Chasing hidden cash flows

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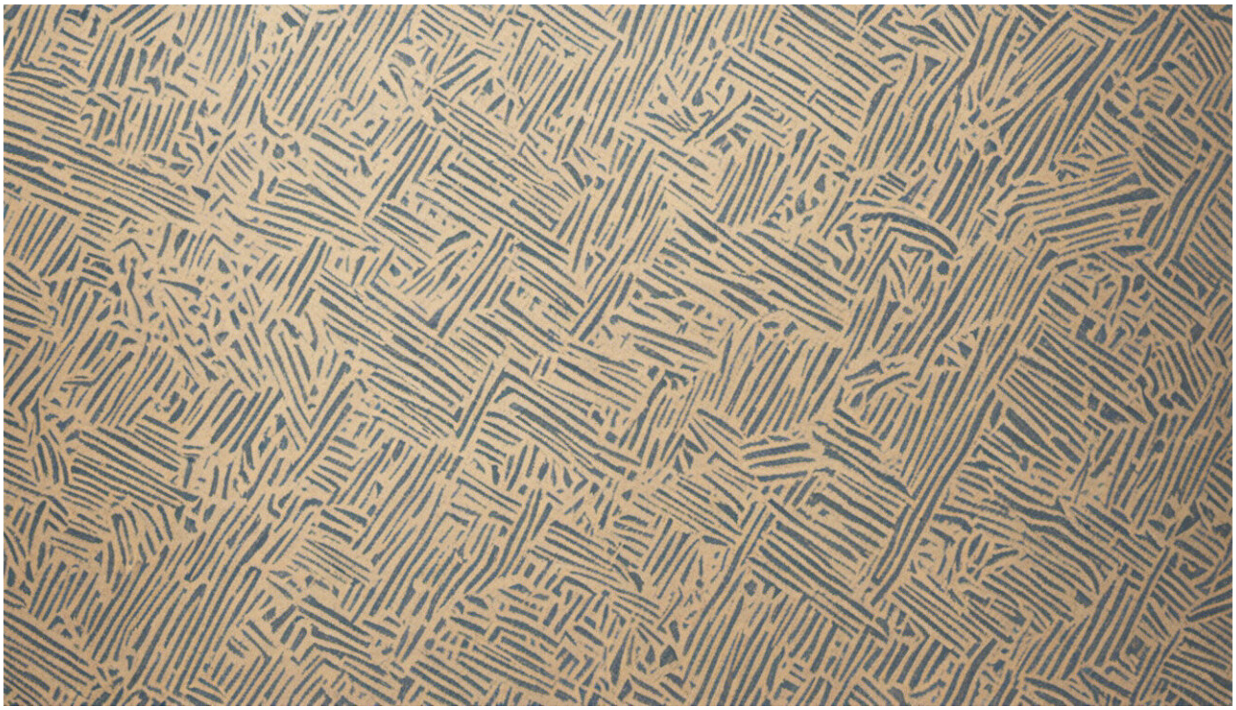

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In global trade, cash flows are hidden to ensure maximum profits. Many developing countries end up as losers in the fight over revenues.

When capital moves across national borders, it also crosses a legal and regulatory no-man's land. Different countries have different tax rules and only exchange information to a limited extent. Global companies with operations in many countries take advantage of this situation. With the help of tax havens and powerful international banks and law firms, revenues disappear as if by magic. Capital is redirected in order to minimise taxes and optimise the companies' profits and competitiveness.

'Such cash flows are often called global wealth chains,' says Leonard Seabrooke, Professor of International Political Economy at Copenhagen Business School in Denmark. He is project manager for a group of 14 researchers from a number of countries. They're currently mapping how capital moves across national borders in international trade. The research project has been given the name STEAL (Systems of Tax Evasion and Laundering: Locating Global Wealth Chains in the International Political Economy).

How global wealth chains arise and function are key issues in STEAL, which is being conducted by the Norwegian Institute of International Affairs (NUPI). The Research Council of Norway has allocated NOK 6.4 million to the project over four years. Project manager Seabrooke says there is a great need for more knowledge about how capital moves across national borders in today's globalised economy.

More and more international transactions take place in multinational companies that operate all over the world. Many choose to register their businesses in tax havens that offer zero tax rate and have laws that prevent other countries' tax authorities from gaining access to information about them.

Global wealth chains co-exist with global value chains. The latter show the value that is created when a commodity is manufactured; from idea, purchase of raw materials and production until the product is sold on the market. Global wealth chains make sure that the big profits do not end up where the value is created, but in the pockets of the global companies and their associates, instead.

Severly affected

Many developing countries are particularly affected by global wealth chains. Access to great natural resources and cheap labour means that many they are important suppliers of input factors in international trade. The value of the goods that are exported does not match the value of the assets that remain behind. Calculations indicate that developing countries lose up to ten times more than they receive through international trade.

These countries are stuck at the bottom of the food chain and do not receive enough revenues to be able to strengthen public institutions and establish a well-functioning tax collection system. This prevents growth and development, and it means that developing countries end up as losers in the global economy. The hidden economy also leads to corruption and the laundering of the proceeds of crime.

Instead of the capital flowing back to the system, where it is needed for new investments and welfare development, it flows up to the top of the system, to wealthy capital cities like London, Singapore and New York, where there is already more than enough capital. Global wealth chains promote inequality and prevent fair distribution,' says Seabrooke.

In order to correct this inequality and ensure that a greater proportion of the profits stays where the value creation takes place, statutory regulation that leads to greater transparency in international trade is needed. These countries' authorities need tools that enable them to follow the wealth chains and levy taxes on value creation in their own country. Politicians and public institutions involved in organising international trade need more knowledge about how the informal wealth chains manage to move capital beyond the reach of the tax authorities. Through the STEAL project, the researchers aim to find out more about these connections and to give organisations and the authorities a better basis for making good decisions.

Uncovering wealth chains

The STEAL project has one main goal and four sub-goals. Its primary goal is to identify the global wealth chains and describe how they work in the interplay between international companies, tax havens and developing countries. Afterwards, the researchers will carry out a complete tax analysis of the cash flows in the global wealth chains and explore the connections between developing countries and tax havens. They will also analyse the potential effect of statutory regulation on tax havens and developing countries.

The main players in the global wealth chains are global industrial giants and tax havens. They are helped by the world's biggest international commercial banks, the most powerful international accounting and auditing firms, and a handful powerful law firms. What they have in common is that they want as little openness and transparency as possible. Consequently, access to open sources of information is therefore limited. Those tax havens that make money from serving as a postal address for the companies have adapted their legislation to prevent the rest of the world from gaining insight and to ensure that those engaged in global trade have maximum freedom of manoeuvre.

Seabrooke is assisted by a broadly composed international team of researchers. Virot Ali of Thammasat University in Thailand is looking at Singapore's role in global wealth chains. Don Marshall at the University of West Indies in Barbados is looking more closely at how tax havens operate, while Attiya Waris of the University of Nairobi in Kenya is studying tax evasion mechanisms in developing countries. In all, 14 researchers from Asia, Europe, Africa, Oceania and America are participating in the project.

In order to gain access to information, the researchers use both open and closed information channels. Seabrooke and his colleague Duncan

Wigan, Assistant Professor at Copenhagen Business School, are developing theoretical models for global wealth chains and mapping their structures and connections. They are also looking at the methods used to transfer and conceal assets to evade taxation. The research team is collecting and analysing quantitative data and interviewing key players on the international financial arena.

Unorthodox methods

Seabrooke also says that they are using unorthodox methods to gain access to information.

'We have a researcher on our team who assumes different identities when he contacts international trade players by email. By posing as a businessman, for example, he can be offered a chance to take part in tax evasion. This gives us insight into the methods that are used. Our research shows that many people are willing to circumvent the law on behalf of their clients. They can just as easily work in the City of London or New York as Nairobi in Kenya. Economic crime in global wealth chains takes place in both industrialised and developing countries ,' says Seabrooke.

The STEAL project started in 2012 and will run until the end of 2015. Seabrooke and Wigan say that new knowledge about how global wealth chains operate is essential if we are to close the legal gaps in international tax policies and achieve a fairer distribution of value creation.

'Politicians need the best possible basis for developing effective laws that ensure that multinational companies are subject to reasonable taxation. Our job is not to propose new legislation but to develop a good factual basis,' says Seabrooke.

Provided by The Research Council of Norway