DEFENSE OF OECD HARMFUL TAX COMPETITION REPORT.
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Letter to the Editor
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Michael McIntyre responds to Professor Wright's “Harmful Tax Competition: Response to Messrs. Osterweil and Francke.”

Defense of Oecd Harmful Tax Competition Report

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Tax Notes
Letter to the Editor

To the Editor:

[1] The OECD report on harmful tax competition was reviewed unfavorably in these pages by Arthur Wright (*Tax Notes*, Oct. 5, 1998, p. 133), an economist at the University of Connecticut. That review provoked some spirited defenses of the report (*Tax Notes*, Oct. 12, 1998, pp. 257-259), and a reply by Wright (*Tax Notes*, Nov. 30,, 1998, p. 1135). The OECD report is a landmark document. Whatever the merits of Wright's review and his self-immolating reply, he has performed a public service in stimulating debate over the merits of the OECD report.

[2] My comments here deal with two points tangential to the major issues raised by the OECD report. The first is whether the OECD staff undermined the effectiveness of the report, as Wright alleges, by writing in a “bureaucratic” tone. I respectfully suggest that grey is the hue of many influential tax reports. A couple of the Appendices to the Carter Commission report show some literary flair, but the main body of the report does not display much color. The Meade report was dark grey throughout. Yet both reports are well regarded in academic quarters. In contrast, the lightly regarded Kemp report displays all the colors of a fruitcake. I find the OECD report to be quite readable, and I doubt that a brighter prose style would have enhanced the message. Indeed, it might have detracted from it by calling undue attention to the messengers.

[3] My second point deals with Wright's cartel analogy. He compares concerted

action of OECD member states to protect their direct tax systems with the concerted, illegal action of a group of private producers to raise the prices of their goods or services in the marketplace. On one superficial level, the analogy works. In both cases, the point of the concerted action is to gain power for the members of the consortium. In another respect, however, the analogy fails.

[4] In a classical cartel, producers band together to reduce the supply of the goods that they produce to jack up the prices that consumers must pay. To manage demand for their goods, they must manage supply by establishing production quotas for each cartel member. The cartel is unstable because each member typically can increase its production over its quota, thereby reaping excess profits at the expense of the other cartel members. The cartel has difficulty preventing such action because the cartel, being illegal, cannot enforce the agreement in the courts.

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[5] The “production” of a modern government is the creation of public goods and the making of transfer payments. When governments band together to make their direct tax systems work better, they do not contemplate a reduction in their production. Those governments may contemplate an increase in tax revenues, in which case government production of public goods and transfer payments would go up. Or they may contemplate a revenue neutral reform in which taxes would go up for some persons, typically holders of mobile capital, and would go down for others, typically wage earners. What they clearly do not contemplate is that they will cut their production and, by so doing, will obtain an overall increase in their tax revenues. That is, they do not intend to operate like a classical cartel.

[6] Another way to see the flaw in Wright's analogy is to compare the motives of customers victimized by a private cartel and taxpayers forced to pay higher taxes because of the concerted action of governments to defend their direct tax systems. The customers of the cartel very much want to acquire the goods produced by the cartel, and it is that desire for the goods that gives the cartel its power to raise prices. The objective of the cartel is to appropriate for its members the consumer surplus that those customers would have enjoyed if the goods had been sold at the free-market price. Taxpayers, in contrast, do not pay ability-to-pay taxes to obtain the benefits of governmental production. They pay because they are compelled to do so under the law. By doing so, they do not get a special claim to transfer payments or a special claim to public goods. Only in the irrelevant case of benefit taxes does the taxpayer correspond in any meaningful way to the customer of a cartel.

[7] Wright's analogy to private cartels leads him to conclude that concerted action by governments to combat harmful tax competition is inherently unstable. Anyone

who knows anything about taxation knows that cooperation between governments on tax policy will not be achieved easily. The OECD report, at best, is a small first step. The problems that must be overcome, however, relate primarily to internal political problems within the member states. They have nothing to do with the economic pressures that tend to make cartels unstable.

Sincerely,

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