

WHAT IF ITALY LEARNED FROM ESTONIA?

The “flat tax” as a possible antidote to the Italian “tax evasion curse”

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The recent launch of the so-called “fiscal shield”, a sort of gigantic fiscal amnesty scheduled to last until April 15th, 2010, has revived once more both careful reflections and harsh polemics relating to the struggle against tax evasion in Italy. Such an initiative, which had been already promoted in 2001 and 2002, is aimed at favoring the “emersion” of all those capitals which have been illegally deposited abroad by their respective owners in order not to be obliged to pay taxes upon them. Hence, according to the measure introduced by the Italian Government, and initiated by the Minister of Economy and Finance, Mr. Giulio Tremonti, all the “remorseful” tax evaders will be able to carry their money back to Italy without any legal consequences. In fact, they will be simply forced to pay an undeniably advantageous fee, whose amount has been previously fixed at only 5% on the overall capital they will declare to possess. In addition, the aforementioned evaders will have the opportunity to remain anonymous even for the Government, since the repayment is always supposed to be finalized through the intervention of an intermediary (presumably a bank), who in turn will not be obliged to disclose personal information of any kind with regard to the evader himself.

Thanks to the “fiscal shield”, Mr. Silvio Berlusconi and his cabinet actually estimate to retrieve up to € 100 billion, which would mean a recovery of up to € 5 billion for the Italian Government. Indeed, the adoption of such a measure has been greatly advertised, especially because the promise of a harsh struggle against tax evasion was presented as one of the strongest points of the whole electoral campaign led by Mr. Berlusconi in 2008. Yet, to tell the whole truth, the “fiscal shield” looks far more like a humiliating compromise hardly achieved by a powerless and disoriented Government, than like the astonishing idea of an ingenious Minister. In fact, the relevance of the estimated figures mentioned above is enormously downsized, if compared with the overall data relating to the current situation of tax evasion in Italy, which, it is also worth bearing in mind, is nowadays the country with the absolute highest Government debt to GDP ratio of the whole EU27 area (105,8% in 2008)¹.

More specifically, every year the estimated overall amount of tax evasion in Italy is about € 135 billion. Such an impressive figure encompasses:

- the so-called “black economy”, which rests on at least two million workers (both clandestine immigrants and Italian citizens trying to supplement their income through a second, or even a third job), who do not even exist in the eyes of the

¹ Source: «EUROSTAT Newsrelease - Euroindicators», April 2009

Italian Government, since they are not regularly registered by their respective employers (€ 30 billion);

- the trafficking activities of all the crime organizations operating on the Italian territory (€ 40 billion);
- the illegal activities of great enterprises and capital companies (€ 17 billion);
- the illegal activities of the so-called “big companies” (€ 31 billion);
- the individual tax evasion of autonomous workers and of small and medium enterprises (SMEs, € 10 billion)².

Given these premises, instead of keeping on wasting huge resources into long and complicated police investigations, which often only lead to objectively daunting achievements, perhaps the Italian Government should rather think more seriously of a radical reassessment of its tax system as a whole. To this end, abandoning the existing mechanism of “progressive” taxation in favor of the introduction of the one-rate (also known as “flat”) tax system could represent an effective, albeit still partial, solution to this sort of “tax evasion curse” which affects Italian economy.

The “flat” tax system was officially adopted for the first time in Estonia in 1994, on the initiative of the then Prime Minister, Mr. Mart Laar. At that time, he had already been in office for two years³, and he was trying hard to drive his country away from the quicksand of the post-communist transition. In fact, in his own words, «the end of communism had created real chaos in the country. Shops were completely empty, and the Russian ruble no longer had any value. Industrial production declined in 1992 by more than 30% [...] while overall price inflation was running at more than 1000% [...] The only “institution” in Estonia that seemed to work was the informal market»⁴. In such a context, the introduction of the “flat” tax system, with only one rate fixed at 26% of the overall yearly personal income, undoubtedly acted as an extraordinary spur for the final economic breakthrough of Estonia. Indeed, it is worth not disregarding that, in the Estonian case, the renewal of the tax system represented only the last crucial step of a broader free-market-oriented reform process, which had already affected, in turn: the enhancement of economic openness; the strengthening of the rule of law; the quest for monetary stabilization; the recognition of private property. However, the adoption of the “flat” tax system gave the Estonian economy such a fundamental boost, that nowadays many analysts and observers are used to speaking of a real “Estonian economic miracle”. Furthermore, in the wake of Estonia, a growing number of countries has gradually shifted from “progressive” to “flat” taxation over the last decade. In fact, within the EU, the “flat tax front” includes, apart from Estonia: Latvia, Lithuania, Romania, Bulgaria, the Czech Republic and Slovakia. In addition, from 2001 on, several important non-EU countries have followed the Estonian example as well, notably Russia, Serbia, Ukraine and Georgia.

The non-negligible results achieved by all the aforementioned countries as a consequence of the introduction of the “flat” tax system should be probably taken far more seriously into account by the Italian Government. More specifically, the “flat” tax system

² Source: Report issued in September 2009, at the instance of the Italian Taxpayers Association (Associazione Italiana Contribuenti), by the KRIS Network on Business Ethics, elaborating on data coming from ISTAT, Banca d'Italia and the Italian Ministry of Economy and Finance

³ Mr. Mart Laar has been Prime Minister of Estonia from 1992 to 1994, and from 1999 to 2002

⁴ MART LAAR (2007), «The Estonian Economic Miracle», *Backgrounder* (magazine published by the Heritage Foundation)

has clearly proved to be able to offer several outstanding advantages. First of all, as mentioned before, it enhances economic growth by increasing the confidence of investors and entrepreneurs: as a matter of fact, the latter are both greatly encouraged to embark into new activities, since they know for sure that the tax rate they will have to pay is not going to soar more than proportionally to the growth of their profits. In the second place, the “flat” tax system helps to eliminate a good deal of useless “red tape”, since it divides the whole population into two big categories: those who are completely exempted from paying taxes, on the one hand, and those who have to give the Government a share of their yearly income, on the other hand. Yet, differently from what happens in all the countries adopting “progressive” taxation, for the latter the calculation of the overall amount to pay becomes enormously easier, since only one rate exists, and it is absolutely regardless of the differences among the various incomes. Last, but not least, the adoption of a “flat” tax system enables to lower the tax burden on the whole, without harming, at the same time, social justice. This is probably the main reason why the countries which have embraced the “flat” tax system so far have all been able to achieve, within a relatively small time interval, absolutely flattering results in their struggle against “black economy”, tax avoidance and tax evasion⁵.

Hence, in the light of all these considerations, the introduction of the “flat” tax system could really help the Italian Government to get rid of its chronic “tax evasion curse”. In fact, the latter can be certainly seen, at least partially, as a consequence of the presence of an excessive tax burden. To give an example, in Italy all the people with a yearly income higher than € 75,000 are supposed to give back to the State the 43% of their profits: it is hard to think of a more powerful incentive to tax evasion, indeed. A lower tax burden could therefore motivate, for instance, a good number of “reluctant” businessmen not to deceive the Government by diverting their capitals abroad. To this end, a stricter anti-evasion legislation could also be of great help. Otherwise, the aforementioned entrepreneurs would probably keep on acting as they have done so far, since they would presumably prefer taking the risk, while waiting for the next fiscal amnesty. Moreover, given these premises, then the Italian Government would also be able to concentrate a greater effort in its struggle against the trafficking activities of crime organizations, since it would be allowed to channel more resources into targeted police investigations, which must remain, in any case, an absolute priority.

To be sure, such a radical reform of the tax system would be extremely difficult to finalize. In fact, it is worth recalling that in Italy the adoption of “progressive” taxation was decided in 1947 by the Constituent Assembly, and was then written in the new Italian Constitution, which entered into force on January 1st, 1948⁶. This could sound a bit weird, but in fact it is not weird at all, primarily in the light of an important historical reason: the Italian Constitution came into existence in the immediate aftermath of the Second World War, and, above all, of the collapse of the fascist dictatorship led by Benito Mussolini. Thus, after the referendum held on June 2nd, 1946, which officially turned Italy into a Parliamentary Republic, the drafting of a brand-new Constitution was entrusted to a Constituent Assembly which was predominantly composed of socialist and communist representatives. As a result, the emphasis on egalitarianism and social justice, which is

⁵ For reasons of clarity, it is worth explaining the difference between “tax avoidance” and “tax evasion”: the former is, at least in principle, a legal activity, since it consists in trying to pay a lower amount of taxes by making the most of some “loopholes” existing in the fiscal legislation in force; the latter, on the contrary, is completely illegal, since it consists in trying not to pay taxes at all

⁶ See also art. 53 of the Italian Constitution

typical of many left-wing politicians, unavoidably emerges from the reading of a pretty large number of articles of the 1948 Constitution.

This has important implications with regard to both the length and the procedure that a potential reform of the Italian tax system would require. In fact, for all the reasons outlined so far, shifting from “progressive” to “flat” taxation in Italy would unavoidably lead to modifying the Constitution. To this end, according to the Italian Constitution itself⁷, the new text must be adopted by both the Chambers of the Parliament by “qualified” majority, which means by two-thirds of the voting Members. Hence, it is easy to understand that, in such a procedure, the votes of the ruling coalition alone could never be enough to trespass this threshold. To tell the whole truth, there is another possibility: in fact, at least in principle, the new text could also be adopted by “absolute” majority, that means by the 50%+1 of the voting Members. Yet, in that case, according once again to the Constitution, a referendum should necessarily be called upon, in order to achieve a sort of “strengthened approval” by asking directly the citizens to decide.

Nonetheless, should such a hypothesis come true, the victory of the “Yes” front could be taken by no means for granted, especially because of the huge propagandistic effort which all the left-wing parties would allegedly produce. This is an old Italian story: every time a center-right Government envisages a possible reduction of tax burden, then all the center-left political forces start complaining that such a measure is aimed exclusively at favoring the rich at the expense of the poor. However, as far as it concerns the shift from “progressive” to “flat” taxation, the previous experiences of all the countries mentioned before can easily prove that this is absolutely not the case. In fact, with regard to the level of income inequality, according to the 2009 UNDP Human Development Report nowadays the Gini index⁸ of Italy is higher than the one of all the EU countries which have introduced a “flat” tax system⁹. Yet, in the eyes of people, propaganda is always far more appealing than a boring table filled with apparently meaningless figures.

This is the main reason why the promotion of such a radical reform of the tax system in Italy would not be straightforward at all. However, the introduction of a “flat” tax (presumably fixed at a rate between 25% and 30%) would certainly be of great help to the Italian Government, especially in the light of the current situation of Italian economy. In fact, on the one hand, as in the case of Estonia, the reduction of tax burden in percentage terms could lead to an increase of the overall tax revenue for the State in absolute terms, since it would encourage a growing number of “hesitant” evaders not to deceive the Government anymore. Thus, on the other hand, the latter could avoid wasting time and resources into long and complicated police investigations focused on the activities of SMEs, or, even worse, of single autonomous workers. As a result, the Italian Government would then have at its disposal far more effective and powerful means to undertake a targeted struggle against the illegal trafficking of crime organizations, which are nowadays by far the cleverest and most indomitable tax evaders operating on the Italian territory.

⁷ See also art. 138 of the Italian Constitution

⁸ The Gini index (also known as the Gini coefficient) is a measure of statistical dispersion, which can be applied, in theory, in any field of science that deals with distribution. With regard to income inequality, the Gini index ranges between 0 and 100: the higher its value, the higher the level of income inequality, and, subsequently, the level of inequality in the distribution of wealth within a given country

⁹ The Gini index of Italy is 36.0: it is therefore higher, for instance, than the one of Slovakia (30.0), of Estonia (34.9), of Romania (31.5), and so forth. *Source*: «The UNDP Human Development Report 2009», pag. 195-198