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Tax and Financial Sharing among Governments

by Richard W. Rahn

Should one democracy have the right to impose its tax laws on another? With which countries, if any, should the U.S. government share your tax and other financial information?

In recent years, some of the most contentious disputes among friendly countries have involved the U.S. attempting to force citizens of, and institutions in, other countries to provide tax and other financial information to the IRS. At the same time, the U.S. has resisted providing similar financial information to foreign governments for a number of very good reasons, including constitutional protections.

Global socialist and big-government groups, like the self-styled "Tax Justice Network (TJN)," that favor higher taxes have been pushing the U.N. (as recently as last week), the OECD, and other international organizations to force countries, such as Switzerland, the U.K., and the U.S., to abolish virtually all financial privacy protections for their citizens and institutions.

The U.S., Switzerland, and the U.K. (including its offshore dependencies) are some of the least corrupt countries in the world, with relatively small "black or grey" economies; yet, the TJN and its allies want these jurisdictions to share information with countries which have much higher levels of corruption and are very likely to misuse the information. Like trying to buy protection from the Mafia, the TJN is asking organizations, such as the U.N. — with many decades of its own corruption scandals, — to help implement more information sharing.

Many advocates of more tax and financial sharing among governments argue that the need for more government revenue trumps financial privacy and other civil liberties concerns. The fact is that almost all governments tax and spend more than is the optimum for economic growth, long-run revenue realization, and the general welfare. Why is it that non-resource rich jurisdictions like Singapore, Hong Kong and Switzerland get along perfectly well with smaller than average sized governments and are far more prosperous than almost all big government states?

The same phenomena can be seen within the U.S. Forty years ago, California was relatively far richer than Texas, although it is not today, and New York was relatively far richer than Florida. Neither Texas or Florida has a state income tax, while California and New York have double-digit rates for upper-income people. Rather than make California and New York richer, the high-income rates have served to motivate many wealthy and accomplished people to move to low-tax states which get along perfectly well without an income tax, all to the benefit of Texas and Florida, etc.

Many of the high-tax advocates are in denial about the disincentive effect of high tax rates. These high-tax advocates also ignore the fact that the rapid advances in information technology enable information workers to live anywhere in the world — making it more and more difficult to tax income at very high rates.

Some decades ago, a wise and very smart man, Edwin Cohen, who had been undersecretary of the Treasury for tax, and a professor at the University of Virginia law school, told me that at some point the tax system would collapse as it became more and more difficult to define "income."

For example, if your company sends you to a nice resort for six weeks of training on new IT systems — is it income or an educational expense? The efforts — which will ultimately be successful — to develop cryptocurrencies and other encrypted peer-to-peer financial information and transfer systems are in part driven by destructive government attempts to tax what people contribute rather than what they consume.

The tools we use to measure much economic activity and the tax base — i.e. the National Income Accounts (NIA) System — were developed during the 1930s for a very different economy. Few improvements have been made. The well-known economist Mark Skousen noticed that a measure of gross output (GO) gave better information about swings in economic activity than the standard measure of gross domestic output (GDP), and he made a concerted push to get the government to publish it on a regular basis, which they are now doing.

But this victory is only a small part of the greatly needed overhaul of the entire government economic information systems.

A major side effect of the new self-driving cars is an expected huge drop in automobile related deaths. Yet, most of this benefit, worth hundreds of billions of dollars, will not be captured with the present NIA system. Little of the trillions of dollars in value of all of the information and tools that billions of people have with their smart phones has been captured in our economic statistics.

Governments are not capable of moving fast enough to provide much of the economic information people really need, as contrasted with what obsolete government agencies think they need. The private sector will find ways of providing real information needs.

Rather than criminalize the financial activities of foreigners who are obeying their own countries laws, and try to enact more self-defeating rules in the increasingly elusive quest to define "income," government fiscal agents should concentrate on only attempting to tax part of consumption.

Change will only occur when more opinion leaders understand the real problems and the constructive solutions — a not insurmountable task.

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