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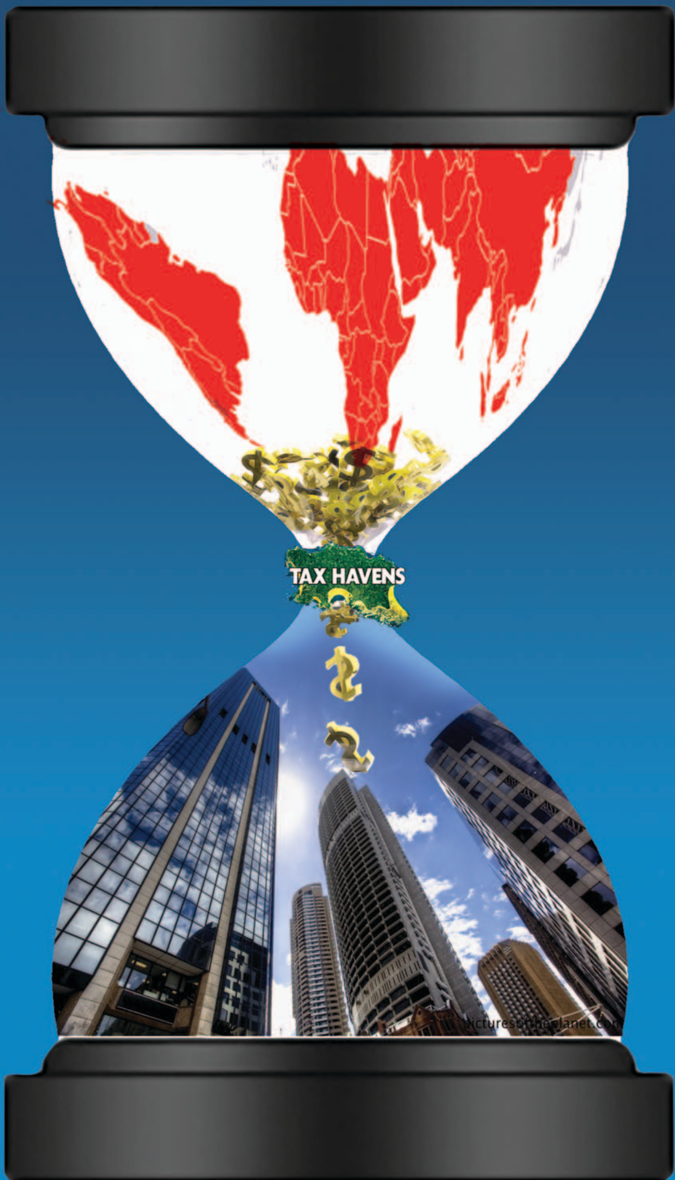
Siphoning the South's resources

Transnational corporations, transfer pricing and tax evasion



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Editor's Note

WESTERN governments, specifically those in Europe, appear to have recently discovered that many transnational corporations are paying little or nothing by way of corporate income tax to their national coffers. As public outrage mounts with media revelations that huge corporations such as Google, Starbucks and Amazon have been using a variety of devices to reduce their tax bill to a minimum, the authorities have been put on the spot after being forced to admit that such tax-evasive devices are perfectly legal.

While Western governments have sought to deflect public anger by feigning moral outrage, attempts to feign ignorance on how this state of affairs came about are less than convincing. After all, it was Western governments, led by the United States, which instituted the current regime of international taxation that has permitted such abuse. As the well-known international tax expert Lee Sheppard reminded us in a *Forbes* article, it was 'the United States [that] imposed the so-called "international consensus" on the taxation of multinational corporations on Europe 50 years ago'. But whatever misgivings Europe may initially have had, they obviously did not last long. Through the Organisation for Economic Co-operation and Development (OECD) – the 34-member 'rich man's club' of nations based in Paris – the US and Europe have jointly been striving to impose this model on the developing countries.

The reason why the rich countries have been so strident in pushing this model is not difficult to understand. As Sheppard explained in another piece, 'The purpose of the OECD model … was to make life comfortable for American, British, German, and French multinationals by ensuring that the taxation of their operations by host countries is limited by separate company accounting and the permanent establishment concept.'

'Separate company accounting' requires the host country to treat the dealings between a transnational corporation and its subsidiaries in different countries as if they were transactions between separate independent companies, i.e., at arm's length. The problem here is that transnationals have long been engaged in the practice of 'transfer pricing', i.e., they price the goods or services traded within the company upward or downward, depending on whichever is beneficial to them. For example, if the taxation rates are lower in the country to which the transnational is exporting to its subsidiary (or better still, if the country is a tax haven), then it is in the corporation's interest to price the goods or services lower so that more of its profits lands up in the low-tax or tax-free jurisdiction. As a result of such tax-evasive practices, developing countries which have hosted transnationals have sustained huge losses in revenue.

The situation is made worse by the 'permanent establishment concept' of the OECD model. By conferring greater taxing right to the country where the transnational is permanently resident rather than where its profits are mainly derived (i.e., source country), the model unfairly grants an exorbitant privilege to the rich country from which the transnational originates, at the expense of the developing-country host.

Developing countries led by the BRICS nations such as India, China and Brazil have now begun to resist the attempts to impose the OECD model on them. The main international forum which they are promoting as the alternative has been the United Nations Committee of Experts on International Cooperation in Tax Matters. To be sure, the composition of the UN committee is hardly representative of developing-country interests. Of its 25 members, only 13 are from non-OECD countries, the remaining 12 being from the OECD countries or their nominees. But despite these weaknesses, it is a far better alternative than an exclusive club of 34 rich countries. What the developing countries have been trying to do is bring this committee into the UN intergovernmental process which would afford them a greater voice and representation. However, the move to elevate the committee into a UN intergovernmental commission is being fiercely resisted by the rich countries, which are intent on preserving their dominance.

While this battle continues, it is painful to reflect that the issue of regulating at the international level the operations of transnationals to ensure that these are not detrimental to the developmental aspirations of Third World countries, has almost faded into oblivion. And yet, for almost two decades from the late 1960s when transnationals burst into the international economic arena, it was these countries which led the debate on this issue, ably supported by the work of the United Nations Centre on Transnational Corporations (UNCTC) after its establishment in 1974.

However, with the ascendancy of neoliberalism in the late 1980s and the adoption of policies of liberalisation and deregulation of all capital flows into the developing world, the UNCTC became a casualty of the paradigm shift. Since then, other than the fight by developing countries at the UN tax committee, it has been left to a handful of non-governmental organisations (NGOs) and activists, many of them in the Western world, to expose the tax-evasive ploys of transnationals and advocate alternative taxation systems such as unitary taxation to replace the current OECD model.

Our cover story, while taking as its point of departure the current uproar in the West over tax evasion and tax havens, seeks to put the issue in the larger perspective of the impoverishment of the South as a result of such activities. While we also highlight the battle to establish the UN as the international body to set the norms on taxation and the proposals for alternative systems of taxation, it is our hope that this whole debate will force developing countries to reconsider the paradigm shift in the development model which has given rise to this impoverishment.

– The Editors

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The current uproar in the West over transnational corporations' tax-dodging practices (picture shows a protest against Starbucks in London) **highlights a problem which has long plagued developing countries and cost them billions of dollars a year in tax revenues.** **14**

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ECOLOGY

Lao dam tests Chinese company's resolve on standards

Although its dam projects in the Upper Mekong region will have serious ecological and human impacts, the positive development is that China's Sinohydro corporation has at last adopted an environmental policy consistent with international standards, says *Grace Mang*.

EARLIER this year, I had the opportunity to travel down the Nam Ou (Ou River) in northern Laos. The purpose of my visit was to assess the impacts of seven dams soon to be built by the world's largest hydropower company in this pristine and remote Upper Mekong region. The Nam Ou hydropower cascade is a large project by any measure, yet almost no information is publicly available about the dam plans and projected impacts. The dams' developer, China's Sinohydro, has not publicly released any documents about the project. International Rivers, the organisation for which I work, decided to travel the river to get information first-hand.

The Nam Ou is one of the biggest and most important tributaries of the Mekong River and critical for its fisheries. The region's remoteness meant that little study has been conducted in this basin. Above Phongsali, the largest town in the region, indigenous communities rarely see outsiders, let alone foreigners. The only way to travel here is by boat.

The region's remoteness has, however, not been an obstacle for the Chinese state-owned Sinohydro Corporation, which has been investigating options for a dam cascade since 2007. In April 2011, the Master Agreement for seven dams was signed. In Sinohydro's words, the Nam Ou is the 'first time that a Chinese company can obtain the development rights toward the whole river basin.' Under the terms of the deal, Sinohydro will build and own the dams for 25 years before handing them over to the Laotian government. After initial plans for the power to be sold to Thailand fell through, Laos now says that the dams will help meet the power demands of northern and central provinces, with the rest to be used for powering a high-speed rail link between China and Laos.

But what about the communities that will be affected – what do they think about the planned dams on their river? I found that villagers were certainly aware of the projects, but in many cases did not know the Laotian word for 'dam' or what a hydropower dam might look like. In fact, the first time they had seen a dam was the illustration on the cover of International Rivers' Laotian language report, 'Dams, Rivers and Rights'.

Many of these people live in villages that had been established for decades – and in a few cases, more than 200 years. All communities rely on the river for transportation and thus communication with the outside world. The river also provides them with food, and electricity from self-installed pico-hydro turbines.

There is no doubt that the lives of the Nam Ou people are very difficult. Several villagers lamented over failed rice crops this year. Young adults were almost always absent from the villages when we visited. Perhaps, then, it was not surprising that many of the people we met said they looked forward to the promise of roads, a new school, new housing, plentiful electricity and a medical clinic that they hoped would come with resettlement. But worry was in the air, too. A village leader said the dam company has 'made many promises if we are forced to move. Compensation is not clear and the new village location is not clear.'

We wondered how these communities might adapt to being relocated far away from the river they had come to rely on for so long. They didn't know either. 'We don't know if there will be enough water,' said one fisherman. 'How will I survive without my fruit trees? It will take me 100 years to establish a new farm,' said one farmer who had already lost half his farm due to road construction and expected to lose the rest to the dam.

The global context

Sinohydro Corporation is responsible not only for its $2 billion investment in the Nam Ou infrastructure, but also for compensating and restoring the livelihoods of those who will be impacted the most (as with most dam projects the world over, affected people living downstream of the dam project are not considered as 'directly affected' and therefore will be uncompensated for their losses). This will be the first time that Sinohydro has carried out such an undertaking. In China, local authorities rather than the dam builders are responsible for resettlement and environmental mitigation work. In the Nam Ou basin, the fate of thousands will be in Sinohydro's relatively inexperienced hands.

Making Chinese dam builders responsible for livelihood development programmes is a surprising turn. Chinese dam builders have only been active in the international hydropower market for the past six to eight years, following the adoption of the 'going out policy' by the Chinese government in 1999. Such encouragement led many state-owned companies to find new business opportunities overseas. China's dam-building industry has been one of the most successful. Driven by a saturated domestic market and low profits, companies such as Sinohydro have prospered overseas with the support of Chinese financiers such as China Exim Bank and China Development Bank. As with so much of China's rocket-like growth, few would have predicted that in less than 10 years, Sinohydro would control over 50% of the international dam-building market.

Laos' biggest dam project to date – the Nam Theun 2 Hydro-power Project – brought tensions between the dam's builder, the World Bank, and civil society. Non-governmental organisations (NGOs) opposed the project for its social and environmental impacts, but ultimately the dam was built. The NGO campaign resulted in the World Bank committing to delivering the best resettlement and livelihood restoration package possible.

Ten years on, the quick rise of China's hydropower companies in international dam building has helped Sinohydro stay under the limelight so far. With Chinese overseas dam builders and banks involved in more than 300 projects globally, it is clear that the business of global dam building has rapidly shifted from the somewhat public multilateral development arena into the closed boardrooms of Beijing.

International Rivers has certainly made headway in the boardrooms of Beijing. In January 2012 Sinohydro adopted an environmental policy consistent with international standards. We will be working to ensure that these policy statements translate to genuine change on the ground, including for the people of the Nam Ou. ◆

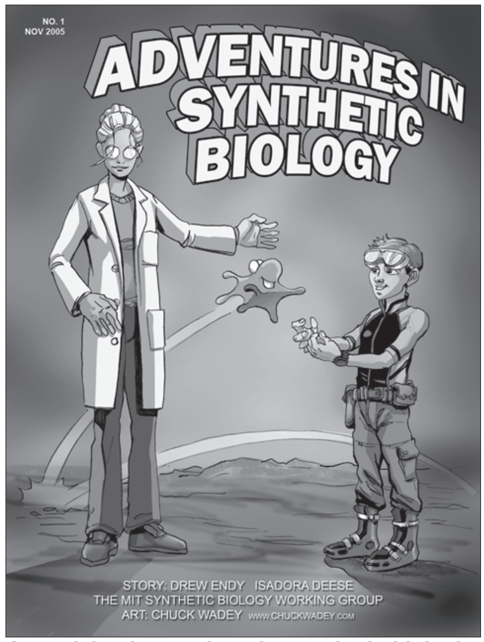
Grace Mang is the China Programme Director at International Rivers, a non-governmental organisation that works to protect rivers and the rights of communities that depend on them. This article is reproduced from the International Rivers publication World Rivers Review *(June 2012).*

A new guide published by International Rivers presents the lessons of past experience and informs interested NGOs how they can best influence the projects and policies of Chinese dam builders and advocate for social and environmental interests. The report provides an overview of the relevant actors, laws and standards in the Chinese dam-building sector, including Sinohydro's new environmental policy. It presents case studies of how NGOs have influenced Chinese overseas projects, and concludes with a list of addresses and other useful information. Entitled 'The New Great Walls', the 60-page report is available at www.internationalrivers.org/node/3962.

Weird science

Jeff Conant discusses the promise and peril of synthetic biology.

IN 1971, a microbiologist named Ananda Chakrabarty patented a bacterium genetically engineered to degrade and destroy crude oil. The next year scientists created the first synthesised gene, a bit of yeast RNA ushered into existence virtually from scratch. These discoveries, among others, raised the curtain on the science of biotechnology. Forty years later, in 2010, biologist Craig Venter, already known as a key figure behind the mapping of the human genome, announced his creation of a microbe that earned the name Synthia: 'the first self-replicating species on the planet whose parent was a computer'.



A comicbook co-written by synthetic biologist Drew Endy to introduce the principles of the science. Synthetic biology essentially entails inventing and breeding living things that have never before existed in nature.

Between Chakrabarty's oil-eating microbe and the birth of Venter's Synthia, a wave of gene therapies, pharmaceuticals, genetically engineered crops, and manufactured biofuels have transformed science, medicine, industry, and, quite possibly, global ecology.

In the second decade of the 21st century, genetically engineered crops account for 88% of the corn, 93% of the soy, and 94% of the cotton grown in the US (by acreage). In 2011, the first commercial flight powered by algae took off from Chicago's O'Hare Airport. During the recent United Nations Earth Summit in Brazil, Amyris Inc., one of the leading companies in the emergent field of synthetic biology, flew a sugarcane-powered airplane over Rio de Janeiro. The same company, with a healthy infusion of cash from the Gates Foundation, is on the verge of releasing a malaria drug that, the company says, will be cheaper and more effective than any on the market today. The drug mimics the action of artemisia, an ancient Chinese herb. But rather than being extracted from a plant, Amyris' drug will be manufactured within the cellular membranes of a fully synthetic strain of yeast.

The eminent evolutionary biologist Stephen Jay Gould once said: 'Our planet has always been in the Age of Bacteria.' But scientists' rapidly accelerating ability to harness microbes and turn them into what the field of synthetic biology calls 'platforms for industrial production' is entirely without precedent. We are witnessing a revolution in the biological sciences of a speed and scale that is dazzling to some, and more than a little frightening to others.

'If you want to change the world in some big way that's where you should start – biological molecules,' Bill Gates told *Wired* magazine in 2010. The microchip revolution has transformed the globe, and men like Gates made a fortune in the process. Unlike microchips, however, microbes are alive, and the implications of tinkering with them are almost entirely unknown.

In April, the Obama administration published a report called the 'National Bioeconomy Blueprint' to assess and promote 'economic activity fuelled by research and innovation in the biological sciences'. Annual revenues from the bioeconomy in 2010, the report announces, totalled $176 billion.

'The growth of today's US bioeconomy,' the report says, 'is due in large part to three foundational technologies: Genetic engineering, DNA sequencing, and automated high-throughput manipulations of biomolecules.' In a certain kind of translation, that means writing genetic code, printing it in vitro, and employing robotic assembly lines to insert it into living microbes. Translated further into simple English, it means inventing and breeding living things that have never before existed in nature.

'Whereas standard biology treats the structure and chemistry of living things as natural phenomena to be understood and explained,' one definition of the technology states, 'synthetic biology treats biochemical processes, molecules, and structures as raw materials and tools to be used in novel and potentially useful ways, quite independent of their natural roles. It joins the knowledge and techniques of biology with the practical principles and techniques of engineering.'

Where genetic engineering inserts genes from one species into another in what many biotechnologists now call a crude, clumsy, and outdated process, the goal of synthetic biology is to create novel life forms by inserting computer-generated DNA sequences into living cells, and then propagating them. As an applied technology, synthetic biology seeks to squeeze diesel out of algae or pharmaceuticals out of yeast by changing the cellular makeup of the yeast used in the fermentation process, or the lipid excreted by the algae. A decade ago, such applications were a mere fever dream. Today, given the exponential speed at which DNA sequencing, nanotechnology, and computational biology are developing, the technology has sparked a billion-dollar industry.

A report for investors produced in 2009 by the insurance giant Lloyd's of London notes that the speed of DNA sequencing has increased 500-fold over the past 10 years and is now doubling every 24 months. 'If this rate of development were to continue,' the report notes, 'it would be possible to have a personalised genome map for under $1,000 by 2020, leading to some interesting questions for life insurers.'

Nor is synthetic biology merely a science. It could be interpreted more as a worldview – a kind of techno-utopian vision that purports to 'support Darwinian evolution', as the boosterish website syntheticbiology.org puts it. Or, as Craig Venter says of one of his strains of synthetic algae, the idea is 'to force nature to produce things for us'. Drew Endy, a Stanford-based synthetic biologist whom the *Wall Street Journal* has called 'the next Steve Jobs', dreams of designing in a few years what it took nature millennia to create, and 'liberating ourselves from the tyranny of evolution by being able to design our own offspring'.

Endy is best known outside the lab for fostering the field of synthetic biology writ large. As an assistant professor at the Massachusetts Institute of Technology (MIT) he founded the international Genetically Engineered Machine competition (iGEM), an annual contest that has engaged thousands of students in inventing artificial organisms and helped make syn-bio (as insiders abbreviate it) an avid hobbyists' art. Endy has also established an open-source 'Registry of Standard Biological Parts' to give lab researchers a collection of 'artificial genetic constructions' to work with. The constructions, called BioBricks, are standardised DNA sequences that, when inserted into living cells, act like switches or signals, performing pre-coded functions. The operative analogy is to Lego blocks, or to transistors or semiconductor chips in a computer.

One of the leading companies in the synthetic biology industry is the California-based Amyris. Picture shows an Amyris demonstration facility in Brazil, where the firm has flown a sugarcane-powered airplane over Rio de Janeiro.

Another method, one that may help to elucidate the exotic inner workings of synthetic biology, is the re-creation of what are called 'metabolic pathways' in plants in order to synthesise high-value chemical compounds. A metabolic pathway is a series of reactions that take place within a cell resulting in the creation of a chemical compound. That compound is then altered by the production of different enzymes, in specific sequences, leading to the creation of another compound which is what we recognise as the product of the plant: rubber, say, or nicotine or vanilla. Synthetic biologists engineer these pathways in order to change the compound that is created. By building a metabolic pathway from scratch using synthetic DNA and then inserting it into a microbial host – say, a yeast cell – scientists change the way the cell metabolises sugars in order to create marketable compounds on demand.

As few as eight key pathways may be responsible for most of the 200,000 natural plant compounds known to science, and synthetic biologists are rapidly and systematically decoding, reconstructing, and patenting these pathways. As they create microbes that act as production platforms for their high-value chemicals, they establish start-up companies to patent, produce, and commercialise the end product.

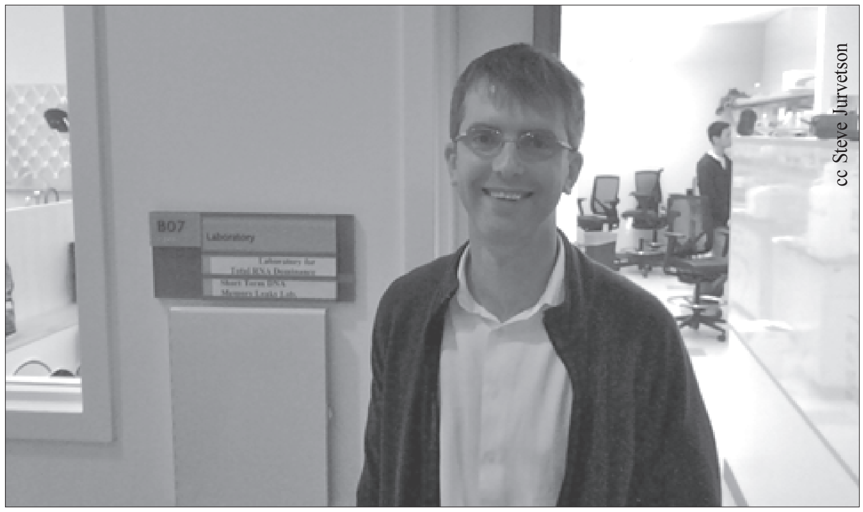
One such company is Amyris. Founded by Dr Jay Keasling, another of syn-bio's leading figures, Amyris develops 'renewable compounds' such as its proprietary molecule, farnesene – a petroleum alternative that can be turned into diesel, surfactants, creams, emollients, lubricants, and other chemicals. Spawned at the University of California Berkeley, where Keasling is a professor, the company has been fed on venture capital, built up with support from the US Department of Energy ($25 million to construct pilot biofuel facilities), and bolstered by philanthropic funding ($42.5 million from the Gates Foundation for its malaria drug). At its plant in Emeryville, a few miles from the UC Berkeley campus, the company genetically modifies microorganisms, uses them as living factories to convert plant-sourced sugars, and employs robotics to create and test thousands of synthetic microbes a day in order to find those that are 'most efficient and scalable.'

Amyris is a flagship company of the synthetic biology industry. It also demonstrates the challenges inherent to the industry. In 2010, Keasling confidently declared to shareholders that the company's microbes could be scaled from the test tube to the refinery, 'ensuring commercial quantities of fuel to stave off the peak oil crisis'. But two years later, Amyris's diesel was running $29 a gallon – too costly to market – leading it to farm out its biofuels business to a subsidiary in order to focus on high-value products like face creams. Its malaria medication, the focus of extensive PR, has yet to yield a single vaccination. The company's stock has fluctuated wildly, bottoming out at $1.57 a share, leading *Biofuels Digest* to call such fluctuations 'the Amyris effect'.

Synthetic biology is in its infancy, and, despite such setbacks, is still an exploding market. Synthetic-bio-based fuels and chemicals brought in $80.6 million in 2008, and the biotech watchdog ETC Group, citing industry reports, says that figure is expected to grow to $1.6 billion in 2013.

Syn-bio is the epitome of a 'team science' – the kind pioneered by government labs going back to the Manhattan Project – that requires huge investment and a broad multidisciplinary approach. As such, the bulk of the firms at the bleeding edge of the industry are fuelled largely either by public money or by investors from the top-tier companies in the fossil fuel, agribusiness, chemical, and big pharma sectors, or, like Amyris, by both.

Earlier this year, at a three-day confab in Berkeley, US Energy Secretary Steven Chu held forth to top corporate executives and researchers and administrators from UC Berkeley and Lawrence Berkeley National Labs about the need to develop closer partnerships between industry and government. Chu, who directed the Lawrence Berkeley Labs before joining Obama's cabinet, is a major booster of synthetic biology. In his first year as the head of the Department of Energy, the department spent over $305 million on synthetic biology research. During his tenure at Lawrence Berkeley, Chu was instrumental in stepping up the lab's leadership in the field. He's now doing everything he can to bolster public-private partnerships and support protégés like Jay Keasling.



Synthetic biologist Drew Endy *(pic)*, **whom the *Wall Street Journal* has called 'the next Steve Jobs', dreams of designing in a few years what it took nature millennia to create.**

In many ways, Dr Keasling is emblematic of the public-private approach driving the syn-bio industry. The multimillionaire founder of numerous biotech start-ups, Keasling is also a lead investigator at the UC Berkeley-based Synthetic Biology Engineering Research Center (SynBERC), and is heading efforts to launch a second Lawrence Berkeley Lab campus in Richmond that will be the largest synthetic biology lab in the world.

If this spate of government support, private investment, and academic enthusiasm reveals a biotech revolution that's poised to underwrite a new wave of green economic development, its detractors fear the opposite: a commodity bubble, a bioethical quagmire, and, potentially, an ecological and public health catastrophe. Some observers believe the entire project to be, to some degree, a hoax.

'Most of what they are selling are ideas. Promises. Hopes for applications that really haven't happened,' says Ignacio Chapela, a UC Berkeley microbiologist best known for his team's discovery of GMO (genetically modified organism) contamination in Mexican corn crops, and the controversy that followed. 'We continue to hear that we're five and 10 years away from the next big breakthrough, but the reality is that biotechnology has always promised a never-ending frontier of innovation and technological application that will drive the world,' he says. 'But they continue to draw a blank. They continue to sell stuff, and they sometimes can produce some things, but they continue to run at a loss. If you look at the markets, you'll see that even though we have invested over 40 or 50 years, and hundreds of billions of dollars, we are still yet to make a profit, and we're still yet to make a predictable, controllable living organism.'

Paul Rabinow, an anthropologist at UC Berkeley whose work focuses on synthetic biology labs, agrees. Referring to Chakrabarty's oil-eating microbe, Rabinow says: 'Here we are 40 years later, and they still claim to be on the cutting edge. But there are big questions about what they are actually achieving.'

As the statements of Drew Endy, Craig Venter, Jay Keasling, and other leading scientists make clear, the science of synthetic biology thrives on speculation. What it promises is a future in which biomachines manufacture our products, eliminate our ailments, clean up our messes, and extend our lives. The venture capitalists financing the science also thrive on speculation. But as we know from the Great Recession, speculation is like a microbial broth – it breeds best in the dark. Speculation makes dreams as real as bricks, as long as it lasts. But how well does it hold up to the light of scrutiny? How well does its promise of rapid innovation and 'automated high-throughput manipulations of biomolecules' hold up to oversight or regulation?

And if the promises of synthetic biology are still a ways off, what of the perils?

Civil society groups like Friends of the Earth and the Center for Genetics and Society, and technology activists like ETC Group and the International Center for Technology Assessment, raise concerns about the risks synthetic biology poses to public health and the environment. They worry about the potential uses of synthetic biology for bio-warfare, citing the long and obscure history of bioweapons research in government labs, including Lawrence Berkeley and the nearby Lawrence Livermore Lab. President Obama's 2010 budget provided $20 million to the Defense Advanced Research Projects Agency, a research arm of the Pentagon, for synthetic biology research. At the same time, a Congressionally mandated panel and numerous independent experts cite poor government response to the 2009 swine flu epidemic – a relatively benign threat – to point out that the US is unprepared to deal with a contagion.

It is not only bio-terror that concerns public interest groups. They're also concerned about 'bio-error'. Just as genetically engineered crops have cross-pollinated with non-GMO plants, there is no guarantee that synthetic organisms won't escape into the environment. As Isaac Berzin, founder of GreenFuel Technologies Corp., the first algae-to-biofuels company, says of his algal product: A leak is inevitable because 'people make mistakes'.

While some of the industry's key figures choose to play down concerns, no one doubts that synthetic biology is a high-risk, high-reward industry. The Lloyd's of London report considers 'What could go wrong,' and concludes that the more significant risks include 'hackers producing viruses just for the kudos of having disrupted global trade,' the creation of monopolies, unexpected gene transfer, unexpected release, evolution ('GM organisms may behave as we expect in the short term, but organisms evolve'), and 'unintended and unimagined consequences'.

'It is hard enough to predict how a single strand of DNA will behave when a new gene is inserted,' the report notes. 'Even harder to consider how it will affect a cell or whole multicellular organism. But the difficulties in predicting how an ecosystem will behave are staggering.'

An article published in March in *Nature* titled 'Four Steps to Avoid a Synthetic-Biology Disaster' warns: 'No one yet understands the risks that synthetic organisms pose to the environment, what kinds of information are needed to support rigorous assessments, or who should collect such data.' The authors argue that at least $20 million to $30 million in government research is needed over the next decade to identify and address the ecological risks of synthetic biology. The amount currently spent on these assessments is closer to zero.

In 2010, following the birth of Synthia, President Obama established a Presidential Commission for the Study of Bioethical Issues to examine such questions. The commission ultimately expressed faith that synthetic biology could 'be developed in an ethically responsible manner'. It established no new principles of government oversight and recommended no funding for risk assessment, preferring to allow the industry to essentially self-regulate.

Synthia's progenitor, Craig Venter, provides one of the strongest cases for independent oversight. A recent profile in the *New York Times Magazine* describes Venter 'riding his German motorcycle through the California mountains, cutting the inside corners so close that his kneepads skim the pavement', and 'snorkelling naked in the Sargasso Sea surrounded by Portuguese men-of-war'. Undoubtedly it takes a man of such outsize will to break the bounds of science and invention. But, without being prudish, it is reasonable to ask whether an industry driven by the likes of Venter can be trusted to conduct appropriate risk assessment.

The scientist-entrepreneurs at the forefront of syn-bio argue persuasively that the technologies are safe. But in an area of science that is moving so rapidly, there is no way to completely ensure safety. The *New York Times*, in a 2010 article titled 'Safety Rules Can't Keep Up With Biotech Industry', cited numerous workers injured and killed in biolabs, including Becky McClain, a former molecular biologist at Pfizer who suffered bouts of paralysis after being infected by a genetically engineered virus. 'The cutting edge can be a risky place to work,' the *Times* wrote.

The Center for Genetics and Society, a watchdog group, says no comprehensive framework for assessment and oversight of synthetic biology exists nationally or internationally. The main US federal agencies overseeing safety in biological laboratories are the Occupational Safety and Health Administration (OSHA) and National Institutes of Health (NIH). A 2010 report produced by the Council for Responsible Genetics points out that 'the NIH guidelines are largely advisory' and 'largely unenforced'. OSHA regulations, 'while mandatory, do not address a broad range of potential safety issues encountered in biological laboratories'.

In the words of syn-bio critic Jim Thomas of ETC Group: 'Saying that synthetic biology is regulated is tantamount to saying that the rules of the road for horse and buggy driving are adequate for car driving.'

'Even with the best intentions,' Thomas points out, 'there will be escapes of synthetic organisms through clothing, waste streams and human error.'

ETC Group, Friends of the Earth, and 111 other civil society groups find the lack of oversight so worrisome that in March they called for a moratorium on the release of any synthetic organisms, 'to make sure the technology does not keep developing as our laws and regulations keep getting more outdated'.

The biologists, however, take the risks in stride. 'We've always bred plants for meeting an industrial goal,' Adam Arkin, another leading synthetic biologist at Lawrence Berkeley and UC Berkeley, told me. 'Synthetic biology is trying to meet industrial goals in a way that is more efficient. And honestly, that's a good thing.'

I asked Arkin about the risk of 'horizontal gene transfer' – the poorly understood passage of genes from one microbe to another, which is one of the primary concerns that scientists raise when looking at engineered microbes.

'What if the genes you put in organism one, get into organism two? Yeah that could be an issue,' Arkin said. 'But the first thing to recognise is that most of the genes that we transplant are already out there in the world, in exceptionally high numbers. Horizontal gene transfer happens all the damn time. The second thing is whether what we're introducing into the environment is actually harmful.'

If anyone should understand the promises and perils of the field, it is Paul Rabinow. He was hired by the National Science Foundation to evaluate the security and ethical ramifications of the work being done by SynBERC and to report his findings to federal administrators. But, Rabinow says, 'these are very high-powered scientists in a very competitive environment, both professionally and academically, and they simply had no time to talk to us seriously.'

From his office on the UC campus, Rabinow told me that the scientists at SynBERC, among them Jay Keasling and Drew Endy, 'were negligent and indifferent' regarding ethical concerns, unconvinced of the need for stricter security measures, and 'wholly tone deaf' to environmental arguments.

Rabinow made a set of recommendations to improve security and preparedness at SynBERC, but his assignment came to an abrupt and contentious end when his recommendations were ignored. Despite his protestations that the role of an ethicist is to be 'outside of and downstream from' the science, he was replaced by Drew Endy, one of the field's leading evangelists.

'I wouldn't say I was muzzled,' Rabinow says with a measure of rancour in his voice. 'But I certainly wasn't taken seriously. Jay Keasling's basic response to me was, "If you want more money, don't complain."' And Rabinow says he was shut out of the presidential bioethics committee. 'The only person in the US who is officially funded by the government to consider bioethics, and I've been consulted by absolutely no one.'

Rabinow is not in principle against the science of synthetic biology. 'I hold the position that we've been manipulating nature for so long that there is no longer any such thing as "nature",' he says. 'But they wanted simple assurance that everything they were doing was fine. And we wouldn't give them that.' He pointed out that the technology might be safe, but whether it is secure is another matter. 'Safety is a lab issue,' he says. 'Security is a political issue.'

In 'The Deadliest Virus', a recent article in *The New Yorker*, author Michael Specter cites a 2002 incident during which a researcher at Stony Brook University acquired hundreds of DNA fragments via the Internet and stitched together a functioning polio virus. Lab escapes or acts of terror based on published genomic information, Specter concludes, are a matter of if, not when.

Beyond issues of bio-terror, which Rabinow holds front and centre, another concern is the ultimate purpose of synthetic biology. 'They are promising technological miracles, but what are they delivering?' he asks. 'Not a single person has been vaccinated with synthetic artemisinin. The BioBricks don't work. Not a single disease has been cured by this research. They've been able to produce fuels from waste, but the case of Amyris shows that they haven't been able to scale up.'

He continues: 'So what are they doing? The same people have said this is genetic engineering, and this is not genetic engineering. There's some amount of continually trying to recast what they're doing in order to get the grants. The whole thing is a bit of a ruse.'

When I asked Arkin about the ethical issues at SynBERC, he reduced them to a problem of perception. 'We speak glibly about these things, much like cattlemen speak about cattle, and maybe we shouldn't. We harness oxen. The fact is we are harnessing these things to work for us. If the ecological sorts are upset about this, then perhaps we should find a new language to talk about it in.'

Arkin, like other syn-bio boosters, appears not to understand that the criticisms of synthetic biology aren't just about the ethics of lab workers or the public perception of the science, but rather, the thrust of the technology. The major innovation of synthetic biology is not simply the insertion of an artificial strand of DNA into a microbe to produce a novel product. It is the convergence of multiple industrial and academic fields in the service of a single goal – the production of artificial life. And it is the assumptions behind it – that 'playing God' is not only okay, but is necessary and lucrative – that are the Achilles heel of synthetic biology.

Wherever the science may go, the multi-billion-dollar drive to solve the problem of artificial life has already ensured that the forces behind it – BP and Chevron, DuPont and Dow, the Pentagon and the Department of Energy – will effectively undermine any ethical oversight or democratic governance. With the ethical concerns and regulatory roadblocks swept aside, the future looks promising for the growth of the artificial life industry. The question is whether this growth is benign or malignant. ◆

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Investment arbitration a 'self-serving' industry, says study

Rather than acting as fair and neutral intermediaries, the international investment arbitration industry has 'a vested interest in perpetuating an investment regime that prioritises the rights of investors at the expense of democratically elected national governments and sovereign states', according to a new report.

Kanaga Raja

A REPORT by the Transnational Institute (TNI) and Corporate Europe Observatory (CEO) describes the international investment arbitration industry as 'a multimillion-dollar, self-serving industry, dominated by a narrow exclusive elite of law firms and lawyers whose inter-connectedness and multiple financial interests raise serious concerns about their commitment to deliver fair and independent judgements'.

'As a result, the arbitration industry shares responsibility for an international investment regime that is neither fair, nor independent, but deeply flawed and business-biased,' say TNI and CEO.

These findings are highlighted in the joint report published in November by the two organisations titled 'Profiting from injustice: How law firms, arbitrators and financiers are fuelling an investment arbitration boom.'

Says the report: 'The international investment arbitration industry is dominated by a small and tight-knit Northern hemisphere-based community of law firms and elite arbitrators. Three top law firms... claim to have been involved in 130 investment treaty cases in 2011 alone. Just 15 arbitrators, nearly all from Europe, the US or Canada, have decided 55% of all known investment-treaty disputes. This small group of lawyers, referred to by some as "inner mafia", sit on the same arbitration panels, act as both arbitrators and counsels, and even call on each other as witnesses in arbitration cases. This has led to growing concerns, including within the broader legal community, over conflicts of interest.'

The TNI-CEO report seeks to 'shine a light on law firms, arbitrators and litigation funders that have profited handsomely from lawsuits against governments,' and shows that the arbitration industry 'is far from a passive beneficiary of international investment law.'

'They are rather highly active players, many with strong personal and commercial ties to multinational companies and prominent roles in academia who vigorously defend the international investment regime. They not only seek every opportunity to sue governments, but also have campaigned forcefully and successfully against any reforms to the international investment regime.'

The report reveals that investment lawyers amongst others have:

- actively encouraged cases and sometimes even pushed corporations to pursue arbitration, exploiting loopholes in investment treaties to create an explosion in the number and the costs of dispute settlement cases, and acted behind the scenes to push countries to adopt investment treaties;
- tended to approach investment law from an almost exclusively commercial angle rather than public interest, ignoring or even denouncing arguments based on human rights and sustainable development;
- aggressively and successfully fought to maintain and expand the current system of investment treaties and arbitration, both through academic circles and by lobbying against reforms that would serve the public interest, and worked alongside speculative investment funds to provide the finance for corporations to bring more cases, at the expense of states and taxpayers.

'These actions have not only confirmed the pro-corporate bias of current investment agreements, they have tilted the regime even further in the favour of large multinational corporations. The result is a system driven by commercial interests rather than the delivery of justice.'

The arbitration industry

The report explains that in international investment disputes, multinational companies can sue governments if the government has done something that the multinational considered harmful to its profits. These cases take place before an international tribunal of arbitrators, three people who decide whether private profits or the public interest are the most important. The legal bases for these disputes are investment treaties between states.

The idea of investment arbitration as a fair and independent space to resolve disputes between multinationals and governments is one of the key justifications for a system which has cost taxpayers dearly and undermines the capacity of sovereign governments to act in the interests of their people.

According to the report, 'the alleged fairness and independence of investment arbitration is an illusion. The law and the consequential disputes are largely shaped by law firms, arbitrators and, more recently, a phalanx of speculators who make a lot of money from the disputes.'

Driven by their own profit interests, this 'arbitration industry' actively encourages an ever-growing number of corporate claims, while creating the necessary legal loopholes and funding mechanisms for its continued functioning. This industry is also responsible for growing its own business with pro-investor interpretations of the treaties.

It further notes that investment arbitration lawyers, arbitrators and funders have largely escaped public attention. Many of their cases are unknown and some never become public. The vested interest behind their actions is well hidden by 'a thick layer of legal rhetoric about judicial independence, fairness and advancing the rule of law'.

Wave of disputes

International investment agreements give sweeping powers to foreign investors, including the peculiar privilege to directly file lawsuits at international tribunals, without necessarily even going through the local courts. Companies can claim compensation for actions by host governments that have damaged their investments, either directly through expropriation, for example, or indirectly through regulations of virtually any kind.

There are currently more than 3,000 such agreements. The vast majority are bilateral investment treaties (BITs) between two countries. Others include free trade deals with investment chapters such as the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States, and multilateral agreements such as the Energy Charter Treaty which regulates investments in the energy sector.

Since the late 1990s, these agreements have triggered a wave of investor claims against states.

In 1996, only 38 investor-state disputes had been registered at the then 30-year-old World Bank International Centre for Settlement of Investment Disputes (ICSID), the main handler for these arbitrations. In 2011, there were 450 known investor-state cases, the majority of which were filed by corporations from industrialised countries against countries from the Global South.

The report highlights some 'emblematic' examples of investor-state disputes:

• On the basis of bilateral investment treaties, tobacco giant Philip Morris is suing both Uruguay and Australia over their anti-smoking laws. The company argues that compulsory large warning labels on cigarette packs prevent it from effectively displaying its trademarks, causing a substantial loss of market share.

[In the case of the dispute against Australia, according to posts on the International Economic Law and Policy Blog, the Philip Morris subsidiary in Hong Kong appears to have bought shares in Philip Morris Australia some months after Australia made public its plans to introduce further regulatory measures for plain packaging to discourage smoking. The share purchase was aimed at enabling the Hong Kong subsidiary to use the Hong Kong-Australia BIT to sue Australia.]

• In 2009, Swedish energy multinational Vattenfall sued the German government, seeking 1.4 billion euros ($1.9 billion) plus interest in compensation for environmental restrictions imposed on one of its coal-fired power plants. The case was settled out of court after Germany agreed to water down the environmental standards, exacerbating the effects that Vattenfall's power plant will have on the Elbe River and its wildlife.

In 2012, Vattenfall launched a second lawsuit seeking 3.7 billion euros ($4.6 billion) for lost profits related to two of its nuclear power plants. The case followed the German government's decision to phase out nuclear energy after the Fukushima nuclear disaster. Both actions were taken under the Energy Charter Treaty, which includes BIT-like investment protection provisions.

• In 2007, Italian investors sued South Africa over its Black Economic Empowerment Act which aims to redress some of the injustices of the apartheid regime. It requires, for example, mining companies to transfer a portion of their shares into the hands of black investors. The dispute (under South Africa's BITs with Italy and Luxembourg) was closed in 2010 after the investors received new licences requiring a much lower divestment of shares.

• When Argentina froze utility rates (energy, water, etc.) and devalued its currency in response to its 2001-02 financial crisis, it was hit by over 40 lawsuits from investors. Big companies like CMS Energy (US), Suez and Vivendi (France), Anglian Water (UK) and Aguas de Barcelona (Spain) demanded multimillion compensation packages for revenue losses.

Skyrocketing costs

As the number of international investment disputes has grown, arbitration has become 'a money-making machine' in its own right, says the TNI-CEO report. Arbitration lawyer Nicolas Ulmer from Swiss law firm Budin & Partners is cited as explaining: 'Arbitration institutions vie for their market share of disputes, legislatures pass arbitration-friendly measures to attract this business, various conference and workshops are held year round, a class of essentially full-time arbitrators has developed and a highly specialised "international arbitration bar" pursues large cases avidly. A veritable "arbitration industry" has arisen.'

The report stresses that investment arbitration is expensive – long before the final settlement is made. Both the state and the investor have to pay for the administration of a case. They also have to pay arbitrators, witnesses and experts who are often scattered across the globe and require translation services and travel and living allowances. And they have to pay their lawyers.

According to the United Nations Conference on Trade and Development (UNCTAD), 'costs involved in investor-state arbitration have skyrocketed in recent years'. For the known cases with available data, the Organisation for Economic Co-operation and Development (OECD) recently found that legal and arbitration costs averaged over $8 million, exceeding $30 million in some cases. The Philippine government spent $58 million to defend two cases against German airport operator Fraport – the equivalent of the salaries of 12,500 teachers for one year, vaccination for 3.8 million children against diseases such as tuberculosis, diphtheria, tetanus and polio, or the building of two new airports.

According to the TNI-CEO report, the lion's share ends up in the pockets of the parties' lawyers. Industry insiders estimate that more than 80% of all legal costs in arbitration are spent on counsel. The tabs racked up by elite law firms can be $1,000 per hour per lawyer – with whole teams handling cases. According to figures from ICSID, arbitrators also line their pockets, earning a $3,000 daily fee plus travel and living allowances.

An empirical study of investment arbitration costs found that 'tribunals most frequently required parties to share tribunal and administrative costs equally and absorb their own legal fees'. This means that even when corporations do not win, taxpayers still have to pay millions in legal fees.

'The real winners? Law firms who collect multimillion-dollar payments, regardless of the result,' the report underlines, citing, for example, the case of Plama Consortium v Bulgaria, where Bulgaria's legal fees totalled $13,243,357 for defending a claim that was ultimately found to be fraudulent. Although Bulgaria was awarded $7,000,000 of these legal fees, it was still forced to pay out the remaining $6,243,357. At that time, Bulgaria was grappling with a healthcare crisis due to a shortage of nurses – the money could have paid the salaries of more than 1,796 Bulgarian nurses.

Critical objection

Originally, investor-state arbitration was envisioned for instances of straightforward expropriation, such as when the government took over a factory. But the system has spun out of control, with multinationals using it to chase down lost profits. The last two decades have seen a number of multimillion-dollar claims against the alleged effects of public legislation.

'Developed and developing countries on every continent have been challenged for tax measures, fiscal policies, bans on harmful chemicals, bans on mining, requirements for environmental impact assessments, regulations relating to hazardous waste etc. Sometimes, the threat of a dispute has been enough to freeze government action, making policymakers realise they would have to pay to regulate.'

According to the report, these legal challenges have raised a global storm of critical objection to investment treaties and arbitration. Some countries have realised the injustices and inconsistencies of international investment arbitration and are trying to abandon the system.

In spring 2011, the Australian government announced that it would no longer include investor-state dispute settlement provisions in its trade agreements.

Bolivia, Ecuador and Venezuela have terminated several BITs and have withdrawn from ICSID, sending a clear political message that they refuse to cooperate in the future. Argentina, which has been swamped with investor claims related to emergency legislation in the context of its 2001-02 economic crisis, refuses to pay arbitration awards.

South Africa has announced that it will not renew old investment treaties due to expire. And India is reported to have decided not to include investor-state dispute provisions in future free trade agreements (after the government was sued for carrying out the orders of the country's Supreme Court to cancel some 2G band telecommunication licences over scam and corruption charges).

[In another case, just reported in the *Economic and Political Weekly*, a Singapore-based arbitral tribunal has criticised the Supreme Court of India and the Indian judiciary for its delays in hearing and disposing of cases, and asked the Indian government (which under the Indian Constitution has no control over the judiciary) to compensate an Australian party, having a contract dispute with an Indian firm, for these delays.]

According to the TNI-CEO report, the UN has recognised that international investment agreements can severely curb states' abilities to fight financial and economic crises.

Argentina has been sued more than 40 times as a result of the economic reform programmes implemented after its economic crisis in 2001. By the end of 2008, awards against the country had reached a total of $1.15 billion. That's the equivalent of the average annual salary for 150,000 Argentinian teachers or 95,800 public hospital doctors.

Potential conflicts of interest

Globally, says the report, three firms have emerged as market leaders in the investment arbitration business: Freshfields Bruckhaus Deringer (UK), White & Case (US) and King & Spalding (US). Freshfields alone claims to have acted in more than 165 investor-state disputes.

Such dominance creates a reputation for these firms, which in turn brings new cases and leads to a concentrated market that is difficult for newcomers to enter. One practitioner estimates that 25 out of 30 new cases at ICSID go to the heavyweights in the field. Non-Western law firms from the countries most sued by investors scarcely get a look in.

As many as two dozen senior lawyers in the top firms also act as arbitrators, 'opening a Pandora's box of potential conflicts of interest because of their vested interest in growing their own business'. An arbitrator might, for example, be tempted to make a decision that will favour a client whom they represent as counsel in another case. Some suggest that the dual role of arbitrator and counsel is 'one of the most significant problems of the investment arbitration regime'.

According to the report, when companies sue governments in international arbitration tribunals, investment arbitrators have the power to divert taxpayers' money to corporations. They can decide to penalise governments for ensuring people's human rights to health, access to water or electricity as well as the right to a healthy environment.

Advocates claim an international arbitration system is needed because national courts are not sufficiently neutral. They say that only international arbitration courts can provide the neutral ground to deal with investors' concerns. That means that investment arbitrators become the guardians of investment arbitration, and confidence in the system is based on their perceived independence.

'Yet investment arbitrators are hardly neutral guardians, who stand above the law. In fact, they are crucial actors in the arbitration industry, with a financial interest in the existence of investment arbitration. Arbitrators, to a far greater degree than judges, have a financial and professional stake in the system. They earn handsome rewards for their services. Unlike judges, there is no flat salary, no cap on financial remuneration,' the report underscores.

'Investment arbitrators are hardly neutral guardians who stand above the law.'

Arbitrators' fees can range from \$375 to \$700 per hour depending on where the arbitration takes place. How much an arbitrator earns per case will depend on the case's length and complexity, but for a \$100 million dispute, arbitrators could earn on average up to \$350,000. It can be far more. The presiding arbitrator in the case Chevron and Texaco v. Ecuador received \$939,000. In another case, the tribunal president billed for 719 hours at an hourly rate of \$660 plus VAT.

'To put it simply, if a doctor is sponsored by a pharmaceutical company, we might question whether the medicine prescribed is the best for our health; if a public servant receives money from a lobbyist, we might question whether the policies they promote are in the public interest. In the same vein, if an arbitrator's main source of income and career opportunities depend on the decision of companies to sue, we should wonder how impartial their decisions are.'

And concerns arise not only from the financial benefits arbitrators gain. Arbitrators frequently combine their role with several other hats: working as practitioners, academics, policy advisers or as media commentators. With these various roles, this small group of investment lawyers can influence the direction of the investment arbitration system such that they can continue benefiting from it.

'Inner circle'

According to the report, arbitrators may not be well known in the outside world, but members of the arbitration club certainly know each other. International arbitrators are the epitome of a close-knit community. Academics, journalists and insiders have described the circuit of investment arbitration as 'small, secret, clubby', 'an inner circle', 'a closed homogenous group comprised of "grand old men" or even "an arbitration mafia".'

Most of the members of the arbitrators' club are men from a small group of developed countries. The proportion of arbitrators from Western Europe and North America is 69% for all cases held at ICSID, and 83% for arbitrators who have sat in more than 10 cases.

Evidence shows that many of the arbitrators enjoy close links with the corporate world and share businesses' viewpoint in relation to the importance of protecting investors' profits.

Given the one-sided nature of the system, where only investors can sue and only states are sued, a pro-business outlook could be interpreted as a strategic choice for an ambitious investment lawyer keen to make a lucrative living.

'How would investment arbitration look if it did not operate as a closed-shop? What would happen if many more lawyers motivated by the public interest sat in panels; if the interpretation of investment clauses was more heterogeneous, or if arbitrators tended to allocate people and environmental welfare higher value than property rights when deciding on the merits of a case?' TNI and CEO ask.

Under such a scenario, they note, it is likely that many lawsuits brought by investors would be dismissed. In fact, the system may even collapse as investors would be more hesitant to pursue cases if the arbitration system became a level playing field.

The report further finds that banks, hedge funds and insurance companies also invest in international disputes.

Brokers and electronic marketplaces where claimants can shop for potential funders and funders can shop for claims are emerging. Commercial third-party litigation funding is most readily described as buying into someone else's lawsuit in the hopes of sharing in the spoils if a payout is awarded. Typically, a funder will take between 20% and 50% of the final award.

Little is known about the industry, but occasional reports suggest that litigation finance shops such as Juridica (UK), Burford (US) and Omni Bridgeway (Netherlands) are becoming an established part of international investment arbitration. Top-tier financier Burford commits on average \$8 million to a case, while Juridica averages \$7.5 million. Returns vary between 30% and 50%.

'No wonder litigation funders' profits have been growing at staggering rates. Burford's profits grew ninefold on their 2010 levels in 2011. In the same period, Juridica saw a 578% growth in its profits.'

By funding lawsuits that might otherwise settle quickly or die altogether, third-party funding has the potential to multiply the number of investment disputes brought before arbitrators, the report says, adding that lessons from the past support the claim that financing stirs up litigation. Australia saw an estimated 16.5% rise in litigation after liberalising its attitude towards third-party funding in general.

Recommendations for reform

In its overall conclusions, the report calls for a 'root-and-branch review' of the investment regime.

It says that even within the current international investment regime, there are a number of options that could help prevent investment lawyers and law firms from exploiting the current investor-state dispute system.

Amongst others, investment disputes could be solved by independent and transparent adjudicative bodies, where sitting 'judges' enjoy objective guarantees of independence and impartiality, and the roster of 'judges' would represent every country in the world.

The report also recommends tougher conflict-of-interest regulations, including a binding code of conduct for investment arbitrators requiring that they can neither work as counsel nor as experts in investment cases during, but also for at least three years before and after service on the roster (cooling-off period), and that a cap be imposed on the costs of lawyers and arbitrators.

It further recommends clarification of the broad and vaguely formulated terms (such as 'fair and equitable' treatment, which can mean anything the arbitrator decides) used in investment treaties, in order to prevent arbitrators from making investor-friendly (expansive) interpretations of certain obligations and to give countries policy space to regulate.

Also recommended is the inclusion of binding investor obligations in investment treaties on issues such as environmental and human rights impact assessments, and compliance with all local and national laws on health, environmental, labour and taxation issues. In this way, the report says, arbitrators will be forced to take these issues into account when deciding on cases. ◆

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Tax troubles: How TNCs enhance profits by avoiding taxes

Since the 1960s, transnational corporations (TNCs) have exploited the faultlines of the international tax system to transfer billions of dollars from Southern countries to the North. Northern governments have protected this system, but are now being challenged by citizens' groups worldwide to put an end to these abuses.

Peter Gillespie

A Zambian copper mine belonging to the Mopani company, which is majority-owned by the Swiss TNC Glencore. It has been suggested that Mopani has shifted sizable profits out of Zambia through trade mispricing.

LAST November, members of the British parliament were shocked by a report from Reuters revealing that the Starbucks chain had paid no corporate income tax over the previous three years despite sales of £1.2 billion in the United Kingdom. British media also reported that in 2011, Google had paid only £3.4 million in taxes on UK sales of £2.5 billion. A follow-up story by the *Guardian* newspaper reported that the giant Internet retail company Amazon had generated UK sales of more than £3.3 billion but paid no taxes at all.

The UK Parliamentary Public Accounts Committee summoned representatives of these three companies to testify about the level of taxes they were paying to the Treasury. An executive from Starbucks told the committee that the UK division of the company was unprofitable. An official from Google admitted that the company collects its income in Ireland because of the lower tax rates. Committee members were incensed when the representative from Amazon was unable to answer questions about his company's revenues in the UK. Parliamentarians subjected the unfortunate man to a verbal beating and vowed they would order another senior executive to appear before them. The Chair of the committee, Margaret Hodge, told the executives that they were not being accused of illegal behaviour; rather, they were being accused of being immoral.

These companies are using creative accounting methods to transfer profits earned in the UK into lower-tax jurisdictions. Amazon collects its UK sales in Luxembourg where profits are taxed at 2.5%. Google collects its earnings in Ireland and through a complicated scheme sends its profits to the tax haven of Bermuda via the Netherlands. Starbucks buys its coffee from a subsidiary in Switzerland. Last year, it paid a substantial royalty fee for the use of the Starbucks brand to another subsidiary in the Netherlands, allowing it to avoid £5 million in UK corporation tax. Starbucks also reduces its taxable income by borrowing money from a subsidiary and repaying at an interest rate of its own choosing. The Reuters investigation showed that Starbucks UK is entirely funded by debt and last year paid £2 million in interest payments to group companies.

These accounting practices are robbing governments of tax revenues and putting local businesses at a serious disadvantage. By some estimates, the cash-strapped British government is losing as much as £120 billion a year in tax revenues. Italian tax authorities are currently pursuing Google for unpaid taxes and Amazon's tax practices are reportedly under investigation in France. A Senate sub-committee in the United States reported that Microsoft avoided paying taxes of $4.5 billion between 2009 and 2011; Apple avoided taxes on $34.5 billion between 2009 and 2011, and Google avoided paying taxes on $24 billion.

The foundations of the international tax system were developed in the early 20th century, a period when transnational corporations (TNCs) were not such a dominant force in the global economy. Since the 1960s, TNCs have exploited the faultlines of this system to shift profits to where it best suits them. Tax havens, more properly called secrecy jurisdictions, are central to these practices. TNCs have created shell companies, usually in secrecy jurisdictions, to carry out financial transactions and to hold company assets such as intellectual property (brands, patents, etc.). Profits can then be allocated to these shell companies even though they usually exist only on paper.

TNCs can also adjust the price of transfers between subsidiaries of the parent company. Since 60% of all world trade occurs among members of the same company, 'transfer pricing' is one of the most important issues in international taxation. A TNC can adjust the transfer prices among its subsidiaries to shift profits from high-tax to low-tax countries. Trade mispricing can also involve re-invoicing trade between unrelated parties. Re-invoicing occurs when goods are exported from one country under one invoice. The invoice is then altered and re-directed to another jurisdiction, usually a secrecy jurisdiction, and sent on to the importing country. By artificially overpricing imports or underpricing exports, companies can shift profits out of higher-tax jurisdictions, usually for the explicit purpose of tax evasion.

While recent attention has focused on tax losses in Northern countries, these problems have plagued countries of the South for decades. Billions of dollars' worth of assets have been stripped from developing countries' economies and channelled through secrecy jurisdictions. This is particularly true of economies dependent on the extraction of natural resources. For example, African countries such as Angola, Nigeria, Republic of the Congo, Gabon, and Equatorial Guinea all have massive oil reserves and should have earned billions in revenues, yet the majority of their citizens remain impoverished.

Research by Léonce Ndikumana and James K Boyce of the University of Massachusetts, Amherst found that resource-rich African countries have lost enormous assets over the past several decades. From 1970 to 2008, Nigeria lost $296 billion to illicit capital flight. Angola lost about $71 billion between 1985 and 2008. Over the last four decades, the Republic of the Congo lost $24 billion, Côte d'Ivoire lost $45 billion, Cameroon lost $24 billion and Sudan lost $18 billion.[1] The Washington-based Global Financial Integrity (GFI) project estimated that up to $1 trillion has been shifted out of Africa over the last three decades; trade mispricing by TNCs accounts for 60 to 65% of these financial outflows.[2]

GFI investigated illicit financial outflows from 48 least developed countries (LDCs); over the period 1990-2008, $197 billion flowed out of these LDCs, mainly into developed countries. A 2009 study commissioned by Christian Aid calculated that trade mispricing by TNCs costs the world's 49 poorest countries $160 billion a year in lost tax revenues.[3] Another study found that commodities trading between 30 African countries and the United States resulted in Africa losing over $13 billion to the US due to trade mispricing between 2000 and 2005.

Zambia is one of the world's largest copper producers and copper represents almost three-quarters of the country's exports. A leaked auditor's report in 2011 suggested that Mopani Copper Mines, majority-owned by the giant Swiss TNC Glencore International AG, had shifted sizable profits out of the country, a finding the company refutes. In 2008, half of Zambia's copper exports were consigned, on paper, to Switzerland. The copper never actually arrived in Switzerland, but was sold on to other international customers at much higher prices than those realised by Zambia. A report by Christian Aid estimated that if Zambia had received Swiss prices for its copper it would have contributed revenues of $11.4 billion in 2008, almost doubling the country's GDP. Zambia's Deputy Finance Minister Miles Sampa recently said that Zambia is losing tax revenues of $2 billion a year, largely through transfer mispricing.

In 2011, Publish What You Pay Norway published an investigation into the labyrinthine corporate structures created by 10 of the world's biggest energy and mining TNCs.[4] The study found that these 10 TNCs controlled over 6,000 subsidiaries, a third of which were incorporated in secrecy jurisdictions. The oil TNCs – Chevron, Conoco and Exxon – had the largest number of subsidiaries in secrecy jurisdictions. Almost half of the subsidiaries belonging to Glencore International AG were based in secrecy jurisdictions.

The extractive industry is not alone in the use of creative accounting practices. A 2010 case-study showed how profits are shifted offshore through the production of beer. ActionAid examined the financial reports of SABMiller breweries in Africa.[5] SABMiller's brand portfolio includes Grolsch, Peroni, Miller, and the African beers Castle and Stone Lager. The company is the world's second largest beer company, with an annual turnover of $19 billion and profits of $3.2 billion. The investigation revealed that SABMiller has more subsidiaries in secrecy jurisdictions than breweries and bottling plants in Africa.

SABMiller's Accra Brewery in Ghana controls 30% of the country's beer market, with 2007-10 sales of $100 million. During this period, the company reported pre-tax losses of almost $5 million. For three of these years, Accra Brewery paid no taxes at all to the Ghanaian government. The investigation showed that SABMiller employed a variety of accounting techniques to shift profits out of the country while allocating costs in Ghana.

The popular African brands are owned by a SABMiller subsidiary in the Netherlands where companies pay next to no tax on royalties. The six SABMiller companies in Africa paid an estimated $67 million in royalties for the use of the brands in one year to the Dutch subsidiary, thereby substantially reducing taxable income in Africa. SABMiller's African subsidiaries also paid significant 'management fees' to a sister company in Switzerland, although the investigation found that the Swiss company provided no such services.

The African breweries procure their supplies, on paper, from a subsidiary based in the secrecy jurisdiction of Mauritius, thousands of kilometres to the east in the Indian Ocean. This is obviously accounting subterfuge as supplies were actually sourced from South Africa. Accra Brewery also 'borrowed' a large amount of money from the Mauritius subsidiary, the interest costs reducing tax liabilities in Ghana. All of these creative accounting techniques reduced SABMiller's African tax liabilities by at least $30 million annually. ActionAid points out that the tax revenue losses in Africa would be enough to put a quarter of a million children in school in the countries where SABMiller operates.

Wealthy individuals, dictators and criminals have also made good use of secrecy jurisdictions. A 2012 report from the Tax Justice Network estimated that $21 to $32 trillion of the financial wealth of people from 139 low-middle income countries has been channelled through offshore secrecy jurisdictions, resulting in global tax losses of at least $200 billion every year.[6] Secrecy jurisdictions have also provided money-laundering services to a substantial gallery of corrupt dictators. The Nigerian dictator Sani Abacha plundered the national treasury of $3 to $5 billion, laundered through Switzerland, Liechtenstein, Jersey, the United Kingdom, and the Bahamas. Indonesia's Suharto looted $15 to $35 billion, Mobutu of Zaire $5 billion. Marcos of the Philippines stole an estimated $5 to $10 billion, laundered through Switzerland and Panama as well as invested in real estate in the US. All of this looting has been made possible by the secrecy provided by more than 70 jurisdictions around the world.

It is clear that developing-country economies are being deprived of vast amounts of potential investment capital and their governments denied tax revenues needed to support health services, education, shelter, social security and public infrastructure. This has led to premature deaths and stunted the lives of vast numbers of people throughout the developing world. Christian Aid estimates that if lost tax resources were invested in health programmes in developing countries, it would save the lives of 350,000 children annually. The Tax Justice Network pointed out that the loss of tax revenues heightens inequality and poverty, corrodes democracy,

The headquarters of Swiss banks UBS *(left)* and Credit Suisse in Zurich. In 2011 Switzerland was ranked highest in the 'Financial Secrecy Index' which assesses countries according to their level of secrecy and the scale of their financial activities.

and obstructs economic growth. Raymond Baker of Global Financial Integrity calls the haemorrhage of resources from poor countries the 'ugliest chapter in global economic affairs since slavery.'

Governments are well aware of these problems. In 1996, the Organisation for Economic Co-operation and Development (OECD) was asked by the heads of state of G-7 nations to develop measures to deal with harmful tax practices. In 1998, the OECD released a list of jurisdictions it considered to be tax havens. Most of the countries identified were small island states; the list did not include European secrecy jurisdictions such as Switzerland, Belgium, Austria or Luxembourg. In not naming its own members, the OECD was accused of hypocrisy.

The OECD initiative went nowhere when the Bush administration withdrew its support. Harmful tax practices and banking secrecy came under scrutiny again in the aftermath of the 2008 financial crisis. At their 2009 meeting in London, leaders of the G20 major economies boldly declared that the era of banking secrecy was over. In subsequent G20 meetings, however, the language on secrecy has all but disappeared. It seems clear that Northern governments will continue to protect their TNCs and shareholders, permitting them to transfer vast resources belonging to Southern countries.

In the absence of international action, the Tax Justice Network launched a 'Financial Secrecy Index' which ranks countries according to their level of secrecy and the scale of their financial activities.[7] The index assesses a country's laws and regulations and international treaties as well as their size and importance to global financial markets. In the 2011 assessment, the top five out of 71 jurisdictions were Switzerland, the Cayman Islands, Luxembourg, Hong Kong and the United States. The index showed that the world's most secretive jurisdictions are largely rich nations and that many are members of the OECD as well as the G20.

The Financial Secrecy Index also reveals that mainstream thinking about the politics and geography of corruption is seriously flawed. Transparency International ranks some of the world's major secrecy jurisdictions such as Switzerland, Luxembourg, the United States, and the United Kingdom as among the 'least corrupt'. Yet, Switzerland's famous secrecy laws have allowed Swiss banks to provide money-laundering services to drug dealers, tax evaders, corrupt officials and dictators. In the United States, it is perfectly legal for financial institutions to handle the proceeds of a lengthy list of crimes as long as those crimes are committed elsewhere. Almost half of the world's secrecy jurisdictions are connected to the United Kingdom as Crown Dependencies, British Overseas Territories or as members of the

Commonwealth.

The Tax Justice Network and Global Financial Integrity, along with collaborating NGOs worldwide, are engaged in a campaign to put an end to abusive tax avoidance and the veil of secrecy that enables these practices. Key among NGO demands is the establishment of a multilateral framework for the automatic exchange of tax information. Such a multilateral agreement would require all governments to collect from financial institutions data on income, gains, and property paid to non-resident individuals, corporations, and trusts.

The campaign is also pushing governments to put an end to the secrecy provisions that provide anonymity to individuals and companies. The beneficial ownership, control and accounts of companies, trusts and foundations should be on the public record. Financial institutions should be legally obliged to identify the ultimate beneficial owners or controllers of any company, trust or foundation seeking to open an account.

NGOs are promoting the adoption of international accounting standards requiring TNCs to report sales, profits, and taxes paid on a country-by-country basis in their audited annual reports and tax returns. Country-by-country reporting would require information on sales, purchases, labour costs, financing costs, pre-tax profits, tax charges, costs, and value of assets. This could lead to an entirely reformed approach to taxing TNCs. Rather than taxing TNCs as separate entities in different geographic locations, a unitary approach would require them to submit accounts for each country where they operate. Taxes would be apportioned on the basis of a formula reflecting their genuine activity in each location. Each country involved would then tax TNCs for its portion of profits. This unitary taxation approach, based on the principle that taxes should be paid according to where income-generating activities are taking place, would greatly reduce international tax avoidance and profit-shifting.

NGOs are advocating that the UN Committee of Experts on International Cooperation in Tax Matters be strengthened in terms of mandate and resources. The G77 group of developing countries and China have proposed that the UN tax committee be upgraded to an intergovernmental commission, a proposition fiercely resisted by the OECD. The UN is much better able to represent the interests of developing countries than the OECD, which is largely a club of rich countries and has serious credibility problems on tax matters.

NGOs are also promoting the integration of responsible tax policies into corporate accountability frameworks. Corporate integrity means complying not merely with the letter of the law, but also with the spirit of the law. Tax revenues pay for the goods and services upon which corporations depend – public infrastructure, access to the environmental commons, an educational system that trains workers, social and health services, significant subsidies, and a costly legal system that safeguards corporate contracts and property rights. Tax expert Richard Murphy argues that tax is not a business cost. Rather, tax is much like a dividend – a return due on investments made by society-at-large, and derived from the 'commons,' from which corporations benefit.

The promotion of transparency and accountability in the international financial system has been resisted by TNCs and the jurisdictions that profit from the status quo. However, there are some promising signs that change may be in the wind. In the United States, amendments to the Dodd-Frank Act require publicly traded oil, gas and mining companies to report payments they make to governments, a provision that will allow citizens to see the revenues provided to their governments. In Africa, the UN has named a High Level Panel, chaired by former South African President Thabo Mbeki, to recommend measures to put an end to financial outflows from the continent.

Citizens' groups are organising in many parts of the world to promote progressive and equitable tax policies. Creative public education activities have developed such as the Tackle Tax Havens and the Robin Hood Tax campaigns. Citizens in Africa are mobilising to demand their governments engage in transparent negotiations with TNCs related to taxation, royalties and the recovery of social and environmental costs.

This international citizens' movement offers the possibility that we might collectively begin to rebuild societies rooted in sound economics and an ethics of responsible citizenship, equality and social solidarity. There is no better place to start than to eradicate secrecy jurisdictions that enable the outflow of critically needed resources from poor countries into rich ones, while communities – and nations – crumble, and the local and global commons erodes and disappears. ◆

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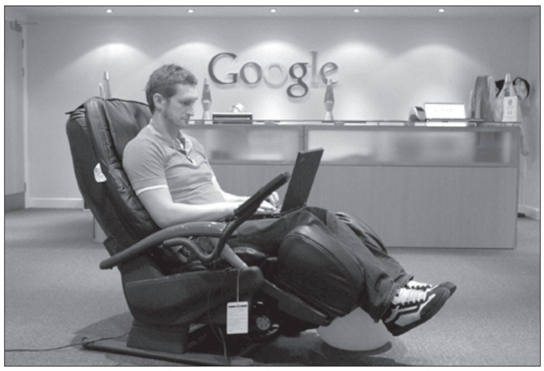
COVER

Transfer pricing and tax evasion: Beyond the trans-Atlantic furore

The current uproar in the West about the tax-evasive ploys of transnational corporations tends to obscure the fact that it is developing countries which have been the main victims. These countries face multiple impacts from the combined effects of tax breaks for foreign investors and manipulative transfer pricing practices, says *Smitha Francis*.



A worker at a Google office in Ireland. Google gets away with paying little or no corporate income tax in Europe by recording most of its revenue at its European headquarters in low-tax Ireland.

AS the countries of the European Union struggle to find the resources required to close their budget deficits and face enormous pressure on their expenditure budgets, tax avoidance by US transnational corporations (TNCs) like Google, Amazon, Starbucks and Microsoft through transfer pricing practices has come under intense scrutiny by fiscal authorities there. Despite the irony, the significance of this should not be lost on developing-country governments, where transfer pricing has long been an issue for host economies of foreign direct investment (FDI).

Transfer pricing refers to the pricing set between two related companies in intra-company transactions or trading. The latter can involve buying and selling of goods, patents or services between a parent company and a subsidiary, or between two subsidiaries controlled by a common parent, etc. Theoretically, TNCs must price such intra-firm transactions at market value. But clearly, subsidiaries and affiliates of TNCs can manipulate their intra-company transaction accounts by selling goods and services to each other at prices higher or lower than the market prices, such that profits from a company in one country can be transferred to another country with lower tax rates. Increasingly, offshore holding companies in countries with lower tax regimes or tax havens have also been used. Both enable TNCs to minimise their net taxable corporate profits in higher-tax jurisdictions. This has significant impact on government revenues.

The charge facing US TNCs like Google, Amazon and Starbucks is that despite generating billions of dollars in revenue in the EU, they get away with paying little or no corporate income taxes in Europe, by allocating their income between foreign jurisdictions. They use complex tax accounting strategies to exploit tax loopholes and differences in national corporate tax rates across Europe, which range from less than 10% to more than 30%. Thus recently, tax authorities in several European countries have begun investigating the transfer pricing practices of TNCs.

A British parliamentary report released in early December criticised US companies for what it described as tax avoidance. The report focused on the tax practices of Starbucks, Amazon and Google, which use lower-tax jurisdictions in Europe like Ireland, Luxembourg and Switzerland to record most of the revenues they earn in Britain, France and Germany. Prior to that, Starbucks had revealed that despite making a sales revenue of $398 million, it paid no corporate tax in Britain. Starbucks was reducing its taxable income in Britain by channelling revenue through its other subsidiaries in lower-rate jurisdictions. It was reported that one unit in the Netherlands was, for example, receiving royalty payments from Britain, which are deductible from taxable income. By showing the technology payments to the Netherlands subsidiary as costs, the British subsidiary is able to bring down its taxable income too.

In the case of Google, it has been brought to light that across Europe, Google's customers sign contracts with the company's subsidiary in Ireland, rather than with local branches. Thus Google records most of its international revenue at its European headquarters in Ireland, where the corporate tax rate is 12.5%. This low tax rate, together with EU membership (that lets companies based in one member state operate across the 27 member countries) and an extensive set of double tax avoidance agreements/treaties (DTAAs/DTATs), makes Ireland a very attractive destination for foreign investment.

In France, fiscal authorities have gone ahead and imposed a bill of $252 million on Amazon for taxes and penalties related to the 'allocation of income between foreign jurisdictions' from 2006 through 2010. Amazon has its European headquarters in Luxembourg, another small country with favourable tax conditions for TNCs. Thus, while the company reported


Tax evasion strategies used by TNCs drain Africa of revenues that could otherwise be allocated to public services like health, education and social support.

$11.6 billion in Europe-wide revenue in 2011, it posted an after-tax profit of only 20 million euros on those sales, and paid tax worth only about 8 million euros.

In Denmark, concerns regarding transfer pricing were raised in 2010, when it emerged that during the period of economic growth in 2006-08, half of the firms did not pay taxes in at least one year, and 28% of companies paid no taxes during the entire three-year period. In the case of Google, it was noted that while it received between 1.1 and 1.2 billion kroner from companies in Denmark in 2009, it recorded a Danish turnover of just 53 million kroner. Again, the discrepancy has arisen because customers are invoiced at Google's European headquarters in Dublin, Ireland, rather than in Denmark.

The story does not end on that side of the Atlantic, though. Through manipulative transfer pricing between offshore companies, US companies transfer the money they earn in Europe to tax havens like the Cayman Islands, Bermuda, etc., and avoid paying US taxes as well. As per current US laws, the standard federal corporate tax rate of 35% is applicable on domestic and foreign profits of US-incorporated companies, whether or not foreign income is already taxed in that jurisdiction. Firms would be required to pay 35% on their foreign earnings when or if they repatriate them to the US, whether for investing or for paying dividends to shareholders. But most US TNCs 'defer' taxes on their foreign business incomes by creating offshore subsidiaries in legal tax havens. For example, a recent report from the Washington-based Institute for Policy Studies ('The CEO Campaign to "Fix" the Debt: A Trojan Horse for Massive Corporate Tax Breaks') shows that Microsoft used its subsidiaries in Puerto Rico, Ireland, Singapore and Bermuda to avoid paying $6.5 billion in federal corporate income taxes over the last three years. Several other US technology companies such as the social networking giant Facebook have begun to utilise similar methods to avoid tax payments to the US government.

But are developed countries the only losers?

When developed countries make a hue and cry that TNCs are exploiting tax rules and using ownership structures to move profits generated from economic activity carried out in their jurisdictions to offshore locations, the irony is not lost. It is being argued that the huge revenue forgone through tax avoidance could otherwise be used to close the budget deficits in these countries and be spent on public services at home. This has been a longstanding public policy issue for developing countries. Since at least the 1970s development practitioners have questioned manipulative transfer pricing practices indulged in by TNCs to move profits generated from economic activity carried out in developing-country host jurisdictions back to the home countries.

Given that host countries have been granting various tax incentives for promoting foreign investments, revenue loss through transfer mispricing was one of the reasons why the debate on the costs and benefits of FDI to the host countries, which raged in international economics during the 1960s and the 1970s, was never settled. But with the widespread acceptance of the neoclassical development paradigm especially after the mid-1980s and also due to the debt crisis faced by many developing countries, country after country in the South has undertaken trade and investment liberalisation in the hope of attracting FDI and promoting exports. Apart from greater flexibility in the rules and regulations pertaining to FDI, other FDI-related policy changes which have been part of a broader financial liberalisation trend included: reduction or removal of exchange controls, permitting wider currency convertibility and greater repatriation of profits and dividends; removal of price controls to allow greater role of market forces, etc. While issues related to transfer pricing by TNCs in developing-country primary and resource-extractive industries were already controversial, each of these policy changes has increased the scope for transfer pricing manipulation.

Meanwhile since the 1980s, the sectoral focus of FDI into the South has shifted towards manufacturing and, more dominantly, services. With technology ownership heavily concentrated in the North, most technology payments and receipts have clearly been intra-firm in nature. Developing countries received more than half of global FDI flows in 2010 and 2011, which reflects the stakes involved. At the same time, developing countries are increasingly large investors themselves, with their share in world FDI outflows approaching 30%.

There are multiple impacts on developing countries from tax avoidance due to the combined effects of tax breaks for foreign investors and manipulative transfer pricing practices. Evidently, the government revenue forgone necessarily reduces the amount of money available for public services such as health, education and social support policies. For example, it has been pointed out that foreign aid would be rendered unnecessary if Africa were to receive tax revenues that are rightfully theirs, but that the tax evasion strategies used by TNCs drain the continent of revenues.

It should also be noted that since the 1990s developing countries have been saddled with institutional innovations such as fiscal rules and medium-term budget frameworks in support of more balanced fiscal policies. Given that tax breaks, while helping TNCs to engage in strategic transfer pricing practices, reduce government revenues, these fiscal rules generate pressures to compensate this impact either by increasing tax in other areas, or by cutting government spending. Both of these will also have direct implications for inequalities facing developing-country populations, depending on who pays disproportionately more due to the higher taxes such as value-added tax (VAT), lower public expenditure on utilities, etc. The tax hikes will hit income tax payees and the companies which duly pay their share of tax, while lower-income people and the vulnerable in society will be disproportionately affected by reduced social support because of the lower government expenditure.

Increasingly, FDI promotion has been couched in terms of integrating developing countries into global production networks for efficient production restructuring and export competitiveness. But the more integrated that a country is with TNC-led production network-driven trade, the greater the possibility for manipulative transfer pricing practices. Thailand, which has followed an FDI-dependent growth strategy since the mid-1980s, may be a useful example. Although foreign companies in Thailand are subject to a withholding tax of 10% on their after-tax profits repatriated to the head office, companies incorporated in countries which have signed DTAAs with Thailand are exempt from this. Given that Thailand has DTAAs with about 55 countries, including tax havens such as Mauritius and the Seychelles as well as major investor countries such as the US, EU countries, China and fellow members of the Association of South-East Asian Nations (ASEAN), and given the level of financial liberalisation pursued by the country since the early 1990s, the corporate income tax revenue forgone under this exemption through transfer pricing would be significant. Thus while the contribution of corporate income tax in Thailand's revenue mobilisation has increased significantly over the years, reflecting the increase of profit share in national income, the nature of exemptions and the high prevalence of foreign ownership across many sectors have meant that the proportion of revenue accruing from corporate income tax has actually been lower than what is due.

Meanwhile, the scope for creating and using multi-company structures spread across many tax jurisdictions that facilitate transfer pricing has increased dramatically as a result of the multitude of bilateral investment treaties (BITs) and the complex web of bilateral and regional economic agreements such as free trade agreements (FTAs), economic partnership agreements (EPAs), comprehensive economic cooperation agreements (CECAs), etc. that developing countries have been entering into. Most of these international investment agreements have a broad, open-ended definition of 'investment' which typically states that 'investment means every kind of asset' and covers equities, securities, loans, derivatives, sovereign debt, as well as a wide range of intangible assets. Similarly, the loose definition of 'investors' in many of these agreements, which determines the nationality of a legal entity solely on the basis of the place of incorporation, creates opportunities for 'treaty shopping' or free-riding by investors not originally meant to be treaty beneficiaries. The broad definitions of 'investor' and 'investment', together with the provision in many of these agreements allowing for 'free transfer of funds', increase the scope for transfer pricing manipulation involving separate entities in differently taxed jurisdictions.

For example, in the case of 44 out of the total 72 Indian bilateral investment agreements in force, companies are defined based on incorporation alone in the case of both India and the bilateral partner. But under such a definition, investors from non-Parties can also benefit from the terms of protection in an agreement simply by incorporating their venture in India or the bilateral partner and thereby benefit from the free transfer of fund inflows and outflows. At the same time, the majority of India's BITs do not recognise any exception to investors' right to transfer funds related to their investments in India. In the case of Mauritius, it is indeed well known that a host of foreign companies have set up their offices in that country and make investments in India as Mauritian investments in order to benefit from the free capital transfer provisions under the bilateral investment treaty with India. Similarly, the India-Singapore CECA states that free transfers are applicable to branches of enterprises incorporated in a third Party but registered/set up in Singapore. Thus, Mauritius and Singapore now rank among the largest sources of 'FDI' in India.

Clearly, the issues involved in manipulative transfer pricing and tax evasion have crucial implications for developing countries as they are losing government revenues to both developed countries as well as tax havens – resources which could otherwise be used to improve the lives of millions of people in these countries.

While fiscal authorities in the developed countries are increasing their scrutiny of tax avoidance by international companies and are moving to collect a greater share of TNCs' taxes, does this offer a window of opportunity to developing-country governments to exert pressure on the international community to revisit these issues? ◆

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Exposing the lost billions

In this article, *Øygunn Sundsbø Brynildsen* explains how developing countries lose billions to tax dodging every year, and how the leaks can be plugged.

IN early December the coffee-shop chain Starbucks was all over the international media headlines. Citizens' movements in the UK found it unfair that their local coffee shop had to pay taxes while multinational Starbucks got away without any tax contributions. Following public campaigning, Starbucks agreed to pay 'a significant amount of tax' over the next two years.[1]

This case is a telling example of how rich corporations, with the help of good lawyers, accountants and complex company structures, can shift their profits to countries in which taxes are low or absent. Google and Amazon are other giant companies whose tax-dodging practices have made it to the headlines.

What is less covered by international media and public debate are the billions of dollars illicitly flowing from developing countries to the Global North every year. These lost billions are the result of the same tax-dodging mechanisms. It is paradoxical that while many European countries are struggling with tight budgets and cuts in essential services, the European Union is not showing enough political will to put in place regulations that would help uncover tax dodging and make companies pay their fair share of taxes in the countries where they operate – be it in Europe or in developing countries.

Accra Brewery, a subsidiary of the world's second largest beer company SABMiller, controls some 30% of Ghana's beer market yet hardly paid any tax in the country from 2007 to 2010.

$1 trillion flowing out from developing countries every year

It is true that citizens in Europe are suffering from an unregulated global financial system. However, developing countries are the real losers from the lack of proper regulations. Every year, around $1 trillion illicitly leaves developing countries. In 2008 the figure was a little higher at $1.26 trillion, while in 2009 illicit flows from developing countries were estimated at around $850 billion.[2] Although there was a decrease between 2008 and 2009 following the downturn in international trade, the long-term trend has been towards rising levels of illicit financial flows. To put the figures in perspective, the illicit financial outflows from developing countries are around nine times the total amount of development aid from OECD countries, or around 20 times the extra $40-60 billion the World Bank estimates poor countries will need annually to meet all the United Nations Millennium Development Goals which aim to halve poverty by 2015.[3]

According to Christian Aid, 'since the United Nations Millennium Development Goals (MDGs) were set in 2000, the developing world has lost an estimated $160bn a year in tax revenues as a result of transfer mispricing within transnational corporations and false invoicing between business accomplices. That is significantly more than the amount of development aid given each year during the same period'. Christian Aid shows that these revenues lost to tax evasion would be enough to save 1,000 children a day if they were added to developing countries' budgets without any change in spending priority.[4]

Looking at sub-Saharan Africa, researchers Léonce Ndikumana and James Boyce found that the region has lost $700 billion to illicit capital flight since 1970.[5] A major part of this is due to untaxed wealth. If countries could start to recover their untaxed wealth, it could have an enormous development impact. Tax evasion is far from being a victimless crime.

Corporate practices are behind the majority of illicit outflows

Corruption is often at the centre of political discussion and rightly a high priority amongst harmful practices to clamp down on. However, corruption makes up less than 5% of cross-border illicit financial flows from developing countries. Criminal activities such as drug trafficking and human trafficking account for around 35%. The remaining 60% of illicit flows out of developing countries are due to commercial activity.[6]

Four years of losses in Ghana, and still gaining markets[7]

A larger-scale parallel to the Starbucks-vs-local-coffee-shop comparison in the UK is found in Ghana. ActionAid shows how the owner of a small beer outlet in Ghana's capital Accra pays her share of taxes every month while her neighbour Accra Brewery, which is a subsidiary of the world's second largest beer company SABMiller, hardly pays any taxes in Ghana. Accra Brewery is Ghana's second biggest beer producer and controls some 30% of the country's beer market. Yet, from 2007 to 2010 it recorded an overall pre-tax loss of £3.07 million. For three of these four years it paid no corporate tax at all.

SABMiller worldwide, by contrast, showed profits of £2 billion a year. Africa is where it dominates the brewing industry, but the group has more tax haven companies – a massive 65 – than it has breweries and bottling plants in Africa. ActionAid estimates that governments in developing countries may have lost as much as £20 million to SABMiller's expert tax dodging, enough to put a quarter of a million children in school. Yet, researchers found no illegalities in SABMiller's accounts, a fact that calls for serious regulations and closure of tax-dodging loopholes.

Why Switzerland is the largest importer of copper from Zambia

Another example of corporate behaviour causing illicit outflows is the Mopani copper mine in Zambia. The story about the second largest mine in Zambia – which in 2010, after 10 years of mining, still claimed it had made no profit in the country – is now going worldwide in the BBC documentary *Stealing Africa*.

Amazon is among the giant transnational corporations whose tax-dodging practices have captured media attention.

Mopani is majority-owned by the commodity trading corporation Glencore located in Switzerland. According to the World Trade Organisation (WTO), in 2008 over half of Zambia's copper exports went to Switzerland. A report by Counter Balance which looks into Mopani's accounts and practices states: 'It is very unlikely that this was all for Swiss consumption, and as the WTO report modestly states, these exports probably have more to do with accounting operations than with real transfers of minerals.'[8]

How corporations dodge taxes[9]

Corporate practices and lack of proper transparency requirements are at the heart of the massive illicit capital outflow from the Global South to the Global North. The absence of adequate transparency regulations allows multinational companies to hide the added value they are producing, concentrating their profits in low-tax jurisdictions or tax havens. Tax havens, or secrecy jurisdictions, are the core enablers of such practices. These countries or jurisdictions deliberately create legislation to ease transactions undertaken by non-residents. As a result, there is often very little real economic activity in tax havens. By providing banking secrecy, tax havens make it almost impossible to find out who owns an account, how much money it contains and where this money comes from.

The OECD estimates that 40-60% of world trade is intra-group trade occurring between related companies.[10] Intra-group trade enables a multinational corporation to shift profits within companies in its own group to make sure the accounts show high profits in low-tax jurisdictions. While some of the corporate practices used to dodge taxes are clearly illegal, such as false invoicing and trade mispricing, in many cases these are difficult to prove, given the lack of adequate instruments to effectively regulate them. Other means of shifting profits intra-group are legal or semi-legal yet ethically highly questionable.

Setting the prices for intra-group trade

While trading parties usually seek the best prices for their individual companies, in intra-group trade there is an incentive to set a price that will yield the best overall result for the group. A company may therefore export or import goods or services at a low or high price in order to shift profits from jurisdictions with higher tax rates to other jurisdictions with lower taxation. This is the case with Mopani in Zambia, where copper was sold at systematically below market prices to headquarters in Switzerland and then sold on for a higher price from Switzerland, leaving the corporate group to make its profits in a low-tax jurisdiction.

By providing banking secrecy, tax havens make it almost impossible to find out who owns an account, how much money it contains and where this money comes from.

A meeting of the Financial Action Task Force (FATF), which sets international standards to combat money laundering. Anti-money-laundering frameworks could, among others, address illegal tax evasion by deterring and punishing the companies and professionals who facilitate it.

According to the OECD 'arm's length principle', goods and services should be exchanged at market prices between the subsidiaries of a group, as if these were independent entities. Most countries apply the arm's length principle and can consider this transfer mispricing as tax evasion and thus illegal.

However, there are serious difficulties in implementing the OECD's interpretation of arm's length, particularly for developing countries. 'The taxation of international transactions, in particular transfer pricing, has become increasingly difficult,' states the African Tax Administration Forum's founding communiqué.[11] Transfer pricing typically involves huge and expensive databases and high-level expertise to handle, which developing countries cannot match.

Use of holding companies

Many multinational companies set up so-called holding companies in low-tax jurisdictions in order to pay less or no tax on their capital income (royalties, dividends, capital gains). Holding companies play the intermediary role between the parent and its subsidiaries and can indeed own most of the subsidiaries without having any actual activities other than collecting the tax-free dividend income from subsidiaries and reinvesting it in the parent company or the head office. The Netherlands is a well-known destination for holding companies.[12]

Thin capitalisation: Borrow from yourself and deduct interest payments

In most countries' legislation, interest paid on loans is deducted when calculating the taxable profits. One way of decreasing taxable profits is therefore to make sure that companies in high-tax jurisdictions take on expensive loans from other subsidiaries in the group. In the case of SABMiller, Accra Brewery got a loan that was more than seven times its capital, from an SABMiller subsidiary in Mauritius. ActionAid estimates that the interest costs on this loan will wipe out £76,000 of Accra Brewery's tax liability each year. In some cases interest rates can be overinflated in order to increase the subsidiary's costs in the high-tax country, resulting in a form of transfer pricing.

Intangibles: Assets that do not physically exist

Some countries have very favourable tax laws on revenues (royalties or licence fees) from intangibles such as intellectual property, including copyrights and trademarks. As a result, many companies make sure to register activities such as procurement services, legal and financial fees and the right to intellectual property and brand use in these jurisdictions.

In theory, transfer pricing rules protect against the use of such structures to shift profits; the arm's length principle says that intra-group trade must reflect regular market prices. However, even if the rules are followed (or rather, if the revenue authority is unable to contest the arrangement), companies frequently manage to arrange affairs such that high-value functions are located in low-tax jurisdictions in a way that shifts profits from operating companies. Michael Durst, a former senior official at the US Internal Revenue Service, puts it this way: 'A trademark is an imaginary product, an estimate of what value consumers place on the product on the basis of a name at best. How you record its value in your books is subjective.'[13]

Management and technical services: Paid for to a low-tax jurisdiction

A growing trend among multinational businesses is to centralise business functions such as accounting and marketing across the group. Because they are services, a business has a lot of leeway in deciding where to locate them, and will commonly choose to do so in a tax haven. Companies based in higher-tax jurisdictions increase their costs by buying these services.

Again, SABMiller can serve as an example. SABMiller's African subsidiaries pay huge 'management service fees' to sister companies in European tax havens where effective tax rates are lower. In Ghana, the fees amount to 4.6% of the company's revenue every year; in India, they are enough to wipe out taxable profits entirely. When asked about the management service fees paid by its operating companies to what appeared to be a skeleton company in Switzerland, the company conceded that the payments were only 'routed' through that company, which did not itself provide any services at all. ActionAid estimates that management fee payments by SABMiller companies in Africa and India amount to £47 million each year, depriving these governments of £9.5 million of tax revenue.[14]

Round-tripping

Between 2000 and 2009, Mauritius was the largest investor in India. Much of this investment is suspected to be due to so-called round-tripping. Many countries offer various incentives to foreign direct investment, including tax cuts. This gives incentives for local companies to move offshore and reinvest as foreign investors back in their home country in order to benefit from such tax incentives. Since 2006 the Indian government has been assessing the revenue lost due to tax incentives to foreign investors. It estimates that the country lost some €10 billion due to tax incentives for large businesses in 2008 and 2009.

Plugging the leaks: How transparency regulations would help

Tax haven secrecy is key to making all of this possible. The examples of SABMiller, Mopani and Starbucks show a complete geographical disconnect between the companies' real activities and the story told in their accounts. Multinational companies are allowed to report their accounts on a

Tax havens like the Cayman Islands *(pic)* are core enablers of corporate tax-dodging practices.

global level, and hence can use the abovementioned methods to shift their profits from where the productive activities take place to their subsidiaries in secrecy jurisdictions. Increased transparency regarding real sales, profits, assets and employees would increase tax collectors' chances of discovering illegal tax evasion, and would shed light on the legal or semi-legal but nevertheless morally unacceptable tax avoidance practices.

Moreover, it is difficult, often impossible, to know who the real owner of a company is. Secrecy around who benefits from and controls corporate vehicles is another feature that helps keep money untaxed. A video by Al Jazeera, *Robbing Africa*, shows how two journalists pretending to be a Zimbabwean diamond dealer and his lawyer easily manage to establish a company group whose explicit aim is to be the secret link between diamond dealers and high government officials. 'I haven't heard anything of what you said the last two minutes,' says the facilitator who willingly helps the undercover journalists set up a corporate structure which complexity makes it practically impossible to trace the real owners.

Forthcoming research by Eurodad (the European Network on Debt and Development) shows how ownership secrecy and opaque legal structures also frustrate other transparency initiatives such as international cooperation through tax information exchange. The veil of corporate secrecy means the taxpayer cannot be identified; as such, it is harder to identify which country to share the information with and the information shared is much less useful.

Small steps towards more transparency

Lawmakers should therefore require corporations to report their accounts on a country level. This would make information available to tax collectors, media and the interested public.

The idea of country-by-country reporting is slowly gaining ground. Section 1504 of the Dodd-Frank financial reform act adopted by the US Congress in 2010 requires publicly traded oil, gas and mining companies in the US to report payments they make to any government on a country-by-country and project-by-project basis. This will cover around 1,100 companies.

The petroleum sector has strongly protested against the law, and the American Petroleum Institute has filed a lawsuit to undo the rules. Together with the US Chamber of Commerce they demanded that implementation of the law be put on hold until the court case is over. The US Securities and Exchange Commission – which is the federal body in charge of the regulation – has however rejected the oil companies' demand. Hence, companies will be required to report according to the new law starting in 2014.

… but more information needed

While these are positive steps, particularly in making it easier to detect corruption between extractive industries and governments and to see how much these companies contribute to the state, Section 1504 is of limited use for uncovering tax dodging. To know what a realistic tax base would be, it would be important to know more than what payments a company makes to the government.

Lawmakers should therefore require a company to report: 1) the name of each country where it operates, 2) the names of all its companies in each country, and 3) its financial performance in each country (sales, purchases, labour costs, employee numbers, financing costs, pre-tax profits, tax charges, costs and value of assets).[15] Such information would make it possible to discover mismatches between real activity and tax payments in a country.

… in more sectors

Moreover, as the Starbucks and SABMiller cases show, country-by-country reporting should be required beyond the extractive industries sector. All companies operating in more than one country should be required to report their financial data on a country-by-country basis.

Although some private sector actors strongly oppose the proposal of country-by-country reporting, others do voluntarily implement country-level reporting. A study done by Christian Aid shows not only that tax is seen as a growing area of risk and that there is a reputational risk attached to the way in which companies operate, but that there is also support for the proposal from several private sector actors.[16]

European Union: Progressive language, but is there political will for implementation?

At the European Union level, much has been said in favour of increased transparency measures and support for domestic resource mobilisation in developing countries. However, it remains to be seen if political will is strong enough to put weight behind the words.

During the Spanish presidency of the EU in the first half of 2010, European leaders confirmed that tackling illicit financial flows from developing countries was a priority and committed themselves to 'pushing for a more development-friendly international framework' in order to address tax evasion and harmful tax practices, and to increase cooperation and transparency. They recommended for the first time that 'country-by-country reporting [should be established] as a [reporting] standard for multinational corporations'.[17]

In 2011-12 EU member states and Members of the European Parliament have had a unique chance to make a real difference through renewing the EU Accounting Directive. Questions of country-by-country reporting beyond the extractive industries sector and beyond only payments to governments have been debated. In this respect, it is a positive step that the lead committee at the European Parliament has voted in favour of country-by-country reporting of payments to governments (only), not only in the logging and extractive industries but also in the banking, construction and telecommunication sectors. However, the final Directive, which could come out in early 2013, is likely to prove less progressive and likely to suffer from the same limitations as Dodd-Frank Section 1504 when it comes to tackling tax dodging. The resistance among several member states and some Parliamentarians to going beyond payments to governments and including more sectors has been strong. Hence, even as an amount equivalent to the aggregate EU health budget illicitly flows out, EU member states are dragging their feet and not showing enough will to put in place regulations that would shed light on the illicit practices.

A new opportunity for the EU to clamp down on tax haven secrecy will come up in early 2013 when the EU begins renewing its Anti Money Laundering Directive. Forthcoming Eurodad research shows how anti-money-laundering frameworks provide an opportunity to secure transparency around who owns and controls companies and other corporate vehicles, by revealing the real people that own and control bank accounts and legal structures such as companies, trusts and foundations. It also shows how such frameworks could address illegal tax evasion by deterring and punishing the companies and professionals who facilitate it, and how greater transparency around beneficial ownership disclosure and harmonisation of laws would make it easier to understand legal or semi-legal aggressive tax planning and avoidance schemes.

International anti-money-laundering standards, including requirements to disclose the real owners of companies and other corporate vehicles, are set out by the Financial Action Task Force (FATF). In 2012, the FATF came up with a new set of recommendations. Just like the EU, several countries will be translating these recommendations into national law. This provides a unique opportunity to ensure legislation that makes it more difficult to hide illicit money in secrecy jurisdictions. Following the HSBC and other banking scandals, in November the US announced that it will review all legislation relating to money laundering.

Not only the revenues

It is promising that awareness of illicit financial flows is increasing, particularly of the enormous sums of capital illicitly being transferred from the South to the North every year, and there is a growing acknowledgement that these flows are largely driven by insufficient regulations and dodgy corporate behaviour. The public mobilisation against Starbucks' tax-dodging practices is a noteworthy example.

Policymakers have also begun to pay greater attention to the issue. The G20 major economies grouping and the EU have issued statements expressing clear ambitions to clamp down on tax havens, the key facilitators of illicit financial flows due to their veil of non-transparency covering the origins of illegal and immoral money. The EU, while concerned about member states' budgets and the pressing need to increase revenues, also strongly emphasises the crucial role of domestic resource mobilisation in its development policies.

Bringing the now illicit flows back into the tax net would yield enormous benefits to governments in terms of increased fiscal revenues that can be spent on pro-poor measures such as health, education and infrastructure. However, tax has multiple functions whereof revenue is only one aspect. Tax is also an efficient tool for redistribution through its progressivity and how tax revenue is spent. Not least, taxation strengthens democracy and a government's accountability to its citizens. As citizens demand that their taxes are spent wisely and for their benefit, this leads to greater public participation in a country's political process.

Uncovering the illicit flows and who is behind them and ensuring that multinational companies pay their fair share of taxes in the countries where they operate requires an end to corporate secrecy. Country-by-country reporting of financial data by all multinational companies will greatly improve tax administrations' ability to discover any irregularities and enable the public to scrutinise the behaviour of corporations in their countries. It would also shed light on the various tax-dodging mechanisms and hence help lawmakers close harmful legal loopholes and strengthen monitoring. Requiring financial institutions to know who they are doing business with is key to knowing who is actually controlling and benefitting from illegal or dodgy behaviour. Public registers of who owns and controls companies, trusts and foundations would again help public scrutiny and be crucial for legal cases, as was underlined by Baltasar Garzon Real, the Spanish judge famous for his high-profile investigations into crimes against humanity, at the 2001 International Anti-Corruption Conference.[18]

Against this backdrop and following its progressive rhetoric and commitments to contributing to international development, the EU should lead in implementing the transparency regulations set out above. Adequate transparency regulations in the form of country-by-country reporting and requirements to reveal the real owners of companies, trusts and foundations are feasible and would be major steps towards shedding light on harmful tax practices diverting money away from slim European budgets and, more importantly, robbing developing countries of billions of dollars every year. They would help tax collectors to uncover irregularities and make multinational companies pay their fair share of taxes in the countries in which they operate. Implementing such regulations is a matter of political will. ◆

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India's onslaught highlights 'divide' over UN tax committee's role

While it is clear that a truly global body comprised of developing and developed countries is needed to effectively tackle the problem of tax evasion by transnationals, the rich countries have stymied all efforts to enable the UN with its universal membership to take on this role. Instead these countries have sought to promote the OECD – the 34-member exclusive club of rich nations – as the sole body to set the norms of international taxation. But as the following article by *Andrew Goodall* reveals, revolt is in the air.

OECD guidelines on transfer pricing and other international tax issues protect the interests of OECD countries only and it is 'improper' to suggest that they represent internationally agreed guidance, the Indian government has claimed.

It was 'extremely important' that the UN Committee of Experts on International Cooperation in Tax Matters be 'upgraded' to an intergovernmental commission, India said in a letter to the UN ahead of a 'special event' on international tax cooperation held on 15 March.

Joint Secretary in the Indian Finance Ministry Sanjay Kumar Mishra *(right)* seen here with OECD Deputy Secretary-General Rintaro Tamaki after India signed a multilateral agreement on mutual administrative assistance in tax matters in January 2012. In a subsequent letter to the UN, Mishra has said that the OECD's separate transfer pricing guidelines reflect only developed-country interests.

The status of the UN committee continues to divide developing and developed countries despite agreement on the importance of the UN's work, according to a summary of the meeting.

The meeting of the UN Economic and Social Council (ECOSOC) considered a report, 'Role and work of the Committee of Experts on International Cooperation in Tax Matters', in which the UN Secretary-General said the UN's tax work should be focused on providing a leadership role 'in areas where there are gaps'.

'Are the global tax tectonic plates shifting?' the ICAEW (Institute of Chartered Accountants in England and Wales) Tax Faculty asked in an item published before the outcome of the meeting was known, noting that there had been 'much talk in recent years' of upgrading the committee. ECOSOC intended to revisit the issue of international cooperation in tax matters in July.

The Secretary-General wrote in his report: 'The UN, thanks to its universal membership and its legitimacy, can be a catalyst for increased international cooperation in tax matters for the benefit of developed and developing countries alike. Since the great majority of UN Member States are not members of either OECD or the G20, it is the role of the UN to ensure the active participation of developing countries, including the least developed countries, in international tax cooperation activities, which will ultimately be of benefit to them. Only if this level playing field is achieved, can enhanced tax cooperation be truly respected as global.'

The UN tax committee comprises 25 members 'nominated by governments and acting in their expert capacity'. The UN's Financing for Development website says: 'The members, who are appointed by the Secretary-General after notification is given to ECOSOC, for a term of four years, are drawn from the fields of tax policy and tax administration and are selected to reflect an adequate equitable geographical distribution, representing different tax systems.'

'Truly universal and inclusive'

An executive summary of the meeting, published on the UN's Financing for Development website, said: 'Developing countries emphasised the need to establish a truly universal and inclusive body for international tax cooperation at the intergovernmental level, which would embody democratic principles on a level playing field by giving developing countries a "full seat" and "equal voice" at the table and thus supported the conversion [of the UN tax committee into an intergovernmental body].

'Developed countries, on the other hand, opposed the conversion and proposed to focus on improving the effectiveness of the current structure and making sure that existing resources were used most effectively.'

Pascal Saint-Amans, Director of the OECD Centre for Tax Policy and Administration, 'called for enhanced involvement of the UN Secretariat in the work of OECD, including UN participation as an observer in the OECD Committee on Fiscal Affairs'.

'Inconceivable'

India's representative had confirmed 'India's position that it was extremely important to bring the UN work on international tax matters into the intergovernmental process by upgrading the Committee of Experts to an intergovernmental commission'.

In a 'letter from India' (reproduced below), also published on the ECOSOC website, Sanjay Kumar Mishra, Joint Secretary of the Central Board of Direct Taxes – part of the Department of Revenue in India's Ministry of Finance – said the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines had been developed 'on the basis of consensus arrived at by the government of 34 countries (all developed countries)'.

It was 'inconceivable', he said, 'as to how a standard developed by government of only 34 countries can be accepted by government of other countries as "standard" of sharing of revenue on international transactions between source and resident country, particularly when it only takes care of the interest of developed countries and has seriously restricted the taxing powers of source country'.

A covering note from India's Ambassador to the UN indicated that the letter conveyed the Indian government's views on the Secretary-General's report. The members of the UN tax committee from China and Brazil 'generally supported' the Indian government's position on this issue, said David Spencer, Senior Adviser to the Tax Justice Network (TJN).

'Information deficiency'

The TJN has called for an 'objective analysis' of transfer pricing issues in the context of developing countries, arguing that 'the OECD's theory of the arm's-length principle no longer applies to multinational enterprises which are highly integrated' and that 'comparables in many if not most cases cannot be found'.

The group said a draft Transfer Pricing Manual being prepared by a subcommittee of the UN tax committee referred to an 'information deficiency problem'.

This was, the TJN said, 'the problem faced by developing countries in getting sufficient information, including comparables, about the activities of multinational corporations'.

The TJN reiterated its support for country-by-country reporting, 'whether countries adopt the OECD's Transfer Pricing Guidelines, or a modified arm's-length principle, formulary apportionment, or a mixed system'. ◆

Andrew Goodall is the News Editor of Tax Journal, *from which this article is reproduced (Issue No. 1118, 13 April 2012).*

'UN tax committee must be upgraded to an intergovernmental commission'

The following is extracted from a letter dated 12 March 2012 from Sanjay Kumar Mishra, Joint Secretary in the Indian Ministry of Finance, to Alexander Trepelkov, Director of the UN Financing for Development Office. The letter conveyed the Indian government's views on the UN Secretary-General's report on 'Role and work of the Committee of Experts on International Cooperation in Tax Matters'.

INDIA in its comments to the United Nations to the Note Verbal 10/340 dated 1st December, 2010, had stated that it will support Inter-Governmental Commission over the existing Committee of Experts on International Cooperation in Tax Matters. India reiterates its stand on this issue.

2. India would like further to state that the Inter-Governmental Commission with a balanced representation from the Governments of developing and developed countries, could play a crucial role in fostering dialogue and cooperation between national tax authorities and in promoting North-South, South-South and multilateral cooperation.

3. The United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model Convention), while avoiding double taxation, allocates a greater share of tax revenue to the source country. Contrary to this, the OECD Model Tax Convention on Income and on Capital (OECD Model Convention) does not recognise the right of taxation of the source country in many cases.

3.1 In the case of Transfer Pricing, although it is governed by domestic legislation of each country, the OECD countries have agreed on common transfer pricing guidelines known as OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines). These guidelines on transfer pricing only reflect the agreements amongst Government of those countries that are members of OECD (developed countries) and accordingly tend to take care of interest of only developed countries. The guidelines do not give right of taxation to source countries accordingly eroding taxing rights of developing countries.

3.2 Even though OECD Transfer Pricing Guidelines do not address the concerns of developing countries, paragraph 3 of the proposed UN Model Convention Commentary of Article 9 indicates that the former non-governmental Group of Experts (year 1999) had stated that all the countries including developing countries will follow the OECD principles as set out in the OECD Transfer Pricing Guidelines for the reasons that these guidelines represent internationally agreed principles. The former expert group had also recommended that the Guidelines should be followed for application of the arm's length principles. However, it has been clarified in the new commentary that views expressed by the former Group of Experts have not yet been considered fully by the Committee of Experts as indicated in the Records of its annual session. India believes that the Committee of Experts does not have jurisdiction to decide the critical issue of whether the OECD Transfer Pricing Guidelines agreed by Governments of developed countries should be followed by the Governments of the developing countries when these Governments are not party to the OECD Transfer Pricing Guidelines. India does not believe that the decision of the former Group of Experts can be interpreted that subsequent revision of OECD Guidelines (after 1999) will automatically become the internationally agreed standards and United Nations guidance will automatically change without participation and agreement by non-OECD countries. India believes that taking such a decision was not within the purview of the non-governmental Committee of Experts (1999) and should be revoked immediately.

3.3 The Committee of Experts has constituted a sub-committee consisting of 13 members of the developed and 7 members of the developing countries with a mandate to develop a practical manual on transfer pricing based on the following principles:

(a) That it reflects the operation of Article 9 of the United Nations Model Convention, and the Arms Length Principle embodied in it, and is consistent with relevant Commentaries of the UN Model.

(b) That it reflects the realities for developing countries, at their relevant stages of capacity development.

(c) That special attention should be paid to the experience of other developing countries.

(mandate as provided by 5th Annual Session of Committee, 19-23 October 2009)

It is evident from above that the mandate does not require that United Nations guidance should be based on OECD Transfer Pricing Guidelines. However, there is a strong view in the sub-committee that due to the decision taken by the earlier group of experts in 1999, the sub-committee should not deviate from existing OECD Transfer Pricing Guidelines. India believes that OECD Transfer Pricing Guidelines cannot be imported to UN guidance particularly when such recommendations of the group in 1999 are not considered by the present committee and are beyond the scope of the non-governmental committee. It is important to note that contrary to the inter-Governmental composition of OECD, at present, all the experts of the UN Committee are working in their individual capacity. Since the majority of members of the sub-committee are from OECD countries who are also Government representatives in WP6 of the OECD, there is a tendency to discuss only OECD work, ignoring practices in developing countries.

3.4 In view of the above, India requests that the United Nations may consider constituting Inter-Governmental Commission (including sub-committees), having representatives from Governments of the developed and developing countries, on various issues relating to International Taxation and Transfer Pricing, to develop guidelines on the basis of consensus amongst Government of all countries which take care of the interests of the developing countries. Further, in developing such guidelines, the recommendations of the Committee of Experts (1999) that the OECD principles as set out in the OECD Transfer Pricing Guidelines should be followed, must be ignored.

4. India further believes that in the revision of the UN Model Convention, which is due to be released on 15th March, 2012, concerns of developing countries have not been taken into consideration, as it has been developed by the Group of Experts and sub-committees having non-governmental representatives and disproportionate representations from OECD countries. India will submit its detailed comments once the revised UN Model Convention is made public.

5. India is also aware of the concerns of the OECD on the work of the United Nations to develop standards in the areas of international taxation and transfer pricing due to the reason that it would be duplication of work. India does not agree with this concern for the following reasons:

(i) The OECD Model Tax Convention and OECD Transfer Pricing Guidelines have been developed on the basis of consensus arrived at by the Government of 34 countries (all developed countries). These guidelines only protect the interests of OECD countries which are parties to such convention. Since the Governments of developing countries are not party to the Guidelines, it is improper to suggest that they represent international agreed guidance knowing fully well that concerns of developing countries have not been taken care of in the OECD Model Convention and OECD Transfer Pricing Guidelines.

(ii) It is inconceivable as to how a standard developed by Government of only 34 countries can be accepted by Government of other countries as 'standard' of sharing of revenue on international transactions between source and resident country, particularly when it only takes care of the interest of developed countries and has seriously restricted the taxing powers of source country.

(iii) Views of OECD and UN on sharing of tax revenue by developing and developed countries are not the same and accordingly concerns of duplication of efforts should be ignored.

6. The above steps would require additional resources and strengthening the Secretariat. India supports the fundraising efforts for this purpose and is of the view that it should not only be on the basis of voluntary contribution. India further offers technical support by way of experts and staff for the Secretariat.

7. India also offers technical assistance including by way of providing space and resources for training facility in the areas of international taxation and transfer pricing for training the officers and staff from developing countries. ◆

Why I love the United Nations tax committee

Martin Hearson, who attended a UN tax committee meeting held in Geneva on 15-19 October, provides a glimpse of the continuing battle between the rich and poor countries on the issue of international taxation and explains why this issue goes to the heart of global political economy.

INTERNATIONAL tax, the way countries coordinate and negotiate tax rules between themselves, is often talked about as if it's about finding technical solutions to technical problems. But it's not. Just as the tax system inside a country is at the absolute core of its political debate, so you can look at international tax and see right to the heart of global political economy. What I love about UN tax committee meetings, such as the one I attended in October, is that you can see this in action.

Members of the UN Committee of Experts on International Cooperation in Tax Matters. Developing countries want more funding and an intergovernmental status for the UN's tax work.

Take transfer pricing, the system through which, in most cases today, the right to tax multinational companies is divided between the countries in which they operate. The pre-eminent international standards defining how this works in practice are the guidelines set by the Paris-based OECD, broadly speaking the world's 'developed' countries. The OECD's guidelines are facing a number of challenges.

Many of these challenges are technical, because the foundations of the transfer pricing were laid at a time when most international trade revolved around physical commodities, whereas today much of the most valuable parts of the economy are intangible and footloose things such as business services, finance and intellectual property. These criticisms and proposals for alternative systems were given a good airing at a Tax Justice Network conference in Helsinki earlier this year.

But transfer pricing also faces a political problem. The OECD itself can no longer count many of the most significant economic players amongst its members. Take note in particular of China, India and Brazil. These countries aren't content to be 'rule takers', and their economic weight means that they don't need to be too concerned about the repercussions of diverging from international standards. Instead, they use OECD guidelines when it suits their interests, but are quite willing to do their own thing at other times.

These countries and the OECD have been locked in a battle for some time over the UN tax committee's new practical manual on transfer pricing in developing countries, approved by the committee on 15 October despite howls of protest from the United States Council for International Business. The eventual document asserts its consistency with the UN's model convention, which in turn refers to the OECD guidelines, despite USCIB's anxiety that parts of it 'undercut' the OECD. But it also includes an appendix which outlines the Brazilian, Chinese, Indian and South African approaches.

So far, so timid, but as someone said on 15 October, 'the baby has been born'. The UN now has a foot in the door on transfer pricing, and over time it would be possible for its manual to gradually diverge from the OECD's guidelines, just as its model convention and that of the OECD have been diverging for some time.

All this is important because of fundamental differences between the characteristics of developing and developed countries' economies. Larger developing countries are choosing to remake the transfer pricing system, not just with a few technical fixes, but to make a grab for a greater share of the 'taxing rights' over multinational businesses. The Chinese approach, for example, starts from the idea that value is distributed unfairly within the global economy, and quite explicitly seeks to correct for this in its transfer pricing system. The fundamental basis of the OECD approach to transfer pricing is that taxing rights should follow the distribution of value in the free market.

In tax language, this is the balance between 'source' and 'residence' taxation. A typical example to explain these terms is a multinational company with its HQ, or residence, in the

US, and some of the business activities that are the source of its profits taking place in India. (It gets more complicated, because the countries I'm talking about here, in contrast to smaller developing countries, have enough multinational companies of their own that they are also residence countries vis-a-vis much of the world.)

At the UN tax committee, participants talk openly about the balance between source and residence taxation. Shifting the balance towards source taxation would mean that less developed countries gain more. Indeed, it was in exactly these terms that a proposal to update the UN's model tax convention to allow source countries to tax technical service, management and consultancy payments made to someone abroad was discussed at the October meeting. Conversely, changes made by the OECD to its model convention have previously been rejected by the UN committee for inclusion in its updated convention because they pulled the balance towards residence and away from source.

The really interesting question is what will happen to this international tax architecture in the future. Will the OECD manage to bring the BRICS (Brazil, Russia, India, China and South Africa) inside its tent, will they continue to do their own thing and drive a movement towards a more multi-polar international tax system, or will the UN emerge as the forum in which the interests of source and residence countries are reconciled through inclusive international standards?

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The October meeting of the UN tax committee saw an interesting exchange tinged with a certain irony.

In the run-up to the meeting, the United States Council for International Business had written a pretty angry letter to the committee, copying in half the US Treasury, complaining about the committee's new practical manual on transfer pricing. USCIB has some process concerns, and wants a public consultation, but its content issues focus on trying to excise any remaining text in the manual that is not watertight in its endorsement of the OECD transfer pricing guidelines.

The OECD's guidelines on transfer pricing are facing a number of technical and political challenges.

In the tax committee's parent body, the UN's Economic and Social Council (ECOSOC), a debate has been raging for some time about the committee's 1) funding and 2) status. As the responses to last year's consultation show, developing countries want 1) more funding and 2) an intergovernmental status for the UN's tax work, while the OECD countries want 1) no more funding and 2) no change to the committee's status.

So it was amusing to hear the tax committee's Mexican chair respond to USCIB's concerns by stating that the committee 1) had no funds to organise a public consultation, and 2) wasn't obliged to take on board any comments, since it is purely a committee of experts expressing their individual opinions, not an intergovernmental body. 'Please keep your intervention short, as there is no room for negotiation on this,' was his last word to USCIB. I wonder if business will consider supporting increased resources and status for the committee as a result?

The committee then agreed the manual as drafted, although this was followed by a remark from the United States official observer to the meeting suggesting that, since the manual is a 'living document', it might seek to implement USCIB's suggested deletions after the membership of the tax committee changes next year.

This wasn't the only US-versus-the-World moment of the tax committee meeting. On 16 October the committee agreed to start work on a new article for its model convention that would give developing countries the right to tax payments for technical services, management and consultancy fees made by their taxpayers to people resident overseas. Depending on how it's done, this could be seen either as a step to help tackle 'base erosion and profit shifting' (a form of tax dodging that we can refer to as 'BEPS') or as a fundamental shift in the balance of taxation towards developing countries.

Numerous developing-country representatives spoke up in what was an animated session, all describing the pressing need for this change to help them tackle BEPS. In contrast, official observers from the US and UK (two countries that are probably big recipients of the kinds of fees to be taxed) not only argued for the need to clarify between the two possible aims, but also cast doubt on the developing countries' argument that there was a problem at all.

The committee noted their objection and carried on regardless. ◆

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The need for research into unitary taxation of transnationals

It is clear that the current method promoted by the OECD of assessing taxes payable by transnationals is seriously flawed as it treats their dealings with affililates as if they were transactions between independent firms. There is a need for more research into the alternative of unitary taxation which treats transnationals as integrated firms, says *Sol Picciotto*.

THERE is currently considerable ferment in the area of international tax, especially on issues of evasion and avoidance, the use of tax havens, the links with capital flight and corruption, and problems of transfer pricing and mispricing. These are all of significant concern to developing countries, and raise issues which should be and are being researched.

There is, however, one topic which is in many ways central to these various issues, and which is under-researched: unitary taxation (UT) of transnational corporations.

From a policy perspective, UT has been put forward as an alternative approach to the accepted methods of dealing with transfer pricing. These methods are based on separate accounting and 'arm's length' pricing, which have been criticised as contrary to basic economic understanding of TNCs as integrated firms, and resulting in practice in distortion of multinational activity and leading to world welfare losses. Many international tax lawyers favour the unitary approach.

A unitary approach would tax multinationals not according to the legal forms devised by their tax advisers, but according to the genuine economic substance of what they do and where they do it. The key would be to require each firm to submit to the tax authorities of each country where it does business a 'combined report' providing consolidated accounts for the whole global group, ignoring all internal transfers. This would provide the tax authorities of each country where the firm has a business presence with an overview of its worldwide business. The report should specify the group's physical assets, workforce and revenues from sales to third parties. The overall worldwide profits would then be divided up among jurisdictions according to a formula weighing these three factors.

Consensus under strain

For various reasons, the policy-making community, dominated by the OECD Fiscal Affairs Committee, has for many years opposed this option. This seems to stem from an understandable fear of the difficulties that might result from upsetting the historically developed consensus around the arm's length principle. Consequently, the unitary approach has never been seriously evaluated by any official body, and has been very little researched.

Yet this consensus, always fragile, is coming under increasing strain. In the context of current fiscal pressures facing most developed states, tax avoidance by TNCs has come increasingly into the spotlight, and tax authorities are under pressure to come up with better solutions. The OECD Fiscal Affairs Committee has launched an initiative to deal with 'base erosion and profit-shifting', although it seemed reluctant to contemplate any significant departure from current approaches. Political pressure has been put behind this initiative in a joint statement by the German and UK finance ministers, who have asked for a progress report to the next G20 meeting in Russia in February 2013.

Developing countries are particularly affected by this policy impasse. They have been urged to strengthen their scrutiny of transfer prices, and strongly pressed to apply the OECD 'consensus' approach, which is backed by considerable efforts in capacity building. Yet this is likely to create significant difficulties for countries themselves, as well as for the system.

Transfer pricing audit based on the arm's length principle is notoriously difficult to administer, requiring considerable specialist expertise and being very time-consuming. At the same time, the OECD Guidelines on Transfer Pricing, which provide the biblical elaboration of the approach, are also both biblically complex and flexible, allowing a variety of different methods in practice. The UN Tax Committee, which is tasked with adapting the OECD approach to the particular needs of developing countries, is completing a revision of its Manual, which extends the scope of flexibility in practice. It includes chapters explaining the methods used by Brazil, China, India and South Africa, which show considerable divergences and indeed conflicts.

The likelihood is that this general strengthening of scrutiny of transfer pricing will both consume enormous administrative and professional resources, and result in conflicting tax assessments on TNCs. When such conflicts become overt, they have to be dealt with by the 'mutual agreement procedure' provided by double tax treaties, which is notoriously slow and inevitably arbitrary.

This should therefore be a good moment for policy-relevant research on this issue. From the perspective of the issue of transfer pricing alone, a good case can be made for research into whether unitary taxation could provide a better alternative, especially for developing countries. There are widespread concerns over the (non-)functioning of the current mechanisms for international allocation of the tax base: an editorial in the *Financial Times* recently (20 October 2012) claimed that '[c]urrent practice has turned tax into a largely voluntary gesture' for multinationals. Complex calculations and negotiations between tax authorities and taxpayers are in many cases followed by international negotiations on the split of the tax base in individual cases, so that the entire process is time-consuming, complex, opaque and includes a substantial degree of room for movement in any given case. In principle, unitary taxation potentially offers a simpler and much more transparent mechanism for reaching the same ends.

This case is greatly strengthened once it is understood that the unitary approach would deal not only with transfer pricing, but with all types of profit-shifting by TNCs, including their use of tax havens. Such research should clearly be carried out as objectively as possible. Indeed, it is surprising that the question of UT seems to have been identified as politically controversial, since it raises some very technical questions. Yet very little research has been done into such questions, perhaps largely because it has been considered controversial.

Issues for investigation

The following are among the issues which could be researched; a focus on tax and development would demand that the issues be approached especially from the perspective of developing countries:

Experience of the unitary approach: What can be learned from previous experience of applying UT, both internationally and within federal states, especially the US? How far is the current EU proposal for a common consolidated corporate tax base (CCCTB) compatible with the

The case for unitary taxation

Mick Moore

TRANSNATIONAL corporations have subsidiary companies in more than one country. Some have them in dozens of countries and some have hundreds of subsidiaries. They inevitably do much of their international business with one another. Unilever, for example, does not manufacture its range of foods, beverages, cleaning agents and personal care products separately in each of the many countries in which it operates. Nor does it brand and market completely separately in each country. Its many subsidiaries and affiliates trade with one another across international borders – in market-ready products, in components, in packaging, in management expertise, in the right to use its 400+ separate brands, in intellectual property and in capital (i.e. inter-company loans).

How, then, should Unilever Worldwide be taxed? There are two main possible answers. The first and most logical is unitary taxation: Unilever could be taxed on its total worldwide profits, allocated according to the location of its activities. It could present annually to the tax authorities of the countries in which it operates a single set of accounts. These would include profits for the firm as a whole, and identify the proportion of its activities (number of employees and wage bill, assets, and sales) in each country where it does business. Its tax bill could then be apportioned among all those countries according to an internationally agreed formula based on a weighting of these factors. That is formulary apportionment.

The second way of taxing Unilever is to disregard that it is a worldwide entity. In this approach, each subsidiary would report to, and be taxed by, the revenue authorities in the country in which it is located. And the parent company would report to the tax authority in the country in which it is formally headquartered. But there it would need to report only the income it actually receives from the other parts of the whole Unilever group, usually as dividends. Other income could be transferred through a chain of intermediaries to holding companies in countries where it is not taxable, either because the country has no income or profits tax, or because it exempts foreign source income. But Unilever does not have to submit accounts for the whole of Unilever Worldwide to any one tax authority.

The latter is sort of what happens at present – although tax law is much more complex, and national tax rules vary enormously. What is wrong with the current system? It is not that it is a bit messy. Any system for taxing transnational corporations is likely to be messy. It is rather that the current system disregards the economic reality of Unilever as a worldwide business, and also provides very strong incentives for the managements of transnational corporations to shift their profits around the world through pure accounting devices. It diverts valuable management, accounting and legal skills into gaming the tax man. It is unfair between countries, because some get much less in tax revenue than they have earned by hosting transnational businesses. And it is a major source of business for tax havens, where little or no tax is paid. If transnational corporations were not using tax havens for this purpose, it would be easier for global authorities to crack down on their more nefarious uses, including money laundering and tax evasion by wealthy individuals.

If we had a system of formulary apportionment, there would be little reason for transnational corporations to put so much effort into shifting profits around the world on paper, and much less incentive to use secret tax havens. ◆

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US state version? How does UT compare with the present system, in terms of ease of operation, as well as outcomes, for firms and for countries?

Harmonisation of definitions of the tax base: What are the main divergences between countries in their tax base definitions? Could convergence be achieved, e.g. by reference to international accounting standards? What might be the economic implications or welfare effects of tax base harmonisation? What would be the implications for administration of tax assessments, compared with the present system?

Identifying a unitary business: What would be the implications of strict or loose definitions of what constitutes a unitary business? How would or should these definitions apply, for example, to joint venture arrangements which are common in developing countries? What would be the implications for administration of tax assessments, compared with the present system?

The apportionment formula: What would be the effect of different variations of the usual three-factor formula (assets-labour-sales) (i) on international allocation of the tax base of TNCs, and (ii) in welfare-economic terms? How would allocation on such a basis differ from that under the present system?

Managing a transition to UT: How far can aspects of the UT approach, e.g. the requirement to submit consolidated accounts (a combined report), be compatible with the existing legal framework especially in tax treaties? What are the implications for this framework of a gradual shift, e.g. by regional adoption of UT, such as under the CCCTB? What changes to the legal framework would be necessary for a transition to UT, and how could it be managed with least disruption? What would be the administrative cost implications, especially for developing countries, of such a transition? ◆

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Endangering women human rights defenders

Colombia and Mexico are the two countries with the largest number of documented instances of death threats against women human rights defenders, and both are major recipients of US aid, say *Christine Ahn* and *Erika Guevara-Rosas.*

WITH the US elections now over, many are speculating over who will succeed Hillary Clinton as Secretary of State to oversee US foreign policy and the $47-billion US Agency for International Development (USAID) annual budget. While a significant chunk of USAID spending goes to education and health programmes, pockets of aid enlarge the already bloated military budgets of recipient governments. The result: less security and more violence against women, particularly women human rights defenders.

Indeed, the plight of these activists is so pervasive, yet unrecognised, that 29 November has been declared International Day of Women Human Rights Defenders. On the fifth anniversary of its founding, we take a look into Colombia and Mexico, the two countries with the largest number of documented instances of death threats against women human rights defenders – and coincidentally two major recipients of US aid.

Marisela Escobedo Ortiz, who became an ardent women's human rights defender in Mexico after the violent death of her daughter, was herself killed in 2010.

Why women human rights defenders?

According to reports from the United Nations and Inter-American Human Rights Commission, although both men and women human rights defenders are subjected to political violence, the situation of women must be analysed and addressed separately given the particular nature of their experience.

Within Latin American societies (as in many others), women face significant social and cultural discrimination. Furthermore, because of their gender, women's rights defenders endure sexual assault and harassment, including having to regularly deflect offensive sexual slurs aimed at discrediting their reputation and work. Women activists are increasingly leading efforts to demand the respect of women's human rights and the end of violence and discrimination. Their struggles challenge not only the political and economic establishments in their countries, but also the patriarchal nature of power relations in their communities. This is why violence against them is more severe.

Most dangerous places for human rights defenders

Colombia and Mexico – both flashpoints for political and drug-related violence – have become notorious places where women's rights to a life free of violence and access to justice are increasingly threatened by the growing militarisation and impunity of organised crime groups.

Since then-president Felipe Calderon launched his escalation of the war on drugs in 2006, at the behest of the US government, 45,000 troops have been deployed throughout Mexico. Instead of providing more security, the militarisation of Mexico has led to the death of over 50,000 people, with thousands more displaced or disappeared. The Mexican government claims that the majority of these deaths are individuals connected with organised crime.

But ordinary citizens, unfortunately, make up the majority of those murdered and disappeared; they are the collateral damage caused by the so-called war on drugs, initiated and funded by the US government. Since 2008, the United States has been silently bankrolling Mexico's militarisation through the Merida Initiative, a programme initiated by the Bush administration and continued under Obama. Other hidden agendas may be at work, namely increased military policing under the banner of narcotic and law enforcement to help facilitate economic 'free trade' expansion for transnational corporations.

It is not a coincidence that Ciudad Juarez is ground zero in the Mexican war on drugs. Of the 50,000 dead, approximately one in four have died in this border city of some 1.5 million people. Ciudad Juarez was once a symbol of globalisation and neoliberalism when the *maquilas* (assembly plants) were built following the passage of the North American Free Trade Agreement (NAFTA). These days, Ciudad Juarez has become ground zero for femicides. Since 2001, an estimated 600 women have been killed and 3,000 more disappeared. The increasing militarisation of the area has brought 'new threats and additional risks to women human rights defenders', write Andrea Medina Rosas and Laura Carlsen.

One of the best-known cases of the plight of women human rights defenders is the late Marisela Escobedo Ortiz. Two years ago Marisela was assassinated outside the governor's office in Chihuahua, Mexico. She was protesting the release from prison of her daughter's murderer, Sergio Barazza. Marisela became an ardent women's human rights defender after the violent death of her daughter Rubi, whose body was found burned and dismembered in a garbage bin. Soon after Sergio's release, Marisela was killed. Norma Andrade of Nuestras Hijas de Regreso a Casa recounts a phone conversation she had with Marisela moments before she was killed. '"Norma, they want to kill each one of us. They are going to kill us." And afterwards they killed her.'

According to a Shadow Report to the UN Committee on the Elimination of Discrimination against Women from the Iniciativa Mesoamericana de Mujeres Defensoras, between 2005 and 2012, violence against women in Mexico claimed the lives of 13 female journalists. In the past two years alone, 14 women's rights defenders have been killed. None of the crimes have been prosecuted. In Mexico, only 2% of all crimes committed are solved or prosecuted.

These stories of terror in Mexico have their counterpart in the southern hemisphere. Colombia, the other most dangerous country for women human rights defenders in the region, seems to have shared best practices with their Mexican counterparts. The country has been one of the largest recipients of US military aid since the Bush administration's $6-billion 'Plan Colombia' was instituted. Just in 2006, Colombia received $72 million in US aid, of which approximately 80% went to the military and police. The Fellowship of Reconciliation uncovered evidence that US aid went 'to assist Colombian military units that have reportedly violated human rights'.

Colombia continues to suffer one of the worst humanitarian and human rights crises in the world. Women's rights defenders are systematically stigmatised and threatened, dragged through criminal proceedings on trumped-up charges, and made targets of sexual violence and murder by all armed actors in the conflict. Since President Juan Manuel Santos took power in August 2010, the Colombian government has demonstrated a more open attitude toward supporting and engaging civil society. However, despite the change in tone, the situation on the ground continues to cause concern. According to a report from Front Line Defenders, in the first three months of 2011, nine human rights defenders were killed, 68 were threatened, and four disappeared.

Mexicans and Americans at a demonstration in New York calling for an end to the 'war on drugs' in Mexico. The US-backed war on drugs has led to the death of over 50,000 people, with thousands more displaced or disappeared – the majority of them ordinary citizens.

Like in Mexico, the war in Colombia justifies all forms of persecution against those who dare to challenge the establishment, even on matters that bear little relation to armed conflict. Mónica Roa, a 36-year-old lawyer and women's rights defender who co-founded Women's Link Worldwide, is one such defender whose work for women's reproductive rights endangers her life. 'Since I was 28, I have been with bodyguards,' Roa told us in a recent interview. 'One thing I think about often is how I'm putting in danger the people that are around me, and that's a difficult thought to handle.'

In 2006, Roa won a landmark case in the Colombian Constitutional Court that established a woman's right to an abortion in limited circumstances. Roa later filed a lawsuit calling for the enforcement of the court's decision, which triggered the deputy inspector general to launch criminal defamation allegations against her. Earlier this year, the Constitutional Court ruled in favour of 1,201 women who brought a constitutional challenge against the inspector general and government officials for violating the right to information of women and girls of reproductive age. These government authorities were not only trying to censor information; they were disseminating biased and distorted information, like that the morning-after pill was not an emergency contraception but instead an abortion pill.

Members of the Colombian army. Colombia, one of the most dangerous countries for women human rights defenders, has been among the largest recipients of US military aid.

The criminalisation of women human rights defenders

Mónica Roa's case demonstrates a worrisome trend now being used to discredit women human rights defenders: the use of unfounded criminal proceedings to mire them in a byzantine legal process. The criminal justice system is now being abused to impugn women's rights defenders' professional and personal lives, often forcing them to divert time away from their human rights work to devote towards their legal defence. These are the same criminal justice systems that have been 'strengthened' with US aid through its law enforcement initiatives.

In Mexico, women's rights defenders are also facing legal harassment for their work. In October, Lucha Castro, leader of the Centro de Derechos Humanos de las Mujeres, A.C. in Chihuahua, faced a media and political campaign to discredit her influential work in defence of other women activists. Lucha has been calling for transparency in the investigation of the 2010 killing of Marisela Escobedo Ortiz. Lucha, who has been vocal in her denouncement of public officials, was herself charged with manipulating Marisela's family and obstructing justice. By publishing as fact the accusations against Lucha, the mainstream Mexican media have also played a part in discrediting her and other women's rights activists who have been seeking justice for the victims of femicide in Ciudad Juarez.

Women-led human rights organisations must raise money to hire security guards, buy security cameras, and pay for expensive lawyers' fees. 'If women's rights defenders don't take care of the threats and don't manage to vindicate their own rights, then we are sending a message to the women we usually defend that there's no hope to make this a priority,' said Mónica Roa. 'On one hand there is this wish to say, it's not that important, nothing will happen. But that sends a very wrong message to the population that we are trying to work for.'

Colombian lawyer and women's rights advocate Mónica Roa: 'One thing I think about often is how I'm putting in danger the people that are around me, and that's a difficult thought to handle.'

Eye on US culpability

According to a March 2012 special report on women human rights defenders in Mesoamerica, 'The militarisation and massive influx of federal agents to combat insecurity has not successfully reversed this violent situation. On the contrary, violations of human rights by security forces – particularly against youth and women – are on the rise.'

While it is crucial to provide financial, legal, and moral support to these women human rights activists, we must also stop the militarisation of their countries, which is further endangering their lives and those of other women. One clear way to do this is to halt US military aid to countries like Mexico and Colombia. The upcoming nomination process for US Secretary of State presents an opportunity to raise the urgent issue of how US military and foreign aid is further militarising Latin American countries and increasing violence against women. ◆

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VIEWPOINT

Egypt's Islamists and the way out of the crisis

In this article, written before the country's recent constitutional referendum, *Tarek Osman* says that severe social, not political, divides are behind Egypt's current crisis as warring factions see different Egypts. He contends that only a representative and competitive political milieu will ultimately diminish polarising ideologies.

Protesters against President Mohamed Morsi confronting soldiers in Cairo. 'Egyptian society is polarised regarding its frames of reference, the shape of the future, its view of its heritage, and crucially its own identity.'

THREE variables will determine the outcome of Egypt's current crisis: whether the liberal forces will manage to continue to mobilise hundreds of thousands, or more, supporters to give credibility to their threat of civil disobedience; whether the military, and not just its leadership, will remain on the sidelines between the ruling political Islamists and the liberal opposition; and whether a compromise could be achieved on the constitution, leaving the decision to the people.

But these three variables will not pave the way for a smooth political transition.

Egyptian Islamists believe that they represent the majority in the Egyptian society (a huge constituency of conservative Muslims), that they have reached out to the other camp searching for a compromise, that their project – the constitution being one of its main manifestations – will be approved by the people, and that they will win the next parliamentary election, and as such cement their mandate with an irrefutable legitimacy.

Egyptian liberals believe that the Islamists are aggrandising power, that one or two elections cannot be the basis for concentrating authority at a moment of a major transformation, that Egyptian heritage is much richer than the Islamist movement's project, and that Egyptian intellectuals, artists, Christians, and different cultural niches should have a clear say in the country's political transition, especially given that the country has an effective illiteracy rate above 40%.

The problem is hardly political but a symptom of the severe social divide that Egypt is currently experiencing. Egyptian society is polarised regarding its frames of reference, the shape of the future, its view of its heritage, and crucially its own identity. Is Egypt a purely Islamic country, or is the country's rich and unique history that blended different religions, cultures, outlooks and ways of life, a given that must be respected irrespective of which political force has the largest mandate at this moment in time?

Egypt's main political forces today will not reach an agreement on these questions, for there was never an agreement on them before.

In the two major social experiences that Egyptian society has witnessed in the past century – liberalism and Arab nationalism – decision-making on all socio-political issues came from the top.

Egyptian liberalism, the period from the mid-19th to mid-20th centuries, created the modern Egyptian state and ushered in major advances in administration, agriculture, manufacturing, education, as well as in media, and arts and culture (from theatre, to literature, to film and music). Its leaders believed that Egypt was pulled towards Europe's ways of thinking, lifestyles, and values.

From the 1950s to the 1970s, Arab nationalism leveraged on Cairo's and Alexandria's then established status as the region's cultural, economic, educational, and entertainment hubs, and tried to turn Egypt into the base of a regional political avalanche empowering the poor and lower middle classes against the elites (that had pioneered and led the liberal wave).

Both projects were impositions from the top. Both projects espoused national projects that inspired and roused wide social segments, especially in the middle classes. Egyptian liberalism was at heart an Egyptian attempt to embrace modernity and transform an agricultural, lagging society into a modern one trying to catch up with the advanced world (especially Europe). The nationalist era started with fighting foreign interests in the country, and later embraced the struggle for independence and Arab nationalism.

And in both projects, very powerful institutions provided the support and momentum to enforce the imposition from the top. In the liberal experiment, it was Egypt's socio-economic elite, the top 5% of the Egyptian population that had controlled over 80% of all landownership and tangible assets; in nationalism, it was the sprawling military establishment.

Charisma also played a major role. Al-Wafd's leaders (from Saad Zaaghloul to Mustapha Al-Nahas), and an array of innovators in literature, cinema, theatre – and theology – imbued Egyptian liberalism with a huge power to attract major social constituencies. Nationalism had Nasser, arguably the most popular Egyptian and Arab leader in several centuries.

Today, no Egyptian political force has a credible national project or really charismatic leaders who can rally major segments of the middle – and lower middle – classes behind them. There is no Egyptian institution with the credence and weight to provide any serious support for an imposition from the top – unless the military decides to intervene by force. And the most important development that the 2011 uprising has given rise to – and represented – was the empowerment of huge social masses.

Bottom-up power is on a rapid rise.

Historic opportunity

Yet, as no agreement materialises, Egypt's political forces should realise that, despite the current chaos, a historic opportunity is unfolding. The 2011 uprising, at its core, was a tsunami of anger against immense political and economic failure, a rejection of predominant feelings of lethargy and weariness; the uprising signifies powerful desires for, not just change, but a complete overhaul of the political-economy structure.

The problem lies with the direction of the immense momentum that the 2011 uprising has unleashed. Confrontations, whether through constitutional declarations, demonstrations, propaganda, or violence, will never result in a decisive victory for either side on the current socio-political divide.

Sound policy will. The fact that almost 50 million Egyptians are under 35 years old, having lived only through former president Mubarak's years without any experience of a national project to fire up their energies and with a very significant percentage of effective unemployment amongst that group, means that socio-economic conditions should be the priority of all political forces – especially those with serious ambitions for sizable representation in the legislature.

A demonstrator carrying a sign that reads 'No to poverty, no to unemployment, no to torture'. 'People will vote for the groups and parties that espouse policies that will benefit them.'

Political ideology will follow. Undertaking free and fair elections will enshrine genuine representation as a given in Egypt's political life. The different electoral manifestos and the political-economy programmes that will materialise and become the policies and positions of the different parties will gradually separate the serious and rigorous political actors from the insignificant and flippant. An open, representative, competitive political milieu will empower non-governmental organisations – professional syndicates, universities, feminist groups, labour and trading associations, free media – to put forward their ideas.

People will vote for the groups and parties that espouse policies that will benefit them. Gradually, polarising ideologies will fade in the background, and the ability to come up with – and implement – strategies and policies that support growth and improvement of socio-economic conditions will become the key criterion for gaining people's support and votes – as is the case in the vast majority of democracies.

The confrontations between forces representing vastly different standpoints, based on deeply held convictions, at a moment of immense fluidity will inevitably result in struggles. Attempting to force another imposition from the top – from either side of the political elite – will exacerbate the political crisis, and, crucially, offer no solution to the societal dilemma about the frame of reference and identity.

The energy – and anger – of masses of young Egyptians could herald a period of, at best disorientation, at worst serious civil unrest. Young Egyptians, the largest and most active segment in the society, need to absorb the lessons of Egypt's rich modern history.

Giving the society – and especially young Egyptians – time to figure out for themselves their own preferences regarding the nature of their state and the shape of their society will not only pull the country out of the impasse it has been in now for months but also vitally allow the country to make these critical choices in more relaxed political and economic circumstances. ◆

Tarek Osman is an Egyptian political economist and author of Egypt on the Brink. *This article is reproduced from Ahram Online (english.ahram.org.eg).*

Otto René Castillo (1934-1967) was a Guatemalan poet who won a number of important literary awards. After the US toppled the country's democratically elected government in 1954 and helped to install or prop up subsequent military dictatorships, his life became one of largely exile. In 1966, his clandestine move to return and join the resistance resulted in his capture and brutal immolation the following year.

Before the scales, tomorrow

Otto René Castillo

When the enthusiasm
of our time
is recounted
for those
yet to be born,
but who announce themselves
with a kinder face,
we will come out winners,
we who have suffered most.

To be ahead
of one's time
is to suffer much.

But it's beautiful to love the world
with the eyes
of those
    still
to be born.

And splendid
to know oneself already victorious
when everything around
is still so cold, so dark.

Translated by Barbara Paschke and David Volpendesta