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Investment: The Future Tax Base

Richard Bolwijn (United Nations Conference on Trade and Development, Division on Investment and Enterprise, Geneva) · Wednesday, July 1st, 2015

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Policymakers are changing the international tax system to counter tax avoidance by multinationals. Has the potential impact on new investment in jobs, growth and development been assessed? An opinion based on UNCTAD's World Investment Report 2015.

Global foreign direct investment (FDI) flows were down 16% in 2014. They are still hovering below their pre-crisis average. In Europe, badly in need of investment in jobs and economic growth, FDI is still at only one third of its historic peak. Developing countries as a group fare slightly better, but the poorest regions are benefitting relatively little. FDI in Africa remains below its 2008 level. Worrisome, because the investment gap to achieve the "sustainable development goals" is close to $ 2.5 trillion.

Closing the investment gap should be a priority. In practice, policymakers are more concerned with public revenues. Austerity and reducing public debt is the order of the day in Europe. Similarly, the development debate is all about improving domestic resource mobilization in developing countries. An obvious target, both in developed and developing countries, is fighting tax avoidance by multinational corporations.

In fact, the climate for policy initiatives tackling tax avoidance is proving fertile. At the global level, the G20 is pushing action against so-called "base erosion and profit shifting" by multinationals. In the EU, tax harmonization is no longer the dirty word it once was, if applied to corporations to counter tax avoidance.

Tax avoidance by multinationals causes revenue losses in developed and developing countries alike, and it causes an unfair distribution of fiscal revenues across jurisdictions. It must be tackled.

But anti-avoidance measures affect the global investment climate. Has anyone scenario-tested the impact on investment of measures being considered? Is there a risk that policymakers take hasty decisions, driven by the short-term need to boost public revenues and by public pressure to take action against unfair practices by corporations?

Perspective and a balanced approach are important. Yes, aim to maximize immediate tax revenues from international investors. But be careful to maintain a sufficiently attractive investment climate

to protect the existing and future tax base. In developing countries, estimated revenue losses from tax avoidance are about $100 billion. Multinational corporations still contribute more than 7 times that amount to government coffers. If economic growth and sustainable development requires both public and private investment, the fiscal climate for investors must be balanced to ensure sufficient revenues to support public investment and sufficient returns to promote private investment.

Much of the scrutiny by the public and by policymakers focuses on the way corporations structure their investments through so-called conduit structures. These tend to be located in countries that offer fiscal advantages for cross-border investors, such as large treaty networks for the avoidance of double taxation, tax rules that do not "skim" profits when they are transferred in or out of the country, and commercial rules that enable corporate structures for the management of international operations. Well-known "investment hubs", such as the Netherlands, Luxembourg, the UK and many others, are increasingly under pressure.

Yes, these investment hubs have negative side-effects and can facilitate tax avoidance by MNEs. But there is another side of the coin. These structures are part of the international financing infrastructure for FDI. They are the "plumbing" of the international investment system. So much investment flows through them (around half of global corporate investment by some estimates) that it is dangerous to tinker with the system without careful analysis of the impact on investment.

How much investment – in Europe and in developing countries – would be lost if it can no longer benefit from the facilitation role of investment hubs? How much would be postponed – when we can least afford it – due to policy uncertainty? How much would be diverted – often to alternative offshore locations with laxer governance – because of unilateral, regional or piecemeal anti-avoidance measures?

Act in haste, repent at leisure. The policy imperative is to tackle tax avoidance and to boost investment. A proper debate on proposed changes in international tax rules is due, taking into account all aspects, including the impact on investment.

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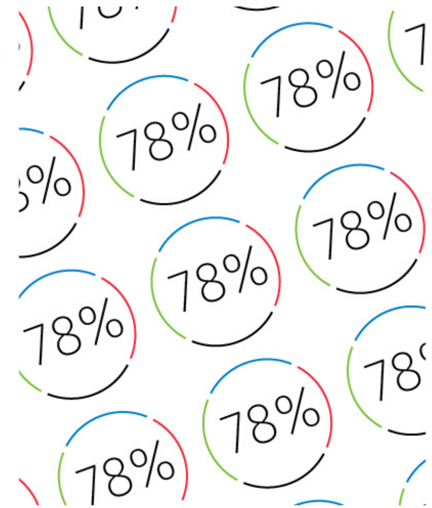

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This entry was posted on Wednesday, July 1st, 2015 at 5:00 am and is filed under Tax Avoidance, United Nations
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