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REDUCE THE RISK OF POVERTY, STRENGTHEN EMPLOYMENT INCENTIVES: REFORMS IN THE TAX-TRANSFER SYSTEM

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This is a translated version of the original German-language chapter "Armutsggefährdung senken, Erwerbsanreize stärken: Reformen im Steuer-Transfer-System", which is the sole authoritative text. Please cite the original German-language chapter if any reference is made to this text.

KEY MESSAGES

- Unlike income inequality, the risk of poverty has continued to rise since 2005. This is due to slow income growth in the lowest income decile.
- In the area of the basic income support system, bundling benefits combined with a low transfer withdrawal rate if income from employment increases can reduce the risk of poverty and boost employment incentives without burdening public budgets.
- A well-developed childcare system is key to increasing the number of parents in paid employment. A reform of the spousal income-tax splitting can strengthen the employment incentives of secondary wage earners.

SUMMARY

Although **income inequality** in Germany rose considerably between 1991 and 2005, it **has hardly increased since 2005**. The **at-risk-of-poverty rate**, on the other hand, **has risen further since 2005**. Some groups of people are particularly threatened by poverty, especially single parents, children and teenagers, as well as people with a migration background. In addition, women, especially single mothers, are more frequently at risk of poverty than men.

Poverty and inequality involve a wide variety of challenges for those affected, as well as undesirable developments at the macroeconomic and societal levels. Cause and effect are often difficult to separate, as the causality goes in both directions. People at risk of poverty in Germany have health problems more often; they have a lower education level and are more frequently unemployed. A lack of social mobility can restrict the innovation potential of society and economic growth.

Improving employment incentives can achieve a **reduction in the at-risk-of-poverty rate** for people with low incomes. Simulation results show that **combining a transfer payment** with a lower transfer withdrawal rate can noticeably increase employment incentives and reduce the at-risk-of-poverty rate – without burdening public budgets. Up to now, discontinuities in the marginal burden on income have made the financial advantage of working more intransparent. If the marginal burden implied by the transfer withdrawal rate remained constant, this would change, because income would increase evenly as employment is extended.

The planned **basic child allowance** can ensure that more beneficiaries actually claim the benefits to which they are entitled. This would help reduce the risk of poverty among children. Greater participation in further training and health measures can also significantly promote employment opportunities. Furthermore, the employment of women in particular should be strengthened by providing well-developed childcare. In addition, a **reform of the spousal income-tax splitting system** can provide stronger employment incentives.

An **instrument** is needed to provide short-term relief in times of crisis that can reach all private households more accurately than up to now. A **mechanism of direct payments** should be set up for this purpose. This should be used to urgently implement the long-announced lump-sum climate payment to offset burdens caused by the CO₂ price.

I. INTRODUCTION

277. Income inequality in Germany rose significantly between 1990 and 2005. Since then it has hardly increased at all. [↪ ITEM 287](#) This is reflected by almost all common distribution indicators. One exception is the **at-risk-of-poverty rate**, [↪ GLOSSARY](#) a relative measure of income inequality. [↪ ITEM 296](#) This rate has continued **its upward trend in Germany** even after 2005. [↪ ITEM 297](#) Based on the latest available data, about one in six people were at risk of poverty in 2019.
278. **Not all population groups are equally at risk of poverty.** Single parents, the unemployed, people with poor educational qualifications, people with a migration background, children and teenagers are at above-average risk of poverty. [↪ ITEMS 301 FF.](#) While the rate of children at risk of poverty has decreased since 2010 in many member states of the European Union (EU), it has hardly changed in Germany. [↪ ITEM 299](#) And there is a gender difference in the overall risk of poverty. On the one hand, women are significantly more likely to be single parents than men. On the other, divorced women are more often at risk of poverty than divorced men. [↪ ITEM 306](#)
279. In Germany, the **risk of poverty and inequality go along with both individual problems for those affected and undesirable developments in the economy and society as a whole.** Cause and effect cannot always be clearly separated. Causalities exist in both directions. [↪ BOX 19](#) In Germany, lower incomes correlate with poorer health and a shorter life expectancy. Educational opportunities for children are very unequally distributed and highly dependent on the family background. In society as a whole, inequality also correlates with higher crime rates and lower social mobility. And if the talents of people at risk of poverty remain unused, this can have a negative impact on innovation and growth.
280. The **at-risk-of-poverty rate can be reduced in particular** by people with little or no earned income **taking up or extending gainful employment.** This would simultaneously increase macroeconomic labour force participation. Taking a new job or working longer also reduces the amount of benefits received from government. In the longer term, **structural improvements to the education system** create equal opportunities for children at risk of poverty and thus improve their chances of finding well-paid jobs during their active working lives (GCEE Annual Report 2021 items 325 ff.).

In the short term, improving the supply and especially the take-up of further training measures can raise wages, increase the likelihood of re-employment after redundancy, and facilitate transitions away from jobs affected by structural change (GCEE Annual Report 2022 item 372). In addition, higher supplementary income opportunities can reduce the at-risk-of-poverty rate. The focus should be on **reducing disincentives in the tax-transfer system** in order to strengthen employment incentives. Ideally, this can avoid the conflict of objectives between reducing the at-risk-of-poverty rate, strengthening employment incentives and avoiding an additional burden on the public budgets. [↪ ITEM 309](#)

281. **Reforms that increase labour force participation and boost the incomes of households in the transfer and low-income sectors** can make a decisive contribution to reducing the risk of poverty. A **reform of the basic income support system** can greatly simplify benefits by merging them. [↘ ITEMS 320 FF](#). This GCEE report quantifies various reform options using a microsimulation model. The at-risk-of-poverty rate can be effectively reduced by a constant, lower marginal burden on income. Furthermore, various reform options can boost employment incentives without burdening the public budgets. In this context, a constant marginal burden [↘ GLOSSARY](#) guarantees that positive incentives are created both for participation in the labour market and for the expansion of gainful employment. A first step towards merging transfer benefits is the planned **basic child allowance**, which aims to bundle child-related benefits. The use of digital procedures for processing applications can simplify the application process.
282. A **reform of the spousal income-tax splitting system** can strengthen employment incentives within partnerships, especially for married couples with children. Using a microsimulation model, the GCEE discusses various reform options in the area of spousal taxation that can increase the labour supply. [↘ ITEMS 336 FF](#). Reforms such as de-facto splitting, a tax deduction or an undiminished or decreasing additional marital allowance can provide varying degrees of employment incentives.
283. Further measures can boost the employment opportunities of households and permanently improve their employment situation. Women with children are less often in employment than men. A **well-developed childcare system** can enable households with children to **participate more in the labour force** and also improve the situation of their children, for example by providing free lunches. [↘ ITEMS 345 FF](#). Free childcare places are also important for families at risk of poverty. **Access to further education and health services** should also be promoted in order to support people who are dependent on basic income support. [↘ ITEMS 350 FF](#). In addition to financial incentives and favourable regulatory frameworks, workplace-based, low-threshold counselling services can increase take-up. People with a migration background are especially at risk of poverty. Language and integration courses as well as administrative simplifications can facilitate their integration into the labour market (GCEE Annual Report 2022 items 456 f.).
284. The economic crises in the recent past have shown that the **tax-transfer system is not very suitable for target reliefs** for private households **in the short term**. Direct payments are an unbureaucratic and quickly applicable crisis instrument. [↘ ITEM 354](#) In contrast to the necessarily improvised relief from a multitude of different and poorly targeted individual measures, direct payments ideally reach all citizens according to uniform criteria. They can also be designed in such a way that the scarcity signals of prices are not distorted. However, there are limits to the extent to which the individual characteristics of the recipients can be taken into account. As a simplified first step, lump-sum **direct per-capita payments** should be used **to set up the climate payments scheme**. In combination with the pricing of carbon emissions, lump-sum direct payments would relieve lower income groups more, relatively speaking, and probably increase the acceptance of

climate policy. [↪ ITEMS 356 F](#). It is therefore important to **create** the technical as well as legal **preconditions for the instrument of direct payments as soon as possible**.

II. INITIAL SITUATION: INCOME DISTRIBUTION AND POVERTY IN GERMANY

1. Income distribution

285. In this section, the GCEE, in accordance with its statutory mandate, updates its regular analyses of the income and wealth distribution in Germany using the current data in the Socio-Economic Panel (SOEP) (most recently in the GCEE 2021 Annual Report items 251 ff.). [↪ BACKGROUND INFO 11](#) As in the GCEE Annual Report 2021/22, the focus is on the development of the income distribution. **There is still a lack of more up-to-date data that would be necessary for an analysis of the distribution of wealth.** Besides, the data basis on wealth distribution in Germany is inadequate. [↪ ITEM 538](#)



[↪ BACKGROUND INFO 11](#)

Data basis: SOEP

The household survey of the Socio-Economic Panel (SOEP) serves as the data basis for the analysis of the income distribution. The SOEP is a representative longitudinal survey of private households. It has been conducted every year since 1984 in western Germany and since 1990 in eastern Germany. The information on incomes and wages is collected retrospectively and is currently available up until 2019. In order to make the SOEP survey more representative, special samples have been added to the survey since 1994. These include subsample D (on migration, since 1994/95), subsample G (high-income sample, since 2002), subsamples M1-M2 and M7-M8a (on migration, since 2013, 2015 and 2020), subsamples M3-M6 (on refugees, since 2016, 2017 and 2020), and subsample P (Top Shareholder Sample, since 2019). These additions can entail structural breaks which complicate the interpretation of how distribution measures develop over time (Peichl, 2020; Stockhausen and Niehues, 2020). The first survey wave of the individual samples is excluded from the calculations, as new respondents are more likely to provide implausible information at the beginning. Furthermore, missing data in the SOEP are retroactively replaced by imputing all missing figures in the new data collection. The survey institute was changed in the 2021 wave. For these reasons, minor differences to earlier evaluations are possible.

286. When analysing the income distribution, a distinction is made between the market income and the net income of private households. **Market income comprises the household's income before state redistribution.** It is made up of gross earned income, consisting of income from self-employment and dependent employment, income from assets and owner-occupied housing, and private

transfer payments. **Net income additionally takes into account state transfer payments and pensions from statutory pension insurance (GRV) or civil servants' pensions, minus taxes and the employees' shares of compulsory contributions to social security funds.** For better comparability, all incomes are equivalence-weighted in the following analyses, as is customary in the literature. [↪ BACKGROUND INFO 12](#)



↪ BACKGROUND INFO 12

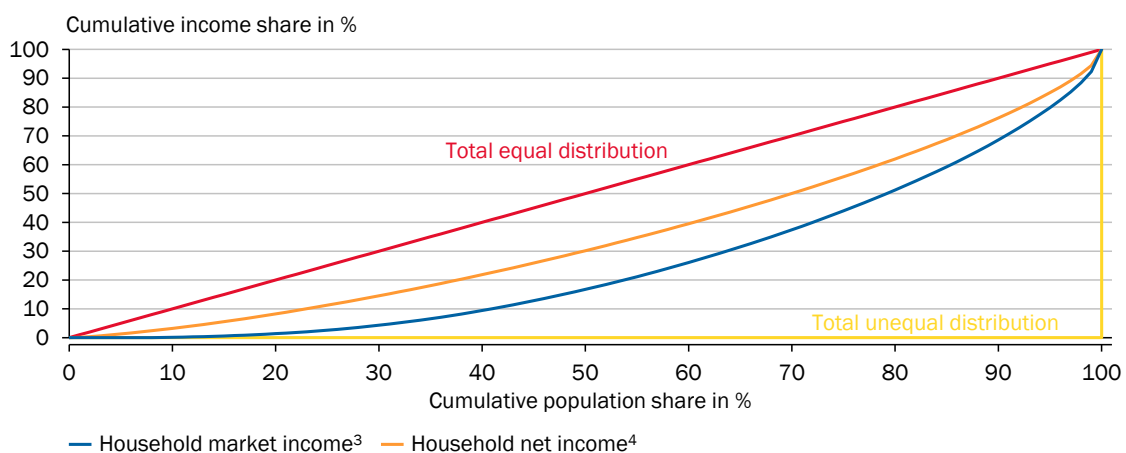
Definition: equivalence-weighted household income

In order to be able to **compare the incomes of households of different sizes and compositions**, they are equivalence-weighted using the modified OECD scale; this leads to a weighted per-capita income called the equivalence-weighted household income. The first household member over the age of 14 is assigned an equivalence weight (based on needs) of one, other household members over the age of 14 are assigned a weight of 0.5 and children under the age of 14 a weight of 0.3 (Hagenaars et al., 1994). The real total income of a household is divided by the sum of the equivalence weights, resulting in an identical equivalence-weighted household income for each household member.

287. One of the most important indicators for measuring income inequality is the Gini coefficient. It has a value of 0 when the distribution is totally equal and just under 1 when income is completely concentrated on a single person. It is calculated as the area between the actual Lorenz curve [↪ GLOSSARY](#) and the hypothetical Lorenz curve under conditions of totally equal distribution relative to the overall area beneath the Lorenz curve under conditions of totally equal distribution. [↪ CHART 85](#)

↪ CHART 85

Lorenz curves¹ of the income distribution in 2019²

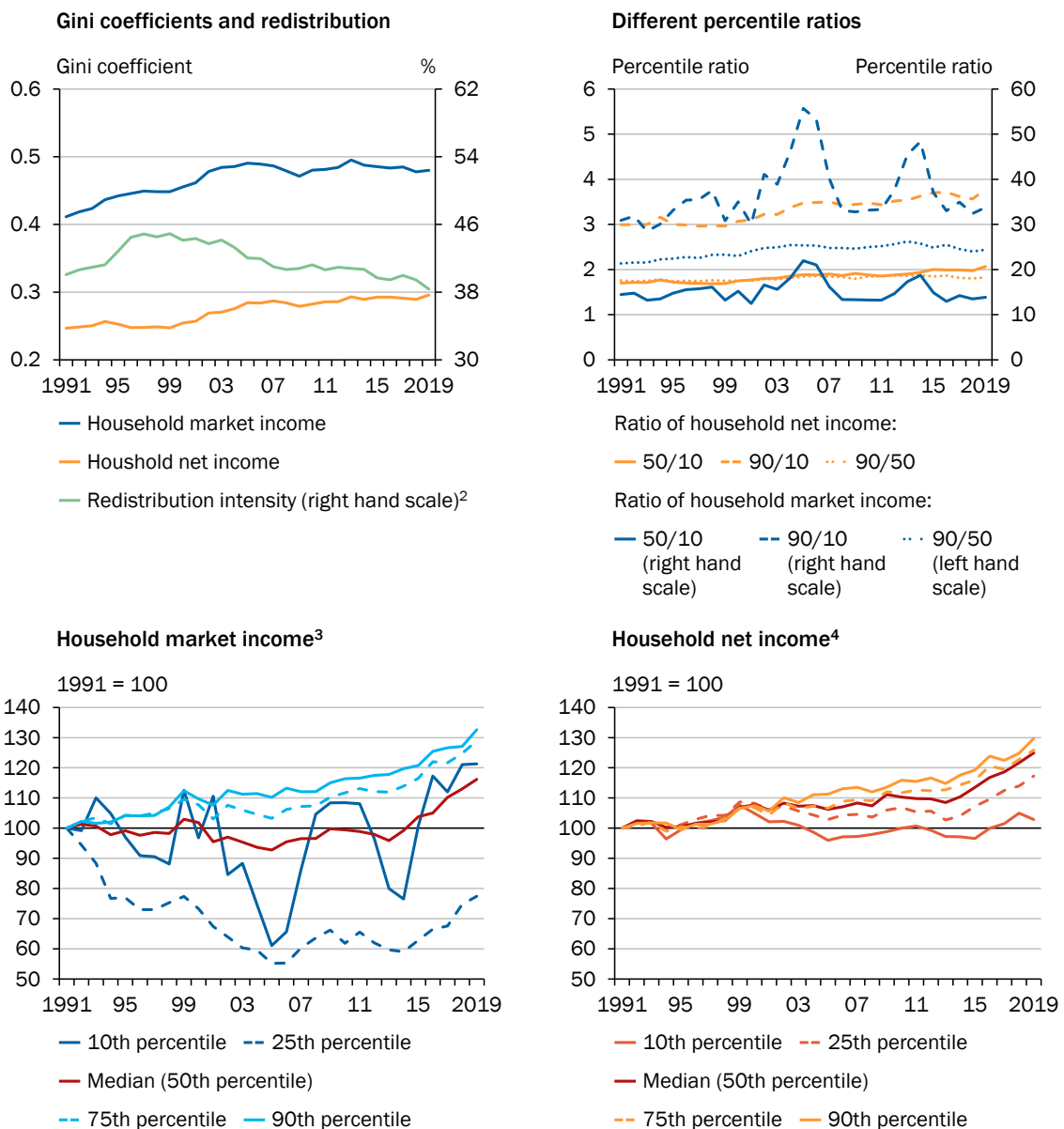


1 – The Lorenz curve graphically represents the distribution of income and thus makes the extent of inequality clear. In the case of total equal distribution, it corresponds to the red 45-degree line. In the case of total unequal distribution, it corresponds to the yellow line. The area between the Lorenz curve and the red 45-degree line, relative to the total area under the red 45-degree line, corresponds to the Gini coefficient. 2 – Price-adjusted with the consumer price index (2015 = 100). Household incomes are equivalence-weighted according to the modified OECD scale. 3 – Income before taxes and transfer payments and excluding pensions from statutory pension insurance and civil servants' pensions. 4 – Income after taxes and transfer payments and with pensions from statutory pension insurance and civil servants' pensions.

Sources: SOEP v37, own calculations
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According to the Gini coefficient, the **inequality of household market incomes in Germany increased** from 0.41 in 1991 to 0.49 in 2005. **Since then, it has hardly changed.** It remained stable in 2019, the year added since the previous analysis conducted by the GCEE. The **Gini coefficient of net income** has risen **only slightly since the strong increase** in the years up to 2005. Most recently it stood at 0.30. ↘ [CHART 86 TOP LEFT](#) The **redistribution intensity**, which relates the difference between the Gini coefficients of market and net incomes to

↘ [CHART 86](#)
Income developments¹



1 – Price-adjusted using the consumer price index (2015 = 100). Household incomes are equivalency-weighted according to the modified OECD scale. 2 – Difference between the Gini coefficient of household market incomes and household net incomes relative to the Gini coefficient of household market incomes. 3 – Income before taxes and transfer payments and excluding pensions from statutory pension insurance and civil servants' pensions. 4 – Income after taxes and transfer payments and with pensions from statutory pension insurance and civil servants' pensions.

Sources: SOEP v37, own calculations
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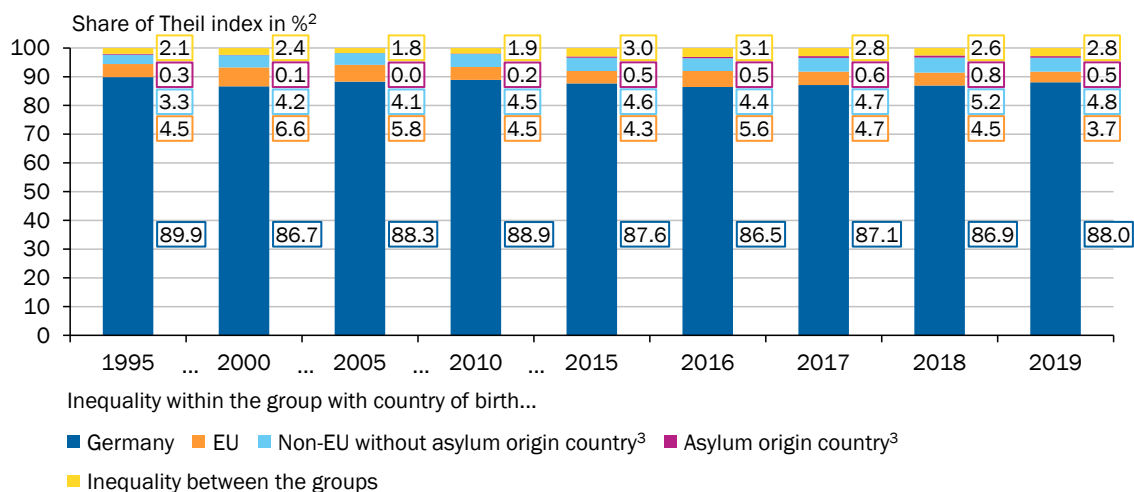
the Gini coefficient of market incomes, has **fallen** significantly **since the early 2000s**. [↪ CHART 86 TOP LEFT](#)

288. A frequent criticism of survey-based income data is the insufficient coverage of high incomes (Frick et al., 2007; Atkinson et al., 2011). An additional high-income sample (the Top Shareholder Sample), which has been collected since 2019, attempts to close this gap in the SOEP by specifically surveying individuals with large company shareholdings. This **high-income sample was included in the analysis for the first time this year**. The **structural break** created by the inclusion of the high-income sample **increases the Gini coefficient**. When the high-income sample was not taken into account, the Gini coefficient of net income was about 0.01 points lower in 2019.

289. Middle and high incomes continued to rise in real terms in 2019 compared to previous years. [↪ CHART 86 BOTTOM LEFT AND BOTTOM RIGHT](#) In the case of net household incomes, the increase was biggest at the percentile limits of the median and the percentiles above, with significant increases also observed at the percentile limits below down to the 20th percentile limit. What is striking, however, is the stagnation of household net incomes at the 10th percentile limit. The general increase in household net income together with a simultaneous, constant development of net household income at the 10th percentile limit also drives the development of the percentile ratios. [↪ CHART 86 TOP RIGHT](#) While the 90/50 percentile ratio stagnated, the 50/10 and 90/10 percentile ratios increased. This development suggests that the **inequality of income distribution** in recent years is due **in particular**

[↪ CHART 87](#)

Decomposition of income inequality¹ by country of birth



1 – Based on price-adjusted (2015 = 100) net household income, equivalence-weighted according to the modified OECD scale. 2 – The Theil index is an inequality measure that, unlike the Gini coefficient, can be decomposed into different components to measure the contributions of individual subgroups to overall inequality. It can be decomposed into components that measure the contributions of inequality within subgroups to the overall inequality and a component that measures the contribution of inequality between subgroups in terms of differences in the level of group-specific average incomes. A higher Theil index indicates a more unequal distribution, while a lower Theil index indicates a more equal distribution. 3 – Afghanistan, Eritrea, Iraq, Iran, Nigeria, Pakistan, Somalia, Syria.

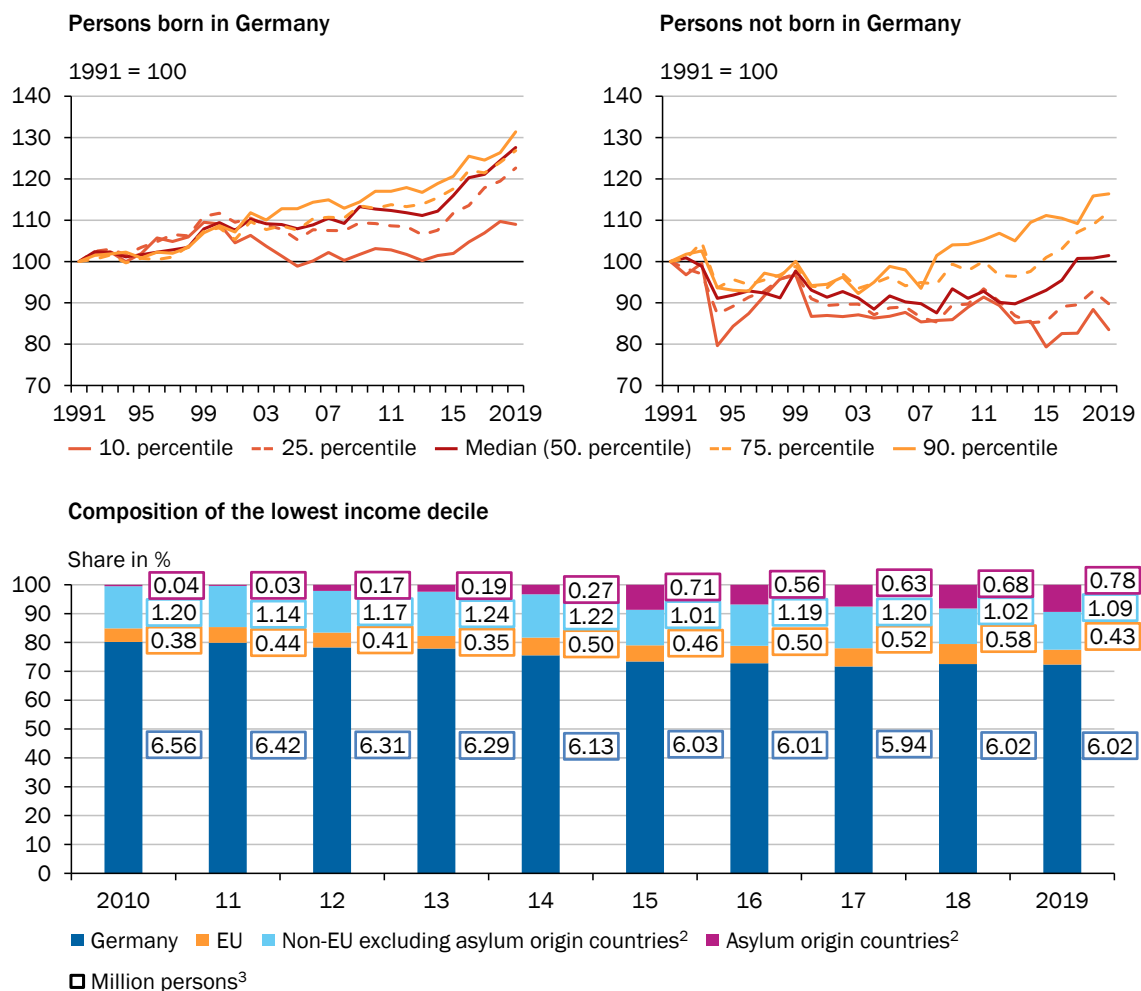
Sources: SOEP v37, own calculations
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to the weak development of equivalence-weighted net household incomes at the bottom end of the distribution.

290. The **development of the income distribution** has **been noticeably influenced by increased immigration since 2010**. With the help of the Theil index ↘ [GLOSSARY](#) – a measure of inequality that describes the income shares of different groups in relation to the size of the groups – the income inequality of people living in Germany can be broken down according to their country of birth. ↘ [CHART 87](#) The breakdown shows that **only a small proportion of the observed income inequality can be explained by income differences between** people with different countries of birth. This share fluctuated around 2 % before 2015 and rose to about 3 % due to increased immigration in 2015 and 2016. On the other hand, **much of the observed inequality can be explained by**

↘ [CHART 88](#)

Households net income developments in Germany by country of birth¹



1 – Based on price-adjusted (2015 = 100) net household income, equivalence-weighted according to the modified OECD scale. Net household income is income after taxes and transfers and with pensions from the statutory pension insurance and civil servants' pensions. 2 – Afghanistan, Eritrea, Iran, Iraq, Nigeria, Pakistan, Somalia, Syria. 3 – Absolute number of persons is approximated with the help of the relative shares of persons by country of origin in the lowest income decile on the basis of the SOEP and the official population level.

Sources: SOEP v37, own calculations
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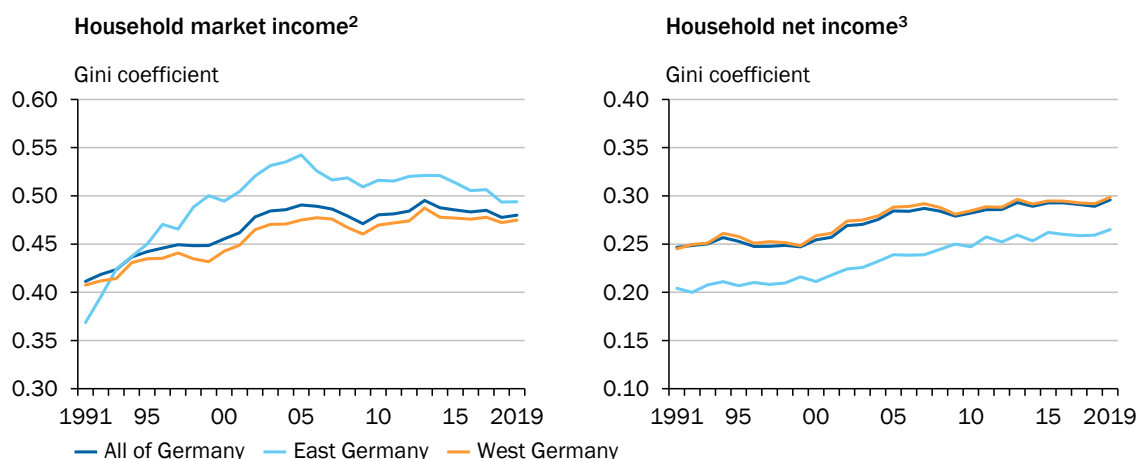
income differences within the groups. However, because they make up a smaller share of the sum of all incomes, inequality within the groups with a non-German country of birth contributes comparatively little to inequality, even though the share explained by people with a non-EU country of birth has increased slightly in recent years.

291. An examination of the development of household net incomes by country of birth shows that the incomes of people born in Germany have developed considerably better than those of people not born in Germany. [↪ CHART 88 TOP](#) Furthermore, the **percentage of people born in most common countries of origin of asylum seekers has increased sharply** in recent years, especially in the lowest decile of the income distribution. [↪ CHART 88 BOTTOM](#) Based on the SOEP, the percentage has risen from just under 0.5 % in 2010 to around 9 % in 2019, while over the same period the percentage of people born in Germany in the lowest income decile fell from around 80 % to around 72 %. This means that the number of German-born people in the lowest income decile fell by about 0.5 million. These people are likely to have improved their income situation, since the income threshold of the 10th percentile has risen adjusted for price by just under 3 % since 2010.

292. **Income inequality in Germany differs** by region. Differentiating the Gini coefficients of household market and household net incomes **according to eastern and western Germany** shows that the level and development of inequality in Germany is dominated by western Germany due to its higher share of the population. In eastern Germany, the inequality of household net incomes is noticeably lower. [↪ CHART 89 LEFT](#) In the case of household market incomes, on the other hand, the level of the Gini coefficient in eastern Germany has been much higher than the coefficient for western Germany since the mid-1990s, although a convergence can be observed in recent years. [↪ CHART 89 RIGHT](#) The strong increase in

[↪ CHART 89](#)

Development of income inequality in East and West Germany¹

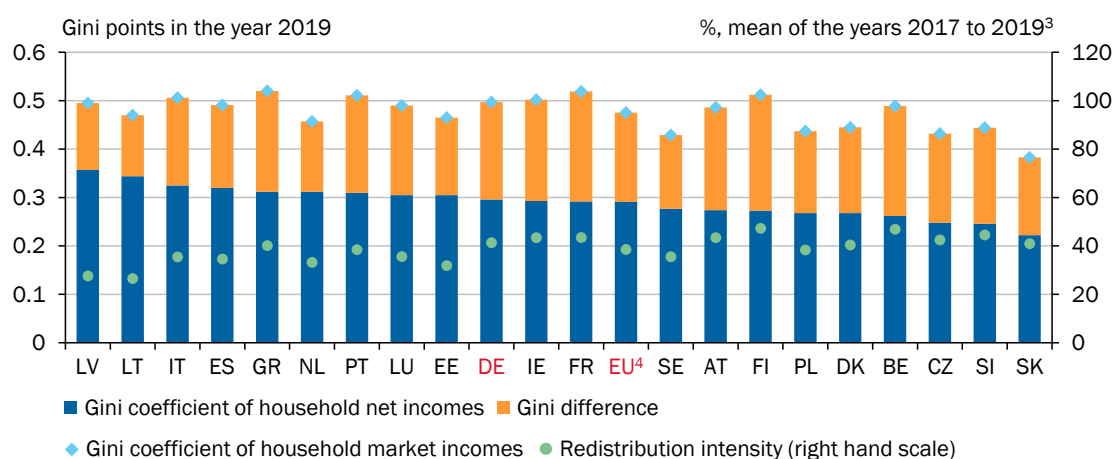


1 – Price-adjusted using the consumer price index (2015 = 100). Household incomes are equivalency-weighted according to the modified OECD scale. 2 – Income before taxes and transfer payments and excluding pensions from statutory pension insurance and civil servants' pensions. 3 – Income after taxes and transfer payments and with pensions from statutory pension insurance and civil servants' pensions.

Sources: SOEP v37, own calculations
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↘ CHART 90

Income inequality and redistribution intensity¹ in the European comparison²



1 – Difference between the Gini coefficient of household market income and household net income relative to the Gini coefficient of household market income. 2 – LV-Latvia, LT-Lithuania, IT-Italy, ES-Spain, GR-Greece, NL-Netherlands, PT-Portugal, LU-Luxembourg, EE-Estonia, DE-Germany, IE-Ireland, FR-France, SE-Sweden, AT-Austria, FI-Finland, PL-Poland, DK-Denmark, BE-Belgium, CZ-Czechia, SI-Slovenia, SK-Slovakia. 3 – BE only 2018 to 2019. 4 – Unweighted mean of the EU27 member states without Bulgaria, Croatia, Malta, Romania, Hungary and Cyprus.

Sources: OECD, own calculations
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inequality of household market incomes in eastern Germany after reunification can be attributed to sharply rising wages combined with high unemployment. Overall, however, average annual household market income in eastern Germany (2019: €24,342) is significantly lower than in western Germany (2019: €32,345). Due to high transfer payments relative to the comparatively low average earned income, there is less inequality of net income within eastern Germany than within western Germany (Biewen, 2001; Fuchs-Schündeln et al., 2010).

- 293. In 2019, with a Gini coefficient of household market income of 0.50, **Germany** was in the middle range in an international comparison, just above the EU member-state average of 0.48. ↘ CHART 90 **In terms of the Gini coefficient** of household net income, Germany was also in the middle range at 0.30 and **just above the EU27 average** of 0.29. The redistribution intensity of the German tax-transfer system, averaged over the years 2017 to 2019, was slightly above the EU27 average.

2. Development of poverty indicators

- 294. An unequal distribution of income in a society is often associated with a high risk of poverty (Atkinson and Marlier, 2010). Poverty can be measured in absolute and/or relative terms. **Absolute poverty is measured by deficiencies in the satisfaction of basic material needs.** It can be calculated, for example, using the indicators on material and social deprivation. ↘ ITEM 300 However, measures of absolute poverty play only a minor role in industrialised countries because, as a result of the high level of prosperity, few people are affected by absolute poverty.

295. **Relative poverty** describes whether a person or a household has a low income compared to the social environment. It is therefore **closely linked to income inequality**. Increases in income that make all incomes in society rise equally in percentage terms do not lead to a reduction in relative poverty. However, wealth ratios and regional differences in living costs are usually not taken into account (Brenke, 2018; Niehues, 2022). Relative measures are helpful because relative poverty is often accompanied by individual problems in the areas of health, education and work, as well as undesirable societal developments. Relative poverty can be a cause or an effect, so causalities exist in both directions. ↘ **BOX 19** This section therefore focuses on relative poverty measures.

↘ **BOX 19**

Background: causes and consequences of inequality and the risk of poverty

Inequality and the risk of poverty correlate with individual problems for those affected by poverty. In this context, inequality and the risk of poverty can be a cause, a consequence or both. Having low incomes correlates with poorer health (Pickett and Wilkinson, 2015) and lower life expectancy (Lampert et al., 2019; Haan and Schaller, 2021). Children and teenagers from households at risk of poverty are more likely to develop health problems (DIW Econ, 2023). In addition, children and teenagers from socially worse-off families have a higher risk of mental health problems, ADHD (attention deficit hyperactivity disorder) and obesity (Kuntz et al., 2018b, 2018a). Health risks are in turn associated with an increased likelihood of becoming unable to work or having to use health services (Effertz et al., 2016).

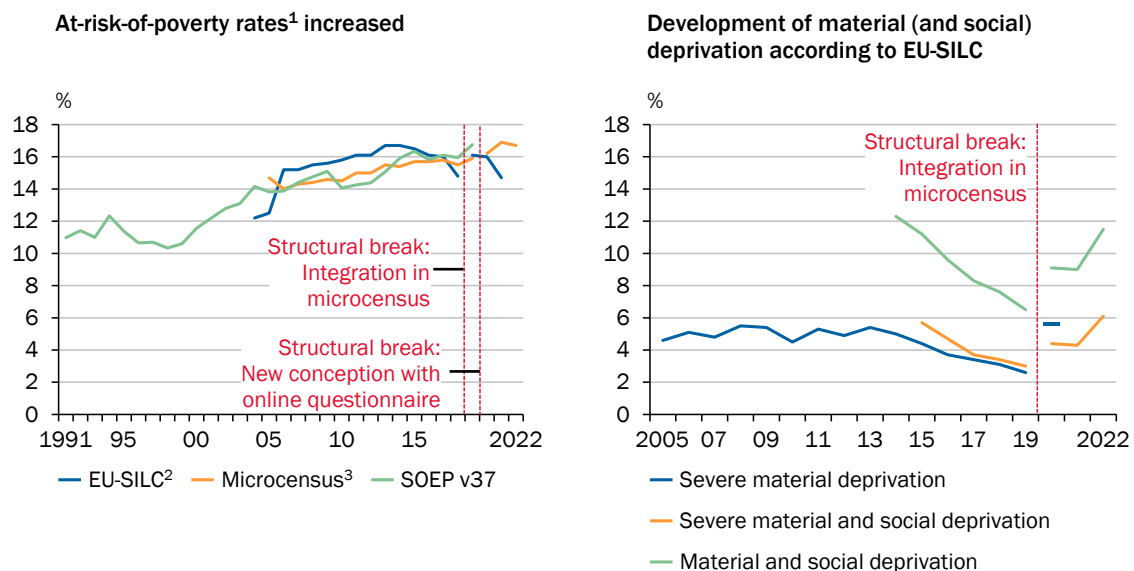
Studies on income mobility conclude that the **educational opportunities of children in Germany are very unequally distributed** and are highly dependent on their family background (Dodin et al., 2021). Poorer access to and the lower take-up of educational opportunities among children affected by poverty leads to lower educational attainment and limited career prospects (Bellani et al., 2019; DIW Econ, 2023; GCEE Annual Report 2021 items 326 ff.). Internationally, the literature also demonstrates a high individual persistence of the risk of poverty (Chetty et al., 2022). Lack of financial resources for social participation for children can have long-term detrimental effects on the social network as well as future labour-market opportunities. As a result, the individuals concerned may experience increased unemployment and long-term dependence on state transfer payments.

Greater inequality or higher at-risk-of-poverty rates also correlate with negative developments in society and the economy. Chetty and Hendren (2018) show that higher income inequality is associated with lower social mobility. This, in turn, can lead to the talents of individuals who grew up in poverty not being utilised, which can have a negative impact on innovation and growth (Bell et al., 2019). For developed economies, the relationship between income inequality and growth is generally negative (Alesina and Rodrik, 1994; Persson and Tabellini, 1994). However, the severity of the negative relationship between inequality and growth depends on the time periods and country groups considered (Cerra et al., 2021; Ferreira et al., 2022; Topuz, 2022). In terms of society as a whole, a correlation can be observed internationally, including in Germany, between inequality and crime (Kelly, 2000; Fajnzylber et al., 2002; Süß, 2020; De Courson and Nettle, 2021) and in particular between youth unemployment and crime (Entorf and Spengler, 2000; Gould et al., 2002). Voter turnout is lower in regions with below-average income (Schäfer and Schwander, 2019). A higher level of inequality is also often associated with less support for democracy and with increased political polarisation (Kriekhaus et al., 2014; Dorn et al., 2018; Proaño et al., 2022).

296. A **core indicator** for measuring **relative income poverty is the at-risk-of-poverty rate**. It states the proportion of people in the population whose equivalence-weighted net income [↪ BACKGROUND INFO 12](#) is below 60 % of the median, the so-called at-risk-of-poverty threshold. The at-risk-of-poverty rate is thus a **measure of the mass of income distribution in the lower income range**. The at-risk-of-poverty rate can vary accordingly with the collection of income data. Results based on different data sources are therefore compared in the following.
297. The **at-risk-of-poverty rate has risen in the SOEP since the late 1990s**. [↪ CHART 91 LEFT](#) With a share of around 12 % of the population, just over one in nine people were at risk of poverty in 2000. By 2019, the figure had risen to one in six people. Due to the relatively strong increase in median incomes, the at-risk-of-poverty threshold, adjusted for prices, rose from around €12,500 to about €14,500 in the same period. The price-adjusted incomes of those at risk of poverty have since increased on average from about €9,500 to about €10,500. This is probably due primarily to the changes in composition of the people at risk of poverty, since the increase in the at-risk-of-poverty rate means that the incomes of the 12th to 17th percentiles are now also used to calculate the average. **However, structural breaks in the selection of households surveyed considerably complicate the interpretation of the development** of the at-risk-of-poverty rate over time. [↪ BACKGROUND INFO 11](#)
298. The at-risk-of-poverty rate can also be calculated and compared across the EU using the **European Union Statistics on Income and Living Conditions**

[↪ CHART 91](#)

Development of at-risk-of-poverty rates and material (and social) deprivation



1 – Share of persons with a net equivalence income of less than 60 % of the median net equivalence income of the population. 2 – For the calculation, the income of the previous year is used as the reference year, therefore the results for the reference year are shown here and not for the survey year. Results from 2019 onwards are only comparable with previous year to a limited extent due to methodological changes. 3 – Results from 2020 onwards are only comparable with previous year to a limited extent due to methodological changes.

Sources: EU-SILC, SOEP v37, Statistical Offices of the Federation and the Länder, own calculations
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(EU-SILC). Due to significant methodological improvements, however, the figures from 2019 onwards can only be compared with previous surveys to a limited extent. [↪ BACKGROUND INFO 13](#) For the years 2015 to 2017, the rate is on a par with the SOEP calculations. However, in contrast to the SOEP, the trend in recent years has been sideways rather than upward. The **microcensus** shows a similar development to the SOEP. However, the interpretation of the development over time is also only possible to a limited extent from 2020 onwards. [↪ BACKGROUND INFO 13](#)



[↪ BACKGROUND INFO 13](#)

Data basis: EU-SILC and microcensus

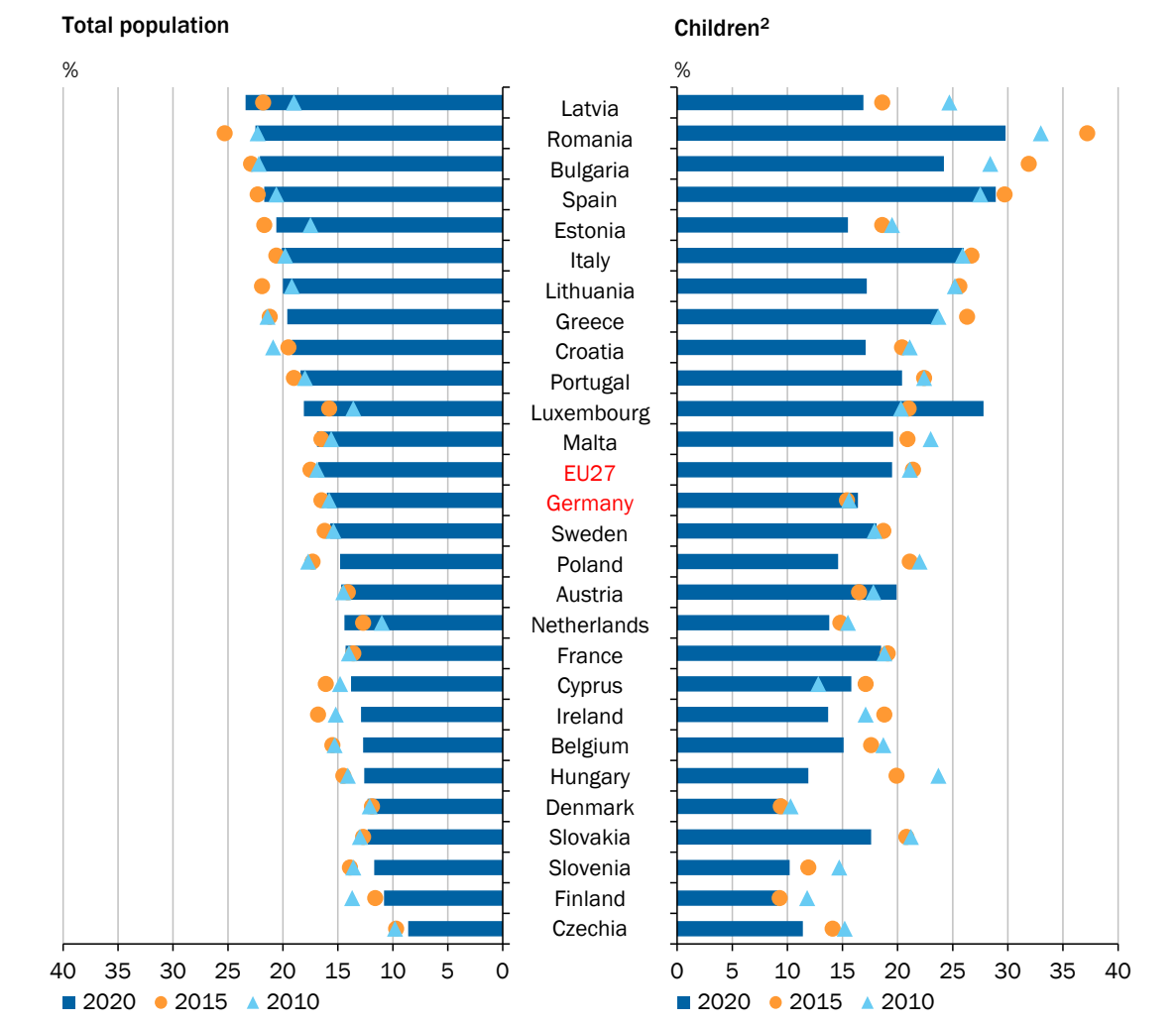
The **main official data source** for measuring poverty risk and living conditions in the **EU member states is the EU-SILC.** This EU-wide comparable survey on income, poverty and living conditions has been conducted since 2005 with uniform definitions and methodological minimum standards. **Since 2020,** the EU-SILC survey in **Germany has been integrated into the microcensus as a separate sub-sample.** This has greatly increased the size of the sample and improved its representativeness, as participation became compulsory. However, due to massive non-response in 2020 and methodological changes, the time series of the EU-SILC is not usable (Hundenborn and Enderer, 2019). Since information on income is collected retrospectively for the previous year, this structural break in the at-risk-of-poverty rate occurs in 2019. The information from the 2022 survey is provisional and may still be revised.

The **microcensus** has surveyed one per cent of households in Germany every year since 1957. Information on risk-of-poverty rates has been available in the microcensus since 2005. However, they are calculated on the basis of the household net income of the previous month respectively, which is only available as a generalized self-classification into income classes, and is asked in a questionnaire that is independent of the EU-SILC. The income information for 2022 is still provisional. In the microcensus, a redesign of the sample and the introduction of an online questionnaire have also led to a structural break, making it difficult to compare the results of 2020 with those of the previous years (Hundenborn and Enderer, 2019).

- 299. The at-risk-of-poverty rate in Germany is in the middle range by European comparison.** However, interpreting developments over time in an international comparison is not possible in the EU-SILC, since structural breaks in the survey occur in different years in different member states. [↪ CHART 92 LEFT](#) The countries with the lowest at-risk-of-poverty rates in the total population include Denmark, Slovenia, Finland and the Czech Republic. **The at-risk-of-poverty rate for children in Germany is also in the middle range by European comparison.** [↪ CHART 92 RIGHT](#) Countries with a lower at-risk-of-poverty rate also tend to have a lower at-risk-of-poverty rate among children. However, there are exceptions like the Baltic States, which have a lower at-risk-of-poverty rate for children compared to the overall at-risk-of-poverty rate, and countries such as France, Italy and Spain, which have a higher at-risk-of-poverty rate for children compared to the overall at-risk-of-poverty rate. Denmark and Finland are again among the countries with the lowest risk of child poverty. Furthermore, the at-risk-of-poverty rate for children has decreased over time in countries like Poland and Hungary, which have raised family benefits.

↘ CHART 92

At-risk-of-poverty rate¹ in EU comparison



1 – Share of persons with net equivalised income of less than 60 % of the median net equivalised income of the population in private households. For the calculation, the income of the previous year is used as the reference year, therefore the results for the reference year are shown here and not for the survey year. Due to methodological changes, the results of the different countries are not necessarily comparable over time. 2 – Under the age of 18.

Source: EU-SILC
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300. For a consideration of absolute poverty, the EU-SILC provides indicators of material (and social) deprivation measured against individual situations of deprivation based on subjective assessments by respondents. ↘ BOX 20 ↘ CHART 91 RIGHT Generally, the indicators of material deprivation are **at a lower level than the at-risk-of-poverty rates**. About 9 % of respondents in Germany lived in a situation of material and social deprivation in 2021, and 4.3 % of respondents lived in a situation of severe material and social deprivation. Both indicators are about two percentage points higher based on the preliminary values for 2022.

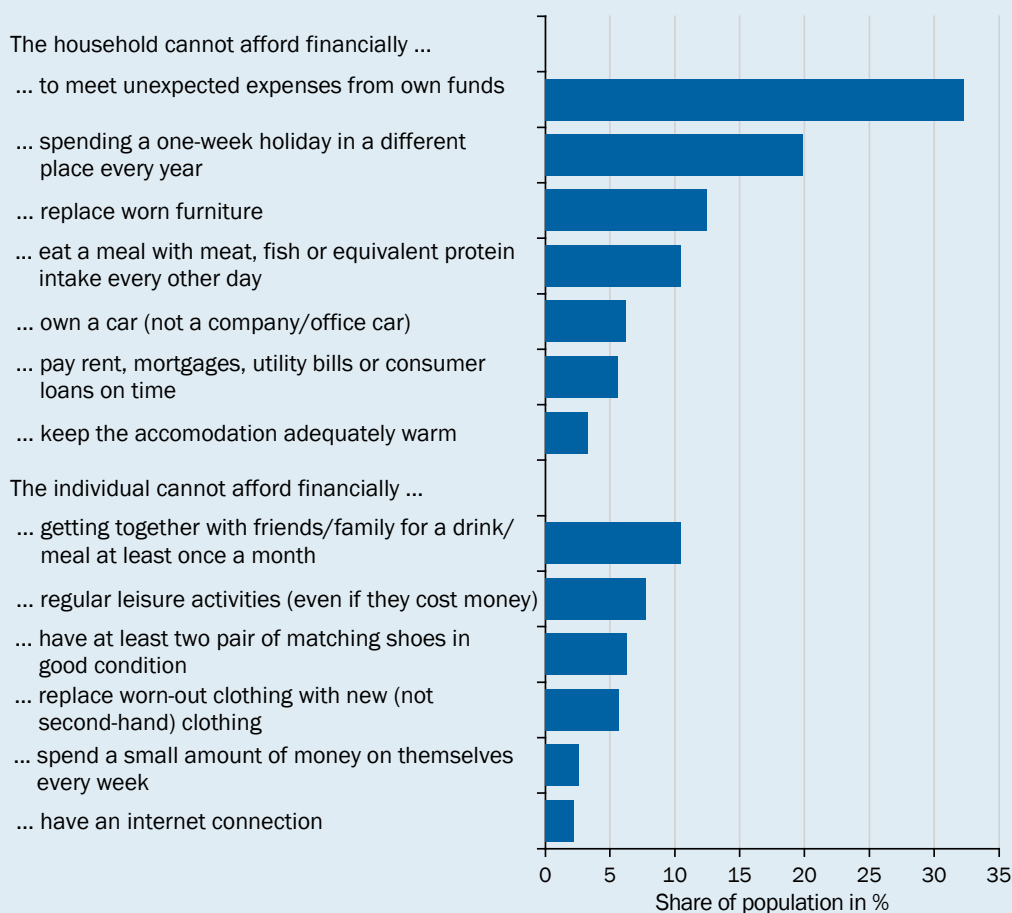
▸ BOX 20

Background: material deprivation and material and social deprivation

The indicators "severe material deprivation", "material and social deprivation" and "severe material and social deprivation" measure the **proportion of people who, according to their subjective assessment, cannot afford a lifestyle considered adequate by society**. The indicator of severe material deprivation was collected in the EU-SILC in the period from 2005 to 2020 (Eurostat, 2022). Following a revision, the indicator was replaced by the measure "material and social deprivation" (Guio et al., 2017). In addition, the EU-SILC was restructured in 2020. [▸ BACKGROUND INFO 13](#) The new indicator was developed to reduce existing measurement inaccuracies, to better document the situation of children, and to measure social participation more accurately. Personal situations of deprivation are assessed here using 13 criteria. [▸ CHART 93](#) Material and social deprivation exists if at least five of these 13 criteria are met in a household. If seven of the 13 criteria are met, the deprivation is classified as severe.

▸ CHART 93

Self-assessment of private households on material and social deprivation in Germany in 2021¹



1 – Multiple answers possible.

Sources: EU-SILC, Federal Statistical Office
© Sachverständigenrat | 23-317-01

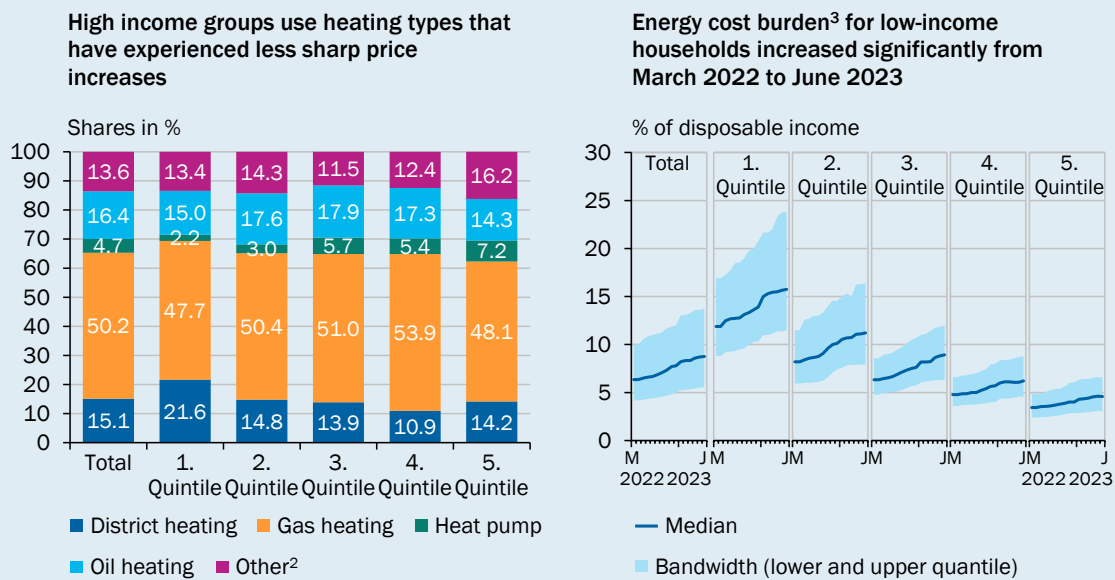
Compared to measures of relative poverty, the **concept of material and (social) deprivation is better suited for revealing actual material deficiency situations**. However, both the choice of areas where material deprivation is measured and the decision on how many areas need to be deficient is a normative one. Moreover, all statements are based exclusively on the

respondents' self-assessment.

In 2021, 3.3 % of private households answered that they could not afford to keep their accommodation adequately warm. [↪ CHART 93](#) Since then, this percentage has likely increased significantly as a result of the **energy crisis**, as suggested by a study on the development of energy poverty (Grimm et al., 2023). Following Russia's attack on Ukraine, there has been a massive increase in wholesale energy prices since spring 2022, which has also had a delayed effect on the level of energy instalment payments for consumers in Germany. **Private households were affected** by these cost increases **at different times and to different degrees**, especially when energy costs are put in relation to household income: different starting situations led to a disproportionate burden on lower income groups. High-income households have more opportunities to avoid costs, for example because they more often live in buildings with a high energy performance standard and more often have heating systems whose energy sources are less affected by the price increases (especially heat pumps). [↪ CHART 94 LEFT](#)

[↪ CHART 94](#)

Consequences of the energy crisis: Types of heating and energy cost burden by income quintile¹



1 – Results of a household-representative survey. In two waves in April/May and June/July 2023, more than 4,444 households were surveyed by the opinion research institute forsa. The values are weighted according to federal state and household size. Quintiles of equivalence-weighted disposable income are shown. 2 – Electric heating, combined heat and power unit, wood heating, pellet heating, photovoltaic system, solar thermal system, hybrid heating, fuel cell heating, other types of heating. 3 – The energy cost burden corresponds to the share of the sum of the monthly instalment payments for heating/hot water and electricity in the household net income.

Source: Grimm et al. (2023)
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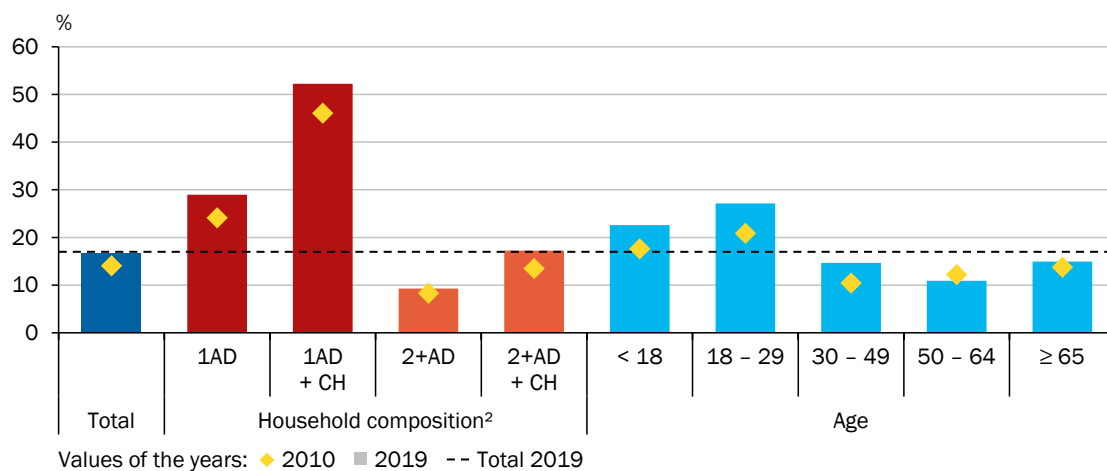
Low-income households, on the other hand, live more often in rented flats with a poorer average energy performance, which are also more often heated using energy sources that experienced a particularly sharp price increase during the energy crisis (especially natural gas, district heating and heating oil). As a consequence, **low-income households were significantly more likely to be threatened by financial overload due to energy costs in June 2023 than in March 2022.** [↪ CHART 94 RIGHT](#) Their **risk of energy poverty** has also **increased** as a result. According to a common definition, a household is considered to be at risk of energy poverty if the share of energy costs exceeds 10 % of disposable income (Henger and Stockhausen, 2022).

3. Groups of people at risk of poverty

- 301. Some groups of people are particularly at risk of poverty.** The characterisation of these groups can help uncover the causes of poverty risk and design social-policy measures in a more targeted way. The SOEP reveals considerable differences in the at-risk-of-poverty rate depending on household composition, age, employment status, education, gender, marital status and migration background.
- 302.** Households with two or more adults are considerably less likely to be at risk of poverty than households with one adult. [↘ CHART 95](#) These differences can be partly attributed to the calculation of the net equivalence-weighted income, which only includes a weight of 0.5 for an additional adult, who often also earns income. [↘ BACKGROUND INFO 12](#) At the same time, households with at least one person under the age of 14 have a higher at-risk-of-poverty rate. These children or adolescents are included in the calculation with a weight of 0.3 and usually have no income of their own. **Single parents and their children are especially at risk of poverty.** About 50 % of these households were at risk of poverty in 2019, while the percentage for adult single-person households without children was approximately 30 %. The at-risk-of-poverty rate for households with two or more adults rose from 9 % to 17 % when at least one person under 14 was also living in the household.
- 303.** The differentiation by age shows that **children and adolescents in Germany** have an **above-average at-risk-of-poverty rate**. Based on the SOEP, it was almost 23 % for children and adolescents under the age of 18 in 2019, higher than the average of just under 17 % for the population as a whole. This phenomenon is also reflected in the high proportion of children receiving benefits pursuant to Book II of the Social Code (SGB II). [↘ BOX 21](#) The majority of children in the SOEP are not interviewed individually, but are considered part of the household of an

[↘ CHART 95](#)

At-risk-of-poverty rates¹ by household composition and age in Germany



1 – Share of persons with net equivalised income less than 60 % of the median net equivalised income of the population.
2 – 1AD-Household with one adult, 2+AD-Household with two or more adults, CH-Household with child(ren) under the age of 14.

Sources: SOEP v37, own calculations
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adult respondent. In this respect, the figures initially only show that an above-average number of children live in households at risk of poverty. Young adults between the ages of 18 and 29 also show an increased risk of poverty. However, many of these adults are in education and training and will be significantly less at risk of poverty in the long term after completing their training and studies.

➤ CHART 97

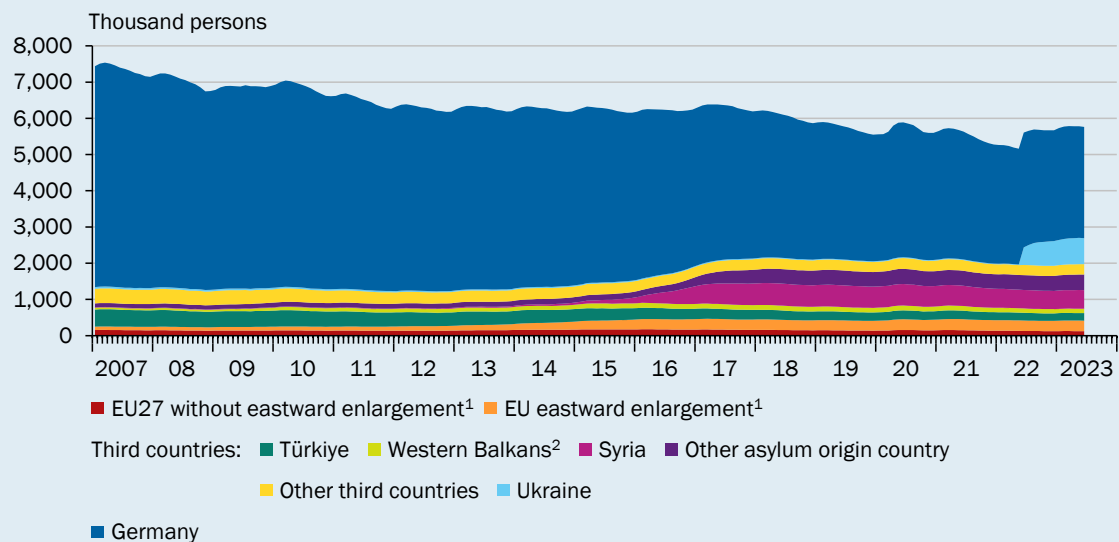
➤ BOX 21

Background: receipt of benefits pursuant to SGB II (Bürgergeld, citizen's benefit)

In the discussion about poverty, the focus is often on the receipt of benefits pursuant to the **Second Book of Social Code, SGB II (Bürgergeld, citizen's benefit)**. These benefits are linked to the socio-cultural subsistence minimum. ➤ GLOSSARY In June 2023, a total of 5.8 million people, or about 6.9 % of the population, lived in the 2.9 million households entitled to benefits covered by the SGB II. ➤ CHART 96 This figure and also the number of people affected have hardly changed over the past 10 years. In May 2023, the 1.0 million households with children entitled to benefits included about 2.0 million children under the age of 18. The number of children covered by SGB II has risen greatly by 0.2 million since December 2021.

➤ CHART 96

Receipt of benefits under SGB II in Germany by nationality



1 – Countries of EU eastward enlargement: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. 2 – Albania, Bosnia and Herzegovina, Kosovo, Montenegro, Northern Macedonia, Serbia. 3 – Afghanistan, Eritrea, Iraq, Iran, Nigeria, Pakistan, Somalia.

Sources: BA, own calculations

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The number of people with German nationality covered by SGB II fell from 6.1 million in January 2007 to 3.1 million in June 2023. The number of people with foreign nationality, by contrast, rose from 1.3 million in January 2007 to 2.7 million in June 2023 and now accounts for 47 % of SGB II recipients. ➤ CHART 96 The inclusion of asylum seekers has contributed significantly to this, especially people from Syria in 2016. Since the war-related influx of refugees from Ukraine in spring 2022, the number of people with Ukrainian nationality covered by SGB II has risen by 0.7 million. The reason for this is the change in the law in June 2022, under which Ukrainian refugees receive benefits directly pursuant to SGB II and no longer initially pursuant to the Asylum Seekers' Benefits Act. Receipt of SGB II benefits is simultaneously a

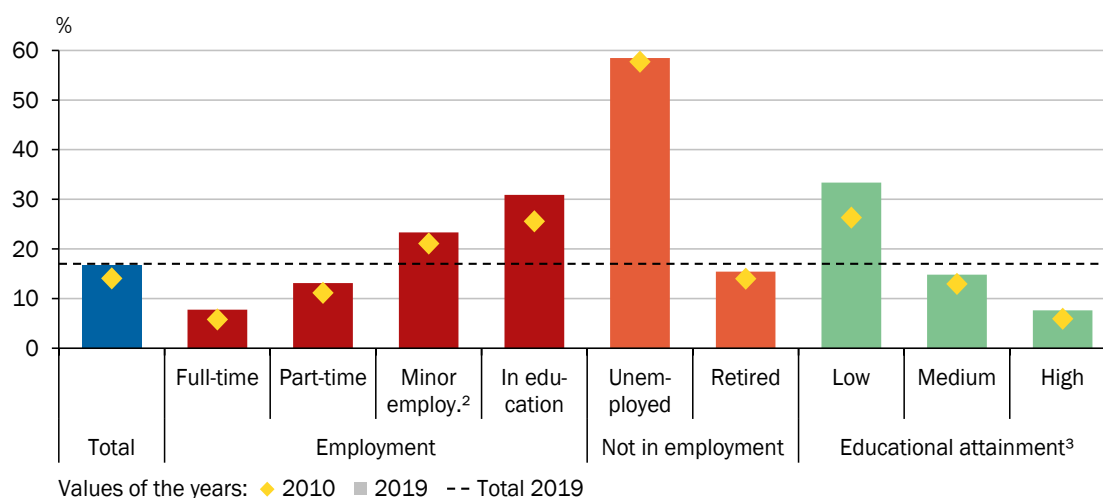
prerequisite for integrating the people concerned into the labour market (GCEE Annual Report 2022 box 21).

In addition to the benefits pursuant to SGB II, about 1.2 million people received **basic income support for the elderly and for persons with reduced earning capacity** (social benefits pursuant to SGB XII) in June 2023. Among them were 0.3 million people with foreign citizenship.

304. In the public discussion, the fear of being at risk of poverty after retirement is frequently expressed in view of the reduced pension level offered by statutory pension insurance (Blank, 2017). The SOEP shows that in 2019 the **risk of poverty for people over 65 and for pensioners** was 15 %, just below the level of the **average for society as a whole**. ↪ CHART 95 However, an expert report by Buslei et al. (2023) commissioned by the GCEE shows that women in particular are more often at risk of poverty in old age, and that this proportion will increase further in the future due to women's higher life expectancy and the associated rise in single-person households in old age. ↪ BOX 25
305. The decisive **factor for the risk of poverty is unemployment**. ↪ CHART 97 While about 58 % of unemployed in the SOEP were at risk of poverty in 2019, this only applied to just under 8 % of full-time employees and about 13 % of part-time employees. The at-risk-of-poverty rate of those in employment who have been unemployed once in the past – sometimes a long time ago – is also significantly higher than for those who have never been unemployed. Furthermore, the risk of poverty in the case of unemployment is exacerbated by the fact that, to a considerable extent, social benefits under unemployment benefits II (Arbeitslosengeld II) or basic income support are not claimed (Buslei et al., 2019; Harnisch, 2019; Bruckmeier et al., 2021). ↪ BOX 22 Since labour force participation and earnings

↪ CHART 97

At-risk-of-poverty rates¹ by employment status and educational attainment in Germany



1 – Share of persons with net equivalised income less than 60 % of the median net equivalised income of the population.
 2 – Marginal employment. 3 – Low education: Neither vocational nor high school diploma; medium education: vocational baccalaureate, high school diploma or vocational diploma; high education: tertiary degree.

Sources: SOEP v37, own calculations
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increase **with better qualifications**, the **risk of poverty falls** rapidly with higher educational attainment. For example, the at-risk-of-poverty rate for adults with a low level of education (neither completed vocational training nor a general university entrance qualification) was around 34 %, for adults with an intermediate level of education (advanced vocational certificate of education, general university entrance qualification or vocational training qualification) almost 15 %, and for adults with a high level of education (tertiary qualification) only just under 8 %.

▸ BOX 22

Background: non-take-up of social benefits

The **take-up of social benefits** in Germany **varies according to the benefit and the group of people studied**. It is difficult to estimate. If a benefit is not taken up, perhaps out of lack of information, this can hardly be determined by surveys or microsimulation models. Study results can therefore differ significantly (BBSR, 2015). On the basis of the SOEP for the years 2005 to 2014, Harnisch (2019) estimates that 55.7 % of eligible people were not claiming Unemployment Benefit II. Using administrative data, Bruckmeier et al. (2021) find non-take-up rates of 37.1 %, with non-take-up higher among women (42 %) than men (32 %). Non-take-up also varies by age, number of children and region. The rate is above average in the 15-24 age group (46 %). By far the highest non-take-up rates are found for married couples without children (60 %).

Non-take-up of the supplementary child allowance is particularly high, ranging from 60 % to 88 %, depending on the estimate (Bonin et al., 2018; Bruckmeier and Wiemers, 2018; Deutscher Bundestag, 2023). Becker and Hauser (2012) find that the rate of take-up declines with the number of children. It is 86.7 % for families with one child, 69.8 % with two children and below 50 % for families with more than two children.

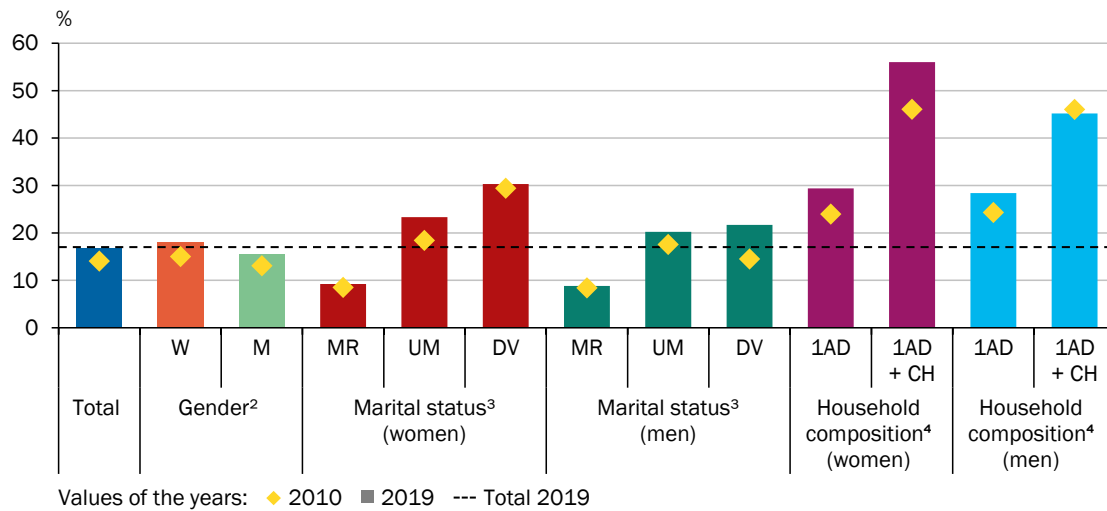
According to an estimate by the German Economic Institute (IW Köln), the **non-take-up rate for housing allowance** is around 50 % (BBSR, 2015), while Bruckmeier and Wiemers (2018) put the rate at 86.6 %. With the help of data from the SOEP, Buslei et al. (2019) find that only just under every third eligible person receives **basic income support for the elderly**. They also observe that the take-up rate rises the higher the entitlement.

Benefits are most likely not to be claimed if the entitlement is not high. Especially **claimants with low entitlements could be discouraged from claiming by opaque eligibility terms, complicated application procedures and a fear of stigmatisation** (GCEE Annual Report 2019 item 674). Moreover, entitled people are not automatically aware of the existence of transfer benefits or what they might be entitled to. Institutional changes, especially administrative simplifications and the digitisation of application procedures, could improve the effectiveness and efficiency of the social system, reduce stigmatisation effects and increase take-up. In particular, the option of submitting applications from home rather than in person could reduce stigmatisation and increase take-up (Friedrichsen et al., 2018; Friedrichsen and Schmacker, 2019).

- 306. In 2019, the at-risk-of-poverty rate was higher among women**, at almost 18 %, **than among men** at about 15 %. ▸ [CHART 98](#) This gender-specific difference can be seen among adults in all age groups and can be explained by lower levels of employment, especially more part-time jobs, lower income and a higher proportion of women in single-parent households (Federal Statistical Office, 2018). Single mothers tend to be more at risk of poverty than single fathers. ▸ [CHART 98](#) However, the number of single fathers in the SOEP is low. In addition, it can be seen that **divorced women in particular have a very high at-risk-of-**

↪ CHART 98

At-risk-of-poverty rates¹ by gender, marital status and household composition



1 – Share of persons with net equivalised income less than 60 % of the median net equivalised income of the population.
 2 – W-women, M-men. 3 – MR-married, UM-unmarried, DV-divorced. For the unmarried and divorced, living arrangements with other adults in the household are included. 4 – 1AD-Household with one adult, CH-Household with child(ren) under the age of 14.

Sources: SOEP v37, own calculations
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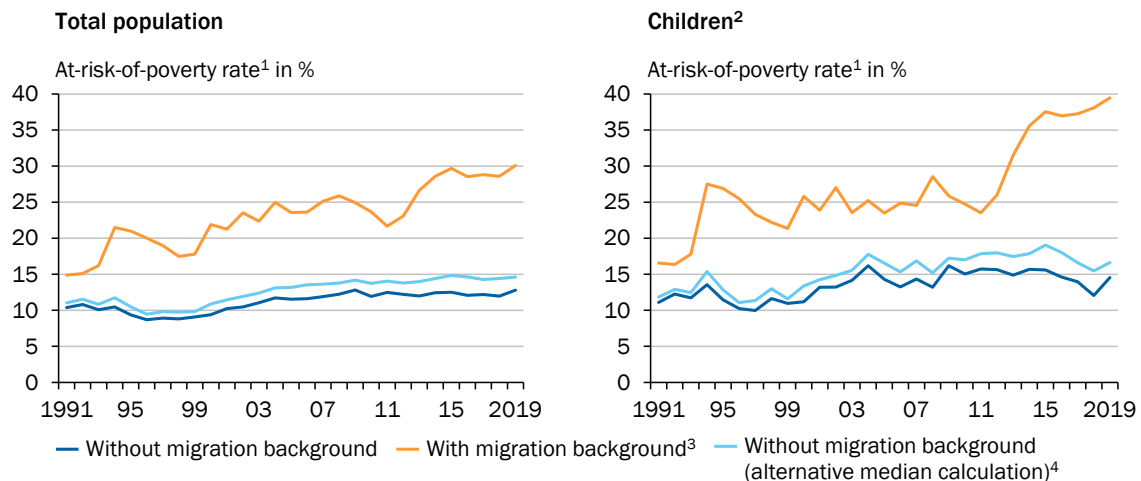
poverty rate. This is because they are more frequently single parents than divorced men are. The at-risk-of-poverty rate is only slightly higher among single women. The proportion of single parents is lower among single women than among divorced women, but higher than among single men. Women with little income of their own but high-income partners are not classified as at-risk-of-poverty because the calculation is made at the household level.

307. While around 30 % of people with a migration background were at risk of poverty in 2019, this applied to only around 13 % of people without a migration background. ↪ CHART 99 LEFT Furthermore, since 1991 the **at-risk-of-poverty rate among people with a migration background has increased** much more than among people without a migration background. The increase in recent years can be partly explained by the large number of refugees with a lower level of labour-market participation. ↪ ITEM 290 However, the structural breaks in the SOEP caused by the addition of migration samples from 2013 onwards make it difficult to interpret the development over time. ↪ BACKGROUND INFO 11 The **higher risk of poverty among people with a migration background** is also reflected in the development of the figures for the receipt of benefits pursuant to SGB II. ↪ BOX 21

On the other hand, the increase was rather small **among people without a migration background.** For them, **the at-risk-of-poverty rate has been stable since 2010.** However, their at-risk-of-poverty rate has been about two percentage points higher over the past five years if the median calculation only takes into account people who do not have a migration background and thus, on average, have higher incomes. But even using an alternative median calculation, there has only been a slight increase in the at-risk-of-poverty rate since 2010 among

↪ CHART 99

Development of the risk of poverty by migration background



1 – Share of persons with net equivalent incomes less than 60 % of the median of the population's net equivalent incomes. 2 – Under the age of 18. 3 – A person has a migration background if he/she or at least one parent was not born with German citizenship. 4 – Median calculation without persons with a migration background.

Sources: SOEP v37, own calculations
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people without a migration background. Overall, this shows that, despite the long-running favourable labour-market development between 2010 and 2019, it has not been possible to reduce the at-risk-of-poverty rate, even when the migration effects are excluded. ↪ CHART 99 However, the number of people with German nationality receiving benefits pursuant to SGB II has almost halved since 2007 in the wake of the good labour-market development. ↪ BOX 21

308. Children with a migration background have an extremely high risk of poverty. ↪ CHART 99 RIGHT In 2019, about 39 % of children with a migration background were at risk of poverty. The figure was 15 % among children without a migration background. While the at-risk-of-poverty rate for children with a migration background tended to develop sideways between 1995 and 2012, there has been a sharp increase since 2013. Here, however, the structural breaks in the SOEP again make the interpretation of this development difficult. ↪ BACKGROUND INFO 11

III. INSTITUTIONAL FRAMEWORK AND POSSIBLE CONFLICTS OF OBJECTIVES

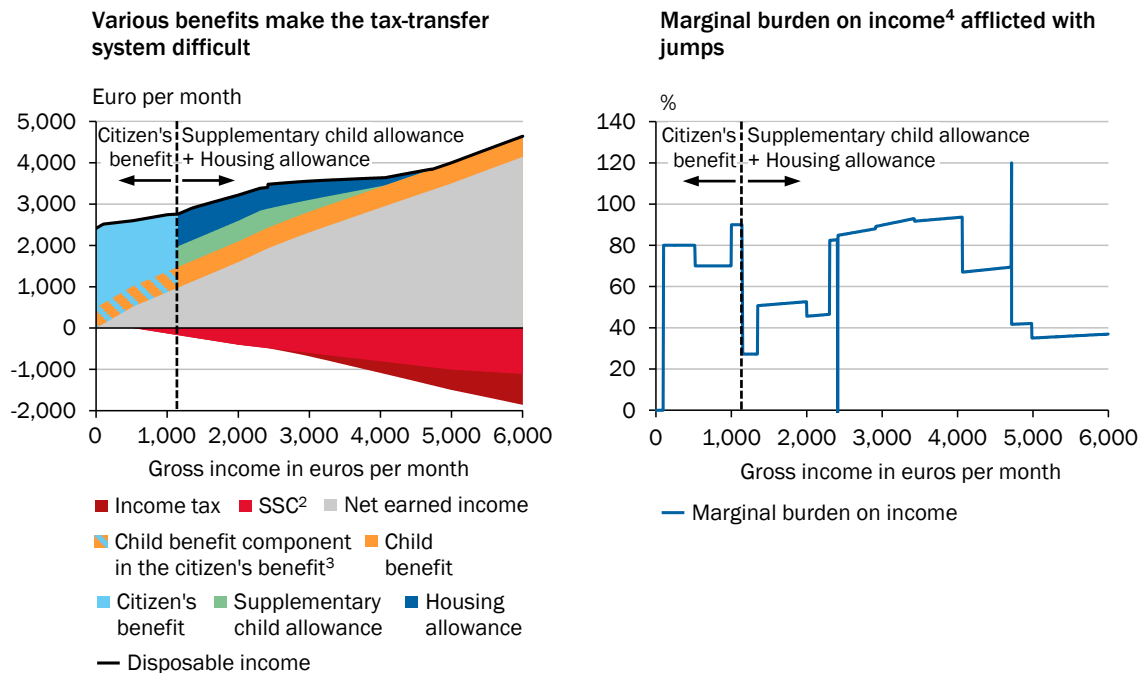
309. The risk of poverty involves both individual burdens for the people affected and undesirable developments in the overall economy. [↪ BOX 19](#) A **reduction in the at-risk-of-poverty rate** can tend to reduce such negative effects. This chapter focuses on **measures in the tax-transfer system** that aim to reduce the risk of poverty by strengthening employment incentives. Measures affecting the pension system can reduce the risk of poverty further. [↪ BOX 26](#) In addition, measures are needed to address the root causes of poverty. These include education-policy measures (GCEE Annual Report 2021 items 325 ff.) and measures that increase employment opportunities, e.g., by expanding childcare [↪ ITEMS 345 FF.](#) and promoting further-training and health measures. [↪ ITEMS 350 FF.](#)

1. The current transfer system

310. The **system of basic income support for job-seekers was comprehensively reformed by the Federal Government at the turn of the year 2022/23**. In that process, Unemployment Benefit II (Hartz IV), which had been introduced in 2005, was transferred to the new citizen's benefit, and the opportunities to earn additional income were improved. [↪ ITEM 312](#) Housing allowance was reformed at the same time. [↪ ITEM 314](#) In addition to the changes already adopted, a reform of benefits for children in low-income families (citizen's benefit for children, supplementary child allowance, education and participation package) is currently being discussed in the context of the introduction of a basic child allowance. [↪ ITEMS 330 FF.](#) The receipt of these benefits is to be income-dependent and linked to certain conditions. Up to now, the receipt of citizen's benefit on the one hand and the supplementary child allowance and housing allowance on the other have been mutually exclusive. [↪ CHART 100 LEFT](#)
311. In the current tax-transfer system, the incentives to take up work or to expand the labour supply are in some cases **very low**, especially for families receiving a supplementary child allowance, and the transitions between the different benefits show **discontinuities in the marginal burden**. [↪ CHART 100 RIGHT](#) As a result, the marginal burden on additional earned income is very high, sometimes even higher than 100 %.
312. The **citizen's benefit** is a **state transfer benefit for people who cannot – or can only to a limited extent – finance their livelihood** from their own income or assets, do not receive unemployment benefit and **can work** at least three hours a day (section 8 of SGB II). It consists of the statutory standard requirements for ensuring subsistence (section 6 of the Act to Determine Standard Requirements), any additional needs, and benefits to cover the costs of accommodation, insofar as these are deemed appropriate. The amount of the entitlements is based on the socio-cultural subsistence minimum [↪ GLOSSARY](#) and is constitutionally guaranteed (BVerfG, 2010a, 2019). In 2023, the standard rate of the citizen's

➤ CHART 100

Household income, benefits, and marginal burden on income for a couple with two children¹



1 – Exemplary representation for a couple with a single earner with two children aged five and nine. Total monthly rental costs of 807 euros are assumed. 2 – Social security contributions. 3 – Child benefit is fully counted towards the child-related benefits in the citizen's benefit. 4 – The marginal burden on income corresponds to the share of an additional euro earned that is deducted again due to transfer withdrawal in the transfer system, income tax or social security contributions. See background info 14.

Source: Blömer and Peichl (2023)
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benefit is €502 for single adults and €451 per person for two adults living together. Other adult members of the household receive €402. The standard rate for children depends on their age: €318 up to 5 years, €348 6-13 years, or €420 14 years and older. Child benefit is fully offset against this standard rate, as the standard rate already ensures the minimum subsistence level (BVerfG, 2010b). Since only people in need of assistance are entitled to the citizen's benefit, they must first use up their own resources. The means test is carried out by the job centres of the Federal Employment Agency. If a person has their own income or realisable assets in excess of the exemptions, these must be used up first. In the case of their own income, the citizen's benefit provides for an exemption of €100 per month. Above this exemption, the amount of citizen's benefit paid is reduced if their income increases (transfer withdrawal). The transfer withdrawal rate indicates by how many cents the transfer payment decreases if the net earned income increases by one euro. ➤ [BACKGROUND INFO 14](#)



➤ [BACKGROUND INFO 14](#)

Definition: Transfer withdrawal rate

The receipt of state (social) benefits is often income-dependent or tied to income thresholds (e.g. citizen's benefit, supplementary child allowance or housing allowance). Above certain thresholds, additional earnings lead to a reduction in the transfer payment: the transfer withdrawal. The reduction in the transfer payment

per additional euro earned corresponds to the transfer withdrawal rate if no social security contributions or income tax have to be paid. For example, if the monthly net earned income is between €100 and €520, the citizen's benefit is reduced by 80 % of that income. If the net earned income is between €520 and €1,000, this transfer withdrawal rate is 70 % (down from 80 % since 1 July 2023), and if it is between €1,000 and €1,200 it is 90 % (section 11b of SGB II). In the case of single people, net earned income in excess of this amount is fully offset against the citizen's benefit until there is no entitlement left. In the case of households with children entitled to benefits, 10 % of the household income between €1,200 and €1,500 is exempt. Similarly, the supplementary child allowance is reduced by a transfer withdrawal rate of 45 % in the event of additional earnings. The marginal burden of income is calculated by adding together the amount of income tax, social security contributions and transfer withdrawals for a given income. If no social insurance contributions or income tax are due, the marginal burden corresponds to the transfer withdrawal rate.

- 313. In addition to the deduction of income, the receipt of the citizen's benefit is also dependent on the person's assets.** In principle, the citizen's benefit is only paid if the entitled person's assets do not exceed a certain exemption (called 'protected assets'). This amounts to €15,000 per person in the household entitled to benefits. In the first year of receiving the citizen's benefit (waiting period), single people may keep assets up to €40,000. This limit is increased by €15,000 for each additional household member. **The actual costs of accommodation are also covered by the citizen's benefit during the waiting period.** Heating costs, on the other hand, are only covered up to a reasonable amount from the start of benefits (BMAS, 2023a). After the waiting period, housing costs, too, are only covered up to a reasonable amount. 45 square metres of living space for the first person in the household are considered adequate. 15 square metres are added for each additional person. Further adjustments were made to the citizen's benefit on 1 July 2023. For example, benefits paid during an educational or training course were increased and the deduction of income was changed (BMAS, 2023b). [↪ BACKGROUND INFO 14](#)
- 314. Housing allowance is a state subsidy towards housing costs** for tenants and owners who have a low income but are not entitled to citizen's benefit. Housing allowance entitlement applies up to an income limit that varies depending on the number of household members. The housing allowance authority makes a rule-based assessment of how much housing allowance is payable. 'Wohngeld plus' ('housing allowance plus'), which was reformed at the beginning of the year, is intended to significantly increase both the take-up of housing allowance and the average payments (Federal Government, 2023a).
- 315.** The family benefits office (Familienkasse) pays the **supplementary child allowance** if a single parent earns more than €600 or couples more than €900, the conditions for receiving child benefit are met and no citizen's benefit or social benefit is received (BA, 2023). It is thus a **transfer payment for households with children in the low-income range** if the income is not enough for the whole family, but the receipt of citizen's benefit is to be avoided. Since January

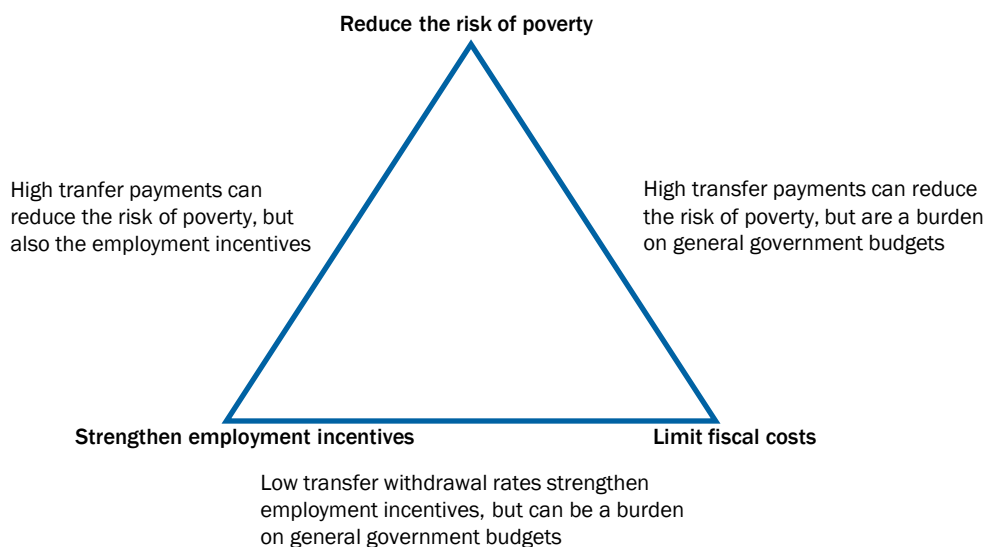
2023, the family benefits office has been paying **up to €250** per month per child. The transfer payment is **reduced at a rate of 45 %** as income rises.

2. Conflicting objectives in the transfer system

- 316. The risk of poverty can be reduced by financial transfers** to low-income households or by **better integrating those affected into the labour market**. Employment offers particularly good protection from the risk of poverty. [▶ ITEM 305](#) A lack of opportunities for gainful employment, e.g., insufficient child-care, has long-term negative effects on employment biographies. It increases the likelihood of having to draw social benefits on a permanent basis. Furthermore, path dependencies reduce the likelihood of a person taking up work in the future and earning a sufficient income (Filomena, 2023). For immigrants, gainful employment also reduces the risk of poverty and helps with integration. [▶ ITEM 307](#) Any disincentives in the tax-transfer system that may affect labour force participation or the extension of working hours should be reduced in order to improve labour-market integration.
- 317.** There are potential **conflicts of objectives** between **reducing the risk of poverty, creating employment incentives** and **limiting fiscal costs**. [▶ CHART 101](#) For example, high transfer payments can reduce the risk of poverty, but also reduce employment incentives, firstly through the income effect and secondly through the substitution effect if the withdrawal rates for additional earnings are high. [▶ ITEMS 320 FF.](#) If, on the other hand, benefits are only slowly withdrawn when earnings rise, this may create a greater incentive for employment. However, this increases the number of eligible households, since those with higher incomes are also eligible for transfer payments. In addition, households that were already eligible for transfer payments receive higher benefits. Depending on the strength of

[▶ CHART 101](#)

Conflicting goals in distribution policy



Source: own depiction
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the behavioural responses, this can increase costs for the public budgets. Furthermore, a larger number of people entitled to transfer payments is associated with more administrative work. [↪ ITEM 327](#) Depending on the behavioural response, the conflict of objectives can also be resolved if better employment incentives increase employment to such an extent that those affected have a higher overall net income, receive less in the way of transfer payments and are subject to a lower risk of poverty. **A higher employment rate could then even reduce the fiscal burden on the welfare state.**

IV. MEASURES: REFORM OPTIONS IN THE TAX-TRANSFER SYSTEM

- 318. Reform options exist in the tax-transfer system that would simultaneously reduce the risk of poverty, increase employment incentives and relieve – or at least not burden – the public budgets.** A reform of the transfer system that integrates previously separate benefits and implements a suitable lower transfer withdrawal rate can achieve all three goals. [↪ ITEMS 320 FF.](#) A reform of the spousal income-tax splitting system can provide additional employment incentives for married second earners in the longer term. [↪ ITEMS 336 FF.](#) In order to encourage or facilitate an increase in the employment of women, who are more frequently at risk of poverty than men, [↪ ITEM 306](#), childcare should be expanded. [↪ ITEMS 345 FF.](#) Promoting further training and health measures can reinforce the positive effects of these reform options. [↪ ITEMS 350 FF.](#) Furthermore, direct payments are an efficient instrument for supporting all households in times of crisis, or for making income-independent payments like a climate payment possible. [↪ ITEMS 354 FF.](#)

1. Strengthen employment incentives

- 319.** This section discusses various reforms to the tax-transfer system that aim to strengthen incentives to take a job or to work more. In an expert opinion for the GCEE, Blömer and Peichl (2023) use a microsimulation model to **quantify the effects of reforms to basic income support and the spousal income-tax splitting system** on the at-risk-of-poverty rate, the labour supply and public budgets. The simulations in this expert report are based on different assumptions. [↪ BACKGROUND INFO 15](#) The design of the basic child allowance is discussed qualitatively.



[↪ BACKGROUND INFO 15](#)

Principles: the expert opinion by Blömer and Peichl (2023) commissioned by the GCEE

The legal situation in the second half of 2023 is taken as the starting point for the simulation calculations. The reform options considered by Blömer and Peichl

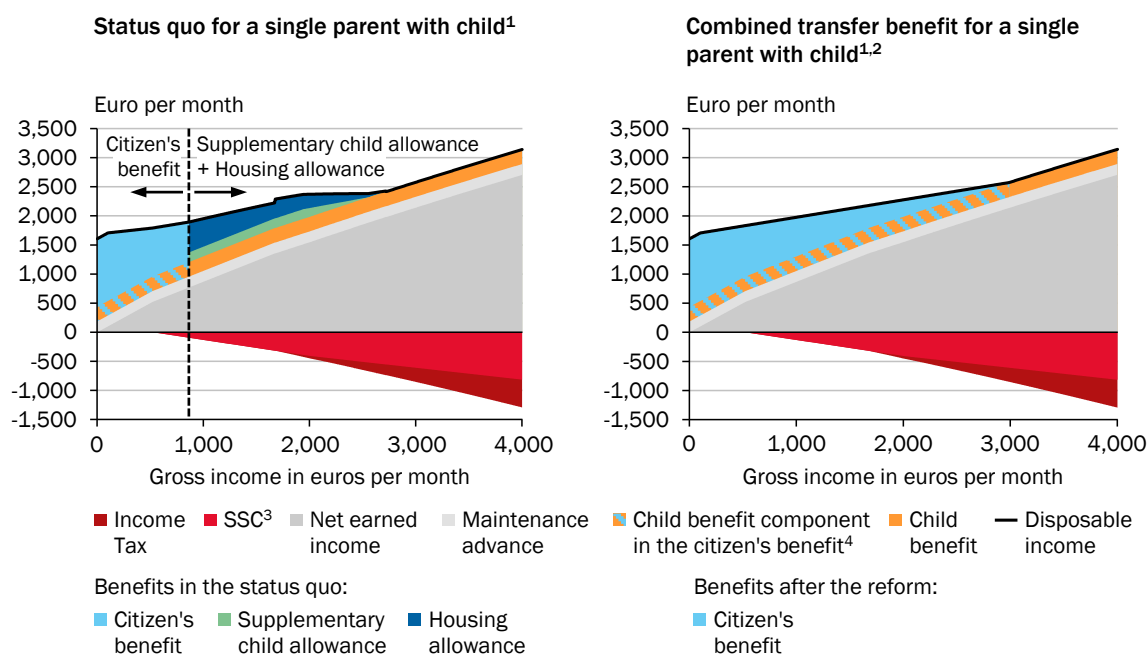
(2023) in the expert opinion retain several core principles of the current system. For example, basic income support is to continue guaranteeing a livelihood, so that the standard benefits for eligible people remain at the same level as the current status quo. The means test is also retained. Furthermore, the reform options in the simulation are designed in such a way that the current benefits for subsistence, housing and children (citizen's benefit, housing allowance and supplementary child allowance) are merged into an integrated transfer benefit. An analysis of the effects of the planned basic child allowance on the at-risk-of-poverty rates and employment incentives was not part of the expert opinion, since the draft law was not available when the report was commissioned. [▶ITEM 330](#)

A simplification of the transfer system

- 320.** The **transfer system** has been significantly **changed in recent years**. [▶ITEM 310](#) However, it continues to be criticised for various reasons (Advisory Board to the Federal Ministry of Finance, 2023). For example, several benefit systems co-exist for which different authorities are responsible and which come into play depending on disposable income. The transitions from one system to another can lead to discontinuities in the marginal burden. [▶ITEM 311](#) For example, once they exceed a certain income threshold, households with low incomes receive housing allowance instead of citizen's benefit, and households with children receive a supplementary child allowance in addition. [▶ITEMS 312 FF](#). The planned basic child allowance aims to bundle child-related benefits, in particular integrating the supplementary child allowance. [▶ITEM 330](#) Such a bundling, for example of citizen's benefit and housing allowance, is not yet planned for adults. Moreover, high transfer withdrawal rates reduce incentives to extend gainful employment (Advisory Board to the Federal Ministry of Finance, 2023; GCEE Annual Report 2019 items 690 ff.). When receiving the supplementary child allowance, a very high marginal burden of up to 94 % for a couple [▶CHART 100 RIGHT](#) can mean there is almost no change in the net income of families when employment is extended.
- 321.** **By introducing a combined transfer payment, subsistence benefits can be bundled, and opportunities to earn additional income can be improved.** Bundling benefits can also reduce discontinuities and – as intended in the case of the basic child allowance [▶ITEM 335](#) – reduce the stigmatisation of drawing benefits. [▶BOX 22](#) Supplementary child allowance and housing allowance are integrated into a reformed citizens' benefit system for this purpose. [▶CHART 102](#) In the new system, households that are currently eligible for a supplementary child allowance and housing allowance would receive the integrated transfer payment. As in the current system, this transfer payment would cover basic needs and be phased out at a transfer withdrawal rate in such a way that the **marginal burden remains constant**. This design ensures that the additional advantage remains constant when working hours are increased. Households can thus transparently estimate the additional benefits of an increase in gainful employment and also avoid discontinuities in the marginal burden.
- 322.** **The key parameters for adjusting the employment-incentive effects** of the combined transfer payment are the **transfer withdrawal rate** and the **exemption**, i.e. the protected proportion of the earned income that is not deducted.

↪ CHART 102

A reform of the basic security system combines benefits



1 – Exemplary representation for a single parent with a child aged five. Total monthly rental costs of 586 euros are assumed. 2 – A reform with an exemption of 100 Euros and a marginal burden on income of 70 % is presented as an example. 3 – Social security contribution. 4 – Child benefit is fully counted towards the child-related benefits in the citizen's benefit.

Source: Blömer and Peichl (2023)

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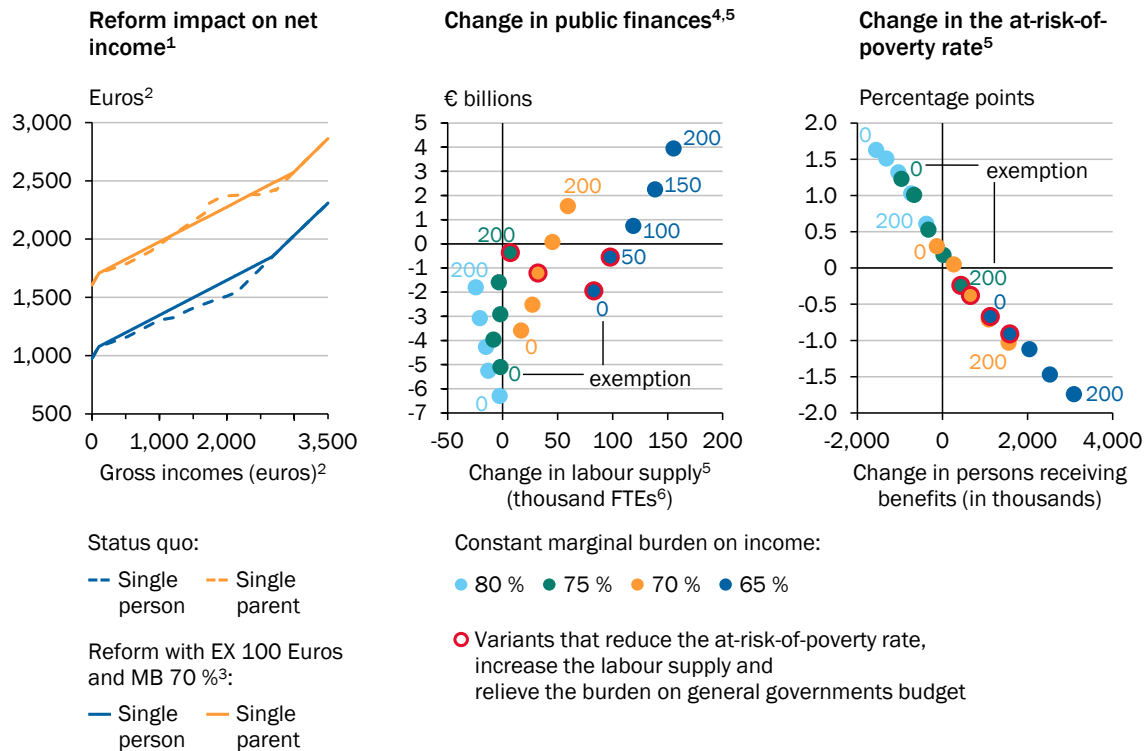
Both factors are **varied in the model scenarios**. Transfer withdrawal rates with a marginal burden of between 65 % and 80 % and exemptions of between €0 and €200 are considered. Taxes and social security contributions are taken into account in the design of the transfer withdrawal, as before under SGB II; this results in a constant marginal burden, while the transfer withdrawal rate can be lower. ↪ CHART 108 APPENDIX Both a reduction in the transfer withdrawal and an increase in the amount of exemption reduce the at-risk-of-poverty rate. ↪ CHART 103 RIGHT A larger exemption combined with a lower transfer withdrawal rate also creates positive employment incentives. At the same time, however, the burden on public budgets increases, since – despite the expansion of the labour supply and a resulting reduction in the burden on social security funds – the transfer payment for a given earned income and the number of recipients of transfer payments increase. ↪ CHART 103 MIDDLE

323. The simulations show that **some reform variants** improve or at least do not worsen the effects of the tax-transfer system in the target dimensions considered. ↪ ITEM 317 At the same time, they **reduce the at-risk-of-poverty rate, strengthen the employment incentives and do not lead to an additional burden on public budgets**. ↪ CHART 103 MIDDLE AND RIGHT Compared to the current system, these variants are characterised either by mean marginal burdens of 75 % or 70 % and high exemptions or by low marginal burdens and low exemptions. In the case of a higher marginal burden, the employment incentives decline and the at-risk-of-poverty rate increases, partly because the flat-rate integration of the

↘ CHART 103

Introduction of a constant marginal burden on income while maintaining or increasing the exemption

Impact analysis compared with the legal status as at July 2023



1 – Exemplary representation for a single person without children and a single parent with a child aged 5. Total monthly rental costs of 475 euros and 586 euros respectively are assumed. 2 – At household level per month. 3 – An exemption (EX) of 100 euros and a constant marginal burden on income (MB) of 70 % are shown. 4 – Negative figures mean a relief for the general government budget. 5 – Extrapolated to the total population. 6 – FTEs-full-time equivalents.

Source: Blömer and Peichl (2023)
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supplementary child allowance and housing allowance assumed here would in some cases put households with children in a worse position.

324. Assuming an exemption of €100 and a standard payment at the same level as today, a transition to a constant **marginal burden of 70 %** would **increase labour supply by up to 32,000 full-time equivalents** ↘ GLOSSARY (Blömer and Peichl, 2023). The labour-supply effects result mainly from a higher participation by previously unemployed people. In addition, the reform leads to single people in particular extending their working hours, while couples work slightly less full-time (Blömer and Peichl, 2023). Due to the overall increase in the labour supply, expenditure on transfer payments would fall and the revenues of the social security funds would increase. Overall, this reform should reduce the at-risk-of-poverty rate by 0.4 percentage points. The public budgets would be relieved by about €1.2 billion. This is likely to lead to different reductions and increases in burdens between the levels of regional and local government – federal, Länder and municipalities – and the social security funds. Compensation between these levels can be politically difficult. The fact that social security funds are earmarked must also be taken into account.

325. The **at-risk-of-poverty rate could be further reduced** by other combinations of the exemption and the transfer withdrawal rate, and the **employment incentives could be further strengthened**. An increase in the exemption to €150 with a marginal burden of 70 % would be accompanied by labour-supply effects of 45,000 full-time equivalents, and an exemption of €50 combined with a marginal burden of 65 % could increase labour supply by as much as 98,000 full-time equivalents. This would reduce the at-risk-of-poverty rate by 0.7 or 0.9 percentage points respectively. With a marginal burden of 70 % and an exemption of €150, the public budgets would be minimally burdened with €0.1 billion, while a marginal burden of 65 % and an exemption of €50 would mean a slight relief of €0.6 billion.

Further-reaching reductions in the at-risk-of-poverty rate of 1.5 % or even 1.7 % with even more positive labour-supply effects of 139,000 or 155,000 full-time equivalents **would be possible** with a marginal burden of 65 % and exemptions of €150 or €200. However, they would burden the public budgets with €2.3 billion and €3.9 billion respectively, and also considerably increase the number of recipients of transfer payments.

326. **Higher exemptions or a lower transfer withdrawal rate** compared to the current citizen's benefit system **increase the number of households receiving transfer benefits**. Depending on the level of the transfer withdrawal rate, the reform could therefore lead to households in the middle-income groups also becoming eligible for transfers. For example, if the marginal burden is set at a constant 70 %, a single-parent household with one child would be entitled to citizen's benefit payments up to a monthly gross income of just under €3,000. [↘ CHART 102](#) For a four-person household with a single earner and two children, the limit would be almost €5,000 and for a single person almost €2,700. Overall, the **number of transfer recipients would increase by 660,000 people** if the marginal burden remained constant at 70 %.

327. **Despite the low entitlements of many transfer recipients, the administrative burden of the citizen's benefit is likely to increase** (GCEE Annual Report 2019 item 690). The lower transfer withdrawal rate and the merging of benefits means that the group of people entitled to benefits will expand significantly. In addition to the 660,000 people who previously did not receive transfer payments and who, with a marginal burden of 70 % and an allowance of €100, will receive basic income support in addition, 3.7 million recipients of supplementary child allowance or housing allowance will switch to basic income support. Overall, the group of citizen's benefit recipients would thus increase in size by about 75 % to 10.2 million people, which, in a linear relationship, would raise the administrative costs by the same percentage. However, since the new recipients are already in employment and require less support than job-seekers, the additional costs are likely to be much lower. In addition, it must be taken into account that the administrative costs that have been incurred to date for the 3.7 million recipients of supplementary child allowance or housing allowance would be eliminated. Furthermore, **combining the benefits would counteract parallel structures**, since the citizen's benefit, supplementary child allowance and housing benefit have hitherto been processed and paid out by different authorities.

↘ [ITEMS 312 FF](#). Furthermore, digitisation of the application procedures could reduce administrative costs in the medium term, especially if there is only one uniform administrative system.

- 328.** In the **reform variants** with a **constant marginal burden** examined here, the former graduation of transfer withdrawal rates would be dissolved. The transfer withholding rate is currently 80 % for a net earned income of between €100 and €520, 70 % for a net earned income between €520 and €1,000, and 90 % for a net earned income between €1,000 and €1,200. ↘ [BACKGROUND INFO 14](#) Furthermore, in the case of households with children entitled to benefits, the marginal burden is still 90 % in the case of a net earned income of between €1,200 and €1,500. However, there are also proposals to maintain a graduation but to adjust it to create incentives for an expansion of gainful employment (Blömer et al., 2019; Blömer and Peichl, 2019; GCEE Annual Report 2019 items 694 ff.). A high transfer withdrawal rate for the lowest incomes can make marginal employment unattractive and thus create incentives to move into higher income areas with a lower transfer withdrawal rate by working more. However, a high transfer withdrawal rate in the lowest income range reduces the incentives of the unemployed to take up employment in the low-income range.
- 329.** A **combined transfer payment** can be **beneficial** for a number of reasons. Bundling benefits into one subsistence-securing payment **eliminates transitions from one benefit to another**. This reduces discontinuities in the marginal burden, which make it unattractive to expand gainful employment due to, in some cases, very high transfer withdrawal rates. ↘ [ITEM 311](#) ↘ [BACKGROUND INFO 14](#) In addition, bundling creates **clear responsibilities for one authority**, especially at the transition points, which simplifies the application process for benefits and can increase take-up. Previously, the citizen's benefit had to be applied for at the job centre, the supplementary child allowance at the family benefits office, and the housing allowance at the housing allowance authority. ↘ [ITEMS 312 FF](#). Furthermore, the bundling of benefit payments can have an **impact on stigmatisation effects**. On the one hand, the stigmatisation effect can increase if transfer recipients in the middle-income range now also receive citizen's benefit. On the other hand, the expansion of the group of recipients and the digitisation of application procedures can contribute to a reduction in the stigmatisation effect of citizen's benefit. ↘ [BOX 22](#) This is particularly true if a single point of contact is responsible for all benefits including child benefit, as this means that all population groups come into contact with this office. Some of the administration in the background could be distributed among different authorities, as is currently the case, in order to facilitate implementation in the short term. **For the public administration**, bundling can lead to **economies of scale** and **avoid parallel structures**. ↘ [ITEM 327](#)

Basic child allowance

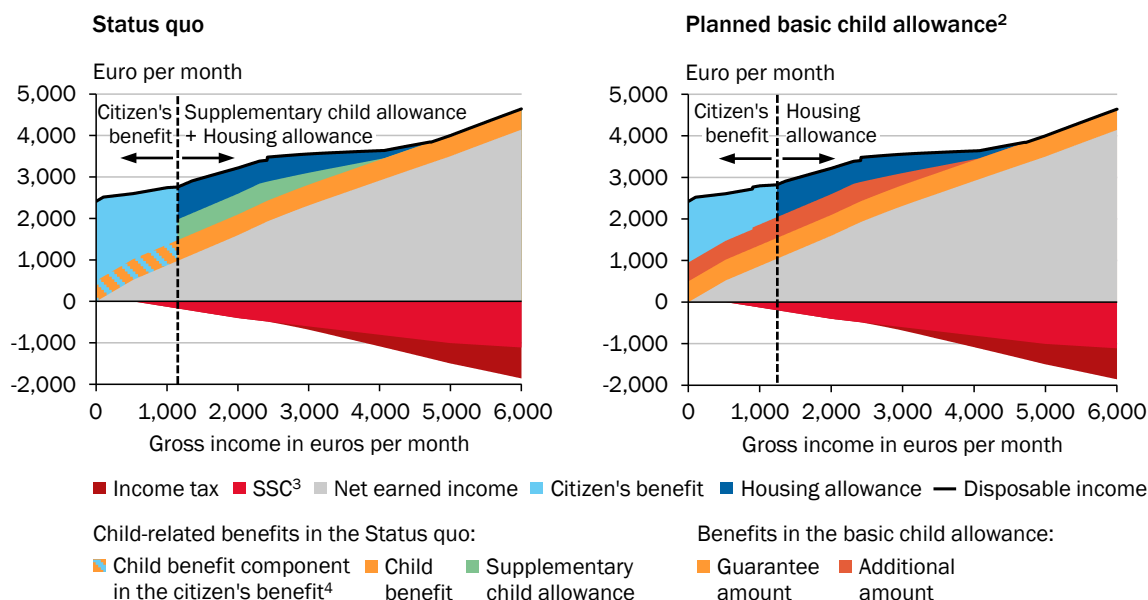
- 330.** In September 2023, the Federal Cabinet agreed on the basic structure of a **basic child allowance** (Federal Government, 2023b). It is to **combine four family transfer payments for children and teenagers in one benefit** from 2025: the child benefit of currently €250 per month and child, the supplementary child

allowance of a maximum of €250 per month and child, the standard requirement for children in the basic income support under SGB II / SGB XII, and parts of the education and participation package. The draft bill provides for total costs of the reform project of almost €2.0 billion for 2025. A total of €6.5 billion has been earmarked for the basic child allowance. However, as a result of the integration, €1.9 billion for the supplementary child allowance and €2.8 billion for benefits under SGB II will be omitted. By 2028, the total costs are expected to rise to €5.9 billion. Payments are to be made by the family services of the Federal Employment Agency (BA), into which the family benefits office (Familienkasse) will change (Federal Government, 2023b). They expect additional administrative costs of €0.4 billion per year from 2025 onwards. The integration is intended to simplify the social transfer system and make it more transparent. At the same time, this should increase take-up, which is very low for the current supplementary child allowance, for example. [↪ BOX 22](#) A digital application system is planned to help increase take-up.

331. Child benefit is to become the new guaranteed income-independent payment. [↪ CHART 104](#) This would contribute to the exemption from taxation of the minimum income required for subsistence, as well as to the promotion of families and to ensuring livelihood security. Similar to the basic or child tax-free allowance in income tax, the guaranteed amount is to be adjusted to the results of the Federal Government's biennial subsistence minimum report (BMFSFJ, 2023a).

The **supplementary child allowance** is to be further developed into a new **subsistence-securing supplement** to the basic child allowance. It will be paid

[↪ CHART 104](#)
Basic child allowance bundles child-related transfer benefits¹



1 – Exemplary representation for a couple with a single earner with two children aged five and nine. Total monthly rental costs of 807 euros are assumed. 2 – The currently planned basic child allowance based on the federal government's bill (Bundesregierung, 2023b). 3 – Social security contributions. 4 – Child benefit is fully counted towards the child-related benefits in the citizen's benefit.

Source: Blömer and Peichl (2023)
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according to income – up to a certain ceiling in full and will then be reduced at a transfer withdrawal rate of 45 %. Up to now, the supplementary child allowance has been paid as an alternative to the citizen's benefit. [▶ ITEM 315](#) This is to change as a result of the reform. In addition, the amount of the supplementary amount is to be based on the child's age, as in the case of SGB II.

332. In the public discussion, one argument often levelled against the basic child allowance is that higher transfer payments do not reach the children. However, an overview study by Stichnoth et al. (2018) finds **no evidence of systematic misappropriation of cash benefits for children and families by parents**. Child benefits in particular are used for children's educational and leisure activities and improve the family's housing situation. The administrative costs of cash payments are furthermore much lower than those of benefits in kind, where, as in the case of the education and participation package, large proportions have to be spent on personnel and material costs for administration (Stichnoth et al., 2018). However, an increase in monetary transfers is no substitute for urgently needed measures to improve the education system and expand childcare services. [▶ ITEMS 345 FF.](#)
333. Whether the basic child allowance **can achieve** its declared **goal of reducing the risk of poverty among children**, and to what extent there are conflicts of objectives with financing and improving employment incentives, **will depend largely on its design**. For example, the aim of combating the risk of poverty can be achieved with the least possible burden on public budgets if the additional amount is only available to those families who would be at risk of poverty without further benefits (Blömer et al., 2021b). However, withdrawing transfers when the supplementary amount expires would increase the marginal burden on income. This can lead to negative employment incentives.

In general, the **negative effects on labour force participation are weaker with a lower transfer withdrawal rate and a higher exemption** than with a higher transfer withdrawal rate and a lower exemption (Blömer et al., 2021b).

334. **As an alternative to a lower transfer withdrawal rate, the guaranteed amount can be increased and the supplementary amount reduced** as a quid pro quo. This would reduce the marginal burden when the supplementary amount expires and provide greater relief for single parents and families with small and medium incomes (Breuer, 2018). Since the sum of the guaranteed and additional amounts does not increase for those who continue to receive the additional amount, this has – depending on the design of the transfer withdrawal – hardly any impact on the risk of poverty if most households exceed the at-risk-of-poverty threshold before the additional amount expires. In this respect, there is a conflict of objectives in the design of the basic child allowance. The additional amount can reduce the risk of poverty for children with relatively little financing, but at the cost of negative employment effects. The guaranteed amount can reduce the negative employment effects, but **places a greater burden on public budgets**.
335. The Federal Government's **basic child allowance** provides for a bundled payment and the merging of different administrations for all children. This can reduce administrative costs. However, separating the benefits for children from the

basic income support for their parents creates a new interface in the transfer system which could increase administrative costs. However, the responsibility of the new family service can **reduce the stigmatisation effect and thus increase the take-up of benefits for children**. A **reduction in the at-risk-of-poverty rate** for children is thus **possible**. The simplification of the basic income support proposed by the GCEE can be seen equivalently as a combined transfer payment for adults that is compatible with the basic child allowance. The basic child allowance could be closely coordinated with this in terms of its amount and gradual reduction as income rises. The further digitisation of the administration in the field of basic income support for adults and children should contribute to reducing bureaucracy and simplify administrative processes.

Reform the spousal income-tax splitting system

336. Women are at risk of poverty much more often than men. This is especially true when children live in the household. [↪ ITEM 306](#) **Women in partnerships still participate less than men in working life** so that they can take care of the household, children or other relatives. [↪ ITEM 345](#) The risk of poverty is especially high for single mothers. At 58 %, it is well above average. [↪ ITEM 306](#) As a result of less work experience and a lack of further qualifications during marriage, the income potential of second earners is permanently lower in the event of divorce (Beznoska et al., 2019, p. 25; Foerster, 2022).
337. An **essential option to reduce the poverty risk among women** is therefore to make **their own employment more attractive**. [↪ ITEMS 345 FF.](#) A **reform of spousal income-tax splitting can** increase the incentives for employment by **reducing the marginal tax burden on second earners** – who are still usually women. [↪ BACKGROUND INFO 16](#) Regulations on mini-jobs and on the non-contributory co-insurance of spouses in statutory health and long-term-care insurance also impact on the incentives for employment. Especially in interaction with spousal income-tax splitting, they can discourage women from increasing their employment (Blömer and Peichl, 2020; Blömer et al., 2021a; GCEE Annual Report 2021 items 317 ff.).



[↪ BACKGROUND INFO 16](#)

Background: effect of the current system of spousal income-tax splitting

Under the current spousal income-tax splitting system, **a couple's two gross incomes are added together and divided by two**. The basic income tax rate is applied to each of the two halves. For example, if a couple has two taxable annual incomes of €100,000 and €20,000, two times €60,000 are taxed. (This is a simplifying assumption. In fact, the gross income is divided. The taxable income may vary due to different deductible expenses). This results in a tax burden of twice €15,242, i.e. a total of €30,484. If individual taxation were applied instead of spousal income-tax splitting, payable taxes would amount to €33,750 (including the solidarity surcharge) on the €100,000 and €1,956 on the €20,000, resulting in a tax payment of €35,706. The tax advantage as a result of spousal income-tax splitting is thus about €5,000. If both people earn the same amount, i.e. €60,000, there will be no difference between individual taxation and spousal income-tax

splitting. Because both incomes are treated equally, the basic tax-free allowance is also applied to both people, even if one of them has no income. The **advantage of spousal income-tax splitting only arises in the** case of unequal incomes and is caused by the progression of the income tax rate. The more unequal the gross incomes, the higher the advantage from splitting. In the case of the spousal income-tax splitting system, the high marginal tax burden of the first earner is significantly reduced (in the example, only the marginal tax rate for €60,000 is applied instead of the rate for €100,000); by contrast, that of the second earner increases significantly (the marginal tax rate for €60,000 instead of the rate for €20,000 is applied). Thus, in comparison to individual taxation, **the second earner is left with less of any additional euro earned, which reduces the employment incentive.**

↘ TABLE 21

338. **Various reform options** of spousal income-tax splitting have been under discussion for years (GCEE Annual Report 2021 box 22). Some possible forms of spousal taxation are subject to constitutional restrictions. In 1957, the Federal Constitutional Court ruled that married couples may not be taxed less favourably than unmarried couples (BVerfG, 1957). **Fully individual taxation is also not possible**, as at least the **subsistence level of both spouses or else maintenance obligations must be tax-exempt** (Advisory Board to the Federal Ministry of Finance, 2018, p. 30; GCEE Annual Report 2013 item 639). However, individual taxation often serves as a conceptual benchmark for analysing the effects of other reform options (Beznoska et al., 2019; Bach et al., 2020; Blömer and Peichl, 2023). Blömer and Peichl (2023) simulated different reform options for spousal income-tax splitting in a microsimulation model for the GCEE and analysed their effects on employment incentives, inequality, **risk-of-poverty measurement** and public budgets.
339. One frequently discussed reform option is the **real splitting**. This reform option is favoured by the expert commission of the current Family Report (Fuest and Peichl, 2020; BMFSFJ, 2021). In the case of real splitting, **a married couple can freely divide a tax-free allowance in a tax-optimal way**. For example, it can be used by the partner with the higher income, which leads to lower taxation of the couple's total income. This maximum transferable tax-free amount can, for example, correspond to the basic tax-free allowance. In alternative versions, amounts equal to the deductible maintenance payments can be divided between the spouses (Spangenberg, 2016; GCEE Annual Report 2021 box 22). Overall, real splitting is in fact a limitation of the current spousal income-tax splitting system. In particular, it results in a higher tax burden for higher income earners, which slightly increases tax revenues for the state as a whole. ↘ TABLE 21 Accordingly, the predicted labour-market participation rises slightly by 15,000 full-time equivalents. ↘ GLOSSARY However, compared to individual taxation this is very little considering the negative labour-supply effects of the current splitting amounting to 109,000 full-time equivalents. ↘ TABLE 21
340. Another reform option provides for an **additional marital allowance**. This variant is also fundamentally based on individual taxation, but **grants the married couple a third allowance in addition to the respective basic allowances**. Couples with the same income would also benefit from this third

allowance. **In the 'undiminished additional allowance' option, this can be divided as desired** (Beznoska et al., 2019). In the 'decreasing additional allowance' option, it diminishes as the income of the second earning person increases (Advisory Board to the Federal Ministry of Finance, 2018). In the case of the undiminished additional allowance, the marginal burden on the second earner would never be higher than for unmarried people. In the option with a decreasing additional allowance, the marginal burden for the second earner is higher than for an unmarried single person, but less so than in the option with a transferable basic allowance. Although the option with the undiminished additional allowance has the highest employment-incentive effects with 185,000 additional full-time equivalents, unlike the other variants, it is likely to lead to noticeable losses of tax revenue amounting to €4 billion compared to the status quo. [▶ TABLE 21](#) Moreover, compared to the other variants, the upper income deciles with a higher household income would benefit (Blömer and Peichl, 2023). By contrast, the option of the decreasing additional marital allowance involves higher tax revenues for the state (€5.5 billion), but significantly lower incentives for employment (41,000 full-time equivalents). In this option, it must be taken into account that although the tax rate remains progressive, the compensatory progressive effect of deductibility is reduced. It is unclear whether this might be constitutionally problematic. [▶ ITEM 342](#) However, with regard to the various reform options between spousal income-tax splitting and individual taxation, the Advisory Board to the Federal Ministry of Finance (2018, p. 5) comes to the conclusion that "constitutional law [is] less restrictive with regard to the constitutionality of alternative models than is often assumed".

341. A more recent **reform proposal by the International Monetary Fund** (IMF, 2019) also begins with **individual taxation**. Unlike the current system, no tax-free allowance is deducted from the tax base; rather, a **tax deduction from the tax liability** is granted. The amount of this tax deduction is based on the tax burden that an individually assessed person would have to pay on the subsistence minimum of a couple at the starting tax rate. At €17,969 in 2023, an individually assessed person would have to pay €1,446 in taxes. This amount would be deducted directly from the tax liability and thus ensure the tax-free minimum subsistence level with a uniform amount.

This would result in strong labour-supply effects (an additional 143,000 full-time equivalents) and high additional tax revenues (€7.7 billion) compared to the reform variants and the status quo. Since the tax base is not reduced, but a fixed amount is refunded, this variant does not lead to relief that increases with taxable income. This reform option has comparatively **strong effects on labour-market participation and the number of hours offered for employment**, since the marginal tax burden would correspond to that of individual taxation (GCEE Annual Report 2021 box 22). [▶ TABLE 21](#) The labour-supply effects are therefore similar to those of fully individual taxation, which is, however, constitutionally impossible. At €7.7 billion, the **additional tax revenues** would be higher than in the case of real splitting. These additional revenues would be generated in particular by married couples with high incomes and by married couples with only one earner.

TABLE 21

Effects of various reform options for the tax benefits of married couples¹

		Individual taxation	Real splitting ²	Unreduced addition marital allowance	Decreasing addition marital allowance ⁴	Tax deduction ⁵
Labour market participation⁶						
Total	Thousand persons	95	21	154	60	133
	%	0.25	0.05	0.40	0.16	0.35
Women	Thousand persons	102	21	122	48	114
	%	0.54	0.11	0.65	0.26	0.61
Men	Thousand persons	- 6	0	32	11	19
	%	- 0.03	0.00	0.16	0.06	0.10
Full-time equivalent (FTE)⁷						
Total	Thousand FTE	109	15	185	41	143
	%	0.31	0.04	0.52	0.12	0.40
Women	Thousand FTE	138	26	164	49	148
	%	0.89	0.17	1.06	0.32	0.95
Men	Thousand FTE	- 29	- 11	21	- 8	- 5
	%	- 0.14	- 0.05	0.11	- 0.04	- 0.02
Fiscal effects in € billion⁸		27.6	6.9	- 4.0	5.5	7.7

1 – The table shows the change compared to the status quo. 2 – With a maximum transferable amount equal to the deductible maintenance payments of €13,805. 3 – In the amount of €7,061 with otherwise basic individual taxation. The amount is calculated for 2023 as the subsistence minimum for couples minus the basic allowance = €17,989 – €10,908 (IMF, 2019). 4 – Based on Advisory Board to the Federal Ministry of Finance (2018). The limit up to which the additional marital allowance is paid out in principle increased by a factor of €10,908/9,000 to €49,159 (cf. also the adjustment in Bach et al. (2020), Blömer et al. (2021a) and Blömer and Peichl (2023)). 5 – Unreduced tax credit for married couples in the amount of €1,446 with otherwise basic individual taxation. The amount is calculated as the standard income tax burden of a single person with a taxable income of €17,969. The tax credit is compared to the sum of the income tax burden of both partners. There is no payment of a negative tax liability. The assessment basis for the solidarity surcharge continues to be the undiminished income tax without taking the tax credit into account. 6 – Indicates how many additional labour force members change to employment. 7 – Employment effect converted into full-time employees with 40 working hours per week. 8 – Taking into account changes in labour supply due to behavioural adjustments. Positive values mean a relief, negative values a burden on the general government budget.

Source: Blömer and Peichl (2023)

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342. A disadvantage of this reform option is that it involves considerable **constitutional risks of individual taxation with tax deduction**. For example, it seems questionable whether a tax deduction that corresponds to the tax burden on the subsistence minimum of a single person at the starting tax rate is compatible with the constitutional requirement that at least the subsistence minimum of the couple must be deducted from the tax base. At least, this reform option is not in line with the current tax system. The income-tax scale is progressive, and other forms of tax relief, especially deductions from the tax base, also follow this progression. If the tax deduction were to be set at such a high level that those paying top tax rates would not suffer any financial disadvantage, high tax losses for the state would have to be expected.

343. **Depending on the reform option, the Gini coefficient falls** by 0.1 to 0.3 percentage points (Blömer and Peichl, 2023), since all reform variants provide for

a limitation of the splitting advantage, so that higher income groups are relatively somewhat worse off. In the case of the real splitting, disposable household income falls in all income deciles. In the case of the decreasing additional marital allowance and the tax deduction, this decrease is limited to the upper three deciles, while income deciles 3 to 6 benefit most. In the case of the undiminished additional marital allowance, only the disposable household income in the top decile falls slightly, while deciles 3 to 9 have significantly more household income at their disposal. The **at-risk-of-poverty rate rises**, especially in the three options with the highest employment-incentive effects (undiminished additional marital allowance, decreasing additional marital allowance and the tax deduction: by 0.71, 0.31 and 0.38 percentage points respectively), as more people are employed, which raises the at-risk-of-poverty threshold. With a fixed at-risk-of-poverty threshold, on the other hand, the at-risk-of-poverty rate would fall slightly (–0.05, –0.06 and –0.01 percentage points; Blömer and Peichl, 2023).

344. **Positive labour-supply effects can be achieved by means of various reform options for spousal income-tax splitting.** The strongest employment-incentive effects are offered by the variant of the undiminished additional marital allowance, which should be legally unproblematic, but involves tax losses. The tax-deduction variant also offers very high employment incentives and significant additional tax revenue, although there are considerable constitutional concerns about it. The decreasing additional marital allowance leads to significantly lower employment incentives and somewhat smaller tax revenues, but could be less problematic in terms of constitutional law (Advisory Board to the Federal Ministry of Finance, 2018). The real splitting option involves the smallest effects on employment incentives and tax revenues.

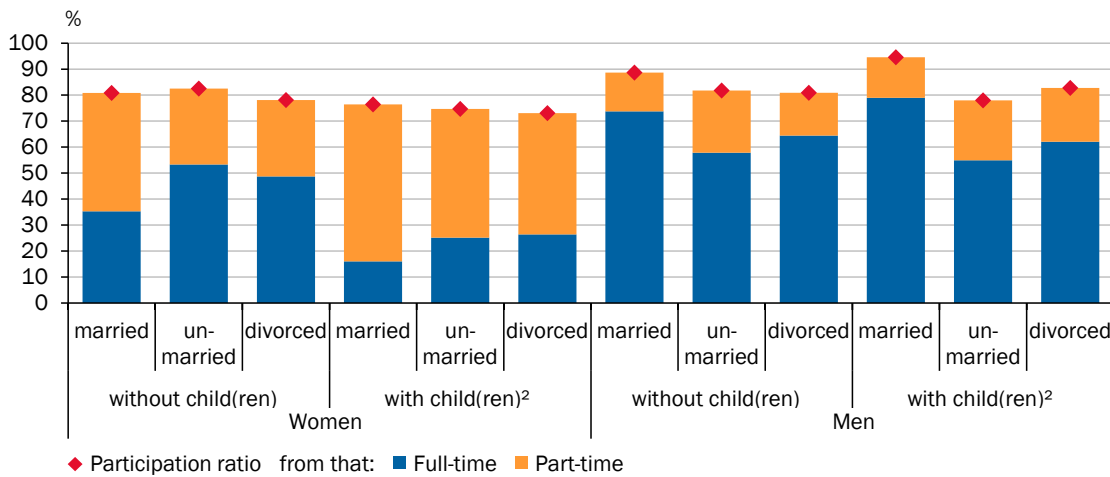
2. Increase employment opportunities

Expand childcare facilities

345. Although the employment rate among women has been rising for years and is approaching that of men (Lembcke et al., 2021), at the same time the number of women working part-time is still significantly higher than the number of men. **The number of women with children working part-time is particularly high.** ↘ [CHART 105](#) The 'gender care gap' measures how much additional time women spend on unpaid care work, such as childcare and housework, compared to men. **Women** in partnerships spend around 52 % **more time than men on care work** (BMFSFJ, 2017). In couples with children, they spend as much as 83 % more time on these tasks. This means that women spend an average of two hours and 30 minutes more per day on care work, especially childcare, than men. **Better childcare services could reduce the time needed for care work in the family.** Women would then be able to pursue employment to a greater extent, make better use of career opportunities and earn a higher income (GCEE Annual Report 2021 item 290). It would also make it easier for single mothers in particular to work.

↘ CHART 105

Participation and part-time ratios by gender and marital status¹



1 – Proportion of the respective group of people in employment or working part-time. Unmarried and divorced persons include living arrangements with other adults in the household. 2 – Households with child(ren) under the age of 14.

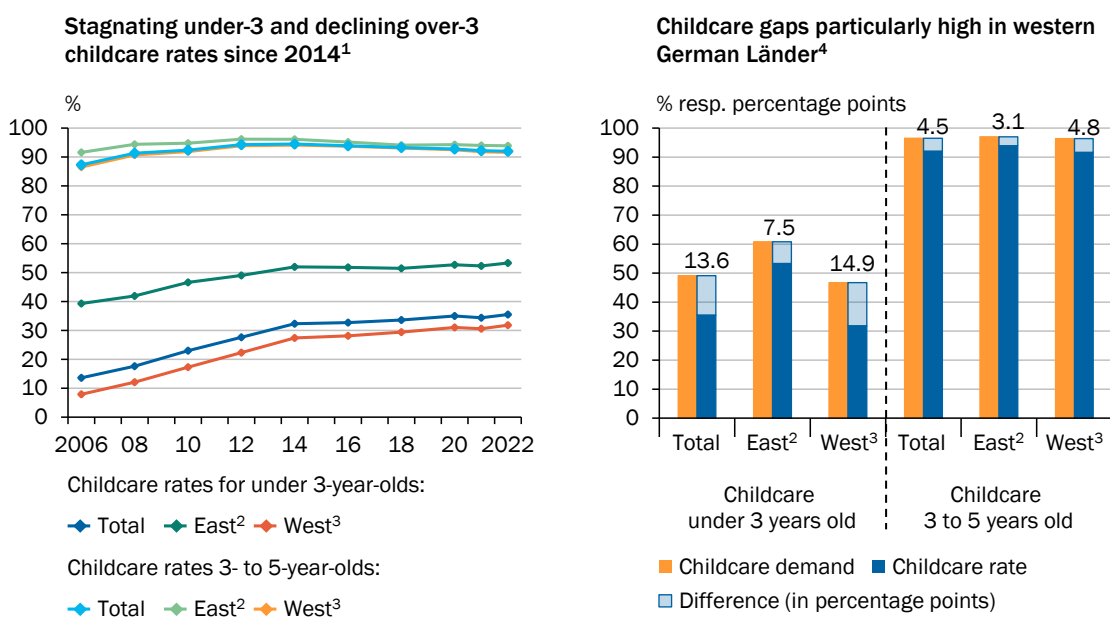
Sources: SOEP v37, own calculations
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346. A lack of childcare facilities prevents women from participating more in the labour market, so that their lifetime income is also lower (Brändle et al., 2022). The **difference between the childcare rate and the childcare needs for children under three** – the childcare gap – was 13.6 percentage points in Germany in 2022, corresponding to about 321,300 childcare places. ↘ CHART 106 RIGHT There are marked regional differences – for example, the gap in eastern German Länder is 7.5 percentage points, compared to 14.9 percentage points in the west (BMFSFJ, 2023b). Despite the **legal entitlement** to care for children under three years of age, which has existed since August 2013, the childcare rate has hardly increased in recent years. ↘ CHART 106 LEFT The **childcare rate for three-to-five-year-olds** was 92.0 % in 2022, continuing a **downward trend** since 2013. This is due to the fact that although more and more children are cared for, the number of children in this age category is growing. As a result, 96.5 % of parents would like childcare for their child, so that here, too, there is a difference of 4.5 percentage points (BMFSFJ, 2023b). ↘ CHART 106 RIGHT The difference in the childcare gap between eastern and western Germany amounts to only 1.7 percentage points for the three-to-five-year-old group. A **marked childcare gap** is found in **all-day care at primary schools**. While the difference in eastern Germany amounted to 7 percentage points (with a childcare rate of 83 %) in 2022, in western Germany it was 21 percentage points (with a childcare rate of 48 %).

347. In addition to the number of childcare places, the **quality and time availability of care are crucial factors** (Rainer et al., 2011; Bonin et al., 2013; Müller et al., 2013; GCEE Annual Report 2021 items 362 ff.). On the one hand, the quality of care is a key factor for high-income families to want to use institutional childcare (Schmitz et al., 2017). On the other hand, it is one of the most effective ways to create equal opportunities for children from different socio-economic backgrounds (Anderson and Levine, 1999; Gathmann and Sass, 2018; Busse and Gathmann, 2020). An important factor here is the staffing ratio, i.e., how many

↳ CHART 106

Development of childcare rates in Germany



1 – Reference date in March of the respective year. In the years 2006 to 2018 data every two years, from 2020 annual data. 2 – East Germany with Berlin. 3 – West Germany. 4 – Reference date 1 March 2022.

Source: BMFSFJ (2023b)

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children there are on average per caregiver. A better staffing ratio is associated with better child development (Viernickel and Schwarz, 2009). While the staffing ratio in the U3 sector in western Germany is 3.6 children per caregiver and thus close to the recommended staffing ratio of 3.0, the ratio in eastern Germany, at 5.7, deviates significantly from this recommendation (Geis-Thöne, 2020; Bock-Famulla et al., 2021). Overall, there is still potential for improvement in childcare (GCEE Annual Report 2021 items 362 ff.). It is therefore **important to further promote the quantitative and qualitative expansion of childcare places**. This includes, in particular, coordinating childcare options with parents' working hours. Part-time childcare hardly ever leads to both partners being in full-time employment (Rainer et al., 2011).

348. Free childcare places are important for families at risk of poverty, so that parents have the opportunity to take up employment and children are not excluded from care for financial reasons. The costs of childcare are a greater burden, relatively speaking, for low-income households (Spiess, 2022). Families with incomes below the at-risk-of-poverty threshold pay 8.8 % of their disposable income for childcare in daycare facilities, while families with incomes above the at-risk-of-poverty threshold have to pay only 5.2 % (Bertelsmann Stiftung, 2018). At the same time, high-income families are more than willing to pay for good childcare, so that a nationwide provision of childcare places free of charge and independent of income would not be advisable (Lembcke et al., 2021).

349. Various empirical studies suggest that the expansion of institutional care services has significantly increased maternal employment over the past decade (Rainer et al., 2011; Bonin et al., 2013; Müller et al., 2013; Zoch and

Hondralis, 2017; Müller and Wrohlich, 2020; Zoch, 2020; Neuberger et al., 2022). The **home childcare allowance** that was paid between 2013 and 2015 **counteracted this increase for a short time**. It was a family-related benefit paid for the private (home) care of two- to three-year-old children outside of public childcare. After its abolition at the federal level, similar benefits, some of which had been in existence for some time, were continued at the state level in Bavaria, Thuringia and Saxony. Empirical studies of similar benefits in other countries suggest that such benefits reduce maternal labour force participation and increase the income gap between women and men (Rønsen, 2009; Hardoy and Schøne, 2010; Rønsen and Kitterød, 2010; Bungum and Kvande, 2013; Lembcke et al., 2021). The resulting lower labour force participation increases the likelihood of the women concerned being at risk of poverty in the long run.

Promote further training and health measures

350. Continuous education and training (CET) ranges from independent informal learning to non-formal educational activities and formal education (GCEE Annual Report 2022 items 369 ff.). **Participation in further training has a positive impact on the participants' labour-market opportunities**, which can counteract the risk of poverty. For example, further education leads to higher wages (Konings and Vanormelingen, 2015; Adriaans et al., 2019; Ruhose et al., 2019; Dauth, 2020; Bönke et al., 2022), increases the likelihood of being re-employed after redundancy (Schmidpeter and Winter-Ebmer, 2021), and can help in moving away from jobs threatened by structural change (Nedelkoska and Quintini, 2018; Tamm, 2018).
351. **Financial incentives and favourable regulatory frameworks** should be put in place to **promote CET**. For example, indirect further-training costs should be covered by subsidised (partial) training leave (Bildungs(teil)zeit) and an individual learning account, and participation in CET should be promoted through bonuses (GCEE Annual Report 2022 items 391 ff.). It is also important to expand the range of CET courses on offer nationwide. In order to achieve a high take-up of CET courses, the courses on offer should be low-threshold (Koscheck and Samray, 2018). Workplace-based and practice-oriented learning processes can further increase the CET participation of people who might otherwise shy away from organised learning (Pothmer et al., 2019; OECD, 2021). One example is the promotion of CET mentors. With low-threshold approaches and workplace-related counselling, company mentors try to encourage especially employees with negative educational experience – and the low-skilled – to participate in CET. This is intended to increase participation in further training in companies that are particularly affected by technological change (BMBF, 2023).

Furthermore, the foundations for lifelong learning can already be laid in the nursery and school system. **Digitisation in schools** can contribute to equal opportunities in the education system (GCEE Annual Report 2021 items 365 ff.). **Social work** in the form of counselling and mentoring programmes can increase social mobility. In particular, **tutoring programmes** for children and teenagers can improve educational opportunities (Levine, 2014). With its "Aktion zusammen wachsen" programme ("Growing together" programme), for example, the

BMFSFJ encourages civic engagement supporting immigrant children and teenagers (BMFSFJ, 2020).

352. Immigrants often encounter obstacles to taking up gainful employment despite existing professional qualifications. Language barriers can be reduced through **language and integration courses**. General language courses as well as vocational language and integration courses have a positive influence on employment (Brücker et al., 2020) because they increase people's employment-participation rate (Lang, 2022) and help boost their expected salaries (Chiswick and Miller, 2015). Furthermore, a reduction in equivalence tests could enable immigrants to take up gainful employment more quickly and to work according to their qualifications (GCEE Annual Report 2022 item 454).
353. **Health promotion measures** can improve people's health situation and also **improve the chances of permanent reintegration into the labour market**. Unemployed people suffer more often from mental and physical illnesses than comparable people in employment (Kroll et al., 2016) and are more often at risk of poverty. [▶ ITEM 305](#) Since they cannot be reached by prevention measures via traditional channels such as schools or factories, we recommend a combination of health and further-education measures, or embedding health-promotion measures in municipal community work or at the workplace (Hollederer, 2021).

3. Enable direct payments to households

354. A **direct-payment mechanism that reaches all households in Germany** would add a quick, effective and potentially efficient tool to the economic- and social-policy toolbox. Direct payments are often preferable to interventions in the tax or price system because, when properly designed, they do not distort the scarcity signals of prices and can thus **avoid disincentives**. For example, instruments to reduce energy prices during the energy crisis – e.g., the temporary reduction in the energy tax on fuels ('Tankrabbatt') – led to an unwelcome incentive to use more energy. Although direct payments have an income effect, if suitably dimensioned, this effect has significantly less impact on demand than the substitution effect from relatively more expensive to relatively cheaper goods generated by relative price changes (Hemmerlé et al., 2023).

Lump-sum direct payments can also have a progressive distributional effect if they are taxed. Moreover, unlike transfer payments or cuts in income tax, they can ideally reach everyone, whereas the existing tax-transfer system does not currently cover everyone. For carefully targeted effects in individual policy areas, the direct-payment mechanism would have to be linked to detailed data sources, just like all other relief measures. In the medium to long term, it would therefore be conceivable to link the direct-payment mechanism with various indicators, especially income-related data, in order to improve targeting accuracy. As an urgent first step, **however, the instrument should be made applicable as soon as possible in a lump-sum per-capita form for all citizens as 'climate payment'**.

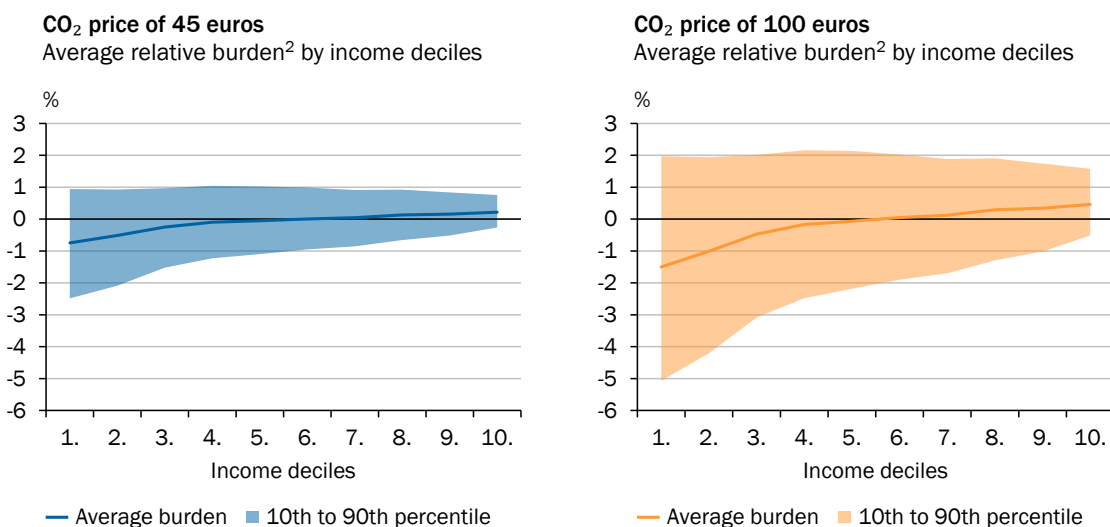
Application scenarios: crisis instrument and climate payment

355. Direct payments are being discussed for **two applications** in particular. **On the one hand**, they would be a useful **supplement to state instruments in crisis situations**. The current social security system is not very suitable for providing short-term, targeted relief to households, because too many needy groups of people are looked after by different authorities. In addition, particularly affected groups of people can sometimes not be identified or are difficult to reach financially. For example, during the energy crisis last year, in view of the sharply and rapidly rising prices for various energy sources, an unbureaucratic and rapid relief instrument in the form of direct payments to households would have been desirable (GCEE Annual Report 2022 item 194). **In times of crisis**, direct payments could also **increase confidence in the government's ability to act** and make relief tangible. Tax cuts or increases in transfer payments, on the other hand, are less visible and cannot be directly linked to the reason for relief (Carattini et al., 2017; Klenert et al., 2018; Stede et al., 2020). In the future, direct payments could be targeted more precisely as a crisis instrument if they were linked to relevant household characteristics, such as income; this could reduce untargeted distributions.

356. On the other hand, direct payments can be used to **compensate for income effects** associated with steering instruments. These include, **for example, climate payment**, the advantages of which have long been pointed out by the GCEE as well as other institutions (Kellner et al., 2022; Bach et al., 2023; GCEE Special Report 2019 items 220 ff.). A form of climate payment can cushion the

▸ CHART 107

Distribution effect of CO₂ pricing in combination with a flat-rate climate fee¹



1 – Calculations for the year 2018. A uniform national CO₂ price is estimated. The price in the EU ETS sector was 100 euros per tonne of CO₂ reached in February of 2023. If a consumer good is covered by the EU ETS, it is not included in the calculations due to the EU ETS price being higher than the uniform national CO₂ price. All scenarios are revenue neutral. A uniform capitation fee is paid for adults and children. 2 – Burden in relation to net equivalised income.

Sources: Federal Statistical Office, Pothen and Tovar Reañes (2018), RDC of the Federal Statistical Office and Statistical Offices of the Länder, Einkommens- und Verbrauchsstichprobe 2018 Grundfile 3 (AAGSHB), own calculations
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hardships associated with the regressive distributional effect of CO₂ pricing by paying out the revenues from national emissions trading to citizens as a lump sum in the form of climate payment (GCEE Special Report 2019 items 220 ff.). An overall package of CO₂ pricing and regular lump-sum payments, i.e., without any income-based differentiation, would provide relatively greater relief for lower income groups. Such a redistribution would be likely to reverse the initially regressive effect of pricing carbon emissions and turn it into a progressive distributional effect (Gross et al., 2022; GCEE Special Report 2019 item 230). [↘ CHART 107](#)

357. A significant **advantage of climate payment as a direct payment** lies in its **visibility and thus in the possible greater acceptance** of political measures, especially in the lower income range. A climate payment would make the relief clear to the recipients with each transfer and credibly signal that the pricing of carbon emissions is intended as a steering instrument for behavioural change but not as an additional source of income for the state. Both could increase the acceptance of carbon-emissions pricing and thus of climate policy as a whole (Sommer et al., 2022; Kalkuhl et al., 2023). However, the amount of the payment would have to be noticeable and should not be significantly lower than the revenue from the pricing of carbon emissions would allow.

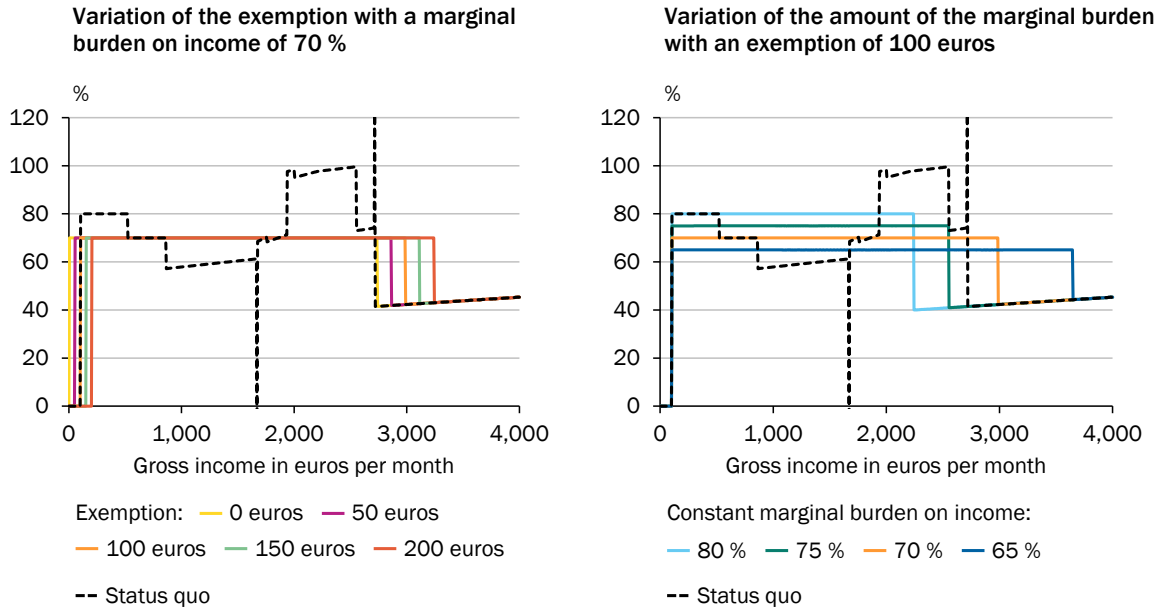
Implementation and design

358. In Germany, there is currently no instrument suitable for direct payments to private households. Austria, on the other hand, already uses such an instrument as climate payment (BMK Austria, 2023). The **Federal Government is currently planning the implementation of a direct-payment instrument** in which an account number is to be assigned to the tax identification number. The technical implementation is expected to take place **in 2025** (Tagesspiegel, 2023). Solutions for people without an account have yet to be found. In Germany, these make up fewer than 1 % of adults (Demirgüç-Kunt et al., 2022). Barcode procedures or cash-payment cheques, such as those used by the Federal Employment Agency, would be conceivable (Kellner et al., 2022). Both variants would be cost-intensive, but would only be used for a small section of the population. Open questions on technical details, such as the disbursement authority, should be clarified as soon as possible so that lump-sum direct payments for climate payment and as a crisis instrument can be used immediately.

APPENDIX

▸ CHART 108

Reform variants with a constant marginal burden on income¹



1 – Exemplary representation for a single parent with a child aged five. Total monthly rental costs of 586 euros are assumed. The marginal burden on income corresponds to the share of an additional euro earned that is deducted again due to transfer withdrawal in the transfer system, income tax or social security contributions. See background info 14.

Source: Blömer and Peichl (2023)
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