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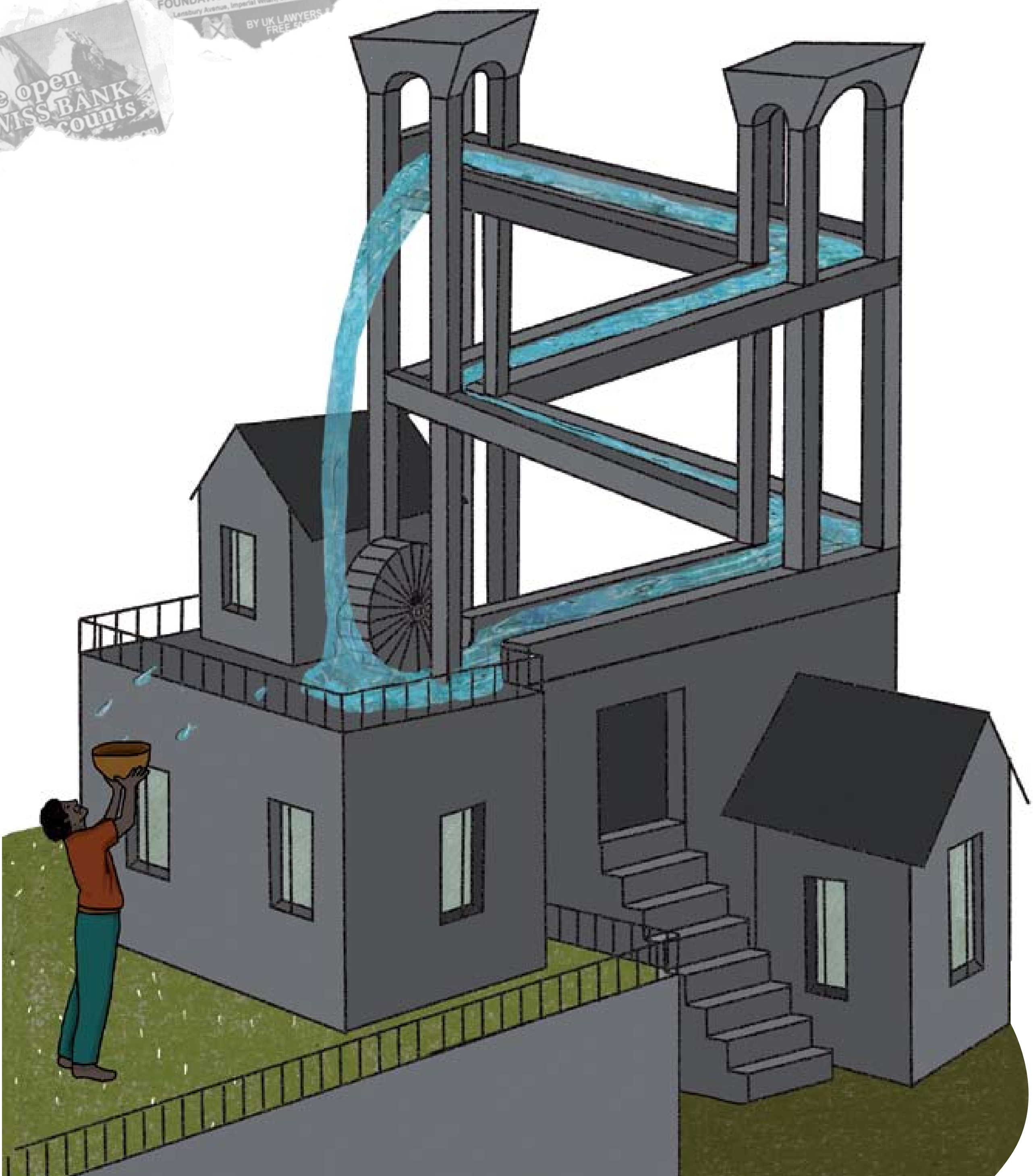
SERVICE CENTRE
FOR DEVELOPMENT
COOPERATION

ILLEGAL CAPITAL FLIGHT FROM DEVELOPING COUNTRIES

– "DEVELOPMENT ASSISTANCE" FROM THE POOR TO THE RICH



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All financial sums mentioned in the report are in euros. Conversions from other currencies are according to the annual average exchange rates publicised by the European Central Bank. Variations in data for 2009 are based on exchange rates at 30.9.2009.

KEPA RECEIVES SUPPORT FROM THE FINNISH MINISTRY FOR FOREIGN AFFAIRS' DEVELOPMENT COOPERATION BUDGET.

SUMMARY

► **ILLEGAL CAPITAL FLIGHT** has been called the biggest obstacle to the development of poor countries. About nine times the amount of world's total development assistance budgets ends up in rich countries, often routed via tax havens shielded by the high level of banking secrecy. The problem can be solved, and in this Finland too could play a considerably more significant role.

There is much talk about corruption. However, public sector resources lost due to corruption play second fiddle to other forms of capital flight. It is estimated that only a few percents of illicit capital flight is due to corruption.

A lion's share of developing countries' tax losses result from tax dodging (evasion and avoidance) by multinational companies, or MNCs. The means used include tax planning that tests the limits of legality and in particular transfer mispricing.

Because of illegal capital flight, developing countries lose sorely needed tax revenue. In addition, local businesses and transparency suffers: it is often extremely hard to get information on the origin and use of financial flows directed at tax havens.

In April 2009, the heads of the leading industrial countries and developing economies of the G20 announced that they would end the banking secrecy of tax havens and help developing countries to benefit from "a new era of cooperation in taxation".

This report shows that the promises given by the G20 and many politicians for reigning in the shadow economy do not tackle the problems caused to developing countries. The international structures that maintain illegal capital flight remain largely unshaken and the voice of the poorest developing countries often remains unheard in deciding measures that affect them.

Development NGOs have in recent years vigorously started to tackle illegal financial flows. The rationale is that neither assistance nor trade alone is not sufficient to bring about development, if the majority of profits flow elsewhere. Low pay jobs created by investment have not been enough to create growth levels and tax revenues needed for development. The financing gap created by economic, food and climate crises increases the urgency of solving the problem.

The European Union and many individual countries have taken a more active role in demanding greater openness for the world economy, which also requires action against illegal financial flows and tax havens. Finland too has sought to conclude bilateral agreements with tax havens on the exchange of information, but the strength of the agreements in dealing with the problem is regrettably questionable (See page 17).

Many solutions have been developed in recent years to support tax collection in developing countries. The most prominent solutions include binding country-by-country reporting regulations for multinational corporations and establishing automatic exchange of information between states in tax matters.

Country-by-country reporting would oblige a company to report its income and paid tax in each jurisdiction where it operates and to publicise additional information. Other proposed solutions include sanctions for transferring wealth to countries with bank secrecy, for instance by using currency transaction tax, as well as increasing the capacity and power of developing countries in international tax matters. ◄

RECOMMENDATIONS FOR FINLAND

- Finland could pursue an active role in development and foreign policy by taking forward one or more initiatives to address the problems at international forums such as the EU, World Bank and OECD.
- One immediate action would be to fulfill the government programme's resolution to participate actively in the debate on innovative funding sources for development.
- This commitment could be followed by joining the advisory panel of the Task Force on Financial Integrity and Development and by commissioning research from the group.

CHAPTER 1:

THE SCALE OF CAPITAL FLIGHT AND THE CONSEQUENCES FOR DEVELOPING COUNTRIES

FOR EVERY EURO OF DEVELOPMENT ASSISTANCE AS MUCH AS NEARLY 10 EUROS FLOWS ILLEGALLY OUT OF THE DEVELOPING COUNTRIES. CORRUPTION AND ORGANIZED CRIME HAVE A ROLE IN THIS BUT THE LARGEST FINANCIAL FLOW IS IN THE FORM OF TAX DODGING BY MNCS.

Development assistance: €80 billion

Illegal capital flight: €680–800 billion

Data for 2006

SOURCE: KAR, DEV AND DEVON CARTWRIGHT SMITH 2009; OECD 2007

► **ILLICIT FINANCIAL FLOWS** from developing countries have become a major development policy issue within a short period. The problem deprives states of tax revenue and, from the perspective of countrie's economic growth, disrupts the vital development of the private sector by distorting competition.

All this creates increased dependency on development assistance. Dependence on assistance, foreign loans or individual large investments increases risks, because financial flows can fluctuate sharply according to changes in the world economy.

By safeguarding developing countries' tax revenue, poor countries can be supported in attaining the Millennium Development Goals and in meeting the financial needs created by global crises. Functioning taxation could also strengthen the ties between citizens and the state: decision-makers become more reliant on the opinions of taxpayers, and citizens begin to trust a state which is able to provide services.

OVER HALF OF CAPITAL FLIGHT COMES FROM DEVELOPING COUNTRIES

Illegal capital flight is frequently channelled via tax havens. The scale of the problem is massive. Even according to conservative estimates, about €1,200 billion crosses state borders illicitly each year.[1] The sum leaving developing countries is estimated to comprise over half of this, €680–800 billion.[2] By way of comparison, the development assistance paid by rich countries to developing countries was €80 billion in 2008, and so is only an ninth or tenth part of the wealth that flows in the opposite direction illicitly.[3]

The example of Sub-Saharan Africa illustrates how serious the situation is. About €340 billion flowed out of this the world's poorest region from 1970–2004. With interest the sum increases to €490 billion. The foreign debt of the countries of the region in 2004 was "only" €183 billion. Therefore the losses incurred by African countries rise significantly even though Africa's share of outward-bound illegal financial flows of developing countries is just three percent. One the other hand, Africa's small share is due in part to inadequate statistics. [4]

Raymond Baker, who heads the international Task Force on International Integrity and Economic Development and the Global Financial Integrity research programme, has stated that capital flight is the single most harmful economic problem for developing countries and transitional economies.[5]

DIFFERENT FORMS OF ILLICIT MONEY

The illicit financial flows comprise three types. Corruption, which was the focus of a wide-ranging discussion during the 1990s, accounts only for three percent of all this money. Crime, such as drug and human trafficking, accounts for about a third.

Tax evasion by companies is clearly of greatest significance. Funds are transferred within a company to subsidiaries located in several tax havens at overly high or low prices. The profits and losses shown in different subsidiaries are distorted in order to minimize company's tax burden. The problem is a common one for rich and poor countries, but developing countries have few resources to tackle it.

Part of illegal capital is lost for good, yet some returns disguised as foreign investments. By routing the investments via tax haven companies, the investors can conceal their true identity, allowing them e.g. to benefit from special treatment targeted to foreign investors. The same mechanism can also be used for laundering money.

For example, in the case of China it is estimated that as much as a quarter of capital illegally taken out of the country returns as "foreign" investments. China is the most important country of origin of illegal financial flows: up to €80 billion of taxable income vanishes each year.[6] Some multinational companies engaging in illegal capital flight are domiciled and operating in emerging economies, but nevertheless, about 80–90 percent of illegally taken capital leaves developing countries permanently.[7] ◄

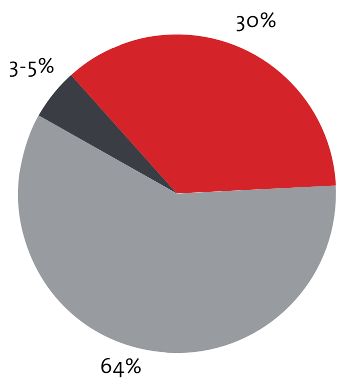
WHAT IS ILLEGAL CAPITAL FLIGHT?

In this report, illegal (or illicit) capital flight means wealth that is earned, transferred or used by breaking a country's laws. It refers to wealth whose origin is connected with illegal activity, such as corruption, the illicit production of goods, other forms of crime, or the concealment of a company's wealth from a country's tax authorities.[8]

The definition used here of illicit or illegal financial flows (or illegal capital flight) comes from the Global Financial Integrity think tank, whose figures have been used by many different development policy organisations, including the World Bank and its Director Robert Zoellick. Some researchers prefer to use the term "recorded" and "unrecorded" when referring to financial flows.

In practice, the majority of unrecorded financial flows contravene the laws of one country or another, which is why it is reasonable to speak of illegal capital flight.

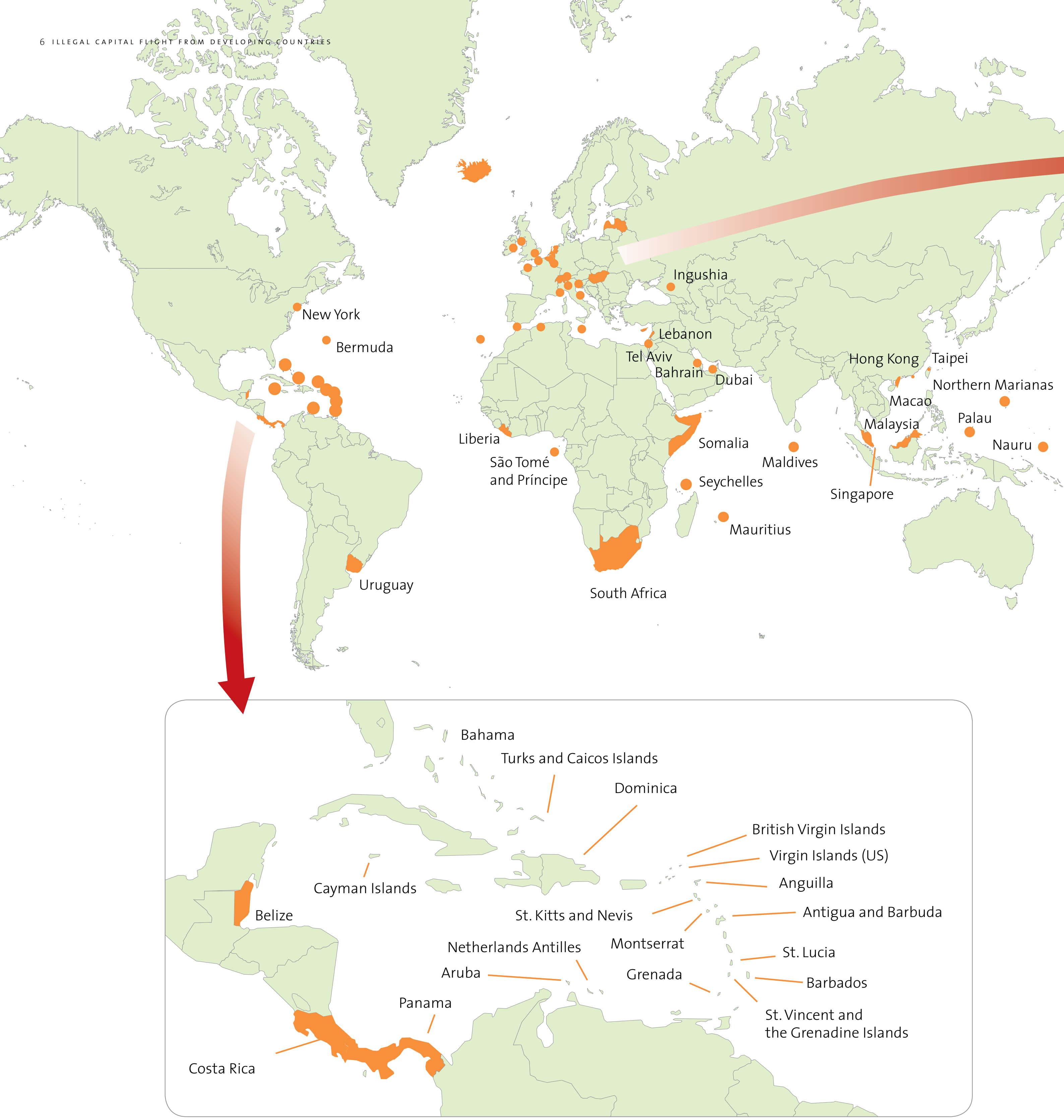
Global Financial Integrity's studies use statistics from the World Bank and IMF, among others. These studies cover and utilize several different ways to measure illegal capital flight in order to get as reliable results as possible. In order to avoid statistical mistakes, exceptionally large financial flows in single years have been left out of the analysis. The estimates of illegal capital flight are therefore moderate. The actual extent of the problem is greater.



ILLEGAL CAPITAL FLIGHT FROM DEVELOPING COUNTRIES

- Illegal commercial capital flight (64%)
- International crime (30%)
- Corruption (3-5%)

SOURCE: GLOBAL FINANCIAL INTEGRITY, 2007



THE GEOGRAPHY OF TAX HAVENS

MOST TAX EVASION TAKES PLACE BEHIND SECRECY PRACTICES AND TAX HAVEN LAWS. WITH THEIR HIGH DEGREE OF BANKING SECRECY, THESE TAX HAVENS OFFER COMPANIES THE OPPORTUNITY TO ESCAPE THEIR TAX OBLIGATIONS, MAKING IT EXTREMELY DIFFICULT FOR AUTHORITIES TO MONITOR FINANCIAL FLOWS. THERE ARE TAX HAVENS ALSO IN EUROPE AND INSIDE THE UNITED STATES.

▸ **HALF OF THE VALUE** of global trade passes through tax havens. The Tax Justice Network reckons that altogether €7,500–€10,000 billion of private wealth is located in them.[9] In 2006, one sixth of all wealth invested offshore was in 20 tax havens. This is more than the total of all the offshore investments of Asia, Africa, Latin America

WHAT IS A TAX HAVEN?

There is no single definition of a tax haven.[16] According to the Organization for Economic Cooperation and Development, OECD, tax havens share the following characteristics:

- low or non existent taxation
- unwillingness to participate in international exchange of information
- companies registered in them do not need to provide factual information on business activity in their own area
- inadequate transparency

Organizations such as the OECD, the IMF and the Tax Justice Network interpret the definitions of tax havens slightly differently, which is why estimates of the numbers of tax havens vary. In 2008 the IMF estimated that there were 46 tax havens in the world, while the Tax Justice Network counted about 70 in 2007.[17]

MAP SOURCE:
TAX JUSTICE NETWORK, 2007

and the former socialist countries of Eastern Europe.[10] Most of the companies registered to tax havens conduct no actual activity in these places.

For instance, in the Cayman Islands there is a building called Ugland House that over 18,000 companies claim as their headquarters.[11] In reality, these companies are registered at the building only on paper. In May 2009 Barak Obama said of Ugland House that it was "either the world's biggest building or the world's biggest tax fraud."[12]

WESTERN TAX HAVENS DEPRIVE DEVELOPING COUNTRIES

The most familiar tax havens are probably small tropical islands, such as Bermuda or the Cayman Islands. But there are also tax havens in Europe and the United States, whose states have wide-ranging rights to decide independently on their taxation and regulation of financial markets.

Small island states are also nearly always mentioned as tax havens, but London and New York are not always found on the lists. Their special legislation makes it possible to get a low tax rate for investments and to conceal the true identity of the investor.

In the EU, Ireland and Cyprus entice companies with low taxes and special laws. Belgium, Denmark, Luxembourg, the Netherlands and Switzerland tax some business activities exceptionally lightly and offer better opportunities than tropical islands to repatriate their profits untaxed to other countries.

It is estimated that the tax haven services provided by the Netherlands alone signify each year an over €100 million deficit in the tax revenue of developing countries.[13] Only about five percent of the wealth of private individuals invested in tax havens has been taxed according to law in the country of origin. The problem concerns poor countries as well as rich ones: some Indians have put away about €1,100 billion in Swiss bank accounts, more than the citizens of any other country.[14]

TAX HAVEN INDUSTRY SAFEGUARDS ITS OWN INTERESTS

Tax havens provide investors and companies with the required tailored legislation, such as high level of banking secrecy, helping investors to conceal their identities. However, banks, accountants and lawyers are an equally essential part of the tax haven economy. They provide the services needed to benefit from the special legislation in tax havens and assist in their use.

Shadow economy benefits the companies, individuals and tax havens that facilitate or use it. This makes it more difficult to address and solve the problems. Financial market interest groups in both the EU and the US have frequently lobbied strongly against legal initiatives to intervene in the tax haven economy.

Tax havens can benefit from their activities for instance by levying small charges on companies registered within their borders. The danger for small island states is that their economic structure may become biased to the financial service industry, increasing the cost of living and housing, if the wage gap between the financial sector and other business sectors rises too high.[15] ◄

TAXATION INCREASES WEALTH, OPTIONS AND RESPONSIBILITY

BY SECURING ENOUGH TAX REVENUE, DEVELOPING COUNTRIES CAN ACHIEVE OTHER OBJECTIVES THAN JUST COLLECTING FUNDING. THE MORE A COUNTRY CAN COLLECT TAX REVENUES, THE LESS DEPENDENT IT IS ON FOREIGN FUNDING. AN EFFECTIVE TAX SYSTEM CAN ALSO PROMOTE DEMOCRACY AND IMPROVE COMPETITIVENESS OF LOCAL ENTERPRISES.

► **SUSTAINABLE ECONOMIC GROWTH** requires the support of functional infrastructure and basic services, such as health care and education. This all costs money. The greater the part of the funding of these public goods that a country is able to collect via taxation, the more stable will be the basis on which it's future rests, and the greater will be its political room to manoeuvre.

Poor states generally do not manage to collect sufficient tax revenue domestically. They try to solve the problem with foreign loans and development assistance. Aid and loans are needed, but in the long run they can increase dependency on donors and worsen the problem of debt. [18]

The transfer of wealth from the poor South to the rich North also threatens to nullify the benefits derived from development assistance and debt relief. It reduces the tax revenue of developing countries that could fund investments and cover public expenditure. The problem can also incite inflation, increase income differentials, disrupt competition and shrink foreign trade. [19]

TAXATION CAN HELP SUPPORT DEMOCRACY AND THE LOCAL ECONOMY

Taxation has an impact on prices in that market prices correspond better to the expenses incurred by society. Matters of common good can be supported, while those that are socially, economically or environmentally harmful can be taxed more. In Finland, for example, tobacco incurs a tax for the harm it causes, while the use of renewable energy is supported.

A functioning taxation system improves political representation and establishes bonds between citizens and the state. Paying taxes also entails rights: citizens are entitled and often are more interested in influencing how their taxes are used. The authorities have to be able to justify their activities to the men and women who pay taxes. [20]

The accountability of governments to the public in the use of their taxes is generally better the more dependent they are on tax revenue and the smaller the role in their budgets is played by natural resources, development assistance and borrowing. [21]

An effective and open taxation system helps the market competitiveness of developing countries. At present the problem is that international taxation systems particularly benefit MNCs. The resulting competitive edge is not based on real efficacy, cheap prices or product inventiveness. Intervening in illegal capital flight will help create the preconditions for competition for developing countries' small and medium sized enterprises.

Taxation is a matter of democracy. The accountability of governments to the public increases when they are dependent on tax revenue. Pictured here a political meeting in Ghana.

ISTOCKPHOTO.COM / PEETER VIISIMAA

The tax revenue collected from citizens and businesses pays for public services and redistributes wealth in order to reduce social inequality and poverty. Equality can also be furthered by progressive taxation, whereby people on good incomes pay a greater proportion of tax on their earnings than people on small incomes.

TAXATION AS PART OF THE UN MILLENNIUM GOALS

Improving the effectiveness of the ability of developing countries to collect taxes is crucial from the perspective of realizing the UN Millennium Development Goals. In autumn 2000 heads of state agreed on these goals, which include reducing child mortality and halving the number of people living in extreme poverty by 2015.

The issue of taxation relates directly to goal number eight, which obligates the international community to create a global partnership for development. There are seven indicators for measuring the realization of the goal. Two of the indicators relate more directly to taxation: they demand a financial and trading system that is open, based on common ground rules, predictable and impartial, and that the debt problem facing developing countries is solved by international measures. [22]

The solution to the problems of taxation – regardless of the attainment of the Millennium Development Goals – will not succeed without changes in the structures of the global economy. Taxation figured strongly on the agenda of the high level UN summit on Financing for Development in 2002 in Monterrey and particularly at its follow-up conference in Doha in December 2008. One of the most contentious issues at the Doha conference was precisely the tackling of illegal financial flows and strengthening the voice of developing countries in deciding on international cooperation on taxation.

The deadline of 2015 for the Millennium Development Goals is drawing near. At the same time, the financial, food and environmental crises that are sorely testing developing countries demand funding.

Development cooperation has an important role in the search for solutions, but its scale nowhere nearly meets the input demanded by the minimum targets. This is why intervening in illegal capital flight is important, and also why it is necessary for Finland to be active both in the UN and other international forums.◄


ISTOCKPHOTO.COM / MARK LINNARD

Tax revenues are a more stable source of funding for building a functioning infrastructure and providing basic services than loans and foreign assistance. Pictured here dilapidated rail stock in Tanzania.

TAXATION VERSUS DEVELOPMENT COOPERATION

Tax revenues are more even and easier to predict than foreign assistance flows, the amount of which varies each year and may drop amidst sudden political or economic changes concerning donor countries. For example, the 2009 financial crisis saw many donor countries cut their development assistance budgets. [23] Bigger tax revenues would therefore lead to more stable budgets. [24]

Developing countries' budget deficit is forecast to reach €240–435 billion in 2009, compared with the total of €80 billion in assistance from the OECD countries. The deficit, created by the financial crises that started in rich countries, has to be reduced by cutting public spending or by new, often high interest loans.

ISTOCKPHOTO.COM / EVGENY KUKLEV

CHAPTER 2:

MULTINATIONAL COMPANIES ARE THE MAIN SOURCE OF CAPITAL FLIGHT

INTRODUCTION

Tax dodging by MNCs accounts for two thirds of the illegal capital flight. Companies are able to engage in various kinds of legal and illegal tax planning, particularly by using subsidiary companies located in different parts of the world – often tax havens.

The network of subsidiaries provides also possibilities to exploit bilateral taxation agreements. The most prominent means of tax evasion is simply to give false information on the content of a company's international trading. Subsidiaries located in countries with low taxation can be made to appear most profitable and the subsidiaries of countries with high taxation most unprofitable so that there is no taxable income created.

The prices used in trade between the subsidiaries owned by a parent company are distorted by abusive use of transfer prices between subsidiaries. In extreme cases, this may mean selling plastic buckets priced at €670 a piece, but the biggest tax losses are generated by small price distortions over a long time span.

Company tax evasion alone causes developing countries tax losses that are appreciably greater than development assistance.

SUBSIDIARY COMPANIES ARE THE MAIN TOOL OF TAX PLANNING

AN EXTENSIVE NETWORK OF SUBSIDIARIES PROVIDES OPPORTUNITIES TO CHANNEL FINANCIAL FLOWS TO FINAL DESTINATION COUNTRIES WITHOUT HAVING TO PAY TAXES TO ANY STATE.

► **MULTINATIONAL CORPORATIONS** generally have hundreds of subsidiaries. Because of tax and other regulations, subsidiaries are nearly always set up in each of the states where the parent company has some activity – and often in tax havens in which there is no proper business activity.

A broad network of subsidiary companies makes it possible to transfer profits to countries with the lowest possible level of taxation. This is why major companies often have a subsidiary company in tax havens like Jersey or the Virgin Islands.

Companies in tax havens are often holding companies, whose only task is to own a parent company's other subsidiaries and collect dividends from them. These kinds of companies are often established in places such as the Netherlands, Ireland, Luxembourg, Switzerland and Denmark.

TAX AGREEMENTS HAVE LOOPHOLES

Parent companies often try to arrange the mutual ownership of their subsidiaries in a way that grants them greatest advantage from bilateral tax agreements. The purpose of these agreements is to prevent double taxation of income in different countries. This way, for instance, income earned in Germany is not taxed again in Finland.

Tax agreements are not usually signed with the most obvious tax havens. In this way taxable profits accruing in the Cayman Islands, for instance, can be taxed if it is reckoned that an arrangement has been made only in order to minimise taxes.

The network of subsidiaries in countries with suitable tax agreements can create opportunities for repatriating income to a parent company's home country at low tax rates or even wholly untaxed.

DEBTS AND INVESTMENTS ARE RECYCLED VIA TAX HAVENS

Many tax agreements between states make it possible to recycle investments via tax havens. Subsidiaries operating in developing countries can thus minimise their taxes.

In 2008, for instance, 67 percent of direct investments leaving Brazil were directed at traditional tax havens. The second biggest amount of investments made by companies favours Denmark and the United States, also for tax reasons.[1]

Mauritius has concluded bilateral tax agreements with many developing countries. The agreements prevent these states from taxing the profits of companies registered in Mauritius operating in the region, and places a tight ceiling on the taxation of dividends of international investors operating from Mauritius. For instance, the estimates show that India lost over €600 million between 2000–2009 due to its tax agreement with Mauritius.[2]

The ministries negotiating the agreements are often the ministry of finance together with the foreign ministry. The idea may be to improve international competition by increasing financial flows and investments. The viewpoint of tax administration is often excluded, even though in practice it is the tax authorities that have to answer for the problems created by the agreements.

Tax agreements are of considerable importance to the financing of foreign subsidiaries. They have an influence on, for example, how worthwhile it is to shift debt between the different parts of a group. For example, artificially high interest on intra-company loans distorts profits of involved subsidiaries and may even be a criminal offence. Developed countries usually have better resources to monitor these kinds of arrangements, but for developing countries this can be extremely challenging. ◄

TAX EVASION VERSUS TAX AVOIDANCE

Tax evasion means the efforts by private individuals and companies to avoid taxation using illegal means. Usually this is done by providing intentionally wrong information or concealing it. A company may, for instance, leave part of its income undeclared or file a tax return that appears to be legal but which in reality contains false information.

Tax avoidance means taking advantage legally of the loopholes in the tax system in order to minimise taxes. Aggressive tax avoidance involves active exploitation of loopholes in tax laws and using mechanisms to shift wealth between different tax systems to reduce overall taxation.

Although this is not against the law, it is also not in compliance with the principles of tax regulations. A company that does not want to pay the right amount of tax in the right place at the right time is acting against the spirit of tax laws. Developing country legislation and administrative arrangements are usually less developed than those of developed countries. The administrative capacity to tackle problems is often also weaker due, for instance, to the tax reforms pushed by loan conditions of the IMF. For these reasons, it is often the developing countries that pay the highest price.

TRANSFER MISPRICING

THE BIGGEST COMPONENT OF ILLICIT CAPITAL FLIGHT, CORPORATE TAX EVASION, RESULTS FROM DISTORTION OF THE CONTENTS AND PRICES USED IN WORLD TRADE. THE MOST IMPORTANT METHOD FOR THIS IS MANIPULATING THE TRADE BETWEEN COMPANY'S SUBSIDIARIES. THIS IS CALLED MISUSE OF TRANSFER PRICING, OR TRANSFER MISPRICING.

► **TRANSFER PRICING** refers to the prices that a multinational company uses in trading between its subsidiaries. According to estimates, about 60 percent of international trade takes place among affiliates within multinational corporations.[3] Raw materials must be sold to their manufacturing plants, financial services from financing units to country offices, and so on.

Transfer pricing can be misused by under- or overpricing products. Transfer mispricing is by far the most significant form of illegal capital flight. Global Financial Integrity estimates that in 2006 €375–400 billion were sent offshore from developing countries.[4]

In the *underpricing* of exports a MNC marks the prices it uses in trading between its subsidiaries cheaper than the real value of the product. The products are then sold at market price in the country of destination. The proportion of capital flight is the difference between the first and second price. The same mechanism works the other way round: taxes can be avoided by the *overpricing* of imports. The remainder can be invested in bank accounts in countries with high levels of banking secrecy.

The value of import and export products can be made artificially high or low also by providing false information about their quality, classification or quantity. Otherwise, the mechanism works the same way as in over- and underpricing.

Companies may also engage in *fictitious trade transaction*, which are paid for even though the products do not exist. The payment may then be transferred from a country with heavier taxation to an area with lighter taxation.

THE DIFFICULTY IN SETTING A MARKET PRICE

There is nothing illegal about transfer pricing as long as the subsidiaries are trading at "arms-legth", using prices they would use if they would be separate companies.[5]

Normally, both buyers and sellers aim for the best price from their own vantage point. In the case of trade between the subsidiaries of MNCs this rule does not always hold: the price may be set to a level that benefits most the parent company. This is why affiliates divide up the profits of their business frequently in a way that minimises the company's tax burden. Transfer pricing becomes illegal when the different units of a MNC sell goods or services to one another at artificially high or low prices.

It is particularly difficult to determine the market price for various services that a company's subsidiaries buy and sell to one another. These include, for example, consultancy services and royalties paid for the use of trademarks or patents.

The ownership of trademarks may be centred to a tax haven company, with subsidiaries in other countries having to pay royalties for using a trademark. For example, the trademarks of Coca-Cola and Ford are owned by subsidiaries based in the Cayman Islands.[6]

The going market prices for immaterial goods are often particularly hard to determine, making them a popular means of transferring wealth to tax havens from rich and poor countries. Tax percentage is determined by tax agreements. In case a company wants to minimise taxes, tax agreements indicate the most profitable destination for registering immaterial rights.

HUNDREDS OF EUROS FOR PLASTIC BUCKETS

Examples of glaring abuse of transfer prices are plastic buckets sold at €670 a piece and lavatory cleaning gloves

WHAT'S IN A BANANA?
– AN EXAMPLE OF TRANSFER PRICING

Only about half of the retail price of a banana remains in the countries of sale and production. The other half remains with multinational banana subsidiaries operating in tax havens.

Dole, Chiquita and Fresh Del Monte dominate over two thirds of the world's banana market. In 2006 these companies paid on average 14 percent on their profits, even though hey are all registered in the United States, where the company tax rate is 35 percent.

ISTOCKPHOT.COM / MBPHOTO

costing €2,830 a kilo, or €9 video cameras and €36 rocket launchers.[7] Most price manipulation happens through small aberrations, which over a long time and large volumes cumulate to significant amounts of money.

Christian Aid has calculated that developing countries lose about €110 billion in company revenue each year due solely to transfer mispricing.[8] This sum alone is considerably greater than the total annual development assistance to the developing countries.

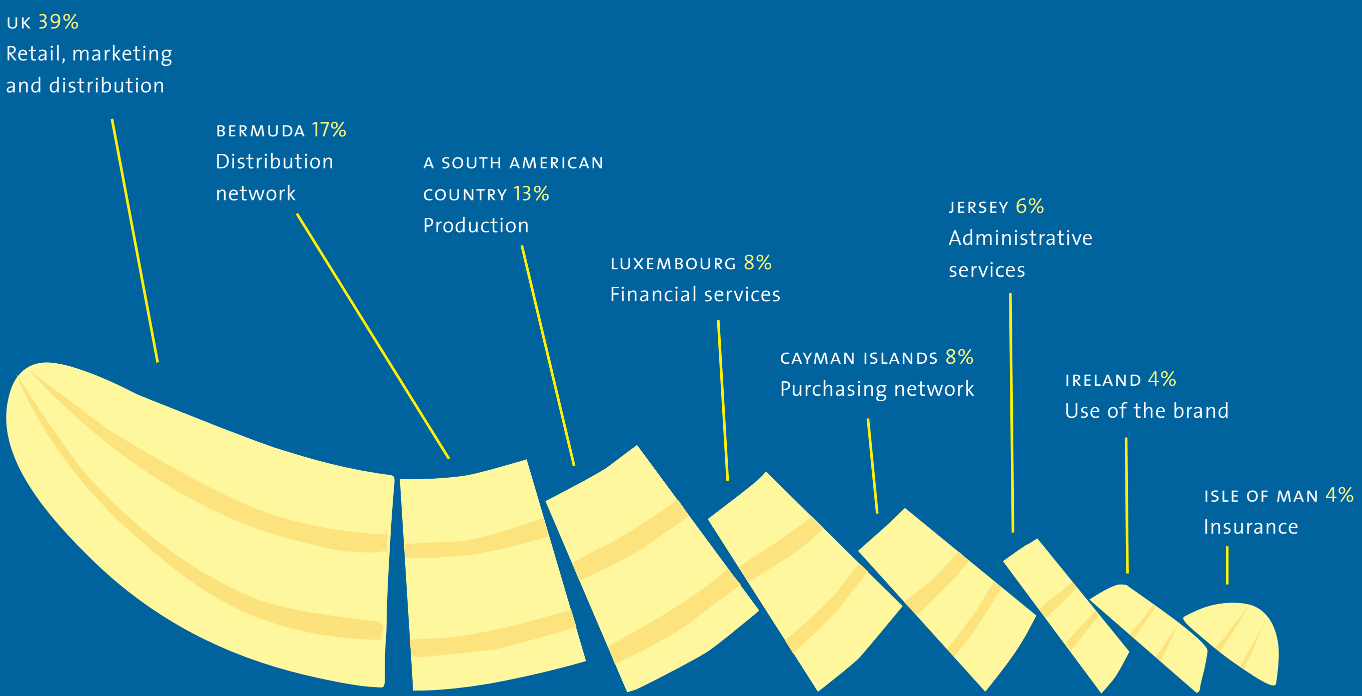
Probably this estimate, however, is far too low. It is based only on publicly available trade figures. If the curtain of tax haven secrecy laws were lifted, the sums would probably be much higher.[9]

INDEBTED SUBSIDIARIES DO NOT GENERATE TAX REVENUE

Another popular method for tax evasion is to finance a subsidiary company located in a developing country by granting it inflated loans from a subsidiary located in a tax haven. The interest of the loans is often tax-deductible. In this way a subsidiary company in a developing country has little or no taxable income. Banking secrecy helps conceal the fact that in reality the companies' owner is one and the same person. This is called thin capitalisation.

It is always an ethical choice whether to exploit or not to exploit the methods described above, which tells us more generally about a MNC's operational principles. Tax has entered the corporate responsibility discussions in recent years. States and democracy need financing. If companies are not willing to participate in this effort, there is little ground to speak of social or corporate responsibility either. ◄

SHARE OF THE FINAL PRICE (%)



SOURCES: GUARDIAN, 6.11.2007; ACTION AID, 2009

SUVI SAVOLAINEN

JIM BOURG / REUTERS / LEHTIKUVA

CHAPTER 3:

CAPITAL FLIGHT CAN BE STOPPED

INTRODUCTION

The worldwide economic crisis has led to increased international cooperation. Tax havens are now in a more difficult situation then before the crisis. Reforms have been, however, pursued mostly on the terms of rich countries. Benefits for the poorest countries have so far remained limited.

"The era of banking secrecy is over," the G20 countries declared in their statement at the London Summit in April 2009. The most prominent initiative so far has been the creation of black and grey lists of tax havens drawn up by the OECD, but they are not enough to solve the problem. Their advantages remain particularly insignificant for poorest countries.

There are several workable solutions. The adaptation of country-by-country reporting standards for companies would make company tax arrangements public and reduce the possibilities of concealing risks created by company losses or investments. Among others, the European Parliament voiced their support for country-by-country reporting standards.

Automatic, multilateral information exchange could be developed between countries. This would help tax authorities get hold of information on offshore investments and would particularly benefit developing countries with scarce administrative resources. Sanctions could be imposed for banking secrecy and financial flows to tax havens, first proposed by the OECD nearly 10 years ago.

The power balance in international tax regulation matters as well. The OECD has been the most important venue for discussing international tax rules. Developing countries, which bear the brunt of illegal capital flight, have little say on decisions made by the OECD. In the UN they would have more power. The World Bank and IMF are powerful players in developing countries' economic policy and should therefore get more active in research and policy advise geared to curb illicit financial flows.

One venue that has been successfully used to produce much needed information and research on illegal capital flight is the Task Force on Financial Integrity and Economic Development. Finland could implement its government programme by commissioning research from the group.

TASK FORCE ON CAPITAL FLIGHT SHOWS THE WAY FORWARD

AN INTERNATIONAL MEMBER STATES' EXPERT GROUP, TASK FORCE ON FINANCIAL INTEGRITY AND ECONOMIC DEVELOPMENT, HAS BEEN A FORERUNNER IN TACKLING CAPITAL FLIGHT. FINLAND SHOULD JOIN THE ADVISORY PANEL OF THE TASKFORCE.

► **SINCE 2007 FINLAND HAS BEEN** a full member of the Leading Group on Solidarity Levies to Fund Development, a group focused on new sources of development funding, comprising over 50 member states. It has established a working group on financial integrity to deal with capital flight.

The working group on capital flight has operated since 2009 under the name the Task Force on Financial Integrity and Economic Development. The task force and the think-tank behind it have rapidly become one of the leading bodies investigating tax evasion and capital flight, because global organisations have been slow to start mapping the problem. woken up to mapping the problem slowly.[1] An advisory panel, whose member states are currently Chile, Denmark, France, Germany, the Netherlands and Spain, in addition to NGO representatives, directs the work of the task force.

In its reports the task force has proposed, among other things, that information on decision-making, accounts and the real owners of companies must be available on public registers. An MNC should report its sales, profits and tax payments concerning every part of a state or legislative region in which it operates.

The task force has also proposed that the exchange of information be automatically applied in taxation agreements, that the rules on transfer pricing be made clearly stricter, and that states standardise judicial procedures in money laundering offences. The most important role of the task force has been, however, as a vanguard for other international actors as a proponent and researcher of a more transparent and open financial system.

A HIGHER PROFILE FOR FINLAND

The programme of the second government of Matti Vanhanen commits Finland to joining the active debate in new sources of development funding. The commitment of the government programme is complemented in the government's 2007 strategic document. This unambiguously sets out the policy that in UN work "the aim is to participate in innovative funding mechanisms for development." Correspondingly, in the OECD the government will "actively take part in the international discussion on innovative funding mechanisms."

These pledges have yet to be matched with deeds. Finland has had no profile in tackling illegal capital flight or on any other initiatives. At the time of writing this report, Finland had not, for example, joined the advisory panel of the task force dealing with illegal capital flight. Norway, in particular, has been active in the task force and has ordered an investigation into illegal financial flows from developing countries. ◄

RECOMMENDATIONS

- Finland must join the task force investigating illegal financial flows and support its work.
- Finland must order an investigation via the task force into, for example, the impact of illegal financial flows on its long-term partner countries in development cooperation.

COUNTRY-BY-COUNTRY REPORTING WOULD TACKLE MANY PROBLEMS

COUNTRY-BY-COUNTRY REPORTING STANDARDS ARE A KEY INITIATIVE IN TACKLING ILLICIT FINANCIAL FLOWS. CURRENT BOOK-KEEPING AND ACCOUNTING STANDARDS MAKE IT POSSIBLE TO TRANSFER PROFITS NON-TRANSPARENTLY VIA TAX HAVEN SUBSIDIARIES. THIS ENCOURAGES TAX DODGING, DISHONEST TRANSFER PRICING AND EVEN CRIMES.

► **INCREASED TRANSPARENCY** in accounting would be important for curbing illegal capital flight, but it would also help to reduce the risks associated with business activity.

Current accounting standards are drawn up by a body comprising professionals from the private accountancy sector, the International Accounting Standards Board (IASB). It is registered in the tax haven state of Delaware, in the United States. The IASB published its standards for the first time in 2003. Two years later they came into force in the European Union.

According to critics, the IASB norms are insufficient. Amidst deficient norms, companies can report the incomes of the subsidiaries of different countries as global or regional income, so that hardly anything is revealed of a firm's internal trading.[2]

At the moment, developing country governments often do not have the resources or the possibilities to investigate the accounts of MNCs' in order to find out what and how much taxes they have paid and what they should pay. This is often very difficult even for a rich country.

Because of insufficient transparency, country's citizens, NGOs that monitor government activities or even members of parliament are unable to find out what kinds of agreements their leaders have concluded with companies. Economic research and forecasting, critical to successful community planning, is difficult or impossible because information on corporate activities is hard to obtain.[3]

MORE INFORMATION OF TRANSFER PRICING AND THE ORIGINS OF PROFITS

A key improvement would be to demand companies to report the income, profits, taxes, investments, wealth and debts for each country where they operate. Country-by-country reporting would open up the details of firm's internal trade, and provide information on where its profits derive from.[4]

Country-by-country information would increase openness, which is necessary for a functioning market and without which it is hard to realise democracy and the rule of law. Investors would have more information about companies at their disposal for making investment decisions. If everyone followed the same rules, businesses could become more open about their activities and relations with the surrounding society.

Until now, country-by-country book-keeping has progressed mainly on voluntary basis. Political pressure for more binding solutions has come from the European Parliament and individual countries such as the UK.

FROM VOLUNTARY SYSTEMS TO BINDING STANDARDS

The most important voluntary reporting initiatives are the Global Reporting Initiative launched by the UN, NGOs and companies at the end of the 1990s, and the Extractive Industries Transparency Initiative (EITI) of the World Bank. More ambitious and binding standards have been promoted especially by the Publish What You pay NGO coalition, which is active in over 70 countries, and the Tax Justice Network.

The Global Reporting Initiative emphasises social responsibility and sustainable development and requires the reporting of paid taxes on a country-by-country basis. Unfortunately, it is very rare for a company to contain such key information in its reports.[5] The problem is that the initiative is based on voluntary action. In order to have any real impact the country-by-country reporting should become an international standard, adopted to national legislations.

Extractive industries have been the focus of intensive debate for a long time. Both Publish What You Pay and the World Bank's EITI aim at increasing the transparency of the mining industry.

At the end of 2007, the European Parliament's Committee on Economic and Monetary Affairs requested the European Commission and the IASB to draw up country-by-country reporting standards for the natural resource industry. This move by the Parliament was criticised for being too narrow, as many considered that equivalent regulations had to concern all big international corporations regardless of the sector.

The European Parliament examined its standpoint a year later and urged the Commission to request the IASB to incorporate into the standards "the demand for country-by-country reporting on the activity of international companies in all sectors." [6] The previously remote objectives of dealing with capital flight have in recent years mustered increasingly broad approval.

Apart from the European Parliament, country-by-country book-keeping regulations have been demanded by many development organisations and private individuals, such as the investor George Soros, who funds the work of the Publish What You Pay coalition.[7] Tax Justice Network has played a key role in drafting a proposal for country-by-country standards. All the necessary information already exists, and transparency would not incur significant additional costs. There would be no hindrance to competition, if the same regulations applied to all companies operating in a particular country or particular countries.

The proposal requires companies to report their countries of operation, as well as the names, basic financial information and taxes paid by their subsidiaries.[8] The initiative has drawn support from the EU and influential figures in finance, such as George Soros and the UK's Deputy Chancellor of the Exchequer Stephen Simms.◄

All information necessary for country-by-country book-keeping already exists. Publishing it would not require significant additional costs but political pressure.

KEY SOLUTIONS

- Country-by-country reporting must be established as an international standard applying to all multinational companies.

TACKLING BANKING SECRECY WITH BETTER INFORMATION EXCHANGE

THE FINANCIAL CRISIS AND RESOLUTIONS OF THE G20 COUNTRY GROUP HAVE ENCOURAGED OECD TO DEVELOP NEW INITIATIVES AGAINST TAX HAVENS. THE BENEFITS FOR THE DEVELOPING COUNTRIES FROM THESE INITIATIVES REMAIN LIMITED SO FAR.

► **IN APRIL 2009,** the leaders of the G20 pledged at their London Summit to build "a stronger, more globally consistent, supervisory and regulatory framework" for the financial markets of the future. According to the Summit statement, the world is headed for "greater consistency and cooperation between countries".

After the April Summit the OECD drew up so-called black and grey lists for uncooperative tax havens. Similar lists were first published already at the turn of the millennium.

In its 2000 report, the OECD listed 47 harmful tax laws or practices in use in its member states.[9] Some of these were removed from the list by a follow-up report. Some were struck down and others were amended in order to drop harmful features. In addition, 41 tax havens were identified outside the OECD countries.

The lists did not really help reign in tax haven economies at the time. It is unlikely that similar lists would be any more effective today. A clear example of the limited effect of current solutions is the fact that illicit financial flows from developing countries have grown by 18.2 percent per year between 2002 and 2006.[10]

CUMBERSOME INFORMATION EXCHANGE

The OECD's work on tax havens is based on black lists. In order to get off from the list, tax havens have to conclude bilateral information exchange agreements with other countries. The first such agreements were signed in 2007.

After the April 2009 G20 meeting, the number of information exchange agreements doubled in a short period. By autumn they totalled 100 and the figure continues to grow rapidly.[11] In practice all countries classified as tax havens have subsequently pledged to increase openness and the exchange of information concerning taxation.[12]

Countries have to conclude 12 bilateral agreements on information exchange with any other countries or autonomous areas (for example the Faeroe Islands) in order to get off from the grey list. On the basis of the agreements, the parties are committed to mutual exchange of information in suspected criminal offences.

In practice, information exchange is difficult and time consuming, requiring detailed identification of a criminal suspect. For instance, the agreement between the United States and Jersey in force until 2001 had been used only four times by October 2008.[13]

The poorest developing countries that suffer the most from the tax haven economy, are unable to negotiate or apply information exchange agreements. Even the rich Nordic countries had to form an alliance in order to gather the resources and political weight for negotiating the agreements.

SANCTIONS INSTEAD OF VOLUNTARY STANDARDS

There are alternatives to the present tax haven black lists and their model of bilateral information exchange. Information exchange could be conducted also on a multilateral basis, with single international agreement that all countries could sign.

The system could be constructed to be automatic, so that information would be available whenever need-

INFORMATION EXCHANGE BETWEEN MONACO AND SAN MARINO?

The OECD initiative to enhance exchange of tax information has drawn plenty of attention. Less attention has been paid to quality and reach of the 12 information exchange agreements required for getting off the so-called grey list.

An extreme example are Monaco's partner countries: Andorra, Austria, the Bahamas, Belgium, France, Liechtenstein, Luxembourg, Qatar, St. Kitts and Nevis, Samoa, San Marino and the United States. Monaco has agreed on information exchange almost solely with other tax havens. It is likely that these agreements become a dead letter.

In September 2009, the Prime Minister of St. Kitts and Nevis Denzil L. Douglas declared that the tax agreement concluded with Monaco "ensures that St. Kitts' financial market sector now reached the highest norms of the international community."[14] The statement accurately showed that these norms are not very high.

Many tax havens have negotiated agreements with the Nordic country group. This enables tax havens to reach seven agreements already, as the group includes Greenland and the Faeroe Islands. After signing the agreement with the Nordic countries, Aruba needed to negotiate agreements only with Antilles, the Netherlands, St. Kitts and Nevis, St. Vincent and the Grenadines and the United States to get off the grey list.

The composition of countries with signed agreements reveals the weakness of the list. The Nordic countries might benefit from agreements in some criminal cases. The benefits to developing countries are miniscule.

There are 50–70 tax havens in the world that should negotiate information exchange agreements both mutually and with over 100 other states. The governments should also be able to use the agreements effectively. By November 2009 only 164 agreements had been concluded.[15]

ed without a complicated authorisation procedure. The EU already has an automatic information exchange between authorities on banking deposits. Many tax havens outside the EU are also included in the system.

The OECD too has formerly pursued more comprehensive, binding models. Already in 1988, the OECD drafted a contract on automatic, multilateral information exchange, but only a few countries joined the agreement. It could, however, act as the basis for a new system, which should also be open to developing countries.[16]

The OECD has also pursued sanctions against countries practicing banking secrecy. In 1998, the organisation published a groundbreaking report on the harmful impact of global tax competition.[17] At the same time the organisation started a programme designed to check harmful taxation practices, which sought to increase fair competition, openness and information exchange.[18]

The report proposed sanctions, such as hindrance taxes, against uncooperative tax havens. These kinds of initiatives would have been a revolutionary step towards breaking the culture of banking secrecy.

However, the programme became a voluntary arrangement, as particularly the US and the UK opposed it, largely as a result of lobbying by small tax haven states. Before the attack against the initiative and the OECD started, even the Bush administration had taken a fairly positive attitude towards the programme.[19]

The initiative's watered-down recommendations did not intervene in tax evasion outside OECD countries, nor did they oblige member states on automatic information exchange. Tax information was to be handed over between states only at individual request. The approach is slow and clumsy even for rich countries.[20]

The conclusions of the April G20 Summit contain a compromise formulation for multilateral information exchange. The countries commit themselves to drawing up a plan by the end of the year that would help developing countries benefit from global cooperation in matters of taxation. Six months later, the G20 meeting in Pittsburgh only referred to "the possibility to use a multilateral instrument". More work is required before the problem is finally solved. ◄

G20 leaders declare an end to the era of banking secrecy at the end of the Summit meeting in London, April 2009. In practice, the initiatives that would benefit developing countries have progressed slowly.

KEY SOLUTIONS

- Adoption of automatic, multilateral information exchange, which takes into account the needs of the developing countries.
- Sanctions need to be imposed on countries that practise banking secrecy and to transactions to banking secrecy jurisdictions.

POWER TO THE UN TAX COMMITTEE

THE UNITED NATIONS IS THE ONLY TRULY REPRESENTATIVE FORUM FOR DECIDING ON GLOBAL RULES AND REGULATIONS. THE EXISTING UN COMMITTEE ON TAXATION (THE COMMITTEE OF EXPERTS ON INTERNATIONAL COOPERATION IN TAX MATTERS) SHOULD BE UPDATED TO AN INTERGOVERNMENTAL ORGAN. RICH COUNTRIES HAVE SO FAR NOT BEEN IN FAVOUR OF A GROWING ROLE FOR THE UN IN TAX ISSUES.

► **TAX ISSUES BECAME** prominent on the UN agenda at the 2002 Monterrey summit on Financing for Development. At that time, countries committed themselves to promote the developing countries' capacity to raise domestic resources, improve productivity, and reduce capital flight. The issue has since been dealt with by several UN summits with increasing weight given to it.

A central body for dealing with capital flight is the UN Committee on Taxation, established in 1968. The expert committee scrutinises tax agreements, tax dodging, tax evasion and capital flight, promotes international cooperation on taxation and supports the tax authorities of developing countries. The committee has 25 members at present, of which 10 are from rich countries and 15 from developing countries or transition economies.

At the end of 2007, the tax committee began to deal with UN procedural regulations aimed at closer cooperation in international tax dodging. The procedural regulations defined minimum standards for both countries and private actors, which must be applied to tackle capital flight, tax avoidance and tax evasion. The guidelines received much support, but their scope was limited to tax evasion, leaving tax avoidance out of their reach.

In September 2008, the European Parliament gave its support to the guidelines. It urged both the European Council and the EU's member countries to promote the application of the worldwide principle on the automatic exchange of tax information. In addition, the Parliament expressed the wish that the UN expert committee would be developed into a genuine intergovernmental body that would have the additional resources at its disposal to put an end to tax avoidance internationally together with the OECD.[21]

However, the guidelines are not mentioned in the final document of the 2008 UN Summit on Financing for Development. This summit, held in Doha, supported strengthening the Committee on Taxation. The final document says vaguely that we "request the Economic and Social Council to examine the strengthening of institutional arrangements, including the United Nations Committee of Experts on International Cooperation in Tax Matters."[22] Decisions on details would remain the responsibility of ECOSOC. At the time of writing this report, the result was still open.

THE UN'S STRENGTH IS ITS WEAKNESS

The greatest strength of the UN, its equal representation of all countries of the world, is also in some respects its greatest weakness. The bigger and wealthiest countries consider the UN to be mainly a talking shop rather than an arena to agree on definite policy lines.

In the UN system, each state generally has one vote, which does not suit countries used to playing a leading role. This is why they try to agree on main policy lines among themselves, for instance in the informal G8 or G20 groups, and then wait for the rest of the world to accept what they have agreed.

The OECD is considered to be more effective compared to the UN, but this is not necessarily the case when it comes to taxation. Its members include several tax havens that can either block or slow down many initiatives. In addition, the problem is that developing countries have less influence in the industrial countries' OECD. ◄

> Although rich countries have a strong say in financial matters, the OECD is unable to set rules for all countries. This could be done by the UN, if it was allowed to act on tax matters.

KEY SOLUTIONS

- The UN Tax Committee should be upgraded to an intergovernmental organ, capable of enhancing international tax cooperation, including cooperation between rich and poor countries.

KEPA / LARISSA BRUUN

SLOW PROGRESS WITH REFORMS IN THE WORLD BANK AND IMF

MORE ACTIVE COOPERATION AND INFORMATION EXCHANGE BETWEEN STATES ALONE IS NOT ENOUGH TO SOLVE THE PROBLEM OF CAPITAL FLIGHT. THE POWERFUL INTERNATIONAL FINANCIAL INSTITUTIONS, THE WORLD BANK AND THE IMF, SHOULD TAKE THE PROBLEM SERIOUSLY.

► **THE INTERNATIONAL MONETARY FUND (IMF)** directs the economic and taxation policies of poor and indebted countries in many ways. The IMF still encourages developing countries to refrain from controls on the movement of capital. For instance, it instructs poor countries to deregulate their capital and further dismantle regulations on the financial markets.

Deregulating the capital accounts leads to a loss of oversight over offshore transactions and the foreign investments directed at the country. Dismantling the regulation of the financial markets diminishes the possibilities for states to monitor international financial flows and to influence them.[23]

The financial crisis has mainstreamed the idea that self-regulation of the markets is insufficient for preventing market shocks and ensuring proper oversight. This observation has not, however, prompted the financial institutions to reform their principles fundamentally.[24]

Developing countries have also been advised to eliminate import duties and to replace the lost revenue with consumer taxes, which particularly affects the poorest of the population.

LOAN CONDITIONALITIES CREATE TAX LOOPHOLES

Stringent economic and political conditions are often placed on foreign assistance, and particularly on loans. For instance, getting an IMF loan has traditionally required cuts in public spending, tax reductions, privatisation and the deregulation of trade and movement of money.

The international finance institutions, particularly the IMF, have promised to relax the loan criteria which even the IMF's own evaluation division has criticised. This did not, however, apply to the crisis loans granted between September 2008 and summer 2009.[25]

In practice, the same conditions apply to nearly all outside funding: most international organisations and individual donor countries tow the IMF line in their funding decisions.

The problematic nature of the situation has become more conspicuous due to the global financial crisis. International trade and foreign investments have slumped, and the majority of developing countries cannot afford to stimulate their economies the way western countries can.

Foreign funding is granted parsimoniously for nurturing the stabilization policy of public spending. In this respect the line followed by the international finance institutions has not altered and neither has that of many donor countries, even though in their own economic policy, due to the crisis, they have started to favour stimulation policies and better market regulation.[26]

EXISTING INITIATIVES LACK COHERENCE

In 2007, the World Bank launched the Stolen Assets Recovery programme (StAR) in order to recover public wealth stolen and invested offshore by corrupt lead-

COMPANIES TAKE MORE THAN THEY CONTRIBUTE

THE RELATIONSHIP BETWEEN FOREIGN INVESTMENTS AND OUTGOING PROFITS IN SOME AFRICAN COUNTRIES IN 1995–2003

The World Bank, IMF and many other donors encourage developing countries to attract foreign investments by tax breaks and other incentives. Investments are vital for development, but their benefits may remain meagre if the profits they generate are transferred abroad.

€ million

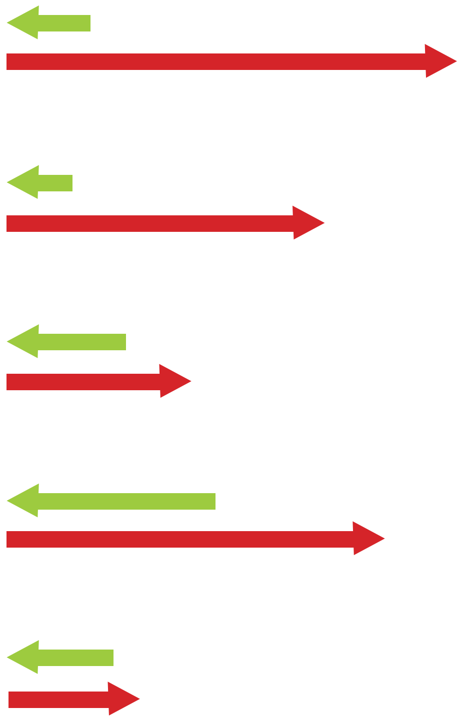
BOTSWANA
Foreign direct investment: 835
Profits repatriated abroad: 4,980
Difference: 4,145

GABON
Foreign direct investment: 725
Profits repatriated abroad: 3,040
Difference: 2,315

NIGERIA
Foreign direct investment: 9,545
Profits repatriated abroad: 10,965
Difference: 1,420

DEMOCRATIC REPUBLIC OF CONGO
Foreign direct investment: 1,435
Profits repatriated abroad: 2,455
Difference: 1,020

MALI
Foreign direct investment: 715
Profits repatriated abroad: 725
Difference: 10



Foreign direct investment
Profits repatriated abroad

SOURCE:
SINGH & KAVALJIT, 2006

DEVELOPMENT BANKS' TAX HAVEN INVESTMENTS ARE A CREDIBILITY PROBLEM

Investments by the World Bank and regional development bank, such as the Asian Development Bank (ADB), channelled via tax haven subsidiaries attract growing international attention. The banks have channelled loans intended to support the private sector in developing countries via the Cayman Islands and other tax havens.

The purpose of these private equity funds is to invest in small and medium size companies with potential for growth. The capital is repatriated when the company has reached desired size and turnover. For example, the ADB invested USD 617 million worth of cash in 37 capital investment funds, some of which are registered in the Cayman Islands and administered from Hong Kong.[29]

Two ADB employees are in charge of the massive overall investment of the private sector division. The bank's means to influence investment decisions are non-existent. It cannot withdraw its investments for 10 years and the bank has no veto rights on the activities of the funds. The documentation of the funds is often deficient and no account is taken of environmental or social standards.

Tax haven investments constitute a coherence problem for the World Bank and the regional banks. The use of tax havens erodes the credibility of donors at a time when international community is gradually waking up to the problems that capital flight and tax havens cause to developing countries.

Some of the Nordic countries have already acted to ensure that their aid money is not channelled via tax havens. In July 2009, Sweden announced it was placing a temporary ban on channelling its aid via tax havens. The temporary halt will be followed by longer-term solution after further investigation of alternative solutions.[30]

Following a conference by the development cooperation organization IBIS in October, the Danish pension fund ATP adopted the policy line that companies must include tax payment as part of their corporate and social responsibility reporting. The discussion within key ministries has also gained momentum.

Norway has been a forerunner in tackling capital flight. The government has been examining ways to restrain state's Sovereign Wealth Fund's connections with secrecy jurisdictions. Development minister Erik Solheim has also obliged the development funding agency Nordfund to identify African investment opportunities which do not involve using tax havens.[31]

ers. The programme is an important step in the battle against capital flight. It does not, however, cover the intermediaries, such as individuals, companies and banks that manage the stolen assets, even though they play an important role in facilitating and promoting capital flight.

The second major defect is that the World Bank programme only focuses on financial flows related to corruption. The Bank therefore ignores tax evasion by MNCs, which involves considerably larger sums.

The World Bank and the IMF seek to assist developing countries in improving their administrative systems. The IMF provides technical assistance to tax authorities and the World Bank gives loans for development projects that focus on capacity building.[27] This may often be important work, but its value diminishes particularly with the IMF's conditionalities that favour tax cuts and capital account liberalisation.[28]

Tackling capital flight requires further research, and the World Bank and the IMF have well resourced research departments. There have, however, been few studies on illegal capital flight. The Norwegian government commissioned a study from the World Bank on capital flight and provided funding for it, but the project has proceeded slowly.

KEY SOLUTIONS

- The World Bank and the IMF must be obliged to conduct more research on the problems that illicit capital flight and tax havens cause to developing countries
- The World Bank and the IMF must be obliged to stop encouraging developing countries to impose VAT-type consumer taxes to replace income outflows, and to offer tax benefits to attract foreign investments.
- The World Bank' StAR programme must be broadened so that it takes into account the illicit financial flows caused by companies' tax evasion.

EU COULD TAKE A LEADING ROLE

THE EUROPEAN UNION COULD TAKE A LEADING ROLE IN THE WORK AGAINST CAPITAL FLIGHT. THE RULES AGREED BY THE EU DIRECTLY AFFECT THE 27 MEMBER STATES OF THE UNION, WITH AN INDIRECT IMPACT TO THE REST OF THE WORLD. THE EU COUNTRIES ARE ALSO POWERFUL PLAYERS IN CENTRAL INTERNATIONAL ORGANISATIONS.

► **BRITISH PRIME MINISTER** Gordon Brown, France's prime minister Nicolas Sarkozy and Germany's prime minister Angela Merkel have demanded action against tax havens in various occasions. France has also pledged that all French banks will withdraw from tax havens by March 2010.[32]

The past decade has seen many EU initiatives to rein in tax havens. Already in 1997, the EU member states committed themselves to ending tax practises that are harmful for other countries, as well as abstaining from developing new ones. [33]

In 1999, an EU working group identified altogether 66 "possibly harmful" tax practises within the Union which matched the distinctive traits of tax havens. Many of these practises have subsequently been abolished, amended or rendered harmless, such as the corporate tax scheme formerly used in the autonomous region of Åland, Finland.

The European Commission has lent support to opening up tax haven structures and encouraged policy coherence concerning tax havens. The so-called savings tax directive requires the automatic exchange of tax information between EU members.[34] The directive helps in curbing tax avoidance within the EU, but it does have several loopholes.

In preparation for the Doha Summit on Financing for Development in September 2008, the European Parliament adopted recommendations for a common EU policy line with respect to development financing. The Parliament urged "the Commission to incorporate preventive measures on capital flight in its policy" so that it could close tax havens, some of which are located in the EU area and operate in close connection with member states.[35]

> The EU and its leaders appear to be active in tackling capital flight, but concrete initiatives have so far had only a minor impact on capital flight leaving developing countries. Europe needs to clean up its own backyard.

The typical image of a tax haven is a tropical island like Bermuda, or the Alpine scenery of Switzerland, but tax havens are also found in the EU. According to some estimates, the City of London is the world's biggest tax haven.

ISTOCKPHOTO.COM / PETE TRIPP

The financial crisis has recently brought some positive developments, such as commitment from Belgium to end its banking secrecy by 2011. Cyprus has also relaxed its secrecy laws.

The EU's capacity to tackle tax flight is somewhat limited because member states decide independently on many tax related issues. As a consequence, it has not been able to solve the problem of capital flight from developing countries.

Although some progress has been made, EU countries have not even been able to solve the problem of tax havens within the Union. Some EU countries receive considerable amounts of illicit financial flows. Among the best known tax havens are probably Belgium, Ireland, Luxembourg, the Netherlands and the UK.

According to some estimates, the worls's largest tax haven is the heart of London's financial district, the City. It is a largely autonomous area within London of banks, insurance companies, accountancy firms and financial consultancies, "a state within a state". [36]

EUROPEAN INVESTMENT BANK AND TAX HAVENS

The European Investment Bank, EIB funds an increasing number of programmes outside Europe. From 2004–2008 the bank loaned over €5 billion to major clients of tax havens from France, the UK and the Netherlands, while €210 million went to African funds exploiting tax havens. Furthermore, a number of major intrastructure projects financed by the EIB in developing countries are linked with tax havens. [37]

The EIB tightened up its tax haven policy in July 2009.[38] The rationale for the policy review was to respond to the new G20 principles on tax issues, but the active campaigning by the NGO Counter Balance probably also had an impact.

In the future, EIB funding will be granted to tax havens only with a condition that the actual economic activity takes place on their territory. EIB is also demanding that client companies already located in tax havens relocate elsewhere.

Although the EIB is going further than other international funding institutions, the current measures are not yet enough. One of the basic problems is that the EIB still follows the OECD's flawed tax haven lists, which weakens the effectiveness of the EIB's new alignments. The EIB also leaves much room to interpret what "actual" business activity is required of financing firms operating in tax havens. ◄

KEY SOLUTIONS

- The EU should take A more active stance against tax havens operating within the Union, such as the City of London, Ireland and autonomous areas such as the Isle of Man and Jersey.
- The EU Parliament and the Commission must support the major initiatives to tackle illicit financial flows, such as the use of country-by-country book-keeping.
- The EIB and EU member states must find alternatives to using tax havens in their investments.

The proportion of the untaxed, unofficial economy is far larger in developing countries than in industrial countries. A large part of it consists of, however, "normal" or generally acceptable activities, such as this market stall in the Cambodian capital of Phnom Penh.

KEPA / TIMO KURONEN

CHAPTER 4:

THE LOCAL CHALLENGES OF SUSTAINABLE TAXATION

EXTENSIVE UNOFFICIAL ECONOMY, LACK OF ADMINISTRATIVE RESOURCES, CORRUPTION... DEVELOPING COUNTRIES' ROAD TO SUSTAINABLE TAX REVENUES ALSO FACES DOMESTIC CHALLENGES.

DEVELOPING COUNTRIES CAN BE SUPPORTED BY HELPING TO STRENGTHEN THEIR TAX ADMINISTRATION. THERE IS ALSO NEED FOR FRESH THINKING IN POLICY ADVICE: THE DEVELOPMENT STRATEGY BASED ON EXTENSIVE TAX INCENTIVES FOR FOREIGN INVESTMENTS HAS NOT BROUGHT THE DESIRED RESULTS.

TRADE AGREEMENTS HAVE FORCED DEVELOPING COUNTRIES TO RAPIDLY ELIMINATE THEIR CUSTOM DUTIES. THIS HAS ALSO HAD SEVERE CONSEQUENCES FOR TAX REVENUES.

► **IN MONETARY TERMS** illicit capital flight resulting from tax evasion by MNCs is by far the greatest challenge for developing countries, but this is no reason to underestimate other challenges. Developing countries' internal problems partly explain why tax revenue remains uncollected. These were long reckoned to be even the main reason, until increased research on illegal capital flight dispelled this myth.

In 2000, tax revenue accounted on average for 13 percent of the GDP of the least developed countries.[1] This is just over a third of the amount of rich countries, which is 36 percent.[2] For example, the proportion of direct taxation paid from wages is particularly small in developing countries, from two to three percent of GDP. In rich countries the figures vary between 12 and 18 percent.[3] These taxes are usually graded according to income levels and so they help even the distribution of income between the rich and poor.

Action Aid has calculated that if all developing countries could collect at least 15 percent of the GDP in taxes – which is the internationally generally accepted "minimum rate" – their annual income would increase by at least €136 billion. This sum is greater than the annual amount of development assistance and would be sufficient to cover the financing needed to achieve the Millennium Development Goals.[4]

There are some encouraging examples. For instance, in Rwanda the capacity and independence of the tax administration was improved by a development cooperation project. As a result the amount of tax collected quadrupled between 1998 and 2006. In Uganda, the tax share of GDP rose from 7.2percent to 12.6percent in under a decade.[5]

Zambia increased its tax revenue significantly when it succeeded with Norway's help in negotiating new contracts with foreign copper mining companies.[6] One less encouraging example is Bangladesh. The country's tax administration has been unable to hire new tax inspectors for over 20 years. The number of officials handling VAT and customs taxes would need to be doubled in order to make the system efficient.[7]

The case of Bangladesh is not the only one of its kind: tax authorities of many developing countries simply do not have enough resources or know-how to collect taxes effectively. Legislation does not always contain the necessary means to intervene in the non-payment of taxes and fines can be very small.[8] For example, the monitoring of the accounts of large multinational companies is a challenge in rich countries, but in poor countries the problems are much worse.

THE INFORMAL ECONOMY CAN ACCOUNT FOR OVER A THIRD OF GDP

The scale of informal economy is substantial in many developing countries. This unrecorded economy does not show up in statistics and is taxed lightly or not at all.

This shadow economy was estimated to account for 43 percent of the GDP of African and Latin American countries in 2002–2003. In Asia it amounts to just under a third. In OECD countries the extent of the grey economy is calculated to be about 16 percent of GDP.[9]

> International comparisons on corruption do not take into account 'corruption services' provided by banks, tax havens and various consultants, which contribute to corruption in developing countries.

The figures are not completely comparable, because the unofficial economy in developing countries includes many "normal" and generally accepted activities that do not appear in statistics. Especially in rural areas most of the activities take place outside the monetary economy. In industrial countries grey economy generally involves more determined neglect of responsibilities.

The tax losses caused by informal economy are nevertheless much more substantial in developing countries than in rich countries. This does not necessarily lead to major losses of tax revenue, because many of the people left out of official statistics live below the poverty line and there is hardly any income to be taxed. Making the informal economy part of the formal economy is nevertheless an important goal because it will improve labour rights and bring employees within the scope of social security.

CORRUPTION HAMPERS TAX REVENUE

The harmful effects of corruption on development and reducing poverty have become a prominent concern in the last 15 years. The debate has been fuelled by bribery scandals in many countries.

Corruption distorts markets and competition, makes citizens more cynical towards the state, weakens compliance with and implementation of laws, and reduces the reliability of the private sector.

Corruption also sustains so-called failed states, which can provide fertile ground for terrorism, money laundering and other global criminal activity.

Tackling corruption requires more sustainable, open and accountable institutions. They must be able to regulate and oversee the financial, political and judicial processes without outside pressure. Primary responsibility lies with the states themselves, but foreign support is important.

CORRUPTION ALSO HAS A SUPPLY SIDE

Discussions on corruption are often limited to its demand side: the bribes that corrupted government officials and politicians take for various kinds of favours. This approach sidelines the "corruption services" offered by banks, tax havens, MNCs and consultants. They form the supply side of corruption that is closely linked to the problems of illicit capital flight.[11]

Without suppliers it would be much more difficult to inject illegally earned money into the legal markets.

TANZANIA'S TAX LOSSES FROM GOLD COMPANIES RUN TO HUNDREDS OF MILLIONS OF EUROS

TANZANIA, A LONG-TERM DEVELOPMENT COOPERATION PARTNER OF FINLAND, HAS LOST HUNDREDS OF MILLIONS OF EUROS BECAUSE FOREIGN MINING COMPANIES HAVE MANAGED TO NEGOTIATE THEMSELVES LOW COMPANY TAXATION AND ROYALTIES. [21] MINING COMPANIES ALSO MINIMISE THEIR TAX BURDEN BY ACCOUNTING TRICKS THAT INCREASE THEIR LOSSES. [22]

► **TANZANIA IS ONE OF** Africa's fastest growing gold producers. The country's gold wealth is estimated at 45 million ounces, which is 1,260 tonnes (one ounce is about 28 grams). At global market prices in October 2009 the value of this wealth is €31 billion.[23] The only African country to exceed Tanzania's gold production is South Africa.

There are also plenty of rubies, sapphires, diamonds and emeralds in Tanzania. Gold is the most important mineral, however: its share of mining exports is over 90 percent. In 2007 €580 million worth of gold was exported.

Valuable natural resources have not helped Tanzania escape poverty. Tanzania is ranked 159 out of 177 countries on the Human Development Index. Over half of the population lives on less than a dollar a day, life expectancy is 55 years, HIV and AIDS kill 140,000 people a year, and almost one in two Tanzanians is undernourished.

Tax agreements are usually concluded behind closed doors, making it hard to get information about them. There is little chance for citizens to have their voices heard and the social impact of mining operations is hardly considered in the mining agreements.

The World Bank encouraged Tanzania to attract private investors and foreign capital in drawing up mining contracts. Tax benefits were the main attraction.[24] The government's 1997 policy programme stresses the role of private sector in mining operations, but only under government regulations.

The Commissioner responsible for overseeing the mining sector, Peter Kafumu, says that negotiating with the mining companies was an intimidating experience: "The companies held the handle of the knife and we were left with the sharp end."

TAX-FREE MINING

The largest six gold mines in Tanzania are run by two foreign companies, the Canadian Barrick Gold and the South African AngloGold Ashanti (AGA), whose main owner is a British company called Anglo American. Their example illustrates how companies avoid their social responsibilities.

When AGA and Barrick started their operations in Tanzania they, like other mining companies, received significant benefits from the government.

According to its own report, AGA paid €77 million in taxes and royalties between 2000–2006. During this period it produced three million ounces of gold, valued at over a billion euros. The taxes and royalties the company paid represented only 6 percent of the value of its exports. The company's total profits were €74 million from the beginning of 2002 until mid-2007.

According to Action Aid, by the end of 2008 AGA was the only mining company that had paid any corporate tax in Tanzania.[25]

Barrick does not reveal how much it pays in royalties and tax to Tanzania. It pays no corporate tax.[26] The company's accounts reveal, however, that its sales profits for 2000–2007 were €77 million.[27]

Barrick and AGA have been able to avoid paying corporate tax because they have reported that they are making losses. Overall reported losses for 1998–2005 totalled €810 million. The Tanzanian Parliament publicised this figure in 2007, but considered it unreliable because the companies were engaged in large investments over the same period.

According to independent research the companies were in reality making profits and they should have paid millions of euros in taxes.[28]

HUNDREDS OF MILLIONS ARE MISSING

In 2003, the Tanzanian government hired Alex Stewart inspection company (ASA) to investigate whether the large gold mining companies publicise true information on their production and financial situation. Once the report was finished, the government declared it classified.

The report was eventually leaked to Public Citizen newspaper. According to the paper, the report found that four mining companies – among them Barrick and AGA – exaggerated their losses by €445 million between 1999 and 2003. Resulting tax losses amounted to €117 million.

The report also noted that thousands of documents had gone missing. It was impossible to find out whether the companies had paid the €22 million in royalties that they should have paid according to their reported production information.

Between 2000 and 2007, the Tanzanian government lost approximately $425 million in non-paid roy-

For example, there is hardly a dictator known to modern world history who had not had secret bank accounts in tax havens.

To eradicate corruption, both supply and demand side need to be tackled. The significance of the supply side of corruption is becoming an increasingly recognised issue and its connection with tax havens and illegal capital flight has become undisputable.[12]

So far corruption indicators have focused on demand side of corruption. Most widely followed indicator has been the Corruption Perception Index of Transparency International, which attracts high profile public atten-

SIMON MAINA / AFP / LEHTIKUVA

A Tanzanian miner climbs up a flooded mine shaft near Arusha in March 2008.

alties and taxes the mining companies evaded.[29]

For an extremely poor country it is King's ransom. In fact, the lost millions are one and a half times the size of the entire budget for the Tanzanian health sector. This money could have been used, for example, to fund primary education, health care, infrastructure and clean water for 8.3 million Tanzanians, or to build 66,000 classrooms.[30]

If companies paid their taxes properly and did not distort their income figures, gold alone would provide the state a larger source of income than foreign assistance.[31]

SLOW PROGRESS

It is hardly surprising that there is pressure for change. At his inaugural address in 2005, the new President of Tanzania, Jakaya Kikwete, pledged to examine the agreements with the mining companies to ensure that natural resources would benefit the people.

In November 2007 Kikwete set up a committee to examine the situation. In spring 2008, the committee proposed stricter measures on taxation and legislation, and the renegotiation of agreements with the mining companies. These changes have not, however, been implemented yet.

In November 2009 the Parliament began reforming the mining legislation. Reform is hampered by the lack of finance for new mining investments. Despite the rise in gold's world market price, the companies are in a favourable negotiating position vis-à-vis the state.[32]

Mining companies in Tanzania are large MNCs that operate in several countries and take advantage of gaps in the regulation of the international finance system. Therefore developing countries like Tanzania alone cannot be expected to bear responsibility for their malpractices.

One effective means of intervention in the tax problems identified in mining and other industries would be country-by-country reporting standards (page 15). If companies had to report their precise income and expenses for each country in which they operate, it would be much more difficult to move profits between subsidiaries without public attention. At the moment this only needs to be done at company level. The solution would not end tax competition, but would nevertheless be a big step forward. ◄

tion every year. The developing country and NGO criticism on too narrow approaches is starting to get more hold, however. For example, in 2009 Transparency International published, for the first time, the report "Corruption in the Private Sector".

TAX COMPETITION ERODES THE TAX BASE

Competition between states for foreign investment has in recent decades weakened the possibilities of developing countries to collect taxes. Many developing countries have established export processing zones that lure companies with tax exemptions or have tailored other incentives to attract increasingly mobile multinational companies.[13] Other fiscal incentives include subsidies, low regulation, exemptions from taxes at source or tax relief on foreign workers used in the investment project.

Aggressive tax competition has become an everyday challenge around the world, especially in poor and middle-income countries. Liberal tax policies advocated by the World Bank and the IMF have exaggerated the problem. In their view tax competition helps developing countries to attract investments the benefits of which then 'trickle down' to other areas of economy.[14] Pressure comes also from MNCs that make states compete against one another for investments.

TAX COMPETITION DOES NOT ALWAYS INCREASE INVESTMENTS

Tax competition does not always increase foreign investments, although its negative impacts are undeniable. For instance, due to tax benefits granted to companies, India lost over 11 percent of all its tax revenue in 2008 and 2009. Zambia earned €50 billion less from mining industries due to reductions in royalty payments.[15]

Low-income African states lowered their corporate taxes by an average of 11 percent between 1980 and 2005. [16] In the last decade, rich states have reduced their corporate taxes even more than poor ones.[17] Industrial countries nevertheless have better preconditions to ensure that statutory taxes are paid. The means available to developing countries to adapt to the pressures of tax competition and to intervene in tax evasion are considerably more limited.

Consequently, corporate tax revenues are on average lower for developing countries than in rich countries. Wages and consumption have to be taxed more to collect the necessary revenues. Higher taxes on labour can have a negative effect job creation. Higher consumer taxes mean more expensive foodstuffs, which aggravates the situation of the poorest people that spend highest proportion of their income on necessities.

Tax competition has been justified by arguing that low-tax assembly, manufacturing and other industries can lay ground for long-term industrialisation. Many countries offer up to 10 years' exemption from taxes in return for investments. It was believed that know-how and technology from factories on free trade zones would transfer to local employees. There is, however, little proof of this happening.

Over a longer period, tax competition may lead to increased poverty and inequality and slower economic growth contrary to the original objectives. Securing economic competitiveness requires long-term development of production capacities. Benefits of tax breaks may remain small, if a neighbouring state makes companies a better offer. Eventually tax revenue diminishes in every country. Mining or other investments can be sold from one owner to the next, but there is no guarantee of new investments.

When making investment decisions, MNCs generally favour good quality of infrastructure, highly educated workforce and dynamic domestic markets over tax benefits.[18] Nonetheless, due to their strong negotiating position MNCs ask for and are often granted exemptions.

The outcome is hardly surprising. The inability to collect tax revenues necessary for development has serious consequences even in rich countries, but the impact is considerably higher in poor countries, where small sums make bigger difference in good or bad.

CUSTOMS DUTIES ARE ABOLISHED TOO QUICKLY

Developing countries also suffer from trade agreements that favour rich countries' interests. They have traditionally received a large proportion of their income from customs duties, which have been easy to collect even in countries with sizeable unofficial economies. In some states, customs duties make up 30 or even 50 percent of the whole tax pool.[19]

During the last two decades the World Bank, the IMF, the World Trade Organization and industrialised countries have pursued sharp reductions in import tariffs as part of general trade deregulation. Wealthy states, whose foreign trade taxation is of little significance, have managed to obtain replacement income from other sources, such as VAT-type consumer taxes. For example, tax income from import tariffs account for only about one percent of government revenues in the United States.[20]

The problem is not so much the abolishing of import tariffs but rather the way it has been done. Securing government revenues on customs tariffs is not a sustainable long term solution. The transfer should nevertheless be done flexibly, in pace with the development of the economy and the tax system. Many poor countries have been forced to implement the reforms too rapidly. They have not managed to replace lost income with other sources of revenue. ◂

For many poor and middle-income countries, tax competition has become routine. The World Bank, the IMF and multinational corporations encourage countries to compete against one another on taxation.

ENDNOTES

CHAPTER 1: THE SCALE OF CAPITAL FLIGHT AND THE CONSEQUENCES FOR DEVELOPING COUNTRIES

1 Christensen, John and Nicholas Shaxson (2008)

2 Kar, Dev and Devon Cartwright-Smith (2009)

3 OECD (2009a)

4 Ndikumana, Leonce and James K. Boyce (2008); Har, Dev and Devon Cartwright-Smith (2009) 5 Baker, Raymond (2008); see also the interview with Raymond Baker published 3.2.2009 on Kepa's website http://www.kepa.fi/uutiset/6895/ (September 2009)

6 Xioa, G. (2004). People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications. Cited from Murphy, Richard et al (2007)

7 Baker, Raymond and Eva Joly (2008)

8 Kar, Dev and Devon Cartwright-Smith (2009)

9 Christian Aid (2008); Tax Justice Network (2009c)

10 Action Aid (2009)

11 General Accounting Office (2008)

12 Bloomberg (2009)

13 Van Dijk, Michiel and Francis Weyzig (2007)

14 Action Aid (2009)

15 John Christensen and Mark Hampton (2007)

16 Government of Norway (2009)

17 Ibid, see also Cristensen, John (2009)

18 Martens, Jens (2008)

19 Baker, Raymond (2008)

20 Brautigam, Deborah et al (2008)

21 See for example Ross, Michael L. (2004)

22 UN Millennium Development Goals, see http://www.un.org/millenniumgoals/

23 KEPA (2009a)

24 Bulir, Ales and A. Javier Hamann (2006)

CHAPTER 2: MULTINATIONAL COMPANIES ARE THE MAIN SOURCE OF CAPITAL FLIGHT

1 Sobeet et al (2009)

2 Action Aid (2009)

3 Kapoor, Sony (2006)

4 Action Aid (2009)

5 Greenpeace (2008)

6 McIntyre, Robert S. (2005)

7 Eurodad et al (2008)

8 Christian Aid (2008)

9 Christian Aid (2009)

CHAPTER 3: CAPITAL FLIGHT CAN BE STOPPED

1 Further information at www.financialtaskforce.org (August 2009)

2 See, for example, www.taxjustice.net and www.publishwhatyoupay.org (August 2009)

3 Tax Justice Network (2008a)

4 Christensen, John (2008)

5 Global Reporting Initiative (2006)

6 European Union (2008) OECD (2000)

7 The Observer (2008)

8 Tax Justice Network (2008b)

9 OECD (2000)

10 Kat, Dev, and Devon Cartwright-Smith (2009)

11 Further information at www.oecd.org/cpt/eoi (September 2009)

12 OECD (2009b)

13 Financial Times (2009)

14 Caribarena (2009)

15 OECD (2009c)

16 Tax Justice Network (2009b)

17 See OECD (1998)

18 Further information on OECD's work against harmful tax practices at www.oecd.org/topic/0,3373,en_2649_33745_1_1_1_1_37427,00.html (August 2009).

19 Sharman, Jason (2006)

20 Murphy, Richard et al (2007)

21 European Union (2008)

22 United Nations (2008)

23 Eurodad et al (2008)

24 See, for example, The Economist (2009).

25 Kepa (2009b)

26 See, for example, The Economist (2009) and Roberts, Danny (2009)

27 An extensive overview on technical assistance can be found at International Tax Dialogue (ITD) webpage at www.itdweb.org. ITD is a collaborative arrangement involving international organisations and financial institutions to encourage and facilitate discussion of tax matters.

28 Eurodad (2009b)

29 Fried, Stephanie (2009); Vöcking, Knud (2008)

30 Development Today (2009a)

31 Development Today (2009b)

32 Daneshkhu, Scheherazade (2009)

33 European Union (1997)

34 European Union (2004)

35 European Union (2008). See also Eurodad (2008).

36 Tax Justice Network (2009a)

37 Ruiz, Marta (2009)

38 European Investment Bank (2009)

CHAPTER 4: THE LOCAL CHALLENGES OF SUSTAINABLE TAXATION

1 Cobham, Alex (2005)

2 Braunsgaard, Thomas and Michael Keen (2005)

3 OECD (2007)

4 Cobham, Alex (2005)

5 Ibid.

6 Action Aid (2009)

7 Tembo, Benedict (2008)

8 Action Aid (2009)

9 Murphy, Richard et al (2007)

10 Schneider, Friedrich (2006)

11 Murphy, Richard et al (2007)

12 Christensen, John (2007)

13 See the section on Tax Competition on the website of the Tax Justice Network www.taxjustice.net/cms/front_content.php?idcat=102 (August 2009)

14 Eurodad (2009b)

15 Action Aid (2009). For more on the dubious consequences of tax competition, see Murphy, Richard et al (2007)

16 Action Aid (2009)

17 Murphy, Richard et al (2007), Appendix 2.

18 Murphy, Richard et al (2007)

19 Ibid.

20 Progressive Policy Institute (2009)

21 Unless mentioned otherwise, information on these figures is based on the Christian Aid report Death and Taxes: the true toll of tax dodging (2008)

22 Curtis, Mark and Tundu Lissu (2008)

23 This is taken from the price of gold in October 2009, which was then about €693 an ounce.

24 Action Aid et al (2009)

25 Ibid.

26 Ibid.

27 Curtis, Mark and Tundu Lissu (2008)

28 Ibid.

29 The calculation is based on the situation where the mining companies would have paid 7.5% in royalties, would have paid company tax, reported their income truthfully and paid for environmental restoration. Christian Aid 2008, p.13.

30 Curtis, Mark and Tundu Lissu (2008)

31 Christian Aid (2008)

32 Action Aid et al (2009) and KEPA Tanzania.

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