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How Fair is Income Taxation in the View of the German Public?

Jürgen Schupp and Gert G. Wagner

It is not possible to provide a scientific answer to questions regarding the 'fairness' of taxation. Nonetheless, empirical economics and social science research can still yield helpful information for legislators charged with deciding on the level and structure of the tax system. Such research also includes the public's assessment of the fairness of the tax system. At the beginning of 2005, DIW Berlin incorporated questions concerning the fairness of income taxation in its 'Socio-Economic Panel' longitudinal study. Preliminary findings of this research are now available.

The tax burden on unskilled workers was considered excessively high by almost two-thirds of respondents. By contrast, the burden on the board members of large enterprises was considered too low by three-quarters of those surveyed, and this view was actually shared by two-thirds of the executive staff in the sample. However, it is not possible to draw any direct conclusions for economic and fiscal policy from these findings. The evaluation of such data is a wholly political act lying in the exclusive domain of the parliament. However, these results at least demonstrate unambiguously that when it comes to the issue of income and fiscal equity, people belonging to all sections of the population think in a more egalitarian manner than is assumed by large segments of public opinion and politics.

Results in Detail

Empirical analyses that examine assessments of the degree of fairness found in society and in working life are becoming more frequent.¹ DIW Berlin showed last year² that the majority of German people in employment feel they are paid fairly;³ however, only around 23% of those surveyed believe executive salaries are fair, and only 29% believe unskilled workers are paid a just wage. Specifically, the respondents are of the opinion that unskilled

¹ For example, since 1991 Bernd Wegener at the Institute of Social Sciences at Humboldt University, Berlin, has been directing a German study group that reports to the International Social Justice Project (ISJP). Cf. James R. Kluegel, David S. Mason, and Bernd Wegener (eds.): *Social Justice and Political Change*, Berlin 1995.

² Cf. Stefan Liebig and Jürgen Schupp: 'Unjust Divergence in Earnings in Germany?' In: *DIW Berlin Weekly Report*, No. 3/2005, pp. 51-56.

Table 1

Opinions on the Fairness of Tax Burdens in Germany Today¹

Opinions in %

	Compared to other groups, an unskilled worker pays ... tax.			Compared to other groups, an executive on the board of a large company pays ... tax.		
	too much	too little	the right amount of	too much	too little	the right amount of
Region						
Western Germany	62	1	37	6	73	21
Eastern Germany	69	1	30	4	81	16
Age Groups						
16-34	63	1	37	8	66	26
35-64	63	1	36	5	76	19
65 and older	64	1	35	4	80	17
Employment status						
Not employed	65	1	34	5	77	18
Dependent employee	62	1	37	6	75	20
Self-employed	55	2	44	8	57	35
Occupational status						
Unskilled worker	89	.	12	4	85	12
Top executive	48	.	51	8	67	26
Quintiles of gross income						
First quintile (bottom 20%)	63	.	37	5	75	20
Second quintile	69	.	31	5	74	21
Third quintile	70	.	29	6	78	17
Fourth quintile	64	.	36	6	75	19
Fifth quintile (top 20%)	47	1	51	7	65	28
Total	63	1	36	6	74	20

¹ SOEP question: "Everyone in Germany must pay taxes on the basis of his/her income. Those who earn more pay a higher percentage of their earnings in tax (this is called "progressive taxation"). What do you think?"

Sources: SOEP; DIW Berlin calculations.

workers earn less, while executives earn more than they deserve. All in all, people would prefer a narrower wage differential. This could be achieved via progressive taxation.

As part of the Socio-Economic Panel (SOEP) longitudinal study, which is carried out by DIW Berlin in col-

³ Views with respect to income-tax payments varied. It is by no means the case that all taxpayers reject tax rates as being too high in general. A survey carried out in Berlin showed that around a quarter of taxpayers believe they pay a fair amount of tax. Amongst those who believe they pay too much tax, it is the respondents with a medium income who are most unsatisfied. Cf. Stefan Liebig and Steffen Mau: Wann ist ein Steuersystem gerecht? Einstellungen zu allgemeinen Prinzipien der Besteuerung und zur Gerechtigkeit der eigenen Steuerlast. *Duisburger Beiträge zur soziologischen Forschung*, No. 1, 2005. Duisburg 2005.

laboration with the TNS Infratest Sozialforschung, Munich, between January and April 2005⁴ almost 8 400 people aged at least 17 were surveyed on these questions.⁵ Of these, a hefty almost two-thirds said that unskilled workers paid too much income tax (cf. table 1). Consequently, over one-third believed this group paid the right amount of tax. The survey revealed no major disparities across different age groups, and there was also little variation between the opinions expressed in

⁴ The full SOEP survey had not yet been concluded at this point in time, but it was possible to carry out preliminary calculations on the basis of the first 8 400 respondents that permitted generalizable results. In any case, the structure of the responses is so unequivocal that the final results of the survey are unlikely to be different in any substantial way.

Table 2
Contribution of Income-tax Payers¹ to Tax Revenue 2004

	Earnings of at least ... euro	Share of ... in %			
		income tax ²	total sum of earnings	taxable income	disposable income ³
Top ... %					
5	85 000	41.4	23.5	24.3	21.3
10	67 000	52.9	34.1	35.1	31.5
20	51 600	67.5	50.4	51.7	47.7
40	34 350	85.1	74.1	75.4	72.0
Bottom ... %					
40	22 680	3.4	10.0	9.1	12.0
20	8 800	–	1.1	1.3	1.6

¹ Result of a forward projection of the income tax sample; jointly assessed married couples are treated as a single taxpayer. — ² Income tax net of children's allowance, where applicable. — ³ Income from dependent employment plus other earnings, wage-replacement benefits, and children's allowance; minus income tax, solidarity tax, and insurance contributions (social security and other types of insurance).

Source: Federal Ministry of Finance, Monthly Report No. 10/2004, p. 53.

eastern and in western Germany. Because egalitarian ideals tend to be more common in general in eastern Germany,⁶ the share of those who believed unskilled workers pay the right amount of tax was lower at 30% in eastern than in western Germany (37%).

The assessment of the tax burden on top executives sitting on the boards of large companies led to different results. Three-quarters of those surveyed believe that this group pays too little income tax, 20% believe they pay the right amount of tax, and only around 5% believe that top executives pay too much tax.⁷ Unsurprisingly, the share of those who would like to see top executives pay more tax is higher in eastern (80%) than in western Germany.

⁵ The question asked was, 'Everyone in Germany must pay taxes on the basis of his/her income. Those who earn more pay a higher percentage of their earnings in tax. What do you think?: (1) Compared to other workers in Germany today, does an unskilled worker pay too much tax, too little tax, or just the right amount of tax? (2) And what about executives who sit on the boards of large companies? Compared to other workers in Germany today, do they pay too much tax, too little tax, or just the right amount of tax?'

⁶ Karl Brenke: 'Der Staat soll's machen – Einstellungen der Ostdeutschen zur Marktwirtschaft.' In: Ulrich Eith and Beate Rosenzweig (eds.): *Die Deutsche Einheit – Dimensionen des Transformationsprozesses und Erfahrungen in der politischen Bildung*. Schwalbach 2003; also see Cornelia Lang: 'Persönliche Einstellungen in der ostdeutschen Bevölkerung.' In: DIW Berlin, IAB, IfW, IWH, and ZEW: *Fortschrittsbericht wirtschaftswissenschaftlicher Institute über die wirtschaftliche Entwicklung in Ostdeutschland*. IWH Sonderheft, No. 3, 2002.

⁷ It must be borne in mind here that only around one-fifth of the population has confidence in large-scale commercial enterprises. Cf. Jürgen Schupp and Gert G. Wagner: 'Vertrauen in Deutschland: Großes Misstrauen gegenüber Institutionen.' In: *Wochenbericht des DIW Berlin*, No. 21/2004.

It is also unsurprising that over one-third of the self-employed believe that top executives pay the right amount of tax (compared to 20% of the general population). At the same time, more than half of the self-employed believe that board members pay too little tax.

The differentiation of the respondents by age group shows that while two-thirds of the younger age group (aged up to 34) believe board members pay too little tax, this is a much lower share than that found amongst the over-65s, of whom 80% express this view.

Only just over 10% of unskilled workers believe they pay the right amount of tax, while almost 90% believe they pay too much. There is little difference between the views of unskilled workers and those of the general population with respect to the tax burden on top executives. And this also applies to executive staff: Two-thirds believe that board members pay too little income tax, a quarter believe they pay the right amount, and only almost 10% believe they pay too much.

This result, which implies a desire for a more progressive system of taxation, is not entirely surprising, rather is compatible with standard assertions of economics. The assumption that the marginal utility of income is diminishing has been well documented empirically.⁸ And above a certain threshold the utility of income is very low compared to changes in utility which are caused by life events like divorces or unemployment.

⁸ For a summary, see Richard Layard: 'The New Happiness', *Penguin Press* 2005; for a slightly different view see Heinz Welsch: 'Life Satisfaction and the Marginal Utility of Income: Evidence from Twelve European Countries'. *Wirtschaftswissenschaftliche Diskussionspapiere der Carl von Ossietzky Universität V-267-04*, Oldenburg.

Accordingly, one of the motivations underlying the idea of progressive taxation is that as incomes rise, the burden of contributions can also rise without an inevitable accompanying increase in the loss of utility.⁹

Conclusions

However, the opinions expressed about the tax burden on the unskilled should be viewed with particular caution. Table 2 shows that many taxpayers actually pay no tax at all, because their incomes do not exceed the relevant allowances. Some members of the sample probably included social security contributions in the evaluation by mistake.

The most important finding of the survey is thus probably the fact that even amongst high income-earners, a clear majority – almost two-thirds – believe top executives pay too little tax.¹⁰

⁹ This line of reasoning is not obligatory, of course, rather normative. The decisive factor behind the choice of tax rates is necessarily always the political majority.

¹⁰ It has been demonstrated in numerous experimental economics studies that fair distribution is an important component of human utility. See Ernst Fehr and Klaus M. Schmidt: 'Theories of Fairness and Reciprocity – Evidence and Economic Applications.' In: Mathias Dewatripont, Lars Hansen, and Stephen Turnovsky (eds.): *Advances in Economics and Econometrics. Eighth World Congress of the Econometric Society*, Vol. 1. Cambridge 2003, pp. 208-257; also see Ernst Fehr and Urs Fischbacher: 'The Nature of Human Altruism.' In: *Nature*, Vol. 425, 2003, pp. 785-791.