# Global tax evasion

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Much of the failure to finance development spending – particularly the failure of wealthy donor countries to provide promised increases in aid budgets – is a failure of political will. But states in the Majority World are unable to sustain their own spending on health, education and infrastructure substantially because they cannot raise adequate revenues for social spending themselves. This article argues that this fiscal crisis is fueled by a global financial architecture of tax evasion and capital flight largely sustained by the Minority World. And it presents evidence that combating the causes of this fiscal crisis could not only help bridge the current deficit in global development financing, but correct features of the international financial system which contribute massively to poverty and global inequality.

The last 25 years have witnessed both the growing cross-border mobility of capital, and the rise of a developmental model exhorting developing countries to offer tax incentives for foreign investment and domestic access to international financial flows. Both financial change and economic ideology have thus encouraged the proliferation of mechanisms enabling wealthy, mobile individuals and corporations to escape from contributing to state revenues.[1] Between the early 1970s and the end of 2004 the number of recognized tax havens has increased from about 25 to 72.[2] Correspondingly, the Organization for Economic Co-operation and Development (OECD) estimates that the volume of world trade which on paper appears to pass through tax havens has risen during this period from a few per cent to over 50%, despite these jurisdictions accounting for as little as 3% of Gross Domestic Product (GDP).[3] This extraordinary mismatch is an indication of the extent to which most major multinational corporations have taken advantage of the transnational mobility of their assets to launder their profits through low-tax regimes and tax havens, using a variety of mechanisms, from re-invoicing and transfer pricing (trading goods between companies owned by the same people or company at arbitrary, non-market rates, allowing an increase in the cost of goods or a reduction in their sales value in higher-tax states) to special purpose corporate vehicles and secretive offshore trusts.[4] And as this effectively stateless shadow economy has eroded the fiscal base of national welfare states, particularly in the Global South, so finding ways to tax this evasive wealth could itself provide the funds to finance the Millennium Development Goals (MDGs).

## The scale of global tax evasion

There remains an urgent need for empirical study into the scale of global tax evasion and avoidance. Research is hampered by the obsessive secrecy surrounding financial transactions and holdings in tax havens. Nonetheless some estimates of the scale of the problem have been made since the Social Watch Report last reported on global tax evasion and avoidance in 2004. Calculations made by the Tax Justice Network suggest that around USD 11.5 trillion of the private wealth of "High Net Worth Individuals" alone is currently held in tax havens, largely undeclared – and therefore probably untaxed – in their country of residence (Tax Justice Network, 2005, p. 34-37).[5] The benefits from taxing just this individual wealth – let alone the undoubtedly larger sums lost through tax evasion and avoidance by corporations – would far outweigh any realistic increase in aid budgets. The annual worldwide income earned on these undeclared assets is likely to be about USD 860 billion.[6] Taxing this income at a moderate 30% rate would produce around USD 255 billion annually: enough to finance the MDGs in their entirety.[7] Put simply, making just the very rich pay their due taxes could immediately fund measures to halve world poverty.

## The global South's burden

Regional breakdowns of tax evasion are even harder to obtain than global estimates. Certainly much of the individual and corporate wealth siphoned into tax havens comes from wealthy countries in the Minority World. But countries in the South arguably suffer disproportionately from tax evasion and avoidance, both because they have proportionately more to lose from capital flight and dirty money flows across their borders to tax havens, and because their under-resourced tax authorities lack the institutional capacity to effectively prevent tax abuse. Oxford University economist Alex Cobham (2005) has used a simple economic model to scale global estimates of the tax revenues lost through individuals' offshore asset-holding and corporate profit-shifting across borders. He estimates that every year developing countries lose USD 50 billion in revenue to each of these mechanisms. Coupled with an estimated USD 285 billion in revenue lost through domestic tax evasion in developing countries' informal economies, Cobham estimates that this individual and corporate profit-laundering contribute to a staggering USD 385 billion in annual lost tax revenue across the developing world. Over 50% of the cash and listed securities of rich individuals in Latin America is reckoned to be held offshore (Boston Consulting Group, 2003). Data for Africa are scarce, but most analysts assume the ratio to be comparable to Latin America or higher. In 1999, *The Economist* estimated that African leaders alone have USD 20 billion in bank accounts in just one tax haven, Switzerland: over 30% more than sub-Saharan African countries were then spending annually in servicing their external debt (Owuso, Garrett and Croft, 2000).

This flight of the global South's financial resources and tax base is not only domestically catastrophic for welfare spending in these impoverished

1 This developmental strategy has not only eroded national tax revenues in the developing world, but has also increased some developing countries' vulnerability to international financial instability. One notorious example of this was the formation of the Bangkok International Banking Facility (BIBF) in 1992, as part of an aggressive strategy by the Thai government to improve the access of Thai firms to the international financial markets. BIBF banks could take deposits or borrow from abroad, and lend in foreign currencies in Thailand and abroad, functioning essentially as an offshore centre with tax incentives and regulatory exemptions on their international business. When the Asian financial crisis broke in 1997, the BIBF accounted for almost half of the country's foreign borrowing. The resulting debt crisis and economic reversal saw Thailand's GDP fall by about 12%, with serious employment and wage impacts, pushing over a million people in Thailand into poverty. See Oxfam GB (2000).

2 Tax havens are here defined as countries or territories whose laws may be used to avoid or evade taxes which may be due in another country under that country's laws. Features include jurisdictions where non-residents undertaking activities pay little or no tax; there is no effective exchange of taxation information with other countries; a lack of transparency is legally guaranteed to the organizations based there; there is no requirement that local corporations owned by non-residents carry out any substantial local activity (indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated). Tax Justice Network, 2005, p. 12-13.

3 French finance minister D Strauss-Kahn, in a speech to the Paris Group of Experts in March 1999, quoted in Christensen and Hampton (1999).

4 For more on the mechanisms of multi-national tax avoidance, including transfer pricing, thin capitalization, re-invoicing, corporate inversions, special purpose vehicles, trusts, see Tax Justice Network, 2005.

5 Estimates made using figures on offshore wealth from Merrill Lynch / Cap Gemini's 1998 World Wealth Report and Boston Consulting Group's 2003 Global Wealth Report.

6 Based upon Merrill Lynch / Cap Gemini's and Boston Consulting Group's estimates that wealth holders expect returns on their assets of 7-8% per annum.

7 The UN Millennium Project estimated in 2005 that meeting all the MDGs would require an estimated USD 135 billion of Official Development Assistance, rising to USD 195 billion by 2015. See: <www.un.org/apps/news/story.asp?NewsID=15497&Cr=MDGs&Cr1=WHO>.

countries. It is internationally regressive, because these flows are overwhelmingly towards the Minority World. Although tax havens include a handful of developing countries like Uruguay or Sao Tomé e Principe, most are linked to wealthy OECD jurisdictions (35 of the world's 72 tax havens are linked jurisdictionally, economically or historically to the United Kingdom alone). The financial architecture of mainly wealthy jurisdictions thus sustains a global theft from South to North, siphoning capital resources from impoverished regions into bank accounts and offshore trusts from Switzerland to the UK's Cayman Islands. Amherst University economists James Boyce and Leoncé Ndikumana (2002) have estimated that between 1970 and 1996, the flight of private capital from 30 severely indebted sub-Saharan African countries accounted cumulatively for over 170% of the region's GDP. This has decimated both African investment and domestic tax revenues.[8] Much will have gone via Northern tax havens. With this rate of capital flight, Ndikumana argues that Africa – a continent we are continually told is almost irrevocably indebted – may actually be a net creditor to the rest of the world.

## Systemic effects of global tax evasion

The figures discussed above make a powerful case that stopping international tax evasion and avoidance could provide both for the financing of the MDGs, and in the longer term for developing countries' own sustainable spending on health, education and infrastructure, providing sustainable revenues which might even outweigh the burdens of debt financing. But action is needed to stop tax evasion and avoidance not simply because it has the potential to bridge the development financing gap, but because unchecked, tax havens and tax avoidance positively damage economic equity.

Since internationally mobile capital benefits from tax havens and international tax avoidance mechanisms, they place wealthy individuals, who can afford to spread their assets internationally, at a distinct financial advantage over ordinary people. They provide market advantages for multinational corporations who can avoid tax through the international movement of their capital and assets, over nationally-based businesses. Even those who advocate growing private enterprise in developing countries as the route to reducing poverty must accept that tax havens and tax evasion damages developing countries' domestic business sectors and wealth accumulation (OECD, 2004). Finally, the banking secrecy and financial services provided by global financial institutions operating offshore provide the 'supply side' of political corruption, fraud, embezzlement, illicit arms trading, and the global drug trade. The lack of transparency in international financial markets contributes to the spread of globalized crime, terrorism, the bribery of under-paid officials by western businesses, and the plunder of resources by business and political elites. Wealthy donor countries continue to insist that corruption in the Global South threatens development; yet tax havens within wealthy donor country jurisdictions, as well as the Western companies and banks who operate in them, provide the 'pinstripe infrastructure' facilitating the money laundering of the proceeds of corruption and all types of illicit commercial transactions.[9]

More insidious still may be the systemic fiscal effects of international tax evasion and avoidance, which may be pressuring states to lower their own tax rates to attract direct foreign investment in a race to the bottom whose consequences for economic equity and development are discussed in much more detail in the chapter on tax competition in this Report.[10]

## What can be done

Sustainable development spending – free from aid and debt dependency, and encouraging political accountability and participation in the global South itself – will remain difficult unless developing countries can mobilize their own domestic resources. This is made impossible by tax evasion and avoidance on an unprecedented scale. Global taxes and innovative finance mechanisms are vital to bridge the development finance gap in the short-term. But they must be coupled with a more traditional finance mechanism: wealthy individuals and corporations paying their due taxes.

This 'traditional' goal, however, will nonetheless require innovative legal and financial action. In contrast to other areas like intellectual property and market access laws, tax policies and law have strikingly failed to keep up with globalization, remaining resolutely national as capital has become transnational. National legislation may be useful in slowing the erosion of national tax bases by closing particular tax avoidance loopholes or ending tax haven legislation enshrining banking secrecy or tax benefits for non-residents. Equally, efforts by corporations towards greater transparency and social responsibility in paying taxes may be valuable, especially in economic sectors like the extractive industries, dominated by multinational companies with a history of siphoning profits from resource-rich developing countries to tax havens. The Extractive Industries Transparency Initiative (EITI) is a useful tool in this respect, although it continues to lack commitment from key countries and companies.[11] National commitments to tackling tax evasion within their jurisdictions should be monitored and reported by international financial institutions as part of global initiatives to tackle corruption, with public reports on tax haven jurisdictions' demonstrable efforts to implement transparency and anti-avoidance measures.

But properly tackling a problem generated by the international mobility of capital will ultimately require international and multi-lateral action. This will need to include:

- Automatic information exchange between countries of interest payments, dividends, royalties, license fees and other income paid by banks and financial institutions to citizens of another country.
- An internationally agreed basis for corporate taxation, taxing profits in the countries in which they are earned.
- A general anti-avoidance principle, enshrined in national or international laws, which would end the 'arms race' of tax avoidance loopholes being opened by creative accountants as soon as they are closed by revenue authorities

All these objectives would be assisted by the creation of a World Tax Authority, as proposed in 1999 by former IMF director of fiscal affairs Vito Tanzi. This body would be charged with ensuring that national and dependent territory tax systems do not have harmful international implications, and working towards international cooperation in these key areas of information exchange, corporate taxation and anti-avoidance.

International progress in these areas has been mixed in 2005. The United Nations should ideally provide the setting for a global tax authority by substantially strengthening the UN Committee of Experts on Cooperation in International Tax Matters,

8 This percentage includes interest earnings on the stock of flown capital.

9 See, for example, the recent report by the UK's All-Party Parliamentary Group on Africa (2006).

10 Cf. Wahl, P. "International taxation: the time is ripe" in this Report.

11 <www.eitransparency.org>.

which met for the first time as a formalized committee in December 2005. But the Committee is currently dominated by OECD countries and tax havens, and representation of the interests of developing countries remains inadequate. The OECD Initiative Against Harmful Tax Practices has made some progress towards creating a framework for negotiating tax information exchange agreements (TIEAS) on a bilateral basis. They have also widened their initiative to cover not only the small island tax haven jurisdictions, but also major players such as Switzerland and the United Kingdom, previously excluded from OECD tax haven lists. Their latest model tax treaty includes a banking secrecy override clause which could be effective in tackling tax evasion. In practice, however, very few TIEAS have been negotiated, and developing country governments will need considerable support in negotiating such treaties, and making effective use of the information provided.

Ultimately, if international institutions like the UN and the OECD are to respond adequately to the unprecedented global challenge of tax evasion and avoidance, then global civil society must force them, and national governments, to take action. The stakes, as this article makes clear, could hardly be higher: the risk of destroying welfare states across the global South; and the potential to fund measures to halve global poverty. ■

### TAX JUSTICE NETWORK ACTIONS

In 2006 the World Social Forum in Bamako saw a proposal to form a continent-wide Tax Justice Network for Africa, to be launched at the 2007 World Social Forum in Nairobi, Kenya. This will be a major step in a new global development struggle, at whose forefront should be activists and campaigners from the Majority World. We invite you to join us. <www.taxjustice.net>.

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