IMK
Macroeconomic Policy Institute

The IMK is an institute of the Hans-Böckler-Stiftung

GERMAN TAX POLICY – A ROLE MODEL FOR BRAZIL?

International Seminar on Tax Systems

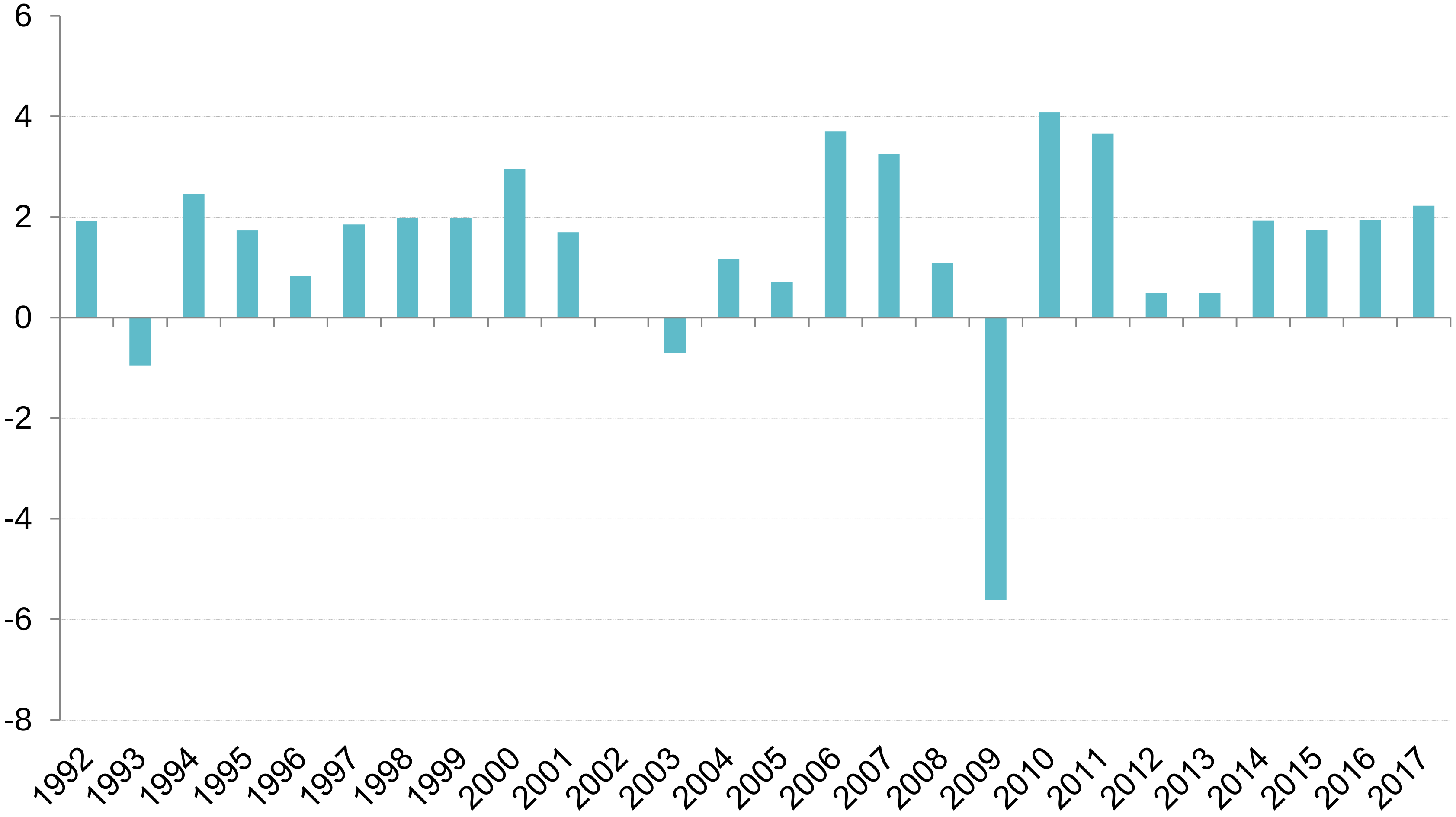
São Paulo, June 4th, 2018

Dr. Katja Rietzler

Overview

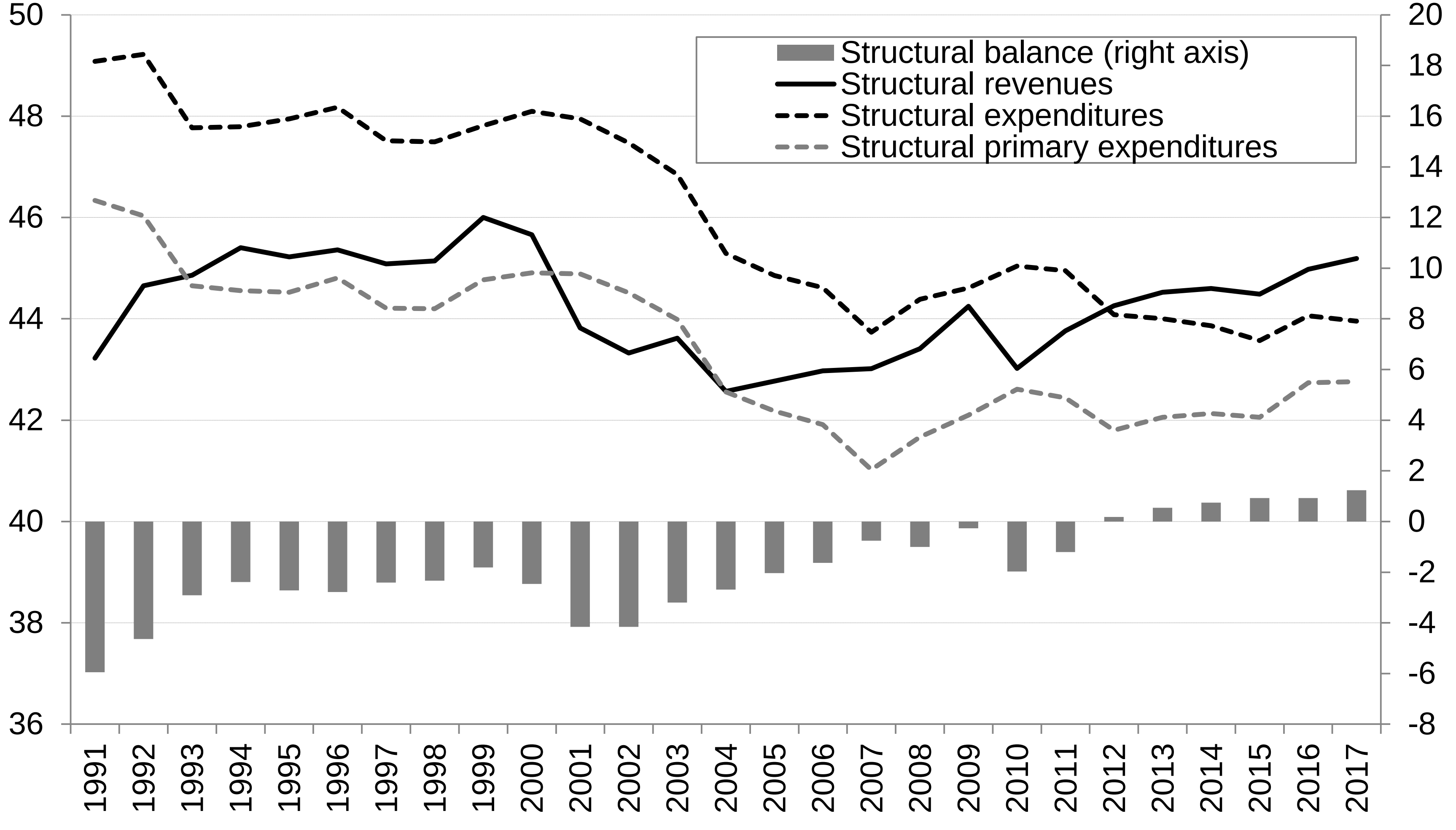
1. German Economy / Tax and social security system
2. Germany has an inequality problem
   - Large low pay sector
   - Income distribution
   - Wealth distribution
3. Inequality and taxation: recent trends and current problems
   - Progressivity of the tax system
   - Income taxation
   - Wealth taxation
   - Social contributions
4. Plans of the new federal government
5. Reform options for a more equitable tax system
6. Summary

Stable GDP growth (% over previous year)



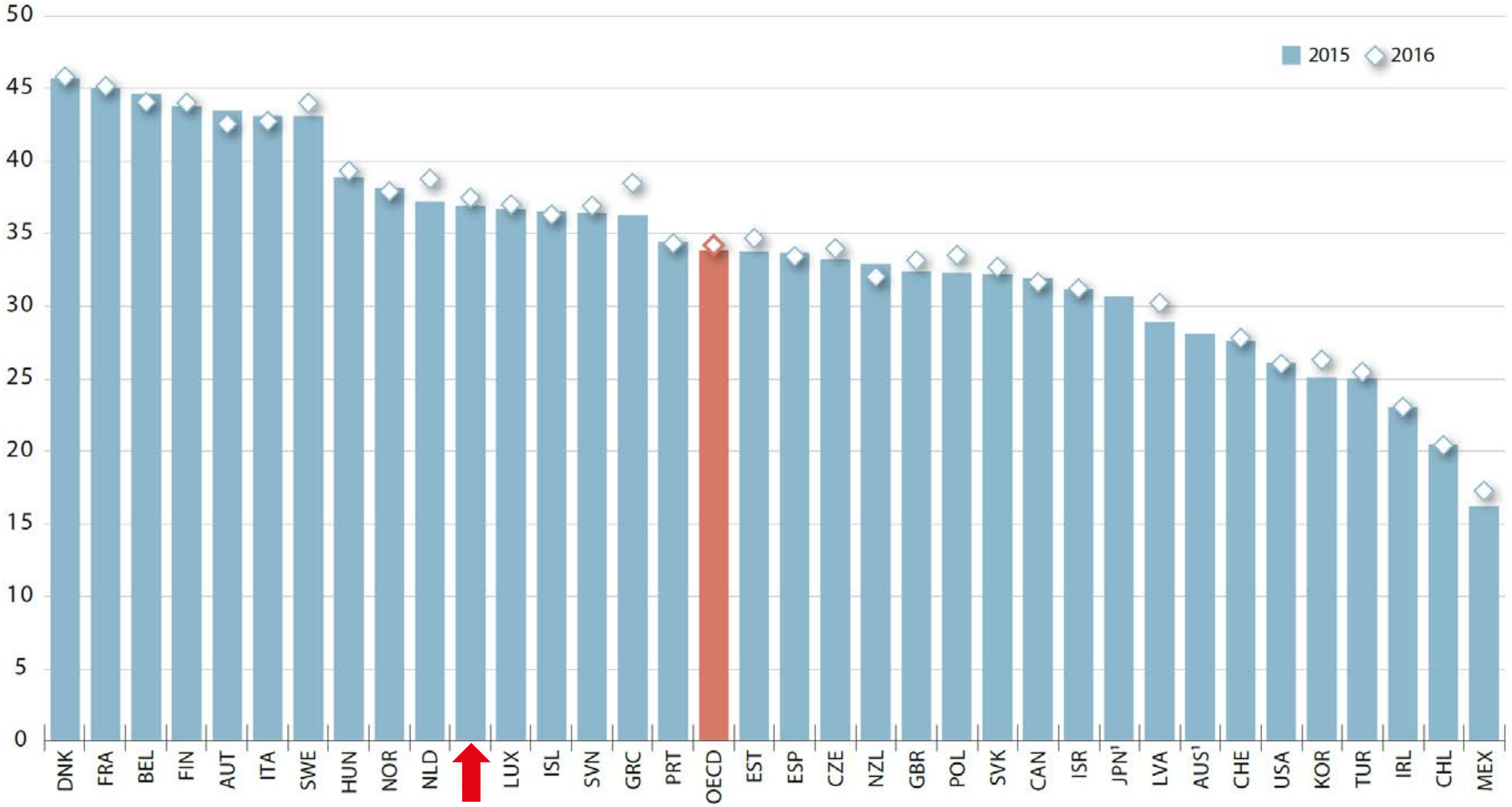
Source: Destatis.

Rapid budget consolidation after the economic and financial crisis (Data in % of pot. GDP)



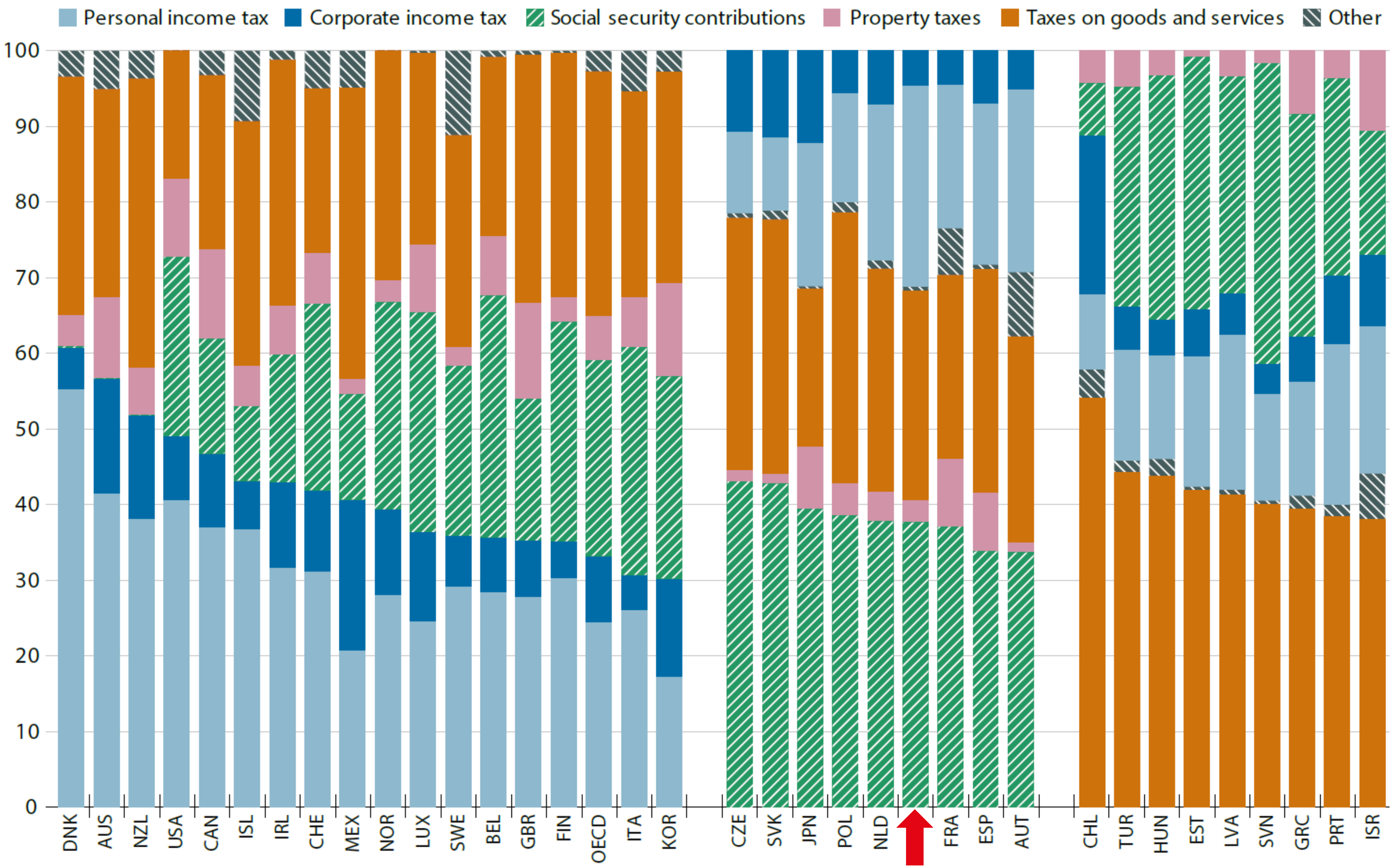
Source: Destatis, Federal Ministry of Finance, Federal Ministry of Economy and Technology, own calculations.

Tax-to-GDP ratio slightly above OECD average (%)



Source: OECD Revenue Statistics 2017.

Relatively high social contributions (%)



Source: OECD Revenue Statistics 2017.

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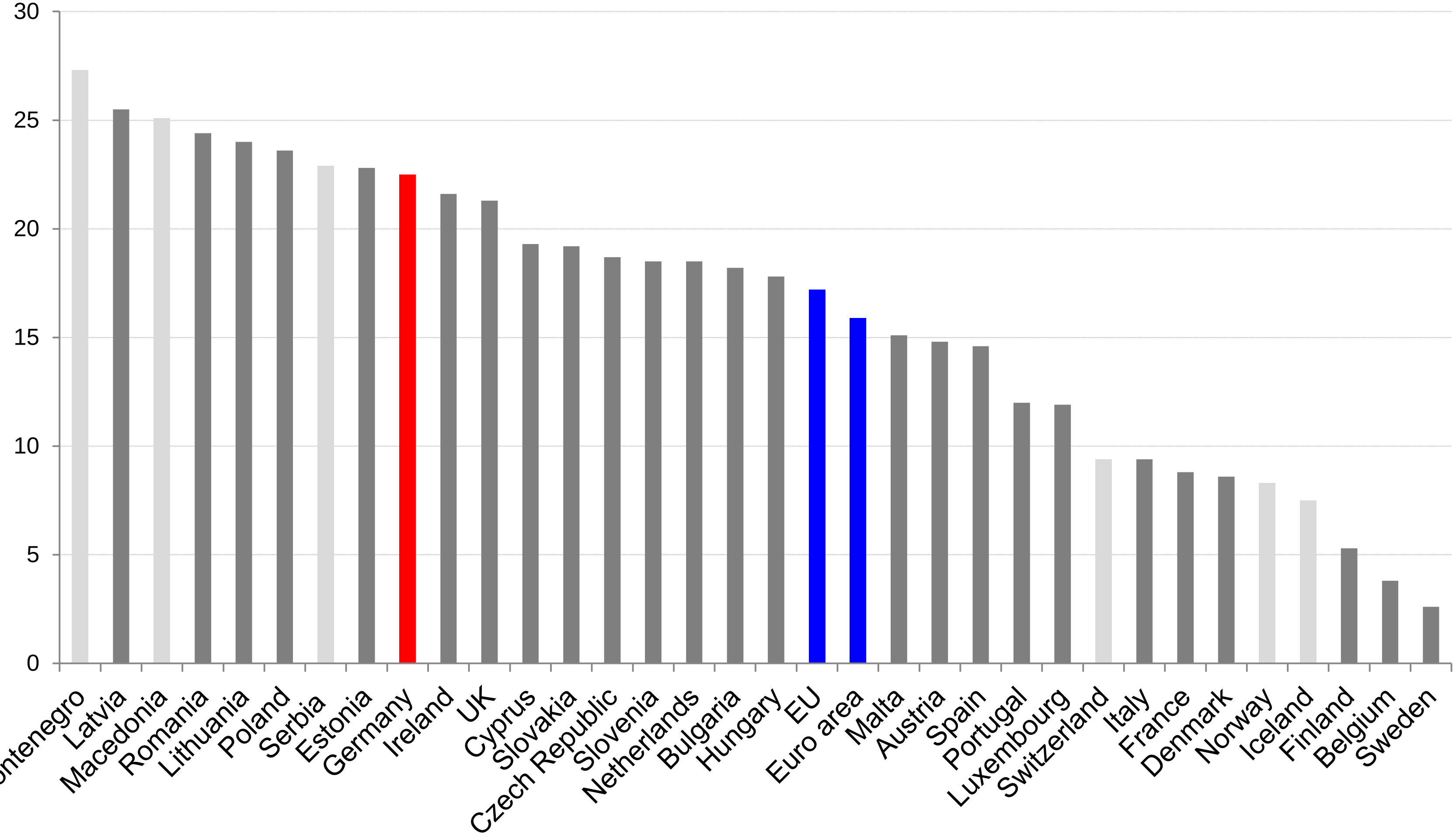
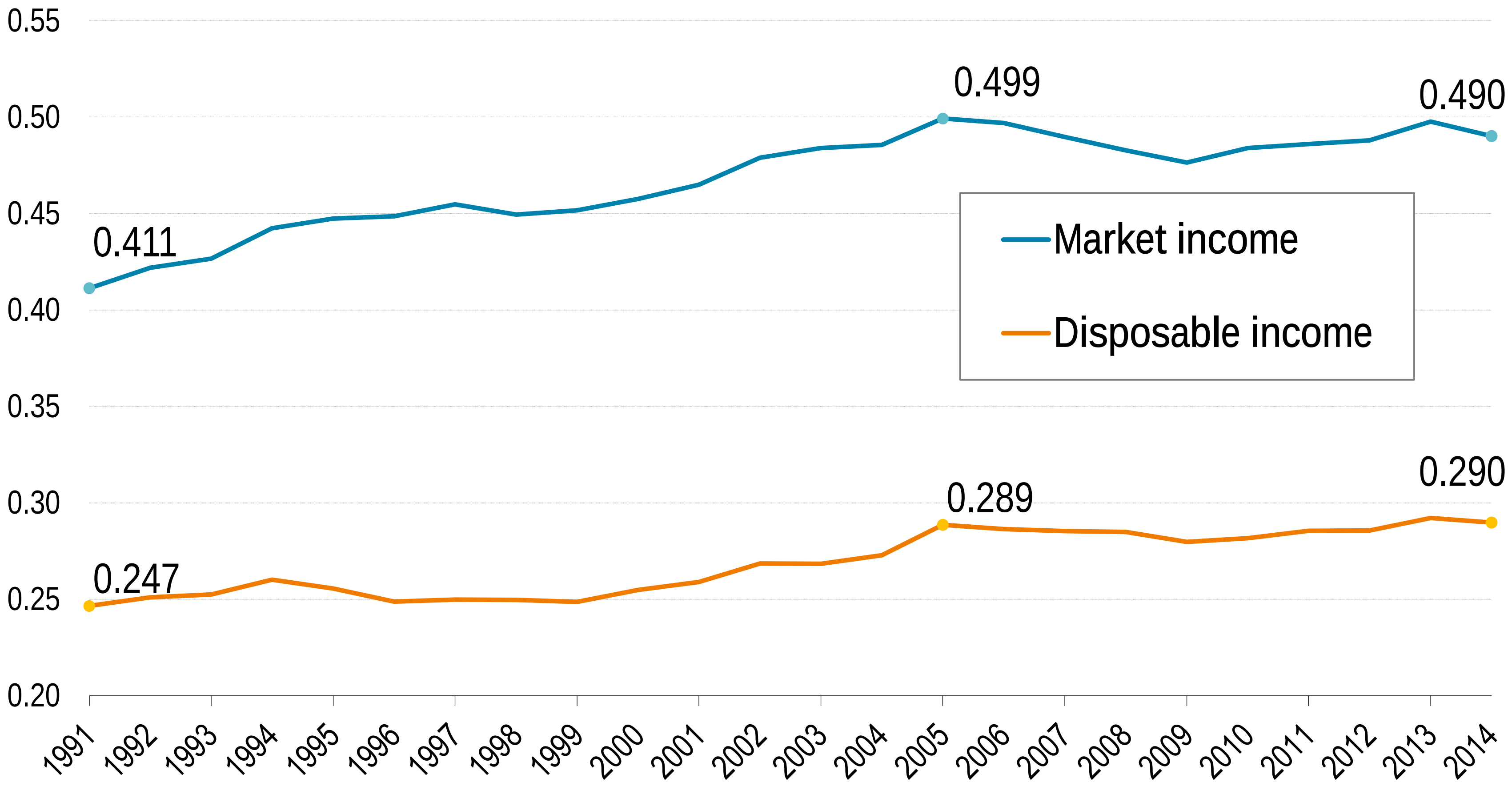
Large low pay sector (Low pay earners in % of total employees).



Source: Deutscher Bundestag (2017).

Income distribution has become more unequal since the 1990s (Gini-Coefficient)



Source: Horn et al. 2017.

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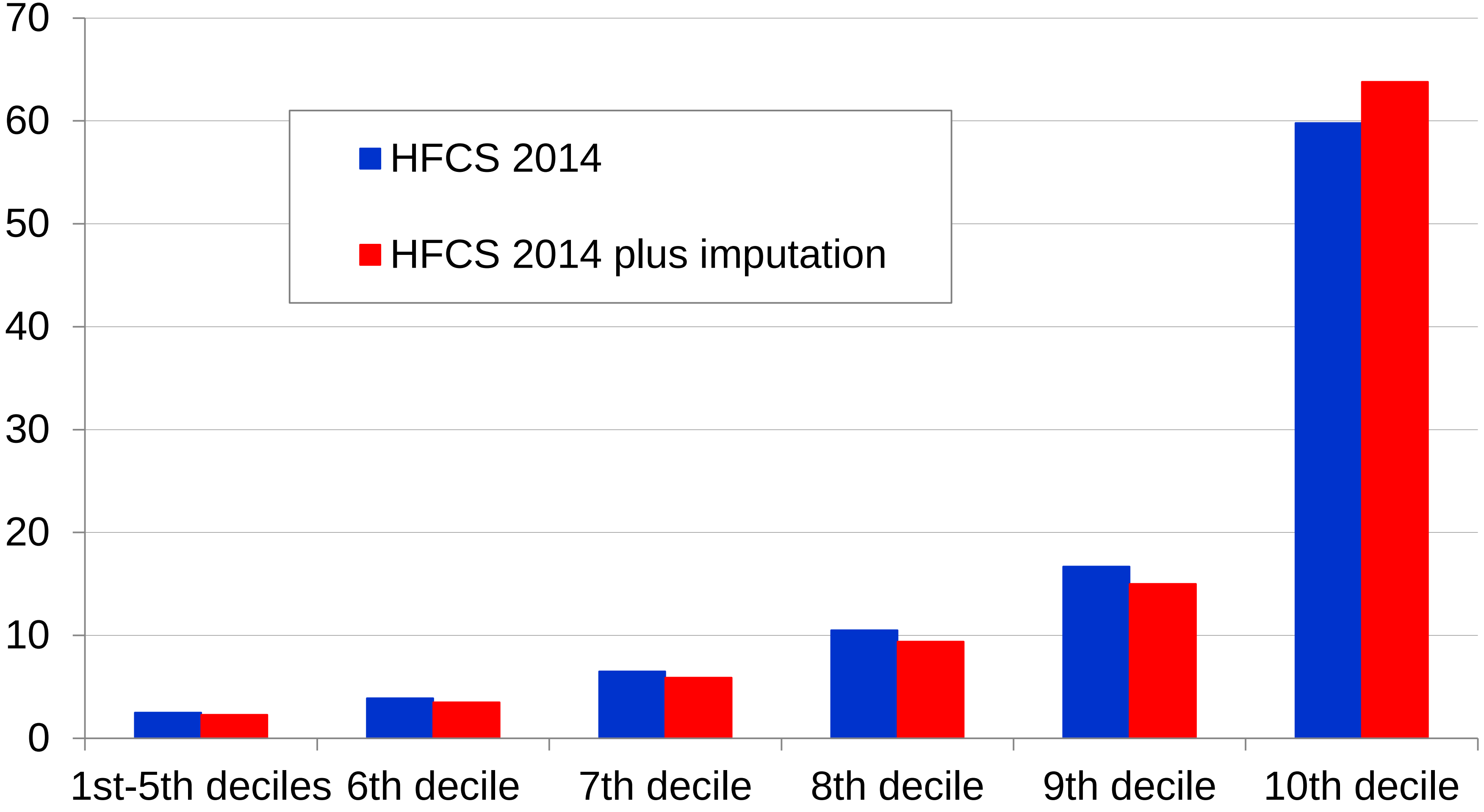
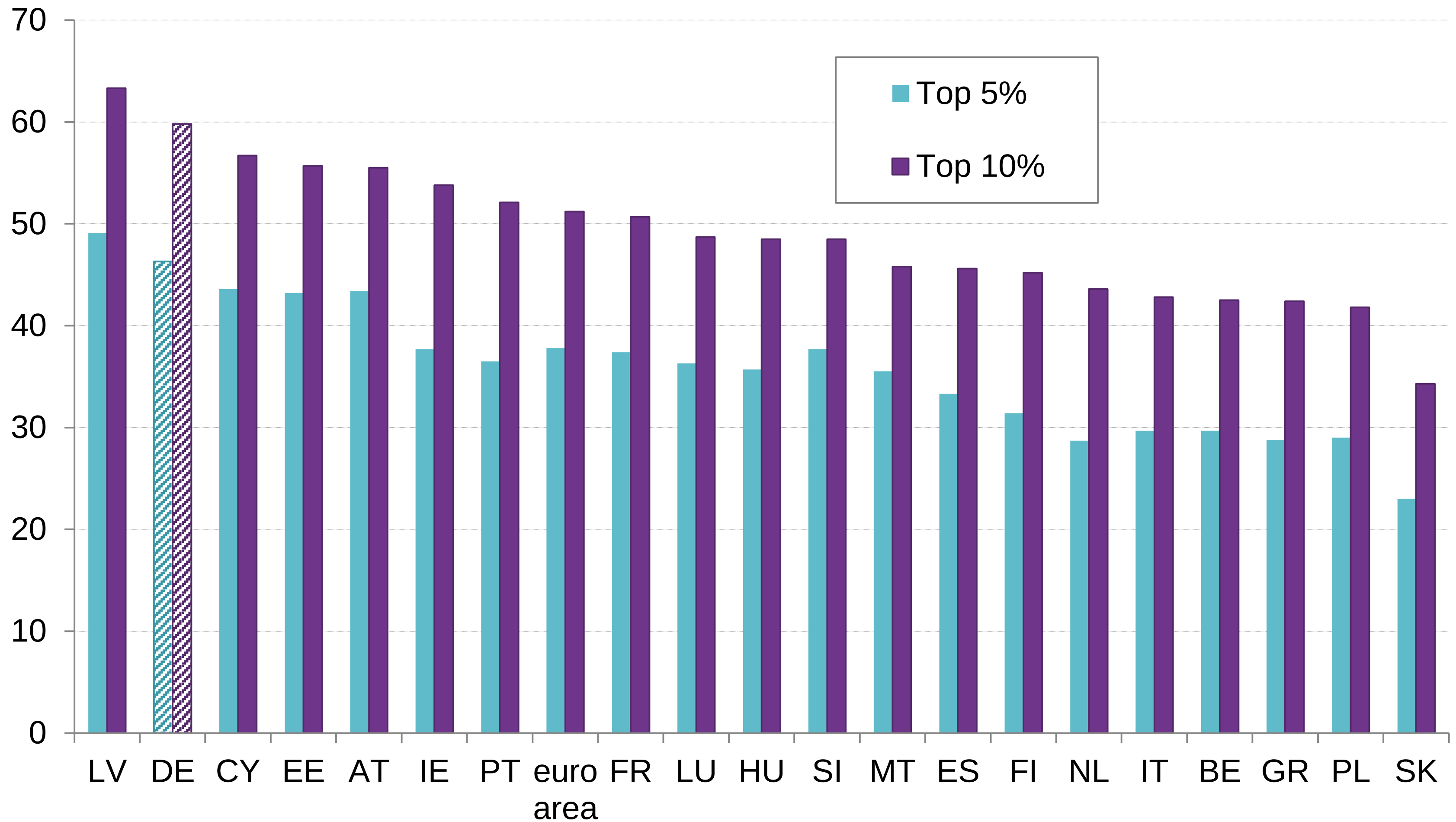
Very unequal wealth distribution (share of total wealth in %)



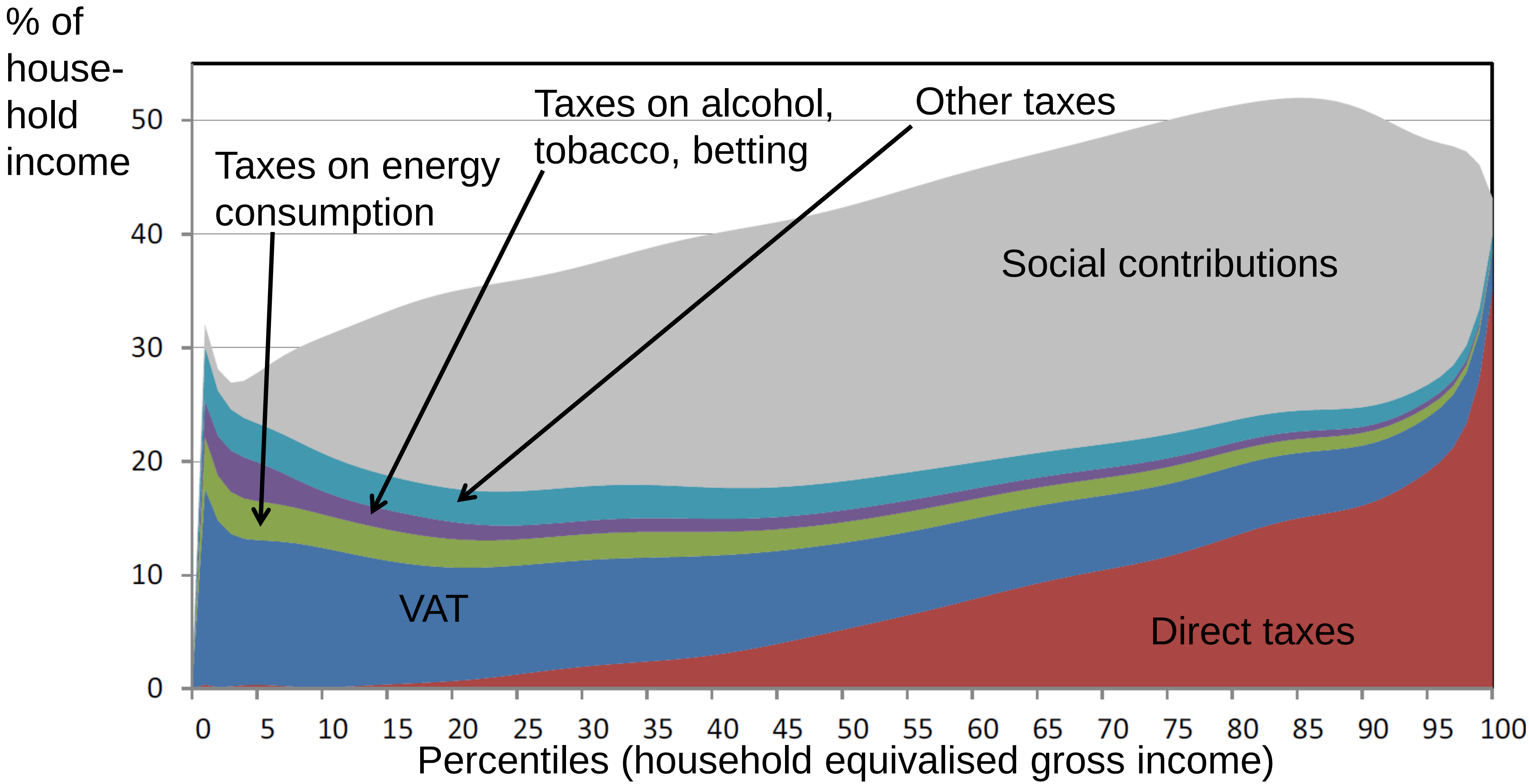
Source: Bach et al. (2018), DIW DP 1717.

Unequal wealth distribution compared to other EU-countries (top share in % of total wealth)



Source: ECB, 2nd wave of the Eurosystem's Household Finance and Consumption Survey (HFCS).

Total system partly regressive (2015 data)



Source: Bach et al. 2016, p. 61.

Progressivity and redistributions measures of the Tax system in 2015

	Direct taxes	Indirect taxes	Social contributions	Taxes	Taxes and social contributions
Progressivity measures					
Kakwani	0.343	-0.205	-0.014	0.104	0.048
Suits	**0.412**	**-0.218**	**-0.069**	**0.137**	**0.039**
Redistribution measures					
Musgrave-Thin	**1.085**	**0.960**	**0.988**	**1.049**	**1.045**
Reynolds-Smolensky	0.051	-0.024	-0.007	0.030	0.027

Source: Bach et al. 2016 (p. 60)

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Summary: Progressivity of the German tax system

1. Income tax (including solidarity surcharge) is highly progressive.

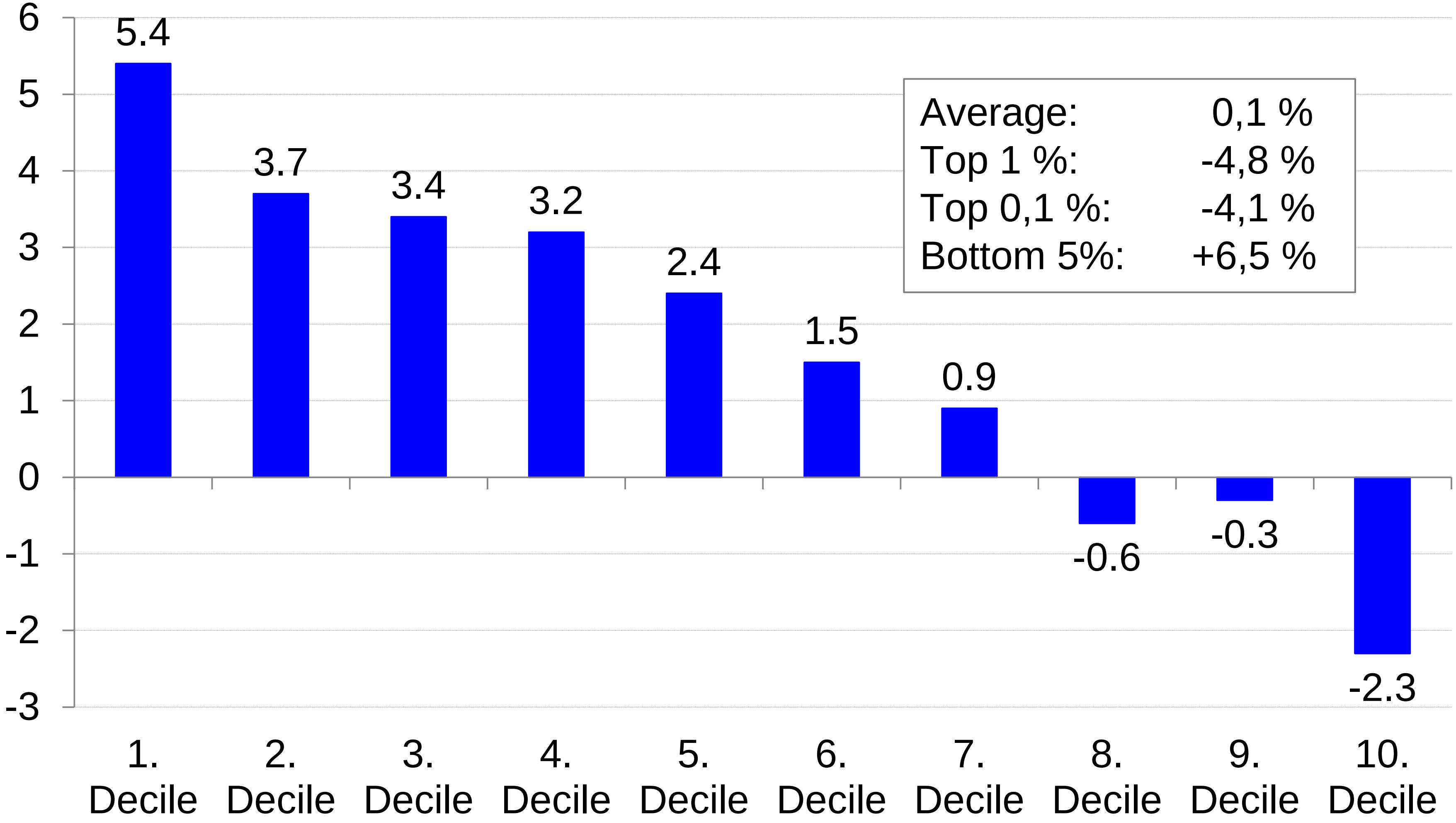
2. Indirect taxes are strongly regressive.

3. Social contributions are regressive, but less so than indirect taxes.

4. Total taxes are regressive at the bottom of the distribution and progressive at the top.

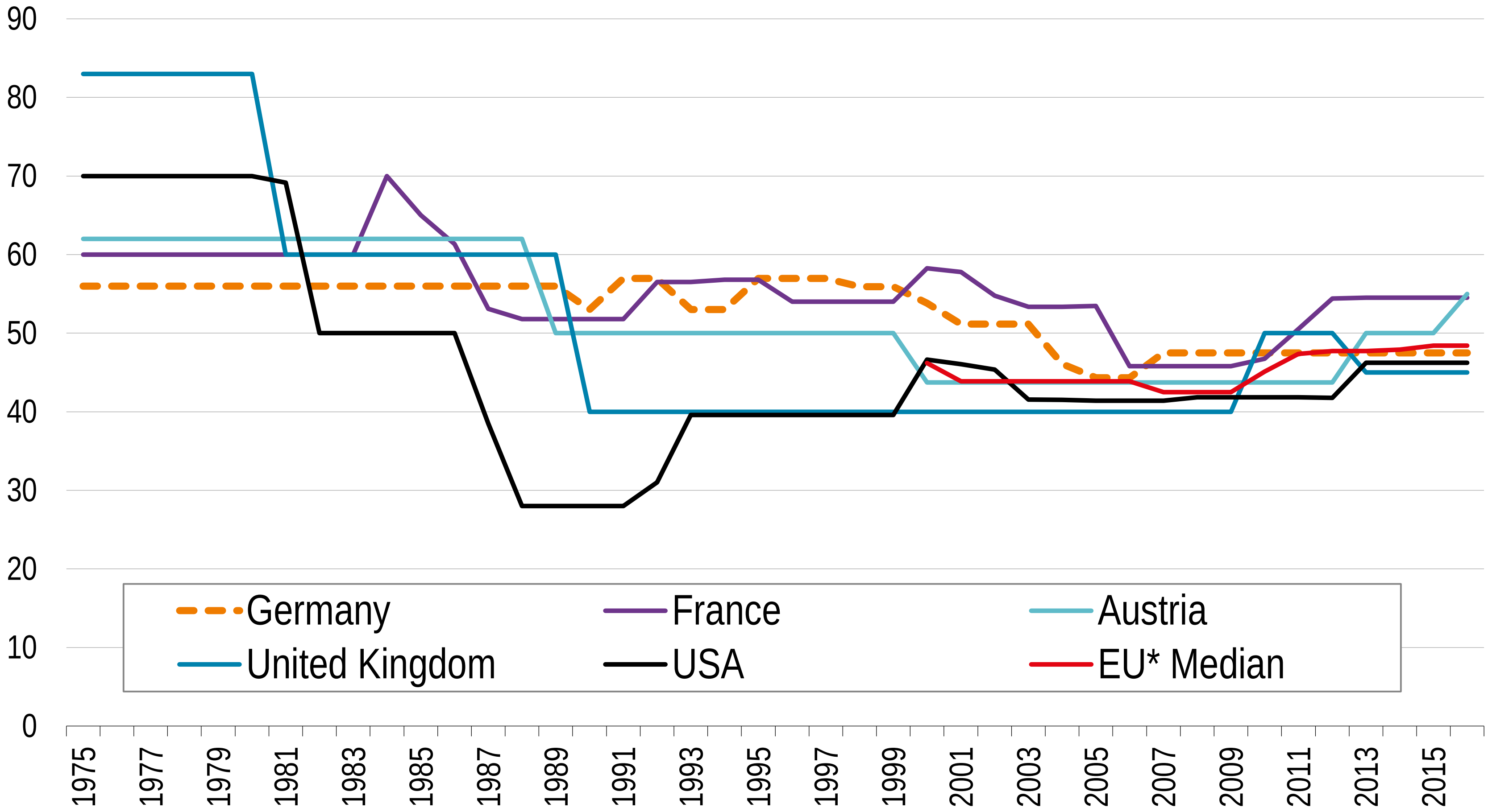
5. If social contributions are taken into account, the total is regressive for the very bottom and the top 15%.

Tax Reforms 1998-2015 favoured the top



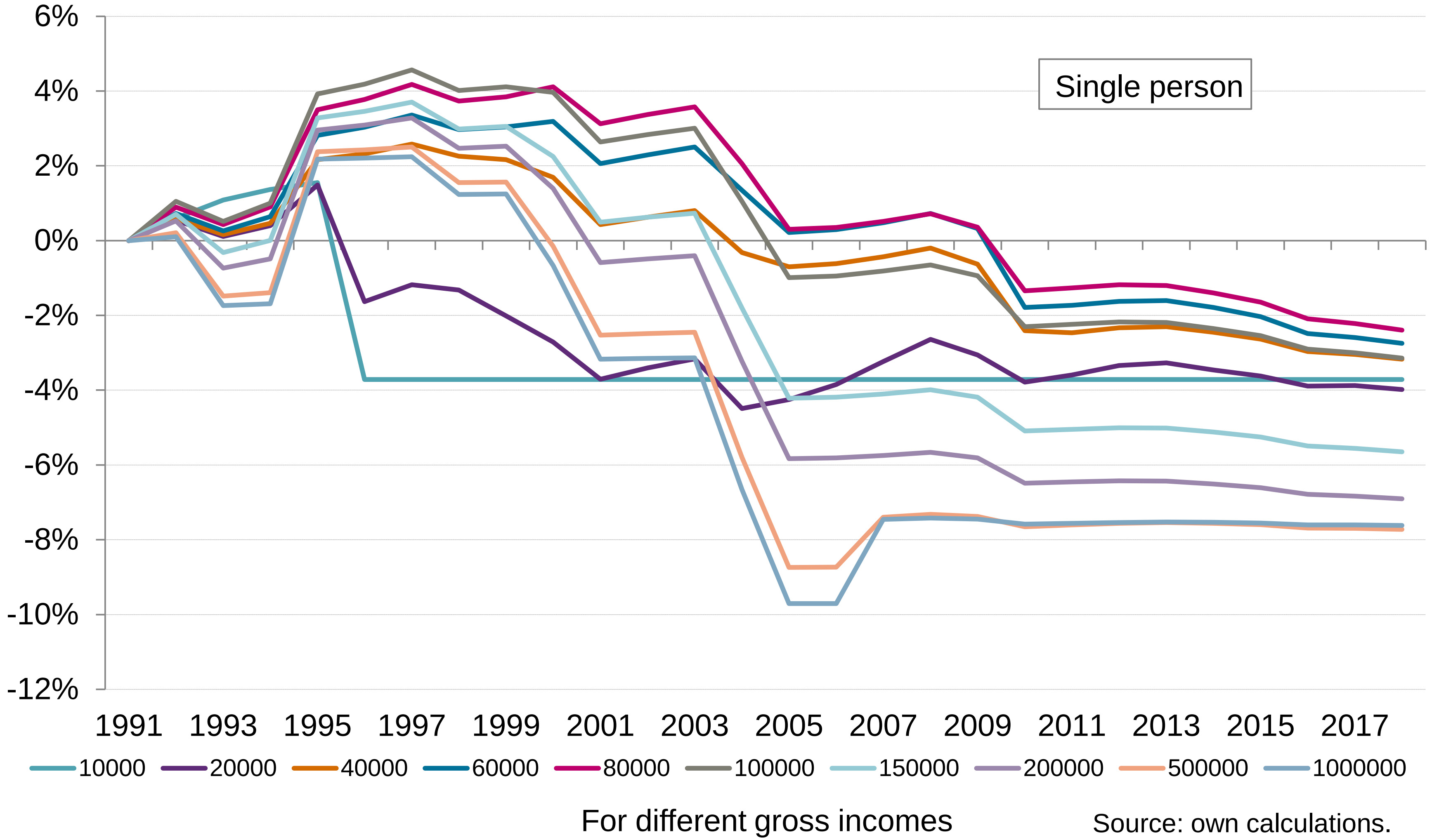
Source: Bach, Beznoska, Steiner (2016)

Top marginal income tax rates (%)



Source: OECD, IMK, Germany including solidarity surcharge, EU excluding Bulgaria, Croatia, Cyprus, Lithuania, Malta, Romania.

Income tax burden (incl. solidarity surcharge) – change relative to 1991 in % (inflation adjusted)



Source: own calculations.

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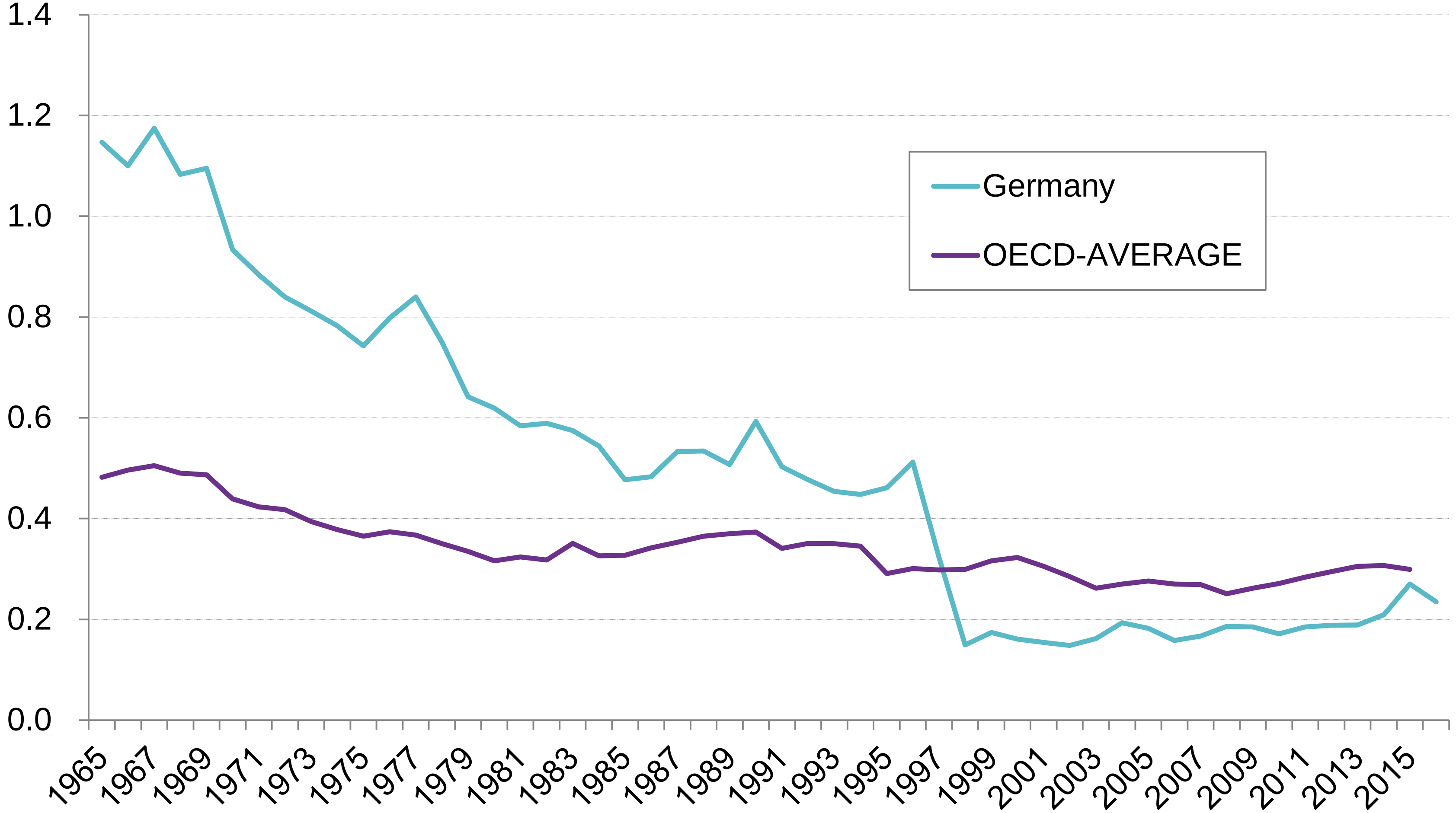
Wealth taxation

- Burden sharing ("Lastenausgleich"): Levy on wealth to finance compensations for losses during World War II (until 1982)
- Wealth tax (1% on net wealth exceeding DM 120,000) until 1996. Since then suspended because of a Federal Constitutional Court ruling declaring it unconstitutional because of inconsistent valuation methods across assets.
- Inheritance and gift tax: Tax rates of up to 50% and exemptions of up to € 500,000 depending on the degree of relationship.
  2009: far-reaching exemptions for business assets.
  2014: ruled "unconstitutional" i.a. because of excessive privileges for large transfers.
  2016: reform to comply with court ruling; mutually offsetting elements – no real tightening

Recurrent taxes on wealth and estate, inheritance and gift tax (% of GDP)



Source: OECD Revenue Statistics.

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Inheritance and gift tax in % of the wealth transfer before deductions (year of tax assessment)

Source: Destatis, own calculations.

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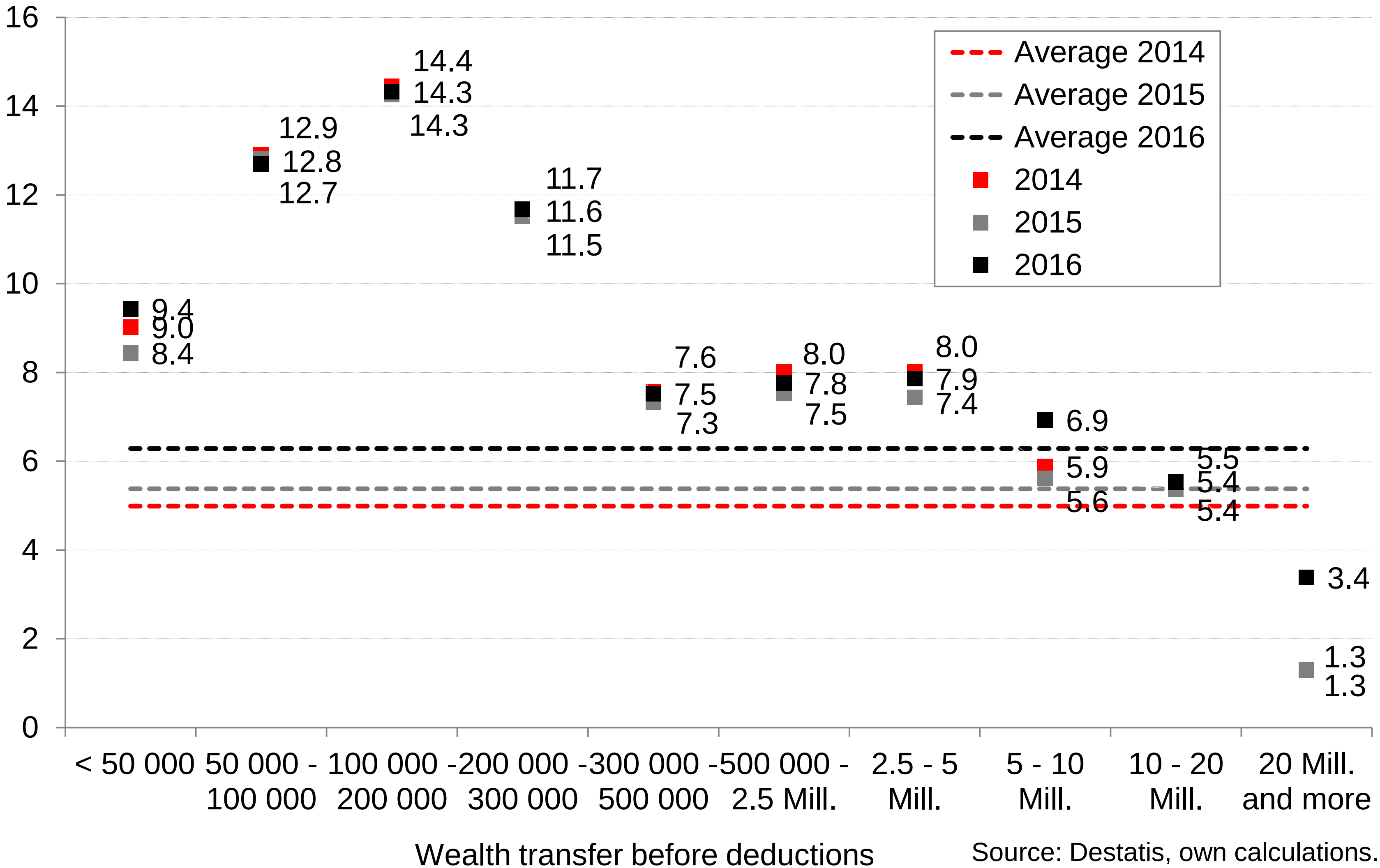
Inheritance and gift tax: effective tax rate (tax/wealth transfer before deductions*100 in %)



Source: Destatis, own calculations.

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Social contributions could be lowered, if non-insurance benefit were financed via taxes

Social security funds provide numerous services/benefits for the wider public beyond their insured members:
e.g. extra pension benefits for mothers, contribution-free insurance for spouses and children in the health insurance, support for handicapped people.

Social insurance branch	Euro billion (in 2016)	% of GDP
Statutory pension scheme	48.5 (26.1)	1.5 (0.8)
Public health insurance	28.7	0.9
Federal employment agency	3.3	0.1
Total	80.5 (58.1)	2.6 (1.8)

Source: Meinhardt (2018)

If non-insurance benefits for the wider public were financed via taxes contribution rates could decrease by 6.7 pp (4.7 pp).

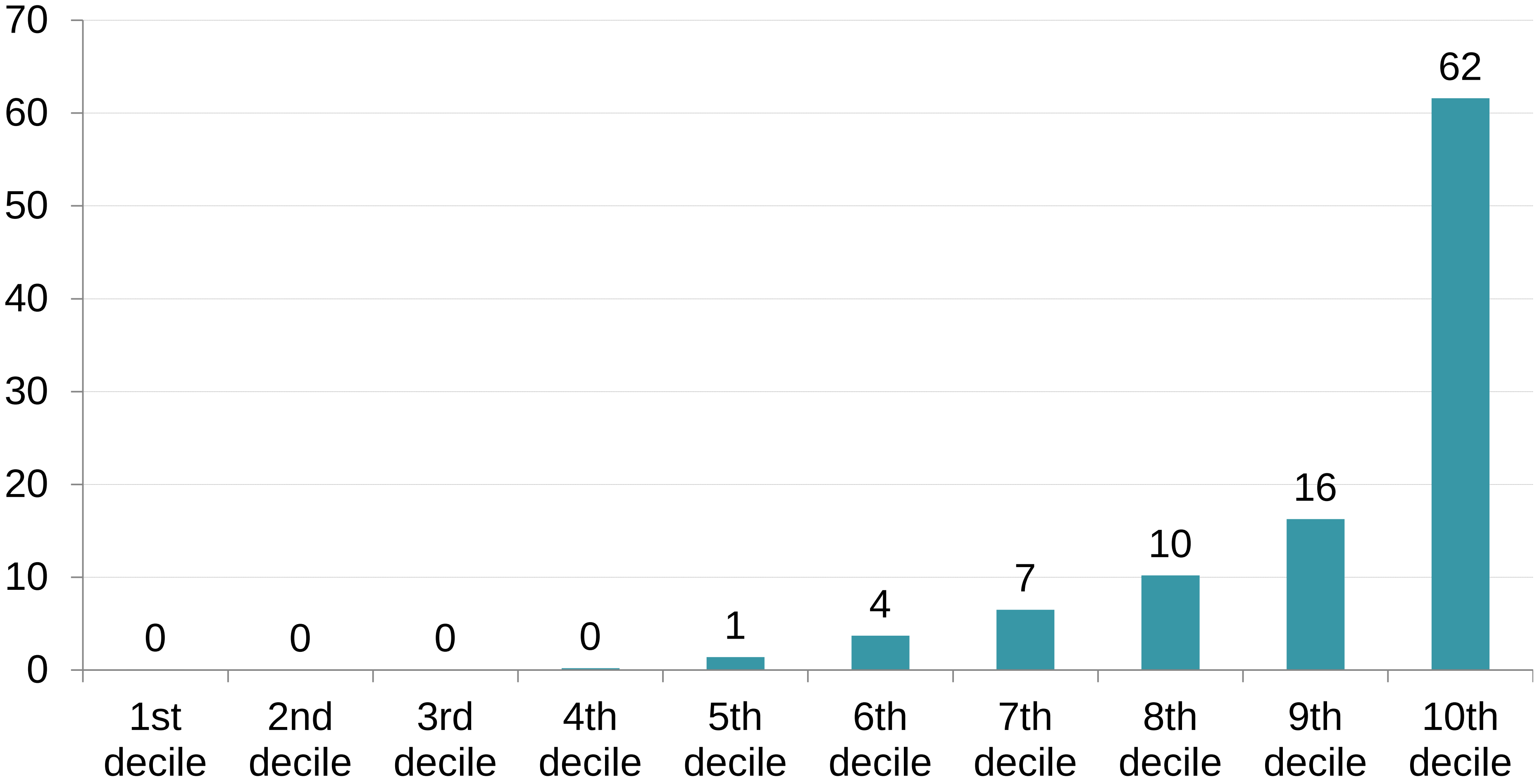
Plans of the new SPD-CDU/CSU government for taxes and social contributions (2017-2021)

1. Raising the child benefit / child allowance (€ 3.5 billion)
2. Home building child benefit (€ 2 billion).
3. Abolishing the solidarity surcharge (a surcharge on income and corporation tax of 5.5 %) in several steps beginning in 2021 (first step 2021: € 10 billion).
4. Abolishing the withholding tax on interest earnings.

Non-priority measures:

5. Lowering the contribution to unemployment insurance by 0.3 pp (€ 10.2 billion – three years).
6. Lowering minimum health insurance contributions (self-employed).
7. Equal health insurance contributions for employees and employers.
8. Lower social security contributions for low wage earners.
9. Full health insurance contributions for recipients of basic social security (€ 28.8 billion – three years).

Distribution effects of an abolition of the solidarity surcharge



Source: Bach/Harnisch (2017)

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Reform options for a more equitable tax system

1. Integration of the solidarity surcharge into the tax scale – ensures a progressive income taxation and needed revenues.
2. Replacing the tax exemptions for business asset in the inheritance and gift tax code by a deferral or shares without vote for the government.
3. A wealth tax for the very top of the distribution.
4. Better than lowering social security contributions only at the bottom and creating further incentives for low-paid part-time jobs: using tax revenues to finance non-insurance benefits, which would allow to reduce contributions by 6.7 (4.7) pp.

Summary

1. Germany needs to address its inequality problem (large low-pay sector, increased income inequality, high wealth inequality). Tax policy is only one of the instruments.
2. Recent tax reforms generally increased inequality by raising indirect taxes, lowering top marginal rates, lowering wealth taxation (no wealth tax since 1997, substantial tax exemptions for business assets in the inheritance and gift tax).
3. Envisaged measures of the new government are insufficient and partly counterproductive. This is particularly true of the phasing-out of the solidarity surcharge – the most progressive tax in the system.
4. High incomes and high wealth need to be taxed adequately.
5. As social contributions burden low incomes much more than income tax, a higher share of social security funds should be financed via (direct) taxes.

➡ German tax policy is not the best role model for Brazil.

Thank you for your attention!!!

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