



## Strategic Memorandum

**Date:** March 30, 2009  
**To:** Supporters of Tax Competition  
**From:** Daniel J. Mitchell, Cato Institute  
**Re:** Prospects for Tax Competition in 2009

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Low-tax jurisdictions are being attacked by several committees in the U.S. Congress. These so-called havens are being assaulted by international bureaucracies such as the Organization for Economic Cooperation and Development (OECD) and European Commission (EC). And they are being turned into scapegoats by the politicians meeting this week for the G-20 Summit. These events do not bode well for supporters of tax competition, fiscal sovereignty, and financial privacy.

In many ways, the election of Barack Obama signaled business-as-usual in Washington. Former President Bush expanded the size and scope of the federal government and President Obama is pursuing the same misguided policies. For advocates of tax competition, however, an Obama Administration (combined with increased Democratic control of Congress) does indicate a shift in policy. Unfortunately, this shift will be in the wrong direction.

First, the good news (at least relatively speaking): President Bush presided over an enormous expansion in the burden of government, but his Administration largely took a hands-off attitude on matters related to tax competition. The Bush White House did not overtly oppose anti-tax competition efforts by the Paris-based Organization for Economic Cooperation and Development (OECD) and Brussels-based European Commission (EC), but – largely thanks to the efforts of the Center for Freedom and Prosperity – the Administration adopted a policy of “benign neglect.” This proved very helpful. Imposing a global tax cartel without the active participation of the United States would be akin to operating OPEC without the support of Saudi Arabia.

As such, the OECD and EC made little progress during the past eight years in their efforts to persecute low-tax jurisdictions. The OECD blacklist did not lead to sanctions, the EU Savings Tax Directive was emasculated, and the United Nations (which also is pimping for high-tax nations) made little if any progress in its efforts to hinder tax competition. The failure to create a tax cartel meant governments were forced to compete with each other, as evidenced by the continuing move in the direction of lower tax rates and the growing list of flat tax nations. The argument for tax competition has always been – and continues to be – that fiscal rivalry forces politicians to implement pro-growth tax policy even though the normal instinct of politicians is to impose destructive tax policies such as higher tax rates and an increase in the tax bias against saving and investment..

Unfortunately, the Bush policy of “benign neglect” is going to be replaced by an Obama policy of “malign attention.” During the campaign, Obama often condemned low-tax jurisdictions (often attacking Uglan House in the Cayman Islands because of the large number of businesses registered at that address, while failing to mention that many more businesses are registered at specific addresses in Delaware). Empty demagoguery is common on the campaign trail, though. The more worrisome sign is that Obama, while in the Senate, was a main co-sponsor of both the Levin and Dorgan bills to blacklist low-tax jurisdictions.

To make matters worse, President Obama has appointed Larry Summers to chair the National Economic Council in the White House. Summers was one of the instigators of the OECD’s anti-tax competition project while serving as Treasury Secretary during the Clinton years, and his views have not moderated. He is an avid supporter of tax harmonization and seems to believe that there is no economic damage associated with punitive tax rates.

A “malign attention” approach by the new Administration has troubling implications for tax competition. It certainly is bad news for taxpayers in high-tax nations since their governments may feel less competitive pressure to lower tax rates (and some governments may even decide it is safe to make tax systems more oppressive). It also is bad news for the so-called tax havens since, at the very least, the plethora of attacks may scare away investors and also likely will mean higher costs for both governments and the private sector.

To summarize, the new regime in Washington is not good for those who value individual liberty. It is quite likely that the Obama Administration will push for bad unilateral policies – such as the Levin and Dorgan proposals. And it is also likely that the White House will push for bad multilateral policies – unleashing the OECD and other international bureaucracies to harass jurisdictions with pro-growth tax policy. The only silver lining to this dark cloud is that the status quo is pro-tax competition and it will take radical changes in order to tip the scales in favor of tax harmonization.

The following list summarizes some of the key threats to tax competition and low-tax jurisdictions:

### **New OECD Blacklist:**

The Organization for Economic Cooperation and Development is likely to call a global forum later this year where the agenda will undoubtedly focus on remaking the global financial system for the convenience of OECD member-nation tax collectors. The Paris-based bureaucracy’s main goal is to coerce low-tax jurisdictions into signing tax information exchange agreements (TIEAs), though it is a bit of a misnomer to call such agreements TIEAs since there is a one-way flow of information from the low-tax jurisdictions to the high-tax nations. The OECD’s likely strategy will be threatening to put jurisdictions on a new blacklist unless they have signed on to a sufficient number of TIEAs with OECD nations.

### **EU Savings Tax Directive:**

The EC several years ago implemented a Savings Tax Directive designed to help high-tax EU nations track and tax the income generated by flight capital. But this agreement to impose an extra layer of tax is not very effective for two reasons. First, it only applies to capital in EU nations and a limited group of non-EU nations (Switzerland and a handful of European principalities), so taxpayers can move their assets to places such as the United States, Singapore, and Panama. Second, it only applies to a limited class of assets, such as individual bank deposits, so it is possible to avoid the tax with a modest amount of financial planning. To address these “loopholes,” the EC wants to expand the initiative so that more jurisdictions are part of the cartel and so that more forms of capital are brought into the net.

### **April G-20 Summit**

The financial crisis is giving governments a new excuse to persecute low-tax jurisdictions. Rather than address the policy mistakes that caused instability, such as loose monetary policy and housing subsidies, politicians intend to use the April G20 Summit in London as an opportunity to push for regulatory harmonization. European nations specifically are preparing a set of common positions that would grant the IMF and FSF more tax money and more authority to impose one-size-fits-all policies on the world. The Europeans specifically want all jurisdictions to participate in the regulatory cartel and they have called for a “list of uncooperative jurisdictions and a toolbox of sanctions” – very akin to the proposal for sanctions for nations that do not acquiesce to the OECD’s proposed tax cartel.

### **Levin and Dorgan Legislation**

As a candidate and while in the Senate, President Obama stated an interest in closing the \$350 billion dollar “so-called” tax gap by stopping “the abuse of tax shelters and offshore tax havens.” He became a leading sponsor of legislation creating blacklists of low-tax jurisdictions. The Levin-Obama blacklist legislation is designed, for all intents and purposes by creating a presumption of guilt, to discourage individuals and smaller businesses from operating in selected low-tax jurisdictions. The Dorgan-Obama legislation is designed, by ending any ability to postpone the imposition of US tax on foreign-source income, to discourage large companies from investing in a slightly different group of selected low-tax jurisdictions.

### **QI Regulations**

The US government is seeking to expand upon existing qualified intermediary (QI) regulations designed to coerce foreign financial institution into helping enforce American tax law. The existing regulations, which were developed during the Clinton Administration, already impose regulatory and administrative costs that discourage investment in the U.S. and infringe on the financial privacy of investors. The new QI regulations would increase this burden and further weaken incentives for foreign investors to invest in the American economy.

## **Conclusion**

Both in the U.S. and abroad, the battle to preserve and protect tax competition has become more challenging. But it was even more challenging ten years ago, when the international bureaucracies had first launched their offensives against low-tax jurisdictions. In 2000, for instance, three different blacklists were unveiled targeting low-tax jurisdictions. A global tax cartel seemed a foregone conclusion.

Thanks to the Center for Freedom and Prosperity, these attacks were largely blunted. Winning the upcoming battles will be even more challenging, particularly with a White House that is dogmatically opposed to tax competition, fiscal sovereignty, and financial privacy. The good news, as noted above, is that the status quo is largely favorable and the other side will need to make huge changes in order for governments to once again feel unconstrained in their ability to impose bad tax policy.

Proponents of good policy therefore need to focus on creating as many roadblocks as possible on this modern-day version of the “Road to Serfdom.” The role of the Center for Freedom and Prosperity, along with its many allies in the Coalition for Tax Competition, will be more important than ever.