The OECD Harmful Tax Competition Initiative[1]

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Introduction

In April 1998, the OECD published a report, *Harmful Tax Competition: An Emerging Global Issue*. The report contained 19 recommendations to counter what it saw as the 'harmful' tax competition of capital income. Subsequently, the OECD set up the Forum on Harmful Tax Practices to oversee the implementation of the recommendations. The first main output of this work was published in June 2000, in a second OECD report, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*.

This paper briefly summarises these two reports. It goes on to consider a number of issues which arise. The first is the underlying rationale for the OECD's approach. This has several components. For example, is there a case for not taxing capital income? What are supposed to be the aims of the process? Does the notion that tax competition can be separated into forms which are 'harmful' and others which are, by implication, 'not harmful' have any rational basis? Clearly one factor in the OECD's approach is a concern about 'significant revenue losses'.[2] A further part of this paper therefore examines patterns of tax revenue on the income from capital in OECD countries, and explores the extent to which revenue losses have become a significant problem for OECD countries. The report goes on to consider the implications for jurisdictions which are labelled by the OECD as either 'co-operative' or 'unco-operative' 'tax havens'.

The OECD Initiative

In its 1998 Report, the OECD distinguished two forms of 'harmful' tax practice. The main distinction was in the countries involved: the first form involved OECD members and the second non-members.

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1 This paper was prepared for the Commonwealth Secretariat by Professor Michael P. Devereux, Professor of Economics and Finance, Warwick University, UK. It was originally presented at the Commonwealth Finance Ministers Meeting held in September 2000 in Malta.

2 See the Executive Summary of the second report.

The first form concerned 'harmful preferential regimes in member countries'. According to the report, four main factors determine whether a particular regime is 'harmful'. They are:

✍The regime imposes low or no taxes on the relevant income;

✍The regime is ring-fenced from the domestic economy;

✍The regime lacks transparency;

✍There is no effective exchange of information.

Other factors were also considered including, for example, the extent of compliance with the OECD Transfer Pricing Guidelines. The OECD emphasised that the first criterion – low or no taxes – was not, in itself, considered to represent a 'harmful preferential regime'. Rather it was important that there was an element of discrimination in the regime. Lack of openness – characterised by a clear set of tax rules and the potential for exchange of information – was also considered an important element. The guidelines introduced by the report recommended that any features in member countries' tax regimes identified as 'harmful' should be removed within five years.[3]

The OECD established working groups of the Forum to identify such regimes. The 2000 Report listed 47 preferential regimes – in a number of OECD countries – which were '*potentially* harmful', since there has not yet been an overall assessment of whether the regimes are '*actually* harmful'. These included regimes such as Belgian Co-ordination Centres, and Irish International Financial Services Centres.[4] The Forum was unable to reach a conclusion about whether a number of holding company regimes were potentially harmful. These were not included in the list.

The next stage in the OECD's work on preferential regimes will be to issue guidance (application notes) on applying the criteria in the 1998 Report. This will be on a generic basis, in that no specific regime will be referred to. The Forum aims to verify by June 2003 whether member countries have eliminated 'harmful' regimes, although the deadline for removing the benefits to taxpayers from such regimes is December 2005. However, the 2000 Report does not outline any action which will be taken against countries which have not complied with eliminating such regimes. It merely states that 'other countries may wish to take defensive measures'.

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3 The 1998 Report, and the recommendations, were approved by the OECD Council with abstentions from Luxembourg and Switzerland.

4 But *not* the Irish intention to set a low corporation tax rate of 12.5 per cent on all activity.

The second form of 'harmful' tax practice identified by the 1998 Report concerned jurisdictions outside the OECD identified as 'tax havens'. Here the focus is, therefore, on jurisdictions, rather than on specific features of their tax regimes. Again there were four main factors which would identify such a jurisdiction:

✍No or only nominal tax on the relevant income;

✍No effective exchange of information;

✍The jurisdiction's regime lacks transparency;

✍The jurisdiction facilitates the establishment of foreign-owned entities without the need for a substantive local presence.

Again, the OECD emphasised that the first of these factors – low taxation – was necessary, but not sufficient in itself, to identify a jurisdiction as a tax haven. Again, transparency and exchange of information figure prominently amongst the criteria listed by the OECD. The OECD also appeared to consider it important whether or not a jurisdiction had a significant untaxed offshore financial services sector relative to its overall economy.

Again, study groups were established by the Forum to identify such jurisdictions; the study groups invited jurisdictions under consideration to submit relevant information, and invited them to verify the factual accuracy of the reports. The OECD published a list of 34 'tax havens' meeting its criteria in the 2000 Report.[5] In doing so, the OECD did not follow the procedure which it adopted towards its own members of declaring regimes to be only *potentially* – as opposed to *actually* – harmful. It is not clear whether the OECD considered that it had more information on which to base a judgement concerning 'tax havens' than it had concerning 'preferential regimes' in member countries.[6] Just prior to the publication of the report, six further jurisdictions made a public political commitment to eliminate their 'harmful' tax practices and to comply with the principles of the 1998 Report. As a result, they were not named in the 2000 Report.

The OECD intends to put in place a two-pronged strategy to deal with these 'tax havens'. It aims to draw up a list of 'unco-operative tax havens' by 31 July 2001. Any jurisdiction regarded as such will be liable to 'defensive

5 The OECD's list is given on page 17 of the 2000 Report.

6 It does seem unlikely that, within a period of time, the OECD could have found out more about the overall tax regimes of the 47 potential tax havens which it considered than it could find out about specific features of the regimes of its members.

measures' outlined by the OECD in its 2000 Report. These are described below. The timescale for this process is therefore much shorter than for OECD member countries, which have an additional two years before the OECD will even declare whether their regimes are *actually* harmful.

To avoid being in this position, identified jurisdictions need to co-operate with the OECD. In effect, this means to make a public political commitment to eliminate by December 2005 any practices which the OECD considers to be 'harmful'. Further, such jurisdictions would generally be expected to develop an acceptable plan in collaboration with the Forum, and to agree not to enhance further any 'harmful' tax practices. Beyond this, the OECD intends to encourage further co-operation by, for example, developing a model vehicle for the exchange of information. As a possible 'carrot' part of a 'carrot and stick' approach, the OECD mentions possible assistance to jurisdictions in transition, involving 'examining how their bilateral assistance programmes can be re-targeted', encouraging international organisations to take into account their special needs, and offering assistance on strengthening tax administrations.

The OECD Forum recommends that jurisdictions identified as 'unco-operative tax havens' by July 2001 should be subject to a range of possible 'defensive' measures. Jurisdictions co-operating with the Forum (presumably including non-OECD members) will be invited to adopt the measures recommended by the OECD (although such measures would be at the discretion of countries).[7] The measures proposed in the 2000 Report relate partly to the enforcement of existing tax regimes. For example, they include the enhancement of auditing and enforcement activities, a requirement for comprehensive information reporting rules and a recommendation to adopt controlled foreign corporation (CFC) rules, all with respect to unco-operative tax havens. However, the measures go beyond this, effectively introducing a penalty for dealing with such jurisdictions. They include proposals to:

- Impose withholding taxes on certain payments to residents of 'unco-operative tax havens', and 'transactional' charges on certain transactions involving 'unco-operative tax havens';
- Deny the availability of the foreign tax credit or the participation exemption with regard to distributions from 'unco-operative tax havens';
- Disallow deductions, exemptions, credits or other allowances related to transactions with 'unco-operative tax havens'.

7 It is not clear whether there would be any consequences of not adopting such measures.

Governments are also invited to reconsider whether to direct non-essential economic assistance to 'unco-operative tax havens'.

A Background to Taxing Capital Income

The main focus of the OECD initiative is clearly on the spillover effects of taxation across countries – that is, how the tax regime in one country can affect the welfare of residents in another country. Before addressing this in detail it is useful to take a step back to consider the underlying rationale for taxing capital income.

An academic and policy debate has continued for decades about whether the main form of taxation should be based on income or expenditure. A tax applied to all income would be applied to all forms of income from capital and all capital gains. A pure expenditure tax would tax only that part of income which was not saved; it would also tax net reductions in saving (i.e. those which represent part of expenditure). But in effect, an expenditure tax would not tax capital income.

There have long been advocates of an expenditure tax, including for example, the Meade Committee in 1978.[8] Advocates of an expenditure tax have made a case on several grounds, including the administrative difficulty of implementing a full (or comprehensive) income tax and the avoidance of distortions to savings decisions. There is not room to summarise these arguments here. However, there is one additional reason for not taxing capital income, not often appreciated, which concerns the effective incidence of a tax on capital income in an open economy with mobile capital.

Suppose investors elsewhere in the world could earn a post-tax return of 10 per cent by investing on world markets. Then they will only invest in any particular host country if they earn the required post-tax rate of return of 10 per cent. But suppose that the host country charges a 50 per cent tax rate on capital income. Then non-resident investors will demand a pre-tax rate of return of 20 per cent – worth only 10 per cent after tax.

How could such a high rate of return be achieved? Most probably by a reduction of total inward investment – with only the better projects selected. And who then bears the effective burden of the tax? Non-residents still earn 10 per cent post-tax. It must therefore be borne by residents: there is less investment in the country, and this will be reflected

8 *The Structure and Reform of Direct Taxation*, Institute for Fiscal Studies, 1978, the report of a committee chaired by Nobel Laureate James Meade.

either in higher unemployment or lower wages, or both. A more efficient tax regime would be one in which (immobile) residents were taxed directly – through a tax on labour instead of a tax on capital. Such a tax would not distort inward investment decisions. So inward investment would be higher and overall welfare would be higher. Local residents bear the tax burden in any case.

However, the argument against taxing capital income is not merely an academic one. Many countries in practice do not tax such income to any great extent. An example is the UK, which has numerous forms of savings vehicles which are effectively untaxed, including pension funds and individual savings accounts (ISAs). Of course, the UK Government, like most other OECD countries, still attempts to tax capital income in the hands of companies active in, and resident in, the UK. The rationale for doing so is undoubtedly that it raises considerable revenue. But the burden of that taxation is probably borne by the immobile labour force in the UK (and UK consumers), rather than by the owners of capital. And there is a good argument that distortions to the UK economy would be lower with other forms of tax. The same would be true for other countries.

Issues in Tax Competition

In evaluating the OECD's initiative it is useful to consider whether it is reasonable to consider some forms of tax competition as 'harmful' or 'not harmful'. A starting point is the normal competition in economic markets. The principle here is that a process of competition between different suppliers to a particular market results in lower prices to the consumers, which in turn tends to lead to more efficient production. But is there an analogy with tax competition?

There is certainly a sense in which jurisdictions may compete with each other, since the tax regime in one jurisdiction is likely to affect the welfare of other jurisdictions. There are at least two distinct ways in which this might happen.

First, a tax cut in one country which increases, say, the probability of a multinational firm locating there makes it less likely that the firm will choose some other location. In practice, most countries aim to encourage inward real investment, since this may have positive effects on domestic welfare through raising total investment and employment, or by increasing productivity. The tax cut may also induce financial flows. Since financial capital is highly mobile, differences in tax rates between jurisdictions are likely to be especially influential in the location of financial activities, and hence there is more likely to be competition over taxes on financial capital.

Second, introducing a new low-tax regime is likely to attract mobile taxable income (through a variety of devices) from other jurisdictions. This may have little or no impact on real economic activity, but serves to reduce the taxpayers' overall tax liability in higher-taxed jurisdictions, and possibly increase the tax revenue of the host jurisdiction.

The OECD does not clearly distinguish between these two possible ways in which the tax policy of one country can affect the welfare of other countries. In places, the OECD reports refer to the misallocation of resources between countries, which seems to reflect a concern with the first effect. However, in its concentration on revenue, it indicates more concern with the second effect.[9]

The OECD also does not distinguish between tax avoidance (reducing tax liabilities by arranging one's affairs in a legally acceptable way) and tax evasion (illegally failing to declare taxable income). While the distinction between these two may sometimes be blurred, the policy implications for combating them are rather different. If OECD countries are concerned only about tax avoidance, they should in principle be able to collect any information required from their resident taxpayers. The focus of the OECD on exchange of information therefore seems more relevant to the problem of tax evasion. Unlike the main thrust of the OECD initiative, this ties in more closely with international concerns over money-laundering.

If there is tax competition between jurisdictions, then the analogy with economic competition would suggest that this would improve welfare. In economic markets, dominant firms with market power seek to restrict competition by a number of means, in order to maintain higher prices and to create higher profit. By this analogy, the OECD plays the role of a cartel of dominant firms: it seeks to pressure jurisdictions which undermine its ability to charge high taxes and raise high revenue from capital income. Low-tax jurisdictions are threatened with sanctions in order to prevent them from reducing the high-tax jurisdictions' ability to raise tax

Of course, as with most such analogies, this one can only be taken so far. The main reason is that it is far from clear that a process of tax competition is beneficial overall. The 'prices' involved in tax competition are tax rates on mobile tax bases – which can apply to the location of real or financial investment, or the location of taxable income. Reducing the

9 In fact, the OECD sends conflicting signals as to its chief concerns. The Executive Summary of the 2000 Report states: 'It is important to note at the outset that the project is not primarily about collecting taxes …'. Later in the same paragraph, however, it claims that 'The project is focused on the concerns of OECD and non-OECD countries, which are exposed to significant revenue losses as a result of harmful tax competition'.

'price' of locating activity in one country makes that country more attractive relative to other countries. In the long run, other countries are likely to respond by reducing their tax rates as well. Many economic models suggest that the long-run outcome of this process must be 'prices' – i.e. tax rates – of zero.

But there are costs of reducing tax rates: the opportunity costs of raising the same tax revenue from other sources, or going without the expenditure made possible by the tax. These costs may vary from country to country. But high costs do not necessarily imply 'inefficiency'; they will reflect the alternative means available to different governments of raising the same revenue, or the benefits of the foregone government expenditure. The fact that most OECD countries continue to have high corporation tax rates – relative to the theoretical prediction of zero – is consistent with them having relatively high opportunity costs.

So the fact that competition in the economic market place may be beneficial is no reason to suppose that a general process of tax competition – whether competition over the location of real economic activity or over taxable income – is beneficial. But attempts by the OECD to define 'harmful' tax competition imply that there is such a thing as tax competition which is not harmful – or even positively beneficial. Instead, differences in tax regimes across jurisdictions, possibly – although not necessarily – as a result of a competitive process, may well leave some individuals or jurisdictions better off and some worse off.[10]

As a final point, the OECD's position is that simply setting a low (or zero) tax rate is not enough to be considered as a tax haven; rather the criteria listed above must be met. But this reflects a lack of economic logic behind its position. Suppose a jurisdiction has a zero tax rate, but exchanges information and meets all the other criteria necessary to be considered not to be a tax haven. That country is still likely to attract capital and taxable profit away from its high-tax neighbour. This may well be considered an outcome of tax competition and it may well leave the high-tax neighbour worse off. But it does not fall foul of the OECD's definition of harmful tax competition.

Tax Revenues in the OECD

The main motivation for the OECD's initiative is apparently concern about the erosion of tax revenues in OECD countries. It is therefore use-

10 This can be seen even within OECD countries: Ireland has benefited from very high investment arising at least in part from its low corporate tax rates.

ful to consider the recent pattern of these revenues. The obvious form of taxation to consider is corporation tax revenue, which is the main (although not the only) type of tax on capital income. If there was reason for increasing concern about the erosion of corporation tax revenue, one would expect to see such revenues declining both as a share of GDP and as a share of total tax revenue.

Figures 1 and 2 present evidence between 1975 and 1997 on the pattern on corporation tax revenues in a number of major economies as well as an average for the EU. Figure 1 presents these as a proportion of GDP in each country. Figure 2 presents them as a proportion total tax revenue in each country.

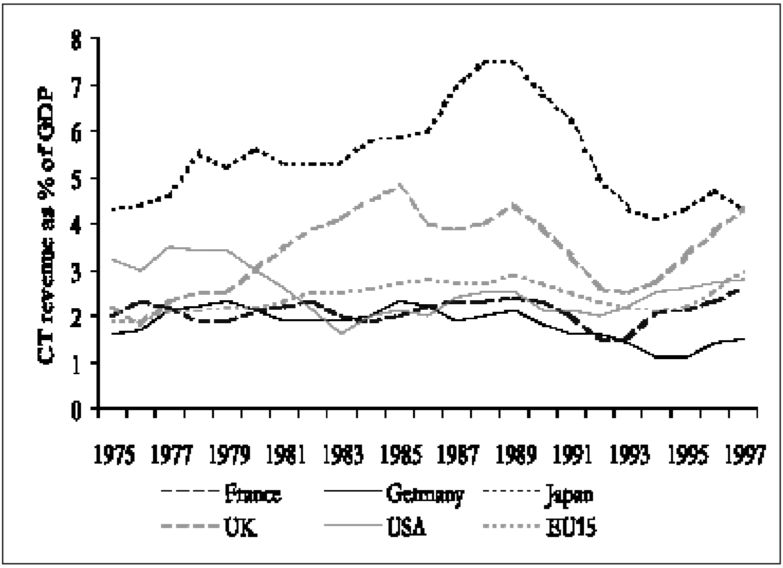

Figure 1. Corporate Tax Revenues as a Share of GDP

Note: EU15 is an average of the 15 EU member states, 1989–1997, and 14, excluding Portugal, prior to 1989. The average is weighted by GDP.

Source: OECD, *Revenue Statistics*, various years.

Both figures demonstrate that the importance of corporation tax revenues varies considerably across countries. Revenues are also quite volatile, tending to move in line with the economic cycle. Although revenues declined in the first half of the 1990s, they recovered up to 1997. Overall, however, there is no clear discernible trend. On average, corporation tax revenues are at roughly the same level as they were 20 years ago.

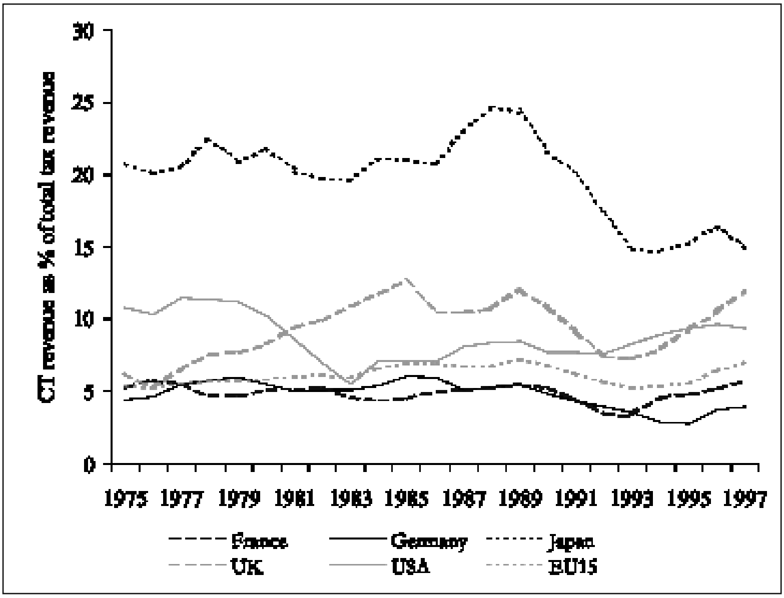

Figure 2. Corporate Tax Revenues as a Share of Total Tax Revenue

Note: EU15 is an average of the 15 EU member states, 1989–1997, and 14, excluding Portugal, prior to 1989. The average is weighted by total tax revenues.

Source: OECD, *Revenue Statistics*, various years.

This is despite the fact that, on average, statutory corporation tax rates have tended to fall over the last two decades. Table 1 indicates movements in the statutory tax rates in a number of OECD countries since 1980. Statutory tax rates have fallen in all but one of these countries since 1980, in some cases by a considerable margin. Part of the explanation of why revenues have held up while statutory tax rates have fallen is that tax bases have tended to be widened over the same period, so the effective tax rate has not changed so substantially.

The evidence here can only really be consistent with the notion of a threat to corporation tax revenues if, in fact, corporate profits have been increasing over the last 20 years, but this increase has coincided with increasing opportunities for tax avoidance and evasion. In this case, the net effect might be to leave revenues unchanged. Unfortunately this hypothesis is not easy to test, because of the difficulties in adequately defining and measuring levels of profitability. However, I am not aware of any study which supports the hypothesis and, to the best of my knowledge, such evidence has not been available to, or been presented by, the OECD.

Table 1. Typical Corporate Tax Rates Over Time[a]

	1980	1990	1999
France	50.0	37.0	40.0[b]
Germany[c]	62.2	57.7	51.6[b]
Ireland[d]	45.0	10.0	10.0
Italy[e]	36.3	46.4	37.0
Japan[f]	52.6	50.9	40.9
Sweden	56.8[c]	52.0	28.0
UK	52.0	34.0	30.0
USA[c]	49.6	38.4	39.3

[a] The rate given applies to retained earnings for a manufacturing company.

[b] Includes a surcharge on corporate income tax.

[c] Includes a deductible local corporate income tax.

[d] The 10 per cent rate for certain manufacturing activities and financial services was introduced in 1981. It is being phased out, and the standard rate of corporate tax is being reduced to 12 per cent on trading income from 2003.

[e] A deductible local corporate income tax of, on average, 16.2 per cent was replaced in 1998 by a regional tax on productive activity of 4.25 per cent, calculated on the net value of production rather than taxable profits, which is not deductible from the corporate income tax.

[f] Includes two local taxes: the enterprise tax (which is deductible) and the inhabitants tax (which is not deductible).

The Impact of the OECD Initiative on 'Tax Havens'

As far as I am aware, there has been little research on the impact of the OECD initiative on those jurisdictions labelled as 'tax havens'. In any case, it is important first to consider carefully the pressure on 'tax havens' to reform the most important features of their regimes. Only then is it possible to consider the economic impact of such reforms.

Jurisdictions labelled by the OECD as 'tax havens' have a choice. First, they can publicly commit to abandoning those elements of their tax regime which the OECD considers relevant; and they will have to actually abandon them by 2005. However, according to the OECD, this specifically does *not* mean that they will be forced to abandon a low tax rate policy.

The crucial issue, therefore, is how important the other elements of the tax regime to which the OECD objects are in making a particular jurisdiction attractive to non-residents. To recap, the three other main elements identified by the OECD as important in recognising a 'tax haven' are exchange of information, the degree of transparency with regard to, for example, financial disclosure, and the extent to which foreign-owned entities are required to have a local substantive presence.

From the perspective of other countries, the first two of these are most likely to be of importance in illegal activity, for example where residents of other countries can evade taxes by holding funds in a 'tax haven' which cannot be traced by the home tax authorities. (Clearly, too, these two factors may be of importance in money laundering, although that is not the focus of this OECD initiative, or of this paper.) But these two factors may have relatively little impact on legal, even if lightly taxed, financial or real activity. A very important issue both for the response of those jurisdictions labelled as 'tax havens' and for the OECD is therefore the relative size of these two kinds of activities. If most financial activities take the form of legal activity, then the 'tax havens' may have little to lose in agreeing to engage in more transparency and in the exchange of information – since if the activity is legal there is no need for the taxpayer to hide it.[11]

The second option for such regimes is to choose not to comply with the OECD initiative. At the moment, there is considerable uncertainty as to what the implications of such a stance would be. It does seem likely that jurisdictions already listed by the OECD would be transferred to the new list of 'unco-operative tax havens', and that the OECD would then invite its members, and possibly other countries as well, to take 'defensive measures' against that jurisdiction.

What is less clear is the extent to which individual countries would enact these defensive measures. Indeed, it is puzzling that larger and richer countries which have apparently been concerned about specific jurisdictions have not unilaterally imposed at least those defensive measures aimed at collecting their own tax revenue (as opposed to attempting to penalise the other jurisdiction). For example, many OECD countries already have complex anti-avoidance regimes in place, which could be extended to attempt to deal with a perceived threat from another jurisdiction. But if there is a cost to taking such action (for example, administration costs), then it seems at least possible that such countries would not be willing to take such action in response to the prompting of the OECD.

11 In any case, where countries do have exchange of information agreements, very little information tends to be exchanged in practice.

But there is a more general problem for the OECD in its dealings with ‘unco-operative tax havens’; that is, that financial capital and taxable profits may be so mobile that it is virtually impossible to properly implement any of the defensive measures. To take a concrete example: suppose that the UK introduced as a ‘defensive’ measure a ‘transactional charge’ on all transactions with, say, Seychelles. That is if, for example, a UK resident paid money to a resident of Seychelles, the UK Government would levy a charge. It is likely then that such a transaction would be unattractive. But would this halt business between the UK and Seychelles?

This seems unlikely. Instead it seems more likely that there will be third countries which could act as an intermediary in the transaction. Either the UK Government would also have to levy a charge on transactions with the third country, or it would have to ‘look through’ the initial transaction with the third country to discover if there was ultimately a transaction with Seychelles. Essentially, to have a significant effect on business between the UK and Seychelles, the defensive measures would have to be comprehensive. For example, if any one of the OECD member countries decided not to introduce such a charge, then all money paid to Seychelles could be routed through this OECD country.[12]

In sum, the threats of the OECD may be less severe than they appear at first sight. If jurisdictions choose to comply with the OECD to avoid being on an ‘unco-operative’ black list, they may in principle still maintain their status as low-tax jurisdictions, although they would probably have to agree to more transparency and exchange of information. If they choose not to comply with the OECD demands, they face a more uncertain future. However, given the possible reluctance of countries to undertake penalising ‘defensive measures’, and the expertise of tax lawyers and accountants in devising tax-minimising strategies, it may be some considerable time before any serious effects of defensive measures are felt.

If the OECD maintains its stance that it will not force ‘tax havens’ to raise their tax rates, then the economic impact on such jurisdictions depends on their response. In turn this may depend on the extent to which the jurisdiction depends on illegal activity. If this affects a relatively small part of the jurisdiction’s economy, then that jurisdiction may have little to lose from agreeing to greater transparency and an exchange of information with the OECD.

12 This is a vital difference from the position of trade and the WTO. If a small country chooses not to sign up to WTO agreements that has little effect on other countries as they trade between themselves. But a small country can, in principle, have a large effect on international tax revenues.

However, it seems that some jurisdictions are likely to increase their tax rates in response to the OECD's initiative. This could have far more serious consequences. Given the great mobility of financial capital, any country which increases its tax rate on such capital is liable to drive it away.[13] Although it is impossible to identify the monetary cost of increasing tax rates, it is reasonable to assume that, for countries which depend heavily on such financial capital, the cost would be very large.

Conclusions

This paper has reviewed the recent OECD initiative on 'harmful' tax competition, primarily from the viewpoint of jurisdictions which the OECD defines as 'tax havens'. Such jurisdictions must choose whether to comply with the OECD in reforming their tax regimes or face the prospect of having 'defensive measures' taken against them.

This paper argues that:

- ✍The planned OECD timescale is significantly shorter in taking action against jurisdictions defined as 'tax havens' than it is against its own member countries which have 'preferential regimes';
- ✍The threats to those jurisdictions judged to be 'tax havens' seem more severe than those against 'preferential regimes' in OECD countries;
- ✍The OECD has not succeeded in making a definition of 'harmful' as opposed to 'not harmful' tax competition;
- ✍By analogy with economic markets, the OECD is akin to a cartel of high price firms seeking to undermine competition;
- ✍There is no evidence that OECD countries are facing a reduction in corporation tax revenues as a result of tax competition – either 'harmful' or 'not harmful';
- ✍'Tax havens' could accept more transparency and exchange of information with the OECD to the extent that there is no illegality involved in the financial activity within their jurisdiction;

13 This is despite the claim by the Business and Advisory Committee (BIAC), an independent but official consultative body to the OECD, that 'multinational enterprises that utilise the environments offered by the tax havens … have *not*, in general, done so primarily for tax saving reasons, but because these locations have developed an expertise in servicing such activities, which, today, are far more significant than tax benefits on attracting business', ('A business view on tax competition', *Tax Notes International*, 19.3, July 1999).

- ✍The 'defensive measures' threatened by the OECD may be difficult to enforce;
- ✍Jurisdictions which feel obliged to raise their tax rates may face a very significant outflow of capital and hence reduction in welfare.

The OECD's 'harmful tax competition' initiative could have a potentially very large economic impact on jurisdictions labelled as 'tax havens'. Even within the scope of the current framework, the analysis in this paper suggests two recommendations. First, that there should be multilateral discussion between the OECD and 'tax havens' to facilitate discussion of common issues. Second, that the timescale for dealing with 'tax havens' should reflect the difficulties which the OECD acknowledges that its own members will have in reforming their tax regimes; this would, for example, imply delaying the drawing up of a list of 'unco-operative tax havens' until 2003.