Fall Of The Berlin Wall: The Problems Of Too Much Equality

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Fears of ever-rising economic inequality have been stoked by the runaway success of Thomas Piketty's book "Capitalism in the 21st Century." Yet the 25th anniversary of the fall of the Berlin Wall should remind us that excessive equality can cause social strain and collapse more surely than excessive inequality.

Millions left East Germany because they found the system unfair: It produced equality by massively denying individual economic opportunities. So, they risked life and limb by fleeing to West Germany, which had more inequality but lots of opportunity.

Many refugees also sought more political freedom. But they were overwhelmingly educated, talented youngsters, for whom forced equality in East Germany amounted to a huge implicit tax. Seen in this light, they sought not just political liberty but freedom from exorbitant implicit taxation. This doesn't mean that inequality is an unqualified virtue; it's possible to have too much of it. Yet the Berlin Wall anniversary reminds us that the virtues of equality can be overstated.

East Germany had equality, no unemployment, free education and health, and succor for the sick, handicapped and aged. It was an egalitarian welfare state with higher living standards than Germany had enjoyed before World War II. Yet, by 1961, an estimated 3.5 million people had fled from egalitarian East Germany to inegalitarian West Germany, inducing the erection of the Wall.

This story was repeated elsewhere. Communist North Korea is more egalitarian than South Korea, yet millions fled from it to the south.

Mao Zedong created an egalitarian China, in stark contrast with Hong Kong, which was among the most unequal places in the world. Yet thousands swam across shark infested waters from egalitarian China to inegalitarian Hong Kong. None swam in the opposite direction, not even Marxist professors.

Piketty says he belongs to the post-Berlin Wall era, and has no illusions about the forced equality attempted by communist states. He favors a high wealth tax to soak the undeserving rich. Since this would induce the highly taxed to flee, just as they fled from East Germany, he proposes a high global wealth tax to prevent migration.

But there is no reason for Singapore, Hong Kong or other low-tax countries to co-operate, since they are happy to attract the rich and talented, and don't care a fig for Piketty's fears. Indeed, these countries are proud to have made themselves so attractive.

This is, of course, inconvenient for nations such as the U.S., which has one of the highest corporate tax rates and estate duties anywhere. President Obama has castigated U.S. corporations and individuals migrating to low-tax countries.

He seems close to echoing an East German government pamphlet of 1955 asking, "Is it not an act of political depravity when citizens, whether young people, workers or members of the intelligentsia, leave and betray what our people have created?"

In the 1970s, the Soviet Union imposed an exit tax on citizens wanting to migrate, linked to their educational levels (to recover costs of the brain drain). The U.S. condemned this as violation of the right to emigrate under Article 13 of the U.N. charter, and imposed trade sanctions through the Jackson-Vanik Act.

However, that moral stance was forgotten when Eduardo Saverin, co-founder of Facebook, exited the U.S. for Singaporean citizenship. Saverin was savaged by politicians and the media, and Sen. Charles Schumer proposed a 30% capital gains tax on such dastardly emigrants, plus a ban on their ever re-entering the U.S.

This idea failed, but was somewhat superfluous as the U.S. already had an exit tax on rich emigrants who'd been U.S. citizens or green-card holders over seven years. Such people had to pay capital gains tax calculated as though all their assets had been sold on the date of emigration.

The USSR levied an exit tax on the human capital of migrants, while the U.S. levies a tax on their financial capital. This is a sort of fiscal Berlin Wall. Like the German version, it has not deterred Americans from exiting.

The lesson is clear: Whatever the merits of equality, it must not be attempted through implicit or explicit taxation so severe that it drives away skill and capital. Nor can such people be retained through fiscal or physical barriers.

To retain such people, a country must make itself attractive enough for them to stay. The policy focus must be on creating more opportunity for the non-rich through superior education and skill acquisition, not on draconian taxation.

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