

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

Silvia Marchesi and Giovanna Marcolongo

Milano Bicocca U, Bocconi U

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- 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

- 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)

## OFFSHORE ACCOUNTS

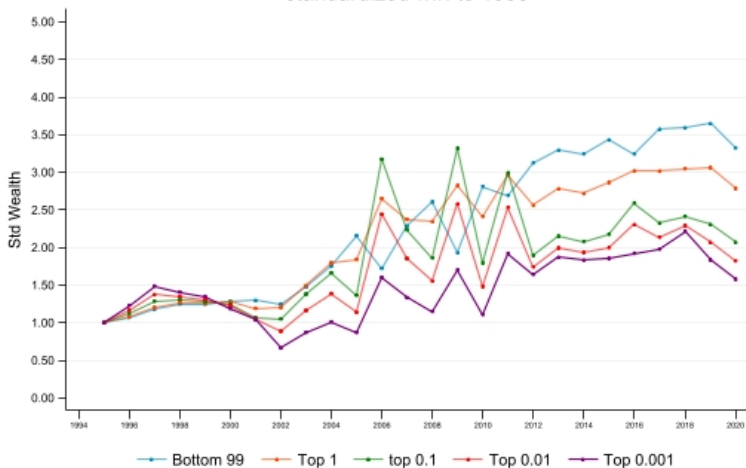
- Measure net wealth positions and provide estimates of offshore tax evasion (Lane and Milesi-Ferretti 2007; Zucman 2013, Johannesen 2014, Johannesen and Zucman 2014)
- Tax havens as facilitators of corruption (Andersen, Johannesen and Rijkers 2021; Andersen, Johannesen, Lassen and Paltseva 2017)

## DEBT CRISES AND INEQUALITY

- Emerging literature on the distributional consequences of sovereign debt crises (e.g., D'Erasmus and Mendoza 2021; Gokmen and Morin 2019; Halac and Schmukler 2004)
- 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

Wealth of Argentina over time  
standardized w.r. to 1995



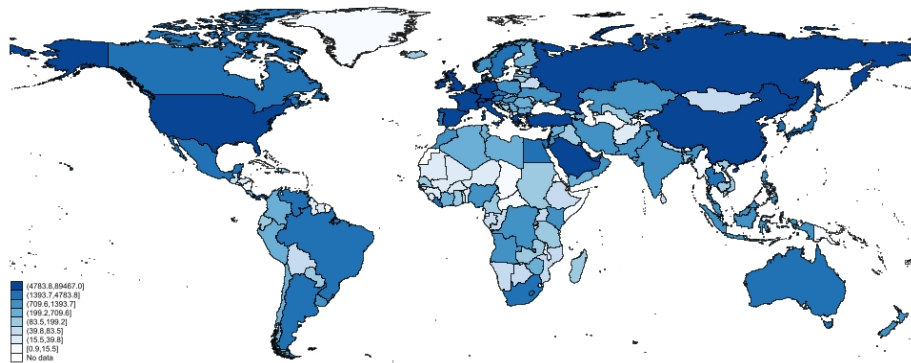
## BIS

- 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)
- Limitations: (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)

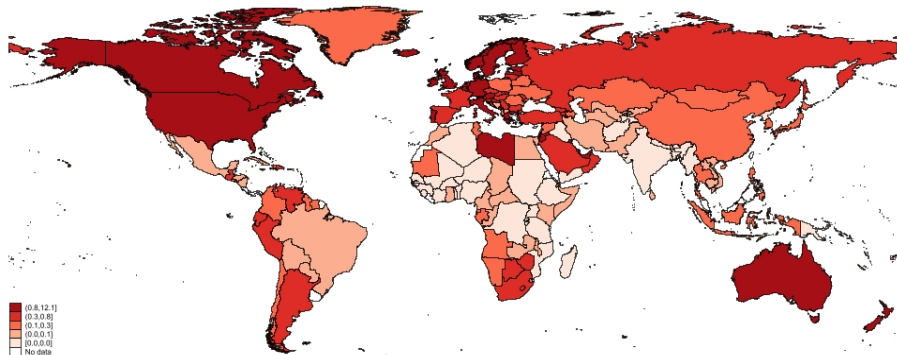
## OFFSHORE LEAKS

- 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
- Limitations: (i) We observe only the last leg of a chain of incorporations, (ii) we can attribute a country only to 1/3 of the entities

# Offshore countries in the sample, BIS



# Offshore countries in the sample, Offshore Leaks



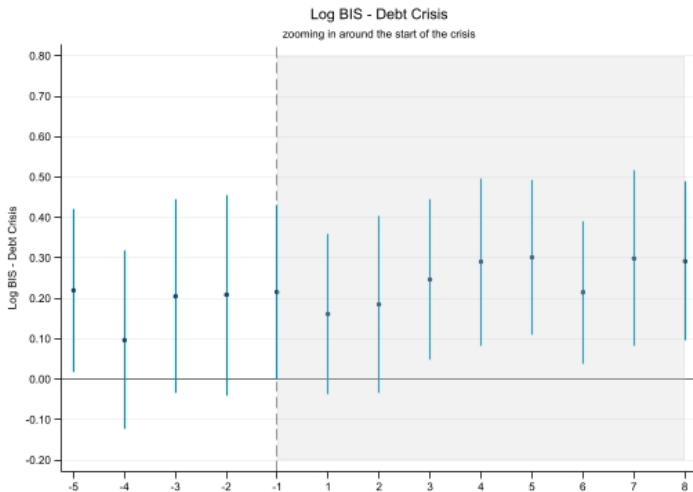




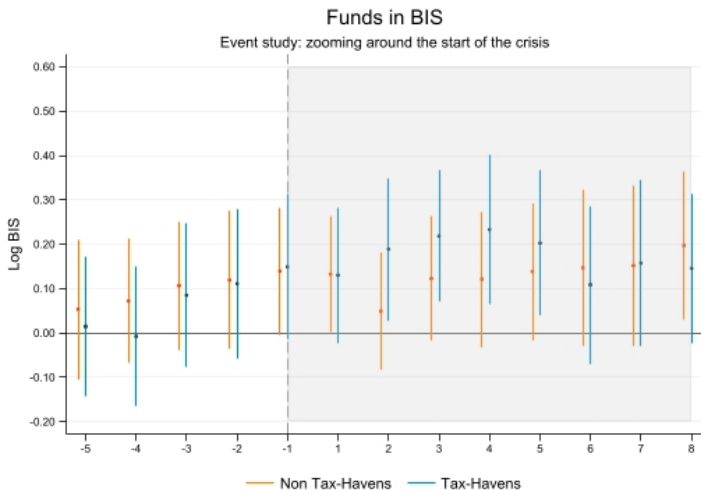
- (1) BIS  $\log(BIS)_{it}$ : the logarithm of the funds country  $i$  holds in tax havens in quarter  $t$
- (2) Offshore Leaks Database:  $\log(shellpercapita_{it})$ : measures the number of new per capita offshore entities incorporated in quarter  $t$  by country  $i$
- Panel data, two-way fixed effects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

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

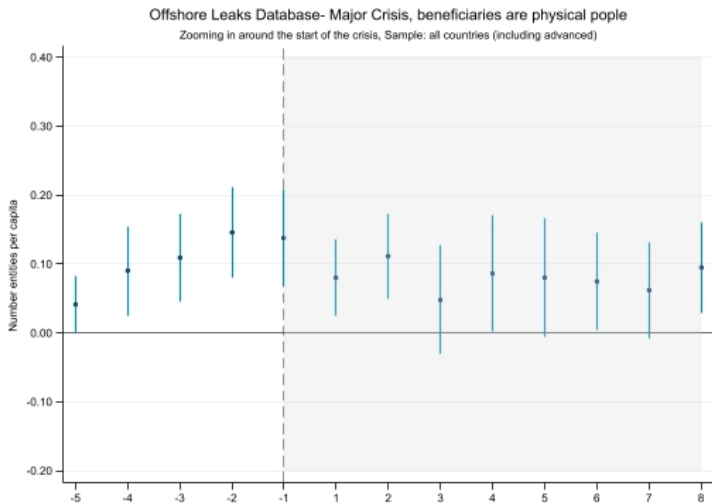
# Zooming around the start of the debt crisis



# Start of major crisis, tax havens vs not tax havens



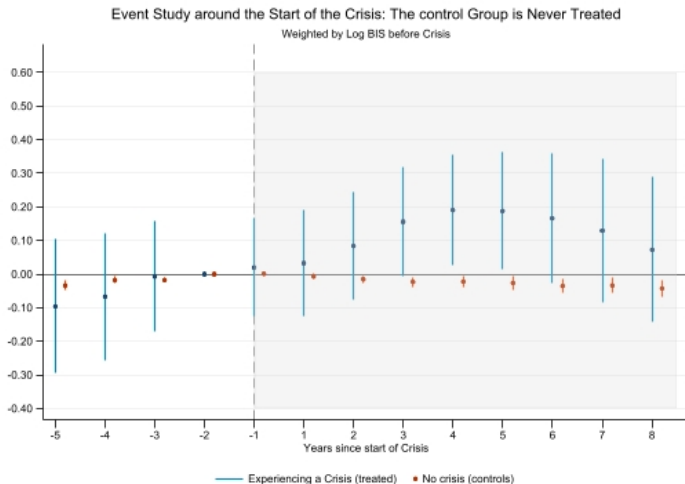
# Start of major crisis, Offshore Leaks



- 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*)

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

# Start of major crisis, tax havens

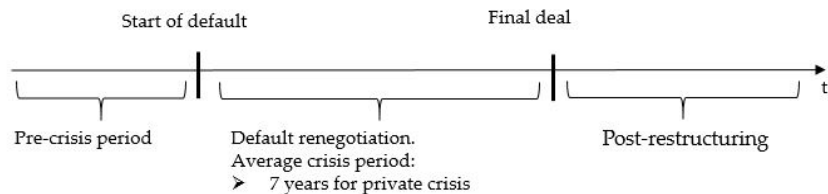


- Relationship between debt (and banking) crisis and variation of bank deposits in offshore financial centers, analyzing 144 countries over 1970-2020
- Using both an OLS and a stacked DiD estimator, we document a relationship between a crisis and capital outflows to tax havens
- Capital flows to tax 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

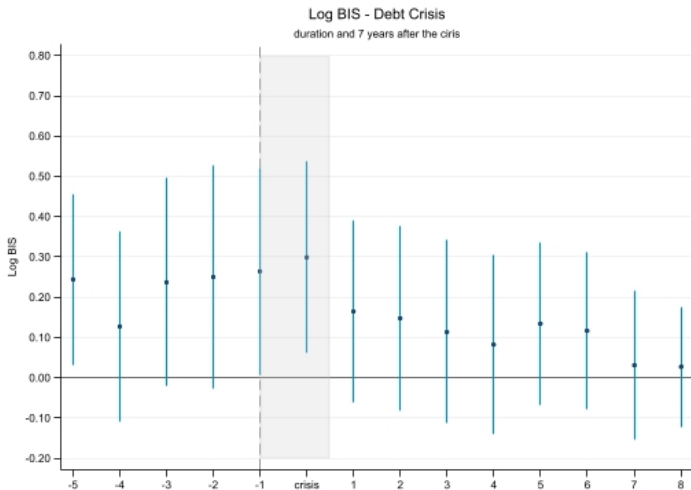


# Additional material

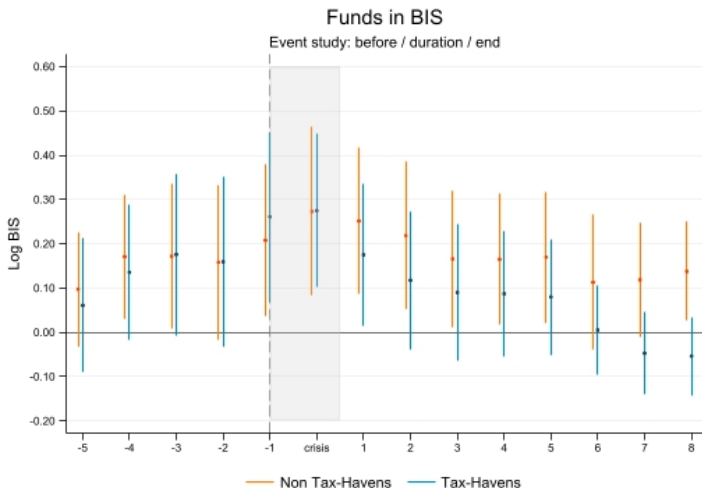
# Crisis Timeline



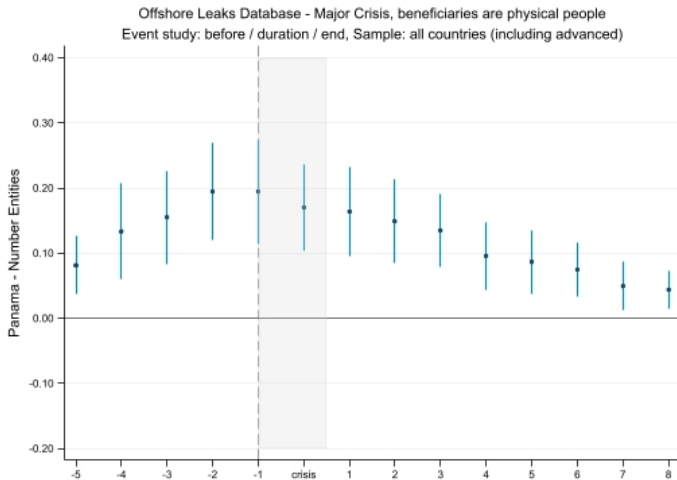
# Before and after the debt crisis (duration)



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



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



# Zooming around start of major crisis, legal, stacked DiD

