Evasive Germans

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Since last Thursday's televised police raid on his home in Cologne, former Deutsche Post CEO Klaus Zumwinkel has become a national symbol of the greedy corporate boss. Mr. Zumwinkel, who resigned the day after the raid, stands accused of evading about €1 million ($1.5 million) in taxes. Yet amid the anticapitalist backlash in Germany, and attacks on tax havens such as Liechtenstein -- where Mr. Zumwinkel allegedly hid his money -- few have taken note of the elephant in the room: Germany's Byzantine tax code and how it may encourage a collective national tax evasion estimated to be €30 billion a year.


Angela Merkel

Instead, on Wednesday we heard Christian Democratic Chancellor Angela Merkel demanding that visiting Liechtenstein Prime Minister Otmar Hasler comply with OECD rules regarding transparency and unfair tax competition. No matter how much pressure is put on one tiny Alpine principality, however, neither Berlin, nor the OECD, for that matter, will be able to close all the escape routes for tax dodgers. Certainly not in this day and age, where billions can be moved electronically around the globe with a mouse-click. Even as they pursue lawbreakers, authorities in Germany and elsewhere should be asking themselves why so many people risk so much to evade taxes.

Germany's progressive income tax system, with a top marginal rate of 47.5%, pretends to be fair and just but its complexity actually smothers justice. The thousands of pages of tax law and myriads of exemptions are baffling. Citizens can never be sure whether they may pay too much by mistake or have exploited all available loopholes. This undermines public confidence in the fairness of a system that invites people to be creative with their tax forms -- rewarding the clever and punishing the honest. Most Western tax codes are equally damaging in their complexity.

As Germans now bemoan the moral shortcomings of their corporate leaders, there is a moral case to be made for low, simple and transparent taxation. The OECD is a notorious enemy of tax havens. Yet it also believes that improving tax codes is key to stemming tax evasion. "We have consistently argued that if governments lower tax rates, broaden the base and simplify the rules, they are more likely to get compliance," Grace Perez-Navarro, deputy director of the OECD's Center for Tax Policy and Administration, told us.

One of the easiest and most transparent systems is a flat tax, which these pages have long advocated. The rising number of countries that have introduced a flat tax -- notably in Eastern Europe -- have generally seen their tax revenues rise, not fall as flat-tax opponents had predicted. Part of the success is due to higher economic growth, because low and uncomplicated flat rates encourage investment and work. But such rates also pay off in more honest tax payments. When Russia introduced a 13% flat tax in 2001, the economy grew almost 5% in real terms over the following year. Personal income tax revenues, though, soared by more than 25%. Coincidence? Economists think not.

"The flat tax reform was instrumental in decreasing tax evasion in Russia," according to a recent study co-authored by Yuriy Gorodnichenko from the University of California at Berkeley and Georgia State University's Jorge Martinez-Vazquez and Klara Sabirianova Peter.

In 2005, a U.K. Treasury in-house study also suggested that a flat tax "should lead to a significant reduction in (tax) avoidance and evasions." There was even hope for Germany when Angela Merkel campaigned in the 2005 general elections. She made Paul Kirchhof, an advocate of a 25% flat tax, her shadow finance minister. Then came the grand coalition and Mr. Kirchhof never got a chance to step out of the shadow.

A flat tax may not have stopped all Germans from parking money tax-free in Liechtenstein. But apart from stimulating economic growth, it would have greatly reduced incentives to cheat. When the cry of the mob dies down, perhaps Mrs. Merkel will think again about reforms to bring about the kind of fairness that so many taxpayers seem to be missing in the