

A better spread of income and wealth will be beneficial for growth and tax revenue, no vicious, but a beneficial circle.

4.9 Conclusion: The global and the national

Clearly, how developments over the past decades afflict the situation of the poor can be best and most convincingly elaborated in view of national contexts, which is why our country studies will be important. Given the world as it is, the nation state is also continually the focal and starting point of everything pertaining to tax justice – which is the proper issue at stake for this research project.

There are still large differences among states, e.g. the three which participate in this study. Just one example: somebody earning as much as US\$ 10 per day is counted among the African middle class, which so far makes up 4% of sub-Saharan African society, a small percentage of the population but a number which is slowly growing (Christian Aid, 2014, p. 13). At the same time the median income in Bavaria, the focal point of the research in Germany, lies at EUR 1,846. There, the middle class still makes up the core of society, but fizzles out at both ends (Bayerisches Staatsministerium für Arbeit und Soziales, 2013, p. 10). At the same time, there are global developments and structures affecting the situation of each and every country, no matter whether it is developed or developing.

For another reason as well, it would be wrong to focus exclusively on the poor in developed countries and their situation and to neglect the situation and assistance for the poor worldwide: Globalization is not just a process in the area of trade and finance. It is not just a one-way road which profits exclusively the wealthy countries. Growing and achieved interdependence always works both ways. The infrastructure enabling travel and transportation of goods between global regions and countries, for example, provides for undesirable effects, hitting those who think that they are far away from trouble. Via transportation, problems in poor countries may well have repercussions on wealthy countries by overcoming national borders, e.g. by the emergence of virus illnesses travelling with tourists, (illegal) migration, worsening of the climate change by deforestation, national and global destabilisation and insecurity due to terrorism.... This is why Ulrich Beck coined the expression “globalization of risk” which may turn into a globalization of insecurity.

5 Context 1: Globalization and inequality

It is now time to look into the structures and the background of major developments underlying the kind of globalization which has been dominating the last decades. The following discussion is not dealing with the question whether globalization processes are good or bad as such. Rather, it is a treatment of just one aspect, namely, the relationship between globalization and inequality and why public poverty and governmental dependence on external financing grew to the existing level globally, regionally and nationally.

Here it has become increasingly obvious that quite a number of assumptions underlying the neoliberal paradigm of globalization are at odds with empirical developments: for example, the already mentioned Kuznets model,¹⁴⁰ the Heckscher/Ohlin prediction (see

¹⁴⁰ As to Kuznets see above 2.5. Here the IMF states ‘Indeed, income inequality has risen in most countries and regions over the past two decades, including in developed countries which were thought to have reached levels of prosperity where inequality would level off in line with the predictions of the Kuznets hypothesis.’ (Jaumotte, Lall, & Papageorgiou, 2013, p. 272+287f.).

5.2.), “Kaldor Facts” or the Cobb-Douglas Hypothesis.¹⁴¹ For that reason a look at facts is important, and taking those as a starting point of reflection is recommendable since it does not make any sense to discuss inequality and poverty-reducing policies if inequality is, at the same time, constantly reproduced and/or deepened because of faulty theoretical assumptions and resulting unfair structures.

5.1 Four drivers of global inequality

Piketty, OECD (2011+2015a) and UNDP, but also a number of IMF studies agree¹⁴² that there are three exogenous (outside) drivers of inequality: Globalization of (1) production and trade and (2) finance as well as the (3) advances of technology. In addition there are endogenous drivers of inequality, namely domestic policies. A helpful overview about the interconnectedness of those drivers and their impact on the different types of income distribution is provided by the UNDP report “Humanity Divided”:

Table 14 Main drivers and various types of income distribution¹⁴³

Drivers	Distribution type				
	Functional distribution	Wage distribution	Primary household income distribution	Secondary household income distribution	Tertiary household income distribution
Exogenous drivers					
1. Trade globalization	X	X	X		
2. Financial globalization	X	X	X		
3. Technical change	X	X	X		
Endogenous drivers					
4. Macroeconomic policies	X	X	X		
5. Labour market policies	X	X	X	X ¹²	
6. Wealth inequality	X	X	X		
7. Fiscal policies: taxation and transfers	X		X	X	X
8. Fiscal policies: government expenditure					X

¹⁴¹ As to the “Kaldor Facts” see 2.2.3; the Cobb-Douglas hypothesis regards the relationship between capital and labour. Here Piketty argues: ‘The point I want to emphasize, however, is that historical reality is more complex than the idea of a completely stable capital-labor split suggests. The Cobb-Douglas hypothesis is sometimes a good approximation for certain subperiods or sectors and, in any case, is a useful point of departure for further reflection. But this hypothesis does not satisfactorily explain the diversity of the historical patterns we observe over the long, short, or medium run, as the data I have collected show.’ (Piketty, 2014a, p. 218).

¹⁴² While OECD, UNDP and IMF mention those four drivers explicitly, it is more indirectly with Piketty. Reading his book, however, one finds a lot especially regarding global financial integration, the importance of technological advance and domestic policies. OECD adds some more drivers of inequality and poverty, for example, changing pattern of families. The papers of Atkinson and Christian Aid are much shorter than the others, but here, too, elements of those drivers are contained, see, e.g., Christian Aid’s discussion of Illicit Financial Flows. For the purpose of this chapter it is not relevant whether they all copied those of one source or whether they reached these findings independently of each other. The most astounding is that those very different persons and institutions could find agreement upon those four areas as drivers of inequality, which contrasts nicely to the hodgepodge of explanations in other areas of scholarship and science.

¹⁴³ See p. 72. Footnote 12 in the graphic says ‘The channel through which labour market policies influence secondary income distribution is through collective labour agreements, which result in government support for transfers such as unemployment benefits or wage subsidies.’

The interdependence between the areas of technology on the one hand, and the globalization of trade and finance on the other is seen as follows: ‘Technological progress as the development and spread of new ideas and methods that enhance productivity and efficiency, and globalization as a catalyst of technology that facilitates the diffusion of ideas and methods around the world.’ (Jaumotte, Lall, & Papageorgiou, 2013, p. 272). Clearly, technological innovation, defined like that, is underlying and advances developments in the two other channels of globalization, namely production/trade and finance.

It is here, where developments lead to a gigantic volume and network of global interaction. Regarding production and trade, ‘the volume of world trade has grown five times in real terms since 1980, and trade share of world GDP has risen from 36 to 55 percent’. Equally momentous were developments in the area of financial globalization: ‘total cross-border financial assets have more than doubled, from 58 percent global GDP in 1990 to 131 percent in 2004’ (Jaumotte, Lall, & Papageorgiou, 2013, p. 280f.).

The important question to ask is: Who is profiting from those developments? All population segments equally? Always the same segments of a population? Or different segments differently? While in the past research interest was rather on the globalization of production and trade with limited attention to financial globalization, a shift can be stated here, devoting more attention to financial globalization. In the wake of the World Financial and Economic Crisis, the IMF reviewed empirical data and conducted a comprehensive analysis of trends in 51 countries over a 23 year period, saying:

Our analysis finds that increasing trade and financial globalization have had separately identifiable and opposite effects on income distribution. Trade liberalization and export growth are found to be associated with lower income inequality, while increased financial openness is associated with higher inequality. However, their combined contribution to rising inequality has been much lower than that of technological change, both at a global level and especially markedly in developing countries. The spread of technology itself is, of course, related to increased globalization, but technological progress is nevertheless seen to have a separately identifiable effect on inequality. The disequalizing impact of financial openness—mainly felt through FDI— and technological progress both appear to be working by increasing the premium on higher skills and possibly higher returns to capital, rather than limiting opportunities for economic advancement. Consistent with this, increased access to education is associated with more equal income distributions on average.[emphasis added] (Jaumotte, Lall, & Papageorgiou, 2013, p. 273f.)

Given these findings, the treatment of globalization of production and trade will be shorter than the treatment of financial integration and the impact of technological advances.

5.2 Trade Globalization

Regarding the globalization of production and trade, assumptions of the Heckscher/Ohlin model were influential in shaping respective policies. It postulated that inequality in developing countries will decline in the long run since trade will increase demand for unskilled labour. This did not work in many countries, e.g. because those trading were often rather interested in natural resources and not so much in unskilled labour. Therefore, in sub-Saharan Africa tendencies occurred away from high-productivity jobs to lower productivity jobs or even informal services.¹⁴⁴

¹⁴⁴ Similar for Latin America, see (UNDP, 2013, p. 90) and IMF (Jaumotte, Lall, & Papageorgiou, 2013, p. 272f.+284).

But still and in spite of negative aspects, the authors of this research would agree that from all dimensions under discussion, globalization of trade is, at the bottom line and when viewed from a global perspective, the most promising dimension when it comes to the potential to decrease inequality and improve the situation of the poor – **provided, better regulation and fairer regimes are implemented than those which have existed over the past decades.** This includes improvements in labour laws, payment of wages and even the area of taxation. It is well-known that Transnational Corporations try to cheat on their tax bills in many ways: by putting pressure on governments to obtain tax exemptions or privileges before investing, by using legal loopholes when transferring profits out of countries, by using trade mispricing to balance gains and losses, etc. This area is, however, already in the focus of international policy makers and is treated within the G20 and OECD context so that here some progress seems to be likely.

There is agreement that trade globalization and financial globalization go hand in hand: trade openness often goes along with financial openness, which is impacting on exchange rates, which is shifting demand rather towards (cheap) imports than (expensive) exports, which is reducing well-paid jobs.¹⁴⁵ States in turn had to intervene with labour market policies, which were further weakening the position of labour in relationship to capital with the consequence that its bargaining power in wage conflicts (negotiations or strike) is sinking (see below 5.3.6).

The borderline between the globalization of trade and the globalization of finance is at times thin and therefore its impact on inequality depends from one's perspective. To take a simple illustration: Foreign Direct Investment. If the aggregate impact of FDI upon inequality is examined, one can find that 'financial deepening had no significant impact on the distribution of wages.' This obscures the fact, that there are two opposing trends which neutralize their effect when "netted": when 'disaggregating the overall FDI into inward and outward components, we find inward investment contributing to reducing wage dispersion and outward investment.... contributing to increasing wage dispersion' (OECD, 2011a, p. 118). One more proof how important it is to examine each case carefully for its underlying assumptions and implications.

5.3 Financial Integration

Financial integration is seen to be a major driver of inequality. But there is a second reason why the topic of financial integration is important for this research project: As is widely known and will be discussed in more detail in chapter 6, Illicit Financial Flows (IFFs) nowadays are a major problem for states when it comes to taxing wealthy individuals and large businesses. Therefore it is necessary to understand better why these outflows are possible at all and why states are not able to get a plug on this leakage. The phenomenon of financial integration is highly complex and what follows now is extremely simplified. But given the multitude of literature available for whoever is interested in a more detailed discussion, it seems permissible to confine the presentation here to that which is absolutely

¹⁴⁵ All this is simplified, therefore a more technically correct example: 'With respect to financial deepening,' it can be shown 'that relaxing FDI regulation (to attract more external investment) is associated with higher wage inequality. The effect is strong and statistically significant at the 1% level. The coefficient indicates that a 10% decrease in the average FDI restrictiveness index would yield a roughly 0.5% increase in the mean wage differential. For a baseline D9/D1 of 3.0, this is an equivalent of an increase of 0.015 points (i.e. $3 \times 1.005 = 3.015$).' (OECD, 2011a, p. 113).

necessary to understand some essential links between financial integration, inequality, illicit financial flows and tax revenue.¹⁴⁶

5.3.1 What is meant by it?

The term “Financial Integration” (alternative and/or related concepts are “Financial Globalization”, “Financial de-regulation”, “Financial Openness”, “Financial Deepening” or “Globalization of Finance”) denotes the result of developments over recent decades in view of financial markets and player. It has an enormous impact and influence on global monetary flows and, arising from there, on national economies and, arising from there, on governance structures such as governments and civil-society organizations. The Wikipedia definition lists characteristic features of financial integration as follows:

Financial integration is a phenomenon in which financial markets in neighbouring, regional and/or global economies are closely linked together. Various forms of actual financial integration include: Information sharing among financial institutions; sharing of best practices among financial institutions; sharing of cutting edge technologies (through licensing) among financial institutions; firms borrow and raise funds directly in the international capital markets; investors directly invest in the international capital markets; newly engineered financial products are domestically innovated and originated then sold and bought in the international capital markets; rapid adaption/copycat of newly engineered financial products among financial institutions in different economies; cross-border capital flows; and foreign participation in the domestic financial markets.¹⁴⁷

For a very long time, the core business of financial institutions was largely to collect and administer savings, e.g. from citizens, and handing out loans and credits to public and business investors. The sector lived mainly from fees and interest. Markets were regulated and the room to manoeuvre was limited. All this changed after abandoning the Bretton-Wood System in the area of the trade with currencies and a more general deregulation of financial markets initiated by Ronald Reagan and Margret Thatcher. Developments were initiated which forced other states to imitate, or to risk getting sidelined which, of course, nobody wanted, since everything seemed to be rather fine in the beginning. Suddenly the profit to be gained from loans to local businesses and citizens (e.g. for building houses) shrunk, the profitability of other business segments rose. The financial sector turned into its own industry with its own “innovative products” such as derivatives and started a flourishing trade with them, even though products were increasingly of such complexity that not even those creating and selling them knew their real “value” and potential danger.¹⁴⁸

It is important to understand this development and its implication for the world economy. A very concise and understandable introduction into the relationship between high-street banking and investment banking, the link between those banking sectors and the real economy, the interconnectedness of large global systemically important banks, the importance

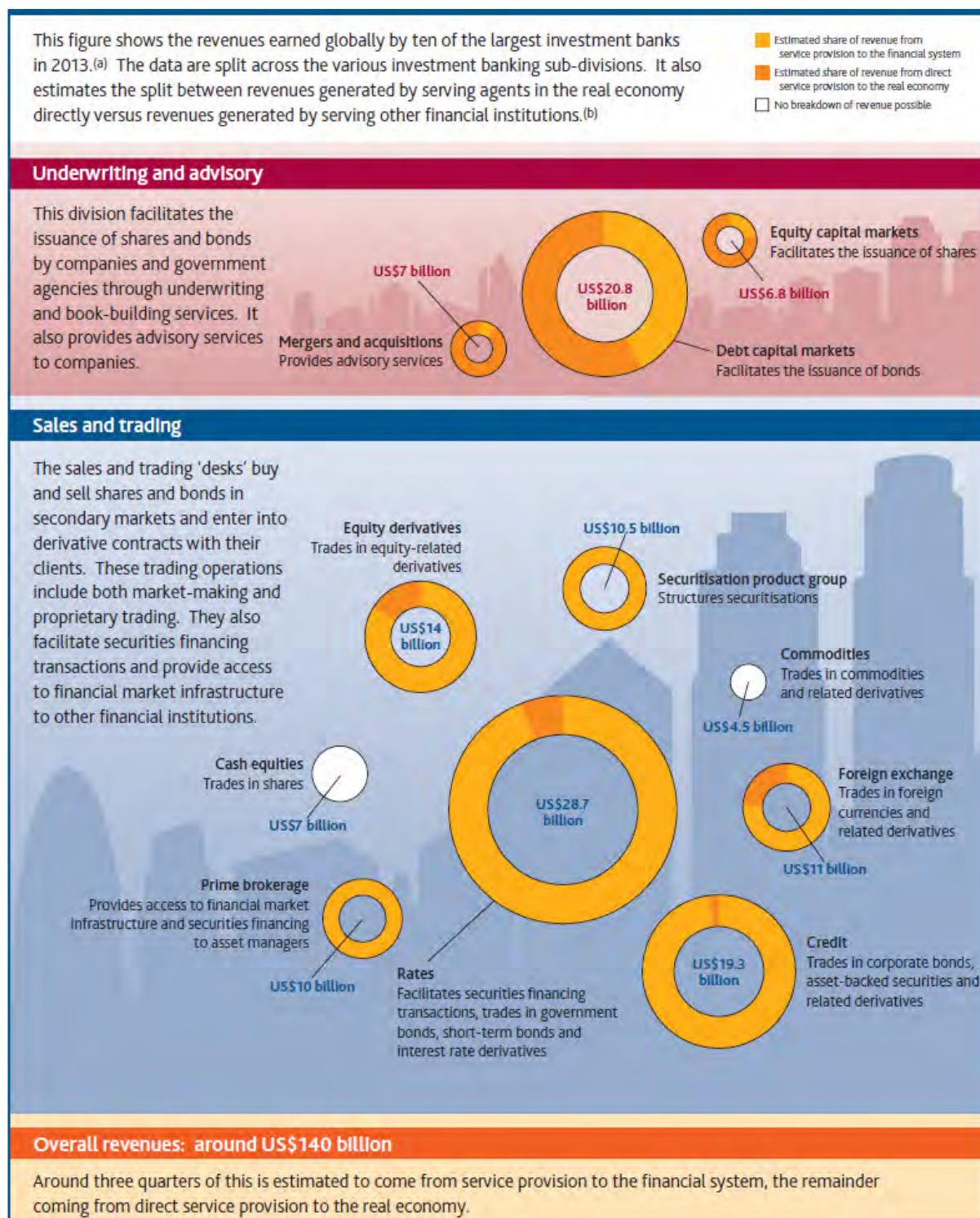
¹⁴⁶ As in earlier publications, e.g. (Alt, Globalisierung, illegale Migration, Armutsbekämpfung, 2009), major publications used for this chapter here are Held D., McGrew, A., Goldblatt, D. & Jonathan Perraton (2001) *Global Transformations. Politics, Economics and Culture*. London: Polity. Castells, M. (2003 ff.) *Das Informationszeitalter*. Vol. 1,2,3. Opladen: Leske & Budrich. Stiglitz, J.(2004) *Die Schatten der Globalisierung*. München: Goldmann. Krugmann, P. (2008) *Die neue Weltwirtschaftskrise*. Frankfurt/New York: Campus, Schumann H./Greffe Chr. (2009) *Der globale Count-down. Finanzcrash Wirtschaftskollaps Klimawandel, Wege aus der Weltkrise*. Kiepenheuer & Witsch.

¹⁴⁷ For more detailed information see http://en.wikipedia.org/wiki/Financial_integration

¹⁴⁸ Quite illustrative is the autobiographic story of Michael Osinski, inventor and creator of CDOs (Collateral Debt Obligations). In: “My Manhattan project – How I helped build the bomb that blew up Wall Street. (2009, March 29) In: *New York Magazine*. Retrieved from <http://nymag.com/news/business/55687/>. Also (Adelson, 2012).

of risk-taking and the increasing “opaqueness” of financial products has been provided by a recent study by the Bank of England (Balluck, 2015). The following graphic gives a helpful overview about the dimension of the financial service industry and how the relationship between the financial service industry and the real economy is judged by Bank of England experts:

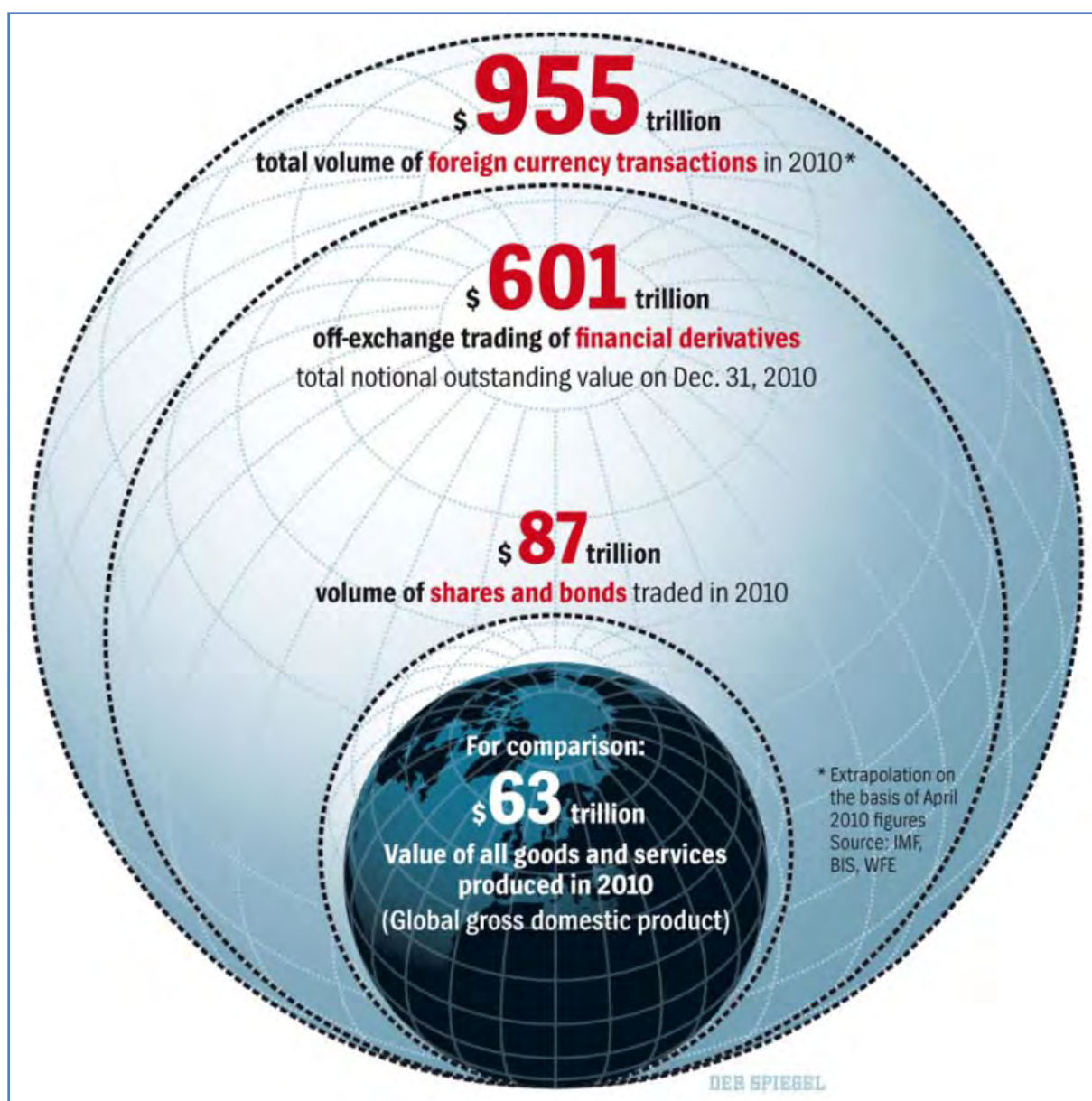
Graphic 65 Links between financial services and real economy



Source 36 (Balluck, 2015, p. 7)

Many financial institutions and funds turned away from supporting long term investment and innovation in the real industry and tried rather to exert quarterly short term profit from companies, which ruined long term capacities and thus jobs in the real economy. Since banks were major shareholders in TNCs and TNCs in turn opened banks in order to participate in this “value creation” and buffer up their balance sheets, small and medium enterprises came under pressure to follow suit, even though (or because) they had no comparable resources to participate in the global casino as the big Global Players did: They, too, were tempted to neglect long term investment and participate instead in the global game of quick big gains via banks and investment funds.¹⁴⁹ That way, Global Finance became increasingly detached from real economic activities, which is illustrated by the following graphic:

Graphic 66 Categories and dimensions of global financial integration



¹⁴⁹ In Germany, a major victim of the World Financial and Economic Crisis was the IKB-Bank, which traditionally was serving predominantly middle sized enterprises.

Of course, things are not that simple and especially Kushal (2015) is good in explaining how products of the financial industry are linked with the needs of the real economy, e.g. futures to hedge international trading activities. But increasingly even experts doubted how many of those “innovative products” are indeed useful for real economy and therefore jobs. Already John Maynard Keynes distinguished between the sensible and stupid. In his famous quote he says ‘Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.’¹⁵⁰ And, as the quote suggests, the speed and “elusiveness” of speculation are among the crucial factors behind the “deviation” of investment from businesses into financial products and speculation, the instability of the financial system and its increasing tendency and frequency to crash. In a similar manner Lord Adair Turner, long term Chair of the Financial Stability Board (London), stated: ‘It is hard to distinguish between valuable financial innovation and non-valuable. Clearly, not all innovation should be treated in the same category as the innovation of either a new pharmaceutical drug or a new retail format. I think that some of it is socially useless activity.’¹⁵¹

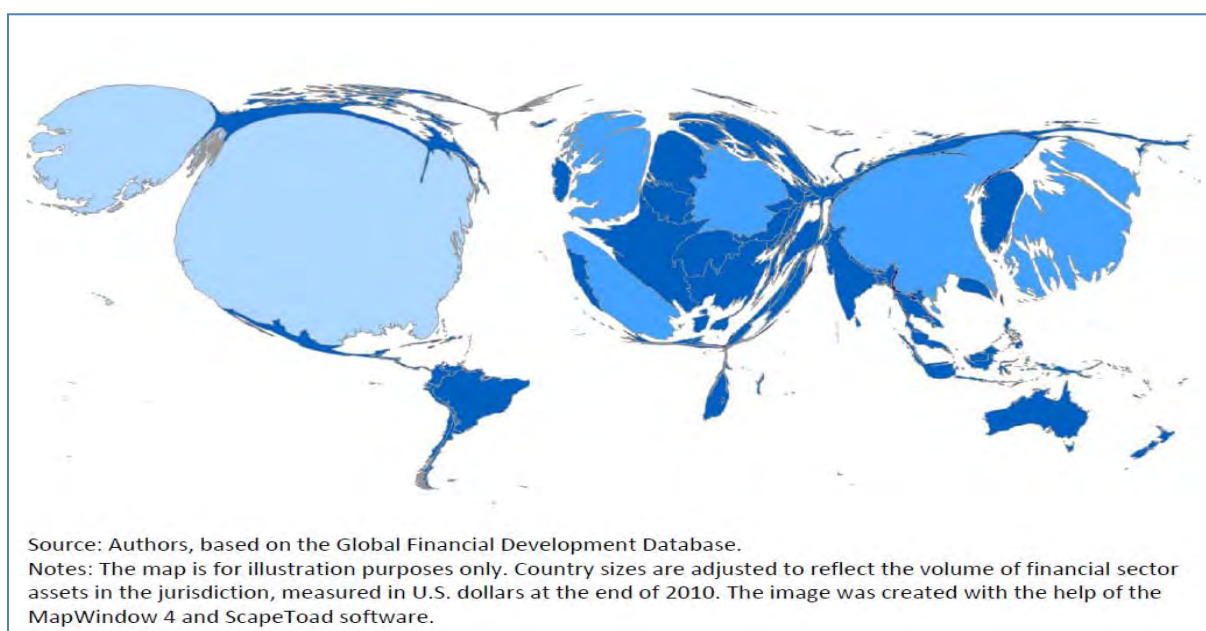
Another problem linked to developments in global finance is the upsurge in loans, credits and resulting debt: the more “financial liquidity” existed, the more urgent opportunities for investments were searched after with the hope to reap gains in paid interest. Here states, businesses and private households were sweet-talked into taking credits and loans, by seductive conditions. At times, the urgency to hand out loans was such, that criteria of credit-worthiness were knowingly ignored. Rather, more “innovative financial products” were invented to insure against those risks, e.g. Credit Default Swaps, Asset Backed Securities, etc.

That way, not only did Transnational Corporations grow across borders, but developments of financial integration led to a global integration of financial markets, states and regions. In the words of Piketty: ‘Indeed, one characteristic of today’s financial globalization is that every country is to a large extent owned by other countries, which not only distorts perceptions of the global distribution of wealth but also represents an important vulnerability for smaller countries as well as a source of instability in the global distribution of net positions. (Piketty, 2014a, p. 193) . At the same time, power is concentrated in a few centres only, as the following graphic illustrates

¹⁵⁰ From his book *The General Theory on Employment, Money and Interest*, chap. 9, VI.

¹⁵¹ Taken from: “How to tame global finance?” (2009, August 29) In: *Prospect Magazine*. Retrieved from <http://www.prospectmagazine.co.uk/magazine/how-to-tame-global-finance/#.U5Lcv3fNzz8>

Graphic 67 The uneven sizes and distribution of financial sector assets



Source 37 (Cihak, Demigüç-Kunt, Feyen, & Levin, 2012, p. 31)

A final reason why some attention needs to be devoted to financial integration: If looking into where the world's super-wealthy make their money, finance, banking and investment are the most widespread uses both for self-made and inherited wealth.

Graphic 68 Sources of private wealth

TOP INDUSTRIES OF UHNW INDIVIDUALS, BY WEALTH SOURCE					
INHERITANCE		INHERITANCE/SELF-MADE		SELF-MADE	
NON-PROFIT & SOCIAL ORGANISATIONS	17.5%	FINANCE, BANKING & INVESTMENT	17.4%	FINANCE, BANKING & INVESTMENT	26.4%
FINANCE, BANKING & INVESTMENT	14.0%	INDUSTRIAL CONGLOMERATES	12.5%	REAL ESTATE	7.3%
INDUSTRIAL CONGLOMERATES	8.8%	REAL ESTATE	8.2%	TECHNOLOGY	6.6%
MANUFACTURING	6.2%	MANUFACTURING	7.2%	NON-PROFIT & SOCIAL ORGANISATIONS	4.6%
FOOD PRODUCTS	6.0%	FOOD PRODUCTS	6.6%	INDUSTRIAL CONGLOMERATES	4.5%

Source 38 (Wealth-X and UBS, 2014, p. 23)

As the chart spelling out the sources of private wealth above (2.7) demonstrated, the world's UHNWIs sit on a huge pile of cash. Given inflation and other threats to its value, UHNWIs are desperate for investing it as profitably as possible. 'The most straightforward way for UHNW individuals to address these concentration biases is to divest wealth from their core business and more aggressively allocate to investment portfolios.' (Wealth-X and UBS, 2014, p. 5). One can safely assume that "aggressive allocation" will try to exert a lot of power and influence and it is likely to assume that the main interest then will be not the interest of the many but rather the interest of the few.

5.3.2 Categories of international financial flows

Since deregulation started, an increasing amount of money has been circulating the globe. To start with, an overview about existing categories is important: First one has to

distinguish between public-institutional sector financial flows on the one hand, and private-market sector regulated and unregulated financial flows on the other. In this case the expression “private” is not confined to individuals, but comprises also market-based institutional investors like investment funds which collect and administrated money from others.¹⁵²

Public-institutional sector financial flows are those under public control, for example originating from or circulating between state-owned or controlled banks (including Central Banks), states (e.g. Official Developmental Aid), or multilateral facilities such as the IMF, the World Bank, Regional Development Banks. This sector comprises also large Pension Funds, who normally pursue a long-term, low risk investment strategy.

As to the private-market sector financial flows, one has to distinguish between regulated and unregulated investors. Regulated are all those which act in accordance with self-imposed or widely accepted rules, for example, whoever is registered at a Stock Exchange has to adhere to the rules going along with this membership. Here one finds large traditional banks, insurance companies, investment funds or Transnational Corporations. But more “typical” for the times of deregulated financial markets are investors acting outside public and Stock Exchange regulation, for example Portfolio investments such as hedge funds or private equity, many of which hand out large amounts of money for high risk projects by asking for high interest in return; and which they often aim for the short-term profit.

Somewhere in between public and private actors are Sovereign Wealth Funds and State Owned Transnational Corporations. While FDIs from the former are rather small in comparison to their assets under management, investment by State Owned Transnational Corporations is growing and reached US\$ 160 billion in 2013. ‘Although their number constitutes less than 1 percent of the universe of TNs, they account for over 11 percent of global FDI flows.’¹⁵³

A last category of financial flows originate from criminal gains such as Mafia and Transnational Organized Crime Organizations or money financing terrorist networks – sadly those flows seem to be gaining massively in quantity.¹⁵⁴

5.3.3 Formal, shadow and other financial networks

Among the emerging inter- and transnational networks, the most well-known is the so-called formal financial sector. It is this sector about which media and the public are normally talking, namely private banks, insurance companies and prominent funds operating on the regulated financial market. It is here where we find the big banking names and it is on this sector that many papers relevant for this research focus when they discuss the transfer of IFFs from developing countries to tax havens. Henry, for example, mentions that one finds in this business the major global players of the world’s financial sector because it is of course those major players who have branch offices in every state and capital of the world. In this top financial sector, power is increasingly concentrating.¹⁵⁵

¹⁵² As to the following categorization see (World Bank, 2009, p. 1ff.) and (Cihak, Demigüç-Kunt, Feyen, & Levin, 2012) and (UNCTAD, 2014).

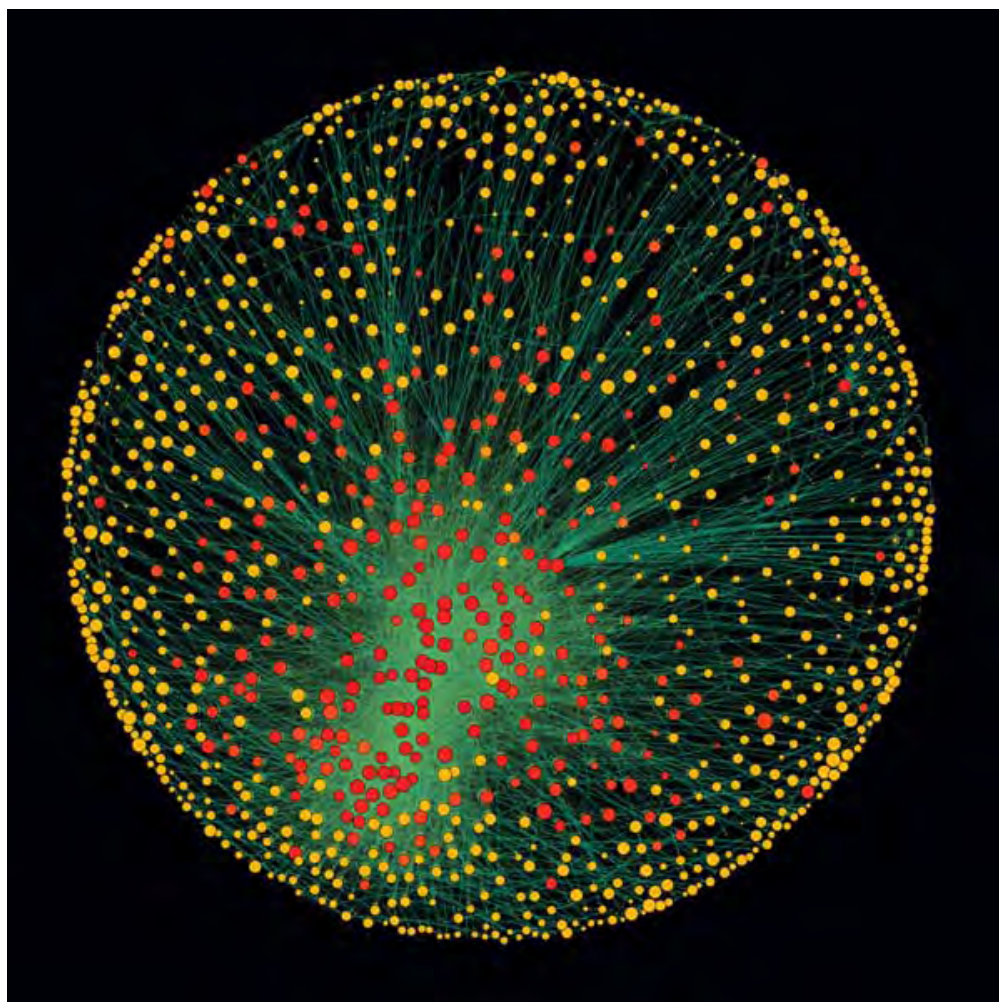
¹⁵³ (UNCTAD, 2014, p. 8f.). A constantly updated data-base of all those previous flows and interrelationships is offered at the World Banks database “Global Financial Development.” See <http://data.worldbank.org/data-catalog/global-financial-development>

¹⁵⁴ The example of Mafia networks see (Schick, 2014, p. 46ff.)

¹⁵⁵ (Henry, 2012, p. 31ff.) and Appendix 3 to his research on website <http://www.taxjustice.net/2014/01/17/price-offshore-revisited/>

An ETH Zurich-based research team (Vitali, Glattfelder, & Battiston) conducted the first investigation of the architecture of the international ownership network in 2011. Using a database containing information about millions of businesses in all countries and applying a set of criteria, they identified 43,060 entities qualifying as TNCs (p.13). Looking into shareholder and other forms of ownerships they found 1,318 TNCs which were strongly connected among each other by interlocking ownerships. Each of them is tied to at least two, on average to 20 other entities of the network – altogether 12,191 links among them. Among those 1,318 were again 147 corporations which were of particular size and importance - resulting in a particular control of other large corporations. Even more: Those 147 companies were almost exclusively owned and controlled by each other (p. 6) and are thus called by the researcher the “super-entity” of the global network of corporations. Graphically, this network of global corporate control looks as follows, node size symbolizes amount of operational revenue at its disposal, and colour indicates degree of network control (p. 3).

Graphic 69 The global network of corporate control



Source 39 (Coghlan & MacKenzie, 2011)

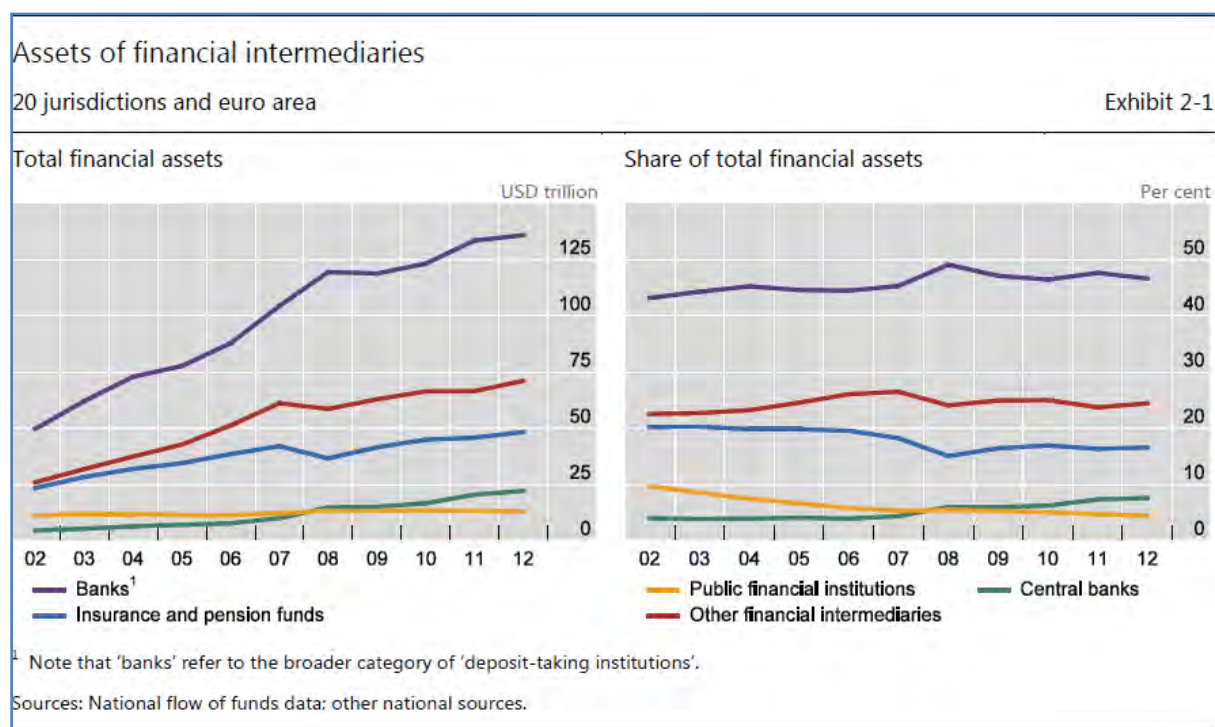
If one now looks at the list of the 50 biggest Global Players worldwide among those 147 one might be surprised that 45 out of 50 belong to the financial sector: Large Banks, Hedge Funds, Investment Funds, Insurance Companies (p. 32f). Accordingly, a large number of the Forbes 2014 billionaires-list comes from this background:

In March 2014, 20% of them (321) were listed as having interests or activities in, or relating to, the financial and insurance sectors, the most commonly cited source of wealth for billionaires on this list. Since March 2013, there have been 37 new billionaires from these sectors, and six have dropped off the list. The accumulated wealth of billionaires from these sectors has increased from \$1.01tn to \$1.16tn in a single year; a nominal increase of \$150bn, or 15%.¹⁵⁶

All this has consequences: First, Glattfeld argues, this network of interlocking ownership means that “‘In effect, less than 1 per cent of the companies were able to control 40 per cent of the entire network’.” And regarding the 1318, ‘although they represented 20 per cent of global operating revenues, the 1318 appeared to collectively own through their shares the majority of the world's large blue chip and manufacturing firms - the "real" economy - representing a further 60 per cent of global revenues.’ Given these interconnections and links, it is easily understandable why trouble in parts of this network threatens to tear down the entire system (Coghlan & MacKenzie, 2011). Those “strongly connected components or core” of world economy are, with more popular expressions, of “systemic” importance for the world economy and “too big to fail”. This is why some of them had to be stabilized and supported with taxpayers’ money in 2007/2008: their downfall would have triggered off a landslide of other banks and companies following them. Here arises a governance problem: It is no longer governments and democracies which decide on what to spend taxpayers’ money. Rather, the international relevance of those transnational players for national economies necessitates public stabilization and intervention without any alternative left (more below 5.3.8).

Besides this formal financial sector there exists, however, another financial sector, commonly referred to as the “Shadow Banking Sector”. ‘The shadow banking system can broadly be described as the system of credit intermediation that involves entities and activities fully or partially outside the regular banking system, or non-bank credit intermediation in short.’ (Financial Stability Board, 2013, p. 5). Within this category of private equity and hedge funds would fall those which operate outside the regulated markets. Even though outside the formal financial sector, parts of the Shadow Banking Sector are linked with the real economy, since in many countries it is easier to receive credit from those institutions (even though at times for outrageously high interest rates) rather than from those operating in the formal sector. Thus, this financial sector also links individuals, institutions and countries and moves billions of US-Dollars across borders. The following graphic illustrates the proportional size of major financial players, the red line symbolizing the Shadow Sector, here called “other financial intermediaries”:

¹⁵⁶ (Oxfam, 2015a, p. 5) As always, a footnote is needed regarding the classification: ‘Billionaires were coded as having business interests or activities in the finance sector if the description of the source of wealth was interpreted to be related to the finance sector. In some cases the source of wealth is explicitly listed as „finance”, in others the company name, such as Bloomberg, a financial sector media service. Some billionaires have interests in more than one sector, including finance.’ (p. 11)



Source 40 (Financial Stability Board, 2013, p. 9)

Even though the FSB, from which this graphic is taken, examines only major developed states (and from Africa merely South Africa), this should not blind one to the fact that both financial sectors are globalized and operative worldwide.

Third, and of rising importance, is Islamic Banking which is organized along the Sharia and is a factor in states belonging to the Organisation of Islamic Countries (OIC). This sector has not yet been examined on a larger scale, which is why the World Bank states 'Surprisingly, there is a lack of comprehensive and consistent data on important aspects of Islamic finance', even though Islamic banking comprises assets ranging at around US\$ 1 trillion to 1.5 trillion.¹⁵⁷

Finally, there are other networks: traditional and age-old money transfer and banking services such as the Hawala or Hundi system, or, more modern, internet based Paypal or Bitcoin or even the mobile M-Pesa system. They, too, gained a wide reach due to incorporating modern information and communication technology into their business models, thus being able to reach across international borders. Actors in this field are more flexible and decentralized; they are accessible worldwide not only at major capitals, but also in smaller towns, which would not be attractive for branches of large institutional players within the formal financial sector.¹⁵⁸

While it is difficult to regulate and tax financial institutions, products and turnover of the formal financial sectors it is almost impossible to do it so the other sectors. And, as should be obvious: all these networks hold multiple options for the global wealth elite and businesses to transfer funds from A to B, out of reach of the tax man. And if all that does not work, one is still able to recur to courier and carrier services.

¹⁵⁷ See Website Islamic Banking Database, World Bank, <http://go.worldbank.org/AE0U8AYQ20>

¹⁵⁸ For the use of Hawala and Hundi structures by illegal migrants, moving billions of remittances every year see (Alt, Globalisierung, illegale Migration, Armutsbekämpfung, 2009)

5.3.4 Financial Integration and taxation

Why is all this important to be considered in a study about tax justice and poverty? Apart from its importance for channelling Illicit Financial Flows (chapter 6) and for the creation and destruction of quality jobs (5.3.6), for the following reasons:

Tax exemptions/privileges for many financial products: All ordinary workers, businesses and consumers pay Turnover Tax and VAT when buying products and services. Financial institutions are thriving on a major set of tax exemptions and privileges when creating and trading their own products.¹⁵⁹ This is even worse because quite a number of “financial innovations” created by the financial industry have as their main (sole?) purpose tax avoidance. While their owners refuse paying tax on gains arising from those certificates, bonds and loans, they are quick, however, to insert incurred losses into their tax bill, thus asking for a lower taxation. Reverse Floater, Zero Bonds, Step-Up Loans, Airbag-Certificates were some of those products where, for example, the German Supreme Financial Court had to be asked to clarify the limits of tax exemptions.¹⁶⁰ And there are many other products which are still not subject to tax law or out of “taxability” for authorities. Parliaments are trying to reduce tax privileges on the trade with innovative financial products, e.g. in the USA. However, similar to the situation in Europe, where ten states try to introduce a Financial Transaction Tax, proposals by the Ways & Means Committee of the US House of Representatives are heavily attacked by the financial industry. Therefore the relevant tax reform with subsequent taxation of those multi-billion turnovers and products is likely to be delayed further.¹⁶¹

Tax avoidance opportunities privilege major private banks as opposed to more traditional banks. There is a misbalance in the tax revenue collected from different types of banks, which shall be shown by taking the German example. The German Banking Sector is based on three pillars: First big private banking corporations with the Deutsche Bank as its largest and most prominent representative. But equally important are the public savings banking sector operating within municipalities or *Länder* (*Sparkassen, Landesbanken*) and the cooperative/mutual savings banking sector (*Genossenschafts-/Raiffeisenbanken*). As far as tax revenue is concerned, there is a marked difference between the Private Banks on the one side, and the public and cooperative banks on the other side. A study by the Trade Union ver.di, analysing data published by the German Federal Bank, reveals that the tax paid by Germany’s large Private Banks between 2000 and 2011 amounts to one twelfth of the taxes paid by the banking sector as a whole, even though their total assets (*Bilanzsumme*) is one third of the banking sector. Public and cooperative banks, on the other hand, account for over 70% of taxes paid.

¹⁵⁹ Turnover Tax exemptions for financial products in Germany are regulated, e.g., in paragraph 4, chapter 8 of Turnover Tax Law. http://www.gesetze-im-internet.de/ustg_1980/_4.html.

¹⁶⁰ Simon, M./ Wenzl, U. (2007, March 3) Richter klären Besteuerung. In: *Focus*. Retrieved from http://www.focus.de/finanzen/boerse/finanzinnovationen/neue-finanzenprodukte_aid_28680.html. Jahn, J. (2007, February, 9) Bundesfinanzhof klärt Besteuerung von Finanzprodukten. In: *FAZ*. Retrieved from <http://www.faz.net/aktuell/wirtschaft/recht-steuern/grundsatzurteile-bundesfinanzhof-klart-besteuerung-von-finanzenprodukten-1409469.html>

¹⁶¹ As to the status of the Comprehensive Tax Reform discussion see <http://waysandmeans.house.gov/taxreform/>. Recent assessment: Scott, J. (2014, January 15) Financial Product Tax Reform Might Not Be Imminent. In: *Forbes*. Retrieved from <http://www.forbes.com/sites/taxanalysts/2014/01/15/financial-product-tax-reform-might-not-be-imminent/>. As for the efforts to introduce the Financial Transaction Tax see: <http://robinhoodtax.org.uk/> and <http://www.steuer-gegen-armut.org/>

Table 15 Tax payments by different categories of the German banking sector¹⁶²

Steuerzahlungen der Kreditinstitute in Deutschland (in Euro)					
Jahr	Großbanken	Sparkassen	Landes- banken	Kreditgenos- senschaften	Alle Banken
2000	- 443 Mio.	2.770 Mio.	1.371 Mio.	1.096 Mio.	6.747 Mio.
2001	- 438 Mio.	1.633 Mio.	296 Mio.	772 Mio.	3.672 Mio.
2002	96 Mio.	1.471 Mio.	399 Mio.	801 Mio.	3.850 Mio.
2003	- 490 Mio.	3.011 Mio.	482 Mio.	1.484 Mio.	5.505 Mio.
2004	- 218 Mio.	2.122 Mio.	835 Mio.	1.458 Mio.	5.583 Mio.
2005	4.030 Mio.	2.285 Mio.	413 Mio.	1.444 Mio.	9.744 Mio.
2006	936 Mio.	1.973 Mio.	878 Mio.	829 Mio.	5.421 Mio.
2007	2.549 Mio.	1.574 Mio.	283 Mio.	1.054 Mio.	5.953 Mio.
2008	-1.096 Mio.	1.016 Mio.	629 Mio.	571 Mio.	1.327 Mio.
2009	-724 Mio.	2.245 Mio.	223 Mio.	1.490 Mio.	3.915 Mio.
2010	488 Mio.	2.513 Mio.	-101 Mio.	1.620 Mio.	5.192 Mio.
2011	563 Mio.	2.744 Mio.	697 Mio.	1.930 Mio.	6.896 Mio.
Summe	5.253 Mio.	25.357 Mio.	6.405 Mio.	14.549 Mio.	63.805 Mio.

Quelle: Deutsche Bundesbank, Monatsberichte, Steuern vom Einkommen und vom Ertrag
In der Spalte „Großbanken“ werden die Deutsche Bank, Commerzbank, Dresdner Bank (bis 2008), Hypovereinsbank und seit 2004 die Postbank erfasst.

This is surprising at first sight, but not at second: while public savings banks and co-operative banks are rooted in their communities, pay their taxes on the spot and invest more into the local economy than others, large private banks operate internationally and thus are able to take part in profit-shifting and other tricks assisting them to avoid taxation or pay taxes in cheap tax areas.

Speculation with products is impacting the poor. When the real property and housing market started to falter in 2007, global investors started to look for new and profitable investment in order to ascertain profitability and high returns. Among other areas they discovered that investing in foodstuffs is a “dead-sure” business since people have to eat at all times. However: investment and speculation with titles including “soft commodities” or “agricultural commodities” (*Agrarrohstoffe*) impact on food prices which affect mainly the poor in poor countries, forcing states to counterbalance these artificially increased prices with tax-funded subsidies so that food remains affordable.¹⁶³

“Privatize gains, socialize losses”. Within the present financial order, there is a mismatch between gaining/profitting and accepting/bearing responsibility for losses.¹⁶⁴ While gains are gladly accepted it is increasingly widespread to not accept liability if something goes wrong or even ask the taxpayer to help out if things are turning sour. This leads to the taking of ever higher risks in trading and investing, totally oblivious of its potential

¹⁶² Key data and the subsequent table are taken from Reinbrecht, J. "Steuerzahlungen der Kreditinstitution in Deutschland". Ver.di Hannover, Mai 2013. See also Kunz, A. (2013, June 21) Deutschlands Großbanken rechnen sich arm. In: *Die Welt*. Retrieved from <http://www.welt.de/wirtschaft/article117352942/Deutschlands-Grossbanken-rechnen-sich-arm.html>

¹⁶³ Neate, R. (2012, November29) UN blames food prices rises on trading in agricultural commodities. In: *The Guardian*. Retrieved from <http://www.theguardian.com/world/2012/nov/29/un-food-prices-trading-agricultural-commodities>

¹⁶⁴ This was made possible, for example, by converting investment banks from partnerships into corporations (Adelson, 2012) or the spreading (hiding?) of risk by the invention of “innovative” financial products like the securitization of mortgages.

consequences.¹⁶⁵ When the bill for all that finally was presented in 2007/2008, billions of taxpayers' money had to be poured into the financial sector at a time, when actors of that sector still awarded themselves huge payments in salary and bonuses.

5.3.5 Volatility and dimensions of damage

The volatility of financial markets illustrates best the dependence of states on external financing or "the markets". Financial markets were always prone to instability, as Carmen Reinhart and Kenneth Rogoff described in their 2009 book "This time is different": They examine 'Eight centuries of Financial Folly' leading to instabilities and crises of all kinds.¹⁶⁶ But also much earlier, in 1996, a study of the World Bank elaborated that, since the end of the Bretton-Wood system 96 „Banking Crises“ and 175 „Financial Crises“ occurred.¹⁶⁷ Those crises hardly remained confined to the financial sector, but affected also the real economy. In the past, however, those crises were largely confined to countries and global regions. This was different when it came to the 2007/2008 World Financial and Economic Crisis, the second World Crisis after the Great Depression in 1929/1930. What was different this time? Given the developments since the 1980s, and the discussion here so far, the following issues seem to be central:

- the complexity of products, the trend to ever greater individual risk taking,
- trading "off the counter" (i.e. outside structures of transparency of control), and, most importantly,
- technological progress (the third of the exogenous drivers of inequality discussed in this chapter): computer and internet enabled volumes, speed and frequency of business transactions unknown so far in history to the extent that (algo)trading is left to the computer, while human beings have difficulty staying on top of events.

That way, incredible gains could be followed by disastrous losses in milliseconds.¹⁶⁸ The panic underlying and driving events leading to the World Financial and Economic Crisis 2007/2008 would perhaps not have had the eventual outcome were it not for the speed and volume of transfers and the lack of mastering developments in crucial milliseconds.

As far as dimensions of damage of financial crises are concerned, one has to distinguish three levels: (a) the destruction of values on the one side and (b) direct and (c) indirect costs for states and the taxpayers on the other. This shall be illustrated by using some examples from the recent World Financial and Economic Crisis:

First, the destruction of financial assets and titles, e.g. banks and their deposits, shares, mortgages, insurances, securities, derivatives, etc.: Given the size of the financial sector, these are already enormous amounts of money. Since no study could be found where this financial loss is comprehensively assessed, just two highlights circumscribing the global dimensions of destroyed values are: Mark Adelson, former Chief Credit Officer of the Standard & Poors rating agency, calculates that the last World Financial and Economic Crises destroyed

¹⁶⁵ According to various authors, idiosyncratic, eventually bonus-encouraged, risk-taking was and is a major cause behind financial crises, see (Adelson, 2012), (Azzimonti, de Francisco, & Quadrini, 2013), but also (Beck, 1986).

¹⁶⁶ A short summary of Reinhart/Rogoffs findings is available on the website of The Economist on <http://www.economist.com/media/pdf/this-time-is-different-reinhart-e.pdf>

¹⁶⁷ Caprio, G./Klingebiel, D. (1996) Bank Insolvencies: Cross Country Experience. Policy Research Working Paper No. 1620. Washington: World Bank.

¹⁶⁸ For example at flash-crashes such as the one on 6 May, 2010, see http://en.wikipedia.org/wiki/2010_Flash_Crash

worldwide US\$ 15 trillion in stock value (Adelson, 2012). Rather moderate, on that background, are early estimates, e.g. by the IMF who in 2009 put the “potential writedown” of global assets at US\$ 4.1 trillion.¹⁶⁹

More of immediate interest for this study are, however, the areas of direct and indirect costs, which have been presented and discussed already above for sub-Saharan Africa and Europe and will be deepened later in the country reports on Germany, Kenya and Zambia.

5.3.6 Financial Integration and Jobs

A more careful look shall be taken at the relationship between capital and labour for three reasons:

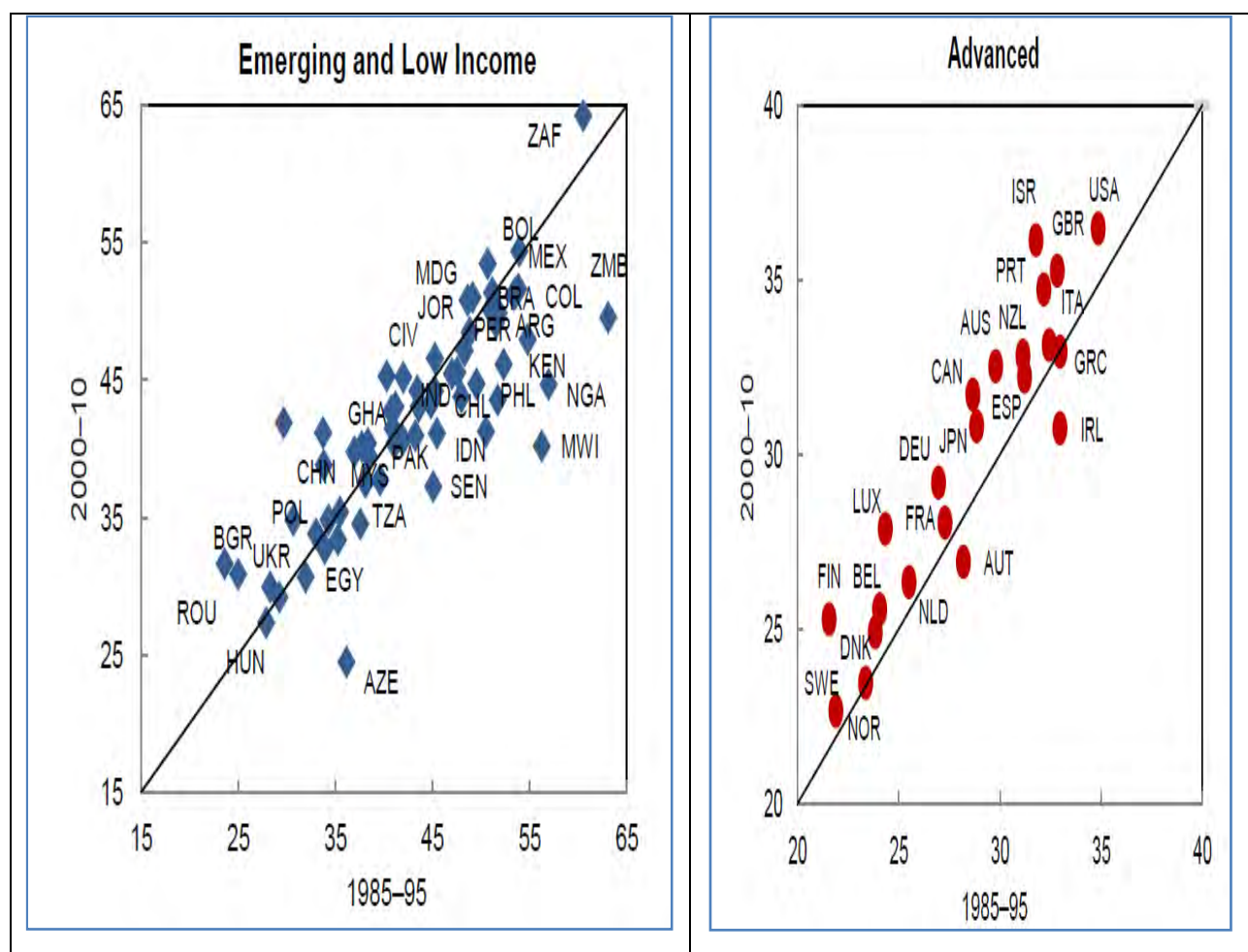
First, it is traditionally an area of major importance for Catholic Social Teaching, the framework within which this research is done.¹⁷⁰

Second, as studies confirm, ‘unemployment is found to be a significant determinant of income inequality. A 1 percentage point increase in the unemployment rate is associated with a 0.3-0.4 percent increase in inequality (and 0.7-0.8 percent for advanced economies)’ (International Monetary Fund, 2013b, p. 17). A clear relationship between the rise of unemployment and a rise in inequality can be established especially for both the developed and developing economies following the 2007/2008 crisis:

¹⁶⁹ Further Action Needed to Reinforce Signs of Market Recovery (2009, April 21). In: IMF Survey Magazine; IMF Research. Retrieved from <http://www.imf.org/external/pubs/ft/survey/so/2009/RES042109C.htm>

¹⁷⁰ In fact, conflicts between capital and labour were at the outset of Catholic Social Teaching, lifting it onto the Agenda of the Pope and making it into a task for the entire church; see (Alt, 2014) and (Percy, 2007).

Graphic 71 Trends in disposable income inequality: Gini Coefficient 1985-2010



Source 41 (International Monetary Fund, 2013b, p. 21)

Third: Findings of the three country reports of this study will demonstrate that by far the largest share in Income Tax, but probably also in other areas, is not paid by the wealthy and capital owners. Rather, most tax revenue is generated from those being dependently employed (via direct wage tax, PAYE, etc.) and their consumption and resulting VAT.

There is a very damaging long-term trend within financial integration affecting employment in general and creation and preservation of quality jobs in particular: The decreasing attractiveness of investment into the real economy, i.e. the part where the jobs of ordinary and average people are. Investment options and bargaining power of capital owners in comparison to states and labour increased threefold:

- First, they had the choice to invest in the financial or the real economy;
- second, they had the choice to invest nationally or internationally;
- third, unfettered mobility of capital increased its advantage over immobile labour forces and lead to investment in those states which most willingly offered tax exemptions and/or tax-funded subsidies, and whose trade unions and labour force were willing to abandon the ideal of well-paid (thus taxable) jobs and to create flexible, mobile, temporary, precarious jobs instead.

But since there were always opportunities to shift production to ever cheaper, more “welcoming” or “accommodating” countries, those concessions often cost a lot of tax revenue

without any long term gain: Often investors moved on to greener pastures, leaving behind unemployed people and indebted states.

Over the decades of deregulation, net investment in the real economy shifted away from production and services within the real economy and turned instead to financial services, real property and housing. Due to the difficulty of obtaining international data here, the following illustration of Germany is given as an example. The following table gives the share of net-investment (i.e. investment not just replacing capital value but adding to the productive potential of an economy)¹⁷¹ in relationship to GDP as a whole, and the amount of net investment into four important economic sectors:

Table 16 Germany: Net investment in share of GDP, net investment into sectors of economy (in billion €)

	Net investment in share of GdP	Investment in Financial Services	Investment in real property and houses	Investment in manufacturing	Investment in construction
1995	9.5				
2005	2.25	0.69	43.5	-10.3	-2
2007	3.9	0.07	53.6	0.6	-0.5
2009	1.4	0.64	45.2	-10.6	-0.8
2011	3.2	2.72	64.1	-1.7	-0.6
2012		2.27	63.7	-4	0.11
2013	2.3				

This table illustrates that investment in important sectors of the real economy, which hold many jobs, namely manufacturing and construction, is decreasing, while investment in sectors which are of interest mainly for the wealthy is increasing. Clearly, if net investment in the real economy is decreasing (in fact down two thirds since 1995), this is undermining net wages, lowering purchasing power and consumption and endangering the collection of public revenue. It needs to be kept in mind that the decrease of net investment in the real economy is not due to a lack of capital. But every absorption of capital by the financial sector necessarily lowers investment in the real economy, thus affecting jobs. Clearly, the German development is certainly not a single, isolated occurrence.

Besides that long-term development, another consideration shall be given to the recent World Financial and Economic Crisis and its impact on labour worldwide. Here, a joint study of the International Labour Office and the World Bank illustrates in its Synthesis Report the plunge in GDP worldwide and respective regions:¹⁷²

¹⁷¹ „Während die Bruttoanlageinvestitionen die gesamten Zugänge zum Anlagevermögen darstellen, zeigen die Nettoanlageinvestitionen die Investitionen, die über den Ersatz des Kapitalverzehr hinausgehen. Die Nettoanlageinvestitionen geben Aufschluss darüber, in welchem Umfang Anstrengungen seitens der Unternehmen, des Staates und der privaten Haushalte unternommen werden, um den gesamtwirtschaftlichen Kapitalstock und damit letztlich das Produktionspotenzial einer Volkswirtschaft auszuweiten.“ From Federal Statistical Office (2014) Volkswirtschaftliche Gesamtrechnung – Beiheft Investitionen. Retrieved from https://www.destatis.de/DE/Publikationen/Thematisch/VolkswirtschaftlicheGesamtrechnungen/Inlandsprodukt/InvestitionenPDF_5811108.pdf?__blob=publicationFile, pp.72ff.

¹⁷² ILO/World Bank (2012) Inventory of Policy Responses to the Financial and Economic Crisis. Retrieved from http://www.ilo.org/empelm/projects/WCMS_158875/lang--en/index.htm Both subsequent tables can be found on pp. 2+3.

Table 17 Global annual Real GDP Growth Rates (%) 2007-2016

Table 1: Annual Real GDP Growth Rates (%)										
Region	2007	2008	2009	2010	2011p	2012p	2013p	2014p	2015p	2016p
WORLD	5.4	2.8	-0.7	5.1	4.0	3.5	4.4	4.6	4.8	4.9
Developed Economies and European Union	2.7	0.1	-3.9	2.6	1.4	1.1	2.0	2.4	2.5	2.5
Central and South-Eastern Europe (non-EU) and CIS	7.8	4.3	-5.9	5.3	4.9	3.7	4.0	4.1	4.0	4.0
East Asia	12.1	7.8	7.1	9.8	8.7	7.7	8.8	8.4	8.6	8.8
South-East Asia and the Pacific	6.7	4.5	1.6	7.6	5.1	5.2	5.8	6.0	6.0	6.0
South Asia	9.4	5.9	6.2	9.2	7.0	6.6	7.6	7.9	7.7	7.9
Latin America and the Caribbean	5.8	4.3	-1.7	6.1	4.4	3.7	4.0	4.0	4.0	4.2
Middle East	7.1	4.4	2.2	4.4	5.0	3.7	4.1	4.4	4.5	4.5
North Africa	5.8	5.1	3.5	4.4	2.1	3.1	4.3	5.0	6.0	6.3
Sub-Saharan Africa	7.1	5.6	2.8	5.4	5.1	5.6	5.5	5.4	5.2	5.3

Source: 2012 ILO Calculations based on ILO – Trends Econometric Models, October 2011, and on IMF, World Economic Outlook, September 2011.

As can be seen, developed economies and eastern European economies have been hit hardest, but the impact of the crisis could be felt all over the globe. Once more it needs to be borne in mind that comparatively small decreases can, where there is already little, mean a lot, especially in countries like sub-Saharan Africa which do not have any social safety networks at all.

A similar picture emerges when looking at global unemployment figures. Worldwide, the crisis deleted 27 million jobs, mostly in developed economies, but not exclusively:

Table 18 Global unemployment in millions 2007-2016

Table 2: Unemployment (millions)										
Region	2007	2008	2009	2010	2011p	2012p	2013p	2014p	2015p	2016p
WORLD	170.7	176.4	197.7	197.3	197.3	201.2	204.3	205.7	206.6	207.8
Developed Economies and European Union	29.1	30.8	42.5	44.7	43.5	44.3	44.4	43.5	42.2	41.2
European Union (27)										
USA										
Central and South-Eastern Europe (non-EU) and CIS	14.5	14.7	18.1	17.0	15.5	15.6	15.7	15.6	15.6	15.7
East Asia	31.6	35.8	36.7	35.6	35.5	36.0	36.3	36.4	36.6	36.7
South-East Asia and the Pacific	16.1	15.7	15.5	14.7	14.6	14.9	15.2	15.4	15.6	15.8
South Asia	23.6	23.3	24.5	25.0	25.0	25.5	26.2	26.7	27.2	27.7
Latin America and the Caribbean	18.4	17.9	21.2	20.2	20.5	21.0	21.5	22.0	22.4	22.7
Middle East	6.4	6.6	6.6	6.7	7.1	7.4	7.7	7.9	8.1	8.2
North Africa	6.6	6.4	6.5	6.7	7.9	8.1	8.3	8.4	8.4	8.4
Sub-Saharan Africa	24.5	25.2	26.0	26.7	27.6	28.3	29.0	29.8	30.6	31.4

Source: ILO-Trends econometrics Models, October 2011.

Regarding unemployment, one has to bear in mind that there was already a job gap before the crisis struck due to demographic developments which brings annually 42 million

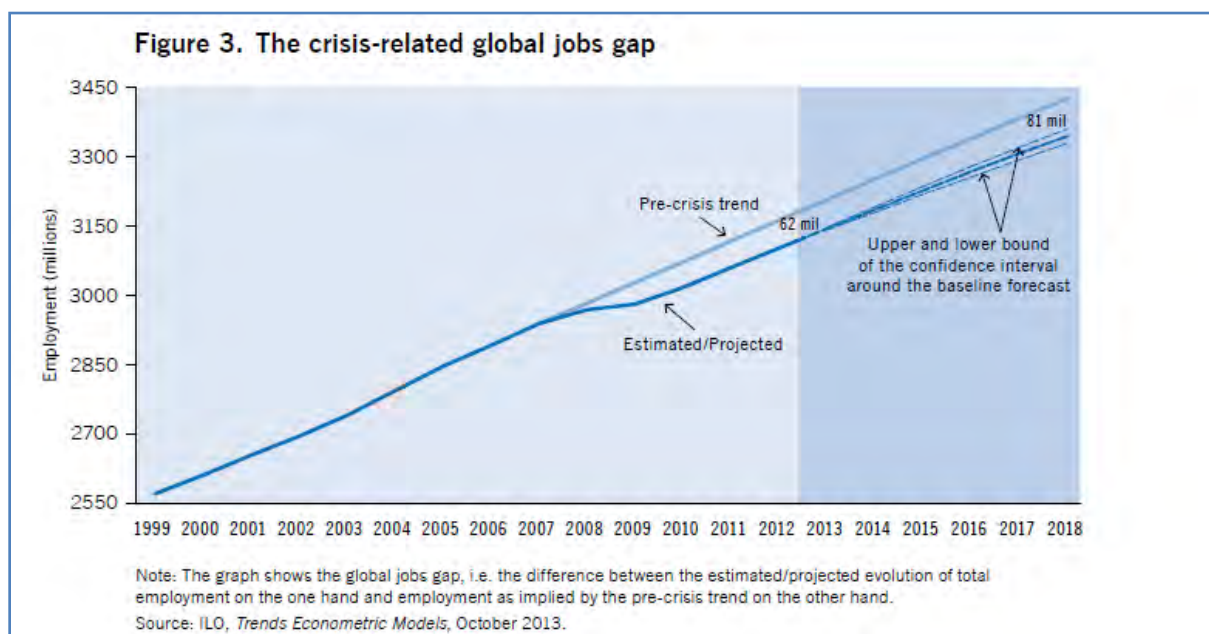
new entrants into the global labour market and which could not be stemmed even by pre-crisis growth levels. This explains the high unemployment figures for sub-Saharan Africa and also, why young people and entrants into the labour market are among the prime victims of the crisis, not only in sub-Saharan Africa, but also in Europe: One has simply to recall the outrageously high unemployment figures among young people in southern European states: In 2013, the rates were as follows:¹⁷³

- Greece: 59.2%
- Spain: 54.3%
- Croatia: 49.2%
- Italy: 41.6%
- Portugal: 36.6%
- EU average: 23.9%

It is easy to imagine the highly explosive situation this creates for those societies and one should remember not only the “Arabellion” in this context, but also the violent uprisings of students and young people in Great Britain and elsewhere in Europe.¹⁷⁴

The situation is aggravated by the findings of ILO specific reports which point out that many lost jobs were not restored after the crisis. Rather, the job gap has been carried forward ever since because of a largely “jobless recovery”. For that and other reasons, the crisis related job gap increased from the original 27 million to 62 million missing jobs by 2013, pushing ever more people into vulnerable and precarious jobs or the informal sector which is difficult to tax in the first place.¹⁷⁵

Graphic 72 The 2007/2008 crisis related jobs gap



¹⁷³ See <http://www.statista.com/statistics/266228/youth-unemployment-rate-in-eu-countries/>

¹⁷⁴ http://en.wikipedia.org/wiki/2011_England_riots,
http://en.wikipedia.org/wiki/2011%E2%80%9312_Spanish_protests and
http://en.wikipedia.org/wiki/2010%E2%80%9312_Greek_protests

¹⁷⁵ For the preceding paragraph and the graphic see (International Labour Organisation, 2013, p. 24+48).

It is striking that the concepts of vulnerable and precarious employment or that of the “working poor” is missing in the joint ILO/World Bank report, which leads to the conclusion that this joint report is talking merely about quality jobs, i.e. those jobs which also pay taxes and social security contributions.

Regarding vulnerable employment, job creation after the crisis exacerbated a trend which could be stated already in the decades ahead, namely, that job quality is changing. Jobs in the time of financial integration are increasingly subject to profitability criteria of investors and capital owners to the extent that more precarious, temporary, less-well-paid jobs replaced the good ones, which did not generate a comparable amount of taxes or worse: If people’s wages are in need of being topped-up with taxpayers money because those employed cannot lead a decent live based upon their wage alone or if people are becoming unemployed and are in need of social benefits or welfare assistance.¹⁷⁶ ‘The number of people in vulnerable employment expanded by around 1 per cent in 2013, which is five times higher than during the years prior to the crisis.’ (International Labour Organisation, 2013, p. 12)

Regarding the so-called “working poor”, i.e. people who labour for US\$1.25 or US\$ 2 per day: they still make up the largest class of global employment. Here the number is admittedly decreasing since the 1990s, but progress has stalled due to the crisis and slow recovery after the crisis in many parts of the world.

In 2013, 375 million workers (or 11.9 per cent of total employment) are estimated to live on less than US\$1.25 per day and 839 million workers (or 26.7 per cent of total employment) have to cope on US\$2 a day or less. ... In 2013, the number of workers in extreme poverty declined by only 2.7 per cent globally, one of the lowest rates of reduction over the past decade, with the exception of the immediate crisis year. (International Labour Organisation, 2013, p. 12)

Clearly, those people also are not able to pay income tax or social security contribution in their countries at all.

Saying this one might conclude with the observation that the overall and speedy recovery in both developed and developing countries after the 2007/2008 crisis might be deceptive: whatever recovery there is, it is not restoring assets and jobs, but creating new ones. Assets which have been destroyed, such as quality jobs which generated taxes and social security contributions, life insurances, pensions..., were not re-created in the way they existed before the crisis struck. This is even more the case since, due to the demographic development, many more of new jobs for even more people were created and people, being desperate for a job, were happy with a lot less on offer than those who looked for work in earlier decades and had a number of options to choose from. All this is why it is rather unlikely that those in the labour market profiting from the new boom are the same ones who lost out – different from capital owners: here those profiting might still be those who also profited before the crisis...

5.3.7 Financial Integration and inequality

In spite of what is presented here, even as late as 2011 senior staff members of the IMF and other financial institutions still adhered to the view that financial integration contributes to economic growth, job growth and a narrowing of the wealth gap. Sarwat Jahan,

¹⁷⁶ As to globalization-induced changes in the job sector see (OECD, 2011a) and pp. 1-32 of ILO (2012) World of Work report. Retrieved from http://ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_179453.pdf

Economist and Brad McDonald, Deputy Unit Chief in the IMF's Strategy, Policy, and Review Department, open their article "A Bigger Slice of a Growing Pie" as follows:

Economic development and financial development reinforce each other. That should come as no surprise. More varied and more accessible financial services – from banking to insurance to stock markets – permit larger pools of savings to be channeled with increasing efficiency toward productive investments that result in stronger growth. But to the surprise of some, there is mounting evidence that financial development does not merely enlarge the pie, but also divides it more evenly.¹⁷⁷

Naturally, even now there may be statistics to prove those authors right. For example, that inequality is integral to the effective functioning of market economy and the incentives needed for investment and growth. And indeed, such a link can be established when looking at short-time developments. The more important question is however: how sustainable are those developments in the longer run? It is a key issue which, so far, has been neglected in research. And here it is obvious that financial flows within open and unregulated markets are producing just the short-time intensive growth-cum-job-creation which lasts as long as investment does not find more profitable markets and withdraws resources, destroying what it has previously created.

Not surprising, therefore, that in 2011 more farsighted IMF staff, e.g. then-director Dominique Strauss-Kahn, admitted that the link between financial integration, growth, jobs and equality cannot be upheld any longer. In a speech he stated:

(W)hen I look around today, I am concerned... (G)rowth ... is not creating jobs and is not being shared broadly. Many people in many countries are facing a social crisis that is every bit as serious as the financial crisis. ... (W)hat should have been a brief spell in unemployment is turning into a life sentence, possibly for a whole lost generation. In too many countries, inequality is at record highs. As we face these challenges, remember what we have accomplished. Under the umbrella of the G20, policymakers came together to avoid a financial freefall and probably a second Great Depression. Today, we need a similar *full force forward* response in ensuring that we get the recovery we need. And that means ... also one that brings employment and fair distribution. ... A few thousand years ago, Aristotle wrote that "*The best partnership in a state is the one which operates through the middle people...*". This was true in the time of Aristotle, it was true in the time of Keynes, and it is true today. Stability depends on a strong middle class that can propel demand. We will not see this if growth does not lead to decent jobs, or if growth rewards the favoured few over the marginalized many. Ultimately, employment and equity are building blocks of economic stability and prosperity, of political stability and peace.¹⁷⁸

What Strauss-Kahn is suggesting here is that (1) he sees a link between Financial Integration and the destruction of jobs, and that (2) it is not enough to repair that what went wrong within the global financial system to bring back jobs, social stability and inner peace. Rather, a different approach is needed with different instruments. In this regard, IMF publications adopted later on a much more sceptical (realistic) approach to the blessings of financial integration, pointing out clearly who is profiting from it and why:

¹⁷⁷ From p. 16 of IMF (2011) Finance & Development, Vol.48 Nr. 3. Retrieved from <http://www.imf.org/external/pubs/ft/fandd/2011/09/pdf/jahan.pdf>

¹⁷⁸ Strauss-Kahn, D. (2011, April 13) The Global Job Crisis – Sustaining the Recovery through Employment and Equitable Growth. Speech retrieved from <http://www.imf.org/external/np/speeches/2011/041311.htm>

Financial globalization and the ability to access cross-border finance, on the other hand, would be expected to operate through capital owners' income. To the extent that financial globalization allows agents to borrow and invest more easily in the production of goods and services or in human capital, this would be expected to boost the future incomes of these agents more than those who are unable to access such financing. ... The adverse impact of financial deepening on inequality could suggest that while overall financial deepening is associated with higher growth, a disproportionately larger share of increased finance goes to those who already have higher incomes and assets which can serve as collateral. (Jaumotte, Lall, & Papageorgiou, 2013, p. 285+302)

As new research by the IMF into long-term relationships between growth and inequality demonstrates: more sustainable, long term growth seems to be linked with rules and regulations for investment and active policies advancing and securing both growth AND equality and the creation of jobs. 'Over longer horizons, reduced inequality and sustained growth may thus be two sides of the same coin.'¹⁷⁹

5.3.8 Governance issues

Given all these analytical facts and even insights and good intentions by prominent global institutions, there are several major problems related to attempts to re-regulate the financial sector and make it serve the many rather than the few: First of all the power, which global capital has nowadays over states when it comes to bring in or withdraw investment from a country. Many of the larger financial crises over the past years occurred (or were increased) when international capital owners decided to withdraw from a specific country or region. A simple threat of influential capital holders to make this happen again might be enough to "induce" governments to avoid anything which could "anger the markets".

A second problem is more systemic: Financial Integration created actors who are "too big to fail" or "systemic relevant financial institutions", meaning: the world's biggest players are interconnected in a way that states and governments can no longer afford to simply have them go bankrupt because ripples of one collapse would pull other institutions to follow and threaten a global meltdown. This knowledge encouraged a behaviour known by the expression "moral hazard", i.e. even though traders know that their products and trading imply high risks for market stability, they just gamble on, as long as the casino is open because they are aware of the need for states to bail them out, because also savings and pension plans, etc. of ordinary citizens would otherwise be affected. Another interesting side-effect: Because they are too big to fail and because everybody knows that governments have to bail them out, it is easier for them to borrow money at lower rates which amounts to an indirect subsidy by the taxpayer – calculated by economists to US\$ 83 billion a year for the largest banks.¹⁸⁰ In the US, researcher of the Federal Reserve even noted that banks tried actively to achieve this "too big to fail" status by paying lots of money in attempts to merge – lastly a 'profitable' deal.

¹⁷⁹ P. 4 of Berg, A., and J.D. Ostry, 2011, "Inequality and Unsustainable Growth: Two Sides of the Same Coin?" IMF Staff Discussion Note 11/08 (Washington: International Monetary Fund). Retrieved from <https://www.imf.org/external/pubs/ft/sdn/2011/sdn1108.pdf>

¹⁸⁰ Editorial "Why Should Taxpayers give Big Banks \$ 83 Billion a year? (2013, February 20). In: BloombergView. Retrieved from <http://www.bloombergview.com/articles/2013-02-20/why-should-taxpayers-give-big-banks-83-billion-a-year->. See also (Schick, 2014, p. 59ff.) and Brewer/Jagtiani (2011, September 2) How much did banks pay to become too-big-to-fail and to become systemically important? Working Paper 11-37, Federal Reserve Bank of Philadelphia. Retrieved 10 February 2015 from <https://www.philadelphiafed.org/research-and-data/publications/working-papers/2011/wp11-37.pdf>

A third problem lies in culture: both the 147 financial global players and other economic TNCs share globally common visions and values, follow established norms and procedures and are linked together with a highly efficient IT infrastructure. The 200 states and state-like entities on the other side, which need to cooperate if they would like to counter and regulate activities of those actors, share no common language, culture, vision, norms and laws. This is, of course, masterly exploited by the big business actors, by pitting those states against each other, suggesting that their cooperation is against their best interest. Even though increasingly major global institutions point out that such lack of cooperation is, in the end, damaging the interests of all (big business and the wealthy few excluded),¹⁸¹ it is rather likely that this lack of cooperation will continue for the foreseeable future. A similar problem emerges when looking at the influence of the world's top private wealth holders. Here, too, it is admitted that those people, due to their extensive social network, exercise a lot of economic and social power "behind the scenes" (Wealth-X and UBS, 2014, p. 34). Above (5.3.3.) the extent has been demonstrated to which financial institutions dominate the world largest and most powerful corporate player and what this means in terms of institutional power towards governments and government regulation

Linked to this is – fourth – the fact that too many academic and research institutions are still occupied by adherents of neo-liberal and neo-classical theories. As long as those people are not replaced by others who purport different economic approaches, it is also difficult to eradicate policy recommendations from the social-public and political discourse. Nothing is more powerful than new ideas whose time has come. But equally nothing is more reluctant to go away from hearts and minds than ideas whose time has run out.

A fifth problem is the dependency of governments on capital markets when it comes to the need to raise capital or to pay interest if they are indebted – one exception being perhaps the United States of America.

A final point is: the efforts undertaken by the financial sector and big business to "assist" governments to develop the "best possible" solutions for today's problems. Not surprisingly, for example, lobbyists with multi-billion-dollar budgets are crowding around governments in the capitals of the world, offering their advice in difficult times. Successfully, as it seems. For example: when of 260 experts discussing in Brussels the consequences of the World Financial and Economic Crisis around 200 were openly on the payroll of financial lobby groups.¹⁸² This is not a unique occurrence: a similar proportional relationship between representatives of financial interest groups on the one side, and representatives from civil-society groups on the other, existed at the parliamentary hearings when the German government and parliament started to look into the feasibility of a Financial Transaction Tax – which would certainly be a good idea to make "socially useless"¹⁸³ products and activities more expensive and perhaps redundant, but would remove a tremendous source of income for trader and those inventing and "designing" those products.

Certainly, some good things have been achieved by governments since the World Financial and Economic Crisis, e.g. a ban on short sales or the trend to get out of speculation with food for "reputational reasons." And yet: too little is achieved and the next crisis is already rising on the horizon. The power of Big Finance and those representing its interests is

¹⁸¹ A strong case for that has been made, for example, by the OECD when trying to move states to action against base erosion and profit shifting behavior of TNCs, see (OECD, 2013a).

¹⁸² ARD Monitor (2011, August 25) Steuermilliarden – Wie sich die Banker in Brüssel die Regeln selber machen. Retrieved from <http://www.wdr.de/tv/monitor/sendungen/2011/0825/bruessel.php5>

¹⁸³ Lord Adair Turner (2009, August 29) How to tame global finance. In: Prospect Magazine

deeply worrying because of their successful attempts to prevent anything from happening which seriously harms their interests.

5.3.9 Growth! Of what and why?

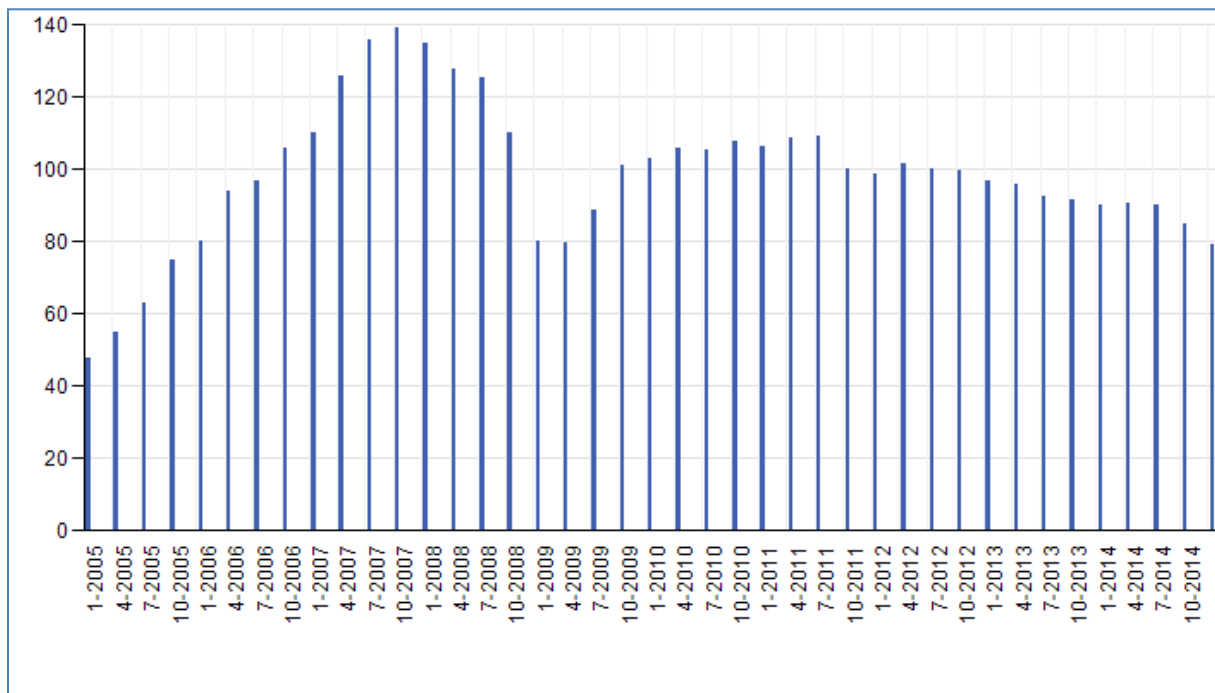
“Economic growth” is the magic word which often is heard when the discussion ponders how to mitigate inequality and poverty. But: Growth of what? And who is profiting from what kind of growth? Above (5.3.6) we noted already that much of the worldwide growth following the World Financial and Economic Crisis was a “jobless growth”, and far too many of the newly created jobs were worse paid than the previously deleted ones. Well paid jobs, however, are most important to remove inequality and poverty or to collect taxes. Ironically: That which is still growing best is the sector which brought the world to the brink of the 2007 crisis: The financial sector. And there are reasons for it:

The main idea of the development and trade of complex financial products is the insurance against financial risks (Schick, 2014, p. 74ff.). For example, if investments are done in developing countries, there is the promise of profit. But, given the insecurity and instability of those states, there is also risk of failure. Or: when buying bonds of certain governments, those states might not be able to repay the loans. Against that one wants to be insured and this is one of the major background of the still booming financial certificate industry. Schick in his book brings some examples and illustrates their inherent risks and dangers, in spite of all promises of the industry, e.g. CMS –Spread-Ladder-Swaps or (p. 100) or Single-Hedgefund Certificates (p. 110f.).

It is the market of derivatives which is the most concentrated and centralized in the world: 67% of all deals are done by the worldwide 10 largest banks, the 87.5% of all deals in the area of Credit Default Swaps are done by the worldwide 15 largest (p. 40f.). This concentration on few actors is accompanied by high-speed trading, which is hardly anymore controllable by human beings – not surprising, that the financial system is getting increasingly volatile.

The market of derivatives and certificates is booming: Were there about 100,000 different products before the World Financial and Economic Crisis, their number currently exceeding 1 million by far – in Germany alone. Here, the website of the German Federation for Derivatives is a treasure trove of information.

Graphic 73 Development of the German Derivative Market (in billion EUR)¹⁸⁴



The irony is that top bankers display a hearty distrust when it comes to derivatives and certificates: Once the CEO of the Deutsche Bank, Hilmar Kopper, admitted, when talking about his own personal investments: ‘My own money I invested solidly, of course. Some shares, some funds, bonds – not a single certificate.’¹⁸⁵

At the same time, OECD studies, e.g. (Cingano, 2014), reveal the link between rising income inequality and sinking economic growth, meaning, reducing inequality would reduce economic growth. OECD secretary-general Angel Gurría argued when presenting findings of Cingano's study: ‘This compelling evidence proves that addressing high and growing inequality is critical to promote strong and sustained growth and needs to be at the centre of the policy debate... Countries that promote equal opportunity for all from an early age are those that will grow and prosper.’¹⁸⁶ This might be dismissed by being a “mere discussion paper” by an isolated researcher. However, whatever is said by Cingano is repeated and supported by the major inequality report “In It Together: Why Less Inequality Benefits all” (see 2.3.3). The OECD's findings are also supported by IMF studies, e.g. (Ostry, Berg, & Tsangarides, 2014).

Finally, an interesting observation by Lord Adair Turner, formally the head of the British Financial Services Authority: According to him, the job spectrum of developed economies is changing; away from productive jobs to redistributive jobs such as lawyers, tax advisors or developer and dealer of complex financial products: All of those do not add any additional value to our economy and society, so Turner.¹⁸⁷

¹⁸⁴ Retrieved on 10 February 2015 from <http://www.derivateverband.de/DEU/Statistiken/Marktvolumen>

¹⁸⁵ Quoted in (Schick, 2014, p. 92)

¹⁸⁶ Press Release on 9 December 2014 “Inequality hurts economic growth, finds OECD research”.

Retrieved from <http://www.oecd.org/newsroom/inequality-hurts-economic-growth.htm>.

¹⁸⁷ Quoted in (Schick, 2014, p. 23f.)

5.3.10 Jobs! But which and why?

A similar question might be asked regarding the kind of jobs which are created by within a society and economy – a question which even the OECD asks in its 2015 report, as is illustrated by the headline “It’s about jobs – but which jobs?” (2015a, p. 30). As it seems, the World Financial and Economic Crisis did little to inflict cuts and restraints for those among the top 1% of the income and wealth hierarchy (even though one has to admit, of course, that due to the crisis some fell down from those heights to more modest position in the income and wealth hierarchy): As shown in 5.4.3, the income situation among the top 1% is continuing and outrageously high.

At the same time, the income situation at the bottom stagnated or got worse in many countries and there is little social mobility when it comes to the chances to escape from the bottom 40% once one is born into that group. Even though the authors of this report admit that temporary, badly paid and precarious employment might not be bad as such, those employment situations are only justified if there is a realistic way out into a better employment contract, as even the OECD admits (see 2.3.3). This does not seem the case and it will not be the case as long as the interests of capital will prevail over labour and as long as the interest of capital has the stronger leverage over public policy via lobbyists and threat scenarios which will prevent states to cooperate with each other rather than compete with each other.

5.3.11 Conclusion

Even though a mixed picture emerges as to what is more responsible for the increase in inequality since the neoliberal variation of globalization took off in force during the 1980s, it seems that financial globalization carries a larger share than globalization of trade. The increase in quantity, its detachment of the production of real good and real services, which make a difference in the real world, its increasing interconnectivity increase global risks: Earlier, when certain sectors were still separated, one crisis could not affect the system. Today, when complex financial products link production and sectors together and increasingly are one global market, a failure in one segment can rip the entire system (Schick, 2014, p. 74ff.)

This is even admitted by some of its earlier champions. Charles Moore, the “authorized biographer” of Margaret Thatcher and editor of the *Daily* and *Sunday Telegraph*, seems to be very close to what one could call a conservative out of conviction and a most influential opinion maker in the United Kingdom. The World Financial and Economic Crisis was a wake-up call for him. In a famous editorial he confessed:

(W)hen the banks that look after our money take it away, lose it and then, because of government guarantee, are not punished themselves, something much worse happens. It turns out – as the Left always claims – that a system purporting to advance the many has been perverted in order to enrich the few. The global banking system is an adventure playground for the participants, complete with spongy, health-and-safety approved flooring so that they bounce when they fall off. The role of the rest of us is simply to pay. This column’s mantra about the credit crunch is that Everything Is Different Now. One thing that is different is that people in general have lost faith in the free-market, Western, democratic order. They have not yet, thank God, transferred their faith, as they did in the 1930s, to totalitarianism. They merely

feel gloomy and suspicious. But they ask the simple question, “What's in it for me?”, and they do not hear a good answer.¹⁸⁸

The “Trickle down” promise, according to which inequality may increase but in the end the situation of everybody would improve, did not come true: the wealth gap opened at both ends, i.e. net-wealth for some did indeed decrease, and the number of the poor remained unjustifiably high with, 842 million people suffering chronic hunger,¹⁸⁹ many more probably frequently or occasionally. Pope Francis puts it like this:

There was the promise that once the glass had become full it would overflow and the poor would benefit. But what happens is that when it's full to the brim, the glass magically grows, and thus nothing ever comes out for the poor ... I repeat: I did not talk as a specialist but according to the social doctrine of the church. And this does not mean being a Marxist.¹⁹⁰

Hunger or deadly diseases are moral obligations to act – especially since, changing Gandhi's famous quote slightly, our world has enough for the needs of all, but will obviously never have enough for the greed of some very few who already have plenty.

The inability (or unwillingness) of Big Finance to come to its right senses and to cooperate in the re-regulating attempts of the financial sector is worrying major stakeholders in the debate. The concluding observations shall be given to the Governor of the Bank of England and the Chairperson of the IMF.

Mark Carney, speaking at a City of London conference ‘warned that there was a growing sense that the basic social contract at the heart of capitalism was breaking down amid rising inequality. “We simply cannot take the capitalist system, which produces such plenty and so many solutions, for granted. Prosperity requires not just investment in economic capital, but investment in social capital.” And he carried on: “Just as any revolution eats its children, unchecked market fundamentalism can devour the social capital essential for the long-term dynamism of capitalism itself. To counteract this tendency, individuals and their firms must have a sense of their responsibilities for the broader system. ... Many banks have rightly developed codes of ethics or business principles, but have all their traders absorbed their meaning?”’¹⁹¹

At the same conference, Christine Lagarde pointed out:

“The behaviour of the financial sector has not changed fundamentally in a number of dimensions since the crisis. While some changes in behaviour are taking place, these are not deep or broad enough. The industry still prizes short-term profit over long-term prudence, today's bonus over tomorrow's relationship.” ... In a speech littered with quotations from Winston Churchill to Pope Francis and Oscar Wilde, Lagarde said... “The bad news is that progress is too slow, and the finish line is still too far off. Some of this arises from the sheer

¹⁸⁸ Moore, Ch. (2011, July 11) I'm starting to think that the Left might actually be right. In: *The Guardian*. Retrieved from <http://www.telegraph.co.uk/news/politics/8655106/Im-starting-to-think-that-the-Left-might-actually-be-right.html>

¹⁸⁹ Constantly updated statistics at <http://www.wfp.org/hunger>

¹⁹⁰ Pope Francis in an Interview with the Italian paper *La Stampa*. Quoted in: Davies, L. (2013, December 15) Pope says he is not Marxist, but defends his criticism of capitalism. In: *The Guardian*. Retrieved from <http://www.theguardian.com/world/2013/dec/15/pope-francis-defends-criticism-of-capitalism-not-marxist>

¹⁹¹ Monaghan, A. (2014, May 28) Bank of England governor: Capitalism doomed if ethics vanish. In: *The Guardian*. Retrieved from <http://www.theguardian.com/business/2014/may/27/capitalism-critique-bank-of-england-carney>

complexity of the task at hand. Yet, we must acknowledge that it also stems from fierce industry pushback, and from the fatigue that is bound to set in at this point in a long race.”¹⁹²

Given these appeals for more ethics and the quotations of non-financial experts by those who are in charge of regulating global financial integration, the time seems to be ripe to no longer leave the field merely to the “experts” and “technicians”. The question is whether any effective coalition is still possible to put up this fight against Big Finance or whether indeed there is no alternative to wait for the next collapse, hoping that out of those ruins something better can be created as Piketty states for the US and Europe after the 1929 global crisis and two world wars.

5.4 Information, Communication Technological progress

5.4.1 General trends

In his Cass Lecture, Lord Adair Turner argues that this third exogenous¹⁹³ driver of globalization is the most important and far-reaching of all. General Motors, he argued, once employed 800,000 people, Microsoft 100,000, Google 50,000 and now Facebook comes along with merely 5,000. At the same time, the value of those ICT entities rises enormously on the markets. In earlier days, mechanization still generated jobs – perhaps they were different from those which they deleted at the same time, but at least they created work, income and taxes. Nowadays, few people can develop an idea and implement it with ever fewer people. In his nightmare scenario, ‘the end point ... is a world in which we have automated everything that can be automated – in which robots powered by solar energy perform an ever-increasing number of functions, and crucially, build evermore robots to perform more functions.’ (Turner, 2014, p. 30).

5.4.2 Skill premium - for the top 1% and qualified labour

But already it is apparent that ICT trends have a very different impact on job creation and, on the whole, contribute greatly to inequality. Certainly, investment in education could prepare people to cope under the changed circumstances – at least to a certain extent. On the positive side, this could lead to higher wages for the skilled worker (“skill premium”). But there are negative aspects as well: a rise in salaries for the skilled worker opens a gap in wages between skilled and unskilled labour. And, if educational efforts were too successful, competition of many school graduates for few jobs might kill the skill premium, because employers can afford lower salaries due to a larger number of people wanting them.¹⁹⁴ Clearly, the impact of technology on the labour market at the lower end and the middle class is complex and diversified and is elusive to any simple analysis, as also the OECD (see 2.3) and Turner (2014) confirm.

It is therefore surprising to read the following analysis of IMF staff, related to advances in technology and related skill premiums in globalization processes. First, the authors forward the thesis that ‘average real income of the poorest segments of the population have increased across all regions and income groups’, so that Globalization indeed seems to have its good aspects for all. If therefore and second inequality has nevertheless increased to

¹⁹² Monaghan, A. (2014, May 27) IMF Chief says banks haven’t changed since financial crisis. In: *The Guardian*. Retrieved from <http://www.theguardian.com/business/2014/may/27/imf-chief-lagarde-bankers-ethics-risks>

¹⁹³ Following the classification of drivers above in 5.1. Others may prefer to view technological progress to be an endogenous/secondary/derivative driver since it is dependent from capital and investment into R&D.


¹⁹⁴ (UNDP, 2013, p. 73ff.) and (OECD, 2011a).

alarming levels, empirical evidence ‘suggests that inequality has increased in the upper parts of the distribution in most countries’ (Jaumotte, Lall, & Papageorgiou, 2013, p. 274f.). Which indicates the following: that segment of the labour market which profits most from skill premiums are the “global stars” and “top performers”, earning (justifiably or not) “supersalaries”. Piketty, OECD and IMF¹⁹⁵ point to the increasing competition among large corporations for the best of the best which they try to attract with hefty payment packages, not only involving large salaries but also other forms of remuneration such as performance-related bonus payments, share options and more.

Those people also belong not just to the top 10%, but rather to the top 1%, 0.1% or even 0.01% of the population. So far, the best analyses of those top incomes exist for the US, where the following division among the top 0.1% people was established.

Graphic 74 Percentage of primary taxpayers in the top 0.1% of the income distribution (including capital gains) that are in each occupation, United States, 2004

Occupation	%
Executives, managers, supervisors (non-finance)	41
Financial professions (including management)	18
Not working	6
Lawyers, real estate	11
Medical	4
Other	20

Source: Bakija et al. (2010).
 StatLink  <http://dx.doi.org/10.1787/888932538339>

Source 42 (OECD, 2011a, p. 352)

Discussing these findings, the OECD states a notable increase of persons working in the financial area from 11% (1979) up to 18 % in just 15 years. The situation in Australia is comparable: in 2008, the share of managers among the top 0.1% was 36%, of professionals 20%, of those retired or without employment 34%. In the UK (in 2007/2008), the share of financial professionals among the top 1% of the population was 21%, of those working in real estate, renting and business 28.5%. Most interesting is the share of people declared under “retired” or “not working”: it seems indeed that there is a class of people, called “patrimonial capitalists” or “rentiers” by Piketty, who no longer need to work at all.

5.4.3 Supersalaries – perceived – real – justified?

It is also among those job holders where the most obscene gaps occur between the top income and the average worker salary of a company. The US Federation of Trade Unions calculated the CEO-worker pay-ratio, based on national and OECD statistical data available. Hence the wage gap between a CEO and an average worker is: in the USA 354:1, in Canada 206:1, in Germany 147:1, in the UK 84:1, in Poland 26:1.¹⁹⁶

Interesting enough, most people are not aware of these gaps. In a survey conducted by Chulalongkorn University’s Sorapop Kiatpongsan and Harvard Business School’s Michael

¹⁹⁵ See Piketty in chapter 9 (“The Rise of the Supermanager”), “The effects of globalization and skill-biased technical progress” in (OECD, 2011a, p. 359f.) and (Jaumotte, Lall, & Papageorgiou, 2013).

¹⁹⁶ See interactive website <http://www.aflcio.org/Corporate-Watch/Paywatch-Archive/CEO-Pay-and-You/CEO-to-Worker-Pay-Gap-in-the-United-States/Pay-Gaps-in-the-World>

Norton,¹⁹⁷ people in various countries were asked what payment difference between a CEO and an unskilled worker would be ideal/justified, and how big, they think, the ratio is in today's real world. In both cases, the ratio given is much lower than it is actually in reality:

Graphic 75 Actual, estimated and ideal pay ratios of CEOs to unskilled workers

ACTUAL, ESTIMATED, AND IDEAL PAY RATIOS OF CEOS TO UNSKILLED WORKERS
According to respondents in 16 different countries.



SOURCE SORAPOP KIATPONGSAN AND MICHAEL I. NORTON, "HOW MUCH (MORE) SHOULD CEOS MAKE?"

HBR.ORG

In numbers:

¹⁹⁷ Insights of the study, including the graphic and table are contained in a Harvard Business Review editors ahead publication (Gavett, 2014) The text itself can be retrieved at (Kiatpongsan & Norton, 2014).

Table 19 What average workers get paid and should/could be paid

WHAT AVERAGE WORKERS SHOULD BE PAID

According to each country's ideal CEO-to-worker compensation ratios.

	RATIO		AVERAGE COMPENSATION		
	<i>Actual</i>	<i>Ideal</i>	<i>CEO</i>	<i>Worker</i>	<i>Worker at the ideal ratio</i>
Australia	93	8.3	\$4,183,419	\$44,983	\$502,012
Austria	36	5.0	1,567,908	43,555	313,582
Czech Republic	110	4.2	2,159,300	19,630	518,228
Denmark	48	2.0	2,186,880	45,560	1,093,440
France	104	6.7	3,965,312	38,132	594,794
Germany	147	6.3	5,912,781	40,223	946,045
Israel	76	3.6	2,189,104	28,804	601,998
Japan	67	6.0	2,354,581	35,143	392,430
Norway	58	2.3	2,551,420	43,990	1,093,481
Poland	28	5.0	561,932	20,069	112,386
Portugal	53	5.0	1,205,326	22,742	241,065
Spain	127	3.0	4,399,915	34,387	1,466,638
Sweden	89	2.2	3,358,326	37,734	1,511,262
Switzerland	148	5.0	7,435,816	50,242	1,487,163
United Kingdom	84	5.3	3,758,412	44,743	704,707
United States	354	6.7	12,259,894	34,645	1,838,975

SOURCE SORAPOP KIATPONGSAN AND MICHAEL I. NORTON, "HOW MUCH (MORE) SHOULD CEOS MAKE?"; AFL-CIO, "CEO-TO-WORKER PAY RATIOS AROUND THE WORLD."

HBR.ORG

Gavett writes in her review that Norton also emphasizes that 'many of the heated debates about whether CEO pay should be capped or the minimum wage increased are debates based on an extreme lack of knowledge about the true state of affairs. In other words, both liberals and conservatives fail to accurately estimate the actual current gaps in our pay. Our hope is that presenting the data to all sides might force people to examine their assumptions about whether some people are making more than they would like, and others less.'

Given the consolidating evidence, that income inequality is one for the reasons of declining economic growth, which leads to crises in jobs and consumption, also the question of "supersalaries" needs to be considered by referring to a number of instruments.¹⁹⁸

Clearly, taxation is not the only, and probably not the best option to discuss the justice aspect of this issue. This question is best dealt with in social bargaining or in a democratic vote, as was tried in Switzerland when a campaign tried unsuccessfully to cap the CEO-worker ratio at 12:1. Equally this is a question of "changing social mores", decency and self-reinforcing: 'Top executive pay is set in a very imperfect market in which norms, benchmarks and comparators play a major role. The more that chief executives are paid on average, the more it seems reasonable to pay each chief executive.' (Turner, 2014, p. 3)

One should be mindful that it is also this top group of people which poses most challenges to tax authorities. For example, they may have multiple passports, houses and bank accounts (which enable them to "spread" (hide) their wealth and which poses the question which tax authority is entitled to what tax payments), they have the best tax advisers, they have the best access to, and knowledge of, financial markets and transactions.

¹⁹⁸ See, e.g., The Equality Trust (ed.) Among Equals. Newsletter Spring 2015, retrieved from <http://www.equalitytrust.org.uk/sites/default/files/civicrm/persist/contribute/file/Among%20Equals%20Spring%202015.pdf>

5.4.4 Conclusion

Clearly, ICTs influence on jobs is alarming, but I would disagree with Turner that it is the most dominant driver of inequality. After all, ICT is used by certain people and groups to increase their “rent” and “profit” – those people could also choose to use it for paying higher minimum wage for the worker they still employ – or to employ even more worker at less time than the average of 8 hours. An ICT based economy, where people are well paid and work less hours would be closer to that which Happiness Economics proposes: To have a wage and salary adequate for a decent living, but otherwise being able to devote more time to things which really matter in life. For Oswald von Nell-Breuning, the great man of Catholic Social Teaching, a society was imaginable where people would spend one third of their time to work for income, one third of time in engagement for the community, one third of time on family, friends, culture and education.

5.5 Domestic policies and regulation

Finally, endogenous drivers of inequality are domestic policies, i.e. policies with which states of the world want to pre-empt or to have in order to counterbalance trends and tendencies triggered off by exogenous drivers of globalization. This has been addressed already above (2.3.1), discussing the OECD’s conviction that domestic institutions and policies (e.g. labour market and welfare) are more influential when it comes to growing inequality than the three exogenous drivers of inequality.

However, even conceding that it was states who created the framework for the globalization of trade and finance, the authors of this research are convinced that right now it is the exogenous drivers which are in the stronger position and now force states to adjust to the situation and to respond with national policies. Doing that, of course, they initiate yet other international dynamics, e.g. by forcing other states to follow suit. The classic example is tax competition: if one state “reforms” its labour or taxation laws or creates nice subsidies to accommodate the demands of capital owners, other states are forced to follow if they do not want to be left out; a vicious circle without any happy end in view.

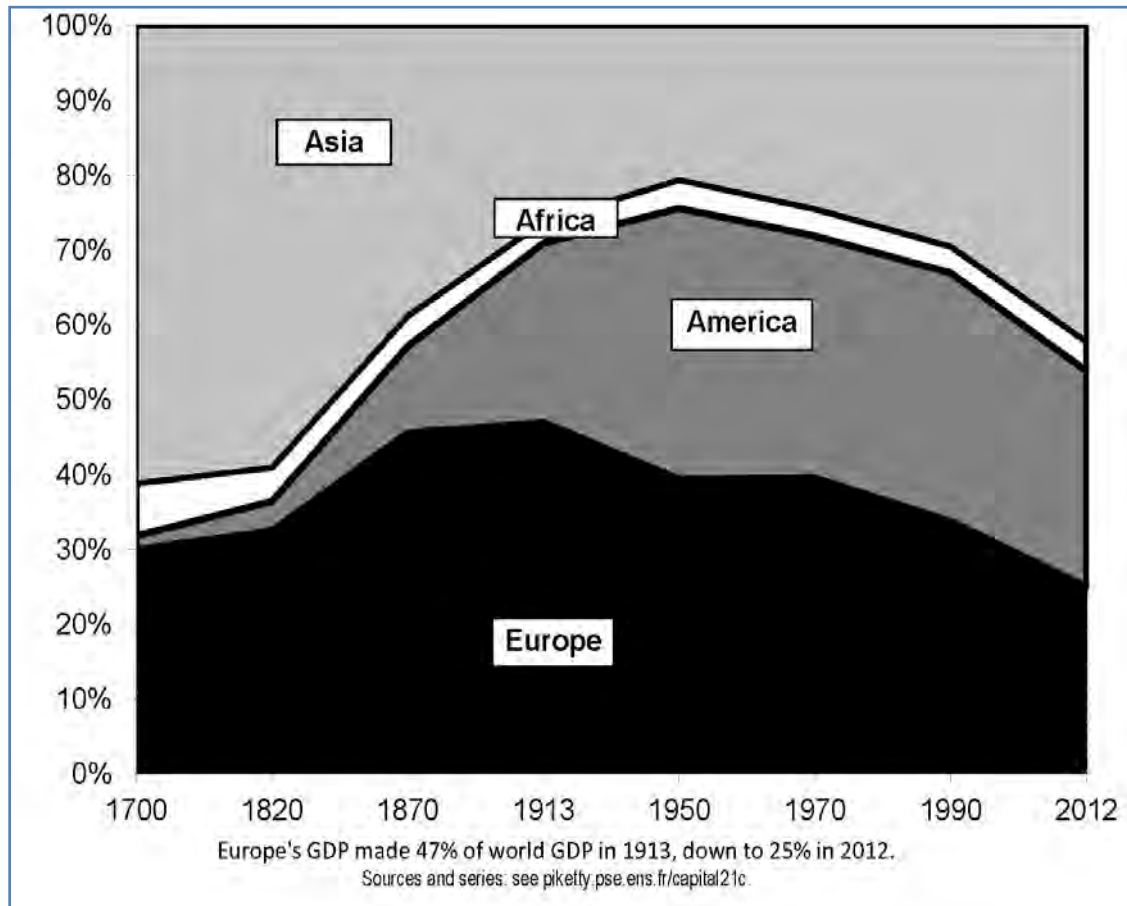
In this context it would be naïve of states and nations to set their hope on improvement in technology and education alone. Piketty emphasizes the importance of governance even here:

In the decades after World War II, people began to think that the triumph of human capital over capital in the traditional sense (land, buildings, and financial capital) was a natural and irreversible process, due perhaps to technology and to purely economic forces. In fact, however, some people were already saying that political forces were central. My results fully confirm this view. Progress toward economic and technological rationality need not imply progress toward democratic and meritocratic rationality. The primary reason for this is simple: technology, like the market, has neither limits nor morality. The evolution of technology has certainly increased the need for human skills and competence. But it has also increased the need for buildings, homes, offices, equipment of all kinds, patents, and so on, so that in the end the total value of all these forms of nonhuman capital (real estate, business capital, industrial capital, financial capital) has increased almost as rapidly as total income from labour. If one truly wishes to found a more just and rational social order based on common utility, it is not enough to count on the caprices of technology. (Piketty, 2014a, p. 234)

5.6 African Marginalization

The position of Africa, and most particularly sub-Saharan Africa, has always been (and is still) one of marginalization. As to its share of world economic output, it is stagnant not only over decades, but over centuries.

Graphic 76 Distribution of world output 1700-2012



There is even no change in the period of globalization. As a more recent comparison of world GDP demonstrates, especially sub-Saharan Africa is still the poorhouse of the world and one can assume that statistics would be ever more miserable if sub-Saharan Africa's powerhouse, the Republic of South Africa, were kept out of the statistics:

Table 20 Distribution of world GDP (2012)

	Population (million inhabitants)		GDP (billion euros 2012)		Per capita GDP	Equivalent per capita monthly income
					(euros 2012)	
World	7,050	100%	71,200	100%	10,100 €	760 €
Europe	740	10%	17,800	25%	24,000 €	1,800 €
incl. European Union	540	8%	14,700	21%	27,300 €	2,040 €
incl. Russia/Ukraine	200	3%	3,100	4%	15,400 €	1,150 €
America	950	13%	20,600	29%	21,500 €	1,620 €
incl. United States/Canada	350	5%	14,300	20%	40,700 €	3,050 €
incl. Latin America	600	9%	6,300	9%	10,400 €	780 €
Africa	1,070	15%	2,800	4%	2,600 €	200 €
incl. North Africa	170	2%	1,000	1%	5,700 €	430 €
incl. Sub-Saharan Africa	900	13%	1,800	3%	2,000 €	150 €
Asia	4,290	61%	30,000	42%	7,000 €	520 €
incl. China	1,350	19%	10,400	15%	7,700 €	580 €
incl. India	1,260	18%	4,000	6%	3,200 €	240 €
incl. Japan	130	2%	3,800	5%	30,000 €	2,250 €
incl. Other	1,550	22%	11,800	17%	7,600 €	570 €
World GDP, estimated in purchasing power parity, was about 71 200 billion euros in 2012. World population was about 7.050 billion inhabitants, hence a per capita GDP of €10 100 (equivalent to a monthly income of about €760 per month). All numbers were rounded to the closed dozen or hundred						
Sources: see piketty.pse.ens.fr/capital21c.						

But even though sub-Saharan Africa is the poorhouse of the world it should not be forgotten that even Africa houses billionaires and millionaires joining the ranks of the global top wealth holders (see 2.7).

Having treated the importance of technology in this chapter, the following table demonstrates how far sub-Saharan Africa lags behind in development, even compared to other low income countries:

Table 21 Infrastructure data for various country groups in comparison¹⁹⁹

Category and measurement Units	Sub-	Other	Sub -	Other
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¹⁹⁹ Based upon: Appendix Table A1: "Africa's Infrastructure lags other developing countries and gap widening over time. Source: Preliminary results of the Africa Infrastructure Country Diagnostic Study (2008)". CFMCBG (Committee of African Finance Ministers and Central Bank Governors) (2009) Impact of the Crisis on African Economies – Sustaining Growth and Poverty Reduction. (17 March 2009). Originally prepared for the G20 summit in London 2009.

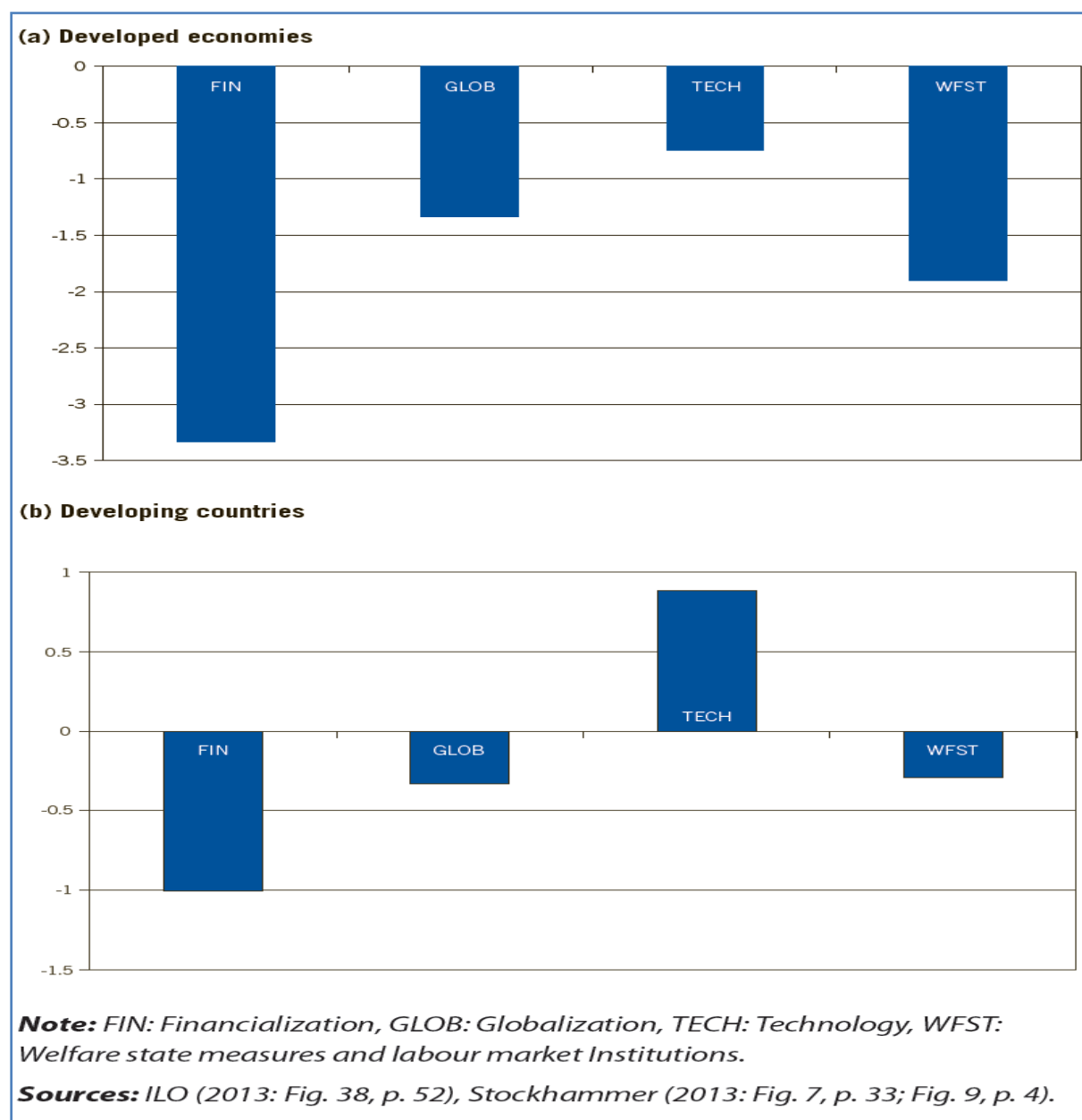
	Saharan Africa LICs	LICs	Saharan Africa MICs	MICs
Paved Road density (Km per Km ²)	31	134	94	141
Total road density (Km per Km ²)	137	211	215	343
Mainline (Rail) Density (Km per Km ²)	10	78	106	131
Mobile Density (lines per 1000 population)	55	76	201	298
Internet Density (lines per 1000 population)	2	3	5	8
Generation Capacity (MW per 1 Mio. population)	37	326	256	434
Electricity Coverage (percentage of population)	16	41	35	80
Improved Water (percentage of population)	60	72	75	86
Improved Sanitation (percentage of population)	34	51	48	74

This table suggests that the marginalization of sub-Saharan Africa is likely to last longer since it seems to be impossible to catch up with infrastructure development, given the present financial situation and constraints.

5.7 Result

Having discussed the impact of the widely accepted four drivers of inequality individually, the question is now whether there is any way to summarize findings in a simple manner. First, a summarizing overview is offered by UNDP regarding the impact of those drivers on the large group of dependently employed:

Graphic 77 Decomposing changes in the average adjusted labour income share between the periods 1990-1994 and 2000-2004 in developed (a) and developing countries (b)

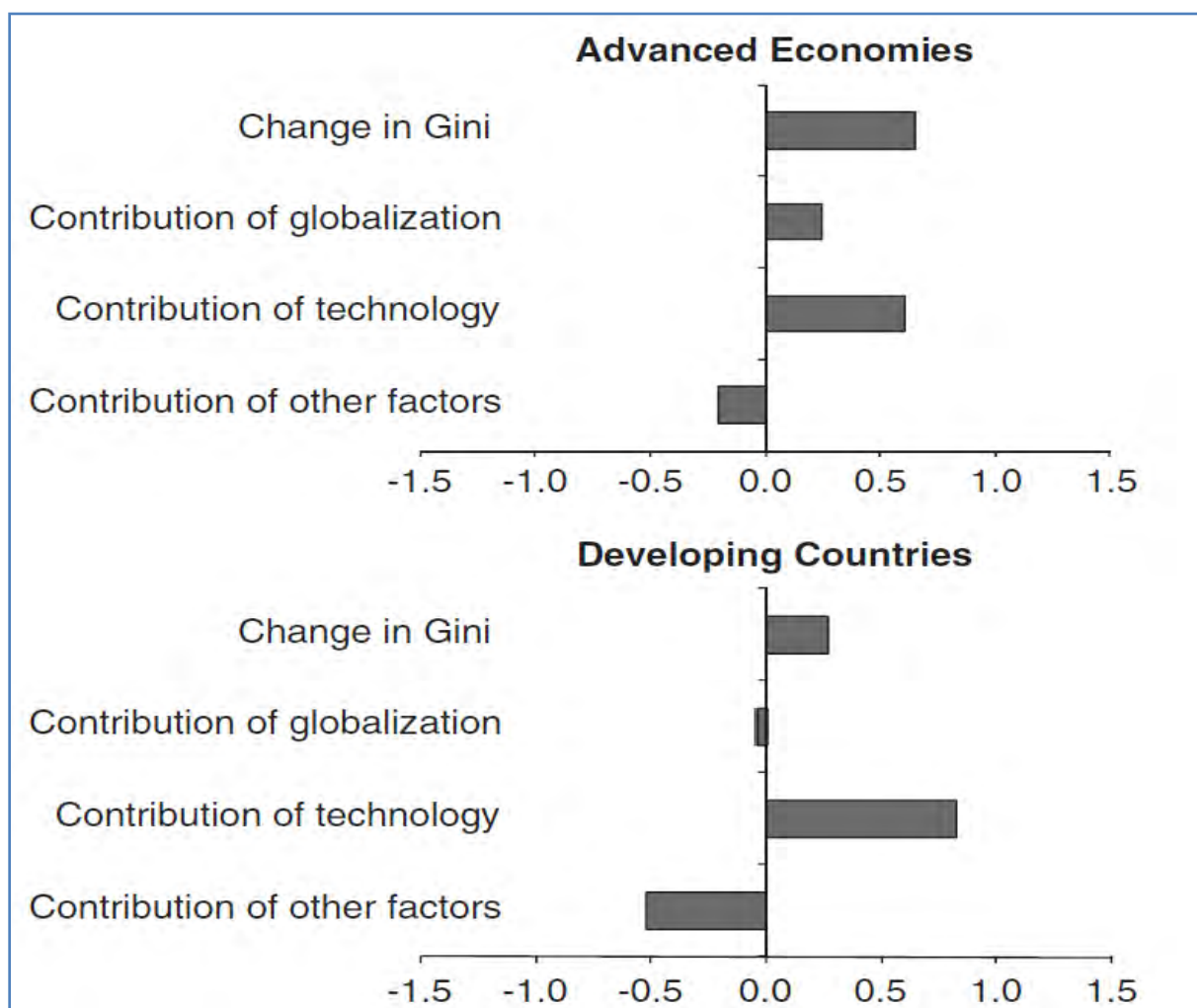


Source 43 (UNDP, 2013, p. 79)

The message is pretty clear: three drivers increased inequality in both developed and developing countries. There are differences in degree, but not in principle. There is just one exception, namely technology. Here, developing countries gained at least somewhat from technological progress. The findings summarized here by UNDP are not shared wholeheartedly by others, though: while, for example, OECD findings support UNDP's view that domestic policies and technological impact are major drivers of inequality, OECD denies a noticeable impact of the globalization of trade and finance on inequality.

Another summary regarding the impact of those drivers on the world's states and societies is attempted by the IMF. The following graphic differs from that of UNDP in two points: behind the term "globalization" IMF staff subsumed both trade and finance, and domestic policies are hidden among "other factors":

Graphic 78 Decomposition of change in Income Inequality



Source 44 (Jaumotte, Lall, & Papageorgiou, 2013, p. 300)

This graphic suggests, first, that technological change indeed seems to be the largest driver of inequality in both advanced and developing countries. As far as the drivers of trade and finance are concerned, however, the picture looks much nicer than UNDP's, but only because of a trick: IMF staff added the opposing effects of globalization of trade (positive) and finance (negative) so that they neutralized themselves to some extent. This is misleading, since they stated earlier that globalization of trade benefited the lower four quintiles of population, while the proceeds of financial globalization accumulated rather among the richest quintile.²⁰⁰ This would have not merely justified, but called for a separate presentation of those two drivers.

Both graphics underline the global shift in the functional income distribution.²⁰¹ While the labour share in gross national income decreased, the share of capital increased. Some important findings of the previous discussions are:

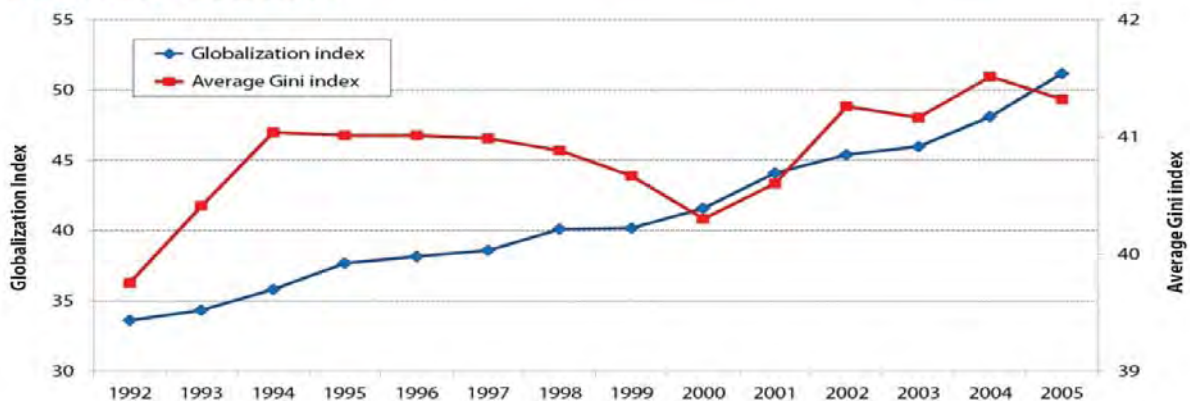
²⁰⁰ All of that on (Jaumotte, Lall, & Papageorgiou, 2013, p. 274).

²⁰¹ 'This is the distribution (allocation) of income between different factors of production, such as rent for land, wages for labour, profit for businessmen and interest for capital owners. This aspect of income distribution came increasingly into focus recently. It 'points to the importance of better understanding the changing position of labour in the production process in order to correctly interpret inequality trends, as labour has been losing ground relative to capital over the past 20 years.' (UNDP, 2013, p. 71).

- The bargaining power of capital was used to dictate conditions for investment towards trade unions and others trying to safeguard labour standards and decent wages.
- Capital investment moves out from the real economy into the financial sector.
- The World Financial and Economic Crisis in some areas led to “jobless recovery”, in others to a “ratched effect”, by which is meant that ‘after an economic shock or a financial crisis, the labour share in gross national income decreases, but then increases at a slower pace than GDP in the phase of recovery’ (UNDP, 2013, p. 76).

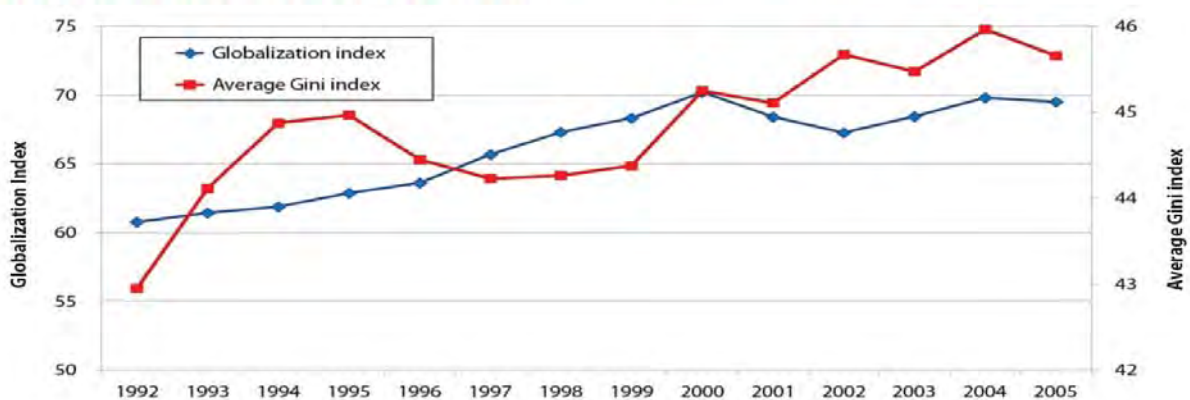
Not surprising, therefore, that a general increase in inequality accompanies globalization as a whole, as the following comparison of the development of the Globalization Index and Average Gini Index suggests:

Figure 3.7. Income inequality and globalization across developing countries, 1992-2005



Source: UNDP calculations using data from Solt (2009).

Figure 3.8. Income inequality and globalization in high-income (developed) countries, 1992-2005

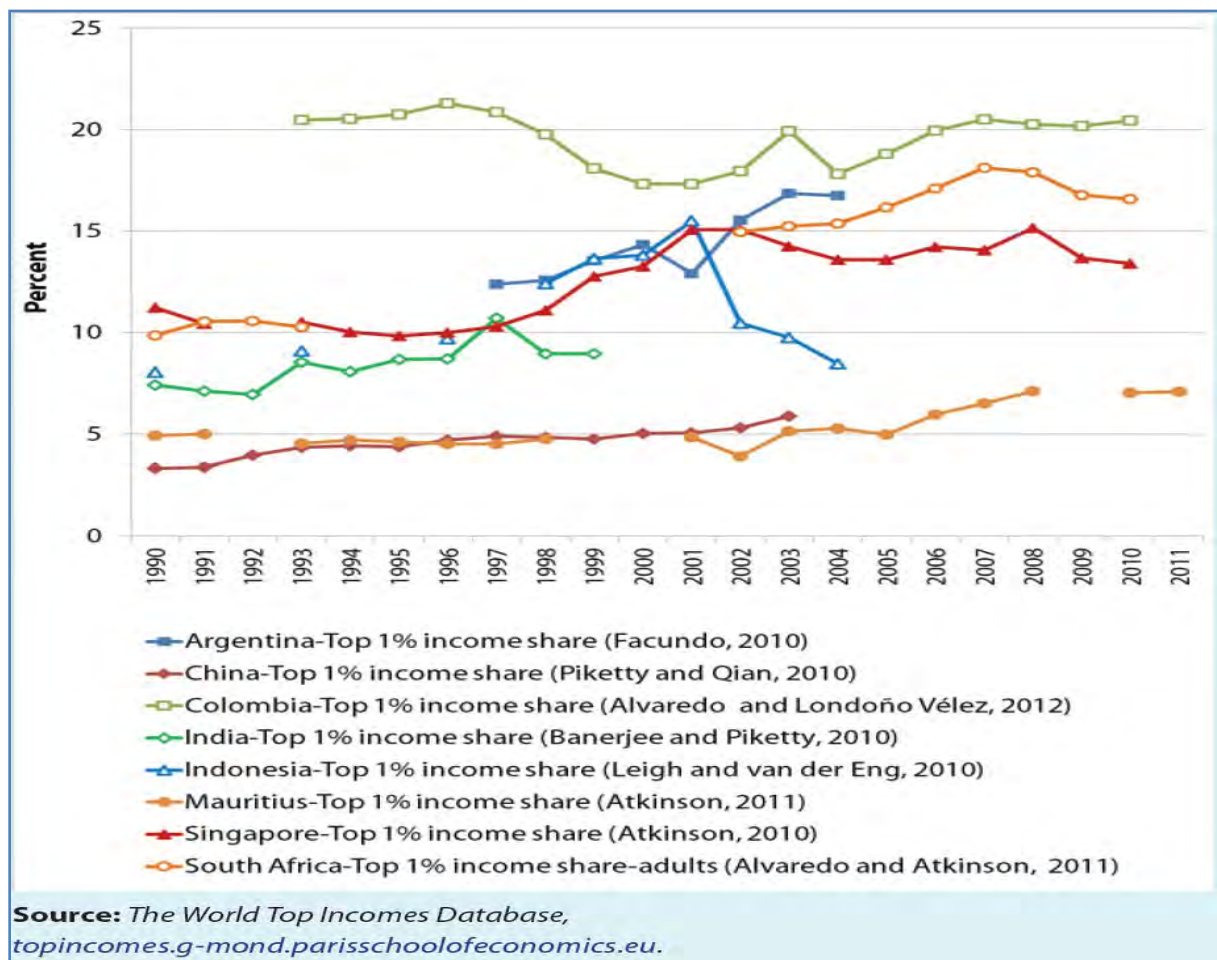


Source: UNDP calculations using data from Solt (2009).

Being mindful of what was said in I/II/3.3 about the “meaninglessness” of average indices when it comes to assess inequality, this result is already alarming. One can guess what could be revealed if the attention of statisticians could be turned to real income distribution and actual household income. An indication is given when looking at the increase in income share of the top 1 percent, which rose in many and different countries across the globe.

²⁰² The “Globalization index” ‘is the most widely based index of globalization, as it combines the major de facto indicators of globalization (trade, foreign direct investment (FDI) stocks, portfolio investment and income payments to foreign nationals) with various de jure indicators (hidden import barriers, the mean tariff rate, taxes on international trade and capital account restrictions)’ (UNDP, 2013, p. 80).

Graphic 80 Top income shares 1990-2011²⁰³



The preceding graphic should be even more alarming since those trends were measured well ahead of the World Financial and Economic Crisis which had yet another serious impact on inequality and ordinary jobs. Regarding the time after the World Financial Crisis, not even the 2014 Wealth Report of Credit Suisse could avoid to note:

Our estimates indicate that global median wealth (i.e. the minimum net worth of the top half of global adults) has decreased every year since 2010, a surprising result given the robust rise in mean wealth. In contrast, the minimum wealth of the top decile has changed little since 2010, while USD 163,000 more is needed now to belong to the top percentile compared to 2008 when the minimum requirement was USD 635,000. These findings hint at rising global wealth inequality in recent years. (Credit Suisse, 2014, p. 11)

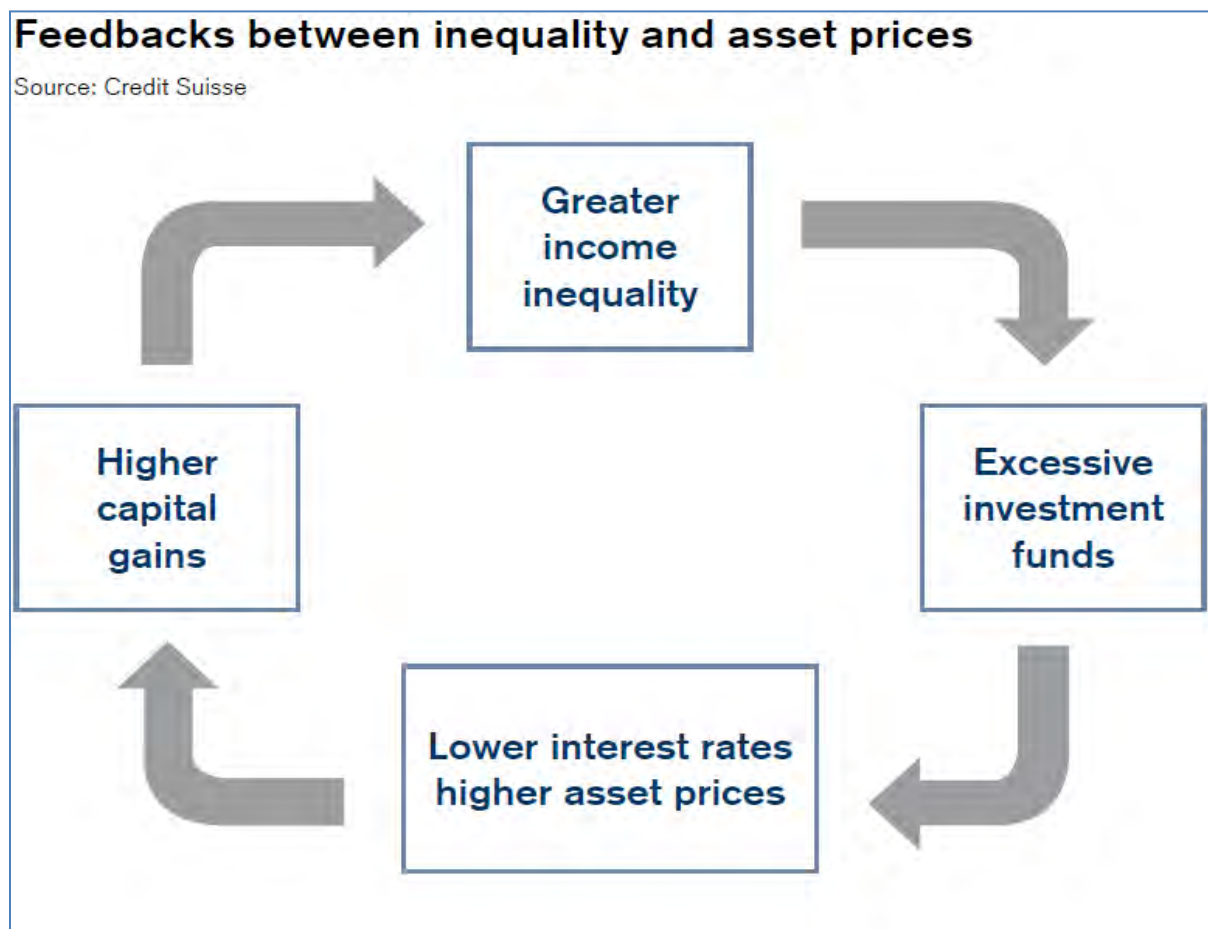
Interesting enough there is also broad awareness growing that there is too much capital circulating round the world and that too much capital is contributing to the growth of inequality. Here Piketty's analysis is shared, for example, by the Global Wealth Report 2014 of Credit Suisse, which included a chapter on Wealth Inequality in its most recent report. On p. 34 they state that "equity" is heavily concentrating among the top income and wealth households in every country.

Some commentators have claimed that rising equity prices are a consequence – as well as a cause – of rising inequality. It is suggested that rising income inequality in the United States

²⁰³ (UNDP, 2013, p. 86) One marked exception in the following graphic is the top income share of Indonesia, but here one has to note that the data base is weaker than in other countries.

from the 1970s onwards raised the disposable income of the top groups, who typically save a higher proportion of their income. As captured in Figure 3, this led to an increase in funds seeking investment opportunities, driving down interest rates and raising stock prices, which in turn created further capital gains for the top income groups, propelling income inequality to even higher levels. In addition, the fall in interest rates encouraged the housing bubble that developed in the United States in the early 2000s and fuelled the unsustainable growth of debt, which triggered the financial crisis of 2007–2008. If this account is even partially true, it raises concerns about the implications of the widespread rise in wealth inequality since 2008, and about the implications for equity markets once low interest rates are no longer regarded as a priority by central banks. (Credit Suisse, 2014, p. 34)

Graphic 81 Feedback between inequality and asset prices



Source 45 (Credit Suisse, 2014, p. 34)

As can be expected, they are pretty elaborate in their formulation. For example the phrase that high-income households are able to “save” more income than low-income households (they simply cannot spend as much as they earn!) or the use of qualifying language (“some” “claim” “if this is true...”). The fact of including the following in their report indicates a growing uneasiness even among those who feel themselves responsible for multiplying the plentitude and an indirect appeal to remove financial assets from circulation: ‘This leads to the expectation that wealth inequality will fall when financial assets are declining as a fraction of the household portfolio – as happened during the early years of this century; and to rise when the share of financial assets is increasing – as happened after the financial crisis’ (ibid.). One way of which would be to encourage long-term investment in the real economy rather than continuing to privilege the financial asset industry.

5.8 Conclusion

As this chapter reveals, there are four major drivers contributing to inequality in times of globalization, but financial integration seems to be of major importance: Since the 1980s one can observe an increasing financialisation and concentration of assets among a very small group of persons and institution of top wealth holders, which experts assess to make up 0.1% of the global wealth and income elite (Murray, 2014). Due to a hitherto unknown global IT infrastructure, loose networks between financial, economical and political elites and the “business model” of handing generously out credit loans to private, corporate and public households they obtain increasingly influence over the real economy and jobs residing there, even though they are not at all competent to understand or judge the generation of real products and services in the real world. While in the US the amount of shares owned by institutions of the financial sector (banks, investment funds...) was around 20% in the 1980s, it increased up to 66% in 2009/2010. Financial assets are increasingly concentrated among the very few. For the US, the following table illustrates its extent for 2010:

Table 22 Control over capital and capital related assets by the top 10%

Vermögenswerte	Oberes ein Prozent	Folgende neun Prozent	Untere 90 Prozent
Aktien und Investmentfonds	35	45,8	19,2
Finanzsicherheiten	64,4	29,5	6,1
Trusts	38	43	19
Eigenkapital	61,4	30,5	8,1
Gewerbliche Immobilien	35,5	43,6	20,9
Gesamter Anlagenbestand	50,4	37,5	12

Quelle: G. W. Dornhoff (Anm. 29); Edward N. Wolff, *The Asset Price Meltdown and the Wealth of the Middle Classes*, New York 2012 (hier einschließlich direkter Aktienbeteiligung und indirekter Inhaberschaft durch Investmentfonds).

Source 46 (Murray, 2014, p. 20)

The situation might be specifically spectacular in the USA, but the tendency is similar elsewhere. For example: Just one investment fund, Black Rock, is the number one owner of shares in the US, Canada and Australia and number three in Germany.²⁰⁴ Beyond that, Black Rock owns 6 percent of all shares of the world’s 300 largest TNCs. And it is here, in the banks and funds, where the top 1% of “leading employees” managing financial assets earns growing salaries: they rose between 1980 and 2003 by around 560%. Indeed it is justifiable to say that a new category of capitalism is emerging in the 21st century, whose distinct feature is not only the concentration of financial and political power, but a power to be exercised nationally AND globally. A power, which, as in earlier times, does not rest with charm, charisma, efforts and skills, but simply in the fact of owning capital which can move around freely, creating new differences in class nationally and a growing north-south divide globally (Murray, 2014, p. 22). A power, not transparent in its execution and surrounded with democratic checks and balances.

Financial integration is, at the same time, a major reason behind dependence of states on external financing and Illicit Financial Flows, which in turn are a major reason for the inability of states to tax private and corporate wealth.

It was not always like that. There is agreement that, for example, the time after the first Global Financial Crisis and World War II was guided by policies advancing and

²⁰⁴ Regarding the power and influence of BlackRock see also (Berger, 2014)

preserving principles of equity which benefited the many rather than the few. Accordingly, inequality was lower from the 1950s all the way up to the early 2000s.²⁰⁵

Clearly, nobody so far was or is able to create a better alternative to market economy, of which financial markets are a part. And, clearly, globalization processes are not in all aspects bad. But even admitting that, it is obvious that many developments, maybe initiated with the best of all intentions, lead to situations which are neither desirable nor sustainable. The problem is how to advance from that insight.

Those who know the present system well argue that activities on three levels at the same time are needed (Collins, 2012, p. 98ff.):

- Raise the floor by supporting the poor and average labourer (minimum wage, labour protection and labour rights).
- Change the rules, aiming again towards a level playing field (better education, reducing influence of money in politics, fair trade rules).
- Break up wealth and power (tax the 1%, rein CEO pay, stop corporate tax dodging, reclaim financial systems, re-engineer the corporation, redesign the tax revenue system)

And indeed, there are signs of progress in certain countries and regions in all areas mentioned. This, however, is not necessarily a merit of globalization, but national and international policies (UNDP, 2013, p. 94f.).

The easiest improvements are possible in the area related to technological change. Here education, technology transfer and ongoing skill training could lead to progress for the many rather than the few. However, education and training cost money.

Globalization of trade is acknowledged to be more beneficial for the lower segments of populations. Here certainly national policies could improve this outcome even more, if they are no longer driven by “capital” or “the markets”, but rather elaborate and implement, in an internationally coordinated manner, a new regulatory framework which would benefit long term growth and job creation. This again, would cost money. For example: if “the markets” would not pay decent wages, tax-revenue-based topping up of wages might have to continue. Or a redistribution of subsidies: For example paying European farmers for NOT producing too much, thus giving African farmers a chance to set up their own agricultural markets.

Taxes might play a role here and money is not a scarce resource in this world; there is more than enough of it. The problem is how to get hold of it, how to end risky and self-serving investments for the benefit of a small elite and how to put finance back in the place where it belongs: to serve the real economy and thus the majority, not a minority of the population. And it is here where taxation could play a part by (a) decreasing the attractiveness of certain financial products and practices (“taxing the bads and not the goods”) and (b) making the global elite contribute its fair and appropriate share for the common good, withdrawing capital from its bloated bubble of turbo-casino capitalism and making better use of it within a social market economical framework.

²⁰⁵ For example: As to the post World War II period see Piketty and Atkinson, as to the time 1960 onwards UNDP: ‘Indeed, the performance of developing countries in terms of growth and distribution was worse during the Washington Consensus era (1980-2000) than from 1960 to 1980, when achieving growth was a central priority of macroeconomic policies.’ (UNDP, 2013, p. 236).

The authors are convinced that efforts to re-regulate the financial sector would also profit many objectives which are of importance also for this research: Not only in the area of illicit financial flows, but also for jobs and growth and for preserving and rescuing global common goods. For that reason, the discussion of higher/better/different/more efficient taxation must always be kept within the larger framework of re-regulating the excesses of the existing neoliberal model of globalization and its four drivers of inequality.

A problem arises from the fact that the 147 core companies of the global economy, via their interlocking ownership with other TNCs and more subordinated businesses, exert too much influence in the “real economy”. They are in such a powerful position, that it is inconceivable how states will be able to withstand their pressure to do whatever they ask.

6 Context 2: Tax avoidance, tax evasion, illicit financial flows (IFFs)

Now follows the second important context discussion: Due to increasing global financial integration and technological innovation, a number of options have arisen for the wealthy and well-advised individuals or corporations to avoid and evade taxation and to transfer money into tax havens where states cannot tax them. It is very important to note that the amount of illicit financial flows do NOT equal the loss of tax revenue. Rather, it is money which is withdrawn from economies as such, which is not being invested, which therefore prevents growth and the establishment of businesses and jobs which THEN could be taxed.

In this field, methodological clarifications are needed since (a) definitions of relevant concepts are used differently by scholars, NGOs and governmental organisations and (b) the quantity and size of damage done to the public and the common good depends on prior agreement on definitions.

6.1 Definitions and categories

6.1.1 Classic IFF definitions

Since there is no universally accepted definition of IFFs, two definitions by standard players in the field shall be given: the OECD and the NGO Global Financial Integrity. According to a research report of the latter,

illicit flows are all unrecorded private financial outflows involving capital that is illegally earned, transferred, or utilized, generally used by residents to accumulate foreign assets in contravention of applicable capital controls and regulatory frameworks. Thus, even if the funds earned are legitimate, such as the profits of a legitimate business, their transfer abroad in violation of exchange control regulations or corporate tax laws would render the capital illicit. (Kar & LeBlanc, 2013, p. 1)

And, on the website presenting the report it is specified:

Illicit financial flows are cross-border transfers of funds that are illegally earned, transferred, or utilized. These kinds of illegal transactions range from corrupt public officials transferring kickbacks offshore, to tax evasion by commercial entities, to the laundered proceeds of transnational crime.²⁰⁶

²⁰⁶ See <http://iff.gfintegrity.org/iff2013/explanation2013.html>

Elsewhere, Raymond Baker, GFIs director, lists the following categories as examples of illicit financial flows:

Much attention has been focused on corruption in recent years, that is, the proceeds of bribery and theft by government officials. In the cross-border flow of illicit money, we find that funds generated by this means are about 3 percent of the global total. Criminal proceeds generated through drug trafficking, racketeering, counterfeiting and more are about 30 to 35 percent of the total. The proceeds of commercial tax evasion, mainly through trade mispricing, are by far the largest component, at some 60 to 65 percent of the global total. (Global Financial Integrity, 2009, p. 1)

Here, frequently a confusion exists between the (legal) transfer pricing, which skilfully uses legal loopholes to lower tax burden, and the intentional fraudulent trade mispricing. All in all, IFFs comprise a huge area of malpractice, as is visible from the research jointly undertaken with the African Development Bank:

The report assumes that unrecorded capital flows are illicit in nature and involve the transfer of money earned through corruption, kickbacks, tax evasion, criminal activities, and transactions of certain contraband goods. Likewise, legal funds earned through legal business but transferred abroad in violation of exchange control regulations also become illicit. (African Development Bank; Global Financial Integrity, 2013, p. 1)

Regarding the previous, however, a deficit is that GFI does not offer a clear definition why and when the transferral of money is legal, illicit, illegal or criminal.

Another major institution dealing with illicit financial flows is the OECD, which, in its report “Measuring OECD responses to Illicit Financial Outflows from developing countries”, defines those flows as follows:

There are various definitions of illicit financial flows, but essentially they are generated by methods, practices and crimes aiming to transfer financial capital out of a country in contravention of national or international laws. Illicit financial flows generally involve the following practices: money laundering, bribery by international companies and tax evasion, trade mispricing. ... In practice, illicit financial flows range from something as simple as a private individual transfer of funds into private accounts abroad without having paid taxes, to highly complex schemes involving criminal networks that set up multi-layered multi-jurisdictional structures to hide ownership. (OECD, 2013c, p. 16)

But here the same question arises as with Global Financial Integrity: if something is ‘in contravention’ of national or international laws, it is clearly illegal, isn’t it? Why, then, do we need the label “illicit” in addition to those already existing? Of course, it is not that easy.

6.1.2 Historical context

The phenomenon and fight against IFFs goes back some years even though it was not yet known under this terminology:

In July 1989, the leaders of the economic powers assembled at the G7 Paris summit decided to establish a Financial Action Task Force (FATF) to counter money laundering as an effective strategy against drug trafficking by criminal ‘cartels’. Here began an international anti-money laundering (AML) regime. Since then it has expanded its scope to fight transnational organized crime and counter the financing of terrorism. During that time other illicit or unregulated money flows have appeared on the international agenda as well. Today, tax evasion and avoidance, flight capital, transfer pricing and mispricing, and the proceeds of

grand corruption are seen as perhaps more detrimental obstacles to good governance and the stability and integrity of the financial system. (Blickman, 2009, p. 3)

And there is even more to it, for example, funding of terrorism or financial flows within the shadow- and/or underground economy are at times included here, while at the same time the question should be asked why remittances by illegal immigrants are not counted under this umbrella concept. Anyhow: the problem, therefore, is that IFFs increasingly develops into a “catch-all” concept, which makes it difficult to understand exactly what criteria need to be applied to determine its characteristics and, accordingly, remedies to address the problem.

6.1.3 Illegal tax evasion, legal tax avoidance, illicit tax avoidance

When trying to offer one’s own definitions with which to clarify and distinguish the different categories under discussion, the easiest way to start is that which is already uncontroversial and established, namely the definitions of tax evasion and tax avoidance. Here the Oxford English Dictionary says:

Tax Evasion: The illegal non-payment or underpayment of tax.

Tax Avoidance: The arrangement of one’s financial affairs to minimize tax liability within the law.

The first definition seems to be the clearest when stating that it is illegal practice, where the law provides clear guidance about what is to be done and what not. Tax avoidance, on the other hand, comprises already a large grey zone “by definition” because there is wide room for interpretation when it comes to the question what is still ‘within the law’. Whatever comes under tax avoidance is not illegal in itself, but there is a wide range of practices which might not be illegal, but leave a bad taste. And it is here, where the concept “illicit” has its place.

But what offers guidance and help to determine more precisely what form of tax avoidance, covered by law, ought to be judged “illicit”?

First of all, as one might guess when reading a study executed by church institutions, it is the personal conscience which is formed by the values and rules of one’s own ethical and moral convictions. Here resides a lot of knowledge regarding that which is right or wrong, good or bad. But since religious groups are diverse and (at least in Europe) a minority group, some more expansive basis is needed if one wants to aim for policy-defining majorities.

Secondly: in every human community there is a wide area determined by social sets of values and tradition which determine proper and improper behaviour, which goes far beyond the clear distinction of legal and illegal. And indeed, this is the area which is commonly referred to with the term “illicit”, which is defined as follows:

Oxford English Dictionary: ‘Not authorized or allowed; improper, irregular; esp. not sanctioned by law, rule, or custom; unlawful, forbidden.’

Collins English Dictionary: ‘Not allowed or approved by common custom, rule, or standard.’

In other words: an illicit act/action/activity is not necessarily against the law, even though it may be something that some/most people do not approve of. An illicit love affair, for example, might be a love affair between a married man and an unmarried woman. Such an

affair is no longer punishable by law, but it would probably be kept secret/hidden nevertheless, since many people in society would not approve of it.

Thirdly, there is guidance provided by the lawgiver who in complex matters is unable to foresee all ways in which legal rules can be abused. In other words: a legal rule might be established for a very good reason, but unforeseeably tricky lawyers find loopholes by stretching the intention and interpretation of the rule in a way that “justifies” activities which were never meant to be permitted by the lawgiver. That way, a legal rule, instituted for a good reason, can be ‘legally’ abused for egoistic or other not-foreseen reasons.

Some countries’ law-codes have provisions against this ‘legal abuse’ of legal norms. In Britain, whose legal system is based on case law, British Law Lord Sydney Baron Templeton said for the sake of clarity

A tax avoidance scheme includes one or more interlinked steps which have no commercial purpose except for the avoidance of tax otherwise payable, and can conveniently be described as artificial steps. A tax avoidance scheme does not leave the taxpayer any better or worse off but leaves the Revenue worse off.

Lord Templeton continues with reference to another British Law Lord, namely Lord Brightman, who characterized tax avoidance as follows:

First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial business end ... Secondly there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax – not ‘no business effect’.²⁰⁷

Templeton and Brightman illustrate another important criterion in how money should be used to serve the wider community: it is essential, whether any financial transaction can be linked to the advancement of the real economy, i.e. real businesses and, most of all, real jobs, or whether it is just ordained towards the purpose of making more money out of money which serves primarily or exclusively its owner.

Clearly, opportunities for tax evasion and tax avoidance multiply if taxation and tax practices are covered not only by one national code of law, but the codes of laws of many countries. In this case not only loopholes within national codes of laws can be used and abused, but even uncovered gaps and the absence of regulation between the law-codes of different countries.

6.1.4 Ethical, unethical and criminal intention

In the next step the categories of the legal, illicit and illegal action need to be placed into the context of the ethical or criminal intention. The distinction is necessary because illegal behaviour can occur unintentionally if somebody, who is not aware of the complexities of the law, acts against it and for that reason qualifies for punishment. For example: since tax law is getting increasingly complex, tax authorities can name many cases where people unintentionally violate the law because they are not aware of anything illegal in their doing.²⁰⁸

²⁰⁷ Both quotations from Lord Templeton’s article in the *British Law Journal* are contained in (Murphy, 2012, p. 6f.).

²⁰⁸ Tax authorities are aware of a substantial group of those people, see#

Equally, an activity can be illegal or illicit, but the person acting has the best of all intentions for doing so. Here, too, a large grey area exists in cases where some people knowingly do something illegal, but for some higher good. A widespread problem is, for example, that in Germany some small business owners cheat on their tax bill in order to keep their business afloat and their labourers employed.²⁰⁹ Another example are legal and illegal migrants, transferring their remittances outside the banking system by using Havalla banking structures, thus not paying Turnover Tax which would, given the size of worldwide remittances, be a source of substantial income. But here, too, many migrants have to act that way because many of them are, due to their residential status, excluded from using legal banking services in the first place.

Clearly, individuals from those two groups need to be judged and treated differently from those who in an organized manner transfer billions of US\$ out of reach of revenue authorities, especially if those proceeds are gains from drug dealing, arms trade, trafficking in human beings, etc.

The criminal intention behind an illegal deed is well informed and well aware of the illegal nature of its act and the criminal therefore intentionally wants to afflict damage to the community and to others for the sake of the advancement of his own egocentric personal or group interests. This widens the scope under examination for this research: Besides tax evasion and tax related crimes, e.g. fraud, other related financial crimes need to be included such as corruption, bribery and money laundering. Reasons for the inclusion of these are obvious: bribery/corruption often paves the way to sloppy tax enforcement; money laundering enters criminal (untaxed) proceeds into a legal economy – in Germany, for example, by Mafia groups from the East, in Kenya, for example, by Somali Pirates.

6.1.5 Conclusion

The term “Illicit Financial Flows” is very broad and ill defined, which requires always a careful examination of what is comprised and dealt with and what not. Indeed: The only common features of that which is meant with this term is the ‘desire to hide illicit wealth’ (High Level Panel, 2015a, p. 41). Most tricky are those areas which are not clearly criminal (e.g. fraud or terrorist funding), but located within a broad spectrum of practices ranging gradually from the legal to the illegal, most importantly commercial (mis)practice such as the trade misinvoicing or, more contested, the (mis-)use of transfer pricing in tax planning schemes – the two latter categories being at the same time and most likely the largest quantitative “strata” within IFFs worldwide (High Level Panel, 2015a).

Regarding tax avoidance, the research team holds the opinion that its practice is acceptably legal only if it is demonstrably in accordance with both the letter of the law and the intention of the lawgiver. It may (!) be legitimate, if it clearly serves a higher good, e.g. creating and preserving quality jobs. It is judged to be illicit, if it perhaps not offends against the letter, but only the spirit of the law. If this is the case, it is called “aggressive tax avoidance” or “aggressive tax planning”.²¹⁰ These practices need to be included when it comes to assessing the dimension of damage of IFFs comprised of illicit and aggressive tax avoidance, illegal tax evasion, criminal financial flows arising from bribery/corruption and money-laundering. Illicit financial flows defined like that, have in common the following points:

²⁰⁹ Tax authorities are aware of a substantial group of those people, see GER/VI

²¹⁰ An expression used by the OECD, e.g. in its Aggressive Tax Planning Directory or (OECD, 2013a).

- a. They directly damage the community by depriving it of revenue and resources which would be urgently needed to address issues of *common* (i.e. also in the interest of the wealthy and businesses!) interest, e.g. the maintenance of infrastructures, health care or education.
- b. They increase the tax burden on those who have to foot the bill.
- c. They distort market competition by offering advantages to those acting in informal market economies as opposed to those acting and paying taxes in the formal and legal economy.
- d. They advance the informal (“black labour”) and criminal (e.g. the trafficking of drugs, arms and human beings) economy.
- e. Finally, these actions benefit primarily those who have already plenty and are able to pay expensive experts for advice.

All this is possible because of the absence of transparency about ownership and clandestine infrastructure. Due to the lack of information for the wider public, it prevents law enforcement and democratic control and protects and serves largely egoistic or even criminal individuals and interest groups, disadvantaging the poor and those being dependent on these shadowy structures.

6.2 Dimensions of illicit financial flows

Unsurprisingly in an area like this, adequate data is difficult to come by for three reasons: First, because of the possibility to define the object matter in different ways. Second, because of different methodological approaches and instruments to measure that which has been defined. Third, because illicit, illegal and criminal activities are taking place outside public scrutiny and it is difficult to access and assess their dimension.

Everybody knowledgeable about this field will admit that any numbers are at best “educated guesswork” or “guesstimates”. These problems underlie the fact that those few guesstimates which are published are sometimes quoted and re-quoted repeatedly by various organizations, which should make one cautious. For example, figures quoted in the publication of organization A in 2013 may not reflect new findings, but just represent findings of organization B in 2005.

6.2.1 Macroeconomic guesstimates based on balance-sheets

A rather influential and prominent source for macroeconomic “guesstimates” is the NGO Global Financial Integrity (GFI). They normally measure the quantity of IFFs in two ways:

The “gross excluding reversals” (GER) method explicitly acknowledges the fact that it is fallacious to net illicit flows in both directions as economists have been doing to arrive at estimates of capital flight. This is because flows are illicit in both directions so that a net of the two would be akin to the concept of net crime. Hence, the GER approach only considers outflows due to trade misinvoicing, that is, export under-invoicing and import over-invoicing. Underlying this approach ... is the simple fact that country A’s imports from country B are also country B’s exports to country A. In a world without trade misinvoicing or statistical errors in compilation, which the IMF has found to be small, the trade data reported by country A and country B should match once they are adjusted to reflect the cost of insurance and freight. In fact, persistent and significant discrepancies abound for trade reported by developing countries in comparison with the corresponding “mirror” trade data reported by advanced countries. GFI uses one of two procedures to calculate trade misinvoicing, depending on the availability of bilateral trade data.

A second source of illicit flows is reflected in leakages from the balance of payments system. GFI uses the HMN method to identify only illicit—not merely unrecorded—outflows from developing countries. These estimates are based on the Net Errors and Omissions (NEO) term for developing countries in the IMF’s Balance of Payments Statistics (BOPS) database. When there are missing values in the BOPS, GFI attempts to fill the gaps by using NEO data from various IMF country reports and the ... Balance of Payments Yearbooks, converted at the appropriate exchange rate as necessary. ... HMN is essentially money that has disappeared from the economy. Examples of unrecorded and illicit financial flows out of the balance of payments would include wire transfers by certain banks and foreign exchange brokers that are not registered with the Central Bank or another regulatory agency. (Kar & Spanjers, 2015, p. 47ff.)

The Website Financial Transparency adds to the latter: ‘The Hot Money Narrow method ... (is) going back to the balance sheet, but this method focuses on the “net errors and omissions” line item. Net errors and omissions (or NEO) is catch-all line to correct for the discrepancies between a country’s current account and capital account (which must be inversely equal). To the extent that the NEO captures flows of money (and not statistical errors) it must include only illicit flows.’²¹¹

Based on these methods, the dimension of IFFs originating from developing countries is assessed as follows:

The study finds that during this ten-year period, the developing world as a whole lost US\$7.8 trillion (see Table X1). In real terms, these flows increased at 6.5 percent per annum (see Chart 2). After a slowdown during the global financial crisis, illicit outflows have been rising, topping US\$1 trillion since 2011 and reaching a new peak of US\$1.1 trillion in 2013.

Table X1. Illicit Financial Flows from Developing Countries, by Region, 2004-2013
(in billions of U.S. dollars, nominal)

Region	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Cumulative	Average Share
Sub-Saharan Africa	32.5	51.9	56.4	77.0	78.6	85.0	78.0	74.3	66.7	74.6	675.0	8.6%
Asia	174.6	191.9	209.1	236.5	277.5	277.1	381.7	361.1	456.7	482.0	3,048.3	38.8%
Developing Europe	107.3	118.4	133.8	190.6	233.8	204.9	221.8	295.5	242.5	250.4	1,998.9	25.5%
MENA+AP	29.9	31.0	33.3	57.4	80.3	51.9	53.0	81.1	68.2	70.3	556.5	7.1%
Western Hemisphere	120.9	131.4	111.0	137.7	157.8	128.1	172.0	195.8	201.8	212.8	1,569.3	20.0%
All Developing Countries	465.3	524.6	543.5	699.1	828.0	747.0	906.6	1,007.7	1,035.9	1,090.1	7,847.9	

Source 47 (Kar & Spanjers, 2015, p. vii)

There are variations of GFI’s approach. For example, the publication “Illicit Financial Flows and the problem of Net Resource Transfers from Africa: 1980-2009”, which was done jointly with the African Development Bank. Here calculations eventually led to a Net Resource Transfer (NRT), referring to the net-loss which probably occurred to African states due to illicit financial outflows (African Development Bank; Global Financial Integrity, 2013, p. 11ff.).

Other approaches compare bilateral data of certain sectors. For example, the Economic Commission of Africa analysed the trade of mispricing components by comparing recorded data of outflow and inflow of the same traded good. Not surprisingly, there is a frequent mismatch between those data for which one of the possible explanations are IFFs. One

²¹¹ Retrieved on 11 December 2015 from <https://financialtransparency.org/comment-illicit-financial-flows-from-developing-countries-2001-2010/>

example given are a recorded USD 7.7 billion of copper reported to be exported from Zambia to Switzerland, without Switzerland recording its import (High Level Panel, 2015b, p. 3f.)

6.2.1.1 Comment

As has been discussed already (6.1.1) the main problem lies in the GFI argument that ‘illicit money is money that is illegally earned, transferred, or utilized.’ (Global Financial Integrity, 2009, p. 7). On background it has been asked why we need the category “illicit” in the first place if things can be clearly categorized as “illegal.”

There is also a confusion regarding trade misinvoicing (GFI) and trade mis-pricing (High Level Panel), at times even transfer-pricing,²¹² although there are differences between those categories and may confuse the reader.

James Henry of the Tax Justice Network also criticizes GFI’s approach. He, too, finds that motives behind unrecorded capital flows do matter, that short-term flows are not as relevant as long-term developments and that aggregate findings are not as helpful as a careful country-by-country, industry-by-industry examination (Henry, 2012, p. 38).

However: GFI is working to improve its methodology constantly and seems to be approach a satisfactorily solution to at least the second part of Henrys critique.²¹³

6.2.2 Macroeconomic guesstimates starting from the shadow economy

A politically influential analysis regarding the European Union was done by Richard Murphy of Tax Research UK, originally done for the Socialist Fraction of the European Parliament (Murphy, 2012). Here originates the frequently quoted figure that the damage done to the states of the European Union due to illicit financial flows amounts to EUR 1 trillion annually. This finding is so popular that it is even quoted by the European Commission in their policy briefs and on their websites.²¹⁴

Murphy uses a much wider definition of what he considers to be illicit financial flows than Global Financial Integrity. On p. 7 of his paper Murphy explains in a lengthy passage:

Illicit flows ... may be defined as those acts, whether deliberate or negligent, that result in tax not being paid either:

- a) contrary to the law, rules or customs of a jurisdiction on an economic event whose substance either occurs within that jurisdiction or that should have been recorded there, or
- b) contrary to the laws of another jurisdiction in which a benefit of that economic event arises.

²¹² This confusing “mismatch” also occurred in 2013 on a GFI website, explaining the methods underlying (Kar & LeBlanc, 2013): ‘The second method, Gross Excluding Reversals (GER), looks at trade misinvoicing, a common method used by commercial entities for the cross-border movement of illegal money. ... *GFI’s methodology is unable to distinguish between the different sources of trade mispricing.*’ [Emphasis added] The quote is taken from a website providing additional information underlying the report (Kar & LeBlanc, 2013), see <http://iff.gfintegrity.org/iff2013/explanation2013.html> Accessed 22 February 2015. Meanwhile, this information has been removed from GFIs website.

²¹³ See constantly updated website on GFIs methodology <http://www.gfintegrity.org/issues/illicit-financial-flows-analytical-methodologies-utilized-global-financial-integrity/>, accessed 11 December 2015

²¹⁴ Clamping down on tax evasion and tax avoidance: Commission presents the way forward. Press release of 2012, December 6. Retrieved from http://europa.eu/rapid/press-release_IP-12-1325_en.htm. The figure of EUR 1 trillion is up to the present day the figure on the Commission’s new website “The fight against tax fraud and evasion” http://ec.europa.eu/taxation_customs/taxation/tax_fraud_evasion/index_en.htm

The essence of this is vital to what follows. What it in effect means is that an illicit flow occurs when:

- 1) An economic event occurs. This could be a sale, purchase, wage payment, gift, gain, payment of a return on investment, and much more besides.
- 2) That economic event is not taxed properly where it actually occurs. So, for example, if it occurs in Italy and is not taxed contrary to the law of Italy then tax has been evaded in Italy. If, alternatively, the economic event is reported in Italy but falls through loopholes in Italian law or is legal but nonetheless contravenes Italian rules or customs then tax avoidance has taken place in Italy.
- 3) That economic event should be recorded in a place other than that in which it really occurs and it should be also taxed in that other place, but is not so taxed. So, for example, if the transaction in the previous paragraph took place in Italy but should have been recorded by a company in Sweden but was not recorded in Sweden despite that fact then tax evasion would have taken place in Sweden. (...)

What should be clear is that:

- 1) Tax evasion and tax avoidance can happen on the same transaction for different taxes in different places;
- 2) Tax evasion and tax avoidance often involve elaborate trails involving more than one person, whether that person is a real live human being or a legal person such as a company, partnership, trust, foundation or charity;
- 3) This issue is complex but invariably involves following a trail of money to work out who really benefits from it, and where;
- 4) Moving transactions across international boundaries increases the opacity of transactions and so increases the chance that taxes can be evaded and avoided.

Murphy starts his “guesstimate” by assessing the size of the European shadow economy, goes on to compare the effective tax rates of EU member states with the size of shadow economies and from there he estimates the implied taxation loss by member states from tax evasion (Murphy, 2012, p. 9). Thus he calculates the magnitude of EUR 150 billion in tax avoidance and an additional EUR 850/860 billion in tax evasion, thus “creating” the widely quoted figure of EUR 1 trillion annually.

6.2.2.1 Comment

Murphy’s approach, to start with the shadow economy, is criticized by those very authors whose studies and findings Murphy himself uses to back up his findings. Friedrich Schneider, for example, the internationally acclaimed expert on studies into the shadow economy, accuses Murphy of having misunderstood his research, misquoted him and misinterpreted his findings which then, of course, would lead to totally exaggerated numbers. Schneider himself would concede only EUR 300-400 billion in damage annually for the simple reason that the volume in black labour does not equal the loss of taxes. Schneider admits, however, that there is a considerable amount of tax avoidance and evasion taking place annually, e.g. by transferring money into tax havens, which cannot be captured with his own calculations and methods. But he prefers to abstain from speculation by saying: ‘Nobody can adequately quantify that figure.’²¹⁵

²¹⁵ Jandrasits, F. Steuerausfall geringer als erwartet. (2013, June 1). In: *Der Kurier*. Retrieved from <http://kurier.at/wirtschaft/wirtschaftspolitik/steuerausfall-geringer-als-erwartet/14.345.176> and (Gattringer, 2012, May 28).

Another critical point in Murphy's guesstimate is his enormous discrepancy between tax avoidance and tax evasion. Most (all?) other qualitatively and quantitatively researched evidence suggests that the magnitude of damage is done in the field of tax avoidance rather than tax evasion. Hence there are reasons to assume that the huge sum suggested for tax evasion by Murphy can be obtained only by adding together categories which should not be added.

In the eyes of this research, however, the shadow economy could be a useful starting point to assess damage done to the community. As explained in 6.1.4, all tax-related practices which in the middle or long range damage the common good should be considered. And here the shadow economy is an important issue in all three countries of Germany, Kenya and Zambia, even though, admittedly, the problem of the shadow economy involves many layers and categories of problems which are of different complexity and urgency to address, as will be shown in the In-Depth study of the Informal Economy.

On that background it is the view of this research that, even if Schneider is correct in his criticism of Murphy's methodology and findings, the approach of Murphy might be justified, provided perhaps that more qualifications and exemption must be used in the methodology applied to filter data and to correct results and outcomes. Such an adjustment would most likely lower the catchy EUR 1 trillion guesstimate.

However, the figure might yet remain considerable for the following reasons: First of all, guesstimates regarding illicit financial flows of capital stemming from private and corporate wealth to tax havens should be added to any estimate based upon the shadow economy. This Schneider refuses to do, but given the work of Piketty and Zucman, there are now plausible and substantiated guesstimates even for this dimension. Secondly, this research does not follow Murphy insofar he excluded certain criminal practices from examination.²¹⁶ They should be included since they have both a damaging effect on the collection of tax as well as distorting mechanisms of the formal economy, e.g. due to bribery/corruption or money laundering.

6.2.3 Combining guesstimates and sources

Another influential player in the field of Tax Justice is, as the name betrays, the Tax Justice Network. An important publication here was James Henry's 2012 study "The Price of Offshore revisited" (Henry, 2012). Henry was once Chief Economist at McKinsey, which should make him thoroughly familiar with the kind of world he took under scrutiny. In his paper, Henry bases his guesstimate upon three main sources, using four different methods. The key sources are (p. 23):

- Underreported capital flows.
- Undertaxed corporate profits.
- Illicit activities of the global underground economy.

Data material arising from these sources is worked upon by triangulating different methods and perspectives (pp. 26ff.):

²¹⁶ 'As such they specifically sought to exclude criminal activities such as burglary, robbery, drug dealing, smuggling, etc., from their estimates, which makes their data appropriate for the purposes of this research.' (Murphy, 2012, p. 10).

- Method 1: A ‘sources-and-uses model’ for country-by-country unrecorded flows. Here Henry starts with data from the World Bank’s World Development Indicators database which provides information about annual flow and value of nations unrecorded capital flow when looking at changes in (a) foreign reserves, (b) current account balance, (c) gross external debtstocks, (d) portfolio investment, (e) nominal gross national income. This model ‘basically ... adds up a country’s measured sources of foreign capital and compares them with recorded uses’ and the difference between these recorded sources and uses ‘may be attributed to unrecorded net capital outflows’ (p. 28).
- Method 2: His “accumulated offshore wealth model” consists in a framework to estimate how much these accumulated (net) flows might be worth over time.
- Method 3 is the “offshore investor portfolio model”, with which he tries to establish investor behaviour.
- Method 4 uses estimates of offshore assets under management of the world’s top 50 global private banks and he analyses cross-border private banking assets under management by those banks for the period of 2005-2010.

Additionally, Henry supplements his findings with evidence from other sources, e.g. data on trade mispricing (including transfer pricing), data on the cross-border demand for liquid money like reserve currency and a review of market research by consulting firms on the size of the offshore banking sector.

All this leads to Henry’s guesstimate that private wealth parked in offshore constructions amounts to US\$ 21 trillion. If on those deposits were a return of only 3% annually, which then could be taxed with 30% Income Tax, this would generate US\$ 189 billion annually in taxes (p. 42). Henry emphasizes the fact that behind all these money-flows are not “Pirate Banks” on some Caribbean Islands, but the world’s top banking and financial institutions. He sees justice issues since those banks were stabilized and rescued with taxpayers’ money when, at the same time, they earned heavily by assisting individuals and corporations to slash taxes (p. 43).

6.2.3.1 Discussion

The good thing about Henry’s study is that he is basing his guesstimate upon different sources and methods, thus his findings are converging from several angles and have some reliability. The shortcoming of Henry’s guesstimate is that his numbers are confined to private wealth, leaving it open how this guesstimate relates to the areas of corporate wealth and criminal wealth: are there overlaps? Or do those proceeds need to be calculated separately and added to his guesstimate? It can be assumed that these areas overlap to a certain extent since, of course, private people are the ones owning corporations and, in the end, earn their “supersalaries”, bonuses, profits and dividends. But, whatever the case, including IFFs originating from corporate and criminal proceedings into the whole bill would just increase his already incredibly high guesstimate.

6.2.4 Guesstimates based on leaked data

The next source for assessing the global dimension of IFFs is leaked information from banks and funds. In 2013, the so-called “Offshore Leaks” scandal started when 260 Gigabytes of information (i.e. 2.5 million files covering 120,000 offshore foundations and trusts) was leaked to the International Consortium of Investigative Journalists (ICIJ), containing detailed information about the services offered to customers by two companies based in the British Virgin Islands. Ensuing media reports revealed a lot about tricks and practices of how the

wealthy shift their possessions around the globe and conceal beneficial ownership. The giant database was an important insight into the secret workings of offshore industries. If somebody should have a lot of time to sift through that documentation, an addition could be done from assets held in those accounts, for example²¹⁷

- US criminal Carmen “Buddy” Cicalese: US\$ 1 million,
- Canadian Lawyer Tony Merchant: US\$ 1 million,
- Venezuelan “business man” Moris Beracha: up to US\$ 10 million, to be used for bribing officials,
- Swedish Real Estate Mogul Hans Thulin: at times up to US\$ 17 million.

Financial services were used by the wealthy, powerful and beautiful, such as German Baroness Thyssen-Bornemisza, Philippine Maria Imelda Marcos Manotoc, friends of Azerbaijani president Aliyev, members of Indonesian and Chinese Elite, etc.

Part of the data leaked to and used by the journalist federation ICIJ was also handed over to public authorities which started investigations into cases of tax evasion, money laundering and other criminal offences.

A comparable situation emerges in Germany from data contained on CDs leaked from banks in Switzerland, Liechtenstein and other tax haven states to tax authorities, which led to a wealth of prosecution against tax-evading citizens.

6.2.4.1 Comments

The problem is that in each case the origin of money and the purpose of transfer needs to be examined which can be, as journalists tell the researcher, at times perfectly legitimate and sensible, for example, in the case of investments in the Peoples Republic of China. Given the amount of data, it is also near to impossible to establish the amount of IFFs stashed in just those two firms at a given point in time – and there are tens of thousands comparable “financial service providers” around the world.

As to legal proceedings against individuals and businesses, by June 2014 no verdict has come to attention. More revealing about the dimension of what is hidden offshore, is the wave self-declarations by citizens towards authorities, who got nervous about the possibility that their name and data, too, would be contained on the leaked CDs. By self-declaring their evasion, they hope to avoid prosecution. Here, an investigation revealed the following in March 2014: so far, 10 CDs containing tax data have been purchased by the states Lower Saxony, Rhineland Palatinate and North Rhine Westphalia. The price for these CDs is a well kept secret, but guesstimates are at ca. EUR 1 million per CD. Other German states and the federation participated in the costs and received in turn data concerning citizens within their area of residence. The outcome of these proceedings has been yet again a well kept secret; rumours have it that EUR 304 million were collected in taxes, settlements and penal payments from culprits. And the Swiss USB Bank paid on 29 July 2014 a EUR 300 million settlement in order to avoid penal investigation due to aiding and abetting tax evasion. However: due to

²¹⁷ Reports underlying the following list see <http://www.icij.org/offshore/american-fugitive-used-big-banks-shuffle-more-1-million-offshore-records-show>, <http://www.icij.org/offshore/ponzi-scheme-used-offshore-hideaways-shuffle-investors-money>, <http://www.icij.org/offshore/bankrupt-swedish-tycoon-had-fortune-stashed-south-pacific>, <http://www.icij.org/offshore/secret-files-expose-offshores-global-impact>, <http://www.icij.org/offshore/unlocking-chinas-secrets>

self-declaration by nervous citizens or those with a bad conscience another EUR 3.3 billion poured into the treasuries since 2010.²¹⁸

6.2.5 Guesstimates based on the findings of authorities

Another indicator for the dimension of IFFs is police work, i.e. what police or related agencies (customs, tax fraud investigators) uncover in their respective areas of responsibility. Another source could be court sentences following those investigations. Once those statistics are established and other factors are added, calculations can be done to establish a guesstimate or tendency over the past years in the areas concerned.

Such statistics are first of all prepared nationally, but sometimes from a wide range of authorities. In Germany, for example, the following annual reports are available:

- The German Federal Crime Agency's (BKA) Financial Intelligence Unit publishes reports regarding money laundering activities.²¹⁹
- The German Customs Agency's reports, containing, e.g. statistics regarding seizure of attempted smuggling of cash or goods with which people want to circumvent tax payments (e.g. cigarettes).²²⁰
- Statistics on (criminal) tax evasion are compiled by the tax authorities of the 16 states (*Länder*).

Beyond national statistics, in some areas data is collected and compiled by international authorities as well. For example, the paper on money laundering prepared by Eurostat and the EU Directorate General Home Affairs describes the process and outcome of such an endeavour.²²¹

By means of an example, the statistics by the Bavarian State Office of Taxation regarding tax evasion and "irresponsible" (the term is not defined!) tax avoidance in Bavaria is provided: given tax revenue of around EUR 75-97 billion Euro, tax evasion of around/less than EUR 150 million is not really big fry:

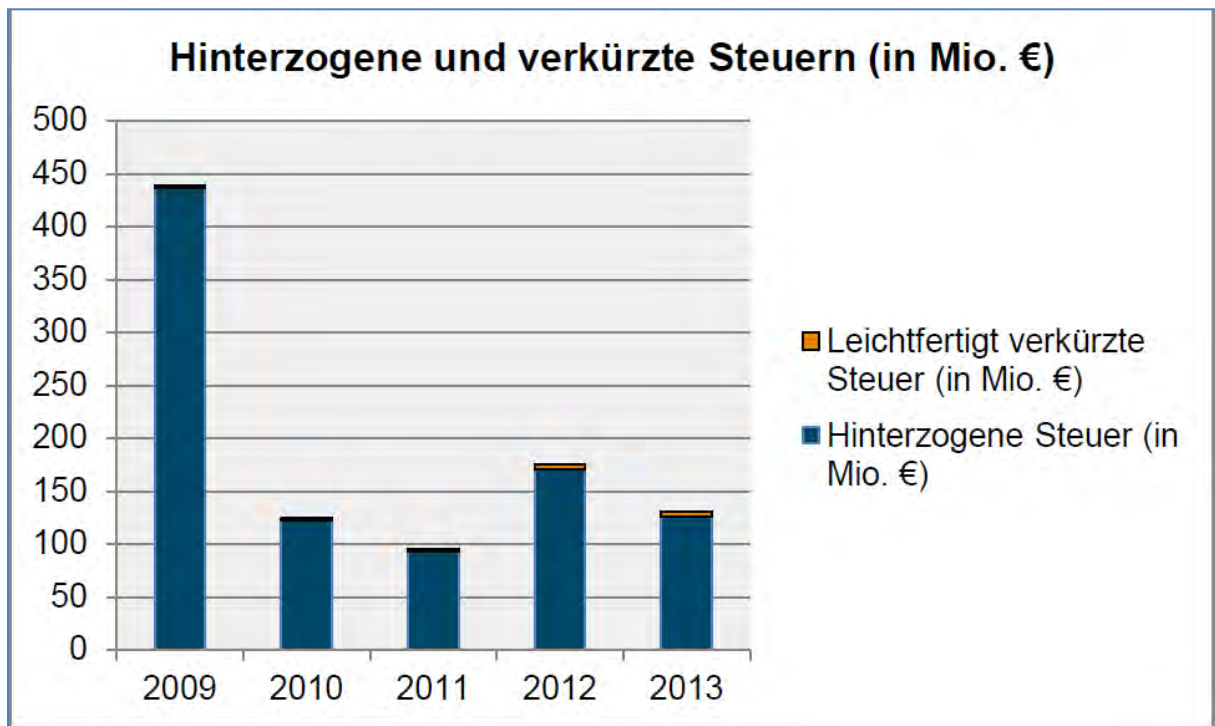
²¹⁸ Houben, M. (2014, March 27) Steuersünder-CDs: Eine Bilanz. In: *ARD Plusminus*. Retrieved from <http://www.daserste.de/information/wirtschaft-boerse/plusminus/sendung/mdr/steuer-cds102.html>

²¹⁹ For download see http://www.bka.de/nr_204298/DE/ThemenABisZ/Deliktsbereiche/GeldwaescheFIU/Veroeffentlichungen/Jahresberichte/fiuJahresberichte_node.html?_nnn=true

²²⁰ For downloads see http://www.zoll.de/DE/Presse/Pressearchiv/2013/Jahresbilanzen/jahresbilanzen_node.html

²²¹ Tavares, C./ Thomas, G./ Roudaut, M. (2013) Money Laundering in Europe. Retrieved from http://epp.eurostat.ec.europa.eu/portal/page/portal/product_details/publication?p_product_code=KS-TC-13-007

Graphic 82 Evaded and avoided tax in Bavaria



Source 48 (Bayerisches Landesamt für Steuern, 2014, p. 90)

The extremely low amount of irresponsible tax avoidance is due to the fact that in a court of law the emphasis is more on (illegal and criminal) tax evasion, which is why one can assume that the amount of tax avoidance as such is much higher in real life. But even the amount of criminal tax evasion is surprisingly low – an indication of law abiding citizens?

6.2.5.1 Comments

The previous example illustrates the problem of prosecution and legal proceedings: The amount published in the State Offices Report is the one established in legal and court proceedings. Nationally, one has to be aware of three points:

- It needs to be borne in mind that police normally suspect much more than they are able to bring to court, also for the reason of legal standards of proof. This again widens the probability that a lot of IFFs are not brought to public attention that way.
- There is a wide difference between that which police uncover (*Hellfeld*) and that which remains hidden in the dark (*Dunkelfeld*). As to the latter, more personnel could certainly shed more light into those hidden businesses since this category of crimes are “control-related” according to the principle: “The more you check, the more you will discover”. But since states, especially in times of financial shortage, need to save costs of personnel, authorities will continue to be short staffed.
- Juridical verdicts normally are below that which police and prosecution bring to the court since the standard of proof is high and, if money is at hand, expensive lawyers are shrewd in drilling holes into the prosecutions’ case; which is why legal proceedings at times do not end in a verdict, but a “settlement” (see GER/VI/4.3.7.2).

Shortcomings of national/local statistics are not improving when moving up to the national or international count. Informants explained to the researchers:

- In some states, there is no single authority able to quantify damage done nationally by IFFs because different authorities are in charge of certain sectors only and there is no requirement to pool their findings. In Germany, for example, one has to deal with the police (bribery, fraud, money laundering), customs (smuggling, black labour) and the tax administration (tax evasion).²²²
- In some areas there are still differences between the ways national statistics are elaborated and common international statistical standards are rare or missing.
- Finally one should not forget the option available in some countries to simply bribe police, the prosecutor or the judge and that way avoid a verdict and “pre-empting” the case...

6.2.6 Adding sectoral guesstimates

A final approach might be to not calculate illicit financial flows with one's own means and efforts, but just add certain categories counted among IFFs provided by others, thus leaving the proof of care and adequacy to those institutions whence the guesstimates are adopted.

For example, the paper “Estimating Illicit Financial Flows” by the UN Office on Drugs and Crimes (UNDOC, 2011) provides a number of estimates for corruption, money laundering, tax evasion and criminal activities. For a change, it follows an example of impressive looking guesstimates regarding untaxed proceeds arising from Transnational Organized Crime all over the world:

²²² „Die polizeilichen Daten können das tatsächliche Ausmaß der Wirtschaftskriminalität nur eingeschränkt wiedergeben. Dies liegt zum einen daran, dass in den polizeilichen Statistiken Wirtschaftsstraftaten nicht erfasst sind, die von Staatsanwaltschaften oder von Finanzbehörden unmittelbar und ohne Beteiligung der Polizei bearbeitet wurden (z.B. Arbeitsdelikte und Subventionsbetrug). Zum anderen ist im Hinblick auf die Interessenlage der Opfer (z.B. bei Anlage von „Schwarzgeldern“ oder Befürchten eines Imageverlusts) von einem in Teilbereichen gering ausgeprägten Anzeigeverhalten und damit verbunden von einem großen Dunkelfeld auszugehen.“ Bundeskriminalamt, Wirtschaftskriminalität. Retrieved from: http://www.bka.de/nr_204298/DE/ThemenABisZ/Deliktsbereiche/Wirtschaftskriminalitaet/wirtschaftskriminalitaet_node.html?_nnn=true

Table 23 Estimates of the extent and value of key transnational organized crime-related flows

TOC PROBLEM		ESTIMATED EXTENT	ESTIMATED ANNUAL VALUE (US\$)
TRAFFICKING IN PERSONS	TO EUROPE FOR SEXUAL EXPLOITATION	70,000 victims (annual) 140,000 victims (stock)	3 billion (stock)
SMUGGLING OF MIGRANTS	FROM LATIN AMERICA TO NORTH AMERICA	3 million entries (annual)	6.6 billion (income for smugglers)
	FROM AFRICA TO EUROPE	55,000 migrants (annual)	150 million (income for smugglers)
COCAINE	FROM THE ANDEAN REGION TO NORTH AMERICA	309 tons (depart) 196 tons (at destination)	38 billion (at destination)
	FROM THE ANDEAN REGION TO EUROPE	212 tons (depart) 124 tons (at destination)	34 billion (at destination)
HEROIN	FROM AFGHANISTAN TO THE RUSSIAN FEDERATION	95 tons (depart) 70 tons (at destination)	13 billion (at destination)
	FROM AFGHANISTAN TO EUROPE (EXCL. RUSSIA)	140 tons (depart) 87 tons (at destination)	20 billion (at destination)
TRAFFICKING OF FIREARMS	FROM THE UNITED STATES TO MEXICO	20,000 weapons, mostly handguns	20 million
	FROM EASTERN EUROPE TO THE WORLD	At least 40,000 Kalashnikovs in 2007/2008	At least 33 million (in 2007/2008 at destination)
TRAFFICKING OF NATURAL RESOURCES	WILDLIFE FROM AFRICA AND SOUTH-EAST ASIA TO ASIA	Elephant ivory: 75 tons Rhino horn: 800 kg Tiger parts: Perhaps 150 tiger skins and about 1,500 kg of tiger bones	Elephant ivory: 62 million Rhino horn: 8 million Tiger parts: 5 million
	TIMBER FROM SOUTH-EAST ASIA TO THE EUROPEAN UNION AND ASIA	Perhaps 10 million cubic meters	3.5 billion (at destination)
PRODUCT COUNTERFEITING	CONSUMER GOODS FROM ASIA TO EUROPE	Some two billion articles per year	8.2 billion (at destination)
	MEDICINE FROM ASIA TO SOUTH-EAST ASIA AND AFRICA	Billions of dose units	1.6 billion (at destination)
MARITIME PIRACY	OFF THE COAST OF SOMALIA	217 attacks in 2009	100 million
CYBERCRIME	IDENTITY THEFT	Around 1.5 million victims	1 billion
	CHILD PORNOGRAPHY	Perhaps 50,000 new images generated annually	250 million

Source: UNODC, *The Globalization of Crime: A Transnational Organized Crime Threat Assessment*, June 2010.

Source 49 (UNDOC, 2011, p. 49)

Another study done jointly by UNODC and the World Bank on Asset Recovery equally contains a number of impressive looking guesstimates. For example, the first figure screaming at the reader from the Executive Summary informs that ‘criminal activities, corruption, and tax evasion is estimated at between \$1 trillion and \$1.6 trillion per year’ for developing (!) countries alone. (UNODC; World Bank, 2007, p. 1).

This sounds much, but is considerably below figures contained from regarding merely bribery and money laundering in the 2013 OECD study on responses to IFFs. That reports quotes a World Bank figure from 2004 to be the ‘most widely accepted estimate of global bribery’ which ‘puts the total at around USD 1 trillion each year.’ Here the figure for the developing world would be US\$ 20-40 billion annually which would amount to 15-30% of all

Official Development Aid. But, building on bribery, contract awarding especially regarding public commissioning due to bribery, a lot more damage is afflicted upon economies in developing countries because of derailed projects, poor quality or inappropriate investment decisions. ‘A USD 1 million bribe can quickly amount to a USD 100 million loss to a poor country’ (OECD, 2013c, p. 73). As far as money laundering is concerned, the OECD report states: ‘Money laundering is defined as the possession, transfer, use, concealment (etc.) of the proceeds of crimes’ (OECD, 2013c, p. 20). In this area in 2009, ‘criminal proceeds amounted to 3.6% of global GDP, with 2.7% (or USD 1.6 trillion) being laundered’ (OECD, 2013c, p. 23). Accordingly: if World Bank and OECD were correct, damage done by bribery and money laundering alone would put global damage within the range of US\$ 2-2.6 trillion each year.

6.2.6.1 Comments

Having criticized already original attempts to establish quantitative guesstimates, not much needs to be said regarding the adequacy and reliability of such “composite” studies which just compile data without bothering about checking its sources. Just to take the OECD quoting a figure released 2004 by the World Bank estimating global bribery at round US\$ 1 trillion each year. This huge figure would suggest that the World Bank is not merely talking about the actual amount of money directly changing hands annually between people. Rather, this huge figure suggests that indirect consequences of bribery such as distorted decisions damaging the economy, growth and the creation of jobs are included. However, if one looks up the World Bank’s figure, its originator, Daniel Kaufmann of the World Bank Institute, confirms that this is ‘an estimate of actual bribes paid worldwide in both rich and developing countries.’ And, as if that were not enough, adds: ‘The \$1 trillion figure, calculated using 2001-02 economic data compares with an estimated size of the world economy at that time of just over US\$30 trillion, Kaufmann says, and does not include embezzlement of public funds or theft of public assets.’²²³ When trying to find the methods and methodologies applied to establish this incredible amount, however, one is disappointed that no adequate or satisfying explanation can be found. When trying to find traces of Kaufmann’s book “Corruption: A Trillion Dollar Industry?” (publication announced as “forthcoming”, its title already qualified with a question mark), no reports or studies are listed on the World Bank Institutes sub-directory on Corruption²²⁴ nor on the internet. So the guess is that whatever underlies this guesstimate was wanting and was therefore removed from the database; which, obviously does not hinder authors and even the OECD referring to and re-quoting it.

6.2.7 Conclusion

As has been shown, establishing the quantity of IFFs is extremely difficult for many reasons. Even though Winston Churchill probably never said it himself, the phrase attributed to him rings loud and clear when used in this context: ‘Never trust a statistic you didn’t fake yourself’. Whatever guesstimates are published, therefore, one should spend some time checking on their underlying assumptions and the methodologies applied.

The more transparent a publication is about its sources and data bases, the more its assumptions are transparent for public scrutiny and verification and the more broad-based triangulation is, the more reliable guesstimates should be. Whatever method or approach one follows, however, one is talking about an awfully large amount of money which is circulating the globe out of reach of the taxman and without any contribution to the common good.

²²³ Press release “The Costs of Corruption” (2004, April 8). World Bank. Retrieved from <http://go.worldbank.org/LJA29GHA80>

²²⁴ See <http://go.worldbank.org/CKBGFF26J0>

But even then one should be mindful that not all illicit financial transaction can be discovered by available methods anyway since not all forms of financial transactions are registered somewhere and therefore accessible for (computerized) investigation and evaluation (see 5.3.2). GFI mentions here cash transactions, which are widespread modes of payments in the informal economy, same-invoice faking, misinvoicing in services and intangibles or hawala transactions (Kar & Spanjers, 2015, p. 2)

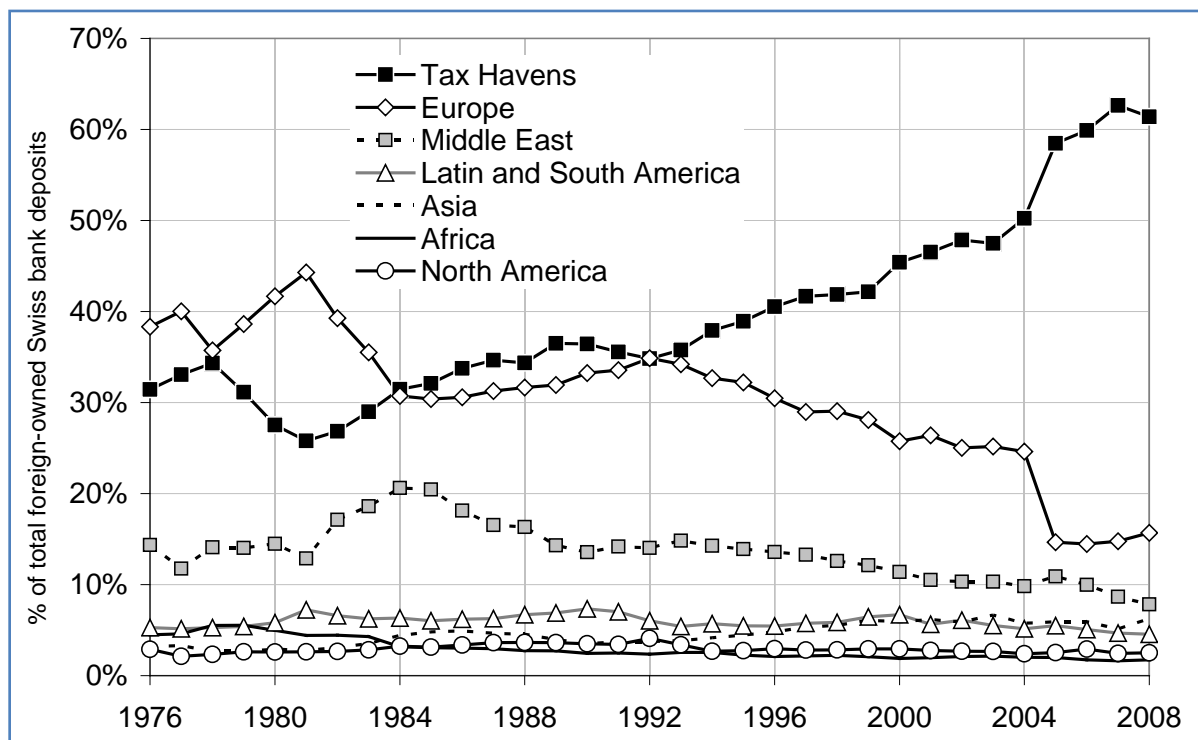
6.3 Private wealth, corporate wealth and Tax Havens

Gabriel Zucman undertook the first academic study to determine personal (household) wealth worldwide (Zucman, 2013a, p. 1343). Subsequently, results from his paper “The Missing Wealth of Nations” are presented, in brackets the page numbers as published in the Oxford Quarterly of Economics. Zucman starts with statistical anomalies in the International Investment Positions (IIPs) which cannot be explained or understood easily, for example (p. 1336):

1. There are more cross-border portfolio liabilities than assets globally.
2. There are more cross-border dividends and interests paid than received globally.

In other words: Due to existing national income and expenditure statistics, the amount of debit and credit should worldwide “zero” each other. However: de facto there is higher debit than credit worldwide, i.e. more money is “owed” than there is money deposited would cover those claims. But if this is the case, that money must be hidden somewhere because otherwise it could not be owed. So: where is the money and who owns it? He tries to answer these questions by using statistics published regularly by the Swiss National Bank, knowing, that Switzerland to-date is one of the largest global tax havens and, in spite of a lot of public and political pressure, is still an attractive destination for assets due to the banking secret and certain products on offer which are useful for hiding wealth, e.g. fiduciary accounts and deposits. The SNB statistic reveals huge deposits of USD 2 trillion - as much as China’s foreign exchange reserve (p. 1329). In other words: Swiss Statistic, if interpreted correctly, reveals that in Switzerland is much more money deposited than people worldwide admit that they have deposited in Switzerland – which answers the question above and consequently the gap between that which is owed and that which is owned narrows.

Graphic 83 Owner nationality of Swiss fiduciary bank deposits, as reported by the Swiss National Bank



Source 50 (Zucman, 2013a, p. 1333).

A large share of this money, Zucman argues, belongs to private households for two reasons: First, developments in the context of the implementation of the EU's Savings Directive which was aimed to curb tax evasion. Between December 2004 and December 2005, the share of European holders of fiduciary accounts decreased by 10%, while the amount of fiduciary accounts held by owners "residing" in tax havens such as the British Virgin Islands, Panama or Jersey increased by 8% (p. 1329). Second: these account constructions are of no use for corporations, foreign banks, insurance companies or funds. Third: the number of African and Asian citizens holding these kinds of accounts is not that large (pp. 1331+34).²²⁵ For these and other reasons, Zucman argues, 62% of the holders are of US or European origin. If this is true, he concludes, the Euro Area is not one of the world's largest net debtors, but a net creditor (pp. 1353ff.).

Based on his methods, database and calculations, Zucman advances a "guesstimate" for personal household wealth held in tax havens worldwide: While Personal Wealth Management Companies estimate USD 6.7 trillion (Boston Consulting) or the Tax Justice Network USD 11.5 trillion, his mark is USD 5.9 trillion, at the lower end. However, he cautions, his focus is 'on financial wealth only, whereas households can also use tax havens for works of art and real estate' (p. 1344).

In a later paper for the *Journal of Economic Perspective*, Zucman tries to quantify private and corporate Offshore holdings for continents and specific countries as well as loss in tax revenue. Here he calculates the following:

²²⁵ Which might also be due to the fact that African Citizens, similar to the Europeans, hide behind "British Virgin Island" nationalities...

Table 24 The World's Offshore Financial Wealth²²⁶

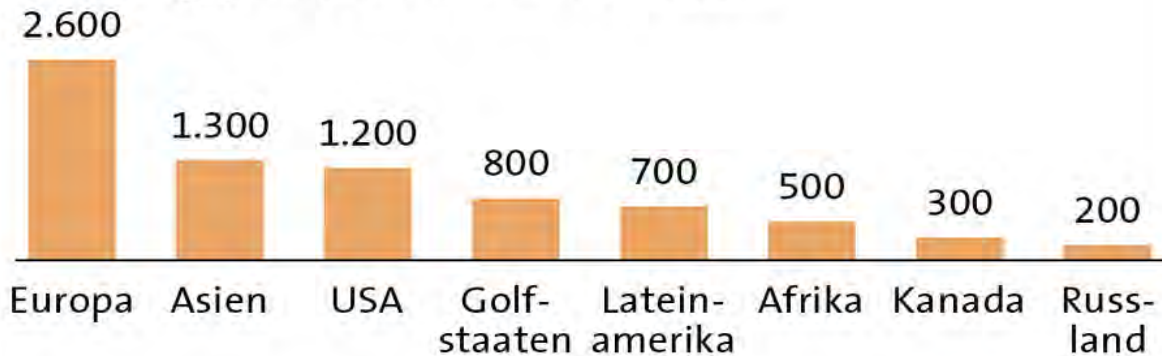
The World's Offshore Financial Wealth			
	<i>Offshore wealth (\$ billions)</i>	<i>Share of financial wealth held offshore</i>	<i>Tax revenue loss (\$ billions)</i>
Europe	2,600	10%	75
United States	1,200	4%	36
Asia	1,300	4%	35
Latin America	700	22%	21
Africa	500	30%	15
Canada	300	9%	6
Russia	200	50%	1
Gulf countries	800	57%	0
Total	7,600	8.0%	190
<p><i>Source:</i> Author's computations (see Zucman 2013a, b) and online Appendix.</p> <p><i>Notes:</i> Offshore wealth includes financial assets only (equities, bonds, mutual fund shares, and bank deposits). Tax revenue losses only include the evasion of personal income taxes on investment income earned offshore as well as evasion of wealth, inheritance, and estate taxes.</p>			

As can be seen from the “Notes”, Zucman focuses on financial assets only and excludes quite a number of categories whose assessment would be of importance as well. In a graphic, the table above looks as follows:

²²⁶ Table on p. 140 of Zucman, G. (2014) Taxing across borders: Tracking Personal Wealth and Corporate Profits. In: *Journal of Economic Perspectives*, Vol.28, Nr. 4, pp. 121-148. Retrieved from <http://gabriel-zucman.eu/files/Zucman2014JEP.pdf>

Geld in Offshore Steueroasen

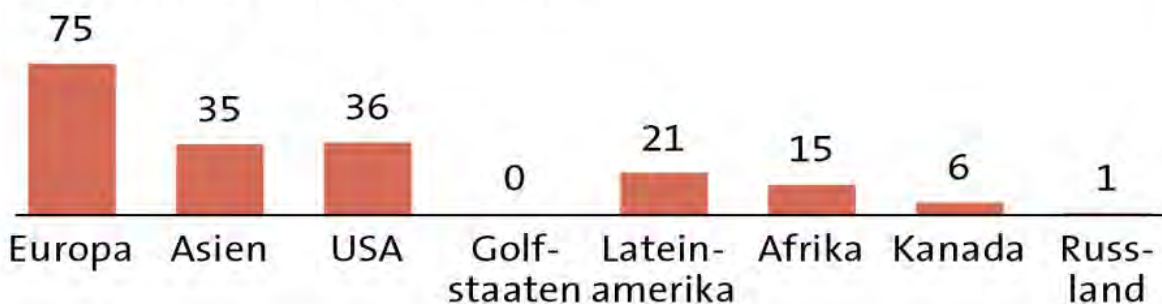
Offshore geparktes Geld in Mrd. USD aus ...



Anteil am jeweiligen Finanzvermögen des Landes in Prozent



Entgangene Steuern in Mrd. USD



Grafik: © APA, Quelle: APA/AK/Zucman



The important numbers are those in the middle, namely the percentage of tax haven deposits in relation to the total financial assets. Here it is obvious that African states are far more disadvantaged as Europe or the US, where, most likely, at least a share of those flows have ended. The number of 30% is close to the number of 33% quoted by the OECD, who in turn refers to calculations done by the Boston Consulting Wealth Report 2013. (Global Forum, 2014, p. 2)

²²⁷ 200 Milliarden Dollar Steuerhinterziehungen über Steueroasen (2015, January 30). In: Format. Retrieved from <http://www.format.at/service/steuern/milliarden-dollar-steuerhinterziehung-steueroasen-5445610>

A study by the Helvea-Baader Bank group comes, regarding Switzerland, to similar results. When calculating EU Assets in Swiss Banks, there are the following “guesstimates” for selected countries regarding the relationships between declared (i.e. known assets to respective tax authorities) and undeclared assets:²²⁸

Table 25 EU Assets in Swiss Banks

Assets in CHFbn	Not declared	Declared	Total	Declared as % of total
Germany	193.4	87.2	280.6	31%
Italy	185.2	1.9	187.1	1%
France	91.7	2.8	94.6	3%
UK	59.6	24.5	84.2	29%
...				
Total	725.8	137.1	862.9	16%

The Helvea studies points out that the grand total of CHF 862.9 billion is pretty much the same figures which the Swiss National Bank, whose database is used by Gabriel Zucman, reveals regarding custody (fiduciary) accounts.

There are similar trends recognizable when looking at flows of corporate wealth. Regarding Europe, the role of Tax Havens for financial flows is also revealed by the following Eurostat statistics regarding FDI in- and outflows as well as stocks (*Bestand*). Regarding FDI flows, the situation is as follows:

Table 26 FDI inflows and outflows to the EU 27 in billion EUR.²²⁹

²²⁸ P. 13 of Helvea (2009) Swiss Banking Secrecy and Taxation. Retrieved from <http://www.safehaven.at/wordpress/cms/wp-content/uploads/2010/03/Helvea-Studie.pdf>

²²⁹ European Commission/Directorate Trade (2014) European Union in the world. Trade-G-2 09/04/2014. Retrieved from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122532.pdf. The star in the table refers to the following explanation at the end of page ‘Offshore Financial Centres (OFC) is an aggregate which includes 38 countries. As examples, the aggregate contains European financial centres, such as Liechtenstein, Guernsey, Jersey, the Isle of Man, the Faroe Islands, Andorra and Gibraltar; Central American OFC such as Panama and Caribbean islands like Bermuda, the Bahamas, the Cayman Islands and the Virgin Islands; and Asian OFC such as Bahrain, Hong Kong, Singapore and Philippines.’

FDI inflows (billion EUR)									
Partner	2004	2005	2006	2007	2008	2009	2010	2011	2012
Extra EU-27	58,3	129,7	231,2	432,1	182,1	274,4	222,6	424,0	291,8
United States	11,5	67,2	74,4	195,0	39,2	108,6	77,8	260,4	98,8
Offshore financial centres (*)	17,1	17,0	74,4	106,6	19,1	55,8	37,5	46,0	81,4
Canada	-4,1	8,0	11,4	7,0	19,0	13,3	19,6	1,2	19,7
Switzerland	16,6	19,1	24,9	29,1	12,3	34,3	31,4	42,4	19,7
Norway	-1,1	1,4	2,6	9,1	2,7	9,2	10,5	10,0	10,6
Liechtenstein	-0,1	0,4	0,7	0,2	0,3	-0,3	1,9	-0,3	9,5
Russia	0,3	2,8	1,5	10,5	2,8	12,5	7,6	3,1	8,4
China (except Hong Kong)	0,5	-0,1	2,2	0,7	-0,4	0,1	0,4	4,3	7,7
Singapore	0,5	-2,0	6,0	10,6	5,8	3,9	10,7	4,4	5,8
Mexico	1,2	1,2	0,3	0,4	0,9	3,0	1,9	0,4	4,9
South Korea	1,4	1,3	0,9	0,4	-0,6	1,6	4,0	1,7	4,3
Japan	8,2	-4,2	16,2	18,3	3,8	6,0	-0,7	10,0	3,9
Israel	-0,2	1,2	0,1	-0,2	3,7	0,9	4,4	0,9	3,1
Turkey	0,3	0,4	-0,3	0,6	-0,2	1,4	0,1	0,3	2,6

Source: Eurostat (bop_fdi_main)

FDI outflows (billion EUR)									
Partner	2004	2005	2006	2007	2008	2009	2010	2011	2012
Extra EU-27	142,3	239,9	317,7	564,2	381,2	331,9	302,6	474,1	255,6
United States	15,5	36,5	105,7	178,3	127,2	95,2	60,5	163,4	62,9
Offshore financial centres (*)	65,0	23,1	59,0	158,6	47,3	85,2	13,7	71,9	39,1
Brazil	5,7	8,5	5,4	14,6	8,6	12,6	44,8	30,3	22,2
Norway	7,6	0,7	5,5	9,4	3,3	3,4	7,7	6,5	19,3
Canada	-2,3	11,9	31,2	30,5	6,3	4,4	-1,8	30,3	17,6
Russia	6,0	9,8	11,5	17,4	27,6	8,8	27,7	8,3	16,2
China (except Hong Kong)	3,9	6,1	6,7	7,1	5,9	8,1	10,5	20,1	15,5
Hong Kong	11,3	3,8	3,6	7,2	4,7	3,7	7,8	7,0	15,0
Australia	0,9	-1,7	6,7	9,4	18,5	-0,5	17,1	-4,0	11,6
India	1,6	2,5	2,5	4,5	3,3	3,5	7,5	13,8	5,5
South Africa	6,0	7,5	5,1	5,1	2,9	10,8	7,1	2,8	4,9
Egypt	1,2	0,7	2,8	1,5	10,8	-3,2	3,0	5,4	4,5
Switzerland	-11,9	74,6	22,1	37,7	31,2	49,0	41,6	48,7	4,5
Iceland	-0,1	-0,2	0,0	0,2	1,3	-1,7	0,5	0,8	4,4

As one can see: money coming from 38 Offshore Financial Centres is the second largest source for financial in- and outflow. The situation regarding FDI inward and outward stocks is identical: in 2012, EUR 1,536.4 billion inward stocks can be attributed to Offshore Financial Centres and EUR 1,655 billion outward stocks. Looking at the table, an additional interesting feature are the spikes in FDI in- and especially outflows from and to Offshore Financial Centres following 2005 (EU Savings Directive) and 2007, the dramatic drop in the year afterwards and the quick recovery.

A similar development is known from India: Largest countries of origin for FDI in India are the two tax havens Mauritius (US\$ 4.85 billion) and Singapore (US\$ 5.98 billion) which make up close to half of India's FDI inflow of US\$ 24.3 billion in 2013/2014. Singapore replaced Mauritius as place of prime choice for investors because 'the Double Taxation Avoidance Agreement (DTAA) with Singapore incorporates Limit-of-Benefit (LoB) clause which has provided comfort to foreign investors based there.' However: 'The India-Mauritius DTAA is being revised amid concerns that Mauritius is being used for round-

tripping of funds into India even though that country has always maintained that there have been no concrete evidence of any such misuse.’²³⁰

6.4 IFFs and Africa’s loss

It is widely known and frequently treated that developing countries would profit a lot if governments would be able to tap into that resource. The OECD, for example, states: ‘Although the exact scale of the problem is unknown, IFFs have devastating effects on developing countries.’ By ‘general consensus’, they ‘likely exceed aid flows and investment in volume.’²³¹ This applies even more to sub-Saharan Africa.

6.4.1 “Guesstimates” regarding direct losses

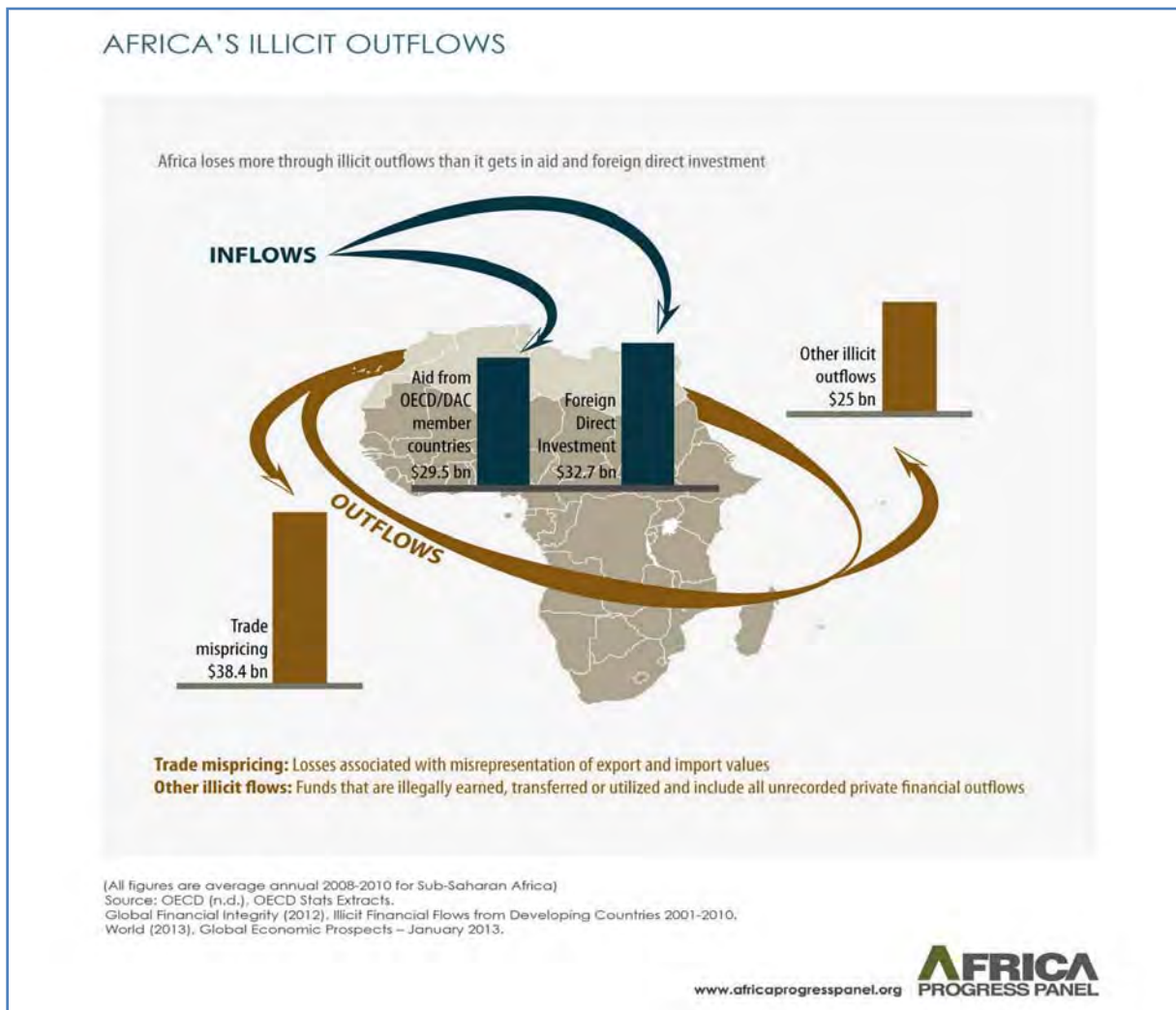
As to Africa, the most frequently quoted guesstimates regarding the quantity of IFFs are the ones by Global Financial Integrity. First, the specific study “Illicit Financial Flows from Africa: Hidden Resource for Development”, covering the years from 1970 to 2008. Here, GFI estimates the outflow at US\$ 854 billion.²³² The second and more updated one is a joint report with the African Development Bank, assessing net-transfers out of Africa for the timespan 1980-2009. Here, the “guesstimate” is US\$ 597 billion in the best case scenario and a staggering US\$ 1.4 trillion in the worst case scenario.²³³ The following graphic, building on different sources and calculated with different methods, illustrates the problem for the years 2008-2010:

²³⁰ Singapore replaces Mauritius as top source of FDI in India. (2014, May 25). Retrieved from Times of India <http://timesofindia.indiatimes.com/business/india-business/Singapore-replaces-Mauritius-as-top-source-of-FDI-in-India/articleshow/35590304.cms>

²³¹ (OECD, 2013c), quotes from Foreword and p. 15. See also (Association of Concerned African Scholars, 2012).

²³² Global Financial Integrity, 2008. Retrieved from http://www.gfintegrity.org/storage/gfip/documents/reports/gfi_africareport_web.pdf

²³³ (African Development Bank; Global Financial Integrity, 2013). However, always be mindful of the methodological questions which can be directed towards the GFI approaches, see chapter 6.1.1.

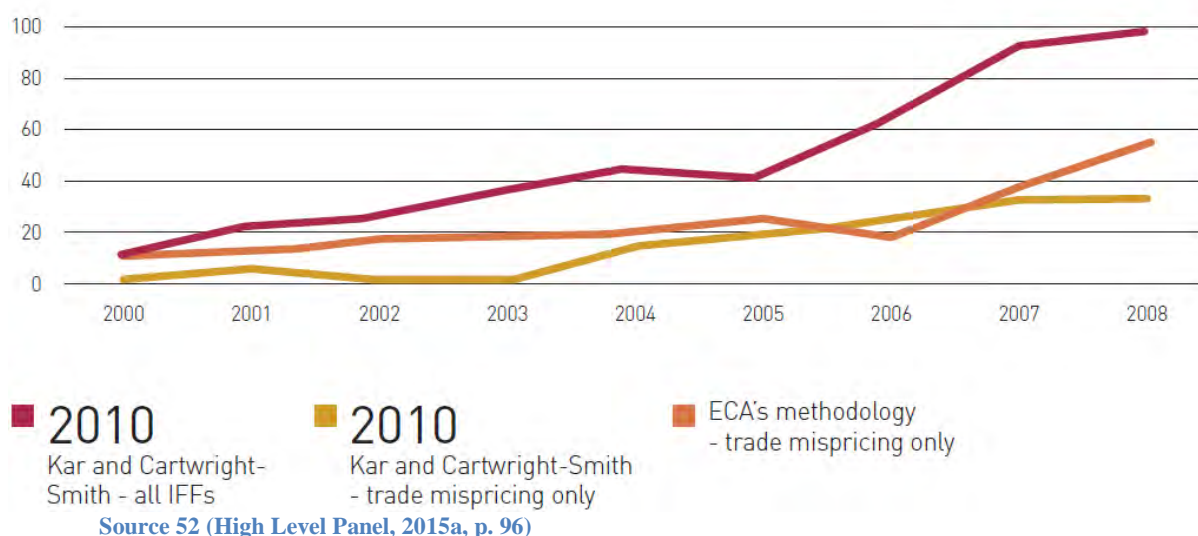


Source 51 (Africa Progress Report 2013, Infographic 22)

Whatever angle one takes, either a focus on trade mispricing and misinvoicing only or on all IFFs, one thing all agree upon: The tendency is rising. From 1970 onwards (where it was close to 0) and more pronounced since the turn of the millennium:

Graphic 86 Evolution of IFFs from Africa 2000-2008

Evolution of illicit financial flows from Africa, 2000–2008 (billions of dollars)



6.4.2 “Guesstimates” regarding indirect damage

GFI points out that IFFs cannot and must not be equalled with tax evasion. If USD 100 million potential IFF would rather remain in a country only ‘a portion of it would accrue as tax revenues, perhaps 10 to 30 percent,... and most of the rest would remain in the economy for investment, consumption, or savings. Indeed, the private component of these flows is more important to the economy than the tax evading component of these flows’ (see below, 6.4.2).²³⁴ This is confirmed by others:

Some have estimated that Africa’s capital stock would have expanded by more than 60 per cent if funds leaving Africa illicitly had remained on the continent, while GDP per capita would be up to 15 per cent more (Boyce and Ndikumana, 2012). Just as telling is the estimate in the 2012 African Economic Outlook that Africa’s ratio of domestic investment to GDP would increase from 19 per cent to 30 per cent if the stock of capital taken out were available for investment within the continent. (High Level Panel, 2015a, p. 52)

Simulations suggest that if all the flight capital over the period 2000-2008 had been invested in Africa – with the same productivity as actual investment – the average rate of poverty reduction would have been 4 to 6 percentage points higher per year.²³⁵

Equally important, the Millennium Development Goals could have been implemented to a far larger degree. For example MDG 4, Child Mortality. After a detailed investigation the panel concludes: ‘If IFFs had been arrested by the turn of the century, Africa would reach MDG 4 by 2016.’ (High Level Panel, 2015a, p. 53)

²³⁴ Analytical Methodologies Utilized by Global Financial Integrity. Retrieved and accessed on 12 December 2015 from <http://www.gfintegrity.org/issues/illicit-financial-flows-analytical-methodologies-utilized-global-financial-integrity/>

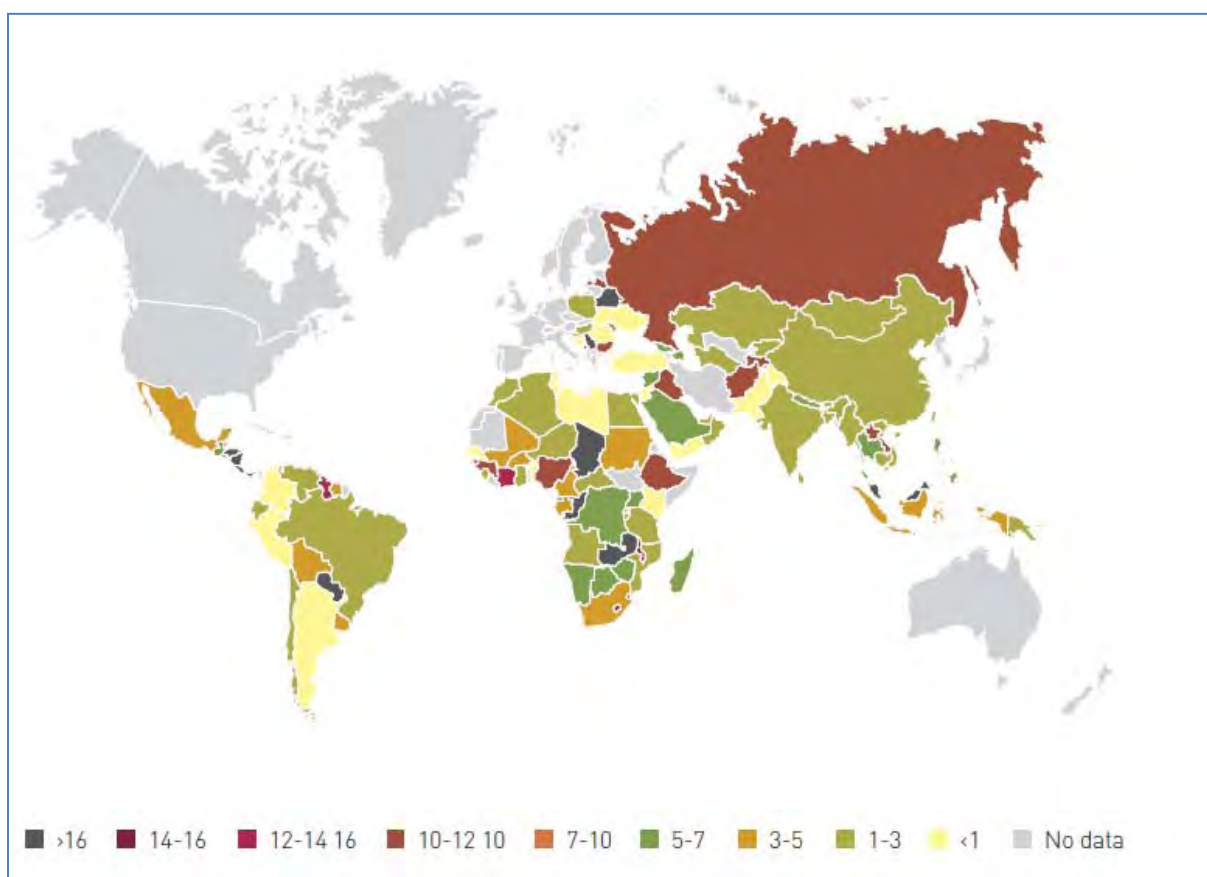
²³⁵ (Christian Aid, 2014, p. 28). See also Ugur, M./Dasgupta N. (2011, April 20) Corruption and economic growth: A meta-analysis of the evidence on low-income countries and beyond. University of Greenwich. Retrieved from <http://mpira.ub.uni-muenchen.de/31226/>

Infrastructure is the condition of possibility of any sustainable economic development. To do this would cost African states annually USD 30-50 billion, approximately the amount which is leaving African annually (High Level Panel, 2015a, p. 14)

Finally: ‘there are also the associated results of undermining the ability to quantify environmental damage and the negative impact on sustainable development. This is also the case for losses arising from secret contracts. The intertemporal loss or reduction in the welfare of future generations due to overextraction permitted by secret contracts is a key concern of our Panel.’ (High Level Panel, 2015a, p. 58)

Of course, the outflow differs from country to country but it is particularly high for sub-Saharan African states:

Graphic 87 IFF outflow as percentage of GDP



Source 53 (High Level Panel, 2015a, p. 21)

6.4.3 Causes and proposed remedies

A very comprehensive and thorough examination of IFFs from Africa has been conducted by the High Level Panel on Illicit Financial Flows, which has been set up by the 4th Joint Annual Meetings of the AU/ECA Conference of Ministers of Finance, Planning and Economic Development in 2011 and published its finding in January 2015.

Regarding the causes, there are some which can be expected: Poor economic and government structures in Africa, weak regulatory structures, not adequate staff in African tax authorities and other investigatory authorities. But there are also some which are less known:

- While everybody agrees that corruption is an essential element enabling IFFs and that there are Anti-Corruption Units in almost every country, there are hardly any transfer-pricing units in African Tax Administrations.
- Double Taxation agreements: They are often distorted by those being in the stronger position. For example, OECD model DTAs ‘do not allow for withholding taxes on royalties and management fees, while the version produced by the United Nations Tax Committee gives stronger rights to taxation at source.’ (High Level Panel, 2015a, p. 42)
- ‘Financial secrecy jurisdictions put in place an elaborate framework to attract financial resources irrespective of their provenance, whereas tax havens mainly aim to exploit differences in tax rates across different jurisdictions. Nonetheless, we feel that the distinction is not a vital one for the purposes of our work, especially as the enabling effect of both financial regimes on IFFs is the same in terms of lack of transparency.’ The latter, the High Level Panel admitted, is a great temptation for African states as well: ‘We found that several African countries desired to become financial services centres, and, though we understand the reasoning, we feel strongly that African countries should not in the process become financial secrecy jurisdictions sucking resources from the rest of the continent.’ (ibid., p.42)
- ‘The capacity imbalance between the prosecuting authority and the multinational corporation it was prosecuting was such that the latter was able to hire the best internationally available legal and accounting expertise, which the State could not afford. This resulted in the prosecutors almost always losing their cases and leading them to suspect prejudice on the part of the judiciary. Other telling examples were the poaching of staff of government agencies by multinationals, sometimes during ongoing investigations into their tax affairs.’ (ibid., p.43)

Parallel, there are some recommendations which are rather known: Strengthen regulatory frameworks or increase the number of staff (which, on the background of the previous) begs the question which state is able to attract and pay qualified people). But there are proposals, and again some of them are less known, but merit deeper consideration:

- Better coordinating tax authorities with the work of other investigating and prosecuting authorities, i.e. the “whole of government approach”. ‘Key in this regard would be the re-examination of policies which restrict the use of tax information solely for that purpose without the ability to share the information with law enforcement agencies.’ (High Level Panel, 2015a, p. 44).
- Model treaties for Double Taxation and the Exchange of Data between authorities developed by the African Tax Administration Forum are better suited to the needs of African states than Model Conventions by the OECD (ibid. p. 44)
- Regarding staffing of developing countries’ tax authorities, the High Level Panel on Illicit Financial Flows from Africa sees here also an area where the Principle of Common but Differentiated Responsibility applies: If there is a serious interest to combat IFFs (which is not yet obvious for everybody on part of the benefitting developed countries), it is also within the larger responsibility of developed states to assist developing states to establish capacities in this area (High Level Panel, 2015a, p. 46)

6.4.4 Outlook

Clearly, if governments would be able to tap into this resource they could considerably improve their tax/GDP ratio which in Africa is pretty low when compared to OECD countries – as has been shown above in 3.2.5 and 3.3.4.

The way it is right now, with strong IFFs and weak tax administrations, the following would apply to many African nations:

- They remain co-dependent from ODA and other external sources of finance like borrowing.
- Regarding revenue at hand, they remain severely restrained in their spending since a considerable share has to go into the payment of interest or repayment of debt.
- States continue to lack necessary funding to implement all those wonderful ideas contained in the surveys conducted among policy makers from developing countries (see 2.5.1.) or to improve infrastructure (see 5.7.).

Clearly: Curbing IF

6.5 IFFs and Europe's benefit

There are always two sides to IFFs: countries losing out because the money is leaving them and countries profiting since the money is coming in to them. Among the latter are not merely secrecy jurisdictions such as the well-known exotic tax havens, such as British Virgin Islands or Cayman Islands. More attractive are areas where money cannot just be deposited, but invested. This brings OECD and EU states into the picture. And indeed: major examinations of past years indicate, 'that significant amounts of illicit financial flows from developing countries have found their way into OECD countries (CDU/CSU/SPD, 2013, p. 23).

One way to establish this is to consider the difference between current account (Leistungsbilanz) and financial account (Kapitalbilanz) surplus.²³⁶ Normally, those two corresponding posts do not match, but in some cases the discrepancy is larger than can be explained. Experts argue that especially unrecorded financial transfers contribute to a disbalance between those two for individual countries, but also between countries of different world regions. For developing and emerging markets, the financial accounts are normally negative, for developed countries the financial accounts are normally positive. This indicates that there is more capital leaving the first and entering the latter unobserved. On the receiving end, three countries emerge in top positions: the USA, the UK and Germany. The accumulated surplus of the financial account for Germany for the years 1999 to 2012 is EUR 253 billion.

Christian Aid examined findings of the report "Jersey's Value to Britain" and summarizes its central findings as follows:

'The analysis of customer deposits in banks for example shows that of the total £112bn, £9.4bn comes from Africa. This compares to £9.5bn from beneficial owners in the Middle East, £5.5bn from Russia, £5.4bn from North America, £4bn from South America, £3bn from China and £2.5bn from India, with the rest coming from the UK, rest of the EU and Switzerland. Estimates of the value of assets held in Jersey trusts by private individuals also show Africa as a leading source region. Out of £391bn held in total, 44% comes from the UK

²³⁶ For this complicated piece see Box 1 of (Klär, Lindner, & Sehovic, 2013, p. 192)

(mainly from ‘non-doms’), with 8% (£31bn) coming from Africa. This far exceeds amounts from Russia (£15.5bn), the Middle East (£14.7bn), North America (£8.6bn), India (£6.4bn), South America (£1.7bn) and China (£1bn). On the other hand, the assets settled by corporate or institutional clients in Jersey trusts and special purpose vehicles shows the UK, rest of EU, Middle East and North America as leading source locations with much less coming from Africa.²³⁷

The report concludes that this practice benefits primarily the United Kingdom:

‘But the uses of these funds disproportionately benefit the United Kingdom. We estimate that almost one half of the combined value held in the stewardship of the island’s trusts and other structures, funds and banks has been invested in assets located in Britain. By this, we mean ultimately located in Britain, and not assets with funding simply intermediated through the City of London. Overall, Jersey’s financial services sector intermediates almost one pound in every twenty of investment by foreigners into the United Kingdom. This scale of investment could potentially support 112,000 British jobs. Much of this investment into Britain depends upon the status of Jersey and the other Crown Dependencies.’²³⁸

Regarding trade mispricing only, there are, depending on the economic sectors, some states who dominate the picture of IFFs between outflowing and inflowing countries:

Table 27 Top destinations of IFF inflow from Africa, different economic sectors

Nigeria - Oil (HS2 code 27)		Algeria - Oil (HS2 code 27)		SACU - Precious metals and minerals (HS2 code 71)		Cote d'Ivoire - Cocoa (HS2 code 18)		Zambia - Copper (HS2 code 74)	
United States	29.0%	Germany	16.1%	India	23.2%	Germany	23.6%	Saudi Arabia	23.4%
Spain	22.5%	Turkey	14.6%	United Arab Emirates	22.7%	Canada	9.4%	Korea, Rep	15.7%
France	8.7%	Canada	11.7%	Italy	14.2%	United States	9.2%	China	10.4%
Japan	8.5%	Tunisia	10.2%	United States	10.8%	Mexico	8.5%	Thailand	5.7%
Germany	7.7%	United States	6.8%	Turkey	7.2%	France	7.4%	Pakistan	2.6%
Top 5 Total	76.4%	Top 5 Total	59.4%	Top 5 Total	78.2%	Top 5 Total	58.1%	Top 5 Total	57.9%

Source 54 (High Level Panel, 2015a, p. 100)

Equally it can be assumed that other EU states profit from IFFs from Africa. Wealth managers admit publicly that Europe is a preferred target for private wealth from insecure and unstable world regions, either people want to bring their assets to safety or because they want to increase their profits (Wealth-X and UBS, 2014, p. 32+44). This applies certainly also for Germany, even though not for money out of Africa. Germany is rather known to be targeted by Organized Crime Groups from Eastern and Southern Europe. However, even before

²³⁷ (Christian Aid, 2014, p. 34). For the original text see: pp. 38+44 of Capital Economics (2013, July 2) Jersey’s Value to Britain. Evaluating the economic, financial and fiscal linkages between Jersey and the United Kingdom. A report for Jersey Finance Ltd. http://issuu.com/jerseyfinance/docs/jfl-capital_economics_final_repor?e=5246825/3796250

²³⁸ Ibid. For the original text see: p. 9 of Capital Economics (2013, July 2) Jersey’s Value to Britain. Evaluating the economic, financial and fiscal linkages between Jersey and the United Kingdom. A report for Jersey Finance Ltd. http://issuu.com/jerseyfinance/docs/jfl-capital_economics_final_repor?e=5246825/3796250.

Offshore Leaks, there was increasing anecdotal evidence that corrupt politicians and comparable individuals from developing countries also dealt with German financial institutions. As will be shown elsewhere (GER/VII), Germany belongs in the category of secrecy jurisdictions (Tax Justice Network, 2013) and the German financial and banking sector is attractive for these IFFs as well:

- German Banks are universally present and accessible,
- They operate in and via Secrecy Jurisdiction,
- The German financial sector is large,
- There is a lack of adequate tax treaties with states where IFFs are likely to come from,
- Germany because its prosperity and social stability is very attractive for investments, and, most importantly:
- The German financial sector lacks adequate transparency.

Due to the latter aspect, hard evidence is difficult to obtain, which is for critics of the German financial sector exactly the proof for the thesis employed – until disproven.²³⁹

6.6 Conclusion

Having not only looked in the studies of Piketty and colleagues, but also at different guesstimates presented and discussed in the preceding parts, two items should be uncontested: First, we are discussing about billions of Euro in IFFs between Europe and Africa, even though no guesstimate shall be advanced by this research project. A figure seemingly small when looking at the dimension of regular trade or financial flows, is at the same time a figure big enough, at any rate, to spend a lot of serious thought on the problem. Second: Developing countries are more severe hit by these money flows than developed countries. Here, Eurodad came up with the latest “guesstimates”: ‘while only 3 per cent of corporate investments in developed countries originate from ‘tax havens’, the comparable figure for developing countries is 21 per cent and the proportion rises to a full 41 per cent for transition economies. Similarly, while 10 per cent of European wealth is held offshore, the comparable figure in Africa is three times higher at 30 per cent.’ (Eurodad, 2015a, p. 15)

To combat this, many initiatives are needed running parallel in the legal and administrative cooperation of states. Just two examples, one for each sector:

Regarding first the legal cooperation, existing laws would need to be scrutinized, clarified and probably simplified, since many loopholes exist because regulations are so complex, offering so many exemptions that those can be used by tax lawyers and others working at aggressive tax planning and avoiding schemes. Here, however, a lot of expertise is needed and it is doubtful whether states have capacities clever enough to deal with lobbyists and lawyers paid by the owners of private and corporate wealth at eye level. Here one should recall the example given above regarding the composition of bodies advising the EU Commission in re-regulation of the financial sector (5.3.8). The need of states to cut spending in all areas (among other reasons because of debt) does not spare the employment of top legal experts in tax and finance departments, which decreases existing capacities of staff already. For that reason, in complex cases ministries lack expertise and they seek outside advice, e.g.

²³⁹ E.g. (Henn, Meinzer, & Mewes, 2013) or The Anti-Corruption Resource Centre „U4“ in its Fact Sheet from 2012, May 23, retrieved from <http://www.u4.no/publications/evidence-of-illicit-financial-flows-from-developing-countries-placed-in-germany/>

by commissioning costly research at expert institutions.²⁴⁰ Here, however, an independent view (if that is possible at all) is not guaranteed, as recent publications indicate.²⁴¹ Even worse are initiatives of governments to exchange personnel with financial and economic institutions under the premise of “increasing mutual understanding”.²⁴² Here all doors are finally opened so that corporate interests take an active and immediate influence on the formulation of legal regulations. The revolving door phenomenon, namely that top people from politics change into the economic sector and vice versa has not even been addressed yet. On that background one needs to ask the following questions: How can legislation benefit the many rather than the few, given the complexity of the situation, be secured? How can public institutions be enabled to adequately examine all potential traps and holes of legal proposals handed in by an army of highly paid specialists before passing it on to parliament? Here, financial resources certainly are important, for example to employ adequate staff to do the job without the need to turn to outsiders, and to offer attractive payment and remuneration so that at least some of the brightest spirits are not going to the private sector.

This leads to the second area. Even the best laws need efficient, competent and honest administrations to get the best out of them. For example: the best law about transparency is toothless if administrators are corrupt, closing their eyes regarding illicit financial flows occurring right under their noses. Or, the best Double Taxation Agreement is worthless if there is no adequate number of tax officials trained in the matter and able to cooperate efficiently with counterparts in other countries, which seems to be a problem in all three countries taking part in this research. Here, again, the question not only of qualification and training is important, but also payment: a well-paid civil servant, in danger of losing payment and other perks in case he is being bribed and unmasked, is the best guarantee of effective and honest prosecution of tax avoidance, tax evasion and other criminal activities in the context of IFFs. This, too, costs a lot of money, both for the training and for the payment of enforcers.

Taxation provides important resources and a source, where those monies could come from, which, right now, are not sufficiently available to implement improvement in just these two areas.

And indeed: it is important, that cooperation within and between Africa and western states regarding IFFs is picking up, just to mention UNECA’s High Level Panel on Illicit Financial Flow, the 2014 EU-Africa summit or the meeting of African leaders with the US.²⁴³

²⁴⁰ Maisch, A. (2014, July 7) Regierung zahlte 33 Millionen für Berater. In: *Die Welt*. Retrieved from <http://www.welt.de/129863192>

²⁴¹ Rügemer, W. (2013, August). Die unterwanderte Demokratie. In: *Blätter für Deutsche und Internationale Politik*. Retrieved from <https://www.blaetter.de/archiv/jahrgaenge/2013/august/die-unterwanderte-demokratie>. And: Rügemer, W. (2014, April 23) Unabhängige Wissenschaft. Online Flyer. Retrieved from <http://www.nrhz.de/flyer/beitrag.php?id=20254>

²⁴² 2004 Agreement between former Home Secretary Otto Schily and Deutsche Bank Chief for Personnel Tessen von Heydebreck about an exchange program between private sector and public ministries, whose original design and intention was to increase understanding for each other’s problem. See: Jellen, R. (2010, October 5) Direkter Lobbyismus. In: *Telepolis*. Retrieved from <http://www.heise.de/tp/artikel/33/33366/1.html>

²⁴³ As to the UNECA High Level Panel see <http://www.uneca.org/iff>. As to the EU-African cooperation see Freymeyer, Chr. (2014, April 4) Illicit capital flows are the elephant in the EU-Africa summit room. In: *Euractive*. Retrieved from <http://www.euractiv.com/sections/development-policy/illicit-capital-flows-are-elephant-eu-africa-summit-room-301319>. As to the US-African cooperation see Dawson, S. (2014, August 8) Africans call on rich nations to crack down on money laundering in new drive against illicit flows. In: *Thomson Reuters*. Retrieved from <http://www.trust.org/item/20140808080141-h5x8o/>

The problem is, however, that it all too often remains at talks and politically motivated declarations and that there is not enough effort to frame intention into convention. For example: The treatment of IFFs in the context of the Finance For Development conference and the Addis Abeba Action Agenda is not really satisfying, the same applies the UN's framework of the post-2015 agenda and the new Sustainable Development Goals (SDGs): The present draft speaks vaguely of curbing illicit financial outflows from the developing countries (target 16.4) and of helping them to improve their tax collection (target 17.1). But there are no specific demands on richer nations to stop facilitating this drain on development. And indeed:

Policy coherence is another victim of IFFs. It is somewhat contradictory for developed countries to continue to provide technical assistance and development aid (though at lower levels) to Africa while at the same time maintaining tax rules that enable the bleeding of the continent's resources through illicit financial outflows. It might indeed be useful to undertake an analysis of the impact of the tax systems of developed countries on African countries. (High Level Panel, 2015a, p. 60)

6.7 Global context findings

The previous examination focused on the relationship between Africa and Europe, but in the context of the 2015 Summit on Financing for Development, a number of other studies emerged, dealing with these questions in the larger context of developing and developed countries worldwide. One recent study was the one by Eurodad (Griffiths, 2014), which drew from a variety of accessible sources, among which were GFI, the World Bank and IMF. The study comes to the conclusion that developing countries, for every dollar they earn, lose two, i.e. that the outflows are twice as high as the inflows. The following graphic illustrates this:

Graphic 88 Financial in- and outflows from developing countries



Source 55 (Griffiths, 2014)

The graphic confirms what has been found in the previous presentation of Africa: The largest source of outflows are IFFs, which would include money from tax evasion and aggressive tax planning, this trend is general, even though there are differences between LICs, LMICs and UMICs. Needless to say that it is the poorest countries which are hardest hit, especially when looked at it not in absolute numbers but in percentage relating outflows to the national GDP (pp.15ff.). Not surprising is further the outflow due to the payment of interest for loans and debt, surprising seems to be the remaining two: Lending to rich countries refers to the need of poor countries to look for secure investment of their reserves which they might need in times of need, for example buying bonds from the US or Germany which is de facto lending money to them. Repatriation of profits means the withdrawal from assets from poor countries back to wealthy countries in times when they are needed there, for example in the aftermath of the World Financial and Economic Crisis. Ever since 2008, repatriated profits exceed FDI inflows (p. 20). On the whole, however, the report finds that domestic sources of finance grew in developing countries improved over the past years, but this does not prevent the balance to be negative on the whole. In fact, the report argues, the situation has become worse for developing countries after the World Financial and Economic Crisis

7 Tax Justice?

The main question this research tries to answer is: How far is taxation (and what kind of taxation is) a justified and justifiable means to reduce the wealth gap and governmental dependence on external financing and to alleviate poverty? This question is particularly urgent when regarding the spread of costs for the recent World Financial and Economic Crisis, which is over-proportionately borne by ordinary citizens. Costs for labour went up, as did costs for everyday life because of hefty increases in VAT. At the same time, (a) no comparable changes were introduced regarding progressive taxation of income, taxes of corporations, capital, rents, real property, wealth or inheritances, (b) known loopholes and weak spots assisting tax evasion and aggressive tax planning were not closed, (c) investment in infrastructure, public services and programs benefitting the poor were cut.

7.1 What are we talking about?

This brings us, finally, to the last concept of our research “Tax Justice”, which binds together both our research focus (wealth gap) and our research goal (alleviating poverty by means of a just taxation policy). How complex the context is in which taxation policies need to be considered has been illustrated in the preceding chapters. But the question of tax justice also requires another dimension of consideration: while everybody knows what we are talking about when we mention “taxation”, the situation is much more diffuse when we talk about “tax justice”. How do you define “just” or “Justice”? What concept of “Justice” do you adopt and follow? Because, depending on the chosen concept of justice, other practical issues will be measured, deduced and applied. The challenge seems to be the variety of religious beliefs, philosophies and ideologies and their different concepts and understandings of “Justice”.

7.2 The importance of values

The preceding parts of this paper could be written in a very “objective” manner. So far, we have been describing situations and developments, i.e. the situation of existing and increasing inequality, governmental dependence on external financing, structures enabling and developments leading to the global situation which we face right now. Here, as well as regarding some causes underlying these situations, far reaching agreement could be stated among very different stakeholders in this discussion. As the paper continues, and to the extent it comes to policy recommendations addressing reforms which need to be implemented, the

discussion will be more strongly influenced by “hidden” values and principles guiding people’s world view.

7.3 Negative determination

Of course, one could avoid problems arising from here by following approaches which simply aim for the improvement of stated “grievances”. As Amartya Sen argues, it is always comparatively easy for people to agree if something is unfair and unjust (Sen, 2010). For example, it should be no problem to find agreement that the private and corporate owners of wealth contribute no longer adequately to the costs of the common good, which then will immediately lead into a practical discernment about what instruments would improve the situation and what could ameliorate the grievance under discussion. Here, the label “justice” could apply to everything which remedies a given grievance. The situation after the reform could be called a “more just” situation, in which indeed more people are better off than before. This approach has also been dealt with by other scholars. For example, Karl Popper labelled this developing of improvements by starting from grievances “social engineering.”²⁴⁴

For example: Take the following policy recommendations by the IMF; they are a good starting point for discussions.

Table 28 Fiscal Reform Options for Efficient Redistribution

	Advanced	Developing
Social Spending		
Improve fiscal sustainability of existing pension systems through increasing statutory retirement ages	X	X
Tighten link between contributions and benefits		X
Expand noncontributory means-tested social pensions		X
Expand means-testing of family benefits with stronger link to work	X	
Intensify use of Active Labor Market Programs (ALMPs) and in-work benefits for social benefit recipients	X	
Develop unemployment savings accounts		X
Consolidate social assistance programs and improve targeting		X
Replace general prices subsidies with targeted transfers	X	X
Expand conditional cash transfer programs as administrative capacity improves		X
Improve design of public works programs as a safety net instrument		X
Improve access to education of low-income families	X	X
Increase private financing of tertiary education	X	X
Maintain access of low-income groups to essential health services	X	
Expand coverage of publicly financed basic health package		X
Taxation		
Implement progressive Personal Income Tax (PIT) rate structures	X	X
Relieve low-wage earners from tax or social contributions	X	
Expand coverage of the PIT		X
Reconsider income tax exemptions, based on a critical tax-expenditure review	X	X
Impose a reasonable PIT exemption threshold		X
Tax different types of capital income in a neutral manner	X	
Develop more effective taxation of multinationals	X	X
Automatically exchange information internationally	X	X
Utilize better the opportunities for recurrent property taxes	X	X
Examine scope for more effective taxes on inheritances and gifts	X	
Minimize VAT exemptions and special VAT rates	X	X
Set a sufficiently high VAT registration threshold	X	X
Use specific excises mainly for purposes other than redistribution	X	X

²⁴⁴See in more detail pp. 70f. of: Alt, J./Fodor, R. (2001) *Rechtlos? Menschen ohne Papiere*. Karlsruhe: von Loeper.

But in the end it will be the principles, norms and values of everybody's world view which determine the readiness for compromise, which is why we need to be (positively) clear about those as well when we want to improve the situation as much as possible.

7.4 Positive determination

It has been indicated already in many places of this paper, that the present situation and the developments leading up to it are to a large extent based on values, principles and norms which are symbolized by that which is normally referred to with the term "neoliberal globalization". After the World Financial and Economic Crisis, support is growing not only to aim for reforms within this paradigm, but to modify or even replace the paradigm by something different. For example, people as different as Pope Francis and Christine Lagarde call for a new ethical framework for global finance which, as has been shown, is a major cause also behind the lead problems of this research, namely the growth in the wealth gap and governmental dependence on external financing. This in turn would impact economies, states and societies. Since neoliberal globalization had a strong fiscal dimension to it (symbolized by what is referred to as the "Tax Consensus"), whatever changes in this ethics will also include a taxation aspect.

This research project is building on the principles, norms and values of Catholic Social Teaching (Alt, 2013). Catholic Social Teaching is not merely a theory, but has also successfully influenced political and social models of governance, e.g. when establishing the post-war republics of Germany and Austria.

7.5 Taxation as an instrument of justice?

7.5.1 What is "just" and "justice"?

Without pre-empting the later in-depth examination, the complex issues at hand shall be briefly demonstrated by illustrating the links between social and (re-)distributive justice and taxation – the selection being done because in the discussion redistribution is an important element for narrowing the wealth gap and paying back public debts with the goal of diminishing dependence on external finance.

As indicated by OECD (2.3.) and IMF (3.6 and the previous table), one of the ideas of taxation is to redistribute wealth inside a given society in order to narrow the wealth gap and to prevent people from getting stuck in poverty and to provide support so that they can "help themselves" get out of poverty. In this context, the principle of "Distributive Justice" is important, because this principle 'concerns the nature of a socially just allocation of goods in a society.' It 'considers whether the distribution of goods among the members of society at a given time is ... acceptable.'²⁴⁵ If this is not the case, taxation can be one way to right the wrongs, because

redistribution of income and wealth or redistribution of wealth is the transfer of income, wealth or property from some individuals to others caused by a social mechanism such as taxation, monetary policies, welfare, charity, divorce or tort law. The desirability and effects of redistribution are actively debated on ethical and economic grounds.²⁴⁶

²⁴⁵ See http://en.wikipedia.org/wiki/Distributive_justice

²⁴⁶ See http://en.wikipedia.org/wiki/Redistribution_of_income_and_wealth

7.5.2 Taxation, social and distributive justice outside CST

The most well-known and probably most influential contemporary debate surrounding the topic of a just society and how taxation fits into it is the dispute between John Rawls and his opponents. Rawls in his writings puts up a strong case for distributive justice which is hailed to be the ‘most compelling case for a more equal society that American political philosophy has yet produced’ (Sandel, 2010, p. 166). In Rawls thinking, however, taxation is not a central element to determine the justice of a society. As he describes in his book “Justice as Fairness”, his goal is a society, whose entire ensemble of institutions

“work to disperse the ownership of wealth and capital, and thus to prevent a small part of society from controlling the economy.” In its ideal form, a property-owning democracy would not produce wide disparities of income and wealth and a few privileged members of society controlling most of the economic and social resources. “Under these conditions ... we hope that an underclass will not exist.” And elsewhere Rawls even calls upon a ‘society “beyond justice”, where ‘taxation would only be about providing government financing for public goods and operations: redistribution would simply be unnecessary (Sugin, 2004, p. 2000+2005).

Clearly, in such an ideal society taxation would not be of central importance. But even John Rawls has to acknowledge that the real world of growing inequalities is far removed from his ideal state of a socially just society, and in the real world taxation is one of the very few means with which to implement some sort of distributive justice. Therefore he reluctantly enters two taxes into the debate, both of which are in accordance with his famous two principles of justice: a flat tax on consumption (Rawls, 1999) and an inheritance tax (Rawls, 2001). On what – and how – the money thus collected should be spent is not elaborated in detail since the real world was not as central a concern for the philosopher Rawls as the ideal world. Scholars guess that perhaps Rawls’ final understanding of ‘justice as fairness is more concerned with sufficient taxation than with the particular distribution of tax burdens.’ But clearly the taxes proposed ‘could certainly raise enough revenue to provide for substantial redistribution, both directly in the form of transfer payments to the neediest members of society, and indirectly, through the provision of public goods that disproportionately benefit the least well-off.’ (Sugin, 2004, p. 1999)

His critics counter that of course the rich and strong need to support the weak and poor, but that the extent and ways in which they do so needs to be left to their own discretion. Robert Nozick, for example, one of the most influential critics of Rawls emphasizes that any transfer can be called “just” only, if it originates from a free gift, sale or other agreement, but not from theft. And here taxation comes in: ‘Nozick argues that all attempts to redistribute goods according to an ideal pattern, without the consent of their owners, are theft. In particular, redistributive taxation is theft.’²⁴⁷

In the view of critics, only voluntary transfers are “pareto efficient”, namely, that because of this transfer one group is better off, but nobody is worse off.²⁴⁸ This may sound strange at first sight but consider this: a wealthy person might have the insight that it is better for him to pay 1000 Euro from his purse for a socially just society, which is therefore free of

²⁴⁷ Taken from <http://en.wikipedia.org/wiki/Justice>, retrieved 18 November 2013.

²⁴⁸ For a general overview see the entry “Distributive Justice” in the Stanford Encyclopedia on Justice, retrieved from <http://plato.stanford.edu/entries/justice-distributive/>. As to the conflict between Rawls and Nozick see Lacewing, M. Rawls and Nozick on Justice. Routledge, retrieved from <http://cw.routledge.com/textbooks/alevelphilosophy/data/A2/Political/JusticeRawlsNozick.pdf>

violent conflicts, than spending the same amount on a flat inside a gated community. Or, he might voluntarily pay for good road infrastructure since it also benefits his BMW.

There is, however, ample evidence to demonstrate, that this kind of insight and behaviour does not exist in the real world to the extent that the above-mentioned indicators of poverty, namely scandalous inequality and governmental dependence, are diminishing. Equally, there are indications that some among the wealthy might be magnanimous, but the majority is not.²⁴⁹ This is neither surprising, nor is it a new insight. Adam Smith stated already that we need the state for those tasks and institutions which are not realized by individuals or small groups simply because it is not profitable enough for them to invest in them.²⁵⁰ This common-sense insight is supported by research into the question, how wealth distributes in a society without any redistributive mechanisms in place: It would concentrate even faster than it does today and instability of society would most likely increase proportionally (Fernholz & Fernholz, 2012).

7.5.3 Taxation, social and distributive justice in CST

Clearly, Catholic Social Teaching with its understanding of, and emphasis on, the common good and public institutions safeguarding this common good is much more in line with Rawls and Sandel than with their libertarian critics. The main objection of the critics, namely that tax is theft, the church pre-empts by calling it not “theft”, but “sacrifice”, which the better-off have to contribute for the sake of those less well-off.²⁵¹ Moreover, Catholic Social Teaching calls exceeding wealth to be theft if it does not show adequate social responsibility to the poor.²⁵²

Before a more exhaustive discussion in the course of the research project, two appeals for redistribution based on CST shall be given. Pope Benedict argues that redistribution

²⁴⁹ For example: Miller, L. (2012, July 1) The Money – Empathy Gap. In: New York Magazine. Retrieved from <http://nymag.com/news/features/money-brain-2012-7/>. Or: p. 4089 of Piff, P./ Stancato, D. et.al. (2012, March 13) Higher social class predicts increased unethical behavior. In: Proceedings of the National Academy of Science. Vol. 109 (11), pp. 4086-4091. Supplementary information about underlying field studies and their evaluation: <http://www.pnas.org/content/suppl/2012/02/22/1118373109.DCSupplemental>. Or: Manne, A. (2014, July 7) The age of entitlement: How wealth breeds narcissism. In: The Guardian. Retrieved from <http://www.theguardian.com/commentisfree/2014/jul/08/the-age-of-entitlement-how-wealth-breeds-narcissism>. Equally the website <http://givingpledge.org/>, publishing names of super-wealthy who donate half of their wealth to the common good: There are admittedly some important names, but even more are missing. Outside the US, such open discussion and engagement of the wealthy is rather unheard of; it is certainly non-existent in Germany, Kenya and Zambia.

²⁵⁰ The sovereign's or commonwealth's task 'is that of erecting and maintaining those public institutions and those public works, which though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expense to any individual, or small number of individuals; and which it, therefore, cannot be expected that any individual, or small number of individuals, should erect or maintain.' (Smith, p. 276). See also I/V#.

²⁵¹ See, for example, Paul VI: 'On the part of the rich man, [building up the human community] calls for great generosity, willing sacrifice, and diligent effort. Each man must examine his conscience, which sounds a new call in our present times. Is he prepared to support, at his own expense, projects and undertakings designed to help the needy? Is he prepared to pay higher taxes so that public authorities may expand their efforts in the work of development? Is he prepared to pay more for imported goods, so that the foreign producer may make a fairer profit? Is he prepared to emigrate from his homeland if necessary and if he is young, in order to help the emerging nations?' (Populorum Progressio Nr. 47).

²⁵² 'With this in mind, I encourage financial experts and political leaders to ponder the words of one of the sages of antiquity: "Not to share one's wealth with the poor is to steal from them and to take away their livelihood. It is not our own goods which we hold, but theirs".' Pope Francis, Exhortation Evangelii Gaudium Nr. 57.

organized by the political community is needed to balance inequalities and distortions which accompany economic activities guided merely by commercial logic:

Economic activity cannot solve all social problems through the simple application of commercial logic. This needs to be directed towards the pursuit of the common good, for which the political community in particular must also take responsibility. Therefore, it must be borne in mind that grave imbalances are produced when economic action, conceived merely as an engine for wealth creation, is detached from political action, conceived as a means for pursuing justice through redistribution.²⁵³

And the Compendium on Catholic Social Doctrine states:

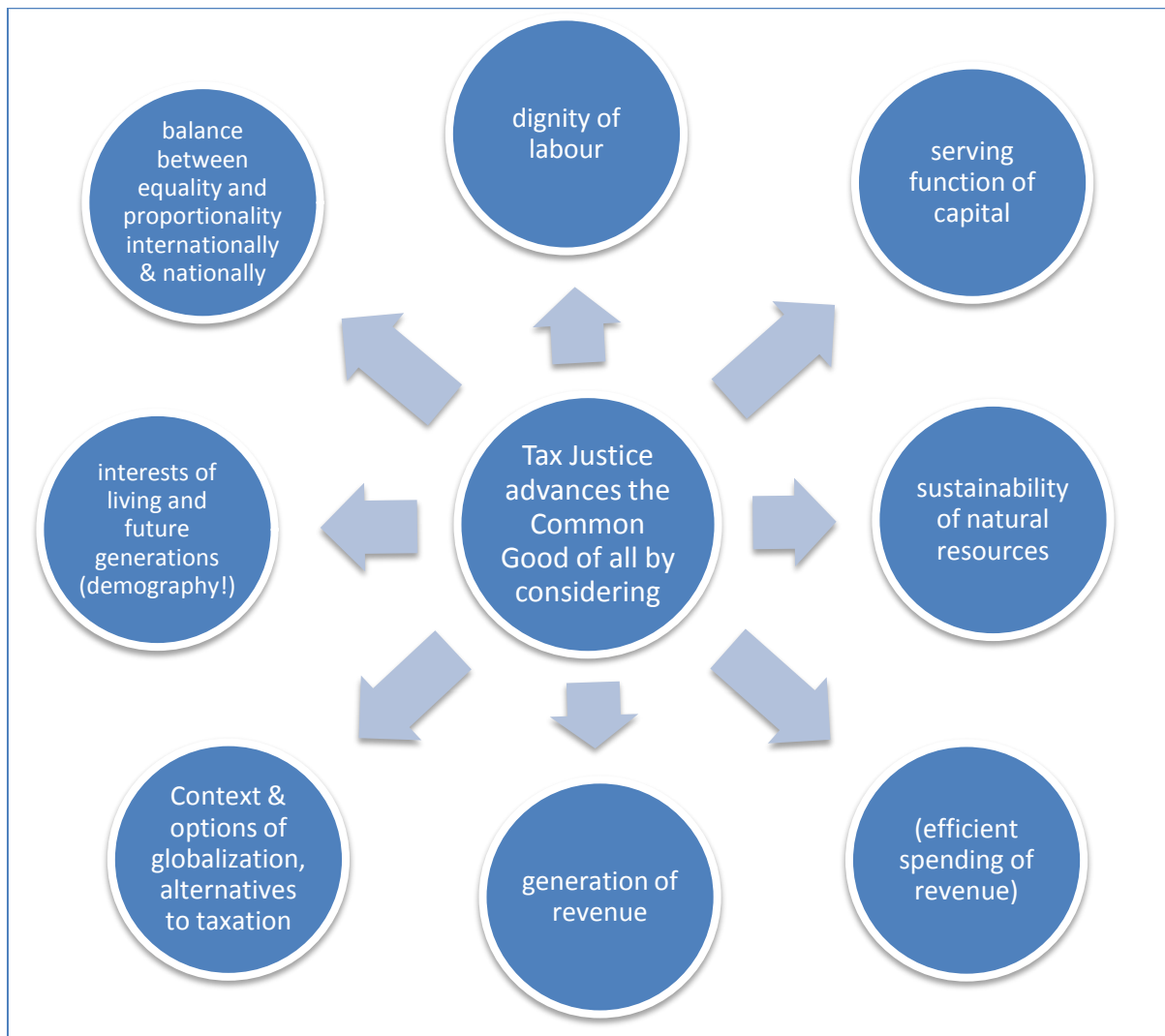
The economic well-being of a country is not measured exclusively by the quantity of goods it produces but also by taking into account the manner in which they are produced and the level of equity in the distribution of income, which should allow everyone access to what is necessary for their personal development and perfection. An equitable distribution of income is to be sought on the basis of criteria not merely of commutative justice but also of social justice that is, considering, beyond the objective value of the work rendered, the human dignity of the subjects who perform it. Authentic economic well-being is pursued also by means of suitable social policies for the redistribution of income which, taking general conditions into account, look at merit as well as at the need of each citizen. (Pontifical Council for Justice & Peace, 2005, p. 227).

7.5.4 Parameter of Tax Justice

Catholic Social Teaching has, of course, to be mindful to find a balance between the ideal and the real, i.e. taxation recommendations which would endanger jobs or which would tempt corporate and private wealth to go offshore would be counterproductive. On the whole, recommendations based upon Catholic Social Teaching should be mindful of the following parameters:

²⁵³ Caritas in Veritate Nr. 36

Graphic 89 Tax Justice parameters underlying recommendations



Following principles and norms of Catholic Social Teaching, Tax Justice does not exist if the taxation system

- endangers jobs (e.g. by risking redundancies or outsourcing)
- endangers the serving function of capital for the real-economy (e.g. by privileging quick-gains at capital markets or retaining rather than investments)
- endangers the sustainability of natural resources (e.g. if employers counterbalance their burden to capital and labour by overexploitation of natural resources)
- does not find the balance between equality and proportionality in the treatment of citizens and businesses nationally and internationally
- is designed to favour the present and burden future generations (being mindful of demographic developments)

Beyond that, one has to be aware that the most ideal legislation can trigger side effects in the real world or even prevent better alternatives. Therefore Catholic Social Teaching has also

- to take into account context and options provided by globalization (Tax havens, profit shifting, illicit financial flows as well as better alternatives to taxation such as Foundations or Social Impact Investment...)
- to be aware that taxation should generate adequate resources for counterbalancing inequalities of income, outcome and opportunities without risking negative backlashes (e.g. a tough tax burden upon the wealthy could endanger businesses, jobs and investment and drive corporate and private wealth out of the country)
- to insist upon transparent, responsible and efficient spending of revenue (which is, however, not the topic of this research)

7.6 Outlook: Distributive justice and redistribution

Indeed, looking into the issue of distributive justice and, building on that, re-distributional policies in the field of taxation may be worthwhile, because institutions as different as the IMF and the Catholic Church agree that both tax collection and tax spending needs to be examined together when discussing about tax justice and fairness.²⁵⁴ This link makes sense. The willingness to contribute to the common good is much higher if those being asked to contribute know for what objectives and purposes their money is being used. Also in this research project on Tax Justice & Poverty, therefore, three areas of validation and verification should be of importance to determine the fairness and justice of taxation systems in any given society and their adequacy for reducing poverty:

1. Does everybody contribute to the common good/commonwealth according to his abilities?
2. Can it be established, due to a redistributive effect, that wealth gap and governmental dependence stop growing (or even diminish) and that therefore poverty both now and of future generations is *prima facie* reduced?
3. Are governmental policies and programs, on which tax revenue are spent, indeed the best possible way to reduce poverty? Or are approaches based on charity better?

The researchers are aware of this link between tax collecting and revenue spending right from beginning, but, at the same time, state also their inability to deal with both aspects with equal diligence. On page 8 of the research concept, they admit:

It is not enough to collect more money. This study is also concerned about how best the money is spent so that poverty is reduced. In other words: It is not in the interest of this study that the money is spent – for example – to fuel more corruption or that programs are funded which are of no use to alleviating national or global poverty. This brings in the question of good governance. On the other hand ... the researchers will not be able to deal with this aspect adequately. (Tax Justice & Poverty, 2013a).

Treatment of the issue of redistribution may be some sort of compromise. The advantage is that the concept of redistribution is a sort of umbrella term, dealing with certain elementary aspects of social justice regarding national and global inequality, but at the same

²⁵⁴ 'The overall fairness of the fiscal system should be assessed in terms of taxes and spending combined, and most redistribution takes place through the latter' (International Monetary Fund, 2013a, p. 34). In the same manner, CST argues: 'Tax revenues and public spending take on crucial economic importance for every civil and political community.... Public spending is directed to the common good when certain fundamental principles are observed: the payment of taxes [739] as part of the duty of solidarity; a reasonable and fair application of taxes; [740] precision and integrity in administering and distributing public resources. [741]' (Pontifical Council for Justice & Peace, 2005, p. Nr. 355).

time the topic alleviates the researcher of the need to go into too much detail regarding the discussion and evaluation of individual policies.

This, however, will have to wait until the analysis of problems regarding the three country reports has been completed and, building on that foundation, thoughts about policy recommendation will be drawn.

8 Conclusion

8.1 Summary

This chapter has started to explain, by making use of findings by very different researchers and institutions that inequality globally has been on the increase for some years. The problem is not that income and wealth at the top is growing faster than at the bottom, meaning, that in the end still everybody would have gained and everybody's situation would have improved, but the bottom not as much as the top. In this case indeed "the rising tide would have lifted all boats." Reality is rather that income and wealth only among the top is growing widely, while middle and lower segments of the population have to struggle either to keep their income or at least to avoid a decrease in substance or even indebtedness. While it seems that worldwide the largest increase on the top is due to income from capital, vulnerable and precarious employment on the bottom is on the rise. In developed states, some market wages are no longer sufficient to guarantee decent living and adequate social security provisions. Here, either several jobs are needed or wages have to be topped-up by public subsidies, which are in turn funded with taxpayers' money.

It has further been demonstrated that inequality in today's world is not an unavoidable and unchangeable feat. There are many things which could be done towards a more equal, fair and just society. The big problem regarding many of those solutions to improve the situation of inequality of outcome and inequality of opportunities was that they cost money which states do not have.

On that background, another strand of examination was started, which established that processes and structures of today's financial integration are among important reasons for – first – growing inequality (e.g. because of the predominance of capital over labour) and – second – for sinking tax revenue because of the Illicit Financial Flows. Once more states are in the backseat of developments. While the financial and economic sector and its actors share in a common culture and norms, states are restricted in their activities by national legislative, cultural and normative frameworks – and these differences are masterly exploited by the global financial and economic elite for their egocentric purpose with the help of corruption, blackmail or simply brilliant lawyers. In their despair, states rather compete with each other and are unable to cooperate.

It is here, where the revenue crisis of states really originates. There is no lack of money for the repayment of debt, the financing of public services, the protection of global common goods and combating poverty. There is equally no lack of good legislation. But there is a lack of ability of states to enforce their tax laws both nationally and internationally. In other words: it is not just a problem of national taxation systems, but also a question of how states respond to global financial structures. Every successful attempt to improve taxation and redistribution, therefore, needs to be done in consideration of underlying global structures – otherwise they will not be effective.

8.2 Outlook

Many reforms in taxation and labour markets over the past decades were justified with competitiveness and in order to attract capital and investment. This might be the case, but if at the same time the result is that owners of capital profit over proportionately from these policies, it is even more important to strengthen redistribution within societies by means of taxation in order to prevent skyrocketing inequality and to preserve social justice and the cohesion of society. Looking at the ways tax systems are working, the following avenues suggest themselves for improvements.

Combating tax evasion: here actors as different as the policy maker surveyed by UNDP (2.5.1.) and EU institutions such as Eurostat (3.3.3.) agree that combating illegal tax evasion would improve the revenue situation greatly. However, although the legal situation is (comparatively) clear, the problem is effective enforcement both regarding tax evasion by the owners of private and corporate wealth, but also regarding black labour in the informal sector, the so-called “tax dodging of small citizens”.

Combating tax avoidance: next, looking at the dimension of illicit financial flows, it has become clear that a lot of private and corporate wealth is transferred abroad by aggressively using legal loopholes in an illicit way. Here, closing loopholes in existing national laws and international tax treaties would be the way to go.

Having said that, however, improving international cooperation on the basis of existing legislation is key: again looking at the dimension of illicit financial flows, but also considering that what has been said by Piketty, OECD (2013a) and IMF (2013a), states have to stop working against each other by giving way to financial and corporate pressure, but rather start to realize that tax competition in the end is damaging the common good of all. In turn, cooperation and assistance in enforcing existing tax law would be benefitting the common good.

The next two steps would require major and important changes beyond that which is already possible with existing legal instruments:

Increasing transparency: a major problem of tax enforcement is the un-transparency of global financial structures which enable owners of private and corporate wealth to transfer money out of the reach of the tax man without the tax man being able to discover what has been done. Equally, as will be shown in the country studies, there is at present no way for national tax authorities to inspect how wealthy a person or corporation is in reality, since they depend on self-disclosed information by the person/company or their lawyers. Here both nationally and internationally, more transparency is required. Nationally, wealthy people should be, on grounds of the principle of equal treatment, as transparent to the tax man as the receiver of social benefits or recipients of wages from dependent labour. This could be done by abandoning the banking secret for tax inspectors. Justified privacy interests of wealth owners towards unauthorized personnel can be protected by strict tax secrecy stipulations such as is the case in Germany’s Fiscal Code. Internationally, an automatic exchange of data would have to be implemented, including the revelation of beneficial owners of trusts and foundations. Here, a lot has started to move after the Offshore Leaks scandal, leading to the signing of the “Multilateral Competent Authority Agreement on implementing a new international standard in the automatic exchange of information (AEOI)” at the meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes in Berlin on 28/29 October 2014. There is, however, a lot of criticism on the part of experts: only 50 of the

members cooperating in the Global Forum signed the treaty, and experts perceive a number of loopholes in the treaty which is why the implementation of this agreement needs to be monitored carefully.²⁵⁵

Higher taxation of private and corporate wealth: as has been demonstrated by all those examined in chapter 2 as well as others such as the IMF or Eurostat, there are many areas where justifiably and effectively wealth and income could be taxed more adequately. To do this in a fair and efficient way, a lot more examination is required within national and regional contexts which will be undertaken in the country studies as well.

The participants in this research project see already a lot of opportunities for cooperation between Europe and Africa.

There should be a common interest of both European and African states to cooperate in all these areas in all international fora available. Here, however, one has to state that African states are not part of the Common Reporting Standard initiative mentioned above and that there are a number of ways to exclude them from its implementation.²⁵⁶

Africa and Europe should not only cooperate because of a shared interest in revenue. It is also due to their neighbourhood and shared problems, e.g. migration and extremism, and because of its past history. Clearly, this past history is certainly also painful especially for Africa. On the other hand African states start to realize that alternatives are equally far from ideal. China, the US and emerging states such as India or Brazil also have more interest in Africa's natural resources than in the genuine wellbeing of its people. Clearly, taxation is certainly not the panacea to all these problems, but it improves the room to manoeuvre. On that background one needs to recall that one of the skills of politics is to cooperate at eye level and forge out compromises serving the common interest and common good. And here, an increased and closer cooperation between Europe and Africa is as good a starting point as it is in the case of any alternatives.

There remains a final problem, namely the growing influence which the top private and corporate holders of wealth have on democratic and political attempts to re-establish control on financial markets, to improve taxation and redistribution. Here indeed is a threat to democracy, not only in the eyes of Piketty, but also the IMF: 'The notion is that, at least in democracies, political power is more evenly distributed than economic power, so that a majority of voters will have the power and incentive to vote for redistribution. However, as pointed out by' numerous researchers 'this need not be the case if the rich have more political influence than the poor.' (Ostry, Berg, & Tsangarides, 2014, p. 8).

²⁵⁵ Information regarding the event and its conclusions see <http://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Taxation/Articles/2014-10-28-global-conference-berlin-fight-tax-evasion.html>. Regarding critique see Meinzer, M./Knobel, St. (2014, October 27) The end of bank secrecy? A new Tax Justice Network Report – Preliminary version. Retrieved from <http://www.taxjustice.net/2014/10/27/end-bank-secrecy-new-tjn-report/>. And: Böcking, St. (2014, October 27) Das Versteckspiel geht weiter. In: *Spiegel Online*. Retrieved from <http://www.spiegel.de/wirtschaft/soziales/steuerhinterziehung-warum-das-bankgeheimnis-nur-scheintotist-a-999438.html>

²⁵⁶ See criticism on the occasion of the OECD's launch of its common reporting standards book by NGO experts "OECD's plan to end tax secrecy blasted by activists" (2014, July 23). Retrieved from http://www.icij.org/blog/2014/07/oecd-plan-end-bank-secrecy-blasted-activists?utm_source=email&utm_campaign=newsletter&utm_medium=icij-email

Here, the wide range of persons, governmental, non-governmental and intergovernmental organisations waking up to the problem and challenge is encouraging. It is hoped also that this research might contribute to a better, more efficient, fair and just taxation which could enable the strong in society to carry once more a tax burden for the common good, more in proportion with their ability. This alone will narrow the wealth gap, will raise revenue, enabling governments to decrease their dependence on external financing and increase their ability to assist the poor.

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