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International Tax Cooperation and Implications of Globalization[i]

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ABSTRACT

Recent developments in globalization raise important issues regarding taxation policy and economic development. First, trends in capital income tax raise concerns about a possible race to the bottom or harmful competition. Second, lack of tax policy coordination results in large losses in tax revenue due to profit shifting by multinational corporations. These practices undermine revenue mobilization in the least developed countries, which also suffer from capital flight and other forms of illicit financial flows. This paper discusses how improved governance of the global financial system and enhanced harmonization in taxation policies may help address these important development problems.

Keywords: Taxation; tax evasion; globalization; saving; capital; economic development

JEL Classification: E21; H26; O16; O19; F13

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This paper was prepared as a contribution to the work program of the United Nations Committee for Development Policy (CDP) on the United Nations' development agenda for the post-2015 era. This research effort aimed at analyzing and proposing solutions to the current deficiencies in global rules and global governance for development. Additional information on the CDP and its work is available at: http://www.un.org/en/development/desa/policy/cdp/index.shtml

CONTENTS

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Acronyms

ADB	Asian Development Bank
AfT	Aid for Trade
AoA	Agreement on Agriculture
ASYCUDA	Automated System for Customs Data
CSOs	Civil society organizations
CV	Custom Valuation
DFID	Department for International Development, United Kingdom
DSB	Dispute Settlement Body
DTIS	Diagnostic Trade Integration Study
EIF	Enhanced Integrated Framework
FAO	Food and Agriculture Organization of the United Nations
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GTZ	German Development Agency
HS	Harmonized System
IF	Integrated Framework
IFC	International Finance Corporation
ITA	Information Technology Agreement
ITC	International Trade Centre
LDCs	Least Developed Countries
MFN	Most Favoured Nation
MoCS	Ministry of Commerce and Supplies
MoF	Ministry of Finance
MoFTR	Memorandum on the Foreign Trade Regime
NGOs	Non-Governmental Organizations
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NTC	Nepal Telecommunication Corporation
ODCs	Other duties and charges
SAARC	South Asian Association for Regional Cooperation
SPS	Sanitary and Phytosanitary Measures
SWAp	Sector-wide Approach
TBT	Technical Barriers to Trade
TPRM	Trade Policy Review Mechanism
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TRQs	Tariff rate quotas
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UPOV	International Union for the Protection of New Varieties of Plants
WP	Working Party
WTO	World Trade Organisation

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http://www.un.org/en/development/desa/policy/cdp/index.shtml.

1 Introduction

Globalization is viewed as the "increasing internationalization of markets for goods and services, the means of production, financial systems, competition, corporations, technology and industries"(UNCTAD et al., 2002, Glossary, p. 170). It is associated with increasing mobility of factors of production – especially capital –, explosion of financial flows, and rapid transmission of technological innovation. The integration of product and financial markets is facilitated by worldwide adoption of liberalization policies in product and service markets as well as in the financial system, and the general trend towards removal of regulatory obstacles to economic activity (UNCTAD et al., 2002, p. 9).

While the increase in trade in goods is the bedrock of globalization, the most rapid expansion has been in the area of finance. Over the span of three decades between 1980 and 2012, capital flows grew five times faster than exports. Global trade in merchandises increased by 820% overall or 7.2% annually, from $1,979 billion to $18,214 billion. During the same period, global (outward) foreign direct investment, for example, increased by 5,290% overall or 13.3% annually, from $549 billion to $23,593 billion.[1] Most of capital flows have been directed to the service sector, including banking. For example, over the 2005-2007 period, services accounted for 60 percent global investment outflows, although they represented only about five percent of global trade (UNCTAD et al., 2012, p. 12) . At the same time, while there have been substantial efforts to establish and strengthen global frameworks for the regulation of trade in goods, much less has been done in terms of coordination of trade in services and finance.

These developments in globalization have important implications for taxation. Tax policy remains a central element of national policy in several ways. It is the main source of revenue mobilization to finance public service delivery and to support counter-cyclical policy interventions. It has an important redistribution role, enabling governments to support livelihoods for low-income segments of the economy. Taxation policy is also an important gauge of equity considerations in the policy stance. Finally, taxation is an important tool for promoting domestic saving and investment, and for attracting foreign capital. It is in this context that developments in globalization are highly relevant for taxation policy. While other dimensions of fiscal policy are important, this paper focuses on the implications of globalization for taxation policy.

There are important issues regarding the links between globalization and taxation policy. First, there is increasing evidence that average taxation rates on capital income have declined over time in developed and emerging countries (Devereux et al., 2008). This raises the question of whether this is a result of deliberate attempts by countries to unilaterally use their tax policy to undercut each other in order to attract foreign capital and saving. In other words, are countries engaging in a "race to the bottom" or "harmful competition" using their tax policies? Second, with the increasing mobility of capital and ease of incorporation of enterprises in foreign territories, there is concern about multinational corporations (MNCs) engaging in profit shifting, taking advantages of loopholes in tax policy, gaps in regulatory frameworks, and lack of coordination of taxation policy across countries. This has important implications for efficiency and equity. The problem is exacerbated by the lack of transparency in the global financial services, especially in safe havens (Shaxson, 2011). Third, there is a concern that there is no level playing field in the globalization process, and that the least developed countries (LDCs) especially are substantially disadvantaged in the allocation of capital and saving. In particular, LDCs suffer large losses in tax revenue due to profit shifting by MNCs operating in the natural resources, manufacturing, and service sectors, while at the same time they face severe haemorrhage through capital flight and other forms of illicit financial flows (AfDB and GFI, 2013; Ndikumana and Boyce, 2011a; Shaxson, 2011).

From a global perspective, taxation policy can also play an important role in advancing global initiatives.

1 Data obtained from UNCTAD's statistical database (online) at http://unctad.org/en/Pages/Statistics.aspx.

This is at two levels. At the first level, taxation can generate valuable resources to support the financing of 'global public goods'. At the second level, targeted taxation can help discipline the production of 'global public bads' such as pollution. Achieving these goals requires a high level of coordination and political commitment by national governments.

This paper discusses these issues with a view to shed light on ways to improve global institutional mechanisms and frameworks to increase efficiency and equity in taxation in the context of globalization. The next section describes the main features and developments in tax regimes under globalization. Section 3 discusses tax competition and potential gains from international coordination in tax policy. Section 4 explores the linkages between tax competition, transparency and the emergence of tax havens as facilitators of profit shifting, transfer pricing, and other illicit financial flows. Section 5 reviews the existing global institutional frameworks for tax coordination and anti-tax evasion conventions, examines their effectiveness and discusses their potential. Section 6 examines the implications of international tax cooperation for revenue mobilization in developing countries. Section 7 briefly discusses the potential benefits from international coordination of taxation policy for financing global public goods. Section 8 concludes.

2 Tax policy in the context of globalization

Special goals and challenges associated with globalization

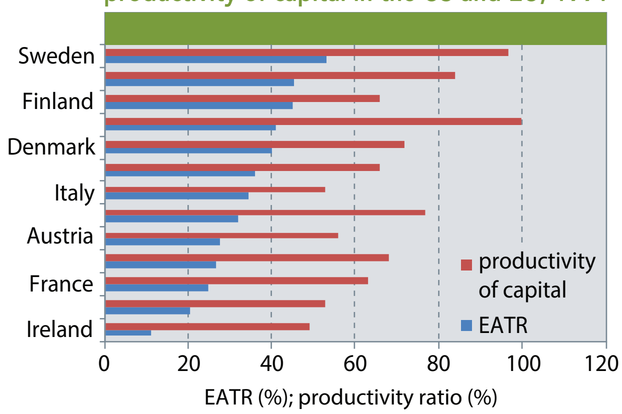
In addition to its traditional role in the domestic economy, tax policy takes on an expanded role in the context of globalization. It is a tool for managing the country's trade and investment relations with the rest of the world, including protecting the domestic economy against external shocks. At the global level, taxation is also a tool for (1) setting up incentives for discouraging the production of public 'bads' such as pollution and (2) for mobilizing financing for public goods. This is further elaborated in Section 7.

In the context of globalization, national fiscal policy design and management is guided by two important objectives. The first is to improve the competitiveness of national enterprises relative to foreign companies. In this respect, fiscal policy uses two main tools: the statutory tax rate on capital and corporate profit; and the effective marginal tax rate on business income. The second objective is to attract foreign capital and saving while retaining domestic capital in the local economy. This objective is challenged by the fact that tax policy is a sovereign policy and therefore there is no expectation that countries will automatically harmonize their policies. In fact, more often than not, tax policies are not harmonized, and this is not new.

The lack of harmonization of tax policy is partly due to the fact that economies are characterized by different levels of productivity of capital and different rates of economic agents' intertemporal substitution between saving and consumption. However, even taking into account these considerations, the evidence tends to show that substantial disparities in taxation rates are not backed by these fundamental characteristics. Take the example of tax on capital. One would expect that differences in tax rates across countries would reflect differences in productivity of capital. Figure 1 suggests that this is not systematically the case.

Fiscal policy in the context of globalization is confronted with the reality of increased cross-border

Figure 1
Effective corporate tax rate (EATR) and productivity of capital in the US and EU, 1991



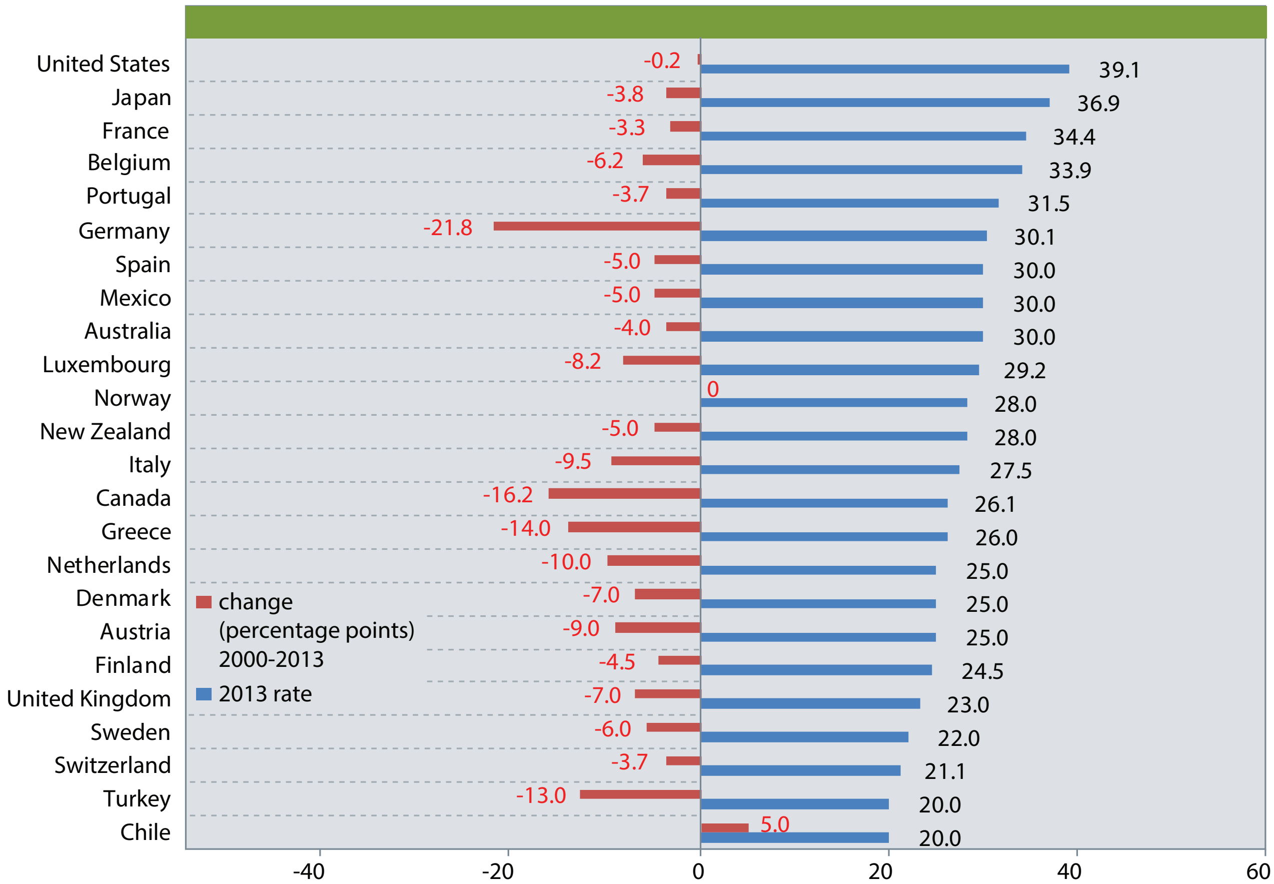
Source: Sorensen (2000).

capital mobility, following the gradual deregulation of capital account regimes. If domestic tax rates are perceived as being higher than in other countries, then businesses will be tempted to move abroad either or both their investments and their business profits. This raises policy concerns as such decisions affect the country's potential for growth and employment creation.

The competitiveness implications of fiscal policy have come to the centre stage in the wake of the 2008 global financial crisis in developed countries as they struggled to ignite and sustain economic recovery. In the United States, the crisis has re-energized claims from the business community and the conservative political establishment that American companies are penalized by relatively higher statutory and effective tax rates compared to other OECD countries. This, as the argument goes, would be one of the major reasons why American businesses have been relocating production abroad, especially in developing and emerging countries to reap the benefits of lower effective costs of capital and labour. Recent evaluations tend to lend some support to the claim about US tax rates being higher than in comparable countries. In 2013, the average effective corporate tax rate was 39.1 percent in the United States, followed by Japan at 37% (Figure 2). All the other major OECD countries had lower rates. In the UK, the rate was a full 16 percentage point lower than in the United States (23%). In all OECD countries except Chile, the tax rates have declined since 2000, and quite substantially in some countries. The United States

Figure 2

Effective corporate tax rates in selected OECD countries, 2000–2013



Source: OECD, Centre for Tax Policy Administration (online data: http://www.oecd.org/ctp/).

experienced a smaller decline in corporate tax rate compared to other countries.

A recent report by PriceWaterhouseCoopers (2013) finds that in the past years, effective corporate income tax rates have gone up in the majority of sectors in the United States. For example, the average effective corporate income tax rate for companies in the third top quartile in the aerospace and defence industry increased by 1.6 percentage point from 32.3% in 2010 to 33.9% in 2012 (Table 1). The data also indicates that the increase in the burden of taxation has been uneven, falling disproportionately on smaller companies. To use the example of the aerospace and defence industry, the average effective corporate tax rate for companies in the bottom first quartile increased twice as much as in the third quartile: by 4.5 percentage points from 19.5% to 24% during 2010-12. The larger companies have experienced a relatively smaller increase in the tax burden. The increase in the tax burden should be even smaller for MNCs, which are able to take advantage of low taxation in foreign territories where their branches and affiliates are located in addition to tax avoidance through various 'tax planning' mechanisms and outright tax evasion (discussed later in the paper).

The differences in effective corporate income tax rates across countries could be a result of many factors. The first is, obviously, the statutory tax rate. However, these differences are also driven by the overall structure of the tax regime. In other words, these differences are a result of cross-country variations in both the tax rate as well as the base. This involves considerations on what activities are taxed or not, what provisions are available for tax deductions and allowances, and differential treatment of income on the basis of where it was earned – domestically or abroad. These considerations are central to tax competition; they are elaborated in Section 3 further below.

Trends and shifts in tax policy regimes

The configuration of tax regimes around the world has experienced three main developments over the last five decades. The first was the introduction of the Value Added Tax (VAT), which is now the most

Table 1
Effective corporate tax rates in selected US corporate sectors, 2010 and 2012

Sector	Quartile	2010	2012
Aerospace and defence	Q3	32.2	33.9
	Q1	19.5	24.0
Industrial products and automotive sector	Q3	34.1	35.2
	Q1	16.4	20.4
Automobile sector	Q3	35.5	34.4
	Q1	16.1	18.4
Chemicals	Q3	32.1	33.9
	Q1	20.8	23.0
Transportation and logistics	Q3	38.3	38.5
	Q1	8.7	15.5
Industrial manufacturing and metals	Q3	33.6	36.0
	Q1	22.9	24.1

Source: Price Waterhouse Coopers (2013).

widespread form of consumption tax. The rationale for this form of taxation was that it is the least distortionary way of taxing private consumption. The second major development has been the general lowering and flattening of statutory income tax rates on high income individuals and corporations (Bird, 2012). The third noteworthy development is a recent push for more equity considerations in tax policy. These changes and trends reflect, to some extent, shifts in views of what good tax policy is within the academic community and the policy arena.

In the 1960s, it was all about income tax. Under what is referred to as Development Tax Model 1.0, progressive comprehensive personal income tax was deemed to be the ideal tax regime (Bird, 2012). In particular, such a regime was considered especially appropriate and preferred for developing countries (Bird, 2012; Bird and Zolt, 2005; Kaldor, 1963). Indirect consumption tax was considered as 'necessary evil'. International and sub-national aspects of taxation were relegated to the margin and were not considered important in tax policy design. This model of taxation eventually proved ineffective in helping developing countries in the mobilization of tax revenue. Tax to GDP ratios did not increase, which was an important cause of the fiscal challenges faced by developing countries in the 1980s in addition to external debt crisis.

In the 1980s, the thinking on taxation underwent an important shift in the context of market-oriented policy reforms enshrined in the so-called Washington Consensus. The prescription was that a broad-based low tax rate model – Development Tax Model 2.0 – was the most appropriate for developing and developed countries (Bird, 2011). It is in this context that the preference shifted to VAT as the more preferable form of taxation. However, like under Model 1.0, the premise remained that "more tax is better"; thus, the objective remained to increase tax revenue. Note, however, that even with the shift towards VAT, income taxes remained important. What changed was that the rates were declining, as were tax incentives, but the bases were broadening.

Under the 2005 United Nations Millennium Project, a minimum of 4 percentage-point increase in the tax to GDP ratio was deemed necessary for developing countries to achieve the millennium development goals. This meant that countries were expected to raise their tax/GDP ratios from an average of 17-18% to 22%. This goal proved to be rather ambitious and even unrealistic. In fact, no LDC achieved this target. In 2011, the IMF recommended a less ambitious goal of 2 percentage increase in the tax/GDP ratio, and suggested that most countries could achieve this increase with VAT alone "with no great effort" (Bird, 2012, p. 8).

More recent debates about taxation regimes exhibit increasing attention to the fiscal exchange and equity dimensions of taxation. Specifically, this is illustrated by reforms in the tax system that seek to achieve a better balance between resource mobilization and income (re)distribution through changes in corporate income tax, personal income tax, tax on wealth, and others.

The evidence, however, shows that these shifts in taxation regimes have not produced commensurate effects in effective tax revenue collection. In fact, the evidence indicates substantial 'fiscal revenue inertia' (Bird, 2012) and there has been little progress in raising tax/GDP ratios, especially in sub-Saharan Africa (Table 2). The leading region in terms of growth of tax/GDP ratio is developing Asia where the ratio grew by nearly 3 percent annually during the 2000-12 period. However, this region continues to trail other regions in tax mobilization, with a 21.7% tax/GDP in 2012 (up from 15.4% in 2000). In Sub-Saharan Africa, there has been virtually no change in the tax/GDP ratio over the past decade. The best performers in this respect are Latin America and the Middle East and North Africa with ratios above 30%.

Several factors have been advanced to explain the poor performance in tax revenue mobilization in developing countries. These include lack of economic transformation that perpetuated the dominance of low-tax generating sectors such as agriculture, and

Table 2
General government revenue in developing regions, percentage of GDP

Group	2000	2005	2010	2011	2012	Average 2000-12	Annual change 2000-12 (%)
Developing Asia	15.4	18.4	20.5	21.5	21.7	18.9	2.9
Latin America and Caribbean	24.5	27.2	30.1	30.9	31.3	27.7	2.0
Middle East and North Africa	30.5a	40.4	34.7	37.8	37.8	36.9	2.2
Sub-Saharan Africa	25.9	27.6	25.4	28.6	27.9	26.8	0.6
For comparison:							
Emerging market and developing economies	23.6	27.6	27.0	28.3	28.3	26.6	1.5
European Union	44.7	43.6	43.5	44.1	44.3	43.8	-0.1

Source: IMF, World Economic Outlook database, accessible online at: http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/index.aspx.
Note a: In 2002.

inefficiencies in tax administration, some of which are due to lack of technical capacity. In the spirit of Kaldor (1963), it may be argued that taxation has not increased as expected "because it is seldom in the interest of those who dominate the political institutions to increase taxes" (Bird, 2012, p. 8).

Moreover, performance in tax revenue mobilization reflects the degree of compliance by tax payers, which in turn is influenced by the public's perception of the efficiency of utilization of resources as illustrated in the supply and quality of public services. In general, accountable states have more leverage in mobilizing tax revenue. In particular, successful strategies for raising tax revenues must be backed by enhanced rule of law, reduction of corruption, improved tax morale, and contraction of the shadow economy. Obviously these are not easy to accomplish, but "some countries may find it easier to do such things than finding oil – and they may well be better off by doing so since oil wealth may solve the revenue problem only at the cost of exacerbating substantially the governance problem" (Bird, 2012, p. 8). In fact, in the case of developing countries, those that 'have found oil' have performed worse in tax revenue mobilization than their less 'lucky' non-oil counterparts (see Ndikumana and Abderrahim (2010) for evidence in the case of African countries).

In addition, the evidence also indicates 'fiscal structure inertia" (Bird, 2012). Despite the various changes in the tax rates and legislations, there has been no major change in the structure of the tax system. In particular, the share of consumption taxes – share of VAT and customs revenues in total tax revenues -- has not substantially increased following the introduction of VAT, as increases in VAT revenues have been offset by declining customs revenues due to trade liberalization (Martinez-Vazquez and Bird, 2011). As for personal income tax collection, there is no systematic common trend across countries; the ratio of personal income to GDP has increased in some countries and decreased in others (Table A.1in the Appendix). The same goes for corporate income tax as a share of GDP (Table A.2 in the Appendix).

3 Tax competition and gains from international policy coordination

Distortionary effects of taxation

The substantial variations in statutory and effective tax rates across countries suggest that there are scopes for competition for capital and savings on the basis of fiscal policy. These disparities may, in fact, be a result of active attempts by governments to compete over mobile capital and savings. This implies that globalization increases the distortionary effects of taxation. In the context of a closed economy, taxation can create a wedge between consumer-saver's marginal intertemporal rate of substitution and the producer-investor's marginal productivity of capital. This can affect the allocation of capital across sectors and activity.

In the open economy context, there are two additional potential distortions due to taxation (Razin and Sadka, 1991). Under globalization, residents in any country may engage in rate of return arbitrage on capital (firms) and saving (households and firms) on the basis of differences in taxation between their home country and the rest of the world. Their objective is to maximize the returns to savings and capital regardless of the country where they choose to locate their investments and channel their savings or profits. Differences in taxation, therefore, can create disparities in the intertemporal marginal rate of substitution, which may result in misallocation of savings across countries. Similarly, differences in taxation may drive disparities in marginal product of capital, resulting in misallocation of capital or investment across countries.

If countries choose to compete over capital and savings using fiscal policy, their tool kit include more than the rate of taxation. In addition to setting the tax rate, governments can choose what to tax, when and how much to tax it. From the tax payer's perspective, this affects the taxable income and the tax base. There are two important dimensions besides the tax rate along which governments can compete to attract and retain capital and savings in the context of globalization. The first is the treatment of foreign-earned income. Here governments can choose between two approaches. The first is the *residence-based* taxation whereby residents are taxed on their world-wide income, regardless of whether the income is earned at home or abroad. Foreigners are not taxed at all in this approach. The second is the *source of income* approach where residents are not taxed on foreign-earned income and foreigners are taxed as residents on income earned from domestic sources. If all countries adopted the same approach, then marginal intertemporal rates of substitution as well as marginal products of capital would be unaffected by tax considerations and savings and capital would be allocated according to country-specific fundamentals; taxation would not be distortionary in an open economy context. But in practice, there is no coordination in foreign income taxation.

The second possible dimension of tax competition is the treatment of debt and equity in taxation. Corporations can (legally) use clever financial accounting to take advantage of allowances for deduction of interest payments not only by increasing the use of debt relative to equity, but also through intra-corporation lending to minimize the overall tax burden. The latter is an avenue for 'thin capitalization' as well as profit shifting across territories, resulting in overall lower effective tax payments for the corporation as a whole. Therefore, the data on effective corporate tax rate may be misleading with respect to the level of statutory taxation in a country. This also means that countries have more tools at their disposal when they use tax policy to compete over capital and savings.

Evidence: do countries engage in tax-based competition over capital and savings?

The question of whether countries effectively engage in tax-based competition has been motivated, in part, by the substantial variations of tax rates across countries as well as the steady decline in effective marginal tax rate on capital and corporate profits (Devereux et al., 2008). Obviously, the decline in the tax rate is a concern because it implies loss in government revenue. But, at least in principle, these losses may be compensated by gains arising from increased economic activity due to inflows of foreign capital if, in fact, the tax provisions do succeed in enticing increased capital inflows.

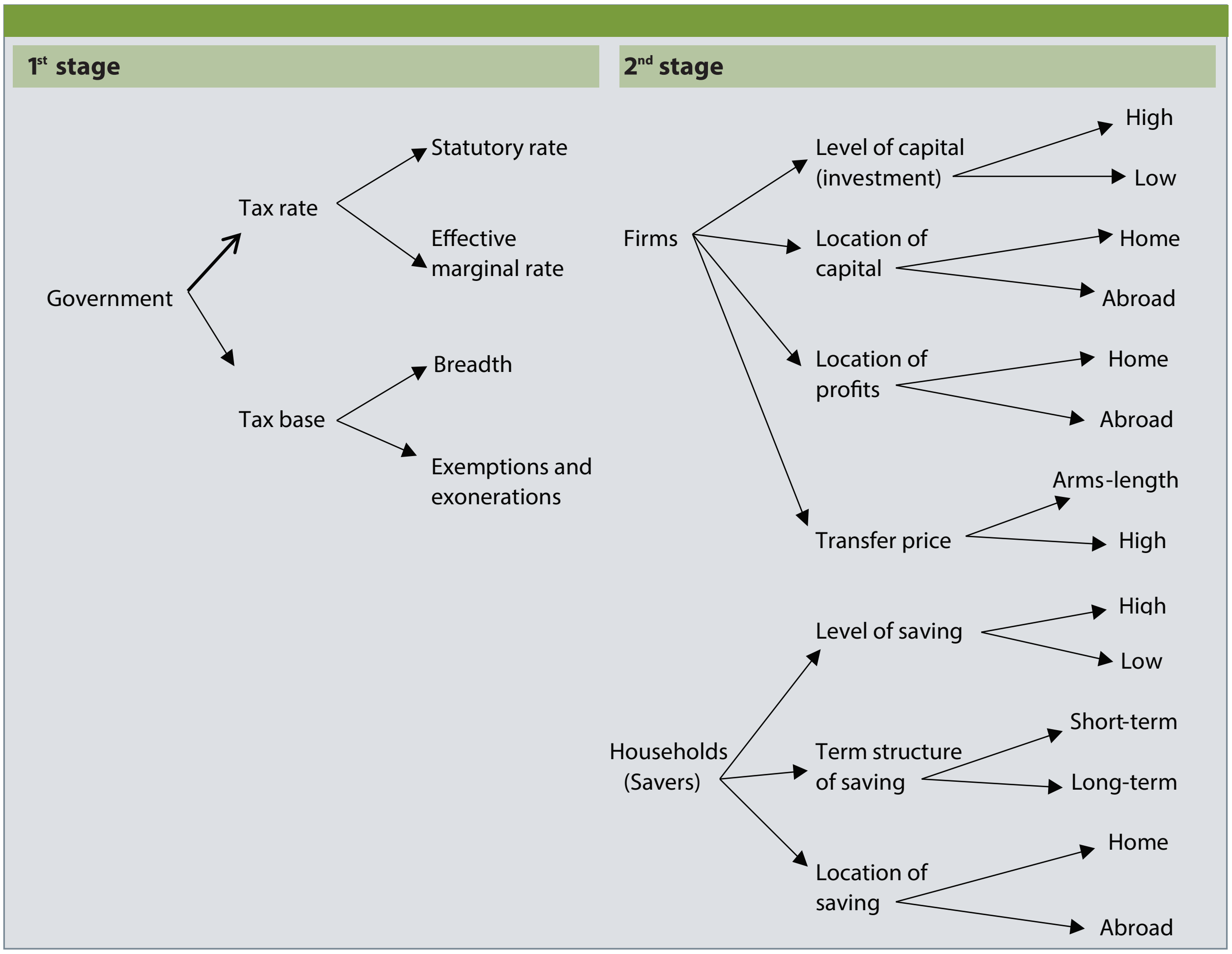
The research community has attempted to shed light on the question above by combining theoretical modelling and empirical analysis to search for evidence of effective tax competition (Devereux et al., 2008; Huizinga and Laeven 2008; Marceau et al., 2010; Paeralta et al., 2006; Wilson and Wildasin, 2004). To get a handle on the question, one must consider the interplay between the decisions by the government regarding taxation and the reactions of private sector actors (firms and individual savers) with regard to the levels and allocation of capital and saving. The interplay can be conceived as a two-stage game between private actors and the government. This is summarized in Figure 3.

The outcomes of these interrelated decisions by the government and private sector actors are critically important for the relative economic performance of countries with accompanying welfare implications. These decisions imply that economic activity may be displaced due to disparities in taxation policies (Desai et al., 2006). There are also possibilities of misallocation of capital and savings across countries as discussed earlier. Information plays a key role in the decisions by firms and savers to allocate capital and saving. This happens at two levels. First, accurate information on the true content of taxation policy – statutory as well as effective tax rates – is important in the determination of the optimal level and location of capital. Second, the extent of disclosure of information, or transparency, affects incentives of firms and savers in determining the location of economic activity (capital), savings and profits.

The literature on tax competition provides some consistent evidence that demonstrates the important

Figure 3

Government, firms, savers and taxation: a game theoretical representation



Source: Author's design.

role of globalization. The evidence confirms that capital and profits have become more mobile across countries, as illustrated by the massive capital flows towards both developed and developing countries, although the lion share is still at the advantage of advanced economies. The evidence also confirms that governments do use taxation policy to compete over capital, profits and savings. Among the tools that are at the disposal of the governments, the key factor that seems to be determinant in tax competition is the statutory tax rate. In contrast, the effective marginal tax rate seems to play a minor role (Devereux et al., 2008).

The analysis in the empirical literature indicates that tax competition has been enhanced by the increasing deregulation of capital flows (Devereux et al., 2008). In the case of developing countries, capital account liberalization occurred in the context of the general push for economic liberalization from the 1980s. In the developed world, the major change was the culmination of the European integration into a common currency, which provided an environment for near-complete mobility of capital. In the context of closed capital account or restricted capital flows, tax competition is less effective in moving capital between countries. But this holds only for transparent and honest movements of capital; illicit capital movements are generally independent of the degree of capital flow regulation (Fofack and Ndikumana, 2013; Ndikumana and Boyce, 2011b; Ndikumana et al., 2013).

Gains from tax policy coordination

The increased capital mobility has motivated debates on the need for global and regional cooperation on corporate income and capital taxation policies (FitzGerald, 2002). The objective is to avoid the "race to the bottom" whereby in an attempt to lure capital to their home countries, governments undercut each other's capital income tax mobilization. Coordination of tax policy is both a technical and a political process. It is critically contingent on systematic and efficient exchange of information on taxation. It also requires sensitive sovereign decisions about trade-offs between gains from harmonization and payoffs from differentiated regimes. In making these decisions, economic and financial calculus is often be trumped by political considerations. This may explain why international conventions and protocols on taxation take long to design and are difficult to implement and enforce. This is further discussed in Section 5.

Coordination and harmonization of tax policy may take place at the regional and international levels. The gains from harmonization in terms of revenue mobilization are maximized if all countries were to agree to exchange full information on taxation and systematically enforce a common regime such as a residence-based taxation. However, the gains from coordination depend on other factors underlying the domestic economies and the regulation of exchange between countries. In particular, a key determinant of the feasibility of coordination and the gains from it is the degree of capital mobility across countries. In the presence of perfect capital mobility at the global level, the gains from regional coordination appear to be rather small (Sørensen, 2004). Regional coordination would be justified if the set of countries in the region are more integrated among each other, but relatively closed vis-à-vis the rest of the world. Given the general trend towards capital account deregulation, harmonization efforts at the regional level need to be effectively coordinated with initiatives at the international level.

4 Tax competition, tax evasion and safe havens

Why care about safe havens

The discussion of coordination of taxation policy in the context of globalization cannot be complete without an analysis of the role of safe havens, or tax havens, secrecy jurisdictions, or offshore financial centres (OFCs). These terms are used often interchangeably although they do not mean the same thing. So, for example, while it is typically presumed that most illicit financial flows are concealed in small tropical islands called safe havens, a substantial share of the funds are, in fact, located in financial centres in major OECD countries. But the latter are rarely, if ever, referred to as OFCs or tax havens. Thus far, the discussion in this paper on how tax regimes induce and affect the mobility of capital, profits and savings has not considered the legal and transparency aspects of transactions. Yet, transparency and legality of financial flows is central to understanding the recent explosion of financial flows around the world, a substantial part of which goes towards or transit through tax havens.

But why should we care about tax havens? There are several reasons. First, due to the services that secrecy jurisdictions offer to capital holders, they facilitate the transfer and concealment of capital including illicitly acquired funds. This has emerged as a major issue for developing countries in the context of debates on development financing and governance. But developed countries have also begun to pay attention to the problem of secrecy jurisdictions because of the substantial revenue losses incurred through profit shifting, transfer pricing and other illicit transactions (Bartelsman and Beetsma, 2003; Sikka and Willmott, 2010). It is estimated that developing countries are more vulnerable to the impact of safe havens in the sense that they are less institutionally and technically equipped to address tax evasion and incur proportionately higher revenue losses (Hampton and Christensen, 2010; Hebous and Lipatov, 2013; Shaxson, 2011). Thus safe havens are central to debates on taxation policy and development financing for developing countries.

Safe havens also deserve attention due to distributional and equity implications of their operations. Part of the massive amounts of capital held in tax havens belong to the economic and political elites of developing countries, who, in addition to acquiring most of it illicitly, do not pay taxes on the earnings from the underlying assets. This implies substantial regressive taxation and a relatively higher burden of taxes on the middle class. Thus, safe havens indirectly contribute to worsening income inequality in developing countries. In fact, given the massive amounts of wealth that is channelled through safe havens, and, therefore, not incorporated in national accounts for income and expenditures, it is likely that the standard measures of welfare and inequality as well as cross-country distribution of wealth may provide inadequate representation of the actual extent of inequality; they may overestimate or underestimate it. (Zucman, 2013).

The attention to tax havens is further motivated by the linkages with corruption in both developed and developing countries. Secrecy jurisdictions provide a safe haven for corrupt rulers to hide stolen assets, including funds obtained through embezzlement of the proceeds from natural resource exploitation and trade. For example, it is estimated that up to 8 percent of all petroleum rents from oil-rich countries with weak institutions end up in private accounts in OFCs (Andersen et al., 2012; Hebous and Lipatov, 2013). By facilitating the transfer and concealment of corruption-related funds, tax havens undermine governance in general (Torvik, 2009). They may also have a negative impact on tax regimes, as they provide incentives for rulers to devise tax regimes that facilitate profit shifting. As a result, tax compliance is undermined as safe havens facilitate tax avoidance and tax evasion by MNCs and the political and economic elites. This further undermines tax morale through negative demonstration effects (Fjeldstad et al., 2012). Indeed, if neighbours do not pay taxes, and especially if they happen to be rulers, then there is less incentive for a regular resident to honour his/her tax obligations.

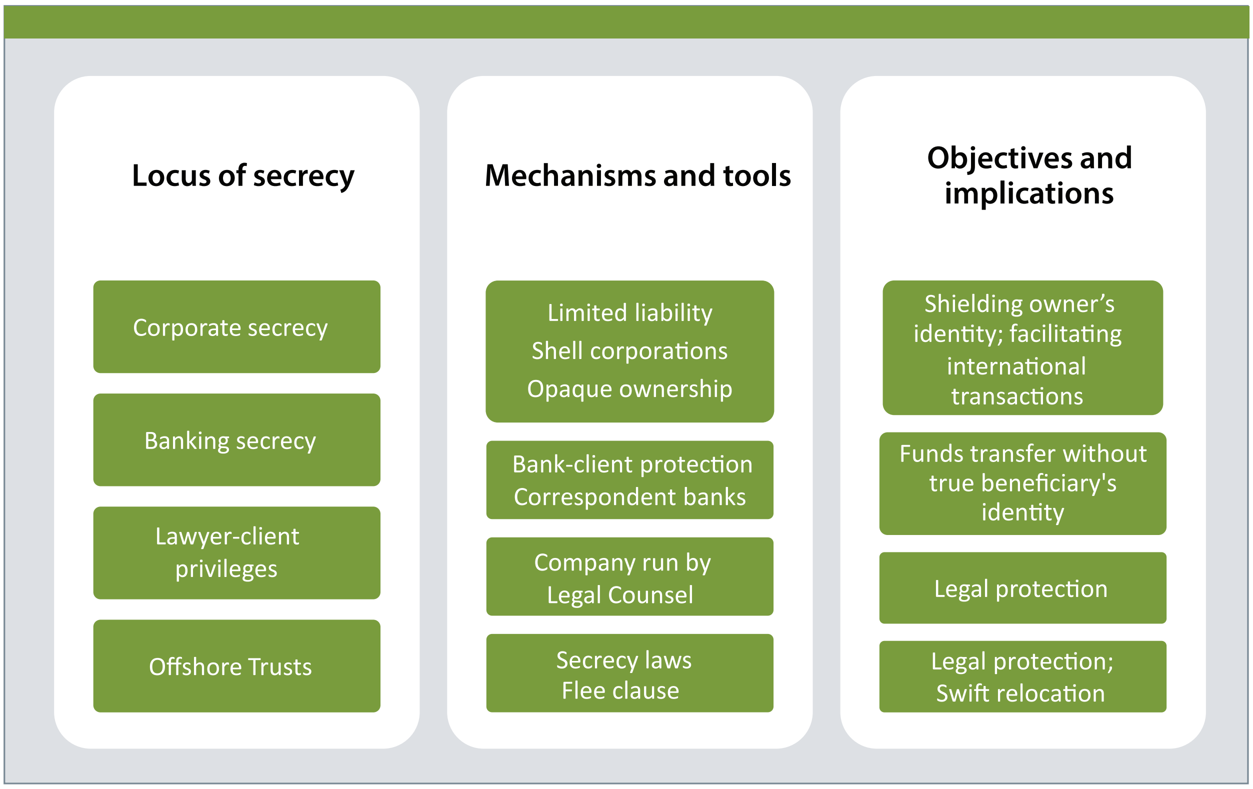
There are, however, voices that have argued that there are some positive effects associated with tax havens. It is argued that secrecy jurisdictions and tax havens enhance competition in neighbouring countries (Rose and Spiegel, 2007), and that they may even have positive welfare effects by providing opportunities for investment by firms fearing high taxes and expropriation in corrupt countries (Hong and Smart, 2010). But these alleged potential benefits pale in the face of the devastating negative effects arising through the drainage of resources (Ndikumana and Boyce, 2011a; Reuter, 2012; Shaxson, 2011), deterioration of governance in the public sector and erosion of business ethics.

Institutional mechanisms of secrecy

Tax havens thrive on secrecy. The key service they sell to their clients is the promise to withhold all the information pertaining to their identity and the characteristics and outcomes of their business activities. That is their main capital, and they work hard to preserve and protect it even in the face of increasing pressure from the global community and individual major countries – especially the United States – to lift their veil of secrecy. Thus, safe havens invest heavily in undermining financial transparency. Financial transparency obtains when "every actor and transaction within a system can be traced to a discrete, identifiable individual" (Sharman, 2010, p. 127).

Secrecy jurisdictions and tax havens are able to provide protection to their customers through complex institutional mechanisms that establish intricate layers of secrecy, and make it difficult to link illicit proceeds to the predicate crime and the ultimate beneficiary; that is, linking crime to the criminal. This is summarized in Figure 4. Secrecy is provided through two main mechanisms. The first is outright anonymity whereby no meaningful information on the beneficial owner of an asset, transaction, or company is recorded during the initiation of a transaction, the establishment of a company or the opening of a bank account. Economic units established in this context are nominative and often do not even undertake any activities in the territory where they are domiciled. These 'shell companies' are created to serve as vehicles for transfer pricing, transfer of illicit funds and other activities, which may include legal as well as illegal operations. The second mechanism is through a web of legal ownerships involving a tangled inter-jurisdictional web of interlocking relationships. There are two key features of these mechanisms. The first is what we may call the chameleon structures of shell companies in the sense that these companies can be modified, restructured, and renamed expeditiously to evade any inquisition by the regulator or law enforcement authorities. The second

Figure 4
Tax havens and layers of secrecy



Source: Author's design.

is the mobile jurisdiction of the companies whereby the domiciliation of the company can be changed at will in no time to evade law enforcement and criminal investigation. These mechanisms are made possible by the lax legal systems and regulations in the secrecy countries. They are also perpetuated thanks to the immense economic power of the companies and individuals that hold wealth and channel their transactions through these territories.

In the popular press, the notion of secrecy jurisdictions and tax havens is typically associated with palm-fringed tropical islands such as the Cayman Island, Bermuda, and others. It also refers to territories with loose governance such as Somalia, which are used as transits for illicit trade and financial transactions. But recent evidence has shown that large OECD countries are also guilty of harbouring banking secrecy, and are both conduits and victims of substantial tax evasion (Hampton and Christensen, 2010; Sharman, 2010; Shaxson, 2011).[2] Moreover, surprisingly, it is actually the well governed countries that tend to become tax havens and that benefit the most when they do so (Dharmapala and Hines, 2009). This is contrary to conventional wisdom where large advanced economies are viewed as having superior legal environments and as being the vanguards of transparency and good governance. This conventional belief is increasingly challenged.

The use of tax havens has been facilitated by the increasing complexity of the structure of MNCs and their multiple-domiciliation characteristics. Being located in multiple territories with different regulatory frameworks with regard to taxation, banking laws, and rules governing business operations in general provides incentives and opportunities for tax evasion. Indeed, larger firms with substantial foreign operations benefit the most from using tax havens (Desai et al., 2006). The implication is that growth of the private business sector may not be accompanied by proportional increase in tax revenue because of these leakages facilitated by tax havens.

Rules and regulations in developed countries are evolving in response to the increasing evidence on the explosion of tax evasion and illicit financial flows. But progress is slow and uneven. As a result, important discrepancies remain in the institutional frameworks, and these differences are exploited for the purpose of tax evasion, profit shifting, transfer pricing and other forms of illicit financial transactions. So, for example, whereas all OFCs regulate corporate service providers, the US and the UK do not. It is possible that this reflects the influence of the interest groups over the regulators in states like Nevada and Delaware that are known as tax havens (Sharman, 2010). It is clear that there is ample room for improvement in coordination.

5 Global conventions and frameworks for tax cooperation and against tax evasion

Existing frameworks

The expansion of activities in tax havens and the explosion of illicit financial flows over the past decades have prompted a push for establishment and consolidation of international regulatory frameworks to increase transparency or rather to combat secrecy and enforce responsible banking and trade practices. Efforts have been initiated at both national and global levels on a bilateral as well as multilateral basis.

As the lion share of tax evasion and illicit financial flows is orchestrated by or through large companies, the first area of focus is the enforcement of standards on corporate governance. The recent global financial crisis revealed that there are widespread and deep shortcomings in corporate governance, especially the lack of reliable checks and balances capable of enforcing responsible corporate practices. In this context, the main instrument to address this problem at the global level is the OECD Principles on

2 More information is available at Tax Justice Network (www.taxjustice.net), including ranking of territories by degree of secrecy ('financial secrecy index').

Corporate Governance, especially chapter VI which specifies that "the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company" (OECD, 2004, p. 24).[3]

Another area of attention is anti-money laundering, which is an important channel of illicit financial flows (R. Baker, 2005). In this context, the recommendations by the Financial Action Task Force (FATF) constitute the global standards recognized internationally against money laundering and terrorist financing. These recommendations are aimed at increasing transparency and providing member countries with a framework and guidance on how to prevent all forms of illicit use of their financial systems.[4] In the same context, Basel Core Principles provide a framework for banking supervision that can also contribute to reducing the use of the financial system for illicit purposes, although this may not be the explicit goal. In the same vein, the conventions on securities regulation, notably the IOSCO Multilateral Memorandum of Understanding, provide a comprehensive framework for cooperation and collaboration among world securities regulators in the exchange of information (IOSCO, 2012).[5] Such collaboration can, in principle, enable tracking of the sources, amounts, destination, and owners of financial transactions around the globe.

Globally, the overarching framework is the United Nations Convention on Against Corruption (UNCAC), whose aim is "to promote and strengthen measures to prevent and combat corruption more efficiently and effectively; to promote, facilitate and support international cooperation and technical assistance in the prevention of and fight against corruption, including in asset recovery; and to promote integrity, accountability and proper management of public affairs and public property" (United Nations, 2003, p. 7). The Convention provides a frame of reference for anti-corruption policies at national and regional level, such as the African Union Convention on Corruption.

At the bilateral level, countries have been establishing agreements to facilitate exchange of information for the purpose of combatting tax evasion, which also can help curb illicit financial flows. In this context, Tax Information Exchange Agreements (TIEA)[6] have proliferated in recent years. But they remain concentrated among OECD countries whereas developing countries have been left on the margin. For example, only Mauritius has a TIEA in Africa.

Limited effectiveness of existing frameworks

The effectiveness of the various conventions and agreements on cooperation in taxation policy has been limited and uneven. For multilateral frameworks, the implementation is often hampered by the lack of coordination among parties to the conventions or agreements and lack of mechanisms of accountability to penalize failure to cooperate. Bilateral agreements also have their limitations. One important challenge is that operators in tax havens are able to take advantage of the complex layers of

3 The OECD Principles on Corporate Governance were released for the first time in May 1999 and were revised in 2004. They constitute "one of the twelve key standards for international financial stability of the Financial Stability Board and form the basis for the corporate governance component of the Report on the Observance of Standards and Codes of the World Bank Group." OECD: http://www.oecd.org/corporate/oecdprinciplesofcorporategovernance.htm.

4 Details on the recommendations can be found on FATF website at: http://www.fatf-gafi.org/topics/fatfrecommendations/

5 See, especially, paragraph 7 (b)ii of the IOSCO Memorandum of Understanding. Created in 1983, the IOSCO gathers the world's securities regulators to set and enforce standards for the securities sector. It "develops, implements, and promotes adherence to internationally recognized standards for securities regulation, and is working intensively with the G20 and the Financial Stability Board (FSB) on the global regulatory reform agenda." (IOSCO, website at http://www.iosco.org/about/).

6 See OECD: http://www.oecd.org/ctp/harmful/taxinformationexchangeagreementstieas.htm

secrecy and intricate legal machinery to make discovery of criminal financial activity difficult and prosecution even harder. Moreover, tax evaders are able to stay one step ahead of the regulator and the investigator. They can shift shell companies, bank accounts and other transactions to territories that are not yet covered by treaties. As a result, the TIEAs have not yet produced a significant decline in tax evasion or meaningful repatriation of funds. The initial impact of TIEAs seems to be a relocation of funds or redirection of new illicit financial flows across jurisdictions (Johannesen and Zucman, 2012).

Moreover, coordination of efforts to fight tax havens is challenging because not all tax havens are created equal. The group includes large and small offshore financial centres, including some in poor nations (Rawlings, 2005). Determining how to sequence global action is difficult. But at the same time, unless action is undertaken at multiple fronts, it is difficult to make a substantial impact. It seems, therefore, that the effectiveness of efforts to fight tax evasion is bound to be limited in the absence of a concerted approach to take on all safe havens at once through a 'big bang' multilateral intervention (Elsayyad and Konrad, 2012). In fact, fighting a subset of tax havens may actually make the remaining ones more profitable as activities shift from safe havens that are under pressure to the ones not covered by the intervention. But the question remains as to how to organize such a 'big bang' combat against all safe havens, especially given that it is not even possible for all stakeholders to agree on a comprehensive ranked list of safe havens.

6 International tax cooperation and revenue mobilization in developing countries

The foregoing discussion on taxation and globalization has important implications for developing countries, especially the least developing countries (LDCs) that face special challenges in taking advantage of globalization and mobilizing domestic revenue. It has been demonstrated in various reports and analyses that developing countries are lagging behind a number of important development goals, and that a key reason for this is the shortage of financing to meet their development needs. In light of the discussion in this paper, international tax cooperation can be a tool for helping developing countries in addressing this critical constraint to economic development. Three important avenues can be singled out: impact on domestic investment; effects on tax revenue mobilization; and effects on allocation of official development aid.

The analysis in this paper suggests that the current configuration of the global financial and taxation systems has detrimental effects on efforts by developing countries to increase their domestic investment as a means of accelerating economic growth and development. In particular, the proliferation of tax havens and their facilitation of tax evasion and illicit financial flows undermine domestic investment in developing countries. On the domestic front, tax evasion facilitated by tax havens creates incentives for channelling domestic capital abroad rather than investing in the home country. This affects both honestly acquired capital and stolen capital that ends up fleeing developing countries towards safe havens. LDCs continue to lose massive amounts of capital annually through capital flight and other forms of illicit financial flows, most of which are motivated by tax evasion (AfDB and GFI, 2013; Henry, 2012; Kar and Cartwright-Smith, 2010; Ndikumana and Boyce, 2011a; Reuter, 2012; UNDP, 2011).

As can be seen in Table 3, developing countries are facing severe financial haemorrhage through capital flight and other forms of illicit financial outflows including corruption related outflows, proceeds from trade in illegal goods and services, and profit shifting by MNCs. Global Financial Integrity estimates that during the period 2002 to 2011, developing countries as a group have lost about $6 trillion through illicit financial flows. A substantial fraction of these outflows occur through misinvoicing of imports and exports. Most of these outflows are domiciled in safe havens where their owners take advantage of low or no taxation, and, most importantly, extreme secrecy practices that protect their identity and the source of their wealth. The leakage of financial resources through illicit financial flows undermines domestic saving in developing countries and, therefore, exacerbates the financing gaps faced by these countries. The resulting capital shortage undermines the ability of these countries to achieve and maintain high levels of investment and growth.

The second avenue of impact of international tax cooperation on developing countries is directly through the capacity to achieve their potential in government revenue mobilization through tax and non-tax revenue. This is achieved in two fundamental ways. The first is by ensuring that international actors operating in developing countries pay their taxes. This is especially the case for multinational corporations which are notorious at using various legal and illegal mechanisms to doge taxes in the countries where they operate. Tax evasion and tax avoidance by multinational corporations are facilitated by lack of transparency in safe havens, inadequate reporting of company operations and profits (especially no country-by-country reporting), and lack of coordination and exchange of tax-related information across countries. While it is difficult to obtain a precise estimate of the losses in tax revenue incurred by developing countries through tax dodging by MNCs, evidence from case studies suggests that these losses are large in absolute terms and relative to other meaningful economic aggregates. Christian Aid estimated that losses in corporate taxes to developing countries due illicit practices by multinational corporations are in the order of $160 billion per year, which exceeds the total amount of official aid to all developing countries (Christian Aid, 2008, p. 3). The practice of tax evasion is facilitated by profit shifting by MNCs through transfer pricing. This is especially prevalent in the natural resource sector. To illustrate, in the case of Zambia, the Extractive Industry Transparency Initiative (EITI) found that while mining companies paid $463 million in taxes to the government, there were $66 million of "unresolved discrepancies" between

Table 3

Illicit financial flows from developing countries (Billions of dollars)

Region	Cummulative illicit flows		Recorded external capital inflows[c]		
	Illicit financial flows: GFI estimates[a]	Capital flight: TJN estimates[b]	ODA (net annual flows)	FDI (net annual flows)	External debt stock
	2002–2011	1970–2010	2011	2011	2011
Africa	555.8	517.9	51.2	46.4	391.5
SSA	487	361.7	47.5	41.2	297.6
MENA	684.5	963.2	15.5	15.9	162.9
LAC	1130.7	1375.5	11.4	145.1	1133.5
East Asia and Pacific	1974.3	1881.7	7.8	339.8	1286.6
Central Europe and Asia	1273.9	1509.9	10.7	73.8	1095.3
South Asia	375.9	60.7	16.7	40.3	461.8
Developing world	5889.5	6152.8	131.8	735.2	

Sources: **a** Illicit financial flows are from Global Financial Integrity (Kar and LeBlanc, 2013); **b** Capital flight estimates are from Tax Justice Network; these measures do not include trade misinvoicing, and; **c** Capital inflows are from the World Bank's Global Development Indicators, complemented with data from UNCTAD's online statistical database (http://unctad.org/en/Pages/Statistics.aspx).

Notes: SSA = sub-Saharan Africa; MENA = Middle East and North Africa; LAC = Latin America and Caribbean.

actual payments and companies' tax liabilities in the same year (Sharife, 2011).[7] The main mechanism of tax dodging is transfer pricing. The EITI report notes for instance that half of copper exports earmarked for Switzerland never made it there, "disappearing in thin air". The price of copper in Switzerland was six times higher than in Zambia and corporate tax rates were lower; thus export earmarking for Switzerland implies substantial profits for the companies involved in the copper trade. As a result of these profit shifting and transfer pricing mechanisms, Zambia may have lost tax revenue that is nearly equal to its total GDP in 2008 (Sharife 2011).[8]

In addition to maximizing tax revenue through curbing of tax dodging by multinational corporations, developing countries can also mobilize substantial amounts of tax revenue by taxing private wealth held abroad through capital flight. One of the motives of capital flight is to avoid taxation on wealth including that which may have been acquired illegally. While there are no precise measures of the amount of tax revenue that could be mobilized through taxation of private capital held abroad by residents of developing countries, estimates based on statistics on capital flight and illicit financial flows suggest that the gains in tax revenue are substantial. Using conservative assumptions about the rates of return to the assets accumulated through capital flight (about 7%) and by applying a modest tax rate (20%) FitzGerald derives estimates of forgone tax revenue due to capital flight from developing countries (FitzGerald, 2013). Using data up to 2006, he finds that developing countries as a group were losing tax revenue in the order of $200 billion per year, representing 2.5% of total GDP of this group of countries (FitzGerald, 2013). Considering the case of sub-Saharan African countries and using data on capital flight over the period of 1970-2004 from Ndikumana and Boyce (2008)[9], he estimates that this group of countries was losing about $6 billion per year in tax revenue. More recent estimates of capital flight from Africa show that the phenomenon has continued and even accelerated over the past decades. By 2010, the continent had experienced a cumulative outflow of unrecorded capital in excess of $1.3 trillion in constant 2010 dollars (Table 4). An important mechanism of capital flight is trade misinvoicing, especially exports underinvoicing which accounted for $859 in unrecorded outflows in the sample of 39 African countries over the four decades. Extrapolating FitzGerald's results on the basis of the updated estimates of capital flight presented in Table 4, we find that capital flight may have resulted in a tax revenue loss of $17 billion annually for this group of countries. This exceeds the average annual inflows in FDI and is about 81% of annual official development aid inflows over the past four decades.[10]

The evidence presented above has clear implications for thinking about official development assistance as a means of helping developing countries reach and sustain high growth rates and accelerate their progress towards their social development goals. The debate on assistance to developing countries needs to move beyond increasing budgetary allocations to foreign aid to consider ways to help developing countries mobilize more domestic resources. Scaling up international cooperation and technical assistance in the area of taxation can go a long way in complementing traditional development aid. In fact, international tax cooperation can help countries graduate from official development assistance. This is especially the case for natural resource-rich developing countries that can substantially increase their tax revenue if they can manage to effectively tax MNCs operating in these

7 See the PricewaterhouseCoopers 2008 independent reconciliation report for a detailed analysis of discrepancies in the tax reported by the mining companies relative to tax authority's records. PWC (2011). *Zambia Extractive Industries Transparency Initiative: Independent Reconciliation Report for Year End December 2008.* (February 2011).

8 See Ndikumana (2013) for more discussion on tax revenue implications of private sector corruption in African countries.

9 The published version is Ndikumana and Boyce (2011b).

10 In Table 4, in calculating cumulative amounts of inflows, the data are matched with availability of capital flight series annually. So, for every country in any given year, the values of ODA and FDI are discarded when capital fight is missing.

Table 4
Illicit financial flows from African countries (Billions of dollars), 2010 prices

Indicator	Cumulative flows over 1970-2010	Annual average
Stock of capital flight	**1685.2**	
Cumulative flows of capital flight	1273.8	31.1
Trade misinvoicing:		
Export misinvoicing	859.2	21.0
Import misinvoicing	-550.1	-13.4
Net misinvoicing	309.2	7.5
Other flows:		
ODA	874.8	21.3
FDI	459.1	11.2
Debt stock: value 2010	267	
Estimated tax loss[a]		17.2

Sources: Capital flight data are from the Political Economy Research Institute's database (www.peri.umass.edu/300).

Note: a The estimated losses are extrapolated from the methodology proposed by FitzGerald (2013), which is based on explicit assumptions about the share of the stock of capital flight that belongs to residents of African countries (assumed equal to 50%), the returns on these assets (7%), and a tax rate of 20% on the taxable income. FitzGerald used capital flight from sub-Saharan Africa as of 2004. The values in this table are obtained by scaling up FitzGerald's results using the proportion of the 2010 cumulative capital flight relative to the 2004 value.

Notes: SSA = sub-Saharan Africa; MENA = Middle East and North Africa; LAC = Latin America and Caribbean.

sectors, negotiate a fairer share in natural resource rents, stem capital flight, and collect tax on private assets stashed abroad by their residents. As resource rich countries are able to mobilize more tax revenue and keep their wealth onshore, then international development assistance would be reallocated to the poorer countries that need it the most (FitzGerald, 2013). The donor community can help these countries in two ways: one is to support and effectively implement measures aimed at preventing tax evasion and related illicit practices by MNCs operating in developing countries; second is to provide technical assistance to developing countries in the design and implementation of reforms of tax systems as well as the monitoring and prosecution of financial crimes, including through establishment and strengthening of specialized institutions such as national financial intelligence units. Generally, by accelerating global efforts to fight against tax evasion and other forms of financial crimes, and by supporting domestic institutional reforms in developing countries, the donor community can better help these countries reap the benefits of globalization or at least minimize its negative effects.

7 Taxation and global public goods

Globalization opens up opportunities for mobilizing efforts behind initiatives that could generate benefits for the larger community as a whole, or global public goods. These include peace and political stability, protection and improvement of the natural environment, preservation of food security, eradication of hunger and poverty, the fight against health pandemics and communicable diseases, and others. Globalization is accompanied by new challenges that affect the stability of the global economic system and the environment, and phenomena whose negative consequences cannot be contained within the borders of the source country. These are referred to as 'global public bads' and they include climate change, the deterioration of the ecosystem, high-impact communicable diseases, systemic attacks on global peace such as terrorism, and global financial instability. Attending to these challenges requires the mobilization of massive financial resources that cannot be met solely by increasing national budgetary allocations to development aid. Therefore, new and innovative financing mechanisms need to be explored.

Coordinated efforts at the global level can leverage innovative taxation as a means both to finance the production of global public goods and to contain or discipline the production or spread of global public bads. In fact, one may even ask why governments only tax goods and do not tax, and even subsidize public bads such as pollution. One of the ways to finance global public goods could be to tax public bads. Thus taxation would generate a 'double dividend'(Griffith-Jones, 2010; Spahn, 2010). It would enable greater production of public goods, while also containing the production and expansion of public bads. Examples of such taxation include the financial transaction tax proposed initially proposed by John Maynard Keyes and aimed at containing financial instability arising from speculative financial transactions (Keynes, 1936). In the same spirit James Tobin proposed in 1974 the introduction of an international currency transactions tax also aimed at taming global currency markets (Tobin, 1978). While these taxes were initially proposed as stabilization tools, they actually can generate substantial tax revenue given the massive volume of transactions that take place on a daily basis globally. Some estimates suggest that even a tinny levy of 0.005% on the transaction of major currencies could raise more than 20 billion euros (Griffith-Jones, 2010; Spahn, 2010). By expanding taxation to a larger set of financial transactions, much more revenue could be raised. Taking 2008 as a base, it is estimated that moderate taxation on all major financial assets traded in the US could generate up to $353 billion annually (D. Baker et al., 2009). Revenues generated through these innovative taxation tools could go a long way in financing major global initiatives such as climate change adaptation and mitigation, the fight against HIV/AIDS, malaria, tuberculosis and others. At the same time these tools can help stem instability in the financial markets.

While there are large potential gains from taxation aimed at financing global public goods and controlling global public bads, the implementation of such tools faces substantial challenges at both technical and political levels. The biggest challenge is to build consensus and support from individual governments and institutions around these innovative taxation instruments. One reason is that it is difficult to quantify and apportion the benefits accruing to each member country. There is, therefore, a risk that individual countries may resist taking the initiative to avoid the first-mover disadvantage associated with the free rider problem. Moreover, global initiatives to mobilize additional tax revenue and to use taxation as a disciplining instrument against global public bads is constrained by the lack of a global institution entrusted with coordination and execution of such initiatives. Today, there is no such thing as a global taxation authority akin to the global institutions responsible for financing issues (e.g., the IMF, the Basel Committee), or trade regulation (e.g., WTO), etc. So far, proposals for a supranational authority in charge of global taxation have not made any headway. A more feasible avenue would be to work with existing institutions and capitalize on experiences at the regional level in policy coordination. In this sense, the European Union can offer a fertile ground for implementation. Indeed there is already a substantial degree of coordination of VAT among EU members which could offer some lessons for the way forward.[11] Such experiences could be emulated in other regions and eventually scaled up at the global level.

11 See Genser (2003); extensive studies and reports are available online at the European Union's "Taxation and Custom Union" website: http://ec.europa.eu/taxation_customs/common/publications/services_papers/working_papers/index_en.htm

8 Conclusion

The discussion in this paper has identified a number of challenges arising from the implications of globalization for taxation that face both developed and developing countries. These challenges derive from the increased mobility of capital and the ease of shifting profits and savings across territories as corporations and individuals take advantage of disparities in institutional and regulatory environments as well as the lack of transparency in international transactions. These developments put a burden on national tax systems that must strike a balance in meeting the dual objective of mobilizing government revenue on the one hand, and facilitating trade, retaining and attracting investment capital and savings on the other hand. The proliferation of tax havens, safe havens, secrecy jurisdictions, and offshore financial centres has made matters even more complicated.

Even as countries continue to make efforts to adapt their taxation systems to the complex and changing global environment, it is important to maintain a realistic and dynamic perspective. As Bird (2012, p. 5) puts it, there is no magical fiscal system, and therefore "what this complex and changing world needs is not some non-existent 'universal fix' but rather a sort of fiscal medicine kit containing a variety of remedies and treatments that may help us cope with the wide variety of fiscal problems and needs that arise at different times and often in different ways in different developing countries." In this regard, policy-oriented research has an important role to play in shedding light on possible avenues for reforms and expected outcomes. Thus far, research has tended to be a step behind and, in fact, it is contended that "research has not led the reform elephant but mopped behind it" in the sense that it has come to only rationalize reforms and innovations that are already occurring in the real world rather than coming up with novel ideas of reforms (Bird, 2012, p. 14). This is a serious challenge to the policy research community.

The existing initiatives at the national, regional and global level geared toward fighting tax evasion through improved tax cooperation and increased transparency have produced limited and uneven results. It is clear, though, that what is lacking is not conventions and agreements. What is lacking is effective implementation and enforcement of existing frameworks; and this is where efforts should be concentrated going forward. In this context, a few areas are worth highlighting. The first is in the area of exchange of information, which is critical to dismantling the tradition of secrecy. In addition to efforts to establish and enforce TIEAs, countries should push for institutionalization of automatic exchange of information on taxation or AEITs. Second, countries and international institutions must swiftly endorse and enforce mechanisms to increase accountability and transparency in the corporate sector, especially with regard to large MNCs. In this regard, the global community must rally behind efforts to institutionalize rules on country by country reporting as well as unitary taxation of MNCs so that all countries are able to duly and systematically collect taxes on all activities taking place on their territories and on all activities undertaken by all their tax payers regardless of their geographical location.

The implementation of the existing conventions, agreements and frameworks on fighting tax evasion, corruption and other illicit financial activities requires substantial technical capacity. Such capacity is generally in short supply in developing countries. Those countries typically have a thin stock of expertise, or what Kaldor (1963, p. 414) called "a corps of capable and honest administrators", which makes it difficult for them to deal with issues of transfer pricing, thin capitalization, and other practices that facilitate tax evasion and profit shifting. Therefore, the debate on international tax cooperation must include strategies for assisting developing countries to build their technical and administrative capacity to combat tax evasion and associated illicit financial practices in the corporate and financial sectors. This should be at the core of the post-2015 development strategy.

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Appendix Tables

Table A.1

Taxes on personal income as percentage of GDP in OECD countries, 1965–2010

Country	1965	1975	1985	1990	2000	2007	2010
Australia	7.1	11.1	12.6	12.0	11.5	10.9	9.9
Austria	6.8	7.9	9.4	8.3	9.5	9.4	9.5
Belgium	6.4	12.9	15.8	13.4	14.0	12.1	12.2
Canada	5.8	10.5	11.5	14.7	13.1	12.3	10.8
Chile							
Czech Republic					4.4	4.2	3.6
Denmark	12.7	21.4	23.4	24.8	25.6	25.3	24.3
Estonia					6.8	5.8	5.4
Finland	10.1	14.1	14.9	15.2	14.5	13.0	12.6
France	3.6	3.8	4.9	4.5	8.0	7.5	7.3
Germany[1]	8.2	10.3	10.3	9.6	9.5	9.1	8.8
Greece	1.2	1.7	3.6	3.7	5.0	4.9	4.4
Hungary					7.3	7.4	6.5
Iceland	5.1	6.0	5.5	8.3	12.9	13.8	12.9
Ireland	4.2	7.2	10.7	10.5	9.4	8.8	7.5
Israel					10.7	8.1	6.3
Italy	2.8	3.8	9.0	9.9	10.4	11.1	11.7
Japan	3.9	4.9	6.6	7.9	5.6	5.6	5.1
Korea		1.3	2.2	3.9	3.3	4.4	3.6
Luxembourg	6.9	9.0	10.1	8.4	7.2	7.1	7.8
Mexico							
Netherlands	9.1	11.0	8.2	10.6	6.0	7.7	8.6
New Zealand	9.4	15.4	18.7	17.7	14.3	14.6	11.9
Norway	11.7	12.4	9.6	10.7	10.3	9.5	10.1
Poland					4.4	5.2	4.5
Portugal				4.3	5.5	5.5	5.6
Slovak Republic					3.4	2.6	2.3
Slovenia					5.6	5.5	5.7
Spain	2.1	2.7	5.4	7.1	6.4	7.5	7.0
Sweden	16.2	19.0	18.4	20.1	17.1	14.6	12.7
Switzerland	5.8	9.3	9.9	8.2	8.7	8.8	9.1
Turkey	2.6	3.9	3.2	4.0	5.4	4.1	3.7
United Kingdom	10.1	14.0	9.6	10.4	10.7	10.8	10.0
United States	7.8	8.9	9.7	10.1	12.3	10.6	8.1
Unweighted average OECD	6.9	9.3	10.1	10.3	9.3	9.0	8.4

Source: OECD Centre for Tax Policy Administration (online data on Tax Policy Statistics).
Note: 1 From 1991 the figures relate to the united Germany.

Table A.2
Taxes on corporate income as percentage of GDP, 1965–2010

Country	1965	1975	1985	1990	2000	2007	2010
Australia	3.4	3.1	2.6	4.0	6.1	6.9	4.8
Austria	1.8	1.6	1.4	1.4	2.0	2.4	1.9
Belgium	1.9	2.7	2.2	2.0	3.2	3.5	2.7
Canada	3.8	4.3	2.7	2.5	4.4	3.5	3.3
Chile							
Czech Republic					3.4	4.7	3.4
Denmark	1.4	1.2	2.2	1.7	3.3	3.8	2.7
Estonia					0.9	1.6	1.4
Finland	2.5	1.7	1.4	2.0	5.9	3.9	2.6
France	1.8	1.8	1.9	2.2	3.1	3.0	2.1
Germany[1]	2.5	1.5	2.2	1.7	1.8	2.2	1.5
Greece	0.3	0.7	0.7	1.5	4.2	2.6	2.4
Hungary					2.2	2.8	1.2
Iceland	0.5	0.8	0.9	0.9	1.2	2.5	1.0
Ireland	2.3	1.4	1.1	1.6	3.7	3.4	2.5
Israel					3.9	4.5	2.9
Italy	1.8	1.6	3.1	3.8	2.9	3.8	2.8
Japan	4.0	4.2	5.6	6.4	3.7	4.8	3.2
Korea		1.3	1.8	2.5	3.2	4.0	3.5
Luxembourg	3.1	5.1	7.0	5.6	7.0	5.3	5.7
Mexico							
Netherlands	2.6	3.1	3.0	3.2	4.0	3.2	2.2
New Zealand	4.9	3.3	2.6	2.4	4.1	4.9	3.8
Norway	1.1	1.1	7.3	3.7	8.9	11.0	10.1
Poland					2.4	2.8	2.0
Portugal				2.1	3.7	3.6	2.8
Slovak Republic					2.6	3.0	2.5
Slovenia					1.2	3.2	1.9
Spain	1.4	1.3	1.4	2.9	3.1	4.7	1.8
Sweden	2.0	1.8	1.7	1.6	3.9	3.7	3.5
Switzerland	1.3	2.0	1.7	1.8	2.6	3.0	2.9
Turkey	0.5	0.6	1.1	1.0	1.8	1.6	1.9
United Kingdom	1.3	2.2	4.7	3.5	3.5	3.4	3.1
United States	4.0	2.9	1.9	2.4	2.6	3.0	2.7
Unweighted average OECD	2.2	2.1	2.6	2.6	3.4	3.8	2.9

Source: OECD Centre for Tax Policy Administration (online data on Tax Policy Statistics).
Note: 1 From 1991 the figures relate to the united Germany.