

A conversation with Alex Cobham, July 14, 2017

Participants

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Note: These notes were compiled by GiveWell and give an overview of the major points made by Alex Cobham.

Summary

GiveWell spoke with Mr. Cobham of the Tax Justice Network (TJN) as part of its investigation into global tax reform policy. Conversation topics included the scope and effects of profit shifting activities, TJN's work, and major players in the tax justice space.

Data

Recent studies

Early investigations into tax havens did not aim to put a precise number on the scope of the problem, only to roughly establish that the problem was large enough to be worth putting on the agenda. Now that it is on the agenda, researchers in this space need to shift towards getting numbers that are precise enough to support specific policy responses.

To this end, a few more rigorous studies have been done in the last few years:

- The **2015 World Investment Report** from the United Nations (UN) Conference on Trade and Development looked at one channel of profit shifting by the use of conduit jurisdictions for foreign direct investment in lower-income countries
- A **2016 International Monetary Fund (IMF) paper** by Crivelli, De Mooij, and Keen explored the effects of profit shifting on developing countries, and found that the effects on the tax base are more significant for developing countries than for advanced countries
 - A **2017 TJN paper** co-authored by Mr. Cobham expanded on this paper using an additional dataset, and included country-level findings

Access to data

It is difficult to put precise numbers on the scope of profit shifting activities because researchers must estimate numbers that are deliberately hidden. In addition, requests for data access take a long time to resolve politically, so even when data are available they come at a lag. These problems will remain until transparency measures are passed.

Most of the data TJN uses come from multinational corporations (MNCs) that have their headquarters in the US, since these are the companies with the best publicly available data. These data cover the years from the early 1990s to 2012, and are public in partially aggregated form, meaning that there are not data for specific companies.

Effects of profit shifting

Scope of profit shifting activities

The share of global profits that US MNCs shift to other jurisdictions has risen from 5-10% in the 1990s to 25-30% in the years since 2010. At the same time, the effective tax rates on MNCs have fallen sharply, from about 30% to under 20%.

Revenue losses

Lower-income countries almost universally lose a higher share of total tax revenues to profit shifting than developed countries do, and this is often a higher share of the countries' GDP as well. Countries that are part of the Organisation for Economic Co-operation and Development (OECD) – most of which are high-income, developed countries – lose about 2-3% of their total tax revenues to corporate tax avoidance, while lower-income countries lose 5-15%.

The best estimate for revenue losses from corporate profit shifting is either

- IMF's estimate of ~\$600 billion per year globally, or
- TJN's estimate of ~\$500 billion per year globally.

Both organizations estimate that ~\$200 billion of the global total relates to developing countries.

Dynamic effects

General equilibrium effects

An important consequence of TJN's efforts to change tax policy is that MNCs will adapt their behavior in response to the new policies.

With country by country reporting (CbCR) in the public domain it will be easy to see the inconsistencies between where activities take place and where profits are declared. This will likely cause a different form of avoidance to emerge, with MNCs pretending their activity takes place in a different jurisdiction than it actually does. It will likely also cause an increase in the intensity of competition for real activity.

Race to the bottom

Almost every country in the world loses money to profit shifting. For US MNCs, there are only six jurisdictions that consistently declare higher profits than is consistent with their share of economic activity. These are Bermuda, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland, all of which charge MNCs effective tax rates below 5%. Other research suggests the Cayman Islands should be included

here also. For the “Big Four” profit-shifting recipients (Bermuda, Ireland, Luxembourg, and the Netherlands), the effective rates are 2% or below.

These low rates mean that other countries cannot compete at meaningful levels of tax, so potential dynamic effects are heavily muted by the fact that unless a jurisdiction offers an effective tax rate close to 0%, it is not attractive for profit shifting purposes. For example, if the UK continues to decrease its effective tax rate from 28%, where it stood in 2010, to 17%, as planned by 2020, it still would not be competitive enough with the sub-5% tax rates to counter outward profit-shifting, and so would simply earn less tax revenue on the remaining profits. This is borne out by the multi-billion-pound losses the UK has suffered since it began to cut in 2010.

Foreign business investment in developing countries

In the late 1990s and early 2000s, economists argued that investment was increased by the presence of tax havens, so changing tax policy would be a net negative for developing countries. However, this assessment has since been disproven.

The World Investment Report 2015 found that the impact of tax havens on e.g. Kenya's tax revenue is net negative. While it is plausible that Kenya has more foreign direct investment (FDI) than it might if MNCs were not using secretive conduits, there are no known benefits of that investment that would outweigh the tax revenue losses. There is no robust evidence that FDI is associated with economic growth in low-income developing countries, and there is some evidence that FDI may negatively impact human development measures.

TJN's work

At the core of TJN's agenda are the “ABC's” of tax transparency:

1. Automatic exchange of tax information (AEOI) on a multilateral basis
2. Beneficial ownership transparency, through public registers
3. Country by country reporting (CBCR)

When TJN started pushing for the ABC's in their initial policy platform in 2003-2005, the policies were considered utopian and unrealistic. By 2013, all three were at the heart of the global policy agenda.

Despite this success, none of the three ABC's have yet been delivered in a way that will ensure that developing countries benefit. Currently, the ABC's allow developed countries to access and exchange tax information more easily, while developing countries still do not have access to that information. This information imbalance leads to unequal abilities to collect taxes, which exacerbates global inequality in the short term.

AEOI

AEOI facilitates the exchange of information about non-residents' financial accounts, between tax authorities in the account holders' country of residence and tax authorities in the jurisdictions where the accounts are located.

About 60 countries have committed to AEOI via the OECD. The first exchange is scheduled to take place in September.

A second tier of countries will be included in automatic exchange in 2018. However, many countries (e.g. Switzerland) are excluding most developing countries from their ostensibly multilateral approach, only giving information to countries that have sufficient leverage over them.

Beneficial ownership

A beneficial owner is a person who enjoys the benefits of owning an asset, such as controlling it and receiving income from it, but does not nominally own it. This has been a problem for tax authorities because this layer of secrecy makes it difficult to hold beneficial owners accountable.

There has been a lot of progress on beneficial ownership transparency. The European Union (EU) and many of the Extractive Industries Transparency Initiative (EITI) countries have agreed to require that information about beneficial ownership be in the public domain. This is not yet an international standard, though TJN hopes it will be soon. As long as the standard is not there, most developing countries will remain at a disadvantage.

CBCR

Background

CBCR requires MNCs to annually report certain information for each tax jurisdiction in which they do business. This includes data on:

- extent of sales,
- staffing,
- tangible assets,
- declared profits, and
- taxes paid.

The OECD created a standard for CBCR in 2013, but there is not yet an agreement to make those data public. However, TJN thinks that will come soon – the UK has such legislation on the books but has not enforced it, and other jurisdictions are considering it as well – not least the European Union, where the European Parliament has voted overwhelmingly in favor.

When CBCR data become public, researchers will be able to put real numbers on the problem of profit shifting, since they will be able to clearly see the difference between where activities are taking place and where profits are being declared. This will give a precise, static revenue loss figure for each individual country.

Data

Profit shifting data (e.g. that on US MNCs) come at a 3-4 year lag, meaning that there will not be good data on how requiring CBCR has affected the share of global profits being shifted until perhaps 2025 (when data on the period up to 2021 would show the impact of the first few years of private CBCR).

The most recent data currently available are from 2013, the year when the OECD first indicated its intention to implement CBCR. Changes in behavior are expected to have started in 2015, when it became clear that the OECD's plan for CBCR was very similar to TJN's original proposal. These data will not be available until 2019.

The OECD is, however, working to make some aggregated (i.e. not company-level) CBCR data available publicly, and this may allow an earlier and more up-to-date view of profit shifting to be seen.

Expected impact

The biggest effect on profit shifting activities will come at the point when the EU requires CBCR data to be made public. However, two significant shifts will have already happened before the data are public – revenue losses are expected to fall sharply first with the introduction of CBCR, and then with the subsequent requirement that the data be made public. In addition, since CBCR data are not yet public, it will not be possible to see the impact of CBCR in real time, meaning that the effects of CBCR will not be able to drive the policy agenda.

Even if CBCR limits revenue losses by just 5%, the monetary benefit of that in one year will be several times the entire cost of TJN over its 14 years of existence. However, seeing those revenues won in practice at the country level is a further step that will take time.

Narrative shift

TJN's work has shifted the narrative such that tax has become a global political issue of a different order of magnitude. Compared to 15 years ago, there has been a massive reduction in the attitude that corruption is a developing world problem that has nothing to do with high-income countries, and the expectation that taxes should be paid is now much stronger, as is the idea that the social contract applies to MNCs and to high- and low-income individuals equally.

Even though the policy is not all in place yet, the global ideological climate is much more receptive to this kind of change than it has been in the past. This kind of success is difficult to sell to a potential funder because it is extremely difficult to quantify, but TJN believes it has been its biggest success so far.

Major players

Bilateral organizations

The United Kingdom Department for International Development (DFID) and the Norwegian Agency for Development (Norad) have been the main bilateral funders for tax work as a development issue. The Norwegians have been the most dynamic

and catalytic funders of tax justice over more than a decade, and continue to lead in this area.

Together, Norad and DFID have also funded the International Centre for Tax and Development (ICTD), which is one of the leading tax justice research centers. The ICTD focuses on collaborating with African revenue authorities in order to develop policy-relevant material and to support research capacity in Africa.

Collaborative organizations

There are three main collaborative organizations that work on tax justice:

- **The Financial Transparency Coalition** – a high-level advocacy coalition, of which TJN is a founding member,
- **The Global Alliance for Tax Justice** – an umbrella group for mass mobilization organizations, currently primarily campaigning on multinational tax issues, and
- **The Transparency and Accountability Initiative (T/AI)** – a donor collaborative that serves as a focal point for foundations interested in this cause.

Together, these three organizations have spent about \$15 million on tax justice issues over the last five years.

Foundations

Prominent foundations in this space are:

- The Ford Foundation
- The William and Flora Hewlett Foundation
- The Omidyar Network
- The Open Society Foundations

These four foundations are all members of the T/AI, and some of them fund the Center for Global Development. They also fund international non-governmental organizations (INGOs) that do work on tax justice, such as ActionAid and Oxfam. Ford takes a leadership role in this space, and in 2009 funded TJN to create the Financial Secrecy Index, which is a ranked list of tax havens. In addition, the Bill and Melinda Gates Foundation has funded some work, including at the ICTD.

Governments

Barriers to involvement

Individual governments have resisted engagement on international tax justice issues because they are constrained by a pressure to conform to globally accepted standards for tax regulation. This pressure comes from donors, MNCs, and professional services firms, all of which have some power to withhold investment from countries whose tax policies are unfavorable to them.

This is particularly true for smaller and politically disadvantaged governments. For example, while Brazil is large enough that it was able to introduce a nonstandard approach to transfer pricing without significant economic consequences, a government such as Malawi's would be more heavily penalized for breaking with the status quo.

In addition to the political challenges, tax justice questions are technically difficult, and many governments do not have anyone who has the time and expertise to engage with them.

Current governmental funding

Despite these difficulties, engagement from governments has recently increased. The G77 is increasingly promoting tax justice demands at the United Nations, and in June of 2017, India made a contribution to the UN Tax Trust Fund, which aims to support the work of the UN Tax Committee. Though the UN Tax Trust Fund was established in 2006, India's is the first voluntary contribution it has ever received.

Regional blocs

It is likely that a set of major changes will happen over time, and that these will be implemented by regional blocs. The EU is one such bloc and can provide a useful model for others to follow, while other changes are more likely to be implemented by a bloc such as the East African Community (EAC).

When disadvantaged countries come together to form blocs such as the EAC, it provides each country with increased political and economic protection. It is much more difficult for MNCs to withhold investment from a group of countries than from just one, which means that regional blocs can implement more progressive tax policies, even if the individual countries that comprise them could not have done so.

Mr. Cobham expects that in five years we will have seen a lot of change initiated by non-OECD countries, effectively for the first time ever – and certainly since the G77's attempts in the 1970s were shut down by corporate lobbying of OECD countries. Rather than a progressive global shift, this may lead to some splintering of tax policy in different regions as blocs implement non-OECD alternatives to international tax rules.

Most valuable uses of additional funding

International institutional tax architecture

TJN would use additional funds to extend research and advocacy in its four main workstreams:

- Financial secrecy
- The scale of tax avoidance and evasion
- Tax justice and human rights, including women's rights in particular
- The "race to the bottom"

In terms of the international architecture for tax, TJN would push for the establishment of a serious intergovernmental tax body at the UN, which would serve as a decision-making forum within the globally representative space. Work on these grounds has pushed the OECD to open up its own processes to developing countries through their Inclusive Framework on Base Erosion and Profit Shifting. Though developing countries are still not given an equal say in setting the rules, this framework has certainly improved their position.

Global tax policy change

TJN will work to ensure that the ABC's of tax transparency are fully delivered, in a way that ameliorates, rather than exacerbating (as at present), the global inequalities in the distribution of taxing rights. In addition, TJN would use additional funds to support further tax policy work in developing countries. There has been great progress in this area since TJN began pushing the ABC's, but global policy continues to not be as inclusive of developing countries as it needs to be. Issues include the prevalence of opaque, unjustified, and often corrupt tax holidays, and the power of lobbying by multinationals to resist effective taxation, most perniciously by big tobacco companies.

Increasing citizen engagement on tax issues

TJN would use additional funds to do tax policy work that focuses on increasing citizens' engagement with their governments. This is the most political piece of the agenda but may be the most important in the long term.

The political importance of taxes

Governments that fund their public spending more through tax than through foreign aid or natural resource wealth, are generally more progressive. This correlation is one of the most powerful results in the field of tax justice. Taxes also affect political representation, and thus are essential to the functioning of not only governments but societies.

Consumption taxes vs direct taxes

Individuals who pay particularly direct taxes, such as income tax, property tax, and capital gains tax, are the most likely to demand accountability from their governments, because they can clearly see that money is being withheld from them. Taxes on consumption do not have the same effect because they are less salient to the people paying them.

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