Tax Harmonisation: A Threat to Liberty

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Its future now turns on its readiness to shrink its economic domain, perhaps by as much as a half. If it fails, it faces the even more formidable prospect of waging guerrilla financial war against the people.

The signs of reality vary from the constitutional to the politically pragmatic. The most menacing, for democracy itself, are the efforts to outlaw the legal practice of tax avoidance. Arthur Seldon (1998: 95)

Introduction

In this paper I set out the argument that tax harmonisation is not only economically undesirable but that it also constitutes a massive expansion of the authority and powers of government. By contrast tax competition is a desirable economic outcome for both taxpayer-citizens and for government itself. To the extent that taxpayer-citizens cannot employ tax havens to shield some of their income from oppressive taxation they may well engage in inefficient forms of tax avoidance (such as consuming more leisure and so reducing the size of the tax base beyond what it otherwise would be). Government has an interest in both the domestic and global economy beyond simply collecting tax. The issue of tax competition is intimately connected to questions of tax avoidance and evasion associated with tax heavens. Of course, not all usage of tax havens constitutes tax avoidance behaviour. Many individuals employ tax havens to protect their privacy and wealth from expropriation by criminals and their own government.

Ultimately the debate over tax competition, tax havens and tax harmonisation is an argument over the size of the tax base. There are good public choice reasons for constraining the size of the tax base and rejecting the notion of 'broad-bases and low-rates'. Experience has shown that giving Leviathan access to a comprehensive and efficient tax base is an invitation to over-government and over-taxation. Disputes over the size of the tax base are particularly acute as disputes over the appropriate scale and scope of government have arisen. The use of coercion to collect revenue for the financing of public goods is more or less accepted. The use of coercion to collect revenue for private goods provided by government, however, is controversial. To the extent that some individuals exit the tax system as a form of protest against over-government Leviathan's appetite is constrained. On the other hand, fiscal vigilantism undermines the rule of law. As in so many instances, the debate about tax harmonisation revolves around balancing the costs and benefits of anarchy against the costs and benefits of Leviathan.

The evidence in favour of tax competition over tax harmonisation is very clear. The assertion of harm brought about by tax competition is not supported by the available evidence. There is little evidence to support any of the claims made by big

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government as to the dangers of tax competition. Similarly the benefits of tax harmonisation are small – and highly dependent on assumptions as to social welfare functions. If citizen-voters are egalitarian – a heroic assumption – the benefits of tax harmonisation might be as high as one percent of GDP.

The real problem bedevilling this issue can be described as 'fiscal vigilantism'. To what extent should individuals resist Leviathan though non-payment of income tax? To what extent should government maintain an extra-territorial system of taxation? Ultimately the debate around tax competition and harmonisation is a question of how comprehensive the tax base should be. There are good arguments to suggest that the tax base should be less, rather than more, comprehensive and that positive spillovers are associated with less comprehensive taxation. Given the more or less oppressive nature of governments around the world the maintenance of tax havens create both positive economic benefits and also positive political benefits. Over-zealous tax officials in countries such as Australia and the United States are undermining economic prosperity, and political freedoms, in many under-developed economies through their aggressive pursuit of taxation revenue.

The issue of tax harmonisation is closely linked to tax competition, the role of tax havens, and the potential for tax evasion. Attitudes to these issues are complex and often somewhat contradictory. While a zero-tolerance attitude to tax evasion may be an appropriate political position it cannot be fully consistent with economic and political liberty.

What is Tax Competition?

Richard Teather has defined tax competition as 'the use by governments of low effective tax rates to attract capital and business activity to their country'.[1] Daniel Mitchell defines a tax haven as 'any jurisdiction, anywhere in the world, that has preferential rules for foreign investors'.[2] Tax havens and tax competition are intimately related to each other. It is important to dispel stereotypical views about what constitutes a tax haven. That view may relate to some tropical island paradise with poor banking practices that allows money laundering, and related criminal behaviour. To be sure, such places do exist, but they are not usually tax havens. Switzerland – the world's most famous tax haven – has none of those features. Dhammika Dharmapala and James Hines have investigated the features of tax havens and report that they are usually well run economies.[3]

> Some of the characteristics of tax havens are well documented in the literature: tax havens are small countries, commonly below one million in population, and are generally more affluent than other countries. What has not been previously noted in the literature, but is apparent in the data, is that tax havens score very well on cross country indices of governance quality that include measures of voice and accountability, political stability, government effectiveness, rule of law, and the control of corruption. Indeed, there are almost no poorly governed tax havens.

[1] Richard Teather, 2005, *The benefits of tax competition*, London, The Institute of Economic Affairs, pg. 25.
[2] Daniel J. Mitchell, 2006, 'The moral defense of tax havens', *Notes from FEE*, www.fee.org.
[3] Dhammika Dharmapala and James Hines, 2009, 'Which countries become tax havens', *Journal of Public Economics* 93 1058 – 1068, pg. 1058.

As Richard Teather describes, in the late 1990s a number of (European) high-tax economies began to fear that tax competition would undermine their own ability to raise tax revenue.[4] Wouter Bos, former Dutch Minister of Finance, argued that tax competition was 'not just a 'race to the bottom' but a 'race to public poverty', ... where total tax income of the countries becomes too low for governments to finance a sustainable and sufficient level of public services'.[5] These high-tax economies began a campaign against tax competition and (some) tax havens using international organisations such as the European Union, the OECD and the United Nations Organisation.

Tax competition, according to its critics, is a negative consequence of globalisation. The argument being that some countries deliberately establish their tax policies in order to erode the tax base of other countries, alter the tax structure of those countries, hamper the application of progressive tax regimes, and impede the redistribution of income or wealth. Those taxpayers who take advantage of tax havens are free riders 'who benefit from public spending in their home country and yet avoid contributing to its financing'.[6] Apparently this decreases 'global welfare'. All these 'undesirable outcomes' can be avoided 'through intensifying international co-operation', in other words, by establishing a tax cartel.[7] Co-operation in establishing uniform tax rates and/or tax bases is often defined as tax harmonisation.

The OECD promotes the view that tax competition has the potential to create harm by distorting investment flows, undermining the integrity and fairness of existing tax structures, discouraging tax compliance, changing the 'desired' mix and level of taxation and government spending, causing the tax burden to shift to less mobile tax bases and increasing the costs of tax administration and compliance burdens. In the next section I demonstrate that (some) of these empirical predictions have not actually occurred. Enrique Mendoza and Linda Tesar have summarised all of these effects into three 'global externalities.'[8] The first externality is an old-fashioned 'beggar-thy-neighbour effect', whereby governments reduce their taxes in order to attract investment from neighbouring countries. The second externality is a 'wealth-redistribution effect', which is caused by inefficient tax-driven investment choices. Finally, there is a 'tax externality' caused by the impact tax competition has on tax revenue.

In 1998 the OECD published a report, 'Harmful Tax Competition: An Emerging Global Issue', which makes a series of claims regarding international taxation. The 1998 Report doesn't provide a concise definition of harmful tax competition, but it does offer the following criterion: 'If the spillover effects of particular tax practices

[4] Teather, as above, pg. 23.

[5] http://www.minfin.nl/nl/actueel/kamerstukken_en_besluiten,2000/06/v00_390.html

[6] OECD, 1998, *Harmful Tax Competition: An Emerging Global Issue*, OECD Publications pg.14.

[7] As an economic argument it is very weak. It assumes that these individuals pay no tax in their home country but consume public services. At best these individuals have paid less for their public services than their government may have wished them to pay. Alternatively, the OECD needs to demonstrate that those individuals making use of tax havens also consume public services. It also fails as a moral argument; see Mitchell (2006) for arguments that show tax competition creates value for non-tax haven economies. In this latter view it is those who do not invest via tax havens who free-ride upon those who do.

[8] Enrique Mendoza and Linda Tesar, 2003, 'A quantitative analysis of tax competition v. tax coordination under perfect capital mobility', NBER Working Paper 9746, www.nber.org/papers/w9746.

are so substantial that they are concluded to be poaching other countries tax bases, such practices would be doubtlessly labelled 'harmful tax competition'.'[9] This is a very convenient definition; spillovers—which economists usually refer to as 'externalities'—are often invoked as a justification for government regulation.[10] A further quote from Wouter Bos highlights this point.[11]

> From an economic perspective, tax competition therefore leads to efficient governments and the highest possible level of wealth for everybody.
> There is only one very important side condition for this last statement to be true, and that is that the global markets are perfect and there are no market failures whatsoever. This is, I am afraid, not the case in real life.
> When markets are imperfect, policy goals can not be achieved by market forces alone. The same is true for competing in the field of tax policies. Any competition needs some form of regulation, so does this one.

Economists differentiate between types of externalities. Pecuniary externalities are those that operate via the price mechanism, while technological externalities don't. Only technological externalities give rise to public policy responses. If they do exist, tax externalities are, at best, pecuniary externalities and wouldn't normally concern economists.

The tax-externality argument is the usual focus of popular discussion. The idea is that tax competition would trigger a 'race to public poverty', in which governments reduce tax on mobile bases (usually said to be corporate income) and, in order to maintain government revenue, increase taxes on immobile tax bases (usually said to be personal income tax and fixed property). Alternatively, governments experience a loss of revenue, and either reduce expenditure or increase government debt, or inflate the economy. Spillovers, and allegations of 'free riding', have the advantage of being intuitively obvious to the layman, but technically difficult to prove. Indeed the OECD admits this point on the very next page of the 1998 Report.[12] The available data do not permit a detailed comparative analysis of the economic and revenue costs involving low-tax jurisdictions', and, further, 'A regime can be harmful even where it is difficult to quantify the adverse economic impact it poses. In other words, despite having no evidence to justify any policy intervention, the OECD had decided that tax competition was undesirable.

Taxation and Coercion

Attitudes towards tax competition are going to be tempered by attitudes towards the legitimate role of government and markets.

The real issue in the tax competition–harmonisation debate revolves around the legitimate scale and scope of government. What should government do, and what should it not do? There can be little doubt that the scale and scope of government has dramatically increased over the past several decades and the legitimacy of that

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[9] OECD, p.16.

[10] This is nonsense – the costs and benefits of intervention need to be evaluate before any government action is taken to alleviate so-called externalities. See also Arthur Seldon, 1990, *Capitalism*, Reproduced as *The virtues of capitalism*, Indianapolis, Liberty Fund, p. 235.

[11] Bos, as above.

[12] OECD, p.17.

expansion is an open question. Classical liberals have long argued that the state should do less rather than more. Adam Smith, for example, describes three functions of government being national security, justice and public goods. He also has as the first of his great maxims of taxation, 'The subjects of every state ought to contribute towards the support of the government …'.[13] Taxation and the functions are government are clearly linked. Herbert Spencer had a more limited role for government; 'to defend the natural rights of man – to protect person and property – to prevent the aggressions of the powerful upon the weak – in a word, to administer justice'.[14] Ludwig von Mises provides a similar perspective.[15]

> As the liberal sees it, the task of the state consists solely and exclusively in guaranteeing the protection of life, health, liberty, and private property against violent attacks. Everything that goes beyond this is an evil. A government that, instead of fulfilling its task, sought to go so far as actually to infringe on personal security of life and health, freedom, and property would, of course, be altogether bad.

This raises the issue of coercion. To what extent can the state coerce its citizens? This is a tricky issue given that the existence of the state implies, at least some, coercion. As von Mises has recognised.[16]

> Liberalism is not anarchism, nor has it anything whatsoever to do with anarchism. The liberal understands quite clearly that without resort to compulsion, the existence of society would be endangered and that behind the rules of conduct whose observance is necessary to assure peaceful human cooperation must stand the threat of force if the whole edifice of society is not to be continually at the mercy of any one of its members. One must be in a position to compel the person who will not respect the lives, health, personal freedom, or private property of others to acquiesce in the rules of life in society. This is the function that the liberal doctrine assigns to the state: the protection of property, liberty, and peace.

As James Buchanan has argued liberal society stands between anarchy and Leviathan.[17] The debate about tax competition–harmonisation is on the very frontline of the trade-off between anarchy and leviathan.

Friedrich von Hayek has written extensively on the use of coercion and the rule of law in his magnum opus, *The constitution of liberty* – 50 years old this year.[18] Hayek tells us that coercion occurs 'when one man's actions are made to serve another man's will, not for his own but for the other's purpose'.[19] Hayek explores the overlap between the proper functions of the state and the limits of coercion. I suspect many

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[13] Adam Smith, 1776 [1976], *An inquiry into the nature and causes of the wealth of nations*, University of Chicago Press, pg. 350.
[14] Herbert Spencer, 1843 [1982], *The proper sphere of government*, In *The man versus the state: With six essays on government, society, and freedom*, Liberty Fund, pg. 187.
[15] Ludwig von Mises, 1927 [2005], *Liberalism: The classical tradition*, Liberty Fund, pg. 30.
[16] Ludwig von Mises, 1927 [2005], above, pg. 17.
[17] James Buchanan, 1975 [2000], *The limits of liberty: Between anarchy and leviathan*, Indianapolis: Liberty Fund.
[18] Hayek, F. 1960, *The constitution of liberty*, Routledge, pg. 117 – 129.
[19] Hayek, as above, pg. 117.

classical liberals would be content for the state's powers of coercion to be limited to the provision of public goods, where public goods are defined as those goods that are non-excludable and non-rival. That is not Hayek's view. He points out that the medieval state was self-financing (as are several oil-rich states in the modern era). Most modern states employ their coercive powers beyond the provision of public goods. It is here that Hayek makes an intriguing comment (emphasis added).[20]

> *Outside of the field of taxation*, it is probably desirable that we should accept only the prevention of more severe coercion as the justification for the use of coercion by government.

This begs the question; within the field of taxation what are the limits of state coercion? Hayek sets out some principles of coercion. The government should never coerce anyone except in the enforcement of a known rule[21] that is certain[22], general[23] and applied equally[24]. With the exception of progressive aspects of taxation, it is very likely that most aspects of taxation would meet those criteria. In other words, it seems that Hayek has little objection to state coercion in raising taxation revenue, rather he has objections to the purposes that revenue may be expended on and the methods that the state employs to achieve its ends. This view is more or less repeated in volume 3 of his *Law, Legislation and Liberty*.[25]

> Indeed, it could be maintained that, even if there were no other need for coercion, because everybody voluntarily obeyed the traditional rules of just conduct, there would still exist an overwhelming case for giving the territorial authorities power to make the inhabitants contribute to a common fund from which such services could be financed.

Here Hayek has added the term 'territorial' and that suggest that he may have had the view that the authorities should only tax activity within the territorial borders of the state. Unfortunately he does not expand on that idea and it is difficult to expound further on what his views may have been, beyond the notion that he had little trouble with the use of coercion in taxation and he didn't have a dogmatic view of the scope and scale of taxation. Hayek's concerns about taxation, and over-taxation, relate to issues of progression and fiscal illusion. In terms of over-government Hayek is of the view that as long as the community fully understands the costs and benefits of intervention and follow the rule of law, then most interventions need to be considered on a cost-benefit basis and cannot be rejected on *a priori* grounds.[26]

These ideas can be represented in matrix form. The matrix below shows the combination of public goods and coercion. The state provides public goods and needs to raise tax revenue in order to pay for those public goods. To the extent that individuals do not pay tax to pay for public goods, society faces a free-rider problem.

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[20] Hayek, as above, pg. 127.
[21] Hayek, as above, pg. 180.
[22] Hayek, as above, pg. 182.
[23] Hayek, as above, pg. 181.
[24] Hayek, as above, pg. 183.
[25] Friedrich von Hayek, 1979, *The political order of a free people*, University of Chicago Press, pg. 41 – 42.
[26] See Hayek, *The constitution of liberty*, pg. 194 and Hayek, 1979, *The political order of a free people*, University of Chicago Press, pg. 41.

As Frank Cowell has argued, ‘The financing of government cannot be organized like the financing of Oxfam or like that of a parish church’.[27] The private economy is characterised as that area where there is no (government coercion) and public goods are not being traded. There is, however, an area of dispute; the presence of coercion where public goods are not being traded. Hayek’s argument is that there is no *automatic* presumption against government in that area – a cost–benefit analysis must be undertaken. Here he finds some support from James Buchanan who argues, ‘Some extensions of state power are more legitimate than others’.[28] Mises on the other hand takes the view that government involvement in this area is ‘an evil’ and ‘altogether bad’.

		Public Good	
		Yes	**No**
Coercion	**Yes**	• Pay Tax	• Disputed Territory
	No	• Free Rider Problem	• Private Economy

Despite Hayek’s view that there is no presumption against government in that area, I make the argument that for the question of tax competition and harmonisation that there is a strong argument against government in the disputed region. As James Buchanan argues, ‘The “wealth of nations” is maximised when persons are “free to choose”.’[29] As the government expands beyond the provision of public goods, individuals are less free to choose. To be sure as the economy expands and more goods and services become available individuals might find themselves making more choices, nonetheless as Leviathan expands so individuals will face fewer choices in areas where before they had more choice.

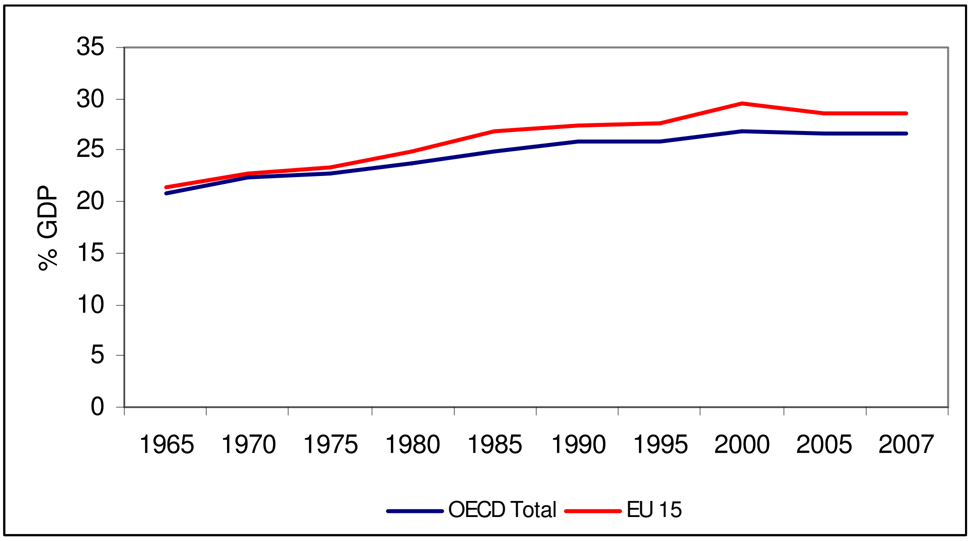
Tax Competition: Harm by Assertion

Opponents of tax competition are quite specific about the adverse consequences of that competition. The tax burden on (mobile) capital will fall and shift to (immobile) labour. The social safety net will be cut and the welfare state will experience a fiscal crisis. The OECD prepared a long list of consequences of tax competition, but nowhere in their report did they actually demonstrate that any of the potential harm had in fact occurred. The OECD, however, had good reason not to appeal to the facts. In this section, I review evidence that ‘harmful tax competition’ has actually occurred in the OECD, and also the EU-15. In Figure 1, I have plotted the Total Tax Revenue to GDP ratio for both the OECD and also the EU-15 over the period 1965–2007. This

[27] Frank Cowell, 1990, *Cheating the government: The economics of evasion*, MIT Press, pg. 37.
[28] James Buchanan, 1977 [1999], The libertarian legitimacy of the state, In *Moral science and moral order*, Liberty Fund, pg. 428.
[29] James Buchanan, 1987, Towards the simple economics of natural liberty: An exploratory analysis, *Kyklos*, 40, 3 – 20.

should provide some perspective on the extent of the fiscal crisis facing those economies.

Figure 1: Total Tax Revenue to GDP



Source: OECD Revenue Statistics 1965–2007; Table 4, p.79. Data exclude social security.

In 1965, total tax revenue (excluding social security) made up 20.9 per cent of GDP. By 2000 this figure had increased to 26.9 per cent. The EU-15 is in an even better position—tax to GDP (excluding social security) increased from 21.4 per cent to 29.5 per cent. Since that time the tax to GDP figures have declined marginally but 0n the basis of these data it is difficult to argue the welfare state is experiencing a fiscal crisis. Tax competition, however, is said to have a huge impact on capital taxes, and corporate tax in particular. A *Financial Times* editorial has argued, 'Corporation tax is a dying tax …'.[30] John Braithwaite blames corporate tax competition on the Thatcher government, which lowered the corporate rate from 46 per cent to 34 per cent in 1984. Ireland has lowered its corporate tax rate to 12.5 per cent. Average corporate tax rates in Europe (and the world generally) have declined. So too, however, have personal tax rates. Chris Edwards and Veronique de Rugy have shown that personal tax rates had fallen on average by 20 per cent in the OECD over the period 1980–2000, while corporate tax rates have fallen by six per cent over the period 1996–2002.[31]

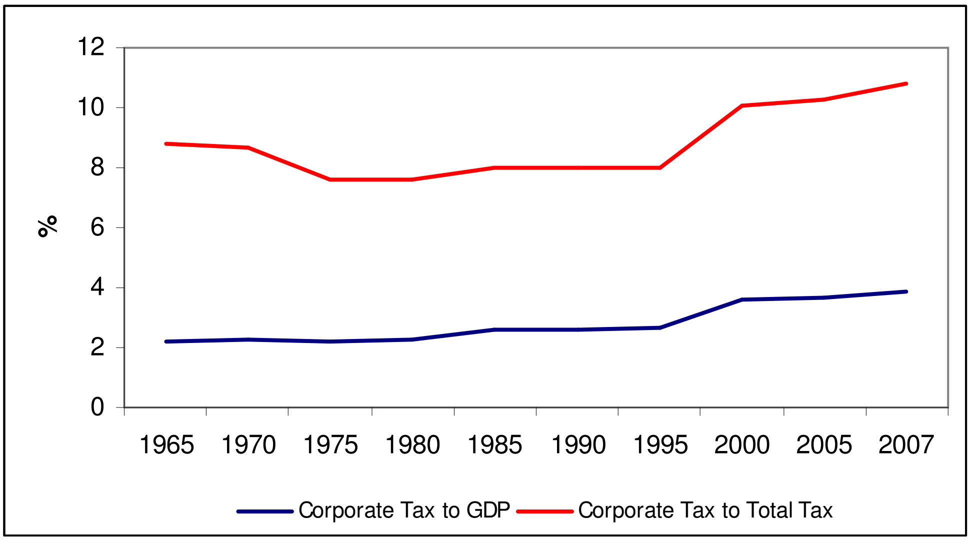
At this point, however, we encounter an important source of confusion in the tax competition debate. Tax rates and tax revenue are not the same thing. The literature assumes existing tax rates are 'optimal'. It is not clear what 'optimal' implies, but the implication is always that government revenue declines due to a decline in tax rates. This assumes that tax rates are always on the upward sloping side of their respective Laffer curves. Furthermore, the literature suffers from a 'fatal conceit' and the

[30] 'Ripe for rejection: Tax harmonization plans reflect Franco-German weaknesses', *Financial Times*, 14 May 2004, p.18.
[31] Chris Edwards and Veronique de Rugy, 2002, 'International tax competition', in James Gwartney and Robert Lawson (eds.), *Economic Freedom of the World: 2002 Report*, Vancouver, The Fraser Institute.

'pretence of knowledge'.[32] Nowhere is it ever conceded that tax changes may occur as a consequence of greater understanding of tax policy, or experience, or changing circumstances. These 'errors', of course, are due in large part to the conflict of visions that permeate the debate.

The OECD Ministers first commissioned the OECD to investigate Harmful Tax Competition in 1996. To the extent that tax competition caused any harm, we might expect to observe declining tax revenue prior to 1996. In Figure 2, I plot the corporate tax revenue as a percentage of total tax and also GDP for the OECD over the period 1965–2007. Tax competition is said to have a huge impact on corporate tax in particular. Between 1975 and 1995 corporate tax increased from 2.2 per cent of GDP to 3.9 per cent, while it grew from 7.6 per cent to 10.8 per cent of tax revenue. There is no evidence of a decline in tax revenue from the source most vulnerable to tax competition.

Figure 2: Corporate Tax: OECD Total



Source: OECD Revenue Statistics 1965–2007; Tables 12 and 13, p.83.

The post-1995 situation is very interesting. Revenue from corporate taxes increased—just as the OECD attempted to establish a tax cartel. It could well be argued that the dot.com bubble was responsible for the increased tax revenues in 2000. The increase in corporate tax revenue since 1980 is particularly interesting, since many OECD economies have reduced their corporate tax rates since 1980. Eurostat calculates an implicit tax rate on capital income for the EU.[33] This measure adjusts for the fact that different EU members have different corporate tax bases, and the like. Eurostat[34] describes the measure as 'the average effective tax burden on the economic activities of private sector investment and saving by dividing tax revenues on capital by a measure of potentially taxable capital and business income in the economy.' Over the period 1995–2001, the implicit tax on capital income increased

[32] FA Hayek coined these terms. See FA Hayek, 1988, *The fatal conceit: The errors of socialism*, Chicago: University of Chicago Press; and FA Hayek, 1974, 'The pretence of knowledge', in, *New studies in philosophy, politics, economics and the history of ideas*, London, Routledge, 1978.
[33] Eurostat, 2003, *Structures of the taxation systems in the European Union: Data 1995–2001*, Luxembourg, Office for Official Publications of the European Communities.
[34] Eurostat, pg.92.

by 4.8 per cent[35]—that is, the tax burden increased at a time when ‘harmful competition’ was said to be driving it down.

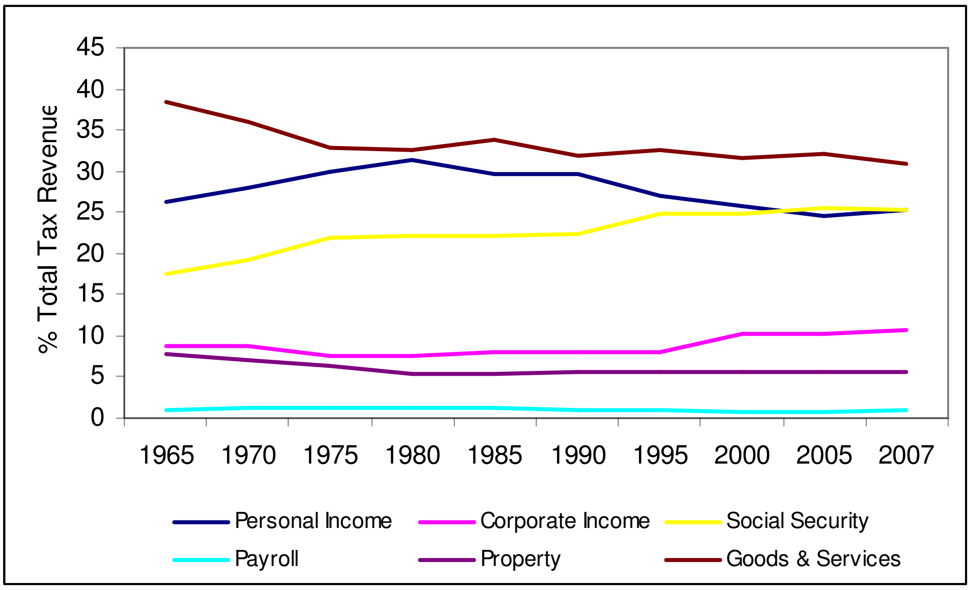
It may well be the case that ‘harmful tax competition’ has put downward pressure on tax rates, yet it is difficult to conclude that governments have suffered any harm when tax revenues have increased. Indeed, given the increased share, corporate tax revenue has increased faster than both general tax revenue and GDP. The tax burden on individuals also increased over that period (from 7 per cent to 9.4 per cent of GDP for the OECD and for the EU-15 from 7.2 per cent to 10.4 per cent of GDP). In short, there is no evidence to support the notion that the OECD is experiencing reductions in tax revenue due to tax competition.

There is another point worth highlighting from the data on corporate tax revenue. For many nations in the OECD this source of revenue makes up a small proportion of total tax revenue, and a tiny proportion of GDP. Yet the authorities attempting to track down this revenue spend a lot of time and effort, and corporations complying with corporate tax legislation spend even more time and effort. This brings us to another problematic assumption in the tax competition literature. Corporations provide benefits beyond simply paying tax. While the tax authorities, and tax-economists, might assume that taxpayers exist simply to pay tax, shareholders, employees, consumers and governments may take a broader perspective. For example, a government may choose to lower taxation in order to boost domestic private investment, or reduce unemployment, and the like. Yet, the tax competition literature explicitly assumes that taxation exists for redistributive purposes and to provide revenue for public goods. The data show that governments and economists have had a huge debate over a threat to a very small portion of their overall revenue. Indeed, the figures show that this threat has not yet materialised.

Finally, I investigate the tax-mix across the OECD. To the extent that harmful tax competition occurs; tax burdens should rise for immobile resources, and fall for mobile resources. It is immediately obvious from Figure 3 that the central prediction of ‘harmful tax competition’ is not supported by the evidence. The personal income tax burden has fallen relative to other forms of taxation. The Social Security burden and the corporate tax burden have increased, while the property tax (predicted to increase) has been quite stable. In short, the evidence from the tax mix does not support any adverse effects from tax competition.

[35] Eurostat, pg.97.

Figure 3: OECD Tax Mix



Source: OECD Revenue Statistics 1965–2005; various tables.

The OECD evidence is not consistent with 'harmful tax competition'. The overall tax revenue of these economies has increased over time, and there is no evidence to support a shift of taxation from mobile to immobile factors of production.

Tax Harmonisation: Very Small Benefits

An important question – glossed by the OECD – is how large are the potential distortions created by tax competition, or the lack thereof? Wallace Oates argued as recently as 2001, 'we have precious little evidence on this.'[36] The situation is little improved since then. Gebhard Kirchgassner and Werner Pommerehne provide an empirical analysis of tax competition and harmonisation within a single economy.[37] Switzerland has a unique constitutional framework. It has a federal structure with a weak federal government vis-à-vis the cantons (states) and local government. The Federal government relies on consumption taxes, while the cantons levy progressive income taxes. Cantons levy income taxes at differing rates and there are no legal impediments to taxpayers moving from high tax cantons to low tax cantons (i.e. the Tiebout hypothesis appears to work). Kirchgassner and Pommerehne report that some tax competition does occur; high-income earners do appear to choose their residence on the basis of tax burdens. In contrast, however, they also report tax competition has not lead to an undersupply of public goods. 'Thus, the negative consequences of competition with respect to direct taxes as feared, …, have not – at least until now – occurred'.[38]

There is a very small academic literature that attempt to provide international evidence of the relative costs and benefits of tax competition and coordination. Ian Parry estimated that the welfare costs from tax externalities are generally less that 5

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[36] Oates, 2001, pg. 137.
[37] Gebhard Kirchgassner and Werner Pommerehne, 1996, 'Tax harmonization and tax competition in the European Union: Lessons from Switzerland", *Journal of Public Economics*, 60: 351 – 371.
[38] Gebhard Kirchgassner and Werner Pommerehne, as above, pg. 366.

percent of capital tax revenue.[39] He concluded that his results ‘cast some doubt on the economic case for harmonizing capital taxes across a bloc of regions such as the Economic Union.’ Peter Sorensen presented a far more comprehensive analysis of tax competition and coordination.[40] He developed a plausible and realistic general equilibrium model providing a synthesis of existing and then estimated (by calibration) the magnitude of gains from coordination. He employed an egalitarian welfare function to evaluate welfare under the alternative tax regimes.[41] The *best-case* scenario is shown in table one.

Table One: Best Case Scenario of Tax Competition and Coordination.

	Competition	Coordination
Policy Variables		
Capital Tax Rates	12.7	42.3
Labour Tax Rates	44.4	44.4
Transfers	100.0	177.0
Infrastructure Spending	100.0	95.0
Other Variables		
Capital Stock	100.0	88.0
Employment	100.0	99.0
Profits	100.0	95.0
GDP	100.0	95.0
Average Real Wage Rate	100.0	96.0
Real Interest Rate	100.0	109.0
Welfare Gain %GDP		0.94

Source: Adapted from Peter Sorensen, 2004, Table 1, pg. 1201.

In the model, tax competition had no impact on labour income taxes. Furthermore the largest impact of tax competition was not under-provision of public goods, but rather too little income and wealth redistribution. In particular, relative to full-blown tax competition, tax coordination would lead to higher taxes on capital, and higher redistribution; but lower infrastructure spending, lower capital stocks, lower profits, lower real wages, lower GDP, and higher real interest rates. All these changes would result is an increase in social welfare of less than one percent of GDP, but only if taxpayers have egalitarian objectives. What happens in the model is that GDP falls but inequality falls by a greater amount *with the net effect* being an increase in the median voter’s level of satisfaction. It is not clear that taxpayers would have egalitarian welfare functions. As Harold Demsetz has argued, one of the great

[39] Ian Parry, 2003, ‘How large are the welfare costs of tax competition?’, *Journal of Urban Economics*, 54: 39 – 60.
[40] Peter Sorensen, 2004, ‘International tax coordination: regionalism versus globalism’, *Journal of Public Economics*, 88: 1187 – 1214.
[41] See Peter Saunders, 2004, ‘What is fair about a fair go?’, Policy, Autumn: 3 –10. Available for download at http://www.cis.org.au/policy/autumn04/polaut04-1.pdf

Nirvana fallacies is that 'people could be different'.[42] In short, taxpayers would be 'happier' because they would all be equally poorer.

Table 1 shows results for the best theoretical case for tax harmonisation. When Sorensen estimated more realistic scenarios, he found welfare gains would be highest in the Nordic economies (0.95 percent) and lowest in Continental Europe (0.03 percent). The increased welfare gains for the UK (0.63 percent) and the US (0.13 percent) are also quite low.

Enrique Mendoza and Linda Tesar provide evidence that tax competition can lead to welfare improvements.[43] They examine tax competition in a two-country dynamic, neo-classical general equilibrium model with perfect international capital mobility. Using data from European economies they then calibrate the model and examine the consequences of tax competition and harmonisation. The results are quite stark; the gains from coordination are very low *even* when tax competition does cause a race to the bottom.[44]

> In the case in which the fiscal solvency externality triggers adjustments in consumption taxes, Nash competition in capital income taxes produces a staggering ''race to the bottom'' in capital tax rates. However, contrary to the conventional wisdom that this reduction in capital taxes is harmful to society, we find that European countries could make welfare gains of about 0.7 percent in lifetime consumption compared to the pre-tax competition equilibrium. The race to the bottom is harmful in the formal sense that the cooperative equilibrium dominates the Nash outcome, but we find that quantitatively in this game of capital-for consumption taxes the gains from tax coordination are negligible at less than 0.04 percent.

They conclude that the structure of European taxation already reflects the outcome of a competitive process and any gains from coordination are likely to be very small.

Mihir Desai, Fritz Foley and James Hines have reported that tax haven activity increases economic activity in nearby non-tax haven economies.[45] Due to the higher after-tax returns that multinational firms are able to enjoy as a consequence of tax havens, they are able to maintain higher levels of foreign investment than otherwise. This empirical result is entirely consistent with the Sorensen theory. In other words, far from having a negative impact on their neighbours, tax havens have a positive impact on economic activity; and there is no evidence that governments suffer any adverse revenue effects from tax competition either. What is particularly damning for the harmful tax competition argument is the fact that tax haven governments do not appear to be smaller than the governments of non-tax haven countries.[46]

[42] Harold Demsetz, 1969, 'Information and efficiency: Another viewpoint', *Journal of Law and Economics*. Reproduced in Harold Demsetz, 1989, *Efficiency, Competition and Policy*, Oxford: Basil Blackwell.

[43] Enrique Mendoza, and Linda Tesar. 2005. 'Why hasn't tax competition triggered a race to the bottom? Some quantitative lessons from the EU'. *Journal of Monetary Economics* 52, 163 – 204.

[44] Mendoza and Tesat, as above, pg. 202.

[45] Mihir Desai, Fritz Foley and James Hines, 2006, 'Do tax havens divert economic activity?' *Economics Letters*, 90: 219 – 224.

[46] James Hines, 2005, 'Do tax havens flourish?', NBER Tax Policy & the Economy, 65 – 99.

Tax Competition: Economic Benefits

In contrast to the argument that tax competition is associated with negative externalities it is possible to argue that tax competition gives rise to positive outcomes. The discussion so far has demonstrated that the adverse consequences of tax competition have not materialised and there is a small 'tax havens are good' literature. It remains to be shown, however, that lower taxes resulting from tax competition can have economic benefits. One of the assumptions that permeate the public finance literature is the notion that government is benevolent and that taxes are already set at optimal levels. Those assumptions are both suspect.

James Buchanan has argued that there are positive and negative externalities associated with taxation.[47] The public finance literature generally recognises that deadweight losses are associated with the tax system but seldom recognises an obvious source of externality. Individuals modifying their behaviour in response to taxation impose costs on the rest of the taxpaying population.[48]

> The man who sits on his sunlit patio when he could be earning taxable income is levying costs on his fellows. The man who labours and thereby earns taxable income when he could be sitting in the sunlight is providing his fellows with benefits.

This insight is based on Adam Smith's notion that the division of labour is determined by the extent of the market. The larger the market the more likely that specialisation and trade will occur, this in turn leads to greater wealth being produced. To the extent that deadweight losses lead to individuals consuming greater amounts of leisure the market will be smaller. This is especially true for those individuals who face high marginal tax rates. An additional point, however, is that there are deadweight costs associated with tax avoidance that don't involve a work-leisure trade-off. To the extent that individuals allocate work-effort or investment away from the best use alternatives to second best alternatives the size of the market is reduced and costs are imposed on third parties. What makes this argument difficult to operationalise, however, is Buchanan's observation that entrepreneurial choice costs cannot be estimated.[49] Nonetheless it is possible to observe the overall consequence high-tax rates have on leisure.

Edward C. Prescott poses, and answers, an important question: 'Why do Americans work so much more than Europeans'?[50] While there are large differences between the labour markets in Europe and the US, where markets are said to be more 'flexible', the key reason why Americans work more than Europeans turns out to be the difference in tax incentives. Prescott derives a simple theoretical model that predicts labour supply (weekly hours worked) for the population aged 15–64. The differences

[47] James Buchanan, 1966, Externality in tax response, In J. Buchanan, 1994, *Ethics and economic progress*, University of Oklahoma Press, pg. 91 – 111.
[48] Buchanan, as above, pg. 111.
[49] James Buchanan, 1969, Cost and choice, Liberty Fund.
[50] Edward C Prescott, 2004, 'Why do Americans work so much harder than Europeans?', *Federal Reserve Bank of Minneapolis Quarterly Review*, 28(1) 2 – 13.

in labour supply across the G7 countries (and across time) can be explained by differences in their tax rates. As Prescott reports (emphasis added):[51]

> An important observation is that when European and U.S. tax rates are comparable, European and U.S. labor supplies were comparable. At the aggregate level, where idiosyncratic factors are averaged out, people are remarkably similar across countries. …
>
> I am surprised that *virtually all the differences between U.S. labor supply and those of Germany and France are due to differences in tax systems*. I expected institutional constraints on the operation of labor markets and the nature of the unemployment benefit system to be of major importance.

Prescott argues that tax factors are more important in the labour supply decision than labour market issues. His evidence indicates high taxes reduce labour supply, but that is only half the story. High tax rates also introduce labour discrimination. There is evidence that high tax rates affect choices between participation in the legal economy and participation in the illegal, underground economy. Steven J. Davis and Magnus Henrekson derive a theory which predicts high tax rates reduce working hours, increase the size of the illegal underground economy, change industry mix, and (importantly) distorts labour demand by 'amplify[ying] negative effects on market work and concentrat[ing] effects on the less skilled'. In other words, high tax rates, often justified on 'equity' grounds, lead to higher rates of unemployment among less-skilled workers.[52]

They test their theory using a sample of OECD economies and find a tax increase of 12.8 percent (one standard deviation) would lead to 122 fewer market hours worked per adult per year, a 4.9 percent decline in the employment-population ratio, an increase in the underground economy and a 10–30 percent decline in value add and employment share in those industries that rely on less-skilled labour. High tax rates lead to skilled workers voluntarily reducing their paid employment, while less skilled workers find their paid employment involuntarily reduced.

Results like this are consistent with Buchanan's argument that high tax rates reduce the incentive to work and to the extent that incurs costs are imposed on the whole of society and not just on the taxpayer who modifies their behaviour. It is not surprising that tax competition makes a positive contribution to societal welfare in those instances where it can be observed.

An additional consideration is that tax competition forces Leviathan to expend its funds more carefully than it otherwise would. Wolfgang Eggert and Peter Birch Sørensen show that tax competition can reduce rents that are available to be captured by self-serving politicians and bureaucrats.[53] In their model tax competition has an

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[51] Prescott, as above, pg. 8.

[52] Steven J. Davis and Magnus Henrekson, 2004, 'Tax effects on work activity, industry mix and shadow economy size: Evidence from rich-country comparisons' National Bureau of Economic Research Working Paper 10509, www.nber.org/papers/w10509

[53] Wolfgang Eggert and Peter Birch Sørensen, 2008, The effects of tax competition when politicians create rents to buy political support, *Journal of Public Economics* 92, 1142 – 1163.

initial positive impact by reducing waste in the economy and only then, if taken to extremes, will it reduce welfare by reducing public services.[54]

> Overall our analysis suggests that while the advocates of tax competition are right in claiming that tax base mobility serves to reduce rent-seeking, it is a double-edged sword that also tends to distort the supply of public goods, as argued by supporters of tax coordination. Up to a certain point tax competition may play a useful efficiency-enhancing role, but if it becomes too intense it is likely to be welfare-reducing. Indeed, in a calibrated version of our model we were able to identify an optimal intensity of tax competition, measured by the elasticity of the tax base with respect to the tax rate. Our quantitative analysis suggested that even very large political distortions can only justify a modest intensity of tax competition. In our model tax competition thus seems a poorly targeted means of curbing rents, compared to domestic institutional reform.

The Eggert and Sorensen paper makes an interesting assumption about rents. They argue that rent seeking is not pure waste but rather a form of redistribution that is itself valuable. To the extent that assumption is contestable they are under-estimating the benefits of tax-competition and over-estimating the benefits of tax cooperation. Arthur Seldon has argued that assumption is highly contested.[55]

> What politicians maintain as the necessary costs of government are increasingly sensed as unnecessary costs of 'over-government'. And its taxes, originally seen by William Pitt as income tax, and accepted for a few years as payment for a good bargain, are being subconsciously but finally resented as too high for the quality and relevance of services available at lower cost and higher quality from competing supplier in the market.

Unfortunately they do not make the more important comparison when they argue that tax competition may be a poorly targeted instrument compared with domestic institutional reform. It is well-known in the corporate governance literature that product market competition is a slow mechanism for improvement compared to other mechanisms.[56] Similarly James Buchanan has argued that in democratic economies citizen-taxpayers can vote government out of office [57]

> if its combined package of outlays and taxes gets too far beyond the limits dictated by the ultimate preferences of a majority of citizens. But such limits are so broad indeed that the conceptualization of the fiscal process in the exchange metaphor may be called into question.

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[54] Eggert and Sorensen, as above, pg. 1157.

[55] Arthur Seldon, 1998 [2005], *The dilemma of democracy*, In *Government failure and over-government*, Liberty Fund, pg.91.

[56] See for example Michael Jensen, 1993, The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems, *The Journal of Finance*, 48(3), 831 – 880.

[57] James Buchanan, 1993 [2001], The individual as participant in political exchange, In *Federalism, liberty and the law*, Liberty Fund, pg. 191.

Yet Eggert and Sorensen propose no domestic institutional reforms that could substitute for tax competition and then compare actual policies against each other.

The Moral Problem of Taxation and Fiscal Vigilantism

The economic arguments for tax competition are quite strong. There is, however, a moral problem; advocates of tax competition appear to be advocating tax evasion. To what extent is fiscal vigilantism acceptable? Even James Buchanan indicates a level of uncomfortableness.[58]

> It took me two decades to shuck off the normative trappings of orthodox economics and to write in defense of tax loopholes.

Non-payment of taxation can range of legal behaviour in response to taxation (consuming more leisure) all the way through to highly illegal behaviour. There is a fine line between legitimate and illegitimate protest and the concern of many is that tax competition encourages illegitimate protest. Tax revolts are well-known in history; for example Australia has just seen a very successful tax revolt by miners against a new mining tax.

The ideas in this section can be shown in matrix format. The matrix below shows the trade-offs between over-government and fiscal vigilantism. If we consider the situation where there is no over-government and no fiscal vigilantism then we have perfect tax morale – individuals do not free ride nor does government exceed its legitimate role. This is a very unlikely situation. We could also observe a situation whereby some individuals attempt to free-ride when there is no over-government. Most classical liberals admit that coercion is the appropriate mechanism to deal with free-riders in this context.

		Over-Government	
		Yes	**No**
Fiscal Vigilantism	**Yes**	• Financial Guerrilla Warfare	• Legitimate Coercion
	No	• Tax Slavery	• Perfect Tax Morale

The situation where we observe no fiscal vigilantism (either through voluntary compliance or state oppression) but we observe over-government can be described as tax-slavery. The far more likely position in one of increasing financial guerrilla warfare – here over-government exists and fiscal vigilantism occurs. The choices I have posed in the matrix are somewhat stark. In practice the issue of fiscal vigilantism isn't a simple yes or no prospect. Rather there is a range of behaviour that constitutes fiscal vigilantism.

[58] James Buchanan, 1987 [2001], Man and the state, In *Federalism, liberty and the law*, Liberty Fund, pg. 171.

The moral issue arises because citizen-taxpayers have no right of privacy against their own government. John Stuart Mill had warned of this in his *Principles*.[59]

> Experience, however, proves that the depositaries of power who are mere delegates of the people, that is of a majority, are quite as ready (when they think they can count on popular support) as any organs of oligarchy, to assume arbitrary power, and encroach unduly on the liberty of private life. The public collectively is abundantly ready to impose, not only its generally narrow views of its interests, but its abstract opinions, and even its tastes, as laws binding upon individuals.

Herbert Spencer alluded this problem too.[60]

> The great political superstition of the past was the divine right of kings. The great political superstition of the present is the divine right of parliaments. The oil of anointing seems unawares to have dripped from the head of the one on to the heads of the many, and given sacredness to them also and to their decrees.

The assumption is often made that the only benefit to having foreign bank accounts – in, for example, tax havens – is for the purpose of tax evasion. To be sure, some individuals do employ tax havens for the purposes of tax evasion. Yet it is not clear that tax havens *per se* are sufficient or necessary for the purposes of criminal behaviour. There are important and legitimate reasons for maintaining the need for secrecy as explained by Richard W. Rahn in the Wall Street Journal.[61]

> Those who demand increased taxes on global capital often rail against financial privacy and bank secrecy – forgetting they are necessary for civil society. It is true that not all people are saintly. But it is also true that not all governments are free from tyranny and corruption, and not all people are fully protected against criminal elements, even within their own governments. Without some jurisdictions in the world enforcing reasonable rights of financial privacy, those living in un-free and corrupt jurisdictions would have no place to protect their financial assets from kidnappers, extortionists, blackmailers and assorted government and nongovernment thugs.

This raises the difficult issue of bank secrecy. The biggest opponent of bank secrecy in recent years has been the United States government. A long-running case against Swiss banks has seen a phenomenal assault on the right to financial privacy. At the same time it is clear that the United States government, on balance, is not a tyranny and does not oppress its citizens. Much the same is true for the rest of the OECD. Nonetheless the OECD campaign against bank secrecy has contributed to oppressive behaviour in the rest of the world. Tax havens cannot simply follow long-established practices of maintaining client confidentiality. They are placed in the position of

[59] John Stuart Mill, 1848 [1987], *Principles of political economy with some of their applications to social philosophy*, Augustus M. Kelley, pg. 944 – 945.
[60] Herbert Spencer, 1884 [1982], *The great political superstition*, In *The man versus the state: With six essays on government, society, and freedom*, Liberty Fund, pg. 123.
[61] Richard W. Rahn, 2009, In defense of tax havens, *Wall Street Journal*, 18 March, pg. A15.

having to select which governments they will or will not share information with. It is not clear that bank officials (or even foreign government officials) should have to determine whether their clients are or are not being oppressed by their own government (or menaced by bandits). Rather liberty is preserved and freedom maximised with a consistent and coherent policy of bank secrecy is maintained for all clients.

This argument, however, is likely to be unsatisfying. Part of the problem is the dearth of information on the extent of tax evasion, money laundering, terrorist financing and various other activities that bank secrecy and tax havens are said to encourage and facilitate. Lord Kelvin famously remarked that 'knowledge is of a meager and unsatisfactory kind' without measurement. The question becomes one of size; how big are the adverse effects of tax competition and bank secrecy?

Tax officials have always argued that tax evasion is rampant. Douglas Houghton (Baron Houghton of Sowerby) has written[62]

> Tax-dodging is like the common cold – prevalent; no certain cure; no cause for alarm, but often seems to be worse than it really is.

He points out that the British authorities were bemoaning tax avoidance in 1905 – when tax rates were less than a shilling in the pound. The problem being that the tax authorities are not an unbiased source of information when dealing with potentially recalcitrant taxpayers and the 'solution' is to increase the already formidable powers of the tax authority. It is very likely that the extent of tax evasion is lower than the authorities public announcements suggest. Erich Kirchler comes to a remarkable conclusion after surveying the academic literature on this point[63].

> The level of tax compliance generally appears to be quite high in most countries, regardless of the incentives to cheat, and much higher than expected by most economists relying on the rational choice model … We are left with seemingly contradictory findings on tax evasion: on the one hand, the amount of evaded tax and the size of the shadow economy have increased. On the other hand, most studies find that only a minority of taxpayers evades taxes; the majority complies.

The point needs to be made that the size of the shadow economy doesn't only reflect tax evasion. In fact it is quite likely that tax evasion makes up a small component of the shadow economy once we recognise that many of the activities within the shadow economy are illegal behaviour that the state would prefer to suppress rather than tax.

How does the right to protest interact with the states right to tax? Over the range of most taxation it appears that the two rights interact well, but there are some instances where they do not. Successful societies constrain the right to protest; individuals do not have unfettered rights to engage in fiscal vigilantism. So too, it seems, successful societies have to constrain the right to tax. As Lord Houghton recognised, 'Taxpayers

[62] Douglas Houghton, 1978, The futility of taxation by menaces, In *Tax Avoision: The economic, legal and moral inter-relationships between avoidance and evasion*, IEA Readings 22, pg. 91.
[63] Erich Kirchler, 2007, *The economic psychology of tax behaviour*, Cambridge University Press, pg. 26 – 27.

are voters and they can hit back'.[64] Tax policy determined at the ballot box can be a very blunt instrument and taxpayers should not have to be provoked to extent that the ballot box becomes the only mechanism of disciplining poor behaviour.

James Buchanan has long argued for a fiscal constitution that provides limits to Leviathan. One of the most obvious limitations would be to restrict the size of the tax base. Geoffrey Brennan and James Buchanan made that argument in their 1980 book *The power to tax.*[65]

> If we translate this relationship into the tax-reform jargon, we can say that the individual at the constitutional stage will seek deliberately to build certain "loopholes" or "escape routes" into the tax structure. These provide the protection or guarantee against undue fiscal exploitation that the individual wants the constitution to embody. This argument in favor of loopholes and against comprehensiveness in tax base runs directly counter to the norm or principle that is central to much of the orthodox tax-reform advocacy.
>
> In this summary section, it may be useful to specify precisely what sort of "defense of loopholes" our analysis implies, and to discuss this defense in the context of existing tax systems. The argument for leaving open avenues for flexibility in behavioral response to tax rates suggests the rationality of *constitutional* loopholes. But what about a possible postconstitutional opening up of loopholes or maneuvering of an agreed-on tax base? Is this action a desirable or undesirable characteristic of in-period political "reform"? The answer to this question must be ambiguous.

Once we accept that government will stray beyond the provision of public goods, it is very likely that citizen-taxpayers will be exploited. One mechanism to keep that exploitation to tolerable levels would be to limit the revenue raising capacity of the state. In practical terms one limit on the tax base would be to limit it to domestically sourced income and not allow worldwide taxation. To be sure that could generate a substantial tax-avoidance industry as individuals attempt to reclassify the domestic base into a foreign tax base. It is an empirical question as to whether the benefits of a worldwide tax system outweigh the costs of policing that system.

Conclusion

The argument surrounding tax competition, tax havens and tax harmonisation mixes both normative value judgements and positive economics into a heady brew of disagreement. The whole area of taxation is riddled with various trade-offs and compromises. As James Buchanan has argued 'passionate men must be reasonable'. Attempts to fleece the taxpayer will give rise to a response. The behavioural costs associated with taxation are very high. It is only by refraining from imposing high rates of taxation on comprehensive tax bases that economic growth and prosperity can be assured.

[64] Houghton, as above, pg. 97.
[65] Geoffrey Brennan and James Buchanan, 1980, *The power to tax: Analytical foundations of a fiscal constitution.* Cambridge University Press, pg. 199; also see chapter 3.

Proponents of free-markets should welcome tax competition, allegedly harmful or otherwise. Tax competition reduces the tax burden for everyone and increases economic activity for everyone. This basic point has been known since Adam Smith's time.[66]

> The proprietor of land is necessarily a citizen of the particular country in which his estate lies. The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could, either carry on his business, or enjoy his fortune more at his ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he left. Stock cultivates land; stock employs labour. A tax which tended to drive away stock from any particular country, would so far tend to dry up every source of revenue, both to the sovereign and to the society. Not only the profits of stock, but the rent of land and the wages of labour, would necessarily be more or less diminished by its removal.

In other words, governments have an incentive not to subject mobile capital to 'vexatious inquisition' least that capital migrates. Leviathan is constrained in how much tax it raises. Richard Teather argues that an upper limit on revenue forces the state to be more efficient in providing public services. These arguments are true, yet given the phenomenal growth in government size it is clear that these constraints are somewhat weak. The benefits of tax competition are more likely to be observed in the private sector. High levels of taxation are known to create deadweight losses that have adverse economic effects. As Alex Robson has argued, 'There is little evidence to suggest that higher taxation increases GDP growth rates, and much evidence to suggest that the opposite is true'.[67] As Richard Teather argues, the opponents of tax competition motives 'are the same as those of all who protest against true global free markets: a tendency to worry more about risks than opportunities, a desire for the status quo, and a distrust of economic freedom'.[68]

In the absence of a fiscal constitution it is likely that Leviathan will continue to expand beyond its current size. The lack of effective and low-cost mechanisms to restrain Leviathan leads to substitute mechanisms that are economically and socially costly. Tax competition has not lead to public poverty or the destruction of the European welfare state – it is difficult to argue that any of the predicted adverse consequences of tax competition have occurred. At the same time it is clear that there are few, if any, economic benefits to tax harmonisation. Clearly the attempt by government to shut down tax havens and limit the effects of tax competition is a mechanism to strengthen its revenue raising powers. That is entirely understandable, but that attempt should be seen for what it is – an expansion of the tax base is an open invitation to impose tax slavery on citizen-voters.

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[66] Adam Smith, 1776, *An inquiry into the nature and causes of the wealth of nations*, University of Chicago Press, p. 375.
[67] Alex Robson, 2006, 'How high taxation makes us poorer', In Peter Saunders (ed), *Taxploitation: The case for income tax reform*, Sydney, Centre for Independent Studies, p. 38.
[68] Teather, ibid. p. 24.

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