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# Lessons from Abroad— Flat Tax in Practice

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## Chapter 4

# Lessons from Abroad— Flat Tax in Practice

*Patrick Basham and Daniel Mitchell*

The North American discussion of the flat tax could be characterized as “nice theory, but not practical.” Some doubters think a flat tax would not work if it were implemented. Others think that ideological objections are too formidable or that beneficiaries of current tax preferences are too powerful to overcome, meaning a flat tax will never get enacted.

In truth, the flat tax is anything but a policy experiment. There are now more than 20 jurisdictions using the flat tax and this number is expected to continue growing. Most of the flat-tax nations are transition economies in Eastern and Central Europe but there are a handful of wealthy economies that use this simple and fair tax system. In other words, the flat tax is a proven instrument of sound fiscal policy. The international evidence, combined with traditional research on tax policy, shows clearly that Canada would benefit greatly from adopting the flat tax.

The modern flat tax has a record of accomplishment that is six decades long. The Southeast Asian territory of Hong Kong built itself into an economic giant upon the fiscal anchor of the flat tax, a system that has been so successful that it survived the jurisdiction’s transition from a British colony to a special administrative region of China (Littlewood, 2007). It is almost a half-century since the island of Guernsey, a British territory located in the English Channel off the

northwest coast of France, joined its Channel Island neighbor, Jersey, as a flat-tax jurisdiction. More recently, a number of central and eastern European countries have enacted flat taxes on personal or corporate income, or both.<sup>1</sup>

This account of the international experience with the flat tax pays particular attention to the Central and Eastern European region for several reasons. First, these countries are the most recent converts to the flat tax as a cornerstone of fiscal policy. Therefore, they provide a contemporaneous illustration of the economic advantages that generally accompany adoption of the flat tax. Second, the fact that a majority of these formerly Communist nations, most notably Russia, has chosen to ditch the “progressive” tax system (that is, the higher one’s income level, the higher one’s tax rate) in favor of a flat-tax system speaks volumes about the desirability of a tax system so clearly antithetical to the ideological values propagated throughout Soviet-controlled Central and Eastern Europe between the end of World War II and the fall of the Berlin Wall.

Third, an analysis of the comparative ease with which these Eastern European countries have instituted their flat taxes reveals, upon closer inspection, the degree to which politics matters. That is, the idea of a flat tax is no more or less relevant to Central and Eastern European economies than it is to the Canadian economy. Nevertheless, almost without exception the political sponsors of flat taxes in Central and Eastern Europe faced limited institutional opposition that paled in comparison with the myriad of extremely powerful, vested interests in Canada that to date have limited the prospects for the discussion, promotion, and eventual passage of a Canadian flat tax.

Finally, globalization is leading to greater tax competition among nations and this means that the list of flat-tax nations is likely to grow. It is now increasingly easy for jobs and capital to cross national borders, and policy-makers face growing pressure to reform tax system in the contest to attract jobs and investment.

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1 ♦ These countries feature single-rate tax systems, though they sometimes deviate substantially from the integrated flat-tax system favored by economists, which is based on both a single rate and a consumption base (meaning no double taxation of income that is saved and invested).

## The flat tax in practice

Economist Andrei Grecu explained how Canadian policy-makers might learn from the experience of those countries that have adopted the flat tax:

Analysing the economy of countries in which the flat tax is in place is a good start for assessing the potential of the flat tax to replace a progressive tax system. Of course, every country is a unique case, and the tax system is only one of the numerous factors influencing an economy. But looking at economic developments in a series of countries that have gone through the same kind of fiscal reforms will show the possible advantages of implementing the flat tax. (Grecu, 2004: 12)

The flat tax is certainly not a new fiscal policy instrument. When income taxes were first implemented, during the first half of the nineteenth century, many industrializing European nations chose flat rate systems.<sup>2</sup> Interestingly, flat-tax regimes were seen as a way of ensuring fairness. Prior to the flat tax's introduction, some nobles and clergymen escaped the payment of income tax entirely, as in eighteenth-century pre-revolutionary France. A principal attraction of the flat tax, therefore, was it ensured the nobility and the clergy paid their fair share of tax.

During the nineteenth century, however, many European nations experienced the spreading ideological influence of Karl Marx, the coauthor of the *Communist Manifesto* and proselytizer of revolutionary, left-wing economics. For Marx, the implementation of “a heavy progressive or graduated income tax” (Engels and Marx, 1848) was a priority item on the path to a classless communist society. As democratic politics gradually moved to the ideological Left during the second half of the nineteenth century, most European nations introduced

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2 ♦ The first US income tax, enacted in 1861 to help finance the Civil War, had a flat rate of 3%, though graduated rates were imposed the following year. For more information, see Tax History Museum (1997–2006).

progressive tax systems featuring several rates to ensure that those earning a higher income paid the most tax (Adams, 2001).

In addition to its historical antecedents, the flat tax has strong theoretical underpinnings, as explained elsewhere in this book. Today, there is an impressive and growing subfield of economic research on the flat tax, itself.<sup>3</sup> There is also a large literature identifying the strongly negative relationship between high taxes and economic growth.<sup>4</sup> Fundamental tax reform addresses this problem. Alvin Rabushka and Robert Hall explain that a flat tax will mean that

[i]mproved incentives to work through increased take-home wages will stimulate work effort and raise total output. Rational investment incentives will raise the overall level of investment and channel it into the most productive areas. And sharply lower taxes on entrepreneurial effort will enhance this critical input to the economy. (Hall and Rabushka, 2007: 127)

This is in stark contrast to the current system. Greco argued that the progressive “income tax is not only complex, it is perverse, diverting energy and resources into uneconomic behaviour forced upon people by the tax code itself.” He maintained that, “[i]n terms of growth foregone and effort misplaced, its [the progressive tax system’s] economic costs reach into billions of pounds each year, maybe tens of billions” (*EurActiv.com*, 2006, November 9).

Under a pure flat tax, the tax man takes the same cut from the last dollar of taxable income you earn as he took from the first.<sup>5</sup> Proponents contend that the introduction of a flat tax minimizes the disincentive to work more and earn more (as well as to save and invest more) that exists under a graduated, progressive tax system. Hence, a simplified tax system featuring a low, flat rate will lead to more efficient economic decision-making.

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3 ♦ See the review of the flat tax literature in Clemens et al., 2003.

4 ♦ See, for example, the research literature review provided in Leach, 2003.

5 ♦ In practice, most flat-tax systems contain generous personal exemptions. Therefore, the tax on your first dollar earned is not equal to the tax on your last dollar earned.

While the evidence discussed throughout this chapter informs us that the flat tax is a sound and sensible policy, it is not a panacea. Economic success is also dependent upon such factors as the regulatory climate, as well as monetary and trade policies. However, the international evidence strongly suggests that the flat tax is a significant contributor to fast-paced economic growth.

More than 20 jurisdictions now have flat-tax systems and all but three of those countries have enacted the flat tax since 1994 (table 4.1). A quarter of all European countries employ a flat tax on either personal or corporate income or both, and these countries provide a global, or at least a regional, proving ground for the flat-tax concept.<sup>6</sup>

In North American policy-making circles, where a national flat tax is characterized as a fine theoretical idea without practical application, the discussion is largely uninformed. The flat tax not only has a long-standing, tangible history but, in practice, is working as well as its proponents predicted it would. As Matthew Lynn, a European business journalist, observed:

Economists can debate the [flat tax] theory endlessly ... Yet this debate doesn't have to be conducted in charts, or tested only in lecture halls. Flat taxes have been introduced in several former communist countries ... In different countries, flat taxes would produce varied outcomes. Still, there is no escaping the evidence. Where they have been introduced, flat taxes are yielding impressive results. (Lynn 2004)

Pessimistic predictions about the flat tax have been proven wrong.<sup>7</sup> The flat tax has stimulated positive economic news across the board, including improved economic growth rates.<sup>8</sup> The *Economist* magazine found that, "Flat taxes have stoked prosperity in every country that has

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6 ♦ See, for example, the discussion in Tzortzis, 2005.

7 ♦ See, for example, the discussion in Aligica and Terpe, 2005.

8 ♦ Simeonova, 2007. See, also *Wall Street Journal*, 2007, April 17. For an earlier discussion of the flat tax's potential to increase economic growth rates, see Stokey and Rebelo, 1995; Ventura, 1999.

**Table 4.1: Flat-tax jurisdictions—personal income taxes**

Jurisdiction	Year of enactment	Tax rate
Jersey	1940	20%
Hong Kong	1947	16%
Guernsey	1960	20%
Jamaica	1986	25% (orig. 33%)
Estonia	1994	21% (orig. 26%)
Latvia	1995	25%
Lithuania	1996	24% (orig. 33%)
Russia	2001	13%
Serbia	2003	14%
Iraq	2004	15%
Slovakia	2004	19%
Ukraine	2004	15% (orig. 13%)
Georgia	2005	12%
Romania	2005	16%
Albania	2007	10%
Iceland	2007	35.70%
Krgyzstan	2007	10%
Macedonia	2007	10%
Mongolia	2007	10%
Montenegro	2007	15%
Bulgaria	2008	10%
Czech Republic	2008	15%
Mauritius	2009	15%

Source: Mitchell, 2007c: 10.

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adopted them” (*Economist*, 2006, June 1). In 2004, for example, GDP growth rates in those countries with a flat tax exceeded the worldwide, average, growth rate of major industrialized countries (*Wall Street Journal*, 2005, October 7). Transition economies should grow faster, of course, as part of a convergence process but transition economies with flat-tax systems are growing more rapidly than transition economies with so-called progressive tax rates.

According to the Economist Intelligence Unit, flat-tax rates are unlikely to undermine government revenue (Economist Intelligence Unit, 2005). In fact, revenue did not dry up in those countries that adopted the flat tax. This revenue outcome comes as a surprise to many, although it should not, as there exists a strong correlation between low or reduced tax levels and revenue stability. Most recently, for example, a KPMG International study of 86 countries found that those countries that cut corporate taxes both attracted business investment and maintained previous revenue levels (Kennedy, 2007).

The “experts” deployed by multinational organizations have been proven incorrect in their advice and forecasts regarding the flat tax. The Cato Institute’s Daniel J. Mitchell, an expert on the flat tax, recalls that, in the case of Central and Eastern Europe, “the International Monetary Fund played no positive role in ... successful economic reforms. Indeed, in many former Soviet Bloc nations, the IMF has created roadblocks to tax reform, and often has urged governments to raise taxes instead” (Mitchell, 2003b).

It should come as no surprise that the former communist countries of Central and Eastern Europe were the first to experiment with the flat tax. After all, most of them in effect were starting with a blank fiscal slate. Immediately after breaking free from communism, most of them imported the kind of discriminatory tax structure found in Western Europe but policy makers concluded (and are still concluding) that graduated rate structures discourage economic activity. Consequently, they opted for the simplest, most efficient system.<sup>9</sup>

The Baltics took the lead, with Estonia becoming the first of the post-communist nations to adopt the flat tax. Lithuania and Latvia

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9 ♦ See, for example, the discussion in Henninger, 2006.

quickly followed. Since their adoption of a flat tax, the three Baltic nations have experienced such strong economic growth, increases in foreign investment, and declines in unemployment that they are now known as the “Baltic Tigers.”

As seen in table 1, other nations are playing follow the leader, with good results. According to Philip Poole, head of research into emerging markets at HSBC in London, a lower, flatter corporate tax has been “an important part of the story in strengthening growth, balances of payments, fiscal performance and currencies” in Eastern Europe (Kennedy, 2007: 5). Hence, as economist Alvin Rabushka observed, “the flat tax has become an integral part of the fiscal landscape in Central and Eastern Europe, from Estonia in the North, to Russia in the East, Georgia in the South, and Slovakia in the West” (Rabushka, 2005c).

The flat tax portends the end of special-interest tax breaks and favors, as a flat tax system is largely or completely free of deductions, exemptions, and exceptions, thereby eliminating the complex rules and loopholes that characterize progressive tax systems. The flat tax constitutes a clean tax system once most preferential treatment is abolished (Berggren, 2003). Consequently, both the declaration of taxes and tax transparency are heightened. The international experience with the flat tax demonstrates that tax evasion is reduced as activity is shifted from the black to the legitimate economy.<sup>10</sup>

As flat tax rates are relatively low, the incentive for tax evasion is also reduced, usually by a significant margin. The Adam Smith Institute’s Madsen Pirie noted that, “The point of the flat tax is that it broadens the tax base. People avoid less, evade less and declare more” (Pirie, 2005). Pirie found that if a government has, “set the [flat tax] rate low enough ... it just isn’t worth going criminal” (Underhill, 2007). Mitchell also found that the flat tax “has curtailed interest-group pleading in Eastern Europe” (Mitchell, 2005).

When it comes to the serious problems of corruption, inconsistent implementation of laws, high volumes of unregistered trade, and low protection of property rights, Natasha Srdoc-Samy, president of Croatia’s Adriatic Institute for Public Policy, found that, “Flat taxes

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10 ♦ See the discussion in Herbert, 2005.

help counteract such problems by closing loopholes and unmasking evasion techniques.” She summarized the post-communist Central and Eastern European experience thus: “Flat taxes also carry a promise to free up economies for growth, by forcing gray economic activity into the legitimate market and simplifying collection. Economic activity increases, and so does honest reporting of income, while tax evasion drops” (Srdoc-Samy, 2007).

Although the absence of a withholding tax in Hong Kong constitutes a significant difference between the Hong Kong and European versions, the flat tax is simple to understand and simple to pay in both Europe and Hong Kong. The straightforwardness of the flat tax system vastly reduces the cost to the tax collector. Even more important, taxpayers are much less likely to need professional assistance to comply with a simple tax code, which is another reason why the flat tax saves taxpayers enormous sums of money. Billions of dollars are saved in compliance costs, as a tax return can be filled in quickly with a minimum of paperwork (Herbert, 2005).

### **Hong Kong**

Hong Kong has had a flat-tax system since the Inland Revenue Ordinance of 1947.<sup>11</sup> Individuals can choose to pay a 16% flat tax (15% beginning in 2008). Alternatively, they can choose to pay tax based on a system with four graduated rates (2%, 8%, 12%, and 17%) and various deductions. Because this alternative system has a generous allowance, the majority of taxpayers among Hong Kong’s 6.9 million residents do not even have to worry about selecting the flat-tax option.

Sixty years later, Hong Kong remains the administrator of arguably the world’s most efficient tax system (Edwards, 2005a). Consider that the American federal income tax generates 66,000 pages of code and regulations. In practice, highly complicated returns can require an American taxpayer to fill out dozens of separate forms. Indeed, the IRS “forms and publications” web site actually gives taxpayers 1,036 options (Internal Revenue Service, 2007). Unsurprisingly, 60%

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11 ♦ For additional economic and historical analyses of Hong Kong’s flat tax, see Reynolds, 1999 and Rabushka, 1979. See also Emes et al., 2001.

of American taxpayers require professional help to complete their tax returns (Moore, 2007). By comparison, Hong Kong's entire tax code is no more than 200 pages (Kerr, 2007). Grecu found that "[t]his combination of simplicity and low level of taxation has reduced the adverse effects of taxation on work effort, saving, and risk-taking and was a key factor in Hong's remarkable economic growth and development" (Grecu, 2004: 13).

Hong Kong has been the world's fastest growing economy over the past 50 years (Mitchell, 2003a). Between 1950 and 1981, Hong Kong ran a fiscal surplus in 27 of those years (Grecu, 2004: 13). Far more impressive, however, is that Hong Kong has constrained the burden of government. Budgetary outlays currently consume only 16% of GDP and government policy is not to allow spending to climb beyond 20% of GDP. Compared to other industrialized nations, where governments consume about 40% of GDP, that's an especially impressive statistic.

No wonder Hong Kong is the world's freest economy (Gwartney et al., 2006: 97). According to the *Economist*, "The territory's tradition of simple and low taxes ... is widely seen as a main reason for its stunning rise to prosperity" (*Economist*, 2000, February 24). Its unparalleled success is indeed based upon a non-interventionist economy policy centred on its income tax system and supplemented by the absence of a pension-related payroll, general sales, or value added tax, and the lack of tariffs on imported goods (Grecu, 2004: 12–13). In 2006, government spending constituted only 17% of GDP compared with an OECD average of over 40% (Long, 2007: 10). Economist Alan Reynolds, a tax specialist and an expert on Hong Kong's fiscal experience, pointed out that "[t]he Hong Kong tax system has one major advantage over even the most elegant theoretical alternatives. It has been tested for more than 50 years. It works" (Reynolds, 2005).

During the past decade, the Hong Kong economy had to withstand Asia's 1997 financial crisis, the bursting of America's dot-com bubble, and the bird-flu and SARS epidemics. Yet, Hong Kong's tax system continues to provide a fiscal environment within which the economy can flourish. Since 1997, the number of multinational companies with regional headquarters in Hong Kong has increased by one third. There also have been billions in capital raised through hundreds

of initial public offerings (Kleinman, 2007). Between 2004 and 2006, Hong Kong's economy grew at its highest rate for two decades, with economic growth of 7.5% in 2005 and 6.9% in 2006. In 2006, GDP per capita stood at an impressive US\$37,300 (Long, 2007: 4, 9).

### **Channel Islands**

The British Crown bestows upon the Channel Islands of Guernsey and Jersey a special constitutional status, which grants them autonomy over fiscal policy. Both Guernsey and Jersey have had flat taxes on personal incomes for several decades.<sup>12</sup> Jersey was the first to introduce a flat tax: in 1940 the island switched from the British income-tax code to a 20% flat tax on both individual and corporate income. Guernsey followed Jersey's fiscal policy example in 1960.

Greco contended that “[t]he Channel Islands offer an even more convincing example of flat tax efficiency” (Greco, 2004: 12) than does Hong Kong. Greco found that “[e]conomic performance in the Channel Islands proves once again that the efficiency, simplicity, and fairness induced by a flat tax have a positive influence upon economic growth, employment, and the overall standard of living” (Greco, 2004: 13). To be sure, the Channel Islands also are rich in part because they serve as offshore financial centers, meaning that they benefit not only from their wise decisions about taxation but also from the misguided decisions of nations with oppressive tax regimes.

Since Jersey and Guernsey introduced the flat tax, their economies have grown far more quickly than the British economy (Greco, 2004: 12). For 67 years, in the case of Jersey, and for 47 years, in Guernsey's case, the economy has performed extremely, and consistently, well. Jersey's GDP, for example, grew 90% in real terms between 1980 and 1990. Meanwhile, Guernsey's GDP has more than tripled since the introduction of a flat tax. Income-tax receipts account for 90% of Jersey government revenue, while 74% of the revenue received by the Guernsey government comes from income-tax receipts (Greco, 2004: 13).

The flat tax is a major contributor to the wealth enjoyed by these British Crown dependencies (Mitchell, 2005). The research conducted

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12 ♦ See the discussion in Emes et al., 2001: 54–55.

by Greco found that “[a] combination of low taxation, stable government, and lack of party politics has brought huge wealth to the Channel Islands by maintaining a highly attractive business environment” (Greco, 2004: 13). Nevertheless, Guernsey has not rested on the laurels of a 20% flat tax on corporate and personal incomes. In July 2006, the Guernsey legislature approved a zero corporate tax rate and capped the maximum tax on individuals at £250,000 (CDN\$530,000) (Hall and Rabushka, 2007: 11).

### **Central and Eastern Europe**

Although both jurisdictions have autonomy over fiscal issues, neither Hong Kong nor the Channel Islands are independent or autonomous countries. Therefore, the next section describes and analyzes the flat tax experience to date in Central and Eastern Europe. The flat tax reforms implemented throughout Central and Eastern Europe vary in the degree of comprehensiveness, as the following analyses show.<sup>13</sup> Estonia was the first European nation to adopt the flat tax. Russia is the most important economy to have adopted the flat tax. As the most developed European economy with a flat tax, Slovakia may be the best comparison for Canadian policy-makers. As of 2007, Lithuania, Latvia, Serbia, the Ukraine, Georgia, Romania, Macedonia, Montenegro, and Albania had also adopted a flat tax. The Czech Republic and Bulgaria will do so in 2008.

#### **Estonia**

When Prime Minister Mart Laar’s government took office in 1992, inflation in newly post-Soviet Estonia was running at an annual rate of over 1,000%, the economy had shrunk 30% in two years, and unemployment topped 30%. The economic situation was so dire that food was rationed and cars were not seen on the streets for lack of gasoline (*Mongabay.com*, 1986–1998). Laar concluded that radical economy surgery was required. The next year, his government passed flat-tax legislation. On January 1, 1994, against the International Monetary Fund’s advice (Slate,

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13 ♦ See the discussion in Heath, 2006: ch. 6. See, too, Grabowski and Tomalak, 2004 for a detailed review of the economic reforms implemented throughout the region.

2005), Estonia became the first European country to implement a flat tax. Three tax rates on personal income and one on corporate profits were replaced with one uniform rate of 26%. The only remaining exemptions apply to those living on government pensions and those with three or more children. A study by the British government of the Estonian experience found “no transitional problems in moving to the flat rate, instead it helped to solve existing problems such as the high inflation rate which led to changing levels of income for each tax bracket.”<sup>14</sup>

With hindsight, it is clear that, as the *Economist* observed, “[a]t the stroke of a pen, this tiny Baltic nation transformed itself from backwater to bellwether” (*Economist*, 2005, April 14a). Within a year of the flat tax’s introduction, unemployment had fallen to 6%. A decade later, Estonians enjoyed low inflation and low unemployment, and the Estonian government’s budget has been in surplus since 2001 (Hall and Rabushka, 2007: 8). The flat tax led to higher productivity levels and, consequently, higher wages (Greco, 2004: 14). The country is on course to double living standards every six years (*Economist*, 2006, December 13).

Estonia’s flat-tax rate was cut by two percentage points to 24% in 2005, by a further two percentage points to 22% in 2006, and reduced to 20% in 2007. It is scheduled to fall to 18% by 2009 (Heath, 2006: 83). Estonia can afford to keep cutting its tax rate because its economy is booming and this is generating a lot of additional tax revenue. Indeed, personal income-tax revenues have nearly doubled since 2000 and corporate tax receipts have jumped by more than 300% (Mitchell, 2007a). The rate could be dropped even faster if lawmakers chose not to use so much of the new revenue to finance additional government spending.

But, even if spending is climbing too rapidly, it is hard to argue with success. The country has experienced impressive rates of economic growth. Estonia has averaged real, annual, economic growth of 5.7% since 1995 (Edwards, 2005a). Real GDP growth this year is forecast at more than 8% (Hansen, 2006). As a result, revenue continues to pour into the government’s coffers. Critics had predicted that repealing its

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14 ♦ Study published by the UK Government Treasury Department; reported in Trefgarne, 2005.

high tax rates on wealthy citizens would erode the country's tax base. This did not happen. In 1993, government revenues were 39.4% of GDP; in 2002, they were 39.6% (*Economist*, 2005, April 14a). According to the Bank of Estonia, government revenue rose by one third between 2001 and 2003 (Lynn, 2004). The government's budget is balanced and the country has no net foreign debt (*Economist*, 2006, December 13).

In practice, the corporate income tax has been abolished. Estonian companies withhold and pay tax on the dividends they send to shareholders and they also pay tax on the fringe benefits they supply to workers, but there is no tax on earnings (Mitchell, 2007a). This means no double taxation on corporate income. Estonia is now a magnet for financial and human capital. For example, foreign direct investment has more than quadrupled, according to the United Nations Conference on Trade and Development's Foreign Direct Investment Database (Heath, 2006: 88). In fact, Estonia is now Europe's biggest per-capita recipient of foreign investment (*Economist*, 2006, December 13).

The simplified tax system means that 80% of Estonians spend only a few minutes online filing an annual tax return (*Economist*, 2005, October 13). Unsurprisingly, then, among Estonians the flat tax is now an article of faith (Landler, 2005).

## Russia

The success of Estonia's experiment with the flat tax encouraged a radical reform of the Russian tax code, a reform launched in 1998 with the goal of reducing the tax burden on individuals and corporations. On January 1, 2001, Russia collapsed its three personal income-tax rates of 12%, 20%, and 30% into a flat 13% tax on all personal income.<sup>15</sup> There are also deductions for charitable contributions, as well as deductions for educational and medical expenses. The corporate tax rate was reduced from 35% to 24%.<sup>16</sup>

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15 ♦ Rabushka, 2004; for a recent overview of the reform process, see Konnovm, 2007.

16 ♦ In stark contrast, companies based in the United States still pay a 35% tax, which is the second-highest corporate tax among industrialized nations. See Mitchell, 2003a.



In *Flat Tax: Towards a British Model*, Allister Heath concluded that “[t]he flat tax has been a key reason—in addition to soaring commodity prices—why the Russian economy has grown strongly” (Heath, 2006: 82–83). The Russian economy has indeed grown rapidly since the introduction of a flat tax almost seven years ago. In 2001, the first year of the flat tax, the country’s real GDP rose by 5.1%. GDP rose a further 4.7% in 2002 and a massive 7.3% in 2003. Since reforming its tax system, Russia has demonstrated that it has the potential to join the ranks of the world’s leading economic powers (Beschloss, 2007). Economic growth has averaged over 6% annually since the flat tax was introduced, an economic growth rate that far out-paces that of the American or European Union economies (Beschloss, 2007). All of which has produced rising disposable incomes among the Russian people themselves (Koza, 2007).

Russia has recorded a remarkable turnaround in government revenues. Receipts from income tax have grown faster than overall revenues and other taxes (Rabushka, 2005b). Revenues rose by more than 20% in each of the flat tax’s first two years (Evans, 2007: 8–9). After one year, the new flat tax on personal income had raised 25.2% more revenue in real terms than its progressive predecessor (Rabushka, 2004; *Economist*, 2005, April 14a; *Boston Globe*, 2005). The following year, personal income-tax revenue rose 24.6% in real terms (Rabushka, 2004). In 2003, personal income tax revenue rose a further 15.2% in real terms (Rabushka, 2004). After adjusting for inflation, personal income-tax revenue rose an additional 16% in 2004 (Lynn, 2004). That meant total real receipts from the personal income tax more than doubled four years after the implementation of the flat tax (Hall and Rabushka, 2007: 8). Heath commented:

Unsurprisingly, some politicians and international bodies (and notably the IMF) (Ivanova et al., 2005) have claimed that this surge in revenues had little to do with the flat tax and all to do with a crackdown on tax evasion. They are right to question whether all the revenue increase came from the flat tax—it didn’t, of course, but nobody is claiming that. (Heath, 2006: 83).

According to Grecu, “[t]his constant expansion of the government tax revenue is the result of less tax evasion and increased incentives to work, save, and invest” (Lynn, 2004). Russia has practically repaid its IMF debt and now holds foreign currency reserves that exceed CAD\$260 billion (Beschloss, 2007).

Compliance by taxpayers has improved dramatically (Rabushka, 2004). In 2000, for example, Russians in the two higher tax brackets reported only 52% of their income to the government. During the first year of the flat tax, these same taxpayers reported 68% of their income (Ivanova et al., 2005).

### Slovakia

The Baltic nations started the tax-reform process in Eastern Europe. Russia’s reforms made the flat tax more visible. So, it was just a matter of time before the idea spread and one of the most impressive stories is Slovakia. Heath characterized Slovakia as “[a] case study of a post-communist, transition economy successfully overhauling its economy” (Heath, 2006: 84).

After the Cold War ended, most Central and Eastern European countries, including Slovakia, modeled their new tax systems on the progressive tax systems in place in Western Europe and North America. Slovakia’s progressive system featured five income brackets between 10% and 38%. It also featured 90 exemptions, 19 potential sources of untaxed income, 66 tax-exempt items, and 27 items with specific tax rates (Tzortzis, 2005; Butler, 2004).

In January 2004, Slovakia became the sixth Eastern European, and the first OECD, country to adopt a flat tax.<sup>17</sup> Slovakia’s flat tax is very comprehensive, rivalling Estonia and Hong Kong for having the system closest to the theoretical ideal. Key features include a single 19% tax rate on personal income and corporate income, as well as a 19% value-added tax. This uniform 19% rate has been very successful, boosting growth and producing higher tax revenues for the government (*Economist*, 2005, March 3; Fund, 2005). A March 2005 report by the Dutch investment bank ING stated:

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17 ♦ For more information, see Chren, 2006.

[T]he flat tax regime has seen a better-than-expected increase in tax collection. The government was surprised to see that the flat tax is a huge marketing tool for foreign corporate investors. Slovakia is now a prime example of a transparent and simple tax system with very low tax rates. Presently, the tax regime is an important factor supporting FDI inflow to the country next to low labour costs, low asset prices, EU membership, etc. (ING, 2005)

The new system has no exemptions and only two deductions, for pensions and charitable contributions. The new tax code's simplicity has led to greater transparency and a reduction in tax evasion (Tzortzis, 2005). According to researchers from the Harvard Business School, Slovakia "implemented one of the most simple, neutral, and effective systems in the world that improved the business environment, reduced tax evasion and, in connection with other reforms, brought about high and sustainable economic growth" (Lagace, 2007).

Slovakia is today the economic reform star of central Europe. The attractive combination of a flat tax, a deregulated labour market, and a well-run, funded pension system has resulted in a flood of foreign investment, which has stimulated economic growth (*Economist*, 2006, June 1; 2005, March 3). In 2004, the World Bank named Slovakia the world's top economic reformer. In the six years preceding the introduction of a flat tax, economic growth averaged 3.4%. Since the flat tax's introduction, Slovakian economic growth has been among the highest in Europe. In 2005, the Slovakian economy grew by 6%; growth in 2006 measured 8.3%, a record high. In 2007, GDP growth is forecast to reach 8.9% (*Dow Jones Newswire*, 2007).

Slovakia has benefited from the significant inflow of foreign investment, especially by automobile and electronics companies, such as Kia Motors, Peugeot, Volkswagen, and Samsung (*Dow Jones Newswire*, 2007). In 2005, total foreign direct investment was six times more than it was in 1998 (Heath, 2006: 93). In fact, the flood of foreign car companies into the country has caused Slovakia to be called the "Detroit of Europe" (Mitchell, 2006). According to corporate executive, Ivan Kocis, the flat tax is "a very important factor" (Tzortzis, 2005) in attracting these new companies.

### Other members of the “flat tax club”

Although Estonia, Russia, and Slovakia have received most of the attention and the lion’s share of the plaudits, several other Central and Eastern European countries have very successfully adopted the flat tax. Lithuania introduced a flat-tax rate of 33% on personal income in 1994, which has been subsequently reduced to 27% (Heath, 2006: 89; also Rabushka, 2005a). The Lithuanian economy has been among the fastest growing in Europe. From 2002 to 2004, real GDP growth averaged an impressive 5.6% (Grecu, 2004: 14). Since the adoption of a flat tax, the decline of tax evasion and higher economic growth combined to increase tax revenues. Lithuanians also have seen declining unemployment and a rising standard of living. Lithuania’s Baltic neighbour, Latvia, adopted a 25% flat tax in 1995. Latvia’s real growth in GDP over the period from 2001 to 2004 also averaged 5.6% (Grecu, 2004: 14).

Borrowing directly from the Russian model, in 2003 Serbia introduced a 14% flat tax on salaries. Different flat rates are levied on alternative sources of income. Under the Serbian system, a personal allowance is set at 40% of the average wage and taxpayers are eligible for a further deduction worth 15% of the average annual salary per dependent. In 2004, the Ukraine introduced a flat tax of 13% (which now has climbed to 15%, an unfortunate change that was included in the original legislation). This replaced the old five-bracket, progressive system that had a top rate of 40%. January 2005 saw Georgia introduce a 12% flat tax. The flat tax replaced the former four-rate progressive system whose top rate had been 20%. The new tax structure reduced the size and weight of the country’s previous tax code by 95% (Rabushka, 2005d).

At the same time, Romania’s progressive tax system, which featured five personal tax brackets ranging between 18% and 40%, was replaced by a 16% flat tax on corporate and personal income. In only two years, the Romanian flat tax has been a tremendous success.<sup>18</sup> As Hall and Rabushka wrote, “Romania’s Finance Ministry reported that income-tax revenue for the first eight months of 2006 greatly exceeded estimates and that the state budget had a significant surplus at the end of July” (Hall and Rabushka, 2007: 9). Revenue has continued to rise over the

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18 ♦ See the discussion in Heath, 2006: 97–98.

past two years (Ionita, 2006; also BBC, 2007; Muntean, 2007). Romania has also experienced a remarkable decline in the underground economy (ROMPRES, 2007). During the flat tax's inaugural year, unemployment fell to 5.5% in 2005, a 13-year low (Heath, 2006: 97).

More recently, on January 1, 2007, Macedonia introduced a 12% flat tax on personal and corporate incomes. It replaced a progressive system that featured personal tax rates that ranged between 15% and 24% (Hall and Rabushka, 2007: 9). The government pledged to reduce the flat rate to 10% in 2008. Prime Minister Nikola Gruevski is confident that “[t]his reform will decrease tax evasion and encourage people to meet their obligations to the state” (Reynolds, 2007: B2).

On July 1, 2007, neighboring Montenegro instituted a flat tax of 15% on personal income. The rate will be lowered to 12% in 2008 and further lowered to 9% in 2009. In Albania, a 10% flat tax on corporate and personal incomes also came into effect on July 1, 2007. In April 2007, Czech Prime Minister Mirek Topolánek announced that the personal income-tax rate would fall to a flat 15% in 2008, replacing progressive rates of 12% to 32% (*Wall Street Journal*, 2007, April 17). The Bulgarians are the latest converts to a flat tax system. On July 29, 2007, the Bulgarian cabinet approved a 10% flat-tax rate. With subsequent approval from the parliament, the new tax rate will be effective January 1, 2008.

## **Taxation politics—why some countries choose to be flat**

The economic argument for adoption of a flat tax is a very strong one, indeed. The introduction of a flat tax, to cite one advantage, increases economic efficiency by reducing the progressive character of the income-tax system and, thereby, removing penalties for being more productive. However, whether Canada actually adopts the flat tax will depend as much upon political as economic considerations. Therefore, a discussion of the political factors that have encouraged adoption in Central and Eastern Europe, for example, will be useful as a contribution to the domestic debate.

As political factors are a fundamental determinant of the tax system (Poterba, 1998), what are the political factors that may bear on the reform of fiscal policy? The subfield of economics known as “public choice” sheds the most light upon this topic.<sup>19</sup> According to public-choice theory, politicians are self-interested actors, that is, their overriding motivation is the securing of votes and campaign donations. Public-choice theory suggests that tax policy is determined by politicians seeking mutually beneficial relationships with special-interest organizations and specific groups of voters. The bottom line is that politicians support tax reform when the new system is likely to provide them with more votes and greater campaign contributions than the current system.<sup>20</sup>

Stanley Winer and Walter Hettich investigated the influence of political factors on the nature of tax systems in democratic countries (Winer and Hettich, 1998). They found that the self-interested policymaker would equate the political cost per dollar of revenue raised from different policy instruments, rather than the economic-efficiency cost. Hence, departures from an economically efficient tax system result from politicians’ rational political, rather than economic, calculations. Consequently, politicians and bureaucrats tend to act in narrow, self-interested, ways that harm the broad national interest. For example, Roy E. Cordato and Sheldon L. Richman explained that a democratic political system is biased toward expanding the size of government (Cordato and Richman, 1986). Hence, Randall Holcombe’s conclusion that “[d]emocracy contains an inherent bias toward inefficiently large government” (Holcombe, 1998: 366). Furthermore, Buchanan and Tullock found that “[a]lmost any conceivable collective action will provide more benefits to some citizens than others, and almost

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19 ♦ For a recent discussion of the application of public-choice theory to the debate over implementing a flat tax, see Atkinson, 2004.

20 ♦ See, most recently, Berggren, 2003. See also Brennan and Buchanan, 1980; DiLorenzo, 1985; Hettich and Winer, 1985; Hettich and Winer, 1988; McCaleb, 1985; Wagner, 1985; Buchanan, 1987; Lee and Tollison, 1988; McChesney, 1988; Spindler and Walker, 1988; van Velthoven and van Winden, 1991; de Vanssay and Spindler, 1994.

any conceivable distribution of a given cost sum will bear more heavily on some individuals and groups than on others” (Buchanan and Tullock, 1962: 291). The economic benefits of government intervention are concentrated on smaller, well-organized groups while the costs are imposed on a larger, unorganized group. As Chris Edwards, a tax expert at the Cato Institute, summarized, “[l]egislators have a bias toward dishing out government largesse to visible and important constituencies, while hiding the resulting costs from current taxpayers” (Edwards, 2005b: 9).

Consequently, different tax systems are associated with different opportunities for seeking political rents (that is, benefits) (Poterba, 1998: 391). Economist James M. Poterba explained how and why specific tax policies are adopted. Poterba is in “no doubt that political factors, notably the political power of various interest groups, play a key role in the determination of tax policy ... tax policy is largely about equating the marginal political costs of different taxes” (Poterba, 1998: 395). Edwards, too, noted that, “Politicians will always be tempted to carve out narrow tax breaks for favored groups” (Edwards, 2005b: 5). The current Canadian tax code, therefore, reflects a gargantuan political balance that has determined the allocation of benefits to various special-interest groups. In short, political bargains were reached with particularly powerful Canadian interest groups, such as elderly voters (Poterba, 1998: 393).

Under such a preferential tax code, government encourages investment in activities that it deems to be in the public interest through deductions and credits. And although it is theoretically possible for a so-called progressive tax system to be free of loopholes, the very existence of higher tax rates generates the political pressure for special preferences. It is not surprising, therefore, that tax systems with graduated rates also contain a multiplicity of exemptions that distort taxpayers’ behavior. Hence, as Richard Epstein stated, “[d]ecisions by citizens about where to set up their homes and businesses are not independent of the tax system” (Epstein, 2004: 14). Edwards explained that “[u]nder the current [progressive] tax system, with its multiple rates, deductions, and credits, politicians can use a divide-and-conquer strategy to confuse the public about who is affected by proposed cuts or increases”

(Edwards, 2005b: 15). This is especially relevant given that narrow tax provisions have potentially large effects on a small set of economic agents (Poterba, 1998: 392).

Anachronistic conceptions of fairness and social justice are the principal reason that Canada and most other Western countries have progressive tax systems. Public finance experts use the term “horizontal equity” to describe a system whereby individuals with similar incomes pay similar amounts of tax. However, Epstein reminded us that “[g]iven the vagaries of the political process, it cannot be assumed that the benefits of a public good are evenly spread across all individuals subject to taxation” (Epstein, 2004: 10). The progressive tax code’s many exemptions, deductions, and credits ensure that, in practice, individuals are treated very unequally (Edwards, 2005b: 14).

Equality of treatment under the law is a cornerstone of the pure flat tax, as all taxpayers pay the same rate on their taxable income. Advocates of the flat tax appreciate that true equality places emphasis upon the economic starting, rather than finishing, line. Under a pure flat tax, there is no preferential tax treatment. The tax does not bestow an advantage upon any particular industry, or type of household, or specific business. When Illarionov advised President Putin on the flat tax, he explained that the flat tax signals “the neutrality of government tax policy towards different types of businesses, towards different types of industries and different types of income received in different sectors. Therefore, it ... leads to a much more efficient allocation of resources in the economy” (Frontier Centre for Public Policy, 2000).

Over the past several years, much of Central and Eastern Europe has simplified and flattened its tax structure. In striking contrast, Canada’s clogged tax code is so laden with breaks, deductions, and exceptions that it retains nothing of its original shape.<sup>21</sup> Taxpayers must contend with more tax forms, longer tax instructions, and returns filled with more credits and deductions.

Canada’s inefficient and costly progressive tax system survives largely (perhaps, entirely) because vested interests are willing to keep it complicated (Moore, 2007). Kevin Waddell, vice president of the

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21 ♦ See, for example, Canada, Department of Finance, 2006.



Boston Consulting Group, articulated the obstacles to adopting the flat tax in Western European nations, obstacles that are equally apparent in the Canadian context. In Waddell's view, "[t]he challenge that Western Europe has is that you have a lot of entrenched interest groups. When you try and put in place a flat tax, you take something away from somebody else" (Tzortzis, 2005). Is the introduction of a flat tax in Canada, then, a lost cause? No, it is not a lost cause; or, rather, it need not be one. Canadian proponents of the flat tax can derive encouragement from the finding that a tax system cluttered with credits, deductions, and exemptions contains the seeds of its own destruction. As T.J. DiLorenzo explained:

The granting of loopholes by politicians is subject to diminishing returns, just as all other activities are. The political benefit of granting additional tax preferences will fall over time. It is also likely that the political costs (to the politician) are rising, for with increased complexity of the tax system comes greater dissatisfaction on the part of voters who complain that the tax system is too complicated and unfair. Thus, at some point it is not politically profitable to create further loopholes. (DiLorenzo, 1985)

Furthermore, the *Economist* surmised that "[t]he more complicated a country's tax system becomes, the easier it is for governments to make it more complicated still, in an accelerating process of proliferating insanity—until, perhaps, a limit of madness is reached and a spasm of radical simplification is demanded" (*Economist*, 2005, April 14b). One trusts that the *Economist* is prescient and a "spasm of radical simplification" is imminent in Canada.

Proponents of the flat tax should be aware, however, that this process might prove to be cyclical (Spindler and Walker, 1988: 72; Buchanan, 1987: 33–34). DiLorenzo maintained that "once the slate is wiped clean and most loopholes are eliminated, the same politicians who benefited from voting for some version of the flat tax can then benefit further by 'starting over' and granting more loopholes, the marginal political value of which would then be relatively high" (DiLorenzo, 1985: 404). One must also bear in mind the cautionary

tale offered by economists Xavier de Vanssay and Zane Spindler that rent-seeking competition over tax reform may diminish prospective efficiency gains (de Vanssay and Spindler, 1994).

## **How does flat tax reform succeed?**

The experiences of Central and Eastern European countries with the flat tax is a contemporary example of how radical tax reform can succeed (see Evans, 2007). What are the political and economic conditions that have resulted in successful implementation of a flat-tax policy in this region? Politically successful flat-tax proposals in Central and Eastern Europe shared the following five characteristics.

- 1 ♦ It is easier to implement simpler, more radical reform than more complicated, piecemeal reform. Slow and partial reforms do not work; fast and deep ones do work. (*Economist*, 2006, June 1)
- 2 ♦ The rate of a flat tax needs to be set at a comparatively low level.
- 3 ♦ The lower the ratios of tax to GDP and government spending to GDP, the better.
- 4 ♦ Though there may be a tipping point of complexity that leads to the “spasm of radical simplification,” the greater the number of current tax loopholes, the harder it is politically to introduce a flat tax, due to the entrenched resistance to change of special-interest groups. (Heath, 2006: 100–01)
- 5 ♦ Tax systems are often closely integrated with benefits or social security systems. Therefore, to avoid the benefits of radical tax reform being diluted, welfare reform ought to accompany tax reform to ensure that incentives to work and save are increased. Merely cutting taxes for some sections of the population may not increase incentives enough if the welfare system continues unchanged (Heath, 2006: 101).

Furthermore, researchers at the Harvard Business School conducted a case study of Slovakia's introduction of the flat tax. Their research led them to conclude:

[T]he countries that have introduced a flat tax have all been in macroeconomic situations where something had to be done to foster growth and attract investments, which indicates a major trend for linking tax reform with, for instance, privatization and labor and welfare reforms. So existing evidence indicates that overhauling other parts of the public system, in order to afford a perceived cut in tax revenues through a flat tax implementation, is needed. This, however, does not indicate that the opposite is impossible. (Lagace, 2007)

How does one navigate the political issues created by the transition from a progressive to a flat tax? Economist Anthony Evans' seminal analysis of the spread of the flat tax throughout much of Central and Eastern Europe confirmed that, "interests matter" (Evans, 2007: 36; also Evans, 2005, 2006) Neither should one underestimate the importance of a political culture that places tremendous value upon a particular, albeit skewed, definition of economic fairness. The Austrian economist Joseph A. Schumpeter suggested that the history of a nation's tax system charts that society's ideological evolution. For Schumpeter, "[t]he spirit of a people, its cultural level, its social structure, the deeds its policy may prepare—all this and more is written in its fiscal history" (Schumpeter, 1918/1954: 7).

In a comment on the political situation in the United States that is equally applicable to Canada, Rabushka does not think that, "politicians here want to defend the argument of rich people getting a tax cut" (Lazarus, 2007:C1) Laura Alfaro and her Harvard Business School colleagues explained that "[t]he case of Slovakia highlights the fact that the beliefs and views of a country on what is fair matter for the long-term sustainability of reforms" (Lagace, 2007). The political debate over personal income taxes is intense during campaign periods. At this time, candidates and their parties generally do not compete with one another over the income-tax rates; rather, they seduce voters with promises

to introduce additional deductions and exemptions once elected to office.<sup>22</sup> Introducing a flat tax in North America or Western Europe, therefore, “would require a change of attitude in countries marked by a substantial history with progressive taxation ... Most certainly, the elimination of deductions and exemptions is a battle many politicians will not want to take on in the near future” (Lagace, 2007).

Hence, Epstein recommends a two-fold strategy (Epstein, 2004: 29). First, one should explain the long-term benefits to the public, including the effects on saving, investment, and economic growth over the next 15 to 20 years. One lesson culled from the European experience is that any changes to fundamental tax habits need to be thoroughly explained to the individuals and groups affected by the changes (Lagace, 2007). Second, the government should phase in the move to a single tax rate. Here, Epstein arguably understates the problematic nature of phased-in tax rate reductions. On the economic side, they create incentives for people to postpone economic activity. On the political side, there is a risk that the phase-in will be aborted.

Without question, mobilizing political support for radical change is much harder in North American and Western European nations than in the Central and Eastern European nations that are more inclined to radicalism (*Economist*, 2005b, April 14). Nevertheless, the international experience teaches us that these political hurdles are surmountable, even in Western Europe. For example, beginning in 1995 Iceland gradually reduced its personal income-tax rates from a high of 33% (excluding the impact of ubiquitous local income taxes). This followed a decade of reducing the corporate tax rate—from 45% to 18% between 1991 and 2001—which tripled corporate tax revenues. A decade of economic growth averaging 4% encouraged the government to go a step further (*Wall Street Journal*, 2007, March 12). Hence, in 2007 Iceland became the first Western European nation to adopt a flat tax for personal income.<sup>23</sup> Iceland today taxes all personal income at a flat rate

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22 ♦ Competition over the income-tax rates did happen, albeit briefly, in Canada. In 1993, during its first national campaign, the Reform Party’s policy platform proposed a flat tax.

23 ♦ For a recent discussion of the fiscal changes in Iceland, see Mitchell, 2007b.

of 22.75%, though local income taxes push the rate up to about 36%. Now, capital gains, dividends, interest, and rental incomes are taxed at a flat rate of 10% (Reynolds, 2007).

Perhaps, Canadian politicians may be converted to the flat tax if they can be convinced that the flat tax holds out the promise of higher revenues. As economist Niclas Berggren explained, politicians “see high revenues ... as valuable for sustaining profitable ties with supporters” (Berggren, 2003: 11). Certainly, political entrepreneurs who are prepared to campaign for efficiency-based tax reform can influence policy-making (Poterba, 1998: 395). In practice, economic research’s polity utility depends on the presence of a political actor—or several—both willing and able to bring the research implications to a wide audience (Noll, 1989). Today, there exists abundant evidence of the flat tax’s superiority and suitability. All that is missing is a confident Canadian leader with the political *nous* to recognize how eminently marketable is the flat tax.

## The role of tax competition

While ideology and public choice will play a role, globalization may be the key to Canadian tax reform. Indeed, it is likely to be the force that leads to the flat tax in other industrialized nations. Simply stated, globalization has reduced impediments to cross-border economic activity. And this means that the proverbial geese with golden eggs have more freedom to find jurisdictions that welcome wealth creation.

Since 1980, top personal income-tax rates have fallen from an average of more than 65% in developed nations to about 40%. This drop of more than 25 percentage points is at least partially due to other nations playing catch-up in response to the tax-rate reductions under Reagan and Thatcher. Similarly, average corporate tax rates in the industrialized world have plummeted from about 48% in 1980 to about 28% today. Reagan and Thatcher got the ball rolling but Ireland’s decision to drop its corporate rate from 50% to 12.5%—and the nation’s subsequent economic boom—deserve most of the credit for the global shift to lower rates.

Even the global tax-reform revolution is at least partially inspired by competition among nations. As transition economies in Central and Eastern Europe compete for jobs and investment, they increasingly have opted for a flat tax as a way of making their economies more attractive. The only question is whether tax competition will help convince Canadian lawmakers to embrace sweeping reform. Already, moves to lower the corporate tax are being explicitly justified with tax-competition arguments. Policy-makers note that lower rates make Canada more appealing than the United States, which has one of the developed world's highest corporate tax rates.

In a global economy, tax competition is going to play an increasingly bigger role. Many governments in developed nations are concerned about jobs and investment flowing to India and China. As these countries continue to liberalize, the pressure for more market-friendly policy will become even more pronounced.

Tax policy is not the only lever to pull, but few policy choices are as dramatic as a flat tax. In one fell swoop, Canada could make itself a magnet for investors and entrepreneurs. And with tax rates likely to climb in the United States, a flat tax would send a powerful signal.

## Conclusion

A century ago, the *New York Times* editorialized against the introduction of the progressive income tax. In a warning that has stood the test of time, the newspaper cautioned that “[w]hen men get in the habit of helping themselves to the property of others, they cannot be easily cured of it” (Moore, 2007: A12). Today, progressive personal income-tax rates make for a needlessly complex tax system. Increasingly, therefore, taxpayers ask if there is a realistic alternative to our wasteful, inefficient tax system. This chapter's answer is a resounding yes. A realistic, proven alternative exists—the flat tax—and its successful international application threatens to relegate the Canadian tax system to a second division of national tax codes.

The international flat-tax experience confounds Hettich and Winer's cynical assertion that it is possible to have a flat tax, or to

have democracy, but not both (Hettich and Winer, 2005). The most telling signal, perhaps, of the flat tax's suitability to the modern capitalist economy is that no country that has introduced the flat tax has reversed course and re-adopted a progressive tax system.

Ninety-one years ago, H.L. Mencken wrote that “[d]emocracy is the theory that the common people know what they want, and deserve to get it good and hard” (Mencken, 1916: 19). In an expanding number of Western democracies, the common people want either to have or to keep the flat tax. One trusts that, in time, Canadian voters will allow the country's taxpayers to experience the flat tax for themselves.

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