

## **The challenges for developing countries in international tax justice**

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### **Abstract**

Developing countries face three main challenges in international tax cooperation. The most widely known is the twin problems of tax avoidance by foreign investors and tax evasion by domestic actors, which have become a major focus of debate in international organisations and of civil society activism in recent years. The second problem, tax competition, incorporates a range of issues from the ‘prisoners’ dilemma’ facing countries competing for inward direct investment through to the harmful tax rules used by tax havens that enable tax avoidance and evasion. This article reviews four recent monographs that analyse these problems at an international level. While they contain much useful discussion of the problems and potential technical solutions, there remains a need for political economy research to understand why certain technical solutions have not been adopted by governments. A third challenge faced by developing countries, barely considered in the tax and development literature up to now, leads to a note of caution: international tax institutions tend to be designed in ways that place disproportionate restrictions on capital-importing countries’ ability to tax foreign investors.

## The challenges for developing countries in international tax justice

Dietsch, P. (2015). *Catching Capital : The Ethics of Tax Competition*. Oxford: Oxford University Press.

Zucman, G. (2015). *The Hidden Wealth of Nations: The Scourge of Tax Havens*. Chicago: The University of Chicago Press.

Pogge, T. & Mehta, K. (Eds.). (2016). *Global Tax Fairness*. Oxford: Oxford University Press.

Dietsch, P., & Rixen, T. (Eds.). (2016). *Global Tax Governance : What is Wrong with it and how to Fix it*. Colchester: ECPR Press.

Tax policy, particularly the problem of international tax avoidance and evasion, once seemed to be the exclusive province of specialist accountants and lawyers. Since the financial crisis of 2008, however, it has risen to the highest levels of international summitry, electoral politics and newspaper front pages. Along the way, 'tax justice' has become a growing strand of development debate and practice, not least because of high profile campaigns run by major international NGOs. Recent special issues of this journal ('The Politics of Taxation,' 2016) and of the *Review of International Political Economy* ('Revenue Mobilization in the Developing World,' 2016) indicate that academia is catching up with this agenda, and four books published in the last two years will be welcome resources for anyone seeking an overview. The books' shift in focus to the global level complements some earlier works on tax and development, which are more grounded in country-level empirical work (Brauner & Stewart, 2013; Brautigam, Fjeldstad, & Moore, 2008; Fuest & Zodrow, 2013).

Two of the books considered here are edited volumes. *Global Tax Fairness* ('GTF'), edited by philosopher Thomas Pogge and accountant Krishen Mehta, includes contributions by tax practitioners and activists who have been involved in recent campaigns against international tax avoidance and evasion, or observed them from the outside. It is framed around their recommendations for what to do next. A chapter co-authored by John Christensen, until recently director of the influential Tax Justice Network, explicitly advocates a transition from tackling tax havens towards a 'Phase Two' of the global battle for tax justice' focused on the 'race to the bottom' across all states fuelled by tax competition among them (GTF p291). Tax competition is already the organising concept behind *Global Tax Governance* (GTG), an interdisciplinary academic work edited by philosopher Peter Dietsch and political scientist Thomas Rixen. These different angles of approach are particularly complementary in areas where the proposals under consideration overlap.

Two single-authored monographs may be better starting points for beginners, as their length allows the authors to describe the existing system from first principles, as well as critique it. *Catching Capital* by Peter Dietsch is a detailed, subtle philosophical work that aims to fill out the normative underpinnings of a question that is taken somewhat for granted elsewhere; how to reconcile the

coercive nature of efforts to challenge tax havens with respect for fiscal sovereignty. Dietsch (CC p27) concludes that, ‘rather than being a constraint on sovereignty, [tax cooperation] should be viewed as a requirement of sovereignty.’ Gabriel Zucman’s *Hidden Wealth of Nations*, meanwhile, is a relatively short work described by Thomas Piketty in his foreword as ‘probably the best book that has ever been written on tax havens and what we can do about them’ (GTF p vii). This is perhaps an overstatement, but it certainly stands out for its clear, simple, concise explanations. Zucman’s methodology, which constitutes one of the more reliable assessments of the amount of offshore avoidance and evasion, has been relegated to online appendices and journal articles.

All these works are explicitly normative and propositional, building a picture of an international tax regime that the authors collectively believe is unfit for purpose, especially for developing countries, as well as a corresponding case for international cooperation to address this. Almost all the authors argue for solutions that would require the creation of new global institutions, in many cases a new international tax organisation with the ability to enforce global tax rules. From the development perspective, however, there are reasons to question the benefits of greater institutionalisation, which none of the books consider. Debate about the potential obstacles and drawbacks to greater international tax cooperation rarely takes place within the edited volumes, but the reader who compares across all four books will find illuminating differences of emphasis.

## **Tax avoidance and evasion**

The tax difficulties for developing countries are longstanding and increasingly well-known. As the introduction to *Global Tax Fairness* notes, developing countries have much lower *per capita* national incomes than developed countries, but they also convert a much smaller percentage of that income into government revenue (GTF p3). This means that taxation raised from multinational companies and wealthy individuals is more precious to them than it is to developed countries, hence the focus of so much attention from development campaigners in recent years on the avoidance and evasion of such taxes. Furthermore, holding on to this tax revenue requires international cooperation, since the tax base concerned is internationally mobile. The problem is that the interests of different groups of countries do not always align. The books address two of the three main challenges that this situation creates for developing countries, but all of them largely ignore a third, which will be returned to later in this review.

The first of these challenges, tax avoidance and evasion, is the dominant theme of *Global Tax Fairness* and *The Hidden Wealth of Nations*. These are problems faced by all countries, but as Zucman’s data show, their impact on developing countries is disproportionate: he estimates that 30 percent of Africans’ financial wealth is held offshore, and 22 percent of Latin Americans’, while the equivalent figures for Europe and the US are 10 and 4 percent respectively (HWN p53). Developing

countries also face particular challenges: on the political side, they lack the power to coerce reforms out of states whose tax systems undermine their own, and must piggy-back on efforts made by the G-20 and OECD; on the technical side, capacity constraints make it difficult to implement the *de facto* global tax rules that are produced by these larger economies' clubs.

Tax evasion, which involves breaking the law and for which the focus is largely on wealthier individuals, is addressed at international level through information exchange. Jurisdictions can supply each other with data on the income earned by each others' citizens abroad, which may otherwise be hidden from their home tax authority. The challenge is to force tax havens, which deliberately use secrecy to attract illicit wealth, into participation in an information exchange regime that will jeopardise their financial service industries. Since 2008, the G-20 and OECD have been ratcheting up pressure on tax havens, a process simultaneously disrupted and catalysed by the USA's unilateral decision to use brute economic coercion to force foreign banks into automatic disclosure. Here we find interesting divergence within and between the books. Itai Grinberg, who has a chapter in both edited volumes, argues that the USA 'catalysed an evolutionary moment' that he sees as 'a success story in global tax co-operation' (GTG p170). The USA here is a benevolent hegemon, using its financial market power to create a public good of information exchange from which others, including developing countries, can benefit. Lukas Hakelberg disagrees, pointing out that while the US Congress demands information from others, it has withheld consent for legislation that would permit its own Internal Revenue Service to reciprocate. As a result, the USA measures 'advantage the US at the expense of less powerful jurisdictions with secrecy provisions' (GTG p125). In *The Hidden Wealth of Nations*, Zucman argues, somewhere between these two poles, that this new information exchange regime is a stepping stone towards something more comprehensive.

Grinberg devotes a passage in GTF to the question of whether developing countries' tax authorities might benefit from the regime that is currently crystallising. He notes that they may need to overcome political disincentives to investigate tax evasion by elites, capacity constraints preventing them from making use of an avalanche of information from overseas, and other countries' reservations that they may not respect taxpayer confidentiality. These are all real concerns that are raised regularly in debates on the topic, in addition to the fact that developing countries have not so far mobilised to demand greater access to automatic tax information exchange. Understanding these constraints on tackling tax evasion in developing countries would require empirical work that was beyond the scope of Grinberg and Hakelberg's chapters, but they offer a good framework from which to embark on such a project, locating their theoretical discussions within broader international political economy literature.

In contrast to tax evasion, which relies on concealment, tax avoidance by multinational firms involves the exploitation of weaknesses in tax laws and administration, often in plain sight of a revenue

authority unable to challenge it. Grinberg's chapter in GTF compares the problem structures for avoidance and evasion, concluding that international agreement on measures to challenge tax avoidance by multinational firms (known in the G20/OECD jargon as 'Base Erosion and Profit Shifting', or BEPS) is likely to be a tougher nut to crack. Why? Because the USA's hegemonic position with respect to finance, which allowed it to force foreign banks to disclose taxpayer information, is not replicated when it comes to foreign direct investment: 'no country is as indispensable a place to do business in general as the United States is as a place to engage in finance.' (p167) This point is taken up by Richard Eccleston and Helen Smith, who identify major obstacles to significant progress on the corporate tax avoidance issue through the G20 and OECD: its focus on tax policy tramples over much more of states' fiscal sovereignty; it requires challenging the powerful multinational business lobby; there are likely to be greater divisions among powerful states.

The asymmetry in interests between different states is certainly an area that would have merited further development beyond the G20/OECD bubble in these books. Eccleston and Smith, for example, focus on the likely conflict within the G20 and OECD, noting that 'there is clear potential for conflict among G20 members in relation to the BEPS agenda between states rich in both capital and intellectual property and poorer jurisdictions.' (GTG p186). The poorer jurisdictions they have in mind include Brazil, India, China and South Africa, but these states have themselves conflicting interests to those of less developed countries, from whose perspective there may be little to choose between the 'BICS' and the OECD. Both groups seem keen to bind a much wider group of developing countries into G20/OECD international tax standards, as was demonstrated by their decision after these books were published to invite developing countries to participate in the remaining 'BEPS' deliberations.

## **Tax competition**

The second problem for developing countries in international tax, tax competition, is the organising principle behind *Global Tax Governance* (whose introduction goes as far as to label it 'the problem') and *Catching Capital*. Countries compete to attract mobile capital by offering lower tax rates, tax incentives, and other advantageous rules such as the secrecy that enables tax evasion. Broadly speaking, tax competition is a problem faced by all countries, since all are looking to attract capital. But because it is usually understood as a race to the bottom to attract inward investment, it is an especially pernicious problem for developing countries that are overwhelmingly capital importers. 'Anyone who worries about the income gap between rich countries and poor countries has to be troubled by tax competition,' argues Dietsch (CC p51). As one contribution to GTG states, 'due to their weak governance capacity, LDCs can neither profit from tax competition nor effectively compensate competition-induced revenue shortfalls in capital taxation from other sources.' (GTG p71).

Both these books clarify the issue through an important conceptual distinction between virtual tax competition to attract paper profits and real tax competition to attract the underlying economic activity that generates those profits. Dietsch refers to the two practices as ‘poaching’ and ‘luring’ the tax base (CC p44). Kimberley Clausing’s excellent chapter in GTG makes a nuanced and persuasive evidenced-based case for this distinction. Put simply, firms respond to tax rate differentials by moving their pre-tax profits around to reduce their tax bills, without moving all the real activities that generate those profits. This means that real economic activity is less receptive to tax competition than are paper profits.

From this observation flow a number of interesting and policy-relevant points, which are explored well across these books. First, both edited volumes contain a chapter discussing the potency of the idea of tax competition. They highlight the inconsistency between the equivocal evidence base connecting tax competition with real foreign direct investment and what Lynne Latulippe (GTG p77) calls the ‘internalised policy goal’ of maintaining a ‘competitive’ tax system. Nick Shaxson and John Christensen (GTF p288) concur that tax competition constitutes ‘a carefully crafted and effective, yet fundamentally erroneous, belief system,’ advocating the creation of a ‘competitiveness institute’ to challenge the logic of tax competition on an ideational level. These chapters are exceptions among the largely rationalist accounts of power and the national interest contained in all four books.

Second, the intersection between the problems of tax competition and tax dodging comes about because some jurisdictions are on the supply side of tax avoidance and evasion schemes, deliberately providing tax rules and secrecy in order to compete for paper profits and illicit wealth. The OECD attempted unsuccessfully to emphasise this point at the turn of the century, propounding then abandoning the concept of ‘harmful tax competition’, as opposed to legitimate measures designed to attract real economic activity. Several authors within these volumes are keen to revive the idea, if not the term, to emphasise how elements of the tax systems of large capital-exporting states, adopted for tax competition purposes, can be just as harmful to developing countries as those of the more stereotypical tax havens. This concern is taken up by Markus Meinzer at the end of his chapter in *Global Tax Governance*, where he argues that ‘many advanced economies are invested in international tax rules allowing for tax-base-poaching and -luring’ (GTG p271).

Third, as Dietsch (CC p60) asks, ‘is the case for shutting down a tax haven less robust when that tax haven is a low-income country?’ The collateral damage for residents of tax havens from ending harmful tax competition is a subject that preoccupies him, but receives little treatment in the other books. It is not a trivial matter: many tax havens are or were developing countries. Some specialised in financial services as a development strategy and have become economically dependent on it, while others have become hugely unequal because of the influx of wealth. Dietsch’s answer to his question is that, in certain circumstances, this tax competition may be justified.

## **An international tax organisation**

The third main problem for developing countries in international tax, which is not given an explicit treatment in any of these books, is referred to in legal scholarship as ‘inter-nation equity’ (Musgrave & Musgrave, 1972). As Thomas Rixen notes in his concluding chapter for *Global Tax Fairness*, the international tax system we have today was largely built to tackle the problem of ‘double taxation’, whereby overlapping claims by states to tax the same cross-border investment risked deterring that same investment by placing an onerous tax burden on it. While Rixen is interested in the inadequacy of this system for tackling tax competition, this is not its only downside. The OECD solved the double taxation problem by developing a set of instruments that divide the tax base of multinational companies between countries, but these instruments give a disproportionate share of the tax base to capital-rich states, at the expense of developing countries, potentially breaching the principle of inter-nation equity (Irish, 1974; Dagan, 2000). Reforming international tax rules in favour of developing countries therefore requires not only tackling ‘harmful’ tax competition that exploits the flaws in international rules, but also looking at the distributional impact of those rules themselves.

This important concern creates a strong caveat to the thrust of all four books, which is to push for greater international cooperation. Many chapters in the edited volumes argue for the need to ‘re-establish the international tax regime’ (GTF p157) or undertake ‘fundamental changes in the “architecture” of the world’s economic relations’ (GTF 251). Most agree with the proposal, developed in most depth in *Catching Capital*, to create an international tax organisation with a more representative membership and strong enforcement powers. Some engage with this from a pragmatic perspective, proposing initial steps that preserve state sovereignty (Tanzi in GTF) or create political preconditions for greater cooperation by shining light on the scandal of tax avoidance and evasion (Meinzer in GTG). The two edited volumes each contain chapters advocating two very different measures – unitary taxation, and a financial transaction tax - that share the idea of raising tax at a global level and dividing it between states on some agreed basis. They focus on how such reforms would enlarge the pie, assuming that developing countries would benefit, but do not discuss how (or indeed if) the pie would be divided in practice. Zucman (HWN p112-113), offering a pragmatic analysis, states that ‘the United States and Europe can advance alone in reforming the taxation of companies,’ apparently assuming that a unitary taxation developed by these states would be advantageous to all.

*Catching Capital* also avoids such a discussion, focusing instead on a notion of ‘background justice’ that is based on respect for democratic governments’ autonomy to determine the size of the state and the level of redistribution. Dietsch shies away from advocating a particular view of global distributive justice on both theoretical and practical grounds, the latter that ‘the current world order poses important difficulties as to its implementation. Is it realistic to expect the citizens of a rich state that,

according to the theory of global justice, has redistributive obligations towards the citizens of a poor state to actually respect these obligations?’ (CC p55-56). For ‘pragmatic’ reasons, his proposal therefore focuses on creating institutional arrangements to correct this – an international tax organisation (CC p104-119) – rather than on the content of inter-nation equity. The belief that greater cooperation will produce a better outcome is further propounded in GTG, where Dietsch and Rixen engage more with distributive questions, arguing that ‘tax competition tends to exacerbate inequalities in income and wealth. Conversely, global tax governance is a crucial element in the fight against increasing global inequalities.’ (GTG p10)

The problem with this line of argument is that the track record of global tax governance so far does not support the assertion that cooperation would produce a better outcome than competition for developing countries. Rather, there is a strong argument that it has institutionalised a distribution of the tax base that favours more powerful states (Brooks & Kreyer, 2015; Hearson, 2016). It is not clear that developing countries would be any better off under a more institutionalised system (Christians, 2010). The experience of the WTO, as Markus Meinzer points out, suggests that rule setting and enforcement can still disadvantage developing countries even in an organisation with near-universal membership (GTG p271).

## **A need for more politics and dissent**

Towards the end of *Global Tax Fairness*, the book takes a turn towards emphasising practical steps that developing countries might take on their own in areas such as mining taxation, race-to-the-bottom competition, and tax avoidance. This detailed agenda for plausible, incremental reform begins to take into account the political and technical constraints in the Global South. Michael Durst, in one of two final chapters focusing on ‘self-help’ actions by governments of developing countries, offers an opinion at odds with much of the book:

to assign responsibility for developing countries’ corporate tax shortfalls solely to decision-makers within multinational companies and their home governments would be simplistic and counterproductive. Developing country governments have long had at their disposal mechanisms...by which they could afford their countries a large degree of protection from base erosion [...] The problem is instead very largely political in nature. (GTF p329)

This shift in emphasis is an essential rounding out of a book whose predominant focus is on the governments of powerful, capital-rich countries as agents of change, as well as lacking voices from developing countries among its authorship. The gender balance of the two edited volumes is also notable: of thirty chapters in total, only four are purely female-authored (three others have mixed gender authorship).

The edited volumes seem keen to emphasise an underlying coherence, perhaps at the cost of incorporating the full range of scholarly opinion in their areas. There is nonetheless a clear effort to



place chapters in GTG in dialogue with each other, in particular in the philosophy section. Elsewhere, there is some sparring about the amount of wealth held offshore: to Zucman (HNW p41), James Henry's estimate of \$21 trillion 'seems excessive'; Henry (GTF p76) shoots back that Zucman's \$7 trillion is 'implausibly low.' One chapter of GTF begins with a footnote stating that the author is 'concerned that many of the substantive international tax policy proposals described in other chapters of this volume would be counterproductive to promoting domestic revenue mobilisation,' a tantalising hint at a policy debate that is not given an airing (GTF p15).

'There are no technical obstacles to the measures I propose' concludes Zucman (HNW p116), and yet 'governments have not been stellar up to now in their boldness or determination.' Why is that, and how can it be changed? He calls for citizen mobilisation against 'capture [...] by offshore finance.' Many chapters of *Global Tax Fairness* also lay the blame at the feet of capital, whether 'lobbying by the MNEs [Global Multinational Enterprises] themselves.' (GTF p125) or 'an influential transnational elite whose wealth is managed and secured by the most talented professional money launderers and tax dodgers that money can buy' (GTF p87). In contrast, Dietsch, Rixen and many authors in *Global Tax Governance* point towards a collective action problem caused by the asymmetrical interests of different states. The trick must be to create the right institutional design that is ethically sound, realistic given the contemporary distribution of power between states, and has enough teeth to tackle the prisoners' dilemma of tax competition.

These four books certainly advance our understanding of the problems and the potential solutions in international taxation, but they do not have as much to say about the political preconditions, especially for developing countries, that might make such change viable. Many of GTF's authors are tax justice campaigners with some successes under their belts, and it would have been interesting to learn more about their theories of change. There are some exceptions, especially Sol Picciotto's astute chapter observing that, '[t]he main obstacle to reform is the gap between the political concerns about the problems caused by the current system, and the technical knowledge of how it works and could be reformed' (GTF p232). This, one suspects, is likely to be a particular problem in developing countries, where policymaking capacity may be more constrained. Hopefully these books will encourage new scholarship that focuses in more detail on the political economic obstacles preventing the implementation of the solutions that they advocate so effectively.

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