

Increasing income inequality in Germany: Unemployment, market returns, and changes in the tax-system¹

Martin Biewen (University of Tübingen, IZA Bonn, DIW Berlin)

Andos Juhasz (University of Tübingen)

This version: 24 February 2010

Abstract. From 1999 to 2006, there has been an unprecedented rise in net equivalized income inequality and poverty in Germany. At the same time, unemployment rose to record levels and there was evidence for a widening distribution of labor market returns, as well as that of other market incomes. Moreover, several changes in the tax system took effect. Other possible explanations for the rise in inequality are changes in the household structure and changes in the distribution of other socio-economic characteristics (e.g. age or education levels). So far, it has been unclear which factor contributed what percentage to the overall inequality increase. In order to address this question, we use a semiparametric kernel density approach to decompose the change in inequality and poverty into changes in the household structure, changes in the distribution of income-relevant household characteristics, changes in the employment outcomes given these characteristics, changes in market returns to characteristics, changes in the tax schedule, and a residual. We find that most of the increase in inequality can be explained by changes in employment outcomes and market returns, and, to a lesser extent, by changes in the tax system. Changes in household structure and other household characteristics seem to have played a much smaller role.

JEL-Classification: D31, C14, I30

Keywords: Income inequality, poverty, unemployment, kernel density estimation

Correspondence:

Martin Biewen, Department of Economics, University of Tübingen, Mohlstr. 36, 72074 Tübingen, Germany, Fax: +49-7071-295013, martin.biewen@uni-tuebingen.de

¹We are grateful to . . . for useful comments. All errors are our own.