Dr. Stefan Bach, Research Associate in the Public Economics Department at DIW Berlin

SIX QUESTIONS TO STEFAN BACH

»Redistribution Reduces Inequality in Household Incomes«

1. Dr. Bach, you have analyzed the impact of Germany's tax and transfer system on income redistribution. How are incomes distributed in Germany? Market income, in other words earned or capital income, is very unevenly distributed. The distribution of gross income (market income plus transfers such as pensions) also remains relatively imbalanced. Social security contributions and income tax are yet to be deducted from this income. But since income tax, in particular, has a highly progressive impact and is increasingly paid by the wealthier members of society, the distribution of net incomes is much more homogeneous. On balance, this means that the poorest 60 percent of the population receive money from the government and the richest 40 percent pay money to the government.
2. How large is the redistributive effect of the government tax and transfer system on households? If we use the Gini coefficient as a measure of inequality, Germany has a high level of income redistribution. For market income, this measure displays a relatively high inequality value of 0.5; the corresponding value for household disposable income is as low as 0.29. What is also clear, however, is that a substantial share of this redistribution is the result of the statutory pension system. In Germany, statutory pension insurance involves employees paying contributions over the course of their working lives which they then receive back when they retire in the form of pension payments. In this sense, it is an insurance which, when calculated over a lifetime, does not result in any appreciable redistribution. If this dimension is removed from the overall redistributive effect of the government tax and transfer system, total state redistribution is reduced by approximately half.
3. What are the most important benefits in the government transfer system? From a macroeconomic perspective, statutory pension benefits account for the largest share of government social security benefits. In the long term, though, this form of insurance does not have a significant redistributive effect insofar as the population has paid contributions for these benefits in the past. However, part of pension insurance falls under what are known as non-contribution-backed benefits which do not require contributions and are consequently part of the state redistribution system. Further, basic social security, which includes basic unemployment benefit II and social assistance for elderly also have a major redistributive effect as they are funded by tax revenues.
4. What percentage of GDP is spent on government transfers each year? Government transfer payments are the biggest item in Germany's entire national budget. Every year they account for 18 percent of GDP. This includes non-monetary government benefits within the social security system, such as healthcare. This clearly shows how important social welfare is to the national economy.
5. How have social security benefits developed in recent years? Social security benefits have remained relatively constant in relation to GDP. This is linked to the dominance of pension insurance. Of course there are certain natural fluctuations over the economic cycle. However, since Germany recovered quickly from the last major economic crisis following the global financial crisis, the impact on social security benefits was minimal.
6. How well targeted are state transfers? Do they really benefit those who actually need them? Unemployment benefit II and social assistance for elderly are of course carefully tailored to ensure that they reach the poor. Needs testing is used to help achieve this. In addition, there are also transfers such as child benefit or care allowance. Whether or not these benefits always actually achieve family policy aims is disputed, however.

Interview by Erich Wittenberg

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