Havens Can Wait

As part of its effort to thwart "harmful tax competition," the Organisation for Economic Co-operation and Development (OECD) recently published a blacklist of seven countries and principalities deemed "uncooperative tax havens"—so named because they refuse to sign an agreement to eliminate their low-tax policies and financial privacy laws. The OECD deputy secretary-general asserts that these havens encourage tax cheating and distort the flow of capital. But hindering fiscal competition only serves to protect governments from the disciplining forces of globalization. | **By Daniel Mitchell**

Ending Tax Haven Abuse
By Seiichi Kondo, Deputy Secretary-General, OECD
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Over the last 20 years, tax havens have flourished. The IMF [International Monetary Fund] estimates that assets worth more than $5 trillion are held offshore. Governments have a duty to protect the interests of honest tax-payers in the face of those who use tax havens to avoid their legal obligations to pay taxes in their countries of residence.

This figure provides little insight about the nature of tax evasion and where it occurs. Institutional investors (pension funds, mutual funds, insurance companies, etc.) control the vast majority of funds in so-called tax havens, and those investments are largely compliant with the tax laws of OECD member nations.

In support of that obligation, the OECD has just published a List of Uncooperative Tax Havens. This marks an important moment in the OECD's work to ensure fair competition in the global financial services market. Uncooperative tax havens represent a threat not only to the tax systems of developed and developing countries but also to the integrity of the international financial system.

A threat? Without competition from "tax havens," the tax burden in OECD countries—already at an all-time high of more than 37 percent of GDP—would likely be worse. Governments are reluctant to overtax when they know economic activity can cross national borders.

Kondo goes on to list the seven jurisdictions the OECD deems tax havens. Two years ago, 41 so-called offenders were on that list, including the Bahamas, Gibraltar, and Panama. The OECD did receive a number of "commitment letters" from most of these low-tax jurisdictions, but few of these letters are binding since they are based on OECD nations agreeing to the same rules.

The seven jurisdictions on the OECD's list—Andorra, Liechtenstein, Liberia, Monaco, The Marshall Islands, Nauru and Vanuatu—have decided that it is not in their interest to join OECD countries and other members of the international community in ending harmful tax practices that facilitate tax cheating and distort the market for financial services. We hope they will review their decision and we are prepared to continue our dialogue with them....

Failure to "review their decision" could carry consequences. The OECD suggests that member nations could subject low-tax regimes to financial protectionism, including proposals disallowing "deductions, exemptions, credits, or other allowances related to transactions with uncooperative tax havens."

The OECD's project on counteracting harmful tax practices is part of a wider initiative to promote good governance in a globalised economy. Globalisation has enormous potential to improve living standards around the world. But it also brings risks, including the risk of abuses of the free market system. The activities of tax havens distort the free flow of capital and undermine the ability of governments to finance the legitimate expectations of their citizens for publicly provided goods and services. By providing a framework within which all countries—developed and developing—can work together to fight harmful tax practices, the OECD seeks to encourage transparent and fair tax competition.

Ironically, an earlier OECD report acknowledges that competition from offshore tax havens helped encourage the deregulation of global capital markets, which "greatly facilitated the free flow of capital across national borders" and "improved the allocation of capital and reduced its cost."

The OECD scheme is a direct assault on fiscal sovereignty. Jurisdictions, many of which are developing nations governed by people of color, are being told they do not have the right to determine the tax treatment of income earned inside their borders.

The OECD does not seek to dictate to any country what its tax rates should be, or how its tax system should be structured. It does not seek to hinder enterprises in carrying out their normal business or to threaten the privacy of taxpayers. It aims to foster economic growth and development and ensure efficient and equitable flow of capital world-wide by promoting fair competition on tax rates.... By promoting transparency and cooperative agreements between all economies, our work will contribute to efforts to counter money laundering and the financing of terrorism (and strengthen the international financial system).

Criminal loot is much more likely to be laundered in nations like the United States, the United Kingdom, and Germany. Indeed, the OECD's Financial Action Task Force admits that only a small fraction of tax havens have inadequate laws against dirty money.

We know that the committed jurisdictions have concerns about establishing a level playing field in which no player gains an unfair advantage from practices that others have shunned. We share these concerns.

After making his case against tax havens, Kondo pledges that OECD countries will clean up their own "harmful" tax practices. Several OECD nations, including the United States, the United Kingdom, Switzerland, and Luxembourg, qualify as tax havens according to the OECD's own criteria—an oversight that prompted critics to complain of a double standard against developing nations.

Financial services are extremely mobile and it is not in our interest that harmful activities move from a committed jurisdiction to another which fails to meet our standards for transparency and the exchange of information. The OECD countries participating in this project have pledged to eliminate their own harmful tax practices by April 2003. By having a large number of onshore and offshore financial centres commit to the same principles, we have gone a long way to achieving a level playing field.

The United States, which has very advantageous tax laws for nonresident foreigners, is the largest tax haven in the world. Yet the OECD lists only one "harmful tax practice" in the United States—the Foreign Sales Corporation, which allows U.S. exporters to reduce their tax bill on foreign profits.

The proposed OECD sanctions against "uncooperative" jurisdictions almost certainly violate WTO obligations, though low-tax jurisdictions fear that OECD nations will use their power to prevent a fair hearing of any complaint.

OECD countries will now consider how to defend their tax bases and an equitable international financial system against the activities of the listed uncooperative tax havens. Co-ordinated defensive measures will prevent these tax havens from gaining a competitive advantage at the expense of other financial centers that have pledged to cooperate in fighting against tax evasion and tax-related crime. Sooner or later, we look forward to the end of tax haven abuse.

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