Tax evasion: hidden billions for development

The tax burden is shifting from the rich to the poor. Developing countries are losing at least USD 50 billion per year, a loss equivalent to the annual official aid of the OECD countries to developing countries. This is the amount required by the World Bank and the UNDP to achieve the Millennium Development Goals. It is also equivalent to six times the estimated annual costs of achieving universal primary education. And it is almost three times the cost of universal primary health coverage. The only successful way to counter harmful tax practices and international tax competition is through global initiatives.

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Today countries from all over the world face a growing problem in collecting taxes to fund public goods and services such as health services, education, infrastructure and, vital for developing countries, to fund the reduction of poverty.

Globalisation undermines the fiscal basis of the welfare state. Markets have become globalised, yet tax structures have remained national. Open borders cause exaggerated tax competition, which in turn leads to a race to the bottom in taxation of companies and high incomes. International tax competition and harmful tax practices are providing more and more opportunities for the wealthy to escape their tax obligations. The burden of taxation is shifting. Wealthy individuals and transnational corporations benefit from tax havens and low-tax regimes throughout the world. Ordinary citizens and smaller domestic business bear the cost in two ways.

On the one hand, governments increase taxes on consumption, smaller incomes and smaller business. On the other hand, governments cut their expenditures for investment in basic services and infrastructure development needed for future growth. Reduced social services will affect poor people far more than rich people. Smaller domestic infrastructure investment stunts economic growth needed for sustainable development. If unchecked, these trends will be disastrous for development.

Tax havens: the new global shadow industry

Financial centres play a destructive role. They serve as loopholes in the tax system of most countries. Capital flight associated with tax evasion in particular steal from developing countries the capital to fund investment and to provide social services. Twenty years ago there were only a few tax havens, managed by a few professionals. With the worldwide liberalisation of capital flows, the dismantling of capital controls and the electronic communications revolution the offshore industry has become a major global business.

Some 60 tax havens span the globe. They compete with each other to attract mobile capital by offering low tax or no-tax environments and dubious benefits such as secrecy and poor regulation. Secrecy encourages the illegal evasion of taxes. Secrecy means non-disclosure of information such as business accounts, ownership of assets, trusts and companies. Where tax is payable, this is often at minimal rates, negotiated in secret with the authorities with little references to tax law. So tax havens offer complete or large and secrete exemptions to non-residents - and only to non-residents - from taxing corporate or personal income.

Tax havens have poor or no regulation. Where codes and laws exist, there is often neither the political will nor the resources to implement them effectively. Governments of offshore centres have little administrative capacity to oversee these financial shifts.

Lack of regulation is also providing suitable environments for money laundering and it undermines the stability of the financial system. Financial crises are more frequent and more profound.

Services at offshore centres include personal and corporate banking, offshore funds and trust management and administration.

The offshore industry is not an isolated phenomenon occurring only on exotic Caribbean islands. Offshore centres are very closely linked to major financial centres like New York, London, Tokyo, Zurich, Hong Kong and Singapore. Most of the world's tax havens are actually located in the big financial centres. The offshore industry has become the new and enormous global shadow industry. Companies for offshore purposes are now being established at the rate of over 150,000 per year. Today there are more than one million offshore companies worldwide. Enron for example had 881 offshore subsidiaries, 692 only in the Cayman Islands. The world biggest oil trader companies are located in Switzerland, though Switzerland has no oil!

Half of the world trade appears to pass through tax havens, although they account for only 3% of the world's GDP. The value assets held offshore, either tax free or subject to minimal taxes, is at least USD 11 trillion, over one third of the world's annual GDP. One third of all cross-border private banking is managed by the Swiss financial sector. And the offshore industry as a whole is involved in about a half of the world's financial transactions.

Winners and losers

The winners of these recent tendencies are transnational companies, wealthy individuals, fiscal havens and offshore centres, the financial service industry, high income specialists and mobile factors such as capital. Shifting resources abroad is often simply a matter of opening up an account and moving capital to an offshore bank.

Tax havens provide legitimate, "well-respected" companies with many means of escaping taxes. Almost every large American or European bank has a branch office or business contacts in the Caribbean. Transnational companies may easily establish subsidiaries in offshore centres, create some simple paperwork, and manipulate prices of goods and services passing through these offshore subsidiaries (transfer pricing). They shift their profits out of the higher tax economy (where the real economic activity is taking place) into the offshore centre where little or no taxes are paid. Philip Morris and RJReynolds, two big tobacco companies, shifted their international headquarters in the mid-1990s from the Unites States to Switzerland to take advantage of Swiss tax and legal advantages.

Transnational companies press governments to reduce taxes on companies' profits, to provide tax holidays or to give other tax incentives. The losers are the states and the governments, who lose their sovereignty over taxation policy. Small and medium domestic businesses have to pay more taxes; so do small and medium salaries and consumers.

One can observe a heavy shift of taxation away from mobile to immobile tax factors, from capital to salaries, from big transnational companies to small business. One can also observe a heavy shift from progressive taxation (taxing higher income more than smaller income) to flat taxes and from profits and incomes to indirect taxes such as value-added-taxes (consumer taxation). In short: the tax burden is shifting from the rich to the poor! So US-billionaire hotel owner Leona Helmsley was right in arguing at her trial for tax evasion in 1989: "Only the little people pay taxes".

Developing countries: the most affected

The shifting of the tax burden threatens the developing world in a particularly disastrous way. Developing countries are losing at least USD 50 billion a

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year.[2] This huge loss is equivalent to the annual official aid of the OECD countries to developing countries. It is the same figure required by the World Bank and the UNDP to achieve the Millennium Development Goals. It is also equivalent to six times the estimated annual costs of achieving universal primary education. And it is almost three times the cost of universal primary health coverage.

With capital account liberalisation the rich are far more able to take their wealth and income out of their countries to deposit in fiscal havens and offshore centres without paying taxes at home. Developing countries are losing tax income of at least USD 15 billion a year due to this tax evasion of their own rich elites. Rich people in India have at least CHF 1 billion (USD 785 million) in fiduciary bank accounts in Switzerland, most probably without paying taxes in India. At a seminar of the Friedrich Ebert Foundation in New York in July 2002 representatives of developing countries were emphatic in pointing out that (from their point of view) the United States and Europe serve as tax havens for their own wealthy citizens seeking to avoid paying taxes at home.

Transnational companies pressure developing countries to keep tax rates on companies' profits and capital very low. They lobby the governments of developing countries to give them tax holidays. They demand that governments provide free or cheap infrastructure services. Developing countries compete with each other to provide better conditions for transnational companies in order to attract their foreign direct investments. Unregulated international tax competition and harmful tax practices of this kind are responsible for the loss of at least USD 35 billion a year. Even the IMF and also the Mc Kinsey Consulting Company found in studies that such tax incentives do not pay!

How to tackle these abuses?

Naturally most countries try to protect their tax basis. But the only successful way to counter harmful tax practices and international tax competition is through global initiatives. Some years ago the OECD started a programme to eliminate harmful tax practices within and outside its membership and published a list of unco-operative tax havens. OECD also promotes information exchange with tax authorities and the financial sector. Within the UN an Ad Hoc Group of Experts on International Co-operation on Tax Matters meets regularly. The EU tries to co-ordinate its tax policies. Preliminary documents to the Monterrey Conference on Financing for Development (March 2002) asked in vain for an international tax authority. The IMF, the World Bank and OECD at that time launched an "International Taxation Dialogue", but did not actually promote the initiative. Another proposal, more discussed within NGO and scientific circles, was to establish a minimum tax on corporate profits.

Our answer: the Tax Justice Network

At the European Social Forum in Florence in 2002 some European NGOs and social movements which have been active in the field of financial criminality got together and founded the European Tax Justice Network (TJN) to fight against tax evasion. This was a response to the harmful trends in global taxation due to economic globalisation, which inhibits the ability of states to tax wealthy beneficiaries and large corporations adequately. TJN found that these trends have disturbing implications for development, democracy, public services and poverty.

At the World Social Forum in Porto Alegre in 2003 the Network was expanded into a global network, thanks to Northern and Southern American organisations. The WSF of Mumbai in January 2004 extended it to Asia. Now the Network needs support from Africa to be really global!

TJN's aims are to:

- Eliminate cross-border tax evasion;
- Limit the scope for tax avoidance;
- Publicise issues and educate interested parties;
- Advocate at an international level, within the UN, IMF, OECD, EU, etc.;
- Encourage, support and co-ordinate national and regional activities;
- Promote links between interested parties around the world, particularly North-South links;
- Encourage research and debate.

In Porto Alegre the TJN discussed a draft for a Declaration/Manifesto.[3] Among others it contains the following important strategic points:

- Eliminating cross-border tax evasion and limitation of the scope for tax avoidance, so that large corporations and wealthy individuals pay tax in line with their ability to do so;
- Increasing citizens' influence in the democratic control of taxation, and restricting the power of capital to dictate tax policy solely in its own interest;
- Restoring similar tax treatment of different forms of income, and reversing the shifting of the tax burden onto ordinary citizens;
- Removing the tax and secrecy incentives that encourage the outward flow of investment capital from countries most in need of economic development.

The TJN presented the finalised Declaration/Manifesto in March 2003 in the British Parliament. All organisations agreeing with the content of the Declaration are invited to sign it. In May 2003 the TJN held an international media conference in Berne, Switzerland. The Network organised in July 2003 a research seminar in Essex, England (a second seminar will be held again in Essex on 1 and 2 July 2004).

The TJN has started its international advocacy work and has already had informal contacts with the OECD tax authority. And it contributed to the recently published report of the ILO World Commission on the Social Dimensions of Globalisation. Representatives of TJN attended as observers the meeting of the UN Ad Hoc Group of Experts on International Cooperation in Tax Matters. The TJN will contribute to the follow-up of the Monterrey process (ECOSOC/BWI meetings).

In the meantime the TJN has created its own website (in English, French, Spanish, Portuguese, German), is publishing a newsletter and is exchanging information through its e-mail list. A provisional steering committee is trying to enlarge the Network, seek more support for the Declaration and deepen the strategy discussion. We have started preliminary discussions to establish a small professional international secretariat. We welcome your contribution and your active collaboration! ■

2 Oxfam GB. *Tax Havens: Releasing the Hidden Billions for Poverty Eradication.* Oxfam Policy Paper. 8 June 2000. www.oxfam.org.uk/shatnew/press/tax.htm

3 For more information or to read and sign the Declaration, or to subscribe to the e-mail list and forum please check our website: www.taxjustice.net