THE FISCAL REFORMS AND FLAT TAX IN EUROPE AND CEE COUNTRIES

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Abstract: *The aim of this paper is to realize a comparative overview of fiscal reforms and flat tax reform experiences of the new EU Member states which implemented the flat tax for fiscal policy making. In conclusion of this paper, we state that there is little evidence that the good economic performance of these countries after the reform was due to the flat tax itself: this could be attributed to wider macroeconomic recovery, better tax compliance and tax administration as a consequence of EU membership requirements.*

Keywords: European and CEE countries, fiscal reforms, flat tax.

JEL Classification Codes: F36, E62, H21

1. INTRODUCTION

Many fiscal reforms took place in the European area in the last decade, especially in the actual financial crisis context. One form of taxation has attracted a lot of attention over the last years: the flat tax. The debate really started in 1983 following the release of Hall and Rabushka's book on flat tax and was rather US-centred, given the complexity of the US tax code. It regained vigour in the last years in the EU enlargement to post-communist countries that have adopted this system. It should be mentioned that in these countries the introduction of the flat tax was part of a wider package of tax reforms, meant to improve tax compliance and administration. There is a certain irony to the growing popularity of the uniform rate of income tax in countries that were previously run by communist parties. It was Karl Marx who, in his Communist Manifesto of 1848, was among the first to call for "a heavy progressive of graduated income tax", at a time when across the early industrializing states the flat rate was the norm. Subsequently, as capitalist societies become more prosperous, they adopted Marx's demand and introduced higher rates of tax on higher bands of income to finance improved social welfare measures.

For those who see government not as benevolent but rather as inclined to waste and pursue the narrow self-interest of policy makers themselves, adoption of a flat tax can be desirable as a means of restricting the size of government. If government can somehow be restricted to using only a single marginal tax rate, then the amount it can raise will be limited, and so the amount of damage that government can do will be diminished. In the post-

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communist economies, the flat tax has been commonly adopted by new governments anxious to signal a fundamental regime shift towards more market-oriented policies and this signal appears to have been well-received. The economies flourished after the reforms.

The aim of this paper is to realize an overview of fiscal reforms and flat tax reform experiences of the EU Member States which implemented the flat tax and to assess the impact of these reforms for fiscal policy making. In order to attain these objectives, the paper is organized as follows. Section 2 describes the flat tax implementation around the world and presents briefly the arguments and counterarguments in introducing a flat tax based on the experience of the European and CEE countries with the flat tax, focusing on the effects on revenue collection. Section 3 provides the concluding remarks.

2. FISCAL REFORMS IN THE EUROPEAN COUNTRIES. AVANTAGES AND COSTS OF ADOPTING THE FLAT TAX REGIME

In the world, there are now twenty two jurisdictions that have some form of flat tax, but the detailed provisions vary a lot across countries (see Table 1). Most of the new flat tax nations are communist countries, perhaps because people who suffered under communism are less susceptible to class-warfare rhetoric about "taxing the rich". Among the new EU Member States, Estonia was the first one in introducing a flat income tax reform in 1994, charging 26% on all personal and corporate income with no deductions allowed. The Estonian example was followed by other two Baltic countries, Lithuania (33%) and Latvia (25%). In 2004, Slovakia imposed a flat tax of 19%. Romania's flat tax, instituted in January 2005, is 16%.

Table 1: Flat taxes on personal income in the world
(at the time of introduction)

Country	Flat tax rate	Year of introduction	Country	Flat tax rate	Year of introduction
Jersey	20% /1	1940	Iraq	15%	2004
Hong Kong	16% /2	1947	Slovakia	19% /7	2004
Guernsey	20% /1	1947	Georgia	12% /10	2005
Jamaica	25%	1980	Romania	16%	2005
Bolivia	10% /4	1986	Kyrgyzstan	10%	2006
Estonia	26% /5	1994	Paraguay	10% /11	2006
Lithuania	33% /6	1994	Macedonia	12% /12	2007
Latvia	25% /6	1995	Iceland	35.73% /13	2007
Russia	13% /7	2001	Mongolia	10%	2007
Serbia	14% /8	2003	Mauritius	15%	2009
Ukraine	13% /9	2004	Tonga	10% /14	n.a.

Source: Rabushka (2007), The Economist (2005), Teather (2005), Grecu (2004), Bird (1992).

/1 Applied to personal and corporate incomes for both Jersey and Guernsey. None have VAT. The channels islands do not tax dividends, interest or capital gains. /2 Taxpayers have the choice between being taxed at a 16% flat tax or under a progressive tax system with marginal tax rates ranging from 2 to 20%. Hing King does not tax dividends, wealth, and capital gains and has no VAT, sales or payroll tax. /3 Accompanied by a 24% corporate tax rate. /4 Capped at ₤ 250,000, making it therefore regressive as soon as revenues reach ₤ 1,250,000. From 2007, the corporate tax rate is reduced to zero. /5 With no basic allowance. /6 13% since 1992. The tax base is all income (wages, salaries, rentals, interest, royalties, etc.),

except foreign-income and capital gains which remain tax-free. There is also a general allowance equivalent to two (previously four) monthly minimum wages (this minimum wage is about Bs 240 or USD 45). The system is designed to fight VAT fraud, so that individuals can offset against this tax the VAT paid, provided they have invoices or receipts. /7 Reduced to 24% in 2005, 23% in 2006, 21% in 2007, 20% in 2008. Estonia has a zero corporate tax rate on retained earnings but taxes distribution (mainly dividends) at 21%. This is accompanied by a general non-deductibility of interest payments./8 VAT paid is tax deductible. /9 Both Lithuania and Latvia's corporate tax rates are set at 15% in 2007. /10 10% from 2008. /11 15% in 2007./12 Corporate tax rate is at 18% and capital income taxed at 10% under a Dual Income Tax System. /13 Accompanied by a 24% corporate tax rate. /14 On both corporate and personal incomes. /15 15% since 2007. /16 Above 2,500 USD. The date of implementation is unknown. The following countries have no tax on personal income: Andorra, the Bahamas, Bahrain, Bermuda, Burundi, Cayman Islands, Kuwait, Monaco, Nigeria, Oman, Qatar, Saudi Arabia, Somalia, United Arab Emirates, Uruguay and Vanuatu.

The proponents of the flat rate income tax reform put forward several arguments in favor of this fiscal system (Saavedra *et al.* 2007):

- reduces the complexity of the tax system and thus administrative costs;
- creates incentives – through lower and simpler rates and clearer rules – for accurate reporting of income and consequently higher compliance by taxpayers;
- lowers marginal tax burdens, creating incentives for investment and saving;
- reduces inefficiencies in the economy by avoiding double taxation and reducing tax-induced distortions in investment behavior;
- promotes labor force participation, including for individuals in higher income brackets that may also have higher skills.

Besides the above mentioned issues, the other most significant legal incentive offered to direct investment towards Romania is the single tax reform, introduced by the Government at the beginning of 2005. This modification brought Romania among the most competitive investment destinations in the region. Starting with 2005, following a successful model already introduced by other countries in the region, corporate and individual incomes are levied with a single tax rate of 16%.

Nevertheless, companies have the possibility of choosing to pay tax on incomes of micro-enterprises, if they qualify as such an entity (annual turnover up to EUR 100,000, number of employees between 1 and 9 and should derive more than 50% of its income from activities other than consultancy and management). Under this regime, a 2.5% in 2008 and 3% in 2009 income tax is applied to revenues of the company.

In spite of the advantages of the new single tax system, its downside appeared already six months later. In order to counter the lower taxes collected on corporate and individual income, the Government was forced to raise quotas for other taxes, such as: tax on dividends (from 5 to 10% for individuals, and subsequently to 16%), tax on capital gains (from 1 to 10%, and then 16%). However, presently, the Romanian single tax rate is competitive compared to the other countries levels of taxation. To date, the following countries have introduced flat tax regimes (Table 2).

Table 2 Flat tax regimes in CEE region

Some countries that adopted flat tax regimes

Country	Rate (%)	Year of enactment
Albania	10	2008
Bulgaria	10	2008
Czech Republic	15	2008
Estonia	21	2008
Latvia	25	1995
Lithuania	24	2008
Macedonia	10	2008
Romania	**16**	**2005**
Russia	13	2001
Slovakia	19	2004
Slovenia	21	2008

Source: Different national reports and other Internet sources

Taxes on business play an important role for attracting investors. So, according to a European Commission, in the EU member states, the tax on profit rages between 10-35% and VAT is between 15 and 25%. EU states with a low tax on profit are: Ireland with 12,5%, Lithuania and Latvia with 15%, Bulgaria and Cyprus with 10%. Romania has a 16% tax on profit. Next are Slovakia and Poland with 19%. The highest tax on profits is in Belgium (34%), France (34,4%) and Malta (35%). A high tax on profit of 29,8% is in Germany, Spain (30%), Italy (31,4%), Luxembourg (28,8), Portugal (29%), Norway (28%), UK (27%). Then Finland follows with 26%, and Sweden (26,3%), Austria (25%), Netherlands (25%). Summing, it appears that the economically developed states tax the profit higher, but this frame is supported by conditions that facilitate the access of the companies to this final stage of results. Regarding the tax on companies profit in Romania, we have to mention that beside the flat tax of 16%, the fiscal code grants to micro-entrepreneurs the possibility of opting for a tax on the total income. For 2007, this tax was of 2%, it increased to 2,5% in 2008 and in 2009 to 3%.

The causes of high budget and current account deficits in CEE region are explained by excessive expensives generated by a lax monetary or fiscal policy. The economic literature shows that in developed countries, with opened economies, both deficits arise as a result of an expansionist fiscal policy, the current account deficit being explained 50% by the diminishing of the share of budgetary incomes of GDP (Botman and Kumar, 2006).

We underline that nine of the ten ex-communist states that are now members of EU, are in the top of the countries with low tax on profit, under a level of 20%. This situation can be a positive signal for the investors that came late in these countries, because of their political regime. The impact of the fiscal frame can be best observed in attracting foreign investments. That is why there were so many critics to Romania when the flat tax was adopted here. The foreign investments were also stimulated in Romania by this flat tax on revenue and on profits of 16% starting with 2005. The value of the FDI inflows in Romania in 2005-2006 was with 70% higher than in the previous year, reaching over 9 billion euro. This amount includes the acquisition of 36,8% of the shares of BCR by Erste Bank (2,2 billions euro). Equity participation were the main component of the FDI inflows in Romania (45,1% of the total FDI), followed by the inter-group loans (33,3% of the total FDI) and the reinvested earnings (21,5% of the total FDI).

Still, in 2007, the FDI inflows in Romania decreased with 43% comparing to 2006. The main component of FDI inflows in Romania was represented by reinvested earnings (48,2% of the total FDI), followed by inter-group loans (39,6% of the total FDI) and the equity participations (only 12,1% of the total FDI). During 2008-2010, FDIs in Romania decreased significantly, because of the crisis and the investors' lack of confidence and prudence.

The FDIs amount decreased also because of the competitor markets. Bulgaria and Hungary are two of the neighbor countries that hold some advantages into attracting investors. The tax on profit is one example. In Romania its level is 16%, while Bulgaria has a level of 10% and Latvia and Lithuania with 15%. As far as Serbian fiscal incentive measures are concerned it is important to emphasize that the tax on profit in Serbia is 10% from 2007, which represents one of the lowest rates in the region and it is far lower than EU average.
Still, regarding VAT, Romania doesn't hold an advantage against its main competitors in the region. Only Hungary in the CEE region has a VAT of 25%, while Romania increased VAT to 24% from 19% in the crisis context. Moreover, comparing to European developed countries, Romania has one of the highest VAT in Europe. Only Denmark and Sweden (that are highly developed and with high life standard) have a VAT similar to the Romanian one (25%).

EU legislation for VAT stipulates the basic principles, but leaves the member states some options. The EU member states that have a VAT below 20% are: France with 19,6%, Germany (19%), Spain (18%), Cyprus and Luxemburg (15%), Malta (18%), Netherlands (19%). Bulgaria, Czech Republic, Estonia, Italy, Austria, Slovenia, Slovakia and UK have a VAT of 20%. EU member states that have the lowest VAT of 15% are Cyprus and Luxemburg, according to European Commission - VAT rates (2011). The other countries with a VAT that overcomes 20% are: Belgium, Denmark, Greece, Portugal, Ireland, Latvia, Lithuania, Hungary, Poland, Romania, Finland and Sweden (21-25%). The higher level of VAT, of 25%, is in three EU member states: Denmark, Sweden and Hungary.
We have to mention that there are still states that have also super reduced levels of VAT for some products, even though the EU opinions converge to eliminating this special regime applied to some products (Spain – 4%, France – 2,1%, Ireland – 4,8%, Italy – 4% and Luxemburg – 3%), namely food products, books, pharmaceuticals, TV license, supply of new buildings. Also, there is a 0 VAT level, mainly used in UK for social housing or for collection of domestic waste and street cleaning, for talking books for persons with handicap, although EU makes efforts for eliminate this 0 VAT level. There are also exemptions of VAT paying mainly for TV license, social services, medical and dental care in many European countries.

However, a country's competitiveness is determined by a number of other factors besides the tax system. It is clear that investment and savings behavior may depend on economic drivers that go well beyond this limited reform. Flat taxes are usually lower taxes. While it is generally true that lower taxes leave more money to circulate and thus to be invested, and that flat rates generally increase the citizens' willingness to pay their taxes, lower taxes may also mean lower tax revenues, which in turn may be detrimental to the given state's budgetary status. Flat taxes are attractive because of their transparency and simplicity in administration. Transparency is indeed an interesting feature, notably because each worker knows about his marginal tax rate, which is something more difficult to assess in a progressive tax system. Nevertheless, in practice, the effective tax on labor income also depends on the pattern of social insurance contributions (Carone *et al.* 2007). Even in countries having a flat tax rate, the effective labor tax schedule is far from flat (see Table 3), especially if social security contributions are considered. Even where flat tax is levied at a low rate, the overall effective rate of tax on labor income may be quite high. Flat tax may also have negative effects on equity. Keen *et al.* (2006) find that the distributional impact of the flat tax reforms is commonly quite complex, and by no means unambiguously adverse for some of the least well-off. Romania has the lowest labor tax rate in the CEE region, followed by Bulgaria and Latvia. Moreover, Romania has one of the lowest labor tax rates in the EU-27. Cyprus, Malta, Portugal, Ireland and UK have low labor tax rate, below 30% and close to the Romanian level. But Romania has also one the lowest share of tax revenue of GDP (27%), among Latvia (26,6%), Ireland (28,2%), Slovakia (28,8%), Bulgaria (28,9%) and Lithuania (29,3%).

Table no. 3

Tax revenue and implicit tax rates by type of economic activity

	Tax revenue, % of GDP			Implicit tax rate* on:								
				Labour			Consumption			Capital		
	2000	2008	2009	2000	2008	2009	2000	2008	2009	2000	2008	2009
EU27**	**40.5**	**39.3**	**38.4**	**35.7**	**33.8**	**32.9**	**20.8**	**21.4**	**20.9**	**25.0**	**25.3**	**24.6**
EA17**	**41.1**	**39.7**	**39.1**	**34.5**	**34.0**	**33.5**	**20.4**	**20.7**	**20.4**	**25.1**	**25.2**	**24.7**
Belgium	45.2	44.4	43.5	43.6	42.5	41.5	21.8	21.2	20.9	29.6	32.6	30.9
Bulgaria	31.5	32.3	28.9	38.1	27.4	25.5	18.5	24.9	21.4	:	:	:
Czech Republic	33.8	35.5	34.5	40.7	39.2	36.4	19.4	21.1	21.6	20.9	19.8	19.3
Denmark	49.4	48.1	48.1	41.0	36.2	35.0	33.4	32.6	31.5	36.0	43.4	43.8
Germany	41.9	39.4	39.7	40.7	39.2	38.8	18.9	19.7	19.8	28.4	23.0	22.1
Estonia	31.0	32.1	35.9	37.8	33.7	35.0	19.5	21.1	27.6	6.0	10.5	14.0
Ireland	31.5	29.7	28.2	28.5	25.3	25.5	25.5	23.3	21.6	:	16.3	14.9
Greece	34.6	31.7	30.3	34.5	32.2	29.7	16.5	14.8	14.0	19.9	:	:
Spain	33.9	33.2	30.4	30.5	33.1	31.8	15.7	14.1	12.3	29.9	31.7	27.2
France	44.1	42.9	41.6	42.0	41.5	41.1	20.9	19.1	18.5	38.4	38.1	35.6
Italy	41.8	42.9	43.1	42.2	43.0	42.6	17.9	16.5	16.3	29.5	35.6	39.1
Cyprus	30.0	39.1	35.1	21.5	24.7	26.1	12.7	20.8	17.9	:	:	:
Latvia	29.5	29.1	26.6	36.6	28.5	28.7	18.7	17.4	16.9	11.2	17.0	10.3
Lithuania	30.1	30.2	29.3	41.2	32.7	33.1	17.9	17.6	16.5	7.2	12.7	10.9
Luxembourg	39.1	35.3	37.1	29.9	31.7	31.7	23.0	27.3	27.3	:	:	:
Hungary	39.0	40.0	39.5	41.4	42.1	41.0	27.5	26.6	28.2	17.1	18.6	18.8
Malta	28.2	33.9	34.2	20.6	19.6	20.2	15.9	19.3	19.5	:	:	:
Netherlands	39.9	39.1	38.2	34.5	36.2	35.5	23.8	26.9	26.2	20.7	16.6	15.4
Austria	43.2	42.6	42.7	40.1	41.3	40.3	22.1	21.6	21.7	27.7	26.5	27.0
Poland	32.6	34.3	31.8	33.5	32.6	30.7	17.8	21.1	19.0	20.5	22.8	20.5
Portugal	31.1	32.8	31.0	22.3	23.3	23.1	18.2	18.0	16.2	31.3	37.5	33.8
Romania	30.2	28.0	27.0	33.5	27.3	24.3	17.0	17.7	16.9	:	:	:
Slovenia	37.5	37.2	37.6	37.7	35.9	34.9	23.5	23.9	24.2	15.7	21.7	21.0
Slovakia	34.1	29.2	28.8	36.3	33.1	31.2	21.7	18.7	17.3	22.9	16.9	17.1
Finland	47.2	43.1	43.1	44.0	41.4	40.4	28.5	26.0	25.7	36.4	28.0	29.9
Sweden	51.5	46.5	46.9	46.8	41.2	39.4	26.3	27.8	27.6	42.8	26.2	33.5
United Kingdom	36.7	37.5	34.9	25.6	26.4	25.1	18.9	17.5	16.8	44.0	44.7	38.9
Norway	42.6	43.0	41.4	38.3	37.1	37.6	31.2	29.4	28.9	41.1	43.6	37.8
Iceland	37.1	36.7	33.7	:	:	:	27.1	26.2	24.3	:	:	:

* Implicit tax rates (ITR) express aggregate tax revenues as a percentage of the potential tax base for each field (see footnote 7).

** EU27 and EA17 overall tax ratios are calculated as GDP-weighted average of the Member States. For ITRs the aggregates are calculated as arithmetic averages of the Member States and adjusted for missing data. For the ITR on capital, EU27 aggregate excludes Bulgaria and Romania.

: Data not available

Source: European Commission, 2011.

Let us explore the experience of some EU members with the flat tax and its implementation effect on revenue collection. Table 4 presents the tax on personal income (PIT) and corporate income tax (CIT) in the EU members and then, we will focus on the experience of CEE countries, new EU member states.

Table no. 4

Top statutory income tax rates, %

	Tax on personal income				Tax on corporate income			
	2000	2010	2011	Difference 2000-2011	2000	2010	2011	Difference 2000-2011
EU27*	**44.7**	**37.6**	**37.1**	**-7.6**	**31.9**	**23.3**	**23.2**	**-8.7**
EA17*	**47.1**	**41.4**	**41.8**	**-5.3**	**34.4**	**25.6**	**25.5**	**-8.9**
Belgium	60.6	53.7	53.7	-6.9	40.2	34.0	34.0	-6.2
Bulgaria	40.0	10.0	10.0	-30.0	32.5	10.0	10.0	-22.5
Czech Republic	32.0	15.0	15.0	-17.0	31.0	19.0	19.0	-12.0
Denmark	59.7	51.5	51.5	-8.2	32.0	25.0	25.0	-7.0
Germany	53.8	47.5	47.5	-6.3	51.6	29.8	29.8	-21.8
Estonia	26.0	21.0	21.0	-5.0	26.0	21.0	21.0	-5.0
Ireland	44.0	41.0	41.0	-3.0	24.0	12.5	12.5	-11.5
Greece	45.0	45.0	45.0	0.0	40.0	24.0	23.0	-17.0
Spain	48.0	43.0	45.0	-3.0	35.0	30.0	30.0	-5.0
France	59.0	45.8	46.7	-12.3	37.8	34.4	34.4	-3.4
Italy	45.9	45.2	45.6	-0.3	41.3	31.4	31.4	-9.9
Cyprus	40.0	30.0	30.0	-10.0	29.0	10.0	10.0	-19.0
Latvia	25.0	26.0	25.0	0.0	25.0	15.0	15.0	-10.0
Lithuania	33.0	15.0	15.0	-18.0	24.0	15.0	15.0	-9.0
Luxembourg	47.2	39.0	42.1	-5.0	37.5	28.6	28.8	-8.7
Hungary	44.0	40.6	20.3	-23.7	19.6	20.6	20.6	1.0
Malta	35.0	35.0	35.0	0.0	35.0	35.0	35.0	0.0
Netherlands	60.0	52.0	52.0	-8.0	35.0	25.5	25.0	-10.0
Austria	50.0	50.0	50.0	0.0	34.0	25.0	25.0	-9.0
Poland	40.0	32.0	32.0	-8.0	30.0	19.0	19.0	-11.0
Portugal	40.0	45.9	46.5	6.5	35.2	29.0	29.0	-6.2
Romania	40.0	16.0	16.0	-24.0	25.0	16.0	16.0	-9.0
Slovenia	50.0	41.0	41.0	-9.0	25.0	20.0	20.0	-5.0
Slovakia	42.0	19.0	19.0	-23.0	29.0	19.0	19.0	-10.0
Finland	54.0	49.0	49.2	-4.8	29.0	26.0	26.0	-3.0
Sweden	51.5	56.4	56.4	4.9	28.0	26.3	26.3	-1.7
United Kingdom	40.0	50.0	50.0	10.0	30.0	28.0	27.0	-3.0
Norway	47.5	40.0	40.0	-7.5	28.0	28.0	28.0	0.0
Iceland	:	46.1	46.1	:	30.0	18.0	20.0	-10.0

* Arithmetic average
: Data not available

Source: European Commission, 2011.

The tax rates applied to the PIT and CIT vary significantly in the five CEE countries. The lowest rate for the CIT in CEE region is 10 percent in Bulgaria, followed by the Latvia and Lithuania with 15 percent and, than, Romania with 16%. On the other hand are CEE countries with 19% CIT (Czech Republic, Slovakia, Poland), 20% (Slovenia), 20,6% (Hungary) and the highest CIT is in Estonia (21%). Romania, Bulgaria, Hungary, Estonia, Lithuania and the Slovak Republic have a flat rate at the same level for the PIT and the CIT and they are also the countries with the lowest PIT in CEE region. The large differences in rates in this group of countries may reflect in part the timing of the reforms. The Baltic countries applied the flat tax in a period of tight fiscal constraints in the mid-1990, and the danger of having a drop in revenues pushed the authorities toward higher rates. On the other

hand, the countries which introduced the reforms from 2004 onward, enjoyed higher rates of economic growth and better fiscal balances at the time of implementation (Lane and Varoudakis, 2007).
We will briefly describe in turn the particular aspects of each CEE country considered for flat tax regime adopted, comparing the present rates with the former progressive rate schedule. This is helpful in understanding the intended goals of policy makers. Moreover, looking at the previous tax systems helps to observe the potential gains in simplicity of a flat rate, especially with the PIT (Tache, 2008).

Estonia - It is the first post-communist country adopting a flat tax system at a rate of 26 percent, which is approximately midway between the lowest and highest pre-reform marginal rates. The initial rate has been lowered since, being settled to 21 percent in 2009. The personal allowance was increased substantially at the time of introduction of the flat tax: from EEK 2,400 to EEK 3,600, although inflation was then such that this represented only a modest increase in the allowance in real terms. The CIT, previously 35 percent, was also set at 26 percent, and then to 21% and the labor income tax has remained aligned to 35%. The best known feature of the Estonian approach to corporate taxation, however, was not part of the flat tax reform, being adopted only in 2000: since then, undistributed profits have been taxed, with distributions taxed at the regular flat rate. There appears to have been no substantial change to VAT or the excises at the time of adopting the flat tax. In 2000, the VAT was 18% until 2008, then it rise to 20%.

Lithuania - The flat tax introduced in 1994 was 33 percent – the highest of the marginal rates imposed prior to the reform. The threshold was largely increased, from LTD 35 to LTD 115 (more than doubling relative to GDP, though still reaching only a very modest 2.6 percent of per capita GDP). The CIT was maintained at 24 percent for a while. The PIT has remained unchanged since 1994, at 33% and then reduced at 15% just like the CIT. The previous general excise tax, which had operated much as a VAT, was transformed into a full VAT at the time of the flat tax implementation, with the rate remaining at 18 percent, in 2009 was increased at 19%, and then, after 2010 was settle at 21%; a new excise tax law was also introduced, and the rates of the excises on gasoline, diesel and beer were increased in late 1994/early 1995.

Latvia - Latvia introduced its flat tax in 1997 at the rate of 25 percent. The year before the reform Latvia had an unusual degressive rate structure (under which the marginal rate falls with income), with a starting marginal rate of 25 percent followed by a marginal rate of 10 percent on the highest incomes. The adoption of the flat tax in Latvia thus resulted in increased tax liability at the very highest incomes. The value of personal allowances was slightly reduced, but remained high (at around 19 percent of per capita income). CIT was 25 percent prior to reform and was maintained at this level a long time, but it decreased at 15% in 2010-2011, PIT has almost the same level (25%) as it has in 2000, and the labor income rate is now 28,9%. So, those taxes have diverged, with the CIT now set at 15 percent. Dividend and interest income were, and continue to be exempt. There seem to have been no important changes to the VAT or excises like in Estonia – during 2000-2008 it was 18%, then rise to 21% and in 2011 it is 22%.

Slovak Republic - The major tax reform of 2004 adopted a single common rate of 19 percent for the PIT, CIT and VAT. This replaced a PIT schedule of five non-zero marginal rates ranging from 10 to 38 percent (with five other rates applying to specific types of income). The personal allowance was more than doubled, from SK 38,760 to SK 80,832, while the spouse allowance increased almost sevenfold, from SK 12,000 to the same value as the personal allowance. Income-related tax allowances for children were replaced by fixed allowances and a refundable tax credit for those with sufficient labor market participation. The reduction of CIT, previously at 29 percent in 2000, and then at 25% in 2004, was accompanied by more rapid depreciation and more generous carry-forward provisions. The dividend tax – 15 percent final withholding, prior to reform – was abolished, along with the inheritance and gift taxes. The income tax reform included important scaling back of exemptions, under both the PIT (for example: the removal of some allowances for interest and capital income, additional private pension contributions and exemptions for soldiers and judges) and the CIT (for example: tax holidays for newly established firms, with limits also placed on the deductibility of charitable giving and tighter rules for provisioning and reserves.). The aggregate social security tax was reduced from 51 to 48.6 percent, with the revenue effect, in part, offset by increasing contribution ceilings.

Romania - The fiscal reform introduced in January 2005 is strongly associated with the flat tax in the public's mind. In fact, two major changes were operated:
a) On the personal income tax progressivity was eliminated and a 16% flat rate replaced the previous complex system with five brackets between 18 and 40 percent.
b) On the corporate profit, where the rate was already flat, the percentage was simply reduced from 25% to 16%.
A number of additional sources of personal revenue, which were previously taxed separately and very lightly (for example, 1% on capital market gains), were included in the taxable base. In general, the logic was to broaden the base and reduce the general rate, in order to ensure more horizontal fiscal equity. The monthly basic personal allowance was raised modestly in real terms. The CIT was also reduced from 25 to 16 percent. Dividends paid to individuals, interest income and capital gains were subject to final withholding taxes at lower than the flat rate, but since 2006 have also been subject to the flat 16 percent. The two rates of VAT (19 and 9 percent) remained unchanged until 2010 when the government increased VAT at 24%, but, later in 2005, several relatively minor exemptions (in relation to entertainment services, for example) were eliminated, and excises increased.

3. CONCLUSIONS

The following remarks can be derived from the present analysis:
1. Generalizations are difficult, given the diversity of reform design.
2. The potential gains are uncertain and depend critically on the details of the reform.
3. In general, the flat tax reforms have been associated with a reduction in revenue from the PIT.
4. Tax policy in other areas may need to be adjusted as a safeguard against some drop in revenues in the PIT and CIT. For instance, if the government intends to shift the burden from direct taxes to indirect ones, tax policy and administration for the VAT and excises should be strengthened before or in tandem with a flat income tax reform.
5. Success in improving PIT collection depends in part on complementary reforms in social insurance and contributions. High marginal rates of pay-roll taxes can be a major obstacle to improved PIT collection after the reform.

In conclusion, there is little evidence that the good economic performance of these countries after the reform until the crisis period was due to the flat tax itself: this could be attributed to wider macroeconomic recovery, FDIs inflows, better tax compliance and tax administration as a consequence of EU membership requirements.

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