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Daniel J. Mitchell

# The Moral Case for Tax Havens



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Phone +49(331) 7019- 210  
Fax +49(331) 7019- 216  
libinst@fnst.org  
www.libinst.de

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# The Moral Case for Tax Havens

Daniel J. Mitchell

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Politicians and tax bureaucrats are viscerally hostile to jurisdictions that offer refuge for the world's over-burdened taxpayers. Laws often are enacted to hinder economic transactions with these so-called tax havens, but these national efforts are just the tip of the iceberg. High-tax nations also have enlisted international bureaucracies such as the European Commission,<sup>1</sup> the United Nations,<sup>2</sup> and the Organization for Economic Cooperation and Development<sup>3</sup> in a coordinated attack on low-tax jurisdictions. Tax havens, we are told, are illegitimate lairs for tax evasion and money laundering.

This campaign against low-tax jurisdictions is fundamentally misguided. Tax havens (to use the pejorative term coined by proponents of big government) have a valuable role in the global economy. They provide a low-tax platform for economic activity. They facilitate the efficient allocation of capital. They encourage the accumulation of capital. And, because of tax competition, they encourage better tax law in the rest of the world. As noted in the *New England Journal of International and Comparative Law*, „Tax competition serves a...beneficial role. It forces greater fiscal responsibility and affords taxpayers the ability to enjoy more of what they earn. This in turn draws savings, investment, and skilled labor into the economy.“<sup>4</sup>

But economic efficiency is not the only reason that tax havens should be preserved. These low-tax jurisdictions also should be defended on a moral basis. Most notably, they encourage policies that promote economic well-being and they offer a safe haven for people subject to persecution. The main accusations leveled against tax havens, by contrast, are based on bad methodology or inaccurate information.

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1 The European Commission is a Brussels-based bureaucracy representing the 25-member European Community. A description of the European Union's „Savings Tax Directive“ can be found at <http://europa.eu.int/scadplus/leg/en/lvb/l31050.htm>.

2 The United Nations is based in New York and professes to represent the entire world. The UN's proposal can be found at <http://www.un.org/esa/ffd/a55-1000.pdf>.

3 The OECD is a Paris-based bureaucracy representing 30 industrialized nations. Most of its members are high-tax European nations. The OECD's report, „Harmful Tax Competition: An Emerging Global Issue,“ can be found at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

4 Phillip O. Figura, „European Union Tax Rate Harmony: An Unattainable and Detrimental Goal,“ *New England Journal of International and Comparative Law*, Vol. 8:1, 2002. Available at [http://www.nesl.edu/intljournal/vol8/taxrate\\_v8n1.pdf](http://www.nesl.edu/intljournal/vol8/taxrate_v8n1.pdf).

## Promoting Economic Growth

The first responsibility of any government is to protect the safety of its citizens, either from external aggression or domestic crime. The second responsibility is to provide an environment conducive to economic growth and opportunity. There are several steps needed to create that environment, including property rights, the rule-of-law, and a stable currency. One of the main conditions for prosperity, though, is a tax system that rewards – or at least does not unduly discourage – productive behavior. Though not normally discussed in moral terms, economic growth should be seen as an ethical obligation for government. Failure to pursue good policy deprives people of opportunity and creates hardship for the most vulnerable members of society.

Indeed, Benjamin Friedman's new book, *The Moral Consequences of Economic Growth*, is dedicated to this thesis. An economist at Harvard, Friedman is a „Democratic partisan“ who has condemned Ronald Reagan's economic policy,<sup>5</sup> but he does recognize that economic growth has numerous positive side effects (or externalities, as economists say). In his book, he notes that, „Economic growth—meaning a rising standard of living for the clear majority of citizens—more often than not fosters greater opportunity, tolerance of diversity, social mobility, commitment to fairness, and dedication to democracy.“<sup>6</sup>

So what does this have to do with tax havens? The answer is that low-tax jurisdictions help create – thanks to jurisdictional competition – the environment that leads to economic growth. And since economic growth has numerous positive externalities, tax havens play a valuable role in moving society in the right direction.

More specifically, the ideal tax system should have the lowest possible tax rates on work, saving, investment, risk-taking, and entrepreneurship. After all, these are the activities that generate income and wealth – and thus the behaviors that create a prosperous economy. The benchmark for the ideal tax system should be a low-rate, consumption-base, territorial system such as the Hall/Rabushka flat tax.<sup>7</sup>

5 Dan Seligman, „Good and Plenty,” Commentary, December 2005. Available at [http://www.commentarymagazine.com/article.asp?aid=12005080\\_1](http://www.commentarymagazine.com/article.asp?aid=12005080_1).

6 Benjamin M. Friedman, *The Moral Consequences of Economic Growth*, Knopf, 2005. Available at <http://www.amazon.com/gp/product/0679448918/104-9903662-7619928?v=glance&tn=3155&tn=507846&ts=books&tv=glance>.

7 Available at <http://www-hoover.stanford.edu/publications/books/flattax.html>

The flat tax has a single low rate, all forms of double-taxation are repealed (which makes it a „consumption-base“ tax), and there is no tax on income that is earned – and subject to tax – in other countries (which makes it a „territorial“ tax).

Unfortunately, tax rates in most nations are far too high. To make matters worse, it also is common for nations to impose extra layers of tax on income that is saved and invested, and this compounds the damage of high tax rates. Capital gains taxes, double-taxes on dividends, taxes on interest, wealth taxes, depreciation taxes (resulting from the failure to allow businesses to expense new investments), and death taxes are all examples of ways that governments tilt the playing field toward immediate consumption at the expense of saving and investment.

These choices have severe negative consequences. Ironically, politicians seem to understand the economic impact of high tax rates when tobacco taxes are on the agenda. They deliberately impose high tax rates because they want to discourage tobacco consumption. Whether or not this is the appropriate role of government, the economic analysis is correct. High tax rates affect behavior, leading to less of whatever is being taxed. Yet for some reason, politicians conveniently forget this elementary economic insight when considering how to tax income and capital formation.

Pervasive double-taxation of saving and investment is particularly perverse since all economic theories – including socialism and Marxism – agree that capital formation is the key to long-run growth and higher living standards. This is confirmed by scholarly research. In a November 2002 article in *Tax Notes* reviewing the academic literature, two economists from the American Enterprise Institute noted:

*... high rates of taxation on capital income...stand in marked contrast to the implications of optimal tax theory in the economics literature. Over the past three decades, numerous studies...have concluded that an optimal tax system in most cases will not include a tax on capital. ...A capital tax introduces a distortion into an economy, a distortion that „explodes“ over time. Hence, even a small capital tax will not be optimal. When capital accumulation and economic growth suffer, it is not just high-income individuals that pay the price. ...workers are better off – their wages are higher – when the capital stock is higher, which makes workers more productive and feeds through to wages.<sup>8</sup>*

Put in simpler terms, high taxes on saving and investment (capital) are akin to eating the seed corn of economic growth. Dividend taxes, interest taxes, capital gains taxes, and death taxes are all levies that punish people for saving and

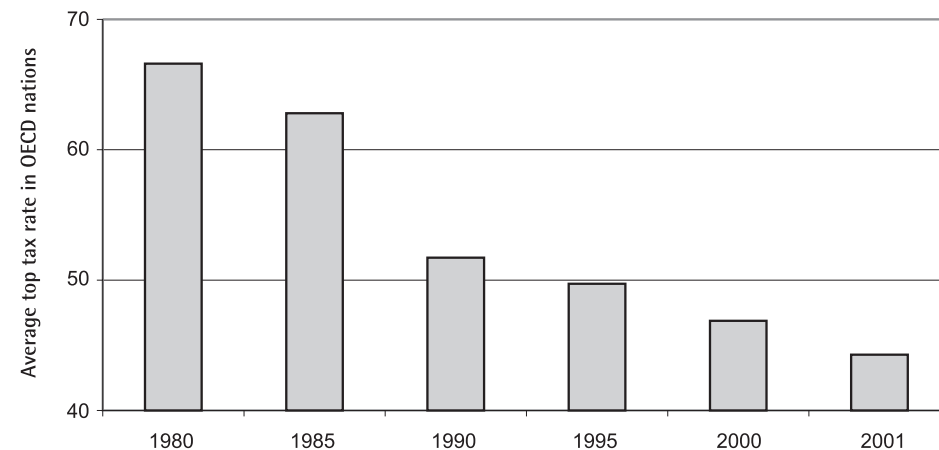
investing – particularly since there are no extra layers of federal tax imposed on consumption. The flat tax, by contrast, represents an „optimal tax“ since income is taxed only one time.

Unfortunately, politicians apparently believe that it is politically expedient to impose high tax rates and impose additional layers of tax on income that is saved and invested. For much of the post-World War II era, advocates of pro-growth tax reforms were unable to overcome these challenges – which is why nations routinely imposed extra layers of tax on saving and investment and generally had top tax rates averaging about 70 percent.

That was the bad news. The good news is that globalization has made it much easier for productive resources to cross national borders, and this has led to a process know as „tax competition.“ Politicians now face pressure to lower tax rates and reform tax regimes to keep the „geese that lay the golden eggs“ from flying to greener pastures. As a senior International Monetary Fund official wrote, „Today, individuals may be able to choose among many countries in deciding where to work, to shop, to invest their financial capital, to allocate the production activities of the enterprises they control and so on. In these decisions, they take into account the impact of taxes, especially as long as the tax systems of different countries diverge as much as they do today.“<sup>9</sup> Tax havens play a critical role in this process. In a new back on international taxation, Richard Teather of Bournemouth University explains, „The havens make international capital markets more efficient and in many cases make international pooling of capital possible... By increasing the efficiency of global capital markets, and ensuring that funds can flow to the most appropriate investments, tax havens therefore increase the efficiency of the allocation of capital and, in turn, increase the global standard of living. In this way the tax havens benefit us all, whether or not we personally invest through them.“<sup>10</sup>

As the accompanying chart illustrates, tax competition has led to a dramatic reduction in income tax rates. Triggered by the Thatcher and Reagan tax rate

Falling Top Tax Rates in Industrialized Nations



Source: James Gwartney an .

reductions, top tax rates in OECD countries have dropped by an average of 22 percentage points. The same process is forcing politicians to lower the corporate tax rate, with the tax rate in OECD nations falling by an average of nearly 20 percentage points.<sup>11</sup> As Teather explained, the „need to be competitive internationally in the face of tax competition, forced governments to adopt more internationally competitive taxation systems and hence more efficient and streamlined government operations. The era of free international capital markets and the increased tax competition that these allowed led to the public finance reforms of the 1980s and 1990s.“<sup>12</sup> The key point to remember, of course, is that lower tax rates mean better economic policy. As the American Enterprise Institute economists explained, „Tax competition has led to sharply lower corporate tax rates ... Because fundamental tax reform ideas that have grown out of the optimal tax literature often suggest replacing the income tax with a consumption tax, one

8 Eric Engen and Kevin Hassett, „Does the Corporate Tax Have a Future?“ Tax Notes, November 8, 2002, at [http://www.aei.org/docLib/20021222\\_raengehass0212.pdf](http://www.aei.org/docLib/20021222_raengehass0212.pdf).

9 Vito Tanzi, „Globalization, Tax Competition, and the Future of Tax Systems,“ International Monetary Fund Working Paper No. 96/141, December 1996.

10 Richard Teather, The Benefits of Tax Competition, Institute for Economic Affairs, London, 2005.

11 Chris Edwards and Veronique de Rugy, „International Tax Competition: A 21<sup>st</sup>-Century Restraint on Government,“ Policy Analysis 431, The Cato Institute, April 12, 2002. Available at <http://www.cato.org/pubs/pas/pa431.pdf>.

12 Richard Teather, The Benefits of Tax Competition, Institute for Economic Affairs, London, 2005.

can state that tax competition has pushed national tax systems in the direction of an optimal tax."<sup>13</sup>

As discussed earlier, lower tax rates are very important for economic growth, but it is equally important to reduce and/or eliminate the double-taxation of income that is saved and invested. Since much of this double-taxation is imposed on individuals, governments will be encouraged to fix the problem only if individuals (the „geese“) can shift their saving and investment (the „golden eggs“) to other jurisdictions with better tax law. This is why tax havens play a key role in the battle for better tax policy. These jurisdictions generally have laws protecting the privacy of savers and investors, a practice that makes it much more difficult for high-tax governments to track – and tax – flight capital.

Indeed, the existence of tax havens has compelled governments to reduce the tax burden on dividends, interest, capital gains, and other forms of capital income. Many Scandinavian nations, for instance, have implemented flat rate taxes on capital income – and these tax rates are lower than other tax rates.<sup>14</sup> The politicians apparently understand that it is better to collect some tax revenue at a low rate rather than no tax revenue at a high rate.<sup>15</sup> Many European nations also are reducing or eliminating death taxes and wealth taxes. Again, the motive is clear. The politicians recognize that punitive tax rates merely encourage oppressed taxpayers to put their money in places such as Zurich, Luxembourg, New York City, or Singapore. As a German economist noted:

*The level of total taxation would indeed be higher in a world without tax competition... Financial assets such as bank accounts, bonds, or equity are highly mobile and easy to relocate. This often allows taxpayers to reduce their tax bill by simply moving their assets across the border. ...Tax competition has largely prevented governments from tapping into this revenue source. ...many countries have lowered their tax claims on resident financial income. Top marginal income tax rates were cut practically everywhere, and some countries even*

13 Eric Engen and Kevin Hassett, „Does the Corporate Tax Have a Future?“ Tax Notes, November 8, 2002, at [http://www.aei.org/docLib/20021222\\_raengehass0212.pdf](http://www.aei.org/docLib/20021222_raengehass0212.pdf).

14 Jeffrey Owens, „Fundamental Tax Reform: The Experience of OECD Countries,“ Background Paper No. 47, The Tax Foundation, November 2004. Available at <http://www.taxfoundation.org/files/c3c38b2a0efdaf06d3f5d5a68afc63e9.pdf>.

15 Organization for Economic Cooperation and Development, „Challenges for Tax Policy in OECD Countries,“ Economic Outlook, No. 69, 2001. Available at <http://www.oecd.org/dataoecd/44/0/2086223.pdf>.

*decided to exempt financial income completely from the global income tax. Norway, Sweden, and Finland turned to so-called dual income tax systems, in which capital income is taxed at low proportional rates.*<sup>16</sup>

To reiterate, tax havens promote good tax policy and this leads to faster growth. Faster growth, meanwhile, means higher living standards. This is – or at least should be – a moral issue since nations with better economic performance score better on a wide range of measures. They enjoy better health outcomes. They create more jobs, particularly for the less fortunate. Just consider the case of Ireland. Thanks to sweeping tax rate reductions and cutbacks in the size of government, Ireland has boomed. Living standards increased by 100 percent in less than one generation – an astounding consequence. Unemployment dropped from 17 percent to 5 percent. No government program has ever come close to delivering this kind of result.<sup>17</sup>

## Intellectual Support for Jurisdictional Competition

German and French politicians complained when Ireland cut taxes, and they certainly are among the leading advocates of tax harmonization. Fortunately, this view is not widely shared. Perhaps because of America's long experience with federalism, many U.S. officials are appropriately skeptical of „one-size-fits-all“ harmonization schemes. John Bolton, currently serving as America's Ambassador to the United Nations, wrote that this approach, „... represents a kind of worldwide cartelization of governments and interest groups. ...The costs to the United States--reduced constitutional autonomy, impaired popular sovereignty, reduction of our international power, and limitations on our domestic and foreign policy options and solutions--are far too great, and the current understanding of these costs far too limited to be acceptable.“<sup>18</sup>

Not surprisingly, economists are particularly critical of efforts to stifle jurisdictional competition. Indeed, several Nobel Prize winners have commented specifi-

16 Philipp Genschel, „Globalization, Tax Competition, and the Fiscal Viability of the Welfare State,“ Max Planck Institute for the Study of Societies, Working Paper 01/1, May 2001. Available at <http://www.mpi-fg-koeln.mpg.de/pu/workpap/wp01-1/wp01-1.html#Über3>.

17 For a thorough history of Irish economic reform, see James B. Burnham, „Why Ireland Boomed,“ The Independent Review, Vol. VII, No. 4 (Spring 2003), pp. 537–556, at <http://www.independent.org/tii/media/pdf/tir74burnham.pdf>.

18 John R. Bolton, „Should We Take Global Governance Seriously?“ Chicago Journal of International Law, 2000.

cally on tax competition. James Buchanan points out that „...the intergovernmental competition that a genuinely federal structure offers may be constitutionally ‚efficient!..“ and that „...tax competition among separate units...is an objective to be sought in its own right.“<sup>19</sup> Milton Friedman, meanwhile, writes, „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.“<sup>20</sup> And Gary Becker observed that „...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.“<sup>21</sup>

Legal scholars also recognize the dangers of harmonization. John McGinnis of Northwestern University Law School recently wrote that, „Jurisdictional competition among sovereign nations is a primary mechanism for empowering the ‚encompassing interest‘ of a nation and reducing the ability of interest groups to take resources from the government. Under jurisdictional competition, sovereigns compete by providing efficient levels of public goods. Leaders are thereby restrained from rewarding themselves, their supporters, or influential special interest groups. A large, diverse democracy, where interest groups are held in check by jurisdictional competition, substantially reduces the incentives for individuals to seek rents through government action. Individuals will instead spend their time, on balance, in relatively more productive and peaceful activity.“<sup>22</sup> Another Professor from Case Western Reserve University Law School echoed these thoughts, commenting, „...a world with lots of borders is nonetheless a far friendlier world for liberty than one with fewer borders. They promote competition for people and money, which tends to restrain the state from grabbing either. Borders offer chances to arbitrage regulatory restrictions, making them less effective. Without borders these constraints on the growth of the state would vanish.“<sup>23</sup>

19 Geoffrey Brennan and James Buchanan (1980), *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press: Cambridge).

20 Letter to Center for Freedom and Prosperity, 2001. Available at <http://www.freedomandprosperity.org/update/u05-15-01/u05-15-01.shtml#3>.

21 Gary Becker, „What’s Wrong with a Centralized Europe? Plenty,” *Business Week*, June 29, 1998.

22 John O. McGinnis, „The Political Economy of Global Multilateralism,” *Chicago Journal of International Law*, 2000.

23 Andrew P. Moriss, „Borders and Liberty,” *The Freeman*, Vol. 54. No. 7, July 2004. Available at <http://www.fee.org/publications/the-freeman/article.asp?aid=4646>.

## Even Critics Agree

Perhaps the most compelling evidence can be found in the writings of those who oppose lower taxes and tax havens. Regarding the link between tax policy and economic growth, economists and policy analysts working for leftist think tanks now admit that lower tax rates and tax reform improve economic performance. To be sure, they will quibble about the size of growth effects and argue that other factors – such as deficit spending – also impact economic performance. But their acquiescence to the fundamentals of „supply-side“ economics is nonetheless a remarkable development.

An Urban Institute paper, for instance, acknowledged that, „lower capital income tax rates reduce the user cost of capital and stimulate investment.“<sup>24</sup> And in an analysis of the recommendations of the President’s Tax Reform Panel, economists writing for the Tax Policy Center admitted, „The report contains a number of interesting and important proposals that would generally move the structure of the tax system in the right direction, with simpler rules, a broader base, generally lower effective marginal tax rates, and more consistent treatment of different types of income.“<sup>25</sup> Perhaps the most interesting admission came from a Brookings Institution paper, which acknowledged both the link between lower tax rates and growth and the fact that lower tax rates and tax reform improve tax compliance:

*The positive effects of tax cuts on growth arise because lower marginal tax rates raise the reward to working, saving, and investing. Holding real income constant, these lower marginal rates induce more work effort, saving, and investment through substitution effects. ... Tax cuts or well-designed reforms may also reduce the extent to which taxpayers legally avoid and illegally evade taxes. This can improve the allocation of resources and hence raise economic growth even without increasing the level of labor and capital inputs.<sup>26</sup>*

24 William G. Gale and Peter R. Orszag, „Deficits, Interest Rates, and the User Cost of Capital: A Reconsideration of the Effects of Tax Policy on Investment,” Discussion Paper No. 27, The Urban Institute, August 2005. Available at [http://www.taxpolicycenter.org/UploadedPDF/311211\\_TPC\\_DiscussionPaper\\_27.pdf](http://www.taxpolicycenter.org/UploadedPDF/311211_TPC_DiscussionPaper_27.pdf).

25 Leonard E. Burman and William G. Gale, „A Preliminary Evaluation of the Tax Reform Panel’s Report,” Tax Notes, December 5, 2005. Available at [http://www.taxpolicycenter.org/UploadedPDF/1000854\\_Tax\\_Break\\_12-05-05.pdf](http://www.taxpolicycenter.org/UploadedPDF/1000854_Tax_Break_12-05-05.pdf).

26 William G. Gale and Peter R. Orszag, „Economic Effects of Making the 2001 and 2003 Tax Cuts Permanent,” Brookings Institution, August 2004. Available at <http://www.brookings.edu/views/papers/20040817galeorszag.pdf>.



Even the OECD has produced some surprisingly honest analysis about these issues. For instance, OECD economists have estimated, „that economies grow one-half of 1 percent (0.5 percent) faster for every 10-percentage-point reduction in marginal tax rates.“<sup>27</sup> Another paper states, „The overall tax burden is found to have a negative impact on output per capita. Furthermore, controlling for the overall tax burden, there is an additional negative effect coming from an extensive reliance of direct taxes. Taxes and government expenditures affect growth both directly and indirectly through investment. An increase of about one percentage point in the tax pressure ...could be associated with a direct reduction of about 0.3 per cent in output per capita. If the investment effect is taken into account, the overall reduction would be about 0.6–0.7 per cent.“<sup>28</sup> They also endorse the optimal tax theory discussed above, noting that, „the best way to improve economic performance would be to replace current wage-income and capital-income taxes by a general tax on consumption.“<sup>29</sup>

Remarkably, OECD economists even understand that tax competition is a liberalizing force in the world economy. They explicitly have noted that, „the ability to choose the location of economic activity offsets shortcomings in government budgeting processes, limiting a tendency to spend and tax excessively.“<sup>30</sup> Another paper admits that, „...decentralisation can make governments more accountable, allowing a better matching of resources to preferences. It may also introduce competition across jurisdictions and thus raise public sector efficiency.“<sup>31</sup> The head of the Tax Policy and Statistics division of the OECD’s Centre for Tax Policy and Administration recently stated that, „The new member states of the EU have come in with very low corporate tax rates...and this is clearly putting pressure

on European countries worrying about business relocating to these lower-tax jurisdictions.“<sup>32</sup> And another report noted, „...because of taxpayer mobility, states’ ability to levy progressive income taxes is quite limited.“<sup>33</sup>

Most amazingly, even one of the anti-tax competition reports produced by the OECD included language admitting that, „The more open and competitive environment of the last decades has had many positive effects on tax systems, including the reduction of tax rates and broadening of tax bases which have characterized tax reforms over the last 15 years. In part these developments can be seen as a result of competitive forces that have encouraged countries to make their tax systems more attractive to investors. In addition to lowering overall tax rates, a competitive environment can promote greater efficiency in government expenditure programs.“<sup>34</sup> Last but not least, it is worth noting that a former Clinton-era Treasury Department official has recognized that tax havens promote better tax policy. Commenting on the ability of governments to double-tax capital when savers and investors can protect their money in low-tax jurisdictions, he admitted, „I think it’s very unlikely that we can continue to impose taxes on capital income.“<sup>35</sup>

These quotes are particularly illuminating, especially since so many of them come from the organization that is leading the charge against tax competition. While this appears to be a sign of intellectual incoherence, it actually is driven by the OECD’s internal structure. The professional economists generally publish good work, as indicated in the previous statements. The Fiscal Affairs Committee, by contrast, is comprised of tax collectors from each member nation, and they are

27 Willi Leibfritz, John Thornton, and Alexandra Bibbee, „Taxation and Economic Performance,” Organisation for Economic Co-operation and Development, Economics Department, Working Paper No. 176, 1997. Available at <http://www.oecd.org/dataoecd/33/25/1863834.pdf>.

28 Andrea Bassanini and Stefano Scarpetta, „The Driving Forces Of Economic Growth: Panel Data Evidence For The OECD Countries,” OECD Economic Studies No. 33, November 2001. Available at <http://www.oecd.org/dataoecd/26/2/18450995.pdf>.

29 Willi Leibfritz, John Thornton, and Alexandra Bibbee, „Taxation and Economic Performance,” Organisation for Economic Co-operation and Development, Economics Department, Working Paper No. 176, 1997. Available at <http://www.oecd.org/dataoecd/33/25/1863834.pdf>.

30 Organisation for Economic Cooperation and Development, Economic Outlook, June 17, 1998. Available at <http://www.oecd.org/dataoecd/50/17/2088806.pdf>

31 Isabelle Joumard and Per Mathis Kongsrud, „Fiscal Relations Across Government Levels,” Economics Department Working Papers No. 375, December 10, 2003. Available at [http://www.oelis.oecd.org/olis/2003doc.nsf/43bb6130e5e86e5fc12569fa005d004c/b9c6758da58f9c76c1256df80035d70c/\\$FILE/JT00155695.PDF](http://www.oelis.oecd.org/olis/2003doc.nsf/43bb6130e5e86e5fc12569fa005d004c/b9c6758da58f9c76c1256df80035d70c/$FILE/JT00155695.PDF).

32 Christopher Heady, „World-wide trends in corporate taxation and tax reform,” Presentation to Tax Foundation Annual Conference, Washington, DC, November 17, 2005. Available at <http://www.taxfoundation.org/2005conference/heady-poschmann/>.

33 Thomas Laubach, „Fiscal Relations Across Levels Of Government In The United States,” Economics Department Working Papers No. 462, Organization for Economic Cooperation and Development, November 2005. Available at [http://www.oelis.oecd.org/olis/2005doc.nsf/43bb6130e5e86e5fc12569fa005d004c/da360144bb5dbe5ec12570c8005c0cfd/\\$FILE/JT00195165.PDF](http://www.oelis.oecd.org/olis/2005doc.nsf/43bb6130e5e86e5fc12569fa005d004c/da360144bb5dbe5ec12570c8005c0cfd/$FILE/JT00195165.PDF).

34 Organisation for Economic Cooperation and Development, „The OECD’s project on harmful tax practices: the 2001 progress report,” 2001. Available at <http://www.oecd.org/dataoecd/60/28/2664438.pdf>.

35 Joseph Guttentag, „Appropriate Responses to International Tax Competition,” American Enterprise Institute, December 9, 2003. Available at [http://www.aei.org/events/eventID.676.filter.all/event\\_detail.asp#](http://www.aei.org/events/eventID.676.filter.all/event_detail.asp#).

the ones pushing the anti-tax competition agenda.<sup>36</sup> The Fiscal Affairs Committee of the OECD, for instance, has complained that tax competition is „re-shaping the desired level and mix of taxes and public spending.“<sup>37</sup> The Committee also has admitted that the anti-tax competition „project is about ensuring that the burden of taxation is fairly shared and that tax should not be the dominant factor in making capital allocation decisions.“<sup>38</sup> And it also has complained that the ability to shift economic activity to low-tax jurisdictions „may hamper the application of progressive tax rates and the achievement of redistributive goals.“<sup>39</sup>

## The Moral Benefits of Growth

Economic growth leads to higher incomes, but why does that matter? Each succeeding generation of Americans enjoys living standards about 50 percent higher than its parents,<sup>40</sup> for instance, but has this added income and wealth made them happier? According to researchers, the answer is yes:

*According data from surveys by the National Opinion Research Center, for example, people in the top fifth of income earners are about 50% more likely to say they are „very happy“ than people in the bottom fifth, and only about half as likely to say they are „not too happy.“ ...a \$1,000 increase in per capita income is associated with a one-point decrease in the percentage of Americans saying they are „not too happy.“<sup>41</sup>*

Moreover, there is direct evidence that lower taxes and smaller government boost happiness. As the Wall Street Journal commented when discussing the National Opinion Research Center findings, „...a \$1,000 increase in government

revenues per capita is associated with a two-point rise in the percentage of Americans saying they are not too happy. In other words, not only can money buy happiness, but it may be that the government can tax it away as well.“<sup>42</sup> The relationship between happiness and small government is echoed by research from a Swiss University:

Our results show that life satisfaction decreases with higher government spending. ... It is alleviated by government effectiveness - but only in countries where the state sector is already small. ...life satisfaction decreases with government's active involvement in the economy. ...the data on life satisfaction are from the third and fourth waves of the World Values Survey... The evidence quite clearly supports the public choice view that excessive government involvement is detrimental to individuals' quality of life. ... We therefore conclude with a rather simple policy implication: governments interested in maximizing the life satisfaction of their voters should, regardless of their ideology, limit their direct interventions in the economy to allow voters a high degree of personal freedom.<sup>43</sup>

Adam Smith predicted the link between income and happiness more than 200 years ago. He noted in *The Wealth of Nations* that, „in the progressive state, while the society is advancing to the further acquisition, rather than when it has acquired its full complement of riches, that the condition of the great body of the people seems to be the happiest and the most comfortable. It is hard in the stationary, and miserable in the declining state.“<sup>44</sup>

An economy that performs well generates substantial increases in living standards. Economists at the Dallas Federal Reserve Bank calculated changes in the purchasing power of an average wage. They note that, „In terms of time on the job, the cost of a half-gallon of milk fell from 39 minutes in 1919 to 16 minutes in 1950, 10 minutes in 1975 and 7 minutes in 1997.“ Likewise, „a typical factory worker had to toil more than 2 years to buy Ford's Model T [in 1908], one of

36 Daniel J. Mitchell, „Paris, Taxes,“ Techcentralstation.com, May 19, 2004. Available at <http://techcentralstation.com/051904A.html>.

37 Organization for Economic Cooperation and Development, „Harmful Tax Competition: An Emerging Global Issue,“ 1998. Available at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

38 Organization for Economic Cooperation and Development, „Towards Global Tax Co-operation,“ 2000. Available at <http://www.oecd.org/dataoecd/9/61/2090192.pdf>.

39 Organization for Economic Cooperation and Development, „Harmful Tax Competition: An Emerging Global Issue,“ 1998. Available at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

40 Dan Seligman, „Good and Plenty,“ Commentary, December 2005. Available at [http://www.commentarymagazine.com/article.asp?aid=12005080\\_1](http://www.commentarymagazine.com/article.asp?aid=12005080_1).

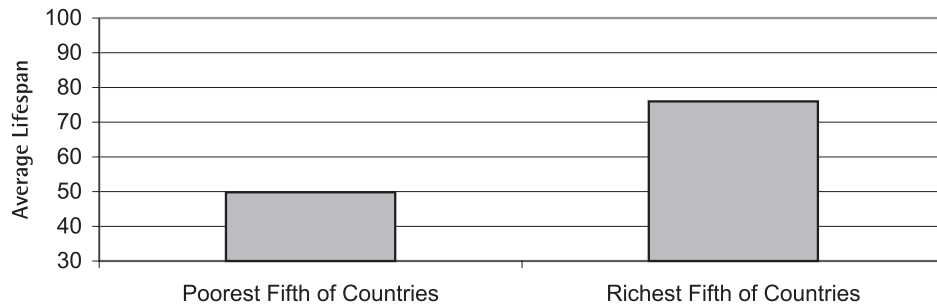
41 Arthur Brooks, „Money Buys Happiness,“ Wall Street Journal, December 8, 2005. Available at <http://online.wsj.com/article/SB113400764335517001.html?mod=opinion&tocontent=otep>.

42 Arthur Brooks, „Money Buys Happiness,“ Wall Street Journal, December 8, 2005. Available at <http://online.wsj.com/article/SB113400764335517001.html?mod=opinion&tocontent=otep>.

43 Christian Bjørnskov, Axel Dreher, and Justina A.V. Fischer, „The bigger the better? Evidence of the effect of government size on life satisfaction around the world,“ Working Paper 05/44, Institute of Economic Research, Swiss Federal Institute of Technology, Zurich, October 25, 2005. Available at [http://e-collection.ethbib.ethz.ch/ecol-pool/incoll/incoll\\_1037.pdf](http://e-collection.ethbib.ethz.ch/ecol-pool/incoll/incoll_1037.pdf).

44 Adam Smith, *An Inquiry into the Nature Et Causes of the Wealth of Nations*, 1776.

### The Importance of Growth: Global Income and Longevity Data



Source: United Nations Human Development Report

the nation's first affordable cars. A 1997 Ford Taurus costs today's worker just 8 months."<sup>45</sup>

Growth also has important implications for the quality of life. People with higher income can afford more health care and better health care. They live in societies that can afford more medical research. This means new drugs that can potentially save lives. Simply stated, wealthier nations are healthier nations.<sup>46</sup> But even „vanity“ health purchases such as cosmetic surgery, laser eye surgery, and orthodontic care are a symbol of the lifestyle improvements found in wealthier societies.

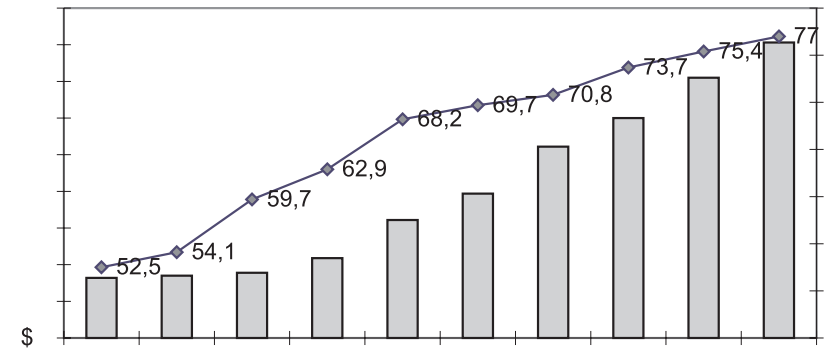
Equally important, living standards also have an impact on the length of life. The two accompanying charts show the relationship between income and longevity. The first uses today's data to demonstrate that people in rich nations live much longer than people in poor nations.<sup>47</sup> The second uses historical data to

45 W. Michael Cox and Richard Alm, „Time Well Spent: The Declining Real Cost of Living in America,“ Annual Report, Federal Reserve Bank of Dallas, 1997. Available at <http://www.dallasfed.org/fed/annual/1999p/ar97.html>.

46 Daniel J. Mitchell, „The Deadly Impact of Federal Regulations,“ Journal of Regulation and Social Cost, Vol. 2, No. 2, June, 1992.

47 United Nations, „Human Development Report,“ 2005. Available at <http://hdr.undp.org/statistics/data/indicators.cfm?alpha=yes>.

### The Importance of Growth: U.S. Historical Income and Longevity Data



illustrate the increases in both income and lifespan in the United States during the 20<sup>th</sup> century.<sup>48</sup> Correlation is not necessarily causation, of course, but there is little doubt that there is a link between lifespan and income.

Economic growth also yields other benefits, particularly with regards to civil society. Benjamin Friedman (no relation to Milton) wrote in his new book that, „The value of a rising standard of living lies not just in the concrete improvements it brings to how individuals live but in how it shapes the social, political and ultimately the moral character of a people.“<sup>49</sup> The Economist agreed with Friedman's hypothesis, writing:

48 U.S. Census Bureau. Statistical Abstract of the United States. Available at <http://www.census.gov/prod/www/statistical-abstract-04.html>. Historical Statistics of the United States, Colonial Times to 1970. Available at <http://www2.census.gov/prod2/statcomp/documents/CT1970p1-07.pdf>.

49 Benjamin M. Friedman, The Moral Consequences of Economic Growth, Knopf, 2005. Available at <http://www.amazon.com/gp/product/0679448918/104-9903662-7619928?v=glance&tn=283155&tn=507846&ts=books&tv=glance>.

*„Growing prosperity, history suggests, makes people more tolerant, more willing to settle disputes peacefully, more inclined to favour democracy. Stagnation and economic decline are associated with intolerance, ethnic strife and dictatorship. ...If people are becoming better off relative to their own past standard of living, they will care less about where they stand in relation to others. If they are not growing better off relative to their own past standard of living,*



become an industry.<sup>53</sup> The International Trade and Investment Organization wrote that, „Affluent taxpayers in at least one major OECD member country also fear that tax data is routinely sold to criminal gangs seeking targets for kidnapping, common in that state.”<sup>54</sup> If bureaucracies such as the OECD and EC succeed in destroying financial privacy, the consequences could be deadly. As the U.N. admitted, „Global sharing of information means that criminal access can occur at the weakest point of entry, multiplying the risks associated with unauthorized disclosure.”<sup>55</sup> This is a pervasive problem. According to the World Bank, 113 nations get negative grades on upholding the rule of law and 117 countries get failing grades on corruption.<sup>56</sup> But if tax havens are allowed to exist and people can use financial privacy to protect legitimate assets, this danger posed by these regimes is lessened. In the example of the Venezuelan entrepreneur, he reduces the threat to his family if he can put his money in a Miami bank, secure in the knowledge that his government will not have access to any information.

- Consider the case of a Congolese merchant: According to Freedom House, she lives in an „unfree” nation.<sup>57</sup> The World Bank says her nation does not respect the rule of law.<sup>58</sup> And Transparency International gives her nation a poor grade on corruption.<sup>59</sup> In this wretched environment, she makes herself the target of a government that routinely seizes private wealth if she accumulates any assets. And since the government almost surely controls the judiciary, there is no rule-of-law to protect her. This is a common risk around the world. There are 48 „unfree” and 54 „partly free” countries according to Freedom House.<sup>60</sup> And there are 120 nations that score below a five on Transparency International’s

1–10 corruption scale.<sup>61</sup> But if, for example, the Congolese merchant has an account in London – unknown to the government – her freedom to provide goods and services to the community is less vulnerable.

- Consider the case of an Argentine businessman: The ability to have private offshore accounts also enables people to protect themselves from financial instability and expropriation. In the case of Argentina, the government’s gross incompetence has subjected citizens to massive devaluations and financial instability. This is not unusual in many places around the world, which is why testimony before a U.S. Senate committee found, „clients were motivated to establish their banking relationships for a variety of reasons, ...includ[ing] ...avoidance of foreign exchange controls, fear of currency devaluation, fear of confiscation resulting from political upheaval.”<sup>62</sup> According to the World Bank, there are 105 nations with negative grades on the issue of regulatory quality.<sup>63</sup> And the Milken Institute found 60 nations with below average grades in its Capital Access Index.<sup>64</sup> Businessmen from jurisdictions with instability issues can protect themselves by using a tax haven, almost all of which receive excellent grades. For the hypothetical Argentine businessman, an account in the Bahamas is an excellent way of protecting his financial affairs from a venal, corrupt, and incompetent government.
- Consider the case of a Middle Eastern Jew: There are still many areas of the world where Jews are treated unfairly, particularly in the Middle East. And the persecution quite likely is linked to the wealth since bigots are especially likely to resent someone who is financially successful. Other faiths also are subject to persecution, either from other governments dominated by other religions or government hostile to any organized religion. According to Open Doors International, for example, Christians are oppressed in 13 nations and persecuted in 31 nations.<sup>65</sup> Tax havens provide a refuge for religious minorities. Indeed, the famous Swiss laws regarding banking secrecy were significantly strengthened

53 United Nations, „Financial Havens, Banking Secrecy, and Money Laundering,” Office on Drugs and Crime, 1998. Available at <http://www.imolin.org/imolin/finhaeng.html>.

54 Towards a Level Playing Field, 2nd Edition, International Tax and Investment Organisation and Society for Trust and Estate Practitioners, October 2003. Available at <http://www.itio.org/documents/Towards-A-Level-Playing-Field-Second%20Edition.pdf>.

55 United Nations, „Financial Havens, Banking Secrecy, and Money Laundering,” Office on Drugs and Crime, 1998. Available at <http://www.imolin.org/imolin/finhaeng.html>.

56 The World Bank, „Aggregate Governance Indicators,” 2005. Available at <http://www.worldbank.org/wbi/governance/pdf/2004kkdata.xls>.

57 <http://www.freedomhouse.org/research/freeworld/2004/table2004.pdf>.

58 The World Bank, „Aggregate Governance Indicators,” 2005. Available at <http://www.worldbank.org/wbi/governance/pdf/2004kkdata.xls>.

59 [http://www.transparency.org/policy\\_and\\_research/surveys\\_indices/cpi/2005](http://www.transparency.org/policy_and_research/surveys_indices/cpi/2005)

60 <http://www.freedomhouse.org/research/freeworld/2004/table2004.pdf>.

61 [http://www.transparency.org/policy\\_and\\_research/surveys\\_indices/cpi/2005](http://www.transparency.org/policy_and_research/surveys_indices/cpi/2005)

62 Testimony of Antonio Giraldi before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, U.S. Senate, November 10, 1999. Available at [http://hsgac.senate.gov/111099\\_giraldi.htm](http://hsgac.senate.gov/111099_giraldi.htm).

63 The World Bank, „Aggregate Governance Indicators,” 2005. Available at <http://www.worldbank.org/wbi/governance/pdf/2004kkdata.xls>.

64 <http://www.milkeninstitute.org/publications/publications.taf?cat=PBriefs&function=detail&ID=459>.

65 [http://sb.od.org/index.php?supp\\_page=wwl\\_2005&supp\\_lang=en](http://sb.od.org/index.php?supp_page=wwl_2005&supp_lang=en)

in 1934 after Adolf Hitler took control in Germany.<sup>66</sup> The ability to maintain assets in Switzerland still today – unknown to oppressive governments – may play a valuable role in helping people fight religious persecution.

- Consider the case of a Haitian taxpayer: According to the World Bank, Haiti has one of the world's least effective governments.<sup>67</sup> In the absence of competent and honest government, taxpayers are left few options. As one academic noted, „There are situations in some developing countries where law-breaking helps to survive. If people want to open a business, to acquire land or build homes they are confronted with high transaction costs. ...tax evasion can be seen as an ‚exit‘ option, a signal through which taxpayers can express their disagreement.“<sup>68</sup> For a beleaguered taxpayer, putting assets in an Anguilla company – shielded from the view of the kleptocratic Haitian government – may be the only rational option.
- Consider the case of a family in Zimbabwe: According to the World Bank, Zimbabwe is among the world's most politically unstable regimes.<sup>69</sup> Moreover, expropriation is a common threat for those who are viewed as enemies by the nation's dictator. But this problem extends even to OECD nations, as illustrated by testimony before the U.S. Senate.<sup>70</sup> If the World Bank is the judge of instability, Zimbabwe is joined by another 100 unstable nations.<sup>71</sup> For people in these nations, a Delaware company is an ideal way of protecting family wealth since it is almost impossible for foreign governments to obtain information about private financial holdings.
- Consider the case of a human rights activist in Turkmenistan: Political minorities are threatened in the absence of financial privacy. In countries controlled by

66 Maurice Aubert, „Swiss Banking Secrecy,“ Schellenberg & Haissly, Geneva, March 1997.

67 The World Bank, „Aggregate Governance Indicators,“ 2005. Available at <http://www.worldbank.org/wbi/governance/pdf/2004kkdata.xls>.

68 Benno Torgler, „Tax Morale: Theory and Empirical Analysis of Tax Compliance,“ Dissertation, University of Basel, July 11, 2003. Available at [http://pages.unibas.ch/diss/2003/DissB\\_6463.pdf](http://pages.unibas.ch/diss/2003/DissB_6463.pdf).

69 The World Bank, „Aggregate Governance Indicators,“ 2005. Available at <http://www.worldbank.org/wbi/governance/pdf/2004kkdata.xls>.

70 Testimony of Amy Elliot before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, U.S. Senate, November 9, 1999. Available at [http://hsgac.senate.gov/110999\\_elliott.htm](http://hsgac.senate.gov/110999_elliott.htm).

71 The World Bank, „Aggregate Governance Indicators,“ 2005. Available at <http://www.worldbank.org/wbi/governance/pdf/2004kkdata.xls>.

dictators – and even in some countries with immature democracies – opposition party leaders and political dissidents often are targeted for persecution. And if the ruling elite is in a position to threaten the personal finances of its opponents, democracy is more likely to wither. In such nations, it is doubtful that the media publicize these abuses. According to Freedom House, 119 nations – including Turkmenistan – do not enjoy a free press.<sup>72</sup> But if political minorities can park their assets in Luxembourg, a nation with strong secrecy laws, they have a greater ability to fight for liberty.

- Consider the case of an ethnic Chinese businessman in Indonesia: Tax havens are especially important for ethnic minorities. The Chinese often are persecuted in places such as Indonesia and the Philippines, for instance, and Indians are persecuted in East Africa. Much of this persecution is driven by envy, so it is particularly important for the Chinese and the Indians to have ways of maintaining their saving and investment away from the public eye. A bank account in Singapore – guarded against outside inquiry – helps protect against ethnic attack since bigots are more likely to seek out those with assets to plunder.
- Consider the case of a homosexual in Saudi Arabia: Sexual minorities still are persecuted in many nations. Depending on the country, gays and lesbians face challenges ranging from ostracism to criminal prosecution. Indeed, there are 84 nations with laws that target homosexuals.<sup>73</sup> Needless to say, the ability to conduct financial operations in a place like Liechtenstein – which would refuse to cooperate with a government seeking to target sexual minorities – may be the only way for homosexuals to guard against an oppressive government getting too much information.

The key link in all these examples is that persecuted people need the freedom to move their assets to jurisdictions with adequate privacy laws. These people are not primarily motivated by a desire to escape excessive taxation, but they nonetheless benefit from tax havens since financial institutions in these jurisdictions generally are not obliged by help enforce foreign laws – particularly when those foreign governments are trying to investigate and prosecute activities that are not illegal in the low-tax jurisdiction. This „dual criminality“ principle is a valuable protection for civil liberties around the world.

72 <http://www.freedomhouse.org/research/pressurvey/allscore2005.pdf>

73 International Gay and Lesbian Human Rights Commission. Available at <http://www.iglhrc.org/site/iglhrc/content.php?type=1&tid=77>.

## Tax Havens Get Good Grades on Governance

The leading tax havens are among the world's most tolerant and pluralistic jurisdictions. They certainly score very well on the World Bank's six governance indicators. Looking at eight nations and territories that are global leaders in the market for offshore services, they rank near the top in some categories and their average grades also are among the highest in the world. Of those leading tax havens, four score higher than the United States and four score lower – and those four are just barely behind America. It is also interesting to compare tax havens to France, since the French are the leading opponents of tax competition. Seven of the eight tax havens rank above France, and the one that is behind – Bermuda – trails by just one slot.

Global Governance Rankings							
	VA	PS	GE	RQ	RL	CC	Ranking
Hong Kong	100	19	17	2	21	20	24
Singapore	117	8	2	3	10	2	20
Cayman Islands	61	4	24	40	29	32	26
Switzerland	6	11	1	16	3	7	5
Luxembourg	10	2	5	1	2	8	3
Liechtenstein	17	14	18	10	23	17	12
Bahamas	28	40	27	52	25	25	28
Bermuda	45	33	25	36	33	38	30
United States	22	82	14	27	17	16	21
France	20	75	20	45	24	23	29

VA = voice and accountability, PS = political stability, GE = government effectiveness, RQ = regulatory quality, RL = rule of law, CC = control of corruption. Note: Average score does not indicate ordinal ranking.

## Even Critics Agree

Perhaps the most compelling arguments for financial privacy come from the reluctant admissions of organizations and individuals who are fighting against tax havens. The United Nations bureaucracy opposes tax competition and seeks to destroy financial privacy, yet the UN Declaration of Human Rights recognizes and protects privacy as a basic human right.<sup>74</sup> The United Nations even has admitted the need for individuals to be protected from oppression. A 1998 report published by the U.N. confessed, „Equally serious issues arise when Governments engage in human rights violations. For much of the twentieth century, Governments around the world spied on their citizens to maintain political control. Political freedom can depend on the ability to hide purely personal information from a Government.“<sup>75</sup>

But the United Nations is not the only hypocritical organization. In a shocking development, the leader of the OECD's anti-tax competition campaign, Jeffrey Owens, recognized the role of tax havens as a bulwark for the protection of human rights. As reported by the U.K.-based *Observer*, „Owens...stressed that tax havens are essential for individuals who live in unstable regimes.“<sup>76</sup> And a former Clinton-era Treasury Department official who was closely involved with the OECD's anti-tax competition campaign admitted, „How far do we want to go with this information exchange, and the secrecy issues, the privacy issues, and so forth, which relates to the problems of corrupt governments, of danger to your children and to individuals. That subject should be discussed.“<sup>77</sup>

The OECD has even acknowledged in publications that, „Bank secrecy has deep historical and cultural roots in some countries“ and that, „Bank secrecy is also a fundamental requirement of any sound banking system.“<sup>78</sup> Yet the OECD – like the United Nations – is willing to suspend important human rights safeguards. Put bluntly, these bureaucracies put the interests of high-tax governments before the safety and liberty of the bulk of the world's population.

74 United Nations, „Universal Declaration of Human Rights,“ 1948. Available at <http://www.un.org/Overview/rights.html>.

75 United Nations, „Financial Havens, Banking Secrecy, and Money Laundering,“ Office on Drugs and Crime, 1998. Available at <http://www.imolin.org/imolin/finhaeng.html>.

76 Nick Mathiason, „Where the rich stash their cash,“ *The Observer*, March 27, 2005. Available at <http://observer.guardian.co.uk/business/story/0,6903,1446130,00.html>.

77 Joseph Guttentag, „Appropriate Responses to International Tax Competition,“ American Enterprise Institute, December 9, 2003. Available at [http://www.aei.org/events/eventID.676.filter.all/event\\_detail.asp#](http://www.aei.org/events/eventID.676.filter.all/event_detail.asp#).

## Sovereignty as a Moral Issue

The campaign against tax havens interferes with the right of jurisdictions to pursue pro-growth policies. This is especially onerous for poor jurisdictions. Having „no or low taxes“ is the main criteria for being listed as a tax haven by the OECD.<sup>79</sup> Yet most OECD nations did not have income taxes during the 1800s, which was the period of time when they climbed from agricultural poverty to middle class prosperity. Why is it wrong for developing nations to follow the same development strategy?

Another issue is the OECD's hypocritical treatment of capital compared to labor. The Paris-based bureaucracy is upset that capital is flowing to low-tax jurisdictions, many of which are in the developing world. But OECD nations are big beneficiaries of a „brain drain“ from developing nations.<sup>80</sup> This flow of talent is very beneficial for „labor-inflow“ nations, just as global financial flows are very beneficial for „capital-inflow“ nations. Yet the OECD is not suggesting that developing nations have the right to tax emigrant income earned in OECD nations, so why should OECD nations be allowed to tax flight capital in non-OECD nations? (The United Nations actually is proposing to give governments in the developing world the right to tax emigrant income.<sup>81</sup> But this idea has no chance of becoming policy because of opposition from wealthier nations.<sup>82</sup>)

Last but not least, the OECD has two sets of rules, one set for its own member nations and one set for the rest of the world. The OECD's 2000 blacklist included 41 jurisdictions,<sup>83</sup> none of which were members of the Paris-based bureaucracy. Yet at least six OECD nations are tax havens, including the United States, Swit-

zerland, Luxembourg, Austria, Belgium, and the United Kingdom.<sup>84</sup> Why are these nations – all of which are tax havens according to the OECD's criteria – not on the blacklist?

## The Right Way to Reduce Tax Evasion

Opponents of tax havens do make one compelling argument. It is unfair, they say, for some people to avoid taxes while others are stuck carrying the load for three tax



In other words, if politicians succeed in taxing income that currently is protected in tax havens, the likely result is that some of this economic activity will shift to the underground economy. And since the weakening of tax competition would encourage politicians to impose higher tax rates, this will further accelerate the flight of productive behavior to the black market. Interestingly, even the OECD seems to understand that high tax rates are the problem, writing, „[I]llegal 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.“<sup>87</sup> Another OECD publication notes, „...lowering statutory corporate tax rates and rates on personal capital income in countries where these are particularly high, may increase the domestic tax base as there are less incentives to shift taxable profits and capital income abroad.“<sup>88</sup>

Indeed, that is the right way to fight tax evasion. The answer, as some officials at the OECD understand, is to cut tax rates and reform the tax system. The lower the tax rate, the lower the incentive to use either legal or illegal means to hide money. In other words, when tax rates are low, people are willing to report more income to the government. This is part of the reason why tax rate reductions often result in increased tax revenues. During the 1980s, for instance, upper-income taxpayers dramatically increased the amount of income they reported--and hence the amount of tax they paid when Ronald Reagan lowered the top tax rate from 70 percent to 28 percent. The same thing happened following the Kennedy tax rate reductions in the 1960s. Revenues rose, and the rich wound up paying more.<sup>89</sup>

Similarly, lower tax rates and better tax systems have reduced the underground economy in the former Soviet Bloc. Russia's 13 percent flat tax, for instance, has dramatically boosted compliance. Indeed, inflation-adjusted personal income tax receipts have jumped by more than 100 percent in just four years.<sup>90</sup> Ireland's low-rate 12.5 percent corporate tax is generating similar results. Corporate tax

revenues are approaching 4 percent of GDP, compared to less than 1.5 percent of GDP when the tax rate was 50 percent.<sup>91</sup>

This economic analysis of tax evasion also should be augmented by a review of the philosophical issues. There are instances where taxpayers no longer have a moral obligation to pay tax. Indeed, in the case of a genocidal government, paying taxes in those situations may be the wrong thing to do. As one scholar noted, „one might ask whether Jews have an obligation to obey all the laws of the country, and to pay all the taxes they legally owe, if Hitler were the tax collector. ...did the Mormons in nineteenth century New York State have an absolute ethical obligation to pay taxes to the very government that was running them out of the state, sometimes at gunpoint?“<sup>92</sup>

Tax compliance also may be morally questionable if government is acting irresponsibly. As one academic article noted, „Tax evasion restricts government's ability to act as a Leviathan by maximising the own preferences. Thus, tax evasion might reduce the tax revenues and therefore the size of government. ...There seems to be a certain consensus that tax evasion is rather allowed when taxes are unfair, the government acts inappropriately or the government is not legitimated.“<sup>93</sup> Another scholar asks, „What if you live under a corrupt government, where a large portion of tax revenue goes to corrupt politicians and their friends and family? ...What if you are in a high tax bracket and the government takes more than 90 percent of your marginal income... If the government uses the tax system as a means of redistributing income rather than as a means of financing legitimate government functions, are you justified in evading taxes?“<sup>94</sup>

Last but not least, some academics wonder whether tax compliance is appropriate in corrupt nations. One academic article states, „Some governments in

87 Organisation for Economic Cooperation and Development, *Economic Outlook*, June 17, 1998. Available at <http://www.oecd.org/dataoecd/50/17/2088806.pdf>

88 Willi Leibfritz, John Thornton, and Alexandra Bibbee, „Taxation and Economic Performance,“ Organisation for Economic Co-operation and Development, Economics Department, Working Paper No. 176, 1997. Available at <http://www.oecd.org/dataoecd/33/25/1863834.pdf>.

89 Daniel J. Mitchell, „The Correct Way to Measure the Revenue Impact of Changes in Tax Rates,“ Backgrounder 1544, The Heritage Foundation, May 3, 2002. Available at <http://www.heritage.org/Research/Taxes/BG1544.cfm>.

90 Alvin Rabushka, „The Flat Tax at Work in Russia: Year Four, 2004,“ *The Russia Economy*, January 26, 2005. Available at <http://www.russianeconomy.org/comments/012605.html>.

91 Eric Engen and Kevin Hassett, „Does the Corporate Tax Have a Future?“ *Tax Notes*, November 8, 2002, at [http://www.aei.org/docLib/20021222\\_raengehass0212.pdf](http://www.aei.org/docLib/20021222_raengehass0212.pdf).

92 McGee, Robert W., „The Ethics of Tax Evasion: A Survey of International Business Academics,“ 60th International Atlantic Economic Conference, New York, October 6-9, 2005. Available at <http://ssrn.com/abstract=803964>

93 Benno Torgler, „Tax Morale: Theory and Empirical Analysis of Tax Compliance,“ Dissertation, University of Basel, July 11, 2003. Available at [http://pages.unibas.ch/diss/2003/DissB\\_6463.pdf](http://pages.unibas.ch/diss/2003/DissB_6463.pdf).

94 McGee, Robert W., „The Ethics of Tax Evasion: A Survey of International Business Academics,“ 60th International Atlantic Economic Conference, New York, October 6-9, 2005. Available at <http://ssrn.com/abstract=803964>

Eastern Europe, the CIS, Latin America and Asia could be labeled as corrupt, if not evil, because of the rampant bribery and suppression of individual rights. ...How evil or corrupt does a government have to be before tax evasion is no longer unethical?" The article also asks:

*What if the government in question does not ruin many lives but merely makes life much more difficult? What if the government ...confiscates the assets of its citizens without due process? ... what is a legitimate legislative authority? Hitler and Mussolini both came to power via the democratic process. Many older Russians would eagerly elect Stalin if he were on the ballot. Many people in China would still vote for Mao even though he killed 30 or 40 million Chinese through a combination of brutality and stupid economic policies that caused millions to starve to death.*<sup>95</sup>

It is not clear whether any of these questions have conclusive answers. But all of these issues illustrate that there is a relationship between the actions of a government and the morality of tax compliance. Presumably most people would agree that it is morally wrong to evade taxes in Hong Kong. The tax system is fair and simple and the government generally is honest. Yet most people also would agree that it is morally acceptable to evade taxes in a brutal dictatorship such as Cuba or Zimbabwe.

In Democratic societies, tax evasion clearly is less acceptable. But some of the economic issues outlined above also are moral issues. Was it okay, for instance, to evade taxes in America when the top tax rate was more than 90 percent? And if it was morally acceptable, at what point did it become morally wrong? When Kennedy brought the top rate down to 70 percent? When Reagan lowered it to 50 percent in the early 1980s? When he lowered it to 28 percent as part of the 1986 Tax Reform Act?

95 McGee, Robert W., „Is It Unethical to Evade Taxes in an Evil or Corrupt State? A Look at Jewish, Christian, Muslim, Mormon and Baha'i Perspectives". Journal of Accounting, Ethics & Public Policy, Vol. 2, No. 1, pp. 149-181, Winter 1999. Available at <http://ssrn.com/abstract=251469>

## The Phony Money Laundering Argument

Despite Hollywood stereotypes, so-called tax havens do not attract a significant portion of the world's dirty money. But this statement is not based on the assertions of low-tax jurisdictions. Instead, it is based on the ratings of U.S. government agencies and international bureaucracies.<sup>96</sup>

The State Department, the Central Intelligence Agency (CIA), and the Internal Revenue Service (IRS) each independently assess the extent to which a jurisdiction attracts – or has the potential to attract – dirty money. Some low-tax jurisdictions are on these lists, but they are clearly outnumbered by high-tax nations. Only 10 tax havens – based on the OECD's 2000 blacklist<sup>97</sup> – are on the State Department's list of problem jurisdictions, far less than the 46 non-tax haven jurisdictions that were placed on the list.<sup>98</sup> The Central Intelligence Agency's blacklist is similarly tilted. Only three tax havens were named as problem jurisdictions, compared to 13 non-tax haven nations.<sup>99</sup> Rather remarkably, even the IRS has approved the anti-money laundering policies of 22 so-called tax havens – including every single major offshore center.<sup>100</sup>

International bureaucracies also give tax havens a clean bill of health when compared to high-tax nations. No tax havens are on the Financial Action Task Force's money laundering blacklist.<sup>101</sup> And more than three-fourths of all tax havens (including every significant offshore center) are members of the Egmont Group, an association of anti-money laundering authorities limited to jurisdictions with effective laws and procedures for fighting dirty money.<sup>102</sup> Non-tax haven jurisdictions cannot make this claim.

96 Daniel J. Mitchell, „U.S. Government Agencies Confirm that Low-Tax Jurisdictions Are Not Money Laundering Havens," Journal of Financial Crime, Vol. 11, No. 2 (Fall 2003).

97 Organization for Economic Cooperation and Development, „Towards Global Tax Co-operation," June, 2000. Available at <http://www.oecd.org/dataoecd/9/61/2090192.pdf>.

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## Conclusion

Tax havens should be applauded, not persecuted. Their existence encourages governments to implement policies that boost growth and create opportunity. Tax havens play an especially key role in fight against the double-taxation of saving and investment. These are the policies that genuinely improve the lives of ordinary people. Economic growth matters, both because of increases in living standards and because of the positive externalities associated with economic growth.

But faster growth is not the only reason to support tax havens. Low-tax jurisdictions also help protect people from political, ethnic, and religious persecution. Tax havens provide a refuge for people living in nations dominated by corrupt and incompetent governments. People living comfortable lives in industrialized democracies sometimes forget that a majority of the world's population lives in nations that are not fully free. For these people, tax havens mean much more than merely a way to reduce fiscal burdens.

The anti-tax competition campaigns of international bureaucracies are based on bad economics and dubious morals. If high-tax nations want to reduce tax evasion, they should fix their tax systems. Thanks to tax competition, this option is underway, but many politicians from high-tax governments – particularly in Europe – are fighting to preserve their uncompetitive welfare states. But the narrow and selfish agenda of these politicians should not be allowed to undermine the valuable role of tax havens in the global economy.

**Daniel J. Mitchell**, Ph.D., is the McKenna Senior Fellow in Political Economy of the Heritage Foundation. He is Heritage's chief expert on tax policy and the economy, Mitchell advocates supply-side tax policy and fundamental tax reform. Mitchell also is the nation's leading opponent of tax harmonization schemes developed by the Brussels-based European Union, the Paris-based Organization for Economic Cooperation and Development (OECD), and the United Nations. His September 2000 analysis of the OECD's „harmful tax competition“ initiative [link] was the opening salvo in a campaign to shift the position of the United States government and thus stymie international proposals to persecute low-tax jurisdictions.

Mitchell's by-line can be found in such national publications as the Wall Street Journal, New York Times, Investor's Business Daily, and Washington Times. He is a frequent guest on radio and television and a popular speaker on the lecture circuit, both domestically and internationally. Mitchell holds a Ph.D. in Economics from George Mason University and master's and bachelor's degrees in economics from the University of Georgia. Prior to joining The Heritage Foundation in 1990, Mitchell was as an economist for Senator Bob Packwood and the Senate Finance Committee. He also served on the 1988 Bush/Quayle transition team and was Director of Tax and Budget Policy for Citizens for a Sound Economy.