// TAX JUSTICE FOCUS

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TAX AND DEVELOPMENT

Why tax is important for development

No country has succeeded in developing a well functioning market based economy without a broad based tax system and tax plays a key role in promoting democracy by making governments accountable to their citizens. Lack of dependence on citizens for tax revenues is a major cause of weak, unresponsive governance in many poor countries, especially those which are heavily dependent on aid.[1]

AID and TAX are both three letter words, but that's where the similarities stop. Tax encourages governments to be accountable to their citizens; aid to donors; tax can provide a predictable long-term source of revenue which is within the control of the government, aid is less predictable; tax enable governments to use the money where it is most needed, aid is often tied to specific projects.

Aid and tax should be seen as complementary: poor countries will continue to need aid as they set about building up their tax capacity. In fact, aid can play a vital role in helping developing countries build up their tax capacity, decreasing in the long term their overall reliance on aid.

The Monterrey Consensus recognised the key role of taxation in mobilising domestic resources (90% of domestic revenue is usually derived from tax with 10% coming from non-tax sources, e.g. fees and charges). This was confirmed at the recent UN Doha meeting where tax issues ran throughout the discussions.

Jeffrey Owens

Yet as can be seen from Figure 1, the ratio of tax to GDP in lower income countries is, on average, about half of that in OECD countries. Nobody is suggesting that Sudan should move to the tax levels found in Sweden, but clearly there is fiscal space for many low income countries to increase their tax take through more effective tax systems.

1 See "Taxation and Governance", OECD, February 2008.

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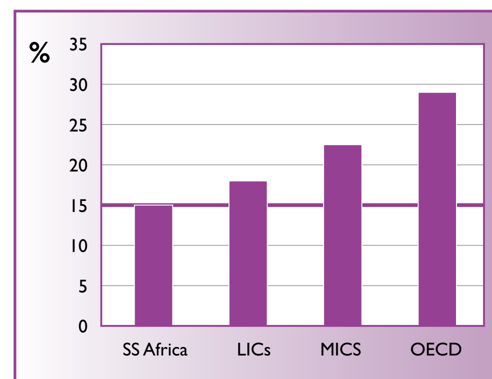
Figure 1. Tax to GDP ratio (2005)



What are the Constraints faced by Developing Countries in raising their Tax Take?

A typical developing country faces multiple constraints in improving its tax capacity: cultural attitudes towards government; weak tax administrations; narrow revenue tax base; competitive pressures from other countries; corruption; capital flight; aggressive tax planning and many more. I will focus on what I see as the three major constraints:

i) ***Heavy reliance on cross-border tariffs***: A typical African country relies on tariffs for more than half of its revenue. Yet this source of funding is under pressure from trade liberalisation promoted by the WTO and regional blocks (e.g. SADC). As countries join these initiatives so they are required to reduce their tariffs. Trade liberalisation is in itself desirable, but it comes at a price for a low income country since tariffs are far easier to administer than alternative sources of revenue (e.g. VAT). Consequently, low income countries are facing a major challenge just to maintain their current revenue base.

ii) ***Weak tax administrations***: Many, although not all, low income countries have tax administrations which are corrupt, with poorly trained and underpaid officials; antiquated administrative structures, often still based upon the old colonial model (e.g. separate departments to deal with income and consumption taxes); weak risk management and poorly articulated strategic goals. Yet a tax system is only as good as its tax administration and without a dramatic improvement in these administrations, it is unlikely that developing countries will meet the Monterrey commitments.

iii) ***Outflow of funds to tax havens***: Tax havens have been referred to as "sunny places for shady people". Whilst many tax havens are sunny places, today they can be found throughout the globe. OECD defines a tax haven as a jurisdiction which has no or nominal taxation and lacks transparency, effective exchange of information and "real activities". Many citizens of developing (and developed) countries now have easy access to tax havens and the result is that these countries are losing to tax havens almost three times what they get from developed countries in aid. If taxes on this income were collected billions of dollars would become available to finance development.

What Needs to be Done?

i) ***Phase-in trade liberalisation***: Before removing tariffs on cross-border trade, governments need to ensure that alternative sources of revenue are already in place. This suggests that as the process of liberalisation continues, there needs to be a phase-in period since all the sources of revenue which could replace tariffs – personal or corporate incomes taxes; sales or VAT; taxes on moveable or immoveable property – are far more complex to administer than tariffs.

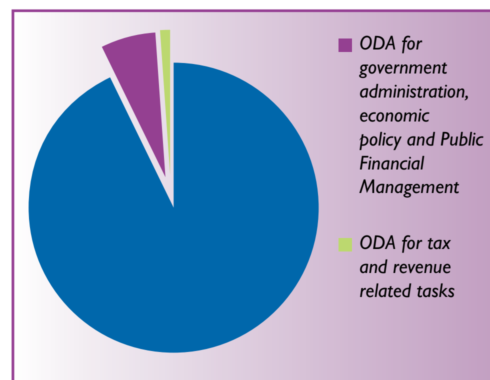
ii) ***Build up the capacity of the tax administration***: In most developing countries this will require creating an independent revenue service with well paid officials, free from corruption and political interference. The Commissioner must be a strong visionary individual, and be able to see tax in the broader perspective of developing a market based democracy. The old colonial divisions between direct and indirect taxes need to be replaced with an integrated administration arranged on functional lines. Risk management needs to replace a system based upon trying to control and audit the vast majority of taxpayers. A balance between enforcement and taxpayer service must be achieved with the revenue service being seen as a "friend" rather than "foe" of business. New technologies will have a role to play in modernising the tax administration but can never, by themselves, provide a substitute for a well designed administration.

iii) ***Broaden the tax base***: Developing countries need to explore how the tax base can be broadened and how people in the informal sector can be brought within the tax base. This may require reviewing the taxation of land and buildings; exploring new ways to tax households; re-examining the tax treatment of small-medium size enterprises; introducing simple environmental taxes. It may also require moving towards a heavier reliance on fees and charges.

iv) ***Reduce the outflow of funds to tax havens:*** Over the last 10 years OECD countries have established high standards of transparency and exchange of information in tax matters which have achieved a global endorsement from the G8, G20 and United Nations Committee on Taxation. Regular assessments are undertaken of how far on and offshore financial centres are meeting these standards.[2] Implementation of these standards is progressing. Twenty-six of the 30 OECD countries already meet the standards as do the vast majority of non-OECD countries. Of the 40 plus tax havens that the OECD identified in 2000, nine (The Netherlands Antilles, Aruba, Bermuda, British Virgin Islands, Cyprus, Isle of Man, Guernsey, Jersey and Malta) are actively implementing the standards either by means of Tax Information Exchange Agreements (TIEAs) or tax treaties and the international community needs to recognise this progress. Hong Kong is reviewing its position on exchange of information. Nevertheless, much remains to be achieved. There are still three jurisdictions on the OECD list of unco-operative tax havens

2 The latest assessment of 84 financial centres was issued in September 2008 under the title Towards a Level Playing Field.

Figure 2. Tax related assistance as a proportion of Official Development Assistance (ODA) in 2006



(Andorra, Liechtenstein and Monaco); some jurisdictions which made commitments to the standards in 2000 are refusing to implement them (e.g. Panama). Singapore has refused to even endorse the standards.

The UBS and Liechtenstein scandals have refocused political attention on the role of excessively strict bank secrecy and how this can be used as a barrier to effective exchange of information. The next 12–18 months will see a fresh impetus towards the implementation of the standards since the G8, G20 and a joint Franco-German initiative have all recently called for a rapid implementation of the standards and a reporting back in 2009.

Developing countries can directly benefit from this initiative. Once a financial centre establishes high standards of transparency these benefit all countries. Similarly a number of developing and middle income countries (e.g. China, India, and South Africa) are in the process of entering into negotiation of TIEAs. Developing countries can only continue to benefit from the move towards less political tolerance of countries that facilitate non-compliance with the tax laws.

What's the Future Role of International Institutions and NGO's?

NGO's have played an important role in linking tax havens and finance for development. They need to continue to build up political support for a truly global implementation of the international standards. They must, however, avoid endangering their case by unsupported claims of the amounts of tax revenues that are being lost by developing countries to tax havens.

The United Nations Committee needs to encourage all of its members to include in their tax treaties the new Article 26 of the UN Model Tax Convention (this is the article dealing with Exchange of Information) and to pursue its work on a Code of Conduct.

The OECD and its Member countries need to move away from a distinction between co-operative and unco-operative offshore financial centres based upon whether there is a commitment to the standards to one based upon whether the standards are being implemented. Also, there needs to be a renewed effort on the part of aid agencies to support projects in developing countries which are aimed at improving their tax capacity. As can be seen from Figure 2, in 2006 only 0.073% of aid went into the tax area yet as can be seen from the example of Rwanda (see Box 1), tax related aid can lead to a significant increase in revenue yields.

Box 1. Tax reform: The Governance Dimension in Rwanda

DFID's support to the Rwandan Revenue Authority (RRA) has resulted in a significant increase in domestic revenue (from 9% of GDP in 1998 to 14.7% in 2005). Costs of collection have also been reduced. This success is the result of strengthening internal organisational structures and processes and of building accountable relationships with external partners, such as central and local government, a growing tax profession and taxpayers themselves. The RRA now plays an important role in strengthening relationships between citizens and the state, helping to build a "social contract" based on trust and co-operation.

Source: Department for International Development (DfID), 2007

In this context the recent initiative of African and OECD Tax Commissioners to create an African Tax Administration Forum deserves strong support. This is an initiative designed by Africans, for Africa with bilateral and multilateral donors, including the African Development Bank and the OECD, playing a supportive role.[3]

The International Tax Dialogue – a grouping of the DFID, EU, IMF, Inter American Development Bank, World Bank and the OECD – can also play a key role in ensuring that the efforts of bilateral and multilateral donors are more co-ordinated and in providing benchmarks against which developing countries can measure the performance of their tax administrations. The ITD efforts in this respect could be reinforced if the UN and more national aid agencies were to join the ITD.

New efforts are required to develop an internationally accepted methodology to measure the size of the offshore sector and the amounts of revenue lost to tax havens. Ministries of Finance, Central banks and international organisations need to lead this work to give it creditability. Also, the focus must be on providing data which can lead to policy responses. From the perspective of a developing country it is more interesting to know how much revenue is lost to Singapore or Panama than what is the global loss of revenue to tax havens.

To conclude, Monterrey and Doha have raised the profile of tax in the finance for development debate. We need to maintain this political profile and to have all the actors – governments, international organisations, NGO's – pulling together, combining their efforts, so that we have a long-term co-ordinated approach to raising tax capacity in developing countries.

Jeffrey Owens is Director of the OECD's Centre for Tax Policy Administration.

The views expressed should not be taken to represent those of the OECD or its member countries.

3 See the Pretoria Communiqué (http://www.oecd.org/dataoecd/1/33/41227692.pdf)

WHAT A YEAR!

editorial

Nicholas Shaxson

The tax justice agenda is now spreading fast. Major non-governmental organisations, professionals, comedians, and newspapers are taking up the campaign, around the world. It is fair to say that in 2008 tax justice moved to the core of the agendas of several of the world's most influential non-governmental groups.

The election in the United States of Barack Obama, co-sponsor of the Stop Tax Haven Abuse Act, is a signal of hope too. And the emerging economic crisis has started to focus attention on these issues as never before: French President Nicolas Sarkozy, German Chancellor Angela Merkel, the Vatican Pontifical Council for Justice and Peace; Angel Gurría, Secretary-General of the OECD (click here) – the Nobel Prize-winner Joseph Stiglitz - among many other influential people – have now made powerful statements supporting our cause. Fights between Germany and Liechtenstein, and between the United States and the Swiss bank UBS, have added to the fire. In the news, articles such as "Blockade the Tax Havens" by an FT columnist, Willem Buiter, now appear regularly; the Irish musician Bono easily won a popular magazine poll to find "the most artful tax dodger", and British supermarket chain Tesco took on the Guardian newspaper in a landmark libel case over Tesco's offshore tricks.

We are getting recognised for our foresight. In October the weighty Observer Newspaper, under a headline "The Seers" singled out TJN – and especially John Christensen, Richard Murphy and our friend Prem Sikka as being among very few to be "bang on the money" about the economic crisis, ahead of time. Christensen, Murphy and others from TJN are appearing regularly on TV and radio and in the written press. Accountancy Age magazine has ranked our Richard Murphy at number 25 in their Financial Power list for 2009.

The Power of Ideas: the TJN International Secretariat Headquarters

The Doha conference on Financing for Development – see our last but one edition of TJF – was a highlight. John Christensen describes it on page 8. We are grateful to many people, especially Jean Meckaert of Plateforme Paradis Fiscaux et Judiciaires (PPFJ) and Maylis Labusquière of Oxfam-France for their work influencing French president Nicolas Sarkozy. In the context of Doha, a remarkable new "South-South" project is now taking shape, led by Jo-Marie Griesgraber and TJN's David Spencer in New York. See page 10. An Africa tax conference in September highlights how this agenda is growing, and Germany's Development Ministry is now, following discussions with TJN and others, pushing for an International Tax Compact and to develop new cooperation at national, regional and international levels. See more here.

We helped stir up a major challenge to Britain's hateful domicile rules which resulted in important changes to the law – though we're not all the way there yet. Expect more fireworks this year. We saw steps to tighten up the European Union's Savings Tax Directive (STD) – which is full of holes but nevertheless the world's pre-eminent transparency initiative of its kind – and we know we were instrumental in helping push change.

Special thanks to Richard Murphy who submitted a report on behalf of Tax Research LLP and TJN to a European Parliament workshop on reform of the STD. More must be done. We have seen major progress in the EU and the US in pushing for Country-By-Country Reporting: mostly limited to the area of extractive industries, but we see broader progress too. Many thanks (again) to Richard Murphy. We should also highlight his lengthy submission, on behalf of TJN, in response to an enquiry on tax havens by the UK Treasury Committee of the House of Commons, to counterbalance the many submissions from tax havens, accounting firms, banks and other financial intermediaries who use Offshore Financial Centres.

2009 – an even fuller agenda

Things will accelerate this year. Following the launch of our Africa network in 2007, we now aim to build a Latin American network: look forward to a Latin American edition of TJF later this year. In Brazil, we plan a two-day seminar on February 2–3 with the International Centre for Tax Law at the University of Sao Paulo, aimed at tax policy specialists, and three seminars at the World Social Forum in Belem. Thanks to Bruno Gurtner and Matti Kohonen for all their work. Watch out, too, for a research workshop in September at the Instituto de Investigaciones Economicas of the Universidad Nacional Autónoma de México. A call for papers will come soon.

We now have funding from the UK Department for International Development (DfId) to support our work on tax and international development – see the news item on page 10 for more details – with an important Latin American component. Given the role that offshore has played in the various Latin American debt crises – among many other problems – imagine the potential political support we hope to harness in this varied continent.

Edmund Valpy Fitzgerald and John Roche are also preparing a ground-breaking Plato Index measuring tax justice, which we hope will eventually be incorporated into the United Nations Human Development Indicators. See his article on page 6, and a short summary here.

Note two other exciting developments. We hope to complete our new Financial Transparency Index, in partnership with Germany's Misereor and Christian Aid (which is starting a new Tax Justice campaign in January) and with Berlin-based Transparency International. This, we hope, will help radically shift global perceptions of what corruption really is. See our major article on corruption published in *The American Interest*, co-authored with Raymond Baker of Global Financial Integrity (GFI) in Washington, which has just published remarkable new research on illicit financial flows.

Our project Mapping the Faultlines, funded by the Ford Foundation and partnered with Baker's GFI, is at least as important. This will produce the first ever publicly available live database on tax havens and tax mechanisms, to be updated and amended over time. First data streams will emerge this year: many thanks to Richard Murphy and Markus Meinzer.

The European Commission has now confirmed funding for a three-year project involving our truly excellent Dutch colleagues at SOMO – which will overlap with Matti Kohonen's work with Dfid on tax and international development (see above.) It has the catchy title *Towards Tax Justice: Raising Awareness, Building Capacity, Supporting International Coordination and Policy Dialogue to Make National and International Tax Systems More Supportive of Development* and will involve multiple partners in Africa, Asia, Europe and Latin America.

Last, but not least, TJN now has agreed a major publishing contract with Random House for a hard-hitting book – we hope it will be a bestseller, reaching large new audiences. Research and writing will happen in 2009 and we expect to publish in mid-2010 – in partnership with a documentary film to be made by Speak-It Films (makers of the remarkable Black Gold, which has been shown in more than 40 countries). This will be a major priority for us in this and future years.

Tax Justice Focus

In our lead article in this edition Jeffrey Owens, head of tax at the OECD, outlines issues of major importance in tax and international development. We generally welcome his words – though we don't agree with them all. For example, his statement that "OECD countries have established high standards of transparency" does not fit the world as we see it. Britain, Luxembourg, Switzerland and others exhibit a shocking disregard for transparency, and this is what we are campaigning to change. Another statement – that non-governmental organisations should be careful about how they present data – is right – though we stand by the substance behind assertions (which do, admittedly, sometimes misrepresent the underlying data), that he seems to refer to.

This edition also contains two top-quality book reviews by experts in their fields – Indira Rajaraman's review of *Institutional Competition* and Alessandro Santoro's look at *Economics of Tax Law,* all round off another fun-packed *Tax Justice Focus*. Enjoy.

A REQUEST

The picture on the previous page illustrates how it is possible to achieve much with minimal funding. Good ideas spread far, with only modest encouragement. But we still need money to run our organisation. We now have a donation button on our website.

Please click here, and give what you can.

THE PLATO INDEX

Measuring tax justice

feature

Edmund Valpy Fitzgerald and John Roche

"When there is an income tax, the just man will pay more and the unjust less on the same amount of income"

PLATO, The Republic, bk. I, 343-D

Tax is increasingly being regarded as being at least as important as trade and aid in the development equation. The long-term goal for developing countries must be to put government revenues on a sustainable footing – and, as the OECD recognises, the only really sustainable source of long-term development finance is tax. The objective of development has to be the creation of viable independent states capable of supporting their own populations.

Tax systems in developing countries are poorly measured. International comparisons of tax burdens simply divide the tax burden by GDP, which does not allow us to measure or compare how progressive taxation is in each country, nor is the effective income base for direct taxation identified. Few countries have official tax incidence statistics, and international organisations do not address this systematically – nor, surprisingly, do they appear to take this issue seriously enough to generate the necessary data.

So Christian Aid, the Tax Justice Network, and the Oxford Department of International Development are therefore creating a joint project that will do two things. First, we are creating a new **Plato Index** that will enable us to measure tax justice through comparisons of direct tax incidence between countries and over time. This has not been done before. Second, we are creating an **international tax research database** to stimulate research in this area.

By being able to measure tax justice across countries, we can have an objective measure to use in order to advocate for better policies. A database will overcome one of the major barriers to researchers looking into this area.

Initial empirical results in our project indicate wide variations over time and region, but there is enough variation and counterexamples to clearly show policy space for progressive change.

Direct tax and developing countries

We know that taxes in developing countries are too low, and poorly administered. While rich countries can obtain direct tax revenues typically equivalent to around 12–18% of their GDP, poor countries can generally only muster 2–6% (see Figure 1).

Poor countries tend to be weak in administering their tax systems, so significant levels of tax are unpaid, both through evasion and corruption. Taxes are also very unfair; unlike in richer countries taxes are not progressive: while in rich countries redistribution is often dominated by cash transfers, most poor country systems lack this. This has not been helped by a 'tax consensus' among international financial institutions that emphasises tax neutrality – in practice meaning a shift away from direct taxation (such as income taxes) towards more regressive indirect taxation (such as Value Added Taxes) – which, as Alex Cobham has shown, has singularly failed to deliver on the four Rs – Revenue, Redistribution, Repricing and Representation – needed for sustainable human development.

Table 1. Estimated direct tax pressure, 2000

The PLATO INDEX

	Around 2000			Around 2000			
	Income shares Top 10%	Income shares Top 20%	Gini coeff	dirtax/ govrev	govrev/ GDP	dirtax/ GDP	PLATO INDEX
Argentina	38.9	56.4	52.2	17.9	14.9	2.7	4.5
Brazil	40.7	64.6	59.1	19.4	25.9	5.0	7.2
Chile	47.0	62.2	57.1	20.3	19.2	3.9	5.9
Colombia	46.5	61.8	57.6	34.2	13.3	4.6	6.9
Mexico	43.1	59.1	54.6	34.0	14.4	4.9	7.7
Venezuela	36.3	53.4	49.1	19.6	20.5	4.0	7.0
UK	28.5	44.0	36.0	39.7	30.0	11.9	21.3
Greece	28.5	43.6	35.4	22.7	30.2	6.9	13.6
Ireland	27.6	43.3	35.9	41.8	29.0	12.1	21.9
Spain	25.2	40.8	32.5	29.7	19.5	5.8	12.5
Russia	22.5	37.5	31.6	26.4	20.3	5.4	12.5
Phillippines	36.3	52.3	46.1	39.8	15.0	6.0	10.3
Turkey	30.7	46.7	40.0	33.5	28.4	9.5	16.9
Source	**HDR**	**HDR**	**HDR**	**GFS**	**IFS**		

"Tax systems in developing countries are poorly measured. Few countries have official tax incidence statistics, and international organisations do not address this systematically – nor, surprisingly, do they appear to take this issue seriously enough to generate the necessary data."

Arguments for higher effective direct taxation in developing countries are based on a recognition that the better off should pay a greater burden of the provision of common infrastructure and social services, and that a progressive tax base combined with direct transfers to the worse off, are the basis for reducing poverty. Direct tax rates on higher income groups in developing countries are extraordinarily low by international standards.

A counter argument commonly used – that this would retard growth by increasing disincentives to work for the poor and reducing incentives to invest for the rich – is undermined by our analysis which shows that the negative growth effects are not large when compared to the welfare gains. So improvements in direct taxation may be the best option for many developing countries seeking greater revenue independence, lower income inequality and clearer channels of political representation.

The Plato Index

We seek to discover the range of direct tax incidence on the upper income groups, to derive some idea of what might be possible and where best practice might lie.

This is why we are creating the Plato Index, which we define as *the ratio of direct tax revenue to the pre-tax disposable income of the top quintile of households.*

Unlike conventional measures, which simply divide the tax burden by GDP, the Plato Index combines information on income distribution and tax pressure. If the upper income groups are strongly taxed then this will be reflected in a higher Plato index. We would normatively expect that for a given direct tax rate, the worse the income distribution, the higher the direct tax yield should be.

The methodology for estimating the index is set out in appendix 2 of this paper. It rests on an assumption that all direct taxation is paid by the first quintile – as the other four quintiles generally fall below the income tax threshold, do not occupy taxable urban property and are not covered by social security. While the assumption may be valid for developing countries, it requires some adjustment for developed countries where lower quintiles do pay significant direct taxes.

We might expect that countries with worse income distribution would exhibit higher Plato, so as to restore equity; but our preliminary work suggests the reverse is true. The evidence in Figure 2 is of a Plato Index value for advanced industrial countries at 20+ and 10-15 for recently industrialised ones. Latin America is very low at 5–7; well below comparable industrialising middle-income countries. We can only conclude from this that there is clearly room for considerable increases in effective tax rates in many developing countries.

The tax database

The international tax research database will provide the basis for comprehensive Plato Index estimates across countries and through time, and in addition will become publicly available as a source for economic research in this area. The first part of the work has been to collate this data into an accessible format that allows for econometric research, using the IMF's Government Finance Statistics. In contrast to other development statistics such as much of the World Bank's and the UN's data which can be accessed through a pub lic website, these IMF statistics require a subscription and are thus less easily accessible.

Although those with connections to universities can often access the data through an institutional subscription, NGOs wanting to work on tax data would have to pay to gain access. In addition, the format that the data comes in is very unwieldy and unconducive to econometric analysis, because it requires extensive reformatting to be analysed using statistical and econometric software. We are therefore creating our own database that compiles the IMF data with other sources of tax data to be publicly accessible on a website linked to the Tax Justice Network. This will provide the research community with a robust data set to allow analysis of issues like the relation between taxation and growth, governance, and human development.

The challenge faced by developing countries in benefiting from taxation requires serious research, which so far has been lacking. A database will overcome one of the major barriers to research. By being able to measure tax justice across countries, we can have an objective measure to use in order to advocate for better policies.

This work will provide a key input to Christian Aid campaigns on tax justice, and we hope to get the Plato Index included in the UNDP's Human Development Report.

"The international tax research database will provide the basis for comprehensive Plato Index estimates across countries and through time, and in addition will become publicly available as a source for economic research."

Edmund Valpy Fitzgerald is Professor of International Development and Director of the Department of International Development at Oxford University, and a senior adviser to the Tax Justice Network. John Roche is a graduate student in the Department of Economics at SOAS and is working on the creation of the tax research database.

news

Doha: A cup half full?

by John Christensen

Tax justice was a key focus at the Follow-up International Conference on Financing for Development (FfD) in Doha, Qatar, from November 29th to December 2nd. This, in itself, represents great progress for TJN, and marks a contrast from the first FfD conference held in Monterrey, Mexico, in 2002.

That conference had lain out a new agenda for development - the Monterrey Consensus - which did emphasise the importance of using domestic resources as a source for both private and public investment – though the many concerns that had been raised at the Monterrey conference about capital flight and tax scarcely got a mention in the final Consensus document.

To understand the recent Doha outcomes, it is necessary to look first at how the FfD process has evolved over time.

In the original Monterrey Consensus, capital flight was mentioned (in paragraph 10) but tax evasion was not. No mention was made of tackling tax practices that undermine development, such as tax competition and tax avoidance, and the role of tax havens in facilitating all of these. Importantly, however, the Monterrey Consensus did include the following commitment:

Doha: a tax haven in the making?

> *Strengthen international tax cooperation, through enhanced dialogue among national tax authorities and greater coordination of the work of the concerned multilateral bodies and relevant regional organizations, giving special attention to the needs of developing countries and countries with economies in transition; (section F, paragraph 64).*

This clause helped stimulate the launch of the Tax Justice Network. We were heartened in December 2003 when the UN General Assembly agreed to upgrade the obscure and flaccid Ad Hoc Group of Experts on International Cooperation on Tax Matters to Committee status, with a mandate to advance the Finance for Development agenda on tax cooperation. TJN was the first genuine civil society organisation to participate as observers at the UN Tax Committee's annual sessions in Geneva, and we now see it as the most legitimate agency working in this important area (the OECD plays a powerful role, but it ultimately represents rich countries.)

From September 2006 the TJN team, strongly supported by the Paris-based Plateforme Paradis Fiscaux et Judiciaires, started to focus on the Doha follow-up conference. It was an opportunity to galvanise European non-governmental organisations (NGOs) around a short list of clear demands, including:

1. Strengthening commitment to tackling illicit financial flows, capital flight, tax evasion and avoidance;
2. Upgrading the UN Tax Committee to intergovernmental status and rebalancing its composition to include a larger number of genuine developing countries and fewer tax haven countries;
3. Including an explicit commitment to progressive taxation (anathema to anti-state extremists);
4. Adopting measures to tackle tax practices that undermine the integrity of tax regimes, e.g. the aggressive tax competition of tax havens; Promoting the UN Code of Conduct on Cooperation in Combating International Tax Evasion.

Our advocacy efforts principally targeted EU member states and the EU Presidency, which was held by President Sarkozy of France during the second-half of 2008.

In the end, we made significant progress with items 1 and 2, but not with 3 and 4. But we had a broader aim, too: raising tax justice up the agenda – and in this we were highly successful: tax issues were centre stage at Doha – and many allies rallied around.

On illicit financial flows, the section on systemic issues saw a new, stronger wording emerge, addressing our calls for more transparency

news

Doha: A cup half full? (Cont'd)

and information disclosure: the key sections are:

> *New and highly globalised financial instruments continue to change the nature of risks in the world economy, requiring continuing enhancement of market oversight and regulation. To strengthen the resilience of the international financial system, we will implement reforms that will strengthen the regulatory and supervisory frameworks of financial markets as needed. We will strive to improve key accounting standards to remedy weaknesses and deficiencies, including those exposed by the current financial crisis. National regulators should enhance financial information and transparency at the domestic level. We will further enhance cooperation amongst national regulators from all countries to strengthen international financial standards. These efforts should address timely and adequate risk disclosure standards in order to improve the foundation of decisions of investors. There is also a need for enhanced transparency by financial institutions. Enhanced disclosure practices and transparency should assist efforts to reduce illicit financial flows. (Paragraph 72)*

That last sentence came in at the last moment, apparently sponsored by the Germans. This gives us a good hook for future work, including the country-by-country reporting standard, and disclosure of beneficial ownership. The reference to risk disclosure has a strong bearing on off-balance sheet vehicles used in the shadow banking system, which in no small way contributed to the current financial crisis. Off-balance sheet financing has no legitimate role and must be outlawed.

Paragraph 16 includes the following:

> *We will step up efforts to enhance tax revenues through modernised tax systems, more efficient tax collection, broadening the tax base and effectively tackling tax evasion. We will undertake these efforts with an overarching view to make tax systems more pro-poor.*

That's OK as far as it goes, but earlier drafts of that sentence read "more progressive and pro-poor." The reference to progressive tax was deleted at the insistence of the American negotiators and their allies. The paragraph continues:

> *While each country is responsible for its tax system, it is important to support national efforts in these areas by strengthening technical assistance and enhancing international cooperation and participation in addressing international tax matters, including in the area of double taxation.*

… which served as a preamble to what was possibly one of the most hotly contended sections of the entire document:

> *In this regard, we acknowledge the need to further promote international cooperation in tax matters, and request the Economic and Social Council to examine the strengthening of institutional arrangements, including the United Nations Committee of Experts on International Cooperation in Tax Matters.*

Now this latter part is hugely important. TJN had been hoping for stronger wording explicitly committing the UN to upgrading its Tax Committee to inter-governmental status. While progress towards this goal may be slower than we would like, the agreed formulation does allows time to map out a more balanced representation in the committee (resisting efforts by vested interests to shoe-horn multiple tax havens into the "developing country" categories), and to push for stronger political status, and better resourcing and staff. We see this as a vital step towards improving on the current situation, where the interests of poor people from real developing countries are not being effectively served by this United Nations body.

Paragraph 20 refers to strengthening national and multilateral efforts to address factors contributing to capital flight and to efforts to tackle money laundering and preventing illicit financial flows. The paragraph is weak on specifics, but the broad commitments are immensely important.

Paragraph 21 elaborates on the fight against corruption "in all of its manifestations" in the private and the public sectors, and calls for "effective legal and judicial systems and enhanced transparency." We have strong views on corruption (see our article in *The American Interest* for more details) and hope to see tax evasion explicitly listed as a corrupt practice under the UN Convention Against Corruption.

Other positive outcomes from Doha included the launch of a book on the South-South Sharing of Successful Tax Practices Programme (see the news item on page 10), and the 2008 Social Watch Report, which includes a chapter on tax and development contributed by TJN.

Half full? Half empty? Definitely the former. Despite strong resistance from the usual suspects, including tax havens from the G-77 group of countries, our demands were supported by important allies, and the wording of the Doha outcome report shows considerable progress since the Monterrey conference. Above all, we came away with a feeling that tax matters have moved from the periphery to the core of the development debate, and we know we have played a part in making this happen. That alone makes our efforts over the past two years more than worthwhile.

news

Tax Systems for Poverty Reduction

TJN's new 3-year DfID Funded Programme

South Africa's Finance Minister Trevor Manuel noted at the Finance for Development meeting in Doha that his initials are T.A.M. – but sometimes he wonders whether they should be T.A.X. Jeffrey Owens of the OECD has a different take – he thinks aid should be spelt with the same three letters – t.a.x.

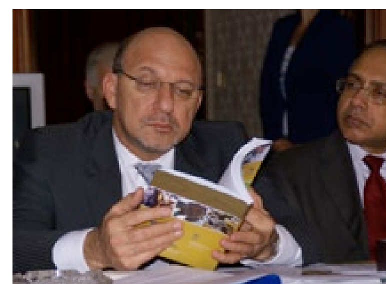
Donors and multilateral agencies are now waking up (so late!) to the central importance that tax plays in finance for development. Now the Tax Justice Network has secured funding from the UK Department for Development (DfID) for a three-year programme from November 2008, to work with civil society partner organisations in Africa, Latin America and Southern Asia to bring tax issues to the forefront of the development and state-building agenda.

The project will produce a new range of bespoke education materials and will deliver training programmes, through a series of workshops and seminars, in Africa, Asia and Latin America. In the first year we will have produced a *Tax Us If You Can Africa* edition and country briefings for Ghana, Kenya, Brazil and Bangladesh. In the second year we will produce regional editions of *Tax Us If You Can* for Latin America and Southern Asia. Richard Murphy's Tax Research LLP (Richard wrote the original *Tax Us If You Can*) is a key player in the rewriting process. We will also write six thematic tax education packs on themes ranging from Tax for Small and Medium-sized enterprises to Tax for Accountability and Democratisation.

A central aim is to strengthen NGO partner interventions in this area, so that they can work more effecively in engaging on tax policy matters. This will help DfID broaden its existing tax work, which in the past has focused largely on capacity building. At the same time we are building a campaign from the ground up, drawing on lessons from the Tax Justice for Africa programme which has been running now for 2 years.

This DfID project, which is being managed by Matti Kohonen on the TJN side, is now in the process of being integrated with a larger initiative managed by our partners SOMO in the Netherlands (through Francis Weyzig and Maaika Kokke) which starts in January 2009.

S4TP – a project for South-South co-operation



Trevor Manuel, South African Finance Minister, reading our book.

Another major programme, complementing the projects with DfID and the EU, is a remarkable initiative led by Jo-Marie Griesgraber of the New Rules for Global Finance coalition (and co-chair of TJN-USA) and David Spencer, a practising New York attorney who is representing TJN (David is one of our senior advisers.) These two organisations are working in partnership with the UN Development Programme (UNDP) and the UN Department of Economic Affairs (UN-DESA). The programme is known as *"South-South Sharing of Successful Tax Practices: Revenue's Role in the Quest for Inclusive Development – What Works and What Can Work Better?"* – or S4TP for short.

The basic idea behind S4TP is to foster the sharing of best tax practices among developing countries, and to identify where there is greater scope for regional and multilateral co-operation. This project is being developed in the context of the Financing for Development process – which started in Monterrey, Mexico in 2002 and whose latest event was the high level conference in Doha, Qatar in November–December 2008 (see "Doha: a cup half full?" on page 9).

The S4TP project brings together experts from developing countries to share their perspectives. We have already held two conferences – the first one in May 2008 was hosted at the prestigious Law School of New York University (see the conference report here), and a second conference on transfer pricing was held in Amsterdam in August, at which David Spencer spoke about transfer pricing as a component of capital flight and illicit cross-border flows.

We have also put together a book (see South Africa's Finance

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S4TP (Cont'd)

Minister reading it, in our picture) which is essentially a collection of papers presented at the New York Conference, with many tremendous contributions from important figures such as Michael Waweru of the Kenya Revenue Authority and Vimal Gandhi, President of India's Income Tax Appelate Tribunal, who spoke about the importance of an effective tax judiciary and the key role it can play in promoting tax justice. The book was launched at the Doha Conference by Vito Tanzi, a former head of the Department of Fiscal Affairs at the IMF who has done important work on tax havens and other "fiscal termites" gnawing away at countries' tax systems. More conferences, materials and co-operation are planned in this multi-year project.

We are very grateful to David and Jo-Marie for their work in this important project, and for the great support we have received from Michael Lennard of the UN Tax Committee.

In film

LA GRANDE ÉVASION

A 52-minute film by Fred Brunnquell

Tax havens on the production line in La Grande Évasion

Our film explores how tax havens work, and looks into how the new globalised world economy really operates. To show this, we designed and used an object to symbolise the tax havens: the snow globe.

In our film we give our snow globes to U2's Bono and to Lakshmi Mittal. We give them to billionaires who don't pay their taxes, and to their attorneys and members of the big accounting firms that help them put together the financial schemes to sidestep taxes. In sequence after sequence, our globes provoked a range of emotions: sneers, delight, smiles and contempt.

In Washington D.C., we meet incorruptible U.S. Senators battling this economic setup. In Ghana, we look at a country that may turn itself into a tax haven. In the British Virgin Islands we did a hands-on demonstration, creating a company to import our snow globes without paying taxes. I remember trying to sell our snow globe in Saint Helier in Jersey, in the street. Nobody was smiling there! In French

THE END OF POVERTY?

Directed by Philippe Diaz; produced by Beth Portello

In a world with so many resources, driven by such continual progress, how can we still have so much poverty? Today 25% of the world's population uses more than 80% of the planet's resources. Two billion people survive on less than a dollar per day. How did we come to this? When did it all begin? When did people start to become rich and poor?

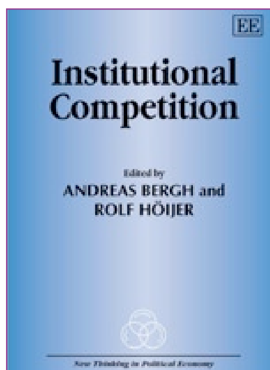
This is the question we are trying to answer, or at least create real and honest debate around, in our new movie: "The End of Poverty?" In the film, we let the experts answer.

The experts interviewed in the film all agree – our chosen economic system always was (and still is) financed by the poor. This is done in many ways, such as by repaying international debts or, as the Nobel Prize-winning economist Joseph Stitglitz explains, by giving monopolistic control over resources and other privileges to multinational corporations, or by using unfair subsidies or tools like intellectual property rights. The poor may have to pay unfair taxes on their labour and consumption, while capital gets a free ride. Capital market liberalisation, as John Christensen points out, opened "a new kind of criminal environment where capital can avoid taxes by being shifted all around the world."

This movie was made by gathering testimonials from experts and poor people alike, to finally (and hopefully) inspire a true debate about the real causes of poverty. The early success of the film – being selected at the Cannes Film Festival and by another dozen international festivals – shows the genuine interest the world has in finding a solution. Are we ready to listen, and even more importantly, are we ready to change our way of living?

www.TheEndofPoverty.com

reviews



Institutional competition

Andreas Bergh and Rolf Hoijer (eds)

Edward Elgar, 2008 xvi + 264

This collection of ten essays from a research project of the Ratio Institute in Stockholm investigates assorted aspects of institutional competition. Going beyond the inevitable debates over the definitional boundaries of institutions, and the arena in which they might be said to compete, the accepted interpretation in all the papers here is that institutional competition denotes competition between states at national or, within nations, subnational level.

States can learn from each other. Positive advantages of this kind from what is called yardstick competition do not even need to be elucidated, since no policy action follows. These advantages are set forth in separate papers by Roland Vaubel and Michael Wolgemuth. Perhaps the only lesson that emerges – and it is an important one – is that decentralisation of governance offers scope for wider experimentation and institutional diversity, with all the information and learning advantages that accrue. There are several instances of this from around the world. In India, free mid-day school meals for all children, or public employment guarantees during agricultural off-seasons, and the experimental evidence that they could be done without bankrupting the exchequer, were learned from pioneering subnational governments. Learning of this kind happens naturally; it does not need prodding.

The possible negative outcomes of tax competition are, however, far more compelling, and call for policy attention. Rolf Hoijer addresses this head-on. In a systematic manner, he identifies three possible negatives and argues against all three. The first is that tax competition distorts investment decisions and violates capital export neutrality (that is, that an investor should face the same taxes regardless of location). The second is the negative impact on public revenue (and therefore on the ability to provide public goods) of a race to the bottom on taxation of capital, as jurisdictions bid to attract mobile capital. The third is that footloose capital can shake off the burden of taxation by roaming the world, leaving relatively immobile labour to bear the tax burden, with implications for the distribution of income.

On distortion of investment decisions and violation of capital export neutrality, Hoijer's refutation falls back on the familiar plank: that tax rates are merely the price for public goods, and that mobile capital looks at tax rates and public services provided as a package. He goes even further to suggest that tax competition facilitates the pricing of public services in different destinations, thus improving the signaling properties of taxes, and therefore potentially improving welfare. This argument might possibly carry conviction in a largely homogenous universe, such as that of the EU. But the nation state in poorer destinations faced with unconstrained tax competition will try to stay afloat by ensuring public services to mobile capital, but denying them to sections of the population without recourse. Scarce water might be diverted to the corporate sector, away from the parched hinterland. Floodlit consumer malls might draw scarce electricity away from irrigation pumps. An internationally agreed corporate tax rate floor would protect against this. The advantage of choice remains with mobile capital: it is still free to rank destinations by public service value for taxes paid – but the rate floor ensures, to that extent, that public goods will not be allocated away from the voiceless population.

On the negative outcome of tax competition on public revenue, Hoijer falls back on Tieboutian mobility (that households reveal their preferences for public goods through their decisions to relocate) to argue that there will be eventual jurisdictional alignment of tax rates with consumer preferences for public services. Hoijer does concede that movement of people is not natural or easy across ethnic divides. Once again, this might not seem an insuperable obstacle within the EU, with visa-free movement. But the opposition of the world community to free movement of people illustrates the fallacy of extending the Tieboutian notion to contexts beyond that for which it was intended. Movement of people will become ever more contentious as climate change forces people to move in the face of advancing sea levels. The 1999 empirical paper by Radaelli is cited to show no obvious fall in government revenues, but as Hoijer concedes, that merely establishes success in finding compensating revenue sourced elsewhere. If a high-rate VAT is the source of replacement revenue, the tax system will become more regressive. Surely that is not a happy outcome.

The third and related issue is the replacement of revenue from capital taxation with revenue from labour taxation. Without adopting what Hoijer labels the Marxist distinction between capital and labour, and

reviews (cont'd)

conceding that embedded human capital is possibly as mobile as financial capital, it is hard to accept his argument that a burden shift is a transfer that permits no conclusions, since interpersonal neutrality does not enable offsetting of the gains to some against the losses to others.) He goes further to cite the classic Diamond-Mirrlees result of 1971 that taxes distorting production impose more deadweight costs than taxes distorting consumption, to suggest that a shifting of the tax burden from capital to labour might actually be a good thing. The leap to that conclusion may not be justified. The key here is the locational distortion posed by inter-country variations in taxes on mobile capital. Even if tax competition leads to successive rate equilibria, there is a distortionary interregnum when rates are constantly re-adjusted. A global tax treaty that imposes a uniform non-zero floor rate of tax imposes an *a priori* equilibrium without distortionary rounds of competitive rate reduction.

The two other papers on the tax competition issue, by Victoria Curzon-Price and Andreas Bergh, echo the general conclusion of Hoijer, that international tax competition is beneficial rather than harmful. One argument - that direct tax rates have indeed fallen, but not (on average) to zero - neglects the crucial issue that some destinations have indeed come down to zero, and that the regulatory burden thus placed on non-zero destinations to monitor transfer pricing is a deadweight loss that poor countries can ill afford. The case for a universal above-zero tax floor surely remains irrefutable. The Bergh paper is set squarely in the European context, where it might be possible to tie tax-benefit packages for the population saddled with a high tax burden on labour income. But in developing countries, the regulatory burden of imposing club restrictions on public services would pose an infeasibly large administrative burden on government.

The only research paper in the book is by Lars Feld. This important contribution is the first ever to test for the impact of fiscal federalism on economic growth, using data based on an OECD method advanced in 1999. The exercise conducted with panel data for 19 OECD countries from 1973 to 1998 is meticulously performed and clearly reported. Neither spending decentralization nor subnational tax autonomy over tax rates or bases has a significant impact on economic growth. However, when subnational jurisdictions participate in joint taxation systems at the national level, the growth performance is worse. From this the author concludes that tax autonomy, meaning the absence of joint taxation, has had a positive influence on the economic performance of OECD countries. However, the leap from here to the conclusion that unlimited tax competition is good for efficiency is not warranted.

An excellent paper by Erich Weede, comparing the institutional features of China and India, closes the book. He executes admirably the theoretical task he sets himself, of finding a common set of institutional factors which explains both why China and India fell behind the West and eventually started to catch up, and also why China outperformed India. Weede correctly identifies the failure to protect property rights in China and India relative to Europe as a key element of the story, and correctly reaches below the surface superiority of property rights in India relative to China, to identify the distortion of incentives in India.

This book has much to commend it, because of the richness and diversity of the issues addressed. However, the uniform support of many of the pieces in it for unbridled fiscal competition is not tenable. The argument in favour of placing a floor above zero on tax competition, whether between countries, or within countries, is very simple. Tax competition introduces noise into the relative attraction of investment-seeking destinations, in a manner that can seriously distort investment decisions away from efficiency. The argument that taxes are merely one side of a public services package, the whole of which goes into the location decision, is invalid in developing country contexts, where reduced taxation of mobile capital will see a corresponding decline in services not to corporate enclaves, but to the non-corporate hinterland. Developing countries increasingly challenged by climate change and food insecurity find themselves effectively deprived of fiscal autonomy. Since at each temporary equilibrium after a round of rate reductions, relative tax advantages are evened out, settlement of a universally agreed and enforced floor will be to the revenue benefit of all, and the relative disadvantage of no partner to the agreed floor.

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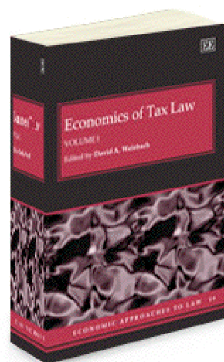
reviews



Economics of Tax Law

edited by David Weisbach

Edward Elgar, 2008

The starting point of *Economics of Tax Law*, a two-volume collection of 40 papers mostly from academic economics and law journals, is a contradiction. On the one hand, more than most legal subjects, taxation has long been the subject of study by both lawyers and economists. On the other hand, the law and economics revolution of the Sixties and Seventies touched taxation far less than it did other fields: economists' abstract models tend to assume away many of the legal details of real tax systems, and lawyers often ignore the economics of taxation and are scared by its daunting mathematics. This book is therefore both important – and difficult.

The papers included in the book can be divided into three areas: first, the basic economics of taxation; second, the choice of the tax base; third, administration and compliance issues.

A few of the 13 papers that cover the basic economics of taxation provide non-economists with a relatively gentle introduction to the optimal taxation of commodities and of income: I would highlight those written by leading economists as William Baumol, David Bradford, Joel Slemrod and Shlomo Yitzhaki.

Economists, on the other hand, may find it interesting to compare their views with those of legal scholars, namely Michael Graetz and Boris Bittker, on issues such as the use (and abuse) of numbers in tax lawmaking, or the interpretation of tax progressivity.

The best-covered area is on the choice of the tax base, including that of tax expenditures (that is, exemptions and allowances) and of the tax unit. Most discussions focus on the alternatives between income and consumption taxes, and I would suggest starting from the 2006 paper by Joseph Bankman and David Weisbach, which provides a comprehensive and non-technical introduction to the theoretical aspects of the alternative between the two tax bases.

The interested reader wants to read the 1996 paper by Alvin C. Warren Jr, and then explore the technicalities by reading the papers by William Andrews, a law professor, and the economist Alan Auerbach. Readers from TJN might be especially interested in the papers discussing progressivity and those discussing tax administration and compliance issues.

A 1987 paper by Joseph Bankman and Thomas Griffith put forward a number of arguments defending progressivity. They looks at the labour-related efficiency costs of progressive taxation and critically examine traditional arguments that progressivity imposes important administrative costs.

David Weisbach, in "Ironing Out the Flat Tax", makes a convincing critique of flat tax proposals. He looks at claims put forward by flat tax advocates - notably Robert Hall and Alvin Rabushka – who argue that flat taxes are simple and efficient, and suggests that these claims may well be false, once you properly analyse the design issues presented by flat taxes. In particular, Weisbach focus his critiques on the openness of the flat tax – that is, that deductions claimed by one taxpayer are not necessarily offset by inclusions of another (and vice versa).

For example, under a flat tax a business may deduct the cost of land purchased from an individual, but the individual is not taxed on the sale. This generates many administrative and compliance issues regarding taxation of financial operations, treatment of losses, and the valuation of goods when they cross international borders. The analysis notes that flat taxes can easily be avoided and that can exacerbate transfer pricing problems.

The part of the book devoted to tax shelters is fascinating, though it includes only two papers, one by Joseph Bankman and another by David Weisbach, whose focus is almost exclusively on U.S. legislation. Bankman's paper describes in detail the new corporate tax shelters – the latest-generation shelters which have been marketed to Fortune 500 companies rather than to high-income individuals, (as was the case for the old 1980s shelters.)

While the 1986 Tax Reform Act put an end to the old individual shelters, the author writes, the new corporate tax shelters are much more sophisticated and complex. Bankman provides a useful taxonomy of the main tax shelter schemes with exotic names: the "High-Basis Low Value" scheme, the "Step-Down Preferred" scheme; the "Instalment Sale" scheme (which

reviews *(cont'd)*

Colgate-Palmolive and others bought from Merrill Lynch), and the "Lease Strips." The common aim of these schemes is to attribute losses to a subsidiary located in the U.S., and then to allocate profits to zero-bracket taxpayers, namely a foreign person not subject to US tax, by using a complex set of financial and contractual arrangements involving at least 3 companies (the parent, the subsidiary and the zero-bracket taxpayer). In many cases, zero-bracket taxpayers are foreign parties located in a tax haven.

The article also looks at the supply side of the tax shelter industry, which is characterised by high competition between the older incumbents (investment banks and the like) and the newer entrants (accounting firms) which have taken up the lion's share of the market, thus limiting the role of law firms. The last part of the article illustrates the possible long-term and short-term policy options. In the short-term the author analyses a number of proposals put forward by legal scholars and by the US Treasury in 1999, and advocates a combination of these as a viable approach.

Finally, another Weisbach paper, Formalism in Tax Law, gives an economic analysis of the alternative options of rules and standards in anti-abuse tax law. The problem with tax rules is that taxpayers manipulate them to create results that were clearly not intended by the drafters. To avoid this, tax rules need to be very detailed and complex, and this increases their administrative and social costs. On the other hand, however, standards are applied ex-post by courts or by administrators, and this reduces certainty and reliability in tax law. Weisbach advocates an intermediate solution: anti-abuse rules that are drafted ex-ante but which are fuzzy at the borders, like standards. These are one-way and purpose-based rules, and they allow the government to depart from the literal language of the law (which is the source of their fuzziness) to require that the taxpayer does not enter into a transaction with a purpose of reducing tax liabilities in a manner contrary to the purpose of the statute or regulation. For example, take mixing bowl transactions, i.e. joint ventures between A and B where A contributes the money, B contributes the asset, and then the partnership is ended by distributing the money to B and the asset to A. These are formally covered by the legislation on partnerships but their economic substance is inconsistent with the purpose of a 'real' partnership. The partnership is just a way to save the tax that B would pay by selling the asset outright to A. An anti-abuse rule would allow the Tax Agency to rearrange this transaction as a standard sale.

A number of interesting issues arise from these two articles which lead us (in a way) back to the contradiction I noted at the start of this review. Tax shelters and tax havens pose huge legal and economic problems for developed and developing countries. Research on this topic is challenging, and requires a deep understanding of corporate finance, the economics of corporate taxation, and corporate tax law. Lawyers tend to focus on the intricacies of the law, while economists adopt an oversimplified approach. In most economists'model, there is virtually no difference between a simple evasion realized by underreporting of revenues and a complex scheme which involves the use of tax shelters. Although recent papers by Jim Hines and Joel Slemrod at NBER may indicate a possible evolution in this important field, important gaps remain for lawyers and economists to fill in future.

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