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The activities of the Organisation for Economic Co-operation and Development (OECD) in 2012-2013

Report¹

Committee on Political Affairs and Democracy

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Summary

The Parliamentary Assembly of the Council of Europe, enlarged to include the delegations of national parliaments of the Organisation for Economic Co-operation and Development (OECD) member States which are not members of the Council of Europe, as well as a delegation of the European Parliament, is once again considering the activities of the OECD.

In line with the objectives of the Assembly's reform and the desire to make the debate more political, the present report focuses on the challenges to citizens' trust in democratic institutions posed by ineffective policy responses and by evidence of fiscal injustice in the course of the ongoing economic and employment crisis.

The OECD initiative on New Approaches to Economic Challenges (NAEC), development and taxation issues, and the OECD work on Base Erosion and Profit Shifting (BEPS) are highlighted. The ability of governments to raise funds through taxation in order to pay for necessary public services is a fundamental anchor for democracy. When the actions of companies and individuals undermine governments' legitimate financing abilities, the very fundamentals of democracy and equitable development are threatened. The OECD should continue to play a leading role in international efforts to bring greater fairness to tax policy worldwide.

1. Reference to committee: Reference 3920 of 30 November 2012.



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A. Draft resolution²

1. The Parliamentary Assembly of the Council of Europe, enlarged to include the delegations of the national parliaments of the Organisation for Economic Co-operation and Development (OECD) member States which are not members of the Council of Europe, as well as a delegation of the European Parliament, is once again considering the activities of the OECD. The enlarged Assembly has reviewed the activities of the OECD in 2012-2013 in the light of the reports by the organisation and the report prepared by the Committee on Political Affairs and Democracy.
2. In line with the objectives of the Assembly's reform and the desire to make the debate more political, the present report on the activities of the OECD focuses on the challenges to citizens' trust in democratic institutions posed by ineffective policy responses and by evidence of fiscal injustice in the course of the ongoing economic and employment crisis.
3. The enlarged Assembly notes the context of the world economy against which the activities of the OECD have been conducted in 2012-2013. While there are at last signs of a recovery, most notably in the United States and in Japan, growth prospects remain weak in most OECD countries and unemployment remains high.
4. In terms of promoting growth of the global economy, it is essential that the OECD strengthen relations between both member countries and non-member countries that play an important role in the world economy. In this context, the enlarged Assembly notes with satisfaction that negotiations for the accession of the Russian Federation to the OECD are continuing. It also notes the OECD decision to embark on a new round of accessions as set out in the Council Resolution on Strengthening the OECD's Global Reach, with an invitation to Colombia and Latvia to begin accession discussions this year and with a view to taking decisions to open accession discussions with Costa Rica and Lithuania in 2015. Furthermore, the enlarged Assembly also welcomes the OECD decision to launch the regional programme for South-East Asia to strengthen its ties with the strategic priority countries in addition to the close collaboration with its Key Partners.
5. Against the background of a hesitant global economic recovery, the OECD Secretary-General has set an agenda for the organisation for the coming year covering three broad areas: Inclusiveness and Growth; Interconnectedness for Growth; and Institutions and Governance for Growth. At national level, governments urgently need to restore growth and competitiveness, reduce unemployment, in particular among young people and the long-term unemployed, rebuild confidence, address inequalities and boost job quality. At the same time, governments face global challenges including the further deepening of globalisation, poverty, rapid population ageing, migration, climate change, growing natural resource scarcity, and a global economy based on knowledge and skills.
6. Development is at the core of efforts to achieve a fair and equitable global economy. With the 2015 deadline for the Millennium Development Goals now close at hand, the enlarged Assembly welcomes the OECD's drive in the context of its Strategy on Development to achieve Policy Coherence for Development and to strengthen engagement and knowledge sharing with developing countries. It looks forward to further progress in mainstreaming development into the Organisation's work.
7. Adequately resolving environmental challenges will be crucial to successful global development. With this in mind, the enlarged Assembly welcomes the OECD's efforts to mainstream its Green Growth Strategy into core policy areas, while it continues to emphasise the importance of innovation. It looks forward to further progress in the OECD's work on indicators and other measurement tools and in its drive to integrate green growth considerations into sub-national and multilateral policy.
8. Successfully addressing the employment crisis is one of the biggest challenges facing governments. The enlarged Assembly welcomes ongoing work in the context of the OECD's Skills Strategy, launched in May 2012, to ensure that today's young people are equipped with the skills that will be needed in tomorrow's changing employment market. Important milestones will include the launch in October 2013 of the OECD's first Skills Outlook, based on the results of its Survey of Adult Skills (PIAAC), and the publication in December 2013 of the latest results of the triennial PISA assessment of competencies of 15-year-old school students. The enlarged Assembly invites the OECD to work with national governments to develop integrated approaches at both national and local levels that cover not only how skills are provided by education and training systems, but also how firms promote the acquisition of the skills they need and how they utilise them in the production process.

2. Draft resolution adopted unanimously by the committee on 5 September 2013.

9. The enlarged Assembly recognises the importance of addressing social inequities and implementing suitable measures to alleviate employment issues as part of the achievement of sustainable and inclusive growth, which will help restore confidence in our governance system. In this context, the enlarged Assembly welcomes the fact that the 2013 OECD Ministerial Council adopted the Recommendation on Gender Equality in Education, Employment and Entrepreneurship and committed to deliver progress on gender equality, and encourages the OECD to further strengthen its efforts to address inequalities

10. While the enlarged Assembly notes the necessity for many OECD member States to deal with a sovereign debt crisis, it also supports the call of the Trade Union Advisory Committee to the OECD (TUAC) that “financing fiscal consolidation through cuts in public services, in social security and pensions would only prolong the jobs crisis and risk a social crisis”.

11. Holistic policies taking account not only of employment challenges but of all aspects of individual countries’ economic realities hold the key to successful emergence from the crisis. In this context, the enlarged Assembly notes with satisfaction the ongoing work in the framework of the OECD’s New Approaches to Economic Challenges (NAEC) initiative. Launched in May 2012, this endeavour to draw lessons from the crisis aims to promote a broader notion of growth that also considers other important outcomes such as well-being, inclusiveness and environmental sustainability.

12. The enlarged Assembly recalls the OECD Secretary General’s response to the Assembly last year that “the OECD policy advice should be strengthened by continuing to upgrade [its] analytical skills”. Therefore it urges the OECD to press ahead with the NAEC initiative with a view to reporting at the 2014 Ministerial Council on the NAEC, including clear policy proposals. The Assembly also recognises the need for each government to restore confidence by adopting reform measures promoted through the NAEC proposal.

13. At a time when the crisis and its fallout have undermined citizens’ confidence in democratic institutions, policymakers need to take steps to rebuild trust in government. The OECD is developing a policy agenda on trust designed to support efforts to build more effective, more transparent and more open government institutions. OECD work focuses on giving citizens a stronger voice in policy development, making institutions more responsive to user needs, and enhancing the flow of information between government and citizens. In addition, building trust in government means ensuring high standards of integrity, particularly in high-risk areas such as lobbying, public procurement and political financing. In today’s increasingly complex and interconnected global economy, it is of paramount importance that the burden of financing government expenditure on necessary services and infrastructures should be seen to be fairly shared. The enlarged Assembly welcomes the OECD’s work on transparency, accountability and integrity issues.

14. The OECD has also increased its co-operation with key partner economies (Brazil, China, India, Indonesia and South Africa) and regions (South-East Asia, the Middle East and North Africa (MENA) region, Latin America and Africa), and plays a key role in supporting the G8 and G20 processes. On the latter, it contributes with analysis and data to better inform discussions on a variety of economic, social and environmental issues, including those linked to structural reforms in the context of the Framework for strong, sustainable and balanced growth, employment, financial education and consumer protection, anti-corruption, green growth, fossil fuel subsidies, trade and investment and taxation. The organisation also plays an active role in supporting the economic, social and political development of the MENA region, in connection to the Deauville Partnership.

15. The enlarged Assembly also welcomes the OECD’s work on Interconnectedness for Growth, in particular the creation with the World Trade Organisation (WTO) of a new database on Trade in Value Added and its work on Global Value Chains. This work has the potential to change our understanding of global trade, investment and production patterns, highlighting the importance of trade facilitation and services liberalisation, and leading to a better measurement of both the gains from trade and the costs of protectionism.

16. The OECD has taken a lead role in the international drive to ensure tax fairness by cracking down on aggressive tax evasion. But governments’ taxation policies will also have to be adapted to an increasingly globalised economy to ensure adequate fiscal revenues and to maintain sound public finances. In this context, the enlarged Assembly welcomes the OECD’s work on Base Erosion and Profit Shifting (BEPS) and in particular the comprehensive and ambitious G20/OECD Action Plan released in mid-July 2013 to address BEPS. The enlarged Assembly urges the OECD to continue to take a determined lead in reforming international rules for the taxation of multinational corporations so as to adequately reflect production and trading practices in today’s global economy. In addition, it recognises the importance of governmental collaboration to co-ordinate tax systems and thereby ensure that tax payers have confidence in them.

17. To ensure fair taxation of global profits, the enlarged Assembly urges the OECD to:
 - 17.1. improve data collection on BEPS as this is critical to monitor the future implementation of the Action Plan, including identifying the types of data that taxpayers should provide, as well as the methodologies for analysing these data to assess the likely economic implications of BEPS and actions taken to address BEPS;
 - 17.2. promote the obligation for transnational corporations to produce comprehensive global financial reports, including country-by-country reporting, as a first step towards a possible multilateral agreement on a system of unitary taxation of transnational corporations;
 - 17.3. push for a “Big Bang” approach requiring transparency of beneficial ownership and automatic exchange of information for tax purposes between all countries in order to ensure tax fairness and compliance by both corporate entities and individuals;
 - 17.4. develop mandatory disclosure rules regarding aggressive or abusive transactions, arrangements or structures, with a focus on international tax schemes;
 - 17.5. propose measures for countering harmful tax practices more effectively, with a priority on improving transparency, including compulsory spontaneous exchange of rulings related to preferential regimes and on requiring substantial activity for any preferential regime;
 - 17.6. analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties accordingly;
 - 17.7. promote international coherence of corporate income taxation, so that the design of tax policy is better informed by the increasing interconnectedness of economies and the gaps that can be created by interactions between domestic tax laws;
 - 17.8. do more to take account of the needs and interests of developing countries in this respect, and to associate developing countries more fully with the preparatory discussions and focus groups that are addressing these various issues;
 - 17.9. push for collaboration between the Global Forum on Exchange of Information for Tax Purposes and the OECD task force on tax and development, the World Bank Group and other organisations to help developing countries identify their needs as regards technical assistance and capacity building.
18. The enlarged Assembly encourages the OECD to step up its fight against the widespread aggressive tax evasion that continues to be encouraged by tax havens and in particular to press internationally for the implementation of arrangements for the automatic exchange of information for tax purposes.
19. Finally, the enlarged Assembly welcomes the OECD’s leading role in formulating various policy initiatives, such as employment creation, Skills Strategy, Development Strategy, promotion of gender equality and works on Global Value Chains (GVC) and on measuring Trade in Value Added terms. The enlarged Assembly also invites the OECD to provide participants in the enlarged debate with information on efforts made with regard to the issues referred to in this resolution in a suitable manner either prior to or at the time of the next enlarged debate.

B. Explanatory memorandum by Mr Van der Maelen, rapporteur

1. Introduction

1. Two weeks after my appointment as rapporteur by the Committee on Political Affairs and Democracy, I attended, from 11 to 13 February 2013, the OECD Parliamentary Days, and in particular the OECD High-Level Parliamentary Seminar on “Following the money: Trade, tax and banks”. On that occasion, I also had the opportunity to meet several high-level members of the Secretariat of the Organisation for Economic Co-operation and Development (OECD) and my compatriot, Yves Leterme, Deputy Secretary-General of that organisation.

2. Following the exchange of views with Mr Leterme, I decided to deal with the following subjects in my report: the OECD initiative on New Approaches to Economic Challenges (NAEC); development and taxation issues; and the OECD work on Base Erosion and Profit Shifting (BEPS). I chose these topics for two major reasons. Firstly, it is my view that governments’ inadequate responses to the economic and employment crisis have damaged citizens’ trust in democracy. This is demonstrated by the rise of populist propositions that characterise public debate in many of our member States, and indeed it has been the subject of a report recently presented to the Assembly.³ Secondly, the ability of governments to raise funds through taxation in order to pay for necessary public services is a fundamental anchor for democracy. When the actions of companies and individuals undermine governments’ legitimate financing abilities, either through aggressive tax avoidance or through illegal tax evasion, the very fundamentals of democracy and equitable development are threatened. This is a problem, not only for developed countries but also for the developing world. The OECD is playing a leading role in international efforts to bring greater fairness to tax policy worldwide.

3. On 8 March 2013, I made a fact-finding visit to the OECD, where I had very constructive meetings with: Sven Blondal, Head of the Macroeconomic Policy Division, on Economic Outlook; Shardul Agrawala, Head of the NAEC Unit in the Office of the Secretary-General, on the NAEC; Grace Perez-Navarro, Deputy Director, Centre for Tax Policy and Administration, on BEPS and the OECD work on Tax and Development; and Willemien Bax, Head of Public Affairs, on OECD activities relevant to the work of the Council of Europe. On 28 and 29 May 2013, I attended the OECD Forum in Paris, which focused on three key themes in the debate on how to achieve a sustainable future: promoting inclusive growth and addressing inequalities; rebuilding trust in the system; and fostering sustainability.

4. In the meantime, I had proposed to the committee at its March 2013 meeting the following timetable, which is the same as we had in 2012, and to which the committee agreed:

- Hearing with relevant OECD high-level officials and other experts on 5 June in Paris, based on an outline report.
- The committee agrees on a draft report during the Assembly’s June part-session.
- The draft report is sent to the overseas delegations and to the OECD, for comments, at the beginning of July.
- Approval of the report by the Committee on Political Affairs and Democracy, enlarged to include representatives of the overseas delegations on 4-5 September in Paris.
- Debate in the enlarged Assembly on 1 October in Strasbourg.

5. On the basis of the above-mentioned agreed timetable and scope of the report, I prepared an outline report for discussion at the meeting of the Sub-Committee on relations with the OECD and the EBRD in Paris on 5 June. On the occasion of this meeting, a hearing was organised with the following participants: Raffaele Russo, Head of the Non-Compliance Unit, International Co-operation and Tax Administration Division, OECD Centre for Tax Policy and Administration; Shardul Agrawala, Head of the NAEC Unit, OECD; John Christensen, co-founder and Executive Director of the Tax Justice Network; and Gabriel Zucman, PhD Candidate, Paris School of Economics.

6. In the light of this hearing and the outcome of discussions with members of the sub-committee, I presented to the Committee on Political Affairs and Democracy a draft report for consideration during the June 2013 part-session, thus respecting the agreed timetable. I took this opportunity to thank Mr Nicholas Bray for his valuable assistance in the preparation of that version of the report.

3. See [Resolution 1888 \(2012\)](#) on the crisis of democracy and the role of the State in today’s Europe.

7. The committee considered the draft report and agreed that it be sent to overseas delegations and to the OECD for comments or contributions. This was done on 5 July 2013. Some delegations and the OECD sent contributions and I am grateful to them. Those contributions which I could accept have been included in the present report.

2. New thinking needed to pull the world economy back on a growth path

8. The financial and economic crisis that exploded in 2008 is still continuing in 2013. Unprecedented action by central banks to inject liquidity into economies has staved off disaster. The tentative recovery that began in 2010 was not, however, strong enough to put the world economy back on a solid growth path and the outlook, particularly in Europe, remains uncertain. Unemployment is high and businesses hesitate to invest. Consumers lack the confidence to increase their spending and OECD governments are under pressure to reduce high public debt levels.

9. According to the OECD's latest economic forecasts, published on 29 May 2013 ahead of the Organisation's annual ministerial meeting, the global economy is gradually regaining strength. The OECD predicted that gross domestic product (GDP) in its 34 member countries would grow by 1.2% this year, with the United States economy expanding by 1.9% and the Japanese economy by 1.6%. Growth in China is forecast to continue at a steady rate of 7.8% this year. However, European economies mostly remain weak, dragged down by record-high unemployment. The OECD forecast that the euro-area economy will shrink 0.6% this year, before returning to a forecast growth rate of 1.1% in 2014.

10. Income inequality is rising, not only between countries but within countries. According to recently published OECD figures, the richest 10% of the population in OECD countries earned on average 9.5 times the income of the poorest 10% in 2010, up from 9 times in 2007. The gap was largest in Mexico, where the richest 10% had 27 times more income than the poorest 10%. But it was also particularly high in Chile, Turkey, the United States and Israel. Further cuts in welfare spending are likely to add to income inequality and cause greater poverty in OECD countries in the years ahead.

11. Against this background, it is not surprising that policymakers are increasingly turning against the neo-liberal free-trade and free-market policies that gained currency during the 1980s and 1990s. In preparing this report, I was struck by the conclusions of the latest Human Development Report from the United Nations Development Program (UNDP). Entitled "The Rise of the South", this report is an invitation to shift from dogmatic thinking to fact-based thinking on socio-economic policies for human development. It shows that developing States that performed well were often those that actively supported private industries and collaborated with the private sector to improve human development; that opened gradually, rather than suddenly, to world markets; and that invested in health, education and human development.

12. This is in stark contrast to the dogmatic Washington thinking of only a few years ago, which imposed on countries in difficulty a recipe of minimal State intervention, immediate opening to trade and structural adjustment with far-reaching cuts in public spending on education and health.

13. This shift in policy approach coincides with a shift in the nexus of growth from West to East and from North to South, and a growing realisation that some economic recipes of yesterday are no longer relevant for tomorrow. In an article in the *OECD Observer* last year, OECD Secretary-General Angel Gurría acknowledged that "the world economy is going through a paradigm shift". Under such conditions, he concluded, "we need to identify which of our previous ideas, frameworks and tools still hold and which need to change". Reality has forced the OECD to engage in some serious soul-searching.

14. A look at some of the economic prescriptions that the OECD was issuing only three years ago shows how far policy advice has been overtaken by events. After the immediate financial crisis of 2008-2009 had passed, many developed countries responded with shock treatment of spending cuts and tax increases in an effort to rein in high public deficits. In its *Economic Outlook 87*, published in the spring of 2010, the OECD recommended that the central banks begin exiting from extraordinary policy measures and in some cases start to "normalise" their policy interest rates in order to guard against a risk that inflation expectations might become "de-anchored" in the context of a forecast recovery in activity. At the same time, it suggested that the European Central Bank (ECB) should prevent overnight rates from converging too soon to the higher key policy interest rate and raise interest rates in the euro zone by the end of 2010, this despite the fact that OECD's models projected low inflation for years to come.⁴

4. See also Krugman (2012), "End this depression, now!", *W.W. Norton & Co.*

15. In this context, one may note that the OECD has consistently highlighted the role of structural reforms, not only in paving the way for strong potential growth over the longer term but also in strengthening activity in support of the recovery. Structural policies are indeed at the heart of its analysis and policy advice and of its response to the crisis.

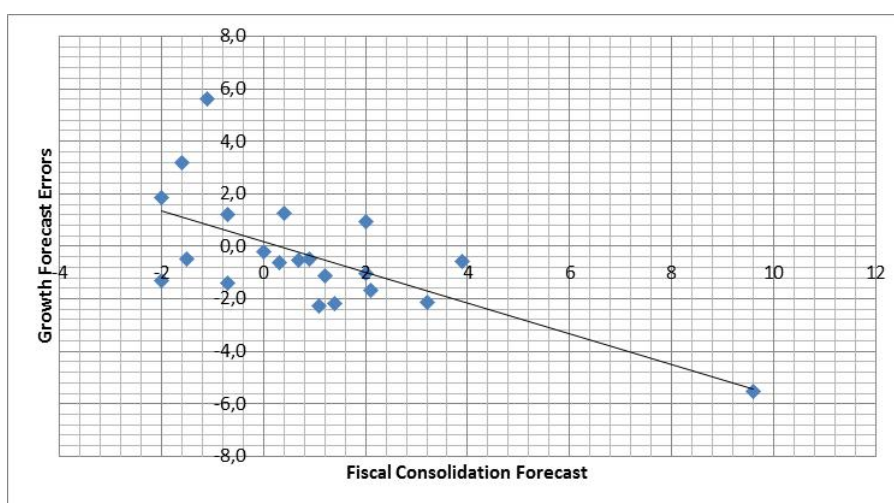
16. Structural reforms were frequently cited as tools to combat macro-economic imbalances and improve competitiveness for deficit euro countries, both in the *Economic Outlook 87* and in subsequent publications, such as *Going for Growth*. Emphasis was put on structural reforms in labour and product markets with the aim of increasing competition, fostering innovation and combating long-term unemployment. European periphery countries were cited in particular as potential beneficiaries of such measures as part of a package to restore competitiveness, but emphasis was also put on the need for reforms in surplus countries that would contribute to a more symmetric rebalancing.

17. In some instances, such as in the economic survey of Portugal in 2010, a combination of lower labour taxes and higher value added tax (VAT) was suggested as a way of giving short-term stimulus, also called fiscal devaluation.

18. The OECD's *Economic Outlook 87* did acknowledge that redressing imbalances through low inflation or deflation in the periphery would be difficult and that not all countries should pursue price competitiveness at the same time. The OECD's advice on monetary, fiscal and structural policy has reflected this, including arguing for strong monetary stimulus to ensure that the inflation target is met and allowing above-target inflation in surplus countries. The advice differentiated on the pace of fiscal consolidation and the urgent need for reforms in surplus countries, but it did not follow up on that observation by recommending higher aggregate inflation in the eurozone or fiscal stimulus in surplus countries as a means of addressing imbalances.

19. Now, after three years of lacklustre growth and ongoing recessions in many member countries, it is time to evaluate the forecasting record and the impact of policy actions taken, including those recommended by the OECD. Actual growth rates have turned out much weaker than those forecast by the OECD and other such bodies in 2010. Figure 1 draws on OECD data to show the forecasting error, namely the difference between forecast and actual GDP growth, as a function of the fiscal consolidation effort that was predicted at that time. It turns out that, on average, countries with large planned consolidation packages have seen larger-than-expected adverse effects on growth. However, the OECD argues that this result is very sensitive to the inclusion of a specific country in the sample and does not necessarily imply a causal link. In addition, other factors such as openness, financial structure and the impact of the euro area sovereign debt crisis appear to have stronger relationships to the forecast errors that were made.

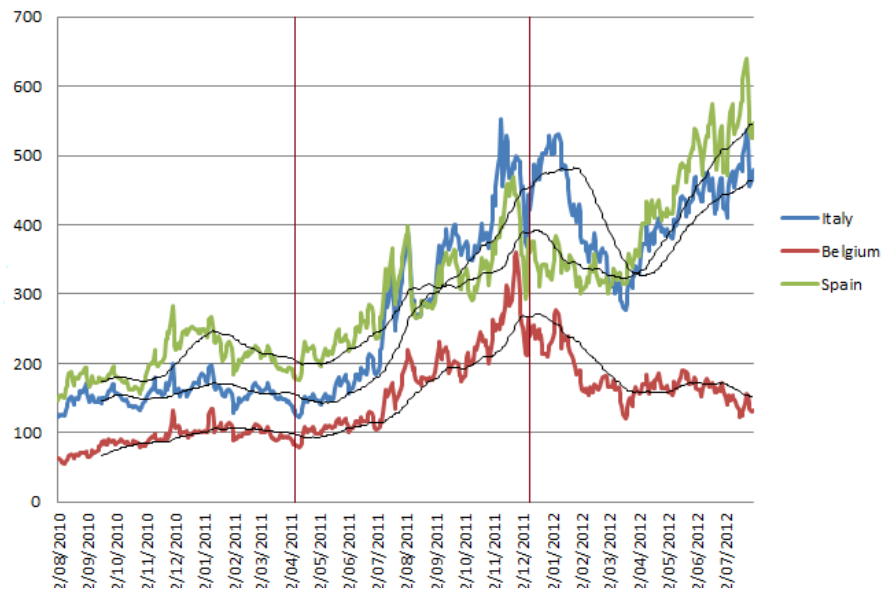
Figure 1: Fiscal consolidation plans and growth forecast errors



Note: The sample used here includes those OECD countries that are considered in the International Monetary Fund's (FMI) World Economic Outlook, October 2012, Figure 1.1.1.

20. Bond spreads in distressed euro countries have widened. Figure 2 shows the rise in the spread of Spain, Italy and Belgium from 2010 to 2012. It suggests a role of the rate increase by the ECB in April 2011 in fuelling panic on European bond markets. By reacting too aggressively to a perceived rise in inflation at that time, the ECB may have implicitly given the signal that periphery countries with overvalued real exchange rates could not count on the ECB to help ease the deflationary spiral in these countries by allowing for more inflation in the core. This led bond markets to conclude that countries would not be able to maintain the deflationary process for long, raising expectations of default and setting off a self-fulfilling crisis. The ECB seems to have underestimated the crucial importance in a monetary union of a lender of last resort, in the form of a central bank that protects the government from a sudden stop in access to funding.

Figure 2: 10-year bond spreads over German Bunds, for Italy, Belgium and Spain



Note: The first line indicates the date of the ECB's rate hike, the second the inauguration of the government Di Rupo-1 in Belgium.

3. The need for “new approaches”

21. Why did this debacle occur? In part, because the adverse effects of fiscal policy on growth were underestimated. It turns out that the impact of fiscal multipliers – materialised in the percentage decrease in GDP resulting from a given amount of fiscal consolidation – has been higher than had previously been expected. Now, at last, there are signs that Europe's policymakers may be coming to their senses and relenting on the pace of co-ordinated fiscal policy tightening. Continued recession, rising unemployment, sub-target inflation, and weak money and credit data have belatedly forced the ECB to play a more active role in favour of expansion. At the same time, the OECD has embarked on a far-reaching review of economic thinking, under an initiative called “New Approaches to Economic Challenges”.

22. If the crisis of 2008-2009 was the result of failing financial markets, there are good reasons to conclude that the ongoing recession after 2010 has been partly the result of bad judgment and policy errors in dealing with the aftermath of the crisis and the legacy of high private debt build-up. This initiative provides a welcome opportunity to review new academic contributions that may help to formulate policies better adapted to the current crisis.

23. Earlier this year, in my role as rapporteur, I had the privilege to look at an OECD working paper setting out some of the considerations that are guiding the OECD's work. I was both surprised and gratified to find phrases referring, for example, to “the need to revisit the objectives of macroeconomic policies” and “the need to upgrade the regulatory capacities of governments”. At one point, the paper referred to the “flawed assumptions about the self-equilibrating character of the economy”, while at another it noted “the need for policies to be better oriented towards promoting well-being through reduced inequality, better jobs and improved environment and not just macroeconomic outcomes”.

24. New Approaches to Economic Challenges (NAEC) was launched at the OECD in 2012 as an organisation-wide reflection process with the aim of catalysing a process of continuous improvement of OECD analytical frameworks and policy advice. Consistent with the ambitions of this endeavour and to ensure a “whole of the house” approach, the Secretary General himself is overseeing this work, with the support of his Chief of Staff and Sherpa to the G20, Gabriela Ramos. While the financial and economic crisis is an immediate catalyst, such a reflection is timely for a number of other reasons as well, to adapt to evolving policy challenges, including a further integration of large emerging markets in the world economy; technological change; increases in international division of labour; population ageing, migration and other demographic shifts; and growing natural resource scarcity, climate change and environmental degradation. A cross-cutting theme in the NAEC initiative is the limitation of existing analytical tools, policy frameworks and governance arrangements to address the significant rise in interconnectedness and complexity of the global economy. This includes interconnectedness across and within countries, between the financial sector and the real economy, and at a deeper level, among various global trends that have been building up for decades.

25. The ultimate objective of NAEC is to develop a strategic policy agenda for well-being and sustainable, inclusive growth built on the interconnectedness, complementarities and trade-offs among different policy objectives and instruments. Working within the NAEC framework, and building on its flagship work on growth, inequalities and well-being, the OECD aim to deliver a new vision that combines strong economic growth with improvements in living standards that matter for people’s quality of life – good health, jobs and skills, and a cleaner environment, including from an intergenerational perspective. A critical element in this agenda is the work on inclusive growth that was launched at the OECD with the support of the Ford Foundation. In its May 2013 report to its annual Ministerial Council Meeting, the OECD set out the objectives of its “New Approaches to Economic Challenges” as being to:

- improve our understanding of the complex and interconnected nature of the global economy and find better ways to cope with policy trade-offs and profit from synergies (such as between growth, inequality, stability and the environment);
- recognise the importance of economic growth as a means, but not as an end, of policymaking. This means having a broader definition of well-being outcomes and developing policy outcomes that combine strong economic growth with improvements in living standards and outcomes that matter for people’s quality of life (good health, employment, etc.);
- identify areas where OECD analytical frameworks need to be adjusted or complemented; and examine the potential for mainstreaming new economic data, tools and approaches (for example behavioural economics);
- enable governments to identify, prioritise and combine reforms to support sustainable, inclusive growth.

26. If such statements are harbingers of a shift in economic thinking, not just in relation to Europe but at a global level, there may indeed be hope for a long overdue meeting of minds between North and South in search of policies for a better shared well-being for all the people of the world. I feel that the OECD is to be encouraged to pursue its work on “New Approaches” with a view to bringing new thinking to a debate that for too long has been going round in circles. The world needs to break out of the bind that it finds itself in. As a grouping of nations committed to best practices in economic policy, the OECD is the right forum in which to take this debate forward.

4. Handling the liquidity trap

27. In the meantime, however, we must not lose sight of the harsh realities. One important observation with far-reaching consequences that emerges from the OECD’s studies is the fact that the crisis seems to have permanent effects on economies’ growth potential. Not only are there short-term effects, with economies underperforming at levels below trend: the long-term productive capacity of a country’s economy is damaged. Economists call this effect hysteresis: the long-term consequences of short-term effects.

28. There are numerous channels through which hysteresis works: reduced capital investments, reduced investment in research and development, reduced labour force attachment on the part of the long-term unemployed, scarring effects on young people who have trouble starting their career, reduction in governments’ physical and human-capital investments. All have the effect of depressing an economy’s potential. Even when the economy recovers, it will find itself on a lower growth path than before.

29. Economists such as DeLong and Summers⁵ have pointed out that hysteresis adds an important new dimension to the austerity debate. Indeed, it is clear that hysteresis endangers the long-term viability of public finances since it puts the economy on a lower growth path. The corollary of that observation is that temporary

fiscal expansion may be self-financing in the long run if hysteresis effects are sufficiently strong. If there are moderate to large fiscal multipliers, fiscal expansion will cause the economy to grow in the short run. The hysteresis effect allows the short-run boost to have long-lasting positive effects. Applying the model to the eurozone, DeLong⁶ states that if long-term real borrowing costs in the eurozone do not exceed 5%, temporary stimulus will probably strengthen fiscal conditions and improve confidence.

30. DeLong and Summers are careful to point out that this effect only works in limited cases. As a first rule, interest rates must be reasonable. Obviously, a government with acute liquidity problems will not be able to finance a short-term fiscal expansion. Also, fiscal multipliers must be reasonably high. DeLong and Summers argue that this is not the case in most instances. In normal times, central banks tend to offset fiscal stimulus through monetary tightening: the fiscal expansion will not have any effect, multipliers are close to zero.

31. In severe crises such as the one that we are living through today, monetary authorities may not “lean against the wind” as they do in normal times. Indeed, their tools are likely to be insufficient to combat the crisis: this phenomenon is called a liquidity trap. These conditions may characterise large parts of the western world today.

32. As your rapporteur, I should like to share some other considerations that I have found interesting in preparing this report. The work of Gauti Eggertson and Paul Krugman⁷ has shown that countries that need to cope with excessive debt may not profit from policies that are otherwise considered as beneficial for growth. They show that increased flexibility and an increase in labour supply may even result in adverse effects. Falling prices and wages due to these policies increase the real value of debt, so that the burden of indebted households becomes even larger than before. The cycle of debt deflation becomes even more vicious than before.

33. In a recent paper, Eggertson et al⁸ apply this framework to Europe. They find that structural reforms may deepen the recession, worsening deflation and increasing real interest rates. They suggest designing reform packages in such a way that structural reforms kick in only when the threat of liquidity trap has passed. They even suggest that *during* the slump structural reforms should be going in reverse, before being implemented during normal times. Nonetheless, results are sensitive to the credibility of the reforms announced and the ability of the central bank to provide for policy accommodation. Likewise, OECD analysis suggests that some reforms can have positive effects on activity even in the short run depending on the nature of the reforms and, as implied by Eggertson et al, the state of the economy.

34. A large debt overhang from speculative bubbles is a serious problem for many periphery countries. Portugal, Ireland and Spain in particular have seen a large build-up of private household debt in the decennium preceding the financial crisis.

35. A shift from labour taxes towards VAT is sometimes presented as another tool to redress competitive imbalances. Received wisdom on this matter says that such an operation can have only temporary effects: after a while, wages rebalance to restore purchasing power which negates the pro-competitive effect. Some studies conclude that these reforms only produce small effects for reforms with relatively large budgetary sizes.⁹

36. If consolidation is needed, the choice of tax instruments to achieve it should take account of equity concerns as well, since it turns out that economic contraction does not hit everyone in the same way. Ball *et al.*¹⁰ show that spending cuts, in addition to raising long-term unemployment, hit wage-earners the most, while profit and rent income recover rather quickly. These results suggest that an equitable consolidation package should contain reforms that shift the tax burden away from labour and towards capital income.

5. DeLong, B. and Summers, L. (2012), Fiscal Policy in a Depressed Economy, presented in the Brookings Papers for Economic Activity.

6. DeLong, B. (2012), Spending Cuts to Improve Confidence? No, the Arithmetic Goes the Wrong Way, www.voxEU.org.

7. Eggertson, G. and Krugman, P. (2012), Debt, Deleveraging and the Liquidity Trap: A Fisher-Minsky-Koo Approach Quarterly Journal of Economics 127(3): 1469-1513.

8. Eggertson, G., Ferrero, A. and Raffo, A. (2013), Can Structural Reforms Help Europe?, unpublished.

9. Lipinska, A. and Von Thadden, L. (2012), Monetary and Fiscal Policy Aspects of Indirect Tax Changes in a Monetary Union, unpublished, Board of Governors of the Federal Reserve System.

10. Ball, L., Leigh, D. and Loungani, P. (2011), Painful Medicine, Finance and Development.

37. From this short review, it should be clear that the economic challenges that lie ahead of us require carefully tailored policy advice to make sure that recommendations fit the needs of the countries in question. Both specific circumstances, such as the existence of a large debt overhang, and the time period in question, including the threat of a liquidity trap, should be taken into account.

38. But in the context of the European monetary union, the shared responsibility of member States should be acknowledged too. If full-fledged budgetary union is not possible, intermediate policies should be considered. For instance, Paul de Grauwe¹¹ argues that countries which have been able to stabilise their public debt-to-GDP ratio should stop trying to balance their budgets and keep debt ratios constant to the level of 2012.

39. The OECD has a vital role in providing policy advice, not just to the governments of its member countries, but to the world community at large. It has already drawn governments' attention to the challenges posed by widening income inequality in most countries, and it has broadened its analysis of pro-growth structural reforms to highlight trade-offs, synergies and unintended consequences of structural reforms on the distribution of income within countries.

40. With the 2015 deadline for the Millennium Development Goals close at hand, the OECD is working in the context of its Strategy on Development to strengthen engagement and knowledge sharing with developing countries. Continuous efforts are being made to mainstream development into the organisation's work and achieve Policy Coherence for Development. In the environmental policy area, too, the OECD is taking a lead role in offering guidance to governments. Its Green Growth Strategy, launched in 2011, is now being mainstreamed into core policy areas. The education work is also covering more and more the realities of developing countries.

41. It is gratifying to see such examples as evidence that the OECD is at last taking a much needed holistic approach to economic policy issues. Specifically, it is taking this work forward with its reflections on "New Approaches to Economic Challenges", which highlight the inclusive growth dimension of its policy advice. I recommend that the enlarged Parliamentary Assembly urge the OECD to continue in these endeavours with a view to presenting clear conclusions at an early date.

5. Tax evasion and aggressive tax avoidance: a threat to democratic institutions

42. As we have seen, the financial and economic crisis is constricting governments' ability to finance necessary health, education, welfare and infrastructure spending. Fiscal pressures are creating a political backlash, as citizen's protest against the double squeeze of recession and rising tax burdens. Revenue shortfalls due to tax evasion and the aggressive tax avoidance practices of multinational companies challenge democratic systems. It is to be welcomed that the OECD is addressing these issues through its campaign against tax havens and its work on BEPS.

43. More needs to be done, however, both to crack down on illegal tax evasion and to promote far-reaching reform of tax systems in order to combat aggressive tax avoidance. Governments have a duty to ensure that taxes are levied both fairly and efficiently. Much of today's tax legislation is based on an outdated vision of economic activity dominated by fixed assets and with limited cross-border exchange. A digital economy, based on intangible assets and rapid cross-border transfers, requires radical new approaches to taxation. The OECD, given its mission to develop rules supporting the efficient operation of global markets, provides an appropriate forum for the elaboration of new approaches. What is needed now is forceful new thinking, backed by the determination to act.

44. I view this as a matter of extreme urgency. In Europe, leaked documents and e-mails concerning funds allegedly hidden in secret accounts in tax havens by politicians, business people and other wealthy individuals have undermined confidence in democratic institutions. Tax evasion and tax avoidance deprive European Union governments of around one trillion euros in annual revenues, according to the European Commission. This exceeds the total amount that European Union member States spend on healthcare and it amounts to four times the amount of money spent on education.

11. De Grauwe, P. (2013), Design Failures in the Eurozone. Can they be fixed? Euroforum KULeuven Policy Paper.

45. European Council President Herman Van Rompuy put the issue in stark relief ahead of the summit on 22 May 2013 at which European Union leaders reaffirmed their commitment to crack down on tax evaders. "Tax evasion is unfair to citizens who work hard and pay their share of taxes for society to work. It is unfair to companies that pay their taxes but find it hard to compete because others do not. Tax evasion is a serious problem for countries that need resources to restore sound public finances."

6. Combating base erosion and profit shifting

46. The issue is not just a matter of concern for developed countries. Developing countries suffer massively from a fiscal haemorrhage to tax havens. Nor is the issue just a matter of illegal tax evasion. It also concerns fully legal practices that are used by multinational companies to minimise their tax bills. In Britain, companies like Amazon, Google and Starbucks have come under fire for accounting arrangements that enable them to minimise legitimately the amount of tax they pay to the United Kingdom Treasury, despite buoyant sales on British soil. In the United States, Apple has been criticised in Congress for avoiding taxes on tens of billions of dollars in revenues from its international operations that were channelled through offshore entities. In other countries, concerns are also growing that multinational corporations are unfairly exploiting cross-border accounting opportunities to maximise their profits by reducing the amount of taxes that they pay.

47. At the heart of such operations is a clever manipulation of the so-called "arm's-length principle", a concept long considered as a core element in efforts to maintain a level fiscal playing field for international businesses. This arm's length principle requires different entities within a multinational group to book transactions between them as if they were independent enterprises for tax purposes. It was conceived as part of a construct to help promote cross-border business by eliminating the double taxation of profits.

48. Recent examples of corporate activities such as those mentioned show, however, that the construct has undergone such a monstrous distortion that in many cases it actually results in artificial profit shifting. The much vaunted level playing field has become a rock-strewn, crater-pitted terrain in which the skilful and unscrupulous can easily outmanoeuvre tax inspectors armed only with outmoded rule books.

49. What is needed now, in addition to a crackdown on tax evasion, is wholesale tax reform. In my view, merely tinkering with the present system will not suffice to address the fiscal challenges facing Europe and the entire world. In the United States, President Barack Obama acknowledged as much in the President's Framework for Business Tax Reform, a joint report published in February 2012 by the White House and the US Treasury. "The empirical evidence", this report stated, "suggests that income-shifting behaviour by multinational corporations is a significant concern that should be addressed through tax reform".

50. G20 leaders have taken up the challenge, stating "the need to prevent base erosion and profit shifting" in the final declaration following their June 2012 summit in Mexico. Responding to a request from G20 finance ministers, the OECD published a report entitled "Addressing Base Erosion and Profit Shifting" in February 2013. This report, which analyses the root causes of base erosion and the reasons why profit shifting takes place, identified a number of technical elements linked to accounting procedures that facilitate these practices. They include hybrids and mismatches which generate arbitrage opportunities; the residence-source tax balance, notably in the context of digital transactions; and intragroup financing, whereby companies in high-tax countries are loaded with debt; and transfer pricing issues, such as the treatment of intangible, group synergies, and location savings.

51. Hybrids, for example, exploit the possibility of having the same money or transaction treated differently by different countries to avoid paying tax. Typical examples include hybrid instruments allowing a company to treat something as debt in one country and equity in another and hybrid transfers that treat a transaction as transfer of ownership of an asset in one country and as a loan with collateral in another. In my view, the enlarged Assembly should welcome this analysis and urge the OECD to follow through with clear proposals for reform.

52. The OECD Secretary-General presented "Addressing Base Erosion and Profit Shifting" at the February 2013 Moscow G20 meeting of finance ministers, who expressed strong support for the work done and urged the development of a comprehensive Action Plan. The Action Plan was developed by the OECD Committee on Fiscal Affairs between February and June 2013. Non-OECD G20 countries participated in this work and they were all present at the meeting held in Paris on 25 June 2013 where the Action Plan was approved by the Committee on Fiscal Affairs. The Action Plan was presented to the G20 finance ministers' meeting of 19 July 2013, where it received unprecedented support.

53. The ambitious Action Plan sets forth 15 actions to address BEPS in a comprehensive and co-ordinated way (for a summary, see Annex). These actions will result in some of the most fundamental changes to the international tax system since the 1920s and are based on three core principles: coherence, substance and transparency. The Action Plan also calls for further work to address the challenges posed by the digital economy. Looking towards innovative approaches to deliver change quickly, the Action Plan calls for a multilateral instrument which countries can use to implement the measures developed in the course of the work.

7. Who is to blame?

54. At the same time, it is to be noted that tax avoidance cannot just be blamed on the aggressive strategies of individual companies; it is also the result of the tax policies of national governments, including those designed to attract investment by foreign corporations.

55. The OECD's February 2013 report warned that the effectiveness of anti-avoidance rules was often reduced as a result of heavy lobbying and competitive pressure. It also pointed an accusatory finger at preferential regimes which lure companies to more attractive tax locations with only minimal benefit to the receiving host country and significant tax base erosion elsewhere. Those familiar with the issue acknowledge that there has been hypocrisy on the part of governments in complaining about erosion of their tax base while offering tax advantages to foreign companies.

56. Following on from its February 2013 report, and for purpose of developing the Action Plan which was presented to G20 Finance Ministers in July 2013, the OECD consulted a range of stakeholders in March and April 2013, including business and industry, through the Business and Industry Advisory Committee to the OECD (BIAC), labour unions, represented by the Trade Union Advisory Committee to the OECD (TUAC), civil society organisations and non-governmental organisations (NGOs). While business and industry representatives expressed predictably nuanced views of the issues raised, the representatives of the labour movement and civil society made no bones about their concerns.

57. In a report entitled "No More Shifty Business", 58 NGOs from across the world greeted the OECD analysis as "an urgent call to design a new international tax system that: (i) redresses the current unjust distribution of the global tax base, (ii) treats multinational corporations (MNCs) as what they really are: complex structures that are bound together by centralised management, functional integration and economies of scale, and (iii) makes MNCs pay their taxes where their economic activities and investment are actually located, rather than in jurisdictions where the MNC's presence is fictitious and explained by unacceptable tax avoidance strategies."

58. In a subsequent follow-up comment, which I think is worth quoting *in extenso*, this group stated as follows:

"Base erosion and profit-shifting result from a deep structural flaw in the international tax system, and is indeed a major cause of the instability of that system. This flaw is the failure to treat multinational enterprises according to the economic reality of their activity. Instead, a principle has become gradually entrenched that they should be taxed as if they were operating as separate enterprises in each country dealing independently with each other. This fiction does not merely allow but encourages multinationals to organise their affairs by forming entities in suitable jurisdictions to reduce their overall effective tax rate.

The systematic tax avoidance which results from this basic structural flaw has many extremely harmful results. Governments and tax authorities are rightly concerned by the immediate revenue losses, but the ramifications go much wider:

systematic tax avoidance by the largest and most powerful companies in the world undermines the legitimacy of taxation everywhere, as the February report on BEPS acknowledges;

it gives the multinationals which exploit these avoidance opportunities very significant competitive advantages over national firms, resulting in inefficient allocation of investment and major distortions to economic activity;

at the same time, it distorts the decisions of these firms themselves, resulting in some benefits to some countries but overall economic welfare losses;

it has particularly distorted the finance sector, greatly contributing to the creation of shadow banking, excessive leverage and other techniques, and hence the financialisation of economies, leading to the bubble which caused the financial crash of 2007-9, and the economic devastation that has followed;

it sustains the international tax avoidance industry, resulting in enormously wasteful expenditures for both firms and governments;

the techniques and facilities devised by the tax avoidance industry, using the 'offshore' tax haven and secrecy system, are also used for all kinds of evasion, not only of taxes, including money-laundering for crime, corruption and terrorism;

Base erosion and profit-shifting, and generally tax avoidance and evasion, seriously undermine efforts to tackle poverty and inequality, including official development aid."

59. As such considerations demonstrate, national governments are going to have to review many aspects of their tax policies. We should neither underestimate the complexity of this challenge nor the urgency of dealing with it. In particular, governments need to ensure that the international rules for the taxation of MNCs are thoroughly reformed so as to adequately reflect production and trading practices in today's global economy. The enlarged Assembly should thus call on the OECD to take a determined lead in moving this process forward.

8. Time to consider "unitary taxation" of transnational corporations

60. In particular, more attention should be paid, in my view, to the distortions that arise as a result of the present application of the arm's-length principle. The "separate entity" approach gives MNCs tremendous scope to shift profits around the globe to suit their own affairs. The OECD has sought to address weaknesses in the system through enhanced co-operation and co-ordination between governments, as well as changes to the OECD Transfer Pricing Guidelines to ensure that the rules achieve the desired effect.

61. However, some commentators have suggested that it is time to give closer consideration to proposals for unitary taxation of MNCs, whereby these are treated as single entities. Under such an approach, MNCs would be required to submit a single set of worldwide consolidated accounts in each country where they have a business presence, apportioning a share of their overall global profit to each country in accordance with a weighed formula that would reflect the true nature of their economic presence. Each country would be able to see the full picture provided by such a report and tax its portion of the global profits at its own rate.

62. This approach, in my view, could offer a number of important advantages. By simplifying tax administration, it could cut the costs of compliance for firms; it could align tax rates more closely to economic reality, improving the fairness and transparency of the international tax system; and it could greatly reduce opportunities for international tax avoidance through profit shifting and the use of tax havens. All of these outcomes would help to create a genuine level playing field for businesses and would particularly benefit developing countries that are frequently disadvantaged by current practices.

63. Advancing towards such a goal will not be easy. As long ago as 1935, the League of Nations concluded that unitary taxation was "politically impossible". At the OECD, officials involved in international tax policy discussions suggest that such an approach would not be feasible in today's environment where tax policy is a matter for decision by sovereign States. Nonetheless, experience in the domain of international tax policy does show that comprehensive change can be achieved. It should be noted that the Action Plan published by the OECD and endorsed by G20 Finance Ministers and Central Bank Governors in July 2013, recognises that if the arm's-length principle is not fit to address the transfer pricing issues associated with intangible assets, risk and over-capitalisation issues, measures that go beyond it will be proposed.

64. Article 26 of the OECD Model Tax Treaty provides for exchange of information on demand as the minimum standard for the bilateral treaties to be signed by member States, but allows for all forms of exchange of information, including automatic exchange, as explained in the Commentary to the OECD Model Tax Treaty. The OECD has worked on automatic exchange of information for many years and many OECD member countries already routinely engage in automatic exchange of information on a number of items of taxable income, as reflected in the OECD Report, "Automatic Exchange of Information: What it is, How it Works, Benefits, What Remains to be Done", which was welcomed by G20 Leaders in 2012.

65. In July 2013, G20 Finance Ministers declared automatic exchange of information as the new global standard. I note with satisfaction that the OECD is at the forefront of promoting it internationally, is advancing on the design of a single global standard for multilateral and bilateral models for automatic exchange of information, and that its Global Forum on Transparency and Exchange of Information for Tax Purposes, which currently has 120 members, has been tasked by the G20 to monitor and review its effective implementation.

66. With respect to efforts to ensure the fair taxation of MNC earnings, I suggest that the enlarged Assembly should call on the OECD not to close the door on unitary taxation, but rather to consider a step-by-step approach which should start with the obligation for MNCs to produce comprehensive global financial reports including country-by-country reporting. Once this has been achieved, further steps could be considered, including possibly the adoption of the unitary taxation approach at the level of regional groupings such as the European Union, the Association of Southeast Asian Nations (ASEAN) and Mercosur, as a prelude to more widespread adoption.

67. In this connection, I further suggest that the enlarged Assembly should call upon the OECD to do more to associate developing countries with the work on BEPS. I note that the OECD has set up focus groups to discuss key aspects of the issues at stake (Countering Base Erosion, Jurisdiction to tax and Transfer Pricing). The OECD notes that countries were invited to volunteer and that the focus groups were constituted on that basis, with most countries' requests being accommodated. However, the participants in these focus groups are exclusively drawn from OECD or G20 membership. As rapporteur, I feel it is important that provision be made for smaller developing countries also to have a voice in such forums.

68. In order to facilitate greater involvement of major non-OECD economies, in the framework of the Action Plan, the "G20/OECD BEPS Project" has been launched with G20 countries that are not OECD members participating on an equal footing. Other non-OECD non-G20 countries can also be invited to participate on an ad hoc basis. Moreover, the OECD's outreach programmes will be used to involve developing countries in the work. In particular, the four Global Fora on Tax Treaties, on Transfer Pricing, on VAT, and on Transparency and Exchange of Information for Tax Purposes, will be useful platforms for developing countries to provide relevant input, as will the Task Force on Tax and Development. In addition, the Committee of Fiscal Affairs (CFA) will benefit from the input of the United Nations, which has been a participant to the CFA since January 2012.

9. Stepping up the fight against tax havens

69. In parallel, I believe that the enlarged Assembly should urge the OECD to step up its fight against the widespread illegal tax evasion that continues to be encouraged by tax havens. In particular, the enlarged Assembly should support the OECD efforts to press internationally for the implementation of arrangements for automatic exchange of information for tax purposes in order to combat illegal tax evasion.

70. The OECD has highlighted that automatic exchange of information can help to counter offshore non-compliance in a number of ways. It can provide timely information in cases where tax has been evaded either on an investment return or the underlying capital sum. It can also help detect cases of non-compliance even where tax administrations have had no previous indications of non-compliance. Finally, it has a deterrent effect, increasing voluntary compliance and encouraging taxpayers to report all relevant information.

71. In this connection, the enlarged Assembly should welcome the progress achieved so far on transparency and exchange of information on request through the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes and of the Forum on Tax Administration. Set up by the OECD in 2000 to agree global tax standards, the Global Forum now has 120 member countries and jurisdictions. Since 2009, when the G20 launched its crackdown on tax havens by calling for the effective implementation of internationally agreed standards of exchange of information on request, the Global Forum has published 113 peer review reports.

72. Progress has been achieved, in particular, in the number of bilateral agreements between jurisdictions for the exchange of information. Five years ago, most exchange of information on request took place on the basis of a network of tax treaties between jurisdictions with a long history of exchange of information. Today, there are over 850 bilateral tax information exchange agreements (TIEAs) worldwide.

73. At the same time, the OECD's move in 2011 to update and expand the joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters (ETS No. 127) has resulted in a more than doubling of the number of signatories and a further increase in exchange of information (EOI) relationships, including 228 new EOI relationships where no bilateral agreement previously existed. Overall, the number of new EOI relationships (bilateral and multilateral) has increased by more than 1 100 since 2009. It should be noted that the convention provides a useful and efficient mechanism for rapid implementation of automatic exchange of information.

74. While some members of the Global Forum still have to remedy deficiencies in their legal frameworks, it is worth noting that most jurisdictions have now qualified at this level and are able to move to Phase 2 reviews looking at the effectiveness of their information exchange practices. In this phase of its work, the Global

Forum will start rating countries' implementation of the standards on the basis of a four-tier classification system: "compliant", "largely compliant", "partially compliant" and "non-compliant". A first set of reviews covering around 50 tax jurisdictions will be completed by the end of this year.

75. In parallel, the enlarged Assembly may take note of the outcomes of the meeting in Moscow on 16-17 May 2013 of heads of tax administrations from 45 economies in the framework of the Forum on Tax Administration, and in particular of the work by the Forum's Offshore Compliance Network, which has been sharing ideas, tools and techniques for tackling offshore tax evasion.

76. Some countries have been particularly effective in collecting and using data about cross-border financial transactions to detect offshore tax evasion. The tools and techniques that they have developed have been documented in a guide that is available to network members. This is complemented by a practical guide for international auditors that allows them to understand the codes used by banks when making cross-border transfers to identify the bank accounts involved in the transactions. In addition, the Network has developed a catalogue listing tactics, illustrated by practical examples, to help its members develop and refine their strategies for dealing with offshore tax avoidance and evasion, particularly in connection with the investigation of complex offshore structures.

77. Despite such advances, however, I believe that more needs to be done to combat the scourge of tax havens. In 2008, according to a study by Gabriel Zucman,¹² of the Paris School of Economics, around 8% of the financial wealth of households worldwide, or the equivalent of around six trillion dollars, was held in tax havens. Not only are vast amounts of capital sheltered from domestic tax authorities, leading to substantial revenue loss for strained government budgets. Offshore financial centres no longer fit with a political environment which, in the wake of the financial crisis, puts ever more weight on transparency and regulation of the financial sector. In today's world, tax havens are increasingly seen as aberrations.

10. The need for a "Big Bang" approach

78. Evaluating the effects of policy changes on the capital flows between offshore financial centres and other countries is by its very nature extremely difficult. However, a study by Zucman and Niels Johannesen,¹³ of the University of Copenhagen, has thrown up some very interesting information. Using data from the Bank of International Settlements (BIS), they were able to track the behaviour of bilateral bank transfers between 14 jurisdictions, including Switzerland and Luxembourg, on a quarterly basis.

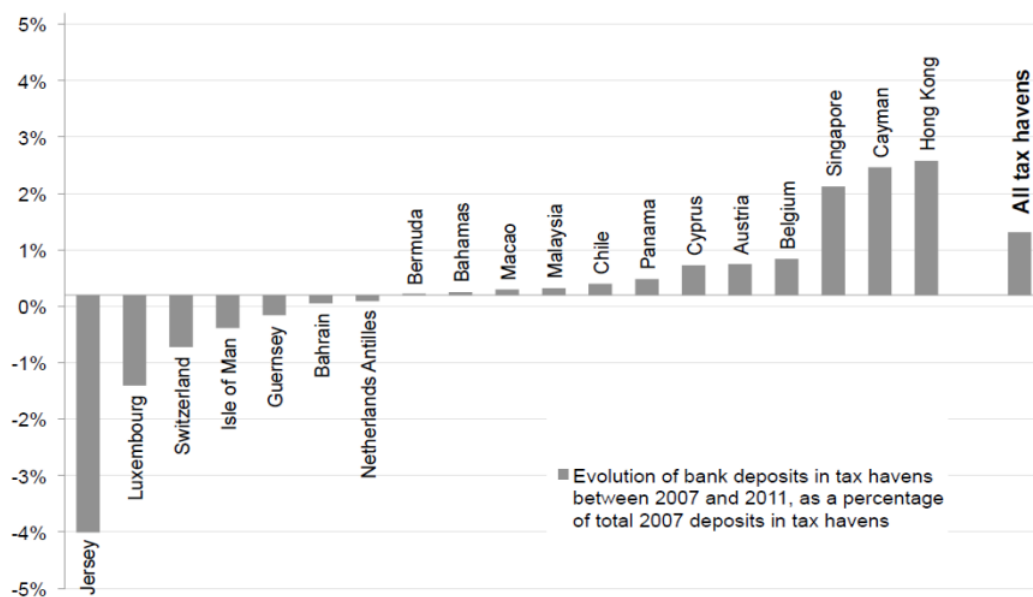
79. The results of their study shed light on the movements of deposits from and between tax havens as the result of treaties signed by tax havens with OECD countries. Tax evaders seem to have responded to the signature of such treaties with only limited repatriation of funds. This suggests that many tax evaders did not perceive a big increase in the probability of being detected as a result of a treaty.

80. Those that did respond to the signature of such treaties did not, for the most part, repatriate their funds to their home country, but instead shifted them to other tax havens that had not signed such treaties. Indeed, after the G20 initiative of 2009 to crack down on offshore tax evasion, the total value of deposits in tax havens actually increased, with evidence of a moderate relocation of deposits between tax havens. This is shown below in figure 3.

12. Zucman, G. (2013), The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors? forthcoming in the *Quarterly Journal of Economics*.

13. Johannesen, N. and Zucman, G. (2012), The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown, forthcoming in the *American Economic Journal: Economic Policy*.

Figure 3



Source: Johannesen, N. and Zucman, G. (2012).

81. The OECD states that it is too early to draw firm conclusions from these data, since many of the 1 100 new exchange of information arrangements are only now coming into effect, meaning that their impact will not become apparent until countries begin using them extensively. Nonetheless, I consider that the findings of Johannesen and Zucman expose the limits of the gradual approach advocated thus far by the G20 and the OECD.

82. The OECD has taken a commendable lead in formulating a policy response to the phenomenon of offshore tax evasion. Its approach, however, and that of the G20, has been to rely on soft, incremental reform. So-called unco-operative financial centres were whitelisted after signing 12 bilateral treaties for exchange of information, freeing them from possible threatened sanctions. Even once such a treaty has been signed, information exchange is not automatic: the current standard of exchange calls only for information on request. Tax evaders exploit loopholes left by the current approach, giving tax havens an incentive to keep the number of treaties signed to a minimum.

83. In addition, the findings of Johannesen and Zucman demonstrate the limitations on governments' ability to track fund flows and illegal tax evasion. Funds are frequently hidden in opaque corporate structures, such as trusts or foundations, which conceal the identity of their ultimate beneficial owner. So-called "secrecy jurisdictions" use legislative and regulatory arrangements designed to reinforce such concealment in order to attract non-compliant capital. In my view, current evidence suggests the need for concerted action on a number of fronts.

84. As your rapporteur, I would like to stress that the bulk of the paper mentioned in footnote 13 is devoted to conducting an econometric analysis that identifies the causal effect of signing on request information exchange treaties on offshore deposits, all other things remaining constant. The key conclusion is that nothing much happens. Since they are on request, information exchange treaties are simply not putting tax evaders in danger; hence the latter do not react much. Those (a small minority) who do react simply move their deposits to non-compliant tax havens. That is what the data say, based on a rigorous methodology that controls potentially confounding factors.

85. I think it is essential to stress once again that there is a real, crucial difference between on request information exchange and automatic information exchange. There is very little information exchanged today through over 800 existing treaties. The French tax administration for instance receives information on about 50 offshore bank accounts per year through its numerous treaties. But French residents have at least 100 000 (and more plausibly 200 000 or 300 000) offshore bank accounts. Automatic exchange of information would mean receiving information about each of those accounts every year – so 200 000 records or so, as opposed to 50 or so today. That is a huge difference. It simply means that 99.98% of the work remains to be done.

86. Experience shows that a concerted drive by major countries can have an impact. In April 2009, when the launch of the G20 initiative appeared to threaten non-compliant jurisdictions with financial sanctions, tax havens moved fast to sign the treaties that were required of them. Small matter that these treaties turned out not to have the force that was expected of them. Nonetheless, the power of concerted action was demonstrated. I am therefore pleased that the OECD and G20 are leading the way in the implementation of a single new global standard of automatic exchange of information.

87. In July 2013, the G20 declared automatic exchange as the new global standard, called on all jurisdictions to commit to this standard and tasked the Global Forum to monitor and review its effective implementation. The G20 also stressed the need to assist developing countries in implementing the new global standard. Other relevant OECD initiatives like the “tax inspectors without borders” were also highlighted by G8 leaders at the 2013 Summit in Loch Erne (Northern Ireland).

88. At the same time, governments need to review basic nuts-and-bolts aspects of their tax-reporting arrangements, including for example the standardised use of fiscal identification numbers, in order to make information exchange effective. On 18 June 2013, the OECD made public a report prepared for the G8, entitled “A Step Change in Tax Transparency”, setting out some of the practical steps that would need to be taken in order to make automatic exchange of information a reality. This report will feed into further discussions at the level of the G20.¹⁴ Also, at the July 2013 G20 Finance Ministers’ meeting, the OECD was asked to submit in November a progress report on the development of a single global standard for automatic exchange, including a timeline for completion of the work in 2014.

89. In my view, in order to combat illegal tax evasion, there is a clear need for more detailed statistical information about financial flows from private households and corporations to low-tax and no-tax jurisdictions. Action should also be taken at an international level to ensure the ability to identify the ultimate beneficial owner of assets held in corporate entities such as trusts and foundations, for example by imposing on the agents that administer these entities obligations similar to those imposed on banks to counter money-laundering. For this reason, the Assembly should also support the G20’s call on the Global Forum to draw on the work of the Financial Action Task Force (FATF) on beneficial ownership.

90. Even if such measures can be agreed and implemented, however, they are unlikely to be effective unless governments agree on a “Big Bang” approach, whereby tax havens are required to sign treaties with all countries, in place of the current incremental policy. This could also be readily accomplished by requiring tax havens to sign the multilateral Convention on Mutual Administrative Assistance in Tax Matters. The Big Bang approach should be supported by the threat of restrictions on financial transactions with non-compliant jurisdictions, in order to prevent the otherwise inevitable prospect of leakage of funds to locations that continue to offer facilities enabling tax evasion. International co-operation at the level of the G20 is needed to achieve such an objective, but the OECD has a key role to play in preparing the ground for such co-operation. The enlarged Assembly should urge the OECD to work with its member countries to significantly step up the pressure for action on all these fronts. The OECD should be the driving force for a new, comprehensive campaign of action against tax havens.

14. www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf.

Appendix – Summary of OECD Action Plan on Base Erosion and Profit Shifting

Action 1: Address the tax challenges of the digital economy – A dedicated task force will identify the issues raised by the digital economy and possible actions to address them. Work will focus on a thorough analysis of the different business models, the ever-changing business landscape and a better understanding of the generation of value in this sector, including from an indirect tax point of view.

Action 2: Neutralise the effects of hybrid mismatch arrangements – Mismatches in the way countries' tax laws treat entities and instruments can allow companies to claim multiple deductions for the same economic expense or cause taxable income to disappear. This action will result in treaty and domestic law provisions to neutralise these schemes.

Action 3: Strengthen controlled foreign companies (CFC) rules – One of the sources of BEPS concerns is the possibility of creating offshore entities and routing income through them to escape taxation in the country of the shareholder. Strong CFC rules can address this issue by including the income of these offshore entities in the shareholder's income on a current basis.

Action 4: Limit base erosion via interest deductions and other financial payments – Some companies use excessive interest deductions to erode their taxable profits, or use debt (which generates interest expense deductions) to finance the production of tax-exempt income. This action will result in rules to prevent BEPS through the use of interest expense and other financial payments.

Action 5: Counter harmful tax practices more effectively – Countries have long recognised that a "race to the bottom" would ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries, whether or not this was the tax policy a country wished to pursue. This action will result in revamping the work on harmful tax practices with a focus on the transparency of the regimes and the economic substance required to benefit from them.

Action 6: Prevent treaty abuse – While tax treaties are designed to prevent double taxation, in some cases they are used to create double non-taxation, in particular through the use of conduit companies set up in a third country (i.e., not the country of the investor or that of the investment). This action will result in provisions that prevent the granting of treaty benefits in inappropriate circumstances.

Action 7: Prevent the artificial avoidance of permanent establishment status – Under the international standard, a country may not tax the business profits of a foreign company unless the company has a permanent establishment in that country. If the company is not taxed on those profits in its jurisdiction of residence, double non-taxation results. This action will result in changes to the definition of "permanent establishment" to prevent the artificial avoidance of permanent establishment status in relation to BEPS.

Action 8: Assure that transfer pricing outcomes are in line with value creation: Intangibles – Transfer pricing rules serve to allocate income earned by an multinational establishment (MNE) among the countries in which the MNE does business. In some cases, MNE have been able to use and/or misapply the existing rules to separate income from the economic activities that produce that income. This action will result in rules that prevent BEPS via the transfer of intangibles.

Action 9: Assure that transfer pricing outcomes are in line with value creation: Risks and capital – Transfer pricing rules serve to allocate income earned by an MNE among the countries in which the MNE does business. In some cases, MNE have been able to use and/or misapply the existing rules to separate income from the economic activities that produce that income. This action will result in rules that prevent BEPS via transfers of risk or excessive allocations of capital.

Action 10: Assure that transfer pricing outcomes are in line with value creation: Other high-risk transactions – Transfer pricing rules serve to allocate income earned by an MNE among the countries in which the MNE does business. In some cases, MNE have been able to use and/or misapply the existing rules to separate income from the economic activities that produce that income. This action will result in rules that prevent BEPS through transactions which would not, or would only very rarely, occur between third parties.

Action 11: Establish methodologies to collect and analyse data on beps and the actions to address it – Further work needs to be done to measure the scale and effects of BEPS, and to monitor the impact of the actions taken to address it. This action will identify tools to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS, including its spill-over effects.

Action 12: Require taxpayers to disclose their aggressive tax planning arrangements – Improved disclosure measures can help tax administrations and tax policymakers to identify emerging risk areas, and also serve as a deterrent to engage in aggressive planning. This action will result in mandatory disclosure rules targeting these kinds of arrangements.

Action 13: Re-examine transfer pricing documentation – While taxpayers are often required to produce voluminous documents regarding their transfer pricing arrangements, in many situations the information does not help tax administrators develop a “big picture” view of a taxpayer’s global arrangements. This action will result in rules regarding transfer pricing documentation that enhances transparency for tax administrations while taking into account compliance costs for business, and will include a requirement that MNEs provide all relevant governments with necessary information on their global allocation of income, economic activity, and taxes paid on a country-by-country basis.

Action 14: Make dispute resolution mechanisms more effective – The actions to counter BEPS must be complemented with actions to ensure the certainty and predictability needed to promote investment in today’s environment. This action will ensure such certainty by developing solutions to address obstacles that prevent countries from solving treaty-related disputes.

Action 15: Develop a multilateral instrument – Changes to the OECD Model Tax Convention are not directly effective without amendments to bilateral tax treaties. A multilateral instrument to amend bilateral treaties is a promising way forward and work has been launched to develop such an instrument to be ready to swiftly incorporate changes.