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THE SPECTRE OF TAX HAVENS:
Secrecy, global crisis and poverty

by
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> *...how much safer would everybody's savings be if the whole world finally came together to outlaw shadow banking systems and offshore tax havens?*

G-20 President Gordon Brown, addressing the Joint Session of The US Congress in Washington on 4th March 2009

The shadow economy and the engines of chaos

A spectre is haunting the global economy – the spectre of tax havens and tax competition. Across the world politicians and officials struggle with the problem of how

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to fund public services in the face of fiscal termites which are steadily eroding their revenues and switching the tax charge from capital onto labour and consumers. Developed and developing countries face a massive dilemma: tax competition is undermining the taxation of corporate profits and hundreds of billions of tax revenue are being lost annually to tax evasion and aggressive tax avoidance. But many of the larger OECD economies, including the United States and the United Kingdom, have come to rely on huge inflows of capital from the South, much of which is illicit in origin. The OECD countries also host or protect many of the world's largest tax havens and offshore financial centres, including London (the core of the British tax haven economy), Dublin, Luxembourg, Austria, Switzerland and the Netherlands, plus a variety of associated territories like Andorra, Guernsey, Jersey, Monaco and the Netherland Antilles, which act as catalysts for tax competition and facilitate tax evasion on an industrial scale.

De-regulation of the financial markets from the 1970s onwards unleashed the power of capital mobility, and political leaders are now struggling to contain the consequences of having de-regulated capital flows without addressing the need for regulatory and tax cooperation. In their efforts to maximise post-tax profits, financiers have created innovative instruments of devilish complexity; they have played a foolish game of "pass-the-parcel" involving sliced, diced and re-packaged debts with unknown risks attached to them; they have created a shadow banking system designed to operate beyond regulatory control; they have perpetrated massive frauds and looted on an awesome scale; they have become accomplices to criminal activity, including insider dealing, money laundering and tax evasion.

With patience and stealth they have created a shadow economy from which they can operate beyond democratic accountability and regulation. Few people know about this shadow economy. You will not learn about it at universities, or read about it in political economic texts. But it is real nonetheless, as the following estimates indicate:

- over half of all international bank lending and approximately one-third of foreign direct investment is routed via tax havens;
- over 50 percent of global trade is routed on paper via tax havens even though they only account for some 3 percent of world GDP;
- personal wealth totalling US$11.5 trillion has been shifted offshore by the super-rich (known in banking circles as High-Net Worth Individuals, or Hen-Wees), evading taxes of over US$250 billion annually;
- up to US$1.06 trillion is shifted illicitly from the poorer countries of the South into the offshore financial markets every year;
- over two million international business corporations and hundreds of thousands, possibly millions, of secretive trusts and foundations have been created in tax havens;
- tax evasion in Europe is estimated to have reached between 2 per cent to 2.25 per cent of European gross domestic product, but poorer countries in the global South are far more vulnerable.

Despite the immense scale of its operations, however, next to nothing is known about how this shadow economy actually works.

Does the shadow economy have a name? Can we find it on a map? The answer to both of these questions is yes. The shadow economy is widely called "offshore", and it is located in the 72 secrecy jurisdictions (we prefer this term to the more widely used term *tax havens*) dotted across the face of the Earth.

Secrecy jurisdictions have played a major part in the current crisis. They have been used for a variety of purposes, including:

- to create complex securitised instruments (mostly collateralised debt obligations) to mix packages of risk that have been marketed indiscriminately around the world;
- to register 'off-balance sheet' entities that have been used to withhold materially sensitive information from investors, regulators, rating agencies, journalists and others;
- to degrade the regulatory regimes of other nation states;
- to create complex and opaque structures criss-crossing multiples of jurisdictions in order to confuse investigation and fragment regulatory effort;
- to evade and avoid tax on an industrial scale.

In other words, these secrecy jurisdictions have become engines of chaos in the financial markets, serving the dual purposes of helping financiers and their clients to 'get-out-of taxation-free' and also 'get-out-of regulation-free.'

In a world of global banking and 24 hour financial markets, regulation is only as effective as the weakest link in the chain: secrecy jurisdictions are the weakest link. This explains why so much of the 'financial innovation' of the past two decades can be traced back to these places. The majority of hedge funds are located in London, the Cayman Islands and the British Channel Islands. Ditto the private equity industry; the issuance of securitised debt; the re-insurance industry, and the structured investment vehicles at the heart of the shadow banking system.

The current crisis does not result solely as a result of the sub-prime mortgage market failure in the United States: it arose because financiers have created a shadow economy that is so opaque in its operations, so complex in its structure, and so blatantly corrupt in its attitude towards democracy, regulation and taxation, that no one can and should trust any of its activities.

De-regulation of financial markets opened the door for tax and regulatory competition. Tax competition has been used to increase returns to capital, and by lowering government revenues, to force privatisation of strategic assets. De-regulation has greatly increased profitability, but at massive cost to workers, consumers and the environment. Secrecy jurisdictions have been used as mechanisms for catalysing both processes, acting as termites which hollow out the structures designed to protect society from predatory practices.

To all intents and purposes, secrecy jurisdictions represent a financial world without rules, where criminality can prosper. My own experiences of working within a secrecy jurisdictions suggest that the secrecy they provide facilitates not just tax evasion, but also insider dealing, market rigging, payment of illicit political donations, non-disclosure of conflicts of interest, facilitation of bribery, and all sorts of other corrupt practices. And this happens day in day out on an industrial scale.

In March 2009 the Tax Justice Network presented the G-20 Presidency with a list of proposals for reform of the financial and fiscal systems. These proposals included measures covering the following:

- comprehensive disclosure of ownership data;
- adoption of a country-by-country reporting standard for multinational companies;
- abolition of the use of 'off-balance' sheet accounting vehicles;
- effective steps to tackle trade mispricing;
- taxation of hedge fund profits as income rather than capital gains;
- a multilateral tax information exchange treaty based on automatic exchange;

Taken as a package, these measures would severely restrict the use and abuse of secrecy jurisdictions. These measures could lead to the collapse of the financial sectors in some of the smaller secrecy jurisdictions, which might need transitional support to restructure their economies. But the overall benefits of our proposals far outweigh the negatives. By injecting transparency into markets they will contribute towards restoring trust and accountability. They will also reduce opportunities for tax crime and other corrupt activities. Tackling the loopholes exploited by the tax avoidance industry will enhance the ability of democratically elected governments to tax on a progressive basis. And they will start the process of re-balancing a system that has created wild inequality of wealth and income distribution.

The detailed reforms proposed by the Tax Justice Network and presented to the G-20 team in March 2009 are given in full in Appendix 1 of this paper.

The true story of a global failure

The phenomenon known as the offshore financial economy began to emerge in the 1960s after the creation of the London-based Euromarket. Large sums of financial capital accumulated outside the country of residence of individual and corporate owners, providing a basis for the emergence of transnationalism.[i] This capital was managed by financial specialists operating from a variety of jurisdictions, many of them microstates, which purposefully set themselves up as secrecy jurisdictions: that is autonomous or semi-autonomous jurisdictions offering a combination of lax regulation, low or zero taxation on income and capital of non-residents, secrecy facilities for banking or corporate ownership, and an absence of effective information exchange with the authorities of third party countries.

Scant attention has been paid to the activities of these secrecy jurisdictions, 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."*[ii] Almost fifty years later, it is increasingly clear that secrecy jurisdictions have become major players in the global financial markets and have played a major role in the sub-prime 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 undermined the efficiency of the capital markets.[iii]

Crucially, however, the secretive legal instruments used by the Hen-Wees and MNCs for tax dodging purposes are also used for a wide variety of other criminal activities, including market rigging, insider trading, making illicit political donations, embezzlement, fraud, and payment of bribes and commission kickbacks. It has become increasingly apparent that secrecy jurisdictions provide a supply side stimulus that encourages and enables grand scale corruption by providing an operational base used by legal and financial professionals, and their clients, to exploit legislative gaps and lax regulation.

The United Kingdom has a key responsibility for taking action against the secrecy jurisdictions: as Nairn pointed out in 1997, *"Most of these (secrecy jurisdictions) were former British colonies. Unquestionably it has been the collapse of the British Empire which has bequeathed most micro-states to the New International Order or Disorder."* [iv]

The role of the pinstripe infrastructure in promoting the use of secrecy jurisdictions for nefarious purposes was highlighted by a 2006 U.S. Senate report which noted how:

> *A sophisticated offshore industry, composed of a cadre of international professionals including tax attorneys, accountants, bankers, brokers, corporate service providers, and trust administrators, aggressively promotes offshore jurisdictions to U.S. citizens as a means to avoid taxes and creditors in their home jurisdictions. These professionals, many of whom are located or do business in the United States, advise and assist U.S. citizens on the opening of offshore accounts establishing sham trusts, and shell corporations, hiding assets offshore, and making secret use of their offshore assets here at home.* [v]

A number of international initiatives have been attempted to control the activities of secrecy jurisdictions, but with remarkably little success. The most important of these, the OECD-led project to tackle harmful tax competition, launched in 1998, set out to radically transform secrecy jurisdictions through increased transparency and improved information exchange between national authorities. This initiative ran into the sands in 2001, when the new administration in Washington withdrew its support. Even progress on improving information exchange has been modest. Other attempts to tackle illicit financial flows through secrecy jurisdictions 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.[vi]

Corruption is widely recognised as harmful to the sustainable development of poorer countries. It is less well recognised how secrecy jurisdictions contribute to the impoverishment of these countries by encouraging and enabling capital flight, tax evasion, and facilitating illicit financial flows originating from the proceeds of corrupt activities. Unless this supply side for corruption is tackled there is little prospect for an end to aid dependency or the creation of economically stable, democratic states able to provide food security, education and healthcare to their citizens.

Capital flight, tax evasion and the undermining of development

The elephant in the living room of the development debate is the role played by the global infrastructure of secrecy jurisdictions, banks, legal and accounting businesses, and related financial intermediaries in providing an offshore interface between the illicit and the licit economies.[vii] This interface facilitates capital flight and tax evasion, distorts global markets to the disadvantage of innovation and entrepreneurship, slows economic growth by rewarding free-riding and mis-directing investment, and increases global inequality. The offshore interface functions through collusion between private sector financial intermediaries and the governments of secrecy jurisdictions which host offshore financial centres.

Despite the evocative images conjured up by the term 'offshore', it would be wrong to think of secrecy jurisdictions and the offshore economy as disconnected and remote from mainstream nation states. Geographically, many secrecy jurisdictions are located on small island economies dispersed across the spectrum of time zones – *see table 1*, but politically and economically the majority of secrecy jurisdictions 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.[viii] In the case of the United Kingdom, itself a tax haven, the bulk of offshore transactions are controlled by the City of London, albeit that many City financial intermediaries operate from offices located on UK Overseas Territories and Crown Dependencies. These jurisdictions project the impression of autonomy, but in practice many, though not all, of these secrecy jurisdictions act simply as booking centres for instructions issuing out of the City of London and other major financial centres. They are primarily of use to the City because they offer more permissive regulatory regimes than those prevailing onshore, and zero or minimal tax rates combined with secrecy arrangements - including non-disclosure of beneficial ownership of companies and trusts.

Most reasonable observers might have expected that governments of major states, e.g. the G-7 nations, would act collectively to prevent regulatory degradation and tax evasion, but the rise of secrecy jurisdictions and the offshore economy is closely linked to the liberalisation of global capital markets and, more broadly, with policy measures generally associated with the laissez faire agenda: deregulation, tax cutting, liberalisation of trade and investment flows, and privatisation. Influential Washington-based interest groups closely associated with laissez-faire economic policies, including the Cato Institute, Americans for Tax Reform, the American Enterprise Institute and the

Center for Freedom and Prosperity, publicly support secrecy jurisdictions and have lobbied strenuously against international initiatives to regulate their activities. Grover Norquist, the lobbyist closely associated with the administration of President George W. Bush, who has famously described his goal as being to reduce government *"to the size where I can drag it into the bathroom and drown it in a bathtub"*, publicly promotes the United States as a tax haven: *"The U.S. is a tax haven, and this policy has helped attract trillions of dollars of job-creating capital to America's economy."*[ix] Secrecy jurisdictions have been strongly supported by what Naomi Klein identifies as *"the intimate cooperation of powerful business figures, crusading ideologues and strong-arm political leaders."* [x]

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.[xi] 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. For the most 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 has tried to investigate or quantify capital flight and tax evasion.

In practice key actors, notably Switzerland, the UK and the USA, 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. 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 secrecy jurisdictions 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 United Kingdom, 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."*

Eva Joly refers to secrecy jurisdictions 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."*[xii] Joly is not alone in pinpointing the City of 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."* [xiii]

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 bring financial institutions and intermediaries into the fray by handing them responsibility for identification of the originators and beneficiaries of financial transactions through 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 per cent of dirty money flowing through Switzerland is detected.[xiv] It is unlikely that other secrecy jurisdictions perform any better. This is partly because of the narrow focus on the wars on drugs and terror, which account for only a small proportion of cross-border illicit financial flows, but also because of the extraordinary 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 (typically an outcome if not a motive for trade mispricing), which is treated as a predicate crime in some countries, but not others, and is an area where developing countries are particularly vulnerable. 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.* [xv]

The Profits of Secrecy

A defining characteristic of secrecy jurisdictions is the provision of conditions of secrecy, either created through banking secrecy laws or through *de facto* judicial arrangements and banking practices. This 'secrecy space' creates an effective barrier to investigation of activities booked through the tax haven,[xvi] 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. 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."*[xvii]

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 secrecy jurisdictions, 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 and the collapsed British bank Northern Rock.[xviii]

Tax haven facilities are actively marketed by financial intermediaries to potential clients throughout the world. Mainstream newspapers 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 totally mobile, the ability to police cross-border dirty money flows remains largely nationally based. The vast majority of dirty money flows are laundered via complex multi-jurisdictional ladders operating through the global banking system. Huge sums are involved, particularly for developing countries prone to capital flight: Africa is estimated to have suffered a net accumulated outflow, including loss of interest earnings, amounting to over US$600 billion since 1975.[xix] Most analysts agree that the outflows of illicit money originating in Africa tend to be permanent, indicating that between 80 – 90 per cent of such flows remain outside the Continent.[xx] Another study concludes that sub-Saharan Africa is a net creditor to the rest of the world in the sense that external assets, i.e. the stock of flight capital, exceed external liabilities (i.e. external debt).[xxi] The problem is that the assets are largely held in private hands, whilst the liabilities belong to the African public.

Table 1: Secrecy jurisdictions of the World

The Caribbean and Americas
Anguilla
Antigua and Barbuda *
Aruba *
The Bahamas
Barbados
Belize
Bermuda
British Virgin Islands
Cayman Islands
Costa Rica
Dominica *
Grenada
Montserrat *
Netherland Antilles
New York
Panama
Saint Lucia *
St Kitts & Nevis *
Saint Vincent and the Grenadines *
Turks and Caicos Islands
Uruguay *
US Virgin Islands *

Africa
Liberia
Mauritius
Melilla *
The Seychelles *
São Tomé e Príncipe *
Somalia *
South Africa *

Europe
Alderney *
Austria
Andorra
Belgium *
Campione d'Italia *
City of London
Cyprus
Frankfurt
Gibraltar
Guernsey
Hungary *
Iceland *
Ireland (Dublin) *
Ingushetia *
Isle of Man
Jersey
Liechtenstein
Luxembourg
Madeira *
Malta *
Monaco
Netherlands
Sark
Switzerland
Trieste *
Turkish Republic of Northern Cyprus *

Middle East and Asia
Bahrain
Dubai *
Hong Kong
Labuan
Lebanon
Macau *
Singapore
Tel Aviv *
Taipei *

Indian and Pacific Oceans
The Cook Islands
The Maldives *
The Marianas
Marshall Islands
Samoa *
Tonga *
Vanuatu

Source: Tax Justice Network,
Note: This list excludes territories with some tax haven features but which are not commonly used as such.

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 abetters came from Jersey. They would have been aware of the source of the funds and must have profited magnificently from handling this stolen property."*[xxii]

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 per cent of cross-border dirty money flows originating from developing and transitional economies. In contrast, the proceeds from illicit commercial activity, incorporating mis-pricing, abusive transfer pricing and fake and fraudulent transactions account for 65 per cent of such flows.[xxiii] At the very least, 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 per cent;[xxiv] and the activities of offshore financial centres should be more 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, 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 2006 index. African countries account for about one half of the countries identified as most corrupt, with Chad, Cote d'Ivoire, Democratic Republic of Congo, Equatorial Guinea, Guinea and Sudan ranking amongst the bottom ten of the 163 countries surveyed. Ghana fares relatively well, ranking at joint 70th position in 2006, though the ranking score of 3.3 out of a possible 10 still places Ghana at the low end (i.e. more corrupt) of Transparency International's corruption spectrum. 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 2006 as 'least corrupt' are secrecy jurisdictions, including major centres such as Singapore (ranked 5th overall), Switzerland (7th), United Kingdom and Luxembourg (joint 11th), Hong Kong (15th), Germany (16th), USA and Belgium (jointly 20th). For good measure Barbados, Iceland, Malta, New Zealand and the United Arab Emirates (all secrecy jurisdictions) also fall into the 'least corrupt' quintile. Not a single African nation is ranked in the 'least corrupt' quintile.

What do these rankings tell us about the current politics of corruption? And who would disagree with the prominent Nigerian politician who, during protracted negotiations to secure the repatriation of assets stolen by former Nigerian President Sani Abacha, commented that: *"It is rather ironical that the European based Transparency International does not think it proper to list Switzerland as the first or second most corrupt nation in the world for harbouring, encouraging and enticing all robbers of public treasuries around the world to bring their loot for safe-keeping in their dirty vaults.*[xxv]*"*

The secrecy space offered by the offshore interface, which currently comprises approximately 72 secrecy jurisdictions clustered near the major onshore economies,[xxvi] represents a glaring flaw in the global financial architecture. This flaw is routinely exploited by financial intermediaries for the simple reason that this is the most profitable fee-earning activity. Senator Joe Lieberman summed up these degraded values when he commented to the U.S. Senate Committee that: *"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."*[xxvii]

The distorted geography of corruption mentioned above may well arise from an obsessive focus on public officials (politicians and state employees) and a lack of attention to the corrupt activities of other elites, including company directors or financial intermediaries. Now the focus must shift to the enablers on the supply side,[xxviii] including:

- governments of jurisdictions (not exclusively those categorised as secrecy jurisdictions) which supply the secrecy spaces where corruption can take place;
- 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[xxix];
- company directors responsible for illicit transactions that contribute to capital flight, tax evasion and tax avoidance.

Both the World Bank and the International Monetary Fund have developed their own anti-corruption agendas, but significantly neither have greatly concerned themselves with offshore banking secrecy other than where it impacts on their rigidly 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 secrecy jurisdictions which have cooperated with its efforts to track the proceeds of narco trafficking and terrorist funding.

Public understanding of what constitutes corruption needs to be radically shifted to encompass *"all activities that contribute to undermining the integrity of the rules, systems and institutions which govern societies."*[xxx] Insider-trading, tax evasion and avoidance, market-rigging, non-disclosure of pecuniary involvement, embezzlement, and trade mis-pricing, all of which activities happen in the private sector and are disguised through offshore structures, are highly damaging to market economies and should be unequivocally identified as corrupt practices within the scope of the United Nations Convention Against Corruption.

The global game of beggar-thy-neighbour

The idea of tax competition, which conflates the micro economic theory of the firm with political economics of the state, is a fallacious notion used to justify tax cuts for powerful companies and rich individuals. The fact that governments do not compete with one another to provide defence, health, education and other public services to their citizens has not inhibited prominent economists from supporting the concept. Milton Friedman, a leading member of the 'Chicago Boys' who advised Augusto Pinochet during his dictatorship, has said:

> *"Competition among national governments in the public services they provide and in the taxes they impose, is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices which they offer."* [xxxi]

Such thinking is manna from heaven for rich people and powerful businesses who don't want to pay taxes, but according to *Financial Times* columnist Martin Wolf: *"The notion of the competitiveness of countries, on the model of the competitiveness of companies, is nonsense."*[xxxii] It seems not to have occurred to Mr Friedman that when businesses fail they are replaced by more efficient businesses, whereas when governments fail the international community is called in to rescue the situation. Furthermore, mounting empirical evidence has shown that tax competition, particularly between low income countries, does not yield a Laffer effect arising from lower taxes stimulating economic growth, and indeed indirect subsidies, which is effectively what tax holidays and special exemptions are, can cause severe market distortions. As Charlton and Stiglitz note:

> *"The main beneficiary of that (tax) competition is international business, and often countries suffer large fiscal losses without commensurate gains to either their domestic economy or to the efficiency of the location of international production."* [xxxiii]

Unfortunately, the fallacy of tax competition has proved enormously influential amongst politicians and has initiated a race to the bottom, not least in the UK. Speaking at the

Mansion House in 2006 the UK Chancellor said: *"We will succeed if, like London, we think globally . . (and) invest in . . . a competitive tax environment."*

"Only the little people pay taxes"

Secrecy jurisdictions 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 analysis, which arguably underlies their inability to explain the 'uphill' movement of capital from poor to rich nations – above all to the USA and Europe – despite the predictions of their economic theories.[xxxiv] 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 offshore. 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 offshore during the laundering prior to reinvestment in the country of origin. 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 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 $385 billion annually in tax revenues foregone.[xxxv] 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 growth;
- Tax dodging corrupts the integrity of tax regimes and 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.

Declining tax revenues in developing countries have stimulated a vicious circle of decline in investment in the human capital necessary to create an attractive environment for both domestic and foreign investors. In its 2006 on Latin America, the World Bank argued that governments must give higher priority to spending on infrastructure likely to benefit the poor and increase expenditure on education and healthcare. In practice a large proportion of government spending in Latin America is skewed in favour of the well off, and governments are collecting far too little tax, especially from the wealthy. The World Bank report concludes that: *"on the tax front, first items in the agenda would be strengthening anti-tax evasion programs and addressing the high levels of exemptions."*[xxxvi]

The litmus test of corporate responsibility

Tax dodging corrupts the revenue systems of the modern state and undermines the ability of the state to provide the services required by its citizens. It therefore represents the highest form of corruption because it directly deprives society of its legitimate public resource. 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"*.[xxxvii] This group comprises wealthy individuals and high income earners, plus a pinstripe infrastructure of professional bankers, lawyers, and accountants, with an accompanying offshore infrastructure of secrecy jurisdictions with quasi-independent polities, judiciaries and regulatory authorities. This type of corruption therefore involves collusion between private and public sector actors, who purposefully exploit their privileged status to undermine national tax regimes by facilitating activities which straddle the border line between the legal and the illegal, the ethical and the unethical.

Despite the fact that many of its practitioners hold professional status, the culture of the tax dodging industry is wholly subversive of democratic norms. The attitudes I encountered whilst working in the offshore financial industry in the 1980s and 90s were perfectly 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."*[xxxviii] No matter how this statement is spun, it

is clearly intended to convey the message that some classes of society are beyond compliance with social norms. Incredibly, none of the professional institutions of lawyers of accountants promote ethical codes of conduct on the marketing of non-compliant taxation behaviour or the use of secrecy jurisdictions by their members. Accountants enjoy a privileged status in most societies, but they, along with lawyers and bankers, have played a lead role in shaping and promoting offshore facilities for their clients. They typically justify their tax avoidance activities on the basis that it promotes economic efficiency. Some practitioners argue that directors have a duty to avoid tax:

> *"Tax is a cost of doing business so, naturally, a good manager will try to manage this cost and the risks associated with it. This is an essential part of good corporate governance."*[xxxix]

This statement needs careful unbundling to understand its underlying politics. Firstly, a tax on profits is not a business cost but a distribution to society. This much is clear from how tax is reported on the profit and loss account alongside distribution to shareholders. Second, the use of the word risk is revealing. What risks arise from tax other than those involving a legal challenge to an avoidance or evasion strategy? Third, 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 minimize their tax payments, especially when this involves actions that might infringe national laws and hiding these actions from the scrutiny of shareholders and national authorities.

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.

In practice, much offshore tax planning involves practices which many would not regard as good corporate governance. Hence the secrecy in which these practices are conducted. In the words of the report on secrecy jurisdictions published by the U.S. Senate in August 2006:

> *"Utilizing tax haven secrecy laws and practices that limit corporate, bank and financial disclosures, financial professionals often use offshore tax haven jurisdictions as a 'black box' to hide assets and transactions from the Inland Revenue Service, other U.S. regulators and law enforcement."*[xl]

Another recent U.S. Senate report on the accountancy industry revealed internal communications from accounting multinational KPMG which contained a warning from one senior tax adviser that, were the company to comply with the legal requirements of

the Inland Revenue Service relating to the registration of tax shelters, the company would place itself at a competitive disadvantage and would *"not be able to compete in the tax advantaged products market."* KPMG was undeterred and went ahead with: *"knowingly, purposefully and wilfully violating the federal tax shelter law."*[xli] During its enquiries the US Senate Committee discovered that KPMG had devised over 500 'active tax products', some of which may have been illegal. Just four of those 500 products cost the US Treasury US$85 billion annually in lost tax revenues, whilst KPMG booked US$180 million in fees. Speaking after the conclusion of the Senate Committee's enquiries, senior ranking Democrat Senator Carl Levin said that: *"our investigations revealed a culture of deception inside KPMG's tax practice."*

In addition to corrupting financial systems by encouraging and facilitating illicit activities, tax haven secrecy 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.[xlii] In every respect this bias works against the operations of fair trade, fair competition and ethical enterprise, but until now the use of secrecy jurisdictions has scarcely registered on the Corporate Responsibility debate.[xliii] Indeed, a business symposium hosted by transnational accounting firm KPMG in 2006 concluded that: *"tax avoidance does not damage corporate reputations and may even enhance them".*[xliv] This situation is now under challenge by those who argue that paying taxes, where they are due, when they are due and in the amount they are due is the litmus test of corporate responsibility.

Conclusion

According to Senator Karl Levin, ranking senior Democrat in the U.S. Senate, *"tax havens are engaged in economic warfare against the United States".*[xlv] The Senator chose his words carefully. Secrecy jurisdictions set out to undermine national sovereignty and democratic forms of government. Their governments purposefully allow the creation of an asymmetric supply of economic and legal information that harms the efficiency of global markets. They knowingly encourage and facilitate grand corruption, embezzlement and fraud. Secrecy jurisdictions contribute towards creating extremes of wealth concentration, which can trigger economic instability and prolonged recessions.[xlvi]

Secrecy jurisdictions persist in a world of globalised financial markets solely because they have been supported by powerful political allies. Most of the problems posed by secrecy jurisdictions could be remedied by strengthening international cooperation. Transfer pricing abuses could be largely overcome through the introduction of an international country-by-country reporting standard, which the Tax Justice Network is lobbying for in conjunction with the Publish What You Pay coalition. Effective automatic information exchange between national authorities would go a long way towards overcoming the problems of capital flight and tax evasion. The barriers posed by banking secrecy could be overcome by over-ride clauses built into information exchange treaties. The secrecy of offshore trusts would be reduced by requiring registration of

key details relating to the identity of the settlor and beneficiaries. There is no reason why those who benefit from the privileges conferred by using companies and trusts should not accept the obligation of providing basic information about their identity. Global frameworks could be agreed for taxing multinationals on the basis of where they actually generate their profits.

Policies such as those proposed above could be implemented in a relatively short time frame. 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 USA and the UK, both of which are leading tax haven states. 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 developing and emerging countries.

The debates around development, accountability, corruption and persistent poverty are undergoing a major shift. Increasingly, campaigners are looking beyond dependence on aid and debt relief, and all the associated conditionalities, and asking questions about the domestic resources of developing countries. The issues of capital flight and tax evasion, which have gone largely ignored for so long, are moving to the centre stage. At the same time the corruption debate is shifting to focus on the role of enablers and the secrecy jurisdictions through which so much dirty money is shifted en route to the mainstream capital markets. Connections are being made between money laundering, corruption, financial market instability, rising inequality and poverty. And secrecy jurisdictions are being identified as a common denominator in each of these problems.[xlvii] Addressing this issue in March 2007, anti-corruption campaigner Eva Joly spoke of the need to shift the corruption debate to Phase Two, in which the role of accountants, bankers, lawyers and offshore financial centres in enabling corrupt practices comes under far greater scrutiny.[xlviii] Addressing the Joint Session of the US Congress in March 2009 UK Prime Minister Gordon Brown finally let the cat out of the bag: in a world of globalised markets we would all be safer and better off without tax havens. Powerful forces stand in the way of making progress to remove these cancers from the global markets, but the current crisis provides a moral and economic imperative to take comprehensive action, and without delay.

APPENDIX 1: ENDING THE OFFSHORE SECRECY SYSTEM

An Action Programme to Strengthen International Financial and Fiscal Regulatory Cooperation

Presented to G-20, March 2009

It is now widely understood that any serious efforts to improve international cooperation and coordination of supervision of the international financial system must include a determined crackdown on the use of `offshore' entities. This should include action to end the ways in which major international financial centres also collaborate in the offshore system, which indeed they themselves originally devised and have helped to maintain.

Offshore entities are extensively used to maintain secrecy which undermines the effectiveness of regulation in the public interest. The strict secrecy provided by tax havens and the offshore system enables in particular abusive avoidance and evasion of both taxation and financial regulation. They have contributed to the current financial crisis in two main ways. First, the opportunities for tax minimisation have greatly increased the volume of funds available for financial speculation, and distorted the international allocation of capital by reducing the cost of capital for financial operations, e.g. by hedge funds, as opposed to real investment. Secondly, the secrecy they provide has contributed to the opacity which has destroyed confidence in the assets and balance sheets of multinational banks and financial institutions, inflicting great damage on the world economy.

International tax avoidance and evasion create a major obstacle for developing countries seeking to generate domestic finance for development, and hence reduce their dependence on aid. It is now time to end the use of artificial legal persons formed in jurisdictions of convenience which distorts and sullies legitimate business activities. To that end, TJN proposes the following Action Programme.

IMPROVING COORDINATION BETWEEN FISCAL AND FINANCIAL REGULATORS

The Compendium of Standards and Codes compiled by the Financial Stability Forum (FSF) should include appropriate standards for International Cooperation in Tax Matters (see below). The FSF itself should be reformed both to include a wider range of countries, especially developing countries, and to provide opportunities for input by civil society organisations.
The Reports on the Observance of Standards and Codes (ROSCs) of international financial centres conducted through the International Monetary Fund (IMF) and World Bank should be made more transparent and provide an opportunity for input by civil society organisations (following fundamental governance reform of the IMF and World Bank to enhance transparency and accountability). It should include assessments of each jurisdiction's compliance with international tax cooperation standards, conducted

by expert reviewers appointed by the UN Tax Committee. No financial centre should be judged compliant unless it has established adequate and transparent mechanisms for comprehensive cooperation in tax matters. Counter-measures for non-compliance with tax co-operation standards are dealt with separately (see below).

Each jurisdiction should establish adequate arrangements for cooperation between tax authorities and regulators responsible for financial supervision, including bodies responsible for fighting money-laundering, corruption and other criminal activities. There should be adequate arrangements within each country, and internationally, subject to proper safeguards, for exchange of information between fiscal and financial regulatory authorities. This should include access by tax authorities to transaction reports related to money-laundering.

INTERNATIONAL COOPERATION IN TAX MATTERS

An international standard for cooperation in taxation should be established, providing for comprehensive exchange of information for assessment and collection of taxes, including automatic, on request and spontaneous exchanges of information. This should be based on existing instruments, such as the Council of Europe/OECD Convention of 1988 on Mutual Cooperation in Tax Matters, and the EU Savings Directive. The Council of Europe/OECD multilateral Convention should be made open for signature by all states. Council of Europe and OECD member states should accede to it, making no significant reservations, and those which have such reservations should withdraw them. Its provisions on automatic exchange of information should be made operational by all participating states. They should also extend its provisions to all their dependent territories.

The European Union should enact the revised version of its EU Savings Directive proposed in November 2008 whilst withdrawing the option for tax to be withheld at source on income paid to non-resident taxpayers in some participating jurisdictions, so that automatic information exchange occurs in all circumstances whilst extending the range of payments covered by the Directive to include dividends and capital gains. The European Union should engage in negotiation with non-member states to extend the geographic scope of the EU Savings Tax Directive to additional jurisdictions, with a particular emphasis upon extension to the USA and the principal current non-participating tax havens of Dubai, Singapore, Hong Kong and Panama, and to developing countries which may have suffered from capital flight.

The OECD Centre for Tax Policy and Administration should accelerate its long-standing work on technical standards for automatic exchange of tax information in electronic form, in conjunction with other appropriate bodies such as the European Commission, the IMF Fiscal Affairs Department and the World Bank. These standards should be internationally agreed and implemented as soon as possible.

The international standard should include rules for obtaining information from both individual nationals and residents, and legal persons formed under the laws of, or resident in, each country. It should include in particular a requirement that all banks and

other financial, legal and corporate service providers collect information, which should be available for regulatory purposes to the appropriate supervisors or regulators (including tax authorities), on the beneficial owners of all payments made, whether to residents or non-residents, individuals and legal persons. It should prohibit legal provisions specifically designed for non-residents, such as legal entities formed to conduct activities exclusively outside the jurisdiction. Compliance should mean actually establishing satisfactory arrangements for exchanging information with other states multilaterally, and not just making non-binding `commitments' or bilateral deals. Progress towards compliance with this standard should be monitored by an appropriate panel of experts, with input from civil society, according to a timetable with a relatively short transition period. Those states which have achieved a satisfactory level of compliance with this standard should then take appropriate defensive measures within their laws to deny recognition to transactions involving entities in non-compliant jurisdictions. This could include, for example, subjecting taxpayers with links to such jurisdictions to special scrutiny, treating entities formed in such jurisdictions as abuses of law, refusing deductibility of interest or other payments to entities taking advantage of secrecy in such jurisdictions, and prohibiting banks from having branches or affiliates in such jurisdictions. Such measures should as far as possible be coordinated.

The UN Committee of Tax Experts should be mandated as a high priority to work on a Unitary approach for taxation of transnational corporations. This should be done in conjunction with the work of the EU on development of a Common Consolidated Corporate Tax Base, and taking account of the experience of the Multistate Tax Commission in the USA with unitary taxation and formula apportionment, and it should draw on the support of the OECD Committee on Fiscal Affairs.

IMPROVED CORPORATE FINANCIAL TRANSPARENCY

The International Accounting Standards Board (IASB) should include within its International Financial Reporting Standard on segment reporting a requirement that multinational corporate groups report on a country by country basis on all their transactions (both third-party and intragroup), labour costs and number of employees, finance costs (third-party and intragroup), profits before tax, provisions for tax and tax actually paid, and tangible and intangible asset investments, without exception for any jurisdiction. This would provide a comprehensive view of each group for investors, stakeholders and tax authorities, with the objective of reducing the cost of capital, ensuring the efficient allocation of resources, eliminating transfer mispricing abuse, and facilitating a more effective and transparent international allocation of the tax base. The constitution of the IASB should be reformed so that this organisation ceases to be a privately owned company with its finances controlled by the large firms of accountants and the financial services community and instead becomes an international agency as a specialist Commission of the United Nations Economic and Social Council, with appropriate provision for input by business and civil society organisations. The IASB project for a revised conceptual framework should be comprehensively reconsidered to reflect the lessons of the current crisis, which show that the IASB's approach has been one-sided in the priority it has given to the information needs of mobile financial investors. Hence, IASB standards should also evaluate the going concern in terms of its

socially embedded use of a society's economic resources and thus contribute to a more socially fair and sustainable economy.

Those national and international bodies producing reporting standards for Corporate Social Responsibility should recognise that payment of the proper level of tax due is the ultimate corporate social responsibility of any company, and should include an obligation to disclose financial and taxation data on a country-by-country basis in the form noted above, which could be based on the IASB standard- if and when an adequate standard is produced.

Professional bodies regulating the activities of financial intermediaries should create Codes of Conduct that their members should be required to comply with as a condition of their membership that promote transparency and responsibility in relation to regulatory and tax compliance. Such Codes should specifically prohibit the promotion of financial obfuscation and abusive tax avoidance. These could be based on the Code of Conduct which is being prepared by the UN Tax Committee. For these purposes: (i) tax compliance means that the correct amount of tax is paid in the correct place at the correct time, on the basis that the economic substance of transactions is properly reflected by the form in which it is reported for taxation purposes; and (ii) abusive tax avoidance means that a transaction is constructed for the main or sole purpose of securing a tax advantage which it was not intended that the law provide.

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