Offshore Tax Havens and Evasion of Financial Sanctions

Kerim Kavakli and Giovanna Marcolongo (Bocconi)
Diego Zambiasi (Newcastle)
Motivation

Putin Faces Sanctions, but His Assets Remain an Enigma

On paper, the Russian president appears to own very little. Yet estimates put his hidden wealth well over $100 billion.

Once more with feeling:

Sanctions are good for inconveniencing someone if you know what they own, and good for freezing property if you know who owns it.

If you don’t know those things, which in the UK we largely don’t, their main use is to generate headlines like this one.

WE’LL GRAB HIM BY THE ROUBLES

11:13 AM · Feb 23, 2022 · Twitter Web App
Research Question

Do financial sanctions affect international financial flows?

If sanction targets flee with their money, where does that money go?
Preview of the Results

Countries hit by financial sanctions:

1. move their funds out of the sanctioning countries
2. move those funds into tax havens
   - evidence from the *Panama Papers*
   - evidence from the Bank of International Settlements
Our Contribution

I) “Sanctions” literature has studied the evasion of *trade* sanctions.
   • We study how actors evade *financial* sanctions.

II) “Tax havens” literature has studied their role in corruption and tax evasion.
   • We study how tax havens facilitate sanction busting.
What Makes Tax Havens Special?

Actors targeted by sanctions want to move their money somewhere safe.

Most countries are not safe because they are transparent. If funds can be located, they can be seized or expelled.

Tax havens provide secrecy, which makes them useful for sanction evasion.
Data

Financial sanctions: Global Sanctions Database

- Yearly information on sanction sender and target, by type of sanctions
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Offshore wealth (I): Offshore Leaks Database (Panama Papers)
- Incorporation of new shell companies by country of beneficiary

Offshore wealth (II): Bank of International Settlements (BIS) data
- Bilateral financial positions between countries
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List of tax havens: Andersen et al (2022)
Analysis of *Panama Papers*

\[
\frac{\text{New Ent}_{ct}}{\text{Pop}_c} = \beta \text{Sanction Severity}_{ct} + X_{ct-1} + \alpha_c + \delta_t + \epsilon_{ct}
\]

- \(\frac{\text{New Ent}_{ct}}{\text{Pop}_c}\): New shell companies per capita
- \(\text{Sanction Severity}_{ct}\): share of the world GDP sanctioning country \(c\) in year \(t\)
- \(X_{ct-1}\): Lagged GDP
- \(\alpha_c, \delta_t\): Origin country and year fixed effects.
- Estimator: Poisson w/ multiway fixed effects
Evidence from *Panama Papers*

Effect of Financial Sanctions on New Entities Per Capita

- **Country**: 0.94
- **Country + Year**: 0.93
- **Linear Trend**: 1.23

Effect of 100% of World GDP Sanctioning
Evidence from BIS Data

\[
\text{Deposits Abroad}_{ct} = \beta_1 \text{Sanction Severity}_{ct} + \beta_2 \text{Tax Haven} + \beta_3 (\text{Tax Haven} \times \text{Sanction Severity}) + \mathbf{X}_{ct-1} + \alpha_c + \delta_t + \epsilon_{ct}
\]

- **Deposits**: Total deposits from origin country in tax haven and non-haven countries
- **\(\mathbf{X}_{ct-1}\)**: Lagged GDP, lagged population
- **\(\alpha_c, \delta_t\)**: Origin country and year fixed effects.
- **Estimator**: Poisson w/ multiway fixed effects
## Evidence from BIS Data

<table>
<thead>
<tr>
<th></th>
<th>Deposits abroad</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td></td>
</tr>
<tr>
<td>Sanction Severity</td>
<td>-1.026***</td>
<td>-1.033***</td>
<td></td>
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<tr>
<td></td>
<td>(0.371)</td>
<td>(0.365)</td>
<td></td>
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<tr>
<td>Tax Haven</td>
<td>-1.334***</td>
<td>-1.334***</td>
<td>-1.341***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.216)</td>
<td>(0.216)</td>
<td>(0.217)</td>
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<tr>
<td>Tax Haven X Sanction Severity</td>
<td>2.566***</td>
<td>2.553***</td>
<td>2.862***</td>
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<tr>
<td></td>
<td>(0.601)</td>
<td>(0.595)</td>
<td>(0.743)</td>
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| N                    | 13,880          | 13,880  | 13,386  |         |

|                      | ✓               | ✓       | ✓       |         |
| Log. Pop\(_{t-1}\)  |                 |         |         |         |
| Log. Real GDP\(_{t-1}\) | ✓           | ✓       | ✓       |         |
| Origin country FE    | ✓               | ✓       | ✓       |         |
| Year FE              | ✓               |         | ✓       |         |
| Origin*Year          |                 |         | ✓       |         |

S.E. are clustered by origin country.
Other Analyses

• Distinguishing sanctions w/ and w/out USA
• Distinguishing sanctions before and after 9/11
• Controlling for time-variant factors (e.g. war in sanction target)
Conclusion

• Sanction effectiveness hinges on the ability to track the target’s funds.
• Tax havens undermine sanctions by helping targets conceal their funds.
• Efforts to regulate tax havens should consider this geopolitical aspect.