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## Time for Me to Defend My Work on Tax Havens

A few days ago, I explained why I'm a big fan of tax competition. Simply stated, we need to subject governments to competitive pressure to at least partially offset the tendency of politicians to over-tax and over-spend.

Tax havens play an important role in this liberalizing process, largely because they do not put themselves under any obligation to enforce the bad tax laws of other jurisdictions. They also use privacy laws to protect their sovereign control of what gets taxed inside their borders (this is what separates a “tax haven” from a more conventional low-tax jurisdiction). This means they are fiscal safe zones, particularly for people who want to protect their assets from the pervasive double taxation that exists in so many nations.

Not everybody agrees with my analysis (gee, what a surprise). To cite one example, the petty bureaucrats at the OECD got so agitated at me in 2009 (when I was offering advice to representatives of so-called tax havens while standing in a public lobby of a public hotel) that they threatened to have me thrown in a Mexican jail.

Now I have a new critic, though hopefully someone who would never consider thuggish tactics to suppress dissent. Ann Hollingshead writes for the Task Force on Financial Integrity and Economic Development, which (notwithstanding the name of the organization) seems to favor bigger government.

Anyhow, she wrote an article specifically criticizing my work on tax havens. So I figured it was time for a fisking, while means a point-by-point rebuttal. Here's how she begins, and I'll follow up her points with my responses.

Officially Dan Mitchell is a Senior Fellow at the Cato Institute, a conservative public policy research organization, and a researcher on tax reform. Unofficially, he has (perhaps ironically?) called himself the “world’s self-appointed defender of so-called tax havens.”

**No irony on my part. As I have openly stated, tax havens are a key part of tax competition, which is a necessary (though sadly not sufficient) process to restrain the greed of the political class.**

Oddly enough, Mitchell and I agree on many of the facts about these havens. We both have observed, for example, that there are buildings in Delaware and the Cayman Islands that house thousands of corporations. Mitchell concludes there is nothing wrong with either; I conclude there is something wrong with both. Mitchell also agrees that the United States “could be considered the world’s largest tax haven.” On that topic, he’s even cited my paper on non-resident deposits in secrecy jurisdictions. In his comment, he does not take issue with my methodology or my results, but rather concludes that my finding that the United States is the largest holder of non-resident deposits “makes the case for pro-market policies.” I, on the other hand, have argued that these findings support across the board reform, rather than that limited to traditional offshore financial centers.

**Fair enough. We both recognize that the United States is a big tax haven. But we have different conclusions. I think it is unfortunate that only non-resident foreigners can benefit from these policies, while Ann wants to crack down on small low-tax jurisdictions such as Monaco, Bermuda, Liechtenstein, and the Cayman Islands, as well as big nations such as the United States. Sadly, Ann’s side has somewhat prevailed, and many of the havens have agreed to become deputy tax collectors for nations with bad tax law.**

So how is it that two (relatively intelligent?) people can draw such different conclusions? I would argue our differences lie not in our facts, or perhaps even our economics, but in our underlying philosophical and theoretical differences.

**I guess I should be happy that she holds out the possibility that I’m “relatively intelligent.”**

Mitchell implicitly takes the position that tax havens do enable tax evasion and this helps to lower tax rates. He argues “it is largely globalization—not ideology—that has driven [a] ‘race to the bottom’” where global top corporate tax rates now average about 27 percent, down from 67 percent in 1980. Mitchell does not only believe this has occurred, but also maintains it is a positive development. He argues tax competition drives tax policy in the “right direction” (i.e., lower tax rates), has called these developments “positive,” and has even likened policy makers to “thieves” and tax competition to home “alarm systems.”

**Ann makes one minor error. Corporate tax rates have dropped from a high of about 48 percent (and are now down to less than 25 percent). Top personal tax rates, by contrast, used to be more than 67 percent (and have now dropped to about 41 percent).**

Regarding these developments, I think they are very positive. And I also think that politicians are akin to thieves, though Godfrey Bloom, a British member of the European Parliament, says it with a much better accent.

Mitchell's argument that lower tax rates are always better and that those who tax others are thieves, makes several implicit assumptions about the relationship of citizens to their government. From his line of reasoning, Mitchell either believes, on a philosophical level, that governments do not have the right to tax their citizens or, on an economic level, that lower tax rates are always better, or both.

I definitely believe that lower tax rates are better than higher tax rates.

Mitchell may believe that taxation is the equivalent of thievery—and therefore that governments do not have the right to tax their citizens, just a thief does not have the right to steal. But he is also (more than likely) not an anarchist, which is the next logical extension of this reasoning, because on a number of occasions he has advocated a flat tax.

Ann makes a good point here. I've already admitted, in this post featuring a funny video mocking libertarianism, that I don't see how to privatize the justice system and national defense, so I'm not an anarcho-capitalist.

Mitchell also argues lower tax rates are universally better, so at what point does the tax rate become acceptable? Clearly he doesn't believe the tax rate should be zero, because that would get back to the anarchism theory. And he did once offer tepid support for Herman Cain's 9 percent rate.

Another fair point. If a 50 percent tax is confiscatory and if politicians who impose such a tax are akin to thieves, then why would a 10 percent tax be acceptable? And would politicians imposing low tax rates still be acting like crooks?

Those are tough questions. But at the risk of dodging thorny philosophical issues, I'll claim it doesn't really matter. Government is too big right now and taxes are too onerous and unfair. If I somehow manage to bring government down to 10 percent of GDP, as the Rahn Curve suggests if we want to maximize prosperity for the American people, then I'll have the luxury of worrying about the moral legitimacy of a limited public sector.

Clearly there's a disconnect. Taxation cannot both be thievery, but also acceptable at a lower level. There is no evidence that, if tax competition through tax evasion is real, it would cease to drive down tax rates at some level that has been deemed acceptable by Dan Mitchell. So at what point does the "race to the bottom" bottom out? And is that a point where the United States can still maintain services that I'm sure Mitchell doesn't advocate giving up, like police and law courts?

If I understand this passage correctly, I disagree. Tax competition does not drive tax rates to zero. It just encourages better policy. There's pressure to

lower tax rates, and there's pressure to reduce double taxation of income that is saved and invested. But there's no reason to think that tax competition and/or tax evasion forces the overall tax burden "to the bottom."

But I would be remiss not to point out some internal inconsistencies in Mitchell's arguments, in addition to his logical ones. While he argues tax competition through tax evasion in havens has fostered lower tax rates worldwide, he has also reckoned that "only a tiny minority" of people who keep their money in havens "are escaping onerous tax burdens." First of all, I would be interested to see where Mitchell got that statistic because no one knows how much money is deposited in havens, let alone its origins. Such information isn't publicly available. That's actually the whole point. And secondly, and more importantly, I'm unclear on how such a "tiny minority" of overseas deposits could drive international tax policy to such an extent that the average corporate tax rates have dropped by more than half in thirty years.

Actually, there is considerable data about the amount of money in tax havens. The Bank for International Settlements is a good place for those who like to peruse such information.

But that's a secondary point. Her main criticism is that I'm inconsistent when I say tax evasion is minor, so let me allow me to elaborate. Tax competition works by making politicians fearful that jobs and investment will migrate to jurisdiction with better tax law. It works just as well when people engage in legal tax planning and legal tax avoidance as it does with illegal tax evasion.

Places such as the Cayman Islands, for instance, rely on completely legal and transparent lines of business such as hedge funds and captive insurance companies. Places such as Panama have completely legal shipping registries. Places such as the British Virgin Islands specialize in completely legal company formation. Places such as the Channel Islands focus on completely legal trusts. Places such as Bermuda are known for completely legal reinsurance firms.

The "illegal" part of the offshore business does exist (at least as defined by high-tax nations), and it tends to be in the areas of private wealth management and banking. And even then, only in jurisdictions that have very strong human rights laws protecting financial privacy.

To be sure, there's no way to precisely state how much tax evasion exists, but I can say with total certainty that the left's claims are absurd. During the 2008 campaign, for instance, then-candidate Obama said that his anti-tax haven policies would generate \$100 billion every year. When his law was enacted in 2010, that huge amount of money shrank to only \$870 million per year. And

even that estimate is a mirage because the President's FATCA law is discouraging productive investment in the United States.

It is not my intention to demonize Mitchell and I hope you'll notice that I've neither called him, nor implied that he is, a "careless and know-nothing hack." I also have no interest in taking easy jabs that imply he is personally benefiting from tax evasion through havens or that he is seeking to destabilize the U.S. government by removing its ability to tax its citizens. Such attacks might generate readers, but they don't generate thoughtful discussion and I'm much more interested in the latter than the former.

You may be wondering why she included the comment about a "careless and know-nothing hack." It's because I used that phrase to describe a journalist who wrote a very sloppy article. But I don't automatically disparage those with different views. I'll disagree with people and argue with them, but I don't mock them if they have serious and substantive views.

I suppose I should also say, just for the record, that I fully comply with all the onerous demands imposed on me by the government. Not because I want to, but rather because I worry that my work on public policy sooner or later will attract some discriminatory and politically motivated attention from the IRS. It hasn't happened yet, so I hope I'm being needlessly paranoid, but suffice to say that I go out of my way to even declare income that I know isn't reported to the tax police.

So here are my questions, to anyone who will answer. 1) On what philosophical basis, if any, do governments draw the right to tax their citizens?; 2) Do citizens have a moral or philosophical right to evade taxation by using tax havens under any circumstances?; 3) If so, at what level of taxation do those citizens no longer have a moral right to evade tax?; and 4) what is the philosophical reasoning that justifies this level?

Now we're back to the hard-to-answer questions. When is government too big and when does it impose so many demands that people are justified in evading taxation? I'm not sure, but I'll fall back on what former Supreme Court Justice Potter Stewart said about pornography: "I know it when I see it."

Put in context, I don't blame people from France for evading confiscatory taxation. I don't blame people in corrupt nations such as Mexico for evading taxation. I don't blame people in dictatorial nations such as Venezuela for evading taxation.

But I would criticize people in Singapore, Switzerland, Hong Kong, or Estonia for dodging their tax liabilities. They are fortunate to live in nations with reasonable tax rates, low levels of corruption, and good rule of law.

Let me now circle back to the main point. In a world with vigorous tax competition, especially when augmented by the strong human rights laws of tax havens, nations will face some pressure to move their policies closer to Hong Kong and away from France. That's something worth protecting and promoting, not something to be stamped out by high-tax nations seeking to create a tax cartel – sort of an OPEC for politicians.

Last but not least, if you haven't yet overdosed on this topic, here's my speech to a Capitol Hill audience on the valuable role of tax havens in the global economy.