

WANT A FLAT TAX THAT MIGHT ACTUALLY WORK? TRY (GULP) RUSSIA

Michael Taube

Ever since Milton Friedman suggested the idea of a 23.5 per cent flat-rate income tax for American taxpayers in his 1962 book *Capitalism and Freedom*, economists and politicians have tried to create a flat-tax model that everyone could accept. Various flat tax proposals in the US—Hall-Rabushka, Armey-Shelby, Forbes—had merit, yet all fell by the wayside. And we all know what happened to Stockwell Day and the Canadian Alliance's 17 per cent single-rate tax proposal, or "Solution 17." The failure to implement any sort of flat tax is enough to make a grown free-marketer cry. It has come to the point where some conservatives and libertarians have given up on the flat tax crusade, and are now working towards the (it seems) politically more feasible goals of larger tax cuts and mandatory debt reduction.

But hope springs eternal. One relatively new flat-tax proposal seems to be gaining momentum and impressing even liberals. Where can one find this flat-tax juggernaut, and who is the free market ideologue to which conservatives owe thanks? Believe it or not, the juggernaut is Russia, and the ideologue is Russian president Vladimir Putin. As incredible as it sounds, conservative policy wonks and activists in the remnants of the old Soviet Union have had far greater success with the flat tax than their counterparts in Canada and the US. Perhaps the rest of the world can learn something from them, and find in the Russian experience a flat tax proposal that actually might work.

Hoover Institution economists Alvin Rabushka and Michael S. Bernstam noted in a report on the Russian economy last summer that Russia is not actually the first country to implement a flat tax. For example, Estonia passed legislation for a flat tax on Jan. 1, 1994, and then in 1999 eliminated the corporate profits tax on retained earnings, "thereby achieving a single flat tax on business cash flow." On Jan. 1, 1995, Latvia also adopted a flat tax similar to Estonia's successful plan. Taxpayer groups have praised these flat-tax models, and *The Economist* has called the Estonia flat-tax system "stunningly simple" and "remarkably successful." Russia's implementation of a flat tax on Jan. 1, 2001 made it the third "transition economy" to adopt a flat tax. Its flat tax stands at 13 per cent. It replaced a graduated system in which income tax rose from a basic rate of 12 per cent to a top marginal rate of 30 per cent.

This new direction in tax policy follows a recommendation from the Center for Economic Development, a think tank created by Mr. Putin and headed up by German Gref, the Russian minister for economic development and trade. As

noted by Robert Cottrell in the *Financial Times* (Jan. 2, 2001), the government hopes that this minimal personal income tax rate "will be enough to make honest taxpayers out of many more prosperous Russians." Russia currently has more than 60 million paid workers. Although roughly one third of the working class should be filing regular income tax returns each year, in 1999 only 4.3 million Russians paid income tax, a number that dropped to 3.8 million in 2000. In Russia, unlike in North America, it is relatively easy to avoid paying annual income tax. The black market has been a massive enterprise since the days of communism, and the tax collection service is quite inefficient. Some wealthy Russians file income tax returns on a regular basis, but most hide their money or do not pay. The same goes for the large Russian working class. But Mr. Putin seems ready to take on the tax evaders once and for all.

The sizeable reduction in the top rate of income tax as a result of the flat tax should have some effect on the underground economy, while a more efficiently managed tax service will increase government revenues. As well, the head of the Russian tax police, Vyacheslav Soltaganov, wants to establish a government intelligence service to help eradicate tax evasion. One shudders at the birth of yet another central agency behind the old Iron Curtain but if Russian democracy is to survive, tax cheats must start paying.

It's too early yet to say whether the new system is working, but Mr. Putin's flat tax has at least earned admiration of from all sides of the political spectrum. It was even endorsed by *The New York Times*, the official organ of US liberalism. In an editorial last May 28, the *Times* wrote that "in a society where few people pay anything close to their legally required taxes, and wealthy individuals often pay no tax, the idea of a progressive tax code is an illusion." A flat tax would "encourage people to pay taxes ... make it easier for the government to track down those who do not" and cut down on "political corruption, removing layers of subsidies in the code that officials like to shower on favored constituents."

To conservatives, the *Times'* position may seem the ultimate double standard. When a flat tax has been proposed for Canada or the United States, liberals have traditionally opposed it on the grounds that it would reduce progressivity. In fact, on October 30, 1999, commenting on a discussion about the flat tax among Republican Party presidential hopefuls, the *Times* itself had argued that "the idea that the flat tax is needed in order to simplify the tax code is disingenuous, when the basic result would ease the tax burden on the super-rich." But a reduced concern for progressivity—and a lower

tax rate for the super-rich—is apparently OK for weak, unstable transition economies. The reaction of Bruce Bartlett, senior fellow at the National Center for Policy Analysis, to the *Times* flip-flop was apt:

Now, apparently, the Times recognizes (correctly) that the wealthy seldom pay the high marginal tax rates imposed on them. Legal tax avoidance techniques can easily lower even the wealthiest person's tax payments to zero, if they want to expend enough time and money to achieve that goal. The Internal Revenue Service reports that in 1997 there were 1,189 Americans with gross incomes above \$200,000 who paid no federal income tax that year.

Although supported by both conservatives and liberals Russia's new flat tax is not without difficulties. In the June 27, 2000 edition of *The St. Petersburg Times*, Tom Stansmore, head of the St. Petersburg branch of Deloitte & Touche CIS—and isn't that an index of how times have changed!—noted that under the old, progressive tax, the majority of payers faced the lowest rate: 12 per cent. As a result, Mr. Dunsmore wrote, a "13 percent flat income tax, from their point of view, means an increase of 1 per cent." While the flat tax may benefit Russia as a whole, it will—ironically—further decrease the incomes of previ-

ously honest, tax-paying individuals.

Despite this difficulty, Russia's new flat tax is a positive step towards proper economic reform, one of several taken recently in that troubled country. Others have included a cap on corporate profit taxes, reduction of an existing tax on corporate turnover, and the abolition of other restrictive taxes. But it is not yet clear that Mr. Putin's government is wholly dedicated to free-market principles. If his tax reforms ultimately fail, there is little doubt that the Russian economy could be sent spiraling into yet another experiment in social engineering. Still, if Russia is able to get its financial house in order and put a crimp on the black market, the flat tax will have achieved an impressive victory. Its success would certainly give North American conservatives new courage in their fight for a flat tax. It would be deeply ironic if Russian ex-communists understood more about finances, taxation, and the need to reduce state interference than mainstream North Americans. But we should take our lessons wherever they may be found.

Michael Taube, a public affairs analyst and commentator, is completing a book on private universities in Canada for the Fraser Institute.

While the flat tax may benefit Russia as a whole, it will—ironically—further decrease the incomes of previously honest, tax-paying individuals.

**NOUVEAU
ABONNEZ-VOUS
EN LIGNE**

Formulaire d'abonnement Options Politiques

☐ Nouveau ☐ Réabonnement (S.V.P. inclure n° d'abonné _____)

☐ 1 an individuel	34.95 \$	+	2.45 \$ TPS*	"	37.40	**
☐ 2 ans individuel	59.95 \$	+	4.20 \$ TPS*	"	64.15	**
☐ 1 an institutionnel	45.00 \$	+	3.15 \$ TPS*	"	48.15	**
☐ 2 ans institutionnel	75.00 \$	+	5.25 \$ TPS*	"	80.25	**

* TPS pour les commandes au Canada.

** Résidents du Québec, ajoutez 7,5 % à ce montant.

États-Unis, ajoutez 15,00 \$ CDN de port par an; autres pays, ajoutez 20,00\$ CDN par an.

*** Paiements en argent canadien seulement.

Nom _____

Compagnie _____

Adresse _____

Ville _____ Province _____

Code Postal _____ Téléphone _____

☐ Règlement ci-joint

☐ VISA

☐ Master Card

☐ Amex

N° de la carte _____

Date d'échéance _____

☐ Facturez-moi

Signature _____

1470, rue Peel
Bureau 200
Montréal (Québec)
Canada H3A 1T1
www.irpp.org