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A CURE WORSE THAN THE DISEASE

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Governments are well known for misdiagnosing problems, finding problems where none exist and then developing solutions to these "problems," which end up causing real problems. However, rarely does this search for the non-problem become a global hysteria that entices many countries down a destructive path.

The problem the global political class has identified is "tax avoidance and evasion" – which is much more a symptom of government fiscal mismanagement. Nevertheless, many politicos and their media allies are ready to burn at the stake those who believe that economic growth, liberty and privacy are higher values than tax collection. Like religious fanatics, the tax increasers ignore evidence, logic and reason. And many seem to be more interested in punishing their fellow citizens than actually collecting tax revenue.

Most of the world's governments do have a real problem, and that is they have promised their citizens more than can be delivered, particularly in the realm of medical and income entitlements and guarantees. Economists working for the Bank for International Settlements1 (BIS) in Basel, Switzerland looked at the fiscal trajectories that all of the major countries are on. They conclude that without major policy changes most countries are headed toward a Greek-style fiscal insolvency or worse.

The problem quite simply is that because of the promises made in past years, most governments are now at the point, or soon will be, where increases in government spending are outrunning economic growth – which equally applies to the world's biggest economy, the US, and one of the smallest, the Cayman Islands. Politicians, desperate for more tax revenue, have focused on evil tax avoiders and evaders as the scapegoats

– ignoring the fact that no increase in tax rates can solve a problem where government spending is growing faster than GDP.

The Organisation for Economic Cooperation and Development – a club of the thirty richest nations – has become the lead horse for stopping tax evasion and avoidance.

After years of trying to obtain full global tax information sharing with little success, the "club" is now succeeding in large part because of the global recession's negative effect on tax revenues. The OECD has just released a new report updating its efforts, Promoting Transparency and Exchange of Information for Tax Purposes2. The first three sentences of the report make totally unsubstantiated claims about the amount of tax avoidance and evasion. In the US case, it claims the "revenue losses amount to 100 billion dollars a year". This number came from a well-known, left-leaning consultant to a Senate committee, who, under questioning, admitted he had no factual basis in making up the number.

Yet this is the only number the OECD cites as its basis for the great threat. Even if the number was accurate, it is less than three percent of US federal government spending. The OECD then goes on to claim: "This translates into fewer resources for infrastructure and affects the standard of living for all of us in both developed and developing economies." The statement ignores the fact that most infrastructure is built by the private sector at a fraction of the cost of most government operations, and that government monies are in general far less efficiently spent than those from the private sector.

The OECD trumpets its success in obtaining a tenfold increase (to 200) in the number of tax information exchange agreements signed annually. These agreements meet the OECD "standards of transparency and exchange of information". The United States signed on 27 May 2010 a "Protocol to the Convention on Mutual Administrative Assistance on Tax Matters" to comply with the OECDs latest model treaty. The trouble is that a number of the countries that have signed on to the standards and have now signed agreements are non-democratic as well as major human rights violators. If you had a neighbour who was known to abuse his family, both physically and financially, and his adult daughter brought some of her jewels to you for safe keeping, would you return them to the abusive father? If you substitute "neighbour" for country and "daughter" for honest citizen, it is apparent that the politicians and government bureaucrats who sign and enforce these agreements have a hole in their moral compass.

The OECD standard agreement requires "No restrictions of exchange caused by bank secrecy or domestic tax interest requirements."

You might ask what right one or a group of countries has in telling some other sovereign (particularly democratic) country that it may not have the tax system its citizens prefer and what right other countries have to deny the citizens of another country the basic human right of financial privacy. The major European powers and the US have used their ability to bully smaller countries and jurisdictions, ranging from Cayman to Switzerland, to engage in information sharing that is not in the interest of the citizens of these lower-tax rate jurisdictions and violates their own – very legitimate – concept of basic human rights.

The OECD standards also require "Availability of reliable information and powers to obtain it." Many countries (including the US) have constitutional and other limits on what information the citizens must give the government as a way of protecting individual liberty. Countries without an income tax system have justifiable limits as to what information they can obtain, without imposing a huge cost on their financial industries and without violating basic rights of their citizens and others.

Finally, the OECD agreement demands "Strict confidentiality of information exchanged." Yet many of the countries on the OECD approved list have high levels of corruption; even in the least corrupt countries, confidential information is often either deliberately or accidentally leaked. For example, the US is not a very corrupt country, yet finds it almost impossible to keep much national security information secret, let alone taxpayer data. To think that the taxpayers of the world have nothing to fear from government bureaucrats in their own countries, let alone foreign countries, is either the height of hypocrisy or naiveté.

The report whines that some countries still "mobilize less than 17% of their GDP in tax revenues against, as an average of around 35% in OECD countries." The authors seem to be unaware that virtually every study of the optimum size of government puts the optimum under 25 per cent of GDP and, perhaps, as low as 12 per cent. Critics of the attempts of big countries to smash the so-called "tax havens" have argued that the high-tax countries are merely trying to build a high-tax cartel. The OECD criticism of limited-government countries adds credence to those who believe in the high-tax cartel theory.

Finally, the report goes on to say: "Globalization exacerbates these fiscal problems, as internationally mobile capital becomes more difficult to tax." As all competent economists understand – whether they are socialists or advocates of free markets – capital is the "seed corn" of the economy and is absolutely necessary for an

economy to grow and prosper. The higher the tax on capital, the less money there is for new plant and equipment, research and development and for job creation. Again, most economists are against the taxation of capital and, particularly, the double or even triple taxation of capital that all too often occurs. Nobel Laureate Robert Lucas, after reviewing the economic literature, concluded that the best single thing policy makers could do to improve economic growth was to remove the taxes on productive capital.

Virtually all income is taxed at least once when the income was generated to produce it. Capital generated by corporations is taxed by the corporate income tax, capital gains taxes and taxes on dividends. A question those within the OECD tax policy centre and other high-tax advocates never answer is “Why would you want to make it easy to tax capital when the result of such taxation is lower economic growth, less economic opportunity and more unemployment?”

Endnotes

1. Cecchetti, Stephen G; Mohanty M S; and Zampolli, Fabrizio. The Future of Public Debt: Prospects and Implications, BIS Working Paper No. 300. March 2010, http://www.bis.org/publ/work300.pdf?noframes=1
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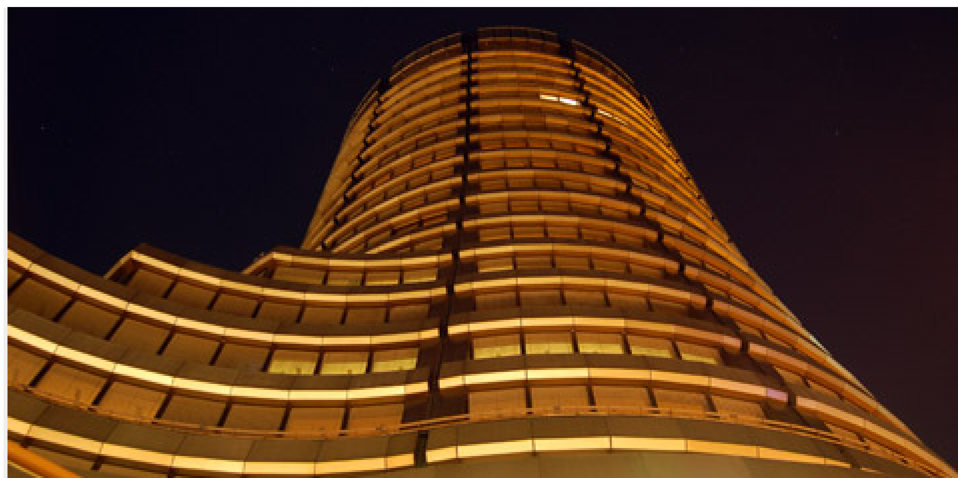

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