Institute of Development Studies

17th October 2007

CORRUPTION, DEMOCRACY AND THE POLITICAL ECONOMY OF TAX HAVENS

John Christensen
Director, TJN International Secretariat

tax justice network

The role of taxation in development:

provide public funds

redistribute wealth and income

re-price goods and services

provide a tool for economic management

Strengthen and protect channels of political representation (*no taxation without representation*)

Three propositions:

Tax havens are a central feature of contemporary financial capitalism – playing a major role in promoting a race to the bottom in regulation, and tax competition

The offshore economy undermines comparative advantages – causing misallocations of capital, market distortions, and facilitating corruption

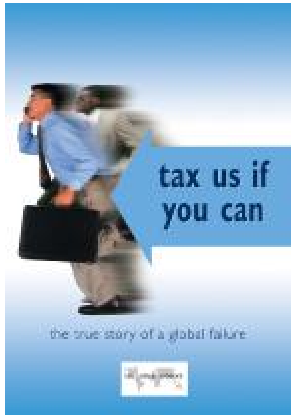
Tax havens / offshore financial centres are politically powerful and economically "successful" (see table 1)

Global top-10 countries by GDP

1	**Luxembourg**	$71,400
2	**Bermuda**	$69,900
3	**Jersey C.I.**	$57,000
4	**Equatorial Guinea**	$50,200
5	**U.A.E.**	$49,700
6	**Norway**	$46,300
7	**Guernsey**	$44,600
8	**Ireland**	$44,500
9	**U.S.A.**	$44,000
10	**Cayman**	$43,800

Source: CIA, 2007

what's broke? **#1**



capital flight and associated tax evasion typically involves use of special purpose vehicles, for example offshore companies and trusts

trade mispricing shifts profits from high-tax states to low/no-tax jurisdictions – arms-length rules are generally ineffective

pressure on states to provide tax incentives for investors is switching the tax burden between factors of production

global trend away from progressive direct taxes, towards less progressive /frequently regressive indirect taxes – including environmental taxes?!

what's broke? **#2**

a *criminogenic* environment is harming tax regimes, distorting markets, slowing growth, and undermining public confidence in the integrity of laws, institutions and systems

Current initiatives to tackle the problem are compartmentalised and restricted in scope:

OECD : harmful tax practices

IMF / Financial Action Task Force : limited in scope

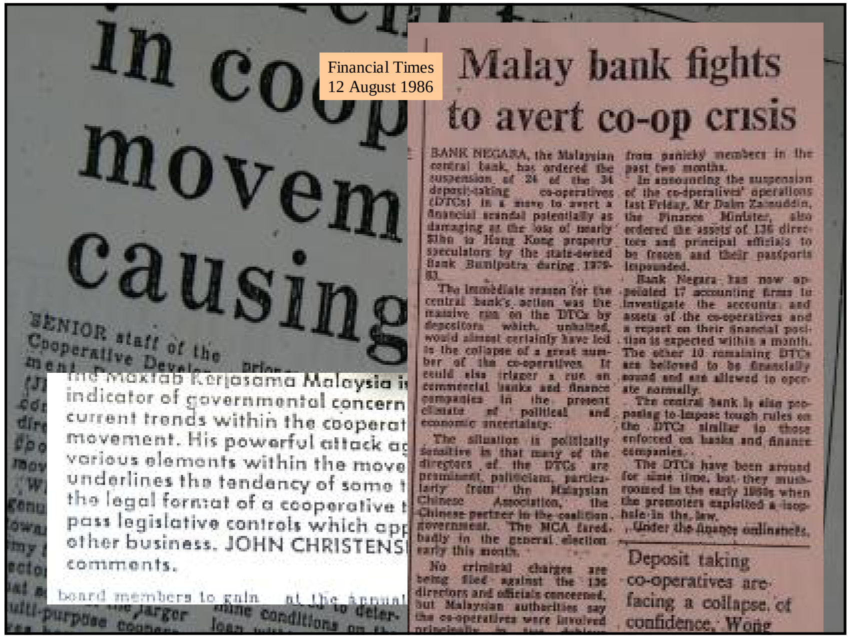
World Bank : flawed understanding of corruption

UN FFD – Tax Committee : dominated by OECD technocrats and under resourced

European Commission – leading the way

The whole culture of Anglo-American finance is increasingly subversive of regulation, taxation and democratic values, even where it remains within the law.

John Plender, *Financial Times*, 28 January 2003



Financial Times
12 August 1986

Malay bank fights to avert co-op crisis

BANK NEGARA, the Malaysian central bank, has ordered the suspension of 24 of the 34 deposit-taking co-operatives (DTCs) in a move to avert a financial scandal potentially as damaging as the loss of nearly $1bn to Hong Kong property speculators by the state-owned Bank Bumiputra during 1979-83.

The immediate reason for the central bank's action was the massive run on the DTCs by depositors which, unhalted, would almost certainly have led to the collapse of a great number of the co-operatives. It could also trigger a run on commercial banks and finance companies in the present climate of political and economic uncertainty.

The situation is politically sensitive in that many of the directors of the DTCs are prominent politicians, particularly from the Malaysian Chinese Association, the Chinese partner in the coalition government. The MCA fared badly in the general election early this month.

No criminal charges are being filed against the 136 directors and officials concerned, but Malaysian authorities say the co-operatives were involved principally in ...

from panicky members in the past two months.

In announcing the suspension of the co-operatives' operations last Friday, Mr Daim Zainuddin, the Finance Minister, also ordered the assets of 136 directors and principal officials to be frozen and their passports impounded.

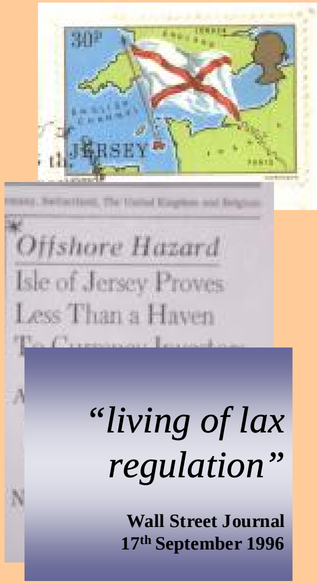
Bank Negara has now appointed 17 accounting firms to investigate the accounts and assets of the co-operatives and a report on their financial position is expected within a month. The other 10 remaining DTCs are believed to be financially sound and are allowed to operate normally.

The central bank is also proposing to impose tough rules on the DTCs similar to those enforced on banks and finance companies.

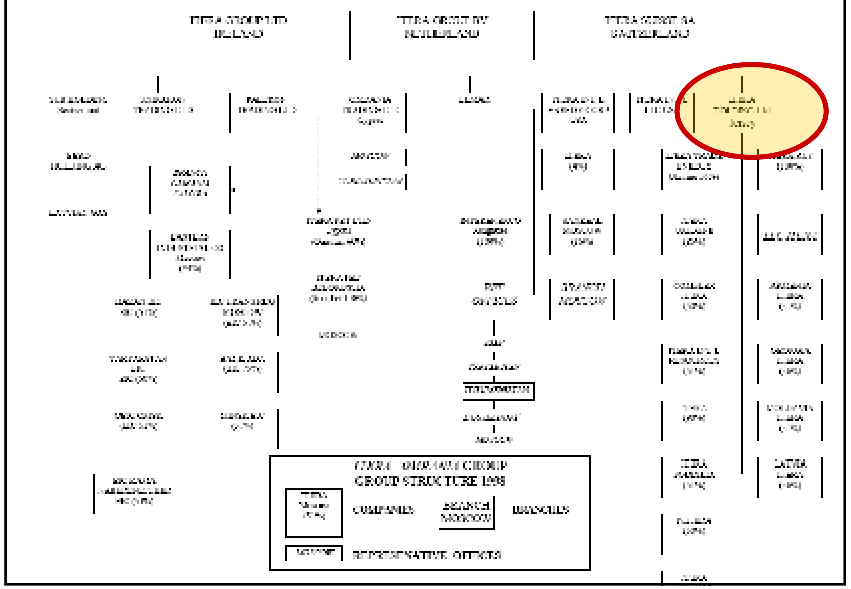
The DTCs have been around for some time, but they mushroomed in the early 1980s when the promoters exploited a loophole in the law.

Under the finance ordinances,

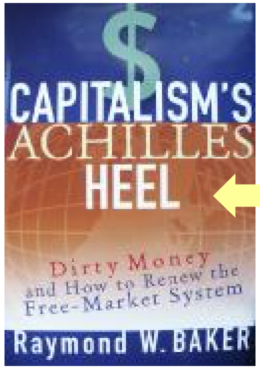
Deposit taking co-operatives are facing a collapse of confidence. Wong



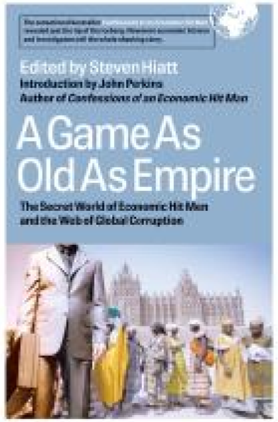
- insider trading
- market rigging
- avoiding disclosure of conflicts of interest
- illicit arms trading
- illicit political donations
- contract kickbacks
- bribery
- fraudulent invoicing, trade mispricing and tax evasion



Defining capital flight: the deliberate and *illicit* disguised expatriation of money on a permanent basis by those resident or taxable within the country of origin. Tax evasion is often the motive for capital flight.



Raymond Baker estimates the volume of cross border illicit dirty money flows at $1 to 1.6 trillion annually, half originating from poorer countries. The majority of these financial assets head to the capital markets in Europe and North America



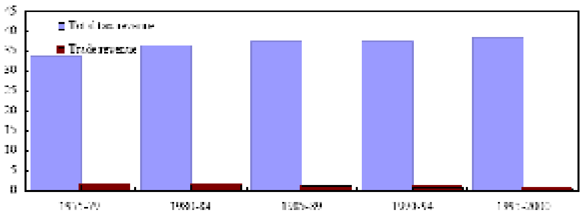
"*the openness of tax havens to proceeds from crime, corruption and tax dodging might explain why flows of capital have been from South to North, from the poor nations of the world to the wealthy ones, rather than the other way round, as economic theory would predict. This largely explains why so many developing countries lack the capital resources they need to finance their own development and instead increasingly rely on external debt and aid to finance services that tax revenues should pay for.*"

ch.3 The Secret World of Offshore Banking

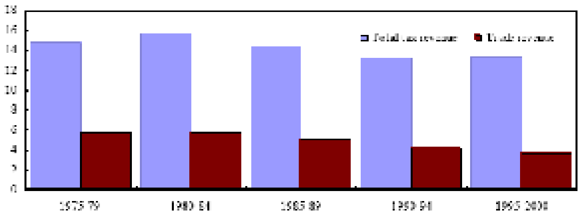
and tax revenues

trade liberalisation

Average tax collections: 1975 to 2000 – high income countries



Average tax collections: 1975 to 2000 – low income countries



a colonial legacy

The City's offshore links

“For each dollar of aid that goes into Africa, at least five dollars flows out under the table. The time has come to confront the tax haven monster.”

30th May 2007

Commonwealth countries and territories with offshore financial centres/tax haven facilities:

Alderney - Antigua - Anguilla - Bahamas – Barbados - British Virgin Islands - Bermuda - Belize – *Brunei* - Cayman Islands - Cook Islands - Cyprus - Dominica – *Dubai* - *Ghana* - Gibraltar - Grenada - Guernsey - Isle of Man - Jersey - Labuan - Mauritius - Monserrat - New Zealand - St Kitts and Nevis - St Lucia - St Vincent & Grenadines - Samoa - Sark - Seychelles - Singapore - Turks and Caicos Islands - Vanuatu

a shadow economy

Half of aggregate world trade passes through tax havens, even though these minor economies account for a mere 3 per cent of global GDP. This anomaly arises because transnational corporations record many intra-company transactions through tax havens solely to avoid tax, with little or no basis in the economic reality of their operations;

The value of private assets held offshore, either tax-free or subject to minimal tax, is estimated at €9.2 trillion ($11.5 tn); over one-third of global GDP;

Over the past 30 years the number of offshore finance centres and tax havens has more than doubled to > 70 centres.

facilitating grand corruption

Country rank	African countries	2007 CPI score
179	Somalia ***	1.4
172	Chad / Sudan	1.8
168	Congo D.R. / Guinean, Equatorial Guinea	1.9
162	Central African Republic	2.0
150	Congo (Republic) / Côte d'Ivoire / Kenya / Liberia / Sierra Leone / Zimbabwe	2.1
147	Angola / Guinea Bissau / Nigeria	2.2

Country rank	Tax haven countries	2007 CPI score
4	Singapore	9.3
7	Netherlands / Switzerland	9.0
12	Luxembourg / UK	8.4
14	Hong Kong	8.3
17	Ireland	7.5
20	USA	7.2
21	Belgium	7.1
23	Barbados	6.9
24	Saint Lucia	6.7
25	Uruguay	6.7
30	Israel / Saint Vincent and Grenadines	6.1
32	Qatar	6.0
33	Malta	5.8

Transparency International's Corruption Perceptions Index: October 2007

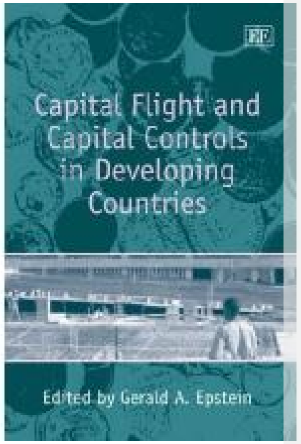
widening wealth inequality

" . . Private wealth held in tax havens is costing governments around the world US$255 billion annually in lost tax revenues according to research published in March 2005. This sum is over three and a half times greater than the highest estimate of the additional financial resources required to meet the United Nations' Millennium Development Goals. ."

TAX JUSTICE FOCUS

Spring 2005 VOLUME 1, NUMBER 1

increasing external debt



Who owes what to whom?

Despite the massive debt incurred in the past, Sub-Saharan Africa is a net creditor to the rest of the world in the sense that external assets (i.e. the stock of flight capital) exceeds external liabilities (i.e. external debt).

The stock of capital flight from SSA (estimated at $274 billion including interest earnings) was equivalent to 145 per cent of the total debt owed by the countries in the mid-1990s.

Boyce, J.K. and Ndikumana, L. (2005)

threatening democratic legitimacy

«the reality is that in the global economy, it is the multinationals themselves rather than national governments who, through transfer pricing and the use of tax havens, determine the level of tax that they pay.

. . given the profound interest in taxes demonstrated by governments everywhere, tax could become the testing ground for international regulation of corporate responsibility.»

The testing ground of tax
Ethical Corporation, January 2005

structural remedies #1

Introduce automatic information exchange between all tax jurisdictions

Improve accounting transparency: an International Financial Reporting Standard on country-by-country reporting

Remove 'beggar-my-neighbour' practices, e.g. the UK tax treatment of non-domiciles

Introduce a General Anti-Avoidance Principle accompanied by purposive legislation

structural remedies #2

Establish a global tax authority with a primary objective of ensuring that national tax systems do not have negative external impacts

Require full public disclosure of beneficial ownership of trusts, companies, foundations and similar entities

Define capital flight and tax evasion as corrupt activities within the scope of the UN Convention Against Corruption

Negotiate a multilateral framework to allow states to tax multinationals on a global unitary basis (formulaic apportionment) with appropriate mechanisms to allocate tax revenues across borders

BBC NEWS

19th June 2007

Ghana 'will be an African tiger'

Ghana's President John Kufuor says the discovery of the country's first major oil deposit could turn the West African country into an "African tiger".

OffshoreNet

Navigator's Blog for a Global Enterprise

April 11, 2007

Ghana Steps up Offshore Banking Effort

The President, Mr J A Kufuor announced at the weekend that the government is in the process of setting up an International Financial Services Centre in collaboration with the Barclays Bank to, among others, transact off-shore banking business; making Ghana the financial hub of the West African sub-region.

more info: taxjustice.net
taxjustice.blogspot.com
taxresearch.org.uk/blog

contact: john@taxjustice.net