The Unseen Threat of Capital Mobility

The secured entrance for bank clerks in St. Gallen, Switzerland. Photo: Kecko

The Hidden Wealth of Nations: The Scourge of Tax Havens
By Gabriel Zucman
University of Chicago Press, $20 (cloth)

Out of Sight: The Long and Disturbing Story of Corporations Outsourcing Catastrophe
by Erik Loomis
The New Press, $25.95 (cloth)

Two new books link rising inequality to unseen forces: tax havens in economist Gabriel Zucman's case, and overseas labor and environmental exploitation in historian Erik Loomis's. The adverse consequences of the free movement of capital suffuse both narratives. Loomis recognizes that the threat of offshored jobs and outsourced supply chains is wielded to discipline the domestic workforce in the United States, and Zucman points out that tax havens have effectively allowed the wealthy to choose their own tax system and regulatory regime. They each question received wisdom and ideologically charged models in which "globalization" is an inexorable force innocent of politics or power, which operates to either universal benefit or at worst whose ill effects can be compensated. In fact, thanks to globalization, the economic body—what its ideological affiliates call "The Market"—is able to transcend the national body politic, to the benefit of multinational corporations and the wealthy individuals who own them.

The march of globalization, as defined by the erosion of national borders in the economic sphere, especially constraints on the international mobility of capital, is neither inevitable nor desirable, Loomis and Zucman argue. Both authors propose tariffs, capital controls, and international regulatory standards that would either re-erect national boundaries or threaten to do so—proposals that will strike many readers as misguided, out of touch with political reality, or both. But these two books offer a powerful counterargument to the prevailing narrative that sees globalization as a natural trend.

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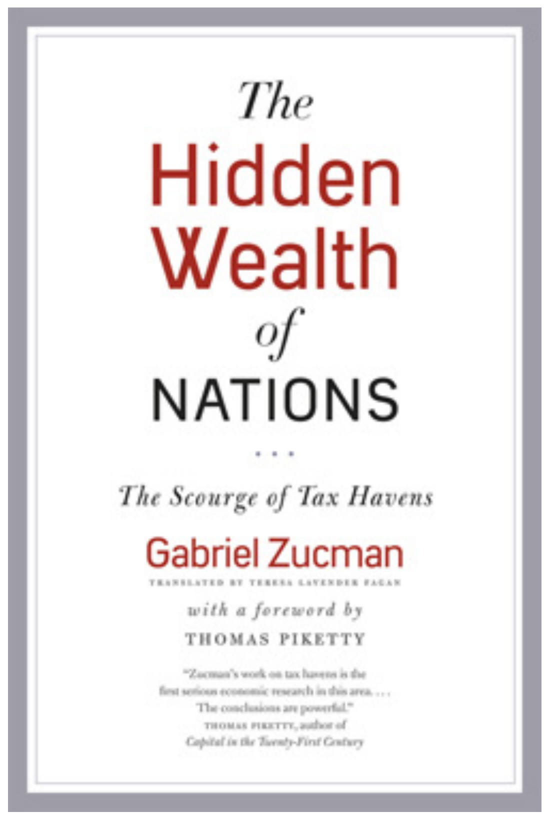

Zucman is an economics wunderkind: his dissertation was supervised by Thomas Piketty and he has published important papers on capital accumulation with Piketty and on wealth inequality with Emmanuel Saez. *The Hidden Wealth of Nations* draws from this dissertation research into the extent of global wealth hidden in tax havens: countries that look the other way when wealthy foreigners and corporations open bank accounts for the purpose of eluding tax authorities in their own countries. Zucman estimates that 8 percent of global financial wealth, amounting to $7.6 trillion, is hidden in havens. This amount has increased by 25 percent in the last five years alone (notwithstanding the notably successful crackdown of the United States' Foreign Account Tax Compliance Act of 2010), with the total foregone tax revenue of $190 billion per year. The ability of U.S. corporations to hide profits in overseas subsidiaries, legally avoiding the corporate tax system, also means that the effective corporate tax rate for

U.S. companies is less than 20 percent, as opposed to the statutory 35 percent.

This hidden wealth explains a discrepancy that arises when the national income accounts of every country are added up: globally, there seem to be more liabilities than assets. In fact, the books balance, but the owners of those missing assets are rich people and companies whose wealth is stashed away to avoid taxes. Because it shifts the tax burden to everyone else, the existence of tax havens gives a powerful boost to rising inequality, Zucman writes devastatingly on the political failures that led to the status quo, particularly within the European Union and its neighbor Switzerland:

> This theft goes on and on, year after year, apparently without really troubling either Swiss bankers, who today depict themselves as paragons of virtue, or European politicians, who like to congratulate themselves on their great determination in fighting tax evasion.

Indeed, it's difficult to avoid the conclusion that tax evasion proceeds mostly with the acquiescence if not collaboration of national policy-makers, who use one another's inaction to justify their own, at the expense of less privileged domestic taxpayers.

Zucman's most comprehensive proposal for dealing with tax evasion by wealthy individuals is to create an international financial register of who owns which financial securities. In the United States, the Depository Trust Company registers the ownership of stocks and bonds for purposes of transmitting electronic payment, and the UK and Europe have their own systems. These could effectively be nationalized and made accessible to tax authorities to verify filed tax returns. Often, the wealthy cite privacy concerns. But privacy concerns about an international financial register imply that only the privacy of the wealthy should matter for policy. As Zucman points out, the ownership of and taxes paid on real estate in the United States is public knowledge and has been for all of U.S. history, and real estate is more equitably owned than financial assets.

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In the meantime, Zucman recommends the use of sanctions against tax havens to induce them to comply with collection by productive economies' tax authorities. He points out that trade agreements permit retaliation for anti-competitive policies through tariffs on the offending countries' exports. For example, Zucman calculates that Swiss bank secrecy costs France, Italy, and Germany €15 billion per year, which could be recouped through a 30 percent tariff on Switzerland's exports. That would mean a devastating loss of income for Switzerland, but no one has brought a tax evasion case before the WTO's system for resolving inter-country disputes. In the European context, Luxembourg poses an even thornier problem, because as a member of the EU, it is immune from trade restrictions of any kind imposed by other members. Zucman says that unless it starts cooperating with its fellow members, they should recognize that it has transformed from an equal, productive nation to a paper-state that exists to trample the sovereignty of real ones, and they should expel it from the EU entirely.

On the matter of corporate taxation, Zucman proposes that instead of quasi-territorial taxation of corporate profits in which multinational companies calculate profits country by country and pay taxes accordingly, we should move to international "formulary apportionment" by sales. Under that system, global profits would be calculated and then apportioned to different jurisdictions depending on the percent of sales in each. The current system is subject to transfer pricing manipulation, whereby, for example, valuable but unmarketable intellectual property is "sold" to Google's Bermuda subsidiary for a pittance (where there is no corporate tax), and the rest of its units pay high rents to that subsidiary for its use. Under formulary apportionment, Google would have to assign profits to the places where its customers reside, and unlike the geography of its profits, it cannot control the location of its customers. The United States already does formulary apportionment for corporate taxation among U.S. states (which have varying corporate tax rates, though far less so than internationally), so there's no reason it couldn't be extended across countries. Furthermore, if the United States were to adopt that system for its own companies unilaterally, it would itself become a tax haven for foreign companies, because they would cease to be subject to the U.S. corporate income tax simply for conducting business in the U.S., as they are now. That is a powerful inducement to their recalcitrant governments to cooperate in creating a global, coordinated corporate tax system.

The Hidden Wealth of Nations is part of a new publishing phenomenon: the polemical but literate attack on received economic wisdom by a practitioner in good standing. 2014's *House of Debt*, by Atif Mian and Amir Sufi, is probably the closest precedent, but Paul Krugman's *End This Depression Now* (2012), Joseph Stiglitz's many books, and Dani Rodrik's imminent *Economics Rules* are others. (Piketty's own *Capital in the 21st Century* has flavors of this, but is also much more ambitious in scope.) Zucman's contribution adds an interpretation of the political failures that lead national policy-makers to cooperate in the reduction of their own power to the benefit of the wealthy.

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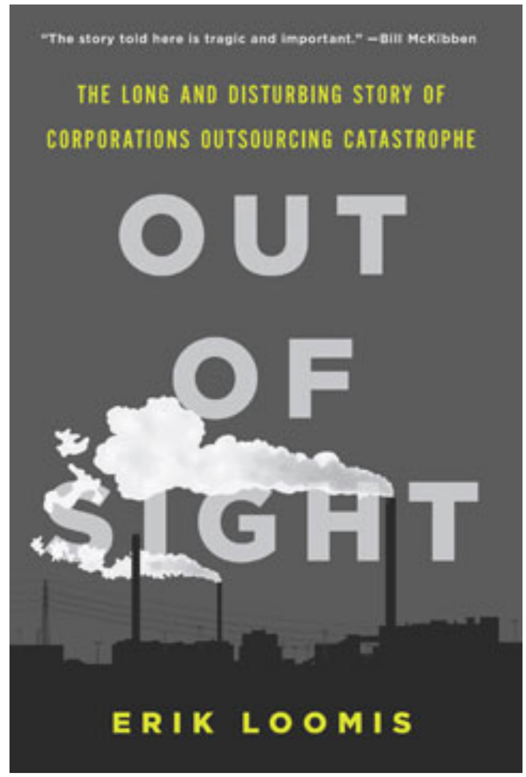
Loomis, a historian of the environmental and labor movements, begins *Out of Sight* by comparing the 1911 Triangle Shirtwaist fire, which killed 146 sweatshop workers, to the 2013 Rana Plaza factory collapse in Bangladesh, in which 1,134 laborers died. He juxtaposes the outraged reaction to the sight of young women thudding onto the sidewalk around the corner from Washington Square with the comparative lack of attention to its far deadlier equivalent on the other side of the world. Like Triangle Shirtwaist, workers at Rana Plaza knew the building was dangerous, but when they demanded it be made safe, they were threatened with unemployment and forfeiture of back wages, so they went back to work, and to their deaths.



In recounting the history of the social movement that eventually enacted workplace, environmental, and consumer protections, Loomis emphasizes the geographic and social proximity of the victims as essential to the movement's success. He cites numerous cases in which unionized workers joined environmental remediation efforts or consumer activists agitated for a safer workplace. This is intended as contrast to what he sees as the fable of opposition between environmentalists and workers, in which workers supposedly identify with their employers' bottom line and despise any regulatory challenge. As the son of an Oregon lumberjack, Loomis witnessed the timber companies blame tree-huggers and their penchant for Spotted Owls when jobs were offshored. This is part of his larger narrative about a corporate strategy to divide the movements that once tamed them by moving operations overseas, making sure that no would-be activist in the west ever sees the victims of Rana Plaza firsthand. Meanwhile, Bangladeshis suffer under a captive political system that caters to foreign investment as its *raison d'etre*, whose only hope of reform would be the remote possibility of a secondary boycott. One weakness of Loomis's book is that although its chronicle of the exploitation in Bangladesh and similar countries is exhaustive, he doesn't say much about local activism or bestow much agency on workers or citizens there, aside from acknowledging their protest over unsafe conditions at Rana Plaza. Workers in developing countries are undoubtedly weak and victimized by multinational corporations and their own captive governments, but they aren't passive—as the massive protests in Bangladesh and elsewhere over the past few years demonstrate.

The other thing Loomis's book lacks—as does Zucman's, despite his training—is the economics that would characterize the ideology supporting anti-regulatory globalization. Neither book mentions the Coase Theorem, a pillar of neo-classical economics that holds that under certain assumptions, government regulation is unnecessary to eliminate private harm between individuals. Rather, they will bargain their way to a convenient remedy. The champion of a broad reading of the Coase Theorem for policy-making has been the libertarian jurist Richard Posner, who famously argued that judges ought to rule in such a way as to bring about a so-called "bargaining solution" when pre-existing property rights and social arrangements do not enable the parties to arrive at one without a court's involvement. Coase's view, as embellished by Posner, is that when the costs of bargaining are low enough because property rights (to pollute, or to clean air, for example) are well established, it is best to let the parties decide for themselves how much pollution should take place. When they are not well established, the court should assign property rights to the highest–market value user of those rights—an inherently inegalitarian rule, since something valuable is bestowed free of charge on the party most likely to be richer *ex-ante*. Either way, the state's regulatory function, ongoing mediation between polluter and victim or between employer and employee, is eliminated.

The Coase-Posner libertarian agenda sustains a political project to wriggle out from under state authority, since that is where regulatory power almost always resides. Thus, trade agreements and the elimination of constraints on international capital mobility are desirable because they relieve productive economic agents from the burden of excessive regulation by enabling them to relocate their supply chains overseas. Unlike domestic, usually democratic politics, international politics is anarchic, just the sort of setting that enables the strong to dominate the weak, which is exactly what the Posner reading of the Coase Theorem calls for.

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Rather than escaping over-burdensome regulation, Loomis's book points to a different understanding of what motivates a political project to enable capital mobility. In a strategic context, in which the owners of capital and of labor are engaged in competition for shares of productive output, the party with more and more valuable outside options to cooperation with the counterparty gains the upper hand, as in any negotiation. In a world of high tariffs and limits to international capital flows, strong labor unions, and state regulation of labor contracts themselves and workplace and environmental safety, labor has the upper hand and is able to secure a robust share of the economic pie. But in a world in which capital can move overseas at any time, where unions are weak and replacement workers hired here or in Bangladesh at little cost, and where labor contracts are not collectively bargained, the returns to capital are much higher.

When the Rana Plaza factory collapsed in 2013, Loomis engaged in a memorable online dispute with Matthew Yglesias, who published a piece on the disaster headlined "Different Places Have Different Safety Rules and That's Okay," essentially repeating the argument that once led Larry Summers to call southern Africa "under-polluted" since the people who lived there are less economically valuable than those in developed countries. The Yglesias corollary is that poor workers benefit more than rich ones from a job at a dangerous factory. Both arguments sustain a commitment to the idea that operating dangerous and environmentally damaging production in poor locales is an economic win-win, and anyone who fails to recognize the truth of this schematization lacks understanding of the way the economy truly works, or is in hock to an outdated leftism that clings to state socialism and can't make sense of inexorable globalization. Loomis's reply to Yglesias at the time is, in essence, the genesis of *Out of Sight*.

The Summers/Yglesias view descends from David Ricardo's Theory of Comparative Advantage: Bangladesh specializes in cheap clothing produced in dangerous conditions, while the United States specializes in higher-value production, and the world is made better off, including workers in both places, the freer is American commerce with Bangladesh. Recently, the debate with Loomis flared up again, following Paul Theroux's October 2nd Op/Ed in the *New York Times* juxtaposing a tour of economic dislocation in the American South with his travels in Sub-Saharan Africa.

Loomis's and Zucman's calls for re-erecting national boundaries and re-empowering democratically accountable regulators are implications of a much more successful model for explaining why inequality has risen so much within developed and developing countries than in Yglesias' just-so story: capital has gained the upper hand over labor by creating and accessing outside options while eliminating those of its opponents. Both books are the product of careful reconsideration and critique of received wisdom in the fields each covers, and more casual commentators would be wise to take heed of their implications instead of peddling discredited objections to any check on international capital mobility.