Secrecy jurisdictions and economic development in Africa

"Secrecy jurisdictions and economic development in Africa: the role of sovereign spaces of exception in producing private wealth and public poverty"

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**ABSTRACT**

This article reviews the scope and function of secrecy jurisdictions and includes new research data on their extensive use by development finance institutions to deliver official development assistance. In order to establish what this empirical data means in terms of economic development, the article builds a theoretical model of secrecy jurisdictions as constructed spaces of exception and exemption. It then reviews how different economic paradigms explain, analyse and assign normative values to secrecy jurisdictions/tax havens, noting that the neoliberal account proffers ideological assumptions which problematise empirical verification. This article argues that the most robust evidence available indicates that secrecy jurisdictions lower ‘onshore’ rewards to national stakeholders, and critically shrink the fiscal base required for sustainable economic development. Further, the article argues that the extensive use of secrecy jurisdictions by development finance institutions sponsors an elite financial class in recipient countries, but otherwise undermines development based in economic justice.

**Key words:** secrecy jurisdictions, neoliberalism, official development assistance, extractive industries, development finance institutions, political economy of development
1 INTRODUCTION

Over the last thirty years, approximately since the onset of the global debt crisis of 1982, global financialisation has been a key conditioner of economic policy in developing countries. For many, the constant threat of bankruptcy has been ameliorated by progressively lax taxation and capital controls on foreign capital, in a desperate attempt to attract hard currency investment. Deregulation has characterised financial, trade and capital markets. The financialisation of the global economy has meant the spread of complex capital structures, the further internationalisation of capital markets and derivative financial instruments, the growth of debt finance and equity finance, and the controlling role of financial funds over productive enterprises (see Saad-Filho and Johnston, 2004; Hildyard, 2008), often using layered structures of domicile which incorporate an offshore tax haven or secrecy jurisdiction. This offshore world of ‘parallel universes’, of tax haven-based subsidiaries (Desai 2005, 188) contributes to the ever growing divergence of ‘book profits’ (communicated to shareholders) and ‘accounting profits’ (communicated to tax authorities). The offshore economy allows “profits to be moved across space, from country to country, and across time to bring forward book profits while pushing back tax profits” (Sharman, 2010: 7), making secrecy jurisdictions, not marginal, but central to the global economy (Maurer, 2008: 160; Palan, 2010: 4). It article argues that a review of research on secrecy jurisdictions, organised by competing paradigms, shows the empirical evidence to be relatively incommensurate across paradigms, but also that the neoliberal case is unconvincing on the criteria of economic justice and development. In which case, the primary research here, which documents the extensive use of secrecy jurisdictions by development actors, unsettles the claims to efficacy of public aid to the private sector. This article argues that secrecy jurisdictions are the global economy of choice for capital-holders, and that the offshore, and its use by development
Secrecy jurisdictions and economic development in Africa institutions, is inimical to development conceived as a national, inclusive and pro-poor social endeavour.

We explore the meaning and function of secrecy jurisdictions in section 2 below. In section 3 the various schools of theory in relation to secrecy jurisdictions are outlined, while in 4 the role of secrecy jurisdictions in supporting the creorder, or making of, globalization and economic development in Africa is explored (to borrow Nitzan and Bichler’s term, 2009) In section 4 the article argues that the apparent hegemony, normalised and necessitarian ‘science’ of neoliberalism (Hay, 2004: 500), belies the workings of modern markets in many ways, and secrecy jurisdiction are a good exemplar of the contradictions of market making in practise. Neoliberalism is conceptualised here as an aspiration whose underlying assumptions need to be made and remade (see Hay, 2004) through the construction of harmful business practices and the creative use of sovereignty (as explored by Picciotto in his ‘legal fictions’ (1999) and Palan in his early work on the haphazard entrenchment of tax havens (1998, 1999, 2002)). Secrecy jurisdictions are central to this work of market formation, as they contain institutions which help the wealthy skew markets in their favour, by sponsoring extractive structures and extroverted investment and corporate value chains which deepen wealth inequality and extract surplus to the detriment of endogenous and geographically proximate economic development.

2 SECRECY JURISDICTIONS

There is an ongoing debate about correct terminology, and the common terms in use – ‘tax haven’, ‘secrecy jurisdiction’, and ‘offshore financial centre’ - have their own etymology and policy consequences. The term ‘offshore financial centre’ is more likely to be used in uncritical, or normatively neutral literature on secrecy jurisdictions (for a further discussion of terms see Palan et al, 2010; Heggstad and Fjeldstad, 2010: 6). However, following the Norwegian Government
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Commission report (NOU, 2009) this article uses ‘secrecy jurisdiction’, defined by two central characteristics of secrecy and differential tax regimes for non-nationals. More specifically, a secrecy jurisdiction:

i) makes special provision in company law for non-residents, often called exempted companies or international business companies, in order to accommodate activities which are carried out elsewhere, which then give preferential benefit to those not resident within their territorial domain;

ii) allows companies to carry out their affairs in secret through the use of these ring-fenced company forms and various exemptions from normal corporate reporting requirements, such as disclosure of beneficial ownership and public reporting of accounts.

Both features serve to undermine the rightful interests and rights to information of third parties in other sovereign territories, while undermining the tax base of other sovereign actors (see NOU, 2009, 9, 12). This use of sovereignty undermines the rule of law exercised through the sovereignty of others.

However, to territorialize the nature of what is of concern to policy makers in secrecy jurisdictions is not helpful in some respects, as it is harmful structures, rather than geographic territories or countries that are core to the definition. Similarly, the terms ‘onshore’ and ‘offshore’ serve little theoretical purpose as the representation of a secrecy jurisdiction as a small offshore island is only tangential to its characterisation, although the image of a small exotic place does confer, in the geographical imagination, a more marginal economic importance than is actually the case, a boon for advocates of their use. Monitoring the specific harmful structures of concern, rather than the sovereign territory as a whole, has been fruitfully pursued by the Financial Secrecy Index, whose
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emphasis on procedures means that many ‘developed’ countries, such as the UK, that traditionally have not been perceived as secrecy jurisdictions, are included on their list. Thus ‘tax haven’ is a territorially based concept but it speaks to a juridical institutional arrangement.

Secrecy jurisdictions facilitate fictional or juridical domiciles for capital, rather than *de facto* abodes, in Palan’s words forming “the sovereign equivalent of parking lot proprietors”, not concerned with the business undertaken by customers, “only that they pay for parking their vehicles there” (Palan, 2002: 152). Palan’s work calls to mind earlier contributions in the Marxian tradition of economic geography, beginning with the seminal Harvey on fixed and fictitious capital (1982), and later Roberts, who initially linked together ‘fictitious capital’, the financialisation of the 1990s, and the growth of offshore markets (1995). Similarly, Hudson wrote of secrecy jurisdictions in an early contribution, as being an exemplar of Massey’s theory of the social construction of space (1998), where far from globalisation inevitably leading to competitive devaluation of fixes spaces, secrecy jurisdictions were theorised as being a construction of trust rules by varying actors, which could be only partially subject to the competition which might undermine this trust. Hudson developed this by adding the insight that in secrecy jurisdictions, sovereignty is ‘unbundled’, maintained as a legal moment, but relinquished in terms of fiscal powers, making secrecy jurisdictions both marginal and central in the global economy, and again, space as constructed, within a ‘postmodern’ geo-political economy (2000). These early theorisations draw on a ‘relational theory of space’ (which Sheppard, 2004, 473, attributes to Leibnitz), where space is both a product of the political economy system (see Swyngedouw, 1992), but also constitutive of economic, political and economic processes (Castree, 2002, 191, citing Harvey 1997), which remains a useful conceptualisation for explaining the offshore moment of accumulation. Unsurprisingly, the concept of fictitious capital is enjoying a revival at present in its application to
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processes of financialisation in the environmental offset, species and carbon markets (cf Igoe, 2010, Sullivan, 2010), which illustrates that the ephemeral spaciality of finance capital remains central to understanding the contemporary global political economy. This article explores the relative fixity for mobile capital offered by secrecy jurisdictions and the effect of this on the political economy of development [and for pressures of space leaves the efficacy of the concept of ‘fictitious capital’ per se to another article].

Secrecy jurisdiction governments adopt a strategy of the commercialisation of state sovereignty taking advantage of their main asset, “the right to write the laws” (Palan, 2002: 151; also Slemrod, 2008), in order to attract capital seeking low or zero taxation, often using double taxation agreements. The services they offer attract firms who are ‘jurisdiction shopping’, where “juridically dispersed subjects [MNCs] have learned to take advantage of the fiction of their fragmentation by rearranging their legal existence in ways they see fit”, such that international tax planning means “the planning of whichever aspect of their “reality” corporations or wealthy individuals are prepared to reveal at whichever location” (Palan, 2002: 172). The motivations which lie behind the creative use of domicile in complex ownership chains are thus related to the distribution of reward, and this article explores where this leaves African investors, fiscal authorities, workers and consumers in finding their just reward for invested capital and labour.

Sharman, developing Desai’s characterisation of the ‘parallel universe’, and Palan’s idea that tax havens allow firms to ‘have their cake and eat it too’ (Palan, 1998; cited in Sharman, 2010: 3) notes that their chief contribution is the ‘pursuit of calculated ambiguity’ on three significant empirical axes: allowing, simultaneously, high and low profits; debt and a debt-free balance sheet; and foreign and local ownership. Specifically:
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“Individuals [and firms] may preserve the advantages of asset ownership while diversing themselves of the liabilities [through Asset Protection Trusts]; offshore subsidiaries may allow firms to report high and low profits [using shell companies]; firms may raise loans but avoid taking on debt [using Special Purpose Entities]; and the same investment can be foreign and domestic [through ‘round-tripping’]” (Sharman, 2010: 3, 8).

This allows firms to “give diametrically opposed but legally valid answers when responding to the same question from different audiences” such that the calculated ambiguities generate handsome dividends for some (Sharman, 2010: 2), and low rewards for others, coming close to “their ideal world” of high profits for investors and zero or negative profits reported to tax authorities. Thus secrecy jurisdictions provide the economic infrastructure, legitimised through the ‘science’ of economics and ‘necessarian neo-liberalism’, with which wealth accumulation is externalised, which in turn undermines the state-building project in Africa by disallowing the territorial fiscal base.

Scope of secrecy jurisdictions

There are now, depending on the definition, between 46 and 60 tax havens housing about two million international business companies (IBCs), and thousands if not millions of trusts, mutual funds, hedge funds and captive insurance companies. Palan et al assert that about “50% of all international banking lending and 30% of the world’s stock of Foreign Direct Investment (FDI) are registered in these jurisdictions” (Palan et al, 2010, 5). This money stock is joined by roughly $12 trillion in wealth ‘belonging’ to very rich people (ibid), or ‘high net worth individuals’ (HNWIs), or ‘permanent tourists’ (PTs). This degree of domicile in secrecy jurisdictions leads to an estimated tax loss of USD 50 billion a year to tax havens or “six times the estimated annual cost of achieving universal primary education, and almost three times the cost of universal primary health coverage” (Oxfam, 2000). Put another way, it is the equivalent of USD 160 billion per year in lost
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corporate taxes which is more than one and a half times the combined aid budget of USD 103.7 billion in 2007, and enough to fund the MGDs by 2015 (Christian Aid, 2008). This tax loss is expressed against the hypothetical amount that these companies would be liable for if they were domiciled in the country of actual economic operations. This was also recently estimated for the European development finance institutions (EDFI) portfolio as in excess of €430 million a year on average over the last five years (Murphy, 2010). Bracking et al, using data from 29 of Norfund’s 81 principle companies for 2008, and just 10 for 2009, calculated that the tax loss for developing countries was over USD 14.6 million and USD 21.6 million respectively, calculated by comparing actual tax paid with a counterfactual variable of what Norfund would have paid if they had been domiciled in the same jurisdictions as their operations, rather than in a secrecy jurisdiction [see endnote 1] (Bracking et al, 2010: 26).

The importance of secrecy jurisdictions to the global economy is due first, to their centrality in the private equity market and second, to their use by companies for tax planning. The larger part of the former is offshore, made up of funds managed or owned by financial investment managers who oversee company acquisitions, cross-investments and mergers, and who decide which firms, and more broadly, economic sectors, prosper and which not, by their fund allocation decisions. Funds have a varied investor base; of firms, large institutional pension funds and mutual funds; as well as funds of flight capital, totalling USD 206 billion in registered funds (IMF World Economic Outlook database); perhaps another USD 641-979 billion in illegal capital flows (Kar & Cartwright-Smith, 2009); and between USD 11-12, 000 billion in 2004 (Tax Justice Network) in placements from high net worth individuals (figures from NOU, 2009: 11). Recent cases of limited disclosure suggest that only around five per cent of the latter has been declared for tax purposes in the country from which it has come. These monies are joined by some DFI funds intended to sponsor
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development, which for those European institutions for which we have sufficient data –Swedfund, Norfund, and CDC - constitute from around half, 77 per cent and definitely the vast majority, of their funds respectively (Bracking, et al, 2010: 11).

Investment and company structures with a submerged offshore component have an effect on the nature of profitability, draining value offshore through the liability of the underlying companies to management fees, leasing fees, and technical assistance fees and so forth to the holding company or equity fund providing the investment to the onshore operation. Profits are transferred to a parent through the three processes of tax arbitrage, transfer pricing and the deferral of home-country taxation (for the US case, see Desai et al, 2006a). These processes partly explain the counter intuitive observation that many mining companies in developing countries apparently never make a profit, but continue in operations regardless, and when sold achieve a high price. For example the Disputada copper mine in Chile, which sold for $1.8 billion in 2002, even though it had not formally made a profit for 23 years and owed $500 million (Riesco et al (2005) summarised in Murphy 2010, 176-179). In Africa, the ‘missing profits’ are of particular concern as whole sectors, such as gold in Ghana, or oil in Nigeria, tend to deliver the rent assigned through the respective ‘Mining Code’ or oil regulations, but beyond that, the companies are perennially and singularly unprofitable, such that the capital gains tax provision across Africa nets only very small returns. Counter Balance summarise that the ability to raise direct taxes is between 2 and 6 per cent of GDP in poor countries, compared to between 12 and 18 per cent in developed countries (Counter Balance, 2009: 6, citing SOMO, 2008: 2-3).

3 DIFFERENT THEORETICAL VIEWS OF SECRECY JURISDICTIONS
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However, scholars quite fundamentally disagree with the consequences of the data reported above, or the role assigned here to secrecy jurisdictions in reproducing poverty, tax avoidance and unjust profits management. Although there is supposedly a clear legal difference between tax evasion and tax avoidance, with the latter being legal, the reality is complex, and many economist support tax avoidance and tax arbitrage, which exploits the differences in rates between jurisdictions, as efficiency measures. Companies perform ‘international tax planning’ in order to exploit the loopholes in bilateral double taxation agreements, go ‘treaty’ and ‘jurisdiction shopping’ in order to get the ‘best deal’, and generate ever more complex company structures to maximise profits globally. Given this context, some see secrecy jurisdiction regulations as commensurate with other competitive taxation regimes used by governments to shape, support and develop manufacturing, industrial and service sectors. The fiscal part of such policies is called a Preferential Tax Regime (PTR) which includes a wide variety of means to attract ‘mobile’ capital, and although restricted in Europe for purposes of competition policy, is still legal. A strategy which routes income through a secrecy jurisdiction to avoid tax liability is a more extreme version of a PTR, where mobile capital is ‘captured’ through a booking function, and where the jurisdiction acts as a repository of a contractual relationship. Supporters of PTRs, and in development, of manufacturing enclaves or Export Processing Zones (EPZs), which have systematic tax privileges in order to sponsor enclave industrialisation, argue that they are merely an expression of rightful competition. There is a sense in which secrecy jurisdictions are similar to EPZs, but are tailored for the financial services sector, rather than for the manufacturing sector. However, secrecy jurisdictions are also different in the two important respects of their i) secrecy rules and ii) that the competitive provisions they make are for people who don’t, in the main, live there. It is significant that they are legislating for non-nationals (NOU, 2009) because of the effects on the sovereignty of others: secrecy jurisdictions are places of exception from the sovereignty of the end invested
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country. The debate on secrecy jurisdictions is found across a large number of variables, involves complexity and contested normative values, and sits on an unsettled research base: it helps to present it within differing economic paradigms.

**Orthodox efficiency paradigm**

For a libertarian or neo-liberal, juridical spaces of exception are acceptable in the pursuit of efficiency, which they believe maximises the public good in the long term. This concurs with the mainstream business view that legislative capacities are being used in a rational, utilitarian manner, and that any negative effect on the fiscal base can be easily offset against the market efficiency gains. Business views low taxation in secrecy jurisdictions as a Tiebout-type efficiency, preventing states from abusing their monopoly position in an exchange relationship to society (excesses of tax, corruption, graft and so forth). Indeed promotional literatures on offshore financial centres’ services are often framed in a rights discourse, and stress their role in protecting the wealthy from predatory regimes. For example, the Botswana International Financial Services Centre, established as a ‘tax haven’ in 2003, describes itself as the ‘Switzerland of Africa’, and in the business of ‘wealth preservation’ (2010). Supporters of secrecy jurisdictions also depict them as being specialist service providers, as “professional, well functioning finance centres” with “political and economic stability, standardisation of language, a tailored legal framework” such that “double taxation of international operations are easier to avoid” (Heggstad and Fjeldstad, 2010, 6). Others stress the importance of the legal structure (Antoine, 2002), and in particular, a specialist legal infrastructure for solving disputes between shareholders. In short, using secrecy jurisdictions represents a rational advantage-maximizing strategy for firms, and there is really no *a priori* need for a normative position, although one might be found in the view that secrecy jurisdictions are service providers which protect the rights of the wealthy.
In development terms a variant of the efficiency argument is often used by development finance institutions (DFIs), whereby secrecy jurisdictions are seen to contribute to a higher level of investment by increasing the effective return on investment (see Desai, Foley and Hines 2006a). In the emergent ‘positive’ school of economic analysis of secrecy jurisdictions, summarised by Dharmapala (2008), (with seminal work in Desai, Foley and Hines, 2006a, 2006b; Hines, 2006, 2007; and Hong and Smart, 2007), there are two claims made about secrecy jurisdictions. First, that their governance is superior to non-secrecy jurisdictions as they are less corrupt and have better political and legal systems, particularly for solving shareholder disputes (Dharmapala and Hines, 2006; Dharmapala, 2008, 2). Kaufmann, Kraay and Mastruzzi’s (2005) governance index, embedded in composite measures of institutional quality is most commonly used (see Dharmapala and Hines, 2006).

Second, that while there is tax avoidance by corporations (Desai and Dharmapala, 2006, 2009), there are circumstances, which are further modelled in Dharmapala (2008), where this is efficiency enhancing. Citing evidence that tax revenues in major industrial countries have exhibited ‘robust growth’, Dharmapala concludes that this is not only despite FDI flows to tax havens, but because these flows enhance efficiency and mitigate tax competition (2008, 1). The model relies on a number of assumptions that might be non-replicable in developing countries – that corporate tax will be passed on to workers, that companies can freely move, and that increased taxes on non-mobile capital will be the effect of lower taxes on mobile capital – such that more research in a developing context would be required to make these results robust. But even if replicable, the ‘positive outcome’ entails the view that “havens enable high-tax countries to impose lower effective tax rates on highly mobile firms, while taxing immobile firms more heavily” (2008, 3).
This outcome is of dubious developmental value as the burden of tax would then be born disproportionately by local investors in the manufacturing and industrial sectors with fixed capital investments; sectors which are essential to growth in employment in developing countries. Moreover, as in Dharmapala and Hines (2006), the theory of optimal taxation in the model assumes that in an open economy a government should not levy “any source-based tax on foreign investors (Gordon, 1986). [because] The burden of such tax would be shifted entirely to domestic workers in the form of lower wages as investors demand higher pretax rates of return” (Dharmapala, 2008, 5). This is an odd assumption to underlie a model of tax efficiency since it implies that taxing the wealthy or powerful, including firms in relation to workers, is always and everywhere to be abandoned as futile before it is attempted. Also, in practice, workers partially resist such pressure which makes the results of this model less than robust. Moreover, governmental development agencies and civil society organisations often support measures to ‘capture the gains’ of leaving more value from production at the base of corporate production chains, particularly in the form of higher wages (see Barrientos, 2008). If DFIs view the tax efficiency of secrecy jurisdictions as enhancing development, in terms of this model, they would be relying on the assumption that corporation tax is not possible as it can always be passed on to workers who cannot mount effective resistance.

In the ‘positive school’ there are a number of papers, which each incorporates a different set of conditions, under which the existence of secrecy jurisdictions is portrayed as beneficial for the MNCs’ home countries, regardless of the effect overseas (Keen, 2001; Hong and Smart, 2007; cited in Dharmapala, 2008, 13-16). Keen’s model relies on the idea that preferential tax regimes allow governments to set preferential rates for mobile capital, and higher rates for immobile capital,
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thus avoiding a standard rate for all firms. Overall, this is then said to raise the effective tax rate overall. This argument might hold for developing countries, but it has still allowed a globalised financial sector to amass rents relative to national capital, an effectively destabilise the world economy. It is of doubtful worth to poorer countries which have a smaller fixed capital base in the first place, do not have many large mobile firms of their own, and who have differently structured fiscal revenue.

For example, as FitzGerald shows, the indirect tax pressure in Africa is approaching the world average rate of 8 per cent of GDP, but income and property tax pressure is only half of the developing country average (FitzGerald, 2010, 9). Thus taxes on capital gains and income from mobile capital investments are already very low comparatively and highly competitive in efficiency terms. This has not caused a surfeit of supply side response in the past from foreign firms, but has narrowed the developmental impact of FDI. FitzGerald argues that savings “are not the key constraint on investment in Africa, [since] Capital flight (up to a half of African private assets) is evidence of private savings surplus” (FitzGerald, 2010, 13). He cites Keen and Mansour (2009) to the effect that tax incentives to investment are ‘too high’ and “need coordination and scaling back to prevent ‘race to the bottom’” (FitzGerald, 2010, 13). Thus instead of the causality in the ‘positive school’ for secrecy jurisdictions, which relates the supply of mobile investment directly to tax rates, other authors, like FitzGerald, would instead see “infrastructure, institutions, uncertainty” as having causal primacy (ibid).

Hong and Smart (2007) propose a ‘positive school’ model where governments are assumed to be incapable of discriminating between immobile domestic entrepreneurs and foreign investors, but still conclude that secrecy jurisdiction use by MNCs lowers the firms’ effective tax rate and “makes
them more willing to invest in the nonhaven for any given statutory rate” (summarised by Dharmapala, 2008, 14). Thus again, here is the logic of efficiency in tax competition leading to a supposed positive supply response from capital markets. However, from a normative developmental perspective, this would not, even if it actually happened, hold as ‘efficient’ below a floor rate of offering MNCs ‘efficient’ investment opportunities for nothing, or even with public subsidy and permanent tax holidays, which has occurred in the past. There are structural issues which condition investment patterns and the rewards or losses of them to society: a government could subsidise at such a price that the investment represents a net loss to society as a whole.

While these efficiency arguments rely on the movement of profits from a high tax country to a lower one – which is sometimes portrayed as a defence against punitive taxation and greedy government – in the DFI variant tax does not feature so centrally. The research being reported here, in which senior personnel in key European DFIs were interviewed in 2010, shows that DFIs advocate the developmental efficiency of secrecy jurisdictions (Bracking, 2010). This is because they believe that by domiciling their investments there, they can attract independent private partners to augment the funds, since they are providing the domicile of choice for, and of, the private partners (see for example, CDC, 2008; Järlund and Lundbom, 2009; Rosencrantz & Co, 2010). For Swedfund, private equity funds augment their invested capital in a ratio of 1 to 10 by attracting independent investors (Rosencrantz & Co, 2010, 3), and 71 per cent of these funds (by number, not value) are domiciled in secrecy jurisdictions (Bracking et al, 2010: 11). CDC reports a ratio of attracting private investors of 1:0.81 for its publically-owned portfolio, and 1:2.3 for Actis and its remaining funds in aggregate (Bracking et al, 2010: 12; derived from CDC, 2008). Figures such as these are used to demonstrate that secrecy jurisdictions generate much needed capital for developing countries because they attract investors to private equity funds, providing, as Desai et
al (2006a) point out, higher returns for higher risk. This argument is combined with references to political stability, legal surety, low corruption and a comparatively good quality of bureaucracy. Norfund have pointed out that Mauritius is attractive because of its low corruption and predictable and stable business environment (NOU, 2009, 53). Similarly, Kjell Rolland, Managing Director of Norfund, has argued that while a robust policy on tax havens is required, it must not have the effect of disrupting these critical funds to developing countries (Development Today, 2009a, 2009b). Unfortunately, the efficiency paradigm has little to say about how the indigenous private sector is undermined by the efficiency gains enjoyed by others, as the onshore tax base shrinks, and the burden of tax they bear grows; potentially offsetting any marginal increases in FDI supplied from secrecy jurisdictions overall.

**Post-neoliberal paradigm**

The OECD began the current wave of concern about tax havens in 1998 with its report on harmful tax practices. As Palan et al show, this report was embedded in a neoliberal view of the benefits of globalisation to open competitive markets, and secrecy jurisdictions were seen to undermine competitiveness (2010). As Chavagneux had earlier suggested, there were contradictory elements to this position, and the OECD report, somewhat inadvertently, eventually opened the door to a paradigm shift toward a post-neoliberal position within the orthox economics school that secrecy jurisdictions were actually market distorting, rather than efficiency enhancing (Chavagneux, 2009).

What Dharmapala (2008) refers to as the “traditional ‘negative’ view” was formally modelled economically by Slemrod and Wilson (2006). In this heterodox, post neo-liberal paradigm, secrecy jurisdictions become morally reprehensible and are seen as an institutional platform to assist companies and individuals to avoid their responsibilities in terms of declaring wealth or adhering
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to principles of corporate social responsibility (CSR), as the figures generated of lost tax by Oxfam and Christian Aid reinforce (see above). Obviously there is an assumption here that releasing these funds would actually lead to spending in social areas, but these reports were seminal in encouraging a tax justice momentum in development NGOs, alongside the Tax Justice Network, which advocates global fiscal transparency and country-by-country company reporting in order to end the tax injustice caused by secrecy jurisdictions (Christensen, 2009; Murphy, 2009; Christian Aid, 2008; NOU, 2009). Pressure on development finance institutions to withdraw from secrecy jurisdictions has also grown, with a Counter Balance report on the European Investment Bank (EIB) concluding that it had ‘false pride’ about it development contribution and instead facilitated tax evasion to the detriment of developing country citizens who “are landed with debts and other liabilities while their states do not build up their fiscal capacity” (2009, 23).

ActionAid develop this analysis and argue that essential public services in developing countries are necessary for poverty reduction, and that increasing governments’ ability to collect tax is key to meeting this challenge. ActionAid calculate that if “all developing countries were able to raise just 15 percent of their national income as tax revenue, they could realize at least an additional USD 198 billion per year”; an amount exceeding all foreign aid and enough to meet or even exceed the annual MDGs funding gap (ActionAid, 2009: 5). ActionAid also cite Global Financial Integrity (GFI), that between USD 471 billion and USD 506 billion left developing countries as a result of transfer mis-pricing in 2006 alone; and the Tax Justice Network (TJN) estimate that governments across the globe lose USD 255 billion annually in tax revenues from high net worth individuals, based on the likely income earned on some USD 11.5 trillion of assets held offshore (ActionAid, 2009: 5-6; see also NOU, 2009; Palan et al, 2010; and on the Netherlands, Weyzig and and Van Dijk, 2007).
The reality of these figures is well illustrated, and perhaps better appreciated, by case studies. For example, in a recent *Private Eye* account of an Australian gold mining company, Mineral Deposits Ltd, funded by the CDC through a private equity fund in Mauritius to mine in Senegal, the immorality of the business structure of private equity is put into sharp relief (Private Eye, 2010). In this, the Mauritius companies facilitated a movement of wealth out of Senegal (where the company nominally never makes a profit, and which has a 30% tax rate) to the order of USD 12.4 million in tax-deductible “technical assistance” fees; USD 11.1 million in 2009 for the leasing of mining fleet equipment; and USD 42 million in tax-deductible interest payments on loans to the offshore parents. In short, Mineral Deposits Ltd paid just USD 45,000 in tax in Senegal, while benefiting from tax exemptions of USD 14.6 million (Private Eye, 2010). Supporters of the view that development is achieved in this way need to offset this revenue loss in Senegal using the argument that without this structure, the foreign direct investment would not arrive at all; that the USD 425,000 a year promised by Mineral Deposits Ltd for social programmes would be arrested; and that jobs would not be created; and that this combined would make Senegal worse off. An increasing number of civil society organisations in Africa, notably the ‘Keep the Oil in the Soil’ network, and Third World Network-Africa (TWN-Africa) to name just two, have reviewed such structures and conclude that the net effect of these investments is negative. But the issue is hotly contested, and much private sector development funding by DFIs globally goes to mining and energy, which are assumed to create growth and ‘development’ (see Bracking and Ganho, 2011 on how DFIs measure development). DFIs often make a counterfactual case that they are supporting firms that would otherwise not have the ability to invest in emerging and developing markets, despite that many firms receiving funds are global multi-nationals who enjoy significant surpluses from other markets and are not capital poor. However, notwithstanding a number of such
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contradictions in DFI accounts of their investment strategy, the private equity model of investment, combined with secrecy jurisdiction domicile, has wide support among DFIs and private firms alike.

In summary, the narratives which are used to explain the necessarian nature of secrecy jurisdictions have strong precedents and overlaps with those which justify the necessity of neoliberalism more generally. Similarly, normative alignments on secrecy jurisdictions are commensurate with those on neoliberal and heterodox approaches to economics. A heterodox reading would be that secrecy jurisdictions reduce the fiscal base in developing countries, encourage capital flight and criminality, and cost lives through exacerbating poverty. In short they are an abuse of the rules and codes of sovereignty and the social contracts which are politically crafted within this legal infrastructure. In contrast, a neoliberal or orthodox view would characterise secrecy jurisdictions as a legitimate and utilitarian use of legislative capacities to attract business; an EPZ for finance, and a specialist international service centre. In the next section we explore what functions secrecy jurisdictions play in the building of neoliberal market structures.

4 NEOLIBERAL ASSUMPTIONS AND THE ROLE OF SECRECY JURISDICTIONS

At the core of neoliberalism, summarised by Colin Hay, is a “confidence in the market as an efficient mechanism for the allocation of scarce resources” combined with beliefs in the desirability of free trade, free capital mobility and a non-interventionist state, excepting the promotion of private companies in public projects (Hay, 2004, 507-8). We saw in the last section how the use of secrecy jurisdictions for capital, and the avoidance of tax, is justified by its advocates using similar propositions: because it allocates resources effectively (by bringing additional FDI to Africa which would not be invested otherwise); because secrecy jurisdictions are important nodes in the global free market infrastructure; and because offshore funds are often
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used in support of public private partnerships, private sector development (PSD) interventions and 
in order to support global multinationals in African industrial and infrastructure markets.

Indeed, secrecy jurisdictions themselves are a kind of public private shared space in which issues 
of ownership of wealth, domicile arrangements and ‘tax planning’ are carried out in negotiations 
between different partners to ‘development’. In this characterisation they conform well to 
Hudson’s theorisation of a socially constructed place (1998). For example, the Commonwealth 
Development Corporation has about 86 per cent of its equity funds, by number, while Norfund has 
approximately 77 per cent of their portfolio by value domiciled in secrecy jurisdictions (Bracking et 
al, 2010: 11; Bracking, 2010). These funds are then used to support investments in African markets 
in investee companies, or underlying portfolio companies, with other investors and funds. The 
development finance emanating from the European states is thus channeled predominantly 
through secrecy jurisdictions, in order to be pooled with other private investors, and then on-lent 
to the private sector ostensibly to sponsor social and economical outcomes consistent with a 
development remit (see Bracking, 2010). Thus the public and private meet in secrecy jurisdictions 
within the political economy of development in a quintessential way: not just to establish different 
narratives for different audiences on ‘book profits’ and ‘tax profits’, but ultimately to decide on 
the distribution of reward to foreign and domestic investors, workers and consumers, while 
pursuing the equally important role, for owners of wealth, of equating business interests with 
development interests through the conduit of the benevolent equity fund. The effort provides a 
development ‘wash’ for private capital, although there has been a growing critical interest in the 
integrity of such practices by NGOs, particularly those mentioned above. However, the highly 
polarised views of secrecy jurisdictions are embedded in the different and competing economic 
paradigms we explored above, and these differences are also evident in work on PSD.
What is evident broadly in the contending paradigms is that the heterodox representation uses empirical data that records outcomes and consequences: lost tax, extractive company structures and emasculated governments. The neoliberal representation, by contrast, contains a bundle of aspirational propositions of how certain economic groups would wish the world to be; which are nonetheless countered by empirical evidence of the failure of the global economy to match these characteristics; but which, despite the evidence, “deliver a spurious necessity to economic policy choices” (Hay, 2004, 521). Hay provides a typology of the core assumptions of the inevitability of neoliberalism in terms of five propositions: first, that capital invests where return is highest using perfect information to do so; that markets are fully globally integrated such that national economies have to be competitive to sustain growth; that capital has perfect mobility with no disinvestment costs; that minimising labour costs and relocating to the lowest taxation regimes invariably means greater returns on investment; and that, consequently the welfare state and tax represent lost capital to mobile asset holders, with no perceived gains to them (Hay, 2004, 520). In this way, states are undermined in their central function of delivering development by arguments that suggest it is inevitably counterproductive to pursue taxation. Secrecy jurisdictions, in the positive school, are synergistic to this representation; the inevitable result of the inevitable and fundamental freedoms of a neoliberal economy. However, they are also constructed places of exception to welfare conventions, such as tax, which would disturb the interests of capital holders, and in this they make each of the aspirational assumptions above - the pretended realities - more realisable: they make the kind of market that capital holders want by means of the habitus they construct for finance.
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In terms of the first proposition, capital invested through secrecy jurisdictions can maximise its return after tax, by creatively relocating domicile, while this process undergirds the further internationalisation of capital, enhances mobility and undermines the welfare state and the fiscal receipts required for African development. Moreover, the type of economic growth generated by the secrecy jurisdiction equity fund privileges elites in various judicial enclaves of relaxed regulation. It is not so much a bifurcation of sovereign space, wherein global competitive pressures can be responded to while the state’s legal sovereignty is preserved in the ‘remainder of its domain’ as theorised by Sharman (2010: 12), so much as the creation of a ‘colander state’ with so many small portals of exception in the infrastructure of regulation. Thus MNCs use secrecy jurisdictions to route their investments through subsidiaries domiciled there; have ‘inverted’ company structures such that valuable income earning assets are stored offshore; indebted their onshore firms to their offshore firms to generate losses and even tax credits; or re-domicile their management, internal banking or equipment leasing functions with the same tax-avoiding effect. The result is the low book profitability of enterprises in countries where elites choose to build a social democratic state formation: the MNC is using a parallel constructed domain in which to store value, while navigating territorial sovereign domains through portals of exception to the national social contract, breaches in the collective regulatory frontier of the state. Thus, different spaces are being creatively rearranged and socially constructed, using the flexibilities found in sovereign domicile law, to produce deliberate ambiguity by the powerful, through their use of secrecy jurisdictions. This, in turn, serves to reduce their accountability in the face of demands for economic justice and social development.

Economics of displacement
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There is always a methodological challenge when researching the absence of something – in this case invisible or displaced capital flows – particularly when the empirical evidence is subject to ‘commercial sensitivity’ that allows the wealthy to privatise it [see endnote 1]. In secrecy jurisdictions, the displacement of the upper echelons of economies have been notionally ‘moved’ to territories which act as privatised jurisdictions, or places of exception in terms of a unitary theory of sovereignty. But studies of the economics of displacement are generally in the context of ill-connection, social exclusion and shadow structures developing through crisis, “reshaping patterns of production, accumulation and exchange” (Hammar, 2010, 266; see Hammar et al, 2010), in places such as Somalia, Southern Sudan, Eritrea, Congo, Sierra Leone, and Zimbabwe (see Jones, 2010). But elites also displace their wealth, economic and financial relationships, in periods of crisis and also of ‘normalcy’, moving assets outside the country, often using secrecy jurisdictions. This form of extraversion allows elites to ‘hook-up’ with DFIs and European venture capital funds, with equity funds and illicit wealth, in order to re-manifest their own selves back in the domestic economy as (wealthy) ‘foreign investors’, with all the privileges that usually accompany this classification (termed ‘round-tripping’ when applied to the funds they own).

Sharman notes that research on the consumers of offshore services are scare (2010, 16), and so is research on the type of political economy which generates the demand for their services, and in turn, on the effect of capital re-domicile on the sending political economy. Some broad contours of motivation can be modelled from ‘normal’ investor behaviour: there is extra profitiability and for some it is part of a process of egress in the face of crisis or predatory government. Industrial strategies of displacement, some more legal than others, include thin capitalisation (where the domestic company is under-invested relative to the offshore parent); inverted company structures (where the bulk is kept offshore, with an onshore shell); transfer pricing; multiple accounts,
offshore accounts, offshore record keeping; and re-domicile in a booking centre or tax haven (Heggstad and Fjeldstad; 2010; citing US Permanent Sub-Committee on Investigations, 2006; 2008). The national economy is reshaped accordingly as wealth is displaced by economic elites (and criminal groups), such that even the business transactions of large firms are ‘informalised’; a characterisation usually reserved for the residual small trader economy, but fitting here when used to describe trade between company forms in which not even the beneficial owners need be publically named or accounts published.

North et al suggest, in their research on the political economy of governance reform, that privileging the economic elite is counter-productive to political development (2009). Private equity and DFI fund investments arguably do this, increasing local inequality, particularly in relation to elites in patronage dominated societies, who become reinforced economically, making it even harder to achieve positive change in reducing corruption and strengthening the rule of law (ibid). North, Wallis and Weingast outline some conditions for making the transition from an elite dominated natural state to an open access order which has the ability to reduce the inequality gap, as well as satisfy basic rights. Enhancing existing elite structures is unhelpful, unless it leads to the development of institutional arrangements that enable elites to create the possibility of impersonal intra-elite relationships (North, Wallis and Weingast, 2009: 26, 158). Thus, a political economy of positive change would be more horizontally and locally embedded, suggesting that the DFIs, with their development remit, are simply working in the wrong jurisdictions.

In southern Africa the structural duality and enclave nature of many political economies, the legacy of colonial intervention, is being reproduced by the greater embedding of neoliberal aspirations (as above) by economic actors working in secrecy jurisdictions. Significant nodes of exchange have been externalised and displaced, including key firms in capital, investment and
commercial banking markets, leaving a flat web of horizontal exchange at the level of the ‘everyday’ economy. The displacement is accompanied by informality, wrought through geographic displacement and territorial re-domicile; and this in turn manifests in the use of arbitrary ‘law’, only minimally related to sovereign precedent, as in many current ‘land grabs’ (see Cameron and Palan, 2004; Agnew, 2005; Ong, 2006; Leander, 2008 on changing meanings of sovereignty).

Statistics on cross border illicit money flows are scarce, but have been estimated in aggregate at USD 1 to USD 1.6 trillion annually, half flowing out of developing countries (Baker, 2005). Dev and Cartwright-Smith (2008) put illicit money flows from developing countries at between USD 800 billion and USD 1 trillion by 2006 (cited in Palan et al, 2010, 173). Secrecy jurisdictions are an expeditious destination, not least because of the difficulty in identifying beneficial owners in the international business companies and special purpose vehicles used by private companies and DFIs alike. There is also evidence of a ‘revolving door’ whereby public loans leave developing countries as private assets, with sometimes up to 80 per cent of the initial value of public debt finance turning into flight capital (Heggstad and Fjeldstad, 2010, 2, citing Ajayi and Khan, 2000; Boyce and Ndikumana, 2001; Cerra et al., 2005; Ndikumana and Boyce, 2008). In sum, the offshore economy reduces the efficacy of national business regulation, national accounting and fiscal regulation, while facilitating money laundering and illicit expropriation of resources including development assistance.

5 CONCLUSION

The nature of the private equity market and its widespread use of secrecy jurisdiction domicile suggest a number of questions which remain inadequately addressed in terms of African economic development. The data on the use of secrecy jurisdictions by development actors, facilitated by
the research reported here, also raises a number of questions more specifically concerned with models for building private sector development in Africa. First, is the macro-economic issue of whether private equity funds, and development finance institutions more specifically, are using this model of company ownership and domicile with the result that critically needed capital flows to African economies are augmented, as the orthodox case would claim, or are drained offshore in capital flight, as the heterodox economists and (re)formed mainstream ‘post-neoliberals’ would assert. The empirical evidence is weak in support of either case, but the review above suggests that the second reading is more viable. Second, is the issue of whether development finance institutions, which employ public money and which should thus prioritise a popular good, are unwittingly invested with money that should have already been delivered to government coffers elsewhere, at least in part, or criminal or laundered money. Third, in structural terms, are DFIs contributing to funds which attract savings out of developing countries and thus contribute to capital flight? Or, in a variation of this question, contributing to money laundering through the facilitation of ‘round tripping’? These questions remain under-researched due to two characteristics of the current research funding map: that it concentrates on the deficiencies of African markets in a national context singularly, occluding international aspects of the political economy of development; and that Northern actors, including DFIs and the private sector, have avoided critical review as they are themselves central in the financial-intellectual epistemic community.

What we do know it that there is a distributional injustice in the private equity model of investment with secrecy jurisdiction domicile, because it privileges the earnings of the ‘international’ investor (public and private) over other national and local stakeholders (Bracking, 2010; see also Oloko, 2010). Thus the political economy of development that secrecy jurisdictions
help sponsor is one which augments wealth inequality and undermines economic accountability through increased opacity and the pursuit of calculated ambiguity. The weight of the limited evidence that exists tends to the conclusion that DFIs cannot currently guarantee their integrity in terms of investment partners; that their evidence for the development benefit of PSD initiatives is weak (see also Bracking and Ganho, 2011); and that they are not exercised by adverse political economy effects (Bracking et al, 2010).

Industrial and infrastructural development in poor countries remains critically constrained but central to development prospects. Yet there is a dearth of research on the relative economic multipliers for growth of offshore as compared to onshore investments. However, there is research that demonstrates that long term sustainable development would be enhanced if embedded investments were made in the sovereign national economy (see Addison, 2010; Chang, 2002; Di John, 2010; Spratt, 2009: 297-335). Also, successful developers have been those countries with benign and directional ‘developmental’ states (Chang, 2002), not countries where the infrastructure of the private economy is designed to circumvent and undermine them. The conclusion here - although some links in it, by necessity, have been made through deductive argument, case studies and consequential associations rather than direct quantitative evidence - is that corporate and DFI use of secrecy jurisdictions is stunting economic and political development in Africa. Also, theories of necessary neoliberalism represent this use as normatively benign, in a standpoint derived from aspirational propositions held by capital holders (modelled by Hay, 2004). However, this is a political view, since the ubiquitous promoter of neoliberal markets is a social form that combines private equity with secrecy jurisdiction domicile in a politically constructed, and in some senses virtual, ‘offshore’ space. This temporal-fix and ephemeral construction of interests simultaneously builds private wealth and public poverty; its ‘common sense’ is synergistic with the assumptions of neoliberalism; and in turn makes these more existant.
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In weaker states this has the consequence that many large firms and individual HNWIs have displaced their firms, and parts of their legal existence outside their countries of domicile, with detrimental consequences to the state’s fiscal income. The specific contribution of this article has been to show that the constructed space they occupy is also the habitus of public investors of development finance, who carry a similar world view - wrongly believing that the way they invest in development is morally right or at least the best that is possible (Bracking, 2010).
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Endnotes

\(^1\) The data on DFI domicile is the product of new research funded by the Norwegian Agency for Development Cooperation, a full report of which is contained in official documents no. 0902364-55 (The Report), and no. 0902364-54 (Evidence & Appendices), referred to here as Bracking et al (2010) and Bracking (2010) respectively. The research reviewed current literature on secrecy jurisdictions, interviewed senior personnel in DFIs, and used two data sets, supplied by Norfund and Swedfund, containing the annual, and sometimes quarterly, company reports of all currently invested companies of the same for 2008 and 2009. NORAD’s financial support is gratefully acknowledged but the opinions here are solely the responsibility of the author. Unfortunately, company identifiers are subject to 10 year Non Disclosure Agreements with both Norfund and Swedfund, which restricts the public reporting of the complete research, while some company accounts supplied did not contain sufficient variables to contribute to the aggregate calculations, such as for tax losses.