The Misguided Attack Against Tax Competition, Financial Privacy, and Fiscal Sovereignty

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International Bureaucracies Seek to Undermine Tax Competition

- OECD's "harmful tax competition" proposal, as well as "corporate governance" and "flags-of-convenience" campaigns.
- EU's numerous tax harmonization proposals such as the savings tax directive and corporate tax base/rate.
- UN's proposed International Tax Organization, augmented by global tax schemes.
- IOSCO and FATF

Specific Threats to Switzerland

- An expanded savings tax directive, affecting a greater range of saving/investment vehicles?
- EU attack against canton tax regimes.
- A rejuvenated OECD anti-tax competition campaign, particularly if Democrats capture the White House?
- Other nations copying America's oppressive worldwide tax regime?
- Anti-tax haven legislation in the US, such as the Levin/Obama proposal?

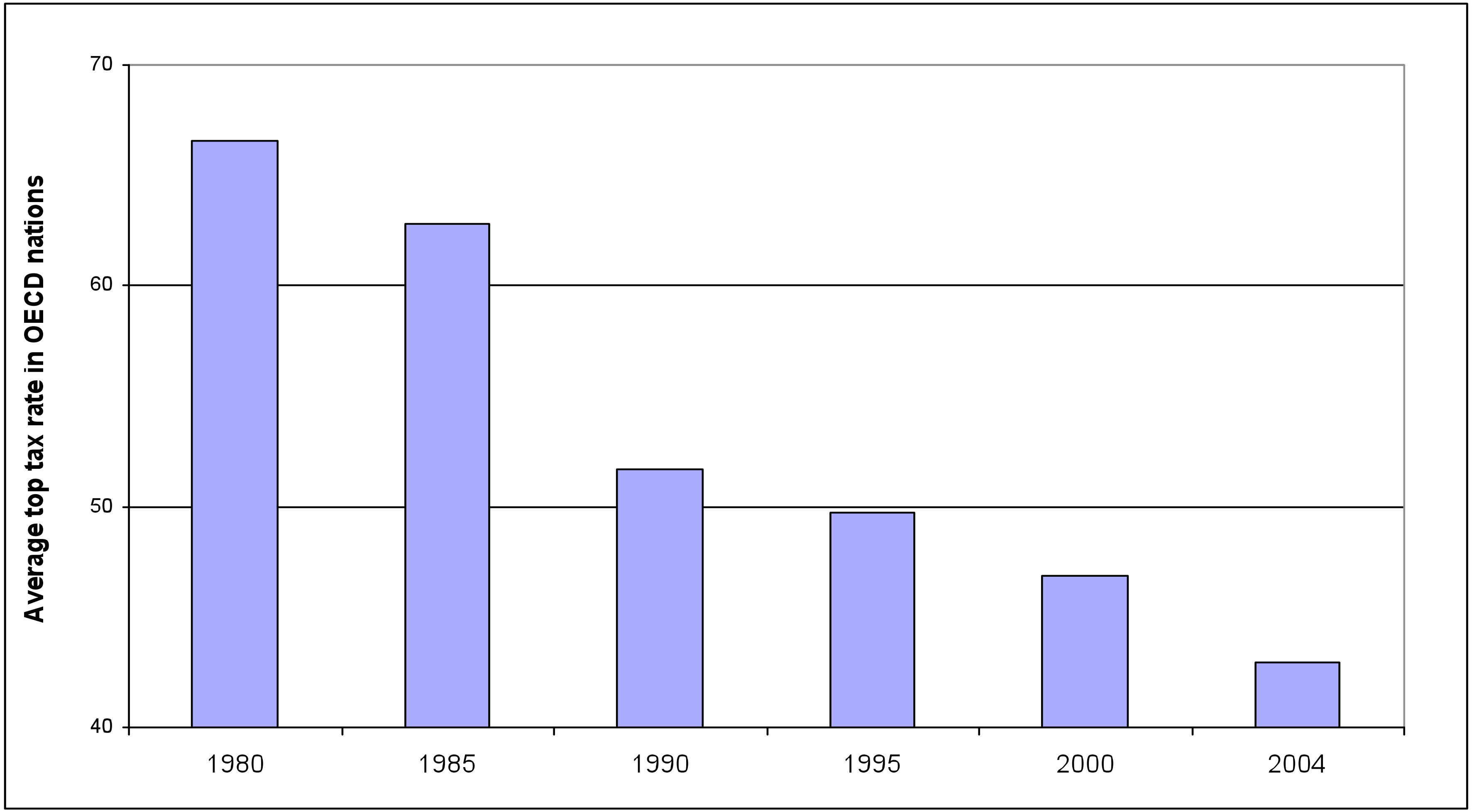
Why Does this Battle Exist?

- Tax competition is a big issue because globalization has reduced barriers to cross-border transactions and this has facilitated the flow of jobs and capital from high-tax jurisdictions to low-tax jurisdictions.
- Tax competition has forced dramatic tax rate reductions and tax reforms.
- High-tax nations are trying to thwart these developments by using international bureaucracies to persecute low-tax jurisdictions.

Tax Competition Promotes Good Policy

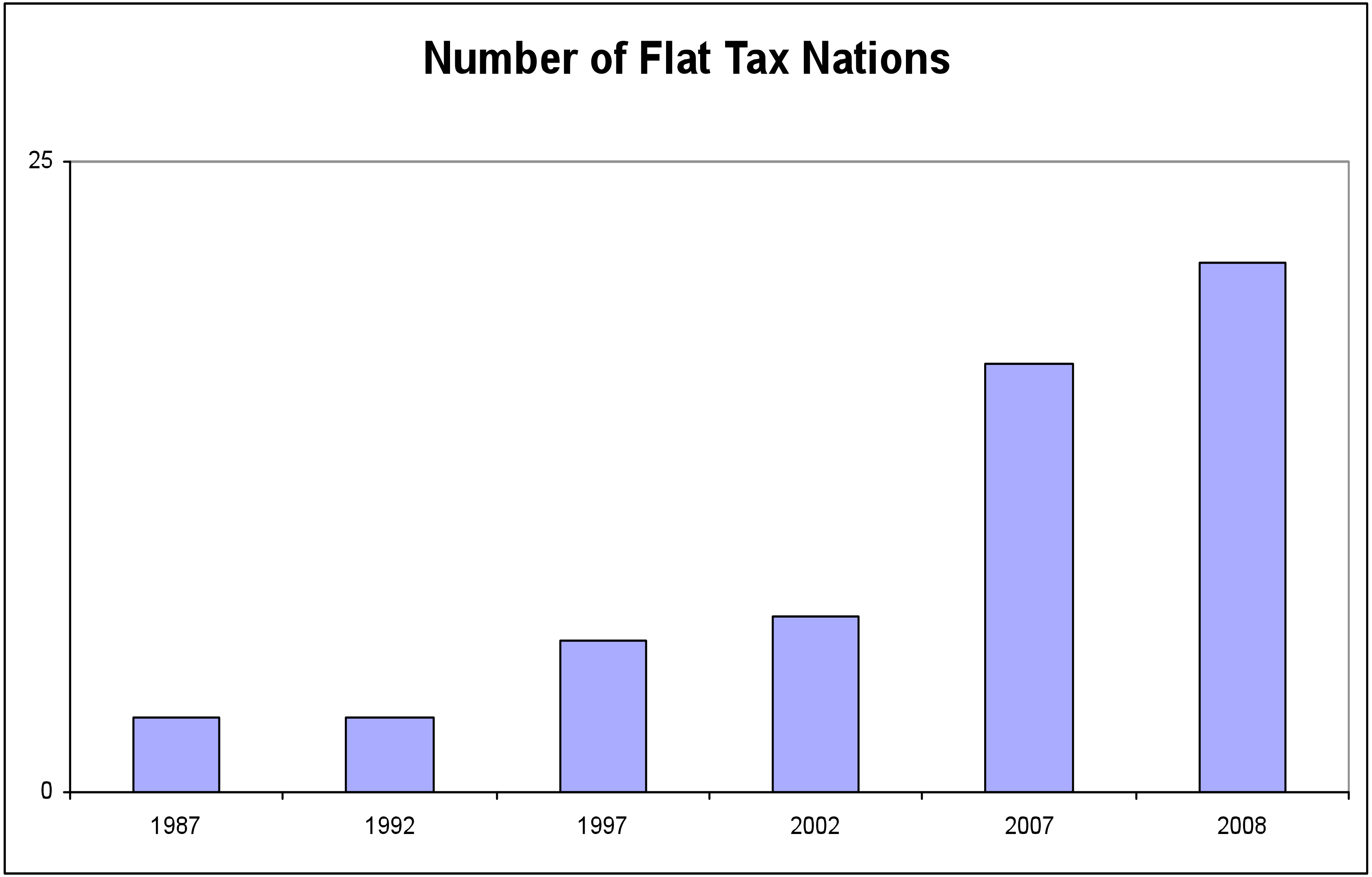
- Thatcher/Reagan personal tax rate reductions rejuvenated the U.K. and U.S. economies, and also led to a 25 percentage point reduction in top tax rates in developed nations.
- Irish corporate income tax rate reductions created the "Celtic Tiger," and also led to a wave of lower corporate tax rates across Europe.
- A flat tax in Estonia has led to an economic renaissance – and also triggered flat tax regimes in many other nations.

Average OECD Top Tax Rates



Falling Corporate Tax Rates

- Average corporate tax rate in 1980 = 48 percent.
- Average corporate tax rate in 1990 = 42 percent.
- Average corporate tax rate in 2000 = 34 percent.
- Average corporate tax rate today = 28 percent.
- America is now an outlier on corporate tax.



Number of Flat Tax Nations
25
0
1987
1992
1997
2002
2007
2008

Flat Tax Jurisdictions	Year	Tax Rate
Jersey	1940	20 percent
Hong Kong	1947	16 percent
Guernsey	1960	20 percent
Estonia	1994	22 percent
Latvia	1995	25 percent
Lithuania	1996	27 percent
Russia	2001	13 percent
Serbia	2003	14 percent
Slovakia	2004	19 percent
Ukraine	2004	15 percent
Iraq	2004	15 percent
Romania	2005	16 percent
Georgia	2005	12 percent
Pridnestrovie	2006	10 percent
Iceland	2007	35.7 percent
Mongolia	2007	10 percent
Kyrgyzstan	2007	10 percent
Macedonia	2007	12 percent
Montenegro	2007	15 percent
Albania	2007	10 percent
Czech Republic	2008	15 percent
Bulgaria	2008	10 percent
Mauritius	2009	15 percent

Nobel Laureates: Gary Becker

- The world's leading economists strongly favor tax competition.
- 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."

Buchanan and 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.

OECD Anti-Tax Competition Project

- The OECD "harmful tax competition" project has been wounded, but it is not dead.
- Most low-tax jurisdictions have sent "commitment letters" to the OECD, but they are not binding since they require all nations to participate.
- This "level-playing field" theme has been quite successful since it is difficult for the bureaucrats in Paris to argue that non-OECD jurisdictions should emasculate their policies if OECD nations are not willing to do likewise.

Dissension in the Ranks

- 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."

The Savings Tax Directive: Part II

- The European Union savings tax directive was finally implemented, though filled with loopholes because of US non-participation and Swiss resistance.
- The EU already has announced that it wants to expand the scope of the savings tax directive – and bring more jurisdictions into the cartel.
- If successful, an expanded savings tax directive might satisfy the "level playing field" clause in OECD "commitment letters."

The Threat of Bad U.S. Legislation

- Senator Dorgan's bill (S. 396) would boost taxes on American companies operating in low-tax jurisdictions by eliminating deferral.
- Senator Levin's bill (S. 681) creates a wide range of discriminatory penalties for operating in low-tax jurisdictions.
- Both bills create blacklists and create authority to add new jurisdictions to the list.
- If these bills are predicted to generate money, they will be a very serious threat.

Reasons for Optimism

- The terms of the debate have improved. Tax competition is widely seen as a positive force. Even the OECD has changed its rhetoric.
- The moral argument – that so-called tax havens provide refuge for victims of oppression – is powerful to journalists.
- Likewise, the media sympathizes with the role of low-tax jurisdictions as a way for people to guard against crime and corruption.
- More governments now have a self-interest in preserving tax competition.

Reasons for Pessimism

- Democrat control of Congress increases risk of bad legislation – loss of deferral, Section 911, anti-inversion laws, etc.
- A Democrat in the White House almost certainly would result in the United States siding with high-tax nations, as happened during the Clinton years.
- Demographic pressures in OECD nations will lead politicians to be more aggressive in their search for more tax revenue to redistribute.

Conclusion

- In 2000, the international bureaucracies appeared unstoppable.
- After Bush's election, tax harmonization efforts were thwarted and tax competition flourished.
- The 2006 elections resuscitated the OECD and the 2008 elections could further strengthen anti-tax competition forces
- Anti-tax competition legislation in Congress is a harbinger.
- Switzerland needs to be engaged.

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.