Tax, Development and Capital Flight

Doha Civil Society Forum

Tax and Development

Tax is the most sustainable source of development finance, providing a domestic, non-cyclical source of *revenue* for nation states to invest in their own development.

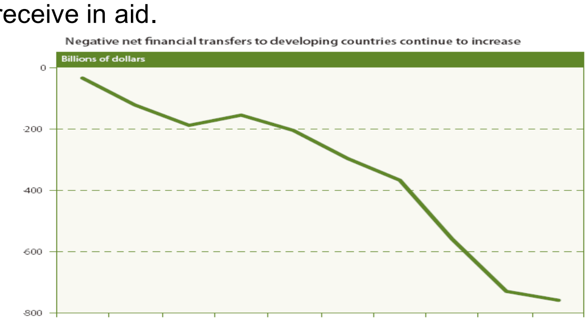
Progressive taxation also benefits the poor by *redistibuting* wealth through society and can limit the consumption of goods which have harmful effects on society or the environment through *repricing.*

A broad tax base improves *representation* accountability between state and citizen. Where governments are dependent on their citizens for revenue, they are more likely to act in the interest of their citizens. Governments have a vested interest ensuring economic growth is shared throughout the population because promoting economic development for all means greater revenues for the state.

Capital Flight

The scale of the problem

It is estimated that between $500bn and $800bn of illicit capital flows from southern countries every year. This is more than total global aid flows to developing countries ($103bn) and Foreign Direct Investment ($240bn) combined. Of this southern countries loose $160bn in tax revenue; one and a half times more than what they receive in aid.



Net financial transfers to developing countries and economies in transition, 1997-2007 (*billions of dollars*). Source: UN (2008) World Economic Situation and Prospects p xi.

Capital Flight in African countries represents a higher burden as a percentage of GDP than in other regions and presents clear links to external Debt. Foreign debt can cause capital flight by contributing to an increased likelihood of a debt crisis, worsening macroeconomic conditions and the deterioration of the investment climate.

The cause of the problem

Commercial illicit flows account for around two-thirds of the illicit capital outflows from developing countries. This is largely facilitated by transfer mis-pricing where commercial companies sell goods and services to sister companies at inflated or deflated prices to minimise the tax burden. This is facilitated by a lack of transparency and ineffective global regulation of financial flows, as well as bank secrecy and tax havens.

Financial Crisis

The financial crisis has been caused by irresponsibile borrowing, buying and selling of risky debt, and the inability of banks to value assets effectively. Again, this was caused by the lack of transparency and ineffective global regulation of financial flows.

Tax havens have played a key role in the current financial crisis by providing opacity necessary to the establishment of special purpose vehicles and speculative financial actors such as hedge funds.

The effects on the south are potentially catastrophic. Falling Aid flows, migrant remittances, and FDI, coupled with falls in export demand for commodities like wheat, mean the poor will be hit first and worst.

Solutions: Financial Transparecy

The problems of capital flight and the financial crisis demonstrate clearly that the complexity of global financial flows has grown far beyond the ability of governments to effectively monitor and regulate them. The current regulatory framework is not fit for purpose.

At the Monterrey Financing for Development conference in 2002, governments pledged to encourage *"the orderly development of capital markets aimed at addressing development financing needs and foster productive investments".* They agreed, that this *"requires a sound system of financial intermediation, transparent regulatory frameworks and effective supervisory mechanisms".*

This has yet to be delivered.
Creating an atmosphere of financial transparency and accountability would help to address issues of capital flight and the current financial crisis which will have a huge detrimental effect on southern countries and the possibility of achieving the Millennium Development Goals (MDGs).

Required outcomes from the Doha FfD Conference

a) A clear statement of the pre-eminence of tax as the only sustainable source of public finance for independent development;

b) That the UN Committee of Experts on International Cooperation on Tax Matters (the UN Tax Committee) should be upgraded into an intergovernmental body, tasked with enhancing international cooperation on tax issues and promoting the goal of effective tax information exchange (not least between developing countries and others);

c) That the Tax Committee adopt a 'UN Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance', of which a draft has already been discussed, and which sets minimum standards to countries' cooperation;