

The Secret Making a Joke out of Development Efforts

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Tax. Not a very sexy subject. Treated as technical and a necessary evil, taxation policy does not attract the same celebrity attention as aid flows, debt, and trade policy. Yet it lies at the heart of problems afflicting the developing world. Tax injustice is embedded in the current international financial system, ensuring that there is a net capital flow from global South to North—from poorer to richer countries and not the other way round. American researcher Raymond Baker estimates that up to US\$500 billion flows out of developing countries each year due to commercial exploitation of taxation weaknesses, corrupt practices, and money involved in criminal activities, most of it ending up in tax havens. To put

that into perspective, the Make Poverty History campaign argues that an immediate annual injection of an additional \$50 billion is needed for countries to make progress towards the Millennium Development Goals. Why have people for so long turned a blind eye to a problem so large in scale it dwarfs and underlies the concerns commonly highlighted in mass campaigns?

The amount of money involved is not the only issue at stake. Current rhetoric on development focuses on sustainability. Taxes are at the centre of the project to create sustainable states with accountable governments. Many a revolution, with the American as a prominent example, has been prompted by one issue: tax. Indeed, the slogan of “no taxation without representation” highlights the intimate connection between fiscal policy and democratic government. Functioning tax systems can provide an important framework for political representation, providing another avenue by which citizens feel they have a higher stake in government and policy outcomes.

For a state to be free from permanent dependence on aid flows and the attached conditionalities, it must be able to generate revenue domestically to provide public services such as health and education systems and to maintain domestic governance structures. Tax systems are not solely instruments for meeting budgetary needs however: they are the main tool for redistribution within a society, valuable for lifting its poorest members out of poverty. A recent UNU/WIDER study demonstrated that levels of pre-tax income inequality in richer countries were similar to those in poorer countries: it was through redistribution that final levels of inequality were lower in richer countries. Oxford academic Alex Cobham argues the impact of redistribution is clear if income inequality levels before and after redistribution in Sweden and the US are compared. Both countries exhibit similar levels of pre-tax inequality but Sweden removes more than half of the original inequality through redistribution.

However, as capital becomes increasingly mobile, the tax burden falls ever more on labour and consumption. In a definite pattern that can be traced from the beginning of the 1970s, there has been a significant growth worldwide in the use of indirect—or VAT style—taxes. These regressive taxes hit the poor hardest because they spend proportionally more of their income on basic necessities. This move towards regressive taxation has been reinforced by International Financial Institutions’ enforced programmes of trade liberalisation. Many of the poorest countries in the world, concentrated in South Asia and sub-Saharan Africa, depend on trade taxes for a third of their overall revenue. The IMF has encouraged countries to replace these taxes on imports and exports with regressive VAT systems. The negative side effects of the regressive tax are compounded by the failure of VAT to replace revenues: a recent IMF study reported that out of every dollar of revenue lost through liberalisation, low-income countries were gaining back less than 30 cents from the implementation of a VAT system.

Poor Countries are “Haemorrhaging Money”

Andrew Pendleton, senior policy adviser at Christian Aid, argues, “For decades, poor countries like Kenya and Bolivia have been haemorrhaging money to which they are properly entitled”. Pendleton authored the NGO’s paper discussing the effects of tax policy on the poor which offers case studies showing how calls for countries to mobilize their own resources for development have not been backed up by the actions of international institutions. Levels of tax revenues remain disturbingly low. While in OECD countries, tax revenues account for around 30% of GDP, in poorer countries, that figure is more like 10-17% of a much lower GDP.

Bolivia has gas reserves with a total estimated value of US\$250 billion. However, in 1996, the gas industry was privatised. A group of companies including BP and British Gas made a deal that they would pay 18% royalties on all new reserves—because the reserves were new they would be exempt from paying a 25% income tax. 97% of Bolivia’s gas reserves were declared new.

In May and June of 2005, widespread unrest hit La Paz and surrounding areas. While high world prices of gas and crude oil meant that companies BP, Exxon Mobil, Shell, and ConocoPhillips were declaring their incomes had risen by 39% from the previous year’s levels, the people of cities like El Alto just north of La Paz, home to many of the migrants attracted by the promise of urban employment, lived without basic water and sanitation infrastructure and cooked their food in crude ovens built from dried mud. How is the construct of the international system causing and prolonging this level of inequality?

Tax Havens Cause Poverty

The French for tax haven is ‘paradis fiscal’, an apt name for the financial centres where rich individuals and multinational organisations are charged minimal or zero tax rates. There are about 70 tax havens around the world, most of which are found in Europe and the Caribbean with prominent examples being the Channel Islands and Switzerland. The Tax Justice Network (TJN), a coalition of activists and researchers which seeks to challenge the problems of tax avoidance, tax competition, and tax havens, argues that a direct link can be drawn from tax havens to poverty. Their research in 2005 found that rich individuals held US\$11.5 trillion offshore, meaning that the tax revenue forgone internationally each year on these individuals’ wealth is around US\$255 billion, greater than the global aid budget the UN claims is necessary to meet the Millennium Development Goals (MDGs) by 2015. They also report that in Latin America, over 50 per cent of the total holdings of cash and listed securities of rich individuals is held offshore; in the Middle East, the figure is closer to 70 per cent. The people of these countries are missing out on desperately needed revenues.

However, individuals are not the sole or even main concern. Multinational companies (MNCs) also reap many benefits from the existence of tax havens, particularly due to the secrecy which enshrouds them. John Christensen, who

directs the international secretariat of the TJN, used to work in financial industry in Jersey and described it as “a world of smoke and mirrors”. Large companies can set up a subsidiary company offshore which on paper owns much of the capital of the firm; in the case of an oil company this could mean rigs, drilling equipment, or even the company logo. The subsidiary based in the tax haven can then rent the capital back to the company at extremely high rates which then can be deducted as expenses, meaning less tax will have to be paid in the country where the resources, say oil or copper, originated. The resulting difficulty in tracing profit derivation is further clouded by the difficulty of tracing ownership. Christensen explains that “a Jersey registered company might be owned by a trust based in Luxembourg, with nominee trustees living in Switzerland.”

Counties in the developed world suffer the effects of MNC practice as well. A good example revealing the centrality of tax havens to corporate tax strategy is the Enron scandal currently being unravelled in American courtrooms. The figures involved in the case are impressive—for instance, the company declared profits of US\$2.3 billion from 1996-1999 but paid absolutely no tax. As author Lucy Komisar recounts, Enron had 881 offshore subsidiaries: 692 in the Cayman Islands, 119 in Turks and Caicos, 43 in Mauritius, and 8 in Bermuda. When the advanced tax authorities in developed countries have trouble dealing with the misbehaviour of MNCs, it is clear that the under-resourced authorities in the developing world will struggle to increase their tax receipts from MNCs.

Companies are aided in designing their tax strategies by major accountancy firms whose attitude towards tax havens runs directly against their claims to care about corporate social responsibility. KPMG, which itself operates from a secretive Swiss base, was heavily criticized for creating the tax strategy for WorldCom, the huge telecommunications firm which declared Chapter 11 bankruptcy in 2002. In December 2005, KPMG’s head of tax Loughlin Hickey gave the Institute of Chartered Accountant’s annual lecture, appealing for the cultivation of trust between tax authorities and accountants. Tax Justice Network advisor Richard Murphy asked whether Hickey could engender some of the trust by ceasing to work in tax havens. Hickey replied, “I am proud that KPMG is in those territories. . . quite frankly if principled firms like ourselves are not in these territories we don’t aid them.”

The claim that tax haven territories are developing countries has also been used at the level of the UN where in the meetings of the low-profile Committee of Experts on International Cooperation in Tax Matters, the representation of tax havens far outweighs that of developing countries. In addition, while thousands of protesters attended the Hong Kong trade negotiations in December 2005, when the UN Committee of Experts on International Cooperation in Tax Matters met, there was only one civil society organisation present—TJN. Developing country and civil society voices decrying tax injustice are only now increasing in volume.

Nairobi 2007: A Tax Justice Network for Africa

African countries are at the centre of the tax injustice crisis, a situation demanding attention and action. Recently at the 2006 World Social Forum (WSF) in Bamako, Mali, the Tax Justice Network met with representatives from across African civil society. The aim of the trip was to discuss the possibility of creating a TJN for Africa at the next WSF to be held in Nairobi in 2007.

Each seminar opened with comments planned to frame a discussion led by the participants. And indeed, what happened in the first workshop and continued throughout the whole forum completely affirmed the need for a TJN for Africa. Overall plans to construct the network were complemented with a depth of knowledge, experience, and passion from all sides of the vast continent. Participants in the workshops—researchers, trade unionists, journalists, NGO workers, and students—offered examples from their own countries of abuse of tax policy by multinationals, the connection between kleptocratic leaders and secret Swiss bank accounts, and the increasingly regressive nature of domestic tax systems. A Ghanaian recounted how mining companies in Ghana, famously operating in the city of Ashanti, are given tax amnesties for ten years and then leave six months before the amnesty is due to run out, giving very little back to the communities living on the land from which they derive their profits. A journalist from Nigeria criticised the multinational oil companies' claim that their tax payments were confidential due to non-disclosure clauses found in their contracts with government: since when were tax payments to the government a commercial secret?

There was also a clear call to go ahead with plans to launch the network in Nairobi. A researcher from South Africa described how COSATU, the Congress of South African Trade Unions, along with other civil society organizations annually publishes the 'People's Budget' which they present to government. To strengthen and improve the initiative, they are also seeking ways to include information on the taxes companies should be paying. They need expertise—exactly what the proposed tax justice network would provide. As well as matching individuals and organizations with accounting expertise and knowledge of campaigns in other parts of the world, the network gives weight to individual campaigns, making activism safer and putting pressure on governments, companies, and international institutions simultaneously.

The secret is out: a financial system based on capital flight, tax evasion, and tax havens must be changed. All eyes on Nairobi 2007.

For more information:

Please contact emma.lochery@st-annes.ox.ac.uk with comments or questions. See "Tax us if you can", A Tax Justice Network Briefing Paper, September 2005 at:

www.taxjustice.net

And briefing papers based on the research by Alex Cobham and other analysts at:

<http://www.oxfordgovernance.org>

Christian Aid's report "The shirts off their backs: How tax policies fleece the poor" is available to download here: <http://www.christian-aid.org.uk/indepth/509tax/>.