A brief critique of '*The Hidden Wealth of Nations*'

Key points

- Gabriel Zucman's estimates of the scale of tax evasion through offshore centres should be treated with caution, as the methodology is based on a misinterpretation of the data
- The discrepancy in global financial balance sheets can be attributed to a variety of factors, all of which have to do with the systematic ways in which the data are collected globally, and little to do with supposed illicit offshore activities
- Zucman's assumptions on global tax evasion – based on data from Switzerland – are deeply flawed, as Switzerland is not a sound exemplar for extrapolation
- Zucman's calculations of tax losses seem to reflect a lost world and provide little acknowledgement of the global value provided by offshore finance centres

1. Zucman's underlying rational and methodology for his measurement of wealth held offshore is a misinterpretation

Gabriel Zucman, a French economist that has written extensively on 'tax havens', has attempted to estimate the amount of wealth that is held in offshore finance centres as well as the amount of tax presumably evaded through these jurisdictions.[1] Zucman contends that there are $189 billion of global tax revenues lost from what he estimates to be $7.6 trillion of assets held in offshore centres.[2]

Estimating global tax evasion is difficult. As such, there is a lack of publicly-available academic research on the topic. As there are few reliable estimates of global tax evasion, journalists and campaigners continue to cite Zucman's research as the *de facto* standard. While Zucman's research fills this research gap, his methodology is deeply flawed.

A starting point for much of Zucman's work is derived from his estimate of household financial wealth held in international financial centres (IFCs), which he estimates to be US$7.6 trillion. This estimate of wealth 'held offshore', whilst lower than some of the more exaggerated estimates, does not hold water.[3] Zucman's analysis rests on the supposed puzzle that international balance sheets systematically show more liabilities than assets. Zucman reasons that the world cannot be in debt to itself, and therefore this discrepancy must be the amount held in secretive tax havens.

However, this discrepancy, which is well-known and well-documented in the international research community, can be attributed to a variety of factors, all of which have to do with the systematic way in which the data are collected globally, and little to do with supposedly illicit offshore activities.

[1] Gabriel Zucman, *The Hidden Wealth of Nations: The Scourge of Tax Havens* (University of Chicago, Chicago) 2015.

[2] This estimate is from his book, published in 2015. Zucman has since updated these estimates. This note focuses on the figures in *The Hidden Wealth of Nations* 2015 edition. Capital Economics' overall analysis and critique still holds if using Zucman's updated figures.

[3] For a critique on the more exaggerated estimates of wealth held offshore, see Capital Economics, *Jersey's Value to Africa: the role for international finance centres in delivering sustainable growth in developing countries*, (Jersey Finance, St. Helier) November 2014.

For example, in the IMF's bilateral investment statistics, data reported by the United States show foreign financial centres – such as Singapore, Switzerland, and the United Kingdom – holding far more U.S. equities than these financial centres' reciprocal statistics on asset holdings suggest. Yet this result is to be expected – these shares may be held by custodians on behalf of non-residents. There is also a lack of information from major asset-rich nations, such as China and many in the Middle East, who do not report in detail to the international statistics-collecting organisations.

As a result, assets are understated relative to liabilities. Overall, these balance sheet discrepancies tell us nothing about the significance of holdings in IFCs.

2. Zucman's assumptions on global tax evasion – based on data from Switzerland – are deeply flawed, as Switzerland is not a sound exemplar for extrapolation

From his estimate of wealth held offshore, Zucman attempts to measure the global revenues that are lost due to offshore tax evasion. He confidently assumes that 80% of all wealth offshore is undeclared to relevant tax authorities. But this assertion is based on one evidence point: the declarations of EU residents with Swiss bank accounts seeking amnesty for historical deposits made while Switzerland upheld its 1930s banking secrecy laws.

The Swiss tax administration reports data on EU account-holders that chose to voluntarily declare their holdings to their home country tax authority against the backdrop for the EU Savings Directive. From 2005, EU citizens earning interest on Swiss accounts had a choice: to declare their assets or to maintain their anonymity, but be taxed 35% directly by the banks. Zucman uses this dataset and applies estimates on the disclosure figures for Switzerland to the behaviour of residents globally.

This is hardly a sound basis for extrapolation. Most IFCs have never had banking secrecy and have adopted transparency measures – such as the automatic exchange of information under the OECD Common Reporting Standard (CRS) – that grant onshore economies full information on monies invested there. As such, this 80% figure bears no relation to the business undertaken in other IFCs.

3. Zucman's calculations of tax losses seem to reflect a lost world, and provides little acknowledgement of the global value provided by offshore finance centres

Zucman's calculations of tax losses seem to reflect a lost world, implying that capital flows into IFCs do not lead to re-investment elsewhere. This is incorrect, as institutional investors use IFCs to pool funds that are directly invested into onshore economies: generating wealth and taxable income flows there. Contradictorily, he also assumes that wealth held via IFCs is able to accrue an 8% return, despite the implication that it is simply stashed in a bank account offshore. The sad reality for offshore depositors is that they receive much lower rates of interest.

Moreover, he reaches his headline-grabbing annual tax loss number of $189 billion by assuming that all of the supposed 80% of offshore wealth that is undeclared is evading three different taxes: income tax, inheritance tax, and wealth tax. In the digital world of tax information exchange under CRS, Zucman's assumptions look prehistoric.