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Constructive revenge

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So, you are mad at the French and have decided not to eat Brie or drink French wine. Or perhaps you want to get real tough with them and put higher tariffs or quotas on French products. The first solution is not likely to have much impact, and the second might get us in a trade war that will hurt us as much as it will them.

Don't despair. There is revenge we can take for their behavior, which will provide considerable benefit to us, and also hurt the high-handed French bureaucrats. The solution is to make a few changes in our tax laws that will encourage even more investment capital to flow out of France into the United States.

By way of background, over the last couple of decades a few hundred billion dollars from the citizens of "Old Europe" (primarily France and Germany) have been invested into the U.S. The reason for this capital flight from Europe is that their tax rates and regulations have been much more punitive than ours. This capital flow into the U.S. has enabled our businesses to invest more in new plant and equipment, resulting in faster productivity growth, more new and higher-paying jobs, and much higher rates of economic growth than Europe.

We have managed to attract this foreign capital, even though the Europeans engage in tax discrimination against our companies, by doing such things as rebating value added taxes (VATs) on the exports of their domestic companies. However, the U.S. does have one stipulation in its tax law that has proved very beneficial. In 1984, Congress enacted the portfolio interest exemption, which has allowed non-resident foreigners to receive interest from bank deposits and bonds, without incurring any U.S. tax liability. It is believed this provision has caused something in the order of an additional one trillion dollars to be invested in the U.S.

President Bush's recently proposed tax reduction and reform includes a specification to eliminate the double taxation of dividends by giving taxpayers exclusion for dividends received from American companies. This provision should be strengthened by also removing the existing withholding tax on dividends owed to foreigners.

By making it unambiguously clear that the dividend exclusion also applies to foreign holders of U.S. stocks, hundreds of billions of dollars of additional foreign capital will flow into our markets. This would significantly boost U.S. stock prices plus give our citizens all the benefits of the resulting higher growth, as noted above.

It is important to understand that, unlike the U.S. which taxes the worldwide income of its citizens, most countries have a territorial system of taxation that only taxes income made within the country or when foreign income is repatriated. Thus, so long as earnings from dividends, interest and capital gains remain outside these countries there is no tax liability.

The Europeans, and particularly the French and Germans, have been claiming that countries that do not tax foreign interest, capital gains, and dividend earnings are engaging in unfair tax competition. They have demanded that low-tax countries raise tax rates, withhold taxes on the earnings of their citizens, send the withheld sums to these bloated European governments and/or report the earnings of their citizens to the home country. These extraterritorial demands by the Europeans on other sovereign countries to engage in economic policies that are destructive are the Europeans last, desperate attempts to prop up their failed socialist economies.

By eliminating tax withholding on foreigners and blanket financial information-sharing, the U.S. would not only be doing its own citizens a favor but one to all the world's people. These beneficial changes would increase tax competition, civil liberties and economic growth, and deny financial information to criminal and terrorist groups.

While most of the economists and other officials in the U.S. Treasury are actively designing and selling pro-growth economic and tax policies, there is a small, retrograde group that is trying to move our policy in the opposite direction.

At the very end of the Clinton administration, this group of Treasury bureaucrats proposed an "interest reporting regulation" that would require those in the U.S. who pay interest to foreign persons to report it to their governments, even though no U.S. tax liability is due.

The regulation was proposed at the request of the European Union, led by France and Germany. It would hurt the United States by driving out foreign capital and increasing costs on our businesses. It would put the civil liberties of those reported on at risk by having such information passed to corrupt governments or those with a history of leaking information to dishonest individuals and governments, including terrorists states.

Every group that has testified or submitted comments on the proposed regulation has strongly opposed it (including public policy, banking, industry, small business and civil liberties organizations). In addition, dozens of members of Congress have written in opposition to this proposal, both because it is bad economic and regulatory policy, and also because it clearly is an attempt to undermine the will of Congress.

Given the depth and breath of opposition and evidence against this dreadful proposal, one can only surmise that those bureaucrats still pushing it do so out of arrogance, ignorance, naivete or disloyalty to the U.S. — but I understate. Some of these Treasury bureaucrats even had the gall to claim we could trust the French with sensitive information despite their long history of leaks to groups and countries hostile to the U.S.

The new Treasury secretary could give the French and Germans the diplomatic equivalent of a chiffon pie in the face by withdrawing the "interest reporting regulation" in a very public way. He would say, "We welcome and will protect your capital until that day when your own governments finally return to responsible economic policies" — constructive revenge, indeed.

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