TAX JUSTICE FOCUS

The newsletter of the tax justice network

THE INEQUALITY EDITION
VOLUME 7, NUMBER 2

INEQUALITY: IT'S WORSE THAN YOU THINK

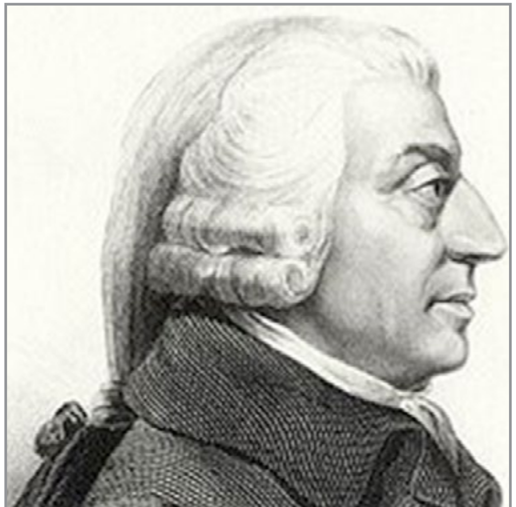
Research on wealth and income has tended to overlook offshore. Nicholas Shaxson, John Christensen and Nick Mathiason explore the yawning gaps in the data..

Economic inequality has reached extreme proportions in many countries and is still widening. But the problem is far worse than previously recognised.

This is because all studies exploring economic inequality have systematically underestimated the wealth and income enjoyed by the world's wealthiest individuals. The enormous quantity of assets held offshore and in opaque and anonymous structures is not factored properly into economists' statistical analyses that inform our understanding of inequality.

For decades, a private and fast-growing global infrastructure of bankers, lawyers, accountants and company and trust formation agents have dedicated their professional lives to hiding the assets of the world's wealthiest individuals, or High Net Worth Individuals (HNWIs) in the bankers' parlance. They have been spectacularly successful.

At its simplest, when an asset is hidden in an offshore bank account, or an offshore trust or company, and the ultimate owner or beneficiary of the income or capital cannot be identified, then this asset and the income it produces are unlikely to be counted in the inequality statistics. If you don't know who owns the asset, you cannot know where to



"The disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition is the great and most universal cause of the corruption of our moral sentiments."

Adam Smith (1723–1790)

Guest Editors: Richard Wilkinson & Kate Pickett
Contributing Editors: John Christensen and Nick Shaxson
Editor: Dan Hind
Design and layout: www.tabd.co.uk
Email: info(at)taxjustice.net
Published by the Tax Justice Network International Secretariat Limited, July 2012

For free circulation, ISSN 1746-7691

"Both wealth and inequality are being underestimated to a very significant degree, in every study and in every country."

allocate it on the income or wealth range. Almost all these hidden assets are owned by the world's wealthiest individuals, so it follows that the inequality statistics, particularly at the top end of the scale, underestimate the scale of the problem.

We interviewed eight of the world's top experts on inequality, and all agree with us. In the words of Milorad Kovacevic, Chief Statistician for the U.N. Human Development Report Office, "I agree with your thesis and I believe - everyone does." Most agreed that no study comes even close to compensating sufficiently. (Our longer report on inequality, entitled *Inequality: you don't know the half of it,* published on July 22, provides more details.)

This study on inequality is complemented by another, much bigger TJN study prepared by TJN senior adviser Jim Henry, former chief economist to McKinsey & Co., which we believe is the most rigorous and comprehensive study ever on the size of wealth sitting offshore. The study, entitled *The Price of Offshore Revisited,* reveals that well in excess of US$ 21 trillion is held offshore, conservatively estimated. This is twice the size of the previous biggest estimate to date.[1]

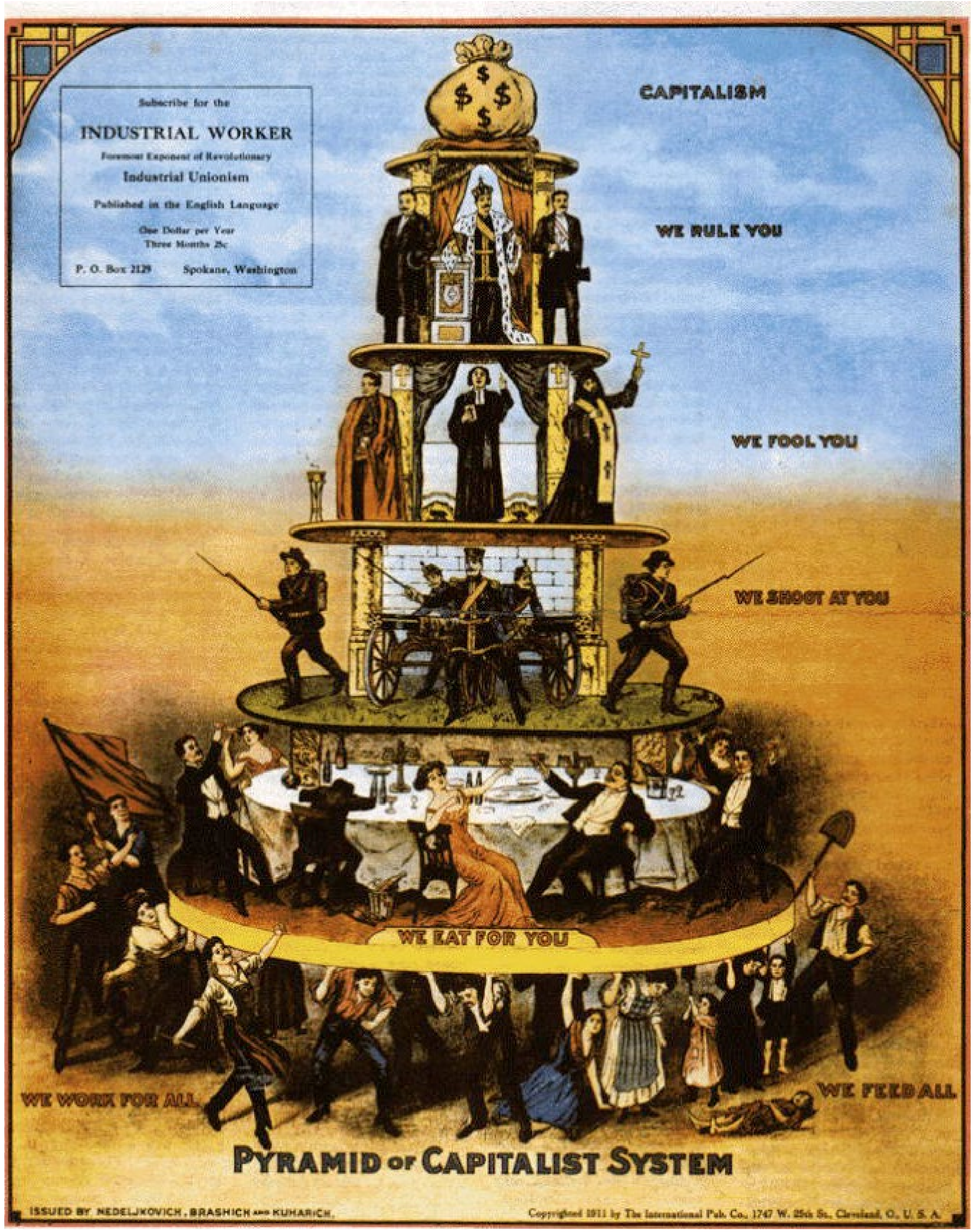
Therefore, both wealth and inequality are being underestimated to a very significant degree, in every study and in every country.

There are, inevitably, nuances in our picture. Because the hidden income is so highly concentrated among the richest 1% it is of course possible to make much sounder measures of the scale of income inequality among the rest of the population. There are also 'missing' assets at the bottom of the income scale, where it is particularly hard to get information about the holdings of the poorest members of society. However, these assets are so tiny compared to the trillions held by the super-rich they make little difference to the overall inequality picture.

What is more, many studies of inequality do recognise that there is a problem with 'missing' assets at the top of the income scale, and try to compensate. But all the experts we contacted agreed that the various methods used to compensate fall a long way short of adequately addressing the problem. Furthermore, before the publication of our major study *The Price of Offshore Revisited,* nobody has access to such comprehensive or such large estimates for the size of the missing wealth.

Our report identifies a number of puzzles, paradoxes and oddities pointing to the problem.

1 The previous biggest estimate was TJN's *The Price of Offshore, published in March 2005.*



In the United States, for example, analysis of income data reveals that the incomes of the top 1% of the U.S. population more than doubled from 1980 to 2010, while the incomes of the top 0.1% more than trebled and the incomes of the top 0.01% more than quadrupled. Over the same period the incomes of the bottom 90% fell by nearly 5%. Yet the wealth data shows a completely different picture: the top 1 percent of households owned 33.8% of all the wealth in 1983, while 26 years later, in 2009, the top 1% owned 35.6%: a tiny increase.[2]

This disconnect creates what Sam Pizzigati, a top U.S. expert on inequality, sees as a major paradox. He sees few possible explanations. People's responses to surveys could be changing over time, but given the depth of research that goes into them that seems unlikely. Another explanation is that "they take that income and blow it on $5,000 dinners every night," he said. "That doesn't make sense. You simply cannot consume away that fantastic amount of money that income inequality has put into their pockets." What is left, then, is a huge pool of missing wealth out there.

Many inequality studies rely on data from tax returns, and here the problems of tax evasion and avoidance rear their ugly heads. Both evasion and avoidance reduce the quality of the tax data used in many inequality studies.

In June 2012 the popular British comedian Jimmy Carr was found to have avoided tax by shifting his earnings to a company in the tax haven of Jersey, then receiving it back as a 'loan', which was not taxable as income. Inequality studies would find this excluded from the income figures, even though most people would argue that it is: even the UK Prime Minister was moved to describe such schemes as 'morally wrong.' The UK tax authorities accepted this, so it was not illegal, but it was clearly abusive, and it raises the question 'what is income?' There are no easy answers.

Other income studies rely on survey data, which has many similar problems, as the example from the United States illustrates. The biggest is that, as study after study finds, the wealthiest sections of society refuse to participate in surveys: as Facundo Alvaredo of the University of Oxford puts it:

> *"while survey interviewers in poor countries can usually collect data in very poor areas, penetrating the gated communities in which many rich people live is often impossible."*

Studies do try to make adjustments for this, but when you are dealing with a society like Britain's where the super-rich are almost entirely untaxed "non-domiciled" members of the Saudi royal family, leaders of powerful Russian crime families, Indian steel magnates and top U.S. financiers, it is hard to know where to start.

With the bottom half of the world's population together possessing barely 1% of global wealth while the top 10% owns 84%,[3] according to traditional estimates, economic inequality is widely and increasingly recognised as a major problem in its own right. Research shows that more unequal societies tend to experience slower growth, higher political instability, and a wide range of negative health and social outcomes.

We have not used Henry's estimates in *The Price of Offshore Revisited* to create new calculations for inequality. We see our report on inequality as a starting point: a canvassing of expert opinion that should serve as a spur to others to conduct proper research to reveal the true picture of the staggering and rising inequality that stalks our financially globalised world.

Nicholas Shaxson is author of Treasure Islands. *John Christensen used to work on inequality measurement. Nick Mathiason writes for the* Bureau for Investigative Journalism. *The text of their full paper is available* here.

2 See Table 2 in EPI Briefing Paper: The state of working America's wealth, 2011: Through volatility and turmoil, the gap widens, By Sylvia A. Allegretto | March 24, 2011 http://www.epi.org/publication/the_state_of_working_americas_wealth_2011/

3 This statistic is from the Global Wealth Report 2011 from the Credit Suisse Research Institute, p10 http://bit.ly/pAHcoa

editorial

INEQUALITY, BEFORE AND AFTER TAXES

Richard Wilkinson & Kate Pickett

Inequality doesn't just affect the poor: it damages the whole social fabric, harming the wellbeing of the vast majority.

Taxation has always been driven by the need to fund public expenditure, and progressive tax rates have been advocated primarily to reflect the ability to pay. But progressive taxation has another hugely important function: it is part of the system for reducing inequality.

For hundreds of years, one of the central pillars of progressive politics has been a commitment to greater equality. But over the last generation, the ground has shifted beneath that commitment. In the 1920s and '30s, when many people still lived in great hardship and squalor, it seemed wrong for others to live in great luxury. But with the transformation in living standards brought about by economic growth, many doubted whether inequality still mattered. As official statistics show, most households in Europe now have central heating and satellite or cable receivers. Most also have a car, a home computer, a CD player and an internet connection.

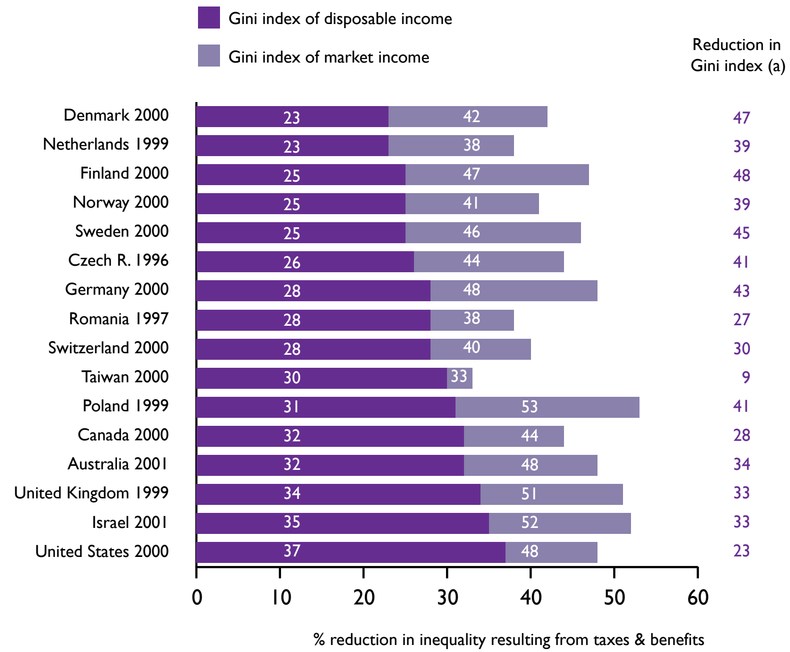
It was this change in living standards that led social democratic politicians in many countries to think that runaway top incomes and rising inequality no longer mattered. But they were wrong: wrong because inequality is not just about differences in material comfort. Even among the richest countries, its powerful psychosocial effects reduce the wellbeing of whole populations.

Inequality is divisive and socially corrosive. For centuries, many people recognised that truth intuitively, but now the data show it is truer than we ever imagined. The bigger the income gaps between rich and poor, the less cohesive the society: community life weakens, people trust each other less and violence increases. Bigger income differences make almost all the problems related to class and status differences worse. The data show that more unequal societies have poorer physical and mental health, lower levels of child wellbeing, higher teenage birth rates, higher levels of imprisonment and of drug abuse, and kids' maths and literacy scores are lower. These problems are between twice and ten times as common in societies with bigger income differences between rich and poor. The differences are so large because inequality doesn't just affect the poor: it damages the whole social fabric, harming the wellbeing of the vast majority.

Politicians who abandoned – or never made – a commitment to greater equality failed to see that differences in material living standards matter far beyond their physical effects. It is because inequality has psychosocial effects that it increases violence, mental illness and drug abuse. It increases feelings of superiority and inferiority, of being valued or devalued, respected or disrespected and looked down on. As Owen Jones' *Chavs* shows, it hurts because we tend to judge people's abilities from their social position and form prejudices against those lower on the social ladder. Status competition and insecurity increase, and social comparisons become more fraught as we all worry more about how we are seen and judged.

So as well as the need to fund public expenditure, progressive taxation is also necessary to reduce the differences in pre-tax incomes. Figure 1 shows how government transfers – taxes and benefits together – reduce the pre-tax income differences in each country.

Figure 1. Income inequality before and after taxes and benefits



Source: Reproduced from Brandolini & Smeeding 2009.

Income inequality before and after taxes and benefits

Of the 16 countries shown in the figure, the four leading English speaking nations, which were early adopters of neo-liberal policies, are clustered at the bottom of the league. The UK had the third most unequal distribution of income before taxes. Although taxes and benefits reduced inequality by 33 percent, it remained one of the most unequal of the rich countries. It is only because of social security benefits that the overall effect of government transfers reduces inequality in the UK: direct and indirect taxes together are not clearly progressive (Byrne & Ruane, Compass 2008). Of the countries shown, government transfers were most redistributive in Finland.

Tax evasion and avoidance among the rich seriously weakens the redistributive effect of income transfers. Although it may seem easier in the current political climate to reduce inequality by campaigning to close tax loopholes and tax havens, Dorling (TJF this issue) uses the very limited data available to estimate that making the rich pay their taxes in full at current rates would not be enough to reverse the increase in inequality which has occurred since the early 1980s.

Nevertheless, while governments across Europe are making cuts in public expenditure to reduce their deficits, the moral case for proper tax enforcement is particularly strong: every €1,000 of tax that the rich avoid paying, creates the need for another €1,000 of cuts to services to the least well off. There is an awful inevitability about how the poorest end up paying for the mistakes and dishonesty of the rich whose actions led to the present recession. The scale of tax avoidance among the rich almost begs everyone else to go on a tax strike until the rich are made to pay.

The article by Piketty, Saez and Stantcheva (TJF this issue) suggests that reductions in top tax rates have usually led not only to increases in post-tax inequality but, more surprisingly, also to widening differences in *pre-tax* incomes. If that is so, then the reductions in top tax rates (which reached over 80 percent in both the UK and USA during the 1960s and '70s) may have been doubly damaging.

If we are to create a more cohesive society and a better quality of life for everyone, then reducing income differences before tax is at least as important as redistribution. The main driver for the widening income differences since the 1970s has been the runaway incomes of the rich. The inflated salaries and bonuses at the top reflect the absence of an effective system of democratic accountability. The average ratio of top-to-bottom full time pay in the FTSE 100 companies is around 300:1. This compares with pay ratios in the public sector (including in the police and armed forces) which are usually between 10:1 and 20:1.) We need to build forms of democratic accountability into large corporations and to support more democratic institutions of all kinds - whether mutuals, friendly societies, employee owned companies or cooperatives. Almost all such companies have much smaller pay differentials within them. Erdal (TJF this issue) contrasts companies run for employees, such the John Lewis Partnership and Waitrose, with those like Marks and Spencer run for external shareholders. He describes how the rise in inequality owes much to the way corporations owned by external shareholders have siphoned money from the producers of wealth into the pockets of the already wealthy.

Rachael Fallis: Hopes and Dreams, winner of the photo competition, The Spirit Level: images of [in]equality, 2011

Among rich nations and among the 50 states of the USA, it doesn't seem to matter whether greater equality comes as a result of smaller differences in incomes before tax or from redistribution through taxes and benefits. Either way, the populations of more equal societies seem to enjoy higher levels of health and wellbeing. So we should campaign for greater equality both through redistribution and by reducing pre-tax income differences. If Piketty, Saez and Stantcheva are right, we will find some synergy between them.

REFERENCES

Jones O. *Chavs: The Demonization of the Working Class.* Verso, London. 2011

Brandolini A, Smeeding TM. Income inequality in richer and OECD countries In: *The Oxford handbook of economic inequality.* Edited by Salverda W, Nolan B, Smeeding TM. Oxford University Press 2009.

Byrne D, Ruane S. *The tax burden: can Labour be called the 'party of fairness?'* Think Pieces No. 40, Compass, London November 2008

TAX DODGING AND INEQUALITIES IN WEALTH IN THE UK

feature

Daniel Dorling

As median incomes and wealth fall, as even the poorest of the best-off five per cent begin to feel the pinch, properly taxing the rich becomes possible again.

Most people pay all their tax. They pay Value Added Tax on most things they buy. If they earn, they pay income tax – as they earn. If they buy a home they pay stamp duty.

Some people dodge a little tax. They buy some cigarettes on the side in the pub, they take care of a friend's child and don't declare it, or they pay a builder cash in hand for a repair (£1.8bn a year is lost due to 'moonlighting', HMRC, 2011).

Corporate tax avoidance (dubious but not strictly illegal) was estimated by the TUC (Trade Union Congress) to be £12bn for the year 2008. Tax avoidance by individuals is believed to cost the Treasury £13bn a year Illegal corporate tax evasion comes to £70bn a year and unpaid corporate taxes to £26bn (TUC, 2010) a year – a total of £121 bn. Those in charge of UK tax inspectorate claim the figures are lower, but the tax inspectors themselves say, in confidence (Goodall, 2012), that the figures are broadly accurate.

These are considerable sums. But even if tax avoidance and evasion cost as much as £120bn a year, and even if all of it were being undertaken by or on behalf of the wealthiest 1% in society (most of it will be) that avoidance, evasion and refusal to pay accounts for only a very small part of the great inequality that has arisen in British society. Ending the dodging would certainly curtail the rise in inequality, but it would not reverse it. This is because the richest 1% are now so incredibly rich and powerful. Tax dodging must be reduced but reducing it alone would not be sufficient to reverse the trends in inequalities to *even* get us back to where we were in the 1980s in terms of how unfair and unequal a nation Britain has become. We know how unfair we now are because inequalities are nowadays more carefully measured.

In January 2010 the National Equality Panel used data from the Office of National Statistics to reveal just how unequal Britain had become. If all wealth is included then the-least-well-off-of the-richest-1%-of-people had £2.6 million or more while the person in the middle of the whole distribution had £204,500 (NEP, 2010. Figure 2.19b). However that figure includes the future estimated value of any pension entitlements you might have and any equity in your home.

The National Equality Panel elaborated to get us a better idea of 'marketable' wealth. If future pension benefits are excluded, then the poorest of the best-off 1% still had wealth in excess of £1.5 million or more while median wealth fell to £145,420 (NEP, 2010, Figure 2.18). Exclude also the estimated equity in the home people lived in and then the poorest of the 1% wealthiest of the population of Britain, had wealth of £665,650 or more, and the median holding was reduced to £42,270 (NEP 2010, Figure 2.17). Meanwhile the mean marketable wealth of the average person in the richest 1% was 175 times high than that median marketable wealth of the population.

To work out the mean marketable wealth of the richest 1% we need to estimate the wealth of everyone richer than the poorest of the 1% richest. The *Sunday Times* Rich list of 2010 showed the best-off 1000 people in Britain, headed by Lakshmi Mital, had a wealth of £335.5bn around that time. The best-off 10 of those 1000 held £69.9bn or 20% of that wealth. If that inequality curve continues down within the richest 1% then the average wealth of someone in the top 100,000 but not the top 1000 would be £13.5mn; the total wealth of the top 100,000 would be £1342bn; and the best-off 1% in total have an average of £7.4mn each (175 times £42,270). That's everyone from Mr-poorest-of-the-1% to Lakshmi inclusive. It's a guestimate. Wealth is secret.

The tables on p7 take a known series of wealth statistics (Dorling, 2011) and then subtract 20 year's worth of the annual £108bn unpaid taxes from the assets of the wealthiest 1% to produce a fictional 2028 wealth distribution if tax had been paid. If this happened then by 2028, instead of the wealthiest 1% having 421 times the wealth of the poorer half of all people in the UK, they would have 217 times, even if all that tax dodging was ended.

Eliminating tax dodging would reduce inequalities in wealth, but not to the levels seen prior to 2006. High income curtailment is also required. No one in the public sector or any private sector body tendering for public sector work should be paid 20 times more than another person. It is a waste of tax-payers' money. Imposing that limit would have a concertina effect down the distribution.

"Changes in tax rates have had an even bigger impact on the amounts the rich pay than evasion, avoidance and non-payment of sums due."

Table 1: Inequalities in Wealth in the UK 1976–2008: Shares of Wealth (%)

	1976	1981	1986	1988	2006-8		2028
					(a)	(b)	
Top 1% of the population	21	18	18	17	28	53	36
Next 4% (top 5% less top 1%)	17	18	18	21	13	10	14
Top half excluding top 5%	54	56	54	56	51	31	42
Bottom half of all people	8	8	10	6	8	6	8
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Townsend 1991, page 33, marketable wealth at death from probate; and final columns calculated by author, a) excluding pension rights and, b) also excluding main residence housing equity from the wealth calculations.

Table 2: Wealth in the UK 1976–2008: comparison with the poor half

Ratio of wealth held	1976	1981	1986	1988	2006-8		2028
					(a)	(b)	
Top 1% of the population	131	113	90	142	165	421	217
Next 4% (top 5% less top 1%)	27	28	23	44	19	20	20
Top half excluding to 5%	8	8	6	10	7	6	6
Bottom half of all people	1	1	1	1	1	1	1

Source: Table 1 above. Wealth of each group is expressed in terms of multiples of the wealth of the average person in the poorer half of UK society. Note the 2028 series continues from 2006-8b. Data sources include NEP (Figure 2.20).

However, even then, and with tax dodging eliminated, the top 5% will still hold half of all wealth by 2028 (they hold 63% today). And most of that top 5%, maybe up to 80% of them or more, will not feel wealthy because they have so little compared to the other 20%.

More progressive income tax is required. Research shows that high rates of income tax do not inhibit economic activity (Picketty *et al,* 2011). A land tax might also be needed if wealth redistribution is to be returned to what it was in 1986 - the last time the poorest half of people in the UK had recourse to as much as a tenth of all wealth. (Table 1) A citizen's income may also be needed.

Changes in tax rates have had an even bigger impact on the amounts the rich pay than evasion, avoidance and non-payment of sums due. The wealthiest 1% have secured a series of changes in government policy. Just quite how they manage this is open to many interpretations, from the influence of press barons to the revolving door between government and the financial sector. But the evidence that this has occurred is easy to see. In countries like Britain where the richest 1% take so much, *effective* taxes on the richest are low and falling. It is not just that income tax on the richest 1% is being reduced on earnings over £150,000, from 50% to 45%, Corporation tax rates were as low as 28% in 2010 and are set of be reduced to 23% by 2013. In itself this is the same in lost revenue as dodging 18% of all that tax.

Manipulating the political process to create a favourable tax regime is only possible when the rest of the population feels it is getting better off. As median incomes and wealth fall, as even the poorest of the best-off 5% begin to feel the pinch, properly taxing the rich becomes possible again. And the wealthy know that.

The wealthy know that many of the options just listed are possible. That is part of the reason they hide so much of their wealth. It is not just to avoid tax. They fear retributive redistribution for the theft of the common wealth of the course of the last generation. The very wealthy often wonder when the 99% of us who have not done so well out of government policy will wake up and do something. They might think we are stupid, but they don't think we are that stupid. If they thought we were really stupid they'd keep all their money in Britain:

"In March 2009 a Swiss banker quoted in the *Financial Times* said he believed that half of all funds deposited in that country would leave if bank secrecy was abolished – implying they must be tainted by tax evasion – and that the bankers know it." (Murphy, 2011, page 33)

Sources

Dorling, D. (2011) Underclass, overclass, ruling class, supernova class, Chapter eight of A. Walker, A. Sinfield and C. Walker, (Eds.) Fighting Poverty, Inequality and Injustice, Bristol: Poverty Press, http://www.dannydorling.org/?page_id=2446

HMRC (2011) Measuring Tax Gaps 2011, An Official Statistics Release 21st September 2011: http://www.hmrc.gov.uk/stats/mtg-2011.pdf

Goodall, A. (2012) HMRC staff 'know' that Richard Murphy is not overstating the tax gap, says PCS, Tax Journal, 22 May, http://www.taxjournal.com/tj/articles/hmrc-staff-know-richard-murphy-not-overstating-tax-gap-46681

Malik, S. (2012) Peter Mandelson gets nervous about people getting 'filthy rich', The Guardian, January 26th, http://www.guardian.co.uk/politics/2012/jan/26/mandelson-people-getting-filthy-rich

Murphy, R. (2011) Tax havens report. London: PCS, www.pcs.org.uk/taxhavens, Quoting Haig Simonian from March 23rd, 2009 in the the FT: http://www.ft.com/cms/s/0/2ed5ef86-17e3-11de-8c9d-0000779fd2achtml

National Equality Panel (2010). An Anatomy of Economic Inequality in the UK. London, Government Equalities Office. http://sticerd.lse.ac.uk/case/_new/publications/NEP.asp

Picketty, P., Saex, E. and Stantcheva, S. (2011) Taxing the 1%: Why the top tax rate could be over 80%, Vox: Research-based policy analysis and commentary from leading economists, *the December, http://www.voxeu.org/index.php?q=node/7402

Ramesh, R. (2012) Britons are stuck in perfect storm of inequality, says Oxfam, The Guardian 14th June. http://www.guardian.co.uk/society/2012/jun/14/britons-stuck-in-perfect-storm-inequality?newsfeed=true

Townsend, P., 1991, The poor are poorer: A statistical report on changes in the living standards of rich and poor in the United Kingdom, 1979-1989, A Report from the Social Policy Monitoring Unit, Department of Social Policy and Social Planning, Bristol: University of Bristol. http://books.google.co.uk/books?vid=ISBN0862923824&redir_esc=y

TUC (2010) The Corporate Tax Gap, Lonodn: TUC, http://www.tuc.org.uk/extras/corporatetaxgap.pdf

Danny Dorling is professor of human geography at the University of Sheffield, England. He is an academic geographer and author whose books include Injustice: Why Inequality Persists *and* The No-Nonsense Guide to Inequality.

HOW EMPLOYEE-OWNERSHIP IS ON THE SIDE OF THE ANGELS: SOME DYNAMICS OF PRE-TAX INCOME

feature

David Erdal

Tax isn't the only way to reduce income inequality. The structure of the enterprise can be used to prevent executive pay and financial engineering from running out of control.

Japanese CEOs are paid a relative pittance, Swedish CEOs are paid a small fortune, but both countries have a relatively low level of inequality in net disposable income. Wilkinson and Pickett have shown how important that is if we want to have a decent society, and indeed both countries excel on social measures of the quality of life. The Swedes lower inequality by having high and strongly progressive tax rates, which are accepted by the great majority of the wealthy. The Japanese don't need to bother – their pre-tax incomes are not so different in the first place.

In most countries personal greed is moderated by an awareness of how others will react: those who run industries, the professional directors, do not use their power to create a grotesque expansion of salaries at the top. This mitigation by cultural values keeps the gap between rich and poor within boundaries, dramatically so in Japan. But in the Anglo-American world there is no such brake on greed and self-aggrandizement. Instead, greed is encouraged and resistance is neutralised by the idea that 'the free market' will produce the best, or the least bad, outcomes for everyone; consequently those who triumph 'in the market' must be allowed, indeed encouraged, in their cupidity.

The element that is missing from this analysis is the distribution of power. The flows of cash from and within companies are not controlled by 'the market'. A business may well be rich or poor depending on how it fares in a competitive market, but the distribution of the wealth created has nothing to do with markets: it is a result of the use of power.

In the case of corporations the right to wield power is bought and sold; where the owners are fragmented, these powers devolve largely onto the CEO and his or her colleagues. This is characterised as private property, but it has little to do with property rights. Equity markets mostly trade the right to wield power over the people who work in the companies, and whose work creates the wealth. That power includes the right to make the decisions (the right to rule) and the right to extract all the wealth created (the right to tax). The people working in the company therefore have no right to be informed, influence the decisions or share in the wealth. Corporations embody the right of one group to rule and tax another, *who lack any entitlement to representation.* Jefferson must spin daily in his grave. This inequality of power and knowledge, inscribed into the legal structure of the limited liability company, makes possible the huge flows of wealth away from the wealth creators to the already wealthy.

Lord Eustace Percy, a Conservative government minister under Baldwin, identified the problem in his Riddell Lecture as early as 1944:

> *Here is the most important challenge to political invention ever offered to the jurist or the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise – the association of shareholders, creditors and directors – is incapable of producing and distributing and is not expected to perform these functions. We have to give law to the real association and withdraw meaningless privilege from the imaginary one.*

"Equity markets mostly trade the right to wield power over the people whose work creates the wealth."

These powers are real, as illustrated by the 2003 private-equity acquisition of the Debenhams retail group. The 'investors' put in £600 million and extracted over £1billion in the first year, removing every scrap of remuneration possible from the people who actually kept the business successful, sacking a great number to replace them with fewer and less expert people on lower pay, and hobbling the company with enormous debt. And why not? They had bought the right to rule and instead of using it to strengthen the business they were perfectly free to use it to tax the business into the ground. Not surprisingly, the reputation of the company on the high street plummeted. In the City that behaviour is justified as the market at work, but it is not: it is the use of naked tyrannical power. And what that did for the distribution of wealth in the UK is clear – those at the bottom got less, those at the top enormously more. People with unchecked power tend to enrich themselves and impoverish those they rule.

Even in more respectable businesses than the bad end of private equity the existence of those powers has enabled the runaway acceleration of inequality seen over the last four decades. Take two of the other great names on the British high street: Marks and Spencer (M&S) and the John Lewis Partnership (JLP), which includes the food retailer Waitrose. M&S is conventionally structured, owned mainly by City financial institutions. JLP is owned by a trust for its employees, with no outside owners. The contrast in what happened over the last year is instructive. The average pre-tax pay per full time equivalent employee – in JLP they are called 'partners' – was very similar, between £21,000 and £22,000. Employee-owned JLP then took £165 million from profits and distributed it to all partners as a bonus of seven weeks' salary, taking the average earnings to over £24,000. The economic effect in the local communities, and the impact on the lives of tens of thousands of families, will have been huge. M&S, by contrast, paid out £268 million to its shareholders. The money was sucked out of the local, real economy and passed to extremely high-paid fund managers and others to 'invest', taking fees and bonuses on the way.

So the effect of two very similar businesses on the distribution of wealth was very different. JLP distributed profits to its 78,700 partners in a broadly equitable way. M&S passed profits to some of the wealthiest people in society. This is not because of any nefarious intent, but because of the way that the ownership is structured.

And that is not the end of the effect on inequality. In addition to the sharing of profit, there is the sharing of pay – here too M&S is making the rich richer. The CEO of M&S received in the previous year about five times what the Chairman of JLP earned. Among the other directors there is similarly a large difference between the two companies, exacerbated by complex share bonus systems in M&S. In JLP, as in other employee-owned companies such as Arup and Scott Bader and Tullis Russell and Swann Morton and Childbase and many others, those at the top show more restraint.

Again, this is about power: the incentive structure for CEOs changes radically with the knowledge that they will be re-elected – or not – at the AGM by the people they manage through the year. The CEO's interests are aligned with everyone else's: they will *all* do better by making the business successful. Empowered employee representatives can control more effectively than outside shareholders any CEO's tendency to indulge in greed. Governance in this structure is tighter than the conventional model, and also than the German co-determination model, which still works in the context of a fundamental conflict between the owners and the employees.

What do shoppers think? Year after year, they rate John Lewis and Waitrose higher than M&S, usually at the very top. There is no justification whatsoever for the idea that the conventional model leads to better performance: actually, employee-owners build better businesses.

Things are worse than Percy realised: the privilege given to shareholders is far from being 'meaningless'. It gives those at the top the power to keep down the earnings of those at the bottom, and to cream off vast fortunes for themselves. And since ordinary people pay their taxes, but the wealthy are capable of getting round many of theirs, the after-tax gap is even worse.

David Erdal researches at the University of St Andrews, Scotland. He has been a trade union shop-steward, a professional communist organiser, ran one of Britain's most successful paper manufacturers (and moved them into all-employee ownership), and advised companies, trade unions and governments in Slovenia, Zimbabwe, China and South Africa on employee ownership. He is the author of Beyond the Corporation *and* Local Heroes.

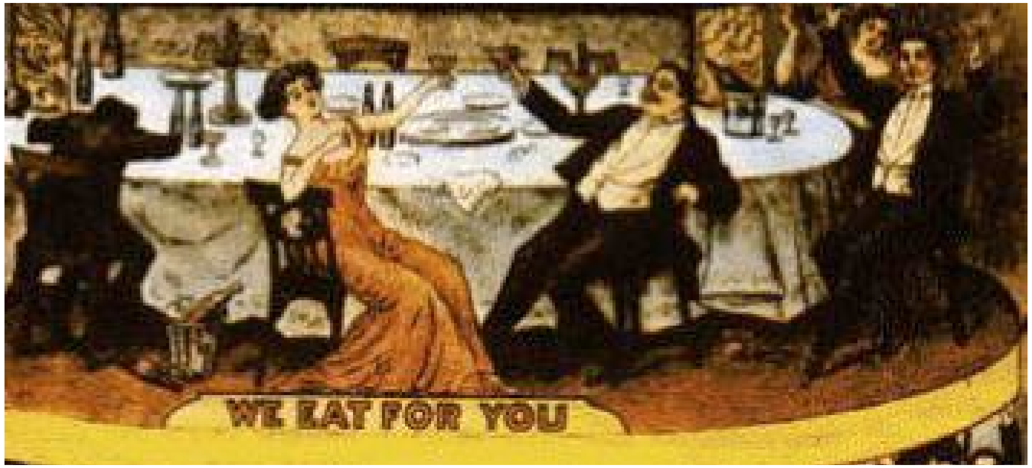
HOW MUCH SHOULD THE RICH PAY IN TAXES?

THE EFFECTS OF TOP TAX RATES ON WORK, TAX AVOIDANCE, AND RENT-SEEKING

feature

Thomas Piketty, Emmanuel Saez & Stefanie Stantcheva

Research shows that lower tax rates for high earners correlates closely with runaway pre-tax incomes for a lucky few.



In the United States, the share of total pre-tax income accruing to the top 1% has more than doubled from less than 10% in the 1970s to over 20% today (CBO, 2011 and Piketty and Saez, 2003). Income concentration has increased substantially in a number of other OECD countries, especially English speaking countries, but only modestly in continental Europe or Japan (World Top Incomes Database, 2011). This heterogeneity across countries implies that, contrary to a widely held view, new technologies or globalization, which have affected all OECD countries, cannot explain those changes.

At the same time, top income tax rates on upper income earners have declined significantly since the 1970s in many OECD countries, again particularly in English speaking ones. For example, top marginal income tax rates in the United States or the United Kingdom were above 70% in the 1970s before the Reagan and Thatcher revolutions drastically cut them by 40 percentage points within a decade. At a time when most OECD countries face large deficits and debt burdens, a crucial public policy question is whether governments should tax high earners more. The potential tax revenue at stake is now very large. For example, doubling the average US individual income tax rate on the top 1% income earners from the current 22.5% level to 45% would increase tax revenue by 2.7% of GDP per year,[1] as much as letting all of the Bush tax cuts expire. This simple calculation is static however and such a large increase in taxes might affect the economic behavior of the rich and the income they report pre-tax, the broader economy, and ultimately the tax revenue generated. Piketty, Saez, Stantcheva (2011) analyze this issue both conceptually and empirically using international evidence on top incomes and top tax rates since the 1970s.

Figure 1 illustrates the strong correlation between the reductions in top tax rates and the increases in top 1% *pre-tax* income shares from 1975-9 to 2005-10 across 18 OECD countries. For example, the United States experienced a 35 percentage point reduction in its top income tax rate and a very large 10 percentage point increase in its top 1% pre-tax income share.

In contrast, France or Germany saw very little change in their top tax rates and top 1% income shares. Hence, the evolution of top tax rates is a good predictor of changes in pre-tax income concentration. There are three scenarios to explain this strong response, which can be tested and have very different policy implications.

First, higher top tax rates may discourage work effort and business creation among the most talented--the so called supply-side effect. Accordingly, lower top tax rates would encourage economic activity among the rich and hence economic growth. If the correlation documented in Figure 1 were due entirely to such supply-side effects, the revenue-maximizing top tax rate would be 57%. This implies that the United States still has some leeway to increase taxes on the rich, but many European countries have not.

Second, higher top tax rates can increase tax avoidance. In this scenario, increasing top rates in a tax system riddled with loopholes and tax avoidance opportunities is not beneficial. Instead, a better policy

1 This calculation assumes that the top 1% income share is 20%. The top 1% income share peaked at 23.5% in 2007, and then fell to 21% in 2008 and 18% in 2009, at the trough of the recession. In 2010 and 2011, the top 1% income share is very likely to increase again to 20%. Total market income reported for tax purposes is about 60% of GDP (on average from 1999 to 2008). Hence, increasing the top 1% average tax rate by 22.5 points raises .6*.225*.2=2.7% of GDP, or $405 billion given the current 2011 GDP of $15 trillion.

"we find that CEOs are consistently rewarded for good outcomes which are directly due to a good industry-wide climate, and hence not achieved by hard work. Furthermore, we find that 'pay-for-luck' is strongly affected by top tax rates: higher top tax rates decrease pay for luck and in the low tax years since 1987, 'non-deserved' pay-for-luck has increased for US CEOs"

would be to first close loopholes, eliminate most tax avoidance opportunities and only then increase top tax rates. With sufficient political will and international cooperation in tax enforcement, it is possible to eliminate most tax avoidance opportunities, which are well known and documented. With a broad tax base offering no significant avoidance opportunities, only real supply side responses would limit how high the top tax rate can be set.

Third, while standard economic models assume that pay reflects productivity, there are strong reasons to be sceptical, especially at the top of the income distribution where the actual economic contribution of managers working in complex organisations is particularly difficult to measure. In this scenario, top earners might be able to partly set their own pay by bargaining harder or influencing compensation committees.

Naturally, the incentives for such 'rentseeking' are much stronger when top tax rates are low. In this scenario, cuts in top tax rates can still increase top income shares – consistent with the observed trend in Figure 1 – but the increases in top 1% incomes now come *at the expense* of the remaining 99%. In other words, top rate cuts stimulate rent-seeking at the top but not overall economic growth – the key difference with the first, supply-side, scenario.

To tell these various scenarios apart, we need to first analyse to what extent top tax rate cuts lead to higher economic growth. Figure 2 shows that there is no correlation between cuts in top tax rates and average annual real GDP-per-capita growth since the 1970s. For example, countries that made large cuts in top tax rates such as the United Kingdom or the United States have not grown significantly faster than countries that did not, such as Germany or Denmark.

Hence, a substantial fraction of the response of pre-tax top incomes to top tax rates

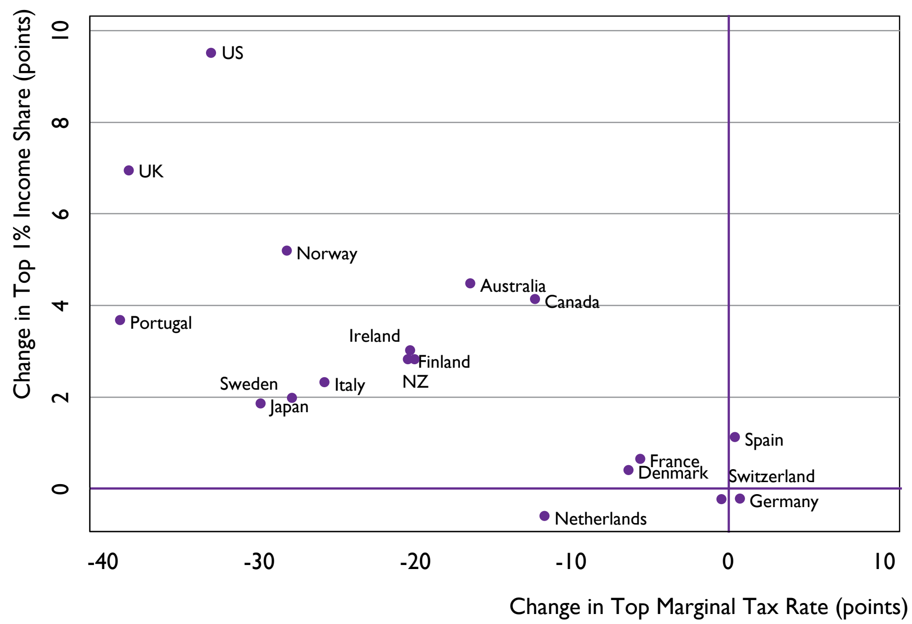


Figure 1: Changes in Top 1% Pre-Tax Income Shares and Top Marginal Tax Rates since the 1970s.

The Figure depicts the change in top 1% pre-tax income shares against the change in top marginal income tax rates from 1975-9 to 2004-8 for 18 OECD countries (top tax rates include both central and local individual income tax rates, exact years vary slightly by countries depending on data availability in the World Top Income Database). Source is Piketty, Saez, and Stantcheva (2011), Figure 4A.

documented in Figure 1 may be due to increased rent-seeking at the top rather than increased productive effort. Naturally, cross-country comparisons are bound to be fragile, but by and large, the bottom line is that rich countries have all grown at roughly the same rate over the past 30 years – in spite of huge variations in tax policies. Using our model and mid-range parameter values where the response of top earners to top tax rate cuts is due in part to increased rent-seeking behaviour and in part to increased productive work, we find that the top tax rate could potentially be set as high as 83% – as opposed to 57% in the pure supply-side model.

To complement our macro evidence, we also directly analyze CEO compensation in the US. We first ask to what extent CEOs are rewarded for outcomes that are the result of 'luck' rather than of their own efforts. This is a form of rent seeking and bargaining because if CEOs were paid according to their real performance, luck shocks should be filtered out. Using a methodology pioneered

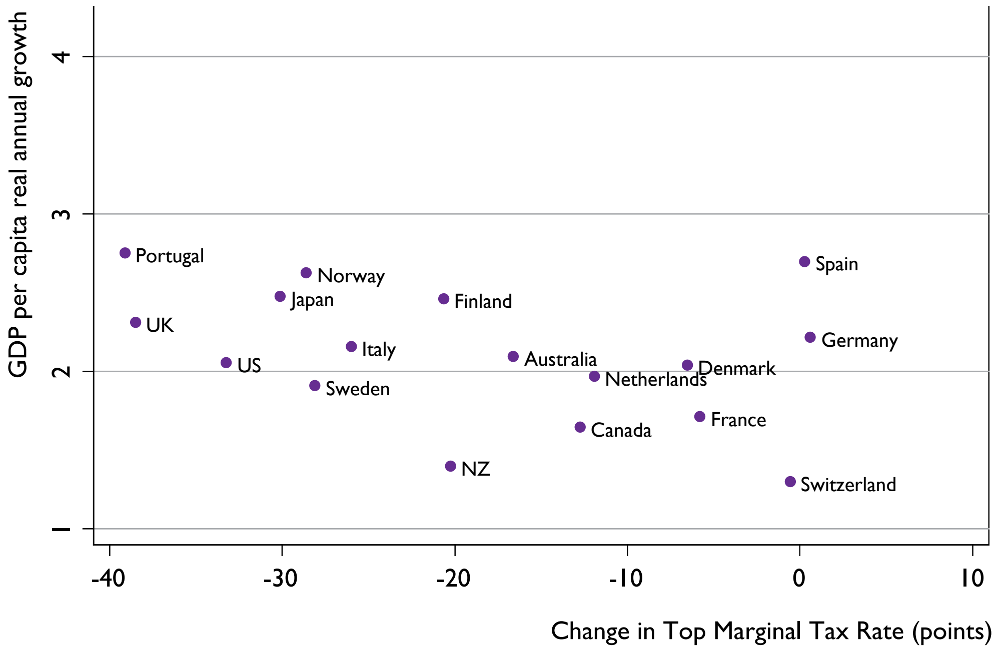


Figure 2: GDP per Capita Growth Rates and Top Marginal Tax Rates since the 1970s.

The figure depicts the average real GDP per capita annual growth rate from 1975-9 to 2004-8 against the change in top marginal tax rates from 1975-9 to 2004-(exact years are the same as Figure 1 and vary slightly by countries). The correlation is virtually zero and insignificant suggesting that cuts in top tax rates do not lead to higher economic growth. Source is Piketty, Saez, and Stantcheva (2011), Figure 4B.

by Bertrand and Mullainathan (1991), we find that CEOs are consistently rewarded for good outcomes (such as increases in Shareholder wealth, Net income or Return on Equity) which are directly due to a good industry-wide climate, and are hence not achieved by hard work. Furthermore, we find that 'pay for luck' is strongly affected by top tax rates: higher top tax rates decrease pay for luck and in the low tax years since 1987, "non-deserved" pay for 'luck' has increased for US CEOs.

In our view, the rent-seeking model is the right framework to account for the very high, quasi-confiscatory top marginal tax rates-80% or more-in the United States and the United Kingdom between the 1940s and the 1970s. That is, policy makers and public opinion at that time probably considered - rightly or wrongly - that at the very top of the income ladder, pay increases reflected mostly greed or other socially wasteful activities rather than productive work effort. The Reagan and Thatcher revolution has succeeded in making such confiscatory top tax rate levels unthinkable since then. But after decades of increasing income concentration that has brought back a new Gilded age, mediocre growth since the 1970s, and a Great Recession triggered by financial sector excesses, a rethinking of the Reagan and Thatcher revolutions is perhaps underway.

The Occupy movement and its famous "we are the 99%" slogan reflects the view that the top 1% may have gained at the expense of the 99%. In the end, the future of top tax rates depends on the public's perceptions of whether top pay fairly reflects productivity or rather unfairly arises from rent-seeking. With higher income concentration, top earners have more economic resources to influence social perceptions (through think tanks and media) and policies (through lobbying), thereby creating some reverse causality between income inequality, perceptions, and policies. In addition, tax policy and tolerance for high CEO pay may both be the result of social norms which have evolved over time. We hope economists can enlighten these perceptions with compelling theoretical and empirical analysis.

References

Congressional Budget Office (2011) *Trends in the Distribution of Household Income Between 1979 and 2007*, US government Printing Press: Washington DC. Available online at http://www.cbo.gov/ftpdocs/124xx/doc12485/10-25-HouseholdIncome.pdf

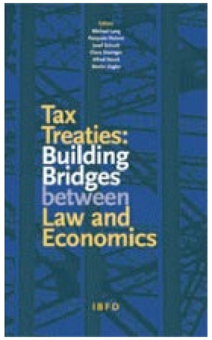
Piketty, Thomas and Emmanuel Saez "Income Inequality in the United States, 1913-1998", Quarterly Journal of Economics, 118(1), 2003, 1-39, series updated to 2008 in July 2010, online at http://elsa.berkeley.edu/~saez/

Piketty, Thomas, Emmanuel Saez, and Stefanie Stantcheva "Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities", NBER Working Paper No. 17616, November 2011, online at http://www.nber.org/papers/w17616

The World Top Incomes Database (F. Alvaredo, T. Atkinson, T. Piketty, and E. Saez), online at http://g-mond.parisschoolofeconomics.eu/topincomes/

Stefanie Stantcheva is studying for a doctorate at the Massachusetts Institute of Technology. Thomas Pickety is Professor of Economics at the Ecole des hautes études en sciences sociales and at the Ecole d'Economie de Paris. Emmanuel Saez is Professor of Economics and Director of the Center for Equitable Growth at the University of California, Berkeley.

reviews



Tax Treaties: Building Bridges between Law and Economics

Michael Lang, Pasquale Pistone, Josef Schuch, Claus Staringer, Alfred Storck, Martin Zagler (editors)

Vienna, IBFD, 2010

Review by Francis Weyzig

"What do you get if four academics-cum-tax advisors from Liechtenstein write on exchange of information?"

Legal and economic scholars live in two different worlds. They do have something in common, though: if you are a full-time scholar in one of these disciplines, you must be either a loser or an idealist - otherwise, you would be earning several times more in a private firm. Anyway, most of us live in yet a different world: the real world, whose problems are more basic and nonetheless more persistent than studies from either discipline would suggest.
Building bridges between individual disciplines can help bring different worlds together. In March 2010, the Vienna University of Economics and Business organized a cross-disciplinary research conference on tax teaties. The IBFD later published a volume with 22 of the conference's papers, called *Tax Treaties: Building Bridges between Law and Economics*. (See the overall description, and the table of contents here). It includes excellent papers that succeed in integrating legal and economic perspectives that provide insights relevant to the real world. However, other papers miserably fail to provide any trace of cross-disciplinary work, and some even should never have been accepted for an academic volume. I start with the good, then turn to the bad, and finally to the ugly.

The economic research paper by Barthel et al., on the relationship between tax treaties and FDI into developing countries, is a good example of bridge building. Whereas economists typically assume that tax treaties attract FDI because they eliminate double taxation, Barthel et el. acknowledge that most treaty provisions are concerned with how taxing rights are allocated between jurisdictions and, in theory, do not have a dramatic impact on the overall tax burden. The core of their paper is their econometric analysis, presented so that it is easily understandable for non-economists, and showing a positive relationship between tax treaties and FDI. They infer that tax treaties have a signalling role, while noting that the results can also be explained by the transition to market economies driving both the conclusion of tax treaties and the increase in FDI.

The paper should be read in conjunction with Pistone's and Thuronyi's legal papers. Pistone argues that the OECD model treaty interferes with the policy needs of developing countries, because it allocates a higher share of taxing rights to capital-exporting countries. Economists often assume this makes the system more efficient, but Pistone questions that assumption in the context of international tax planning, notably multinationals avoiding tax on foreign income. He concludes that developing countries would benefit from replacing shared allocation of taxing powers with exclusive allocation to one country. Thuronyi notes that evidence from econometric studies on tax treaty effects is not surprising, because investors often route FDI through a country that has a treaty with the target country. He argues that tax treaty negotiations are extremely complex, whereas most treaty effects, including enhanced investor confidence, can also be accomplished by unilateral measures. For issues that must be addressed internationally, such as exchange of information, a "light" multilateral treaty might be ideal.

In another example of bridging disciplines, Gérard and Traversa present an economic model of a multinational established in three countries. The model involves quite intuitive assumptions and shows that profit shifting to the lowest-tax country can be countered if the other countries adopt consolidation and formula apportionment, supplemented by a foreign tax credit system and CFC rules. The paper continues with a detailed legal analysis and concludes it is nearly impossible to implement such a proposal in the EU.

In these four papers, the bridging follows a particular pattern: legal insights reveal that standard economic results do not fully hold in the real world. One lesson is that developing countries should think twice before negotiating a bilateral tax treaty. This may be enlightening, but apparently there is only one-way traffic on the bridge. Why does the volume not provide examples of economic insights that put legal analysis into perspective? One reason might be that the volume includes too few economic papers. Another reason is that many of the legal papers are bad ones.

Leaving aside a couple of essay-like pleas, many papers are written in the worst of legal academic traditions. To put it bluntly, these papers

reviews (cont'd)

are pointless narratives, without an analytical framework, that comment endlessly on tax treaty commentaries and case law, notably the *Prévost* and *Indofood* cases.Various papers lack a proper introduction, a lead question or purpose, or even a conclusion. (The worst of economic traditions is represented too: Eggert et al. present a highly artificial game model of tax competition in a paper that is difficult to follow even for economists.)

Then there is the ugly. What do you get if four academics-cum-tax advisors from Liechtenstein write on exchange of information? You guessed it: a highly selective reading of law and economics in defence of "the level playing field of tax competition". Unashamedly, Wenz et al. argue it is not necessarily bad for high-tax countries that tax havens allow wealthy individuals to evade tax, because this, they claim, keeps the wealthy from physically migrating abroad.

Perhaps the next bridge should connect to political science, to assess how special interests and power relations influence the outcomes of tax policy – getting ever closer to the real world.

news in brief...

The European Commission 'puts forward a Communication on concrete ways to tackle tax evasion and fraud in EU'

In a press release in late June the Commission noted that 'some studies estimate the level of tax evasion and avoidance in Europe to be around €1 trillion, and recent reports also suggest that tens of billions of euros are off-shore, unreported and untaxed.'

The Commission will present an 'Action Plan on fighting fraud and evasion together with its initiative on tax havens and aggressive tax planning' by the end of the year.

Automatic for the People: OECD Stops Taking Requests from Tax Havens

The OECD has long fended off automatic information exchange by insisting that 'exchange on request; was the 'internationally agreed standard'. But in a June report the Secretariat acknowledged that automatic exchange provided 'a useful way to implement enhanced international tax co-operation'.

This is a major change of heart from the OECD and creates new problems for offshore centres like Switzerland, which have protected effective banking secrecy by insisting that they comply with OECD guidelines.

Nick Shaxson writes in more detail about the difference between 'automatic' and 'on request' information exchange here.

Economist: Tax Capital!

In May the *Economist* gave a respectful hearing to the idea that taxes on capital might not be quite as disastrous as many conventional economists think they are. For one thing, as Thomas Picketty and Emmanuel Saez – co-authors of a piece for us on top rates of income tax in this edition of the Focus - point out, conventional economists tend to ignore the existence of inheritances.

The newspaper goes on to note the duo's suggestion that 'capital-tax rates as high or higher than those on labour may make sense'. This is because, 'when wage taxes are high and capital taxes are low, firms simply shift compensation from salaries to stock options and dividends, cutting revenue without boosting growth'.

Of course, the *Economist* knows that higher taxes on capital will require greater coordination between countries to prevent 'footloose companies' from 'shopping for the tax regime they find most attractive.'

How long before the *Economist* joins the Tax Justice Network?

The IMF and the Return of the Repressed

For decades the International Monetary Fund argued that controls on international capital were counter-productive. In the last few years they have been revising their position. Now, as the *Financial Times* notes, the organization believes that 'capital flow management measures' on inflows are 'permissible en route to liberalization'. Even restrictions on outflows can be countenanced 'in or near financial crises'.

Though this falls some way short of a return to its Keynesian founding principles, the IMF is slowly moving away from its disastrous advocacy of breakneck capital market liberalization. This is how the era of 'globalization' ends, one shame-faced policy paper after another.

A Funny Thing Happened on the Way to Jersey

Comedian Jimmy Carr helped raise the profile of tax avoidance in Britain when the *Times* reported that he had been part of a large and controversial Jersey-based scheme called K2. A thousand individuals are believed to use K2 as a tax shelter.

Unlike many denizens of offshore, Jimmy Carr is not a Conservative Party donor. He did, however, provide the set-up for a ludicrous display of moral indignation from the Prime Minister, David Cameron. Cameron singled out Jimmy Carr for condemnation and justified himself on the grounds that Carr's was 'a particularly egregious example' of tax avoidance.

Cameron's political inspiration, Benjamin Disraeli, once called a Conservative government 'an organized hypocrisy.' Cameron seems determined to ensure that the description remains half true.

news in brief (contd)

Islands in the Data Stream

At the end of June the *Guardian* began running a series of articles on the Channel Islands and their role as offshore resources for the global rich. Highlights include a suggestion by Jersey's assistant Chief Minister that 'the island should be prepared to stand up for itself and should be ready to become independent if it were necessary in Jersey's interest to do so'.

Nick Shaxson of the Tax Justice Network described the politician's remark as 'pure bluff' – appropriately enough, given that another of Channel Islands, Alderney, is the centre of world's internet gambling industry.

US Tightens Tax Code on Offshore Holdings

The Foreign Account Tax Compliance Act (FATCA) comes into force this tax filing season in the United States. According to the IRS, under FATCA, 'U.S. taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS'. The Act also requires 'foreign financial institutions to report directly to the IRS information about financial accounts held by U.S. taxpayers, or held by foreign entities in which U.S. taxpayers hold a substantial ownership interest'.

UK Uncut Legal Action

On June 13th, the British pressure group UK Uncut secured a judicial review of a deal made between HMRC and Goldman Sachs. According to the *Guardian*, both sides are expected to file amended grounds for their cases by September 14th.

Tax Avoidance, Corruption and Crisis

The 2012 research workshop co-organized by the Association for Accountancy & Business Affairs and the Tax Justice Network, explored the connections between tax avoidance, corruption and crisis.

Papers can be found at http://visar.csustan.edu/aaba/taxworkshop2012.html

Tax Inspectors Without Borders

In May the OECD Task Force on Tax and Development launched 'Tax Inspectors Without Borders'. It will establish an independent foundation that will 'provide international auditing expertise and advice to help developing countries better address tax base erosion, including tax evasion and avoidance'.

There are more details on the OECD website.

More Bad News For 'Wall Street's Guantánamo'

Even before the LIBOR scandal broke in early July the authorities in the United States were expressing concerns about the state of regulation in London.

According to an article in the *Financial Times*, trading losses at JP Morgan prompted the chairman of the Commodity Futures Trading Commission (CFTC), Gary Gensler, to remark that 'if the American taxpayer bails out JP Morgan, they'd be bailing out that London entity as well'.

A Democratic representative from New York, Carolyn Maloney was also quoted in the Financial Times. She pointed out the 'disturbing pattern in the last few years of London literally becoming the centre of financial trading disasters'.

Meanwhile, in what looks like an attempt at regulatory arbitrage familiar to offshore watchers, JP Morgan is claiming that it will lose business to European rivals if its London operations become subject to regulation by the CFTC.

The Low Tax Take By the Lake

Noted Swiss NGO, Berne Declaration, has published an e-book, *Commodities: Switzerland's Most Dangerous Business*, available for free download here. It highlights the role played by Switzerland-based companies like Glencore in the global trade in minerals, energy and food.

Follow the Money: Risks and Rewards in the Global Trade in Illicit Drugs

A new study by two Colombian researchers, Alejandro Gaviria and Daniel Mejía, describes how vast profits from the illegal drugs trade find their way to criminal networks and financial institutions in consuming countries.

In an interview with the *Guardian*, Gaviria pointed out that 'in Colombia they ask questions of banks they'd never ask in the US. If they did, it would be against the laws of banking privacy. In the US you have very strong laws on bank secrecy, in Colombia not – though the proportion of laundered money is the other way round. It's kind of hypocrisy, right?'

His co-author added that 'it's an extension of the way they operate at home. Go after the lower classes, the weak link in the chain – the little guy, to show results. Again, transferring the cost of the drug war on to the poorest, but not the financial system and the big business that moves all this along'.