tax justice network

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Taxing times for Bolivia's energy industry

Sarah Wilson

Bolivia is the poorest country in South America, with around one third of the nine million population living on less than US$1 per day, yet it sits on gas and oil reserves worth billions. The contradiction between the country's grinding poverty and the fact that companies such as British Gas and BP have been paying relatively little tax for extracting its valuable resources has not been lost on the Bolivian people; popular protests have toppled two governments in as many years.

When Bolivia's gas industry was privatised in 1996, under heavy pressure from the IMF, consortia of companies negotiated a deal that meant they paid very little tax on the value of the gas extracted at the well-head. For the new reserves, companies were only required to pay 18 per cent of the market price, in a form of tax known as royalties. Ninety-seven per cent of Bolivia's reserves were deemed new, thus exempting them from a further 25 per cent income tax.

The idea behind the 1996 privatisation was that it would increase investment in exploration and thereby boost production. So even if Bolivia's share of the cake were smaller, the cake itself would be larger. But in practice, while production did increase dramatically, Bolivia's earnings barely rose.

Meanwhile, British Gas, BP and others were enjoying very healthy profits from their operations in the country. In April 2005, the four biggest multinational oil companies – BP, Exxon Mobil, Shell and ConocoPhillips – announced that their incomes had risen by 39 per cent compared with the previous year. Ten years after privatisation, as prices of crude oil and natural gas reached record highs, the Bolivian people called for changes to the rules of the game.

This is the background to the civil unrest seen in Bolivia earlier this year. In May, in an attempt to resolve the long-running conflict over the nature of the exploitation of Bolivia's natural gas reserves, the Bolivian Congress passed a new Hydrocarbons Law which would result in increased taxes on foreign companies investing in the gas and oil extraction industries in Bolivia.

For many, however, the law did not go far enough and there were calls for the nationalisation of the country's energy industry. Tens of thousands of protestors, made up of a mix of indigenous and left-wing groups, held daily demonstrations in Bolivia's capital, La Paz. Aided by geography and Bolivia's sparse road network, protesters were able to bring La Paz to a virtual standstill for three weeks. Road blocks resulted in fuel and food shortages in the city, and some protesters engaged in street battles with police.

In early June 2005, Bolivia's President, Carlos Mesa, was forced to step down.

Debate in Bolivia's Congress on the new Hydrocarbon Law during the year leading up to the protests had already set international alarm bells ringing; the US and UK Governments as well as foreign private sector interests went to considerable lengths to lobby against the new law. In October 2004, a deputation from the UK Foreign Office reportedly told the Bolivian government that a British promise to cancel Bolivia's foreign debt could be at risk if the Bolivians raised taxes on gas production.

Before President Mesa's resignation in June, British Gas wrote a letter to the Bolivian gas minister, Guillermo Torres, which he interpreted as threatening to initiate proceedings at an international arbitration court for breach of contract if the proposed tax increase went ahead. A spokesman for British Gas told development agency Christian Aid the letter was written: "in order to reserve our rights in respect of decrees and resolutions, which contravened the terms of the previous Hydrocarbons Law of the Shared Contract… At no stage did the company initiate legal proceedings or state an intention to do so."

While millions of Bolivians live in extreme poverty, the country has enormous wealth. It has some of the cheapest gas production costs in the world, making it an extremely profitable place in which to operate. Companies such as British Gas and BP could afford to pay higher taxes and still achieve enviable profits.

In Venezuela, for instance, companies pay 30 per cent royalties on the value of the oil they produce, as well as 50 per cent income tax. But there is still plenty of foreign investment.

In the 1950s, Norway was one of the poorest countries in Europe. By the 1960s, it became clear that there were substantial oil and gas deposits in the Norwegian continental shelf. Through careful management of these reserves, the government was able to substantially improve the nation's financial position.

The Norwegian tax system is complex, but according to one study, the average government take for a standard 100-million-barrel field is around 75 per cent. This money is channelled into the Norwegian Government Petroleum Fund, which is invested to subsidise the welfare state, both now and in the future, after the reserves have run out.

Much of US and European government development policy in Bolivia has focused on aid and debt relief. But raising the tax levied on extracting Bolivian gas would provide an enormous development fund, without costing US and European taxpayers a penny.

Sarah Wilson is Christian Aid's Latin America specialist.
This is an abridged version of the case study on Bolivia in Christian Aid's September 2005 paper *The shirts off their backs: how tax policies fleece the poor*. The paper is available as a download from:
(w) www.christian-aid.org.uk.

Editorial

To achieve sustainable economic development, Latin America, like all the world's regions, needs to be able to mobilise domestic resources. Government revenues from taxation are vital. Yet as two of our articles demonstrate – the leader article on Bolivia and an opinion piece by Latin American economist Oscar Ugarteche – fiscal sustainability in the region is being seriously undermined by the associated problems of tax evasion, tax avoidance and tax competition.

These issues have also been explored in the context of the Chilean mining industry in important work undertaken by Manuel Riesco for UNRISD (see Research Roundup).

In Europe, we can only hope that the westward creep of flat tax enthusiasm has been stopped in its tracks by Germany's rather messy general election on September 18th.

As our article on the German election debacle shows, flirting with a flat tax can prove a dangerous strategy for political parties in Western Europe. While our article on Slovakia reveals that even in the Eastern European context, the flat tax is far from the silver bullet that its supporters have claimed.

Campaign Digest

Spain: debates on Global Economic Justice

Juan Hernandez Vigueras

Attac Spain and the Ateneo de Madrid have organised a series of debates on the topic 'Global Economic Justice' which are taking place during September and October. Themes include global financial markets, global taxes and tax havens. For further information see:
(w) www.attacmadrid.org

The Spanish Alliance Against Poverty (Alianza Española contra la pobreza), which unites over one thousand unions and social, religious and ecological groups including Attac Spain, met with Spanish Prime Minister Zapatero on 24 September to voice their disappointment at the achievements of the recent UN Millennium Summit.

Switzerland: OECD-DAC asks Switzerland to tackle capital flight

Bruno Gurtner

The Development Assistance Committee (DAC) of the OECD, which periodically reviews the aid programmes and policies of member countries, has recently published the Peer Review of Switzerland.

Among other recommendations, the DAC has asked Switzerland to "bring the issue of capital flight to the attention of the international community, with the aim of addressing its root causes and impact on developing countries".

TJN members in Switzerland were able to influence the DAC Review process through consultations carried out by SDC (the Swiss Agency for Development and Cooperation) as well as in meetings with DAC delegation.

The Review recognises positive steps taken by Switzerland to prevent its financial centre from being abused in order to combat money laundering and corruption. Yet capital flight remains a problem. The Review states that Switzerland's highly developed financial services industry and the enforcement of banking secrecy are key factors in attracting assets from developing countries.

The DAC Review states that Switzerland could do more to address this issue including considering extending recent agreements to return tax revenues to developing countries, in a similar way as is done between Switzerland and the EU. Given the importance of broad international agreement for such measures to ever be truly effective, the DAC Review also suggests that Switzerland could advocate for wider international reform in this area.

TJN members in Switzerland will continue to engage with policymakers during follow-up discussions. TJN members in other countries with major financial centres – such as the UK, Belgium and Luxemburg – should be encouraged to contact DAC delegations during the peer review process.

A summary of the Review's main findings and recommendations as well as the PDF of the full report can be found on the DAC website: (w) www.oecd.org/dac.

UK: Publish What You Pay report on improving transparency in the extractive industries

Richard Murphy

Publish What You Pay (PWYP) NGO coalition members (including CARE International UK, Global Witness, Open Society Institute, Save the Children UK and Transparency International UK) published a report on 19 September entitled ***Extracting Transparency: the need for an International Financial Reporting Standard for the Extractive Industries.***

As the International Accounting Standards Board, the body responsible for developing global accounting standards, begins the process of defining new standards for companies in the extractive industry – in what is called an International Financial Reporting Standard (IFRS) – the PWYP report puts forward the case for the disclosure of revenue payments on a country-by-country basis.

In line with the views of TJN, the PWYP report states that country-by-country reporting on commercial performance, taxes and other benefits paid to governments, and reserves is essential information for making useful decisions about companies engaged in the extractive sector. At present, such information is not available, as current standards only require the disclosure of information on, for example, a regional or continental basis in most cases.

As the PWYP press release states: "Disclosure of revenues paid by oil, gas and mining companies for every country of operation is a fundamental step towards improving governance, reducing poverty, and combating corruption in the management of this important source of income for many of the world's poorest countries."

The report includes a questionnaire that interested readers are encouraged to fill out to share their observations on the ideas and proposals put forward by PWYP. It is available at:
www.publishwhatyoupay.org/ifrs

Uruguay: TJN featured on website

Juan Vigueras

The Attac-Uruguay website currently features information on TJN and documents on tax justice issues in Spanish. For further information see:
(w) www.uruguay.attac.org

Research Roundup

Raymond Baker, ***Capitalism's Achilles Heel: dirty money and how to renew the free-market system***, Wiley, Chichester, 2005

"Drawing on his time running businesses in Nigeria in the 1960s and 1970s, and his subsequent research into money laundering as a guest scholar at the Brookings Institute, Baker dispels any notion that offshore corporate lawlessness began with Enron, WorldCom and Parmalat. Things may have got worse since the 1980s, but Baker compellingly demonstrates the extent to which international trade and investment patterns have been constructed around elaborate tax evasion schemes in use since colonial times. With at least half of all world trade now being conducted on paper via tax havens, the opportunities for fraud and skullduggery are immense."

"Challenging the view that financial scandals and tax dodging are isolated cases in an otherwise robust system, *Capitalism's Achilles Heel* shows how these 'negative externalities', as economists describe them, have generated a spirit of lawlessness that threatens the integrity of the market system and the finance industry as a whole."

Extracts from a review of *Capitalism's Achilles Heel* by John Christensen published in *The London Review of Books* (29 September 2005). To read the full review: (w) www.lrb.co.uk.

William Brittain-Catlin, ***Offshore: the dark side of the global economy***, Farrar Straus Giroux, New York, 2005

In the era of offshore capitalism, says Brittain-Catlin, the modern nation state, "with its immense capacity for international business and war, fashions the world on the back of its mutually willing corporate allies".

Journeying to the Cayman islands to investigate how this cluster of low lying wetlands has metamorphosised from being on the edge of economic extinction to ranking amongst the largest financial centres of the world, *Offshore* is also an exploration of the soul of global financial capitalism. Having finally broken free from the chains of geographical location and any sense of belonging to place or community, capital is able to roam free, unfettered by the economic or social obligations imposed by the onshore world.

But freedom from tax and regulation has its dark side. The secrecy space which attracts businesses seeking a competitive edge through tax evasion and minimal regulation is equally attractive to those who engage in the elaborate personal and corporate scams that have made the islands synonymous with greed and criminality.

A BBC producer and corporate investigator, Brittain-Catlin knocks on the doors of those who have helped to shape the Cayman's recent history and ruminates, perhaps excessively, on how, in the age of democracy, offshore was created in response to the needs of wealthy and powerful elites to disguise their goal of overthrowing the constraints imposed by modern states.

Despite their links to the British Crown, the Cayman spirit echoes the extreme edges of American libertarianism. Close links to the Bush administration, which has described Cayman as "one of the most important countries in the world", have protected the islands from potential fallout from association with major scandals, including Enron and Parmalat. "We love it when the Republicans are in power", one ex-pat financier tells Brittain-Catlin. "Here, here", said the attendants around him.

Manuel Riesco, Gustavo Lagos and Marcos Lima, ***The Pay Your Taxes Debate: Perspectives on Corporate Taxation and Social Responsibility in the Chilean Mining Industry***, United Nations Research Institute for Social Development (UNRISD), Geneva, 2005

This forthcoming paper, one of a series of UNRISD studies on the impact of corporate social responsibility in developing countries, is currently available to view in draft format on the UNRISD website (www.unrisd.org) by going to the Business Responsibility for Sustainable Development project and selecting unpublished papers.

UNRISD had previously commissioned a paper by Manuel Riesco on the fiscal performance of foreign mining companies in Chile, the role of government policies in shaping fiscal behaviour, and the nature of policy reforms that might enhance the developmental contribution of TNCs.

The paper fuelled a national debate on the question of why foreign mining companies paid no royalties and so few taxes.

The Riesco paper was criticized by some in Chile, and one of the companies examined in the study submitted a paper to UNRISD (by Gustavo Lagos and Marcos Lima) which takes a different view. UNRISD is now publishing both papers in the form of a debate, together with a reply by Riesco and a rejoinder by Lagos and Lima.

United Nations, ***World Economic and Social Survey 2005: Financing for Development***

This year's *World Economic and Social Survey*, published in July, focuses on the Monterrey Consensus as the current framework for international cooperation for development. The report examines the broad agenda for action that was set out in the Consensus, highlighting issues – in the areas of finance and trade – that will need further work in order to achieve the Millennium Development Goals. The report is available as a download from:
(w) www.un.org/esa/policy/wess

Alex Cobham, ***Tax evasion, tax avoidance and development finance***, The Oxford Council on Good Governance, August 2005

Against the backdrop of the current search for new, innovative sources of development finance, this paper argues that successfully addressing the problems of global tax evasion and avoidance could provide the most promising long-term solution. As the author states: "Domestic revenue mobilisation is key to sustainable development finance – only self-sufficiency will allow the development of fully functioning states with flourishing systems of political representation and economies reflecting society's expressed preferences in regard to, for example, inequality".

The paper begins by surveying the tax structures of different regions of the world, with an examination of changes over the last three decades. It then sets up a simple model for tax revenues and identifies three key areas of 'tax leakage': (i) the income earned on assets held offshore by wealthy individuals; (ii) corporate sector profits that are transferred to low tax jurisdictions; and (iii) income from 'shadow' economic activity. The author estimates that the potential gain for developing countries, if each of these areas could be adequately addressed, would be in excess of US$200 billion per year. The paper then discusses some of the proposals that have been put forward – particularly on increased transparency of corporate tax contributions – that might help developing countries move towards long-term fiscal sustainability. The paper ends by setting out an agenda for much needed future research.

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Thierry Godefroy and Pierre Lascoumes, ***Le capitalisme clandestine: l'illusoire regulation des places offshore***, La Decouverte, Paris, 2004 and ***El capitalismo clandestine: la obscena realidad de los paraisos fiscales*** Paidos, Barcelona, 2005 (*Clandestine capitalism: the illusory regulation of offshore financial centres*)

This book, published in both French and Spanish, takes a critical look at the impact of free capital movements combined with the growth of offshore, and at the efforts of international organisations to contain their most harmful consequences.

A full review of Clandestine Capital will appear in the next edition of *Tax Justice Focus*.

Media Digest
2005 (third quarter)

US. **American Prospect Online**. 6 June 2005. 'The Easy Money', Max B Sawicky.
This article looks at tax avoidance and tax evasion in the context of the US "tax gap", the US$350 billion of tax due to the federal government that goes unpaid every year. Discussing efforts to reverse harmful trends in global tax policy, the author mentions TJN.

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Spain. **Temas para el Debate**. July 2005. 'The failed OECD project to tackle tax havens', Juan Hernandez Vigueras (TJN Spain)
In the context of the recent scandals in Marbella/Gibraltar involving offshore activity, this article evaluates the progress of the OECD's initiative to tackle harmful tax practices. Since the OECD project began in 1998, the article laments, it has been consistently watered down in response to political pressure from a range of interested parties including the US Government. In an effort to combat the negative impacts of the offshore industry, including the financing of terrorism and the laundering of proceeds from drug trafficking, Attac-Spain has led a national campaign against tax havens.

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UK. **Socialist Worker**. July 2005: G8 Special. 'My image of Africa', Charles Abugré, head of policy and advocacy at Christian Aid.
In the context of the Make Poverty History campaign and the G8 meeting in Gleneagles, this article stresses the importance of a more rigorous analysis when discussing Africa; in order to heal, the author argues, it is essential to get the diagnosis right. As well as discussing debt and trade liberalisation, the article highlights the negative consequences of tax competition and the loss of revenue associated with tax avoidance. The author cites the TJN calculation of US$255 billion per year in tax revenues lost to governments globally solely as a result of private wealth held in tax havens.

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UK. **The Guardian**. 11 July 2005. 'Plug the leaks – or waste the aid'.
Focussing on the G8 meeting at Gleneagles, Sony Kapoor and John Christensen (TJN UK) write of the importance of stopping capital flight out of Africa and other developing country regions. 'Plugging the leaks' – by tackling tax havens – would allow countries to rely less heavily on development assistance. The authors argue that the issue of capital flight, and the tax havens that facilitate it, should be added to the traditional development triumvirate of debt, aid and trade.

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UK. **Accountancy Age**. 4 August 2005. 'UK plc takes on Treasury in avoidance battle', Alex Hawkes.
This article examines PWC's moves to head off criticism over corporate tax avoidance by proposing new ways to disclose the total tax contribution made by companies. Discussing the higher public profile of tax issues in recent years, the article refers to the last issue of *Tax Justice Focus* which featured a number of contributions on CSR and taxation.

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UK. **The Financial Times**. 18 August 2005. 'Managers under pressure to give tax its due', Vanessa Houlder.
The profile of tax has been raised significantly in recent years, and this

article examines the new pressures on directors – from legislators, tax authorities and investors – to take responsibility for their company's tax affairs. The article refers to KPMG's paper *Tax in the Boardroom* and the last issue of *Tax Justice Focus*. Tax, the article concludes, is one of a company's biggest risks.

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US. **Tax Notes** (weekly magazine from tax analysts).
29 August 2005. 'Reputation or lower taxes?', Martin Sullivan.
This article examines the current focus on tax as a CSR issue and warns of the new dangers involved for those who get "too cute" with their tax planning. TJN, described as a "source of irritation", is in part responsible for the current "news value" of tax, the article states. In the context of KPMG's paper *Taxes in the Boardroom*, the author asks "Who should care what a bunch of Euro Lefties think about corporate taxes?" The reply, "the boards of directors of the world's largest corporations, that's who".

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Australia. **On Line Opinion** (e-journal of social and political debate). 31 August 2005. 'Poverty: aid, trade and corruption', John Sweeney and Zeena Elton.
Against the backdrop of the G8 meeting at Gleneagles, this article asks which policies will actually be most effective in helping Africa achieve better human security and sustainable development. The authors state the need for an "accurate analysis which identifies all of the factors, internal and external, that continue the cycle of poverty in Africa". They highlight the problems of structural adjustment, debt, unfair trading systems, environmental degradation, corruption and conflict. The authors then go on to discuss the role of multinational corporations in Africa and the problems of tax avoidance, tax evasion and tax competition; the TJN figure of US$11.5 trillion held in tax havens is cited.

UK. **The Financial Times**.
15 September 2005. 'Flat tax offers Britain economic disaster' letter from John Christensen and Richard Murphy (TJN UK)
This letter draws attention to the increases in social security contributions that have tended to accompany the introduction of flat rate taxes on personal and corporate incomes. This means that should a flat rate of tax be introduced in the UK, middle income earners would suffer not only higher taxes but also higher social security contributions while the well off would enjoy tax cuts. This not only makes the proposed 'flat tax' politically unacceptable, it also undermines any chances of the tax-driven boom that its advocates have optimistically predicted.

FLAT TAX SPECIAL

Germany's 'flat tax elections': a tax justice analysis of the conservative defeat

Sven Giegold

In the lead up to the German general elections of September 18th almost everyone was sure: the conservative coalition lead by Angela Merkel would win by a large margin and drive the red-green coalition out of office.

A fortnight before the elections Merkel's Christian Democrats (CDU) together with its Bavarian counterpart (CSU) enjoyed a comfortable lead of around 12 percentage points over Schröder's coalition made up of his Social Democrats (SPD) with the Green Party. Just two weeks of fierce debate on tax ensured that this lead had been whittled down to less than one point by polling day. What was behind the voters' change of heart? And what can we learn from it?

Most German voters had become convinced that Schröder and his red-green coalition had shown themselves to be incapable of leading Germany out of a crisis.

Merkel had enjoyed a fairly stable lead in the polls for a number of months, despite the CDU/CSU announcing a programme of proposed reforms set to increase the dose of the neo-liberal medicine that Schröder had already used with little success.

In the field of tax policy Merkel wanted to increase VAT by 2 per cent to 18 per cent, lower the top marginal rate of income tax from 42 per cent to 39 per cent, and abolish many tax breaks – particularly for low and middle income earners. This programme would represent a continuation of Schröder's government policy which had already cut the top marginal rate of income tax from 53 per cent to today's 42 per cent.

Conservatives appoint radical reformer Kirchhof

Although Merkel's programme was already tough, both she and some radical liberals in her party wanted even more. Spurred on by encouraging opinion polls, Merkel made Paul Kirchhof responsible for finance in her 'team of competence', with the promise that he would become finance minister in a future government.

Paul Kirchhof is a professor of fiscal law at the University of Heidelberg and a former constitutional court judge. In a number of controversial decisions he has helped to shape Germany's tax laws. After his active time as a judge, Kirchhof campaigned for the introduction of a flat rate of tax in Germany, putting together a team of experts to draft a new income and company tax code. Kirchhof managed to garner a fair amount of political support for his proposals.

These proposals consisted of three key ideas: the lowering of the top rate of marginal income tax to 25 per cent; the abolition of tax breaks; and, in order render this programme less brutal, the introduction of two lower tax rates for those on low incomes. This last idea meant that Kirchhof's proposed tax system would retain a progressive element, unlike the harsher flat tax regimes in some Eastern European countries.

However, these proposals were seriously out of step with conservative policy as outlined in the manifesto and this caused considerable confusion among voters. Should the conservatives get into office, which policy would Kirchhof follow – the party's or his own? More importantly, the Kirchhof proposal was seen as deeply unjust. Many voters failed to grasp the concept of the lower tax rates for lower income groups, yet everybody understood that the rich would only have to pay 25 per cent. The flat tax was seen as another reform which would result in the poor having to pay in order to make the rich better off.

German voters reject the 'flat tax'

The Kirchhof proposal gave the SPD and the Greens the ammunition they needed to launch a fierce counter attack centred on a social issue. German opinion polls consistently show that more than 70 per cent of voters want to retain the welfare state. Initially most of the mainstream media supported Kirchhof, but this began to shift as the stormy public debate over taxation raged on. Kirchhof's flat tax would have created a €20 billion per year hole in Germany's public finances. The CDU/CSU failed to explain how this deficit would be financed.

At the same time, the German Institute for Economic Research together with Attac Germany disproved Kirchhof's claim that less tax breaks for the well-off under his proposal would mean that they would actually end up paying more tax. Tax data clearly shows that the large majority of the high income earners would be much better off with Kirchhof. The campaign against the flat tax was helped by labelling it a 'Einheitssteuer' (or 'unique tax') during the public debate. For while the term 'flat tax', like most Anglo-Saxon words, sounds modern and cool in German, 'Einheitssteuer' smacks of an old-fashioned 'one size fits all solution'.

By September 18th, just two weeks after Kirchhof's appointment, Merkel's conservatives had lost eight percentage points and they fared even worse in the election than Helmut Kohl in 1998. Two days later Kirchhof quit. Hopefully it will be at least two decades before any party in Germany proposes a flat tax again.

What lessons can be drawn from the German experience?

In Western democracies, the concept of a progressive tax system is deeply rooted in the public consciousness. As recent events in Germany have shown, most voters equate a single rate of tax for all, regardless of income level, with injustice. This deep-rooted belief provides an essential counter-balance to the sometimes seductive arguments put forward by supporters of the flat tax. The German experience has shown that the public can be mobilised in the rather abstract field of tax policy. As the flat tax idea surfaces in other countries, it will be down to economic institutes, unions, journalists, and political and faith groups to present the counter arguments that will help to mobilise public opinion.

It is clear that middle-income earners would be hit hard by a 'flat tax' while those on high incomes would benefit most. Flat tax advocates claim that their proposals would boost economic growth, yet there is no evidence that shows a significant positive correlation between the level of the top rate of income tax and economic growth or employment. Flat taxers also claim that lower tax rates are increasingly necessary in order to compete in a global environment characterised by fierce tax competition. While tax competition is a reality, using this to justify lowering national tax rates merely risks a further escalation of the tax 'race to the bottom' we have already seen in some areas of the world. Policymakers should instead turn their attention to taking serious action against international tax evasion and harmful tax competition.

Sven Giegold is co-founder at Attac Germany and Chair of the Tax Justice Network's Steering Committee.

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Sleepless in Slovakia: the flat tax and what it conceals

Prem Sikka

Free market think-tanks are busy promoting the idea of flat rate taxes. They claim that somehow this will stop tax evasion and avoidance and result in increased tax revenues.

We have heard these claims before. In the UK, the top rate of income tax was reduced from the punitive 83 per cent to 40 per cent and the corporate tax rate was reduced from 52 per cent to 30 per cent. Yet this has not eliminated the tax avoidance industry nor reduced tax avoidance which now costs the UK around £100 billion each year. The reduction in headline tax rates was accompanied by an increase in indirect taxes (or VAT) to 17.5 per cent. This means that the UK taxation system has become more regressive as the less well-off now pay a higher proportion of their income in taxes. The UK experience does not serve to support the claims of the flat tax advocates.

It is claimed that countries like Slovakia have benefited from the introduction of a flat rate of tax. On 1 January 2004, Slovakia adopted a flat rate of 19 per cent for individuals and companies. Previously, Slovakia had a progressive system of taxation under which individuals paid income tax at the rate of 10, 20, 28, 35 or 38 per cent, depending on their income. Now, everyone earning above a certain threshold pays tax at the flat rate of 19 per cent.

Similarly, the corporation tax rate of 25 per cent has been reduced to 19 per cent. At the same time, the dividend tax has been eliminated to appease multinational corporations and
tax holidays of up to five years can be granted to certain firms with foreign capital.

Of course, multinationals continue to launder profits through tax havens, transfer pricing, arbitrary allocation of costs, income, profits as well as the abuse of residence and domicile rules – thus managing to escape even the reduced 19 per cent tax rate. Resident companies are taxed on worldwide income; non-residents are taxed on their Slovakian source income only, thus giving them further incentives to launder profits.

Large multinationals tend to remain headquartered in the more advanced economies where they have access to the infrastructure that enables them to function. Operations in countries such as Slovakia usually create few jobs as they are run by skeletal staff.

The introduction of the flat rate of tax at 19 per cent in Slovakia may mean that the country attracts more inward investment. This carries the danger of unleashing a tax 'race to the bottom', where competitor economies may emulate with even lower taxes.

Moreover, revenue shortfalls have to be made up for in order for the government to fund investment. This has meant that other sectors of the economy and the less well-off have been penalized. Prior to 2004, Slovkia had two rates of VAT; a standard rate of 20 per cent, and a reduced rate of 14 per cent on many essential items. This has now been replaced by a single standard rate of 19 per cent.

The flat rate tax in Slovakia has been hailed as a success because it resulted in an increase of tax revenues from SK 200 billion in 2003 to SK 209 billion in 2004. However, The Financial Times (29 March 2005) reported that "income tax revenues fell 21 per cent. The government covered most of the shortfall with higher excise and sales taxes".

This illustrates how flat taxes shift the tax burden onto consumption and labour, yet official sources are silent on this shift and its social consequences.

Local employers are penalized to appease multinationals. Local employment is taxed heavily. For each employee, the employer has to make a social security contribution of 35.2 per cent of the salary. The employee's contribution is 13.4 per cent of the salary. This covers state pension, unemployment and care insurance. Employers are obligated to deduct the amount of tax and national insurance due from salaried workers each month.

This means that the employee suffers an effective tax rate of 32.4 per cent (19 per cent + 13.4 per cent) whilst the employer (companies) suffer an effective tax rate of 54.2 per cent (19 per cent + 35.2 per cent). This is much higher than in most Western European countries. It penalizes local employers and distorts competition by favoring "brass plate" operations. Many Slovaks are unable to save for a decent pension.

Under instructions from the IMF, the Slovakian government has implemented a form of “shock therapy” including a raft of privatisations and tax breaks for companies. Further plans to reduce labour costs and rights are being developed. The pension reform applicable from 2004 has increased the statutory retirement age from 60 for men and 55 for women to 62 for both. Further plans to raise it to 65 are being considered.

Flat rate taxes are designed to work people to death.

Prem Sikka is a Professor of Accounting at the University of Essex and a Senior Adviser to the Tax Justice Network

Flat refusal: what commentators in the UK press have said about a flat rate tax

Victor Keegan. The Guardian. 1 September 2005

"There is something about flat rate taxes and social justice that just do not mix."

David Walker. The Guardian. 6 September 2005

"Flat taxes are inherently a device for protecting the incomes of the better off."

"Flat tax isn't really about tax at all. It's about spending. Look at the idea's provenance: the Hoover and Adam Smith Institutes. Their game is cutting government."

Martin Wolf. The Financial Times. 8 September 2005

Martin Wolf describes the flat tax as an idea that has been "grossly oversold". Giving a number of reasons why a flat rate tax wouldn't work in the UK context, he adds: "…any fiscally responsible flat tax – one that would generate as much revenue as before – would produce a large number of losers, most of them falling in the middle of the income distribution. The reason for this is that the new marginal rate would almost certainly have to be considerably higher than today's basic rate. I cannot imagine that any party would dare to fight an election promising to make multi-millionaires vastly better off at the expense of teachers, junior doctors and skilled workers."

Will Hutton. The Observer. 11 September 2005

"The flat-tax campaign is rather symptomatic of a feeding frenzy of the rich that so far has gone unchallenged by our political class in general and our left-of-centre politicians in particular or, indeed, by society at large."

Heather Stewart. The Observer. 11 September 2005

"The right-wing Adam Smith Institute, one of the few groups to have produced detailed proposals for a flat tax in the UK so far, admits that its plan…would initially result in a £60 billion reduction in annual government revenue."

Philip Stephens. The Financial Times. 12 September 2005

Commenting on the huge hole in the public finances that a flat tax in the UK would create, Philip Stephens, associate editor of the *Financial Times*, writes: "The economics of the flat tax are at very best dubious….You have to have an awful lot of faith in supply side economics to believe it would be filled by an explosion of enterprise."

He adds: "The gains for those on low incomes are minimal. Most of the tax paid by the poor is value added tax. ...Conversely, the big gains from abolishing the top rate of income tax go the richest."

OPINION: Fiscal Erosion in Latin America

Oscar Ugarteche

Over the last twenty years, many Latin American countries have suffered 'fiscal erosion'. The combination of three simultaneous processes – the rapid growth of the offshore industry, global financial liberalisation, and sweeping economic reforms introduced in many developing countries – has led to a massive increase in the level of cross-border capital flows passing through tax havens in order to avoid taxation. This trend, coupled with the generous tax breaks offered by individual countries in order to attract investment, have created large holes in government financing.

TNCs abuse offshore

Trans-national companies (TNCs) investing in Latin America often channel their investments through offshore subsidiaries in order to avoid paying tax in both the country where they are operating and where they are headquartered. In Peru, one third of total registered foreign investment in the CONITE (Commission on Foreign Investment & Technology) originates from a tax haven. This figure is about the same for Latin America as a whole.

Tax breaks trigger a tax 'race to the bottom'

Countries in the region have also introduced a range of tax incentives with the objective of stimulating economic activity in certain regions, encouraging particular sectors or attracting foreign investment. The granting of tax breaks is often determined by the degree of influence that various interest groups have to press for favourable treatment. Despite their widespread popularity, tax incentives used to attract foreign investment often spark a tax 'race to the bottom' among countries in the same region, resulting in insufficient and falling tax revenues.

The mining industry

In order to encourage the sector, mining companies in many countries in Latin America are exempt from paying VAT on capital goods needed to develop their business. In Bolivia, the mining industry is exempt from paying income tax in those areas where the government wants to encourage the mining sector. Until recently mining operations in Chile and Peru were not subject to payment of royalties (although the law has recently changed in Chile). The legal vacuum with regard to the taxation of the mining industry in Chile has caused considerable problems over the years, allowing firms to pay significantly less tax than they should have been.

Many Latin American countries allow mining firms to use accelerated depreciation, thereby reducing their net profits and so their tax liability, in an attempt to attract foreign investment. This is also the logic behind the lack of environmental provisions for the mining industry in Latin American countries.

TAXATION IN THE LATIN AMERICAN MINING SECTOR

	Argentina	Brazil	Chile (Oil)	Chile (Mining)	Ecuador	Colombia	Bolivia	Peru
VAT on capital goods	û	ü	û	û	û	ü	û	û
Royalties	ü	ü	û	û	ü	ü	ü	û
Accelerated Depreciation	ü	û	ü	ü	û	ü	û	ü
Income Tax on operations	ü	ü	ü	ü	û oil exploration	ü	ü	ü
Environmental Provision	ü	û	û	û	û	û	û	û

Falling revenues

Companies investing in Latin America, both foreign and domestic, have made extensive use of tax havens in order to avoid paying tax. In addition, investment incentives in the form of tax breaks have been widely used by Latin American countries, including in the agricultural, mining and financial services sectors. This has sometimes resulted in countries, such as Chile and Peru in the mining sector, engaging in a tax 'race to the bottom' in order to attract more investment.

In countries with a higher degree of economic openness, such as Chile and Mexico, there is a tendency towards stable fiscal revenues; where increases in GDP growth are not accompanied by a rise in tax receipts. This means that there is no direct relationship between increases in GDP and fiscal revenue.

So, paradoxically, increased economic openness, accompanied by tax reforms, has failed to deliver expected improvements in state finances. In theory, fiscal reforms should have broadened the tax base and resulted in increased revenues, but the liberal use of tax breaks has prevented this from happening.

The experience of Peru illustrates a trend which is fairly widespread in Latin America. During the 1990s, corporate taxation became increasingly less important in the country's overall tax system. This was a deliberate policy, backed by the IMF, to increasingly base the fiscal framework on taxation of consumption as a way of encouraging private sector investment. By 1994, some 80 per cent of the country's tax revenues were dependent on consumption taxes. At the same time, tax breaks were aimed at increasing private investment by allowing firms to make higher profits. When the IMF itself stated in a report of 2000 that Peru's tax system should be more progressive, the business lobby argued that this would damage the country's competitiveness – and so the advice has been ignored.

Preventing fiscal erosion

The offshore world needs to be dismantled, and this process should be accompanied by agreements to end or equalise the various tax exemption schemes so that they no longer contribute to the erosion of state financing – and thereby threaten the very viability of nation states.

Evidence from the United States and various countries in Latin America also suggests that current taxation systems are predominantly based on consumption taxes, and are therefore openly regressive. This goes against the principals of good governance and equity, which are necessary bases for sustainable growth. Competition on tax breaks to encourage private investment serves only to fuel a tax 'race to the bottom' eroding the fiscal sustainability of all countries.

Oscar Ugarteche is a Senior Researcher at the Instituto de Investigaciones Económicas at the Universidad Nacional Autónoma de México (UNAM) and a member of the Tax Justice Network's International Steering Committee.

TJN and Christian Aid join forces to achieve tax justice

On 12th September, Christian Aid launched a report on tax justice entitled ***The Shirts Off Their Backs: How tax policies fleece the poor*** to coincide with the publication of the TJN report ***tax us if you can*** in the UK. Here is a selection of the media coverage for the two reports:

UK. **BBC News, web edition**
12 September 2005
'Tax dodgers "rob poorer nations"': article covers the Christian Aid report, with mention of TJN and quotes from Andrew Pendleton, author of Christian Aid's *The shirts off their backs*.

UK. **Reuters AlertNet**
12 September 2005
'Company tax dodgers derail bid to end global poverty': article with coverage of both reports, with quotes from Andrew Pendleton.

UK. **The Herald**, Scotland
12 September 2005
'Christian Aid report accuses firms of "ripping off the poor"': article covering both reports with a discussion on corporate tax evasion.

UK. **The Guardian**,
14 September 2005
'Foreign investment not doing the job for Africa': article on the limited beneficial impact of FDI in Africa and the problem of capital flight, with a mention of *tax us if you can*.

UK. The **Observer**,
18 September 2005
'British tax havens "help cheat Third World out of billions"': article with quotes from Andrew Pendleton.

India. The Financial Express,
20 September 2005
'Tax havens to blame for the hell in developing countries': article featuring extensive quotes from the Christian Aid paper.

You can download ***tax us if you can*** – in English, French and Portuguese – from the TJN website:

(w) www.taxjustice.net

You can download ***The Shirts off Their Backs: How tax policies fleece the poor*** from the Christian Aid website: (w) www.christian-aid.org.uk

Printed copies of the English edition of ***tax us if you can*** are available for purchase from the International Secretariat info@taxjustice.net at €12 per copy – including postage.

The next edition of Tax Justice Focus will focus on capital flight.

CALENDAR OF EVENTS

2005	Tax Justice Network	General
October 5	Madrid, Spain: debate on Global Taxation, part of a discussion series on Global Economic Justice organised by Attac Spain and the Ateneo de Mardrid. For more information: www.attacmadrid.org	
October 13-14.	Basel, Switzerland: International Sustainability Conference, University of Basel. Presentation on aggressive tax avoidance by André Rothenbühler, Aktion Finanzplatz Schweiz For more information: www.isc2005.ch or afp@aktionfinanzplatz.ch	
November 2		Mass lobby of MPs at UK parliament on trade justice as part of the Make Poverty History Campaign. See: www.makepovertyhistory.org
November 8-9	Tax Justice Network Germany and Evangelische Akademie Berlin. Conference: *Tax Justice and the chances of international regulation.*	
November 19	Stockholm, Sweden. The Socialist Forum of Sweden, Discussion on International Tax Policy, Sven Giegold (TJN) on panel	
December 5-9		Geneva, Switzerland. ECOSOC Financing for Development: First meeting of the Committee of Experts on International Cooperation in Tax Matters. For further information see: http://www.un.org/esa/ffd/ffdtaxation.htm
December 8	Wiesbaden, Germany: panel discussion with the local Liberal Deputy on international tax competition.	
December 13-18		6th WTO Ministerial Conference Hong Kong, China. See: www.wto.org
January 2006 25-29	Public Eye on Davos Awards, Switzerland:	World Economic Forum 'Mastering our Future', Davos, Switzerland. See: www.weforum.org The Public Eye on Davos Awards 2006 (January 25) See: www.evb.ch
January 24-29		Polycentric World Social Forum 2006: *Americas*: Caracas, Venezuela (with the 2nd Americas Social Forum); *Asia*: Karachi, Pakistan; *Africa*: Bamako, Mali See: www.forumsocialmundial.org.br