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The East Is Flat

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It wasn't too long ago that Albania was joked about as the last Communist holdout, a kind of Marxist museum. Not anymore. The small Balkan country is about to halve its personal income-tax rate, starting August 1, to a flat 10%. The corporate rate is also slated to drop to 10% in early 2008.

Albania's flat tax is the latest sally in an intramural tax competition fueling growth in the former Communist bloc. The trend began with Estonia in 1994 -- then-Prime Minister Mart Laar had read Milton Friedman's "Free to Choose" -- and now extends to a dozen nations. The Czech government says its move to a flat 15% tax next year is "a certainty." And Montenegro plans to reduce both income and corporate taxes to a flat 9% by 2010.

The Adriatic Institute for Public Policy, a think tank based in Croatia, has found that governments that adopt flat-tax regimes see either steady or increased revenues within the first year. Macedonia expected increased revenue when it reduced both its 15% corporate tax and its 15-18-25% progressive income tax to a flat 12% at the beginning of the year. But it got more than it bargained for. Finance minister Trajko Slaveski recently told the Economist that "lower taxes did not just yield higher revenue -- they yielded 20% more than we projected."

For Western Europeans, their neighbors' low, flat taxes are both an opportunity and a lesson. In the first quarter of this year, the euro zone -- dominated by France, Germany and Italy -- for the first time sold more goods to the 11 new Central and Eastern European EU members than to the U.S. Old Europe has these new customers in large part because New Europe is getting its fiscal policy right. Both would be richer if the West followed the East's example.