

# PROSPERITAS

A Policy Analysis from the Center for Freedom and Prosperity Foundation

June 2004

Vol. IV, Issue I

## The OECD's Dishonest Campaign Against Tax Competition: A Regress Report<sup>1</sup>

*The Organization for Economic Cooperation and Development has a campaign against tax competition – largely targeting so-called tax havens. After being threatened with financial protectionism by the OECD, many low-tax jurisdictions made "commitments" to weaken their attractive tax and privacy laws. But these nations and territories also stated that their commitments would be valid only if all OECD nations agreed to the same flawed rules. Fortunately, this "level playing field" requirement does not exist. In its original form, the European Union's Savings Tax Directive might have satisfied that condition, but the EU failed to convince nations like Switzerland, Luxembourg, and the United States to share confidential information about nonresident investors with foreign tax authorities. Nonetheless, the OECD is still using threats and extortion in an effort to bully low-tax jurisdictions into helping high-tax nations enforce their bad tax laws. In so doing, OECD officials are acting in a dishonorable fashion. They failed to live up to their end of the bargain, but they still want low-tax jurisdictions to surrender their fiscal sovereignty and compromise their economic futures. Moreover, the OECD also is proposing discriminatory sanctions against blacklisted jurisdictions, a policy that is completely inconsistent with previous commitments to impose uniform sanctions on all nations and territories with market-based tax laws. The OECD's anti-tax competition project has always been fundamentally flawed, but it has degenerated into a sordid and discriminatory campaign to inhibit the development of poor nations to serve the narrow interests of rich countries.*

**By Daniel J. Mitchell**

The Organization for Economic Cooperation and Development (OECD) is persecuting low-tax jurisdictions as part of its "harmful tax competition" initiative. The Paris-based bureaucracy, comprised mostly of European nations, believes that it is unfair when jobs and investment migrate from high-tax economies to low-tax economies. The OECD wants to hinder this process by giving high-tax governments the right to tax economic activity that takes place outside their borders. Low-tax jurisdictions specifically would be required to help high-tax nations track – and tax – flight capital.

In 2000, the OECD put dozens of low-tax jurisdictions on a blacklist and threatened them with financial protectionism if they did not agree to this scheme.<sup>2</sup>

---

<sup>1</sup> This paper updates a *Prosperitas* published last October. That paper, entitled "The Level Playing Field: Misguided and Non-Existent," can be found at <http://www.freedomandprosperity.org/Papers/lpf/lpf.shtml>.

Economists and other public finance experts vigorously condemned the OECD scheme because it promoted extra-territorial taxation and the double-taxation of saving and investment – policies that are completely inconsistent with good tax policy.<sup>3</sup>

Nonetheless, many low-tax jurisdictions were so concerned about the threat of protectionist barriers that they sent so-called commitment letters to the OECD. But since these jurisdictions also understood that unconditional surrender would condemn them to economic decline, they clearly stated that they would only emasculate their attractive tax and privacy laws if all OECD member nations agreed to abide by the same misguided rules. The OECD simultaneously committed to this “level playing field” principle and also promised that financial protectionism would be imposed on any jurisdiction – even an OECD country – that refused to eliminate its “tax haven” policies.

The “level playing field” condition is important because several of the countries that belong to the OECD – such as the United States, Switzerland, Luxembourg, and the United Kingdom – also are “tax havens.” Like the jurisdictions on the OECD blacklist, these OECD nations are sanctuaries for flight capital. People from around the world can invest their money in places like London, New York, Zurich, or Luxembourg and protect themselves from all sorts of dangers in their home countries – including ethnic persecution, crime, political instability, religious discrimination, corruption, expropriation, and fiscal oppression.

Blacklisted jurisdictions, many of them relatively small and powerless, properly argued that they should not have to acquiesce to the OECD’s anti-growth policies if bigger and wealthier nations were not similarly disadvantaged. This created a stalemate, but the OECD hoped that a European Union proposal known as the “savings tax directive” would create something roughly akin to a level playing field by weakening financial privacy laws in OECD nations. Fortunately, this proposal has been emasculated. The United States refused to participate, and Luxembourg and Switzerland have chosen to retain their financial privacy laws.<sup>4</sup>

Even though the OECD failed to comply with its side of the bargain, the Paris-based bureaucracy is still pressuring low-tax nations and territories. In a remarkable display of bad faith, the OECD wants these market-oriented jurisdictions to force their

---

<sup>2</sup> Organization for Economic Cooperation and Development, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*, June, 2000, available at [www.oecd.org/daf/fa/harm\\_tax/Report\\_En.pdf](http://www.oecd.org/daf/fa/harm_tax/Report_En.pdf).

<sup>3</sup> Eric Engen and Kevin Hassett, "Does the Corporate Tax Have a Future?" Tax Notes 30th Anniversary Issue, Spring 2003. Available at [http://www.aei.org/docLib/20021222\\_raengehass0212.pdf](http://www.aei.org/docLib/20021222_raengehass0212.pdf).

<sup>4</sup> Lisbeth Kirk, “Breakthrough in talks with Switzerland,” EU Observer, May 14, 2002, available at <http://euobserver.com/?aid=16040&rk=1>. John Rega, “Switzerland to Miss Jan 1 Deadline for EU Tax Plan,” Bloomberg.com, May 19, 2004, available at <http://quote.bloomberg.com/apps/news?pid=10000085&sid=afenliQZiiic&refer=europe>. Anna McLauchlin, “Further setbacks for EU savings tax law,” EUpolitix.com, May 26, 2004, available at <http://www.eupolitix.com/EN/News/200405/89bc0b85-c9e5-4412-a146-7edec7c60f8b.htm>. Ulrika Tomas, “EU warns savings tax directive could be delayed,” Tax-news.com, May 28, 2004, available at <http://www.tax-news.com/asp/story/story.asp?storyname=16160>.

domestic financial institutions to share confidential financial information with tax authorities in other countries – even though OECD nations are allowed to preserve their fiscal sovereignty and thus would not have to abide by these rules. Equally galling, the OECD is also reneging on its commitment that there be uniform consequences for nations and territories that refuse to comply. As such, jurisdictions on the blacklist could be subject to financial protectionism while OECD nations with similar policies would escape any sanction.

This paper is divided into three sections. The first part is a reminder that the OECD initiative is fundamentally misguided. The Paris-based bureaucracy seeks to undermine tax competition in order to prop up the destructive policies of high-tax welfare states. This section explains why tax harmonization is the wrong approach – something the OECD would understand if it listened to its own economists. The second part concisely demonstrates that the “level playing field” does not exist. It will show that several OECD nations have policies that qualify them as “tax havens” according to the Paris-based bureaucracy’s own criteria.<sup>5</sup> Most important, it dissects the OECD’s most recent “Sub-Group paper” – published on May 24 – and shows that the OECD has violated its commitment to abide by the “level playing field” requirement. Last but not least, the third part of the paper shows that the OECD is reneging on the promise to impose “uniform consequences” on nations and territories. The May 24<sup>th</sup> Sub-Group paper is extensively quoted to demonstrate the OECD’s deceitful actions.<sup>6</sup>

### ***Part I: The OECD is Seeking the Wrong Level Playing Field***

The economics profession does not have many inalienable truths, but one of them is that competition is good. Competition leads to the efficient allocation of resources and maximizes societal wealth. Rivalry among enterprises generates innovation and punishes privilege. In short, competition is the process that improves living standards and quality of life. Another inalienable truth is that monopoly is bad. Monopoly leads to waste and inefficiency. It breeds favoritism and stifles initiative.

These principles of competition and monopoly apply to business and they apply to government. In both cases, competition yields better results since providers in the public and private sector must attend to the interests and desires of the general public. Monopoly, by contrast, breeds sloth and a lowest-common denominator approach to decision-making.<sup>7</sup>

For all intents and purposes, the OECD’s anti-tax competition initiative seeks to create an “OPEC for politicians.” A handful of bureaucrats in Paris, guided by a narrow “tax enforcement über alles” mindset, want to insulate governments from the discipline

---

<sup>5</sup> The complete definition of “tax haven,” along with the OECD’s tortured explanation of why tax competition is bad, can be found at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

<sup>6</sup> Entitled, “Sub-Group on Level Playing Field Issues: Proposals for Achieving a Global Level Playing Field,” this paper is available at [http://www.freedomandprosperity.org/oecd-global\\_forum\\_june\\_2004.pdf](http://www.freedomandprosperity.org/oecd-global_forum_june_2004.pdf).

<sup>7</sup> John O. McGinnis, “The Political Economy of Global Multilateralism,” *Chicago Journal of International Law*, Vol. 1, No. 2, Fall 2000. Available at <http://cjl.uchicago.edu/contents/v1n2/>.

of market forces. This would delay the implementation of desperately needed economic reforms and thus cause lower living standards.<sup>8</sup>

### **Pro-growth tax policy**

More specifically, the OECD vision is completely contrary to good tax policy. There is a growing consensus that low-rate, consumption-based, territorial tax systems maximize economic growth.<sup>9</sup> The OECD's agenda, by contrast, is designed to help certain countries maintain high tax rates and impose double-taxation on saving and investment - even when economic activity occurs in other jurisdictions. One of the desirable features of tax competition is that nations are induced to lower tax rates and reduce the discriminatory tax treatment of income that is saved and invested. Indeed, scholarly papers have shown that tax competition is having this beneficial effect. Of course, this is precisely why high-tax nations are seeking to undermine this liberalizing process.

### **Information exchange is tax harmonization**

Tax harmonization exists when taxpayers face similar or identical tax rates no matter where they work, save, shop, or invest. Harmonized tax rates eliminate fiscal competition, much as a price-fixing agreement among gas stations destroys competition for gasoline. Tax harmonization can be achieved two different ways:

\* Explicit tax harmonization occurs when nations agree to set minimum tax rates or decide to tax at the same rate. The European Union, for instance, requires that member nations impose a value-added tax (VAT) of at least 15 percent. The EU also has harmonized tax rates for fuel, alcohol, and tobacco, and there are ongoing efforts to harmonize the taxation of personal and corporate income tax rates. Under this direct form of tax harmonization, taxpayers are unable to benefit from better tax policy in other nations, and governments are insulated from market discipline.

\* Implicit harmonization occurs when governments tax the income their citizens earn in other jurisdictions. This policy of "worldwide taxation" requires governments to collect financial information on nonresident investors and to share that information with tax collectors from foreign governments. This "information exchange" system tends to be a one-way street since jobs and capital generally flow from high-tax nations to low-tax nations. Under this indirect form of tax harmonization, just as under the direct form outlined above, taxpayers are unable to benefit from better tax policy in other nations, and governments are insulated from market discipline.

---

<sup>8</sup> Daniel Mitchell, "The Economics of Tax Competition: Harmonization vs. Liberalization," in Marc A. Miles, Ph.D., Edwin J. Feulner, Jr., Mary Anastasia O'Grady, and Ana I. Eiras, ed., *Index of Economic Freedom*, The Heritage Foundation, 2004, available at <http://www.heritage.org/research/features/index/>.

<sup>9</sup> Daniel J. Mitchell, "Jobs, Growth, Freedom, and Fairness: Why America Needs a Flat Tax," Heritage Foundation *Background* No. 1035, May 25, 1995, and "Flat Tax or Sales Tax: A Win-Win Choice for America," Heritage Foundation *Background* No. 1134, August 17, 1997.

Both forms of tax harmonization have similarly counterproductive economic consequences. In each case, tax competition is emasculated, encouraging higher tax rates. This hinders the efficient allocation of capital and labor, slowing overall economic performance.

Several Nobel Prize winners have commented on tax competition. James Buchanan points out that "...tax competition ...is an objective to be sought in its own right."<sup>10</sup> Milton Friedman writes, "Competition among national governments in the public services they provide and in the taxes they impose is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices at which they offer them."<sup>11</sup> And Gary Becker observed that "...competition among nations tends to produce a race to the top rather than to the bottom by limiting the ability of powerful and voracious groups and politicians in each nation to impose their will at the expense of the interests of the vast majority of their populations."<sup>12</sup>

### **The OECD should listen to its own economists**

Ironically, the professional economists at the OECD agree with the academic economists. Recognizing that tax competition is a liberalizing force in the world economy, they have written that, "[T]he ability to choose the location of economic activity offsets shortcomings in government budgeting processes, limiting a tendency to spend and tax excessively." The OECD economists do not try to scapegoat so-called tax havens. Instead, they acknowledge that the real problem is bad tax policy, writing that, "[I]llegal tax evasion can be contained by better enforcement of tax codes. But the root of the problem appears in many cases to be high tax rates."

OECD economists understand the relationship between tax policy and economic performance. They have estimated, "that economies grow one-half of 1 percent (0.5 percent) faster for every 10-percentage-point reduction in marginal tax rates." They also note that, "the best way to improve economic performance would be to replace current wage-income and capital-income taxes by a general tax on consumption." Indeed, OECD economists just called for lower tax rates in Eastern Europe and cited Ireland as an example of how a nation can use market-based policies to dramatically boost national living standards.

Unfortunately, the division of the OECD responsible for the anti-tax competition effort – the Committee on Fiscal Affairs – is insulated from economic analysis or peer review.<sup>13</sup> Comprised primarily of lawyers and guided by representatives of tax agencies from member governments, the CFA does not consider the broader impact of its work.

---

<sup>10</sup> Geoffrey Brennan and James Buchanan (1980), *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press: Cambridge).

<sup>11</sup> Letter to Center for Freedom and Prosperity, 2001.

<sup>12</sup> Gary Becker, "What's Wrong with a Centralized Europe? Plenty," *Business Week*, June 29, 1998.

<sup>13</sup> Daniel J. Mitchell, "Paris, Taxes," *Techcentralstation.com*, May 19, 2004, available at <http://www.techcentralstation.com/051904A.html>.

Economic growth, national sovereignty, constitutional freedoms, civil liberties, and free trade are completely irrelevant to its deliberations.

To its credit, the CFA is sometimes honest about its intentions. Beginning with its original 1998 report, the CFA has explicitly stated that it wants to hinder tax competition to prop up high-tax welfare states.<sup>14</sup> Statements from the OECD include:

- Low-tax policies "unfairly erode the tax bases of other countries and distort the location of capital and services."
- "[T]ax should not be the dominant factor in making capital allocation decisions."
- "These actions induce potential distortions in the patterns of trade and investment and reduce global welfare."
- Tax competition is "re-shaping the desired level and mix of taxes and public spending."
- Tax competition "may hamper the application of progressive tax rates and the achievement of redistributive goals."
- "Harmful tax practices may exist when regimes are tailored to erode the tax base of other countries. This can occur when tax regimes attract investment or savings originating elsewhere."

The OECD now tries to mask some of this statist ideology, and some documents even include insincere statements in favor of very limited forms of tax competition. It is worth noting, however, that section I.4 of the Sub-Group paper states that the purpose of their anti-tax competition effort is, "...to prevent the migration of business to economies that do not engage in transparency and effective exchange of information for tax purposes." The CFA leopard at the OECD has not changed its spots.

It is also worth mentioning that the OECD is not being truthful when it claims that its anti-tax competition project does not seek to interfere with the sovereign right of jurisdictions to determine their own tax rates. The very first criterion the OECD uses to define a "tax haven" is the presence of "zero or low tax rates." The OECD also admits in the May 24<sup>th</sup> Sub-Group paper that its member nations frequently discriminate against nations and territories that have tax rates below specified levels. Indeed, Annex 3 of the Sub-Group paper contains 12 pages of information on discriminatory policies by OECD member nations against low-tax jurisdictions – many of which exist expressly because those jurisdictions have tax rates that are considered too low.<sup>15</sup>

---

<sup>14</sup> For more information on the OECD project, see Daniel J. Mitchell, "An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy," Heritage Foundation *Background* No. 1395, September 18, 2000, available at <http://www.heritage.org/Research/Taxes/BG1395.cfm>.

<sup>15</sup> These rules generally involve the treatment of company subsidiaries operating in low-tax jurisdictions.

### **Choosing the correct level playing field**

The next part of this paper discusses whether a “level playing field” exists -- but this ignores the more important question – which is determining the correct level playing field. Should the playing field be level because all nations agree to implement bad tax policy that undermines competition and economic growth? Or should the playing field be level because all nations agree to respect each other’s sovereign right to control the taxation of income earned inside national borders?

The OECD is pushing the first option – an approach that is inconsistent with good tax policy and individual freedom. The rest of this paper will focus on whether this first option is being fairly applied. The paper will explain why the OECD’s “level playing field” does not exist and why the OECD is failing to abide by its commitment to impose uniform sanctions on “non-cooperative” jurisdictions.

The OECD’s discriminatory and deceitful actions should be condemned, but it is important to realize that the complete disintegration of the “harmful tax competition” project is the only desirable outcome. Yes, a level playing field would exist if nations such as Luxembourg, Switzerland, the United States, and the United Kingdom agreed to abide by the same rules that the OECD is trying to impose on the rest of the world, but this simply magnifies the adverse impact of the “harmful tax competition” project on the global economy. Victory will only be achieved if the OECD’s scheme is abandoned and all jurisdictions retain the sovereign right to control their own tax policy.

### ***Part II: The Non-Existent Level Playing Field***

The OECD uses several criteria to define a “tax haven.” First on the list is the presence of low - or zero - tax rates.<sup>16</sup> There are three other criteria, but the OECD is most fixated on financial privacy laws. The Paris-based bureaucracy is opposed to these laws since privacy protections make it harder for high-tax nations to track flight capital. According to the OECD, "bank secrecy" hinders the ability of high-tax nations to enforce their punitive tax laws.

The OECD wants to emasculate privacy laws by requiring low-tax jurisdictions to collect confidential data on nonresident investors and then share that information with foreign tax authorities. The OECD calls the policy “information exchange,” even though the flow of data would be a one-way street. It is no exaggeration to state that the OECD’s main short-term goal is the emasculation of privacy laws in low-tax jurisdictions. Three of the five bullet points in the summary of the Sub-Group paper focus on “information exchange,” and Annex 4 of the Sub-Group paper contains a 20 page draft questionnaire designed to determine all of the privacy protections that exist in low-tax jurisdictions.

Not surprisingly, low-tax jurisdictions do not appreciate the OECD’s interference. But they have been placed between the proverbial "rock and a hard place." These jurisdictions understand that they would suffer if OECD nations subjected them to fiscal

---

<sup>16</sup> <http://www.oecd.org/dataoecd/33/0/1904176.pdf>

protectionism, but they also recognize that acquiescing to the Paris-based bureaucracy will cause severe economic damage.

The desire to escape this no-win situation eventually led low-tax jurisdictions to unofficially embrace a "level playing field" strategy. These persecuted jurisdictions correctly noted that many OECD member nations also have "tax haven" policies, and they stated that they would not obey OECD demands unless all other jurisdictions agreed to abide by the same misguided rules.

### **The real tax havens**

The level playing field requirement creates a bit of a problem for the OECD since the world's biggest tax havens are all members of the Paris-based bureaucracy.<sup>17</sup> Indeed, "onshore" jurisdictions that belong to the OECD may control as much as 80 percent of the world's offshore business.<sup>18</sup> The United States, for instance, has more than \$5 trillion of passive investment from overseas and much of that money benefits from very attractive tax and privacy laws. The United Kingdom also has similar provisions to attract flight capital from around the world.

Switzerland and Luxembourg are even better sanctuaries for global investors. Both nations have stronger privacy laws than the US and the UK, and these policies have helped attract trillions of dollars of offshore business. Other OECD nations with "tax haven" policies include Austria and Belgium, both of which have bank secrecy laws protecting nonresident investors. Last but not least, there are some non-OECD jurisdictions such as Hong Kong, Singapore, and Malaysia that actively compete for "offshore" business.

Yet none of these jurisdictions were placed on the OECD's blacklist. Needless to say, the nations and territories that were put on the blacklist vociferously complained about the OECD's discriminatory approach. Equally important, they noted that non-blacklisted "tax havens" would be the biggest beneficiaries if they surrendered to the OECD.

### **The EU savings tax cartel does not create a level playing field**

The OECD had hoped that this problem would be solved by a European Union tax harmonization scheme known as the savings tax directive. In its original form, the directive would have required all 15 EU nations – and selected non-EU nations such as the United States and Switzerland – to collect confidential financial information about nonresident investors and share that data with foreign tax authorities. While this proposed cartel would not have completely satisfied the level playing field requirement, it would

---

<sup>17</sup> See Marshall Langer, "Harmful Tax Competition: Who are the real tax havens?," Tax Notes International, December 18, 2000. Available at <http://www.freedomandprosperity.org/Articles/tni12-18-00.pdf>.

<sup>18</sup> Richard J. Hay, "A Level Playing Field for Tax Information Exchange?," Review, Tax Planning International, September 2003.

have been a significant step. Blacklisted jurisdictions would have faced enormous pressure to acquiesce.

Fortunately, the original EU directive was not implemented. In 2002, two senior level Bush Administration officials announced that the American government was opposed to the savings tax directive.<sup>19</sup> The Chairman of the Council of Economic Advisers stated that, "We are not for the European savings initiative,"<sup>20</sup> and the Chairman of the National Economic Council remarked that, "The Administration does not support the EU savings directive. There is zero interest in it."<sup>21</sup>

In an effort to keep the proposal alive, the EU chose to quietly ignore the US position. But this ploy didn't work because Switzerland refused to compromise its long-standing commitment to financial privacy. And since Switzerland refused to surrender, EU nations such as Luxembourg, Austria, and Belgium also refused to dismantle their privacy laws. Indeed, the EU directive<sup>22</sup> unambiguously protects a number of jurisdictions from information sharing. Clause 17 of the preface, for instance, states, "...Austria, Belgium and Luxembourg cannot apply the automatic exchange of information..." Clause 18 states, "In order to avoid differences in treatment, Austria, Belgium and Luxembourg should not be obliged to apply automatic exchange of information..." The Directive also acknowledges that the non-EU nations control the fate of the proposal. According to Clause 24:

"So long as the United States of America, Switzerland, Andorra, Liechtenstein, Monaco, San Marino and the relevant dependent or associated territories of the Member States do not all apply measures equivalent to, or the same as, those provided by this Directive, capital flight towards these countries and territories could imperil the attainment of its objectives. Therefore, it is necessary for the Directive to apply from the same date as that on which all these countries and territories apply such measures."

While the ultimate fate of the EU savings tax directive is unknown, it clearly will not require "information exchange" by the "tax havens" that belong to the OECD. There is no level playing field today and there will be no level playing field in the future.

### **The OECD reneges**

In Section I.3 of the May 24<sup>th</sup> Sub-Group paper, the OECD admits that the level playing field is supposed to apply to "all countries, large and small, OECD and non-

---

<sup>19</sup> <http://www.freedomandprosperity.org/press/p10-29-02/p10-29-02.shtml>.

<sup>20</sup> Edward Alden, Francesco Guererra, and Amity Shlaes, "US opposes sharing information on savings taxation: White House advisers come out against European request for data on foreign-held accounts," Financial Times, September 26, 2002.

<sup>21</sup> International Money Management, "EU threatens Swiss again over information exchange," November 8, 2002.

<sup>22</sup> The text of the directive can be found at: [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=32003L0048&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=32003L0048&model=guichett).

OECD.” It admits in Section I.4 that “All countries...should meet such standards.” And the OECD admits in Section II.7 of the paper that “Central to the concept of a global level playing field is that it is fundamentally about fairness. A convergence of existing practices of information exchange to meet high standards would achieve a global level playing field.”

Yet these are empty words. There is no mechanism requiring OECD member nations to change their laws. The battle over the EU savings tax directive unambiguously demonstrates that several OECD nations have no intention of compromising their appealing privacy laws. Moreover, there is no procedure to force jurisdictions like Hong Kong and Singapore into the cartel. The OECD claims in Section III.C.ii.24 that “no country be permitted to profit from being neither a party to the principles nor a part of the process,” but the OECD’s only plan to make sure this happens is to “discuss how to engage all relevant countries in the process.”

If the OECD had any honor, it would acknowledge that the level playing field does not exist and it would abandon the project. At the very least, it would cease harassing low-tax jurisdictions and devote all of its efforts to a campaign to convince its own member nations to implement the ill-advised policies that the OECD wants blacklisted jurisdictions to adopt.

Not surprisingly, the OECD has not chosen to behave in a decent fashion. Instead, it is violating its own commitment and it is still trying to compel low-tax jurisdictions to become vassal tax collectors. The bureaucrats in Paris are not stupid, however, and they do not admit that this is their strategy. Instead, they note in Section II.9 that “It would be ideal if all significant financial centres would agree to and implement high standards of information exchange at the same time and in the same manner. However, because information exchange generally is implemented through bilateral agreements there will inevitably be some timing differences in implementation.”

Translated from bureaucratese into English, this means that low-tax jurisdictions are expected to repeal their financial privacy protections while OECD member nations with similar laws are permitted to protect their own interests.

Section III of the Sub-Group paper is entitled, “A process for achieving a level playing field,” but it offers no means of enlisting the cooperation of non-blacklisted jurisdictions. It does propose in Section III.C.i.18.a that “information would be compiled on all OECD countries, all non-OECD Participating Partners, and all significant financial centres that are outside of these two groups.” Such information theoretically would come from the questionnaire in Annex 4 of the Sub-Group paper, but the OECD offers no method of ensuring that jurisdictions would answer the questions or that they would agree to change their laws.

Section III.C.ii.23 says that this information – or lack thereof – would be included in a report, and Section III.C.ii.24 says that the report would provide “public recognition” of jurisdictions that have policies approved by the OECD. It is unclear whether the

bureaucrats at the OECD are naïve enough to believe that this “public recognition” would have any impact on any jurisdiction’s decision-making process.

In the “Concluding Remarks” of the Sub-Group paper, the OECD says it is vital that “all significant financial centres” participate to ensure “that financial centres that meet such standards are not unduly disadvantaged.” This is rubbish. The level playing field does not exist and there is no possibility that it will exist in the next ten years. The OECD’s continued persecution of low-tax jurisdictions is disgraceful.

### **The OECD’s Deceptive Tactics**

From its very inception, the OECD’s anti-tax competition campaign has been marked by deceit. Their unethical behavior falls into three broad (and inter-related) categories:

**1. Deliberate misstatements.** Throughout the entire process, the OECD has tried to mislead low-tax jurisdictions. The Paris-based bureaucrats have mischaracterized the positions of some jurisdictions while trying to strong-arm other jurisdictions. They refer to their initiative as an “inclusive process” even though low-tax jurisdictions are participating under duress. They talk about “mutual benefits through bilateral implementation” even though jurisdictions with good tax law do not try to tax income outside their borders – and thus receive no benefit from the OECD’s one-way information exchange schemes. Worst of all, the OECD promises “a consistent and rigorous approach to any failure to implement” even though the Sub-Group paper explicitly acknowledges that OECD member nations have no obligation to sanction other OECD nations.

**2. Reneging on agreements.** The OECD misuses its control of the drafting process to produce documents that do not accurately reflect discussions with representatives of low-tax jurisdictions. To a large extent, the entire May 24 Sub-Group paper falls into this category since the OECD is trying to sidestep its previous commitments for both a level playing field and uniform consequences. Indeed, the OECD’s own website ([www.oecd.org/document/35/0,2340,en\\_2649\\_34897\\_15091043\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/35/0,2340,en_2649_34897_15091043_1_1_1_1,00.html)) acknowledges that there is “no consensus” among OECD nations to permit foreign governments access to bank information – and no consequences for the OECD nations that blocked the consensus.

**3. Creating agreements where none exist.** The OECD is very clever about taking one of their talking points from one meeting and characterizing it as a consensus viewpoint in the documents prepared for the next meeting. A good example is the language in Section II.6 of the May 24 Sub-Group paper: The OECD takes boilerplate language generated by the Ottawa Global Forum and tries to characterize that as a sweeping endorsement of the OECD’s “Model Agreement” on information sharing. Numerous low-tax jurisdictions also complain that the OECD draft documents deliberately distort what is actually said in meetings.

While some OECD tactics deserve condemnation, others are perversely clever. The bureaucrats are particularly skilled at using language to drive the debate in a certain direction. The Sub-Group paper refers to low-tax jurisdictions as “Participating Partners” in an absurd effort to create a sense that everyone should be equally anxious to undermine tax competition. The OECD endlessly refers to “high standards” of information exchange in a silly effort to put bad tax policy in a nice-sounding package. The OECD even talks about “public recognition” for jurisdictions that surrender their fiscal sovereignty, as if a pat on the head from the Paris bureaucracy could somehow compensate for suicidal actions.

### ***Part III: The Fantasy of Uniform Consequences***

In addition to promising a level playing field if low-tax jurisdictions made commitments, the OECD also promised that financial protectionism would be imposed equally on all jurisdictions that chose to retain “tax haven” policies. The May 24<sup>th</sup> Sub-Group paper reiterates this commitment. The Summary of the paper acknowledges, “The importance of uniform consequences for failure to implement the standards of transparency and effective exchange of information in connection with the evaluation of the achievement of the global level playing field.”

Despite this strong statement, the fine print of the Sub-Group paper completely reneges on that promise. Buried in the annexes, the OECD clearly states that its member nations are under no obligation to impose uniform consequences. Here are a few of the incriminating passages:

- Annex 3.34 explicitly states that “The 2000 Report also acknowledged, however, that countries retain the right to apply, or not apply, defensive measures unilaterally to any jurisdiction.
- Annex 5.29.c states that “...each participant retains the sovereign right to apply or not apply any defensive measures as appropriate, either within or outside a framework of co-ordinated defensive measures.”
- Annex 5.29.d states that “Each participant may choose to implement and enforce the defensive measures...”
- Annex 5.29.e states that “There are different forms of harmful tax practices and different defensive measures may be appropriate in different circumstances.”

#### **A new attack on low-tax jurisdictions**

The OECD’s dishonesty is appalling, but it gets worse. Also buried in the annexes is language proposing specific additional methods that can be used to apply discriminatory sanctions against blacklisted jurisdictions. For instance:

- Annex 5.31 outlines a special procedure by which “any OECD member country” can propose sanctions against a non-OECD jurisdiction, and that “OECD member countries will then discuss the issue.” Interestingly, even this proposal acknowledges “...the sovereign right of member countries to apply or not to apply defensive measures...”
- Annex 5.33 welcomes “Non-OECD economies that wish to associate themselves with the work on harmful tax practices” and says that those countries “may also want to co-ordinate their actions with those of OECD member countries.”

In other words, the OECD not only has no intention of applying “uniform consequences,” but it also envisions even stronger efforts to harass and discriminate against blacklisted low-tax jurisdictions.

### ***Conclusion***

The OECD made two commitments to low-tax jurisdictions. First, it promised that it would achieve a “level playing field.” This promise has been broken. Second, it committed to the even-handed application of sanctions against nations and territories with free market tax policy. This “uniform consequences” promise also has been broken. Low tax jurisdictions should be outraged by the OECD’s deceitful actions.

Low-tax jurisdictions now have a compelling reason to resist OECD pressure due to the absence of a “level playing field” and the abandonment of “uniform consequences.” But the debate should not focus solely on these technical issues. Low-tax regimes must aggressively defend tax competition as a liberalizing force in the world economy. For too long, low-tax jurisdictions have been defensive, acting as if there was something wrong with pro-market tax and privacy laws. The time has come to point the finger of blame at the real culprits - the uncompetitive European welfare states whose bad tax laws have hobbled economic growth and caused a flight of jobs and capital. It is nations like France and Germany that are harming the world economy.

Advocates of tax harmonization policies such as information exchange have no moral legitimacy. They are pursuing policies that will diminish global economic growth and reduce individual opportunity. Developing nations would suffer most, since they would be effectively prohibited from using good tax law to attract economic development - much as Western nations experienced their growth spurts during the 1800s prior to the enactment of income taxes.

Tax competition has helped lower tax rates around the world. Tax competition has helped reduce discriminatory taxes on income that is saved and invested. And since even OECD economists have widely written that lower tax rates and proper treatment of capital are important contributors to economic growth, the time has come to seize the moral high ground.

Daniel J. Mitchell is the McKenna Senior Fellow in Political Economy at The Heritage Foundation.

---

*The Center for Freedom and Prosperity Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported, and receives no funds from any government at any level, nor does it perform any government or other contract work. Nothing written here is to be construed as necessarily reflecting the views of the Center for Freedom and Prosperity Foundation or as an attempt to aid or hinder the passage of any bill before Congress.*

*Center for Freedom and Prosperity Foundation, the research and educational affiliate of the Center for Freedom and Prosperity (CFP), can be reached by calling 202-285-0244 or visiting our web site at [www.freedomandprosperity.org](http://www.freedomandprosperity.org).*

**Additional Issues of Prosperitas:**

10) October 2003, *Prosperitas Volume III, Issue IV*, The Level Playing Field: Misguided and Non-Existent, by Dan Mitchell, Web page link below:

<http://www.freedomandprosperity.org/Papers/lpf/lpf.shtml>

9) July 2003, *Prosperitas Volume III, Issue III*, “How the IRS Interest-Reporting Regulation Will Undermine the Fight Against Dirty Money,” by Daniel J. Mitchell, Web page link below:

<http://www.freedomandprosperity.org/Papers/irsreg-dm/irsreg-dm.shtml>

8) April 2003, *Prosperitas Volume III, Issue II*, “Markets, Morality, and Corporate Governance: A Look Behind the Scandals,” by Daniel J. Mitchell, Web page link below:

<http://www.freedomandprosperity.org/Papers/corpgov/corpgov.shtml>

7) February 2003, *Prosperitas Volume III, Issue I*, “Who Writes the Law: Congress or the IRS?,” by Daniel J. Mitchell, Web page link below:

<http://www.freedomandprosperity.org/Papers/irsreg/irsreg.shtml>

6) April 2002, *Prosperitas Volume II, Issue II*, “The Case for International Tax Competition: A Caribbean Perspective,” by Carlyle Rogers, Web page link below:

<http://www.freedomandprosperity.org/press/p03-25-02/p03-25-02.shtml>

5) January 2002, *Prosperitas Vol. II, Issue I*, “U.S. Government Agencies Confirm That Low-Tax Jurisdictions Are Not Money Laundering Havens,” by Daniel J. Mitchell. Web page link below:

<http://www.freedomandprosperity.org/Papers/blacklist/blacklist.shtml>

4) November 2001, *Prosperitas, Vol. I, Issue IV*, “The Adverse Impact of Tax Harmonization and Information Exchange on the U.S. Economy,” by Daniel J. Mitchell. Web page link below:

<http://www.freedomandprosperity.org/Papers/taxharm/taxharm.shtml>

3) October 2001, *Prosperitas*, Vol. I, Issue III, “Money Laundering Legislation Would Discourage International Cooperation in the Fight Against Crime,” by Andrew F. Quinlan. Web page link below:

<http://www.freedomandprosperity.org/Papers/kerry-levin/kerry-levin.shtml>

2) August 2001, *Prosperitas*, Vol. I, Issue II, “United Nations Seeks Global Tax Authority,” by Daniel J. Mitchell. Web page link below:

<http://www.freedomandprosperity.org/Papers/un-report/un-report.shtml>

1) August 2001, *Prosperitas*, Vol. I, Issue I, “Oxfam's Shoddy Attack on Low-Tax Jurisdictions,” by Daniel J. Mitchell. Web page link below:

<http://www.freedomandprosperity.org/Papers/oxfam/oxfam.shtml>

Complete List of Prosperitas Studies, including summaries:

<http://www.freedomandprosperity.org/fpf/prosperitas/prosperitas.shtml>