

Michigan Journal of International Law

Volume 26 | Issue 1

2004

Tax Competition: Harmful to Whom?

Michael Littlewood

Auckland University Law School

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TAX COMPETITION: HARMFUL TO WHOM?

*Michael Littlewood**

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* Auckland University Law School, Auckland, New Zealand; m.littlewood@auckland.ac.nz. I am especially grateful to Reuven Avi-Yonah and I am grateful also to Diane Graham, Lawrence Brock, Michael Barr, Abdel Hamid Bouab, Anthony Clunies-Ross, Jim Evans, Jane Kelsey, Sol Picciotto, Sheryl Baster, Lane West-Newman, Joe Atkinson and the participants at the Conference on Globalization, Law and Development hosted by the University of Michigan Law School (in particular, the Center for International and Comparative Law and the John M Olin Center for Law and Economics) and the William Davidson Institute in April 2004. I am grateful also to Daniel Gilchrist for his research assistance and to the New Zealand law firm Chapman Tripp for its financial support of the research upon which the paper is based. The usual acknowledgment of sole responsibility is in this instance inadequate: most of those to whom I am indebted actually disagree with at least some of my interpretations and conclusions.

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I. INTRODUCTION

The history of humankind is for the most part the story of a struggle to survive. For the overwhelming majority of people, life has largely consisted of the pursuit of food and shelter and the avoidance of calamity. The last 500 years or so, however, have seen unprecedented economic growth. About a quarter of the world's population now enjoy a material standard of living which, judged against the backdrop of history, is extraordinarily high. Billions more are at least relatively secure in the satisfaction of what are nowadays seen as their basic needs—not just food and shelter, but at least a rudimentary level of education, medical care, and so on. And yet the number of people living in desperate poverty is still enormous and possibly greater than ever before.

One method of alleviating poverty might be to redistribute the wealth which already exists in the world. There is, it seems, enough. This logically-possible solution suffers from a number of problems, however, not the least of which is that it seems most unlikely to happen. The only alternative solution to the problem of poverty seems to be economic growth. If the economic successes of the richer countries could somehow be emulated by the poorer ones, perhaps the problem could be solved. Growth will not *necessarily* end poverty because the fruits of it might go to some only and not to all (as has happened, taking the world as a whole, to date). For practical purposes, however, growth seems to be a prerequisite to the alleviation of poverty.

How best to promote economic growth in less-developed countries is perhaps, therefore, the most important political question facing the world today. One way in which many of these countries have sought to do it is by attracting foreign investment, and one way in which they have sought, in turn, to do that is by offering tax incentives to foreign investors. The basic idea is that growth requires capital and technology; that the less developed countries have insufficient capital and insufficient technology;

that if a foreign firm invests in a country (by, to take the prototypical case, building a factory), it supplies both capital and technology; and that foreign firms are more likely to do this if they are taxed lightly or not at all.

One problem with this strategy is that it might lead to a “race to the bottom.” If one country seeks to attract foreign investment by offering preferential tax treatment (that is, by taxing foreign investors less heavily than it taxes resident investors), other countries might be more generous still. The ultimate consequence might be that countries go on cutting the taxes they impose on foreign investors until the benefit they derive is reduced to zero. Thus, tax competition, rather than facilitating growth in poor countries, might merely enable firms from rich countries to go on exploiting the resources of poor ones (land, labor, minerals, and so on). Indeed, perhaps the principal effect of such incentives is to make such exploitation more profitable than before. In other words, tax incentives targeted at foreign investors, far from alleviating poverty, might perpetuate and even exacerbate it.¹

If developing countries succeed in attracting foreign investment, this could entail negative consequences for the country of residence of the foreign investor. For example, a firm might close down a factory in a high-tax rich country and establish a new one in a low-tax poor country. From the rich country’s point of view, the consequences might include both (a) a decrease in economic activity generally (manifesting itself in job losses, in particular) and (b) a fall in government revenue. It is not surprising, then, that the rich countries have watched with some discomfort the efforts of the developing countries to attract foreign investment by means of tax incentives.

In recent years, the discomfort has led to action. Most notably, the Organization for Economic Co-Operation and Development (OECD or Organization) (apparently prompted by the G7 countries—the United States, Japan, Germany, the UK, France, Italy, and Canada) has embarked on a “project” to eradicate two forms of “harmful tax competition,” namely (1) tax havens and (2) harmful preferential tax regimes.²

1. See Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1639–48 (2000).

2. OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998), at <http://www.oecd.org/dataoecd/33/0/1904176.pdf> [hereinafter OECD, 1998]; OECD, TOWARDS GLOBAL TAX CO-OPERATION: REPORT TO THE 2000 MINISTERIAL COUNCIL MEETING AND RECOMMENDATIONS BY THE COMMITTEE ON FISCAL AFFAIRS: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES (2000), at <http://www.oecd.org/dataoecd/9/61/2090192.pdf> [hereinafter OECD, 2000]; OECD, THE OECD’S PROJECT ON HARMFUL TAX PRACTICES: THE 2001 PROGRESS REPORT (2001), at <http://www.oecd.org/dataoecd/60/28/2664438.pdf> [hereinafter OECD, 2001]; and OECD, THE OECD’S PROJECT ON HARMFUL

A tax haven is essentially a jurisdiction which serves as a means by which firms and individuals resident in other jurisdictions can escape the taxes that they would otherwise be obliged to pay there. There are at least several dozen tax havens in the world. The OECD's objective is to eliminate them. That is, its objective is to persuade these jurisdictions to remodel their tax systems so that they can no longer be used to avoid other jurisdictions' taxes. Jurisdictions functioning as tax havens presumably benefit from doing so (or, at least, perceive themselves as benefiting).³ Therefore, persuading them to desist will presumably require carrots or sticks or both. But defining "tax haven" is more difficult than it might appear.

A preferential tax regime is essentially a targeted tax incentive. That is, a country might operate a "normal" tax system, but exempt specified classes of income from tax (or subject them to tax at lower rates than apply to other forms of income).⁴ The tax incentives with which developing countries seek to attract foreign investment are, thus, preferential regimes. Currently there exist in the world hundreds of such regimes.⁵ Again, the OECD's objective is to eliminate them—or, at least, to eliminate such of them as may be "harmful." As with the Organization's campaign to eradicate havens, it seems inevitable that this will require sanctions or enticements or both. But defining "preferential tax regime" is no easier than defining "tax haven," and the distinction drawn by the OECD between those preferential regimes that are "harmful" and those that are not is likewise problematic.

TAX PRACTICES: THE 2004 PROGRESS REPORT (2004), at <http://www.oecd.org/dataoecd/60/33/30901115.pdf> [hereinafter OECD, 2004].

3. In order to function satisfactorily as a tax haven, a jurisdiction must generally provide legal, accounting, banking and related services of a standard acceptable to clients (that is, those wishing to avoid taxes) in developed countries. Tax avoidance is indeed a very substantial industry. The revenues generated by the provision of such services may account for a substantial part of the haven's economy. In some cases, depending on the tax structure of the haven in question, taxes paid by those providing the services likewise account for a substantial part of the haven's public revenues. The extent to which the tax avoidance industry benefits the residents of havens generally (as distinct from merely benefiting those who work in that industry) is debatable, but it seems reasonable to assume that there is generally some benefit.

4. OECD, 1998, *supra* note 2, at para. 35. Given the very great diversity of tax systems which exist in the world, and the even greater diversity of theories as to how, if at all, income *ought* to be taxed, it seems clear that the assumption that there is such a thing as a "normal" income tax is problematic. That the OECD proceeded on this basis is, however, indicative of a tendency to assume that its Member States' ways of going about things are normal and that those of the rest of the world are not.

5. Some countries offer no tax incentives, but others (including, as will be seen, some of the OECD's own members) offer several. To cite only one important example, China alone offers dozens. The number of such regimes seems, consequently, to exceed the number of countries which exist in the world.

It is also possible, however, that developed countries gain from developing countries' preferential tax regimes. Most obviously, the firms that take advantage of the regimes presumably benefit from doing so, as do their shareholders. It is not self-evident that the gains made by such shareholders are outweighed by losses suffered by the populace generally. Moreover, to the extent that a less-developed country does not tax income derived from within its jurisdiction, such income would appear to be more readily available for taxation in the country of residence of the firm or individual by whom it is derived. It is true that the developed countries are mostly democratic; that their tax systems therefore represent (albeit less than perfectly) the democratically determined preferences of their peoples; and that any undermining of these preferences by other countries' preferential regimes would amount to an undermining of democracy. But it is also possible that the Leviathan hypothesis is true (that democracy somehow produces a higher level of taxation than would optimally satisfy the electorate),⁶ and if this is so, other countries' preferential regimes might constrain developed countries' tax systems in such a way as to raise welfare in those countries.

The aim of this paper is to examine the theory that it is both desirable and feasible to prevent less-developed countries from operating preferential tax regimes (that is, offering tax incentives) as a means of attracting foreign investment. More specifically, the paper makes five main points. First, the theory (proposed by the OECD and others)⁷ that the overall effect of preferential tax regimes is a lowering of global welfare remains unproven. The theory that developing countries' preferential tax regimes are harmful to the countries that operate them is even more open to doubt. Second, even if developing countries' preferential regimes are *generally* harmful to the countries that operate them, some of these countries seem plainly to have benefited from doing so. Third, the theory that developing countries should be prevented from operating preferential tax regimes requires some refinement. Even if such regimes were invariably harmful to the countries that operate them (which seems not to be the case), it is not clear that it is appropriate for a body such as the OECD (dominated by G7 countries) to save them from themselves. Given that some developing countries seem clearly to be benefiting from their regimes, the appropriateness of OECD intervention is even less apparent. Fourth, even if it is accepted that it would be desirable to prevent

6. See GEOFFREY BRENNAN & JAMES M. BUCHANAN, *THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION* (1980); JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* (1965); and JAMES M. BUCHANAN & ROGER D. CONGLETON, *POLITICS BY PRINCIPLE, NOT INTEREST: TOWARD NONDISCRIMINATORY DEMOCRACY* (1998).

7. See, e.g., Avi-Yonah, *supra* note 1, at 1675.

developing countries from operating preferential tax regimes, the practicalities of doing so seem to present difficulties (both technical and political) which have yet to be resolved. Fifth, although some less-developed countries have gained by operating preferential tax regimes, others have not. The task remains, therefore, of determining how, if at all, such countries might reform their tax systems so as to promote growth (and, thus, alleviate poverty).

This paper consists of six main parts. The first of these recounts the progress to date of the OECD's project on harmful tax competition. This part concentrates on the OECD's plan to eliminate preferential tax regimes in developing countries. It examines also the other two components of the OECD project (these being its plans to eliminate such regimes in OECD countries and also to eradicate tax havens), but only insofar as is necessary to assess its attack on preferential regimes in developing countries.⁸

The second part of the paper examines the merit, in principle, of the OECD project. Again, it concentrates on preferential regimes. In particular, this part of the paper assesses the theory, proposed by the OECD, that eradicating harmful preferential tax regimes will raise global welfare. The rationale for the OECD's campaign against tax havens is assessed also, but only to the extent that it bears on the campaign against preferential regimes.

The third part of the paper addresses some practical aspects of the OECD project. It is suggested, in particular, that the OECD's manner of operation has been opaque and in some respects arbitrary; that the Organization's approach to the identification of tax havens seems flawed; and that, consequently, some havens seem to have escaped the OECD's attentions. Perhaps more importantly (for present purposes, at least), the OECD's approach to the identification of preferential regimes seems

8. See also Hugh Ault, *Tax Competition: What (If Anything) To Do About It?*, in 26 INTERNATIONAL AND COMPARATIVE TAXATION: ESSAYS IN HONOUR OF KLAUS VOGEL 1 (Paul Kirchhof et al. eds., 2002); RAJIV BISWAS, INTERNATIONAL TAX COMPETITION: GLOBALISATION AND FISCAL SOVEREIGNTY (2002); WOLFGANG SCHON, TAX COMPETITION IN EUROPE (International Bureau of Fiscal Documentation, Amsterdam, 2003); Reuven Avi-Yonah, *Tax Competition and E-Commerce*, 23 TAX NOTES INT'L 1395 (2001); Reuven Avi-Yonah, *Tax, Trade, and Harmful Tax Competition: Reflections on the FSC Controversy*, 21 TAX NOTES INT'L 2841 (2000); Kimberly Carlson, *When Cows Have Wings: An Analysis of the OECD's Tax Haven Work as it Relates to Globalization, Sovereignty, and Privacy*, 35 J. MARSHALL L. REV. 163 (2002); Frances M Horner, *Do We Need an International Tax Organization?*, 24 TAX NOTES INT'L 179 (2001); Javier Salinas, *The OECD Tax Competition Initiative: A Critique of its Merits in the Global Marketplace*, 25 HOUS. J. INT'L L. 531 (2003); Miranda Stewart, *Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries*, 44 HARV. INT'L L. J. 139 (2002); Alexander Townsend, Jr., Comment, *The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition*, 25 FORDHAM INT'L L. J. 215 (2001); David R Burton, *Towards a Global Tax Cartel*, POL'Y MAG. 9 (Summer 2002-03); and Terry Dwyer, *The New Fiscal Imperialism*, POL'Y MAG. 12 (Summer 2002-03).

unsatisfactory as does the distinction that the Organization draws between “harmful” and “harmless” preferential regimes.⁹

Parts four, five and six are much briefer. Part four of the paper examines the rhetoric that the OECD has used in support of its project. Part five suggests, very tentatively, some factors that might help explain why some preferential regimes seem to succeed and others to fail. And part six examines the possibility that the eradication of preferential tax regimes, if a worthwhile project, would be better undertaken by some more representative body, such as the UN, rather than by the OECD.

The objective, throughout, is not only to assess the OECD project as an end in itself but also to use such an assessment as a convenient means of examining the theoretical case for and against developing countries’ use of tax incentives as a means of attracting foreign investment.

II. THE OECD PROJECT ON HARMFUL TAX COMPETITION

The OECD’s project on harmful tax competition began in May 1996, when the Organization’s Member States called upon it “[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.”¹⁰

The stated aim was, thus, not to enquire into the effects of tax competition. Rather, it was assumed that tax competition is harmful (in some circumstances, at least) and that it could produce “distorting effects” (in some circumstances, at least), and the aim was for the Organization to “develop measures to counter” these effects. Moreover, it seems clear that the OECD’s Member States were concerned not with promoting global welfare generally (let alone with the special needs of developing countries trying to attract foreign investment) but with the fate of their own treasuries—for the “national tax bases” to which they referred were presumably not those of the countries (both within and outside the OECD) engaging in “harmful tax competition” but those of its own members who were *not* engaged in “harmful tax competition” (or who, at least, were prepared to desist, if other members did likewise).

That the basic objective was to protect the OECD Member States’ revenues was confirmed by a communiqué subsequently issued by the G7 countries. This expressed concern that “harmful tax competition”

9. The OECD itself seems not to use the word “harmless.” Rather, it distinguishes between those preferential regimes that are “harmful” and those that are “acceptable.” See OECD, 1998, *supra* note 2, at para. 4. This false dichotomy is but one of many usages belying the Organization’s tendency to regard G7 norms as applicable in the rest of the world.

10. *Id.* at para. 1.

would lead to “the erosion of national tax bases”¹¹ and urged the OECD “to vigorously pursue its work in this field, aimed at establishing a multi-lateral approach under which countries could operate individually and collectively to limit the extent of these practices.”¹²

From the beginning, then, the stated objective of the OECD’s tax competition project was to facilitate some sort of coordinated action by the G7 countries and other like-minded OECD members aimed at preventing other countries—at this point unidentified—from engaging in “harmful tax competition.” That the OECD should act in the interest of its members, and in the interest of the G7 countries in particular, is unsurprising. Nor is it surprising that the OECD would subsequently seek to present its project as being in the interest not only of its members but of the world generally. But it is worth keeping in mind the origins of the project, because the claim that it might benefit anyone other than the G7 countries and other like-minded OECD members is plainly self-serving and, therefore, suspect.¹³

That the G7 countries should have decided to act through the medium of the OECD is unexceptional. Indeed, it could perhaps even be said that orchestrating a project of this nature is exactly what the OECD was set up to do.¹⁴ The origins of the project on harmful tax competition, however, are murky, and the roles of the Organization and of its larger members seem not to have been disclosed. The reason the OECD member countries arranged for the Organization to undertake the project was presumably that at least some of them had already determined that their revenues were suffering, or were likely to suffer, as a result of harmful

11. *Id.* at para. 2.

12. *Id.*

13. It is possible that the interests of the OECD countries and those of the rest of the world coincide. That is, it is possible that the OECD’s argument is sound. But it is also possible that it is not. That is, it is possible that the project might benefit some countries only. This is examined in part III of this paper.

14. Article 1 of the Paris Convention of 1960 (by which the OECD was established) provides that the Organization’s aim is

to promote policies designed:

(a) to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;

(b) to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and

(c) to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

tax competition. Presumably the larger countries, at least, had also already assessed not only the problem but also the range of possible solutions, but their analyses seem not to have been published. It seems reasonable to suppose also that, both before and after launching the OECD on its project, the Organization's larger members might have informally discussed these issues. Perhaps, too, they determined in advance what they would find it helpful for the Organization to recommend. Again, however, such proceedings seem not to be a matter of public record.

The course of action ultimately recommended by the OECD is not especially complex (though the potential political problems would seem to be formidable). Indeed, it was reasonably predictable (in its technical aspects, if not its political). It seems possible, then, that the purpose of the project was not so much to perform the technical task of devising solutions but to perform the political task of orchestrating broad, multi-national political support for solutions already agreed in principle by the OECD's larger members. But whether this is so is difficult to say because of the opaque nature of the Organization's proceedings.

A. The 1998 Report

In any event, the OECD's Committee on Fiscal Affairs (Committee) duly "launched" its "project on harmful tax competition,"¹⁵ and in January 1998 submitted a report on its work called *Harmful Tax Competition: An Emerging Global Issue* (1998 Report).¹⁶ In April 1998, the OECD Council approved the 1998 Report. Switzerland and Luxembourg (the OECD's two leading tax havens) abstained,¹⁷ thus apparently confirming that the "national tax bases" about which the Organization was concerned were those of its members who were *not* engaged in "harmful tax competition."¹⁸ The Council also instructed the Committee to "pursue its work in this area and to develop a dialogue with non-member countries."¹⁹

In the 1998 Report, the Committee identified two phenomena which it categorized as "harmful tax practices." These were (1) "tax havens" and (2) "harmful preferential tax regimes."²⁰ By "tax havens," the OECD

15. OECD, 1998, *supra* note 2, at Foreword.

16. *Id.*

17. *Id.* at Foreword and Annex II: Statements by Luxembourg and Switzerland.

18. As will be seen, it was subsequently to transpire that most of the OECD Member States (including five of the G7 countries) were operating preferential regimes. To be precise, therefore, the OECD's concern was to protect the "national tax bases" of those of its members who were prepared to cease their harmful tax practices if other countries would do likewise.

19. OECD, 1998, *supra* note 2, at Foreword.

20. *Id.* at para. 4.

meant jurisdictions that impose no income taxes (or only nominal income taxes) and that “offer themselves as places to be used by non-residents to escape tax in their country of residence.”²¹ This coincides, more or less, with normal usage. Even so, as will be seen, when the Committee set out to define “tax haven,” so as to draw up a list of them, it found the concept troublingly elusive. Consequently, as will also be seen, the result was to be less than satisfactory. In particular, some jurisdictions which seem plainly to be tax havens escaped the list.

The term “harmful preferential tax regimes” is at least as problematic. By it, the Committee meant countries that have a “normal”²² tax system, but one that subjects specified classes of income to “low or no taxation.”²³ The targeted tax incentives with which developing countries seek to attract foreign investment seem to constitute, in the eyes of the OECD, “harmful tax competition.” As will be seen, however, the OECD’s campaign against this form of harmful tax competition seems to have encountered difficulties. Not the least of these is that the OECD seems not to have satisfactorily distinguished between those preferential regimes which are harmful and those which are not.

The 1998 Report covers: (1) countries which are members of the OECD; (2) countries which are not; and also (3) non-sovereign dependent territories. This last category predictably turned out to be crucial because of the somewhat embarrassing prominence of exotic island dependencies (mostly British) among the jurisdictions which the Committee was subsequently to include on its list of tax havens.²⁴ The Committee made clear also that its concern was not that countries *engaged* in “harmful tax practices” (that is, tax havens and harmful preferential tax regimes) might suffer (as a result of a race to the bottom or otherwise) but that “harmful tax competition” might “erode the tax bases of *other* countries.”²⁵ The Committee asserted too that harmful tax competition “diminishes global welfare,”²⁶ but it neither explained what it meant by this nor offered any satisfactory evidence.²⁷ The theory that tax havens detract from global welfare seems, at worst, plausible. As will

21. *Id.* at para. 42.

22. *Id.* at para. 35.

23. OECD, 1998, *supra* note 2, at para. 40. The Committee did not define what it meant by “low” and still has not.

24. *See* OECD, 2000, *supra* note 2, at para. 17.

25. OECD, 1998, *supra* note 2, at para. 4 (emphasis added).

26. *Id.*

27. Nor did the Committee provide any evidence that tax competition might harm other countries’ tax bases. As has been recounted, however, it was simply told by its members that this was the case and instructed to devise solutions. What evidence the Organization’s members might have had for regarding tax competition as harmful to their revenues remains unclear.

be seen, however, the theory that preferential regimes have similar effects seems dubious in the extreme.

The Report concentrates on, as the Committee put it, “geographically mobile activities, such as financial and other service activities, including the provision of intangibles.”²⁸ As the Committee explained, “[t]ax incentives designed to attract investment in plant, building and equipment have been excluded *at this stage*.”²⁹ The Committee’s recommended strategy seems, then, to have been that the OECD should start by picking off the easier targets (preferential regimes catering to financial services and also tax havens) and then, at some later stage, move on to the politically more sensitive task of stopping developing countries (and its own members) from using tax incentives to attract investment in manufacturing.³⁰

The Report consists of three main chapters. The first of these surveys the phenomenon of global tax competition. The second contains the Committee’s suggestions as to how tax havens and harmful preferential tax regimes should be identified. Finally, the third examines the methods proposed by the Committee for “counteracting” harmful tax competition. Eliminating tax havens and harmful preferential tax regimes would, of course, require a large number of countries (most of them not members of the OECD) to effect radical changes to their tax systems (and to various other parts of their legal systems, such as the rules relating to bank privacy). As one would expect, therefore, the Committee regarded it as self-evident that this would require the application (or, at least, the threatened application) against recalcitrant jurisdictions of “[s]evere countermeasures”³¹ and that these would need to be coordinated “at the international level.”³² Indeed, as has been recounted, the reason the OECD was instructed to launch the project was that the G7 countries had already decided that multilateral measures were required.

B. Tax Havens

The Committee’s basic function, then, was to propose methods, including severe multilateral sanctions, by which the G7 and other like-minded countries could eliminate tax havens and harmful preferential tax regimes. This, of course, would require reasonably objective and defensible methods of identifying what was to be eliminated. The Committee

28. OECD, 1998, *supra* note 2, at para. 6.

29. *Id.* (emphasis added).

30. To pave the way for this latter phase of the project, however, the Committee noted that “the distinction between regimes directed at financial and other services on the one hand and at manufacturing and similar activities on the other hand is not always easy to apply.” *Id.*

31. *Id.* at para. 95.

32. *Id.* at para. 89.

did not attempt to *define* either “tax haven” or “harmful preferential tax regime,” but it did devote substantial parts of its 1998 Report to the question of how these phenomena might be recognized. It proposed that tax havens should be identified principally by reference to four “key factors”³³ as follows:

1. “no or only nominal taxes (generally or in special circumstances);”³⁴
2. “laws or administrative practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from the low or no tax jurisdiction;”³⁵
3. “lack of transparency;”³⁶ and
4. the absence of any requirement for substantial activity.³⁷

Of these, the Committee regarded the first as most important: “[n]o or only nominal taxation,” it said, “is a necessary condition for the identification of a tax haven.”³⁸ Indeed, low or only nominal taxation, combined with “a situation where the jurisdiction offers or is perceived to offer itself as a place where non-residents can escape tax in their country of residence” could be “sufficient to identify a tax haven.”³⁹ Depending on the circumstances, however, the other three “key factors” might also be relevant.

C. Harmful Preferential Tax Regimes

The method by which the Committee proposed that the OECD should identify “harmful preferential tax regimes” was likewise based on four “key factors” (though not quite the same four), to which, however, the Committee added (1) a further eight “other” factors and (2) three “economic” considerations. The four “key” factors were as follows:

33. *Id.* at para. 52, Box I.

34. *Id.* at para. 52. The Committee did not explain what it meant by “nominal.”

35. *Id.* “Low” was not defined. Governments commonly exchange information about taxpayers so as to assist each other in the enforcement of their tax laws. Such exchanges are typically specifically provided for by tax treaties (of which there are in the world about 1,500, almost all of them bilateral and based on a model produced by the OECD) and conducted pursuant to such provisions. Tax havens, however, generally do not participate in such exchanges; indeed, one of their attractions has traditionally been that they do not provide information of this kind to other governments.

36. *Id.*

37. *Id.* What this was intended to mean is examined below.

38. *Id.*

39. *Id.* This approach would seem to lead to the identification as havens of a very large number of countries, including, notably, the United States (in respect of the exemption from tax of interest paid to non-residents). See *infra* note 81.

1. a low or zero effective tax rate on specified kinds of income;⁴⁰
2. “ring-fencing;”⁴¹
3. lack of transparency;⁴² and
4. no effective exchange of information with other governments.⁴³

The eight “other” factors were as follows:

1. an “artificial” definition of the tax base;⁴⁴
2. a failure to adhere to international transfer pricing principles;⁴⁵
3. the exemption of foreign-source income from tax;⁴⁶
4. negotiable tax rates or tax bases;⁴⁷
5. the existence of secrecy provisions;⁴⁸
6. access to a wide network of tax treaties;⁴⁹

40. OECD, 1998, *supra* note 2, at para. 61. The Committee did not define “low.” It explained that an “effective” tax rate might be lower than the formal rate “because of the way in which a country defines the tax base” (*Id.* at Box II); but it did not explain how the OECD might go about measuring the difference between formal and effective tax rates.

41. *Id.* at para. 62. By this the Committee meant where the preferential tax regime is “partially or fully isolated from the domestic economy.” *Id.* Ring-fencing, the Committee said, can take several forms, including (1) where the benefits of the regime are available only to non-residents; and (2) where firms which benefit from the regime are “prohibited from operating in the domestic market.” *Id.* at para. 62, Box II.

42. *Id.* at para. 63.

43. *Id.* at para. 64.

44. *Id.* at paras. 69–70. By “artificial” the Committee seems to have meant merely narrower than is usual in major OECD countries. *See id.*

45. *Id.* at paras. 71–72. The Committee’s assumption that its own principles are “international” and that all countries ought to “adhere” to them is typical of its tendency to assume that the rest of the world ought generally to do things the way they are done in the OECD countries.

46. *Id.* at para. 73. The Committee’s assumption that foreign-sourced income should be taxed is similarly typical of its assumption that the rest of the world should adopt OECD-style tax systems. The theory that each country should confine its system of income tax to income arising within its own territory is defensible on principled grounds. *See, e.g.,* ROBERT E HALL & ALVIN RABUSHKA, *THE FLAT TAX 75–77* (1995).

47. OECD, 1998, *supra* note 2, at para. 74. Negotiable tax rates can serve a number of purposes. For example, a country might enact legislation taxing income at higher than nominal rates (and so escape classification as a haven) but in fact allow taxpayers to pay tax at lower rates or not at all (and so profit by in fact functioning as a haven without appearing to do so).

48. *Id.* at para. 75.

49. *Id.* at paras. 76–77. Some jurisdictions have built up networks of treaties so as to make themselves attractive to foreign investors. This seems indeed to be one of the principal functions for which the OECD’s own model tax treaty was devised. Conversely, most havens have few tax treaties because, (1) having no (or only nominal) income taxes, they have nothing

7. the promotion of the regime as a tax minimization vehicle;⁵⁰
and
8. the encouragement by the regime of purely tax-driven operations or arrangements.⁵¹

As with tax havens, a “low or zero effective tax rate” was regarded by the Committee as “the necessary starting point,”⁵² but, said the Committee, an “evaluation” of a regime “should be based upon an overall assessment” of each of the four key factors and also, “where relevant,” the eight “other” factors.⁵³ The Committee said also that, in “examining” a regime, it would be “helpful” to assess its “economic effects.”⁵⁴ This, it explained, could be done by posing the following three questions:

1. “Does the regime shift activity from one country to the country providing the preferential tax regime, rather than generate significant new activity?”⁵⁵
2. “Is the presence and level of activities in the host country commensurate with the amount of investment or income?”⁵⁶
3. “Is the preferential tax regime the primary motivation for the location of an activity?”⁵⁷

The Committee indicated also that it expected preferential regimes to be found both in countries belonging to the OECD and in other countries (whereas it appears to have anticipated not classifying any of its own members as tax havens—the apparently clear cases of Switzerland and Luxembourg notwithstanding).

D. Remedies

As I have recounted, the OECD’s Member States initiated the project in order to produce remedies (though exactly why remedies were required they did not explain). It is not surprising, then, that the Commit-

to gain from treaties, and (2) they do not want to participate in the exchange of information. Perhaps, then, this factor would be better reformulated. What seems to count is not so much whether a country has “access to a wide range of treaties” as the detail of their provisions and how they operate in practice.

50. *Id.* at para. 78. But any tax incentive, by definition, can serve as a means of minimizing tax.

51. *Id.* at para. 79.

52. *Id.* at para. 61.

53. *Id.* at para. 59.

54. *Id.* at para. 80.

55. *Id.* at paras. 81–82.

56. *Id.* at para. 83.

57. *Id.* at para. 84.

tee likewise regarded it as self-evident that remedies were required (though it, too, did not explain precisely why). "Governments [said the Committee] cannot stand back while their tax bases are eroded through the actions of countries which offer taxpayers ways to exploit tax havens and preferential regimes to reduce the tax that would otherwise have been payable."⁵⁸

Various governments, it observed, were already using unilateral and bilateral methods to protect their tax bases against the "detrimental actions" of other countries engaged in "harmful tax competition." But these, it went on, were insufficient because the problem was "essentially global in nature."⁵⁹ The Committee accordingly concluded that there was a "need for coordinated action at the international level."⁶⁰

The Committee went on to make a series of nineteen recommendations, some concerning domestic legislation; some concerning tax treaties; and some concerning the "intensification of international cooperation."⁶¹ Those which, for present purposes, it is necessary to examine were as follows:

1. that countries without controlled foreign corporation (CFC) rules should consider adopting them;⁶²

58. *Id.* at para. 85.

59. *Id.* at para. 87. By this the Committee meant that unilateral or bilateral responses are likely to be inadequate. The reasons for this, in turn, the Committee expressed as follows:

First, the jurisdictional limits to the powers of a country's tax authorities restrict the ability of those authorities to counter some forms of harmful tax competition. Second, a country may believe that taxing its residents in a way that neutralizes the benefits of certain forms of harmful tax competition will put its taxpayers at a competitive disadvantage if its action is not followed by other countries. Third, the necessity to monitor all forms of harmful tax competition and to enforce countermeasures effectively imposes significant administrative costs on countries adversely affected by such competition. Fourth, uncoordinated, unilateral measures may increase compliance costs on taxpayers.

Id.

60. *Id.* at para. 89.

61. *Id.* at para. 92.

62. *Id.* at paras. 97–100. CFC rules (controlled foreign corporation rules) are rules providing for the taxation of persons resident within a jurisdiction on offshore income accumulated in offshore corporations. In the absence of such rules, such income is generally not taxable because it is neither derived by a resident nor derived from the jurisdiction. Most OECD countries' taxing statutes contain such rules. In almost all cases, however, the CFC rules are not comprehensive. For example, it is common for such rules to apply only to passive income. For an account of the US CFC rules, see, for example, chapter 15 of JOSEPH ISENBERGH, *INTERNATIONAL TAXATION*, (2000). For a more general account, see ROY ROHATGI, *BASIC INTERNATIONAL TAXATION* 374–95 (2002). For a survey of a large number of jurisdictions' CFC rules, see Mattias Dahlberg, *Limits on the Use of Low-Tax Regimes by Multinational Businesses: Current Measures and Emerging Trends*, 86b CAHIERS DE DROIT FISCAL INT'L 827 (2001). It is notable that the OECD did not recommend that all countries

2. that countries without foreign investment fund (FIF) rules should consider adopting them;⁶³
3. that countries whose tax systems are confined to domestic income should extend them to cover offshore income;⁶⁴
4. that all countries should follow the OECD's transfer pricing guidelines;⁶⁵
5. that the OECD Member States should establish a Forum, subordinate to the Committee, to "undertake an on-going evaluation of existing and proposed [tax] regimes in member and non-member countries . . . ;"⁶⁶
6. that the Forum should draw up a list of tax havens;⁶⁷
7. that the Forum should draw up a list of OECD Member States' harmful preferential tax regimes;⁶⁸
8. that OECD Member States should "remove . . . the harmful features of their preferential tax regimes" within five years;⁶⁹ and

should actually adopt CFC rules but only that they should consider doing so. It seems, then, that the OECD does not require all countries to adopt CFC rules (presumably because, in the case of countries which are either very small or very poor, the establishment of such rules would be disproportionately burdensome and in any event probably unworkable) but might look with some undisclosed degree of disfavor upon countries that do not (at least in some circumstances). It seems likely that this kind of imprecision, coupled as it is with threats of sanctions for non-compliance, is seen in non-OECD countries without CFC rules as unsettling and overbearing and that it will consequently undermine the perceived legitimacy of the OECD's project.

63. OECD, 1998, *supra* note 2, at paras. 101–03. FIF rules (Foreign Investment Fund rules) are rules imposing tax on persons resident within a jurisdiction on income accumulated in offshore entities. The main difference between CFC regimes and FIF regimes is that FIF regimes apply irrespective of control (whereas CFC rules apply only to entities controlled by a small number of persons—for example, five—resident within the taxing jurisdiction). Again, it is notable that the OECD did not recommend that all countries should adopt FIF rules but only that they should consider doing so. *See supra* note 62 and accompanying text.

64. OECD, 1998, *supra* note 2, at paras. 104–05. *See also supra* note 46 and accompanying text.

65. OECD, 1998, *supra* note 2, at para. 111. Once more, the OECD has assumed that it is appropriate to formulate standards, to exclude most of the world from the process of formulation, and then to require the countries excluded to comply.

66. *Id.* at paras. 140–48.

67. *Id.* at paras. 149–51.

68. *Id.* at paras. 149–51, Box III.

69. *Id.* The 5 year period was to run from the date on which the OECD Council approved the guidelines. *See id.* at Guideline 3, Box III. This happened on 9 April 1998. *See id.* at Foreword. The 5 years, therefore, ended in April 2003. There was also a "grandfathering" provision, according to which preferential regimes could continue to operate until 31 Decem-

9. that the Forum should “engage in a dialogue” with countries outside the OECD, with the aim generally of advancing the project on harmful tax competition.⁷⁰

The Report finished with a list of seven “topics for further study.”⁷¹ All were further possible multilateral measures, which, the Committee said, it might be necessary to recommend in the future. They included restrictions on the deductibility of payments to tax haven entities,⁷² withholding taxes on certain payments to residents of countries engaging in harmful tax competition,⁷³ and, not least, “the possibility of addressing harmful tax competition using a wide range of non-tax measures”⁷⁴ (though the Committee said nothing about what sorts of non-tax measures might be effective or appropriate).

E. The 2000 Report

In 2000, the Committee on Fiscal Affairs submitted to the Organization a second report called *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices (2000 Report)*.⁷⁵ This contained a list of forty-seven “potentially harmful preferential tax regimes” in OECD member countries.⁷⁶ More importantly, for present purposes, it contained also a list of thirty-five jurisdictions that, the Committee said, satisfied its “criteria for being tax havens.”⁷⁷ The 2000 Report said very little, however, about preferential regimes in non-member countries.

F. Preferential Tax Regimes in Member Countries

The Forum proposed by the Committee⁷⁸ was duly established. Once in being, it requested each OECD member country to perform a “self-review” to identify any aspects of its tax system which would constitute a preferential tax regime according to the criteria formulated by the Committee in 1998.⁷⁹ This process determined that most OECD

ber 2005 but only for the benefit of taxpayers benefiting from them on 31 December 2000. See *id.* at Guideline 3, Box III.

70. *Id.* at para. 156.

71. *Id.* at paras. 157–71.

72. *Id.* at paras. 158–59.

73. *Id.* at paras. 160–61.

74. *Id.* at paras. 171.

75. OECD, 2000, *supra* note 2.

76. *Id.* at para. 11.

77. *Id.* at pg. 6 and para. 17.

78. See OECD, 1998, *supra* note 2, at paras. 140–48.

79. OECD, 2000, *supra* note 2, at para. 5.

members were operating potentially harmful preferential regimes of one kind or another. In all, there were forty-seven such regimes, operated by the following countries: Australia, Belgium, Canada, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Korea, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United States.⁸⁰ The only member countries *not* operating preferential tax regimes were, therefore, Denmark, the United Kingdom, Japan, New Zealand, Mexico, the Czech Republic, and Poland. The forty-seven regimes provided for preferential tax treatment for a range of activities, such as banking, insurance, financing, shipping, operating a corporate headquarters, and so on.⁸¹ The number of regimes was greater than the number of countries because some countries operated more than one regime. Canada, for example, appeared on the list three times as it operated regimes catering to: (1) international banking; (2) international shipping; and (3) non-resident owned investment corporations.⁸² Now that the Committee had completed this provisional list of “potentially” harmful regimes, it confirmed that the next step would be for the countries concerned to identify which of them were, or might be, “actually” harmful.⁸³ These countries would then have until April 2003 to eliminate these regimes’ “harmful features.”

As explained above, the process was confined to regimes catering to “financial and other services;”⁸⁴ the task of identifying preferential tax regimes available to manufacturers was left for another day.

80. *Id.* at para. 11.

81. *Id.* Most countries, including OECD countries, treat interest derived by non-residents more generously than interest derived by residents. That is, in most countries, interest derived by a non-resident is either not taxed at all or taxed at a lower rate than it would be if derived by a resident. *See, e.g.,* Avi-Yonah, *supra* note 1, at 1576:

Since the United States abolished its withholding tax on interest paid to foreigners in 1984, no major capital-importing country has been able to impose such a tax for fear of driving mobile capital elsewhere (or increasing the cost of capital for domestic borrowers, including the government itself). As a result, individuals can generally earn investment income free of host-country taxation in any of the world's major economies.

See also ROHATGI, *supra* note 62, at 197–200. It seems, however, that the OECD does not regard such favorable treatment as constituting a preferential regime. This seems odd because it seems to satisfy the OECD's own criteria. *See supra* notes 40 to 57. The OECD seems not to have explained why it does not regard the preferential treatment of interest paid to non-residents as a preferential regime, let alone a harmful one.

82. OECD, 2000, *supra* note 2, at para. 11.

83. *Id.* at Executive Summary (page 6).

84. OECD, 1998, *supra* note 2, at para. 6.

G. The OECD's List of Tax Havens

The Forum began the task of identifying tax havens by drawing up a list of jurisdictions which, it said, "appeared to have the potential" for satisfying the tax haven criteria devised by the Committee in 1998.⁸⁵ The OECD has not published this list, though the 1998 Report does reveal that the number of jurisdictions on it was forty-seven.⁸⁶ The Forum then undertook "an in-depth factual review" of these forty-seven jurisdictions, a process in which "the full participation of each jurisdiction was invited and encouraged."⁸⁷ Six of the jurisdictions reviewed by the Forum (Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino)⁸⁸ "committed" themselves "to eliminate their harmful tax practices and to comply with the principles of the 1998 Report."⁸⁹ This was called an "advance commitment."⁹⁰ These jurisdictions were excluded from the list of tax havens. Another six jurisdictions were excluded also, on the basis that, on closer inspection, they turned out not to satisfy the criteria. The identity of these jurisdictions was not disclosed (and seems still not to have been disclosed). The result of this process was a list of thirty-five jurisdictions classified as tax havens.⁹¹

Until this point, the OECD's project on harmful tax competition had been conducted entirely in terms of abstract concepts (or, at least, the public record of the project had been so conducted). It is therefore necessary to name the thirty-five tax havens, so as to give a more concrete idea of the project on which the Organization had embarked. They were as follows: Andorra; Anguilla; Antigua and Barbuda; Aruba; the Bahamas; Bahrain; Barbados; Belize; the British Virgin Islands; the Cook Islands; Dominica; Gibraltar; Grenada; Guernsey, Sark and Alderney; the Isle of Man; Jersey; Liberia; Liechtenstein; the Maldives; the Marshall Islands; Monaco; Montserrat; Nauru; the Netherlands Antilles; Niue; Panama; Samoa; the Seychelles; St Lucia; St Christopher and Nevis; St Vincent and the Grenadines; Tonga; the Turks and Caicos; the U.S. Virgin Islands; and Vanuatu.⁹² Most of these are very small. Some are extremely small. Niue, for example, is a small island in the South Pacific with a population of about 2,000.⁹³ Some are rich—for example,

85. *Id.* at para. 8.

86. *Id.*

87. *Id.*

88. *Id.* at 29. See also OECD, 2001, *supra* note 2, at para. 17.

89. OECD, 2000, *supra* note 2, at para. 17.

90. *Id.*

91. *Id.*

92. *Id.*

93. U.N. DEP'T OF ECONOMIC & SOCIAL AFFAIRS, 2000 U.N. DEMOGRAPHIC Y.B. 121 (2002).

the Channel Islands (Jersey, Guernsey, Sark and Alderney)⁹⁴ and Monaco.⁹⁵ Others—for example, Liberia and Niue—are very poor; their populations consist mainly of subsistence farmers.⁹⁶

The Committee emphasized that the list of tax havens was not intended “as the basis for possible coordinated defensive measures.”⁹⁷ Rather, the intention was to develop a further list of “uncooperative” tax havens for this purpose.⁹⁸ This the Committee proposed to do by July 31, 2001.⁹⁹ Every jurisdiction on the list of tax havens would automatically be included on the proposed new list.¹⁰⁰ Other jurisdictions found to be tax havens would be included on it also.¹⁰¹ But any jurisdiction appearing on the list of uncooperative tax havens (or about to appear on it) could have itself removed (or preempt its appearance) by making a “commitment” to the OECD to eliminate its harmful tax practices.¹⁰² Jurisdictions making such a commitment, and sticking to it, would not be subjected to coordinated sanctions. To preempt prevarication, the Committee stipulated that a jurisdiction making a commitment would also have to work in collaboration with the Forum to produce a detailed plan incorporating a timetable and “milestones to ensure steady progress;”¹⁰³ it would have to complete “a significant and concrete action during the first year;”¹⁰⁴ and it would have to “engage in an annual review process with the Forum to determine the progress made.”¹⁰⁵

94. Neither the UN nor the World Bank seems to have published economic data on the Channel islands. According to the CIA, however, per capita GDP at purchasing power parity in 1999 was US\$24,800 in Jersey and US\$20,000 in Guernsey. CENTRAL INTELLIGENCE AGENCY, WORLD FACTBOOK (2004) at <http://www.cia.gov/cia/publications/factbook/geos/je.html> and <http://www.cia.gov/cia/publications/factbook/geos/gk.html>.

95. Neither the UN nor the World Bank seems to have published economic data on Monaco. According to the CIA, however, per capita GDP at purchasing power parity in 1999 was US\$27,000. This figure was accompanied however by the observation that Monaco “does not publish national income figures” and the caution that the CIA’s estimate was “extremely rough.” CENTRAL INTELLIGENCE AGENCY, WORLD FACTBOOK (2004) at <http://www.cia.gov/cia/publications/factbook/geos/mn/html> (last visited Oct. 19, 2004). See also U.S. DEP’T OF STATE, BUREAU OF EUROPEAN AND EURASIAN AFFAIRS, BACKGROUND NOTE: MONACO (Mar. 2004) at <http://www.state.gov/r/pa/ei/bgn/3397.htm>.

96. According to the World Bank, per capita GDP in Liberia in 2003 was US\$192. WORLD BANK, LIBERIA DATA PROFILE, WORLD DEVELOPMENT INDICATORS ONLINE, at <http://devdata.worldbank.org/query>.

97. OECD, 2000, *supra* note 2, at para. 17.

98. *Id.* at para. 19.

99. *Id.* at paras. 17–23.

100. *Id.* at para. 19.

101. *Id.*

102. *Id.* at paras. 20–23.

103. *Id.* at para. 21.

104. *Id.*

105. *Id.*

Satisfactory annual reviews would mean that the jurisdiction would stay off the list of uncooperative tax havens, but any jurisdiction failing to adhere to its timetable or showing any sign of “not acting in good faith in accordance with its commitments” would find itself back on the list.¹⁰⁶ Conversely, any jurisdiction appearing on the list would be able at any time to make the requisite commitment and so be removed from it. A jurisdiction would also have its name removed from the list if it ceased to meet the tax haven criteria, whether it made the commitment or not.¹⁰⁷

H. Preferential Tax Regimes in Non-Member Countries

From the OECD's point of view, preferential tax regimes in non-member countries would seem to be at least as large a problem as either preferential regimes in member countries or tax havens. One might, therefore, have expected the Committee to explain why it said so little about them in its 2000 Report, but it did not. It can perhaps be inferred that the Committee had made little progress in this aspect of its work. Havens are more manifestly objectionable than preferential regimes. Moreover, most tax havens are small and weak, whereas a number of the non-OECD countries operating preferential regimes (or, at least, whose tax systems feature incentives apparently constituting preferential tax regimes) are large and powerful—for example, China.¹⁰⁸ It seems reasonable to surmise that, for these reasons, the Committee decided to concentrate on havens and to leave for another day the more difficult problem of non-member countries' preferential regimes. As for the elimination of the OECD member countries' own preferential regimes, this was presumably regarded as both easier and politically necessary—for it was (and remains) not only an end in itself but also presumably a prerequisite to the larger objective of eliminating such regimes in non-member countries. The reason is that it would obviously be difficult for the OECD to move against non-member countries' preferential regimes without first putting its own house in order. The 2000 Report did, however, contain this statement.

106. *Id.* at para. 22.

107. *Id.* at paras. 17–23.

108. Whether the OECD regards China (or any other particular non-OECD country) as operating preferential regimes remains unclear, because the Organization has not publicly expressed an opinion on this point. But a number of large countries, including China, appear to satisfy the OECD's criteria for operating harmful preferential regimes. On 14 June 2004, the OECD announced that China would become an “observer” on the OECD's Committee on Fiscal Affairs and so “intensify [its] cooperation with the OECD.” See *China, South Africa to participate in Work of OECD's Committee on Fiscal Affairs*, OECD, June 14, 2004, at http://www.oecd.org/document/21/0,2340,en_2649_34487_32074069_1_1_1_1,00.html (June 14, 2004). South Africa, Russia and Argentina are also observers on the Committee on Fiscal Affairs.

Some non-member economies feature strongly in the global financial marketplace, with possibly major distortions being caused by the harmful tax practices they have put in place. There is a significant risk that a failure to address these practices in parallel with the work in relation to Member countries will cause a shift of the targeted activities to economies outside the OECD area, giving them an unwarranted competitive advantage and limiting the effectiveness of the whole exercise.¹⁰⁹

This rather vague passage was presumably directed at non-member countries' preferential regimes (for havens and member countries' preferential regimes were both dealt with explicitly, as outlined above). The analysis seems sound enough (leaving aside for the moment the Committee's unexplained assumption that the shifting of economic activity from OECD countries to non-member countries would be a bad thing), but the Committee neither named the jurisdictions it had in mind nor indicated any progress at all in identifying them.

I. Remedies (Again)

In its 2000 Report, the Committee reiterated its call for collective action against harmful tax competition.¹¹⁰ To coordinate such action was, after all, what it had been called upon to do.¹¹¹ The Committee now proposed a new list of measures that might be collectively directed at uncooperative tax havens.¹¹² This generally restated proposals already made in the 1998 Report.¹¹³ It also contained some new proposals, such as the imposition of "transactions" charges on certain (unspecified) transactions involving uncooperative tax havens.¹¹⁴ Also, in 2000, the Committee positively recommended some of the strategies which in 1998 it had regarded as requiring further study.¹¹⁵ In particular, it now advocated both restrictions on the deductibility of payments to tax haven entities and the imposition of withholding taxes on certain (but unspecified) payments to residents of tax havens.¹¹⁶ The Committee also gave some substance to its previously vague suggestion that "non-tax measures" could be brought to bear on recalcitrant tax havens:¹¹⁷ it now suggested that these might include the withholding of "non-essential

109. OECD, 2000, *supra* note 2, at para. 29.

110. *Id.* at Executive Summary.

111. OECD, 1998, *supra* note 2, at paras. 1–2.

112. OECD, 2000, *supra* note 2, at para. 35.

113. OECD, 1998, *supra* note 2, at paras. 157–71.

114. OECD, 2000, *supra* note 3, at para. 35.

115. OECD, 1998, *supra* note 2, at paras. 157–71.

116. OECD, 2000, *supra* note 2, at para. 35.

117. OECD, 1998, *supra* note 2 at paras. 149–51.

economic assistance.”¹¹⁸ This would presumably provide considerable leverage in the case of havens dependent on such aid such as, for example, the Cook Islands. Richer havens—Monaco, for example—seem unlikely to have been much perturbed.

J. The 2001 Report

In 2001, the Committee submitted its third report (2001 Report). It was called simply *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report*,¹¹⁹ but its principal message seems to be that not much progress has been made. The Committee did not actually concede that this was so, but it seems clear that the project, having moved on from the easy world of theoretical generalities to the hard business of specific applications, was making less progress than had been envisaged. Even within the OECD, support seems to have been fragmenting. As before, Switzerland and Luxembourg abstained. This time, though, Belgium and Portugal abstained too.¹²⁰ The smaller Member States, it seems, were feeling squeezed.

The 2001 Report is notable also for displaying a new-found *enthusiasm* for tax competition. The Committee had previously been careful to direct its project not at *all* tax competition but only at competition which it characterized as “harmful” (though, as I have mentioned, the Committee had left the distinction between harmful and harmless tax competition troublingly vague). In other words, it had effectively acknowledged that not all tax competition is harmful. It had also, however, been notably unenthusiastic about tax competition of any kind. In its 2001 Report, in contrast, the Committee presented the OECD as seeking “to promote tax competition” so as to “foster economic growth and development world-wide.”¹²¹

The point of the project, the Committee went on, was to ensure that tax competition was not only “free” but also “fair.”¹²² This marked an intriguing change of emphasis—or, at least, of terminology. The 2001 Report recounted also that the jurisdictions on the list of tax havens had

118. OECD, 2000, *supra* note 2, at para. 36.

119. OECD, 2001, *supra* note 2.

120. *Id.* at 4, n.1, which consists of this statement:

Belgium and Portugal abstain from this Report. Luxembourg recalls its abstention to the 1998 Report, *Harmful Tax Competition: An Emerging Global Issue*, which also applies to the present Report and regrets that the 2001 progress report is further away from the goal of combating harmful tax competition with respect to the location of economic activities. In addition, Switzerland notes that its 1998 abstention applies to any follow up work undertaken since 1998.

121. *Id.* at para. 3.

122. *Id.*

objected to some aspects of the campaign against them.¹²³ Moreover, small and weak though they were, they had won significant concessions.¹²⁴ As for the other two central parts of the project—preferential regimes in member and non-member countries—the 2001 Report said virtually nothing about either of them. Some important havens, as I have recounted, were not even on the OECD’s list. The Committee presumably intended to treat these jurisdictions as operating harmful preferential regimes, but its work on preferential regimes seems to have ground to a halt. Or, at least, if progress had been made, it was not mentioned in the 2001 Report.

K. Concessions to Tax Havens

As I have explained, the OECD proposed to identify tax havens principally by reference to four key factors. The first of these was the imposition of “no or nominal taxes on the relevant income.”¹²⁵ One might have inferred, therefore, that in order to have itself taken off the list of uncooperative tax havens, a jurisdiction might be required to tax income and to tax it at more than nominal rates. In its 2001 Report, however, the Committee was concerned to emphasize that this was not its intention. “The no or nominal tax criterion [it said] is *not* sufficient, by itself, to result in characterization as a tax haven. The OECD recognizes that every jurisdiction has a right to determine whether to impose direct taxes and, if so, to determine the appropriate tax rate.”¹²⁶

The Committee gave ground on the fourth key factor also. This was originally expressed, in 1998, as “the absence of a requirement that the activity be substantial.” Exactly what was meant by this is unclear. In 2000, the Committee reworded this “factor” as follows: “the jurisdiction facilitates the establishment of foreign-owned entities without the need

123. *Id.* at paras. 23–35.

124. *Id.* The havens targeted by the OECD (most of which, as I have observed, were small, poor, and politically uninfluential) appear to have regarded the OECD project as unprincipled and unfair because the OECD, whilst targeting them (the listed havens) appeared to be ignoring: (1) the OECD’s own havens (Switzerland and Luxembourg); (2) the OECD countries which, whilst not generally regarded as havens, have tax systems which can be and are used as havens in some circumstances (for example, the non-taxation by the United States of interest paid to non-residents); and (3) various other “offshore financial centers” such as Hong Kong and Singapore. *See, e.g.*, Letter from Rene R. Harris, President of Nauru, to Donald J. Johnston, Secretary-General, OECD (Dec. 3 2003), at <http://www.oecd.org/dataoecd/19/18/21842603.pdf>. *See also* OECD, THE OECD’S PROJECT ON HARMFUL TAX PRACTICES: A BRIEFING NOTE FOR JOURNALISTS (Mar. 22, 2004), at <http://www.oecd.org/dataoecd/59/63/30930917.pdf>. *See also* OECD, A PROCESS FOR ACHIEVING A GLOBAL LEVEL PLAYING FIELD (June 4, 2004), at <http://www.oecd.org/dataoecd/13/0/31967501.pdf>.

125. OECD, 2000, *supra* note 2, at para. 7, n. 4. The OECD has not explained what is meant by “nominal” or “relevant” in this context.

126. OECD, 2001, *supra* note 2, at para. 16 (emphasis in original).

for a local substantive presence or prohibits these entities from having any commercial impact on the local economy.”¹²⁷ This seems an improvement but still obscure—for many jurisdictions that are not tax havens impose restrictions on the establishment of corporations by foreigners,¹²⁸ and some tax havens are indifferent as to whether corporations owned by foreigners engage in local activity.¹²⁹ In 2001, the Committee explained that “in interpreting the no substantial activities criterion, the Forum sought to determine whether there were factors that discouraged substantial domestic activities.”¹³⁰ Again, however, some havens are indifferent to whether corporations owned by foreigners engage in local activity. In any event, whatever this fourth factor was supposed to mean, the tax havens on the OECD’s list objected to it, and the Committee responded by downgrading its significance.

Its resulting status is unclear. It seems that the Committee still regards factors discouraging to substantial domestic activity as relevant to the identification of tax havens, but it no longer regards such factors as key. Moreover, it no longer requires tax havens to modify this aspect of their tax systems. This relaxation was retrospective. That is, tax havens that had already given a commitment to eliminate their “no substantial activity” requirements were released from it.¹³¹

L. Transparency and the Exchange of Information

The OECD thus does not object to countries not taxing income. And it no longer objects to countries permitting the establishment of foreign-owned entities whilst discouraging them from engaging in substantial activity in the local economy. This leaves only the second and third key factors; that is, the OECD now requires tax havens only (1) to ensure that their tax systems are transparent and (2) to provide for the effective exchange of information. Any jurisdiction satisfying these two criteria will not be classified as uncooperative.

In its 2001 Report, the Committee elaborated on both of these requirements. It had made considerable progress in operationalizing these previously vague concepts. The transparency requirement it explained as follows:

127. OECD, 2000, *supra* note 2, at para. 7, n. 4.

128. A good example is China. *See, e.g.*, KENNETH A. LANCASTER, *TAXATION AND INVESTMENT IN THE PEOPLE’S REPUBLIC OF CHINA* (2003).

129. A good example is Hong Kong. *See, e.g.*, PHILIP SMART & ANDREW HALKYARD, *TRADE AND INVESTMENT LAW IN HONG KONG* (1993).

130. OECD, 2001, *supra* note 2, at para. 27.

131. *Id.* at para. 29.

By committing to transparency, a jurisdiction agrees that there will be no non-transparent features of its tax system, such as rules that depart from established laws and practices within the jurisdiction, “secret” tax rulings or the ability of persons to “negotiate” the rate of tax to be applied. Transparency also requires financial accounts to be audited or filed. Exceptions to this standard may be warranted where the transactions of an entity are de minimis or the entity is engaged solely in local activities and does not have foreign ownership, beneficiaries, management or other involvement. A committing jurisdiction also agrees that its governmental authorities should have access to beneficial ownership information regarding the ownership of all types of entities and to bank information that may be relevant to criminal and civil tax matters.¹³²

As regards the exchange of information, the Committee observed:

By committing to effective exchange of information, a jurisdiction agrees to establish a mechanism for the effective exchange of information that includes the following elements. The commitment ensures that there is a legal mechanism in place that allows information to be given to a tax authority of another country in response to a request for information that may be relevant to a specific tax inquiry. An essential element of effective exchange of information is the implementation of appropriate safeguards to ensure that the information obtained and provided is used only for the purposes for which it was sought. The adequate protection of taxpayers’ rights and the confidentiality of their tax affairs is essential to preserving the integrity and effectiveness of exchange of information programs In the case of information requested for the investigation and prosecution of a criminal tax matter, the information should be provided without a requirement that the conduct being investigated would constitute a crime under the laws of the requested jurisdiction if it occurred in that jurisdiction. In the case of information requested in the context of a civil tax matter, the requested jurisdiction should provide information without regard to whether or not the requested jurisdiction has an interest in obtaining the information for its own domestic tax purposes. The committing jurisdiction is also asked to agree that it will have administrative practices in place so that the legal mechanism for

132. *Id.* at para. 37. On negotiable tax rates, see *supra* note 47.

exchange of information will function effectively and can be monitored.¹³³

Work was continuing, the Committee said, on determining “the types of information that should be available for exchange” and “the means by which the information could be obtained.”¹³⁴

M. *Timing*

The timetable originally proposed by the Committee would have had the effect of requiring tax havens to eliminate their harmful tax practices before the OECD Member States were obliged to eliminate theirs. The havens complained that this was unfair. The Committee accepted this complaint and modified the timetable for havens so as to bring it into line with that for OECD members. This meant that havens and OECD members were all required to eliminate their harmful tax practices by 31 December 2005.

As has been recounted, the Committee did not report any progress at all in even identifying the harmful preferential regimes operated by non-OECD members. Presumably it had not yet begun the job of attempting to extract from the governments concerned commitments to eliminate their preferential tax regimes’ “harmful features.” In any event, although the Committee provided timetables for havens and OECD members to eliminate their harmful tax practices, it provided no timetable for non-OECD members (other than havens) to do the same.

N. *The OECD’s List of Uncooperative Tax Havens*

In April 2002, the OECD duly published its list of uncooperative tax havens. There were only seven of them: Andorra, Liechtenstein, Liberia,

133. OECD, 2001, *supra* note 2, para. 38.

134. *Id.* at para. 42. The question of the types of information which countries are to be required to exchange is crucial and difficult. The achievement of the OECD’s objectives would seem to require havens to collate an enormous volume of information of kinds that they currently do not collect at all. Indeed, it seems probable that complying with the OECD’s requirements will be beyond the current administrative capacity of at least some of the listed havens—even if they were enthusiastic partners in the project. In fact, they are unenthusiastic; by the OECD’s own reckoning, they will suffer as a result of ceasing to function as havens, and the taxpayers (or tax evaders) about whom they will be expected to collect information have an obvious interest in not providing it. Given that the number of havens is large and that many of them are remote, achieving even the OECD’s revised objectives would appear to present formidable difficulties. The OECD has offered to “assist” (*see* OECD, 2000, *supra* note 2, at paras. 26–27, 30) but the nature and scale of such assistance remains unclear. The extent to which governments requesting information from other governments would pay for it remains unclear.

Monaco, the Marshall Islands, Nauru, and Vanuatu.¹³⁵ The other jurisdictions designated as havens had all, it seems, either ceased their harmful tax practices (for example, Tonga)¹³⁶ or made commitments, in terms acceptable to the OECD, to do so (for example, Anguilla).¹³⁷ In May 2003, Vanuatu made the commitment asked of it and so was removed from the list.¹³⁸ In December 2003, Nauru did the same and so was likewise removed.¹³⁹ There thus remain only five jurisdictions on the OECD's list of uncooperative tax havens: Andorra, Liechtenstein, Liberia, Monaco, and the Marshall Islands.¹⁴⁰

O. The 2004 Report

In 2004, the Committee submitted its fourth report, called simply *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (2004 Report).¹⁴¹ In it, the Committee reported significant progress in its work on eliminating harmful preferential regimes in OECD Member States and information exchange with havens. Perhaps most notably, the Committee reported that of its own Member-States' preferential re-

135. See generally Press Release, OECD, The OECD Issues the List of Uncooperative Tax Havens (Apr. 18 2002), at http://www.oecd.org/document/19/0,2340,en_2649_33745_2082323_119690_1_1_37427,00.html. See also Press Release, OECD, The OECD List of Uncooperative Tax Havens—A Statement by the Chair of the OECD's Committee on Fiscal Affairs, Gabriel Makhouf (Apr. 18, 2002), at http://www.oecd.org/document/19/0,2340,en_2649_33745_2082323_119690_1_1_37427,00.html.

136. Press Release, OECD, Tonga No Longer Tax Haven (Aug. 23, 2001).

137. Press Release, OECD, Anguilla and Turks and Caicos Islands Commit to Cooperate with OECD to Address Harmful Tax Practices (Mar. 8, 2002).

138. Press Release, OECD, Vanuatu Makes Commitment and is Removed from OECD List of Uncooperative Tax Havens (May 20, 2003), at http://www.oecd.org/document/31/0,2340,en_2649_201185_21863583_1_1_1_1,00.html.

139. Press Release, OECD, Nauru is Removed from OECD List of Uncooperative Tax Havens (Dec. 12, 2003), at http://www.oecd.org/document/31/0,2340,en_2649_201185_21863583_1_1_1_1,00.html.

140. It does not follow, of course, that the number of tax havens in the world has been reduced to five. On the contrary, many of the jurisdictions which have made the commitment required by the OECD seem in fact still to be operating as havens. Published data on such operations seem to be virtually non-existent, but this is unsurprising given that these jurisdictions seem to be attempting to operate as havens whilst simultaneously assuring the OECD and its members that they are not, and the taxpayers using these jurisdictions as tax havens have at least as strong an interest as the jurisdictions' governments in not publicizing their activities. Similarly, a number of jurisdictions which were omitted from the original list of havens are continuing to operate as havens. Examples include Hong Kong, Singapore, and Switzerland. This would appear to present the Organization with a dilemma. If it restores (or adds) these jurisdictions to its list of uncooperative havens, the list will grow, and the project will appear to be going backwards. If it does not, these jurisdictions will presumably remain free to function as havens, and the project will in fact be going backwards.

141. See OECD, 2004, *supra* note 2. See also Robert Goulder, *TNI Interview: Jeffrey Owens*, 33 TAX NOTES INT'L 1189 (2004); Cordia Scott, *OECD Unveils Progress Report on Harmful Tax Regimes*, 33 TAX NOTES INT'L 1151 (2004). Owens is the head of the OECD's Centre for Tax Policy and Administration.

gimes, *all* had either: (1) been abolished; (2) been amended to remove their “potentially harmful features;” or (3) been found to be “not harmful.”¹⁴² The Committee did not report much progress in its work on preferential regimes in non-member States, but it did contain this statement: “With the progress made on other aspects of the work, the Committee will now be able to focus and accelerate its work in this area.”¹⁴³

It would seem, then, that work on the most difficult, most problematic, most important, and potentially most counter-productive part of the project is about to begin. It remains unclear, however, whether the OECD’s plan is to continue on the basis of confining the project to services¹⁴⁴ or whether it will at this juncture broaden it so as to cover manufacturing also.

III. THE MERITS OF THE OECD PROJECT

The two basic components of the OECD project—tax havens and preferential regimes—raise different issues; their merits must therefore be separately assessed.

A. *The Case Against Tax Havens*

There are good reasons for regarding tax havens as objectionable. In particular, they are commonly parasitical. They do not seek to attract real investment.¹⁴⁵ Rather, they make themselves available as a means by which people and firms can escape the taxes they might otherwise have to pay in other countries. Some of them, at least, deliberately set out to undermine other countries’ tax systems and to profit by so doing. Moreover, what havens typically facilitate is not avoidance (clever, but disclosed, structuring of entities and transactions) but evasion (dishonesty or non-disclosure of relevant facts). Further, developed countries’ losses to havens are substantial, the populations of havens are small, and only a very small part of the revenues lost by developed countries reappear in the revenues of the havens. The OECD seems on solid ground, therefore, in its assertion that tax havens generally detract from global welfare. There are, therefore, good reasons for eradicating tax havens.

142. OECD, 2004, *supra* note 2, at paras. 11–12.

143. *Id.* at para. 37.

144. *See supra* notes 28–30.

145. At least, they do not, in their capacity as havens, seek real investment. It is possible for a jurisdiction to be a tax haven and also to seek real investment, but the two functions are distinct.

Even so, not all havens are indefensible. There are perhaps two sorts of tax havens. Some set out deliberately to function as havens. That is, they have structured their tax systems (and other aspects of their legal systems) deliberately to profit by providing foreign individuals and firms with a means of avoiding taxes in their own countries. There seems to be no reason for the countries affected to tolerate this if they can stop it by legitimate means.

It seems possible, however, that not all havens are of this type. For perhaps some havens function as havens only incidentally. Perhaps, that is, their tax systems were developed to meet the needs of their own residents, and it transpired that they incidentally enabled foreigners to avoid tax.¹⁴⁶ For the OECD to dictate policy to such jurisdictions seems harder to justify than in the case of jurisdictions which set out deliberately to undermine other countries' tax systems. For why should a country not structure its tax system however it wishes? If other countries' taxes are so onerous that their residents are motivated to resort to elaborate offshore structures and criminal non-disclosure of income in order to escape them, it is not self-evident that it is the tax havens' fault (at least if the haven did not design its tax system with this objective). But to distinguish between havens on the basis of the intentions of their legislatures would appear to be problematic.

Of the thirty-five jurisdictions on the OECD's list of havens, it may be that all are of the former type. That is, it may be that they all designed their tax systems deliberately to provide a means by which foreign firms and individuals might avoid taxes in their own countries.¹⁴⁷ This may be so also, therefore, of the five jurisdictions still on the Organization's list of "uncooperative" havens. Perhaps, though, the OECD's campaign against havens can be interpreted as having spared jurisdictions that did not set out to become havens but became so incidentally.¹⁴⁸ Even if this is so, however, until all, or nearly all, havens are closed down—including those, if any, that became havens only incidentally—it is difficult to see how the OECD's campaign can succeed.

146. In recent years, tax history has been something of a growth industry. See, e.g., JOHN TILEY, *STUDIES IN THE HISTORY OF TAX LAW* (2004); STEVEN WEISMAN, *THE GREAT TAX WARS* (2002); and the Tax History Project, at <http://www.taxhistory.org>. But much remains to be done in explaining the history of even the major OECD countries' tax systems; the history of most other countries' tax systems remains very largely unwritten.

147. Given the state of the literature, it is impossible to determine the extent to which this statement is valid.

148. Again, given the state of the literature, it is impossible to determine the extent to which this statement is valid. The difficulty is exacerbated by the fact that most (and perhaps all) of those jurisdictions which are traditionally not thought of as tax havens can be used as tax havens in some circumstances. An important example is the United States, in respect of interest derived by non-residents. See *supra* note 81.

More importantly, even though tax havens are harmful, it does not follow that it is necessarily desirable for the OECD (or any other collective of countries) to attempt to eradicate them. The reason is that the cure may be worse than the ailment. That is, if the matters on which a small group of rich countries can dictate policy to the rest of the world are extended to taxation, this seems to represent a further erosion of national independence and diversity.

Another charge routinely made against tax havens is that they facilitate the money-laundering activities of drug dealers, gun runners, terrorists, and so on. A number of havens appear, indeed, to be guilty.¹⁴⁹ Conduct of this kind seems a more compelling reason for countries affected to violate the sovereignty of the haven facilitating it. It does not follow, though, that the havens should reform their tax systems. If the problem is money-laundering, taxing it is not the point. Indeed, for a government to tax money-laundering (and thus to participate in illicit gains) would be objectionable.

It is worth noting also that, although some of the tax havens identified by the OECD are rich (for example, Monaco and the Channel Islands), many are very poor (for example, the Cook Islands and Liberia). The carrying out of the OECD program seems likely to entail the intensification of poverty in places already poor. Perhaps it already has. Those who use tax havens seem unlikely to suffer from the OECD's campaign, at least in the medium-term—for the closing down of their haven of choice will mean only that they use another. The volume of transactions channeled through tax havens seems unlikely to be much reduced, therefore, until all, or almost all, the havens cease to function as such. One of the defining characteristics of such transactions is, after all, that they have no necessary connection with the haven through which they are channeled. It seems likely that the lawyers, accountants, and other tax professionals who practice in tax havens (and of whom many are already expatriate) will prove similarly mobile. That is, they are likely to move on to the new haven of choice, taking their clients' business with them, and carry on more or less as before. As a result, the new haven will be bigger, richer, more sophisticated, and better able to resist the efforts of the OECD. It seems likely, though, that those who remain behind in the ex-haven might suffer more enduring losses. In other words, it seems likely that, to some extent, the wealth accruing to those providing professional services in tax havens trickles down to the havens'

149. See Benjamin R. Hartman, *Coercing Cooperation from Offshore Financial Centers: Identity and Coincidence of International Obligations Against Money Laundering and Harmful Tax Competition*, 24 B.C. INT'L & COMP. L. REV. 253, 254-55 (2001); Peter J. Kacarab, *An Indepth Analysis Of The New Money Laundering Statutes*, 8 AKRON TAX J. 1, 33 (1991).

other residents and that the cessation of these services would consequently impair welfare in these societies generally.

The Committee recognized that for a tax haven to cease operating as such would cause its economy to contract; that in some cases this would mean that very low per capita incomes would be lower still; and that aid of some kind would be needed.¹⁵⁰ Curiously, however, the Committee assumed also that such an economic contraction would occur only in some havens, not all (though it did not say which) and that even in these it would be merely temporary,¹⁵¹ but it did not explain why. The Committee indicated also that, in its view, it would only be *cooperative* tax havens which deserved aid.¹⁵²

B. *The Case Against Preferential Tax Regimes*

As I have explained, the aim of the OECD's campaign against preferential tax regimes is to protect the economies of the G7 countries and of its other like-minded Member States and, more particularly, to preserve their tax revenues. This raises an awkward question: why should other countries, particularly developing countries, go along with it? The reason preferential tax regimes exist is presumably that the countries that operate them calculate that it is in their interest to do so. Specifically, they calculate that their preferential regimes promote economic growth. To scrap the regimes would, therefore, according to these countries' own calculations, impair growth. Why, then, should these countries sacrifice their own economies for the sake of enabling relatively rich countries to protect their economies and maintain their relatively generous public spending?

The OECD maintains that harmful tax competition (that is, havens and harmful preferential regimes) is causing, or is about to cause, a "world-wide reduction in welfare"¹⁵³ and that eliminating these phenomena would raise global welfare. Thus, whilst it seems plain from the OECD's reports that its principal concern is the protection of its Member States' own economies and public revenues, the Organization has, not surprisingly, sought to portray the project as being of more general benefit.

But demonstrating that preferential regimes have caused, or might cause, a reduction in "global welfare"¹⁵⁴ would appear to present methodological difficulties so grave as to be for practical purposes (and

150. OECD, 2000, *supra* note 2, at paras. 26–27.

151. *Id.*

152. *Id.*

153. OECD 1998, *supra* note 2, at para. 37; *see also id.* at para. 4.

154. OECD, 2000, *supra* note 2, at para. 4.

perhaps for theoretical purposes also) insoluble. The first of these is that it would appear to require the measurement of "global welfare." Even if welfare meant simply some function of income and wealth, the difficulty would be serious. But welfare is presumably not simply a matter of aggregate wealth and income. An increase, no matter how large, in the world's wealth would presumably have only a very small effect on its welfare if it all went to a single person. Welfare, then, is presumably a function not only of wealth and income but of distribution too (and perhaps of other factors also). But what is the relationship between distribution and welfare? This seems to be very largely a matter of opinion.

Secondly, there is the problem of demonstrating causation. Even if global welfare could be defined and changes in it measured, on what basis could they be attributed to preferential regimes rather than other factors? The need to demonstrate consequences in advance would seem to make the proof of the hypothesis more difficult still.

Governments, of course, formulate and implement policies all the time without being in a position to answer questions of this nature. So, too, do multilateral organizations. But this is one of the reasons democratic procedures are an ultimate value. If it is impossible to demonstrate with reasonable confidence the likely consequences of a proposed policy, it is important that the procedure by which the policy is determined should allow a suitable voice to all those likely to be affected. The OECD's tax project seems not to satisfy this criterion.

In any event, as to precisely how developing countries' preferential regimes might cause a reduction in global welfare, the OECD's analysis is vague. According to the 1998 Report, preferential regimes might cause the following harmful effects:¹⁵⁵

1. they might "erode the tax bases of other countries;"¹⁵⁶
2. they might "distort trade and investment patterns;"¹⁵⁷
3. they might "alter the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption);"¹⁵⁸

155. In explaining the mechanisms by which harmful tax competition reduces global welfare, the Committee has not systematically distinguished between the effects of havens and the effects of preferential regimes. Rather, it has lumped them together as harmful tax competition and attributed to them the consequences listed here. That the Committee has not assessed separately the effects of havens and of preferential regimes is a good measure of both the inadequacy of its analysis and the extent to which it has sacrificed analysis to rhetoric (for the idea seems to have been to tar preferential regimes with the same brush as havens).

156. OECD, 1998, *supra* note 2, at para. 4.

157. *Id.*

158. *Id.* at para. 23.

4. they might undermine “taxpayer confidence in the integrity of tax systems;”¹⁵⁹
5. they might “undermine the fairness, neutrality, and broad social acceptance of tax systems generally;”¹⁶⁰ and
6. they might “hamper the application of progressive tax rates and the achievement of redistributive goals.”¹⁶¹

The Committee’s key complaint is its first: that preferential regimes might “erode the tax bases of other countries.” Presumably by this it meant that preferential regimes might erode not only OECD Member States’ tax bases but non-member States’ also. Although the Committee did not elaborate, this complaint seems sound. The aim of a preferential regime is to attract investment. Such investment might be new (that is, it might be in addition to all existing investment and so not entail the withdrawing of some other investment); or it might be merely shifted (for example, a firm might close or curtail its operations in some other country so as to invest in the country offering the preferential regime). If the latter, the tax base of the former country will tend to shrink (or, at least, grow less speedily than would otherwise be the case).¹⁶²

But this core component of the OECD’s theory, although sound in itself, is insufficient to bear the weight the Organization seeks to place on it. Granted that preferential regimes are likely to lead to the erosion of other countries’ tax bases.¹⁶³ Granted, indeed, that this is in a sense their principal objective, it does not follow that such regimes are likely to detract from global welfare (however defined).¹⁶⁴ The reason is that the losses suffered by the countries whose tax bases are eroded might be offset—or more than offset—by the gains made by the countries operating the preferential regimes. Indeed, given that the countries making the complaint are mostly rich (as is evidenced by the fact that they used the OECD as their vehicle), and given also that the countries using preferential regimes are mostly poor, the theory that the shifting of investment resulting from preferential regimes (or from causes including preferential regimes) is likely to *add* to global welfare seems entirely plausible.

159. *Id.* at para. 4.

160. *Id.*

161. *Id.* at para. 23.

162. But only if the investor’s home country does not operate comprehensive CFC rules. See *supra* notes 62–63.

163. See Avi-Yonah, *supra* note 1, at 1597–99, 1634.

164. Even if global welfare is defined purely in terms of wealth and income (without reference to distribution or other factors), it does not follow that the erosion of some countries’ tax bases must entail a reduction in it. Nor, therefore, does it follow if a more complex definition is used.

Given that the shifting is induced by tax incentives, it may be that the tax revenues lost by the country losing the investment do not reappear in the hands of the government of the country gaining the investment.¹⁶⁵ It does not follow, however, that the country operating the regime cannot gain. The reason is that the shifted investment, although producing less tax revenue than in its original country, might nonetheless produce private benefits for its new host country—in forms such as wages, training, and technology transfer.¹⁶⁶ Benefits of these kinds seem in fact to be common. They also, in some circumstances, generate government revenues—for example, tax on income from employment.

In any event, the proposition that the erosion of some countries' tax bases as a result of other countries' preferential tax regimes has led to (or is likely to lead to) a "world-wide reduction in welfare" (however defined) seems at this point purely speculative. It might be susceptible to proof, but the OECD has to date not offered any satisfactory evidence. The proposition consequently remains unproven.¹⁶⁷ It therefore does not afford a satisfactory basis for action of the kind envisaged by the OECD (entailing, as it does, the imposition of sanctions by rich countries on poor ones).

The OECD's second complaint is that preferential tax regimes might "distort trade and investment patterns."¹⁶⁸ That firms and individuals tend (all else being equal) to shift their investments from wherever they are to countries where they would be taxed less heavily or not at all seems uncontroversial. What is not clear, however, is why this should be regarded as a *distortion*. The OECD's use of the word seems to imply that the patterns of trade and investment which currently exist in the world are somehow optimal and that they should therefore be preserved, or, alternatively, that the levels of taxation which prevail in the OECD countries are somehow optimal and that they should therefore be preserved. The Organization has not explained, however, why this should be so. Moreover, the hypothesis that existing patterns of trade and investment are

165. Even this is not necessarily so. The rate of tax in the country operating the preferential regime is *ex hypothesi* lower than the rate in the country from which the investment was shifted. But the gain made by the country gaining the investment might be greater than the loss suffered by the country losing it. That is, there might be an increase in overall economic activity. If so, a lower rate of tax might produce equivalent (or greater) revenues.

166. See Yoram Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries*, 23 VA. TAX REV. 161, 175–80 (2003). Such spillover benefits might be difficult to quantify. For example, a job regarded as relatively undesirable and poorly paid in a rich country might be regarded as relatively prestigious and well paid in a poor country—even if the remuneration is in fact less.

167. Indeed, the OECD, far from demonstrating that preferential regimes have actually caused the erosion of other countries' tax bases, has not yet produced evidence showing satisfactorily that this is likely to happen, or even that it is a contributing factor.

168. OECD, 1998, *supra* note 2, at para. 4.

likely to maximize global welfare seems inherently implausible. It may be, on the contrary, that preferential regimes promote the efficient allocation of resources.¹⁶⁹ The gap between rich countries (most of which are members of the OECD) and poor countries (most of which operate preferential regimes) seems as wide as ever, and there are far more people in poor countries than in rich ones. The contrary hypothesis—that shifting investment from OECD countries to poor countries (whether operating preferential tax regimes or not) is likely to *add* to global welfare (however defined)—therefore seems, again, at least as plausible as that offered by the OECD. Again, these hypotheses are purely speculative: the OECD has yet to produce any satisfactory evidence.

Thirdly, the OECD complains that preferential tax regimes might “alter the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption).”¹⁷⁰ In the case of countries operating preferential regimes, this seems almost axiomatic. Such regimes, by definition, seek to attract foreign investment by taxing it less heavily than domestic investment. The establishment of a preferential regime must therefore tend to shift the burden of taxation from mobile foreign investment to “relatively immobile factors” (in particular, labor) and from income to consumption. As for countries which do not operate preferential regimes, they will presumably tend to lose investment to countries which do. Again this will tend to shift the burden of taxation to other, less mobile, factors. Perhaps too, it will tend to shift the burden from income to consumption. Such countries might respond by establishing preferential regimes of their own. This too, would tend to result in a shifting of the tax burden from mobile to relatively immobile factors and from income to consumption. Again, then, the OECD’s complaint seems entirely plausible (though again, the OECD has offered no satisfactory evidence).

Even if the OECD’s hypothesis is sound (that is, even if developing countries’ preferential regimes have caused a shifting of the tax burden in developed countries), this does not necessarily mean that there will be a decline in global welfare. The reason, once more, is that the OECD has offered no reason to suppose that any loss to developed countries will be greater than the gain to developing countries operating preferential regimes.

The OECD’s fourth complaint is that preferential regimes might undermine “taxpayer confidence in the integrity of tax systems.”¹⁷¹ Exactly

169. See Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543, 552–64 (2001); Mitchell B. Weiss, *International Tax Competition: An Efficient or Inefficient Phenomenon?*, 16 AKRON TAX J. 99, 118–21, 128–30 (2001).

170. OECD, 1998, *supra* note 2, at para. 23. See Avi-Yonah, *supra* note 1.

171. OECD, 1998, *supra* note 2, at para. 4.

what it means by this is unclear. In particular, it is unclear whether the OECD is concerned about taxpayer confidence in the countries operating the preferential regimes, in the countries whose tax bases are being eroded, or both. As regards the countries operating the regimes, the OECD's concern seems misplaced: if these countries choose to operate such regimes, it is presumably because they have calculated that the costs (including any undermining of taxpayer confidence) are outweighed by the benefits.¹⁷² Moreover, most of the countries operating preferential regimes are not members of the OECD. The Organization's mandate to devise and impose solutions to their problems is, to say the least, unclear.

As for the countries suffering erosion of their tax bases, the Committee's complaint seems to have more substance. These countries' citizens seem clearly displeased at the shifting of investment from their countries to other countries. It seems reasonable to suppose that their confidence in the integrity of their countries' tax systems is undermined also.¹⁷³ In particular, it seems to be commonly thought that the emigration of capital is likely to lead to a relative increase in the taxation of labor (as, indeed, the OECD asserts and that this is undesirable. Once more, this seems entirely plausible. To characterize it as undermining "taxpayer

172. From the point of view of developing countries, the principal objection to preferential tax regimes may be that the countries operating them derive no benefit from so doing. Rather, the benefit goes to the firms which, under the regimes, pay little or no tax. The principal effect of such regimes is, therefore, according to this line of reasoning, that large firms operating internationally are able to escape taxes on substantial parts of their profits. This argument essentially endorses the OECD's position, although its principal concern is not the erosion of the developed countries' tax revenues but the untaxed exploitation of developing countries by foreign firms. See ANDREW CHARLTON, INCENTIVE BIDDING FOR MOBILE INVESTMENT: ECONOMIC CONSEQUENCES AND POTENTIAL RESPONSES 14 (Research Programme on Governing Finance and Enterprises: Global, Regional and National, OECD Development Centre, Working Paper no. 203, 2003), at <http://www.oecd.org/dataoecd/39/63/2492289.pdf>. An alternative argument is that the effect of preferential regimes is to shift tax revenues from the countries operating the regimes to the countries of residence of the firms taking advantage of them (because to the extent that a profit is not taxed in the country from which it is derived, it is more readily available to be taxed in the country in which the firm deriving it resides). See Kevin Fletcher, *Tax Incentives in Cambodia, Lao PDR, and Vietnam* 4–16 (Aug. 16–17, 2002), at <http://www.imf.org/external/pubs/ft/seminar/2002/fdi/eng/pdf/fletcher.pdf>.

173. Even so, taxpayers' attitudes towards and understanding of their own and other countries' tax systems seems to be a subject in urgent need of research. Such research could usefully cover (among other aspects of the subject) taxpayers' beliefs and attitudes as to preferential regimes. The impressionistic evidence is intriguing. Certainly there seems to be considerable discontent in the developed countries at the emigration of capital and perhaps also at the consequences for these countries' public finances. On the other hand, one of the most notable phenomena in countries operating apparently successful preferential tax regimes (for example, China) is the optimism, indeed ebullience, of the people. Empirical research into people's attitudes to taxation might also usefully investigate the extent to which people (in both OECD countries and developing countries) know about and approve of the OECD's project on harmful tax competition.

confidence in the integrity of tax systems” seems reasonable enough. Again, however, this falls short of demonstrating a decline in global welfare. The reason, again, is simply that the OECD has offered no reason for supposing that the losses suffered by countries losing investment are greater than the gains won by countries attracting it.

The OECD’s fifth complaint is that preferential tax regimes might “undermine the fairness, neutrality, and broad social acceptance of tax systems generally.”¹⁷⁴ “Fairness,” “neutrality,” and “broad social acceptance” appear to require separate consideration. The neutrality point seems relatively straightforward. Preferential regimes seem, by definition, to constitute deliberate departures from neutrality. The hypothesis that preferential regimes “undermine” neutrality is, therefore, in a sense true (though the word “undermine” seems inapt in this context). The OECD’s main point is, presumably, that a preferential regime in one country tends to undermine neutrality in other countries, and perhaps this is true. Even so, there seems again to be no particular reason to suppose that the developed countries’ losses (that is, the losses resulting from any undermining of their tax systems’ neutrality attributable to developing countries’ preferential regimes) are greater than the developing countries’ gains.

As for fairness, it is very largely a matter of opinion. Moreover, fairness is not necessarily an absolute value. In particular, if the peoples of the less-developed countries regard their own preferential regimes as unfair (a point upon which evidence is, again, lacking), they might nonetheless regard such unfairness as a price worth paying for the benefits of attracting investment. The peoples of the developed world might have other priorities. Again, however, there is no obvious reason to suppose that any undermining of tax equity in developed countries represents a loss greater than the gain made by developing countries.

The same analysis applies to “broad social acceptance.” Perhaps it is true that the developing countries’ preferential regimes undermine the broad social acceptance of the developed countries’ tax systems (though the OECD’s meaning is, again, far from clear). But this remains unproven, and, even if it can be established, the losses suffered by the developed countries might be outweighed by the gains to the less developed.

Similarly with the OECD’s sixth complaint, that preferential regimes might “hamper the application of progressive tax rates and the achievement of redistributive goals.”¹⁷⁵ It might be true, but it remains unproven, and once more, even if it is true, there seems to be no reason to suppose,

174. OECD, 1998, *supra* note 2, at para. 4.

175. *Id.* at para. 23.

without satisfactory evidence, that the developed countries' losses (if any) are greater than the developing countries' gains.

C. *A Race to the Bottom?*

The OECD's reports say curiously little about the consequences of preferential tax regimes for the countries that operate them. The Organization's position seems to be, however, that the countries operating such regimes are effectively engaged in a "race to the bottom,"¹⁷⁶ that they consequently derive little or no benefit from their regimes, and that they, in fact, suffer a loss as a result of their regimes.¹⁷⁷ The theory is that, if a country seeks to attract foreign investment by offering preferentially generous tax treatment, some other country might compete for the same investment by offering even more generous treatment; the first country might respond by offering treatment more generous still and so on and so on, until the benefit of attracting the investment has been reduced to zero. Indeed, the country which succeeds in attracting the investment might even suffer a loss because it might find itself permitting the foreign investor to benefit from its expenditure (on, for example, infrastructure and education) without charge. If this is so, the preferential regime, far from generating growth, will function so as merely to permit the foreign investor to exploit the host country.

This theory, while apparently containing much truth, is not self-evident. In some cases, it may be that the foreign investor, although benefiting from a preferential regime (that is, although paying less tax than would a resident investor), nonetheless still pays sufficient tax to cover the public spending (and other unpaid-for resources) from which it benefits. In such a case it is difficult to see how the country operating the regime has lost as a result. Granted, it has not done as well as it would have done if the foreign investor had made the investment and paid tax without the benefit of the preferential regime—but it cannot be assumed that that alternative is available because, without the preferential regime, the investment might not have been made.

In other cases, the foreign investor may not pay enough tax to cover the cost of the public spending from which it benefits. In other words, the host government has effectively subsidized the foreign investor. This does not necessarily mean, however, that the country as a whole has suffered a loss as a result of the investment. The reason is that (as mentioned above) the investment might have produced private benefits for residents of the host country (in forms such as wages, training, and

176. *Id.* at para. 43.

177. *See* Avi-Yonah, *supra* note 1, at 1647; *but see* Roin, *supra* note 169, at 549–50.

technology transfer),¹⁷⁸ and these benefits might exceed the subsidy. For a government effectively to subsidize private benefits in this way might raise difficult issues of equity, but these seem to be fully within the province of the domestic political processes of the country concerned. The OECD, in any event, has not claimed a mandate to participate in their resolution.

D. *Preferential Regimes and Global Welfare*

All in all, the OECD's theory that eliminating harmful preferential tax regimes will raise global welfare seems to have been something of an afterthought. It is supported by only the most skeletal theory and no satisfactory evidence. It is plainly self-serving and, therefore, suspect. Having decided to eliminate harmful preferential tax regimes, the OECD needed to persuade the countries operating them to desist. It was thus necessary to assert that this would be in these countries' own interest. But the theory that the interests of the world as a whole happen to coincide with those of the G7 seems suspiciously felicitous—especially given that the countries which operate preferential regimes presumably calculated that they would gain by doing so.

The OECD's basic complaint is that developing countries' preferential regimes are harmful to the economies and public revenues of OECD member countries. If this is true at all, it is presumably equally true of countries which are *not* members of the OECD. That is, the OECD's position is presumably that other countries' preferential regimes are as harmful to non-members as to members. When it comes to the effect of preferential regimes on the countries operating them, however, the OECD's position is vague in the extreme. This lack of clarity seems itself a telling measure of the weakness of the Organization's case against preferential regimes. It seems possible, however, to construct three basic theories that might serve to justify the OECD's campaign to eradicate developing countries' harmful preferential tax regimes.¹⁷⁹

The first of these is that all countries operating preferential tax regimes suffer as a result. Given the OECD's premise—that countries that

178. See Margalioth, *supra* note 166, at 175–80.

179. These three theories are formulated here as if: (1) all developed countries were members of the OECD; (2) the OECD's membership included no countries other than developed countries; and (3) all developing countries operate preferential regimes. The first and second of these three assumptions are in fact false, and it is possible that the third is also. Nonetheless, to proceed in this manner seems sensible because it is simpler. It is necessary to emphasize, however, that the cost of this simplicity is that the analysis ignores the position of: (1) developed jurisdictions which are not members of the OECD (for example, Hong Kong and Singapore); (2) the Organization's less-developed members (for example, Poland and Mexico); and (3) any less-developed jurisdictions which do not operate preferential regimes.

do not operate preferential regimes are harmed by countries that do—this would mean that preferential regimes harm *all* countries—both those that operate them and those that do not. If this is so, the consequence of eradicating such regimes could only be that all countries would gain (leaving aside the cost of effecting the eradication).¹⁸⁰ The second theory is that, of the developing countries that operate preferential regimes, some suffer; some gain; and the net result is negative. Given again the OECD's premise (that countries that do not operate preferential regimes are harmed by countries that do), the net result, again, could only be negative. Again, therefore, the net result of eradicating preferential regimes would be positive (leaving aside, again, the cost of effecting the eradication).¹⁸¹ The third theory is that, even if the overall effect of developing countries' preferential regimes is positive for the countries that operate them, nonetheless their global impact is negative, because of their effects on countries that do not. Once more, then, the overall effect of eradicating preferential regimes would be positive (leaving aside, once more, the cost of effecting the eradication).¹⁸²

The OECD itself seems not to have analyzed in any such terms the benefits of its campaign to rid the world of "harmful" preferential regimes. Rather, it seems simply to have asserted that eradicating harmful preferential regimes would somehow raise global welfare—without explaining how. It seems difficult, though, to justify the OECD campaign against harmful preferential regimes other than on the basis of some such theory. But none of these theories, nor any variant of them, seems satisfactory.

E. *The Theory that Everyone Loses*

The first theory (that all countries operating preferential regimes suffer as a result) seems most plausibly to be based on the "race to the bottom" theory. Countries might compete to attract foreign investment by offering more favorable tax treatment than their neighbors, and so investment might occur only in countries which offer treatment so favorable that they suffer a net loss of welfare as a result. That is, any benefit

180. The principal costs would seem to be the loss of the developing countries' autonomy inherent in their taking instructions from the OECD (an organization of which they are not members), the reduction in the diversity of tax systems operating in the world, the cost of reforming the developing countries' laws so as to eliminate the preferential regimes, and the cost of administering the reformed law.

181. In this case, the costs would seem to include the factors identified in note 180 and also another: compelling countries currently benefiting from their preferential regimes to desist.

182. In this case, the costs would seem to be the same as those identified in note 181, except that the number of countries bearing them would be larger.

to the country operating the preferential regime (taxes, if any; employment; training; transfers of technology and know-how; etc) is less than the cost (use by the foreign investor of resources provided by the host country). The host country would therefore, in effect, be subsidizing the foreign investor.

Once more, the first difficulty with this theory is that it remains unproven. Moreover, what evidence there is seems to contradict it, for some countries operating preferential tax regimes have enjoyed considerable economic success. Perhaps the best current example is China, which over the last twenty years or so has operated a large number of preferential regimes,¹⁸³ attracted an enormous volume of foreign investment, and experienced spectacular economic growth.¹⁸⁴ The extent to which, if at all, China's growth is attributable to its preferential tax regimes is, of course, debatable. It is possible that, had China not established these regimes, its growth would have been even more spectacular (particularly if other countries, too, had refrained or been prevented from offering tax incentives for foreign investment). But there seems to be no particular reason to suppose that this is so. On the contrary, there seems every reason to suppose that the Chinese government calculated that tax incentives aimed at attracting foreign investment would promote economic growth and that its calculations have been thoroughly vindicated by events. Indeed, it seems possible that it is precisely because preferential regimes have proved so successful in countries such as China that the OECD now wishes to shut them down.

A second difficulty is that, even if it is accepted that developing countries' preferential tax regimes are invariably harmful to the countries that operate them, it is not self-evident that it is appropriate for the OECD to attempt, condescendingly, to save them from their own collec-

183. On the structure of China's tax system generally, see MICHAEL J. MOSER & WINSTON K. ZEE, *CHINA TAX GUIDE* (3d. ed. 1999) and LANCASTER, *supra* note 128.

184. According to the World Bank, per capita GDP in China increased from US\$173 in 1981 to US\$1024 in 2003 (at constant 1995 US\$). WORLD BANK, *WORLD DEVELOPMENT INDICATORS ONLINE*, at <http://devdata.worldbank.org/query>. According to the United Nations, China's per capita GDP rose at a rate of 9.1% per year from 1981 to 1990 and 9.7% per year from 1991 to 2002. U.N. DEP'T OF ECONOMIC & SOCIAL AFFAIRS, *WORLD ECONOMIC AND SOCIAL SURVEY*, 2003, at 269, U.N. Doc. ST/ESA/283, U.N. Sales No. E.03.II.C.1 (2003). References to data on China's economic growth and the scale of foreign investment in China are given below at notes 272 and 273. Growth in poor countries will not necessarily alleviate poverty, because any increase in wealth might be very narrowly distributed. Indeed, an increase in a country's wealth, if narrowly distributed, might be accompanied by an increase in overall poverty. In fact, growth in less developed countries has commonly been characterized by extreme inequalities of distribution. Even so, growth seems in many countries to have resulted in a widespread alleviation of poverty. China is, again, a good example. In any event, there seems no reason to suppose that wealth in poor countries is any less likely to alleviate poverty than in rich ones.

tive folly. Rather, it would clearly have been better for the developing countries to have been involved in the process—and on an equal footing, not on the receiving end of the OECD’s “dialogue.”¹⁸⁵ As it happens, the developing countries themselves seem to have made no effort to eliminate this form of tax competition. If they perceived themselves as suffering from their own and one another’s preferential regimes in a race to the bottom, one might have expected them to club together to stop this from happening or at least to make the attempt. That they appear not to have done so seems powerful evidence that the developing countries do not perceive this as a race to the bottom and that some of them, at least, are benefiting from their preferential regimes.¹⁸⁶

There is no obvious reason to regard the OECD (which, as it acknowledged from the outset, is principally concerned for its own Member States’ treasuries)¹⁸⁷ as any better placed to calculate the interests of the developing countries. Moreover, if the OECD had any evidence that the developing countries were suffering as a result of their preferential regimes, one might expect it to publish it, but it seems not to have done so. Presumably, then, the OECD possesses no such evidence. It is worth noting also in this context that, as is recounted above, the OECD’s view of jurisdictions functioning as havens is that they are likely to benefit from doing so and so are likely to suffer if they desist.¹⁸⁸ This seems entirely plausible. But if it is true of havens, what reason is there for supposing that it is not true of countries operating preferential regimes?

F. *The Theory that the Net Result is Negative*

The second theory that might provide a justification for the OECD’s project to eliminate harmful preferential tax regimes is that, of the countries that operate such regimes, some suffer, some gain, and the net result is negative. But this, too, is unsatisfactory. In particular, again, it remains unproven. Perhaps, in fact, the net result is not negative—maybe some countries gain, others lose, and the net result is positive. This is an empirical question, entailing difficult issues of measurement. To date, again,

185. See OECD, 1998, *supra* note 2, at para. 156.

186. The OECD has suggested also that countries “may find themselves in a ‘prisoners [sic] dilemma’ where they collectively would be better off by not offering incentives but each feels compelled to offer the incentive to maintain a competitive business environment.” *Id.* at para. 80. In its traditional form, however, the point of the prisoners’ dilemma is that the prisoners are unable to communicate or to engage in mutually reassuring behaviors. It is not clear why this should be so of governments, and the OECD does not explain.

187. See *id.* at para. 1.

188. See OECD, 2000, *supra* note 2, at paras. 26–27.

the OECD seems to have presented no evidence satisfactorily supporting this theory.

Moreover, even if this theory is sound (that the net outcome of preferential regimes in the countries which operate them is negative), it raises again, in a slightly different form, the question of the appropriateness of OECD intervention.¹⁸⁹ It is one thing for the OECD to seek to dictate tax policy to poor countries, if all involved accept that the poor countries in question will benefit as a result. But if some developing countries are gaining as a result of their preferential regimes, it is unclear why they should cease to operate them (other than that the OECD countries might punish them if they do not). To treat such regimes like tax havens seems unfair because their objective is not to undermine other countries' tax systems but to attract real investment.

G. *The Theory that Tax Competition Harms Those Who Decline to Compete*

The third theory which might serve to justify the OECD's campaign against preferential tax regimes is that, even if the countries that operate such regimes collectively benefit from doing so, these benefits are outweighed by the combined losses suffered by countries that do not. The first problem with this theory is that, like the others, it remains unproven.

Another, more serious, objection is that this third theory seems reducible to the proposition that the developing countries should sacrifice their growth (and sacrifice also, therefore, their attempts to alleviate poverty) so that the developed countries can protect their economies and maintain their relatively high levels of public spending. The assertion that this might somehow maximize global welfare seems difficult to justify. This is perhaps why the OECD has not articulated it. Nonetheless, the hypothesis that this is exactly what the OECD has set out to achieve seems all too plausible.¹⁹⁰

H. *Selective CFC and FIF Regimes: A Form of Harmful Tax Competition?*

It would appear to be possible for the OECD countries (and other like-minded countries) to eliminate the effectiveness of other countries' preferential tax regimes by adopting more comprehensive CFC and FIF regimes. That is, such countries could extend their CFC and FIF regimes

189. See *infra* note 279.

190. As Avi-Yonah has observed, the OECD's emphasis on its own Member States' revenues "is unfortunate, given both the paucity of the evidence and the impression it gives of government bureaucrats trying to protect their cherished tax revenues; it certainly does nothing to combat the Leviathan critique." Avi-Yonah, *supra* note 1, at 1658, n. 405.

so as to cover *all* income accumulated in offshore entities rather than only some of such income as is currently provided for by most countries' CFC and FIF rules.¹⁹¹ Technically, this would be simple. Much of the complexity of most countries' existing CFC regimes is due to the differential treatment of CFCs. CFCs in some foreign countries are treated differently from CFCs in other foreign countries; CFCs which are actively engaged in business are treated differently from those which are not and so on. If the developed countries were to eliminate such differentials, the consequences would seem to include the elimination of the effectiveness of other countries' preferential tax regimes.¹⁹² It would entail other advantages also. In particular, it would be more equitable,¹⁹³ and it would make it possible for the law to be significantly simpler.

The reason the OECD countries have mostly not taken this simple step seems to be that they are competing with one another. For a country (say, the United States) to eliminate this kind of avoidance would be technically straightforward.¹⁹⁴ It would mean, though, that U.S. firms would be at a disadvantage, as against firms resident in other countries, in offshore investment. Assume, for example, that China operates a preferential tax regime under which corporations owned by non-residents and engaged in manufacturing in China are exempt from Chinese tax for ten years; assume also that a U.S. firm and a British firm are both considering establishing manufacturing subsidiaries in China so as to benefit under this regime, and assume lastly that these two firms compete in the same markets. If the British CFC rules do not tax the British firm on the undistributed profits of its Chinese subsidiary, the British firm will be able to defer its liability to British tax by accumulating profit in its subsidiary. If the U.S. CFC rules operate in the same manner, the U.S. firm and the British firm will compete on an equal footing; both will be able to defer home-country tax on the undistributed profits of their Chinese

191. See *supra* notes 62–63.

192. Most countries' CFC rules are not comprehensive. For example, they commonly do not apply to CFCs actively engaged in business. Consequently, a firm can commonly avoid tax by operating its active offshore business through a CFC and accumulating the profit in the CFC. Such profit will typically be taxed if distributed to the parent company in the form of a dividend, but if it is not distributed, it is commonly not taxable to the parent. See sources cited in *supra* note 62. An example of a country operating comprehensive CFC and FIF regimes is New Zealand. For a brief account of New Zealand's CFC regime, see Rohatgi, *supra* note 62, at 386–87.

193. Such action would be more equitable in that it would result in equal tax treatment for domestic and offshore investment in the firm's home jurisdiction.

194. Avoidance of this kind is sometimes referred to as deferral because the parent company's tax liability in its home jurisdiction is deferred until the foreign subsidiary distributes its profit in the form of a dividend. But if the subsidiary never pays a dividend, the parent never becomes liable for tax.

subsidiaries.¹⁹⁵ But if the United States were to extend its CFC rules so as to cover the undistributed profits of the U.S. firm's Chinese subsidiary (while Britain left its CFC regime unchanged), this equality would be lost: the profits of the U.S. firm's subsidiary would be chargeable to U.S. tax (whether distributed to the parent or not), but the profits of the British firm's subsidiary would not be chargeable to British tax (unless distributed to the parent). The U.S. firm would consequently find itself at a competitive disadvantage as against the British firm.

Thus, it is not only the countries which operate preferential regimes which can be seen as engaged in a race to the bottom. So, too, can the countries operating leaky CFC regimes. One solution to this problem (if it is a problem) would be for the countries operating preferential regimes to desist. Another would be for the countries operating leaky CFC regimes to eliminate the leaks. That is, the United States, the United Kingdom, and the other capital-exporting countries could extend their CFC rules so as to cover *all* income accumulated in their residents' CFCs. Both solutions appear to require coordinated action. In order to solve the problem by eliminating preferential regimes, it would be necessary to eliminate all of them (or, at least, nearly all of them) and to do so more or less simultaneously; otherwise the tardy would gain. Similarly, in order to solve the problem by plugging the gaps in the capital-exporting countries' CFC regimes, it would be necessary to eliminate all of the gaps (or, again, nearly all of them) and to do so more or less simultaneously; otherwise, again, the tardy would gain.

It might be feasible, in the short term, for the OECD and its Member States to implement the latter solution on their own, without involving non-member States at all. The reason is that the overwhelming majority of multinational enterprises (MNEs), accounting for an even more overwhelming proportion of their combined capital, are resident in OECD countries.¹⁹⁶ It would be more satisfactory to arrange for the participation of all of the countries in which MNEs are resident, but the OECD Member States (and other like-minded non-members) might suffice.

In the longer term, the adoption of comprehensive CFC regimes by all the OECD countries might prove an inadequate solution. The adoption of comprehensive CFC rules by a country might bring it to tax its resident MNEs' CFC income in the short-term, but in the long-term, it might induce MNEs to emigrate. That is, MNEs might shift their residence from countries that operate comprehensive CFC regimes to

195. Both will, therefore, have an advantage over those of their competitors who conduct their manufacturing in the United States or the United Kingdom.

196. See Avi-Yonah, *supra* note 1, at 1665.

countries that do not.¹⁹⁷ Assuming, then, all OECD countries to have adopted comprehensive CFC regimes, MNEs might shift to non-OECD countries. The consequence would be that the OECD country in which a MNE had previously been resident would generally lose the tax revenues it had previously derived from that MNE, except to the extent derived from income either attributable to a permanent establishment within the country or derived from within the country.

Once more, it is not self-evident that global welfare would suffer as a result of such corporate emigration, for perhaps the loss suffered by the OECD country would be offset, or more than offset, by the gain enjoyed by the non-OECD country to which the MNE had emigrated. In any event, to the extent that the MNE's shareholders were resident in the OECD country in question, it would appear to be relatively straightforward for that country to recover its lost tax revenues. If it already had in place a comprehensive FIF regime,¹⁹⁸ nothing would be required; the shareholders would be taxable on the MNE's profits (whether distributed or not) and on the profits of its subsidiaries. If it did not have such a regime, all it would need to do would be to establish one.

It is possible that natural persons holding the ultimate beneficial ownership of the MNE might emigrate too. To this, there seems to be no solution. But, if an OECD country finds its citizenry emigrating to non-OECD countries in order to escape its taxes, perhaps the remedy lies in reducing the burden.

In summary, it is the OECD countries which regard the current state of affairs as problematic, and it is within their power to fix it (by adopting comprehensive CFC and FIF rules) without involving non-OECD countries. As outlined in its reports, however, the OECD's preference is for the burden of fixing the problem to be borne by the developing countries—even though they do not see it as a problem. The OECD seems not to have explained, however, why it prefers this solution (that is, for the developing countries to abolish their preferential regimes) to the other (that is, for the developed countries to extend their CFC and FIF regimes).¹⁹⁹

197. See, e.g., Robert T Kudrle & Lorraine Eden, *The Campaign Against Tax Havens: Will it Last? Will it Work?*, 9 STAN. J. L., BUS. & FIN. 37, 58–60 (2003). See also Avi-Yonah, *supra* note 1, at 1665–66.

198. See *supra* note 63.

199. One possible explanation is the disproportionate influence of those OECD residents who enjoy significant and currently under-taxed offshore income, and who are therefore opposed to any extension of their home-countries' CFC and FIF rules (which could effectively tax their currently under-taxed offshore income).

IV. PRACTICAL ASPECTS OF THE OECD PROJECT

The OECD's campaign to eradicate tax havens and harmful preferential tax regimes seems flawed, not only in principle, but in several important practical respects also. In particular, the Organization has carried out its project in an opaque and secretive manner. Moreover, the two basic categories upon which it has based its project seem inadequately defined. That is, the OECD has not adequately explained what it means by "tax haven" or by "harmful preferential tax regime." These procedural deficiencies have led to results which seem unsatisfactory. In particular, a number of jurisdictions which seem plainly to be tax havens have escaped the OECD's attentions. As to why some jurisdictions have been classified as havens and others have not, the OECD has not explained. The Organization has, thus, made important decisions about a large number of non-member States on the basis of ill-defined rules and without giving reasons. It seems, consequently, to have left itself open to the charge of having made these decisions on the basis of undisclosed political or other considerations.

The total population of the jurisdictions which might be classified as tax havens seems to be only a few million people.²⁰⁰ Perhaps, then, the OECD calculated that this was a *de minimis* problem and that it was therefore unproblematic to sacrifice the livelihoods of these people for the greater good. The Organization has also, as I have mentioned, proposed providing transitional aid to cooperative havens, and their populations might be small enough for such aid to be meaningful. The countries which might be classified (according to the OECD's rather amorphous criteria) as operating harmful preferential regimes, however, seem to account for a sizable majority, perhaps an overwhelming majority, of the world's total population. To make decisions intended to affect the structures of these countries' economies on the basis of ill-defined rules and without giving reasons would appear to require some justification. The OECD has not proposed providing aid to less-developed countries which cooperate in eliminating their harmful preferential regimes, but, even if it were to do so, the number of persons likely to be affected is so immense that it seems unlikely that any such aid would be meaningful.

A. Opacity

The OECD's project has to date been unsatisfactorily opaque in a number of respects. First, the OECD appears at no point to have at-

200. This is excluding production havens (see Avi-Yonah *supra* note 1, at 1584 n.26, 1588-89), which the OECD seems to count as preferential regimes rather than as havens.

tempted to determine whether tax competition is, in fact, harmful. Rather, its Member States seem simply to have instructed the Organization that this is the case and required it to devise a solution. Presumably the Member States based their position on evidence of some kind, but this seems not to have been disclosed. The OECD appears to have acted, in accordance with its instructions, on the premise that tax competition is harmful (in some circumstances, at least). It seems, however, to have gone further in that it has asserted that tax competition is not only harmful to the tax bases of its Member States but also detracts from "global welfare."²⁰¹ But the Organization seems not to have disclosed the basis for this assertion. Perhaps the Organization's members instructed it to proceed on this basis; perhaps they provided some empirical support, or perhaps the proposition is based on nothing more than the OECD's own speculations.

Moreover, the OECD has not disclosed how it came to conclude that there are two, and only two, forms of tax competition requiring remedies, namely tax havens and harmful preferential tax regimes. In particular, the OECD has not explained why it does not regard developed countries' leaky CFC and FIF regimes as harmfully competitive. Perhaps, again, the Organization was merely carrying out instructions received from its members. Or perhaps it formulated this theory itself. In any event, it is unclear whether the theory is based on evidence of some kind or is purely speculative.

The manner in which the OECD went about identifying havens was similarly opaque. It started by drawing up a list of forty-seven jurisdictions which it thought might be havens. It did not, however, publish this list. It then removed six jurisdictions from the list on the basis that it had determined, on closer inspection, that they were not havens after all. The OECD seems, however, not to have disclosed the identities of these six jurisdictions. Nor has it explained the basis upon which it initially determined that they were havens. Moreover, the number of marginal cases would appear to be greater than six. That is, there are jurisdictions that should probably be counted as havens but that were not even on the original list of forty-seven. The OECD's criteria for identifying havens are vague and ambiguous. Moreover, the OECD has revealed almost nothing as to how it went about weighing each criterion against the others.

The opacity of the OECD's procedures is ironic given that one of the Organization's main requirements of havens (and, presumably, of countries operating preferential regimes, though this remains to be seen) is transparency.

201. OECD, 1998, *supra* note 2, at para. 4.

B. What is a Tax Haven?

In order to eradicate tax havens, it is necessary to determine with defensible precision what the term means. This, however, is not as straightforward as it might seem. The term "tax haven" is commonly used to denote a jurisdiction which imposes either no income taxes at all or only nominal income taxes. Some jurisdictions, however, tax some forms of income (at higher than nominal rates) and exempt others and, in fact, function as havens. That is, individuals and firms routinely conduct transactions through such jurisdictions for no other purpose than to escape taxes which they would otherwise be obliged to pay in other jurisdictions.

This basic ambiguity in common usage has found its way into the OECD's analysis, with unsatisfactory results. That is, it is unclear whether, according to the OECD, a tax haven is simply a jurisdiction which imposes no income taxes (or only nominal income taxes) or whether a jurisdiction might count as a tax haven if it imposes tax at higher-than-nominal rates on some forms of income but no tax at all (or only nominal tax) on other forms of income.²⁰² The former definition is unsatisfactory, for it permits havens of the latter kind to escape. The merits of the OECD's campaign against havens are debatable but to wage a campaign against jurisdictions coming within the narrower definition of haven (no or only nominal taxes) but not against jurisdictions only coming within the broader definition (higher than nominal taxes, some categories of income exempt, in fact functioning as havens) seems problematic because: it would seem not to solve the problem with which the OECD is concerned (erosion of the Member States' tax bases); it seems unfair to impose sanctions on some havens and not others; and this apparent unfairness might make it politically difficult to impose sanctions on some havens and not others. But the latter definition seems problematic also because it blurs the distinction between havens and preferential regimes, and it appears to cover a very large number of countries (for example, the United States, in respect of the non-taxation of interest derived by non-residents) which seem unlikely to restructure their tax systems.²⁰³

202. In its 1998 Report, the Committee said that havens are jurisdictions which "are able to finance their public services with no or nominal income taxes." *Id.* at paras. 42-44. This Report also, however, contained this statement "No or only nominal taxation on the relevant income is the starting point to classify a jurisdiction as a tax haven." *Id.* at Box I (emphasis added). But it did not explain what was meant by "relevant." The thirty-five havens identified by the OECD in 2000 seem generally to come within the narrow definition of haven.

203. Indeed, most countries, and possibly all, are used as tax havens. That is, with respect to every country, it is likely that transactions are channeled through it so as to produce a tax advantage in some other country.

Worse, if such a jurisdiction is not a haven, it is not even clear that its exemption of some forms of income would count as a preferential regime because such an exemption might not satisfy the other criteria for preferential regimes. In particular, it might not be ring-fenced. That is, it might be available not only to non-residents but to residents also, and it might be subject to no restrictions as to operating in the domestic market. If a jurisdiction operating such an exemption could count (under the OECD's criteria) as neither a haven nor a preferential regime, that would seem to leave a substantial gap in the Organization's scheme. This basic uncertainty seems to have allowed a number of important havens to escape the Organization's attentions. Examples include Switzerland²⁰⁴ and Luxembourg (both of which are members of the OECD, and both of which, as I have recounted, declined to endorse the Committee's report) and Hong Kong.

Hong Kong serves as a convenient example.²⁰⁵ The OECD has not explained why it did not include Hong Kong on its list of havens (let alone on its list of uncooperative havens). The reason is presumably that Hong Kong imposes significant taxes on income. The maximum personal rate of tax is currently 16%.²⁰⁶ The corporate rate is 17.5%.²⁰⁷ The territory's rules on matters such as deductibility, depreciation, perks, and transfer pricing, however, are very generous compared to those to be found in OECD countries.²⁰⁸ The ways in which these rules are interpreted and administered are likewise relatively generous.²⁰⁹ Perhaps, then, when the OECD comes to look at Hong Kong, it will conclude that the "effective"²¹⁰ rate of tax is generally less than the formal rate of 17.5% and perhaps much less. By OECD standards, then, Hong Kong's rate of tax is low; apparently, though, it is not low enough to make Hong Kong a haven.

204. Described in one analysis as "the uber-haven." Kudrle & Eden, *supra* note 197, at 42.

205. Hong Kong's system of income taxation is provided for (still) by the H.K. Inland Revenue Ordinance Ch. 112 (2003), at <http://www.ird.gov.hk/eng/abo/ord.htm>. Pieces of primary legislation in colonial Hong Kong were called ordinances, not acts. This appears to have been the custom in British colonies not possessing responsible government. The practice has survived the return of the territory to Chinese rule in 1997. The best general commentary on the Ordinance and the cases bearing on its interpretation is PETER WILLOUGHBY & ANDREW HALKYARD, *ENCYCLOPAEDIA OF HONG KONG TAXATION* (1993).

206. In some circumstances, there is a marginal rate of 20%, but total liability is capped at 16%. Very few people are actually taxed at this rate; most pay significantly less. The allowances are so generous that about two-thirds of the workforce pay no tax on their incomes at all. See Inland Revenue Ordinance §§ 13, 43, schedule 2.

207. *Id.* § 14, schedule 8.

208. See generally WILLOUGHBY & HALKYARD, *supra* note 205.

209. See generally *id.*

210. See OECD, 1998, *supra* note 2, at para. 61.

But Hong Kong is, in fact, obviously a tax haven: very large sums of money pass through it for no other reason than that they would otherwise be taxed (or taxed more heavily) elsewhere.²¹¹ The main reason it is possible to use Hong Kong as a haven is that, although it taxes some classes of income (in particular, profits,²¹² rents,²¹³ and salaries²¹⁴ but in each case only if derived from Hong Kong) at higher than nominal rates, others are not taxed at all. In particular, the following categories of income are commonly or invariably not taxed in Hong Kong: interest, dividends, and offshore income of all kinds.²¹⁵ This does not depend on residence; neither residents of Hong Kong nor non-residents are taxed on income of these kinds. The scope for persons resident in other countries to use Hong Kong as a tax haven is consequently enormous.²¹⁶ Indeed, the fact that Hong Kong is not *merely* a haven tends to make it a more attractive one. The reason is that, although a very large number of transactions go

211. As I have mentioned (*supra* note 203), most countries and perhaps all function as havens to some extent. The question seems, therefore, to be one of degree. Hong Kong is singled out here not because it is a haven (for that is likely true of all countries), but because it is a particularly instructive case. It is important to emphasize also that, although Hong Kong functions as a tax haven (that is, foreigners are able to use it to escape taxes in their home jurisdictions), the territory's government did not design its tax system with that objective in mind. That is, it did not set out deliberately to undermine other countries' tax systems. On the history of Hong Kong's tax system, see Michael Littlewood, *Taxation Without Representation: The History of Hong Kong's Troublingly Successful Tax System*, 2002 BRIT. TAX REV. 212 (2002). Moreover, Hong Kong is not *merely* a tax haven. It is a complex, affluent, modern society. The populace numbers seven million. The government, although not democratic, is mindful of public opinion. It finances a range of public services including a large public housing program, a comprehensive public health service, and an expensive public education system. In some respects, Hong Kong's public services are not up to the standard of those to be found in comparably affluent western societies. For example, Hong Kong's public housing is cramped and uncongenial by western standards. In others, they are better. Examples include the public transport system and the financing of the territory's eight universities. Hong Kong cannot, therefore, be written off as merely a haven. On Hong Kong's system of government generally, see NORMAN MINERS, *THE GOVERNMENT AND POLITICS OF HONG KONG* (1998).

212. Inland Revenue Ordinance § 14.

213. Inland Revenue Ordinance § 5.

214. Inland Revenue Ordinance § 8.

215. Interest is taxed if produced by the carrying on of a business (for example, banking or selling goods on credit), but interest is generally otherwise not taxable. Dividends are not taxable in any circumstances. Offshore income is taxable in very limited circumstances—for example, profits derived from outside Hong Kong by a bank carrying on business in Hong Kong are taxable (but not if attributable to a permanent establishment outside Hong Kong). If a firm carries on business in Hong Kong, its actively-produced profits are generally treated as derived from Hong Kong (and therefore taxable), but not if they are attributable to an offshore permanent (or, perhaps, temporary) establishment (in which case, they are not taxable); passive income is routinely accepted as being derived from outside Hong Kong (and therefore not taxable). Also, there is no tax on capital gains in Hong Kong. See generally WILLOUGHBY & HALKYARD, *supra* note 205.

216. Persons resident in Hong Kong are likewise commonly able to escape tax on income derived from other countries, see generally WILLOUGHBY & HALKYARD, *supra* note 205, but the OECD presumably regards this as a minor aspect of the problem.

through Hong Kong entirely for tax reasons, an even larger number go through it for genuine commercial reasons. If a resident of an OECD country derives income from, or makes a payment to, an entity in, say, Vanuatu or the British Virgin Islands, the OECD country's tax authority will tend to suspect, with good reason, that the transaction is driven by an intention to avoid tax. But, if the entity is situated in Hong Kong, the OECD country's tax authority will be less sure—for a transaction through Hong Kong might be tax-driven but is very likely also not.

Perhaps the OECD's unstated strategy is to deal with the easy targets first (for example, Vanuatu) then move on to the harder (for example, Hong Kong) and so by degrees eliminate the use of tax havens. But this process might be more difficult than it seems. One reason for this is that eliminating one or two or even thirty-five tax havens is unlikely to eliminate the transactions that would otherwise have been channeled through them. Rather, the parties to the transactions will simply tend to use some other tax haven. Thus, so long as *any* tax havens exist, the problem will remain largely unresolved. Moreover, in the meantime, the surviving havens will win the business that would have gone through those havens that have been shut down. Thus, the OECD's project seems likely merely to shift tax-driven transactions from the targeted tax havens to those as yet untargeted.

Perhaps, too, the OECD's intention is to accept that jurisdictions such as Hong Kong are not havens and to attack their capacity to function as havens by classifying them instead as harmful preferential tax regimes. But this is less than satisfactory because the matter is not merely one of semantics. The OECD's ostensible plan was to identify havens as such and stigmatize them as such. To spare some havens, on purely semantic grounds, would seem unfair. Moreover, the OECD's progress against preferential regimes has been much slower than its progress against havens. To treat some havens as preferential regimes thus seems unduly lenient. More seriously, it appears possible that the OECD will treat Hong Kong neither as a haven nor as a preferential regime and that the territory might consequently escape the Organization's attentions altogether. As already explained, the OECD seems not to regard Hong Kong as a haven. But it seems possible that Hong Kong's non-taxation of some classes of income (offshore income, dividends, and so on)²¹⁷ might not satisfy the OECD's criteria for being a preferential regime either.

A further problem is that the OECD's campaign against tax havens has produced outcomes which seem to be not only technically flawed but politically unfortunate. In particular, the smaller, weaker havens all seem to have been classified as such; whereas the havens that have escaped (to

217. See generally *id.*

date, at least) include some that are larger, richer, and better-connected. The Cook Islands and Vanuatu, for example, are very small and very poor. They appeared on the OECD's list of havens. Switzerland and Hong Kong, in contrast, are relatively large and relatively rich. Moreover, Switzerland is a member of the OECD. It would therefore seem to have been able to veto the OECD's original 1998 Report (rather than merely abstaining). This might not have been fatal to the project, but it would have been embarrassing for the Organization and its other members and would probably have led to delay. As for Hong Kong, it is part of China, and the OECD, whilst having few qualms about dictating tax policy to, say, Vanuatu (and damaging its small and inconsequential economy), might have hesitated to do the same to China (especially given the scale of OECD-resident firms' operations both in Hong Kong and in other parts of China).

C. *What is a Harmful Preferential Tax Regime?*

Similarly, in order to eradicate harmful preferential tax regimes, it is necessary to determine what these words mean. That is, it is necessary, first, to determine what counts as a preferential tax regime and, second, to determine how harmful regimes are to be distinguished from harmless.²¹⁸

The OECD's answer to the first question seems to be that a preferential regime is one which exempts a specified class or classes of income from tax in a jurisdiction which taxes income generally. Even this, however, is not as straightforward as it might seem. Again, Hong Kong illustrates the problem. As I have explained, important categories of income are not taxed in Hong Kong at all. These include offshore income of all kinds, dividends, and interest.²¹⁹ But whether the non-taxability of income of these kinds can properly be described as a "preferential tax regime" (or a series of regimes) is unclear. The term "preferential tax regime" connotes a set of rules providing for preferential treatment of some kind. The implication is that there is a general rule imposing tax, to which the preferential regime provides some sort of exception. This, however, is not an apt description of Hong Kong's non-taxation of offshore income, dividends, or interest—for there is no general rule imposing tax on offshore income, dividends, or interest nor, therefore, any exemption of income of these kinds. There is, indeed, no tax at all on income as such. Rather, there is a schedular system of three separate taxes on three different kinds of income: property tax is charged on

218. See OECD, 1998, *supra* note 3, at para. 4.

219. See generally WILLOUGHBY & HALKYARD, *supra* note 205.

rents;²²⁰ salaries tax is charged on income from employment;²²¹ and profits tax is charged on profits.²²² Income of other kinds (such as, notably, dividends and interest) is, therefore, simply not taxable.²²³ To classify these limitations as “preferential regimes” seems an unnatural use of the term. Moreover, each of the three taxes is imposed only on income “derived from Hong Kong.”²²⁴ Income derived from outside Hong Kong is, therefore, simply not taxable.²²⁵ Again, to classify this as a “regime” seems odd.

The OECD’s approach to the distinction between harmful and harmless preferential regimes seems even more problematic. The distinction seems to be crucial, for harmful regimes are to be eradicated and harmless ones left alone. Getting rid of *all* preferential regimes would have been very much simpler (though perhaps politically more difficult). As I have recounted, the OECD has already found that some of its own Member States’ preferential regimes are harmless.²²⁶ Presumably it will in due course conclude that some *non*-OECD countries’ preferential regimes are harmless also. At the same time, though, the Organization has been very coy about conceding that this is so. It acknowledged, for example, that, “at certain stages”²²⁷ of development, tax incentives might be “justifiable from the point of view of the country in question”²²⁸—but this is hardly an enthusiastic endorsement. Moreover, the OECD seems to regard *any* shifting of investment as suspect. It alludes to countries “bidding aggressively”²²⁹ for other countries’ tax bases and of countries “poaching”²³⁰ a tax base that “rightly belongs”²³¹ to another country and concludes that “such practices would be doubtlessly labeled ‘harmful tax competition.’”²³² But none of these terms—“bidding aggressively,” “poaching,” “rightly belongs”—is defined.

220. Inland Revenue Ordinance § 5.

221. Inland Revenue Ordinance § 8.

222. Inland Revenue Ordinance § 14.

223. See WILLOUGHBY & HALKYARD, *supra* note 205.

224. To be precise, salaries tax and profits tax are charged on (and only on) income of the relevant kinds “arising in or derived from Hong Kong” (*see* Inland Revenue Ordinance §§ 8 and 14 respectively), and property tax is charged on rents derived from property (that is, land and buildings) “situate in Hong Kong” (*see* Inland Revenue Ordinance § 5). *See also* WILLOUGHBY & HALKYARD, *supra* note 205.

225. *See* WILLOUGHBY & HALKYARD, *supra* note 205.

226. OECD, 2004, *supra* note 2, at paras. 11–12.

227. OECD, 1998, *supra* note 2, at para. 27.

228. *Id.*

229. *Id.* at para. 29.

230. *Id.*

231. *Id.*

232. *Id.* at paras. 29–31. The OECD itself put the words “poaching” and “rightly” in quotation marks—but what this signifies is not clear.

As is outlined above, the OECD proposed to determine whether a preferential regime is "harmful" or not by reference to four key factors, eight other factors, and three questions as to the regime's "economic effects." But the Organization has proposed only the vaguest of methods for weighing this complex of factors. That the relevant income is subject to no taxation at all or to a low rate of tax is a threshold requirement (though neither "relevant" nor "low" is defined). Presumably greater weight is to be attached to the "key" factors than to the "other" factors or to the answers to the three questions. Beyond this, however, nothing systematic is indicated. Rather, the intention seems to be that all the factors specified as relevant are to be thrown together, and somehow the answer will emerge. Depending on the weight given to the various factors, any preferential regime could probably be counted as either harmful or harmless. Once more, then, this hardly amounts to a rule. At best, the results will be arbitrary and, at worst, dependent on undisclosed and ostensibly irrelevant political or other considerations.²³³

Once more, Hong Kong provides an instructive example. If the territory's non-taxation of offshore income, dividends, and interest constitute preferential regimes, these regimes would seem to pass the threshold test of imposing low or no tax on the relevant income (depending, perhaps, on what is meant by "relevant"). As for the other three key factors (ring-fencing, transparency, and information exchange), Hong Kong's preferential regimes seem, on balance, not to be harmful. In particular, its preferential regimes (assuming its non-taxation of offshore income, dividends, and interest qualify as such) are not "ring-fenced." Rather, income of these kinds is generally not taxed in Hong Kong irrespective of whether the person deriving it is resident within the jurisdiction or not,²³⁴ and there are virtually no restrictions on foreign entities operating in the domestic market.²³⁵ As for transparency, Hong Kong's tax system

233. In addition to its four Reports, the OECD has also produced a series of "Application Notes" on various aspects of its position on harmful preferential regimes. See OECD, CONSOLIDATED APPLICATION NOTE: GUIDANCE IN APPLYING THE 1998 REPORT TO PREFERENTIAL TAX REGIMES, at <http://www.oecd.org/dataoecd/60/32/30901132.pdf>. These seem not, however, to assist in resolving the basic problem: that the OECD has not defined the distinction between harmful and harmless preferential regimes. In its 2004 Report, the OECD reported that of its own member-states' preferential regimes, all had either: (1) been abolished; or (2) been amended to remove their "potentially harmful features"; or (3) "been found not to be harmful. . . ." OECD, 2004, *supra* note 2, at paras. 11-12. This Report, too, however, seems to offer little or no guidance as to how the distinction is to be drawn between harmful and harmless preferential regimes.

234. See Inland Revenue Ordinance §§ 5, 8, 14; WILLOUGHBY & HALKYARD, *supra* note 205.

235. See SMART & HALKYARD, *supra* note 129. For tax purposes, Hong Kong is separated from the rest of China by a fiscal "firewall." Michael Littlewood, *The Taxing and Spending Powers, in Hong Kong* (Anton Cooray ed.), in INTERNATIONAL ENCYCLOPAEDIA OF

seems to score reasonably well—though whether it satisfies the OECD's requirements in this regard is unclear. On information exchange, it would presumably fail, for it has few treaties under which to exchange information (though the number has recently increased significantly).²³⁶ On the basis of the key factors, then, Hong Kong's preferential regimes (if that is what they are) seem to qualify as harmless—but whether the OECD would reach this conclusion is impossible to say, especially given that Hong Kong, in fact, functions as a haven.

The eight other factors yield even less satisfactory results. Whether the way in which Hong Kong defines its tax base is "artificial" is unclear. The territory adheres somewhat to "international transfer pricing principles" but not in anything like the manner the OECD countries generally do (partly because it has traditionally been a beneficiary of abusive transfer-pricing).²³⁷ Hong Kong does not tax offshore income, irrespective of the type of income and irrespective also of the residence of the person or firm by whom the income is derived.²³⁸ It does not offer negotiable tax rates or tax bases. Its secrecy provisions are comparable to those in OECD countries.²³⁹ It does not have access to a wide network of treaties.²⁴⁰ It is, however, in the process of adding to the small number of treaties to which it is a party, perhaps with a view to exchanging more information.²⁴¹ The Hong Kong government does not exactly promote any of its regimes (if that is what they are) "as a tax minimisation vehicle," but it does advertise that its taxes are lower than many other jurisdictions', and some of this advertising mentions that offshore income is generally not taxed.²⁴² Similarly, the Hong Kong government does not exactly *encourage* "purely tax-driven operations." But that Hong Kong can be used as a tax haven is very well known; encouragement hardly seems necessary.

The three questions as to economic effects yield answers which are mixed but, on balance, apparently adverse to Hong Kong. Hong Kong seems both to attract activity from other jurisdictions and to generate

LAW: CONSTITUTIONAL LAW 248, 250 (R. Blanpain ed., 2003). Hong Kong's domestic market is presumably therefore Hong Kong, not the whole of China.

236. Since Hong Kong generally does not tax offshore income, its residents are generally not exposed to double taxation. There is correspondingly less need for treaties than elsewhere.

237. See Inland Revenue Ordinance § 20; WILLOUGHBY & HALKYARD, *supra* note 205.

238. See Inland Revenue Ordinance §§ 5, 8, 14; WILLOUGHBY & HALKYARD, *supra* note 205.

239. See Inland Revenue Ordinance § 4.

240. Though whether this should count in Hong Kong's favor or against it is unclear. See OECD, 1998, *supra* note 2, at paras. 76–77.

241. See WILLOUGHBY & HALKYARD, *supra*, note 205.

242. See, e.g., Hong Kong Inland Revenue Department website, at <http://www.ird.gov.hk>.

new activity. Much of this activity (both shifted and new) seems to be attracted not by the territory's "preferential regimes" (that is, the non-taxability of some kinds of income from tax) but by the low rate of tax. Yet Hong Kong also functions as a tax haven. Large sums of money pass through it without any other significant activity at all.

On the other hand, Hong Kong seems not to be "poaching" tax bases which "rightly belong" to other countries. Income taxes were introduced in the territory in 1940, and the system then established remains basically intact. Offshore income and dividends have never been taxed. A tax on interest was introduced in 1941, but it was very limited in its scope and abolished in 1989.²⁴³ The legislation has been refined from time to time but generally with a view to *extending* its scope.²⁴⁴

All in all, it is difficult to say whether, according to the criteria set out by the OECD, Hong Kong operates any preferential tax regimes or whether (if so) they are harmful. Predicting how the OECD might go about applying its criteria is more difficult still. Hong Kong is, in fact, a tax haven. The OECD, however, accepts that it is not. If it does not classify Hong Kong as operating harmful preferential regimes, it is difficult to see how its project (against havens, let alone against preferential regimes) can succeed. On the other hand, the difficulties lying in the way of such a classification seem considerable.

There is, moreover, no obvious reason to regard Hong Kong as a special case. It seems probable that numerous other jurisdictions could present difficulties comparable in scale but otherwise unique. As I have recounted,²⁴⁵ the OECD concluded in 2004 that its Member States' preferential regimes had *all* either been abolished, been amended to remove their "potentially harmful features," or been found to be "not harmful."²⁴⁶ But it is difficult to see how the OECD can achieve its basic objective (preserving the tax bases of its Member States) without dealing with non-member States' preferential regimes rather more harshly than it has dealt with members'. It seems likely that this will require much political effort and some dexterous theorizing.

243. The main reason for the abolition of the tax on interest was that Singapore's tax treatment of interest was, in important respects, more generous than Hong Kong's, and the Hong Kong government thought it advantageous to compete.

244. See Michael Littlewood, *Tax Reform in Hong Kong in the 1970s: Sincere Failure or Successful Charade?*, in *STUDIES IN THE HISTORY OF TAX LAW* 379, 390–410 (John Tiley ed., 2004); Littlewood, *supra* note 211, at 227–31.

245. See OECD, 2004, *supra* note 2, at paras. 11–12.

246. *Id.*

D. Remedies (Once More)

The OECD's original plan, in 1998, was to require developing countries to abolish their harmful preferential tax regimes or, at least, to "remove" their "harmful features."²⁴⁷ Perhaps this is still its plan.²⁴⁸ If so, the difficulties—both technical and political—are formidable. It also seems possible, though, that the OECD has lowered its sights. In the case of havens, the OECD now requires only transparency and information exchange.²⁴⁹ Given that havens (which commonly seek to undermine other countries' tax systems) seem manifestly more objectionable than preferential regimes (which seek merely to attract real investment), it would seem to be problematic for the OECD to seek to impose more onerous requirements on countries operating preferential regimes than on countries functioning as havens. Perhaps, then, the OECD will require of countries operating harmful preferential regimes only what it requires of havens—that is transparency and information exchange. But this seems problematic, too, because it would appear not to achieve the OECD's basic objective (that is, preventing the erosion of OECD Member States' tax bases).²⁵⁰ Perhaps it is the difficulty posed by this dilemma—whether to confront the enormously difficult task of actually eliminating harmful preferential regimes or to settle for much less—which explains the OECD's apparent lack of progress against preferential regimes.²⁵¹

E. The Difficulty of Eradicating Harmful Preferential Regimes

For a jurisdiction operating preferential regimes to cease to do so would commonly entail a radical transformation of its tax system. Once

247. OECD, 1998, *supra* note 2, at Box III.

248. See OECD, 2004, *supra* note 2.

249. See *supra* notes 132–134.

250. It is reasonable to suppose that transparency and information exchange will largely solve the problem in the case of havens but not in the case of preferential regimes.

251. An alternative solution has been suggested by Avi-Yonah, that "demand" countries (that is, the countries in which goods and services are consumed) should impose a tax on imported goods and services which tax would, however, be refunded in some circumstances to the country where the goods or services were produced. This would appear to address both the technical and the political difficulties more satisfactorily than the proposals of the OECD. But Avi-Yonah's proposal seems also to raise questions. First, it seems possible that the imposition of a tax at the level suggested might entail cash-flow difficulties for taxpayers. Secondly, Avi-Yonah's solution calls for governments to collect taxes, the burden of which would seem to be borne by their own citizens, and then to pass on the revenues raised to other countries. It might be difficult to persuade voters of the merits of such an arrangement. Or, at least, if voters were persuaded of the merits of the tax, it might be difficult to persuade them of the merits of handing the revenues over to someone else. Avi-Yonah notes that it would be reasonable for the collecting state to withhold for itself a fee for collecting the tax. See Avi-Yonah, *supra* note 1, at 1670–74.

more, Hong Kong illustrates nicely the scale of the problem (and, again, it seems reasonable to suppose that comparable—but different—problems would be presented by dozens of other jurisdictions).

As I have explained, Hong Kong generally does not tax offshore income of any kind or interest or dividends.²⁵² The elimination of these “preferential regimes” would, therefore, require Hong Kong to extend its tax system to cover income of these types.²⁵³ The people of Hong Kong have never been taxed on their offshore income, their dividends, or their interest.²⁵⁴ So dramatic an extension of the territory’s tax system would obviously produce considerable popular discontent to say the least—especially if the aim was not to benefit the people of Hong Kong but merely to comply with an edict issued by the OECD.²⁵⁵

The difficulties would be not merely political but technical and administrative also. As I have explained, Hong Kong has no tax on income, as such. Instead, there are separate taxes on rents, income from employment, and profits. To tax interest and dividends, it would, therefore, be necessary either to extend the existing taxes to cover income of these kinds (perhaps by extending the scope of profits tax—but what then to do about the double taxation of corporate profits?) or to add new taxes (perhaps a “dividends tax” and an “interest tax”) or to scrap the existing schedular system of taxation and institute in its place a comprehensive tax on income as such. Any of these courses would obviously entail a radical transformation of the territory’s existing tax system. Extending Hong Kong’s tax system to cover the offshore incomes of persons resident in Hong Kong would entail similarly radical changes. And that is not all. The OECD has also proposed that all countries should adopt

252. Offshore income is taxable in very limited circumstances—such as when the taxpayer is a bank. See Inland Revenue Ordinance § 15(1)(i). Interest, too, is taxable in some circumstances—such as when the taxpayer is a bank or carrying on a business of money-lending or supplying goods on credit; interest in those cases being the profits of the business. See *id.* § 14; WILLOUGHBY & HALKYARD, *supra* note 205. Dividends are not taxable in any ordinary circumstances. See *id.*

253. Indeed, the OECD’s recommendations specifically include that *all* countries should tax their residents’ offshore incomes. See OECD, 1998, *supra* note 2, at paras. 104–05.

254. Except in the comparatively limited circumstances referred to in note 252. There was, in addition, a tax on interest from 1941 until 1989, but its scope was limited. See *supra* note 243.

255. Consider how difficult it might be to persuade the U.S. legislature to withdraw the exemption from tax of income derived by non-residents so as to comply with an edict issued by the OECD (even though the U.S. is a member of the OECD and the tax would be paid by non-residents); the extensions to Hong Kong’s tax system which the OECD’s logic seems to require are clearly far more substantial (and Hong Kong is not a member of the OECD, and the tax would fall on residents).

CFC rules and FIF rules,²⁵⁶ that they should follow the OECD's transfer-pricing guidelines, and so on.

Such changes would present administrative difficulties. It is currently unnecessary for Hong Kong's Inland Revenue Department (the territory's tax authority) to determine whether taxpayers are resident in the territory or not (for liability depends simply on whether the relevant income is derived from Hong Kong; residence is irrelevant).²⁵⁷ Hong Kong residents are therefore not required even to declare their offshore income, and the Inland Revenue Department operates no systems for determining it. Similarly, Hong Kong residents are not required to declare dividends or (in most circumstances) interest. If Hong Kong were to tax dividends, interest, and offshore income, not only the law but also the administration of the law would have to be radically changed. CFC rules, FIF rules, and adherence to the OECD's transfer-pricing guidelines would also entail enormous administrative burdens. A complete change in the Inland Revenue Department's ethos would probably be required, not to mention a substantial increase in its personnel.

It is unclear how all this is to be reconciled with the OECD's claim that it is not seeking to determine the structure of non-member States' tax systems.

F. Requiring Only Transparency and Information Exchange

If, on the other hand, the OECD intends to require of countries operating harmful preferential regimes only that they make their tax systems transparent and that they participate in the requisite level of information exchange, this in itself will not solve the problems with which the Organization is principally concerned (that is, the erosion of its member countries' tax bases). Nor, if the race really is to the bottom, will transparency and information exchange save the contestants from getting there.

In the case of havens, transparency and information exchange will very largely solve the problem. The reason is that most OECD countries operate CFC and FIF regimes, and these regimes impose taxes on persons resident in OECD countries in respect of passive income they accumulate in corporations and other vehicles in tax havens.²⁵⁸ Presumably, therefore, the OECD countries' existing CFC and FIF regimes are generally effective against the avoidance of tax using havens (so long as

256. Given that Hong Kong currently does not tax offshore income even if derived directly by a resident, the introduction of CFC and FIF regimes would represent a very marked extension of the territory's tax system.

257. See Inland Revenue Ordinance § 8; WILLOUGHBY & HALKYARD, *supra* note 205.

258. See *supra* note 62.

the OECD country in question holds sufficient information about its residents' transactions in havens—hence, presumably, in the case of havens, the OECD's eagerness to procure and willingness to settle for transparency and information exchange). But most OECD countries' CFC and FIF regimes do not prevent the deferral of tax through active operations in countries operating preferential regimes (for reasons explained above).

In order to prevent the erosion of their tax bases as a result of their residents using preferential regimes, therefore, it would seem to be necessary for the OECD countries either to persuade the countries operating such regimes to desist or to extend their CFC and FIF regimes to cover *all* CFCs and FIFs. Both courses of action would seem to be problematic but the latter considerably less so—especially given that it would require the coordination of the OECD's own Member States only and not the rest of the world as well.

V. THE OECD'S RHETORIC

The purpose of the OECD's campaign against "harmful" tax competition is to protect the treasuries of its members. In order to achieve this, however, the OECD seems clearly to have thought it expedient to present the campaign as being of more general interest. The Organization's four reports accordingly seem to have been intended to serve several purposes. First, they were intended to analyze the "problem" of "harmful" tax competition and set out a cure, as required by the OECD's members generally and the G7 countries in particular. This was for the benefit of these countries, who perceived themselves as losing tax revenues as a result of havens and harmful preferential regimes. But resolving this problem would seem clearly to require almost every country in the world (OECD members and non-members alike) to effect substantial modifications to its tax system. Not surprisingly, then, the OECD has presented its project as being not merely beneficial to its own members but as raising "global welfare."²⁵⁹ The Reports' second purpose, therefore, was to play a part in persuading non-member States, especially tax havens and states operating preferential tax regimes, that it was in their interest to join the campaign (or, at least, to surrender to it). Perhaps the objectives also included persuading people resident in OECD countries that what was being done for their benefit would not harm deserving poor countries. In any event, the reports were not merely technical documents but

259. OECD, 1998, *supra* note 2, at para. 4.

political ones. As a result, precision seems to have given way to rhetoric.²⁶⁰

As might be expected, the reports are notable for their orientation to the perspective of the G7 countries. They assume that the tax systems to be found in the major OECD countries are “normal,”²⁶¹ and they refer to countries “poaching” tax bases that “rightly belong” to other countries.²⁶² Similarly, the OECD uses the word “dialogue”²⁶³ to refer to what would seem to be more accurately described as arm-twisting. Likewise, it describes its assault upon the tax systems of the rest of the world as “defensive.”²⁶⁴ Perhaps most tellingly, the 1998 Report contained this statement: “Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so.”²⁶⁵ The problem with this is that there are no “internationally accepted standards” in taxation—or at least there were none until the OECD took it upon itself to treat its own norms as such.

That such language is loaded is obvious. In other respects, however, the nature of the OECD’s rhetoric may not be so self-evident. Two of these require comment. First, the OECD has asserted so repeatedly that its project against harmful tax competition will raise “global welfare” that one might think this has somehow been established. But, as is mentioned above, the OECD has not even explained what the proposition means, let alone provided satisfactory evidence in support of it.

Secondly, the OECD’s use of the term “tax competition” is particularly misleading. The Organization uses the term to cover both tax havens and preferential tax regimes. These are, however, very different sorts of phenomena. Havens do not seek to attract real investment. Rather, they provide a means by which foreigners can evade tax in their own countries (typically by means of dishonesty), and typically they seek to profit by so doing. This seems parasitical and manifestly objectionable. The OECD’s claim that it detracts from global welfare, however defined, seems at least plausible. The disrepute generally attaching to tax havens is therefore deserved. Preferential regimes, on the other hand, are intended to attract real investment. There is nothing dishonest about them. They might facilitate avoidance, but they do not facilitate evasion.²⁶⁶ They are not parasitical. Perhaps, rather, they are just

260. See Stewart, *supra* note 8, at 171–88.

261. OECD, 1998, *supra* note 2, at para. 35.

262. *Id.* at para. 29.

263. See *id.* at para. 156. *id.*

264. *Id.* at Box II; OECD, 2000, *supra* note 2, at para. 20.

265. OECD, 1998, *supra* note 2, at para. 26.

266. That is, countries which operate preferential regimes do not necessarily facilitate dishonesty. Of course, any such country might also, in addition to operating a preferential

another form of healthy economic competition.²⁶⁷ In any event, the theory that preferential tax regimes *contribute* to global welfare seems, on the current state of the evidence, as plausible as its opposite. There is, in sum, nothing disreputable about preferential regimes.

By lumping tax havens and preferential tax regimes together, the OECD not only confuses the issues but also creates the impression that developing countries' preferential regimes are somehow similarly disreputable sorts of phenomena. Poor countries, doing their generally inadequate best to stimulate growth (and, according to the OECD, caught up in a race to the bottom, presumably through no fault of their own), are stigmatized as tax havens. This is misleading and unfair. It also appears to be deliberate: that is, the OECD seems deliberately to have put the developing countries' preferential regimes in the same category as tax havens so as to make it easier to mount an attack on them.

The problem is, essentially, the classification of tax havens as competitive—for there is nothing competitive about them. Or, at least, the only competition in which havens are generally engaged is with one another. They do not compete with jurisdictions which are not havens—for their objective is not to attract real investment but merely to facilitate the evasion of other countries' taxes (and to profit by so doing). Preferential regimes, on the other hand, are genuinely competitive; countries operate them so as to offer investors a more attractive place to invest than others they might choose. Moreover, such competition may well be productive, for it might tend to produce an optimum balance of taxation and public spending. The classification of havens as competitive seems calculated to give competition a bad name. It seems difficult to avoid the conclusion that there must be something wrong with any project requiring such Orwellian justification.

VI. PROMOTING GROWTH

From the OECD's point of view, the problem with preferential tax regimes is that some of them appear to work. That is, they succeed in attracting foreign investment. In some cases, they also appear to stimulate growth and alleviate poverty. Perhaps they even raise global welfare. If these regimes did not succeed in attracting foreign investment, the OECD would presumably take no interest in them. Perhaps, though, the more serious problem is that some preferential regimes seem *not* to work. That is, they do not attract foreign investment, or they attract it in

regime, do so in such a way as to facilitate dishonesty. But if so, it is the dishonesty which is the problem, not the preferential regime.

267. Roin, *supra* note 169, at 550–61.

such a way so as not to promote growth. In some countries, preferential tax regimes seem to have played a crucial role in attracting foreign investment, stimulating growth, and alleviating poverty. The obvious current example is China.²⁶⁸ Other countries, for example Nigeria, have operated preferential regimes without such positive results.²⁶⁹

The extent to which, if at all, China's growth is attributable to its preferential tax regimes remains to be ascertained. Presumably a number of other factors contributed also. In particular, the Chinese government's decision in the late 1970s to permit and encourage commercial enterprise (of any sort, but in particular foreign investment) seems clearly to have been a prerequisite to the country's subsequent economic successes.²⁷⁰ It seems reasonable to suppose that other important contributing factors might have included China's 5,000 year old civilization, its orderly and cohesive society, its stable political order, its high levels of literacy and numeracy, its language (used, as it is, by a fifth of the world's people), and the industry and entrepreneurial spirit of the Chinese people. China's revitalized legal system would appear likewise to have been an important contributing factor. In particular, it seems likely that legal factors contributing to China's economic growth might have included the re-establishment of property rights (or of something resembling property rights), of the enforceability (after a fashion) of contracts, of the availability of privately owned corporations, and of somewhat-credible procedures for the resolution of commercial disputes.²⁷¹ Last but not

268. See sources cited *infra* notes 270–273.

269. According to the World Bank, per capita GDP in Nigeria was US\$314 in 1980 and US\$275 in 2003 (in constant 1995 US\$). WORLD BANK, WORLD DEVELOPMENT INDICATORS ONLINE, at <http://devdata.worldbank.org./query>. For an account of the tax incentives operated by Nigeria, see UNCTAD, TAX INCENTIVES AND FOREIGN DIRECT INVESTMENT—A GLOBAL SURVEY at 56–58, U.N. Doc. UNCTAD/ITE/IPC/Misc.3, U.N. Sales No. E.01.II.D.5 (2000). Nigeria's tax system seems not to provide for preferential treatment for foreign investors as such. But it does provide for preferential treatment for investors engaged in certain specified industries, in particular oil and gas, and it appears that all or virtually all investors in these industries are, in fact, foreign. See, e.g., Economist Intelligence Unit, *Country Briefings: Nigeria*, *Economic Structure*, at <http://www.economist.com/countries/Nigeria/profile/cfm?folder=Profile%2DEconomic%20Structure> (2004). Whether the OECD will treat such provisions as preferential regimes is unclear.

270. See LEE G. BRANSTETTER & ROBERT C. FEENSTRA, TRADE AND FOREIGN DIRECT INVESTMENT IN CHINA: A POLITICAL ECONOMY APPROACH 1 (Nat'l Bureau of Econ. Research, Working Paper No. 7100, 1999); Economist Intelligence Unit, *Coming of Age: Multinational Companies in China* 10–11 (June 2004).

271. For accounts of the rapid recent development of commercial law in China, see WILLIAM BERGH GAMBLE, INVESTING IN CHINA: LEGAL, FINANCIAL, AND REGULATORY RISKS (2002); DANIEL CHAN ET AL. BAKER & MCKENZIE GUIDE TO CHINA & THE WTO (2002); ALBERT HUNG-YEE CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA (3d ed. 2004). See also Thomas Yunlong Man, *National Legal*

least, China seems somehow to have persuaded almost all the MNEs in the world that they cannot afford not to invest there²⁷²—irrespective of short-term profitability.²⁷³ No doubt these factors—and others—played a more important part in China's recent growth than its preferential tax regimes. Nonetheless, it seems reasonable to suppose that the country's preferential tax regimes played a significant part—and still do (hence, perhaps, the OECD's concern).

Similarly, Nigeria's dismal economic record is presumably attributable to a range of factors.²⁷⁴ It seems extremely unlikely that preferential tax regimes, of whatever scale or nature, would on their own make much difference. But, in combination with other factors, perhaps they would.

It would, therefore, seem to be useful to construct a taxonomy of preferential tax regimes so as to determine the characteristics of those which seem to succeed—that is, to determine the characteristics which seem to correlate with the attraction of foreign investment, with growth, and with the alleviation of poverty. Similarly, it would seem useful to

Restructuring in Accordance with International Norms: GATT/WTO and China's Foreign Trade Reform, 4 IND. J. GLOBAL LEGAL STUD. 471 (1997).

272. E.g., Zhang Jin, Wu Yi: *China to Go Further than WTO Promises*, CHINA DAILY, Sept. 9, 2004. "Until July, a total of more than 490,000 foreign-invested enterprises have been set up in China with actual investment of US\$540 billion . . . Among world's top 500 multinational corporations, more than 400 have invested in China" Economist Intelligence Unit, *supra* note 270, at 6 "The very visible growth of demand within China has made building a business there not only feasible but also essential for any performance-oriented multinational. These days, a truly global company would no more ignore China than it would the UK or France." *Id.*

273. E.g., Economist Intelligence Unit, *supra* note 270, at 10–11:

In the past the enthusiasm of the initial trip rarely lasted long, with companies soon realising that the potential market was, in reality, better measured in thousands rather than millions, and that accessing even this pool of consumers was made difficult, if not impossible, by poor infrastructure and anti-business policies. China became famous as a market in which foreign firms lost their shirts. For many multinationals, it became a market to bypass, not cultivate . . . For much of the 1980s and 1990s the experience of multinationals seeking to tap China's domestic market was defined by unrealistic expectations and disappointment. Now it is characterised by real opportunities, revenue growth and sometimes even profit. China is no longer a market that multinationals should or can ignore. . . . Our own survey shows that foreign firms still judge success in China by revenue growth and market share rather than return on capital.

274. E.g., OFFICE OF THE U.S. TRADE REPRESENTATIVE, 2004 NATIONAL TRADE ESTIMATE REPORT 354 (2004):

Despite efforts to improve the country's investment climate, disincentives to investing in Nigeria continue to plague foreign entrepreneurs. Potential investors must contend with high business taxes, confusing land ownership laws, arbitrary application of regulations, corruption, and extensive crime. There is no tradition supporting the sanctity of contracts, and the court system for settling commercial disputes is weak and sometimes biased.

determine the characteristics of preferential tax regimes which fail—that is, to determine the characteristics which seem to correlate with a failure to attract foreign investment at all or with the attraction of foreign investment but without stimulating growth or alleviating poverty.

Very considerable work of this nature has been done. Generally, however, this literature concentrates on the *formal* characteristics of the preferential regimes in question—that is, on the country's tax law generally and on the rules providing for the preferential regime in particular. The rules are no doubt important, but it seems possible that other factors may be important also. The case of China, for example, suggests that it might be beneficial for a country to offer not just one preferential regime but a whole bewildering array of them, varying in mostly minor respects; for the rules providing for such regimes to be in a non-European language; for the rules to be vague; for their interpretation and application thus to require the exercise of broad administrative discretions; and for the administration exercising such discretions to be effectively free of judicial supervision. In sum, it may be that one reason China's preferential regimes have succeeded is that they are not based on the rule of law (insofar, at least, as the idea of the rule of law is typically understood in the West).

It may be, too, that these are the same characteristics which foreign investors in China find most irksome. Indeed, perhaps one measure of a preferential tax regime's likelihood of success is the degree to which it infuriates foreign investors. But foreign investors put up with this infuriation only because they are making profits or think that they will soon make profits. China's achievement, then, seems to have been to attract (by means of a variety of enticements, including preferential tax treatment) a very large volume of foreign investment but to attract it on China's own terms so that much of the foreign investment in China has been notoriously unprofitable;²⁷⁵ the great majority of foreign investors nonetheless continue to invest, and more arrive every year;²⁷⁶ China has

275. Economist Intelligence Unit, *supra*, note 270, at 22:

It is accepted wisdom that the China accounts of almost all foreign firms drip with red ink. Executives in multinational companies (MNCs), dazzled by the prospect of selling to one billion consumers, have failed to notice that few of these people actually earn much money, that selling even to this group is made difficult by the country's poor infrastructure and that any resultant profits would be siphoned off by corrupt local officials. Historically, this perception has not been far from the truth. It is not difficult to uncover a number of horror stories detailing the misadventures of foreign firms that have overestimated the size of the domestic market and understated the difficulties of accessing it—and ended up losing lots of money.

276. Foreign direct investment in China rose from about US\$5 billion in 1991 to more than US\$50 billion in 2002. *Id.* at 7.

enjoyed enormous spillover benefits (in the form of employment and technology transfer, in particular);²⁷⁷ and the Chinese State, since its preferential regimes tend to take the form of finite tax holidays, will be in a position to tax foreign investors in the future (perhaps, if current trends continue, at about the same time as the foreign investors' Chinese ventures become profitable).²⁷⁸

VII. THE OECD OR THE UN?

The two basic components of the OECD project—the campaign against havens and the campaign against preferential regimes—both entail the Organization seeking to persuade non-member countries to make changes to their tax systems. In respect of both campaigns, therefore, there arises the issue of the appropriateness of the OECD's dictating tax policy to non-member States.

From the inception of the project, the OECD has taken pains to emphasize that it is not attempting to dictate non-member countries' tax policy. For example, in its original 1998 Report, the Committee on Fiscal Affairs observed: "The Committee recognizes that there are no particular reasons why any two countries should have the same level and structure of taxation. Although differences in tax levels and structures may have implications for other countries, these are essentially political decisions for national governments."²⁷⁹ In its 2001 Report, the Committee made the point more forcibly: "The OECD project [it said] does not seek to dictate to any country what its tax rate should be, or how its tax system should be structured."²⁸⁰

In the earlier phases of the project, at least, such protestations seem plainly to have been disingenuous. For the OECD's aim was (and appar-

277. "Of course, FDI projects often involve a transfer of valuable technology and management expertise, in addition to an inflow of funds." *Id.* at 18. "Foreign companies bring capabilities, skills, technologies and expertise which domestic companies lack and, through competition, can compel Chinese companies to improve and strengthen themselves." *Id.* at 21.

278. It is difficult to address these issues without considering broader strategic questions. In particular, is the OECD's objective to maximize its Member States' welfare in absolute terms and to help the rest of the world to do likewise? Or to help the rest of the world only insofar as it adopts acceptably democratic procedures? Or not even then? According to Goldman Sachs, the Chinese economy will be as large as the American by 2041. DOMINIC WILSON & ROOPA PURUSHOTHAMAN, DREAMING WITH BRICS: THE PATH TO 2050 3 (Goldman Sachs, Global Economics Paper No. 99, 2003), at <http://www.gs.com/insight/research/reports/99.pdf>. A billion people will have raised themselves out of poverty. But the world's military and political balance of power will have been transformed, too, and in favor of a state whose government still operates along Leninist lines.

279. OECD, 1998, *supra* note 2, at para. 26. See also OECD, 2001, *supra* note 2, at para. 16.

280. OECD, 2001, *supra* note 2, at para. 3.

ently remains) to eliminate tax havens and harmful preferential tax regimes, and the Organization seems initially to have thought that this would require the havens and the countries operating harmful preferential regimes to restructure their tax systems. Despite its protestations to the contrary, then, the OECD seems to have regarded dictating the structure of other countries' tax systems as the basic point of the exercise. In 2001, however, as I have recounted, the OECD revised its objectives. It no longer required the havens to restructure their tax systems. All it now required them to do was to make their tax systems transparent and to adopt procedures providing for the exchange of information.²⁸¹ So long as a haven met these two requirements, it would apparently be free to structure its tax system however it wished. Perhaps, then, the OECD's requirements of harmful preferential regimes were revised so as to correspond with its requirements for havens, though this remains unclear.

But even if it is so, the OECD would seem still to require other countries to change their tax systems; it is just that its requirements would no longer relate to the structure of these countries' tax systems. Rather, they would relate only to transparency and information exchange. The Organization's claim that it is not dictating to non-member States how they should structure their tax systems might now, therefore, be strictly true but only in a sense so narrow as to be positively misleading. In other words, the OECD is still dictating policy but has changed somewhat the policy it is dictating.

The question, then, is not whether the OECD is attempting to dictate tax policy to non-member countries, for plainly it is. The question, rather, is whether this is appropriate. In one sense, the question is naïve. The Organization's basic function is to promote the interests of its members.²⁸² That is, presumably, what it has been doing (or, at least, what it thinks it has been doing). It has no obligation to countries outside its membership, or, at least, any such obligation is subordinate to the obligations owed by the Organization to its members.

It is important also in this context to consider the nature of the threats with which the OECD has backed up its attempts to dictate tax policy to other countries. It has threatened that its Member States will disallow the deductibility of payments made to entities in havens and that they will impose withholding taxes on payments made to residents of havens.²⁸³ These are serious threats; they appear, if carried out, to have

281. What it means to "restructure" a tax system is a semantic question susceptible to a range of answers. But I take the OECD to have meant that the "structure" of a tax system consists of provisions determining what is taxable and at what rate. On this basis, I have treated requirements relating to transparency and information exchange as not structural.

282. See Paris Convention, *supra* note 14, art. 1.

283. See OECD, 1998, *supra* note 2, at paras. 158–61.

the potential to cause very considerable distress. The OECD has also threatened that its Member States will withhold non-essential aid to havens.²⁸⁴ Again, the consequences of withholding aid seem likely to be serious.

The OECD has not announced what actions it might take against countries operating preferential regimes. Perhaps, indeed, it has not yet decided. Given, though, that preferential regimes seem clearly less objectionable than havens, the OECD will perhaps not propose to penalize countries operating preferential regimes any more severely than it proposes to punish havens. It seems likely, therefore, that the OECD (if it pursues its campaign against preferential regimes at all) will propose adopting the same measures against countries operating them as it recommends against havens—that is disallowing deductions to entities in offending jurisdictions, imposing withholding taxes on payments made to residents of offending jurisdictions, and withholding non-essential aid.

Whether these actions should be characterized as violations of sovereignty (as some have suggested)²⁸⁵ is largely a matter of semantics. For a country, or a group of countries, to dictate another country's tax policy is, in a sense, a violation of sovereignty. On the other hand, if the tax havens are free to structure their tax systems however they wish, why not the OECD Member States? That is, if the tax havens are free to structure their tax systems so as to facilitate the avoidance of other countries' taxes, it seems to follow that other countries should be free to structure their tax systems so as to discourage the use of havens. Conversely, if there are limits on the OECD States' freedom to structure their tax systems however they wish, such restrictions presumably apply to havens also. Similarly, it seems difficult to categorize the withholding of aid as a violation of sovereignty.

Even so, the OECD project entails the formulation of international norms in a fundamentally important area of public policy. It entails also the bringing to bear of very considerable pressure to encourage compliance. It would seem obviously preferable, in principle, for any project of this nature to be undertaken by as representative a body as possible. The OECD seems not to satisfy this criterion. Its membership is still relatively small and very unrepresentative. The Organization is clearly not representative of the world as a whole; despite the widening of its membership over the years, it is still very clearly a rich countries' club—as is evidenced by the fact that the project on harmful tax competition seems to have been launched at the instigation of the G7 countries and that its

284. See OECD, 2000, *supra* note 2, at para. 36.

285. See BISWAS, *supra* note 8, at 1–2; Carlson, *supra* note 8, at 177–80; Townsend, *supra* note 8, at 219–20.

purpose seems to be to protect the G7 countries' treasuries. There is no reason to suppose that the interests of the OECD members—let alone of the G7 countries—happen to coincide with the interests of the world as a whole.

Moreover, there was an alternative; the United Nations.²⁸⁶ Indeed, that the UN would have been, in principle at least, a more appropriate vehicle for a project of this nature seems obvious. The question, therefore, arises: Why did the G7 countries choose the OECD as the vehicle for their project rather than the United Nations? The G7 countries themselves seem not to have offered any explanation. Nor has the OECD (other than its vague and unsupported assertions that the whole world will somehow benefit).

Two answers, however, seem possible. First, if the project had been undertaken by the United Nations rather than the OECD, it seems inevitable that it would have been handled differently and that it would have produced different outcomes. Specifically, it seems likely that it would have produced results calculated to be beneficial to the world generally rather than to the members of the OECD in particular. In other words, the G7 countries might have used the OECD rather than the United Nations precisely because they saw it as in their interest to protect their own treasuries rather than to produce some more generally advantageous accord. This, of course, is not an ordering of priorities which the rest of the world can be expected to endorse. It is also possible, however, that, even if a project of this nature would be beneficial to the world as a whole, the United Nations might find it politically difficult to initiate such a project. That is, the United Nations, whilst in principle the most appropriate body to undertake the project, might in fact have been unable to do so.²⁸⁷

In any event, it is still possible that the OECD's project will produce outcomes beneficial to the world as a whole (as, indeed, the Organization claims it will), even if it would have been better undertaken by the United Nations. In this respect, it seems necessary to

286. See, e.g., *High-Level International Intergovernmental Consideration of Financing for Development*, U.N. GAOR, 55th Sess., Agenda Item 101, U.N. Doc. A/55/1000 (2001). Another possibility is the World Trade Organization. See Joel Slemrod & Reuven Avi-Yonah, *(How) Should Trade Agreements deal with Income Tax issues?*, 55 TAX L. REV. 533 (2002). A third is the establishment of a World Tax Organization. See Horner, *supra* note 8.

287. For example, it might be that eliminating tax havens would raise welfare (however defined) in OECD countries without harming any other countries apart from havens and that eliminating havens would therefore (given their very small aggregate population compared to the OECD) raise global welfare. But non-OECD countries might nonetheless oppose the eradication of havens. It is possible that havens, even if harmful to developing countries, are more harmful to developed countries. If this is so, developing countries might not support the eradication of havens because the consequences might include a widening of the gap between developing and developed countries. In other words, developing countries might see it as in their interest to add to the wealth of the developed world only if adequately compensated.

distinguish between the two main arms of the project, the campaign against havens and the campaign against preferential regimes. Specifically, that the OECD should have taken it upon itself to orchestrate a campaign against tax havens seems defensible. That it should have embarked on a campaign against non-member countries' preferential regimes is much harder to justify.

The reason, in short, is that the campaign against havens seems relatively defensible on the merits. That it has been undertaken by the OECD, rather than the United Nations, is a serious flaw but perhaps not so serious that it would be better if the Organization had never embarked on it. It would have been better if it had been the United Nations rather than the OECD which had embarked on the project—for the United Nations' mandate to conduct a project of this sort seems clearly superior to the OECD's, and the project would therefore possess greater legitimacy under the auspices of the United Nations. In particular, the project would then look less like an attempt to protect the special interests of the G7 countries and more like the attempt to further global welfare that the OECD claims it to be. Equally, it would be better now if the OECD were to hand the project over to the United Nations rather than pursue it itself. But for the campaign against havens to be run by the OECD is perhaps better than for it not to be run at all. The reason is that it seems reasonable to suppose that the eradication of tax havens would not only raise global welfare (as the OECD claims) but would also accord with the particular interests of developing countries (other than, of course, those developing countries currently operating as tax havens).²⁸⁸ At least, it seems unlikely that the campaign against havens will actually harm developing countries—other than, again, those developing countries actually operating as havens.²⁸⁹ It would have been much better, to be sure, for the project to have been undertaken by a suitably representative body. That it was not is a serious shortcoming. Nonetheless, the outcome seems defensible.

The campaign against preferential regimes raises more difficult questions. As has been explained, its merits are far less clear. Moreover, the total number of people resident in non-OECD countries operating

288. Leaving aside the possibility that the eradication of tax havens would widen the gap between developed and developing countries and that this would be to the relative disadvantage of the latter.

289. It seems likely that the less-developed countries, if asked to express an opinion on the OECD's campaign against tax havens, would generally not have been supportive. Indeed, it seems likely that it was for exactly this reason that the G7 decided not to ask them. It does not follow, however, that the campaign was not in their interest. One reason for this is that many developing countries' governments are not democratic, and their politicians and bureaucrats are notorious for their personal use of tax havens. See also *supra* text accompanying note 287.

preferential regimes is enormous. These countries seem to include, to identify only the most populous of them, China, India, Indonesia, Russia, Pakistan, Brazil, Nigeria, and Bangladesh.²⁹⁰ The number of people potentially on the receiving end of the OECD's campaign against preferential regimes seems, thus, to be several times the combined populations of the OECD countries and a very substantial majority—perhaps an overwhelming majority—of the world's population.²⁹¹ The campaign against preferential regimes would clearly possess greater legitimacy if handled by the United Nations rather than the OECD. Indeed, so long as it remains under the auspices of the OECD, the campaign against preferential regimes will be difficult to justify (other than on the basis that it is legitimate for the OECD's own Member States to promote their own interests at the acknowledged expense of the rest of the world). Moreover, even if the OECD were to offer to hand the campaign against preferential regimes over to the United Nations, it seems unlikely that this would suffice to cure its deficiencies. The reasons are as follows.

If the United Nations were to adopt the OECD's goal of ridding the world of tax havens, it would seem reasonable also for it to adopt the work done towards that goal by the OECD to date. That is, it would seem reasonable, if the United Nations were to adopt the end, for it to adopt the means also. It seems possible, too, that the United Nations would, in fact, take this view (if, that is, it were to take on the project at all), for, if the objective of eliminating havens is accepted, the means adopted by the OECD does not seem objectionable.

In the case of the campaign against preferential regimes, however, this seems far less clear. The United Nations remains to be convinced of the merits of this campaign.²⁹² But, even if the United Nations were to accept that preferential regimes are harmful and to adopt the goal of eradicating them, it seems unlikely that it would adopt also the way in which the OECD has proposed to go about achieving that goal. For the OECD's motives seem mixed at best; the project was intended (or so the Organization has maintained) to benefit the whole world, but it was also intended to benefit the more particular interests of the members of the OECD (and, more particularly still, those of the G7 countries). Consequently, the OECD's work seems tainted. It would be better, therefore, for the United Nations to start afresh.

290. But which countries the OECD will regard as operating preferential regimes, and which of these it will regard as harmful, remains to be seen.

291. In contrast, the number of people resident in tax havens is tiny, and the number resident in jurisdictions identified by the OECD as havens is smaller still (because of the omissions from the Organization's list).

292. At any rate, the United Nations seems to have shown no sign of any inclination to adopt the OECD's project.

A good place to begin would be with an investigation into the effects of preferential regimes. That is, the United Nations should start by attempting to determine whether preferential regimes are, in fact, harmful. It should not start, as the OECD did, by taking this crucial question on faith from the G7. Rather, it should attempt to measure the effects of preferential regimes both on the countries that operate them and on those that do not. It would also be helpful if the United Nations were to attempt to discover why some preferential regimes seem to have succeeded in attracting foreign investment and others have not. This might be useful to countries operating, or considering operating, preferential regimes (if it turns out that preferential regimes add to global welfare rather than detract from it as maintained by the OECD).

It is possible that the United Nations, having investigated the question, would conclude that the OECD's analysis is sound. It might also decide to adopt the same courses of action as have been proposed by the OECD. This would not, however, mean that the investigation was a waste of time and effort, for it would give the project the theoretical foundation and legitimacy it currently lacks. It is also possible that the United Nations might propose other courses of action (for example, that capital-exporting countries, if concerned about other countries' preferential regimes, should deal with them by means of their own CFC and FIF regimes) or none. In any event, it would presumably be helpful for the OECD to make available to the United Nations whatever record of its project it has maintained. Before the OECD Member States arranged for the Organization to embark on the project, they (or, at least, some of them) presumably collated and analyzed evidence of some kind, upon the basis of which they concluded that preferential regimes were harmful (or, at least, potentially harmful). It would likewise be helpful for these countries to make their analyses available to the United Nations and to publish them—for, so long as they remain unpublished, the suspicion will remain that the reason is that they support the theory that the developing countries benefit from operating preferential tax regimes.

The OECD's work on double taxation and tax treaties is instructive in this regard. There are currently about 1,500 tax treaties in the world. Almost all of them are based on a model devised by the OECD.²⁹³ The Organization's aim, in devising this model, and in revising it from time to time, was to meet the needs of its members.²⁹⁴ Consequently, the model treaty, although representing some sort of optimal satisfaction of the OECD's members, is widely perceived as biased in favor of the de-

293. OECD, *OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL* (2003).

294. See *id.* at I-1-14; PHILIP BAKER, *DOUBLE TAXATION CONVENTIONS: A MANUAL ON THE OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL A-1 to J-4* (3d ed. 2004).

veloped countries and against the less-developed. Subsequently, the United Nations facilitated the development of another model tax treaty, intended not to suffer from this bias.²⁹⁵ This United Nations model treaty is, however, closely based on its OECD predecessor. If the task of devising the model upon which the world's tax treaties were to be based had fallen to the United Nations instead of to the OECD, it seems likely that the result would have been different, and perhaps superior. It would also have enjoyed greater legitimacy. The same would seem to be true of any coordinated action against (or in support of) preferential tax regimes.

It is also worth noting that diversity among nations may be an inherently desirable phenomenon—and worth preserving and fostering, even at a cost. The homogenizing of the world's legal systems and tax systems is, therefore, not necessarily a good thing, especially if it is effectively imposed by some countries on others. The OECD project has an uncomfortable but pervasive feel of Big Brother to it. In a sense, the project is a product of democratic processes. It is, however, remote. Even in OECD countries, most well-informed voters seem to be wholly unaware of it. Moreover, most of the people affected by the project do not live in OECD countries; consequently, they do not enjoy even the formality of a vote.

VIII. CONCLUSION

The OECD's campaign against tax havens and harmful preferential tax regimes might be defended on the basis that the Organization's principal function is to promote the interests of its members²⁹⁶ and that that is the objective to which the campaign is directed.²⁹⁷ Whatever obligations the Organization owes to countries outside its membership are presumably subordinate to the obligations it owes to its members. Perhaps, too, there can be no objection to the OECD's using to this end whatever lawful means it finds advantageous, including dubious claims about maximizing global welfare. To this it might be added that the OECD's members are subject to, at most, a merely moral obligation to do anything about relieving poverty in other parts of the world and that, as a matter of practical politics, they are unlikely to go so far as to tolerate the compromising of their own economies and public finances.

295. U.N. DEP'T OF ECONOMICS & SOCIAL AFFAIRS, U.N. MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES, U.N. Sales No. E.01.XVI.2 (2001).

296. See Paris Convention, *supra* note 14, at art. 1.

297. Whether the campaign, if successful, will achieve the objective is, as I have indicated, debatable.

Such points might be valid, but they are far short of the whole truth. The OECD has embarked on a campaign to eradicate harmful preferential tax regimes,²⁹⁸ and it has claimed that this campaign will contribute to global welfare. It has not, however, substantiated the claim. Indeed, it has not even attempted to do so. Moreover, the OECD's project presents technical difficulties which the Organization has not addressed (or, at least, if it has addressed them, it has not published the results). And yet the OECD's intention is to require other countries to cooperate and to punish them if they do not. This is unsatisfactory in several respects. Perhaps most importantly, it is disingenuous: the OECD's chief concern is the G7 countries' treasuries, and the Organization has offered no satisfactory evidence for its claim that the world as a whole will benefit. Moreover, the resort to disingenuous argument, public threats, and perhaps other means also to procure the cooperation of non-OECD countries seems likely to aggravate the ill-will with which much of the rest of the world regards the G7. Worse, it seems likely that at least some developing countries will suffer a loss of investment if they comply with the OECD's wishes and close down their preferential tax regimes. This is likely to aggravate ill-will further, and the OECD's claim that the process is raising global welfare is likely to be felt as salt in the wound. Last but not least, it seems precipitate for the OECD to have embarked on the implementation of its project without, apparently, having first devised solutions to the technical problems it poses. It is conceivable that the project will fail, in which case a great deal of time, money, effort, and political good-will will have been wasted. Even if the project succeeds, its cost may prove exorbitant.

It would seem, then, to be in the interest of the OECD, and the rest of the world, for the Organization to revise its strategy. One possibility would be for the Organization to postpone its campaign against preferential regimes until such time as it has established the validity of the theory upon which it is based. A second would be to pass the project to the United Nations. If the United Nations is prepared to take it on, the project will at least enjoy the legitimacy that comes with broad-based international support, and the lack of a coherent theoretical foundation supported by satisfactory evidence will be less of a problem. Conversely, if the G7 cannot arrange for United Nations support, that would seem to betoken widespread international opposition, or at least lack of interest. This, in turn, might mean that the project is unlikely to succeed in any event. Finally, if the OECD cannot arrange United Nations support but wishes to proceed regardless, it would be seemly for it to base the pro-

298. And tax havens. But, as is indicated in the introduction, the primary concern of this paper is with preferential regimes, not havens.

ject cleanly on its real rationale (the furthering of the Member States' collective interests, as perceived by the Organization) and to dispense with the rhetoric about improving global welfare until, again, its validity has been established.

The OECD maintains that eradicating preferential tax regimes (or, at least, such of them as are "harmful") will raise global welfare. Maximizing global welfare seems a noble objective, but it also does not seem to be a principle upon which international relations are usually based. Perhaps it would be a good thing if it were. If so, however, foisting tax reform on unenthusiastic developing countries seems an oblique way to go about it. It would seem more effective for the OECD and its members to address the goal more directly—for example, by reducing the restrictions they put on imports from less-developed countries, by reducing the restrictions they put on immigration from less-developed countries, or by simply increasing the aid they make available to them.

