Ignoring the elephant in the room? Why financial transparency is necessary to finance development.

- Sustainable development goals are wishful thinking unless we finance them.
- Financial transparency and taxes are the keys to finance development.
- Did you know that one mechanism that can fight financial secrecy already exists? It is low cost, effective, and targeted to use. It will show where the money is built up. The only thing missing is politicians willing to use it.

Written by: PWYP Norway
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What is the problem?

- Any discussion about sustainable development goals risks becoming wishful thinking unless we discuss how we shall finance the goals and target a root cause behind the problem, not just the symptom.

Sustainable development goals (SDGs) are a new universal set of goals, targets and indicators that UN member states will be expected to use to frame their agendas and political policies over the next 15 years. The SDGs follow on and expand on the millennium development goals (MDGs) which were agreed by governments in 2000 and are due to end at the end of 2015.

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- We cannot ignore that between 2002 and 2012, more than $6.6 trillion flowed out of developing nations. This illicit money that comes from crimes like tax evasion, money laundering, and bribery. These illicit financial flows (IFFs) are increasing at a staggering rate of 9.4% per year. That is twice as fast as global gross domestic product (GDP) is increasing. The latest data reveal that IFFs peaked in 2012, totalling more than $911 billion.

GDP is the standard measure of the value of final goods and services produced by a country during a period minus the value of imports.

- For every official development aid dollar coming into developing countries, more than $10 left countries in IFFs in 2012. No matter how you look at it, developing nations are losing more financial resources than they are gaining.

- IFFs are destructive to the prospect of sustainable development. No country is protected against IFFs; they hurt developing countries so much more. They undermine the taxbase and thereby hinder mobilising of a country’s own resources. Imagine how many education budgets, vaccine programmes, healthcare centres, teachers, and schools IFFs amounts to.

- The fact that many large multinational companies and the super-rich hardly pay any income tax at all has created an intense and international debate about whether paying taxes has, in practice, become a “voluntary thing.”

- This can happen because multinational companies and the super-rich have access to a big toolbox of secrecy mechanisms that they can use in order to avoid paying taxes. This toolbox of secrecy is useful for everyone, whether they are multinational companies, super-rich drug dealers or terrorist networks.

The multinational corporation is a business organisation whose activities are located in more than two countries and is the organisational form that defines foreign direct investment.

- One major problem is secrecy jurisdictions (tax havens). A common feature of legislation in tax havens is that they do not have an informative public company registry, or very limited statutory obligations, no obligation to preserve, no audit requirements, and no duty to disclose who the real owners are. It is quite possible to be anonymous if you wish. It is possible to set up trusts to hide who is shipping and hide where the value creation actually takes place.


- Secrecy jurisdictions: Places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. The regulations designed to undermine the legislation or regulations of another jurisdiction. To facilitate its use, secrecy jurisdictions also create a deliberate, legally-based secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.


- The extractive industry is a powerful industry with huge profits. Exports of oil, gas, and minerals alone were equivalent to approximately nine times the value of international aid to Africa in 2008. This is important, as 2/3 of the world’s poorest people live in the most resource-rich countries, in the world but have seen little income.


- The consequence is that profits that should have translated into, and invested in the commended (such as education, healthcare and jobs) are drained out of the country instead, and transferred to companies and tax havens where little or not tax is paid. Costs are moved to where companies has, to pay its taxes or to corrupt leaders, which can lead to maintaining corrupt and irresponsible regimes.

- Countries offering such secrecy claim that this is an exercise of sovereignty. However, either an exercise of sovereignty is an unacceptable intention affecting the sovereignty of other countries that are losing their revenues. Tax havens assure that this capital, which should be given to the developing countries (resource capital) or the developed countries (financial capital), is transferred and placed in jurisdictions without transparency.

- Because all of the secrecy, it is difficult to single out and reveal the difference between tax evasion and organised crime and corruption, both in politics and elsewhere in society. The secrecy that surrounds both the information and the profits.

- It is a paradox that multinational companies and the super-rich seem to expect to use society’s infrastructure, have the advantage of society’s rule of law and order, use its effective communication services, and have access to well-educated people, good health services, and a market but seem unwilling to contribute to finance all of this by paying their fair share in taxes.

- This creates a global increase in the income for those who do not pay taxes, but also increases the cost for ordinary citizens who are left to pay for upholding a functioning civilisation.

- This allows gains in wealth to arise both between and within nation-states to the benefit of a small minority, and in the detriment of the rest of the citizens. The consequence is greater inequality in the world. The global economic system and global world leaders are failing developing countries, and they are failing ordinary citizens.

- It is difficult for citizens to try to unravel layers upon layers of secrecy when multinational companies intensively use secret jurisdictions, anonymous shell companies, anonymous beneficial owners, and fake companies to cover their tracks.

- Financial secrecy occurs when there is a refusal to share financial information with the legitimate authorities and bodies that need it - for example to tax citizens appropriately, or to enforce criminal laws.


- Financial secrecy is not an inevitable force of nature. It is only politics, and it is very possible to do something about it. Mechanisms and solutions that can significantly hinder financial secrecy do exist.

- Political root causes can be unpleasant and difficult to tackle but obviously this is a relationship between politics, power, the market, and inequality. However, once the bottom will leave everyone at the bottom. Society has solved inequality in two ways over the course of history conflict and war or preventative redistribution. A more transparent economic system is the only sustainable solution in the long term.

- We believe that an informed and demanding youth culture can bring the attention and interest of people, politicians and the media. Youth can offer insight and knowledge on financial secrecy and how it harms societies and show that there are existing policy measures that can significantly hinder it, if only politicians were willing to use them.

Anonymous shell companies: Companies which only exist on paper, with no real employees or offices.

Source: The Economist, Shell companies: Laundromats Anonymous, September 2013

Beneficial owners: An anonymous beneficial owner of company means the natural person(s) who directly or indirectly ultimately owns or controls the corporate entity.


Beneficial ownership is a powerful industry with huge profits. Exports of oil, gas, and minerals alone were equivalent to approximately nine times the value of international aid to Africa in 2008. This is important, as 2/3 of the world’s poorest people live in the most resource-rich countries, in the world but have seen little income. Natural resource owners have the largest value creation potential to mobilise tax revenue, but profit often ends up elsewhere.

Anonymous shell companies; Beneficial owners; Paper companies, Longman Business English Dictionary

- The development of natural resources is a powerful industry with huge profits. Exports of oil, gas, and minerals alone were equivalent to approximately nine times the value of international aid to Africa in 2008. This is important, as 2/3 of the world’s poorest people live in the most resource-rich countries, in the world but have seen little income.


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Ignoring the elephant in the room? Ignoring the elephant in the room?

However, on a global scale, this corruption only accounts for 5% of the problem. The second part of the problem is criminality, such as drug trafficking, human trafficking, trafficking of endangered animals or parts of animals, and all types of criminal networks, including terrorist networks. The secrecy offered in tax havens is very useful for anyone who has something to hide. On a global scale, this amounts to 35% of the problem.

The third part of the problem is commercial transactions being routed through multinational companies with intensive use of tax havens. This part of the problem has to do with multinational companies organising themselves in such a way that they can trade through their own structures, and across countries in order to manipulate many types of taxes in order to avoid paying taxes. This amounts to 60% of the problem, and is the major problem.

For all three types of problems, the only remedy is transparency. Even though different types of IFFs have been categorised, it is difficult to single out and reveal the difference between tax evasion and organised crime or corruption. This is because of the secrecy that surrounds both the information and the profits. Because all of the secrecy, money from drug trafficking, for example, can easily be invested in the legitimate economy.

What do we know about IFFs?

What are IFFs?
IFFs are illegal movements of money or capital from one country to another. It is called illicit flow when the funds are illegally earned, transferred, and/or used.

Illicit Financial Flows from Developing Countries: 2003 - 2012
(In millions of U.S. dollars, nominal)

<table>
<thead>
<tr>
<th>Year</th>
<th>Developing Asia</th>
<th>South Asia</th>
<th>Sub-Saharan Africa</th>
<th>Latin America and the Caribbean</th>
<th>MENA</th>
<th>Western Hemisphere</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>1,538,247</td>
<td>643,753</td>
<td>750,000</td>
<td>142,000</td>
<td>269,907</td>
<td>26,932</td>
</tr>
<tr>
<td>2004</td>
<td>1,749,253</td>
<td>888,253</td>
<td>900,000</td>
<td>160,000</td>
<td>359,907</td>
<td>36,932</td>
</tr>
<tr>
<td>2005</td>
<td>1,968,253</td>
<td>1,118,253</td>
<td>1,050,000</td>
<td>178,000</td>
<td>459,907</td>
<td>46,932</td>
</tr>
<tr>
<td>2006</td>
<td>2,198,253</td>
<td>1,348,253</td>
<td>1,200,000</td>
<td>196,000</td>
<td>559,907</td>
<td>56,932</td>
</tr>
<tr>
<td>2007</td>
<td>2,428,253</td>
<td>1,578,253</td>
<td>1,350,000</td>
<td>214,000</td>
<td>659,907</td>
<td>66,932</td>
</tr>
</tbody>
</table>

Source: Global Financial Integrity

How much do the regions of the world really lose?
A part of the problems that IFFs are increasing at a staggering rate of 3.4% per year. That is twice as fast as global GDP is increasing. This graph shows IFFs to GDP per region.

Illicit Financial Outflows to GDP by Region: 2002-2011
(Average annual illicit outflows from developing countries as % of GDP)

<table>
<thead>
<tr>
<th>Region</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>3.48%</td>
<td>3.48%</td>
<td>3.51%</td>
<td>3.54%</td>
<td>3.57%</td>
<td>3.61%</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>3.3%</td>
<td>3.3%</td>
<td>3.3%</td>
<td>3.3%</td>
<td>3.3%</td>
<td>3.3%</td>
</tr>
<tr>
<td>MENA</td>
<td>3.5%</td>
<td>3.5%</td>
<td>3.5%</td>
<td>3.5%</td>
<td>3.5%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Europe</td>
<td>3.4%</td>
<td>3.4%</td>
<td>3.4%</td>
<td>3.4%</td>
<td>3.4%</td>
<td>3.4%</td>
</tr>
<tr>
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<td>3.6%</td>
<td>3.6%</td>
<td>3.6%</td>
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</tr>
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Source: Global Financial Integrity

What do IFFs consist of?
There are three different types of unrecorded money moving between countries.

The first includes corruption, the proceeds of bribery, and theft by government officials. When we think about what the problem is, we often think about corruption in a developing country. We also think about leaders who are living their lives in extreme luxury while the rest of the citizens in the country are being held as hostages in poverty and even dying because of lack of access to basic healthcare. This is an important part of the problem, and corruption is destructive for development.

However, on a global scale, this corruption only accounts for 5% of the problem.

The second part of the problem is that huge profits end up in places other than in developing countries. We can compare different, relevant data and information to each other in order to get a picture of what may hinder countries from mobilising their own resources, and which resources may be available for sustainable development.

Governments may need to find as much as $1.5 trillion a year to finance sustainable-development goals. It means that politicians have to mobilise about $22.5 trillion over the next 15 years of implementing the sustainable-development goals.

This graph shows a comparison of how much money we need to finance development and how much money rich people have hidden in tax havens.

What compose illicit financial flows?
- Corruption (embezzlement of national wealth)
- Criminal activities (trade in drugs, weapons, and people)
- Commercial transactions through multinational companies

Can all this money just be reversed and put directly into development?
No, of course not. The point is that huge profits end up in places other than in developing countries. We can compare different, relevant data and information to each other in order to get a picture of what may hinder countries from mobilising their own resources, and which resources may be available for sustainable development.

For example domestic resources (which include domestic investment and government revenues, "lost resources"), such as invested in the legitimate economy.

The second part of the problem is that big, profitable companies are taking profits out of developing countries in the form of "investment" or "reinvestments". These amounts to 60% of the problem, and is the major problem.

For all three types of problems, the only remedy is transparency.

Even though different types of IFFs have been categorised, it is difficult to single out and reveal the difference between tax evasion and organised crime or corruption. This is because of the secrecy that surrounds both the information and the profits. Because all of the secrecy, money from drug trafficking, for example, can easily be invested in the legitimate economy.

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This is how the companies are avoiding taxes:

• They’re hiding to build financial muscles

PWYP Norway revealed that ten of the world’s most powerful extractive industry giants own at least 6,038 separate companies, and a minimum of 1/3 of these separate companies are located in secrecy jurisdictions (tax havens). In PWYP Norway’s investigation, Delaware was the favourite place for multinational oil companies to register. The Netherlands came in second place.

• They get a fancy address at, for example, 1209 North Orange Street, Delaware, CT, USA:

At least 285,000 companies are registered at a single address in Delaware in the United States. More than 95% of all US publicly traded companies are incorporated in Delaware. Among them are Google, Apple, Coca-Cola, Bank of America, Ford, General Electric, JPMorgan Chase, Wal-Mart, American Airlines, and many more. The secrecy for sale is used by multinational corporations, small businesses, and private individuals to minimise taxes, avoid regulations. And their own governments conceal information, and cover their tracks, but smugglers, drug traffickers, criminals, and money launderers are also here. Delaware is the state that requires the least amount of information. It’s easy to set up shell companies in Delaware, no questions asked.

• Companies say they are just following the law, so try to tax them if you can:

Wealthy people have placed between $21–32 trillion in tax havens; this amount is roughly similar to the US and Japanese economies combined.

• They are using secrecy as a business model:

51 of every $2 of large corporate investment in developing countries is channelled through tax havens. The key features of a tax haven are that it is a state, country, or territory where the legal system favours secrecy over transparency, and which requires little or no information for taxes. Such rules do not apply to residents who live there, only to those who do not live there so that they can avoid obligations in their home countries. The business model is to sell secrecy to tax havens, have, illegal, or other taxpayers by giving those who avoid taxes the means to do so, as long as they can pay for it, which leaves others to finance society back home.

• Trading with themselves:

More than 60% of world trade takes place within a multinational companies.

• Transfer mispricing their billions:

A study by PWYP Norway estimates that over $110 billion disappeared through mispricing of crude oil in the United States and the EU between 2000 and 2010.

• Leaking like a fish net:

IFFs from developing countries peaked at $991 billion in 2012.

• Give themself shelter:

World Bank showed that 70% of corrupt politicians used anonymous companies in 200 major corruption cases to conceal their identity. When money was stolen, the recovery rate was only 0.2%. Money from corruption, crime, and tax evasion can be easily laundered into our economy through concealment, secrecy, and anonymity.

• Profits or proceeds of avoiding tax?:

56% of US companies’ foreign profits are attributed to tax-friendly sites.

• They borrow to pay dividends:

Apple has the biggest build-up of cash in corporate history (around $200 billion) stashed away in tax havens. So in order to pay dividends to their investors, Apple decided not to take the money out of tax havens because this would require them to pay taxes to the authorities. Instead, they borrowed money in order to pay dividends.
10 reactions

"We've got a building in the Cayman Islands that supposedly houses 12,000 corporations. That's either the biggest building or the biggest tax scam on record."

Barack Obama, president of the United States

"Inevitably, when we talk about tax avoidance, the spotlight falls on the high-profile cases. But tax avoidance is not confined to a small number of wealthy companies and individuals – it is a whole, grubby industry from which shameless tax advisers and promoters are making big bucks. That is simply unacceptable. We cannot have an industry in this country based solely on ripping off the public purse."

Dr. Jeffrey D. Sachs, professor in Economics at the Earth Institute, Columbia University and a Special Adviser to UN Secretary General Ban Ki-moon.

"We have created a system which ensures that billions of dollars are placed outside our control. It is an international system, and countries, including Great Britain, have contributed to creating this system. This is a legal but terrible system. In combination with globalisation, it constitutes a death trap for tax."

Margareth Hodgson, Labour MP, UK

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"There would be more revenue for all if countries resisted the temptation to compete with each other on taxes to attract business. By definition – a race to the bottom leaves everybody at the bottom."

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"Tax havens are indeed heavens for tax evaders and fraudsters, but they are hell for the law-abiding citizen and responsible tax-payer."

José Manuel Barroso, former European Commission President

"While the poor and middle class fight for us in Afghanistan, and while most Americans struggle to make ends meet, we mega-rich continue to get our extraordinary tax breaks."

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"Inevitably, when we talk about tax avoidance, the spotlight falls on the high-profile cases. But tax avoidance is not confined to a small number of wealthy companies and individuals – it is a whole, grubby industry from which shameless tax advisers and promoters are making big bucks. That is simply unacceptable. We cannot have an industry in this country based solely on ripping off the public purse."

Barack Obama, president of the United States

"We have created a system which ensures that billions of dollars are placed outside our control. It is an international system, and countries, including Great Britain, have contributed to creating this system. This is a legal but terrible system. In combination with globalisation, it constitutes a death trap for tax."

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"You've got a building in the Cayman Islands that supposedly houses 12,000 corporations. That's either the biggest building or the biggest tax scam on record."

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"We often say: how do you spell development? T A X. We need to allow countries to gather their own domestic revenues in order to finance their own development."

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"There would be more revenue for all if countries resisted the temptation to compete with each other on taxes to attract business. By definition – a race to the bottom leaves everybody at the bottom."

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"No one has the right to set his own tax rates. It is not right for individuals to grow wealth from free trade and economic integration only to take off profits at the expense of their neighbours. That is outright theft."

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"Tax havens are indeed heavens for tax evaders and fraudsters, but they are hell for the law-abiding citizen and responsible tax-payer."

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What are the consequences for society?

We have achieved much in our global world. But, amidst progress for some, billions of people across the world still lack access to basic food, water, health services, energy, security, education, and jobs. Corruption, capital flight, and financial secrecy are preventing us from addressing the most urgent problems.

Our forests, water, and biological diversity are threatened in the name of profit, often through companies where the real owners are hidden. We see environmental destruction, and the erosion of the rule of law. We are facing the beginning of the problems that we will be facing. It is one of the most pressing moral questions of our time, and it is urgent that we make capital flows more transparent so that we can finance our common global challenges. The problems we are facing are truly global, and we must all strive to do our part and inspire others to accept their responsibility.

We see increasing and widening income inequality. This widening gap is one of the defining problems of our time. If a goal is to spark economic activity, we cannot ignore the widening income social strata because income inequality is harming the potential for economic growth.

Today, more than 7 billion people are living on our planet. One billion of the world’s citizens receive 80% of global income. One billion barely survive on less than $1 a day. This is an inequality that is not sustainable, and which urgently needs to be addressed. In countries where inequality and poverty levels are high, illicit financial flows also are high.

Global inequality seems to be slightly decreasing, and inequality within nations is increasing. But a small decrease in overall inequality may not be true because available national data regularly underestimate the top 1% of incomes, and because global tax havens conceal the reality of those incomes.

We will not be able to address our global challenges with the current economic system, which allows the richest to get richer. By increasing the income share of the poorest and the middle class we can see an increase in growth. Increasing income share in the top 20% results in lower growth—this means that when the rich get richer, the benefits do not trickle down. Excessive inequality does not enable sustainable growth, so if you increase the income share of the poorest, you get a manifold effect that you do not get if you increase the income share of the richest.

An economic system where multinational companies and the super rich are allowed to make money exactly the way that they want to, is effectively undermining both competition and the market.

Multinational companies and the super rich are able to pay for legal and accounting advice on how to avoid rules and laws, and how to get rid of rules and laws. Through lobbying and litigation, companies are able to get rid of regulations they do not like, such as environmental protection, and to try to get politicians to shift the tax burden away from capital and onto labour. Such advice has developed into an industry in itself. We used to see oil companies pushing contracts on countries that had clauses that said their contracts should be above any national and international laws. Today, we see that multinational companies and the super rich are getting richer and increasingly more able to control political power.

Multinational companies are spending billions on lobbying governments (in some countries, they even are financing political campaigns), and they are pushing and lobbying to create trade agreements that contain clauses say they shall be allowed to make money exactly the way that they want to, and if the government interferes, they will sue them.

The multinational companies and the super rich may claim it’s all legal. It may be legal, but it is not right. And it is not sustainable.

22 Increasing the income share of the poor and the middle class actually increase growth while an income share of the top 20% results in lower growth—this means that when the rich get richer, benefits do not trickle down.
23 http://www.corporations.org/system/top100.html

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What has been said and done about the problem?

What does the UN do about financial secrecy?

With the eight Millennium Development Goals (MDGs) derived from the Millennium Declaration and adopted by all United Nations Member States in 2000, world leaders made a commitment to time-bound goals to combat poverty, hunger, and diseases, provide education to all children and equal opportunities to both women and men, protect the environment, and establish a global partnership for development. They pledged to achieve all of these goals by 2015.

These goals focused mostly on the difference between rich and poor countries, not the inequality within countries. There has been important progress in achieving universal primary education, gender equality, and safe drinking water in rural areas, but there have also been shortfalls, most notably on human development goals such as reducing child mortality, improving maternal health, and on environment goals such as on CO2 emissions and protecting forests. Some have achieved much, but financing is still needed for the remaining goals.

Likewise, by 2015 a global debate on what to come after the Millennium Development Goals (MDGs) has been undertaken. The UN released a report that set up six essential elements to frame and reinforce the sustainable development agenda, which again focused on the MDGs. The discussion about how we can finance such development has been held within many countries and is called the Financing for development debate.

This discussion comes after the world has experienced a global financial and economic crisis. Many countries were hit hard and each faced different challenges. The more inter-connected a country has been with the world economy, the more seriously the country has been hit. This has had an impact on the willingness of industrialised countries to fund development in other countries because they are struggling with their own problems. At the same time, we know that financial secrecy is one core aspect of the financial crisis.

The UN member countries are using the MDGs as criteria for not having sufficiently addressed illicit financial flows. A global community is pushing the UN to stop illicit financial flows. Although these laws are milestones for transparency, they are still a minimum standard for country-by-country reporting because this is information on tax payments. Information on tax payments may reveal possible discrepancies that can be investigated further in order to see if corruption has happened. It is necessary and relevant, but it cannot address illicit financial flows.

What does the EITI do on financial secrecy?

The EITI is a voluntary standard to standardise processes with requirements for improving the governance of natural resources, and it is a voluntary part of the transparency process that brings together stakeholders from government, civil society, oil, gas, and mining companies and investors.

The goal is to produce an EITI report, which discloses company payments to the government and governments’ receipts. The purpose is to allow citizens to see how much their government is receiving from the country’s natural resources, and thereby strengthen government and company systems, informing a public debate, and enhancing trust. Some countries have put the EITI requirements of payments to governments into their law system.

The information in an EITI report isn’t accounting reporting, so it is not possible to use this as statistical financial information across countries, and different countries also contribute differently to the EITI process. The EITI is a mechanism established because other mechanisms were lacking.

Historically, the EITI has focussed on payment of taxes and other payments, which may reveal discrepancies and potential for corruption. More recently, the EITI is arguing for transparency for benefits, which can reveal who owns a company.

What does the USA and the EU do about financial secrecy?

A minimum requirement for transparency has been introduced in the USA and the EU. The law requires publicly traded companies in the extractive industries to disclose what they paid in taxes to foreign governments. The EU has also included forestry. The intention is that it should be possible to compare payments from companies with the state authorities. It is what the government says it receives for all countries from which it extracts resources.

These are the same principles as the EITI, but it has been established as a requirement in law. This minimum reporting on tax payments is called ‘country-by-country reporting’.

The US laws called the ‘Dodd-Frank Act’ and the EU laws called the ‘EU Transparency Directive’. What they have in common is that they are laws that demand oil companies to publish information on tax payments.

The International Monetary Fund (IMF) showed that international companies have managed to push the income tax down to zero, and the countries lose up to 15 percent in tax revenue. They said that the more countries that yield to investors’ demands when it comes to taxes, the more the international society will suffer. The fact that international companies reduce the tax they pay and legally review tax claims has major implications for national economies, as well as for undermining its ability to finance government expenditure.

The African Union (AU) is a continental union consisting of 54 countries in Africa, which was established in 2002. It is interested in addressing the problems of African integration and development.

What does the OECD say about financial secrecy?

The process OECD has had to address financial secrecy is its work on base erosion and profit shifting called BEPS. The OECD addressed the problem by saying that the country-by-country information should only be intended for, and accessed by, tax authorities, which will have to collect the information themselves through formal processes—and only in order to address possible transfer pricing purposes and with high ex-clusion thresholds.

The companies do not have to publish annual accounts in the public domain. It is very unlikely that this mechanism will have any effect for issues related to base erosion and profit shifting out of developing countries.

The Organization for Economic Co-operation and Development (OECD) is an organisation of 34 member countries and 6 other participating states. They claim to promote policies that will improve the economic and social well-being of people around the world.

What does the International Bar Association’s (IBA) say about financial secrecy?

The International Bar Association (IBA), the world’s largest legal organisation, sees tax avoidance from a human rights perspective. When an increasing number of multinational companies use legal advice and other mechanisms to avoid paying taxes, the effect is that the companies are removing the resources that nations need to realise human rights.

This can be achieved on human rights, says IBA, who connected tax abuse, poverty, and human rights.

The International Monetary Fund (IMF) is an organisation of 189 countries. It was conceived at a UN conference in 1944 to build a framework for economic cooperation. The IMF’s main task is to ensure stability in the economic system.
An extended country-by-country reporting standard

In the report “An extended country-by-country reporting standard: A policy proposal to the EU,” PWYP Norway provides a policy proposal requiring multinational extractive companies to be transparent about their operations in every country.

THE PROBLEM

2/3 of the world’s poor live in countries rich in natural resources. Extraction of these resources is an opportunity to mobilize capital that can be invested in poverty reduction. Still, the money often ends up elsewhere. Multinational oil and mining companies have been given access to profit on the extraction of natural resources from many of the world’s poorest countries. The extractive industry has been under increasing criticism for corruption, tax evasion, human rights violations and stealing profits from source countries to other parts of their corporate structure, often tax havens. All is done under a veil of secrecy, contracts are secret, parts of the corporate structures are undisclosed. Financial information is so aggregated and condensed that even the most interested reader is left uneducated. These companies are continuously protected by a veil of secrecy that is owned by the countries they operate in, and the companies sell their products in transparent markets provided by other countries. The demand is rising for these companies to become transparent about their operations instead.

THE CONSEQUENCES

Until today, multinational companies have not been required to provide key information about their activities in the countries they operate in. Instead, the companies are able to build large fortunes from the extraction of natural resources and hide them in tax havens, where information about ownership, accounts and transactions are kept secret. The lack of international regulation has made financial secrecy possible and lucrative. For over 50 years, this financial secrecy has contributed to a generation of citizens in resource-rich developing countries of the financial basis that could have added sustainable development. When governments, investors, journalists or citizens ask the companies for information about where the money has gone, they meet a wall of silence and secrecy.

A SOLUTION

An extended country-by-country reporting standard is one of the best, most targeted and inexpensive tools to hinder corruption and capital flight in the extractive industries. In addition, it will create a more level playing field for the companies worldwide. The policy proposal will require the companies to report key accounting figures for every country that the companies operate in. These few figures will provide governments, investors and citizens with the information they need to assess how the companies manage the resources, whether the money flows and whether the countries get their fair share of the revenue. Only with such reporting are citizens able to hold their governments and the companies accountable, and investors able to know the true value of their holdings.

Q&A

What does the “extended” in country-by-country reporting stand for?

The European Union and the United States have both introduced country-by-country reporting for the extractive industries, requiring companies to report tax payments in each country in which they operate. This is a great step in the right direction, but PWYP Norway has demanded that Norway takes the regulation further by introducing “extended” country-by-country reporting. This involves providing the reporting standard with two important criteria. The first concerns the content. Taxpayers need to be presented with net income. No figure presented in isolation gives much meaning. Unless the reporting includes key accounting figures, it will not be meaningful. The second concern is the form. The reporting should be included in the consolidated financial accounts of companies and take the form of notes to the consolidated financial accounts, at least with respect to tax accounting numbers. The financial accounts are already audited and therefore trustworthy and would not need additional and costly auditing and verification. If companies are not required to present the reporting from their audited financial accounts, they will have a considerable scope for circumventing. Any country-by-country reporting that fails to meet these two core requirements will automatically entail less confidence in the reporting and will have higher costs. The reporting requirements in the US and the EU do not include these two criteria yet, but the parliament is about to change. Norway can take the lead and demand country-by-country reporting for banks based on financial accounts. The proposal from PWYP Norway is supported by investors, tax authorities, the ministry of Foreign Affairs, the central unit for prosecution for investigation of economic and environmental crime, the Association of Norwegian editors and organizations at large in Norwegian civil society. The proposal has also been presented to the EU commission in 2012.
How close are we to extended country-by-country reporting in Norway? What remains?

- Natural resources have not helped citizens of poor countries escape poverty.
- Cash flows often end up elsewhere, in the accounts of multinational companies in tax havens.
- The Norwegian Ministry of Finance has issued regulations on extended country-by-country reporting, which will show where cash flows end up.

15 out of 18 elements have already been implemented in the extended country-by-country reporting. However, 3 critical elements are still missing for the legislation to work as intended and prevent companies from avoiding tax.

What is the problem?
- What is the solution?

How YOU can ensure that we rectify the last few omissions.
- Investors can trace their money and assess how companies manage assets.
- Lawmakers can treat companies equally and create a level playing field.
- Citizens can hold their governments and companies accountable.

Downstream pollution of upstream numbers in Statoil’s first country by country report

The Norwegian regulations are clear: It is the production activities (upstream) that should be reported for each country. Publish What You Pay Norway’s analysis shows that Statoil in its reporting has allowed numbers from downstream operations to be mixed with, and possibly, the numbers from upstream operations.

If Statoil also wants to report on its downstream businesses, that is fine. But upstream operations must still be reported separately, and in accordance with the regulation.

The Norwegian country by country regulations on the same definition as the EU directive of retail constitutive upstream activities, undertaking activity in the extractive industry means accounting along with any activity involving exploration, production, discovery, development, and extraction of minerals, oil, natural gas, deposits or other materials. This is what is called upstream activities in other industries. Downstream activities are refining, trading, and marketing. Selling final production downstream is not an integral part of the definition of the current country by country reporting under the EU directive, nor under the Norwegian regulation.

The Norwegian country by country regulations, which have been adopted by the extractive industries worldwide. That is because there is no clear separation between the activities on upstream activities, and the costs which are paid (upstream activities).

Therefore Statoil should publish a report on the Norwegian regulations, and report upstream activities on a country by country. If downstream activities are reported separately, then revenues and costs associated with downstream should be reported in the country where income is actually earned or costs, incurred.

Norwegian politicians and the public should take some of the blame for Statoil not getting it complete in the first country by country reporting in the world.

What is the problem?
- Taxpayers to the employees, the investors, the production, the revenues, the costs and the taxes for extractive activities (that is upstream) in every country around the world – nothing more, nothing less.

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The implication of the regulation being limited to producer activities, it becomes difficult to identify the real profits of companies operating with at least 6,000 subsidiaries and countries only is that we ignore all company subsidiaries and corruption.

RED FLAG 1 is about CONTENT: RED FLAG 2 is about FORM: RED FLAG 3 is about FORM: RED FLAG 4 is about CONTENT.

Downstream pollution of upstream numbers in Statoil’s first country by country report

In the table below, Statoil has in the table below tried to distinguish how to do this. Statoil should do this, and Statoil can do this. But then Statoil may still be criticized when they do not report the revised numbers in line with the regulations.

When regulations only require companies to report purchases of goods and services, the full cost of upstream is not shown. This means that it seems as if profit in individual countries are higher than it actually is, which in turn may have the effect that taxes reported seem relatively lower than they actually are. That means that the company can attract or decide for paying to little tax relative to the apparent profit. Norwegian authorities have therefore exposed Statoil and other companies for unnecessary and unfair criticism when they have made amalgamation containing such weaknesses. Publish What You Pay Norway has worked intensively since long before the regulations came out that Norwegian authorities must rectify weaknesses in the reporting in order to ensure that the reporting is as accurate as possible. We have come far, but regulation is missing these key elements to function as intended. Politicians have a responsibility to take legal actions and to make sure that the figures reported only upstream activities on upstream activities that are separated out, and with all upstream costs included.

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Transparency Agreement - A tool for multinational transactions

How to expand and fix the toolbox used by tax administrations

A recurring problem in the global market is a number of asymmetries between the multinational companies and the host countries. In this report, Publish What You Pay Norway gives a complete overview of transparency initiatives in the world today, and introduces a less known transparency instrument: The Transparency Agreement – which is a unilateral contractual arrangement between a company and a government, whereby the company guarantees that in exchange for its “license to operate” within a country, it will be transparent when the authorities wants insight.

THE PROBLEM

PWYP Norway’s main focus is to ensure that extended country-by-country reporting (CBC) is legislated in as many countries as possible, to enable the public oversight of extractive industries by investors, governments, media and civil society. The extended CBC reporting is, in simple, low-cost and effective tool to get broad insight into multinationals.

However, one institution has deeper needs for insight into multinational companies’ transactions than the rest of society, and that is the tax administration. The reason is that the tax administration is the institution that is responsible for assessing the correct tax base and collecting the taxes from the multinational’s representative company in the country. Tax administrations have limited insight and ability to follow transactions through the value chain with multinationals.

Automatic Exchange of Information (AEI) has been proposed as a solution, but it is insufficient for tax administrations can use this insight on a full basis within a multinational.

The reason is that tax administrations and courts of law lack the insight to distinguish a tax scam from a legitimate transaction. This may have two consequences: (1) tax scams are not discovered and reassured leading to taxes that are lost forever; and (2) transparent transactions may incorrectly be assessed as tax scams.

A SOLUTION

One very low-cost, simple and effective solution is to give the tax administration insight into the tax chain of transactions that occur within multinationals. It is important that this insight is based on sampling, so that the burden on the company does not become too high while retaining the intention of the instrument – to give insight into the full chain of transactions within a multinational company.

The transparency agreement (or guarantee) has been designed to give tax administrations insight on a sampling basis into the chains of transactions within multinationals. In order for it to work, an agreement or guarantee has to be demanded, either by law by agreement, before a multinational is given a licence to operate or establish a presence within a country. Failure to agree to be open and transparent – on a sampling basis, shows a non-cooperative behaviour.

In the report “Protection from derivative abuse”, Publish What You Pay Norway reveals the harmful use of the financial instrument called derivatives in the extractive industries.

THE PROBLEM

Today, trade in non-renewable natural resources such as oil or minerals does not have to be connected to the physical and geographical extraction of them. Rather, much of today’s trade is made through the use of financial instruments. Some of the most complicated financial instruments are derivatives, which are used extensively in the extractive industries. These are legal and can have positive effects. Unfortunately, derivatives can also be abused in order to move capital across countries and thereby evade tax. Most of these instruments are used for the companies’ own benefit, and at the expense of poor host countries where the resources are being extracted. By using derivatives, companies can transfer revenues out of the host countries before the revenues are taxed.

THE CONSEQUENCES

The well-known investor ‘Warren Buffet’ has termed derivatives as “financial weapons of mass destruction” that can harm the whole economic system. Derivatives can cause both rich and poor countries. Derivatives are used to transfer untaxed money out of host countries (where the companies extract resources) and hide this money circulating within a multinational corporation without taxation, or without taking the money back to the home country (parent company jurisdiction). Poor developing countries are particularly vulnerable to this abuse. Tax revenues from the extraction of their natural resources might be the only financial basis of such a size that it can help fight poverty. Tax evasion made possible by amongst other abuse of derivatives, taps host countries of their legitimate and strongly needed resources. Furthermore, few developing countries have the resources or capacity to uncover abuse of derivatives, as they are very complex instruments.

Lack of transparency in the extractive industries makes this task even more difficult.

A SOLUTION

PWYP Norway outlines an effective policy proposal to hinder the abuse of derivatives and their harmful consequences. Countries can single out derivatives as a separate tax base. We call this the ‘separation method’. The companies’ income from derivative activities would thus be taxed separately from their income from extractive activities. This means that gains are taxed based on the general tax rate in the country, and losses can be used against current gains or carried forward and taken against future gains.

This would limit the abuse of derivatives for transferring untaxed funds from poor countries.

The method can be implemented unilaterally and online with how most countries have set up their tax systems, and with legislative systems in general. It fixes the market failure created by derivative abuse, while at the same time does not discourage the proper use of these instruments.

Q&A

Does PWYP Norway promote the transparency agreement?

PWYP Norway has investigated and found that a transparency agreement would be effective for tax administrations, but would need promotion as such. Countries and tax administrations should be able to access this tool on a good side by themselves. PWYP Norway’s main concern is to secure the interest of the public, which is why PWYP Norway promotes extended CBC reporting.

The Ministry has stated that the purpose of the bill is to draw a line between the two areas: tax evasion and confidentiality and the tax authorities’ right to information about income and wealth which is important for tax taxation. "You need more about the draft bill and the different consultative statements from relevant actors at the Government’s website, see www.regjeringen.no.

Is it dangerous for a country to demand a transparency agreement from multinational companies?

No, it is not dangerous, but it may be that some multinational companies will say no to signing the country if they have to sign on to a transparency agreement.

However, a country needs to think through whether that multinational company is the kind that would move to the country or whether it is better to invite those that are willing to sign the transparency agreement.

Why is the transparency agreement not public, but only to tax administrations?

Because the transparency agreement allows insight into individual documents, and these are regarded as private papers only relevant for the company itself, and the tax administration that is paying to access the company.

Why should I read this report?

Many people think tax administration have too much information about normal taxpayers. They should be cleared to know how little tax administrations know about multinational companies. This is why you should read this report.

Q&A

What is a derivative?

A derivative is a financial instrument that allows speculation on the future price of a product - without buying the actual product. The price is linked to the market place the product is derived from, but there is no physical delivery to back the transactions, only settlement of derivative contracts. A derivative is thus demand of its own.

How does it work?

Derivatives (like futures, options and swaps) were developed to allow investors to “hedge” risks in financial markets - in effect buy insurance against market movements. Used correctly, hedging is a good instrument for securing profits and keeping this money circulating within a multinational corporation. In order for it to work, an agreement or guarantee has to be demanded, either by law or by agreement, before a multinational is given a licence to operate or establish a presence within a country.

For more information, see the website www.regjeringen.no.
In the report “Lost Billions: Transfer pricing in the extractive industries”, Publish What You Pay Norway investigates the potential trade mispricing in imports of crude oil in the European Union (EU) and the United States (US) between 2000 and 2010.

**THE PROBLEM**

The report finds that at least $10 billion US dollars have disappeared during import of crude oil to the EU and the US during 2000-2010. To understand how and why we need to look closer at “transfer pricing” – which happens when related companies trade with each other and set a price for this transaction. This is not itself abusive or illegal, but it becomes so when the price is set deliberately too low or high in order to avoid paying taxes or to shift profits across borders. This is called transfer pricing. Today, over 50% of worldwide trade is taking place within multinational companies. Transfer mispricing is one of the most-used techniques for extractive companies to transfer profits from host and home countries to the company itself.

**THE CONSEQUENCES**

Transfer mispricing misleads the overall tax bill for the company and helps the company move much of its profits to tax havens with lower or no taxes. As a result, tax authorities in the home and host countries, as well as the company itself, are collecting lower taxes than they would otherwise. Developing countries in particular often lack access to the necessary information, as well as the capacity to verify the prices set by companies and their related entities outside their own jurisdictions. This makes it even more difficult, if not impossible, when tax havens are located in secrecy jurisdictions or tax havens, where company accounts are not required or available.

**Q&A**

*How does transfer pricing work?*

Take for example a company that extracts gold in Tanzania and then processes it and sells it in the United States. The company does this through three subsidiaries: one in Tanzania (host country, where most of the mining happens), one in a tax haven (zero taxes) and one in the United States (home country). The subsidiary in Tanzania sells the produce to the subsidiary in the tax haven at an artificially low price, creating a virtually zero profit for the latter. The subsidiary in the tax haven then sells the produce to the subsidiary in the US at a very high price, creating artificially high profits in the US, and consequently a lower tax bill for the US corporation. In this way, the company is able to hide money and earnings in tax havens and home bases. It will allow investors to follow<meta> companies and governments to access valuable and standardised information across all jurisdictions where the companies operate. Only through such reporting can governments be certain that they are collecting their fair share of revenues and taxes.

*In the report “Silence is golden”, Publish What You Pay Norway sheds light on an unintended and concerning consequence of lawyers’ duty to maintain client confidentiality.*

**THE PROBLEM**

To plan and facilitate tax evasion for multinational companies, they use a set of complex corporate structures and related tax flows, which can be understood when looking at the distribution of these between home countries, tax havens, and host countries. They will often create a legal “shelter” for their profits in the tax haven, which is then sold abroad at a higher price, effectively hiding the profits from taxation. This means that the tax authorities in the home country have no way of knowing how much money is being moved through the company structure and transferred to tax havens. Companies often use lawyers to structure these transactions. Lawyers have a duty of confidentiality, which helps them to protect the confidentiality of their clients’ affairs. The real purpose of this principle is to protect an individual’s ability to access the justice system, and safeguard rule of law in the society. Yet it is necessary to shed light on the unintended consequence of this confidentiality: companies can use it to avoid paying taxes and to profit from tax havens. It also protects the lawyers from having to disclose their own contributions to tax evasion.

**THE CONSEQUENCES**

Multinational companies, with the help of lawyers, build complex corporate structures that make it nearly impossible to prosecute companies for human rights violations, or for illicit tax evasion from both rich and poor countries. The global financial integration has developed much faster than the national governments’ capacity to get an overview over the implications for their legislations and economies. Poor countries with non-renewable and finite natural resources are in a particularly vulnerable position. Developing countries are being drained of nearly $1000 billion US dollars each year through illicit financial flows. This equates to the value of total international aid to poor countries. Tax evasion from commercial companies constitutes the largest share of illicit financial flows. Complex corporate structures and lack of transparency makes it nearly impossible for tax authorities to prosecute the companies.

**A SOLUTION**

Lawyers’ duty of confidentiality is vital, noble and necessary for a free and civilized society. Yet it is important to separate a lawyer’s passive protection of clients, from active contribution to crimes like illicit tax evasion. Publish What You Pay Norway sees no contradiction in seeking to protect the lawyer’s duty of confidentiality on the one hand, and at the same time ensure that this confidentiality cannot be abused. It is vital to make this distinction, as the abuse of the privilege of confidentiality can undermine the privilege itself. One potential solution is to remove the duty of confidentiality on specific and limited areas concerning client accounts, in order to ensure tax authorities’ ability to access and collect their fair share of tax and revenue. This possibility has been discussed in Norway and is supported by PwC Norway.

*The essential purpose of the global shadow financial system is the shift of money from poor to rich. This is about getting rich secretly and not having to account for such riches locally*, writes Raymond Baker, Director of the think-tank Global Financial Integrity (taken from another of our reports, “Piping Profits”).
What can young people do to make financial transparency possible?

Young people are an important force of change in the world. Several times, history has proven that when young people mobilise, they can accomplish extraordinary things and change unjust structures. The abolishment of slavery and apartheid are examples of big changes that would not have happened without global movements of young people.

Today, the world is facing new challenges. Poverty and climate change are challenges that are causing human suffering. 1-2 billion people live in extreme poverty and are not able to live their life to its fullest potential. Financial secrecy is one of the main causes of poverty and increasing inequality in the world. Illicit capital flows drain resources from people who need it the most and are making the challenge of poverty and inequality more severe.

However, there is good news! Illicit capital flows happen because of politics. It is because of the systems being built that companies and individuals are able to evade tax and drain money away from important development. This is good news because we can change politics!

This is why KFUK-KFUM Global is working to mobilise young people to influence decision-makers. Through KFUK-KFUM Global, young volunteers are coming together to work against financial secrecy in order to stop poverty. During the spring of 2015, they worked to influence the negotiations on financing for development in the UN. Through campaigns, meetings with politicians, inputs to the foreign ministry in Norway, and workshops, they have communicated the importance of changing legislation to fight secrecy. Volunteers have spoken to young people all over Norway in order to get more people involved in the fight against injustice. They have met the prime minister of Norway and told her to remember the importance of fighting poverty in top-level meetings that she is attending internationally. Our volunteers have challenged youth politicians to get involved in fighting financial secrecy. This work is important. Only by mobilising the force of change that young people all over the world represent, we can change the unjust structures that are causing poverty and inequality.

You can find out more about how to become part of KFUK-KFUM Global’s voluntary network at www.kmglobal.no or by sending an email to global@kfuk-kfum.no.

KFUK-KFUM Global is a member organisation of PWYP Norway.

How can young people fight financial secrecy?

Ingebrikt Kval (25 years old)
Member of the political committee of debt and capital flight, Changemaker

How are you engaged in the fight against financial secrecy?
I am engaged by volunteering for Changemaker. This is important to me because financial secrecy permits capital flight, and it affects the weakest in the society. Poor countries lose big incomes because of the tax cheating from multinational companies. This affects the poorest people, who lose their opportunity to go to school and have good health care.

Why is it important to be involved in the fight against financial secrecy?
It needs a lot of effort to fight selfishness. According to my experience, there are strong forces in the financial sector that are fighting for secrecy. Therefore, it is important that a lot of people work for transparency! I have been part of Young Peace Performers the last year, which is an exchange programme run by KFUK-KFUM Global. We have worked a lot with illegal capital flight. It is very clear that we need more transparency around companies and how it is important that we can share information and have discussions about this topic.

Iselin V. Marøy (23 years old)
Participant Young Peace Performers, KFUK-KFUM Global

How are you engaged in the fight against financial secrecy?
Volunteers from KFUK-KFUM Global has this spring travelled around to tell about the importance of financial secrecy to youth all over Norway. Photo: Iselin Marøy

Ingebrikt has proved that when young people mobilise, they can accomplish extraordinary things and change unjust structures.

Why is it important to be involved in the fight against financial secrecy?
Financial secrecy makes bigger gaps in the world, especially in developing countries. We cannot accept this. If you want more justice in the world, you have to fight for greater transparency regarding companies activities and work against illegal capital flight.

Martin Giset (25 years old)
Leader of Follo/NMBU, Attac

How are you engaged in the fight against financial secrecy?
Throughout our work in Attac, we have figured out that known and “beloved” Norwegian companies as Freia, Statkraft and ISS use tax havens. We have used this result to create consciousness about the problem. We wanted that self-proclaimed “tax haven free zones” should require transparency of companies in the bidding process.

Why is it important to be involved in the fight against financial secrecy?
Big multinational companies and the “economic elite” are today enjoying the secrecy that is offered by tax havens. They are avoiding tax and hiding corruption. To build a more democratic and just society we need to put the spotlight on the “black holes in the world economy.”

Iselin V. Marøy (23 years old)
Participant Young Peace Performers, KFUK-KFUM Global

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Participating in Young Peace Performers has been very amazing and inspiring. We have travelled around to tell about financial secrecy. We have communicated the importance of this issue to everyone.

Participant Young Peace Performers, KFUK-KFUM Global

How are you engaged in the fight against financial secrecy?
Volunteers from KFUK-KFUM Global has this spring travelled around to tell about the importance of financial secrecy to youth all over Norway. Photo: Iselin Marøy

Ingebrikt has proved that when young people mobilise, they can accomplish extraordinary things and change unjust structures.
Which small steps can you take to fight financial secrecy?

The following are three different steps you can take to help fight financial secrecy:

1) Spread the message on social media:
- Participate in the fight against financial secrecy on social media. Follow PWYP Norway on social media, participate in the debate, and sign up for PWYP Norway’s newsletter on the webpage www.pwyp.no.
- Invite your friends to take part in the debate on social media and share posts and tweets.

2) Become a volunteer:
- Contact an organisation for which you want to volunteer. Your voice, time, and energy are crucial for the fight against financial secrecy!
- Take part in a political committee or a local group in your organization that focuses on the fight against financial secrecy.

3) Talk about it:
- Tell your friends why it is important to fight financial secrecy. PWYP Norway has developed material that can be used to present the facts to your friends or your organization. Go to www.pwyp.no to find the material or send an email to post@pwyp.no.
- Write an opinion piece in the local newspaper on why it is important to fight financial secrecy. Contact post@pwyp.no for support in contacting the newspaper and writing the text.

If you have any questions about how you can get engaged, please send an email to post@pwyp.no.
HELP US CONTINUE OUR WORK:
Do you think our work is important?
Do you want to see financial transparency and accountability in the extractive industries?

You can support PWYP NORWAY by sending a text message

Text PWYPNORWAY to 09316
followed by (donation amount)
e.g. pwypnorway 500
(donations in NOK, international users must use +47 417 16 016)

YOUR SUPPORT MAKES OUR WORK POSSIBLE

PWYP Norway is the Norwegian chapter in a network of 800 organisations from more than 70 countries worldwide. We work for financial transparency in the extractive industry to promote sustainable societies.