

Eco L3 - Globalization, Inequality, and Redistribution

Lecture 5: Tax havens and financial opacity

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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

- Official statistics of central banks (e.g., Swiss National Bank)
- 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
- Historically, mostly evaded taxation—but notable evolution since automatic exchange of bank information in 2018

	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

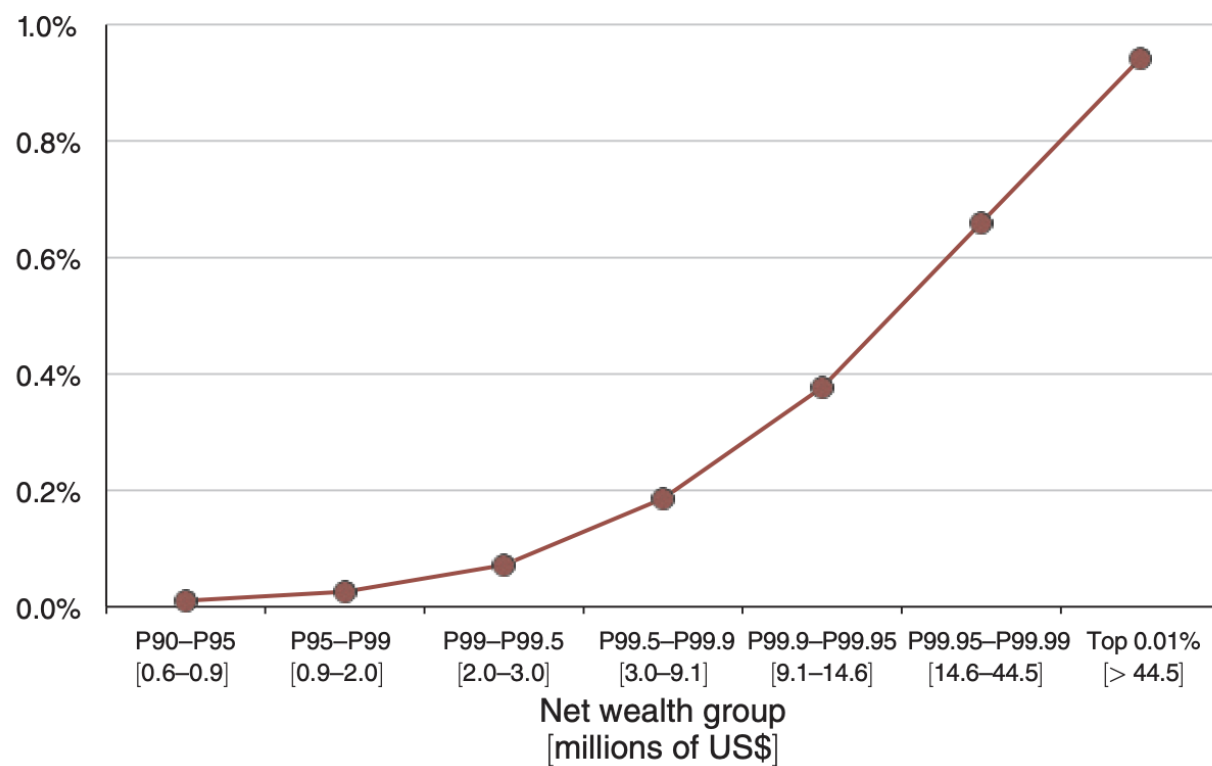
Source: Zucman (2015)

2084

THE AMERICAN ECONOMIC REVIEW

JUNE 2019

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



Source: Alstadsæter, Johannesen and Zucman (2019)

Panel B. Average wealth hidden at HSBC, by wealth group (percent of total wealth (including held at HSBC))

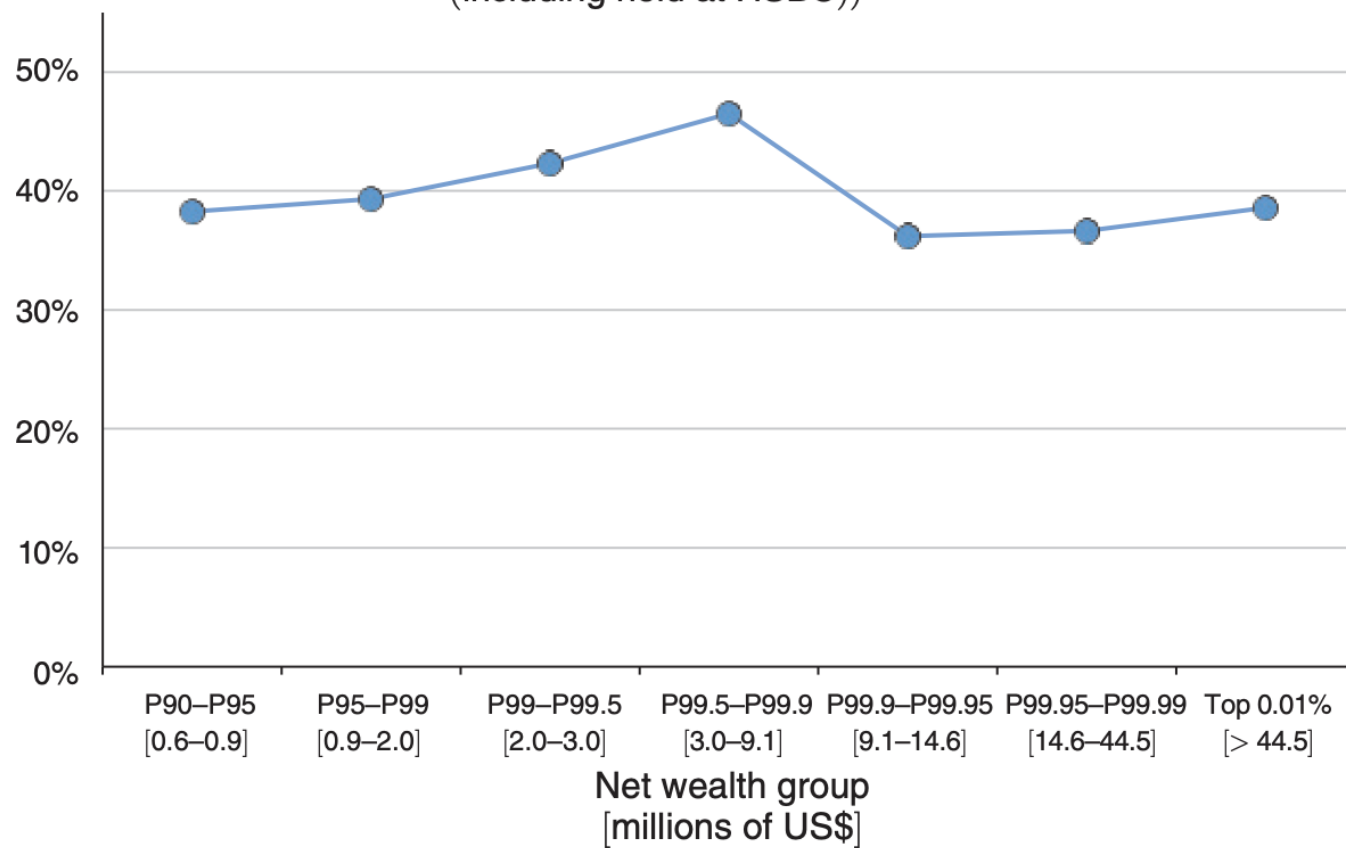
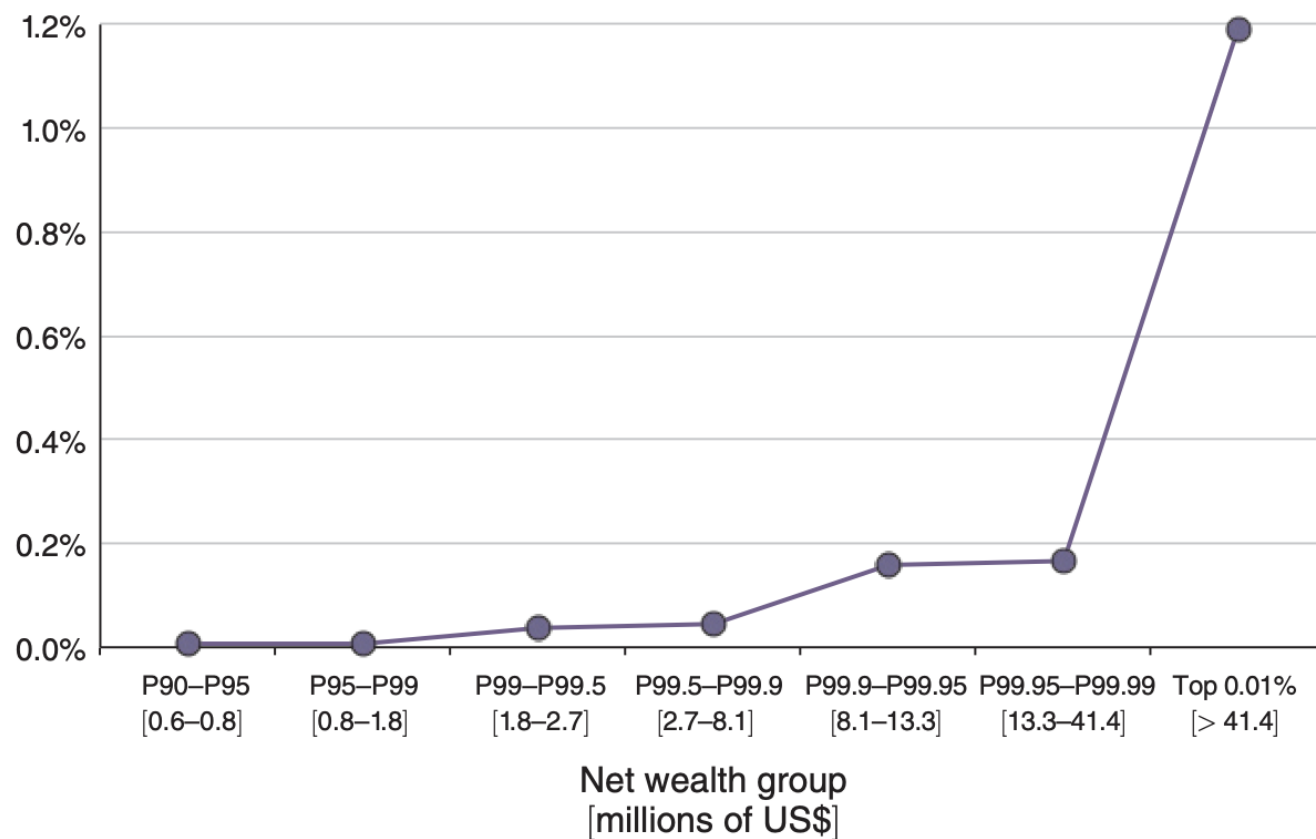


FIGURE 2. TAX EVASION AT HSBC: INTENSIVE VERSUS EXTENSIVE MARGIN

Source: Alstadsæter, Johannesen and Zucman (2019)

Panel A. Probability to appear in the Panama Papers, by wealth group
(shareholders of shell companies created by Mossack Fonseca)



Source: Alstadsæter, Johannesen and Zucman (2019)

Panel B. Probability to voluntarily disclose hidden wealth, by wealth group
(Swedish and Norwegian tax amnesties)

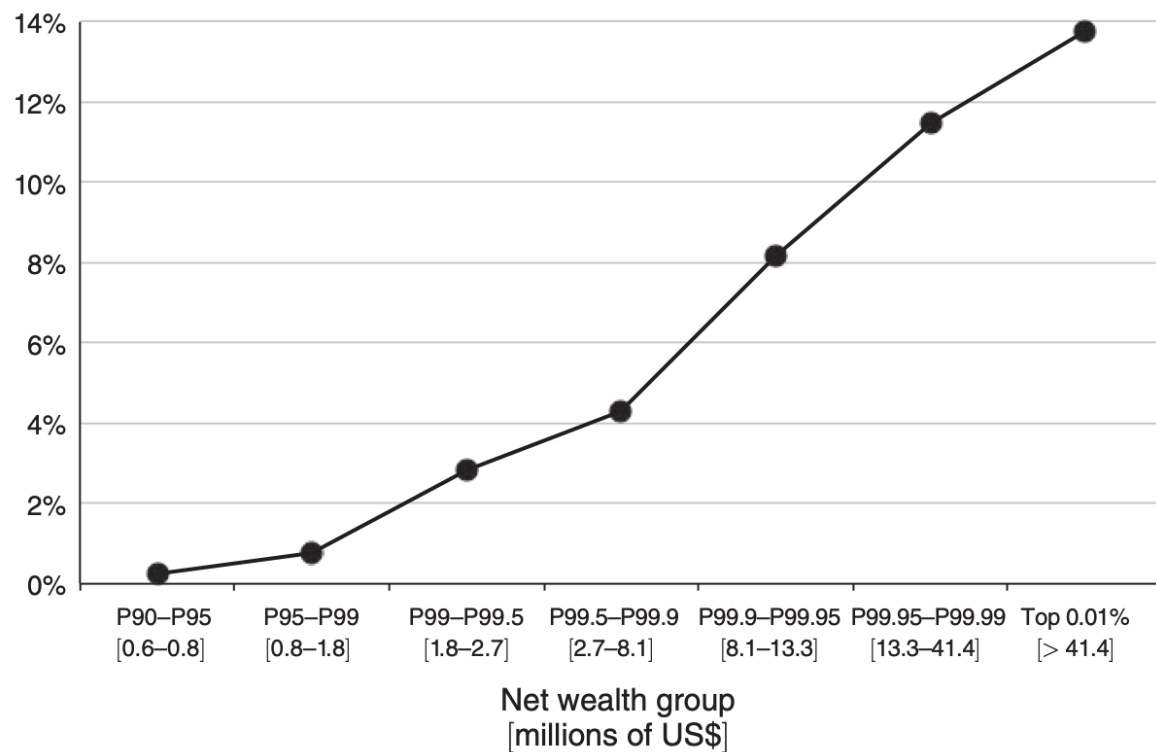
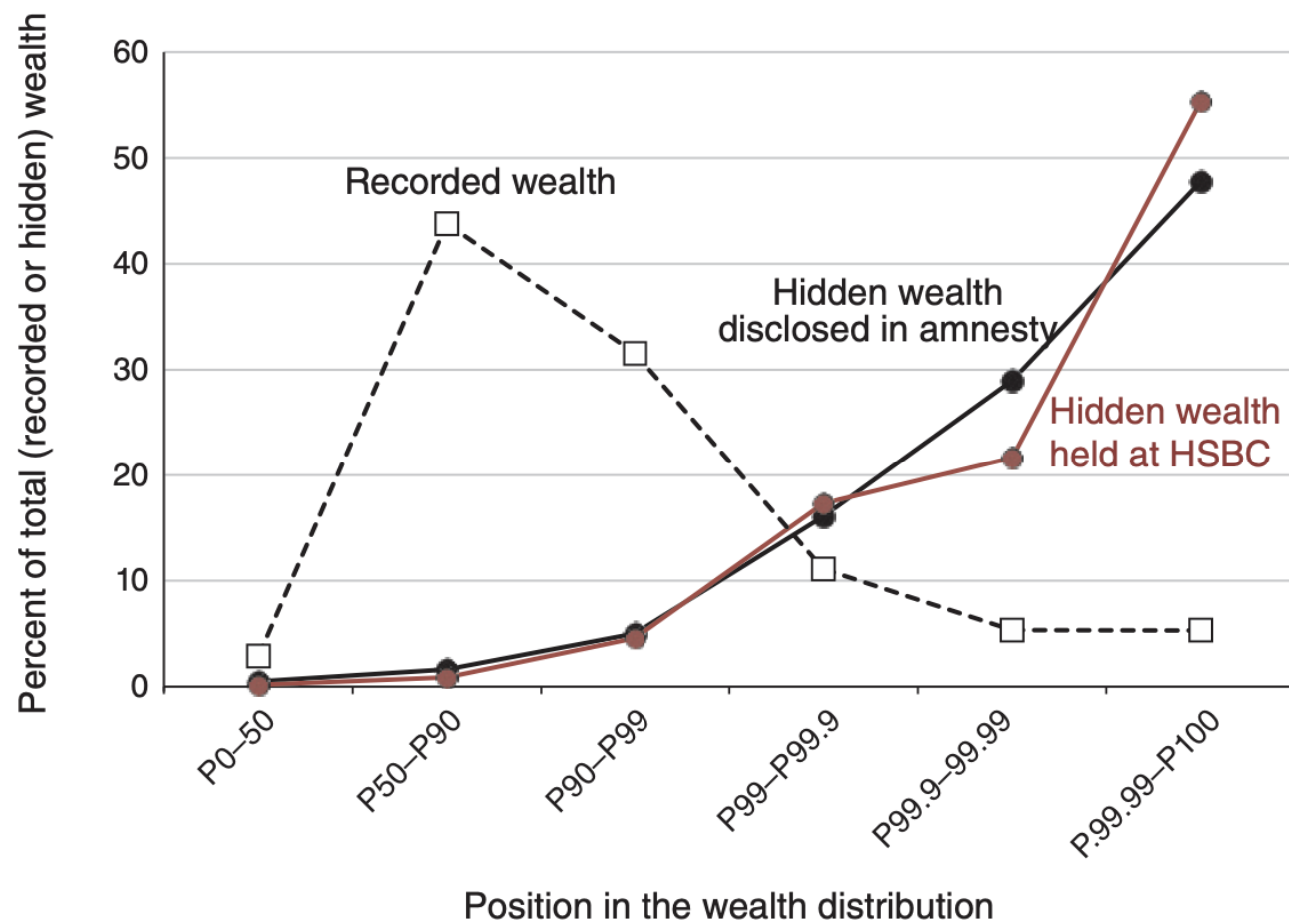


FIGURE 3. PROBABILITY TO BE IN THE PANAMA PAPERS OR USE AN AMNESTY

Source: Alstadsæter, Johannesen and Zucman (2019)

Panel A. Distribution of wealth: recorded versus hidden



Source: Alstadsæter, Johannesen and Zucman (2019)

Panel B. Offshore tax evasion, by wealth group

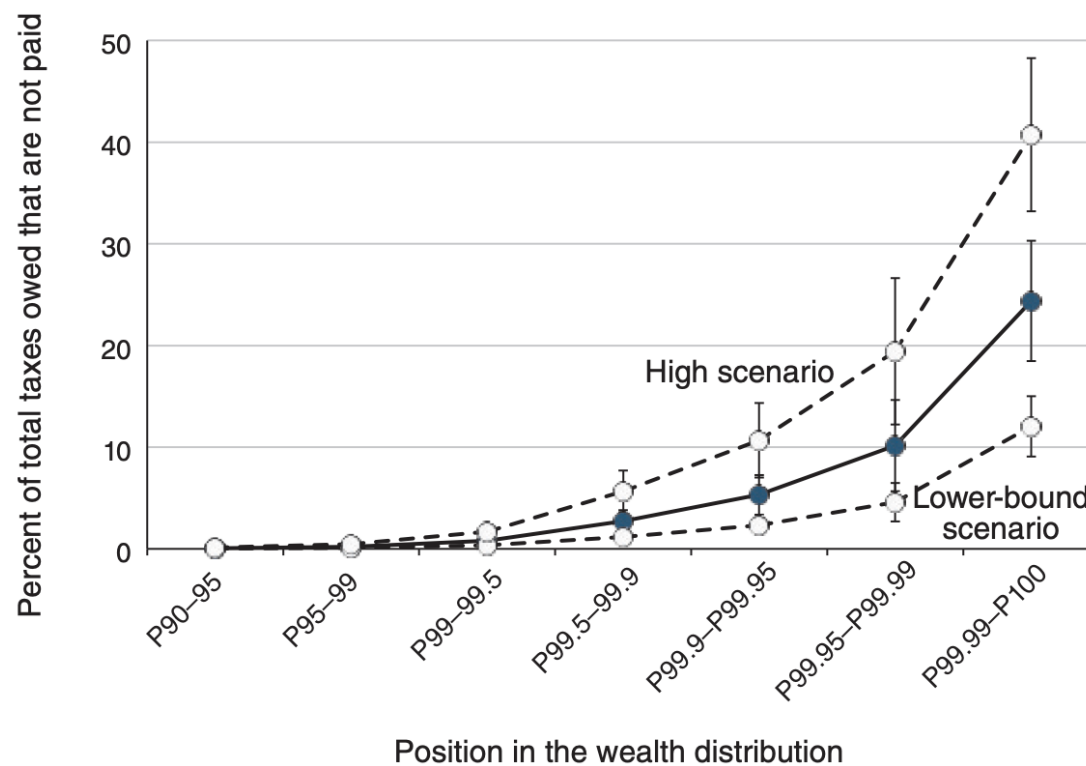
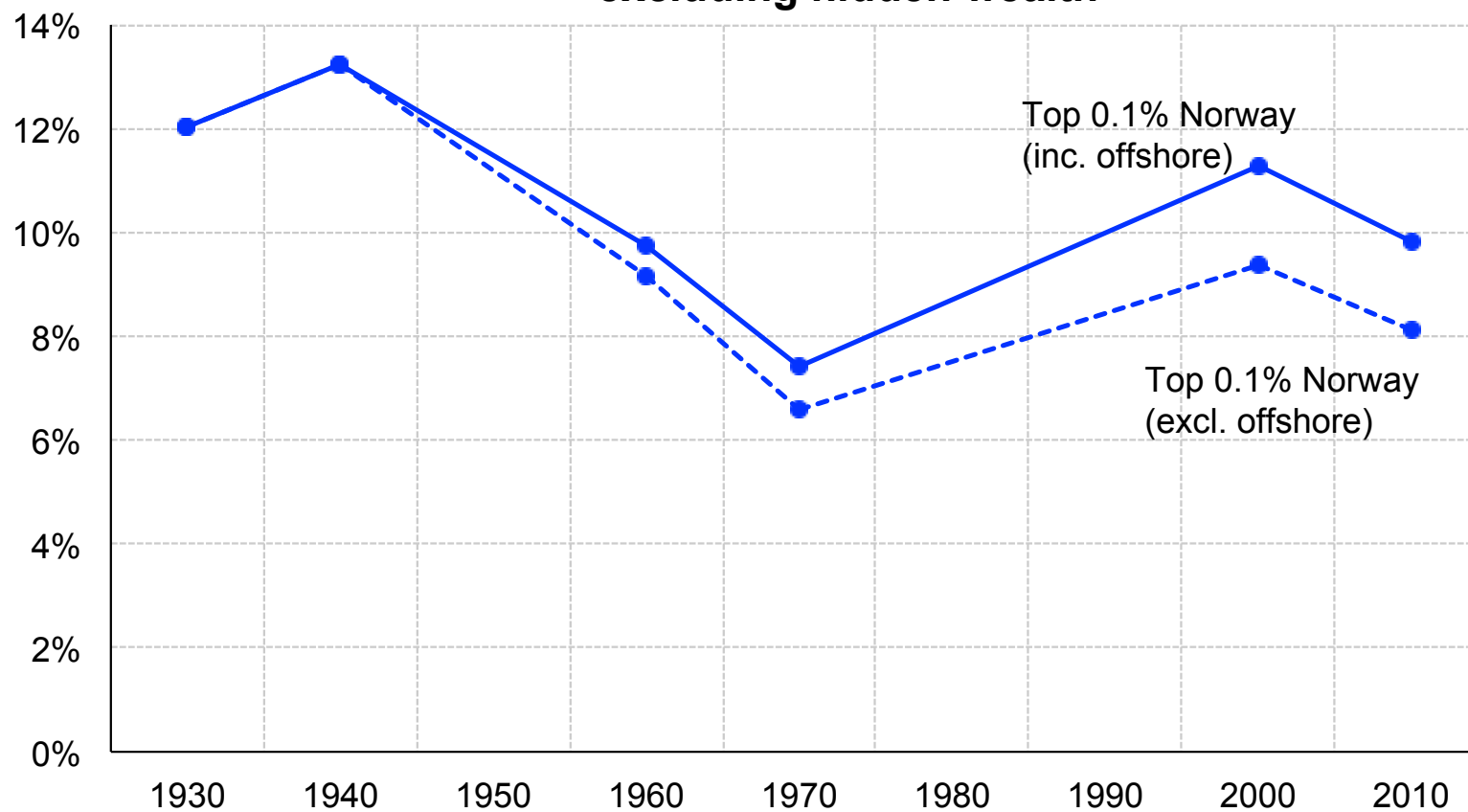


FIGURE 4. THE DISTRIBUTION OF OFFSHORE WEALTH AND OFFSHORE TAX EVASION

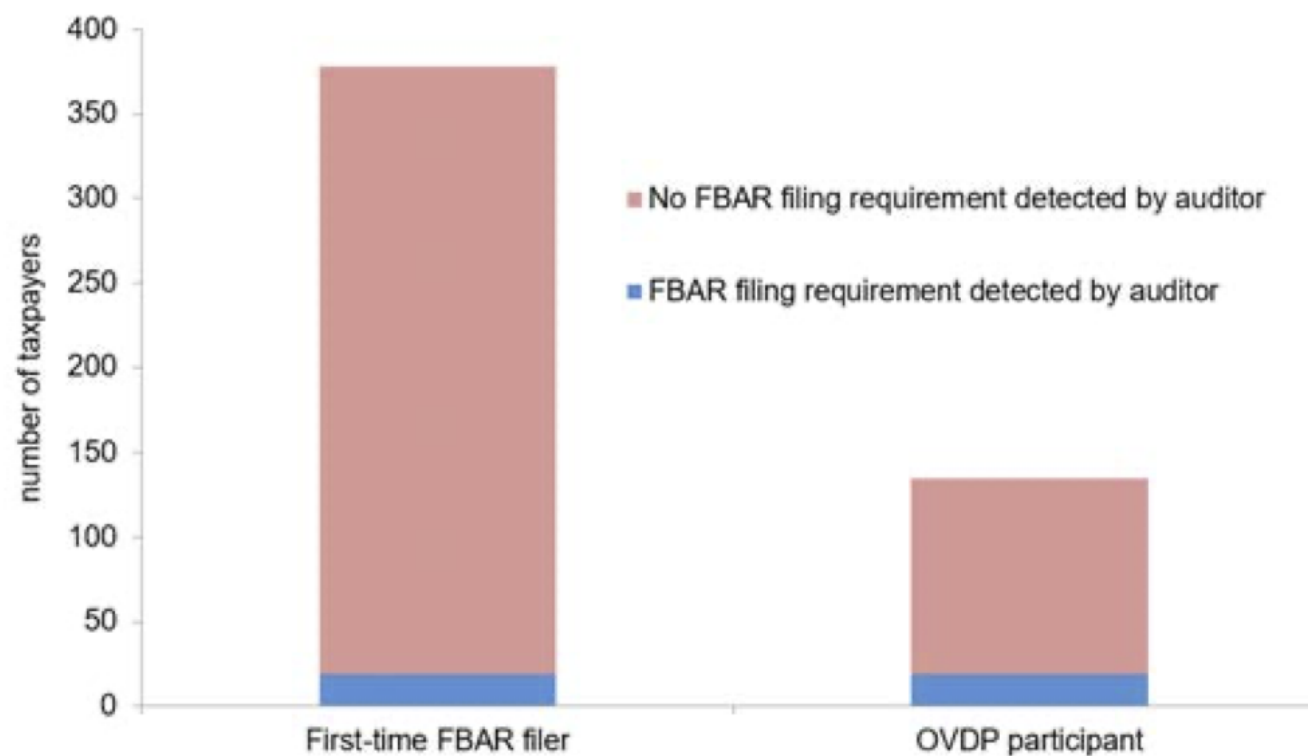
Source: Alstadsæter, Johannesen and Zucman (2019)

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



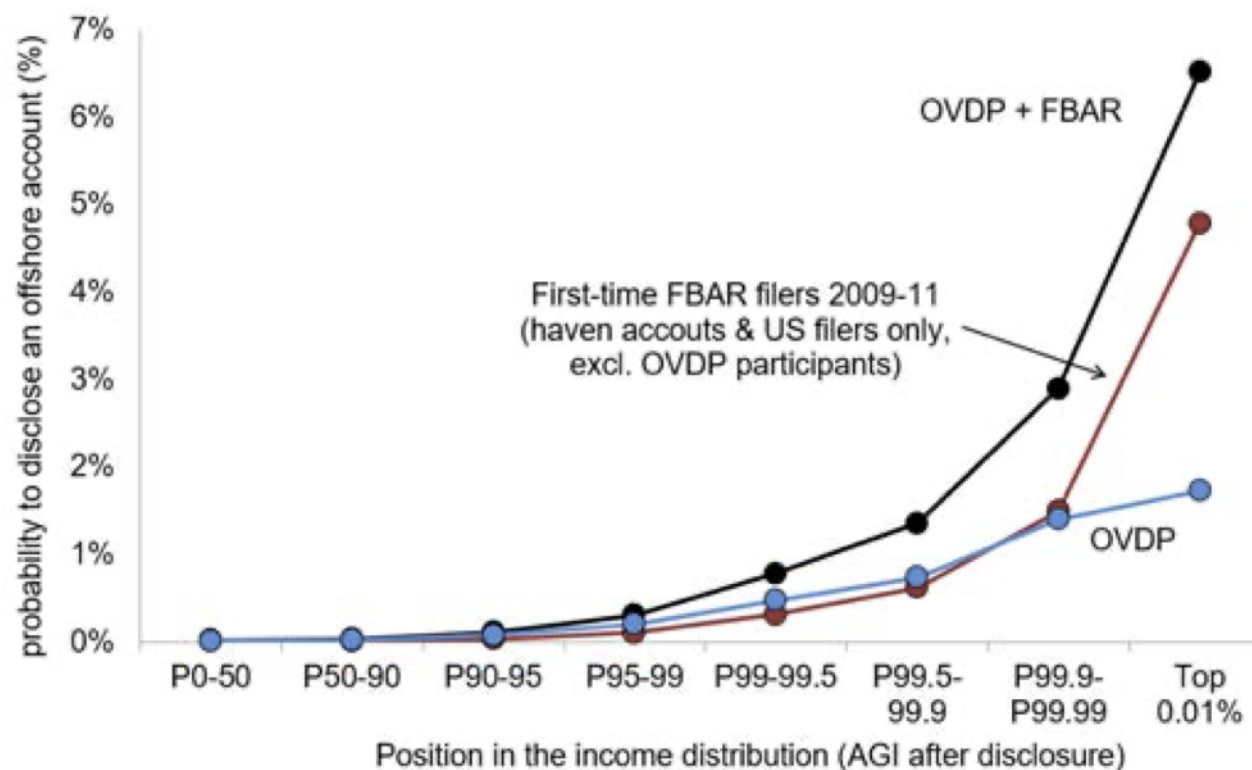
Source: Alstadsæter, Johannesen and Zucman (2016)

(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?

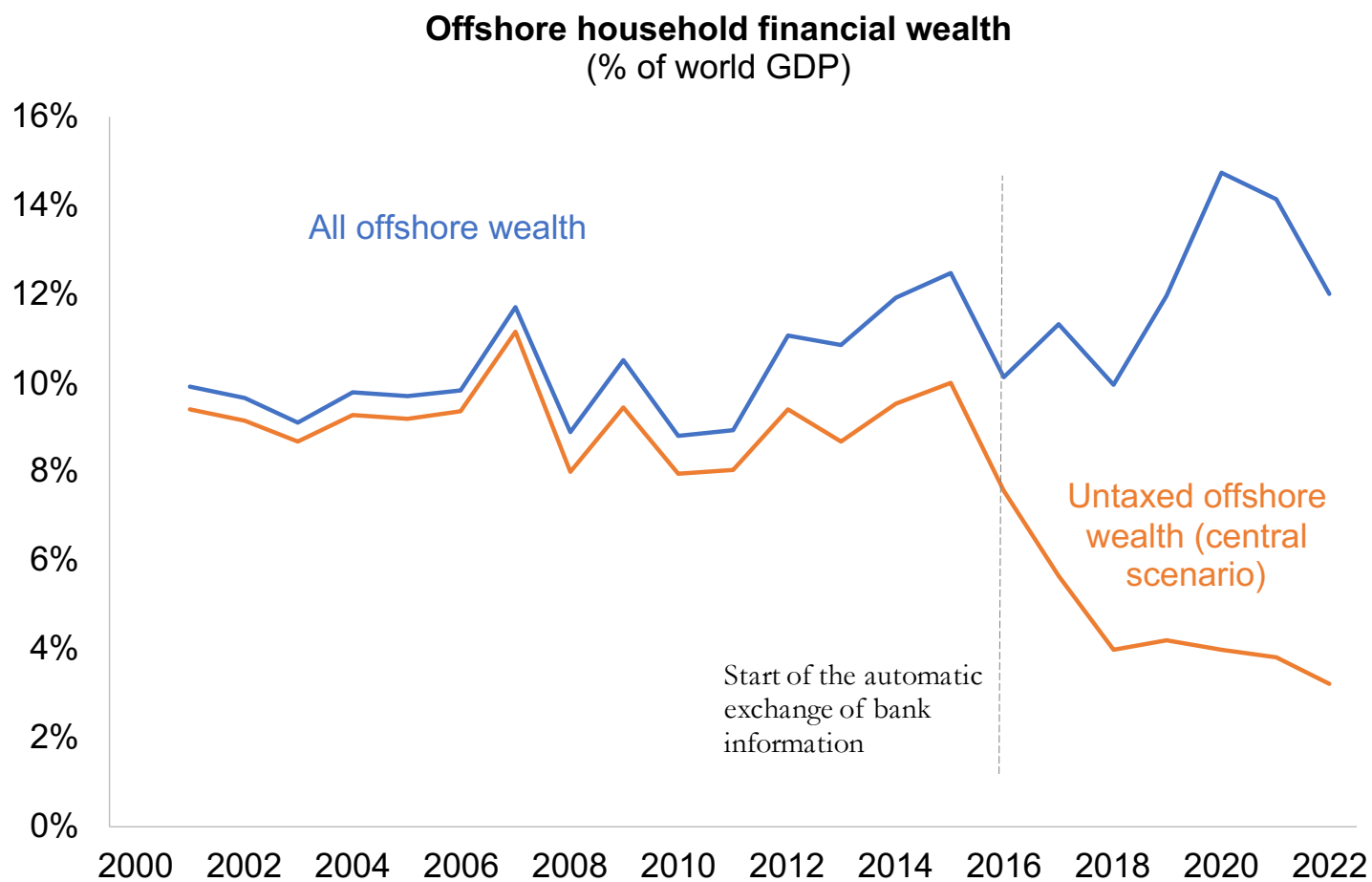
- Increase detection probability λ : third-party reporting. But can be difficult to enforce internationally

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

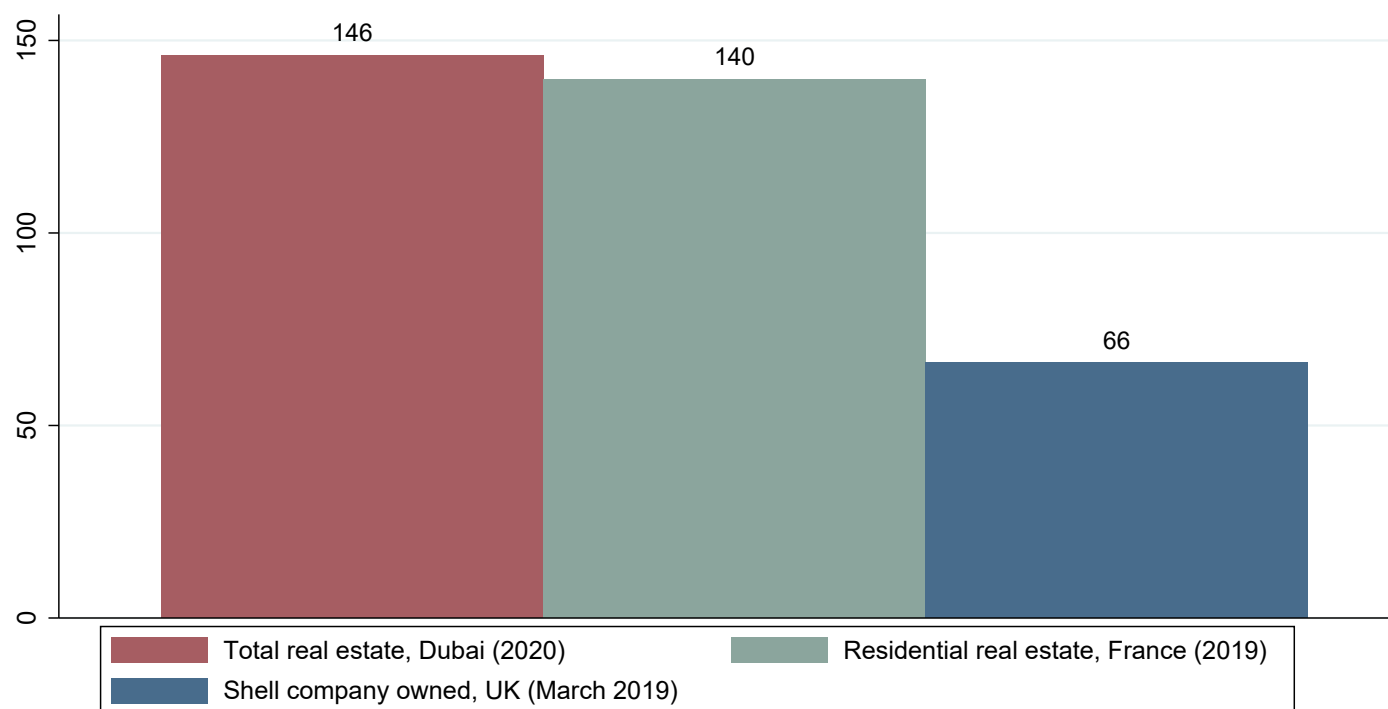


Source: Global Tax Evasion Report 2024

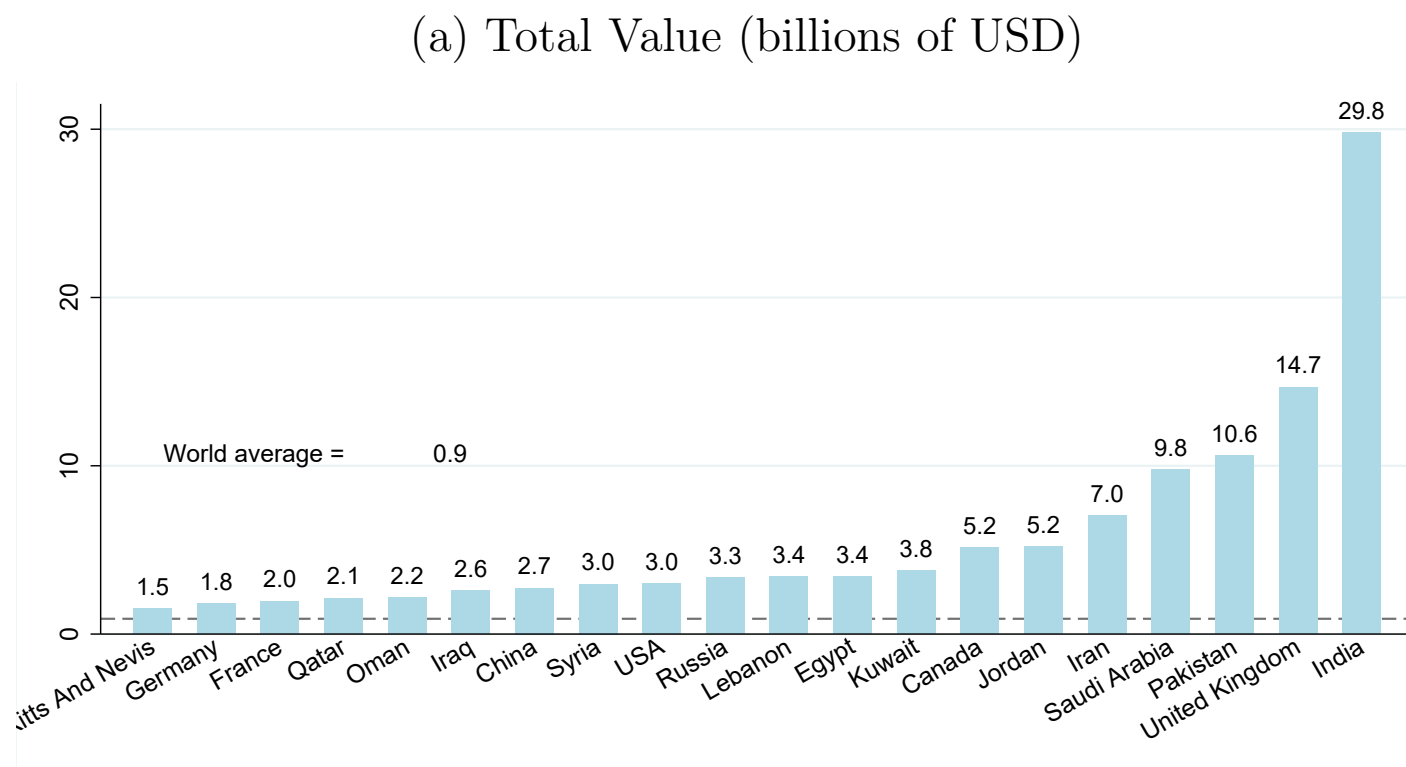
4 Offshore real estate

- 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

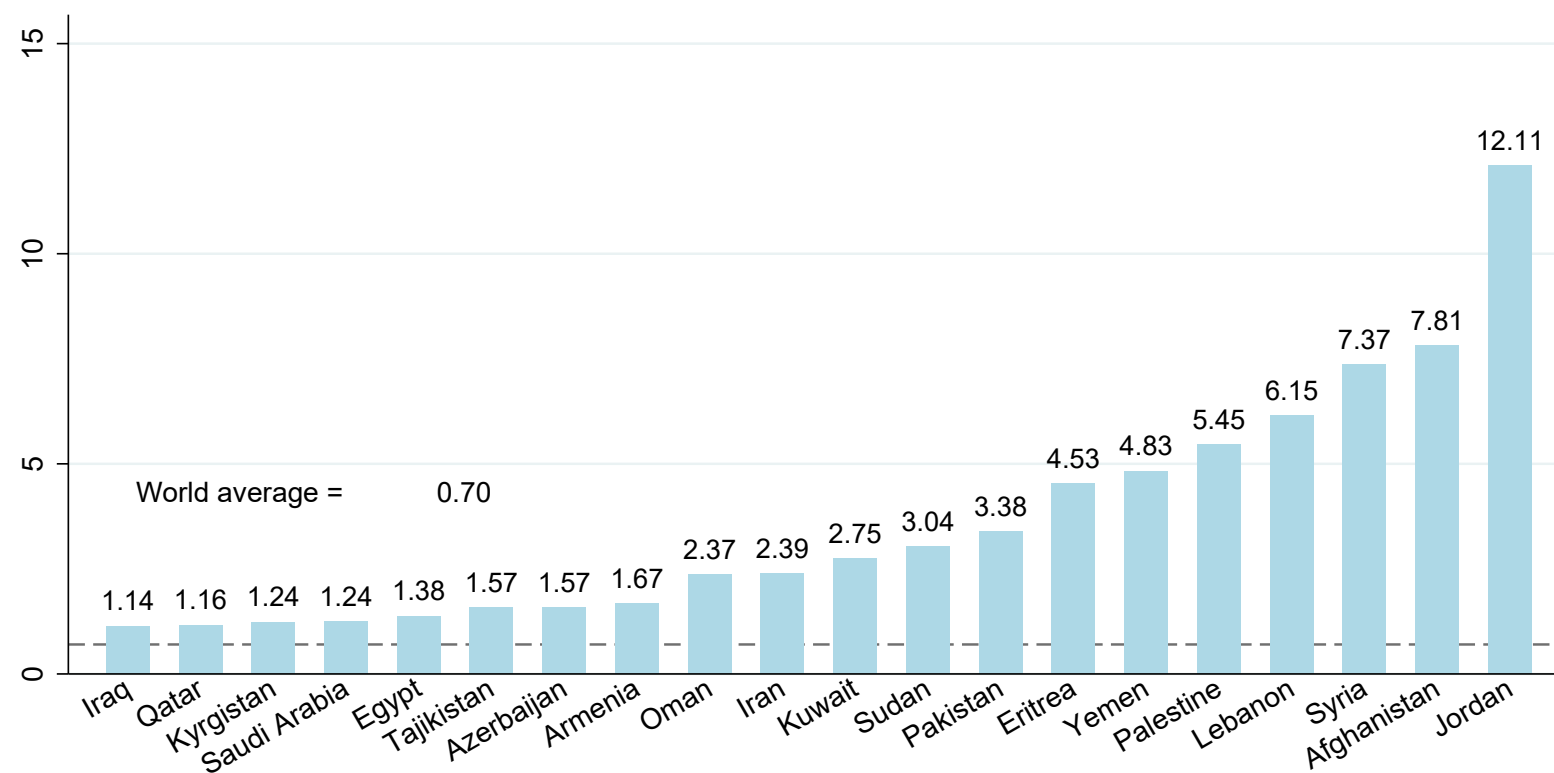


Source: Alstadsæter, Planterose, Zucman and Økland (2022)

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

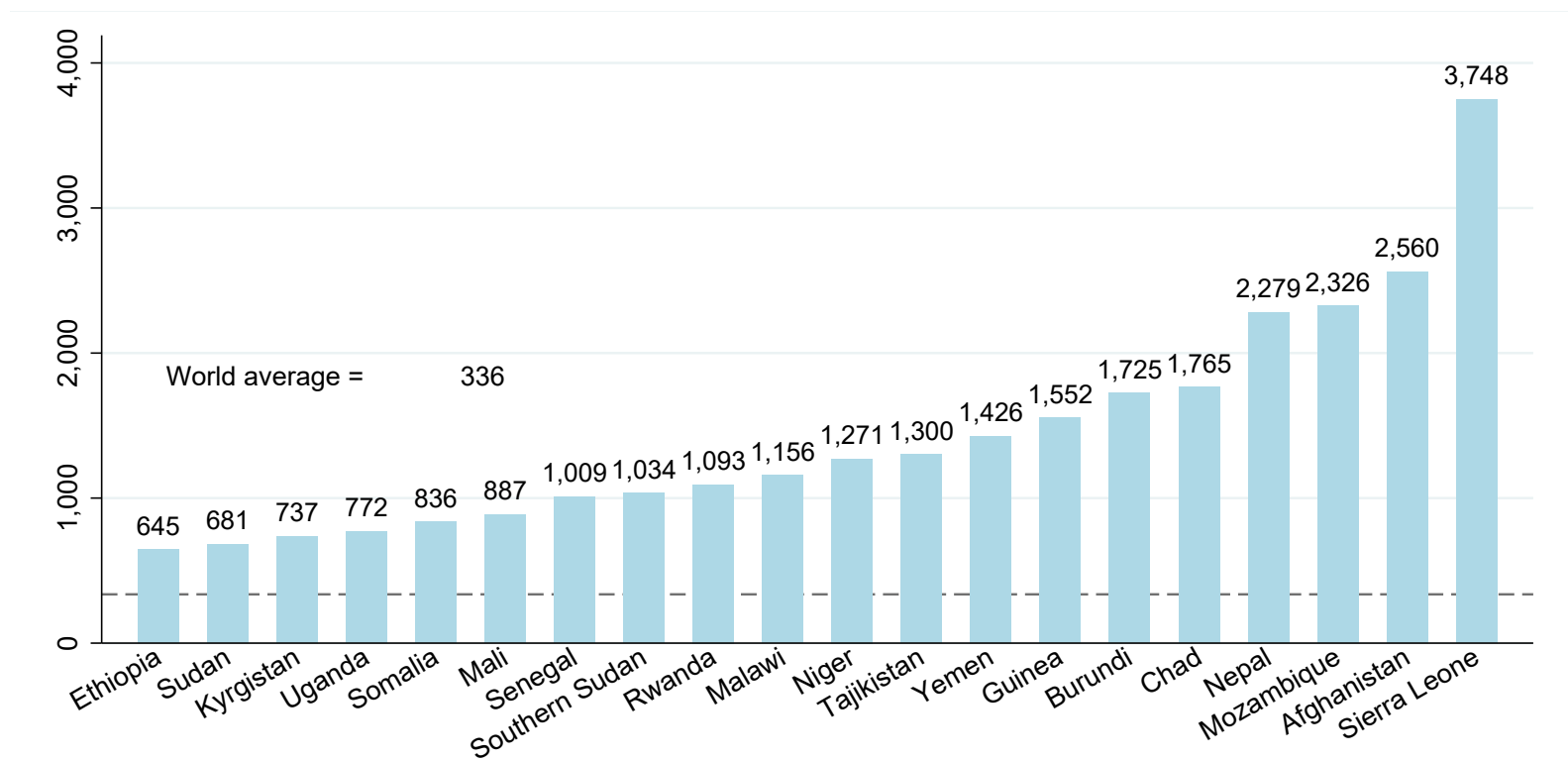
Source: Alstadsæter, Planterose, Zucman and Økland (2022)

(a) Total Value (% of GDP)

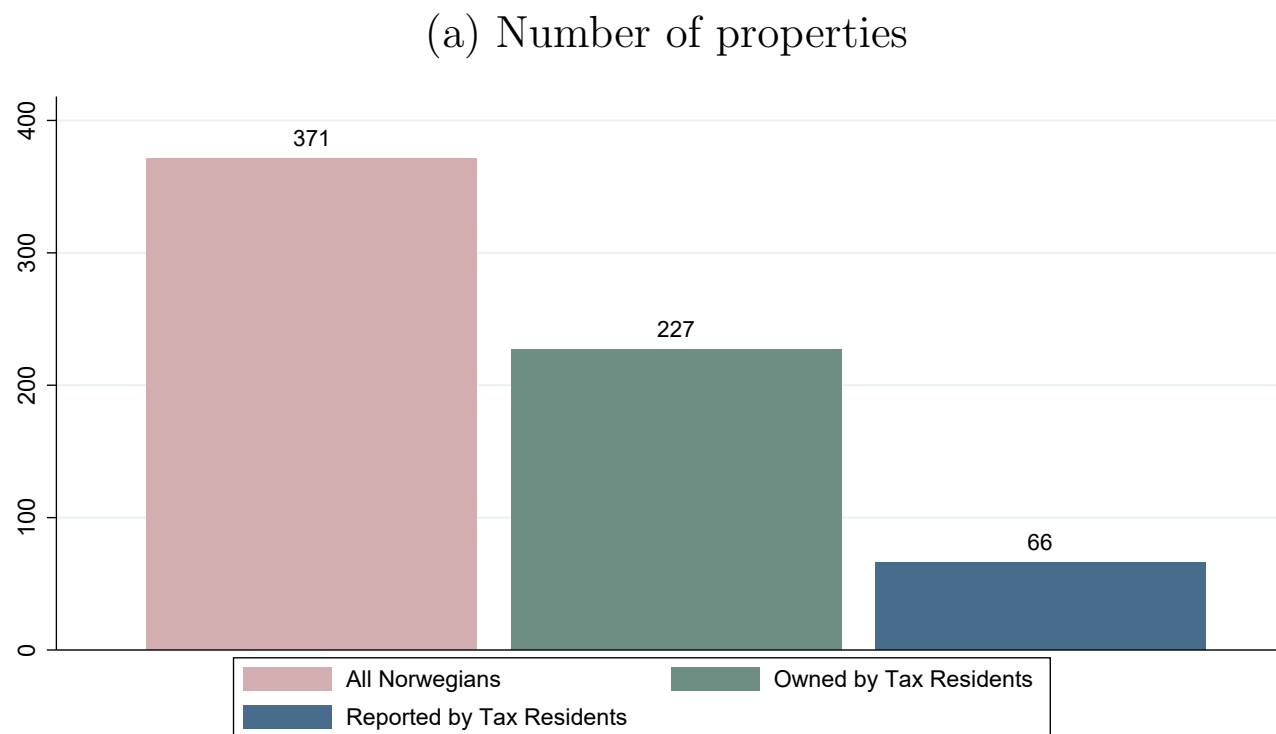


Source: Alstadsæter, Planterose, Zucman and Økland (2022)

(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

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
- But significant gaps remain