TAX JUSTICE FOCUS

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THE TAX CONSENSUS HAS FAILED

A consensus has built up around the world over the past couple of decades about what taxes should do and how they should be set up. Unfortunately, this Tax Consensus has failed. Alex Cobham explains.

The Tax Consensus has been led by economists and tax experts working with the international financial institutions. A look through the IMF's Article IV consultation documents with member countries shows how pervasive it has been in driving recommendations and, ultimately, policy. Unfortunately, this Tax Consensus has failed.

To understand why this consensus has failed, first consider the four clear outcomes of taxation: the four Rs.

The first *R* is **Revenue**. Taxes raise money to pay for health, roads and education, or for more indirect things like good regulation and administration. Most people are familiar with, and accept, this function. Not everyone, however, recognises that there is more to tax than this.

The next R is **Redistribution**: taxation can help reduce poverty and inequality, and spread the benefits of development more widely. Different taxes have different effects: according to a recent survey of two decades of tax studies, income taxes are usually progressive (they reduce inequality;) corporate taxes are regressive (increase inequality) at low incomes but then become progressive; property taxes are progressive; indirect taxes (like value-added tax, VAT) are generally regressive, and the overall picture is mixed, although at low incomes, taxation is often regressive. Many people are familiar with this function of tax, although not everyone agrees with it.

The third R is **Re-pricing**. Taxes (and subsidies) can be used to change behaviour: taxing tobacco, pollution or carbon-based energy, for example, is accepted by many people as a way to curb potentially harmful activities.

The final R is the one most often forgotten, and it may be as important as the first: **Representation**. Taxation strengthens and protects channels of political representation: when citizens are taxed, they demand representation in return from their rulers. (This is also discussed in Mick Moore's paper, below.)

Why the Tax Consensus has failed

For developing countries in particular, the Consensus has failed on each one of these four Rs.

First, it emphasises *tax neutrality*: a tax system should not distort production or consumption decisions, because it is argued that this would reduce economic efficiency. In practice, however, this has meant a shift away from direct taxation (which is generally progressive) and towards more regressive indirect taxation

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(as well as trade liberalisation, in the name of greater efficiency) and the net result has been that governments in poor countries have been stripped of the essential tools for redistribution – frequently with the effect of worsening inequality, hence often damaging political stability and consequently harming efficiency too. Little political space has been left for re-pricing either.

How the consensus undermines redistribution in poor countries

The Consensus also emphasises that *redistribution should happen, if at all, via spending, not via taxation*. But this assumes that governments have available a full range of instruments, including – critically – an option to make direct cash transfers to households, which can theoretically be combined with non-progressive taxation to generate the equivalent effects of a progressive (e.g. income) tax. But in low-income countries, including much of sub-Saharan Africa, governments simply do not have the capacity to make these transfers. So following the tax consensus involves giving up most of their power to reduce inequality. This can have disastrous effects.

How the consensus undercuts revenues

Another feature of the Tax Consensus is that *governments are supposed to aim for revenues of around 15–20% of GDP* – even though revenues in the EU-15 countries average more than 30%, and quite often significantly more than that. Governments are consequently encouraged to limit their revenue targets and constrain their spending. A study by Michael Ross of the University of California, Los Angeles (UCLA) showed that channels of representation are systematically strengthened when the share of tax revenue in government spending is higher – that is, when governments rely most on tax. Other research has shown that direct taxation (through personal income taxes and corporate profits) is the most important, in terms of strengthening relationships of accountability between rulers and ruled. But the Tax Consensus is telling poor countries to avoid direct taxation, and to reduce revenues, again with potentially very negative results on the strength of governance and the quality of institutions.

> *"Paying tax reflects, to a significant degree, a desire to participate in society, not just economic maximisation."*

Government is an outcome of taxation

In short, the Consensus holds that governments should focus above all on revenues (with a role also for redistribution and re-pricing). What is missing is this: the system of government itself is one of the most important outcomes of tax. In other words, healthy political representation emerges from the process of taxation, leading citizens to hold governments to account. The Consensus implicitly assumes that the channels of political representation are already strong. For this reason alone it is unsuited to poor countries.

Not only that, but the Consensus has not generated sufficient revenues. One reason is that it tends to ignore massive revenue losses as corporations and High Net Worth Individuals (HNWIs, or Hen-Wees) evade and avoid taxes. I estimate that US$385bn of tax revenues are lost annually by developing countries, and a key part of this is due to international tax evasion. The amount that might be recovered using better tax policies significantly exceeds global aid flows.

Tax is a social act

But more broadly, and not just for these reasons, compliance in poorer economies is particularly low. This raises another issue: paying tax is a social act. People don't pay tax according to raw economic maximisation, as the consensus implicitly assumes – in fact, studies repeatedly show that tax compliance significantly exceeds what you might expect from maximising, rational agents, given the existing levels of fines and (expected) chance of getting caught. The experimental |economics literature has found that people's behaviour is more complex than this: compliance depends positively on (i) the perceived or expected level of redistribution, and (ii) individuals' expectation of others' compliance levels (one study refers to 'tax morale' – a belief in contributing to society by paying tax – and shows that the size of the shadow economy depends directly on this.) So it seems that paying tax reflects, to a significant degree, a desire to participate in society, not just economic maximisation. This, then, is the final flaw in the Tax Consensus. Domestically it has undermined redistribution, and at internationally it has failed to prevent evasion – and together these perpetuate non-compliance and the continued failure of tax systems in poorer countries.

Conclusion

The Tax Consensus has failed. It has failed to deliver desperately needed revenues; it has little or no place for redistribution; and this, with the absence of international measures to tackle evasion through tax havens and by multinational firms has fostered dismal levels of real (and perceived) compliance. This outdated ideology now needs to be overthrown, so that poor countries can put a range of policies back on the table and be free to choose the tax policies that they really need: tax systems that raise revenue, redistribute and strengthen channels of political representation for genuinely sustainable development.

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WAKE UP, DONORS

Nicholas Shaxson

Two 3-letter words ending in "x" have enormous capacity to generate newspaper headlines. One is tax. As our blogs indicate, TJN's concerns about tax distortions and tax havens have become unusually news-worthy in recent months. More importantly, political debate is starting to shift in a healthy direction, too.

"Several recent empirical studies show that a larger share of tax revenues in total government revenues — in particular direct tax revenues — is associated with more democratic institutions."

For decades, tax has been the domain of specialists who are typically accountable solely to their clients and are often unconcerned about the social and broader economic outcomes of their work. Many specialists thrive on complexity, which makes it harder for non-specialists to understand the issues and which increases possibilities for creating and exploiting loopholes. As a result, we have what Alex Cobham calls the failed Tax Consensus.

A glaring failure of much debate around taxation is the excessive focus on efficiency, and notably the treatment of tax as a burden to be minimised. There is nothing wrong with efficiency, but it does obscure a crucial aspect of taxation: Representation, the fourth "R" in Cobham's analysis.

The fourth "R" changes everything: as Martin Sandbu of the University of Pennsylvania points out,[1] "several recent empirical studies show that a larger share of tax revenues in total government revenues — in particular direct tax revenues — is associated with more democratic institutions." The plight of poverty-stricken, conflicted and corruption-prone countries that depend on natural resources such as oil illustrates the problem: when states depend largely on taxing mineral-extraction companies, they no longer have to bargain with the citizens they rule, and so feel less accountable to them.

This political dimension to taxation is often forgotten. Tax, and especially direct taxation, represent key tools that can be used for tackling poverty and inequality, and efforts to improve matters are undermined by a widespread failure to tackle tax evasion (and tax avoidance). Building accountability through taxation needs two dimensions: first, strengthening domestic tax systems, and second, giving states more freedom to tax élites who would otherwise move their income and assets offshore. This would give all stakeholders in a society stronger incentives to demand better accountability at home.

So it is surprising that aid donors remain reticent about tackling not only tax avoidance and evasion internationally, but also taxation inside states. On April 24th TJN's John Christensen, along with Professor Mick Moore, held an event for parliamentarians, policy makers and others in London called "Why Are Aid Donors Frightened of Taxation?" Moore argued that donors often purposefully avoid the issue.[2] This is unacceptable: donors have a responsibility to wake up to the importance of tax, not just because good taxation fosters better governance; but also because the end goal should be to let poorer countries finance development from tax revenues rather than by relying endlessly on foreign aid.

But there are other ways of strengthening accountability. One is to increase the transparency of businesses in the countries where they operate. Hence our interest in International Financial Reporting Standards: another debate which has been dominated by the specialists for too long. Richard Murphy's article outlines what might now be achieved. TJN is also developing a Code of Conduct for Taxation, with the aim of influencing an emerging debate about the role of companies, governments and tax advisers in their interactions with the onshore and offshore worlds. As you will see from Prem Sikka's article in this edition, we are just at the start of what will be a long and interesting journey.

[1] Natural Wealth Accounts: A Proposal for Alleviating the Natural Resource Curse, by Martin Sandbu, World Development No. 34, 2006.

[2] See "Dangerous Ideas in Development - Why Are Aid Donors Frightened of Taxation?" at http://www.ids.ac.uk/ids/news/Archive%202007/taxation_apr07.html

feature

HOW TAX AFFECTS GOVERNANCE

Mick Moore & Nardia Simpson

In the field of development policy, debate over tax has mostly been conducted by economists concerned with fiscal stability, equity or economic efficiency. That is now starting to change. There is a growing literature on the connections between tax and governance, and a debate is starting to emerge about its relevance to policy.

Historians are familiar with the links between taxation and governance. In seventeenth century Britain, conflicts between the king and Parliament revolved around a struggle for control of public finance. American colonists rejecting British colonial rule in the eighteenth century famously demanded "no taxation without representation".

The message from history is this: governance, or the way that states acquire and use their power and authority, is shaped by the ways that citizens are taxed. Better governance comes from making states respond better to the needs of their citizens; first, from rules-based mechanisms (such as electoral democracy) – which require them to answer to and be accountable to their citizens; and second, from the capability of the state – this means not just political capability (determining what the needs are, or managing competing interests) but also bureaucratic capability to design and implement policy, and to enforce authority.

Research by the Centre for the Future State based at the Institute of Development Studies (IDS), suggests that while most states rely on broad taxation to raise revenue, some states rely instead on other, more problematic forms: notably from natural resources, but also from aid. Foreign borrowing can also have this effect. States relying on these alternative forms of taxation tend to feel less need to negotiate with, or be accountable to, their citizens, or to build their capacity to raise and administer tax. By contrast, states that rely on broad taxation have greater incentives to practice better governance, for three main reasons. First, broad taxation affects the state itself, which focuses more on obtaining revenue by taxing citizens. Second, tax affects citizens: it engages them politically. Third, through taxation states and citizens begin to interact, and to bargain over revenues. Citizens pay tax in exchange for being able to influence the level and form of taxation and the uses of revenue. Better accountability tends to follow.

Poor countries and the politics of tax

The clearest illustrations of these basic mechanisms come from the history of states in Western Europe, where governments used to raise taxes mainly to fight wars. But in poor countries nowadays, the politics of taxation are more complex. For example, taxpayers in poor countries are often more diverse, with fewer shared interests. Complex tax systems, with large numbers of exemptions, often encourage taxpayers to make individual bargains with government instead of taking collective action on behalf of taxpayers generally. In such countries, tax collection can be arbitrary, unfair or brutal, and it can even undermine constructive political engagement between government

"Even though the links between tax and governance are complex, there is compelling research evidence that the core argument about the contribution of broad taxation to better governance remains valid."

and taxpayers. Tax collection is difficult, for example, in agrarian economies: there are few records so it involves face to face interaction, which can increase discretionary power and thus extortion. Coercive, arbitrary taxation can poison relationships between citizens and governments.

Even though the links between tax and governance are complex, there is compelling research evidence that the core argument about the contribution of broad taxation to better governance remains valid.

Tax reform can help

There are some very practical steps that donors and national policymakers could take to increase the chances that tax policy contributes to better governance.

In general, policymakers need to concern themselves with how tax is raised, not just how much. The goal is not necessarily just to raise more taxes, but also to foster more consensual tax relationships. For example, a shift from indirect trade taxes to more direct kinds of tax makes taxation more visible, which is more likely to mobilise taxpayers politically, generating the healthy relationships of accountability. It can also be helpful to abolish some taxes, to simplify other taxes, to widen the tax net by reducing exemptions, by extending tax registration, and by increasing transparency. All of these measures reduce the scope for individual lobbying, and boost the incentives for public action. Better administrative capacity can, of course, also help. In particular, there are six things that aid donors can do:

- Stop focusing only on the scrutiny of public spending, and encourage more debate about the links between sources of revenue and the goals of public spending.
- Offer longer term aid commitments in exchange for tax reforms that make revenue raising fairer and more effective, with a view eventually to phasing out aid.
- Take more urgent action internationally to help make revenues from natural resource exports more transparent.
- Clamp down on money laundering, and on corruption by companies from donors' home countries, thus limiting the access of political elites in poor countries to this source of 'unearned' income.
- Keep supporting professional networking of tax experts from developed and developing countries, to exchange views and experience on tax policy, and to enhance professionalism.
- Seriously consider ending tax exemptions for aid inflows. This would set a good example; it might reduce transaction costs for national revenue authorities; and **it could** narrow opportunities for fraud.

Unlike several other, more intrusive, plans to improve governance, tax is a relatively low-profile entry point for policymakers. These policy changes could mostly be made in small steps, yet they could nevertheless have a very tangible impact on governance by increasing the chances of constructive bargaining between governments and taxpayers.

This article is based on a Policy Brief written by Mick Moore and Sue Unsworth. It draws on research conduced by Mick Moore, the Director of the Centre for the Future State, a DFID-funded Development Research Centre based at Institute of Development Studies, Brighton.

The full text of this Policy Brief (http://www.ids.ac.uk/gdr/cfs/pdfs/PB34.pdf) and a longer Working Paper are available for free download at: http://www.ids.ac.uk/gdr/cfs/

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HOW TO MAKE MULTINATIONAL COMPANIES MORE TRANSPARENT

feature

Richard Murphy FCA

Under current international accounting standards, companies typically report for an entire geographical region, making it impossible to unpick the reporting data for each country where an MNC operates. This can particularly harm poor countries, which lack resources or skills to monitor properly what MNCs are doing on their territory, or to find out who really owns them and whether they are paying taxes properly. These gaps also foster secrecy and corruption. TJN wants the rules to be changed, to introduce an international requirement for Country-by-Country (CbC) reporting.

The campaign for Country-by-Country reporting by multinational corporations (MNCs) arose from two initiatives. First, the Tax Justice Network (in its very early days) wanted to get disclosure of which MNCs were using tax havens and were abusing transfer pricing. I wrote a draft International Financial Reporting Standard for discussion, which was published by the Association for Accountancy and Business Affairs (AABA) in 2003.[1] Then, in 2004, I started advising Publish What You Pay (PWYP) coalition on the Extractive Industries (that is, industries based on minerals like oil) and, more specifically, the Extractive Industries Transparency Initiative (EITI). My report, "Making it Add Up",[2] was published by Global Witness and Save the Children UK in February 2005, highlighting problems with EITI. It suggested, among other things, that:

> *companies in each country [should] publish all their payments to government, in a full and timely manner, which allows for meaningful comparison.*

PWYP then asked me to develop an accounting standard for the Extractive Industries.[3] When it became clear that this avenue for progress was closed for the time being, PWYP and TJN made a submission[4] to the IASB (International Accounting Standards Board, a private Delaware corporation) in March 2006. Eighty organisations supported our submission.

What we're calling for

We are calling for standards that would go beyond the extractive industries and would embrace all companies. These standards would require each MNC to report:

1. In which countries it operates;
2. What it is called in that location;
3. What its financial performance is in each country, identifying third party and intra-group trade, and labour-related information;
4. How much tax (and other benefits) it pays to government locally as a consequence.

This information should be reported for all territories, without exception, where the multinational corporation operates. Anything less will not do. (This does not require every country to agree to accept the standard, as the requirement would be imposed at an international level.)

Why this is important now

In November 2006 the IASB, which is trying to get its standards to converge with U.S. accounting standards,) issued its latest standard, known as IFRS-8. They had clearly ignored our submission and we felt it was a backwards step: it not only did not incorporate a CbC requirement, but also moved away from clear geographic reporting and gave huge discretion to management on how to report financial data. We think the old standard, IAS-14, is better.

However, the opportunity to lobby on this increased recently, because the European Commission is reviewing a proposed accounting standard that could be amended to make such reporting mandatory for all European based companies. This opens an opportunity to put pressure on the EU to reject the IASB standard, revert to the old one and go back to basics.

Various EU parliamentarians have expressed concern about IFRS, and now we are getting significant support from UK and international financial institutions: the UK's National Association of Pension Funds and Investment Management Association are behind us, and see the merit of our arguments. Internationally, the International Corporate Governance Network, with $10 trillion under management, has expressed reservations about IFRS-8 in a letter signed by Calpers, America's largest pension fund. (The link with investors does not guarantee victory, but it

1 You can find it here: http://visar.csustan.edu/aaba/ProposedAccstd.pdf

2 http://www.globalwitness.org/media_library_detail.php/130/en/making_it_add_up

3 That is available at http://www.publishwhatyoupay.org/ifrs/pr_190905.shtml

4 http://www.taxresearch.org.uk/Documents/IAS14Final.pdf

"Europe must have the right to reject an IFRS, or democratic control of reporting passes to a privately owned Delaware corporation substantially funded by the Big Four accountants."

adds considerable institutional weight to the arguments, and suggests that we are raising questions of broad concern.)

Many people and organisations shy away from things like this, which may seem remote and arcane. Believe me, they matter. Europe must have the right to reject an IFRS, or democratic control of reporting passes to a privately owned Delaware corporation substantially funded by the Big Four accountants. Accounts should be about more than the question of whether to buy or sell shares (the IASB's definition of 'decision usefulness') but should also be about accountability and stewardship. The benefits are hard to quantify, but we believe that CbC reporting could potentially benefit poor countries as much as all foreign aid, and it could substantially bolster democracy and governance in rich and poor countries alike. Here are a few more reasons to be concerned:

1. **Accountability matters.** A company cannot be accountable unless it can be identified. This means that the names an MNC uses locally must be on public record. Too often they are not. CbC reporting names and identifies local subsidiaries.

2. **Corporate governance matters.** Many recent corporate scandals have involved offshore subsidiary companies. These are becomingly increasingly common, but it is recognised that managing them creates severe governance issues for MNCs, resulting in increased risk for shareholders and others.

3. **Corporate social responsibility (CSR) matters.** CSR is about the relationship between a company and its host community. The host community should know the companies operating locally. CbC reporting provides that information.

4. **Corruption matters.** The EITI, for example, seeks to hold companies in the extractive sector to account for tax payments they make, and the governments that receive those payments to account for what they do with them. Many MNCs resist disclosing information because of competitive pressure, contractual obligations and local political opposition. By making the standards international CbC would overcome these objections, enhancing transparency.

5. **Development matters.** Aid can sometimes help poor countries develop, but it is not a sustainable answer. Local declaration of economic activity by MNCs, with consequent accountability for taxes paid, could help break this cycle and create independent, accountable governments much better able to raise their own taxes.

6. **People matter.** MNC accounts include statements on the number of employees a company has and their aggregate remuneration. CbC would require this statement for every country, providing invaluable information on labour conditions worldwide.

7. **Tax matters.** MNCs have more opportunity than any other group to plan their tax affairs. They can shift profits from state to state, artificially, to find the lowest overall bill. CbC discloses companies' profits and taxes in each country where they operate, so they can be held accountable for what they do and don't pay. If this were tackled, enough tax might be collected to pay for the Millennium Development Goals.

8. **Trade matters.** 60% of world trade is intra-group trade across national boundaries between companies under common ownership or control. Existing MNC accounts encourage transfer mispricing by hiding this trade from public view. CbC shows it all.

9. **Transparency matters.** In many countries a corporation does not have to publish its accounts: so what it does in that country is not a matter of public record. What MNCs do has enormous implication for the wellbeing of the world. CbC overcomes this problem, by putting all MNC activity 'on the record.'

10. **Where you are matters.** Some countries are unstable, politically unacceptable, or subject to sanctions. If a company trades there, shareholders and civil society should know. Where you are matters. Currently, companies can hide where they operate. CbC would expose them to transparency.

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COMING SOON: A CODE OF CONDUCT FOR TAXATION

feature

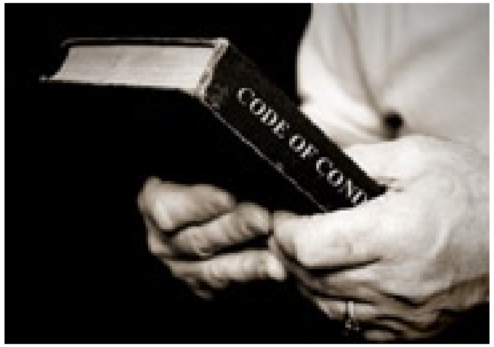
Prem Sikka

Governments do sometimes try to tackle the problem of tax losses resulting from outflows of financial capital to offshore secrecy jurisdictions. But when it comes to the other side of the equation – inflows of financial capital – political will is much harder to find. And yet the world would be a better place if this could be achieved on a global basis. International co-operation on taxation is the obvious answer to this "prisoner's dilemma" problem. A code of conduct for taxation would be a useful step in this direction.

Later this year the Association for Accountancy and Business Affairs (AABA) and Tax Justice Network (TJN) will launch a "Code of Conduct for Taxation", which Richard Murphy has been developing after extensive consultation.

Co-operation on tax and in related fields tends to be confined to narrow issues like money-laundering, and footloose corporations and elites consequently use the uncoordinated international architecture to play jurisdictions off against each other, using tax havens and the services of a global tax avoidance industry (accountants, lawyers, and banks) to avoid taxes, leaving others to shoulder the tax burden. Governments tend not to support each other in this field, probably because each gains advantage from attracting tax dollars from others. As a result of this international game of beggar-thy-neighbour, millions of people go without adequate healthcare, pensions, education, housing and other necessities, and governments cannot fund proper social investment or redistribute wealth. Citizens feel less engaged in national democratic politics.

The US loses over $300 billion annually through organised tax avoidance, while developing countries are believed to be losing



nearly $385 billion each year. One reason why this state of affairs has developed is that international tax policy has been formulated by tax specialists, without input from civil society organisations. We hope that this code will help re-balance the equation.

Part of the international financial architecture is missing

Although several transnational governance institutions exist, such as the World Bank, the International Monetary Fund (IMF) and the World Trade Organisation (WTO) – and the international financial architecture is growing – what is missing is broad international structures to help or enable nation states to collect taxes. There is also considerable scepticism about the use of Codes to regulate commercial life and to curb predatory behaviour. Nevertheless, codes can have considerable influence, and now would be good time to try and push for change, for early signs are appearing that the mood might be shifting. An editorial in the *Financial Times* on June 25th this year provides one illustration of the emergence of new thinking:

> *The survival of unchained financial capitalism cannot be taken for granted. It will endure only if a sizeable portion of humanity decides that it serves their interests… democracy rests on the perception of fair treatment of its citizens. Most people accept the wealth earned by successful business activity. Far less acceptable, however, is the ability of the rich to avoid almost all taxation. Regulation must be global. Moreover, such regulation must include taxation. As finance goes global, so must the depth of co-operation among fiscal authorities. A world in which a global plutocratic class pays little or no tax, while benefiting from the stability generated by taxes imposed on the 'little people', will prove unsustainable… A political backlash is already now visible. In the next downturn it is sure to grow. It is one the financiers themselves must not ignore."*

Another example of the changing mood comes from Matthew Slaughter, one of President Bush's former economic advisors, who recently called in the prestigious American journal *Foreign Affairs* for large-scale wealth redistribution through taxation, to head off a backlash against globalisation.

"The best way to avert the rise in protectionism is by instituting a New Deal for globalization – one that links engagement with the world economy to a substantial redistribution of income. In the United States, that would mean adopting a fundamentally more progressive federal tax system."

"A world in which a global plutocratic class pays little or no tax, while benefiting from the stability generated by taxes imposed on the 'little people', will prove unsustainable."

Financial Times, June 2007

More specifically, the EU, the UN, the OECD and others are all talking about formulating a Code as a first step towards developing a comprehensive framework for taxation, and AABA and TJN will offer this Code voluntarily, to influence the emerging debate.

What a Code of Conduct would mean

Collecting democratically agreed taxes usually involves three parties: governments, taxpayers, and their advisers or agents. A code of conduct will require each party to accept certain obligations, such as:

- Participating governments will introduce a 'General Avoidance Principle' (Gantip), undertaking not to offer artificial tax incentives that invite retaliation. The Code will require that countries give full support to other tax authorities trying to collect taxes due.
- Tax records should be transparent and publicly available. Taxable transactions should be recorded where their economic benefit is best determined to arise. Accounts of all material entities should be publicly available. Taxpayers and their advisers should consistently disclose all tax planning and related data to the relevant authorities; tax planning and tax reporting should be guided by the principle of 'substance over form'.
- Governments should publish budgets and spending plans in advance and secure parliamentary approval for them. States should voluntarily submit themselves to an annual appraisal of their conduct, which could be reviewed by a Committee of Independent Experts appointed by participating states. Disputes can be resolved by binding arbitration.
- Taxpayers will not suffer discrimination because of race, ethnicity, gender, nationality, age, income, or any other reason. This is not only for the usual social reasons, but also because certain forms of discrimination can open up tax loopholes – such as Britain's controversial domicile rules which allow wealthy "non-domiciled" residents to pay very low amounts of tax, thus discriminating against other British taxpayers who do not have access to such advantages.

The Code should be flexible (it may need to be revised in its early form, in response to experience and developments;) it should be grounded in enduring "first principles," and it should interact with a variety of institutional arrangements, governance structures and democratic understandings around the world. We hope governments will develop ways to help enforce it, through, for example, domestic laws, international laws, EU directives or multilateral treaties.

We acknowledge the difficulties associated with using codes to change behaviour. However, the business and commercial world also seeks certainty and a stable environment. Taxpayers complying with the code may find that administrative burdens are lower; corporations abusing the code may lose public confidence.

The ultimate prize would be better governance of tax matters and advancement of democracy, openness and public accountability.

Prem Sikka is Professor of Accounting at the University of Essex and is the director of the Association for Accountancy and Business Affairs (AABA).

news and research

Illicit Financial Flows: Will the World Bank rise to the challenge?

by John Christensen

RAYMOND BAKER IS A determined man. At a TJN meeting with the World Bank's governance team in 2006, he politely but very firmly asked: "What will it take to persuade the World Bank to do a proper job of investigating dirty money flows?" Baker estimates such outflows at $1.0-1.6 trillion per year, half from developing and transitional economies, but he wants the World Bank's experts to do their own sums. At the meeting there were embarrassed smiles and shuffled papers, but no clear indication that the Bank, for all its fine words about tackling corruption, was willing to engage.

How things have changed over the intervening 12 months. Dirty money, capital flight and tax evasion are moving centre stage and were the theme of a major conference in Washington on June 28 which assembled lawyers, policy specialists and investigators, many of whom had not properly thought about the issues before. Paul Wolfowitz had recently left as head of the World Bank, and Norwegian diplomat Bjorn Brede Hansen announced at the conference that his government will commission Wolfowitz' successor, Robert Zoellick, to prepare a forensic study into how illicit funds flow out of developing countries. Ray Baker can take much of the credit for making this happen. Hansen also announced his government's plans to lead an international task force to investigate tax havens and crack down on the abusive practices they enable. TJN and Ray Baker's team at the Global Financial Integrity program will be advisers to this task force.

"We have an integrated global structure in the Square Mile and Manhattan whose basic purpose is to shift money from the poor to the rich."

"We have an integrated global structure in the Square Mile and Manhattan," Baker said in his introductory speech, "whose basic purpose is to shift money from the poor to the rich." Startling evidence was presented at the conference of how this is done, with offshore legal entities evolving to enhance tax haven secrecy in the face of global anti money laundering initiatives. Concerns were raised about how new countries, including Ghana in West Africa (where a large oil discovery was recently announced), are preparing to create offshore financial centres to compete in an already crowded market. *The Economist* also recently described efforts by Sudan to set itself up as a tax haven. According to Ray Baker:

> *"A mineral exporting nation serving as an offshore financial center and tax haven is surely the worst combination possible. Ghana's own wealth will inevitably get sucked into this black hole, driving apart rich and poor and forestalling economic development. Opting for such an unwise step should signal the end of any further need for foreign aid."*

Raymond Baker is the author of Capitalism's Achilles Heel *and heads the Global Financial Integrity program in Washington.* www.gfip.org

Speaking on the World Bank's behalf, global governance director Daniel Kaufmann acknowledged that corruption had received no attention before the 1990s, and agreed that much still needs to be done. Yet he downplayed concerns about tax evasion to a second rank issue, and failed to demonstrate that the World Bank understands how tax havens create enabling environments for grand corruption. Herman Wiffjels, World Bank executive director for the Netherlands, showed a far better grasp of the subject, and spoke of the Bank's failure to act as a truly global institution. "Zoellick has to take the World Bank to the next level," he said, "explicitly including the element of illicit financial flows in this equation."

news and research

Getting underway in Africa

Representatives from eight African countries meeting in Cape Town, June 2007

SIX MONTHS AFTER THE launch of the Tax Justice Network for Africa, its Steering Committee met for the first time at the end of June in Cape Town, to map out its network development, research, campaign and advocacy priorities for the coming 24 months.

The top priority will be to develop the African network during the early stages. It was agreed that regional workshops on the theme of: *"Why should civil society organisations in Africa engage with tax issues?"* will be used to broaden involvement of researchers and NGOs. Four workshops are planned for the first half of 2008. One will be in southern Africa, another in eastern Africa, and two will be held in western Africa – one for Anglophone countries, and another for Francophone countries. Sponsors are being sought for these workshops.

The following topics were agreed as research priorities, (in no particular order):

- Tax incentives for foreign direct investment (trends, patterns and impacts)
- Bilateral tax (double taxation) agreements on foreign investment
- Trade liberalisation and loss of revenue.
- Tax harmonisation and regional trade agreements – regional integration.
- The role of international financial institutions in tax policy formulation
- Country by country pro-poor analysis of tax regimes
- Issues related to capital flight

The Steering Committee also agreed to organise the preparation and publication of an African edition of *Tax us if you can*.

Alvin Mosioma acts as co-ordinator for TJN4Africa and can be contacted at africa@taxjustice.net

More information on TJN's African chapter is available at www.taxjustice4africa.net

BUSINESS DAILY

It is time tax justice… was addressed as national policy

by Jeremiah Owiti

7th July 2007

In Kenya, it is time that tax policy in general and tax justice in particular are mainstreamed and addressed in national policy discussions.

This could be the key to sustained high economic growth rates required to lift millions of Kenyans out of poverty.

It could also be crucial to generating national political consensus, which is a necessary ingredient for building a nation in which all can live a life of dignity and opportunity, regardless of ethnicity, region, or economic class.

Such moves if guaranteed can generate overall national wealth and also we could witness sustainable development.

reviews

Corporate truth – the limits to transparency

Adrian Henriques

Earthscan 2007

ISBN 978-1-84407-390-0

Corporate truth – the limits to transparency

by Richard Murphy

Since this book is about transparency I'd better get the disclosures over and done with: I get an acknowledgement in this book, and I'm quoted in it.

I had no idea what to expect of a book I was told was meant to be a primer, and from which I might not learn much. In that case, let me continue in candid tone. I unreservedly recommend this book. It's much more than a primer, although it certainly succeeds at that level. Anyone looking for an introduction to the issues of accountability and transparency and how they relate to the nebulous theme of corporate social responsibility might do well to start here.

In this context Adrian does what I expect of him. He reviews the literature (although some sections seem more up to date than others – tax, for example, being in the latter category). More importantly, he does this while asking the big questions that need to be addressed. Indeed, this is what Adrian does best. His case studies do not work very well for me, and the section on reporting (in which Adrian is well experienced) is not a strength. But read the sections on "Coming to terms with transparency" and "What is a company, exactly?" and you have two really worthwhile chapters which raise excellent questions that I have not seen in such accessible form before.

I'm delighted that Adrian recognises the "reality theory" of corporations. This is a contentious area. Reality theory says there really are such things as companies and they are created by society; the law merely gives form to social phenomena that actually exist. This is contrasted with the 'legal fiction' theory (that says corporations do not really exist because they are merely agents for their members) and the rather similar 'aggregate theory' (which says you can reduce companies to the sum of actions of ordinary people.) Economists use these last two to justify many of their claims, including the notion that companies do not really pay tax, because they simply pass the tax on to others. (Some people use that far-fetched notion to argue that companies *should* not pay tax.) Adrian implicitly dismisses this by taking the existence of the corporation seriously. And, in a neat twist, he says that if the reduction argument is used (whereby all a company comprised was a bundle of legal rights and borrowed assets), you still have consider what it does. "The answer," he says "is that a company is a way of organising stakeholder relationships. That is all a company does." Think of it like that, and this is a very different entity from the 'legal fiction' that some economists promote.

> *"Reality theory says there really are such things as companies and they are created by society."*

This idea permeates his work. He argues that the stakeholder perspective means that transparency is simply an enquiry about the activities of another of the organisations's stakeholders and that "behind the challenge and counter-challenge of NGO campaigns against companies lies the assumption that both parties are moral agents, whatever the apparent size of their respective moral surpluses and deficits". He also says "There is a moral case, and therefore a need for transparency when there is a significant power relationship between a company and one of its stakeholders". These are, I think, important insights.

He applies it in a number of areas. Tax, to which he dedicates twelve pages of the book, is one of them. He features arguments for country-by-country reporting, and introduces key concepts such as transfer pricing and the tax haven issue. We should be grateful for this.

Unfortunately he does not sell the advantage of transparency for companies and for society as a whole as well as he might, since he is rather micro-focused. He could have looked more at the economic idea that without transparency, markets are inefficient: anything less than transparency results in asymmetrical information, the abuse of the consumer, and super-normal profits. But this - and my other concerns - are incidental. More than that, they may actually indicate the most successful dimension of this book, which at its best it made me think about why I agreed or disagreed with it. Whatever the answer, the book provides a framework in which creative discussion is possible.

Recommended.

news

Launch of TJ-Nederland

Geert van Maanen, acting chair of TJN-Netherlands, speaking at the launch of TJN-Nederland

TJN LAUNCHED A DUTCH CHAPTER on May 10 in the Idazaal, The Hague. The Netherlands is important because it is considered a conduit country for international taxation the country has been in the news partly because the musician and poverty campaigner Bono (and other rock stars including the Rollling Stones) have shifted their tax affairs to the Netherlands to cut their tax bills.

Francis Weyzig, researcher of the Dutch organisation SOMO said: "Of all foreign direct investments worldwide, 13% flows through the Netherlands. Other countries, including developing countries, miss out tax revenues because of this." The launch of TJ-Nederland followed in November 2006 a report by SOMO entitled: "The Netherlands: a Tax Haven?" which explores the issues in more detail. The launch was attended by members from the Dutch Ministries, tax consultants, accountants, civil society organisations, academics, and other experts. The event was organised in three parts, with a seminar in the first part of the day on taxation and development, and this was followed by the official launch of TJ-NL, then, finally, a public debate on tax policy and development co-operation, involving Dutch members of parliament, tax experts, and members of the general public.

TJ-NL is being co-ordinated by Miranda Broerson (Oikos). More details can be found (some in Dutch, some in English) on www.taxjustice.nl/

Transnational Institute

AN EXPERT SEMINAR WAS HELD on June 12-13 at the Transnational Institute (TNI) in Amsterdam entitled "Money Laundering, Tax Evasion and Financial Regulation." (TNI was one of the initiators of Tax Justice NL.) One of the aims of the conference was to try and find common ground between criminologists and others who are tackling narrow money-laundering and other issues, and those with a wider interest in taxation.

The seminar discussed the effectiveness of the Anti Money Laundering regime that has been built over the past two decades, and the more recent attempts to control tax evasion, capital flight and harmful tax competition. "The Anti Money Laundering regime that has been built during the last two decades completely neglects financial deregulation manifest in tax havens and offshore financial centres that facilitate tax evasion, capital flight and money laundering," said TNI researcher Tom Blickman. Susan George, a prolific author and Chair of the Planning Board of TNI, said that "corporate social responsibility should be, first and foremost, about paying tax." Professor Tom Naylor of McGill University said that tax havens should be seen as "co-conspirators rather than clerks" in the tax evasion process, "morphing money behind a veil of secrecy". A selection of papers and presentations from the seminar Money Laundering, Tax Evasion and Financial Regulation is available on the TNI website: www.tni.org/detail_page.phtml?&&act_id=17022

"corporate social responsibility should be, first and foremost, about paying tax."

CALENDAR

July 23
Bruno Gurtner and John Christensen to speak at substantive session of ECOSOC in Geneva.

Sept 7
John Christensen to speak at Sbilanciamoci forum in Maghera (Venice). Title: "Welfare, Citizenship, Tax Justice: Proposals For Realisation Of Cohesive Social Distribution".

Sept 23–24
Richard Murphy to be key speaker at panel of Leading Group of Countries at summit in Seoul, South Korea. Theme: capital flight and tax evasion.

September
New York: UN General Assembly and GT-7 side event (to be confirmed)

Oct 9–2 Nov
Third Session of the Committee of Experts in International Cooperation in Tax Matters, Geneva, Switzerland

Oct 22–25
TJN lecture tour of French Universities: Rennes, Nantes, St. Malo, Laval. John Christensen to speak about tax justice issues.

Fourth Quarter 2007
New York: UN General Assembly High-level Dialogue on Financing for Development