MNC, Africa and tax cheating

by Dapo Ladimeji (MA. MBA. FCA. CTA)

Africa receives large amounts of Aid from rich countries, most of which comes with extensive and substantive strings attached. At the same time a much larger amount of tax revenues are lost from the behaviour of Western MNC's. Christian Aid in its report, 'The Shirts Off Their Backs', quoting a Brookings Institution report, suggests that $500 billion a year is lost by developing countries due to tax practices of MNC's. They may well have understated the problem. At a meeting at the Commonwealth Society in Jan 2006 just one western company was found to be evading tax in Africa by at least £180m per year. When challenged the senior executive who had inadvertently revealed this information defended his company by saying that the pressures of the stock market demanded this and that if their competitors were doing the same they had no choice. There is no official of any western stock market who will support the suggestion that the stock market encourages let alone requires tax evasion. In fact they will insist that the stock market requests genuine operating profit for valuation and if it discovered that the profits were manipulated by tax evasion there would be a significant downward revaluation. Clearly the defense by the western executive was worthless. On the one hand rich western countries support their companies evading African taxes by billion of dollars while on the other hand they then give back a small proportion of that loot but now with the option of inflicting political control over African governments.

What is important at this stage is to understand the tax environment where all is not as it seems. There are two kinds of tax evasion: tax prejudice or tax discrimination and simple tax dilution/evasion. Too many of the uninitiated think of tax evasion as simply optimising profits but this is not necessarily the case. Often a company has a choice as to where it will show its profits either in Africa or in its home country, say Holland. For example it may have earnt $300m in profit and pays $90m in taxes. It may have a choice of showing proifts of $150m in Holland and $150m in Africa. If it did this then $45m of tax would be paid to African countires. However if it showed $250m profit in Holland and $50m in Africa it will pay only $7.5m in taxes to Africa and $22.5 in taxes to Holland. The Chief Executive and Board of Directors of the Dutch company may well feel from either nationalism or hatred of or contempt for Africa a preference to pay more tax to their homeland than to Africa. It should be clear that this decision neither increases nor decreases the overall tax burden of the company so that neither profit maximising nor the demands of the stock market can be used as an explanation or defense. The other kind of tax evasion is where tax is evaded in Africa and not accounted for in their home country. In order to achieve this often unusual accounting practices are required and opportunities for pure corruption and diversion of money arise. Enron, Halliburton, ITT and other mnc's have clearly demonstrated the opportunities that can arise for graft, bribery, corruption of government officials and corporate theft.

Many Africans and supporters of Africa mistakenly believe that nothing can be done and that the situation is inevitable given the power of mnc's. Nothing could be further from the truth. In order to appreciate this one must understand the tax environment. Where one mnc avoids taxes in a territory then the others feel a competitive need to imitate and not allow their competitor to achieve an illegitimate advantage. However when all the mnc's begin to evade the local taxes another factor comes into play. It is obvious to the companies that if none of them are paying taxes the local economy will be unsustainable. At this point the companies begin to cut their long term investments and play short term strategies on the assumption that the economy is about to hit a crisis. Their collective lack of investment and rapid extraction of funds accelerates the oncoming crisis from some time in the future to a near term certainty. As each mnc seeks to gain advantage from the coming collapse a 'race to the bottom' in terms of investment and corporate behaviour ensues. The impact of a loss of confidence by the business community in a local government's tax strategy is seldom addressed by international agencies and advisers.

In fact the role of foreign advisers requires closer scrutiny. Many official international aid advisers give one set of advice in their official papers and another 'face to face' with government officials. They advise that the local economy must relax its tax regime to encourage foreign investment, and in effect advise them not to enforce most of the taxes that are on the books in order not to 'frighten' foreign investors. But as shown above a failure to collect tax leads to a loss of confidence and very negative corporate behaviour. But what is worse is that the taxes imposed by Africa would be credited in the mnc's home country so that it would make no difference to the mnc's overall tax burden. The role of these international advisers cannot be explained merely by a wish to increase the benefits to their home country. What they are doing harms Africa far more than it benefits their home country if it benefits them at all, so that one can only conclude that their motives are simply evil and contemptuous (see 'Confessions of an economic hit man' by John Perkins). These international advisers are paid for by foreign governments and major foreign institutions and have no accountability to the country they are advising. If one looks at their advice which is basically to reduce the regulations and taxes on foreign mnc's they are basically recommending African governments to become pimps offering their people up for the pleasure and exploitation of foreigners. The advisers justify their proposals on the basis that the ensuing economic growth will then benefit the majority of the people. But this is exactly the argument of all pimps, people traffickers and modern day slavers. Temporary prostitution/ slavery will allow you to save money to do more respectable things later - but as with all pimps, people traffickers and modern day slavers - it turns out impossible to save money and the so-called and much promised economic growth never materialises.

What then is to be done about this by patriotic legislators? Having investigated this I have discovered that much to my surprise the solutions are neither complicated nor hard to implement. First and foremost the legislator must ensure that the tax regime is enforced fairly - that all mnc's and local companies pay their taxes and that there is no individual favouritism. Once that principle is established then the business community can act as assistant enforcers by being encouraged to privately denounce any business that is violating the rules. In a truly competitive market any company that is seeking to gain advantage by failing to pay taxes will incur the wrath of its competitors who can then be relied upon to wish to seek the end of this unfair advantage. The second step is that product markets must be made truly competitive. Venal foreign advisers focus on the need to reduce taxes and regulations as means of encouraging FDI. But this deliberately ignores the main barrier to entry for competitors which is the network behaviour of incumbent producers. It is the ability of incumbents to frighten away FDI that needs to be addressed. Incumbent producers are those foreign companies that have been operating in the market for many years and have developed close political and often corrupt relations with domestic power brokers. They use their influence to have laws passed that are discriminatory to new entrants, to establish connections with institutions that grant licences and deal with the importing and distribution infrastructure that can be used to deter new entrants. In Africa most product markets are dominated by a small number of producers who have been in the market for decades, often dating from before independence. An effective legislative response is to target key product markets and offer infrastructure subsidies to new entrants on condition that they commit to the domestic economy for a number of years. A mere offer of subsidies for infrastructure to new entrants will have the effect of signalling that the government is committed to fair competition, to eradicating barriers to entry and to nullifying any negative network behaviour.

This mention of infrastructure brings us to the third item. Far more valuable to companies than tax breaks are infrastructure. Tax affects only a proportion of their profits while infrastructure affects all of their costs. Further, infrastructure is by its very nature best viewed as a public good and publicly funded. The advantage of infrastructure subsidy is that if the original target company leaves the infrastructure remains to attract other new entrants whilst a direct tax subsidy vanishes with the so-called investor. Parts of our major cities should be set aside for 'export sectors', 'multimedia producers', 'hq administration' with the most modern appropriate infrastructure established. The costs can be recovered not as a dubiously collectible tax but directly recoverable rent. Infrastructure subsidy represents an opportunity for the central government to provide upgrades to local services that are particularly relevant to a new entrant but which should be available to all companies, domestic or foreign.

Let us consider the implications of the above three initial steps. Fairness and self policing by the business community will lead to greater transparency of the tax regime and greater uptake of tax revenues. Greater competition will lead to greater investment because once there is a competitive market then commpanies will have to lower their costs which can only be done by establishing better capital investment, increased training of local staff, cutbacks in the excessive number of foreign 'consultants' and their excessive remuneration and localising as much technology and knowledge as possible to take advantage of the low local labour costs. Training and turnover of staff will lead to a diffusion of modern management and technical knowledge throughout the economy.

A final step for a patriotic legislator is the creation of a viable and sustainable tax policy. Throughout the world countries with 'no tax' i.e. tax havens are characterised as having low population with low or nil infrastructure. High tax regimes are characterised as having highly educated and professional workforce, larger populations and sophisticated infrastructure. The high tax is a negligible issue in the context of the high value addded provided by the population. Work on genomics or space research requires scarce human resource talents and high quality communications infrastructure. Tax rates are a minor irrelevance for such enterprises. Most African countries have large populations, poor infrastructure and undervalued human resources that are often self-exporting to places where they are valued. If the infrasturcture is tragetted by establishing specific zones in cities where appropriate infrastructure exists then new companies will arrive and soak up talented local human resources which will cease to be self exporting. This implies a medium overall tax rate, sufficient to pay for the infrastructure upgrades. Large populations have two effects upon an appropriate tax policy: there is an economic requirement to encourage job creation/employment and the tax revenue focus should be shifted from profits to employment taxes. Employment taxes can be efficiently collected and from the employer's point of view are generally considered as part of the employment costs i.e. not refunded in the case of losses. To increase local employment one has to target the value added of the labour force rather than seeking to lower wages. To increase their value added it is necessary to steeply increase the training. In many mnc's the yearly training for senior managers costs far more than that spent on their entire tertiary education by the home country. Tax policy should encourage employers to provide such training to their local managers. Encouragement can be provided by establishing and subsidising state of the art training facilities thus encouraging the establishment of local training policies with top rated training staff flown into the local economy rather than senior staff always sent abroad. The economics of training are such that once a trainer is sent to a country it is more efficient to provide as much training to as many people as possible whilst the trainer is there. For overseas training the high costs of travel and accomodation, disruption through non-availability of staff, determine rationing of such scarce resources. Additional levies can be placed on companies that do not provide training to ALL their management staff or some similar policy.

To summarise the main points: tax policy is important and should be considered in the context of creating competitive local product markets. Foreign advisers are often venal - I have attended meetings of the International Fiscal Association (the main body of international tax experts) where western professional advisers have said it was OK to cheat Africa of its taxes because they would only waste the money anyway! Finally, foreign governments take more away by colluding with their national companies to avoid African taxes than the strongly tied Aid they give back and so it is a political imperative to correct this tax anomaly and regain our fundamental political independence.