

(from <http://online.wsj.com/search#SB114679674294044620>):

THE AMERICAS

Flat Tax Models		
Flat-tax nations and their rates		
	INDIVIDUAL	CORPORATE
Estonia	23%	24%
Georgia	12	20
Latvia	25	15
Lithuania	33	15
Romania	16	16
Russia	13	24
Serbia	14	14
Slovakia	19	19
Ukraine	13	25

Source: Cato Institute

Costa Rican Poverty Fighter

By MARY ANASTASIA O'GRADY
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Immediately after President-elect Oscar Arias takes office in Costa Rica on Monday, he will have an historic opportunity to help bring his country into 21st-century competitiveness. The choice? Whether to adopt a national flat tax on corporate and individual income.

Mr. Arias is a seasoned social democrat who earned an international reputation for his work on Central American peace, for which he won a Nobel Peace Prize in 1987. He has already served one term as president from 1986-1990.

Yet despite his reputation as a man of the left, Mr. Arias is also a practical socialist, blessed with common sense and not averse to leading on controversial issues. He has pledged to fight for the ratification of the Central American Free Trade Agreement even though the country's labor unions are militantly opposed to it.

On the flat tax, Mr. Arias is already sending encouraging signals. Last week his National Liberation Party made an agreement with the Libertarian Movement in Congress to seriously explore the idea. Together the two parties would have enough votes to make it a reality.

The concept is anathema to Costa Rica's hard left, which is crying foul on grounds that a single, low rate is unjust: Under a flat tax the rich don't pay their fair share and it leads to profits -- a dirty word to Latin socialists -- for business.

Yet the flat tax has already proved an effective way to fight poverty in a host of developing countries. (See nearby table.) For individuals, tax evasion goes down and tax collection goes up because of better compliance. Low corporate rates attract capital, spurring economic growth and job creation. That means there is more money in government coffers to help the needy. Without a laundry list of tax exemptions and loopholes, corruption is thwarted.

If anyone can sell these concepts to Costa Ricans, it's Mr. Arias. He has the confidence of many Costa Ricans who tend to distrust the private sector, thanks in part to the systematic indoctrination of young minds by the left-wing national teachers' union.

In this sense, Mr. Arias is not unlike Chile's former Socialist President Ricardo Lagos, Brazil's former President Fernando Henrique Cardoso or Britain's Labor Prime Minister

Tony Blair. Like Messrs. Lagos, Cardoso and Blair, Mr. Arias seems to be actually interested in good ideas and in creating a legacy that leaves behind a better nation.

The bad news for the new president is that there is not enough money in the budget to fund his campaign promises of more social spending on education, health care and housing. With 80% of the revenues already committed to wages, pensions, debt service and higher education, the only way to offer more is to ensure that the pie gets bigger. There is also fiscal pressure to enhance law enforcement funding, which has not kept up with modern crime, and to address a national epidemic of potholes in the dilapidated highway system.

The traditional Latin American method of curing the condition known as scarce resources is to raise taxes. But one reason the budget is already strained is that Costa Rica's steeply progressive income tax rates for individuals have provoked skyrocketing evasion. Government estimates say 70% of taxes owed are not paid.

On the corporate side, the current rate of 30% already discourages investment. And Costa Rica's special tax-free zones for exporters need to be phased out by 2009 if the country is to remain compliant with World Trade Organization rules. Thus there are strong incentives to create a new flat tax for both individuals, to boost compliance, and for corporations, to regain competitiveness.

Introducing a flat tax is analogous to hanging out a sign that says: Open for business. Just ask Slovakia, which in 2004 adopted a flat tax for corporations and individuals of 19%. Since then it has been drawing in large amounts of capital from Western Europe and its economy is growing rapidly. After Russia implemented a 13% flat rate for individuals, evasion went down and revenues rose sharply.

Mr. Arias already understands the connection between lower corporate taxes, investment and rising living standards. He has mentioned Ireland, with its 12.5% corporate rate, as a model for Costa Rica. The Costa Rican daily *La Nación* reported last month that he was considering special corporate tax zones with rates below 10%. Referring to a 15% rate under discussion in Congress, *La Nación* reported that "Dr. Arias asserted that one cannot fool himself thinking that anyone can compete at that high tax."

That's a promising start for the debate but to be competitive Costa Rica will have to avoid a policy of limiting low flat rates to special economic zones since other flat-tax countries don't attach strings. Moreover, as Chris Edwards of the Cato Institute points out, "Carving out special tax rates and incentives for particular industries and regions is not only inefficient, it is an open invitation for corruption."

There is growing support for a flat tax from some of Costa Rica's opinion makers. An April 10 editorial in *La Nación* supported the idea and an important former central bank president has come out in favor of it. If Costa Rica introduces a flat tax now, it could get a jump on its Cafta neighbors in attracting investment. With its highly literate population, a flat-tax Costa Rica could easily become a prime destination for multinational

investment.

A recent KPMG survey reported that the average corporate rate for the Latin American region is over 28%. That means that any Latin country that adopts a simple, low rate for the entire nation will instantaneously grant itself a vast comparative advantage. Over to you, Mr. Arias.