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Germany: Still a Divided Country? An Analysis Using Distributional National Accounts

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30 years after the Reunification of Germany, substantial income and wealth differences persist between those living in the Eastern and Western part of the country. Convergence is slow and still far from complete. In this study we want to venture an in-depth analysis of the persisting inequalities within Germany as a whole, within the former East and West and between the two parts.

The recent rise in income inequality in rich countries across the world has increasingly been the subject of academic and public debate. A recent contribution by Piketty et al. (2018) for the United States establishes a methodology to estimate Distributional National Accounts (DINA) bringing together macroeconomic information from National Accounts and administrative and survey data at the micro level. This methodological approach fills the blind spots of former studies that either relied on tax data or on survey data. Second, it integrates previously not included components such as retained earnings into the analysis. Last, it allows to compute inequality measures for both pre- and post-tax income for the entire population.

This paper provides new long-run income inequality series for Germany combining all potential income data sources from tax data, household survey data to national accounts. Estimating Distributional National Accounts, we capture 100% of national income and can compute inequality measures for both pre- and post-tax income for the entire population. Thereby, we can investigate how government redistribution influences inequality over time, which is probably the most important contribution to both the public debate and our understanding of long-run trends. Moreover, we can compute growth rates for each quantile of the pre- and post-tax income distributions that are consistent with macroeconomic growth. Last, we can decompose the development of pre- and post-tax incomes by federal state, age and gender groups.

We will apply this DINA method to the case of reunified Germany to answer the following questions: Who benefits more from economic growth over time: employees or capital owners? The bottom 50%, the middle class or the top 10%, 1% and 0.1% of earners? Are we on a path

towards a rentier society? What leverage do welfare state institutions such as progressive taxation, public pensions or collective bargaining have to mitigate pretax income inequality across the population?

In the case of Germany, the DINA methodology can provide an interesting insight into the structure of inequality between the former Western and Eastern part of Germany. In the 1990s, we saw a massive investment flow going from West Germany to East Germany. Politicians during this time fostered these investments by incentives such as tax reliefs on real estate and business incomes. How have these investments shaped the economic structure of both parts of the country? Who receives incomes generated in the East German federal states: Does the local East German population receive mainly labor incomes, while most of the capital income generated in the East flows to West German capital owners? In this paper, we will explore these questions by comparing incomes from micro tax and survey data and national accounts of the federal states.

The aim of this paper is to (1) produce a harmonized long-run inequality series for Germany before and after taxes covering the entire population applying both internationally standardized and innovative methods using every available income data source, (2) compare this new German series with the existing series for France and the United States and others to come to understand long-run trends, (3) to compare and discuss the economic development of West and East Germany and (4) investigate the role of the German welfare state in mitigating inequality. This project is part of the global effort coordinated by the World Inequality Database (WID)-project to improve inequality analyses by compiling information on inequality for as many countries as possible in a harmonized and comparable manner.

First results indicate that the labor share in national income has declined substantially from almost 80% in 1992 to 72% in 2013, while capital incomes, especially retained earnings, have risen substantially. Up to the 98th percentile of the income distribution, labor income dominates all other income types, whereas the top two percentiles mostly rely on business and capital incomes. The top 0.01 percentile's income arises to around 60% from business incomes and around 40% from interests and dividends. Wealth, and thereby capital income, is concentrated in very few hands in Germany. This is due to the specific German structure of the family-owned mid-sized firms – the so-called 'German Mittelstand' – which are not traded at the stock exchange. Additionally, only a small share of the population is invested at the stock exchange holding a large share of their savings in savings deposits.