HAVING THEIR CAKE AND EATING IT TOO

THE BIG CORPORATE TAX BREAK

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HAVING THEIR CAKE AND EATING IT TOO: EXECUTIVE SUMMARY

A wake up call

'In this world nothing is certain but death and taxes', the late Benjamin Franklin once famously said. But for corporations, taxes constitute anything but a certainty. Statutory corporate tax rates are plummeting whilst business keeps finding more and more ways of getting around paying taxes at all. In just two decades, governments have asked for fewer contributions from business by cutting tax rates by a third, inventing a plethora of tax exemptions, and lavishly handing out tax holidays. Corporations, particularly those that are multinational, have returned the favour by expatriating their profits to tax havens and engaging small armies of lawyers and accountants to find them new tax loopholes.

As problematic as this development is in itself, its current timing and future trends make it even more worrying and challenging. The parallel tendencies of corporations sharpening their skills in tax avoidance and governments competing against one another in cutting corporate tax rates come at a time when economies and societies might soon need corporate contributions more than ever. There are several reasons for this:

- The continuing trend towards a global labour market has given capital an upper hand not seen since the industrial revolution and boosted profits to their highest level in decades. With current global labour reserves, technological developments and waves of market liberalisation and deregulation, the current context is characterised by stagnating wages and soaring profits, and the near future looks to be the same. Relying on the income and spending of wage earners to finance ever larger parts of public finances will either hollow out government budgets or lower workers' incomes.

- Corporations increasingly base their success on institutional and societal competitiveness, in short the qualities of the societies they are part of, typically financed by public funds, rather than qualities they have built and developed independently of these. As a result, more and more government spending is used to enhance such competitiveness. Not just equity but efficiency considerations would suggest that corporations, not just their workers, should contribute substantially to the investments and expenditures that make them flourish.

- Ownership structures of private business are becoming more international on a daily basis. This means that more corporate profits in the form of dividends escape national tax collection, and thus contribute nothing to the spending and investments necessary to maintain and extend institutional and societal competitiveness – a trend that from day one is undesirable for countries and their citizens, and in the long term even goes against the interests of the companies. If tax on corporate dividends increasingly eludes national taxation, then taxing corporate profits should surely be the first place to look for compensation.

- The system of employer-provided welfare is disintegrating. From China to the US fewer and fewer employers are willing to provide health care and pensions. Welfare schemes are being scaled back and costs shifted to workers. As inequality grows, in a not too distant future governments may well have to patch up the social safety net by picking up more of this tab. That will require new public funds – and corporations should chip in their share.

With corporate tax rates in industrialised countries falling from around 45% to 30% in a couple of decades and intensified tax competition in the new millennium, corporate tax rates are fast approaching rock bottom. Add to that the growing number of multinationals paying either no tax at all or being taxed way below statutory rates, due amongst other things to the rise of tax havens, and you might see a future where corporate profits are sheltered from having to make any kind of public contribution.

Fortunately, that future is not yet here. Whilst on a worldwide scale, corporate taxes – due to broadened tax bases and rising profits – roughly make up the same amount of GDP and total tax revenue as they have done for decades, as recent developments show, they are not destined to do so forever. And they will definitely become a thing of the past if governments and business keep complementing each others' efforts to make them history. This report serves as a long-overdue wake-up call – we must act now if we are to avert further inequality and a world where corporations are a fiscal law unto themselves.

Going down

For more than a century, governments have experimented with different combinations of corporate tax rates and bases, weighing the incentives and disincentives of their policies on investment and economic development against the need for raising public funds. In most countries, corporate taxation was rather limited and its impact insignificant in the beginning of the twentieth century, peaked during World War II and the post-war years, and has been on a steady decline since then. Though over the last century there have been some similarities between countries' policy choices, it is not until the last few decades that these have become real parallel developments. However, as interde-

pendence between countries and the importance of economic links between them has become unprecedented, so have national corporate tax rates been converging internationally.

More domestically-based companies have become multinational and more foreign companies have set up operations within countries. This has made corporate taxation all the more difficult and complicated. In particular, the mobility of multinationals – away from countries they are 'unsatisfied' with and to those that answer their demands – has put pressure on governments to reduce corporate income taxes in order to remain attractive capital investment locations. Indeed, taxation has become an active tool in attracting and maintaining capital, and many governments have referred to international competition when cutting corporate tax rates.

For example, the UK Chancellor of the Exchequer stated in his 1997 budget speech that, "I want the United Kingdom to be the obvious first choice for new investment. So I have decided to cut the main rate of corporation tax by 2 percent from 33% to 31%, the lowest ever rate in the UK. This means that we will have the lowest corporation tax rate of any of our major competitors". And in its 2000 budget, the Canadian government stated that "In recent years, many industrialized countries have either reduced their corporate tax rates or announced their intention to lower them. If no action were taken, Canada's general corporate tax rate would not be competitive with those of our trading partners. The Government's objective is to reduce, within five years, the federal corporate income tax rate to 21% from 28%." But the advantage gained by one country from lowering its taxes is often short term, as it is frequently quickly offset by similar moves in neighbouring countries. This leads to long term revenue losses in all countries that engage in such short-sighted competition.

The mobility of multinational companies has increased within the last 20 years. In this period corporate tax rates have fallen by a third, from around 45% to less than 30% on average in the 30 OECD countries. And a similar development has taken place in forty five non-OECD countries where rates have dropped from just above 40% to a little less than 30%. Lately, however, the mobility of multinationals has increased further and tax competition has intensified. In just five years, from 2000 to 2005, 24 out of the 30 OECD countries have lowered their corporate tax rates. Only six OECD countries have so far kept their rates steady. And no OECD country has raised its rates in the period. On average, rates in all OECD countries have dropped from 33.6% in 2000 to 28.6% in 2005. In these years, major cuts have taken place in Austria, from 34% to 25%, Germany, from 52% to 39%, Greece, from 40% to 32%, Iceland, from 30% to 18%, Ireland, from 24% to 12.5%, Poland, 30% to 19%, Portugal, from 35% to 27%, and the Slovak Republic, from 30% to 19%. Outside the OECD this practice has been mirrored during the same five years in countries such as Bangladesh, where rates have fallen from 35% to 30%, Brazil, from 37% to 34%, India, from 38.5% to 33.5%, Pakistan, from 43% to 35%, Panama, from 37% to 30%, and Singapore, from 26% to 20%.

In the European Union in particular – due to the easy mobility of capital, investments and companies within the union – many of the 25 member states have engaged in active competition on lowering statutory tax rates. The accession of ten 'new' countries in 2004, which on average rely less on corporate taxation to finance their budgets, has intensified this rivalry. Thus, in the ten years from 1995 to 2005 the average statutory rate in the 'old' member states fell by 8.1 percentage points whilst falling by 10.8 percentage points in the 'new' ones. And as the 'new' members of the union started out with lower rates than the old ones, by 2005 their average nominal tax rate was ten percentage points lower than in the 'old' member states.

In spite of these already dramatic falls, statutory corporate tax rates in Europe will continue their race to the bottom. In 2005, a handful of 'old' member states lowered their corporate tax levels: Austria, as already mentioned, by nine percentage points, Finland from 29% to 26% and Greece from 35% to 32%. In 2006, the Czech Republic will reduce its rate from 26% to 24%, and Estonia will cut its rate by two percentage points annually over the next two years to reach 20% in 2007. Germany is currently preparing a major corporate tax overhaul, and the accession of Romania and Bulgaria in 2007 will further increase the downward pressure on rates, as taxation in these countries is well below the EU level: in Bulgaria the government reduced the corporate tax rate from 19.5% in 2004 to 15% in 2005 and in Romania a flat rate of 16% for income and corporate profits was introduced in 2005.

Minimum taxation and regulation, maximum discretion and secrecy

Tax competition, however, does not only take place in the form of more-or-less transparent drops in statutory rates. Just as widespread is the effort to attract investments by granting multinational corporations special conditions such as tax deductions or tax holidays, i.e. periods where they are exempted from taxes. One way of doing this on a more or less permanent basis, which consequently makes the 'holidays' multinationals enjoy much longer than the vacations most human beings will accumulate in a lifetime, is the use of export processing zones. Such zones usually provide companies with exemptions from import and export duties, capital gains taxes, property and land taxes, sales and consumption taxes, together with tax holidays for corporate profits of ten or 20 years at a time. A few decades ago there were only a handful of these worldwide, by 1998 they had reached 850, and by 2004 there were more than 5,000 of them.

Though export processing zones are promoted as an easy way for countries to earn badly needed foreign currency, and thus may be set up with funds from international institutions such as the World Bank, their positive impact on economies and societies is as absent as their tax contributions. As they regularly flaunt labour laws, ban trade unions, and violate a range of human rights, their development effect is negligible or indeed negative. In fact, such zones often require a lot of government

investment in infrastructure, are isolated from the economic environment of their host countries, and either just host low-tech, labour intensive industries or fail to transfer technology to the industries on the other side of their fences. Beside forcing corporate taxes downwards, they risk in the end being a cost rather than a benefit to the countries they are established in.

Tax competition has been taken to its extreme by the steadily growing number of so- called tax havens. Their low taxes and thin financial regulatory regimes attract not only wealthy individuals but also multinational corporations that use them as shelters from corporate taxation. There are at least 73 countries and territories that fit the classification of a tax haven – half of them have been established within the last 25 years. They are sovereign states, colonial territories and parts of sovereign states that enjoy partial autonomy. And their various traits attract distinct clientele. Though they still primarily cater to individuals, a growing number of companies are now taking advantage of their services as well. This is either done by artificially relocating headquarters to a tax haven – not much more than a paperwork transaction, such as a P.O. Box in Bermuda or a brass plate on an office building in the Bahamas – or by setting up subsidiaries in such places. Both practices are widely used.

As the raison d'etre of tax havens is their secrecy, it is hard to estimate the scale of tax income lost due to them. The exercise has, however, been attempted with regard to money made from the total assets – not just accounting for what is lost on corporate profits – held offshore in such jurisdictions. One study showed that the taxes not paid on the returns made on such funds amounted to more than US$ 250 billion a year. Another study set a conservative estimate of the revenue losses due to tax havens for developing countries at US$ 50 billion annually – the equivalent of the annual aid flows to these countries or six times the estimated annual costs of achieving universal primary education. Though the financial policies of tax havens might be seen as a fair route to economic growth and prosperity for such impoverished small states, it is clear that the main beneficiaries of tax havens are foreigners and not local residents. Add to that the corrupt and illegal practices by business, criminals and dictators that tax havens often enable to flourish, as well as the contribution to tax avoidance, tax evasion and downward tax pressure on onshore countries that they cause, and it is hard to see the sound arguments for their lack of taxation, minimal oversight and maximum secrecy.

Crumbling from within

Big business' tax contribution to public finances and society in general is not only deteriorating through cuts in statutory corporate tax rates, the rise of export processing zones, and the spread of tax havens. The basis on which corporate taxes are collected and the extent of deductions, exemptions and other loopholes enacted by governments, be it in order to please special interest groups or in the sincere hope of maintaining jobs, is just as prominent a trend when it comes to tax com-

petition. In fact, official tax rates only tell part of the story of how much companies are taxed. This is most evident in one of the countries that has kept its statutory tax rate high and steady for more than a decade. Although the overall tax rate in the US, counting both federal and state taxes, has been 39% since the mid 1990s, over the last ten years the country's largest corporations have paid less and less taxes, and corporate taxes have had an only minor role in financing public spending. Overall, corporate taxes in the US have dropped from 9.4% of all tax income in the 1990s to 7.5% in the first four years of the new millennium, and from 2.6% of GDP in the 1990s to 2.1% of GDP from 2000 to 2003. If looked at from a longer perspective, the fall is even more significant: in the 1970s and the last five years of the 1960s, corporate taxes on average made up 11.7% and 16.1% of all tax revenue, and 3.0% and 4.2% of GDP.

Whilst economic cycles can skew such statistics by using averages for each decade, the main trend evident in these developments is very obvious. The chief determinant is not difficult to identify: through the years US lawmakers have generously handed out corporate tax rebates en masse. Legislation enacted in 2002 and 2003, for example, gave business tax subsidies of US$ 175 billion over a three year period.

In Japan, the world's second largest economy and a country where corporate taxation for several decades has made up a substantial part of total taxation, the tendency of business contributing markedly less to public finances is even stronger than in the US. In the first four years of the new millennium, corporate taxation made up 13.0% of total tax revenue, down from 16.8% in the 1990s and 21.6% in the 1980s. As a share of GDP, corporate taxation is down from 6.0% in the 1980s and 4.6% in the 1990s to 3.4% in the period from 2000 to 2003.

In Germany, the world's third largest economy, revenue from corporate taxation, as part of both total tax income and GDP, has fluctuated much more than in Japan and the US. Nevertheless, a clear downward trend is also visible here: in the 1980s corporate taxation on average made up 5.4% of total tax revenue, in the 1990s it made up 4.0%, and in the first four years of the new millennium it made up 3.2%. Similarly, on average it made up 2.0% of GDP in the 1980s, 1.5% in the 1990s, and 1.2% in the period from 2000 to 2003.

In the UK – the world's fifth largest economy in 2005, and a country that has kept its corporate tax rate more or less stable in the last ten years - the rate was cut from 33% to 31% in 1997 and has remained at 30% since 1999. Business is also contributing less and less to public spending, both when measured overall and at the company level. In the 1980s corporate taxation made up 10.6% of total tax revenue and 3.9% of GDP. By the 1990s these figures had dropped to 8.6% and 3.0% respectively, before regaining some ground by rising to 9.0% and 3.3% in the first years of the third millennium. Moreover, though nominal rates were steady, the UK authorities set 'expected tax rates' at decreasing rates every year from 2000 to 2004. The Italian experience, representing the seventh

largest economy in the world, does not appear as notable if looked at over several decades. Yet from the early 1990s, it shows the exact same tendency as the other major economies: corporate taxation dropped from 9.0% of total tax revenue in the 1990s to 7.3% from 2000 to 2003, as well as from 3.8% of GDP in the 1990s to 3.2% in the first four years of the new millennium.

In summary, five out of the seven largest economies in the world have seen corporate taxation decline over the last decades. Of the seven, only France has maintained a stable, in some years even increasing, contribution to public finances from business[1]. Most notably, in the US, Japan, Germany, and Italy – together representing close to half of the world's economy – the significance of corporate taxation to public finances has dropped by around 20% between the mid 1990s and today. Extending the view and looking at each country individually, corporate taxes as a share of total taxation have dropped by 15% in the UK since the 1980s, by 22% in Italy since the 1980s, by 41% in Germany since the 1970s, by 43% in Japan since the 1970s, and by 53% in the US since the late 1960s.

Same, same but different

The difference between tax avoidance and tax evasion is in principle vast - though recently, it appears in practice to have been the thickness of a lawyer's brief that has determined the distinction. Tax avoidance is legal while tax evasion is illegal. But the consequences of corporate tax avoidance and evasion are the same: fewer contributions from business and a larger burden on workers and consumers, or just less government funds to run states on.

When assessing the fall in corporate taxes and the risks it poses to our societies, the otherwise important question of legality can take a backseat to the pragmatic question of how much tax is avoided and evaded. At the end of the day, if there is a legal loophole, it should be fixed; if there are corporate delinquents, they should be punished. Whether avoidance or evasion is the main cause of the decrease of individual companies' tax payments on corporate profits is moreover hard to tell when the perspective is large-scale. That they have decreased, on the other hand, is obvious.

Scrutinising the financial records of 275 of the largest corporations in the US, a recent study found that these multinationals have become better and better at ducking when the tax authorities throw the rule book at them. In 1988, they paid an effective federal tax rate of 26.5%, in 1998 this was down to 21.7%, in 2001 to 21.4% and in 2003 to 17.2%. The statutory federal tax rate has been 35% since 1993 and was 34% for the corporations in question in 1988. Almost a third of these corporations, 82 of them to be precise, paid no taxes or received a tax refund in at least one of the three years between 2001 and 2003. And in 2003 alone, 46 of the companies paid nothing or got a refund, though they reported pre-tax profits of US$ 42.6 billion. In fact, 28 of the companies had negative federal income tax rates over the entire three years in spite of pre-tax profits at US$ 44.9 billion in

this period. Finally, between 2001 and 2003, the 275 companies proudly told their shareholders that they had made almost US$ 1.1 trillion in pre-tax profits. But they only reported about half of that amount, US$ 557 billion, to the tax authorities. The other half was effectively hidden away.

Across the water, a study launched in 2006 found that the UK's 50 largest corporations had paid US$ 38 billion (UK£ 20 billion) less in taxes on their profits during the five years from 2000 to 2004 than what could have been expected. And that this 'expectation gap' had increased over the years. It moreover showed that the difference between what the authorities expected them to pay and what companies ended up paying had increased from 4.2 percentage points in 2000 to 7.6 percentage points in 2004. This meant that on average they paid 22.1% in corporate taxes instead of the expected 29.7% - quite a difference. Extrapolating this tendency across all UK companies, the study found that the likely overall loss in tax revenue amounted to as much as US$ 17 billion (UK£ 9 billion) a year – or about 28% of all corporate tax receipts in the tax year 2004-05.

Besides lobbying law makers to continuously enact tax concessions, it seems clear that many corporations have become more efficient at avoiding and evading. Thanks to the growing sophistication and diversification of financial products and services, companies have plenty of lawful means by which to escape their responsibilities to contribute to society's needs. Among those many financial engineering tools, share-buy-back programmes stand out prominently as a true 'double whammy' by which corporations reduce their income tax base and shareholders see their investments inflate artificially.

With developments linked to globalisation, multinationals have found it even easier to take advantage of their ability to break themselves into many entities on paper, and treat completely phoney, non-existent transactions among those entities as if they really happened. And thus, as they typically operate in many jurisdictions through multiple subsidiaries, they have plenty of opportunities to move profits away from where they are earned and into places where they will not be taxed. Or, as happens just as often, they may borrow from one of their subsidiaries in a low-tax location, deduct the interests against income that otherwise would be taxable in a high-tax location, and at the end have these interests taxed little, if at all, by the low-tax location. As a third alternative, they may transfer the ownership of a trade name - often a very valuable asset - to a low-tax location and then charge their taxable operations large royalties to use the name, thus once more avoiding huge amounts of taxes. Whether legal or illegal, and most of these alternatives are actually within the law, the damage of such operations is evident and their ethics highly questionable.

Caught in a vicious cycle

Tax competition – whether it is through lowering rates, granting wide scale deductions, exempting special areas from taxes, establishing tax havens or spreading export processing zones out

over the world – inevitably leads to declines in the amount of taxes paid by corporations, a loss of public revenue, and a greater burden on individuals. As tax bases have been broadened while rates have been cut, globally the corporate tax crisis is still at bay. But there is a limit to how much corporate tax bases can be broadened. And in the OECD countries in particular, this limit is not far away. More self-evidently, even the broadest tax base will not matter when tax rates hit zero. If the linear trends in both OECD and non-OECD countries – the overall fall in corporate tax rates from more than 40% to less than 30% in just 20 years – are extrapolated and extended into the future, tax rates will hit zero by the middle of the century. And if the active tax competition we have seen the last five years continues at its present pace and volume, this will happen much earlier.

The irony is that the countries that have participated most actively in the downward tax competition have not even had the short term gains in the form of increased foreign direct investment they could have expected. In fact, the 'new' member states of the European Union have not received more investments from the 'old' member states in the years they have aggressively been cutting their corporate tax rates. The 'new' countries have on average attracted the same level of investments as before their sharp cuts, and the only consequence of their deteriorating tax rates has thus been falling corporate tax income. Similarly, the many tax subsidies given by US lawmakers in the last years to the country's biggest corporations, with the objective of increasing investments, have not had the desired effect. The corporations that took up the largest share of these tax savings, 25 companies garnering two thirds of the tax benefits given to the 275 companies from the study mentioned above, cut their investments in the areas these subsidies were supposed to motivate by 27% from 2001 to 2003.

Developments in several of the world's largest economies – the US, Japan and Germany in particular, where business' contribution to public finances has dropped by one fifth in ten years, and two fifths in 30 years – show that no country, no matter its size, can expect to keep the downward pressure on corporate taxes at bay by itself. Whilst the established wisdom is that large economies are less at risk of capital flight, need to do less to attract foreign investments, and should thus be under less pressure to engage in tax competition, it is the world's largest economies that have lost most corporate tax income over the last decades, whether the period examined is from the 1990s to the new millennium or from the 1960s until today.

While some of these losses might be explained by changing definitions of companies, i.e. more and more small businesses being taxed as individuals rather than corporations, another explanation, particularly for the losses endured in the last ten years, would seem to be the continuing rise in importance of multinational corporations. The world's multinationals, a majority of which originate in the largest economies, are by far the ones most adept in exploiting and abusing national tax systems. Due to their total size they can force many governments and authorities to grant them spe-

cial tax breaks, and by reason of their international scope they can shift around their revenue, profits, losses, and debt as they please.

Strikingly, the diminishing payments of taxes from multinationals come at a time when they have never been bigger, and should thus have an even more significant contribution to make to their societies – the 250 largest corporations in the US and the 50 largest in the UK have paid up to one third of all corporate taxes in these countries for the last couple of years. If they continue to reduce their tax payments year on year, the impact will certainly be felt by smaller companies, workers and consumers who will have to pick up the tab left by the multinationals. Moreover, and perhaps even more markedly, multinationals are set to pay less and less taxes at a time when their profits are booming and their employment payrolls are plummeting. Indeed, as a share of economic activity, many multinationals are seeing record high surpluses and some of the lowest employee commitments ever.

This is nothing but a vicious circle: multinationals are concentrating more and more economic activity and capital within their operations, paying less and less taxes, and employing fewer and fewer people compared to the size of their operations. Add to that the tendencies identified initially – business taking up a larger share of productivity gains than workers, the significance of institutional and societal competitiveness, increasing international ownership of companies, plus the blows to employer sponsored welfare systems – and you have a tax crisis, which is unjust, unreasonable and unsustainable.

Countering the imminent tax crisis

As already argued and illustrated, we are on the verge of a global tax shortfall that will increase the tax burden on labour and consumption, and cause a loss of revenue for governments that are dependent on that tax income to function, to provide all kinds of welfare and to keep their societies internationally competitive. In the long term, this will not only be detrimental to societies and their citizens but also to corporations themselves and to the business environments they operate in.

To counter this imminent crisis governments must understand that 'beggar-thy-neighbour' tax competition is leading to a damaging global loss of public revenues. The corporate world must realise that its competitiveness requires public investments and that it should pay its share of the financing of the social and other capital that it relies on. By forcing countries to lower corporate taxes, the business world will reduce its own ability to innovate, slow down its growth and ultimately undermine its future prosperity.

As the undermining of corporate taxation is occurring because countries are competing against each other and often being played against one another by multinational corporations, only multilat-

eral solutions can stop this downward spiral. The leadership of a few or a group of countries will not be enough. What is needed is a global recognition that all countries have a common interest in cooperating to achieve a minimum level of corporate taxation; and that to make a start, countries at comparable levels of economic development, and states geographically close to each other, should begin co-operating to eliminate the destructive effects of tax competition between themselves.

Whether governments, the international political community and its institutions actively do something constructive and worthwhile to limit harmful tax practices by both countries and companies depends on political will and dedication. And regrettably, it has precisely been the lack of political will and dedication that has hindered some of the most promising initiatives to combat harmful tax practices from thriving. Hence, though the OECD has done pioneering work on the issues of harmful tax practices, tax havens, transfer pricing and tax evasion it has several times been set back in this work by some of its largest member states. Within its member states, a necessary condition for combating harmful tax practices is support for the work of the OECD in this area.

In practical terms, the following avenues should be pursued to counter harmful tax competition and the abuse of tax systems by multinational corporations:

- The possibilities of establishing regional and global tax authorities, representing the interests of citizens, and ensuring that national tax systems do not have negative global implications, should be evaluated.

- The OECD's initiatives on harmful tax practices should gain broader political support and be backed by stronger financial commitments, recognising that it is currently the only multilateral agency with the capacity to deal with global tax issues.

- Export processing zones and other institutional arrangements that give certain companies, producers and employers tax advantages compared to other national actors, should be phased out.

- Comprehensive and automatic information exchange systems between all tax authorities, in order to fight tax evasion and facilitate better assessment and collection of taxes, should be developed.

- Corporations should be taxed where they operate, where their workers are and where real value is added, not in artificial tax havens where they carry out paper transactions or where they file corporate registrations.

- Standards requiring multinational corporations to refrain from harmful tax avoidance and evasion should be introduced as part of official and voluntary codes of conduct for these companies and for the tax planning industry.

- Corporate executives, together with their lawyers and accountants, should be made liable for criminal penalties for tax evasion.

REALISING THE DYSTOPIA: HOW TAX COMPETITION AND HARMFUL TAX PRATICES DRIVE CORPORATE TAXES TO THE BOTTOM

Corporate taxation has been around, in one way or another, for a good 100 years. But it might not be so forever. Indeed, it seems like corporate taxation might be a thing of the past in much less than 100 years. Ask the real experts, those who work with the issue every day, and they will give you a clear indication of what to expect.

“A few years ago, at the first World Tax Conference sponsored by the Canadian Tax Foundation, a corporate tax panelist asked for a show of hands from the audience of tax professionals. He asked, ‘How many of you think there will be a significant corporate income tax in industrialized countries ten years from now?’ Only a few hands went up. ‘How many of you think there won't'? Almost all hands were in the air. That response is not a scientific survey, but it shows which way the wind is blowing”, notes Thomas F. Field, a tax professor. [2]

Is getting nothing getting it right?

Governments can combine corporate tax rates and bases in a variety of ways and have done so for decades. When doing so they weigh the incentives and disincentives to investment and economic development of their policies against the need for raising public funds for a range of expenditure to ensure the competitiveness and welfare of their countries. The level and composition of corporate taxes influences the timing and magnitude of investment in plants, technology, research and development, and other business assets. Higher tax rates may reduce investment, though the influence of taxes on investment also depends on the tax treatment of expenditures towards investments, as most governments reward investments with tax rebates either through ‘depreciation allowances’ or lump sump tax subsidies. Hence, at the end of the day, there is no linear correlation between the two, and a relatively high level of corporate tax rates does not necessarily deter investments.

Countries and their governments have been trying to get the policy mix right for the last century. At the beginning of the twentieth century, corporate taxation was rather limited and its importance for

public finances somewhat insignificant in most countries. As industrial production matured and the construction of welfare states began, corporate taxation slowly picked up in significance, peaking around the Second World War and in the immediate post-war years. Since then however, corporate taxation – measured both against the income of individual companies, GDP and total tax income – has been in steady decline. But as competition for lowering corporate taxes intensifies and it is being suggested that corporate taxes might soon be history, it is worth considering whether getting nothing is getting it right when it comes to corporate taxes.

There have always been some similarities between the policy choices regarding tax policies in different countries, but it is not until recent decades that national corporate taxation has converged internationally, and that one country's tax reduction has been echoed by similar reductions in neighbouring countries. As interdependence between countries and the volume of economic links between them has reached an unprecedented extent, corporate taxation has become a somewhat international issue, though it remains a national choice, challenge and benefit.

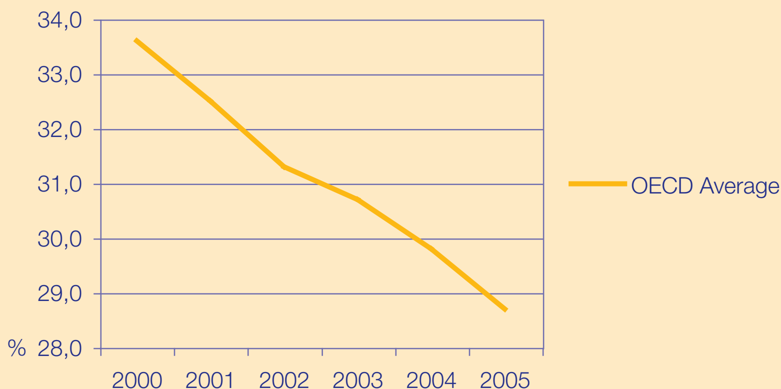
Many countries, perhaps the majority around the world, have found themselves in a situation where many multinational and foreign owned companies operate within them. This has made corporate taxation all the more tricky and complex. And it has started a trend of multinational companies playing countries off against each other, moving away, or threatening to do so, from countries they believe charge them too many taxes and into those that either have a low tax level in general or offer them special tax incentives. This has put pressure on governments to reduce corporate income taxes in order to remain attractive as investment locations and sites for capital accumulation. Taxation has thus become a much used tool in attracting and maintaining capital, with most cuts in corporate tax rates within the last ten to fifteen years explained and justified by international tax competition and the need to stay attractive to multinational capital. But as the advantage of such cuts in corporate tax rates is often negated by similar or further cuts in other countries, the gains of this kind of continuous cutting are indeed short term. And what is worse, they tend to lead to long term losses in all countries that engage in such rivalry.

The results of tax competition in the era of increasing globalisation and mobility of corporations and capital are clear: within the last twenty years, corporate tax rates have fallen by a third, from around 45% to less than 30% on average in the thirty OECD countries. And a similar development has taken place in the forty five non-OECD countries where rates have dropped from just above 40% to a little less than 30%.[3] If these linear trends were extrapolated and extended into the future, tax rates would hit zero by the middle of the present century.

As mobility of multinationals in the last five to ten years has increased, tax competition has intensified and the lowering of corporate taxes rates has sped up. Thus, between 2000 to 2005, 24 out of the 30 OECD countries lowered their corporate tax rates. Only 6 of them kept rates steady. And no

OECD country raised its rates in this period. In these years, major cuts took place in Austria, which cut its corporate tax rate from 34% to 25%, in Germany, from 52% to 39%, in Greece, from 40% to 32%, in Iceland, from 30% to 18%, in Ireland, from 24% to 12.5%, in Poland, from 30% to 19%, in Portugal, from 35% to 27%, and in the Slovak Republic, from 30% to 19%. These cuts, plus a series of cuts of less magnitude in other OECD countries, mean that average rates in all OECD countries have dropped from 33.6% in 2000 to 28.6% in 2005.[4]

TOP CORPORATE TAX RATE IN THE OECD



Outside the OECD this practice has been mirrored during the same five years, from 2000 to 2005, in countries such as Bangladesh, where rates have fallen from 35% to 30%, Brazil, from 37% to 34%, India, from 38.5% to 33.5%, Pakistan, from 43% to 35%, Panama, from 37% to 30%, and Singapore, from 26% to 20%.[5] In general, and not only in the new millennium but over recent decades, reducing statutory corporate tax rates has manifested itself as a global phenomenon. But tax competition, as will be elaborated later on, does not only take place in the form of cutting rates. In fact, in many countries, questions of how and on what basis corporate taxes are collected are used just as actively to attract investments and capital. And in many developing countries, tax exemptions and tax holidays – often given within the borders of export processing zones – have become the favoured means of appealing to foreign investors.

The true Euro-sclerosis

Because of the easy mobility of capital, investments and companies within the European Union, many of its twenty five member states are engaged, and have been for the last ten years, in fierce competition on who is willing to lower their statutory corporate tax rates the most. The accession to

TOP COMBINED FEDERAL AND STATE CORPORATE TAX RATES IN OECD COUNTRIES

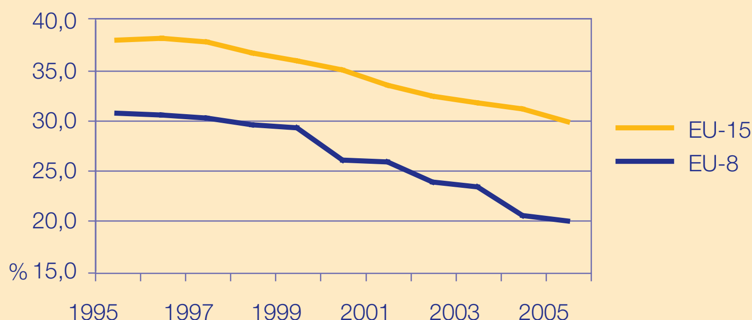
	2000	2001	2002	2003	2004	2005
Australia	34.0	30.0	30.0	30.0	30.0	30.0
Austria	34.0	34.0	34.0	34.0	34.0	25.0
Belgium	40.2	40.2	40.2	34.0	34.0	34.0
Canada	44.6	42.1	38.6	36.6	36.1	36.1
Czech Republic	31.0	31.0	31.0	31.0	28.0	26.0
Denmark	32.0	30.0	30.0	30.0	30.0	28.0
Finland	29.0	29.0	29.0	29.0	29.0	26.0
France	37.8	36.4	35.4	35.4	35.4	35.0
Germany	52.0	38.9	39.9	40.2	38.9	38.9
Greece	40.0	37.5	35.0	35.0	35.0	32.0
Hungary	18.0	18.0	18.0	18.0	16.0	16.0
Iceland	30.0	30.0	18.0	18.0	18.0	18.0
Ireland	24.0	20.0	16.0	12.5	12.5	12.5
Italy	37.0	36.0	36.0	34.0	33.0	33.0
Japan	40.9	40.9	40.9	40.9	39.5	39.5
Korea	30.8	30.8	29.7	29.7	29.7	27.5
Luxembourg	37.5	37.5	30.4	30.4	30.4	30.4
Mexico	35.0	35.0	35.0	34.0	33.0	30.0
Netherlands	35.0	35.0	34.5	34.5	34.5	31.5
New Zealand	33.0	33.0	33.0	33.0	33.0	33.0
Norway	28.0	28.0	28.0	28.0	28.0	28.0
Poland	30.0	28.0	28.0	27.0	19.0	19.0
Portugal	35.2	35.2	33.0	33.0	27.5	27.5
Slovak Republic	29.0	29.0	25.0	25.0	19.0	19.0
Spain	35.0	35.0	35.0	35.0	35.0	35.0
Sweden	28.0	28.0	28.0	28.0	28.0	28.0
Switzerland	24.9	24.7	24.4	24.1	24.1	21.3
Turkey	33.0	33.0	33.0	30.0	33.0	30.0
United Kingdom	30.0	30.0	30.0	30.0	30.0	30.0
United States	39.4	39.3	39.3	39.4	39.3	39.3
OECE average	33.6	32.5	31.3	30.7	29.8	28.7

Source: OECD Tax Database

the union of ten ‘new’ members in 2004 – countries that on average rely less on corporate taxation to finance their budgets than the ‘older’ member states – has only intensified this rivalry. In the ten years from 1995 to 2005 the average statutory rate in the ‘old’ member states fell by 8.1 percentage points while it fell by 10.8 percentage points in eight of the ten ‘new’ ones. As these ‘new’ members of the union started out with lower rates than the older ones, by 2005 their average nominal tax rate was 10 percentage points less than in the ‘old’ member states.[6]

Despite these already dramatic falls, statutory corporate tax rates in Europe will continue their race to the bottom. In Austria, rates were cut from 35% to 25% the year after the new countries joined.

AVERAGE TOP CORPORATE TAX RATES IN EU-15 & EU-8



Counting in special deductions, the effective level of taxation is approximately 21%. Emphasising the tax practices of the country's long-time neighbours and new partners in the EU, among them the Slovak Republic with a top statutory corporate tax rate at 19% and Hungary with 16%, when Austria's finance minister in 2004 announced his country's new corporate tax system, Karl-Heinz Grasser stated that, "This was, for sure, causing trouble for us", before pointing out, "We are convinced this is a huge step forward for Austria as an investment location and for creating new jobs."[7] .

A handful of other 'old' member states also lowered their corporate tax level in 2004 and 2005 - Denmark from 30% to 28%, Finland from 29% to 26%, Greece from 35% to 32%, and the Netherlands from 34.5% to 31.5%. In 2006, the Czech Republic will reduce its rate from 26% to 24%, and Estonia will cut its rate by 2 percentage points annually over the next two years to reach 20% in 2007. Germany is currently preparing a major corporate tax overhaul. The accession of Romania and Bulgaria in 2007 will further strengthen the downward pressure on rates, as taxation in these countries is well below the EU level: in Bulgaria the government reduced the corporate tax rate from 19.5% in 2004 to 15% in 2005 and in Romania a flat rate of 16% for income and corporate profits was introduced in 2005.[8]

The 'new' member states of the European Union also differ from the older ones in relation to how and on what basis they tax corporations. Thus, they have a more extensive system of depreciation rules, exemptions and subsidies, and in effect tax corporations even less than what their statutory rates indicate. A UN study shows that in 2004, companies were taxed almost 2.5 times as much in the EU-15 as in the EU-10 in spite of statutory tax rates only being 50% higher in these countries.[9] Another study, comparing the Nordic countries with some of the new member states, confirms this marked difference.[10]

TOP COMBINED FEDERAL AND STATE CORPORATE TAX RATES IN EU-15 & EU-8 COUNTRIES

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Austria	34	34	34	34	34	34	34	34	34	34	25
Belgium	40.2	40.2	40.2	40.2	40.2	40.2	40.2	40.2	34	34	34
Denmark	34	34	34	34	32	32	30	30	30	30	28
Germany	56.8	56.7	56.7	56	51.6	52	38.9	39.9	40.2	38.9	38.9
Greece	40	40	40	40	40	40	37.5	35	35	35	32
Finland	25	28	28	28	28	28	29	29	29	29	26
France	36.7	36.7	36.7	41.7	40	37.8	36.4	35.4	35.4	35.4	35
Ireland	40	38	36	32	28	24	20	16	12.5	12.5	12.5
Italy	52.2	53.2	53.2	41.3	41.3	37	36	36	34	33	33
Luxenbourg	40.9	40.9	39.3	37.5	37.5	37.5	37.5	30.4	30.4	30.4	30.4
Netherlands	35	35	35	35	35	35	35	34.5	34.5	34.5	31.5
Portugal	39.6	39.6	39.6	37.4	37.4	35.2	35.2	33	33	27.5	27.5
Spain	35	35	35	35	35	35	35	35	35	35	35
Sweden	28	28	28	28	28	28	28	28	28	28	28
United Kingdom	33	33	31	31	30	30	30	30	30	30	30
EU-15 Av	38.0	38.2	37.8	36.7	35.9	35.0	33.5	32.4	31.7	31.1	29.8
Czech Republic	41	39	39	35	35	31	31	31	31	28	26
Estonia	26	26	26	26	26	26	26	26	26	26	24
Latvia	25	25	25	25	25	25	25	22	19	15	15
Lithuania	29	29	29	29	29	24	24	15	15	15	15
Hungary	19.6	19.6	19.6	19.6	19.6	18	18	18	18	16	16
Poland	40	40	38	36	34	30	28	28	27	19	19
Slovenia	25	25	25	25	25	25	25	25	25	25	25
Slovak Republic	40	40	40	40	40	29	29	25	25	19	19
EU-8 Av	30.7	30.5	30.2	29.5	29.2	26.0	25.8	23.8	23.3	20.4	19.9

The detrimental rise of tax competition in Europe has sparked intensive debate about whether corporate taxes should be harmonised within the community. So far, however, this has proven such a highly controversial issue that it has been difficult to reach any kind of consensus. While it seems that no one dares suggest common statutory tax rates and an agreed minimum level to deter future 'beggar-thy-neighbour' tax competition, the differences in how corporate taxes are collected and their strong impact on the final taxes paid has tempted the European Commission to suggest harmonisation of tax bases. A common EU-wide corporate tax base would, in its view, supplement the European single market, making it easier for companies to operate within this, and provide greater transparency on how countries tax business.

The proposal that the European Commission put forward on harmonisation of tax bases in the spring of 2006 was, however, quickly shot down by ministers."It's a waste of time and capacity. I'm not nervous of it because I don't think it is a realistic objective," said Ivan Miklos, finance minister of the

Slovak Republic. He was complemented by his Dutch colleague, Gerrit Zalm, noting "Not in ten years time and I am being optimistic" when asked for a timeframe, and the Irish finance minister, Brian Cowen, simply commented "I wouldn't put any money on that because I don't like putting money on bets that never come in".[11]

So it seems that most European countries are ready to continue their 'we-will-host-you-cheaper' efforts to drive down corporate tax rates, and maybe bases too, which in the long-term will reduce the funds available for public investment and spending within the countries. Strikingly, this is happening at a time when Europe more than ever needs public finances to invest in languishing productivity and faces a mounting demographic challenge. Furthermore, as the last chapter of this report elaborates, it is happening on the basis of the perception that this is what their countries need, as well as an often false belief that such cuts indeed attract new investment. If there has ever been a Eurosclerosis, it is this determination to make corporate taxes hit rock bottom as quickly as possible.

Holidays and havens – who could say no?

Tax competition does not only take place in the form of more or less transparent declines in statutory rates. Just as widespread, and even more prominent in some parts of the world, is the attempt to draw investment to one's country by giving away tax deductions and tax holidays to any multinational considering setting up operations within one's borders. On a more or less permanent basis, this is being done through the extensive use of export processing zones (EPZs). These zones typically exempt companies from import and export duties, capital gains taxes, property and land taxes, sales and consumption taxes. And they top that with tax holidays, a period of no tax obligations, for corporate profits of ten or twenty years at a time. A few decades ago there were only a few export processing zones worldwide, but by 1998 they had reached 850, and by 2004 there were more than 5,000 of them.[12]

EPZs are set up in all kinds of countries, yet most often they offer the same incentives – many of them related directly or indirectly to taxation. The Commerce Ministry of India, where the first EPZ in the Asia-Pacific region was established in 1965, recently decided to double the number of EPZs in the country. According to the government, such zones "are intended to provide an internationally competitive, duty free environment for export production (…) fewer cases of labour disputes (…) and insulation from regulatory agencies".[13] As in most other countries, they offer tax holidays together with duty free imports and exports. Indeed, tax holidays in these zones have just been enhanced from 5 to 10 years. But an even stronger indication of the present rate of tax competition and the future of corporate taxation is the fact that the Indian government has announced that it would turn the arrangements into Free Trade Zones, treating them as being outside the customs territory of the country, yet allowing them enhanced access to domestic markets.[14]

ALL YOU COULD WANT FROM A MANUFACTURING SITE:

EXPORT PROCESSING ZONES IN BELIZE

One company in Belize offers assistance in setting up any kind of operation in tax havens or incorporation of companies in just 24 hours. It claims to be part of a financial services conglomerate and it explains that Belize's EPZ programme is intended to attract both local and foreign investment to boost production for export with a focus on manufactured goods and non-traditional agricultural products. Fittingly its slogan is 'the off-shore professionals you can trust'.

The benefits to companies of EPZs in Belize according to this company include:

- Full import and export duty exemptions
- Exemptions from capital gains tax, property and land taxes, excise, sales and consumption taxes, taxes on trade turnover, on foreign exchange and transfer tax
- Tax holiday of 20 years with an option to extend and deduct loses from profits following the tax holiday period
- Dividend tax exemption in perpetuity
- Opportunity to open foreign currency bank accounts in Belize and abroad
- Opportunity to sell, lease or transfer items, goods and services within an EPZ
- Customs inspection at the Zone for expediency
- Work permits at no cost for all professional and technical staff
- Exemption from the Supplies Control Act and its regulations
- No import restrictions on raw materials …
- No import or export licensing requirement
- No trade licenses

Source: Dominion International Limited [15]

Although export processing zones are promoted as a desirable way of earning foreign currency, and hence are aften setup with funds from international institutions such as the World Bank, their positive impact on economies and societies is questionable. For instance, the government of the Philippines, caught in a tight fiscal situation, has recently considered rationalising the incentive system it offers in its EPZs and asked its Department of Finance to estimate its revenue losses due to such arrangements.[16] As export processing zones regularly flaunt labour laws, ban trade unions, and violate a range of human rights, their development effect is generally negligible or indeed negative. In fact, as such zones often take great government investment in infrastructure, are isolated from the economic circuits of their host countries, and either just host low-tech, labour intensive industries or fail to transfer technology to the industries on the other side of their fences, as well as forcing corporate taxes downwards, they risk costing the countries in which they are established more than they benefit them.

Tax competition has been taken to its extreme by the steadily growing number of so called tax havens. Their low taxes and thin financial regulatory regimes attract not only wealthy individuals but also multinational corporations that use them as shelters from corporate taxation. There are at least 73 countries and territories that fit the classification of a tax haven – and half of them have been established in the last 25 years. They are sovereign states, colonial territories and parts of sovereign states that enjoy partial autonomy. And their various traits attract distinct clientele. Though they still primarily cater for individuals, a growing number of companies are now taking advantage of their services as well. This is either done by artificially relocating headquarters to a tax haven – not much more than a paperwork transaction, including a P.O. Box in Bermuda or a brass plate on an office building in the Bahamas – or by setting up subsidiaries in such places. Both practices are widely used. Some multinationals, such as Accenture for example, have lately expatriated their headquarters to tax havens while many others, including corporate giants such as Boeing, Halliburton, Morgan Stanley, Pepsi and Xerox have increased their subsidiaries in tax havens by several hundred or thousand percent in just five years.

A WORLD OF HAVENS

Tax havens have many different kinds of shapes, sizes and characteristics. In 2005, there were an estimated 73 of them. This is where in the world they are located (the 34 territories marked with an asterisk have developed their activities in the last 25 years):

The Caribbean and Americas

Anguilla
Antigua and Barbuda *
Aruba *
The Bahamas
Barbados
Belize
Bermuda
British Virgin Islands
Cayman Islands
Costa Rica
Dominica *
Grenada
Montserrat *
Netherland Antilles
New York
Panama
Saint Lucia *
St Kitts & Nevis *
Saint Vincent and the Grenadines *
Turks and Caicos Islands
Uruguay *
US Virgin Islands *

Africa

Liberia
Mauritius
Melilla *
The Seychelles *
São Tomé e Príncipe *
Somalia *
South Africa *

Middle East and Asia

Bahrain
Dubai *
Hong Kong
Labuan
Lebanon
Macau *
Singapore
Tel Aviv *
Taipei *

Europe

Alderney *
Andorra
Belgium *
Campione d'Italia *
City of London
Cyprus
Frankfurt
Gibraltar
Guernsey
Hungary *
Iceland *
Ireland *
Ingushetia *
Isle of Man
Jersey
Liechtenstein
Luxembourg
Madeira *
Malta *
Monaco
Netherlands
Sark
Switzerland
Trieste *
Turkish Republic of Northern Cyprus *

Indian and Pacific Oceans

The Cook Islands
The Maldives *
The Marianas
Marshall Islands
Nauru *
Niue *
Samoa *
Tonga *
Vanuatu

Source: Tax Justice Network, OECD, Economist Intelligence Unit [17]

As one of the characteristics that enable tax havens to exist is their secrecy, it is not easy to estimate the amount of corporate tax income lost on their account. Yet with regard to money made from the total assets – not just what is lost on corporate profits – held offshore in such jurisdictions, an estimate has been made. One study showed that the taxes not paid on the returns made on such funds amounted to US$ 255 billion each year.[18] Another study, from 2000, set a conservative estimate of the revenue lost due to tax havens for developing countries alone at US$ 50 billion annually.[19] This is the same amount as the annual aid flows from industrialised countries to the developing world, and equivalent to three times what is needed to achieve universal heath coverage or six times the annual costs of achieving universal primary education.

For some, the policies and practices of tax havens might appear as a reasonable way to achieve economic growth and prosperity for resource-deprived, small states. But more often than not, the main beneficiaries of such tax havens are foreigners and multinational companies, not local residents or communities. Add to that the corrupt and illegal practices by business, criminals and dictators that tax havens may facilitate, and the arguments for tax havens start to crumble. The contribution to tax avoidance, tax evasion and downward tax pressure that they cause – what in institutional terms has been dubbed harmful tax practices – constitute a hindrance to solving some of the largest challenges on the planet.

Estimating the loss

Most tax experts, from academics to political advisers, are likely to argue that we are far from a global shortfall in taxes raised on corporate profits. Referring to recognised studies on the subjects, they will note that in the industrial world – the EU and the G7 in particular – corporate taxes have been more or less stable for decades: statutory rates have fallen but tax bases have been broadened, above all in the 1980s, and though effective tax rates might have fallen for profitable projects, they have remained fairly steady for operations that just break even or make low profits. As a proportion of GDP, they will note, tax revenues from corporate profits have stayed the same since 1965, while as a share of total tax revenue they were in decline until 1980 but have been relatively constant since then.[20]

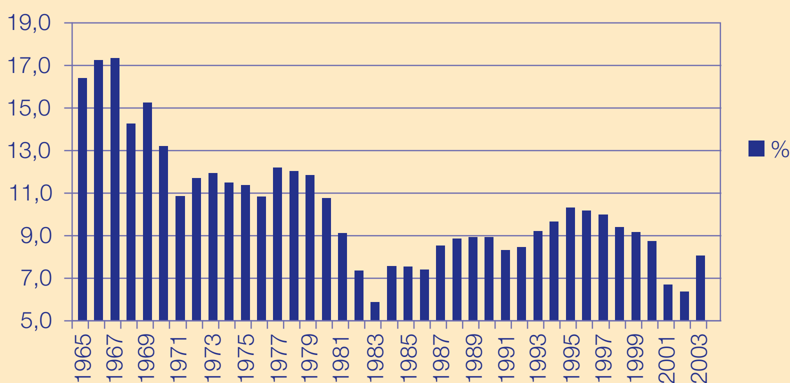
However, tax competition has intensified within the last five to ten years, and with increased mobility of multinationals, this kind of rivalry seems destined to continue. And the results are telling. Significantly, over the last decades, the world's largest economies – the US, Japan, Germany, the UK and Italy – have seen their income from corporate taxation decline substantially. They appear to have engaged less actively in tax competition, only cutting their statutory corporate tax rates moderately during this period, but are indeed the countries that have lost most former public revenue from corporate profits. So though theory tells us that large economies are prone to resist tax competition because by nature they have fewer incentives to cut corporate tax rates – capital flight is not as probable as in

small economies, capital inflow only makes up a relatively small part of total capital available for investment, and the revenue loss from cutting taxes, due to these tendencies, will thus most often be much larger than the possible gains from such cuts – experience certainly shows us the contrary.

This suggests that the tax contribution from the corporate world to public finances and society in general is not just declining by way of reductions in statutory corporate tax rates, the upsurge in export processing zones, and the proliferation of tax havens. The basis on which corporate taxes are collected and the extent of deductions, exemptions and other loopholes enacted by governments, be it to please special interest groups or in the sincere hope of maintaining jobs, is just as significant as the developments in tax rates, tax holidays and tax havens.

The world's largest economy, the US, is living proof of this. Here statutory corporate tax rates have been kept at 39% since the mid 1990s, when counting both federal and state taxes. Yet over the last ten years the country's largest corporations have paid less and less tax. And corporate taxes have had until now a minor role in the financing of public spending. Overall, corporate taxes in the US have dropped from 9.4% of total tax income in the 1990s to 7.5% in the first four years of the new millennium, and from 2.6% of GDP in the 1990s to 2.1% of GDP in the years between 2000 and 2003. Extending the view and counting in a couple of other decades, the fall is even more drastic: in the 1970s and the last five years of the 1960s, corporate taxes on average made up 11.7% and 16.1% of all tax revenue, and 3.0% and 4.2% of GDP.[21]

US - CORPORATE TAXES AS PERCENTAGE OF TOTAL TAX INCOME

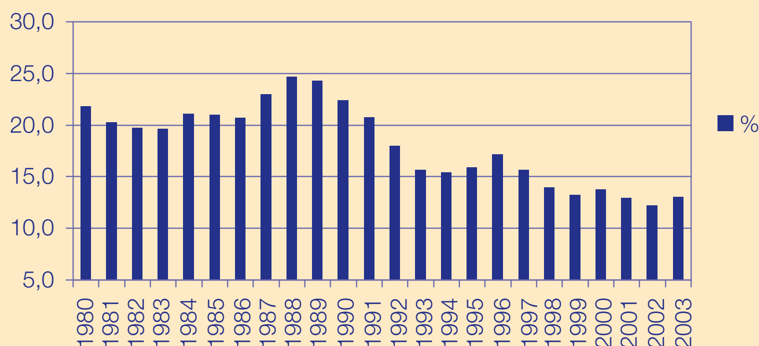


Economic cycles do impact on such statistics, as years of high corporate profits will result in a higher corporate tax intake than years of low corporate profits. However, by using averages for each decade, as done above and in the following, cyclical impacts are almost eliminated. More interest-

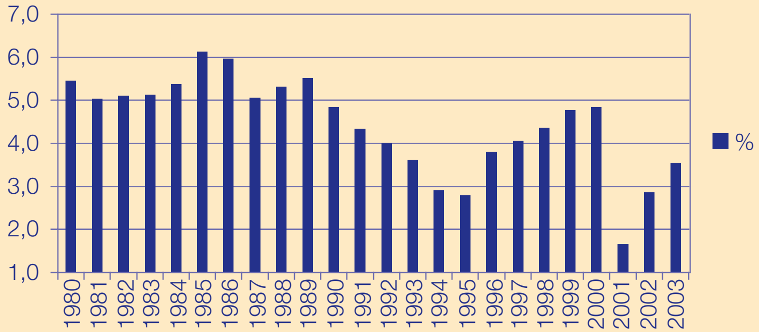
ingly, if a clear trend can be identified over twenty years or longer, one has to assume that there are more than just economic ups and downs to that trend. With regard to the US, such a trend is very obvious – both within the last ten years and in the longer term. And the chief determinant should not be difficult to identify, as US lawmakers have handed out tax rebates extensively and generously over the years. Legislation passed in 2002 and 2003, for instance, gave the US corporate world tax subsidies of US$ 175 billion over a three year period.

In Japan, the world's second largest economy, corporate taxation has for several decades made up a substantial part of total taxation. Yet here the trend of corporations contributing noticeably less to public finances is even stronger than in the US. Corporate taxation made up 13.0% of total tax revenue in the first four years of the new millennium, a marked decline from 16.8% in the 1990s and 21.6% in 1980s. And as a share of Japan's GDP, corporate taxation is down from 6.0% in the 1980s and 4.6% in the 1990s to 3.4% from 2000 to 2003. Once again, this development is beyond economic cycles, as Japanese companies actually have seen larger profits in the new millennium than in many of the years of the 1990s.[22]

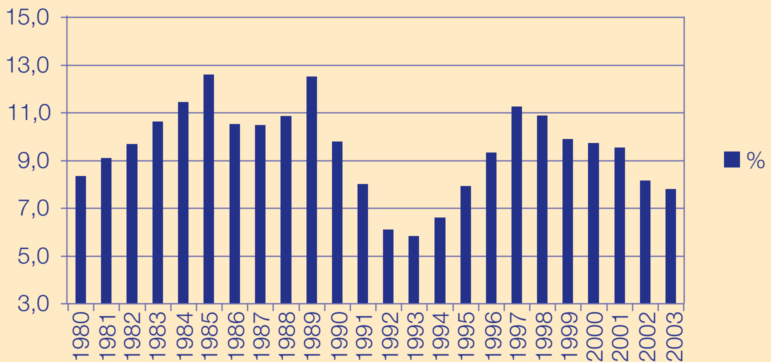
JAPAN - CORPORATE TAXES AS PERCENTAGE OF TOTAL TAX INCOME



In the world's third largest economy, Germany, revenue from corporate taxation, as part of both total tax income and GDP, has fluctuated much more than in Japan and the US. And because of the way the German tax system is designed, with many companies being taxed as individuals rather than counting in the statistics of corporate taxation, such taxation has in general made up a smaller part of both GDP and total tax revenue. Nonetheless, an obvious downward trend is also visible in this country: in the 1980s corporate taxation on average made up 5.4% of total tax revenue, in the 1990s it made up 4.0%, and in the first four years of the new millennium it made up 3.2%. Similarly, on average it made up 2.0% of GDP in the 1980s, 1.5% in the 1990s, and 1.2% from 2000 to 2003.[23]

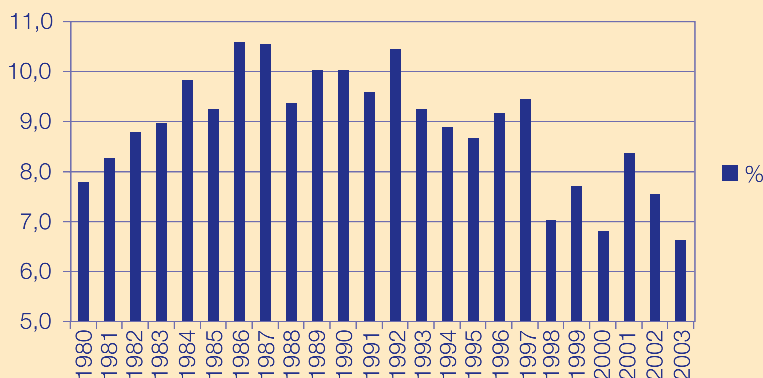


In the UK – the world's fifth largest economy in 2005 – business is also contributing less and less to public spending, both when measured overall and at the company level. Again, this has happened in a country that according to theory should not be significantly affected by tax competition, and which has kept its corporate tax rate more or less stable in the last ten years, reducing it from 33% to 31% in 1997 and maintaining it at 30% since 1999. In the UK, corporate taxation made up 10.6% of total tax revenue and 3.9% of GDP in the 1980s. In the 1990s these figures dropped to 8.6% and 3.0% respectively, before gaining a some lost ground by rising to 9.0% and 3.3% in the first years of the third millennium.[24]



In Italy, the seventh largest economy in the world, the trend is not that notable when the 1980s are included, as in the figure below. Yet from the early 1990s, the exact same tendency is visible here as in the other major economies: corporate taxation dropped from 9.0% of total tax revenue in the 1990s to 7.3% from 2000 to 2003, as well as from 3.8% of GDP in the 1990s to 3.2% in the first four years of the new millennium. Here it is much more obvious that the cuts in statutory corporate tax rates influence the intake of revenue from corporate profits, as the Italian top statutory corporate tax rates have fallen from 52.2% in 1995 to 33% in 2005.[25]

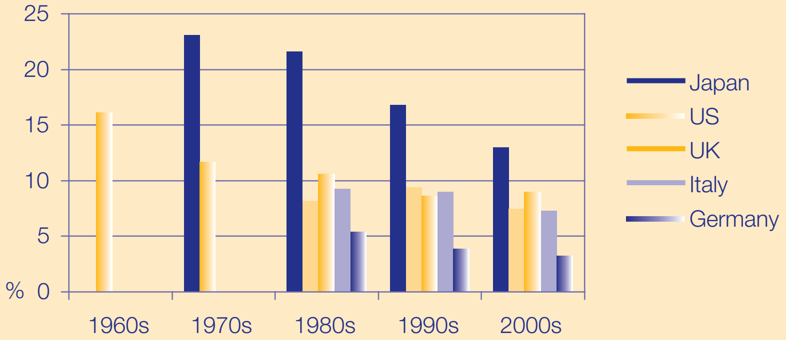
ITALY - CORPORATE TAXES AS PERCENTAGE OF TOTAL TAX INCOME



Out of the seven largest economies in the world, only France (China, today the fifth largest economy in the world but soon to be the third largest, is not comparable due to its economic system and the lack of data for the country) has maintained a steady contribution from business to public finances over both the last decades and since the 1960s and 1970s. In France, corporate taxation has indeed made up a larger part of total taxation in the first years of the new millennium than in both the 1990s and 1980s. And the statutory rate in that country is today almost on a par with its 1995 level. So some countries apparently do stand the external and internal pressure to continuously lower corporate taxes.

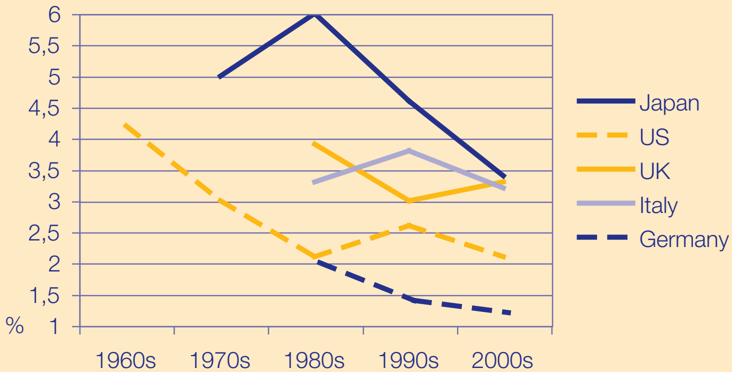
Most interestingly, and as previously mentioned despite conventional wisdom, five out of the seven largest economies in the world have seen corporate taxation depreciate over the last decades. Remarkably, in the US, Japan, Germany, and Italy – together representing close to half of the world's economy – the significance of corporate taxation to public finances has dropped from around 20% between the mid 1990s and today. Looking at each country individually, and going further back in time, corporate taxes have in most of these countries lost even more significance. As a share of total taxation, corporate taxes have dropped by 15% since the 1980s in the UK and by 22% in Italy since

CORPORATE TAXES AS A TEN YEAR AVERAGE OF TOTAL TAX INCOME



the 1980s. And they have taken an even more striking dive in Germany, dropping by 41% since the 1970s, in Japan, falling by 43% since the 1970s, and in the US, plummeting by 53% since the late 1960s. This development has been mirrored in the amount corporate taxation has made up of GDP in these countries.

CORPORATE TAXES AS A TEN YEAR AVERAGE OF GDP



THE RISE OF TAX SHELTERS: THE CORE CORPORATE BUSINESS OF AVOIDANCE AND EVASION

The corporate world has become better and better at avoiding and evading taxes in recent years. Through a range of on-shore and off-shore operations, multinational corporations are sheltering profits and plainly exploiting tax laws and systems. Some of this is legal, other aspects and parts are illegal. Although the issue is not as high on the political agenda as it ought to be, the aggressive use of all kinds of tools, instruments and measures to dodge taxes is a growing concern: "I think we ought to look at people who are trying to avoid U.S. taxes as a problem. I think American companies ought to pay taxes here and be good citizens,"[26] the benefactor of some of the largest tax breaks in recent times, President George W. Bush, told reporters at the height of the Enron scandal. And in the US Senate it has been emphasised that "there is a corporate tax shelter problem"[27] and that "the problem is becoming widespread and significant", whilst a former IRS Commissioner named corporate tax shelters "one of the most serious and current compliance problem areas".[28]

Hard to measure, easy to spot

Owing to its nature, the extent of tax avoidance and evasion is difficult, perhaps impossible, to measure precisely. The fact that it's occurring and is on the rise is noticeable when corporate tax payments are scrutinized. Dissecting the financial records of 275 of the largest corporations in the US, a recent study found that these multinationals have consistently lowered their tax commitments. In 1988 they paid an effective federal tax rate of 26.5%, in 1998 this was down to 21.7%, in 2001 to 21.4% and in 2003 to 17.2%. The statutory federal tax rate has been 35% since 1993 and was 34% for the corporations in question in 1988.

Almost a third of these corporations, 82 of them to be precise, paid no taxes or received a tax refund in at least one of the three years between 2001 and 2003. And in 2003 alone, 46 of the companies paid nothing or got a tax refund, though they reported pre-tax profits of US$ 42.6 billion. In fact, 28 of the companies had negative federal income tax rates over the entire three years in spite of pre-tax profits of US$ 44.9 billion during this period.

These companies keep two sets of books – one for their shareholders and another for the tax authorities. Thus, between 2001 and 2003, the 275 companies proudly told their shareholders that they had made almost US$ 1.1 trillion in pre-tax profits. But they only reported about half of that amount, US$ 557 billion, to the tax authorities. The other half was effectively sheltered away.[29] And it is not only the largest corporations that are able to dodge taxes. Hence, in 2004, to much surprise to some, the US General Accounting Office told the public that between 1996 and 2000, 61% of all US corporations "reported no tax liabilities", or in other words, paid no taxes at all.[30]

In the UK, a study launched in 2006 found that the country's 50 largest corporations had paid US$ 38 billion (UK£ 20 billion) less in taxes on their profits during the five years from 2000 to 2004 than what would have been expected from them. It moreover showed that over the years the companies had increased the difference between what the authorities expected them to pay and what they ended up paying, the so called 'expectation gap', from 4.2 percentage points in 2000 to 7.6 percentage points in 2004. This means that in this year on average they paid 22.1% in corporate taxes instead of the expected 29.7%. Extrapolating this tendency across all UK companies, the study moreover found that the likely overall loss in tax revenue amounts to as much US$ 17 billion (UK£ 9 billion) a year – or about 28% of all corporate tax receipts in the tax year 2004-05.[31]

Playing the system

With the trouble tax authorities around the world are having collecting what they are lawfully due, it is clear that corporations have become better at avoiding and evading. Thanks to the growing sophistication and diversification of financial products and services, companies have plenty of lawful means to escape their responsibilities to contribute to society's needs. And with the developments linked to globalisation, multinationals have found it even easier to take advantage of their ability to break themselves into different entities on paper and treat completely phoney, non-existent transactions among those entities as if they really happened. As they typically operate in many jurisdictions through multiple subsidiaries, they have plenty of opportunities to move profits away from where they are earned and to places where they will not be taxed. Or they can take advantage of tax havens by either artificially off-shoring their headquarters or establishing subsidiaries in such places.

The most extensively used form of corporate tax dodging is probably transfer pricing. Companies that operate across borders arrange their transactions so that profits show up in jurisdictions with more lenient tax collectors. They can do so because a large part of international trade is intra-firm trade, and thus takes place within the same corporations either as sales between subsidiaries or as sales between parent and subsidiary companies, where prices are not set by market forces. To elude taxation in one country, subsidiaries or trading offices buy the products from the producing

unit in this country at sharply reduced paper costs and sell it abroad at market value, in effect ensuring that the home company makes no profit. The profit stays with the subsidiary or trading company in the tax haven. Conversely, a subsidiary or trading company buys goods at market prices and sells them to the company in the high taxation country at grossly inflated prices so that the company in this country has costs to deduct when it uses the item in its manufacturing or resells it at a loss.

To measure the results of transfer pricing, one university study used aggregate customs data to examine the impact of over-invoiced imports and under-invoiced exports on US federal income tax revenues for 2001. The findings were staggering. US companies were buying plastic buckets from the Czech Republic for US$ 972 each, tissues from China at US$ 1,870 a pound, and cotton dish-towels from Pakistan for US$ 154 each. And they were selling bus and truck tires to Britain for US$ 11.74 each, colour video monitors to Pakistan for US$ 21.90, and prefabricated buildings to Trinidad for US$ 1.20 a unit. On paper, these companies were not getting much for the products they sold and paid overpriced amounts for what they were buying. But by using such measures they would boost their profits in the havens where no taxes would be levied on them and minimize them where they would be taxed substantially. Comparing all the stated export and import prices to real world prices, the professors behind the study estimated that the tax loss was US$ 53.1 billion that year. What's more, data from the studies indicated that the problem was getting worse. The 2001 loss was thus up from an estimated US$ 44.6 billion in 2000, US$ 42.7 billion in 1999 and $35.7 billion in 1998.[32]

Other research, commissioned by the US IRS and conducted by a team of university professors, showed that multinational corporations were shifting US$ 87 billion of pre-tax income out of the US each year. This figure was uncovered by comparing the effective tax rates and the returns on assets for 6,212 multinational corporations. And although the authors of the study admit that it is possible for companies to legitimately shift income abroad by moving productive assets such as factories into a tax haven and earning income there, that was not what they saw happening: “We observed how much companies were earning in a foreign jurisdiction relative to their assets there. Then we observed the same thing domestically and made the assumption that if companies had not manipulated transfer prices, after-tax return on assets would have been equal between a parent company and the foreign subsidiary.”[33] But they were not. Among 686 firms shifting income out of the U.S., for instance, on average foreign return on assets was 11.3% compared to domestic return on assets of 2.4% And after looking closely at data from those 686 companies alone, the authors concluded that US$ 62 billion of pre-tax income was shifted abroad by those companies.

Another way of dodging corporate taxes is by what is often called income stripping. Here money is lent by an offshore subsidiary to a parent company or another subsidiary in a country with high

corporate tax rates and paid back to the offshore subsidiary at exorbitant interests. Those interests can then be deducted against income that would otherwise have been taxed in the home country. Finally, this income will then either be only taxed insignificantly or not taxed at all, and the parent company has thus effectively transferred profits to a place where tax authorities will stay at arms-length. A recent example of this is Tyco, a conglomerate with revenues of around US$ 40 billion in 2005, which set up a subsidiary in Luxembourg to finance most of the company's debt. The Luxembourg subsidiary made loans to Tyco units around the world, which then deducted the interest payments from their taxable income.

A third way of reducing corporate taxes is by transferring the ownership of a trade name, often a very valuable asset, to a low-tax location and then charging a company's taxable operations large royalties to use the name. It can also be done with patents, where subsidiaries then charge licensing fees for the use of these patents. Such parking of intellectual property offshore can effectively shelter huge profits, and has become an ever more popular trend since the 1990s. Indeed, it is now so widespread that it has prompted an aggressive crackdown by the US IRS with alleged abuses possibly totalling tens of billions of dollars.[34]

Transfer pricing, income stripping and the parking of intellectual property rights are all done by the use of subsidiaries in countries that tax corporations at insignificant rates or are just plainly tax havens. The number of subsidiaries set up in tax havens is thus a good indicator of the extent of the practices – and the figures that have more or less blown up in recent years. Thus between 1997

SURGE IN TAX HAVEN SUBSIDIARIES

Company	Subsidiaries in tax havens	Subsidiaries in tax havens in 1997	Increase
El Paso (2002)	244	52	369%
AES (2002)	195	2	9650%
Morgan Stanley (2003)	99	2	4850%
Citigroup (2003)	92	19	384%
Aon (2002)	87	43	102%
Halliburton (2002)	58	8	625%
Marriott International (2003)	41	16	156%
Boeing (2003)	31	10	210%
Pfizer (2002)	30	21	233%
Pepsi Co (2003)	29	14	107%
J.P. Morgan Chase (2003)	27	11	145%
Sara Lee (2002)	26	14	85%
Xerox (2002)	23	6	283%

Source: Citizen Works

and 2003, a number of the largest multinationals increased their subsidiaries in tax havens by several hundred and even thousand percent: Boeing went from 10 to 31, Sara Lee from 14 to 26, Xerox from 6 to 23, J.P. Morgan from 11 to 27, Pepsi Co from 14 to 29, Marriot International from 16 to 41, Halliburton from eight to 51, Citigroup from 19 to 92, Morgan Stanley from two to 99, AES from two to 195, and El Paso, the energy company, from 52 to 244, according to Citizen Works.[35]

Taking the use of tax havens to yet greater heights, several large companies have moved their official headquarters offshore and thus reincorporated themselves in tax havens. Most often, however, management and physical operations stay onshore. Yet on paper the move makes sense, as it allows the companies to significantly reduce their taxes at minimal expenses. So much sense in fact that that accountancy and consultancy firms are helping facilitate this increasingly popular trend,. Or as an Ernst & Young tax partner explained, "we are working through a lot of companies who feel that just the improvement on earnings is powerful enough that maybe the patriotism issue needs to take a back seat."[36]

That most headquarters of big business in tax havens only exist on paper is obvious when walking down Church Street in George Town, the capital of the Cayman Islands. Here a modest five-story building is the official address of 12,748 companies. That this, and similar practices in other tax havens, are within legal parameters is the cause of a lot of frustration among the authorities: "The whole business is a sham," says New York District Attorney Robert Morgenthau. "The headquarters will be in a country where that company is not permitted to do business. They're saying a company is managed in Barbados when there's one meeting there a year. In the prospectus, they say legally controlled and managed in Barbados. If they took out the word 'legally,' it would be a fraud. But Barbadian law says it's legal, so it's legal."[37]

As the false nature of such measures is most often so obvious, they have sparked outrage when they appear on the radar screens of communities and the media. Thus, when Stanley Works, a tool company, made public that it was moving its headquarters on paper from Connecticut, US to Bermuda and shifting its imaginary management to Barbados, the result was public outcry. Its buildings and staff would stay in Connecticut, where the company manufactured hammers and wrenches, but it would no longer pay taxes on profits from international trade. Yet Stanley was planning to save on more than the taxes on business done outside the United States. With the help of its accountants, it indicated in 2002 that even though it had paid US$ 7 million US tax on foreign income in 2001, the move would save it at least U$ 25 million in US taxes. This suggests that the company was planning to cut taxes on US profits by turning them into foreign profits. When the Connecticut's Attorney General took them to court Stanley withdrew its plans. But others have been more persistent. Tyco has moved its management from New Haven in the US to Bermuda, and set up more than 150 subsidiaries in the Cayman Islands, Jersey, and other offshore havens - many of these are, shell companies that play accounting games to shield Tyco interests, dividends, roy-

alties, and other income from US taxes authorities. And one must admit with great effect: in 2001, Tyco reported that although 65% of its revenues came from the United States, only 29% of its 'income' did – a trick that erased 71% of its US$ 36 billion profits from its US tax statement.

Among the most absurd contradictions of tax avoidance and evasion by multinational corporations is the fact that many of these corporations receive billions of dollars' worth of government contracts. In the US, for instance, according to the General Accounting Office, four of the top 100 federal contractors that are publicly traded corporations – Accenture, Tyco, Foster Wheeler and McDermott International – are incorporated in a tax haven. These four companies accounted for about US$ 2.7 billion of contracts in the financial year of 2001. Accenture, for example, has over U$ 1 billion in federal contracts, including a five-year contract to overhaul the IRS's own web site. Beyond irony one would say, particularly considering that Accenture paid just 7% of its profits in taxes worldwide from 1997 to 2000. Further, a number of companies that have obtained large contracts for military support and the reconstruction of Iraq after the recent war are among those with the largest number of subsidiaries in offshore tax havens - including Halliburton.[38]

Corporate Social Irresponsibility?

The ongoing battle between corporations and authorities regarding their respective payments and collection of taxes is an uneven game. The corporations hold the power of information and initiative, while the authorities can only rely on what the corporations tell them and furthermore often find themselves under-funded to the extent that they have difficulties performing their core tasks, let alone cracking down on creative tax evaders. But paying their dues in corporate taxes is basically a question of good corporate governance and citizenship of any business. Though private corporations by nature are profit maximizing, it is no law of nature that they should do all they can to avoid taxes, even if such avoidance is within legal parameters. This is not good corporate citizenship and should not be considered good corporate governance either. And evasion, when the dodging becomes illegal, strays into the domain of corporate crime, far beyond the limits of good corporate citizenship.

To represent a responsible business practice, corporate tax planning should leave the shady sphere it currently hides in, and live up to the criteria of transparency and accountability applied to most other business operations. However positive a track record a given company might have in relation to other aspects of social responsibility, such achievement matters little if the company continuously abuses the corporate tax system. Indeed, a company that aggressively engages in stretching the boundary between legal and illegal sidestepping of corporate taxes fails to live up to the expectations of responsible corporate behaviour society rightfully expects from it. And such a failure to be transparent about one's corporate tax liabilities might in fact hide deeper financial

problems or even fraud and conspiracy: from 1996 to 1999, Enron paid no federal income tax, reported tax losses of US$ 3 billion to the tax authorities, and at the same time, reported over US$ 2 billion in profits to its shareholders. If investors had known of this gap of more than US$ 5 billion, they might have recognized the trouble the company was in before it was too late.

Businesses have a choice as to whether they engage in tax avoidance and evasion. And judging by the surge in tax lawyers, accountants and consultants, as well as firms and departments dedicated to tax planning alone, not to mention the falling effective corporate tax payments by multinationals, it seems their choice is increasingly to engage in such practices, not refrain from them. But what is missing from the maths done in the corporate boardrooms is that tax avoidance and evasion is more than just socially irresponsible. It is, as elaborated in the following chapter, also unsustainable for both the individual enterprise and society in general.

BAD TIMING:
HOW THE DECLINE IN CORPORATE TAXES RISKS UNDERMINING FUTURE SOCIAL STABILITY

Collected on income, consumption, property and profits, taxes have for centuries been the number one source of public funds and a key building block in the construction of societies. Without taxes, there would be no legal system, police and military, nor public education, health, roads, or other social spending. Taxes are also used to ensure some degree of income distribution, equal opportunity, and a minimum of living standards. In short, the sustainability of any modern society and economy requires the state to have sufficient revenue to fund the physical and social infrastructure essential to economic welfare, development, stability and security.

The design and construction of tax systems basically depends on two considerations: what taxes should be used for and what sources should be taxed. This comes down to what the need for public funds is and what revenue, income and resources are available to a society. A basic principle is to tax what you have lots of and use it for what you value the most. Thus, countries that have been abundant with raw materials such as oil and minerals have usually taxed these relatively more than countries where these have been scarce. On the other hand, countries whose main national income has been expended in wages have tended to rely on income taxes for the largest share of their public funds.

Taxes derived from corporate profits have played an important part in building the societies of the twentieth century, thus ensuring the continuing success of the companies that contributed to their establishment. This has been a virtuous cycle: corporations have financed societies, which in turn have made the corporations flourish, increasing their contributions to society, which again strengthened and enhanced corporate operations. Since the 1950s, however, business has shared less of their profits with societies though they have become more and more dependent on their functioning and quality. And over the last decade, a trend that suggests that business will share less and less of their profits with society has taken form and quickly matured.

At a time when business is taking up a larger share of productivity gains at the expense of workers, when societal qualities and characteristics have become more important to their competitiveness,

when ownership of private corporations is increasingly internationalised, and when employer-sponsored welfare systems are crumbling, it is illogical that corporate profits should elude national tax bills. Indeed, at a time when there is a larger need of public funds for both citizens and companies, and business is sitting on an even bigger share of national income, declining corporate taxation is particularly badly timed.

Soaring profits, plummeting wages

Around the world corporations are celebrating golden times at the expense of ordinary wage earners. On average, business has never been better. Corporate profits are at record levels. In the G7 economies as a whole – that is the US, Japan, Germany, the UK, France, Canada and Italy taken together – the share of profits of national income has never been higher, estimates UBS, the Swiss bank. In 2004, after tax profits in the US rose to their highest as a proportion of GDP for 75 years. And corporate profits in the Euro area and Japan are also close to their highest for at least 25 years.[39] To no surprise, this means that labour's share of economic activity and national income has hardly ever been lower.

The mounting difference between profits and wages is most visible in the US. Here corporate profits increased by 21.3% in 2005 after haven grown by 20% in 2004 and 19% in 2003.[40] In the same years, GDP has grown by only 3.5%, 4.2% and 2.7%. Corporate profits stood at 11.6% of national income in the fourth quarter of 2005, the biggest share since the summer of 1966, according to the US Department of Commerce. Add to that the tax breaks big business has received over the last years, and Merril Lynch will tell you that after-tax profits in the US rose from about 5.5% of national income in the early 1990s to more than 9% in 2003.[41] It is normal that profits surge in the short-term after a recovery, such as the one the US economy has been undergoing since 2001, and then slows as the economic cycle matures, firms hire more workers and costs rise. But this has not yet happened in the US, in spite of four years of strong growth. In fact, a bigger slice of the increase in national income in this recovery has gone to profits than in any of the previous six post-war recoveries.

Corporate profits in the US are having such a heyday because almost all the gains from productivity improvements are flowing to the owners of capital rather than to workers. That subdued wage growth plays its part is very obvious. In 2005, labour compensation rose by 5.5%, but after adjusting for inflation, population growth and taxes, real disposable per capita income was up just 0.5%. And the outlook for 2006 is not much better, with the new rises in oil and gas prices the last nail in the coffin for workers who hoped to see any real improvement in wages this year: inflation for 2006 is likely to remain in the 3.4% to 3.8% range, wiping out average wage increases of 3.0% to 3.5%, and leaving workers with less purchasing power. Indeed, the share of national income going to

wages and workers has fallen substantially in just a couple of years, standing at 56.9% in 2005, down from 57.6% in 2003, and, except for a brief period in 1997, the lowest share for labour income since 1966.[42]

JOBLESS GROWTH
IN BIG BUSINESS

The 2006 Fortune 500 list shows that median revenues per employee for the largest US companies hit US$ 400,000 in 2005, rising sharply from $300,000 in 2004.

There was little or no change in the number of workers employed in these companies, the median number of workers employed by a Fortune 500 company in 2005 being 26,000, down slightly from 26,950 in 2004.

The main companies adding employees to their squads seem to be those offering low wages and poor working conditions: Wal-Mart added 400,000 workers between 2003 and 2005, and remains the largest employer in the United States. McDonald's, the second largest employer and another low-wage company, added 29,000 workers in the period. Companies like IBM and General Electric that offer higher paying positions, on the other hand, added relatively few people to their payrolls between 2003 and 2005, but still enjoyed substantial revenue growth.

Overall, the Fortune 500 increased their number of employees by just 2% in 2005 while their revenues rose by 10.2% and their profits jumped 18.8%.[43]

In Europe the picture is much the same. Several companies set new records for corporate profits in 2004 in their countries – both BP and Royal Dutch/Shell in the UK for example – and taken together, the profits of the big firms tracked by the S&P Europe 350 index rose by a striking 78% in 2004 and was set to grow by another 30% in 2005.[44] But workers' share in such profitability improvements has been at a minimum. Only two EU countries experienced wage growth above 3% in both 2004 and 2005, while wage growth was below 1% in six countries. In Germany, there was negative wage drift in both 2004 and 2005, and in Belgium and the Netherlands wages declined in 2005. Furthermore, in most European countries, corporations have pocketed most of the productivity gains realised within the last couple of years. Thus, in 12 out of 19 surveyed countries in 2003, and in 15 out of 19 in 2004, real wage growth remained below productivity growth. In 2004, wage growth was indeed more than 2% lower than productivity gains. In Europe, the share of national income going to wages and workers has also fallen substantially as of late. Wages made up around 59% of GDP in the 'old' 15 EU members in 2005, down from 60% in 2001 and 68% in 1982.[45]

Similarly, China's economic rise and emergence as a labour intensive, leading manufacturer of cheap products for the whole world has been to the benefit of Chinese business and at the expense of its workers. Employment prospects have not become much better for the Chinese through the last decade. In the 1980s, when China's economic growth was 9.3% a year, net employment growth was around 3%, according to estimates from the World Bank. Similarly, in the 1990s, when economic growth was about 10.4%, net employment growth was as low as 1.1% per year. All in all, between 1996 and 2001, the number of urban workers fell from 149 million to 108 million, a reduction of 28%. And what is worse, the new jobs created in the country are of even lower quality than the ones that were lost, as they are unprotected and outside formal employment regulations. The number of workers in such employment situations climbed by 13.3 million, a 57% increase in the urban areas from 1996 to 2001.[46]

STAGNATING OR DECLINING

REAL WAGES IN BOOM TIMES

A recent survey by Mercer Consulting shows that pay for salaried workers at 350 large companies barely keeps pace with inflation while profits keep rising through the roof.

In 2004 wage increases were 3.4 % in the 350 companies studied, though profits at those companies rose by 23%. In 2005, the average salary increase of 3.6% was wiped out by 3.4% inflation, yet profits still rose 13%. For 2006, planned wage increases for salaried employees average 3.5%, which again means that their gains will be obliterated by higher consumer prices.

Chief executives at the same 350 companies saw their salaries and bonuses jump 14.5% in 2004 and 7.1% in 2005, excluding their stock grants and other long-term incentives that add millions to their pay packages and represent more than 60% of total CEO compensation. [47]

Corporate profits are soaring. Not just in absolute figures but also relative to labour. While many would tend to attribute this to the technological revolution we have seen within the last decade, such developments usually only produce short term profit gains, and we have to look for another source of this long lasting change in income distribution. Thus, the most striking global economic development in the last decades is the entrance of China and India, but also Russia and Brazil, to the world economy, effectively by the turn of the millennium. Bringing a vast supply of labour along with them, the integration of these countries into the global production system has in effect doubled the amount of available workers in the world - but without substantially altering the amount of capital available for investments and operations. As this increases the global ratio of labour to capital, it lifts the relative return to capital in a lasting way, and has thus given capital an advantage unknown for a century.

India and China, in particular, have attracted a lot of foreign direct investment, and plenty of manufacturing and service operations have been off-shored to these countries, but without great wage increases in these countries. And just as significantly, the mere threat of off-shoring keeps a lid on wages and wage demands in the rest of the world. It is therefore likely that the share of profits in national and global income will stay high for some time yet and that labour's share, accordingly, will remain low. Thus, while many would argue that profits cannot continue to grow faster than GDP – since competitive market forces will narrow profit margins in the long term, as companies will have to reduce prices at some point – stock market investors seem to think otherwise. Their current share valuations assume that profits will continue to outpace GDP growth and most analysts expect US profits to grow by 10% annually over the next couple of years, while nominal GDP growth will be at around 5%.

The upper hand that capital has gained vis-à-vis labour in a relatively short time is evident when looking at the profitability of engaging employees. From 2001 to 2004 employer return on wages and benefits in the US rose by 35.7%. Costs for each worker dropped by 2.2% in that period, corporate revenues from each full-time equivalent rose 22.7%, and corporate profits per employee jumped with a staggering 190.7%. In Europe, the trend was the same, if slightly less extreme: revenues per employee rose by 20.4% and corporate profits per employee climbed by 46.8%.[48]

Shifting an increasing part of the tax burden to workers at a time when their wages are more or less stagnant and the profits of their employers are booming – over the past three years US corporate profits have risen by 60% whilst wage income has only risen by 10% – is unreasonable and unwise, to say the least. With the relative return to capital higher than to labour, corporate profits represent a necessary source of public finance. Depending on wage earners to fund yet larger shares of public spending will either force such spending to shrink or leave workers with much less to live on.

NO MONEY FOR EMPLOYEE COMPENSATION BUT FISTFULS OF DOLLARS FOR EXECUTIVE COMPENSATION

- **In the US, the pay gap has grown at fast speed: In 1980, a chief executive made US$ 42 for every dollar earned by a blue-collar worker. By 1990, that ratio was US$ 85. But the real gains in the boardroom were made in the decade that followed as firms ramped up share options. By 2000, chief executives were earning $531 for every dollar taken home by a typical worker. In 2004, after the technology boom and stock market bubble had burst, it was US$ 431 per blue-collar dollar.**

- **A Harvard study found that the compensation given to the top five executives in the largest US companies accounted for about 10% of those firm's earnings in 2003 compared to 5% in 1995.**

- **In the UK, an average chief executive is paid 113 times more than an average UK worker. Directors' pay at Britain's top companies climbed an average of 16.1% in 2004 - four times faster than average earnings and eight times the rate of inflation. This increase takes the average pay for a chief executive, including bonuses and gains from long-term incentive plans, to more than £2.5m. The 16% increase for 2004-05 follows a 13% rise for the previous year and 23% the year before that.**

Top 5 most paid CEOs in 2004

Yahoo Inc.	Terry S. Semel	$109,301,385
Coach Inc.	Lew Frankfort	$64,918,520
XTO Energy Inc.	Bob R. Simpson	$62,141,981
United Health Group Inc.	William W. McGuire	$58,784,102
Viacom Inc.	Summer M. Redstone	$56,017,985

- **It would take someone on the US minimum wage around 11,000 years to earn the $109 million banked in 2004 by Yahoo chief Terry Semel.**

Sources: AFL-CIO, The Guardian, UAW

The importance of institutional and societal competitiveness

Corporations increasingly base their success on institutional and societal competitiveness, in the form of all the factors they are supplied with by the societies they are part of, as opposed to their core competitiveness, derived from the resources they have invested in and developed themselves. Though such aspects of competitiveness have always been central, they are even more significant in today's knowledge economy and information age.

Businesses rely on the societies they are born out of and operate in for: a) material infrastructure, from roads and ports to postal services and telecommunications; b) effective governance and regulatory systems, general legal security and IPR enforcement for example; and c) immaterial infrastructure, from brain power in the form of education, training and general skills enhancement, to public investment in research and development, diffusion of technology, and other quality public services.

It is obvious that many of the most successful companies of our time, not least the ones involved in information technology and pharmaceuticals – most often the ones with the largest return on investments and operating profits – would never have emerged in countries with small public sectors and low public expenses. They have often materialised from public-private partnerships, taken advan-

tage of the technological developments in the countries where they were set up, used public inspection systems to guarantee the quality of their operations, and relied on government purchases to ensure the income stability needed to expand. And they still rely on universities that are most often publicly funded to supply them with talented and well-educated individuals and to undertake government sponsored research.

Hypocrisy, however, often sidetracks the debate when societal and institutional frameworks are discussed – not least when the corporate world has a chance to influence such debates. Thus, business in general has a tendency to recognise the importance of public spending for their competitiveness when it has a chance to influence such spending, while arguing for "small government" and lower public budgets when the debate is about what they should contribute to society. The statement released in May 2006 by BIAC, the representative of the major industry and employers' organisations in the OECD, makes this very clear. On one hand, BIAC states that "overly high tax burdens, for both business and consumers, has a detrimental impact on economic growth and robs the economy of its growth potential", that "governments' role should be to establish and enforce laws, ensure public order and safety, protect property rights, defend against external threats for national security, build and maintain some infrastructure, secure fair competition practices in all markets and provide public services and goods", and that "governments need to reduce their excessive size and scope in order to allow their economies to flourish". But, on the other hand, when it comes to government spending, not the contributions of business, they emphasise that there should be more

HIGH TAXES AND STRONG COMPETITIVENESS – THE SWEDISH EXAMPLE

Sweden is a good example proving that government spending is central for competitiveness. But it also takes substantial tax contributions to facilitate such spending. The country has had one of the largest tax burdens in the world for decades, and increased its contribution of corporate taxes to total tax income from the 1980s, when it was 3.7%, to the 1990s, when it averaged 4.7%. Since 2000, corporate tax rates have been stable and from that year and until 2003, corporate taxes made up 5.7% of total tax income. Yet in the same period, Sweden's manufacturing industry has increased productivity faster than any other industrialised country, including the US. Thus between 1990 and 2003, hourly labour productivity in the Swedish manufacturing industry grew at 6%, compared to 5.2% in the US and 3.2% in the UK.

To little surprise, Sweden has the highest ratio of spending on research and development to GDP of all OECD countries, much of which is publicly funded. The country's success is a clear case of the importance of institutional and societal competitiveness, showing that setting high corporate contributions to public spending is sustainable, and that high levels of social spending and taxation are not inconsistent with dynamism.[50]

focus on “the consequences of open innovation, particularly within public-private partnerships”, “fostering a high-quality international system for IPR”, “the interdependencies between public and private sectors in executing R&D,” and “the supportive role that governments should play in fostering a policy climate that encourages investment in R&D and the commercialization of new innovative products”. And they note, of course, that “education is indisputably a core responsibility of governments.”[49]

More and more public spending is used to enhance institutional and societal competitiveness, not to extend welfare and social programmes. Indeed, in most industrialised countries the current political debate is about how to dismantle benefit systems and transfer the released funds to research, education and innovation policies. When more and more public spending is concentrated on strengthening business operations, and corporations are thus set to benefit even more than they already have from public spending, it is puzzling that they should expect to contribute less and less to government budgets. It would seem sensible and fair if, on the contrary, they contributed more to the investments and expenditures upon which they thrive.

International ownership of business

Ownership structures of private business are increasingly international, in many cases with a majority of shareholders of publicly listed companies living in other countries than where that company is headquartered, listed and holds its main operations. As such foreign owners are only taxed on their personal capital income in their home countries, not the country where the company is taxed. The profits they make on their shares through dividends and surpluses from selling at higher prices than what they have bought at will not be taxed in the country on whose competitiveness these profits at the end of the day are based. Corporate profits that are paid out as dividends to foreign owners therefore contribute nothing to the public spending and investments necessary to maintain and extend institutional and societal competitiveness.

For example, a Belgian company listed on the stock exchange in Brussels will very often have more non-Belgian owners than Belgian ones, in the form of private and institutional investors from a range of other countries. As they are foreign based the profits they make on the investments will not be taxed in Belgium but in the home countries of the shareholders, and thus will not help Belgium make the investments to keep the country and its companies competitive.

Due to their increasing international ownership structures, private corporations – including their long term shareholders, their management and their employees – actually have a certain interest in being taxed directly and not only indirectly through the dividends they pay to their shareholders. Thus, for business in general, there is an enlightened self-interest in contributing to their national

budgets in the form of corporate taxes, rather than to another country's budgets in the form of capital income taxes in this country. The fact that many shareholders are based in tax havens – the International Monetary Fund estimates that one third of all financial assets worldwide are held in such offshore refuges – only means that corporate profits paid out as dividends totally escape any kind of taxation and thus contribute nothing to national budgets.

The combination of growing international business ownership, relatively higher profit growth than wage increases, and falling corporate tax rates means that national government income will plummet. Or in the least, that governments will lose income unless they raise taxes on consumption and wages.

As both ownership and operations of companies are set to become even more international, corporate taxation cannot be allowed to decline yet further without detrimental consequences to public finances and to the long term competitiveness and societal wellbeing they are used to finance.

The end of employer-financed welfare schemes

Fewer and fewer employers, from China to the US, are eager to continue providing health care and pension benefits to their employees. Employer financed schemes are being rolled back and costs are shifted to workers or governments, as the companies whose profits are rocketing and tax contributions are plummeting argue that they cannot afford to provide their employees with these benefits anymore.

In China, only ten years ago, a job – most often in a state owned enterprise – would include access to medical care, housing, education, maternity leave, pensions and living allowances in the case of redundancy or disabilities. State owned enterprises had a multifaceted role, combining capital accumulation, the provision of employment and welfare. Today, most of these enterprises have closed down, been sold off or restructured. Like most companies in China, they no longer provide many of the benefits they used to. Universal health-care, pension and social security systems have been replaced with 'pay as you earn' systems, which transfer the onus from the employer to the individual worker.

In the US, employers have provided health-care and pension benefits since World War II, often encouraged by tax breaks. The system was reasonably stable for decades but has lately been cracking. Steelmakers, airlines and auto companies have bought their way out of pension promises, and big, healthy companies have frozen old pension plans and moved to schemes that will save them money and shift risks to workers. Only 45% of US private sector workers are offered employer provided pension coverage, while 60% have some kind of employer paid health insurance. Both

figures have been slipping since 2000. And 45 million people, or 15% of the population, are now without any health care coverage at all.

What is more, those that have pension plans are seeing the features of these plans deteriorate, with the shift from defined-benefits to defined-contributions plans. The former have traditionally promised workers pension benefits based on a percentage of their final salary. In the latter, the employer only contributes a fixed amount to the plan each year, and thus shifts the investment risk and responsibility to individual workers. Since 1978, the number of defined-benefit plans has dropped from 128,041 plans covering some 41% of private-sector workers to only 26,000 today, covering around 21% of employees in this sector, according to the U.S. Bureau of Labor Statistics. A bad development for wages earners but a good move for employers who have cut their bills: under defined-benefit pensions, employers usually contribute around 8% of the payroll to pensions. With defined-contributions they get away with paying less than 3% of payroll.[51]

THE TWO-TIER RETIREMENT SYSTEM

Everybody deserves a secure retirement. Yet increasingly, companies are terminating their pension plans and transferring the risk of saving for retirement onto their employees. One group of employees, that is. Since at the same time, many of these companies have turned their executive pension plans into CEO wealth-creation devices. As a result, many companies have a two-tier retirement system: one for the CEO and another for everybody else.

Top 10 CEO pension plans

Company	CEO	Annual retirement benefit
Pfizer Inc.	Henry A. McKinnell	US$ 6,518,459
Exxon Mobil Corp.	Lee R. Raymond	US$ 6,500,000
AT&T Inc.	Edward E. Whitacre	US$ 5,494,107
United Health Group Inc.	William W. McGuire	US$ 5,092,000
IBM Corp.	Samuel J. Palmisano	US$ 4,000,000
Home Depot Inc.	Robert L. Nardelli	US$ 3,875,000
Colgate-Palmolive Co.	Reuben Mark	US$ 3,700,000
Comcast Corp.	Brian L. Roberts	US$ 3,600,000
Bank of America Corp.	Kenneth D. Lewis	US$ 3,486,425
Union Pacific Corp.	Richard K. Davidson	US$ 2,700,000

Source: AFL-CIO

If corporate-funded welfare systems continue to crumble there are basically three choices to be made: to make workers pay health and pensions themselves, to make it cheaper for employers to cover this, or to have governments pick up more of the tab. Which ever choice is made, business stands to save while workers stand lose to. Combining the corporate retreat from health care and pensions with the declining corporate tax rates and contributions, it is hard to see how government or wage earners can cover the costs. In an ideal world, neither employer-provided benefits nor corporate taxes would be disappearing. In the real world, that is exactly what is happening.

COUNTERING
THE IMMINENT GLOBAL TAX CRISIS: CONCLUSIONS AND SOLUTIONS

Tax competition inevitably leads to declines in the amount of taxes paid by corporations, a loss of public revenue, and an increased burden on individuals. The extensive tax evasion and avoidance by multinational corporations only adds to this development. Since tax bases have been broadened while rates have been cut in many countries, globally the corporate tax crisis has not occurred yet. But there is a limit to how much more corporate tax bases can be broadened. In the OECD countries in particular, this limit is not far off. In fact, it seems that it has been reached in some of the world's largest economies, and that rather than being broadened, it is already shrinking in these countries. Nevertheless, even the broadest tax base will not matter much if tax rates hit zero. As mentioned in a previous chapter, if the latest falls in corporate tax rates in both OECD and non-OECD countries continue into the future, tax rates will hit zero by the middle of the century. And if the active tax competition we have seen over the last five years continues at its present pace and strength, this will happen much earlier.

The wrong medication

Strikingly, the bitter irony of international tax competition is that the much proclaimed reductions in corporate taxes do not seem to do the job they are meant to do. They do not appear to either attract foreign investments or induce local enterprises to increase their investments. Thus, the countries that have participated most actively in the downward tax competition have not even had the short term gains they could have expected. In Europe, the 'new' member states of the European Union have in relative terms not received more investment from the 'old' member states in the years they have aggressively been cutting their corporate tax rates. The 'new' countries have on average had the same attractiveness as before their sharp cuts, and an extensive study on the issue thus concludes that the "predominant and only motive" for locating FDI in these countries since the mid-1990s has been local market potential, not their lower statutory and effective corporate tax rates.[52] The only consequence of their declining tax rates has thus been falling corporate tax income, not further investment and growth.

In Canada, the results of corporate tax reductions have been much the same. The statutory corporate tax rate has been cut from 28% in 2000 to 21% today. But there has so far been no impact on investment. On the contrary, corporate pre-tax profits have soared to a record share of national income, while real business investment in structures and in machinery and equipment has languished. Corporate pre-tax profits have risen from 11.3% of GDP in 1999 to 13.8% in 2004, whereas investments in buildings has dropped from 4.8% of GDP in 1999 to 4.2% in 2004, and machinery and equipment investments which made up 8.1% of GDP in 1999 have fallen every consecutive year and only made up 6.6% of GDP in 2004. This is not an impressive case for the proponents of the idea that tax cuts encourage investment: instead of investing their higher profits in their operations, Canadian corporations have boosted returns to shareholders, accumulated large cash surpluses, and invested abroad. Indeed, in the years of the critical cuts in corporate tax rates, there has been a serious decline in the net flow of foreign direct investment. Net flows of FDI have gone from positive figures of CA$ 11.2 billion and CA$ 32.8 billion in 1999 and 2000 to negative amounts of CA$ -13.3 billion in 2001, CA$ -8.5 billion in 2002, CA$ -21 billion in 2003 and CA$ -49 billion in 2004.[53] Again, the placement of investments seems to depend on much more than corporate taxation.

Likewise, the many tax subsidies given by US lawmakers in the last years to the country's biggest corporations, with the objective of increasing investments, have not had the desired effect. The corporations that took up the largest share of these tax savings, 25 companies garnering two thirds of the tax benefits given to the 275 companies from the study mentioned above, cut their investments in the areas these subsidies were suppose to stimulate by 27% from 2001 to 2003.[54]

Thus, it seems that most cuts in corporate tax rates are made on the false premise that such reductions will increase investment and attract foreign capital, and that if they are not made the country in question will be doomed to non-growth and under-development. Despite the lack of evidence, this argument is working for the corporations that increase their after-tax profits and their shareholder dividends. One example of how this false premise affects important political decisions is the continuous reduction in corporate tax rates in Canada. As mentioned, Canada has cut its federal corporate tax rate from 28% to 21% over the last five years. Yet in the 2005 federal Budget, it was announced that these rates would be reduced another notch in order to reach 19% by 2010. The Budget was quite clear in its argument: "In today's global economy, capital is highly mobile internationally, and a competitive tax system is critical to fostering business investment in Canada. Investment in new capital improves productivity, leading to economic growth, and higher wages and living standards."[55] But what it failed to mention, or apparently take into consideration, is the fact that Canada already had a very competitive tax system. In 2004, the annual 'Competitive Alternatives Report', released by the consulting firm KPMG, found that effective corporate tax rates in Canada were lower than in the US – more than 5 percentage points lower for manufacturing and with a negative tax rate on R&D, in effect making it 25 percentage points lower than the US – and

generally ranked very well out of a series of industrialised countries. The KPMG study moreover found that Canadian corporate taxes only accounted for between 3% and 11% of location-specific business costs, and that Canada all in all had the lowest location-specific costs of any of the eleven countries compared in its report. More or less the same conclusions have been reached by other business consulting groups, such as the Economist Intelligence Unit and the World Competitiveness Report.[56] Thus, in short, Canada does not have a cost-competitiveness problem or a tax-competitiveness problem. Yet on the premise that it does indeed have such a problem, corporate taxes have been cut again and again.

A vicious cycle

The development in several of the world's largest economies – the US, Japan and Germany in particular, where the contribution of business to public finances has dropped by one fifth in 10 years and two fifths in 30 years – shows that any country, no matter its size, can come under internal and external pressure to cut its corporate taxes. Although the established expertise teaches us that large economies are less at risk of capital flight, need to do less to attract foreign investments, and thus are less prone to engaging in tax competition, it is these economies that have lost most corporate tax income over the last decades, whether these are calculated from the 1990s onwards or from the 1960s and until today.

Whilst some of these losses might be explained by changing definitions of companies, i.e. more and more small businesses being taxed as individuals rather than corporations, the main explanation, particularly for the losses endured in the last ten years, is the continuous rise of multinational corporations. The world's multinationals, a majority of which originate in the largest economies, are by far the ones most agile to exploit and abuse national tax systems. Because of their size they can put pressure on governments and authorities to grant them special tax breaks. And by means of their international scope they can move their revenue, profits, losses, and debt around almost as they please.

The declining payments of taxes from multinationals are taking place at a critical time. The companies concerned have never been bigger and had larger revenues and profits than they do today, and they should have a correspondingly more significant contribution to pay to their societies. In fact, so much capital and activity is concentrated among a few multinationals that the 250 largest corporations in the US and the 50 largest in the UK have contributed up to one third of all corporate taxes in these countries for the last years. If these companies continue to reduce their tax payments year on year, the effect will certainly be felt by smaller companies, workers and consumers who will then have to bear the brunt of paying for public finance to an even larger extent than they already are. Even more markedly and unreasonably, multinationals are set to pay fewer taxes at a time when their profits are soaring and their employment payrolls plummeting. Indeed, as a share of their eco-

nomic activity, many multinationals are seeing record high surpluses and record low employee commitments

We therefore risk a global tax crisis that will in the long term also hit business itself. As tax income is necessary for governments and states not only to function and to provide all kinds of welfare, but also to keep their societies internationally competitive, tax shortfalls will be detrimental to the corporate actors that, in the short term, benefit from reductions in corporate taxes. The corporate world should therefore realise that its competitiveness requires public investments, and that it should pay its share of the financing of the resources it thrives off. And it should understand that forcing any country to engage in competition over lowering corporate taxes will hamper its own ability to innovate, slow its growth and undermine its future prosperity.

Political commitment urgently required

Corporate tax rates are set by governments and it is they that can close legal loopholes that are exploited in the name of tax avoidance and evasion. Thus, to counter the imminent tax crisis governments must first of all understand that 'beggar-thy-neighbour' tax competition is leading to a damaging global loss of public revenues. And they must realise that generous tax breaks seldom have the desired economic effect, that loopholes will be abused cynically, and that under-funded tax authorities are destined to lose the battle against corporate tax dodgers.

But governments must also face another kind of music: the fact that the undermining of corporate taxation is happening because they are competing against each other and being played against one another by multinational corporations. And hence, only multilateral solutions can stop this downward spiral. The leadership of a few or a small group of countries can go some way but it is only the global recognition that all countries have a common interest in cooperating to achieve a minimum level of corporate taxation that will fix the problem; and that to make a start, countries at comparable levels of economic development, and states geographically close to each other, should begin co-operating on eliminating destructive effects of tax competition between themselves.

Yet whether governments, the international political community and its institutions actively do something constructive and worthwhile to ameliorate destructive tax competition and to limit the damage done by tax havens and EPZs, as well as tax avoidance and evasion by companies, comes down to will and dedication. Unfortunately, it is exactly the lack of political will and dedication that so far has hindered some of the most promising initiatives to combat harmful tax practices from taking off. Thus, while the OECD has done pioneering work on the issues of harmful tax practices, tax havens, transfer pricing and tax evasion it has often been set back in this work by some of its largest member states.

Through the OECD, member states have agreed to act collectively and individually to eliminate harmful tax practices, particularly with respect to preferential tax regimes within the OECD. In relation to this commitment, a preferential tax regime is considered harmful if it imposes low or no taxes on the income in question (for example from geographically mobile financial services), if the regime is ring-fenced from the domestic economy, if it lacks transparency, if there is inadequate regulatory supervision or financial disclosure, or if there is no effective exchange of information with respect to the regime. Member states have committed themselves to refrain from adopting new measures, strengthening and extending the scope of measures that constitute harmful tax practices, to review existing measures for the purpose of identifying those that constitute harmful tax practices, and to remove the harmful features of any harmful preferential regimes within 5 years. And the results have so far been positive. Out of 45 preferential tax regimes identified as potentially harmful in 2000, 18 regimes had been abolished or were in the process of being abolished by 2004, 14 had been amended so that any potentially harmful features had been removed and 13 had been found not to be harmful based on further analysis.[57] And the OECD has also done some fruitful work in increasing the transparency of tax havens outside OECD countries. Hence, by 2004, a total of 33 countries and jurisdictions had committed to the principles of effective exchange of information and transparency with the organisation and its members.

Nevertheless, when the organisation has taken initiatives that would make an even larger difference, it has more than often been blocked in its endeavours. When it had worked out a policy for dealing with tax havens, which aimed at taking 'defensive measures' against these jurisdictions, it was halted by the US President George W. Bush had only recently taken up his office, when his Treasury Secretary at a G7 finance ministers meeting expressed concerns that the OECD was trying to dictate countries' tax rates. And later that year, he stated that the OECD demands were 'too broad' and in consequence withdrew US support.[58] Since then, the programme has in effect been less ambitious. But ambition is exactly what is needed for the global tax crisis to be countered. Ambition, political will and true dedication from governments is necessary if there is to be any chance of true international cooperation around taxation, not least corporate taxation.

Practical steps

To counter harmful tax competition and the abuse of tax systems by multinational corporations around the world, new inventive measures must be taken. Governments and international institutions must be bold to ensure the effectiveness of such measures. In practical terms, the following initiatives should be pursued in one way or another:

- To offset detrimental tax competition, the possibilities of establishing regional and global tax authorities, representing the interests of citizens, and ensuring that national tax systems do not

have negative global implications, should be examined. Such authorities should, if their establishment is possible, be established within the UN system. The experiences and expertise of the OECD should be used to guide such work.

- To enhance the work on harmful tax practices, including tax havens, tax evasion and transfer pricing, within OECD countries and more generally, the OECD's initiatives should gain broader political support and be backed by stronger financial commitments, recognising that it is currently the only multilateral agency with the capability of dealing with global tax issues.

- To counter one of the most widespread harmful tax practices, export processing zones and other institutional arrangements that give certain companies, producers and employers tax advantages compared to other national actors, should be phased out. Granting certain entities tax benefits that do not apply to other entities should be regarded as illegitimate competition and as trade distorting measures in the relevant bodies, such as the WTO for example.

- To fight tax evasion and to better facilitate assessment and collection of taxes, comprehensive and automatic information exchange systems between all tax authorities should be developed. Such systems should, at the end of the day, be compulsory and have adequate institutional backing. Countries or jurisdictions that do not live up to them should be eligible for economic penalties and sanctions.

- To limit the possibilities of transfer pricing and other activities that take advantage of tax havens through artificial transactions or constructions, corporations should be taxed where they operate, where their work is being done and where real value is added, not where they carry out paper transactions or where they file corporate registrations.

- To reduce the worst and most detrimental tax practices by corporations, standards requiring multinational corporations to refrain from harmful tax avoidance and evasion should be introduced as part of both official and voluntary codes of conduct for these companies and for the tax planning industry.

- To deter unlawful tax evasion, corporate executives together with their lawyers and accountants should be made liable for criminal penalties for profit laundering and tax evasion.

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The International Confederation of Free Trade Unions (ICFTU), was set up in 1949 and has 236 affiliated organisations in 154 countries and territories on all five continents, with a membership of 155 million, 40% of whom are women.

It is a Confederation of national trade union centres, each of which links together the trade unions of that particular country. Membership is open to bona fide trade union organisations, that are independent of outside influence, and have a democratic structure.

The ICFTU organises and directs campaigns on issues such as:
- the promotion of decent work for all,
- the respect and defence of trade union and workers' rights,
- the eradication of forced and child labour,
- the promotion of equal rights for working women,
- the environment,
- education programmes for trade unionists all over the world,
- the organisation of young workers,
- the trade union and human right situation in many countries.

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