Tax Competition: A Bogus Excuse for Governmental Collusion
Richard E. Wagner

What goes around comes around, so people say. The United States was founded partly on a rebellion against high taxes. It still has tax rates that, while now quite high and rising are still lower than a number of European nations. Now the United States, through its Treasury Department, is playing a leading role in trying to raise taxes throughout the world. Truly, what goes around comes around.

Over the past several years, our Treasury Department through its participation in the Organization for Economic Cooperation and Development (OECD), has repeatedly decried what it calls “harmful tax competition.” OECD’s proposed antidote is to form a tax cartel to raise the level of taxes throughout the world, and particularly in places where they are now low. Interestingly enough, the Director of Fiscal Affairs of the International Monetary Fund has also issued reports speculating in a positive vein about whether the time has come for the creation of a World Tax Organization. The point of a World Tax Organization, or of any of the measures advanced by the OECD, would be to restrict the ability of competition among governments to generate lower taxes.

The argument that competition among governments is harmful is a fine illustration of how a logically valid argument can nonetheless be wrong. “John is a baby. All babies cry a lot. Therefore, John cries a lot.” Logically speaking, this argument is valid. It may, however, be wrong. John might not cry a lot, even though he is a baby. If the premise “all babies cry a lot” is granted, the rest
follows as a matter of logic. A valid argument derived from a false premise can lead to nonsense. To say that many babies cry a lot, or even that most of them do, does not mean that all of them do.

The OECD argument about harmful tax competition is similar:

“Competition keeps taxes low. Low taxes prevent governments from supplying vital public needs. Therefore, competition prevents governments from supplying vital public needs.” The OECD’s argument follows logically from a false premise. The false premise is that low taxes prevent governments from supplying vital public needs.

Think of what it means to claim that low taxes prevent a government from supplying vital public needs. This describes a situation where taxpayers would actually support a proposal to increase taxes to supply those services. After all, taxes are imposed to provide public services. While no one like to pay taxes, if there is widespread agreement that additional public services would be particularly valuable, there would be little opposition to proposals to increase taxes to provide those services. There would be a general clamor for higher taxation.

Such a clamor does not currently exist. All we see are some people supporting higher taxes and larger government, and mostly because other people would pay those taxes. This is a case of tax eaters seeking to soak taxpayers. Our Treasury Department and the bloated welfare states of the OECD nations are on the side of the tax eaters. For instance, over 90 percent of the federal income tax is now paid by but 50 percent of the taxpayers, which
means that a majority of taxpayers is nearly free of income tax. It is when taxes get heavy, when they are used to finance unproductive and even counterproductive programs, and when they are used simply to redistribute wealth from citizens in general to the politically favored, that taxes evoke strong opposition. What keeps taxes from becoming even higher than they might otherwise be is the ability of people and capital to flee to friendlier, lower tax places.

We generally regard competition as a good thing. It is competition among producers for the favor of consumers that brings us new and improved products and low prices. The belief that competition is good provides the foundation for the public support of our various pieces of anti-monopoly legislation. If competition among businesses is good for consumers, is not competition among governments likewise good for taxpayers? Similarly, if collusion among businesses is bad for consumers, is not collusion among governments bad for taxpayers?

It is easy enough to see what the OECD is concerned about. The European nations have the highest tax rates in the world. The increasing mobility of capital and commerce that is coming to characterize our world has put increasingly intense pressure on these high-tax nations. Unemployment rates are high in Europe, economic growth is low. A competitive response to this situation would be to lower taxes and reduce government. A monopoly response is to seek to restrict competition to keep taxes high. The OECD is seeking to establish a tax cartel to keep tax rates higher than competition would otherwise
allow them to be. Our government should not participate in any such effort.

Indeed, it should seek to dissolve this tax cartel.