

# Prosperitas

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## Oxfam's Shoddy Attack on Low-Tax Jurisdictions

*Oxfam, a U.K.-based charity, published a study last year claiming that so-called tax havens deprive developing nations of \$50 billion of tax revenue each year. Supporters of the anti-tax competition initiative of the Organization for Economic Cooperation and Development (OECD) frequently cite this figure in hopes of creating a schism among developing nations. Yet the study is grossly flawed, which explains why even the OECD refuses to endorse its methodology. A large share of supposed foregone revenue – 70 percent, or \$35 billion – comes from a calculation of multinational tax revenues in which Oxfam makes up figures for both corporate profits and corporate tax rates. Foregone taxes on individual savings are claimed to “cost” governments about \$15 billion, but this figure also is based on make-believe tax rates. At no point does Oxfam recognize the pro-growth impact of lower tax rates. Instead, the organization clings to an outmoded ideological affinity for larger government.*

By Daniel J. Mitchell

Based in England, Oxfam originally was created during World War II as a charity “to overcome poverty and suffering.” In recent years, however, the organization has veered into the political arena, adopting simplistic left-of-center views on trade, industry, and development.

Although Oxfam claims to favor policies that will allow poorer nations to compete with richer nations, the organization published a study last year (“Tax Havens: Releasing the Hidden Billions for Poverty Eradication”) attacking jurisdictions that use attractive tax and privacy laws to boost economic development. This study, which argues that tax competition between governments makes it hard for developing nations to collect adequate tax revenues, frequently is cited by supporters of the so-called “harmful tax competition” initiative being sponsored

by the Organization for Economic Cooperation and Development (OECD).

By way of background, the OECD is an international bureaucracy that represents 30 relatively wealthy nations from Europe, North America, and the Pacific Rim. Based in Paris, the bureaucracy published a blacklist of 41 “tax havens” in June 2000. These low-tax jurisdictions are being threatened with financial protectionism unless they agree to change their tax and privacy laws so that it will be easier for OECD nations to enforce their tax systems on a worldwide basis.

The OECD initiative has attracted a great deal of criticism. Economists object to the creation of a cartel for the benefit of high-tax nations. Privacy advocates fear that allowing governments to obtain and exchange private financial data will result in

the creation of what has been labeled a “global network of tax police.”

Another common criticism is that the Paris-based bureaucracy is engaging in fiscal imperialism. For instance, none of the “tax haven” nations that are part of the OECD – such as the United States, the United Kingdom, Switzerland, and Luxembourg – were put on the blacklist. Instead, the OECD list contains only non-OECD jurisdictions, most of which are developing nations and many of which are governed by people of color. Why, they ask, should a bunch of wealthy, white nations be allowed to dictate tax and privacy laws for these less-fortunate regimes?

In an effort to deflect this criticism, supporters of the OECD initiative almost always cite the Oxfam study. Fattening the already-bulging coffers of European welfare states is not really the goal, they piously proclaim. Instead, we are told, the OECD's effort to stamp out tax competition is actually designed to help boost tax collections for the developing world's high-tax nations.

Regardless of whether this claim is plausible, it is clear that the Oxfam study is being used as part of a divide-and-conquer strategy. The European welfare states backing the OECD scheme clearly wish to create a schism between developing countries that have market-based tax policies and those that do not. The wedge issue, not surprisingly, is money. The Oxfam study asserts that so-called tax havens are costing developing nations \$50 billion in foregone tax revenue every year, and high-tax OECD nations are trying to convince poorer nations that they will get their hands on this loot if the anti-tax competition effort succeeds.

But there is one big problem with this strategy. The Oxfam study is total nonsense. The \$50 billion figure is based on methodology that would receive a failing grade in a remedial economics class. The bulk of the \$50 billion, roughly 70 percent, comes from a make-believe calculation about foregone corporate income tax revenue. The remaining amount, based on an estimate of foregone taxation of individual interest income, is almost equally specious.

Some will want to assume that this is a mischaracterization of the study, but the following is a verbatim quote of the relevant section:

“Supposing a rate of return on FDI [foreign direct investment] of 20 percent, and a tax rate of 35 percent, developing countries should be receiving tax revenues of around US\$85 billion a year from foreign corporations. They actually receive around US\$50 billion per year at most. This implies that developing countries as a whole could be missing out on tax revenues of about US\$35 billion a year as a result of tax competition.”

There are so many absurd assumptions in this single passage that it is difficult to know where to begin, but the claim that foreign direct investment earns a 20 percent annual return is a good place to start. Simply stated, there is no evidence to back up this spectacular assertion. If returns were this high, capital would be pouring into developing jurisdictions. Why would investors settle for “paltry” 10 percent average returns in the stock market, after all, when they could earn twice as much money in the third world?

This astounding error is then compounded by assuming that corporate tax rates in the developing world average 35

percent. And what makes this mistake particularly noteworthy is that the previous paragraph – indeed, the sentence immediately preceding the statement above – admits that “average corporate tax rates tend to be much lower than 35 percent in many developing countries today.”

In other words, the Oxfam estimate is based on a combination of over-stated profits multiplied by inaccurate tax rates. If these mistakes are corrected, the \$35 billion of “missing” tax revenue turns out to be a mirage. Indeed, it is quite likely that corporations deliberately make excess tax payments to the developing world. Not because they want to, of course, but because they use transfer pricing and other techniques to avoid declaring profits in OECD nations where corporate rates tend to be higher. In other words, tax competition probably increases corporate tax collections in the third world.

Oxfam's calculation of foregone revenue from interest income taxation is similarly suspect (it appears, incidentally, that Oxfam is referring to all individual income from savings and investment, not just interest income). Again, rather than run the risk of being accused of misinterpretation, the relevant passage is quoted:

“Supposing a rate of return of 10 percent, and a tax rate of 22 percent, tax on interest income from the US\$700 billion in capital flight could be contributing to developing country tax revenues to the tune of around \$15.4 billion each year.”

The rate of return assumption is high, but not unreasonable. As the report points out, sophisticated investors (or, more accurately, their fund managers) can earn 10

percent average annual returns with long-term stock investments. To be sure, most investors and fund managers diversify by including lower-yield bonds and cash holdings in their portfolios, but the 10 percent figure is somewhat defensible.

What is not defensible, by contrast, is the assumption that this savings would be subject to a 22 percent tax. This figure appears to be a complete fabrication. The paper notes that the income currently is usually untaxed, but then blithely asserts that “a tax rate of 22 percent would be reasonable.” The only so-called evidence for this figure is a sentence referring to an abandoned European Union proposal for a minimum 20 percent withholding tax on savings.

The biggest mistake, however, is the assumption that savings is unresponsive to tax. In other words, even if developing nations could stop capital flight, and even if they did levy 22 percent tax rates on interest income, it is completely unreasonable to assume that the same amount of saving would occur. In part, this is because people will save less if the tax code punishes them for saving. Perhaps even more important, capital flight is not motivated solely by tax issues. Many successful people in the developing world are concerned about instability, crime, expropriation, extortion, and kidnapping. They want to protect their family assets, and the choice of a non-tax environment is merely the icing on the cake.

Another serious flaw with the Oxfam study is that it completely overlooks the role of the underground economy. According to a wide range of research at places like the International Monetary Fund, a huge share of economic activity in developing nations takes place in what is sometimes known as the informal economy. Not all of this is tax-

motivated, of course, but a substantial portion is an effort to avoid harsh taxes imposed by governments that are perceived as corrupt. Needless to say, this problem will worsen if tax competition is eliminated and nations start raising tax rates.

Last but not least, Oxfam should have set aside ideology and examined the real world. Even casual observation would have demonstrated that many of the world's most successful developing economies are persecuted low-tax jurisdictions. The 2001 World Bank *Atlas*, for instance, lists OECD-identified tax havens as being the 2<sup>nd</sup>, 3<sup>rd</sup>, 5<sup>th</sup>, 6<sup>th</sup>, 10<sup>th</sup>, 37<sup>th</sup>, 52<sup>nd</sup>, 53<sup>rd</sup>, 63<sup>rd</sup>, 65<sup>th</sup>, 66<sup>th</sup>, and 68<sup>th</sup> richest economies in the world (out of 207). It also is no surprise that there are many OECD nations that also qualify as tax havens, including Luxembourg, the United States, Switzerland, and the United Kingdom, and they are the world's 1<sup>st</sup>, 4<sup>th</sup>, 7<sup>th</sup>, and 29<sup>th</sup> richest nations, respectively.

In conclusion, the Oxfam study does make some good points. Most notably, it exposes the double-standards used by the OECD. According to the report, "OECD efforts to address harmful tax competition have involved a crackdown on small state financial havens, while a far more light-handed approach has been applied to member countries." Oxfam specifically singles out New York City and London as major offshore centers and also wonders why Singapore, Hong Kong, and Switzerland are left untouched.

Yet these statements are tiny kernels of truth in a grossly flawed study. It should come as no surprise that the OECD has refused to endorse Oxfam's methodology. The Paris-based bureaucrats may use the study when trying to convince some developing nations to break ranks with their

brethren, but they are sufficiently astute that they will not sanction the results.

Oxfam has produced an ideological statement, not a research study. The numbers cited in the paper are virtually worthless. All that remains is the usual collection of radical concepts such as giving a multilateral organization the ability to define the tax base, the imposition of unitary (global) taxation of corporations, and the creation of a "world tax authority." Leaders of developing nations, even those that want more money to spend, should not be misled by this report.

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*The Oxfam study is online at <http://www.oxfam.org.uk/policy/papers/taxhvn/tax.htm>.*

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