

# German Debates on Inequality and Public Policy

Ulrike STEIN

**In these turbulent times, the vivid empirical material and proposals for reform provided by Thomas Piketty's book *Capital in the Twenty-First Century* bring new grist to the inequality debate in Germany. The "Piketty effect" is visible in many areas even before the release of the German edition, and both supporters and opponents of his work seize the opportunity to publicize their arguments on the subject of inequality.**

## **The Piketty Debate in the German Context**

To put things in a national context, Germany has paid a heavy price for a supply-driven economic policy that has been dominant since the 1970s. After a brief period when policy focused on collective negotiation, solidarity and wage-levelling, in the wake of the 1967 *Stability and Growth Act*, priority was given to lowering comparative labour costs through wage moderation, labour market deregulation and the reduction of non-wage labour costs. Up to the outbreak of the global economic and financial crisis, this policy approach has dominated politics and economics.

The effects of this policy are evident in many areas. Inequality has increased in Germany. The deregulation of the labour market and the weakening of collective bargaining standards have led to the emergence of a dual labour market, characterised by a large low-wage sector (Kalina and Weinkopf 2013). For part of the population, increasing inequality has not only been associated with diverging incomes, but also with real income losses for part of the population (Grabka and Goebel 2013).

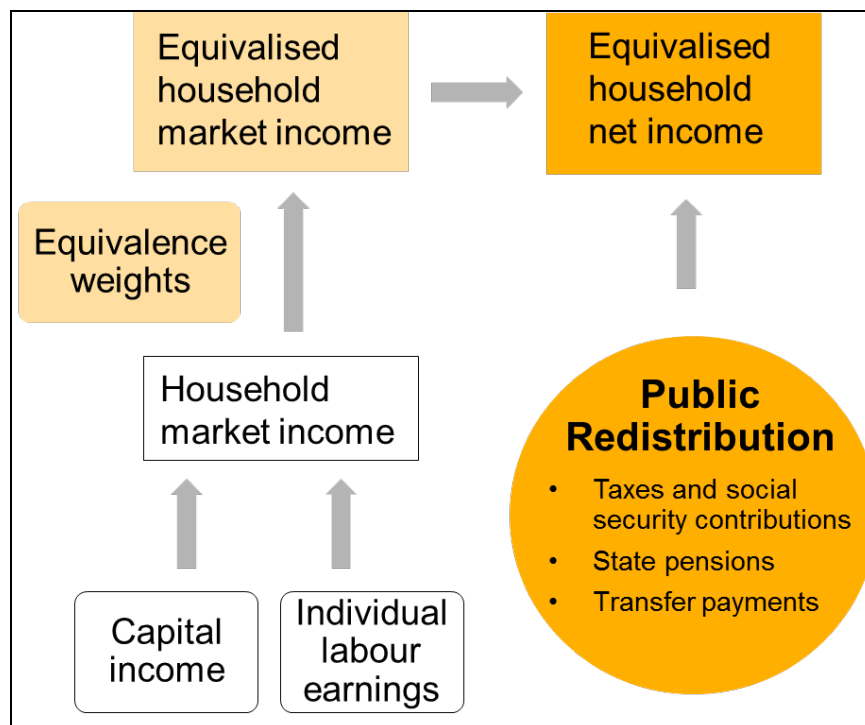
The sharp increase in income inequality, especially in the first half of the 2000s, is now perceived as a problem: a subject of public discussion and an integral part of political debates, which focus on ascertaining whether the rise in inequality has been the result or the cause of long-lasting economic weakness and stagnation. More and more people consider the one-sided focus on the German export strength, combined with the urge to improve German competitiveness to be the real source of the problem. Meanwhile, very weak wage development has caused the growth of unit labour costs to lag dramatically behind other countries of the euro area. As a result enormous current account imbalances built up, which in turn contributed to the development of the crisis (Stein et al., 2012).

Although it remains to be seen whether there will be a paradigm shift in Germany, this double problem - the Euro crisis and inequality, inseparably linked - requires a change of policy. In spite of increased criticism of the current economic system, many still want to hold on to it, and feel confirmed by the strong performance of the German labour market, identifying the labour market reforms of 2003-2005 (Hartz reforms) as key to this improvement. For them the fact that income inequality has not increased further is already a success.

## Wealth and Income Inequality in Germany

Piketty's analyses shed an interesting light on German wealth distribution mainly because data is scarcer in Germany than in many other countries. There has been no need to collect such information since the German wealth tax was abolished in 1997, and the evaluation of wealth inequality is therefore usually based mainly on household surveys, leaving out very high fortunes. Despite the partial lack of data, it is undisputable that in Germany as in the United States, wealth is distributed extremely unevenly, more so than in any other country in the euro zone (Grabka and Westermeier 2014).

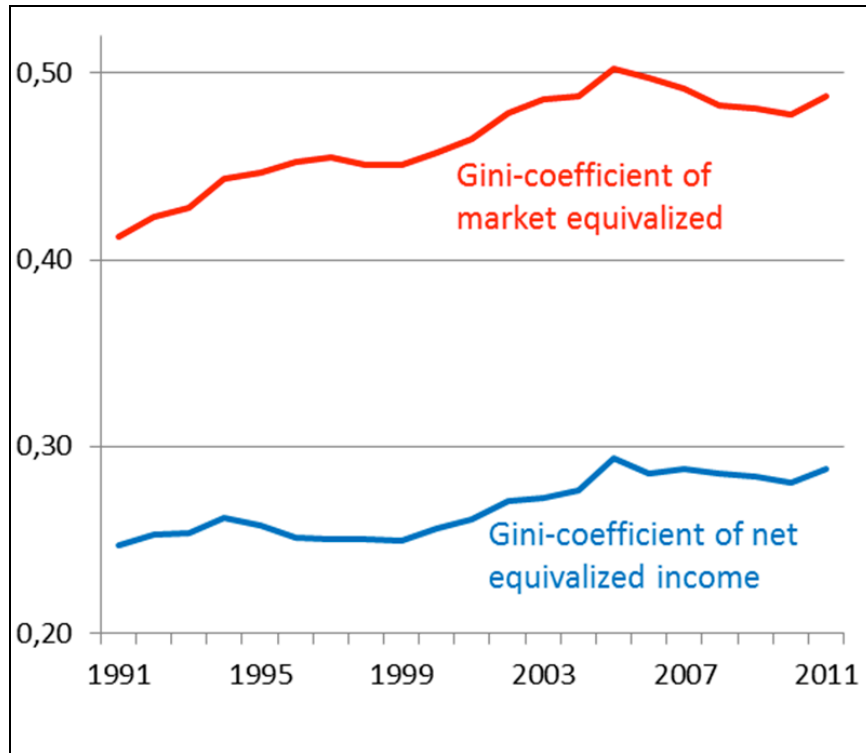
The data available for personal income distribution is much better. The increase in income inequality since the German unification is well documented and evident at all levels of the income distribution (Grabka and Goebel 2013, OECD 2008, OECD 2011, Schmid and Stein 2013, Schmid et al. 2013). However, one must distinguish between different concepts of income: while the equivalised household income (both market and net income) takes the redistributive impact of households into account, the concept of individual earned income does not (see Figure 1).



**Fig. 1: The concept of equivalised income – Factors influencing the distribution of income**

*Source: Stein, U. (2014): Erklärungsansätze für die Ungleichheitsentwicklung in Deutschland, forthcoming, Sozialer Fortschritt*

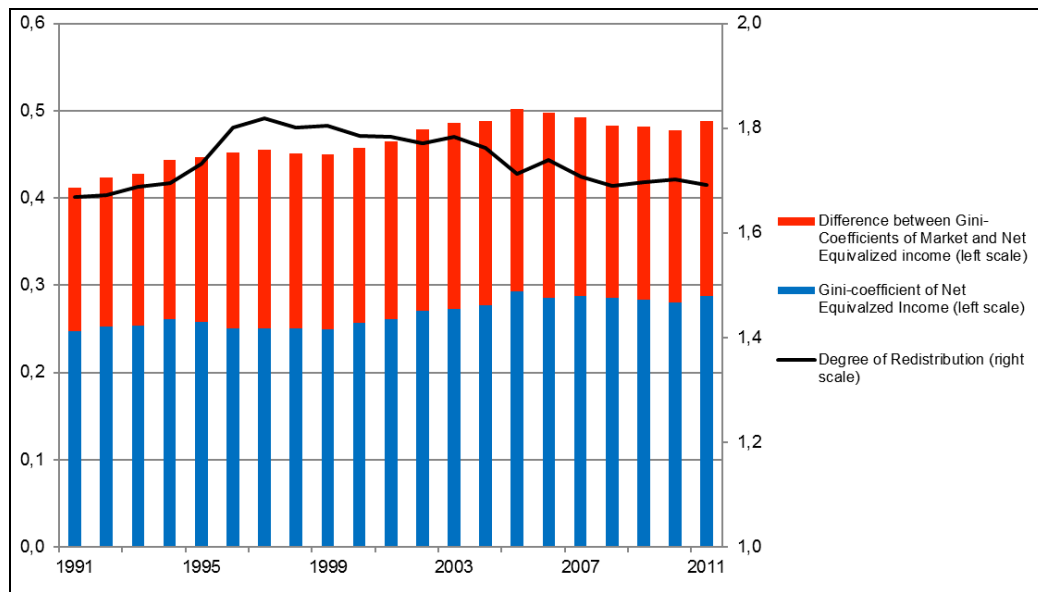
Whereas the inequality of household market income rose sharply from the German unification to 2005, and fell slightly after that, household net income followed a different pattern (Figure 2).



**Fig. 2: Gini-coefficients of equivalised incomes**

Sources: SOEP Group (2014), own representation

Inequality there was prevented from rising in the 1990s by the effectiveness of public redistribution. In the 2000s this public redistribution effect diminished gradually, and as a consequence inequality in net income increased significantly until 2005 (Figure 3), later to remain at a high level.



**Fig. 3: Effectiveness of redistribution from market to net income, 1991-2011**

Source: Updated version of Figure 5.1 in Schmid/Stein (2013).<sup>1</sup>

The good situation on the labour market is responsible for the decline in inequality of market income after 2005 (Figure 4). It is striking that inequality in net income has not declined to the same extent, and signs now point again to an increase rather than to a decline in income inequality (Grabka and Goebel 2013).

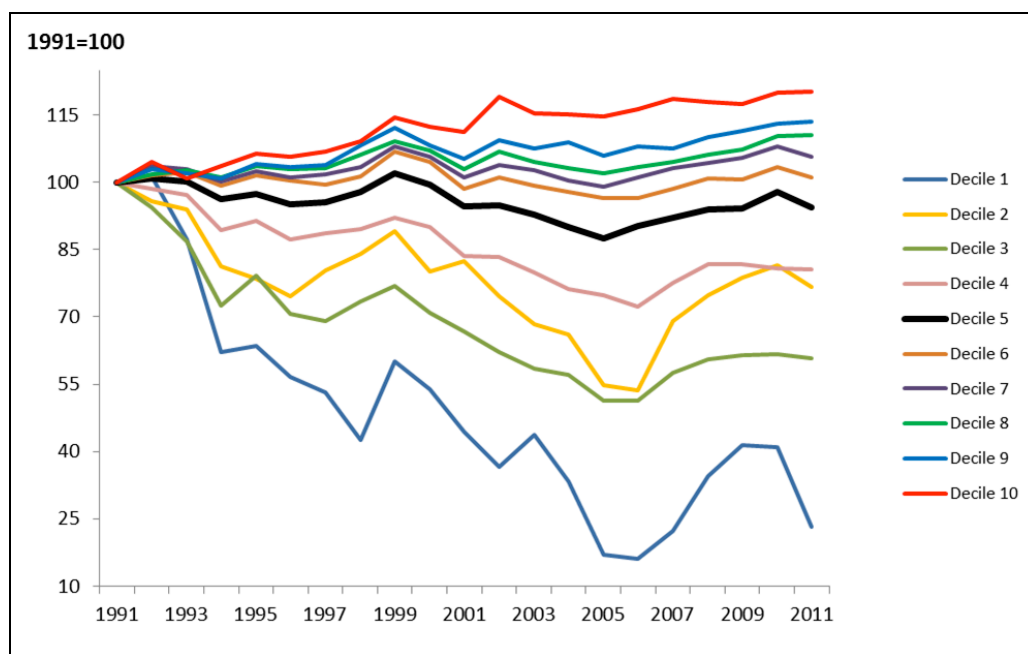
<sup>1</sup> This figure approximates the effectiveness of the tax and public transfer system in redistributing market income among households for Germany from 1991-2011. We contrast the Gini coefficients of net with market equivalised income. The dark red line illustrates the ratio of the two concentration measures and captures the degree to which market income is redistributed

	Market Equivalised Income	Net Equivalised Income
<b>1991-2010: Long-term trend</b>	Steady increase in inequality through: <ul style="list-style-type: none"> <li>declining household size, shifts in age and education structure, increasing significance of atypical employment, rising capital income shares</li> <li>additionally, increasing wage spread among full-time employees</li> </ul>	Rising inequality through: <ul style="list-style-type: none"> <li>steady increase in concentration of market income</li> <li>decreasing redistributive effect of tax and public transfers</li> </ul>
<b>2000-2005: Acceleration</b>	Slight acceleration of the increase in income concentration due to: <ul style="list-style-type: none"> <li>rising unemployment, increase in atypical employment, strong increase of capital income shares</li> </ul>	Significant increase in concentration through: <ul style="list-style-type: none"> <li>accelerated concentration of market income</li> <li>cut of the maximum income tax rate</li> </ul>
<b>2006-2010: Stagnation</b>	Decreasing inequality from 2006 onwards because of: <ul style="list-style-type: none"> <li>strong increase in employment</li> <li>no further expansion of the share of atypical employment</li> </ul>	No further increase in inequality since 2005 because of: <ul style="list-style-type: none"> <li>decreasing market income concentration</li> <li>reduced effectiveness of the taxes and public transfer system</li> </ul>

**Fig. 4: Main drivers of income inequality in Germany, 1991-2010**

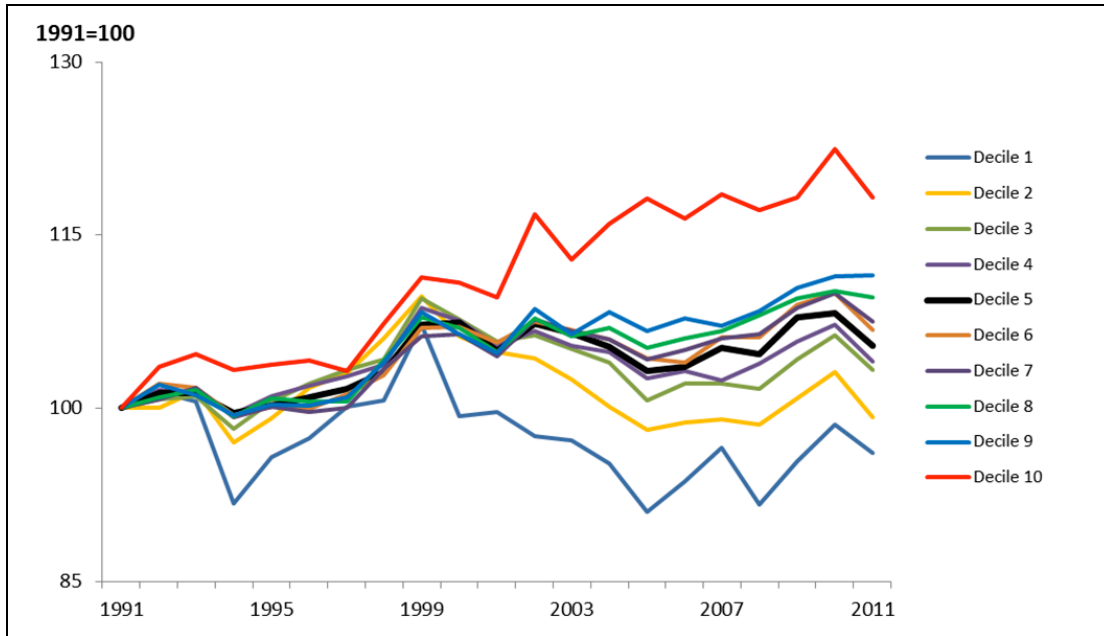
*Source: Modified version of Table 7.1 in Schmid/Stein (2013)*

By focusing on inequality measures one often forgets the evolution of the income levels themselves. An increase in inequality would be much more bearable in a society where all individuals would benefit from welfare gains. In Germany the opposite was true. The development of market income (Figure 5) shows that only the individuals at the top of the income distribution experienced real income gains.



**Fig. 5: Development of gross income sorted by deciles**

In contrast many individuals at the bottom end of the income distribution suffered real income losses. In terms of net income (Figure 6) the development was less dramatic in the 1990s, but in the 2000s we find that the bottom 40 percent of the income distribution did not participate in the welfare gains, and had to cope with real income losses.



**Fig. 6: Development of net income sorted by deciles**

Sources: SOEP v29l, author's own calculations<sup>2</sup>

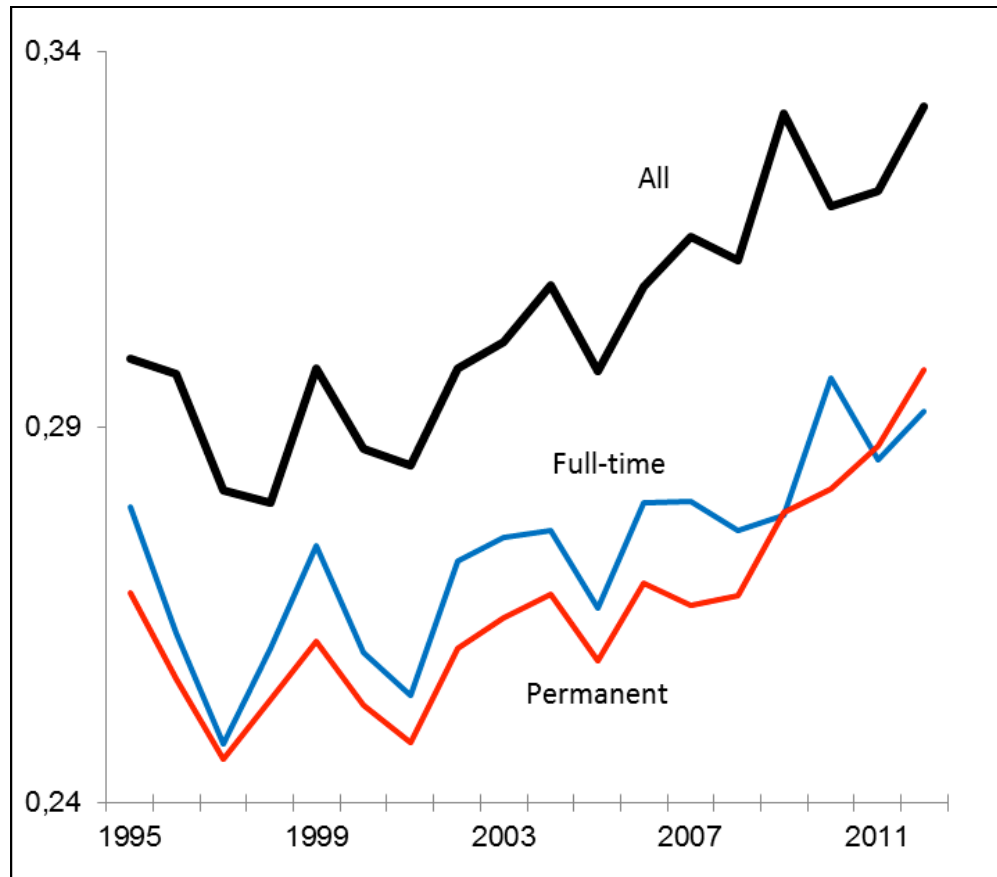
### The Conceptual Illusions of Inequality

In Germany the focus on net income, and the concept of net equivalised household income on which we base our measures of inequality tend to mask the persistent increase in the inequality of earned income (even after 2005). As well as market income from capital and employment, this concept of income also comprises taxes and transfer payments from the state. In addition, it takes into account not only public redistribution but also redistribution within households, which is particularly pronounced in Germany (Lohmann and Andreß 2011). These can work in opposite directions and cancel each other out with the effect that the overall income inequality might remain unchanged. Thus, despite rising earnings inequality, but due to the crisis-induced fall in capital income, the concentration of inequality of net income has not risen since 2005 (Grabka and Goebel 2013).

If we look at earned income alone without the different redistribution mechanisms (in the household context or through tax and public redistribution), it is a worrying picture. Wage inequality has increased at both ends of the wage distribution: in the upper

<sup>2</sup> The figure illustrates the development of real net equivalised incomes by deciles in Germany from 1991-2011 at 2005 prices. Incomes by deciles refer to the median incomes for each decile. Incomes are needs-weighted using the modified OECD equivalence scale.

tail in the 1980s, and at the bottom since the 1990s (Fitzenberger 2012). Even when only full-time workers are considered in the analysis, the data from the employment statistics show an increase in the pay spread (IAB 2013). My own analysis of wage inequality based on gross hourly wages also shows the increase in inequality of labour earnings (Figure 7).



**Fig. 7 : Gini-coefficients hourly gross wages**

*Sources: SOEP v29l, author's own calculations*

Lately, the problem of the rising spread of labour earnings has become a subject for public debate, even for individuals and institutions which had previously been strong supporters of the German system of wage moderation and had taken every opportunity to defend further supply-side economic policy. The German Federal Bank has recently argued for higher wage settlements (Bundesbank 2014), and the OECD (2014) has shown that increased numbers of low-income earners and workers in atypical employment have not benefited equally from the economic boom. They also criticise the high relative risk of poverty, which has not been reduced despite the good performance of the German labour market, and denounce the fact that the upward mobility of low-income workers has decreased.

Piketty has shown that the returns from capital increased faster than the growth rates of GDP and labour income. This would not be a problem if capital were equally

distributed across all individuals. However, this is not the case, and a chosen few benefit from social prosperity more than the majority. This also implies that there are no equal opportunities or performance-related fairness: prosperity in Germany depends largely upon how rich the family is, what somebody inherits or how rich someone is getting married to. The combination of lack of upward mobility and growing inequality is a source of enormous social unrest.

### **An Urgent Need for Reform**

There are a large variety of measures available to correct these trends. Two tackle inequality at the source. These are measures aiming to reduce the inequality of capital income and wealth concentration, on the one hand: changing inheritance tax by reducing the generous exemptions in the case of inherited firms, for instance, or undoing the flat tax on capital income to equalise the taxation of capital and labour income, or reactivating property tax (with the advantage that information on wealth in Germany would inevitably be recorded again). Another series of measures aims to reduce the inequality of labour earnings which accounts for the largest part of market income: by stabilising the collective bargaining system, reducing the low-wage sector and strengthening earned labour incomes. The legal minimum wage, due to come into effect on January 1<sup>st</sup>, 2015 in Germany, will prevent further downward pressure on wages and stabilise wages at the bottom of the distribution. The argument put forward by some opponents of the minimum wage, that it will lead to massive job losses, is empirically unfounded (e.g. Schmitt 2013, Reich et al. 2014, Bosch und Weinkopf 2014). Finally, the effectiveness of public redistribution needs to be strengthened again, because this determines how much of market income is left at the end as net income.

However, Germany will also face new challenges. For instance, the statutory pension scheme is also part of the public redistribution counted in the concept of net equivalised income. Recent reforms that led to a lowering of the pension entitlements, combined with the fact that future retirees will have more often interrupted work histories, will tend to boost income inequality, and if the government is not counteracting these effects a sustainable reduction in income inequality appears unlikely.

Society as a whole would benefit from a less unequal distribution: ironically, this interesting result was published by the International Monetary Fund (Ostry et al., 2014) demonstrate the advantages of egalitarian societies by showing a positive correlation between lower income inequality and faster and more sustainable economic growth. They also show that policy actually can do something about inequality, because public redistribution has no detrimental effect on growth.



### **Bibliography:**

Bosch, G., Weinkopf, C. (2014): *Zur Einführung des gesetzlichen Mindestlohns von 8,50 € in Deutschland*, Düsseldorf: Hans-Böckler-Stiftung. Arbeitspapier, Arbeit und Soziales; 304, [http://www.boeckler.de/pdf/p\\_arbp\\_304.pdf](http://www.boeckler.de/pdf/p_arbp_304.pdf).

Bundesbank (2014): „[Präsident Weidmann ordnet Bundesbank-Position in der Lohndebatte ein](#)“.

Fitzenberger, B. (2012): „Expertise zur Entwicklung der Lohnungleichheit in Deutschland, Arbeitspapier des Sachverständigenrates zur Begutachtung der gesamtwirtschaftlichen Entwicklung“, 04/2012, [http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/publikationen/arbeitspapier\\_04\\_2012.pdf](http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/publikationen/arbeitspapier_04_2012.pdf).

Grabka, M.M., Goebel, J. (2013): „Rückgang der Einkommensungleichheit stockt“, DIW Wochenbericht 46/2013, [http://www.diw.de/documents/publikationen/73/diw\\_01.c.431412.de/13-46-3.pdf](http://www.diw.de/documents/publikationen/73/diw_01.c.431412.de/13-46-3.pdf).

Grabka, M.M., Westermeier, C. (2014): „Anhaltend hohe Vermögensungleichheit in Deutschland“, DIW Wochenbericht 9/2014, [https://www.diw.de/documents/publikationen/73/diw\\_01.c.438710.de/14-9-1.pdf](https://www.diw.de/documents/publikationen/73/diw_01.c.438710.de/14-9-1.pdf).

IAB (2013): „IAB-Stellungnahme 3/2013 – Lebenslagen in Deutschland – Vierter Armuts- und Reichtumsbericht“, Institute for Employment Research (IAB), Nürnberg, <http://doku.iab.de/stellungnahme/2013/sn0313.pdf>.

Kalina, T., Weinkopf, C. (2013): „Niedriglohnbeschäftigung 2011 - Weiterhin arbeitet fast ein Viertel der Beschäftigten in Deutschland für einen Niedriglohn“, IAQ-Report 01/2013, <http://www.iaq.uni-due.de/iaq-report/2013/report2013-01.pdf>.

Lohmann, H., Andreß, H.-J. (2011): „Autonomie oder Armut? Zur Sicherung gleicher Chancen materieller Wohlfahrt durch Erwerbsarbeit“, *WSI-Mitteilungen*, 64(4), pp. 178-187, [http://www.boeckler.de/wsimit\\_2011\\_04\\_Andress.pdf](http://www.boeckler.de/wsimit_2011_04_Andress.pdf).

OECD (2008): “Growing Unequal? – Income Distribution and Poverty in OECD Countries”, [http://www.oecd-ilibrary.org/social-issues-migration-health/growing-unequal\\_9789264044197-en](http://www.oecd-ilibrary.org/social-issues-migration-health/growing-unequal_9789264044197-en).

OECD (2011): “Divided we Stand – Why Inequality Keeps Rising”, [http://www.oecd-ilibrary.org/social-issues-migration-health/the-causes-of-growing-inequalities-in-oecd-countries\\_9789264119536-en](http://www.oecd-ilibrary.org/social-issues-migration-health/the-causes-of-growing-inequalities-in-oecd-countries_9789264119536-en).

OECD (2014): „OECD-Wirtschaftsberichte: Deutschland 2014“, OECD Publishing [http://dx.doi.org/10.1787/eco\\_surveys-deu-2014-de](http://dx.doi.org/10.1787/eco_surveys-deu-2014-de).

Ostry, J.D., Andrew Berg, A., Tsangarides, C.G. (2014): “Redistribution, Inequality, and Growth”, IMF (International Monetary Fund) Staff Discussion Note, February 2014, <http://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>.

Piketty, T. (2014): *Capital in the Twenty-First Century*, Harvard University Press, Cambridge, Massachusetts.

Reich, M., Jacobs, K., Bernhardt, A. (2014): “Local Minimum Wage Laws: Impacts on Workers, Families and Businesses”, IRLE Working Paper No. 104-14, <http://irle.berkeley.edu/workingpapers/104-14.pdf>.

Schmid, K., Stein, U. (2013): “Explaining Rising Income Inequality in Germany, 1991-2010”, IMK Study 32, [http://www.boeckler.de/pdf/p\\_imk\\_study\\_32\\_2013.pdf](http://www.boeckler.de/pdf/p_imk_study_32_2013.pdf).

Schmid, K., Stein, U., Zwiener, R. (2013): „IMK-Verteilungsmonitor – Einkommensverteilung in Deutschland, 1991-2010“, [http://www.boeckler.de/pdf/imk\\_pj\\_vertelungsmonitor.pdf](http://www.boeckler.de/pdf/imk_pj_vertelungsmonitor.pdf).

Schmitt, J. (2013): “Why Does the Minimum Wage Have No Discernible Effect on Employment?”, CEPR, Washington, <http://www.cepr.net/documents/publications/minimum-wage-2013-02.pdf>.

SOEP Group (2014): “SOEP 2012 – SOEPmonitor Person 1984-2012 (SOEP v29)”, SOEP Survey Papers 193 - update: Series E, Berlin: DIW/SOEP, [http://panel.gsoep.de/soep-docs/surveypapers/diw\\_ssp0193.pdf](http://panel.gsoep.de/soep-docs/surveypapers/diw_ssp0193.pdf).

Stein, U., Stephan, S., Zwiener, R. (2012): „Zu schwache deutsche Arbeitskostenentwicklung belastet Europäische Währungsunion und soziale Sicherung. Arbeits- und Lohnstückkosten in 2011 und im 1. Halbjahr 2012“, IMK Report, Nr. 77, November 2012, [http://www.boeckler.de/pdf/p\\_imk\\_report\\_77\\_2012.pdf](http://www.boeckler.de/pdf/p_imk_report_77_2012.pdf).