Eco L3 - Globalization, Inequality, and Redistribution

Lecture 6: Tax havens and financial opacity

Gabriel Zucman

gabriel.zucman@psemail.eu

Roadmap

- How big is the wealth in tax havens?
- Implications for inequality
- Determinants of top-end evasion: the role of the supply
- Policies to curb offshore tax evasion

1 How big is the wealth in tax havens?

1.1 What do offshore centers do?

A great deal of activities, some of which legal and legitimate:

- Investment funds (Luxembourg, Ireland...)
- Shadow banking (Caymans...)

- Treasury management (U.S.-Cayman...)

- Personal wealth management (Switzerland, Singapore...)

- Offshore real estate (London, Dubai...)

But some offshore centers, institutions and instruments also facilitate tax evasion by wealthy individuals

1.2 How offshore tax evasion works

- Shell companies
- Fake invoices
- Offshore accounts
- Disconnecting legal and beneficial ownership

1.3 Magnitude of offshore tax evasion

- Monthly statistics by the Swiss National Bank

- Systematic anomalies in the international investment positions of countries caused by offshore portfolio wealth

- Leaked data: Panama Papers, paradise papers, etc.: `https://offshoreleaks.icij.org`

Main orders of magnitude:

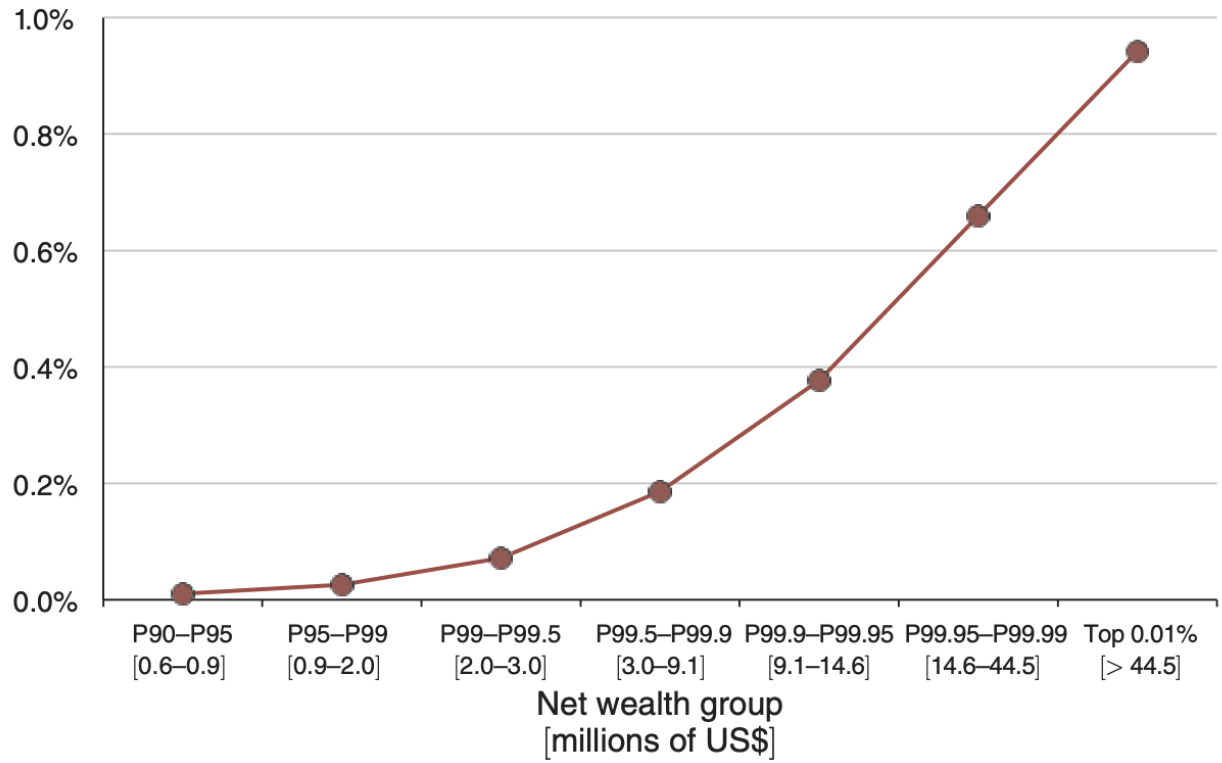
- About 8% of the world's financial wealth offshore

- High concentration towards the top of the wealth distribution

	Offshore wealth ($ bn)	Share of financial wealth held offshore	Tax revenue loss ($ bn)
Europe	2,600	10%	75
USA	1,200	4%	36
Asia	1,300	4%	35
Latin America	700	22%	21
Africa	500	30%	15
Canada	300	9%	6
Russia	200	50%	1
Gulf countries	800	57%	0
Total	**7,600**	**8.0%**	**190**

Source: Zucman (2015)

Panel A. Probability to own an unreported HSBC account, by wealth group (HSBC leak)



Source: Alstadsæter, Johannesen and Zucman (2019)

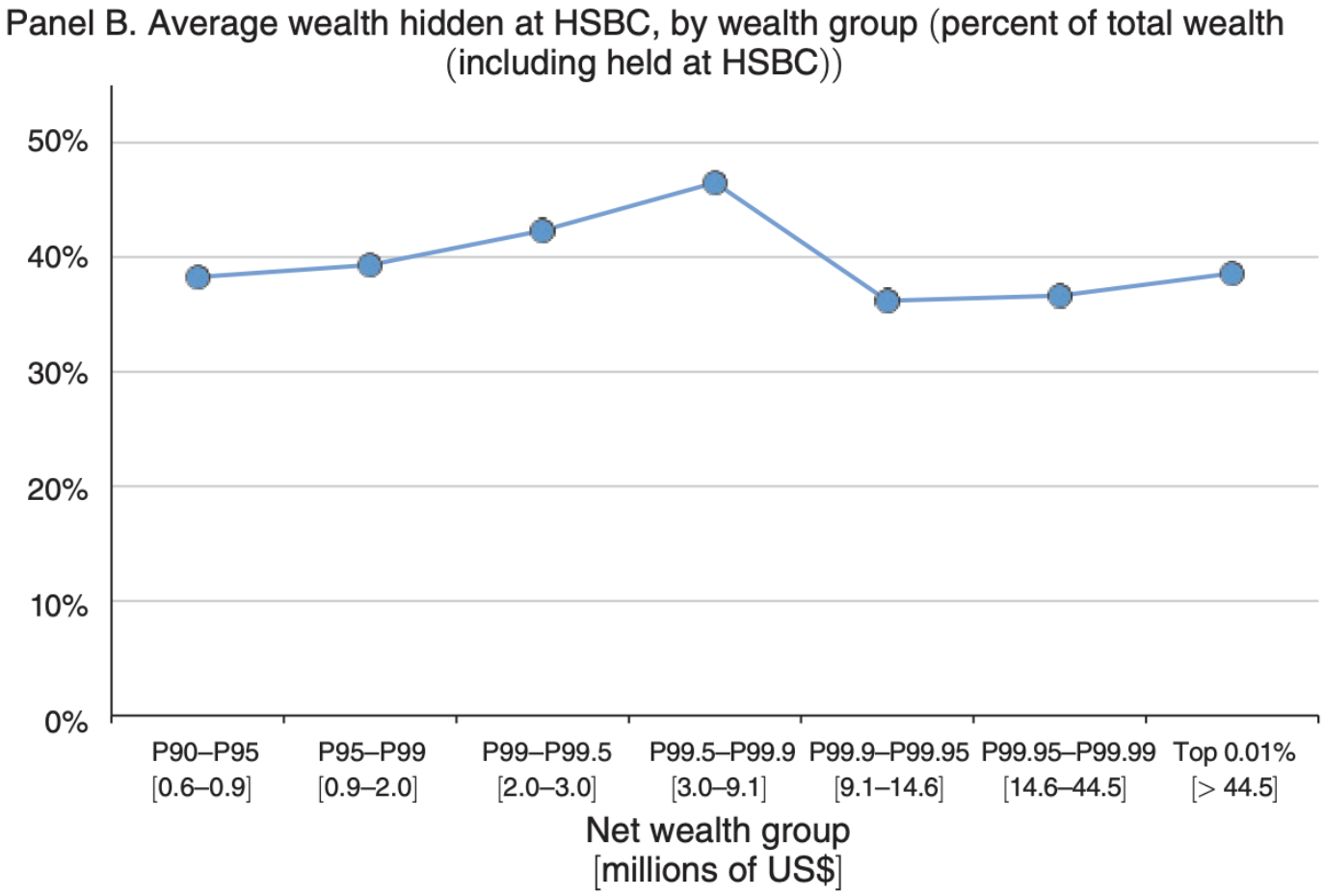
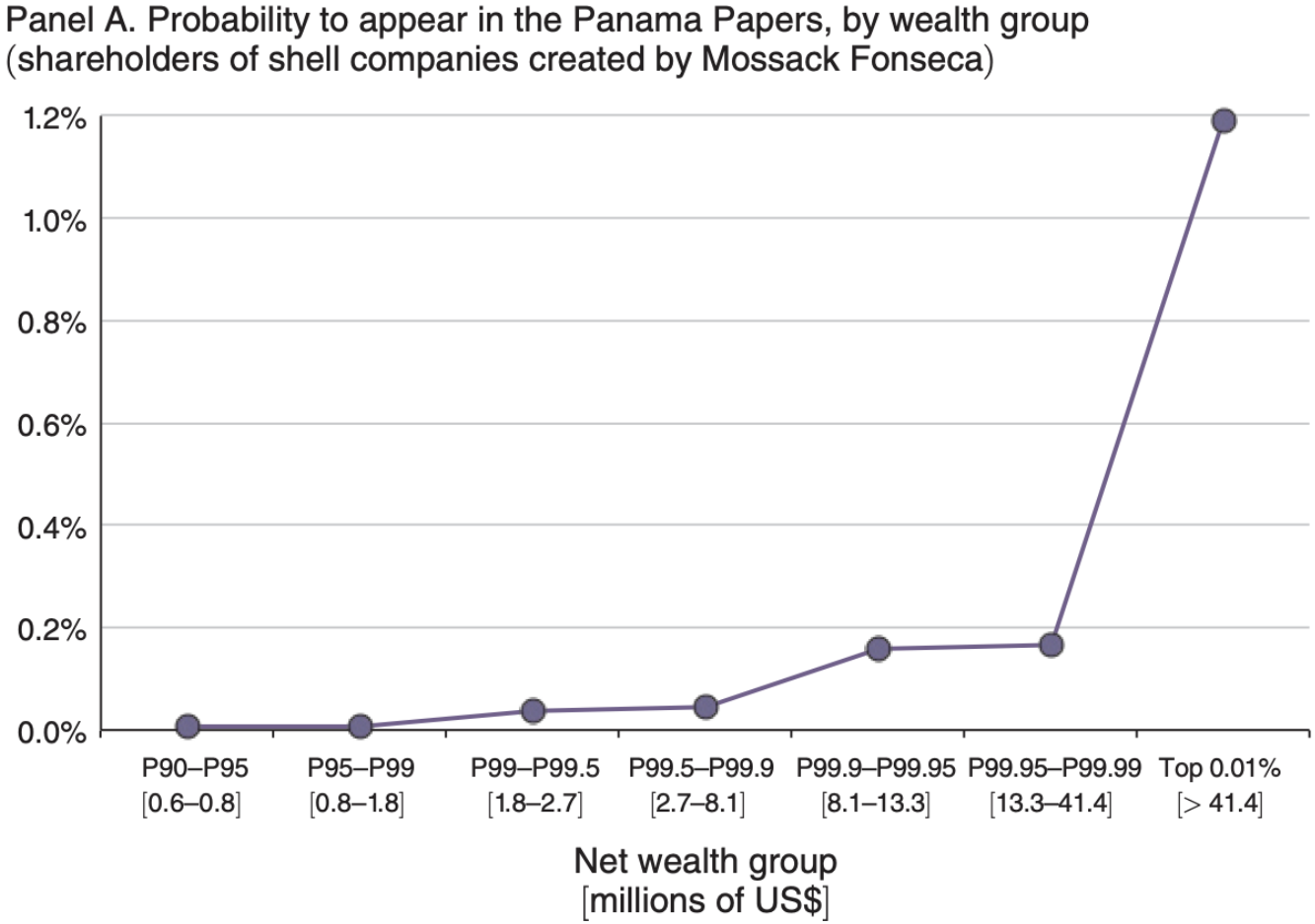


FIGURE 2. TAX EVASION AT HSBC: INTENSIVE VERSUS EXTENSIVE MARGIN

Source: Alstadsæter, Johannesen and Zucman (2019)



Source: Alstadsæter, Johannesen and Zucman (2019)

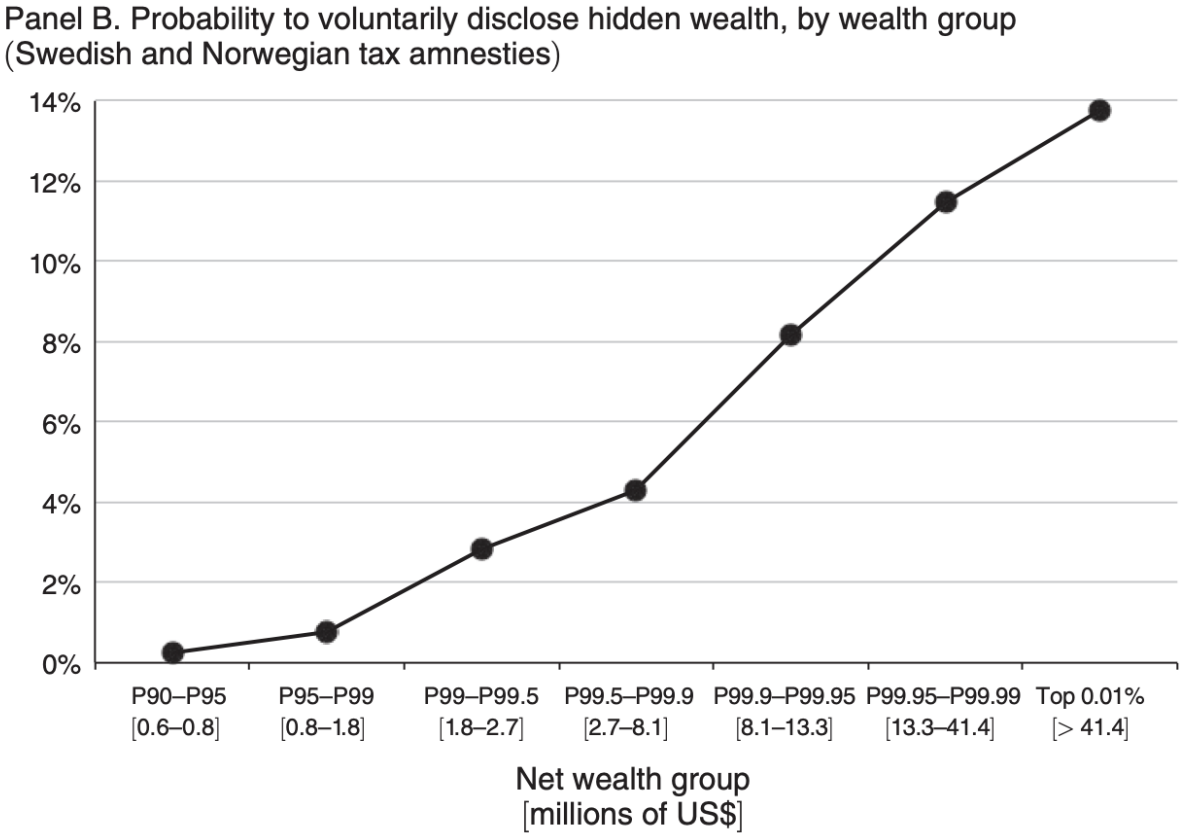
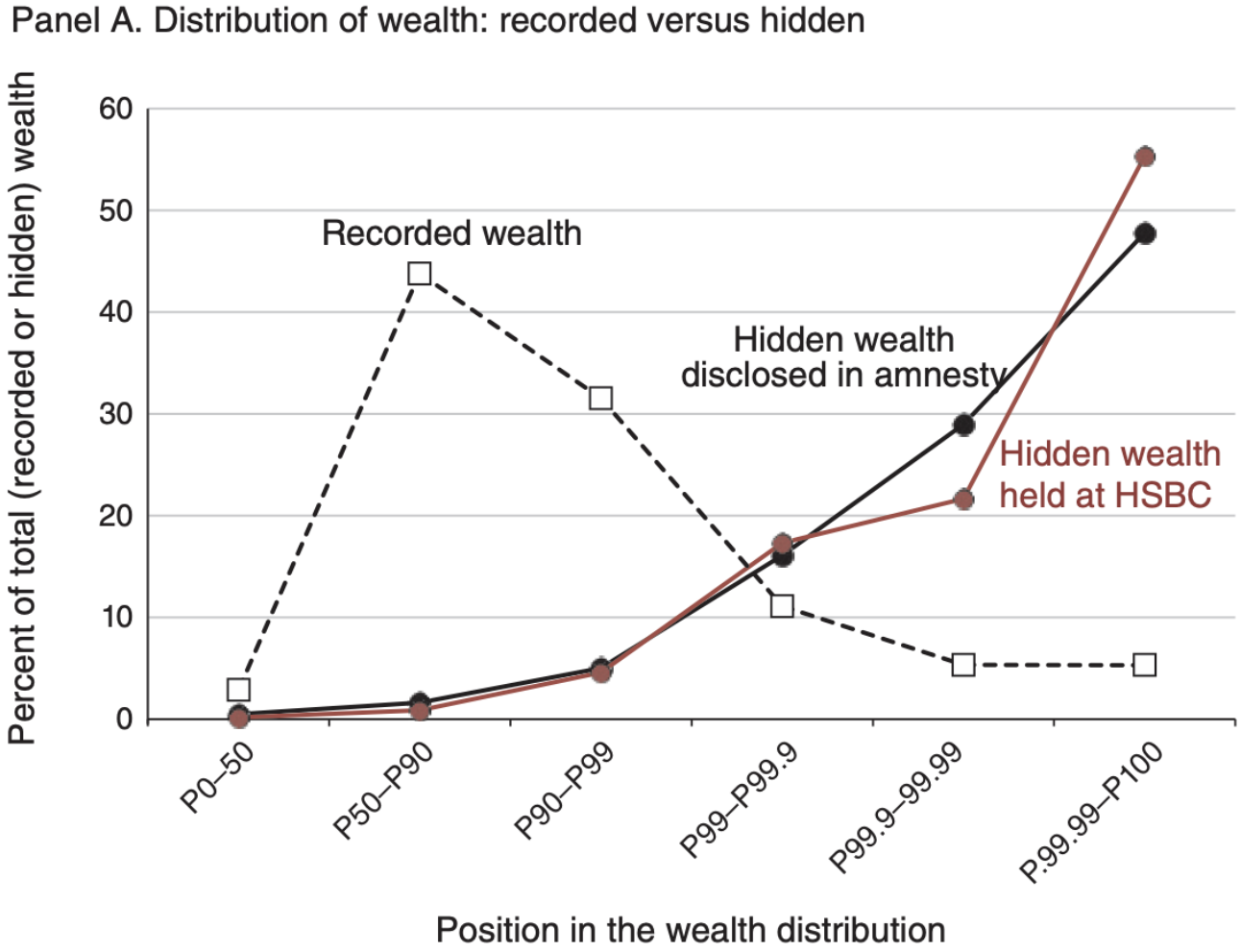


Figure 3. Probability to Be in the Panama Papers or Use an Amnesty

Source: Alstadsæter, Johannesen and Zucman (2019)



Source: Alstadsæter, Johannesen and Zucman (2019)

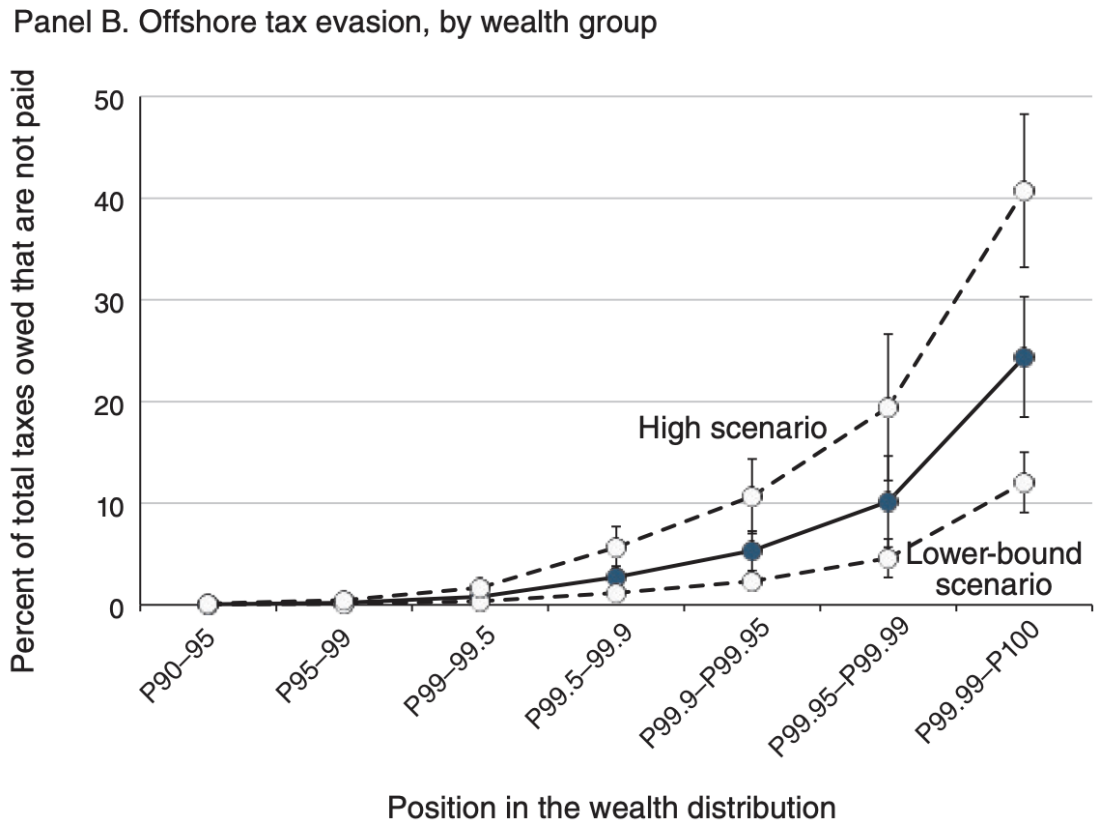
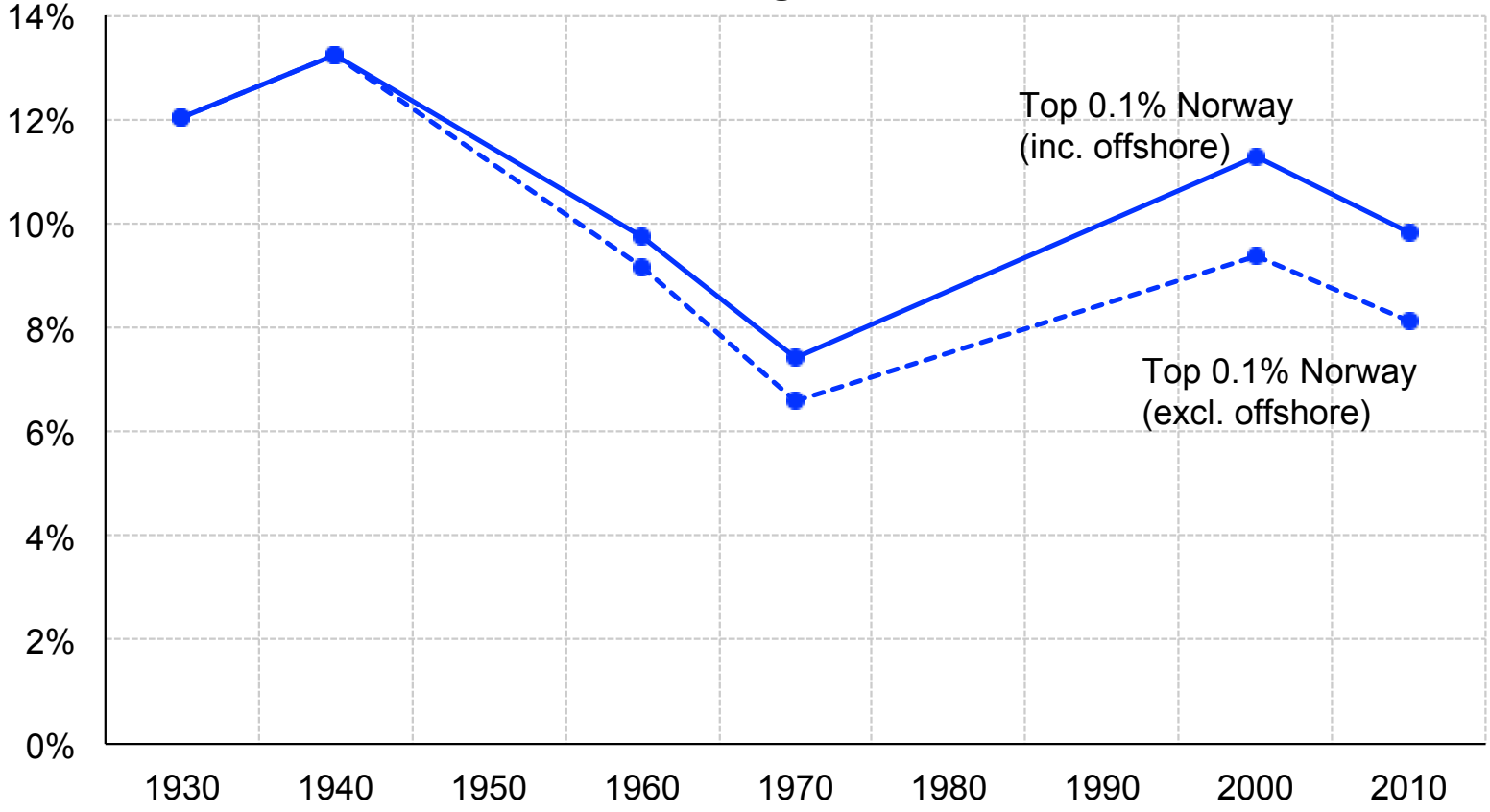


FIGURE 4. THE DISTRIBUTION OF OFFSHORE WEALTH AND OFFSHORE TAX EVASION

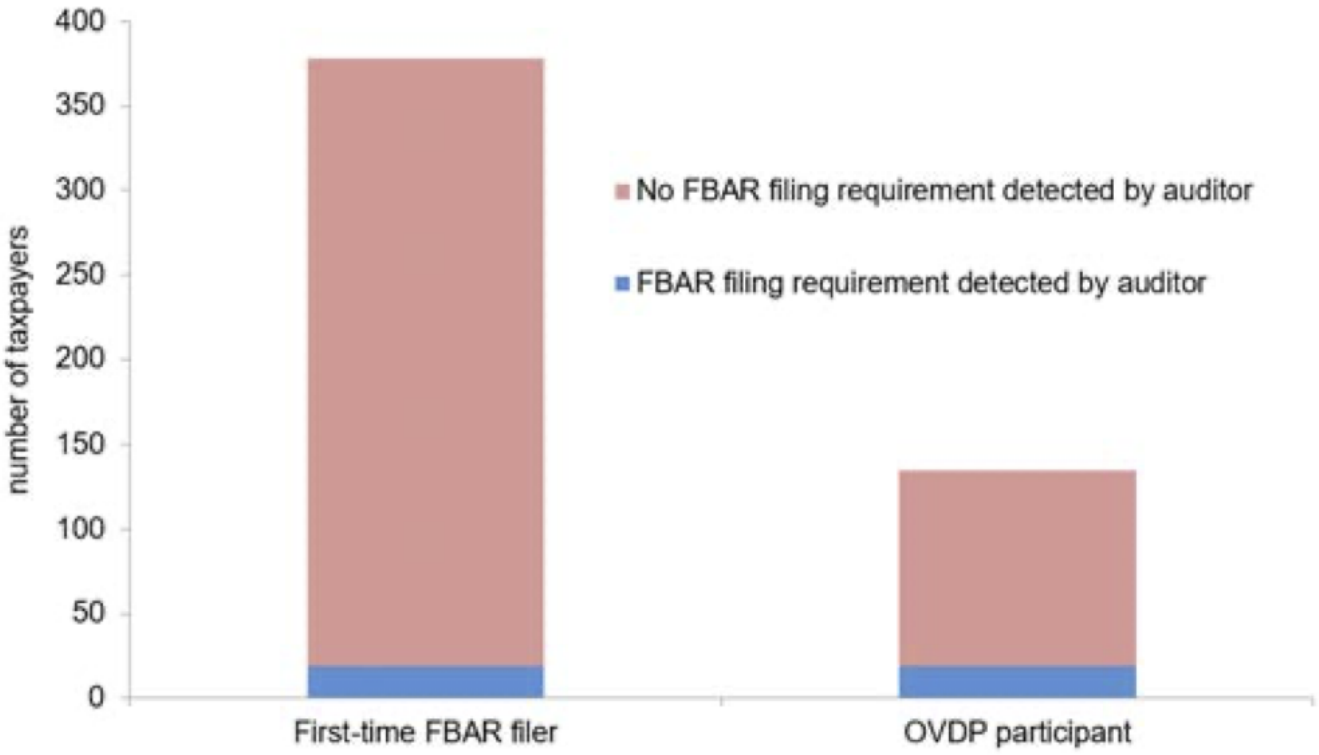
Source: Alstadsæter, Johannesen and Zucman (2019)

Figure : Top 0.1% wealth share in Norway: including vs. excluding hidden wealth



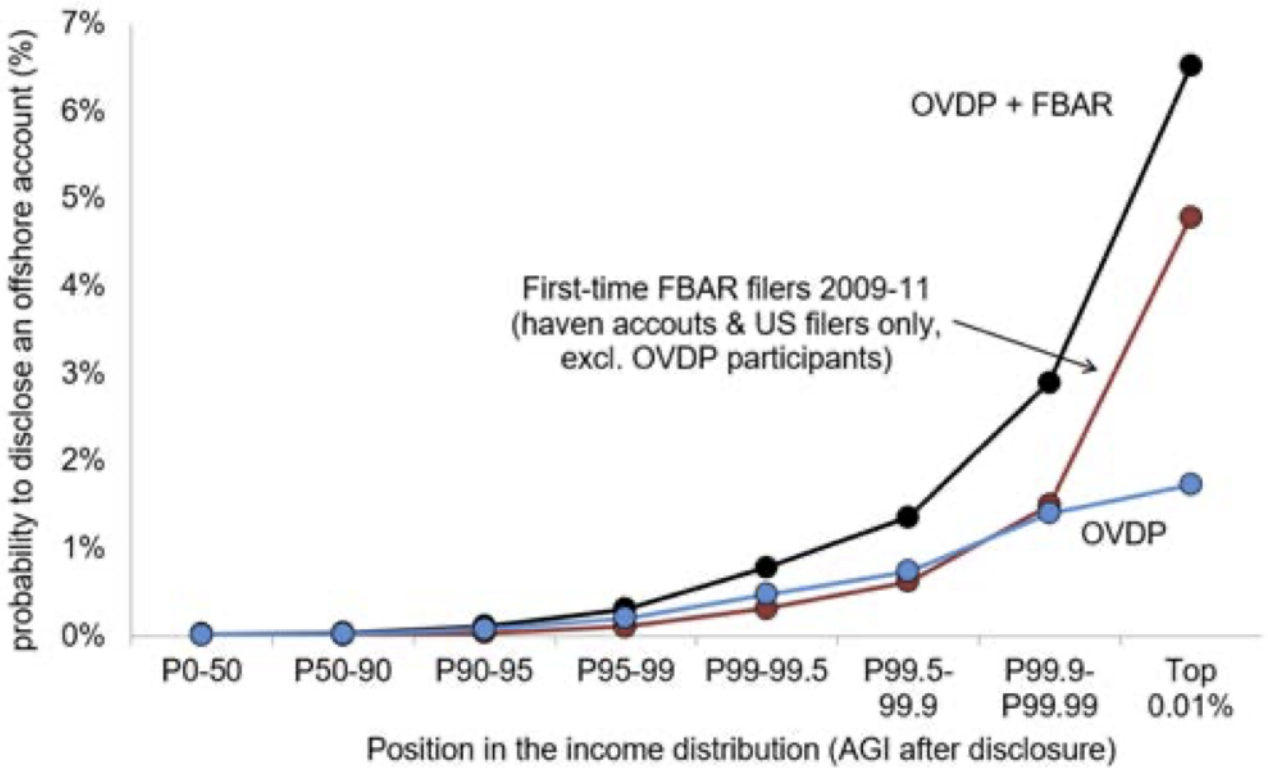
Source: Alstadsæter, Johannesen and Zucman (2016)

(a) Do NRP audits detect offshore evasion?



Source: Guyton, Langetieg, Reck, Risch, and Zucman (2021)

(b) Share Disclosing by Income Rank



Source: Guyton, Langetieg, Reck, Risch, and Zucman (2021)

2 The supply of evasion services

Why high evasion rates at the top? Hard to understand in AS model (= demand side). Alstadsæter et al. (2019): model of supply side

- Population of mass one with wealth density $f(y)$

- Monopolistic bank sells tax evasion services (historically, Swiss banks have operated as a cartel), charges θ per \$ of wealth hidden

- Infinitely elastic demand at price θ: bank optimizes on # of clients

- Manages $k(s)$ in wealth when serves $s = 1 - F(y)$ and earns $\theta k(s)$ in revenue

Bank has probability λs to be caught $\rightarrow$ fine $\phi k(s)$

Risk-neutral bank maximizes profits

$$\pi(s) = \theta k(s) - \lambda s \phi k(s)$$

At interior optimum:

$$\theta = \left(\frac{1}{\epsilon_k(s)} + 1 \right) \phi \lambda s$$

- Where $\epsilon_k(s) = sk'(s)/k(s)$ is elasticity of the amount of hidden wealth managed with respect to s

If wealth Pareto-distributed, supply of evasion services is:

$$s = \frac{\theta}{(1+b)\,\lambda\phi}$$

- b is the inverted Pareto-Lorenz coefficient

Higher λ or higher $\phi \rightarrow$ fewer & richer clients

If high inequality, bank will serve tiny fraction of the pop.

3 Policies to curb offshore evasion

3.1 Model implications

- High fines for suppliers (ϕ): shrinks the supply of evasion services
- More practical than high fines for evaders, but "too big to indict" problem
- Tax evasion: increasingly a financial regulation problem?

- Increase detection probability λ: third-party reporting. But can be difficult to enforce internationally

3.2 What has been done

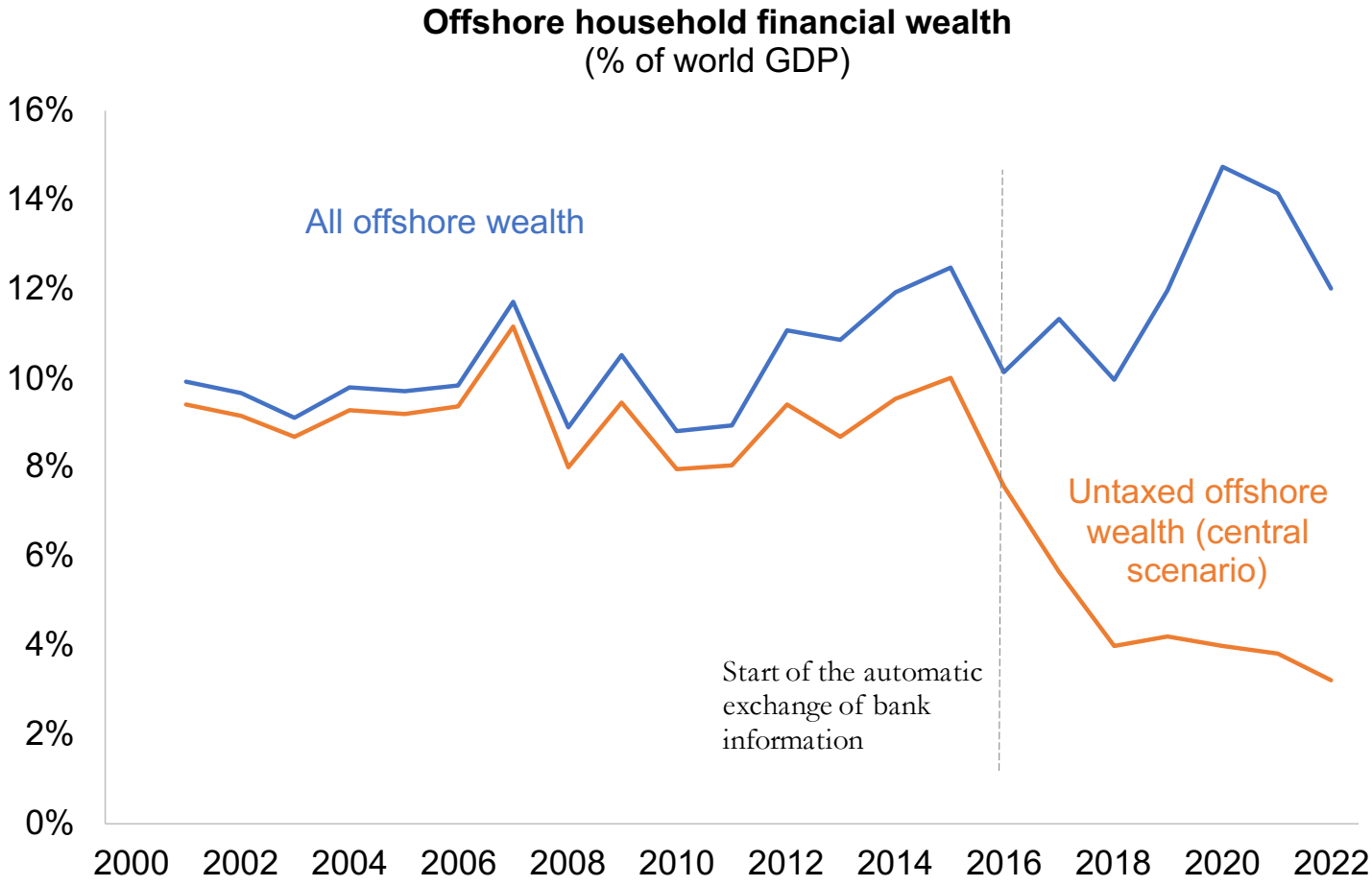
- Automatic exchange of bank information

- First US law (FATCA passed in 2010, started in 2015), then global standard (Common Reporting Standard, started in 2018)

- A landmark: from bank secrecy to bank transparency

Main limits:

- Incentives of offshore financial institutions to truthfully cooperate
- Many developing countries still excluded
- Financial opacity
- Only financial assets, excludes real estate



Source: Global Tax Evasion Report 2024

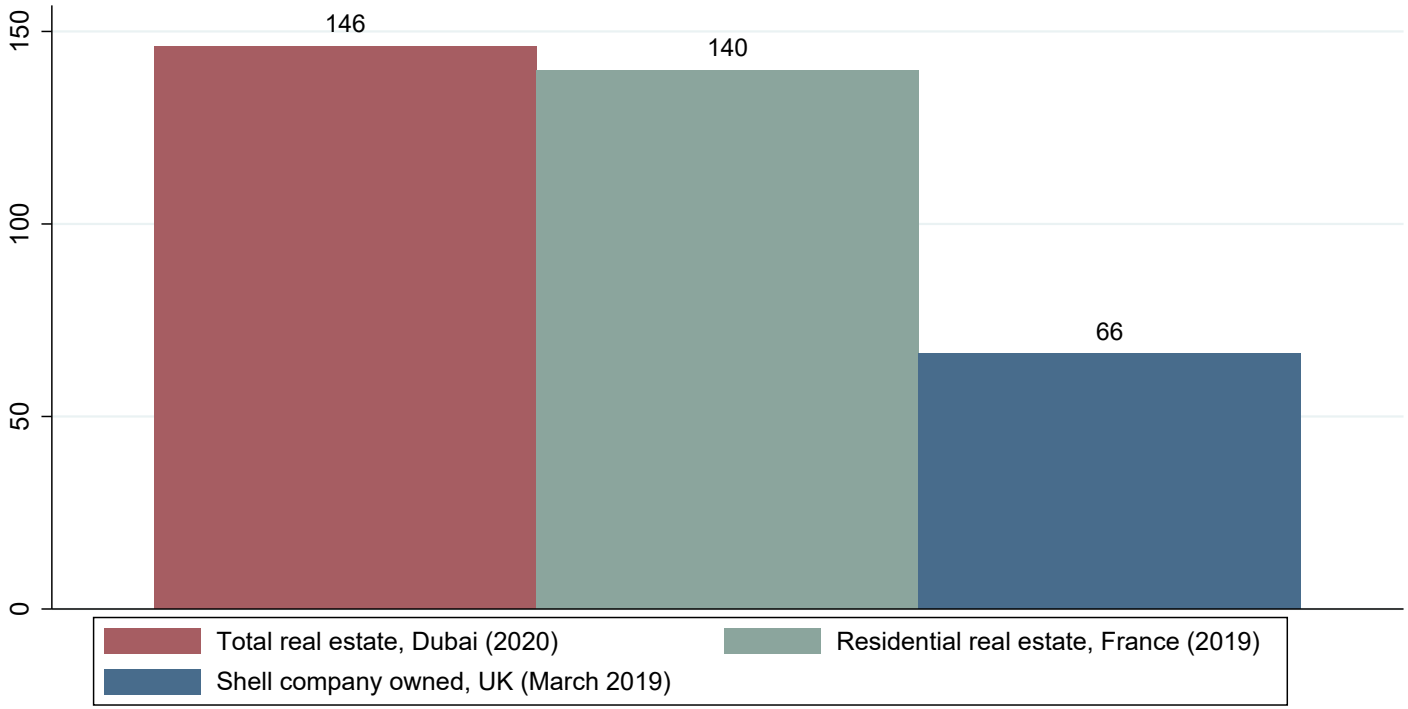
4 Offshore real estate

- Offshore real estate not covered by automatic exchange of bank information

- How big? What fraction evades taxes?

- illustration with the case of Dubai (Alstadsæter, Planterose, Zucman, and Økland, 2022)

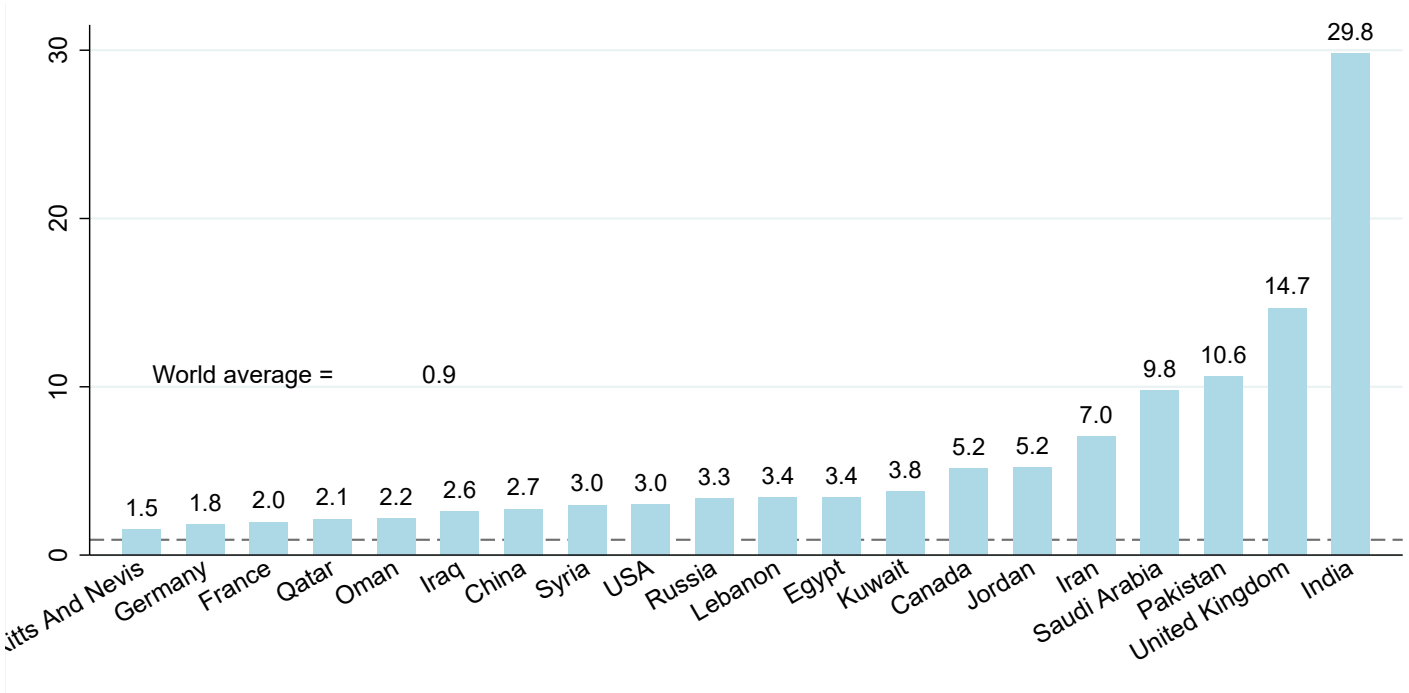
(a) Estimates of offshore real estate wealth



Source: Alstadsæter, Planterose, Zucman and Økland (2022)

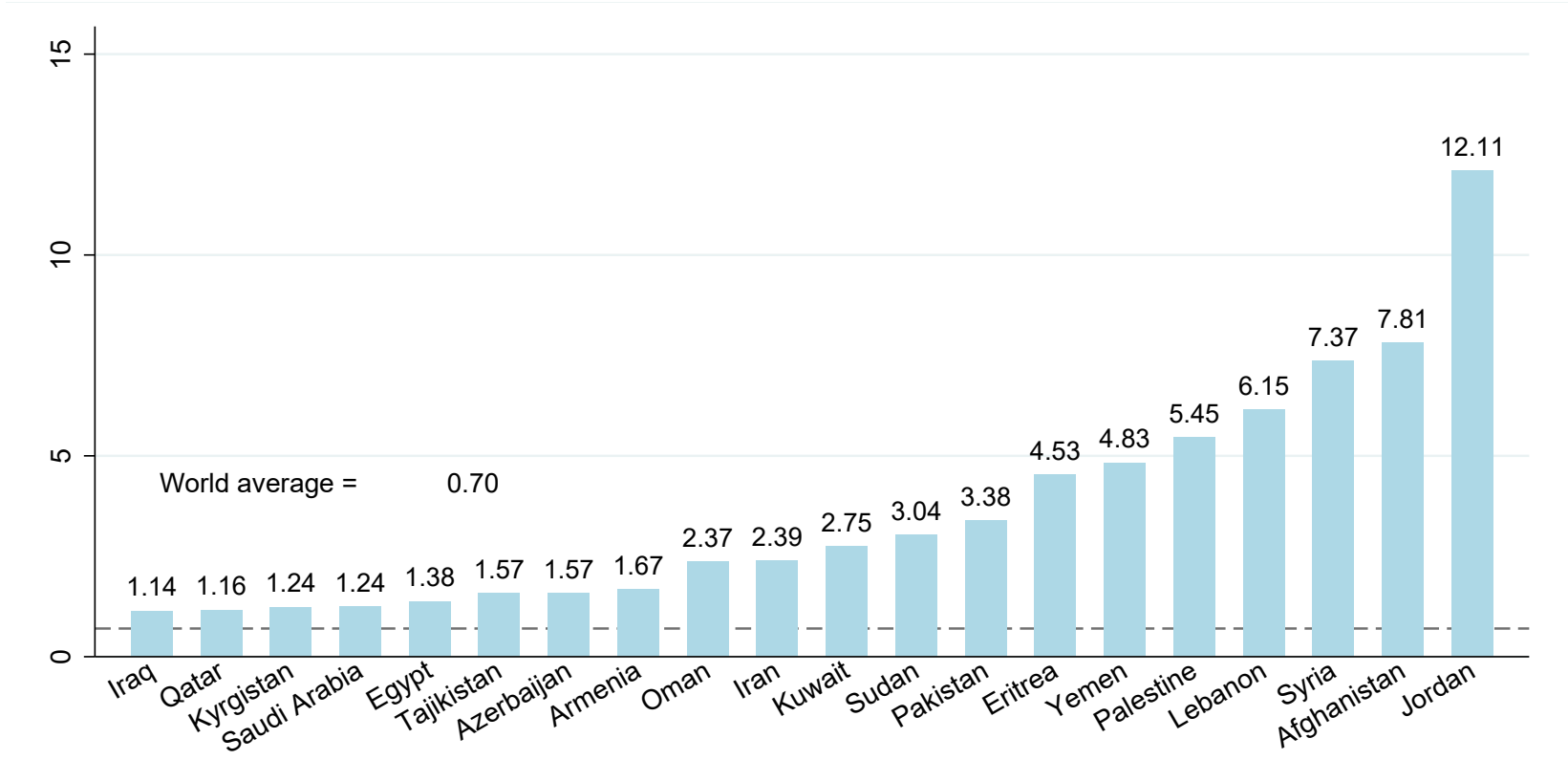
Figure 4: Real Estate Held in Dubai in 2020: Top 20 Countries

(a) Total Value (billions of USD)



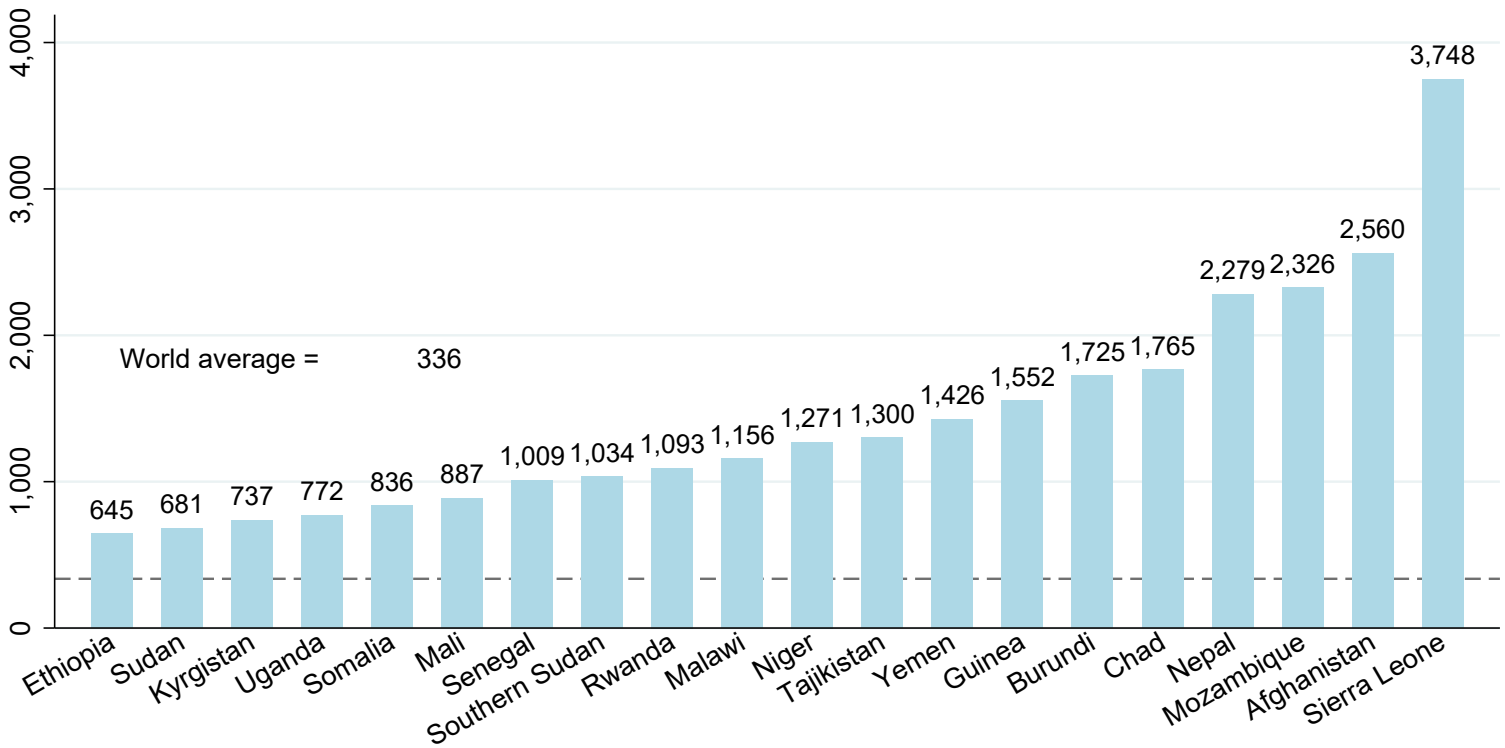
Source: Alstadsæter, Planterose, Zucman and Økland (2022)

(a) Total Value (% of GDP)



Source: Alstadsæter, Planterose, Zucman and Økland (2022)

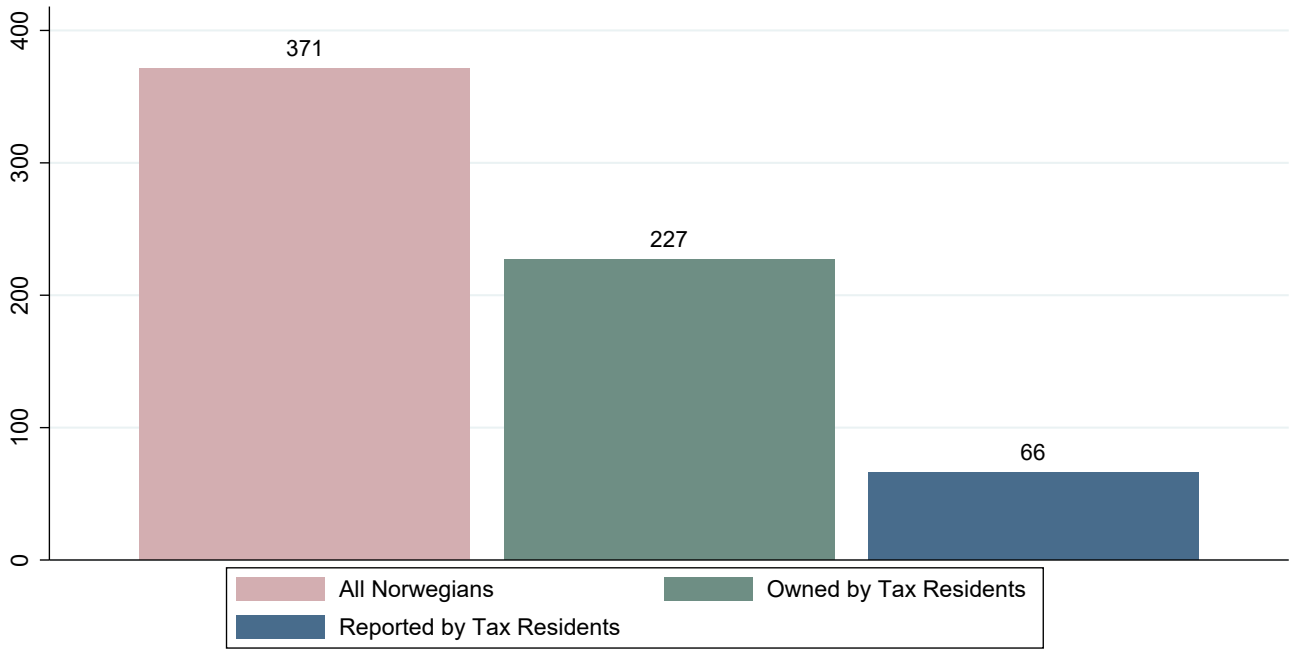
(b) Average Value (Multiples of GDP Per Capita)



Source: Alstadsæter, Planterose, Zucman and Økland (2022)

Figure 10: Reported vs. Total Dubai Real Estate of Norwegians

(a) Number of properties



Source: Alstadsæter, Planterose, Zucman and Økland (2022)

5 Summary

- About 8% of the world's financial wealth is held in tax havens globally
- Accounting for it increases wealth concentration
- Important policy developments over the last decade has reduced this one form of evasion
- But significant gaps remain