Bermuda, Freedom, and Economic Growth

by Robert Stewart

Senator John Kerry of Massachusetts, the presumptive presidential candidate of the Democratic Party, says he wants to end Bermuda’s offshore “creed of greed” and crack down on the “corporate Benedict Arnolds” who move offshore to avoid paying U.S. taxes. (The statements are taken from the Bermuda Mid Ocean News, January 23, 2004.)

Kerry said, “I am tired of seeing chief executives permitted to take their millions or billions to Bermuda and leave the average American here at home stuck with the tax bill. You know what I call that? Unpatriotic.”

As someone who lives in Bermuda, who is committed to the free market, and who is also an investor in the U.S. stock market (and, incidentally, who pays U.S. taxes on dividends), do you know what I call CEOs who relocate to Bermuda to reduce their tax burden and improve their profitability? Smart and conscientious.

They are protecting the interests of the owners of their companies—the shareholders, the raison d’être for the corporation. In the long run they are also looking after the interests of their employees and consumers. As if moved by Adam Smith’s invisible hand, the CEOs are promoting an end that is no part of their intentions: the health of the world economy and freedom of the individual. Let me elaborate.

Once profits are taxed and disappear into the black hole we call the government treasury, the funds cannot be invested. When capital investment is curtailed, productivity tends to plateau, which has a depressing effect on wages. In addition, diminished investment arising from high taxation means that consumers are unable to benefit from cheaper and better goods and services.

One of the financial facts of life is that private investment provides greater benefits to the public than government-sponsored projects, such as sports arenas, pork-barrel stunts, or national airlines. Consumers are helped with more products and lower prices, employees with higher wages and benefits. General prosperity is enhanced. A 1998 Joint Economic Committee report for Congress showed that if government expenditures as a share of GDP in the United States had remained at 1960 levels, the average income for a family of four would have been $23,440 higher. (See James Bovard, “Political Accounting,” The Freeman, September 1999.)

Government expenditure on prestige projects or roads to nowhere wastes funds that could be better used in investments to raise living standards. Government is too inefficient, too big, and too powerful; and it generates more costs than benefits for the populace. Low-tax countries do everyone a favor,
except the governing classes and their minions, by compelling governments to compete with each other to be more efficient, more nimble, and less repressive. What is not clearly understood is that business creates prosperity and wealth, while government inhibits innovation and consumes (and often wastes) wealth created by others. The answer to the problems faced by high-tax regimes is surely to reduce the tax burden, not to penalize low-tax countries that prevent financial mugging and wealth destruction.

The United States is a country founded on the principle of low taxation, although ironically after more than 200 years of increasing government interference in the economy, it is now a country of high taxation. In 1902, Tax Freedom Day, which is calculated by the Tax Foundation, was January 31; in 2002, it was April 19.

Low taxes result in more freedom and more prosperity; high taxes result in less freedom and less prosperity. Citizens of the United States now hand over to their governments (federal, state, and local) something approaching 40 percent of their incomes. In many European countries that percentage is closer to 50. Ten percent was considered appropriate by God, but 40 percent or more is deemed appropriate by today’s politicians. Who knows what the appropriate percentage is? It could be 50 or 60 or 70 or 80 or more. Once the power to tax becomes unlimited, government power also becomes unlimited, and freedom for the individual is diminished.

As former President Grover Cleveland put it, “When more of the people’s sustenance is exacted through the form of taxation than is necessary to meet the just obligations of government and expenses of its economical administration, such exaction becomes ruthless extortion and a violation of the fundamental principles of free government.”

In a similar vein, Frédéric Bastiat, with his usual clarity and wit, observed, “Look at the law, and see if it does for one man at the expense of another what it would be a crime for the one to do to the other himself.” In Bastiat’s opinion, when government taxes highly, it becomes a brigand and looter, and a device by which “everyone seeks to live at the expense of everyone else.”

**Docile People**

Politicians regard taxpayers as a gigantic cash machine. The taxpayer in the United States (and elsewhere) is a model of docility, living under more oppressive conditions than King George III imposed in 1776. Most politicians depend for their success on that docility—taxpayers acting like cattle who stand passively in the barn waiting for a handout. They count on voters to keep their mouths shut, because high taxation depends on the silence of good men. The electorate is expected to fall for the hooey that avoiding taxes is unpatriotic.

Clearly most American voters have never heard, or understood, the statement of Judge Learned Hand: “Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes. Over and over again the courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike, and all do right, for nobody owes any public duty to pay more than the law demands.”

It is not well understood by many in the media that when a U.S. corporation moves its headquarters to a foreign location, it does not “evade” taxes. It still must pay the full U.S. tax on the portion of its income effectively connected to a U.S. trade or business. It just does not pay U.S. tax on its foreign operations in lower-tax countries. It is also worth noting that corporations are abstract legal entities, which means that any tax paid by a corporation is, in the final analysis, paid by real flesh-and-blood people like you and me, who may be shareholders, employees, or customers of the corporation.

When citizens decide that they do not like high taxes on income, they will take actions to avoid the unpleasant plundering activities. Once the government bite on individual
incomes reaches 30 percent or thereabouts a silent tax revolt takes place. People either stop working, or they fudge their tax returns, or they shift assets and commercial activities abroad where the tax regime is less hostile to earnings and the preservation of capital. Just as the exploited and victimized physically left Europe in the eighteenth and nineteenth centuries for the freedom of the United States and elsewhere, the wealthy also vote, not with their feet as did “the huddled masses yearning to breathe free,” but with their bank balances and intellectual capital. They are heirs to a time-honored custom of free people telling overbearing government to take a hike. Confiscatory taxes force otherwise law-abiding citizens into revolutionary action called tax avoidance by its supporters and tax evasion by its critics.

There is a huge morally important point at stake. Government confiscation of private property through taxation is usually justified by the fact that it performs good works and provides endless benefits to its citizens. The state is wiser than the individual, and the taxpayer should willingly cough up his share because of all the benefits showered on him by benevolent rulers. Others, like the American Founding Fathers, argue that the individual takes precedence over government and that there are inalienable rights to privacy, life, liberty, and property.

Once income and corporate taxes are imposed, the level of earnings the taxpayers and corporations are allowed to keep becomes dependent on the goodwill of the government; they become the modern equivalent of medieval serfs. Those who value individual freedom over government benevolence (or should that be malevolence?) seek to protect their assets and their privacy from prying eyes, but they are usually portrayed as greedy, selfish, and unpatriotic, neglectful of their responsibilities to those at home.

However, it is not only ambitious American politicians who pillory insignificant dots on the map like Bermuda and seek to make them vassals of the United States for having the temerity to enact tax codes fundamentally different from high-tax jurisdictions. Over the past ten years or so, European governments and quasi-governmental organizations such as the Organization for Economic Cooperation and Development (the reason for whose existence is best determined by the anthropologist rather than the economist) have targeted so-called tax havens like Bermuda and the Cayman Islands on the grounds that they siphon off legitimate tax revenues. This has been described as “harmful tax competition” (a code name for lower levels of taxation and a contradiction in terms), or has been categorized as illegal tax evasion. In some cases, vague accusations of money laundering have been made. To identify such miscreants, it is argued that governments should exchange financial information.

Nothing to Fear?

It is said that honest people having nothing to fear from governments’ sharing tax and banking information. But this assumes that governments are honest too, a mistake that has cost many honest people their liberty or lives in the past—just check the history of Germany and Russia.

Making it easier for government to have access to private information is simply stoking up trouble for the future. The more power government has, the greater is the temptation to misuse it. And if history is a guide, that temptation is rarely resisted. The only way to keep government honest is to limit its powers and its access to private information about citizens, a lesson the Founding Fathers tirelessly taught. They knew full well that governments all over the world usually fail to operate at high moral standards.

Providing information to the authorities is one of the main ways the power of government expands. Indeed, when the records of the majority of governments in the world are examined, it is difficult not to conclude that government is the greatest threat to liberty and prosperity. History is full of examples of people naively trusting government by providing data and living to regret their actions.
Tax evasion is a crime, and it is necessary to formulate a policy to discourage criminal acts. Low tax rates, lower government spending, and simplification of Byzantine tax codes suggest themselves as being effective methods of minimizing tax evasion. The trouble is that high-spending Western governments, desperately seeking to keep their bloated welfare states afloat, are enamored of ending financial privacy for individuals and corporations, and of requiring governments to enforce such things as the European Union’s Savings and Tax Directive.

This directive aims at ending or at least stemming the flow of legitimate money from the oppressive tax sinkholes of Europe to more welcoming and less-restrictive economies, like those in Switzerland and Bermuda. Such flights of funds are not illegal acts of tax evasion, and they are not acts of people who are unpatriotic. They are acts of legitimate tax avoidance by people and corporations who wish to protect their assets from seizure.

Just as government-sponsored cartels for the production of oil, cotton, or coffee are harmful to consumers, so is the creation of a tax cartel that prevents the most productive use of investment funds and that benefits high-spending politicians at the expense of taxpayers. Low-tax countries have no obligation to help high-tax countries drain the wealth of their citizens. Indeed, low-tax countries have an essential economic function—assisting productive citizens to make more effective use of their money rather than have it squandered by free-spending politicians.

Bermuda does not harbor latter-day Benedict Arnolds. It assists ordinary people by limiting the power of governments to tax their citizens, and by providing greater freedom to the individual. It has nothing to be ashamed of.

Test your knowledge of history:

Compared to the beginning of the 20th century, the death rate owing to war and genocide is today:

a) twice as high, b) about the same, c) half as high, d) 1/100th as high.

Surprised that the answer is d)? You shouldn’t be. As political scientist James Payne documents in this remarkable new book, there is a long-run tendency for all uses of force to decline. Of course there’s still violence in the world, and government coercion is still deplorably common. But by almost any measure—and Payne advances several dozen—there is less reliance on force than there used to be.

This far-reaching, carefully researched book opens exciting new perspectives on government’s past—and its future.

To order *A History of Force*, send check for $27.45 ($23.95 plus 3.50 S&H) to: Lytton Publishing Company Box 1212 • Sandpoint, ID 83864 Or visit www.lyttonpublishing.com
The freedom and growth literature has consistently shown that nations which have fewer restrictions on private agents and transactions tend to higher levels of economic growth. It is less clear, however, whether freedom causes growth, growth causes freedom, or the two are jointly determined. To assess these possibilities, Granger-causality tests are performed on annual freedom indicators developed by the Heritage Foundation and national growth rates. They have confirmed the relationship between economic growth and economic freedom. In the article, we assume that economic freedom is determined by the cumulative effect of many economic and non-economic factors. Although the idea that economic freedom leads to economic growth was not challenged directly, it nonetheless fell by the wayside earlier this century. That was due partly to developments in economic theory and partly to world events. Around the turn of the century, methods in economics began to more closely resemble the hard sciences, especially physics. The Keynesian revolution hit economics with the publication of John Maynard Keynes’s The General Theory of Employment, Interest, and Money in 1936. Keynesian economics argued that modern economies need active government policies to manage them and to maintain prosperity.

Economic Freedom in a Neo-classical Growth Model. Regressions based on the neo-classical model are reported in Table 2 (Regressions 1 to 3). The first regression uses only the variables in the basic model: \( \log \text{PPP-adjusted per capita GDP in 1980} \), \( \text{INV} = \text{investment share in GDP, average for 1980-99} \), \( \text{FERTIL} = \text{total fertility rate, average for 1980-99} \), used as the measure of population growth. This suggests that the growth-effect of economic freedom depends not only on the absolute level of the EFW index during any given period, but also on the direction (and magnitude) of the change in the index over that period. 4. Geography, Economic Freedom and Growth. Bermuda Assists Ordinary People by Limiting Government Power. Tuesday, June 1, 2004. Kerry said, “I am tired of seeing chief executives permitted to take their millions or billions to Bermuda and leave the average American here at home stuck with the tax bill. You know what I call that? Unpatriotic.” As someone who lives in Bermuda, who is committed to the free market, and who is also an investor in the U.S. stock market (and, incidentally, who pays U.S. taxes on dividends), do you know what I call CEOs who relocate to Bermuda to reduce their tax burden and improve their profitability? Smart and conscientious. They are protecting the interests of the owners of their companies.”