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THE NEW WORLD WAR AGAINST ECONOMIC GROWTH AND CIVIL SOCIETY

Introduction

Global economic growth and civil society are now under attack by a group of largely unelected government and international organization bureaucrats who either do not understand or do not care about the ultimate consequences of the policies and actions which they advocate. The aggressors in this new war began by attacking so-called harmful tax competition in their quest for “tax harmonization”, code words for higher levels of taxation, particularly on capital, throughout the world. Financial capital is the “seed corn” of economic growth. More financial capital means more productive investment which in turn causes faster economic growth, more and higher paying new jobs, and enhanced living standards. Increasing the tax burden on financial capital means less capital available for new investment, hence falling growth rates, more unemployment, and lower living standards.

In order to achieve “tax harmonization” it is necessary to eliminate so-called capital flight, which requires extensive information sharing among governments, and international organizations. In reality, information sharing must be complete and will ultimately strip away any vestige of financial privacy. This is because, in the age of digital electronics where almost any asset can be securitized, financial capital will flow through any electronic hole on the globe that is not blocked. To stem capital flight, governments are requiring increased financial reporting by their citizens and resident institutions, in order to fully monitor all sources of income and expenditures. As this sensitive information is increasingly shared among government agencies and between various governments, more of it is subject to leaks and misuse. Personal and institutional financial information is of enormous benefit to corrupt or despotic governments, and to various criminals, whether they be kidnapers, extortionists, or other lawbreakers. As more and more financial privacy is stripped away, and revealed either deliberately or inadvertently, to the criminal and corrupt, both individuals and institutions become increasing at risk, and as a result civil society is undermined and ultimately destroyed.

The remainder of this paper details the causes and consequences of this war, and what must be done to stop it.

Background:

The countries of continental Europe are welfare states with partially socialized economies. Birth rates have been declining for several decades with the result that fertility rates in the Euro area are now below replacement level. At the same time there have been continuing increases in life expectancy. The combination of low birth rates and increasing life expectancies

means the burdens of the welfare state are accelerating due to growing medical and retirement demands of an aging population. As tax and regulatory burdens have grown to support these social welfare states, economic growth has declined, both in absolute terms, and relative to their major economic competitors in America and Asia.

Europe is an increasingly unattractive place in which to invest and engage in business. Tax rates are well over the point of diminishing returns. Taxes on labor have resulted in average unemployment rates 50 to 100% higher than in the U.S. for well over a decade. Taxes on goods and services have reached the level where black markets thrive and the rule of law and civil society is undermined. Tax rates on saving and productive investment are so high that capital has been flowing out of Europe for a generation, thus diminishing economic growth. Government leaders, in their desperation to find more tax revenue to feed the ever-growing bureaucracy and welfare state have turned their guns on flight capital.

The statist officials and bureaucrats that control these governments argue, if they were able to tax the capital that has been leaving Europe, they could solve part of their revenue problems. This argument ignores several inconvenient facts. First, people will not save if their savings are taxed away. Second, if governments increase the tax burden on productive savings and investment, there will be even less investment and even slower growth, which will increase the burden of the welfare state. Third, capital flight is almost impossible to stop in a world where nearly anything can be securitized, and where capital can move over the Internet almost at the speed of light. Fourth, the right to hold and use property is a basic human right, and to the extent it is taxed or regulated away, liberty is diminished.

Much of the capital that left the E.U. went either directly to the United States or Asia or through low tax jurisdictions (pejoratively called “tax havens” by high tax advocates). Some of the jurisdictions that have been called tax havens include the Channel Islands, the Isle of Man, Luxembourg, Switzerland, Liechtenstein, Bermuda, the Bahamas, the Cayman Islands, and other Caribbean and Pacific island nations and colonies, and even the United States (because it does not tax most interest and capital gains earned on portfolio investments in the U.S. by foreigners).

Despite these inconvenient facts, European officials convinced the OECD (Organization for Economic Cooperation and Development), a multinational organization made up of 30 major democratic nations whose original mission was the collection and dissemination of economic data, to prepare a report attacking “harmful tax competition”. The original OECD report on Harmful Tax Competition was published in 1998. In addition, the Financial Action Task Force (FATF), an international organization established in 1989 related to the OECD, attacked many of the low tax entities for not preventing money laundering (more of this later), conveniently overlooking the fact that most money laundering takes place in London and New York. The United Nations got into the act in 2001, when it issued a report calling for an “International Tax Organization” which would fight tax competition, assist in full financial information sharing among its members, and provide certain tax revenues directly to the U.N. without going through member states. The E.U. piled on in 2000 by proposing a “savings tax directive”, which would require automatic exchange of information on investment earnings among the member states, and certain other selected countries including the United States. Subsequently, the Clinton Administration, issued an proposed interest reporting regulation that would require U.S. banks to

report U.S. source interest earned by foreigners to foreign governments (the U.S. does not tax most bank deposit interest earnings by foreign non-resident citizens).

The Bush Administration announced that they are explicitly in favor of tax competition. They also have stated that they will not support the E.U. savings tax directive. However, they are still considering supporting a modified version of the interest reporting regulation that would initially apply only to certain OECD countries with which we have a tax treaty. A number of the so-called tax haven countries (including some British Crown colonies) have announced that they will not agree to the E.U. savings directive unless the U.S., Switzerland, and others also agree to it. The Swiss (whose banks have about a third of all foreign capital deposits) have explicitly refused to accept the E.U. savings directive or participate in blanket information sharing. They have told the E.U. that under certain conditions they may engage in tax withholding to be remitted to the E.U. on a country-by-country basis, without identifying the holders of specific accounts.

Is Tax Competition Harmful?

Virtually all forms of competition are considered desirable, because competition results in greater efficiency and consumer choice. Monopolies, whether they be private firms or governments, have little incentive to be efficient or to provide consumers what they need and want at reasonable prices. Economists have long argued that competition between governments is beneficial because it reduces wasteful government spending and forces a certain discipline on politicians. Politicians invariably tend to spend taxpayer money on projects that will benefit the politician directly or his or her re-election chances, with little or no benefit to the citizens. Recent papers issued by the National Bureau for Economic Research, and the Institute for Economic Affairs both conclude that the OECD and E.U. anti-tax competition initiatives are harmful, even to the E.U. countries, because increasing tax competition is likely to improve voter welfare. Tax competition results in less non-productive government spending.

Those government bureaucrats, who are pushing to eliminate tax competition, have made it abundantly clear that their goal is to increase taxes particularly on productive saving and investment. The overwhelming importance of investment in plant and equipment for economic growth has been demonstrated in virtually every study that has dealt with the matter. Both technological progress and labor productivity are highly correlated with capital investment. If you tax savings and investment, you get less productive investment and hence lower productivity growth, more unemployment and lower real wage growth, lower real incomes and more poverty. Studies have shown that every major country in the world now taxes productive savings and investment above both the tax revenue and growth maximizing rates. To further increase such taxes would be both economically and morally irresponsible, but that is exactly what the OECD and E.U. are proposing.

Should Governments Engage in Blanket Information Sharing?

Financial capital is the most mobile of all the factors of production. Land cannot be moved, manufacturing plants can only be moved with great expense and difficulty, and there are many personal and legal impediments to the free movement of people. Financial capital,

however, can be moved at very low cost and in a very short time to almost any place on the globe through electronic means. Legal restrictions on capital movements can often be thwarted by well motivated individuals since there is an almost infinite number of ways to move capital, and, with the rise of new techniques such as public key encryption, the ability to evade government knowledge of such movements is increasing.

If enacted, the E.U. savings tax directive, and related measures are almost doomed to fail because of the many ways to both legally and illegally evade the directive. Such evasion will almost certainly be met with calls for even more extensive and intrusive information sharing. There are representatives of FATF and other government bureaucrats who understand that any partial blanket information sharing scheme is almost doomed to failure, because in the electronic digital age any partial electronic wall can be easily breached. Therefore, they have called for an end to all financial privacy. Proposals have been made at the Cambridge International Symposium on Economic Crime (September 2001), and other professional forums, to require that governments collect total income, expenditure, and wealth data on all of their citizens and then share such data with all other governments as the only way to stop financial crimes and tax evasion. (Some officials have argued that if such sharing were limited to reliable and responsible governments it would be “discrimination”).

A world without reasonable financial privacy, would be a world where the law abiding and those with means would be easy prey for criminal governments, criminal and corrupt government officials, and other criminal institutions. Information of course is power. If you have detailed financial information about someone else, you could use such information for your own purposes against the best interest of the target individual. These temptations will be almost certainly too much for many people to resist. It is no co-incidence that one of Hitler’s first acts upon taking power in Germany was to give the German government the right to inspect and monitor people’s bank accounts, because he understood that part of controlling the opposition was controlling their use of their financial resources.

The argument against financial privacy is, “if you have nothing to hide, why do you need financial privacy?” That argument is only true if you know with 100% certainty that everyone with access to your finances will always be responsible and honest, and will not disclose your information to others who will not meet such tests. In the real world, there is no government that can honestly make such a claim. Government officials always say, “you can trust us”, but then reality strikes when people find they have been betrayed. The U.S. and U.K. governments are far more honest, and have greater respect for their individual citizens than most other governments yet, every year in both countries, all too many cases and scandals arise where the revenue services have misused sensitive personal or corporate information for political or personal benefit of those with access.

The scandals that have occurred are minor to what will happen if governments have access to every citizen’s financial records and every government has access to the data held by every other government. All governments leak information, and many governments have few controls or sanctions for such leakage. One does not need great imagination to understand how despotic regimes could use such information against internal political opponents or government employees of nations in which they are in conflict. (Diplomats and soldiers would be

particularly at risk.) Kidnappers and extortionists, and even business competitors, would find it easy to bribe government officials somewhere to get information they could use to destroy others. Civil society would collapse and the law of the jungle would prevail.

The argument is made that governments need to share information in order to stop terrorists and criminals. This is true provided the information is shared among democratic governments that respect the rule of law under a legal regime that has enforceable limits on the use to which the information can be put and is limited to individuals or organizations about whom there is reasonable suspicion of wrong-doing. The potential for abuse grows as the amount of data, the number of people or organizations about which the information is being shared, and the number of countries with the shared records grows. This is why proposals for blanket information sharing are so dangerous, and unnecessary.

It is also argued that information sharing is required to stop money laundering. The war on money laundering has even been a bigger failure than the war on drugs. There an almost infinite number of ways to launder money, and the chances of being caught are remote. The evidence is over-whelming that the war on money laundering has neither been cost-effective nor a deterrent. Cash transactions and suspicious activities reports are costly to create and manage and have been shown to be ineffective. If a fraction of the money that governments and private sector financial institutions have spent on anti-money laundering activities had been spent trying to stop the underlying crimes, rather than the use of the money, the world would be a far safer place.

The Currency Transaction Reports (CTRs) system is particularly ineffective because of the sheer volume of reports generated and because the system is so simple to evade by even moderately sophisticated criminals. Suspicious Activity Reports (SARs) are problematic because of the necessary lack of clear and objective guidelines. Unfortunately, the U.S. Congress just made the situation worse with the passage of the USA PATRIOT Act which further expands the reporting system and, in effect, increases the size of the haystack which the law enforcement community must search for the terrorist and criminal “needle.”¹

The problem is growing worse. 156,000 SARs were filed in 2000, 203,538 in 2001 and 12.3 million CTRs were filed in FY 2002.

In sum, blanket information sharing will never be effective in either stopping capital flows, or crime. Unless all information is shared about everyone with everybody, those seeking confidentially will exploit the electronic holes remaining. The more information that is shared about more individuals and institutions, the more liberties will be endangered and the more civil society and the rule of law will be undermined. Blanket information sharing is a fool’s quest, and a danger to anyone about whom information is shared.

¹ The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001 (which includes the *International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001*, the *First Responders Assistance Act*, the *Crimes Against Charitable Americans Act of 2001*, and the *Critical Infrastructures Protection Act of 2001*) (H.R. 3162; Public Law No: 107-56).

What should be done?

First identify the enemy. Most of those who are advocating an end to tax competition and financial privacy, and promoting global financial information sharing are well meaning but not very thoughtful people, who are ignorant of the consequences of their own actions. Many in this group are the later day brethren of the utopian socialists who had little understanding of the wreckage and human misery they were going to create. In addition, there is a smaller group of power and resource seeking bureaucrats who care little about the long run consequences of their actions, but only about their shorter-term personal gain.

This war will be won not by guns and bullets, but by educating opinion leaders about the risks of the anti-tax competition and information sharing proposals. A major effort needs to be made to discredit the whole fallacy of “harmful tax competition” by showing that it is a concept without intellectual merit, and is not worthy of serious discussion or consideration. To win the arguments against “harmful tax competition” and blanket information sharing, the efforts of those who are capable of making the serious intellectual case against these concepts need to be supported. Then, the work must be translated into user-friendly articles to educate the press and political leaders, and then widely disseminated.

The purveyors of this intellectual dishonesty and naiveté, who have put everyone at risk have had the advantage of their access to the public purse to spread their poison. Thus, those who both understand the danger and have the financial means to support the battle for freedom, civil society, and prosperity have the responsibility to underwrite the war.

An Agenda for Constructive Action

In May 2001, The Task Force on Information Exchange and Financial Privacy issued a *Report on Financial Privacy, Law Enforcement and Terrorism*. The Task Force, Chaired by former US Sen. Mack Mattingly, was composed of leading former law enforcement officials, tax attorneys and economists.² It developed a program that would enhance the ability of responsible governments to fight terrorism and organized crime while enhancing the financial privacy of ordinary law abiding citizens.

The Task Force recommended the formation of an effective international Convention on Privacy and Information Exchange composed of democratic governments that respect the rule of law. The Convention proposed by the Task Force would streamline and improve the exchange of information for law enforcement, national security and anti-terrorism purposes and establish under international law enforceable restrictions on the use to which collected information could

² The Task Force included former U.S. Sen. Mack F. Mattingly, Chairman, former Rep. and Vice Presidential nominee Jack F. Kemp, former attorney general Edwin Meese, III, David R. Burton, Dr. Veronique de Rugy (Cato Institute), Stephen J. Entin (Institute for Research on the Economics of Taxation), James W. Harper, Esq. (PolicyCounsel.com, Privacilla.org), Dr. Lawrence A. Hunter (Empower America), J. Bradley Jansen (Free Congress Foundation), Dan Mastromarco (Prosperity Institute, Argus Group), Dr. Daniel Mitchell (Heritage Foundation), Andrew Quinlan (Center for Freedom and Prosperity), Dr. Richard W. Rahn (Discovery Institute), Solveig Singleton, Esq. (Competitive Enterprise Institute), Mark A. A. Warner, (Hughes, Hubbard & Reed), and the Hon. John Yoder, Esq. (Burch and Cronauer).

be put. Moreover, the Convention would establish a private right of action to enforce individual legal rights under the Convention.

The Task Force also proposed that money laundering laws be better targeted. Rather than bury investigators in a mountain of millions of currency transactions reports or suspicious activity reports with respect to law-abiding citizens, a more effective system should be developed where, the activities of persons on a government watch list are provided by financial institutions to the appropriate national authorities. Persons could be placed on the watch list if the government had a reasonable and significant suspicion of unlawful conduct..

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