Tax Havens: An Emerging Challenge to Africa’s Development Financing

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The term ‘tax haven’ is a bit of a misnomer because they are not just about tax, but about a whole range of other things too. There is no generally agreed definition of what a tax haven is, but if you drill right down to the core of what these places offer, you end with two words: ‘escape,’ and ‘elsewhere.’ Once we understand what this means, it becomes clear why they are such a threat to Africa.

First, escape. Tax havens help wealthy individuals and large corporations escape from criminal laws, from financial regulation, from transparency and disclosure, from inheritance rules, from professional liability, and more. Take your money to a tax haven, and your home rules no longer bind you. In other words, tax havens help wealth elites escape from the rules of civilized society, whether by illegal means or not. The implications for Africa are obvious.

Second, ‘elsewhere.’ The secrecy facilities or tax loopholes provided by the 600,000-odd International Business Companies in the British Virgin Islands¹ are not for the benefit of local islanders: they are for foreigners, elsewhere. You don’t like the rules and laws that apply at home, so you take your money somewhere else. ‘Elsewhere’ - hence the term ‘offshore.’ Offshore lawmakers are always separated from those people who are actually affected by the laws they write -- so there is never proper democratic consultation when these laws are written. This is the whole point. These are laws by insiders, for insiders, and the lines of democratic accountability are deliberately cut. So offshore is, almost by definition, the proverbial smoke-filled room, where decisions are taken behind closed doors, with no public accountability. Once again, the implications for Africa should be clear.

Tax havens respond, in their defense, that they are ‘efficient’ conduits for capital, helping it flow smoothly around the world, channeling much-needed investment into African and other developing countries. Lots of money does indeed flow into Africa through Mauritius and other tax havens.

But it is important to consider what this ‘efficient’ money flow means.

Since the 1970s, economists and accountants have fallen in love with a particular notion of efficiency, meaning a lack of friction in economic transactions. Low-tax, low-regulation tax havens epitomize this ‘frictionless’ finance.

There is indeed a lot of investment in Africa via tax havens—but that may not be such a good thing. Consider the issue of ‘round-tripping.’ African countries, like many others, offer special tax and other incentives to foreigners, which are not available to locals. They create these incentives in the hope of attracting foreign investment. But what so often happens is that locals take their money offshore, dress up in offshore secrecy and return it back home, disguised as foreign investment, availing themselves of all the perks that are not available to their less wealthy compatriots. It is hard to see what is ‘efficient’ about this. Meanwhile, academic research suggests that these tax incentives do not seem to promote growth (http://taxjustice.blogspot.ch/2009/07/imf-lower-corporation-taxes-and-tax.html).

¹ http://www.britishvirginislands-ibcregistration.com/BritishVirginIslands_International_trade_and_investment.html
There is worse. In the book *Africa’s Odious Debts*, James Boyce and Léonce Ndikumana estimated capital flight from 33 African countries at an accumulated $735bn from 1970-2008, worth $944bn at conservative interest rates; this number happens to tally closely with industry estimates of the holdings of African High Net Worth Individuals at $800-1,000 billion. Most of this capital flight escaped offshore, and stayed offshore. Compare these numbers to the estimated external debts for these countries of ‘just’ $177 billion in 2008 – suggesting that Africa was a net creditor to the world of $767 billion. The trouble is, of course, that the assets are in the hands of a small, wealthy African elite, while the liabilities are shouldered by the broader African populations in the form of reduced health, education and infrastructure – or higher taxes.

James Henry’s 2012 paper *Explaining Capital Flight*, looking at the drivers and effects of these flows, notes how a big share of this capital flight has been actively been driven by the borrowing itself, which comes in then is quickly recycled offshore, often with the aggressive intervention of private bankers from London, Geneva and New York. They have been ruthlessly ‘efficient’ in shifting the assets to Africa’s wealthy elites and the liabilities to the African public.

Consider another aspect of ‘efficient’ and frictionless finance. To get around a particular annoying regulation; or to get your container quickly through that port; or to get that permit expedited fast, or to skirt that tax – there is an approach that can seem highly ‘efficient’ from an individual company’s perspective. That approach is called bribery. But while bribery can certainly seem efficient for an individual or corporation, a society plagued by bribery is a very different matter. Likewise, tax havens make global financial markets more efficient by removing obstacles. But what are those obstacles? They are tax, regulations, disclosure requirements and so on—all of which, for all their warts, are put in place for good reasons. It is not immediately obvious why removing them should be ‘efficient.’

African countries are relatively powerless in the face of the nebulous, complex, shifting, frictionless world of offshore finance. But in this context it is worth asking the question: rich countries also lose billions to the offshore system too, and their economies are the victims of untold financial crimes hidden by offshore secrecy. So why do they tolerate it?

The answers to this question are illuminating.

Start by considering how many Nigerians stash their money secretly in London or Switzerland. There is no hard data available, but there may be hundreds of thousands. Now consider how many British or Swiss residents will choose Lagos or Abuja as the best place to stash their secret, tax-evading wealth? It is hard to imagine many.

The point is this: tax havens are generally located in wealthy, stable countries, and the illicit financial flows head overwhelmingly in one direction: from poor, unstable countries to rich, well-governed ones.

The rich countries like your money, and making financial flows more ‘efficient’ and more secretive will accelerate this gigantic one-way net flow.

On April 2, 2009, the G20 countries declared in a summit in London that “the era of banking secrecy is over.” They promised a crackdown on offshore secrecy, and assigned the task of leading the crackdown to the OECD, a club of rich nations. This sounded exciting – but an examination of what actually happened demonstrates the power and effectiveness of the offshore lobby.

The OECD had a black, white and gray list of tax havens – and it is a measure of how serious this initiative was that the blacklist was empty by April

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7, 2009 – just five days after the G20 statement.
Jurisdictions could get onto the white list by signing
12 so-called Tax Information Exchange Agreements
(TIEAs) – bilateral agreements by which tax havens
are supposed to cough up information about foreign
assets stashed in their jurisdiction to the partner in
the agreement. The trouble is: these OECD
agreements are useless. These agreements prohibit
what they call ‘fishing expeditions’ where Ghana,
say, could put in a blanket request to the Cayman
Islands for all information about Ghanaian citizens’
assets. No, you have to already know the
information you are looking for about a particular
Ghanaian citizen, then ask the Cayman Islands to
confirm that! These agreements are slightly better
than useless – but not much. The OECD was asked
to drain a swamp, but it has been handing out
drinking straws.

The tax havens busily starting signing these TIEAS
in order to get the 12 agreements, but well over a
third of these are with other tax havens or with tiny
jurisdictions such as Greenland, Andorra and the
Faroe Islands. Worse still, of the over 200 TIEAs
signed, just three were with African countries,
leaving aside Liberia, which is a tax haven in its
own right.3

The rich countries’ big model for transparency is
not working. And that is deliberate. Instead of
properly cleaning up the tax havens, the world’s
rich countries are resorting to the tried and tested
palliative: foreign aid. The global rules for taxing
multinational corporations are not much better: the
basic aim of the OECD-led system is, in the words
of international tax expert Lee Sheppard, “to make
life comfortable for American, British, German, and
French multinationals.”4 The rules are clumsy tools
that affluent developed countries have used among
themselves, to their collective detriment, and seek
to impose on developing countries.

It is essential to understand where the tax havens
are located. In the popular imagination, they are
mostly small, shady islands such as Cayman, or
secretive little bolt holes such as Monaco. These
jurisdictions are important, but in reality the
dictators’ assets tend to get parked in the places
where they and their families like to go shopping:
that means London, Miami or Geneva.

How are these assets owned? Typically, a super-
wealthy African might own a luxury apartment
through a multi-jurisdictional structure. One of the
simpler structures may involve a Bahamas trust
whose trustees are in Jersey; that trust will then hold
a company in the British Virgin Islands, which in
turn owns the apartment, alongside a bank account
in a branch of a Swiss bank in Singapore.

Assuming criminal tax evasion, which is the guilty
tax haven here? Nobody and everybody, of course.
But that is not the end of the story. Britain (or, to be
more economically precise, the City of London
financial center) runs a series of satellite tax havens,
spread across the world in concentric rings. In the
inner ring are Britain’s Crown Dependencies:
Jersey, Guernsey and the Isle of Man. The next ring
out are the 14 Overseas Territories: the last
remnants of the British Empire, which include some
of the world’s most important small island tax
havens: the Cayman Islands, the British Virgin
Islands, Bermuda, Turks and Caicos, Anguilla and
Gibraltar. These two offshore networks, which are
essentially the last remnants of the British Empire,
are partly British, and partly independent.

Each has its own political system with its own
independent politics, but each has a Governor (or
Lieutenant Governor) appointed by the Queen.
Britain is officially responsible for their foreign
relations and defense, and for their good
governance. The last court of appeal is the Privy
Council in London.

Further out in the web are a number of other tax
havens with ongoing strong historical or

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4 http://taxjustice.blogspot.ch/2012/08/top-us-tax-expert-in-
savage-attack-on.html.
commercial ties to the UK: Hong Kong, Mauritius, the Bahamas, and others.

From Britain’s point of view, this network operates along the lines of a spider’s web, with the City of London at the center. Each haven tends to have something of a geographical focus: the Caribbean havens focus most heavily on North, Central and South America, while the Crown Dependencies will focus most heavily on European business, as well as Africa and the Middle East. They capture huge amounts of money (and the business of handling money) up to the City of London. Just in the second quarter of 2009 the UK received net financing of US$332 billion just from its three Crown Dependencies. Martyn Scriven, secretary of the Jersey Bankers’ Association, describes the relationship: “If I have money to spare, I pass it to the father. Great dollops of money go into London from here.” Promotional literature for Jersey Finance, says it plainly: ‘Jersey represents an extension of the City of London’ (http://www.jerseyfinance.je)

My book Treasure Islands explores the emergence of the modern City of London from the mid 1950s - just as the British Empire was crumbling – with the so-called “Eurodollar” markets, which transformed the City of London as the financial engine at the heart of the British Empire to a ‘light touch,’ deregulated Wild West center, which over time increasingly became fed by the web of British (and other) tax havens around the world. Looking at this from an African perspective, it is not unfair to say that Britain left its colonies by the front door – then stole back in by a side window, retaining a huge influence over, and profiting significantly from, Africa’s international money flows.

It may surprise some people to discover that the United States is also a gigantic tax haven (or secrecy jurisdiction, a term that some of us prefer,) in its own right, thanks to state-level laws that allow the formation of anonymous corporations providing bullet-proof secrecy, and federal laws that for decades have deliberately turned a blind eye to dirty foreign money, often fed into Wall Street by foreign ‘feeder’ tax havens. Bain capital, the private equity firm formerly run by current U.S. presidential candidate Mitt Romney, is one of many that has solicited potentially tax-evading (and perhaps other criminal) money from foreigners, who have typically invested in the United States via funds based in the Cayman islands. Although U.S. taxpayers suffer greatly from offshore tax havens, Wall Street benefits from the offshore inflows—and it is increasingly Wall Street that calls the shots in Washington.

The biggest tax havens, it turns out, are not the small islands of the popular imagination, but the world’s biggest economies. The Tax Justice Network’s Financial Secrecy Index or FSI which combines a jurisdiction’s secrecy score with a weighting for the size of its offshore financial sector, reckoned in 2009 that the world’s five most important providers of offshore financial secrecy were the United States, Luxembourg, Switzerland, the Cayman Islands and the United States, in that order. The subsequent 2011 FSI, which mathematically emphasized the secrecy score than the 2009 index did, gave Switzerland the top rank, followed by the Cayman Islands, Luxembourg, Hong Kong, and the USA. In both cases, however, Britain would have ranked head and shoulders above the others if TJN had, as one might reasonably do, included the British Overseas Territories and Crown Dependencies as part of Britain.

With this short history and analysis, it becomes easier to see why rich countries tolerate tax havens, and why they will be so hard for Africa to confront. We like the money, so we create the secrecy, and we tolerate the tax havens. It is little wonder that the OECD’s efforts to crack down have been such a charade.


But one thing is now changing. Civil society and the public in Britain and other countries are at last waking up to the importance of tax havens, and are no longer content to argue simply that the answer to Africa’s ills is more aid. It is important – essential that African voices also start to become more vocal about tax havens.