Tax evasion: the main cause of global poverty

LSE's Isabella Mosselmans calls on Western governments to monitor and enforce global companies to pay the correct taxes in the countries in which they operate.

The OECD has estimated that developing countries lose an estimated 3 times more to tax havens than they receive in foreign aid each year.

Raymond Baker, the Director of Global Financial Integrity, has called it the "ugliest chapter in global economic affairs since slavery".

If you read this article very quickly, only another 28 children will have died from hunger by the time you have finished. Developing countries lack the public resources that would provide the nutrition, healthcare and education to lift people out of poverty.

The banking sectors of London and New York are partly culpable for global poverty Photo: Alamy

Although public opinion perceives that localised corruption in developing countries is the key cause of global poverty, sixty tax havens and the banking sectors of London and New York have much more to account for. While the World Bank estimates that corruption by government officials costs developing countries a significant US$30 billion a year – this is only 3% of the US$900 billion of public funds lost through tax evasion schemes and other illicit practices by multinational companies.

The primary way which money flows out of these countries is through transfer mis-pricing. In its simplest form this entails three steps. Firstly, a corporation working in a developing country sets up a subsidiary in a tax haven. Secondly, they sell their product at an artificially low price to this subsidiary – enabling them to declare minimal profits and consequently pay very little tax to the government of the developing country. Thirdly, their subsidiary in the tax haven sells the product at the market price – for comparatively huge profits coupled with a low tax rate (or none at all). In other words, corporations are manipulating prices to pay minimal taxes. This practice is estimated to account for 60% of capital flight from Africa.

For instance, state-owned mines in the Democratic Republic of Congo (DRC) were sold to anonymous "shell" companies in the Virgin Islands for an exceptionally low price – only to then be sold on at their market price to major listed companies. Such deals cost the DRC US$1.35 billion, which is twice the education and health budget of a country where 71.3% of the population currently lives below the poverty line. The shell companies' owners who benefitted from these dubious transactions remain hidden.

While banks play a critical role in the global economy and many countries' tax systems, many have also played a significant part in facilitating tax avoidance schemes. ActionAid has recently launched a "Clean-up Barclays Campaign" due to their promotion of tax havens in Africa.

Barclays, the largest UK bank in Africa, channels some of its business through tax havens, enabling its clients to avoid tax and consequently deprive poor countries of vital resources. In 2012, 471 of their subsidiaries were listed in tax havens.

ActionAid has two key concerns about Barclays' practices. The first is that their Offshore Corporate division is encouraging investors in Africa to use Barclays in order to benefit from the low tax offshore jurisdictions used by the bank. The second is that the bank's advertising campaigns in Africa are aggressively promoting the benefits of establishing a subsidiary in the tax haven of Mauritius; as a way of channelling investment into Africa through a "favourable local tax regime".

Tax avoidance schemes used by corporations can lead to situations such as that of Marta Luttgrodt, who was profiled by both the Guardian and ActionAid. Marta, a small scale businesswoman in Ghana who runs a beer and food stall, pays more tax than Accra Brewery – a member of SABMiller, which had profits of US$5.6 billion in 2012. Many SABMiller companies, particularly in Ghana and India, operate nearly tax-free because of their use of tax havens.

It is increasingly difficult for under-resourced African revenue authorities to track profits and tax liabilities through a maze of shell companies, holding companies and offshore entities used by investors. Foreign direct investment, instead of acting as a catalyst for development, can harm long-term social and economic prospects – particularly when corporations are reaping developing countries' resources without giving the government its deserved tax revenue.

The Daily Mail and UKIP's recent nationalist pleas to the government to "stop giving foreign aid" seem misplaced when one considers these statistics. The fact is that flows from poor to rich countries vastly exceed those from rich to poor. The OECD has estimated that developing countries lose an estimated 3 times more to tax havens than they receive in foreign aid each year. Rather than cuts to overseas aid, what is necessary is a change of policy towards tax evasion. As Jason Hickel, a Fellow at LSE points out "If poor countries can't reap the multi-billion dollar benefits of their countries' copper, diamonds, bauxite, oil and so on, then how will they stop needing foreign aid?"

Companies can no longer use the "letter of the law" to avoid paying tax. It is the spirit of the law that matters, and laws are rarely made with the intention of helping corporations evade tax.

While in October, David Cameron announced that he would set up a public register on beneficial ownership of companies, this is likely to be no more than a PR exercise if companies are not required to provide any corroborating evidence to prove the validity of their returns. Western governments need to effectively monitor and enforce companies so that they abide by the spirit of the law and pay the correct tax rates in every country in which they operate.

The public and government should support Action Aid's call for Barclays to eliminate all activities in tax havens that do not support the real economic substance of its customers' businesses. They should also be urged to publish details of profits, turnover, staff numbers/costs and numbers of clients, broken down by onshore and offshore activity for each subsidiary and permanent establishment, in each remaining tax haven.

Tax-related capital flight is a problem all over the world. UK and other Western governments have a substantial influence over corporations operating in developing countries – and a duty to help people living in poverty benefit from the tax revenues their government should be receiving.

If the money lost to tax evasion was available for governments to allocate, according to current spending patterns; the amount going towards health services could save 1.9 million children a year. That's 21 fewer children dying in the time it took you to read this article.

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