

**STATES, MARKETS, THE FINANCE LOBBY  
AND  
THE EUROPEAN UNION  
SAVINGS TAX DIRECTIVE**

by

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## Abstract

The thesis analyses, from an international political economy perspective, the negotiations and lobbying that took place to achieve the European Union Savings Tax Directive. The theoretical approach is mainly based on Professor Susan Strange's doctrinal framework of the four structures of power.

Some of the primary documents from and a number of newspaper reports on the negotiations have functioned as the main sources for the study. The thesis concentrates on structural factors that have facilitated and constrained the negotiation process. These are described on three different analytical levels – the world systemic, the inter- and transnational and the national levels. Special and equal emphasis is put on the analysis of states and international organizations, as well as market forces and private actors.

The thesis argues that the juxtapositions of the negotiations originate primarily in historical factors and the different market conditions of the national financial industry. The disparities are most noticeable between high-tax industrialized countries and tax havens. But countries like Belgium, the UK and the USA have also slowed down the process by taking principled positions in certain matters. One of the most important conclusions of the thesis is that agreement on the directive was finally achieved because perseverant positions were discarded in favour of relevant transfers of resources for security, production, finance and knowledge justifiable to all parties.

The necessary compromises have tended to limit equality between the parties and to accentuate the structurally strong position of the richest. Smaller investors suffer more from negative effects of the directive than big ones and some of the strongest financial centres – London, New York and Switzerland – have managed to avoid rigorous EU regulation.

## Sammandrag

Avhandlingen analyserar förhandlingarna och lobbyaktiviteten kring Europeiska Unionens direktiv för beskattning av inkomster från sparande (EUSTD) ur den internationella politiska ekonomins perspektiv. Den teoretiska approachen baserar sig i huvudsak på professor Susan Stranges referensram om fyra maktstrukturer.

Med stöd av tidningsreferat om förhandlingarna och valda ursprungsdokument analyseras strukturella faktorer som å ena sidan befrämjat förhandlingarna men som å andra sidan också begränsat dem. Dessa beskrivs allmänt på tre nivåer – den världssystematiska, den internationella och transnationella, samt den nationella. Speciell vikt har lagts på att analysera såväl staters och internationella organisationers som marknadskrafters och privata aktörers inflytande på förhandlingarna ur ett perspektiv som utgår från att alla aktörer behandlas jämlikt.

Avhandlingen argumenterar för att de motsatsförhållanden som uppstått staterna emellan har sitt ursprung dels i historiska faktorer och dels i olika marknadsvillkor för ländernas finansiella industrier. Tydligast är skillnaderna mellan högbeskattande industriländer och s.k. skatteparadis. Men även länder som Belgien, Storbritannien och USA har satt käppar i hjulet för direktivet och ofta intagit orubbligt principiella positioner. En av de viktigaste slutsatserna är att enighet om direktivet slutligen uppnåddes efter att principiella ståndpunkter övergivits och man istället gått in för att beakta relativa överföringar av säkerhets-, produktions-, kunskaps- och finansiella resurser, vilka var skäliga för alla involverade parter.

De nödvändiga kompromisserna har tenderat att begränsa det rättvisa och framhäva de rikaste parternas strukturellt starka position. Mindre investerare lider, relativt sett, mera av direktivet än de förmögna, och de allra starkaste finansiella centrumen – New York, London och Schweiz – har sett EU:s klor glida förbi.

## Prologue: A Short History of the EU Savings Tax Directive

The history of the European Union Savings Tax Directive (EUSTD) has been a lengthy saga of bargaining and horse-trading, full-stops and redraftings, but in the end the directive passed and will be ratified as from July 2005. In many ways the story starts in 1987 when the European Commission proposed a directive eliminating all capital exchange controls within the European Communities (EC). The free movement of capital was generally welcomed by the member states as an important step toward a single European capital market. But it also aroused worries of tax competition and of the EC eventually turning into a single large tax haven. France and Italy were particularly concerned that the liberalization of capital movements would undermine their fiscal position. (Dehejia & Genschel 1999, 412.)

In order to calm these fears, an additional paragraph was added to the capital movements directive before it was passed in 1988. This instructed the Commission to make proposals on how to prevent tax competition and committed the Council to decide on these proposals by mid-1989. Thus the Commission proposed the introduction of a common 15 percent withholding tax on interest income from savings and bonds. Some members already levied such taxes, but the rates varied greatly, with Luxembourg, the Netherlands and Denmark not levying any withholding taxes at all. A common tax rate seemed necessary to prevent free capital movements from creating a race to the bottom. After the plan had been put on hold in late-1989, it was relaunched by Belgium and Germany in 1993. The reactions to the proposals were almost identical at both occasions. (Ibid., 413)

### *Attempt Number One - and a Half*

The 1989 suspension of negotiations and their resumption in 1993 were both due to changes in the German position. In 1989 Germany had introduced a *national* withholding tax that had caused serious problems for the German financial sector and it was quickly withdrawn. The similarity of the German tax to the Commission's proposal - and the near coincidence of its introduction - worked as powerful reinforcement. With the withdrawal of the German tax came also the (surprising) withdrawal of German support for the EC negotiations. (Bonte 2002, 3)

Since Germany joined the ranks of the dissenters in the negotiations as well, the hopes of winning unanimous agreement on a common European withholding tax were dashed. The problem of tax competition did not however go away. Some member states lowered their withholding tax rates or extended tax exemptions in order to prevent domestic funds from flowing out and encourage foreign funds flowing in, in an effort to counteract the effects of the free capital movements. This was particularly true for Belgium, which was losing a lot of funds to its low-tax and secretive neighbour Luxembourg. (Ibid., 3.)

In 1993 Belgium joined forces with Germany to relaunch the plan for a common withholding tax. In early 1993 Germany had reintroduced a national withholding tax and again suffered a massive outflow of funds. The main beneficiaries were Luxembourg and the German banks doing business there. Struggling to finance German unification, the German government demanded Community action to 'plug the loophole' that was Luxembourg. (Ibid., 4; Dehejia & Genschel 1999, 413.)

On both occasions the British government flatly denied the necessity for any tax co-ordination and supported 'full tax competition'. The British government was the most outspoken of all members in its criticism of the Belgian-German initiative. It argued that a common withholding tax would drive financial business away from London to New York and Tokyo because of the increased costs it would mean. The British thus called for 'a free market in taxation.' (Ibid., 413.)

Luxembourg complained that the proposed tax was 'anti-European' and would drive money away from the EC mainly to offshore financial centres (OFCs)<sup>1</sup> in jurisdictions not affected by the directive that was by now known as the European Union Savings Tax Directive (EUSTD). The Luxembourgers argued for co-ordination, if any, on OECD level. (Ibid., 413.)

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<sup>1</sup> The definition of OFCs and the use of the word vary. The term offshore comes from the fact that tax havens and safe havens are often small islands and from that transactions and activities in these locations are made by people who do not live there. OFCs are though not necessarily islands, but are jurisdictions that are characterized by any mix of banking secrecy (safe havens), low taxes (tax havens) and/or lax financial regulations. Leading OFCs are Switzerland, Luxembourg, the Cayman Islands and Hong Kong, but also the Eurobond market in London's stock exchange is usually considered an OFC because of the lack of financial regulation connected to it. Austria and Belgium are rarely defined as OFCs despite their strict banking secrecy laws. (Engdahl 2004, 15-16.)

### *A Second Shot*

The next attempt to revive the tax co-operation negotiations began in the spring of 1996. The Commission issued a report on the dangers of tax competition and asked the member states to agree on a comprehensive package of measures to defend fiscal revenues from erosion. The so-called tax package included the taxation of cross-border savings (the EUSTD), a code of conduct to avoid harmful (corporate) tax competition, and the elimination of source taxes on cross-border payments of interest and royalties between associated companies. Struggling to meet the Maastricht fiscal criteria, France, Germany, and Italy looked quite favourably upon attempts to regulate tax competition. (Dehejia & Genschel 1999, 414.) Once again though, the negotiations proved to be difficult.

A 'taxation policy group', chaired by the Commission and consisting of representatives of European Union (EU) finance ministers, was formed to advance the proposals of the Commission. It experienced difficulties due to the significant differences that existed between various member states regarding the co-ordination of tax policy in general, and notions of harmful tax competition in particular. The fact that some member states were reluctant from the outset to consider any move towards tax co-ordination is a clear indication of how difficult a task the Commission and prime movers such as France faced when pushing for tax co-ordination reforms. (Gilligan 2003, 57.)

Nevertheless, the Commission proposed that it should prepare a draft proposal for a directive by April 1998. Taking into account the failures of earlier attempts to introduce a common withholding tax, the Commission now proposed a dual approach. Member states could choose between providing information to the other member states about the investment income of their resident individuals or applying a withholding tax at a minimum of 20 percent. This co-existence model provided the possibility for e.g. Austria and Luxembourg to hold on to their banking secrecy laws, while the United Kingdom, because of the negative effects it thought it would have on the financial business in London, was opposed to a compulsory withholding tax. The directive was agreed to be limited only to interest earnings of individuals, an agreement that was carried through to the final directive. Dividends and capital gains from cross-border investments will remain free from any disclosure or requirement of tax, as will corporate and most trust holdings. (*International Money Marketing*, Jul 21, 2003.)

Despite this compromise proposal, the British were not satisfied, and wanted the

abolition of the withholding tax possibility altogether referring to the advantages of information exchange, including that it would guarantee a fairer distribution of tax revenues among countries and that

*'(it) would be sufficient to draw the attention of the country of residence to the existence of the income-producing asset - the tax authorities could then seek sufficient information from the investor to work out the tax liability. In contrast, applying withholding might in some circumstances require a financial institution to perform complex calculations not needed for its own purposes. In addition, a withholding system would require additional administrative costs in order to manage tax deductions or investor certification.'* (HM Treasury 2000.)

The British feared the cost of such administrative complications would hit the Eurobond market particularly hard. For example

*'a British investor in French bonds could ask for the UK's Inland Revenue to levy the withholding tax. However, for that to be accepted, the French authorities would have to provide certificates to accompany every interest payment'* (Paul Tipping of the British Bankers Association quoted in *European Voice*, 18 February 1999).

Further, the 1998 draft directive did not require selected third countries or EU member states' dependencies taking similar or equal measures in order to prevent a flight of funds to non-EU safe havens. Luxembourg had raised fears of funds leaving the EU altogether already back in 1989, but did not have to articulate their opposition to the 1998 draft directive, as Luxembourg was able to hide behind the British objections (*European Voice*, 29 June 2000). The Commission and the Finnish presidency had hoped to finalize arrangements for the EUSTD at the Helsinki EU Summit in December 1999. Considering the various national interests affected and the intensity of the disagreement it was in the end not surprising that this aim was not achieved. But at least the European leaders once again agreed that savings tax evasion was not acceptable and they also agreed to give greater consideration to the British proposals for information exchange. (Gilligan 2003, 58-59.)

### ***The Final Push***

The EUSTD negotiations continued despite these new challenges; some suspected the multiple delays were down to the British 'trying to talk the thing to death' (*European*

*Voice*, 2 September 1999). The principles of a new draft directive and a timetable for its adoption (that changed many times since) were agreed during the Portuguese presidency in the first half of 2000, resulting in a second draft directive issued in 2001. The aim of the agreement was complete information exchange between member states, certain British and Dutch dependent territories and countries adopting similar measures (US, Switzerland, and four European microstates), with a seven-year transitory period during which Luxembourg, Belgium and Austria (all who have strict banking secrecy laws) could instead levy a withholding tax. The EUSTD still formed a part of the larger three part 'tax package', the other parts of which had already been agreed upon earlier.

The initial deadline for the adoption of the new directive was over-ambitiously set for the end of 2000. The deadline was pushed forward two years until the end of 2002 when the Council recognized not only the difficulties of finding a common position amongst member states, but also acknowledging the complexities associated with competing regulatory regimes outside the EU. As negotiations on the technicalities of the transitory withholding tax regime both within the EU and particularly with Switzerland dragged on, the end of 2002 deadline passed. This delay was also in part due to Italian Prime Minister Silvio Berlusconi blocking the finalizing of the deal because of unrelated issues. However, the directive was finally adopted in July 2003 during the Greek presidency, albeit in a watered-down form. Contrary to the 2000 agreements, the ultimate aim of information exchange among all countries after a seven-year period was abolished. Now, to please Switzerland, the directive has a seemingly indefinite transitory period, the end of which is dependent on the success of OECD negotiations. (European Communities 1998; 2001; 2003; *European Voice*, 27 March 2003.)

But there were still further hiccups on the way to implementation of the directive. The original date of implementation was January 1st 2005. But the lengthy and difficult negotiations with Switzerland, which were concluded only in May 2004, gave the Swiss, and others, too little time for implementing the directive (*BBC News*, 2004/05/19). The EUSTD is now applied as of July 1st 2005. When the Swiss deal was concluded, deals with the European microstates were quickly reached according to the Swiss model. The agreement gives the countries the possibility of becoming members of the Schengen, but without judicial and administrative co-operation on direct tax fraud.<sup>2</sup>

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<sup>2</sup> Switzerland has signed the Treaty, but the microstates have not yet started negotiations (and might not

Interestingly there seems to be quiet consent that the US satisfies the EU's criteria, but that a similar written deal as with other third states is not necessary with the US. The US administration has allowed the Internal Revenue Service (IRS) to force US banks to disclose the amount of bank deposit interest paid to non-resident foreign depositors from 15 countries, including most EU members, but excluding Belgium, Austria and Luxembourg. Thus the Bush administration can continue to maintain to its domestic audience that it is not signing up to the EU proposal, while signalling to Brussels that it is prepared to co-operate. (*Knight Ridder Tribune Business News*, Sep 15, 2002.)

Controversially, the UK had already in early 2003 committed its dependencies to the EUSTD, although its right to do so was not apparent. This caused the Cayman Islands to threaten to go to court with the issue. Such legal action would almost certainly have dragged into 2005 and held up the implementation of the EUSTD. The Caymans finally agreed to participate as the result of horse-trading with the British government; consequently no further delays were caused. (*Financial Times*, Feb 3 2004; *International Money Marketing*, March 2004.)

Cayman Islands officials and bankers were also reported to be angry that the directive does not cover Bermuda, another British dependency. Bermuda has apparently been left out by oversight in the EU administration. The 2000 principles state that 'dependent or associated territories in the Caribbean and Channel Islands' are affected by the EUSTD. Bermuda of course is in the mid-Atlantic, not the Caribbean... (*International Money Marketing*, Nov 2003; *The Royal Gazette*, Jun 5, 2003.) This inconsistency was like a jewel in the crown of a directive that had failed live up to its original principles on so many other occasions.

Considering the complexity and length of the negotiations, the reader is advised to consult the table below (table 1), when necessary, in order to place events in relation to the total timeline of the negotiations. The table provides a summary of the main developments of the negotiations.

<p><b><u>Table 1: Timeline</u></b></p> <p><b>1989 – Commission proposal for an EC-wide withholding tax</b>          1989 – Germany withdraws support for Commission proposal          1993 – Germany and Belgium push for a restart of discussions          1996 – Commission report on tax competition  <b>1998 – First Commission draft directive: the co-existence model</b></p>	<p>want to do so either) ('Schengen Treaty' at Wikipedia website.)</p>
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- 2000 – British report argues for the exclusive use of information exchange
- 2001 – Second Commission draft directive: information exchange**
- 2003 – Directive adopted with significant amendments**
- 2004 – Negotiations with Switzerland concluded
- 2005 – Directive implemented**

## 1 Introduction

*'Politics, n. Strife of interests masquerading as a contest of principles.'*

Ambrose Bierce (1842 - 1914), *The Devil's Dictionary*

This roughly sums up how 15 years of negotiations on the European Union's Savings Tax Directive (EUSTD) were hoped to usher in a new era in global financial principles, but in the end achieved too little, too slowly.

The EUSTD has for the first time in history introduced an automatic cross-border exchange of banking information. The directive will have a very tangible impact for the savers it targets, the states that tax and the financial business community. The impact will be felt – if nowhere else - at least in the amount of bureaucracy to handle.

The indirect impacts, however, could in the long term turn out to be very significant indeed. Automatic cross-border exchange of information could, in time, establish a principle and contribute to a change in the overall climate for international business and tax policy (Radaelli, 7 July 2005). It also represents the first important intra-EU deal on direct taxation, a policy area that has so far been considered to be the exclusive competence of individual member states' national legislation. Success with EUSTD could boost the chances of tax policy one day becoming subject to deeper European integration. And if it proves unsuccessful, calls for tightening up the EUSTD will almost certainly become stronger. Finally, the EUSTD is designed to ease possible tax competition in one of the most visible attributes of a state's tax system, namely the top tax rates that it levies on its wealthiest citizens. The tax race to the bottom is seen by many non-governmental organizations (NGOs) as one of the main challenges of globalization<sup>3</sup> and the EUSTD is clearly an attempt to answer this challenge in part.

Until only a few months before the conclusion of the agreement with Switzerland in May 2004, few of the targets of the directive believed in the chances of the EUSTD ever carrying through.

*'[The conclusion of the EUSTD] presupposes that Switzerland's argument on linkage of other issues is resolved (...). But since the Savings Tax Directive took at least 14 years to see the light of day [in the intra-EU negotiations], perhaps we shouldn't hold our breath.'* (*International Money Marketing*, Mar

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<sup>3</sup> See e.g. *Tax Justice Network* website

2004.)

Moreover, a good deal of established theories of politics and negotiations (e.g. rational choice and game theory, see Dehejia & Genschel 1999) suggested a low probability of success in the EUSTD negotiations.

At times EUSTD negotiations brought out unexpected national objections or linkages; both Italian cows and Nazi administration have been used in the debates around the deal.<sup>4</sup> The many twists and turns that the directive has experienced during the negotiation process can be illustrated by the fact that Belgium, one of the prime initiative-takers for the regulation of cross-border savings, now actually has seen it necessary to negotiate itself an exception to the EUSTD.

Not only have there been the expected clashes between EU member states, but also fundamental differences of philosophy between two international organizations, namely the EU and the OECD (*European Voice*, 3 December 1998). The financial business community - without doubt a very powerful and influential lobbying group<sup>5</sup> - played an active role in lobbying and even in submitting direct proposals for a revised directive. To add a final interesting twist to the extraordinary mix of interests in the EUSTD negotiations, the directive is dependent not only on EU member states, but also equal measures being taken by selected third countries, including the United States and Switzerland, as well as member states' tax haven dependencies. This gives the whole process a unique international political dimension. It is not often that national and subnational, as well as international and transnational interests are so clearly present in one set of negotiations.

It has been a lengthy saga of bargaining and horse-trading, full stops and redraftings, but in the end – despite the difficulties and even the occasional sense of despair - the directive was approved and is now being implemented. This however raises the main question of the thesis: *Why is the EUSTD a fact of today? What – including structural mechanisms and forms of power - has generated the change of norms in international political economy that is embodied in the EUSTD?*

This thesis focuses on the negotiation and lobbying process leading up to the conclusion

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<sup>4</sup> A Jersey official has been quoted as pointing out that 'it was the Nazis who introduced many of the banking secrecy rules when they occupied the island in World War Two', while Italian Prime Minister Silvio Berlusconi made it clear at an EU summit that he would renege on the EUSTD deal if Rome was not given 30 years to pay a €50 million fine for exceeding milk quotas (*European Voice*, 20 January 2000; 27 March 2003).

<sup>5</sup> See e.g. Mahoney 2004.

and ratification of the EUSTD, starting in 1989 and ending in 2004. It will seek to explain, not simply describe, the events of the negotiating process. It will go beyond the surface of the at times dramatic exchange of words to try to find regularities that might have caused the actors to act the way they have. This requires a deeper probing of the historical circumstances of the negotiations. The short historical outline in the prologue represents the surface, which will be both expanded and deepened throughout the analysis. Instead of looking only at the articulated interests of the actors, the aim is to systematically organize and describe those factors that have caused the interests to be formulated and advanced the way they have.

These factors are presumed to form structures of power within which each actor operates. These structures, which may be limiting for some and to the advantage of others, are the primary object of this thesis. In the words of Susan Strange (1989, 24) structural power is 'the power to shape and determine structures of the global political economy within which other states, their political intuitions, their economic enterprises and (not least) their scientists and other professional people have to operate'. On the other hand, relational power, 'as conventionally described by realist writers of textbooks on international relations, is the power of A to get to B to do something they would not otherwise do' (Ibid., 25). It is argued that in the competitive games now being played out in the world system, it is structural power that counts far more than relational power.

A closer study of structural power in the context of the EUSTD negotiations can be helpful in bringing up new information and conclusions which could be of relevance also for future negotiations on direct taxation in the EU and globally. An awareness of the structural power that affects negotiations in such issues can give an indication of the direction in which the field of direct taxation is heading in the EU, as well as make decision-makers and negotiators more aware of hidden issues that could affect future negotiations.

### *1.1 Some Initial Clarifications*

The purpose of the directive is to enable savings income in the form of interest payments made in one EU member state, or in Dutch and British dependencies in the Caribbean and the Channel Islands<sup>6</sup> and in selected third states adopting similar

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<sup>6</sup> The Dutch dependencies: The Netherlands Antilles and Aruba. The British dependencies: Anguilla,  
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measures (the United States, Switzerland, Andorra, Liechtenstein, Monaco and San Marino), to beneficial owners who are individuals with a permanent residential address in another member state, to be made subject to taxation in accordance with the laws of the state in which they are residents. It affects interest payments from savings and bonds, but not income from share dividends, unit trusts or insurance policies. Under the directive, depositors in offshore centres as well as Luxembourg, Belgium and Austria may choose to have tax deducted directly by their banks or to forfeit secrecy and allow banks to report the interest paid on their accounts. Customers would then be liable to pay tax at home, according to the EUSTD rules. In the other 22 EU countries, depositors do not have the secrecy option. (*Bloomberg.com*, June 30, 2005; see also table 2.)

**Table 2: Who Pays, Who Tells**

**EU members exchanging information:**

Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, the Netherlands, Poland, Portugal, Slovakia, Slovenia, Sweden, United Kingdom (incl. Gibraltar)

**Other states exchanging information:**

United States

**Territories exchanging information:**

Anguilla, Aruba, Cayman Islands, Montserrat

**EU members levying the withholding tax:**

Austria, Belgium, Luxembourg

**Other states levying the withholding tax:**

Andorra, Liechtenstein, Monaco, San Marino, Switzerland

**Territories levying the withholding tax:**

British Virgin Islands, Jersey, Guernsey, Isle of Man, the Netherlands Antilles, Turks & Caicos Islands

It is important to understand that the EUSTD is not a measure for tax harmonization, but for tax co-ordination. Especially in the early days of the EUSTD negotiations, when a common 20% withholding tax for interest income in the form of interest payments was the primary objective of the directive, it was often interpreted - incorrectly - by the media as being tax harmonization. Notably, while tax harmonization is the EU's objective with respect to indirect taxes, the concept of approximation rather than

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British Virgin Islands, Montserrat, Turks and Caicos, Cayman Islands, Isle of Man, Jersey and Guernsey.

harmonization is the stated objective for direct taxes (Anthony & Roels 1998, 17).

The EUSTD aims to give the member states a chance to effectively collect the taxes properly due from their residents. Also the withholding tax principle still gives the member state the authority to set the actual level of income tax. The EUSTD thus represents a co-ordination of tax policy, which aims to prevent cross-border tax evasion. With most countries applying information exchange rather than a withholding tax, there can be even less doubt that the EUSTD is a co-ordination measure. This, the Commissioner responsible for taxation in the 1990s Mario Monti, described as 'helping member states do what they want to do anyway' (Ibid, 2).

### *1.2 Review of Earlier Research*

The approaches for analysing what drives and explains changes in international tax policy are diverse, varying from mathematical models of competition and co-operation<sup>7</sup> to more constructivist approaches such as Gilligan's (2003) case study of the EUSTD. Yet the results of earlier studies rather seem to support than contradict each other, if only for the obvious reason that there is a myriad of factors that influence policy formation. Three wide explanations for changes in the international tax policy dominate. These are internationalization, institutions and country size, each of which will be opened up below (see Hallerberg & Basinger 1998; Gilligan 2003; Dehejia & Genschel 1999).

The mathematical models, tending to be described as economic research rather than political science, try to find explanations for one particular factor of influence. The descriptive case studies on the other hand, are apt to be more comprehensive in the sense that they do not necessarily reject the conclusions of the mathematical models (they may well embrace them), but try to give a more complete picture of factors that influence changes in tax policy. This study shares with those studies the objective to provide a comprehensive, rather than specific or schematic, picture of structural influences on tax policy change.

In a comparative study entitled 'Internationalization and Changes in Tax Policy in OECD Countries' Hallerberg and Basinger (1998) analyse the role that economic and political factors played in tax reforms in OECD countries between 1986 and 1990. The

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<sup>7</sup> E.g. Kanbur and Keen 1993.

basis for the analysis is the common perception that internationalization in the form of economic integration and technological advances has put pressure towards either a harmonization of the tax system or increased (downward) competition, i.e. the race to the bottom. They argue that this standard account about economic integration and countries adjusting their tax systems overlooks political explanations such as the orientation of the government or institutional structure. But they find a weak correlation between the orientation of political parties in power and the propensity to lower taxes.

This conclusion supports the decision to concentrate on the different forms of structural power in this thesis, rather than on relational power, which is more closely connected to the direct opinions of different actors. It is structures that limit or advance actors' possibilities and propensity to drive issues that Hallerberg and Basinger find more important. Of these, different forms of economic integration are found to be secondary, only giving the reason for initiative. The political structure in the form of the number of veto-players (e.g. party coalitions in government, upper houses and lower houses etc.) seemed to have the most significance. Countries with fewer veto-players were more likely to be able to adjust to the tax pressures initiated by economic integration, while those with more veto-players did not have the same possibility to react to the integration and would thus presumably be more likely to push for harmonization or co-ordination.

In a EU setting the conclusions of Hallerberg and Basinger are not particularly enlightening; it is hardly news that the compromise-ridden decision-making processes in the EU lead to a watering down of policies. But if the conclusion is turned on its head, one can ask not only who has veto-power, but also who has the power to drive issues forward. This is a particularly important question in connection with the EUSTD, which has stayed on the EU agenda for such a long time despite many setbacks.

Dehejia and Genschel (1999: 'Tax Competition in the European Union'), although taking a very different approach in their study, also fail to systematically explain the persistence of the EUSTD on the EU's agenda. They set out to prove the irrelevance of the prisoner's dilemma model as an explanation to the EUSTD negotiations. They find, unsurprisingly, that tax co-ordination is a loss for small tax havens and gains the large diversified economies. This is contrary to the prisoner's dilemma model, which supposes that there is *mutual* gain to be found in co-ordination, if only the prisoners can see beyond their wish to maximize *personal* gain. Dehejia & Genschel find that the prisoner's dilemma and other game theoretical approaches do not apply to tax

competition/co-ordination because tax policy co-ordination is neither mutually beneficial, nor is the relevant choice between global co-ordination and global competition, but rather between regional co-ordination (like the EUSTD) and no co-ordination at all. Because there might be a leakage of the benefits of the regional co-ordination to the parts of the world that are not part of the regime, regional co-ordination might not yield enough intracoalition benefits to make the necessary side payments (to the coalitional losers) feasible because of transaction costs. The gains from the EUSTD are thus not obvious in the black and white sense that game theory suggests. Yet it has been pushed through, and it will lead to redistribution of power and wealth, if not in the simplistic way suggested by game theory. Dehejia and Genschel give no suggestions on how to explain decision making in this multifaceted situation, but are happy to conclude that no decisions will be made, and the race to the bottom would continue. But as is evident from the empirical evidence of the EUSTD, decisions that further co-ordination can be made even in complicated environments.

Gilligan's (2003) article 'Whither or Wither the European Savings Tax Directive?' represents a study of tax policy changes much better applied to the specifics of policy-making in the EU. Gilligan has made an analysis of the EUSTD within the framework of regimes, or social capital. Social capital can be interpreted as 'the norms, networks and typologies of trust that societies share in order to achieve shared objectives'. The EUSTD fits into this description and it can be asserted that the EUSTD is an international taxation regime, though a complicated one. He concludes that 'different jurisdictions (whether they are EU member states or not) will seek to produce social capital for themselves in different ways, and are more than likely to have different views of the types of taxation regimes they want to adopt in order to achieve their objectives'.

While Gilligan's article remains an important point of reference for the present study, the aim is to go a bit wider, and raise some additional issues. Gilligan mostly answers to the question: What are the different opinions of the actors on the EUSTD? It would be useful to be able to answer also such questions as: Why does the EUSTD prevail as a norm? How have the different opinions been formulated? Within which constraints and opportunities have the decisions been made? And what have been the opportunities and constraints for raising the issue in the first place?

Regime change theory, as applied also by Gilligan (2003), tends in practice to direct

most attention to inter-governmental mechanisms and agreements on policy objectives and thus to the decision-making procedures of international organizations. The approach focuses strongly on what goes on within the organization, or in the negotiations between governments concerning the nature of international 'regimes'. The regime analysis too often overlooks or underrates the forces of the market and technology as they affect state domestic and foreign policies and distributional outcomes for both states and companies. Regimes are reduced to objects that makes it possible 'to analyse the structural environment as a set of given constraints and opportunities and not as something that is being continually reshaped by the historically constituted and intersubjectively reproduced societal biases' (Guzzini 1993, 475).

The regime approach starts at the wrong end of analysis, at the developments in international organizations, rather than exploring where they emanate from. Simply because organizations are slow to change their principles and objectives, or to adapt their established procedures, they can be rather distorting mirrors. The analytical framework suggested for this thesis tries to not leave these factors out of the political economy picture. Following the suggestions of Susan Strange (1989, 199-200) the theoretical framework will start with changes in structures of power, rather than starting at the other end with the reflections of change in the efforts of intergovernmental organizations (IGOs).

### ***1.3 Structure of the Thesis and Empirical Materials***

The theoretical foundations of the thesis are laid in chapter two. By building up a firm theoretical framework based on the analysis of structural power, the thesis can overcome some of the problems faced in previous analyses of tax co-ordination measures. Based on the theoretical framework I will develop a methodological approach that I call *bargain analysis* (chapter 2.3).

The main analysis of empirical materials, for the most part based on official documents and press reports of the negotiations, takes place in chapters three through six. The material used for the analysis needs to describe and relate to the process of negotiations on the EUSTD, starting in 1989, but with an emphasis on the intensified negotiations from 1996 onwards. Looking at the bargains that have been made is the suggested way to start drawing the picture of the framework of power. This will in practice mean looking at material from both official negotiations and their results, such as minutes and

press reports and releases of Ecofin<sup>8</sup> and Council meetings. Other important materials are Commission studies and drafts, as well as opinions given by e.g. countries affected by the directive and lobbying groups and comments given to the press by different actors.

The main press resources used are the two leading newspapers on European issues; European Voice and the Financial Times, plus International Money Marketing, a premier source for news and comment on the European and international investment industry. The press reports are treated as primary material, a type of historical record describing how the negotiations have proceeded. Any analysis that the press reports might result in will be evaluated from the theoretical perspective of this thesis before being accepted or rejected. Press reports from non-Anglo-Saxon resources would have been a welcome addition, but unfortunately the economic resources for obtaining such materials were not available for this thesis.

In addition, the thesis will also make an effort to put the negotiations into a broader historical framework, tracing the bargaining positions back in time, often much further than the beginning of the EUSTD negotiations. Secondary sources inform this analysis of more distant historical bargaining positions. The discussion section will also address possible future developments.

The chapters roughly proceed from the systemic level in chapter three via the interstate level in chapter four to the domestic level in chapter five. Subchapter 3.1 looks at the specific impact of general European integration. The subchapters in chapter four concentrate on the roles of specific actors: the EU member states; the OECD; the US; and the colonial dependencies. The chapter on domestic issues focuses on the domestic constituencies, banks and business associations. Chapter six is a chapter on actors that have not played a role in the EUSTD negotiations in spite of their desire to exert influence. The chapter explains why these 'non-actors' have not participated and what their future possibilities are.

In the conclusions (chapter seven) the thesis summarizes the main findings and arguments of the thesis. The chapter brings together the different aspects of the study, in an attempt to make the implicit connections between different dynamics of the negotiations more explicit. A discussion of power relations - who has been left in a strong and who in a weak position during and as a result of the negotiations - forms an

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<sup>8</sup> Council of Ministers in its configuration of economic and finance ministers.

important part of the conclusions. The discussion naturally raises some questions for future research. Questions of power will also be discussed from a theoretical point of view.

## 2 Theoretical and Methodological Framework

The governance of finance is a relevant theme in terms of studying power, and vice versa. In the regulation of finance states are increasingly subject to international governance. On the other hand, private actors on the national level are subject to less public sector regulation while they have become influential participants in the regulatory efforts that remain. The EU's savings tax directive (EUSTD) is a prime example of a result of these complex dynamics between different actors.

Any academic analysis of the international political economy (IPE) and its dynamics needs to be based on a theoretical framework that can handle questions of power without automatically putting the state at the centre of analysis. Rather, power can be seen as floating on a two-dimensional axis, where one axis is a continuum between local, national, and transnational and the other is a continuum between private and public.

Taking an IPE approach to an EU policy process can hopefully contribute to the mainstreaming of EU scholarship that Wallace (2000, 65) calls for. EU integration theories have a foundation in the European experience, and tend to explain the processes of the EU as being unique, a *sui generis*. True as it might be, it does not tell very much about the characteristics of the EU in any broader context. There is a need to improve theoretical comparison and avoid analytical isolation and self-centredness.

EU integration theories too often begin with the institutions and their technical set-up. They define a certain formula or institutional mechanism that policy processes experience. Yet it is recognized that that the process varies greatly from case to case, and from one time in history to another. Also it cannot be taken for granted that the EU institutions provide the main junction box through which connections are made between country level and the global level interactions. (Wallace 2000, 6-8.) The generalizations provided by the theories do not give the necessary space for nuances required for an accurate picture of policy processes.

This institutional focus, just as state-centrism, constructs a conception of politics that does not provide a full understanding of the human condition. Such a conception of politics fails to account for 'the range of entities that have economic and political power, and the range of issues and sectors that are actually driving politics.' In analysing an issue like the EUSTD, where clearly so many and diverse actors are involved, it is

essential to have a theoretical framework that does not focus too much on the state or a formal institutional framework.

Another simple, but fundamental point is that the core of political economy is the link between economics and politics. It is a link that needs to be reinforced, as many theories tend to emphasize the autonomy of the 'political', show a massive indifference to economic forces, to markets and market operators and have a fixation with the state and military power. On the other hand, international economics tends to disregard power. Further, conventional international relations (IR) theories do not acknowledge the absolutely crucial issues of finance/credit and technology.<sup>9</sup> (Tooze 2000, 282, 284.) The more fashionable rational choice and constructivist meta-approaches offer a more inclusive point of departure, but have their own specific problems, as will be discussed towards the end of the next subchapter.

Susan Strange's approach of structures of power in the international political economy is unconventional but useful, as it puts the human condition rather than the state at the centre of study of IPE. Her approach is a framework, rather than a consistent theory, for the analysis of the world economy. In fact, Strange utterly refused to engage in theoretical debates and thought IR theories - spearheaded by realism and liberalism and their neo-versions - tell students what to think, rather than providing a way to think. (Ibid, 282, 284.) Taking into account the rapid development of IPE theory discussions since she wrote her key book in 1989, its current relevance lies in its particular view on epistemological and ontological questions. The approach is best understood through a criticism of other theories.<sup>10</sup>

## *2.1 Normative Concerns and Analytical Questions of IPE*

According to Ngaire Woods (2001, 278) the core question of IPE is: what drives and explains events in the world economy? The correct answer is not a simple account of states versus markets, but rather of states and markets. On the world market everything

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<sup>9</sup> IPE has gone to great lengths to overcome these limitations during the past 20-30 years, but - as expected in any discipline of social sciences, and especially in such a young one as IPE - significant disputes remain over the relevant paradigms of contemporary IPE and global political economy theories. See Palan 2000, 2.

<sup>10</sup> Susan Strange (1923-1998). As a 'loner' in the IR debate, as one that utterly detested 'schools of thought' and preferring an 'eclectic' approach, it is unlikely that there ever will be a Strangeist school of IR/IPE. However, when bracketed among other IPE theories, Strange's approach is usually labelled iconoclastic realism. (Palan 1999, 125, 131-132.)

cannot be exchanged as freely and straightforwardly as in the local bazaar. Equally, politicians cannot rule the world economy as they like. World markets and states, local firms, and multinational corporations, which trade and invest within and with each other, are all shaped by layers of regimes, i.e. rules, norms, laws, organizations (notably banks), and even habits. The study of IPE tries to explain what creates and perpetuates these regimes and what impact regimes have on the world economy. This will be the task of this thesis with the EUSTD as a concretisation.

There are several competing explanations for the nature of regimes and the international system of political economy. The liberal, mercantilist and Marxist traditions are the most important approaches, each of which has a particular moral and analytical angle on global economic relations.

The three theories have quite different ways of thinking about international economic relations. The liberal tradition is a prescriptive, broad political economy theory that suggests to how a society might be best governed – or left ungoverned. However, it does not give much attention to the role of power, which – in my view - is unavoidable in the study of international political economy. Mercantilists see the world economy as an arena of competition between states, and thus use an explicitly state-centric approach. The two approaches represent at least ideotypically *rationalist methodologies*, which will be discussed later.

Finally, the Marxist approach, and its neo-Marxist versions, has proved particularly useful in developing a political economic interpretation of the world system that is not entirely based on the concept of a pluralist state system. Yet in today's world the emphasis on production and classes seem unavoidably too narrow a perspective. Additionally, it can also be argued that the neo-Marxist approaches have developed a paradoxically ahistoric analysis that lacks nuances. These structuralist approaches<sup>11</sup> represent a mode of thought broadly akin to the now more prevalent *constructivism*<sup>12</sup>. (Nederveen Pieterse 2000, 204; Palan 2000, 6-7.)

In the specific case of the EUSTD, to which the issue of banking secrecy is central, all of the three theories face their particular problems: The liberal tradition finds no evident correct answer to whether banking secrecy is desirable or not; banking secrecy itself undermines the mercantilists' much cherished sovereignty of states; and finance seems

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<sup>11</sup> I.e. social realities determined and patterned by macro-structures (Nederveen Pieterse 2000, 204.)

<sup>12</sup> I.e. social realities being socially constructed (Ibid., 204.)

in this case more relevant than the Marxist emphasis on production.

Each of the theories focuses on different actors (policy-makers, states, and social classes) and driving forces (policy, competition, and conflict) in the world economy, and each has a different conception of what order means and what is necessary to achieve it. Comparing the three different traditions also highlights three different levels of analysis: the structure of the international system, the nature of a particular government or competition within its institutions, and the role of interest groups and societal forces within a country. At each of these levels it is necessary to ask: what drives the actors concerned and therefore how might we explain their preferences, actions and the results they achieve? In answering these questions the focus of the debate shifts to more methodological deliberations, which today divide the study of IPE. (Woods 2001, 286.)

### 2.1.1 Contemporary Methodological Debates

The dominating issue of the contemporary methodological debate in IPE is that of how one might best explain policies and outcomes in IPE. The core of the debate is centred on the question if, or to what extent, one can know what states' and other actors' preferences and interests are. If you can, then *rational choice* approaches to IPE make sense. However, if you open up the question as to why and how states and other actors come to have particular preferences, as this thesis aims to do, then one is inclined to use approaches often labelled as *constructivism*.

Instead of focusing on the ideas, personalities, ideologies, or historical traditions and other constraints which lie behind policies and institutions, *rational choice* focuses on the incentive structure faced by those making decisions. It is assumed that the actors' interests and preferences are known or fixed and that actors make strategic choices as to how best to promote their interests. (Gilpin 2001, 51.) The rational choice approach is useful even though a particular policy may seem stupid or wrong, because it may well have been 'rational'.

However, actors cannot be credibly said to have only one single aim. What more, actors would have to obtain complete information about their environment to be able to make a credibly rational choice. In any situation there are different possible aims, and the preferred one undoubtedly is defined by value judgements (the thesis will return to these later). This goes to show how the rational choice approach is *devised* to explain anything and everything. Devising a theory leads to the automatic endorsement of the

status quo, and does not offer any real new information on the functioning of the world economy. Rational in this sense means that it was a rational choice for the actor given the specific incentives and institutional constraints and opportunities that exist at a specific time. (Guzzini 2000, 55.)

Much more attention should be paid to the ways in which actors formulate preferences, as well as the processes by which decisions are made and implemented. Rather than assuming that a state's or decision-maker's preferences reflect rational choices within given constraints and opportunities, analysis in the constructivist tradition of IPE examine the beliefs, roles, traditions, ideologies and patterns of influence which shape preferences and behaviour and outcomes (Gilpin 2001, 19-20).

This gives a much better chance of predicting future outcomes and recommending certain strategies in order to achieve desired outcomes. By showing which patterns of influence have shaped the decision-making on the EUSTD, this thesis hopes to add knowledge on what might shape the decision-making in the EU in the future on similar issues of automatic information exchange on other forms of cross-border financial investments.

It is a point of departure of the theoretical and methodological framework that one cannot assume that preferences of actors within the world economic system reflect objectively definable competing interests. Rather, the way actors understand their own preferences will depend heavily upon prevailing beliefs and patterns of thinking in the world economy, many of which are embodied in institutions. The question this provokes is: whose interests and ideas are embodied in the rules and norms of the system?

For *neo-Gramscians* the answer to the question lies in that whose interest is embedded in hegemony. The hegemonic power within the system will achieve goals not just through coercion in the form of relational power, but equally by ensuring the consent of other actors within the system. This means that dominant powers will form institutions, ideologies and ideas all of which help to persuade other actors that their best interests converge with those of the dominant power. (Woods 2001, 288.)

This form of power will be called structural power. For example the dominance of neo-liberalism in today's world economy, a phenomenon often labelled the Washington consensus, can be interpreted as a reflection of US interests in the global economy. The interests have been successfully projected through structures of knowledge (it became

the dominant paradigm in top research universities), forceful proponents (such as the US dominated IMF), and through broader cultural beliefs and understandings (the very language of 'free' market contrasting with restricted or repressive regimes). The ability to attain international attention to certain issues, as e.g. anti-globalisation protests have done, places them on the agenda of international organizations and meetings and it also puts pressure on political leaders and encourages interest groups and pressures to form within a state. As a result, the beliefs, ideas and conceptions of interest in international relations change and this can shift the attention, nature and functions of international institutions.

## ***2.2 A Framework for Analysing Structural Power***

The theoretical framework of this thesis holds the neo-Gramscian assertion of the significance of *structures of knowledge* as important determinants of structural power as essentially correct and necessary in order to achieve an integrated political economy framework of analysis. Ideas are obviously important, but there are many material, economic and technological constraints that limit the influence of certain ideas (Gilpin 2001, 20). The Marxist preoccupation with the *production structure* is thus seen as complimentary to, rather than excluding of, the knowledge structure. The framework will, however, argue that there is a need to add two more structures of power - namely the *security structure* and the *financial structure* - in addition to the knowledge and production structures for a complete analysis of world political economy.

Susan Strange developed this typology of four structures of power to overcome the limitations of conventional paradigms of IR and IPE theory, such as state-centrism and the artificial separation of economy and politics.<sup>13</sup> None of the four structures of power are necessarily more important than the others, each of them can affect the others and each of them is dependent on the others. The sources of power in the structures are control over security, production, credit, knowledge, beliefs, and ideas. What is common to all four kinds of structural power is that the possessor is able to change the range of choices open to others, without apparently putting pressure directly on them to take one decision or to make one choice rather than another. A key argument is that the dominant power within the system will achieve goals not just through coercion in the

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<sup>13</sup> Other theorists have used the concept of structural power too, with slightly different, though related, meanings and definitions. For a thorough discussion, see Guzzini 1993.

form of relational power, but equally by ensuring the consent of other actors within the system. (Strange 1989, 29-31.)

Strange also asserts that the four structures of power are the primary structures of power, and that there are many secondary structures, which are dependent on the four primary structures. These secondary structures include, for example, trade, welfare, transport, and energy. This thesis will not pay further attention to the secondary structures.

These structures form the outer limits of actions, but Susan Strange thought that a framework that suggests a way to think, rather than what to think, should be based on the fundamentals of the human condition. 'We have to start by thinking about the basic values which humans seek to provide through social organization, i.e. *wealth, security, freedom and justice*' [emphasis added] she suggests. All organized societies need to produce these four values, but give them each a different priority or weighting. Some societies put security and order first, compromising the freedom of the individual (North Korea is an extreme example). Others give the production of material wealth the highest priority. And so on. Societies therefore differ from each other in the proportions in which they combine the different basic values. (Strange 1989, 17.) The top part of figure 1 represents a visual presentation of a specific ordering of the four values (the size and order of the value boxes is in this case irrelevant, for the example they could have been any other).

Observing what weight has been given to these values is essential to the approach. The key question is 'Cui bono?' Who benefits? Who benefits from a new international financial arrangement; who benefits from free trade; who benefits from advances in technology; who benefits from the growth of the corporation; who benefits from the dominance of neoliberal ideas? (Tooze 2000, 284.) Or in more colourful terms: 'Who is the hammer and who is the anvil? And whose ox gets gored?' as Strange herself (1991, 48) has put it. What in reality decides the nature of the mix of these values is a question of power. The study at hand will try to unveil this power. Strange recommends power should be thought of 'backwards from its effects, and not in terms of intended outcomes' (Guzzini 2000, 61-62).

To analyse structural power, one needs to investigate both authority and power in specific historical circumstances - there is no set of universal generalizations capable of providing understanding of the functioning and dynamics of the world economy.

Strange defines structural power as 'the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate'. Structural power, she continues, confers the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises. 'Setting the agenda' and the design of international regimes of rules and customs is one aspect of structural power in the world economy, but it is not all. She argues that it is impossible to have political power without the power to purchase, to command production, and/or mobilize capital just as it is impossible to have economic power without the sanction of political authority, without the legal and physical security that can only be supplied by political authority. (Strange 1989, 24-25.)

Strange's approach is not to be understood as an overarching theory to unify 'economy' and 'politics'. Rather it is unifying in the sense that it searches for common points; the effects of the four structures of power in the policy-outcomes as seen in the weighing of the four values, mediated by institutions (including in a broader sense states), markets, and technology. (Cox 1996, 175; Strange 1991, 38-39.)

Strange's conception of power is structural in two senses. Firstly, it is so in the diffusion of international power, in both its effects and its origins, due to increased nonterritorially linked networks. Here, power is structural because of its indirect diffusion via structures. Secondly, power is structural because it refers to the increasingly diffused sources and agents that contribute to the functioning of the world economy. (Guzzini 1993, 456-457.)

Realistically the structures do not only restrict the choices open to actors, but also change themselves. The EUSTD is a good example; it is a regime that will have real implications for the power structures of the world economy. But for the present purposes of analysing the negotiations, and not the results as such, the restrictive nature of the structures is of greater importance. It has to be kept in mind though, that the EUSTD might indeed have had some real world implications and entailed some changes even *before* it has stepped into force.<sup>14</sup> Based on Strange's (1989, 29-31) motivations, let me in the following give a few examples of the significance of the structures in relation to the EUSTD.

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<sup>14</sup> 'For the lesson that perceptions count in politics, whether national or international, is one of the fundamental axioms learned by every student of international relations. It is apt to be overlooked by economists, although, as noted earlier, it is central to Soros' concept of the reflexive principle in social science' (Strange 1998, 69 reference made to Jervis 1976.)

The greater the perceived threat to *security*, the higher price will be willingly paid and the greater risk accepted that the same defence force that gives protection will itself offer another kind of threat to those it claims to protect. The obvious example with relevance for the EUSTD would be the September 11th attacks, which put pressure for increased regulation and transparency of offshore investments. This happened in spite of the earlier perceived harm of such actions. (Stiglitz 2002, 228.) At the same time the slightly changed US attitude to the question has raised criticism among a significant part of the economic elite of the US, the possible increased regulation measures pose a new kind of a threat, they claim, to economic success. This can be seen as a balancing act, or a changing of the mix, between values of order and freedom.

As Cox (1987) and many radical and left wing writers have demonstrated, the mode of *production* is the basis of class power over the markets. In today's markets, geared towards a production for world markets rather than national markets, the challenges are different and the problems of the classification by class are apparent. But some similar developments remain. With the internationalization of production many industries and multinational companies (MNCs) can move their factories, or expand elsewhere, while the worker cannot move. This has robbed labour unions in industrialized countries of some of their power to win concessions by the threat of strike. It strengthens the MNCs' positions. MNCs are often also known to be friends of multinational financial arrangements, not least involving the banking-secrecy of the OFCs. Controlling where, how, by whom, for whom, and what is produced, is structural power. It is also important to note that an increasingly important part of the production structure is made up of the production of services, such as with regard to the EUSTD, banking and investment services. These are also part of new alliances and networks of loyalty in production.

*Finance*, or the control of credit, has enormous power to determine outcomes in security, production and research. It implies the power to allow or deny other people the possibility of spending today and paying back tomorrow. The financial structure can be defined as the sum of all arrangements governing the availability of credit plus all the factors determining the terms on which currencies are exchanged for one another. Taxation is a central factor in the accumulation of capital and access to credit. The financial structure is arguably the structure of power the most intimately connected to the EUSTD as, essentially, the directive regulates financial flows.

Fourthly, and finally, *knowledge* is power and whoever is able to develop or acquire and

to deny the access of others to a kind of knowledge respected and sought by others; and whoever can control the channels by which knowledge is communicated to those given access to it, will exercise structural power. At the practical or operational level offshore banking has been facilitated by the development of technology, which is dependent on knowledge and, knowledge may yet prove it possible to find ways around the EUSTD.

But the knowledge structure can also be seen as a source of structural power on an abstract level of ideas. It could be seen as dominant to the other three structures if it is considered in the light of the spread of the capitalist system. Susan Strange has been criticized for 'perhaps (...) underestim[ing] the autonomy of frameworks, their basis in intersubjective meanings, in acquired and deeply rooted habits of thought, sustained, to be sure by a hierarchy of real power, but not necessarily shaped consciously to make structures.' (Cox 1996, 184.) Indeed, in the analysis of structural power lies a danger of - in the end - explaining things from a relational power view, as Strange can be argued to do when she speaks of the United States as determining the frameworks. However, this only highlights the importance of the power inherent in structures, which may not always be the power to consciously make structures. But for the sake of clarity, in a study that is conducted at a specific level and not the world-cultural level, it is better to consider the capitalist system as an overarching normative umbrella that is affected by and consists of the four structures of power, rather than as a part of the knowledge structure that automatically affects the other three structures of power.

### **2.2.1 Annotations on Strange's Theoretical Framework**

The fact that Strange's theoretical framework embraces both the neo-Gramscian constructivist approach (knowledge), the neo-Marxist structuralist approach (production), the realist tradition's views of security, and her own groundbreaking thoughts on finance, makes it prone to serious criticism from several intellectual traditions. Realism, structuralism and constructivism all represent traditions that make assumptions about the functioning of the international system, which are incompatible with each other. However, Strange did not see the world as functioning according to some single theoretical notion, while theory is still important to unveil the extent of the possible (Guzzini 1998, 177; Strange 1998b, 22). Her greatest contribution to the IPE discussion lies not in theoretical rigidity, but in her contribution to the conceptualization of structural power.

Structural power approaches, however, run the risk of overplaying their causal strength and understating the non-materialist aspects of rule or governance (Guzzini 2000, 54). It is thus important to always be as clear as possible in the description of the source of power. Yet this is exactly the problem of the structural power approach - it emphasizes the results, not the sources of power. This is because the source of power is very elusive, a structure; a systemic bias or an unintended result.

The four different forms of structural power run the risk of becoming a short-circuit for leaving things unexplained despite opposite appearance. Strange's approach includes the theoretically equal treatment of sources and structures of power, and their interdependence. This implies a fungibility, or exchangeability, of sources of power. Yet no formula or theory of how this actually works is presented. However, in the constructivist underpinnings that the theory embraces there is an obvious answer: The exchangeability of sources of power is an effect of social conventions, not some inherent or objective criteria. (Guzzini 2000, 65.)

Systematic bias effects are only incidental - a theoretically rigid hypothesis of when a structural bias will produce a tangible result or effect has not been outlined by Strange, nor by anyone else (Guzzini 1998, 181). Are the unintended effects environmental constraints or purely random phenomena? Both, perhaps, but that begs the question of who is responsible? (Guzzini 1993, 459.) Such an analytical weakness provides the basis for strong criticism towards Strange's approach - in her own research she has been at times very explicit in pointing a finger at the guilty ones of creating or supporting the weaknesses of the world economy. It is hoped - perhaps - that the constant questioning of 'cui bono' will show who the winners and the losers are. But are the winners synonymous with those responsible?

Another underdeveloped area of the structural power concept is the non-separation of the non-decision, unintended result bias and the systemic bias through conscious manipulation. Both are lumped together under the term structural power, yet it would seem they are quite different in their nature. (Guzzini 1993, 462.) However, the mere fact that the structural power concept draws attention to such unconventional forms of power makes it valuable, if not (yet) precise enough.

In conclusion, the structural power approach leaves much to be desired, despite its theoretical eclecticism. In particular its inductive methodology combined with the apparently random results produced by intended as well as unintended structural

processes and dynamics, produce theoretical consequences that are difficult to grapple. What is the causal and especially the predicative character of the structural power approach if context plays such an important role? It has the potential of providing detailed and accurate analysis of a particular situation, but as a consequence no generalizations are possible. Indeed, discussion may amount to little more than educated guesses, but this is preferable to ignoring the problem of making generalizations in the social sciences. (Guzzini 2000, 60, quoting Baldwin 1985, 22.)

### ***2.3 Bargain Analysis***

The aspiration to overcome the divide between domestic and international, as well as political and economic research, plus the focus on issues that are rarely considered together, such as market, finance, knowledge and power and their interdependencies, makes the structures of power approach a powerful tool for providing as complete a picture of reality as possible. After having recognized the importance of looking at structures in the international political economy - also in the case of the EUSTD - the next step is to outline a more concrete way to proceed with the analysis. How can a particular situation be analysed so as to discern in more detail where a government, a political movement or a corporate enterprise has a range of feasible choices, and what possible scenarios might follow, depending on which choices are made? Strange (1989, 39-42) proposes that one should look at the key bargains in any situation, and then decide which might, and which probably will not, be liable to change, altering the range of choices for all or some of those concerned. Building on these thoughts, I will develop a basic methodological approach of my own that I have named *bargain analysis*.

To do this one needs to start by looking at the bargains between different actors and display empirical, historical and causal links to these bargains. In order to concretize Strange's framework and to gain a systematic formulation of explanatory positions, the bargains will be arranged into separate categories under each structure of power. The key bargains in the international political economy that in Strange's view one should look at are those between (1) authority and market, (2) intergovernmental and (3) domestic bargains (and their connections), (4) bargains between central and commercial banks, and (5) bargains between private sector actors. These bargains form part of a web that constructs the structures of power of the international political economy.

The basic bargain to look for is often a tacit one, that between *authority and market*. Even in a command economy there is a kind of bargain between authority in the form of the state ministries, and market in the form of consumers and producers. To maintain the authority of the state, a bargain has to be struck with the producers - managers and workers - to reward them sufficiently and to give effective incentives for them to produce the goods and services that will sell to consumers.

Regarding the EUSTD, the relevant authorities in the negotiations on the savings tax directive need to be outlined, and a deliberation especially on the role of international organizations and non-state actors is necessary. Also the market must be analysed. The market conditions may or may not be vulnerable to change in the power structures. It might depend on if the market is in stable or volatile condition, whether there are many or few 'buyers' and 'producers' on the market.

One set of bargains - inevitably in a system in which political authority is so concentrated in the hands of many states - is that made *between governments of states*. These are often dependent on the *domestic bargains*. Such bargains can be between political parties, or between the government and representatives of sectoral interests. Identifying whose support, political, financial or moral, is indispensable to the partners in the key bargains is often an essential stage in the analysis of a dynamic situation.

Another set of bargains, which is of importance for the world economy today, is the bargain *between central banks and commercial banks*. Bankers should not be too sure that the central bank will bail them out in times of crisis, so that there is some limit to the risks that are taken. Yet, if they do not have confidence in the willingness of the central bank as a lender of last resort, they are unlikely to listen to it and follow its warnings.

With corporations, whether private or state-owned, as well as with commercial banks, the bargains struck will differ in character from country to country and from sector to sector. Different forms of *co-operational structures and organizations* between private financial institutions on a European and international level might be of particular importance in relation to the EUSTD.

All of these bargains might not have relevance for the EUSTD negotiations under each structure of power, but this does in no way diminish the validity of the approach. Part of Strange's eclecticism is to allow the researcher to engage with events as they happen and not leave out any important facts just to validate a reductionist theory. (Palan 1999, 60

126; Tooze 2000, 284.)

Strange's theoretical framework can be seen to form a web or space of nexuses where the bargains between each set of actors is made concerning the four basic values (wealth, security/order, freedom/independence, and justice/equality) in each structure (security, production, finance, and knowledge). With different combinations of the different 'ingredients' there are hundreds of different 'types' of nexuses that can be identified (see figure 1). Values are given a specific prioritization or weighting as illustrated in the top part of figure 1. These value judgements are made between a specific pair of 'actors' or 'players' (the rows) in a specific structure (the columns). Add to this the fact that there may be other values than the four main values described by Strange, that there are substructures to the four main structures of power and that the nature of actors in any specific bargain may vary greatly. The nuances are so many that it is impossible to make any simplification that would accurately describe the 'reality'.

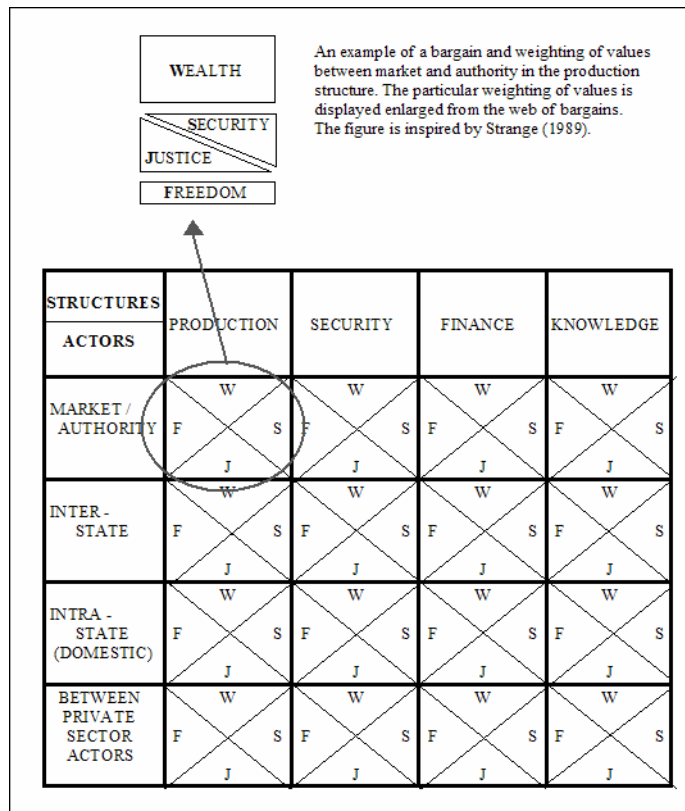


Figure 1: The web of nexuses: 442 possibilities.<sup>15</sup>

<sup>15</sup> Central bank/private banks could also be added to the actor column. However, in this thesis their relevance towards the EUSTD negotiations is significantly less than the relations between other actors.

W = wealth, F = freedom, S = security, J = justice

This almost infinite possibility of combinations describes well the complexity of society. The nexuses can be described as dots in a children's 'connect the dots' drawing. The nexuses cannot be seen as separate from each other; the connections between them, how they affect each other and how they are interlinked, will have to be considered. The web that they form, is the structure of power within which, in this case, the negotiations and lobbying on tax policy change have been held. In a historical process nexuses often form simultaneously; a change in the production structure of banking services is often also a change in the financial structure; change in job security is often also a change in wealth, increased order may result in increased or decreased justice.

It is important to note that the values shall be understood in their broad meaning (Strange 1989, 5), security refers to e.g. military security, job security and increased order in the form of financial regulation. Justice refers to issues of equal treatment; freedom to both economic freedom, often opposed to increased order/regulation and to freedom of choice or an entity's independence. Wealth is also a complicated notion, even though it at first might seem the most 'quantifiable'. Wealth can be relative or absolute, economic or cultural, and it can be measured at different levels (e.g. European, national or company level).

Because of their simultaneousness and their interdependence it is not easy to explicitly include the nexuses in written form without obstructing the understanding of the historical situation and straining the text by splitting it up according to theoretical notions. In this respect I agree with Strange (1989, 6, 229), who thought theoretical rigidity never should obstruct the understanding of a historical situation, and also concluded that her own analysis of e.g. the transport systems and supply of energy of the world became essays in sectoral analysis, rooted in the lived experience.

This thesis will attempt to give the analysis more theoretical support by incorporating in visual form the most important nexuses at each historical passing of events described. The nexuses will clarify which value judgements have been discerned, and from which the analysis has started, which actors are seen to have been the main bargainers of these values, and within which structure of power they have primarily acted. All these choices can certainly be criticized, and represent my interpretation of the lived experience, albeit often with the support of expert analysis. Following Strange's (1989, 229)

recommendations, they are 'my own picked strawberries, not a basket of ready-picked and packaged fruit'.

The nexus is formed as a compromise or bargain between different values and different actors in one structure (figure 1). From this I derive a simplified model, that outlines the two main values between which the bargain has been weighted, and the two main parties (actors) to the bargain (see figure 2).

structure	
<i>value</i>	actor
actor	<i>value</i>

**Figure 2: Visualization of a nexus**

Otherwise similar interconnected or simultaneous bargains may only differ in one aspect; either in one of the values or in one of the actors. In order to save space, in such situations a third actor can be included in one and the same visual representation of a nexus. As the four structures are interdependent, the bargains will often happen simultaneously in two or more structures. At such instances only the structure judged more important will be visualized in a nexus.

Structural power is not anything clearly touchable or easily definable. Thus the nexuses describing part of the extremely complex web that a historical process relies on can appear somewhat detached from the text and they may disturb the reading if paid too much attention to. They are a heuristic map and serve as theoretical pinpoints along the way of the study. While the actors will be quite easy to connect to the text, and also the structural context is usually fairly clear, the values are often very implicit. This happens because e.g. bringing in new market regulations is not easily reduced to any one of the four values. Regulation can bring more justice in distributional outcomes; it can bring more security and predictability (order) to the markets; it might entail costs, but it might also create more wealth; and usually more regulation means less freedom for markets. Their frequent implicitness does not reduce the validity of the approach though, as their spelling out in the visualization of the nexuses only constructs a theoretical web upon which a more nuanced historical reality exists.

In conclusion, the greatest advantage of bargain analysis, as opposed to analysis of reform in international organizations or abstract economic theory, is that it is more likely to result in a feasible prescription for policy-makers in business or in government and politics. The bargain analysis can also function as an indication of what changes have been and are attempted to be made in the structures of power, and what changes face obstacles in the structures of power. (Strange 1989, 42.)

## ***2.4 Detailed Research Questions***

This thesis will avoid the judgements of correct policies that the liberal economic school advocates in its approach. Rather it will try to answer the question *why certain decisions have been made on the EUSTD*. The study does not content itself with looking at the state as the main actor that affects markets, as does the mercantilist approach. There are many other actors that potentially need to be taken into consideration, and the markets also affect the states. It is important to look at states and other authorities, as well as the market and the balance between them. This study shares the concern about structures with Marxism, an approach that also offers a cross-sectoral state-market approach that overshadows the artificial division into political and economic studies. Marxism's concentration on only the production structure is seen as not comprehensive enough, however. The four relevant structures are production, finance, security and knowledge.

Synthesizing the aims of the research, the specific research question can be formulated as: *What has generated the change of norms in the international political economy that is embodied in the EUSTD?* Although accepting that the EUSTD is an international regime, the issue will not simply be analysed within the framework of regime-change. In addition to the question *'what were/are the different opinions of the actors on the EUSTD?'* the thesis aims to answer also such questions as: *Why does the EUSTD prevail as a norm? How have the different opinions been formulated? Within which constraints and opportunities have the decisions been made? And what have been the opportunities and constraints for raising the issue in the first place?*

In line with the open-ended approach that Susan Strange's theoretical framework provides, the research will also try to determine whether the current set of actors see the EUSTD as a completed project or as a work in progress. *How do the actors see their current opportunities and constraints on the EUSTD issue?* Adding another interesting perspective the thesis will also consider the potential actors that have been constrained to stay outside the EUSTD negotiations, despite their wish to participate: *What are the opportunities and constraints for potential (not only actual) actors?*

To do the above, the lobbying and decision-making on the EUSTD will be analysed in the broad framework of four structures of power in IPE. With some of their main features in mind, the study will through bargain analysis discern in more detail *where a government, a political movement or a corporate enterprise has a range of feasible choices, and what possible scenarios might follow, depending on which choices are*

*made*. The theoretical approach will dent the study towards a narrative nature, including ventures into history.

The study will now proceed by roughly starting from the most general and global level (chapter three), via the state-state dominated international level (chapter four), to the domestic bargains (chapter five). Because the levels cannot be neatly separated from each other, each chapter presents a mixture of interconnected bargains.

### 3 Sovereign States and Offshore Markets

By looking at the basic dynamics of the global markets (such as competition and mobility), the legal foundations of the state system and the political underpinnings of sovereignty, and their respective significance for offshore finance, this chapter aims to discern the most relevant constraints and opportunities for regulatory efforts such as the EUSTD. They define a certain space of possibility for the negotiations and are as such a concretisation of structures of power. These dynamics are also historically defined and are a result of *longue durée*<sup>16</sup> historical bargains. In the latter part of the chapter the aim is to answer the question how these general systematic dynamics lend themselves to the introduction of new regulatory efforts such as the EUSTD.

Offshore finance is essentially a legal device used in connection to many different, though interconnected, markets (Palan 1999, 21). One cannot separate a specific offshore financial market, but there are many overlapping markets that use offshore to a greater or lesser extent. Offshore can be understood as a characteristic describing the markets. In the context of the EUSTD the most important markets are the Eurobond market and the service market of banks offering offshore savings accounts to individuals (Brouwer & Kinnegim 2003, 1). Both carry a degree of offshore traits that the EUSTD aims to regulate.

In his essay on the origins and characteristics of offshore, Ronen Palan (1999, 35) concludes that: 'While sovereignty plays an enabling role in the evolution of offshore, it equally plays a constraining or distortive role'. This is a good starting point for making an important distinction between the enablement and constraining of offshore. What this research aims to look at is the constraining of offshore, through the implementation of the regulatory regime represented by the EUSTD. So while the research concerns the constraining of offshore, it also concerns both the enablement and constraining of possibilities for regulation.

Palan already provides some answers. He says that offshore is: (a) an integrated space, (b) supported by the legal framework of the state system, and (c) driven 'unwittingly' by

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<sup>16</sup> French historian Fernand Braudel's conception of the *longue durée* (usually translated rather misleadingly as "the long perspective") is not easy to express in non-historical terms as a theoretical concept; it is the recognition that human society develops and changes at different rates in relation to different underlying forces, and that all the elements within any human situation interact with one another. There are underlying geographical constraints; there are natural regularities of behaviour related to every activity, whether climatic or seasonal or conventional; there are social customs; there are economic pressures. (see Braudel 1969)

interstate competition (Ibid., 35).

finance	
freedom	state system
markets	order

The legal framework is composed of a state's sovereign right to write *specialized and targeted laws* that affect either a distinct geographic area of its territory or a 'virtual' device, such as a special booking device that allows for regulatory laxity.

Offshore defines areas of activity in which states have chosen to withhold some or all of the regulations and taxation they otherwise impose on their territories. (Ibid., 25.) Why have they chosen (through action or non-action) to do so? The answer lies in competition.

finance	
independence	UK
dependencies	security

Capital seeks to gain a *competitive advantage* by locating in low-tax jurisdictions with strict banking secrecy and political stability. One major source of stability for the otherwise politically quite isolated tax havens is – in the case of the

British dependencies – the use of the sterling pound as their currency, adding to the economic stability of the country. Customers are also seeking security at the micro level of the banks and other institutions that they use offshore. Most offshore finance centres do not offer sophisticated consumer protection legislation or compensation schemes, so investors are more likely to use a bank operating in a tax haven if they feel secure in the knowledge that a banking crisis would be bailed out by the central bank of a major metropolitan power, such as the Bank of England. (Christensen, John, personal communication, May 3rd, 2005.) Andorra, Monaco and San Marino have all adopted the euro, much for the same reasons (Bonte 2002, 8). Tax havens with a less stable currency, such as Vanuatu that uses its own vatu, are invariably less successful.

Savings and bonds are a particularly *mobile tax base*, so that the competition for this base should be expected to be especially pronounced (Dehejia & Genschel 1999, 412). There are two possible ways that capital mobility may affect tax rates. First, capital may become more mobile during a given period, which makes states more vulnerable to capital flight than they were before. Technological advances, which are widely agreed to have enhanced the possibilities of making use of offshore finance, are the most obvious example of a means of making capital more mobile. Also, greater economic openness may increase the awareness of a high-income person of his or her net worth in other countries and of his or her ability more generally to take advantage of different tax rates. These two issues are often connected to the process or phenomenon of

globalization. Bird and Wilkie (2000, 83) write:

*'The villain, of course, is "globalization" - an imprecise term that to some degree has become the mantra of analysts captivated and confused by challenges to the relevance and effectiveness of national tax and trade policies arising from transnational activity, particularly in contexts such as the EU and NAFTA, in which such activity is encompassed in a new(ish) institutional framework. Globalization implies the increased intersection of national or regional economies, in a setting in which fewer intrinsic characteristics of economic activity associate it with any particular political jurisdiction.'*

A second possibility is that capital already is somewhat mobile at a certain time in history in which there exists an equilibrium. This equilibrium then changes when one country (of particular importance) reduces its tax rate relative to others. (Hallerberg & Basinger 1998, 330, 334.)

But offshore also has its own costs. Among the distortive roles of sovereignty in relation to offshore, Palan finds that offshore in contradiction to the theory of comparative advantage moves economic activity to geographically irrelevant areas and thereby distorts the relocation of international capital. It is also expensive to run offshore facilities as vast amounts of resources are diverted from productive investments to secondary services such as accountants, lawyers and civil servants. (Palan 1999, 35.) Similarly, capital investments are made where profit opportunities are the greatest. Whether the savings that finance those investments are filtered through a tax haven or not makes little difference for their final destination. If the location of bank deposits had any significant effect on business investment, the Cayman Islands would be clogged with factories (*The American Prospect*, Nov 18, 2002).

Nevertheless, 'creative' accountants and lawyers who are highly rewarded for their activities aid the offshore process. Financial markets have been instrumental in creating new 'high-net worth individuals'; many of the richest people in the world are fund managers or, in some cases, petty investors turned millionaires. (Patomäki 2001, 51; Palan 1998, 639.)

production	
equality	banks
offshore branches	wealth

Offshore centres (OFCs) not only compete with each other in their particular niches, but also rely on each other's existence in a *functional hierarchy*. Most banks located in the OFCs are branches or subsidiaries of international banks. Their main

activity is collecting deposits from various markets and channelling them back to their

parent institutions: The Caribbean locations interact with New York, and the Channel Islands with London. The Caribbean and Channel Islands centres are essentially booking agencies where deposits and loans are legally placed, but where no transactions are physically made. (Lewis 1999, 84-85.)

finance	
justice	EU MS
EU MS	wealth

The shutting down of one offshore centre, or one type of regulatory activity in a particular OFC, does not prove a problem for the structural foundations of offshore. Another will simply replace one OFC, e.g. Cuba was by and large replaced in the 1960s as an OFCs by the Bahamas (Palan 1999, 33). Not only countries designated as OFCs form part of the puzzle. Eleven member states (of the then fifteen members) of the European Union do not tax interest on the savings of individuals based in other member states, a ploy to attract capital (*Financial Times*, Mar 15, 1999). Which brings us back to the 'unwitting' competition.

\* \* \*

The regulatory system of sovereign states that today's world is based on, together with the capitalist markets, are of no one's particular construction. However, both the Westphalian nation-state system and capitalism largely emerged in Europe and have been copied and spread elsewhere. The systems have evolved sometimes with more co-ordination and sometimes with less. Most of the basic bargains between the authorities and markets are tacit ones. Some of the tacit bargains could be changed by the (unrealistic) change of world system<sup>17</sup>. Within the current world system, reversing the enabling features of offshore and strengthening the constraining features of offshore can change the bargains.

Consequently, any meaningful regulation must be as global as possible in character and the regulator has a set of options open to pursue for the structural enablement of regulation: It can seek to increase the costs of offshore activities relative to 'onshore' activities; increase the profits of onshore activities; decrease the rewards (wealth, reputation) for lawyers and other professionals; aim at any particular level of the offshore hierarchy; build on the legal framework provided by different state actors that contribute to the offshore system at a selected level of the offshore hierarchy; decrease the sovereign rights of any entity to write its own law; physically interfere with the

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<sup>17</sup> Some would say the EU is doing just this, with its model of regional co-operation spreading to other continents. At the same time there are indications of interregional co-operation, e.g. the Asia-Europe Meeting (ASEM).

technical systems enabling offshore transactions; and constrain knowledge about tax rates and benefits in other countries. The mere threat of decreasing sovereign rights or physical interference may be enough to make a difference, and these two elements can also to some extent be categorized as relational power rather than structural power.

The above is not a list of elements that are included in the EUSTD, but a list of bargains that enable regulation of offshore based on a system of sovereign states. They are mirror images of the 'regulation-constraining' and 'offshore-enabling' features. Bargains are not absolute in the sense that they would represent all or nothing, but they all place on a continuum of enabling and disabling (or neutral). Verbs such as increase, decrease, and constrain all represent a direction rather than an absolute end; even interfering can be of varying intensity. (Only 'build' used in connection to legislation work, is more absolute; avoiding legislating is not possible in the system of sovereign states.) E.g. if the profits of offshore activities change for the worse, there may be less opposition to regulation. The thesis will now proceed to discerning in more detail where and why on the continuum these general bargains have fallen in the EUSTD negotiations.

### 3.1 From European Security to European Taxation and Back

finance	
<i>freedom</i>	EU MS
markets	<i>order</i>

Of the above-presented tacit bargains between market and authority, the greater economic openness that particularly European market integration has brought deserves careful attention when looking at the EUSTD. European integration

has increased the awareness of tax rates in other countries, and has with the introduction of the euro made the comparison of a person's net-worth easier. But, above all, the EU and its member states have themselves removed much regulation by eliminating all capital exchange controls within the EC during the 1990s. Member states were prepared to make his bargain, and it was generally judged to be crucial in increasing the competitiveness and wealth of the EU. What historical factors explain the EU member states' positions?

security	
<i>freedom</i>	Germany
US	<i>order</i>

It is well known that the 'European project' has its origins in issues of security, in (particularly the French) attempts to 'tie down' Germany (in the 1950s, to begin with, its coal resources) through a union with supranational authority. Arguably the

most serious disruption of the project so far came in the mid-1960s in divergence over

Germany's and France's respective relations with the United States and the European Union. France was uncomfortable with the increasing powers of the Commission, and eventually stalled the European project. Also, France under de Gaulle, against American wishes, had opened trade relations with the Soviet Union. A few weeks later France withdrew from NATO, declaring the independence of a French nuclear *force de frappe*.

France, laying to the west of Germany, could better afford to be a partial free rider on American Cold War strategies. Also France, proud of its culture and eager to portray itself as a leading figure in world affairs, was not at ease with the ever-stronger American influence throughout the world. The French attitude towards America was mirrored in financial politics. De Gaulle attacked the 'extraordinary privileges' of the dollar in the international gold exchange standard set up under the Bretton Woods Agreement back in the 1940s. But Germany failed to stand by France in the debates on international monetary reform. (Strange 1998, 64.) Strange (1998, 65) explains:

*'Germany owed its security from the Red Army to the US nuclear umbrella; the price, as the United States repeatedly made clear, of the implicit bargain was German membership and support for NATO and compliance with US interests in the management of money and finance.'*

finance	
freedom	EU MS
markets	order

With increasing uncertainty in the international monetary system, due to the growing US deficit on the balance of payments<sup>18</sup>, the EC governments were since the late 1960s pushed towards the creation of an internal market and a monetary union. Also volatile exchange rates made the agreed interventions prices in the common agriculture policy difficult to realize. But due to the power of financial markets over governments, both the Werner Plan of the 1970s and the European Exchange Rate Mechanism (ERM) of the 1980s and 1990s came apart. As governments were not prepared to take the necessary commitments to stymie the markets (e.g. committing to treating national reserves as common property), their attempts failed due to financial reasons. (Ibid., 66-68.)

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<sup>18</sup> The increasingly serious pressure on the US balance of payments was in turn connected to both the security and production structure. The dollar outflow was strong because of American spending on security in Western Europe and the Pacific. To reduce the dollar drain, the Americans had either to spend less abroad and curtail American globalism or increase exports by lowering American wages. The devaluing of the dollar was neither an option, as it would have meant that the US would have to sacrifice its unique international monetary position at the centre of the Bretton Woods system. Eventually the Americans tried to solve the problem by introducing capital controls. The move led to the creation of the Euromarkets. (Frieden 1987, 82-84.)

security	
<i>freedom</i>	EU MS
US	<i>equality</i>

The global financial structure both pushed the Europeans to several attempts at monetary integration and tore the attempts apart. But contrary to de Gaulle's attempt in the 1960s to gather a common European position on financial policy, the security structure was from the mid-80's onwards pushing the Europeans in a common direction. The United States seemed to be more and more inclined to act unilaterally in defence and foreign policy in Europe, without bothering to consult the Europeans, which upset also the Germans. (Ibid., 68.)

From this perspective the fact that European monetary integration has considerably speeded up since the end of the Cold War - with the advent of the EMU in 1991 - is not a mere coincidence. The conflicts in the Western Balkans prompted the development of the EU's own military capabilities (Bretherton & Vogler 1999, 24). By the end of the Cold War, the security structure changed so that the Germans were less susceptible to pressures from Washington. With the Commission being headed by Frenchmen, the Commission was no longer an enemy, but rather a tool of French ambitions. Amongst other, the push by the European Round Table of Industrialists for a single European market created a euro-euphoria after a long time of stalled integration.<sup>19</sup>

knowledge	
<i>order</i>	EU
markets	<i>freedom</i>

The shift from a dominant Keynesian economic consensus towards monetarism in the late 1970s and 1980s, narrowed the debate on EMU, enabling policy-makers to focus on monetary policy without taking broader macroeconomic and fiscal implications into considerations (Wallace 2000b, 529). As earlier attempts had shown, without this blind-eye there could be no financial integration in the EU.

With these political underpinnings the EU member states tried to resolve the problems of the ERM, and knowing where the EMU is today, one cannot deny at least their short-term success. The monetary turmoil experienced in 1995, largely caused by the slide in the value of the dollar, in fact strengthened the member states' political determination to go ahead with EMU. (Strange 1998, 69-70; 'The second stage of the EMU' at *Europa* website.)

Yet, clearly the power of financial markets is tearing on the strengths of the EMU, considering the recent loosening of the stability pact. It seems, as Strange (1998, 74)

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<sup>19</sup> The assertion is a contested one: Some scholars emphasize the role of supranational actors like the ERT, the Commission and the ECJ, while others argue that the single market was the product of interstate bargaining (Young & Wallace 2000, 95).

had predicted in 1998, that German monetary hegemony in the EU has doomed European economies to prolonged slow growth, high unemployment and low competitiveness. This in turn means that there is an incentive for governments to lower taxes in order to boost growth, yet tax money is needed on a short-term basis to finance the welfare systems. The EUSTD in this sense represents an ideal solution for governments struck by slow economic progress (notably Germany and France, but not the UK); an immediate source of income without the burden of *de jure* raising taxes. One can note an increased tendency by the member states to see action by the EU and the Commission as an answer to the immoderations of globalization (Bonte 2002, 5).

\* \* \*

production	
<i>freedom</i>	EU MS
markets	<i>wealth</i>

The EUSTD's origin in European integration, in particular in the free movement of capital - one of the four freedoms of the internal market - and in the EMU is undisputed. Loukas Tsoukalis (2000, 175) writes:

*'Monetary union carries implications for a wide range of other policy domains (...). The regulation of financial markets is one field of potential spill-over, especially given the rapid restructuring in this sector, partly a consequence of the move towards a single currency. Questions of tax harmonization, or of the prevention of harmful tax competition, are creeping on to the EU agenda'*

This is reflected in a 1996 Commission motivation for the necessity to introduce an EU-wide tax package ('the Verona paper'). The Commission had identified a structural change in the EU member states' tax systems, with the less mobile labour tax base being taxed more heavily than the more mobile capital tax base. The Commission expressed increasing concern that the burden on labour cannot be made any heavier, pending the risk of the tax base erosion through the underground economy, but also not to worsen the already negative effects on labour costs and employment. The diversity of national tax regimes for capital income, and particularly the generally favourable treatment given to interest paid to non-residents, produces economic distortions both within and between member states, and were/are seen as non-compatible with the notion of a single capital market within the EU. Counteracting the erosion of member states' tax revenues was seen as a particularly crucial objective as they were, and still are, making efforts to meet the Maastricht requirements on fiscal discipline. (Commission of the European Communities 1996, 2-5, 9.)

The smooth functioning of the internal market is of course essential for the

competitiveness of the European Union. The EU and its member states increasingly see the European project as one of competition with the rest of the world. In the early days of integration, there was a desire to remove barriers and unnecessary bureaucracy between member states - 'negative integration'. As progress has been made in many such areas, there has been a move to 'positive integration', a desire to build something innovative and uniquely European.<sup>20</sup> This is not least proved by the rhetorical emphasis laid on the implementation of the EU's Lisbon and Gothenburg Strategies on European competitiveness and development, even though significant divergences on how to actually implement the strategies remain.

While the European project started out as a peace-building project, it has moved increasingly in the direction of a competition project, profiling the EU against the rest of the world (Cooper 1999, 18-19). As the security structure has moved to the background, first the production structure and then the financial structure have emerged at the front of the European project. The difference in quality of the relations with the US could not be clearer. The relatively strong euro in relation to the dollar gives the EU increased political muscle (although serious internal political divergences that prevent it from being used remain). Recently the EU has moved into profiling itself on foreign and security policy ever more actively, a venture that the US has received with mixed feelings and scepticism. As the security structure has re-emerged as a determinant of the European project, the reversed parallels to the Cold War times speak for themselves.

These macro-level bargains, combined with the dynamics of the markets and the state system, and the acceptance of these by the member states is what got the EUSTD on the political agenda of the EU already back in 1989. Together the dynamics and macro-level bargains are similar to what Helen Wallace (2000, 41) calls 'forces of magnetism':

*'Sometimes forces of magnetism are so strong that they create a propensity to settle policy at transnational level, while at other times the country-based forces of magnetism keep policy-making located at the country level.'*

Different EU countries are differently affected by economic integration. Their economic structures are in many ways different from each other, even though they now rely on an integrated base. In the long run, what is bad for the EU as a whole in terms of competitiveness is also bad for all member states. In the short run, this may not be so, and this - in part - has created the basic divergences surrounding the EUSTD

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<sup>20</sup> For a comprehensive overview of theories of regulation in the European context see e.g. Hix 1999.

negotiations. The story of this chapter has showed the structural positions and self-perceptions in the *conjunctures*<sup>21</sup> evolving towards being more favourable for EUSTD-type regulations. The EUSTD appeared on the agenda deeply embedded in historical dynamics.

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<sup>21</sup> Braudel used the concept to place within an understanding of time simultaneously the long and short duration: in other words, structural process and event. (see Braudel 1969)

## 4 Intergovernmental and IGO Bargains

The previous chapter provided an overview of *longue durée* structural issues of offshore activity. In the subchapter 3.1 a first move towards a *conjuncture*, i.e. where structures meet *events*, was observed. It represented a conjuncture of the structures of power and events in the EU's general development and integration. As such it represents an essential background for understanding the specific conjunctures of structures and events of the EUSTD negotiations.

The study now moves on to an analysis of the bargaining and structural issues of the specific events of the EUSTD negotiations. These may be conjunctures of the *longue durée* and specific EUSTD events or connections between an EUSTD event and some other conjuncture, such as the EU's or a member state's general development. Bargaining between governments are the most animated, as is evident from the prologue, and dominate this chapter - domestic and private sector bargains will be discussed in chapter five. Intergovernmental bargain analysis should not be misinterpreted as a state-centric approach. The finance lobby is an important actor and in particular, the market dynamics, and also technological development, affected and influenced the negotiations at all levels.

The chapter aims to set the events of intergovernmental into a context where causal connections between other related events become clear, and to display the way these events have been influenced by structural power. This often happens from a point of view of a historical analysis that extends further than simply the events of the negotiations themselves.

### 4.1 War of Words: Setting the Agenda

Although it is not the most essential of bargains, and uncovers only a few facts of what goes on in politics, the setting of the agenda in the EU is a good starting point for the analysis of bargains struck between governments. The appearance of the EUSTD on the Commission's agenda is the apparent beginning of the EUSTD. Before that, any bargains struck with an effect on the proceedings of the EUSTD were tacit bargains between market and authority (see chapter three).<sup>22</sup> The EUSTD has stayed on the EU's

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<sup>22</sup> There had been discussions in the EU about the necessity of co-operation in direct taxation since the 1960's but these did not lead to the beginning of a bargaining process (Fraenkel 2005, 39-44) - so

agenda for an extremely long time considering it is a negotiation process over one directive, albeit combined with the two other elements of the tax package.

The reasons why the push for the EUSTD began can be derived from some of the dynamics described in chapter three. With a considerable variance in the top income tax rates of EU countries, high taxing jurisdictions are likely to perceive greater gains from greater co-ordination of tax regimes both within and outside the EU. At the same time these are some of the most pro-integrationist countries of late (Germany, France, the Netherlands). The reluctance and/or opposition displayed by smaller member states such as Austria and Luxembourg indicates that they with all likelihood would have 'just liked the whole issue to go away.' (Gilligan 2003, 66.) But it did not go away, almost inevitably staying on the EU agenda.

There are two central actors in the setting of the EU agenda; the Commission and the member states. The Commission can in principle make directive proposals quite independently, though only in accordance with the general political guidelines set by the European Council and the Council of Ministers. The EUSTD goes back to 1989, when the Commission came up with a proposal for a common system of withholding tax on interest income, largely at the instigation of the French presidency (*European Voice*, 22 February 1996).<sup>23</sup> So in practice the Commission initiatives usually have significant support among the member states - there is no sense in the Commission making proposals that have no chance of passing. The role of the Commission in agenda setting is a debated one though, and its role varies according to the issue at hand. The Commission's reliance on the Council is higher in an issue like the EUSTD where many member states are opposed, the issue is political rather than technical in nature, and unanimity is required. (Nugent 2001, 188.)

The rotating presidency of the EU, in quite concrete terms, sets the agenda of the meetings of the Council of Ministers. That this really does make a difference is confirmed by the fact that the EUSTD reared its head in 1993 and 1994 respectively under the German and Belgian presidencies that were in favour of tax co-operation. At those instances, however, the EUSTD did not win enough support that it would have started a continued process towards a directive.

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essentially the EUSTD started from a clean table as far as specific events are concerned.

<sup>23</sup> There had been attempts by the Commission to get direct tax harmonization to stick on the agenda already back in the 60's and 70's, without any success. The Commission was at those instances, with no significant backing from any member state, effectively a non-actor. (Tsoukalis 1997, 106-107.)

knowledge	
order	EU MS
Commission	wealth

By pure virtue of its presidency a country can make an issue appear on the EU agenda, but it cannot necessarily make it stay there.<sup>24</sup> The necessary bargains to start a process have to be in place in order to set an issue permanently on the EU's

agenda. In spite of there being three consecutive EUSTD-sceptic presidencies in a row (Luxembourg '97, UK and Austria '98) the EUSTD stayed on the agenda after the Italians put it there in 1996. With the advent of the EMU the Commission made a new and revised effort to motivate why tax co-ordination was necessary, trying to affect member states' opinions through its control over the European level knowledge structure (the Commission is after all accepted to be a 'eurocracy', in good and bad). For national governments, information from the Commission on pan-European issues is an alternative to the information provided by the business community (Bernhagen & Bräuninger 2005, 59; see also chapter 5). The Commission was aware of this strategy in 1996 when it took serious steps to relaunch the EUSTD:

*'Even if the unanimity requirement were to be maintained [in tax policy], more progress might still be made if greater consideration were given - already in the presentation of Commission proposals - to the wide-ranging consequences of failure to adopt the various proposals. The costs of accepting certain proposals are often clear to Member States, while the costs of rejecting them are less so.'* (Commission of the European Communities 1996, 11.)

By introducing new arguments the Commission tackled the previous obstacles that its EUSTD efforts had encountered in pre-1994 negotiations. In the 1996 the Commission report on harmful tax practices (a.k.a. the 'Verona paper') introduced according to Radaelli 'an important innovation in that it suggested that the main problems are the functioning of the single market, the degradation of the fiscal systems and unemployment' (Radaelli 1999, 669). Claudio Radaelli (1999, 672) continues:

*'This narrative magnifies the economic and political gains available to states through European co-operation. By contrast the [previous] approach of tax neutrality (...) - based on the selective elimination of domestic taxes hampering the growth of genuine multinational companies in Europe - highlighted gains to be won by companies and costs borne by states.'*

knowledge	
order	EU MS
MNCs	wealth

Such a shift of perceived gains is remarkable in a world where firms are said to gain power to the loss of states. Clearly the

<sup>24</sup> Interestingly, the new 'Constitution for Europe' introduces an elected, not rotating, president for the European Council for a term of 2,5 years, and a stronger three-tier co-operation in the Council of Ministers' presidency. This complicates the setting of the agenda for an individual member state.

picture is much more nuanced. In those instances where decision-takers (usually states) actually have arrived at a point where meaningful regulation appears possible, they are in a stronger position than other actors. The Commission did thus not (yet) have to shift its position vis-à-vis the ultimate goal of preventing tax evasion, but rather undertook a rhetorical and technical shift in its approach. The Commission was well aware of this strategy of shifting attention:

*'I am satisfied that the discussions of the past two years have changed the climate on tax policy. Ministers have been put under pressure, on the one hand, because we have shown them the negative consequences for employment from a lack of tax coordination, while on the other, we have convinced them that we are not here to achieve full tax harmonisation but instead tax cooperation.'*  
(Commissioner Mario Monti quoted in *European Voice*, 7 May 1998.)

The Commission also tried to influence member state positions in a favourable direction through media coverage in the member states, thus trying to have its say in essentially domestic bargains:

*'The Commission is making a great effort to get its views across to the public and press of certain Member States, and in particular to correct a number of misapprehensions about its position. In some Member States the issue of [qualified majority voting] in the tax field is presented in far too simplistic a way, giving the impression that the Commission wants to harmonise corporation tax or raise tax levels throughout Europe to finance the construction of a "superstate". There is no truth in these assertions. Basing a discussion on false premises gets in the way of a proper debate on the issues.'* ('FAQ' at European Commission website.)

Considering that general trust for the European Commission, as for European institutions in general, has never been particularly high among the European public<sup>25</sup>, the Commission's quest to get its views heard was and is probably not very successful.

Eurointerest groups may have an effect on the Commission's knowledge. They may initiate new legislative proposals. But they will probably not be able to directly affect the Commission in the direction of not putting a nascent issue on the agenda. Eurointerest groups in the case of the EUSTD step in only after the issue was on the agenda. Commission consulting procedures start only once an issue is on the agenda. Consultations take place during the drafting of the directives and discussion papers preceding it, and belong in that sense to a later stage of the bargaining process. (Nugent

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<sup>25</sup> *Eurobarometer* 2005

2001, 199.)

knowledge	
<i>prestige</i>	EU
LUX	<i>wealth</i>

Narratives, however, do not operate in a vacuum. The general policy environment has already been discussed in chapter three. Another important point is the institutional setting. In the aftermath of the Verona paper the Commission suggested setting up the taxation policy group. The idea was accepted by member states, as there was no apparent risk of giving agenda setting powers to the Commission.<sup>26</sup> The group was clearly a very political body, as opposed to earlier expert dominated forums. This made it easier to strike deals 'when the political advantage of coming to an agreement was greater than the economic cost of renouncing a certain tax scheme.' For e.g. Luxembourg the costs in reputation and prestige of vetoing proposals became higher in the context of a high-profile political negotiation. (Radaelli 1999, 666, 673)

Once the process had been started, and a few bargains had been struck, it was difficult for the upcoming presidencies to take the issue off the agenda after 1996. Governments hesitated to question the established agenda, where it did not suit their immediate interests, because they had embedded interests in other policy fields, and because they were pursuing other interests through parallel negotiations which they hesitated to put at risk (Wallace 2000b, 526).

knowledge	
<i>wealth</i>	presidency
major MS	<i>success</i>

At its best, a new presidency had a better chance than others to attach the issue to some new bargains, as the Austrian presidency tried to do in 1998 by connecting energy use taxation to the taxation of savings (*European Voice*, 5 November 1998). But in order to get backing for its own priorities and to have any chance at 'a successful presidency' in the eyes of the domestic constituency, it is not possible for a presidency to take a process set in motion and backed by some of the largest member states (with the most to bargain for) off the agenda. Thus it is necessary for an issue to have the backing of at least one big state, preferably more, for it to stay on the agenda.

A small member state usually does not have enough functional resources (especially if it is alone on the issue) to offer the presidency for the solution of bargains (e.g. Finland's effort to keep the 'Northern Dimension' programme on the agenda has been a struggle) (Nugent 2001, 188). It is not an understatement that France and Germany pushed the

<sup>26</sup> The taxation policy group met four times during 1996.

EUSTD through. Gilligan (2003, 67) connects this structural power, perhaps a bit too simplistically, to budget shares, but the rationale behind his thoughts is correct:

*'So have France, Germany and the UK been bullies regarding the EUSTD? The answer is almost certainly yes, but given political, economic and social realities what else could one expect? (...) It is an underlying economic reality that those who bankroll the larger share of the common budget might be expected to have their voice heard in a more active sense, and more often, at the negotiating table than those whose budgetary contribution is relatively small.'*

\* \* \*

finance	
<i>order</i>	states
IGOs	<i>wealth</i>

Issues of tax evasion are of course not limited to the EU agenda. There is an alphabet soup of organizations on whose agenda the issue can be brought forth (EU, G7, OECD, BIS, IMF, FATF, UN), each representing a different mix of institutional set-up insiders and outsiders. Those countries with the most sources of structural power are the ones that have been able to push the agenda in one direction or another (EU, US, Switzerland). The OECD has (in addition to the EU) turned out to be the arena of choice for the issue, probably owing to the attitude of its civil servants.

Developing countries, which presumably suffer the most from capital flight into OECD and non-OECD financial centres, have not yet expressed themselves articulately and forcefully on international tax matters (Spencer 2003, 17). This is to be expected as they have the least control over resources to bargain with and the least to give to have their cause listened to on the global stage. The mere fact that third world countries are not represented at all or systematically underrepresented in the organizations and their institutional set-ups is telling of the situation. And even if they would have equal representation that would not be enough:

*'Effective participation requires that the representatives of the developing countries be well informed. Because the countries are poor, they simply cannot afford the kinds of staff that the United States, for instance, can muster to support its positions at all the international economic institutions.'* (Stiglitz 2002, 227.)

But in the area of tax evasion, things are not looking up for the third world countries, with the UN<sup>27</sup> - where the third world has its best and most comprehensive

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<sup>27</sup> The UN has recommended the establishment of a UN International Tax Organisation (UNITO) which would amongst other aims: *'develop international norms for tax policy and administration . . . take a lead role in restraining tax competition designed to attract multinationals with excessive and unwise incentives . . . develop procedures for arbitration when frictions develop between countries on tax questions . . . Sponsor a mechanism for multilateral sharing of tax information.'* (Gilligan 2003, 63.)

representation - suffering substantial blows to its credibility and being notably sidelined by the US (Gilligan 2003, 68).

The beginning of the EUSTD negotiations is a product of competition between the national and (other) transnational arenas to provide effective authoritative results within a certain historical setting. Here the word ‘results’ is important; the EU arena gathers much of its strength from the extent to which it can deliver more solid outcomes than alternative arenas of public policy. (Wallace 2000, 41.) Chapters 4.2 – 4.5 will outline in detail those outcomes, results, and opportunities, in addition to the constraints, that the EU policy process has offered actors, notably also in comparison to what the OECD offered.

#### ***4.2 Pleasing the Big Boys: The Intra-EU Negotiations***

finance	
<i>order</i>	markets
UK	<i>wealth</i>

The EU member states’ different positions on tax co-ordination were closely knitted together with the reasons for divergences on financial liberalization in the EU, a process strongly supported by the UK, but treated with more reservation by Germany and France. The major difference between the UK (and other opponents of the EUSTD) on the one hand, and France and Germany (and other proponents) on the other, lay in the prolonged process whereby successive British governments from the 60’s onwards had internalized world financial markets as part of the domestic financial system. (Story & Walter 1997, 276.)

Meanwhile, financial institutions in the rest of the EU (with the notable exception of Luxembourg) were embedded first and foremost in their domestic context. German and French regulatory regimes of the financial markets were geared towards satisfying domestic needs, while the British, spearheaded by the Euromarkets, were geared towards global needs. (Hirst & Thompson 1999, 253; Story & Walter 1997, 276, 279.) Today, the national financial systems of the EU have increasingly been opened up, although there is still significant diversity in the types of financial instruments. This means that even though there is an increasing amount of foreign participation on the national markets, they are still in most countries geared towards the national economic space. (European Commission 2004). For example the Royal Bank of Scotland is in Germany primarily to satisfy and compete on the German market, but Deutsche Bank is in London also to gain access to the global markets. That means that taxation and

regulation policies take a different point of departure in relation to markets in the different jurisdictions.

Throughout the negotiations - and also later - the British reactions to the EUSTD proposal and its principles were very reserved:

*'Europe must conclusively rule out tax harmonisation, agree it is a barrier rather than a spur to global competitiveness, and resolve that tax competition is the basis on which Europe can compete with the rest of the world as well as command popular support.'* (British Chancellor of the Exchequer Gordon Brown's column in Wall Street Journal Europe quoted in *Evening Standard*, 16/10/03.)

finance	
order	markets
GER/FRA	wealth

Acting on a global market required more sensitivity to global competition by the UK than by most other member states participating in the EUSTD negotiations. For the British less regulation had been the name of the game in finance since the

1960s. Much of their success in financial business built on less regulation in comparison with the Germans and French. The British were, together with the Americans, at the very heart of internationalization - they had created it and benefited from it. Some thirty years of steady internationalization had meant that regulatory authorities controlled a declining portion of bank activities. This proved particularly serious for German supervisors, given the importance attached to the tight control over financial institutions. The German authorities have proved eager to extend regulations internationally, of which the EUSTD is a prime case in point. (Story & Walter 1997, 281, 284-286.)

France, for its part, has emphasized the necessity for reciprocity. There were a number of reasons for the French position, all related to a shared view across the French elites of the vulnerability of their financial institutions. The fact that due to increased tax evasion there appears to have been a unilateral benefit for third countries from the liberalization of the European capital markets clearly does not mesh well with the French call for reciprocity. The French and the Germans, who were not competing for world market positions to the same extent as the British, clearly would have less difficulty in introducing trans-European regulation in the form of the EUSTD. 'Tax competition' - as global competition in general - was also compatible to the UK's vision of a Europe of the states, open to world business. (Ibid., 281, 284-286.)

From their very different historical positions, the EU member states have nonetheless arrived at a common platform of financial integration. They act increasingly in an interconnected market environment, but yet see it in very different ways due to their differing historical trajectories. Financial integration has been 'a battle of the systems' (Story & Walter 1997) and now, moving into taxation of capital interest with the EUSTD, continues to be so.

#### 4.2.1 Blurring the Facts: The Complexity of Excluding the Eurobonds

finance	
freedom	markets
UK	wealth

The fact that the British accepted the EUSTD in the end could be traced back the UK's transformation of the lightly regulated financial cartels 'into regulated and competitive retail and wholesale markets'. This has happened simultaneously and in connection with European financial integration. To cut a long story short, contrary to conventional interpretations, the Thatcher government actually introduced stricter regulation of financial market practices in order to introduce more competition, by circumventing several cartels through policies introduced by the Conservatives. (Story & Walter 1997, 316.) Regulation is thus not necessarily contrary to business interests or a globally competitive national economy:

*'With the globalization of trade and financial markets, multinational companies and financial institutions have sought intergovernmental assistance in developing standardized international tax rules in areas such as transfer pricing, global trading of financial instruments, taxation of new financial instruments, allocation of interest price expense, electronic commerce, tax treaties, and advance pricing agreements. Therefore, multinational companies and financial institutions do have an interest in certain internationally standardized tax rules.'*  
(Spencer 2003, 7.)

Additionally, at least on the level of rhetoric, the New Labour government has had aspirations of being a world leader in questions of global governance<sup>28</sup>. Thus the UK had some divergent points of departure on the EUSTD question, which created the space and possibility of EU horse-trading.

finance	
order	US
UK	freedom

While including all interest payments to individuals, the mainly London-based Eurobond market was predicted to be particularly

<sup>28</sup> The UK has pledged to pay 10 % of the developing world's foreign debt. (BBC News, 4/4/2004.)

hit by the withholding tax requirements of the 1989 and the information requirements of the 1998 draft directive. Many special interest associations connected to the City of London's financial institutions reacted strongly. Their strongest card was the potential of market chaos caused by the refinancing of up to \$ 40 billion of Eurobonds, a result of the legal-technical 'design' of bonds (*European Voice*, 18 Feb 1999).

The design and very existence of Eurobonds is a consequence of the historical non-regulation of the markets. The creation of the Eurobond market in London in the 1960s was driven by crucial decisions reached not in Europe, but in the United States. Later, to increase London's competitiveness in relation to New York and Tokyo, the British pushed for deregulation and free trade in the European financial services market. Experts in the finance industry have since had their hands free to develop new and ever more complex instruments. (Strange 1998, 36, 40-41, 169.) Now, as our example shows, the instruments are in many ways beyond the control of the authorities. The control over the financial structure that the markets had gained with increasing speed during the 1990s meant that the options open for the authorities were constrained. But the opportunities were not completely closed either. Working out a feasible solution to the bargains between market and authorities and among states, i.e. finding some balanced answer to the *cui bono* question was the key.

production	
job security	finance lobby
UK	justice

With the threat of loss of jobs in the UK based finance business, it was clear the UK would not accept such a bad bargain as the original 1989 withholding tax proposal or the 1998 first draft directive. The UK's discontent resulted in an expression of preparedness to look at 'all sorts of proposals' to tax private investors' holdings of international bonds while exempting the wholesale<sup>29</sup> market, which is thought to cover about 90 per cent of all bond issues (*Financial Times*, May 26, 1999).

It was clear that this represented a much better bargain for the UK. Here, the structural power of big-money market institutions could not be clearer. The income and jobs that depended on their existence were a precious asset for the government. The EU could offer the UK nothing to balance this up. The small savers (in the world of international finance this is very much a relative term) are the ones who will be taxed, while the big

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<sup>29</sup> Wholesale: a wholesaler buys goods in large quantities from their manufacturers or importers, and then sells smaller quantities to retailers, who in turn sell to the general public. Source: Wikipedia website.

boys will get away untaxed. Good or bad for the economy? Who should be taxed and how much - a classic question of financial politics. There seemed to be a generally accepted feeling that the proposed solution discriminated against small savers:

*'Eddie George, the governor of the Bank of England, urged other countries to look at the new UK proposal and said objections to the UK plans on the grounds they discriminated against small savers ignored the very small role of such savers in the international bond market.'* (*Financial Times*, Sep 3, 1999.)

finance	
order	markets
EU	justice

Equally, it can be argued that the inclusion of the wholesale market was a flaw on the Commission's side. The European executive had set out in the directive only to tax individuals. The wholesale market lies on the very borderline of individual

and institutional investing and their separation according to any clear-cut principle is simply not possible, because of the interconnectedness and complexity of the markets.

The UK ran into this very problem when producing a report on the legal and technical issues involved in differentiating between private and professional bondholders. Other member states had called for concrete British proposals on how to find an acceptable solution for London's Eurobond market, instead of just being faced with continued negative British reactions. Thus the UK circulated a position paper among fellow finance ministers in 1999 in the build up to the Ecofin meeting at the end of the Finnish presidency in 1999, where it was hoped the first draft directive could have been accepted. But other member states saw the British suggestion of restricting the withholding tax only to small private investors with bond holdings below €40 000 or focusing the directive only on bank and other deposits as equally arbitrary as the Commission's original broader definition had seemed to the UK (*Financial Times*, Sep 13, 1999; HM Treasury 1999):

*'Everybody is hoping that this [the British position] is just a negotiating position. We all understand the special problem of the City, but that does not mean we are going to give a total exemption to eurobonds.'* (Diplomat of the Finnish presidency quoted in *European Voice*, 14 October 1999.)

Both sides were right, there was no way of clearly separating the individual investors from other types of actors.

This is a view echoed by Bird and Wilkie (2000) when discussing the issue of source versus residence based taxation in the European Union, the former corresponding to the withholding tax and the latter to the exchange of information. In another attempt to

minimize the effects of the directive on the Eurobond market, the UK issued another position paper in early 2000. The paper suggested the principle of a withholding tax should have been completely abandoned in the forthcoming second draft directive. Instead the UK envisaged the uniform introduction of information exchange throughout the EU (HM Treasury 2000).

Bird and Wilkie regard the two principles as being simply theoretical guidelines intended to explain and test the utility of particular allocative or jurisdictional decisions, but the decision itself is 'inherently economic in concept and commercial in practice' (Bird & Wilkie 2000, 79-80). They conclude that:

*The fundamental problem is that an economic solution is needed to assess and divide the tax base. Any attainable solution will inevitably be somewhat artificial. But it need not be as artificial as the present system, rooted in a simpler day in which there was, on the whole, a much closer correspondence between financial flows and economic activities, when a bond was a bond, a dividend a dividend, and a foreign investment was physical – a hole in the ground or a building on top of it. Times have changed in all these respects.'*  
(Bird & Wilkie 2000, 93-94.)

Thus any practice should not be judged according to how well it accords with some normative principle, but rather how well it works and how likely it is to prove acceptable to most major actors in the international tax game. The source-residence question is then essentially one of 'who gets how much tax income?' or indeed 'cui bono?'

finance	
wealth	presidency
SWE, DK, NL	justice

From this perspective it was hardly surprising that Sweden, Denmark and the Netherlands raised the issue of revenue-sharing in early 1999 right before the beginning of a streak of an unprecedented four high-level meetings under the Finnish presidency. Because of the confusion around the British position, it was very uncertain which principle was going to be applied. The three countries' finance ministers claimed the 1998 first draft directive only gave 'an illusion of legitimacy', implicitly referring to the fact that it is not the acquiescence to the normative principle that counts, but the share of the cake that each actor gets. (*European Voice*, 14 January 1999.) The British position on international bonds was the 'biggest problem'<sup>30</sup> only from the point of view

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<sup>30</sup> Quoting finance minister Sauli Niinistö of then EU Presidency holder Finland in *Financial Times*, Nov 29, 1999.

that the UK compared to others possibly stood the most to lose from the first draft directive, not from any logical point of view of 'first the principles, then the details'.

The consequences of the 1998 first draft directive in terms of who gets what on the international bond market were highly contested, with the Commission saying that British claims of job losses were greatly exaggerated (*Financial Times*, Feb 11, 1999). In the end, the views of the British finance lobby - with the support of research by groups such as the International Primary Markets Association (IPMA) and the Corporation of London - seemed to have gained resonance among other member states (*Euromoney*, Aug 1998; *Financial Times*, Nov 3, 1998). Through an effective use of the knowledge structure by the lobbying groups affiliated to the City, came the realization among member states that the withholding tax might have rendered not only London but also the entire EU uncompetitive. This gains more significance when put into the context of the EU's metaproject to enhance its competitiveness in comparison to other economic powers (chapter 3.1).

*'Recent research [by IPMA] has shown that the concentration of financial services in London provides the EU with savings on the cost of financial services business of 17 percent. The research also showed that if this concentration in London did not exist, less than half of the financial services business lost from London would flow to other EU countries. In the global competition for financial services business, London is therefore a rival, on behalf of everyone in the EU, of Zurich, New York and Tokyo.'* (*Financial Times*, Jan 26, 2000.)

knowledge	
order	finance lobby
Commission	justice

By contrast, the Commission's position changed little during the negotiations of the EUSTD, and new proposals came mainly at the instigation of member states. This can be explained by the relatively low European level consultation and institutionalized interest group activity in the area of tax policy. Research

conducted by Christine Mahoney shows that as tax policy is a new and only evolving area of EU policy it displays relatively low interest group activity. If Commission competence would grow in the area, interest group activity on the EU level would likely increase. Secondly, she also found a bias towards the trade and business associations in Commission consultation. The Commission seems to prefer to consult organizations with a broad international membership and a Brussels office (which again indicates the power of the money). (Mahoney 2004, 448-454.) If and when EU competence and activity in direct tax policy increases, the Commission can be expected to face similar

dilemmas as the member states do at the domestic level (see chapter five) in determining the reliability of knowledge provided by these interest groups.

knowledge	
<i>justice</i>	MS
finance lobby	<i>wealth</i>

So, among the member states there was by the summer of 1999, half a year after the publication of the 1998 first draft directive, an increasing understanding generated for the British position. Italy, France, the Netherlands and Germany now spoke in favour of special treatment for Eurobonds in the directive, whereas some months earlier the UK had seemed isolated on the matter (*Financial Times*, Apr 19, 1999). This - it seems - is a rare situation in which an essentially national finance lobby affiliated to the City of London has been able to drive an issue so convincingly that its opinions and control over knowledge has affected also other member states. The resonance its position found among financial elites throughout Europe quite likely played a role (see e.g. *Financial Times*, Apr 9, 1999).

The efforts of the British to introduce a sole principle of information exchange were accepted on the face of it in the second draft directive of 2001, but in reality the inclusion of the possibility for Luxembourg, Belgium and Austria to use the withholding tax principle indefinitely instead meant the final directive was a 'co-existence model' that the UK originally had opposed. The UK itself secured an important concession for the City, when the date for exempting Eurobonds in circulation from the directive was set for March 1, 2002. (*Financial Times*, May 3, 2000; *Financial Times*, Mar 5, 2001.) The deal *de facto* represents a gradualist approach to tax co-ordination, rather than a holistic one. It is the result of a process of muddling through, rather than an attempt to solve the problem by some grand design. Its basis lies in that it is acceptable, workable and an improvement. (Bird & Wilkie 2000, 99-100.) This is also reflected in the state-state bargain of a 75 per cent transferral of the revenues from the withholding tax to the non-resident investor's state of residence, with the source state retaining 25 per cent; 'a striking but little remarked-upon feature' (Keen & Ligthart 2004, 2).

#### 4.2.2 The Institutional Brew: The Specifics of the Veto

finance	
<i>short term</i>	EU MS
Belgium	<i>wealth</i>

There is clearly a tendency among individual member states to look for compromises that would benefit them immediately.

Belgium, one of the initiative-takers of the EUSTD in 1989 and 1996, which is still allowed to stick to the withholding tax principle it prefers, nearly derailed the final compromise of the EUSTD negotiations in 2003. It demanded extra time to phase out the special tax regime applicable to 'co-ordination centres' of MNCs, a plea which if accepted effectively would have undermined the Code of Conduct on business taxation that formed part of the tax package together with the EUSTD. (*International Money Marketing*, Jul 21, 2003.)

The fact that Belgium which before the watering down of the directive could see the benefits of tax co-ordination, failed to see it in the parallel context of business taxation is an indication of the extreme short-termism that dictates the compromises states make. A compromise for e.g. Belgium in one issue means a compromise for another member state in another issue, often a connected one. The Commission, always seeing the EU as a whole, is almost intrinsically poised to be at odds with a number of member states in any one set of negotiations. Which issues that are connected to each other and in which way on the agenda, not to mention the issues being on the agenda in the first place, is a question of the power of agenda setting (see chapter 4.1). Considering that package solutions are widely accepted as increasing the possibility of making necessary compromises, Belgium's actions were descriptive of the fact that there are no simple solutions to complex issues.

Clearly much of the structural power also lies in the very politico-technical set-up of the EU institutions: who has how many votes, who can veto and on what terms in which questions. The EUSTD negotiations were played out in one particular institutional set-up for tax policy, namely the unanimity requirement. The set-up's immediate significance in the form of one veto, one vote is clear in most bargains between member states. Direct tax policy in the EU has been left at the level of maximum difficulty for passing directives, while many other areas have been moved to the slightly less stringent qualified majority voting (QMV) system.

Each member state in principle has as much to say on the issue of institutional set-up as the next, every member state has a veto in institutional questions. But as Luxembourg Prime Minister Jean-Claude Juncker has put it so aptly in typical politico-speak:

*'The institutions are only an instrument of our ambitions. Once you agree on the future, the rest flows.'* (*Financial Times*, Jun 2, 1998.)

Compared to nation-states, where institutional set-ups tend to be quite stable, the fact that the EU's institutional set-up is evolving and is so closely connected to the policies themselves is a unique feature of the EU. This brings out the more covert structural issues connected to the EU's institutional set-up and reform. The institutional set-up is not simply a question of the power of saying 'no' and the ensuing 'loss of sovereignty' that EU opponents so often emphasize. What needs to be considered is what each country will gain and lose in concrete matters from an institutional set-up. E.g. Luxembourg may lose in some issues that are pushed through, but will similarly win in other issues that other countries may oppose. Agreeing explicitly or implicitly on some principles of into which areas and how deep European integration should go is the key to any institutional set-up.

Consequently it can be concluded that the current institutional set-up is the result of a series of bargains struck at a particular time in history.<sup>31</sup> Each country has its own preference about which areas it would promote a deeper integration depending on the perceived gains (security, production, knowledge and finance) from such integration. Any decision to proceed with integration in a particular area is a gain for some and may be a loss for others, although it is not a zero sum game. The totality of these bargains forms the bargain of institutional reform. Some countries are bound to hold greater resources as a whole to bargain with, few can deny that e.g. France would not hold more control of the four structures than say Cyprus or Luxembourg. Larger countries thus tend to dominate the direction in which European integration is going. But as long as these decisions/bargains as a totality continue to give more perceived gain than loss for all member states (again, it is not a zero-sum game), deepening integration can continue.

Integration itself and many other historical developments in a feedback-like process then change the structures. As structures change there is increasing necessity for new bargains to be struck. The changed structures may though not anymore create bargains that favour deeper integration, but may well create increased opportunity for disintegration. E.g. a macroeconomic shock of some sort could potentially throw the common currency project into serious trouble. The enlargement is also an example of an event that has changed structures, but arguably slowed down deeper integration. But the change of structures may as well (or, depending on one's general view on the current benefits of European integration, is even more likely to) induce deeper integration.

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<sup>31</sup> The most recent amendments to the EU Treaty were agreed as part of the latest enlargement in 2004.

For the moment it seems deeper integration in direct tax policy is not the way the EU is going in the immediate future in terms of institutional set-up. In the constitutional treaty approved by the heads of state of government following the Intergovernmental Conference in June 2004, all tax decisions to be taken at European level are still subject to the unanimity rule. The Commission expressed its disappointment:

*'A handful of Member States dug their heels in, ensuring that unanimity remains the rule for tax related issues. In practice, in a 25-member EU, that would probably mean total immobility on tax. This is a pity, all the more so since the preparatory work by the economic governance working group chaired by Klaus Hänsch made it clear that the great majority of Convention members from across the political spectrum agreed that a move towards QMV was necessary.'*  
(FAQ' at the European Commission website.)

The Commission had expressed its support for the enlargement of the use of QMV 'in a limited number of tax fields, essentially proposals necessary for the proper operation of the Internal market, proposals to combat tax fraud and tax evasion and proposals related to the protection of the environment'. The Commission continues to specify that '[q]ualified majority voting is necessary for provisions governing mutual assistance, exchanges of information and co-operation between tax authorities within the Community, notably to curb fraud and tax evasion and facilitate the recovery of tax due'. ('Intergovernmental Conference' and 'The limits of unanimity voting in taxation' at the European Commission website.) For now, the Commission is left with its power to set the agenda (see chapter 4.1).

### ***4.3 Divide and Conquer: The Failure of the OECD Initiative***

The OECD's tax evasion initiative, which is based on the principle of exchange of information on demand, effectively fell apart due to continuous opposition from Switzerland and Luxembourg from the turn of the millennium onwards. The legitimacy of the information exchange based OECD initiative was – once the EUSTD had been concluded in 2003 - easy to put into question for the two countries, because the EU *de facto* accepted the withholding tax principle. But Switzerland and Luxembourg could have pushed for the OECD initiative to go through, rather than agree to the EUSTD. In such a situation there would have been little chance for other EU countries to criticize Switzerland and Luxembourg for not being co-operative.

The OECD initiative would have demanded less rigorous regulatory efforts from Switzerland and Luxembourg and created a level playing field that would have included Singapore and other OFCs that now are poised to attract business away from the European countries. It would also have demanded less co-operation and less administrative costs from them. An agreement on the OECD initiative would have set the standard for tax evasion co-operation globally. Now the EUSTD came first, and it has effectively shattered the OECD initiative, at least for now. An OECD agreement before the conclusion of the EUSTD would presumably have meant the death-knell for the EUSTD as it would have been politically very difficult for the EU to break the level-playing field once agreed. So why did Luxembourg and Switzerland prefer the EUSTD rather than the OECD initiative?

Switzerland and Luxembourg are active in a global market, of which Europe is only one part. They, as all other jurisdictions, have arrived to where they are today from their particular historical trajectories. Their rather exceptional taxation regimes, together with those of the four European microstates, are usually described as 'historical accident'. When countries around them in the mid-20<sup>th</sup> century evolved into welfare states based on high taxes and resource transfers, these 'anachronistic formations' failed to follow suit. They were therefore unable to co-operate with other states in tax matters, and retained tax matters under civil law, rather than criminal law. Consequently they became tax havens in which the rich of the world placed their assets. (Palan 1998, 638.)

production	
<i>order</i>	CH, LUX
markets	<i>freedom</i>

They have continued to evolve from this basis and do not want more regulation or a level playing field, as their business is built on as little regulation as possible. Being part of a global market significantly affects the loyalties of banks and firms

(Palan 2000, 5). Clearly, freedom is more important than regulation for those jurisdictions depending on the offshore banking business. By agreeing to the EUSTD, Switzerland and Luxembourg have avoided global market regulation from a (effectively) global authority, the OECD. Even if the OECD's initiative did not demand standards as high as the EUSTD in information sharing, there would have been an international standard to work from. From such a standard, new and more rigid demands could have been made. Now, because of the EU allowing a withholding tax, there is not a standard even in the EU, never mind globally. Reaching such a standard will now, with the EUSTD in force, be significantly more difficult.

By committing to the EUSTD Luxembourg and Switzerland have divided and conquered, and thus avoided global regulation. As members of the EU and the OECD, two of the core institutions that shape global financial frameworks, Switzerland and Luxembourg have had an important position as veto-holders. With the current agreements the Swiss and Luxembourg banking information on Americans and other non-European citizens are secured, which they would not have been under OECD regulation. Both countries are convinced that the EUSTD will not have too much impact on their economies. Luxembourg's financial industry is actually trying to turn the EUSTD to its own advantage and is preparing the ground for the next generation of investors by racing to get the EU's latest investment fund legislation on to its statute books before its rivals. Its historic success as a financial centre has been based primarily on its ability to identify niches and transpose European directives more rapidly than its potential rivals in other EU states. (*Financial Times*, Jun 6, 2002; *International Money Marketing*, Jul/Aug 2004.)

finance	
order	CH
EU/OECD	wealth

Unsurprisingly Switzerland really hit paydirt. Not only did this alpine confederation avoid global regulation, but, once the intra-EU principles were becoming clearer and the external negotiations started in 2001, the Swiss were also in a position to engage in some serious horse-trading with the EU. For any desire to change the global financial structure to be successful, it had to include Switzerland due to its key position.<sup>32</sup> Not least having EU member Luxembourg on its side in the game of relational power enhanced Switzerland's position. Luxembourg Prime Minister Jean-Claude Juncker was at the height of the EU's negotiations with Switzerland in 2002 quoted saying that the big EU members 'are treating Switzerland as an alpine Iraq. I won't stand for it.' (*BBC News*, 8/10/2002.) For Switzerland, the EU was a favoured negotiating partner to the OECD. The OECD was able to offer no carrots, and the threat of blacklisting an OECD member state like Switzerland seemed unlikely. In 1998 Switzerland, along with Luxembourg and Singapore (all OECD members) had, apparently because of subjectivity, been excluded from an OECD blacklist of tax havens (Powell 2000, 5).

Clearly it could not have been just any actor that could have demanded limitations on Switzerland's tax haven status. The EU's partial control over Swiss production,

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<sup>32</sup> In 2002 Switzerland controlled a 27 % share of the private financial management world market, Luxembourg 19 % and Great Britain 11 % (EFD, 2002).

knowledge and even security played a significant role. The EU had much that Switzerland wanted during the 2001-2004 negotiations, covering areas such as environment, trade and freedom of movement. Switzerland wanted to enter the Schengen agreement on free cross-border movement, but without judicial and administrative co-operation on direct tax fraud which may apply in the future to the Schengen group. The EU finally agreed to the Swiss Schengen demands in 2004, thus securing the banking secrecy laws in Switzerland. Luxembourg demanded, and received, the same concessions as the Swiss if it were to accept the Swiss deal on the EUSTD at all. (*International Money Marketing*, Jun 9, 2004.)

finance	
equality	market
EU	wealth

Did the EU's failure to see the importance of the OECD negotiations mean that the horse-trading was in vain? Probably not, as the EU countries stood to gain far more tax revenue from the EUSTD, than from the OECD initiative. Switzerland and

Luxembourg were able to avoid the potential increase in regulation over the global financial market, while the EU and most of its member states gained in both financial and knowledge power much more from the EUSTD than they would have from the OECD initiative. The real losers were many of the non-EU OECD countries. But with the EU not playing on their side, using the control it has over financial, production, knowledge and even security structures and being able to offer carrots and trade-offs to secure the EUSTD, the OECD initiative did not stand a chance. One observer commented:

*'The OECD had been expecting the EU's directive would mirror its own pronouncement that transparency was what was required not perpetuation of measures that assisted tax avoidance. Not surprisingly, it was not impressed the EU could declare that apples were really the same as hedge clippers simply for the purposes of saving face, and said as much.'* (*International Money Marketing*, Mar 7, 2003.)

On the surface, the wrapping up of the EUSTD certainly 'saved face'. More importantly though, because of the EU's structural power, both Switzerland and the EU member states maximized for their parts the bargains that were up for grabs in the international political economy.

### 4.3.1 Puzzle Key: The Future of the EUSTD and the OECD Initiative

finance	
equality	LUX
market	wealth

The game is not necessarily over yet for the OECD initiative. The EUSTD stipulates that the withholding tax that Luxembourg, Belgium and Austria, along with Switzerland and others, will be levying will gradually increase. This retention tax is 15 per cent until 2007 and 20 per cent until 2011. Thereafter the rate will be 35 per cent. Many experts believe that when the tax rises to 35 per cent, countries will look to switch to exchange of information.

Many of the smaller OFCs, like Guernsey, saw the adoption of the withholding tax option as necessary to maintain 'a competitive level playing field' for the financial industry, in other words ensuring no one would get the upper hand on the financial services market. But if EU countries like Belgium and Luxembourg would switch to exchange of information, it seems likely others would follow suit. (*International Money Marketing*, Jul 21, 2003.) It remains to be seen how e.g. Luxembourg weighs the benefits of information exchange and a 35 per cent withholding tax. Taking into consideration that a Europe-wide automatic exchange of information would put the EUSTD in line with, or even beyond the OECD guidelines, there is actually more at play than just short-term economic benefits or losses in the EUSTD context. It is a balancing act over the importance that should be given to order and freedom, and justice and wealth.

finance	
equality	CH
market	wealth

Once the withholding tax vs. exchange of information dilemma would be solved, it would open up the possibility for those favouring increased co-operation in tax evasion issues to push the agenda to new levels. The most obvious is that there would be little possibility to resist the OECD initiative anymore. And for the EUSTD it could mean tightening up the directive, for any parts that member states are unhappy with its functioning. An increase in authority over the global financial market would follow and OFCs would be the losers.

But there are many ifs and buts along the way to such a situation. This is not least due to Switzerland. It has been agreed between the EU and Switzerland that the 35% withholding rate will remain also after Switzerland has adopted OECD standard exchange of information. This is noteworthy, because the same does not hold for the three EU members that apply the withholding tax. The three EU countries will, in fact,

according to the EUSTD switch to exchange of information if the EU decides unanimously that Switzerland and the other third countries of the EUSTD, are complying with OECD rules on exchange of information on request. (Spencer 2003, 5.) Switzerland can thus have the cake and eat it; it can comply to OECD information exchange rules while still ensuring that there is no global standard of information exchange through its agreement with the EU.

The Swiss have been able to take advantage of their key position in financial structure to the maximum. The fact that Switzerland has the option of holding on to the 35% withholding tax, while effectively forcing others to the automatic exchange of information if it agrees to the OECD guidelines, could give Switzerland a competitive advantage on the financial market. And it would certainly leave the financial market less of a level playing field, with the dependencies and micro-states having to decide if they should follow Luxembourg's or Switzerland's example.

The importance of banking secrecy to Switzerland is not to be underestimated. Each tax haven has a slightly different combination of low taxes, lax regulations and banking secrecy. There will always be investors who are looking for maximum banking secrecy, in combination with a stable currency and a politically stable environment. At the dawn of offshore banking, Switzerland became the benchmark jurisdiction and any newcomer OFC had to up the stakes. Whereas the Swiss created the numbered account, meaning that only one or two officials in the bank know the identity of the account holder, Luxembourg has taken the principle a step further, allowing only one bank official to know the identity of the holder of a numbered account. In Austria the principle has been taken to its logical conclusion: under Austrian law none of the banking officials needs to know the identity of the holder; s/he is merely an untraceable number. (Palan 1998, 640.)

Secrecy is clearly a very significant ingredient in the competition for high-net-worth individuals. How individuals and states weigh off the bargain between 35% source taxation and banking secrecy remains to be seen, but it would be fair to predict that there is a niche for both approaches. With those changes that the EUSTD could cause to the Austrian and Luxembourg systems, Switzerland has the chance to regain a competitive advantage in banking secrecy.

Is there any chance for the EU to get Switzerland in line with the OECD or the EUSTD requirements of information exchange? As concluded above, there could be an incentive

for Switzerland to agree to the OECD guidelines, with an ever more split playing field being the consequence. As for any Swiss agreement to automatic information exchange, the sources of structural power of the EU relative to Switzerland in this question seem to be exhausted; to change an explicitly agreed principle would be difficult. This is a common experience within the EU (Wallace 2000, 526).

Power relations do change, however, over time. The key might lie with the US. The Swiss and the Americans have entered an income tax agreement in 2003, providing for more extensive exchange of information. Then acting US Treasury Secretary Kenneth Dam stated that the agreement is 'a significant step in our efforts to ensure that no safe haven exists anywhere in the world for the funds associated with illicit activities, including tax evasion'. (Spencer 2003, 12.)

If the US were to become more proactive in the area of global tax co-ordination, there could be increased pressure on Switzerland to adhere to stricter principles. Together no doubt, the US and EU hold a great many structural as well as relational carrots and sticks. If they were to have a common goal, they could use their power without risk of playing out each other as they undoubtedly are doing now, with the EU making the OECD process more difficult and the US displaying indifference towards the EUSTD.

#### ***4.4 US Power and Double Standards: The American Response***

finance	
<i>order</i>	US
EU	<i>equality</i>

The role of the US in relation to both the OECD and the EU initiative has shifted with the change of the US administration's partisanship. In the waning days of the Clinton administration, the Internal Revenue Administration (IRA) proposed to require US banks to report the interest they pay to foreign depositors. The goal was to curb tax cheating, both by foreigners in their home countries and by Americans pretending to be foreigners in order to evade US taxes. This was a remarkable concession and display of tolerance towards the EU and zeal towards the cause of curbing tax evasion. In 1998 the EU finance ministers had effectively isolated the US in the OECD negotiations by agreeing to kick off separate talks on the basis of the first EUSTD draft directive. 'We are too concerned that if we try to work on this at the OECD level, it will take too long and there are too many fundamental differences of philosophy,' said a senior EU tax policy official (*European Voice*, 3 December 1998).

The US had been a driving force behind the OECD crackdown on tax havens but all that changed when George W. Bush took office in 2001. Reactions from Washington to the 2001 second draft EUSTD were very confusing:

*'Although senior White House officials continue to assure lobbyists, policymakers and Republican congressmen that President George Bush will not agree on the proposals, the White House has so far failed to come out officially against them.'* (Knight Ridder Tribune Business News, Sep 15, 2002.)

Eventually the Clinton proposal was withdrawn. Under a revised plan by the Bush administration, interest paid to residents of the 12 European countries that apply automatic information exchange under the EUSTD, plus Canada, Australia, New Zealand, and Norway, will have to be reported. But everyone else, including Luxembourg, Austria and Belgium, and countries with the biggest tax-evasion offenders - such as Russia, Mexico, Chile and other Latin-American nations - will be exempt. It is thus not quite clear how the US effectively has satisfied the condition of equivalent measures of the EUSTD. The US reporting system is significantly narrower than the EUSTD (it covers only deposit interest, while the EUSTD covers a broader range of interest income) and it provides only for the *possible* exchange of information with foreign tax authorities, not automatic exchange. (Spencer 2003, 10-11.)

The rather ambiguous approach of the US administration begs for an explanation. Even if the EUSTD does not concern US citizens and has a marginal effect on the US financial market<sup>33</sup>, there is an inability and unwillingness by the Americans to come forth clearly and firmly on the matter. The US *de facto* through its own policies accepts tax evasion as a problem; it has in 2003 entered into an agreement with Switzerland that provides more extensive exchange of information than previous agreements (Spencer 2003, 7-8). One can conclude that as on other issues of global concern, governments find it comparatively easy to draw up an agreement on what needs to be done (less tax evasion), but extremely difficult to translate that agreement into political reality (automatic exchange or not, bilateral or multilateral approaches, etc.) (Strange 1998, 141).

In a broader view,

*'US decisions have usually enhanced the power of market forces, increasing*

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<sup>33</sup> None of the US finance industry lobby groups have used any possible direct impact on the US financial market as an argument against the EUSTD. (see e.g. 'The EU and EUSTD' at *Center for Freedom and Prosperity* website.)

*volatility and uncertainty. But some have also been consciously system-preserving, imposing re-regulation rather than deregulation, and undertaking new costs and responsibilities in the interests of global financial stability rather than simply the shorter term interests of the US economy and its taxpayers.'*  
(Strange 1998b, 21.)

finance	
order	US
markets	wealth

As in the UK, the national government's direction and management of financial affairs has had rather good results on the whole (owing to the US's historically defined position at the centre of the global financial structure of power), and should probably not be lightly abandoned. There most certainly exists a general American scepticism of global governance as seen in the many instances in history of American unilateralism and protectionism. The EUSTD represents a much stronger version of global governance with its built in automatic information exchange, compared to the OECD initiative of the much more 'traditional' and diplomatic approach of demanding information from another jurisdiction. Global harmonization of taxes sends the alarm bells ringing throughout the American lobbying organizations. And although the EUSTD does not in that sense concern the US, it does - together with the OECD effort - represent a step in that direction and could provide a platform. The American finance industry lobbying groups speak of a tax cartel:

*'European politicians may believe that it is unfair for jobs and capital to flee from high-tax countries to low-tax countries, but the United States has no obligation to prop up Europe's welfare states. The Savings Tax Directive is a significant threat to market-based policy and fiscal competition. But most of all it is a threat to America's interests.'* ('Bush Should Reject European Tax Cartel' at the *Cato Institute* website.)

The American system of financial regulation is not necessarily a model for other countries as it is embedded in social and political attitudes highly specific to the US (Stiglitz 2002, 80-81), something those who talk about tax cartels propping up the welfare systems clearly fail to see. US governments have so far not been good at taking into consideration how their own actions affect others. Whether and how this may change as American firms become more and more dependent on the international economy is one of the key issues of this century. The EUSTD is just one issue of international tax competition on which the EU and US disagree:

*'The EU has waged a bitter dispute against the US foreign sales corporation (FSC) system through the WTO. Under the FSC regime, certain US corporates*

*located offshore have benefited from benign tax treatment - a system that has been used to particular advantage by the aviation industry. Under strong pressure from Airbus Industrie, the EU has lobbied successfully with the WTO to have the system disallowed. But tax disputes over anything from bananas to steel continue to flare up between the two regions.'* (Strategic Direct Investor, Nov/Dec 2002.)

finance/knowledge	
order	US
EU/finance lobby	freedom

The US patched together some of its divergent demands by giving the EU a chance of saying before the 2005 implementation of the directive, that the US administration does fulfil the requirements of the EUSTD, at the same time as it could claim to its home core constituencies that it does not. Tax cheating is at least an implicitly recognized problem (recognized more by the IRA than by the rest of the administration), yet for political reasons the responses to the problem had to be low profile in nature. At the same time, the US has taken an unprecedented step in accepting the necessity of some international level management of world economic affairs by ceding some of its authority to the WTO. Additionally the EUSTD has almost certainly become a bargaining chip in the economic competition between the EU and the US.

trade/finance	
justice/wealth	US
WTO/OECD	freedom

The future of the international political economy, and of international finance, depends on how conflicting interests concerning the new economic realities are fought out in the political systems of the world's nations (Frieden 1987, 163-164). Here it is interesting to see that the US has accepted some international level management of trade affairs through the WTO and given up some of its own authority. Its lame, yet existing, support for the OECD initiative reflects that the structures are partially in place for the US to accept some global governance also in financial affairs. In relational power terms, however, a significant shift in the administration's policy is required for any progress, realistically through a change of ruling partisanship. The political mood in the US Congress seems to have shifted even further towards a sceptical position than in the administration (Christensen, John, personal communication, September 13th, 2005).

#### 4.4.1 Crooks and Books: Synergies with Crime Fighting

The US finance lobby groups criticized during the negotiations that '[s]ince September 11, the EU has also tried to bolster its case by jumping on the anti-terrorist bandwagon,

arguing that financial privacy is an obstacle to law enforcement' ('Bush Should Reject European Tax Cartel' at *Cato Institute* website).

Was there any truth behind this argument? Susan Strange (1998, 123) points to the connection between money laundering and tax evasion, and other criminal activity. The fact that serious crimes are enabled by the very same OFCs where tax evasion is taking place was confirmed once again when it became clear that the OFCs' banking secrecy was a key in providing financing for Al Qaeda (Stiglitz 2003, 227). As a result many countries have introduced or reinforced their anti-money laundering laws. At the same time, tax authorities are beginning to co-operate globally to an unprecedented degree in the fight against tax evasion. It is tempting to believe that, just as there are strong connections between the enabling of money laundering and tax evasion, there is a strong connection between the disabling of the two. But the connections are not as obvious as they might seem at first sight.

knowledge	
security	FATF
technology	justice

Even before September 11th, substantial momentum had already been gathering in support of the global effort against money laundering. The extent to which this progress is reflected in a similar consensus to combat tax evasion is unclear. Such parallels are much down to the control of the knowledge structure and which rhetoric connections that are accepted as legitimate. The OECD's Financial Actions Task Force (FATF) has 'explored how anti-money laundering systems could contribute effectively to deal with tax-related crimes, without undermining the effectiveness of these systems' (OECD 1999, 5). Whether this approach is reflected in the FATF's recommendations on methods to be used to achieve FATF anti-money laundering standards is unclear.

There is thus a desire, where possible, to reduce the cost of tax evasion initiatives by placing reliance on anti-money laundering documentation. Recent developments in the US and the EU highlight this approach, but give little evidence of any real synergies on the technical level. While the information needed is similar, it is not exactly the same, with tax evasion efforts often needing more information than that needed for anti-money laundering. Burnie and Fusco (2002, 16) conclude:

*'Money laundering and tax evasion rules are clearly not moving in unison as regards their tests for identifying customers. Unlike money laundering, tax law requires a method to ensure not only that a person claiming funds is entitled to*

*them, but that the person is not claiming tax benefits that are not rightfully theirs. The real issue concerns the way tax compliance obligations have been and are continuing to be imposed on the financial sector under the false assumption that such costs will be low, as most compliance requirements will already have been imposed under money laundering rules.'*

knowledge	
<i>freedom</i>	markets
withholding tax jurisd.	<i>wealth</i>

On the cross-border level there is another technical aspect of the EUSTD which is of more relevance for the negotiations than the technical link between money laundering and tax evasion combating efforts. Many of the tax havens affected by the

EUSTD that have opted for the withholding tax, are zero-tax rate jurisdictions. This means that they previously had no technical systems for the deduction of these types of taxes. Many banks and institutions thus had to create mechanisms to deduct the tax from interest earnings before July 2005.

Complicating matters is that individual EU-resident clients may have the option to request that details of their earnings be passed to their home tax authorities instead. (*International Money Marketing*, Oct 8, 2003.) The fact that customers may choose between the two options in these countries gives them a freedom of choice not allowed for customers in those countries opting for the exchange of information. It is a freedom accepted by the jurisdictions in question on the basis that their customers are less likely to move away if they have the choice of applying the withholding tax principle. But clearly it is also a compromise for these jurisdictions; a compromise where the cost of the installation of double technical systems to cater for both principles is seen as smaller than the cost of losing banking secrecy.

Unlike the anti-money laundering systems, the double mechanisms now installed in tax havens will clearly facilitate any future move to complete automatic exchange of information in these jurisdictions. The lack of technology and the cost thereof may have constrained the EUSTD negotiations, yet the offered freedom of choice of knowledge mechanisms advanced the negotiations. Future negotiations start from a new equilibrium, where less freedom is not associated with a compromise in wealth in the knowledge structure due to technical costs, but only with the compromise in wealth in the financial structure due to the competitive loss of secrecy.

#### ***4.5 Rule Britannia: Colonial Policy in the Twenty-first Century***

security	
<i>order</i>	UK
US	<i>wealth</i>

The Cayman Islands, a self-governing United Kingdom overseas territory (formerly dependent territory or crown colony), is the world's fifth largest finance centre. The islands with a population of 35 000, rank behind only the UK, Germany, Japan and the USA in the enormity of their foreign deposits. (Engdahl 2003, 69.) The lucrative status as one of the world's leading, if not the leading, offshore tax havens has been hard to achieve. The Cayman Islands first began to develop its offshore industry in the sixties, when - like Jersey, Bermuda, and Gibraltar - it was encouraged by London to find new ways of becoming self-sufficient. Some changes along the way were not deliberately introduced by the British, but were connected to the change of the security structure. Three tax havens - Malta, Cyprus and Gibraltar - are all former British naval and air bases. As times changed, the US took over security in the Mediterranean. Consequently there was a necessity for new sources of income and the solution was an OFC. (Strange 1998, 133.) Taxes were set at virtually zero, and disclosure requirements were minimal; in effect, companies and bank accounts could be owned anonymously.

Now, when the world's attention on OFCs and the consequences of offshore banking is unprecedented, both the UK and the dependencies have to reconsider their policies. This became very evident in the EUSTD negotiations between the UK and its dependencies, particularly the fierce EUSTD opponent Cayman Islands. The UK sought after the tax income the EUSTD would bring. According to many analysts the UK also wanted to improve its image as a 'good European'. Agreeing to the EUSTD would potentially have meant a loss of business and revenue for the dependencies. Why did the dependencies, including the Cayman Islands, agree to the EUSTD in the end? Things could have taken another turn, as apparently there was nothing in relational power terms that would have prevented the Caymans from refusing to implement the EUSTD.

The UK is responsible for the defence and international relations of the dependencies, and the Crown is ultimately responsible for their good government. In theory the UK could eventually have imposed legislation on the Cayman Islands through what is called an Order in Council or through primary legislation in the British parliament. These options were discussed and used as a stick towards the Caymans during the 2003-2004 negotiations. Such a move would have been embarrassing for the Cayman Islands, and could possibly have lead to speculation of the secession of the islands from UK

dependency.<sup>34</sup> The Order in Council would have enforced the UK's preference for exchange of information, but would have been challenged legally by the Caymans' administration. This would have meant a delay in the implementation of the EUSTD as a whole. (*International Money Marketing*, Mar 2004.)

finance	
<i>prestige</i>	UK
CI	<i>wealth</i>

So rather than actually having diametrically opposed incentives, both sides stood to lose from the non-acceptance of the EUSTD by the Caymans. The fact that the UK would have stood to lose from such a situation is by common sense explained by the loss of potential tax revenue and loss of prestige. After all, most would agree that in addition to judging the values wealth, justice, security and freedom, politicians (as well as ordinary individuals) are also driven by a sense of nationalistic pride. To increase their bargaining positions during the 2003-2004 negotiations with the UK, the Caymans were ready to introduce - as they ultimately did - the exchange of information principle favoured by the British. This position was probably based on assumptions about the insignificance of European individual investors in the Caymans.<sup>35</sup> Also, the withholding tax principle poses a problem for the Cayman Islands since it has no tax laws.

With the UK having so many things that the Caymans were ready to horse trade with - especially the UK's control of market access and financial benefits that it could offer the Caymans - it was only a matter of time before an agreement could be reached. The Caymans' demands included recognition of the Cayman Islands Stock Exchange, wider access to EU and UK financial markets, a greater role for the Caymans in international meetings that involve their interests, and UK promotion of the islands' tourism industry in Europe (*International Money Marketing*, Mar 2004). In its 2004 bilateral agreement with the Cayman Islands, the UK has taken positive steps as a means of striking a balance to the potential financial threat of the EUSTD to the Caymans ('Tax Law to Affect Personal Accounts' at *Cayman NetNews Online*).

The result of the process was that the British dependency became more dependent on its London-based metropolis, but at the same time its strong relations with America must be kept in mind. With the potential loss of revenues that the EUSTD brings about, the

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<sup>34</sup> Such moves would find significant support in international law. The Cayman Islands along with several other British Caribbean dependencies are listed on the UN decolonization list of non-self governing territories ('Non self-governing territories' on *United Nations* website).

<sup>35</sup> Indeed Cayman Director of Public Relations, Portfolio Finance and Economics Ted Bravakis has said that 'the impact on the Cayman Islands is not as severe as people may think. In large part the Cayman Islands is involved in large institutional funds. The Directive will affect individuals only.' (*Cayman NetNews Online*, June 28, 2005.)

Caymans have slightly less financial power of their own. Thus, an increasing part of the finances of the islands are dependent upon UK efforts such as tourism promotion. And with the threat of imposition of legislation, its self-governance has been undermined. Although the revenue loss that the EUSTD may cause is only a drop in the sea for the Cayman Islands' coffers, it is an indication of the problems that the UK's twenty-first century colonial model contains. The UK's requirement that its dependencies be self-sufficient and its (direct or indirect) encouragement of the establishment of OFCs, have increasingly tended to backfire.

#### 4.5.1 Global Cohesion Policy: Other Dependency Arrangements

finance	
justice	UK
CI	wealth

While the Caymans' increased dependence on the UK has come with an undermining of the islands' self-governance, this needs not necessarily be the case with dependencies. Overseas territories have never been considered integral parts of the UK, and have never had representation in the British Parliament, on the grounds that they are separate jurisdictions. This is in contrast to other European countries, such as France, Denmark, and the Netherlands<sup>36</sup>, whose dependencies have varying degrees of integration with their so-called 'mother countries'. They have received financial support from their host governments, the way regions within the mainland of a country get subsidies from the central government. ('Crown Colonies' on *Wikipedia* website.)

The production structure of these remote dependencies often has limited capacity and diversification. Other sources of financing are thus needed. With adequate finances available from the 'mother countries' of these dependencies, there has never been a very large incentive to start an offshore activity. The UK though, has insisted on the self-sufficiency of its dependencies, despite their limited production structure. Now the UK has to face up to reality, and is forced to act as a responsible host as it considers financial assistance with the expansion of Grand Cayman's airport (*International Money Marketing*, Feb 2004).

finance	
justice	EU MS
Commission	wealth

The different policies are due to different answers to and interpretations of the *cui bono* question. The EU can play a part in the resolution of the question in relation to its own member states.

<sup>36</sup> The Netherlands provided a \$97 million aid package to the Netherlands Antilles in 1996 and \$127 million to Aruba and Suriname

With its structural funds the EU is able to influence the development of different areas of the economy of its member states. It has the financial power to direct investments into areas that could be an alternative for helping especially Luxembourg reduce its dependence on the financial industry.<sup>37</sup> Luxembourg Prime Minister Jean-Claude Juncker suggested Luxembourg should accelerate its adjustment to the information revolution as a response to the EUSTD and other changes taking place in the finance industry (*Financial Times*, Jun 2, 1998). The less successful tax havens Malta and Cyprus should be even easier to appease.

production	
<i>freedom</i>	EU/UK
Gibraltar	<i>wealth</i>

The contrast between British and e.g. French policy towards their respective overseas territories is also illustrated by the status of the territories vis-à-vis the European Union; the French Caribbean territories of Martinique and Guadeloupe are part of the EU and use the euro. They have a natural access to both the benefits and the duties that come with being an EU member. But it is not only the dependencies' relationship with the 'mother state' that determines their relationship with the EU. This is confirmed by the example of British dependency Gibraltar. Gibraltar's position is different from that of other UK territories such as the Channel Islands and the Caribbean dependencies in that it has been an associate member of the EU since the UK joined the union in 1973. Gibraltar has been able to enjoy the benefits of EU membership in their various forms. Gibraltar is represented by the UK in the EU, and thus the information exchange option of the EUSTD was imposed on it.<sup>38</sup> (*International Money Marketing*, Jul 21, 2003.)

The move is a clear indication of how the autonomy of nationally strong but small regions is circumvented by EU membership. Previously domestic issues, such as tax policy, when moved to the European arena suddenly fall under the title of foreign policy, and thus beyond the formal competencies of the dependencies. The structural power to decide upon such shifts of policy areas to the European level lies in a

<sup>37</sup> The EU's cohesion policy is geared towards eradicating the biggest differences in standards of living between the EU countries. Although it also is concerned with the ability of regions to implement EU directives, Luxembourg falls well outside any regions eligible for support. Also, the directives that cohesion policy is concerned with have usually not concerned financial regulation. (Allen 2000, 252.)

<sup>38</sup> So far though, Gibraltar has been lucky: As Gibraltar is as far as the EU concerns considered a part of the UK, so the reporting of savings income should be submitted via the UK. Yet Gibraltar's bank secrecy has not been, and cannot be according to the Gibraltese argument, removed by the UK. Thus no information is currently flowing from Gibraltar to the UK. (Richard Murphy, 9 July 2005.) The situation is clearly unstable, and would lead to EU sanctions against the United Kingdom. The incentive for the UK to amend the situation quickly is thus there. In anticipation of this, Gibraltar is raising a case in the European Court of First Instance for its right to have a different and more favourable tax regime than the UK (*The Daily Telegraph*, 4 July 2005).

complicated balance between the Commission and the member state governments, not with the autonomous regions. For any dependencies possibly considering EU membership (see e.g. 'Jersey hints at joining the EU' at *Accountancy Age* website) as an answer to continued clampdown on their tax avoidance schemes, this is an important point to remember. Even if they instead of full membership only gain greater access to the EU market, and consequently will be more dependent on it, they will have little or no authority over it. The claim that 'the EU rather than just the UK may in the future be regarded as the Channel Islands' "protecting power" (quoting leading Jersey lawyer Michael Lombardi in *Financial Times*, Nov 28, 2003) can certainly be questioned.

trade	
<i>freedom</i>	EU
ACP	<i>wealth</i>

Following the many corporate scandals connected to banking secrecy, the issue of information exchange and transparency is far from being a closed chapter after the long-awaited conclusion of the EUSTD negotiations in 2004. The Parmalat scandal was a wake-up call for the Commission leading to the production of a Commission paper entitled 'Preventing and Combating Corporate and Financial Malpractice' (Commission of the European Communities 2004). It calls for concrete actions to ensure that the EU's partners (e.g. British Virgin Islands and Cayman Islands) are transparent and suggests introducing banking transparency into existing EU trade and aid deals with African, Caribbean and Pacific (ACP) countries and territories.

This would give Brussels the power to use such things as banana quotas and development grants as bargaining chips over access to financial information. Brussels is also offering 'economic support' to help 'co-operative' territories that open up their financial sectors to scrutiny. OFCs may have few reasons to surrender to such an approach but the hope is their need to protect a small number of rich people may be dwarfed by the need to access European markets and EU handouts.

A new set of bargains is being hammered out, with new connections being made between the structures of power. Critics often stress that OFCs and tax havens could easily be shut down with the help of sanctions, if just the economic giants of the world would want to. However, the attitudes of key actors such as the US and the UK have been rather accepting. But with the EU now controlling much of the trade ('a substructure' to especially production and finance) previously controlled by the individual member states, notably the UK, the situation is possibly changing (Bretherton & Vogler 1999, 48). The European Commission has a quite different historical

trajectory behind it than any of the member states and has an explicit target of looking at the general European well-being. With the significant support of many major member states, it seems unlikely the previous stand of the Commission on the issue of tax co-ordination is going to change any time soon. (See also chapter 4.2.)

Another way in which the EU has succeeded in making it clear where the dependencies stand in the international hierarchy is by requiring them to adopt the 'same measures' as EU countries, while the six independent states mentioned in the EUSTD are asked to adopt 'equivalent measures'. The difference in terms is of great significance. (Spencer 2003, 7) As discussed in the chapter on the OECD initiative all EU countries may sooner or later be likely to, or depending on Swiss policy even forced to, adopt the exchange of information system. In such a situation the EUSTD rules demand that also dependencies shift from a withholding tax to exchange of information, while notably Switzerland is free to stick to the 'equivalent measure' of a withholding tax. Without further carrots offered by the 'mother countries' or the EU, such a demand is poised to cause mayhem among the dependencies. The EU and its member states will seriously have to consider if it wishes to create such a split playing field, or if it would be more fruitful to push the issue gradually through the OECD, possibly combined with a change in British overseas policy.

## 5 Domestic Bargains

Domestic bargains are intimately connected to those made at the intergovernmental level. The thesis has already touched upon several domestic bargains such as reactions in Germany to national withholding taxes in the 1990s; the American government's considerations of its home constituency in deciding its position on the EUSTD; the German emphasis on stability and French emphasis on reciprocity in financial markets; and, the prioritisation of wealth over equal treatment in tax havens' preferential regimes for non-residents.

Exploring all domestic bargains is beyond the scope of this thesis. The focus of the thesis is on policy-making through negotiations, not the politics of the EU as such. Hence the thesis deliberately does not deal with some topics, such as the electoral politics of the EU and its member states.

Instead some of the general dynamics of domestic bargains will be explored; what structural factors influence them in the context of tax co-ordination measures in the EU? Within most European countries the political arena encompasses different levels and layers of politics; and increasingly that arena is invaded by cross-boundary influences and interactions. Meanwhile, the transnational public policy processes are embedded in political institutions that are less clearly defined, and much less authoritative, than those of a traditional state. An important point to note here is that some political actors have easier access to the transnational policy processes than others - be they governments, NGOs or special interest groups. There is an imbalance in participation and access. (Wallace 2000, 35.) The role of lobbying groups is of much relevance. Thus the first subchapter naturally moves to an analysis of private sector bargains and the chapter finishes with concrete examples from the EUSTD negotiations.

### *5.1 Political Supply and Demand: The Formation of EU Policy*

Commenting on tax co-ordination as well as the parallel issue of the institutional set-up of EU tax policy decision-making, Hallerberg and Basinger (1998, 339) rightly draw the reader's attention to domestic veto-players. They argue that:

*The higher the number of domestic veto-players, the harder it is to pass laws and the greater is the chance that the status quo will be maintained. The implication is that states will not be able to respond equally to a shock that they*

*all experience together - states with one veto-player will be able to react swiftly to any change in their situation . . .'*

They conclude that in the EU,

*'[s]tates that have more veto players may become the real losers from further integration because they will not be as able to adjust to a rapidly changing fiscal playing field. One can imagine a cleavage developing on tax issues between states with one veto-player and those with two or more, with states with more veto players calling for some form of tax harmonization of rates, whereas countries traditionally with one veto player favouring competitive solutions and non-intervention.'* (Hallerberg and Basinger 1998, 347.)

While the initial argumentation seems correct, the conclusion does not. Tax harmonization (or, comparably, co-ordination) on the EU level is seen by the authors as a kind of a non-decision, which does not require a domestic bargain to be struck: As if it was an easier decision for countries with many veto-players 'ceding sovereignty' than holding on to it. This is of course not true; tax co-ordination represents just one response among others to fiscal competition.

Obviously member states of the European Union have very different ways of forming their EU policy - some have stricter domestic rules, some less. All the same, a minimum bargain in the formation of an EU policy at the national level is made in the government. Hallerberg and Basinger (1998, 339) recognize this and emphasize the significance of the size of coalitions, but only in cutting tax levels, not in forming an EU policy. But they are indeed relevant for the formation of EU policy too. The conclusions of Hallerberg and Basinger, that countries with few veto-players will adapt better, may still be correct. This is not because of a difference in domestic institutional set-up, but a consequence of the EU's institutional set-up, which makes decision-making difficult. It seems we are back to square one; the national position on tax co-ordination and other responses to fiscal competition seem to depend more on the perceived gains and losses of any particular bargain solution.

This is not to deny that domestic factors do have an impact. The goals of parties should reflect the preferences of their core constituencies. Most would agree though that these preferences cannot be perfectly mirrored in the party, because there are interfering factors. Among these factors one can include outside party financing and possible interpersonal loyalties of the (political, economic and cultural) elite. Further, in questions where the constituency does not have sufficient knowledge it is easy for the

party elite or media to manipulate the opinions in a desired direction. Control over the knowledge structure is of great significance here. This is not only a question of who runs the medias, but also of who the media listens to, which institutions do the public show respect for, and which are perceived to do a valuable job. Although public trust in parties is consistently low and trust in radio and television is usually high throughout Europe, the Eurobarometer<sup>39</sup> opinion polls unfortunately do not display the levels of trust in special interest organizations of industries or civil society organizations.

Another way in which governmental positions on specific issues are formulated is through direct lobbying by special interest groups. How they are allowed to influence government policy is of great importance in determining the interest group environment. In other words, it is not simply a question of changing structures that generates new organized interests ('supply side'), but also of how the government allows them to come forward and develop ('demand side'). The state (government) can wield influence through (Mahoney 2004, 442): (1) direct subsidies, payments, grants, and other financial incentives (financial structure), (2) determining which issues are afforded formal arenas of debate and which interests participate in those arenas (knowledge structure), and (3) its own growth and levels of activity in different areas of policy (multiple structures).

The third point is quite parallel to the 'supply side' forces, and goes hand in hand with the deepening and expansion of integration already discussed in chapter 4.2.2. The first point is not of great significance for big-money institutions such as finance lobby groups, and governments tend to finance citizen organizations rather than business associations. That leaves the second point as the most interesting. Which issues are afforded formal arenas of debate and which interests participate in those arenas? Such consulting procedures vary greatly between member states, and the different procedures might to some extent be reflected in the governments' decision-making in the EU. Chances are that corporate interests dominate on the European level because the follow-up on most issues is likely to be stronger from the corporate sector than from the civil society or the general public, who relies on the still - in terms of European coverage - underdeveloped nationally based media.

The weak correlation that Hallerberg and Basinger (1998, 337) found between partisanship and the willingness of governments to tax high-income individuals and

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<sup>39</sup> Eurobarometer website, 2005

corporations is not as much an indication of different institutional set-ups at the domestic level, as it is an indication of a much more complicated set of interdependence and cross-border bargains that make up the answer to the 'cui bono' question. Even if the opinions of the core constituencies of parties could be taken for 'pure' un-manipulated opinions and even if they would be reflected directly without interference into the party's opinions, it still presents problems. Political questions are not (and never have been) answered by the constituency according to some international norm of how left and right should always structure e.g. taxation, but by the notion of what gains 'us'<sup>40</sup> the most (in security, wealth, justice and/or freedom). If there ever was international uniformity in how the left and right answered these questions, there certainly is not anymore.<sup>41</sup> Deeper integration on a European level might though, eventually, result in more convergence on the perceived benefits of different policies among European parties, but for the moment most experts agree that the European field of political parties is rather fragmented.

## *5.2 Whatever You Say, Sir: Loyalties of the Finance Lobby*

Market forces determine much of the notions of what gains 'us'. One of the four basic values, the creation of wealth is very much dependent upon markets. The increased global market integration and markets becoming more sizable and 'quicker' (and more volatile) in their moves, is reflected in the political decision-making. The domestic bargains thus very quickly link up with bargains between market and authority. Frieden (1987, 121) describes:

*'The response of international banks, bond markets, and foreign currency traders must be considered by national governments as they weigh the costs and benefits of public works, tax reform, monetary policy, and virtually anything else a government might do.'*

The perceptions by the markets of what impact a certain policy might have are of great importance. The reactions to a political statement, rather than the later action and implementation itself, are immediately reflected in the markets. Policy-makers face

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<sup>40</sup> The notion of 'us' and 'them' in international politics leads us to the area of identity politics. How people's and decision makers' identities are formed is of great importance for their domestic and international loyalties.

<sup>41</sup> The recent proposals coming from the G-5 Lula Group (airline ticketing tax) and from the supporters of the Tobin tax introduce the interesting possibility of extending redistributive taxes from the national to the international domain. An unforeseen positioning of the left/right ideological spectrum on an international level could consequently take place.

huge informational problems with regard to economic consequences of policies as well as how these are evaluated by citizens, while special interest groups have privileged access to the pertinent information. This does not mean that policy-makers are slaves of the markets - business interests failing to gain their desired policy outcomes in policy struggles has frequently been observed. Despite their privileged access to knowledge, business cannot exaggerate implications of a certain policy if it wants to retain a credible and important role in future consultations. Additionally sometimes the costs of lobbying might surpass the benefits of changing or outmanoeuvring a policy.

In the case of the EUSTD, the finance lobby in the UK did its very best to guarantee a minimum of concessions in the wake of the 1996 Verona paper up until 2000. Internationally the finance lobby was more split throughout the negotiations, although powerful institutions such as the International Primary Markets Association, the International Securities Market Association, the International Swaps & Derivatives Association and the International Paying Agents Association teamed up to criticize the plans for the directive since the very beginning of the negotiations until their very end (*Euromoney*, Aug 1998). Together with the British finance lobby they denounced the Commission's consultation practices, which, as expected, had focused on European level business organizations, including the European Mortgage Federation (EMF). It was said that the EMF represents a plethora of often conflicting European views. This may be true and it brings up the question of why the British finance lobby was allowed to dominate the views of business to the extent that its views affected even foreign governments.

knowledge	
<i>freedom</i>	Eur. finance lobby
UK finance lobby	<i>order</i>

The members of bankers' associations in some high-taxing European countries one might assume would have gained from the directive and could have raised some alternative opinions to the British finance lobby. The fact that they laid low in

1999-2000, while the debates surrounding the EUSTD's effects on the Eurobond market dominated, is the most significant bargain between private interests in the EUSTD negotiations. The biggest banks even in the smallest of EU member states are however involved in offshore activities, often maintaining branches in Luxembourg<sup>42</sup>. So even if some funds might be repatriated to the onshore banks as a result of the EUSTD, their webs of interdependence stretching to the offshore and the risk of losing the richest customers did create a divergence of interests for these finance business associations.

<sup>42</sup> e.g. <http://www.nordea.lu/>; see also Fraenkel 2005, 48.

The more or less multinational banks create alliances and informal relationships; this is called alliance capitalism in the academic literature (Phillips 2000, 38-39). Thus the negative expectations of the British finance lobby - building on the Washington consensus rhetoric of tax competition - were clearly expressed, while the more balanced expectations of other national finance business lobbies were not heard.

finance	
wealth	markets
BEL/ITA	justice

Finance business interests' values and worldview to some extent have a reflexive self-sustaining effect. The authorities can take advantage of this reflexivity. Those individual investors that anticipated they were going to be hit by the EUSTD, could at first instance 'punish' the European governments for their plans by relocating to other jurisdictions, as happened in Germany in the early 1990s. But some of the countries that are believed to gain the most from the introduction of the EUSTD, namely Italy and Belgium, have since the conclusion of the EUSTD both announced tax amnesties for individuals (and in Italy also for corporations) who repatriate offshore savings to a national bank account. The Italian tax amnesty meant that some € 70 billion were repatriated. The Belgian tax amnesty coincided with the introduction of the EUSTD in 2005. Responses from the market are already positive:

*'All in all, Belgian banks are not unhappy with the tax amnesty, and they are keen to advise their clients about the opportunities of the tax amnesty. The amnesty tax is relatively low and the reasons for keeping savings offshore may not outweigh the taxes they face in Belgium. (...) Foreign banks such as UBS and Lombard Odier (Switzerland) and Edmond Rotschild (Luxembourg) have already set up an office in Belgium to follow their clients' savings.'* (International Tax Review, Dec. 2003.)

finance	
wealth	EU
GER	justice

An important part of the tax amnesties is that the return cannot be used as an indication of undeclared income allowing the tax authorities to start an investigation. Justice is compromised for wealth. Other countries, such as Germany, were not ready to make this compromise. Thus, an EU-wide concerted tax amnesty to increase pressure on Switzerland was not possible, though it was considered already in 2002. (*Knight Ridder Tribune Business News*, Nov 10, 2002.) But the compromise favouring justice over wealth could be more expensive than thought at first hand. Spencer (2003, 17) argues that unless the residence country (e.g. Germany) provides an incentive for repatriation, such as through amnesty, the imposition of a withholding tax in the source country (e.g. Luxembourg), without automatic exchange of information, 'normally will

not result in the repatriation of funds not yet declared in the residence country. A withholding tax without exchange of information may provide an incentive for more tax evasion, and may result in further cross-border capital flight.'

## 6 The Non-Actors

The thesis has so far in many senses been open-ended: Temporally, not taking the EUSTD negotiations and the resulting regime as neither independent from its history nor its future; functionally, not limiting itself only to dynamics in the financial structure; and in terms of actorness, not making the state theoretically superior to others. Following from the latter, the study will now further extend its inclusive approach to some actors that have been excluded from the bargaining process, despite their wish to influence matters.

The EUSTD, as any policy change, was a reaction to, or a consequence of, changes in the structures of power. By and large, the changes, emanating from the dynamics presented in chapter three, were a consequence of (re)action by states and substates making up the sovereign system of states, by capitalist markets, by lawyers and accountants rewarded by companies, and by one IGO in particular, namely the European Union as represented by the Council of Ministers and the European Commission. The actors also included finance lobby groups claiming to represent 'market operators'. These 'actors' are also the ones that consequently have figured in chapters four and five. The relevance of all these involved actors is based on their control over resources of structural power.

For the 10 applicant countries to the EU, the EUSTD came as part of the enlargement package. For the eight central and eastern European countries the EUSTD posed no problem, and their position was thus comparable to other small and medium sized members of the EU. The net effect for them was expected to be positive. Cyprus and Malta, as tax havens, had more to play for in the EUSTD (*European Voice*, 11 June 1998). But faced with the complicated bargaining process for EU membership, they were faced with a situation where their comparably modest control over any sources of power was evident. Other bigger questions, where they could find support among larger member states were their best bet for a good bargaining position. For Cyprus it was a security question; the reunification with Northern Cyprus that overshadowed their accession negotiations and for Malta it was the much controversy causing fisheries and agriculture policy.

Some actors that one might have expected to appear in the process have not done so. These include other European Union institutions, namely the European Parliament, the Economic and Social Committee (ESC), and the European Court of Justice (ECJ).

Notably, there are also civil society movements and organizations, claiming to hold knowledge about the issue (e.g. Attac, Tax Justice Network - from here on 'tax justice movements'), that have not been part of the EUSTD process in any significant way. These 'non-actors' have no or limited control over resources of structural power. Their best claim to power no doubt lies in the knowledge structure. The Parliament, the ESC and the finance lobby groups all primarily give opinions in issues of direct taxation. But contrary to the finance lobby groups, the 'non-actors' cannot with the same impetus claim to know market reactions.

Of the non-actors the ECJ also gives opinions, but its opinions are of course particular in that they are binding upon anyone within its jurisdiction. If and how the ECJ could have had any role in the EUSTD will not be deliberated upon here. Suffice it to say that in matters of direct taxation at large, the ECJ may have a role to play: 'The ECJ has a mandate to drive forward a single market agenda (...) and thus it will decide cases according to that agenda'.<sup>43</sup> (*Strategic Direct Investor*, Nov/Dec 2002).

The Parliament and the ESC have a strictly defined mandate of giving opinions to the Commission and/or the Council. The ESC is recognized as being an intrinsically weak actor (Wallace 2000, 25) and Commission consultations are only to give the consulted 'a voice, not a vote'. Although the Parliament's institutional position is growing stronger all the time, it does not have much formal influence in questions of tax policy. Its increased power over other sources of structural power might though put it in a better bargaining position in the future, linking up issues of tax policy with other issues that it has some control over. If the legitimacy of the Parliament was to increase in the future, so that also the citizens of Europe would feel that the Parliament represents them well at the European level, then it could claim to possess some knowledge about the reactions of the people to different policies.

As the Parliament and ESC, civil society organizations also have some chance of getting heard by the Commission in consultation procedures. The Commission particularly encourages a coherent approach to representation of civil society<sup>44</sup>

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<sup>43</sup> The politics surrounding the ECJ's jurisprudence in taxation matters is being increasingly recognized as an emerging arena of governance, especially as conventional policy-making and decision-taking in the EU seems paralyzed at the moment due to both the general identity crisis and specifics in connection to the dynamics of tax policy in an enlarged union (Radaelli, 7 July 2005).

<sup>44</sup> Defined as including e.g.: trade unions and employers federations, consumer organizations, environmental organizations, human rights organizations, charitable organizations, training and educational organizations, youth organizations, family associations, and religious communities. (Commission of the European Communities 2002, 6.)

organizations at European level. But in the EUSTD negotiations the Commission consulted only 'market operators'. The Commission emphasizes that it is especially important to be able to claim some representation of a specific interest. The same is true also for consultations by the national governments.

Contrary to the Parliament and the ESC, the civil society organizations' 'mandate' is not limited to the institutionalized consultation procedure. They can thus potentially use their knowledge power in a more constructive way. If a civil society organization can generate a change in the knowledge structure, it can set in motion processes that are beneficial to the goals of the civil society organization. History displays instances when this has indeed happened. The anti-land mine campaign is one of the most high profile of recent cases.<sup>45</sup> The campaign led to a change in the global knowledge structure. This enabled the formation of the new regime.

The anti-land mine campaign has in common with the tax justice movement that a global standard is necessary for the regime to be effective - if not, countries will have a military or financial advantage not acceptable to those considering participating in the new regime. Many human rights regimes, which also have been generated through the knowledge structure, do not possess this property, but they will remain intact and functional even if only a few countries participate in them (e.g. minority rights).

*'The diffusion of international norms in the human rights area crucially depends on the establishment and the sustainability of networks among domestic and transnational actors who manage to link up with international regimes, to alert Western public opinion and Western governments.'* (Risse & Sikkink 1999, 5.)

The generation of change in the knowledge structure thus quite simply is a question of media coverage, lobbying and sufficient research on the subject. It is also necessary that:

*'Transnational advocacy coalitions frequently engage norm-violating governments in an argumentative process whereby truth claims have to be justified and moral convictions are challenged.'* (Risse & Ropp 1999, 236-237)

The difference between human rights and offshore is that the target actors of such processes in the context of offshore is hard to pin down. It clearly includes those jurisdictions that enable offshore activities, but to which extent should it also engage other actors? The individuals and companies that take advantage of such arrangements

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<sup>45</sup> Of less recent cases a comparison to the anti-slavery drive of the 19th century illuminates the challenging of existing economic power relationships from an essentially moral perspective.

have to be challenged, as do the banks and finance institutions that enable such transactions. But what about such (large Western) governments that do not have formal power over offshore jurisdictions, but who all the same encourage them to be used or abstain from discouraging their usage?

It is argued that international norms start with principled ideas being pushed forward by transnational actors. The less contested their ideas become, the more international actors and states sign up to them. (Risse & Ropp 1999, 266.) Interestingly the land mine case shows a norm that has been internalized by a group of countries to the extent that they will also pressurize other countries to internalize them, only so that they themselves would be able to accept their own norm. The weakness of the tax justice movement can thus be turned into its strength, namely its indispensably global character. Progressive governments may engage more strongly in the process to make the norm truly global.

Interestingly the human rights literature often takes the relevance of Western governments for granted in affecting the bargaining process on human rights issues vis-à-vis less developed countries. They do so despite the fact that Western countries may have human rights violations of their own. Such hypocrisy might well pass on the offshore agenda too. All the same, the ensuing bargaining processes are always very context specific. In contrast to Risse and Ropp (1999, 234-266), who present a model of human rights socialization, this thesis will not venture into hypothesizing over any 'model' that 'tax justice socialization' could follow.

### ***6.1 Networking: Empowering the Tax Justice Movements***

When dealing with issues of economy, it seems to be important to be able to connect the control over the knowledge structure to control over some other structure. This is especially so as the dominant knowledge structure of the international political economy is that of the Washington consensus which has a favourable or ignorant approach towards tax evasion (i.e. 'tax efficiency'). So far, the only obvious example of such an association is the connection between the security structure and terrorist financing through offshore secrecy.

Just as finance interest groups claim to represent 'market operators', other civil society organizations need to claim they know some other aspect of market reactions. In the EUSTD it is quite obvious that while financial institutions have been consulted, the

other group affected by the directive - the taxpayers - have not. Just as 'market operators' on the European level are a very heterogeneous group, even more so are of course the taxpayers. Claims of legitimacy are indeed very complicated in the area of taxation.

Most European countries have an organization that claims to represent the taxpayers. The organized interests in the area of taxation often represent the upper end of the income scale. 'British Taxpayers' say that their job is 'to be against the [Inland] Revenue on your behalf. If there is a legitimate way for you to pay less tax then we can help you find it.' The Taxpayers' Association of Europe is a federation of taxpayers' associations throughout Europe. It has even more explicit goals than the British association as it 'works towards a society with lower taxes and more individual freedom.' (*British Taxpayers* website; *Taxpayers' Association of Europe* website.) They include freedom of the individual from government control as one of the value judgements that are worth pursuing, but not justice between individuals. Working for lower taxes is a clear statement involving a wealth judgement made completely out of context.

At the core of the offshore debate is the issue of banking secrecy. It represents a bargain between the right to know and the freedom to hide. Transparency International (TI) works for the right of the taxpayers to know what happens to their money in order to prevent corruption ('About us' at Transparency International website). Like with the taxpayers' associations, this is a goal, which concentrates on the relationship between government and individuals.

In contrast to TI and the taxpayers' associations, the tax justice movements can claim to know the market result of a certain policy at the inter-individual level. The connection of the inter-individual (or inter-corporate) level to the market must be well conceptualized. The basic argument must be that secrecy at any level cannot be part of a well functioning market<sup>46</sup>. This is not only the case in 'vertical' market-authority bargains, but also in 'horizontal' bargains between private sector actors (including individuals). By avoiding an absolute wealth judgement of the desirable absolute level of taxes (high or low), the movements will appear less politically loaded and their claim to represent taxpayers in general will be more convincing.

Both Transparency International and the taxpayers' associations have a mix of individual and corporate membership. Their corporate membership increases the

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<sup>46</sup> An argument well developed by several economists, see e.g. Stiglitz 2003.

seeming dependency that policy-makers perceive they have on their judgements (see chapter five). The fact that offshore activities are in practice only open to rich individuals and big corporations, thus giving them an unfair advantage is a point to be remembered for the tax justice movement. Including small- and medium sized enterprises in their membership would give them increased control over the knowledge structure as well as the production structure and a claim to know not only horizontal bargain reactions, but also vertical ones between market and authority. Evidence that this may turn out to be a viable approach already exists.<sup>47</sup>

Out of the EUSTD context, but still in the context of tax evasion, it is possible to imagine civil society gaining claims to sources of structural power in other ways. Notably, the tax justice movements could function as co-ordinators for non-EUSTD, non-OECD, and non-OFC countries (i.e. developing and newly industrialized countries, NICs), to help them formulate a coherent and forceful position on the matter.<sup>48</sup> Such positions could potentially be representative of a significant part of the world's population. Especially if NICs would participate they could make claims to some sources of structural power. Realistically speaking, such involvement by these countries in the bargaining process seems difficult to orchestrate. They are faced with many serious challenges, and because short-termism tends to dominate in difficult situations, co-ordination would be difficult.

In conclusion, one can note that the current non-actors are facing a huge challenge if they are to become relevant actors in tax policy change. The European Parliament's role may change in due time with changes in the institutional set-up of the EU, while the ESC seems condemned to a marginalized consultative role. The civil society organizations may improve their position on two levels. Firstly, they may attempt to become sources of influence in their role of organizations to be consulted by the Commission (and national governments). Secondly, and more ambitiously, they may attempt to push new issues to the (global) agenda by generating a change in the knowledge structure. Both require claims to control over the knowledge structure and other structures, as well as knowledge of market reactions. New claims to legitimacy

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<sup>47</sup> 'The Forum of Private Business [in the UK] has reported [music store] HMV and the Guernsey Government to the Treasury as part of its campaign to stop a host of retail giants exploiting the Channel Islands' tax status to sell cut-price goods – a practice the FPB says is fatally undermining high street shops.' (FPB website, 27 July, 2005.)

<sup>48</sup> Meanwhile, OFCs have been highly effective in creating their own lobbying organization - the International Trade & Investment Organisation - to lobby primarily against the OECD initiative (*ITIO* website).

require plenty of new connections - veritable networking. Additionally the change of the knowledge structure in a favourable direction requires alerting the public opinion and decision makers to the issue.

## 7 Conclusions

This thesis set out to answer the questions that were presented in chapter 2.4. The main question was: *What has generated the change of norms in the international political economy that is embodied in the EUSTD?* This question was split into a number of subquestions through which the aim was to answer also the main question.

*What were/are the different opinions of the actors on the EUSTD?*

The positions on the EUSTD were to some extent polarized, but almost none of the member states of the European Union maintained fixed positions throughout the negotiation process from 1989 through 2003. As the prologue on the history of the EUSTD showed, Germany, Belgium and Italy were some of the prime initiative takers. But at times each of them has also abandoned their support for the directive. The fiercest opponents among the EU member states were the UK and Luxembourg. The finance lobby was particularly outspoken in the UK, warning of the EUSTD's negative consequences for British job security and European wealth in general. Luxembourg's opposition was initially not so outspoken, but once the UK started pushing for the uniform application of the information exchange principle in the directive, Luxembourg became much more outspoken in its opposition.

It was not surprising to find that the third state (and substate) parties that were involved in the negotiations were rather unsympathetic towards the EUSTD regime, as they had been selected on the basis of being particularly important OFCs. Each of them emphasized the necessity of 'a level playing field' and claimed that funds would otherwise flow to non-EUSTD OFCs such as Singapore and Hong Kong. The United States displayed a peculiar double faced attitude towards the EUSTD by agreeing to some of the measures required in the EUSTD, but still claiming to its home constituency it was not signing up to the EU's initiative. The OECD could also be found among the opponents to the directive. The OECD had engaged in a similar initiative based on exchange of information on demand, instead of the combination of automatic information exchange and withholding tax that is the basis of the EUSTD. The Paris-based IGO also emphasized the necessity of a level playing field in the battle against tax evasion, and was disappointed to see the EUSTD being ratified.

*How have the different opinions been formulated?*

The different opinions emanated from three interlinked main sources: the different

historical trajectories of the actors, the anticipated market reactions and the different answers to the 'cui bono' question regarding a level playing field.

With respect to the historical trajectories presented in chapter 4.2, the position of the UK and the US as initiators (through decisions and non-decisions) of the offshore realm, and their parallel positions at the centre of the world economy explain their reluctance towards the regulatory efforts of the EUSTD. Switzerland and Luxembourg arrived at similar positions through non-decisions in that they 'failed' to adopt the resource-transfer based welfare structures of the surrounding countries. Germany as one of the main initiators of the directive, and France as one of its strongest supporters, had a quite different political economic history behind them. German economic success was based on strict regulations and principles, while France in both European and global economic integration always has called for reciprocity. Their historical trajectories were thus much more compatible with the principles of the EUSTD.

As a consequence of their different histories, the states had also arrived at different market positions. The British and Luxembourg finance markets have a particular specialization on the global financial markets, while most of the other EU member states have finance markets that are geared towards needs at the national level. Consequently, the regulation that the EUSTD proposed meant that capital was expected to flow away from the parts of the international market controlled by the British and Luxembourgers, either into national markets or to parts of the international markets controlled by non-EUSTD jurisdictions.

For this reason the actors also had different needs for 'a level playing field'. Especially the UK has been striving to be a good global citizen, and accepts the need for some global governance. In addition, regulation is not necessarily seen as the opposite of competition. The only way for the UK to combine the necessity to stay competitive in the global finance market with global governance, was for it to call for a level playing field. The OECD initiative based on information exchange on demand represented an initiative based on those principles. Consequently it was important for the British to make the EUSTD compatible with the OECD initiative, in addition to the lesser administrative costs expected, and thus they pushed for automatic information exchange.

The Americans are in a similar position to the UK in the sense that the US is at the very centre of the global financial markets. Their approach has also been a result of fitting

together divergent expectations. Considering the lesser support for global governance and indeed for any regulation in the United States, it was no surprise that the US bargain was one at the very minimum level, and appeared double faced.

*And what have been the opportunities and constraints for raising the issue in the first place?*

The most fundamental of constraints and also opportunities for putting the EUSTD on the agenda was the tacit bargain between sovereign states and offshore markets presented in chapter three. The increased integration of the global economy and technology advances, together with changes in moral judgements about offshore, has increased the opportunity for offshore activities. These activities build on the legal system of the sovereign states and are driven by the unwitting competition between them. The competition in turn is based on the dynamics of the capitalist markets.

International market integration, taken to its furthest in the European Union, has in the European context been linked to increased co-operation among governments. This is what lies at the very basis of creating an opportunity for raising the EUSTD issue in the first place; the change of market dynamics and a forum on a supranational level in which the authorities can react to these changes. The connection to the current EU debate on the future of the Union as a 'pure market union' or as a 'political union' is evident.

The EU as a forum has its own opportunities and constraints for raising an issue to its agenda. One of the most fundamental of these is that an issue, in order to appear and stay on the agenda has to have the backing of both the pro-integrationist Commission and one or many of the big member states. These two often correlate with each other; the Commission rarely raises issues that have no support among major member states. To raise an issue to the European agenda, a country, or a group of countries, must have enough control over sources of structural power so that they are able to strike the first bargains and set the negotiating process in motion.

In short, explanations of the beginning of the policy-process depend on 'the context, the functional needs, the motives of those involved, and the institutional arrangements' (Wallace 2000, 48). Changes in the EU's external environment force changes in embedded bargains (Wallace 2000b, 538). The dynamics work in a feedback-like procedure as the EU itself also affects this external environment, or the global context. Thus, even though direct tax policy traditionally has been seen by most member states

as an area where national competence should be retained - and still no one really would like to let it go - the EUSTD still changed this bargain that was embedded at the outset.

*Within which constraints and opportunities have the decisions been made?*

Once the EUSTD was firmly on the European agenda, there were a host of conditions that played into the bargains that were struck. It was, in the end, a question of control over the four different structures of power; finance, knowledge, production, and security. None of these four structures can be said to have been more important than the other in the negotiations, nor does any one actor appear to have held a decisive role in all the negotiations.

One particular constraint is the difficulty for regulators to know what the market reactions to proposed regulations will be. Policy-makers thus listen carefully to the private sector's predictions of market reactions. The subsequent power of finance lobbying groups on the issue of EU tax policy was and is, however, somewhat constrained, as they are not yet organised on a European level. Also, lobbying groups cannot exaggerate the consequences of a certain policy; otherwise policy-makers would not trust them in future negotiations.

Additionally, the Commission has quite an interesting role vis-à-vis the member states as a source of European expertise and is considered to hold knowledge about market reactions on a European scale. However, the national and/or a short-term view tend to dominate the thinking of national governments, and the Commission is thus almost always poised to be at odds with a few of the member states in any particular bargaining situation.

An essentially British based finance lobby succeeded in convincing the member states that the effect of the original directive would have been negative for Europe as a whole, even though the Commission did not believe this. This was an extraordinary achievement and reflects the extremely powerful positions and connections that the financial elite wields. Other national 'market operators' failed to express their positions as forcefully. This tacit concession was the most important intra-private sector bargain of the negotiation process. The positions of other European market operators (except possibly Luxembourg) were in practice somewhat different from the British. This was evidenced by the positive market reactions to the Italian and Belgian tax amnesties.

Once the necessity for excluding Eurobonds and thus also for renegotiating the principles of the first draft directive had been established among the main bargainers of the EU (Germany, France, UK, Italy), the constraint of insufficient control over the knowledge structure emerged again. This was reflected in the difficulty of separating the wholesale from the retail market. The innovations and technical advances in the finance market had blurred borders to the extent that any clear-cut separation was impossible. The technical standards, which had been developed earlier in the fight against money laundering, were of little help for the EU tax evasion regulators.

Another bargain involved the market and the authorities, primarily in the financial structure. It was a triangular bargain, and it involved inseparably state-state and market-authority deals. It was the peculiarity of Switzerland and Luxembourg abandoning the OECD initiative, and agreeing instead to the seemingly stricter EUSTD. But by agreeing to the EUSTD, Luxembourg and Switzerland avoided the creation of a global regulatory platform from which further advances could be made into the area.

It should not be forgotten that also the EU countries gained financially from this arrangement. With its stricter rules the EUSTD will probably bring in more money to the governments than would have the OECD's initiative.

Additionally the Swiss and Luxembourgers received concessions connected to other structures, notably in relation to the Schengen, which is part of the security structure in which both Switzerland and Luxembourg have very little to offer. The other EU countries, with the exception of the UK, did not so much need a global principle, as the stricter rules of the EUSTD compared to the OECD initiative, combined with its quasi-global reach, guaranteed that the British government's coffers would receive at least a few extra euros. For the UK, the EUSTD's principled (but in reality almost non-existent) commitment to the eventual use of information exchange satisfied its need to patch up its divergent interests.

The UK's positive attitude to the EUSTD appeared most evident in the negotiations with its dependencies. The UK's willingness to use its control over financial resources to persuade the dependencies, in particular the Cayman Islands, to agree to the EUSTD, meant that there was some common ground to be found for both sides. Both sides could avoid a lengthy and even humiliating legal battle, and both could gain financially. The Caymans benefited from British subsidies and increased market access, and the UK from tax incomes. This was actually a three-way deal that also included the markets, as

tax havens find that too staunch opposition to regulation might give them a bad reputation and a worsened market position. Indeed, many take pride in including the relevant regulatory information in their legislation as smoothly and quickly as possible, once the regulation has been decided upon. Additionally, the Caymans were not and continue not to be very dependent on European money, but rather on American money.

The aforementioned short-sightedness of the politicians highlights the significance of relational power as a compliment to structural power in determining the outcomes of politics. How one sees the losses and gains, and which priorities one gives to the four different basic values - justice, wealth, security, and freedom - depends not only on the prevailing circumstances, but on how one understands them and sees them. Thus as change of government may well make a difference for the policies a state pursues. In relation to tax evasion this is most evident in the United States, where the Democrats have indicated a greater willingness than the current Republican administration to promote some kind of global regulation.

Also, the important issue of the desired extent of European integration is a result generated through the combined dynamics of structures as well as relational power. Integration is such a vast and complicated bargain, that the total result for a certain member state may not be so evident. The way in which a certain party in power prioritizes the different values may vary over time. But the prioritization is always constrained by structures, any party not giving due consideration to the real effects of their policies will eventually perish. (For the Communists in the Soviet Union it took 70 years, the Chinese Communist party has adapted to the structures of power of the world economy, and thus survived.)

*Why does the EUSTD prevail as a norm?*

The EUSTD prevails as a norm both despite and because of asymmetrical power relationships. Asymmetrical is not used here in the traditional realist sense, where one actor simply has 'more' power than the other. What is meant is that each holds different kinds of power in different ways (both qualitatively and quantitatively) and each one is affected by different circumstances depending on historical developments and the functional issue at hand.

There are several very difficult problems in international tax policy and all approaches are inevitably deficient. Perfection is not attainable, but a pragmatic solution should be, and this the EUSTD shows. (Bird & Wilkie 2000, 104.) This muddling through has

been embodied in the EUSTD's very visible 75/25 % direct transfer of resources that Huizinga and Nielsen (2000, 137) refer to:

*'Since the effects on [participating] tax havens are expected to be negative, some transfer of resources to these countries may be needed to persuade them to accept an increase in minimum withholding taxes on interest in the EU.'*

Herein lays also one of the reasons why the withholding tax principle had to be included: The exchange of information system is more problematic than the withholding tax in the sense that it does not offer a 'natural' way of transferring resources to the small tax haven countries. But the bargains are much more complicated and also involve the markets, an aspect well forgotten by Huizinga and Nielsen. Resisting the creation of a global platform for tax co-operation, adaptation to new niches and gaining access to alternative markets all played a role in the muddling through.

There were also 'transfers' of other resources than financial. The Schengen agreement with Luxembourg and Switzerland concerned security. There is a security aspect in a broader sense also in the smooth functioning of relations between dependencies and the mother country. As two economic giants of the world, ever more bargains between the EU and the US are almost inevitably going to involve some of the very big questions of the world economy and its future. The EUSTD certainly was/is a piece in the competition puzzle between the EU and the US, which now includes not only production, but increasingly finance (e.g. the euro), knowledge (e.g. human rights) and security (the EU's emerging foreign and security policy).

In conclusion, agreement on the directive was finally achieved because perseverant positions among member states, and other involved states and substates, were discarded in favour of relevant transfers of resources for security, production, finance and knowledge justifiable to all parties.

In this context it is notable that the Commission has no real competency in the direct taxation policy of the EU beyond the knowledge structure. It was not in a particularly good position for participating in the bargaining, and became at the latest post-1999, when the co-existence model had been reject by the British, somewhat of a non-actor. This development is coherent with the developments in other new policy areas of the EU, there seems to be a tendency among member states to shun away from the so called Community method, to a stronger institutionalization of inter-governmental co-operation (Wallace 2000b, 637).

*How do the actors see their current opportunities and constraints on the EUSTD issue?*

The Commission is the most visible proponent of further integration in the area of direct tax policy. Its attitude also reflects the fact that most member states would be ready to advance integration in this area, including changing the institutional set-up so that qualified majority voting would be the decision-making system used. Despite the fact that tax policy in the EU is going to remain subject to unanimity voting in the foreseeable future, it is not necessarily a closed issue. The Commission is ready to seek to affect reluctant member states' opinions by making use of its unique position as a European level bureaucracy. Additionally it is ready to push smaller OFCs that are part of Europe's Africa-Caribbean-Pacific partners to greater transparency through its control over trade and aid. Exploring the possible positions of a wider range of actors, including the developing countries themselves and the international development agencies, would be a necessary and interesting part of future research.

The fact that the Commission can push weak non-members, while not being able to do much about its own members who are hanging on to the same principles of secrecy, highlights the large discrepancies that exist in world politics. It underlines the EU's image of a fortress Europe or a 'rich men's club'. It is also an indication of the EU's increased significance as an independent actor in world politics.

None of the actors involved with the EUSTD see it as a closed issue, although some certainly would like it to go away. The fact that the regulations of the EUSTD will change over time, with the gradual increase of the withholding tax percentage, and the ambiguity about what is going to happen if/when Switzerland adopts OECD rules causes concern to most EUSTD OFCs. Incidentally Switzerland is probably the actor that most sees the EUSTD as a closed issue. This is very much down to its structurally strong position. Switzerland got many concessions from the EU in the EUSTD negotiations, notably a deal on Schengen. As a member of the OECD it feels little pressure from that organization to adhere to its rules, very much in the same way as the Commission has little direct power over EU member states in QMV policy questions. So far the Swiss have taken a firm stand, implying that there are no more concessions to be made on banking secrecy:

*'The [Swiss Bankers' Association] expects EU member states to abide by the principles of the agreement reached with the EU, and that Switzerland's professional secrecy for bankers will not come under new attacks.'* (Urs Roth of the Swiss Bankers' Association quoted in *International Money Marketing*, Jul 21,

2003.)

Switzerland has a key position concerning both the European and OECD initiatives on tax evasion. Everyone else has to wait and see what the Swiss are going to do, if they are going to do anything at all.

Making Switzerland move on the issue would likely have to include the United States, and be connected to a truly global effort rather than a European led one. The future of tax co-ordination thus relies very much on the perceived necessity for global governance. Together with the UK, the US uses tax efficiency and tax competition rhetoric which gives little appreciation for tax co-ordination efforts. Yet at the same time, they are both accepting that for the international economy to work efficiently, and to promote liberal ideas, there is at times a necessity for supranational authority (WTO).

It seems the UK also has a broader understanding of the necessity of global governance, as long as it does not hurt the UK's own industry too much. The direction in which the global economy is moving is never going to be a closed issue. For now it would seem that tax co-ordination stands a chance if transparency can be connected with the smooth working of the global economy. Overall, wealth takes priority over justice in the global economy today, and it seems unlikely this will change much in the future despite increasing efforts to make the global economy more just. If it can be successfully argued and shown that transparency creates more global wealth, then tax co-ordination should stand a chance.

*What are the opportunities and constraints for potential (not only actual) actors?*

The developing countries have little or no chance to profile themselves on the issue. Third world countries generally do not possess such resources that are necessary for the bargaining process and thus are in a structurally much weaker position than e.g. the EU in battling the negative effects of tax evasion. There are bleak expectations for the combating of tax evasion in the developing countries. They would require strong support from the big developed Western countries, which seems unlikely if there is not a significant global change in norms.

The 10 new member states of the European Union were completely sidelined in the bargaining process around the EUSTD, faced with a much bigger set of crucial bargains embedded in the expansion of the EU. Now that these states are EU insiders, and will never again be faced with a bargain bundle the size of the enlargement, they stand a better chance to actively participate in the formation of future EU policy.

The European Parliament and the EU's Economic and Social Committee were sidelined too. They are trapped by their institutional positions, though the Parliament's role might increase in due time if it is given greater powers in EU tax policy. To some extent the Parliament is also trying to work as an opinion builder outside of its institutional role, and has a better chance of finding a common position compared to the nationally biased Council of Ministers.

A better opportunity to affect opinions outside any institutional role that they might be given is held by civil society organizations. The finance lobby is notoriously strong, and if e.g. tax justice organizations can make similar claims to knowledge about market reactions as e.g. Transparency International or taxpayers' associations, they stand a chance of generating some change in the knowledge structure.

To return to the main research question:

*What has generated the change of norms in the international political economy that is embodied in the EUSTD?*

Drawing on the elements that mirror-image the enabling of offshore listed at the end of chapter three, and in the light of subsequent analysis, one can make conclusions about where and why on the continuum the 'regulation-enabling' and 'offshore-constraining' bargains have fallen in the context of the EUSTD:

- 1) In the negotiations the profits of onshore have been increased relative to offshore by a transferral of financial, production, and security resources between states.
- 2) The profit of onshore has also been increased through tax amnesties.
- 3) Rewards for professionals who carry offshore into effect have not been decreased in any significant way.
- 4) The negotiations have increasingly been focused on the smaller offshore users, while those using more sophisticated instruments and with larger deposits have arguably got away painlessly.
- 5) The negotiations have built on a legal framework that pertains to European citizens only. In comparison to the OECD initiative, this gains EU member states and most EUSTD OFC jurisdictions.
- 6) In the case of some of the dependency jurisdictions, it can be argued that the sovereign rights of the entities in question to write their own laws have been decreased.

7) There has been no interference in technical systems, although there was an unsuccessful ambition to draw on already existing anti-money laundering knowledge structures.

8) The American government has constrained the public knowledge about their policies, not directly about tax rates in other countries as was suggested as a possibility.

What is it possible to learn from the above listed eight strategies used in the EUSTD negotiations, besides their historical relevance for that specific set of negotiations? Do we learn something that can be of use for future negotiations in the same subject area? Do we learn something more general about the world economy and how it works? It would be dangerous to draw broad conclusions outside of the context of the EUSTD negotiations, but the eight points do raise some interesting points for discussion.

The EUSTD affects interest payments from savings and bonds, but not income from share dividends, unit trusts or insurance policies, though there is thought to be a desire among commissioners and leading politicians to make progress also in this area (Engdahl 2003, 121). Most experts agree that tax policy will increasingly fall within the EU's competence in the future, with the taxation of corporate interest income being the most important target. Already some major EU countries would be more than willing to tackle these issues on the EU level, while some experts are suggesting that the watered-down EUSTD will be tightened up in the future (*International Money Marketing*, Mar 2004; *International Money Marketing*, Jul/Aug 2004).<sup>49</sup> The Commission has also been instructed to enter into discussions with other important financial centres; with a view of equivalent measures to the EUSTD being applied e.g. in Singapore or Hong Kong ('European Union Seeks Expansion of New Savings Tax Agreement' at *Bloomberg.com* website).

So a new round of negotiations is already in sight. It seems most likely it would be based on a territorial expansion of the EUSTD to Singapore and Hong Kong. What strategies could be used in these negotiations?

For any future negotiations in this area to be successful, negotiators need to focus on the real-world outcomes in terms of different resources of the four structures of power rather than trying to stick to principles. Concerted action and a view of the totality of benefits at stake in the negotiations, in combination with tax amnesties in those

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<sup>49</sup> EU authorities have reacted coolly to German calls for greater regulation of hedge funds (*European Voice*, 19 May 2005).

countries wishing to regulate, constitute a good rule of thumb. Certainly the tax amnesties compromise justice, but from the regulator's point of view considerably facilitate the achievement of the goal.

However, the compromise in justice and prioritisation of wealth have a more basic presence in the structures: Any future developments in the area seem likely to follow the same pattern as the EUSTD, where the negotiations have increasingly focused on the lower level of the offshore hierarchy. Both the relatively smaller investors and the hierarchically lower OFCs can be expected to be the target of further regulation, while London and New York get away without being significantly hurt. It would not be unfair to say this is the clearest indication the thesis has produced of where the most structural power of the world economy resides: with the richest people and the richest countries. The rather unsurprising systemic bias of the international system is thus unveiled: A bias in favour of the international business civilization – 'a transnational class' (Guzzini 1998, 182; Strange 1989, 170).

Unused potential for reducing the rewards for professionals who enable offshore do exist; civil society in particular can potentially enlarge the emerging discussion on the morality of large rewards for hazy corporate activities (see e.g. *USA Today*, 18/09/2002).

The fact that the negotiations have built on an EU-centred legal framework also reinforces the picture of the structural power of the richest and the compromise in justice that this entails. The two strongest international organizations that have the potential of realistically making advances in the area are the EU and the OECD. Both are institutions bringing together (mostly) some of the richest countries of the world (and exclude the poorer).<sup>50</sup> Truly global institutions (notably the UN) are weakened by their very divergent membership, and the poorest countries are in any case effectively sidelined in them. Regional institutions constituting of poorer countries such as the African Union, do not possess enough resources of structural power to initiate similar processes as the EUSTD in the EU.

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The fact that there has been a particular intensity of institutional and substantive experience in EU-level policy regimes in general is undeniable. This has endowed the EU with capabilities beyond those of most other transnational organizations. Hence

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<sup>50</sup> Over half of the OECD membership consists of EU member states.

there is some plausibility in the argument that policy-makers from EU member states will tend to prefer the EU to other international organizations, or will prefer to experiment first at the EU level before proceeding to build broader transnational regimes. (Wallace 2000, 43.) Does the EUSTD add to this experience and will it follow a particular route of development in the future?

One of the key issues in the future is going to be the relationship between the OECD and EU tax co-operation initiatives. The actual functioning of the EUSTD and its consequences for the European economies are going to be all-important. The consequences are expected to be rather minimal all round, which might provoke arguments of pretty much any sort both in favour of the EUSTD, of the OECD or of a return to nationally based regimes.

The variety of future possibilities indicates the futility of trying to predict future events through political analysis. Indications, however, already exist that the EUSTD and the OECD initiatives will both continue to evolve, without as strong conflicts of interest between the two international organizations as during the 1990s. After all, there is no apparent reason why the two regimes could not exist side by side.

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Besides the answers to the main questions on the generation of change in the international political economy in the context of the EUSTD, the theoretical framework has been potent enough to lead to some 'by-products'. It has provided answers to questions that the thesis did not set specifically out to answer, but that have proved to be relevant for the understanding of the dynamics in the EUSTD negotiations.

Firstly, the thesis has confirmed that the separation of the political field into left and right on a European level or in a European comparison is obsolete and inapplicable. Value judgements are made on a national level about issues that almost invariably have an international dimension. The historical trajectory of each nation state is different from the next. Thus decisions are going to be based on a purely national, not global, conception of what gains 'us' the most.

It can be argued though, with some evidence, that the left used to be more internationalist in its thinking. The one-sidedness of the political lobbying throughout the negotiation period tells an interesting story about how the forces on the left, political parties, unions, think-tanks and progressive civil action groups, have lost the plot on globalization and tax policy issues. Further research into why this *problematique* would

be useful.

Secondly, the thesis has also provided a basic theoretical understanding of the dynamics of European integration. It has been argued that integration is the sum of a multitude of bargains based on what gains and losses member states perceive they result in. If the totality of the bargains included in further integration is perceived as positive, integration can continue. If not, there will be no further integration. In this bargaining larger member states will always hold more control over the resources of structural power, and they will thus be in a stronger position. It is important to note though that member states do not exist in a vacuum, and are influenced in their decisions also by non-governmental actors. This view corresponds broadly to the supranational perspective in the academic debate about leadership in the European Union (Nugent 2001, 218), though couched in qualified terms relating to the specificity of each negotiation process.

How integration is perceived is based on circumstances defined by structural power. Structures change historically, and will create pressure for new institutional decisions. The changes in structures may not necessarily be changes that are promoting favourable perceptions of integration, but may well push in the direction of disintegration. The existence of Europe as a forum for 'positive' as well as 'negative' integration should not be taken for granted:

*'Europe is still at the point where great deal of institutional work needs to be done to ensure that its effective economic integration is irreversible. At the primitive level, as a single market, integration is probably irreversible. The same does not hold for the development of the extended economic governance of this single economic space.'* (Hirst & Thompson 1999, 254.)

Thirdly, the thesis has pointed to some inherent problems in the British policy towards its dependencies. The historical dynamics that have lead to the creation of tax havens in the British dependencies are a result of British policy. Their creation and political separation meant that the tax havens were separated from the general structures of power that dominated mainland UK. The connections were almost purely offshore connections, and the onshore connections between the mainland and the dependencies were comparatively negligible. With the deepening of European integration, the 'onshore' dynamics in the UK are slowly changing, and they are on a crash course with the offshore policies of the dependencies. It seems that a consolidation of British overseas policies with its domestic and European policies would be desirable. This

would have to include a greater responsibility on the part of the UK of the well-being of its dependencies.

Essentially this is the same incoherent approach that the developed world in general has towards the developing world. The Western world structurally pushes, even if by mistake, the developing world into difficult decisions. This does not only concern the financial structures, as in the case of the UK's relations with its dependencies, but all structures of power. When they backfire, e.g. in the form of tax evasion or increased support for extremist movements, the West fails to take responsibility to correct the mistakes at their root, yet deplors the situation.

### ***7.1 Theoretical and Methodological Discussion***

The main research question (*what has generated the change of norms in the international political economy that is embodied in the EUSTD?*) is also an inherently theoretical question, to which any practical answer is undoubtedly deficient. On a theoretical level the question could be answered by saying that: The change of norms has been generated by the circumstances *where a government, a political movement or a corporate enterprise has a range of feasible choices, and by the scenarios that emerge, depending on which choices are made.* In the EUSTD negotiations each actor has made decisions about the prioritization and weighing of the four basic values - security, justice, freedom and wealth. Each decision has been constrained by the actors control over different proportions and aspects of the sources of the four structures of power. Similarly these very same qualitatively and quantitatively asymmetrical power relations advance each decision.

Strange's analytical approach has indeed mostly worked as a mode of thought, making the author think about the connections between decisions and the power relations embedded in the prevailing and historical circumstances. Thinking about the four basic values necessary for societal organization has drawn the attention back to the consequences for individuals. In discussions that focus on 'high-politics', this has proved important so as not to detach the study from 'the lived experience'.

The thesis has built on the view that 'single models are unavoidably reductionist, shutting out significant aspects of political interaction in order to achieve the cleanliness of parsimonious simplicity' (Wallace 2000b, 541). I have preferred to illustrate the

complexity and diversity of policy-making and particularly to provide a larger picture, uncovering connections beyond the traditional sphere of financial policy.

As the used approach is not a theory as such, there have been no preconceived answers. Thus the loose connection between theoretical deliberations and the historical passage described in the study is understandable. The simplified nexuses have been somewhat apart from the text. But, one should not have expected more, after all the nexuses are only a theoretical conception of a framework of power that approximates those that exist in the real world. It is a web that builds 'below' the level of the text, shaping the text, yet not determining it as such.

The major challenge - as often is the case - has been operationalizing Strange's theoretical framework. The suggested way to do it - bargain analysis - might well lie somewhat beyond the spirit of eclecticism of Strange. At a methodological level it is quite rigid, setting up a clear-cut model of a recipe for analysis. Yet I would argue that the almost infinite possibilities of combinations and a tolerance for own thoughts and innovations, give it an air of eclecticism. An interesting, yet utterly non-Strangeian, idea would be to operationalize numerically the different weights given to the four different values. Thus one could count medians, averages and frequencies of different actors' behaviour, in hope of finding a pattern. The problem with this idea lies in that each bargain is made in its own unique setting and that they are not directly comparable with each other. Bargains are relative, not absolute and thus meaningful numerical patterns would be difficult to find.

One of the most challenging concepts is involving markets in a power game together with states and other socially (more or less) organized actors. How and when can market players (e.g. banks), their representatives (e.g. the finance lobby) and the dynamics of market be separated from each other? One possible answer could be that the socially organized entities (banks, finance lobby) can exercise 'positive power', consciously forming strategies, making connections about causes and consequences, while the market dynamics are a 'negative' power force in relation to other actors. With negative power I mean a process whereby the market dynamics limit, constrain and gnaw into the power of socially organized actors. Yet also socially organized actors constrain each other's capabilities to exercise power.

Moreover, the notion that markets can only produce negative power builds on a premise whereby there is some original balance of power or a situation where all power

belonged to the state (and none to markets). The power of markets and the relation between markets and other actors are important points for further theoretical discussion.

Palan (2000, 3-4) uses the word 'market' as synonymous to firms. But as Guzzini (1993, 470) notes:

*'One must in fact expand the small structuralist account of a logic of the market not reducible to agency to one of markets as institutions that work with and through a specific set of intersubjective rules and practices. These structures constitute power practices that are continually allocating and reallocating agents to categories that are differently affected by the working of the [structural] bias.'*

This thesis as well has used such a concept of structural power in relation to market dynamics and its agents/actors, whereby there is a conspicuous freerider problem, which seems by common sense incorrect. Namely, the basic dynamic of tax evasion is such that it also seemingly confers structural power to the small OFCs. Is there any way of separating market dynamics from the agents that make it possible/create it?

Guzzini goes on to suggest a solution of two different but interlinked concepts of agency and structures. Roughly speaking, 'power' refers to such structural power that is represented in an agent's capacity for affecting resources, which affects social relationships, while 'governance' refers to the capacity of intersubjective practices to affect outcomes. (Ibid., 471.) Intersubjective practices cannot be reduced to 'market dynamics' but rather refer to superior level of how things are perceived. This highlights the theoretical supremacy of the knowledge structure, as already discussed at the end of chapter 2.2. Yet, as this thesis on the EUSTD negotiations has demonstrated, in a more concrete situation than an analysis of the world economy as a system, the theoretical supremacy of the knowledge structure might serve to obscure the relevance of the structural effects of security, production and finance...

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