

Europe's Flat Tax Revolution

It is well known that the flat tax is the "holy grail" for fiscal conservatives. While our lawmakers in Washington, DC continue to only contemplate fundamental tax reform, Europe has been road testing it since the 1990s. Most recently, Poland's Prime Minister, Donald Tusk, has come out in support of a single-rate flat tax on personal income by 2010.

Additionally, Serbia, Montenegro, Bulgaria and Cyprus have all recently lowered their corporate tax rates to 10 percent. This will leave Hungary the only nation in Eastern Europe outside of the region's "flat tax club." In fact, in the former Soviet bloc there are now nine countries that have adopted flat tax systems. In total, 24 nations now have flat tax regimes, and thanks to the resounding success of these pro-growth tax policies, that number is likely to expand even further.

In the 1980s, Ronald Reagan took bold measures to cut tax rates and simplify the tax code. This allowed millions of hardworking taxpayers to keep more of their hard-earned money, while stimulating the economy and increasing investment. Unfortunately, years of inaction have eroded the competitive edge of the United States in the world-wide battle for business investment and economic growth.

Today, the uncompetitive nature of our corporate tax system has placed an undue burden on business investment in the United States. When you add the top U.S. corporate tax rate of 35 percent to corporate taxes in the states, a business looking to invest in the U.S. will face the prospect of paying a combined tax rate that is among the highest in the industrialized world. In fact, the top combined corporate rate in the U.S. exceeds the top corporate tax rates in Canada, France and Sweden.

Governments that have introduced flat tax systems in Eastern Europe have clearly been successful in their endeavors—so why is the West still wary? Regular debate continues in the UK, and other countries such as Greece and Spain are also considering the benefits of a simplified tax system. America should follow the progress of the Eastern European experiment closely. The most talked about success of the flat tax revolution in Europe is how it increases economic productivity and promotes business investment. Russia adopted a flat tax of 13 percent in 2001 and due to the increased economic activity in just one year, revenues increased by 26 percent. Romania cut individual income tax rates from 40 to 16 percent to help bring in untaxed earnings, which were estimated at half of all collections.

However, it isn't all rosy for Europe's "flat tax club" because they are also part of another club – the European Union (EU). Officials in Brussels are claiming low corporate tax rates are producing unfair competition in the 27 member state bloc and are threatening to cut EU funding sources to these nations to compensate. Currently all EU member states operate by a "code of conduct" on taxation which, ironically, is allowing the European Commission to push forward with its proposals. In addition to eliminating corporate tax competition, the commission also seeks to

increase taxes on energy.

Even though Eastern Europe is leading the way, not all nations in Western Europe are behind the curve. Formerly one of the poorest nations in all of Europe, Ireland adopted free-market reforms, which dismantled the welfare state and slashed tax rates to attract investment. In 1997, Ireland announced that it would reduce its uncompetitive 50 percent corporate tax rate to 12.5 percent. This policy change made Ireland so attractive for international business investment that over 1,000 multinational companies moved in. In the process, corporate tax collections actually *increased* by 600 percent. Ireland now has the lowest corporate tax rate among its neighbors, helping to bring about the renaissance of the Irish economy.

The resulting economic growth propelled Ireland's economy to such a level that Ireland now surpasses France and Germany in terms of economic output. Now the "Celtic Tiger" of Europe, Ireland serves as a valuable case study, highlighting the ever-increasing power of free markets and tax competition in the 21st century.

Hopefully the U.S. will sit up and take note of the success of pro-growth tax policy in Europe—particularly with more free market reforms expected abroad. In today's competitive business climate, capital is increasingly liquid and can easily be shifted between competing opportunities throughout international markets. Our policymakers in Washington would be foolish to ignore the power of tax competition in today's marketplace. If anything, the U.S. should join in the flat tax revolution that has swept Europe, increasing economic growth and opportunity along the way.

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