**Logic of Appropriateness or Logic of Consequence?
Competing Explanations for the OECD Campaign against
Tax Havens**

By

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Abstract

This thesis provides an alternative explanation to existing constructivist accounts of the OECD campaign against tax havens. It reinterprets the OECD project through a neoliberal institutionalist lens and offers a different take on each major historical development. It brings the narrative up to date, describing the events of the past two years and explaining the underlying causes in a manner consistent with the neoliberal reinterpretation. It finishes by considering what this account might predict for the future of tax information exchange. The thesis finds that transformative change happens in accordance with state interests rather than with identities and norms. International institutions fundamentally exist to advance the interests of their member-states and will adapt their goals to reflect changing collective interests. States that are coerced to change their behaviour can be expected to comply only to the extent required to avoid sanctions.

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List of Abbreviated Terms

CARICOM	Caribbean Community
CFP	Center for Freedom and Prosperity
CFA	Committee on Fiscal Affairs (OECD)
CHOGM	Commonwealth Heads of Government Meeting
DTA	Double Taxation Agreement
EOI	Exchange of Information
FATF	Financial Action Task Force
G7	Group of Seven (Canada, France, Germany, Italy, Japan, the UK, the US)
G20	Group of Twenty (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the UK, the US and the EU)
GDP	Gross Domestic Product
GFC	Global Financial Crisis
IFI	International Financial Institution
IMF	International Monetary Fund
IP	Intellectual Property
ITIO	International Tax and Investment Organisation
NCJ	Non-cooperative Jurisdiction
OECD	Organisation for Economic Co-operation and Development
PIF	Pacific Islands Forum
TIEA	Tax Information Exchange Agreement
TNC	Transnational Corporation
UN	United Nations
WTO	World Trade Organisation

Chapter One: Introduction

Since publication of its seminal report *Harmful Tax Competition: An Emerging Global Issue* in 1998, the Organisation for Economic Co-operation and Development (OECD) has been recognisably at the centre of an international campaign against tax havens. This movement began amidst a series of monetary crises in the early-mid 1990s which were aggravated by the swift actions of investors in withdrawing and/or injecting capital.¹ In this context, tax havens were seen to facilitate the movement of capital offshore and to undermine the ability of governments in capital-rich states to tax the proceeds. The concept of an international ‘race-to-the-bottom’ in corporate tax rates emerged, as tax havens were seen to compete for capital by undercutting the tax rates of other countries. There was (and to some extent continues to be) a fear that unless tax rates and corresponding social services were cut to competitive levels by governments, capital that underwrote state economies would be lost. Neither of these options was attractive to governments and the decision was further complicated by its nature as a prisoner’s dilemma, because any individual state’s movement of its tax rates could lead to exploitation by investors or by other states.²

The OECD was directed to initiate the project on *Harmful Tax Competition* by the Group of Seven (G7) in 1996.³ “Harmful competition” was defined broadly by the 1998 report as including both preferential regimes (special concessions for foreign entities) and the practices of tax havens. Tax havens were states with no or low taxation that offered or were perceived to offer themselves as places where non-residents could escape tax in their country of residence. In addition, tax havens had no substantive activity, a lack of information exchange and a lack of transparency.⁴

The campaign gained momentum in June 2000 with the publication of the OECD’s *Towards Global Tax Cooperation: Progress In Identifying And Eliminating Harmful*

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¹ Hampton, Mark P., and Jason P. Abbott. ‘The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors’ Introduction’, in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 2.

² Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 146.

³ *Ibid*, p 145.

⁴ Organisation for Economic Co-operation and Development Centre for Tax Policy and Administration. *Harmful Tax Competition: An Emerging Global Issue*, 1998.

Tax Practices (hereafter referred to as the 2000 Progress Report), containing a now infamous ‘blacklist’ of jurisdictions meeting the criteria for a tax haven. The blacklisted countries were given a deadline of 31 July 2001 by which time they were to have committed to removing their harmful tax practices by 31 December 2005.⁵ Any tax havens that failed to make this commitment would be published in a new list of “uncooperative tax havens” and this would be the basis for imposing “defensive measures” (i.e. sanctions). The report provided a lengthy list of potential measures including additional taxation, targeting for audit, refusal to negotiate or apply bilateral tax agreements, punitive transactional charges and denial of non-essential economic aid.⁶ Such measures could be applied unilaterally according to individual state discretion, and coordination of such measures would be considered across the OECD. The blacklisted states responded rapidly, with six making commitments prior to the report’s publication in exchange for being excluded from the original list, and a further five committing in exchange for subsequent removal from the list.⁷

At this time, constructivist explanations began to account for the effectiveness of the blacklist. Blacklisting was a “speech act” which changed the reputation of states by virtue of the list’s publication. The damage that blacklisting caused to states’ reputations resonated among investors, thus producing pressure to comply through actual or anticipated capital flight.⁸ States responded to the blacklist and chose to cooperate with the OECD even without sanctions and at great cost to their economies.

Despite this rapid initial success, in the following OECD Progress Report of November 2001 (the 2001 Progress Report), the project was vastly scaled back. The first two elements considered essential to tax havens – no or low taxation and no substantive activities – would no longer be pursued by the project. Instead, commitments would be sought only in respect of transparency and exchange of information, and the 31 July 2001 deadline (which had passed without mention) was extended to 28 February 2002.⁹

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⁵ Organisation for Economic Co-operation and Development. *Towards Global Tax Cooperation: Progress In Identifying And Eliminating Harmful Tax Practices*, 2000, pp 9 and 18.

⁶ *Ibid*, p 25.

⁷ Organisation for Economic Co-operation and Development. *The OECD’s Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 9.

⁸ Sharman, J.C. ‘The bark is the bite: International organizations and blacklisting’, *Review of International Political Economy*, Vol. 16, No. 4, October 2009, pp 573–596.

⁹ Organisation for Economic Co-operation and Development. *The OECD’s Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 10.

In addition, the OECD guaranteed that any defensive measures would not apply to the uncooperative tax havens any sooner than they would apply to OECD members with harmful preferential regimes.¹⁰ Given that four OECD member-states – Austria, Belgium, Luxembourg and Switzerland – all maintained secrecy laws, and had abstained from the report, it was believed by many that sanctions would never get off the ground and that tax secrecy was safe for the foreseeable future.¹¹

The constructivists responded to these developments by arguing that tax havens had been able to successfully exploit the inherent, normative contradiction of the campaign.¹² Because the very concept that competition could be harmful and should be suppressed went against the OECD's founding, liberal economic principles, tax havens were able to take up these principles in a "mimetic challenge".¹³ By lobbying on the basis of free-market principles in addition to norms of fairness, sovereignty and multilateralism, tax havens presented the OECD campaign as inconsistent with expected standards of appropriate behaviour.¹⁴ The credibility of the campaign was quickly lost and the OECD was unable to continue with its project in its existing format.¹⁵

Although the OECD continued its campaign against tax havens in its new form targeting tax information exchange, it made no real progress.¹⁶ A new Exchange of Information (EOI) Article was added to both the OECD and United Nations' (UN)

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¹⁰ Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 10.

¹¹ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 819 and Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

¹² Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 53.

¹³ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 73.

¹⁴ Sharman, J.C. 'International Organisations and the Implementation of New Financial Regulations by Blacklisting', in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61 and Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006).

¹⁵ Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006), p 5.

¹⁶ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 819 and Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

model tax conventions to act as negotiating standards for bilateral tax treaties.¹⁷ However, Double Taxation Agreements (DTAs) were very rarely entered into by tax havens for the logical reason that there was no double taxation to relieve, and because these agreements by their nature must have reciprocal effect. The OECD therefore pushed for tax havens to sign on to Tax Information Exchange Agreements, or TIEAs. These alternative bilateral agreements enable states to share certain tax information held by one state at the request of the other, in limited circumstances. But despite this, just 23 TIEAs were signed globally between 2000 and 2007.¹⁸ As recently as 2007, the OECD project was thought to have almost entirely petered out, and many predicted that it would never achieve the breakthrough it needed to combat tax secrecy.¹⁹

Following the height of the global financial crisis (GFC) in September 2008 with the collapse, takeover or bailout of financial institutions such as Lehman Brothers, Merrill Lynch and AIG, sudden and dramatic progress was made. The G20 Washington Summit on 15 November 2008 directed governments to “vigorously address” the lack of transparency and tax information exchange²⁰ and in the months that followed, intensive negotiations were begun between the dominant G20 states and the key secrecy jurisdictions.

Just weeks before the next G20 Summit in London on 2 April 2009, all the major secrecy jurisdictions including Austria, Belgium, Luxembourg and Switzerland suddenly removed their formal reservations and committed to the OECD standard of information exchange.²¹ In the wake of these announcements, it was revealed that the OECD planned to release a new blacklist on the day of the London Summit.²² The new

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¹⁷ Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 5.

¹⁸ Originally published by the Organisation for Economic Co-operation and Development, ‘Promoting Transparency and Exchange of Information for Tax Purposes’, 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 13.

¹⁹ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 819 and Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

²⁰ G20. ‘Declaration of the Summit on Financial Markets and the World Economy’, 15 November 2008, available online at <http://georgewbush-whitehouse.archives.gov/news/releases/2008/11/20081115-1.html>, accessed 13/04/2010.

²¹ Organisation for Economic Co-operation and Development. ‘OECD Assessment Shows Banking Secrecy as a Shield for Tax Evaders Coming to an End’, 31/08/2009, online at www.oecd.org/documentprint/0,3455,en_2649_34897_43592376_1111.00.html accessed 13/04/2010.

²² Mathiason, Nick. ‘Beginning of the End for Tax Havens’, *The Guardian*, 14/03/2009, online at <http://www.guardian.co.uk/business/2009/mar/13/switzerland-tax-evasion-fight>, accessed 23/08/2010 and

list assessed any state that had not signed on to at least 12 TIEAs (or DTAs containing Exchange of Information Articles) as either “not committed” or having “not substantially implemented” their commitments.²³ These agreements instantly became the global standard by which to assess transparency and exchange of information.²⁴ Leaders at the G20 London Summit declared they were “ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over.”²⁵

A new Global Forum on Transparency and Exchange of Information was established by the OECD to monitor the effective implementation of the information exchange standard. At its inaugural meeting in Mexico City on 1-2 September 2009, OECD Secretary-General Angel Gurría said:

What has happened in the tax area over the past 10 months is nothing less than a revolution! ... For decades it has been possible for taxpayers to hide income and assets from the taxman by abusing bank secrecy or other impediments to information exchange. This will no longer be the case. Cooperation between tax administrations is now becoming the rule. The threshold of tolerance for tax evasion has dropped to zero.... We have delivered more in 10 months that we achieved in more than 10 years.²⁶

At the following G20 Summit in Pittsburgh on 24 – 25 September 2009, leaders stated that they were “ready to use countermeasures against tax havens from March 2010.”²⁷ By January 2010, over 300 TIEAs had been signed worldwide.²⁸ No states still remain on the “not committed” blacklist.²⁹

Anon, ‘Switzerland Eases Banking Secrecy’, BBC, 13/03/2009, online at <http://news.bbc.co.uk/2/hi/business/7941717.stm>, accessed 23/08/2010.

²³ G20. ‘Global plan for recovery and reform: the Communiqué from the London Summit’, 2 April 2009, online at <http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/>, accessed 13/04/2010.

²⁴ Bubenzer, Peter. ‘OFCs in the Crosshairs but not Alone in their Struggle to Survive’, *Offshore Investment*, Issue 204, March 2010, p 3.

²⁵ G20. ‘Global plan for recovery and reform: the Communiqué from the London Summit’, 2 April 2009, online at <http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/>, accessed 13/04/2010.

²⁶ Organisation for Economic Co-operation and Development. ‘Remarks by Angel Gurría at the Global Forum on Transparency and Exchange of Information’, 02/09/2009, online at www.oecd.org/documentprint/0,3455,en_2649_344487_43596999_1_1_1_1,00.html accessed 13/04/2010.

²⁷ G20. ‘Leaders’ Statement: The Pittsburgh Summit, 24 – 25 September 2009, online at <http://www.pittsburghsummit.gov/mediacenter/129639.htm>, accessed 13/04/2010.

²⁸ Owens, Jeffery. “Taking Forward the G20 Tax Initiative”, Interview by OECD TV, 18 January 2010, available on YouTube at <http://www.youtube.com/watch?v=U4MgXdG7MYU>, accessed 13/04/2010.

²⁹ Organisation for Economic Co-operation and Development. ‘A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard’, 18 August 2010, online at <http://www.oecd.org/dataoecd/50/0/43606256.pdf> accessed 23/08/2010, accessed 23/08/2010.

Given that banking secrecy had remained firmly entrenched and largely non-negotiable in many jurisdictions despite years of OECD work against it, the suddenness of the concessions on banking secrecy has been stunning.

The question this thesis explores is *why* the OECD campaign against tax havens (in its most recent form, against banking secrecy) has succeeded so suddenly despite its setback in 2001 and the following years of stagnation.

This thesis will describe the emergence of tax havens and ensuing debate over their value. The origins of the OECD campaign and its early work are described and a neoliberal account is provided for the project's change of focus in 2001. The decline of the campaign is discussed leading up to the dramatic breakthroughs in banking secrecy in the wake of the GFC. The role of G20 leaders in bringing about a global standard for tax information exchange is explained in terms of a structural change that affected domestic political economies in a way that reshaped state interests. The havens' compliance is attributed to coercion through both the anticipated consequences of blacklisting and imminent sanctions. Finally, the future of tax information exchange is considered in light of the new Global Forum on Transparency and Exchange of Information. The effectiveness of Tax Information Exchange Agreements is deliberated and the likelihood of mock compliance is assessed.

The thesis finds that the structural effect of the GFC shifted the interests of dominant OECD states in a way which aligned them with the OECD's dormant movement against secrecy jurisdictions. This neoliberal institutionalist argument challenges the body of constructivist literature that has, so far, interpreted the fight against tax havens as intrinsically linked to the reputations and identities of states and of the OECD itself. The dramatic developments of the past two years appear to undermine the current constructivist explanation of the OECD campaign, which provides a springboard to look further back at the fight against tax havens to reinterpret it from a neoliberal perspective.

This reinterpretation reveals that transformative change happens in accordance with state interests rather than identities. For international institutions representing state interests (here being the OECD's Committee on Fiscal Affairs), their policies are

effective only when there is alignment between the interests of its most powerful member-states.

Background: tax havens and banking secrecy

The term ‘tax haven’ has been widely used since the 1950s, yet there has never been consensus on its meaning.³⁰ In the broadest sense, it is used to denote offshore jurisdictions where tax residence can be relocated in order to escape local taxation laws.

Tax havens first became possible with the invention of fictional tax residence – the separation of legal residence from the physical location of business activities or investments.³¹ Fictional tax residence dates back to the turn of the 20th Century with the United Kingdom House of Lords case of *De Beers Consolidated Mines Ltd v Howe*. The Court held that that a company’s residency for tax purposes depended on where the “centre of management and control” was located, rather than where the company was incorporated.³² This decision was adopted by lawmakers in most common law jurisdictions and became an accepted standard for tax residence.³³

The modern tax haven results from discordance between the increasing internationalisation of capital through forces of globalisation and the parallel insulation of the sovereign state in law.³⁴ The fact that individual state governments maintained the right to determine their tax rules in the context of nomadic capital searching for the highest net return on investment led states to use their law-making authority as a competitive advantage.³⁵ In the age of the social state and correspondingly high tax rates in the developed world, mobile capital was easily lured to states offering low or no taxation.

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³⁰ Palan, Ronen. ‘The History of Tax Havens’, *History and Policy*, online at <http://www.historyandpolicy.org/papers/policy-paper-92.html>, accessed 10/03/10.

³¹ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 802.

³² *De Beers Consolidated Mines Ltd v Howe*, (UK) (1906) 5 TC 198 5TC213.

³³ Murphy, Richard. “Tax Justice and secrecy jurisdictions” *Soundings* 41 (2009), p 66.

³⁴ Palan, Ronen. ‘Tax Havens and the Commercialisation of State Sovereignty’, *International Organisation*, Vol. 56, No. 1, 2002, p 153.

³⁵ Palan, Ronen. *The Offshore World: Sovereign Markets, Virtual Places, and Nomad Millionaires* (Ithaca: Cornell University Press, 2003).

Because the centre of management and control of a multinational company is difficult to prove, companies may conduct activities elsewhere but fly the directors to a low/no tax jurisdiction for its annual meetings in order to claim that this is where control is exercised. Often as little as a plaque at the reception of a building in the low/no tax jurisdiction has been used to establish the head office of the company despite the absence of the company directors. This is popularly known as a “brass plate company”. The most famous brass plate company headquarters is Ugland House in the Cayman Islands, a five-storey building where 12,000 corporations claim to be headquartered. Subsidiaries of Coca-Cola, Procter & Gamble, General Motors, Intel, FedEx and Sprint all claim to be based there.³⁶

The modern tax laws of most states now apply multiple bases for tax residence. For companies, this includes a range of factors intended to capture both the place of incorporation and the centre of management and control.³⁷ This means that in offshore situations there may be multiple taxing rights and unless a Double Taxation Agreement allocates a primary taxing right to one country, the income may be taxed more than once. This approach means that to escape the home country’s tax net, the company must both incorporate and have its centre of management and control in a foreign jurisdiction. In practice this is often not difficult to do, and tax havens may deliberately make these processes easy to attract foreign business.

But in the age of the multinational company, changes in tax residence are necessarily common and most often occur between states with similar levels of taxation. Therefore, the modern definition of a tax haven also requires that the offshore jurisdiction offers a tax saving through low or no taxation. Even still, this definition would capture any country with tax rates significantly below the OECD average, including countries such as Ireland and Singapore, which have uniform low company tax rates. While the attraction of foreign capital is likely to have been a key driver for these low tax rates, low company tax rates are also employed to encourage domestic investment and growth of local business.

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³⁶ Leary, Alex. ‘Obama Targets Cayman “Tax Scam”’, *PolitiFact*, 09/01/2008, online at <http://www.politifact.com/truth-o-meter/article/2008/jan/09/obama-targets-cayman-islands-tax-scam/> accessed 23/05/2010.

³⁷ For example, see the section YD 2 of the New Zealand Income Tax Act 2007 and section 23A(2) of Ireland’s Taxes Consolidation Act 1997.

In addition, it can be very difficult to prove that the reason the taxing right has shifted from one country to another is due to a deliberate intent on the part of the taxpayer to take advantage of a foreign low tax rate. For example, companies may take advantage of low/no tax jurisdictions by allocating their intellectual property (IP) rights (such as the company brand, product design or recipe) to a company incorporated and managed in a low/no tax jurisdiction. The company then sets up subsidiaries in high tax jurisdictions which conduct business and generate profit. The IP-owning parent company can charge the subsidiary royalties for the use of its IP. This reduces the taxable profits in the high tax jurisdiction and instead transfers the profits so it is subject to taxation in the low/no tax jurisdiction. There are many legitimate reasons why a company would restructure this way, and provided that the taxation result is merely a by-product rather than a primary intention behind the structure it usually does not constitute tax avoidance.

Some definitions add a “reputation test” to assess whether a state offers itself or is generally perceived to offer itself as a place to be used by non-residents to escape tax in their country of residence. This subjective approach was adopted by the OECD in an early (1987) report and has been retained as one factor that may contribute to a state’s classification as a tax haven.³⁸ This is obviously a problematic assessment, as it might be possible to deem any country with a low tax rate as having deliberately enacted tax legislation to attract business from higher taxed jurisdictions.³⁹

The OECD’s definitive classification of a tax haven was contained in its 1998 report on *Harmful Tax Competition*. The report defined a tax haven as having four elements:⁴⁰

1. No or nominal taxation;
2. No substantial activities;
3. Lack of effective information exchange; and
4. Lack of legal transparency.

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³⁸ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 18.

³⁹ Palan, Ronen. ‘Tax Havens and the Commercialisation of State Sovereignty’, *International Organisation*, Vol. 56, No. 1, 2002, p 154.

⁴⁰ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 18.

The no or nominal taxation element requires no further explanation. The assessment of whether there are substantial activities was intended to indicate that a jurisdiction may be attempting to attract investment or transactions that are purely tax driven.⁴¹ It might also mean that a state is unable to commercially compete for capital and business in the absence of the tax advantages that it offers.⁴²

Effective information exchange refers to the sharing of tax information between authorities, usually under a Double Taxation Agreement (DTA) or a Tax Information Exchange Agreement (TIEA). In a globalised economy, governments often cannot rely on domestic information sources to enforce their tax laws, so information exchange is employed to deter non-compliance.⁴³ If a state does not have any such agreements, or it has only the form of such agreements with limited or no real effect, this is usually the result of strict secrecy requirements under domestic banking laws that prevent the collection and sharing of information.

The transparency element is therefore closely related to the exchange of information requirement. It refers to the domestic secrecy laws of a state, for example maintenance of anonymous accounts and/or criminal penalties for breaching client confidentiality. Such laws mean that tax administrators are unable to seek information on suspected tax evasion and are therefore unable to provide such information if it is requested by another jurisdiction. Consequently, states that maintain such laws are unable to sign on to bilateral or multilateral information exchange agreements.

Secrecy is essential to tax havens because it allows people to take advantage of the benefits of tax havens with the assurance that their home jurisdictions will not be able to hold them accountable. This secrecy is often viewed as facilitating both tax evasion and money laundering.⁴⁴

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⁴¹ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 23.

⁴² Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 5.

⁴³ *Ibid*, p 5.

⁴⁴ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 24.

Following the 2001 Progress Report, the OECD now only targets the lack of effective exchange of information and transparency aspects of tax havens.⁴⁵ These aspects will together be referred to from now on simply as secrecy.

Switzerland has long been viewed as a “stronghold of banking secrecy”.⁴⁶ Banking secrecy first developed as part of Swiss customary law as early as the 16th Century and became more widely practiced during the French Revolution.⁴⁷ But it was not until 1934 that Swiss banking secrecy was afforded official protection under the Penal Code. The 1934 Swiss Banking Law rendered “enquiry or research into the 'trade secrets' of banks and other organisations a criminal offence.”⁴⁸

It is widely claimed that secrecy was included in the Swiss Banking Law to protect Jews and other “enemies of the State” from having assets confiscated by Nazi Germany.⁴⁹ However, Murphy argues that this is “wholly untrue” and that Swiss banking secrecy was instead enacted in response to a political scandal in early 1930s France, when it was revealed that many high profile citizens were evading tax through the use of Swiss banks.⁵⁰

Whatever the case, Swiss banking secrecy provided assurance to investors that their affairs would be kept from the authorities at home. It was quickly emulated by other states including Austria, the Bahamas, Liechtenstein and Luxembourg.⁵¹ Tax evasion is not a crime in most secrecy jurisdictions, therefore individuals cannot be extradited for alleged tax evasion.⁵²

It should be noted that banking secrecy may hide a range of information, including both the identity of account holders and transaction details. It therefore has a number of

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⁴⁵ Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001.

⁴⁶ Mueller, Kurt. ‘The Swiss Banking Secret: From a Legal View’, *The International Comparative Law Quarterly*, Vol. 18, No. 2, April 1969, p 361.

⁴⁷ *Ibid*, p 361.

⁴⁸ Palan, Ronen. ‘The History of Tax Havens’, *History and Policy*, online at <http://www.historyandpolicy.org/papers/policy-paper-92.html>, accessed 10/03/10.

⁴⁹ Mueller, Kurt. ‘The Swiss Banking Secret: From a Legal View’, *The International Comparative Law Quarterly*, Vol. 18, No. 2, April 1969, p 361.

⁵⁰ Murphy, Richard. “Tax Justice and secrecy jurisdictions.” *Soundings* 41 (2009), p 68.

⁵¹ Palan, Ronen. ‘Tax Havens and the Commercialisation of State Sovereignty’, *International Organisation*, Vol. 56, No. 1, 2002, p 162.

⁵² Sharman, J.C. ‘Norms, coercion and contracting in the struggle against 'harmful' tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, pp 145-146.

benefits beyond tax avoidance. Secrecy can enable criminal activities such as money laundering or bribery, which are targeted by the Financial Action Task Force (FATF).⁵³ Secrecy can also be an advantage in private legal matters such as relationship property disputes and will contestations. A lack of transparency may also reduce the cost of commercial transactions by reducing regulatory obligations (companies registered in tax havens may not have to perform public audits or maintain a central register of shareholders).⁵⁴ So although banking secrecy has a range of benefits, the OECD project combats secrecy only in relation to taxation.

In addition to tax haven secrecy, the OECD has targeted “preferential regimes.” These are special tax concessions that apply only to foreigners and are “ring-fenced” from the domestic economy. It can be concluded that such tax rules are adopted for the sole purpose of attracting foreign investment, because the state is not willing to bear the cost of lost revenue from its own tax base.⁵⁵ In Palan’s words, “the motive of these states is to draw rent surpluses from the income that would otherwise accrue to larger states.”⁵⁶ Preferential regimes are fairly commonly used by OECD member-states and their characteristics are carefully distinguished from those of tax havens.

What’s so wrong with tax havens?

Over the course of its campaign, the OECD has cited a plethora of reasons to explain why tax havens are harmful. It has claimed that tax havens:

- Erode the tax base of home jurisdictions;
- Are a source of “unfair” competition;
- Distort investment flows;
- Force governments to shift taxation away from mobile capital to less mobile sources such as labour and land;
- Raise the costs of state tax administration and compliance costs of taxpayers;

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⁵³ Murphy, Richard. “Tax Justice and secrecy jurisdictions,” *Soundings*, vol. 41 (Spring 2009), p 71.

⁵⁴ *Ibid*, pp 68-69 and Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, pp 145-146.

⁵⁵ Organisation for Economic Co-operation and Development. *The OECD’s Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 5.

⁵⁶ Palan, Ronen. ‘Tax Havens and the Commercialisation of State Sovereignty’, *International Organisation*, Vol. 56, No. 1, 2002, p 152.

- Reduce regulation and transparency of companies;
- Undermine faith in the equity of tax systems.⁵⁷

However, these often-cited arguments against tax havens are not universally accepted. There is a significant alternative argument which views tax havens as an essential and even useful part of a free global market. This view has had particular resonance within the United States.

It has been accepted by the domestic Courts of most OECD countries that a person bears the right to structure their affairs so as to minimise their tax burden. This has given rise to legal debate surrounding the distinctions between tax minimisation, tax avoidance and tax evasion, and of which practices might fall into each category. If one can accept that in a free-market society it is desirable for individuals and companies to reduce their tax burden within the limits of the law, it is also reasonable to consider that tax competition might be good for the global economy.⁵⁸

At a basic level, tax havens are seen to promote economic growth and healthy competition. Some US economists have found that the presence of tax havens has led to an increase in economic activity in nearby non-tax havens. This is because multinational firms can enjoy higher after-tax returns and therefore can maintain higher levels of foreign investment than they could otherwise.⁵⁹

It is argued that tax havens act to regulate the levels of taxation applied by other governments. The sovereign state has a monopoly over the taxation of its citizens, and without competition between states for mobile capital, the government could theoretically set its tax rates as high as it desired. In addition, the government can impose whatever regulative requirements it chooses. From the perspective of economic growth, the lower the tax rates and the lower the compliance costs, the better. Therefore

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⁵⁷ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, pp 145-146.

⁵⁸ Bubenzer, Peter. 'OFCs in the Crosshairs but not Alone in their Struggle to Survive', *Offshore Investment*, Issue 204, March 2010, p 2.

⁵⁹ Davidson, Sinclair. 'Here is the truth about tax havens', *The Age*, 16 October 2007, available online at <http://www.theage.com.au/news/business/here-is-the-truth-about-tax-havens/2007/10/15/1192300685572.html> accessed 08/08/2010.

tax havens help to ensure that states do not abuse their monopoly to the detriment of the wider economy.⁶⁰

Beyond the monopoly of a single state to tax its citizens, there is concern that the OECD might seek to achieve tax coordination between jurisdictions, leading to a global monopoly. A University of Copenhagen study has found that co-ordination of state tax policies would lead to higher capital taxes and higher wealth redistribution — but lower infrastructure spending, lower capital stocks, lower profits, lower real wages, lower GDP, and higher real interest rates.⁶¹

It is alternatively argued that the state's sovereign monopoly over taxation is sacrosanct. The state has the right to apply whatever laws it sees fit, including laws which enable it to compete against other states for capital.⁶² This is a rational policy to pursue, particularly for developing states that may have structural disadvantages, such as geographical distance from global financial centres or a lack of natural resources. Special tax incentives may be employed in order to offset non-tax disadvantages, including any additional costs of relocating to such areas.⁶³

Up until the 1990s, setting up shop as a tax haven was sometimes viewed as a legitimate development strategy for small island nations that had little other means of attracting capital. Some were actively encouraged by states with large financial centres in the hope that a nearby tax shelter would attract more active business to the main centre. The United Kingdom is one such state that encouraged its associated overseas territories and dependencies to develop offshore financial centres to help maintain London's status as a global financial centre.⁶⁴

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⁶⁰ Palan, Ronen. 'Tax Havens and the Commercialisation of State Sovereignty', *International Organisation*, Vol. 56, No. 1, 2002, pp 152 and 158.

⁶¹ Davidson, Sinclair. 'Here is the truth about tax havens', *The Age*, 16 October 2007, available online at <http://www.theage.com.au/news/business/here-is-the-truth-about-tax-havens/2007/10/15/1192300685572.html> accessed 08/08/2010.

⁶² Palan, Ronen. 'Tax Havens and the Commercialisation of State Sovereignty', *International Organisation*, Vol. 56, No. 1, 2002, p 159.

⁶³ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 15.

⁶⁴ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 797.

Advocates of this view often respond to the OECD's condemnation of tax havens by stating that it is not the practices of tax havens that cause the problems it cites, but rather the citizens of OECD member-states who abuse tax havens.⁶⁵ By targeting secrecy laws instead of the tax laws of havens, the OECD is seeking to enable its member-states to punish its own citizens instead of tax havens. Therefore the OECD campaign since November 2001 has been less offensive to those who adhere to this view.

Beyond this conventional debate for and against tax havens, Palan argues that tax havens are:

“a case of having your cake and eating it: maintaining the sovereign state system, as organiser and mediator of conflict and tension, and yet removing the threat of regulation and taxation associated with the state – all done in the name of and by the state system itself.”⁶⁶

Therefore, for better or worse, tax havens are seen to be an integral part of maintaining the sovereign state system in the context of global economic markets.⁶⁷

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⁶⁵ Palan, Ronen. 'Tax Havens and the Commercialisation of State Sovereignty', *International Organisation*, Vol. 56, No. 1, 2002, p 159.

⁶⁶ Palan, Ronen. 'Offshore and the Structural Enablement of Sovereignty', in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 20.

⁶⁷ Hampton, Mark P., and Jason P. Abbott. 'The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors' Introduction', in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 13.

Chapter Two: A Review of the Constructivist Literature

The predominant explanation among political economists of the OECD campaign against tax havens has, so far, been constructivist.

Constructivism in international relations

Constructivism is an agential rather than a structural theory, which explains the status quo as the result of the particular identities and interests of interacting states.⁶⁸ For constructivists, interests and identities are not structurally determined. Rather, they are defined through the process of interaction.⁶⁹ Identities are collective meanings built over time through repeated interactions giving rise to expectations for future interactions. States then determine their interests and act towards other states in accordance with the intersubjective expectations of what is appropriate behaviour.⁷⁰

Constructivists argue that state behaviour is constrained by a “logic of appropriateness”. In other words, states decide what they ought to do in consideration of the social context in which they find themselves. Shifting international norms may change what is appropriate, and states may in turn change their policies because it is seen as appropriate to do so. In this way, norms are able to redefine state interests.⁷¹

Constructivists say that instances of cooperation between states, even for self-interested reasons, initiate a process of interest-reconstruction in terms of shared commitments to social norms. Cooperation therefore alters states’ conceptions of Self and Other in the direction of developing a collective identity.⁷²

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⁶⁸ Wendt, Alexander. ‘Anarchy is What States Make of It: The Social Construction of Power Politics’, *International Organisation*, 46 (2), 1992, p 355.

⁶⁹ Ruggie, John. ‘What Makes the World Hang Together? Neo-utilitarianism and the Social Constructivist Challenge’, *International Organisation*, 52, 4, Autumn 1998, p 879.

⁷⁰ Wendt, Alexander. ‘Anarchy is What States Make of It: The Social Construction of Power Politics’, *International Organisation*, 46 (2), 1992, pp 396-397.

⁷¹ Suganami, Hidemi. ‘On Wendt’s Philosophy: a Critique’, *Review of International Studies*, 28, 2002, p 24.

⁷² *Ibid*, p 24.

For constructivists, agency plays an important part in the formulation of ideas, which then become sedimented as a discourse.⁷³ In turn, entrenched assumptions become self-fulfilling in their logic.⁷⁴

Constructivists view institutions as inseparable from the understandings that states bring to their actions.⁷⁵ Institutions are established on the basis of shared meaning or collective intentionality, and may be cooperative or conflictual.⁷⁶ Thus, a social institution is a self-reinforcing, objective social fact, which certain states may have a vested interest in reproducing.⁷⁷

On this basis, constructivists argue that international institutions such as the OECD have gone beyond simply regulating states' behaviour and have also established intersubjective frameworks of understanding by which member-states determine and agree on the appropriateness of certain behaviours in accordance with this framework.⁷⁸

The constructivist explanation of the OECD campaign

Jason Sharman is the predominant contributor to current constructivist explanations of the OECD campaign against tax havens. He has followed the OECD project for a number of years and has updated his argument in response to developments between 1998 and 2006.

Sharman argues that the OECD campaign began in response to a widespread normative discourse that viewed globalisation as an uncontrollable force eroding the economic and political sovereignty of states. Sharman contends that this view of globalisation was adhered to and promoted by the OECD Secretariat, and also aligned with the beliefs of national policy-makers. Therefore the normative framework of globalisation as

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⁷³ Hay, Colin and Ben Rosamond. 'Globalization, European Integration and the Discursive Construction of Economic Imperatives', *Journal of European Public Policy*, Vol. 9, Iss. 2, April 2002, p 151.

⁷⁴ *Ibid*, p 150.

⁷⁵ Ruggie, John. 'What Makes the World Hang Together? Neo-utilitarianism and the Social Constructivist Challenge', *International Organisation*, 52, 4, Autumn 1998, p 872.

⁷⁶ Wendt, Alexander. 'Anarchy is What States Make of It: The Social Construction of Power Politics', *International Organisation*, 46 (2), 1992, p 399.

⁷⁷ *Ibid*, p 413.

⁷⁸ Ruggie, John. 'What Makes the World Hang Together? Neo-utilitarianism and the Social Constructivist Challenge', *International Organisation*, 52, 4, Autumn 1998, p 870.

‘Prometheus Unbound’⁷⁹ informed the interpretation of state interests so that states became convinced of the need for a coordinated response to tax competition.⁸⁰

When the OECD published its first blacklist in 2000, Sharman argued that this was a ‘speech act’ that changed the reputation of states merely by virtue of being published.⁸¹ The list of states that the OECD deemed to be tax havens named and shamed those states. Therefore “the bark”, being the publication of a state’s name on the blacklist, was in fact “the bite”, because the damage it did to the state’s reputation caused instantaneous and automatic harm.⁸² This is what caused tax havens to comply with the OECD’s demands, despite a lack of either inducements or sanctions.⁸³

The “bite” of the blacklists came from the authority lent by the OECD’s reputation for impartiality and technocracy. This reputation gives the OECD the authority to shape international public policy.⁸⁴ Therefore the OECD depended on its identity for the authority of its blacklists – without this the blacklist would merely have delivered an easily ignored “bark”. To maintain its authority and legitimacy, the OECD was bound by the normative standards which it promoted.

When the OECD scaled back its project in 2001, Sharman argued that this was because tax havens had been able to successfully exploit the inherent, normative contradiction of the campaign. The contradiction was simple – the OECD’s founding purpose was to advance principles of free-market capitalism, yet the *Harmful Tax Competition* project suggested that firstly, competition could be harmful, and secondly, that such

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⁷⁹ Hampton, Mark P., and Jason P. Abbott. ‘The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors’ Introduction’, in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 2.

⁸⁰ Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 159.

⁸¹ Sharman, J.C. ‘International Organisations and the Implementation of New Financial Regulations by Blacklisting’, in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61.

⁸² Sharman, J.C. ‘The bark is the bite: International organizations and blacklisting’, *Review of International Political Economy*, Vol. 16, No. 4 October 2009, pp 573–596.

⁸³ Sharman, J.C. ‘International Organisations and the Implementation of New Financial Regulations by Blacklisting’, in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61.

⁸⁴ Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 160.

competition between states should be eliminated.⁸⁵ Sharman has termed this as “rhetorical self-entrapment.”⁸⁶

Sharman argued that the tax haven states exploited this contradiction by employing the normative arguments of the OECD in a “mimetic challenge” within other organisations (such as the Commonwealth, the Caribbean Community and the Pacific Islands Forum) and to powerful OECD states, in particular the United States. Sharman contended that tax havens managed to persuade the US as well as other OECD member-states that the OECD’s framing of the campaign was inconsistent with liberal economic theory in addition to norms of fairness, sovereignty and multilateralism. Norms “shape the instruments or means that states find available and appropriate” and also what means are unavailable and inappropriate.⁸⁷ Sharman goes on to state that the OECD’s identity is partly constituted by expectations of appropriate behaviour that conflict with the coercive nature of blacklisting⁸⁸ Therefore, the OECD was unable to continue with its project in its existing format because the credibility of the campaign had been lost.⁸⁹

There is a circular logic to Sharman’s explanations of both the initial success of the blacklisting and the 2001 failure of the OECD’s project on *Harmful Tax Competition*: “the way an actor is perceived affects the impact of its rhetoric; the rhetoric of an actor, or of third parties about that actor, in turn affect the way others perceive it.”⁹⁰ This provided an explanation for why the conflict appeared to have been resolved in the favour of tax havens and against the perceived interests of wealthy and powerful states.⁹¹

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⁸⁵ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 73.

⁸⁶ Sharman, J.C. ‘The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak’, in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 53.

⁸⁷ Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 143.

⁸⁸ Sharman, J.C. ‘International Organisations and the Implementation of New Financial Regulations by Blacklisting’, in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61 and Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006).

⁸⁹ Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006), p 5.

⁹⁰ *Ibid*, p 2.

⁹¹ *Ibid*, p 5.

Michael Webb has provided a similar explanation wedded to constructivist assumptions about the internalisation of norms. Webb states that: “Normative considerations influence states’ decisions about the priority to attach to their different interests.”⁹² Constructivists define norms as “standards of appropriate behaviour for actors with a given identity.”⁹³ Therefore, Webb views arguments regarding what is appropriate as bearing a normative, persuasive weight in negotiations between states.⁹⁴

In the international taxation arena, Webb argues that international organisation officials “are a crucial part of the audience which judges the appropriateness of state policies, and the judgements of these non-state actors heavily influence the judgements made by state members of the audience.”⁹⁵

Webb agrees with Sharman’s explanation for the failure of the OECD project in 2001. By using the OECD’s own arguments against them, OECD officials were forced to acknowledge the legitimacy of the arguments made by the havens and the havens’ supporters. The fact that in 2001 havens were able to win the battle that had been raged against them, despite the OECD’s overwhelming economic power over them, “suggests that who has the better argument in intergovernmental deliberations is not solely determined by state power; the logic of arguing does have an impact independent of the logic of consequences.”⁹⁶

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⁹² Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 789.

⁹³ Finnemore, Martha and Kathryn Sikkink, ‘International Norm Dynamics and Political Change’, *International Organisation*, vol. 52, 1998, p 891.

⁹⁴ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 789.

⁹⁵ *Ibid*, p 792.

⁹⁶ *Ibid*, p 821.

Chapter Three: Approach - Neoliberal Institutionalism

Neoliberal institutionalism is an alternative international relations approach, which will be applied to critique the explanation of the OECD campaign against tax havens offered by the existing constructivist literature and to explain recent developments.

Neoliberal institutionalists (hereafter, “neoliberals”) assume that all states rationally pursue their interests and that these interests are objective and structurally determined. So in contrast to constructivism’s “logic of appropriateness”, neoliberal institutionalism contends that states make decisions on the basis of a “logic of (anticipated) consequences,” whereby states make a rational calculation of how certain actions will affect their interests before choosing the course of action that maximises their gains.⁹⁷

It follows that if interests are determined by the structural environment, and behaviour can be predicted in accordance with interests, then the status quo of the international system has been shaped by structural causes. Therefore, structural changes, such as a global economic recession, may bring about changes in state interests and behaviour. In this sense, neoliberalism is a predictive theory, as a change in the structure determines logical consequences.⁹⁸

Joseph Nye has contributed the concept of “soft power” to the neoliberal field, arguing that rational actors may use attraction to obtain its interests rather than coercion or payment.⁹⁹ Soft power is framing the preferences of others in order to get them to want the outcomes that you want – it co-opts its subjects through attraction.¹⁰⁰ Therefore a state may be able to further its agenda by causing other states to want to follow it, to admire its values, to emulate and aspire to its prosperity or way of life.¹⁰¹ Persuasion

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⁹⁷ Ruggie, John. ‘What Makes the World Hang Together? Neo-utilitarianism and the Social Constructivist Challenge’, *International Organisation*, 52, 4, Autumn 1998.

⁹⁸ Wendt, Alexander. ‘Anarchy is What States Make of It: The Social Construction of Power Politics’, *International Organisation*, 46(2), 1992, p 396.

⁹⁹ Nye, Joseph. ‘Public Diplomacy and Soft Power’, *Annals of the American Academy of Political and Social Science*, vol. 30, (March 2008), p 94.

¹⁰⁰ *Ibid*, p 95.

¹⁰¹ *Ibid*, p 94.

and the ability to move people by argument is an important part of soft power¹⁰² and the values, practices and policies of a state or international organisation are crucial.¹⁰³ If a state is able to combine both hard and soft power, it has even more effective “smart power.”¹⁰⁴

It should be noted that the neoliberal utilitarian rationality is conceived more broadly than by neorealists, because neoliberals consider the pursuit of long-term absolute gains as potentially more rational than maximising short-term relative gains.¹⁰⁵ The logical conclusion is that states will cooperate where they identify significant common interests.¹⁰⁶ Therefore neoliberals view cooperation as a more likely outcome than neorealists, however cooperation remains a strategic interaction rather than a social one as conceived by constructivists.¹⁰⁷

Cooperation always comes at the risk of defection and the rewards for a single actor might be greater if it can cheat or free-load on the benefits of others’ cooperation. In the world of tax havens and global finance, havens fear that if they cooperate with the OECD, other havens might not comply, and this would enable tax avoiders to simply move their funds to non-complying havens. Unless all havens abide by the new standards, those that do will lose business to those that do not. This is a classic example of a collective goods dilemma.

International institutions have emerged as a way to mediate cooperation in order to prevent cheating and free-loading to ensure that collective goals are fulfilled.¹⁰⁸ They do this in a number of different ways, such as by facilitating discussion, setting agreed standards, lending credibility to commitments, providing technical assistance,

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¹⁰² Nye, Joseph. ‘Public Diplomacy and Soft Power’, *Annals of the American Academy of Political and Social Science*, vol. 30, (March 2008), p 95.

¹⁰³ *Ibid*, p 95.

¹⁰⁴ *Ibid*, p 107.

¹⁰⁵ Hellman, G. & R. Wolf. ‘Neorealism, Neoliberal Institutionalism, and the Future of NATO’, *Security Studies*, 3(1).

¹⁰⁶ Keohane, Robert and Lisa Martin. ‘The Promise of Institutional Theory’, *International Security*, Vol. 20, No. 1 (Summer, 1995), p 39.

¹⁰⁷ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 789.

¹⁰⁸ Goldstein, Joshua and Jon Pevehouse. *International Relations*, Brief 2006-2007 Edition, (Pearson Longman, 1997), p 80.

coordinating actions, sharing information, and through monitoring, sanctions and other means of enforcement.¹⁰⁹

Institutions are formed on the basis of shared interests, rather than shared meanings, and exist for as long as they continue to serve common interests. Institutions are often formed in response to a structural shift, such as the beginning of a war or fiscal crisis, because such international events can have a similar impact on the interests of a number of different states. A new alignment of individual state interests might give rise to collective interests which provide an impetus for cooperation.

Institutions may equally survive a structural change if the consequent change in interests results in new collective goals. As circumstances change, so may institutions.¹¹⁰ But each state will only continue to cooperate to the extent that doing so is in its long-term interests. Where an institution ceases to facilitate absolute gains for its members, it will lose its relevance.

Cooperation both directly between states and through mediating institutions has, over time, led to complex, strategic interdependence between states. This interconnectedness increases the likelihood of collective goods and therefore provides further motivation for states to cooperate.¹¹¹

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¹⁰⁹ Keohane, Robert and Lisa Martin. 'The Promise of Institutional Theory', *International Security*, Vol. 20, No. 1 (Summer, 1995), p 42.

¹¹⁰ Sterling-Folker, Jennifer. 'Competing Paradigms or Birds of a Feather? Constructivism and Neoliberal Institutionalism Compared', *International Studies Quarterly*, 2000, volume 44, p 103.

¹¹¹ Milner, Helen. 'The Assumption of Anarchy in International Relations Theory: A Critique', *Review of International Studies*, 17 (1), January 1991, p 85.

Chapter Four: Case Study - the OECD Campaign against Harmful Taxation

The key institution in the tax havens case study is the Organisation for Economic Development and Cooperation (OECD). The OECD has 32 member-states, including European, North American and Australasian states, as well as Japan, Korea, Mexico and Chile.¹¹² These are all relatively wealthy countries, the majority of which are capital exporting.

The OECD is made up of three major parts: the OECD Council, the Secretariat and Committees. The Council is the OECD's decision-making body and is made up of one representative per member country, plus a representative of the European Commission. The Secretariat is composed of 2,500 independent professional staff drawn from OECD member countries and based predominantly in Paris. Its staff carry out work as directed by the Council. Finally, there are roughly 250 committees, working groups and expert groups involving 40,000 senior officials from national administrations who attend OECD meetings and contribute to work as directed by the OECD Council and sometimes in partnership with the OECD Secretariat.¹¹³

The OECD – promoter of norms or state interests?

According to its 1960 Convention, the OECD's aims are to promote policies designed to achieve:

- the highest sustainable economic growth in its member countries (including growth in employment and standards of living);
- the maintenance of financial stability;
- the sound economic expansion of member-states;

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¹¹² Organisation for Economic Co-operation and Development. 'Ratification of the Convention on the OECD: OECD Member Countries', online at http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html, accessed 16/07/2010.

¹¹³ Organisation for Economic Co-operation and Development. 'Who Does What', online at http://www.oecd.org/pages/0,3417,en_36734052_36761791_1_1_1_1,00.html, accessed 16/07/2010.

- the economic development of non-member countries; and
- the non-discriminatory expansion of world trade.¹¹⁴

These are goals which could easily be seen to be in the rational, collective interests of all OECD member-states. However, it could equally be argued that they appear to be normative goals supportive of liberal economic theory. As an institution, the OECD has been termed “a missionary for values of liberalisation”.¹¹⁵ However the extent to which these norms are promoted by the OECD due to some kind of intrinsic normative value, and the extent to which they rather act as vehicles employed to further the objective interests of the OECD member-states, is a moot point between constructivists and neoliberals.

From a constructivist standpoint, the OECD is a norm promoter with a degree of independence and the ability to socialise states and to redefine state interests. Constructivists emphasise the role of the independent, technocratic Secretariat in promoting policies aligned to the OECD’s normative goals and in socialising the member-state representatives in the Council and Committees so that state interests are reconsidered in accordance with these normative goals.

The OECD operates on the basis of consensus decision-making and voluntary cooperation. In the near absence of binding agreements and powers of enforcement, constructivists view the consensus imperative as a key way in which states are socialised into normative agreement with their peers. By including all members in decision-making, states buy into the establishment of international standards of appropriate behaviour. This behaviour is then reinforced through monitoring procedures and peer reviews to socialise states and to institutionalise OECD norms.¹¹⁶

Constructivists view the OECD as having an identity as a promoter of liberal economic norms. This identity binds the OECD to behave in a way that is consistent with the

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¹¹⁴ Article 1, *Convention on the Organisation for Economic Cooperation and Development*, Paris, 14/12/1960, online at http://www.oecd.org/document/7/0,3343,en_2649_201185_1915847_1_1_1_1,00.html, accessed 16/07/2010.

¹¹⁵ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 792.

¹¹⁶ *Ibid*, p 792.

norms it promotes.¹¹⁷ As a norm entrepreneur, the OECD is influential only to the extent that its reputation for objectivity and its legitimacy as a technocratic authority remain intact.¹¹⁸

From a neoliberal perspective, the OECD is an institution formed by states with the fundamental underlying motivation of advancing common member-state interests to achieve absolute economic gains. The promotion of liberal economic norms is seen to support and advance member-state interests. Therefore norms have no intrinsic value beyond their ability to persuade others in such a way that allows a state or group of states to advance its individual or collective interests.

Neoliberals focus on the OECD Council and Committees as they are composed of national representatives who are held accountable to their individual state governments. The centre of power within the OECD is the Council and therefore no decision can be made without the agreement of member-state governments. Although the Council and Committees may be influenced by advice from the OECD Secretariat, the Secretariat is funded by and therefore to a large degree accountable to the member-states.

The Committee on Fiscal Affairs – engine room of the OECD campaign

The OECD Committee on Fiscal Affairs (CFA) sets the OECD tax work programme, while its detailed work is carried out by a number of subsidiary working parties. Decisions taken by the CFA generally require the approval of the OECD Council. Both the CFA and its working parties consist entirely of senior civil service tax experts from member governments.¹¹⁹ Non-member state servants sometimes also take part in discussions.¹²⁰

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¹¹⁷ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 821.

¹¹⁸ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 162.

¹¹⁹ Organisation for Economic Co-operation and Development Centre for Tax Policy and Administration, 'Centre for Tax Policy and Administration: About', online at www.oecd.org/about/0,3347,en_2649_3497_1_1_1_1_1,00.html, accessed 15/07/2010.

¹²⁰ *Ibid.*

Outside the CFA, these high-level civil servants also provide policy advice to their governments. While they can generally discuss their technocratic views freely within the working parties, they ultimately serve their government ministers. Issues are debated with regard to individual state contexts and laws.¹²¹

Outcomes from discussions within the working parties are usually in the form of CFA reports which state the OECD view or approach to particular issues. Draft reports are often made available for comment by business groups and private tax organisations and these comments may inform the working party discussion. These reports often indicate diverging views between states, and they act as recommendations which are non-binding on governments.

However, there is some debate as to the level of persuasiveness these reports might offer to domestic courts for interpretation in legal disputes and therefore officials are cautious to ensure that the wording of the reports does not go against their state's policies. The reports are written during working party meetings and individual words are often debated at length. Where officials representing different states disagree, care is taken to achieve language vague enough to satisfy all views, and where this cannot be achieved, wording is deleted entirely.¹²²

Often the work of the CFA working parties results in changes to the OECD Model Taxation Convention text or commentary. These changes are made by Working Party One and do not require consensus; however states that disagree with the dominant view are able to lodge reservations against changes to the text and observations to changes to the commentary. The Model Convention itself is not binding on states, but it acts as a starting point for bilateral tax treaty negotiations, therefore a reservation indicates to negotiating partners that a state intends to depart from the Model.¹²³

The OECD Model contains an article on Exchange of Information (EOI), which provides for governments to share their tax records when requested by their treaty partners for the purposes of carrying out the domestic tax laws of the requesting state.

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¹²¹The author is employed by New Zealand's Inland Revenue Department and has worked in the area of international tax policy, including on a number of OECD projects. Therefore some information comes from the author's working knowledge and that of colleagues which is not able to be directly referenced.

¹²²*Ibid.*

¹²³*Ibid.*

Until 2009, Austria, Belgium, Luxembourg and Switzerland had reserved against this article and agreed to only very limited versions, if any, in their bilateral treaties.¹²⁴ The OECD Model is also frequently used in bilateral negotiations between non-OECD countries, however it holds arguably less persuasive influence in interpreting these treaties than it does between OECD member-states, due to the lack of non-member-state participation in the drafting of the Model Convention.

It is the CFA that determines the content of the OECD Model Taxation Convention and makes decisions on tax issues, which are endorsed by the OECD Council. It is also the body that has consistently overseen the OECD campaign against tax havens in its various forms since 1998.¹²⁵ It is made up entirely of senior civil servants who fly in and out of Paris several times a year from their respective capitals. The debates within its Working Parties are framed by the laws and policies of the member-states. It is therefore fundamentally representative of state interests.

What started the movement against tax havens?

From a neoliberal perspective, the OECD campaign was a collective response to a fundamentally structural cause: economic globalisation. Economic globalisation refers in a general sense to the proliferation of finance and trade that crosses, penetrates and transcends state borders.¹²⁶ The rapid integration of state economies has been facilitated by concurrent advances in communication technology and international law, which have in turn enabled international banking. As a result, capital mobility has rapidly become an international phenomenon.¹²⁷

The structural fact of the mobility of capital across borders has had the consequence of rapidly decreasing the ability of states to enforce their taxation laws. Of course, not all

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¹²⁴ Organisation for Economic Cooperation and Development, 'OECD Assessment Shows Banking Secrecy as a Shield for Tax Evaders Coming to an End', 31/08/2009, online at www.oecd.org/documentprint/0,3455,en_2649_34897_43592376_1111,00.html accessed 13/04/2010.

¹²⁵ Organisation for Economic Cooperation and Development Centre for Tax Policy and Administration, 'Harmful Tax Practices: About', online at: http://www.oecd.org/about/0,3347,en_2649_33745_1_1_1_1,00.html, accessed 13/04/2010.

¹²⁶ Scholte, Jan Aart. 'Global Trade and Finance', in John Baylis and Steve Smith, *The Globalization of World Politics*, 2nd ed. (Oxford University Press: New York, 2001), p 520.

¹²⁷ Nicodeme, Gaetan. 'On Recent Developments in Fighting Harmful Tax Practices', *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, pp 756.

sources of taxation are highly mobile. Generally, labour is the least mobile source of tax revenue and therefore is the least sensitive to changes in tax rates. People commonly make decisions about where they will live for non-economic reasons and are often constrained by immigration laws.

On the other hand, companies generally have greater freedom to locate wherever in the world is most economically efficient. The tax rate that the company will be subjected to may be a significant factor in determining where a company will be based, although other factors, such as the location of those who run the business, or the location of customers, are often of greater relevance. If it is possible to keep all such variables constant, the rational, profit-maximising company will choose to locate in the country with the lower tax rate, because its after-tax profits will be highest.

Investment income (or capital) is the most sensitive to taxation, because it has become very easily relocatable. Money can be transferred between jurisdictions with the click of a mouse, and the rational economic investor is motivated only by the highest financial return. Therefore investment capital is highly susceptible to being lured away from its country of origin by low or non-existent tax rates offered by tax havens.

By undercutting the tax rates of most OECD countries, tax havens were seen to facilitate the movement of investment capital offshore. OECD member-states with traditionally high taxation and social spending policies discovered that not only were they losing the tax revenue from capital sources, but that they were also losing their core capital wealth to low-tax jurisdictions.

This realisation was heightened by a series of monetary crises in the early-mid 1990s, such as the 1992 'Black Wednesday' crisis in the United Kingdom and the Mexican Peso crisis in 1994. Although there were a multitude of identifiable reasons for these crises, the swift actions of investors in withdrawing and/or injecting capital were, at the very least, aggravating features, which served to illustrate that free-market forces alone were unable to construct a secure liberal financial order.¹²⁸ Left unchecked, free markets allowed for rapid and potentially highly destructive capital flight that could ruin state

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¹²⁸ Thirkell-White, Ben. 'The International Financial Architecture and the Limits to Neoliberal Hegemony', *New Political Economy*, Vol. 12, Iss. 1, 2007, pp 20-21.

and regional economies almost overnight.¹²⁹ This realisation led to a renewed focus on regulation by governments and international financial institutions. Financial crises had to be controlled in order that they might be prevented.¹³⁰

In the context of taxation, fear of capital flight gave rise to the concept of an international 'race-to-the-bottom' in corporate and investment tax rates. It became widely believed that tax havens were leading governments to aggressively compete with one another for a limited supply of capital by continually lowering their tax rates. Left unregulated, the laws of the global economic market would present states with two options: either cut tax rates to competitive levels (thus making corresponding cuts to social spending), or lose economic capital and therefore potential economic growth.

Although it has been noted that this is viewed by some as healthy competition that may lead to a net increase in global capital, the 'race to the bottom' in taxation is overwhelmingly viewed as a lose-lose game for governments. In this sense it is often portrayed as a prisoner's dilemma. If all states maintain high tax rates, they each retain high government revenue and there is no tax-motivated movement of capital between states. However, without an agreement between states to cooperate, all are at risk of having their high tax rates undercut by another government, thereby losing both revenue and capital. Further, if all governments attempt to compete by cutting their tax rates, they will all lose government revenue yet none of them will gain any new capital.¹³¹ From a neoliberal institutionalist perspective, the solution is clear – to protect their collective interests, states should cooperate through an institution that will provide some assurance that its members will not cheat.

Constructivists challenge this explanation of globalisation as the structural cause of aligned state interests. Sharman argues that this structural explanation of globalisation as an uncontrollable force eroding the economic and political sovereignty of states is in fact a normative discourse rather than an objective fact. The of agency states in

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¹²⁹ Hampton, Mark P., and Jason P. Abbott. 'The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors' Introduction', in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 2.

¹³⁰ Thirkell-White, Ben. 'The International Financial Architecture and the Limits to Neoliberal Hegemony', *New Political Economy*, Vol. 12, Iss. 1, 2007, p 25.

¹³¹ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 145.

formulating ideas is what establishes this discourse and these entrenched assumptions become self-fulfilling in their logic.¹³² Sharman contends that this view of globalisation was adhered to and promoted by the OECD Secretariat, and also aligned with the beliefs of national policy-makers. Therefore the normative framework of globalisation as 'Prometheus Unbound'¹³³ informed the interpretation of state interests so that states became convinced of the need for a coordinated response to tax competition.¹³⁴

However, the constructivists overstate the extent to which states have been agents in the processes of globalisation. While governments are responsible for trade liberalisation policies and the development or adoption of international finance laws, the technological developments that enabled them were largely produced by non-state actors. In addition, the exponential rate of transformative change adds weight to the argument that even if states were responsible for the initiation of globalisation; they have since lost control of the consequences.

Although governments such as those of Thatcher and Reagan had liberalised their economic markets a decade or so earlier, the extent to which globalisation had mobilised capital was not realised until the mid-1990s.¹³⁵ Some have put its value in the range of \$5-7 trillion US dollars,¹³⁶ but even today the extent to which capital is held offshore can only be roughly estimated.

Of course, not all capital held offshore represents tax evasion. But once again, the portion of offshore capital held by tax havens is largely unknown. Murphy suggests that as much as 60% of world trade is in fact only notional and is undertaken solely to redirect profit from where it is earned to where it will be accounted for.¹³⁷ This may be

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¹³² Hay, Colin and Ben Rosamond. 'Globalization, European Integration and the Discursive Construction of Economic Imperatives', *Journal of European Public Policy*, Vol. 9, Iss. 2, April 2002, p 150.

¹³³ Hampton, Mark P., and Jason P. Abbott. 'The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors' Introduction', in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 2.

¹³⁴ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 159.

¹³⁵ Murphy, Richard. "Tax Justice and secrecy jurisdictions: tax havens, once an unassailable part of the global financial system, are now increasingly under threat - and that is good news for supporters of international social justice." *Soundings* 41 (2009), p 73.

¹³⁶ Nicodeme, Gaetan. 'On Recent Developments in Fighting Harmful Tax Practices', *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 758.

¹³⁷ Murphy, Richard. "Havens and Have Nots," *The Guardian*, 07/11/2007, online at <http://www.guardian.co.uk/commentisfree/2007/nov/07/comment.ethicalbusiness> accessed 09/05/10.

for reasons other than to reduce taxation, but tax savings are frequently a key motivator. Palan cites estimates that range up to as much of half of the world's capital either residing in or passing through tax havens.¹³⁸ Despite the lack of certainty in these estimates, it is clear that the scale of the capital being redirected via tax havens is far from negligible. It is also clear that the presence of this capital has made tax havens wealthier. Between 1982 and 1999, the GDP of tax haven states reportedly grew at a rate of 3.3 percent compared to 1.4 percent for the rest of the world in that same period.¹³⁹

Collective interests

The OECD is often referred to as a “country club” because of its almost uniformly high-wealth membership. It is also overwhelmingly Western in its cultural make-up and its members are homogenously democratic in their governance. Its member-states have large public sectors with correspondingly high levels of government expenditure. Therefore the OECD member-states predominantly apply high tax rates and their citizens account for the vast majority of tax haven customers. These common features of the individual states lend themselves to the close alignment of those states' interests.

In its 1998 *Harmful Tax Competition* report, the OECD argued that tax havens exploited the high tax rates of other countries by developing tax policies aimed at diverting mobile capital. In doing, tax havens distorted patterns of trade and investment and reduced the overall global welfare. This forced all states to alter their taxation systems, if not by reducing rates then by shifting taxation away from capital to depend more heavily on less mobile sources such as labour and consumption. This would make taxation less equitable, reducing the ability of socialist states to redistribute wealth and would potentially have a negative impact on employment.¹⁴⁰

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¹³⁸ Palan, Ronen. ‘Tax Havens and the Commercialisation of State Sovereignty’, *International Organisation*, Vol. 56, No. 1, 2002, p 151.

¹³⁹ Nicodeme, Gaetan. ‘On Recent Developments in Fighting Harmful Tax Practices’, *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 758.

¹⁴⁰ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, pp 14 and 66.

The scale of tax haven activity became known at a time when most OECD governments needed to reduce their budget deficits. By seeking to enforce existing tax laws against those avoiding them in tax havens, governments could reduce the need for unpopular cuts to public spending or even more unpopular increases in tax rates.¹⁴¹

But there are jurisdictional limits to the state apparatus in seeking to enforce its tax laws, which prevents it from stopping its citizens from benefiting from the laws of tax haven states. An alternative measure might be for the individual state to alter the taxation of its residents in a way that neutralises the effect of revenue lost to havens, however, in a globalised economy this would put businesses in that state at a competitive disadvantage vis-à-vis other states. Enforcing counter measures would also impose significant administrative costs on the state and compliance costs on taxpayers.¹⁴²

The benefit to havens in attracting customers was much less than the value lost in both capital and revenue to the states whose citizens utilised tax havens. The havens usually gained very little in revenue terms because they generally did not levy taxes; rather any revenue raised would be collected from small licensing or set-up fees. These fees would usually be just “the smallest fraction” of what the higher-taxing state would be losing.¹⁴³ Havens would also benefit from capital being relocated to their economies, although it was not always necessary to physically move the capital – rather it could be notionally redirected. The party that benefited most from tax havens was the investor – either as an individual or as a shareholder – who received a greater return. Therefore among all the world’s governments, there was a loss in absolute terms caused by the use of tax havens.¹⁴⁴

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¹⁴¹ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 795.

¹⁴² Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 37.

¹⁴³ Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 154.

¹⁴⁴ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 18.

The fact that the tax haven problem exhibited prisoner's dilemma characteristics meant that unilateral or bilateral solutions would not be effective. It required a multilateral approach with the support of all the world's major economies.¹⁴⁵

The tax havens issue first gained prominence at a multilateral level at the G7 Ministerial Summit in May 1996. In the Summit's official Communiqué, the Ministers called upon the OECD to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998". In response to this request, the OECD's Committee on Fiscal Affairs launched its project on harmful tax competition.¹⁴⁶

Later that year, the G7 Heads of State Summit was held in Lyon.¹⁴⁷ The Summit's official Communiqué endorsed the statements made by the G7 Ministers and stated that:

"[G]lobalisation is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases. We strongly urge the OECD to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices."¹⁴⁸

A former Special Advisor to the US Treasury Secretary has revealed that the G7 deliberately chose to avoid working through the World Trade Organisation (WTO), the UN or any other organisation with open membership. This is because they wanted to avoid lengthy negotiations and did not want to compromise on solutions. It was also feared that the G7 states could be easily outvoted in other forums. It was considered that it would be much more effective for the world's most powerful states to design a new set of rules which could then be imposed in a 'top-down' manner at a global level.¹⁴⁹

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¹⁴⁵ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 146.

¹⁴⁶ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 3.

¹⁴⁷ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 145.

¹⁴⁸ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 7.

¹⁴⁹ Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), pp 47-48.

From a neoliberal perspective, this admission implies that a campaign against tax havens might not have been in the interests of less economically powerful states. If states are rational and cooperate only where it is in their interests to do so, it would logically follow that states would not vote in support of a multilateral framework which went against their interests. In a similar way, the G7 states were rational to choose to work within an institution that served its collective interests in order to maximise the benefits they would receive from the campaign rather than to situate it within an organisation that served a wider range of interests. Tax havens were a collective problem for OECD countries and collective action against havens could be expected to result in absolute gains for OECD states.

The OECD campaign against *Harmful Tax Competition*

The OECD issued its first report, *Harmful Tax Competition: An Emerging Global Issue*, in April 1998. The report contained a definitive classification of what constituted a tax haven. The four elements that identify a tax haven are collectively:

1. No or nominal taxation;
2. No substantial activities;
3. Lack of effective information exchange; and
4. Lack of legal transparency.¹⁵⁰

These elements have already been discussed above and so require no further explanation here.

Tax havens were just one of two types of harmful tax competition addressed by the report. Harmful preferential regimes (providing special concessions for foreigners, not available to domestic investors, in order to attract mobile financial activities) were also discussed.¹⁵¹ The report also set out four factors for identifying harmful preferential tax regimes:

1. the regime imposes a low or zero effective tax rate on the relevant income;
2. the regime is “ring-fenced”;

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¹⁵⁰ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 18.

¹⁵¹ *Ibid*, p 25.

3. the operation of the regime is non-transparent;
4. the jurisdiction operating the regime does not effectively exchange information with other countries.”¹⁵²

Essentially these are the same features as tax havens, but the special rules apply only in limited circumstances rather than being available across the board. They were considered harmful because they distorted investment decisions by attracting capital that would most likely not locate in a particular jurisdiction without the tax advantages offered.¹⁵³ However, such preferential regimes were fairly commonly used by OECD member-states and therefore the OECD was careful to distinguish them from tax havens. Sharman and Mistry have noted that this was a prejudiced approach that sought to counter only the tax practices deemed harmful to the interests of the OECD member-states.¹⁵⁴

Based on these criteria, 47 regimes (many within OECD countries) were identified as potentially harmful.¹⁵⁵ The report then went on to provide some guidelines for how states should deal with them. Member-states with preferential regimes were advised to refrain from adopting new measures, to review their existing measures and to remove the harmful features of their preferential tax regimes within 5 years (by 2003).¹⁵⁶

The report went on to recommend that a list naming the states that fulfilled the tax haven criteria be put together for publication within a year. States included on this list could then be subjected to a framework of sanctions, to be applied bilaterally but coordinated across OECD countries. The report listed a range of possible sanctions, including withdrawal from double taxation agreements, disallowing tax deductions for

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¹⁵² Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 25.

¹⁵³ *Ibid.*, p 25.

¹⁵⁴ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 46.

¹⁵⁵ Nicodeme, Gaetan. ‘On Recent Developments in Fighting Harmful Tax Practices’, *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 759.

¹⁵⁶ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 56.

activities in havens, subjecting any transactions with havens to special scrutiny and imposing additional charges on transactions with tax haven states.¹⁵⁷

To prevent compliant countries from being undermined by dissenters and potentially losing further capital, the report endorsed a principle known as the 'level playing field'. This meant that all states were meant to commit to the same standards on the same timetable and with the same consequences for non-compliance.¹⁵⁸ The list of tax havens was also intended to encourage uniform compliance.¹⁵⁹

The 1998 report also established a Forum on Harmful Tax Practices as a subsidiary to the OECD Committee on Fiscal Affairs. The Forum was set up to continue the OECD's work against tax havens and preferential regimes. It was tasked with seeking self-appraisals by member-states of their own preferential tax regimes. It also asked states to report on their peers and to conduct external reviews of tax havens.¹⁶⁰ Most significantly, the CFA directed the Forum to construct the list of tax havens for publication the following year.¹⁶¹

The report's recommendations were adopted by the OECD Council on 9 April 1998, to which Luxembourg and Switzerland abstained.¹⁶² Significantly, Switzerland and Luxembourg both have strong bank secrecy laws and relatively low taxes, therefore they refused to be bound by the report or any work of the Forum on Harmful Tax Practices.¹⁶³

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¹⁵⁷ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 146.

¹⁵⁸ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 173.

¹⁵⁹ Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 577.

¹⁶⁰ Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 155.

¹⁶¹ Organisation for Economic Co-operation and Development. *Harmful Tax Competition: An Emerging Global Issue*, 1998, p 57.

¹⁶² *Ibid*, p 65.

¹⁶³ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 146.

Interests, reputation and “death-by-blacklisting”¹⁶⁴

In June 2000, the OECD Centre for Tax Policy and Administration (overseen by the CFA) released its first progress report on the *Harmful Tax Competition* project. As had been promised, this report contained a list of 35 states (mostly non-OECD) as tax havens. Six other states had made hasty advance commitments to reform their tax systems in line with OECD demands just a week before the list was published in exchange for their removal from the list.¹⁶⁵

The 2000 report stated that the 35 identified tax havens would face further blacklisting through a new list of ‘uncooperative tax havens’ if they did not commit to making the demanded changes by 31 July 2001.¹⁶⁶ States on the 2001 list of uncooperative havens would then be subjected to sanctions.¹⁶⁷ The report provided a lengthy list of potential measures including additional taxation, targeting for audit, refusal to negotiate or apply bilateral tax agreements, punitive transactional charges and denial of non-essential economic aid.¹⁶⁸ Such measures could be applied unilaterally according to individual state discretion, and coordination of such measures would be considered across the OECD.

The majority of the named tax havens rapidly made commitments towards reform. In exchange, their names were removed from the list.¹⁶⁹ Why was it that non-OECD countries benefiting both from administrative revenue and economic capital by operating as tax havens would comply with the demands of the OECD by committing to cease these activities?

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¹⁶⁴ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 174.

¹⁶⁵ Sharman, J.C. ‘The bark is the bite: International organizations and blacklisting’, *Review of International Political Economy*, Vol. 16, No. 4, October 2009, pp 577-578.

¹⁶⁶ Hishikawa, Akiko. ‘The Death of Tax Havens?’, *Boston College International and Comparative Law Review*, Vol. 25, No. 2, 2002, p 389.

¹⁶⁷ Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillian: New York, 2005) p 156.

¹⁶⁸ Organisation for Economic Co-operation and Development. *Towards Global Tax Cooperation: Progress In Identifying And Eliminating Harmful Tax Practices*, 2000, p 25.

¹⁶⁹ Nicodeme, Gaetan. ‘On Recent Developments in Fighting Harmful Tax Practices’, *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 762.

Sharman's constructivist explanation states that by blacklisting tax havens, the OECD committed a "speech act" that unilaterally damaged their reputations among investors, thus producing pressure to comply through actual or anticipated capital flight.¹⁷⁰ Rather than simply reflecting the existing reality, the OECD list in fact created a new reality: any state named on their blacklist was objectively a tax haven, and any state not on the list was not a tax haven.¹⁷¹ The blacklist of states that the OECD deemed to be tax havens named and shamed those states. This is what caused tax havens to comply with the OECD's demands, despite a lack of either inducements or sanctions.¹⁷²

This approach overstates the importance of state reputations while understating the importance of rational interest calculation. It is clearly correct that investors responded to the blacklisted states by withdrawing capital. For example, one study found that Barbados' inclusion on the OECD blacklist in 2000 contributed to a drop in new company registrations but growth picked up in 2003 following its removal.¹⁷³ Therefore Sharman argues that reputation matters. However, reputation matters to states and to investors only to the extent that it provides basic information upon which a calculation of risk and likely consequences can be based. Therefore unless there is an actual or anticipated material impact on a state's interests, its reputation is irrelevant.

Investment decisions by their very nature are speculative and based upon perceptions.¹⁷⁴ The share value of a company is prospective – it involves an educated guess about how well the business will do in future. In the global financial markets, investors often make face-value judgements about their investments. Reputations enable investors to quickly make assessments about which investments are likely to pay off, and which might be risky. The reputation itself is insignificant – it is what that reputation means for the investors' interests – usually defined in terms of expected profits – that matters. A rational investor will look at the blacklist and the list of sanctions that the OECD has

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¹⁷⁰ Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, pp 573–596.

¹⁷¹ *Ibid*, p 580.

¹⁷² Sharman, J.C. 'International Organisations and the Implementation of New Financial Regulations by Blacklisting', in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61.

¹⁷³ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) pp 13 and 15.

¹⁷⁴ Hampton, Mark P., and Jason P. Abbott. 'The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors' Introduction', in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 7.

recommended and factor the risk of such sanctions being carried out into their decision of where to invest their money. This corresponds with the investor's desire to maximise the chances of a high return and to minimise the chances of a loss.

Tax havens were therefore rationally concerned with being blacklisted to the extent that this would affect investors' risk assessments. Havens were highly dependent on foreign investment as the basis of their economies; therefore they had a clear interest in attracting and retaining this investment. It follows then that there were two categories of states that complied in response to blacklisting – firstly, those that reacted to material economic losses after investors began withdrawing and secondly, those that anticipated material economic loss and therefore sought to pre-empt this damage.¹⁷⁵ The study mentioned above also concluded that:

The single most important factor explaining the adoption of these new international standards in [Barbados, Mauritius and Vanuatu] has been fear of the consequences of being blacklisted by international organisations in the event of non-compliance.¹⁷⁶

This illustrates behaviour responsive to a logic of consequences, not a logic of appropriateness.

It was reported that growth of Mauritius' international financial services industry stalled even before it had been blacklisted, in response to publication of the *Harmful Tax Competition* report in April 1998.¹⁷⁷ This report did not name Mauritius as a tax haven and therefore it could not be said to have unilaterally changed its reputation. However, it could be logically concluded that investors assessed Mauritius as a likely candidate for defensive measures imposed by OECD countries and therefore were reluctant to increase their investment in a risky jurisdiction.

Various sources have named Argentina, Australia, Brazil, Ecuador, France, Indonesia, Italy, Mexico, New Zealand, Peru, Poland, Portugal, Slovenia, Spain, Venezuela and the United States as having their own national blacklists of tax havens in their domestic tax

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¹⁷⁵ Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 574.

¹⁷⁶ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p xi.

¹⁷⁷ *Ibid*, p 46.

legislation.¹⁷⁸ Although these blacklists may have been influenced by the OECD blacklist, they do not completely align with it. Notably, these states have not followed the OECD in removing havens from their list following commitments towards action.¹⁷⁹ These national blacklists provide a basis for distinguished tax treatment and/or scrutiny under domestic tax law. But regardless of whether a state has published a formal list, most tax authorities pay special attention to transactions involving low-tax territories.¹⁸⁰

Many major international banks have established their own informal blacklists as part of due diligence. The names of listed jurisdictions may be included as terms on private software designed to trigger enhanced scrutiny.¹⁸¹ The result of extra scrutiny is usually a decline in share prices.¹⁸² Transactions with some jurisdictions have been perceived to be more trouble than they are worth, with many major international banks now refusing to process transactions involving havens such as Vanuatu. In such cases, domestic banks are forced to replace their correspondent banking relationships. As with the national blacklists, private blacklists have often not been updated following a state's removal from the OECD list.¹⁸³ Therefore, in addition to the harm caused to a state by the withdrawal of capital and decline in government revenue, it is often also costly for states to campaign for removal from the various blacklists.¹⁸⁴

However, not all tax havens responded to blacklisting by the OECD. Liechtenstein is a key state that was repeatedly included on the OECD lists but consistently refused to cooperate.¹⁸⁵ Sharman's research found public and private sector officials to be frank in acknowledging that the state's low tax rates combined with secrecy laws were the

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¹⁷⁸ Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 581.

¹⁷⁹ Ernst & Young, '2009 Global Transfer Pricing Survey', September 2009, online at [http://www.ey.com/Publication/vwLUAssets/2009_Global_transfer_pricing_survey/\\$FILE/Ernst%20%20Young%202009%20Global%20transfer%20pricing%20survey.pdf](http://www.ey.com/Publication/vwLUAssets/2009_Global_transfer_pricing_survey/$FILE/Ernst%20%20Young%202009%20Global%20transfer%20pricing%20survey.pdf), accessed 27/05/2010, p 7 and Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 581.

¹⁸⁰ Ernst & Young, '2009 Global Transfer Pricing Survey', September 2009, online at [http://www.ey.com/Publication/vwLUAssets/2009_Global_transfer_pricing_survey/\\$FILE/Ernst%20%20Young%202009%20Global%20transfer%20pricing%20survey.pdf](http://www.ey.com/Publication/vwLUAssets/2009_Global_transfer_pricing_survey/$FILE/Ernst%20%20Young%202009%20Global%20transfer%20pricing%20survey.pdf), accessed 27/05/2010, p 7.

¹⁸¹ Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 581.

¹⁸² *Ibid*, p 581.

¹⁸³ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 175.

¹⁸⁴ Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 582.

¹⁸⁵ *Ibid*, p 589.

primary attractions for foreign investors.¹⁸⁶ This illustrates a rational calculation of interests in which the cost of compliance with OECD demands was determined to be higher than the cost of non-compliance.¹⁸⁷ Liechtenstein consistently remained immovable despite damage to its reputation,¹⁸⁸ instead acting in accordance with its economic interests. If damage to a state's reputation was the key to compliance with OECD standards, then this cannot explain why some states, such as Liechtenstein, did not comply.

The states that complied with the OECD demands following blacklisting were invariably small, developing states with little to continue to attract investment in the absence of tax advantages. Whilst larger financial centres such as Liechtenstein's and Switzerland's are able to weather financial scandals and survive relatively unscathed, small, developing financial centres may never recover from a severe financial shock.¹⁸⁹ Therefore it would seem that despite the high cost of compliance, the material costs of non-compliance were higher for the states that conformed to OECD standards. Although blacklisting may have damaged states' reputations, this could not be said to be the reason for their compliance. Instead there is clear evidence of states' rational calculations of interests consistent with a logic of consequences.

Harmful Tax Competition to Harmful Tax Practices

The OECD's next Progress Report published in November 2001 contained substantial modifications that had the effect of drastically reducing the scope of the project against tax havens. The most significant changes were as follows:

1. The OECD would no longer pursue states on the basis of no substantial activities and it clarified that it had never considered no or low taxation in isolation as warranting classification of a state as a tax haven. Therefore two of the four criteria it had included in the definition of a tax haven were effectively removed

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¹⁸⁶Sharman, J.C. 'The bark is the bite: International organizations and blacklisting', *Review of International Political Economy*, Vol. 16, No. 4, October 2009, p 590.

¹⁸⁷*Ibid*, p 590.

¹⁸⁸*Ibid*, p 589.

¹⁸⁹Hampton, Mark P., and Jason P. Abbott. 'The Rise (and Fall?) of Offshore Finance in the Global Economy: Editors' Introduction', in Mark P. Hampton and Jason P. Abbott (eds.), *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*, (Ichor Business Books: Indiana, 1999), p 11.

from the scope of the project. Instead it would only pursue commitments from states with respect to transparency and effective information exchange;

2. Sanctions (referred to by the OECD as “coordinated defensive measures”) would no longer apply to non-OECD uncooperative tax havens any earlier than they would to OECD members with harmful preferential regimes (timetabled for April 2003);¹⁹⁰
3. The 31 July 2001 deadline for making commitments towards reform (which had passed without mention) was deferred until 28 February 2002. The time for jurisdictions to develop implementation plans was also extended from six to twelve months after the date of making their commitment;
4. The time states that had made commitments were given to develop implementation plans was extended from six months to twelve;¹⁹¹

Despite removing two of the four criteria of a tax haven from the scope of the OECD project, the Report was careful to note that these modifications did not alter the fact that the original four factors were all relevant to defining a tax haven in accordance with the 1998 Report. Therefore instead of being ‘uncooperative tax havens’, future lists would refer only to ‘uncommitted jurisdictions’.¹⁹²

The most crucial change was the abandonment of the substantial activities criterion. The criterion meant that tax havens were required to stop offering tax benefits to investors that did not conduct substantial business in the tax haven. By removing this, the OECD abandoned the attempt to force tax havens to actually change their tax systems.¹⁹³ In addition, states that had already made commitments prior to the 2001

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¹⁹⁰ Hishikawa, Akiko. ‘The Death of Tax Havens?’, *Boston College International and Comparative Law Review*, Vol. 25, No. 2, 2002, p 389.

¹⁹¹ Inland Revenue Department (New Zealand). ‘OECD Report on Tax Havens Released’, published 15 November 2001, online at <http://taxpolicy.ird.govt.nz/news/2001-11-15-oecd-report-tax-havens-released#release> accessed 01/04/2010.

¹⁹² *Ibid.*

¹⁹³ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 816.

Report were allowed to review these commitments in respect of the no substantial activity criterion.

The report went on to say that the OECD would continue to welcome removal of practices connected with the no substantial activities criterion despite the fact that it would no longer pursue this.¹⁹⁴ The fact that the OECD maintained that these practices were harmful while indicating that it would not pursue them indicates that the OECD was defeated, at least on this point.

All that now remained within the scope of the OECD project was that it could continue to put pressure on havens to agree to share information when requested by foreign tax authorities.¹⁹⁵ This would require that secrecy laws be dealt with in such a way that the requested information could be both collected and disclosed.

Although the deadline for commitments was extended, it is significant that the 2001 Report made no mention of what would happen on that date other than to say that no blacklist would be required if all states made commitments towards effective information exchange prior to the expiration of the deadline. In addition, it could have been expected that the 28 February deadline would not be strictly enforced because the Committee on Fiscal Affairs was not due to meet again until May 2002, which would be the first opportunity to discuss any sanctions.¹⁹⁶

Very little attempt was made to explain why the project was so dramatically scaled back. In its press release, the OECD simply stated that “The changes were made in response to the dialogue that has taken place.”¹⁹⁷ The report itself gave little additional information, disclosing only that some member-states and some tax havens had expressed concerns regarding the no substantial activities criterion and the application

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¹⁹⁴ Inland Revenue Department (New Zealand). ‘OECD Report on Tax Havens Released’, published 15 November 2001, online at <http://taxpolicy.ird.govt.nz/news/2001-11-15-oecd-report-tax-havens-released#release> accessed 01/04/2010.

¹⁹⁵ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 816.

¹⁹⁶ Meeting date obtained on the basis of the author’s employment with New Zealand’s Inland Revenue Department.

¹⁹⁷ Inland Revenue Department (New Zealand). ‘OECD Report on Tax Havens Released’, published 15 November 2001, online at <http://taxpolicy.ird.govt.nz/news/2001-11-15-oecd-report-tax-havens-released#release> accessed 01/04/2010.

of co-ordinated defensive measures to tax havens.¹⁹⁸ In addition to Luxembourg and Switzerland's abstentions which carried through from the initial report, Belgium and Portugal abstained on the 2001 Report.¹⁹⁹

An additional change was that the name of the project was changed from *Harmful Tax Competition* to *Harmful Tax Practices*. This change was not directly acknowledged in the Report, however there was a notable shift in rhetoric with the Report stating that:

[T]he OECD seeks to promote tax competition that will achieve the overall aims of the OECD to foster economic growth and development world-wide. The OECD project does not seek to dictate to any country what its tax rate should be, or how its tax system should be structured. It seeks to encourage an environment in which free and fair tax competition can take place.²⁰⁰

Angel Gurría, the current OECD Secretary-General, later addressed this point in an interview in 2009:

One of our capital principles is the free-flow of capital. In the OECD we have a set of mandatory, binding principles, a key part of our armoury of capital, that promote the free-flow of capital, the best practices, actually recommend the free-flow of capital. That is not the question. The capital can flow freely; the question is disclosures for purposes of every tax authority just doing their homework.²⁰¹

Much has been made of this rhetorical change. An OECD official was quoted by *The Economist* magazine in September 2000 as saying, with reference to the then *Harmful Tax Competition* campaign: "As an economist, how can you ever say anything bad about competition?"²⁰² This drew attention to the internal contradiction between the principles of free-market capitalism, upon which the OECD was founded, and its contentions through its *Harmful Tax Competition* project that tax competition could be

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¹⁹⁸ Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 9.

¹⁹⁹ Inland Revenue Department (New Zealand). 'OECD Report on Tax Havens Released', published 15 November 2001, online at <http://taxpolicy.ird.govt.nz/news/2001-11-15-oecd-report-tax-havens-released#release> accessed 01/04/2010.

²⁰⁰ Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 4.

²⁰¹ Gurría, Angel. 'Interview with Angel Gurría on Progress in the Fight Against Tax Evasion', OECD, 02/09/2009, online at www.oecd.org/documentprint/0,3455,en_2649_37427_43601579_1_1_1_1,00.html, accessed 13/04/2010.

²⁰² Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 50.

harmful and should be eliminated.²⁰³ As has been discussed above, there is a significant viewpoint that aligns with dominant liberal economic beliefs that views tax competition as a healthy way to prevent government inefficiencies.²⁰⁴

Sharman and Webb have both explained this as a normative weakness that eroded the OECD's legitimacy.²⁰⁵ By preaching one thing while practicing another, the OECD put itself in a position where states with a real motivation to defect from their earlier commitments could claim the OECD was hypocritical. These states would then be able to excuse themselves from their commitments without damaging their own reputations, because the organisation holding them to their pledges had lost its credibility. Sharman has termed this as "rhetorical self-entrapment."²⁰⁶

Sharman and Webb agree that the haven states exploited this contradiction by employing the normative arguments of the OECD in a "mimetic challenge"²⁰⁷ within other organisations (such as the Commonwealth, the Caribbean Community and the Pacific Islands Forum) and to powerful OECD states, in particular the United States. Sharman explains that havens were able to do this because "the irreducible plurality of meanings in language can sometimes enable the weak to use the principles of the strong for their own subversive ends."²⁰⁸ In this way, havens managed to persuade OECD member-states that the OECD's framing of the campaign was inconsistent with liberal economic theory in addition to norms of fairness, sovereignty and multilateralism.²⁰⁹

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²⁰³ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 73.

²⁰⁴ Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 50.

²⁰⁵ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 821 and Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 53.

²⁰⁶ Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 53.

²⁰⁷ Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006), p 5.

²⁰⁸ *Ibid*, p 13.

²⁰⁹ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 821.

The emphasis of this approach is on the resonance of the normative arguments put forward by tax havens with those who held the power to change the OECD project. The constructivists argue that tax havens succeeded at their cause because they appealed to norms that had already been accepted as a framework for appropriate behaviour at the international level.²¹⁰ These norms shaped expectations of appropriate behaviour that partly constituted the OECD's identity.²¹¹ So by acting to coerce the havens' compliance through blacklisting, the OECD acted against both what was expected of it and what defined its own reputation.²¹² By drawing attention to the fact that the OECD was not behaving appropriately, its legitimacy as the arbiter of whether individual states were living up to those same standards was worn away. The OECD was unable to continue with its project in its existing format because the credibility of the campaign had been lost.²¹³

The OECD was forced not only to dramatically scale back the scope of the project, but to go further and change the project's title and associated rhetoric. Sharman and Webb argue that the OECD's inconsistent and defensive reaction clearly shows that the tax havens' framing of the campaign as hypocritical was successful not just among the OECD member-states that called for the changes, but also within the OECD institution itself.²¹⁴

Once again, this approach largely ignores the interests of the states involved in the project. From the perspective of the OECD as an institution separate from other states (and the extent to which it acts independently of state interests has already been questioned), the OECD was able to preserve the life of its campaign against tax havens by shifting the rhetoric to persuade havens that their voices had been heard, but yet at

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²¹⁰ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 143.

²¹¹ Sharman, J.C. 'International Organisations and the Implementation of New Financial Regulations by Blacklisting', in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61 and Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006).

²¹² Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 143.

²¹³ Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006), p 5.

²¹⁴ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, pp 817-818 and Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 50.

the same time, the end result of the project would still be the same. The OECD agreed to no longer target the tax regimes of havens, but instead it would intensify its efforts to force the havens to provide information on those using them. The goal in doing this was to allow OECD member-states to convict their residents of tax evasion and thereby deter others from using tax havens in future. Without customers, tax havens would be forced to change their strategies.

In addition, when the domestic tax laws of the havens were the primary focus of the OECD campaign, the havens were able to make arguments in terms of sovereignty and non-interference. Once the focus shifted to secrecy, OECD states could instead utilise these same norms to advance its interests by arguing that the havens were using secrecy to undermine the domestic tax laws of OECD states.²¹⁵

By changing the title of the project and its associated rhetoric, the OECD framed the way in which tax havens viewed the campaign. Then the OECD could continue to make progress towards its original goals but this time with the implicit support of tax havens. From this perspective, the OECD used norms as a tool towards achieving the goals that its member-states had set in accordance with their collective interests.

From the perspective of individual member-states, there is even stronger evidence of rational interest calculation as the driver behind the change in the OECD's normative rhetoric. The United States was undoubtedly the driving force behind the 2001 changes to the OECD campaign and this can be explained by domestic pressures existing at the time of the George W. Bush Administration. In addition, the OECD's campaign against tax havens went indisputably against the interests of the havens, which did everything they could to lobby for their interests within other international institutions. To some extent, tax havens did find ready ears among certain OECD member-states that were persuaded that some aspects of the OECD campaign were not in the interests of the member-states themselves. The interests of the United States, the tax havens and other OECD member-states will be discussed in turn below, with the conclusion that the OECD will ultimately favour whichever norms suit the interests of its most powerful member-states.

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²¹⁵ Murphy, Richard. "Tax Justice and secrecy jurisdictions," *Soundings*, vol. 41 (Spring 2009), p 68.

Domestic lobbying and United States interests

The fact that pro-tax haven arguments had a significant support base within the United States has already been alluded to. This reality needs to first be placed within its context before it can be further explained.

The OECD project against tax havens was born under the presidency of Bill Clinton, a Democrat who was thought to represent the interests of lower and middle-income voters and who held power during a time of relative fiscal restraint. It was in this context that the United States offered its initial strong support for the *Harmful Tax Competition* initiative.²¹⁶

Clinton was followed by the Republican Administration of George W. Bush, a president renowned for representing business interests and the principles of liberal economics. In addition, Bush was sceptical of cooperation with multilateral institutions, and at the time of the changes to the OECD Project in 2001, the United States was enjoying a period of rapid economic growth.

These two presidents clearly represented different domestic interest groups and perceived what was in the United States' interests very differently. In addition, changes within the United States' fiscal climate occurred between these presidencies and would have had a bearing on how US interests were determined.

The pro-tax haven rhetoric came almost exclusively from within the Republican movement in the United States. Webb states that "the Republican Administration was ideologically predisposed to accept the critiques of the right-wing coalition that had formed in the US to oppose the [OECD *Harmful Tax Competition*] project."²¹⁷ In keeping with the constructivist school of thought, Webb implies that the Republican Administration listened to its lobbyists because of the normative resonance of its arguments. Although not himself a constructivist, Payne has agreed that lobbyists during this period were able to effectively play upon the conventional low tax

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²¹⁶ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 152.

²¹⁷ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 813.

convictions of most American Republicans.²¹⁸ While a neoliberal approach might concede that within the domestic realm, state interests are to some extent perceived in accordance with ideology, it would emphasise that the Republican Administration was more likely to have been motivated by its core constituency's interests and its own interests in being re-elected.

The coalition that Webb refers to includes right-wing think tanks such as the Center for Freedom and Prosperity (CFP), the Cato Institute and the Heritage Foundation. The CFP was said to have been the leader of the movement and was formed in 2000 with the specific intention of countering the OECD project on *Harmful Tax Competition*. The CFP lobbied the US Congress, the Bush Administration and sought support directly from tax havens.²¹⁹ The CFP was known to have been in particularly close contact with Caribbean governments.²²⁰

Sharman and Webb have both focused on the ideology and norms that the CFP perpetuated as being the key to its success in persuading the US government and foreign governments to withdraw their support for the OECD project. Webb describes the CFP as “libertarian anti-tax”, “anti-government” and “deeply suspicious of European welfare states.”²²¹ Sharman states that the CFP portrayed the OECD campaign as an attempt by socialist governments to establish a “global tax police.”²²²

It appears that rather than making any particular normative argument, the CFP used a range of alternative arguments depending on its audience and displayed a willingness to use whichever argument would be most effective at furthering its cause. When addressing tax havens, the CFP made arguments in terms of sovereignty and non-intervention. It gained support from the Congressional Black Caucus by characterising the OECD project as harmful to poor developing neighbours. In other circles it argued

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²¹⁸ Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

²¹⁹ Ring, Diane. ‘Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation’, *Florida Tax Review*, Vol. 9, 2009, p 564.

²²⁰ Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 151.

²²¹ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 813.

²²² Sharman, J.C. ‘Norms, coercion and contracting in the struggle against ‘harmful’ tax’ competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, pp 150-151.

directly that the OECD project went against US interests.²²³ Aspects of US federal and state taxation were presented as at risk of being categorised as harmful by the OECD.²²⁴ It was even argued that the US itself met the OECD definition of a tax haven and therefore would be targeted by the OECD campaign. It was also stated that US investors benefitted from the use of other tax havens and that it would harm US business interests if the havens were abolished.²²⁵

In addition to the right-wing think tanks, transnational banks and tax advisors also voiced their strong opposition to the OECD campaign. The industry argued that a crackdown on tax havens would severely hurt their businesses and that they should not be restricted from engaging in international tax planning. These private firms had significant political influence as lobbyists with connections to finance and treasury departments throughout OECD member-states.²²⁶ Further, the key clients of these banks and tax practitioners were big businesses who stood to face increased effective taxation abroad as a result of the OECD project. It is likely that many of these large multinationals had similar connections to the US government as the tax service industry.

The US government reflected both normative arguments and national interest arguments when it publically announced its change of position. On 10 May 2001, US Treasury Secretary Paul O'Neill stated:

I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems.²²⁷

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²²³ Ring, Diane. 'Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation', *Florida Tax Review*, Vol. 9, 2009, p 564.

²²⁴ Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillian: New York, 2005) p 157.

²²⁵ Ring, Diane. 'Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation', *Florida Tax Review*, Vol. 9, 2009, p 564.

²²⁶ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 797.

²²⁷ United States Department of the Treasury Office of Public Affairs, 'Treasury Secretary O'Neill Statement on OECD Tax Havens', PO-366, online at <http://www.ustreas.gov/press/releases/po366.htm>, accessed 28.07.2010.

The normative arguments regarding sovereignty, non-intervention and the right to development clearly are not ones that had absolute and inherent resonance with the Bush Administration and the Republican Party. Webb admits that the apparent sympathy for the unfair treatment of non-OECD states “can only be seen as a rationalisation for policy driven by other concerns, since the US is an enthusiastic proponent of using international institutions like the IMF to ‘dictate’ other kinds of economic policy in developing countries.”²²⁸ Norms of sovereignty and non-interference have demonstrably been drawn upon by the US government where they have been perceived to serve US interests and blatantly ignored where they were not. It therefore appears that the US government has used norms in the present case just as it has in others as tools to further its rational pursuit of the national interest.

O’Neill went on to discuss US interests in relation to the OECD project:

The United States simply has no interest in stifling the competition that forces governments - like businesses - to create efficiencies. In fact, the Administration is actively working to lower tax rates for all Americans.²²⁹

Clearly, the OECD project in its format at that time no longer aligned with the policy goals and perceived national interests of the US government. O’Neill directly confirmed this, stating that “In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities.”²³⁰

O’Neill then clearly defined the aspects of the project that did support US interests. He stated that the US needed information from tax havens in order to prosecute its own citizens for tax evasion and therefore the key issue it wanted to see the OECD address was secrecy. In “appropriate circumstances”, organisations “like the OECD” could be used to build a framework for information exchange. He emphasised that “Where we share common goals, we will continue to work with our G7 partners to achieve these goals,” specifically calling for the OECD initiative to be refocused on “our common goal” of information exchange.

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²²⁸ Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 814.

²²⁹ United States Department of the Treasury Office of Public Affairs. ‘Treasury Secretary O’Neill Statement on OECD Tax Havens’, PO-366, online at <http://www.ustreas.gov/press/releases/po366.htm>, accessed 28.07.2010.

²³⁰ *Ibid.*

Despite the adoption of normative arguments in the first part of O'Neill's speech, a clear emphasis is given to the fact that the OECD project no longer aligned with US interests. This suggests that rather than following a logic of what was appropriate, the normative arguments served to advance rationally calculated interests. In withdrawing its support for the OECD *Harmful Tax Competition* project, the United States acted in accordance with a logic of the likely consequences.

There is little debate surrounding the extent to which the US was responsible for the shift in the OECD project. Murphy, Webb, Nicodeme and Payne have all attributed the changes directly to pressure from the United States.²³¹ Webb points to the fact that all that remained of the OECD project following these comments from the US were exactly the elements that the US had deemed acceptable – transparency and information exchange.²³² Payne has added that “the antipathy of the US government did more to check the progress of the OECD initiative than any amount of hostility from Barbados and other listed countries.”²³³

Bearing this in mind, the secondary role of tax havens in shaping the changes to the *Harmful Tax Competition* project will be discussed below.

The tax haven lobby

It requires no great leap of logic to accept that the OECD *Harmful Tax Competition* project went directly against the interests of tax havens. Tax havens by their very nature have little domestic investment and few attractions for foreign investors aside from the tax advantages they offer. Tax concessions for foreigners are at the very centre of their economic strategies. Therefore in the absence of such tax advantages, they would most

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²³¹ Murphy, Richard. “G20: Goodbye to tax havens – almost”, *The Guardian*, 02/04/2009, online at <http://www.guardian.co.uk/commentisfree/2009/apr/02/g20-tax-havens/print>, accessed 09/05/2010 and Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 814 and Nicodeme, Gaetan. ‘On Recent Developments in Fighting Harmful Tax Practices’, *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 762 and Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

²³² Webb, Michael C. ‘Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD’s Project on Harmful Tax Competition’, *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 821.

²³³ Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

likely be driven out of the market for financial services with disastrous consequences for their economies.²³⁴

Some of the havens went so far as to argue that the OECD campaign sought not only to recover capital and tax revenue by eliminating the havens, but that it also sought to remove competition for its financial centres such as London, New York and Tokyo that stood to attract the former clients of tax havens.²³⁵

Tax havens began lobbying within their regional groupings, most notably in the Caribbean Community (CARICOM) and the Pacific Island Forum (PIF).²³⁶ A significant proportion of the members of each of these institutions had been blacklisted by the OECD; therefore it was in the collective interests of these institutions to take up the tax havens' cause.

Seven Pacific Island states had been blacklisted in 2000 and it was claimed that the income these states received from their offshore financial sectors amounted to as much as eight to ten percent of their GDP.²³⁷ These states lobbied through the PIF which in turn demanded compensation from OECD members for the business that would be lost to its members' economies as a result of their compliance with OECD standards.²³⁸ A wider conference of Pacific states was held in Japan in February 2001, including representatives from the Commonwealth Secretariat, and this was followed by a joint OECD-Pacific Islands Forum meeting held in Fiji in April 2001.²³⁹

Commonwealth tax havens took their case to the Commonwealth Finance Ministers meeting in September 2000.²⁴⁰ The result of this meeting was an official statement from the Commonwealth criticising the *Harmful Tax Competition* campaign as partial,

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²³⁴ Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), p 49 and Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillian: New York, 2005) p 157.

²³⁵ *Ibid*, p 49.

²³⁶ Carlson, Kimberly. 'When Cows have Wings: An Analysis of the OECD's Tax Haven Work as it Relates to Globalisation, Sovereignty and Privacy', *John Marshall Law Review*, Vol. 35, No. 163, 2002, p 179.

²³⁷ *Ibid*, p 179.

²³⁸ *Ibid*, p 180.

²³⁹ Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 8.

²⁴⁰ Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillian: New York, 2005) p 157.

coercive and an infringement of the principle of non-intervention. The Secretary-General of the Commonwealth then invited the OECD to co-sponsor a meeting to be held in Barbados in January 2001.²⁴¹ The resulting joint OECD-Commonwealth meeting had over 160 participants including 13 OECD countries, 13 Caribbean states, 5 Pacific Island states and representatives of CARICOM and the PIF.²⁴²

As a result of these meetings and with help from the Commonwealth, CARICOM and the PIF established the International Tax and Investment Organisation (ITIO) to coordinate their lobby against the OECD campaign.²⁴³ The ITIO has been credited with persuading certain OECD members to alter their positions on the OECD campaign. In early 2001, Australia, Canada and New Zealand, each Commonwealth states with close links to developing blacklisted states (Australia and New Zealand with the Pacific and Canada with the Caribbean) urged the OECD to look for cooperative solutions rather than using sanctions that would destabilise already fragile economies.²⁴⁴

The constructivists have argued that tax havens managed to persuade not only these three countries but also the United States of the normative value of their case. Sharman claims that:

Small states secured a key victory in persuading the United States to defect from the OECD campaign in May 2001....After a period of initial indecision, the Bush Administration became convinced by the rhetoric of the tax havens and their supporters.²⁴⁵

This argument ignores the fundamental interests of both the tax havens and the states they are said to have persuaded. Firstly, it has been clearly established that the OECD campaign went directly against the rationally-conceived interests of tax havens. Many of the arguments made by the havens when lobbying other institutions and states were made directly in the terms of their calculated interests. The normative arguments

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²⁴¹ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 150.

²⁴² Organisation for Economic Co-operation and Development. *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*, 2001, p 8.

²⁴³ Sharman, J.C. 'Norms, coercion and contracting in the struggle against 'harmful' tax' competition, *Australian Journal of International Affairs* Vol. 60, No. 1, pp. 143_ 169, March 2006, p 150.

²⁴⁴ *Ibid*, p 150.

²⁴⁵ Sharman, J.C. 'The agency of peripheral actors: small state tax havens and international regimes as weapons of the weak', in John M. Hobson and Leonard Seabrooke (eds.), *Everyday Politics of the World Economy*, (Cambridge University Press: New York, 2007), pp 49-50.

therefore can be seen in a context where the underlying driver remained state interests, and as such, the norms were merely tools used to advance those interests.

Secondly, it seems unlikely that the most powerful state in the world could be persuaded to change its approach solely on the basis of normative arguments from self-interested backwater states. Had the tax havens' cause not happened to have aligned with the causes of the financial services industry, big business and the right-wing lobbyists within the US, it is unlikely that the US government would have paid them any attention. The domestic lobby within the US is the more likely candidate for successfully persuading the US government to reassess its interests with respect to the *Harmful Tax Competition* campaign. Once the US government came to perceive the OECD campaign as no longer according with its interests, its interests had aligned with those of tax havens. This alignment of interests is what explains the alignment of rhetoric employed by both the tax havens and the US.

The way in which the OECD rapidly responded by redefining the goals of its campaign against tax havens illustrates the neoliberal contention that institutions will adapt in accordance with the shifting collective interests of its member-states. By also altering its normative rhetoric in line with that used by the United States, it revealed that the OECD will ultimately favour whichever norms suit the interests of its most powerful member-states.

Secrecy and decline

In accordance with the 2001 Progress Report, the OECD shifted its focus to transparency and information exchange. This approach sought to enable OECD member-states to enforce their domestic tax laws rather than requiring tax havens to change their tax systems.

A 'Global Forum on Taxation' had been established with little fanfare in 2000 by a group of 32 states in support of the OECD *Harmful Tax Competition* campaign. This Forum became the new centre of discussions on how non-OECD countries might be assessed for compliance with the OECD's exchange of information (EOI) standards. The OECD's Model Convention on Double Taxation contained an article on EOI

(Article 26), which provided a basis for bilateral Double Taxation Agreement (DTA) negotiations. However, DTAs were not an appropriate medium for tax havens to commit to information exchange, because DTAs are only entered into where there is double taxation requiring relief. High-tax states would not wish to enter into an agreement to reduce their taxing rights in cross-border situations when the other state does not levy any taxes. To resolve this issue, the Global Forum on Taxation designed a Model Agreement on Exchange of Information on Tax Matters in 2002, providing a basis for bilateral agreements relating solely to tax information exchange. Agreements that were later negotiated from this model became known as Tax Information Exchange Agreements (TIEAs).²⁴⁶ However, while high-tax states were motivated to enter into DTAs for the mutual benefits they afforded, TIEAs were of no advantage to tax havens except that signing on to them would ensure they did not face any future OECD sanctions.

The EOI article in the OECD Model Tax Convention and the new Model Agreement on Exchange of Information on Tax Matters were endorsed by G20 Finance Ministers at their Berlin Meeting in 2004 as the internationally agreed standard by which to assess effective information exchange.²⁴⁷ The standard provides that information must be exchanged between states on request where it is “foreseeably relevant” to enforcement of the treaty partner’s tax laws. It also requires that states have the power to obtain the requested information from those operating in its jurisdiction in a reliable way. The EOI standard also provides that information may not be denied on the basis of banking secrecy laws or because the provider has no interest of its own in the requested information. Finally, there must be strict confidentiality of information exchanged.²⁴⁸

Most of the remaining blacklisted tax havens made commitments towards the OECD transparency and information exchange standards after the initiative was scaled back, and by April 2002 when the OECD published its new list of ‘uncommitted jurisdictions’,

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²⁴⁶ Nicodeme, Gaetan. ‘On Recent Developments in Fighting Harmful Tax Practices’, *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 763.

²⁴⁷ Organisation for Economic Co-operation and Development. ‘A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard’, 18 August 2010, online at <http://www.oecd.org/dataoecd/50/0/43606256.pdf> accessed 23/08/2010, accessed 23/08/2010.

²⁴⁸ Organisation for Economic Co-operation and Development. ‘Promoting Transparency and Exchange of Information for Tax Purposes’, 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 5.

only seven names remained (Andorra, Liberia, Liechtenstein, Monaco, the Marshall Islands, Nauru and Vanuatu). Nauru and Vanuatu were later removed in 2003 and Liberia and the Marshall islands were removed in 2007, leaving just three states (Andorra, Liechtenstein and Monaco).²⁴⁹

Webb argues that this willingness to cooperate reflected the fact that the OECD's conditions were no longer onerous.²⁵⁰ Tax havens could continue to offer tax breaks to foreign investors so long as they committed to sign on to TIEAs. A commitment was enough to be removed from the list and while many havens did negotiate a number of bilateral TIEAs, very few were actually signed and brought into legal effect.²⁵¹ What is more, the havens had been assured that they would not be subject to sanctions if they failed to keep their commitments until such a time as the OECD was willing and able to apply the same sanctions to Austria, Belgium, Luxembourg and Switzerland who continued to veto the OECD project. The immovable positions of these four key OECD states led observers to believe that "the OECD juggernaut" had effectively "ground to a halt"²⁵² and that OECD was unlikely to ever achieve its stated goal of a 'level playing field'.²⁵³

What happened in 2008-09?

The stalemate that had existed from the time of the OECD's 2001 Progress Report ended dramatically in 2008 in the wake of the global financial crisis (GFC). The GFC had reached its peak in September 2008 with the collapse, takeover or bailout of financial institutions such as Lehman Brothers, Merrill Lynch and AIG.

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²⁴⁹ Nicodeme, Gaetan. 'On Recent Developments in Fighting Harmful Tax Practices', *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 762.

²⁵⁰ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 816.

²⁵¹ Organisation for Economic Co-operation and Development. 'Promoting Transparency and Exchange of Information for Tax Purposes', 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 13.

²⁵² Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

²⁵³ Webb, Michael C. 'Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition', *Review of International Political Economy*, Vol. 11, No. 4, October 2004, p 819 and Payne, Anthony. *The Global Politics of Unequal Development*, (Palgrave Macmillan: New York, 2005) p 157.

On 15 November 2008, the G20 held a *Summit on Financial Markets and the World Economy* in Washington. Led by the United Kingdom and France, the Summit was intended to address some of the key causes of the GFC. On the agenda was the role of international financial institutions (IFIs) such as the International Monetary Fund (IMF), regulation of financial markets, monetary policy and recapitalisation of multinational banks.²⁵⁴ The Summit was referred to by the media as ‘Bretton Woods II’²⁵⁵ because it was hoped it would result in significant reforms to the global financial system.²⁵⁶

The G20 – OECD alliance

The G20 Washington Summit has been credited with initiating a strong political impetus to tackle tax evasion.²⁵⁷ The Washington Summit Declaration by G20 leaders stated that the G20 was committed to promoting “information sharing, including with respect to jurisdictions that have yet to commit to international standards with respect to bank secrecy and transparency.”²⁵⁸ The G20 also outlined an ‘Action Plan to Implement Principles for Reform’ stating that:

Tax authorities, drawing upon the work of relevant bodies such as the OECD, should continue efforts to promote tax information exchange. Lack of transparency and a failure to exchange tax information should be vigorously addressed.²⁵⁹

It is now clear that there was a dramatic revival of the OECD campaign in the months that followed, although the OECD made no public announcements regarding its work

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²⁵⁴ Anon, ‘Bretton Woods II: five key points on the road towards a new financial deal’, 14 November 2008, available online at <http://www.guardian.co.uk/politics/2008/nov/14/g20-summit-key-aims-imf>, accessed 13/04/2010.

²⁵⁵ *Ibid.* and Parker, George, Tony Barber and Daniel Dombey, ‘European Call for Bretton Woods II’, *Financial Times*, 16 October 2008, available online at http://www.ft.com/cms/s/7cc16b54-9b19-11dd-a653-000077b07658.Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2F7cc16b54-9b19-11dd-a653-000077b07658.html&_i_referer=http%3A%2F%2Fen.wikipedia.org%2Fwiki%2F2008_G-20_Washington_summit accessed 13/04/2010.

²⁵⁶ *Ibid.*

²⁵⁷ Organisation for Economic Cooperation and Development, ‘OECD and the G20’, online at http://www.oecd.org/document/35/0,3343,en_2649_201185_43731875_1_1_1_1,00.html, accessed 13/04/2010.

²⁵⁸ G20. ‘Declaration of the Summit on Financial Markets and the World Economy’, 15 November 2008, available online at <http://georgewbush-whitehouse.archives.gov/news/releases/2008/11/20081115-1.html>, accessed 13/04/2010.

²⁵⁹ *Ibid.*

until immediately prior to the next G20 Summit in London on 2 April 2009. In one remarkable week in March of 2009, Austria, Belgium, Luxembourg and Switzerland all dramatically withdrew their reservations to Article 26 (Exchange of Information) of the OECD Model Tax Convention.²⁶⁰ This was a major breakthrough for the OECD project, as there was no longer any opposition from OECD member-states.

The most striking was Switzerland's announcement, because it implied that the country's century-old strict bank secrecy rules would be breached where there was suspected tax evasion.²⁶¹ Switzerland was thought to provide shelter to at least US\$1.89 trillion of the world's estimated US\$7 trillion of private wealth²⁶² and the removal of the promise of secrecy for these investments would undoubtedly harm Switzerland's offshore finance sector.²⁶³ British Prime Minister Gordon Brown hailed the Swiss announcement as "the beginning of the end for tax havens".²⁶⁴

The Swiss government was open in its reluctance to concede. The announcement was made following an overnight meeting with the OECD²⁶⁵ and Swiss officials objected publically to "the criticism and threats made towards Switzerland by various states in connection with the issue of the exchange of information in tax matters."²⁶⁶ Various media reported that this pressure had come from the US Obama Administration and the European Union.²⁶⁷ Media reports also widely claimed that Switzerland had ultimately

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²⁶⁰ Organisation for Economic Cooperation and Development. 'OECD Assessment Shows Banking Secrecy as a Shield for Tax Evaders Coming to an End', 31/08/2009, online at www.oecd.org/documentprint/0,3455,en_2649_34897_43592376_1111,00.html accessed 13/04/2010.

²⁶¹ Boitelle, Thierry, Florence Bouvard and Aliasghar Kanani. 'Exchange of information – Switzerland can no longer bank on secrecy', in *Euromoney Handbooks*, available online at http://www.altenburger.ch/uploads/tx_altenburger/tb_fb_ak_2010_Exchange_of_information_Switzerland.pdf, accessed 23/08/2010, pp 143 – 149.

²⁶² Mathiason, Nick. 'Beginning of the End for Tax Havens', *The Guardian*, 14/03/2009, online at <http://www.guardian.co.uk/business/2009/mar/13/switzerland-tax-evasion-fight>, accessed 23/08/2010.

²⁶³ Boitelle, Thierry, Florence Bouvard and Aliasghar Kanani. 'Exchange of information – Switzerland can no longer bank on secrecy', in *Euromoney Handbooks*, available online at http://www.altenburger.ch/uploads/tx_altenburger/tb_fb_ak_2010_Exchange_of_information_Switzerland.pdf, accessed 23/08/2010, pp 143 – 149.

²⁶⁴ Mathiason, Nick. 'Beginning of the End for Tax Havens', *The Guardian*, 14/03/2009, online at <http://www.guardian.co.uk/business/2009/mar/13/switzerland-tax-evasion-fight>, accessed 23/08/2010.

²⁶⁵ Anon. 'Switzerland Eases Banking Secrecy', BBC, 13/03/2009, online at <http://news.bbc.co.uk/2/hi/business/7941717.stm>, accessed 23/08/2010.

²⁶⁶ Swiss Federal Department of Finance. 'Switzerland Removed from OECD 'Grey List'', 24/09/2009, online at <http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=29205>, accessed 23/08/2010.

²⁶⁷ Anon. 'Switzerland Eases Banking Secrecy', BBC, 13/03/2009, online at <http://news.bbc.co.uk/2/hi/business/7941717.stm>, accessed 23/08/2010.

conceded because it had learned that it was going to be included on a new blacklist of uncooperative tax havens being drawn up by the OECD.²⁶⁸

How this new blacklist came to light is not clear, as it had not been announced by the OECD. Some media reported that it was Swiss Ministers who leaked the information,²⁶⁹ however the Swiss Federal Department of Finance maintains that “despite being a founding member of the OECD, [Switzerland] was not notified of the production of the list.”²⁷⁰ It was widely expected that the release of the blacklist would be timed for the next G20 Heads of State Summit in London on 2 April 2009.²⁷¹ The OECD denied that a blacklist was being formulated and Head of Media and Public Affairs and Communications Nicolas Bray stated that “There is no new ‘OECD list’ of tax havens and we are not quoting any specific number of tax havens.”²⁷² However, he was also forced to clarify that media reports had been referring to “an information table” providing information on jurisdictions that currently did not conform to the internationally agreed standards of transparency and information.²⁷³

Just days before the London Summit, French President Nicolas Sarkozy (then also President of the EU), revealed that negotiations were underway with Andorra to seek its commitment to information exchange. Sarkozy dramatically threatened that unless Andorra cooperated fully, he would resign as the microstate’s co-prince.²⁷⁴ He reportedly also told MPs of his ruling party: “I want a list of tax havens and I want to

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²⁶⁸ Mathiason, Nick. ‘Beginning of the End for Tax Havens’, *The Guardian*, 14/03/2009, online at <http://www.guardian.co.uk/business/2009/mar/13/switzerland-tax-evasion-fight>, accessed 23/08/2010 and Anon. ‘Switzerland Eases Banking Secrecy’, BBC, 13/03/2009, online at <http://news.bbc.co.uk/2/hi/business/7941717.stm>, accessed 23/08/2010.

²⁶⁹ Mathiason, Nick. ‘Beginning of the End for Tax Havens’, *The Guardian*, 14/03/2009, online at <http://www.guardian.co.uk/business/2009/mar/13/switzerland-tax-evasion-fight>, accessed 23/08/2010 and Anon. ‘Switzerland Eases Banking Secrecy’, BBC, 13/03/2009, online at <http://news.bbc.co.uk/2/hi/business/7941717.stm>, accessed 23/08/2010.

²⁷⁰ Swiss Federal Department of Finance, ‘Switzerland Removed from OECD ‘Grey List’’, 24/09/2009, online at <http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=29205>, accessed 23/08/2010.

²⁷¹ Boon, Darren. ‘Singapore among nations on tax havens “blacklist”? No such list, says OECD’, *The Online Citizen*, 27 March 2009, online at <http://theonlinecitizen.com/2009/03/singapore-among-nations-on-tax-havens-%E2%80%9Cblacklist%E2%80%9D-no-such-list-says-oecd/>, accessed 23/08/2010.

²⁷² *Ibid.*

²⁷³ *Ibid.*

²⁷⁴ Anon. ‘Sarkozy May Resign as Co-Prince Over Bank Secrecy Laws’, *Radio France Internationale*, 26 March 2009, online at http://www.rfi.fr/actu/en/articles/111/article_3281.asp, accessed 09/05/2010.

punish them.”²⁷⁵ Almost immediately, Andorra, in addition to Liechtenstein and Monaco, the only three states still remaining on the OECD’s blacklist of ‘non-cooperative tax havens’, all endorsed the OECD standard of information exchange.²⁷⁶

The Official Communiqué from the G20 London Summit noted that leaders agreed:

to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over.²⁷⁷

These were the strongest words to date by political leaders in support of the OECD campaign.

The G20 also published a supporting annex: ‘Declaration on Strengthening the Financial System’, containing detailed proposals to address “Tax Havens and Non-Cooperative Jurisdictions”.²⁷⁸ Citing an “essential” need to protect public finances against non-cooperative jurisdictions, the Declaration reiterated that “We stand ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency.”²⁷⁹ It then listed a “toolbox” of effective counter measures for countries to consider taking against non-cooperative jurisdictions. These recommended counter measures were identical in substance to those that had been consistently suggested by the OECD from the time of its 2000 Progress Report. They included compulsory reporting of transactions involving non-cooperative jurisdictions, additional (withholding) taxes on transactions, disallowing tax deductions, withdrawing from DTAs and reconsidering provision of bilateral aid to non-cooperative jurisdictions. In addition, international institutions and regional development banks could be asked to review their investment policies with regards to non-cooperative jurisdictions.²⁸⁰

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²⁷⁵ Anon. ‘Sarkozy May Resign as Co-Prince Over Bank Secrecy Laws’, *Radio France Internationale*, 26 March 2009, online at http://www.rfi.fr/actuen/articles/111/article_3281.asp, accessed 09/05/2010.

²⁷⁶ Organisation for Economic Co-operation and Development. ‘Promoting Transparency and Exchange of Information for Tax Purposes’, 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 4.

²⁷⁷ G20. ‘Global plan for recovery and reform: the Communiqué from the London Summit’, 2 April 2009, online at <http://www.londonsummit.gov.uk/en/summit-aims/summit-communication/>, accessed 13/04/2010.

²⁷⁸ G20. ‘Declaration on Strengthening the Financial System – London Summit, 2 April 2009’, online at <http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-fin-sysm>, accessed 13/04/2010, pp 4-5.

²⁷⁹ *Ibid*, pp 4-5.

²⁸⁰ *Ibid*, pp 4-5.

The use of the terms ‘tax haven’ and ‘non-cooperative jurisdiction’ is noteworthy because the OECD had made it clear from the time of the 2001 Progress Report that it was no longer targeting tax havens, except to the extent that they and any other states failed to commit to transparency and information exchange standards. The term ‘non-cooperative jurisdiction’ had been employed by the OECD to indicate states which had failed to commit to these standards. However by the time of the London Summit, no states remained on the list of non-cooperative jurisdictions. At the following G20 Summit in Pittsburgh (discussed below), the two terms were used interchangeably and the latter abbreviated to ‘NCJ’. The fact that their use no longer corresponds with the definitions provided by the OECD (or any other known definition) implies that they may be used to refer to any state that the G20 wishes.

The G20 noted that on the same day as its London Summit, the OECD published ‘A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard’ (the 2009 Progress Report).²⁸¹

The single-page report contained a table listing states under specific headings:

- ‘Jurisdictions that have substantially implemented the internationally agreed tax standard’ (which became known as the “white list”);
- ‘Jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented’ (the “grey list”); which was divided into 30 ‘Tax Havens’ and 8 ‘Other Financial Centres’ (Switzerland, Singapore, Luxembourg, Austria, Belgium, Brunei, Chile, Guatemala). [Although no explanation for the distinction was offered, it appears that the OECD had reverted to its 1998 definition of a tax haven and therefore the ‘other financial centres’ would be excluded on the basis of having substantive activities.]
- ‘Jurisdictions that have not committed to the internationally agreed tax standard’ (the new “blacklist”) containing Costa Rica, Malaysia (Labuan), Philippines and

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²⁸¹ G20. ‘Global plan for recovery and reform: the Communiqué from the London Summit’, 2 April 2009, online at <http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/>, accessed 13/04/2010.

Uruguay.²⁸² Upon publication of the list, these four jurisdictions immediately committed and were moved to the “grey list” by April 7.²⁸³

The standard by which the white list was determined was simply the number of DTAs or TIEAs containing effective information exchange clauses that each country had signed. Any state that had not signed at least 12 of these agreements was automatically downgraded to the grey or blacklist, depending on whether they had accepted the information exchange standard in principle.

It is interesting to note that the Malaysian Federal Territory of Labuan is the only domestic jurisdiction on the list. Its inclusion immediately draws attention to the fact that many such special financial jurisdictions exist, including the US state of Delaware and the UK island of Guernsey. The OECD has not attempted to explain this discrepancy. A neoliberal explanation would consider that the OECD exists to advance the collective interests of its member-states; therefore it is not surprising that powerful OECD members were not targeted.

At the next G20 Summit in Pittsburgh on 24 – 25 September 2009, leaders stated that:

Our commitment to fight non-cooperative jurisdictions has produced impressive results. We are committed to maintain the momentum in dealing with tax havens... We stand ready to use countermeasures against tax havens from March 2010.²⁸⁴

By the time the OECD published its next white/grey/black list on 18 August 2010, all jurisdictions had committed to the OECD EOI standard. 13 states remain on the grey list, however these generally reflect developing countries with few resources that are nevertheless making progress in signing on to TIEAs.²⁸⁵

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²⁸² Organisation for Economic Co-operation and Development. ‘A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard’, 2 April 2009, online at <http://www.oecd.org/dataoecd/38/14/42497950.pdf>, accessed 23/08/2010.

²⁸³ Organisation for Economic Co-operation and Development. ‘Promoting Transparency and Exchange of Information for Tax Purposes’, 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 4.

²⁸⁴ G20. ‘Leaders’ Statement: The Pittsburgh Summit, 24 – 25 September 2009, online at <http://www.pittsburghsummit.gov/mediacenter/129639.htm>, accessed 13/04/2010.

²⁸⁵ Organisation for Economic Co-operation and Development. ‘A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard’, 18 August 2010, online at <http://www.oecd.org/dataoecd/50/0/43606256.pdf> accessed 23/08/2010, accessed 23/08/2010.

Tax Information Exchange Agreements (TIEAs)

Before the G20 Washington Summit on 15 November 2008 a total of just 44 TIEAs had ever been signed.²⁸⁶ In the four months between the Washington Summit and the London Summit the OECD reports that TIEA and DTA signings skyrocketed, with 21 new agreements completed.²⁸⁷ By the time the next G20 Summit was held in Pittsburgh in September the same year, an additional 164 agreements were in place. Of the 38 jurisdictions on the grey list, 36 had implemented enough agreements by the end of 2009 to secure their removal, signing a staggering 200 TIEAs and 118 DTAs between them. At the time of writing, TIEAs and DTAs continue to be rapidly established, with 133 new TIEAs and 40 new DTAs between January 2010 and 18 August 2010.²⁸⁸

*Figure 1: OECD graph of TIEAs signed globally*²⁸⁹

Figure 1 (above) dramatically illustrates the suddenness with which the TIEAs were signed. It should be noted that this does not include an additional 158 new or

²⁸⁶ Organisation for Economic Co-operation and Development. 'Promoting Transparency and Exchange of Information for Tax Purposes', 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 13.

²⁸⁷ *Ibid*, p 13.

²⁸⁸ *Ibid*, p 13.

²⁸⁹ Originally published by the OECD, *Ibid*, p 13.

renegotiated DTAs updating the EOI article. The reason these bilateral treaties were able to be signed so quickly is because a significant number had been pre-negotiated by tax havens (following the OECD's adoption of TIEAs as its standard) as insurance against any future OECD blacklisting. Therefore many states were able to rapidly respond by signing and giving effect to TIEAs that had been sitting dormant since as early as 2004.²⁹⁰

In light of the universal commitment of states to TIEAs (and EOI in DTAs), combined with their endorsement by the UN in its Model Tax Convention, the OECD has proclaimed its model for EOI as an undisputed, global standard.²⁹¹ However, the fact that most states were aware of the standard many years before they adjusted their behaviour, and the way in which so very few were prepared to sign on in the absence of overwhelming political pressure and the threat of imminent sanctions, suggests that states did not adopt TIEAs because of new international norms or a new standard of appropriateness. Neither could it be said that they were attracted or induced by the soft power of the OECD or other member-states. Rather, the evidence is clear that they were coerced.

What motivated the G20's dramatic action?

*With the crisis, global public opinion's expectations are high, their tolerance of non-compliance is zero and we must deliver.*²⁹²

Mark Blyth's studies of great historical transformations to the international system have revealed that in circumstances of institutional stability, state interests are likely to also be stable and consistent. But in situations of instability, such as during a major

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²⁹⁰ Information from author's knowledge working in the area of international tax policy as an employee of New Zealand's Inland Revenue Department.

²⁹¹ Organisation for Economic Co-operation and Development. 'Promoting Transparency and Exchange of Information for Tax Purposes', 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 2.

²⁹² OECD Secretary-General Angel Gurría, quoted in 'OECD Global Forum Consolidates Tax Evasion Revolution in Advance of Pittsburg', 02/09/2009, online at www.oecd.org/documentprint/0,3455,en_2649_37427_43601579_1_1_1_1,00.html, accessed 13/04/2010.

economic crisis, the way in which states conceptualise their interests changes drastically.²⁹³

The collapse of global financial markets in the wake of the GFC brought massive instability to the international realm. The ensuing recession in the major OECD states brought with it dual imperatives for governments to fund economic stimuli and social services while restraining spiraling budget deficits. This environment restricted the ability of governments to significantly adjust tax rates or reduce public spending, so state interests were redefined under enormous pressure to find alternative sources of revenue. Policing tax evasion offered a potentially significant alternative source of income for governments, but tax haven secrecy prevented them from pursuing offshore tax avoiders. The way that the GFC affected nearly all OECD countries in this same manner caused the closer alignment of interests supporting decisive, collective action against tax havens.

The collapse of financial markets brought about a structural change that presented tax havens as undermining both domestic revenue and international financial stability. It further brought to light the way in which tax havens were used by the same financial institutions that required bail-out by public funds – public funds that their tax avoidance had diminished. The GFC therefore brought about enormous political pressure to do something about tax havens and state interests were redefined in accordance with this new reality.

To date there has been no new constructivist literature attempting to explain tax secrecy developments in the wake of the GFC. However, constructivism would not consider the structural force of a global economic recession to be the fundamental cause of change. Rather, change to the status quo is explained as the result of interaction between states, redefining state identities and interests over time.²⁹⁴ It is these identities and interests that determine state actions in accordance with expectations of appropriate behaviour.²⁹⁵

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²⁹³ Blyth, Mark. *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century*, (Cambridge: Cambridge University Press, 2002) p 30.

²⁹⁴ Wendt, Alexander. 'Anarchy is What States Make of It: The Social Construction of Power Politics', *International Organisation*, 46 (2), 1992, p 355.

²⁹⁵ *Ibid*, pp 396-397.

The suddenness of the changes in state behaviour with respect to banking secrecy means that it would be difficult to explain them in terms of social discourse or global norms. There were clear, material factors that motivated OECD governments to reignite their dormant campaign against tax havens, and this time the economic and political stimuli were stronger than ever before. This explains why the project achieved such rapid success and also why it had been unsuccessful previously. In 2001, the *Harmful Tax Competition* campaign was overhauled in alignment with the shifting priorities of dominant OECD states. In the years that followed, the structural environment did not provide sufficient motivation for serious pursuit of transparency and information exchange. The GFC provided the necessary instability for a rapid reconception of state interests along with the broadness of a structural change that affected dominant OECD states in a universal way, causing their interests to collectively align.

Sharman has stated that norms of multilateralism and non-intervention had regulated the OECD campaign in 2001 by ruling out the use of both coercive measures as illegitimate.²⁹⁶ He argued that expectations of appropriate behaviour are what stopped the OECD from continuing with its *Harmful Tax Competition* campaign because the OECD's identity conflicted with the coercive nature of blacklisting.²⁹⁷ If this claim is accepted, it is difficult to see how the OECD identity and norms that dictate appropriate behaviour could have changed so dramatically in less than a decade, unless this is attributed to a sudden structural shift.

Domestic budgets

The GFC had an undeniable impact on governments' balance sheets throughout the world and particularly on those of the United States and Europe. Facing multi-billion dollar deficits at the same time as high unemployment and stagnant economies, governments were left with the unenviable task of making trade-offs between fiscal austerity, measures to boost economic growth and the increased demand for social

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²⁹⁶ Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006), p 8.

²⁹⁷ Sharman, J.C. 'International Organisations and the Implementation of New Financial Regulations by Blacklisting', in Jutta Joachim, Bob Reinalda and Bertjan Verbeek (eds.), *International Organisation and Implementation: Enforcers, Managers, Authorities?* (Routledge: Hoboken, 2007), pp 48-61 and Sharman, J.C. *Havens in a Storm: The Struggle for Global Tax Regulation*, (Ithaca: Cornell University Press, 2006).

services. The need for spending had increased at the same time that tax revenues had declined due to economic recession. Facing such pressures, governments looked for ways both to increase their revenue and to reduce their expenditure.

Raising tax rates was largely considered to be out of the question, both because this would inhibit economic recovery and because it was not politically viable at a time when many constituents were suffering. The contrary was true of public spending, as it could assist with economic recovery and win support from voters, but with government deficits already stretched, extra funding was scarce. A third option was to seek to attract economic stimulus in the form of capital investment from abroad.²⁹⁸ This increased competition between states for limited capital and has led some governments to reduce corporate or savings tax rates even though this reduces their short-term revenue. But ultimately, the ability of governments to compete with other countries for mobile capital is constrained by the domestic political economy.²⁹⁹

As capital-exporting states, a significant proportion of the wealth of OECD members is invested offshore. If its governments were unable to attract this wealth home through attractive tax rates, they could instead seek to ensure that they at least are taxing the proceeds. The amount that could potentially be recovered in this manner is not insignificant. The US Senate has estimated that the revenue it loses to tax havens amounts to 100 billion dollars a year and in many European countries the sums run into billions of euros.³⁰⁰ The estimated 18.5 billion pounds that the UK Treasury loses to tax havens each year is particularly pertinent when compared against its total 44 billion pound deficit.³⁰¹

The most significant barrier between OECD governments and the enormous potential revenue they could unlock by stopping offshore tax evasion is the banking secrecy laws of tax havens and their corresponding inability or refusal to provide information on their foreign tax residents. The structural change of the GFC brought with it enormous

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²⁹⁸ Thomas Plumper, Vera Troeger and Hannes Winner. 'Why is There No Race to the Bottom in Capital Taxation?', *International Studies Quarterly*, 2009, 53, p 766.

²⁹⁹ *Ibid*, p 781.

³⁰⁰ Organisation for Economic Co-operation and Development. 'Promoting Transparency and Exchange of Information for Tax Purposes', 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 2.

³⁰¹ Sweeney, John. 'Nowhere to Hide for Tax Havens?', BBC Panorama, 02/02/2009, online at http://news.bbc.co.uk/panorama/hi/front_page/newsid_7858000/7858253.stm accessed 30/04/2010.

political and economic pressure to come out of recession as quickly as possible. This redefined state interests so that revenue collection became a very high priority. A solution lay in the large source of potential tax revenue lost due to the use of tax havens and so a renewed and heightened campaign against tax haven secrecy was in the interests of OECD states.

Tax havens as a contributory cause of the GFC

Opacity, facilitated by banking secrecy, was at the heart of the GFC. Because the level of risk associated with complex financial products was disguised, banks could no longer trust their peers' structures and accounting disclosures. This caused a breakdown in global banking systems and gave rise to the subsequent credit crunch.³⁰²

Banking secrecy offered by tax havens can be used to hide anything from assets to liabilities to toxic debt.³⁰³ In the lead-up to the GFC, banking secrecy assisted in hiding the toxic debt levels of many complex financial products (such as special purpose vehicles, structured investment vehicles, collateralised debt obligations, private equity and hedge funds), thereby disguising their associated investment risk.³⁰⁴ Substantial levels of sub-prime debt originating from the US housing market are thought to have been repackaged and on-sold through tax havens such as the Cayman Islands and Jersey.³⁰⁵ So although tax havens were not the cause of the GFC, it would have been more difficult to disguise and pass on toxic debt without them.³⁰⁶

Offshore subsidiaries were established in poorly-regulated tax havens to disguise the true ownership of financial vehicles. A separate entity such as a trust or even a supposed charity would be used to isolate ownership from onshore parents and to secure higher credit ratings. When the subsidiaries fell into default it was difficult to prove

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³⁰² Christensen, John and Murphy, Richard. "The threat lying offshore", *The Guardian*, 10/10/2008, online at <http://www.guardian.co.uk/commentisfree/2008/oct/10/tax-banking>, accessed 09/05/2010.

³⁰³ Anon. 'Tax Me if You Can', *BBC Panorama*, 30 January 2009, online at http://news.bbc.co.uk/panorama/hi/front_page/newsid_7856000/7856445.stm, accessed 30/04/2010.

³⁰⁴ Murphy, Richard. "Tax Justice and secrecy jurisdictions," *Soundings*, vol. 41 (Spring 2009), p 71.

³⁰⁵ Mathiason, Nick. 'Beginning of the End for Tax Havens', *The Guardian*, 14/03/2009, online at <http://www.guardian.co.uk/business/2009/mar/13/switzerland-tax-evasion-fight>, accessed 23/08/2010 and Murphy, Richard. "Tax Justice and secrecy jurisdictions," *Soundings*, vol. 41 (Spring 2009), pp 71-72.

³⁰⁶ Murphy, Richard. "Tax Justice and secrecy jurisdictions," *Soundings*, vol. 41 (Spring 2009), pp 71-72.

their ties with the parent company, so losses and associated liability were contained within these legally separate units. Therefore many that benefited from on-selling toxic debt instruments were protected from the fall-out.³⁰⁷

The use of tax havens also enabled the exploitation of regulatory gaps across a number of jurisdictions. Even if each haven had been properly regulated each jurisdiction only accepts responsibility for what happens in its domain.³⁰⁸ This drew attention to the need for supranational regulation, because even if all OECD governments were able to pass laws to prevent a future crisis, if tax havens continued to apply different standards or to facilitate avoidance of new standards, the whole effort would be undermined.³⁰⁹ So even though they were not completely to blame for the GFC, tax havens have increasingly come to be seen as a key part of its solution.³¹⁰

Tax havens provided an additional source of anger for the general populous affected by the ensuing recession because of the fact that governments were required to bail out failing financial institutions using taxpayer dollars, when those same financial institutions had employed tax havens to avoid contributing to such government funds. The irony of financial institutions taking from a source that they had effectively stolen from did not go unnoticed. OECD Secretary-General Angel Gurría has expressed this sentiment succinctly:

There's a worldwide crisis, the worst that we've ever seen in our lifetimes. The level of tolerance of tax evasion and of your neighbour helping *your* citizens pay *less* taxes becomes absolutely intolerable.³¹¹

The collapse of financial markets was the structural change that exposed tax havens as a threat to domestic economies and fuelled domestic political pressure to take action against them. The interests of states at the centre of the GFC were therefore redefined in accordance with the new economic and political reality.

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³⁰⁷ Christensen, John and Murphy, Richard. "The threat lying offshore", *The Guardian*, 10/10/2008, online at <http://www.guardian.co.uk/commentisfree/2008/oct/10/tax-banking>, accessed 09/05/2010.

³⁰⁸ *Ibid.*

³⁰⁹ *Ibid.*

³¹⁰ Gaetan Nicodeme, 'On Recent Developments in Fighting Harmful Tax Practices', *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 755.

³¹¹ Gurría, Angel. 'Interview with Angel Gurría on Progress in the Fight Against Tax Evasion', OECD, 02/09/2009, online at www.oecd.org/documentprint/0,3455,en_2649_37427_43601579_1_1_1_1,00.html, accessed 13/04/2010.

Why did the secrecy jurisdictions comply?

For decades, states had applied domestic secrecy laws offering a competitive edge over traditional financial centres. The advantages of these laws in attracting foreign capital rendered them highly successful and despite periodic condemnation from core states, they continued to function largely undisturbed. Although the *Harmful Tax Competition* forced many to make commitments towards change, very few actually implemented any changes. Further, when the campaign was scaled back in 2001, those that had made commitments with respect to their domestic tax systems were given the opportunity to back down.

Against this backdrop, the changes made by tax havens over the past two years are unprecedented. Not only did they commit to make changes, but they implemented their commitments by signing on to numerous bilateral EOI agreements at a phenomenal pace. Ratification of the new TIEAs and DTAs requires that domestic laws are adapted in line with these commitments and therefore secrecy jurisdictions have had to overhaul their legislative codes to give effect to their agreements.

The offshore financial centres have been vocal in expression of their reluctance to make these changes while G20 leaders have been almost candid in conveying the extreme pressure that they applied to them. It cannot be disputed that the secrecy jurisdictions complied under enormous international pressure by way of blacklisting and an imminent threat of sanctions.³¹²

The change in behaviour of tax havens in swiftly agreeing to the EOI standard is difficult to explain from a constructivist perspective. The coercive pressure applied to tax havens did not take the form of normative persuasion and any standard of appropriate behaviour that could be said to now exist certainly did not exist at the time when the key secrecy jurisdictions announced their compliance. The new global standard for EOI came about as a result of key states succumbing to coercive threats

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³¹² Perez-Navarro, Grace. 'The OECD is Working with Governments to Clamp Down on Tax Havens', 05 October 2009, on You Tube at <http://www.youtube.com/watch?v=HrAOW1jAHrk&NR=1>, accessed 13/04/2010.

from other states – they did not comply because of an existing standard of appropriate behaviour. Clear evidence of imminent material consequences for states that did not comply gives further weight to the conclusion that the havens acted on the basis of anticipated consequences rather than a logic of appropriateness.

Blacklisting

The material impact resulting from the blacklisting of tax havens by the OECD in 2000 has been well documented.³¹³ States understood that the consequences of being blacklisted (for a second time in some cases) would cause significant damage to their economies. It has been noted already that blacklisting negatively affects the risk assessments of both potential and existing investors – the higher the risk of resulting sanctions, the riskier the investment. The secrecy jurisdictions anticipated that investors would withdraw in response to blacklisting and material economic loss would result. Havens responded to both imminent and actual blacklisting by seeking to prevent consequential damage.

Although the material cost to their financial sectors through compliance was also likely to be high, tax havens were particularly vulnerable to blacklisting because they were themselves affected by the structural change of the GFC. In the new international environment of the credit crunch, these states were already straining to retain scarce capital and maintain the confidence of their investors. In the absence of any other substantial business activity, tax havens were highly dependent on this foreign investment as the basis of their economies.

The previous experience of blacklisted tax havens had also illustrated that there could be long-term effects in the form of targeting by individual state governments and by the private sector. Some states had fought for years to have their names removed from copycat lists and even full compliance did not guarantee removal. These lists provided a basis for extra-scrutiny, compliance costs and outright boycotts of certain jurisdictions by investors. Once a state had been blacklisted, it could take years for the spotlight to

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³¹³ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008).

shift and for investors to begin to have confidence in its stability again. Hence the potential long-term effects of blacklisting would have provided additional weight to the case for compliance.

Sanctions

In contrast to the blacklisting of states in 2000, this time the threat of sanctions was much more concrete. No longer was it just the OECD that was talking about defensive measures – now the heads of state of all the world's largest economies were jointly threatening them. In addition, these governments had a highly visible, material cause to follow through with their threats – they had to balance their books in the face of deficits, economic decline and rising social costs. G20 leaders had been frank about the need to protect their public finances in this structural environment,³¹⁴ and there was more reason to believe them than ever before.

The proposed sanctions were afforded much wider publicity with their inclusion in the G20 London Summit Declaration³¹⁵ and their potentially very extensive nature was bound to have frightened both the governments of the havens and investors. Even in the absence of a blacklist, the announcement of these intended measures would likely have caused investors to pull out of known tax havens and their governments to pre-emptively comply.

The future of banking secrecy and compliance

It is not the case that tax haven abuse will stop in the near future. That is too much to hope for; and there are too many locations to tackle for this to be realistic. It does seem, however, that a tipping point has been reached. From their high point in 2002, when they appeared unassailable, tax havens have now reached a point of significant vulnerability, from which it appears they cannot, in the long term, recover.³¹⁶

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³¹⁴ G20. 'Global plan for recovery and reform: the Communiqué from the London Summit', 2 April 2009, online at <http://www.londonsummit.gov.uk/en/summit-aims/summit-communique/>, accessed 13/04/2010.

³¹⁵ G20. 'Declaration on Strengthening the Financial System – London Summit, 2 April 2009', online at <http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-fin-sysm>, accessed 13/04/2010, pp 4-5.

³¹⁶ Murphy, Richard. "Tax Justice and secrecy jurisdictions," *Soundings*, vol. 41 (Spring 2009), p 75.

In light of the unprecedented changes that have occurred in the past 24 months, it is pertinent to consider to what extent these changes represent a permanent departure from the former status quo. The OECD Secretary-General and leaders of the G20 have been quoted extensively in saying that banking secrecy for tax purposes is no more. A new global standard has been established and the vast majority of states have already implemented it. In addition a new institution, the Global Forum on Transparency and Exchange of Information, has been established to ensure that the EOI standard is adhered to.

Global Forum on Transparency and Exchange of Information

The Global Forum on Transparency and Exchange of Information was established by the OECD in September 2009 and this time it comes much closer in living up to its name. While its predecessor, the Global Forum on Taxation, had just 32 member-states and a very low profile, the new Global Forum boasts 95 members including all offshore jurisdictions in addition to the G20 and OECD members.³¹⁷ It has also gained the support of large developing economies such as Argentina, China, India, and South Africa.³¹⁸

The new Global Forum was created for the purpose of “ensuring rapid and effective global implementation” of the EOI standard by monitoring progress and conducting peer reviews.³¹⁹ It has a three-year mandate to peer review all members and any “other jurisdictions which may require special attention”, and to provide recommendations for

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³¹⁷ Organisation for Economic Co-operation and Development. ‘Promoting Transparency and Exchange of Information for Tax Purposes’, 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 3.

³¹⁸ *Ibid*, p 3.

³¹⁹ Organisation for Economic Co-operation and Development Council. ‘Decision of the Council Establishing the Global Forum on Transparency and Exchange of Information for Tax Purposes’, published 25 September 2009, p 2, available online at <http://www.oecd.org/dataoecd/29/57/43917665.pdf> accessed 13/04/2010.

reviewed jurisdictions.³²⁰ The first set of peer reviews were launched on 1 March 2010.³²¹ Global Forum Chair Mike Rawstron has stated that:

This is the most comprehensive, in-depth review on international tax cooperation ever... With these reviews we are putting international tax cooperation under a magnifying glass.³²²

OECD Secretary-General Angel Gurría has explained that the Global Forum is a new institution intended to provide states with assurance of the cooperation of their peers. It provides tax havens with “cross-security” so that in implementing costly changes to their banking secrecy regimes they can be sure that other states are not taking advantage. The Global Forum is intended to resolve the prisoner’s dilemma and implement a “level playing-field” for all states. The reason for this security is that states know they are being monitored and if they do not comply they will be subjected to sanctions.³²³

If Angel Gurría is to be believed, the Global Forum will be a model of neoliberal institutionalism. It has come into existence with the intended goal of overcoming a collective goods dilemma through coordination of individual state action. Yet neoliberals would also point out that states can only be expected to continue to cooperate for as long as it remains within their own interests to do so.³²⁴

It is uncertain whether it will remain in the interest of offshore financial centres to continue to participate in the Global Forum. It required enormous pressure to tip the balance of tax havens’ interests in favour of compliance given the significant financial costs that information exchange will bring. When these costs really start to bite, these states may rationally calculate that the greater cost is from continued compliance. In addition, as the world economy recovers from recession, the impetus on G20 states to maintain the same level of pressure on havens could be expected to slacken. Therefore

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³²⁰ Organisation for Economic Co-operation and Development. ‘Promoting Transparency and Exchange of Information for Tax Purposes’, 18 August 2010, online at <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 23/08/2010, p 3.

³²¹ *Ibid*, p 3.

³²² Anon. ‘Global Tax Forum Starts Peer Review of Countries’ *Business Standard*, 21 March 2010, online at *Business Standard* www.business-standard.com/india/printpage.php?autono=89056&tp=on accessed 13/04/2010.

³²³ Gurría, Angel. ‘Interview with Angel Gurría on Progress in the Fight Against Tax Evasion’, *OECD TV*, 02/09/2009, online at www.oecd.org/documentprint/0,3455,en_2649_37427_43601579_1_1_1_1,00.html, accessed 13/04/2010.

³²⁴ Goldstein, Joshua and Jon Pevehouse. *International Relations*, Brief 2006-2007 Edition, (Pearson Longman, 1997), p 81.

although the Global Forum will provide some assurance to states and will regulate the behaviour of its members in the short-term, its future is by no means certain.

Will the TIEAs have any practical effect?

Given that the new global standard for effective EOI has become the number of TIEAs (or DTAs containing EOI) that a state has signed, the effectiveness of these agreements will be very significant to the Global Forum's success. Given also that these agreements are so new, there is very little evidence on which to base an assessment. So far, very few requests have been made under such agreements. One of the most long-standing TIEAs is between the US and Jersey, having been in force since 2001, yet there has been just five pieces of data exchanged in this time.³²⁵ Commentators point to the fact that requesting governments need to know a significant amount about a suspect to be able to request the right evidence from a foreign government, and given that states are able to maintain secrecy except in the case of specific requests, tax authorities simply don't know what they don't know.³²⁶

There is thought to be a deterrent effect against tax evasion from the knowledge that information could be requested and provided to the home government, but it will most likely require some high-profile convictions to have any significant effect.³²⁷

There is a growing demand for automatic information exchange between governments whereby all data on foreign income would automatically be sent to the taxpayer's home jurisdiction.³²⁸ However, there is a high level of opposition to this proposal on the basis of the privacy laws of many states and the prohibitively high cost of administering such a scheme.

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³²⁵ Murphy, Richard. "G20: Goodbye to tax havens – almost", *The Guardian*, 02/04/2009, online at <http://www.guardian.co.uk/commentisfree/2009/apr/02/g20-tax-havens/print>, accessed 09/05/2010.

³²⁶ Nicodeme, Gaetan. 'On Recent Developments in Fighting Harmful Tax Practices', *Forum on International Tax Avoidance and Evasion, National Tax Journal*, Vol. LXII, No. 4, December 2009, p 767.

³²⁷ Murphy, Richard. "G20: Goodbye to tax havens – almost", *The Guardian*, 02/04/2009, online at <http://www.guardian.co.uk/commentisfree/2009/apr/02/g20-tax-havens/print>, accessed 09/05/2010.

³²⁸ *Ibid.*

The nature of TIEAs as one-sided agreements could also be expected to have an impact on their effectiveness. For obvious reasons, tax havens generally have no interest in requesting information from other states. Therefore these agreements create a situation whereby small states bear all the expense of gathering and providing requested information for no compensation.³²⁹ Beyond the pressure created by the Global Forum, its peer reviews and the threat of sanctions, tax havens have no motivation to take their TIEAs seriously.

Mock compliance

Andrew Walters has theorised that governments may have incentives to visibly signal compliance with international standards, when in fact their underlying behaviour is inconsistent with compliance. He has termed such behaviour as “mock compliance” and has applied his theory to the case study of East Asia’s adoption of financial standards following the 1997 Asian Financial Crisis.³³⁰ Walters argues that mock compliance is most likely to occur where:

1. Private sector compliance costs are relatively high; and
2. The costs of outright compliance costs are relatively high; and
3. Third party compliance monitoring costs are relatively high.³³¹

Walters’ framework for assessing the likelihood of mock compliance might indicate whether the new global EOI standard will be adhered to by tax havens.

With respect to private sector compliance costs, Walters explains that where the adoption of international standards lowers the profitability of domestic firms, incentives to diverge will be strong.³³² In the present case study, tax havens have few domestic firms. However, the core business of those that do exist is generally the provision of offshore financial services. To enable governments to provide effective EOI, these service providers will be required to establish records they may not have maintained

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³²⁹ Mistry, Percy S. and J.C. Sharman. *Considering the consequences: the development implications of initiatives on taxation, anti-money laundering and combating the financing of terrorism*, (Commonwealth Secretariat, London, 2008) p 177.

³³⁰ Walters, Andrew. *Governing Finance: East Asia’s Adoption of International Standards*, (Ithaca: Cornell University, 2008), p 32.

³³¹ *Ibid*, p 36.

³³² *Ibid*, pp 33-34.

previously, such as the full details of entity and account ownership. Although it is expected that such data will be rarely requested, full records will still be necessary in order to service these requests. Given that most tax havens operate on small profit margins, often only attracting revenue in the form of one-off licensing fees, the cost of compliance with EOI standards could be proportionately high. For small, developing states, these compliance costs are likely to be even more onerous.

Walters describes outright compliance costs as consisting of both the internal costs of implementing new systems in accordance with the new standards as well as external costs in the form of market responses to the potential revelation of damaging information.³³³ With respect to internal costs of EOI, tax havens will be required to establish systems that will enable them to meet the requests of foreign governments in sufficient detail. The cost to governments might not be as high as to the private sector because they would not need to hold data on all foreign entities and transactions – they would only need to be able to obtain this information from the private sector when requested. However, the government's role in regulating private sector compliance could be significant, especially for developing states with small public sectors and limited resources.

External compliance costs faced by tax havens could be expected to be highest, as this includes both the loss of revenue from licensing fees or levies and the loss to the wider economy due to capital flight. Without the guarantee of secrecy, tax avoiders will be less inclined to invest in tax havens as the tax savings they offer may be outweighed by the potential cost of being caught. Many tax havens have no other significant domestic business activity beyond their offshore services industry and lack the means to compete in any other industry. Therefore the external cost of EOI might be fatal for tax havens' economies.

The third factor in Walter's framework contends that mock compliance will only be viable if all parties believe that compliance will be difficult and expensive to measure and punish.³³⁴ If compliance is assessed solely on the basis of the number of TIEAs in force, it would be easy and inexpensive to measure. However, it would be unlikely to

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³³³ Walters, Andrew. *Governing Finance: East Asia's Adoption of International Standards*, (Ithaca: Cornell University, 2008), p 33.

³³⁴ *Ibid*, p 42.

provide a true assessment of the extent to which a state complies with EOI requests. The Global Forum has indicated that it will conduct comprehensive, in-depth reviews of all its members.³³⁵ This will, to a certain extent, rely on the full cooperation of the member-states. It is also likely to take a significant period of time to assess all 95 members. There is no existing standard for punishment other than having less than 12 TIEAs, so it is not clear how the Forum would address a lack of effective EOI found in spite of a state meeting the 12 TIEA requirement. Given the uncertainty of each of these key variables, states may come to the conclusion that the Global Forum peer reviews will not be effective. Once the first round of reviews has been completed, other states will be in a better position to form a view on the likely success of mock compliance.

The costs to tax havens in substantively complying with the EOI standard, with respect to their private sectors, governments and levels of foreign investment, will no doubt be high. Whether or not mock compliance is considered to be in a haven's interests will therefore depend on its assessment of the likelihood of being caught. If a haven is assessed by the Global Forum as failing to meet the EOI standard, this in itself may have a similar effect to blacklisting. The haven may be censured by market forces because investors have shown little tolerance for the risk of dealing with named jurisdictions. However, investors will only remain intolerant of this risk for as long as the threat of sanctions remains real.

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³³⁵ Anon. 'Global Tax Forum Starts Peer Review of Countries' *Business Standard*, 21 March 2010, online at *Business Standard* www.business-standard.com/india/printpage.php?autono=89056&tp=on accessed 13/04/2010.

CHAPTER 5: Conclusion

This thesis has contributed an alternative explanation to the existing constructivist account of the OECD campaign against tax havens. It has reinterpreted the OECD project through a neoliberal institutionalist lens and has offered a different take on each major historical development. It has brought the story up to date, describing the events of the past two years and explaining the underlying causes in a manner consistent with the neoliberal reinterpretation. It has finished by considering what this account might predict for the future of tax information exchange.

The constructivist explanation for the beginning of the OECD campaign in 1998 has been contested. The account of capital flight as a normative discourse overstates the extent to which states have been agents in the processes of globalisation. While governments were responsible for specific policy changes in relation to trade liberalisation, subsequent technological developments gave rise to an exponential rate of irreversible transformative change. This thesis has found that the OECD campaign began in the wake of the structural challenge of capital mobility. OECD countries were unable to compete with the tax advantages offered tax havens because they were restricted by their domestic political economies. They therefore had a collective interest in preventing tax havens from competing. The OECD provided a solution to the collective goods problem in the form of an institutional environment that regulated state behaviour to prevent cheating.

A neoliberal account has been provided for tax havens' compliance in response to blacklisting. The thesis has determined that tax havens responded to actual or anticipated consequences. Blacklisting caused investors to reassess the level of risk associated with dealing with named tax havens because of the threat of sanctions. Tax havens were coerced into compliance not because of damage to their reputations, but because blacklisting indicated imminent sanctions.

The scaling-back of the OECD campaign in 2001 was found to have been caused by a change in US interests. US interests were reassessed in light of both a change in economic circumstances and domestic political pressure from lobbyists. Although the

lobbyists used normative arguments, they displayed a willingness to employ whatever norms would further their goal. They targeted each audience with different norms that supported the pre-existing, objective interests of the group. The US government was convinced to change its tact not because of the normative rhetoric of the lobbyists, but because the lobbyists demonstrated that it would harm US business interests if havens were abolished. The OECD campaign also threatened US domestic policy of reducing tax rates. Without the support of the world's largest economy, the OECD would no longer have been able to regulate the prisoner's dilemma, therefore it was forced to adapt to maintain US participation.

Tax havens acted rationally and in accordance with their interests by lobbying through alternative institutions where their collective voice bore greater weight. Their success in achieving the support of particular OECD states was the result of their close proximity to those states. Australia and New Zealand have a vested interest in the stability and economic welfare of the Pacific and the economic damage to the region caused these states to determine that aspects of the OECD project went against their regional interests. The close ties between Canada and the Caribbean, particularly with respect to economic development, leads to a similar conclusion. The change in these states' interests contributed to the OECD's decision to adjust its project in line with new collective interests.

The change to OECD rhetoric at this time has been explained in line with Nye's soft power thesis. Because institutions employ whichever norms are most useful in achieving the goals of its members, their rhetoric will shift in accordance with changes in collective interests, or changes in the interests of its dominant members.

The OECD project stagnated between 2001 and 2008 because the collective interests of members did not dictate that secrecy be vigorously pursued. Dominant OECD members were not prepared to challenge the strong opposition of Switzerland and the other leading secrecy jurisdictions because there was no imperative to do so. Consequently, there was no real threat of sanctions and so tax havens had no motivation to sign on to TIEAs. Despite the fact that a new OECD standard of information exchange was established during this time, the associated norms of transparency were not sufficient to change tax haven behaviour because their interests clearly favoured banking secrecy.

The OECD's sudden success in 2008-09 has clearly illustrated that transformative change is only possible when the interests of powerful states align. The structural effect of the GFC impacted the domestic political economies of G20 leaders providing them each with a fiscal imperative as well as a political imperative to be seen to do something. This rapid alignment of interests explains why G20 states applied such intense pressure to secrecy jurisdictions. The havens responded once again, due to the anticipated consequences of investors responding to blacklisting as an indicator of imminent sanctions. The fragility of tax haven economies meant that a loss of investor confidence, with or without accompanying sanctions, would have a severe impact on their interests. They were therefore left with no choice but to comply.

The neoliberal perspective has provided insight into the likely future of tax information exchange. The new Global Forum with its much broader membership provides greater assurance to states that their peers will not cheat. However, this will only be true for as long as collective interests are maintained. If the pressure on tax havens reduces as the world economy recovers, the cost of their compliance may outweigh the benefits. TIEAs might not be an effective assessment of true compliance with the EOI standard; therefore mock compliance can be expected if the chances of sanctions become remote.

This case study has revealed that transformative change happens in accordance with state interests rather than with identities and norms. International institutions fundamentally exist to advance the interests of their member-states and will adapt their goals to reflect changing collective interests. States that are coerced to change their behaviour can be expected to comply only to the extent required to avoid sanctions.

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