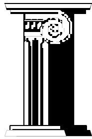

INSTITUTE BRIEF

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The Case Against Worldwide Taxation

by David Hogberg

In Chapter Five of FEDERALIST GOVERNMENT IN PRINCIPLE AND PRACTICE, Professor Mason Gaffney warns against worldwide uniform taxation. He notes that the Organization for Economic Cooperation and Development, an influential international policy institute, has called for tax uniformity among nations. According to the OECD, "international tax competition is 'harmful' and should be stamped out."[1] Specifically, the OECD wants every nation to tax what Gaffney calls mobile capital—non-land capital, such as investment capital, stocks, bonds, etc.—at the same rate.

However, as Dr. Gaffney warns, a uniform tax "is NOT uniform in its effects."[2] To demonstrate this point, Dr. Gaffney refers to the "Bradley-Burns Uniform Sales Tax Act,"enacted by the California State Legislature in 1955. The impetus for this measure was the notion that "inter-urban tax competition [was] harmful because it keeps cities from raising local sales taxes."[3] Thus, the California Legislature decided to enact a uniform sales tax on all localities in the state. Yet retailers in wealthy areas of California were able to absorb the new sales tax, while retailers in more marginal areas were not. To attract retailers, many cities now subsidize retailers, yet those areas best able to subsidize retailers are already wealthy, leading to an even greater disadvantage for marginal areas. The unintended consequence of uniform sales tax is a retail vacancy rate of 33%.

Tax uniformity on mobile capital will have a similar effect on poor nations. Wealthy nations, which have more resources such as a better educated populace, better public services, etc., will have little trouble attracting capital under an international uniform tax structure. Poor nations will find it more difficult. One way that poor nations can attract mobile capital is to adopt what Dr. Gaffney calls a "magnetic tax structure." A poor nation can reduce its tax rate on capital, thus increasing its attractiveness to potential investors.

A hypothetical example should clarify. Let's say that a multi-national corporation is deciding where to build a new manufacturing plant. It can choose Country A, which is a wealthy nation with lots of resources, or Country B, which is a poor nation. How can Country B compete? One way is to offer lower tax rates. Say that Country A imposes a 20% tax on corporate income. Country B can make

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itself more attractive by offering a lower tax rate on corporate income, say, 5%. Although Country B does not have the resources of Country A, its lower tax rate will enable it to compete with Country A in attracting capital.

According to Dr. Gaffney, "Hong Kong is the sparkling paragon of a rich territory that embraced magnetic tax policies." Once a very poor nation, "it redoubled its natural magnetism by shunning repellent taxes of most kinds...With a tiny land area, it became a world center of both secondary and tertiary industry, with a population of five million, and a high per capita income."[4] Nations like Hong Kong would not have this option under an international uniform tax regime envisioned by the OECD.

Finally, Dr. Gaffney warns that the OECD uniform tax scheme will not only harm competition, but will also endanger national sovereignty. The OECD concedes that such a tax scheme might mean "a role for intervention by a central authority."[5] Gaffney spells out the implications much more clearly: such a tax scheme "calls for nothing less than a worldwide intelligence network with vast powers of search and seizure."[6] So the OECD's proposal would hinder the ability of poor nations to make economic progress and would result in the creation of an intrusive international bureaucracy. There are no better reasons to resist the OECD's tax scheme.

ENDNOTES:

[1]Gaffney, Mason. "Immobile Taxation In A World Of Mobility," in *Federalist Government in Principle and Practice*, eds. Donald P. Racheter and Richard E. Wagner. Boston: Kluwer Academic Publishers, p.97
[2] Ibid, p.97
[3] Ibid, p. 98
[4] Ibid, p. 98
[5] Ibid, pp. 97-8
[6] Ibid, p. 108

This Institute Brief is one in a series on the chapters of a just published book, FEDERALIST GOVERNMENT IN PRINCIPLE AND PRACTICE, *edited by Dr. Don Racheter, President of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chairman of the Institute's Academic Advisory Board.* FEDERALIST GOVERNMENT IN PRINCIPLE AND PRACTICE *looks at the relationship between federalism and liberty and explores the substantive practice of federalism, particularly the centralizing processes at work and the opportunities for decentralization.*

The author of this chapter of FEDERALIST GOVERNMENT IN PRINCIPLE AND PRACTICE *is Dr. Mason Gaffney, Professor of Economics at The University of California-Riverside.*

This summary of Dr. Gaffney's chapter was written by David Hogberg, a Research Analyst with Public Interest Institute.

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