Globalization, Taxes & Inequality

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Harris lecture, Harvard
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Introduction

Globalization has created new ways to avoid taxes:

- ▷ Multinational firms shift profits to low-tax places
- ▷ Countries compete by cutting their tax rates
- ▷ Wealthy households can move assets to tax havens

How does this tax avoidance redistribute income between nations and between social groups?

$\rightarrow$ Key question to think about about the **economic and political sustainability of globalization**

This talk is based on 4 papers

- “The Missing Profits of Nations” (w. Tørsløv, Wier)
- “The Exorbitant Tax Privilege” (w. Wright)
- “Tax Evasion & Inequality” (w. Alstadsæter, Johannesen)
- “Global Wealth Inequality”

Two goals of this research agenda:

- Positive **macro-distributional analysis of globalization** (data: http://gabriel-zucman.eu)
- Design policies to make globalization more sustainable

The Missing Profits of Nations

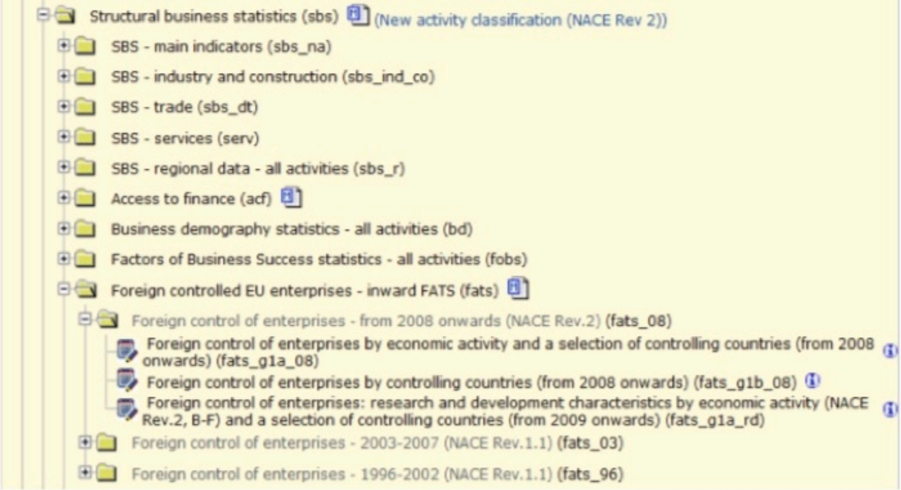
How much profits move across countries because of differences in corporate tax rates?

- ▷ Firms move capital to low-tax countries
- ▷ Firms shift paper profits to tax havens

If there was a **perfect international tax coordination:**

- ▷ Which countries would gain/lose profits?
- ▷ How? Relocation of capital, or reduced profit shifting?

New data: foreign affiliates statistics $\rightarrow$ wages, profits, etc. of foreign firms



—> Use these new data to provide first global map of where multinationals book their profits

How we estimate the amount of profits shifted to tax havens

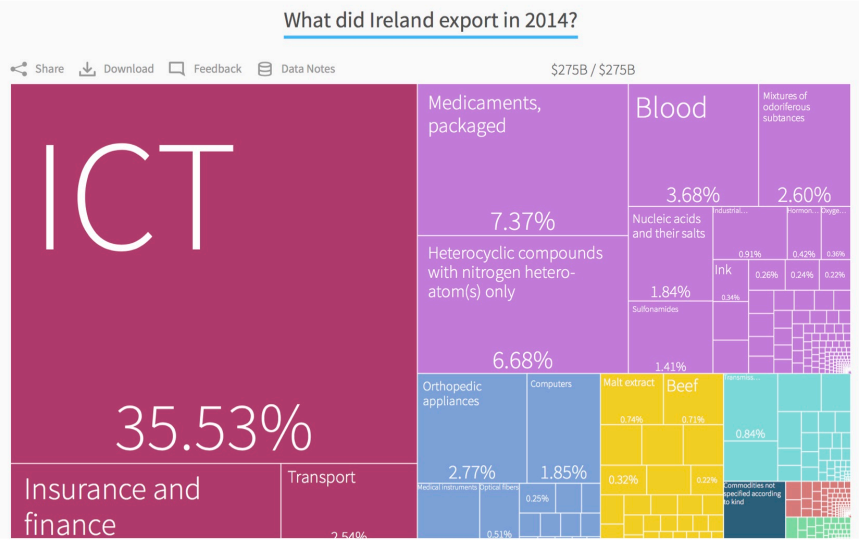
We compute **capital shares α in foreign vs. local firms** across the world. Striking global pattern:

- ▷ Foreign firms have lower α than local firms...
- ▷ ... Except in tax havens: hugely higher α

Benchmark estimate: set profitability of foreign firms in havens equal to profitability of local firms in havens

- ▷ Transparent
- ▷ Robust

New data: bilateral service trade



—> Use these new data to allocate shifted profits to the countries where they have been made

How we allocate the shifted profits

Benchmark: follow destination of tax havens' service exports and intra-group interest receipts

- ▷ Services: focus on royalties, management fees, fin. services, etc. → most conducive of shifting
- ▷ Outcome: granular estimates of profit shifting (eg, France–Ireland, Germany–Switzerland, etc.)

→ **New global database** to study (some of) the redistributive effects of globalization (2015)

- ▷ Will update annually → make it possible to study dynamics (eg, effect of policies)

Main results

40% of multinat'l profits ($\approx$ \$600bn) shifted to havens

- $\triangleright$ Main winners: Ireland, Luxembourg, Singapore, etc. (impose low rates but on big \$600bn base)
- $\triangleright$ Main losers: non-haven EU countries
- $\triangleright$ Profit shifting swamps tax-driven tangible capital mobility (different welfare implications)
- $\triangleright$ Rise of capital share is higher than in official data $\rightarrow$ provide corrected estimates of α, GDP, trade

Why should we care?

Whatever one's view about efficiency costs of capital taxation, global profit shifting raises policy issues:

- Distorted competition
- Inequality
- Loss of tax revenue

How multinational shift profits offshore

Three ways firms shift profits to low-tax countries:

- ▷ Manipulation of intra-group export and import prices
- ▷ Intra-group interest payments (tax deductible)
- ▷ Strategic location of intangibles (eg, Google)

Data to estimate global profit shifting

Directly observable profits booked in tax havens
based on foreign affiliates statistics (FATS)

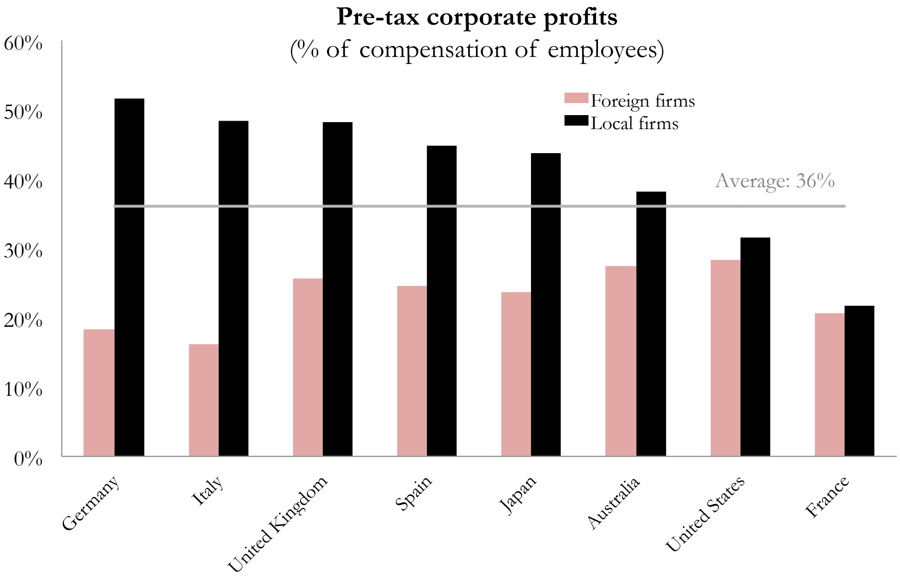
- ▷ Census-like confidential surveys
- ▷ Harmonized definitions and guidelines
- ▷ No double-counting ($\neq$ financial accounting)
- ▷ Missing countries (eg, Caribbean): use balance of payments and partners' FATS $\rightarrow$ global coverage ▸ BoP

Conceptual framework

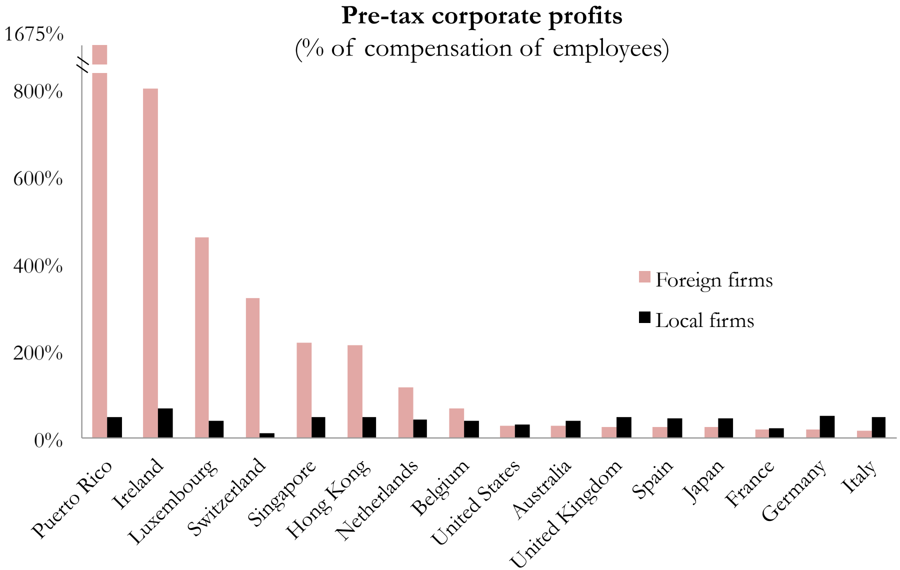
Compute profitability π of foreign vs. local firms
(foreign: $>$50% foreign-owned)

- ▷ Country's corporate output $Y = F(K, AL) = rK + wL$
- ▷ Labor share $= wL/Y$; capital share $= 1$ – labor share $= rK/Y$ ($r =$ normal $+$ above-normal return) $\equiv \alpha$
- ▷ Net interest paid $= p\%$ of rK
- ▷ Pre-tax profits/wage ratio: $\pi = (1 - p) \cdot \alpha/(1 - \alpha)$
- ▷ Recorded $\pi = f(\mathit{shifting}, \mathit{other})$

In non-havens, foreign firms are less profitable than local firms



In tax havens, foreign firms are much more profitable than local firms

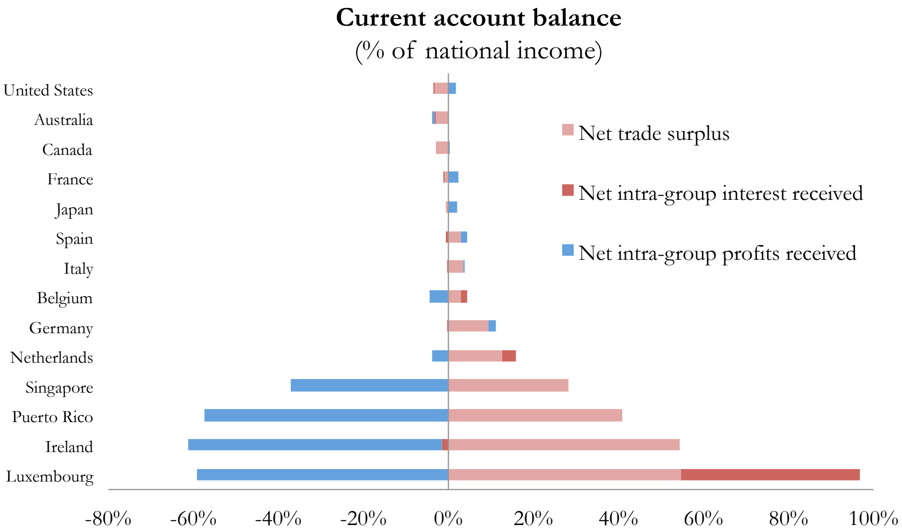


Benchmark estimate of profits shifted to tax havens

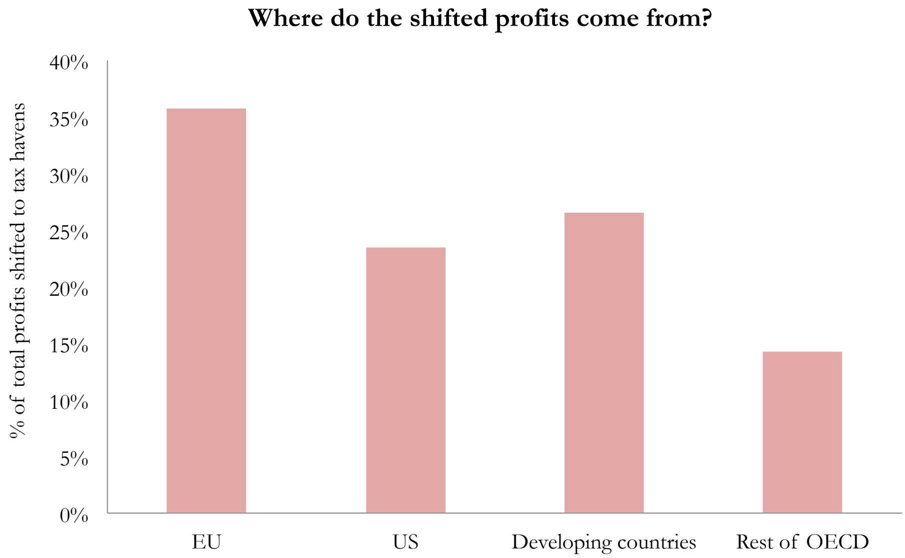
Set π_f in havens equal to local firms profitability π_l

- ▷ Easy to track for policymakers
- ▷ Allows havens to have π higher than other countries
- ▷ Robust
  - ▷ Vary π_l in havens $\rightarrow$ little difference
  - ▷ Sectoral composition $\rightarrow$ $\pi_f >> \pi_l$ within sector

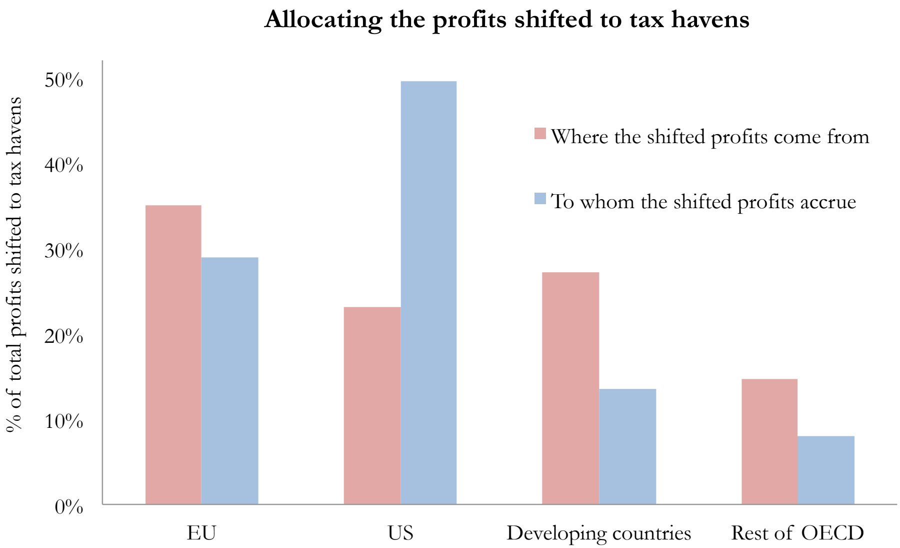
To study who loses profits, follow the money in balances of payments of havens



Who loses most? The EU.



Who loses most? The EU.
Who shifts most? The US.



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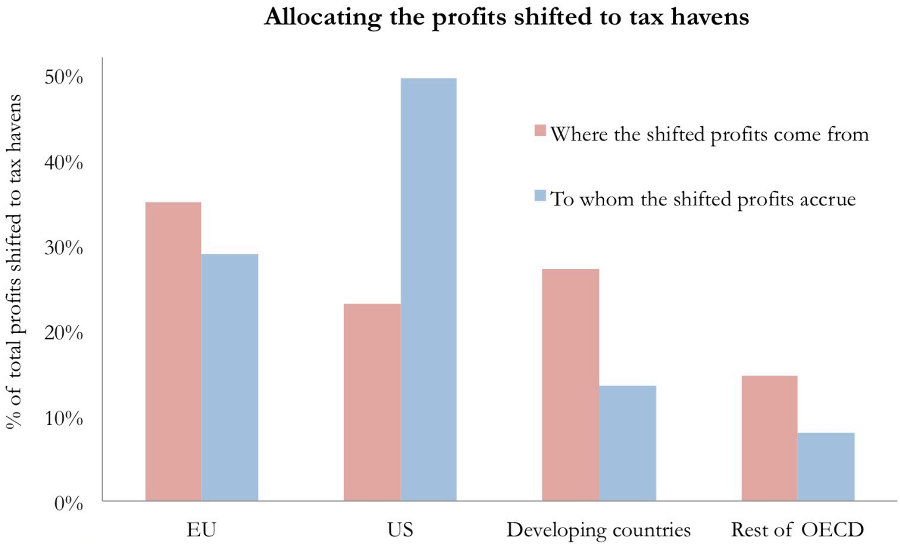


Why do US multinationals shift more profits? Implications?

Profit Shifting by U.S. Multinationals

The Exorbitant Tax Privilege

Study profits, wage, capital, rates of returns, and taxes of US multinationals back to 1966

Key source: BEA survey of activities of US multinat'l

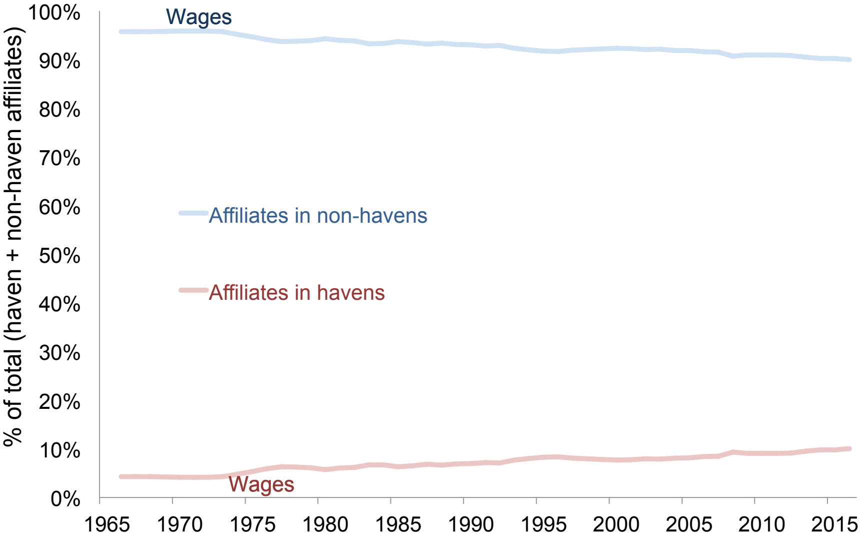
- ▷ Annual since 1982, every 5 years back to 1966

Supplement with IRS tabulations (form 5471)

- ▷ Main advantage: annual back to early 1960s

$\rightarrow$ **First long-run series on effective tax rate paid by US firms on their foreign operations**

Where do US multinationals operate?



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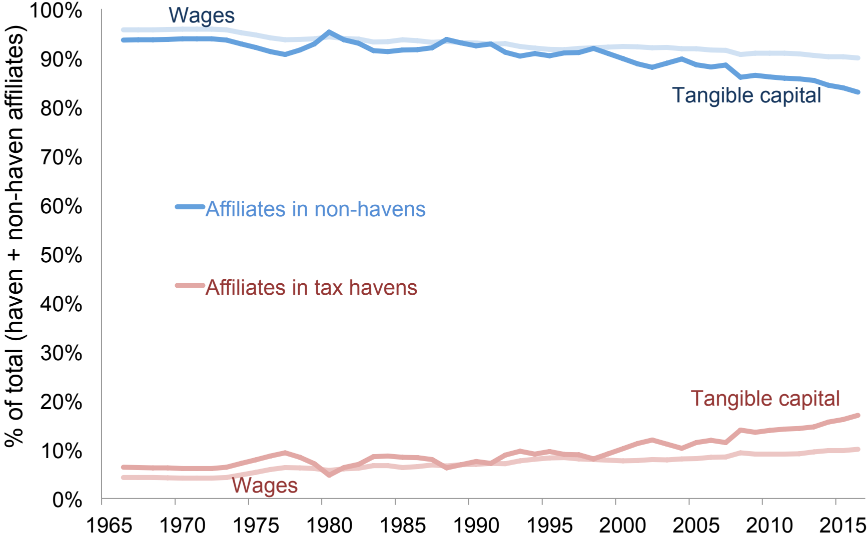
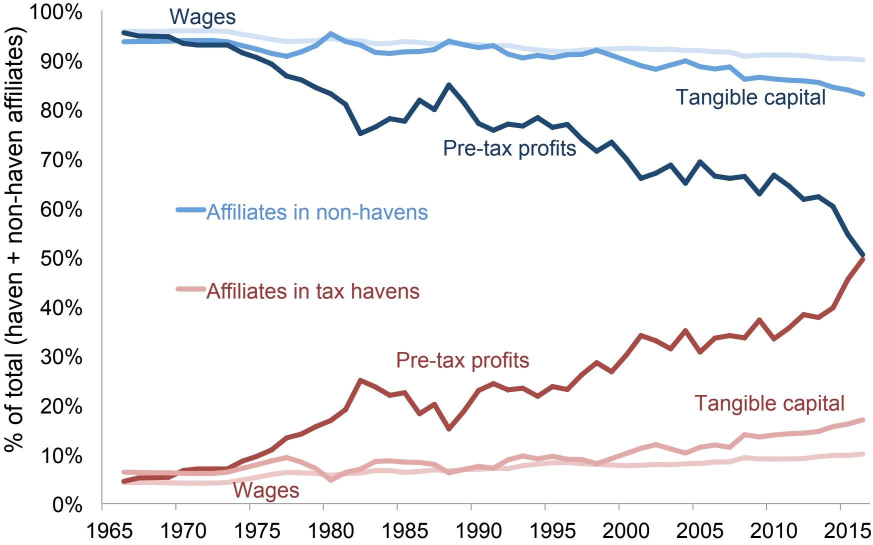
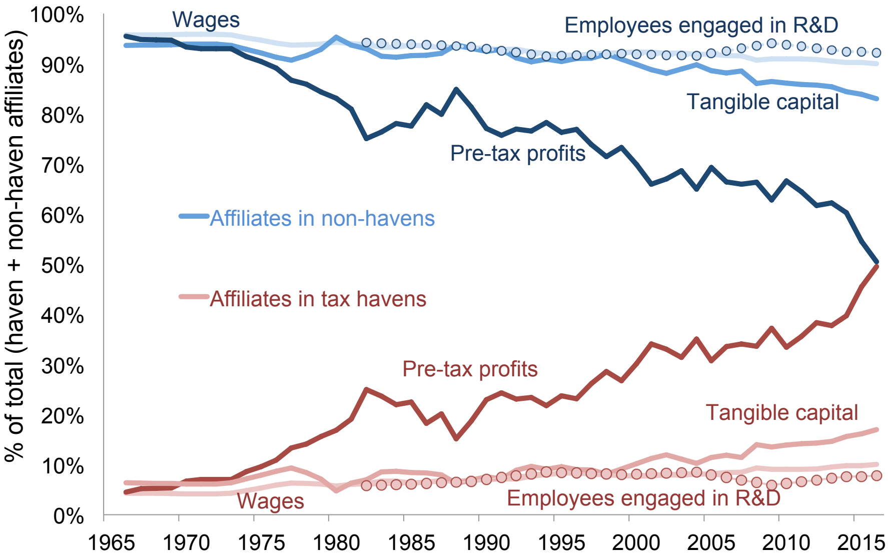


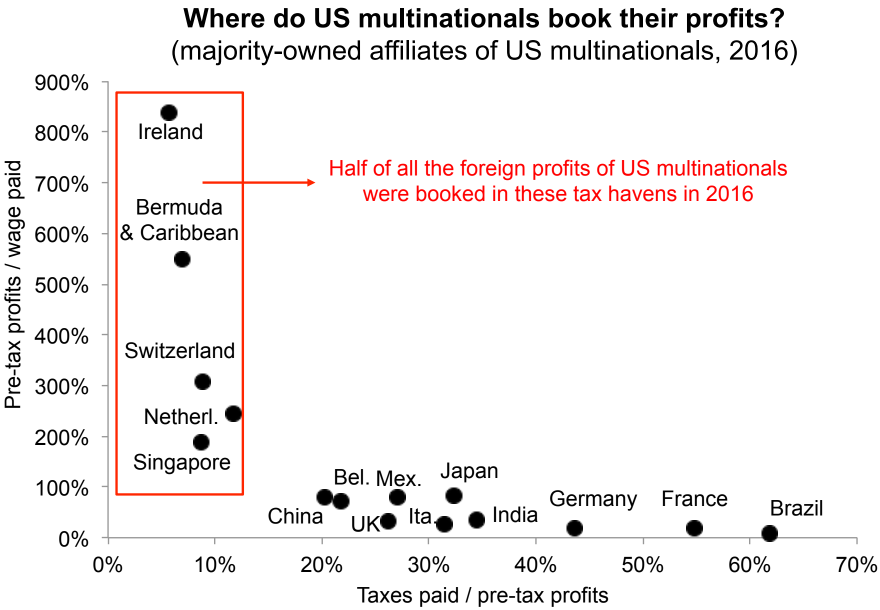
Where do US multinationals book their profits?



Where do US multinationals produce intangibles?



In 2016: 50% of profits in havens (taxed at 7%), 50% elsewhere (taxed at 27%)



Why do US multinationals shift so much profits to tax havens?

Perceived national interest of the US: good to let US multinationals shift out of foreign high-tax countries

- ▷ Until 2017, US taxed worldwide profits, with credits given for foreign taxes paid
- ▷ If foreign profits booked in 0 tax places: no credits given $\rightarrow$ more tax revenue in US upon repatriation
- ▷ 1996: US Treasury facilitates shifting to tax havens (check-the-box regulations) $\neq$ other countries

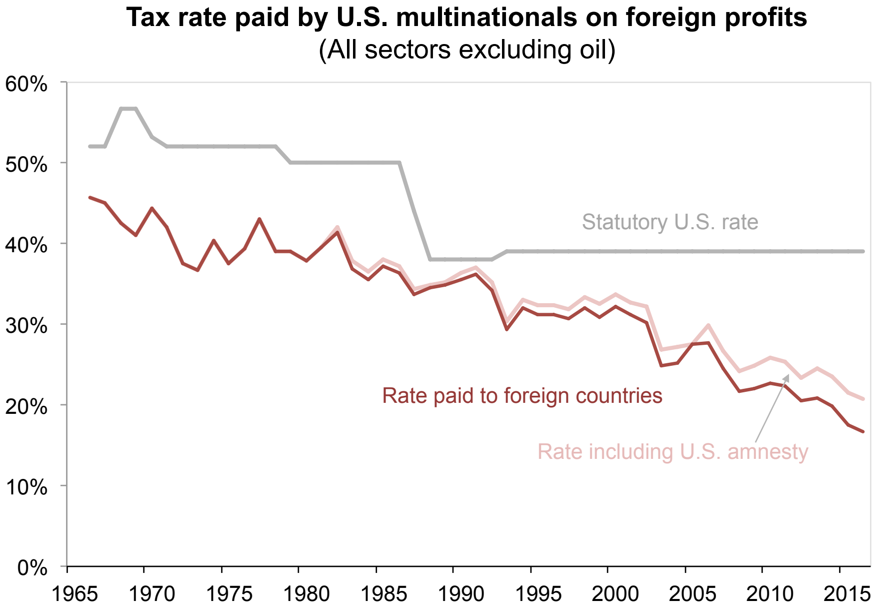
Did profit shifting enhance US tax collection?

It did not:

- $\triangleright$ Haven profits perpetually retained $\rightarrow$ avoided U.S. tax
- $\triangleright$ Rising untaxed profits $\rightarrow$ rising lobbying for amnesty
- $\triangleright$ 2017 law: mandatory one-time tax at low rate ($<$8%) of past untaxed profits

$\rightarrow$ We can now compute total taxes on foreign profits of US multin'ls (already paid + owed to US due to 2017 law)

Total tax rate on foreign profits, including effect of 2017 mandatory repatriation



The redistributive effects of profit shifting

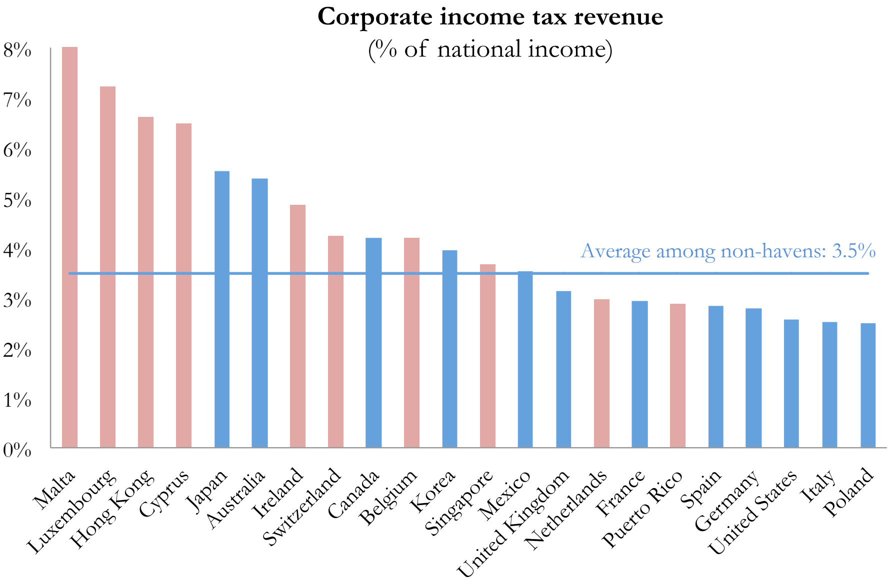
1) Redistribution across income groups:

- ▷ Rise of global after-tax profits $\nearrow$ income for shareholders
- ▷ Ongoing work (with C. Gaubert & W. Sandholtz) to estimate how much various income/wealth groups gain/lose in each country

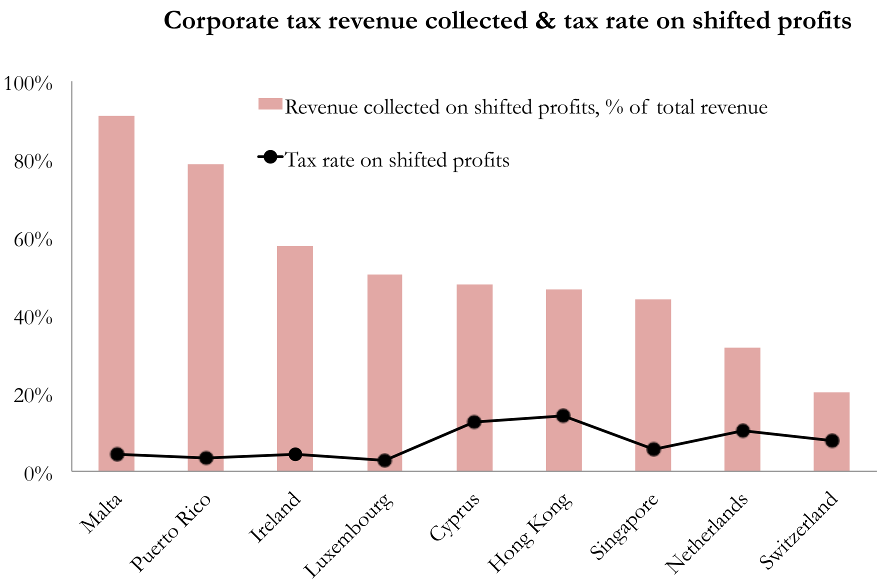
2) International redistribution of tax revenues:

- ▷ For small countries, revenue-max. rate $0 < \tau^* <$5%: havens with $\tau \approx \tau^*$ generate very large tax revenue
- ▷ Can explain the rise of the supply of tax avoidance schemes (e.g., tax rulings: Apple – Ireland)

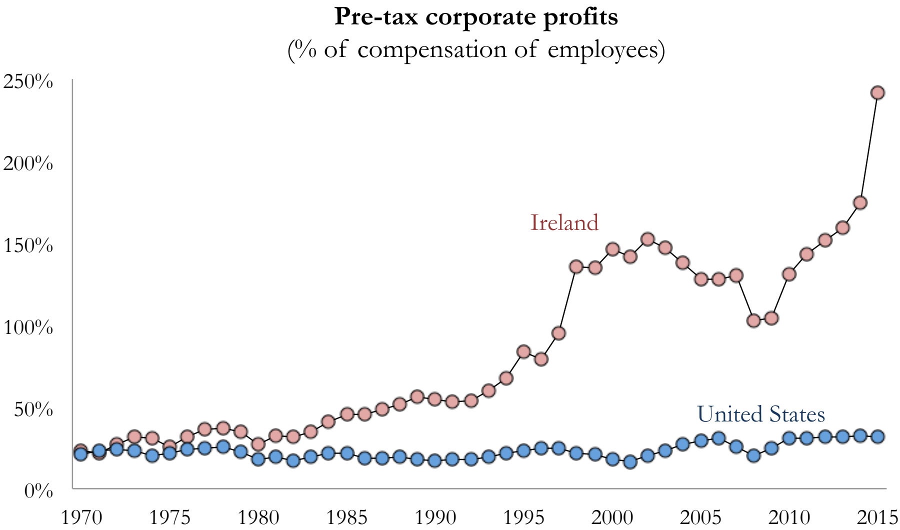
Many havens collect a lot of tax revenue...



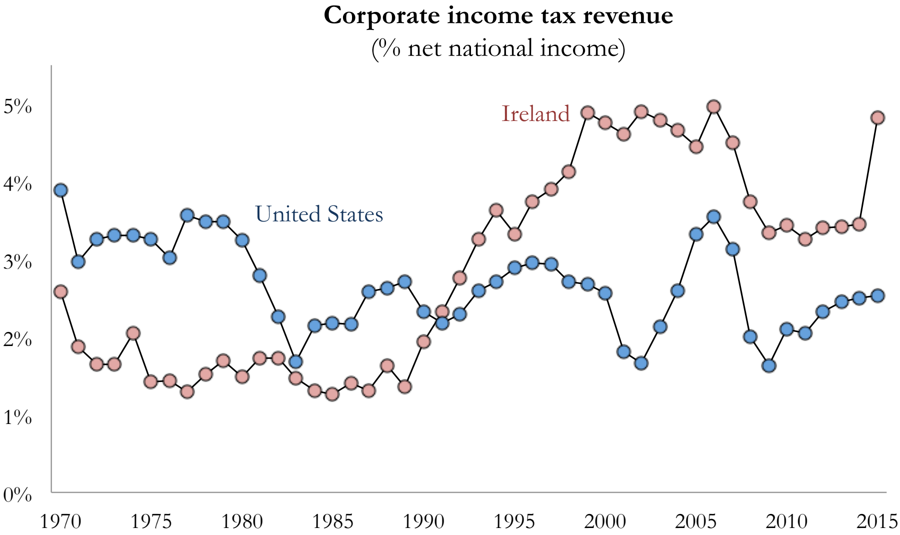
… By applying low rates to the huge tax base they attract



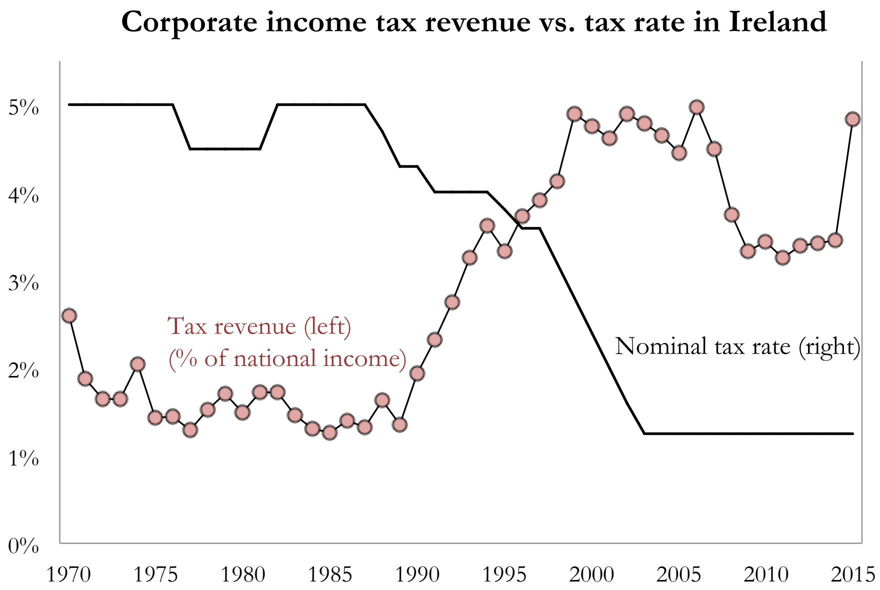
As profit shifting rose...



...Tax revenue rose in many havens, while they ↓ or stagnated in high-tax countries



The lower the rate, the higher the revenue



Tax Evasion in a Globalized World: Evidence from Leaks

Tax Evasion and Inequality

Anecdotal evidence that wealthy conceal assets abroad (UBS, Credit Suisse, Panama Papers, Manafort...)

- ▷ How important is this form of tax evasion?
- ▷ How concentrated is it?
- ▷ How does it change what we know about inequality?

We analyze new data capturing evasion by the wealthy

Massive leaks from HSBC Switzerland and Mossack Fonseca ("Panama Papers")

- ▷ Leaks random & from big offshore wealth managers
- ▷ Match to tax records in Norway, Sweden, Denmark (ongoing work in US with D. Reck et al.)
- ▷ Combine with macro stats on wealth hidden in havens

Two key findings:

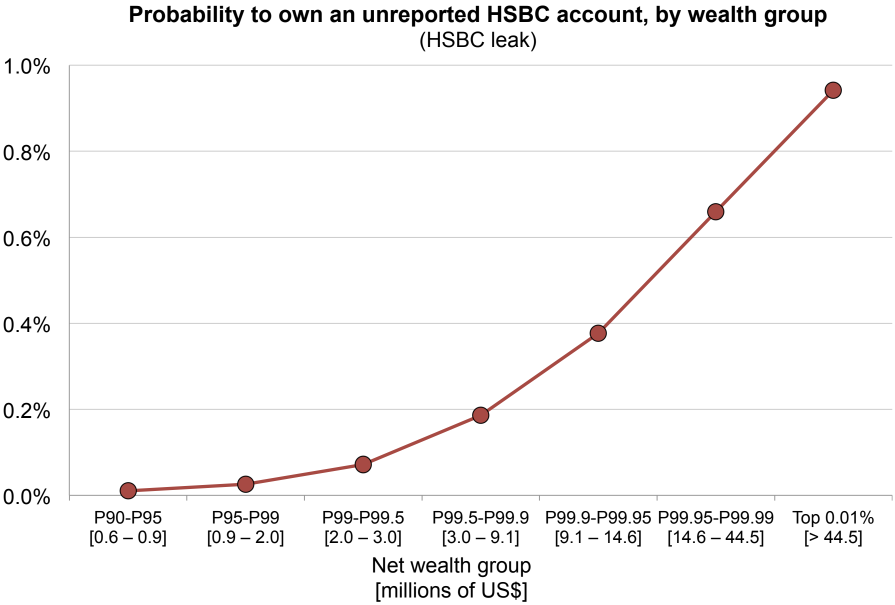
- ▷ Offshore evasion very concentrated
- ▷ At the top, way larger than evasion detected in random audits

The HSBC leak

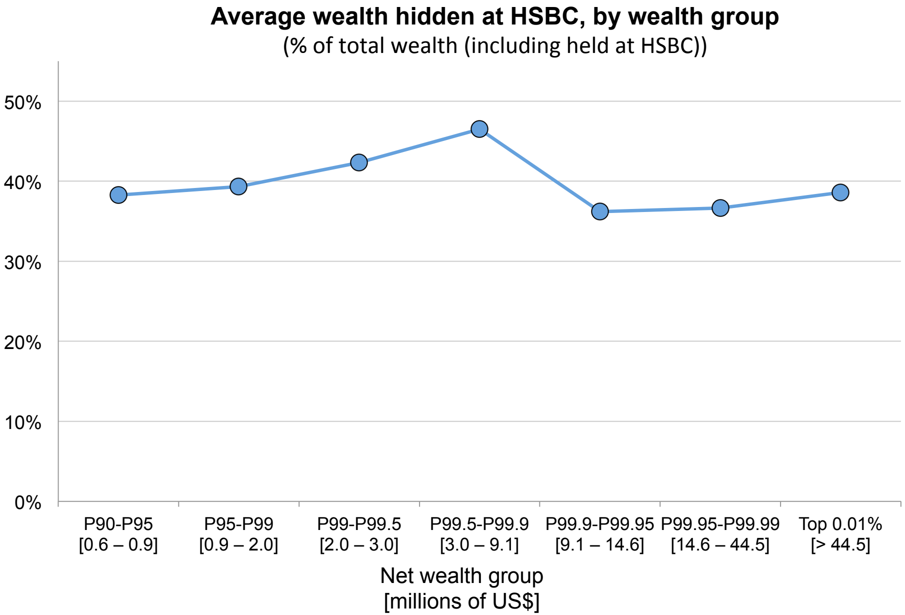
Key strengths:

- ▷ Large bank (among top 10 Swiss banks)
- ▷ Representative
- ▷ Recorded identity of beneficial owners
- ▷ Clear-cut way to identify evasion

The proba to have an unreported HSBC account rises sharply within the top 1%



HSBC evaders hide close to half of their wealth at HSBC



Other samples

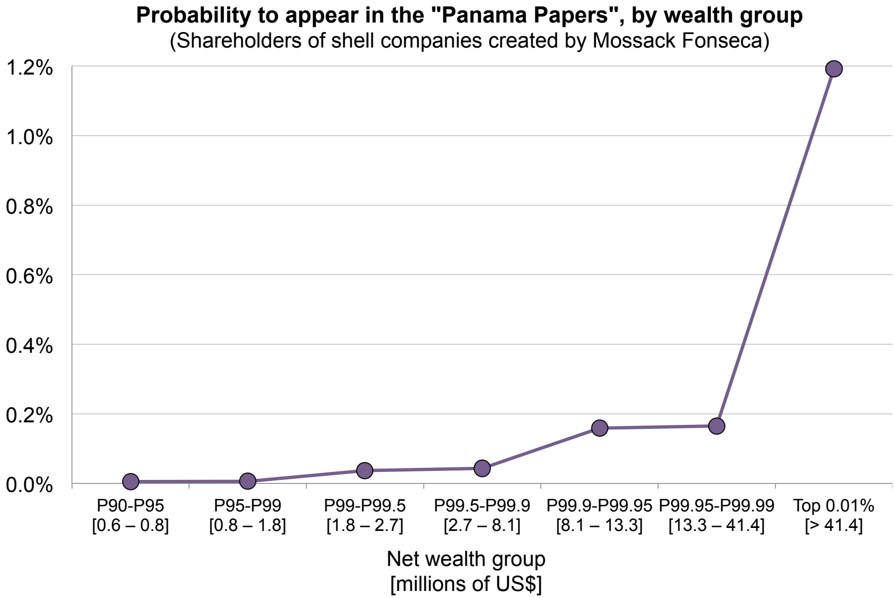
Panama Papers:

- ▷ Another large intermediary
- ▷ But not possible (yet) to identify evasion v avoidance

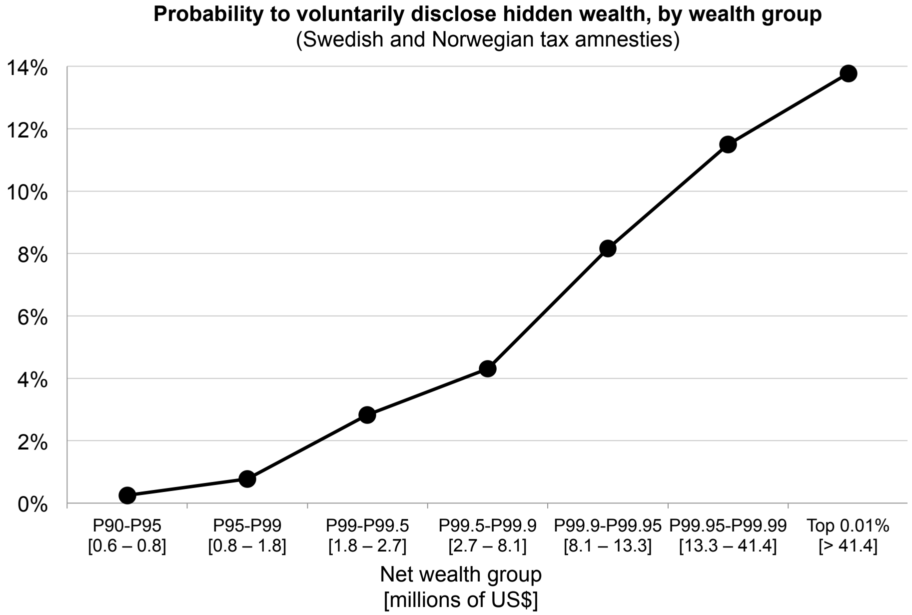
Amnesty participants:

- ▷ Big samples (1,422 hholds Norway; 6,811 Sweden)
- ▷ Tax evasion by definition involved
- ▷ But self-selection

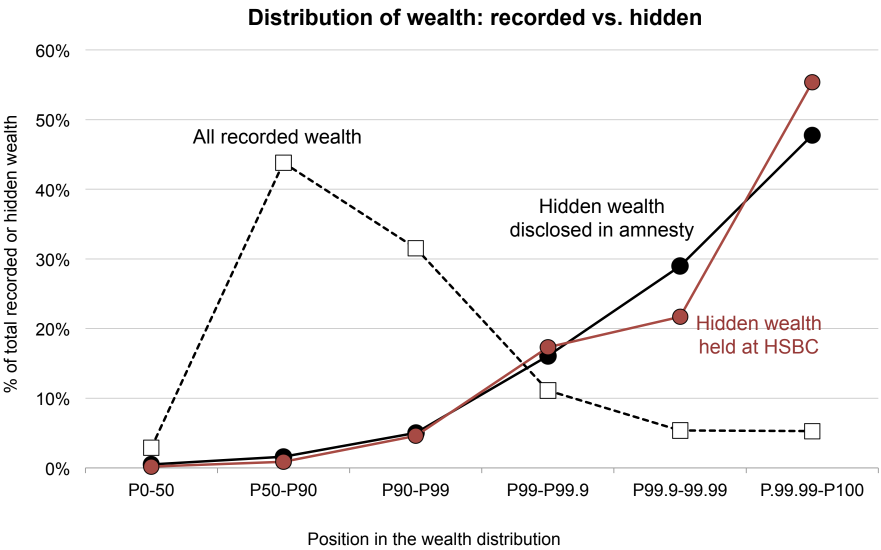
The Panama Papers confirm that the use of tax havens rises sharply with wealth



Amnesty data show widespread evasion at the top



Hidden wealth is extremely concentrated

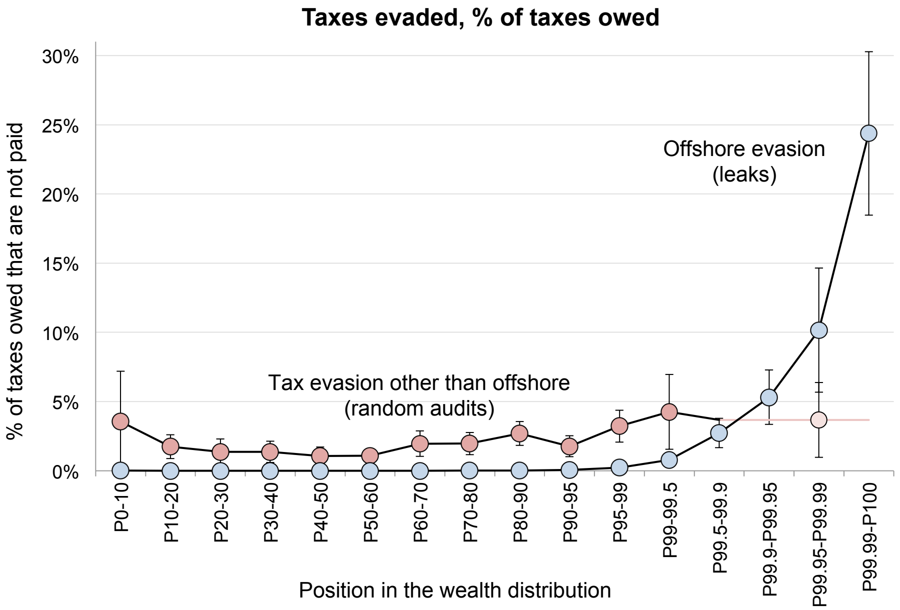


Estimating tax evasion through offshore intermediaries

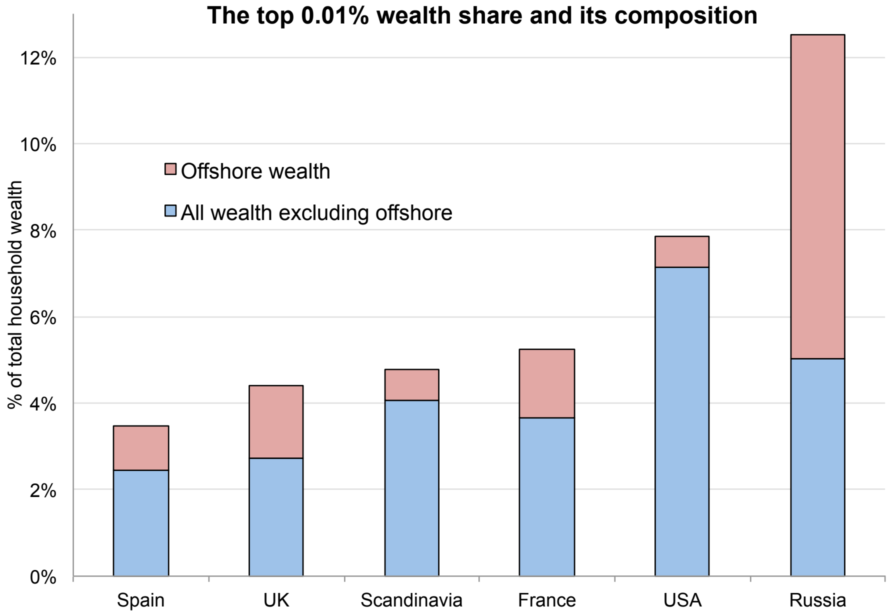
Five steps:

- ▷ Macro stock of offshore wealth
- ▷ What fraction hidden v declared
- ▷ Distribute like in HSBC and amnesties
- ▷ Apply rate of return
- ▷ Use tax simulator to estimate evaded tax

Offshore tax evasion vs. tax evasion detected in random audits



Factoring in offshore wealth is important to measure inequality at the top



Conclusion

The redistributive effects of globalization

Much attention has been paid to redistributive effects of international trade:

- ▷ Large academic literature
- ▷ Major effort to coordinate trade policies post-WW2

Less attention has been paid to challenges raised by tax competition, profit shifting, financial opacity:

- ▷ Major redistribution of revenue both across countries and social groups
- ▷ Need to design policies to address these challenges