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Tax Reform for Equity and Sustainability

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KAIROS joined church delegates from every continent at the ***Global Ecumenical Conference on a New International Financial and Economic Architecture*** *in São Paulo, Brazil, September 29 - October 5, 2012. The conference was sponsored by the World Communion of Reformed Churches in partnership with the World Council of Churches and the Council for World Mission.* ***The São Paulo Statement on International Financial Transformation for the Economy of Life***[1] *includes several proposals for tax justice based on research KAIROS prepared for the conference and elaborated on in this Briefing Paper.*

Introduction

Reform of taxation is a feasible way to reduce inequality, fund social programs and finance investments in harmony with Earth's ecological carrying capacity. Taxation measures can also be effective for curbing speculation and excessive investment in ecologically destructive activities.

This briefing paper will elaborate on four proposals that are part of the ecumenical plan of action contained in the *São Paulo Statement:*

1) Ending tax avoidance by the wealthy and transnational corporations;
2) Financial Transaction Taxes;
3) Ecological taxation;
4) Progressive tax reform.

1. Ending Tax Avoidance by the Wealthy and Transnational Corporations

In *The Price of Offshore Revisited*, James Henry, formerly chief economist for the consulting firm McKinsey & Company, calculates that between US$21 trillion and $32 trillion in wealth lies hidden in tax havens, an amount larger than the U.S. GDP ($14.4 trillion).[2] His estimates are for financial wealth only, excluding such possessions as real estate or yachts.

Henry calculates that if the lower amount ($21 trillion) were invested at a modest return of 3% annually and the earnings taxed at a rate of 30%, the tax revenue would amount to US$189 billion each year.

Henry asserts that at the end of 2010: "The top 50 international private banks ... collectively managed more than $12.1 trillion in cross-border invested assets from private clients."[3]

Global Financial Integrity estimates that developing countries lost on average between US$725 billion and $810 billion each year from 2000 to 2008, due mostly to commercial tax evasion. This is nearly 10 times larger than all official development assistance over those years.

Raymond Baker, Director of Global Financial Integrity, expresses the moral outrage that tax justice advocates feel concerning the gross injustice of a system that allows such massive transfers from impoverished peoples to wealthy individuals and corporations: "For the first time in the 200-year run of the free-market system, we have built and expanded an entire integrated global financial structure, the basic purpose of which is to shift money from poor to rich. This is the ugliest chapter in global economic affairs since slavery."[4]

Peter Gillespie, a researcher with the Halifax Initiative coalition, notes: "Half of all international bank lending and at least half of all global trade on paper is conducted through secrecy jurisdictions, enabling multinational corporations to allocate profits in low-tax jurisdictions and costs to high tax jurisdictions."[5]

Christian Aid commissioned a study that found lost tax revenues for 49 low-income countries due to transfer pricing by transnational corporations amounts to US$160 billion each year.[6]

Seventy jurisdictions worldwide function as tax havens. Contrary to what many people assume, the most active havens are located within developed countries and not in small island states offshore. Gillespie notes: "The tiny state of Delaware is one of the world's largest secrecy jurisdictions, home to thousands of shell companies and holding an estimated $5 trillion in undeclared assets."[7]

Canada is not exempt from the practice of hiding wealth abroad. Economists at the Université du Québec à Montréal estimate that Canada's five major banks avoided $16 billion in provincial and federal taxes between 1991 and 2003 by channelling money through their offshore subsidiaries.

'The era of banking secrecy is over'

When the Group of Twenty industrial and emerging countries met in London in April 2009, their official communiqué boldly declared: "The era of banking secrecy is over." Unfortunately this proved to be false.

The Organization for Economic Cooperation and Development was supposed to publish a "blacklist" of jurisdictions that were not in compliance with OECD standards on transparency and the exchange of tax information. But that list named no developed countries and only four developing countries – Costa Rica, Malaysia, the Philippines and Uruguay – none of whom are major tax havens. Within days of the G20 meeting, the OECD's blacklist of countries not in compliance was empty and only a few were on its "grey list" of jurisdictions that had made commitments but not yet complied with OECD standards.

Those standards are very weak, covering only bilateral treaties and dealing only with individuals who hide money from tax authorities while ignoring the activities of transnational corporations. The OECD regime places the burden of proof on the authority requesting an investigation, something that is beyond the capacity of most developing countries.

Despite the hyperbole of the London G20 communiqué, the reality is there has been no major crackdown on non-cooperative jurisdictions.

Measures needed to fight tax avoidance

Tax justice advocates demand a multilateral framework for the automatic exchange of tax information that has more power than the OECD's weak bilateral agreements. They also call for international accounting standards that would require transnational corporations to "report sales, profits, and taxes paid on a country-by-country basis in their audited annual reports and tax returns."[8]

The UN Commission of Experts on Reforms to the International Monetary and Financial System, chaired by Joseph Stiglitz, makes a strong case for multilateral action. The commission names the fact that: "The principal sources of tax evasion, tax secrecy, money laundering, and regulatory arbitrage [are] located in developed countries' on-shore banking systems…. The biggest money laundering cases involved banks in London, New York and Zurich."[9]

The Commission denounces the "discriminatory targeting of small international financial centres in developing countries while a blind eye is turned to lax rules in developed economies." [10] Instead of relying on the OECD, it calls for multilateral cooperation to establish fair rules for all through a new intergovernmental commission to strengthen international tax cooperation.

Accordingly, the ***São Paulo Statement on International Financial Transformation for the Economy of Life*** makes the following proposal for addressing tax evasion and avoidance:

"A multinational framework for the compulsory exchange of tax information on individual and corporate accounts that will effectively end the use of tax havens must be established. Transnational corporations should be required to report sales, profits and taxes paid on a country by country basis in their audited financial reports."

2. Financial Transactions Taxes

KAIROS and many other members of the ecumenical community have long advocated financial transaction taxes as a means for achieving tax justice. The Catholic Church's Pontifical Council for Justice and Peace recognizes that "such taxation would be very useful in promoting global development and sustainability."[11]

Likewise, when the Archbishop of Canterbury endorsed transactions taxes, he suggested that part of the revenues should be devoted to international development goals.[12] The World Council of Churches Central Committee has also called for the use of financial transaction and carbon taxes "to pay for global public goods and poverty eradication."[13]

In September 2009, on the eve of the G20's Pittsburgh summit when public awareness of the huge costs of the 2008 financial crisis was still vivid, Germany's Finance Minister, Peer Steinbruck, wrote an opinion piece in the *Financial Times* calling for a global Financial Transactions Tax (FTT).

Steinbruck estimated the potential annual revenues from a global tax applied at a rate of 0.05% on all trades in equities, bonds, derivatives and foreign exchange at US$690 billion. His rationale for such a tax was to make financial corporations that had derived "significant benefits from government bailouts ...[but were] not pulling their weight" to accept more responsibility for paying the costs of the crisis.[14]

However G20 leaders at their 2009 summit were not willing to endorse Steinbruck's call for an FTT. Instead the G20 Pittsburgh communiqué asked the International Monetary Fund to prepare a report on options to force the financial sector to make "a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system." To the surprise of many observers, the IMF's report tabled in April 2010 said an FTT, "should not be dismissed on the grounds of administrative practicality."[15]

French President Nicolas Sarkozy, German Chancellor Angela Merkel and British Prime Minister Gordon Brown became the strongest advocates. French support survived a change of government when the new president, François Hollande, remained an advocate.

The new British prime minister, David Cameron, distanced himself by maintaining that Britain would only accept an FTT if it were applied globally by all nations. This is disingenuous since the UK itself maintains a 0.5% stamp duty on equity trades that raised US$5.86 billion for the British treasury in 2008 without leading to a migration of trading to other jurisdiction.

Canadian Prime Minister Stephen Harper was the strongest opponent of an FTT. Prior to the June 2010 G20 summit in Toronto, he sent cabinet ministers to New Delhi, Beijing and Washington to lobby against approval of any kind of transactions tax. Harper personally went to London and Paris to lobby against a tax. Despite his efforts, by 2011 several G20 countries, including Argentina, Brazil, France, Germany and South Africa had declared their support for a tax.[16]

President Obama agreed with a proposal by some of his advisors that the U.S. endorse an FTT. According to journalist Ron Suskind, even though the president had declared, "We are going to do this!" at a White House meeting, no FTT ever materialized due to opposition from Lawrence Summers, one of Obama's chief economic advisors.[17]

Summers' opposition to any kind of FTT marked a 180 degree turn from the position he had taken as an academic economist in 1990 when he co-authored an essay advocating a securities transaction tax.[18]

But after his brief tenure as President Clinton's Treasury Secretary and a controversial term as president of Harvard University, Summers had become a consultant to a hedge fund. Working only one day a week, Summers reportedly earned US$5.2 million in one year as he became acclimatized to the culture and values of Wall Street.[19]

Support for some kind of an FTT continued to grow particularly in Europe, due in large part to civil society's campaign for a Robin Hood tax.[20] Eleven European countries (France, Germany, Spain, Italy, Portugal, Greece, Austria, Belgium, Estonia, Slovakia and Slovenia) back legislation tabled by the European Commission for a tax that would apply first to those countries willing to participate and later be open to participation by other EU members.

Under the European Commission's proposal, a 0.1% tax would be imposed on the trading of shares and bonds, a 0.01% rate would apply to derivatives and there would be no tax on currency trades. In August 2012, France inaugurated a national FTT, setting a precedent for a wider tax.

Discouraging speculation

In his *General Theory of Employment, Interest and Money* published in 1936, John Maynard Keynes denounced financial speculation as harmful and unproductive. He declared: "Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation."[21] As a remedy, Keynes proposed that a small tax be placed on stock market transactions to encourage investors to consider long-term fundamentals rather than engage in short-term speculation.

In the 1970s, U.S. economist James Tobin picked up on Keynes' idea by advocating a uniform tax on all foreign exchange trades including spot sales and deliveries pursuant to futures contracts and options. Tobin called his proposal "a realistic second-best option" because he believed that an even better option, the establishment of "a permanent single currency [to] escape all this turbulence" was not politically feasible.[22]

A new innovation that makes an FTT especially relevant today is the practice of high-speed trading using computer algorithms and fast data connections to detect tiny differences in prices on different financial markets. Computers, located in offices close to stock exchanges, issue buy or sell orders within microseconds (millionths of a second) after they detect small differentials in market prices.

German economist Paul Bernd Spahn proposed a two-tiered variation of currency transaction taxes in order to overcome any conflict between their revenue-raising and speculation-deterrent goals. His plan recommended that a basic tax on currency trades, including their derivatives, be established to raise revenue for worthy purposes.

This basic tax rate would be set low enough so as not to interfere with normal transactions, or encourage tax avoidance, while still collecting significant revenue. Then during periods of high exchange rate volatility, as would occur when there was a speculative attack against a currency, national authorities could quickly add a temporary, second tier tax at a rate high enough to deter speculation.[23]

Revenue potential

Estimates of the revenue potential of FTTs vary widely according to the scope of its application and the tax rate. An FTT on major currency trades at a rate of only 0.005% would raise about US$33 billion a year according to Rodney Schmidt of the North-South Institute.

Schmidt effectively silenced critics who claimed that an FTT on foreign exchange could easily be avoided by pointing out that currency trades go through centralized exchanges and therefore a tax could easily be collected at the locations where all trades are cleared or settled.

The Austrian Institute for Economic Research estimates that a global FTT on stocks, bonds, currencies and derivatives at a rate of 0.01% could raise US$286 billion a year. A 0.05% global tax could raise approximately US$650 billion a year and a 0.1% tax would collect US$917 billion.[24] In practice, FTTs are likely to be applied at different rates on different financial instruments as is the case with the European Union tax described above.

Civil society advocates of FTTs have consistently called for using the revenues for international needs including the fight against poverty, diseases such as HIV/AIDS, and climate change. Some have also advocated dedicating a portion of the revenues to tackling domestic poverty and unemployment.

FTTs are progressive taxes

FTTs are progressive taxes since they are paid mostly by the buyers and sellers of financial assets. The European Tax Commissioner estimates that 85% of trades in financial instruments, such as hedge funds, are carried out by banks and other financial institutions serving wealthy investors.

Ordinary investors and pension funds would not be highly inconvenienced by an FTT since, for the most part, they hold on to their investments for long periods of time and would only pay the tax when shares or bonds are bought or sold.

In contrast, high-frequency traders who hold assets for very short periods of time, measured in seconds or even milliseconds, would be among those most affected. Many believe, as James Tobin expresses it, that "putting sand in the wheels" of high frequency trading would bring more stability to financial markets.

Worldwide there are 40 examples of various kinds of transaction taxes that either currently exist or, in a few cases, have expired. Most of these are small duties on trades in corporate shares.

Accordingly the ***São Paulo Statement on International Financial Transformation for the Economy of Life*** makes the following proposal:

"A Global Financial Transactions Tax on trades in equities, bonds, currencies, and derivatives should be established immediately. Likewise, a democratically representative agency to receive and allocate the proceeds for global public goods, including the eradication of poverty and disease, and the costs of climate change mitigation and adaptation incurred by low-income countries, must also be set in place."

3. Ecological Taxation

Ecologists advocate several kinds of "green tax reform." One measure would be to shift taxes away from areas such as payroll taxes on incomes to "ecological bads" such as activities that pollute or destroy ecosystems.

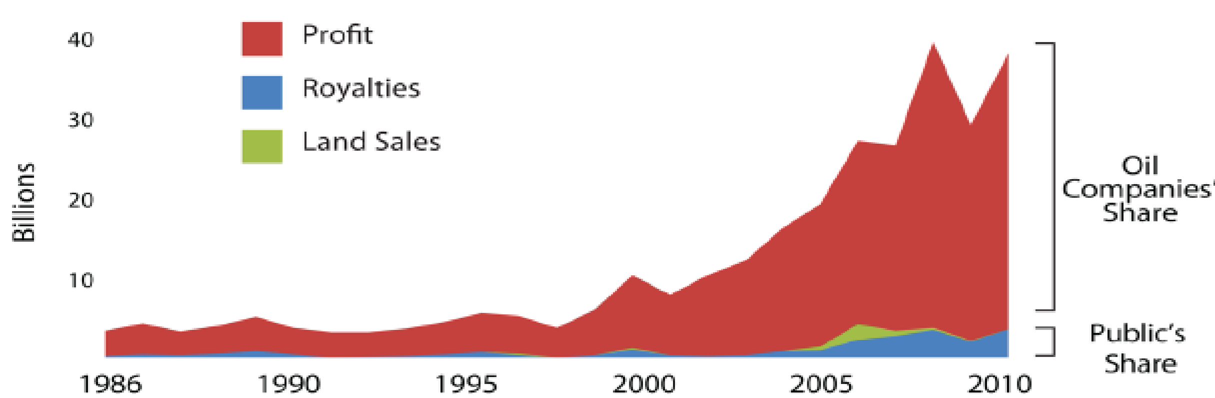
Taxes can be used to capture "economic rents," that is, the excess that corporations amass from natural resource extraction after allowing for production costs and a normal rate of profit.

For example, a study by the University of Alberta's Parkland Institute found that between 1999 and 2008 the provincial government allowed conventional oil and gas corporations to collect $121 billion worth of excess profits because royalty rates were very low. Similarly, from 1997 to 2008, tar sands companies earned between $97 billion and $127 billion in pre-tax profits, of which 80% to 90% were in excess of a normal 10% rate of return on investments.[25]

As a consequence of these low royalties, taxpayers were effectively subsidizing one of the most ecologically destructive projects on Earth. Extraction of synthetic petroleum from the tar sands leaves a huge ecological footprint that emits 3.2 to 4.5 times more greenhouse gases than conventional oil at the point of extraction.

The following figure shows that public revenues amounted to only 6% of the total value extracted from the tar sands over 24 years.

FIGURE 1 | Distribution of Tar Sands Revenue ($2010)



Source: Calculations based on data retrieved from CAPP, Statistical Handbook,November 2011.

Figure reproduced from *Misplaced Generosity: Update 2012. Extraordinary profits in Alberta's oil and gas industry.* Edmonton: Parkland Institute. Used with permission.

Low provincial royalty rates are only one way that governments subsidize tar sands production. In addition, tar sands producers are allowed to deduct from their federal and provincial corporate taxes the costs of the natural gas they use to extract and upgrade bitumen.

Carbon taxes

Carbon taxes could be effective measures both for fighting climate change and raising revenue for investments in low-carbon alternatives. A US$20 per tonne carbon tax in the United States could raise US$1.5 trillion over 10 years.[26] Estimates of the revenue potential of a global carbon tax range from US$318 to $980 billion by 2015, and from US$527 to $1,763 billion by 2030.[27]

Part of the revenue from a carbon tax should be rebated to low-income households so that the poor who spend a higher percentage of their income on energy are not unduly affected. Another portion of the revenue should be invested in energy efficiency, conservation and renewable energy projects to assist in the transition from fossil fuels to low-carbon alternatives.

Accordingly **the São Paulo Statement on International Financial Transformation for the Economy of Life** makes the following proposal for ecological taxation:

"Ecologically destructive industries and activities must be heavily taxed or prohibited. Fossil fuel extraction and carbon emissions should be taxed while at the same time rebating some of the proceeds to low-income households and using other revenues for investments in energy efficiency, conservation and renewable energy to assist in the transition to a low-carbon economy."

4. Progressive Tax Reform

As noted by former World Council of Churches General Secretary Konrad Raiser in a study for the WCC's Greed Line Working Group: "The traditional method of reducing inequalities and achieving internal redistribution has been the taxation system."[28]

The financial corporations and the trading activities that were instrumental in causing the 2008 financial crisis are generally under-taxed compared with other industries. In many jurisdictions value-added taxes are not applied to most financial transactions. Capital gains are often taxed at only half the rate of other income.

Nobel laureate economist Joseph Stiglitz asks, "Why should those who make their income by gambling in Wall Street's casinos be taxed at a lower rate than those who earn their money in other ways?"[29]

Thanks to a series of rate cuts by federal and provincial governments, "The effective corporate income tax rate for Canada's big six banks declined from 31.6 percent in 2000 down to an estimated 20.7 percent in 2010."[30]

Reductions in tax rates for individuals have had a dramatic effect. In Canada, the top marginal tax rate, including both provincial and federal taxes, was 80% in 1948. It fell to an average of 42.9% in 2009.[31]

Between 1990 and 2005 the wealthiest one percent saw their taxes cut twice as much as the taxes paid by average Canadians. As a result, by 2005 the richest one percent were paying 30.5% of their income at a slightly lower rate than the 30.7% paid by the poorest 10 percent.[32]

"Since 1980 the top 1% has increased its share of national income from 8.1% to 13.3%. A shift of C$67 billion."[33] If this lost revenue had been collected, Canada would not have any federal or provincial budget deficits nor any need for austerity programs.

Anti-tax sentiment a manufactured consent

For most of the last century there existed in North America a general consensus on the need for taxes as a means of financing public goods. This consensus was summed up in the famous dictum of U.S. Supreme Court Justice Oliver Wendell Holmes who declared in 1904: *"Taxes are the price we pay for a civilized society."*

Journalist Linda McQuaig and tax law professor Neil Brooks argue that the mania against taxation was in large part manufactured. Groups such as the Canadian Taxpayers Federation and Americans for Tax Reform worked hard to reshape public opinion. In Canada, the Fraser Institute sponsors an annual "tax freedom day" that supposedly marks the day when Canadians finally start working for themselves after having laboured for half the year to pay taxes and fees levied by all levels of government – federal, provincial and municipal.

In the United States, moderate Republicans initially resisted signing the pledge from Americans for Tax Reform by which they promised to oppose all efforts to raise taxes on the rich. But they eventually came around, as did some Democrats.

Political scientists Jacob S. Hacker and Paul Pierson have analyzed how public opinion in the United States was manipulated to win approval for tax cuts during the George W. Bush administration. When opinion polls asked whether people favoured "Bush's tax cut proposal" without providing a context, most respondents invariably said yes. But when the question was framed as whether voters favoured tax cuts or Social Security, "Tax cuts lost by a margin of 74 to 21; versus Medicare, they lost 65 to 22 percent."[34]

The Bush administration proceeded with a strategy of presenting tax cuts as part of its "starve the beast" strategy, i.e., the theory that the best way to reduce the size of government is to deprive it of revenue. Despite the fact that this theory has been empirically shown to be counterproductive, the myth that one can shrink spending and deficits through tax cuts persists.[35]

According to the Center for Responsive Politics, "The finance, insurance and real estate sector combined to spend US$6.8 billion on federal lobbying and campaign contributions from 1998 through 2011."[36] Financial sector lobbyists outnumber members of Congress by a ratio of 3.7 to one.

In the United States, billionaire Warren Buffett offered a stark perspective in his August 14, 2011, opinion piece in *The New York Times* entitled "Stop Coddling the Super-Rich."[37] He noted that the previous year he had paid only 17.4% of his taxable income in taxes while the average tax rate of the 20 people he employs in his office had been 36%.

Buffett noted one major reason why investors like himself pay lower taxes is their ability to classify income as "carried interest" or as capital gains, both of which are taxed at a rate of 15%. Accordingly, Buffett concluded that tax rates for those earning more than US$1 million a year should be raised immediately with even higher rates for those earning over US$10 million.

Buffett's intervention in the debate led to a guideline proposed by President Obama known as "the Buffett Rule" that would apply a minimum 30% tax rate on the income of individuals making more than $1 million a year. This proposal was contained in a Senate Bill, the "Paying a Fair Share Act of 2012," which received 51 votes.

However, it was blocked by a filibuster by Republican Senators who prevented it from receiving the 60 votes needed for proceeding to debate and final approval. Public opinion polls indicated that 60% to 72% of U.S. citizens supported the Buffett rule but it was staunchly opposed by Republican members of Congress.

Economists Emmanuel Saez and Thomas Piketty analyzed what the "Buffett Rule" would actually achieve and found it would do little to close the wealth gap. They propose top marginal tax rates of 50% to 70%, even as high as 90%.[38]

While the 90% figure may appear high, it is important to recall that in 1945 the top marginal tax rate was 94%. It was still 91% in the 1950s and 70% in the 1960s and 1970s. After the Tax Reform Act of 1986 it was lowered to 28%, raised to 39.6% in the 1990s during the Clinton Administration before it fell to 35% under President George W. Bush.[39]

Saez and Piketty, along with colleague Stefanie Stantcheva, investigated the claim that tax cuts for the rich are needed to stimulate economic activity and that tax increases would slow it down. A study of 18 OECD countries found "little empirical support for the claim that reducing the progressivity of the tax code has spurred economic growth, business formation or job growth." [40]

In fact the opposite is true. Redistribution of income is more stimulative as low-income people spend while the wealthy tend to put money realized through tax reductions into savings. Saez and economist Peter Diamond estimated the optimal top marginal tax rate, that is the one that would raise most revenue without slowing the economy, could be as high as 83%.[41]

The case for progressive taxation

Joshua Farley and fellow ecological economists argue: "The measure of tax justice should not be how much is taxed away, but rather how much income remains after taxes." [42] They take the example of hedge fund manager John Paulson who earned US$4.9 billion in 2010 and reportedly paid no income taxes.

Farley and colleagues calculate that if Paulson were to pay a flat tax of 99% of his income he would still retain nearly one million dollars a week in take-home income. They conclude that until reforms to monetary and fiscal policy make it impossible for hedge fund managers to earn such extraordinary incomes, "extremely progressive taxation should remain an option."[43]

Accordingly the ***São Paulo Statement on International Financial Transformation for the Economy of Life*** makes the following proposal for progressive taxation:

"Capital gains must be taxed in the same way as other income. Likewise income taxes should be made much more progressive, especially for the highest income earners. Revenues from wealth taxes and estate taxes should be used for public purposes."

Conclusion

Christian churches have important roles to play as advocates for tax reform to fight poverty, redistribute wealth and care for the wellbeing of the human and non-human community of life on Earth.

Taxes can serve both a revenue raising function and also be used to discourage financial speculation. They can serve as measures for achieving ecological justice in a world where life as we know it is threatened by climate change.

Theologian Rebecca Todd Peters invokes images of covenant relationships between God and peoples as "a strong foundation for developing a theological basis for decisions about tax policy. Remembering our own covenant relationship with God, we are called to think about our covenant responsibilities to each other as Christians in community; to the earth and all our neighbours, near and far; and to God." [44]

KAIROS: Canadian Ecumenical Justice Initiatives unites eleven churches and religious institutions in work for social justice in Canada and around the globe.

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