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Based on personal experiences in international banking, Christensen has observed how poor countries are deprived of the income they generate, particularly through transfer pricing. This involves a company setting up a shell corporation in a tax haven, buying goods at low prices from poor countries and selling them at high prices to rich countries. Since the profit is made in a country with little or no taxation, the company avoids paying taxes on the transaction. This kind of deceptive trade practice has increased in recent decades from capital account liberalization and trade liberalization, which were promoted by the IMF and World Bank as part of the Washington Consensus. That ideologically-driven policy also encouraged poor countries to cut taxes on imports and raise taxes on domestic production, which seriously damaged weak economies. In addition, countries were forced (by debt conditionalities) to privatize their industries and services in a manner that allowed foreign investors to buy up public assets at bargain prices.

How I Became Involved in Banking

I grew up on the island of Jersey in the 1960s. I left to study as an economist. I worked for many developing countries in my twenties on co-operative savings systems.

In the mid-1980s, I was working in Malaysia with the national government. Their banks were then very poorly regulated. Hundreds of millions of dollars of deposits had been shifted out of Malaysia into offshore accounts. That was disturbing. To shift hundreds of millions of dollars, the people who were embezzling the money were using sophisticated and secretive offshore bank accounts. I was puzzled that the bankers, lawyers, and accountants involved paid no attention to the embezzlement. None asked any questions about whether the money was legal. Much of the embezzled money came from normal deposits that were supposed to be protected by Malaysian law, but they were not.

Since some of the funds had disappeared to my native island of Jersey, my curiosity was aroused. Once I finished my job in Malaysia when I was in my mid-thirties, I decided to return to Jersey to learn about the new offshore economy that was emerging.

Capital Flow Liberalization Promotes Illegal Activity

A bit of background to the offshore economy. From the late 1970s to the middle of the 1990s, the World Bank and the IMF forced countries to adopt capital account liberalization, which enabled capital to move freely between countries without any control. This was part of the conditionality of the Washington Consensus. They ignored the fact that when capital moves freely across borders, it can be shifted into secret accounts and change its identity. There is no way of tracing that capital back to the people who own it, and that is what offshore banking does.

Capital account liberalization encouraged capital flight, the illicit movement of capital from one country to another, particularly into jurisdictions with banking secrecy, where owners could evade taxes.

The IMF and the World Bank, by liberalizing capital flows, opened up a wholly new criminal environment, where capital could be shifted into tax havens around the world and evade taxes. To give an idea of the size of this movement, the most recent estimate of the capital now held offshore by rich individuals is US$11.5 trillion. For those people who want to tackle

poverty, this raises intriguing questions. If we taxed that capital at 30% on the income, we could raise $255 billion a year. That would more than pay for the Millennium Development Goal program of tackling poverty.

Offshore Banking as Tax Haven

In 1986, when I came back from Malaysia, Jersey had changed a lot. The island had become an offshore center. Lots of banks around the world were opening branches there. I took a job with a big accounting firm in a division that specialized in offshore trusts and company administration, so I was right at the heart of the beast.

I began to pick up on how it all worked. Nothing was managed through Jersey. Many of the instructions came from the City of London. Capital was coming in from all over the world and being distributed through many jurisdictions. We set up schemes which hid the ownership of money. We might establish an offshore company in Luxembourg, owned by an offshore trust in Bermuda, with trustees in New York or London or Switzerland, and a secret bank account in Luxembourg or Switzerland. With that structure, it becomes almost impossible for the authorities in any country to track it back to the real owner.

This serves anyone engaged in criminal activity, including tax evasion. Offshore tax havens like Jersey are almost exclusively and entirely used for activities that are either criminal, like tax evasion, or bordering on the criminal, because they are setting up tax avoidance strategies. Lawyers and bankers would say tax evasion is illegal but tax avoidance is okay. Some people regard it as the duty of a good citizen to avoid tax. However, if someone is avoiding tax, it means either someone else, usually a poorer person, pays more taxes, or there will be cutbacks in public services.

The African Union says that every year at least $148 billion is taken out of Africa, typically heading to either Europe or North America, and the vast majority of that capital never returns. This is a crisis for Africa in two senses. First, Africa's financial resources are literally disappearing northwards. No tax revenues flow back to Africa, even though the owners remain in Africa. Second, if that capital were invested in Africa, it would create both jobs and tax revenues. So Africa loses the capital, and the tax revenues. As dirty money from drug trafficking, embezzlement, bribes, fraud, or corrupt practices is transferred abroad, the tax burden is shifting increasingly onto middle income earners and lower income earners. That increases the gap between the rich and the poor.

Transfer Pricing and Tax Avoidance

Very often people think of bribery as the principal source of corruption, but bribery is actually a very minor part of corruption. Less than 10% of dirty money stems from bribery. The vast majority arises from commercial transactions, using what is called "transfer pricing." Typically this arises from cross-border trades where false invoicing is used to shift capital out of one country into another country, typically a tax haven, in order to avoid or evade tax.

Extreme examples of this can be found in Africa, where a lot of the mineral resources are traded on paper through tax havens like Jersey. Oil is invoiced to an offshore subsidiary in Jersey or in Switzerland. It is exported out of Africa at a very low price so that the offshore company is paying Africans way below the market price for the oil or mineral. The profits will be retained in the offshore subsidiary. The oil will be re-invoiced back to the mainstream economy where it is being sold to the end user at a high price. The difference between the low invoice price paid to Africa and the high invoice price received when the oil is sold is retained offshore in the tax-free or minimum-tax jurisdiction. That is the way the vast majority of capital flight operates.

An American researcher [at Pennsylvania State University], Simon J. Pak, has compiled examples of these practices from American customs records.* He has found bicycle tires being imported at $400 each and prefabricated houses being exported out of America to Trinidad at $1.50 each. These practices minimize taxable income in the US by raising reported costs (such as the bicycle tires) and lowering reported revenue (from the prefabricated houses).

A more elaborate example is Mobutu, the dictator-president of Zaire for many years and the pioneer of African kleptocracy. During his presidency from 1965 to 1997, his company, Gecko Mines, exported diamonds out of Zaire at about $8.55 per karat, which is far below the world market price of diamonds. Over the course of his presidency, Mobutu embezzled approximately $5 billion out of Zaire into offshore accounts using that kind of transfer pricing strategy.

Aggressive tax avoidance using transfer pricing applies across most sectors. It is not peculiar to extractive industries. It is used by pharmaceutical

* Simon J. Pak (2006) "Capital Movement through Trade Misinvoicing: The Case of Africa," *Journal of Financial Crime*, Vol 14, No. 4, 2007, pp 474 – 489.

industries, media, and communications. It applies to many horticultural and agricultural exports out of Africa, in fact to virtually any cross-border trades. This is very corrupting. Transfer pricing is regarded not just as normal business practice—it is regarded as good business practice. This is a challenge to companies that claim they want to be good corporate citizens. They should begin by paying the taxes that are due on the profits they generate in the countries where they operate. However, very few companies disclose what profits they earn in the jurisdictions where they operate, what taxes are due on those profits, and what taxes are paid on those profits.

One of the things that amused me about Jersey, a rather cold and windswept island in the middle of the English channel, is that "on paper" a lot of tropical commodities come from there, yet I never saw a banana plantation or a coffee plantation there. Many agricultural commodities coming out of Latin America and Africa are traded via tax havens like Jersey in order to shift the profits out of Latin America and Africa.

Hidden Monopoly Power

Offshore companies are also used to disguise the monopolistic positions of big companies that dominate trade in Latin America and Africa. Disclosure of beneficial ownership reveals that supposedly competing companies are in fact owned by the same company. In Kenya, for example, the cement market appears to be highly competitive between four large companies and a number of others. In fact, these four companies are not competing. The market is dominated by a major French company called La Farge, which effectively controls the market price.* The same applies to other trading sectors. Combining that with transfer pricing means very little value remains in the country of origin. It is shifted offshore. They achieve very high monopolistic prices but use all sorts of devices to shift the profits out of the country of origin into a tax haven where they pay no tax at all.

The Washington Consensus

Offshore bank accounts and offshore trusts and offshore companies have been in use since the 1920s. Concerns about this were first raised in

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* Ed.: Lafarge has a 41 per cent stake in East Africa Portland, a 17 per cent stake in Athi River Mining Ltd., and a 58.6% controlling stake in Bamburi Cement. It also holds a majority stake in cement manufacturers in both Uganda and Tanzania. http://www.mashada.com/blogs/RIBA_CAPITAL/2007/12/10/___Lafarge_Acquires_Egypt_s_Cement_Company.

1923 with the League of Nations. The World Bank and the IMF must have been aware that capital account liberalization would increase the potential for tax evasion and aggressive tax avoidance structures. Apparently, they were so committed to the ideological agenda of the Washington Consensus that they went ahead blithely, uncaring about the consequences.

The Washington Consensus went beyond capital account liberalization because they were also pushing for trade liberalization. The idea was to create a world of free trade, so they wanted to reduce tariff barriers. They ignored the huge subsidies that are paid in the European Union and the US—so, by forcing a reduction in tariffs, they only looked at one part of the equation. At that time tariffs comprised 50 to 60 percent of government revenue in Africa and Latin America. The IMF insisted that countries substitute a value-added tax or a general sales tax. The IMF claimed the revenues lost from tariffs would be regained through a tax on consumption. Now behind this was a rather quirky economic theory devised by an economist named Arthur Laffer that if you reduce taxes, you will stimulate sufficient economic growth to recover the lost revenue.

Laffer's theory was put into practice by the Thatcher government in the UK and the Reagan government in the US, and some people claimed it had some success. More recently, it has proven to be wrong, and no economist will give it serious consideration. But the IMF pushed forward trade liberalization. IMF research in 2007 has revealed that for every $1.00 of tax revenue that governments in Africa lost through trade liberalization and cuts in tariffs, they recovered, at best, 30¢ through the new VAT regime.† The change in tax regimes hit the poor hardest. Whereas trade taxes are quite progressive because wealthy companies and people pay tariffs on their imports of luxury goods, general sales taxes and VAT regimes are generally quite regressive. They have a disproportionate impact on the poor. Not only did the governments of these countries lose tax revenue; their poor people had to pay more tax. Bravo IMF! Bravo World Bank! But they are still in Africa telling the African countries what is best for them.

The ideology imposed by the IMF and World Bank did not stop there. The Washington Consensus had four key strands. First, capital account liber-

† Ed.: See Thomas Baunsgaard and Michael Keen, Tax Revenue and (or?) Trade Liberalization, December 2005, IMF Fiscal Affairs Department, Working Paper WP/05/112 Washington, D.C. : International Monetary Fund. http://www.imf.org/external/pubs/ft/wp/2005/wp05112.pdf . A later version of the same paper appears at http://www.ssc.wisc.edu/~scholz/Seminar/Keen.pdf.

alization, second, trade liberalization, third, reduce your taxes and stimulate growth by following the Laffer Curve (a bit like following the "yellow brick road"—it led nowhere at all). Tax revenues declined for most developing countries, particularly in Africa.

The fourth strand of the Washington Consensus was selling off the state's assets. In most cases, they were sold off so badly and the fees that were paid to World Bank consultants and all of the Western consultants involved were so astronomical that the end price that many developing countries got for themselves was minimal. In other words, they sold the family silver and got very little in return. Worse than that, privatization in many areas, particularly in sectors like water, did not lead to new investment. It simply led to higher prices and massive profit-taking. Very often the fine print of the privatization sales involved all sorts of in-built subsidies, tax holidays, and capital depreciation allowances way beyond the norm. In short, privatization was handled in such a bad way that the vast majority of countries gained very little from it.

Debt Versus Democracy: Accountable to Whom?

Alongside faulty privatization programs, the IMF and World Bank also pushed developing countries deeper into debt. The most efficient and least expensive way of raising government revenue and financing capital expenditure is to tax. It is the cheapest way, particularly for sovereign nations with relatively good credit ratings. Borrowing externally is the most expensive option, and worse still it brings with it a whole lot of conditionalities. The IMF and World Bank have undermined the ability of many governments in Africa and Latin America to raise their own taxes. This raises a lot of very troublesome questions about the commitment the IMF and World Bank have to democracy, which depends on the ability of citizens and parliaments to raise and spend tax revenues. So the IMF and the World Bank have purposely pursued programs which undermine democracy in these countries.

African people are deeply troubled that they are accountable to external people more than to their own electorates. It is not just the World Bank and the IMF that are imposing conditions. Government aid departments, such as Britain's Department for International Development, have offered advice and imposed conditions upon their advice. In many cases, the advice has been extremely poor.

So rather than use taxes to fund expenditures on health services or education, many countries in Africa have been forced to privatize, to impose

costs onto education and borrow massive debt externally. In my consultations with 18 countries in Africa, I have learned that because of the high price charged for education, most African families cannot afford to take their children through education beyond primary level. Secondary level is just too expensive. The tertiary level, higher education at university or education colleges, is beyond their means. There is wholesale under-investment in education in Africa, which will lead to lower rates of economic growth.

The World Bank and the IMF have undercut the basis of economic growth in Africa. They have created much less stable social environments in Africa. They have created the conditions in which criminality, not just bribe-taking but all sorts of other crimes, including tax evasion, has become the norm. This has led to a political environment which is a great deal less secure now than it was before the IMF and the World Bank intervened. To understand why, across Africa, Middle East and some parts of Asia you have such high levels of insecurity, resentment towards the West, and indeed terrorism, you need to understand that the West is largely responsible for the undermining of the economies here and for the social disintegration that I have seen in the last 30 years.

"The End of Poverty?"

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