than those prescribed in the agreement. It is also unlawful for the employees to take industrial action over wage issues already resolved by the agreement. During the agreement period, neither employers nor employees can escape from the binding effect of a collective agreement by leaving the signatory parties representing them.

7.3 Individual employees and works council within an establishment may sue their employer if the latter unilaterally offers wages and other fringe benefits less than the agreed levels. The case may be put to the representing trade unions which are entitled to bring a claim into the Federal Labour Court or regional labour courts for ruling.

Penal provisions

7.4 Normally, collective agreements do not provide for penalties against breaching the agreements. If an employer pays wages less than the applicable minimum wages, it is liable to refund to the affected employees only the arrears in wages.

7.5 Nevertheless, the employers in the sectors covered by the *Posted Workers Act* are not only liable to wage refunds but also subject to administrative fines up to €500,000 (HK\$5.35 million) and exclusion from competition for supply, works and services contracts.

8. Empirical studies on the minimum wage system

8.1 In recent years, there has been a heated public debate in Germany on whether a statutory national minimum wage should be introduced. Supporters generally opine that it can help ensure an acceptable living standard for the working poor, stimulate consumption, and generate the incentives for the unemployed to re-enter the labour market. However, opponents worry that without fitting into the unique situations in different sectors and regions, an across-the-board wage floor may cause significant job losses by pricing the marginally employed out of the market.

8.2 A research institute of the Federal Employment Agency of Germany has conducted a study on the impact of minimum wage in the construction sector¹⁵. The study reveals that the introduction of minimum wages has had positive impact on the wage levels of low-pay employees in the sector in both western and eastern Germany. However, the employment impact is insignificant in western Germany and negative in eastern Germany.

¹⁵ König & Moller (2007).

8.3 As regards the debatable proposal for a statutory national minimum wage, the German government has not published any research report regarding the possible impact on the labour market. Yet there were some empirical studies conducted by academics. According to a study by the Institute for Work and Technology (IAT)¹⁶, the introduction of a statutory national minimum wage, if set at €7.5 (HK\$80.2)¹⁷ per hour as proposed by the German Labour Alliance, would raise income for some 15% of employees in Germany. The beneficiaries would mainly comprise female and low-skill workers, particularly those in small enterprises and lower-skill service sectors. However, the additional labour cost borne on the employers would be in the range of €10 billion (HK\$106.9 billion) – €12 billion (HK\$128.3 billion) annually. This is roughly equivalent to around 1% of the total annual employee compensations in Germany. It should be noted that this percentage represents only an economy-wide average. The actual cost impact is reckoned to be higher for those sectors and enterprises hiring more low-wage workers.

8.4 Another study on the subject was conducted by Joachim Ragnitz and Marcel Thum¹⁸, two economists from the Ifo Institute for Economic Research at the University of Munich. While acknowledging the benefits to those workers who manage to keep their jobs after a pay raise, the study indicates that a statutory national minimum wage of €7.5 (HK\$80.2) per hour would lead to a reduction in low-wage employment of around 1.1 million. This job loss would comprise around 0.8 million workers or 3% of employees in western Germany and around 0.3 million workers or 6.4% of employees in eastern Germany. The additional labour cost thus borne on the employers is estimated at €3.2 billion (HK\$34.2 billion) or 0.2% of the total amount of wages and salaries paid annually in Germany.

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¹⁶ European Industrial Relations Observatory On-line (2006).

¹⁷ The average exchange rate of Euro against HK dollar in 2007 was €1 = HK\$10.69.

¹⁸ Ragnitz & Thum (2007).

Appendix**Selected economic and labour statistics of Germany in 2006**

Population	82.4 million
Labour force	43.3 million
Employment <i>Of which: employees</i>	39.0 million <i>34.6 million</i>
Average unemployment rate	9.8%
Gross domestic product at current market prices	US\$2,916 billion
Per capita gross domestic product at current market prices	US\$35,433
Consumer inflation rate	1.6%

Sources: Federal Statistics Office of Germany; International Monetary Fund.

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