

Government benefits for families

The financial consequences of bringing up children are reflected in additional expenditures but also in income losses if a parent gives up her/his job or switches to part-time working. General government assumes a substantial part of these costs by providing largely free education and subsidising childcare institutions, but also by means of transfers and tax benefits. The scale and nature of these government activities are ultimately an expression of societal preferences. They largely defy an objective evaluation, and it is not the intention of this article to judge such government activities. Instead, following a brief general analysis, the article provides an overview of the various benefits granted to families by general government and of their development over the past decade. The cumulative impact of these government benefits on the incomes of standardised households is illustrated using several model-case calculations. Looking to the future development of family policy benefits, attention must be paid to the fiscal requirement to ensure a sustainable public finance trend by reducing the government expenditure ratio. Given that constraint, any further increases in family policy benefits can be financed solely by reallocating resources within general government budgets.

The nature of and reason for public benefits for children

Cash and non-cash benefits

General government provides benefits in numerous ways to ease the burden on families with children. For example, many non-cash benefits are provided in Germany; these notably include the largely free provision of education and the subsidisation of childcare facilities. In addition, special child-related cash transfers are paid or tax allowances provided (for details see box on page 18).

Government guarantee of subsistence level

Pursuant to the principle of social equity embodied in the Basic Law (Article 20), the government is required to secure the subsistence level of its citizens, where necessary through transfer payments. Families who cannot bear the financial strains that are inevitably associated with bringing up children themselves have the right to claim support. In the first place the basic requirements in respect of children are largely met by the provision of non-cash and cash benefits by general government; any remaining gaps are then covered by social assistance. The precise scope and the nature of the assistance provided by the state to ensure that families reach the subsistence level is ultimately a political decision.

Consideration of families' limited tax-paying potential

Furthermore, the additional expenditure which rearing children inevitably entails reduces families' tax-paying potential. As a general principle, therefore, only income which exceeds the subsistence level (as defined in social assistance legislation) is subject to taxation. This means that families' basic maintenance requirement for children should

not be taxed. Above all, the Federal Constitutional Court has repeatedly underscored this principle and prompted Parliament to take appropriate action.

In addition, various benefits are granted for children or for particular life and income situations of parents. These include child-rearing benefit, extra assistance for parents who are unemployed or who are buying a home as well as claims on the statutory pension insurance scheme in respect of years spent bringing up children.

Government activity redistributes income across the life-cycle of individuals. Whereas extensive government transfers are received during childhood and youth (and again after retirement), people generally make net payments to government throughout their working life. Such an intertemporal transfer system has considerable redistribution effects both within and between generations. The latter applies particularly whenever significant changes in benefit levels or major demographic shifts occur.

The issue of the scope and nature of child-related transfers in Germany is currently also being considered in the context of demographic developments, which are leading to a considerable ageing of the population.¹ Thus the continued existence of the pay-as-you-go statutory pension insurance scheme is also reliant in the long term on the rearing of children.

Intertemporal redistribution across the life cycle

Demographic background

¹ Whereas in 1960 each German woman gave birth to an average of 2.4 surviving children in her lifetime, in 1999 the figure had fallen to 1.4.

*Distortion of
the labour
supply decision*

Also of relevance in this connection is the question of the link between rearing children and employment. Key factors in this context are the revenue losses resulting from interrupting or giving up work – usually affecting the mother – and the (frequently insufficient) availability of affordable childcare facilities. It should also be borne in mind that the decision as to whether or not to return to work is strongly distorted by the tax and social security system. This is because the parent has to pay, out of his/her net income after deduction of tax and social security contributions, the income of the child carers, which in turn is also subject to government levies. The tax wedge – which distorts the labour supply decision – between gross income and the net income left after deducting the cost of childcare is therefore particularly large.

General government expenditure in connection with rearing children

*Tax exemption
for the subsistence level and
child benefit*

A look at the child-rearing costs borne by the government in 2000 shows first that tax relief measures for parents were very extensive (see the table on page 19 for details). As a general principle, the component of income required to assure the subsistence level for children is exempt from income tax. Since 1996 this tax exemption has largely taken the form of child benefit, which is granted independently of the level of income and is offset against wage tax receipts. Alternatively, parents may claim a tax allowance for financially assuring the basic needs of their children if this – for higher income earners – provides greater relief to the beneficiary than child benefit. If family

allowances had been paid in 2000 solely in the form of this (constitutionally mandatory) income tax allowance, this would have depressed tax receipts by €20½ billion. As it was, the total burden resulting from the family allowance system totalled just over €31½ billion. Hence the “real” extent of government assistance in 2000 amounted to only €11 billion, ie the difference compared with the payment of a pure tax-free allowance.

Another kind of financial assistance to parents is the increment granted for each child in connection with the home buyer’s allowance; according to the Federal Government’s Subsidy Report, this led to tax shortfalls of just over €2 billion in 2000.² Moreover, the income ceiling up to which this allowance is claimable, which has been reduced since 2000, also rises with the number of children (the associated additional costs are not recorded). Further revenue shortfalls of €3 billion resulted in 2000 from various other measures, primarily the (temporary) household allowance for single parents plus maintenance and education allowances. In total, child-related tax measures in 2000 added up to over €37 billion.³

*Other tax relief
measures*

On top of these tax relief measures, parents also benefit from direct expenditures of

*Child-rearing
benefit*

² There were additional tax shortfalls of just over €½ billion from the preceding arrangement for assisting home buyers pursuant to section 34f of the Income Tax Act.

³ The common practice of jointly assessing the tax liability of spouses (the validity of which has largely been upheld by the Federal Constitutional Court), which in 2001 curtailed tax revenue by €23 billion compared with the amount which would have been raised if each spouse had been assessed separately, is dependent on marital status and therefore cannot be considered a promotional measure related to children, even though the bulk of this benefit accrues to families with children.

Statutory benefits for families with children

Tax measures

Child benefit: Paid for children up to the age of 18, if unemployed up to 21 years of age and if in full-time education up to 27 (extended by the length of military or non-military service). As from 2002, it amounts to €154 per month for each of the first three children and €179 for all other children (2000: DM270 for the first and second child, DM300 for the third child and DM350 for all other children).

Children's tax allowance: Granted as part of the family allowance system as an alternative to child benefit if the income tax assessment shows that this allowance is more advantageous to the recipient. It is a tax-free allowance for the subsistence level of children and as from 2002 amounts to €3,648 (2000: DM6,912). Even if only child benefit is paid, the children's tax allowance reduces the solidarity surcharge assessment base.

Childcare allowance: This tax allowance, which is likewise offset against child benefit and which from 2002 includes a child-rearing and education allowance, amounts to €2,160 (2000: DM3,024 for children under 16).

Tax deduction for proven childcare expenses: From 2002 such expenses exceeding €1,548 for children under the age of 14 can be deducted from the income tax assessment base up to €1,500.

Education allowance: Granted for children aged 18 and over living away from home and in full-time education; amounts to €924. The wider education allowance granted until the end of 2001 up to a maximum of DM4,200 has been integrated into the childcare allowance.

Household allowance: Granted to single parents in 2002 in the amount of €2,340; will be progressively phased out by 2005 (2000: DM5,616).

Maintenance allowance: Ceiling for the deduction of maintenance expenses for persons for whom no child benefit can be claimed; amounts to €7,188 (2000: DM13,500).

Home buyers' allowance: The tax grant paid to home buyers since 1996 for a period of eight years, amounting annually to €2,556 for new properties and €1,278 for older properties, is increased by €767 per child. In addition, the income ceiling for claiming the grant is raised by €15,339 per child.

Transfers from central, state and local government

Child-rearing benefit: Paid by the Federal Government for a maximum of 24 months following the child's birth, if the parent works no more than 30 hours per week (prior to 2001: 19 hours); amounts to €307. It is paid during the first six months if the annual (net) income does not exceed €38,247 for single parents and €51,129 for married couples. In the following months the benefit is graduated according to income. There is an income ceiling, up to which no deductions are made, of €13,498 for single parents and €16,464 for married couples (until the end of 2000: DM23,700 and DM29,400 respectively). Since 2001, eligible persons who satisfy these requirements have, alternatively, been able to draw €460 per month over a period of twelve months ("budget"). Income which exceeds the ceiling reduces the monthly claim by just over 4% of this additional income (or 6% in the case of the "budget"). In the case of two children or more, the income ceiling is, at present, €2,797 higher per additional child (2000: DM4,200).

Pension claims for periods of child-rearing: Since July 2000 parents with children born after 1991 are credited average contributions to the statutory pension insurance scheme for three years. The Federal Government pays the corresponding amounts to the scheme.

Social assistance: Children have an age-related claim to social assistance which ranges from 55% to 90% of the standard rate applying to the head of the household (at present up to around €290 per month depending on the individual state). Furthermore, additional assistance is also available to children for special requirements. Single parents with small children can claim additional assistance amounting to 40% of the standard rate. Other income (for children, in particular, child benefit less a "bonus" of €10) is deducted from the gross claim in order to calculate the payment amount.

Study grant: Pupils in further education and students can claim a grant financed jointly by central and state government if the income and savings of their family do not exceed a certain ceiling. The current maximum claim is €583 per month. However, students receive only half of this amount as a free grant; the rest must be repaid on preferential terms after they have completed their studies.

Maintenance advance: Paid to single mothers with children under 12 years of age by local government, in accordance with the Standard Rate Regulation, for a maximum of 72 months if the father fails to meet his maintenance obligation or pays less than the minimum amount. A maximum of €111 per month is currently paid for children under 6 in the west German states.

Housing allowance: The housing allowance claim partly depends on the size of the household. Each child (as well as another adult) leads to a higher rent subsidy if income remains unchanged.

Unemployment assistance: After exhausting their entitlement to unemployment benefit, unemployed persons may receive means-tested unemployment assistance from the Federal Government. If there are children in the household, the assistance amounts to 57% of the net pay at the time of employment, compared with a level of 53% for childless claimants.

Benefits through the social security funds

Co-insurance for children under the health insurance fund: As long as children do not exceed certain income limits, they are co-insured for free with the statutory health insurance funds of their parents, up to the age of 25 (extended by the length of military or non-military service). However, if the main earner in the family is insured privately, children are not co-insured in the statutory health insurance fund.

Maternity benefit: As a rule, six weeks before and eight weeks after the birth, the statutory health insurance fund reimburses the mother's loss of net earnings up to €13 per day (2000: DM25). In the case of mothers who are insured privately, the Federal Government pays a lump sum of, at present €210. For all mothers, whether insured privately or with the statutory health insurance fund, the employer makes up the difference between €13 and her previous net earnings.

Surviving dependants' pension: The 2001 pension reform stipulates that, for spouses who were born after 1961 or who married after 2001, the surviving dependants' pension increases depending on the number of children they have raised. For the first child two contribution years will be considered at average income levels and for all other children one year.

Orphan's pension: If at least one parent with a pension claim dies, the children receive benefits from the statutory pension insurance scheme.

Unemployment benefit: Unemployed persons with children can claim 67% of their previous net earnings from the unemployment insurance fund compared with 60% for childless claimants.

central, state and local government. Child-rearing benefit is paid by the Federal Government for a maximum of 24 months after the birth of a child if one parent stops working or works less as long as certain income thresholds are not exceeded. The Federal Government spent a total of €3½ billion on this benefit in 2000.⁴

Social assistance

In the case of social assistance, benefits for children mainly take the form of current cost-of-living subsidies. At the end of 2000, 2.7 million persons were receiving such assistance of whom 1 million were under the age of 18. The latest Social Report put the social assistance benefits for married couples and families in 2000 at just under €2.8 billion. However, it should also be borne in mind that the other government benefits for children are largely offset against social assistance. On top of this were remedial measures for children and help to ensure an adequate school education, which resulted in expenditure amounting to €1.4 billion. Like the income tax exemption for subsistence requirements, child-related social assistance is derived from the government duty to ensure a minimum level of existence for the population.

Contributions for periods of child-rearing

Since 1986 periods of child-rearing have been included when calculating the retirement pension payable under the statutory pension insurance scheme. The underlying idea is to make up the parent's lost contributions dur-

⁴ The states of Baden-Württemberg, Bavaria, Mecklenburg-Western Pomerania, Saxony and Thuringia pay supplemental child-rearing benefit in addition to that granted by the Federal Government. The nature of these benefits differs, however, from one state to another. These state payments totalled just over €¼ billion in 2000.

Benefits granted for families with children in 2000 *

Type of benefit	€ billion
Tax measures	37.3
<i>of which</i>	
Child benefit	30.9
Children's tax allowance in the family allowance system	0.7
Home buyers' allowance	2.8
Other tax measures ¹	2.9
Transfers from central, state and local government	26.9
<i>of which</i>	
Child-rearing benefit	3.7
Pension claims for child-rearing ²	11.5
Social assistance	4.1
Study grant	1.3
Maintenance advance	0.8
Housing allowance ³	1.2
Unemployment assistance	0.3
Child increments for public-sector employees	4.0
Non-cash benefits from central, state and local government	71.0
<i>of which</i>	
Nursery schools	7.4
Assistance for young people	8.0
Schools	45.3
Higher education institutions ⁴	10.3
Social security benefits	16.0
<i>of which</i>	
Free health insurance ⁵	11.5
Maternity benefits ⁶	2.9
Orphan's pension	1.1
Unemployment benefit	0.5
Total	approx 150

Sources: Federal Ministry of Finance, Federal Ministry of Labour and Social Affairs, Federal Statistical Office, Federal Labour Office, Bund-Länder Kommission and Bundesbank calculations. — * Only benefits over € ¼ billion for which an estimation base or benefit data are available. — ¹ Particularly tax allowances outside the family allowance system. — ² Contributions paid by the Federal Government to the statutory pension insurance scheme for periods of child-rearing. — ³ Estimate of additional housing allowance claims by households with children. — ⁴ Share of net expenditure less specific receipts for education purposes in accordance with the Bund-Länder Kommission's Education Finance Report 1999/2000. — ⁵ Only benefits for children. — ⁶ Primarily non-cash benefits and maternity payments from the statutory health insurance fund. — ⁷ According to annual accounts statistics for 1999.

Deutsche Bundesbank

ing the first phase of the child's life, when it needs particularly intensive childcare. Since June 1999 the Federal Government has paid separately recorded contributions to the statutory pension insurance scheme to finance credits for periods of child-rearing arising in the same year.⁵ Since these additional pension claims have been significantly extended but only subsequently result in pension expenditure, the Federal Government's corresponding contributions to the statutory pension insurance scheme in 2000 (€11½ billion) far exceeded the scheme's related benefit payments (almost €5½ billion). However, these contributions are not set aside but instead are used to finance current expenditure, thus enabling the current contribution rate to the statutory pension insurance scheme to be lowered to a corresponding extent. The higher claims will burden contribution payers at a later date, over and above the probably generally rising level of social security contributions.

Total transfers from general government

Including several other support measures (education assistance, maintenance advance, supplements to housing allowance and unemployment assistance as well as increments for children paid to public-sector employees), child-related transfers amounted to roughly €27 billion in 2000.⁶

Non-cash benefits from general government for nursery schools and assistance for young people ...

The expenditure of central, state and local government in connection with childcare and education is even more extensive. However, most of these benefits cover a necessary minimum requirement in respect of children. The alternative of financing such costs by charging them to the user would inevitably entail

higher tax allowances and social assistance expenditure for children. According to the annual accounts statistics for 1999 (the latest available), spending on nursery schools, net of revenue, amounted to almost €7½ billion. Assistance for young people is aimed at combating special problems connected with raising, educating and looking after young people, eg by providing accommodation in a children's home or with foster parents. The cost of this to public finance in 2000 was €8 billion.

Net expenditure on general schools and vocational colleges less fees and other receipts amounted in 1999 to almost €42 billion. School administration, pupil transport and other school-related expenditure, such as counselling and homework assistance, cost central, state and local government an additional €3½ billion. Net expenditure on tertiary education, according to the 1999/2000 Education Finance Report of the Bund-Länder Kommission, reached almost €10½ billion.⁷ Altogether, the volume of non-cash transfers totalled €71 billion.

... as well as schools and universities

Besides central, state and local government, the social security funds also provide special benefits for families with children. The most important such measure is the free co-

Social security benefits

⁵ Since that date the overall amount transferred depends on the contribution rate, average wages and salaries and the total number of children under three years of age. Prior to that, the cost of upgrading parents' pension claims for periods of child-rearing was included as a lump-sum as part of the general Federal grant to the statutory pension insurance scheme.

⁶ Families with children are also given preferential treatment in the field of public housing. The size of these benefits cannot be quantified, however.

⁷ The expenditure on research in the tertiary education sector is not allocated to child-related benefits.

insurance of children in the statutory health insurance funds. In 2000, 13.8 million people under the age of 20 profited from this arrangement. In financial terms (based on age-related expenditure profiles of the health insurance funds) this support may be estimated at €11½ billion. Including other elements (birth-related non-cash benefits, maternity benefit, pension entitlements for surviving dependants and orphans, and higher unemployment benefit claims), the total amount of assistance related to children granted by the social security funds amounted to €16 billion in 2000.

*Sum-total of
assistance for
families*

When totalled (notwithstanding the different reporting years),⁸ the list of general government benefits granted to families with children adds up to a grand total of €150 billion. As already mentioned, however, a good part of this does not represent extra government aid but rather serves to meet mandatory income tax allowances for the subsistence of children or finances benefits intended to safeguard a minimum level of existence in the context of social assistance. Furthermore, child-related expenditure is funded from government revenue, a considerable part of which is paid by families with children themselves. Based on a rough calculation of this share contributed by families themselves, households containing children financed about one-third of the benefits provided to them in 2000.⁹

The development of benefits in the 1990s

*Overall devel-
opment*

Between 1992 and 1999 (the latest year for which detailed annual accounts statistics are

available) general government benefits for families with children increased by almost one-third to just over DM290 billion (or close to €150 billion), which was much steeper than the rise in the overall expenditure of general government.¹⁰ In terms of GDP, too, an increase from 7.1% to 7.6% was recorded; it was concentrated on the years between 1995 and 1999 (see table on page 22 for details).

Looking at the different types of benefit, tax concessions (adjusted for the changeover of the family allowance system in 1996) increased most – by just over half. In 1996 the dual system of a children's tax allowance plus the additional payment of child benefit was replaced by a unified system in which a children's tax allowance was only provided as an alternative to child benefit. The latter is now the primary benefit and is offset against wage tax. At the time of the changeover the annual tax-free allowance – following rulings of the Federal Constitutional Court – was raised sharply starting from DM4,104 to DM6,264 and then DM6,912 in 1997. Lower-income households were given extra assistance in that, after the changeover, the monthly child benefit for this group clearly exceeded the value of the alternative tax-free allowance and was raised considerably in 1999 to DM250 for each of the first two chil-

*Expansion of
the family
allowance
system*

⁸ The addition of benefits from various reporting years appears acceptable – also given the uncertainties which exist anyway – because the expenditure recorded in 1999 probably changed little in 2000.

⁹ This estimate is based on data from the 1998 sample survey of income and expenditure (regarding turnover tax) and the wage and income tax statistics of the Federal Statistical Office.

¹⁰ The number of inhabitants aged up to 21 changed only marginally during this time.

Development of benefits for families with children

Type of benefit	1992	1995	1999		1995/1992	1999/1995
	in DM billion			in € billion	Increase per year in %	
Tax measures (including child benefit from the Federal Government)	44.0	44.9	68.5	35.0	0.7	11.1
<i>of which</i>						
Child benefit (since 1996 tax reduction)	22.0	21.3	57.8	29.5	} - 0.5	} 15.4
Children's tax allowance	16.3	16.4	0.1	0.1		
Home buyers' allowance	1.3	2.3	4.9	2.5	23.1	20.3
Other tax measures ¹	4.5	4.8	5.7	2.9	2.7	4.2
Transfers from central, state and local government	40.8	43.9	53.5	27.4	2.5	5.0
<i>of which</i>						
Child-rearing benefit	7.7	7.7	7.6	3.9	0.0	- 0.3
Pension claims for child-rearing ²	13.8	14.8	23.3	11.9	2.3	12.0
Social assistance ³	5.6	7.2	7.9	4.0	9.1	2.2
Other ⁴	13.7	14.2	14.7	7.5	1.3	0.9
Non-cash benefits from central, state and local government	115.2	133.6	138.9	71.0	5.1	1.0
<i>of which</i>						
Nursery schools	10.7	13.6	14.4	7.4	8.4	1.5
Assistance for young people	12.7	14.9	15.7	8.0	5.5	1.5
Schools	74.9	85.9	88.6	45.3	4.7	0.8
Higher education ⁵	17.1	19.3	20.2	10.3	4.1	1.2
Social security benefits	24.0	28.4	30.8	15.8	5.7	2.1
<i>of which</i>						
Free health insurance ⁶	17.2	20.5	22.2	11.4	6.1	2.0
Maternity benefits ⁷	4.1	4.5	5.4	2.8	3.5	4.7
Orphan's pension	2.1	2.3	2.2	1.1	3.2	- 1.4
Unemployment benefit	0.7	1.0	1.0	0.5	15.2	0.2
Total	224.0	250.8	291.8	149.2	3.8	3.9
as % of GDP	7.1	7.1	7.6	7.6	.	.

Sources: Federal Ministry of Finance, Ministry of Labour and Social Affairs, Federal Statistical Office, Federal Labour Office, Bund-Länder Kommission and Bundesbank calculations. — ¹ Especially household, maintenance and education allowances. — ² Estimated Federal Government contributions to the statutory pension insurance scheme required for claims for periods of child-rearing. — ³ Updated estimates for assistance towards cost of living (in accordance with the Social Reports) as well as social assistance in special circumstances. — ⁴ In particular, child increments for public-sector employees, study grants, additional

housing allowance for families, maintenance advances and additional benefits in the framework of unemployment assistance. — ⁵ According to the breakdown in the Education Finance Report 1999, 61% of expenditure on higher education financed by general financial resources. — ⁶ Extrapolation of benefits for co-insured dependants under 20 years of age. — ⁷ Non-cash benefits from the statutory health insurance fund in connection with maternity, as well as maternity benefit paid by the fund.

dren. In addition, the tax breaks for families with children buying their own home were considerably expanded, which was responsible for a large part of the overall growth in housing subsidies. The additional home buyer's allowance for each child, which had previously amounted to between DM600 and DM1,000, was raised to DM1,500 per year.

*Different trends
in the individual
transfers*

Expenditure on child-related benefits by central, state and local government increased by almost one-third during the period under review. The growth of social assistance, which was concentrated on the first half of the 1990s, resulted particularly from the increase in the number of minors receiving benefit and the marked rise in the defined requirement levels up to the mid-1990s. By contrast, the Federal Government's contributions to the statutory pension insurance scheme credited for periods of child-rearing rose most sharply after 1995. They were fuelled partly by the increase in the contribution rate and partly by the fact that the level of earnings credited for the three-year period was raised in stages from 75% to 100% of average earnings as of July 2000. Furthermore, as from July 1998 contributions paid by a parent in employment are in effect no longer offset against the government credits. Expenditure on child-rearing benefit has remained virtually level on balance. Although the entitlement period was extended from 18 to 24 months for children born after 1993, this was offset by the marginal decrease in the number of births and the fact that the income ceiling for claiming this central government benefit was not raised up to the end of 2000.

The non-cash benefits granted by central, state and local government increased sharply until the mid-1990s but thereafter went up only marginally. For example, the obligation imposed by Parliament on local authorities to guarantee every child aged between three and six a place in a nursery school as from 1996 considerably accelerated the growth in expenditure for these institutions in the first half of the 1990s. For education but also for assistance for young people the relatively sharp increase in wages and salaries in the public sector which occurred at this time presumably pushed up expenditure substantially, whereas the weaker trend in income growth subsequently had a dampening effect. Expenditure on non-cash benefits increased by one-fifth in all between 1992 and 1999.

Increase in non-cash benefits, particularly up to 1995

Social security benefits, too, grew strongly until 1995 and then much more slowly up to 1999. Over the whole period these benefits increased by one-quarter. Expenditure by the statutory health insurance fund on co-insured family members under 20 years of age went up by the largest rate. This was due not only to an increase in the number of co-insured children and youngsters but also to the ballooning trend in health spending. The maternity-related benefits of the statutory health insurance funds likewise expanded sharply.

Social security benefits

Effects of general government benefits on households' income

*Comparison of
disposable
income before
and after the
birth of a child*

The level of general government benefits and statutory private transfers may appear limited when considered individually. For parents, however, they often have a sizeable cumulative impact on the amount of disposable income. This is illustrated below using model-case calculations for 2002 which only take into account those benefits that directly affect disposable income. In particular, non-cash benefits and the crediting of periods of child-rearing in the statutory pension insurance scheme are excluded.

In most cases, the labour income of one parent ceases or at least decreases following the birth of a child. The income effects of family-related transfers which are then paid as a substitute are calculated by comparing the disposable income after the birth with an income not affected by reduced employment due to child-bearing. This corresponds to a comparison with similarly structured households without children. However, this does not capture the complete change in the standard of living because children increase the family's requirements. To be able to include this in a rough approximation, the disposable incomes are additionally measured in relation to the social assistance claims of the various types of household, which captures the minimum level of additional requirements related to children.

*Different situations of
parents*

The situation of parents varies greatly with regard to the level of labour income, marital status and whether or not they take up (part-

time) employment after the birth of the child. Also, the level of some benefits is graduated over time, so that the age of the child also plays an important role. In order to take the differences on board, the analysis is based on standardised cases, with a trade-off between a realistic view comprising many types of cases and a simplifying overview. In the following analysis, three different income levels (half average, average and double average income) are combined with the two different family types "single mother" and "married couple", each with one child. In addition, the assumption/resumption of part-time employment in the child's second year is also considered. The comparison covers the period from the start of maternity leave prior to the child's birth until the child's fourth year (which largely reflects the situation in the following years). The assumptions made are summarised in the Annex (for the detailed results, see the table on page 25 and the accompanying charts).

The change in disposable income after the birth of a child, if the parent stops working completely, strongly depends on the level of labour income earned before the birth. For a single parent who, prior to the birth, earned half the average income, disposable income in the first two years after the birth is roughly two-fifths higher. Besides child-rearing benefit, this increase is due predominantly to the fact that social assistance is paid according to need. As it is assumed that the father likewise has a low labour income, maintenance payments contribute only a limited amount to the single mother's overall income. Compared

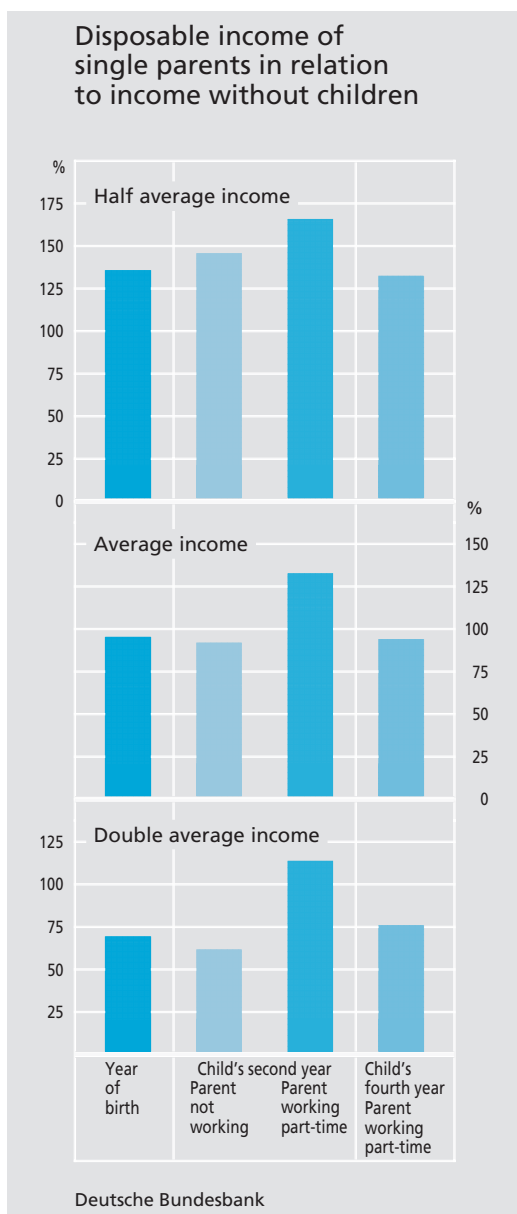
*Single parent
with half
average
income, ...*

Comparison of income before and after the birth of a child

in €

	Single parent					Married couple				
	Final year before the birth	First year, parent not working	Second year		Fourth year, parent working part-time	Final year before the birth	First year, parent not working	Second year		Fourth year, parent working part-time
			Parent not working	Parent working part-time				Parent not working	Parent working part-time	
Half average income										
Employment income, gross	14,259	–	–	7,130	7,130	28,518	14,259	14,259	21,389	21,389
Social security contributions	2,944	–	–	1,472	1,472	5,889	2,944	2,944	4,417	4,417
Income tax ¹	704	–	–	–	–	1,408	–	–	78	78
Private health insurance contribution ²	–	–	–	–	–	–	–	–	–	–
Child's maintenance claim	–	2,794	3,048	3,048	3,048	–	–	–	–	–
Mother's maintenance claim	–	–	–	–	–	–	–	–	–	–
Maternity benefit	–	3,221	–	–	–	–	3,300	–	–	–
Child benefit/children's tax allowance	–	847	924	924	924	–	1,694	1,848	1,848	1,848
Child-rearing benefit	–	2,610	3,684	3,684	–	–	2,610	3,684	3,684	–
Housing allowance	432	–	–	–	–	–	1,392	2,400	1,296	1,296
Social assistance	–	5,522	8,422	5,008	5,008	–	–	–	–	–
Disposable income	11,043	14,993	16,078	18,322	14,638	21,221	20,310	19,247	23,722	20,038
<i>Memo item: social assistance claim ³</i>	9,087	12,271	12,271	12,271	12,271	13,277	15,400	15,400	15,400	15,400
Average income										
Employment income, gross	28,518	–	–	14,259	14,259	57,036	28,518	28,518	42,777	42,777
Social security contributions	5,889	–	–	2,944	2,944	11,778	5,889	5,889	8,833	8,833
Income tax ¹	5,164	–	–	173	173	10,328	2,363	1,666	5,719	5,719
Private health insurance contribution ²	–	–	–	–	–	–	–	–	–	–
Child's maintenance claim	–	2,794	3,048	3,048	3,048	–	–	–	–	–
Mother's maintenance claim	–	4,075	6,307	4,389	–	–	–	–	–	–
Maternity benefit	–	5,094	–	–	–	–	6,074	–	–	–
Child benefit/children's tax allowance	–	847	924	924	924	–	1,694	1,848	1,848	1,848
Child-rearing benefit	–	2,610	3,684	3,684	–	–	1,952	1,874	–	–
Housing allowance	–	1,224	–	–	1,320	–	–	–	–	–
Social assistance	–	–	2,115	–	–	–	–	–	–	–
Disposable income	17,465	16,644	16,078	23,186	16,434	34,930	29,985	24,685	30,072	30,072
<i>Memo item: social assistance claim ³</i>	9,087	12,271	12,271	12,271	12,271	13,277	15,400	15,400	15,400	15,400
Double average income										
Employment income, gross	57,036	–	–	28,518	28,518	114,072	57,036	57,036	85,554	85,554
Social security contributions	6,912	–	–	3,650	3,650	13,824	6,912	6,912	10,562	10,562
Income tax ¹	17,191	–	–	4,296	4,296	34,382	11,723	10,592	21,035	21,035
Private health insurance contribution ²	1,200	2,000	2,400	1,200	1,200	2,400	2,675	2,700	2,700	2,700
Child's maintenance claim	–	3,311	3,840	3,612	3,840	–	–	–	–	–
Mother's maintenance claim	–	9,075	13,099	11,827	–	–	–	–	–	–
Maternity benefit	–	8,191	–	–	–	–	10,087	–	–	–
Child benefit/children's tax allowance	–	847	924	924	924	–	1,694	1,848	2,256	2,256
Child-rearing benefit	–	2,610	3,684	379	–	–	1,228	–	–	–
Housing allowance	–	–	480	–	–	–	–	–	–	–
Social assistance	–	–	–	–	–	–	–	–	–	–
Disposable income	31,733	22,034	19,627	36,113	24,136	63,466	48,735	38,680	53,513	53,513
<i>Memo item: social assistance claim ³</i>	9,087	12,271	12,271	12,271	12,271	13,277	15,400	15,400	15,400	15,400

¹ Including solidarity surcharge. — ² Employee's share. — ³ Recognised average requirement, adjusted for actual rent costs.



post-birth income drops considerably. Whereas before the birth the mother earned almost twice the social assistance level, her income in the two years following the birth is only about one-third higher.

Single parents whose income before the birth was double the national average sustain by far the largest losses. Their disposable income in the year of the child's birth is almost one-third below the level without a child and in the second year (after payment of the relatively high maternity benefit has stopped), it is nearly two-fifths lower. In this case, the maintenance payments from the father initially have a predominant share in the household income.¹¹ Government transfers, by comparison, have little significance given the relatively high level of maintenance stipulated by family law. While the income position drops dramatically in relation to the social assistance level compared with that of a household without children, it is still considerably higher than that minimum standard. When child-rearing benefit and the mother's maintenance cease to be paid, however, single parents in all income groups fall to the social assistance level unless they take up employment again.

... and double average income

with an income derived solely from social assistance, she still marginally improves her lot.

If the mother had earned an average level of income prior to the child's birth, her disposable income declines noticeably. Although the mother receives maintenance payments from the father in the first few years, they are offset against government transfers. Compared with the social assistance level, the

... average income ...

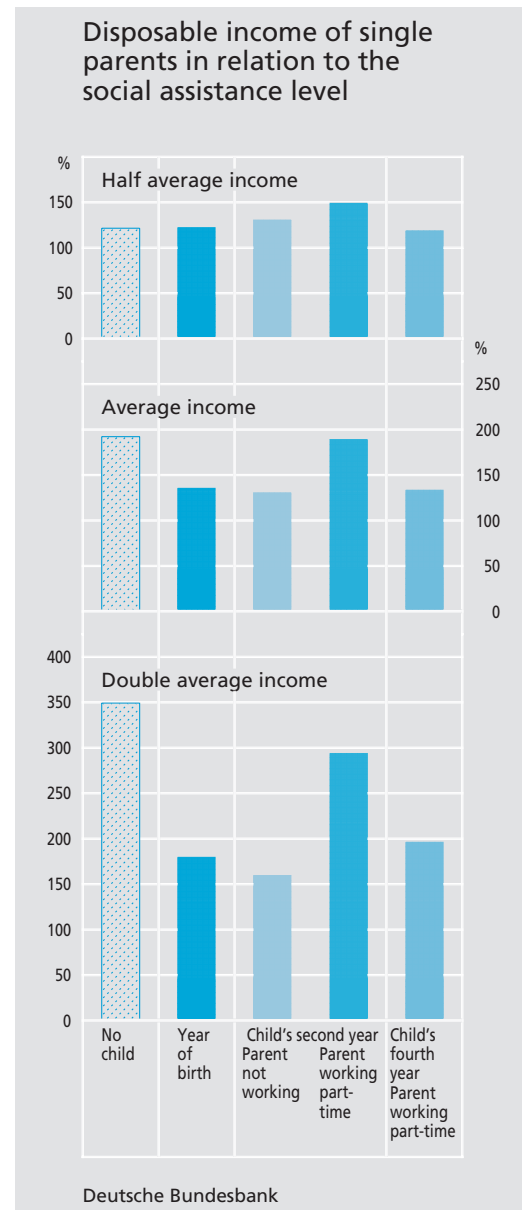
One issue that is of relevance in the context of social and labour market policy is the extent to which single parents can improve their financial situation by going back to

Single parents in part-time employment

¹¹ After deducting these payments, even the father – if he keeps his current job – in this case attains only about three-fifths of his corresponding childless income level. Only if he earns half the average income level does he retain a significantly larger share owing to the minimum amount stipulated for his own subsistence.

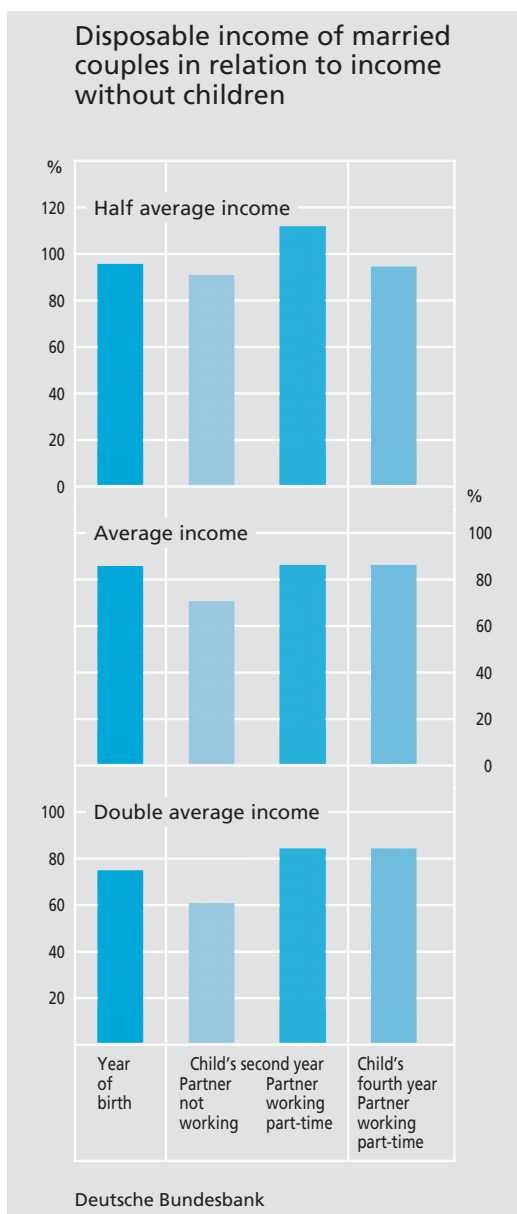
work. By resuming their former employment on a half-time basis in the second year after the child's birth, low income earners do not improve their position significantly – even leaving aside the question of childcare costs. Their disposable income increases by only 14% as a result of going back to work. The main reason for this is that the income from employment is largely counterbalanced by the reduction in social assistance. By contrast, single parents in the higher income groups, for whom social welfare transfers are less important, improve their income position much more if they take up part-time employment – for the average-income group by two-fifths and for high-income groups by as much as four-fifths, although for the latter group the entitlement to child-rearing benefit falls sharply. Another benefit which has a particular impact in this case is the household allowance currently granted to single parents (although it is to be gradually phased out by 2005), which at the moment is worth a potential of almost €800 in tax savings. Disregarding childcare costs, high income earners retain almost 60% of their part-time earnings, medium earners 50% and low earners little more than 30% due to the offsetting of social benefits.

In the child's fourth year the position of all income groups worsens perceptibly, chiefly on account of the cessation of child-rearing benefit (for low and middle income earners) and the mother's maintenance claim (for middle and high income earners). This fourth year is particularly relevant in that it also gives an impression of the income position of single parents with older children.



Married couples in which only one partner continues to work after the birth of a child likewise sustain a substantial drop in disposable income – although it is still higher than that of single parents. As in the case of single parents, the size of the loss rises with the amount of the forfeited labour income. Besides lower child-rearing benefit in the first years, this is due to the fact that family allowance has a relatively smaller impact the higher

Married couples without ...



the income is. However, the losses in the case of higher income earners are cushioned by the considerable tax savings resulting from the joint assessment of the spouses for income tax purposes, the effect of which increases if one partner stops working.¹² While in the child's second year the disposable income of parents with a previously low labour income falls from just under 160% of the social assistance standard before the birth to

125% afterwards and basically only exceeds that level thanks to child-rearing benefit, the disposable income of parents in the middle income bracket recedes from over 260% to 160% and that of high income earners from just under 480% to just over 250%.

If the parent takes up part-time employment in the child's second year, the disposable income of the lower income group improves by just over one-fifth – and thus more than in the case of single parents. The principal reason for this is that if one partner already has a full employment income, the means-tested transfers are relatively small, so that the reduction in benefits if the other partner takes up part-time employment are less significant. In the case of middle and high incomes, however, the disposable income does not increase as sharply as that of single parents. This is due especially to the more sharply rising income tax burden, which is caused not least by the smaller impact of joint income tax assessment once the second partner takes up employment.¹³ The smaller increase in the case of middle incomes is mainly attributable to the discontinuation of child-rearing benefit. Disregarding childcare costs, married couples on a low income retain just over 60% of their extra earnings, those with a middle income keep almost 40% and those with a high labour income retain just over 50%.

... and with the parent in part-time employment

¹² These savings range from just over €700 for half average income to €6,500 for double average income.

¹³ If part-time employment is taken up, the advantage of joint income tax assessment is reduced by almost €100 for the lower income group, by just over €3,300 for middle income earners and by just over €5,300 for high incomes.

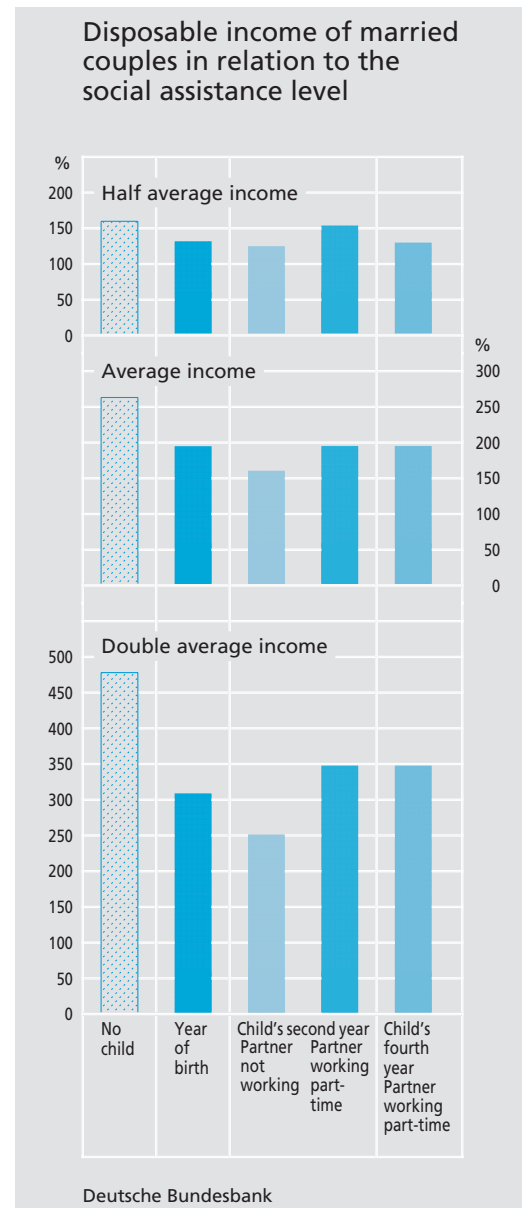
If taking up part-time employment involves childcare costs, the growth of real disposable income is reduced perceptibly, particularly as these costs can only be partly offset against income tax. This substantially curbs the monetary incentives to take up paid employment.

Conclusion

Growing importance of public benefits for children

In the second half of the 1990s, in particular, benefits for children grew much faster than overall general government expenditure. This reflects, *inter alia*, the intention to ease the financial burden on parents to a greater extent than before. In turn, this was prompted in part by Federal Constitutional Court rulings which notably brought about a significant increase in the tax allowances to cover children's minimum subsistence. In its latest ruling, which stipulated that contribution rates to the statutory nursing care insurance scheme need to be geared in favour of families – which is still to be implemented by Parliament – the Court also stressed the importance of children in the current pay-as-you-go social security system.

Government assistance for childcare plays a decisive role in enabling parents to reconcile work and family life. Extensive and affordable childcare facilities make it easier for parents to take up or resume paid employment after a child has been born and reduce the costs associated with losses in their income. For one thing, this can be a positive factor influencing couples to have children. For another, a higher rate of participation in the labour force increases the utilisation of the available



human capital, with corresponding positive macroeconomic effects. Against this backdrop, governments have stepped up childcare benefits considerably by implementing the recently stipulated legal right to a place in a nursery school for children aged between three and six years. Government childcare assistance for children under three and for children of school age is less comprehensive.

Education, which is largely provided free of charge, accounts for the bulk of overall general government measures related to children. Promoting the creation of human capital is a vital government contribution to future macroeconomic development and the optimal utilisation of the potential labour force.

Varied consequences for disposable income

The model-case calculations presented above have shown that parents sustain large financial losses if they give up their job or switch to part-time working, especially once their child has reached the age of four. This does not apply to single parents on a low income, who are broadly able to maintain their (modest) standard of living even after the birth of a child. Admittedly, they can boost their disposable income only modestly, at least if they take up a part-time job, owing to the high marginal burden on additional earnings due to deductions from benefits, so that their incentive to work is comparatively small. For all other parents, the additional burden to be borne if they return to work is lower. However, due account must be taken of the fact that the costs associated with childcare – es-

pecially if very high – significantly weaken the pecuniary incentives to take up gainful employment.

In the final analysis, decisions on the nature and scale of benefits related to children and families have to be made on the basis of value judgements and hence political compromises. Any attempt to expand these benefits, however, must take account of the fact that aggregate government expenditure already adds up to almost half of GDP, resulting in a heavy burden of taxes and social security contributions that inhibits growth. A major fiscal policy objective is to gradually reduce the general government expenditure ratio in order to achieve a durable consolidation of public finance and, subsequently, to be able to lower the burden of levies further. For these reasons, any expansion of family assistance measures can only be achieved by reallocating resources within general government budgets. Moreover, the efficiency of government activity in this field, too, needs to be continuously monitored and improved as far as possible.

General government benefits for children and fiscal consolidation requirements

Annex

Comparison of incomes of households with and without children

The model-case calculations made in this article are based on the assumption that, prior to the birth of a child, single persons – and, in the case of married couples, both partners – are gainfully employed, drawing an employment income amount-

ing to 50%, 100% and 200%, respectively, of average earnings. Any other sources of income have been disregarded. Furthermore, it is assumed that the mother interrupts her gainful employment upon termination of her maternity leave (which in this case begins at the start of the year and thus ends in April of the year of birth). Income levels are computed for the year of birth as well as the child's

second and fourth years of life, embracing alternative scenarios regarding the mother's gainful employment. The respective calculations assume that the mother returns to her old job, halving both her working hours and her former gross income, and that no extra childcare costs have to be borne by the mother while working.¹⁴

In the case of single mothers – single parents are rarely fathers – claims to maintenance payments, which are governed by family law incorporated into the Civil Code, play a significant role. The estranged parent must pay maintenance for the child. The amount is determined by the “Düsseldorf Table”, which is used by judges in west German states, according to an adjusted net income and other maintenance obligations. The amount payable is then supplemented by half the child benefit claimable by the person liable for maintenance, to the extent that the claim – calculated on the basis of the Düsseldorf Table – is less than €254 per month. It is assumed that the persons liable for maintenance make these payments in full, although this does not always correspond to reality.¹⁵ Where applicable, the parent obliged to make maintenance payments also bears the cost of the child's private health insurance. Moreover, during the child's first three years of life the mother is entitled to receive maintenance upon termination of maternity benefit. The amount is based on her previous income but cannot fall below a certain minimum subsistence level. The mother is not expected to take up paid work during that period; if she does, half of the income she receives is deducted from the defined maintenance requirement. To avoid overburdening the person liable for maintenance, the latter, *inter alia*, is allowed to keep a certain minimum amount, and his maintenance liability towards the child's mother is limited to three-sevenths of his relevant income.

With respect to health insurance, it is assumed that persons whose income exceeds the threshold for opting out of the statutory health insurance scheme take out private health insurance, which they maintain even when not in gainful employment.¹⁶ The tax relief granted under the family allowance system is not taken into account when calculating the income tax liability; instead, it is shown separately under “child benefit” (including any additional savings from the children's tax allowance). Any work-related tax-deductible expenses in excess of the basic allowances or tax-deductible special expenses in excess of social security contributions are disregarded. For single parents, the income tax calculation is based on the household allowance in effect in the current year.

Maternity benefit is assumed to be fully paid in the year of birth. This type of income is not liable for social security contributions but is subject to the progression rule under the income tax regime. Maternity benefit is offset against child-rearing benefit, so that the latter is paid only from the child's third month in all model-case calculations.

The calculation of the housing allowance is based on the assumption that the monthly rent is €410 (single persons) and €510 (married couples) and that recipients live in an area for which peak rents are assumed and in dwellings not older than 10 years. The additional tax grants for families in the context of the home buyer's allowance are disregarded.

¹⁴ With effect from 2002, part of these costs are deductible from income tax; an eligible claim to social assistance would increase by the corresponding amount.

¹⁵ In that case, central, state and local government pay a certain minimum amount for up to six years pursuant to the Maintenance Advance Act.

¹⁶ For simplicity, monthly contributions are assumed to be €200 (adults) and €50 (children).

In these model-case calculations, entitlement to social assistance covers not only the standard rates for household members but also benefits paid to finance extra and special needs as well as the cost of housing. The average gross social assistance requirement published by the Federal Statistical Office has been corrected insofar as rents have been

set at the levels mentioned above. The income of social assistance recipients may exceed this level since child-rearing benefit and, where the parent works, a minimum amount of retainable income amounting to almost €200 per month as well as €10 of the child benefit are not offset against the social assistance claim.