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## Trust . . . and tax rates

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Have you ever wondered why many Scandinavians apparently are willing to endure much higher taxes than most Americans? At the same time, former communist countries are adopting the "flat tax" with low maximum tax rates for individuals.

Russia and Ukraine now have maximum individual tax rates of 13 percent, and Slovakia is considering the adoption of a flat tax with a 19 percent rate. One's perception of how wisely the government is likely to spend the taxpayers' money can, in part, explain why voters in Denmark, Finland, Norway and Sweden are willing to accept maximum individual tax rates of more than 50 percent, while Russians prefer a 13 percent maximum.

During the last 15 years, I have spent considerable time in the former communist countries as an adviser on economic transition, and some time in Scandinavia. Scandinavians are often puzzled by why Americans tend to be more hostile to government than they are.

Part of the answer is that Scandinavians often get more for their tax dollars than Americans do. There tends to be a high level of honesty and social cohesion in Scandinavian societies. Most of them are (nonpracticing) Lutherans. As a result of relatively small populations with a high level of homogeneity and education, society operates more like a club or an affiliation group.

Government employees who are discourteous or lazy are more likely to meet with social disapproval in Scandinavian countries than in the U.S. or other large and more heterogeneous countries. In the U.S., there is a contrast in the attitude and willingness of most local government employees in small towns to help and the attitudes of many government employees in large cities or parts of the federal work force.

The former Soviet Union was an extremely low-trust society. Centuries before the communists took over, the citizens of Russia and Ukraine most often were the victims of their governments, hence over time people learned not to trust other people who were not family members or longtime known associates.

The communists claimed to provide every conceivable government service, but, in reality, service standards were abysmally low, and government was correctly perceived to be the ultimate exploiter. Immediately after the fall of communism, most of the new noncommunist governments tried to put in high, European-type tax systems, despite the advice of some of us who recommended low, flat taxes.

The high-rate tax systems failed to produce much revenue. The new 13 percent Russian flat tax has been in effect for two years, and government revenue from individual income taxes has more than doubled, even though the maximum tax rate has fallen by two-thirds. The Russian economists made a correct calculation on human behavior — it is costlier for people to hide their income, hire protection, pay bribes, etc., than to pay a low flat-rate tax and have a peaceful sleep at night. Furthermore, the perception of what people get from government vs. what they pay is now closer to reality.

Russia and the other former communist countries also had the advantage of seeing that the flat tax in Hong Kong (15 percent) worked extremely well, and provided the necessary revenues for needed government expenditures. The new generation of Russian economic policymakers is well read in the economic literature and familiar with the flat-tax proposal developed by Professors Robert Hall and Alvin Rabuska of Stanford University, as well as knowledgeable of the problems with the existing, highly progressive Western tax-rate systems.

In the early '90s, I was on the board of a Russian-American joint-venture company. We were doing business in Moscow and had become slightly profitable after our first year. While going through the financial statements, the American directors noticed no provision had been made to pay any taxes to the Russian government.

When I asked about this, I was told by our Russian directors that "only fools pay taxes." I explained that some taxes were necessary for civil society, and the rest of the American directors (all advocates of low tax rates) also insisted on paying any taxes owed. Our Russian partners were still thinking government only did things to them, not for them. The current Russian economic team understands it needs to build trust with the people by making sure the provision of government services is in line with the tax burden.

France suffers the highest in the world "Tax Misery Index" according to Forbes magazine. Government service delivery in France, and much of the rest of "old Europe," is not perceived to be worth the costs, hence France is suffering from high rates of corruption, tax evasion and capital flight.

Even in Scandinavia, increasing numbers of people no longer believe they are getting government benefits equal to the costs, hence there is a tax revolt brewing in several of the countries, notably Sweden. The trust is breaking down.

When given a choice, people tend to move to areas where they think the tax burden is reasonable given the benefits they receive. Parents want to have good schools for their children; drivers want to have good roads, etc. High-tax jurisdictions (whether they be

countries or localities), particularly ones that fail to deliver good value for the tax dollar, most often see a flight of both people (when given a choice) and capital.

People and their money move to places where they are treated well by government. Why is money moving from California and New York to Texas and Florida? Why is money moving from "old Europe" to Switzerland and the U.S.? The answer is trust and tax rates.

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