Transcript of IMF podcast:

Alex Cobham on Tax Injustice

Alex Cobham:

Economies grow better when they're more equal. People live longer and longer healthier lives when they're more equal. There's less likely to be conflict, less likely to be violence. In a sense, everything is better almost when we reduce inequalities. But our tax systems do the exact opposite.

Bruce Edwards:

Death and taxes as the adage goes, are inevitable, but increasingly, international corporations and the world's wealthiest people are proving that taxes can, in fact, be avoided.

Alex Cobham:

We have half of the property in some cities in the world owned anonymously, often owned by oligarchs from other countries that we might look askance , but we've allowed this to become the way of doing business.

Alex Cobham:

I'm Alex Cobham, I'm the Chief Executive of the Tax Justice Network, which is an international organization that leads the fight against tax havens and tax abuses around the world.

Bruce Edwards:

Journalist Rhoda Metcalfe, connected with Alex Cobham to talk about his article, Taxing for a New Social Contract in the March issue of Finance & Development Magazine.

Rhoda Metcalfe:

I think it's fair to say that most people do not enjoy paying taxes, but you say that taxation is actually a vital system to close the gap between rich and poor. And you argue that our current tax systems both the national systems and international system are doing a very bad job of this. So what's the problem?

Alex Cobham:

Well as you say, nobody really likes paying tax, even I don't get up in the morning and think, yes, today I will be making my contribution through the income that I make. And yet tax almost for that reason is absolutely fundamental to the relationship that we have with states. The fact that we don't like paying it is why we then hold government to account for what we think of as our money. I want to make sure that you are using that in a good way, that you're not wasting it corruptly. We say, it's kinda what holds the social contract between citizens and states together. There are other ways revenues can be raised, but taxes in a sense the best. It allows countries to be independent... When governments are more reliant on tax than other forms of revenue, they are more responsive to their people and so the way that they spend money is better.

Alex Cobham:

So for example, if you have a public health system that is more reliant on tax than other sources of funding, that public health system for the same amount of spending will be more inclusive of people. So, there'll be less people left out of the system and the health outcomes will be better just because the money is better when it comes from tax, because it builds this accountability relationship. But the big thing with tax really is, you're talking about the tool that allows us to make sure that the people with the highest incomes and the greatest wealth are paying a fair share in order that we can all be part of something better. So, we think they're tools for reducing inequality, but in a great many cases, they're actually making things worse. We allow the richest households to dodge their responsibilities at the top end, while at the bottom end, we fail to include in the benefits of public services, the people who most need it.

Alex Cobham:

And those people are also being hammered for taxes. They may not be paying direct taxes because they're not in formal employment, but they're probably paying a bigger share of their income in informal taxes, taxes on consumption and so on. So, we have a system or a set of systems nationally around the world that worsen political as well as economic inequalities and that in turn relates to the international problem that's a version of the same thing.

Rhoda Metcalfe:

Well, actually, I'd like to pick up on that point. In your article, you say that one of the biggest international problems is the way multinational companies are taxed. So, how does this work? How do countries tax a company that has operations all over the world?

Alex Cobham:

Good question. So look, if you or I set up a business in the country that we happen to be in today, we'll register it, we'll probably publish annual accounts and then we'll pay tax in the country where we are making our money. And that's 99.9% of companies around the world are in a position roughly like that.

Multinational companies are different by definition. They go across borders, so they operate in more than one jurisdiction. Because effectively of a set of decisions that the imperial powers took at the League of Nations in the 1920s and 30s, we have international rules for multinational companies that don't require them to pay tax in that same way, that allow them to engineer very low, effective tax rates on the profits brought back from overseas. Back in the early 1990s, US multinationals shifted about 5% of their global profits away from the countries where they actually made their money and did their business. By the early 2010s, that had exploded to 25, 30% and kept rising.

Alex Cobham:

So, this went from being almost a marginal problem in the global economy to being effectively the core behavior of the biggest economic actors in the world. Multinational companies' tax abuse conservatively, and this is only the biggest eight to 10,000 multinationals around the world, cost in tax revenue lost each year, something like 312 billion. The biggest numbers are for the biggest economies... So the United States is one of the biggest losers. But as a share of current tax revenues, it's much bigger for lower income countries, often as much as 50% of the public health budget, simply due to this handful of multinational companies being able to exploit the failures of the international rules.

Rhoda Metcalfe:

So, I'm just trying to think of an example of how this works. If you're in a smaller developing nation, but you have factories for example, that are run by a multinational company, does that country receive none of the taxes from that production in their country? Is that what we're talking about?

Alex Cobham:

So, just to use that example, let's say you manufacture in, I don't know, let's say Malawi and your final sales destination is in the UK. Now, obviously the key part of that as economic activity is what's happening in Malawi. That's where the raw material is generated and turned into the finished product. What's happening in the UK is a relatively straightforward sales transaction. So, most of the profits ought to be in Malawi and most of the tax ought to be paid there. But what you can do is to say, look, we will argue that the actual price of what's being produced in Malawi is in fact very low, only just enough to cover the costs of the factory. And then it's the sales operation in the UK in fact, that's incredibly productive and that's where all these very high profits are generated.

Alex Cobham:

But if you want to go one step further you say, look, we don't want to pay tax in the UK either so we'll create a third subsidiary and we'll call this a trading subsidiary. And this will be responsible for buying at a low price from Malawi and selling at a high price to the UK. And then all of the profit ends up in the middle, where there just happens to be- as luck would have it, an effective tax rate of 0%. And then everyone's winner. Everyone except people who pay their taxes in Malawi and in the UK. And until we sort that out, we have an international system that is making the lower income countries, the countries that most need revenues to invest in public health and other services, is making them poorer.

Rhoda Metcalfe:

Is this a pretty typical scenario? Is this the way a lot of multinational companies operate?

Alex Cobham:

Yeah. Unfortunately it's a question of degree. It isn't that there are some multinationals that do none of this and some that are the bad guys. Part of the reason for that is that all of them really have the same, pretty small number of law firms and the big four accounting firms advising them on how to, let's say, manage their tax liabilities. So, as soon as one of them finds a trick that works, then they'll sell it to all of their other clients. So, the speed with which the games go around the world is far quicker than tax authorities can keep up with.

Rhoda Metcalfe:

So, what would the alternative be to the current system?

Alex Cobham:

Well, there is really one alternative, and that's what's called unitary taxation. Instead of trying to work out how much profit there is at each subsidiary, the question is different. We're saying how much of the global profit at the unit of the multinational should be apportioned to each country where it operates? And this is the way that within the United States for example, companies apportion their profits to different states. So, if they make 10% of their sales in Alabama, then perhaps 10% of their US profits are apportioned there and Alabama gets to tax that at whatever the rate is. Switzerland does the same among its cantons, Canada among its provinces.

Alex Cobham:

What we need is to do this globally. So, that to go back to that example, if Malawi has 90% of the employees in its factory and 10% are doing sales in the UK, then that would be the split. And normally you talk about using a combination of employment and sales so that you have a balanced formula between the production and the final consumption. And that gives you just a completely different basis and has the additional benefit that all profit is a portion somewhere.

Rhoda Metcalfe:

Another point, your organization, the Tax Justice Network is calling for more transparency in what you call beneficial ownership. Can you explain this to me is this all part of the same problem?

Alex Cobham:

Certainly very closely linked. The multinational companies are the biggest actor in terms of tax abuse. The problem of anonymous wealth is the one that goes alongside this. And this is about people typically using legal vehicles, companies, but also trusts and foundations and partnerships, to hide the fact that they are the warm blooded human being ultimately behind these legal entities. Now, at the simplest that allows you to do something like hold a bank account without anyone knowing who's really holding the money. Because that relatedly allows you to do all sorts of other things, not just not to pay tax on your assets and on your income streams to hide it from your spouse in case you divorce, to hide political corruption, to hide the proceeds of crime and launder them around the world.

Alex Cobham:

If we don't have effective information about who is the ultimate beneficial owner of legal vehicles and of assets, then we cannot enforce any of the financial regulations, including sanctions... this is the problem we're seeing now for those imposing sanctions on the Russian regime, actually their own economies are rife with anonymous ownership making it impossible to enforce, even in this moment of political urgency, the regulations, the sanctions they want.

Rhoda Metcalfe:

Interesting.

Alex Cobham:

That's what plays out with tax every day, every year in every country. Along with all of the corruption that is also made possible.

Rhoda Metcalfe:

But I assume some countries must be benefiting from the status quo or else they would've changed the system a long time ago?

Alex Cobham:

So, it's a good point, but the actual winners from this are very few indeed. There's only a handful of jurisdictions. The big corporate tax havens that are responsible for the great majority of tax losses suffered by everyone else. Now, those jurisdictions include some very powerful ones, particularly a lot of member countries of the OECD the Organisation for Economic Co-operation and Development, which is responsible for setting the tax rules. So, lower income countries are not members of the OECD and struggle to have their voices heard. But even the high income countries that are among the biggest losers don't seem, within the OECD, to be able to maneuver the multinationals and their tax advisors. A lot of countries will say publicly that they are trying to fix the system, they are trying to get multinationals to pay a fair share of tax, while privately they're actually working to prevent the system being effective at least to prevent it being effective on their multinationals.

Rhoda Metcalfe:

Because they're afraid that they're going to lose in some way?

Alex Cobham:

Well, I think they've been convinced by their multinationals that they could, but there's really no evidence for this. What the research shows is pretty clear. If you allow your multinational companies to abuse tax over there, they don't leave that at the border. They come home and do it to you as well. They don't want to pay your taxes anymore than they want to pay taxes in Malawi or in India. So, there's a really good argument for us all to get together and sort this out. But as long as it's left in the OECD rather than in the United Nations, the risk is that we just keep banging our head against the same wall.

Rhoda Metcalfe:

Is there any indication that this will end up being picked up by the United Nations?

Alex Cobham:

There's a real momentum building around this. So, two years ago, the UN Secretary General set up his initiative on financing for development during the pandemic and that actually made a recommendation to the ministers of finance of the world, that they create a UN Tax Convention in order to raise the international standards including around beneficial ownership and to create the forum where you could negotiate the international tax rules. Then last year, you have the FACTI panel, which is a high level UN body on financial integrity recommending and in more detail a UN Tax Convention to deliver the same thing. And I think the momentum is there. I would be surprised if we don't have a process of negotiation on the UN Tax Convention moving forward within the next couple of years.

Rhoda Metcalfe:

Wow. So, you are very optimistic then that change is in the wind?

Alex Cobham:

Look, you have to be, but I genuinely am. When the Tax Justice Network was set up in 2003, we often couldn't get in the room because the technical tax people said, well, no, you are activists, you're political, this is only a technical discussion. And it took us a long time to kick that door down and convince people that the decisions they were making with accountants and multinational companies and tax lawyers around the table, they weren't technical, they were political. It took us till 2007, so four years, to get the first front page major newspaper story about corporate tax abuse. And the headline was just how big companies dodge the taxmen, which today, that just sounds like "dog bites man". Things are really moved on incredibly... That the public awareness of tax abuse is just manifestly different from what it was even 10 years ago.

Alex Cobham:

That doesn't mean we are there, but it does mean that the weather has shifted, has brightened up let's say, it's a bit sunnier than it used to be. And the power on the other side remains huge between the multinational companies, wealthy individuals and all the professional services companies that advice them and make money from them, but the political imperative to fix this is becoming stronger every day. The questions really are, how quickly can we go? And how sure can we be that countries at all income levels are being included... That we are fixing it for everyone including the countries where it really matters most?

Rhoda Metcalfe:

Well. Alex Cobham, you're fighting the good fight out there. And I really appreciate you coming and speaking with us today, it's been really fascinating.

Alex Cobham:

Thank you. My pleasure.

Bruce Edwards:

Alex Cobham is Chief Executive of the Tax Justice Network. He was speaking with Rhoda Metcalfe. Look for his article, Taxing for a New Social Contract in the March issue of Finance and Development. Check it out at imf.org/fnd or download the Finance and Development app.

Bruce Edwards:

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Rhoda Metcalfe:

And I'm Rhoda Metcalfe.

Bruce Edwards:

Thanks for listening.