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University of Exeter: Claudio M. Radaelli and Ulrike S. Kraemer

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Summary

This report presents the findings of the project on The Changing Architecture of International Tax Governance. In part 1 we introduce the key research questions that have led us to the choice of a specific theoretical framework, that is, strategic constructivism. Part 1 also shows how this theoretical framework is applied to EU and OECD tax coordination issues, and the substantive findings. Part 2 provides more details on the segment of our research project dedicated to the EU. Instead of looking at tax policy instruments such as tax rates or corporate tax structures, we take a governance approach to the analysis of tax coordination. Our major result is the explanation of why policy makers choose to differentiate among different governance arenas in order to process issues of tax policy that cannot be deal with at the systemic level. Part 3 carries on with our governance approach to tax coordination and introduces the theme of policy learning in order to interpret recent dynamics at the OECD level. Both part 2 and part 3 explore new modes of governance across time and arenas – the main argument being that in order to understand shifting modes of governance, one has to look at the political logic (in turn, both ideational and material-distributive) around which governance arenas are built.

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I. Part: Summary and conclusions

I.1 Introduction

This report presents the main findings of the project on the Changing Architecture of International Tax Governance carried out at the *Centre for Regulatory Governance*, University of Exeter, by Professor Claudio Radaelli with research assistance from Ulrike Kraemer.

Direct tax policy is a traditional domain of the nation state, at the heart of state sovereignty. Taxation determines the capacity of the state to fund its policies and redistribute resources. Developments in welfare state policies and other redistributive programs can be explained by looking at the tax system (Steinmo 1993). Although in a common market some forms of coordination of indirect taxes provide efficiency gains, one would not expect delegation of direct taxes to the supranational level. It is therefore not surprising that there are no specific Treaty provisions for dealing with direct taxation at the European Union (EU) level.

Outside the EU, the Organization for International Cooperation and Development (OECD) has a long track record of experiments in tax coordination. The results have historically been limited to bilateral cooperation. Yet over the last ten years or so, the OECD has engaged with multilateral cooperation. Additionally, it has become apparent that the EU direct tax policy requires a broader framework of cooperation – thus making the policies of EU and OECD highly interdependent.

Specifically, there is convergence of the EU and the OECD as to the final goal of international tax cooperation – that is, to create a level-playing field. However, over the last ten years there have also been episodes showing divergence on the choice of governance instruments (such as exchange of information versus withholding taxes) and some frictions on the timing of initiatives (some derogations granted by the EU are said to have somewhat made it more difficult for the OECD to convince reluctant offshore jurisdictions to start exchanging information). This set of converging aims, interdependence of actions, and cases in which the choice of instruments has seemed to go in different directions invite a comparison of the EU and OECD policy initiatives. They also suggest a focus on modes of governance selected for cooperation – in contrast to the current approach in the literature to contrast cooperation and competition without looking at what we find ‘inside the box’ of cooperation.

I.2 Methods

Our project has covered corporate tax coordination in the EU and the OECD, using different tools including literature review, analysis of primary documents, semi-structured interviews, chronologies of events, systematic process tracing, exploratory workshops with academics-practitioners and interactive sessions with different stakeholders. We have interviewed a large number of policy-makers in the EU institutions and the member states using a semi-structured interview protocol. Another set of interviews has been carried out in offshore jurisdictions, the finance-banking industry, with the Tax Justice Network, think tank leaders, and Swiss banks.

We also used an interactive technique as both a research method and a way to increase awareness, participation, and mutual understanding among tax policy makers and between them and civil society organisations, lawyers, and policy research institutes. This was done in the context of an international round table - a highly interactive workshop around four key themes, which gathered 20 European high-level policy-makers, practitioners and academics engaged in international taxation in 2006. It was the first time for some of these stakeholders to sit together around a table, acknowledge their respective role, and engage in a structured conversa-

tion under Chatham House rules. The idea was to use Exeter University, respectively the Centre for Regulatory Governance, as a platform for a balanced discussion. The international tax issues are topical and often hotly debated but the basic assumptions, concepts, and frameworks have often not been clarified yet. Thus, the main goal was to forge a common language in the area of highly heterogeneous policy preferences.

I.3 Theoretical framework: strategic constructivism

The type of research we have carried out is not a test of specific theories. Instead, it was motivated by specific problems highlighted by previous empirical research on international and EU taxation. In a sense, we would like to describe our research in terms of ‘empirics first, then interpretation’. We have gone through the following steps:

- (i) Empirical analysis and process tracing,
- (ii) Identification of the research puzzle in need of explanation,
- (iii) Choice of an interpretative account, and
- (iv) Findings

This has to be clarified because most of the research on taxation and more generally in political science and political economy is of a different type (‘theory first, then testing’). Our findings, therefore, do not show how a set of propositions drawn from a theory explains xx per cent of the variance. The aim is to explain empirical puzzles instead.

The dependent variable is the choice or selection of a mode of governance, specifically hierarchy or facilitated coordination. This can be seen as a choice between different forms of hard and soft forms of governance, often hybridised. Governments can also use competition – international tax competition is the default solution indeed.

What are the frameworks that can be used to explain the emergence and selection of modes of governance? At the outset of our project, we considered the following options:

- (i) Socialisation and identity-formation in the EU. Socialisation develops some patterns of trust, compliance, multilateral understandings that provide the essential mechanisms through which modes of governance operate
- (ii) A variation on the socialisation theme is the epistemic community approach - socialisation in highly technical networks based on shared causal beliefs about policy. Beliefs, in turn, enable policy makers to focus on specific governance solutions, such as benchmarking or peer review, use of indicators, and so on.
- (iii) Principal-agent models provide yet another option. The principal delegates, but imposes on the agent a specific mode of governance. The latter performs the function of reducing the autonomy of the agent, or restricts agency’s slack.
- (iv) Finally, there is the option of experimental learning in networks. The idea is that policy-makers are willing to solve a given problem (think of international double taxation) but they do not know how to do it. Policy networks can then be used as radars to choose the mode of governance that increases the capability to learn and explore solutions.

These options run through the overall research activity of *New Modes of Governance*, as shown by the vision papers that lay out the main hypotheses behind this integrated project. They are certainly useful. Yet the empirical puzzles in direct taxation do not lend themselves quite naturally to any of the above-mentioned explanations. This is the reason why we concluded that we could not use any of these macro-frameworks, and we went down the ladder of

abstraction looking for a framework that would enable us to make sense of the empirics. Hence, our aim was not to take one of the macro frameworks off the shelves and test it, but to provide an accurate interpretation of empirical evidence.

This leads us to the question what is peculiar about our empirics? Consider the following points:

- Heterogeneous preferences and high distributional conflicts across jurisdictions make tax competition the default option. In consequence, even before we explain the choice of a mode of governance, we have to ask the question: why do governments coordinate instead of competing? Note that the vast majority of the literature is in fact on tax competition, not on tax coordination. When the literature addresses tax coordination, it is often silent on the process leading to choice of a specific type of tax coordination. Therefore, to pose the question of tax coordination instead of tax competition is already an innovative point of view, on which existing scholarship has not progressed much.
- We also have to explain why actors coordinate in the EU and not at the OECD level – indeed, there are different fora available for coordination. Economic analysis shows that the EU level is not the most efficient forum. And historically there has been more socialisation in the OECD than in the EU bodies dedicated to direct taxation. The latter has had very few and they have been historically weak. However, the situation has changed since 1997, which is why we look at the EU in our report.
- In previous work by Radaelli (1999, 2003), we have considered socialisation and epistemic communities in EU direct corporate tax policy. The conclusion of these studies is that we cannot explain the selection of policy instruments by using these two frameworks. Socialisation emerges as a consequence of the use of modes of governance and a result of the adoption of instruments like the code of conduct in business taxation. Hence it is a consequence of – rather than an explanation of – the selection of policy instruments (Radaelli 2003). Epistemic communities work on the elaboration of solutions, but the main ideational innovations in our case (think of the idea of defining the conditions under which tax competition is harmful) are not drawn from economic analysis or social sciences. They are policy narratives in which purposeful entrepreneurs are much more important than embryonic epistemic communities (Radaelli 1999).
- Learning and problem-solving attitudes are much less important than political conflict over distribution (of the tax base across competing jurisdictions), ideology (this is one the red lines for more than one EU government) and legal competence to coordinate or harmonise direct taxes. Thus our case studies is not a good case for the use of the experimental democratic governance perspective elaborated by authors such as Sabel and Zeitlin.
- Modes of governance are not selected synoptically – that is, as solution to a set of governance problems affecting the whole of this policy area. There are very interesting processes taking place at the sub-systemic level - within-case analysis is important. Within-case analysis in this case is not a methodological choice to increase the number of observations, it is a choice dictated by the difficulties to make valid propositions for the macro level of policy.
- Strategy is important, but there is no clear sense propensity to delegate power to networks or agencies. This limits the potential of principal-agent analysis.
- In any case, strategy has two components: objectives in terms of policy outcomes and objectives in terms of process. These two dimensions make explanation more complex.

- Strategy alone does not explain the erratic choice of modes of governance over time. We enter ideas in our explanation; we draw on strategic constructivism by tracking down “where do ideas come from?”. Ideas provide the definition of the EU tax policy problems (alternative problem definitions include: harmful tax competition, corporate tax reform, tax discrimination and barriers to the single market) and discourses (in various guises, but often in the form of policy narratives). Ideas enable actors to articulate their interests and make them ‘actionable’ (Blyth 2002: 39). The ideational dimension does not determine policy outcomes in a crude cause-effect relationship; it rather enables some actors and constrains others. Finally, ideational pressures are linked to the actors that push strategically for change and alternative definitions of tax policy problems. Thus, we go back to actors and the strategic dimension of policy making.

I.4 Findings: the EU

To answer these questions, we look at direct tax policy as a set of governance arenas rather than a single entity. The major actors are the Member States, the European Commission, and the business community. The European Court of Justice is of course another major player in the tax arena but we consider the ECJ case law as part of the material context constraining and enabling other actors. We will elaborate on this later.

We explain modes of governance by looking at how actors balance power relations across arenas. We argue that there is no actor dominating all arenas.

The Commission has orchestrated the creation of two different governance arenas to balance the power relations between itself, the Member States, and the business community and reduce its ‘capture’ problem. We call one arena ‘harmful tax competition’ and the other ‘corporate tax reform’. For the Commission it is vital to secure a process goal, that is, to make progress on EU direct tax policy. Revenue authorities are the dominant actor in the harmful tax competition arena, whilst in the other one both Member States and the business community play an important political role.

But neither the Commission nor the Member States have controlled the emergence of a third arena dominated by the European Court of Justice.

The selection of one mode or another takes place within the individual governance arenas. In the ‘harmful tax competition’ arena a code of conduct has been negotiated in the context of a tax package including directives and the regulation of state aids with a fiscal component. The Commission has used state aids rules to convince the recalcitrant governments to abide by the code of conduct – a classic example of soft governance in the shadow of hard governance.

The arena of corporate tax reform on the other hand shows a clearer preference for facilitated cooperation. This in turn is explained by the technical complexity of the exercise, the exploratory nature of this arena, and by the political hesitation of the Member States to make progress with directives.

The emerging third arena dominated by the Court of Justice (ECJ) is characterised by hierarchy. The Commission has tried to steer the reaction of the governments to the ECJ jurisprudence by producing communications and recommendations on how to coordinate the response, but the reaction of revenue authorities has been lukewarm. Finance ministers have also tried to react to the ECJ jurisprudence via soft intergovernmental cooperation, but this has produced more discussions than concrete results.

As mentioned, the main actors involved in these modes of governance are the Member States, the Commission, the ECJ and the business community. They gain different things from coor-

dination at the EU level. The Member States secure increased domestic policy autonomy via the protection of the revenue base in the harmful tax competition arena. Pressure groups manage to probe solutions to the tax problems of multinational business in the single market in the corporate tax reform arena, and the Commission pursues a process goal by balancing power relations between the first and the second arena.

In the third arena, both Member States and the Commission would definitively gain from coordination and the use of a cooperative mode of governance, but the Member States insist that cooperation should be exclusively intergovernmental, whilst the Commission would like to use its recommendations to steer the process and control the agenda. So the Commission is not in favour of the creation of a tax body within ECOFIN, whilst the governments do not want to engage in cooperative governance with the Commission in the pilot's seat. The result is that neither the Member States nor the Commission are in control of the third arena, and pressure groups often win. At least so far the jurisprudence of the ECJ has favoured the taxpayer - future decisions may be more erratic.

I.4 Findings: the OECD

The analysis of the OECD campaign for a tax level-playing field is based on the same approach we used for the EU, that is, strategic constructivism. We do not look at the OECD for the purpose of comparing it with the EU. Rather, the idea is to situate EU tax coordination initiatives in the wider context of coordination activities that take place in the OECD. In consequence, most of the empirical research and fieldwork has been done on the EU, with a limited number of interviews on the OECD scene.

We relate the ideational components to the material preoccupations of revenue authorities and the OECD strategy to promote multilateral cooperation. We do not reduce ideas to material pressures and strategic behaviour, however. Harmful tax competition has had its own autonomous impact on the policy process. For a start, it has generated a more political discourse. In turn, this shift in discourse has made political leaders more alert to the problems arising out of unbridled tax competition – with of course a big difference in terms of propensity to cooperate between winners and losers from tax competition. But it has also put taxation on the radar of NGOs, which see an opportunity to transform international taxation into a vehicle for social mobilisation and for a debate on international justice and fairness. Further, harmful tax competition has made the hard questions surrounding the relationship between offshore jurisdictions and the OECD members explicit. Looking inside the business community, the issue of the uses of offshore finance has implications for socially responsible corporations. An embryonic debate on the public interest in international taxation is gradually emerging.

Turning to substantive findings, international tax governance has become more ambitious than in the past and the selection of modes of governance has changed accordingly. The tax policy formulated within the OECD has reached out to third countries and tax havens.

For decades international taxation had dealt with low political salience issues. The OECD was merely a forum for the elaboration of governance instruments to be voluntarily adopted by the members. International tax governance was eminently bilateral and international tax policy was not contested because it was somewhat insulated from wider political debates and the scope of governance was limited. There was high acceptance within networks of specialists and revenue officers.

By contrast, the new world of international tax cooperation is one where tax debates are more political than in the past. The scope of governance has widened, with the OECD (but also the

United Nations and the G7-G8 Ministers) engaged in multilateral coordination. The fact that coordination is fragile if achieved only by a limited number of countries has pushed towards an ambitious attempt to promote the level-playing field outside its jurisdiction. Modes of governance have become more multilateral, and for the first time sanctions have been discussed, thus introducing an element of hierarchy on what was essentially facilitated coordination.

Some achievements can be seen. There has been a process of learning. The OECD has learned that blacklisting and sanctions are less important than establishing a process by which off-shore jurisdictions take commitments to transparency and discuss the scope for exchange of information upon request. The number of uncooperative tax havens went down from 33 to 5. Additionally, tax havens have learned the advantages of transparent tax competition. However, there is still the exception of major financial centres like Monaco and Liechtenstein, which stay outside the framework of the Global Tax Forum, preventing the establishment of a true global level-playing field and raising the anger of those who have committed themselves to the principles of the OECD. But in turn this will create additional pressure to join the vast majority of the jurisdictions that have agreed to the level-playing field.

Another dimension on which achievement should be measured is process. Several processes of dialogue, coordination, and exchange of information have been created since the mid-1990s. The OECD has been the most active player in this area, with initiatives such as the memorandum of understanding and the Global Tax Forum. Future work should look at how other organisations (such as the UN, IMF, the World Bank, and the WTO) are creating clubs for coordination and whether the overall web of clubs and initiatives is efficient.

Finally, it is too early to talk about outcomes in terms of the overall degree of tax competition. Indeed, the whole issue here is not to increase or decrease the level of tax competition. The goal is about limiting some forms of undesirable tax competition. The level-playing field advocated by the OECD is not about setting floors to tax rates or harmonising tax policy.

I.5 The substantive findings

The harmful tax competition arena seems to have reached its peak. The code is already considered an experience of the past, and with the review of harmful regimes in the new Member States some participants feel that the future of the code lies in technical analysis of standstill, that is, making sure that Member States notify potentially harmful regimes and accept to peer review them. Other participants have mentioned the possibility of terminating the code of conduct group because there is not much political momentum for new initiatives in this area. The level of participants in the group chaired by Dawn Primarolo has gone down, from high level tax authorities, often the same people who would accompany their ministers at ECOFIN, to less important figures. The directive on savings was watered down during the negotiations especially in 2003. With its limitations, it represents a tool to implement rather than a template for a new series of initiatives against tax avoidance and tax evasion in the EU. Overall, it is hard to see where the political fuel for this arena may come from, especially after the British red line on tax coordination during the negotiation of the EU Constitution and the current political difficulties of the EU after the French and Dutch no to the referendum on the Constitution.

The idea of relaunching a large-scale debate on taxation with a dedicated ECOFIN body, a European Tax Committee has been ditched for the time being. At the same time, the ambitious plans that characterise the corporate tax reform arena are projected in the future. A future that may lie too far ahead – we would submit – to produce concrete results over the next five years or so. In this case again, the fact that there is no momentum for tax coordination in the EU is the major obstacle. Companies may well get access to this arena, but Member States

are still reluctant to make progress. The main issue in the arena of corporate tax reform is one of technical difficulties compounded by diverging political views. France and Germany have made no mystery of their intention to look at tax base coordination under the condition that ‘this will go hand in hand with a common minimum rate’. In 2004, the then French Minister Sarkozy sounded his EU colleagues on the idea of making the provision of structural funds to the new Member States conditional on the increase of their tax rates. This contrasts with the position of the UK, Ireland, and the Baltic States shows how differently Member States approach the ‘technical’ working group on common base coordination. The gap is eminently political.

With one arena already seen as a legacy of the past and the other being a project for the distant future, and with no possibility to coordinate policy within specific institutional ECOFIN bodies, the current state of affairs looks bleak. But the present is not ‘politically empty’. In fact, it is dominated by an emerging third arena, where the ECJ plays a major role.

The question is whether this emerging third tax governance arena will produce the political determination to either revive the arena of harmful tax competition or to move quickly, with concrete results, in the arena of corporate tax reform. Otherwise Member States may well end up ‘locked in’ a situation where tax harmonisation in Europe is inevitable, but steered by judicial rather than political action. The only way to react to this state of affairs would be – from the perspective of governments – to make progress at the systemic level, but this is exactly the option that was vigorously denied in the first place.

The EU needs the OECD to deliver on the level-playing field goal to succeed in its aim. The final outcome of the EU and OECD activity should not be measured on the degree of tax competition. There may be more or less tax competition as a result of the OECD campaign. Indeed, there is anecdotal evidence of increased tax competition. But the quality of tax competition is changing, from opaque, non-transparent, often unlawful tax competition to a more transparent process in which governments legitimately select their tax policies in order to achieve economic and social goals. The challenge for the future is whether commitment to the new modes of governance, such as the EU code of conduct and the OECD memorandum of understanding, and most importantly to the principles of transparency will also produce concrete action and policy change.

II. Part: New modes of governance in EU taxation

II.1 Tax competition, tax cooperation, and modes of governance

The tax representation nexus and conflicts of preferences between winners and losers in tax competition are serious hurdles to the emergence of multilateral cooperation in international direct taxation. Unsurprisingly then, most of the literature has focused on tax competition (Devereux and Sørensen 2006; Zodrow 2003). Competition is analyzed either as dependent variable (i.e., why states compete, and how; see Tanzi 1995; Genschel and Pluemper 1997) or independent variable (i.e., the impact of international tax competition on domestic policy autonomy, Ganghof 2006; Swank 1998). Most economists tend to portray the problem as a classic prisoner's dilemma leading to a race to the bottom (Gordon 1992). Political scientists have argued that institutions determine the type of race taking place and its outcomes (Hallerberg 1996; Basinger and Hallerberg 2004; Hays 2003).

In the European Union (EU), cooperation in indirect taxation is facilitated by specific Treaty articles and by the commitment to create a single market. But there are no Treaty provisions for direct taxation. EU legislation in this area can be made following general single market provisions in which unanimity in the Council of Ministers applies. The contrast between winners and losers from tax competition (put differently, a stark contrast of Member States' preferences) makes unanimity a serious hurdle.

Yet multilateral tax cooperation exists, as shown for example by the OECD track record in transfer pricing and, over the last ten years, the campaigns for an international tax level-playing field (OECD 1988, Webb 2004). The nature, forms, and specific modes of international tax cooperation are emerging questions on the agenda of governance studies. Tax cooperation has been explored by economists such as Hamada (1976), Gordon (1983), Canzoneri and Henderson (1991), Persson and Tabellini (1995, 2000) and Sorensen (2004). Here we address questions about the emergence, content, and institutionalisation of tax coordination in EU direct taxation by introducing four conceptual innovations.

The point about governance arenas brings us to the second innovation. The international tax literature tends to privilege models based on strategic interaction between two or more governments operating under conditions of economic interdependence. However, governments are only one group of actors involved in the making of international tax policies. There are also other relevant actors, such as the European Commission, pressure groups, and communities of experts¹. Even within the business communities, the preferences of firms towards tax coordination vary depending on the degree of exposure to international trade and other factors (Bernauer and Styrski 2004).

In any case, we cannot assume – as the literature on the economics of tax competition often does - benevolent governments and the possibility of making binding commitments in the international political arena losing sight of domestic and international constraints on government behaviour and the independent choice of actors like interest groups.

When the research focus changes from tax competition to tax cooperation – we argue – it is useful to draw on a richer form of strategic interaction approaches, based on three types of actors. In our report, we consider governments, EU institutions, and pressure groups. The European Court of Justice (ECJ) is another, increasingly important, actor in the field of EU

¹ The European Parliament plays no formal role in direct taxation, which is on the EU level exclusively dealt with by the Council. Civil society organizations concerned with taxation, such as the Tax Justice Network, have appeared on the stage in recent years but their influence is still very limited.

direct taxation. Legal scholars hotly debate if the Court has in fact a political agenda towards tax harmonization (Graetz and Warren 2006) or has to be seen as a mere interpreter of the Treaties and the four freedoms (Gammie 2003). In this report we follow the approach that the ECJ has no political tax agenda other than ruling in favour of the abolishment of cross-border obstacles and the completion of the single-market². Thus, we consider the Court being part of the material context of actors in the EU direct tax area rather than as an actor in its own right.

Thirdly, the conventional approach to strategic interaction looks at the ‘race’ and its outcomes (‘race to the bottom’ or ‘tournament models’ are classic examples, see Hallerberg 1996; Basinger and Hallerberg 2004). This approach does not say much on the policy-making process³. Another limitation of the race-inspired models is that they downplay the role of ideas. By drawing on a variety of strategic constructivism based on the concept of governance arenas, we explain how arenas emerge as a result of material pressures, ideas championed by skilful actors, and preferences. Political strategy uses ideas as repertoires of concepts that can mobilize actors and make them think reflexively about their preferences. Theoretically, this third innovation is based on a combination of an actor-centred approach and strategic constructivism as defined by Jabko (2006).

Fourthly, the choice to study direct taxation rather than tax policy as such is in contrast with the conventional assumption that the best level of analysis is the policy. Instead, we show that even within direct taxation there are governance arenas that respond to different political logics.

We first sketch briefly the evolution of cooperation in EU direct tax policy in terms of modes of governance (rather than in terms of policy instruments). We then draw on strategic constructivism and empirical observation to explain how actors respond to the material and ideational context and choose a mode of governance rather than another. Modes of governance are dependent variables in our analysis. We show that the choice of one or another is the result of the political logic that characterizes a specific arena. By focusing on three main actors, that is, the Member States, the Commission, and the business community, we show the emergence of these functionally differentiated governance arenas and explain the different political and interactional logics within them. The conclusions present the results and the implications of our analysis.

II.2 Pressures, ideas, and strategic interaction

One striking feature of EU tax cooperation is that, in terms of governance, it is impossible to detect a linear development from traditional ‘Community method’ governance to softer and more informal modes of cooperation. Following Majone’s account of the decline of the classic Community method (Majone 2005), one would expect a steady decrease of binding legislation and an increase of more flexible forms of tax coordination. But this is clearly not the

² There seems to be a divide between American and European tax lawyers on this issue (see Lang 2007 for a collection of articles resulting from a conference on the ECJ tax activities in comparison to the Supreme Court’s tax law). While most European scholars consider recent Court decisions, however troublesome for national revenue authorities, coherent with its task to ensure a functioning single market, US-American scholars tend to draw comparisons and parallels to the US Supreme Court and therefore, unsurprisingly, attest the ECJ a stronger political will of its own.

³ This is of course a simplified representation of the tax literature. We are aware that there is more recent work attempting to explain why the predicted ‘race to the bottom’ never actually took place, taking domestic constraints and de facto mobility of capital into account (for an excellent sophistication of classic tax competition models see Troeger 2007). However, our argument still holds that the policy-making process and the role of ideas have been largely neglected so far.

case. Dichotomies (i.e., ‘old’ versus ‘new’, classic Community method versus new modes of governance, hard law versus soft law) cannot be used in this context.

Four elements must be considered. Firstly, instead of a dichotomy between ‘old’ and ‘new’, one should situate direct tax initiatives on a continuum. Closer to the pole of soft modes of governance are the initiatives for corporate tax reform (such as the Working Group on Common Consolidated Tax Base established in 2004 and the Transfer Pricing Forum) and the Arbitration Convention on transfer pricing disputes of 1990.⁴ The code of conduct on business taxation, adopted in 1997, is also close to the pole of soft alternatives to traditional EU regulation, but it is ‘hardened’ by the fact that it was negotiated within a package comprising two directives (on taxation of savings and on interest and royalties) and rules for state aids with a tax component (Radaelli 2003). Turning to the pole of more formal modes of governance, the Community method has been used in different periods of time, specifically in 1990 (parent-subsidiary and merger directives) and 2003 (savings directive). There is no clear trend over time.

The European Court of Justice (ECJ) has gradually increased its jurisprudence in direct (personal and corporate) taxation over the last 20 years. Corporations have found out that it is profitable to try to bring cases to the Court, because, roughly speaking, decisions tend to favour the taxpayers. However, the Court’s jurisprudence may be moving towards a closer consideration of the implications of its decisions on the budget of the Member States – and balance this with the legitimate interests of the taxpayer (Lang 2005; Raedler 2005). The impact of ECJ rulings on domestic tax rules has been considerable (Farmer 2003).

Secondly, the EU has pursued different goals across the years, from providing tax neutrality in the single market to fighting harmful tax competition, and, most recently, creating the pre-conditions for comprehensive corporate tax reform at the EU level. The agenda has been redefined more than once.

Thirdly, the selection of modes of governance responds to political transaction costs (Epstein and O’Halloran 1999). When the political costs of reaching agreement in the Council on directives are prohibitive, the EU looks at soft tools like the transfer pricing forum, the code of conduct on business taxation, pilot projects on home state taxation, and technical groups on consolidated common base taxation. However, this notion is too general. The whole EU direct taxation is a territory of (high) political transaction costs. Further, there is the above-mentioned problem that the substantive content of the policy initiatives varies to a large degree: some initiatives target the issue of harmful tax competition; others deal with corporate tax reform. The decisions of the European Court of Justice add another dimension, where the main policy problems are discrimination and tax barriers in the single market.

Fourthly, it would be wrong to assume that an organisation like the EU is a unitary actor. It is a political system in which ‘actor constellations’⁵ interact. One has to provide a parsimonious description of the main actors to explain why the agenda is redefined, when, and with what choices in terms of modes of governance. Actors operate in an institutional context. We agree that the interaction of actors in the shadow of EU governance rules is fundamental, but we also consider material pressures and ideational dynamics. In doing so, we subscribe to Jabko’s theoretical position to keep material pressures, ideational forces and institutional rules distinct

⁴ For a detailed description of the individual instruments see http://europa.eu.int/comm/taxation_customs/taxation/company_tax/gen_overview/index_en.htm and Picciotto 2003.

⁵ According to Scharpf 1997:44 a constellation of actors ‘describes the players involved, their strategy options, the outcomes associated with strategy combinations, and the preferences of the players over these outcomes’.

in the analysis of EU governance. Ideas and institutions filter material pressures, but ideational frames and institutional rules are activated via political strategy (Jabko 2006). Strategy is often the product of an entrepreneurial actor, who brings ideas into the policy process in order to create consensus among constellations of actors.

Our variety of strategic constructivism draws on the following elements:

1. Constellations of actors – namely three types of actors, EU institutions, governments, and pressure groups.
2. Interaction in institutional settings that reduce empirical variance. Institutions provide rules and styles of interaction. The most important styles of interaction are hierarchy, negotiation, and learning-facilitated coordination. Given the EU institutional context, we consider the preferences of actors in terms of process and outcome.
3. Institutional rules and styles are fundamental, but the political logic of tax coordination is also sensitive to material pressures and ideational dynamics. The material dimension includes both economic and legal pressures, which demarcate the boundaries of what is politically possible. Of course, the actors can interpret these pressures in different ways. Ideational filters matter.
4. Turning to ideas then, they provide the definition of the EU tax policy problems (alternative problem definitions include: harmful tax competition, corporate tax reform, tax discrimination and barriers to the single market) and discourses (in various guises, but often in the form of policy narratives). Ideas enable actors to articulate their interests and make them ‘actionable’ (Blyth 2002: 39). The ideational dimension does not determine policy outcomes in a crude cause-effect relationship; it rather enables some actors and constrains others.
5. Finally, ideational pressures are linked to the actors that push strategically for change and alternative definitions of tax policy problems. Thus, we go back to actors and the strategic dimension of policy-making. We then end up in a position that is very close to Jabko’s strategic constructivism and Radaelli’s argument about the interplay between interests and ideas (Jabko 2006: 26-27; 39-41; Radaelli 1995).

Put differently, we have to account for material pressures, ideational pressures, and strategic behaviour in governance arenas where multiple actors interact. Material pressures limit the range of options available to actors. Ideational changes make tax policy problems more or less visible and understandable to actors. Most importantly, ideas provide meaning to material pressures and contribute to the identification of interests so that actors can act upon them. Following Hay (2002, chapter 6) and Radaelli (1999), we do not rule out the hypothesis that tax narratives and policy ideas can change the preferences of actors. Finally, once material and ideational factors have been identified, in order to explain change we have to show how actors use them strategically, and the modes of interaction.

Material pressures on Member States arise out of economic integration in Europe and ‘globalisation’. Without necessarily drawing bold inferences from functionalist explanations, there is no doubt that the single market has exposed the role of tax barriers and distortions and has made discussions on corporate tax reforms more urgent. At the same time, an integrating world economy has magnified the role of tax competition. In turn, this has contributed to the degradation of domestic tax systems (Tanzi 1995; Avy-Yonah 2000) and to the emergence of a discussion on harmful tax competition at the OECD and in the EU.

In terms of pressures within the EU, however, the single major factor is the jurisprudence of the ECJ. Although the Treaties do not envisage large-scale intervention of the Court in direct

taxation, tax regulations and entire tax laws have been struck down by the Court in more than one hundred cases. The ECJ has targeted both overt and covert discrimination (between a resident and a non-resident company, provided that they are objectively comparable). It has also attacked the tax barriers to the exercise of freedoms in the single market – derogations are possible only to protect the public interest. This has been conceptualised by the Court as the need to safeguard the cohesion of the tax system, to protect the efficiency of fiscal supervision, and to prevent tax evasion. However, Member States have to demonstrate that the tax measures used to protect the public interest are appropriate, necessary, least onerous, and proportionate (Gammie 2003: 93). The legal pressures of ECJ jurisprudence amount to revenue losses when the Court strikes down domestic tax rules. They also create imbalances in the overall tax system: the ECJ decides that a rule is incompatible with the Treaties; it does not say how it should be substituted. As Member States have not agreed on a coordinated response to the ECJ and have not managed to rein in the Court, the overall impact (as seen from the point of view of domestic revenue authorities) is erratic.

Material-legal pressures are interpreted via ideational filters (Blyth 2002; Hay 2002; Steinmo 2003 adds the ideational filters evolve). Two ideational factors have played a role. One is the policy narrative of harmful tax competition (Radaelli 1999). Although both the European Commission and the OECD have engaged in the promotion of this narrative, it is at the EU level that explicit connections have been made between harmful tax competition, the degradation of tax systems, the imbalances between capital and labour taxation, and negative implications for the European ‘social model’. Ideas and interests are intimately connected: more often than not, new ideas enter the policy debate only if an actor or a coalition of actors ‘pushes’ them. Narratives such as harmful tax competition do not land on the policy stage as *deus ex machina*. They have been pushed by ideational entrepreneurs. The Commission has been an active ideational actor. The 1996 Commission’s paper to the informal ECOFIN meeting of Verona is considered the starting point of the rise of harmful tax competition in the EU debate (Commission 1996a; 1997b; Radaelli 1999).

The other ideational factor has been generated by the business community and EU level think tanks. In the 1990s, a small team of tax lawyers (sometimes referred to as the Stockholm group⁶) elaborated ideas for EU corporate taxation, which, instead of starting from harmful tax competition as the main problem, focused on the presence of then 15 different tax rules, and obligations for companies. The Group met in October 1998 and January 1999 and drafted early ideas that could form the basis for further consideration of a proposal for home state taxation in Europe. The idea of home state taxation (see Lodin and Gammie 2001) developed from the research by Malcolm Gammie during his 1998 Unilever Chair in International Business Law at Leiden University.

Proposals for corporate tax reforms, including common base taxation and home state taxation, were then comprehensively assessed in two task forces established by the think tank Centre for European Policy Studies (CEPS 2000; 2001). The CEPS task forces included some 30 members of the business community. They provided a forum for a closer dialogue between business, the Commission, and the Council’s top officers.

⁶ The Stockholm Group comprised the following individuals: Sven-Olof Lodin, Albert Raedler, Robert Baconnier, Ad van der Kinderen, Malcolm Gammie, Jim Hausman, Hugh Ault, and David Tillinghast. The Group met regularly since 1993 to discuss the development of the corporate tax systems in their respective countries and the development of corporate tax systems within Europe and internationally.

II.3 The emergence of functionally differentiated governance arenas

There are several actors involved in EU direct corporate taxation, including the European Parliament and civil society organisations. Here we focus on the Member States, the Commission, and the business community.

The preferences can be sketched as follows. To begin with, the business community is not a unitary actor. The preferences for tax coordination may change depending on whether a company is exposed to international trade or not, the sector, and other variables, as shown by Bernauer and Styrski (2004). However, as far as EU direct tax coordination is concerned, it is fair to say that the main goal of the business community has been to impose an agenda based on the elimination of the tax obstacles encountered by firms operating in the single market. The role of the business community in terms of ideational politics has been to push for a redefinition of the EU tax policy agenda and to provide templates for possible solutions to the tax problems encountered by business in the single market.

Turning to the Member States, represented by revenue authorities and finance ministers, their main goal is to guard the revenue base - although they also want to attract foreign investment and mobile capital via a competitive tax environment (Sinn 2003). Concessions to the goal of policy coordination can be made when negotiations take place at the highest political level and there is diffuse political determination to crack down on 'clear and present' dangers (in the perception of Ministers). Otherwise technical negotiations with the Member States' revenue authorities are always characterised by the preference for the status quo. To conclude, Member States' goals can be specified in terms of outcome rather than process. Member States have of course different pay-offs from tax cooperation. Some are winners and some are losers in the tax competition game - they approach cooperation from radically different positions.

As for the Commission, Brussels has a process goal, that is, to formulate policy and make sure that political discussion leads to an agreement. But there is also a goal in terms of outcome. The Commission has changed strategy on several occasions since the early days of the Community. In the 1990s, it changed from a single market and business-friendly strategy (as evidenced by the proposals of Commissioner Scrivener at the end of the 1980s and the idea to establish a committee of experts and business leaders chaired by Onno Ruding) to Monti's strategy against harmful tax competition (Radaelli 1999). The latter was much more palatable to Member States than the former.

The legacy of the past provides an important learning point for the Commission. The tax strategies pursued in the 1990s by Brussels were characteristically unbalanced in terms of power relations. Scrivener's approach based on tax neutrality in the single market was biased towards the interests of multinational firms. Monti's strategy was more sophisticated. It revolved around a two-step approach, based on the elimination of beggar-thy-neighbour, harmful tax practices in the first stage, and then on the completion of a single market without tax barriers (step 2). Chronologically, however, it was step 1 that dominated the scene between 1996 and 2000. The problem was one of power relations, this time too close to the goal of the tax authorities to guard the revenue base.

This is a classic catch-22 situation. Each time the Commission got one actor on board (governments or corporations), it lost the support of the other one. This is how a goal in terms of outcome emerged within the tax directorate of the Commission (DGTAXUD). It can be described as the goal of balancing power relations.

One obvious way to balance power relations is to have a high-level body in which the preferences of the governments and the business community can be accommodated. Systemic coor-

dination in one single, high-level governance arena is possible only if there are shared beliefs on the final goal of tax coordination. Preference heterogeneity would not prevent the emergence of systemic-level cooperation if the final benefits of coordination were clearly specified and agreed.

But this is not the case. Hence, it is impossible to balance power at the macro-systemic level, that is, a level where all major tax issues, including harmful tax regimes, corporate tax reform, and the implications of the tax decisions of the ECJ, can be comprehensively assessed. Unanimity and the rhetoric of some governments about ‘red lines’ and ‘strong opposition’ to tax coordination make systemic-level coordination around an explicit, shared final goal a chimera⁷.

This has led the Commission to the development of a political strategy based on functionally differentiated tax governance arenas. Preferences are accommodated, and the capture problem of the Commission is eased, but only across arenas, not within a single individual arena.

Governance arenas in direct taxation have the following properties. Firstly, they provide distinct rules for the selection of participants, modes of interaction and decision-making rule. Secondly, arenas evolve around different ideas. The precise meaning of tax coordination (that is, what tax coordination is supposed to fix) varies across arenas, due to the ‘skilful playing’ (in the sense of Jabko 2006:37) of ideas by strategic actors. Thirdly, tax arenas have emerged diachronically, not simultaneously, as a result of a political strategy in which some goals had to be achieved before constellations of actors could move on to other goals. Finally, arenas empower actors differentially (in order to balance power relations across arenas some actors can be pivotal in some arenas but not in others) and enable actors to choose their own policy instruments. The choice of a more formal or more informal governance instrument takes place at this (sub-systemic) level.

Over the last ten to fifteen years, two main governance arenas instigated by the Commission have emerged, that is, the arena of harmful tax competition and the arena of corporate tax reform. However, a third emerging arena dominated by the ECJ is becoming increasingly relevant.

II.3.1 The harmful tax competition (HTC) arena

This arena developed in the second part of the 1990s, further to the 1996 Verona paper of the Commission and the 1997 ECOFIN agreement on the main components of a tax package to handle tax competition. The major innovation has been the identification of a policy problem, i.e. harmful tax competition, combined with solutions that, taken together, could turn individual negative-sum games into a larger positive-sum game.

The main actors in this arena are the Member States and the Commission. The style of interaction is eminently negotiation. The savings directive is the best example, but the whole discussion around the tax package has followed a negotiation style, although there are elements of hierarchy (in the area of fiscal aids) and facilitated coordination (in the code of conduct). The material context is characterized by globalization and deep economic integration in the single market. The ideational variables work via the mobilizing aspects of the narrative of harmful tax competition. The selection of modes of governance is politically contingent in

⁷ Note, that when we say Commission we largely talk about DG TAXUD. The Commission in itself is not always a unitary actor, as shown by Irish Commissioners McCreevy’s reaction to the proposals of a common tax base by the end of 2008 (made by tax Commissioner Kovazc in 2005). He stated that tax harmonisation was not and would not be on the Brussels agenda whether ‘by the front door or the back’.

that within this arena there is no clear preference for one mode of governance or another. What matters is the political result of combining more formal and more informal modes.

As mentioned, negotiation in this arena was quite longsome. Although some of the most controversial measures gained extensions, the code of conduct (examined by Radaelli 2003) has had an impact. It is not easy to pin down the notion of ‘impact’, but certainly there has been an effect in terms of socialization processes within the code of conduct group. Member States have accepted the principle of peer review of harmful tax regimes. It has to be observed, however, that socialization has been limited to the Member States. All meetings and documents have been protected by strict confidentiality. Parliaments, civil society organizations, and business have been kept out of the code. There has been an impact on specific regimes in the Member States and their dependent territories - most measures are being rolled back, although some dependent territories are thinking of moving from selective tax concessions to across-the-board tax competition.⁸ The latter, although acceptable under the specifications of the code, can trigger races towards the bottom (Keen 1999). The overall business climate has also changed. In our interviews with accounting firms, the opinion was expressed that ‘the code has had an effect. It absolutely changed the way people do their tax planning. And it also changed the strategies of governments’, although the statement was clarified: ‘Some countries still play the game. Maybe the effect is not permanent after all’ (Interview at a top-5 UK consultancy, 23 May 2005). On balance, there is evidence of embryonic institutionalization of a mode of governance based on peer review, soft pressure, and commitment to rollback harmful measures.

The directive on savings entered into force just on 1 July 2005. Switzerland and other European third parties (such as Andorra, San Marino, Liechtenstein and Monaco) were supposed to adopt equivalent measures to the Member States for the directive to be agreed by the Council. After years of negotiation, the EU and Switzerland finally agreed in October 2004. However, banks and financial advisors in Switzerland and elsewhere have already advertised financial products that are not affected by the directive. Additionally, the directive does not tackle trusts. The driving idea of automatic exchange of information has been dented by extensions granted to Austria, Belgium, and Luxembourg. The three Member States will collect withholding taxes instead for a long transitional period, until 2015. The Financial Times called the compromise ‘unacceptable’ and demanded a ‘solution that does not destroy the credibility and effectiveness of information exchange’⁹. Even the OECD criticized the agreement, fearing that the global effort on cracking down on tax havens would be undermined by EU plans that allow some of their jurisdictions to maintain bank secrecy (Gnaedinger and Radziejewska 2003).

Finally, the procedures against tax aids (i.e., state aids with a tax component) have been used successfully to put pressure on Member States in the context of the negotiation of savings and the rollback process of the code. In July 2001, the Commission launched the state aid procedure against no less than 15 fiscal aid regimes. The idea was to increase pressure on Finance Ministers by using the state aid procedure. The Commission noted in its 2004 report on state aids relating to business taxation that: ‘The Commission’s state aid work, carried out in paral-

⁸ The Isle of Man is currently planning to introduce a zero tax rate across the board (see the Isle of Man Treasury Income Tax website: <http://www.gov.im/treasury/incometax/strategy/tax.xml>) while Jersey is following a zero-ten tax strategy (States of Jersey, Finance and Economics Committee (2005) Fiscal Strategy, p. 44, 8 March).

⁹ Financial Times Editorial ‘Reject the squalid tax compromise’ 17 January 2003, page 10.

lel with the code of conduct work, has facilitated the conclusion of an agreement on the code of conduct’ (Commission 2004:19).

Different modes of governance, such as the ‘soft’ code and the ‘hard’ directive on savings and state aids, have been used strategically to reinforce each other in the same governance arena. Some Member States have not liked it, and argued that the Commission could not demand agreement on a soft learning process within the code, and at the same time dangle the Damocles’ sword of the Treaty-based state aid procedure on the recalcitrant governments. But this is precisely what the Commission’s political strategy was trying to achieve.

II.3.2 The corporate tax reform (CTR) arena

The main actors in this arena are the business community, the Commission (sometimes with a key role played by individual Commissioners), and, often reluctantly, the Member States. The material pressure is provided by the fact that economic integration in Europe exposes the tax obstacles to genuine cross-border and multinational economic activity in several areas, such as transfer pricing, tax treaties, dividend taxation, exit taxation, and so on. The major ideational variables are competitiveness and the abolition of tax barriers to economic activity in the EU. The Lisbon agenda, with its insistence on competitiveness, is often mentioned by actors involved in CTR (Commission 2005), although the discourse on corporate tax reform predates Lisbon as it was shaped by the Stockholm group. The style of interaction is facilitated coordination. The modes of governance are more informal than in the harmful tax competition arena, and in some cases there is an emphasis on participation (limited to the business community, although some Member States hesitate about opening up the policy process).

The change of Commissioners obviously mattered when looking at the development of a corporate tax reform agenda (see Smith 2003 on the role of Commissioners in EU politics). Commissioner Bolkestein was less interested in playing in an arena characterized by a package that was linked to Mario Monti and dubbed ‘Monti package’ by the press. A former high-level Commission official stated in an interview for this project (12 May 2005):

‘The code of conduct and the whole tax package was based on the direct involvement of the Commissioner. Monti chaired practically all meetings. He insisted with the governments to get the best people in the Tax Policy Group and the Primarolo Group. [...] When Bolkestein arrived, he was not so interested in chairing meetings. [...] Bolkestein had a set of priorities, they were well known, and it is a fact that taxation was not one of his priorities’.

Commissioner Bolkestein put more emphasis on corporate tax reform than on the fight against harmful tax competition. As mentioned, it has always been an issue for the Commission to balance power relations. As soon as Brussels felt that some progress was being made in the HTC arena, it released a communication with the following plan of action for CTR: “Now that the work on the tax package seems to be progressing satisfactorily, increased attention must be paid to the removal of these obstacles. It is high time to put much more emphasis on the concerns of the EU taxpayers” (Commission 2001a; 20). The point was reiterated in a 2005 document, arguing that the elimination of harmful tax regimes was meant to re-establish the integrity of the tax base in the interest of the fiscal authorities. Having eliminated the main elements of fiscal degradation, the EU should eliminate the main fiscal obstacles to economic cross-national activity and turn to the preoccupations of European taxpayers (Aujean et al. 2005: 12-13). This is an important element of political strategy: the two arenas developed diachronically because the Commission had a clear priority of goals in mind and wanted to achieve goals in the HTC first. But the ideas, in this case, were provided eminently by the business community.

Following the proposal for home state taxation by the Stockholm Group, ECOFIN had already requested the Commission in December 1998 to carry out an analytical study on company taxation in the European Union. The Permanent Representatives Committee (COREPER) refined this request into a final mandate in July 1999. This study – COREPER (1999:2) argued - should examine differences in the effective level of corporate taxation and identify the main tax provisions that might cause distortions in the cross border economic activity in the Community. In October 2001 the Commission published the results of the requested study in the communication “Towards an Internal Market without tax obstacles” (Commission 2001b). The study included an economic analysis of taxation and the results of a panel of business experts on the key tax obstacles to the single market. Since then, the Commission has launched several initiatives for corporate tax reform (on transfer pricing and a common consolidated tax base). They fall outside the classic Community method. This suits the political logic of the CTR arena rather well, given its long-term nature, the problem-solving attitudes of bodies like the Transfer Pricing Forum and, most importantly, the effort to tone down the political implications of tax base coordination – the Commission has insisted on the technical nature of the exercise, knowing that revenue authorities in countries such as the UK and Estonia fear that soft governance will lead to draft directives on the harmonization of the tax base and to the consideration of minimum rates for corporate taxation (Ruding 2005; interviews with DGTAXUD and revenue authorities in Germany and the UK, 2005).

On the one hand, this arena scores well on transparency and participation, at least with reference to the Transfer Pricing Forum and the consultation process for the pilot project on home state taxation. On the other hand, the Common Consolidated Tax Base Working Group refused to have permanent non-governmental experts participating, although they agreed on building an expert group that can be consulted on request. Some members of the Group even wanted to keep meeting records unpublished until informed by Commission services that there is an obligation imposed by the Council and the European Parliament to disclose working documents, the same as for the meetings of the Joint Transfer Pricing Forum (CCCTB WP 2004:5). The business community does not like the fact that the group is not permanently open to them:

‘Having established that we have a favourable opinion of the CCCTB Working Group; we have put forward a number of reservations. [...] UNICE would have preferred a working group of the Council, modelled on the successful experience of the transfer pricing forum. The CCCTB Working Group is not permanently open to companies; it is essentially a group of member states’ delegates. We are consulted, but who knows what’s going to happen in the future?’ (Interview with a representative of a national federation of industry, 6 May 2005).

It is difficult to evaluate this arena. Some of the exercises are highly ambitious and technically complex. A common consolidated tax base, for example, requires a detailed analysis of accounting standards and their relation with the tax concepts. The pilot project on home state taxation for small and medium sized enterprises went through an extensive consultation process and has entered a trial period of five years. The Transfer Pricing Forum has produced a code of conduct for the effective implementation of the Arbitration Convention (Council 2005) but it deals with a wide range of issues - from practical functioning of the Arbitration Convention to documentation requirements and the suspension of tax collection, interest and penalties. On some issues, specifically documentation requirements, business and Member States have different positions. The Commission extended the Forum’s mandate for another two years in 2004, acknowledging that progress has to be made slowly.

More crucially, one major problem is the declining political attention to EU taxation. Some governments think the tax package has delivered what it could, and there are no other urgent issues to address at the moment: ‘There is no political explosiveness behind it anymore and the things we deal with are purely technical’ (Interview with a member of the Code of Conduct Group, 19 May 2005).

The arena of corporate tax reform is dominated by informal governance modes dealing with technically complicated and long-term oriented issues. If political determination across arenas is decreasing, it will be difficult to find the political determination necessary to agree on these far reaching matters and achieve concrete results in corporate tax reform.

II.3.3 The emerging arena of judicial tax policy

For the domestic tax policy makers interviewed for this project, the major source of pressure is neither globalization (via races to the bottom) nor the code of conduct. Instead, it comes from the Court in Luxembourg. Companies and banks discuss the decisions of the ECJ more often than any other EU tax topic. Both companies and policy-makers are performing a number of risk-assessment exercises to see whether tax rules will stand up to future judgments of the Court.

The Commission has sought to use the ECJ decisions strategically, arguing that the ECJ policy impact is asymmetrical: “even when a ruling forces a number of Member States to introduce new tax rules, they often do so in vastly different ways” (Commission 2001a: 22). In its 2003 Communication, the Commission proposed the adoption of informal governance, especially recommendations (prepared by non-papers, working papers, and informal discussions) to provide guidance and “pro-active coordination of those features of Member States’ tax systems that are or are likely to be in conflict with EU law” (Commission 2003: 7). Accordingly, Brussels issued Communications on the tax treatment of occupational pensions (2001), investment funds (2000), dividend taxation (2003), exit taxation and cross-border loss relief (2006). There were plans to also publish recommendations on thin capitalization rules, controlled foreign company legislation – all issues targeted by important ECJ cases. Edward Troup, an expert who has worked both for the private sector and the Treasury, has argued that too many pieces of the tax systems are being carved off by the ECJ. He has also noted that:

‘Herein lies the rub: the only corporation tax system truly compatible with those freedoms is a fully harmonized one [...] As long as harmonization is off the agenda, EU governments should establish new parameters for the application of the single market rules to taxation, before they find they have no corporation tax revenues left to defend.’ (‘Europe is losing control of company taxation’, www.FT.com, 4 February 2003)

The reaction of Member States to the Commission’s Communications has been lukewarm. In June 2005, the UK decided to launch an inter-governmental initiative for the reduction of the ECJ powers in tax legislation in the context of the British Presidency of the EU, and the German finance Minister Hans Eichel asked at the June 2005 ECOFIN Council to set up a reflection group to consider the implications of ECJ tax decisions.¹⁰ We are not aware of any plan of action on this, although there have been a few very recent attempts to coordinate the posi-

¹⁰ This is what was reported by EuroActiv.com on 20 June 2005. The official press release of ECOFIN from 12 June 2005 is more laconic: ‘Over lunch, Ministers discussed the budgetary impact of judgements delivered by the Court of Justice in the field of taxation’. See http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ecofin/85253.pdf

tion of some member states at major Court's tax hearings. Perhaps we are witnessing some embryonic inter-governmental coordination, but without the involvement of the Commission. In the meantime, ECJ cases provide uncertainty on the future of domestic tax systems. The cases take a long time, and this may prevent the Commission from presenting proposals, knowing that a case on the issue is pending at the Court. Brussels is not gaining any political capital in this governance arena.

II.4 Conclusions

We have examined EU corporate direct tax cooperation by focusing on the selection of modes of governance. In contrast to traditional scholarship, we have taken a multi-actor governance perspective rather than looking at tax rates or policy instruments. In contrast to explanations based only on political preferences or 'the consequences of globalisation', we have shown how taking the ideational dimension of politics into account can modify strategic approaches. Ideas and knowledge, however, enter the policy process via interests and political strategies - a point made originally by Radaelli (1995) and recently revived by Jabko's strategic constructivism. The emergence of functionally differentiated governance arenas is explained by material and ideational factors that provide the context, but, crucially, actors' strategies make the difference. The Commission's preferences in terms of power relations across arenas explain the emergence of arenas across time.

In comparison to other studies (especially Jabko 2006), our analysis is more explicit on the limitations of political strategy. The Commission has successfully contributed to the emergence of two arenas, but although it has tried to use the ECJ jurisprudence to convince governments to go ahead with tax reforms coordinated by Brussels, the third arena is well out of control of the Commission. There has been political entrepreneurship on the part of the Commission, but it does not mean that Brussels has really succeeded in securing legitimacy for tax coordination. Turning to modes of governance, they are dependent variables in our analysis: the choice of one mode or another is the result of the political logic that characterises a specific arena. So our conclusion is that we have to look at arenas within policies to understand modes of governance. This is in contrast with much of the literature, which has privileged the policy level.

III. Part: Modes of governance in international tax policy

III.1 Introduction

The main objective of this third part of the final report is to situate the EU initiatives in the wider context of international tax coordination. Thus, we do not compare the EU and the OECD – strictly speaking, comparison between two organisations that differ so much in terms of their political characteristics and membership is not very informative. However, we relate the EU scene (examined in Part 1) to the OECD for substantive and theoretical reasons. Substantively, we can establish what the EU can achieve only by looking at whether there is a wider framework for coordination outside the Union – otherwise undesirable tax competition will simply spill out the EU to OECD jurisdictions that are not member of the EU. The OECD has also a fundamental role in getting third parties, such as offshore centres and tax havens that are neither members of the EU nor of the OECD, into the framework of a tax level-playing field. Theoretically, we wanted to probe our strategic constructivist approach by looking at tax coordination in an arena different from the EU.

Specifically, we examine modes of governance in international taxation by addressing the following questions. Firstly, looking at the initiatives instigated by the major player, that is, the Organisation for Economic Cooperation and Development (OECD), there has been a shift regarding modes of governance. In the 1990s, the OECD changed its role from a body eminently concerned with policy templates for bilateral tax coordination (such as the model treaty convention) to an agent of multilateral tax cooperation. We are not interested in whether the OECD is an autonomous agenda setter or a diligent agent of its member states. One way or another, the OECD has contributed to a redefinition of the scope and contents of governance and one has to explain the structural and strategic forces at work in this process of change.

Secondly, like in the case of EU taxation presented in Section 2, structural-strategic components are only part of the story. Ideational politics has also played a role. Harmful tax competition has provided a focal point for the initiatives of all the major organisations involved in the creation of multilateral tax governance – not only the OECD, but also the EU, the United Nations, and the G7-G8-G20. The question arises why has harmful tax competition become an idea whose time has come?

Thirdly, governance has also changed in terms of style. We refer to the increasing politicisation of the discussion on international tax organisations and tax coordination. What are the causes of politicisation? Does it produce less legitimacy for organisations such as the OECD? Or is politicisation a vehicle for policy learning, and if so how?

The fourth question is about what has been achieved. We cannot handle this question without specifying different types of achievement. Accordingly, we measure achievements in three broad categories, that is, (a) the creation of specific processes for mutual cooperation, exchange of information, and tax cooperation; (b) policy learning at the level of the major players (that is, the OECD, the member states, and offshore jurisdictions); and finally (c) outcomes (for example, whether a level-playing field has emerged and is affecting the degree and type of tax competition).

Before we start, we have to specify the relationship between international tax coordination and the broader discussion on modes of governance. In regulatory theory, political science, international relations, and European Studies there is a lively debate on ‘new policy instruments’, ‘informal governance’, ‘soft law’, and alternatives to ‘traditional command and control regulation’ (Abbott and Snidal 2000; Christiansen, Follesdal and Piattoni 2003; Heritier 2003; Howlett and Rayner 2006). We borrow from this discussion the idea of a continuum

between formal and informal governance. We define formal governance in international taxation as binding measures operating in the shadow of sanctions, with a high degree of rigidity (typically, they are applied to all members of a political organisation without opt-out options). By contrast, informal governance is non-binding, operates in the shadow of political determination to act (as opposed to sanctions), and it is often based on ‘a la carte’ options. We see formal and informal as poles of a continuum¹¹.

But in all cases (formal as well as informal governance) the key actors are Finance Ministers and revenue authorities meeting in organisations like the OECD. There is no important aspect of tax policy that is entirely delegated to the self-regulation of social actors. Moreover, the notion of international tax governance does not imply high degrees of institutionalisation of governance. The ‘international tax order’ is a metaphor. Thus, we should perhaps say ‘embryonic tax governance’: there is more chaos than order in this notion.¹² Accordingly, we would expect informal governance to be the default mode in international tax policy.

This does not mean that governments are always the winners. We argue that they will always participate, but winners and losers may change. Indeed, one theme in the history of international direct taxation is that it started with business as the main beneficiary of informal governance, whereas recent patterns seem to benefit revenue authorities more than business interests (see section 2 for an analysis on the EU). The preferences underlying the political economy of international tax policy have changed over time.

The academic debate often indicates informal governance as ‘new’ – to contrast it with the rigidity and formality of ‘old’ governance. This is misleading as far as taxation is concerned. Here, informal governance is ‘old’. The League of Nations experimented with soft mechanisms used for the diffusion of principles of income taxation in the first part of the last century. Principles, rules, and instruments were then somewhat institutionalised by the OECD in the context of the model treaty convention and transfer pricing guidelines.

In recent years, the OECD has ‘hardened’ its approach to modes of governance in three directions. First, the OECD – as mentioned - has stepped up gear from bilateral solutions for adoption by member states (note that even the single articles of the tax treaty convention can be adopted with flexibility and the insertion of special clauses by governments) to multilateral initiatives.

Second, the OECD has sought to produce policy change in offshore jurisdictions, thus effectively proposing a more formal definition of its worldview of a ‘fair tax world’.

Third, at least in some critical junctures, the OECD has made use of the shadow of sanctions to put pressure on recalcitrant jurisdictions. Thus, there is no general trend, but movements along the formal-informal continuum that have to be explained.

We first present a concise overview of the events. We then discuss the recent OECD initiatives, looking at the interplay of formal and informal governance and the implications in terms of style. We move on to questions about scope of governance, ideational politics, and politicisation. Finally, we discuss the theoretical implications of our analysis and provide an assessment of what has been achieved so far.

¹¹ In both cases we deal with multilateral tax governance, although the distinction formal-informal can also be used to analyse bilateral tax cooperation.

¹² So much so that the idea of a dedicated International Tax Organisation has been discussed on several occasions. See Tanzi (1999) and Horner (2001).

III.2 The search for international tax governance

At the outset, the most relevant problem of international direct taxation was the jurisdictional conflict about the taxation of diplomats. But soon the explosion of world trade in the first part of the 20th century brought corporations into the scene. The League of Nations 1928 report on international taxation was a landmark (Picciotto 1992). It defined a set of principles for international taxation. It also established a soft, informal method to deal with international tax governance – one based on the gradual diffusion of principles and policy solutions via consensus. Put differently, the role of international governance was to provide a catalogue of problems, a menu of solutions, and a forum for discussion. The diffusion of specific definitions of problems, solutions, and instruments was left to the propensity of individual governments to buy in into the menu, with some *a la carte* options.

After World War II, the major agent of diffusion of mainly informal governance in international taxation was the OECD¹³, with primary emphasis on developed countries, although the United Nations has also been active for the rest of the world. Broadly speaking, today the international tax system still follows the path breaking suggestions of the League of Nations and the ‘codification’ efforts made by the OECD between the 1960s and the 1980s. The main components of this system are the classification of types of income, the residence principle, the Treaty network, and arm’s length rules for transfer pricing. The key concept behind this system is tax neutrality – that is, limiting the distortions created by the interplay of different national tax laws applied to firms with multinational business.

The OECD is the most significant organisation in the area of international tax policy (Webb 2004, 792; Webb 2001). The Committee of Fiscal Affairs (CFA) was established in 1971 to provide a forum for policy makers to discuss international and domestic tax matters. The Center for Tax Policy and Administration (CTPA) services the CFA and examines all aspects of taxation apart from macro-fiscal policy which is dealt with by the Economic Policy Committee.

The CFA work program is carried out by a number of subsidiary bodies, consisting mainly of participants from OECD countries. Table 1 gives an overview of OECD groups concerned with tax issues.

¹³ Member Countries of the OECD (by March 2006) are Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The European Commission also takes part in the work of the OECD.

Table 1: OECD bodies dealing with taxation

Working groups	
Working Party 1	Tax Treaties, Tax Conventions and related issues
Working Party 2	Tax policy analysis and statistical work
Working Party 3	Company taxes (wound up after completion of task)
Working Party 4	Taxation of international bond issues (wound up after completion of task)
Working Party 5	Negotiation of securities (wound up after completion of task)
Working Party 6	Taxation of multinational enterprises
Working Party 7	Taxation of energy (wound up after completion of task)
Working party 8	Tax evasion and avoidance
Working Party 9	Consumption taxes
Fora	
Forum on Harmful Tax Practices	Created in 1998 to take forward the OECD's work on harmful tax practices
Forum on Tax Administration	Created in 2002 to improve taxpayer service and compliance
Recent ad-hoc groups	
Meetings with financial market specialists	Taxation of new financial transactions
Joint group of fiscal and environmental experts	Eco-taxes
Groups with a consulting function	
Business and Industry Advisory Committee (BIAC)	Advice to the CFA
Trade Union Advisory Committee (TUAC)	Advice to the CFA

For a long time, this approach was effective and considered legitimate by governments and the business community. In the 1990s, however, it became clear that the micro-foundations of the approach (principles, instruments, and problems) were no longer up to the job¹⁴. This triggered a reorientation of the OECD activity. The approach based on bilateral action informed by OECD guidelines and model conventions was not rejected. Rather, it was supplemented by a shift of gear, from bilateralism to multilateralism, with political implications for non-OECD jurisdictions. Over the last five years the CTPA has widened its dialogue with non-OECD countries: Argentina, Russia and South Africa are now observers in the Committee and there's a regular dialogue with over 70 non-OECD economies. It also sponsors the International Tax Dialogue (ITD), which is a joint initiative with the International Monetary Fund

¹⁴ For details see CEPS 2000.

(IMF), the World Bank, and the United Nations (UN)¹⁵ to provide a forum for the improvement of international coordination in taxation. The CFA also cooperates with the World Trade Organization (WTO), the Financial Action Task Force, and regional tax organisations (e.g. CIAT¹⁶, CREDAF, and IOTA¹⁷).

Table 2 shows the OECD approach until the mid-90s – distinguishing the system of interaction from the outcomes of governance - and contrasts it with the recent changes we will examine next.

Table 2: Changes in international tax governance

	Until 1998	1998-2006
<i>System of Interaction</i>		
Problem Definition, Ideational Context	Tax neutrality - Elimination of double taxation - Allocation of taxing rights among jurisdictions	Harmful tax competition
Instruments	Informal governance tools (Model treaties, guidelines)	More formal tools (peer review, name and shame, defensive measures, timetable for compliance)
Institutions	Working Parties	Working Parties, Global Tax Forum
Key actors involved in OECD-led processes	Revenue authorities, business community	Revenue authorities, offshore jurisdictions, public pressure from individual politicians, business funded think tanks, NGOs and media
<i>Outcomes of Tax Governance</i>		
Impact on third countries	None	Yes
Level of Politicization	Low	High

¹⁵ The United Nations further operate the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries. This group was established in 1968 pursuant to an ECOSOC resolution after considerable efforts made by the League of Nations, the Organization for European Economic Cooperation (later on OECD) and the United Nations. In 1980 this group finalised the UN Model Double Taxation Convention whose aim was to promote the conclusion of treaties between developed and developing countries, acceptable to both parties. In April 1980 the ECOSOC renamed the Group Ad Hoc Group of Experts on International Cooperation in Tax Matters. Members are 25 tax administrators from 10 developed and 15 developing countries. Task of the group is to explore in consultation with interested international agencies ways and means of facilitating the conclusion of tax treaties between developed and developing countries and bearing on international cooperation in tax matters. The group examines among other things transfer pricing, mutual assistance in collection of debts, treaty shopping and treaty abuses, interaction of tax, trade and investment, and capital flight. The group became a standing committee in November 2004 and had its first meeting in December 2005 in Geneva.

¹⁶ Centro Interamericano de Administraciones Tributarias.

¹⁷ Intra-European Organisation of Tax Administrations.

III.3 Widening the Scope of Governance

The landmark report on harmful tax competition (OECD 1998) was a sea change in terms of problem definition, instruments, and scope of tax governance. It has also started a process that is changing the system of interaction and the outcomes of governance (table 2). In the 1998 report, the major problem of international tax coordination is defined in terms of harmful tax competition. Neither the existence nor the practices of ‘tax havens’ and offshore financial centres has been new. But the 1980s and early 1990s witnessed new material pressures on actors: an increasing fear among governments of losing revenue to low tax jurisdictions. The success of the Irish Dublin Docks scheme, the emerging flat tax systems in Estonia, Slovakia and Russia and special tax regimes in Luxembourg, Belgium and the Netherlands caused some of the bigger EU states, such as Germany and France, to push harmful tax competition parallel to the EU on the OECD and G7 agendas¹⁸. At the G7 summit in Lyon in June 1996 the heads of government declared:

“Finally, 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 of work by the OECD, which is due to produce a report by 1998. We will also follow closely the OECD’s continuation of its important work on transfer pricing, where we warmly endorse the significant progress that the OECD has already achieved.”¹⁹.

The OECD created a task force in 1997 to look into the newly defined problem. The result was the 1998 report, adopted by the CFA in January and by the ministers on 28 April 1998. This report was an exercise in political creativity rather than a case of usage of ideas developed by economists. Economists are familiar with tax competition, and have discussed the conditions under which coordination improves collective welfare. But the identification of ‘harmful’ tax competition goes beyond what can be drawn by the scientific literature on tax competition²⁰. Instead, in the 1998 report the OECD achieved consensus on a set of specific criteria to be used to test the presence or absence of tax competition.

¹⁸ All 15 old and 4 of the new EU Member States are also members of the OECD. The EU state aid rules also apply to the European Economic Area (Iceland and Norway are also EU members). Therefore the developments on the EU level are particularly important for the OECD campaign. With the Verona Paper in April 1996 the EU started as well to engage in the debate about harmful tax competition. The code of conduct on business taxation also established criteria for determining whether a tax regime falls within its scope or not. These criteria are very similar to the OECD’s 1998 report. A number of regimes listed by the code of conduct Group do not appear on the OECD list: The OECD list does not contain holding company regimes, nor does it include measures for substantial activities. Apart from that almost all EU measures listed by the OECD are also on the code of conduct list. Differences between the EU tax package and the OECD initiative resulted mainly out of the exemptions made for three EU member countries (Belgium, Austria and Luxembourg) under the EU savings directive. They are allowed to introduce a withholding tax instead of joining the exchange of information system. This led to considerable critique from media, experts, and the OECD.

For a detailed analysis of EU tax policy development see Authors (2006), Bratton and McCahery (2001), and Pinto (2003).

¹⁹ Economic Communiqué: Making a success of globalization for the benefit of all, Lyon G7 summit, 28 June 1996, paragraph 16.

²⁰ For a review of international tax competition see for example Swank (2002), Wilson and Wildasin (2003), and Zodrow (2003).

The OECD defined classical tax havens (see Box 1), preferential regimes (see Box 2), and normal tax regimes (regimes that collect significant revenues from individual and corporate income taxes, but at relatively low effective rates). Tax policy coordination was thus provided with new concepts, new vocabulary and a new ideational context.

Box 1: OECD Tax Haven Criteria

Four key factors are used to determine whether a jurisdiction is a tax haven. The first is that the jurisdiction **imposes no or only nominal taxes**. The no or nominal tax criterion is not sufficient, by itself, to result in characterization as a tax haven. The OECD recognizes that every jurisdiction has a right to determine whether to impose direct taxes and, if so, to determine the appropriate tax rate. An analysis of the other key factors is needed for a jurisdiction to be considered a tax haven. The three other factors to be considered are:

- Whether there is a **lack of transparency**
- Whether there are **laws or administrative practices that prevent the effective exchange of information** for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation.
- Whether there is an **absence of a requirement that the activity be substantial**

Transparency ensures that there is an open and consistent application of tax laws among similarly situated taxpayers and that information needed by tax authorities to determine a taxpayer's correct tax liability is available (e.g., accounting records and underlying documentation).

With regard to exchange of information in tax matters, the OECD encourages countries to adopt information exchange on an "upon request" basis. Exchange of information upon request describes a situation where a competent authority of one country asks the competent authority of another country for specific information in connection with a specific tax inquiry, generally under the authority of a bilateral exchange arrangement between the two countries. An essential element of exchange of information is the implementation of appropriate safeguards to ensure adequate protection of taxpayers' rights and the confidentiality of their tax affairs.

The no substantial activities criterion was included in the 1998 Report as a criterion for identifying tax havens because the lack of such activities suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. In 2001, the OECD's Committee on Fiscal Affairs agreed that this criterion would not be used to determine whether a tax haven was co-operative or uncooperative.

Source: www.oecd.org

Box 2: OECD Preferential Regime Criteria

Four main factors are used to determine if a preferential tax regime is harmful:

- The regime imposes low or no taxes on the relevant income (from geographically mobile financial and other service activities). Although a low or zero effective tax rate is the necessary starting point of an examination of a preferential regime, it alone is never sufficient to find harmfulness. The OECD recognizes each country's right to determine its own tax rate.
- The regime lacks transparency;
- There is no effective exchange of information with respect to the regime;
- The regime is ring-fenced from the domestic economy.

A regime is ring-fenced if a country insulates its core tax base from the effects of providing the preference. For example, if a country offering a preferential tax regime denies that regime to resident taxpayers or domestic activities, it means that it is not willing to bear the cost in lost revenues with respect to its own tax system.

There are also a number of other factors to be considered in evaluating whether a preferential tax regime might be harmful, including the extent of compliance with the OECD Transfer Pricing Guidelines. Any evaluation requires an overall assessment of each of the above factors and once a regime has been identified as potentially harmful the economic effects would, where necessary, have to be examined.

Source: www.oecd.org

The report issued a number of multilaterally orientated recommendations and some guidelines “for dealing with harmful preferential tax regimes in member states”. The recommendations included among others greater access to banking information for tax authorities, greater use of exchange of information, the establishment of a Forum on Harmful Tax Practices to implement the guidelines and recommendations, the creation of a list of tax havens and the engagement in dialogue with non-members. The guidelines for member states consisted mainly of proposals for peer review, standstill and rollback of preferential tax regimes in member states.

The scope of tax governance was changed. The campaign against harmful tax competition enabled the OECD to engage with multilateral coordination. But it was the first time that multilateralism became so prominent. The scope of governance went further than the OECD itself, by affecting non-OECD members.

A substantial blow to the impact of the 1998 report came from the abstention of Switzerland and Luxembourg. Both countries accepted that tax competition can be harmful but refused to agree with the report on the grounds of regarding it partial, unbalanced and aiming at the abolishment of bank secrecy. Switzerland even considered to veto the report but was eventually persuaded to abstain so as not to prevent other members from adopting it.

The 1998 report demanded the creation of two lists: a list of the potentially harmful measures in the OECD member states themselves and a list of tax havens. Both lists were presented in the 2000 Progress Report ‘Towards Global Tax Co-Operation’. The Forum on Harmful Tax Practices identified 47 preferential tax regimes in member states as potentially harmful and asked for their elimination by April 2003. The second list was a list of 35 non-member tax havens²¹.

²¹ These were Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, the British Virgin Islands, the Cook Islands, Dominica, Gibraltar, Grenada, Guernsey (including Alderney and Sark), the Isle of man, Jersey, Liberia, Liechtenstein, the Maldives, the Marshall Islands, Monaco, Montser-

At this stage, tax governance was hardened in that jurisdictions unwilling to sign the Memorandum of Understanding²² were threatened with possible defensive measures. To the surprise of the OECD, a considerable number of offshore jurisdictions showed interest in cooperation and more dialogue with the OECD in order to have objective criteria and a fair process. This was unexpected for the OECD but the organisation quickly changed its strategy from a focus on sanctions to more emphasis on dialogue. In its effort to collect a high number of signatures to its Memorandum of Understanding, the new motto became: “We want a list without any names on it”²³.

An important step was taken by the so-called ‘Global Tax Forum’ created at a meeting hosted by Barbados in early January 2001, which led to the separation between cooperative and uncooperative regimes. Only jurisdictions placed on the uncooperative list would be subject to defensive measures after 31 July 2001. These defensive measures included among others not to enter into any comprehensive income tax conventions with uncooperative tax havens (UTHs), to consider terminating existing ones, to impose charges on transactions involving UTHs, to ensure that domestic defensive measures are also applicable to transactions with UTHs, to impose withholding tax on some payments to residents of UTHs, etc. On the other side, there were offers for cooperative regimes to assist in restructuring their economies and strengthening their tax administrations.

The 2001 progress report was drafted in the context of two major changes to the project on harmful tax practices. The first was the strengthened dialogue with non-OECD members and the increasing importance of the tax partnership programme that explicitly promoted cooperation with non-members. The second was the amount of contestation the OECD had to face.

The debate, especially in the US and the tax havens, soon became political. When the Bush administration changed the US Treasury Secretary and Paul O’Neill took over from Larry Summers, the American support for the OECD campaign declined. In May 2001 O’Neill wrote an op-ed in the *Washington Times*²⁴ questioning the punitive intent of the OECD and the idea of ‘stifling competition which forces governments, like businesses, to create efficiencies’. The op-ed was accompanied by a private letter to the OECD. This was the first time that the OECD project was discussed outside the technical framework of working groups of revenue authorities and specialists conferences. The tone of the article was aggressive and explicitly political. Additionally, the newspaper chosen by O’Neill was different from the newspapers that routinely host technical discussions, such as the *Financial Times*. The reaction of offshore jurisdictions was also vocal and political. Most of the technical points made by the OECD report about the difference between desirable and harmful competition were ignored. So was the fact that the OECD report did not argue for any initiative on tax rate coordination. The public attack on the OECD revolved around the notion that the OECD was against low tax rates and that the organisation had no legitimacy to act as the ‘tax police of the world’.

rat, Nauru, the Netherlands Antilles, Niue, Panama, Samoa, the Seychelles, St. Lucia, St. Christopher and Nevis, St. Vincent and the Grenadines, Tonga, Turks and Caicos, The US Virgin Islands, and Vanuatu. Examined and omitted from the list were Brunei, Costa Rica, Dubai, Jamaica, Macao and Tuvalu. A further six jurisdictions avoided being listed by committing to the principles of the 1998 report and to eliminate their preferential tax regimes by the end of 2005. These were Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino.

²² To sign the memorandum of understanding meant to commit to the above-mentioned principles of the 1998 report.

²³ Interview with OECD officials on 19 April 2005.

²⁴ O’Neill, Paul. 2001. Confronting OECD’s notions on taxation, *Washington Times* May 10.

Offshore jurisdictions and some parts of business soon found their advocates in the media and the U.S. Congress. A right wing lobbying organisation, The Center for Freedom and Prosperity (CFP), was established with anonymous funding. Its members visited offshore jurisdictions and started lobbying against the OECD in Washington²⁵.

Some U.S. American politicians criticised the OECD. They claimed that the organisation was focusing on the wrong problem and on instruments, which may violate WTO obligations. In September 2000, the House majority leader Richard Armey wrote a letter to the U.S. Treasury Secretary, in which the OECD was portrayed as a 'tax cartel'. On 3 January 2001, U.S. representative Sam Johnson, a Republican from Texas, wrote to the OECD Secretary General making several criticisms. In March 2001, Armey wrote a second letter, this time posted to the then U.S. Treasury Secretary, Paul O'Neill, describing the OECD project as 'a global tax cartel for the benefit of a small handful of high-tax nations'. He argued that the OECD initiative is 'fatally flawed and contrary to America's interests'²⁶.

A trio of US legislators, among them the chair of the Foreign Affairs Committee at the US Senate (Jesse Helms), criticised openly the OECD in their separate letters to the U.S. Treasury²⁷. U.S. Senator Don Nickles, a Republican assistant majority leader of the Senate, used his influential position to argue in yet another letter to O'Neill that the 'financial protectionism of OECD nations' is 'contrary to America's economic interests' because tax competition 'keeps politicians in check and enhances economic growth'²⁸. And a Democrat from the Virgin Islands (and Congressional black caucus member), Delegate Donna M. Christensen, stepped up pressure on O'Neill with her 12 March 2001 letter in which she argues that the 'OECD should not have the right to rewrite the rules of international commerce on taxation simply because they are upset that investors and entrepreneurs are seeking higher after-tax returns'²⁹. Others, like tax attorney Marshall Langer, criticised the OECD countries as a whole but especially the United States for having forced some of the tax havens to adopt tax practices that the OECD was now calling into question³⁰.

None of this produced the withdrawal of US support to the OECD campaign, but it made it more qualified. The OECD had to face the challenge of addressing an overtly political dialogue. Neither the organisation's civil servants nor the revenue authorities serving on the OECD committees were used to the political limelight. It was impossible for them to reply to the political accusations made in the US congress and offshore jurisdictions with political argumentations. However, the OECD reacted successfully by promoting more dialogue with offshore jurisdictions and by insisting on exchange of information as the final objective of the campaign, capitalising on the issue linkage between tax transparency, money laundering, bank secrecy, and security which has characterised the post 9-11 environment. However, they compromised on the following points: a) the deadline for making a commitment to cooperate

²⁵ Goulder, R. New coalition strikes back at OECD tax haven campaign. *Tax Notes International* 11 December: 2650-2654.

²⁶ Scott, C. 2001. House Majority leader, Congressional black caucus member join growing list of US lawmakers opposed to OECD tax haven campaign. *Tax Notes International* 26 March: 1479-1480.

²⁷ Goulder, R. 2001. Trio of US legislators question OECD tax haven initiative. *Tax Notes International* 19 March: 1339-1340.

²⁸ Goulder, R. 2001. US Senator questions OECD policy on tax competition. *Tax Notes International* 26 February: 944-945.

²⁹ Scott, C. 2001. House Majority leader, Congressional black caucus member join growing list of US lawmakers opposed to OECD tax haven campaign. *Tax Notes International* 26 March: 1479-1480.

³⁰ Kirkell, S. 2002. OECD: 2002 Year in Review. *Tax Notes International* 30 December 2002: 1316-1318

was extended - from 31 July 2001 to 28 February 2002, b) coordinated defensive measures would not apply to UTHs any earlier than to OECD member countries, and c) the ‘no substantial activity’ criterion no longer determined whether a jurisdiction is considered to be a UTH. Now the OECD considers jurisdictions to be cooperative if they commit to the international standards of transparency and effective exchange of information upon request.

When the 2004 Progress report was released on 4 February 2004 there were only 5 uncooperative tax havens left on the list. Box 3 gives an overview on the originally listed tax havens and the dates of signing the Memorandum of Understanding.

Box 3: Tax Havens commitments to the OECD principles

Original list of tax havens	Date of commitment
Bermuda	Prior to 2000 progress report
Cayman Islands	Prior to 2000 progress report
Cyprus	Prior to 2000 progress report
Malta	Prior to 2000 progress report
Mauritius	Prior to 2000 progress report
San Marino	Prior to 2000 progress report
Aruba	Prior to 2000 progress report
Bahrain	Prior to 2000 progress report
Isle of Man	Prior to 2000 progress report
Netherland Antilles	Prior to 2000 progress report
Seychelles	Prior to 2000 progress report
2000 Progress report - released on 26 June 2000	
Antigua and Barbuda	20 February 2001
Guernsey	27 February 2001
Jersey	27 February 2001
Grenada	27 February 2001
St. Vincent and the Grenadines	27 February 2001
Deadline to commit: 28 February 2002	
Dominica	5 March 2001
St. Christopher and Nevis	5 March 2001
St. Lucia	5 March 2001
Montserrat	7 March 2001
Anguilla	8 March 2001
Turks and Caicos	8 March 2001
US Virgin Islands	11 March 2001
Gibraltar	14 March 2001
Bahamas	18 March 2001

Belize	20 March 2001
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Cook Islands	27 March 2001
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British Virgin Islands	3 April 2001
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Samoa	18 April 2001
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Publication of the revised list on 18 April 2002

Vanuatu	20 May 2001
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Nauru	12 December 2001
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2004 Progress Report – released on 4 February 2004

Andorra	Accepts invitation to participate in the Global Forum on transparency and exchange of information on 9 February 2005, but no commitment to the OECD principles on harmful tax practices yet
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Liechtenstein	No commitment
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Liberia	No commitment
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Monaco	No commitment
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Marshall Islands	No commitment
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The 2004 progress report still provoked hostile reactions from organisations like the CFP:

‘The OECD made two commitments to low-tax jurisdictions. First, it promised that it would achieve a "level playing field." This promise has been broken. Second, it committed to the even-handed application of sanctions against nations and territories with free market tax policy. This "uniform consequences" promise also has been broken. Low tax jurisdictions should be outraged by the OECD's deceitful actions’³¹.

Already in October 2003, Antigua and Barbuda had announced that it was withdrawing its commitment and Prime Minister Lester Bird called on other Caribbean nations to follow his lead at a meeting of the Caribbean Financial Action Task Force in Trinidad³². The main point of the complaint was the notion of level-playing field: OECD member countries – it was argued - were not held to the same standards as non-member tax havens. From the 47 potentially harmful measures identified by the 2000 Progress Report just 18 regimes were abolished or in the process of being abolished by the time of the 2004 Progress report. 14 regimes had been amended to remove any potentially harmful features, and 13 were found not to be harmful. Two regimes (Switzerland’s administrative company regime and Luxembourg’s 1929 Holding company regime) are still discussed.

However, the political dialogue with offshore jurisdictions has now become a reality, under the aegis of the OECD Global Tax Forum. The OECD’s Committee for Cooperation with Non-members (CCN) in 2000 developed the Global Forum on Taxation as one of eight

³¹ Daniel Mitchell, The OECD’s Dishonest Campaign Against Tax Competition: A Regress Report, www.freedomandprosperity.org

³² Scott, C. 2003. Two Tax Havens Suspend Commitment Letters to OECD. *Tax Notes International* 20 October.

Global Forums. It is one of the two main pillars of the work with non-members the other being country and regional programmes. The Global Forum on Taxation builds on the expertise of the CFA, the interaction of non-OECD economies and members and tries to incorporate some of the criticism the OECD had to face. At the Global Forum in Berlin in June 2004 the OECD introduced the definition of a global level playing field (see Box 4).

Box 4: The definition of Global Level-Playing Field

A) Concept

The level playing field is fundamentally about fairness to which all parties in the Global Forum are committed.

In the context of exchange of information achieving a level playing field means the convergence of existing practices to the same high standards for effective exchange of information on both criminal and civil taxation matters within an acceptable timeline for implementation with the aim of achieving equity and fair competition.

B) Features:

Will provide for i) inclusive process, ii) mutual benefits through bilateral implementation, iii) a consistent and rigorous approach to any failure to implement, iv) review and verification mechanisms, v) the standard and the timeline.

C) Role:

The level playing field serves as a goal.

Achieving a level playing field in respect of exchange of information requires that all jurisdictions, OECD and non-OECD members, should act in a manner consistent with the concept in their bilateral relationships and more broadly.

Source: OECD, 2004, A Process for Achieving a Global Level Playing Field, Global Forum on Taxation, Berlin, 3-4 June, p. 2ff

The last meeting of the Global Forum took place in November 2005 in Melbourne where government officials from 55 OECD and non-OECD countries met for discussions on what is needed for a 'global playing field' in the areas of transparency and effective exchange of information in tax matters. The concluding remarks state:

“The underlying objective of the global level playing field is to facilitate the creation of an environment in which all significant financial centres meet the high standards of transparency and effective exchange of information on both criminal and civil taxation matters. This is vital to ensuring that countries can obtain from other countries the information necessary to enforce their own tax laws, to ensuring that financial centres that meet such standards are not unduly disadvantaged by doing so, and to ensuring that financial centres that meet such high standards are and remain fully integrated into the international financial system and the global community. Any significant financial center that decides not to adopt high standards of transparency and effective exchange of information must not be permitted to profit from that decision.”³³

Overall, the style of governance has become less technocratic and more political. The degree of politicisation has increased for yet another reason, that is, the activity of NGOs on taxation.

³³ OECD, Progress Towards a Level Playing Field: Outcomes of the OECD Global Forum on Taxation, Melbourne, 15-16 November 2005

Charities such as War on Want³⁴ have campaigned on tax issues like the Tobin tax since 1998. The Tobin Tax Network³⁵ was set up in 2000, after the EU finance ministers' meeting within ECOFIN voted against a European Tobin Tax. In 2000 the charity Oxfam published a report on tax havens, capital flights, and poverty (Oxfam 2000). The anti-globalisation organisation Attac³⁶ and the Tax Justice Network (TJN) are fighting against tax havens. The advent of NGOs has raised new moral issues in the discussion of tax avoidance. Newspapers have been sent 'tax stories' about scandals, poverty and capital flight, major abuse of transfer pricing legislation, figures on the amount of tax revenue 'lost' in tax havens. Although TJN is a small organisation, its media campaigns have been carefully planned, for example with figures on tax avoidance released on Easter Sunday, when Bishops in the UK speak about global fairness. The United Nations has revived its ad-hoc group of experts on international taxation and tax matters, now called the Committee of Experts on International Cooperation in Tax Matters, and NGOs have been invited to attend³⁷.

To conclude, the OECD campaign shows some important changes in patterns of tax governance. There has been a shift towards pressure on jurisdictions outside the OECD and multilateralism. The diffusion process is no longer based on the adoption of instruments that governments can use as they see fit, nor is it based on the intrinsic efficiency of the model. Instead, it is based on a mechanism of learning and a certain degree of coercion. On balance, this new mode of governance is more political, more ambitious, and more formal than the one used up until the mid-1990s.

III.4 Explaining Shifting Modes of Governance

Two questions arise from our discussion of shifting modes of governance: Firstly, why has the OECD move towards a different mode of governance? And secondly, why has governance switched from technocratic to political?

We answer the questions in reverse order. The politicisation of international tax policy is explained by the emergence of a new focal point. Following Michael Blyth (2002) and Sven Steinmo (2003), we acknowledge that ideas about taxation and interests (of revenue authorities and the business community) are interrelated³⁸. Within this approach to ideational politics, Steinmo (2003) has discussed the evolution of ideas about taxation in the 20th century. His account of changing paradigms in tax policy terminates with the advent and institutionalisation of the paradigm according to which tax policy should promote the efficient allocation of resources (as opposed to a paradigm oriented towards equity and 'ability to pay'). This ideational turn was consistent with the interests of an increasingly mobile capital and the economics of open markets.

However, Steinmo's account can be usefully completed with the changing economic ideas in the last decade of the 20th century. This is the period in which tax policy-makers became aware of some undesirable consequences of unbridled competition in tax matters, especially in terms of the deterioration of tax systems and revenue losses. In a (evolutionary) sense, tax

³⁴ For more information about War on Want see www.waronwant.org

³⁵ For a position paper by the Tobin Tax Network on the International Financial Facility see <http://www.globalpolicy.org/socecon/develop/oda/2003/09iff.htm>

³⁶ For more information about Attac see www.attac.org

³⁷ Zagaris, Bruce. 2005. The United Nation's role in international tax cooperation. *Tax Notes International* 25 April.

³⁸ For an analysis of the problems that this interrelation creates see Hay (2004).

policy-makers were discovering the inefficiencies (in open economies and at the global level) of what looked sensible at the purely domestic level: to tweak tax systems in order to attract capital from abroad without losing the domestic revenue base.

These material preoccupations were reflected in the emerging narrative of harmful tax competition – ‘the’ emerging narrative of international tax policy in the 1990s. As shown in Radaelli (1999), this narrative is more than the reflection of the interest of revenue authorities. It is also the product of ideational entrepreneurs like the European Commission and, in the OECD, the Committee for Fiscal Affairs. These entrepreneurs successfully promoted a more political discussion of international taxation by shedding light on the harmful consequences (not only for the revenue coffers, but for the welfare state and employment as well) of some wicked types of tax competition.

Rapidly, harmful tax competition has become a dominant discourse in international tax policy circles. As mentioned, this discourse is more political than the discourse on tax efficiency. It brings in considerations of fairness in the tax world, moral considerations about tax justice and injustice, norms of behaviour according to which the actions of offshore jurisdictions should be assessed, North-South imbalances and distortions induced by tax-generated capital flights from Africa and Latin America.

This more political discourse has gone further than rekindling cooperation among revenue authorities at the OECD and in the EU. It has also wetted the political appetite of tax NGOs like Tax Justice Network, that see this as an opportunity to transform international taxation into the ‘new environmental politics’ (in terms of political mobilisation of citizens)³⁹. Further, harmful tax competition has brought into the debate the thorny political question of the relationship between offshore jurisdictions and the OECD members, and, within the business community, the issue of the legitimate uses of tax havens for socially responsible corporations. The whole notion of the public interest in international taxation is gradually emerging in tax policy discussions, with potentially large implications about the range of actors involved and the issues to be addressed. To conclude on this point, our answer to the second question is that the emergence and institutionalisation (in the EU and the OECD) of the narrative of harmful tax competition (in turn, linked to interest politics) has widened the range of actors and policy issues, and has made technocratic approaches obsolete, at least for the time being.

How do we explain the OECD’s selection of governance modes? Three mutually reinforcing factors were at work. First, the narrative of harmful tax competition was grounded in real preoccupations of the revenue authorities, increasingly frustrated by the difficulty to tax their own residents via traditional instruments. It should be considered that the Committee for Fiscal Affairs of the OECD is eminently a committee of revenue authorities. Second, and in connection with the previous point, due to technological innovation and financial sophistication, the marginal returns of unilateral (i.e., controlled foreign company legislation) and bilateral solutions to tax avoidance and tax evasion decreased quickly between 1980 and the 1990s – a point illustrated by Hugh Ault (2002). The OECD multilateral action should not be seen as an alternative to unilateral and bilateral initiatives, but as a much-needed complement to increasingly limited instruments (OECD 1998: 42). In consequence, the choice of the OECD was one of widening the menu of instruments available rather than drastic redirection. Third, in the late 1980s and the 1990s tax policy problems showed their connection with another bundle of policy problems, emanating from money laundering, security, political corruption, and lack of

³⁹ Houlder, Vanessa. 2004. The tax avoidance story as a morality tale. *Financial Times* 22 November.

transparency in international economic transactions. The bundling of taxation with other and more political salient problems made the harder and more ambitious approach suggested by the OECD possible.

III.5 Conclusions

In the conclusions, we show the theoretical implications of our analysis and provide an assessment of what has been achieved. One important point throughout the analysis presented here is the ideational dimension of politics and its links with the structural-strategic dimensions.

We have related the ideational components to the material preoccupations of revenue authorities and the OECD strategy to promote multilateral cooperation. We do not reduce ideas to material pressures and strategic behaviour, however. Harmful tax competition has had its own autonomous impact on the policy process. For a start, it has generated a more political discourse. In turn, this shift in discourse has made political leaders more alert to the problems arising out of unbridled tax competition – with of course a big difference in terms of propensity to cooperate between winners and losers from tax competition. But it has also put taxation on the radar of NGOs, which see an opportunity to transform international taxation into a vehicle for social mobilisation and for a debate on international justice and fairness. Further, harmful tax competition has made explicit the hard questions surrounding the relationship between offshore jurisdictions and the OECD members. Looking inside the business community, the issue of the uses of offshore finance has implications for the socially responsible corporations. An embryonic debate on the public interest in international taxation is gradually emerging. To conclude, we have shown the many ways in which ideas matter and produce policy development. This is our contribution to an otherwise sterile debate about whether ideas matter in politics. We think it is more important to show empirically the ways in which ideas impact on policy.

Apart from ideational politics, what are our conclusions about the changing scope of governance and the overall style? Tax governance has become less informal and more ambitious than in the past. The impact of tax policy formulated within the OECD has reached out to third countries and tax havens. The business community has less impact than in the past on policy formulation. Non-governmental groups are, broadly speaking, still outside the radar, but occasionally they make their presence more visible. Opaque organisations such as the Center for Freedom and Prosperity have made the attack on the OECD political and visible to policy-makers in the US Congress. Political movements such as War on Want, Attac or Oxfam have limited influence on specific tax issues.

So, is international tax governance more contested now than 80 years ago? The question is not that international tax coordination has less legitimacy than in the past. The real question has something to do with the scope of governance and the range of actors involved therein. The wider the scope and the range of actors targeted by informal governance, the higher the potential for more political discussions – and political discussion is often conflictual. Conflict, in turn, may lead some actors to argue that the other is not legitimate enough to impose its preferences on policy.

We then look into the issue of ‘legitimacy for whom’ to dissipate ambiguities about this term. The old world of international taxation was dealing with low political salience issues. It was limited in scope. The OECD operated like a forum for the elaboration of instruments to be voluntarily adopted by the members. International tax governance was eminently bilateral. International tax policy was not contested because that world was somewhat insulated from

wider political debates and the scope of governance limited. There was high acceptance within networks of specialists and revenue officers.

By contrast, the new world of international tax cooperation is one where tax debates are more political than in the past. The scope of governance has widened, with the OECD (but also the United Nations and the G7-G8 Ministers) engaged in multilateral coordination. For the OECD, the structural properties of tax coordination – notably, the fact that coordination is fragile if achieved only by a limited number of countries – have pushed towards an ambitious attempt to promote the level-playing field outside its jurisdiction. The emphasis on harmful tax competition has made tax issues more prominent in the political agenda, but has also raised the political awareness of a multitude of actors. Corporations want to know more about discussions on tax regimes where there is a lot of corporate money invested. National parliaments do not provide any major input in the discussion about the rollback of tax regimes. NGOs and radical political organisations from the left and the right try to influence the agenda.

Overall, the process is not one of lower degrees of legitimacy over the long run, but one of politicisation of the debate. Politics has brought more fundamental discussions about the competences of actors into the previously insulated world on international taxation. Hot discussions about “legitimacy” – we submit – are an indicator of the maturation of the debate.

Clearly, there have been achievements – our last point. There has been a process of learning. The OECD has learned that blacklisting and sanctions are less important than establishing a process by which offshore jurisdictions take commitments to transparency and discuss the scope for exchange of information upon request. The number of uncooperative tax havens went down from 33 to 5. Additionally, tax havens have learned the advantages of transparent tax competition. There is still the exception of major financial centres like Singapore, which are still outside the framework of the Global Tax Forum,⁴⁰ preventing the establishment of a true global level playing field and raising the anger of those who have committed themselves to the principles of the OECD. But in turn this will create additional pressure to join the vast majority of the jurisdictions that have agreed to the level-playing field.

Another dimension on which achievement should be measured is process. Several processes of dialogue, coordination, and exchange of information have been created since the mid-1990s. The OECD has been the most active player in this area, with initiatives such as the memorandum of understanding and the Global Tax Forum. Future work should look at how other organisations (such as the UN, IMF, the World Bank, and the WTO) are creating clubs for coordination and whether the overall web of clubs and initiatives is efficient.

Finally, it is too early to talk about outcomes in terms of the overall degree of tax competition. Indeed, the whole issue here is not to increase or decrease the level of tax competition. The goal is about limiting some forms of undesirable tax competition. The level-playing field advocated by the OECD is not about setting floors to tax rates or harmonising tax policy. The final outcome should not be measured on the degree of tax competition. There may be more or less tax competition as a result of the OECD campaign. Indeed, there is anecdotal evidence of more tax competition. But the quality of tax competition is changing, from opaque, non-transparent, often unlawful tax competition to a more transparent process in which governments legitimately select their tax policies in order to achieve economic and social goals. The challenge for the future is whether commitment to the memorandum of understanding and to the principles of transparency will also produce concrete action and policy change.

⁴⁰ China Hong Kong and China Macao have recently decided to join in.

IV. References

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