THE HIDDEN BILLIONS FOR DEVELOPMENT

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Aggressive tax avoidance by transnational companies results in huge tax revenue losses for developing countries and in under-investment in social and physical infrastructure. Tax avoidance is a major barrier to reach the **Millennium Development Goals** (MDG) of the **United Nations**.

«As firms grow, they provide a larger source of tax revenues to the government, which in turn supports increased public investments.» *(Investing in Development. UN Millennium Project 2005).* In its report on the MDG published last week, the UN defined tax paying as one of the potential contributions by the private sector to supporting the MDGs. We from the global **Tax Justice Network** wish this quoted sentence would correspond with reality. But it does not! Quite the opposite!

Aggressive tax avoidance, unregulated international tax competition, and non-payment of tax on flight capital are particularly disastrous for the developing world. Whilst the tax avoidance industry is clearly damaging to the interest of developed countries, it is almost certain that harmful tax practices are an even greater problem for economies in transition and developing countries.

We know since April of last year, when the **General Accounting Office** (GAO) – a kind of business inspectorate working for the **U.S. Congress** - published its report, that two-thirds of the companies operating in the USA paid no federal taxes on their profits between

1996 and 2000. For the year 2000, 94% of all US firms paid taxes of less than 5 % of their profits. A 2001 US Senate report put the amount of taxes consequently foregone at US$45 billion annually.

In the absence of powerful and sophisticated tax authorities like the **US Inland Revenue Service**, it is even easier for transnational companies and for rich local elites to erode the potential tax base in developing countries than in well developed states. According to **Oxfam GB**, a leading development NGO, the revenue losses to developing countries from tax competition, harmful tax practices amounts to at least US$ 50 billions annually. This is a very conservative estimate.

This $50 billion loss is nearly the equivalent to the annual official aid of the OECD-countries to the developing countries. It is the same amount that is required by the **World Bank** and by the UN to achieve the Millennium Development Goals. It is also equivalent to six times the estimated annual costs of achieving universal primary education. And it is almost three times the cost of universal primary health coverage.

Capital mobility enables multinational corporations to choose between different jurisdictions according to the preferential tax terms and other benefits on offer. Transnational companies put pressure developing countries to keep tax rates on companies' profits and capital very low. They are permanently lobbying governments of developing countries for tax holidays. They are demanding that governments provide free or cheap infrastructure services (roads, ports, railways, electricity etc). Developing countries are competing with each another to provide better conditions for transnational companies to attract their foreign direct investments.

The revival of foreign direct investment in developing countries, confirmed two weeks ago by **UNCTAD**, is likely to intensify competition between governments seeking to attract new investors. Tax has become one of the most used instruments at governments disposal despite the fact that economists usually disapprove of the use of tax incentives to attract business. The main argument of many economists: tax incentives generally do not justify the cost by creating a sustainable increase in investment. Even the **International Monetary Fund** found in studies that such tax incentives do not pay! And a study published in 2003 by consulting firm **McKinsey** concluded that fiscal inducements offered by four major emerging countries – China, Brazil, Mexico and India – had negative and unintended consequences. *«Without materially affecting the volume of investment in most cases»,* said McKinsey, *«popular incentives such as tax holidays, subsidized financing or free land, serve only to detract value from those investments that would likely be made in any case. »*

The proliferation of such tax breaks leads to a 'race to the bottom' and is responsible for the loss of tax revenue at least of US$ 35 billion of the above mentioned 50 billion a year. It results either in a transfer of the tax burden to labour and consumption, which in both case is socially regressive, or in a net reduction in the revenues available to the state to invest in social and physical infrastructure.

These tendencies have prompted some initiatives to achieve greater co-ordination of corporate income taxation. The EU and OECD have both introduced some limited forms of co-operation in the last years. And some West African countries have also started to make efforts to harmonise their tax incentives for foreign direct investment to reduce ruinous tax competition.

The Tax Justice Network welcomes such initiatives, even if they are not far-reaching enough. We also welcome the upgrading of the former high-level expert group of the UN towards a inter-governmental organization. The Tax Justice Network supports the proposal to integrate the fight against international tax evasion into the discussion of new and innovative resources for development financing. We will follow other global initiatives to counter harmful tax practices. There is a strong need for a multilateral framework that will better balance the need for sovereign states to protect their tax revenues from aggressive tax avoidance. At the same time measures are needed to empower countries, especially developing countries, to stem their tax losses and to resist pressure from transnational corporations to degrade their tax regimes.

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Investing in Development. A Practical Plan to Achieve the Millennium Development Goals. UN Millennium Project. Jeffrey D. Sachs, Director. < http://unmp.forumone.com/index.html >.