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An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy

Daniel J. Mitchell, Ph.D.

The Organisation for Economic Co-operation and Development (OECD), a Paris-based institution with 29 member nations from the industrialized world, has launched a project seeking the elimination of "harmful tax competition."

In a report titled "Towards Global Tax Co-operation," the OECD calls on member nations to eliminate "harmful tax practices"—low-tax policies that attract foreign investment. Moreover, it is pressuring 41 low-tax nations and territories (called "tax havens") to dismantle their "harmful tax regimes" and repeal their financial privacy laws. If they do not, the report recommends that OECD members exercise financial protectionism against them.

The OECD proposal is misguided. Globalization is making it harder for governments to overtax, because it is increasingly easy for taxpayers to shift their productive activities to lower tax environments. This is what is known as tax competition. Unfortunately, not everyone favors this development.

Tax competition should be celebrated, not persecuted. It forces politicians to be more responsible, pushing tax rates down and allowing people to enjoy more of the money they earn. Tax competition is a particularly good thing for the United States, drawing savings, investment, and skilled labor into the economy.

It should not come as a surprise that government officials do not like tax competition. They are like the owner of a town's only gas station, who suddenly has to deal with a bunch of competitors after years of being able to charge high prices while offering poor service. The residents of the town are like the world's taxpayers. Competition between governments makes their lives better.

Tax competition should be preserved. It is good for taxpayers and good for the global economy.

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The policies being advocated in the OECD report, by contrast, represent:

- **An Attack on Taxpayers.** The OECD report argues that it is detrimental when low-tax countries lure economic activity away from high-tax countries. To stop this process, the OECD study seeks to have low-tax countries raise their taxes. In effect, they want to create a cartel of high-tax nations. Supporters of this policy have even stated their desire for a global authority that would have the power to veto tax cuts and block tax reforms.

- **An Affront to Free Trade and Global Commerce.** The OECD report asks member nations to subject low-tax regimes to severe and discriminatory financial protectionism. This heavy-handed attack would impose crippling restrictions on international capital flows. In effect, the conditions and restrictions envisioned by the industrialized world would impose a financial blockade against targeted nations.

- **An Attack on Sovereignty.** The proposed recommendations would interfere with the right of sovereign nations to determine their own tax policies. High-tax nations should not be allowed to bully "tax havens" into raising their tax rates and eliminating financial privacy. Most OECD nations made the jump from poor, agriculture-dependent economies to industrial powers during the 1800s when they did not impose income taxes of any kind. Today, poorer nations are being told they cannot adopt similar polices.

- **An Attack on Privacy.** The OECD proposal seeks to give governments unlimited access to personal financial information in order to make it easier to tax economic activity in other countries. Proponents of this approach would expand the controversial "know-your-customer" regulations so that other professional service providers would have to join banks in spying on their customers.

Supporters of the approach recommended in the OECD report suffer from several misconceptions. Specifically they do not understand that:

- **A tax cartel is the wrong way to fight tax evasion.** There is a right way and a wrong way to fight tax evasion. The wrong way is to suspend civil liberties and destroy financial privacy in an effort to force greater compliance. The right approach is to cut tax rates and reform the tax system. The lower the tax rate, the lower the incentive to use either legal or illegal means to avoid taxes or even to hide money.

- **A system that taxes "worldwide" income and assets is the wrong way for a country to tax.** In large part, the OECD proposal seeks to eliminate financial privacy and reduce sovereignty in order to make it easier for some member nations to tax the "worldwide" income and assets of its citizens. A territorial system that seeks only to tax economic activity inside a nation's borders is a much better approach since it is simple to administer and avoids any conflict between nations.

- **Destroying financial privacy is the wrong way to address money laundering.** Most criminal profits are laundered in OECD nations, not tax havens. To the extent that some tax havens are a problem, the OECD's proposal would undermine incentives for them to cooperate, since many poorer regimes would be forced to seek a new source of funds to replace legitimate investments driven out by the OECD project.

U.S. policymakers should reject the OECD initiative. It is a threat to America's national interests. More important, it will be bad for U.S. taxpayers, weaken national sovereignty, destroy financial privacy, hinder technological innovation, lead to protectionism, and undermine the rule of law.

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AN OECD PROPOSAL TO ELIMINATE TAX COMPETITION WOULD MEAN HIGHER TAXES AND LESS PRIVACY

DANIEL J. MITCHELL, PH.D.

> A spectre haunts the world's governments. They fear that the combination of economic liberalization with modern information technology poses a threat to their capacity to raise taxes.[1]
>
> —*The Financial Times,* July 19, 2000

Globalization is making it harder for governments to overtax, because it is increasingly easy for taxpayers to shift their productive activities to lower tax environments. This is what is known as tax competition. Unfortunately, not everyone favors this development. The Organisation for Economic Co-operation and Development (OECD), a Paris-based international organization with 29 member nations from the industrialized world, has urged its member states to stop "harmful tax competition."[2]

In "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices," the OECD is calling on its members to eliminate low-tax policies that attract foreign investment.[3] It is also trying to dictate tax policy in non-member nations by pressuring 41 low-tax nations and territories (called "tax havens" in the report) that have "harmful tax regimes"[4] to sign an

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1. *The Financial Times,* "Wooing the Global Taxpayer: Governments Must Ensure They Provide Value in the Face of Porous National Boundaries and Technological Change," July 19, 2000.
2. Organisation for Economic Co-operation and Development, "Harmful Tax Competition: An Emerging Global Issue," 1998. See also *www.oecd.org/daf/fa/material/mat_03.htm#material_tax competition.*
3. Organisation for Economic Co-operation and Development, "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices," Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs, 2000, at *www.oecd.org/daf/fa/harm_tax/Report_En.pdf.*

agreement to remove their low-tax policies and repeal their attractive financial privacy laws. If they do not, the report recommends that OECD members exercise financial protectionism against them.

Such an effort contradicts international norms and threatens the ability of sovereign countries to determine their own fiscal affairs.[5] The OECD proposal, which is backed by officials in the primarily high-tax nations that form the core of its membership, would create a cartel by eliminating or substantially reducing the competition these high-tax nations face from low-tax regimes. The United States, a member of the OECD and its biggest source of funds, should put a stop to this ill-advised effort by unequivocally stating that it will not impose financial sanctions against the 41 blacklisted countries. (See Table 2.)

Critics have characterized this OECD effort as "an attempt by governments of high-tax countries to protect their tax revenues."[6] Indeed, some opponents of tax competition have estimated that successful implementation of the proposed initiative could mean a tax increase that is "likely to be in the hundreds of billions, if not trillions, of dollars worldwide."[7] Needless to say, a return to the profligate fiscal policies like those of the 1960s and 1970s would threaten the economic advances that have occurred over the past 20 years.[8]

Some policymakers from high-tax OECD nations appear so desperate to hold tax revenues hostage that they ignore the interests of less-developed countries. As one Canadian tax expert points out, the OECD proposal targeting the so-called tax havens would pit "wealthy—and white" industrialized nations against "predominantly black, poor" countries.[9] Indeed, some politicians are so greedy for tax revenue that the G–7 nations, the seven most powerful countries in the world, urged that taxes be enforced "with the same laws used against the laundering of drug proceeds."[10]

Table 1 B1395

The OECD Member States

Australia	Korea
Austria	Luxembourg
Belgium	Mexico
Canada	Netherlands
Czech Republic	New Zealand
Denmark	Norway
Finland	Poland
France	Portugal
Germany	Spain
Greece	Sweden
Hungary	Switzerland
Iceland	Turkey
Ireland	United Kingdom
Italy	United States
Japan	

But such efforts miss the point. The fact that low-tax nations are magnets for jobs, capital, and entrepreneurial talent is a development that should be celebrated, not persecuted.[11] Govern-

4. *Ibid.*
5. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition," at *www.biac.org.*
6. Commonwealth Secretariat, "Harmful Tax Competition," Paper prepared for the Meeting of Law Ministers and Attorneys-General of Small Commonwealth Nations, LMSCJ(00)12, May 15–17, 2000, p. 3.
7. *The Independent* [United Kingdom], "OECD Takes Aim at 'Harmful' Tax Havens: Threat of International Sanctions Could Spell the Beginning of the End for 35 Regimes' Special Status," June 27, 2000.
8. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."
9. David Louis, "Blacklist," *Tax Notes,* CCH Canadian Limited, No. 451, August 2000.
10. Michael Allen, "Wealthy Nations Plan Crackdown on Tax Evasion, Offshore Havens," *The Wall Street Journal*, May 21, 1998.

ments should not be sheltered from competition. Globalization is helping to create more prosperity by forcing businesses to be more productive. The same competitive forces should be allowed to impose fiscal discipline on government.

A cartel would have adverse consequences for U.S. taxpayers and threaten national sovereignty, financial privacy, technological development, and the rule of law. America should not participate in a regime that undermines one of its most significant competitive advantages—a low-tax environment compared with other industrialized nations. Instead, U.S. policymakers should make the economy even more competitive by reducing tax rates. Ultimately, lawmakers should enact a flat tax, a reform that would lure more economic activity to America's shores as well as substantially reduce incentives to either avoid or evade the tax system.

Table 2 B1395

The OECD's "Harmful Tax Regimes"

Andorra	The Maldives
Anguilla	Malta*
Antigua and Barbuda	The Marshall Islands
Aruba	Mauritius*
The Bahamas	Monaco
Bahrain	Montserrat
Barbados	Nauru
Belize	Netherlands Antilles
Bermuda*	Niue
British Virgin Islands	Panama
Cayman Islands*	Samoa
Cook Islands	San Marino*
Cyprus*	Seychelles
Dominica	St Lucia
Gibraltar	St. Kitts & Nevis
Grenada	St. Vincent and the Grenadines
Guernsey/Sark/Alderney	Tonga
Isle of Man	Turks & Caicos
Jersey	U.S. Virgin Islands
Liberia	Vanuatu
Liechtenstein	

Note: *Nations and Territories that signed the OECD's Advance Committment Letter.
Source: OECD.

WHY SOME GOVERNMENTS WANT TO ELIMINATE TAX COMPETITION

The OECD's "Towards Global Tax Co-operation" report on efforts to eliminate low-tax competition and financial privacy is, at its core, a response to globalization. As one European bureaucrat explains, "differences in national tax systems are becoming increasingly evident and are therefore having an increasing influence on economic decisions concerning, for example, investment, savings, employment and consumption."[12] And just as banks, pet stores, and car companies treat customers better when they know there is a competitor down the block, governments treat taxpayers better when they know economic activity can cross national borders.[13]

As the world economy becomes more integrated and technology improves, it is becoming much easier to avoid excessive taxation. As a senior International Monetary Fund (IMF) economist noted:

> Today, individuals may be able to choose among many countries in deciding where to work, to shop, to invest their financial capital, to allocate the production activities of the enterprises they control and so on. In these decisions, they take into account the impact of taxes,

11. Christopher Adams, "Nowhere to Hide," *The Financial Times,* June 26, 2000.
12. See Frits Bolkestein, "Taxation and Competition: The Realization of the Internal Market," European Commission, March 17, 2000, at *http://europa.eu.int/comm/taxations_customs/speeches/17march2000_en.htm.*
13. *The Financial Times,* "Wooing the Global Taxpayer."

The OECD's Disdain for Tax Competition

The fact that tax rates affect economic decisions is not an outcome that most policymakers welcome. In part, they fear the loss of revenue, which affects their ability to spend.[1] Yet some of them think tax competition is economically counterproductive, as statements from various OECD publications show:

- Low-tax policies "unfairly erode the tax bases of other countries and distort the location of capital and services."[2]
- "[T]ax should not be the dominant factor in making capital allocation decisions."[3]
- "These actions induce potential distortions in the patterns of trade and investment and reduce global welfare."[4]
- Tax competition is "re-shaping the desired level and mix of taxes and public spending."[5]
- Tax competition "may hamper the application of progressive tax rates and the achievement of redistributive goals."[6]
- "Harmful tax practices may exist when regimes are tailored to erode the tax base of other countries. This can occur when tax regimes attract investment or savings originating elsewhere."[7]

1. Dow Jones Newswire, "Caribbean Leaders to Discuss Offshore Banking Blacklist," July 3, 2000.
2. OECD, "Towards Global Tax Co-operation," p. 5.
3. *Ibid.*
4. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 14.
5. *Ibid.*, p. 16.
6. *Ibid.*, p. 14.
7. OECD, "Harmful Tax Practices," April 13, 2000, at *www.oecd.org/daf/fa/harm_tax/harmtax.htm.*

> especially as long as the tax systems of different countries diverge as much as they do today.[14]

This taxpayer mobility—the ability to "vote with one's feet"—means that countries with high tax rates are likely to lose revenue, making it harder for their policymakers to fund expensive government programs. Supporters of the OECD initiative tend to see the effort as an attempt by governments "to regain the capacity to finance redistribution through tax revenue."[15] As Michel Vanden Abeele, the Director General of the European Commission's Taxation and Customs Union puts it, "protection of adequate tax revenues is of particular concern in order to guarantee the survival of the fair and caring society."[16] Needless to say, lawmakers who support these programs prefer that tax competition did not exist.

The only way to stop taxpayers from fleeing to lower tax environments, however, is to have all governments agree to maintain high tax rates—in effect, by establishing a tax cartel. The OECD pro-

14. Vito Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems," International Monetary Fund *Working Paper* No. 96/141, December 1996.
15. Oxfam, "Tax Havens: Releasing the Hidden Billions for Poverty Eradication," *Oxfam GB Policy Paper,* June 2000, at *www.oxfam.org.uk/policy/papers/taxhvn/tax.htm*.
16. Michel Vanden Abeele, "Globalization of the World Economy," Speech to the Taxes Without Borders World Tax Conference, Tampa, Florida, February 27, 2000, at *http://europa.eu.int/comm/taxation_customs/speeches/vda_tampa_en.htm* (September 8, 2000).

posal is just the latest development in an ongoing battle between taxpayers and their governments. Under the guise of "tax harmonization," for example, high-tax nations in the European Union have been working for years to impose a cartel on taxpayers.[17]

The creation of a tax cartel may be just the beginning of a process that results in higher taxes and a more costly government—policies that will adversely affect U.S. taxpayers. In order to understand why eliminating tax competition is bad public policy, it is important to understand what tax competition is and is not, and how it benefits people around the world.

WHAT IS TAX COMPETITION, AND WHY IS IT GOOD?

Competition exists when rivals offer similar or better products at lower prices. In the business world, competition leads to innovation, lower prices, and good service. In effect, competitive markets mean the "customer is king." Competition serves the same role when the taxpayer is the consumer and governments must learn not to overtax lest they drive economic activity away.[18]

Government officials who fear tax competition are like the owner of a town's only gas station who suddenly has to deal with a bunch of competitors after years of being able to charge high prices while offering poor service. The residents of the town are like the world's taxpayers. The competition lowers the price of gas and auto repairs and makes their lives better.

This is the central reason why tax competition is a good thing. As a response by Switzerland in a 1998 OECD report noted, "competition in tax matters has positive effects. In particular, it discourages governments from adopting confiscatory regimes, which hamper entrepreneurial spirit and hurt the economy, and it avoids alignment of tax burdens at the highest level."[19] Moreover, as one academic expert notes, "Competition will often have a 'negative effect' on less competitive suppliers in a market, but the losses incurred by them, while real, are not 'harm' in the proper sense."[20] A British newspaper notes that tax competition is only damaging

> in the absurdist sense that any government that finds itself in competition with a lower-tax regime can condemn its competitor as "harmful." Accept this and you introduce an irresistible upward bias in international taxation. Bad news for the tax havens, for sure, but scarcely better for the citizens of some of the tax hells that we hear rather less about.[21]

Perhaps most important, tax competition is not about governments. It is about people and whether they enjoy more freedom and have more opportunity.[22] Tax competition tilts the balance of power away from government and towards taxpayers.[23] Or, as *The Wall Street Journal* opined,

> Tax competition between states is a good thing. The power of individuals and companies to vote with their feet is one of the most potent weapons against overweening government. Any attempt to deprive them of places to run must surely be considered an attack on freedom and a threat to prosperity.[24]

17. *The Economist,* "The Mystery of the Vanishing Taxpayer," January 29, 2000.
18. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."
19. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 77.
20. Mason Gaffney, "International Tax Competition: Harmful of Beneficial," Monograph, 1998.
21. *The Independent* [United Kingdom], "Punishing Offshore Havens Won't Solve Tax Problems," June 27, 2000.
22. Neil King, "Sark, 'Utopia' of English Channel, Faces Heat for Offshore Havens," *The Wall Street Journal,* July 16, 1998.
23. *The Independent* [United Kingdom], "What Will Governments Find to Tax in the World of the New Economy," June 22, 2000.

The Attraction of Lower Taxes. Ample evidence exists that economic activity is drawn to low-tax regimes.[25] People work, save, invest, and take risks in order to improve their after-tax income. This insight is particularly relevant to international investment flows since, as an expert from the University of California in Riverside observes,

> [A]rbitrage in capital markets causes rates of return to converge; but it is the net rates of return after taxes that tend to converge, not gross rates of return, so that businesses in jurisdictions with high taxes must offer and generate correspondingly higher gross rates of return on capital, to continue to attract investment.[26]

Consider the example of an investor looking at two potential business opportunities. In Country A, a project might generate a 10 percent return, while in Country B, a similar investment is expected to yield a 7 percent return. On paper, this would suggest the investor would take advantage of the opportunity in Country A. But what if Country A has a 50 percent tax and Country B has no tax? In that case, the investor will choose to invest in the project in Country B. This choice is made because the actual after-tax return in Country A falls to 5 percent, less than the 7 percent after-tax profit that could be earned in Country B.

This does not mean, of course, that all investment will flow to low-tax nations. It does mean that investors will steer away from projects in Country A unless the expected pre-tax return is sufficiently large to compensate for the tax burden. In non-economic terms, this means that where there are two equally attractive projects, investors will choose the project that is subject to lower tax rates.[27]

Taxation is not the only government policy that influences economic decisions. It may not even be the most important one. Excessive regulation, corruption, inflation, and protectionism also make an economy unattractive to entrepreneurs and investors.[28] Other factors include property rights, flexible labor markets, and government spending.[29] If the OECD project is any indication, however, government officials clearly think tax policy plays a dominant role in economic decisions.

The United States is a good example. Compared with Europeans, Americans enjoy low taxes, which seems to have a notable impact on economic performance. The United States has experienced faster economic growth, which has resulted in the creation of 30 million net new jobs since the mid–1970s compared with 3.5 million in all of Europe (almost all of which were government jobs).[30]

There is compelling anecdotal evidence that people do care about taxes when deciding where to live, work, save, and invest. For instance:

- British sports millionaires like cricketer Ian Botham, Formula 1 driver Nigel Mansell, and golfer Ian Woosnam live in the Channel Islands or the Isle of Man, two of the so-called tax havens.[31] Boris Becker and Luciano Pavarotti have taken up residence in Monaco.[32]

24. *The Wall Street Journal Europe,* "Tax and Trade," September 22, 1999.
25. James Hines, "Lessons from Behavioral Responses to International Taxation," *National Tax Journal,* Vol. 52, No. 2 (June 1999).
26. Gaffney, "International Tax Competition: Harmful of Beneficial."
27. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."
28. Vito Tanzi, "Globalization and the Future of Social Protection," International Monetary Fund *Working Paper* No. WP/00/12, January 2000, p. 15.
29. Gerald P. O'Driscoll, Jr., Kim R. Holmes, and Melanie Kirkpatrick, *2000 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, 2000).
30. David Smith, "Will Tax Harmonization Harm Job Creation," *A European Harmony,* Stockholm Network Conference, May 8, 1999.
31. Patrick Jenkins, "Idylls Where the Jet Set Find Life Not too Taxing," *The Financial Times,* July 28, 2000.

- Fruit of the Loom moved its headquarters to the Cayman Islands, saving almost $100 million in taxes each year.[33]
- U.S. insurance companies are moving some of their operations to Bermuda to avoid America's 35 percent corporate income tax.[34]
- Many Scandinavians and Germans have bank accounts in Luxembourg.[35]
- Many Latin American countries no longer tax dividends and interest to reduce the amount of capital going overseas.[36]

Tax Competition Promotes Growth

It is almost universally accepted that high tax rates inhibit economic growth.[37] Tax competition, by encouraging lower tax rates, must therefore be beneficial to the economy.[38] This general concept is known as the Tiebout Hypothesis, after the author of a seminal 1956 article on this issue.[39] More specifically, tax competition generates big dividends by making it harder for the government to double-tax savings and investment. In today's global economy, this means both more investment and better investment. For instance:

- **By helping to reduce the tax bias against savings and investment, tax competition results in more capital formation.**[40] This increases productivity and the technological development of an economy and boosts long-term growth and living standards.[41] The OECD mistakenly assumes that taxes on capital simply shift *where* investments take place. But as one tax scholar notes, "The world's supply of capital is not fixed and depends on the net rate of return. If all governments increase the tax burden on capital income, world capital accumulation slows down and economic growth will slow."[42]
- **The lower tax rates caused by competition encourage savings and investment to move more easily around the globe.** This means "world resources are better allocated; thus, output and standards of living rise."[43] The OECD acknowledges that open capital markets have resulted in more economic growth.[44] Perhaps even more noteworthy, the OECD admits that so-called tax havens are partly responsible for these open markets, since deregulation was "in part a response to the threat to financial markets posed by offshore centers. The result-

32. Ulrika Lomas, "Boris Becker Meets Taxman on Centre Court," Tax-News.com, August 2000, at *www.tax-news.com/html/old-news/st_becker_08_08_00.htm.*
33. Bruce Bartlett, "Internet Low Tax Sightings," *The Washington Times,* July 10, 2000.
34. Dow Jones Newswire, "Six Offshore Locations Plan to End Tax-Haven Practices," June 19, 2000.
35. Joe Kirwin, "EU Finance Ministers Agree to Resolve Savings Tax Directive by Year's End," BNA *Daily Report for Executives,* July 18, 2000.
36. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."
37. For a good survey paper discussing the impact of taxes on economic performance, see Vito Tanzi and Howell Zee, "Fiscal Policy and Long-Run Growth," *International Monetary Fund Staff Papers,* Vol. 44, No. 2 (June 1997).
38. Terry Dwyer, "Harmful Tax Competition and the Future of Offshore Financial Centres, Such as Vanuatu," *Pacific Economic Bulletin*, Vol. 15, No. 1 (2000).
39. C. Tiebout, "A Pure Theory of Local Expenditures," *Journal of Political Economy,* Vol. 64, No. 5. (October 1956), pp. 416–424. See John Douglas Wilson, "Theories of Tax Competition," *National Tax Journal,* Vol. 52, No. 2 (June 1999).
40. Hines, "Lessons from Behavioral Responses to International Taxation."
41. Tanzi and Zee, "Fiscal Policy and Long-Run Growth."
42. Dwyer, "Harmful Tax Competition and the Future of Offshore Financial Centres."
43. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."
44. OECD, "Improving Access to Bank Information for Tax Purposes," 2000, p. 23.

ing liberalization and harmonization of financial markets greatly facilitated the free flow of capital across national borders, which improved the allocation of capital and reduced its cost."[45]

Tax Competition Promotes Fiscal Responsibility

Economists like tax competition because the resulting lower tax rates reduce the penalties on productive behavior.[46] Taxpayers have a more narrow perspective—they simply enjoy the prospect of keeping more of the money they earn. The Reagan tax rate reductions—and the tax cuts that followed around the world—demonstrate that tax competition has generated big savings already for taxpayers.[47] Another compelling piece of evidence is the new round of tax cuts currently taking place in Europe.[48] It is likely that these tax cuts will induce other nations to propose competing tax rate reductions.[49] This certainly has happened in the past. For instance:

- In response to the U.S. tax rate reductions in the 1980s, all but two OECD countries lowered their top marginal rate on personal income tax between 1986 and 1991.[50]
- Rates of income tax all over the world dropped by up to 50 percent after the Reagan and Thatcher tax rate reductions.[51]
- Following the Reagan tax cuts, all but one European Union nation reduced corporate tax rates between 1985 and 1998.[52]

Yet many government officials, particularly in Europe, do not like this competitive process.[53] In effect they are losing their power to set tax rates.[54] And as an IMF official observed in a recent publication, with the passage of time it will likely become even "more difficult and more costly for a country to maintain high taxes."[55] So long as tax competition continues, taxpayers will win.

Tax competition limits the growth of government. A vast majority of budget expenditures are financed by tax revenue. It stands to reason, therefore, that a policy that puts downward pressure on taxes will help to control spending. This is a welcome development, particularly since lower levels of government spending are associated with better economic performance.[56]

It is not just that tax competition can make governments smaller.[57] It also can encourage lawmakers to be more frugal with the money they collect.[58] According to the OECD's business advi-

45. *Ibid.,* p. 22.

46. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

47. Gabriel Makhlouf, "A Perspective on International Tax Issues," Speech to the IBC International Tax Forum in Milan, October 28, 1999, at *www.bnasoftware.com/tmweb/memo5.htm.*

48. John Tagliabue, "France Joins Wave of Plans for Big Tax Cuts," *The New York Times,* September 1, 2000, p. A12.

49. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."

50. Mark Hallerberg and Scott Basinger, "Internationalization and Changes in Tax Policy in OECD Countries: The Importance of Domestic Veto Players," unpublished manuscript, February 1997.

51. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

52. Haroldene Wunder, "International Tax Policy and the European Monetary Union," *Tax Analysts,* WTD 137-15, 1999.

53. Smith, "Will Tax Harmonization Harm Job Creation."

54. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."

55. Tanzi, "Globalization and the Future of Social Protection," p. 15.

56. Tanzi and Zee, "Fiscal Policy and Long-Run Growth."

57. Tanzi, "Globalization and the Future of Social Protection," p. 15.

58. Wilson, "Theories of Tax Competition."

sory group, tax competition "creates pressure for less wasteful, and, therefore, more efficient uses of public funds."[59] In more academic terms, tax competition is

> not a "race to the bottom" (towards zero tax rates), but a race to the most efficient use of tax receipts. The institutional competition that will be triggered by mobile labor and capital will consequently indicate or reveal what is efficient and inefficient government use of tax income.[60]

Finally, tax competition frees people to pursue better lives; taxpayers have more opportunity to "vote with their feet."[61] Savings and investment are particularly mobile, making excessive taxation of capital difficult to maintain.[62] But people, particularly highly productive individuals, also can cross national borders and migrate to tax systems that reward entrepreneurship and hard work; this migration is a form of tax competition.[63] This process maximizes economic growth and advances individual liberty, benefits that will evaporate if the OECD succeeds in creating an international tax cartel.

HOW THE OECD WANTS TO LIMIT TAX COMPETITION

The OECD proposal began in earnest with the 1998 publication of "Harmful Tax Competition: An Emerging Global Issue," which largely outlined the theory that low taxes are unfair and harmful because they lure economic activity away from high-tax nations.[64] Subsequently, the OECD investigated low-tax policies around the world that would qualify as "harmful," and published the results this year in "Towards Global Tax Co-operation." The new report lists 47 supposedly "harmful tax practices" in OECD member nations and names 41 "harmful tax regimes"—non–OECD nations and territories that have very attractive tax systems. Specifically:

- **The OECD recommends that member nations eliminate tax practices that are deemed to be harmful.** The "Towards Global Tax Co-operation" report lists 47 such policies that are considered unfair because tax rates are too low. This effort resembles the EU's "tax harmonization" campaign, although the OECD does not have enforcement powers. Other than making a list of offending tax laws and suggesting a date by which it would like to see these provisions repealed, the OECD does not propose a plan to make this happen. Moreover, it does not suggest any penalties for member nations that do not acquiesce to its wishes.
- **The OECD demands that "tax haven" nations and territories make an open-ended commitment to change their laws so that foreign governments can more easily collect taxes on the "worldwide" income and assets of their citizens.** This will include requirements to raise tax rates and/or eliminate financial privacy. The OECD does not have any enforcement power over non-members. It is trying to enforce its demands, however, by asking its member nations to impose financial protectionism against "Uncooperative Regimes" that do not capitulate and sign the agreement.[65] The list of sanctions (see Appendix) is so severe that six of these jurisdictions, including

59. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."
60. Kurt Wickman, "Is Harmonization of Tax Policies Between EU Countries a Good Idea," Stockholm Network Conference, March 1999.
61. Jonathan Chevreau, "Welfare States' Spiteful Attack on Tax Havens: OECD Targets the Symptom, Not the Cause: Overtaxation," *Financial Post* (Canada), August 22, 2000.
62. Wickman, "Is Harmonization of Tax Policies Between EU Countries a Good Idea."
63. *Ibid.*
64. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 9.
65. OECD, "Towards Global Tax Co-operation," p. 24.

Bermuda and the Cayman Islands, have already signed the OECD letter.

Double Standards

As described above, the OECD is not being even-handed. The proposals require that low-tax regimes make unlimited concessions or face penalties for being "non-cooperative." The same harsh standard is not recommended for OECD member nations. They are being asked to make changes in their tax laws, but there are no specific penalties for non-compliance.[66]

Similarly, the OECD is using a double standard in its campaign against privacy. Many industrial nations respect citizens' financial privacy and are reluctant to eliminate their bank secrecy laws. Switzerland, for instance, has refused several times to abolish financial privacy.[67] Austria's constitution guarantees privacy and the government has fought to preserve bank secrecy.[68] Luxembourg, Belgium, and Greece, to their credit, also have indicated a reluctance to phase out financial privacy.[69] Yet none of these nations are being threatened with financial protectionism from other countries.

Targeting Low-Tax Non-Members

A cartel to keep taxes high is doomed to failure unless every country in the world signs on. Consider what would happen if all OECD member nations agreed to implement and maintain high tax rates. At first glance, "harmful tax competition" would decrease. Canadians, for example, no longer would have an incentive to move to America, and Europeans no longer would have an incentive to protect their assets in Switzerland. Yet this kind of cartel would not deliver the desired results—more revenue in high-tax nations—as long as investors and entrepreneurs are free to shift their activities to low-tax jurisdictions.

The OECD report acknowledges that an agreement to maintain high taxes in the industrialized world would "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."[70] This, of course, would mean that high-tax nations would fail to collect more revenue, defeating the purpose of the project. U.S. Treasury Secretary Larry Summers has been forthright about this goal, stating that, "The OECD's work and our unilateral initiatives are first steps in ensuring that our policy objectives can be realized without fear of eroding our tax base."[71]

This is why the OECD has taken the unprecedented step of trying to force non-member nations to alter their tax policies. The organization realizes a cartel will not work unless low-tax regimes are forced to participate. In addition to shutting down low-tax nations, OECD members want to make sure new tax havens do not spring up to take their place. Therefore, the report states that it intends to maintain a permanent project to prevent any nation from adopting competitive tax policies in the future.[72]

What Are Tax Havens?

Tax havens, more properly known as offshore financial centers (OFCs), are usually perceived as places with low tax rates and financial privacy.[73] According to the U.N. definition, an offshore insti-

66. Michael Devereux, "The OECD 'Harmful Tax Competition' Initiative," Commonwealth Secretariat, London, August 2000.

67. AFX, "EU Summit Focus," June 20, 2000.

68. Geoff Winestock, "EU Countries Strike Compromise, Delaying Action on Tax Evasion," *The Wall Street Journal*, June 21, 2000.

69. Joe Kirwin, "EU Disagreement Continues on Phase-Out of Bank Secrecy Laws, Withholding Tax," BNA *Daily Report for Executives,* May 31, 2000.

70. *Ibid.*, p. 22.

71. Larry Summers, "Tax Administration in a Global Era," Speech to the 34th General Assembly of Inter-American Center of Tax Administrators, Washington, D.C., July 10, 2000.

72. OECD, "Towards Global Tax Co-operation," p. 20.

The OECD's Allies in the Fight Against Tax Competition

Several other multinational organizations are helping the OECD effort, particularly in forcing so-called tax havens to change their laws.[1] In fact, nearly every international institution dominated by the industrialized world has joined the attack.[2] Under the guise of fighting money laundering, for example, the United Nations attacked low-tax regimes by making it appear that countries that offer financial privacy are guilty of hiding "dirty money" until they prove themselves innocent.

The Financial Action Task Force (FATF), an adjunct of the OECD, is using the same excuse to list countries and territories that allegedly contribute to money laundering.[3] Though the list offers no proof of improper behavior, it appears that the mere existence of financial privacy is tantamount to guilt. Ironically, but perhaps not surprisingly, the FATF does not list any industrialized nations, even though the U.S. Department of State admits that several OECD nations (including the United States) are in fact money laundering centers.[4]

The G–7 nations—the United States, Great Britain, Germany, Japan, France, Italy, and Canada—have joined the fray, creating the Financial Stability Forum (FSF)[5] to identify regimes that supposedly destabilize the world's financial system by being sources of mobile capital.[6] Once again, the appearance of guilt is enough to justify inclusion in the list. The FSF has tarnished the reputations of many low-tax regimes even though its own report acknowledges that they are not "a major causal factor in the creation of systemic financial problems."[7] And despite the fact that New York and London are the world's largest financial centers with huge "offshore" holdings, the FSF conveniently did not include the United States and Great Britain on the list.[8]

The European Union has been working to harmonize taxes among member countries. Indeed, its actions should serve as a warning for those that think the OECD's campaign against tax competition can be ignored. The EU requires a minimum value-added tax (VAT) of 15 percent.[9] An EU committee has recommended a minimum corporate income tax rate of 30 percent.[10] Another major EU project surrounds the mandatory minimum taxation of personal savings.[11] These last two items have not been implemented, but only because a handful of low-tax (by European standards) nations have exercised their veto. Not surprisingly, the EU is pushing to change the rules so that the wishes of the minority can be overridden.[12]

1. King, "Sark, 'Utopia' of English Channel, Faces Heat for Offshore Havens."
2. Caricom, "Statement on OECD Harmful Tax Policy," Caribbean Community, at *www.caricom.org/expframes2.htm.*
3. Financial Action Task Force (FATF), "Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures," Paris, June 22, 2000.
4. U.S. Department of State, *1999 International Narcotics Control Strategy Report,* Bureau for International Narcotics and Law Enforcement Affairs, Washington, D.C., March 2000, at *www.state.gov/www/global/narcotics_law/1999_narc_report/ml_intro99.html*.
5. Financial Stability Forum, "About FSF," September 27, 1999, at *www.fsforum.org/About/Home.html.*
6. Financial Stability Forum, "Financial Stability Forum Releases Grouping of Offshore Financial Centres (OFCs) to Assist in Setting Priorities for Assessment," Public Releases, May 25, 2000.
7. Financial Stability Forum, "Report of the Working Group on Offshore Centres," April 5, 2000.
8. Oxfam, "Tax Havens: Releasing the Hidden Billions for Poverty Eradication."
9. Smith, "Will Tax Harmonization Harm Job Creation."
10. Hallerberg and Basinger, "Internationalization and Changes in Tax Policy in OECD Countries."
11. Commission of the European Communities, "Towards Tax Co-ordination in the European Union: A Package to Tackle Harmful Tax Competition," COM(97) 495, October 1, 1997.
12. Abeele, "Globalization of the World Economy," speech at the Taxes Without Borders Conference.

tution is "any bank anywhere in the world that accepts deposits and/or manages assets denominated in foreign currency on behalf of persons legally domiciled elsewhere."[74] The Financial Stability Forum defines OFCs as "jurisdictions that attract a high level of non-resident activity."[75]

OFCs exist all over the world. According to the United Nations Offshore Forum, between 60 and 90 nations and territories participate in the offshore market.[76] The U.S. Department of State lists 52 regimes, including the United States.[77] The largest OFC, by some measures, is London.[78] In addition to being an OFC, the United States serves as a tax haven for overseas funds;[79] and the state of Montana is seeking to become a depository for offshore money.[80]

Notwithstanding the false stereotype that all OFCs are sun-drenched islands in the Caribbean and South Pacific, some of the popular perceptions about tax havens are accurate. As a general rule, OFCs either do not tax bank accounts by foreign nationals or they impose very modest levies. Also, these regimes are likely to be among the 90-plus jurisdictions around the globe that "offer themselves as providers of bank secrecy."[81]

According to the United Nations, about $8 trillion is invested in offshore companies and accounts.[82] According to a British-based interest group, the so-called tax havens are estimated to have attracted $6 trillion to $7 trillion in assets, with $3 trillion to $4 trillion of that amount representing the savings of the wealthy.[83] (To put these figures in perspective, the total holdings of the world's well-to-do are believed to be in excess of $25 trillion.[84])

OFCs are also major business centers. American banks, for instance, often make overnight deposits in the Cayman Islands to avoid burdensome U.S. regulations.[85] Indeed, a *Wall Street Journal* article reports that "more than 90 percent of deposits in Cayman banks are short-term, inter-bank funds booked by 'on-shore' banks."[86] Bermuda, meanwhile, has used the absence of income taxes, combined with reasonable levels of regulation, to become one of the world's major insurance centers.[87]

73. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 23.
74. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering," 1998, at *https://www.imolin.org/finhaeng.htm.*
75. Financial Stability Forum, "Report of the Working Group on Offshore Centres," April 5, 2000.
76. Michael Sesit, "U.N. Targets Offshore Centers; Plan Aims for Minimum Standards," *The Wall Street Journal*, January 25, 2000.
77. U.S. Department of State, 1999 International Narcotics Control Strategy Report, Bureau for International Narcotics and Law Enforcement Affairs, Washington, D.C., March 2000, at *www.state.gov/www/global/narcotics_law/1999_narc_report/ml_intro99.html*.
78. Financial Stability Forum, "Report of the Working Group on Offshore Centres."
79. Mark Nestmann, "When is Tax Competition Harmful?," A-Letter, The Sovereign Society, Vol. 1, No. 8 (December 3, 1999).
80. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."
81. *Ibid.*
82. Jack Blum, "Criminal Money Laundering and Illegal Flight Capital, Brookings Press Briefing, Washington, DC, September 29, 1999.
83. Oxfam, "Tax Havens: Releasing the Hidden Billions for Poverty Eradication."
84. William Hall, "World's Wealthy Press for Service," *The Financial Times*, July 7, 2000.
85. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."
86. Michael Allen, "U.S. Tax Fraud Probe Opens View Into World of Offshore Banking," *The Wall Street Journal,* August 3, 1999.

Since major U.S. banks view such "tax havens" as a safe investment, it should come as no surprise that other businesses utilize their services as well. Companies operating in countries with unstable financial systems use OFCs to protect liquid assets.[88] Low-tax jurisdictions also are widely used because of financial privacy, a practice that enables firms to "maintain their privacy and thereby their competitive edge in a business environment in which competitive intelligence has become almost mandatory."[89] Even the much-maligned international business companies (IBCs) have a variety of uses, "such as the holding of patents, the legitimate exploitation of tax treaties and the conduct of legitimate foreign trade transactions."[90]

Low-Tax Policies That Attract Wealth. Major OFCs such as the Cayman Islands, Bermuda, and the Bahamas do not have personal or corporate income taxes.[91] Other so-called tax havens have income taxes that tend to be very low. Guernsey, for example, has a 20 percent flat tax and does not tax capital gains or inheritances.[92] And because policies like this are the norm rather than the exception, people from G–7 countries boosted their investment in offshore jurisdictions by more than 500 percent between 1985–1994.[93]

Evidence that low-tax regimes attract investment abounds:

- The Cayman Islands has 580 banks with $500 billion in holdings.[94] It has 2,238 mutual funds, 499 insurance companies and 40,000 offshore companies.[95]
- St. Vincent and the Grenadines has 15 banks and 7,000 IBCs.[96]
- St. Kitts and Nevis has 9,000 offshore companies.[97]
- There are 3,000 IBCs in Niue, a nation of only 2,000 people.[98]
- Dominica has 5,800 IBCs.[99]
- Liechtenstein has 75,000 business entities.[100]
- The Cook Islands have 6,000 IBCs and 2,000 international trusts.[101]
- The Bahamas has 580 mutual funds, 60 insurance companies, and 100,000 IBCs.[102] It has $350 billion worth of assets under manage-

87. Joseph Treaster, "International Business: Bermuda Takes the Risk; From Tourist Paradise to Haven for Insurance Business," *The New York Times,* April 28, 1999.
88. David Hardesty, "Attack on the Havens, E-Commerce Tax News, at *www.ecommercetax.com/doc/071600.htm.*
89. United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."
90. Ibid.
91. The MOSSFON Report, "Statement by the Bahamas Rejects Harmful Tax Practices," May 2000.
92. Astrid Wendlandt, "Guernsey Stands Alone in the Face of Economic Sanctions," *The Financial Times,* July 27, 2000.
93. Arthur Cordell, "Nothing Fails Like Success: Online Growth in the Offshore World," *Journal of Internet Banking and Commerce,* June 1998, at *www.arraydev.com/commerce/JIBC/9806-08.htm.*
94. Michael Allen, "Tax Havens Cave in to Global Pressure," *The Wall Street Journal,* June 20, 2000.
95. U.S. Department of Treasury, Financial Crimes Enforcement Network, *FinCEN Advisory,* Issue 14, July 2000.
96. *Ibid.*, Issue 27.
97. *Ibid.,* Issue 26.
98. *Ibid.,* Issue 22.
99. *Ibid.,* Issue 16.
100. *Ibid.,* Issue 19.
101. *Ibid.,* Issue 15.
102. *Ibid.,* Issue 13.

ment.[103] There are 418 banks from 36 countries in the Bahamas.[104]

- The Channel Islands and Isle of Man have $525 billion in assets.[105]
- The Netherlands Antilles has 50 international banks.[106]
- The British Virgin Islands is the fourth largest source of foreign investment into Shanghai.[107]
- Austria has 24 million anonymous accounts with assets of $100 billion.[108]
- In Luxembourg, 90 percent of all accounts are foreign-owned.[109]
- Monaco has 70 financial establishments, which manage 350,000 accounts.[110] With only 30,000 residents, it has $44 billion on deposit.[111]

The ability of "tax havens" to attract investment demonstrates that the right fiscal policies can help poor nations develop and rich nations become more prosperous:

- The so-called tax havens, which account for 1.2 percent of the world's population, have 26 percent of the world's assets and 31 percent of the net profit of U.S. multinationals.[112]
- Liechtenstein's people have the highest living standard in Europe.[113]
- The Cayman Islands is the fifth largest banking center in the world, after New York, London, Tokyo, and Hong Kong.[114]
- The service sector accounts for three-fourths of Panama's national income.[115]
- Banking in the Channel Islands is so popular that the minimum account has jumped to more than $100,000.[116]
- Offshore banks are more likely to be profitable than onshore banks.[117]
- In Asia, countries like Hong Kong, Malaysia, and Singapore have escaped Third World status thanks to low-tax policies.[118]
- Financial services provide 80 percent of Jersey's income.[119]

103. *The Economist,* "All Havens in a Storm," July 1, 2000.

104. William Allen, "Statement by the Bahamas to the OECD Forum on Harmful Tax Practices," OECD, August 30, 1999.

105. Michael Peel and Francesco Guerrera, "OECD Eyes Deal with Island Tax Havens," *The Financial Times,* August 4, 2000.

106. Wickman, "Is Harmonization of Tax Policies Between EU Countries a Good Idea."

107. Michael Allen, "British Virgin Isles' Flagship Business, Under Scrutiny, Is Named 'Tax Haven,'" *The Wall Street Journal,* June 29, 2000.

108. Michael Allen, "Austria Escapes Censure by Ending Secret Accounts," *The Wall Street Journal,* June 16, 2000.

109. Joe Kirwin, "EU States Agree to Long-Term Framework for Cross-Border tax on Savings Income," BNA *Daily Report for Executives,* June 21, 2000.

110. Agence France Presse, "Monaco Haven for Money Laundering," June 21, 2000.

111. *Australian Financial Review,* "Monaco a Money Laundering Haven," June 26, 2000.

112. *The Economist,* "Gimme Shelter," January 29, 2000.

113. Charles Trueheart, "Small Nations Buck Global Tide," *The Washington Post,* July 22, 2000.

114. Senator Charles Schumer, Testimony to House Banking Committee, March 9, 2000.

115. U.S. Department of Treasury, Financial Crimes Enforcement Network, *FinCEN Advisory,* Issue 23, July 2000.

116. Wickman, "Is Harmonization of Tax Policies Between EU Countries a Good Idea."

117. Luca Errico and Alberto Musalem, "Offshore Banking: An Analysis of Micro- and Macro-Prudential Issues," International Monetary Fund, *Working Paper* 99/5, January 1999.

118. Bruce Zagaris, "The Assault on Low Tax Jurisdictions: A Call for Balance and Debate," European Financial Forum, May 1999, p. 53.

WHY THE OECD PROPOSAL IS MISGUIDED

Because the OECD proposal was developed in order to protect member nations from tax competition, it will have sweeping ramifications. Taxpayers will be harmed, of course; but the proposal also will have significant adverse implications for privacy, sovereignty, free trade, technological development, and the rule of law.

An Assault on Taxpayers

The OECD report clearly argues that tax competition is bad and that governments should work together to stop "harmful" tax practices. What this really would entail, however, is the creation of a cartel of high-tax nations that would impose its will on low-tax jurisdictions.[120] The issue was neatly summarized by an Australian economist, who wrote

> If the concern is with whether a country's tax regime induces economic activity to shift, than all tax competition is necessarily harmful. The only way to prevent tax-induced changes of investment location would be for all countries to adopt the same tax system and the same tax rates.[121]

To the non-economist, a tax cartel would be a way to change the rules of the game so that the "losers" would not have to compete.[122] The OECD study advocates that governments work together to stop "unfair competition." Consider, for instance, the following published OECD statements:

- "That 'race to the bottom', where location and financing decisions become primarily tax driven, will mean that capital and financial flows will be distorted and it will become more difficult to achieve fair competition"[123]
- "[I]nternational cooperation is necessary"[124]
- Global enforcement of tax laws is "difficult to address effectively on a unilateral basis"[125]
- "[T]axation is no longer simply the territory of individual governments … global action is needed"[126]
- "Tax authorities must develop global cooperative networks."[127]

Many of the world's policymakers apparently think that a tax cartel is a good idea. For high-tax nations like Germany and France, this is understandable.[128] Yet the OECD project is receiving support from such relatively low-tax nations as the United States and the United Kingdom that currently benefit from tax competition. U.S. Treasury Secretary Larry Summers, for instance, has stated that "Cooperation between national tax administrators is absolutely critical."[129] Moreover, he says, "A key element of this effort must be to minimize opportunities for tax arbitrage across borders. Cooperation between national tax administrators is absolutely critical."[130] Great Britain also seems

119. *The Financial Times,* "Tax Havens Island's Referendum Call Prompted by Government Support for Efforts to Increase Financial Transparency," August 29, 2000.

120. *The Financial Times,* "Wooing the Global Taxpayer."

121. Dwyer, "Harmful Tax Competition and the Future of Offshore Financial Centres."

122. Wickman, "Is Harmonization of Tax Policies Between EU Countries a Good Idea."

123. OECD "Harmful Tax Practices," April 13, 2000, at *www.oecd.org/daf/fa/harm_tax/harmtax.htm.*

124. OECD, "Improving Access to Bank Information for Tax Purposes," 2000, p. 11.

125. *Ibid.*, p. 13.

126. Donald Johnston, "Taxation and Social Progress," *OECD Observer*, No. 215, January 1999.

127. Donald Johnston, remarks to High Level Symposium on Harmful Tax Competition, June 29, 2000.

128. *The Economist,* "Gimme Shelter."

129. Summers, "Tax Administration in a Global Era."

unwilling to defend its national interests. The government supports "coordinated international action" to stop tax competition.[131]

Even more worrisome, a tax cartel may be just the beginning. Advocates of the OECD project repeatedly stress the need for "global" action.[132] As the *Irish Times* reported, the OECD has acknowledged that the current campaign is just the first step.[133] Unfortunately, that next step may be a radical proposal to create a new international organization "with worldwide enforcement powers."[134] The U.K.–based Commonwealth Secretariat foresees the OECD's actions as "the initial kernel of a 'world tax organization.'"[135] This may sound preposterous, but consider the following statements:

- Oxfam, an interest group that supports the OECD's campaign, urges the use of "global standards to define the tax base."[136] Moreover, it says a "global tax authority could be set up with the prime objective of ensuring that national tax systems do not have negative global implications."[137]
- A senior U.K. tax collector observed that "countries affected by harmful tax competition must take measures to protect themselves.... [D]omestic action is simply not effective and has to be underpinned by concerted international cooperation."[138]
- A high-level IMF official suggested that, "At some point the United Nations or some international conference should prescribe the minimum regulatory framework a country should have."[139]

Whether the OECD "only" creates a tax cartel or whether this effort ultimately results in the creation of a global tax authority, the outcome will be bad news for taxpayers. The business community clearly understands this and has written that the OECD effort "translates into higher taxes for business."[140] But individual taxpayers are also in the crosshairs. Using language that suggests redistributive policies, the OECD has written that, "The goal of these measures is to ensure that the burden of taxation is shared fairly."[141] This sentiment has been echoed by interest groups with pronounced left-of-center leanings.[142]

An Affront to Free Trade and Global Commerce

In order to force the so-called tax havens to comply with their non-binding requests, the OECD report proposes that member nations subject low-tax regimes to severe and discriminatory financial protectionism.[143] (See Appendix.) This

130.*Ibid*.

131.Government of the United Kingdom, "G7 Initiative on Harmful Tax Competition," HM Treasury Press Release 70/98, 1998.

132.Summers, "Tax Administration in a Global Era."

133.*Irish Times,* "Ireland Cited by OECD over its Tax Practices," June 27, 2000.

134.Dwyer, "Harmful Tax Competition and the Future of Offshore Financial Centres."

135.Commonwealth Secretariat, "Harmful Tax Competition," p. 3.

136.Oxfam, "Tax Havens: Releasing the Hidden Billions for Poverty Eradication."

137.*Ibid*.

138.Makhlouf, "A Perspective on International Tax Issues."

139.Vito Tanzi, "Macro-Economic Aspects of Offshore Centres and the Importance of Money Laundering in Offshore Financial Flows," United Nations Panel Discussion, June 10, 1998, at *www.imolin.org/ungapanl.htm.*

140.Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

141.OECD, "OECD Identifies Tax Havens," *OECD in Washington,* July 2000.

142.We the Peoples Millennium Forum Declaration and Agenda for Action, "Strengthening the United Nations for the 21st Century, May 26, 2000, at *www.millenniumforum.org/html/papers/mfd26May.htm.*

heavy-handed approach would impose crippling restrictions on international capital flows. In effect, the conditions and restrictions envisioned by politicians who support this initiative would impose a financial blockade against the targeted nations.[144]

Though the OECD has no legislative powers, the organization does suggest a panoply of fees, penalties, charges, restrictions, and other measures that could be implemented by member nations. In a remarkable twist, the OECD even referred to these steps as "defensive measures."[145]

A key question, of course, is whether the OECD member nations actually would implement the drastic steps the organization proposes. Unfortunately, it appears that the answer may be yes. The G–7 nations issued a statement that they are willing "to condition or restrict financial transactions with those jurisdictions."[146] The U.S. Treasury Secretary, meanwhile, has endorsed added regulatory burdens on financial institutions in low-tax countries.[147] Another Clinton Administration official has endorsed discriminatory treatment against offshore institutions.[148] The French have gone further, arguing that "the International Monetary Fund should oversee capital flows into these centers."[149]

Some policymakers in OECD member nations want to go even farther, imposing a total embargo against low-tax nations and territories. Representative Jim Leach (R–IA) has introduced a bill (H.R. 3886) that would "bar U.S. institutions from providing correspondent banking services for a whole class of banks that are licensed in offshore jurisdictions."[150] Senator Charles Schumer (D–NY) has testified that financial institutions incorporating in areas with "bank secrecy laws should not be allowed to participate in the U.S. financial system or transact with U.S. financial institutions.[151]

Once again, the French have adopted the most extreme position. The French president talked about outlawing all financial transactions with low-tax regimes.[152] The French Finance Minister echoed this sentiment, stating that he is ready to "cease all financial relations of whatever type" with offending countries."[153] The British *Manchester Guardian* expressed a similar view, editorializing that, "Ultimate sanction may even be a ban on banking transactions between institutions in countries belonging to the OECD and banks in tax haven nations."[154]

These views are antithetical to the free flow of trade and commerce, as any type of discriminatory treatment or financial embargo would be "accompanied by onerous rules, which will restrict and impede legitimate worldwide commerce."[155] Moreover, financial protectionism contradicts the

143. Adams, "Nowhere to Hide."

144. Eileen Canning, "New Treasury Advisories List Nations With Poor Anti-Money Laundering Regimes," BNA *Daily Report for Executives,* July 13, 2000.

145. OECD, "Towards Global Tax Co-operation," p. 24.

146. Dow Jones Newswire, "Full Text of G7 Statement."

147. *Financial Post,* "Summers Says U.S. to Introduce Crackdown on Tax-Haven Banks: Stiffer Standards," July 11, 2000.

148. Henry Pulizzi, "U.S. Administration Unveils Anti-Money Laundering Strategy," Dow Jones Newswire, September 23, 1999.

149. Steve Rhinds, "Strauss-Kahn: Banks Should Boycott International Centers," Dow Jones Newswire, June 23, 1999.

150. Michael Allen, "Money-Laundering Bill May Affect Bank Dealings with Foreign Clients," *The Wall Street Journal,* September 21, 1999.

151. Senator Charles Schumer, Testimony to House Banking Committee.

152. Dave Pearson, "Chirac: Russia Has Not Asked For Debt Relief," Dow Jones Newswire, July 21, 2000.

153. *The Economist,* "All Havens in a Storm," July 1, 2000.

154. Nestmann, "When is Tax Competition Harmful?"

OECD's professed support for "the concept of free trade and investment across national frontiers."[156]

Not surprisingly, several countries have pointed out this hypocrisy. Caribbean leaders have stated that "tax competition is just another form of free trade in a globalized world."[157] And as Switzerland observed, "This results in unacceptable protection of countries with high levels of taxation, which is, moreover, contrary to the economic philosophy of the OECD."[158]

An Attack on Sovereignty

The OECD's proposal would substantively interfere with the right of sovereign nations to determine their own tax policies. High-tax nations are especially interested in forcing so-called tax havens to raise their tax rates and eliminate financial privacy. But as the former Vice President and Chief Economist of the U.S. Chamber of Commerce, Richard Rahn, noted, such a radical approach represents "financial imperialism."[159]

In effect, the OECD seeks to overturn 200 years of established international practice so that high-tax nations can impose taxes on assets and activities outside their own territory.[160] Traditionally, governments have used a "territorial" or "source-based" rule for taxation, allowing them to tax all incomes and activities within their borders.[161] And because this type of system was not concerned with economic activity in other nations, conflicts were non-existent.[162]

The problem with a territorial system—at least from the perspective of the OECD—is that it facilitates tax competition between nations.[163] As such, even though it is a recognized rule that one country should not be compelled to collect taxes for the benefit of another country, the OECD appears willing to discard tradition so that its member nations can seize more revenue.[164]

The OECD report would impose restrictions on the tax policies of member nations.[165] More important, it would make low-tax countries abandon the activities upon which their livelihoods have been based.[166]

Pressuring Third World Countries. Most OECD nations made the jump from poor, agriculture-dependent economies to industrial powers during the 1800s—a period when most did not impose income taxes of any kind. Today, poorer nations are being told they cannot adopt similar policies in order to have an attractive investment climate—a demand that has been called an "infringement on their sovereignty by a group of rich white nations."[167] In a stunning display of arrogance, a senior OECD official reportedly stated that the tax

155. Hardesty, "Attack on the Havens."

156. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

157. Dow Jones Newswire, "Caribbean Group to Fight Money Laundering, Challenge OECD," July 25, 2000.

158. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 77.

159. Richard Rahn, "The Future of Financial Privacy in the Age of Digital Money," Remarks at Geneva Financial Center Conference, September 8, 1999, at *www.geneva-finance.ch/e/conference.htm.*

160. Ian Lambert, "Tax Information Exchange–Offshore Jurisdictions Looking for a Place to Stand," Offshore Investment, December 1999/January 2000, p. 14.

161. *Mail & Guardian,* "No Refuge in Tax Havens," South Africa, May 12, 2000.

162. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."

163. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 32.

164. Gaffney, "International Tax Competition: Harmful of Beneficial."

165. OECD, "Towards Global Tax Co-operation," p. 9.

166. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

167. Louis, "Blacklist."

OECD's "Advance Commitment" Letters to Low-Tax Jurisdictions

The following excerpt is from the text of an actual OECD-dictated "advance commitment" letter sent to a low-tax regime, which prefers to remain unidentified:

> I am writing in connection with the OECD's project on harmful tax competition. [Jurisdiction] shares the concerns of the OECD about the global effects of harmful tax competition and would like to associate itself with that work. To this end, I am pleased to inform you that [jurisdiction] hereby commits to the principles of the OECD's Report, *Harmful Tax Competition: An Emerging Global Issue* (the "OECD Report"). In fulfillment of this commitment, [jurisdiction] undertakes to implement such measures (including through any legislative changes) as are necessary to eliminate any harmful aspects of [jurisdiction's] regimes that relate to financial and other services.

The OECD also demanded that each low-tax regime sign an annex agreement to accompany the advance commitment letter. Selected portions of that text follow. Unlike the advance commitment letters, the OECD has not released the text of these agreements:

> [Jurisdiction] makes domestic law changes sufficient to allow information to be exchanged with tax authorities (such that the tax authorities in other states can obtain the information without recourse to [jurisdiction's] courts).
>
> In the case of information required for the investigation and prosecution of criminal tax cases, the information must be provided without the requirement that the conduct being investigated would constitute a crime under the laws of [jurisdiction], if it occurred in [jurisdiction].

competition project was designed to "close down the islands in the sun."[168]

The OECD's approach toward developing nations has been one-sided from the outset. One European representative, for example, bragged, "This is like a military campaign."[169] And a group affiliated with the OECD declared that the publications attacking low-tax regimes had "a sinister tone."[170] Faced with rhetoric like this, it would be no exaggeration to state that the OECD's tactics are like the modern-day equivalent of gunboat diplomacy.[171]

The "advance commitment" letters the OECD sent to the so-called tax havens are a stark example of the organization's disregard for sovereignty. These OECD-drafted letters (see sidebar) require low-tax nations to make "imprecise and open-ended commitments" with regard to changing their tax system."[172]

The OECD insists that with these letters it is merely trying to uphold internationally accepted standards, but it would be more accurate to say that the organization is trying to change international norms and practices. According to *The Financial Times*, "The implication is that the OECD

168. Offshore Investment, "Mistrust of the OECD Inquiry into Tax Havens," May 2000.

169. Nicholas Bray, "Crackdowns on Euro Schemes to Accelerate," *The Wall Street Journal,* April 29, 1998.

170. Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

171. Louis, "Blacklist."

172. Caribbean News Agency, "Barbados Minister Rejects OECD Report Categorizing Country as a Tax Haven," Bridgetown, June 27, 2000.

intends that certain rules and practices relating to tax matters, of the most powerful countries in the world, should be imposed internationally on other jurisdictions."[173] Stripped of diplomatic double-talk, this is simply an "attempt to bully tax havens into raising their tax rates."[174]

Many of the elected leaders in the less-developed nations clearly understand what is at stake. A sampling of their reactions includes:

- The OECD is engaged in "economic terrorism";[175]
- "[T]he proposed OECD actions have no basis in international law and are alien to the practice of inter-state relations";[176]
- The Dominica Prime Minister vowed, "We will not give up our sovereign rights";[177]
- "[I]nternational organizations must not be allowed to discriminate against countries that do not have a seat at the decision-making table";[178]
- The OECD "would make us tax collectors for foreign countries";[179]
- Chief Minister David Brandt of Montserrat said, "The territory will not be relegated to the position of informer";[180]
- "[O]ur success should not lead other[s] to want to penalize us";[181] and
- A Barbados minister accused the OECD of practicing "institutional blackmail."[182]

If a tax cartel is implemented, taxpayers in the industrialized world will be adversely affected. For certain countries targeted by the OECD, however, the results could be catastrophic. Some countries could see their GDP drop by as much as 25 percent—similar to what happened to the United States during the Great Depression.[183] In all likelihood, this would make these regimes dependent on OECD nations for aid, thus replacing market-based self-reliance with government-to-government dependency.[184]

Writing in the *Canadian Tax Notes*, David Louis grimly notes that, "the prospect of driving some of these countries back to banana republic status is not troublesome to the OECD, if that is what it takes to impose its tax policies."[185] An expert in the United Kingdom, meanwhile, observed that:

> The unspoken message seems to be—remain poor and we will occasionally throw you a bone of foreign aid or buy your expensive bananas. But don't get uppity and try to compete, or we will hit

173.Gaffney, "International Tax Competition: Harmful of Beneficial."

174.*The Financial Times,* "Editorial Comment: Taxing Times for Offshore Centres," July 27, 2000.

175.Michael Alberga, "Offshore Finance in the Caribbean: Benefits and Challenges," Caribbean Latin American Action, June 16, 2000.

176.Caribbean Community, "Statement on OECD Harmful Tax Policy," July 6, 2000.

177.Dow Jones Newswire, "Caribbean Leaders to Discuss Offshore Banking Blacklist,"citing remarks from Dominica Prime Minister Rosie Douglas.

178.OECD, "The Cayman Islands–Serving the Global Economy," *OECD Observer,* No. 221/222, Summer 2000.

179.Paul Harris, "OECD and its Impact on the Cayman Islands," *The Washington Times,* December 15, 1999.

180.Caribbean News Agency, "Government Reluctant to Act as Informer Over Tax Havens," Bridgetown, June 30, 2000.

181.OECD, "The Cayman Islands."

182.Caribbean News Agency, "Barbados Minister Rejects OECD Report Categorizing Country as a Tax Haven," Bridgetown, June 27, 2000.

183.Commonwealth Secretariat, "Harmful Tax Competition," p. 4.

184.Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

185.Louis, "Blacklist."

> you with everything we can, from income tax to stamp duty.[186]

The OECD tries to defend its actions by asserting that it also is asking member nations to eliminate "preferential regimes."[187] Nevertheless, the organization is not acting in an unbiased fashion. While it would threaten to penalize low-tax regimes, it includes no concrete penalties for its own members. In any event, it is trying to sidestep the core argument over whether sovereign regimes should be able to determine their own fiscal affairs.[188]

AN ATTACK ON PRIVACY

Because it is impossible to tax worldwide income without knowing the worldwide assets and activities of taxpayers, eliminating financial privacy is an integral element of the OECD's proposal. This is a drastic step, one that undermines the common law principle that bank secrecy is an implicit part of the contract between banker and client.[189] Financial privacy historically has been viewed as "an essential safeguard of the citizen against the power of dictatorship."[190] Indeed, the famous Swiss laws regarding banking secrecy were significantly strengthened in 1934 after Adolf Hitler took control in Germany.[191]

Supporters of the OECD argue that people no longer need to worry about individual freedom and government oppression. Yet the United Nations recently stated that, "For much of the twentieth century, governments around the world spied on their citizens to maintain political control. Political freedom can depend on the ability to hide purely personal information from a government."[192] And even if there is no immediate threat of dictatorship, privacy is still an important value, and government is prone to misuse personal information.[193]

But bank secrecy laws do more than just protect privacy. They also provide systematic benefits to a country's financial institutions. The OECD admits that, "Customers would be unlikely to entrust their money and financial affairs to banks if the confidentiality of their dealings with banks could not be ensured."[194] As a result, bank secrecy laws can help stimulate a vibrant financial services industry.[195]

Finally, privacy also makes it harder for criminals to select victims.[196] Many citizens, particularly those from the developing world, want confidentiality to reduce the likelihood of kidnapping and other violent crimes.[197] The ability to have private offshore accounts also enables people to protect themselves from financial instability and expropriation.[198]

Those benefits could soon disappear. The OECD initiative would give government carte blanche access to personal financial informa-

186.Stein, "Economics and Tax Harmonization."

187.OECD, "Towards Global Tax Co-operation," p. 9.

188.Business and Industry Advisory Committee to the OECD, "A Business View of Tax Competition."

189.OECD, "Improving Access to Bank Information for Tax Purposes," p. 33.

190. Adams, "Nowhere to Hide."

191.Maurice Aubert, "Swiss Banking Secrecy," Schellenberg & Haissly, Geneva, March 1997.

192.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

193.James Glassman, "Government Privacy Violators," at *www.techcentralstation.com* (July 24, 2000).

194.OECD, "Improving Access to Bank Information for Tax Purposes," p. 19.

195.*Ibid.*

196.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

197.Testimony of Amy Elliot before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, U.S. Senate, November 9, 1999.

tion.[199] And the ability to snoop would not be limited by national borders. If successful, this effort would give tax collectors "a license to inspect any bank account anywhere."[200] To make this happen, the OECD is pressuring low-tax nations to sign agreements that would give foreign tax collectors the right to rummage through accounts in search of tax revenue.[201]

The G–7 nations supported this effort in a communiqué:

> We also reaffirm our support for the OECD's report on improving access to bank information for tax purposes and call on all countries to work rapidly toward a position where they can permit access to, and exchange, bank information for all tax purposes."[202]

But the assault on financial privacy extends well beyond low-tax nations. The OECD and its allies want to force financial institutions and other businesses in all countries to divulge information about their customers to the government. In effect, opponents of tax competition want to extend the controversial "know-your-customer" regulations that compel banks to spy on their customers to other professional service providers.[203] Ultimately, proponents of the OECD approach would like to repeal all types of client confidentiality.[204] Consider, for instance, these proposed measures:

- Under a plan being advocated by the Clinton Administration, "broker/dealers, casinos and money-service businesses would be forced to file the same suspicious activity reports";[205]
- The EU's taxation commission has been pushing regulations that some critics fear would seriously undermine lawyer-client confidentiality;[206] and
- The French government wants to force non-financial agents such as lawyers, real-estate agents, and casinos to inform on customers.[207]

The organizations that back these types of initiatives argue that privacy must be curtailed in order to detect criminal violations. Oftentimes, this argument is packaged as a campaign against money laundering. Even if this assertion were true, policymakers should stop and ask whether the assumed benefits justify monitoring "all aspects of their nationals' private lives, interfering totally in their privacy—although real criminals will always find a ways of bypassing detection systems."[208]

The OECD is pushing a one-size-fits-all view of low-tax regimes that completely dismisses the value of financial privacy.[209] If the organization is successful, ordinary citizens will suffer a significant loss of liberty.[210] They certainly no longer will

198.Testimony of Antonio Giraldi before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, U.S. Senate, November 10, 1999.

199.OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 74.

200.Graham Mather, "Tax Competition and the OECD," European Financial Forum, London, June 2000. See also Alberga, "Offshore Finance in the Caribbean: Benefits and Challenges."

201.OECD, "Towards Global Tax Co-operation," p. 20.

202.Dow Jones Newswire, "Full Text of G7 Statement."

203.Patrick Moulette, "Money Laundering: Staying Ahead of the Latest Trends," *OECD Observer,* April 2000, p. 29.

204.FATF, "Review to Identify Non-Cooperative Countries or Territories."

205.Dow Jones Newswire, "Summers Outlines Plan to Combat Intl Money Laundering," September 21, 1999.

206.Dow Jones Newswire, "EU Fails to Agree Extension of Money Laundering Rules," July 17, 2000.

207.David Pearson, "France Proposes Code for Tax Havens, Money-Laundering," Dow Jones Newswire, September 25, 1999.

208.Jacques Rossier, Remarks at Geneva Financial Center Conference, "The Future of Financial Privacy in the Age of Digital Money," September 8, 1999, at *www.geneva-finance.ch/e/conference.htm.*

209.OECD, "Improving Access to Bank Information for Tax Purposes," 2000, p. 31.

have privacy. One government official from a low-tax regime warned, "This is a utopian world, where you computerize everything and everyone has access to it."[211] Taxpayers are supposed to accept this attack on their rights just so tax collectors have an easier time collecting money that is earned in other countries.

A Threat to Technology and Innovation

The desire to maintain tax revenues gives governments a reason to limit innovation and control new technologies. One of the most promising financial developments for consumers is the creation of "smart cards," which are similar to prepaid phone cards, that can be used to make cash purchases.[212] Unfortunately, those who back the OECD proposal may fear these stored-value cards would make it harder to collect taxes.[213] More specifically, they do not like the fact that smart cards allow anonymous transactions.[214]

Online banking is also a concern to tax collectors, largely because "the nature of the Internet is such that a particular country may find it difficult, if not impossible, to prohibit its citizens from setting up accounts … with institutions offering on-line banking from other locations beyond its borders."[215] The expansion of e-commerce also causes headaches for governments, since the Internet enables people to shop and do business where taxes are lower.[216] Because deregulation has led to the development of these new technologies, it is no wonder that the United Nations blames unfettered markets for making it more difficult for governments to track money.[217]

Consumers, of course, like innovative new products and services. As a result, the OECD and its allies cannot make a direct attack on the high-tech sector. Instead, they resort to dire warnings about anonymous financial transactions.[218] For example, one OECD official wrote that online banking was a dangerous development.[219] Other critics have pointed to cyber-payment systems as a problem.[220]

There is a distinct danger that those who seek to forestall tax competition will interfere with innovation and technological development. The OECD, for instance, has suggested limiting "the types of on-line services or the amount of such transactions."[221] The U.N. frets about "stock exchanges and other financial institutions that allow anonymous trading."[222] Last but not least, the Financial Action Task Force (FATF) does not like the fact that automated teller machines allow multinational bank withdrawals.[223]

210.Zagaris, "The Assault on Low Tax Jurisdictions," p. 43.

211.Astrid Wendtlandt, "Offshore Centres Reject EU Plan to Share Information," *The Financial Times,* July 25, 2000.

212.Rahn, "The Future of Financial Privacy in the Age of Digital Money."

213.OECD, "Improving Access to Bank Information for Tax Purposes," p. 24.

214.Graham Mather, "Tax Competition and the OECD," European Financial Forum, London, June 2000.

215.Financial Action Task Force, "Report on Money Laundering Typologies," Paris, February 3, 2000.

216.Hardesty, "Attack on the Havens."

217.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

218.Moulette, "Money Laundering: Staying Ahead of the Latest Trends," p. 29

219.*Ibid.*

220.David Mussington, Peter Wilson, and Roger Molander, "Exploring Money Laundering Vulnerabilities Through Emerging Cyberspace Technologies," Rand, 1998.

221.OECD, "On-Line Banking: A New Vehicle for Money Laundering," *OECD in Washington,* July 2000.

222.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

223.FATF, "Report on Money Laundering Typologies."

An Affront to the Rule of Law

The OECD's "harmful tax competition" project would violate established legal principles at home and abroad. For example, the organization is seeking to blur and perhaps even eliminate the distinction between tax avoidance, which is lawful, and tax evasion, which is illegal.[224] Yet, as Judge Learned Hand stated, "There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich and poor; and all do right, for nobody owes any public duty to pay more than the law demands."[225]

The OECD's proposal clearly advocates a substantial shift in the traditional practices governing international enforcement of tax laws. In large part, this is an inevitable consequence of trying to tax income earned in other countries. Such an effort creates all sorts of conflicts, particularly as OECD nations try to tax capital gains, inheritances, and incomes that their citizens earn in other jurisdictions. Standard international practice—known as the "double incrimination" principle—is that "before assistance can be provided to a requesting country, it must be established that the conduct being investigated would constitute a crime under the laws of the requested country."[226] Needless to say, since many "tax havens" do not tax income, capital gains, or inheritances, asking them to help enforce other nations' laws in this regard would violate international norms.

More generally, as one offshore expert explains, no country has the

> legal right to investigate the activities of any person in any other country without first obtaining the consent and cooperation of the country in which the investigation is to be conducted. Even then, the investigation must be conducted under the law of the country in which the investigation is to take place, not under the laws of the country conducting the investigation.[227]

Not surprisingly, the OECD's willingness to ignore these legal principles has been noted by low-tax nations. A Barbados Minister has grumbled that, "The OECD has no standing in international law and no right to impose its will on a sovereign country."[228] The Prime Minister of St. Kitts and Nevis, meanwhile, has argued that "The OECD knows it doesn't have a legal leg to stand on."[229]

Protecting Civil Liberties. The OECD's proposal also poses a threat to Americans and other residents of industrialized nations. The U.S. government has failed to "develop notice and due process procedures for taxpayers affected by tax information exchange requests by foreign governments."[230] This glaring error means that taxpayers often cannot "participate in the processing of the request and raise any issues at stake" in order to protect their legal rights.[231]

Even more troubling, two important legal principles are being threatened by the actions of the U.S. government. First, the constitutional presumption of innocence is being eroded. The operating presumption of the U.S. Department of Justice is that "any one with offshore bank accounts or other offshore financial structures is presumed probably guilty of money laundering."[232] The FATF shares this view, assuming that anyone that wants financial privacy is likely to be laundering money.[233] One critic of this trend,

224. Gaffney, "International Tax Competition: Harmful of Beneficial."

225. *The Economist,* "The Mystery of the Vanishing Taxpayer," January 29, 2000.

226. OECD, "Improving Access to Bank Information for Tax Purposes," 2000, p. 15.

227. J. F. Straw, "Offshore Banking is not Evil," at *www.ofshoreinfo.com/straw.html.*

228. Dow Jones Newswires, "Caribbean Leaders to Discuss Offshore Banking Blacklist."

229. Dow Jones Newswire, "Caribbean Group to Fight Money Laundering, Challenge OECD," July 25, 2000.

230. Zagaris, "The Assault on Low Tax Jurisdictions," p. 27.

231. *Ibid.,* p. 55.

speaking to a U.N. panel, remarked, "I do not feel comfortable with the notion of reversing the burden of proof in these cases. If we are going to tar someone as a criminal, I think it behooves us to prove that this person is a criminal beyond all reasonable doubt."[234]

The second constitutional principle under assault is the Fourth Amendment protection against unreasonable search and seizure without both court warrant and probable cause. The American Civil Liberties Union correctly notes that money-laundering legislation requires "the reporting of personal financial information for law enforcement purposes without probable cause of a crime, and creates incentives for banks to spy on their customers."[235] Yet as discussed earlier, the OECD proposal would dramatically expand this type of snooping.

Similar assaults on legal rights and constitutional freedoms are taking place all over the world. Because financial privacy is a hindrance to tax collectors, the OECD study recommends making it easier to obtain information—even if that means suspending or repealing the legal rights of taxpayers and property owners. Supporters of tax competition argue that these steps are needed to crack down on crooks, but almost all nations—including the low-tax countries—allow access to information during criminal investigations.[236]

Notwithstanding popular perception, almost all of the routinely vilified "tax havens" cooperate with law enforcement and tax authorities. Liechtenstein will assist in criminal investigations.[237] In the Bahamas, "where there are allegations of criminality, a judge of our High Court may grant access to information on bank accounts to the proper authority."[238] Likewise, the Cayman Islands is willing to cooperate, but they do not want to allow foreign tax collectors to go on "fishing expeditions."[239] Switzerland is another country that cooperates on criminal investigations, including tax fraud.[240] And the British Virgin Islands will release confidential information if a court approves the request.[241]

To be sure, having laws in place does not guarantee that they will be effective. If there is corruption, public officials can misuse legal protections to protect criminal activity. As such, it is important for laws to be vigorously and fairly enforced.

The Money Laundering Red Herring. Since some argue that the OECD's proposal will make it easier to fight money laundering, it is worth examining this issue in more detail. As the U.S. Treasury Department's Financial Crimes Enforcement Center (FinCEN) defines the crime, "Money laundering involves disguising financial assets so they can be used without detection of the illegal activity that produced them."[242] The theory is that governments can thwart such criminal activity by going after the proceeds of the crime, instead of trying to punish the actual underlying criminal offense.[243]

232.Testimony of Robert Bauman to the House Banking Committee, 106th Cong., March 9, 2000.

233.FATF, "Review to Identify Non-Cooperative Countries or Territories."

234.Tom Naylor, at a United Nations Panel Discussion on June 10, 1998; see *www.imolin.org/ungapanl.htm.*

235.Laura Murphy and Gregory Nojeim, Letter to US Congress, American Civil Liberties Union, July 13, 2000.

236.OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 24.

237.William Hall, "Liechtenstein Bridles at Threat of Bank Blacklist," *The Financial Times,* June 21, 2000.

238.The MOSSFON Report, "Statement by the Bahamas Rejects Harmful Tax Practices."

239.Dow Jones Newswire, "St. Kitts Prime Minister Calls Measures Against Money Laundering a 'Sinister Plot,'" July 17, 2000.

240.Associated Press, "Switzerland Remains Firm on Bank Secrecy Following EU Tax Plan," June 28, 2000.

241.Allen, "British Virgin Isles' Flagship Business, Under Scrutiny, Is Named 'Tax Haven'."

242.U.S. Department of Treasury, Financial Crimes Enforcement Network, "FINCEN FAQs," at *www.ustreas.gov/fincen/faqs.html.*

Assuming that money laundering investigations are pursued within constitutional confines, these laws can help law enforcement. It appears that some politicians around the world, however, are more interested in using the laws to fatten their coffers. The G–7 nations, for instance, recently agreed to refocus money laundering efforts to catch tax evaders.[244] Their motive may have been a U.N. report that estimated the amount of income escaping tax was a "multiple of the amount of the proceeds of all types of crimes."[245]

Yet, money laundering is the opposite of tax evasion. Bill Gilmore, Professor of International Criminal Law at the University of Edinburgh, writes that money laundering and tax flight "are activities with radically different purposes and practical outcomes."[246] The U.N. comes to the same conclusion, declaring,

> Tax evaders under-report the earnings of their legal enterprises, thereby paying less tax than they legally should. Criminals, by contrast, over-report the earnings of any legal enterprises they use for cover, therefore paying more tax than their legitimate front companies would normally be required.[247]

If nothing else, money laundering laws create "an ever-increasing regulatory burden on the banking industry."[248] Financial institutions had to file 13 million currency transaction reports list year, each requiring 24 minutes, at a cost to the industry of more than $100 million.[249] Yet fewer than 1/1000ths of 1 percent are ever used in a money laundering conviction.[250]

Because financial institutions "risk the possibility of committing a crime" if they fail to ask their customers enough questions, money laundering laws are also a legal minefield.[251] These questions are not trivial requests for Social Security numbers and home mailing addresses. Instead, the government wants banks to ask "questions about their [customers] personal background, even their lifestyles and spending habits."[252] In effect, "Congress has forced bankers to become spies."[253] These regulations have become so intrusive that federal bureaucrats last year were forced to withdraw a proposal after public protest.[254]

Also missing from the discussion is any cost-benefit analysis of money laundering laws. There are 700,000 daily electronic money transfers involving $2 trillion.[255] With this magnitude of transactions, trying to find criminal money by ask-

243.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

244.OECD, "Improving Access to Bank Information for Tax Purposes," 2000, p. 13.

245.*Ibid.,* p. 25.

246.Bill Gilmore, "Money Laundering and International tax Cooperation: Exploring the Interface," European Financial Forum, London, June 2000.

247.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

248.Edward Yingling, "ABA Statement on House Banking Committee Approval of Money Laundering Act," American Bankers Association, June 8, 2000.

249.Ron Paul, Tom Campbell, Bob Barr, and Walter Jones, "Report Together with Dissenting Views [To accompany H.R. 3886]," *International Counter-Money Laundering and Foreign Anticorruption Act of 2000,* House Banking Committee, Report No. 106-728, July 11, 2000.

250.*Ibid.*

251.Zagaris, "The Assault on Low Tax Jurisdictions," p. 12.

252.Testimony of Robert Bauman to the House Banking Committee, March 9, 2000.

253.*Ibid.*

254.Maureen Murphy, "Banking's Proposed 'Know Your Customer' Rules," Congressional Research Service, March 23, 1999.

255.United Nations, Press Briefing on Money Laundering, June 5, 1998.

ing customers personal questions may be like looking for a needle in a haystack. In any event, it is not very successful. The Treasury Department has estimated that 99.9 percent of the criminal money coming into the United States is successfully laundered.[256] Other countries such as Germany have reached similar conclusions about their own financial systems.[257]

"Dirty money," therefore, is not a problem unique to low-tax nations and it is not necessarily associated with financial privacy. Indeed, as the U.N. reports, "Money laundering can proceed very easily without bank secrecy; in fact, it may well be that launderers avoid it precisely because it acts as a red flag."[258] What is known is that some of the biggest money laundering scandals, such as the Bank of New York–Russian money incident, occurred in OECD nations.[259] According to a Brookings Institution expert, America is the "largest repository of ill-gotten gains in the world."[260] Moreover, most of the service providers linked to money laundering—accountants, lawyers and similar professionals—operate in OECD countries.[261]

Money laundering laws should not be used as a weapon against low-tax nations; they inadvertently could make things worse by driving capital out of well-established financial centers and into less competent and/or unfriendly jurisdictions.[262] An attack on financial privacy, after all, could lead people to shift their funds to rogue operations that have no incentive to cooperate with OECD law enforcement officials.[263] This result would set back progress in cooperation in handling issues of regulation, transparency, accounting standards, and criminal behavior.[264]

Are High-Tax Nations Pressuring the OECD?

The OECD proposal to eliminate "harmful tax competition" is a sharp break with the organization's record of supporting free markets. Indeed, the OECD has published insightful and useful studies on a variety of subjects and, as a general rule, has been an unapologetic advocate of globalization and market liberalization—claiming that "[l]iberalization is at the core of the Organization's work and is aimed at facilitating cross-border flows of trade and investment" in the preface of its "Harmful Tax Practices" study.[265]

The OECD also has written extensively on the harmful economic impact of cartels, noting that when competitors collude, "The resulting harm to consumers and the world economy is estimated to run into billions of dollars."[266] It even has accepted the fact that "globalization has had a positive effect on the development of tax systems,"

256.Raymond Baker, "Money Laundering and Flight Capital: The Impact on Private Banking," Testimony to The Permanent Subcommittee on Investigations, Senate Governmental Affairs Committee, U.S. Senate, November 10, 1999.

257.Raymond Baker, "The Biggest Loophole in the Free-Market System," *The Washington Quarterly*, Autumn 1999.

258.United Nations, "Financial Havens, Banking Secrecy, and Money Laundering."

259.Peter Goldstein, "EU Tampere Summit to Mull Anti-Money Laundering Measures," Dow Jones Newswire, October 1, 1999.

260.Testimony of Raymond Baker before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, U.S. Senate, November 10, 1999.

261.Moulette, "Money Laundering: Staying Ahead of the Latest Trends," p. 29.

262.John Willman, "City Could End up Loser in Tax Haven Curbs," *The Financial Times,* July 25, 2000.

263.Anthony Travers, "Double Standards and the OECD Report," *The Journal*, Society of Trust and Estate Practitioners, Summer 2000.

264.B. Persaud, "OECD Curbs on International Financial Centres: A Major Issue for Small States," Commonwealth Secretariat, London, August 10, 2000.

265.OECD, "Harmful Tax Practices."

266.OECD, "Hard Core Cartels," *OECD in Washington*, June 2000.

A Crisis of Too Much Revenue

The OECD "harmful tax competition" initiative seeks to keep tax revenues from declining, but there "is little, if any, evidence that the tax systems of the industrial countries are collapsing."[1] A recent OECD publication notes that, "In 1998, OECD governments collected almost US$8 trillion in taxes: the equivalent of 37.2 percent of the aggregate GDP of their economies and the highest figure recorded since revenue data began being collected by the OECD."[2] Moreover, the OECD has acknowledged that, "There has been a continuing trend towards higher tax levels: from 29 percent of GDP in 1970, to 33 percent in 1980, to 36 percent in 1990 and more than 37 percent in 1998."[3]

Some have argued that tax competition is causing corporate tax receipts to fall. Yet, *The Financial Times* noted that the corporate tax "share in OECD countries' total tax revenue has remained constant."[4] Indeed, the OECD observed, "For over two decades the share of corporate income tax has remained some 8 per cent of total taxes."[5] To be sure, revenues from other taxes have climbed, most notably from the value-added tax.[6] But this shows why tax competition is so important. The EU has created a tax cartel that mandates that all value-added tax (VAT) rates must be at least 15 percent.

If there is a tax crisis in OECD nations, it is that taxes are too high. The organization admits that high-tax policies have caused damage, and that the damage would have occurred even if there were no low-tax competitors.[7] Not surprisingly, the higher taxes in OECD nations led to higher spending without helping the economy or improving social welfare.[8] Even the normally pro-tax EU has confessed that, "It has been estimated that several percentage points of the current rate of unemployment are due to this increase in the taxation of labor."[9]

OECD nations should be grateful that so-called tax havens exist. As bad as European tax burdens are today, they surely would be worse in the absence of competition.[10] Low-tax regimes also have helped high-tax nations by being a source of investment funds, thus partly offsetting the damage of bad tax policies.[11]

It may be the case that Europe is slowly realizing that high taxes—not low taxes—are the source of distortion.[12] Defenders of tax competition are pointing out that "tax havens" only exist because other nations have imposed high tax rates.[13] As such, they argue that "it is rather we who should harmonize taxes in the direction of low-tax jurisdictions, instead of trying to force them up to our level."[14] If the latest wave of tax cuts is any indication, Europe may be turning the corner.

1. Tanzi, "Globalization and the Future of Social Protection," p. 15.
2. OECD, "Fiscal Affairs," 2000, p. 12.
3. *Ibid.*
4. *The Financial Times,* "Editorial Comment: Taxing Times for Offshore Centres," July 27, 2000.
5. OECD, "Fiscal Affairs," p. 12.
6. *Ibid.*
7. OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 35.
8. Tanzi, "Globalization and the Future of Social Protection," p. 19.
9. Commission of the European Communities, "Towards Tax Co-ordination in the European Union."
10. Tanzi, "Globalization, Tax Competition, and the Future of Tax Systems."
11. Persaud, "OECD Curbs on International Financial Centres."
12. Mason Gaffney, "Taxation of Mobile Capital in a Global Free Market: Opportunities and Threats for Low Tax Countries," Illinois Real Estate Letter, Spring 1999.
13. World Tax Daily, "Liechtenstein Takes Issue with 'Tax Haven' Label, but Remains Open to Future Dialogue with OECD," *Tax Analysts,* January 26, 2000.
14. Stein, "Economics and Tax Harmonization."

and it is "the driving force behind tax reforms which have focused on base broadening and rate reductions, thereby minimizing tax induced distortions."[267] And in the past, OECD nations have recommended that poorer nations develop competitive tax systems and suggested that they promote the financial services industry to help offset the decline in income from other sources.[268]

Clearly, the OECD's tax competition proposal is an atypical study. It is a response to pressure from certain member governments to advocate a policy that supports their narrow interests at the expense of other nations and the global economy in general.

THE ADMINISTRATION'S PUZZLING SUPPORT FOR THE OECD INITIATIVE

The OECD campaign to reduce competition from low-tax countries is not in America's interest. The United States is a low-tax nation compared with most other industrialized nations, and its taxpayer-friendly status has attracted jobs, capital, and entrepreneurial talent away from costly welfare states, especially in Europe.[269] Unfortunately, the Clinton Administration supports the OECD's proposal, which would effectively create a tax cartel.[270] Consider:

- Treasury Secretary Larry Summers has complained that "it will be increasingly easy for companies to avoid taxes by taking advantage of different tax rules";[271]
- According to Summers, "In today's global economy, it is vital that we put an end to international tax practices that encourage tax evasion and improper tax avoidance and that distort capital flows";[272]
- Summers said that the G–7 participants agreed that "there is also a dark side to international capital mobility";[273]
- A senior U.S. Treasury official tried to convince U.S. financial institutions to support attacks on financial privacy as a competitive weapon against foreign banks;[274]
- "[O]ne of the top officials at the US Treasury said … that something seems not to be right, if a small country like Switzerland manages such a large portion of the world's assets."[275]

The actions of the Administration are puzzling, but perhaps can be better understood in the context of a broader international debate. In a recent speech, an English entrepreneur remarked, "There is a fundamental difference in philosophy between the Anglo-Saxon economic model and the dirigiste continental model. We call a low-tax regime a competitive business environment. They call it unfair tax competition."[276] Yet the White House has decided to side with the French, the Germans, the Swedes, and other high-tax European nations

267.OECD, "Harmful Tax Competition: An Emerging Global Issue," p. 20.

268.Letter from Commonwealth Secretary-General HE Rt Hon Donald C McKinnon to OECD Secretary-General Donald Johnston, July 20, 2000.

269.Zagaris, "The Assault on Low Tax Jurisdictions," p. 46.

270.*The Wall Street Journal,* "Clinton Takes Aim at International Tax Havens," February 23, 2000.

271.Summers, "Tax Administration in a Global Era."

272.Dow Jones Newswire, "Six Offshore Locations Plan to End Tax-Haven Practices."

273."'Considerable Optimism' Seen in World Economies, Summers Tells G-7 Ministers," BNA *Daily Report for Executives,* July 11, 2000.

274.Jonathan Talisman, "Remarks to the GWU/IRS Annual Institute on Current Issues in International Taxation," December 10, 1999, at *www.ustreas.gov/press/releases/ps289.htm.*

275.Villiger, "Switzerland: A Strong Player in the Global Financial Market Place."

276.Nick Herbert, "Great Britain and the Euro v. Sterling Debate," The Heritage Foundation, *Heritage Lectures* No. 682, August 16, 2000.

on this issue against the best interests of American taxpayers.

Before joining with the Administration in backing efforts to reduce tax competition, other U.S. policymakers should fully consider whether this effort is in America's long-term economic interests. America has traditionally been reluctant to give government too much power. They appreciate entrepreneurship and admire success. Tax competition is a natural part of the federal system in America, with states forced to be somewhat responsible so as not to drive away businesses. Compare this with attitudes in Europe. The French Finance Minister referred to low-tax policies as a "gangrene,"[277] and tax competition as "modern piracy."[278]

It makes sense, in a perverse way, for France to fight tax competition. The French know that they are suffering a brain drain because talented young people are fleeing to low-tax environments.[279] The French government resents the fact that it has had to announce tax cuts to keep pace with tax rate reductions proposed in Germany.[280] The OECD's project is tailor-made to serve the interests of such European nations.

THE RIGHT WAY TO FIGHT TAX EVASION

The OECD proposal's supporters do make one compelling argument. It is unfair, they say, for some people to avoid taxes while others are stuck carrying the load. For those who believe that the law should apply equally to all, this is an important issue. The key question, of course, is how this inequity can be solved. This is where the OECD approach breaks down. Even if all the "tax havens" surrender and join the OECD nations in a tax cartel, the desired result will not materialize.

Simply stated, people will enter the underground economy if the OECD proposal is implemented and the tax burden climbs. Economists know that the shadow economy already has reached a remarkably large size.[281] In Europe, for instance, the underground economy accounts for 13 percent to 15 percent of economic output.[282] In some countries, such as Greece and Italy, more than one-fourth of economic activity takes place underground.[283] And if the research is correct, the shadow economy continues to grow.[284] The biggest reason for the existence of the shadow economy, not surprisingly, is tax burden.[285] This is why efforts to address tax avoidance and evasion through an international cartel are doomed to failure.

Fortunately, there is a right way to fight tax evasion. The answer is to cut tax rates and reform the tax system. The lower the tax rate, the lower the incentive to use either legal or illegal means to hide money. In other words, when tax rates are low, people are willing to report more income to the government. This is part of the reason why tax rate reductions often result in increased tax reve-

277. Michael Phillips, "U.S., Major Allies to Urge Bank Scrutiny of 15 Nations' Money Laundering Curbs," *The Wall Street Journal,* July 10, 2000.

278. Rhinds, "Strauss-Kahn: Banks Should Boycott International Centers."

279. Larry Speer, "OECD Says France Should Push Forward With Ongoing Fiscal and Tax Reforms," BNA *Daily Report for Executives,* July 10, 2000.

280. David Pearson, "The Tax Man Cometh, And He Goeth Away," Dow Jones Newswire, August 25, 2000.

281. Friedrich Schneider and Dominik Enste, "Shadow Economies Around the World: Size, Causes, and Consequences," International Monetary Fund, *IMF Working Paper* No. WP/00/26, February 2000, p. 44.

282. Friedrich Schneider and Dominik Enste, "Increasing Shadow Economies All Over the World: Fiction or Reality," unpublished manuscript, 2000.

283. John Burton, "Going Underground," Stockholm Network Conference, December 1999.

284. *Ibid.*

285. Schneider and Enste, "Shadow Economies Around the World: Size, Causes, and Consequences," p. 39.

nues. During the 1980s, for instance, upper-income taxpayers dramatically increased the amount of income they reported—and hence the amount of tax they paid. The same thing happened following the Kennedy tax rate reductions in the 1960s. Revenues rose, and the rich wound up paying more.[286]

Tax reform is an essential part of any campaign to reduce tax evasion. In part, this is because proposals such as the flat tax have a low tax rate. But the flat tax has many other features that will minimize tax avoidance and evasion. For instance:

- **A flat tax is territorial.** This means America will become a more attractive place to invest money. People will have less reason to park their money offshore.
- **Under a flat tax, savings and investment income is taxed at the business level.** In simpler terms, interest and dividend payments are non-deductible, meaning that a company or financial institution withholds and pays taxes on the income of stockholders and bondholders. As such, it does not matter whether the dividend and/or interest is then sent to someone is Kansas or to a confidential account in the Bahamas. The tax already has been paid and the government has no reason to pursue the matter further.
- **Since the flat tax applies only to income, not assets, there is no capital gains tax or death tax.** By eliminating these forms of double taxation, the flat tax eliminates incentives for taxpayers to hide assets overseas.
- **The flat tax does not double-tax savings.** To prevent the double-taxation of income that is saved, the flat tax incorporates what can be thought of as a universal back-ended (or Roth) IRA. More specific, all income is taxed the year it is earned with a flat tax, but there is no second layer of tax if the income that remains is saved and generates a return. By collecting the tax when the income is earned (as opposed to when savings are consumed (the traditional IRA approach), the government does not lose any revenue if a taxpayer chooses to save and invest his after-tax income overseas—whether in a "tax haven" or elsewhere.

There are many other benefits of a flat tax, including the repeal of alternative minimum taxes, the implementation of immediate expensing for business investment, and radical simplification of a mind-numbingly complex tax code.[287] Tax avoidance and tax evasion would plummet, and tax competition would accelerate. America's major trading partners would have no choice but to implement their own reforms unless they want to watch jobs, capital, and entrepreneurial talent flee to American shores.

CONCLUSION

Tax competition is a positive force in the global economy. It forces politicians to be more responsible, pushing tax rates down and allowing people to enjoy more of the money they earn. Tax competition is a particularly good thing for the United States—which is, by industrialized country standards, a low-tax nation. This status helped to make the U.S. economy the strongest in the world, in part by attracting savings, investment, and skilled labor.

Unfortunately, some policymakers in high-tax nations have come up with a strategy to stop beneficial tax competition. Working through the OECD, they are pushing a plan to shut down so-called tax havens and create a cartel of high-tax nations. One of America's top tax lawyers explains the dangers this would pose:

> The ferocious attack on the offshore jurisdictions by the OECD and EU tax initiatives, as well as parallel initiatives by national governments and international organizations, risk raising Americans' tax

286. Daniel J. Mitchell, "Time for Lower Income Tax Rates: The Historical Case for Supply-Side Economics," Heritage Foundation *Backgrounder* No. 1253, February 19, 1999.

287. For further information on the flat tax, see Daniel J. Mitchell, "Jobs, Growth, Freedom, and Fairness: Why America Needs a Flat Tax, Heritage Foundation *Backgrounder* No. 1035, May 25, 1995.

bill on a variety of areas in the medium and long-term, and robbing the US Congress of its constitutional authority over revenue. The assault on bank secrecy and financial privacy and concomitant increases of exchange of tax information will further erode privacy in an era when both law enforcement, electronic commerce, and various information gatherers have dismantled much of the foundation of privacy law. The initiatives will further alienate many Americans on the need to support globalism, since the impact of the initiatives will fulfill their worst fears of the erosion of national sovereignty and the loss of individual rights to the rise of global government.[288]

U.S. policymakers should reject the OECD initiative. It is a threat to America's national interests. More important, it will be bad for U.S. taxpayers; it will undermine national sovereignty; it will destroy financial privacy; it will hinder technological innovation; it will lead to protectionism; and it will sabotage the rule of law.

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288.Zagaris, "The Assault on Low Tax Jurisdictions," p. 55.

APPENDIX

Proposed OECD Sanctions Against Uncooperative Regimes

The OECD, in "Towards Global Tax Cooperation," proposes that its members take action against any non-cooperative low-tax regime.[289] Specifically, member nations should:

1. Disallow deductions, exemptions, credits, or other allowances related to transactions with uncooperative tax havens or to transactions taking advantage of their harmful tax practices.

2. Require comprehensive information reporting rules for transactions involving uncooperative tax havens or taking advantage of their harmful tax practices, supported by substantial penalties for inaccurate reporting or non-reporting of such transactions.

3. Consider, if a country does not have controlled foreign corporation (CFC) or equivalent rules, the adoption of such rules; or if has such rules, ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices (Recommendation 1 of the 1998 OECD report).

4. Deny any exceptions (*e.g.*, reasonable cause) that may otherwise apply to the application of regular penalties in the case of transactions involving entities organized in uncooperative tax havens or taking advantage of their harmful tax practices.

5. Deny the availability of the foreign tax credit or the participation exemption with regard to distributions that are sourced from uncooperative tax havens or to transactions taking advantage of their harmful tax practices.

6. Impose withholding taxes on certain payments to residents of uncooperative tax havens.

7. Enhance audit and enforcement activities with respect to uncooperative tax havens and transactions taking advantage of their harmful tax practices.

8. Ensure that any existing and new domestic defensive measures against harmful tax practices are also applicable to transactions with uncooperative tax havens and to transactions taking advantage of their harmful tax practices.

9. Not enter into any comprehensive income tax conventions with uncooperative tax havens; and consider terminating any such existing conventions unless certain conditions are met (Recommendation 12 of the 1998 OECD Report).

10. Deny deductions and cost recovery, to the extent otherwise allowable, for fees and expenses incurred in establishing or acquiring entities incorporated in uncooperative tax havens.

11. Impose "transactional" charges or levies on certain transactions involving uncooperative tax havens.

289. See OECD, "Towards Global Tax Co-operation," 2000, p. 25, and "Harmful Tax Competition: An Emerging Global Issue," 1998.