

July 12, 2008

Europe's Flat Tax Revolution

By Jonathan Williams and Catherine Bray

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. 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.

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.

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.

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.

Jonathan Williams is a Fiscal Policy Fellow with the Kansas-based Flint Hills Center for Public Policy and Director of Tax and Fiscal Policy at the American Legislative Exchange Council (ALEC). A complete bio on Mr. Williams can be found at <http://www.flinthills.org/content/view/24/39/>, and he can be reached at williams.jonathan.p@gmail.com. To learn more about the Flint Hills Center, please visit www.flinthills.org.

Catherine Bray is ALEC's Director of International Relations.

www.patriot.eponym.com

July 12, 2008
Opinion