The EU, Tax Justice and the Modernisation of Less Developed Countries

Jeremy Leaman (Loughborough)

Introduction

Europe’s post-colonial role in the promotion of the economic development of LDCs has been characterised firstly by preferential trade regimes (Yaoundé, Lomé) and more recently by the Economic Partnership Agreements (EPAs) following the Cotonou Agreement, and – via the WTO – by efforts to extend the scope of trade liberalisation. While the EPAs contain new dimensions, including the promotion of improved governance and the strengthening of civil society, the political agenda driving them remains centrally informed by the trade and investment interests of European economic actors and by the neo-liberal preferences of the so-called ‘Washington Consensus’.

In the process, the preconditions of effective economic and social modernisation in LDCs have by and large been neglected by European political and economic elites: these include a) the ability of LDC states to provide an appropriate quantity and quality of public goods (physical and social infrastructure) according to national/ regional priorities and b) to develop the endogenous potential of the national/ regional economy through the selective use of mercantilist measures to nurture ‘infant industries’ (c.f. Chang, Rodrik etc). Without these preconditions, particularly in the case of the least developed states of Africa and Asia, the comparative advantage of developed and emerging large states in global economic relations will persist, the modernisation potential of LDCs unfulfilled. In neglecting their own mercantilist origins (and current practice), the EU and its MS are guilty of double standards and economic short-sightedness.

This paper focuses on the first of the above preconditions (the importance of sustainable fiscal resources in LDCs) and on the deficiencies of EU policies on taxation as they affect global tax developments and the fiscal cultures of LDCs. This includes the failure to address the problem of the damage inflicted on many fiscal jurisdictions by the tax arbitrage behaviour of multinational corporations, of tax competition within Europe, the toleration of tax havens in Europe and in former and current colonial territories and the rampant pursuit of tax avoidance (tax efficiency) by the majority of international corporations. These abuses affect LDCs disproportionately, denying them revenue and encouraging tax avoidance/ evasion on the part of their elites as well as a general culture of non-compliance. The resolution of Europe’s tax anomalies would be first step towards resolving the chronic problems of fiscal leakage in LDCs, towards the reform of global tax governance and towards establishing an economic order based on tax justice.

The Asymmetries of the Politico-Economic Relationship of the EU with Less Developed Countries

Whether one approaches EU-LDC relations through World Systems Theory, Neo-Gramscianism or indeed more mainstream models of international political economy, the disparities of political and economic leverage favouring the EU are self-evident. The standard economic performance indicators (per capita GDP, capital stock, productivity, sectoral distribution, diversity of products and services, innovation and patents etc) do not need enumerating here. Equally, the trade and investment flows between the two indicate an extreme unequal inter-dependence. If we take African economies as representative of LDC trade patterns, this inequality is palpable. They depend on European demand for 38.8
percent of their predominantly primary product exports (mining and agricultural), while Europe exports only 3.2 percent of its predominantly high-grade manufactured goods to Africa (Figures: WTO *International Trade Statistics* 2010: 10). This dependence is reinforced by the particular weakness of African intraregional trade which contrasts with the very high level of regional trade integration in Europe (Table 1). Africa is by far the weakest region for trade within the continent, having exchanged less than 10 percent of its products among its own economies for decades. The responsibility for this consistent weakness lies in large measure at the door of European colonial states, as noted by a recent UNCTAD report: ‘This was largely a consequence of the pattern of trade favoured by colonial rulers, which was extractive and outward-oriented and did not encourage African countries to develop strong trade linkages among themselves’ (UNCTAD 2009: 21). Patterns of trade are also mirrored in FDI flows, with a very small proportion directed towards LDCs and the bulk either remaining within the ‘developed’ bloc or targeted at the new group of BRIC economies (c.f. UNCTAD 2011: 40ff).

In addition to the dominant position occupied by Europe’s major states in central institutions of global governance – as major shareholders in both the IMF and the World Bank, as permanent members of the UN Security Council, as founding members of GATT etc – *colonial legacies*, both formal and informal, have shaped the pattern of relationships between the EEC/EC/EU and most LDCs, through Yaoundé and Lomé agreements to Cotonou and the recent round of Economic Partnership Agreements and associated development aid programmes. Above all, the co-authorship by European states of the norms of global liberalisation and deregulation (qua Washington Consensus) has influenced the trajectory of the global political economy over the last three decades and the fate of most LDCs within the new order. The transformation of the commercial conditions for development programmes from low, fixed, long-term real interest rates in the 1970s to high, flexible, short-term real interest rates in the 1980s, administered by both the political institutions of the ‘North’ and by the private financial institutions of Europe and the US, cemented the unequal interdependence in a turbulent period of stunted development in which the ideological and foreign economic preferences of Europe’s major states prevailed. The picture of EU-LDC relations thus corresponds to the pattern of dominance (in productivity, trade and finance) postulated by Imanuel Wallerstein (1980) in his core-periphery analysis.

The core-periphery approach allows a better appreciation of the fundamental ambivalence of European political and economic elites to issues of LDC develop-

Table 1 Intraregional imports and exports as a proportion of total trade 2004-2006 averages (in percent)

<table>
<thead>
<tr>
<th>Region</th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>9.6</td>
<td>8.7</td>
</tr>
<tr>
<td>Developing America</td>
<td>20.9</td>
<td>18.5</td>
</tr>
<tr>
<td>Developed America</td>
<td>23.3</td>
<td>39.8</td>
</tr>
<tr>
<td>Developing Asia</td>
<td>48.1</td>
<td>45.5</td>
</tr>
<tr>
<td>Developed Europe</td>
<td>68.1</td>
<td>71.4</td>
</tr>
</tbody>
</table>


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1 Brazil, Russia, India and China
opment; it is an ambivalence which employs the rhetoric of modernisation through partnership as vehicles for economic improvement but, strategically, has consistently maintained a policy-mix which sustains the comparative advantage of the ‘core’ states over those of the ‘periphery’: implicit in the EU’s most recent flagship programmes (the Lisbon Agenda/ Process and Europe 2020) is the need to enhance Europe’s ‘competitiveness’ as a region, making it ‘the most competitive and dynamic knowledge-based economy in the world’ (EC 2000: 2), seeking to ‘promote the competitiveness of Europe’s primary, manufacturing and service industries and help them seize the opportunities of globalisation and of the green economy’ (EC 2010a: 3). The ‘hegemonic mercantilism’ (Leaman 2008: 76ff) of the European Union needs to be borne in mind when examining both the anatomy of EU-LDC relations and the indirect consequences of the EU’s internal decisions and non-decisions on developing countries.

The Fiscal Dimension of EU-LDC Relations
It is a commonplace among most policy analysts that strong and reliable state revenues are a pre-condition for successful statehood and for economic modernisation. ‘Wagner’s Law’ – which established a correlation between higher tax ratios/ higher state ratios and higher levels of economic development – is more contested, in particular by neo-liberal theorists, but it is a working assumption of this paper.

In April 2010 the European Commission published a communication to the European Parliament, the Council and the European Economic and Social Committee entitled ‘Tax and Development: Cooperating with Developing Countries on Promoting Good Governance in Tax Matters’ (EC 2010b), which addressed – albeit briefly – issues relating to the promotion of ‘effective, efficient, fair and sustainable tax systems’ in less developed countries. Like many EU policy analyses, the report contains correct observations, concerning the problems confronting LDCs, firstly on the domestic front: a) the structure and competitiveness of LDC economies, b) political and macro-economic instability, including poor public management, corruption and legal deficiencies, and c) features of the tax system which hinder the progress of tax reforms. The report also highlights problems deriving from international developments: i) the increasing geographical mobility of taxpayers, ii) the adjustment issues relating to globalisation, iii) the pitfalls of tax incentives for inducing foreign direct investment and iv) the influence of harmful tax practices and ‘non-cooperative’ jurisdictions.

Indirect Taxation
The EU’s new interest in the fiscal position of developing countries has thus been influenced by the evidence of problems associated with the programme of global liberalisation, promoted by the so-called ‘Washington Consensus’ to which it has long subscribed. Above all, the promotion of customs tariff ‘disarmament’ in developing countries, firstly within GATT and, since 1995, within the WTO has been a consistent theme of EC/EU trade diplomacy. This has had significant consequences for the state finances of less developed countries, so long reliant on customs duties as a major source of revenue; the share of import duties has fallen consistently in recent decades (IMF 2011: 15f). According to a World Bank report ‘trade taxes tend on the whole to be more important in the lower-income group, where they account for 24 percent of tax revenues, compared to only 1 percent in the higher-income group’ (Bird & Zolt 2003: 7); more
dramatically ‘a typical African country relies on tariffs for more than half of its revenues’ (Owens 2008: 2); in the Latin American group, the decline of trade taxes as a proportion of total revenue was particularly marked after 1990 (Profeta & Scabroseti 2010: 97-100; Tables 5.1a & 5.1b), and the associated process of joining the WTO. However, some of the poorest LDCs – like Haiti and the Dominican Republic – continue to raise around a third of all their revenues from trade duties (ibid.). Replacing trade duty income streams by tapping other tax bases is thus ‘a major policy challenge currently facing many developing countries’ (Tanzi & Zee 2001: 8).

The customary advice to developing countries from the Bretton Woods institutions (IMF and World Bank) has been the replacement of trade duties with Value Added Tax; Marshall talks of a tax consensus and a ‘one-size-fits-all’ approach on the part of the IMF, rooted in the assumption that indirect taxes ‘minimise distortions’ (Marshall 2009: 4). The IMF view is shared by the European Commission: ‘consumption taxes do not distort intertemporal decisions the way income taxes do. Consumption taxes fall partly on accumulated assets, which are an inelastic tax base. Moreover, consumption taxes do not impact on returns from saving’ (EC 2011b: 38). In its ‘Tax and Development’ communication, the Commission talks suitably vaguely about the need to achieve ‘the appropriate balance between direct and indirect taxes’ (2010b: 5) but this is set in the explicit context of ‘the nexus between tax reform and the improvement of the business environment’ (p.4) and ‘bringing in the informal economy, productive investments and facilitating employment generation’ (p.5). Given the strong European influence within the IMF (shareholdings, presidency), Marshall’s notion of a tax consensus can be equally applied to the EU, therefore.

The logic of the current ‘tax consensus’ is persuasive up to a point, particularly if one takes the necessity of tariff disarmament as given: with the complexity and high differentiation of both personal and corporate income tax systems and, above all, with the mobility and lower visibility of their respective tax bases, consumption taxes have the advantage of being more visible, less mobile and thus more accessible tax bases. As a consequence they require less sophisticated institutional arrangements to administer; most early modern European tax systems were themselves heavily reliant on consumption taxes (as well as customs duties) implying that they could indeed be more appropriate for developing countries, particularly if modified to include progressive features – higher rates for luxury goods, consumed by wealthier consumers, taxes on land and fixed assets, zero ratings for basic foodstuffs, for example.

However, as Marshall observes, in the prescriptions handed down by the IMF and others, ‘the multiple rates critical to distributional concerns in the cases of inefficiencies are often ignored in favour of a simple revenue-maximising single-rate structure’ (Marshall 2009: 5); this removes any progressive element from the indirect tax regime and cements the regressive effect of indirect taxation, especially if VAT or excise duties are applied to basic goods. Furthermore, Emran and Stiglitz stress the importance of the ‘informal’, unregulated economy in many less developed countries and the corresponding narrowing of the potential tax base for indirect taxation. In consequence, a ‘revenue-neutral radial increase in VAT increases the inter-sectoral distortions between formal and informal sectors .... . As a result, contrary to the prevailing consensus, such a reform reduces welfare’ (Emran & Stiglitz 2005: 600). It is therefore not surprising that several studies record revenue losses for the states of low- and middle-income countries as a result of reduced trade tariff revenues (Khattry & Roy 2002), a fact also acknowledged by an IMF study of 125 countries from 2004, which
found that middle-income countries had had been able to recover only 45-60 cents of every dollar of lost customs revenues from indirect taxes and low-income states 30 cents at most (Baunsgard & Keen 2004: 18). This has nevertheless not prevented the IMF from maintaining an overwhelming preference for VAT as a substitute for trade-related revenues according to studies of the Washington institution (Marshall 2009; Ruiz, Sharpe & Romero 2011). Critical observers therefore stress the need a) to set aside blanket prescriptions and to tailor policy recommendations to the political and economic circumstances of LDCs (Marshall 2009: 5), b) to take a flexible approach to the timing of trade liberalisation and accordingly to have in place a viable set of alternative revenue sources (Owens 2009: 2; OECD 2011: 21) and c) to ensure that VAT systems are sufficiently differentiated to allow discretionary rates and avoid regressive effects on income distribution.

While the EU’s policy influence in the field of indirect taxation in developing countries does not match the explicit policy prescriptions of the IMF or the World Bank, it is nevertheless evident in the consistent advocacy of trade liberalisation within the WTO, implicit in the relative harmonisation of VAT within the EU (minimum standard rate of 15% etc) and in its support for VAT harmonisation within regional LDC networks. In addition, the EU has presided over a gradual shift towards a greater reliance on indirect taxation within the EU27 and, in particular, in the 2004/2007 transition states (European Commission 2010c: 19).

Direct Taxation
A far greater influence on the development of LDC fiscal regimes has been the very slow progress within the EU towards the harmonisation of standards in direct taxation, notably of personal income tax (PIT) and corporation tax (CT), and in particular towards controlling the programmatic abuse of tax systems (including those of LDCs) by transnational enterprises (TNCs) and ‘high net-worth individuals’ (HNWIs) through tax and regulatory arbitrage, through trade mispricing, transfer-pricing, the shadow global finance system, profit-shifting and the use of secrecy jurisdictions (‘tax havens’). The policy failures and omissions of the EU in this area – which matches the failure of the OECD, the G7 and the WTO – have arguably been major obstacles to the development of strong, sustainable and growth-promoting fiscal regimes in developing countries. The co-responsibility of the ‘North’ in this regard is serious and culpable (Martens and Obenland 2011: 10).

It is, above all, the mobility of the tax bases of PIT and CT that has facilitated the emergence of a deeply embedded culture of corporate arbitrage in relation to taxation and regulation and thereby initiating and maintaining a corrosive process of ‘tax competition’ between the (by definition!) immobile sovereign states of the world; this mobility was predicated on the political suspension of exchange controls by the world’s major states in the 1970s and 1980s. In consequence, the shifting of mobile physical assets by companies from a high-taxing jurisdiction to a lower- or zero-taxing jurisdiction is an increasingly common feature of the global political economy; even more straightforward is the shifting of intangible assets (intellectual property, money) to shell companies and shell accounts in low-tax locations. The predictable political consequence of corporate asset-shifting has been the well documented and successive reduction by states, large and small, of both nominal and effective rates of corporation tax worldwide (Devereux et al. 2002; Rixen 2011; Schratzenstaller 2011; Ganghof & Genschel 2011); it is a process that is actively encouraged and applauded by a
significant group of market fundamentalists (Teather 2005; Trovato 2007; Price 2011) and their well-resourced sponsors, like the Coalition for Tax Competition, the Cato Institute, the Liberales Institut Zürich etc. The process has asymmetrical results for the states involved, with smaller states deriving greater marginal gains from poaching the tax bases of larger states (Genschel & Schwarz 2011: 341f); it is therefore not surprising that the jurisdictions with the lowest rates of corporation tax are generally small in size. The general results of tax competition, however, are corrosive not only of the volumes of revenue of most states but also of the norms of governance. Given that rate reductions are primarily driven by the political desire to attract or maintain inward investment, a number of studies demonstrate a quantifiable correlation between rate changes and FDI flows. Two recent surveys of econometric studies of tax elasticities, produce a quantifiable correlation between a one percentage point reduction in corporation tax and an increased flow of inward FDI, to the tune of 3% (De Mooij & Ederveen 2008) or 1.7% (Feld & Heckemaier 2008). The typical burdening of immobile tax bases (consumer goods, wages and salaries) which results from rate reductions and other incentives for mobile capital represents, for Schratzenstaller, ‘a violation of the principle of equivalence, because it becomes increasingly impossible to require of enterprises that they make an adequate contribution to the financing of public goods and services that are relevant to business’ (Schratzenstaller 2011: 307-8). Christensen, campaigner and former advisor to a tax haven, is even more forthright in his judgement: ‘Across the world politicians and officials struggle with the problem of how to fund public services in the face of fiscal termites which are steadily eroding their revenues and switching the tax charge from capital onto labour and consumers. Developed and developing countries face a massive dilemma: tax competition is undermining the taxation of corporate profits and hundreds of billions of tax revenue are being lost annually to tax evasion and aggressive tax avoidance’ (Christensen 2009: 1-2).

Christensen is right that tax competition and tax avoidance affect both developed and developing states, but it is also evident that developed states have certain strengths with which they can, initially at least, absorb the pressure of corporate arbitrage strategies, which most developing countries lack: this includes refined and regulated political economies with a broad set of tax bases, skilled and well staffed tax administrations, accepted norms of tax compliance in relation to PAYE and assessed income tax for SMEs, VAT and excise duties. The narrower tax bases of many LDCs, their weaker administrations, and less established norms of governance and compliance, along with a higher dependency on external sources of investment and development aid make them much more susceptible to illicit outflows of taxable assets and much less able to resist pressure from corporations for lower effective rates of taxation, tax holidays and other tax incentives, lower levels of monitoring and elite collusion.

The haemorrhaging of taxable assets from LDCs is not a matter of dispute among the institutions of global governance (c.f. Lane & Miresi-Ferretti 2010 [IMF], Kaufmann 2004 [World Bank Institute]², Kar 2011 [UN]) nor on the part of the European Union (European Commission 2010b)); there is also agreement that the causes go beyond the role of kleptocratic elites, and extend to trade mispricing and abusive transfer pricing (see below). There is, nevertheless, no consensus about the scale of the abuse. Global Financial Integrity in its updated re-

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² An extensive report for the World Bank by Peter Reuter entitled Draining development?: The sources, consequences, and control of flows of illicit funds from developing countries is due to be published in November 2011
port on all ‘illicit financial flows from developing countries’ estimates that these ‘have increased to a range of US$1.26 trillion to US$1.44 trillion in 2008 and that, on average developing countries lost between US$725 billion and US$810 billion per year over the nine-year period 2000-2008’ (Kar & Curcio 2011: vii).

Christian Aid, in its 2008 report Death and Taxes, estimated the annual loss to developing country treasuries through ‘transfer mispricing’ alone at $160 billion (Christian Aid 2008: 49), already considerably more than the $122 billion received by developing countries in development aid in 2008 (Martens & Obenland 2011: 31).

The full extent of fiscal haemorrhaging from LDCs is very difficult to assess, given its very nature; it is a discrete process, below the radar of policing authorities in many cases and subject both to the (in-)convenience of the principle of banking secrecy and the byzantine methods of concealment adopted by TNCs, their banks and the army of tax avoidance specialists employed by KPMG, Deloitte, PWC, Ernst & Young and others. The simple fact that it is sufficiently large to attract the attention of IMF, World Bank, UN, EU, OECD as well as numerous NGOs indicates a significant crisis of global governance and of efforts to promote prosperity and democracy worldwide.

The cost of the global tax mess, in particular of programmatic abuse by economic and political elites, is thus both quantitative and qualitative:

‘The costs of capital flight and tax avoidance do not simply exist in the revenue losses for state budgets. Taxes, apart from their revenue function, ... have a fundamental distributive and steering function and increase the answerability of governments and parliaments. Through capital flight and tax avoidance, corrupt elites and transnationally active enterprises thus do not simply remove urgently needed resources from states; they also hamper the political ability of governments to manage, widening the gulf between rich and poor through their unscrupulous self-enrichment and undermining the development of good governance (Martens & Obenland 2011: 33).

Avoiding Direct Taxation: Secrecy Jurisdictions and Tax Justice

Thirty percent of global foreign direct investment is directed towards secrecy jurisdictions or tax havens; secrecy jurisdiction (SJJs) are also recipients of over fifty percent of global bank lending and act as virtual conduits for around 50% of global trade (Christensen 2009: 2). In 2005, the Tax Justice Network estimated that the world’s High Net Worth Individuals (HNWIs) held some $11.5 trillion (€8.07 trillion) offshore; TJN also cites IMF estimates of $18 trillion (€12.6 trillion) in external assets and liabilities in small international financial centres (TJN 2005). In 2009 Oxfam reported that $6.2 trillion of developing country wealth is held offshore by individuals. Cap Gemini, in its World Wealth Report 2007 estimated HNWI global wealth at $37.2 trillion and forecast it rising to $51.6 by 2011 (ibid.). It is estimated that 60 percent of all hedge funds – which on the eve of the global financial crisis held $2.29 quadrillion 4 (€1.6 quadrillion) of derivative contracts – are registered offshore. Prem Sikka estimates that tax havens provide brass plate facilities for between two and three million corporations (Sikka 2009); 810,000 companies are registered in the British Virgin Islands alone, giving a ratio of 34 companies for every inhabitant; the average ra-

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4 A quadrillion is one thousand million million (1,000,000,000,000,000) or $10^{15}$
tio in Italy, France and Germany is 0.04! (Martens & Obenland 2011: 24). One building on the Cayman Islands, Ugland House is the registered address of 18,857 companies, described by Barack Obama as ‘the biggest tax scam on record’ (quoted in New York Times, October 3 2009).

These small island secrecy jurisdictions, along with 33 others, were identified by the OECD in 2000 as examples of ‘harmful tax practices’, following the launch in 1998 of its programme ‘Harmful Tax Competition: An Emerging Global Issue’. The programme ‘was the first serious and sustained intellectual assault on the secrecy jurisdictions in world history’ (Shaxson 2011:193) and presented four key criteria for identifying ‘tax havens’: a) low or no effective taxes b) lack of effective exchange of information, c) lack of transparency and d) absence of substantive economic activity (OECD 1998: 23). The list is interesting for what it omits, as much as for it includes (Box 1).

**Box 1: OECD List of Uncooperative Tax Havens 2000**

<table>
<thead>
<tr>
<th>Andorra</th>
<th>The Principality of Liechtenstein</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anguilla – Overseas Territory of the United Kingdom</td>
<td>The Republic of the Maldives</td>
</tr>
<tr>
<td>Antigua and Barbuda</td>
<td>The Republic of the Marshall Islands</td>
</tr>
<tr>
<td>Aruba – Kingdom of the Netherlands</td>
<td>The Principality of Monaco</td>
</tr>
<tr>
<td>Commonwealth of the Bahamas</td>
<td>Montserrat – Overseas Territory of the United Kingdom</td>
</tr>
<tr>
<td>Bahrain</td>
<td>The Republic of Nauru</td>
</tr>
<tr>
<td>Barbados</td>
<td>Netherlands Antilles – Kingdom of the Netherlands</td>
</tr>
<tr>
<td>Belize</td>
<td>Panama</td>
</tr>
<tr>
<td>British Virgin Islands – Overseas Territory of the United Kingdom</td>
<td>Samoa</td>
</tr>
<tr>
<td>Cook Islands – New Zealand</td>
<td>The Republic of the Seychelles</td>
</tr>
<tr>
<td>The Commonwealth of Dominica</td>
<td>St Lucia</td>
</tr>
<tr>
<td>Gibraltar – Overseas Territory of the United Kingdom</td>
<td>The Federation of St. Christopher</td>
</tr>
<tr>
<td>Grenada</td>
<td>&amp; Nevis</td>
</tr>
<tr>
<td>Guernsey/Sark/Alderney – Dependency of the British Crown</td>
<td>St. Vincent and the Grenadines</td>
</tr>
<tr>
<td>Isle of Man – Dependency of the British Crown</td>
<td>Tonga</td>
</tr>
<tr>
<td>Jersey – Dependency of the British Crown</td>
<td>Turks &amp; Caicos – Overseas Territory of the United Kingdom</td>
</tr>
<tr>
<td>Liberia</td>
<td>US Virgin Islands – External Territory of the United States</td>
</tr>
<tr>
<td></td>
<td>The Republic of Vanuatu</td>
</tr>
</tbody>
</table>

Source: OECD 2000

Missing from this list are several jurisdictions which met the tax haven criteria but which had made ‘advance commitments’ to comply with OECD guidelines (OECD 2000: 16f). These included Luxembourg, Switzerland, Austria and Belgium, but the UK and the USA were not included at any stage, even though they, along with Luxembourg and Switzerland, represent the most significant hubs in the network of shadow banking and secrecy jurisdictions. Nicholas Shaxson’s *Treasure Islands* identifies a ‘layered hub-and-spoke array of tax havens centred on the City of London’:

‘The City’s offshore network has three main layers. Two inner rings – Britain’s Crown Dependencies of Jersey, Guernsey and the Isle of Man;
and it Overseas Territories, such as the Cayman Islands – are substantially controlled by Britain ... . The outer ring is a more diverse array of havens, like Hong Kong, which are outside Britain’s direct control but nevertheless have strong historical and current links to the country and the City of London. One authoritative account estimates that this British grouping overall accounts for well over a third of all international bank assets; add the City of London and the total is almost a half.’

(Shaxson 2011: 15)

The omission of the UK and the USA which, in Delaware, has a state that provides brass plate addresses and low capital taxes for hundreds of thousands of corporations, augured very badly for the process of combatting tax havens and tax competition. In 2002, the OECD even removed the criterion concerning the lack of substantive activities under pressure from the USA, requiring compliant states firstly to commit themselves merely to ‘an exchange of information on request’ (my emphasis JL) in all tax matters for the administration and enforcement of domestic tax law .... It also provides for extensive safeguards to protect the confidentiality of the information exchanged’; secondly, jurisdictions which wished to be removed from the original black list, had to sign bi-lateral agreements on tax-information exchange with twelve other jurisdictions (OECD 2011).

By 2003, virtually all the 35 small jurisdictions had been removed from the black list onto a ‘grey list’ (committed but not implemented) and by August 10, 2011, the black list was empty, there were just five states on the grey list, and the white list of ‘compliant’ states was brim full of the main money-laundering secrecy jurisdictions. The highly questionable basis for ‘white’ status was reinforced by secrecy jurisdictions concluding many agreements with each other (Martens & Obenland 2011: 25); the ‘on request’ provision has also been widely criticized by campaigners for global taxation reform (Shaxson 2011: 213; McIntyre 2009; Martens & Obenland 2011; McIntyre 2009; Murphy 2011). Palan (2011: 8) concludes that the OECD is ‘ill-equipped’ to address the problem of SJs.

With ‘the offshore system ... now growing again at ferocious speed’ (Shaxson 2011: 213), the OECD’s ‘harmful tax competition’ initiative is significant not simply because it has been a failure but because it continues to provide the basis for the EU’s approach to ‘good governance in tax matters’ (European Commission 2009c). After a flurry of pronouncements in 2009 on the death of tax havens from European leaders, Barack Obama and the G20, and notable events surrounding whistleblowers in Liechtenstein and Switzerland, there is a ‘business as usual’ feel about the way that EU member states are pursuing their individual arrangements with European and other secrecy jurisdictions (e.g. Germany and UK).

The EU’s endorsement of the OECD’s ‘Model Effective Tax Information Exchange Agreement’ represented a culpable neglect of responsibility, both to its own collective regional interests and to the interests of LDCs. Michael McIntyre’s ‘reasons for guarded optimism’ (2009: 258) that the momentum was ‘with the tax reformers’ (ibid. 260) look less convincing two years on. Secrecy jurisdictions continue to thrive, together with the hyper-complex network of multi-layered shell companies and shadow banking that facilitates industrial-scale tax evasion and tax avoidance.

The EU’s neglect of the alternative, refined and much more satisfactory Financial Secrecy Index, proposed by the Tax Justice Network, is surprising in one
respect – the real scientific merits of the Index – but less surprising in another respects, namely that the FSI ranks four EU states in the top ten secrecy jurisdictions (Luxembourg, United Kingdom, Ireland and Belgium) and a further three in the top twenty (Austria, Netherlands, Portugal). Europe as a whole (Israel is included in the region) accounts for 21 secrecy jurisdictions, as much as the Americas and the Caribbean combined. The FSI methodology is worth outlining in some detail. A so-called opacity score is derived from the results of enquiries into the following issues and then combined with a global weighting based on the volume of international financial transactions and estimates of financial holdings in a particular jurisdiction. The survey seeks to discover:

1. Whether the jurisdiction has formal, legally enforced, banking secrecy
2. Whether a jurisdiction has a central register of trusts and foundations that is publicly accessible via the internet
3. Whether the anti-money laundering regime of a jurisdiction is considered appropriate by the Financial Action Task Force
4. Whether a jurisdiction requires all types of companies to publish their annual accounts in an online central database
5. Whether a jurisdiction requires all available types of company to publish beneficial ownership information on public record accessible via the internet;
6. Whether a jurisdiction requires all available types of company to submit beneficial ownership information upon incorporation and update it thereafter
7. Whether the jurisdiction participated in the TJN 2009 survey;
8. Whether the jurisdiction participates in automatic information exchange on tax matters;
9. Whether a jurisdiction has at least 60 bilateral treaties with broad tax information exchange clauses for both civil and criminal tax matters;
10. Whether the jurisdiction has effective access to bank information for the purposes of information exchange for both criminal and civil tax matters;
11. Whether a jurisdiction allows companies to change their jurisdiction of incorporation by re-domiciling;
12. Whether a jurisdiction allows the establishment of a ‘protected cell company’

The 2009 survey produced a ranking which reflects more convincingly the centrality of the USA (ranked 1) and the UK (5) to the functioning of the global network of secrecy jurisdictions; Luxembourg (2) has a better opacity score than Switzerland (3) but the quantitative weighting of asset and transaction volumes is considerably larger. The more favourable opacity of the UK, Ireland (6) and the Netherlands (15) is likewise offset by high quantitative measures. (See Table 2 below)

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5 A PCC (or segregated portfolio company) is defined by the TJN as ‘a little known type of corporate entity, found almost exclusively in secrecy jurisdictions. Essentially a PCC is a corporate entity that contains within itself, but not legally distinct from it, a number of cells which behave as if they are companies in their own right, but are not. Every cell has its own share capital, assets and liabilities and the income and costs of each cell are kept separate. Moreover, each cell is assigned its own share of the overall company share capital so that each owner can be the single owner of one cell but owns only a percentage of the overall PCC’; c.f. http://www.secrecyjurisdictions.com/kfsi
### Table 2: Financial Secrecy Index 2009

<table>
<thead>
<tr>
<th>Secrecy Jurisdiction</th>
<th>Opacity Score</th>
<th>Global Scale Weight</th>
<th>Opacity Component Value</th>
<th>Financial Secrecy Index Value</th>
<th>Financial Secrecy Index Rank</th>
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Joint 39: Brunei, Dominica, Samoa, Seychelles, St Lucia, St Vincent & Grenadines, Turks & Caicos Islands; Joint 46: Antigua & Barbuda, Cook Islands, Gibraltar, Grenada, Marshall Islands, Nauru, St Kitts & Nevis, US Virgin Islands; 54: Liberia; Joint 55: Liechtenstein, Anguilla; 57: Andorra; 58: Maldives; 59: Monserrat; 60: Monaco

Source: Tax Justice Network

The grouping of the top five secrecy jurisdictions (US, Luxembourg, Switzerland, the Caymans, UK) with the magnitudes evident in Column 5 clearly represents a major dilemma for the EU and the OECD. The degree of concealment that the two big EU secrecy jurisdictions offer, directly or through small island
intermediaries in Jersey, Guernsey, the Caymans, BVI et al., has arguably become a structural precondition of corporate activity worldwide, in particular of ‘tax planning’ (tax avoidance by any other name). In particular the ability for enterprises to acquire shell companies (predominantly limited liability companies) in low-tax jurisdictions, the marketing of which frequently includes explicit reference to secrecy and non-disclosure, represents a colossal abuse of commercial law and the fiduciary norms with which ordinary citizens and smaller enterprises generally comply.

The state of Delaware in the United States stands out both in the scale of abuse and the shameless nature of its brass-plate, shell company scams. More than half of the US’ publicly traded companies are incorporated in Delaware, including 60% of Fortune 500 corporations. A single building at 1209 North Orange Street, Wilmington, operates as the registered address of over 200,000 corporations. The Delaware Company, with its logo Incorporating America, cites the privacy, asset protection and taxation advantages of incorporating as an LLC in the state: the privacy advantages should raise at least an eyebrow within the OECD or the European Tax and Customs Directorate:

‘Company ownership need not be disclosed to the State of Delaware
‘Company ownership transfers need not be reported to the State of Delaware
‘Delaware does not maintain a publicly available database of companies’ management
‘The reporting and disclosure obligations imposed by the State of Delaware are minimal’

There are similar companies operating in London, Luxembourg and Switzerland. CODDAN (Companies Formation Worldwide) in London

‘provides a full range of professional incorporation services from provision of a simple and fast company formation, to provision of a registered office address ... UK toll-free telephone numbers, general mail-forwarding, mail-scanning, virtual office and UK, EU, USA and offshore domain names registration’

CODDAN also has a remarkably cheap scale of fees (e.g. Nominee Directors: from £125!!)⁷. EuroTop International Holding S.A offers Luxembourg Shelf Companies for €5000 (including a nominee director)⁸ while COFINAX SA Geneva (which describes itself as a Swiss Fiduciary Company) is currently offering ‘anonymous relocatable shell companies ... with (sic!) special prices’, guaranteeing ‘total anonymity’⁹.

By enquiring after the legality of protected cell companies, the TJN’s Financial Secrecy Index actually allows most European countries to achieve a higher opacity score than they perhaps deserve; of the EU27, only Luxembourg and Malta permit protected cell companies; Switzerland and the UK Crown Dependency of Guernsey are the other two jurisdictions in Europe that allow them. However, the legality of shell company marketing, with off-the-peg LLCs, nominee directors, virtual offices and pantomime services, allows very similar arrangements to emerge through serial incorporations, multi-layering, bogus trusts and impenetrable labyrinths of asset valuations and financial flows. The protect-

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⁷ C.f. http://www.ukincorp.co.uk; the website suffers from numerous linguistic mistakes!
ed cell company provides concealment in institutional form; shell company combinations allow concealment in effective form. The difference is like that between a ready-made cupboard and a flat-pack cupboard kit!

The FIS remains a clear and damning endictment of OECD and EU failure. After the ‘charade’ (McNair) of the OECD’s white-listing of many of the major secrecy jurisdictions, Europe’s interest in harmful tax competition waned temporarily, perhaps encouraged by the temporary stability on international capital markets between 2002 and 2007.

In February 2008, a disk with the details of 1400 secret accounts in Liechtenstein was sold to German authorities for €5 million, sparking a debate in Germany on tax evasion even before the September crisis. Then, in the wake of the devastation wrought by the crisis on both revenue and expenditure patterns of EU member states, new and radical calls to ‘dry out’ and ‘put an end to’ tax havens emerged, led by Peer Steinbrück, Gordon Brown, Nicolas Sarkozy, Angela Merkel, and others, including Barack Obama. This put the subject high on the agenda of both the EU and the G20 in March and April 2009. However, the superficial unanimity of EU Finance Ministers and heads of government in March 2009 was very short-lived. The G20 summit in London on April 2nd, 2009 coincided with the OECD’s ‘Progress Report’ on secrecy jurisdictions which, while it repeated the optimistic message of almost universal commitment and/or implementation of its information exchange standards, still included Luxembourg, Austria and Belgium on the list of ‘other financial centres’ that had not ‘yet substantially implemented’ the tax standard. The non-inclusion of the United States prompted Jean-Claude Juncker, the Luxembourg prime minister, to demand (quite justifiably) that Delaware, Wyoming and Nevada should be put on the G20 list (c.f. eu.business.com/news-eu/1238597221.72). If Juncker expected unanimous support from his EU colleagues, he was mistaken. Peer Steinbrück, the German finance minister, spoke of Luxembourg, Switzerland and Austria resembling the secrecy level of Ouagadougou in Burkino Faso, enflaming his EU counterparts in these countries and some of his allies in Germany and elsewhere, but he received corroborative support from a Burkino Faso NGO (Spiegel-Online, May 6, 2009). Steinbrück’s criticism was in part informed by the refusal of Luxembourg to support the proposal by László Kovács, EU Tax Commissioner, to conclude EU information-exchange agreements with third countries. The blocking of this modest initiative has paralysed the EU’s proposal to pursue ‘coordinated action by Member States to ensure an appropriate follow-up’ to its April discussion on tax havens (c.f. EU Commission 2009c: 7), effectively inviting the latter to continue as before. That Steinbrück picked on Luxembourg and failed to mention the EU’s other major secrecy jurisdiction, the UK, reflects the success of Gordon Brown’s rhetorical bluster rather than any serious prospect that Britain, even under a re-elected Labour administration would have taken any serious steps to dismantle its ‘hub-and-spoke’ system of crown dependencies, British Overseas Territories and small island independent members of the Commonwealth.

10 C.f. Stern 21.10.2008; The Telegraph, 14.03. 2009; Süddeutsche Zeitung 12.03.2009; Guardian 4.03.2009; Stern 4.05.2009

11 The constitutional status of the Crown Dependencies (Jersey, Guernsey, Isle of Man) is highly problematic; while the dependencies are British possessions of the Crown, and are not sovereign nations in their own right, the power to pass legislation affecting the islands ultimately rests with their own respective legislative assemblies, but with the assent of the Crown.
One opportunity for influencing the Cayman Islands arose in September 2009, when its leader, William Bush, was refused permission by the UK Foreign Office to cover the country’s budget deficit unconditionally through borrowing; Chris Bryant, the then Foreign and Commonwealth minister, suggested that the islands consider the introduction of a payroll tax (Guardian Sept.25 2009); in subsequent discussions between the FCO and the Caymans administration, it was agreed that the Islands could resolve their budget crisis through expenditure cuts, rather than tax increases, but would be required to produce a 3-year plan to resolve their revenue weaknesses. The borrowing was sanctioned and the payroll-tax condition lifted. The annoyance of the Caymans authority at the indignity of even having to ask UK permission was nevertheless clear at the time but made more explicit in William Bush’s budget address (Partnership for Recovery) in June 2010. Here he compares his relationship with the new Cameron administration and its predecessor in London: ‘I think it is very safe to say that there is a world of difference between the nature of that relationship over the past 12 months as compared to the one recently established over the past 4 weeks (Bush 2010: 11ff). The address illustrates the at best half-hearted attempt by the UK to influence a dependent territory and at worst the renewed indifference to the effects of tax havens on global economic affairs on the part of the Cameron administration. It is Cameron’s good fortune to have allies within the EU27 – Luxembourg, Belgium, Holland, Austria – that will also seek to block future initiatives to outlaw tax havenry.  

Unsurprisingly, the unanimity within the G20 was also superficial, with unsuccessful French demands that Hong Kong and Macao (Chinese dependencies) should be included on a list of uncooperative jurisdictions. The headline in The Guardian – ‘G20 declares door shut on tax havens’ (Guardian April 2 2009) – was thus less than wholly convincing. Moreover, the evaporation of the Democratic majority in the US Congress would seem to have closed the window on any idea that the Obama administration would lead the way on outlawing tax havenry worldwide or indeed in Delaware, Wyoming and Nevada. Thus, purely at the level of defining and identifying secrecy jurisdictions and their respective harmful tax practices, the EU has failed to achieve a common view. This clearly affects the context in which individual issues of company taxation in Europe are addressed and, by implication, the way in which the international coordination of tax governance is conducted, most notably affecting the states of less developed economies.

European Initiatives in Company Taxation

Despite the subsidiarity principle applying to tax affairs in general and to direct taxation in EU member states in particular, there have been a number of initiatives to harmonise direct taxation, in particular company taxation, from the early days of the EEC. The Neumark Committee in 1962 recommended the adoption...
of a split-rate system of corporation tax throughout the Community with a lower rate on distributed dividends than on retained profits. The Van den Tempel Report in 1970 proposed a common corporation tax system within the Community, influencing the Council decision in 1971 to harmonise CT systems in the event of future monetary union to avoid distortions in the deployment of cross-border investments. Arguably the most radical initiative by the European Commission emerged in 1975 with a proposal to introduce statutory CT rates within a band of 45%-55%, along with a common partial imputation system and a 25% national withholding tax on the dividends of companies resident in individual member states. The proposal omitted the idea of common corporate tax base (CCTB) and was criticized accordingly. However, rather than making good the omission, harmonisation was set aside in favour of ‘approximation’ and ‘coordination’ (European Parliament 2000: 4). A separate and promising initiative on the CCTB between 1988 and 1991 was in turn shelved, and replaced by less incisive directives on the taxation of parent companies and subsidiaries and on the deferral of capital gains tax in conjunction with cross-border mergers.

The detailed report of the Ruding Committee of 1992 resurrected a wide variety of issues, raised in the Van den Tempel Report and the Commission’s 1975 proposals, including rate-harmonisation, double taxation and a common tax base, but with new recommendations for combatting tax evasion, the abuse of transfer-pricing and for common accounting standards (European Parliament 2000: 6-8). Once again, the Commission looked less favourably on the more radical proposals, rejecting a minimum CT rate of 30% as ‘too high’ (ibid.: 8). What eventually emerged in the shape of the ‘Monti Package’ in 1997 was the so-called Code of Conduct, which sought to establish a common set of principles of fair competition which avoided tax measures that were harmful to others. The ‘Monti Package’ reflects the hortatory and (predictably) ineffective quality of EU tax recommendations: the same year that it was published, the Irish government reduced its top rate of Corporation Tax from 40% to 36%, followed by a further 4 percentage point reduction in 1998 and rapid incremental reductions in subsequent years, ending with the introduction of the highly contentious 12.5% rate in 2003; at the same time, it retained a special 10% rate for particular investment projects. Add to this tax ‘conduct’ of an existing member state the development of CT rates in the applicant states and the concomitant and competitive reduction in EU-15 states and you have an all-too-typical picture of EU-policy failure (See Table 3). Figure 1 shows a clear acceleration of competitive rate reductions between 2000 and 2009. While the process of CT rate reductions was accompanied by the removal of allowances, studies which simulate the development of effective rates, which seek to account for modifications to the tax base, indicate a general downward shift. In her a recent conspectus, Margit Schratzenstaller notes average falls of 7.8 percentage points for the EU27 between 1998 and 2008 (EU15: -5.4, New MS: -10.8) in one study of effective average tax rates (Centre for European Economic Research, Mannheim) and of 11.4 percentage points in longer series study (1982-2005) by the Institute for Fiscal Studies in London (Schratzenstaller 2011: 306). The average scores of the EU’s own Implicit Rate of Corporation Tax show an increase (!) of 2.6 points for the EU15 but these are essentially worthless because they do not include data from the four EU15 states with the most telling reductions of nominal rates between 1995 and 2008 (Ireland: -27.5; Germany: -27.0; Greece: -15.0 and Portugal: -13.1). The EU’s implicit rate approach (which is also applied to other taxes) is also methodologically questionable, even without the glaring omissions.
### Table 3: Corporation Tax Rates in EU Member States 1980-2009

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Source: World Tax Database; Bönker 2003; Vienna Institute of International Economics (wiiw)

*standard proportional rates, except for countries with differential rates; ** denotes top rates; § Germany’s current basic rate of corporation tax (15%) plus the Solidarity Surcharge of 5.5%, introduced to co-finance German unification

### Transfer Mis-Pricing

Effective rates of taxation are crucially dependent on the breadth of the tax base (the taxable income of individuals or companies) that is presented to the tax authorities; the tax base can be narrowed by tax allowances/ tax breaks provided by a particular jurisdiction, but more significantly it can be narrowed by the invoicing practices of individual companies. Given that two thirds of all global trade is conducted within individual corporations, the scope for ‘tax-efficient transfer-pricing’ strategies is very considerable. These strategies are particularly relevant for the operation of double taxation agreements between different jurisdictions. Transfer Mis-pricing thus involves the deliberate distortion of intra-firm prices to maximise tax advantages. In the context of its work on Tax and Development (EC 2010b), a report was commissioned by the EU on Transfer

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15 The TJN provides a simple example of this kind of strategy: ‘(T)ake a company called World Inc., which produces a type of food in Africa, then processes it and sells the finished product in the United States. World Inc. does this via three subsidiaries: Africa Inc. (in Africa), Haven Inc. (in a tax haven, with zero taxes) and America Inc. (in the United States). Now Africa Inc. sells the produce to Haven Inc. at an artificially low price, resulting in Africa Inc. having artificially low profits – and consequently an artificially low tax bill in Africa. Then Haven Inc. sells the product to America Inc. at a very high price – almost as high as the final retail price at which America Inc. sells the processed product. As a result, America Inc. also has artificially low profitability, and an artificially low tax bill in America. By contrast, however, Haven Inc. has bought at a very low price, and sold at a very high price, artificially creating very high profits. However, it is located in a tax haven – so it pays no taxes on those profits (TJN Transfer Pricing webpage: http://www.taxjustice.net/cms/front_content.php?client=1&lang=1&parent=91&subid=91&idcat=139&idart=250

16
Pricing and Developing Countries, supported by the European Parliament and conducted by PriceWaterhouseCooper (PwC). It was published in July 2011. The Report provides an overview of problems confronting LDCs in assessing, administering and policing the transfer pricing strategies of MNEs, discusses both the OECD and the UN models on TP and presents a set of recommendations for staged improvements in TP procedures in developing countries, including capacity building, legislation and implementation (EuropeAid 2011: 41-2).

Inasmuch as the report thematises the relationship between TP and taxation in LDCs, it performs a useful purpose. In most other respects, however, it represents a disappointing affirmation of a dysfunctional status quo (c.f. TJN 2011). The result was arguably predictable given that it was PwC that was commissioned to write it. PwC is one of the ‘Big Four’ global accountancy corporations that explicitly provide ‘tax-efficient transfer pricing’ advice in the technically legal process of tax avoidance16. The EU’s ‘Taxation and Customs Union’ Directorate contains a consultative group, The EU Joint Transfer Pricing Forum, which contains sixteen private sector representatives, including all the Big Four and several other large MNEs, some of which have been openly accused of programmatic tax avoidance17.

The 2011 Report has yet to generate specific recommendations from the Commission but the prospects are poor. Chief among the weaknesses of the Report is that the recommendations focus almost entirely on deficiencies in TP management at the level of the LDC, as if the accounting and invoicing practices of MNEs based in Europe’s developed states do not merit closer scrutiny, and general promotion of transparency in accounting standards and tax information exchange worldwide would not contribute to an improvement in the fiscal position of LDCs. Additionally, by commending the existing OECD model of ‘arm’s length’ transfer pricing, the Report favours an approach which is both theoretically contested (Bhat 2009: 14f) and in practice highly complex, administratively expensive and subject to large discrepancies in valuations; this tilts the advantage away from the LDC tax authority with weaker ‘capacities’ and towards the MNE and its supporting team of experienced tax advisors. Bhat (2009) and Otusanya (forthcoming) also stress the difficulties associated with the exchange of ‘intangibles’ within a corporation. Thus, while ‘capacity-building’ in LDCs is of clear and urgent relevance to the improvement of their fiscal systems, the model to which they are being encouraged to align that capacity will most probably continue to thwart the ambitions of tax authorities in both developed and developing countries. Rixen and Uhl (2007: 10ff) underscore the continuing problems of transfer pricing in Europe within the current orthodoxy of arm’s length/separate entity accounting (see also Sikka & Willmott 2010: 18ff).

16 PWC markets its tax-planning services with explicit reference to the ‘opportunities which benefit their group’s effective tax rate by looking at effective tax and transfer pricing strategies’ (c.f. http://www.pwc.co.uk/eng/publications/achieve-a-tax-efficient-sustainable-business-model.html);

17 Companies represented include Shell, Unilever, BAE Systems and Sanofi Aventis, all involved at one time in litigation over tax avoidance. The membership of the Forum is listed at: http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/forum/index_en.htm#members
A further criticism of the OECD model, recommended by the EU’s EuropeAid Report, is that it is predicated on the conclusion of a multitude of bi-lateral agreements by all participating states with their concomitant costs in economic diplomacy, a cost less affordable to LDCs. Even before one considers the vital interest of LDCs in attracting and maintaining foreign direct investment, the opportunity costs of ‘tax efficient transfer pricing’ for MNEs are currently lower than the administrative costs of policing of cross-border transactions on the part of LDCs.

**Combatting Profit-Shifting through Harmonisation of the Tax-Base: EU Initiatives**

On top of its initiatives concerning harmful tax competition and transfer-pricing, both the Commission and individual member states have given increasing attention to the divergence of national company tax law and the associated compliance costs for MNEs involved in cross-border trading within the EU. The acknowledged problem of apportioning a fair and appropriate tax charge on enterprises in multiple locations is rooted in the information asymmetry between states and business taxpayers, and the resulting difficulty in assessing the true level of both economic activity and profits. Accordingly, the Commission established a Work Programme in 2004 to explore the potential of a Common Consolidated Corporate Tax Base (CCCTB). The CCCTB Working Group has produced interim findings which are, in part, very promising. The Taxation and Customs Union website expresses a strong vote of confidence in the principle of CCCTB:

> The European Commission believes that the only systematic way to address the underlying tax obstacles which exist for companies operating in more than one Member State in the Internal Market is to provide companies with a consolidated corporate tax base for their EU-wide activities. ([http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm))

The draft proposals of the Working Group envisage MNEs operating in more than one EU country presenting a consolidated profit and loss return for the whole group which individual jurisdictions would be able to tax, according to an agreed formula based on the three equally weighted factors of assets, labour costs and total turnover. The preconditions for the implementation of CCCTB with formula apportionment would include shared standards for valuing assets, calculating depreciation and other deductible expenses and agreement on non-deductible expenses. The formula would be revised annually. If successful, the approach would provide much improved transparency and render simple profit-shifting considerably more difficult; it would reduce compliance costs, the costs associated with tax planning and transfer pricing and the costs of cross-border investments (see EC 2007b).

A formal proposal on an EU-wide CCCTB was published on March 16th 2011. If implemented it would represent a clear advance in the harmonisation and simplification of company taxation. It nevertheless presents two significant and residual problems. It explicitly rules out the harmonisation of tax rates and it is not mandatory, i.e. firms can choose to continue to use separate accounting based on arm’s length transfer pricing. The omission of any notion of a minimum standard rate of CT, as in the Commission’s 1975 proposals and in the Ruding Report, runs the risk of tax competition and tax arbitrage being shifted to the field of real investments (Rixen & Uhl 2007: 16) and of allowing a further erosion of
effective tax rates. The voluntary basis of MNEs being able to opt-in or opt-out of such a scheme would reintroduce the distortionary complexities of the current system and neutralise the cost advantages to tax administrations of simplified procedures.

A parallel initiative, where the EU Commission – but particularly the European Parliament – has shown active interest, concerns the possible introduction of country-by-country-reporting as a core principle of international accounting standards. This system, spearheaded by Richard Murphy and the UK Tax Justice Network would, under the umbrella of a global Accounting Standards Board, would impose a set of straightforward requirements on MNEs to declare a) which countries they operate in; b) what they are called in each location; c) what their financial performance is in every country, identifying third party and intra-group trade in addition to information on labour costs, and d) how much tax they pay to the tax authorities in each location. Following a number of resolutions in the European Parliament, the Commission has organised a ‘public consultation on country-by-country reporting by multinational companies’ in 2010, and the Competitiveness Council of Ministers in March 2011 made a specific request that the Commission take the initiative on CbCR in relation to the extractive industries, along the same lines as the American Dodd-Frank Act, and to encourage the OECD to continue its work on CbCR. Lesage & Kaçar (forthcoming) consider that this ‘minimalist’ option, relating to oil, gas and mineral extraction, has the greatest likelihood of implementation on a global level.

This conclusion is reinforced by the strong support of the G8 and the European Commission for the Extractive Industries Transparency Initiative (EITI), chaired by former UK overseas development minister, Clare Short; in his supporting statement Barroso declared:

*I want to go further by making these commitments binding in EU law. In October, the European Commission will present a legislative proposal for amending the Transparency Directive to include disclosure requirements for extractive industry revenues* (Barroso, quoted in Libération, 23.3.2011)

Were the EITI guidelines to be written into law in all EU and other OECD countries, as well as in those developing countries that are heavily dependent on the royalty and tax revenues of extractive industries, it would represent a significant advance for the principle of country-by-country reporting, for which the broad-based campaign, including the EP and the EC could take considerable credit. The centrality of mineral resource exploitation in many LDCs, notably in sub-Saharan Africa, to the key issue of revenue-loss through corporate mis-pricing and political corruption, makes the ‘minimalist’ sector-specific option urgently necessary, but it could also mark a significant first stage in the promotion of the universal application of CbCR to the accounting standards of all global corporations. The organisational and governance model of the EITI compares very favourably with the EU’s Joint Transfer Pricing Forum (see above), with a strong representation of civil society groups and developing countries as well as major corporations. The limitations of the EITI have been noted by several civil society groups, in particular the narrow scope of the data-sets required of MNEs and governments and the need to extend reporting requirements to companies engaged in ‘transportation and transit, downstream oil and metals processing and agricultural commodities’ (Publish What You Pay 2011). The successful implementation of the EITI guidelines as a mandatory requirement for all participating companies and governments would, above all, strengthen the pressure for a change in the behaviour of giant, private corporations in all sectors. This in turn
might help to reduce or indeed eliminate the parasitic free-rider abuse of sovereign states and their taxpayers which is currently hard-wired into the operational mind-set of corporate elites.

**Personal Income Tax**

There are two particular areas of concern in relation to EU policy on PIT that affect the development of taxation systems in LDCs. The first is that of the general principle of progressive taxation, the second is the specific issue of the taxation of savings income; both have clear relevance for the achievement of tax justice.

The European Union has a poor record in the area of progressive taxation. The idea that, in a capitalist economy with significant differentials in individual or household income, the state should place a higher proportional burden on higher income groups became firmly established in the course of the twentieth century within the group of advanced states. Accordingly, all EU member states up to the sixth enlargement (1995) had higher marginal income tax rates for higher earners; the effective PIT rates of the EU15, which reflect tax allowances in particular for unincorporated businesses, were also consistently progressive. The core and intended functions of progressivity was both to finance a broad range of public goods and to counteract poverty and deprivation through the redistribution of national income. The paradigm shift within the OECD away from this typical orthodoxy of welfare Keynesianism towards neo-liberalism in the early 1980s sought to reverse the redistributive function of the capitalist state, sometimes with the explicit promotion of increased inequality (e.g. Gilder). This paradigm shift, which became firmly entrenched in the policy architecture and policy preferences of the EU and its MS, thus prefigured the collapse of state socialism in central and eastern Europe and the transition of its economies to market-based systems. In consequence, both ECOFIN and the Commission failed to include the principle of progressivity or minimum standards of PIT in the convergence criteria which would qualify CEECs for EU-membership. While the acquis include a minimum standard rate of VAT (15%), neither it nor the Copenhagen Criteria (1997) mention progressivity. Nor was there a significant response to the decision of the Baltic states to introduce a flat income tax regime in 1994-95, nor to the subsequent adoption of similar arrangements in four other CEE states. By 2008 seven of the ten CEE members had introduced flat rates of income tax ranging from 10% in Bulgaria to 21% in Estonia (further details: Leaman 2009).

**Flat Tax Rates among the New Member States 2008 (percent)**

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<td>Czech Republic</td>
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<td>Estonia</td>
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The results of this process are well known: increased competition within the EU27 to attract mobile high earners, a consequent flattening of the curve of progression in states which retained higher marginal rates, a shift towards a higher state dependence on (generally regressive) indirect taxation and a gradually declining tax ratio throughout the EU and in aspirant member states in SE Europe. These developments, in particular the considerably lower tax ratios of the CEECs within the general declining trend, contain very significant lessons for
developing countries in their own transition towards economic modernisation. Arguably, the lower CEEC tax ratio\(^{18}\) of 31.7% (EU15: 41.3) represents a profound weakness in the ability of new and aspirant member states to tackle both the general challenges of modernisation and the specific challenges of crisis management. It is no coincidence that the states with the lowest tax ratios within the EU were those, like the Baltic states, that were unable to mount any anti-cyclical measures in their colossal recessions of 2008-9, or those like Ireland and Greece and Portugal which could not show the potential for sizeable revenue streams to repay sovereign debt. Even if many developing countries do not have a high proportion of households with higher and thus potentially more taxable incomes, it is vital to maintain and assert the inseparability of progressive taxation as a primary means of combatting world poverty in line with the Millennium Development goals and of reducing the socially destructive potential of income and wealth inequality.

Additionally, the EU must recognize that the toleration of both flat tax reforms in CEECs and of lower tax ratios among a significant number of its member states was a serious error of judgement. The absence of strong redistributive potential and of strong endogenous revenue-generation potential in these states reduces their capacity to develop coherent and cohesive socio-economic arrangements and makes them chronically dependent on imported (private) capital to finance infrastructural investments and, as has been shown in the ongoing eurozone crisis, chronically dependent on intra-regional transfers. Persistent wide disparities in tax ratios can only generate further political and economic fragmentation. This is not an object lesson that the EU can afford to present in its encouragement of improved governance and policy-making in developing countries.

\textit{Stifled Hope? The European Savings Tax Directive}

Arguably, the most promising tax initiative in the EU’s recent chequered career was the 2003 Directive on the taxation of savings income, which came into force in 2005. The Savings Tax Directive (STD) applies solely to natural persons that are resident in an EU country, not to companies. The original scheme envisaged a uniform exchange of information between all member states and including the UK’s Crown Dependencies (Jersey, Guernsey, Isle of Man), the UK’s overseas territories (the British Virgin Islands, Caymans, Turks & Caicos, Anguilla), the Netherlands Antilles, Aruba and some small European territories (Andorra, Monaco, Liechtenstein and San Marino). The primary objectives were to neutralise one significant source of tax evasion and to expand EU state tax revenues through widening the tax base. Because of opposition from Austria, Luxembourg and Belgium, as well as Switzerland and the Channel Islands, to the abandonment of bank secrecy implicit in the exchange of information plan, a compromise was struck allowing some states to levy a ‘withholding tax’ on accounts held by EU nationals, while the majority introduced the full disclosure of both savings accounts and the identity of the account holders. While the Caymans and Anguilla have opted for the information exchange option, the three EU secrecy jurisdictions, together with Switzerland and the other non-EU jurisdictions have chosen the withholding tax option.

Even with the concession of secrecy and the limitation of the arrangement to interest income (dividends are not included), the Directive was highly significant

\(^{18}\) This figure includes the states of the Western Balkans; the group averages are 27.5% for the Baltic states, 35.2% for the Visegrad group and 30.3% for the Western Balkans. Figures are for 2008
in achieving unanimity in the sphere of direct taxation, and committing key secrecy jurisdictions to address long-standing grievances on tax evasion by EU citizens, either directly or indirectly. This significance was recognized by major campaigners for tax justice, but more tellingly, by the secrecy merchants in major global financial centres. One ‘wealth management’ outfit dubbed the STD ‘the single biggest threat to offshore revenues’ such that ‘(o)ver half of the (financial services JL) industry harbors serious concerns that it will drive assets onshore’\textsuperscript{19}. Veronique de Rugy of the Cato Institute saw the STD as ‘an enormous threat to America’s long-term prosperity’, if the then Bush administration were to sign up to it on the grounds that the US, as ‘the best tax haven in the world’, could lose some of the $9 trillion of foreign capital that was attracted to the US annually (de Rugy 2002).

The ‘threat’-rhetoric by proponents of offshoring and tax-havenry represented a negative endorsement of the potential of this multilateral initiative. Conversely, the reactions to the two recent bi-lateral deals between Switzerland and both Germany and Britain suggest that a serious blow has been dealt to the STD in favour of further beggar-thy-neighbour politics. The deals, struck on the 10\textsuperscript{th} and 24\textsuperscript{th} of August respectively, both envisage Swiss banks levying a one-off retrospective tax of between\textsuperscript{19} and 34 percent on the accumulated interest income of German and UK tax evaders with accounts in Switzerland and a future annual withholding tax. The withholding tax rate differs significantly: the rate applied to German account holders of 26.4 % corresponds to Germany’s own Abgeltungssteuer on savings accounts, that applied to UK account holders is 48%, which is close to the new 50% top marginal rate for high earners. The details of the bi-lateral deals are less relevant than the damage inflicted on the multilateral STD initiative and on the principles of transparency, legality and honesty which the EU, together with the IMF, World Bank and UN, is seeking to encourage in the tax governance of developing countries. It is not surprising that the assessment of the agreements by Patrick Didier, president of the Swiss Banking Association, was ‘positive’ (quoted in EurActiv, 26.8.2011), and that the Neue Zürcher Zeitung noted that Switzerland had ‘succeeded in protecting the interests of the clients to an unexpectedly high degree’ (NZZ 25.8.2011). Nor was it a surprise that Swiss bank share values rose on hearing the news. There has been vociferous opposition from both prominent tax justice campaigners and the political opposition parties in both countries\textsuperscript{20}. A telling critique appeared in the FT Lex Column, which suspects a ‘lingering tolerance for dubious practices’:

‘Swiss banks will pay taxes anonymously and in bulk. As long as specific names and account details remain secret, determined tax evaders will have an edge over governments. So why have Germany and the UK been willing to settle for less than the standard set in this area in the European Savings Tax Directive, and for fewer concessions than the US received in 2009?’ (Financial Times 25.8.2011)

With further bi-lateral negotiations between Switzerland and other EU states underway, it is difficult to assess the overall damage these deals do to European harmonisation efforts, but they will significantly disrupt the work of the Tax Directorate under Semeta and above all, send the completely wrong message to the political elites and the civil society groups in LDCs, to other offshore financial centres and to the tribe of accountants and tax lawyers running their money-launderies.

\textsuperscript{19} Thus Global Information Inc. at http://www.giiresearch.com/report/dc24138_eu_saving_tax.html ; c.f. also Cato Institute, Veronique de Rugy

\textsuperscript{20} One of the most detailed critiques of the UK deal was the immediate response of the UK Tax Justice Network at: http://taxjustice.blogspot.com/2011/08/tjn-on-dishonorable-uk-swiss-deal.html
A European Financial Transactions Tax?

LDCs might have been encouraged by the burst of activity in Europe in support of an International Financial Transactions Tax (FTT) or Tobin Tax; it was mooted by several European leaders in 2009, included on G20 agendas in 2009 and 2010 and remains under active discussion within the Commission, the European Parliament and several of its MS parliaments (in particular France, Germany and Belgium). The dual purpose of this sumptuary tax (akin to that on tobacco) is to reduce the volume/velocity of short-term speculative financial transactions, involving currencies, shares and derivative ‘securities’, and to generate revenue for specific purposes, including the pursuit of Millennium Development goals or a Global ‘Marshall Plan’. The imposition of a very modest FTT of between 0.01 and 0.05% percent has the potential to yield $billions for individual states in Europe (notably the UK and Germany) or for the EU27 as a whole. Given a sufficiently robust design, which maximised ease of collection and minimised evasion routes, Schulmeister et al. (2008) calculate that the revenue yield of an FTT levied on major exchanges in the EU would be between 0.2% and 0.8% of the nominal GDP of the EU 27 plus Norway and Switzerland (i.e. between $35.4 and $118.6 billion; if implemented globally the yield would be ‘roughly three times higher’ (Schulmeister et al. 2008: 56). The technical feasibility of an FTT nevertheless remains contested (c.f. Honahan & Yoder 2010), even before one considers the political obstacles that still stand in its way. The pessimistic view that it could only succeed in the unlikely event of a global agreement is nevertheless challenged by its proponents, who assert that the heavy geographical concentration of financial transactions in a handful of locations would make an FTT simple to implement, given agreement between just a few jurisdictions; a levy in just London, Tokyo and New York would capture almost 60 percent of all speculative financial transactions. A tax confined to Europe would effectively only involve London and Frankfurt, where 97 percent of transactions are conducted through technically well-equipped exchanges. Moreover, the evidence of the British ‘stamp duty’ on equity transactions suggests at least that the danger of migration to other centres is exaggerated. London remains the dominant location in Europe for share-trading despite stamp duty of 0.5%; the same would arguably apply to the imposition of a transaction levy on equity derivatives, on currency trades and currency derivatives and on interest rate derivatives, particularly if the rate were only 0.05 percent. Notwithstanding the desirability and feasibility of a European FTT, without the UK it would be of little more than symbolic significance; George Osborne, the UK Finance Minister/ Chancellor of the Exchequer, has made it clear that the current British government will not support anything other than a global FTT, deploying the migration-fear argument (The Guardian 29 June 2011). Despite an overwhelming majority in favour of the tax in the European Parliament (529 to 127), the unanimity principle would thus seem to rule out its effective implementation in the short term.

CONCLUSIONS AND RECOMMENDATIONS

Taxation is absolutely central to socio-economic development. There is an irrefutable link between higher levels of development (in democracy and well-being as well as in living standards) and higher state (tax) ratios. In the 21st century, only collective, democratically legitimated political institutions can ensure the provision of the essential range of public goods for the maintenance and en-
enhancement of decent, fulfilled and environmentally sustainable human existence. Only such institutions, set in an active, reflective and critical civil society, can mitigate or even prevent public ‘bads’. Such institutions require revenue resources.

The unequal interdependence between European and less developed countries – in trade, investment, finance, intellectual property, diplomatic leverage etc – together with urgent need to reduce poverty and social injustice, make the EU’s role in assisting LDCs in tax matters an issue of key significance. It is not sufficient to provide assistance in training tax legislators and tax administrators, nor to recommend off-the-peg models of transfer-pricing and information exchange à la OECD. Such assistance will not halt the haemorrhaging of the tax base in LDCs through corporate or elite malpractice. It is unlikely, alone, to encourage the development of expertise and a compliant and efficient tax culture. In an environment in which taxation has become a global issue and in which tax avoidance has acquired global, endemic proportions, European states and the EU in particular can assist LDCs by addressing their issues as problems of global rules and global governance and, crucially, as issues of global behavioural norms; this assistance is also highly relevant to the transition states in Europe’s ‘neighbourhood’. There are several courses of action that the EU could and should pursue:

- Acknowledge the centrality of a strong tax ratio as the basis for self-determined statehood and the provision of the public goods vital for economic modernisation.
- Stress the centrality of progressive taxation – above all of income – as the basis for targeted programmes of redistribution, for social justice and political legitimacy; re-establish that principle as the basis of tax policy for all EU MS.
- Regularize the exchange of information on taxation, particularly relating to mobile tax bases, as the first step in a global process of tax transparency; fragmented and inconsistent European practice is no model for regional integration in Africa, Asia and Latin America.
- Promote vigorously the implementation of country-by-country reporting by multi-national corporations as a mandatory basis for commercial activity within the EU, together with the introduction of a Common Consolidated Corporate Tax Base and a minimum rate of standard Corporation Tax which is high enough to discourage income-shifting and incorporation.
- Implement at the earliest opportunity a Financial Transactions Tax within the EU as a means of both dampening short-term speculation (including high-speed trading) and accumulating strategic funds for deployment in Europe’s wider periphery and in developing countries.
- Put an end to the destructive poaching of tax bases by harmful tax competition within Europe as a principle of ‘tax sovereignty’; tax competition ultimately erodes all tax sovereignty; tax harmonisation restores it at least residually.
- End the destructive tax and regulatory arbitrage of MNEs, by making it illegal for European-based corporations to maintain shell company registrations in black-listed security jurisdictions.

Inaction on the above will diminish the image of Europe in the eyes of the citizens of struggling LDCs. It has already been seriously diminished by its co-authorship of neo-liberalism and by its self-serving but contradictory approach to post-colonial conflict and the power hierarchies of the global political economy. By reasserting the virtues of cooperative statehood in its own reform pro-
grammes and promoting the same in its global diplomacy, it can help restore some sense of decency and international solidarity.

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