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How the Rich Hide Their Wealth: Tax Havens and Capital Flight

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"I believe that banks are more dangerous than armies" (Former US President Thomas Jefferson)

The power and wealth of the biggest banks and financial institutions is one of the most under-reported issues in society. They control so much money, and they can move it between countries so easily, that they can destabilise whole countries. They are part of an exploitative financial system whose consequences are every bit as bad as war, and which contributes to death, starvation, poverty, malnutrition and ill-health on a huge scale. Despite our greater understanding since the 2007 crisis of the problems that unethical financiers can create, there is still little discussion of how banks extract huge amounts of wealth from poor countries.

Tax Havens

A tax haven is a place where anyone can open bank accounts to hide money, usually to avoid paying tax. They are sometimes called secrecy jurisdictions. They are used by big corporations, wealthy individuals, crime syndicates, money launderers, drug dealers, dictators and corrupt government officials from all over the world. They are intended to make it very difficult for tax authorities from other countries to investigate the tax affairs of their citizens and corporations.(1) One recent estimate is that $21 trillion is hidden in tax havens worldwide leading to $189 billion in tax going unpaid each year worldwide.(2)

When most people hear the phrase 'tax haven', they think of places like the Cayman Islands or Panama, but Britain, the US and Switzerland are considered to be the world's most important tax havens.(3) London is at the centre of a global network of inter-connected tax havens in former British colonies. Many commentators in rich countries blame poverty in poor countries on corruption, but corruption at the highest levels could not take place on the scale it does without the assistance of international banks and other corporations from rich counties. The biggest four UK banks, HSBC, Barclays, Lloyds and RBS, have over 1,600 subsidiaries in tax havens.(4) The ten biggest private banks managed more than £4 trillion in 2010, having experienced a huge increase as wealthy people try ever-harder to hide their money from the taxman.

Capital Flight

The theft of a nation's wealth is an extremely significant source of poverty. Leaders from poor countries transfer money into bank accounts elsewhere. This is known as capital flight. In this context, capital is just another word for money. In 1979 when inspectors looked at what had become of money loaned to Nicaragua, they found that three-quarters of it was quickly stolen and deposited abroad by the ruling dictator.(5) It is believed that a similar proportion of all loans to South America are stolen.

Detailed analysis of the wealth of poor countries shows that in most cases, a small number of rich families control most of what is important. In his book, The Blood Bankers, James Henry noted that 14 families controlled over 90% of El Salvador's land and finance. In Nicaragua, one family owned a quarter of all the land suitable for growing crops. The same is true of many middle-income countries, such as Mexico and Argentina. Brazil's stock market was once described as a casino controlled by 15-20 wealthy groups. At the same time, a large proportion of the population live in poverty.

International banks have advised these wealthy people, and their corporations, about hiding their money abroad for decades. This is very profitable for the banks because they know that much of the money is stolen. This enables them to charge fees of 20% knowing that their clients will not complain.(6) In a slightly ironic twist, one of those people who stole large amounts of money from her country, Imelda Marcos, wife of the former President of the Philippines, once said of Swiss banks "It was very easy to put in money there. But it was impossible to take it out."

Banking specialists have pointed out that the amount of money that rich people in developing countries have plundered is almost certainly greater than the total debt of those countries. One expert stated:

> "The problem is not that these countries don't have any money, the problem is that it's all in Miami…We could easily repay our loans to Mexico with their flight capital."(7)

The use of tax havens also affects rich countries. It is estimated that at least £16 billion of taxes are unpaid each year in the UK alone due to tax havens. In relation to Europe, one journalist noted:

> "A solution to the Eurozone's debt crisis might be within reach – if only Europe's governments could get a grip on the wallets of their own wealthiest citizens."(8)

Governments in Rich Countries Assist With These Crimes

Whilst banks are occasionally prosecuted, banking authorities would mostly prefer to avoid trials regarding complex matters like commissions (bribes) and capital flight (as well as other issues like weapons sales) because they do not want the scale of the corruption to come to light. The extreme secrecy laws of banks in Switzerland and elsewhere mean that illegal flows of money cannot be controlled. In Switzerland, people have actually been locked up for telling the authorities about bank crimes.(9) Some politicians talk in general terms about closing down tax havens, but most countries do not want to close down their own tax havens because they make too much money from them, and too many powerful people use them. One commentator from the developing world said that:

> “Switzerland should top the list of most corrupt nations for harboring, encouraging and enticing robbers of public treasuries around the world to bring their loot for safe keeping in their dirty vaults.”(10)

Companies in Rich Countries – Transfer Pricing and Tax Evasion

Approximately one-third of international trade involves one part of a company selling something to a different part of the same company in a different country. This enables them to do what is known as transfer pricing. By changing the prices on these transactions, the company is able to pretend that most of its profits are made in places with low or zero taxes, creating opportunities for tax evasion. This is known as profit-shifting.(11) The scale of lost taxes because of this is estimated to be hundreds of billions of dollars each year. It affects both rich and poor countries.(12)

Big corporations carry out this tax evasion by structuring themselves in complicated ways using subsidiaries, shell companies and holding companies in different parts of the world. News International (Rupert Murdoch’s global media business) paid no tax on its UK operations for many years by using a network of 800 offshore companies, depriving the taxman of an estimated £350 million.(13) Many of the world’s biggest companies, such as Microsoft, Pfizer, ExxonMobil and Citigroup have avoided paying billions of dollars in taxes by using tax havens.(14) Catching companies who are bending or breaking the rules is difficult, but in 2006 the pharmaceuticals company Glaxo Smith Kline paid $3.4 billion to the US taxman for this type of cheating between 1989 and 2005.

There is a simple solution to this type of corporate tax evasion, known as country-by-country reporting (cbcr). This requires that international companies provide information about how much activity they carry out in each country. The idea was created by tax expert Richard Murphy.(15) It is gradually being implemented but there is still much to work out, and big companies are resisting.

Accountancy Firms Are Criminals

Tax havens can be used in much more complex ways. The energy company Enron carried out numerous frauds. One of the world’s biggest banks, JPMorgan Chase, helped Enron design transactions with fake companies in offshore tax havens to create fake profits of more than $1 billion.(16) This enabled Enron to manipulate its accounts and deceive investors and regulators.

Almost all international companies have their accounts prepared by a small number of huge accountancy firms. In Enron’s case, the accountancy firm Arthur Andersen assisted with the frauds. The system of tax havens, tax evasion, money laundering and capital flight could not operate without the active participation of the big accountancy firms.(17)

The Rich Steal From The Poor

If we add up all the money that goes from rich countries to poor countries (such as aid and investments) and then compare it with the total money going from poor to rich (such as capital flight and debt repayments) the net result is that a total of $2 trillion goes from poor countries to rich countries every year. This is the opposite of what most people expect. Rich countries are not helping poor countries. Rich countries are plundering poor countries. Capital flight is the single biggest source of wealth transfer out of poor countries.(18) The combination of capital flight and tax havens is one of the key reasons why poor countries are unable to finance their own development. The World Bank conceded in 2006 that poverty reduction is not feasible without a major crackdown on tax evasion.

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