Knockin' on H(e)aven's door.
Sovereign debt crises and hidden wealth

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DebtCon5, EUI, 25-26 May 2022

Motivation

- Capital flight features prominently in contemporary debates about economic development
- Capital is scarce in developing countries, thus the flight of assets is potentially detrimental to development
- Since the great financial liberalization in the 1980s, enormous offshore wealth has developed (about 10% of all global financial wealth)
- Offshore capital - not taxed by anybody, not productive but deployed in wealth management- may exacerbate inequality

Approach

- Despite the emerging literature on offshore accounts, little is known about the relationship between sovereign debt crisis and hidden wealth
- We examine the link between debt crisis and variation of bank deposits in offshore financial centers, in 144 countries over 1970-2020
- We use both an OLS and a stacked Difference-in-Differences estimator
- We take two measures of hidden wealth: (1) bank deposits in offshore financial centers (BIS) and (2) incorporation of shell companies in tax havens (Offshore Leaks Database)

Related work

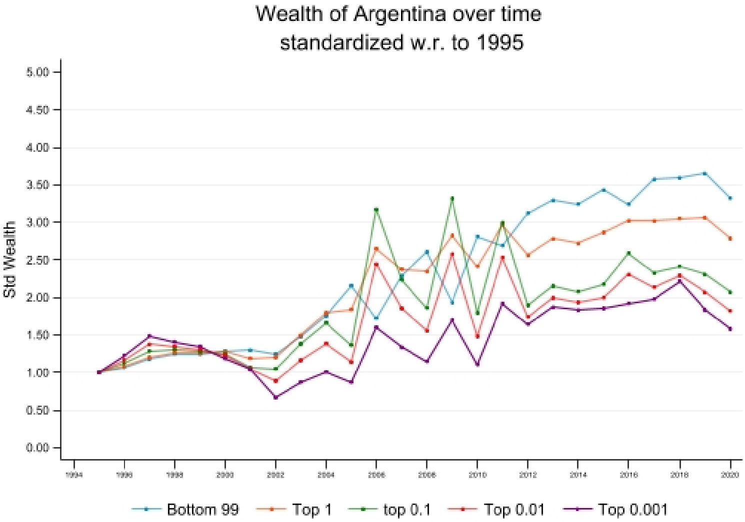
OFFSHORE ACCOUNTS

- Measure net wealth positions and provide estimates of offshore tax evasion (Lane and Milesi-Ferretti 2007; Zucman 2013, Johannesen 2014, Johannesen and Zucman 2014)
- Tax havens as facilitators of corruption (Andersen, Johannesen and Rijkers 2021; Andersen, Johannesen, Lassen and Paltseva 2017)

DEBT CRISES AND INEQUALITY

- In the aftermath of financial crises, redistribution from the non-financial economy to the financial sector widens inequality (Halac and Schmukler 2004); distributive effects of foreign debt service (Frieden 1989, 1991)
- Redistribution effects are based on wealth within the border, while a debt crisis may lead the rich to move financial resources into offshore accounts, shifting the burden of repayment on poorer citizens

A case study: Argentina



Data: offshore wealth

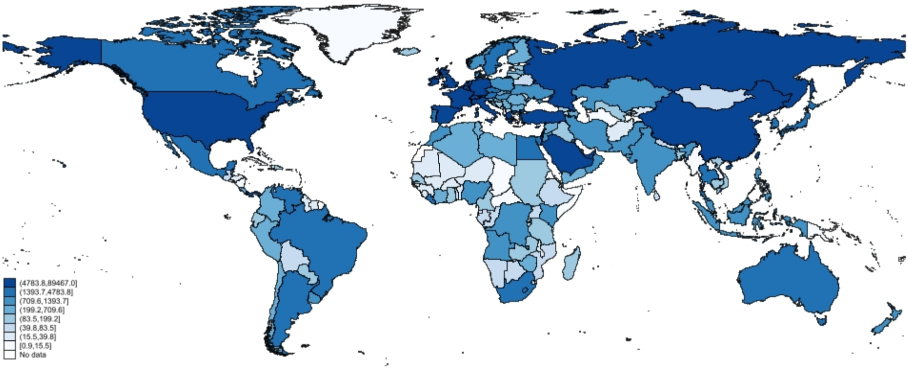
BIS

- Locational Banking Statistics of the BIS: cross-countries bilateral positions since 1977 (quarterly) (value of deposits in Swiss banks owned by Argentina)
- We focus on the non-bank deposits in 9 major tax havens (Hong Kong, Macao, Austria, Belgium, Guernsey, Isle of Man, Jersey, Luxemborug and Switzerland). (Andersen et al. 2021)
- (i) the reported net position toward the last depositor of the funds may not coincide with the ultimate owner; (ii) residents could transfer their capital via other means (e.g., real estate or other securities)

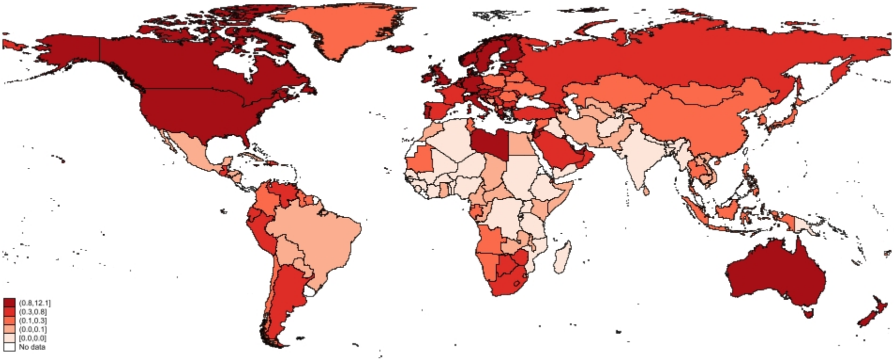
OFFSHORE LEAKS

- Data from 3 leaks occurring between 2010 and 2018 (Panama papers...)
- Collected by the International Consortium of Investigative Journalists (ICIJ) providing information on the identities of the beneficiaries and on the date of incorporation of shell companies
- (i) We observe only the last leg of a chain of incorporations, (ii) we can attribute a country ony to 1/3 of the entities

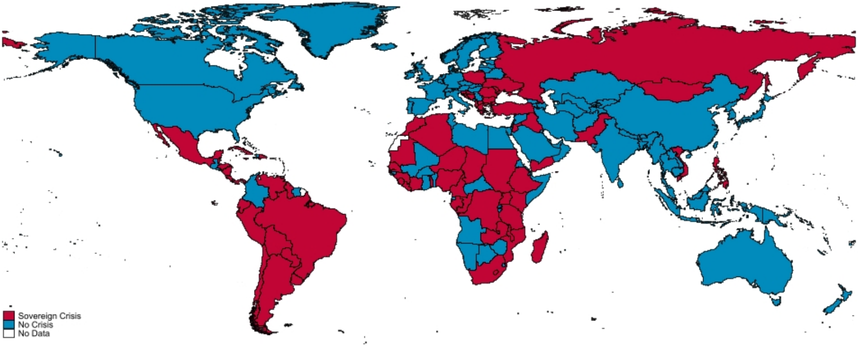
Offshore countries in the sample, BIS



Offshore countries in the sample, Offshore Leaks



Data on sov debt crises

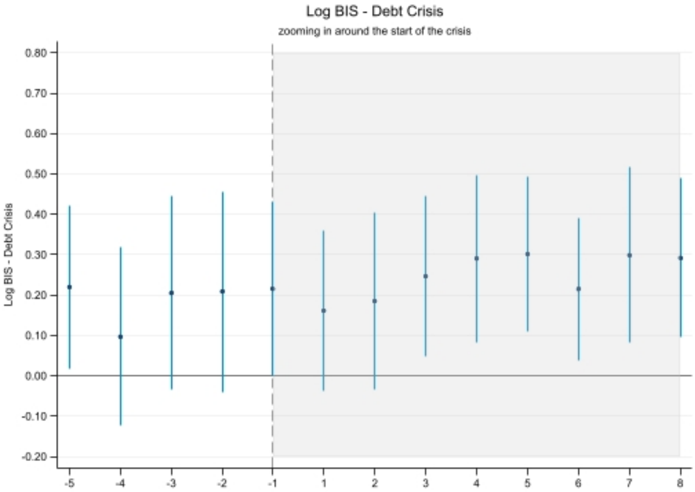


Empirical model

- (1) BIS $log(BIS)_{it}$: the logarithm of the funds country i holds in tax havens in quarter t
- (2) Offshore Leaks Database: $log(shellpercapita_{it})$: measures the number of new per capita offshore entities incorporated in quarter t by country i
- Panel data, two-way fixed effects at the country-year-level, quarterly data, 144 countries over 1970-2020, standard errors clustered at the country level

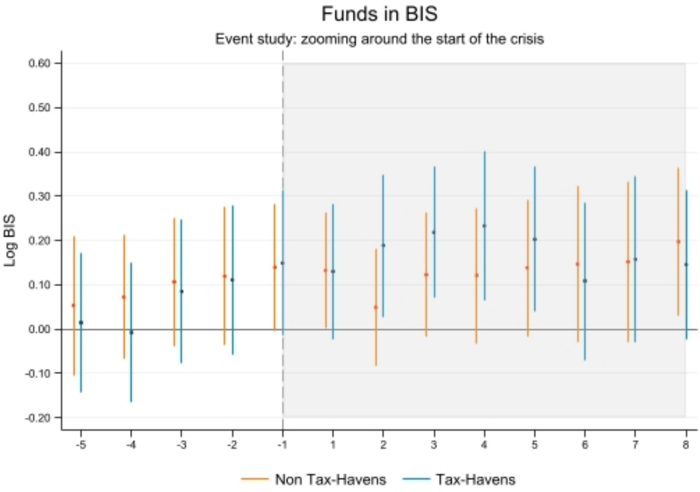
$$d_{i,t} = \beta_h StartC_{i,t+h} + \gamma Z_{i,t-1} + \eta_i + \tau_t + u_{i,t} \qquad h = -5, -4, ..., 7, 8$$

Zooming around the start of the debt crisis



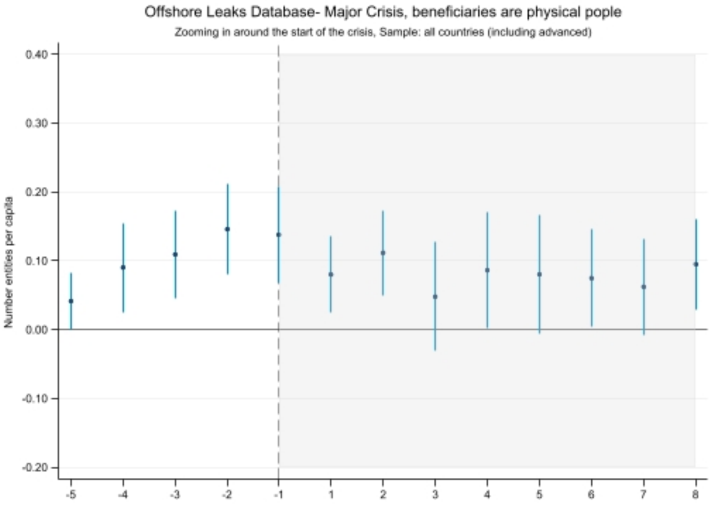
Duration

Start of major crisis, tax havens vs not tax havens



Duration

Start of major crisis, Offshore Leaks



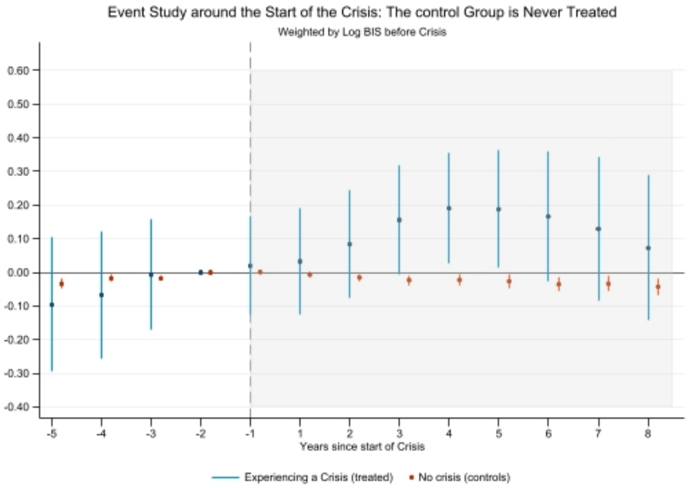
Duration

Stacked DiD

- Two-way fixed effects estimates may produce inconsistent estimates as debt crisis at different points in time
- Alternative estimation strategy: "stacked difference-in-differences" (Cenzig et al. 2019; Deshpande and Li 2019)
- Every country experiencing a debt crisis (*treated*) is compared only to *clean* controls, countries that did not experience a crisis, nor they will ever experience it in our sample (*never treated*)

$$
\begin{aligned}
log(BIS)_{ict} = & \sum_{k=-5,\neq-2}^{k=8} \beta_k (Crisis\ in\ k\ years)_{ck} + \\
& \sum_{k=-5,\neq-2}^{k=8} \delta_k (Crisis\ in\ k\ years)_{ck} \times Treat_{ic} \\
& + \alpha_i + \tau_t + \gamma Z_{i,t-1} + u_{i,c,t}
\end{aligned}
$$

Start of major crisis, tax havens



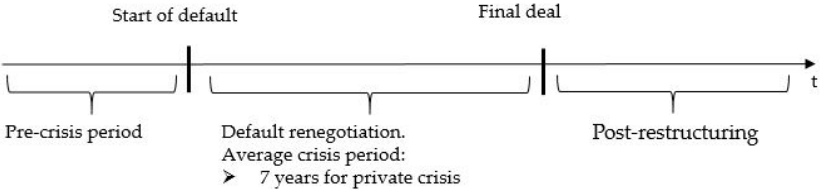
Legal

Conclusion

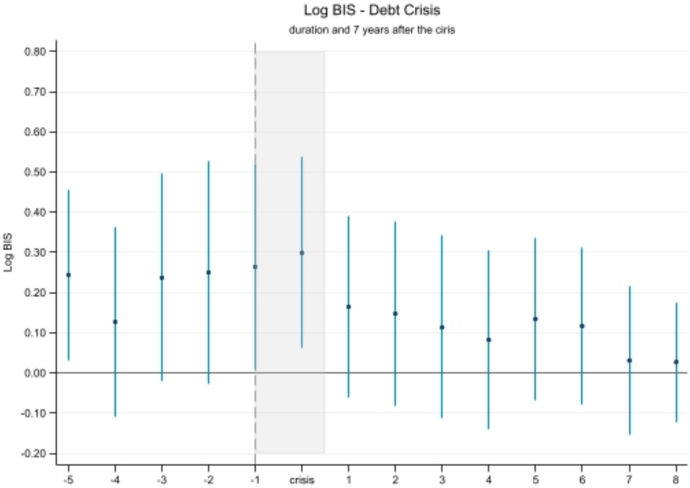
- Relationship between debt (and banking) crisis and variation of bank deposits in offshore financial centers, analyzing 144 countries over 1970-2020
- Using both an OLS and a stacked DiD estimator, we document a relationship between a crisis and and capital outflows to tax havens
- Capital flows to tax havens hinder development: (i) they are not used for productive purposes neither taxed; (ii) they exacerbate inequality
- As the looming presence of debt restructurings, are expected to materialize in the near future, it is important to consider who is going to bear the actual costs of crises

Additional material

Crisis Timeline



Before and after the debt crisis (duration)



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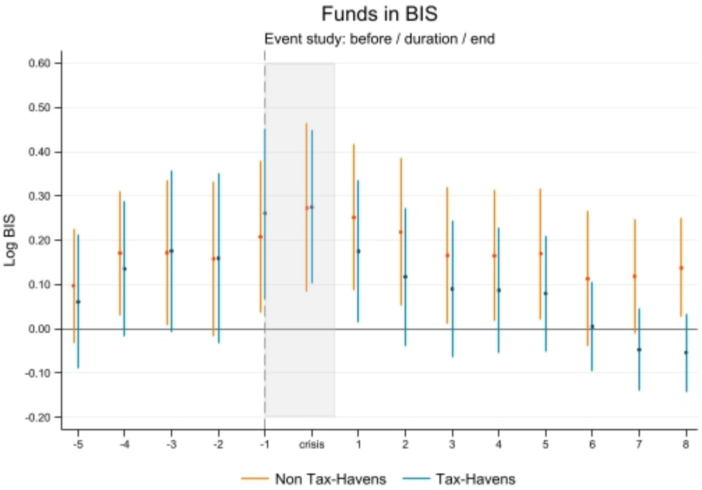
Before and after the major crisis, legal vs illegal (duration)



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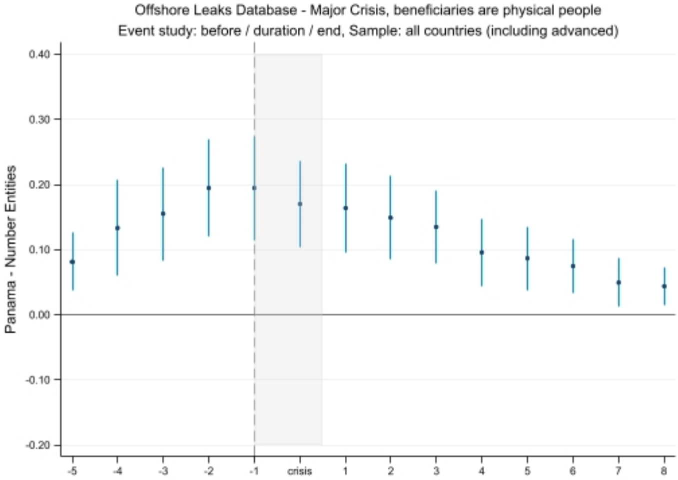
Before and after the major crisis, Offshore Leaks (duration)



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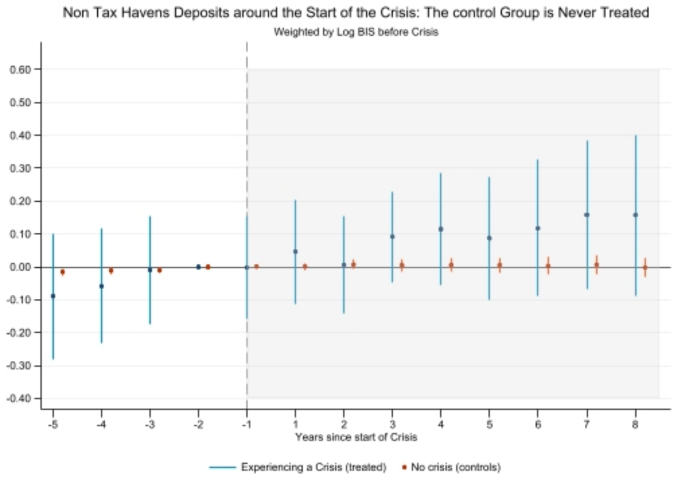
Zooming around start of major crisis, legal, stacked DiD



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