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Germany in reverse gear

by Michael Heise

The success of the German economy, thanks in large part to earlier structural reforms aimed at the labor market, pensions and public finances, served as an example and inspired similar efforts in other eurozone countries. However, Germany itself is now in the process of abandoning the path of reform and is busy unraveling decisions taken in the past, for instance with retirement at 63. This is above all problematic because Germany will be particularly harshly affected by the aging of the population. Come 2030, the old-age dependency ratio will be topped only by Japan and will be higher than in all other eurozone countries. Life expectancy is also rising rapidly elsewhere, but in Germany there is a shortage of young people to cover future pension payments without placing a hefty additional burden on the working population. This means that younger generations will have to shoulder the additional costs – hardly “social justice”.

Subjecting taxpayers to bracket creep is also questionable. Even if wages rise only in line with inflation, the percentage tax deduction increases due to the progressive tax scale. In real terms gross incomes in Germany have risen by 6.8% since 2010, whereas wage tax revenue has climbed by 19% nominal and around 13% real. Tax revenues are climbing from one all-time high to another. The taxpayer, by contrast, cannot claim compensation for the additional tax he has to pay due to inflation, he is referred to necessary spending and essential financing needs. He can be thankful that he is not being asked to cough up further special taxes like our evergreen solidarity surcharge to repair the roads or fund non-insurance pension spending.

The German state already sucks in more taxes and levies than most other countries, as the OECD recently highlighted again. In the case of single people on average earnings we even leave the Scandinavians behind. For families with children the deduction is lower but still high by international standards. Precisely those on low and medium earnings are hit the hardest by bracket creep, leaving the man on the street struggling to put something aside for retirement and offset the inevitable decline in his statutory pension.

It is time to eliminate bracket creep, and without funding it with other revenue increases elsewhere. One thing the German state does not suffer from is a lack of revenue. The question is rather what it does with the revenue and whether its spending priorities are right. For instance, the overall costs of the pension reform, put at EUR 160bn, far outweigh the additional EUR 5bn earmarked for transport infrastructure over the next four years. Opening up ever new revenue sources is not the right way. Germany needs to set a better example here.