tax justice network

The significance and subversion of SDG 16.4

Multinational tax avoidance as IFF

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Thank you and good morning. I was going to talk through a set of technical slides about the ways in which we can measure, or find good proxies for, illicit financial flows. But I am seized of a political urgency to talk to you about something else, so I am not going to use my slides.

The Tax Justice Network, just as background, was established in 2003 as an expert network of economists, lawyers, accountants, political scientists, and a range of other experts, who shared a common sense that the international policy discussions in the areas of tax and financial transparency did not really reflect the scale and the nature of the problems faced – for lower-income countries but also for high-income countries. And over time, that's the agenda that we've promoted, and the policy solutions – which were initially written off as utopian and unrealistic – have come to be the basis of the international policy agenda, and I'll talk through that a little bit.[i]

Worsening inequalities in global taxing rights

But the issue we have is that those policies, although now increasingly discussed and within this agenda on illicit flows also, have not yet been delivered in a way which ensures full inclusion – and so the benefits so far have overwhelmingly accrued to high-income countries. In fact, by only going a certain distance with this agenda we've actually exacerbated the global inequalities in taxing rights that lower-income countries suffer.

Now, the political threat about which I would like to raise the alarm in this forum is an attempt to subvert the global political agreement that underpins the Sustainable Development Goals target on illicit flows. Let me explain.

Biased perceptions of corruption, and the role of financial secrecy

The illicit flows agenda emerged in a fair degree as an opposition to a view of corruption which saw corruption as a problem in *developing* countries overwhelmingly. In 2007 we began to work on the Financial Secrecy Index, which identifies major financial jurisdictions like Switzerland – which typically does very well in perceptions of corruption – as central to the problem of producing and promoting corrupt flows elsewhere.[ii] And if we continue with a narrative that sees corruption in lower-income countries only, we miss this central driver of the problem.

Now the illicit flows agenda, the reason it's important, the reason it's such a big step forward to have it in the SDGs, is that it's exactly a reaction to this biased perception of corruption. It recognises the centrality of financial secrecy to the undermining of revenues, the undermining of good governance in countries all around the world – and rather than saying 'Why is your country corrupt?', it says, 'What are the drivers of corruption?'

And in particular, that's the financial secrecy which is largely in the biggest financial centres of the world, underpinning every major case of corruption that we find around the world, every major case of tax abuse. We find anonymously owned companies, from the British Virgin Islands to Delaware. We find opaque corporate accounting, typically in the biggest stock markets in the world, that cover the degree of profit-shifting and tax avoidance. And we find deliberate failures to exchange financial information that protect, even now, banking secrecy.

The US has played a very important role, as Eric mentioned,[iii] in breaking the Swiss commitment to complete banking secrecy. But Switzerland, like many other countries, has signed up to the OECD's multilateral process for information exchange, without agreeing to provide information to more than a handful of lower-income countries, because they simply don't have the same threat that the US does.[iv] This session is around promoting international cooperation, and international cooperation is key here: to require a fully multilateral approach.

The threat to subvert SDG 16.4

Now the threat is very clear. We see increasingly, not least within the process now ongoing to develop targets within the SDGs on illicit flows, **an attempt to remove multinational tax avoidance** from the definition of illicit financial flows – despite the fact that that is, within almost every estimate we have, the biggest element of illicit flows in most countries. It is the underpinning of trade misinvoicing in many cases, and through work of researchers at the IMF, or us at the Tax Justice Network, and many others, we find it is a bigger problem in LICs both as a share of GDP, and the resulting impact as a share of revenues.[v] And yet: this is now under pressure to be removed from the target.

The remaining problem, I think, is that there is – despite the global agreement following the work of the High Level Panel on Illicit Flows out of Africa, and also the high Level Panel co-chaired by David Cameron, reporting to the then Secretary-General – avoidance is central to the definition used of illicit financial flows, and so when SDG 16.4 was agreed, there was no question that avoidance was included.[vi] But what we see now is an attempt to remove it, by organisations unfortunately including the International Monetary Fund that does not see it as part of issues of significance, but also by very active corporate lobbying.

Where we are left is a position where it is entirely possible that the process to define the target on illicit financial flows may subvert the expressed global agreement contained in the Sustainable Development Goals.

I would like to talk to you about the transparency measures which we could use to construct IFF targets that would ensure accountability in countries at all income levels for their role – rather than simply putting the pressure back on LICs to fight corruption domestically, which is important but insufficient. But those transparency measures really are only of value if we can maintain the agreement that avoidance is a fundamental part of the illicit flows agenda.

At that point, looking at:

- automatic exchange of financial information;
- beneficial ownership transparency of companies, trusts and foundations; and
- ensuring public country-by-country reporting by multinationals, so that the difference between where profits are declared, and where actual economic activity takes places and be managed down;

becomes a viable agenda that will deliver enormous revenue and political governance benefits around the world.[vii]

But if that battle is lost in the definition of the illicit flows target, much of that will be in vain and we'll be looking again at whether the UN can establish a tax commission to take responsibility here for those avoidance issues, having lost it despite the agreement in the SDGs.

Endnotes

[i] A brief overview of progress since the Tax Justice Network's formal establishment in 2003 can be found at http://bit.ly/tjnJC.

[ii] The Financial Secrecy Index is published every two years, and ranks jurisdictions according to the secrecy and scale of their global exports of financial services, on the basis of 48 objectively verifiable indicators. Switzerland currently ranks as the most important financial secrecy jurisdiction. See Cobham, A., Janský, P. and Meinzer, M. (2015), 'The Financial Secrecy Index: Shedding New Light on the Geography of Secrecy', *Economic Geography* 91: 281–303. doi:10.1111/ecge.12094, or open access via http://www.taxjustice.net/2015/06/01/tax-justice-research-bulletin-15-2/.

[iii] Eric Hylton, Executive Director of International Operations, Internal Revenue Service – Criminal Investigations, United States.

[iv] See recent updates on the automatic exchange process, including risks inherent in bilateral approaches, in A. Knobel & M. Meinzer, 2017, 'Delivering a level playing field for offshore bank accounts: What the new OECD/Global Forum peer reviews on automatic information exchange must not miss', *Tax Justice Network/Financial Transparency Coalition Briefing*: http://www.taxjustice.net/wp-content/uploads/2013/04/TJN_AIE_ToR_Mar-1-2017.pdf; and on the Swiss approach at http://www.taxjustice.net/2016/11/28/switzerland-information-exchange-tweak-tweak-something-will-always-remain/.

[v] The term 'illicit financial flows' was popularised by Raymond Baker, an American businessman who was so shocked by the degree of profit shifting by multinationals he encountered while working in a number of sub-Saharan African countries that he subsequently wrote a book, *Capitalism's Achilles Heel (*John Wiley, 2005), and established the NGO Global Financial Integrity to challenge the abuses. In Baker's assessment, grand corruption accounted for just a few per cent of illicit flows, and laundering of the proceeds of crime between a quarter and a third. The largest component by far was 'commercial tax evasion', through the manipulation of trade prices, accounting for around two thirds of the problem.

While Baker (quite reasonably) views all of the latter activity as illegal (and GFI's definition follows from this), it is clear that much that has been labelled multinational tax *avoidance* by others would be included. Baker also sat on the High Level Panel on Illicit Financial Flows out of Africa, which put avoidance squarely at the forefront of their scrutiny: "The various means by which IFFs take place in Africa include abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange." (p.24)

Turning to the estimates of scale, GFI's reliance on discrepancies in *national*-level trade has been criticised for inflating the resulting IFF estimates (see e.g. the work of trade specialists Simon Pak and Volker Nitsch), but the top line findings indicate gross outflows from all lower-income countries of $620 billion to $970 billion in the most recent year. In the meantime, analysis of profit shifting by IMF researchers, and application of the same approach to stronger data by the Tax Justice Network (A. Cobham & P. Janský, 2017, 'Global Distribution

Of Revenue Loss From Tax Avoidance: Re-Estimation And Country Results', *WIDER Working Paper* 2017/55: https://www.wider.unu.edu/publication/global-distribution-revenue-loss-tax-avoidance), indicate revenue losses to developing countries over $200 billion a year. Assuming an average tax rate of 25% would imply that profit-shifting is at least equal to the total of GFI's IFF estimates. Allowing for the possibility either that GFI's estimates are inflated, as claimed; or that they do indeed contain some component of multinational tax avoidance, as seems inevitable; it would then follow that avoidance provides the largest single component of illicit financial flows.

Finally, the same avoidance estimates indicate losses of just a few percent of all tax revenue in OECD, but 6-13% in lower-income countries: a much more significant cost to those countries that have been largely excluded from OECD attempts to reform the deeply flawed international tax rules.

[vi] There are three main reasons why multinational tax avoidance should be considered a central component of IFFs. First, definitional: 'illicit' is not synonymous with illegal'. Any dictionary defines 'illicit' as meaning 'illegal' *or* forbidden by custom. What large scale tax avoidance has in common with evasion, apart from the resulting revenue losses, is that multinationals seek secrecy to hide their actions – in this case through active lobbying to prevent having to publish country-by-country reporting, and through the use of secrecy jurisdictions to obscure key parts of the process. Secondly, as noted, there is a practical reason to include avoidance – it is not only likely to be a large part of the problem of IFF, but may also be disproportionately open to reduction (since only political will is required to ensure profits are declared in proportion to the share of real economic activity in a given jurisdiction). By far the most important reason to retain avoidance within the IFF definition, however, is the political one: there is no question that those signing up to the SDG agreement to include target 16.4, did so in the belief that avoidance was included. Per endnote *v* above, the key texts (the two High Level Panel reports) both contain multiple references to and discussion of avoidance – as did the contemporaneous political discussions. Excluding avoidance now would be a clear subversion of the agreement.

[vii] These three bullet points, the ABC of tax transparency which formed the policy platform initially laid out by the Tax Justice Network in 2003-05, can also provide the basis for powerful indicators for SDG 16.4. There are two risks with currency estimates of the scale of IFF. First, the leading estimates are subject to substantial degrees of uncertainty, given the general data problems in this area, and the specific difficulties of seeking to measure phenomena which are deliberately hidden. Second, the risk of using scale estimates is that the attribution and possibility the accountability would rest only with the country *suffering* the illicit flows. An alternative or complementary approach is laid out in A. Cobham, 2014, 'Illicit Financial Flows Assessment Paper: Benefits and costs of the IFF targets in the post-2015 development agenda', *Copenhagen Consensus Center*: http://bit.ly/CC-PDF. Here it is proposed that each country be monitored according to their performance on the ABC: the proportion of the world with which they have automatic exchange of financial information; the share of their companies, trusts and foundations for which beneficial ownership information is publicly available; and the proportion of their multinationals which are required to publish their country-by-country reporting data. In this way, the SDG target would track the origins of illicit flows, in terms of the enabling financial secrecy – instead of supporting the discredited narrative of corruption as just a lower-income country problem.