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Africa's Bane: Tax Havens, Capital Flight and the Corruption Interface

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Summary

Corruption is widely recognised as harmful to sustainable development. Less well recognised, however, is that secrecy jurisdictions (also known as tax havens) and the bankers, lawyers and accountants who operate from these jurisdictions, actively encourage and support corrupt practices by facilitating illicit financial flows through an 'offshore interface' between the illicit and licit economies. Financial market liberalisation has contributed to this problem by not addressing the 'secrecy space' comprised by banking secrecy, non-disclosure of ownership of corporations and other legal entities, lack of accounting transparency for multinational companies, and the lack of provisions for effective exchange of information between national authorities.

The outcome of this failure to ensure sufficiently transparent financial flows has been the creation of a criminogenic environment, in which illicit flows are easily disguised and hidden amongst legitimate commercial transactions, encouraging capital flight and tax evasion on an awesome scale. Sub-Saharan Africa (SSA) has suffered a net accumulated outflow of capital amounting to over US\$600 billion since 1975, and for every dollar of external debt borrowed by SSA countries 80 cents has flowed outwards as capital flight in the same year. The situation is deteriorating, not least because the Government of Ghana has recently announced its intention to support the development of offshore banking services in Accra, which could contribute to a significant increase in the volume of cross-border illicit financial flows in the West African region.

Unless this supply side of corruption is tackled there is little prospect for an end to aid dependency and sovereign indebtedness or the creation of economically stable and democratic states able to provide food security, education and healthcare to their citizens.

Key words: secrecy jurisdictions, corruption, illicit financial flows, tax evasion, transparency.

Introduction

Tax havens and illicit financial flows are shifting from the twilight to the centre stage of the development discourse. Until Oxfam published its report *Tax Havens: Releasing the Hidden Billions for Development*, little attention had been paid to the role played by tax havens in depriving developing countries of their domestic resources through facilitating illicit financial flows and tax evasion. This situation is changing rapidly. It is increasingly recognised that steps to assist poorer countries to move beyond aid and debt dependence will require measures to tackle capital flight, tax evasion and unnecessary tax exemptions. It is also recognised that international aid makes governments accountable to donors, whereas tax enforces accountability to citizens (Bräutigam *et al.*, 2008), and tax evasion undermines this basic pillar of civil accountability and reduces respect for the rule of law.

The scale of capital flight and tax evasion far outweighs aid flows and debt relief programmes. The World Bank's Stolen Asset Recovery initiative reports that the cross-border flow of proceeds from criminal activities, corruption and tax evasion amount to between US\$1 trillion and US\$1.6 trillion a year: approximately half of this flow originates from developing and transitional economies. The British non-governmental organisation Christian Aid has calculated that just two forms of tax evasion, transfer mispricing within multinational corporations (MNCs) and falsified invoicing between apparently unrelated companies, cost the developing world US\$160 billion a year in lost

revenue (Christian Aid, 2008). That figure alone represents more than 150% of the combined aid budgets of all donor countries. Looking at a different part of the tax evasion equation, the Tax Justice Network has estimated that if the income from personal assets held in offshore accounts (and almost entirely untaxed) were subject to tax at even a modest rate, additional revenue exceeding US\$255 billion a year would be available for, for instance, poverty alleviation purposes (Tax Justice Network, 2005).

At the same time, it is also recognised that the corruption debate, which until recently has largely focussed on the demand side, and in particular on bribe taking and payments of commission kickbacks, needs to widen its focus to include those who provide the supply side of corrupt practices, including the financial intermediaries who create and administer the elaborate legal structures through which illicit cross-border financial flows are routed via offshore financial centres (OFCs) into the mainstream banking system (Baker, Christensen & Shaxson, 2008). Crucially, the secretive legal instruments used by MNCs and high net-worth individuals (HNWIs) for tax-dodging purposes are also used for a wide variety of other criminal activities, including market rigging, insider trading, payment of illicit political donations, embezzlement, fraud and payment of bribes and commission kickbacks (Baker, 2005). This underlines the role of tax havens in providing a supply-side stimulus that encourages and enables grand-scale corruption by providing an operational base for lawyers, financial professionals and their clients to exploit legislative gaps and fragmented regulation (Christensen, 2008).

A number of international initiatives have been attempted to control transfer mispricing and the activities of tax havens, but with little success. The OECD guidelines for transfer pricing within MNCs using the ‘arms-length’ pricing technique, which assumes a world market price for bespoke products, services and intellectual property rights, have introduced complexity without significantly diminishing transfer mispricing. The OECD has also led the international project to tackle harmful tax competition, launched in 1998, which amongst its goals included a radical transformation of tax havens through increased transparency and improved information exchange between national authorities (OECD, 1998). But the OECD programme was met with fierce resistance and progress on improving information exchange has been modest.¹ Other attempts to combat illicit financial flows have been timid and unproductive, largely because the international organisations charged with tackling illicit financial flows have taken too narrow a definition of what constitutes money laundering.

This paper explores the nature of tax havens and the ‘offshore’ economy, arguing that public impressions that tax havens are remote from the mainstream political economy are erroneous and that, in practice, these places are major and integrated features of globalised financial markets, operating as a corruption interface between licit and illicit cross-border financial flows. The paper then considers how tax havens facilitate capital flight and tax evasion, and how these linked activities undermine developmental processes. This is followed by an examination of the scale of capital flight and tax evasion in Africa, and the potential for the recently proposed offshore financial centre in Accra, Ghana, to exacerbate these problems in the West African region. The paper concludes with policy recommendations for how to tackle capital flight and tax evasion.

Tax Havens and the Offshore Interface

Despite the evocative images conjured up by the term ‘offshore’, it would be wrong to think of tax havens and offshore financial centres (the cluster of banks, legal and other intermediary firms that operate from these jurisdictions) as disconnected and remote from mainstream nation states. Geographically, many tax havens are located on small island economies dispersed across the spectrum of time zones (see Table 1), but politically and economically the majority of tax havens

¹ Christensen & Spencer (2008).

are intimately 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 (Palan, 1999). The City of London, itself categorised as both a tax haven (Tax Justice Network, 2005) and a major offshore financial centre, exemplifies this political relationship: the City is powerfully represented in UK political affairs by the Corporation of London, which is to all intents and purposes a state within a state. The lobbying activities of the Corporation are supplemented by other powerful actors, including banking associations, legal associations, the Society of Trust and Estate Practitioners, and other influential financial lobbies. Many of the banks, law firms and accounting businesses located in London also operated out of satellite offices located in British Overseas Territories and Crown Dependencies. These jurisdictions project the impression of autonomy, but in practice many, though not all, act largely as booking centres for instructions issuing out of the City of London and other financial centres, including New York, Tokyo, Frankfurt, Paris and Zurich. Their primary use to major banks and their clients lies with their permissive regulatory regimes, and zero or minimal tax rates combined with secrecy arrangements –including non-disclosure of beneficial ownership of companies and trusts–.

Table 1. Tax Havens of the World

The Caribbean and Americas	Frankfurt
Anguilla	Gibraltar
Antigua and Barbuda	Guernsey
Aruba	Hungary
The Bahamas	Iceland
Barbados	Ireland (Dublin)
Belize	Ingushetia
Bermuda	Isle of Man
British Virgin Islands	Jersey
Cayman Islands	Liechtenstein
Costa Rica	Luxembourg
Dominica	Madeira
Grenada	Malta
Montserrat	Monaco
Netherlands Antilles	Netherlands
New York	Sark
Panama	Switzerland
Saint Lucia	Trieste
St Kitts & Nevis	Turkish Republic of Northern Cyprus
Saint Vincent and the Grenadines	
Turks and Caicos Islands	Middle East and Asia
Uruguay	Bahrain
US Virgin Islands	Dubai
	Hong Kong
Africa	Labuan
Liberia	Lebanon
Mauritius	Macau
Melilla	Singapore
The Seychelles	Tel Aviv
São Tomé e Príncipe	Taipei
Somalia	
South Africa	Indian and Pacific Oceans
	The Cook Islands
Europe	The Maldives
Alderney	The Marianas
Andorra	Marshall Islands
Belgium	Samoa
Campione d'Italia	Tonga
City of London	Vanuatu
Cyprus	

Note: this list excludes territories with some tax-haven features but which are not commonly used as such.
Source: *Tax Us if You Can*, Tax Justice Network, 2005.

Until very recently scant attention had been paid to tax havens even though it was recognised as early as 1961 that they attract ‘all sorts of financial wizards, some of whose activities we can well

believe should be controlled in the public interest'.² Almost 50 years later it has become evident that tax havens are major players in the global financial markets: over half of all international bank lending and approximately one-third of foreign direct investment is routed via tax havens; 50% of global trade is routed on paper via such jurisdictions even though they only account for some 3% of world GDP;³ over two million international business corporations and hundreds of thousands, possibly millions, of secretive trusts and foundations have been created in tax havens; personal wealth totalling US\$11.5 trillion has been shifted offshore by the super-rich (HNWIs, known in banking circles as 'Hen-Wees'), evading taxes of over US\$255 billion annually.⁴ Tax havens have also played a major role in the banking crisis that emerged in 2007, providing an environment of lax regulation which, combined with the opacity and complexity of structured investment vehicles and collateralised debt obligations, has significantly reduced the ability of the financial markets to assess and price risk.⁵

Whilst there is a large academic literature on international finance, most of it takes little or no account of the role of tax havens as conduits for cross-border capital flows, and the activities of offshore financial centres remained relatively unexplored until the late-1990s. During the past decade researchers have discussed tax havens in the Caribbean (Hudson, 1998; Roberts, 1999), the British Isles (Hampton, 1996; Johns & Le Marchant, 1993) and Asia-Pacific (Abbott, 2000; Van Fossen, 2002). Others have discussed the political economy of tax havens (Palan, 2007; Viguera, 2005) and the relations between offshore financial centres and the state of the host jurisdiction (Hampton & Christensen, 1999b; Mitchell, Sikka, Christensen, Morris & Filling, 2002).

The proponents of tax havens argue that they 'oil the wheels of financial capitalism', a splendid phrase with little meaning in an age of liberalised capital markets and electronic financial transfers, and as recently as 2007 a special review in *The Economist* on tax havens came to similar conclusions:

'OFCs... have by and large done well out of globalisation. Two decades ago, they were mainly passive repositories of the cash of large companies, rich individuals and rogues. Some jurisdictions still ply this trade today and should be put out of business. But the best of them –for example, Jersey and Bermuda– have become sophisticated, well-run financial centres in their own right, with expertise in certain niches such as insurance or structured finance' (*The Economist*, 2007).

This special review was written before the financial crisis, but long before February 2007, when *The Economist* published their review, critics were warning about the extraordinary risks hidden within securitised debt obligations –a Jersey speciality– and likewise the risk exposure of the insurance industry.

Other supporters of tax havens regard them as powerful disciplinary agents on high-tax/high-spend governments, particularly the social democratic governments in Western Europe and Scandinavia. The Heritage Foundation, for example, through its associated Center for Freedom and Prosperity, argues that tax havens:

'Must aggressively defend tax competition as a liberalising force in the world economy. They should argue that tax competition has helped lower tax rates and reduce discriminatory taxes on income that is saved and invested' (Center for Freedom and Prosperity, 2003).

² Extract from a memorandum concerning the Bahamas dated 3 November 1961 submitted by W.G. Hulland of the British Colonial Office to B.E. Bennett of the Bank of England: seen by the author in the Bank of England archive.

³ The French Finance Minister, D Strauss-Kahn, in a speech to the Paris Group of Experts, March 1999. Quoted in Christensen and Hampton (1999a).

⁴ See http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf (accessed 20/VIII/2006).

⁵ See, for example, Mathiason (2008).

McCann defends tax havens on similar grounds:

‘Since taxation is a major component in economic global enterprise, so also is tax mitigation – and this explains why many financial centres benefit from being used by taxpayers (ranging from individuals to multinational companies) as components in tax mitigation strategies. No one is obliged to pay more tax than is due. Consequently, taxpayers are entitled to use financial centres to mitigate their tax if they so choose. Taxpayers are not entitled to evade tax. Perfect positive correlation between “Offshore” finance centres and the evasion of tax has not been proved beyond reasonable doubt’ (McCann, 2006).

This statement needs careful unbundling to understand its underlying politics. The language is obfuscatory: tax mitigation is a fancy term for avoidance, which always, by definition, involves the exploitation of loopholes to circumvent national tax laws. Using tax havens to ‘mitigate’ tax involves introducing artificial structures, a process known as ‘aggressive tax avoidance’ since there is no real economic substance behind the transactions routed through such structures. What McCann is defending might not be illegal, but it is clearly abusive in so far as it challenges the will of elected parliaments: directors wanting to pursue ethical corporate practices would generally not regard tax avoidance as acceptable practice and are therefore likely to resent pressures from competitors who abandon ethics in favour of higher short-term profits. Finally, there is no requirement under company law –anywhere in the world– for company directors to minimise tax payments, especially when this involves hiding actions which frequently infringe national laws from the scrutiny of shareholders and national authorities.

The Organisation for Economic Cooperation and Development (OECD), acting at the behest of the G-7 leading industrial countries, has taken the lead in examining the role of tax havens in promoting harmful tax practices (OECD, 1998), and set out to radically transform tax havens through increased transparency and strengthened arrangements for information exchange between national authorities. This initiative ran into the sands in 2001, when the new Administration in Washington withdrew its support, but even before the Treasury Secretary Paul O’Neill removed US support, strong resistance from small island jurisdictions, organised under a lobbying group called the International Trade & Investment Organisation, had reduced the political momentum of the OECD-led project. Even progress on improving information exchange has been modest. Other attempts to tackle illicit financial flows through tax havens have been timid and unproductive, largely because the international organisations charged with tackling illicit financial flows have taken too narrow a definition of what constitutes money-laundering.⁶ Civil society has also taken an increasingly critical view of the impact of tax havens on development processes and as ‘engines of chaos in the globalised financial markets’. The British NGO Oxfam led the way with its report on the impact of tax havens on international development, which included an estimate that harmful tax competition costs poorer countries US\$50 billion a year due to aggressive tax avoidance (Oxfam, 2000). Other development-focused NGOs have also recognised the important role played by tax havens in enabling capital flight, profit shifting, tax evasion, tax competition and regulatory degradation (Sikka *et al.*, 2005; Christian Aid, 2008). The Tax Justice Network has explored the connections between the lax or ‘light-touch’ regulation offered by tax havens and the evolution of the off-balance sheet shadow banking system that lay at the heart of the financial crisis that emerged in the second half of 2007 (Tax Justice Network, 2008).

The combination of tax havens and offshore financial centres (ie, the clusters of banks, legal and accounting firms, and other financial intermediaries that agglomerate in these tax havens) creates a highly secretive and under-regulated globalised infrastructure which functions as an offshore interface between the illicit and the licit economies (Hampton, 1996). Importantly, the majority of illicit financial flows are transacted via complex structures involving legal entities established in several different tax havens. This is a world of smoke and mirrors, where a typical tax evasion

⁶ Christensen & Spencer (2008).

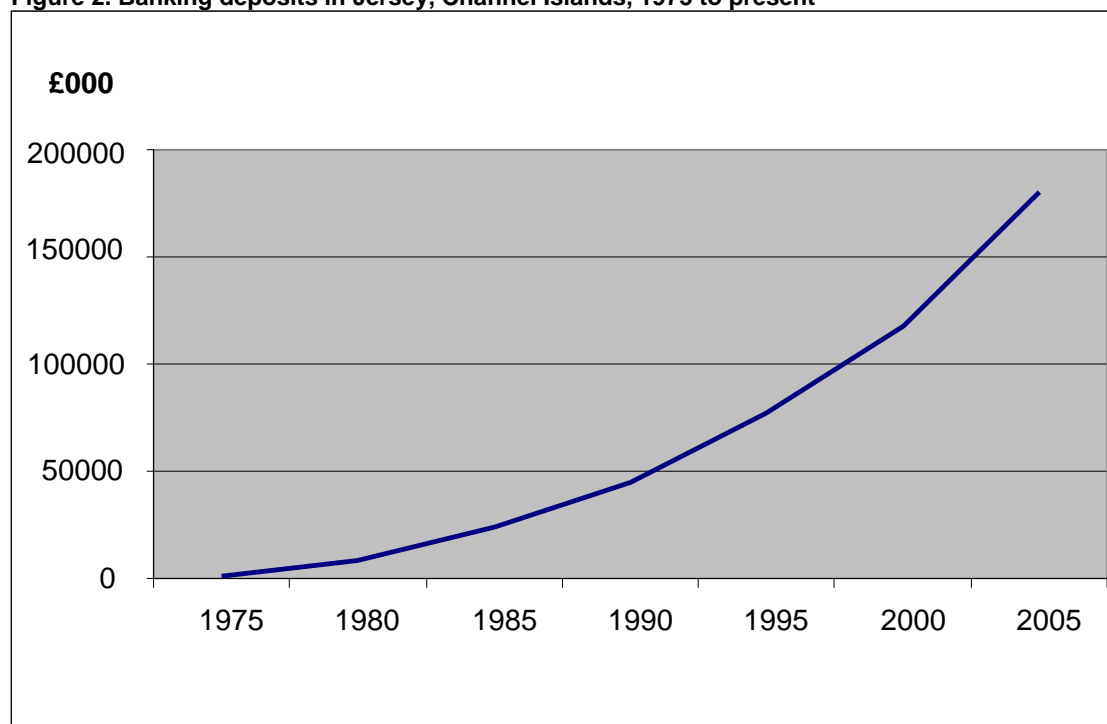
strategy might well involve an offshore trust created in jurisdiction A with trustees in jurisdiction B, which is the sole shareholder in an offshore company registered in jurisdiction C with nominee directors and shareholders, with the company operating a secret bank account in jurisdiction E. The ultimate beneficiaries of this structure will very probably have no apparent connection with any of these jurisdictions (Christensen, 2005) and the entire structure, which is expensive to both create and operate, will have been designed to prevent investigation. Worse still, even when investigators are able to penetrate these hidden structures, flee clauses written into trust agreements, and re-domiciliation clauses in corporate memorandum and articles of association, allow the structures to shift instantly to other jurisdictions at the first sign of investigation: another instance of legal mechanisms being used for illicit purposes. All sorts of reasons are offered to justify these devices, including avoidance of political risk and succession management, but tax evasion is almost invariably an outcome of these actions, and banks are actively engaged in providing the enabling mechanisms for dodging taxation. This active collusion between banks and their clients in creating tax evasion schemes is vividly demonstrated by the US Justice Department's investigations into the operations of the Swiss bank UBS, a major player in the private banking market for HNWIs, which discovered that:

‘... managers at the Swiss Bank, including defendant Birkenfeld, assisted these wealthy US clients in concealing their ownership of the assets held offshore by assisting these clients in creating nominee and sham entities’.⁷

The number of tax havens, and the scale of the offshore economy, has increased dramatically since the period of financial market liberalisation began in the late 1970s. One study enumerated 32 tax havens in 1977 (IBFD, 1977), but research conducted in 2005 enumerated 72 (Tax Justice Network, 2005), and the number continues to rise, suggesting that a powerful process of contagion is underway as more jurisdictions compete for this lucrative activity. Precise measurement of the growth in use of such jurisdictions is difficult: cross-border illicit financial flows and abusive tax practices are hard to define, heavily disguised and hidden within licit flows, and protected from scrutiny by a pervasive culture of secrecy. An idea of the growth of the offshore economy can be glimpsed from data for the British Channel Island of Jersey, which has prepared banking statistics since the 1970s (see Figure 2). These show a remarkable growth in the banking deposits held by non-residents, rising from less than £1 billion in 1975 to approaching £200 billion in 2008. The growth rate continues to rise despite efforts to strengthen international cooperation in the exchange of information between national authorities.

⁷ See <http://www.usdoj.gov/usao/fls/PressReleases/080619-01.html> (accessed 4/VIII/2008).

Figure 2. Banking deposits in Jersey, Channel Islands, 1975 to present



Source: States of Jersey Statistical Review, 2007.

The growing use of tax havens is closely linked to the liberalisation of global capital markets and, more broadly, with policy measures generally associated with the orthodox economic agenda: deregulation, tax cutting, liberalisation of trade and investment flows, and privatisation. Influential Washington-based interest groups closely associated with neo-liberal policies, including the Cato Institute, Americans for tax Reform, the American Enterprise Institute and the Center for Freedom and Prosperity, publicly support tax havens and have lobbied strenuously against international initiatives to regulate their activities. Grover Norquist, a lobbyist closely associated with the Administration of President George W. Bush, has famously declared his goal as being to reduce government ‘to the size where I can drag it into the bathroom and drown it in a bathtub’, and publicly promotes the US as a tax haven: ‘The US is a tax haven and this policy has helped attract trillions of dollars of job-creating capital to America’s economy’.⁸ Tax havens have played a major role in advancing the neo-liberal agenda, and have been strongly supported in this process through what Naomi Klein identifies as ‘the intimate cooperation of powerful business figures, crusading ideologues and strong-arm political leaders’ (Klein, 2007).

The use of tax havens is actively marketed by financial intermediaries to potential clients throughout the world. Mainstream newspapers and magazines such as *The Economist* carry advertisements promoting offshore structures and tax efficient wealth-managements schemes. These advertisements are an open invitation to capital flight and tax evasion. They reveal a major fault line in the financial liberalisation process. Whilst capital has become almost completely mobile, the ability to police cross-border dirty money flows remains largely nationally based. The vast majority of dirty money flows are laundered through the global banking system via complex multi-jurisdictional ladders created and operated by legal and financial professionals acting in collusion with their clients. As the US Senator Joe Lieberman commented to the US Senate Committee: ‘ranks of lawyers and financial accountants have abused the law and their professional ethics simply for the sake of huge sums of money to be made helping their clients evade taxes’.⁹

⁸ See <http://www.freedomandprosperity.org/press/p04-07-05/p04-07-05.shtml> (accessed 17/VII/2008).

⁹ See http://hsgac.senate.gov/index.cfm?FuseAction=PressReleases.Detail&Affiliation=R&PressRelease_id=580&Month=11&Year=2003 (accessed 14/VIII/2006).

Secrecy, Complexity and Corruption

Capital market liberalisation has stimulated an extraordinary increase in cross-border financial flows, which have increased eightfold since 1990 to US\$8.2 trillion in 2006 (McKinsey Global Institute, 2008). Illicit financial flows constitute around one-fifth of this amount, but by and large governments and multilateral agencies have downplayed concerns about dirty money except when drugs and terrorism are concerned. James Wolfensohn provides an exception: during his presidency of the World Bank he suggested that illicit financial flows might partially explain why the bank had failed in its mission to tackle poverty. Speaking in 1996, Wolfensohn said the Bank should give priority to tackling ‘the cancer of corruption’, but whilst the Bank now considers corruption the greatest obstacle to economic and social development, it has not yet accepted that tax havens play a key role in providing an enabling environment for corrupt activities. For the greater part, however, anti-corruption initiatives have focused on bribery of public officials and politicians, and looting by despots and their cronies, rather than on the workings of a global financial system that encourages and facilitates the laundering of dirty money. Astonishingly, neither the World Bank nor the IMF have tried to investigate or quantify capital flight and tax evasion.

Powerful states, notably Switzerland, the UK and the US, have acted to thwart efforts to enhance global cooperation in tackling illicit financial flows. The UK, for example, allows its Crown Dependencies to persist with facilitating tax evasion, despite the fact that it is ultimately responsible for ensuring the good governance of those islands (Murphy & Christensen, 2006). Notwithstanding the ‘smoke and mirrors’ appearance of quasi independence, all domestic laws enacted by the governments of the Bailiwicks of Guernsey and Jersey need prior approval from the Privy Council. It is therefore safe to conclude that the UK Department for Constitutional Affairs, which is responsible for government relations with the Crown Dependencies, would resist any laws it considered contrary to UK interests. Approximately half of all enumerated tax havens are directly linked to Britain, either through Overseas Territory or Crown Dependency status, or through membership of the Commonwealth. When asked at the conclusion of her enquiries into the Elf scandal whether corruption on a similar scale could occur in the UK, the Norwegian anti-corruption campaigner Eva Joly singled out London as the tax haven she found particularly obstructive to investigators: ‘The City of London, that state within a state which has never transmitted even the smallest piece of usable evidence to a foreign magistrate’ (Shaxson, 2007).

Eva Joly refers to tax havens as the principal target in the emerging phase of the anti-corruption debate, arguing that: ‘There is nothing more important for those who want to tackle poverty in the world than to make it possible to trace dirty money flows and impose sanctions on those territories which don’t cooperate with this process’.¹⁰ Joly is not alone in pinpointing London and its offshore satellites as important players on the supply side of the grand corruption equation. In its report on the UK and Corruption in Africa, the UK Africa All Party Parliamentary group commented that:

‘The international financial system is riddled with loopholes. Poor enforcement of laundering regulations leads some experts to suggest there is as much as \$1 trillion of illicit cross border flows annually. Unfortunately the UK, including the City of London and Overseas Territories and Crown Dependencies, has been implicated in this practice’ (UK AAPPG, 2006).

These illicit flows persist despite the elaborate and very expensive follow-the-money strategy introduced in the 1980s to tackle narcotics trafficking but subsequently broadened in an attempt to pre-empt terrorist attacks through tracking related financial flows. The logic of this strategy, which began with the creation of a new offence called money-laundering, was to make financial institutions and intermediaries key players in the ‘wars’ on drugs and terrorism by handing them responsibility for identification of the originators and beneficiaries of financial transactions through

¹⁰ Quoted from ‘Eva Joly: “le G8 ne lutte pas vraiment contre la corruption”’, interview in *La Tribune*, 6/VI/2007.

the ‘know-your-client’ rules, whilst also requiring bankers to inform the authorities of currency transactions exceeding a certain level (Currency Transaction Reports) and any transaction or transactor that raised reasonable suspicion in the minds of the banking personnel involved (Suspicious Transaction Reports).

Notwithstanding these anti-money laundering initiatives, however, the failure rate for detecting dirty money flows is astonishingly high. According to a Swiss banker, only 0.01% of dirty money flowing through Switzerland is detected (Baker, 2005). It is unlikely that other jurisdictions perform any better. This is partly because of the narrow focus on money related to illegal drugs and terror, which account for only a small proportion of cross-border illicit financial flows, but also because of the extraordinarily lax attitude in many countries towards commercial trade mispricing and fraudulent invoicing, which account for the majority of such flows. This laxity also extends to tax evasion, which is treated as a predicate crime in some countries, but not others, and is an area where developing countries are particularly vulnerable (Baker, 2005). It is hard, however, to judge the success or otherwise of the follow-the-money strategy. One commentator concludes:

‘The result is a cumbersome and increasingly intrusive regulatory framework which has imposed heavy cost on innocent parties. Yet, amazingly, to this day there exists no sensible and defensible criteria by which its success or failure can be judged’ (Naylor, 2007).

The ‘secrecy space’ (Hampton, 1996) offered by tax havens creates an effective barrier to investigation of activities booked through the secrecy jurisdiction, and facilitates the laundering of proceeds from a wide range of criminal and unethical activities, including fraud, embezzlement and theft, bribery, narco trafficking, illegal arms trafficking, counterfeiting, insider trading, false trade invoicing, transfer mispricing and tax dodging (Christensen & Hampton, 1999b). Elaborate schemes are devised to ‘weave’ dirty money into commercial transactions and to disguise the proceeds of crime and tax evasion using complex multi-jurisdictional structures. According to one expert investigator:

‘Methods to launder money vary dramatically from low-level, relatively simple to highly-structured and complex business scenarios for transfer of money offshore. What is being increasingly identified is the infiltration of criminal identities into otherwise legitimate business interests. None of these people could get away with a lot of what they were doing if it wasn’t for lawyers, accountants, financial advisers, and the like, knowingly assisting them to launder and hide assets’.¹¹

US\$1.6 trillion of dirty money flows annually into offshore accounts, approximately half of which originates from developing countries (Baker, 2005). Crucially, the techniques used for tax dodging and laundering dirty money involve identical mechanisms and financial subterfuges: multi-jurisdiction structures, offshore companies and trusts, foundations, correspondent banks, nominee directors, dummy wire transfers, etc. 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 operations of tax havens, charitable trusts are regularly set up for the purposes of owning ‘special purpose vehicles’ used for international tax planning and for hiding both assets and liabilities ‘off-balance sheet’, as happened with Enron (Brittain-Catlin, 2005) and the collapsed British bank Northern Rock.

Dirty money¹² flows present regulators with a massive headache due to the problem of distinguishing them from legitimate financial flows. Raymond Baker, an expert on money-

¹¹ Detective Superintendent Des Bray, of the Commercial and Electronic Crime Branch, interviewed in the *Adelaide Advertiser*, ‘Lawyers Helping to Launder Money’, 4/VI/2007.

¹² Dirty money is defined here as money that has been obtained, transferred or used illicitly.

laundering at the Brookings Institute in Washington, distinguishes between three categories of dirty money: (1) criminal money, ie, the proceeds from crimes such as drugs trafficking, theft, etc; (2) looted money, ie, the proceeds of fraud, embezzlement, bribery and related practices; and (3) commercial money, ie, the proceeds from trade mispricing and similar practices, and the associated tax dodging that accompanies these practices. The latter category of dirty money accounts for the majority of cross-border illicit flows and is by far the hardest to detect and track (Baker, 2005).

It is time to turn the current focus on corruption and development on its head. Who could disagree with African anti-corruption campaigners who, whilst deploring domestic corruption involving bribe-taking, fraud and embezzlement, are puzzled by the way in which the corruption debate has focused on the demand side of the equation whilst largely ignoring the crucial role of supply side agents:

‘the looting of (Nigeria’s) resources, which reached its peak during Sani Abacha’s presidency in the 1990s, happened with the active connivance of an extensive infrastructure of banks, lawyers and accountants who provided the means for tens of billions to be shifted offshore. Some of these aiders and abettors came from Jersey. They would have been aware of the source of the funds and must have profited magnificently from handling this stolen property’ (Christensen, 2005).

It is disturbing, to put it mildly, that the prevailing corruption discourse remains largely focused on pointing fingers at petty officials and ruling kleptomaniacs. In terms of orders of magnitude, the proceeds from bribery, drugs money laundering, trafficking in humans, counterfeit goods and currency, smuggling, racketeering and illegal arms trading, account in aggregate for 35% of cross-border dirty-money flows originating from developing and transitional economies. The remaining 65% comprise the proceeds from illicit commercial activity, incorporating mispricing, abusive transfer pricing and fake and fraudulent transactions account (Baker, 2005). In these circumstances, equal emphasis should be given to corruption in both private and public spheres, greater prominence should be given to how corruption can reduce tax revenues by as much as 50% (UK AAPP, 2006) and the activities of tax havens should be very carefully scrutinised to ascertain their harmful impacts on the functioning of global markets and on the integrity of the rule of law. As Baker notes in the concluding chapter of *Capitalism’s Achilles Heel*:

‘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’.

Regrettably, Transparency International (TI), despite its commendable role in putting corruption onto the political agenda, has undermined the efforts of reformers through its publication of the Corruption Perception Index (CPI) which reinforces stereotypical perceptions about the geography of corruption. Year in, year out, since 1995 the CPI has identified Africa as the most corrupt region of the world, accounting for over half of the ‘most corrupt’ quintile of countries in the 2007 index. African countries account for about one half of the countries identified as ‘most corrupt’, with Somalia ranking lowest amongst the 179 countries covered by the index that year. But despite the attention given to the CPI in the African and global press, these statistics provide a very partial and biased perspective. A more critical examination of the index reveals that over half of the countries identified by the CPI in 2007 as ‘least corrupt’ are tax havens, including major centres such as Singapore (ranked 4th overall), the Netherlands and Switzerland (7th), UK and Luxembourg (joint 12th), and Hong Kong (14th). For good measure Barbados, Uruguay, Malta and Qatar (all ranked as tax havens –Tax Justice Network, 2005–) also fall into the ‘least corrupt’ quintile. Not a single African nation is ranked in the ‘least corrupt’ quintile. The perversity of this ranking situation is not improved by TI’s other statistical tool, the Bribe Payer’s Index, which lists Switzerland, that

secret repository of vast quantities of stolen and embezzled wealth, as the world's 'cleanest' country. Clearly something is not quite right here.

This distorted geography of corruption may well arise from TI's definition of corruption as 'the misuse of entrusted power for private gain'. Operationally, this has led to an obsessive focus on public officials (politicians and state employees) and a lack of attention to other elites, including company directors or financial intermediaries. Now the focus must shift to the enablers on the supply side, including:

- Jurisdictions which supply the secrecy space through will illicit money flows.
- Private sector agents, including and especially professional intermediaries such as bankers, lawyers, accountants, company formation agencies and trust companies, whose activities facilitate (or overlook) corrupt financial practices (US Senate, 2006).
- Company directors responsible for illicit transactions that contribute to capital flight, tax evasion and tax avoidance.

A radical change is needed in the public understanding of what constitutes corruption. The focus needs to shift from individuals to the systems and processes that encourage and enable corrupt activities. Corruption always involves narrow interests, both in the public and private spheres, who abuse the common good. It always includes insiders using guarded information who can operate with a high level of impunity. And it always corrodes public confidence in institutions, laws, rules and systems that are intended to promote the public interest. Thus, it might be more useful to define corruption as 'the abuse of public interest and the undermining of public confidence in the integrity of the rules, systems and institutions that promote the public interest' (Baker, Christensen & Shaxson, 2008). Broadening the definition of corruption in this way creates room for a wider range of actors and their facilitating activities. It widens the focus to encompass activities such as insider-trading, tax evasion and avoidance, market-rigging, non-disclosure of pecuniary involvement, embezzlement and trade mispricing, all of which occur in the private sector and are disguised through opaque and complex legal structures. Economic crimes such as these are highly damaging to market economies and pressure is mounting for tax evasion to be identified as a corrupt practice within the scope of the United Nations Convention Against Corruption (Ban Ki-moon, 2008).

Welcome to a World Without Rules

Tax dodging deprives society of its legitimate public resource, but despite widespread recognition of the scale of this problem international efforts to tackle evasion have been thwarted at every step by intense lobbying. 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' (Reich, 1992). This group comprises wealthy individuals and high income earners, plus a sophisticated pinstripe infrastructure of legal and financial professionals operating out of tax havens with compliant polities, judiciaries and regulatory authorities. Tax evasion involves collusion between private and public sector actors, who purposefully exploit their privileged status to undermine national tax regimes by facilitating activities that straddle the border line between the legal and the illegal, the ethical and the unethical. To all intents and purposes these professionals, their clients and the tax havens that accommodate their activities, have declared a secret war on the national sovereignty of other jurisdictions.

The attitudes prevailing amongst professionals operating from tax havens are captured in the following quote given to a national newspaper in response to the 2004 financial statement by the UK Chancellor of the Exchequer: 'No matter what legislation is in place, the accountants and lawyers will find a way around it. Rules are rules, but rules are meant to be broken'.¹³ No matter

¹³ Guy Smith, tax adviser, Moore Stephens, quoted in *The Guardian*, 18/III/2004.

how this statement is spun, it shows the extent to which these elite groups regard themselves as beyond compliance with democratic and social norms. Incredibly, none of the professional institutions of lawyers or accountants promote ethical codes of conduct on the marketing of non-compliant taxation behaviour or the use of tax havens by their members. Accountants typically justify their tax avoidance services on the basis that they promote economic efficiency: some even suggest that directors have a duty to avoid tax.

Another frequently heard justification for tax avoidance is that tax policies are overly complex and therefore impose unnecessary burdens on business. The reality is that tax rules have become complex partly in response to the increasingly elaborate tax planning strategies used to avoid paying taxes. This is a chicken and egg situation which has added unnecessary costs to both tax planning and tax collection. A blanket anti-avoidance principle enshrined in law and accompanied by purposive statements in tax laws would cut through this particular Gordian knot, though in the long run it would be preferable to adopt an international system to tax MNCs on a unitary basis, using agreed formulary apportionment to divide profits between the countries where they arise.

In practice, much offshore tax planning involves practices which most people 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 US Senate in August 2006:

‘Utilizing secrecy jurisdiction secrecy laws and practices that limit corporate, bank and financial disclosures, financial professionals often use offshore secrecy jurisdiction jurisdictions as a “black box” to hide assets and transactions from the Inland Revenue Service, other US regulators and law enforcement’ (US Senate, 2006).

European efforts to tackle tax havens, for example through the Code of Conduct Group on Business taxation, are limited in scope and the processes followed by that Group have been shrouded in secrecy. The European Commission’s attempt at combating tax evasion through the Savings tax Directive (EUSTD), which came into force in July 2005, was rendered virtually impotent by extensive lobbying and political shenanigans. When it was disclosed in March 2008 that the Commission was planning to revise the EUSTD to close existing loopholes, Mr Jean-Claude Junckner, the prime minister of Luxembourg (a secrecy jurisdiction) was quoted in the press as saying: ‘I’m looking forward to many years of fascinating and fundamental discussions.’ Similarly, attempts to move towards a common consolidated corporate tax base for MNCs operating in Europe have met resistance from countries like Denmark, Ireland and the United Kingdom, and little progress is being made at present. Despite intensifying tax competition and falling corporate tax rates in most countries, there is little sign of any improvement in international cooperation in the foreseeable future.

Both the World Bank and the International Monetary Fund have developed their own anti-corruption agendas, but significantly neither has greatly concerned itself with banking secrecy other than where it impacts on their 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 probably worsened the situation by appearing to legitimise tax havens which have cooperated with its efforts to track the proceeds of drugs trafficking and terrorist funding. Significantly, all have dropped their blacklists of tax havens, despite the demonstrable effectiveness of these lists in forcing these jurisdictions to cooperate.

In addition to corrupting financial systems by encouraging and facilitating illicit activities, secrecy jurisdiction corrupts the capitalist 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 (Tax Justice Network, 2005). In every respect this bias works against the operations of fair trade, fair competition and ethical enterprise, but until now the use of tax havens has scarcely registered on the Corporate Social Responsibility debate (Christensen & Murphy, 2004). Indeed, a business symposium hosted by the transnational accounting firm KPMG in 2006 concluded: 'tax avoidance does not damage corporate reputations and may even enhance them'.¹⁴

Capital Flight and Finance for Development

Tax havens encourage capital flight, exacerbate financial crises and impose economic costs in the form of reduced investment, slower economic growth and higher unemployment. Many orthodox economists overlook the role of the offshore economy in their analyses, which arguably underlies their inability to explain the capital flows paradox –ie, the 'uphill' movement of capital from poor to rich nations– above all to the US and Europe –despite the predictions of their economic theories– (Guha, 2006).

Capital flight involves the deliberate and illicit disguised expatriation of money by those resident or taxable within the country of origin. Capital flight impacts significantly on the capital accumulation and investment processes of many developing countries, resulting in lower levels of domestically-financed investment and reduced tax revenues for publicly-funded revenue and capital expenditure. Capital flight also depresses economic activity and has a negative impact on long-term growth rates (Lessard & Williamson, 1987).

Tax evasion is often a motive for the flight of capital and the two are intricately linked, but other motives exist, including seeking a secure location for cash resources, the avoidance of local currency risk (even if that is illegal in the country in which the taxpayer is resident) and avoidance of inheritance laws. For these reasons, capital flight would remain a problem even if there were no tax incentive implicit within it. What is certain, however, is that capital flight impacts negatively on capital-scarce economies: the loss of domestic savings leads to lower levels of internally-funded investment, and the loss of tax revenues flowing from those savings leads to lower revenues available for public expenditure on health, education and public infrastructure. Additionally, use of external borrowings to finance government deficits imposes a debt servicing burden which impacts heavily on economic growth and social stability, exacerbating perceptions of economic and political stability.

It is also important to keep in consideration that the tax loss from capital flight is likely to be greater than that from domestic tax evasion of initially similar value. This is because in the case of domestic tax evasion the money stays in the country and generates at least some tax revenue (for example, sales tax or VAT when it is spent in the local economy) whereas capital that has fled offshore is not invested locally and does not generate local tax revenue.

Capital flight has certain characteristics that help distinguish it from normal monetary and resource flows. These are:

- Flight capital is domestic wealth permanently put beyond the reach of appropriate domestic authorities. Much of it is unrecorded due to deliberate misreporting.
- Because no (or little) tax is paid on wealth that is transferred as capital flight, it is associated with a public loss and private gain.

¹⁴ See <http://www.taxresearch.org.U.K./Blog/category/kpmg/> (accessed 28/VIII/2006).

- Because tax evasion is illegal and subject to criminal sanction in most countries, the management of flight capital is a form of money laundering. Offshore secrecy arrangements play a crucial part in the laundering process by enabling the origin and ownership of the capital to be effectively disguised.

It must be stressed that legal, well-documented and reported flows of wealth on which proper taxes have been paid are a perfectly legitimate part of everyday commercial transactions and do not constitute capital flight. Legal international payments include those where:

- The source of the wealth being transferred abroad is legal.
- The outflows represent fair payment in a commercial transaction.
- The transfer of wealth does not violate any laws of the country relating to foreign exchange or capital control.
- The taxes due on the capital being transferred have been paid in the country of their origin.
- The flows constitute a part of the official statistics of the country involved and are properly reported, documented and recorded.

While capital flight often occurs through similar channels to those used for the legitimate transfer of funds, it does not meet some (or all) of the characteristics listed above.

The prospect of financial crises might be a primary cause of capital flight, but tax-free status creates a strong incentive for wealthy domestic asset holders in developing countries to retain their assets in tax havens. Doing this on an anonymous basis enables them to protect their wealth from potential currency devaluation and from taxes. But not all the capital that flees developing countries stays out. Some returns disguised as foreign direct investment. This is the consequence of the flight money being re-cast once it has been shifted offshore, typically by being transferred to the ownership of a special purpose vehicle set up on behalf of the true beneficial owner. This is a process known as 'round tripping'. The preferential treatment accorded to many foreign investors provides an incentive to round trip. For example, many governments offer foreign investors lower tax rates, favourable land use rights, convenient administrative supports and a variety of direct and indirect subsidies. They also enjoy superior property rights protection. These investment incentives are discriminatory in so far as they provide a significant financial advantage to external investors (even when in practice the investors are locals who have round-tripped capital to take advantage of these fiscal subsidies) and put local businesses at a financial disadvantage. Round tripping also occurs when investors see opportunities to buy domestic assets at bargain basement prices, for example during privatisation programmes and after a devaluation. Round-tripped capital is also involved in illicit funding of political parties, bribery of public officials, market rigging, insider dealing and other corrupt and illegal activities. The fact that ultimate ownership of the capital is disguised through offshore secrecy arrangements provides a very high level of immunity from investigation by revenue and law enforcement agencies, and in most cases even the major international commercial investigation agencies find it difficult if not impossible to penetrate the multi-jurisdictional structures created to perpetrate such crimes.

An inevitable outcome of this massive rupture of capital heading northwards is that developing countries lose both their investment capital and the tax revenues that would otherwise flow from this capital being invested in the domestic economy. They 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 US\$385 billion annually in tax revenues foregone (Cobham, 2005). This clearly represents a massive haemorrhaging of the domestic financial resource of many developing countries, which undermines sustainability in a number of ways:

- 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, reducing investment and slowing down growth.
- Tax dodging creates harmful economic distortions which penalise those who follow ethical practice and benefits those who bend the rules.
- Tax dodging undermines public respect for the rule of law and the integrity of democratic government.

It is clear that capital flight and tax evasion represent significant barriers to the process of enabling developing countries to finance their development from domestic resources. The 2002 Monterrey Consensus highlighted domestic resource mobilisation in both public and private spheres as essential to sustaining productive investment and increasing human capacities. But domestic resource mobilisation cannot succeed without major fiscal reform at national level to strengthen revenue administration and remove needless exemptions:

‘In the long-run, a sustained increase in the revenue capability of the public sector and diversification of the tax base is critical for mobilizing resources for development and meeting the Internationally Agreed Development Goals, including the Millennium Development Goals. It has been noted that there is scope in most developing countries to increase tax revenues through more effective tax collection, modernization of tax legislation and broadening the tax base’ (Ban Ki-moon, 2008).

At the same time, national sovereignty in tax matters remains under threat from the lack of international cooperation in tax matters, especially in respect of combating tax evasion and tax competition. This has been recognised by developing countries, which in the run-up to the Monterrey Review Conference in Doha, Qatar (end-November 2008), have been pressing for strengthened international cooperation in this area and for the upgrading of the UN Committee of Experts on International Cooperation in Tax Matters to inter-governmental status.

The Scandal of Africa’s Revolving Door

The missing piece of the Africa’s development equation is the impact of illicit financial flows, including tax evasion, on capital accumulation and public and private investment (Murphy, Christensen & Kapoor, 2007). Capital flight contributes to financial crises and carries costs in the form of reduced investment, unemployment and slower economic growth rates (Stiglitz & Charlton, 2005). In addition, tax evasion has negative impacts on equality, with wealthy citizens escaping the tax burden and poorer citizens facing higher taxation and cuts in public services. At the macroeconomic level, this shift in the tax charge from capital onto labour and consumers alters the cost ratio of the factors of production, rendering capital less expensive relative to labour, and reducing job creation (OECD, 1998).

Developing countries are particularly vulnerable to illicit financial flows, partly because of their heavy reliance on the extractive industries and other natural resources and therefore their greater degree of exposure to the risk of falsified invoicing and transfer mispricing (Murphy, Christensen & Kapoor, 2007), but also because their national administrations generally lack the resources to engage in lengthy investigations into tax evasion cases. This administrative constraint is illustrated by the fact that, according to one tax expert, to date not a single African country has managed to successfully conclude an investigation into transfer mispricing (Murphy, Christensen & Kapoor, 2007). Africa, with its large natural resource base, is highly vulnerable to capital flight and tax evasion: the Democratic Republic of Congo (DRC), for example, lost an estimated US\$15.5 billion due to capital flight from 1980 to 2006 (GFI, 2008). Commenting on the rupture of financial resource, a former IMF economist, Dev Kar, noted:

'If the DRC would have been successful in stemming this capital flight through prudent macroeconomic policies and better governance, not only would the DRC have paid off its entire external debt at end 2006 (US\$11.2 billion), another US\$4.3 billion would have been left to add to the country's foreign exchange reserves or used to invest in infrastructure and human capital' (GFI, 2008).

DRC also provides a case study of how MNCs have created opaque and complex offshore structures to evade taxes in the resource extraction industries. Greenpeace International, working with the Tax Justice Network, has uncovered how a Swiss-based logging company, the Danzer Group, has been exporting timber products at below world market price to shift profits out of the Congo to its offshore subsidiary Interholco (Greenpeace, 2008).

Estimates of capital flight from Africa vary considerably: according to the African Union, US\$148 billion leaves the continent every year because of corruption (UK AAPPG, 2006). Other researchers have estimated that Africa has suffered a net accumulated outflow, including loss of interest earnings, amounting to over US\$600 billion since 1975 (Ndikumana & Boyce, 2008). Most analysts agree that the outflows of illicit money originating in Africa tend to be permanent, indicating that between 80%-90% of such flows remain outside the Continent.¹⁵ Another study has estimated the volume of capital flight plus accumulated interest earnings at 145% of the total external borrowings by sub-Saharan countries in the mid-1990s: meaning that despite its massive external debt burden, Sub-Saharan Africa is a net creditor to the rest of the world in the sense that its stock of flight capital held in privately-controlled offshore accounts exceeds the stock of external debt either held or guaranteed by governments (Boyce & Ndikumana, 2005). According to one study of the sub-Saharan region there is a clear link between external borrowing and capital flight: over the period 1970-1996, for every dollar borrowed from outside the region 80 cents flowed outwards as capital flight in the same year. As the authors note: 'this suggests that external borrowing directly financed capital flight (Ndikumana & Boyce, 2003). What is certain is that the net flow of capital stock is negative, meaning that more capital leaves Africa than enters, and the gross sum of flight capital eclipses the value of aid and debt relief promised to African leaders at the 2005 G-8 summit at Gleneagles by a significant margin.

The value of capital shifted out of West Africa over the past decade is not known, but it has been estimated that Africa's political elites alone hold somewhere between US\$700 billion to US\$800 billion in offshore accounts outside the Continent (Baker, 2005). Trade mispricing accounts for a large proportion of capital flight from Africa: as much as 60% of trade transactions into or out of Africa are mispriced by an average of 11%, yielding a net outflow of capital exceeding US\$10 billion a year (Baker, 2005). Fake transactions are estimated to account for an additional US\$150-200 billion a year (UK AAPPG, 2006). Unfortunately, the incidence of transfer mispricing and fraudulent invoicing to achieve capital flight out of Africa has accelerated significantly. A study of import and export transactions between Africa and the US found that between 1996 and 2005 net capital outflows to the US grew from US\$1.9 billion to US\$4.9 billion (an increase of 257%) through the use of low-priced exports and high-priced imports (Pak, 2006).

Tax evasion amplifies the harm caused by this leakage of domestic capital. According to one expert, tax evasion, tax avoidance and other forms of corruption are estimated to reduce tax revenues in some countries by as much as 50%, reducing the funds available for public spending.¹⁶ Even the more sophisticated African countries are severely impacted by tax evasion. The South African Revenue Service, for example, estimates that the tax gap in that country ranges up to R30 billion

¹⁵ Raymond Baker, from the Center for International Policy, Washington, quoted from oral evidence given to the UK Africa All Party Parliamentary Group in January 2006.

¹⁶ Interview with David Kaufman, Global Governance Director, World Bank, quoted in UK Africa All Party Parliamentary Group (2006), *The Other Side of the Coin: The UK and Corruption in Africa*, p. 12.

(45% of government revenue) largely due to evasion by rich individuals and avoidance by companies.¹⁷ In 2005, the Kenyan Revenue Authority revealed that it was owed a staggering US\$1.32 billion in unpaid taxes, much of which, according to KRA Commissioner-General Michael Waweru, was probably unrecoverable. This sum represented approximately one half of the total government revenues for Kenya, which at that time had external debts amounting to US\$6 billion (Guindja & Christensen, 2005).

In mid-April 2007, the Ghanaian President John Agyekum Kufuor announced his government's plans to proceed with setting up an offshore financial centre in Accra in collaboration with Barclays Bank, a British multinational banking business. In his announcement, President Kufuor expressed hopes that the creation of an offshore financial centre in Accra would make Ghana the financial hub of the West African region. What he did not discuss, however, is how this offshore financial centre can be prevented from worsening Africa's long-standing problems with capital flight, tax evasion and other corrupt activities.

Barclays has had a presence in Ghana for over eight decades, operating branches in several commercial centres, including Accra, Cape Coast, Kumasi, Sunyani, Takoradi, Tamale and Tema. Barclays has retained its foothold in Ghana and other countries in the West African region since the colonial days, providing a range of retail and commercial banking services, including private banking services and foreign currency accounts. High net-worth Ghanaians are actively encouraged to use Barclay's private and business banking services, which include offshore wealth management services. As the bank's website for Ghana explains: 'Trade and exchange rate liberalisation within Ghana are features of the reforms designed to facilitate international investment'.

In practice, the development of an offshore financial centre in Ghana will provide a major conduit for illicit financial flows throughout the region. As the author of a Bank of Ghana Working Paper on the development of an offshore financial centre points out:

'The anonymity of financial transactions, opaqueness of offshore corporations, and legal protections in some OFCs make them attractive to money launderers' (Amediku, 2006).

The problem of banking secrecy is compounded by the fact that most tax havens have few, if any, bilateral tax information exchange treaties with developing countries, making it nigh on impossible for national authorities to track capital flight and tax evasion. Ghana has no tax information exchange agreements with any neighbouring countries in the West African region, nor are the national tax authorities in most countries in the region geared to handling the extensive workload imposed when seeking mutual legal assistance in pursuing illicit financial flows and tax evasion.

The UK, and British banks like Barclays Bank, have played a major role in providing the enabling environment for these dirty money flows originating from Africa. Eva Joly, the Norwegian-born French magistrate who successfully investigated high level corruption within the French government (involving Elf Aquitaine's West African oil production operations), has described London's role as a financial centre at the heart of a global network of satellite jurisdictions (including the Cayman Islands, the Channel Islands, the British Virgin Islands, Bermuda, Gibraltar and others) which provide secrecy as a core service to their clients. According to Joly, the UK has maintained the competitive advantages of British companies by allowing them to operate from tax havens linked to the City of London. 'The expansion in the use of such jurisdictions', she says, 'has a link to decolonisation. It is a modern form of colonialism' (Shaxson, 2007).

Some of the capital flight occurring within the West African region involves cash and other portable valuables, including gemstones and high-value metals, being smuggled across national

¹⁷ See <http://www.moneyweb.co.za/economy/tax/153684.htm>.

boundaries. Its geographical location makes Ghana an ideal conduit for smuggling wealth out of neighbouring countries. Trade mispricing is an alternative way of shifting capital across national boundaries, particularly when large sums are involved. Trade mispricing can be conducted in a number of ways, including mis-invoicing, transfer mispricing, re-invoicing through an apparently unrelated trading partner in an offshore territory, typically a tax haven, and other fraudulent invoicing practices. Abnormally high-priced import transactions are used to reduce the taxable profits in the country of import. They can also facilitate money laundering and can be used to disguise illegal commissions hidden in the inflated prices (Pak *et al.*, 2004). Investigation of these types of fraudulent activities is made significantly more difficult by the opaque offshore structures used to disguise the identities of the different parties to the transactions. As the author of the Bank of Ghana's working paper cited earlier comments with notable understatement:

'... the operation of IFSC has implications for the Central Bank's work on the promotion of good governance because it can reduce transparency, including through the exploitation of complex ownership structures and relationships among different jurisdictions involved' (Amediku, 2006).

Towards a New Financial Architecture for Tackling Illicit Financial Flows

The banking crisis which emerged into the public domain in mid-2007 has exposed one part of a larger systemic failure in the global financial architecture. It is clear that lightly regulated or unregulated financial markets have not acted as efficient distributors of capital and, worse, that asymmetric information flows have encouraged corrupt and fraudulent behaviour. In a *Financial Times* article published in March 2008, the economics commentator Martin Wolf wrote:

'Remember Friday March 14 2008: it was the day the dream of global free- market capitalism died. For three decades we have moved towards market-driven financial systems. By its decision to rescue Bear Stearns, the Federal Reserve, the institution responsible for monetary policy in the US, chief protagonist of free-market capitalism, declared this era over. It showed in deeds its agreement with the remark by Josef Ackermann, chief executive of Deutsche Bank, that "I no longer believe in the market's self-healing power". Deregulation has reached its limits' (Wolf, 2008).

The stage is therefore set for creating a new architecture that protects public interest from predatory behaviour and places a far greater emphasis on market transparency. Tax havens, which create the opaque and laxly regulated financial markets within which complex yet unstable financial structures have flourished, can have no part to play in a world of globalised capital markets.

Creating effective systems for information exchange between national authorities should become a priority goal for the coming decade, with a particular focus on extending the principle of automatic information exchange beyond the confines of the EU to include developing countries. This will require far swifter progress towards developing personal identification numbers for information exchange purposes and agreeing on data formats for electronic information transfers.

Financial and legal professionals need to be mobilised in the struggle against capital flight and tax evasion. Too many bankers, lawyers and accountants currently take the role of the wilfully-blind professional in either supporting or ignoring these activities. Financial intermediaries should be required to include tax evasion in their suspicious-activity reporting procedures.

A large proportion of capital flight and tax evasion involves trade mispricing. An effective way of tackling this problem lies with requiring companies to report on their activities on a country-by-country basis. This would greatly increase accounting transparency and reduce the opportunity for transfer mispricing between subsidiaries of a multinational company.

Another effective way of tackling capital flight would be to introduce banking secrecy override clauses into information exchange agreements. The OECD has already included such a clause in its Model Agreement, and this approach should become the norm for all such agreements.

The International Monetary Fund should take a lead in tackling illicit financial flows, starting with comprehensive enhancement of its Reports on the Observance of Standards and Codes (ROSCs) procedures to include reporting on jurisdictions which fail to implement and support measures to tackle capital flight through effective information-exchange processes. Such reporting should be made a mandatory feature of ROSCs, and those jurisdictions that do not demonstrate ability and willingness to implement effective information exchange should be blacklisted.

Tax evasion should be defined in national and international laws as a predicate crime for anti-money-laundering purposes and the activities of tax havens need to be factored into global anti-corruption measures, leading to a wholesale reappraisal of what constitutes corruption, who promotes it and how it can best be tackled. With this in mind, the Tax Justice Network is currently developing a new global index of corruption, the Financial Transparency Index, which will highlight those secrecy jurisdictions that are most prominent in supporting illicit financial transactions.

In a world of global financial markets there is no reason for continuing to allow individuals to hide their identities behind nominee directors and shareholders. This lack of transparency encourages corrupt activities and creates asymmetric access to important market data. Global standards are required for full public disclosure of beneficial ownership of companies and trusts and other legal entities, with minimal standards for annual reporting.

To add a bit of muscle to the process, international sanctions are required against tax havens which fail to cooperate in the struggle against illicit financial flows and tax evasion. Political and civil society pressure needs to be exerted on the professional associations of bankers, lawyers, accountants and other financial intermediaries who profit from the activities of tax havens: codes of best practice should be produced to assist professionals with understanding both the technical and ethical procedures for combating capital flight, tax evasion and tax avoidance.¹⁸ It is depressing to note that not a single professional association, anywhere in the world, has issued a code of conduct for their members relating to the use of tax havens. This reflects a generally anti-social culture which permeates the higher levels of these associations. Civil society needs to act decisively against this culture, making it clear that those who enjoy the privilege of professional status cannot continue to abuse that privilege for personal gain. In this respect, the proposal to adopt a United Nations Code of Conduct on international cooperation in combating tax evasion would be a major, and symbolically important, step forward.¹⁹

¹⁸ See, for example, <http://www.taxresearch.org.uk/Blog/2007/10/18/the-tax-justice-network-code-of-conduct-for-taxation/>.

¹⁹ See Professor Michael McIntyre's article on the proposed UN Code of Conduct at <http://taxjustice.blogspot.com/2008/04/tax-justice-focus-doha-edition.html>.

Conclusion

Tax havens set out to undermine national sovereignty and democratic forms of government. Their governments purposefully allow the creation of asymmetric supplies of economic and legal information which harms the efficiency of global markets. They knowingly encourage and facilitate grand corruption, embezzlement and fraud. Tax havens contribute to creating extremes of wealth inequality, which can trigger economic instability and prolonged recessions (Batra, 1987).

Tax havens persist in a world of globalised financial markets solely because they serve the economic interests of elite groups. Most of the problems posed by tax havens could be remedied by strengthening international cooperation. Policies such as those proposed above could be implemented in a relatively short timeframe. The principal barrier standing in the way of progress towards achieving these goals is the lack of political will on the parts of the governments of the leading OECD nations, most notably the US and the UK, both of which are leading tax havens. The reality of their commitment to 'globalisation' is that they want liberalised trade on their own terms but continue to use lax regulation, secrecy and fiscal incentives to distort the trade system in favour of their domestic businesses and to attract capital from other countries.

The debates around development, accountability, corruption and persistent poverty are undergoing a major shift. Increasingly, civil society is looking beyond dependence on aid and debt, and the conditionalities associated with aid and debt relief: the focus is shifting to domestic resources, capital flight and tax evasion (Oxfam, 2000; Christian Aid, 2008; Ban Ki-moon, 2008). The issues of capital flight and tax evasion, which have gone largely ignored for so long, are moving to the centre stage. Connections are being made between money laundering, corruption, financial market instability, rising inequality and poverty. And tax havens are being identified as a common denominator in each of these problems (Murphy, 2008).

In this context, the proposal to encourage the development of an offshore financial centre in Accra raises a host of questions about how a country like Ghana, with a relatively unsophisticated revenue service and very limited regulatory experience and capacity, can protect itself –let alone neighbouring countries– from tax evasion and other corrupt practices. With the best of intentions, laws and regulations can be placed on the statute book and regulatory structures established, but effective implementation requires a massive commitment of resources and political will, and good governance in this area is often undermined because the state lacks the power to resist pressures from special-interest groups.

There is a further issue to which the government of any prospective secrecy jurisdiction must give careful consideration. Globally, the fundamental attractions of tax havens –low or no taxation, banking secrecy, non-disclosure of ownership, minimal financial regulation and lack of information exchange– face a significant threat of erosion from external intervention by states coming under increased pressure to protect their tax bases (Hampton & Christensen, 2004). Tax and regulatory competition between jurisdictions is also eroding the financial returns that offshore financial centres have enjoyed in the past. It is therefore likely that newcomers will be forced to compete in an already cut-throat market by offering very low costs and low standards of regulation. Lacking in any particular expertise or comparative advantage in the global financial services market, newcomers will be compelled to compete by allowing non-residents to exploit fiscal or regulatory advantages, or to use secretive structures for nefarious purposes.

Despite the potential for economic diversification outlined in the Bank of Ghana working paper, the potential economic benefits are unlikely to be significant, particularly in view of the high cost of recruiting and retaining sufficiently trained and experienced regulatory staff (Amediku, 2006). On the downside, however, given the existing capital flight problem of the West African region, the omens are not promising, as Raymond Baker commented in an interview with this author in June 2007:

'A mineral-exporting nation serving as an offshore financial centre and secrecy jurisdiction is surely the worst combination possible. Ghana's own wealth will inevitably get sucked into this black hole, driving apart rich and poor and forestalling economic development. Opting for such an unwise step should signal the end of any further need for foreign aid'.

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