

QUOTE OF THE DAY**To be ill adjusted to a deranged world is not a breakdown.**

— Jeanette Winterson, British writer, broadcaster and activist.

Opinion & Analysis

South Africans are biggest losers in face of transfer pricing, misinvoicing

CAPITAL FLIGHT ANALYSIS

Jeff Rudin

AS A CONSEQUENCE of the Marikana Massacre, the current strike by platinum workers serves to draw attention to low pay, migrant labour and the living conditions of miners and their families. It has also recently brought to the surface the somewhat mysterious issue of transfer pricing and similar forms of misinvoicing as matters of public debate.

It should be no surprise that the platinum corporations at the centre of the longest mining strike in the country's history have rejected the allegations of large-scale and prolonged tax and wage avoidance recently made against them by the Alternative Information and Development Centre (AIDC). However, until these allegations go beyond the current *prima facie* evidence, the issue must remain open.

What is not open to any doubt, however, is that transfer pricing and other forms of capital flight from South Africa – both legal and illegal – by mining companies in particular is not new. Nor is it confined to South Africa. It is, indeed, a practice common to mining in the rest of Africa and elsewhere in the world as well.

Before developing these confident statements about the widespread practice of transfer pricing, a clear understanding of transfer pricing is relevant.

A hypothetical example is offered for this purpose. Company A is a mining transnational company (also known as a multi-national company) based in countries X and Y. Let's say the corporate tax rate in X, where the actual mining takes place, is 28 percent and 18 percent in Y.

Consequently, Company A would automatically increase both its absolute profit and its rate of profit per share by 10 percentage points if it were taxed in country Y rather than X. It achieves this desirable objective simply by invoicing itself a 50 percent discount for its own company in Y. Thus, instead of a market price of, say, R20 million, it charges itself only R10m. In this way, it simultaneously reduces its taxable income by R10m in high tax country X, while increasing its taxable income in low tax Y.

This results in a saving of R1m (10 percent of R10m), which is fine for the company, its investors and the bonuses of its senior management, but not so good for Country X. In this single transaction, Country X is not only deprived of taxes of R280 000 (28 percent of R1m) – tax avoidance – but the whole R1m that could otherwise be used to pay its workers a living wage. This latter is what AIDC's Dick Forslund calls wage avoidance.

Capital flight – with transfer pricing being an important channel – has been endemic in South Africa for a considerable time. Various economists have attempted to quantify the size of the problem. Given that much of the flight was illegal and that tax avoidance measures are opaque by design, it is not surprising that the only agreement among economists is that it was flight on a large scale, by large conglomerates.



An old miners' hostel at Wonderkop in Marikana, North West Province.

PICTURE: BOXER NGWENYA

A 1991 estimate puts the total capital flight between 1970 and 1985 at \$15.38 billion (R164.2bn) at 1985 prices.

Other studies expressed capital flight as a percentage of gross domestic product (GDP).

The uncut, or rough value of diamonds in 2011 was \$1.73bn. Yet, diamond companies paid just \$11m in mining royalties from 2010 to 2011.

A 2005 paper argued that the percentage increased from an average of 5.4 percent a year between 1980 and 1993 to 9.2 percent of GDP a year between 1994 and 2000. More recent calculations found that capital flight between 2001 and 2007 was on average 12 percent of GDP a year. This figure increased year-on-year from 2001 and peaked at 23 percent in 2007. At 23 percent and a then GDP of about R2.02 trillion, this amounted to a rather sizeable loss of R463.72bn. Another way of gauging the

size of this loss is that it was more than double the already grossly inadequate level of domestic investment.

What is particularly disturbing from these figures is that the rate of loss increased enormously during the life of our new country – from 9.2 percent in 1994 to 23 percent in 2007. This means that, at the same time the government was implementing Thatcherite neoliberal policies to bring foreign investment to South Africa, a vastly greater volume of capital was leaving our country.

What is even more incomprehensible (were it not for the vested interests of the Minerals-Energy Complex studied by, in particular, Professor Ben Fine of London University's School of Oriental and African Studies) is that the SA Reserve Bank and the government have made it easier for capital to leave our shores both legally and illegally. Signalling that the escape of capital was not taken seriously, the central bank's Voluntary Disclosure Programme of 2010 gave amnesty to illegal capital flight. A flat rate fee of 10 percent of the value of illegally expatriated assets voluntarily disclosed was the only penalty.

Moreover, the confession allowed the criminals to keep illicit assets offshore. It was estimated in 2010 that if only a quarter of these offshore assets was invested in sub-Saharan Africa, the region would leap from trailing to leading other developing

areas in terms of domestic investment. Subsequent amendments to the Exchange Control Regulations have been designed to make capital flight easier by making the abscondment increasingly legal.

Helping to make sense of these colossal numbers is, for instance, that \$859bn would have not only allowed the region to pay off its 2008 debts of \$250bn, but would have had a potential surplus of at least \$600bn for development.

Common to these reports is the significant finding that corruption accounts for only a small portion of capital flight. Tax evasion through trade misinvoicing was by far the largest cause.

Such is the scale of the problem of capital flight from Africa, that in 2012, the UN Economic Commission for Africa (UNECA) established a high-level panel to undertake in-depth studies on the problem.

Former president Thabo Mbeki heads this panel. Speaking at its launch, Mbeki put the annual illicit flow out of Africa at \$50bn, which he compared with the total inflow of aid and foreign direct investment of \$25bn.

Mining companies in Africa are increasingly being fingered as the continent's major tax dodgers. With an estimated worldwide 6 000 subsidiaries, many of which are located in tax havens, the major mining transnationals are well-placed for transfer pricing and other forms of misinvoicing, whether deemed to be legal or not.

This is highlighted by a recent report on diamonds, by Sarah Bracking and Khadija Sharife. The uncut, or rough value of South African diamonds in 2011 was \$1.73bn. Yet, diamond-producing companies – two of which, De Beers and Petra Diamonds, account for 95 percent of production – paid just \$11m in mining royalties from 2010 to 2011, according to the latest Tax Statistics report, produced by the Treasury and the SA Revenue Service.

The platinum miners' strike has drawn fresh attention to allegations of transfer pricing. The time is ripe for a formal Commission of Enquiry to replicate in South Africa what Mbeki is heading in Africa.

The outward flow of money from South Africa is mirrored by the continent. As with South Africa, economists are unanimous in agreeing that the loss is huge, and they have difficulty when it comes to quantifying the loss. Thus, while one 2008 study, covering the years 2002-2006, found that Africa lost \$859bn a year in cumulative capital flight, another put the number at a total of \$420bn for the 35-year period from 1970 to 2004. By contrast, a 2010 study estimates that Africa lost between \$854bn to \$1.8 trillion in cumulative capital flight during the 39-year period 1970-2008.

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least first forcing him to pay penance for his past sins of warmongering.

The senior senator from Arizona now wants to take his pyromaniac style of foreign policy into Iraq once more, echoing his "bomb, bomb, bomb" spirit of a decade ago. If that, he is guided not by any sense of patriotism, but by all the impetuosity of an anarchist that he can muster.

McCain is not only one of the chief proponents of the American pyromania that destroyed Iraq, but also one of the most senior still holding political office.

The most basic fact of the matter is this: Anybody who was out to topple Saddam Hussein – and thereby turn all of Iraq into a powder keg – at best showed complete ignorance of the history of the region.

A deep-seated sense of religiously fuelled enmity throughout the ages has shaped life in West Asia for ages. Shia and Sunnis, when pitted against each other, and then presented with an opportunity, have always been inclined to make a blood sport out of the pursuit of the other.

The crucial role that Iraq has traditionally played in that kind of highly combustible environment was that it served as a satellite buffer state that essentially separated the Levant and Asia Minor from Iran/Persia, providing a check on the expansion of empires from either direction.

Internally divided due to shifting

borders and occupiers from repeated conquests, Iraq has often stood at the crossroads between large Western Sunni powers and the Shia Persian power to the east.

Even before the rise of Islam and its fictions, the area was the dividing zone between western and eastern empires. Even Rome sometimes held Mesopotamia, during its long-running struggle with what is now Iran.

However, with the Cheney/Bush/McCain clan's resolutely amateurish move into Iraq, that crucial buffer disappeared and turned itself into a wall of fire. Their collective amateurishness is only superseded by the ahistorical US foreign policy-making in the region.

The whole Iraq episode and the current conundrum also show what a terrible ally the UK has been for the US over the past decade or so.

True, the post-Empire UK has long made it a habit of punching above its weight class, usually by acting as

America's sidekick. But for all the immense ambitions that this points to, traditionally the UK government has at least usually been mindful of history.

To be sure, the British Foreign Office had enough smart people who knew about Iraq's historic role inside the Muslim world as a buffer state – to keep religious emotions from exploding.

Evidently, Tony Blair was so eager to please his American master that this most critical advice was suppressed. Even if the US ally had been unprepared or unwilling to listen, it would have been all the more incumbent on the UK to speak out loud.

That is what good allies do. In fact, that is what Germany and its then-Chancellor, Gerhard Schröder, did at the time when he warned the US government publicly of an ill-advised "adventure".

Which is exactly how this all turned out to be. But that public courage, of course, didn't keep Schröder from becoming the US political establishment's favourite bête noire. Yes, it is true that once he left office, he made some distasteful career choices.

But that does not in any sense invalidate the character he displayed while in office, when he warned the Americans of the inferno(s) to come.

Tony Blair, meanwhile, the snake-charming, bomb-throwing sidekick to George Bush, is still in the good graces of

many Americans. The only promising step of sorts toward penitence that Blair has made since then is that he has converted to Catholicism.

While that is very unusual for a (former) British leader, he is at least on the right track. He has much to atone for. And it will take a long line of Catholic priests to hear all the confessions Mr Blair still needs to make.

On the US side of the disaster initiated in 2003, however, it seems that all such confessions of guilt will go entirely unspoken. If the recent round of cheerleading for re-invasion is any indication, McCain and friends are not only unrepentant but still actively in denial that they ever made any mistake in the first place.

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China's rising millionaire figures take centre stage

AMASSING FORTUNE

William Pesek

UNNY how everyone thought China would get old before it got rich. The opposite seems to be true. A new Boston Consulting Group (BCG) study shows America's lock on the most-millionaires title may be in jeopardy after a surge in Chinese wealth.

The Middle Kingdom surpassed Japan and Europe in the most recent survey, boasting 2.4 million millionaires. That is still far off the US's 7.1 million, of course.

But the absence of transparency in China and the vast networks that exist to spirit wealth into bank accounts overseas makes it a sure bet BCG's figure is wildly conservative.

This should be good news for a Communist Party trying to transform "poor" China into a prosperous country, right?

Dangerous bubble

In fact, this millionaire bubble is dangerous for two reasons. One, it is raising the odds of social instability. Two, as the ranks of those profiting from the status quo grow, there's even less impetus to restructure the economy.

The first risk is straightforward enough. Even if a few million are rolling in yuan (several million, more likely), most of China's 1.3 billion people are not.

Indeed, the gap between rich and poor is among the highest anywhere.

Take China's Gini coefficient, an inequality measure in which 0 represents perfect equality while 1 means wealth is in hands of one person.

The UN warns that a score of more than 0.4 can cause social instability. China's was 0.55 in 2010, up from 0.3 in 1980.

Creating an oligarchy was not Deng Xiaoping's plan when he initiated China's economic opening in 1979. Yet the combination of huge gains in gross domestic product and an opaque political system has fuelled a robber-baron culture.

This reality is coming to light at an awkward moment.

Try as they might, Xi Jinping's army of internet censors can not quell the anger lighting up chat rooms, microblog platforms and text-message systems.

In March, censors struggled to tamp down outrage over reports that ex-security chief Zhou Yongkang might have amassed an estimated \$14.5 billion (R154.7bn) in ill-gotten gains. Nor could Beijing control the Bo Xilai narrative a year earlier.

Authorities wanted the masses to be enraged by the Chongqing Communist Party chief's disloyalty to the memory of Mao Zedong. But all Chinese could talk about was how a modestly paid civil servant was living the high life and sending his son to Harvard.

Or how Bo's extended family, according to the New York Times, quietly amassed a \$160 million fortune.

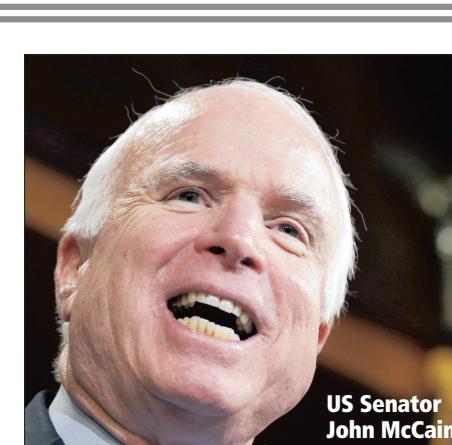
Such tales are toxic for a ruling party that has become communist in name only.

Bloomberg's website has been offline in China since 2012 after an exposé on the estimated \$376m amassed by Xi's own family.

Average Chinese are becoming savvier about the insider trading, land grabs and old-fashioned rent seeking that enriches government officials and their cronies. They are starting to realise that the "Chinese Dream" President Xi waxes on about may hold true for the 1 percent only. That is making Xi's reform drive even more difficult.

The BCG figures are a stark reminder of the roadblocks to expanding China's services sector and reducing the role of exports and excessive investment.

Think about the nature of China's recent wealth gains.

Stock market rallies

US Senator John McCain

PHOTO: REUTERS

From the US to Southeast Asia, wealth creation has been driven by stock market rallies. In China, the windfall has been fuelled by shadow-banking vehicles like trusts, the value of which surged 81.5 percent last year.

How does Xi rein in this financing monster when it is enriching the very people whose co-operation he needs to retell the economy? It is hard enough to tell Chinese to accept slowing growth. How does he tell fellow officials and well-connected power brokers that they must take a bath on their trust investments in order to limit broader risks to the financial system?

More likely, this huge vulnerability will go unchecked.

Xi wants to pull off a Deng 2.0, setting China on a new, more sustainable growth path. But it is the millionaires who may ultimately decide if China stops borrowing and building its way to insolvency. And their ranks are swelling as we speak. – Bloomberg

US unrepentant over Iraq's predictable fate

POLITICAL IMBALANCE

Stephan Richter

IN THE HISTORY books, the US Republicans will never live down the fact that they "Iranified" Iraq, disrupting thousands of years of calibrating regional balance. That country long served as a buffer state for one purpose only – to suppress the implosion of the region. True, the Democrats who backed the invasion aren't much better, because they were swayed by the idiotic "patriotic" fervour of 2003.

But at least they seem to recognise the error, even if it should have been visible at the time: Any US leaders who take an action that, historically speaking, must inevitably hand Iraq to Iran and restore Iran as the dominant regional power needs to have their heads examined.

It is well known that John McCain, the US presidential candidate and prisoner of war, likes to pour oil into any fire he sees. It is in his nature to do so. The question is why we let him do so without at

the Globalist

least first forcing him to pay penance for his past sins of warmongering.

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