



# The New Assault on Tax Competition and Threats to Switzerland

Institut Libéral  
April 29, 2013



## *What Do Opponents Want?*

- ⊕ More money, of course.
- ⊕ Anti-tax competition advocates also believe in a theory called “capital export neutrality.”
- ⊕ Basic premise is that taxpayers should not be able to lower their tax rates by shifting economic activity across borders.
- ⊕ Tax evasion and tax avoidance are equally bad.



## *More on Capital Export Neutrality*

- ✦ CEN is better for economic performance, statisticians argue, since taxpayers can only make choices on the basis of pre-tax rates of return when all tax rates are the same.
- ✦ In other words, tax harmonization.
- ✦ This is the view of the OECD, the European Commission, and almost all Treasury Departments and Finance Ministries.



## *Why CEN Is Wrong*

- ❖ In the world of blackboard theory (and in law schools), CEN makes sense.
- ❖ And it conveniently is in the interests of the political class.
- ❖ In the real world, the theory has three fatal flaws.
  - ❖ It assumes that tax rates are exogenous.
  - ❖ It assumes that economic activity is fixed.
  - ❖ It overlooks “public choice” theory.



## *What Is the Status of the Fight?*

- ❖ Sadly, high-tax nations are winning and choking off tax competition.
- ❖ All jurisdictions now agree, at least in theory, that there is an obligation to enforce the bad tax laws of high-tax nations.
- ❖ Jurisdictions now need a minimum number of TIEAs to avoid persecution.
- ❖ There is a “peer-review” process at the OECD dominated by high-tax nations.



## *The Next Steps*

- ⊕ Remember, tax evasion and tax avoidance are equally bad according to CEN theory.
- ⊕ This coincides with the desire of politicians to extract more money from the productive sector of the economy.
- ⊕ Always-moving goal posts.
- ⊕ Today's demands pave the way for future demands.



## *Prepare for More Demands*

- ✦ Breaking down financial privacy and imposing TIEAs is just the beginning.
- ✦ The goal is to curtail – and then eliminate – all tax planning.
- ✦ The state has first claim on economic output.
- ✦ A three-prong threat – unilateral (such as FATCA), bilateral (TIEAs), and multilateral (OECD, EU STD, etc).



## *The Attack on Financial Privacy*

- ⊕ High-tax nations will not stop until there is automatic information sharing for all income and assets.
- ⊕ Sort of a global version of FATCA, or the EU savings tax directive on steroids.
- ⊕ Much more pervasive and sweeping double taxation of income that is saved and invested.
- ⊕ Even for non-democratic governments.





## *The Attack on Multinational Firms*

- ❖ The OECD's new "base erosion and profit shifting" project is based on the premise that legal tax planning is illegitimate.
- ❖ A report has been issued, to be followed by recommendations to the G-20.
- ❖ All signs point to global formula apportionment, probably based on sales.
- ❖ That will greatly undermine Swiss competitiveness.



## *The Tragic Implications*

- ✦ Bigger government and less individual liberty.
- ✦ If the statisticians succeed, several bad things will happen.
  - ✦ Tax rates will increase
  - ✦ Governments will postpone needed fiscal reforms
  - ✦ Fiscal crisis will be more likely
  - ✦ Human rights will be eroded
  - ✦ Economic growth will slow even further



*Appeasement Doesn't Work:  
Don't Feed an Alligator*





*He'll Want Another Meal  
Tomorrow...and Bring a Friend*





## *But What if the Alligator is Big?*

- ❖ This is the challenge for Switzerland.
- ❖ Is it possible to fight all the big nations when they want a tax cartel – sort of an OPEC for politicians?
- ❖ Yet does it make sense to acquiesce when any capitulation becomes the starting point for a new set of demands?
- ❖ The American political environment will change, but not for 3-plus years.



## *Obama's Sloppy Approach*



- ✪ Obama said that more than 12,000 companies are registered at Uglend House, making it “either the biggest building in the world or biggest tax scam in the world.”
- ✪ He doesn't understand business and economics.



# *Cayman Islands vs. Delaware*





## *The Onshore Fiscal Problem*

- ⊕ Politicians claim more revenues are the solution to red ink.
- ⊕ But the problem is bigger government. Deficits are just a symptom of that problem.
- ⊕ Higher taxes simply facilitate a larger public sector and undermine growth.
- ⊕ This accelerates the fiscal crisis and makes it worse.





## *George Stigler and Gary Becker*

- ✪ Stigler: "Competition among communities offers not obstacles but opportunities to various communities to choose the type and scale of government functions they wish."
- ✪ Gary Becker: "...competition among nations tends to produce a race to the top rather than to the bottom by limiting the ability of powerful and voracious groups and politicians in each nation to impose their will at the expense of the interests of the vast majority of their populations."



## *James Buchanan and Milton Friedman*

- ✦ James Buchanan: "...tax competition among separate units...is an objective to be sought in its own right."
- ✦ Milton Friedman: "Competition among national governments in the public services they provide and in the taxes they impose is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices at which they offer them."



## *Vernon Smith*

- ✦ “[Tax competition] is a very good thing. ...Competition in all forms of government policy is important. That is really the great strength of globalization ...tending to force change on the part of the countries that have higher tax and also regulatory and other policies than some of the more innovative countries. ...The way to get revenue is doing all you can to encourage growth and wealth creation and then that gives you more income to tax at the lower rate down the road.”



## *Edward Prescott*

- ✪ “With apologies to Adam Smith, it’s fair to say that politicians of like mind seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise taxes. This is why international bureaucracies should not be allowed to create tax cartels, which benefit governments at the expense of the people.”



## *Edmund Phelps*

- ❁ “[I]t’s kind of a shame that there seems to be developing a kind of tendency for Western Europe to envelope Eastern Europe and require of Eastern Europe that they adopt the same economic institutions and regulations and everything. ...We want to have some role models... If all these countries to the East are brought in and homogenized with the Western European members then that opportunity will be lost.



## *Douglas North and Friedrich Hayek*

- ❖ North: "...international competition provided a powerful incentive for other countries to adapt their institutional structures to provide equal incentives for economic growth and the spread of the 'industrial revolution.'"
- ❖ Hayek: "...while it has always been characteristic of those favouring an increase in governmental powers to support maximum concentration of powers, those mainly concerned with individual liberty have generally advocated decentralisation."



## *What Does Adam Smith Say?*

- ✦ An inquisition into every man's private circumstances, and an inquisition which, in order to accommodate the tax to them, watched over all the fluctuations of his fortunes, would be a source of such continual and endless vexation as no people could support.... The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could...



## *Adam Smith...Continued*

- ✦ ...either carry on his business, or enjoy his fortune more at his ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he left. Stock cultivates land; stock employs labour. A tax which tended to drive away stock from any particular country would so far tend to dry up every source of revenue both to the sovereign and to the society. Not only the profits of stock, but the rent of land and the wages of labour would necessarily be more or less diminished by its removal. —Adam Smith, *An Inquiry into the Nature & Causes of the Wealth of Nations*, 1776.





## *Even OECD Economists Admit...*

- ❖ OECD economists have written that “the ability to choose the location of economic activity offsets shortcomings in government budgeting processes, limiting a tendency to spend and tax excessively.”
- ❖ OECD economists note that “legal tax avoidance can be reduced by closing loopholes and illegal tax evasion can be contained by better enforcement of tax codes. But the root of the problem appears in many cases to be high tax rates.”



## *Conclusion*

- ✦ The overall tax environment is going to become more challenging because of political pressure to finance bigger government.
- ✦ The CEN ideology means that it may just be a matter of time before nations with better tax policy are coerced into adopting bad law.
- ✦ Protecting tax competition – and so-called tax havens – is the only way to stop bad developments.



## *For More Information...*

- ✦ Website: [www.cato.org](http://www.cato.org)
- ✦ Policy videos:  
[www.youtube.com/afq2007](http://www.youtube.com/afq2007)
- ✦ Twitter: [@danieljmitchell](https://twitter.com/danieljmitchell)
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