Strengthening the fiscal capacity of developing countries and supporting the international fight against tax evasion

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Resumen

Avanzar en el proceso de desarrollo exige movilizar de forma más plena los recursos financieros propios de los países en desarrollo. Ello comporta, en primer lugar, mejorar los sistemas fiscales y fortalecer las administraciones tributarias de estos países; y , en segundo lugar, generar un entorno internacional más transparente y cooperativo, que facilite la recaudación de los países y persiga el fraude, los flujos financieros ilícitos y la evasión de capitales. El presente documento realiza un análisis de estos aspectos, sugiriendo diversas medidas de reforma que podrían ser apoyadas desde un marco más activo de cooperación internacional.

Palabras clave: Sistema Fiscal, Administración Tributaria, Cooperación Internacional, Evasión Fiscal, Paraísos Fiscales

Abstract

Making progress on development means mobilising the financial resources developing countries already have in a fuller way. That involves, firstly, improving taxation systems and strengthening the fiscal administrations of those countries; and secondly, generating a more transparent and cooperative international environment, which facilitates countries' tax collection and pursues fraud, illicit cash transferrals and capital evasion. The present document analices those aspects, suggesting different methods of reform that could be supported by more active international cooperation.

Key words: Tax System, Tax Administration, International Cooperation, Tax Evasion, Tax Havens.

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Index

Executive summary 7

1. 1ntroduction 15
   - 1.1. A fuller mobilisation of domestic resources....15
   - 1.2. Creating quality institutions 16
   - 1.3. A legitimate and efficient global government....17

2. Design of tax systems 19
   - 2.1. Importance of the tax system 19
   - 2.2. Main characteristics of taxation systems in developing countries....19
     - 2.2.1 Public income 19
     - 2.2.2 The structure of taxation income 20
     - 2.2.3 Deficiencies in the fiscal systems of developing countries....20
   - 2.3. Remaining challenges 24

3. Strengthening tax administrations....29
   - 3.1. The role of the tax administration....29
   - 3.2. An effective tax administration in the implementation of the tax system...29
   - 3.3. An administration with the tools and resources to fight fraud and tax evasion....31
   - 3.4. A modern, rigorous and efficient social and legal framework 33

4. International fiscal cooperation....35
   - 4.1. Globalisation and tax systems....35
     - 4.1.1 International double taxation....35
     - 4.1.2 Tax competition....36
     - 4.1.3 Tax evasion 37
   - 4.2. International tax cooperation 38
     - 4.2.1 Technical cooperation 38
     - 4.2.2 Legislative cooperation 38
     - 4.2.3 Information cooperation 39
   - 4.3. Institutions for tax cooperation....39

5. A transparent and cooperative tax environment....43
   - 5.1. Illegal financial flows 43
   - 5.2. The cost of maintaining non-cooperative regimes....44
   - 5.3. International response....46
   - 5.4. Proposals for the future 49

Bibliographical references....52

Executive summary

1. THE IMPORTANCE OF THE TASK

There are many reasons why the development agenda should pay greater attention to promoting good governance on taxation. Firstly, if we want to promote development, we need to create the conditions for countries to mobilise their domestic financial resources and make a more efficient use of them, and that means they need more solid and efficient taxation policy, tax administration and public finance management systems; secondly, in order to development countries need legitimate and efficient institutions, an objective that is undermined by the persistence of phenomena such as corruption, capital evasion and tax fraud, which is sometimes encouraged or tolerated internationally; and thirdly, achieving an adequate governance of the international system involves ending grey, non-transparent areas and bad practices in taxation and financial matters. The goal should be to involve the highest possible number of countries in more decisive and efficient action to improve good governance in taxation policy, ending tax evasion and fraud, and favouring transparency and international cooperation.

This objective is fully in line with the Monterrey and Doha Declarations on Financing Development, in which capital evasion and the existence of illicit cash flows were identified as serious obstacles to mobilising domestic income for development. It is also in line with the decisions recently adopted in the EU framework. In particular, in the European Council of General Affairs and Foreign Relations (CAGRE), in November 2008 and May 2009, the Ministers for Foreign Affairs and Cooperation agreed to support partner countries in their efforts to improve their taxation capacity and strengthen their taxation and customs administrations by promoting international conventions against corruption and tax evasion and in favour of transparency and information sharing. There were similar decisions presented by the Council in May 2010 under the title, "Tax and Development: Cooperation with Developing Countries in Promoting Good Governance in Tax Matters". The European Parliament itself, in its resolution of 10 February 2010, urged member States to promote an improvement in OECD standards with a view to making multilateral and automatic information sharing an international norm and it called on the Commission to make progress on drawing up a Common Consolidated Corporate Tax Base with the aim of ending practices associated with transfer costs and tax evasion by mutinationals in the EU.

Lastly, the G-20 tried to tackle these aspects in the framework of reforms to the international financial system, which were seen as necessary due to the crisis. After declaring in London that "the age of banking secrecy is over", it pointed to the OECD as the organisation responsible for determining the list of countries "evaluated by the Global Forum in terms of international norms on exchanging tax information". It also stated the Financial Stability Board to be an important forum for establishing joint policy on matters of taxation, economic transparency and the promotion of financial stability.

In conclusion, making progress in this field is crucial if we want to increase opportunities for developing countries to make progress, reducing levels of dependency on foreign financing (including aid), and if we want to give the international system a legitimate regulatory framework, one which provides greater stability, efficiency and transparency to financial markets. That implies supporting improvements to national taxation systems and administrations and facilitation fiscal transparency and cooperation internationally, ending so-called fiscal paradises.

2. DESIGNING TAXATION SYSTEMS

A good fiscal system is an essential requirement for the progress of nations since it affects the economic behaviour of individuals and determines the capacity of the public sector to promote goods and services and to carry out income redistribution and economic stability programmes. However, establishing a good taxation system is a complex task, even more so in developing countries, which have numerous limitations.

This can be seen both in the size and the composition of their fiscal systems. In fact, the tax revenue share in low-income countries (around 13% of GDP on average) is almost a

third of that of industrialised countries (whose share is 38% of GDP). In those conditions, it is difficult for the States in many developing countries to promote the necessary public services to attain and maintain the Millennium Development Goals. There are also important differences in the composition of respective tax systems with developing countries collecting a higher proportion of their taxes from tax on international trade and on sales and a smaller proportion from income and social contributions.

Developing countries face very diverse problems in creating a capable, fair and efficient tax system: some of them come from the nature of their economies (where agriculture and the black economy are important); others are related to technical and institutional weaknesses in their tax administrations and public management systems; finally, the international framework imposes difficulties, due to the increasing factor mobility, the growing international competition in attracting investment and the persistency of non-cooperative jurisdictions on taxation matters, which encourage capital evasion and illicit capital movements.

If we want to improve developing countries' ability to progress it would seem necessary to support their efforts to establish a balanced taxation system and a tax administration that gives the State the necessary resources to promote public goods that society demands, in order to back essential action for stability and progress and to encourage those social and redistribution policies considered necessary. Developing that capable and efficient fiscal system is a task for each country, its society and its government; however, the international community should support those efforts and establish international norms to make it possible.

In the last few years a large part of the developing world has started reforms to improve tax systems and to adapt them to the new environment of globalisation. The general objectives of these reforms have consisted in increasing income, making tax administrations more efficient and increasing the efficiency of tax collection. That meant introducing reforms to numerous different taxes. Generally, in terms of direct taxation: i) for income tax on individuals, the aim has been to reduce the maximum rates, increase the minimum rates and to widen the tax bases; ii) for corporation tax, the reforms have focused on reducing the number of rates and the maximum rates, with a much less notable emphasis on widening tax bases and improving the design and management of the tax. Reforms to indirect taxation were much more important: i) in the case of taxes on goods and services, general taxes on sales were exchanged for value-added taxes; ii) the weight of taxes on international trade was reduced, due to the generalised process of trade liberalisation; and iii) the tendency has been to reduce the number of selective taxes with hardly any exploration of the possibilities of introducing environmental taxes.

Despite the progress made, these reforms can be considered insufficient, firstly because, broadly speaking, they have all followed a common pattern and the unique aspects of each country have not been taken into account. As a result, the real application of tax reforms has been less intense than expected, with a reverse in the reform process relatively common. Secondly, the reforms have focused on increasing income and improving the efficiency of the taxation process, paying much less attention to distribution matters. The distribution of tax revenue is extremely important, not only because fairness is one of the most fundamental tax principles but also because in developing countries it is crucial to achieve social legitimacy for the public sector. Finally, a third limitation is related to the weaknesses of the existing institutional framework, which manifests itself in limited material and human resources and in the excessive influence of certain social groups in decision-making or in corruption.

Due to all this, despite the reforms undertaken in a large part of the developing world, their taxation systems still have problems, which means more profound change needs to take place. It is clear that every country should define the measures it considers suitable to strengthen its fiscal system in accordance with its specific conditions. However, the following elements should be among those considered in those measures:

• The level of taxation and the adequate design of the tax structure, considering: i) the balance that should be established between direct and indirect taxation, correcting the low weighting of direct taxation; ii) a proper streamlining of tax rates and a clear definition of income levels subject to taxation, avoiding unjustified exemptions and relieves; iii) the areas subject to VAT, which should be as wide as possible in

keeping with the economic structure of the country; iv) a progressive compensation for the loss of taxation collection in trade taxes; and v) an adequate justification of selective taxes.

•The definition of a tax framework that encourages a widening of the formal economy, facilitating the progressive inclusion of registration systems, regulatory protection and fiscal responsibility for informal activities.

•The need to establish a taxation structure adapted to the economic conditions of the country, which favours economic stability, stimulates entrepreneurship, fuels the creation of good jobs and is capable of attracting foreign investment.

•The establishment of a stable and predictable tax system, based on rules, with transparent procedures and limited management costs.

•Finally, the definition of a system that works towards desirable objectives of fairness and promotion of social cohesion.

International organisations and donors can play an important role in the road that still needs to be travelled. On one hand, they can do this through financial and technical aid. On the other hand, they can help ensure the necessary international cooperation so that tax systems meet their objectives.

3. STRENGTHENING TAX ADMINISTRATIONS

The efficiency and fairness of a fiscal system does not only depend on it having properly designed rules; it also needs to have an adequate taxation administration, which is capable of guaranteeing citizens voluntarily pay their taxes and of pursuing fraudulent behaviour and conduct that attacks the Public Tax Office. That means: i) an efficient administration, which is properly organised, well-respected by society and which facilitates the meeting of tax obligations; ii) giving the tax administration the necessary instruments to efficiently combat fiscal fraud, in a world that is as dynamic and changeable as the current one, meaning fraud constantly evolves and takes on new forms; and iii) a social and political framework that is concerned to maintain social cohesion and to defend the State's action in its functions of ensuring citizens rights, attending its needs and applying a fiscal system to the criteria of justice and fairness.

In order to achieve those objectives, it is crucial above all to have integrated organisations (or ones that are well defined and coordinated) for managing internal taxes and those collected by the customs, with close links to the tax administrations at other levels of government and to the social security system. There are also various other reasons why the organisation in charge of tax collection, the taxation agency, should have a different Statute to that of other traditional ministerial departments.

Another key factor for the correct functioning of the taxation administration concerns human resources. Here it is necessary above all to promote stability for the civil servants and workers in charge of managing taxes, in order to guarantee consistent work that is not conditioned by political pressures; secondly, reasonable, incentive-creating and competitive wage levels should be determined and codes of conflicts of interest should be established in order to ensure the professional standards and independence of the tax administration and inspection; finally, workers in the sector not only need to be required to work properly from a purely professional point of view, they also need to be obliged to follow a clear ethical code in this field.

From the point of view of the work to be carried out, a modern tax administration should try above all to distinguish between taxpayers who meet their obligations and those who are breaching the law; secondly, they should be capable of effectively managing personalised and massive taxes. It seems reasonable for the organisation to structure its activity around the types of taxpayers although without losing sight of the need to coordinate the monitoring tasks of the various groups. An excessive specialisation does not seem advisable; rather, the organisation should be capable of making the most of synergies, learning from the experience of multidisciplinary working groups and helping its workers to identify with the fundamental goals of the organisation and its common tasks.

As a general guideline, cooperation should be established with private economic agents. Their knowledge should be tapped, the setting up of clear "rules of the game" that are accepted by everyone should be facilitated and management responsibilities should even be

shared with them when it is appropriate. The work of the agencies should also pay special attention to small companies, self-employed workers and professionals, especially sensitive sectors where important volumes of tax evasion tends to take place.

In terms of taxpayers who do not meet their tax obligations, it is important to draw up rigorous plans of action, using key strategic tools. Plans to fight fraud should be based around a careful programme of the goals of the Tax Agency. They should include: 1) the development of efficient action to dissuade evasive tax behaviour that goes beyond the ordinary business of monitoring and acting on irregular behaviour; 2) a general use of extensive control procedures, based on a systematic use of information available to the Administration; 3) convey to taxpayers, through communication campaigns, the idea that fraud will decrease if the probability of identifying and punishing tax evaders is increased; 4) select the sectors where tax evasion and fraud is most likely, establishing cooperation with other institutions within the Administration that are also involved (police and judiciary); prevent and fight money laundering through specific plans; 6) create specialised units to tackle sophisticated fraud, providing there are the resources for them; 7) make the most of cooperation from the general public in fraud prevention; 8) improve information at the tax office and ensure it uses adequate systems; and 9) improve coordination with the equivalent institutions in other countries and, in general, inter-administrative cooperation.

Educating citizens about meeting their duties as part of the society and about demanding their rights is a fundamental factor in any strategy to tackle fraud. This goal can be achieved through tax education programmes and institutional communication measures favouring the voluntary payment of taxes and dissuading fraudulent behaviour. In turn, the correct functioning of those programmes demands a parallel effort across public services to improve their delivery and make constant efforts to improve the attention given to citizens.

Applying tax regulation is a technical and professional task that should be independent of political debates. It is important to avoid tax administrators being subjected to the volatility of the political cycle or to a change in the political party of the government of countries. The autonomy of the agencies does not mean they are independent or free from democratic controls, but it is necessary for reasons of efficiency, pragmatism and the need to meet the goal of obtaining the maximum amount of possible resources in order to finance public services. For the same reasons, an efficient implementation of the tax system demands a basic stability to the rules and their general application. To achieve that it is not advisable to create expectations about future fiscal amnesties, or moratoria on taxes or unjustified cancellations, except in extraordinarily limited cases.

The implementation of any good tax system is predicated on an efficient, modern and up-to-date code, which is able to spell out at any point in time the remit and penalty system for fiscal crime. The tax code should have a rigorous, but balanced, punishment system, which can deliver reasonable penalties, which means that the sanctions for breaches of the law should not be so severe that they cannot be applied in practice.

Lastly, as well as improving tax collection capacity, it is also necessary to strengthen budgetary planning systems and the management of public spending in partner countries. An improvement in the management systems for public finances, to make them more transparent, efficient and responsible, will not only improve the conditions of governance in countries, it will also improve the management of international aid, which is nowadays very heavily based on budgetary support. The approach of the *Public Expenditure Financial Accountability* (PEFA) is a very useful tool for achieving this.

4. FISCAL COOPERATION

The increase in international economic relations that globalisation has entailed has important repercussions for different countries' fiscal systems. The greater interdependence that is generated between countries on one hand presents important challenges for the design and management of fiscal systems and, on the other hand, means greater cooperation between the various tax administrations is required.

As a result of this greater interdependence between national fiscal systems, a series of problems have arisen that tax administrations must tackle. Among those we can highlight the following problems: 1) the great mobility of

the income to be taxed, which leads to increasing competition between jurisdictions; 2) there are sometimes difficulties in determining where taxes should be paid; 3) the development of new and complex organisational structures in the business world, which makes identifying who should pay what taxes difficult; and 4) an increase in the sophistication of money-laundering and tax evasion techniques.

All those problems have given way to significant changes in the functioning and design of the tax administrations and it fiscal systems. An increasingly globalised economic climate demands a more global approach to tax policy and management. Limitations resulting from action abroad are, if possible, even greater on developing countries, meaning their already restricted room for manoeuvre is reduced further still.

One of the problems resulting from internationalisation is to do with double taxation. In order to avoid that, various alternatives are used. There are unilateral solutions where a country reduces the tax burden on income that has already been taxed in another State. Then there are international agreements, mainly based on two models: the OECD model and the United Nations' model. The first involves applying the principle of taxation by the country where the taxpayer is resident, a principle that disadvantages developing countries since in general they are not the chosen country of residence for multinationals. The second model does give developing countries a greater share of taxation, however, it gives companies a wide room for manoeuvre, which can have an effect on the way taxes are distributed between countries.

Another of the results of globalisation is the intense fiscal competition that started to take place a few years ago with the aim of attracting investment and income to jurisdictions or simply to prevent funds from leaving for more favourable fiscal jurisdictions. Despite the widespread use of these fiscal tools in the developing world, the truth is that empirical analyses are not conclusive when it comes to demonstrating their efficiency to attract foreign investment and the cost of these mechanisms can be high: they reduce the tax base, make tax administration more complicated, generate serious losses in collection and remove income from the tax economy. It is, though, difficult for a country to avoid applying certain tax incentives when others are offering them since that could have negative consequences on investment and productive activity. This becomes, therefore, destructive competition that could only be avoided through coordination between affected countries. International fiscal competition also has important distribution effects since it works on those incomes that move around more, principally on capital.

The other side of the coin is that in order to make fiscal systems more efficient it is increasingly necessary to instigate greater international fiscal cooperation, in three main areas: technically, legislatively and in terms of information. International technical cooperation can be especially important for developing countries trying to improve their fiscal systems, by contributing resources and knowledge. Although there are already a whole series of regional organisations that partially meet this role, their effective capacity is limited. In terms of legislative cooperation, although this is much more difficult to achieve, there are areas where it would be a good idea to do seek to do more: the use of fiscal incentives, the design of new rules to geographically distribute the income and expenditure of multinational companies, a sharing of information between countries, mechanisms of obligatory arbitrage and the development of effective mechanisms to tax the interest received by non-residents are some of the more important potential measures. In terms of information cooperation, we are not talking here about a measure to fight fraud but rather a key piece in the puzzle to maintain the viability of fiscal systems. Despite the increasing importance attached to different national Tax Offices sharing information, there is still a long way to go. It is necessary to embark on a fresh drive towards information swapping since without it the increasing mobility of capital and people could create serious problems for national tax systems.

The multilateral institutions that exist in the fiscal area at the moment are not capable of tackling all these challenges. There are various regional organisations that carry out tax cooperation: The Interamerican Centre for Tax Administrations, the Association of Commonwealth Tax Administrations, the Caribbean Organisation for Tax Administrations, the African Association of Tax Administrations and the Pacific Association of Tax Administrations are all examples. Despite their usefulness in some respects, the remit of their action

is limited. Out of all the non-regional institutions, without a doubt the one that has done the most work to promote fiscal cooperation internationally is the OECD. Some of its initiatives include the *Global Forum on Taxation*, the *Global Tax Network*, involving the World Bank and the IMF, and the *Forum on Tax Administration*. However, it is difficult for countries outside this organisation to feel properly represented by the OECD work, even if they are invited to take part in some of their initiatives. This is the reason why, at the International Conference on Development Financing, the Zedillo report proposed creating an International Fiscal Organisation to include all countries. The tasks suggested by the report for this organisation seem well defined but the chances of this organisation being created are pretty unlikely given countries' position towards such an entity. As long as progress is not made in this field, which is clearly necessary, the greatest achievements here are made in situations of dialogue such as the International Dialogue on Taxation or the Committee of Experts on International Cooperation on Questions of Taxation, created under the umbrella of the United Nations. In any case, making progress in fiscal cooperation that is really multilateral would require the establishment of a new institutional set-up that gives representation and real influence to all countries, including developing countries.

5 A TRANSPARENT AND COOPERATIVE CLIMATE ON FISCAL MATTERS

Part of the tax collection capacity of developing countries has been lost as a result of the capital withdrawals that those countries suffer. Some of those capital withdrawals are associated with legitimate practices that are the result of justifiable decisions from an economic point of view but they are also significant capital withdrawals from developing countries that happen through illicit routes, in order to hide personal wealth or income from the fiscal authorities in the country in question. Establishing the size of this type of illegal transferrals is difficult since their very nature makes them hard for normal registration systems to detect. Even so, investigators have rolled out indirect procedures to estimate their size. Applying these procedures, investigators estimate these illegal transferrals are in the region of 500 and 800 million dollars. It is interesting to determine the part of these illegal financial flows that are associated with the use of transfer prices. Here research also reveals figures of notable size, in the region of between 90 and 160 million dollars.

So-called "tax havens" play a crucial role in sustaining this type of practice: in other words, those countries that welcome international capital by applying zero (or minimum) tax rates and guaranteeing discretion (or limited information) about where those resources come from. As the OECD highlighted, four traits characterise this type of jurisdiction: i) they have a zero or low taxation rate on capital; ii) they have a special tax regime for international companies that use a local base (*shell companies*); iii) they are not transparent about property and have a low level of supervision; iv) they do not exchange information about fiscal matter with other countries and jurisdictions.

The existence of this type of jurisdictions facilitates, through various routes, a loss of resources to developing countries. Estimates on this that have been carried out are approximate, but suggest that losses could amount to around 500 billion dollars (five times the amount of international development aid). This is the result of the failure to tax financial activity based in these locations, which are often the result of capital evasion, of the protection given to multi-nationals to practice abusive transfer pricing and, finally, of the lack of transparency and protection given to resources generated in the black market.

As well as the effects mentioned, there are two others that are extraordinarily important, but harder to quantify. The first has to do with the impact that these havens have on developing countries' tax policies, encouraging a lowering in the tax burden as a supposed way to compete in attracting foreign capital. In any case, their permissive fiscal regimes fuel a "race downwards" in taxation in an increasingly openly competitive world. The second perverse effect has to do with the effect that their non-transparent regimes and defence of banking secrecy has on the construction of an international rule-based system. The mere existence of these countries, with their exceptional regulations, calls into question the universal reasoning that should characterise international rules, generates unjustified discriminations and opens up zones of protection for illicit economic practices (including the laundering of dirty money, embezzlement, fraud, corruption, illegal arms and drug trafficking). It is difficult to consider the construction of a

fair and legitimate institutional framework to organise international relations to be compatible with the existence of these spaces that have been deliberately intended to be exempt from the usual regulations.

Apart from the progress made in these last two years in the fight against tax evasion, fraud and illicit financial flows, there are many who think the measures adopted so far are insufficient, even if they are headed in the right direction. In order to make progress in this field, it is necessary to at least study the possibilities of joint action in the following areas:

• Firstly, it is necessary to achieve general *backing for those regulatory frameworks that would allow progress to be made on illicit economic practices*, such as the *Convention of United Nations against Corruption and the OECD's Convention against the Bribery of civil servants in international businesses*. Similarly, those initiatives that encourage companies to get involved with activities in favour of transparency and that penalise criminal behaviour in international business matters (such as StAR or EITI) should be supported.

• Secondly, it is necessary to *support cases of international cooperation and dialogue on fiscal matters,* in order to encourage shared rules and standards, both globally (such as those promoted by the United Nations and the OECD) as well as those that exist at a regional level.

• Thirdly, it is necessary to make progress on *automatic formulas for exchanging information internationally*, taking the EU rules on tax on savings (Directive 2003/48/EC) as a precedent, but increasing its efficiency.

• Fourthly, it is necessary to *end those accounting standards and regulations that encourage companies to be non-transparent;* and instead modifications should be introduced to the rules drawn up by the IASB *(International Accounting Standards Board*), to encourage multinationals and financial institutions to draw up country by country reports in which they show sales, profits and taxes paid by those companies in all the jurisdictions where they operate.

• Fifthly, initiatives that stimulate the *voluntary contribution of companies to transparency practices and the fight against fraud and corruption* should be encouraged (such as EITI y EITI++, in the extractive industries).

• In sixth place, it is necessary to support the promotion of the abilities of developing countries to identify and fight practices of transfer pricing that are damaging to their collection capacity, and the OECD Guidelines to this effect should be followed.

• Lastly, both the IMF and the World Bank should be encouraged to include information in their *Reports on Observance of Standards and Codes* (ROSCs) on the willingness of countries to contribute to more transparent and cooperative governance on taxation matters.

The measures mentioned above designed to create a more transparent international environment would produce limited results, however, if they are not accompanied by support to strengthen the Tax Administrations in developing countries, as well as their abilities to properly manage public finances and to pursue fiscal fraud, capital evasion and other economic crimes.

1. Introduction

The succession of financial crises that have shaken the international economy during the last two decades show the need to correct two of the imbalances on which the process of globalisation under way has been based. On one hand, there are high levels of sophistication and interdependence attained by the markets, beyond national borders, and yet there is a limited capacity of the international system to generate coordinate mechanisms capable of governing those interdependencies; and on the other hand, there is an imbalance between the distribution of the benefits of globalisation and the assumption of responsibility in relation to its costs. The first imbalance has meant that globalisation has been accompanied by a process of increase in risk, as a result of both the greater probability that episodes of crisis take place as well as because of the wider knock-on effect of their effects because of the possibilities of contagion; the second imbalance causes sections of the planet's population to feel excluded from the benefits of globalisation and existing institutions and coordination organisations are perceived as inefficient or not legitimate, affecting the governance of the international system. Overcoming those problems requires more international coordination, on one hand, and more development opportunities for low-income countries on the other. The theme of this document is based around those two pillars: how to strengthen international cooperation to allow developing countries to make fuller and more efficient use of their possibilities for progress.

Three reasons justify the priority that should be given to tasks to strengthen fiscal capacity and the fight against fraud and tax evasion in the development agenda. Set out in brief terms: i) firstly, if we want to promote the development of poor countries, it is essential to promote and make an efficient and full use of their domestic financial resources, which requires a more solid taxation system; ii) secondly, development requires legitimate and efficient institutions in countries, an objective that is undermined by the persistence of phenomena such as corruption, capital evasion and fiscal fraud, occasionally tolerated internationally; and iii) thirdly, an adequate governance of the international system demands the end of areas where information is less than transparent, where discrimination and bad practices exist in the fiscal, financial and economic sphere in general. The initiative this document discusses aims to tackle these three objectives simultaneously. Let us take a brief look at these three arguments.

1.1. A FULLER MOBILISATION OF DOMESTIC RESOURCES

There is an increasing consensus about the importance that mobilising domestic resources has for promoting development in low and medium-income countries, stimulating and correctly allocating their savings. International financing can be important, but it will always play a complementary role to a country's own capacity to mobilise its own resources. That is why if we want to increase the capacities to finance development it would be a good idea to promote the conditions, both within a country and within the international environment, that are necessary to be able to more fully and efficiently mobilise domestic financial resources. This goal that is always key becomes obligatory at times of crisis like the current one. Two types of action seem necessary to work towards that objective: those aimed at giving the State resources, through an adequate tax system and those aimed at avoiding the loss or waste of available savings.

a) Mobilise domestic resources through an adequate tax system

Promoting domestic savings and investment depends on a complex range of factors. Firstly, the existence in a country of an adequate framework of policies and institutions has an influence, stimulating progress and preserving economic and social stability. Saving means postponing the capacity for expenditure into the future, which means that it is difficult for saving to take place in a context of sharp instability, clear judicial insecurity or high uncertainty. Similarly, a solid and efficient financial system that is capable of stimulating the generation of savings and channelling them into productive uses also affects the mobilisation of domestic resources. At the end of the day, the financial system is in charge of making the most from savings by intermediating between savers and those in need of capital. All that said, in addition to those factors, it is also key to have a capable taxation system, one that is fair and efficient, that rewards savings, stimulates investment and provides the State

with the necessary resources to promote economic growth and the adequate provision of public goods. This was how the Doha Conference on Development Financing understood it. Its declaration highlighted an important task to be the need to: "increase fiscal turnover through modernised tax systems, a more efficient collection of taxes, the widening of tax bases and the fight against tax evasion".

At the moment, tax revenue share in low-income countries (13% of GDP) is almost a third of that in the developed countries (38%). The reforms carried out in the past decade have tended to focus on efficiency and simplicity in management. It is necessary to deepen the reform process, paying more attention to elements of equity and the capacity of the State, so that the State can adopt a more active role in the provision of public goods. Only in this way can we help avoid developing countries depending on resources for their growth that are either highly volatile and selective (foreign investment), or that create difficult commitments for future generations (debt) or that lead to undesirable situations of dependency (international aid). Growth in tax collection ability should be accompanied by a strengthening in the efficiency and social legitimacy of the institutions of governance of a country; and it should be compatible with the stimulation of economic activity and with the promotion of a climate that is favourable to investment.

b) Avoiding the loss or embezzlement of resources

In spite of the efforts a country may make to collect taxes, some of the savings generated may be lost to productive uses. That happens as a result of *tax fraud, corruption or capital evasion.* It is important for countries to strengthen their institutional capacities to pursue these types of practices. Developed countries play a decisive role in that objective. Certain aspects of international regulation and practices help national agents as well as foreign investors to evade their contribution to public taxes in countries that have fragile tax administrations. It is necessary, therefore, to strengthen the fiscal capacity of developing countries and to revise international regulation to avoid the process of open trade and international integration leading to a shrinking in the already weak tax collection ability of developing countries or generating open spaces for evasion, corruption or other types of criminal practices.

1.2. CREATING QUALITY INSTITUTIONS

The second reason to give relevance to this field in the development agenda is to do with the narrow relationship that exists between the availability of a solid tax system and the conditions that are necessary to establish quality government. There are an increasing number of studies that reveal that a large part of poverty traps are linked to problems related to the institutional framework that is available in poor countries. The international community has called on developing countries to make an effort to improve the quality and efficiency of its institutional framework; and a large part of international aid is targeted at that objective. It is difficult, however, for that objective to be achieved if practices such as corruption, the hiding of resources or defrauding the State are tolerated. It is not possible for the institutional framework to be consolidated and to attain necessary legitimacy if it lacks the resources to provide the public goods that society demands or if phenomena of tax evasion, fraud or corruption exist that encourage crime and dilute the collective responsibility of the groups in power.

There are also arguments and some empirical evidence that shows that the way in which the State obtains its resources is relevant to determine the quality of the institutions of the country in question. When the State obtains its income from non-taxation routes (such as through exploiting valuable mineral resources), the effect on the institutional quality is a doubtful one: much of the literature on the "curse of natural resources" tackles this ambiguous relationship (excellently summed up by Ross, 1999; and in relation to the matter treated here, Dietsche, 2007). By contrast, in the case of resources coming from taxes, the underlying fiscal pact creates a more demanding relationship between State and citizens, obliging the State to be more transparent and accountable, which helps to improve the quality of the institutions. The supposed relationship between the solidity of the fiscal pact and institutional quality is founded in the work of Bates (2001 and 2008) and de Tilly (1992), having been analysed more precisely by Moore (1998).

In a recent study, Alonso and Garcimartín (2008) confirm that the existence of a proper fiscal pact is one of the variables that deter-

mine institutional quality[1]. The hypothesis is confirmed through procedures that avoid the problems of the endogenous nature of the relationship (in other words, the double causal relationship) and it holds up to a change in the institutional quality indicators and the composition of the sample. Helping developing countries to attain an efficient and capable fiscal system constitutes a way of helping their ability to create quality institutions.

1.3. A LEGITIMATE AND EFFICIENT GLOBAL GOVERNMENT

The present crisis has shown the need to carry out serious reforms to the international financial structure if we want to preserve stability and avoid a crisis of the magnitude that we are experiencing at the moment in the future. Although there are many fields where reforms are needed, one of them is the need to tackle the presence of non-transparent, uncooperative fiscal regimes. This was neatly summed up in the G-20 meeting in London that declared "the age of banking secrecy has ended" and it was necessary to "take steps against uncooperative jurisdictions including fiscal paradises".

The existence of this type of jurisdiction helps create zones that are protected from international regulation and supervision. This last crisis illustrated the costs of maintaining spaces outside regulatory action in a financial climate that is highly integrated. The costs are not only the effects of regulatory arbitrage that they create, but also the coverage they provide to inadequate business transactions that are outside proper supervision. In the extreme case, this type of regime can create spaces of impunity through which the illegal economy, operations by drug-trafficking networks and even financial terrorism channel their financial activities. Dealing with that problem, therefore, goes beyond the strictly economic field to the conditions of international security.

Despite the G-20 declaration, the truth is that the measures adopted so far, especially those initiated by the OECD, have been a step forward but there still leave room for work towards the creation of an international order that is subject to joint regulation that creates better economic and political security and provides the system with a more balanced framework to distribute development opportunities.

The European Union has also made progress in this field although the advances are fundamentally in terms of declarations. In its conclusions in the Council for General Affairs and External Relations, in November 2008 and May 2009, the Ministers for Foreign Affairs and Cooperation agreed to support partner countries in their efforts to improve their tax collection capacities and to strengthen their tax administrations and customs offices, promoting international conventions against corruption (from the United Nations and the OECD) and against fiscal evasion and in favour of transparency (STAR and EITI initiatives). Additionally, the European Union declared its interest in cooperating in those areas with the Financial Stability Forum and the Financial Action Task Force; it declared its support to complete the *United Nations' Code of Conduct* to make the fight against tax evasion more effective. Additionally, it invited ECOSOC to strengthen its tax committee, including a balanced representation of representatives from different types of countries, with a transparent selection process and a well-defined mandate.

More recently, in the European Council meeting of May 2010 a declaration was approved entitled *"Tax and Development: Cooperating with Developing Countries in Promoting Good Governance in Tax Matters"* which insisted on the need to strengthen developing countries' fiscal systems and various measures were proposed to promote a "transparent and cooperative fiscal environment". That means promotion country-by-country reports as a standard for multi-national companies, stimulating an international system to automatically exchange tax information, in the way that the EU does, to reduce abuse through transfer prices, in keeping with the OECD indications, establishing common criteria for the treatment of non-cooperative investments and jurisdictions and including in the *Reports on Observance of Standards and Codes* (ROSCs) the commitment of countries on the exchange of tax information and their implication in pursuing fraud and other economic crimes.

Lastly, the Resolution of the European Parliament of 10 February 2010 called on the member states to promote an improvement in the OECD standards with the aim of transforming

[1] The other variables are the country's level of development, the social fairness that exists and the level of training of people. See Alonso and Garcimartín (2008)

multilateral, automatic information exchange into the international norm. In this context, the Parliament considered that the Directive 2003/48/EC (the *European Union Savings Directive*), which established the principle of automatic multi-lateral information exchange between countries, constitutes a first step in that direction. Finally, the Commission was called on to make progress on a Common Consolidated Corporate Tax Base with the aim of ending practices associated with transfer prices and tax evasion by multi-nationals on EU territory.

The fact that all these international initiatives have taken place at the same time underlines the importance and opportunity of the task. The importance of the task comes from the effects that a more transparent and cooperative taxation order could have on promoting opportunities for development and stability in the international system; and the opportunity that is associated with the reforms to the international financial system that have to take place after the present crisis.

The present document aims to analyse those aspects, taking two large vectors for the analysis. Firstly, it looks at the measures required to support the strengthening of the fiscal capacity of developing countries which, in turn, involves tackling aspects related to the design and reform of fiscal systems on one hand (section 2), and the strengthening of the tax (and customs) administrations on the other hand (section 3). Secondly, we look at the measures aimed at creating a more transparent and cooperative fiscal order internationally (section 4), which involves tackling the subject of the positions of discriminatory fiscal regimes and un-cooperative attitudes and stimulating measures in the fields of information transmission and promoting transparency (section 5).

2. Design of tax systems

2.1. IMPORTANCE OF THE TAX SYSTEM

A good tax system is an indispensable requirement for the progress of nations since it affects the economic behaviour of individuals and determines the capacity of the public sector to provide goods and services and to carry out programmes to redistribute income and to stabilise the economy. In reality, the fiscal system defines the social contract through which taxes are paid in exchange for representation and citizenship, making democratic governance possible (Tilly, 1992; Moore, 2002). As Ángel Gurría, General Secretary of the OECD, put it at the Conference for Development Financing in 2008: "taxation matters for effective state-building. Bargaining between governments and taxpayers plays a central role in the emergence of democratic governance".

However, creating a good taxation system is a complicated task, even more so in developing countries where there are a series of limitation making that objective difficult: the strength of the informal economy, the large number of very small companies, poor institutional quality, a shortage of tax statistics and the limited development of the financial system. All that, as well as their poorer income, has meant that generally the fiscal systems of developing countries lag behind notably those of developed countries. Firstly, the tax collection capacity of developing countries is notably inferior. Secondly, in terms of the structure of tax revenue, there is a clear bias in developing countries towards indirect taxes. Finally, they are behind in the design of the main taxes.

Despite the fact that in the last two decades a large part of the developing world has started processes to reform their tax systems, there are still numerous problems both generally as well as specific problems with each tax. Logically, the seriousness of each one of these varies from country to country since just as the developing world is heterogeneous so are its tax systems. In the case of the poorest countries the shortfalls are considerable and there is a long way still to go to attain more solid tax systems. By contrast, middle-income countries, especially some of them, have institutional infrastructure and socio-economic conditions that could make the success of reforms possible if the reforms are correctly designed and carried out with sufficient effort. For that to be the case, international organisations and donors can play an important role – through financial and technical aid and through international cooperation on tax matters that is increasingly necessary, given the process of globalisation of the world economy. The greater mobility of capital, the growth of commercial and financial relationships, tax competition and the presence of fiscal paradises demand it.

2.2. MAIN CHARACTERISTICS OF TAXATION SYSTEMS IN DEVELOPING COUNTRIES

2.2.1 Public income

One fundamental difference between the fiscal systems of developing countries and developed countries is that public revenue is notably lower in the first. While the average public revenue as a proportion of GDP reaches about 40% in developed countries, in lower income countries it is less than a third; around 22% in lower middle-income countries and 28% in upper middle-income countries[2]. Nevertheless, it is worth highlighting that the differences between developing countries are very high since there are countries where public revenue hardly reaches 5% and others with very similar levels to those in developed countries.

Although these differences in public revenue follows to a large extent the disparities that they show in taxes, there are also interesting variations in non-taxation income. In OECD countries, non-taxation income makes up a proportion of total income that is noticeably lower than in developing countries, especially in low-income countries. In reality, it tends to be the case that as the level of development of a country grows so does the level of tax revenue, but the non-taxation income does not necessarily grow. Non-tax revenue plays an important role in those developing countries where there are alternatives to taxes to obtain revenue, mainly through exploiting natural resources. Those alternatives can have negative consequences on countries' institutions, given that this is revenue that is often less transparent than taxes and which does not oblige authorities to be accountable in the same way as taxation.

[2] The figures included in section 2 were taken from Garcimartín, Alonso and Gayo (2006).

2.2.2 The structure of tax revenue

As well as the total amount of taxes, there are also important differences in the structure of taxation in developing countries compared to developed countries, even if there are significant differences between each group of countries. Taxes on goods and services (general ones on sales, value added taxes and selective taxes) present a relation to the level of development in the form of an inverted U: in low-income countries those taxes make up 30% of total tax revenue, in middle-income countries they rise to almost 40% and the rate falls to 30% again in the richest countries. It is worth highlighting that the importance of these taxes in middle-income countries is a phenomenon that started in the nineties, since previously they had similar figures to the other two groups.

One of the largest differences in tax structure between the developed and developing world is found in the field of social contributions. Their share in total tax revenue is around 8% in low-income countries and 15% in lower middle-income countries; while in upper middle-income countries they reach a similar level to the level in rich countries, 25% and 27% respectively, although that follows the high proportion of countries from Europe and Central Asia in the upper middle-income group. In fact, the variation is very high within each group especially in low and lower middle-income countries.

Taxes on international trade are another of the traditional differences between the tax structures of developing and developed countries. These taxes are more important in developing countries. While they make up barely 2% of total taxes in high-income countries, in upper middle-income countries they make up about 8%, in lower middle-income countries they make up 14% and low-income countries they rise to 23%. However, the importance of this type of taxes has been notably reduced in all groups over time, mainly due to the process of trade liberalisation that has taken place in many countries. Despite that, there are very acute differences within each group of countries and from a geographic point of view, differences are also considerable between developing countries. The highest level by far is to be found in Sub-saharan African countries (30%).

In terms of income tax, which includes income tax on individuals as well as corporate tax and capital gains, the importance also differs significantly depending on countries' levels of development. While the richest countries make 35% of total taxation from income taxes, low-income countries make 21% from them, lower middle-income countries make 26% and high medium-income countries 23%. Nevertheless, in contrast to what happens with trade taxes, which have fallen in all groups over the years, here, while in high-income and lower middle-income countries these taxes have remained relatively constant, in low-income and particularly in upper middle-income, these taxes have significantly fallen. We can also see notable geographical differences in developing countries, with the highest levels by far in Eastern Asia and the Pacific and the Middle East and Northern Africa. Another traditional difference that existed between income tax in developed and developing countries was that the latter favoured corporation tax, probably because it is simpler to tax companies than individuals. The ratio of taxes obtained from individuals compared to those from companies is around 1.4 for low-income and upper middle-income countries, 0.8 for lower middle-income countries and 3.6 for the richest countries.

In short, we can say that generally in low income-countries, taxes on international trade are relatively more important, with the opposite being the case for income tax. As developmental level increases, international trade taxes decrease while sales taxes increase. Finally, taxes on foreign trade occupy a marginal role as countries develop and income tax becomes more important. However, we should point out that the differences that exist between taxation systems in different countries are not related to their level of income but also to other characteristics such as the nature of their productive and social systems, the importance of the urban population or the exports of natural resources.

2.2.3 Deficiencies in the fiscal systems of developing countries

In the last few years, many countries, both developed as well as developing countries have embarked on tax reforms with the aim of tackling accumulated shortcomings and adapting their systems to the new environment that globalisation has produced. In the case of the developing world, these reforms have been largely promoted by international organisa-

tions and their general objectives have basically consisted in increasing income, reducing budgetary deficits, achieving greater efficiency and improving the tax administration and the efficiency of collection. In reality, the first of those objectives, at least in the initial phase of the reforms, has been the chief goal. In fact, it has been the principle component of the strategies to attain the Millennium Development Goals (MDG) since, for example, one of the recommendations of the 2005 report on the United Nations' Millennium Project was to increase domestic resources by four percentage points of GDP (Sachs et al., 2005).

In terms of specific reforms to the main taxation types, *income tax on individuals* has tended to be an inefficient and unfair tax in developing countries, with its most common deficiencies being the following:

• Firstly, often the number of people obliged to pay income tax has been limited. When it comes to the higher rates of income tax, few individuals were eligible for them, at least formally, while, in the case of the lowest tax rate, sometimes the ceiling exempting individuals from any tax was too high (Tanzi y Zee, 2000).

• Secondly, it was also common in much of the developing world to maintain a high number of tax brackets and high marginal rates, with the aim of making the tax progressive. However, the progressive nature of the tax was in reality limited given the large number of exemptions and deductions available, which benefited the highest income tax bands (exemptions on capital gains, reduced rates for financial income, generous deductions on medical and educational expenses, among others) (Tanzi y Zee, 2001).

• Thirdly, in some developing countries the marginal income tax rate amply exceeds that set for the corporate tax, which encourages taxpayers to pay as individuals rather than as companies for fiscal reasons.

• Fourthly, although income from interest and dividends is a problematic area globally, in developing countries two aspects stand out. In many countries, when interest is taxed it is taxed through a final tax at a rate substantially less than the highest marginal income tax rate. This procedure might be acceptable in the case of recipients of income from work, but when it is applied to recipients of company income it means that it is possible to obtain a significant saving through arbitrage transactions, as well as a potential reduction in interest (Tanzi y Zee, 2001). In the case of dividends, the problem is double taxation and for developing countries it can be preferable, for reasons of administrative simplification, to totally scrap taxes on dividends or to levy them at a relatively low rate, perhaps through a final tax at the same rate as that levied on interest (Tanzi y Zee, 2001).

In view, therefore, of those problems, and following a tendency that also existed in the richest countries, the main measures adopted for reforming income tax for individuals in developing countries has consisted in a reduction of the maximum rates, an increase in the minimum and an enlargement of the tax base. However, these reforms have in many cases proved insufficient and have not been without problems. The lowering of tax rates has, as well as other factors, meant that the proportion of income tax in developing countries has not approached that in developed countries. That is more important in middle-income countries and, especially, in upper middle-income countries where differences to rich countries have notably grown but where there is still considerable margin to reduce exemptions, increase tax bases and, consequently to increase collection (Heady, 2001). Despite the progress made, there is still a long way to go in terms of the discriminations that exist in the tax in terms of the type of income. For example, in many countries, income tax is not global in nature; instead, every type of income is linked to a different tax regime with different rates and numerous exemptions depending on the source of the income (interests, dividends, etc.), which means that in practice almost all the tax burden falls on dependent workers.

Corporate tax is in general terms problematic, or at least complicated, since it is one of the taxes that has undergone the largest number of changes at a world level. Among other factors, the greater mobility of capital, the growth of trade and financial relationships between the various branches and units of the same company and the growing use of this tax as a tool to attract foreign investment have created strong pressure to reform it. In the case of developing countries, the common problems of corporate tax can be summed up as the following ones:

• Firstly, the existence of multiple rates, de-

pending on business sector.

• Secondly, there are inconsistencies in the depreciation systems, with it being common to find an excessive number of categories in goods and depreciation rates which also tend to be excessively low and the structure of which does not respond to the obsolescence rates of the corresponding goods.

• Thirdly, the existence of fiscal amnesties, popular in developing countries because they are easy to administrate. They present numerous drawbacks: they tend to benefit investors who expect large returns more than those who do not and benefit investors who would have made the investment anyway, they incentivise the avoidance of tax payment through relationships between exempt and non-exempt companies, the duration of the moratorium can be abusively extended, by transforming old investments into new investments, the moratoria set for a fixed period promote short-term projects to the detriment of long-term projects and lastly the cost of moratoria is rarely transparent (Tanzi and Zee, 2001).

• Fourthly, abuse by multi-national companies of transfer prices. Although this is a global problem, it is more serious in the developing world because not all countries have adequate legislation in this area and because, since pursuing this area is complicated in practice, still more so for developing countries, given the limited resources that many of them have.

• Finally, an excessive use of fiscal measures have been used to encourage direct foreign investment, which creates two types of problems. The first is that given the *WTO Agreement on Subsidies and Countervailing Measures* bans tax incentives to encourage exports, developing countries have had to or will have to eliminate exemptions from corporate tax in tax-free areas by 2015 at the latest. On the other hand, fiscal competition between developing countries to attract foreign investment has meant sometimes measures adopted have reduced tax income.

Despite the diversity of problems, the reforms of the last few years have focused on reducing the number of tax rates and the maximum rates, with a much more limited focus on widening tax bases and improving the design and management of the tax. In the case of developed countries that has led to an increase in collection, given that despite the lowering in the tax rates, an increase in the tax bases has been produced; by contrast, in developing countries the effect has been a reduction in tax collection since the tax bases have not been changed. In this way, although the nominal rates are very similar, the effective rates differ substantially between both groups of countries. For example, in the case of tax on capital, which includes property, capital gains and profits, the effective rate in Latin America is three times less that that of the European Union (Martner and Tromben, 2004). On the other hand, the old problems stemming from transfer pricing, lack of capital and income transferrals from and to tax havens continue to be serious, not only from a practical point of view, but a good number of countries have still not incorporated norms on them into their legislation.

Indirect tax is the area of tax in the developing world that has undergone the greatest change. In the case of taxes on goods and services, the most significant change has been the replacement of general taxes on sales with value-added taxes. This change has managed to increase the indirect tax base, reduce the number of selective taxes and make the most of the advantages of VAT compared to other general taxes. Among them, the elimination of the cascade effect that existed in former taxes, the disappearance of incentives to companies that reduce the payment of taxes, their neutrality from the point of view of foreign trade, important tax information that they provide and the greater degree of payment of the tax because of its liquidation mechanism. However, despite its clear advantages, VAT presents notable problems in its application, problems that are especially acute in developing countries. VAT is a tax that is complex and costly to mange, both for the taxpayer as well as for the administration. It is often the case, too, that in many developing countries important sectors like services or retail are not subject to VAT. Agriculture is one special case where many governments are incapable of properly levying taxes, and where the importance to total production is high in developing countries. In fact, in the face of this inability, some academics have even suggested taxing the transactions of this sector with the rest of the world (Stiglitz and Dasgupta, 1971; Heady and Mitra, 1982). It is also common for the deduction mechanism to be excessively restrictive, meaning the deduction of the input VAT is denied or postponed, especially in the case of capital goods. This means one of the common worries

about VAT is related to its regressive nature. In order to reduce the regressive nature of the tax, it is common to apply lower rates to those products that play an important role in the purchases of those on the lowest incomes. However, that introduces administrative complexities, which can be excessive in developing countries (Tanzi and Zee, 2001) and there is always a risk that the beneficial rates finish up being used to benefit pressure groups rather than for distribution objectives. Lastly, although VAT is neutral from the point of view of foreign trade, in groups of small countries with a high degree of integration between their economies, it is necessary to harmonise bases and rates.

In short, although the introduction of VAT in the developing world can be seen as positive to the extent that it has replaced poor quality indirect taxation schemes, there are still problems. In many countries it is necessary to expand the bases of the tax, to rationalise rates and make administrative improvements. All that has meant that the compliance rate, expressed as the VAT collected as a percentage of the rate of VAT multiplied by final consumption, is lower in developing countries (Ebrill et al., 2002).

As for *taxes on foreign trade,* their importance has been significantly reduced in developing countries over the last few years. This is not only due to taxation reforms, but in an important way also to the trade policies of the different countries that have embarked on a generalised process of opening up trade, both globally as well as regionally. The adoption of measures such as changing restrictive amounts in customs, reducing the number of restrictions and their average rate or the elimination of export taxes has led to a serious fall in foreign trade tax income. However, these taxes still represent a high proportion of total taxes in the developing world. That is why the reduction in income that has taken place so far and the planned continuation of this process in the future will affect developing countries significantly and, although to a smaller extent, it will also affect middle-income countries. In principle, that should not be a problem since taxes on international trade can be replaced by general indirect taxes, achieving efficiency improvements and even increasing income through increasing the tax base. In practice, however, such a transformation is not simple. While customs duties are easy to collect, VAT is much more complicated administratively. In fact, much VAT income is collected at the border in developing countries, in many cases close to half the VAT collected (Baunsgaard and Keen, 2005; Agosin et al, 2005). The empirical analyses about this replacement of taxes are not very optimistic. Baunsgaard and Keen (2005) point out that developed countries have been able to swap forms of taxation in this way, middle-income countries have achieved 45-50% of the swap and low-income countries do not even reach 30% in the best cases. However, the result depends on the correct design of reform and on reform being accompanied by adequate monetary and exchange policies (Agbeyegbe et al., 2004; Abed, 1998.

When it comes to *selective taxes,* the objective has been to tax goods with negative externalities, low elasticity or, in some cases, for reasons of equity. In developing countries, though, it is common for these taxes to be applied to too many products and their application is not justified by the above reasons, but simply by ease of collection (Tanzi and Zee, 2001). This is why there has been a tendency to reduce their number although there are still a lot of them left. By contrast, in the particular case of environmental taxes developing countries have ample margin left, above all for those that tax fuel, especially since these taxes are easy to administrate, their collection rate is high and they improve the quality of the environment (Heady, 2002).

In terms of *social contributions,* as we have highlighted, the lower importance of them in developing countries is one of the main differences in the taxation systems of developed and developing countries. Nevertheless, there is a dual reality in the developing world in this respect: countries either have non-existence social contribution levels or their level is very similar to the richest countries. That means if we want to increase social welfare coverage it will very probably be necessary to increase social contributions given that resources from other taxes are already limited; in addition, a system financed by social contributions presents advantages to a system financed through general income. Basically, there are two reasons for this: firstly, social contributions are easier to introduce politically since the rewards are more visible and secondly, their administration is simpler since they tend to be applied to salaries without deductions for personal circumstances. Despite this, there are some disadvantages that are worth considering

such as the fact that they increase the cost of labour and they have a limited ability to be redistributive. Both problems should be taken into account in developing countries (Heady, 2002). In the same way as other taxes, the possibilities here differ between countries, and they can be more easily introduced in countries with a certain developmental level where the informal economy is smaller and the management capacity is greater.

2.3. REMAINING CHALLENGES

The deficiencies highlighted above along with the new conditions imposed by globalisation have led numerous developing countries to introduce reforms to their fiscal systems. However, their results have varied (Chu et al, 2000; and Tanzi and Zee, 2000, among others). That is because apart from the traditional problems of the main tax types, there is also a series of obstacles inherent in developing countries that have conditioned their results. Those obstacles include firstly the fact that much of the fiscal reforms carried out in developing countries have been instigated by international institutions or by donors, and so they have been based on an one-size-fits-all theoretical scheme that has not taken into account in many cases the shortcomings of those countries or the particularities of each one of them. The aim has generally been to transplant the design of the taxation systems of developed countries to developing countries, without considering that taxes that work well in the OECD do not necessarily work well in all developing countries (Heady, 2002). Among other consequences, this inflexibility has meant that the actual application of taxation reform has been less intense than expected, with steps backwards in the reform process being relatively common (Tanzi and Zee, 2000).

Another reason for the poor results of many taxation reforms by developing countries in the last few years is that the focus has been on increasing taxes and making the system more efficient, with barely any interest in distributive aspects. That is a real problem not just because fairness is a fundamental taxation principle but also because in the case of developing countries the distributive aspects are crucial to give social legitimacy to the public sector, particularly taking into account the fact that income in the developing world is more uneven than in developed countries. In those circumstances, the redistribution capacity of the developing world's fiscal systems becomes especially important. The studies available show that neither the old systems achieved this function nor do the current ones (Chu et. Al., 2000; Behrman et al., 2000; Moreley (2000).

A third reason for the limited success of the reforms is the poor quality of institutions in the developing world; in other words, there are limited material, technical and human resources in the administration, and phenomena such as corruption and the excessive influence of certain social groups go unchecked. This poor institutional quality has meant that taxation reforms have run up against serious obstacles. On one hand, they have faced problems purely stemming from administrative deficiencies, from the shortage of material, technical and human resources. Managing taxation is a complicated matter and in more than a few cases countries have contradictory legislation, difficulties for the taxpayer in meeting his/her fiscal obligations, poor training of tax administration workers or serious legislative loopholes. Introducing taxes like VAT is only fully beneficial to countries if they are implemented with sufficient administrative capacity; the application of a modern crporation tax requires the necessary resources in the administration to avoid problems like transfer prices or a lack of capital. Without sufficient administrative capital, the results of tax reforms can be very poor. On the other hand, there are serious problems of corruption and tax evasion and the tax reform projects promoted by international organisations have barely referred to this issue, although they have included a certain element of administrative improvements (Barbone et al. 1999).

In terms of fiscal corruption, the forms in which it manifests itself are numerous. The purely bureaucratic corruption that can be mentioned includes the following practices: providing tax exemption certificates to people not eligible for them, eliminating tax data and debts from systems, creating false fiscal identities, manipulating and concluding audits without penalties, facilitating contraband, undervaluing goods or classifying them in different categories to the ones in which they really belong and giving tax rebates on exports that have not taken place (Tanzi, 1999). Examples of political corruption, which according to Bowles (1998) are at least as serious as bureaucratic corruption in many developing countries, include protecting serious tax evad-

ers, making limited checks on civil servants and biased decisions and information control. In fact, as Asher (2001) points out, when it comes to tax incentives, politicians and high civil servants are the groups most connected to corruption while in cases of corruption in trade taxes lower level civil servants are most closely involved. The limited awareness that reforms showed in terms of institutional matters has been changing in the last few years, especially since the Asian crisis of 1997. The IMF, the World Bank and the regional development banks, among other institutions, are prioritising change in this field although, as Rodrik (2000) highlights, this is a long and slow process where knowledge about how to create adequate institutions is still in an elementary phase.

Another of the obstacles that developing country taxation systems have faced and continue to face is the intense competition to attract foreign investment that has led an increasing number of developing countries to offer tax benefits. The success of these incentives in attracting foreign investment looks doubtful (Blomström et al., 2000) but their cost has often been high. Some authors such as Avi-Yonah (2001) have judged these practices to be a destructive taxation competition, but it is difficult to eliminate them because of problems of coordination between countries. The need to find a solution to this problem is more pressing, if that is possible, given that developing countries have to eliminate corporation tax exemptions in tax-free zones by 2015 at the latest. The risk that that will lead to a reduction in tax rates and a fall in income from corporation tax makes international coordination on taxation more necessary than ever (Agosin et al, 2005).

In short, despite the reforms undertaken in much of the developing world, their taxation systems still have serious problems, which make it necessary to deepen reforms and to tackle remaining challenges. Remaining challenges include general ones and others related to selective taxes. General tasks that still needed to be carried out include the following:

• *Increase the ratio of taxes to GDP.* Despite the fact that the amount of taxation is, at the end of the day, the result of society's choices, it seems true that the current level in many countries is too low in terms of the need of public intervention in aspects such as efficiency and fairness. Here it is sufficient to highlight that on average the current situation of developing countries is such that if the proportion of taxes in GDP was increased by one percentage point, the corresponding income would amount to a slightly higher figure than the total mount of income received from official development aid (Aarnes, 2004). It is obvious that possibilities are not equal in all countries but, without a doubt, middle-income countries have sufficient room to act. In terms of fiscal pressure, the distance between middle-income countries and high-income countries is a lot higher than the distance between middle-income countries and the poorest countries. This would not be an easy task but it is a possible one.

• *Change the tax structure.* After the tax reforms undertaken, a strong bias has been produced in favour of indirect taxes, above all in high medium-income countries. Given the level raised through these taxes and if we take into account that trade taxes will probably continue to fall and that some selective taxes are difficult to collect and justify, it is clear that income tax and social contributions will have to be increased. In terms of income tax, there is still a bias towards corporate tax, which means that it will certainly be in terms of income tax on individuals where the greatest changes can take place (although this will not rule out action in other fields), deepening reforms begun and improving aspects of management and control, elements that are no less important.

• In order to make tax systems work better it is necessary to *substantially improve taxation statistics,* among them those related to income distribution, the sources of income, patterns of consumption and the distribution of the tax burden. Only by being aware of the impact of different taxation alternatives can correct decisions be taken. Many developing countries have serious deficiencies in this field, but the cost of making improvements is certainly small compared to the benefits that could be provided (Heady, 2001). In the case of middle-income countries, deficiencies are smaller, as well as the marginal cost of tackling them, so the return from carrying out these improvements is very high. In addition, in this field both international organisations as well as donors can play an important role inexpensively.

• The reform programmes should place greater emphasis on *institutional and distributive as-*

pects. Until now, the main objectives have focused on self-sufficiency and efficiency, but, leaving aside the elements already mentioned – institutional and distributional questions – very significant problems have emerged that have limited the efficiency of the reforms. Firstly, purely from a collection and efficiency point of view, there is a need to strengthen tax administrations and to achieve a better commitment to fight corruption and tax evasion. In this field international organisations and donors can also play an important role, not only by helping to strengthen internal conditions but also by facilitating the necessary international agreements on taxation matters. The second problem is that little emphasis has been given to institutional elements and fairness and this has been pernicious in trying to achieve the social legitimacy needed for tax systems. Often it has been said that the lack of a taxation culture is an obstacle that needs to be eliminated in order to create a solid efficient system in the long-term, but there are grounds to think that, as long as the system is full of inefficiencies, corruption, sectarianism and nepotism, it is difficult for that culture to be created (Fjeldstad and Rakner, 2003).

In terms of the main types of taxes, generally and taking into account the diversity of different countries' situations, the most significant (specific) changes needed are the following ones:

• *Income tax on individuals,* in strictly quantitative terms should play a more relevant role that it does today, since the percentage of this tax as a proportion of total taxes in developing countries not only has not approached that of developed countries but in middle-income countries the distance between their weighting of income tax and that of developed countries has further increased. That explains why while the process of rationalisation of tax rates is rather advanced, there is still a long way to go in terms of tax bases, which must be widened. In order to reach this objective, it will be necessary to reduce the number of tax deductions and exemptions, to reduce differences between taxes depending on income types, to lower minimum thresholds for exempt income, to apply the concept of global income in those countries where it still does not exist and to place a greater emphasis on the fight against fraud.

• When it comes to co*rporate tax,* its basic problem is similar to the problem of income tax: tax rates have been rationalised (although there is still much still to be done) but the problems of the tax bases have hardly been tackled. Elements such as transfer pricing, lack of capital, depreciation methods and fiscal incentives still need profound reforms. For that to be effective, important obstacles should be eliminated. The first has to do with low institutional quality and the capacities of tax administrations: limitations that it is necessary to overcome if achievements are to be made in this field. Given that progress requires time, transitory alternatives can be studied to increase the collection of this tax. For example, a minimum tax could be applied on expected income established in relation to gross sales (Agosin et al, 2005). However, we should insist that these are temporary solutions since such a tax presents allocation and efficiency problems from the cascade effect that is generated (Gómez Sabaini, 2005). Another solution would be to divide taxpayers in terms of their size and characteristics since sometimes it is not a good idea to subject large and small companies to the same criteria and norms. Small companies can be crucial in terms of their number but have a low impact on collection. Therefore, the aim would be to establish a simplified tax declaration and payment system for micro and small companies that includes VAT, corporate tax and social contributions, facilitating the administration and reducing the costs that come from tax breaches and informality (Tanzi, 2000). The second obstacle for corporation tax is to do with the conditions from the foreign climate. The increasing integration of economies, capital mobility and fiscal competition make greater international cooperation on tax matters necessary. In fact, many countries have been reluctant to modernise corporation tax for fear of losing investments or leading capital to leave the country, which has led them to incorporate norms into their laws on transfer pricing, harmful tax competition or to not exchange information. In both respects, institutional improvements and international coordination, developed countries can play a fundamental role, helping developing countries to create modern taxation systems.

• In the *case of VAT,* the taxable base should be widened to the services in those countries where they are still not subject to this tax. Likewise, management of VAT refunds should be improved because poor functioning in this area can generate significant liquidity problems for businesses. On the other hand, ex-

perience seems to suggest that the proliferation of rates with redistributive goals requires an efficient tax administration and a thorough analysis of the effects of the rates. If the system has both, a range of rates may be desirable, but if it does not, it seems preferable to have greater uniformity of VAT rates. Something similar happens with selective taxes. The case of fuels is very revealing because the empirical evidence suggests that while taxes levied on petrol have a high revenue potential and are fair, those charged on kerosene are regressive. Certain selective taxes trialled in developing countries have proved very interesting because, under certain conditions and by being very specific to each country, have shown to have positive effects. One of the most striking examples in this regard is the tax on banking transactions, which has the advantage of being simple to administer, with a high potential collection capacity, it raises taxes from the black market, provides information and has redistributive capacity (Coelho et al. 2001). However, there are also raises serious doubts about the tax's long-term effects because it has a cascade effect, reduces the liquidity of the banking market and creates economic distortions. This type of tax should therefore be studied as a solution to short-term problems and they should only be used on a temporary basis.

• With respect to *taxes on international trade,* what happens to them will depend more on trade policy than on tax policy. The importance of these taxes will probably continue to decline in the future, so the problem lies in finding replacement taxes for the income derived from this income.

In short, despite the fact that developing countries have embarked on a major process of reforming their tax systems, there are still many problems, both general problems and those specific to each tax. International agencies and donors can play an important role in the work that still needs to be done. On the one hand, they can offer financial and technical assistance. On the other hand, they can offer the necessary international cooperation to ensure tax systems meet their objectives.

3. Strengthening tax administrations

3.1. THE ROLE OF THE TAX ADMINISTRATION

The legality and fairness of a tax system depends not only on the adequacy of its regulatory design. This is certainly a necessary condition but that alone is not enough. As Professor Musgrave argued, "a tax system is worth the same as the organisation responsible for applying it." For a tax system to be efficient and to comply with criteria of justice, it is essential for its implementation to be effective and consistent (Diaz Yubero, 2010). To achieve that, the administration of the system should ensure the best conditions to facilitate voluntary compliance with tax obligations and it should have the best means of control to minimise the possibilities of fraud or tax evasion. When this is not done, the incentives for people to voluntarily pay their taxes as they should disappear and only the most honest taxpayers end up paying or those with the least capacity to commit fraud.

As Bird and Casanegra (1992) highlighted, the above considerations attain special significance in the case of undergoing processes of economic development. In that case, say these authors, "tax administration *is* tax policy." The tax system should ensure the fulfillment of two essential requirements: i) voluntary compliance with tax obligations by the vast majority of taxpayers, and ii) the unrestricted pursuit of fraudulent conduct against the Public Tax Office.

Reducing fraud and creating a proper culture of taxation and citizenship requires the fulfillment of three basic conditions. Firstly, it requires the existence of a tax administration that effectively implements the system, is properly organized, socially well-respected and which facilitates the fulfillment of tax obligations. This condition, to varying degrees, has started to be established in many developing countries. Some have invested significant human and financial resources and information on their tax administrations and, in some cases, those administrations have become a role model for the rest of the authorities in those countries.

The second condition consists in equipping the tax authorities with the necessary tools to effectively combat fiscal fraud in a world as dynamic and changing as the current one, where fraud is constantly evolving and acquiring new forms and manifestations, among other reasons because tax evaders change their behaviour in relation to the monitoring systems in place, forcing the government to continuously adapt their strategies.

The third condition is the existence of a social and political framework concerned about social cohesion and defending the State's actions in its role of ensuring citizens' rights, meeting their needs and implementing a tax system based on criteria of justice and fairness. In this context, a key additional factor is a tax code that is consistent, complete and continuously updated.

3.2. AN EFFECTIVE TAX ADMINISTRATION IN THE IMPLEMENTATION OF THE TAX SYSTEM

In many countries, many of the taxpayers meet their fiscal obligations, which means the Tax Administration, concerned to obtain the necessary resources to fund quality public services, should provide the best possible services to facilitate and encourage voluntary compliance. The tax authorities should be responsible for implementing the implicit pact agreed with the citizens to defend their rights and facilitate compliance with its obligations, reminding citizens that public money raised goes entirely towards funding public services and meeting the collective needs of their own citizens.

If we had to determine the main objectives that the tax administration should pursue, they could be summarised as three priorities: firstly, to obtain the maximum resources possible, within the framework of a scrupulous respect for individual rights, in order to finance public expenditure. Secondly, they should continually improve the tax administration's management, ensuring the costs associated with the tax administration are reduced as much as possible. Finally, the administration must use every means at its disposal to mitigate to the extent possible, the indirect fiscal or psychological pressure imposed on citizens.

To achieve these objectives, a first requirement is to have integrated (or well-defined and coordinated) organisations to manage internal taxes and customs duties, with close links to any tax administrations at other levels of gov-

ernment and to the social security system. It is also crucial to have appropriate monitoring and handling of many taxable items, in order to justify their taxation. This is the case for customs valuations, the control of transfer pricing, taking advantage of economies of scale, the monitoring of payrolls and work records, reducing indirect costs borne by taxpayers and other activities.

There are many reasons to justify the organisation responsible for collecting taxes, the tax agency, having a different status to other traditional ministerial departments. The importance of the work, which conditions the activity of other public administrations, makes it a good idea to give the tax administration a degree of autonomy and flexibility in matters of managing human resources, budgeting, finance and recruitment. This greater flexibility, particularly justified from a technical-professional perspective, does not mean the general organisation of the administration is independent or uncontrolled. The defining of this type of agency should be carefully done to avoid creating unfairness in relation to other government departments, and to ensure that it meets the existing monitoring and evaluation requirements for the whole administration.

Over the last few years, various countries in the developing world (Latin America, Africa and Asia) have created semi-independent tax agencies, following the recommendations of international donors and institutions. The results of these tax agencies are mixed. Firstly, they do not appear to have resulted in a statistically significant increase in tax revenue in these countries, at least not as a characteristic that can be generalised. However, it does seem that they have facilitated visible reforms in the ways in which taxes are determined and collected (Fjeldstad and Moore, 2009). More precisely, it is considered that the existence of these agencies has operated as a sort of catalyst to promoting and extending reform (Bodin and Baer, 2006). Although we cannot conclude that the tax agencies are a solution to the many problems existing in the fiscal administration in developing countries, they may be an appropriate way to strengthen reforms and to prevent them from being affected by the pressure of interest groups.

Human resources are crucial to the proper functioning of the tax administration. It is essential to ensure stability for the officials and employees of the organisation dedicated to the management of taxes in order to ensure consistent work that is not conditioned by political pressures. Stability, though, should not be confused with granting absolute job-for-life security to posts. An appropriate balance should be found between stability, mobility and monitoring the performance of those who carry out this work. Similarly, pay is another important factor in ensuring efficient work. Reasonable salary levels, that are competitive and offer proper incentives need to be determined. Finally, once rigorous standards and internal evaluations are ensured, we must demand workers not only do a proper job from a purely professional perspective, but also from an ethical perspective, a particularly important requirement in this field. That involves a faithful observance of codes of conduct developed by the organisation, which are intended to clarify the obligations of employees; it also involves attention being paid to training, the recycling and staying up-to-date with knowledge in the field and the regular attendance of programmed training courses.

Those in a senior position and the main managers of the organisation must also be offered stability. It is very difficult to find examples today of efficient and profitable organisations, whether private or public, which do not guarantee stability for their management posts. In the case of tax administration, as is clear, the directors need to have the trust of the politicians in charge, but in line with the position we have been advocating, it is necessary to put the emphasis on the technical-professional capacity and management of these managers, which means, as far as possible, they must be separated from political upheaval. This does not mean, of course, that they are beyond the established control processes that must be applied with particular rigour in this field. Here, for example, one prerequesite is for senior managers in the organisation to make a declaration of their assets before they assume their public duties and again once they relinquish them.

In terms of the work to be done, a modern tax administration should attempt to first clearly distinguish between taxpayers who comply with their obligations and those who engage in criminal and illegal behaviour and illegal. It should also be able to properly manage personalised and mass taxes. This requires, firstly, the availability of large volumes of information that can be managed efficiently and, secondly, the progressive integration in the system of a

growing number of taxpayers with a high culture of voluntary compliance. This implies, in addition, consideration and respect for taxpayers as citizens of a democratic State that meet their civic duties and should be given special consideration and respect.

It is only possible to have large amounts of information if tax administrations have sufficient, modern and permanently updated IT resources. The digitalisation of information is necessary, particularly for services to assist the taxpayer, control tax returns, make inspections and collect taxes. However, investment in technology is worthless on its own. We must put the resources at the service of the needs of the organisation since having large volumes of information without the ability to manage and use it effectively is of little use. Digitalisation should be used to support the improvement and proper definition of the processes of running the organisation.

In the same vein, the organisation must structure its activity according to the typology, but without losing sight of the need for coordination of the various groups. Excessive specialisation does not seem to be a good idea; indeed, the organisation must be able to exploit synergies, learn from the experience of multidisciplinary working groups and enhance the identification of its workers with the fundamental objectives of the organisation and its overall tasks.

As a general guideline for action, experience shows that cooperation should be established with private economic agents in order to take advantage of their knowledge, to facilitate the development of clear “rules of the game", accepted by everyone, and even, when appropriate, to share management responsibilities with them. It should not be forgotten that companies, and particularly business groups, as well as being major contributors to the system in terms of the taxes they pay, are also partners in the management of personal taxes and suppliers of large quantities of useful information for tax administration.

From another point of view, the work of agencies should pay particular attention to small businesses, self-employed workers and professionals, sectors that are particularly sensitive where significant volumes of tax evasion tend to take place. This is also the area where gross violations of the principle of horizontal equity tend to happen most clearly. Many workers with average or low salaries complain that they pay significantly more in tax than those belonging to the groups mentioned above when the resources of those groups are similar, or even higher. That means it is necessary to clarify the point up to which simplified objective formulas should be set, when they should be updated, and how better tax compliance here should be ensured. It might be a good idea to consider concentrated payment means, such as the single tax payment in Argentina, as a possible way to make progress in this field.

Finally, before completing this section, we should emphasise the importance of tax organisations using modern assessment and supervision models. Here, the experiences tested in various countries of comprehensive assessments based on the contracts-programme methodology could be worth exploring.

3.3. AN ADMINISTRATION WITH THE TOOLS AND RESOURCES TO FIGHT FRAUD AND TAX EVASION

For those who do not meet their tax obligations it is vital to implement rigorous action plans. The aim is to have key strategic tools targeting those who do not pay their taxes, their society dues and whose behaviour damages the interests of public finances. We must also remember that fraudsters and tax evaders are detrimental to the majority of citizens who meet their tax obligations and must bear the burden equivalent to the tax fraud. Fraudsters and tax evaders also introduce an element of unfair competition into the sector in which they carry out their activity, thereby also affecting the country’s economy.

The design of plans to combat fraud must include a careful scheduling of the objectives of the Tax Administration so that such plans are operational and simultaneously guide the actions of the Agency, adapting its internal organisation to the strategy devised. The main areas to be considered in such plans might be:

a.) *Action to deter tax evasion.* Action should be devised that goes beyond the Agencies’ usual controls and monitoring of irregular conduct, such as action to educate citizens on tax matters, which we will discuss later, acts to deter black market activities or more rigorous help to taxpayers, with special attention being given to new entrepreneurs to encourage them to have a correct relationship with the tax administration. The strengthening of the tax

culture of citizens can be achieved through tax education programmes, aiming especially at children and young people, as well as by institutional communication initiatives to promote voluntary tax compliance and deter fraudulent behavior.

b) The generalisation of *extensive control procedures* based on the systematic exploitation of information available to the Administration and on the intensive use of information technology. The resources that tax administrations have today make possible a broad range of action, especially in relation to taxpayers with income eligible for taxation and for correcting errors and breaches in tax returns that are easily detectable. In low-income countries it is possible that the resources available to the tax administrations are limited. International cooperation can play a role in reinforcing national efforts to improve equipment and resources. However, without trained personnel it is difficult, even if these facilities exist, to achieve the desired results. Extensive control procedures, while necessary to facilitate the management of tax breaches, should not become the only strategy for prosecuting fraud.

c) Bring to the subjective perception of taxpayers the idea *that fraud will be less the greater the likelihood that tax evaders are caught and punished.* Consequently, in addition to an effective prosecution and penalty system, that system must also be properly communicated. That will generate direct effects (people and companies deciding to follow the law, sanctions and individual incentives for better compliance) and knock-on effects (social pressure on individuals to meet their tax obligations). Here the tax administrations must define an effective internal and external communication strategy to explain to citizens the necessary nature, the relationship between tax revenues and public services and the main results achieved through public management.

d) The *primary focus* of the communication strategy mentioned should be aimed at the *most reprehensible behaviour,* when the fraudster's behaviour can be described as criminal, or when there are systematic breaches or intentional behaviour, easily perceived as damaging to the public. In such cases, the use of mechanisms to coperate with the police and the prosecution of fraud through the criminal justice system are essential.

e) With respect to the management priorities of the Tax Agencies, the plans should contain a *selection of the sectors that are most likely to breach tax obligations* and to seek to avoid taxes, such as the underground or black market economy or, more specifically, sectors such as real estate, sectors of professionals and self-employed workers, usually subject to objective taxation regimes, or the financial sector, in which phenomena such as tax evasion or money laundering take place. It is also necessary to consider tax "escapes" that result from overlaps or a lack of coordination between different tax collection agencies (in addition to the Tax Office, the Customs Administration, the Land Registry or the Social Security), particularly in relation to taxes associated with foreign trade and indirect taxes in general.

f) In many countries the strategy for *preventing and combating money laundering* becomes particularly important in the face of the proliferation of this type of crimes and therefore money laundering should be given special consideration in plans to combat fraud. Drug trafficking and other illegal activities result in significant money laundering operations, which are often poorly controlled. Again we are facing an area in which international cooperation could be crucial to make effective progressive in developing countries.

g) *Specialised units* should be created to understand fiscal crime cases that are examples of sophisticated fraud using abusive tax planning and tax offense records in cases of fraud involving the use of sophisticated tax planning abuses and anomalous businesses. Despite their complexity, these cases should not be neglected and it is essential to control those who have come to be called *"risky taxpayers."* Cooperation with more established agencies can be extremely useful here.

h) Other preventive actions are necessary for the correct application of the tax system. In this sense it is very important to have *social cooperation in the prevention of fraud.* Cooperation agreements are especially useful in economic sectors in which widespread tax evasion has been observed.

i) *Tax information* available to the tax agencies to combat fraud must be *helpfully structured.* As already stated, this is a fundamental task that should result in a substantial increase in the effectiveness of control. The accumulation of information is often useless if it is not struc-

tured properly. There is a wealth of international experience in structuring information that could be very useful to developing countries.

j) In the light of comparative experience, from *an organisational perspective,* the structure of the Agencies must include a Central Office for Large Taxpayers wholly dedicated to analysing the circumstances, characteristics and degree of compliance of high capacity. The system should also have a Fraud Investigation Unit in charge of analysing the phenomenon and its implications and carrying out practical investigations, with a high level of specialisation. Furthermore, it is essential that the tax authorities establish permanent cooperation with the police, as well as with other tax collection institutions.

k) Finally, as we have been suggesting, given the growing importance of international aspects of fraud, a strategy to prevent and fight tax evasion is increasingly important. To this end, it is essential to *coordinate* with similar institutions in other countries and, in general, to cooperate between administrations, as well as to use maximum risk techniques to prevent fraudulent conduct at an international level. There are increasing calls to consolidate or create multi-lateral organisation as meeting points for experts from different countries and for to design effective strategies to combat fraud. This is a key element at a time like the present one in which increasing globalisation makes it unfeasible to solve the problems of fraud and evasion only with national measures.

3.4. A MODERN, RIGOUROUS AND EFFICIENT SOCIAL AND LEGAL FRAMEWORK

As has been highlighted, educating citizens about their social dues and the rights they are entitled to is a key factor in any strategy to combat the fraud. The question of taxation should be given particular attention because of its undoubted importance for providing services, ensuring security and stability and its implications from the perspective of the concept of citizenship. The strengthening of awareness of citizens of the need to pay taxes can be achieved through tax education programmes, directed in particular at children and young people, and institutional communication measures to promote voluntary compliance and to deter fraudulent behavior.

Education on taxes should take place first and foremost in the general education system itself, though it should not be limited to it. As many developing countries do, it is important to design plans for the various educational levels and for the different segments of the adult population, in order to convey the main messages about the need for tax compliance as a payment for the services received from the public authorities. To reinforce those messages, it is important to transfer timely information about what (and how) the tax administration does on behalf of citizens.

As is clear from the previous reflections, any programme of education or communication is not feasible if public servants do not make a parallel effort, in their different policy areas, on public services, their implementation and constant efforts to improve and provide adequate attention to the public. Fiscal awareness can only be created if citizens know that their taxes are used to finance quality public services that are able to adequately cover their needs and expectations.

From another point of view, we must remember that the application of the tax system is, as mentioned above, a technical and professional task and political debate should, therefore, be left aside. This is a permanent recommendation by the specialised agencies and, in particular, by the OECD. In order to avoid political debate, countries should ensure that the organisations of the tax administration are not subject to the vicissitudes of the political cycle, or to changes in parties in the governments of various countries. The autonomy of the agencies does not imply they are totally independent from democratic controls, but autonomy is justified for reasons of efficiency, pragmatism and to ensure they can properly work towards their goal of obtaining the maximum possible resources to fund public services.

In the field of general law, the tax administration must have sufficient powers to control antisocial behavior. In that sense, for example, the work of the tax administrations is strengthened if all taxpayers have a single tax identification number and if they can access all the sources of income of the taxpayers, following all the legal regulations in force. Bank secrecy, therefore, is consequently not justified since it is not a tool to protect citizens' right to privacy, but more often a mechanism to defend a lack of transparency and to protect the interests of fraudulent behaviour.

For the same reasons as argued above, to maintain a solid tax system there needs to be a basic stability to the regulations and their application in general. That is why it is not a good idea to create expectations about possible fiscal amnesty, payment moratoria or unjustified tax cancellations, or worse still to introduce them, except in very exceptional cases. Although the use of amnesties or moratoria can be tempting for short-term political reasons, such policies generate scepticism and distrust in taxpayers, undermining many of the positive effects achieved with proper educational programmes on tax. A proper application of the tax system, as is the case with other institutions, is based on trust being generated in the institutions and those running them. The use of such exceptions breaks that trust and gestures society towards some of the antisocial and illegal behaviour that was exonerated by the amnesty policies.

Finally, we must recall that at the centre of every good tax system in practice is the existence of an efficient, modern and up-to-date tax code, which is able to establish the scope and penalty system related to tax crime. The tax code should have a rigorous but balanced penalty system, which provides a reasonable punishment system in the sense that the penalties for legal breaches or crimes are not so harsh that they cannot be applied. The code should particularly punish intentional tax law breaches as well as crimes related to concealing information or a failure to meet formal obligations.

In short, preventative and punitive measures designed to punish fraudulent behavior are the two components needed to complement the work of a rational and effective tax administration. Moreover, as we have highlighted, the increasing globalisation of our economies makes it vital for us to take a wider look and for us to explore international coordination mechanisms to all us to better respond to the new problems we are facing in this field.

4. International fiscal cooperation

4.1. GLOBALISATION AND TAX SYSTEMS

The increase in international economic relations that globalisation has brought with it has important repercussions on the fiscal systems of different countries. The greater interdependence which it generates between countries, on the one hand, poses significant challenges to the design and management of tax systems and, on the other hand, it obliges greater cooperation between different tax administrations. In particular, Owens (1993) identifies three main consequences of this increased interdependence between tax systems. Firstly, the mobility of tax bases on income and wealth has increased considerably and, therefore, differences in taxation between jurisdictions have greater consequences. Secondly, for tax administrations it is becoming increasingly difficult to determine and collect taxes on those activities that occur outside their borders. Finally, the modus operandi of these administrations are increasingly complicated, obliging greater coordination with other administrations, both national and international. Moreover, the phenomenon of economic "disintermediation" sometimes reduces the role that certain intermediaries (financial institutions, among others) have played as a source of information (Caamaño and Calderón 2003).

As a consequence of the increased interdependence of national tax systems, a number of problems have arisen that tax administrations have to tackle. Some of them worth highlighting include the following:

• The increased mobility of tax bases leads to increased competition between jurisdictions.

• It is sometimes difficult to determine the place where the taxable activity has taken place or the base of the buying and selling transactions, while transactions carried out through e-commerce are even harder to tax.

• The development of new and complex organisational structures in the business world makes it difficult to correctly identify tax subjects and taxable income.

• The increasing sophistication of the mechanisms of money laundering and tax evasion.

All these problems have led to important changes in the operation and design of government tax and fiscal systems. In particular, it is increasingly necessary to take into account effects from abroad and to enhance international coordination and collaboration. An economic environment that is increasingly globalised makes a more global approach to policy and tax management absolutely vital. Moreover, in developing countries the limited from abroad are, if possible, still greater, which further reduces their already limited room for manoeuvre. The main problems and challenges that globalisation is throwing up in national tax systems are analysed below.

4.1.1. International double taxation

The problem of international double taxation arises when the taxable activity is subject to two different tax laws, so that it is taxed twice. A common case is, for example, double taxation of the income of a particular company, firstly in the country where it has generated the income and secondly in the country where the company is based, due to the application of the principle of residence. As a result, the income is taxed in two different jurisdictions, which means it is being discriminated against compared to purely national income, and that double taxation also penalises international trade and investment.

To avoid this problem, several alternatives are used. On the one hand, there are unilateral solutions where a country reduces the tax burden on income that has already been taxed in another State. This can be done through a tax exemption on the tax base of such income or through a reduction on taxes paid in another country. The second option is easier for the State where the income is generated since the owner recovers all or part of the taxes paid in another country in his country of residence. This difference is important for developing countries when designing policies to attract foreign investment since the exemption in the country of origin of foreign firms converts taxes paid in the country of the investment into final payments.

The second approach used to solve the problem of double taxation is the signing of an agreement between the two countries involved (the country where the income is generated and the residence of the recipient) whereby income is only taxed in one of the countries. There is in fact a network of tax agreements of

this type, affecting developing countries, and based on the *OECD Model Tax Covention,* which means applying the principle of taxation in the country of residence. In principle, it might seem that this type of solution is similar to unilateral measures, in the sense that it eliminates double taxation. However, there is one important difference: it tends to benefit companies' countries of residence. In the case of agreements between developed countries, this is not a serious problem because final income tends to even out since all these countries have multi-nationals. However, this is not so in agreements where one of those involved is a developing country since, in general, they are not the bases for multi-nationals and, although these agreements discuss the taxes to be applied in the country where the income is generated, the agreement struck will depend on the negotiating capacity of each party (Heady, 2002).

That is why the United Nations developed an alternative model which, though based on the OECD's model, contains important differences in the definition of permanent establishments and taxes in the country where the income is generated, which allow developing countries to obtain a larger share of the tax burden. However, despite the improvement that this has made on the model of the OECD convention, the United Nations leaves companies a great deal of room to minimise their tax burden in the country where the income is generated, and it has done little to ensure developed countries cooperate more actively with developing countries in information matters (Michael, 2005).

4.1.2. Tax competition

Another effect of globalisation on tax systems and, in particular, of the increased mobility of tax bases is the intense competition that started a few years ago to attract these tax bases. Countries use diverse fiscal advantages to try to attract investment and income to their territory, or simply to try to stop them moving to more tax-friendly territories.

During the past decade, competition to attract foreign investment has led an ever increasing number of developing countries to offer tax benefits. About half of the 40 developing countries analysed by Keen and Simone (2004) used temporary tax exemptions in 1990 to attract investment, 31% granted tax benefits on exports, 40% used low tax rates and 18% had tax-free zones, in 2001 these figures had increased to 58%, 45%, 60% and 45% respectively. Singa (2006) estimates that there are currently about 2700 free trade areas, spread over 100 countries, while in 1975 there were only 79 in 25 countries.

Despite the pervasiveness of these fiscal tools in the developing world, the truth is that the empirical analyses are not conclusive in demonstrating their effectiveness as mechanisms for attracting foreign investment. Most of the studies conducted before 1990 found that foreign investment is not responsible to differential tax rates (Hartman, 1984; Young, 1988), however, other more recent evidence is contradictory. Some studies conclude that foreign direct investment responds to the tax conditions of the recipient country (Devereux and Freeman, 1995, Devereux and Griffith, 1998), other work, by contrast, indicates that many of the incentives offered by developing countries play only a limited role in determining where multi-nationals decide to settle (Blomström et al., 2000).

Though fiscal instruments exercise a doubtful influence in attracting foreign investment, their cost may be high since they reduce the tax base, complicate tax administration, generate substantial losses for collection and remove taxable income from the tax economy (Gupta and Tarek, 2008). We should bear in mind that tax incentives are not the only subject of importance for foreign investors; they are also concerned about dividend policy and legislation in their country of origin. In fact, if profits obtained in the host countries are taxed by those countries applying a reduction for double taxation, the fiscal benefits offered by the developing countries are not benefiting the companies making the investment but instead the tax offices in their countries of residence, thereby only producing income transfers from state to state (Tanzi and Zee, 2001).

Despite the dubious effectiveness and high cost of fiscal measures to attract foreign investment, it is difficult for a country to avoid applying them when other countries are doing this since that would create significant adverse effects on investment and productive activity. In other words, tax competition ends up having net negative consequences for all countries that implement them, the recipients of the tax benefits being the only ones to gain. This damaging competition can only be avoided by coordination between the countries affected. In

fact, according to Avi-Yonah (2001), developing countries would prefer not to give tax incentives if they could guarantee other developing countries would also refrain from offering them. This is a typical case of "the prisoner's dilemma", where the search for optimal individual results generates an inefficient aggregate result. The problem could be solved, to start with, within the OECD, which is the location of 85% of multi-national companies, by all members agreeing to tax their multinational companies on income earned abroad. In the longer term, a WTO agreement should be reached in order to generalise the agreement and to include both multi-nationals as well as the governments of developing countries. Furthermore, the need to find a solution to this problem has become, if possible, more urgent given that developing countries need to eliminate corporation tax exemptions for tax-free zones by 2015. This is very important for areas such as Central America, where companies established there made up 26% of total employment in the manufacturing sector in 2001 (Gómez Sabaini, 2005).

The other drawback to international tax competition is that it affects those incomes with greater mobility, in other words mainly capital gains, since income derived from less mobile factors such as labour is much more difficult to qualify for the incentives offered by other jurisdictions. This has important consequences on the distribution of the tax burden. Firstly, it affects productive factors since it is much easier for capital income to take advantage of tax benefits. Secondly, it affects the distribution of the tax burden on taxpayers since it also easier for large companies, with a greater international presence, to benefit from this tax arbitrage. Finally, it affects personal income distribution since it is often easier for individuals with high income to take advantage of international fiscal competition.

Thus competition may not only have a negative impact on total government revenue, but also on the distribution of the tax burden. This is more problematic in developing countries, since their tax administrations have fewer resources to design and implement an efficient and fair tax system and income distribution within those countries is generally less equitable. All this undermines the legitimacy of the State and the underlying fiscal pact while weakening the institutions of the countries.

4.1.3. Tax Evasion

Apart from the difficulties created for tax systems by harmful tax competition, those difficulties also undermined the revenue capacity of the systems to combat tax evasion. Over time, tax evasion strategies have been developed, both at an individual and company level, which are increasingly complex and difficult to pursue. Among these, due to their volume, we should highlight the use of transfer prices by multi-national companies in internal operations, in other words between subsidiaries of the same group located in different countries. The setting of different prices to the market prices in these operations allows the shifting of profits across jurisdictions, from those where the tax burden is higher to those where it is lower. In this way, the total tax payment is minimised.

Although this is a global problem, in the developing world it is more serious for several reasons - Firstly because not all countries have adequate legislation on this subject; secondly, because even in those countries where such practices are banned, pursuing such practices is difficult in practice, given the limitations of developing countries' tax administrations. Finally, it is more serious because an effective fight against this type of operation requires collaboration between tax administrations that tends to be lower in developing countries.

Another major problem that reduces tax revenues in developing countries refers to revenues from the exploitation of natural resources. Frequently, contracts signed by companies to exploit those natural resources do not generate the desired benefits for the country that owns those resources. This is either because they are signed to benefit certain elites rather than the whole nation or because the countries lack bargaining power and the ability to monitor the compliance of signed agreements. The *Extractive Industries Transparency Initiative* was launched to correct these problems, among others. Although this initiative has been a step forward in achieving greater transparency in payments by companies to governments, its voluntary nature notably limits its effectiveness[3].

[3] The Extractive Industries Transparency Initiative was created in 2002 at the World Summit for Sustainable Development, and came into force in 2005. Its objective is to increase the transparency and accountability of these industries. Participation in the initiative is voluntary both for countries as well as companies.

Finally, as well as the problems of corporation tax evasion, we must add those of individuals. The increased mobility of capital, technical advances and tax competition - including that from tax havens - have facilitated the concealment of income from tax authorities. Again, although it is a problem that affects all countries, it is more acute in the developing world. There are several reasons for this: firstly, because tax revenues are inherently more limited, secondly, because they have less technical capability to pursue such practices and, finally, because evasion is not only a loss of revenue but also introduces regressivity into the tax system. Tax evasion is easier for high-income individuals to carry out; and, in general, developing countries have a less equitable income distribute that helps facilitate tax evasion.

4.2. INTERNATIONAL TAX COOPERATION

As argued in the previous pages, the process of globalisation has created greater interdependence between the tax systems of different countries, which inevitably limits national capabilities and autonomy in tax design and management. That is why greater international tax cooperation is required to increase the efficiency of these systems. It is true that this cooperation may involve a loss of fiscal sovereignty and autonomy, which will increase the more coordination is achieved. However, it is worth remembering that globalisation has already seriously reduced sovereignty (Caamaño and Calderón, 2003). This necessary increase in international tax cooperation should take place in three areas: technical, legislative and information.

4.2.1. Technical cooperation

Technical cooperation may be particularly important to improve tax systems in developing countries. Among other aspects, many of these countries' tax statistics are very poor, which hampers the assessment and design of tax policy. Without adequate knowledge about income distribution, sources of income, consumption patterns or the distribution of the tax burden, it is difficult to design and evaluate a good tax system. Solving the problems of tax evasion and the use of transfer pricing also requires greater technical capacity than that which many developing countries currently have.

Greater international cooperation can contribute resources and expertise to developing countries. We should make clear that there are already a whole range of regional organisations that partially fulfill this function: the Inter-American Center of Tax Administrations, the Commonwealth Association of Tax Administrators, the Caribbean Organization of Tax Administrators, the African Tax Administration Forum and the Pacific Association of Tax Administrators. However, their capacity is limited, mainly for two reasons (McCloskey, 2002). Firstly, the focus of these organisations is practically limited to the tax administrations and they hardly tackle fiscal policy at all. Secondly, many of these organisations have a limited technical and financial capacity, which limits their operational capability. It therefore seems necessary to introduce greater support from international agencies and developed countries, but avoiding the frequent duplication of effort that has occurred in the past.

4.2.2. Legislative Cooperation

Regulatory cooperation represents a significant step forward to purely technical cooperation since it is not only much more difficult to achieve, but can entail a significant loss of autonomy. Owens (1993), for example, identifies the following areas where greater coordination would be desirable:

1. The establishment of common guidelines on the use of tax incentives.

2. A gradual convergence on income taxes and capital taxes.

3. The design of new rules to geographically distribute the income and expenditure of multi-national companies, which in turn implies new agreements on transfer pricing.

4. The establishment of a new framework for the exchange of information between countries.

5. The establishment of binding arbitration mechanisms.

6. A more multi-lateral approach to the whole network of existing bilateral agreements.

7. The development of effective mechanisms to tax the interest received by non-residents.

In addition to these measures, others have defended the need to further involve the private sector. For example, some argue for an obligation for auditors to communicate transfer pricing practices by multinational companies or demand greater corporate social responsibility on tax matters.

As can be seen, these measures are complex and require a strong spirit of cooperation from the various countries. Although there are examples of this cooperation, such as the savings directive of the European Union, it is difficult to reach international agreements that involve some relinquishing of sovereignty. However, it should be noted that in other areas such as trade, progress has been noteworthy.

In addition, there are two additional problems that should be considered (Caamaño and Calderón, 2003). The first concerns how to provide measures of a coercive character. The second refers to the legitimacy attached international legislation since the regulation is not drawn up by a national parliament, but by representatives of States in the context of a multilateral organisation.

4.2.3. Information Cooperation

As a result of the globalisation process, the long-term survival of existing national tax systems makes intense international tax cooperation in matters of information also vital. It is not only a means to combat fraud, but is a key to maintaining the viability of tax systems (Calderón, 2001).

This need for cooperation in information exchange was stated in the recommendations of the *OECD Report on Harmful Tax Competition* 1998. Subsequently, the OECD report of 2000 on *Access to Bank Information for Tax Purposes* developed this initiative in greater detail, with the aim of improving the efficiency of information exchange between the countries belonging to this organisation. The aim of these moves was to remove legal barriers to information exchange, and, secondly, to remove the practical difficulties that undermine the effectiveness of such exchanges. Thus, among the measures being promoted that are worth highlighting are the carrying out of simultaneous tax audits by tax authorities in different countries on the same taxpayer, the standardisation of language and formats in the automatic exchanges of information and the necessary changes to national legislation so that the definition of money laundering includes all its serious manifestations.

The momentum of the OECD and other international organisations has spawned an entire network of agreements on exchange of information between tax administrations. However, as the need for information exchange between territories has increased, these agreements have been reducing the for those administrations to acquire the information they need (Dean, 2008). In fact, there are still many barriers to cooperation between tax administrations and groups fighting money laundering in a country (banks, lawyers, auditors, etc.) and foreign tax offices. As well as the simple negatives to cooperation, it is also worth noting the requirements of reciprocity from various countries in meeting a request for information or the secondary interest of national administrations – that already have limited material and human resources - in answering a request from a foreign tax office.

In short, despite the growing importance of cooperation in terms of information between the various national tax offices and the progress that has been achieved, there is still a long way to go in this regard. It is necessary to give fresh impetus to information exchange. Without it, the high mobility of capital and people made possible by globalisation could create serious problems for national tax systems.

4.3. INSTITUTIONS FOR TAX COOPERATION

As noted, there are several regional organisations that carry out cooperation on taxes: the Inter-American Center of Tax Administrations, the Commonwealth Association of Tax Administrators, the Caribbean Organization of Tax Administrators, the African Tax Administration Forum and the Pacific Association of Tax Administrators. However, despite their usefulness in certain areas, their remit of action is limited. Firstly, they are limited due to their technical capacity and, secondly, because the need for fiscal cooperation goes beyond the regional sphere. The exchange of information, regulatory cooperation and technical assistance needs to move into a multilateral framework (Owens, 1993).

However, the multilateral institutions which currently exist are insufficient. The non-regional multilateral organisation that has probably worked most actively in fiscal coo-

peration is the OECD. Although this is an organisation whose members are developed countries, in recent years it has shown a more inclusive will, seeking to extend its work on tax cooperation to developing countries. It has developed a series of global initiatives, most notably including the *Global Forum on Taxation,* a framework of dialogue for both members and non-members, the *Global Tax Network,* which includes the OECD, the World Bank and the IMF, the work of which has been limited almost exclusively to technical cooperation and assistance, or the *Forum on Tax Administration,* composed of members of the OECD countries and certain countries outside the organisation.

However, despite all this, it does not seem possible for the OECD to become a truly global body (Avi-Yonah, 2000). This is due to several reasons. Firstly, the interests of developed and developing countries are very different; for example, when it comes to taxation on foreign investment. Secondly, the agenda at OCED meetings is determined by member countries, which gives rise to a continual complaint from developing countries that certain topics they are interested in remain outside discussions; for example, income deposits from residents of certain developing countries in developed countries or the limited cooperation of developed countries in information exchange (Horner, 2001). Thirdly, there is an important problem of representation of developing countries when it comes to the most important OECD initiatives; for example, in the *Global Forum on Taxation* the participation of non-members is by invitation only.

For all these reasons, it would seem that basing a truly multilateral fiscal cooperation on the OECD is not the best option and it is necessary to create a new institutional framework to correct the main problem of the OCED: its lack of representativity and real influence for developing countries (Horner, 2001). In fact, for this author, tax issues for the developing world are inseparable from the development agenda and we need a new organisation to incorporate this vision of fiscal policy.

In this regard, various proposals have been made, including the most ambitious by the International Tax Organisation proposed by the Zedillo Panel as part of the initiative associated with the International Conference on Financing for Development. This initiative, sponsored by the United Nations, began in 1999 with the aim of proposing new formulas for financing development and the Report published in 2001 included tax cooperation as a key element in the recommendations, including the creation of the International Tax Organisation. This would be in charge of:

1. Compiling statistics, identifying trends and issues, publishing reports, providing technical assistance and being a forum for the exchange of ideas and development of standards for policy and tax administration.

2. Monitoring tax systems in a similar way to the monitoring carried out by the IMF on macroeconomic policies.

3. Negotiating with tax havens in order to persuade them to cease activities amounting to unfair tax competition, and to try to curb tax competition designed to attract multinationals.

4. Developing procedures for arbitration in tax disputes between countries.

5. Sponsoring a multilateral mechanism for information exchange aimed at reducing tax evasion.

Despite these recommendations from the Zedillo Report, the creation of an International Tax Organisation seems neither easy nor immediate. To date, the implementation of the International Tax Dialogue is probably the greatest advance in the matter. It is a partnership between the World Bank, the IDB, the European Commission, the IMF, the OECD and the UK's Department for International Development (DFID), which aims to promote the discussion of tax matters between national tax authorities, international organisations and other interested agencies. We should also mention the Committee of Experts on International Cooperation in Tax Matters, established within the United Nations, dating back to 1968, which took its current name in 2004. The Committee comprises 25 members from developed and developing countries and its mandate has been extended several times. It is now responsible for examining aspects related to transfer pricing, mutual assistance between countries, international agreements, taxation on financial assets, aspects of taxation related to trade and taxes on electronic commerce.

However, the creation of an International Tax Organisation is not the only proposal to develop a more multilateral tax structure. Several

authors have highlighted other more modest proposals as a more realistic way to increase international cooperation. For example, Avi-Yonah (2000) believes that the WTO could partly fulfill the task of increased international tax coordination, especially when tax and trade issues are so closely related. Furthermore, the WTO has extensive experience in resolving disputes between countries, a crucial issue for taxation. That said, in order for the organisation to deal with tax issues, the number of experts in the WTO should be increased. Another factor that would have to be considered in relation to the WTO, is that developing countries have always expressed concern that increasing the agenda of the WTO could become a means for developed countries to slow down discussion of issues of interest to the developing world.

Other authors consider that there is room in the current institutional framework to deepen multilateral cooperation, at least until the creation of a true international tax agency. For example, among the various proposals are measures to improve the present system of bilateral agreements through greater uniformity in their design and interpretation or through the promotion of greater accountability in the private sector through international codes of corporate social responsibility in tax matters.

In fact, the limited progress made towards the creation of an international institutional framework to enables greater coordination illustrates the complicated nature of the task. Tanzi (1996a), although advocating the need for an international tax organisation (Tanzi 1996b), admits the difficulties involved due to the reluctance of countries to cede sovereignty, a fact amply illustrated, according to this author, by the EU experience. This will be the case to an even greater extent in the international community where countries with markedly different developmental levels co-exist, meaning they will have very diverse interests and problems.

5. A transparent and cooperative tax environment

As we have seen, in order to improve the revenue capacity of developing countries, it is not enough to improve their tax systems and strengthen their tax administration. It is also necessary to foster international cooperation in order to avoid, above all, certain behaviour by economic agents that can be detrimental to the revenue capacity of the countries involved and we must review international standards on places that encourage tax bases to be hidden because of discriminatory taxation.

5.1. ILLEGAL FINANCIAL FLOWS

Part of the revenue capacity of developing countries is lost as a result of capital flows from these countries. Some of the capital that flows out of developing countries is associated with lawful practices that the result of justifiable result of decisions from an economic point of view. The desire of investors to diversify their portfolio to avoid risk, to stay ahead of regulatory changes, or to optimise yields, among other factors, drive this kind of behaviour. However, there are also significant capital outflows from developing countries through illegal channels, with the purpose of concealing wealth or income from the tax authorities of the country. More generally, illegal financial flows can be defined as "the cross-border movement of money that is illegally earned, transferred, or used" (Hollingshead, 2010). Often this type of flow has its origin in activities that are illegal in themselves, such as smuggling, corruption, economic crime or other criminal practices. One component of such flows is associated with transfer pricing *(trade mispricing):* that is, the deliberate use in international trade of invoices containing distorted prices for tax evasion purposes.

Determining the extent of such illegal flows[4] is difficult since their very nature makes them invisible to normal registration systems. Even so, researchers have carried out indirect procedures to estimate their size. In particular, and in a very general way, three types of estimation procedures have been mainly used, which are not necessarily mutually exclusive: i) first, the model of speculative capital *(hot money),* which associates illegal flows with errors and omissions from the balance of payments of the country in question, with some appropriate adjustments; ii) second, the so-called residual model, which determines the financial flows as a contrast between the sources of funding in a country and the registered use of these flows (outflows and capital expenditures); and iii) thirdly, the model which determines the transfer prices, which compares a country's exports with the imports recorded in the rest of the world from this country, after the costs associated with freight and insurance has been deducted. These procedures to estimate the figures can be supplemented by the use of surveys that can contribute information from a well-selected sample.

Applying the last of the above methods, the Baker (2005) survey estimates that illegal financial flows from developing countries transferred between 539 and 778 billion dollars in 2005. This is a significant amount that is between five and seven times the sum mobilised by all donors giving international development aid to developing countries.

Three years later, Kar and Cartwright-Smith (2008) undertook an investigation to determine the magnitude of financial flows during the period 2002-2006, based on the indirect procedures referred to above. Three interesting conclusions can be taken from his estimate:

• First, it confirms the scale of illegal financial flows estimated by Baker (2005) given that the figures offered for that same year ranged between 675 and 806 billion dollars.

• Second, the data suggests an increase in the amount of illegal financial flows, which seems to have increased from the more modest estimate of 371 billion dollars to 858 billion between 2002 and 2006, and, if take a less limited estimate, the flows rose from 435 to 1,060 billion dollars. Beyond statistical factors, it is clear that deregulation of capital accounts and the intensification of international financial flows, in an environment of economic growth, help explain this trend.

• Third, Asia is the region where such flows are most significant, playing a striking role in China, India, Malaysia, Indonesia and the Philippines. Europe is the second most important

[4] As the reports *Global Financial Integrity* correctly state, the term "illegal financial flows" is preferable to "capital leakage". The latter expression appears to suggest that the problem is based in the developing countries themselves that allow such "leakage" to take place; on the contrary, the first term emphasises the illegal nature of the action of the economic agent that is benefiting from such practices.

region for them, with a significant role in Russia. Behind them are Latin America, the Middle East, and in the last position Africa. It is quite possible that in the latter case the figures are undervalued as a result of deficiencies in registration systems.

The estimated figures for all the illegal financial flows match those obtained in studies on specific countries in terms of magnitude. Such is the case, for example, of the study by Zu, Li & Epstein (2005) on China, of Almounsor (2005) on Saudi Arabia, Loungani and Mauro (2000) on Russia, and Chipalkatti and Rishi (2001) on India.

It is interesting to determine the amount of these illegal financial flows that are associated with the use of transfer pricing. Here there are also several possible approaches. For example, Christian Aid (2008), in a study by Cobham, applied the rate that Baker (2005) attributed to transfer prices to the trade of each group of developing countries; and that amount was related to the taxes collected associated with the respective corporation taxes. According to this procedure, the estimated revenue loss associated with this type of practice is close to 160 billion dollars a year. In a subsequent study by this same NGO, conducted by Pak, in which the differences in quality of the exchanged goods was taken into account, the estimated tax loss to developing countries was put at 122 billion dollars (Christian Aid, 2009).

Hollingshead (2010) used information provided by the IMF *(Direction of Trade Statistics)* on the discrepancies in assessments of trade between the partners and the World Bank residual model, which captures the discrepancy between the sources and uses of funding received by countries. The estimates obtained from these sources are compared to the tax collection that countries make from corporation tax, which is taken from the *Index of Economic Freedom,* prepared by the *Heritage Foundation* and the *Worldwide Tax Summaries* database created by *PricewaterhouseCoopers LLP.* Applying this procedure, which is only an imperfect estimation, the tax losses to developing countries by way of transfer pricing is estimated at between 98 and 106 billion dollars, as an average for the period 2002-2006. This represents a loss equivalent to 4.4% of total tax revenue in the developing world. This figure is an average for the countries, with some places recording estimated losses exceeding 25% of revenues (as is the case of Zimbabwe, Nicaragua, Democratic Republic of Congo).

Just as with illegal flows, this component has also undergone significant growth over the period. In fact, the most modest estimates show losses to tax offices as a result of transfer prices rising from 63 to 125 billion dollars, between 2002 and 2006; and the larger estimate puts the figures at 68 and 135 billion dollars. These figures are very striking, exceeding the resources that developing countries receive in international aid.

5.2. THE COST OF MAINTAINING NON-COOPERATIVE REGIMES

Despite the tentative nature of the above estimates, they are sufficient to confirm that illegal financial flows are a significant source of loss of resources and tax collection capacity for developing countries. This was recognised by both the Monterrey Consensus and the Doha Declaration, which consider tax evasion and illegal financial flows to be one of the ways in which developing countries are drained of their own resources. So-called "tax havens", those countries or territories that welcome international capital, by applying zero (or minimum) tax rates and ensuring discretion (or a lack of transparency) about the origin of resources, play a crucial role in maintaining tax evasion and illegal financial flows.

There is no single criterion to define tax havens. In fact, some authors prefer to use alternative names to identify them, for example, "*off-shore financial centres,* "*secrecy jurisdictions", "uncooperative jurisdictions"* or discriminatory fiscal jurisdictions. Each of these names points to some of the features that characterise such places. The OECD (1998) identified four features to characterise them, namely: i) they have low or no taxation of capital, ii) they have a special tax regime for international companies located in them *(shell companies),* iii) they have no transparency on ownership and a low level of supervision; iv) they do not exchange information on tax matters with other countries and jurisdictions.

Given the diverse nature of the concept, even the very status of a tax haven country is subject to debate, with some countries considered as such by some analysts but not registered as such by the OECD (the largest discrepancies

are between the NGO *Tax Justice Network,* which defines 72 jurisdictions as tax havens, compared with 40 recognised by the OECD in 2000). In fact, the OECD proceeded to correct its own list of uncooperative jurisdictions defined in 2000[5], in accordance with the extent to which countries subscribed to the standards of transparency and exchange of tax information.

Besides the number of them, tax havens distort the regulatory framework governing international business. The main negative implications of these jurisdictions arise from the fact that they: i) have discriminatory tax systems that give favourable treatment to those foreign companies that set up in the country without any intention of conducting business in the country (or destination) in question *(a ring-fenced tax system),* and ii) they maintain secrecy with regard to property, transactions and the results of the businesses located there. It is the combination of these two elements which makes tax havens particularly harmful to the proper governance of the economic system, with the most severe costs to developing countries.

To appreciate the implications that the existence of these places operating discriminatory tax regimes imply, we should consider their ability to attract resources from the developing world. To underline some approximate figures, the Bank for International Settlements noted that offshore assets included in the balance sheets of banks were in the region in 2004 of close to 4.6 billion dollars (0.9 in the Caribbean, one in Asia and the remainder, 2.7, in offshore financial centres). Since total deposits in that year were valued at 14.4 billion dollars, that means that one third of these assets are offshore. It is worth noting that this estimate only considered assets in the form of bank deposits, not other types of assets.

For its part, the firm Nerril Lynch/Cap Gemini estimated in 2002 that the value of the estates of wealthy individuals in the world (in other words those with liquid assets worth over one million dollars) amounted to 27.2 trillion dollars, of which 8.5 trillion (approximately one third) were offshore assets. In 2003, the Boston Consulting Group estimated the wealth held offshore internationally to an amount very close to that, $9 trillion. Finally, the NGO network *Tax Justice Network,* in 2005, raises those figures to 11.5 billion dollars. Moreover, in this last case, the NGO considered these figures, expressive of a particular way of amassing and maintaining wealth, to be subject to a dynamic of rapid growth. In short, if we take these studies as a guideline, it seems plausible to accept that we are talking about assets in offshore centres reaching 8 to 12 billion dollars.

If we assume these figures to be correct, the revenue lost by the affected countries as a result of their inability to tax such assets is very high. *Tax Justice Network* itself (2005) evaluates the revenue lost, which could have been taxed at 225 billion dollars a year, result from applying a 30% tax on income (in other words, around 860 billion dollars).

FitzGerald (2010) provides a new estimate, rebuilding foreign assets from the flow information provided by *Global Finance Integrity* and after applying an average effective tax rate of 20%. The results suggest a tax base of just over one trillion dollars and uncollected taxes for developing countries of 214 billion dollars. Of these, 101 billion comes from Asia, 44 billion from Europe, 39 billion from North Africa and the Middle East and just over 3 billion from sub-Saharan Africa. An estimate by Ndikumana and Boyce (2008) somewhat increases the figure for sub-Saharan Africa, which would in any case be the region with the lowest relative share of assets abroad. The estimated tax losses represent about 2.5% of the GDP of developing countries and amount to a market share of nearly 10% of the tax income in those countries. These are very significant quantities, which underline the interest we should have in combating capital flight and tax evasion.

However, the resources that developing countries lose as a result of these offshore financial centres exceed the lost revenue through the movement of assets. We should also consider first, as we have seen, the loss of revenue that results from the use of transfer pricing by multinationals established in developing countries and a central office (real or fictional) in these tax havens, and, secondly, those revenue losses that are linked to criminal practices such as corruption, which are protected by the practices of non-transparency in informational terms that characterises those places.

[5] The list included 40 jurisdictions denominated tax havens. That list did not, however, include the OECD countries. Otherwise, the list has not been updated even though the OECD has periodically recognised that some jurisdictions that were previously uncooperative have since signed up to standards of transparency and information exchange.

Raymond Baker (2005) attempted a tentative estimate of the various components of revenue that developing countries lose as a result of the existence of tax havens. According to his estimate, the total loss of resources due to the existence of these financial centres is estimated at a minimum of 500 billion dollars annually, of which 50 billion are due to corrupt practices that are protected by the lack of transparency of tax havens, 200 billion result from the application of transfer pricing by multinational companies located in these places and 250 billion are due to other forms of illegal flows (capital flight) from developing countries.

In addition to the effects mentioned above, there are two other extraordinarily ones which are harder to quantify. The first refers to the impact that these places have on the taxation of developing countries by encouraging a downward trend in the tax burden as a supposed way to compete in attracting foreign capital. Their permissive tax regimes fuel a "race to the bottom" in taxation, in a world that is increasingly open to international competition.[6] The second perverse effect of these centres is related to the impact that their information systems and defence of banking secrecy have on the construction of a rules-based international system. Their very existence challenges the universal nature that should characterise international standards, creates undue discrimination and open up spaces where illegal economic practices (including dirty money laundering, embezzlement, fraud, corruption, illegal arms trafficking or drugs) can hide. It is hard to imagine an institutional framework that is fair and legitimate, created to order international relations, being compatible with the existence of spaces intentionally excluded from the rules.

A recent study by the *Norwegian Commission on Capital Flight from Developing Countries* echoes the costs to developing countries involved in maintaining havens. The effects are displayed in a variety of areas, which limit countries possibilities for development (Box 1). The conclusion is clear: "The Commission has established that tax havens are a major obstacle to growth and development in poor countries, and they create opportunities for political and economic elites in developing countries to harm the achievements in development of their own countries. Putting an end to the harmful activities of tax havens is important. "

Box 1: Tax havens: types of effects on developing countries

As a result of their secret and discriminatory tax treatment, tax havens generate the following effects, among others:

1.- They increase the risk premium in international financial markets.
2.- They undermine the operation of tax and national public finances.
3.-They increase tax income inequality.
4.- They reduce the efficient allocation of resources in developing countries.
5.- They make the illegal economy and crime more profitable.
6.- They promote income-seeking activities and reduce private incomes in developing countries.
7.- They harm institutional quality and hinder the growth of developing countries

Source: Commission on Capital Flight from Developing Countries (2009): *Tax Havens and Development*

5.3. INTERNATIONAL RESPONSE

There are many reasons why the international community intends to end the existence of tax havens. The first and most important appears to be linked to the need to avoid loopholes in the international economy, areas of impunity for practices that could be criminal. A second reason concerns the need to move towards a minimum harmonisation of the fiscal and financial practices between countries: in a space increasingly open to international trade, it is necessary to minimum agreement on regulatory and fiscal matters. Thirdly, it is necessary to put an end to tax havens for reasons of distributive fairness since it is the most affluent classes (and the most powerful companies) that benefit from the offshore tax evasion that these havens facilitate, at the expense of low and middle-income sectors and countries.

This has been understood by various international agencies that have advanced timidly in pointing out the need to end the abnormal practices of such financial markets. In particular, the IMF has developed a programme around the *offshore financial centres,* through which it encourages jurisdictions identified as such (42 in total) to an assessment of the rules and regulatory systems and a statistical reporting. In 2003, the IMF started work evaluating and monitoring practices, based on interna-

[6] In fact, that is the reason cited by some neoliberals who justify the role of tax havesn in the world today.

tional standards set by the BIS, IOSCO, IAIS and the FATF. From 2008 these evaluation activities were incorporated into the *Financial Sector Assessment Programme* (FSAP), conducted in collaboration with the World Bank, IMF member countries.

The G-7 set up the *Financial Action Task Force,* in 1989, as an organisation in charge of advising countries on policies to combat money laundering. The fruits of its efforts are a wide body of recommendations - the *40 +9* Recommendations - which have become international standards in the field. They have been enriched over time, as a result of the emergence of new themes or as old themes have acquired growing importance (the financing of terrorism, for example). In accordance with their evaluation processes, the FATF has identified a group of jurisdictions (23 in total) as non-cooperative, demanding additional measures from them against money laundering practices. Some 32 countries plus the European Commission and the Gulf Cooperation Council belong to the FATF.

The Financial Stability Forum also participated in efforts to tackle illegal financial flows, asking countries for information about the functioning of their financial systems and regulatory and supervisory mechanisms. This work is done primarily in relation to the OECD, the IMF and IOSCO. In 2008, at an international conference, the FSF issued a statement stressing the need to increase transparency and "integrity in the financial markets." More precisely it identified the need to protect against "illegal financial risks stemming from non-cooperative jurisdictions." As is known, the G-20 meeting in London decided to replace the institution with a new, more inclusive organisation called the *Financial Stability Board.*

Of all the international agencies, there is no doubt that the one that has most actively worked in this field is the OECD. Through its report *Harmful Tax Competition* of 1998, the OECD pointed out the unfair tax practices of tax havens, suggesting the elimination of tax benefits on transactions with these financial markets, said exchange of information was necessary and argued for the cancellation of tax deductions for profits coming from tax havens. The OECD defined standards of transparency and the exchange of tax information considered necessary for countries to subscribe to by using mandatory agreements. As a result of this process, since 2000 the list of countries deemed uncooperative jurisdictions has been declining significantly. In some cases, the requirement that at least 12 countries sign agreements related to these standards before countries could be removed from the list of uncooperative jurisdictions resulted in an absurd situation: countries deemed uncooperative partnered with other uncooperative regimes to sign the agreement, even though they had little interest in transparency and tax information exchange.

However, since 2008, following the financial crisis and the G-20 meetings, considerable momentum has been seen in this area. Standards of transparency and exchange of information are now widely accepted. Although in some countries they lack the proper implementation and policy development, that has generally been achieved in OECD countries (like Austria, Belgium, Luxembourg and Switzerland) that until recently were reluctant, as well as in places (like Andorra, Liechtenstein and Monaco) which had previously been opposed and in non-OECD countries (including Brazil, Chile and Thailand) that had expressed reservations about one of the articles of these rules (Article 26) and, finally, those same standards have been incorporated into the *UN Model Tax Convention,* 2008. For the standards to be properly implemented the signing of agreements and their subsequent implementation is necessary: to monitor this process the *Global Forum on Transparency and Exchange of Information for Tax Purposes* was strengthened in 2009. In fact, at present more than 90 countries belong to the forum, including all members of the G-20, all OECD countries and all *off-shore* jurisdictions, and there is a Secretariat to provide continuity to peer reviews.

As a result of this process, the number of *Tax Information Exchange Agreements* (TIEA) has increased exponentially: the number of those signed per year increased from 2 in 2005 to 12 in 2007 and reached 200 in 2009. The number of *Double Taxation Conventions* has also increased (reaching 110 in 2009). The impact of the successive G-20 summits has been decisive in this process. As noted by the OECD (2010), "these policy changes represent a significant step toward levelling the playing field in relation to the exchange of information for tax purposes."

The UN does not have a specific programme in relation to tax havens, but has several lines of action to combat economic crime, strengthen

the tax systems of countries and promote cooperation in tax matters. For example, the United Nations operates the *Money Laundering Information* Network (IMOLIN), to combat this type of crime, and there is an Office on *Drugs and Crime* (UNODOC). Furthermore, in collaboration with the World Bank, the UN developed the StAR initiative to combat corruption in developing countries. The United Nations also has a Committee of Experts in International Tax Cooperation whose mission is to provide recommendations on tax treaties, strengthen national tax systems and to combat illegal tax flows (especially in relation to transfer pricing).

The EU also made progress in this field through the European directive on the taxation of savings, which has established the principle of automatic information exchange between countries and the obligation for similar taxation to be required of domestic companies to those owned by non-residents. Some countries have refused to assume this rule, in exchange for a tax on interest. It should be noted, in any event, that the EU directive affects the interest earned by individuals but not that earned by companies. This opens up two ways to avoid this commitment to automatic transmission of information: i) either through transferring interest to jurisdictions not included in the directive ii) or through the establishment of an entity (company or trust) which takes ownership of the interest. The European Commission itself is aware of these possibilities, is considering revising the policy, to extend its effectiveness to other economic flows (as well as interest) and to other people.

Within the efforts of the EU, we should highlighting the Commission's Communication on the subject entitled *Cooperating with Developing Countries on Promoting Good Governance in tax matters.* Additionally, the Council of General Affairs and External Relations of the EU, of November 2008 and May 2009, agreed to support partner countries in their efforts to improve tax collection capacity and to strengthen tax and customs administrations to promote international conventions against corruption and tax evasion and illegal financial flows and in favour of transparency and the exchange of information.

This year, in May 2010, the European Council adopted a declaration entitled *"Tax and Development: Cooperating with Developing Countries in Promoting Good Governance in Tax Matters",* which stresses the need "to strengthen support for the mobilisation of domestic resources of developing countries" and to "promote the principles of good governance in tax matters, supporting countries in the fight against tax evasion and other harmful tax practices." In this second aspect, the Council declared the intention to: i) promote country-to-country reports as a standard for multinational companies; ii) to support an international system of automatic exchange of tax information, as the EU legislation suggests iii) to implement measures to reduce the abuse of transfer pricing, following the recommendations of the OECD; iv) to establish criteria for the treatment of investment in non-cooperative jurisdictions, v) to incorporate into the *Reports on Observance of Standard and Codes* (ROSCs) the willingness of countries to collaborate in the exchange of tax information and the fight against fraud and money laundering and vi) to encourage the participation of developing countries in international forums for cooperation in taxation.

The European Parliament in its resolution of February 10, 2010, also urged member states to promote better OECD standards to make the multilateral and automatic exchange of information an international standard, and it urged the Commission to advance the development of a CCCTB (Common Consolidated Corporate Tax Base) to end the practices associated with transfer pricing and tax evasion by multinationals in EU territory.

Finally, as noted, this whole process has been boosted as a result of the meetings of the G-20 as a result of the crisis. Specifically, the Washington Summit noted that it would promote "the exchanges of information, including jurisdictions that have undertaken to meet international standards with regard to banking secrecy and transparency." At the summit in London, the G-20 was more decisive and declared that "the era of banking secrecy is over", committing signatory countries to "take action against non-cooperative jurisdictions, including tax havens." Here, it pointed to the OECD as the body to recognise the list of countries, "assessed by the Global Forum in accordance with the international standard for the exchange of tax information." Additionally, it designates the *Financial Stability Board* as an important forum for the creation of a concerted policy on tax matters, financial transparency and the promotion of financial stability. Finally, at the Pittsburgh summit, the

group declared "the commitment to the fight against non-cooperative jurisdictions has yielded impressive results. We are committed to maintaining the momentum in the treatment of tax havens, money laundering, the process of corruption, the financing of terrorism and preventative rules."

5.4. PROPOSALS FOR THE FUTURE

Beyond the progress experienced in the last two years in the fight against tax evasion, fraud and illegal financial flows, there are many who think that the measures taken so far, although headed in the right direction, are insufficient. In order to make further advances in this field, we need to at least study possible joint action in the following areas:

• First, it is necessary to achieve widespread *support for those regulatory frameworks that allow for progress in the fight against illegal economic practices.* Here, it seems obligatory to make progress in the adopted of the UN Convention against Corruption and the Convention on Combating Bribery of officials in international OECD businesses. Similarly, those initiatives should be encouraged that promote business involvement in activities to promote transparency and penalise criminal behavior in international business. This happens, for example, with the StAR initiative against funds derived from high-level corruption, the *Stolen Assets Recovery Initiative,* to return the resources extracted from a country through illegal means, and in the *Extractive Industry Transparency Initiative* (EITI), on the provision of information from the extractive industries. The problem with some of these initiatives - such as EITI - is the voluntary nature of signing up to them and the limited ability to sanction non-compliance. A summary of the main requirements for a strong, just and fair economy can be found in the document presented to the G-8 at its recent meeting in Italy (Box 2).

• Secondly, it is necessary to *support instances of international cooperation in tax matters,* in order to promote shared norms and standards. Here the work of the Committee of United Nations Experts on Cooperation in Tax Matters is very useful, and we should strengthen and intensify their work. Also relevant is the work of the OECD, which has accumulated a remarkable experience in this field, which it has intensified in recent years. The Financial Stability Forum and its broader successor, the Financial Stability Board, can perform an important task in tax cooperation, the establishment of criteria and standards and transparency. Similarly, the work of the *Financial Action Task Force* (FATF) may also be important. In addition to examples of global cooperation, it is important to strengthen those born from regional initiatives, such as the CIAT (Inter-American Center of Tax Administration) or the ATAF (African Tax Administration Forum), to mention just two of them.

• Thirdly, it is necessary to move towards *automatic formulas for exchange of information internationally.* In this regard, the Community rules on taxation of savings (Directive 2003/48/EC) might be an interesting precedent, that could be generalised. However, to move in that direction it would be necessary to correct the deficiencies and limitations that are still present in the EU directive.

• Fourth, it is necessary to *put an end to those standards and accounting rules that encourage non-transparency* in terms of company information. Here, it would be necessary to amend the regulations arising from the IASB *(International Accounts Standard Board),* to promote development by multinationals and financial institutions country-by-country reports, which express sales, profits and taxes paid by these firms in every jurisdiction in which they operate. The practice of consolidated reporting would be abandoned, to enable the provision of better information, segregating each group's business segments in each market. This would require revising the IFRS6 for mining, quarrying and IFRS8 for other productive activities. Additionally, it would be necessary to review the governance structure of the IASB, now dominated by private groups, to ensure that regulatory frameworks respond to public interests and that there are mechanisms of control by national authorities in their task of generating standards in the accounting field. In parallel with the modification of IFRS6, paragraph 14 of the TOD Directive of the European Commission (2004/109/EC) should also be amended on the harmonisation of transparency requirements in relation to information about the issuers of securities in regulated markets. This legislation *encourages* extractive industry companies to disclose payments made to governments in countries where they operate in their annual financial reports. A minimum of consistency with the points made above would oblige the requirement to be made mandatory and binding, to

encourage the practice of reporting "country by country.

• Fifthly, initiatives that encourage *the voluntary contribution of companies to practices of transparency and the fight against fraud and corruption* should be given a boost. That is the case, for example, of the Extractive Industries Transparency Initiative (EITI), cited earlier, which seeks the transparency of companies with respect to company payments and income from or paid to the governments of the companies where they settle. Although major mining companies are part of this initiative, its results so far are modest, largely due to the limited monitoring and penalties for non-compliance. In May 2008, the World Bank introduced a new initiative in a similar vein, the EITI + +, which includes widening the scope of the demands for transparency to the whole value chain of activities related to the mining industry, from the tender to commercialization. Although this initiative is also positive, its application may be conditioned by the same limitations outlined above.

• Sixth, it is necessary to support the promotion of capacities of developing countries to identify and address the transfer pricing practices that are harmful to their tax collection capacity. At the expense of what the Committee of UN Experts drew up on this matter, the *Guidelines* developed by the OECD could be a good approach. Developing the capacity of poor countries to negotiate and implement agreements on the exchange of tax information (the TIEA) and, if appropriate, double taxation conventions (DTCs) are also important.

• Seventh, we should support both the IMF and the World Bank included in its *Reports on Observance of Standards and Codes* (ROSCs) information about the willingness of countries to contribute to a more transparent and cooperative governance in the tax area. In particular, the ROSCs should provide information on: (i) if a country engages in the exchange of tax information, and (ii) if it pursues tax evasion as a crime and other criminal practices such as money laundering.

• Finally, the above measures aimed at creating a more transparent international environment would produce limited results if they are not accompanied by tasks to support the strengthening of the Tax Administrations of developing countries and their capacity for the proper management of public finances and the pursuit of tax fraud, capital evasion and other economic crimes.

Box 2: 12 Principles for a solid, fair and clean economy

Contributing to the debate proposed by the OECD on a "Global Standard" (www.oecd.org / globalstandard), a group of international experts, under Italian leadership, prepared a proposal of 12 principles to promote a fairer, more transparent international regulatory framework. The proposal won the support of the OECD and was presented to the G-8 meeting in L'Aquila in 2009. The principles, which were presented under the title of *Common Principles and Standard are Propriety, Integrity and Transparency,* refer to the following aspects:

1 .- A solid, fair and clean economy should be based on the values of propriety, integrity and transparency. These values should be promoted by public policies and supported by the business sector. The effective monitoring of the implementation of these principles and standards should be practised on a regular basis.

2 .- Governments, companies and all private entities, whatever their legal form, all over the world should recognise that these values are the key to a market economy that serves the needs and aspirations of the citizens of all countries (...)

3 .- A race to the bottom in labor standards, social and environmental and regulatory arbitrage between jurisdictions should be prevented through international cooperation and the convergence of domestic legal frameworks.

4 .- Fraud and tax evasion are harmful to society as a whole and companies and all private entities, regardless of their legal form, should meet their tax obligations, including respect for those practices related to prices transfer.

5 .- Interaction between business and government (...) should be based on the principles of balance, transparency and justice for all parties and mutual commitment.

6 .- The practice of business and governance structures of companies, whatever their legal form (...) should ensure accountability and justice in relations between management, the board of directors, shareholders and other actors involved (...) s

Structures and financial instruments should not be used to conceal the real profits of the owners and corporate products should not be used for illegal activities, including money laundering, bribery, asset protection from creditors, illegal tax practices, self-management and diversion of assets, fraud (....)

7 .- It should ensure the provision of timely and accurate information on the activities, structure, property, financial position and performance of companies.

8 .- Payments and compensation schemes should be sustainable and consistent with (...) long-term goals and prudent risk taking.

9 .- Bribes, including those produced in international business, should be considered a criminal offense and should be effectively prosecuted and penalized.

10 .- Money laundering should be criminalised and the crime of money laundering should be applied (...) to the widest range of misconduct.

11 .- All forms of protectionism should be banned

12 .- Banking secrecy should not be an obstacle to the implementation of the principles outlined above, including proper implementation of fiscal obligations in the world.

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