Tax Havens and the Rise of Inequality

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Date : January 25, 2016

Gabriel Zucman, The Hidden Wealth of Nations (2015).

Tax literature is bitterly divided on the role that tax havens play in global economy. The negative view of tax havens paints them as parasitic, poaching revenue from other jurisdictions. The positive view suggests that tax havens facilitate low-cost capital mobility, mitigating some of the distortive effects of taxation.

To date, this extensive scholarly debate has produced very little information on tax havens *themselves*. This is hardly surprising, since tax havens are well known to be secrecy jurisdictions. This aspect of tax havens forces scholars who write about them to resort to financial modeling or available country data – data which is rarely on point. Zucman's book is a unique breed in this context. In order to address the role of tax havens in global economy, Zucman actually collects and interprets the necessary data. Zucman assesses the wealth held in tax havens based on a long lasting anomaly in public finance: that in the aggregate, more liabilities than assets are recorded on national balance sheets, as if a portion of global assets simply vanishes into thin air, or as Zucman put it: "were in part held by Mars." Zucman meticulously collected macro-economic data of multiple jurisdictions, and discovered that roughly the same amount of assets missing from national balance sheets shows up as ownership interest in investment pooling vehicles (such as mutual funds) organized in tax havens.

Zucman uses his data (which he makes freely available online) to make original contributions that can roughly be divided into three parts: First, he quantifies the amount of wealth held in tax havens. Second, he explains why we should care. Third, he offers a prescription for reform. I'll briefly discuss each in turn.

Zucman estimates the wealth held in tax havens at $7.6 trillion, or about 8% of total global wealth! This estimation is conservative, as it ignores considerable amount of wealth that is not held in financial accounts, such as works of art. The book is full of eye popping figures. For example, did you know that Luxembourg national accounts report $3.5 trillion in mutual fund shares held in the Grand Duchy, yet $1.5 trillion is unaccounted for and unreported, since all countries, in the aggregate, report their citizens only hold $2 trillion in Luxembourg mutual funds? Equally concerning is the gradual but steady increase of offshore wealth accumulation noted by Zucman, in spite of the recent adoption of measures such as FATCA, specifically aimed at addressing such issues.

This should startle us all, as Zucman clearly and painfully explains. Zucman is unapologetic in adopting the negative view of tax havens. His view is that tax havens plainly "steal" revenue from other jurisdictions. Zucman estimates that as a result of haven-based tax evasion, non-haven jurisdictions lose about $200 billion in tax revenue each year. This estimation assumes that some of the assets held in tax havens are properly reported by their owners to tax authorities. Once he throws into the mix the role of tax havens in U.S. multinationals' income-shifting strategies, another $130 billion of lost revenue annually results.

The revenue lost through tax evasion and avoidance facilitated by tax havens is presumably compensated for by increased taxes on taxpayers who lack the wealth and sophistication to make use of tax havens. This in turn leads to increased inequality. Zucman draws a direct line between the success of tax havens and the steady increase in inequality. Thomas Piketty, who wrote the forward for Zucman's book, concludes that such process is so destructive that is may eventually impair the basic social contract on which modern democracies are built: "everybody has to pay taxes on fair and transparent basis". Tax havens impair both fairness and transparency, and for the first time we have data to support such argument.

As depressing as it may seem, Zucman's last part of the book offers some cautious optimism. He broadly outlines a plan which combines a global registrar of financial assets, and a small gross tax on such assets. Such tax would function as a form of presumptive taxation. That is, owners may claim credit for such tax, but in order to do so they will have to identify themselves to authorities. He would supplement such regime with sanctions (including in the form of trade tariffs) on uncooperative jurisdictions.

As much as such plan seemed grandiose to me at first, I ended up being convinced that it is technically feasible. As Zucman explains, most financial assets are registered today in very few repositories, the combination of which will account for most true ownership of financial assets. Once a registrar is instituted, the gross tax levy becomes administratively doable. Even trade sanctions on non-cooperative jurisdictions are not far-fetched. For example, Zucman calculates that if Germany, France and Italy alone cooperate in imposing a tariff on Swiss goods, a 30% tariff rate would be enough to deny Switzerland of all benefits associated with being a tax-haven. 30% is the same level of penalty imposed on non-cooperative taxpayers by FATCA. If more jurisdictions joined forces, the necessary tariff might become substantially smaller.

While I am convinced that Zucman's plan is technically feasible, I am less than certain that the political will to adopt such a plan exists. Nonetheless, advocacy is the first step in any political change, and Zucman's book makes a compelling case. The book is an essential reading if only for the trove of data it contains, and for clearly explaining how the ascent of tax havens hurts everyone else. Zucman does all that in 200 pages of plain English, free of any condescending jargon, yet with all the rigor of academic research.

Cite as: Omri Marian, *Tax Havens and the Rise of Inequality*, JOTWELL (January 25, 2016) (reviewing Gabriel Zucman, **The Hidden Wealth of Nations** (2015)), http://tax.jotwell.com/tax-havens-and-the-rise-of-inequality/.