The great American jobs and tax scam

In the United States, tax competition among states is a major problem. Greg LeRoy looks at the evidence and assesses some of the implications for tax revenues and employment.

Tax competition is an international blight, but it is also a plague within the borders of the United States. In fact, competition for jobs and tax receipts within the United States has been an 'economic war among the states' for more than three decades.

Economic development – defined as spending by states and cities for job creation or retention – now finds the average state with more than 30 subsidy programmes: property tax abatements, corporate income tax credits, sales and excise tax exemptions, tax increment financing, low-interest loans and loan guarantees, free land and land write-downs, training grants, infrastructure aid – and just plain cash grants.

The bottom of the iceberg – in every sense of the word – is tax breaks. Those granted by states – income, sales and excise – are the least visible, least accountable, and most corrosive ways states fund economic development. Those granted locally – especially property tax abatements and diversions – are especially harmful to schools.

This system has a long history and many moving parts. It traces back to at least the 1930s and the Great Depression, and really matured by the 1970s. By then, most of the key actors were in place: secretive site location consultants who specialise in playing states and cities against each other; ‘business climate’ experts with their highly politicised interpretations of tax and jobs data; and an organised corporate network orchestrating attacks on state tax systems.

Today, this industry has spawned a more elaborate cast of characters: rented consultants packing rosy projections about job creation and tax revenue; subsidy-tracking consultants who help companies avoid leaving money on the table; and even an embryonic industry to help businesses buy and sell unused economic development tax credits, now legalised in at least four states.

States and corporate lobbyists justify economic development tax breaks by claiming job creation and tax base enhancements. But they routinely fail to deliver on both counts. Investigative journalists, non-profit researchers, and state auditors routinely find companies – many companies – that have failed to create or retain as many jobs as they said they would. Companies that are paying poverty wages or failing to provide healthcare to their employees. Companies that are abandoning the cities and sprawling onto farmland and natural spaces. Even companies that are outsourcing jobs offshore. It is not unusual to find companies that have not created any new jobs, even some that have actu-
ally laid people off since receiving the subsidies. Others that got subsidised just to move existing jobs from one place to another, where they are proclaimed to be ‘new.’

Less well known is the corrosive effect job subsidies have on state and local tax revenue. There is a growing body of evidence, from national statistics and from individual states, that over the past 25 years corporations – especially big ones – are getting lower tax rates and paying a smaller share of the cost for public services. The evidence is especially disturbing on income taxes: in many states a large share of big companies are paying zero state income taxes, or tiny minimum taxes.

University of Iowa Professors Peter Fisher and Alan Peters use a ‘representative firm’ computer model to take a hypothetical new factory – with an average-size capital investment and rate of profit – and project the tax result if the factory is built in a state’s enterprise zone, which bundle multiple tax breaks.

In 20 industrialised states, they find that “incentive wars have proceeded to the point that state corporate income taxes are on the verge of disappearing in some states, at least with respect to new investment.” In other words, new factories generate such large tax credits, they pay little or no income tax. In fact, for 12 of those 20 states, their model indicates that typical companies building new factories can actually generate net tax credits – that is, the deals create negative income taxes.

Analysing by 16 industrial sectors (such as food processing, transportation equipment, etc.) they found that for Texas, in 9 out of 16 sectors, companies are getting negative income taxes; in Ohio, it’s 13 out of 16; and in Kentucky, 15 out of 16. In three states – Iowa, Michigan, and South Carolina – they found that in all 16 sectors, companies are getting negative tax rates!

The aggregate evidence of revenue corrosion comes from government studies of state revenue, academics, taxpayer watchdog groups, studies of large publicly traded companies – even from a few angry governors and state treasurers. Experts conclude that tax breaks enacted in the name of economic development are a major problem, along with surging corporate use of loopholes like Delaware Passive Investment Companies.

First, the national evidence. The Congressional Research Service (CRS) – a non-partisan body that works exclusively for Members of Congress – tracks long-term trends in state and local corporate taxes. It reports that the effective corporate rate for all state and local taxes – in other words, income, property, sales, excise, utility taxes, etc. – has declined sharply over the past two decades. In the 1980s, companies paid an average of 6.93 per cent of their profits in all state and local taxes. In the 1990s, the average rate was 5.12 per cent, and by 2002, the last year studied, the rate had declined to just 4.99 per cent. That’s an overall rate decline of 28 per cent.

Why are corporations paying less? “Perhaps the most obvious explanation is the tax competition among states to attract business,” the CRS concludes.

More evidence comes from the Center on Budget and Policy Priorities. In the second half of the 1990s, when the U.S. economy was sizzling, federal corporate income tax revenues grew an average of six per cent a year. But state corporate income tax collections rose at just half that rate. Same companies, same profits, same years, half the tax.

It’s not just the rate of corporate taxes, it is also the share of revenue companies provide. In 1980, corporate income taxes accounted for 9.7 per cent of state tax revenue; by 2000, it was down to 6 per cent, and for the next three years, it averaged only 5.2 per cent.

Put another way: if corporations contributed the same share to state treasuries in income taxes in 2003 as they did in 1980, the states would have received $27.3 billion more to help pay for smaller school-class size, public safety, healthcare and infrastructure. Or they could have avoided raising that much in taxes, especially the regressive consumption taxes that many states enacted.

To give a state-specific example, in Florida, the St. Petersburg Times found that 98 per cent of companies in the state paid no income tax in 2002, including cruise- ship giant Carnival Corp., with 4,220 employees in the state, more than $1 billion in 2002 profits – and a corporate registration in Panama.

Despite such findings, progressive state-budget advocates are cautiously optimistic about their chances for reform. Already, 12 states have some form of annual, company-specific disclosure of costs and benefits (including four that disclose on the web); 19 states use money-back guarantee ‘clawbacks,’ and one state, Illinois, has enacted a mandatory Unified Development Budget that will help expose the ‘bottom of the iceberg’ – corporate tax breaks.

Greg LeRoy directs Good Jobs First. This article is adapted from his 2005 book The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation (Berrett-Koehler).

www.goodjobsfirst.org
Editorial
John Christensen

Welfare for the rich

Across the world a scandal has occurred involving huge sums of public money handed out to the rich and powerful. The handouts have taken a variety of forms: tax holidays, lower profit tax rates, property tax abatements, accelerated depreciation rates, corporate income tax credits, subsidised infrastructure and energy, sales tax exemptions, and so on. The recipients of this public largesse have generally been big, long-established businesses, typically multinationals. Some small businesses have benefited but not to the same extent.

The supposed purpose of these welfare payments has been to attract investment in new jobs, but in practice companies only employ staff where there is a genuine economic rationale to do so, and the handouts achieve little apart from increasing the corporate bottom line. The cost to the taxpayer of this upside-down socialism has been enormous. Subsidy packages in the US are estimated to exceed US$100,000 for each job created. No attempt has been made to establish an equivalent estimate for the European Union, though it might be higher than the US figure.

It is not inconceivable that the full cost to developing countries of so-called ‘tax competition’ is considerably more than this, particularly in the case of the mineral exporting economies where greatest political pressure has been put on governments to lower tax and royalty rates and where few jobs are actually created.

How did we arrive at this scandalous situation where public handouts flow upwards and companies are offered negative income taxes? Well it started with a corruption of the meaning of the term ‘competition’. In economic theory the purpose of competition is to provide consumers with a choice between the suppliers of goods and services. This puts pressure on companies to improve quality and keep prices low. The same arguments cannot be applied to sovereign states. Citizens cannot choose between regional governments to provide their public services, and lowering government revenues by forcing rates cuts does not translate into more efficient service provision. In practice the process which politicians and journalists call tax competition creates market distortions and should more accurately be described as ‘tax incentivisation’.

Liberalisation of capital flows has created a situation in which countries have believed themselves compelled to offer incentives to attract or retain investment. These incentives achieve nothing in terms of improving market efficiency; on the contrary they distort the crucial feature of the theory of comparative advantage whereby investment flows to where it is most productive. Tax incentives don’t improve productivity, but they do increase the returns to capital by enabling companies to free-ride on publicly provided resources.

Companies get away with free-riding because they know that tax incentives can be negotiated by playing one national or regional government off against another.

As a starting point we propose one simple thing: let it be recognised that so-called ‘tax competition’ amounts to nothing more than welfare for the rich.

John Christensen directs the TJN International Secretariat.

christensen.tjn@neweconomics.org
www.taxjustice.net
Export processing zones: the Kenyan experience

Export processing zones have been promoted as a panacea to Africa’s investment deficiency, but since 1990 the Kenyan experience has shown a reality of poor working conditions, minimal technology and skills transfer, and a massive increase in tax avoidance. Bob Awuor asks where do we go from here?

The use of export processing zones (EPZs) as a regional or national development strategy extends back to the 1920s when the first zone was established in Spain. More recently, the UK Thatcher government was a leading advocate of ‘enterprise zones’ and Kenya also started to experiment with the idea in the 1980s.

EPZs represent a direct form of tax and regulatory competition in which special laws provide for a range of incentives to attract offshore investment for export production. The packages of incentives vary from zone to zone, with some common features including: tax holidays, duty-free import and export, unrestricted repatriation of profits and exemption from national labour laws. Some countries and regions also offer exemption from environmental laws and regulations. Critics of EPZs argue that tax incentives shift the tax burden onto local businesses and labour, and the regulatory exemptions undermine hard-won measures to protect labour and the environment. Supporters of tax incentives regard them as necessary for countries wanting to attract mobile capital.

Kenya enacted its EPZ Act in 1990. This made it possible for EPZs to be established with incentives such as a 10 year corporation tax holiday, subsidised credit, state sponsored infrastructure and exemption from trade tariffs on imports. At that time the Kenyan government anticipated that EPZ programmes would create jobs, attract new types of higher value-added processing and manufacturing activity, and diversify export earnings away from reliance on unprocessed agricultural produce.

EPZs are now an established feature of the Kenyan economy. Approximately 40 zones have been gazetted, and according to the Kenyan Human Rights Commission (KHRC), over 35,000 Kenyans are employed by businesses offshored in this way. The majority of these workers are women.

At face value the EPZ policy appears to have created a lot of jobs and the businesses established in these zones have recorded profits. Export volumes have also risen, particularly since the US government negotiated the African Growth and Opportunity Acts (2000 and 2002). More recently there has been a huge growth in trade with China. But Chinese interest in investing in Kenya appears to be motivated by the possibilities for using Kenyan quotas for textile exports to the US market.

**Giving it all away**

**Investment incentives in the Kenyan EPZ Act**

- Ten year corporate tax holiday and thereafter corporate tax at 25%.
- Exemption from duty and VAT on all inputs.
- Exemption from payment of withholding tax.
- Unrestricted offshore borrowing.
- Freedom from exchange controls with respect to investment by foreigners.
- Repatriation of dividends and operation of foreign currency accounts.
- Work permits for technical, managerial and training staff.
- Exemption from complying with various laws (e.g., Factories Act, Industrial Registration Act, Statistics Act).
- High quality infrastructure at the zones, paid for by the government from public funds into which EPZ enterprises make no tax remittances.
- Tax-free earnings for foreign workers (expatriates) of EPZ enterprises.
The apparent success of the EPZ policy was challenged in 2003 when a series of wildcat strikes by mainly women workers exposed a pattern of exploitation and harsh working conditions. These strikes were organised in Nairobi and Athi River in protest against subsistence wages, non-payment of overtime, summary dismissals, sexual harassment and failure to observe health and safety standards. The workers were not supported by the Central Organisation of Trade Unions and the Trade Minister branded the strikers as ‘hooligans’. However, subsequent research by the KHRC has revealed a pattern of companies pressuring workers to achieve production targets by working long hours of frequently unpaid overtime. The outcome, according to KHRC, was high staff turnover, stress, fatigue, absenteeism and labour unrest. The government responded in 2004 by calling for freedom of association for workers in EPZs but few companies have since recognised trade unions.

As well as degrading the rights of Kenyan workers, EPZs have contributed little to the economy. The great majority of businesses established are engaged in labour intensive, low value-added garment assembly. And although EPZ companies are generating profits, there is no evidence that they are being re-invested in the Kenyan economy. Most appear to go offshore through transfer pricing arrangements.

As well as degrading the rights of Kenyan workers, EPZs have contributed little to the economy. The great majority of businesses established are engaged in labour intensive, low value-added garment assembly. And although EPZ companies are generating profits, there is no evidence that they are being re-invested in the Kenyan economy. Most appear to go offshore through transfer pricing arrangements.

Speaking recently in London, Kenyan Finance Minister, Mr Amos Kimunya, said: “We have sealed loopholes through which people previously evaded tax, and have instituted reforms and legal measures that broaden the tax dragnet, so that financing for public expenditure is largely drawn from internal resources”. I hope that the tax dragnet will be extended to target EPZ enterprises because the real cost of the EPZ programme far outweighs any benefits. The question we must now ask is whether there are any grounds for continuing to subsidize big, non-tax-paying foreign business through the EPZ programme.

Bob Awuor is an urban and regional development planning consultant and researcher specialising in issues relating to globalisation, urbanization and development.

bob.awuor@yahoo.com
Capital mobility and the effects of tax competition

International tax competition has damaging consequences for economic development in both the North and the South. Alex Cobham examines new research which shows that richer countries are better able to resist the pressures of tax competition, and discusses some of the policy and research implications.

As part of the study of globalisation, economists have been concerned with the overall effects of greater capital mobility. Simplistic readings of basic theory suggest that greater freedom for capital should expand global economic possibilities and benefit everyone, more or less without caveat. Academic studies in the late 1990s, however, and subsequent IMF research, highlighted a contrary econometric result: liberalisation of capital movements has had no discernible growth benefits for developing countries.

This finding has raised questions about whether the current structure and management of international finance is beneficial. In particular more needs to be known about when capital flows are beneficial, and how they may be damaging, in order to improve the outcomes.

A key problem is the potential for tax competition to undermine states’ ability to benefit from economic activity in order to provide for their citizens. One strand of research has focused on whether tax incentives are effective in attracting foreign direct investment (FDI). While the results here are inconclusive, empirical work has questioned the existence of growth benefits of FDI. J. Benson Durham of the Federal Reserve Bank found no support for positive effects – and in many poorer countries, FDI appears actually to be associated with reduced growth.

If power lies with investors, the growth effects for countries may be small, possibly negative. Evidently the relative ‘power’ of the different agents engaged in the process of attracting FDI can affect the outcome; for example, richer countries may be better placed to extract benefits from FDI than their poorer counterparts. To understand how to maximise the benefits of investment (which need not be the same as maximising the absolute volume of investment) we need to consider ways in which capital mobility will affect countries with different characteristics.

Political and media commentators often give the impression that the impact of corporate tax competition – the general phenomenon of which FDI tax incentives are a special case – may be limited or indeed beneficial. Sheila Killian of the University of Limerick has written that “the term ‘harmful tax competition’ has become endemic”, contributing to the idea that only extremes of behaviour are damaging. The implied category of ‘benign’ tax competition is assumed to allow more flexible and dynamic patterns of economic activity, ultimately to the benefit of society. The actual criteria for distinguishing the conditions in which tax competition might be benign, harmful, or merely harmless, have not been delineated.

Evidence-based analysis of the impact of tax competition has been somewhat scarce, however. A newly-published paper from the Central Bank of the Netherlands offers fresh insights into the ways in which increases in capital mobility have changed rates of corporate tax. Harry Garretsen and Jolanda Peters analyse a sample of annual data on 19 high-income OECD countries from...
1981-2001, and present three main findings.

First, they confirm the reality of tax competition: an increase of 1 per cent in capital mobility is associated with a reduction in the corporate tax rate of between one half and a third of one per cent.

Their second result is that the behaviour of neighbouring countries is important – where neighbours maintain higher rates, the pressure to cut rates is lower. Tax competition may be a global phenomenon, but it is additionally effective at the local level.

The third result is that agglomeration effects matter. Larger – and hence more powerful – economies like the UK and Germany are better able to resist the pressures of tax competition.

If we consider the political implications of this last result, it may help to explain why counter-action against tax competition has been limited. If powerful countries tend to be least directly damaged by, for example, the behaviour of Ireland in seeking to benefit from multinationals’ profit-shifting, it follows that attempts to mobilise international political will to counter tax competition are likely to be blocked.

Given that these agglomeration effects are sufficiently large to be found in a sample of exclusively high-income countries, the implied costs for medium- and low-income countries may be much higher. Most vulnerable of all will be smaller, poorer countries with neighbours that pursue aggressive tax competition policies. This suggests the possibility of regional cooperation in, for example, the Caribbean as a way of limiting the costs of competition (in the absence of coherent international action).

Two further issues require consideration. First, to what extent are cuts in statutory tax rates associated with falling revenues. We need not deal with the debunked idea that policy can be made on the basis of a Laffer curve; but it is certainly true that (i) more aggressive anti-avoidance measures and the removal of exemptions have in some cases allowed revenues to be maintained (in the short-term at least); and (ii) that the extreme cases such as Ireland have shown increasing revenues due to profit shifting (albeit at the expense of global tax revenues).

Second, researchers need to explore the broader economic and social effects of tax competition. There is an obvious possibility that falling government expenditure on public services, on infrastructure and on human capital investment, has a direct impact on the level of economic growth. In this way tax competition plays a role in vicious cycles of low development and low growth. Another area for research is the direct impact on inequality and poverty rates.

It may be only when the full costs of the current treatment of international financial flows are known, that policymakers will start to question the concept of ‘benign’ tax competition – and take steps to address it. The majority of poorer and richer countries will suffer in the mean time.

Alex Cobham is Director, Political Economy Section, the Oxford Council on Good Government and Supernumerary Fellow in Economics, St Anne’s College, Oxford.

alex.cobham@oxfordgovernance.org

Ready, steady, GO for Nairobi

Eighteen months after launching our consultative process with African civil society, and 12 months after the proposal to launch a TJN 4 Africa received a resounding yes vote at the World Social Forum in Bamako, Mali, we are ready to take the next steps at WSF 2007 in Nairobi, Kenya.

Events in Nairobi get going with a Research Workshop on the theme of Tax, Poverty and Finance for Development on 18th / 19th January 2007. Sponsored by the UK-based Network for Social Change (a philanthropic group), and co-hosted by the University of Nairobi, the African Community Development Foundation, the Association for Accountancy & Business Affairs and TJN International Secretariat, the workshop programme includes papers from 12 researchers, and has attracted 50 participants from 18 countries. The workshop programme will be finalised for download from the Tax Justice 4 Africa website by 5th January 2007.

During the WSF itself, TJN and its partner organisations will be holding two seminars and two workshops. The first seminar programmed for 21st January, titled ‘New Perceptions on Corruption’, will focus on how financial intermediaries and tax havens encourage and facilitate corrupt practices. Dr Paul Mbatia from the University of Nairobi will be chairing this seminar.

The second seminar, programmed for 22nd January and chaired by Odour Ong’Wen of SEATINI, will address the issue of the role of tax in tackling poverty and financing development.

One workshop is programmed for 23rd January and will be used primarily to plan and agree a process for launching a continent-wide TJN 4 Africa and regional / national chapters. Chaired by Dereje Alemayehu of Christian Aid, Kenya, this workshop will be open to all organisations and individuals interested in
becoming founder members and sup-
porters of TJN 4 Africa.

The second workshop also on 23rd Janu-
ary, titled ‘A Rich Seam’ and chaired by
Charles Abugre of Christian Aid, will
explore issues around mining investment
and tax competition.

TJN will also be represented at a semi-
nar organised by Social Watch on the
subject of Alternative Budgeting and
Budget Monitoring on 22nd January, and
at a roundtable discussion on 23rd Janu-
ary, also organised by Social Watch, on
the redesign of global financial architec-
tures.

Details of the venues and times of these
events will be confirmed when WSF
Nairobi publishes the final programme,
which is issued to participants when they
register in Nairobi.

For further information about TJN
events in Nairobi, contact Alvin
Mosioma.
africa@taxjustice.net
www.TaxJustice4Africa.net

Tax competition: a case of winners take all?

Richard Murphy

A t taxation and economic seminars
all over the world it is suggested
that ‘tax competition’ is a good thing.
But, as Professor Michael Devereux of
Oxford University admitted at the EU
tax competition conference in Septem-
ber 2006, this is more a statement of
faith than proven fact.

The Tax Justice Network does not ac-
cept that tax competition is benign. We
consider it harmful because it is designed
and promoted by political and commer-
cial interests acting on behalf of a tiny
minority in society.

This claim requires justification. First it is
important to define what tax competi-
tion is. It is a variety of processes involv-
ing preferential treatment whereby gov-
ernments compete to attract mobile
capital to locate in their country. This
might involve minimal or zero tax rates,
as are offered by tax havens, but it also
includes tax holidays and the subsidies
offered through export processing
zones, and other forms of direct and
indirect subsidies which serve to attract
mobile capital. The biased nature of tax
competition is demonstrated by the fact
that it seldom manifests in the form of
lower rates of sales tax, which are re-
gressive in nature: indeed in the majority
of low income countries sales taxes have
been increased, typically without exemp-
tions, to compensate for lower tax yields
from capital.

Next it should be noted that those who
promote tax competition do so for four
reasons:

1. They argue that individuals and com-
panies spend more wisely than govern-
ment, the logic being that government is
not receptive to consumer preferences.

2. They assume that in the absence of
competitive pressure, government is
inherently inefficient, a trend exacer-
bated by their belief that all governments
are prone to spend for the aggrandise-
ment of politicians or civil servants. This
tendency, they claim, is so pervasive that
even the ballot box is unable to curtail it.

3. They claim that business efficiency is
undermined by the administrative and
financial burdens that taxation imposes.

4. They suggest that taxation gives inap-
propriate price signals to markets and as
such all taxation should be reduced to
minimise market distortions.

In combination these arguments demon-
strate that tax competition lies at the
heart of the Neo-Conservative agenda.
Because Neo-Conservatives believe that
democratic governments are unable to
contend with these issues, they support
the use of tax havens to encourage the
relocation of mobile capital and to exert
pressure on the governments of popu-
lous states to reduce their tax rates.

There is no evidence to support the case
for tax competition. Firstly, taxation
exists because societies want the State
to act as a provider of key services, in-
cluding law, its enforcement and defence.
In addition, most societies recognise that
there are other services which only the
State can supply because they must be
provided for the benefit of their whole
population or the greater cost of not
doing so will be borne by all members of
society and not just those that fail to
receive them. These services include the
 provision of health and education ser-
dices and the supply of the complex
physical and societal infrastructure which
enable modern commerce to function.
Access to these services needs to be
available to all irrespective of their
means. The greatest overall beneficiary
of this public provision is business, which
as a result of these services enjoys the
advantage of having a healthy and productive workforce with the financial means to enjoy the products companies seek to supply.

Second, in practice markets cannot function efficiently in sectors such as health care, education and pension provision. The need to ensure service provision for the benefit of all means there will never be sufficient capacity to provide significant choice in these sectors. Consequently, private supply would result in private monopoly which is universally considered abusive. The ballot box is therefore the best regulator available to avoid abusive market structures and indicate society’s preferences. The resulting services may be less than perfectly efficient, but as has been shown by the experience of privatisation, the market frequently does worse. This is especially true when markets are used to provide welfare services to ensure that people live free from fear of destitution or unemployment. Freedom from fear is fundamental to the success of markets because fear discourages people from spending and is an impediment to investment.

Third, the assumption that government is inherently inefficient is wrong, as is the assumption that market signals are needed in the supply of all services. In many cases those signals transmit misinformation and misallocate resources or result in unmet demand. Market based arguments for tax competition are therefore not valid when electorates can make a genuine choice between centre-left and centre-right political actors.

Finally, the argument that low tax states are needed to ‘correct’ the result of such ballots reveals contempt for the concept of democracy. This contempt can only be based on the belief that some in society deserve preferential treatment, which is the belief at the core of the Neo-Conservative argument for tax competition.

The tax justice argument is based on the simple proposition that it is preferable to protect the well-being of the majority through regulation and taxation rather than allowing capital to roam without constraint and untaxed. This proposition recognises that the burden imposed by tax competition arises from the deliberate actions of players pursuing self-interest. As an example, PricewaterhouseCoopers recently wrote a report for the World Bank* in which they asserted that:

If, for example, [taxes] are used for transfer payments, then the net impact on long-term economic growth may be negative.

Transfer payments are the pension and benefit payments which old, disabled, sick and unemployed people – as well as the providers for many children – rely on to avoid absolute poverty. In the same report PWC also asserts:

Attempts to impose internationally uncompetitive tax rates on these forms of mobile capital may be particularly damaging to an economy in the long-term.

Neither assertion is referenced or supported by data. Both are statements of preference indicating a bias towards the rich and powerful.

Our job is to offer alternative choices which provide balance in this debate. Our prime motive is a concern for poor people, especially in the developing world, but we also argue that effective markets are as important for society as effective governments. Without the security provided by public services there are compelling grounds for believing that markets will fail due to a crisis or crises of confidence. Tax competition that undermines state revenues could precipitate such a crisis.

With public services crumbling in many developing countries – and with even developed countries being forced to switch the tax burden increasingly away from capital and onto middle and lower income earners – the case for combating tax competition to protect markets and societies from predatory practices is compelling.

* The report is available on the PWC website:

www.pwc.com

Richard Murphy is Director of Tax Research LLP.

richard.murphy@taxresearch.org.uk
Reviews and new research

Hilton McCann
Offshore Finance
Cambridge University Press, 2006

Unreliable perceptions

Offshore Finance is written by a banker and former acting chief executive of the Financial Services Commission of Mauritius. The author strongly supports the offshore economy and is unapologetic for its use in tax avoidance: “No one is obliged to pay more tax than is due” he writes, “Consequently, taxpayers are entitled to use finance centres to mitigate their tax if they so choose.” So far, so political, but what about the following: “Perfect positive correlation between ‘offshore’ finance centres and the evasion of tax has not been proved beyond reasonable doubt.” How can statistical evidence be deployed when offshore secrecy obstructs quantitative analysis? This assertion, like much else about the book, is bogus scholarship, which the publishers should have challenged from the start.

And Offshore Finance gets off to a very poor start indeed. The attempt to define offshore, and distinguish it from onshore, is clumsy and inadequate in making distinction between the political economy of offshore and the physical presence of offshore finance centres on small islands. This causes confusion throughout the book. Despite quoting at length from the recent works of Mark Hampton and Ronen Palan, the issue of how offshore functions as an interface between the licit and illicit is glossed over and no mention is made of Raymond Baker’s seminal work on this subject. On the other hand, McCann draws heavily on the dated analysis of R.A. Johns and the website of the Center for Freedom and Prosperity (a Neo-Conservative lobbying organisation believed to be funded by offshore banks) to support the unoriginal proposition that offshore acts as a platform for tax mitigation. The default position throughout is that paying less tax is an unchallengeable virtue with winners but no losers other than the big, bad State.

The OECD’s 1998 report on harmful tax competition is referenced but dismissed without serious consideration of its content: “Competition is good, not bad. If tax competition is ‘harmful’, that implies that other forms of competition may also be harmful also – or at least suspect. This type of argument is difficult to defend.” No mention is made of Oxfam’s briefing paper on Releasing the Hidden Billions for Poverty Eradication, or of the existence of the Tax Justice Network. Despite the accumulated evidence of the abuses of tax havens – including several reports by the US Senate Permanent Subcommittee on Investigations – informed criticism is brushed aside on the grounds that: “Such opinions and assessments are unreliable because they are based on perceptions that may or may not conform to reality.” Nice one, Hilton.

The lack of critical enquiry into the role of offshore is compounded by the paucity of the economic analysis. No attempt is made to understand how offshore promotes economic free-riding (Hello?), or creates an un-level playing field between economic actors (the basis of the OECD’s analysis). McCann seems unaware of the fact that tax is not a cost of production (Hello again?) and treats government expenditure as inefficient, despite the evidence that direct investment flows to locations which provide good infrastructure, well educated labour, and buoyant private and public sector demand.

Other than as an endorsement of Neo-Conservative politics in general and offshore tax planning in particular, it is hard to determine what readership this book is aimed at. Most of the ‘facts’ provided, are readily obtainable from websites. In avoiding serious analysis of the recent major critiques of the offshore economy, the book fails as a work of scholarly analysis and research. But neither is it adequate to serve as a technical manual for financial regulators. This is not a book that can be recommended to anyone with a serious interest in the subject, not least because it is, frankly, dull.

John Christensen

The next Tax Justice Focus will be a special edition on inequality.
TJN / South Centre meeting on tax avoidance and development
Prem Sikka

Tax Justice Network in collaboration with the South Centre held a seminar at the Palais des Nations, Geneva, Switzerland on 30 October 2006. The aim of the seminar was to provide a broad overview of tax issues pertinent to developing countries. The seminar was held to coincide with the commencement of the 2nd Session of the United Nations Committee of Experts on International Cooperation in Tax Matters. It was attended by some forty ambassadors from developing countries.

Dr. Yash Tandon, director of South Centre, opened the seminar. The meeting was addressed by Bruno Gurtner, Senior Economist with AllianceSud, Switzerland and a member of the TJN Board of Directors. Gurtner outlined the role of TJN and NGOs in raising awareness of tax avoidance and how it deprives developing countries of much needed revenues for social and economic development.

The presentations were followed by a lively discussion and consideration of policy developments. We received very positive feedback and are hopeful of further developments.

UN tax experts support the strengthening of information exchange
Bruno Gurtner and Sol Picciotto

Strengthening information exchange is essential - was clearly the opinion of the majority of members and observers at the second meeting of the UN Committee of Experts on International Cooperation in Tax Matters held in Geneva (30 October to 3 November 2006). But participants did not always agree on the details of how to reform the famous Article 26 of the UN Model Double Taxation Convention. Delegates supported an idea, sponsored by TJN and proposed in a paper submitted by Professor Mike McIntyre, to start work on a Code of Conduct on Promoting Tax Compliance.

A subcommittee will finalise proposed changes in the wording of Article 26 by the next meeting at the end of 2007. Points of particular interest for TJN included:

- Extensive support for the inclusion of a reference to ‘combating tax avoidance’.
- The scope of information exchange should be wide.
- Special attention should be paid to the effectiveness of information exchange.

Points of particular interest for TJN included:

- Bank secrecy should not hinder information exchange.

Less clear is the outcome of the discussion related to the dual criminality requirements. A proposal made by David Spencer a year ago aimed to include a paragraph saying that the UN Model Treaty does not require double criminality as a pre-condition for information exchange.

TJN had previously proposed to ECOSOC that it consider the establishment of a Code of Conduct on Co-operation in Combating Capital Flight and International Tax Evasion and Avoidance. This proposal generated a lot of interest during discussions in Geneva. Some delegates from developing countries strongly supported the idea. Representatives from the USA and other OECD countries, while not openly opposing the idea, did raise questions about the status of such a code, the relationship with other codes and doubted if the committee had the resources to take on the work at this time. The committee
will do more work on this subject which TJN will monitor closely.

Other issues discussed included: anti-abuse provisions in treaties; mutual assistance in tax collection; the definition of a permanent establishment; taxation of development projects; restructuring of the UN Manual for Negotiation of Tax Treaties; dispute resolution; and taxation of Islamic financial instruments (definition of interest).

The Committee’s agenda is dominated by narrow technical-legal issues because it is mainly concerned with revising the wording of the UN Model Tax Convention. It tends to build on work done by the OECD Committee on Fiscal Affairs — making some adaptation for developing countries. Political issues such as measures against tax avoidance and capital flight are not much discussed. The Committee also has very limited resources so much of the work must be done by the members themselves. This greatly reduces the contribution that the experts from developing countries are able to make because they are usually already over-stretched. Indeed, some of the developing country members were not even able to attend the Geneva meeting.

There is clearly still an urgent need for a more inclusive and transparent global organisation to tackle the issues of international tax avoidance and capital flight.

### Stiglitz speaks out against tax evasion and capital flight

**Lucy Komisar**

Joseph Stiglitz, Nobel Laureate in Economics, spoke at a meeting on 2 November strongly in opposition to the system of offshore-enabled tax evasion and capital flight. The event, before an invited audience of civil society groups and media at Columbia University, was co-sponsored by TJN-USA and Stiglitz’s Initiative for Policy Dialogue at Columbia.

Stiglitz was head of the US Council of Economic Advisors under President Clinton, then served as chief economist of the World Bank, and is now a professor at Columbia University.

The text of his talk and a video will be posted as soon as they are available.

www0.gsb.columbia.edu/ipd

### Ghana meeting shifts the focus towards tax revenue

**John Christensen**

Although seldom discussed by civil society, the sources of tax revenues are important determinants of good governance, with governments being most responsive to electorates in states where tax regimes are broadly based. This was the context for a three day workshop in early December co-organised by the International Budget Project and the Ghana-based Integrated Social Development Centre.

Held in Accra, Ghana, the workshop considered why civil society needs to focus more on how governments source their revenue incomes, and explored several related themes, including the tax incidence (using a Mexican case study to illustrate the regressive nature of the current fiscal regime); the gender impacts of the tax regime in South Africa; how local government taxes impact on development in India and Croatia; and how evasion and harmful tax incentivisation have undermined efforts to reduce poverty around the world.

Drawn from 16 countries - ranging east to west from Indonesia to Guatemala - 24 budget analysts representing a range of civil society organisations and re-search institutions took part in the programme of seminars and break-out meetings. TJN was represented by John Christensen, who led discussions around how to introduce tax justice issues in a variety of countries, including Argentina, Bangladesh, Croatia, and hopefully so on through the rest of the alphabet.

Judging from the huge interest shown in Accra for focusing more research and advocacy resources on tax revenue issues, similar workshops will be held in other regions in 2007, and TJN will commit to providing its expertise to support this process of widening budget analysis to include revenue income.

www.internationalbudget.org

www.isodec.org.gh

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Background documents are available for download on the FfD website:

www.un.org/esa/ffd/Taxation

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1 Background documents are available for download on the FfD website:
Tweedledum and Tweedledee go offshore

The following unpublished extract from Alice in Wonderland was recently found in a Jersey attic...

“It’s obvious” said Tweedledum, adopting a rather condescending tone.

“Self-evidently true” snapped Tweedledee, peering at Alice over his reading glasses.

“If you don’t cut our taxes,” continued Tweedledum, “profits will fall and you will have even less money in the treasury.”

Alice sighed. She had heard this before, but it still didn’t make sense. Taxes on profits were already low, businesses paid far less tax than in the past, but they just wanted more tax cuts and subsidy.

“We need the money to invest in health and education…” Alice began, but before she could finish her sentence, Tweedledee jumped up from his chair and strode to the window.

“Privatise.” he snapped “Let business do it more efficiently.”

Nonsense, thought Alice. Look at the mess that business had made of the trains and the water industry. And how many people can afford to pay the rates charged by private schools?

Gazing out the window, Alice saw the expensive motorcars in the executive car park and thought about how many of her constituents could barely afford to pay their rent.

Whilst these thoughts crossed her mind, Alice heard Tweedledee and Tweedledum muttering in an agitated way about how business needed lower taxes and less regulation. Listening hard, she heard words like ‘globalisation’ and ‘deregulation’ and ‘share options’.

“Gentlemen” she interrupted, firmly but politely, “for many years business has been demanding subsidies and tax cuts. I think business should pay its fair share towards public services.”

But this made them mutter even more loudly, and after a while Tweedledum strode across the boardroom and stood rather too close for Alice’s comfort.

“You see, my dear” he said, and his smile sent a shiver down her back, “unless we pay ourselves more money, we won’t have incentive to invest”.

Alice was not impressed by this line of argument. She knew the gap between rich and poor has kept rising, and with debt spiralling out of control, something needed to be done to redistribute wealth and income, because otherwise the economy would stagnate.

As Alice gathered her thoughts to ask why businesses were paying so little tax when they were making record profits, Tweedledum leant forward menacingly and hissed: “If you don’t give us our tax cuts we will go offshore. And then we won’t pay any taxes at all.”

But whilst Tweedledum and Tweedledee marvelled at this splendid idea, Alice leant forward to read the tiny badge on Tweedledum’s jacket, which said: “Only the little people pay taxes.”