Roadmaps
A Guide for Intellectual Entrepreneurs

How IME Achieved a Flat Tax for Bulgaria

Svetla Kostadinova
Executive Director
Institute for Market Economics
How IME Achieved the Flat Tax in Bulgaria

By Svetla Kostadinova

This piece shares the steps and strategies used by the Institute for Market Economics (IME) from 2003-2007, to achieve massive tax reform in Bulgaria. The goal is to provide a guide so that other think tanks can follow IME’s footsteps, and achieve similar results. The lessons learned in this article can be applied to virtually any project taken on by a think tank.

Since its establishment in 1993, the Institute for Market Economics played a vital role in achieving institutional change in Bulgaria—a post-communist country that needed vast, quick, and targeted reforms. From pension reform to the business environment to judicial reform, legislators needed to rebuild the law according to new principles. Unfortunately, during the first years after the fall of the communist regime (1991-1997), the government did not implement any major reforms. Even the severe 1996 bank crisis resulted in laws that were only basic preconditions for reform. From 1997 – 2001, the post-communist government finally began to implement economic and social reforms such as stabilizing the financial system with a new currency board regime. Additionally, the government established much needed widespread privatization efforts and initiated the negotiation process for European Union (EU) accession.

This willingness to embark on meaningful reforms encouraged IME to establish the low tax campaign as a major priority for 2003. While the entire IME team supported his efforts, this project was initiated by economist Mr. Georgi Angelov.

The first step was to define the goals of the low tax reform.

**Step 1: Establish specific, easy to understand goals.**

IME’s goals:
1. Introduce a single marginal rate of 10% for the personal income tax;
2. Reduce the profit tax to 10%;
3. Reduce the social security contribution to 10% (through major pension reform entailing the introduction of private pension accounts).

IME called these three steps the “10-10-10” campaign.

Here is a comparison of IME’s bold propositions to the tax rates that existed at the time:

<table>
<thead>
<tr>
<th></th>
<th>Applicable rates in 2003 in Bulgaria</th>
<th>IME Flat tax reform proposals in 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit Tax</td>
<td>23.5%</td>
<td>10%</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>15%-29%</td>
<td>10%</td>
</tr>
<tr>
<td>(several brackets)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social security</td>
<td>42.7%</td>
<td>10%</td>
</tr>
<tr>
<td>contributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(pension, health,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>unemployment,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>maternity, other)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For some, the proposals were provocative— for others, an unthinkable challenge. For the IME team, however, the 10-10-10 campaign was the only way for Bulgaria to achieve higher economic growth while also limiting state redistributions, which were approaching 40% of GDP.

With solid arguments, a team, and a catchy name established, we began our campaign.
**2003**

**Activities:**

**Alternative Budget with Low Taxes for State Budget for 2004 (October 2003)**

In October, IME presented its Alternative State Budget with Low Taxes. This plan showed an alternative government policy that would accelerate the rates of economic development and increase the welfare of Bulgarian citizens. The policy called for an alternative budget because of the tax and security contribution cuts we presented.

**IME Open Letter to the Prime Minister and Minister of Finance (October 2003)**

IME wrote an open letter to the prime-minister, the deputy prime-minister, the minister of economy, and the newly elected director of the Bulgarian National Bank. Through the letter, we hoped to provoke reflection on some long-term aspects of the taxes currently enforced with the current budget and financial (monetary and fiscal) policy. Many leading Bulgarian economists supported the letter. The letter was public and anyone was able to sign it via e-mail. This allowed us to identify supporters of the campaign with whom we would contact later.

The letter was reprinted in major newspapers generating additional responses from the public. Eventually, the Minister of Finance publicly agreed with the idea of tax reduction in general, but not with IME’s reduction scale. Regardless of his skepticism about IME’s large proposed cuts, the Minister’s acknowledgement of the potential for tax reform was encouraging.

**Press-conference (November 2003)**

A press-conference was held to present our evaluation of the possibilities and our recommendations for reducing taxes in Bulgaria. This was the first time that the Bulgarian people truly saw the real burden of the current tax rate and the wider income effects of lower taxes.

**Impact:**

By the end of 2003, legislators implemented the following tax reductions to take effect in 2004:

- Reduction of the profit tax from 23.5% to 19.5%.
- Reduction of the lowest marginal rate of income tax from 15% to 12%.

These marginal reductions signaled to our team that broader reforms were possible, and encouraged us to keep up the fight.

**2004**

**Activities:**

**Open letter from 100 economists and intellectuals to the Minister of Finance and the Prime Minister (March 2004)**

Through IME, more than 100 economists, analysts, researchers, finance experts, and intellectuals sent an open letter asserting that the introduction of a single marginal
rate of 10% for all direct taxes: income, profit, and social security contributions, was vitally necessary.

The Minister of Finance answered the open letter with partial support. The letter, the answer from the finance minister, and the response from other political figures and administrators began a national conversation. Articles, opinion pieces and alternative recommendations were offered to build public support.

Press-conference on why direct taxes should be reduced (August 2004)

Representatives of IME and of the Center for Liberal Strategies held a press conference that provoked a powerful response, especially in the media. Two organizations-- the Department of Finance and a private economic institute-- tried to disprove our arguments and tried to organize a conference against the proposed changes, but later gave up.


IME began publishing, “Bulletin for low taxes: Flat tax”. (Bulletins are still published to this day). The bulletin was started by Mr. Georgi Vassilev, a banker in Geneva and the founder of a prize for innovative Bulgarian thinkers.

In addition to email distribution, the bulletin was sent by post to all members of Parliament, as well as to major political parties, media, business organizations, trade unions, ministries, state agencies, universities, and non-governmental organizations. At that time, there were not many publications on current issues so the bulletin was very popular.

Tax calculator for the current tax burden vs. the 10% flat tax proposal

We prepared a tax calculator that showed how the tax rate suggestions of leading political parties could impact an individual’s income. This enabled citizens to compare proposed alternative policies to our 10% flat tax rate suggestion and judge which policy would be in their best interest.

Impact:

By the end of 2004, legislators implemented the following tax reductions for 2005:

- Reduction of profit tax from 19.5% to 15%.
- Reduction of the highest marginal rate of income tax from 29% to 24%.

2005

Activities:

An Open Letter for reduction of taxes signed by IME and 10 other non-governmental organizations (April 2005)

Together with 10 other non-governmental organizations, IME published an Open Letter for the Reduction of Taxes which once again received wide media coverage and support. The number of people and organizations who signed it consistently grew.

Political Activity (June 2005)

During the parliamentary elections in 2005, three IME economists ran for Parliament and became leaders in the pre-election campaign by their presence in the press, electronic media, radio, and television. As candidates, they were able to change the rhetoric of pre-election disputes.
One of the three IME MP candidates, Mr. Martin Dimitrov, was elected and later, he became the deputy chairperson of the Budget and Finance Committee in Parliament. Bulgarian society owes significant credit for the improved tax environment during this year to Mr. Dimitrov. He continued to advocate for low taxes while in Parliament thereafter.

Alternative Budget with Low Taxes for State Budget for 2006 (November 2005)

For a third successive year, IME prepared an alternative budget. This time, we made the case that the reduction of taxes was achievable within a relatively short period of time.

“Bulletin for low taxes: Flat tax”

In 2005, IME put forth six publications with a special focus on the effects of the 10% proposal on the public, businesses, and the national budget.

Impact:

By 2005, IME observed the following reforms that would take effect in 2006:

- Reduction of security contributions from 42.2% to 36.2%.

2006

Using both old and new tactics, IME continued the debate over tax reduction policy in 2006. The following is a list of IME’s efforts in 2006:

Activities:

- International conference in Sofia on “Economics, capitalism and happiness” (November 2006)
- Alternative Budget with Low Taxes for 2007 State Budget (November 2006)
- “Bulletin for low taxes: Flat tax”

Impact:

By 2006, IME observed the following tax policy reforms:

- Reduction of profit tax from 15% to 10%.

2007

In January of 2007, the IME achieved the first goal of their “10-10-10” campaign with the introduction of a 10% flat tax on profits.

This achievement was a much needed outcome not only for the Bulgarian people, but for the IME team specifically. This victory inspired the team to push forward on the additional goals of the campaign.

The following is a summary of the tools we used in 2007 to continue the tax reform effort:
Activities:

- “Bulletin for low taxes: Flat tax”
- Alternative Budget with Low Taxes for 2008 State Budget
- Press conference organized by IME and other economists on “Why the government should reduce social security” (June 2007)
- More than 200 articles published on the topic
- A public discussion organized in Sofia with Mr. Simeon Djankov (with the World Bank Doing Business team at the time) (October 2007)
- A public discussion organized in Sofia with Mr. Mart Laar (former Estonian president) (October 2007)
- Numerous media appearances by IME economists.
- A special website dedicated to Economic Freedom in Bulgaria promoting low taxes
- More than 25 visits and reasoned arguments presented at Tax and Budget Parliamentary Committee hearings

Impact:
IME observed the following changes in 2007 that would take effect in 2008:

- Abolishment of the progressive income tax and introduction of the 10% flat income tax.
- Reduction of security contributions from 36.2% to 33.2%.

2008

By January 2008, the second goal of the campaign was achieved with the introduction of the 10% flat tax on personal income.

The next step was for the IME team to focus on the last goal: a reduction to 10% social security contributions and an overall transition of the pension system to private pension accounts.

We focused our efforts on pension reform explicitly for the following two years and used these tools to work toward our last goal:

Activities:

- Jose Pinera visited Sofia (Chilean pension reformer.) (October 2008)
- Press-conference on Chile’s experience in pension reform (October 2008)
- Press-conference on “The effect of the raised social insurance thresholds on business, citizens, and the state” (March 2009)
- More than 60 pension focused articles published in national newspapers
- More than 100 media appearances from IME on to future pension reform
- Participation in informal discussions with government officials
- Alternative state budget proposals with low taxes (November 2008 and 2009)
• Pension calculator (June 2009)
• A specific column on pension facts of the current pay-as-you-go system in the most renowned daily newspaper (2009, 2010)
• Assessment of the basic political parties’ pre-election programs in regard to pension reform plans (2009)
• Establishment of Independent Pension Council (2010)

Impact:
Between 2008-2010:

• Reduction of security contributions from 33.2% to 29.2%.

The overall results of IME’s 10-10-10 campaign

Of course, these changes were not the result of IME efforts alone. Indeed, there were other developments that IME did not control but that still contributed greatly to the success of the campaign.

Svetla Kostadinova became the executive director of the Institute for Market Economics in 2007, succeeding the founder, Krassen Stanchev. She joined the institute in 2001 and served as Senior Economist since 2004. Svetla has a master’s degree in Finance from the University of National and World Economy in Sofia, Bulgaria.

Lessons Learned

Though our strategy was not specifically clear at the outset, the “10-10-10” campaign did indeed achieve its goals. Additionally it inspired hundreds of avid supporters who continue to advocate for further reforms today.

Below is a comprehensive list of IME’s successful strategies:

- Regular efforts that became our trade mark;
- Specific, tailored, arguments for each interest group – for working people, pensioners, young people, politicians, media, etc.
- Very specific goals that were easy to understand, to accept and to promote;
- Easy to understand statements/appeals that attracted supporters and called for specific changes;
- Repetition: we included the flat tax proposal in every article, media appearance, and official statement from IME. After some time, the people accepted the flat tax idea as something natural and logical for Bulgarian policy;
- Involvement of familiar public figures in the campaign in order to reach different demographic groups;
- Straightforward communication of information since most of the public would not want to exert much effort in order to learn facts about the issue;
- Educated journalists on the topic in order to have allies among media outlets;
- Memorization of several simple, easily understood phrases for all IME team members to use when discussing the topic, regardless of the team member’s expertise;
- Investigation and presentation of facts and figures from other countries that show the positive effects of the policy for which we advocated;
- Open seminars and students’ contests on the issue in order to educate the public;
- Communication of concise information to members of Parliament four times every year.