Germany's tax reform: the end of the "social market economy"

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The passage of the German tax reform bill, which surmounted its last parliamentary hurdle when the Bundesrat (the upper house of Germany's parliament) voted in favor on July 14, is a watershed in German politics.

Comparable to historic turning points such as the 1956 Godesberg party conference when the German Social Democrats (SPD) severed their last ties to the workers movement and transformed the SPD into a “popular party”, or the Social Democratic/Green party government's active support of the Kosovo War last year (the first German participation in a war of aggression since 1945), this tax reform signifies a qualitatively new stage in the development of German society. It is nothing less than the end of the “social market economy”, Germany's landmark system of welfare-buttressed capitalism.

Largely credited to post-war conservative (Christian Democratic Union—CDU) leader Ludwig Erhard, the “social market economy” was based on government economic policies—and particularly fiscal policies—aimed at creating a certain degree of social balance within the framework of market economy conditions. All that is over and done with.

Superficially, the SPD/Green tax reform does include a certain amount of tax relief for middle-level incomes. The media have made a big thing of this, and the government has been placing full-page advertisements proclaiming that the 80 billion mark tax relief involves all sectors of society (“Everyone is benefiting from this reform!”).

But this is pure deception. The slight tax reduction in the mid-level income bracket doesn't even compensate for the increase in the “eco-tax” (a surcharge levied mainly on gasoline), not to mention the effects of old and new reductions in government spending.

No matter how one attempts to present the tax reform, the fact remains that its core element is a drastic reduction in corporate taxation. In particular, taxes on profits—regardless of whether they are corporate profits, dividends or speculative profits—have been reduced to a degree that was hitherto inconceivable.

The corporate income tax for joint-stock companies will be nearly halved from its present level of 40 percent to 25 percent. The same politicians who not so long ago warned against the social consequences of American-style “turbo-capitalism” are now revealing themselves to be even worse than the most ruthless American or British monetarists.

Up to now Germany has been in the uppermost category with regard to the taxation of joint-stock companies, with a top tax rate of 56 percent on retained profits, almost 10 percent more than in the US. This will now change drastically. In future, Germany will have the fourth lowest tax rate in Europe—38.6 percent, which is much lower than the top US tax rate of 46.5 percent.

The top tax rate for private income, which was 56 percent throughout the 1980s and still 53 percent at the end of the Kohl administration's term of office, will be reduced to 42 percent by 2005. For someone who makes a million marks a year, this means a reduction in taxes of more than 100,000 marks.

The really explosive element of the new tax bill, however, is the abolition of the tax on profits accrued from selling off stakes in other companies. Until now companies had to pay up to a 53 percent tax on these profits. As of the beginning of next year, this tax will no longer exist.

When Finance Minister Hans Eichel (SPD) announced this move last winter, share prices soared on the Frankfurt stock exchange. In particular the stocks of the major banks and insurance companies shot up. The passage of the tax reform bill on July 14 likewise brought about a surge in the stock prices of the big financial institutions. The Munich-based Allianz insurance group gained 7 percent, and the prices of major bank stocks increased by up to 6 percent.

The jubilation in the financial markets is not without reason. The abolition of the tax on investment profits is a fundamental change in course, effectively unraveling the close-knit network of banks, insurance groups, manufacturing industry, trade unions and politics that was the characteristic element of Germany's “social market economy”. Previously, this corporatist network served to keep foreign rivals at a distance, control international competition and regulate social problems. That is now all in the past.

From now on, taxation will follow a completely different principle. Whereas in the past the idea was (at least, in principle) to bind together society as a whole and reduce the extremes at both ends of the income scale, the new fiscal philosophy is "Enrich the rich!"

The Schröder government has thus introduced shareholder value as the overriding principle of society in Germany as well. Effective immediately, economic and social policies will be based exclusively on the interests of the major corporations and banks and oriented towards short-term increases in stock prices.

The spokesmen of the influential industry federations have been demanding this kind of policy, styled on the monetarism introduced by Reagan and Thatcher in the early 1980s. But the Kohl government proved incapable of implementing this change, which was based on the interests of the major banks and corporations. Nor could it do so today, as the acrimonious conflicts within the CDU with regard to the tax reform have shown.

There are a number of reasons for this. For one thing, the conservative Christian Democratic Union/Christian Social Union (CDU/CSU) is largely based on middle-class elements and mid-level companies, which feel disadvantaged in relation to the big corporations and banks. The more significant aspect, however, was that the Social Democrats blocked this kind of tax reform as long as they were in the opposition. Although this was pure electioneering, it did—albeit in a highly distorted manner—reflect widespread hostility in the population to such policies.

This is the reason why big business, which had been served so faithfully by Kohl, wanted a change in government after 16 years of his administration. What was required to overcome resistance against the tax reform was to get the SPD and the Green party firmly entrenched and responsible for running the government. Right from the start, Germany's ruling elite considered the task of the SPD/Green government to be the opening up of the German economy and the German welfare state to meet the requirements of globalised markets.

When we pointed out this aspect two years ago, hardly anyone was predisposed to believe it. Inclination was too strong to see voting for the SPD as the only way to finally get rid of the despised Kohl administration. But in actual fact, voting Schröder into office was about as effective as trying to put out a fire with kerosene.

Under the headline "Whither the SPD?", we wrote in the fall of 1997: "After 15 years of the Kohl administration, which has created a devastating social crisis, almost any alternative would seem to be the lesser evil. But caution would be well advised. It is all too easy to jump out of the frying pan and into the fire in a situation like this.... Based on the widespread opposition to Kohl and company, efforts are being undertaken to prepare and bring to power a government that is in every respect more capable of furthering the interests of the capitalists and implementing decisive action against the interests of the general population" (*Gleichheit*, November 1997).

At the time, this perspective was not at all clear to many people. But after only two years in office, Schröder and his Green ally Fischer have made it clear that they see their task as pushing through the very policies their conservative predecessors failed to implement.

After the passage of the tax reform bill there was no mistaking the jubilant mood of the international financial world. The *Wall Street Journal* proclaimed a "Big Bang in Germany", and saw a "touch of Reaganomics" spreading throughout Germany.

As so often in history, this development is belated in Germany. Two decades have passed since the advent of Reagan and Thatcher, and the devastating social consequences of their policies are obvious to all in the US, Britain and many other countries. There will be a dramatic escalation of the social crisis in Germany as well. Already next year, the federal government, the states and the municipalities will be facing a 45 billion mark drop in tax revenues. As of 2005, this deficit will even reach 75 billion marks. Further austerity measures are inevitable.

Chancellor Schröder, who likes to be called "the bosses' comrade", and his chief accountant Hans Eichel, whose main claim to being a brilliant finance politician is his ability to sense the requirements of big business even before they have been uttered, will soon be faced with the social consequences of their policies. The more obvious the class character of this government becomes, the more acutely is posed the issue of a political alternative that allows broad layers of the population to act independently.

It may thus well be that another forecast in the *Gleichheit* article quoted above will be realized: "Very soon, the party that 150 years ago started its historic path under the banner of socialism and which today acts as the mouthpiece and instrument of big business will find itself confronted by furious workers."