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Taxation and Social Inequality in Germany: Fiscal Constraints and Redistribution Dynamics

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ABSTRACT

Germany has one of the largest welfare states of the advanced industrial countries, and also has one of the highest tax burden relative to the GDP. Although with such fiscal strength, Germany has had high and growing income and wealth inequalities as an important characteristic of its political economy. This paper will examine how well the German tax system mitigates/reproduces social inequality through an examination of political economy, fiscal structure, distributional results, and political narratives to better explain how the high level of aggregate taxation exists with limited wealth redistribution in Germany; analysis will involve information obtained from OECD fiscal datasets, World Inequality Database estimates, IMF fiscal studies, and the current comparative political economy literature. The analysis demonstrates that the German tax system has a highly progressive tax structure with large amounts of income tax being levied against wage earners, but due to the structural constraints placed upon it by the predominance of revenue sources being from labour, along with minimal taxation of wealth and capital (as well as being given large amounts of tax exemptions when receiving inheritance), there remains a continuing dual distribution gap between income inequality and wealth inequality. This article will add to the existing debates surrounding fiscal justice in coordinated market economies by demonstrating how the rational design of institutions and political constraints impact redistributive capacity within larger-capacity welfare states.

1. Introduction

Due to their high capacity to collect taxes and the high level of institutional coordination between governments and employers/employee organisations, Germany is widely regarded as a leading Coordinated Market Economy (CME) characterized by institutional coordination and strong welfare protections. Theories of comparative political economies often regard the country as an example of how a strong fiscal state can achieve both economic competitiveness and social protection. Germany's tax to GDP ratio has been about 38–40% since the mid-1990s, making it one of the highest taxed economies in the OECD (OECD, 2023a). Accordingly, a high capacity to collect taxes that are approximately equal to 38–40% of the GDP suggests that the country has a comparatively strong capacity to reduce inequality through redistribution. Current empirical data regarding the distribution of income/wealth suggest more complicated outcomes than anticipated.

Despite fairly effective means of redistributing income through taxes and transfer payments, Germany has been unable to eliminate assets inequality (or wealth/housing concentration). According to World Inequality Database statistics, the top decile holds a disproportionately large amount of net wealth relative to the bottom half who only collectively hold a small amount of net wealth (Chancel et al., 2022); this wealth inequality indicates that while income inequality is being reduced by using fiscal policies, wealth/housing inequalities are largely embedded within the economy. This creates an important political economy paradox within advanced welfare states, creating a strong capacity to generate revenues yet a welfare state limited in its ability to redistribute wealth concentrations.

Existing literature has devoted considerable attention to welfare redistribution in Germany. Nevertheless, not enough attention has been paid to the structural difference between income redistribution and wealth concentration. This paper discusses this issue in exploring how German fiscal institutions simultaneously mitigate labour market inequality and sustain wealth inequality. Germany's fiscal structure has historically focused on wage redistribution and social security. After World War II the government created mechanisms that would stabilise the labour market, support collective wage negotiations and provide security via a contributory welfare system.

The traditional fiscal system in Germany has helped to minimise labour-market inequality; however, the fiscal model does not provide adequate support for asset-based inequality. Contemporary developments in asset-based inequality increasingly occur due to capital gains, increases in the residential housing market and inherited wealth rather than due to labour-market outcomes (Piketty et al., 2022). The structure of taxes in Germany creates further imbalance where public revenues are predominantly raised through taxes on labour and contributions to social security, with taxes on wealth and property having a relatively limited place. While income tax is technically progressive, its redistribution function is diluted by indirect taxation on consumption, thresholds for social contributions, and inheritance tax exemptions, particularly for business estates (OECD, 2023b). Additionally, Germany no longer levies a recurrent net wealth tax since its suspension in the mid-1990s.

1.1 Research Question

The research question that underpins this paper is:

> *How do the various components of the German fiscal system serve to redistribute income and structurally reproduce wealth discrepancies?*

1.2 Contributions

The paper will provide three primary contributions to the literature:

1. Theoretical framework for understanding the duality of taxation, showing how the German tax system reduces income inequality while reproducing a concentration of wealth through unequal treatment of labour versus capital.
2. Advances a political economy analysis of fiscal structures and their relationship to institutional and political limitations, and develops reasons for the persistence of labour-based tax systems and the decline of asset-based inequality.
3. Places Germany in the context of CMEs and provides evidence that institutional combinations give rise to considerable levels of income redistribution but create structural weaknesses with respect to wealth redistribution.

2. Literature Review: Taxation, Inequality, and the Political Economy of Redistribution

2.1 Taxation and Redistribution in Advanced Economies

In recent years, public financing and political economy have shifted from narrow, traditional assessments of statutory tax progressiveness to broader assessments on how the structure of fiscal systems impact distribution of results. Taxation and transfers are critical tools for addressing income disparity in more developed economies; nevertheless, the effectiveness of these measures often depends on whether labour, capital or consumption-related taxes are the principal form of taxation. Recent studies published after 2021 have found that other tax characteristics besides just marginal tax rates influence equity outcomes to a greater extent than had previously been thought possible. For instance, Jensen and Radu (2022) have shown that two tax systems with progressive rates may produce vastly different results relating to income inequality. Labour-based tax systems generally produce shorter term benefits for income distribution than capital-based systems because capital grows faster than labour does.

2.2 Wealth Inequality and the Limits of Income-Based Redistribution

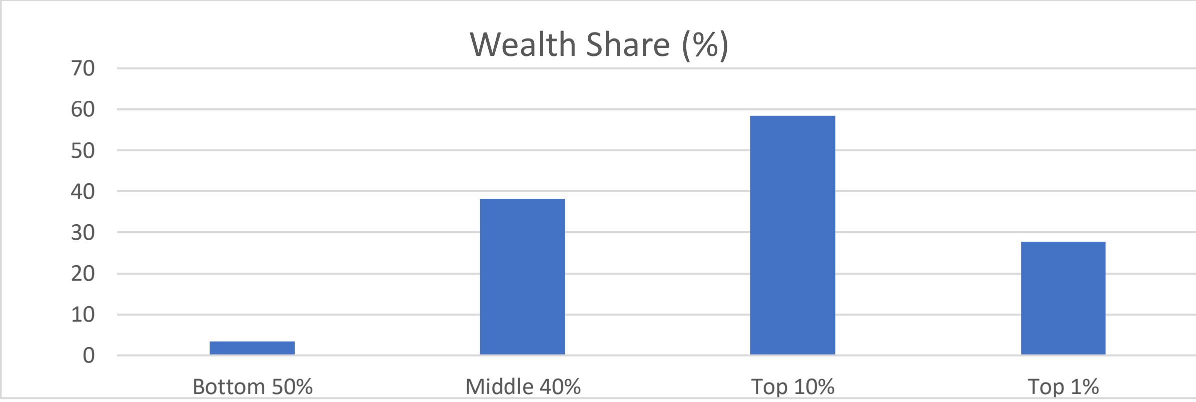
A growing body of research suggests that, historically, traditional redistributive tools developed by nations' welfare states have been inadequate to address the current dynamics of income and wealth inequality in advanced economies. Data indicate that the gap between levels of income and wealth inequality has continued to increase; and that wealth inequality has been both increasingly pronounced and persistent over time. Empirical research published by Chancel et al. (2022) based on the World Inequality Database demonstrates that, in advanced economies overall, concentrations of wealth have consistently outstripped concentrations of income inequality; and that the concentration of wealth has been primarily driven by the returns from capital, inflation of asset prices and flows of inheritance.

Table 1. Wealth Distribution in Germany by Population Group (2024)

Population Group	Share of Total Wealth (%)	Average Wealth per Adult (PPP €)
Bottom 50%	3.4	8,417
Middle 40%	38.2	236,426
Top 10%	58.4	1,445,789
Top 1%	27.7	6,857,593

Source: World Inequality Report 2026, Germany Country Sheet; World Inequality Database (2026).

Figure 1. Wealth Concentration in Germany: Share of Total Wealth Held by Population Groups, 2024



Source: World Inequality Database (2026); World Inequality Report 2026.

The figure above represents the highly concentrated nature of wealth in Germany. While the bottom half of the population holds just 3.4% of total wealth, the top 10% owns over 58.4%. Alvaredo et al. (2023) point out that the evolution to a stock-driven regime of inequality has led to long-term earnings disparities largely derived from accumulated assets rather than attributable to annual income streams. Germany exemplifies income-centered redistribution: while income inequality has significantly moderated, wealth inequality continues to have deep structural roots.

2.3 Fiscal Structure and Tax Composition

Current literature strongly implies that the structure of a given country's tax system is a major factor in determining redistributive results (OECD, 2023a; European Commission, 2022). Tax systems that primarily rely on income from labour tend to establish stable revenue flows; however, they provide only limited opportunities for responding to increased capital-labour inequality. According to Fuest et al. (2022), inheritance tax exemptions, particularly for business property, cause inheritances to have a lower effective redistribution, allowing capital accumulations to proceed without adequate fiscal intervention.

2.4 Institutional Constraints and Fiscal Policy Limits

Taxation outcomes reflect not just economic design, but also institutional and legal limitations. Schmidt (2022) discusses that the German fiscal system operates according to constitutional law frameworks that set limits on judicial oversight and predefined principles of law. These limitations establish a legal-institutional ceiling on wealth taxation, a concept known as "fiscal constitutionalism," where legal frameworks restrict what redistributive policy governments can implement.

2.5 Political Economy of Redistribution

The nature of the taxation system is also influenced by political rivalry between various ideologies. Social Democrats and Greens in Germany tend to advocate for increased redistribution through progressive taxation, while conservatives and liberals are concerned about competitiveness and investment (OECD, 2023a; Schmidt, 2022). Such ideological differences are aggravated under conditions of coalition politics. The contemporary academic literature views this process as "inertial policy equilibrium," according to which opposing preferences and interests hinder the emergence of transformative changes in tax and fiscal policies despite growing inequality (Cambridge University Press & Assessment, 2022).

2.6 Financialisation and Changing Inequality Regimes

A steadily growing volume of research connects persistent inequalities to financialization and the increasing role played by asset-related incomes. Under this paradigm, inequality arises due to asset returns rather than differences in wages. Alvaredo et al. (2023) argue that these modifications have made the nature of inequality in developed states different from its traditional characteristics, reducing the efficiency of traditional redistributive tools. Germany exemplifies this perfectly: the tax system remains labour-based but inequality has become asset-related.

2.7 Synthesis and Research Gap

Three key findings from the literature can be noted. First, tax systems are still successful in terms of reducing income inequality but lack the ability to reduce wealth inequality. Second, the structure of taxation, specifically the ratio of labour and capital taxes, is essential in determining redistributive results. Third, institutional and political restrictions prevent the implementation of substantial changes in fiscal policies. Most previous studies examine each of these factors independently, creating a gap in understanding how these factors combine to create persistent inequality regimes. This paper contributes to filling that gap by creating a holistic theoretical framework.

3. Methodology

This research employs a qualitative analytical framework supported by secondary statistical data obtained from OECD, IMF, and World Inequality Database sources.

3.1 Research Design

This paper employs a qualitative political economy approach, namely the technique of structured interpretive synthesis. Instead of econometric estimation, it aims at understanding the underlying mechanisms with the help of secondary sources and the relevant scholarly literature. Germany is used as a critical case of a country with a high-capacity welfare state featuring inequality in wealth despite successful income redistribution. The study is conducted in three stages: (1) synthesis of the scholarly literature (2022–2026) in the realms of political economy and public finance; (2) secondary dataset triangulation using OECD, IMF, European Commission, and World Inequality Database data; and (3) interpretive synthesis based on fiscal structure, inequality outcomes, and political-institutional constraints.

3.2 Data Sources

In this study, credible databases and academic literature are used: OECD (2023a, 2023b), IMF (2022), European Commission (2022), World Inequality Database (2026), and scholarly articles (2022–2026). Data sources are selected due to their institutional credibility, scientific rigor, and relevance to the taxation-inequality relationship study.

3.3 Analytical Framework

The research employs a political-economic methodology focused on mechanisms and structured along three analytical tiers: (1) Fiscal Structure Level: analysis of tax system composition (personal, corporate, consumption, social contributions); (2) Distributional Effect Level: examines income inequality and wealth inequality as two related but separate phenomena; and (3) Political-Institutional Level: provides explanation of the stability of fiscal disparities via party competition and legitimacy.

3.4 Analytical Logic

This study involves triangulation of data sets and literature to uncover structural mechanisms; no statistical causality estimates are applied. Interpretive analysis remains the main tool, typical of political economic research.

3.5 Limitations

The study does not calculate effect magnitude using econometric models. Interpretive mechanism analysis is prioritized. Although statistical generalizability is limited, triangulation of various institutional data increases robustness and mitigates one-sidedness. Further study can involve econometric or comparative analysis. One limitation is the study's reliance on secondary macroeconomic datasets, which may not fully capture regional variations in wealth inequality across Germany.

4. Analytical Framework

4.1 Fiscal Structure of Taxation in Germany

The fiscal policy of Germany can be considered an institutional framework balancing redistribution, economic coordination, and competitiveness preservation. Instead of serving as a unified redistributive tool, the taxation system functions as a differentiation institution where different tax tools have particular economic and political functions. An essential characteristic is the crucial importance of labour-sector income as the main redistributive tool. The personal income tax system is highly progressive, featuring marginal rates up to 45% for top incomes and tax exemptions securing subsistence incomes. Research data reveal that redistribution systems of this kind contribute immensely to a reduction of disposable income inequalities between OECD member states (Román-Aso et al., 2025), while Germany performs better than the average OECD state regarding post-tax income stabilization (OECD, 2023a).

Contrary to labour taxation, wealth and capital taxation in Germany remains relatively modest. Due to the lack of any recurrent wealth tax, along with favourable conditions in the taxation of inheritance, the ability to deal with accumulated wealth becomes highly constrained. Earlier research indicates that exemptions of inheritance taxes, particularly related to business property, have significant impacts in lowering the effective tax rate on very large intergenerational transfers (Fuest et al., 2022). Additionally, capital income taxes have their own flat-rate schemes, apart from any differential with labour income (OECD, 2023b). The above components result in a tax regime that could be called a hybrid: progressive wage taxation, modest wealth taxation, and regressive aspects related to consumption.

4.2 Distributional Outcomes and Inequality Transmission

Structurally speaking, the implications for distributional issues of Germany's fiscal structure differ from both an income and a wealth perspective. In relation to income distribution, Germany's tax and transfer policies continue to show high levels of efficiency in mitigating income disparities, but their effect on wealth inequalities is much weaker. According to OECD statistics, the use of progressive taxation together with transfers helps to greatly reduce income inequality when considering disposable income, thus placing Germany among the most redistributive advanced countries (OECD, 2023a). Nevertheless, some recent studies have indicated that Germany's redistribution is increasingly driven by transfer systems rather than progressive taxation (IMF, 2022).

Wealth inequality, however, persists and is relatively insensitive to fiscal policy measures (World Inequality Lab, 2026). The lack of a periodic wealth tax and the presence of substantial inheritance tax exemptions (Şen & Kaya, 2026) lead to a reduced ability of the current system to redistribute already accumulated wealth (OECD, 2023b). Middle-income earners experience relatively heavy effective tax burdens due to the combined effect of income taxation and social contributions, together with their limited ability to earn from capital income and savings. Households at the top of the income distribution enjoy significant structural advantages: preferential tax treatment of capital incomes, the possibility to engage in tax planning activities, and low effective taxation rates of inheritances (Beckert, 2023; OECD, 2023b).

4.3 Political Economy of Taxation in Germany

4.3.1 Redistribution as Structural Correction: Social Democratic and Left Perspectives

In the context of Germany's political economy, social democratic and left-wing actors view taxation as an important tool for redressing the structurally produced inequalities resulting from market interactions. The theoretical basis includes the premise that inequality stems from broader mechanisms related to unequal access to capital, labour market power asymmetry, and the generational transfer of wealth. Recent findings showing the importance of compounding capital gains in wealth accumulation (Alvaredo et al., 2023; Chancel et al., 2022) have justified this perspective. Policy focus should be shifted to wealth and inheritance taxation and reforms in capital income taxation as means to counter asset inequality (Saez & Zucman, 2022; Piketty et al., 2022). Nevertheless, German constitutional principles relating to proportionality and equality, especially in regard to wealth taxes (Schmidt, 2022), constrain the realization of these interests.

4.3.2 Competitiveness and Fiscal Restraint: Conservative and Liberal Perspectives

The central criteria in the conservative and liberal paradigm are efficiency, competitiveness, and incentive effects. Taxation is regarded not as an instrument of distribution, but as a distortive factor for labour supply, investment, and economic activity. This understanding is central to the German system, which is based upon labour-intensive social contributions and which taxes wealth and capital formation more modestly. The approach aligns with the general international discourse maintained by OECD and the IMF, which underline the importance of ensuring internationally competitive taxes for open economies (OECD, 2023a; IMF, 2022). In this context, wealth taxation can be regarded as an economic risk, particularly given the importance of family businesses for economic coordination in Germany (Fuest et al., 2022). However, this approach does not entirely deny redistributive mechanisms; it places priority on ex-post redistribution based on transfers rather than ex-ante redistribution based on taxation.

4.3.3 Integrating Redistribution and Sustainability: The Green Fiscal Perspective

The Green economic perspective brings a unique facet to the analysis by connecting redistribution to environmental change. This perspective views taxation as a multi-faceted means which serves dual purposes: mitigating environmental externality and addressing social inequality. Environmental taxation (especially carbon pricing) can be progressive if implemented together with compensations and climate dividends (European Commission, 2022). Green fiscal strategies also include mild changes to wealth and inheritance taxes based on inequality reduction and intergenerational justice arguments. Despite the innovative nature of Green fiscal policies, policymakers face institutional constraints in their policy implementation that limit systemic change.

4.4 Institutional Equilibrium and Policy Inertia

The outcome of this clash results in the creation of a stable but limited equilibrium. Instead of reaching any agreement leading to a consistent redistributive tax policy, German tax policy becomes a continuous conflict between redistributive aspects, competition, and sustainability factors. In political economy literature, such situations can be described as "policy inertia equilibria," where conflicting preferences and institutional constraints lead to little structural change (Schmidt, 2022). Coalition politics ensures that fiscal policy must involve agreement among ideologically varied parties, leading to reforms that are gradual, path-dependent, and accommodating. Constitutional constraints restrict the scope of policy innovation, while administrative complexity raises the costs of structural reforms. The outcome is a system marked by high stability but low adaptability, described as "bounded redistribution," whereby fiscal policy moderates inequality but does not transform the distribution of wealth (Culpepper et al., 2025; Román-Aso et al., 2025).

5. Discussion: Structural Limits of Redistribution

The tax system of Germany is an example of a high-capacity redistributive mechanism working under tight structural constraints. Although redistribution through taxation continues to be quite effective for dealing with income inequality, there is little capacity for mitigating socio-economic stratification. These results are the outcome of a synergy among three different levels of structural constraints, namely fiscal structure, institutional structure, and political governance, collectively forming a redistributive mechanism which stabilizes income inequality while leaving wealth inequality largely untouched.

5.1 Fiscal Structure Constraint

The first limitation comes from the tax base structure. German tax policy continues to be highly oriented towards taxes from wages and social contributions, while taxes from capital and wealth continue to be underdeveloped, a legacy of historical complementarities among institutions in the coordinated market economy framework. This creates a dual tax structure: income flows are regulated effectively, while wealth stocks are not controlled adequately. Fiscal policy operates on an annual basis in relation to incomes, but structural disparities are created in the process of capital gains, long-term assets growth, and intergenerational transfers.

5.2 Institutional Constraint

The second constraint is institutional, stemming from the legal and constitutional setting of tax regulation. The German Federal Constitutional Court places very high demands regarding proportionality, equal treatment, and property rights, especially when it comes to wealth taxation. These constraints create a legal-institutional ceiling on redistributive action. While income taxation has already-established legal preconditions, wealth taxation is subject to higher complexity due to valuation problems and constitutional constraints. Politically, this means that even though the legal framework creates greater certainty for economic players, it hinders the government's capacity to use fiscal means to respond to changing forms of inequality resulting from capital concentration.

5.3 Political Constraint

The third constraint involves politics, based on the multi-party nature of government in Germany. The results of fiscal policies are achieved through negotiations between groups with different ideologies: redistribution, competitiveness, and sustainability. Such an equilibrium features only gradual structural reforms that can be achieved with cross-party agreement. Voters' preferences for redistribution are conditional and heterogeneous, meaning there are no incentives for revolutionary change. Redistribution does occur, but with moderation through the current system.

5.4 Integrated Outcome

The three constraints together lead to a stabilised redistributive regime which redistributes income through taxation and transfers but leaves wealth inequality largely untouched. In essence, this dichotomy demonstrates a broad trend in modern political economies: redistribution evolves into a means of stabilising the income structure rather than equalising the social stratification structure.

5.5 Theoretical Implications

The findings of the research have three broader implications: (1) Despite high capacity, redistribution is not universal when the tax system is oriented towards labour; (2) Constraining factors play a major role rather than being peripheral; and (3) Fragile politics stabilise inequality regimes by preventing drastic reforms. In combination, the findings indicate that fiscal disparities persistence is a matter of structure rather than non-existent policies.

6. Conclusion

This paper provided an explanation for Germany's persistent high level of wealth inequality, even in a country with a strong public fiscal capacity and a comparatively efficient system of income redistribution. The analysis suggests that persistence of socio-economic inequality is not a policy failure, but rather a function of a fiscal equilibrium where redistribution is institutionally enabled but institutionally restricted.

The German regime of redistribution operates on a combination of progressive income taxation and transfers designed to ameliorate market income inequalities. In that respect the German welfare state remains effective in curbing income inequality. However, these mechanisms do not work as well on the issue of wealth inequality, where the accumulation, capitalization, and intergenerational transmission of assets proceeds in a fashion only weakly regulated by the state fisc. This can be explained through three factors: (1) the nature of the German tax system, heavily dependent on labour taxation and social contributions while relying less on taxes on capital; (2) the constraint on wealth taxation imposed by institutions and the constitution; and (3) the nature of coalition politics that reduces prospects for fundamental redistributive change.

Together, these institutional and policy constraints mean that while the German redistributive regime is stabilizing and reduces inequalities, it does not fully mitigate the problem. The German fiscal system can therefore be characterized as a hybrid: it controls income inequality, but not wealth inequality. In a broader sense, Germany represents the emergence of a tension within advanced capitalism between fiscal systems grounded in labour taxation and economies increasingly determined by asset ownership and capital accumulation. Further research comparing the degree to which various forms of coordinated market economies in Europe have been able to counter long-term wealth concentration through their fiscal systems would be valuable.

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