IDEAS ON LIBERTY
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Harmful Tax Practices?

by David N. Laband

The Organization for Economic Cooperation and Development (OECD), a Paris-based group of 29 governments (including the U.S. government) is demonizing tax havens around the world. Consider this statement from a recent OECD report: "Harmful tax practices may exist when regimes are tailored to erode the tax base of other countries. This can occur when tax regimes attract investment or savings originating elsewhere and when they facilitate the avoidance of other countries' taxes."*

In June the OECD published a list of 35 tax havens, warning of sanctions a year from now if these countries fail to change their ways. A CNN.com story quoted from an OECD statement that these countries "are being given the opportunity over the next 12 months to determine whether or not they wish to work with the OECD to eliminate harmful features of their regime" and that "defensive measures" could be taken against places that chose not to conform with international tax standards.

The OECD Web site (see note) is particularly illuminating. Beneath the headline "Harmful Tax Practices" is written: "Globalisation and new electronic technologies can permit a proliferation of tax regimes designed to attract geographically mobile activities. Governments must take measures, in particular intensifying their international cooperation, to avoid the world-wide reduction in welfare caused by *tax-induced distortions in capital* and financial flows and to *protect their tax bases*" (emphasis added). Evidently, the OECD has a problem with tax competition: "If nothing is done, governments may increasingly be forced to engage in competitive tax bidding to attract or retain mobile activities. That 'race to the bottom', where location and financing decisions become primarily tax driven, will mean that capital and financial flows will be distorted and it will become more difficult to achieve fair competition for real economic activities."

Furthermore, the OECD warns that tax havens make collecting taxes on "mobile activities" difficult—creating serious consequences: "If spending is not reduced to make up for this revenue loss there is a real risk that taxes on labour, consumption and non-mobile activities will need to be increased. This shift will make tax systems less equitable and, by narrowing the tax base, will introduce further distortions. By increasing non-wage labour costs, it may also have a negative impact on employment. . . . The potential impact of these developments is significant."

OECD estimates that "foreign direct investment by G7 countries in a number of jurisdictions in the Caribbean and in the South Pacific island states, which are generally consid-

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*Organization for Economic Cooperation and Development, "Harmful Tax Practices," www.oecd.org/daf/fa/harm_tax/harmtax.htm#Report. According to the organization's Web site, the OECD "most importantly, provides governments a setting in which to discuss, develop and perfect economic and social policy."

ered to be low-tax jurisdictions, increased more than five-fold over the period 1985–1994, to more than US$200billion."

Sounds bad, huh? Well, it *is* bad. Only the real problem is that the OECD is trying to kill a tried-and-true cure for the underlying problem of high taxes. Throughout recorded history, when taxes, social or religious policies, or other political conditions have become onerous, freedom-loving individuals have either fought to overthrow the oppression or fled to other locations where they were not so oppressed. Like the Pilgrims who fled religious persecution in England in favor of America, the oppressed vote with their feet. This clearly is welfare-enhancing for the formerly oppressed individuals, although likely welfare-reducing for the former oppressors. On net, it almost certainly is the case that social welfare is enhanced by voting with the feet; otherwise the oppressors would have been willing and able to strike a bargain with the oppressed to induce them not to leave.

Fleeing Oppression

Corporate raiders specialize in taking over mismanaged companies and finding better management. The raider is not the cause of the acquired company's problems; he is an entrepreneur who helps cure the underlying problem of mismanagement. Similarly, capital flight away from political mismanagement serves the same purpose. Whether the political mismanagement takes the form of direct seizure of real or financial assets or indirect seizure through high taxes or onerous regulation, capital flight sends an unmistakable message that individuals are oppressed. Labor flight serves the same purpose. The point is, the problem does not originate in the country where the owners of labor and capital settle; it originates rather in the country from which the owners of labor and capital fled.

Indeed, if the discussion were focused on the large-scale movement of politically or ethnically oppressed refugees from Rwanda to Uganda or from Kosovo to Montenegro, there likely would be strong agreement within OECD that the real problems lay in Rwanda and Kosovo, not in the safe havens of Uganda or Montenegro. The seeking of a safe haven is symptomatic of underlying pathology in the home country; it is not the pathology itself.

Not everyone who is oppressed can or will move. A variety of factors (family or social reasons, not easily transferable labor skills, immobile physical capital, religious beliefs) may make an individual immobile, despite political, religious, social or other oppression. It hardly seems efficient to preclude those who are willing and able to move on the grounds that there are others who are unable or unwilling to do so.

Yet that is exactly what the OECD argues for: "There is no reason why taxpayers that do not or cannot take advantage of harmful tax practices should have to pay the taxes avoided by those who have easy access to tax havens and harmful preferential tax regimes."

This position reflects only one possibility and one that likely misses the mark by a wide margin. Perhaps those left behind *should* pay the taxes avoided by those who have fled to tax havens. If one group of citizens is politically able to use the fiat power of the state to force everyone to pay taxes to fund projects valued highly only by members of that group but abhorred by everyone else, welfare is enhanced by increasing the taxes on the former and reducing taxes on the latter. Seeking tax havens is one way of accomplishing this result; eliminating tax havens in this context is welfare-reducing, not welfare-enhancing.

Back to the issue of causation: the problem here is not tax havens and not mobile capital. Tax havens do not create mobile capital. Rather, mobile capital (just like mobile labor) continuously seeks a better place to live. The real problem is high taxes and oppression. High taxes reduce the return to owners of capital and labor. The owners of both react predictably: by reducing the amount of capital and labor they supply. They do so either by converting their immobile capital to mobile capital and leaving the area entirely in favor of a location where the returns are higher, or by refusing to work (or to put their capital to work). Either way, the impact of high taxes is welfare-reducing. By implication, then, the impact of tax havens is unmistakably welfare-enhancing. The more capital (or labor) that flees to tax havens, the stronger the message sent to the politicians that taxes are too high. This is information that political leaders need to have in order to make fully informed decisions about tax policy. Full information is a sine qua non of efficient decision-making.

Key factors used by the OECD in identifying and assessing harmful preferential tax regimes include no or low effective tax rates, lack of transparency, and lack of effective exchange of information. It is ironic, if not hypocritical, that the OECD faults tax havens for their lack of "transparency" and lack of effective exchange of information while simultaneously doing its utmost to prevent an effective flow of information from taxpayers to politicians. Absent this information, taxes almost certainly will be too high.

The OECD policy initiative (Forum on Harmful Tax Practices) that is responsible for identifying and attacking tax havens does not promote welfare (although it claims to, of course). Rather, it is a mechanism designed to protect members of the OECD cartel. A reasonable person could infer the OECD's real intent from the previously highlighted quote from its Web site: countries need "to protect their tax bases." Enough said. □

Economics

Marginalism and the Morality of Pricing Human Lives

When I ask students in my large economics classes if some things are just too important to put a price on, someone always answers, "human life." This seems like a reasonable answer. After all, how many people would sacrifice their lives for cash, no matter how much was offered? What is the point of being a rich corpse? But economists reject the notion that human life is priceless. They put a price on human life, not because they are uncaring, callous, and completely lacking in moral sensitivity, but because they have a professional interest in understanding human action and because they understand that there is nothing morally lacking about pricing human life.

All of us put a price on our own lives every day with the choices we make and the actions we take. And pricing human life provides information that can save large numbers of lives, certainly not an immoral activity. Unfortunately, the moral superiority that so many people feel when expressing outrage at pricing human life helps keep in place government policies that cause many people to die needlessly.

Recognizing that prices reflect the marginal value of things is the key to understanding why economists put prices on human life. The price of asparagus gives us information on the value of one more pound of asparagus, not the value of the entire crop. Similarly, when economists talk about the price of human life, they are referring to the marginal value of life—the value of a slightly longer life expectancy—not the total value. The total value we put on our lives is extremely high (in most cases infinite), so we would not agree to be killed for any amount of money. Yet we put a very low marginal value on our lives. We routinely do things that reduce our life expectancy by marginal amounts in return for rather minor conveniences and pleasures. We often stay up too late, eat and drink too much, fail to get enough exercise, and drive too fast. When we do so, we are putting a price on our lives, and a pretty low price. Just how much is it worth to eat that extra cream puff or drink that extra beer? You would probably forgo the cream puff for $10, but not to avoid reducing your life expectancy by a marginal amount. If so, the implication is clear—the marginal value, or price, you place on your life is no more than $10.

The Risks of Government Policies to Reduce Risks

There is nothing wrong or irrational about putting a low marginal value on our lives. We face tradeoffs in everything we do, and living a meaningful and satisfying life requires doing things that reduce how long we can expect to live. It is sensible to avoid paying very much to avoid very small risks and the corresponding reductions in life expectancy.

In many situations we can choose how much to pay to avoid risks. We can choose to

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