International Tax Justice – Why Brazil Should Play a Lead Role

James S. Henry
Tax Justice Network International Board Member
www.taxjustice.net

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Muito bom dia. I am going to focus on international tax, even though you have been focusing on domestic tax issues. I believe there is an important opportunity for Brazil to lead on international tax issues – and not just wait for First World countries like the United States, because that wait could take a very long time.

You may also have an opportunity to use the kind of conciliatory process employed here, to come together and try to form a consensus about what tax justice really

[1] These remarks accompanied a lengthy Powerpoint presentation by the author, entitled "Tax Justice: The Advantage of a Long Memory."

means in Brazil. And that is a very exciting – especially because that kind of consensus may not be achievable any time soon.

One of the most helpful things in life is to have a long memory, and I have a pretty long memory with respect to Brazil -- my perspective goes back about thirty years, to my first visit here in 1979, and many more since then. In that period you had a rather different approach to development policy, and the folks in charge didn't do a very good job of it.

The results included heavy debts built up in the 70s and 80s, a great deal of corruption and capital flight, heavy interest burdens – and lots of lousy projects all over the country, including several poorly-designed hydro-electric dams. My favorite "white elephant" dam is Balbina, in the north. If you've ever been there, you know that the artificial lake that it created, Lago de Balbina, basically flooded a huge area, but at the end of the day could not generate any electricity. There were many such projects.

So from my perspective, Lula, the "dangerous radical" that I first met back in 1989 when he ran for President and narrowly lost to Fernando Collor, basically did a magnificent job when he was elected in 2002, and he and his successor have a real chance of laying the foundations for tax justice in this new Brazil.

Just to highlight this, I've pulled together a few economic metrics on one slide that that provide a comparison between the US, and Brazil since the 1980s. If you compare 1980s to the last decade in terms of growth, health care spending, indebtedness, and several other important measures, hands down, Brazil has been making progress while my own country has been slipping backwards. So one point that I want to make is to implore you to continue that kind of progress, and extend it to tax justice.

Indeed, as the next slide shows, not only Brazil, but Latin America as a whole, has really solved its debt problem since the 1980s – especially if we take into account foreign reserves: its "net debt" per unit of GDP has shrunk shrunk way below the levels of most OECD countries, including the US and Europe, and way below that of eastern Europe.

THE FIRST WORLD DEBT CRISIS

On the other hand, the world has now invented a whole new category that we might call *"heavily-indebted RICH countries," or HIRCs*-- in contrast with what the World Bank and the IMF used to label "heavily –indebted poor countries," or the so-called "HIPCs." This is illustrated by the heavy, very worrisome heavy lending that's been going on among OECD members like the US, the UK, France, Germany, especially to the so-called "PIIGS" -- Portugal, Italy, Ireland, Greece, and Spain.

Overall, there is now close to $1 trillion dollars of cross-border bank loans outstanding to the PIIGS, plus nearly another $1 trillion of foreign currency loans outstanding to Eastern European countries. This exposure is two-thirds of the entire developing world's $3.2 trillion foreign debt as of the 1990s. And, and unlike that debt, this all involves relatively wealthy First World countries. This is a serious unsolved problem, which provides an important context for any discussion of global tax justice.

This provides a nice introduction to our next topic -- how much untaxed offshore private wealth is there, and why should Brazil care about it?

The roots of the problem that we're discussing really go back to that $3+ trillion that was loaned to developing countries, including Brazil, in the 1970s and 1980s.

The fact is that much of this $3.2 trillion went into poorly-planned, over-priced projects, as discussed above. But the largest chunk of it didn't remain in the borrowing countries. Directly and indirectly, it helped to finance a huge volume of capital flight from developing countries to First World banks, much of which was accumulated offshore and out of the reach of tax authorities in developing countries.

Now for obvious reasons, there are no official reports on this kind of offshore capital. If we want to measure it, we have to use a variety of indirect techniques that I call "investigative economics." This involves, not "top-down" model-building, but looking closely at puzzles and anomalies in the data.

OFFSHORE CURRENCY DEMAND

To take a simple example, it turns out that a great deal of US paper currency, as well as Euro paper currency and paper Swiss francs, is not inside the US or Euro-zone countries, but outside of them, in private hands, providing the lubricant for the global underground economy. I've carefully studied this offshore demand for such so-called "reserve" currencies, like the $100 bill or the € 500 note. As shown in the slides, for example, there's more than $700 billion of US currency outstanding that *outside* of the US – about 70 - 80 percent of the total. The same thing applies to the Euro, so all told, we are talking about more than $1.2 trillion of offshore cash wealth.

Of course currency is just one form of off-the books private financial wealth,. Much of it serves as a medium of exchange for the global underground economy, or a portable savings vehicle for folks without bank accounts -- kind of "poor man's private banking asset," especially in countries whose own currencies are unstable.

CAPITAL FLIGHT AND PIRATE BANKING

We get even larger numbers when we try to estimate the volumes of unrecorded flight capital that poured out of developing and developed countries alike, often by way of the tiny archipelago of secrecy jurisdictions known as tax havens. Here the key hidden private offshore assets concerned are not just currency, but precious metals and gems, foreign bank deposits, real estate, stocks, bonds, and so-called “alternative” investments, by way of hedge funds.

My first introduction to this massive unrecorded “capital flight” problem involved looking at that puzzle of where the money went that was loaned to Latin America in the 1980s. We knew that it certainly hadn’t gone into productive investment – the whole continent’s growth stalled in the 1980s and early 1990s. In addition to uncovering the hidden role of US currency in the underground economy, I was also the first to uncover the fact that a great deal of this flight capital ended up back in the very same banks that had loaned the money.

For example, when I was Chief Economist at McKinsey in the mid 1980s, I was shocked to learn, that Citibank had actually taken more money out of Mexico in the 1970s and 1980s than it had loaned to Mexico during the same period. Indeed, their private bankers made a specialty out of calling on wealthy Mexicans, even though they knew the country was also a big borrower from them and their lending syndicates.

That finding led me to pursue many other cases of “investigative economics on this topic, looking for what became of the money. investigations in that period of time about where the money went.

One of my favorite examples involved the Philippines, where the Philippines’ Central Bank – the country’s largest single borrower -- basically borrowed heavily from New York banks and then wired the loan proceeds directly to Switzerland, where it ended up in Ferdinand Marcus´ private accounts. In effect, these stolen loans were used to finance capital flight from the Philippines directly. To this day, the government is still servicing at least $5 to $10 billion of this stolen loot, even though the loans never even really entered the country.

The other side of this ugly picture is that much of this capital flight finally ended up, not in tiny Caribbean tax havens like the Cayman Islands, but in First World countries like Switzerland, the UK and the US. Indeed, with respect to Latin America, it turns out that for decades the US has been one of the largest single *ultimate-destination tax havens*, in terms of where people around the world like to plant their money, tax free. In fact, the US and **these other key First World destination havens** have designed their tax codes to make them very attractive to places to invest without paying any taxes, for so-called "non-resident aliens."

This is actually far from a new issue – here's a cover story that I wrote about it for the New Republic in April 1986, and another from the Washington Post (January 29, 1989) entitled "America the Tax Haven."

The issue of this outrageous behavior by OECD banks toward developing countries has surfaced periodically, and then it has gone back under ground. For example, in February 2009, Agustin Carstens, Mexico´s Finance Minister, wrote a letter to US Secretary of the Treasury Tim Geithner, asking for information on the volume of bank deposits by Mexicans in US banks. The letter was never answered. Even though Secretary Geithner, the US Treasury, and the Internal Revenue Service have been making a big deal out of trying to collect taxes on US citizens who are hiding their money offshore, when it comes to reversing this process and treating Latin American countries and developing countries in general the way that we´d like to be treated, reciprocity isn't applied.

This issue surfaced again this year in the US Congress, where organizations like Tax Justice International have strongly criticized the US for adopting a double-standard: on the one hand, criticizing banks like UBS for helping US citizens to evade taxes; on the other hand, allowing major US banks like JP Morgan Chase, Bank America, Wells Fargo, and Citibank to build enormous “pirate banking” operations that do the same thing for wealthy tax-dodgers in countries like Brazil Mexico, and the Philippines.

We at Tax Justice Network would really welcome an effort by developing countries like Brazil and Mexico to join with other developing countries and demand more transparency from countries like the US, the UK, Germany, Canada, and Switzerland, where most of this untaxed offshore loot hangs its hat.

Our organization, Tax Justice Network, was established in 2002 as a result of efforts by people cross many countries to understand the impact of secrecy jurisdictions and “enablers” like major global banks and law firms on the developing world – and to see what could be done about it, given that leading so-called “development multilaterals” like the World Bank, the IMF, the UNDP, and the OECD have completely dropped the ball.

The need for this effort is the product of three basic factors – (1) the tremendous growth in offshore activity by individuals and corporations since the 1980s; (2) the specific emergence of leading OECD countries like the United States, the UK, and Switzerland as well as intermediary havens as key destinations and conduits; and (c) the fact that there has come to be a huge global industry that is essentially devoted to facilitating tax evasion and money laundering.

AGENDA – INTERNATIONAL TAX REFORM

We have a formulated a very concrete agenda for reform, based on assembling leading legal, accounting, and economic experts in the field from around the globe.

Especially in the last three years, we have finally been gaining recognition for the importance of this issue, presenting before leading forums like the OECD, the UN, and the G20. We believe that this is indeed the ideal time for a coordinated global effort to curtail offshore evasion, and help developing countries to close loopholes, recover or tax the offshore capital that's fled, and increase the penalties for those enablers who have been helping to facilitate this kind of illicit traffic.

The basic perspective is that the global community needs to come together and crack down on offshore tax evasion by the richest people in the world. Our core policy agenda includes several key provisions that sound technical, but are actually pretty simple to understand. Among TJN's key policy initiatives:

(1) Automatic information exchange among tax authorities, as is now routinely done by some OECD countries, like the US and Canada;

(2) "Country-by-country" reporting and a new transfer pricing standard for multinational companies. "Transfer pricing" basically has to do with how much income a foreign company doing business in Brazil and other countries, for example, shows on its local tax returns in each country. This is actually one area where Brazil has already taken a lead in contesting the OECD's so-called "arms length" standard, which is hard for most developing countries to implement. We are hoping that Brazil will continue to work with countries like India that are also very interested in generating fair taxes from multinationals.

TJN and its global team of experts have been especially active on this proposal – in particular, I'd like to highlight the fact that Mr. Richard Murphy, a leading accountant and tax analyst in the UK, and Mr. David Spencer, a leading banking and taxation attorney in New York, have been widely recognized for their innovative efforts on international transfer pricing reform and country-by-country reporting.

(3) Beneficial ownership reporting. This refers to the outrageous fact that many offshore (and domestic) companies and trusts are able to conduct their affairs and accumulate and manage assets all over the world without any disclosure of who the ultimate beneficial owners are.   This basically permits a huge amount of "funny business" to go on beyond the reach of tax authorities and other government regulators. TJN supports an end to this kind of excessive private secrecy, and is pushing for such reforms with organizations like FATF and the US Congress.

(4) Stricter penalties for global banks, law firms, and accounting firms that facilitate illicit capital flows and outright tax evasion.

These are controversial issues, and we are opposed by a very influential lobby for financial institutions in Washington DC and other world capitals. I am sure that you face one here as well. In the case of Washington DC the average expenditure per day per US Congressperson by this lobby for every since day since 1990 is close to three thousand dollars (in real $2010 dollars) – nearly $7 billion, including only reported campaign contributions and lobbying expenses. This has had a tremendous impact on our laws.

Finally, how much untaxed offshore private wealth is there, and how much income is it generating. Well, the numbers are staggering. For example, our best estimate is that the stock of "flight wealth" from Brazil that is located outside the country is now worth at least three hundred to four hundred billion dollars, and that Latin America as a whole has nearly $1.4 trillion. While capital flight from Latin America has recently slowed down considerably – partly because bad bank lending has also slowed – much of this offshore flight capital was accumulated back in the 1970s, 1980s, and 1990s, and it is still sitting there. Latin America as a whole has recently been passed by Russia and Eastern Europe, in terms of the world total, but it still owns a major piece of total private offshore financial wealth.

This offshore wealth generates income, much of which is reinvested tax free, and is not consumed. In Brazil´s case, the total unreported income on the foreign flight capital since the 1980s is more than $250 billion, and is now on the order of more than forty billion dollars a year.

So even though fresh outflows of capital flight from Brazil have declined dramatically since the eighties, the actual unreported private earnings on this offshore capital is still very large – indeed, almost high enough to rival the highest annual levels that the original capital flight flows ever reached. In a sense, then, there is still "capital flight, " but it is in the form of unreported, reinvested income that the national authorities never see.

This means that we are at a point where Brazil is not really a "debtor" country at all, in terms of foreign debt, once we take into account the volume of offshore private assets owned by Brazilians.

So the real problem is not a "debt" problem; it has become an "assets" problem, and a tax problem. The real problem is – those private assets, much of which are based on the accumulated proceeds of tax evasion or other crimes, are beyond the reach of tax justice. And so ordinary Brazilians have to pay higher taxes because the owners of all this offshore capital are able to avoid fair taxation.

Now we can do a similar analysis for every other region in the world, and when we do so, we find that there is a staggering 20 to 25 trillion dollars (in $US 2010) offshore, owned by private individuals, beyond the reach of tax authorities. Furthermore, the ownership of all this offshore financial wealth is incredibly concentrated, with the world's top 100,000 families owning at least a third of it, and the top 8 million own at least 55-60 percent of it. About a third of that is accounted for by developing countries – the rest by offshore private capital from residents of high-income countries.

Among other things, this implies that all of the figures we heard earlier today about "Gini coefficients" and income inequality in Brazil actually understate the degree of inequality, because they are based on reported incomes – which leave out all this offshore income. That means there is probably even more tax injustice in Brazil than those figures would lead you to believe.

Furthermore, if you compare this stock of offshore capital to the total amount of debt relief that was provided to the entire developing world by First World institutions, my research shows that all "debt relief" only added up to a grand total of $300 billion dollars -- almost nothing compared to the total stock of capital flight wealth offshore.

Finally, it also turns out that global banks have played a critical role in the growth of this offshore industry. Indeed, if you look at private "assets under management," you find at least $12 trillion of it under management by the world's top 50 private banking institutions So we really need to think seriously about the role of the financial services industry in all this – "pirate banking" -- as a key enabler of the offshore industry.

All this leads to a "modest" proposal for a new global withholding tax on all this offshore loot. Of course we will continue to work hard for fundamental reforms in the global "offshore secrecy system," like those already mentioned above. But while we are waiting for those reforms to work, perhaps we should at least insist that all this dirty money at least contributes something to the soaring costs of development assistance, climate change, and disaster relief around the planet.

Given the very concentration of assets under management in these banks, we believe that it wouldn't be difficult for First World countries as a group to agree to have, say, a modest 1 percent annual withholding tax, by these big banks themselves, on all the so-called "anonymous" private capital that they manage – much of which now pays zero taxes. This might easily raise as much as $100 billion per year -- enough to make a valuable contribution to the a fund that is used to finance development aid, disaster relief, or the costs of climate adaption.

Of course getting such a global tax implemented, let alone all the other reforms that TJN is proposing, will not happen over night. As noted earlier, we are up against one of world's best financed, best organized lobbies – global financial services.

However, as we've just seen, the last three decades of globalization has also had a darker side. And one of its darkest elements is this "black hole" of untaxed private offshore wealth, and all the hidden income -- and inequality -- that it generates.

After all, it is not as if all this global inequality and tax injustice has been accompanied by glowing performance of high growth and job growth for the world economy as a whole. While some countries have recently experienced high growth, many others have continued to struggle. And much of the "growth" that has occurred may not be sustainable, because it is based on excessive debts and other imbalances that will have to be corrected. So we need to worry about whether the global market economy is providing a sink hole for untaxed savings that are making it difficult for countries to avoid being in debt, by perpetuating the kind of domestic regressive taxes that we've heard described earlier today.

So, again, we believe that Brazil has a real chance to lead the reform efforts in this offshore tax area, emphasizing the important linkage between offshore tax justice and domestic tax justice. At the end of the day, it is simply intolerable for the kind of tax injustice that we've described to be allowed to continue. We look forward to working with Brazil and other leading developing countries to reduce it.

Muito obrigado pela opportunidade de falar com você.

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