TAX HAVENS

Financial secrecy - profits from the laundry

Campaigning magistrate Eva Joly wants to open a new chapter of the global war on African corruption and highlight the Western financial systems that share its profits. So begins a campaign to stem the flow of dirty money from Africa to Western banks.

THE OUTFLOW OF UNTAXED CAPITAL

Eva Joly, the **Norwegian**-born **French** magistrate who broke open the Elf Aquitaine affair in Paris – which involved oil-fired corruption in **Gabon**, **Congo-Brazzaville** and **Angola** (AC Vol 42 No 3) – is stirring the pot again. Her article on corruption, published in Norway's *Development Today* on 6 March, is matched by a separate interview with Norway's Development Minister, **Erik Solheim**, and was prompted by a report from a relatively new non-governmental organisation (NGO), the Tax Justice Network (TJN).

Joly's basic point is that the most widely accepted marker of corruption around the world, the Corruption Perceptions Index compiled by Berlin-based Transparency International (TI), should be revised or replaced to include the activities of the global tax havens that, she says, are 'one of the biggest problems the world faces today'. Those questioned by TI ranked countries such as **Switzerland** and **Luxembourg** among the world's 'least corrupt' (its Bribe-Payers' Index ranks Switzerland as the world's 'cleanest' country). Yet through the financial systems of these and other countries – mostly small, and several, like the Isle of Man, Jersey and the Cayman Islands, **British** dependencies – flow hundreds of billions of dollars that rightly belong in the treasuries of poor nations. Joly calls confronting tax havens and the financial secrecy that operates in them 'Phase Two' in the global corruption debate.

In the 1990s, TI led the fight to put corruption on the development agenda. Its campaign was welcomed by, among others, the World Bank, whose then President, **James Wolfensohn**, said in 1996 that the time had come at last to deal with the 'cancer of corruption' as a fundamental reason for poverty. New academic research and publications by NGOs, e.g. Global Witness (which reported on Angola's oil industry, AC Vol 48 No 4), attracted wide audiences in the West.

The spotlight fell on the countries where the flow of money starts and on the obvious thieves, villains and political bosses who set the flow going. Many of these were African (although vastly greater sums oozed out of relatively prosperous Latin America). Little attention was paid to the countries and rich-world institutions that receive and manage the proceeds of corruption and theft. Well-informed Africans have been shouting about this for years, if only to shift the blame on to others' shoulders. On 6 March **Kenya**'s Constitutional Affairs Minister, **Martha Karua**, complained of the hurdles her country faces in trying to recover more than US$2 bn. of looted funds from Western banks.

No one can put a precise figure on the dirty money sluicing through the world's financial systems but in 1998, the International Monetary Fund Managing Director, **Michel Camdessus**, said that 'estimates of the present scale of money laundering transactions are almost beyond imagination: '2% to 5% of global GDP would probably be a consensual range.' Applied to global gross domestic product of $32 trillion a year, that indicates a range of $640 bn. to $1.6 tn. a year.

This figure is just part of the dirty money equation. Laundered money is money that breaks money-laundering laws. It does not cover the billions of dollars of tax-evading funds, the revenues from commercial crime on transactions that are deliberately mispriced to move money – mainly out of developing countries – to offshore tax havens.

Powerful interests in Western countries, including Britain and the **United States**, oppose more fiscal regulation and surveillance. This is because their economies, not to mention their banks and other financial institutions, make big money by keeping transactions secret. It is also because billions of dubious money from Third World sources are trivial beside the trillions involved in, for example, legitimate (or at least lawful) tax avoidance by multinational corporations, whose activities would be much curtailed without it.

CORRUPTION - SUPPLY AND DEMAND

The issues are extremely complex and few NGOs have the resources or expertise to tackle them. Ideology gets in the way, too. When the Cold War ended, it might have seemed that flows of secret money were neither a left-wing nor a right-wing problem. They are, though, a central issue in the debate about how 'free' markets should operate. A 15-page survey of 'offshore financial centres' in *The Economist* (24 February) puts the free-market case that tax havens are generally a good thing. Yet, since Africa's problems are too small to matter much to the tax-haven operators, the survey almost entirely ignored Africa (although it did look benignly on a would-be offshore centre for Khartoum). It barely touched on corruption.

NGOs that focus on poverty – TJN, Oxfam, Christian Aid and War on Want – are entering Joly's Phase Two. TJN argues that corruption has a demand side (money-launderers, tax evaders, kleptocrats, etc.) and a supply side (those that offer financial secrecy and sell the services that exploit it).

The mood may be changing in the USA too, as defenders of tax-havens in the right-wing think-tanks see their influence wane. The US Internal Revenue Service has for some years been pursuing companies that excessively reduce their American tax payments by exploiting the secrecy of havens. Presidential candidate **Barack Obama**, with fellow-senators **Norm Coleman** and **Carl Levin**, has introduced the Stop Tax

Haven Abuse Act; they calculate the loss to the US Treasury from offshore tax evasion at $100 bn. a year. They declare that 'tax havens have declared war on honest US taxpayers'. They have been involved in probing bank accounts held by (among others) Presidents **Teodoro Obiang Nguema Mbasogo** of **Equatorial Guinea** and **Omar Bongo Ondimba** of Gabon.

TJN estimates that at least $255 bn. is lost in global tax revenue each year to tax havens from assets held offshore by wealthy individuals. That is more than twice the sum spent on foreign aid by rich countries each year. Far larger sums are lost through legitimate tax avoidance by multinational companies, through skilful 'transfer pricing' – they take their taxable profits in jurisdictions where the tax on profit is low.

Recent academic studies suggest that Africa's external assets (including capital moved out of Africa to London, Switzerland and other offshore financial centres) are greater than its external debts. The assets are held, often secretly, in private hands, while the liabilities are open and belong to the African public sector. Since most of the business is by definition secret, information is scarce and unreliable, but many experts believe that more than half of the cash and listed securities belonging to rich individuals in Africa is held offshore.

Joly, who is working with the Norwegian Agency for Development Cooperation on its anti-corruption project, recently discussed the subject with the World Bank's current President, **Paul Wolfowitz**; in late March, she will visit Washington with Development Minister Solheim in an attempt to persuade the USA government and congressional leaders to tackle the issue. Solheim says the US has shown more commitment so far than European Union (EU).

Joly notes the large share taken by Britain in responsibility for tax haven activities. London's role as a financial centre and owner of several tax havens has given British companies huge privileges. Joly saw similar links between France and French-speaking African countries when probing the Elf affair.

TI's Corruption Index is not an objective measure of a country's performance but is based on its informants' perceptions. Joly argues that TI is mistaken to define corruption as 'the abuse of entrusted power for private gain'. This focuses the debate too heavily on bribery of public officials in favour of multinational companies that want to reduce the cost of bribery. She wants to tackle the 'supply side' of international corruption, including activities such as trade mispricing by multinational corporations, and tax evasion and avoidance by rich individuals and companies. TI says its Index cannot be changed to accommodate tax haven issues.

Accepted definitions of corruption cover only activities that are formally illegal. Joly wants to widen the target, by including individuals and governments whose lawful services contribute to corruption: the accountants, lawyers, bankers and rich-world regulators that are involved in the trade.

American writer **Raymond Baker** argues in 'Capitalism's Achilles' Heel' (John Wiley, 2005) that there are three main forms of dirty money: criminal money (for example, from drug dealing, terrorism etc.); looted money (e.g. the oil billions hidden overseas by the late **Sani Abacha** of **Nigeria**); and commercial money (e.g. cash hidden by big, respectable firms from tax authorities). All three use the mechanisms and subterfuges of financial secrecy. Current rich-world efforts, such as the anti-money-laundering regulations devised by the Organisation for Economic Cooperation and Development, focus on only a small proportion of this money, so fail to achieve their goals. It might be better to tackle the secrecy at the heart of offshore finance, as governments try to do in order to weaken perceived international terror networks. Any such move would confront the obstacles that the EU encounters when its officials talk of harmonising tax rules within the community. They are promptly told to back off. ●

MEASURING THE DIRTY MONEY

International institutions such as the World Bank and United Nations are belatedly looking in detail at the effects of mispricing, tax avoidance schemes and other forms of capital flight on developing economies. Until recently Bank officials argued that better macroeconomic management would solve the problem of capital flight. Now they are less convinced.

The Bank is hosting a conference of experts on capital flight in May. There are no precise statistics on the volume of capital flight from poor to rich countries, but most economists agree that losses from capital flight outweigh the volume of foreign aid many times.

Transparency International estimates that Africa's political elites and their foreign business allies hold US$700-800 billion in offshore accounts – outside Africa. These transactions are facilitated by a pinstripe army of mainly Western bankers, lawyers and accountants using a network of tax havens in wealthy jurisdictions.

The most important ways of shifting capital from Africa are the mispricing schemes, identified by **Raymond Baker** and others. The revenue companies' gain from mispricing dwarves the cash generated by kickbacks on contracts or drug smuggling schemes, says Baker. Transnational companies can avoid tax by mispricing transactions between different jurisdictions and subsidiaries, allowing their profits to be moved offshore, without paying tax. Transfer pricing schemes have become increasingly sophisticated to counter new fiscal regulations. Tax agencies in many African states lack the staff to stop such schemes.

Capital flight from Africa due to transfer mispricing exceeds $10 bn. a year, according to Baker, and is rising. A **United States**' Commerce Department study found that capital outflows from Africa to the USA in 1996-2005 grew from $1.9 bn. to $4.9 bn, through the use of excessively low invoices for exports (e.g. a tonne of cocoa for $2) and excessively high invoices for imports (a portable generator for $10,000). The pattern is repeated between Africa and Europe, which is still the continent's biggest trading partner. ●