Taxing Dis-harmony

Mason Gaffney warns tax havens: Beware the thought-control police

THE TINY Cayman Islands in the West Indies is championing the right to employ tax policies of its choosing in a David and Goliath battle with the giant nations, *writes Fred Harrison.*

The OECD countries want to curb what they call "unfair competition", and they brand the Cayman Islands as a tax haven because it does not tax people's incomes. Not surprisingly, it does a roaring trade in financial services. Money is attracted from high-tax regimes. This has annoyed North American and European governments, who have banded together to try and straitjacket the deviant low-tax economies.

Last year the Paris-based OECD published *Harmful Tax competition: An Emerging Global Issue*. This states that a tax haven is "a place to be used by non-residents to escape tax in their country of residence". With the electronic age making it possible to circulate money around the globe at the push of a few buttons - $1.5 trillion every day - governments are losing a lot of revenue. That is why they want to clamp down on the havens.

This has led to curiously contradictory positions held by the British government.

- It is pressuring the havens within its domain - the Channel Islands of Jersey and Guernsey - to toe the UK fiscal line.
- But Chancellor of the Exchequer Gordon Brown has read the riot act to Germany, which is exploiting the tax harmonisation theme to try and force increases in corporation taxes in other EU countries. Germany wants to shift taxes off labour and on to capital, but the overall effect would be an increase in the tax burden. Mr. Brown warned that he would use the veto. "As far as Britain is concerned, tax policy is made in Britain not in Europe. It is by cutting taxes, not raising them, that is the way forward to create jobs."

FINANCE minister Oskar Lafontaine is using Germany's presidency of the EU to try and standardise tax rates. One target is the relatively lower tax regime in Ireland. But the debate is confused by the use of value-laden words which do not necessarily correspond to the consequences of intended actions. For example, the harmonisers say they want "to avoid harmful tax competition".

But who is being harmed? When it comes to national interest, the meaning of words become plastic. Take, for example, the statement offered by *The Financial Times* in an editorial on November 24. It acknowledged the need to eliminate distortions in tax policy, and then noted: "But where a country chooses to have a different tax structure from its neighbours, because it is considered more equitable or more efficient, that cannot be regarded as unfair competition. It is perfectly legitimate".

This definition invites a consideration of what constitutes a fair and efficient tax. Unfortunately, government advisors do not engage in an open review of all the options in the quest for harmony in tax policy.

TAX EXPERT Mason Gaffney, a professor of economics at the University of California, flew to the Cayman Islands to debunk the rhetoric employed by the tax harmonisers. He warned a packed meeting of the Society of Trust and Estate Practitioners: "When a powerful international political organisation officially brands you as 'harmful', look out".

He said that the OECD's proposals "call for more enforcement, and to scapegoat small tax havens. To enforce an income tax today calls for nothing less than a worldwide intelligence network with vast powers of search and seizure. It also calls for worldwide thought-control to give it moral authority and general support. The end of this thought-control is to criminalise income".

Words like *uniformity* and *fairness* were employed to disguise vested interests which advocated taxes that were discriminatory between payers and abusive in their impact. As an example, Dr. Gaffney cited the sales tax: "A 'uniform' sales tax is not uniform in its effects. Retailers in rich locations can bear it and survive; those in marginal locations cannot. The result is especially to penalise poorer neighbourhoods and regions and communities".

He also exposed the hypocrisy of the harmonisers. For example, the OECD branded as "harmful" a nation which allows a person to deduct costs when the corresponding income is not taxed. "That sounds reasonable," said Dr. Gaffney, "and yet that is the standard treatment of most real estate income in the USA, the largest member of the OECD."

Lurking behind the rationale for harmony were the governments of richer nations which employed policies to attract inward investment at the expense of poorer nations. Dr. Gaffney pointed out that attracting skilled labour and capital was possible by offering superior public services. This was possible for nations that were fortunate to occupy the best lands on the planet, and "It seems rather miserly of them to deny to nations occupying less favoured lands the only compensatory measures available".

Less well-endowed nations could attract resources by offering "a magnetic tax structure". Declared Dr. Gaffney: "The OECD report was written by people wearing blinders that keep their eyes and minds fixated only on kinds of taxes that penalise and repel mobile activities. There are taxes that...positively attract them. The OECD does not like them".

The professor identified revenue-raisers which benignly supported economic activity. These measures raised revenue directly from the rental income of land and natural resources. The alternative, said Dr. Gaffney, was "a worldwide inquisition by the revenue agents of every nation into the records of every other nation".

SPURIOUS though its logic may be, and harmful the consequences, the OECD report has initiated a debate which could be turned against the high-tax harmonisers.

In paragraph 29 of its report, the OECD talks of poaching from "the tax base [which] 'rightly' belongs to" another country, which can be labelled harmful competition. This thesis rests on the implicit claim that there is a unique property in a country's total revenue. This is

Turn to page 17 ☞

OECD Secretary-General Donald Johnston claims that tax policy plays an important role in achieving "the triangular paradigm of social progress. That means keeping economic growth, social cohesion and good governance in balance with each other".*

This balance is achieved through education and social programmes which needed to be financed through taxation. But he claimed: "However, taxation is not an easy area to get right. It never has been and it probably never will".

In a review of the constraints on public finance, the head of the leading think-tank representing the industrial nations made no concession to the one fiscal policy that would automatically synthesise the three corners of his paradigm: the policy that emphasises the need for governments to charge people for the benefits they derive from possessing and using land and natural resources.

The OECD is worried about the "mobility of national tax bases" without offering any guidance to member countries on the tax base that is immovable: land. Consequently, the OECD is drafting a stack of conventions that narrow the freedom of people to earn incomes under the conditions of their choosing.

* Donald Johnston, "Taxation and social progress", *OECD Observer*, Jan. 1999, p.3.

TAXING DIS-HARMONY

Continued from page 14

claimed by the sovereign government as its property, to the point where it wishes to coerce other governments which dare to deprive it of its legitimate revenue.

This raises serious questions which ought to engage fiscal philosophers, in an attempt to pin down the high tax regimes which presume to intrude into the affairs of sovereign nations. For example:

- Exactly which parts of a nation's income "rightly" belongs to the government? Do the citizens know that part of their income does not "belong to" them at all?
- What is the size of the tax base that "rightly" belongs to the government?
- On what grounds do governments claim the right to reserve that revenue for its exclusive use?

The language in which the OECD conducts its analysis lays the foundations for international conflict which could move from fiscal to force of a different character. For example, in paragraph 31 it talks of governments being able to conclude that some countries could be "poaching other countries' tax bases". In the past, nations have gone to war for less. But again the high-tax harmonisers need to be challenged on their property claims. Poaching pre-supposes ownership, which needs to be defined and legitimised in the court of world opinion.

The coercive philosophy behind the views expressed in the OECD report are revealed by the comment that "countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so" (para. 26). The basis of those standards needs to be critically examined before sovereign nations are intimidated into complying with the strictures of those who dominate the public discourse.

Sources: Mason Gaffney, *International Tax Competition: Harmful or Beneficial?* (Aug. 1998), and "Taxation of mobile Capital in a Global Free Market", speech, 2.9.98, Grand Cayman.