

Taxation and International Development

North-South Conflicts over Capital Flight and International Taxation Issues after World War II, 1945–1970

PhD candidate Samuel Beroud, University of Geneva

Dr. Christophe Farquet, University of Geneva

Prof. Marc Flandreau, University of Pennsylvania

Dr. Thibaud Giddey, University of Lausanne

PhD candidate Yejin Heo, Graduate Institute, Geneva

Prof. Matthieu Leimgruber, University of Zurich

Corresponding author: matthieu.leimgruber@uzh.ch

Table of contents

Executive Summary	2
WP1. Multilateral fiscal diplomacy and expertise from the League of Nations to the OEEC/OECD	2
WP2. Quantitative and qualitative estimates of capital flight from developing countries before 1970	4
WP3. Tax evasion and technical tax assistance: national case studies	6
Conclusive considerations	7
Ongoing and future collaboration with other researchers	8
Project output	9

Abstract

The purpose of this research project was to study capital flight and international tax evasion between developed and developing countries during the 1945-1970 period. This period was selected as it has been neglected by existing research on the topic, which tends to focus almost exclusively on the post-1970 (and even post-1990) period. The project aimed to combine an analysis of international tax negotiations, based on archival sources, and the quantification of illicit capital flows in an effort to increase theoretical reflections on the basis of these empirical data. In conclusion, the project output working papers emphasize the shortcomings of both multilateral and bilateral approaches in the attempts to fight capital flight from developing to developed countries. These shortcomings are compounded by the resilience of the defence of tax havens in core industrialized capital exporting countries.

Executive Summary

The purpose of this research project was to renew the study of capital flight and international tax evasion between developed and developing countries during the 1945-1970 period. This period was selected as it has been neglected by existing research on the topic, which tends to focus almost exclusively on the post-1970 (and even post 1990) period. The project aimed to combine an analysis of international tax negotiations, based on archival sources, and the quantification of illicit capital flows in an effort to increase theoretical reflection on the basis of these empirical data.

This research project intended to test three hypotheses regarding the 1945-1970 period:

1. Given the restrictions on financial flows and the still limited mass of movable assets in non-Western countries, South-North capital flight was a controllable problem at the end of World War II;
2. Governments of South countries made every effort to curb international tax evasion;
3. A coalition of economic powers was formed within international bodies against the establishment of taxation and capital flow regulations favorable to developing countries.

Should all three hypotheses be confirmed, this would lend support to the idea that the post-war period was a lost opportunity for the regulation of international tax evasion from the poor countries due to the attitude shown by the major Western powers as well as business circles originating from these countries.

The SNIS group has produced eight working papers (two of them have already been published as of July 2017) exploring various domains related to these three hypotheses. We present below a brief synthesis of these research results, bringing together working papers in three “work packages” (WP). We then offer some intermediate conclusions on the whole of this research effort and we underscore ongoing collaboration that might enable us to pursue research after the formal end of the SNIS project. This executive summary also contains a list of all the working papers produced in the context of this SNIS project.

WP1. Multilateral fiscal diplomacy and expertise from the League of Nations to the OEEC/OECD

The four papers realized in the context of this first working package analyze the multilateral diplomatic arenas and transnational tax expertise networks that were central to international tax issues and capital flight from the 1920s to the late 1980s.

The first paper, **Farquet/Leimgruber 2015**, has served as a background study for the SNIS project. It charts the ebbs and flows of three cycles of international mobilization against tax havens and offshore finance from 1920 to 1990 and identifies the key international committees in charge of discussing capital flight and tax evasion at the League of Nations (1923-1939/43), at the United Nations (UN, 1944-1955) and, finally, at the Organization for

European Economic Cooperation (OEEC, 1956-1961) and the Organization for Economic and Cooperation and Development (OECD, since 1961).

After briefly recounting the first attempts to regulate offshore finance in the 1920s and underscoring the disappearance of international debates on tax evasion during the 1930s and after World War II, the paper identifies the period 1956-1963 as a second key moment for international tax regulation. With the increase of offshore practices, amid early financial liberalization, the US and several other European countries attempted to prevent tax evasion. However, these early efforts brought only very narrow outcomes. After this brief flourish of regulatory attempts, pressure on tax havens again subsided for almost a decade. During the third cycle of mobilization, spanning the 1970s and the 1980s, which coincided with a growing budgetary crisis in Western countries, an increasing number of multilateral initiatives against harmful tax practices emerged. Yet, beyond rhetorical threats, tax havens remained largely untouched: at the turn of the 21st century, a paradigmatic tax haven such as Switzerland could still easily brush off international actions against tax evasion. Explaining such resilience is a key puzzle that is addressed in this contribution.

The paper also underscores the weakness of the Global South in all these discussions. Most developing countries were, of course, still colonies during the League of Nations years and the pace of decolonization picked up only during the 1960s. Second, the concentration of debates within the OEEC/OECD, an international organization with a pronounced Western/Northern profile until the 21st century, much contributed to this exclusion. By contrast, the paper identifies the moment during which the UN was in charge of international taxation regulation, from 1944 and 1954, as a brief – but missed – opportunity for developing countries to make their voices heard.

This neglected transition period is analyzed in detail in **Sandoz 2016**. Using UN archives, the author retraces the 1940 and 1943 Mexico tax conferences, during which capital importing nations from Latin America attempted to weigh on multilateral tax debates by insisting on the need to develop source-based taxation of multinational corporations' activities, instead of following, as the League of Nations the principle of taxing at the residence, which offered more leeway to creditor countries of the West. The works of the UN Fiscal Commission responded in part to these calls for enlargement both in terms of participation and topics (such as the relationships between tax systems and development). At the same time, the author shows how creditor nations and business lobbies quickly re-centered multilateral tax debates, first during the 1946 London tax conference and, a decade later, when the UN was finally bypassed and tax topics were transferred to the much more exclusive setting of the OEEC/OECD.

The role of the UN is explored further in **Giddey 2017**. This research paper tracks the activities of the 'Ad Hoc Group of Experts on tax treaties between developed and developing countries', which was established by the UN Economic and Social Council in 1967. Set up in response to a UN resolution which designated tax treaties as a way to promote investment flows into developing countries, the Ad Hoc Group of Experts attempted to draft an alternative reference to the 1963 OECD model tax convention (revised in 1977). The aim was to make this OECD scheme more favorable to taxation in the country of source, as most developing countries were net capital importers. Whereas the activities of the Ad Hoc Group

has usually been linked to the encouragement of foreign investment, its first reports underscore that the issue of capital flight was an underlying question. In 1969, the UNCTAD secretariat opened a discussion with the Ad Hoc Group of Experts to consider the use of the exchange of information provision in tax treaties to obtain fiscal information about developing countries citizens and firms from tax administrations in developed countries. Although this project was debated within the UN, the final UN model convention which emerged in 1980 did not provide a significant improvement with regard to anti-capital flight measures.

This paper identifies two main reasons for these disappointing results. First, the members of the Ad Hoc Group were invited because of their technical knowledge and were not country representatives; the presence of business organizations (mainly the International Chamber of Commerce and the International Fiscal Association) as well as other multilateral organizations representing capital exporting countries (OECD, IMF) thus influenced the discussions. Second, developing countries were unable to define and defend their common interests because of their great diversity as a group, and the issue of capital flight did not affect them equally.

The fourth and last research paper, **Leimgruber 2017** analyzes non-state expert and business networks in the domain of international taxation. The paper focuses in particular on the creation and development of the International Fiscal Association (IFA) from the 1930s to the 1980s. Founded right before World War II by a closely-knit group of European and American tax scholars and practitioners with the aim to supplement the works of the Fiscal Committee of the LoN, the IFA emerged by 1950 as the key meeting point for corporate tax advisers and lawyers. The IFA and its members, which at first came exclusively from capital exporting countries, thus served as a connector between official multilateral tax fora, such as the UN Fiscal Commission and, from 1955 onwards, the OEEC/OECD Fiscal Committee, and multinational enterprises and financial interests. The paper argues that the IFA worked as a kind of "shadow tax cabinet" closely attuned to business and financial interests and how their actions have contributed to the persistent ineffectiveness of multilateral attempts to fight capital flight and tax evasion.

WP2. Quantitative and qualitative estimates of capital flight from developing countries before 1970

The two contributions of this work package use new qualitative sources, new data as well as new methodology in order to assess the extent of capital flight from the developing countries from the 1950s to the 1970s. These decades are crucial in order to understand the shaping of the Global South as they encompass both the decolonization period, during which new countries enter *en masse* the United Nations, and the attempt of the new Global South to assert its presence on the multilateral stage (through organizations and platforms such as the Non-Aligned Movement, the G77 country group and the UNCTAD). Both papers focus on the African continent, a region that figures prominently in discussions about capital flight and its debilitating impact on socio-economic and political development.

Using IMF and IBRD/World Bank datasets on balance of payments and capital flows, **Heo 2016** presents new quantitative estimates of capital flight from 22 African countries for the period 1950-1970. The paper follows three methods in order to ascertain the extent of this phenomenon. It relies first on a survey of net errors and omissions in balance of payment statistics, ii) the “Hot Money” approach, which also takes into account short term private capital flows, and iii) the trade misinvoicing approach, which tracks discrepancies between the value of exported and imported merchandise in African countries trade statistics. Despite the sub-optimal quality of data available for this period, this triangulation method underscores that the third method (trade misinvoicing) might be the most promising for further studies.

In a second step, the paper applies an econometric analysis to a subset of 12 African countries where sufficient data on taxation and external debt exist for the period 1950-1970. This analysis identifies higher national taxation, increased external debt, and decolonization as clear «drivers» for capital flight. In its final section, the paper briefly delves into Ethiopia, Ghana, and Tanzania.

Table 1. Sample of capital flight cases from developing countries towards Switzerland, 1955-1978

	1950s	1960s	1970s
Evidence rank	0 2 0	3 3 7	0 3 5
Latin America (N = 4)	Argentina (1955-1956), Cuba (1959-1962)	Dominican Republic (1961- 1967), <i>Brazil</i> (1969)	
Asia (N = 2)		Indonesia (1966-1969)	<i>Ceylon</i> (1972)
North Africa (N = 2)		Algeria (1964-1975)	<i>Egypt</i> (1976)
Sub-Saharan Africa (N = 15)		<i>Angola</i> (1966), <i>Congo (I)</i> (1963-1964), Congo (II) (1964-1967), <i>Ghana</i> (1966- 1970), <i>Nigeria (I)</i> (1966- 1967), Nigeria (II) (1967- 1968), <i>Senegal</i> (1963), <i>Sierra</i> <i>Leone</i> (1967), Sudan (1968)	Ethiopia (1974-1975), Kenya (1972-1973), Nigeria (III) (1974- 1977), <i>Rhodesia</i> (1978), <i>Uganda</i> (1971-1972), <i>Zaire</i> (1975)

Evidence rank is based quality of the archival documents, ranked as **high**, acceptable, *low*

Sources: see **Farquet 2017a**

Using Swiss diplomatic sources **Farquet 2017a** demonstrates that qualitative methods may in certain cases enable us to overcome the lack of reliable quantitative data about capital flight, a key issue underscored by the preceding paper, and bring to light new facts and data about specific case. Because of the intimate proximity between Swiss diplomats and bankers, Swiss diplomatic sources provide an excellent observation platform to collect new qualitative and quantitative evidence about capital flight that has remained buried in unpublished correspondence, reports and memoranda. Table 1 (see above) briefly presents the 23 cases of capital flight from developing countries towards Switzerland that have been collected during the preparation of the paper and classifies them by regions as well as chronologically. For

around half of the 23 cases studied, the quality of the evidence found in archival documents can be considered as "high" or "acceptable". Besides bringing to the surface these cases – some of them for the first time – and documenting them, this paper also discusses how Swiss diplomats developed routines in order to deal with regular accusations against the uses of Switzerland as a tax and wealth haven and repeated criticism against the banking secrecy techniques that were deemed to favor capital flight.

Needless to say, the cases surveyed remain fragmentary, and pinpoint in particular «affairs» and «scandals» that were deemed important enough to be carefully followed by diplomatic channels. However, and despite its obvious limits, this sample highlights the repeated and growing issue of capital flight from the 1960s onwards, at the apex of decolonization. The cases listed in Table 1 are also more numerous than other lists previously presented by authors working on this topic, which underscores to need to extend the investigation to further archives.

WP3. Tax evasion and technical tax assistance: national case studies

A third group of paper deals with the attitude of selected developed countries regarding North-South capital flight. Based on national archives, they show how economic, political and even geopolitical considerations contributed to shape their reaction to the claims of developing countries. They help us to understand the position of these countries in multilateral discussion as such motives remained usually unstated in the public sphere.

Beroud 2017 explores the ambiguous attitude of the US government regarding technical fiscal assistance to Latin America in the decades following World War II. On the one hand, the US was keen to maintain liberal – and in many cases permissive – fiscal systems in the Global South to protect US investments, in particular the repatriation of the profits of multinational enterprises. This was particularly important with regards to Latin America as the area absorbed an impressive 41 percent of US foreign investments in 1950. On the other hand, the US followed in the postwar era a policy of “hemispheric defense” that sought to prevent the emergence of Communist regimes in Latin America. Although Washington did not hesitate to support military regimes when it did not itself intervene to overthrow socialist leaders, the US also understood that the role of inequalities of income and wealth as well as capital flight as underlying causes for political instability and lack of economic growth. The establishment of an efficient fiscal system in these countries were therefore seen as a prerequisite for long-term socio-economic and political stability.

Underscoring the tensions between the objectives of the US State Department and the Treasury is a common topic in US economic and diplomatic history. This paper shows, however, that the Treasury Department itself, and in fact even its Office of the Assistant Secretary for International Affairs (OASIA) was divided on the issue of international taxation. Indeed, while the OASIA opposed efforts from the Global South to regulate capital flight, in particular within the UN, it provided at the same time and on case-by-case base technical fiscal assistance to Latin American countries. This paper underscores the evolution of an

unstable compromise between the need to promote fiscal systems that would not hit US interests and would not constitute an obstacle to further foreign investment while improving the overall efficiency of the fiscal machinery. Indeed, as a 1958 US-Brazilian study showed, combatting tax evasion on the basis of the existing fiscal regime would have been sufficient to eliminate budgetary deficits of the Brazilian federal state. However, these regulations were poorly implemented.

Farquet 2017b analyzes the situation of the Swiss tax haven during the post 1970 expansion of offshore finance. During this period, characterized by increasing deregulation of international financial flows after the dismantling of Bretton Woods constraints, the Swiss tax haven found itself in a delicate situation. If financial deregulation at first contributed to a dramatic increase of foreign untaxed financial flows towards Swiss banks and financial institutions, the generalization of offshore brought new challenges to the fore. On the one hand, the fact that several other banking and financial places (such as Austria, Luxemburg or the United States) were now actively adopting practices to attract offshore flows meant that the Swiss tax haven faced increased competition. On the other hand, the erosion of state finance and the rise of public debt in both industrialized countries and the Global South also meant that the Swiss tax haven faced increased criticism at the multilateral level, in the context of bilateral relations and, last but not least, from domestic actors within Switzerland itself. Using original archival documents, this paper documents how Swiss diplomats, bankers and politicians fended off attempts to discuss topics such as tax evasion, capital flight and banking secrecy in the context of the OECD, in negotiations with France, Germany and Belgium, and how the Swiss government and the Swiss Bankers' Association finally defeated in 1984 an unprecedented Socialist Party initiative against offshore banking practices.

Conclusive considerations

The failure of international attempts at regulating capital flight and tax issues between developing and developed countries between 1945 and 1970 was one of the key issues of this SNIS project. The eight articles and working papers produced provide different and partial answers to the question, according to the various approaches and perspectives adopted. While some focus on the inadequacy and inefficiency of the multilateral debate platforms (League of Nations, United Nations, OEEC/OECD), others highlight the harmful effect of some business organizations and the powerful resilience and primacy of national interests both in multilateral and bilateral negotiations. Moreover, the lack of coherence of the South countries and their representatives on the international stage also appears as a key factor.

This last argument highlights that future research on this topic should mainly focus on the attitude of developing countries. The SNIS project, primarily fueled by archival evidence from Western/North actors, has not adequately taken into account the point of view of developing countries.

Ongoing and future collaboration with other researchers

Working papers from this SNIS research project have been presented at various venues, workshops and conferences within and outside of Switzerland (for a full list, see section "Project Output" below). These public presentations have enabled us to build contacts with new scholars and research networks working on the history of international taxation. Several of these collaborations will continue to be developed despite the formal end of the project in July 2017.

For example, we are planning to organize in October 2017 in Lausanne or Geneva a meeting with Dr. **Martin Hearson** (London School of Economics and Political Science, Department of International Relations).¹ Dr. Hearson has worked on bilateral tax diplomacy between the United Kingdom and developing countries in the postwar period and is also a tax justice expert. This informal workshop will be centered on three papers from the SNIS group – (**Leimgruber 2017**), (**Beroud 2017**) and (**Giddey 2017**) – and will also discuss the preparation of a special issue of a scholarly journal on the issue of international tax diplomacy with a focus on North-South issues in historical perspectives.

The SNIS group is also in regular contact with Professor **Vanessa Ogle** (University of Pennsylvania, Department of History), which acted as the convener for the international conference "Global histories of taxation and state finances since the late 19th Century" held in Basel in December 2016. Continuing collaboration with Professor Ogle will be facilitated by the fact that Professor Marc Flandreau was hired in February 2017 as Howard Marks Professor of Economic History at the University of Pennsylvania.

The SNIS group has also been in contact from the spring 2017 onwards with the **COFFERS network** (Combating Fiscal Fraud and Empowering Regulators, see <http://coffers.eu>) financed by the EU Horizon 2020 program. We are in particular in contact with the research group based at the Copenhagen Business School (Profs. Duncan Wigan, Brooke Harrington and Leonard Seabrooke). Works with this research group will presumably take the form of a joint paper co-written by Professor Matthieu Leimgruber and PhD candidate Rasmus Corlin Christensen (COFFERS Copenhagen), with the aim of comparing the pre-1990 role of the IFA and its current position in transnational tax expertise networks.

¹ <http://www.lse.ac.uk/researchAndExpertise/Experts/profile.aspx?KeyValue=m.hearson@lse.ac.uk>

Project output

This list presents (in chronological order) the eight working papers, book chapters and articles produced in the context of the SNIS project between 2015 and 2017. When applicable, this list also indicates the conferences and workshops during which these papers were presented, as well as their progress towards publication.

1. **(Farquet/Leimgruber 2015)**

Christophe Farquet & Matthieu Leimgruber, Catch me if you can! Switzerland, the market for tax evasion and fiscal diplomacy from the League of Nations to the OECD, 1920-1990, working paper, Paul Bairoch Institute of Economic History, University of Geneva, 2015

-> this working paper has been presented at the following venues/workshops:

European Business History Association, Leiden (25.08.2014) ; Workshop International tax competition and financial secrecy, University of St Gallen (Switzerland, 27-28.11.2014) ; Staff Workshop Paul Bairoch Institute of Economic History, University of Geneva, 18.05.2015 ; Geschichtskontor, University of Zurich, 06.10.2015

2. **(Sandoz 2016)**

Marie Sandoz, Une parenthèse onusienne? Les débats fiscaux multilatéraux de la SDN à l'OECE (1939-1956), Mémoire de maîtrise en histoire économique, Institut d'histoire économique Paul Bairoch (sous la direction de Matthieu Leimgruber), Université de Genève, Janvier 2016

3. **(Heo 2016)**

Ye Jin Heo, Capital Flight from Africa: New Estimates, 1950-1970, working paper, Graduate Institute, Geneva, September 2016

-> this working paper has been presented at the following venues:

BBL Seminar, Graduate Institute, Geneva, 04.2016; Schweizerische Gesellschaft für Sozial- und Wirtschaftsgeschichte, Bern, 09.2016

-> **forthcoming** in Gisela Hürlimann, Juan Flores Zendejas, Luigi Lorenzetti, Hans-Ulrich Schiedt, Texte und Zahlen. Der Platz quantitativer Ansätze in der Wirtschafts- und Sozialgeschichte/Des textes et des chiffres. La place des approches quantitatives dans l'histoire économique et sociale, Annuaire SSHES/Jahrbuch SGWSG, Zürich: Chronos, 2017

4. **(Farquet 2017a)**

Christophe Farquet, Au-delà des affaires, de la corruption et de la spéculation. Analyse de la fuite de capitaux vers le nord au temps de la décolonisation au travers des sources diplomatiques suisses, Working Papers of the Paul Bairoch Institute of Economic History, University of Geneva, 4/2017 (<https://archive-ouverte.unige.ch/unige:93527>)

5. **(Farquet 2017b)**

Christophe Farquet, "The Swiss Tax Haven, the Bretton Woods System Crisis and the Globalisation of Offshore Finance », in Marc Buggeln, Martin Daunton, Alexander

Nützenadel (eds), *The Political Economy of Public Finance. Taxation, State Spending and Debt since the 1970s*, Cambridge: Cambridge University Press, 2017, p. 126-148.

-> previous version **Christophe Farquet**, Le havre fiscal et la globalisation de l'offshore, Working Papers of the Paul Bairoch Institute of Economic History; University of Geneva, 3/2017 (<https://archive-ouverte.unige.ch/unige:93528>)

6. **(Leimgruber 2017)**

Matthieu Leimgruber, Tax lawyers of the world, unite! Mitchell B. Carroll (1898-1987), transnational tax networks and international capital, working paper, University of Zürich

-> this working paper has been presented at the following venues/workshops:
« Global histories of taxation and state finances since the late 19th Century », Basel, 12.2016;
Society for the Advancement of Socio-Economics (SASE 2917), Lyon, 29.06.2017)

7. **(Beroud 2017)**

Samuel Beroud, Fiscal evasion and political stability: The US dilemma towards Latin America, 1950-1973, working paper, Graduate Institute, Geneva, June 2017

8. **(Giddey 2017)**

Thibaud Giddey, UN fruitless efforts to combat capital flight from developing countries: double taxation convention model and the Ad Hoc Group of Experts, 1967-1980, working paper, Graduate Institute, Geneva, June 2017