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A Swiss Response to American Fiscal Imperialism

By Dan Mitchell

Switzerland is in the unfortunate position of being bullied and harassed by the U.S. government. The crux of the problem is that the United States arguably has the world's worst tax system for international activity, and this creates conflict with other nations, particularly ones that have good tax laws that attract investment.

This has resulted in a number of different attacks against Swiss sovereignty. On the multilateral front, the Obama Administration is actively supporting the anti-tax competition project of the Organization for Economic Cooperation and Development.

On the unilateral front, the United States is imposing onerous laws on the entire world, such as the Foreign Account Tax Compliance Act (FATCA), which seeks to coerce foreign financial institutions into acting as deputies for the Internal Revenue Service (IRS. And on the bilateral front, the American government has initiated actions that specifically target Switzerland, such as legal attacks on individual institutions and pressure for tax agreements that would violate long-standing human rights laws protecting individual privacy.

The challenge for Switzerland is that the United States is the most powerful nation in the world, and the U.S. government has decided to treat its "Sister Republic" almost as if it was some sort of pariah regime.

What makes this situation particularly frustrating is that it is entirely the result of bad American policy.

* America has pervasive double taxation of saving and investment and an imperialistic worldwide tax system, and those bad policies motivate the multilateral, unilateral, and bilateral assaults.

* America is in terrible fiscal shape thanks to overspending by both Presidents Bush and Obama, creating an environment where the IRS has free rein to be extra aggressive in the search for more revenue.

*America has a political class that is willing to engage in (or capitulate to) class-warfare politics, regardless of the adverse impact on U.S. prosperity and competitiveness.

To be optimistic, there is a possibility that these problems will become less onerous after the 2012 elections, even if President Obama wins reelection. To be sure, the President is hostile to the private sector and he ideologically supports higher taxes, so he will want to maintain the U.S. government's unfriendly approach to Switzerland. But it is quite likely that Republicans will control both the House and Senate beginning next year, and that will hinder the President's ability to pursue a hostile agenda. To cite one example, it is quite likely that Congress will seek to slash subsidies for the OECD.

If Governor Romney wins, that could make a difference, especially since he presumably will understand that bad American policy is the reason for the conflict. But that doesn't ensure a change in policy unless America's punitive tax laws are reformed. Unfortunately, Romney will be reluctant - because of his personal wealth - to advance policies that can be portrayed as helping the so-called rich. We can't expect a Reagan-style agenda of economic liberty and individual freedom, so something like a flat tax is very unlikely.

In other words, while the situation will probably improve after the elections, there will still be major challenges. Given this semi-pessimistic outlook, what can Switzerland do to protect its fiscal sovereignty and human rights privacy laws?

Part of the answer is to have a reactive strategy. Swiss firms already are getting rid of American clients. This is particularly bad news for overseas Americans, who are being greatly inconvenienced by the bad laws coming out of Washington, but it is probably too costly and too risky for Swiss institutions to have customers that are also U.S. tax residents.

Swiss institutions also can seek to disengage from the American economy. Without direct investments in American stocks and bonds, there's no nexus for the IRS to exploit. But while this might be an effective approach for particular firms, it's presumably not realistic for the broad financial services industry.

The Swiss government also can help by effectively resisting some of the most outrageous demands by the American government. The Justice Department and Treasury Department are run by leftist ideologues, but some of the bureaucrats who negotiate agreements will not be as unreasonable. And the State Department presumably will have a better understanding of how America's bad tax laws are fundamentally inconsistent with Switzerland's legal and economic policies.

It is also important to have a proactive agenda. Switzerland should be more aggressive about explaining that the conflict with the U.S. government is a result of bad American tax laws. The Swiss government should proudly discuss its admirable human rights policy with regards to financial privacy. And it should educate people in the United States about how policies of fiscal prudence and respect for individual rights have created substantial prosperity.

Switzerland has many allies in the United States, both in Washington and all across the nation. And with an effective education campaign, more support can be generated from members of Congress, public policy groups, and academic experts. The message should be simple: Swiss policies should be emulated, not persecuted.

Last but not least, government officials and private sector representatives in Switzerland should offer some much-needed friendly advice to their American counterparts. There is increasing resentment around the world toward the United States, and there is a growing desire to restrain Uncle Sam - leading some people to say that it's time to end the dollar's role as the world's dominant currency. This would be bad news for the United States, which reaps big benefits because the dollar is the main currency for international transactions, as well as the biggest reserve currency.

This would not happen overnight, particularly since the most obvious alternative - the euro - lost some prestige when the European Central Bank sacrificed its independence by agreeing to bail out some of Europe's bankrupt welfare states.

But if several European nations decided to make a shift, joined by oil-exporting nations and Asia's emerging economic powers, things could change dramatically in just a few short years. That is so especially because nations would see a fringe benefit of being much less susceptible to bad laws such as FATCA once correspondent relationships with U.S. institutions become less important.

To be blunt, the U.S. government needs to understand that bullying unilateralism to enforce bad law is a risky proposition. Not only is it discouraging foreign financial institutions from investing in the American economy, it also could cause other headaches.

Switzerland has the right policy and the moral high ground. With the right approach, a virtuous David can triumph over a misguided Goliath.

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