WORLD SOCIAL FORUM, NAIROBI, KENYA, JANUARY 2007

MIRROR, MIRROR ON THE WALL, WHO'S THE MOST CORRUPT OF ALL?

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Abstract

The current pre-occupation of the World Bank and G-8 countries with corruption and money-laundering is based on a narrow definition of both issues, which ignores the role of the offshore financial system in encouraging and facilitating capital flight and tax evasion. In focusing their agenda on bribery of public officials, these institutions have shaped perceptions of corruption around the concerns of multinational companies, which, driven by the pursuit of profit, want to reduce the 'cost' of bribery, but are unconcerned about the wider costs to society arising from their own aggressive tax avoidance policies and the broader economic impact of the globalised banking industry which encourages rich individuals to hold their assets offshore where they can evade taxes with almost total impunity.

This paper examines how ideological factors have shaped the geography of the corruption discourse to identify developing countries, particularly in Africa, as the primary locus of corruption, whilst concerns about how the prevailing financial infrastructure profits from handling the proceeds of criminal activity, including tax evasion, have been consistently ignored. The paper concludes with a number of recommendations for how perceptions of corruption can be re-aligned to take account of how 'supply side' factors influence global corruption.

Corruption: a game for two or more players

Since the mid-1990s corruption has moved to the centre stage of global politics. In 1995 Transparency International (TI) launched its international Corruption Perception Index (CPI) which encouraged the international media to give greater prominence to corruption whilst also exerting pressure on politicians, banks and international funding agencies to rank corruption amongst the core criteria for assessing credit risk and aid-worthiness. That same year, in its year-end editorial the *Financial Times* nominated 1995 the International Year of Corruption and identified the issue as a major impediment to cross-border investment and growth. Since that time a plethora of initiatives have been set in motion at the highest levels to tackle corrupt practices, most notably the OECD's Anti-Bribery Convention (1999) and the UN Convention Against Corruption (2003). Corruption has become a central feature of the development discourse, with key players, including the International Monetary Fund, the World Bank and the UK Department for International Development, identifying corruption as an impediment to growth and stability.[ii] Corruption is also increasingly seen as threatening equality and social stability, harming public trust in state institutions and governance,[iii] and damaging public confidence in business integrity.[iv]

> The globalised structure of secretive offshore financial centres has facilitated the cross-border transfer and laundering of dirty money

The deepening of globalised markets since the 1970s is seen as having increased the opportunities for corruption. The emergence of globalised corporations with huge financial and political power relative to national governments has provided additional resources for high-level corruption. The rapid pace of transfer of state assets to private ownership in North and South created opportunities for embezzlement of both assets and the income flows from those assets. The globalisation of financial markets, and in particular the creation of a poorly regulated globalised structure of secretive offshore financial centres, has facilitated the cross-border transfer and laundering of dirty money. In combination these factors have stimulated a virtual free-for-all in which illegal transactions have become almost indistinguishable from legitimate transactions, and criminals are able to draw upon the services of a sophisticated 'pinstripe infrastructure' of legal and financial advisers.

Crime has become increasingly complex, frequently involving cross-border transactions based on the arbitrage of differences between national legal or tax regimes. The relative ease with which such crimes can be perpetrated undermines public confidence in the rule of law, and corrodes the integrity of democratic forms of government. Some commentators identify the source of this high-level corruption as stemming from the divergence of capitalism away from the moral philosophy upon which Adam Smith based his vision of free, competitive markets towards the utilitarian ideas of Jeremy Bentham:

> *" . . his (Smith's) vision for this new economic order anticipated leaders of integrity, prudence, modesty and grace who would operate the free-market system with a sense of justice and fair play. Unfortunately,*

Smith's moral sentiments got separated from his economics. The greatest good for the greatest number – "maximising" – became the foundation of utilitarianism, a competing school of thought much more compatible with budding capitalists."[v]

Economic theory about corruption is underdeveloped and consequently tends not to take account of the way in which economic policies can create 'criminogenic environments' which stimulate crime.[vi] This is illustrated by the rapid growth of tax evasion which swelled in the wake of capital account liberalisation in the 1980s. The IMF promoted capital account liberalisation despite the evidence that offshore secrecy would hinder investigation efforts and make tax evasion virtually undetectable, especially in the case of developing countries with limited resources available for tax fraud detection. Predatory financial intermediaries recognised that profitable fees could be earned from selling tax dodging services on an industrial scale, and a culture of 'crime pays' became rampant. The intriguing question is whether the IMF anticipated this outcome but considered tax evasion a minor evil or whether this was an unintended consequence of its commitment to the Washington Consensus.

The incidence of tax evasion, and the scale of its impact on the revenue income of poorer countries, has risen significantly in the past three decades, but for the greater part this crime is scarcely recognised by those who have shaped the current corruption debate. The reason for this omission might partly arise from the general adoption of TI's definition of corruption as *"the misuse of entrusted power for private gain."*[vii] Operationally this definition has been interpreted in a way which largely focuses on the activities of those who hold power in the public sphere (politicians and state employees) and little attention has been paid to other power elites, including company directors, and financial intermediaries.

It is debatable whether TI intended to shape the corruption debate in this way, but the tendency to treat corruption as synonymous with bribery of public sector officials is partly due to the methodology of the CPI, which draws on the perceptions of businesses and a narrow range of think tanks. Unsurprisingly this community has tended to concentrate on those areas of corruption which impose a cost on business, bribery and kickbacks being the foremost issue of concern in this respect, without paying attention to issues such as tax evasion and trade mispricing which involve business imposing costs on the rest of society. Concerns have been expressed about the methodological biases of the CPI,[viii] and critics argue that the index distorts the geography of corruption by reinforcing negative images of developing countries and ignoring the higher level corruption of major companies and governments from the North.[ix]

The CPI identifies Africa as the most corrupt region of the world, accounting for over half of the 'most corrupt' quintile of countries in the 2006 index. A critical examination of the index, however, reveals that 53 per cent of the countries identified by the CPI as 'least corrupt' are offshore tax havens, including Iceland and New Zealand (minor players but both ranked joint 1st overall) and major centres such as Singapore (ranked 5th overall), Switzerland (7th), United Kingdom and Luxembourg (joint 11th), Hong Kong (15th), Germany (16th), USA and Belgium (jointly 20th). For good measure Barbados, Malta, and the United Arab Emirates (all tax havens) also fall into the 'least corrupt' quintile. Not a single African nation is ranked in the 'least corrupt' quintile.

Table 1: Tax havens economies ranked amongst the 'least corrupt' countries in Transparency International's 2006 Corruption Perceptions Index.

Country rank	Tax haven jurisdictions*	CPI score
1	Iceland / New Zealand	9.6
5	Singapore	9.4
7	Switzerland	9.1
9	Netherlands	8.7
11	Luxembourg / United Kingdom	8.6
15	Hong Kong	8.3
16	Germany	8.0
18	Ireland	7.4
20	Belgium / USA	7.3
24	Barbados	6.7
26	Macao	6.6
28	Malta / Uruguay	6.4
31	UAE	6.2

* source: Christensen, J. & Hampton M.P. (2005) tax us if you can, TJN-IS

What do these rankings tell us about the current politics of corruption? And who could disagree with the former Nigerian politician who, during protracted negotiations to secure the repatriation of assets stolen by former Nigerian President Sani Abacha, commented that: *"It is rather ironical that the European based Transparency International does not think it proper to list Switzerland as the first or second most corrupt nation in the world for harbouring, encouraging and enticing all robbers of public treasuries around the world to bring their loot for safe-keeping in their dirty vaults".*[x]

The perversity of the CPI rankings reflects the general confusion and inadequacy of the current corruption discourse. Through its operational focus on the public

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sector, and its dependence on the perception of a somewhat biased range of actors - at least some of whom have conflicts of interest – the CPI highlights one element of corruption without paying sufficient attention to other aspects of corruption, including:

- the activities of the supply side infrastructure of financial intermediaries who market aggressive tax dodging schemes and facilitate the laundering of the proceeds of crime through offshore companies, trusts and similar subterfuges; and
- the role of governments which actively collude in the process of encouraging illicit capital flight and tax evasion by offering secretive offshore facilities and soft regulation.

Trying to broaden the terms of debate upon which perceptions of corruption are shaped is not merely an issue of semantics. Corruption is a politically contested issue, defined according to the *"legal or social standards constituting a society's system of public order."*[xi] Cultural norms diverge significantly, for example in the way in which commissions are paid in return for high-level introductions, and although a process of convergence is underway, which might ultimately allow the formulation of a globally agreed definition of corruption, this is not likely in the foreseeable future.[xii] In view of these definitional complexities, some commentators argue that debate over definition might be counter-productive, proposing instead that the focus of anti-corruption initiatives should be less concerned with identification of an all-embracing definition and more concerned with pin-pointing the specific activities which contribute to the undermining of public confidence in the integrity of the systems of governance of public and private sector activity.[xiii] One critic argues that the CPI fails to fulfil a useful role in shaping the corruption discourse, concluding that *" . . it should no longer be published in its present form as it actually undermines the efforts of reformers."*[xiv]

These criticisms of the CPI challenge its legitimacy as the lead indicator used by multilateral institutions and private banks when determining the credit ratings of sovereign states. In its current format the CPI creates a distorting prism from which the activities of tax havens (most of which are closely linked to leading industrialised countries) are excluded. This bias might or might not be derived from an ideological slant within TI itself, but the CPI's deficiencies are sufficiently grave for its methodology, and the uses to which it is put, to be called into question. Disquiet about the CPI is not diminished by the close involvement of multinational audit and accounting firm Ernst & Young in its production. Ernst & Young has itself been implicated in a wide variety of corruption cases, and operates in many offshore tax havens.[xv]

TI is aware of the shortcomings of its index. In the press documentation accompanying the results of the 2006 CPI, TI noted that:

" . . the [corrupt] transaction is often enabled by professionals from many fields. Corrupt intermediaries link givers and takers, creating an atmosphere of

mutual trust and reciprocity; they attempt to provide a legal appearance to corrupt transactions, producing legally enforceable contracts; and they help to ensure that scapegoats are blamed in case of detection."[xvi]

It has yet to be seen, however, whether and how TI can adapt the CPI to create an international comparator index (or indices) which encompasses these broader concerns about corruption.

Tax havens create an offshore interface between the illicit and licit economies. They distort global markets and increase global inequality.

The political economy of the offshore system

It is impossible to conceive of the possibility of combating corruption without also tackling the broader issues of tax havens and the offshore economy. Tax havens provide an 'corruption interface' between the illicit and licit economies. They distort global markets to the disadvantage of innovation and entrepreneurship; slow economic growth by rewarding free-riding and mis-directing investment; and increase global inequality. The corruption interface functions through collusion between private sector financial intermediaries and the governments of states which host offshore tax haven activities. The majority of these states are major developed nations and their dependent territories. Despite the evocative images conjured up by the term 'offshore', it would be wrong to think of offshore as disconnected and remote from mainstream nation states.

Geographically, the majority of the 70 or so recognised offshore tax havens are located on small island economies dispersed across the spectrum of time zones. From a political economic perspective, however, these tax havens are inextricably linked to major OECD states, and the term 'offshore' is strictly a political statement about the relationship between the state and parts of its related territories.[xvii] In the British economy, for example, the bulk of offshore transactions are controlled by the City of London (also classified as a tax haven) albeit that many City financial intermediaries operate out of centres located on UK Overseas Territories and Crown Dependencies. These centres have a tangible form, with quasi independent fiscal and judicial systems, functional banks, trust companies and law offices, but in practice they do not function autonomously from the mainstream economies. They are primarily of use to the City because they offer zero or minimal tax rates combined with secrecy arrangements (including non-disclosure of beneficial ownership of companies and trusts) and regulatory regimes which are more permissive or less inquisitive than those prevailing in onshore economies.[1]

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[1] The British Channel Island of Jersey exemplifies this more permissive regime. The 2005 IMF inspection identified a problem with the lack of investment into financial crimes investigation, but no additional resource has been allocated since that time [Herbert, C., (2007) **Jersey 'lagging behind' in financial crime laws**, *Jersey Evening Post*, 4th January]

The defining feature of the offshore interface is the element of secrecy it provides, either through banking secrecy laws or through *de facto* judicial arrangements and banking practices. Secrecy creates an effective barrier to investigation by external authorities,[xviii] and facilitates the laundering of proceeds from a wide range of criminal activities, including fraud, embezzlement and theft, bribery, narco-trafficking, illegal arms-trafficking, counterfeiting, insider trading, false trade invoicing, transfer mispricing, and tax evasion. This reveals a major fault line in the financial liberalisation process. Whilst capital has become almost totally mobile, the ability to police cross-border dirty money movements is hindered by the lack of cooperative arrangements between national authorities. This applies in particular to attempts to tackle tax evasion. There are a number of reasons for this. Firstly, by definition capital flight involves illicit cross-border transfers which almost invariably lead to tax evasion in the country of residence of the beneficial owner. However, tax evasion is not generally included in definitions of money-laundering despite the fact that it involves criminal activity. We must ask ourselves why not? Secondly, the initiative by the OECD to tackle tax evasion through information exchange agreements has not succeeded to anywhere near the extent that was originally expected; ditto the European Savings Tax Directive, which since coming into force in July 2005 has failed to meet initial expectations.

The cause of these failures lies not with technical problems, which are surmountable, but with the lack of political will to achieve an international framework for cooperation. The unsurprising outcome has been a massive increase in cross-border dirty money flows, conservatively estimated at US$1 trillion annually.[xix] Half of this dirty money originates from developing countries. The vast majority of these funds are laundered via complex offshore ladders operating through the global banking system. Despite a plethora of anti-money-laundering initiatives the failure rate for detecting dirty money flows is astonishingly high, with one Swiss banker estimating that only 0.01 per cent of dirty money flowing through Switzerland is detected.[xx] It is unlikely that other major offshore finance centres, including Frankfurt, London and New York, are any better.

Many major companies are heavily implicated in the establishment of complex offshore financial systems explicitly designed to hinder legitimate investigation by national authorities. Experienced investigators refer to purposeful obstruction, even in cases where there is overwhelming evidence of criminal activity. For example, Patrick Smith, editor of *Africa Confidential*, alleges in the context of illegal oil bunkering and corruption in Nigeria that oil companies or their accountants sometimes maintain *"two sets of accounts. They will show you the set of accounts they want the government and officials to see. There will be another one locked away."*[xxi]

Over one half of global cross-border trade is routed on paper through tax havens, and about one-third of the assets of the global rich are held in offshore structures. The scale of the offshore interface is therefore immense, though many economists nonetheless overlook offshore in their analysis, which might explain their inability to explain the 'uphill' movement of capital from poor to rich nations despite the predictions of economic theory.[xxii] The prospect of financial crises might be a primary cause of capital flight, but offshore secrecy creates a strong incentive for the rich in developing countries to retain their assets in a tax-free environment. Most analysts agree that the awesome scale of capital flight from Africa, estimated by the African Union at $148 billion annually, results in a permanent drain of between 80 – 90 per cent of the capital to offshore financial centres in Europe, the Caribbean or North America.[xxiii] A study of Sub-Saharan African countries, for example, has concluded that the region is a net creditor to the rest of the world in the sense that its external assets (i.e. including the stock of flight capital) exceeds external liabilities (i.e. external debt).[xxiv] The chronic poverty that afflicts the region arises from the fact that the assets are largely held in private hands[2], whilst the liabilities have been assigned to the African public.

In March 2005 the Tax Justice Network published a briefing paper which estimated the stock of private wealth held 'offshore' by rich individuals, and largely undeclared in the country of residence, at about US$11.5 trillion.[xxv] The annual worldwide income on these undeclared assets is estimated at about US$860 billion, and the annual worldwide tax revenue lost on such undeclared income is about US$255 billion. This figure significantly exceeds the sums needed to finance the UN's Millennium Development Goals. Whilst the majority of this $11.5 trillion of undeclared assets originates from developed countries, a significant proportion comes from developing countries. For example, over 50 per cent of the cash and listed securities of rich individuals in Latin America is reckoned to be held offshore.[xxvi] Data for Africa are scarce, but most analysts assume the ratio to be comparable to Latin America or higher. The African Union, for example, has estimated capital flight from the Sub-Saharan region at $274 billion, equivalent to 145 percent of the total regional external debt.[xxvii] This loss easily eclipses the value of aid and debt relief promised to African leaders at last year's G-8 summit at Gleneagles.

But the figure of $255 billion in tax revenue lost to tax evasion on assets held offshore is only one part of the equation. Developing countries also lose out to tax evasion in the domestic context (often from activities in the informal economy), from tax avoidance on cross-border trade, and from the pressures to compete for investment capital through offering unnecessary tax incentives. In combination these issues are estimated to cost developing countries approximately $385 billion annually in tax revenues foregone.[xxviii] This clearly represents a massive haemorrhaging of the financial resource of many developing countries, which undermines sustainability in a variety of ways:

[2] For example, in November 2006 members of the Angolan opposition party Partido Democrático para Progreso demonstrated outside the French embassy in Luanda accusing government officials of hiding *"billions of dollars . . on the Côte d'Azur."* [Thompson, C., Diary, London Review of Books, volume 29, No.1 4th January 2007]

- Declining tax revenue income from the wealthy and high income earners forces governments to substitute other taxes (typically indirect) with a consequent regressive impact on wealth and income distribution;
- Falling tax revenues force cutbacks in public investment in education, transport and other infrastructure;
- Tax dodging creates harmful market distortions, rewarding economic free-riders and penalising those who follow ethical practice;
- Tax dodging undermines public respect for the rule of law and the integrity of democratic government.

The scale of tax dodging in poorer countries has stimulated a vicious circle of decline in investment in public services like education and vocational training, reducing their attractiveness to both domestic and foreign investors. In its latest report on Latin America, the World Bank argues that governments must give higher priority to spending on infrastructure likely to benefit the poor and increase expenditure on education and healthcare. In practice a large proportion of government spending in Latin America is skewed in favour of the well off, and governments are collecting far too little tax, especially from the wealthy. The World Bank report concludes that: "*on the tax front, first items in the agenda would be strengthening anti-tax evasion programs and addressing the high levels of exemptions.*"[xxix]

Crucially the techniques used for tax dodging and laundering dirty money involve identical mechanisms and financial subterfuges: tax havens, offshore companies and trusts, foundations, correspondent banks, nominee directors, dummy wire transfers, and an absence of financial transparency. Legal institutions granted special status and privilege by society have been subverted to purposes for which they were never intended. For example, the original purpose of trusts was to promote the protection of spouses and other family members who are unable to look after their own affairs, and to promote charitable causes. Incredible as it must appear to those not familiar with the offshore economy, charitable trusts are regularly set up in offshore tax havens for the purposes of owning 'special purpose vehicles' used for international tax planning and for hiding both assets and liabilities offshore, as happened with Enron, Parmalat and Worldcom.[xxx]

Many examples can be cited of how the offshore system has been constructed to encourage corrupt activities and distort global markets.[xxxi] Some of the smaller tax havens have played a lead role in this process, partly because the scale of their legislatures makes it easier for major banks and accounting firms to influence the political processes and secure favourable regulatory and fiscal treatments.[xxxii] Economically vulnerable small island economies (SIEs) are particularly easy for global capital to capture in this way because of the small scale of their governments and the lack of separation of legislative and judicial processes.[xxxiii] As a result, SIEs have often been prepared to enact new measures to promote tax and regulatory competition on behalf of the organised tax avoidance industry. The British Channel Island of Jersey, for example, introduced a new trust law in May 2006 which allows the creation and operation of 'sham' trusts which can only serve the purposes of tax dodgers.[xxxiv] The law appears to serve no other purpose. Jersey is a dependency of the British Crown and this law would have been presented to the Privy Council for approval prior to its enactment. Since these 'sham' trusts will largely be created on behalf of high net-worth people from outside the island, it is clear that the UK government is not serious about tackling the global tax dodging industry.

The United Kingdom is often seen as a key player in promoting the offshore interface and thereby sustaining the supply side of globalised corruption. This assessment is based on a number of aspects of British economic policy which undermine public confidence in the integrity of government policy and are ultimately harmful to national and international interests. These are:

- Britain's domicile rules which provide preferential treatment to high net wealth persons resident but claiming non-domiciled status in Britain;
- Britain's role as a defender of the tax haven activities of its overseas territories and Crown dependencies, including the continued abuse of European VAT rules by the Channel Island based fulfilment industry;
- Britain's extensive use of tax competition to gain international advantage, e.g. the tax free status of the London Eurobond market;
- Britain's refusal to engage with other European Union members in defining a common basis for taxing multinational businesses;
- Britain's role in undermining the effectiveness of the European Union's Savings Tax Directive by failing to advise the European Commission that the directive as agreed would allow interest paid to trusts to fall outside the tax deduction provisions. This omission appears to have been deliberate and has left a massive loophole in the Savings Tax Directive.[xxxv]

Furthermore many of the legal subterfuges that play a part in the offshore interface have their origins in British law. This includes offshore trusts and shell companies, and the long standing concept of the separation of the place of incorporation of a company and the obligation to pay tax. The latter concept remains a key element of offshore tax planning. Britain, therefore, could play a major role in tackling the supply side of corruption, but successive governments have baulked at the task. We must ask ourselves why this been the case and, more generally, why: *"The whole culture of Anglo-American finance is increasingly subversive of regulation, taxation and democratic values, even when it remains within the law."*[xxxvi] The root of this problem might partly lie with the unhealthy proximity between major financial intermediation businesses and key Whitehall departments, including and especially the Treasury, and the extent to which the main political parties have become dependent on donations – including staff secondments – from the corporate world. Overall, it is hard to avoid the conclusion that when it comes to the provision of the enabling infrastructure for high level corruption Britain is a lead player.

Pinstriped subversion

> *"I have to challenge some of my own inherited perceptions that London is safe, Lagos is not. Britain is free of corruption, but Nigeria is not. Much of the corruption stems from London and Washington. Many of the mechanisms that keep Nigerians poor – the networks of offshore bank accounts that companies use to bleed Nigeria dry of its profits – are based in tax havens that were set up by the British and other colonial powers."*
>
> Andy Rowell, Changing Perceptions [xxxvii]

"Rules are rules, but rules are meant to be broken. No matter what legislation is in place, the accountants and lawyers will find a way around it."

Tax dodging corrupts the revenue systems of the modern state and undermines the ability of the state to provide the services required by its citizens. It therefore represents a higher form of corruption because it directly deprives society of its legitimate public resource and undermines public trust in the rule of law and the equity of the tax system. Tax dodgers include institutions and individuals who enjoy privileged social positions but see themselves as an elite detached from normal society and reject *"any of the obligations that citizenship in a normal polity implies".*[xxxviii] This group comprises the rich and high income earners, plus a pinstripe infrastructure of professional bankers, lawyers, and accountants, with an accompanying offshore infrastructure of tax havens with quasi-independent polities, judiciaries and regulatory authorities. This type of corruption therefore involves collusion between private and public sector actors, who purposefully exploit their privileged status to undermine national tax regimes by facilitating activities which straddle the border line between the legal and the illegal, the ethical and the unethical.

Despite the fact that many of its practitioners hold professional status, the culture of the tax dodging industry is wholly subversive of democratic good practice. This spirit of disdain for public interest is perfectly captured in the following quote given to a national newspaper in response to the 2004 financial statement by the UK Chancellor of the Exchequer: *"Rules are rules, but rules are meant to be broken . . . No matter what legislation is in place, the accountants and lawyers will find a way around it.."*[xxxix] No matter how you attempt to spin this statement, it is clearly intended to convey the message that some classes of society are beyond compliance with social norms. Incredibly, none of the professional institutions of lawyers of accountants promote ethical codes of conduct on the marketing of tax avoidance structures and the use of tax havens by their members. Journalists have also played a role in shaping and perpetuating a degree of ambivalence towards tax dodging, illustrated in the reporting in the western media of the trial of Mikhail Khordorkovsky, former Chief Executive Officer of Russian oil giant Yukos, who was indicted and subsequently found guilty of tax evasion. The evidence presented to the court was overwhelming. The sums involved were massive. There was no question that Yukos executives set out to flagrantly flout the Russian tax laws, indeed former Yukos Chief Finance Officer Bruce Misamore (an American) had told the oil press that the company had *"exercised its constitutional right to manicure its tax affairs."*[xl] None of which prevented the western press, much of which is controlled by owners who make extensive use of offshore tax havens, from disregarding the evidence of criminality and treating Khordorkovsky as a victim of political repression.

Accountants enjoy a privileged status in most societies, but they, along with lawyers and bankers, have played a lead role in shaping and promoting offshore facilities for their clients. They typically justify their tax avoidance activities on the basis that their clients are over-burdened by the complexity of tax laws, an argument which conveniently skirts around the fact that a significant proportion of this complexity arises from the need for the tax authorities to counter their own aggressive tax avoidance strategies.[xli] Some economists also seek to argue the case for tax avoidance on the basis of its promoting economic 'efficiency' – a politically loaded term in almost all uses. However, their models have generally underestimated the regressive impacts of the tax reforms which they promote to improve 'efficiency' and are typically based on closed economies which are wholly removed from the reality of a world of unrestricted capital movements, banking secrecy and tax dodging.

Some practitioners even argue that directors have a duty to dodge tax:

> *"Tax is a cost of doing business so, naturally, a good manager will try to manage this cost and the risks associated with it. This is an essential part of good corporate governance."*[xlii]

This statement needs careful unbundling to understand its underlying politics. Firstly, a tax on profits is not a business cost but a distribution to society. This much is clear from how tax is reported on the profit and loss account alongside distribution to shareholders. Secondly, the use of the word risk is revealing. What risks arise from tax other than those involving a legal challenge to an avoidance or evasion strategy? Thirdly, directors committed to business integrity might prefer an ethically based approach in which *"the tax-planning industry is encouraged to establish codes of conduct to provide a socially responsible, rather than merely legal, dimension to the tax advice that is offered to transnational corporations."*[xliii] Finally, there is no requirement under company law – anywhere in the world – for company directors to avoid tax, especially when this involves actions that might infringe national laws, and hiding these actions from the scrutiny of shareholders and national authorities.

In practice, much offshore tax planning involves practices which most citizens would not regard as good corporate governance. Hence the secrecy in which these practices are conducted. In the words of the report on tax havens published by the U.S. Senate in August 2006:

> *"Utilizing tax haven secrecy laws and practices that limit corporate, bank and financial disclosures, financial professionals often use offshore tax haven jurisdictions as a 'black box' to hide assets and transactions from the Inland Revenue Service, other U.S. regulators and law enforcement."* [xliv]

The findings of this report led Senator Carl Levin, senior ranking Democrat in the Senate, to conclude that: *"tax havens have in effect declared war on honest taxpayers."* Tax havens are, of course, only a more visible manifestation of the organised tax avoidance industry which functions on behalf of wealthy individuals and corporate clients in a manner explicitly intended to confront the will of elected legislatures around the world. Tax avoidance is justified by some on the basis that it is legal, though one widely used definition describes it as a course of action designed to conflict with or defeat the evident will of Parliament.[xlv] The scale of this assault on parliamentary will is massive, involving not thousands but hundreds of thousands of highly educated legal and financial specialists operating in jurisdictions across the globe.

As illustration of the subversive nature of the organised tax avoidance industry, another recent US Senate enquiry revealed internal communications from accounting multinational KPMG which contained a warning from one senior tax adviser that, were the company to comply with the legal requirements of the Inland Revenue Service relating to the registration of tax shelters, the company would place itself at a competitive disadvantage and would *"not be able to compete in the tax advantaged products market."* KPMG was undeterred and went ahead with: *"knowingly, purposefully and wilfully violating the federal tax shelter law."*[xlvi] During its enquiries the Senate Committee discovered that KPMG had devised over 500 'active tax products', some of which may have been illegal. Just four of those 500 products cost the US Treasury US$85 billion annually in lost tax revenues, whilst KPMG booked US$180 million in fees. Speaking after the conclusion of the Senate Committee's enquiries, senior ranking Democrat Senator Carl Levin said that: *"our investigations revealed a culture of deception inside KPMG's tax practice*."

The USA is ahead of the game in investigating and condemning the activities of the organised tax avoidance industry. Significantly, the Senate report mentioned above was produced by a Subcommittee chaired by a prominent Republican and supported by a prominent Democrat. Nothing similar has been produced by either the European Commission or Parliament. The Commission's attempt at combating tax evasion through the Savings Tax Directive, which came into force in July 2005, was rendered virtually impotent by extensive lobbying and political shenanigans. Both the World Bank and the International Monetary Fund have developed their own anti-corruption agendas, but neither institution has sought to tackle offshore banking secrecy other than where it has impacted on their rigidly restricted anti-money laundering programmes. The Financial Action Task Force formed by G-7 heads of state in 1989 to spearhead global anti-money laundering programmes, has resolutely turned a blind eye to capital flight and tax evasion, and has arguably legitimised the tax havens which cooperated with its efforts to track the proceeds of narco-trafficking and terrorist funding.

In addition to corrupting financial systems by encouraging and facilitating illicit activities, offshore secrecy corrupts the market system more generally by enabling company directors to engage in aggressive tax planning to raise short term profitability (thereby enhancing share option values), and gain a significant advantage over their nationally based competitors. In practice, this bias favours the large business over the small, the long established over the start-up, and the globalised business over the local.[xlvii] In other words, corporate tax avoidance works against the operations of fair trade, fair competition and ethical enterprise, but until now tax justice has scarcely registered on the Corporate Social Responsibility debate.[xlviii] Indeed, a recent business symposium hosted by transnational accounting firm KPMG concluded that: *"tax avoidance does not damage corporate reputations and may even enhance them".*[xlix] So much for corporate social responsibility!

The corruption interface

There is clearly an urgent need for reassessment of what constitutes corruption; how it is perpetrated; and by whom. It is impossible to disagree with those who, whilst deploring domestic corruption involving bribe-taking and kickbacks on contracts, are puzzled by the way in which the corruption debate has focused on the bribe-taking by public officials whilst largely ignoring the role of private companies in offering bribes and kickbacks, and the equally important role of the pinstripe infrastructure which encourages, facilitates and profits from handling the proceeds of criminal activity, including tax evasion. As one expert witness described it to a recent UK Parliamentary enquiry into the role of the UK in corrupt activities in Africa:

> *"With one hand, the West has pointed the finger at corrupt African leaders, with its other hand, its bankers, lawyers, accountants, art dealers, health authorities, universities, estate agents and embassies have been actively or passively encouraging wealth out of Africa into the West's economies."*[l]

In terms of scale, the proceeds from bribery, drugs money laundering, trafficking in humans, counterfeit goods and currency, smuggling, racketeering, and illegal arms trading account in aggregate for around 35 per cent of cross-border dirty money flows originating from developing and transitional economies. On the other hand, the proceeds from illicit commercial activity, incorporating mispricing, abusive transfer pricing and fake and fraudulent transactions account for 65 per cent of such flows.[li] The very least one might expect in such circumstances, is that equal emphasis be given to corruption in both private and public spheres; that greater prominence be given to how corruption can reduce tax revenues by as much as 50 per cent;[lii] and that the activities of the offshore system should be more carefully scrutinised to ascertain the harmful impacts of tax havens on the functioning of global markets and on the integrity of the rule of law. As Raymond Baker notes:

> *"Illicit, disguised and hidden financial flows create a high-risk environment for capitalists and a low-risk environment for criminals and thugs. When we pervert the proper functioning of our chosen system, we lose the soft power it has to project values across the globe. Capitalism itself then runs a reputational risk. As it is now, many millions of people in developing and transitional economies scoff at free markets, regarding the concept as a license to steal in the same way as they see other others illicitly enriching themselves.*[liii]*"*

The secrecy space offered by the offshore interface, which currently comprises approximately 70 tax havens spread across the globe,[liv] represents a glaring flaw in the global financial architecture. This flaw is routinely exploited by financial intermediaries for the simple reason that this is the most profitable fee-earning activity. It is long overdue that the role of the facilitators, and of their professional associations which fail to effectively regulate their activities, is recognised as harmful and corrupt and consequently given parity of attention to that paid to the bribe-taking of less well paid officials in the world's poorer countries.

Support for a shift in the corruption debate to include the role of the supply side agencies is evident in the 2006 statement of the Pontifical Council for Justice and Peace, which noted that:

> *"A ready climate for corruption is fostered by a lack of transparency in international finances,* ***by the existence of financial havens*** *and by the disparity between the level at which corruption is fought – often limited to the level of single states – and the level at which corruption is carried out, usually at the supranational and international levels."*[lv]

Despite evidence that public attitudes towards corruption are hardening throughout the world, further convergence is required before a truly international definition of corruption can be arrived at. In the interim it would be preferable to identify the entire range of activities which involve the abuse of power and privilege for personal gain, and not focus principally on those involving the bribery of public officials in developing countries. Comparatively speaking the losses to most of the world's poorer countries from illicit capital flight and tax evasion are likely to considerably exceed the financial cost of bribery, and consequently greater weight needs to be given to identifying the scale of the problem and to tacking the failures of the financial architecture which allow the perpetuation of these practices. It is in this context that the Tax Justice Network calls for a wider debate about what constitutes corruption, and whether and how it can be defined and measured to include the activities of the supply side agencies and the offshore interface. TI could and should play a lead part in this process by rethinking the definition employed in the CPI's construction to take in a wide range of activities which undermine public confidence in the integrity of the governance of public and private sector institutions. The conclusion of this debate might lead to a less generalised approach, with specific activities (bribery, embezzlement, tax fraud, market-rigging, insider-trading, etc) being treated as distinct forms of corruption. If TI wishes to retain the national comparator approach of the CPI it should extend the range of indicators used to identify corrupt practices to include factors which facilitate corrupt practices such as non-disclosure of corporate beneficial ownership; the use of nominee directors and shareholders; banking secrecy laws; the lack of transparency of ownership and beneficiaries of trusts and similar legal entities; and non-cooperation with bilateral information exchange between national authorities. Other institutional factors such as the framework of international accounting standards which enable multinational corporations to adopt elaborate aggressive tax avoidance strategies and to use opaque accounting systems and trade mispricing practices should also be taken into account, particularly since this is an area of corporate governance where the rules are set by a private sector agency which is not accountable to democratic scrutiny or control.

The losses to most of the world's poorer countries from illicit capital flight and tax evasion are likely to considerably exceed the financial cost of bribery

Throughout the developing world, tax evasion and the looting of resources to secret bank accounts has nurtured resentment, caused unemployment, reduced investment in infrastructure and public services, and shifted the tax burden increasingly onto middle income earners and poor people. But this need not be the case. Most of these problems could be remedied by strengthening international cooperation. Effective information exchange between national authorities would go a long way towards overcoming the problems of capital flight and tax evasion. The barriers posed by banking secrecy could be overcome by over-ride clauses built into international treaties. The secrecy of offshore trusts would be reduced by requiring registration of key details relating to the identity of the settlor and beneficiaries. There is no reason why those who benefit from the privileges conferred by using companies and trusts should not accept the obligation of providing basic information about their identity. Global frameworks could be agreed for taxing multinationals on the basis of where they actually generate their profits. Policies such as these could be implemented in a relatively short time frame. The principal barrier standing in the way of progress towards achieving these goals is the lack of political will on the parts of the leaders of the OECD nations, most notably Switzerland, the USA and the UK, all of which are leading tax haven states. This lack of political will stems largely from the fact that western leaders, who point fingers at corrupt politicians and public servants in poorer countries whilst conveniently ignoring the harmful role of the offshore interface, are all too aware of the extent to which their own economies have become geared to dependence on capital flows from the poorer countries. They get away with this because public perceptions in the west have been shaped to pay no attention to the offshore interface. The CPI has done nothing to change this situation.

If western leaders are genuine about their commitment to helping African nations to effectively tackle corrupt practices, they should begin by addressing the structural flaws in the global financial architecture which enable the exploitation of fiscal loopholes and offshore tax havens. They need also to recognise that the culture of corruption which causes so much harm in Africa is a reflection of a similar culture in the industrialised countries, where privileged business and political elites regularly abuse their status for personal gain. It needs also to be recognised that the reality of Europe and North America's commitment to 'globalisation' is that they want liberalised trade on their own terms but continue to use fiscal incentives to distort the trade system in favour of their domestic businesses and to attract capital from developing and emerging countries. Britain stands pre-eminent in this respect, and should take a lead in helping African nations by tackling its own, deeply embedded culture of corruption.

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