

Germany's „flat tax elections“

A tax justice analysis of the conservatives' defeat

Just until the German general elections of the 18th of September almost everyone was sure: The conservatives (CDU/CSU) of Angela Merkel would win with a large margin and drive the red-green coalition out of office. Two weeks before the elections the CDU/CSU had a comfortable lead to the social-democrats (SPD) of about 12% in the polls. Just two weeks of a fierce tax debate made Merkel's CDU/CSU loosing 8% and the lead to the SPD shrink to 0,9%. What was behind it? What can we learn from it?

The majority of the Germans were convinced that Schröder and his red-green coalition has proven that they cannot lead Germany out of crisis. The lead for Merkel in the polls had been more or less stable for many months although the conservatives had announced a programme of reforms which was supposed to increase the dose of the neoliberal medicine which Schröder already used with little success. In the field of tax policy Merkel wanted to increase VAT by 2% to 18%, to lower the top marginal income tax rate from 42% to 39% and to cut lots of tax exemptions, mainly for low and middle incomers such as people working late and on holidays or long distance commuters. These reforms would continue the tax cuts of Schröder's government lowering the top marginal income tax rate from 53% to today's 42%.

Although Merkel's programme was already tough, she and some radical liberals in her party wanted even more. Encouraged by the good opinion poll results she named Paul Kirchhof as responsible for finance in her "team of competence" promising him to become finance minister.

Paul Kirchhof is a professor of fiscal law at the University of Heidelberg and a former head judge serving on the constitutional court. In a number of controversial decisions he co-shaped Germany's tax laws. His most famous decision was the "Halbteilungsgrundsatz" which limits the tax bite to 50% of disposable income. As this principle includes income and wealth taxes it limits radically redistribution through the tax system. Although this decision was never fully accepted in Germany's legal discussions, it restrained strongly the creative thinking of tax policy makers as they feared a defeat at the constitutional court. After his active time as a judge he became a "hobby tax policy maker" promoting to introduce the flat tax in Germany. He not only supported the flat tax idea but organised a team of liberal experts which wrote a draft for a new income and company tax code. Being a charismatic person of self-proclaimed Christian conviction he managed to gather a lot of political support for his proposals.

His proposal consists of three key ideas. First, Kirchhof wants to lower the top marginal income tax rate to 25%. Second, he plans to cut more or less all tax exemptions. Third, in order to render this programme less brutal he wants to introduce lower two tax rates for low incomes. This latter measure would result in effective average tax rates for lower incomers which resemble a progressive tax system. Kirchhof's proposal is therefore a milder version of the Eastern-European flat tax models.

This proposal contradicts strongly the conservative manifesto and caused considerable confusion in the public debate. Which concept would Kirchhof try to put into the practice? The party proposal or his own one? Furthermore, the CDU/CSU refused to publish the "toxic list" of more than 400 tax exemptions which Kirchhof wants to cut. This further increased the irritations. Most importantly, the Kirchhof proposal was seen as deeply unjust. While the majority did not understand Kirchhof's compromise for lower income groups, everybody

understood that the rich would only have to pay 25%. The “flat tax” was seen as another reform which the poor would have to pay and make the rich better off.

The Kirchhof proposal allowed the SPD and the Greens to launch a fierce counter attack polarising on a social issue. Opinion polls in Germany show consistently that more than 70% of citizens want to keep the welfare state. Therefore, the claim of the SPD, that their reforms were socially just while the reforms of the conservatives were a social onslaught, had a strong political potential.

In the beginning the majority of mainstream media supported Kirchhof. But during the fierce public debate more and more doubts were raised which strengthened the suspicion of the public. Kirchhof’s “flat tax” would have created an annual hole in the budget of another 20 bn €. The CDU/CSU could not explain how to finance this deficit. Furthermore, the German Institute for Economic research and Attac proofed Kirchhof’s claim wrong that because of reduced tax exemptions the rich would in reality pay more than today. Tax data shows clearly that the large majority of the high incomers would be much better off with Kirchhof.

In order to win the debate it helped a lot to establish a new term into the public debate calling the “flat tax” a “Einheitssteuer” (unique tax). While “flat tax”, as most Anglo-Saxon terms sound modern and cool in German, “Einheitssteuer” resembles rather an old-fashioned “one size fits all solution”.

On the election day of 18th of September, two weeks after the appointment of Kirchhof, Merkel’s conservatives lost 8% and scored a worse result than Helmut Kohl in 1998 which was a historic defeat of the CDU/CSU. Two days after the elections Prof. Kirchhof declared his retreat from politics. Hopefully it will take at least two decades that a political party dares to suggest a “flat tax” in Germany.

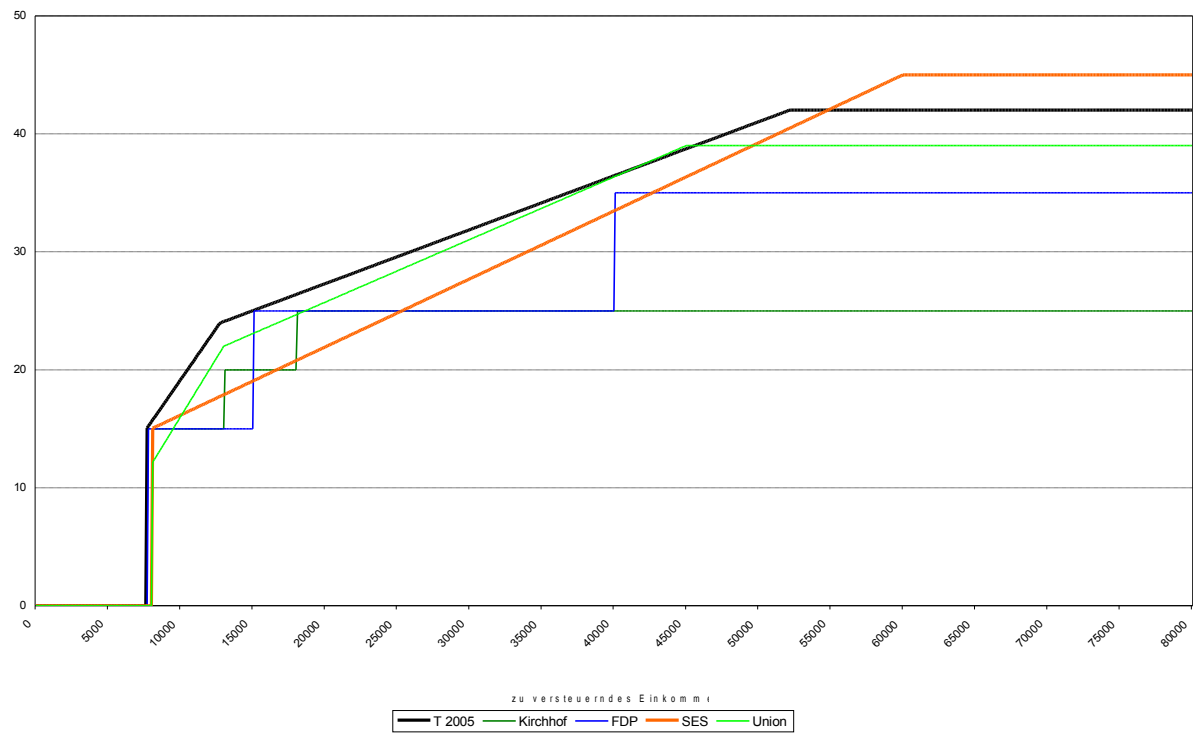
What can tax justice campaigners learn from this experience?

The flat tax proposal can be defeated. In Western democracies the idea of progressivity in the tax system is deeply rooted in public opinion. This can easily be mobilised if a wide coalition of economic institutes, unions, parties, faith groups and alterglobalists use their specific resources. The fact that everyone has to pay the same tax rate is a strong symbol for injustice. An injustice the majority of Germans does not accept. The burden of paying a marginal income tax rate of 25% is much higher for the middle classes than for the rich. Furthermore, it does not work for the flat tax that many voters do not understand the difference between equal tax payments and equal tax rates. The German flat tax elections show that the public can also be mobilised in the rather abstract field of tax policy. This holds particularly true if the neoliberal attack is as symbolic as the flat tax and the opponents can establish a denouncing counter term in the public debate such as the “Einheitssteuer”.

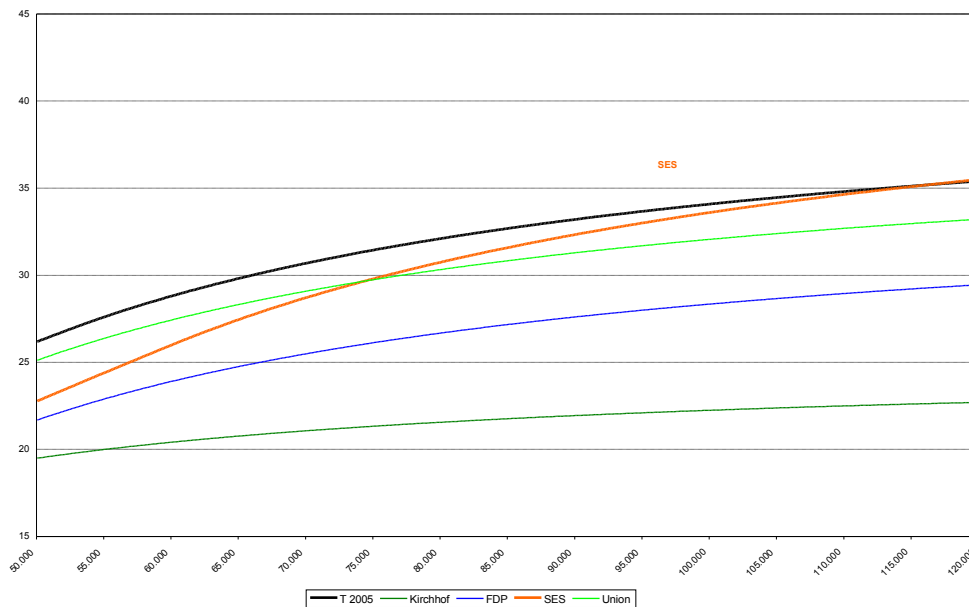
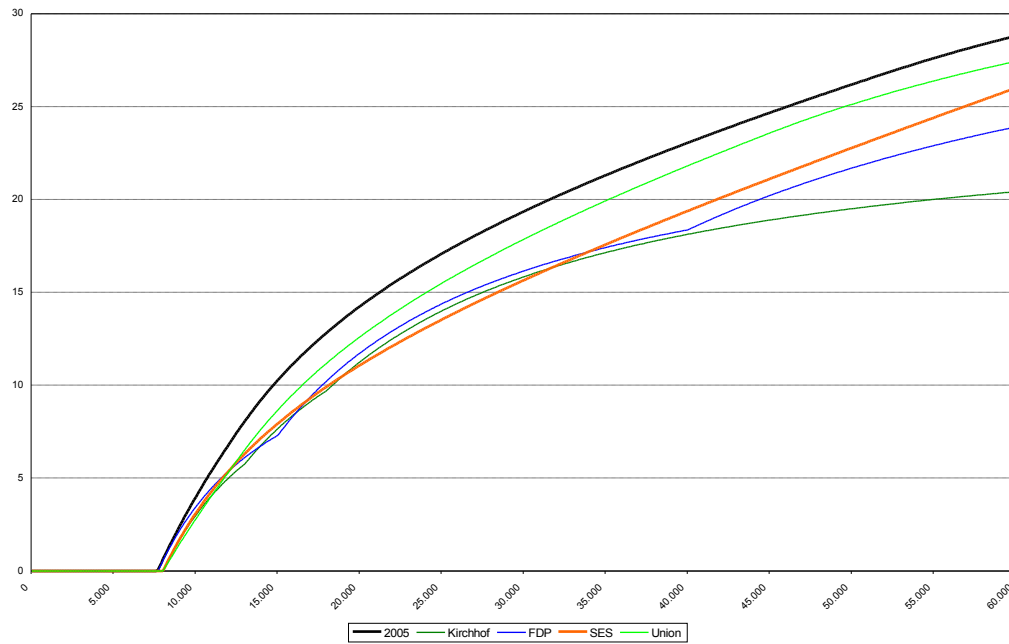
The proponents of the flat tax claim that their idea would increase economic growth and the low tax rates are necessary in order to compete in fierce tax competition. Both claims can easily be refuted. There is no study which proves a significant positive correlation between the level of top marginal income tax rates and economic growth or employment. Tax competition is a reality. But as long as the same political and economic elites which argue for lowering national tax rates do not seriously act against international tax evasion and tax competition, they argument lacks consistency and credibility.

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Graph 1: Marginal income tax rates of different tax reform proposals depending on the taxable income (Attac/verdi 2005: Solidarische Einfachsteuer, 2. Auflage).



Graph 2: Average income tax rates depending on taxable income according to different income tax reform proposals (Achim Truger, IMK).