Globalization and Tax Justice

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October 2017
How can we make globalization and tax justice compatible?

One of the most pressing policy questions of our time

Clear by now that globalization is making redistribution harder

Policy response so far: protectionism and/or let’s all become tax havens (Brexit, Trump, race to bottom)

Another route is possible, but it requires: (i) a good understanding of the issues, (ii) creative policies
Why globalization and tax justice are conflicting

Tax havens severely affect national tax policies:

- Multinationals’ artificial profit-shifting
- Rising personal tax avoidance and evasion
- Internalizing this, gov’t cut capital taxes & top rates

Cuts need to be offset by ↑ taxes elsewhere / less spending

→ Does globalization have a future if it means ever lower taxes for the rich, and higher for the rest of us?
Multinationals’ Profit-Shifting to Tax Havens
The share of profits made abroad in U.S. corporate profits

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). Foreign profits include dividends on foreign portfolio equities and income on US direct investment abroad (distributed and retained). Profits are net of interest payments, gross of US but net of foreign corporate income taxes. Source: author's computations using NIPA data, see Online Appendix.
63% of the foreign profits of US multinationals are now made in havens

The share of tax havens in U.S. corporate profits made abroad

Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2016, total income on U.S. DI abroad was about $450bn. 16% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.
The effective rate paid by US corporations has been reduced by 1/3 since late 1990s

Nominal and effective corporate tax rates on US corporate profits

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). In 2010-2016, over $100 of corporate profits earned by US residents, on average $16 is paid in corporate taxes to the U.S. government (federal and States) and $4 to foreign governments. Source: author's computations using NIPA data, see Online Appendix.
Globally, 40% of multinationals’ profits are artificially shifted to tax havens

Note: This figure illustrates the amount of tax base wrongly allocated to tax havens in 2015, as well as the regions from which it originates. The total profits shifted to tax havens is estimated at 627 billion Euros. The size of mis-allocated tax base is equal to the estimated “Excess Profits” of the havens. The profits are allocated to the countries of origin, proportionally to the sum of high-risk service imports and FDI interest payments by partner countries. Foreign income is defined as income made by non-tax havens on investments abroad. The foreign income in 2015 was 1.4 trillion Euros.
The EU loses 20% of its corporate tax revenue due to tax havens

Lost corporate tax revenue as a share of current corporate tax revenue

Note: This figure illustrates the amount of tax revenue lost per country as share of current total corporate tax revenue in 2015. The bars are split into the share lost to EU-havens and non-EU havens. The green line shows the top statutory tax rates of the countries. The tax losses are allocated using the share of high risk imports and interest paid to tax havens (Our benchmark scenario).
The winners: tax havens

Corporate Income Tax Revenue (% Gross National Income)

Ireland

U.S.

E.U.

Note: EU is the average of France, Germany, U.K., and Italy.
Offshore Wealth
A high and growing amount of personal wealth is held in tax havens.

The global amount of household wealth in tax havens:

- **Global offshore wealth (BCG)**
- **Global offshore wealth (Our estimate)**
- **Offshore wealth in Switzerland (Swiss National Bank)**

% of world GDP
From some countries, offshore wealth is as high as 50% of GDP.
Hidden wealth is extremely concentrated.

**Distribution of wealth: recorded vs. hidden**

- **All recorded wealth**
- **Hidden wealth disclosed in amnesty**
- **Hidden wealth held at HSBC**

Position in the wealth distribution:

- P0-50
- P50-P90
- P90-P99
- P99-P99.9
- P99.9-99.99
- P.99.99-P100
Combining offshore tax evasion with other forms of tax evasion

Taxes evaded, % of taxes owed

% of taxes owed that are not paid

Position in the wealth distribution
Tax evasion is widespread among the very wealthy

Taxes evaded, % of taxes owed
(stratified random audits + leaks)

Average: 2.8%
Tax evasion makes the tax system regressive at the top.
Because of offshore wealth, we significantly under-estimate inequality.

The top 0.01% wealth share and its composition:

- Offshore wealth
- All wealth excluding offshore

% of total household wealth

- Spain
- UK
- Scandinavia
- France
- USA
- Russia
The Solutions
Despite recent policy initiatives, much remains to be done to fight tax evasion.

Automatic exchange of bank info is becoming global standard: big progress.

Three obstacles:

- Incentives of offshore bankers
- Financial opacity
- Incentives of tax havens

What is missing: well defined sanctions and a world financial registry.
We need a world financial register to fight financial opacity

The case for a world financial register

The companies Clearstream, Euroclear, etc. feed the world financial register. Tax authorities can verify that tax-payers indeed declare all the financial securities included in the register.

- Despository Trust Corporation (USA)
- Clearstream (Luxembourg)
- Euroclear France (France)
- Other central securities depositories & other sources
- U.S. tax authority
- U.K. tax authority
- French tax authority
- Other tax administrations
Reforming the corporate tax

**Formula apportionment**

Works reasonably well for US States

Based on final sales to remove incentives to move real activity

It’s the best way to levy taxes efficiently and fairly

Can be done unilaterally

But best done multilaterally as part of free trade agreements
Supplementary Slides
The probability to have an unreported HSBC account rises sharply within the top 1%.
HSBC evaders hide close to half of their wealth at HSBC

Average wealth hidden at HSBC, by wealth group
(% of total wealth (including held at HSBC))
The Panama Papers confirm the sharp gradient in use of tax havens by wealth

Probability to appear in the "Panama Papers", by wealth group
(Shareholders of shell companies created by Mossack Fonseca)
Amnesty data show widespread evasion at the top

Probability to voluntarily disclose hidden wealth, by wealth group
(Swedish and Norwegian tax amnesties)
Even in countries with low total evasion, including hidden wealth, inequality a lot
Tax evasion on hidden wealth

Offshore tax evasion, by wealth group

% of total taxes owed that are not paid

Position in the wealth distribution

Lower-bound scenario

High scenario
Tax evasion detected in random audits

% of taxes owed that are not paid

Position in the wealth distribution

Macro average: 2.3%
Random audits detect a lot of errors on tax returns

Fraction of households evading taxes, by wealth group
(stratified random audits)
But random audits fail to capture sophisticated evasion at the top.

Fraction of income undeclared, conditional on evading
(stratified random audits)
Tax evasion in random audits: US. vs. Denmark

Figure S.23: Fraction of income undeclared (stratified random audits)

US (right) average: 11%
Denmark (left) average: 1.8%
Why is detected evasion higher in US?
DCE multiplier + self-employment

The share of self-employment income in GDP in OECD countries
(Gross mixed income as a % of factor-cost GDP)
Stronger enforcement $\rightarrow$ fewer, wealthier clients
Income inequality in the United States

Pre-tax national income share: top 1% vs. bottom 50%

Source: Appendix Table II-B1
Changes in Tax Progressivity

Figure 5.2.2

Note: The top marginal tax rate of the income tax (applying to the highest incomes) in the U.S. dropped from 91% in 1963 to 40% in 2017.

Sources: piketty.pse.ens.fr/capital21c and WID.world updates.
Tax progressivity in the United States

Average tax rates by pre-tax income group

% of pre-tax income


Source: Appendix Table II-G1.
During the same period of time, the top 1% income share increased by 9.5 points.

Note: in the USA, the top marginal income tax rate was reduced by 33 points between the early 1970s and the early 2010s.

Source: Piketty, Saez and Stantcheva (2014)
No growth for the U.S. bottom 50% since 1980

Average annual growth by percentile, 1980-2014

Real average annual growth, 1980-2014

Income percentile

-1%  0%  1%  2%  3%  4%  5%  6%
5  10  15  20  25  30  35  40  45  50  55  60  65  70  75  80  85  90  95  100

Post-tax
Pre-tax
Average adult
Top 0.001%
P99.99
P99.9
P99