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Hundred Year High Inequality in Germany? – A Fairy Tale Based on Selective Perception*

Wikipedia defines selective perception as a psychological phenomenon whereby only certain aspects of the environment are perceived while others are blanked out. And this definition perfectly describes the current debate on inequality in Germany. The only facts and half-truths widely perceived and publicised by the media are those supporting the argument that there is a steadily growing gap between the rich and the poor. Other facts, which show that inequality is falling, are ignored because they do not fit in with the simple, easy-sell story of a growing divide.

The most recent example is the widespread assertion that inequality in Germany has reached its highest level in a century. “Inequality Hits Hundred-Year High” is the headline that appeared in many newspapers claiming that this is the message delivered by the latest *World Inequality Report*. The report does show that the income share of the top 10 percent in Germany is currently as high as in 1913. But to conclude that inequality is therefore as high as it was a century ago is to ignore two key facts.

Firstly, the report looks at gross income. Inequality, however, should be measured by net income. Germany’s tax system currently redistributes income to a far greater extent than at the time of the German Empire. Prior to World War I there was no nationally-levied income tax as we know it today. Rudimentary forms of income tax did exist in the German Länder: in Prussia, for instance, an income tax with a top rate of 4 percent was levied for a long time. Shortly before the First World War a tax with some features of an income tax (Wehrbeitrag) was introduced to finance military build-up. Today the top income tax rate in Germany is over 47 percent. That is why the share of disposable income held by the 10 percent of top earners, which is what matters in the end, is far lower than in 1913.

Secondly, the fact that using other inequality measures leads to different results is also blanked out. The *World Inequality Report* highlights the income earned by the top 1 percent of high earners as a share of overall income. Since 1913 this share has dropped from 18% to 13% in Germany. According to this indicator, the headline should read that inequality in 1913 was 38% higher than today, and was far greater again if taxes are taken into account. To report this fact alone would also be selective perception, but the message would be a completely different one.

Let us take this a step further. The key development in global income distribution is undoubtedly that the share of people living in absolute poverty has fallen from over 40 percent at the beginning of the 1980s to around 10 percent at present. But there has not only been a drop in poverty, global income inequality has also diminished. Measured by the Gini-Index, the most common measure of inequality, global income inequality has fallen over the last three decades. The *World Inequality Report* confirms that the poorest 50 percent of the world's population as a share of total income has not fallen since 1980, but risen. If we take a look at Germany and focus on the last 10 years, there has been no change in income inequality. Among the G7 states Germany has the lowest level of disposable income measured by the Gini coefficient.

To conclude from these facts that inequality in Germany and globally has either fallen or remained unchanged is also misleading. In Germany, for example, income inequality has not risen over the last ten years, but did rise in the previous decade between 1995 and 2005. This was primarily due to rising unemployment and falling pay for low-skilled work. In the USA income inequality has risen dramatically since the 1980s. At a global level, poverty is falling but the share of income earned by the richest 1 percent is also rising.

What do these figures mean? They show that the problem of economic inequality is multifaceted and calls for a differentiated analysis that does not ignore key facts in favour of simple and alarmist messages that attract more attention.

Inequality at an international level is developing in very different ways. Germany is a country with a well-developed welfare state and relatively low income inequality compared to similar countries. However, differences in pay for high- and low-skilled work are growing in Germany too; and parents exercise a dominant influence over education opportunities, which tends to reduce social mobility. What can politics do to combat this? The combined effect of taxes, social security contributions and transfers means that there are few incentives to perform better for those in the middle income bracket. This would seem to favour using scope for tax reductions to eliminate the "middle-class bulge" in the German income tax schedule. Children from educationally-disadvantaged backgrounds also need to be given more support in nurseries and primary schools. Such steps would be far more constructive than shrill cries of inequality hitting hundred-year highs.

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