



ENLIGHTEN H2020 AGORA® Forum

Advocacy, Governmental Organisations and Research Networks Associated

April 11 - 12th 2016

Hosted by Pr. Vivien Schmidt @

**BOSTON
UNIVERSITY**

ARE HARD TIMES THE MOTHER OF INVENTION?

Efficiency & Legitimacy of Crisis-born European Modes of Governance

ROUNDTABLE 1 BACKGROUND NOTE 1

THE FAST-BURNING EUROZONE CRISIS AND GLOBAL SHIFTS IN MONETARY POLICIES & ECONOMIC REGULATION: INSTITUTIONALIST FRAMES OF ECONOMIC REGULATION

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*This activity acknowledges the support of the H2020 RIA research project
ENLIGHTEN - European Legitimacy in Governing through Hard Times: the role of European Networks
European Commission Project Number: 649456*



RESEARCH SUMMARY

The ENLIGHTEN project argues that Europe's fast-burning crises have indeed threatened the legitimacy of European institutions and modes of governance, but that these challenges must also be viewed in a longer-term frame. What we term 'slow-burning' crises are also critical for differentiating what kinds of EU governance architecture and associated modes of governance enhance the legitimacy of the European project. Slow-burning crises extend beyond normal political and business cycles within Europe. They include issues such as the financial sustainability of Europe; how governments can continue to provide public services to their population; and the political, social, and economic consequences of chronic unemployment and underemployment. In slow-burning crises politicians are less vocal in raising alarm than during fast-burning crises and knowledge is 'cold' in the sense that experts consider and argue what constitutes good science in addressing the issue at hand. In slow-burning crises, it is professionals in expert networks, rather than politicians, that point to problems and prompt the European governance architecture to address them.

The political challenges to Europe include both these fast- and slow-burning crises. While politics is more immediately present in fast-burning crises, where national and European discourses concentrate on crisis resolution, in slow-burning crises a key factor is how issues are constructed and how discourses of response are articulated as European problems to be faced by particular modes of governance.

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Work Package 2 is concerned with Banking Crisis and Financial Sustainability, with resolutions to recent financial crisis in the fast category and long-term issues of financial sustainability, including 'fiscal leaks' and tax capacity, in the slow one.

At the moment it seems that the European Union has safely navigated the tumult unleashed by the global financial crisis. Less than three years ago this was in no way guaranteed and securing, at least for the time being, the stability of Europe's financial system and the medium term viability of the single currency itself represents a substantive success. This apparent success, however, has not come cheaply or without debate. On one hand, many view the current stability as momentary given that the objectives of prudential supervision, sovereign debt management, and financial markets are frequently at odds. On the other hand, the distribution of the costs incurred in pursuit of stability has generated acute conflicts across member states. Such dynamics are playing out with the European Banking Union, which presents significant progress while not providing the means to resolve disputes between European member states. There is no sufficiently empowered European institution that can provide lender of the last resort and single deposit insurance functions. This will surely provoke further tensions.

The banking and sovereign debt crises present fast-burning crises that have significantly rattled European institutions and ushered in a period of Executive Supranationalism and Contractualisation as modes of governance to deal with policy coordination problems across Europe, as well as target economic problems in particular European member states. Against a backdrop of increasingly interventionist and hierarchical modes of governance on financial regulation are redoubled efforts to change the regulatory landscape for fiscal matters through expert networks that are interacting with an incoherent European institutional framework.

For ENLIGHTEN my research thus far has focused mainly on expert networks dealing with tax reform within Europe and globally. With Duncan Wigan I have been exploring how institutional frames for regulation are being established through competition between expert activists, regulators, and practitioners from the private sector.

The issue is how multinational corporations (MNCs) account for their financial performance and what taxes they pay. The EU, OECD, UN, large global accountancy firms, and non-governmental organizations (NGOs) have been active in challenging and defending forms of corporate financial reporting in recent years. The spring beneath much of this activity has been the international financial crisis, which highlighted the significance of 'fiscal leaks' in many advanced economies.



MNCs such as Apple, Amazon, and Starbucks, have come under scrutiny, as some layers of their intricate tax structures have been peeled away. These practices have heightened perceptions that firm financial performance comes from tax trickery rather than production and sales. Many note a permanent schism between the location of value creation and the geographical allocation of profits.

The distributional and market implications of tax-motivated corporate practices have led to calls from the NGO community for a new accounting standard for geographical reporting called Country-By-Country Reporting (CBCR). A company's disclosure of tax and financial data in each country of operation would shed light on tax avoidance schemes and the source of many fiscal leaks. By increasing transparency CBCR promises to systematically reduce opportunities for tax-motivated corporate profit shifting. CBCR has been pushed by a group of professionals strongly associated with global tax activism, especially through the Tax Justice Network (TJN). They have been able draw attention to CBCR from the EU, the G8 and the G20.

In a new article in the *Journal of European Public Policy* Wigan and I establish how expert battles over CBCRs were strongly influenced by activists. Their tactics in changing European institutionalist frames have led to a new tax regime that may be further bolstered by the 'Panama Papers' leak of recent weeks, not because of a direct link, but because of political momentum.

On CBCR, at what was at first promoted as a limited purpose technology, combatting corruption, has been inflated to become an all-purpose technology available for policy makers. The European Commissioner for Internal Market and Services made this clear in promoting maximalist CBCR across the European corporate sphere:

I welcome today's vote by the European Parliament on the new Accounting and Transparency Directives. Financial reporting obligations have been modernised and costs reduced, in particular for SMEs. With the new rules on country by country reporting, we have created a framework where businesses and governments must disclose revenues from natural resources. This framework will also contribute to the fight against tax fraud and corruption. But we must go further now and take measures on more transparency on tax for all large companies and groups – the taxes they pay, how much and to whom. I think it should be possible to introduce rules for the publication of the information on a country by country basis, similar to those approved for banks in CRD IV, or in the Commission's proposal on improving the transparency of certain large companies on non-financial reporting, adopted in April.

As matters currently stand CBCR has gone from an idea to a new international standard with the potential to address issues of corporate transparency and tax compliance. Our research suggests that in slow burning crises, such as tax reform, expert battles are important in setting institutionalist frames.

In the CBCR case the professionals associated with TJN were able to place this corporate financial reporting technology into policy debates with success. Whether or not CBCR is an actionable idea is no longer a point of contention in professional battles. Rather, the form of CBCR, be it minimalist or maximalist, is the concern. While TJN may be seen superficially as a garden variety NGO, it is a loose organizational form through which particular professionals with specific skills coordinate to push forward an activist agenda on global tax policy. In our case, this capacity rests to a large extent on professional expertise. The professionals associated with TJN were able to engage a broader NGO network, notably PWYP, and substantially push forward their idea on financial reporting to others on how this issue should be treated. They grafted their agenda into the political sphere by circumventing the traditional transnational authority, the IASB, and by instilling CBCR as an alternative and preferred form of corporate financial reporting. TJN were able to draw upon a skill set scarce among the wider NGO community and commensurate with the skills of those traditionally tasked with crafting accountancy standards. In doing so CBCR is now part of our regulatory landscape within Europe and globally. As CBCR has both issue salience and valence those propagating it can make linked technical and moral claims about its necessity and superiority.

Importantly, this is not an isolated case. The European Union wants such voices. The European Parliament's creation of Finance Watch in 2010 as an independent NGO to provide oversight to the European financial sector comes directly from a desire to fuse technical expertise with moral authority.¹² The MEPs behind Finance Watch asked the professionals staffing the new body to consult TJN about organizational and campaigning strategies.¹³ Given the opportunity, the right professionals can confront established technical authorities and power ideas through expertise, by fusing technical knowledge with moral claims to create change in the international political economy.



PUBLIC POLICY ASSESSMENT

The current point of public policy reflection is, of course, centered around the ‘Panama papers,’ a leak of 11.5 million files from Mossack Fonseca, reportedly the world’s fourth largest law firm providing offshore financial services. They are creating a scandal, as they reveal how a huge range of political elites and celebrities – from the suspect, like members of Putin’s inner circle, to the seemingly squeaky clean, like a quarter of Iceland’s ruling cabinet – have used shell companies and accounts to stash their capital. Shell companies can be used for a variety of legitimate purposes, but can also be used to avoid paying taxes or to hide ill-gotten gains. Lists of political elites, including 12 current national leaders, their advisors and various celebrities have emerged.

This isn’t the first such leak – in recent years, we have seen leaks from Luxembourg, Singapore and Switzerland. The Panama leak provides us with a longer list of names to point our fingers at. The more important question is the underlying one. Why do we need whistleblowers to see what is going on in this murky world of offshore finance?

Our research suggests that the answer is that we don’t have the power and resources to regulate offshore finance, and we don’t have systematic access to information. There are three basic reasons why.

First, the service providers who set up shell companies and accounts have little incentive to provide information. Secrecy is their business model. They use the international legal system – and the protections given by sovereign states – to obscure or hide information from authorities and provide advantages to their clients. This occurs within rich countries that belong to the Organization for Economic Cooperation and Development (OECD) as well as in traditional tax havens, as tax activists are keen to point out.

Second, existing institutions for information exchange are bureaucratic and inefficient. Imagine, for example, that one OECD state requests another OECD state to provide it with account information on a single bank transfer, so that it can investigate possible tax evasion. Our field research reveals that such requests can take up to six months. This may be the best case scenario – information exchange between friendly countries with well developed bureaucracies. Imagine how long it takes to get information from unfriendly jurisdictions with little organizational resources. Perpetrators can move money at will and at great speed. This means that police and tax investigators usually prefer to deal with purely domestic cases, which are easier, rather than dealing with thornier international investigations, even though the latter might reveal where the big money is.

Third – the big powerful states of the international financial system have been reluctant to push for really tough rules. The reason is that they themselves may benefit from sheltering other countries’ hot money. The UK controls over 50% of the jurisdictions that provide secrecy for mobile elite wealth. Recent research has shown that Delaware, not Panama, is the easiest place to set up an anonymous shell company.

The first and second problems will only be solved if the third is addressed. There is momentum for change after the Financial Crisis. States want money to do things, and G-20 leaders are now looking to plug ‘fiscal leaks’. The US unilaterally lurched forward in 2010 with the Foreign Account Tax Compliance Act (FATCA), requiring foreign financial institutions to report to the IRS on US held accounts. The G20 then called on the OECD in 2013 to establish a standard for Automatic Exchange of Information (AEOI) between participating tax authorities.

However, progress is patchy. The OECD did release a new standard for information sharing among tax authorities in 2015. However, Panama, for instance, has backtracked on the new OECD standard. The OECD took until February to comment on Panama’s recalcitrance. Notably, the US while demanding information from others is proving more reluctant to share what they know about foreign accounts in its jurisdiction. There are also questions about whether developing countries, those that suffer most from illicit financial flows and tax abuse, stand to benefit from the new initiatives. On automatic information exchange it is far from clear that the Great Powers, like the US, are willing to provide the technical assistance to developing countries necessary to enhance their participation in the new system.

The Panama papers may help reinforce a policy trajectory towards more regulation and information sharing. Just as LuxLeaks led to political action in the EU and the OECD, this data is less important for the information it provides than because it raises the profile of the issue of tax evasion, and makes states more willing to come together to tackle it.



What might a more substantial action plan involve? First – it could lead to greater transparency. Even the UK supports transparency of information that would allow people to figure out who the ultimate owners of firms are. The UK could also rein in its crown dependencies – micro-jurisdictions like the Channel Islands and the Isle of Man that thrive on tax avoidance strategies. Similarly, the US could shut down the activities its own havens – states like Delaware and Nevada - at the federal level. Capital flows to errant jurisdictions could be curtailed. One important fact that emerges from the data is that the number of shell company incorporations is in decline. States may have a renewed incentive to accelerate this decline.

However, renewed activism will also lead to new fights that pit OECD policy makers against economic elites who have enrolled tax experts, including the world’s biggest accountancy firms, to protect their wealth. The protagonists in global tax battles include professional experts, policymakers, and civil society activists. For a long time, the private sector experts have set the agenda. The Panama Papers could help build a new potential alliance between policy makers and activists to push back against them.

POLICY SUGGESTIONS

1. In general, the European Commission should, following the Finance Watch model, help establish a broader NGO watchdog network for transparency and accountability from European economic institutions.
2. On financial regulation we need more information on ECB rule-making procedures, as well as those of the European Stability Mechanism. The role of the Single Supervisory Mechanism relies on the ECB’s credibility, and the decisions adopted by the ESM cannot be seen as the consequence of the Eurogroup’s whims (including to exclude member states from their talks). The Eurogroup’s actions in July 2015 were extraordinary and unfortunate for a range of reasons.
3. On tax matters, the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes should be emboldened. At the moment the Forum is informally accountable to the G20 as its ‘action arm’. There is no reason why the institutions of the European Union cannot give it a further spur. Technical assistance to boost the capacity to use Automatic Exchange of Information is a key barrier to the global regime.

ENDNOTES

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