The G20 and Tax Havens: Maintaining the Momentum?

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Introduction: Tax havens and the dark side of globalization

Offshore financial centres, also referred to as "tax havens", specialize in attracting financial activity and investment from abroad, thereby mostly making use of zero tax rates, banking secrecy and weak regulation (Palan et al. 2010). Since about 15 years, they have come under greater scrutiny from Western governments and international bodies such as the G7, International Monetary Fund (IMF), Financial Stability Board (FSB), and Organization for Economic Cooperation and Development (OECD). This is because they are said to play a negative role in several global issues at the same time associated with the "dark side of globalization": financial instability, money laundering, terrorist finance, and tax evasion. With regard to taxation, the G7 summit in Lyon already stated: '[…] globalization is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases. We strongly urge the OECD to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices. We will follow closely the progress on work by the OECD, which is due to produce a report by 1998' (G7 1996). In fact, this was an endorsement of a decision the OECD ministers had already taken in May 1996 (OECD 1998).

OECD: From a tough to a soft approach

The OECD effectively came up with a report in 1998, which called for action against both special tax regimes for – mainly – multinationals in OECD countries, and against tax havens outside the OECD (OECD 1998). It is on the latter aspect that we focus here. In its report, the OECD laid down a set of criteria to identify "tax havens": no or only nominal taxes; lack of effective exchange of information; lack of transparency; no substantial activities. The report envisaged blacklisting and internationally coordinated sanctions against havens that persisted in luring other states' tax bases. Yet, a few years later, the OECD relaxed its approach. Small tax havens in the Caribbean and Pacific had successfully lobbied mostly Anglo-Saxon countries, thereby raising development concerns in case the OECD crushed their financial centres. When President George W. Bush came into power in 2001, the US also changed course. Furthermore, the OECD started to face mounting pressure because it turned a blind eye to Luxemburg and Switzerland, two OECD members and tax havens. Ultimately, zero tax rates and no substantial activities were dropped as criteria to target jurisdictions. The idea of internationally coordinated sanctions also moved to the background. From then onwards, the OECD chose to work towards a level playing field through its Global Forum on Transparency and Exchange of Information. In that forum, OECD members and non-members (i.e. tax havens) negotiated on an equal footing and in a more or less consensual way (Sharman 2006). Yet, although more and more tax havens announced commitment to the OECD criteria, in many cases implementation remained poor.

Scandals and crisis

Events in the course of 2008-2009 put an end to this cozy relationship between the OECD membership and tax havens. Severe tax scandals concerning financial institutions in Liechtenstein and Switzerland made the governments of France, Germany and the US very angry. Citizens of the latter had invested millions of dollars in these countries without paying due taxes to their home country. The election of Barack Obama, a well-known supporter of tougher action against tax havens, was another factor that shifted the mood. On top of this came of course the global financial crisis, which enhanced pressure on the tax havens in multiple ways. Tax havens were depicted as at least

permissive causes of the crisis. Their weak regulation had facilitated the development and worldwide dispersion of opaque and risky financial products, and made it difficult to assess the financial health of financial institutions having activities and assets in these centres. As Western governments' fiscal difficulties mounted, appetite to recover lost tax revenue from tax havens grew correspondingly. Moreover, governments found it no longer acceptable that, while bailing them out, certain banks helped their clients to re-route money to tax havens or even operated through tax havens themselves.

In fact, the current intensification of the international fight against tax havens started with an ad hoc meeting in Paris convened by the French and German governments in October 2008. 17 countries were represented, including several ministers. They stated that the OECD process was going too slowly, as tax havens dragged their feet with regard to implementation. The OECD was called upon to publish new lists, with those countries and jurisdictions that fully implemented the OECD standards and those that did not. In the margin of this meeting Germany openly said that Switzerland should be put on the blacklist (Kubosova 2008). The issue of tax havens got a modest mention at the first G20 summit at the level of heads of state and government in Washington, still under the presidency of George Bush: 'Tax authorities, drawing upon the work of relevant bodies such as the Organization for Economic Cooperation and Development (OECD), should continue efforts to promote tax information exchange. Lack of transparency and a failure to exchange tax information should be vigorously addressed' (G20 2008).

The G20 taking the lead

In the weeks and months after Washington, it became clear that tax havens would be one of the top priorities at the G20 summit in London in April 2009. France and Germany continued their activism. The British government also took a much tougher stance than in the past, including against British territories such as the Isle of Man (BBC 2008). The US was engaged in a heavy fight with the Swiss bank UBS to obtain data on American taxpayers. Interestingly, in the run-up to the London summit, tax havens such as Switzerland, Liechtenstein, Luxembourg and Monaco announced that they would commit to the OECD standard with regard to transparency and exchange of information, provided that the requesting state could show indications of fraud (Willis 2009). This was quite revolutionary, since this further undermined their legendary banking secrecy. Apparently, these countries absolutely wanted to avoid to be put on a new blacklist and be punished by the 20 largest economies. The OECD standard is defined as follows (OECD 2010a):

- Exchange of information on request where it is "foreseeably relevant" to the administration and enforcement of the domestic laws of the treaty partner.
- No restrictions on exchange caused by bank secrecy or domestic tax interest requirements.
- Availability of reliable information and powers to obtain it.
- Respect for taxpayers' rights.
- Strict confidentiality of information exchanged.

At their London summit, the G20 leaders agreed 'to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over' (G20 2009a). They envisaged a 'toolbox' with possible sanctions, suggesting the following measures (G20 2009b):

- increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions;
- withholding taxes in respect of a wide variety of payments;
- denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction;

- reviewing tax treaty policy;
- asking international institutions and regional development banks to review their investment policies; and,
- giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programs.

In addition, the G20 took note of a set of three lists, prepared by the OECD. The lists contained all the relevant financial centres in the world. The first listed the 40 jurisdictions 'that have substantially implemented the internationally agreed tax standard'. To be allowed to this "white" list, a jurisdiction had to conclude at least 12 bilateral agreements with other jurisdictions containing provisions on information exchange according to the OECD standard. On the white list featured most OECD countries, but also tax havens such as Jersey, the Isle of Man and Mauritius. A second, "grey", list were the jurisdictions 'that have committed to the internationally agreed tax standard, but have not yet substantially implemented'. This list contained 30 tax havens (defined as such according to the OECD's 1998 definition) and 8 'other financial centers' such as Chile, Singapore, Belgium, Luxembourg, Austria and Switzerland. Yet, the latter 4 European countries had already announced to comply with the threshold of 12 agreements in the near future. Finally, there was a "black" list with 4 jurisdictions 'that have not committed to the internationally agreed tax standard', namely Costa Rica, Malaysia (Labuan), Philippines and Uruguay (OECD 2009a).

Naming and shaming, and power politics

The publication of the OECD lists did not go without power politics. In fact, China did not like the idea of the lists very much. The lists could target the Chinese territories Hong Kong and Macau. These financial centres are amply used by Chinese firms and by the entire region. Moreover, this work was done by the OECD, an organization of which China is not a member. The French President Nicolas Sarkozy, on his part, vehemently insisted on strong language and a complete list, and this already in a context of chilly French-Chinese relations because of an earlier meeting between the French President and the Dalai Lama. This standoff risked to derail the whole tax haven effort and even damage the entire summit. The host, British Prime Minister Gordon Brown, was mostly concerned about the overall outcome of "his" London summit, and deemed the multi-billion Chinese commitment to the IMF more important. After mediation by President Obama, the Chinese President Hu Jintao ultimately obtained that China as such was put on the white list, with the mention in a footnote that Hong Kong and Macau, 'which have committed to implement the internationally agreed tax standard', are not included (Hall et al. 2009; Watt et al. 2009). Another element of the compromise was that the G20 only 'took note of' and not 'endorsed' the lists (Wintour et al. 2009; Luce 2009; Mason 2009). Yet, in order to broaden the sense of ownership of the listing exercise, the OECD always indicates rightly that the UN has also adopted the OECD standard for its tax work (OECD 2010a). It remains strange however to see how a list of the OECD, a multilateral organization with a membership much broader than the G20, is fine-tuned on the spot by G20 leaders. In the meantime, the OECD asserts that Hong Kong and Macau are not tax havens according to the OECD's definition, that both have committed to the standard and set out a timetable to implement it, and that both are among the 84 jurisdictions that are surveyed by the Global Forum (see below) (OECD 2009c). It seems, though, that they should have appeared on the grey list.

The EU members Austria, Belgium and Luxemburg in their turn were not amused by the fact that the official EU representation at the G20 summit (the President of the European Commission and the Czech Prime Minister as rotating chair of the EU), allowed the publication of these lists, while the 3 countries had already announced substantial implementation. This was at odds with agreed EU

language prior to the London summit (Nasra et al. 2009). This demonstrates that, although the EU is formally a member of the G20, smaller member states are not in a position to block an agreement among the major powers. When the big EU member states in the G20 agree, it is unlikely that the rotating president and the Commission would use their veto. It also shows that smaller countries have little leeway to intervene in the interplay between major power groupings and (secretariats of) international organizations such as the OECD and the EU of which they are members themselves.

Keeping the process going

A few days after the London summit, the blacklist was already empty. The 4 remaining jurisdictions eventually committed to the standard (OECD 2009b). Whether this is a sign of the G20's power and effectiveness, or to the contrary, of the weakness of this G20-OECD blacklisting effort, will depend on the follow-up with regard to the jurisdictions on the grey list. Anyway, world leaders kept pressure. This time not the G20, but the G8 summit in L'Aquila, Italy, in July 2009, gave the OECD and the Global Forum some new "orders" (G8 2009). Most of them have already been implemented. The Global Forum expanded its membership to 91, to include all G20, OECD and offshore jurisdictions. Responding to the requests of the G8, the Global Forum started a 3-year peer-review process to monitor both jurisdictions' regulatory frameworks and the concrete implementation of the standard. The Global Forum will report on this review. This initiative is very meaningful, because it will help to bring to light whatever deficiencies in the process, which then can be discussed, published, mediatized, and mobilized upon. Jurisdictions know that, if they do not take the standard seriously, they might face new stigmatization by the G20 and eventually sanctions. The process can also help to hold even the most powerful accountable, for example the US on the State of Delaware, or China on Hong Kong and Macau. Another issue that can be raised during the review is that the threshold of 12 bilateral agreements in order to move to the white list, is too low to get an effective global implementation of information exchange. Furthermore, in line with what the G20 London summit had already requested and the G8 in L'Aquila repeated, the Global Forum became more attentive to stronger involvement of developing countries, 'to make it easier for developing countries to secure the benefits of a new cooperative tax environment' (G20 2009b). Besides the expansion of the Global Forum's leadership, the OECD therefore also started with pilot projects consisting of multilateral negotiations to conclude bilateral agreements. This method reduces transaction costs for both developing and developed countries.[1]

At their third summit in Pittsburgh in September 2009, G20 leaders took note of the 'impressive results' thus far. They also said to stand ready to take countermeasures against tax havens by March 2010. By this, they meant jurisdictions on the grey list, as the black one was already empty (G20 2009c). At this moment, only 9 tax havens and 5 other financial centers remain on the grey list. Austria, Belgium, Luxembourg and Switzerland have already moved to the white list. Another substantial step forward, was the amendment in May 2010 of the Convention on Mutual Administrative Assistance in Tax Matters of the OECD and Council of Europe, which had been opened for signature in 1988 (OESO 2010b). Through the new Protocol, the OECD standard is now included in this multilateral agreement. Moreover, the Convention has been opened up to non-members of both organizations. The Global Forum currently investigates further possibilities for multilateral agreements in the world (Global Forum 2009). It is obvious that multilateral negotiation methods for

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[1] For more information:
http://www.oecd.org/document/32/0,3343,en_2649_33745_44820704_1_1_1_1,00.html.

bilateral agreements on the one hand and multilateral agreements as such on the other, make the expansion of the exchange of information regime more easy. Like many other initiatives already discussed above, the reassertion of the multilateral track is equally a result of the renewed G20/G8/OECD activity that took off in the fall of 2008.

But the job is far from done

It seems that the G20's June 2010 Toronto summit is not going to produce anything new on the information exchange agenda. The OECD's head of tax, Jeffrey Owens, stated in March 2010: 'We have moved from the political stage to the implementation stage' (quoted in Houlder 2010b). Now there is a big danger, however, that the G20 are going to think that their job is almost done, or at least that they can wait 3 years (the period of the Global Forum's peer-review) before taking new action. One of the pressing problems is the problematic and arbitrary threshold of 12 bilateral agreements. There is no guarantee that this way an effective global regime for information exchange will be set up, and this is really the Achilles heel of the whole effort. In fact, the G8 in L'Aquila alluded to this by stating 'criteria used to define jurisdictions which have not yet substantially implemented internationally agreed standards on tax information exchange and transparency should be revised as part of the peer review assessment process to ensure an effective implementation of international standards' (G8 2009). In January 2010, Jeffrey Owens even said that the list with countries that signed at least 12 agreements, cannot be described as a "white" list, because there 'was a widespread desire to move beyond 12 agreements and a need to ensure that agreements were implemented' (Houlder 2010a).

There are more problems, however. Bilateral agreements based on information exchange upon request in many cases lack effectiveness, because of the burdensome procedures to formulate a request (some requested jurisdictions demand a lengthy document in which a very strong case is already made), and because some information in the requested jurisdiction is very hard to obtain altogether, due to legal, regulatory and administrative obstructions (in some cases, the requested information is almost not available). So, apart from the general principle of the OECD standard, implementation is often severely hampered or even made impossible due to technical issues that are not properly settled in bilateral agreements (Tax Justice Network 2009). It can be hoped that the Global Forum's peer-review will identify all these technical, but fundamental problems, and that the OECD and/or G20 will effectively address them (and why not, even before the end of the peer-review process). Therefore, it is highly recommendable that G20 Finance ministers continue to follow this process closely, and put it on the agenda of each meeting.

For the abovementioned reasons, a number of experts put forward the principle of multilateral automatic exchange of information as a superior method. Multilateralism has the advantage that transaction costs to negotiate agreements are drastically reduced, which makes it easier to involve much more jurisdictions in the information exchange regime. Automaticity, in its turn, is obviously much more effective, because it obliges all jurisdictions involved to collect the necessary information on their soils, can bring cases of fraud to light of which tax authorities were not yet aware of, and has therefore a major deterrence effect. Thanks to available technological means and regulatory know-how, this approach is technically feasible for all jurisdictions, developed and developing alike. Automatic information exchange for tax matters on a multilateral basis is not at all science-fiction: the European Union already applies it through its Savings Directive among 24 of its member states (Tax Justice Network 2009). It is a missed opportunity that the G20 has not seriously considered this

option. There is a good possibility, though, that the peer-review process will amply demonstrate that an international information exchange regime can only be made effective, if more drastic measures are taken. Then, it is mainly a matter of political will at the level of the G20, OECD and other fora to take the necessary action.

To conclude, one should not underestimate the magnitude of the unfinished business. True, the G8 and G20 have done a tremendously good job in helping to change the global political mood concerning the issue of tax evasion and bank secrecy. It was also a very good step to initiate the peer-review process plus reporting duty within 3 years. This process can bear various unpredictable results, going into various directions, but probably all in a positive one. The mere existence of a multilateral forum where parties can discuss whatever they want on an equal footing, empowers agendas for change; if there is no physical site for debate, things that cannot bear the light of day, can go on for a very, very long time. But G20 leaders have to be careful not to get entrapped in a path-dependent logic around a model – information exchange upon request, mainly through bilateral agreements – that might not work. They have the power and authority to change course whenever that appears necessary. In that case, the current wave of commitments to the OECD standard and the rapid proliferation of bilateral agreements is to be considered as another useful step in the right direction.

What does this process learn about the G20?

This case learns us several interesting things about the usefulness of G20 summitry. First, the existence of the G20 at leaders' level has greatly helped Germany, France, the OECD secretariat and other committed players to move their concerns about tax havens to the top of the global political agenda. In due course, big emerging economies got also involved. Without the infrastructure of G20 summitry, this would have been much more difficult to achieve and the end result probably less effective. Second and related, the prospect of a G20 summit publishing blacklists and coordinating sanctions, had a major impact on tax havens, which rapidly started to make commitments and negotiate bilateral agreements, in particular in the run-up to the London summit and the months that followed. Third, it is likely that delicate acts, such as listing countries (especially the grey list which was an innovation and based on broader criteria than before) and threatening with sanctions, can more easily be undertaken by heads of state and government, in consultation with each other. Therefore the G20 summit again provides a suitable format. Fourth, the awareness that subsequent and heavily mediatized summits of leaders will evaluate each step of the process, encourages all actors at the lower levels in the process to deliver. Fifth, this case shows again a fascinating interplay between summitry and multilateral organizations such as the OECD. The G7/G8/G20 and the OECD have been closely cooperating for a very long time on taxation and many other issues. For the observer, it remains difficult to ascertain, though, who is actually guiding whom with intellectual and entrepreneurial leadership. Is it the G-x that gives instructions to the OECD, or is it the OECD that precooks what the leaders have to say? Anyhow, it seems that there is a close symbiosis, with G-members and OECD secretariat simultaneously feeding the process with new ideas. Sixth, and this is a point of criticism, G20 summitry is infused with power politics. In this case, we see an issue of double standards, with for example great powers such as the US and China getting away with their own troublesome tax practices. Seventh, beyond the PR and spin surrounding visible deliverables, the quality of decision-making remains a problem. Luckily, the in-built follow-up agenda provides some hope that manifest flaws in the approach can be remedied in the medium term.

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