



506

NOVEMBER
2017RESTORING LEGITIMACY TO
WESTERN DEMOCRACIES**Francis Ghilès**, Senior Associate Research Fellow CIDOB

As ever more private “revelations” of tax avoidance and tax havens hit the front pages of the German newspaper *Süddeutsche Zeitung*, the British *The Guardian* and the French *Le Monde* - the aptly name Paradise Papers (13.4m files), many ordinary people in Europe have convinced themselves that all their political leaders are dishonest and out to line their pockets rather than work for the public good. In coordination with the International Consortium of Investigative Journalists, 381 journalists in 67 countries have worked with the leaked information, much of which originated with the Bermuda law firm Appleby, to report stories on how wealthy individuals and companies use offshore accounts to make their fortunes untraceable and unreachable. The stories began appearing in early November.

Coming two years after the Panama Papers which were leaked from the Panamanian law firm Mossack Fonseca- which revealed how dictators and other rich and powerful people avoided tax and hid their wealth, the recent spate of articles is fuelling the wave of populism which has become a feature of European and American politics recently. More broadly, many ordinary people feel that the rules and laws which they are asked to respect do not apply to those individuals and wealthy international corporations such as Nike, Apple and Starbucks whose avoidance of tax requires an encyclopaedic knowledge of the law, extraordinary amounts of cunning, pedantry and sophistication.

Trumpeting the Paradise Papers as revealing one great con scheme is somewhat disingenuous on the part of commentators whose knowledge and understanding of international economics and finance seems all too often driven by ideology and a shaky understanding of how the system we live in works. Putting Queen Elisabeth II on the front page may sell more newspapers but it hardly encourages a serious debate about why the rich are getting richer and many people are finding it ever harder to make ends meet. Two things are worth noting: capitalism for all its faults – some of which are very real, has lifted more than 1bn people out of poverty since the late 1970s; second, the very low interest rates which have prevailed since the financial crisis of 2008 have, as much as any other single factor, helped to increase the wealth of the rich and very rich. Technology is another factor.

Much avoidance of tax may be legal but using loopholes and grey areas that lawmakers did not intend, at the very least, goes against the spirit of the law. Tax avoiders thrive at the expense of a state they refuse to adequately contribute to. Between \$8tn and \$10tn of the world's wealth, one tenth of the total, is estimated to be offshore, a figure which is much too high. It is not hard to understand why this massive loss of tax income owed to European and North American states risks bankrupting the social order which underpins western democracy. In his article *Why the Paradise Papers matter*, Martin Sandbu argues that it would be wrong to conclude that this is simply a case of "move on, nothing to see". More reforms are needed and while the EU moves towards a blacklist of 53 tax havens goes in the right direction, it needs "to be much firmer on what sanctions blacklisted countries would suffer". For the sake of presentation and credibility, it hardly helps that the president of the European Commission Jean Claude Juncker spent years as prime minister of Luxembourg crafting rules which attracted major corporations to base their headquarters in the Grand Duchy precisely to avoid paying taxes. In the UK reform is well nigh impossible under a government which resembles a flying circus but President Macron is not the only senior politician in Europe attempting to get the rules concerning the avoidance of tax by international companies tightened.

Disparities in wealth have been growing across western democracies for more than a generation - a key factor which fuels the popular discontent. This discontent is exacting a political toll in European countries and America. The former US presidential candidate, Bernie Sanders has warned that the world is fast becoming an "international oligarchy" controlled by a tiny number of billionaires. He certainly has a point and that perception weakens the western democracies which have for so long held up their methods of governance as a model to all and sundry across the world. The election of Donald Trump has done great damage to the image of the United States, the country whose engagement with the world since 1945 has been crucial to the underpinning of the international security and trade systems, which have allowed most countries to grow in relative peace. American disengagement from international agreements - be they on climate, trade or security, is led by a wealthy man whose sharp business practices and manner of governing embarrass many of his peers, including in his own Republican Party. However, whatever the Paradise Papers revealed corruption in the West pales in comparison with what goes on in Russia, China, India and Arab countries. At least China is growing fast and India more so in recent years than before but corruption in Russia and across the Middle East is best described a high way robbery.

The revelations offered by the release of millions of documents by the Paradise Papers has led many critics to argue that corruption is hardwired into our financial system: that is simply wrong. It has prompted calls to blacklist offshore tax havens by the likes of the UK Labour leader Jeremy Corbyn. More realistically, the EU tax commissioner, Pierre Moscovici has said that "it is time that we agree and publish a blacklist on tax havens". Much has been done to tighten rules, more needs to be done but when Transparency International argues that the recent leaks offered proof that oversight of the global financial system was broken, they are scoring ideological points, not offering a realistic account of the situation. That major international corporations have shopped around for years to avoid paying tax is well understood European governments are putting increasing pressure to make them more accountable in the countries where they do business. The sight of Apple or Starbucks avoiding billions of dollars in tax, albeit by using perfectly legal rules and laws is acting like a red rag to the bull of public opinion at a time when many younger Europeans are finding it hard to get a steady job.

Western political leaders should have heeded the wake up call faster. Following the financial crisis of 2008, virtually none of the bankers responsible for the complex financial structures which played a key role in starting the crisis ended up

behind bars. Those who paid the price of the bail outs which were essential to prevent the structures of world finance from collapsing were ordinary people, the citizens of the US and European countries. Many lost their jobs, others saw their incomes drastically reduced. Middle classes incomes were squeezed and, in the Euro zone, matters were made worse by the very tight budgetary rules which are enshrined in the Treaty of Maastricht.

Three years ago, the phenomenal success of a 700 page tome about economic inequality *Capital in the Twenty First Century*, by a then little known French economist, Thomas Piketty's surprised many. The themes the author brought up had been enshrined in discussion by progressive economists for decades: no fewer than three Nobel Prize winners – Joseph Stiglitz, Paul Krugman and Robert Solow – had devoted much of their careers to studying inequality. Beyond the unquestionable quality of the work, the book found huge support because it appeared to strengthen the case for redistribution. The likes of Bill Gates and JK Rowling have earned more than CEOs or authors in the past while incomes in the middle class and lower middle classes are often stagnating below what previous generations could expect. The new rich flaunt their money, as they have always done, but in an era of ever growing information and instant pictures, this wealth is far more visible to the have nots. Hence their resentment.

This brings us back to The Paradise Papers. Martin Sandbu argues that even if all the schemes “are found to be legal – and some may not once the tax authorities investigate them – the conclusion surely is that they should be illegal.” Tax authorities rely, to a large extent on self reporting which encourages attempts to camouflage something that is taxable, which is what webs of offshore companies facilitate. Some observers conclude that this massive loss of tax income owed to European and American states risks bankrupting our social order because it reveals that something is rotten in the Kingdom of Denmark. That is overstating the case but blends in with the growing sense of outrage which characterises more and more social and traditional media reporting in recent years. The Paradise Papers certainly contribute to further delegitimizing western democracies but President Trump's way of governing is, arguably a far more important factor, as it is the wave of fake news and Russian trolls. That said, explaining the role of offshore financial centres and tightening the rules further on tax evasion are the first steps on the road to restoring greater credibility to the democracies of Europe and North America.