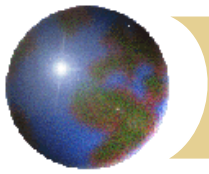


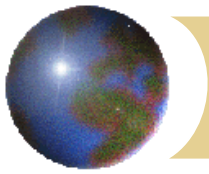
Tax Harmonization vs Tax Competition

Free Market Road Show
2016



What Is Tax Competition?

- ✚ Tax competition exists when governments feel pressure to lower tax rates (or pressure to forego tax hikes) because of concerns that jobs and investment will flee to jurisdictions with less onerous fiscal policy.
- ✚ Tax competition is linked to globalization, which enables more cross-border economic activity.



Does Tax Competition Matter?

- ✚ In the past 35 years, tax rates have fallen by significant amounts.
- ✚ The average top personal income tax rate fell from 67-68 percent to 41-42 percent.
- ✚ The average corporate tax rate has dropped from 48 percent to 24 percent.

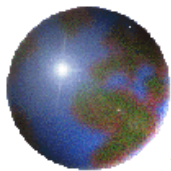
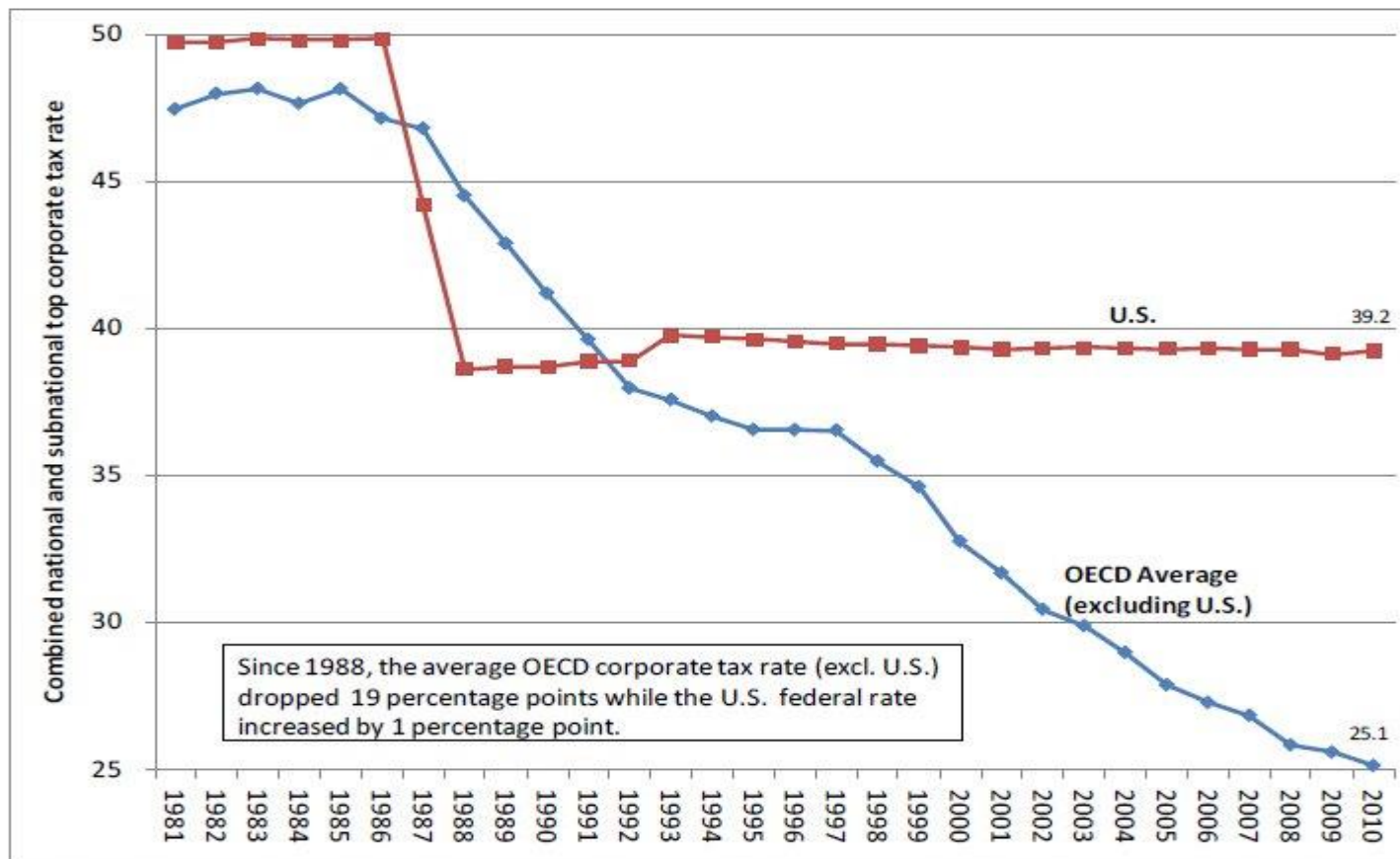
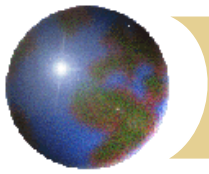


Figure 1.--Average OECD Member Country Corporate Tax Rate, 1981-2010

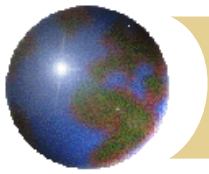


Source: OECD tax database; 2010 average includes reported tax rates for three members that acceded to the OECD in 2010 that are not yet included in the tax database. The U.S. rate is based on the 35-percent federal tax rate and average state taxes of 6.47 percent, which are deductible from federal taxes.



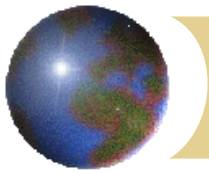
The Tax Competition Premise

- ✚ These changes in tax policy in part were driven by governments having to compete for labor and capital.
- ✚ Why did France and Germany lower tax rates when even the supposedly right-wing parties support big government?
- ✚ Globalization has changed the rules.



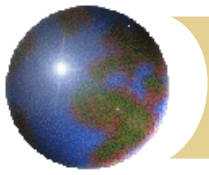
Additional Evidence

- ✚ Many nations also eased the degree of double taxation on interest, dividends, and capital gains.
- ✚ Death taxes and wealth taxes were reduced or eliminated.
- ✚ Number of flat tax jurisdictions jumped from 3 to about 30.



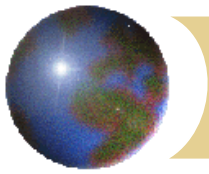
The Global Battle

- ✚ On one side are economists and taxpayers who see tax competition as a liberalizing force in the global economy.
- ✚ On the other side are politicians and international bureaucracies who see tax competition as something that hinders the ability of governments to conduct fiscal policy.



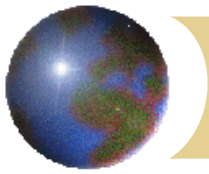
Who Is Right?

- ✚ Depends what you want.
- ✚ Lower tax rates and more efficient government?
- ✚ Higher tax rates and more spending?
- ✚ More growth?
- ✚ More redistribution?

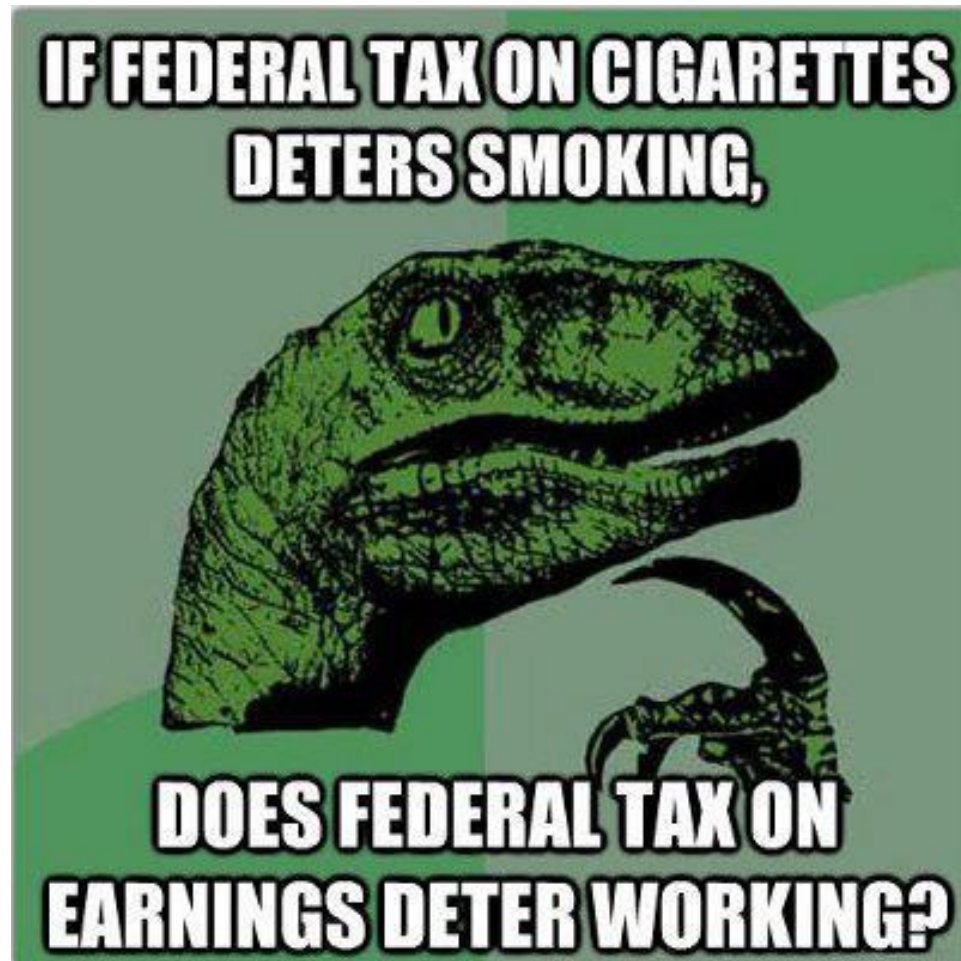


What Is Good Tax Policy?

- ✚ Low tax rate(s).
- ✚ No double taxation of income that is saved and invested (consumption base, not Haig-Simons).
- ✚ No loopholes
- ✚ Territorial taxation, the good-fences-make-good-neighbors approach.



Tax Rates Determine Incentives



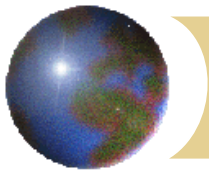


Best Way to Harvest Apples?

🎯 Pick from tree?

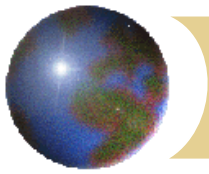
Chop down tree?





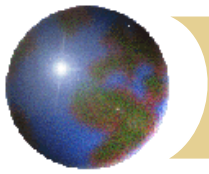
What Do Opponents Want?

- ✚ Anti-tax competition advocates believe in a theory called “capital export neutrality.”
- ✚ Basic premise is that taxpayers should not be able to lower their tax rates by shifting economic activity across borders.
- ✚ Tax evasion and tax avoidance are equally bad.



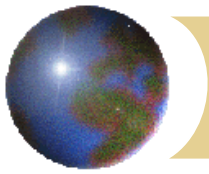
What is Tax Harmonization?

- ✚ Direct harmonization is identical tax rates, akin to VAT requirement in EU. Taxpayers obviously have no options.
- ✚ Indirect harmonization is when global information sharing enables a home government to impose its tax rates, even if a taxpayer engages in economic activity elsewhere.



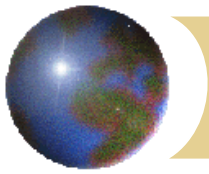
Why CEN Is Wrong

- ✚ In the world of blackboard theory (and in law schools), CEN makes sense.
- ✚ In the real world, the theory has three fatal flaws.
 - ▣ It assumes that tax rates are exogenous.
 - ▣ It assumes that economic activity is fixed.
 - ▣ It overlooks “public choice” theory.



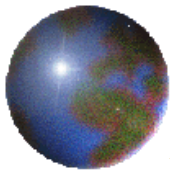
What's the Motive for Statists?

- ✚ They like bigger government.
- ✚ They should be happy since government is getting bigger.
- ✚ And because of demographics, it will get even bigger.
- ✚ The problem is that they're running out of taxpayer money.



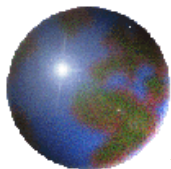
The Onshore Fiscal Problem

- ✚ Politicians claim more revenues are the solution to red ink.
- ✚ But the problem is bigger government. Deficits are just a symptom of that problem.
- ✚ Higher taxes simply facilitate a larger public sector.



In other Words...

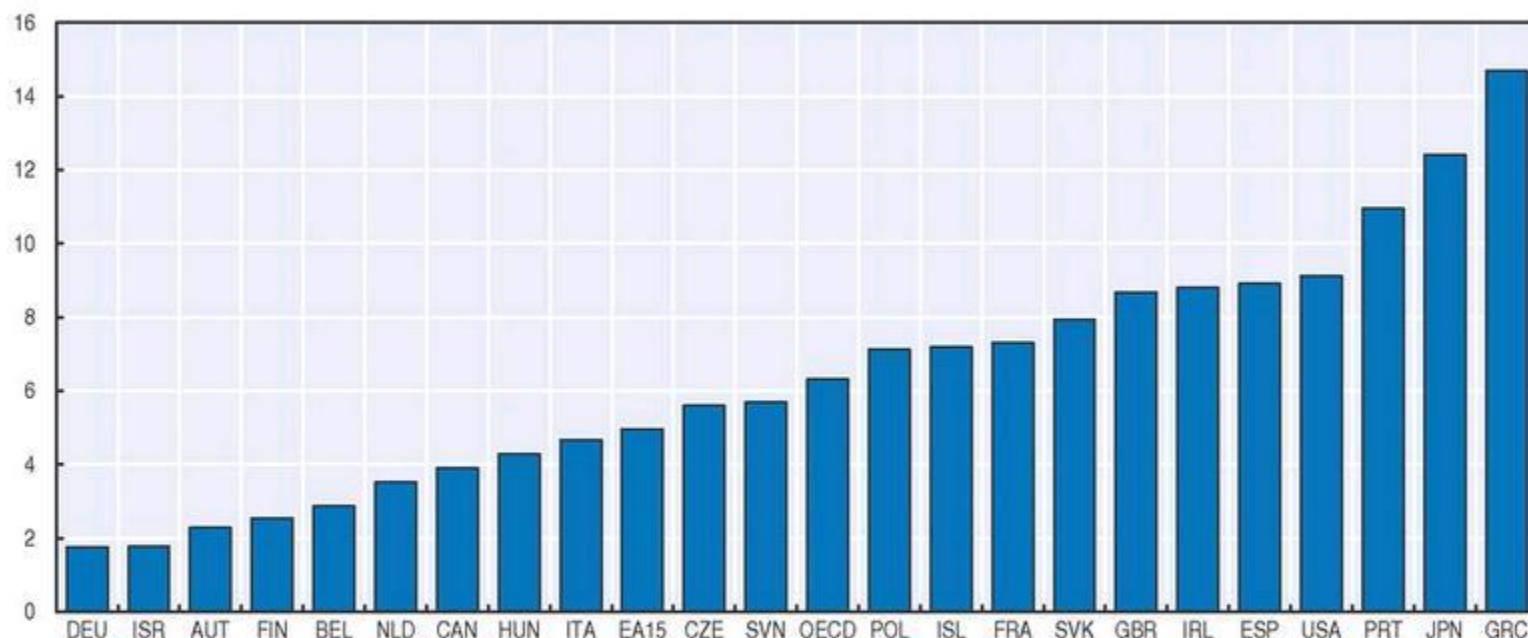




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Figure 1.12. **Budgetary consolidation requirements to reduce government debt to 60% of GDP**

Average change in the underlying primary balance (2010-2030), percentage points of GDP



Note: The average measure of consolidation is the difference between the underlying primary balance in 2010 and the average underlying primary balance between 2015 and 2030, except for those countries for which the debt target is only achieved after 2030, in which case the average is calculated up until the year that the debt target is achieved.

Source: OECD (2013), OECD Economic Outlook 93 Long-Term Database.

StatLink  <http://dx.doi.org/10.1787/888932983870>

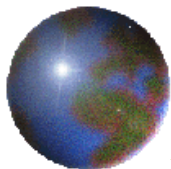
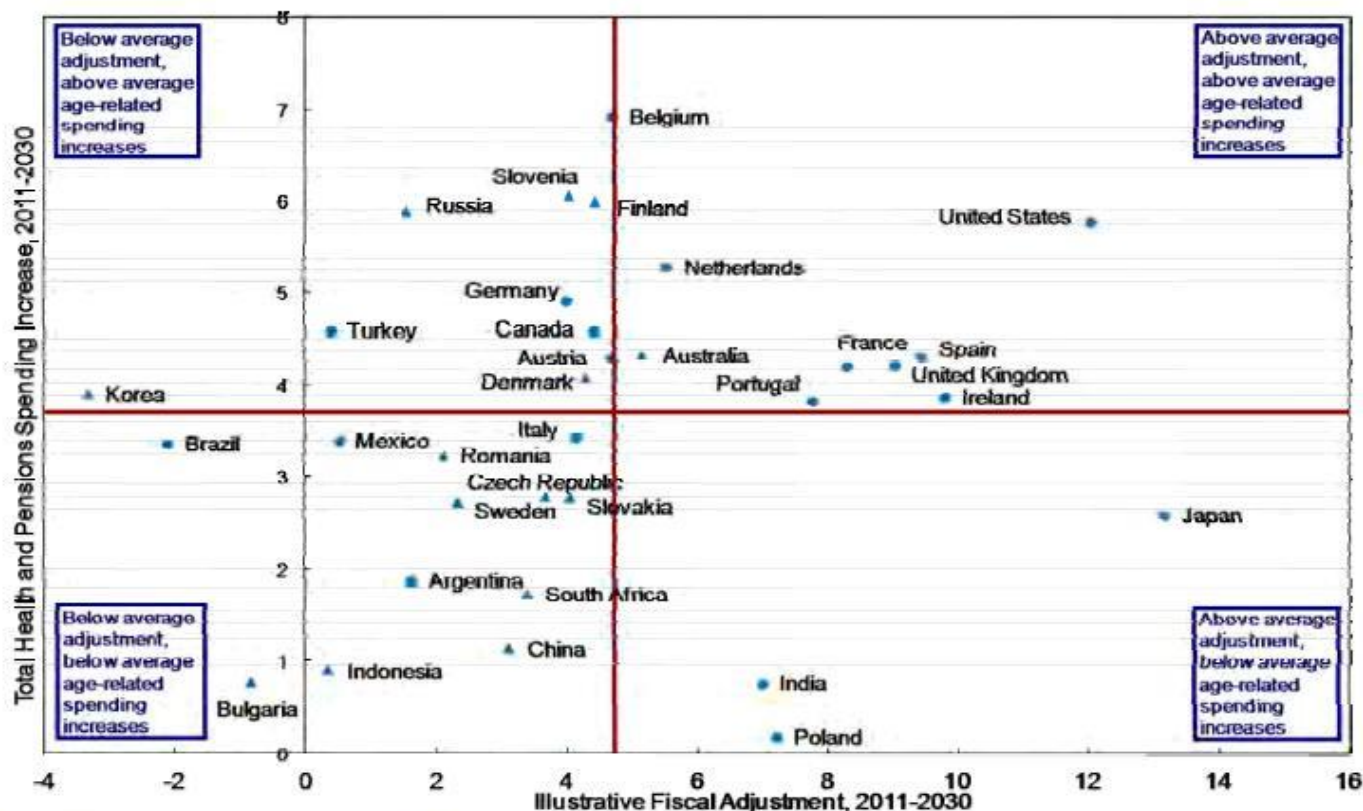


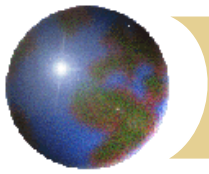
Figure 14. Illustrative Fiscal Adjustment and Projected Age-Related Spending Increases in 2011–2030 (In percent of GDP)



Source: IMF staff estimates and projections; IMF (2010c).

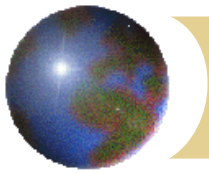
Note: Fiscal adjustment refers to improvement in the cyclically adjusted primary balance needed to achieve the illustrative gross government debt target. Circles indicate debt ratios above 60 percent for advanced economies and 40 percent for emerging economies, projected at end-2012 (higher debt); triangles indicate debt ratios below 60 percent for advanced economies and 40 percent for emerging economies, projected for the same period (lower debt). See note in Figure 11 for further details. The vertical and horizontal lines represent unweighted averages.

For Australia, the figures do not take into account the federal government budget, released on May 11, which envisages a return to federal government surpluses by 2012/13. For Greece (not shown), the illustrative 2011–30 adjustment need is 9.2 percent of GDP, after measures of 7.6 percent of GDP undertaken in 2010. The increase in health and pension spending is projected at 7.6 percent of GDP.



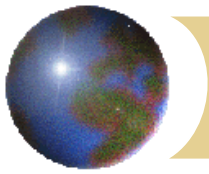
Moral of the Story

- ✚ Politicians are pushing against tax competition because they want more money to prop up the welfare state.
- ✚ If they succeed, there will be global economic misery.
- ✚ Inevitable bad news when government grows faster than the private sector.



What about Tax Enforcement?

- ✚ Governments have the right to impose bad tax policy.
- ✚ But that power should be constrained by national borders.
- ✚ Foreign financial institutions and/or foreign governments should not be obliged to enforce bad tax laws of other governments.



Conclusion

- ✚ Blog: www.danieljmitchell.wordpress.com
- ✚ Website: www.cato.org
- ✚ Policy videos: www.youtube.com/afq2007
- ✚ Twitter: @danieljmitchell