Exchange of information and bank deposits in international financial centres

by

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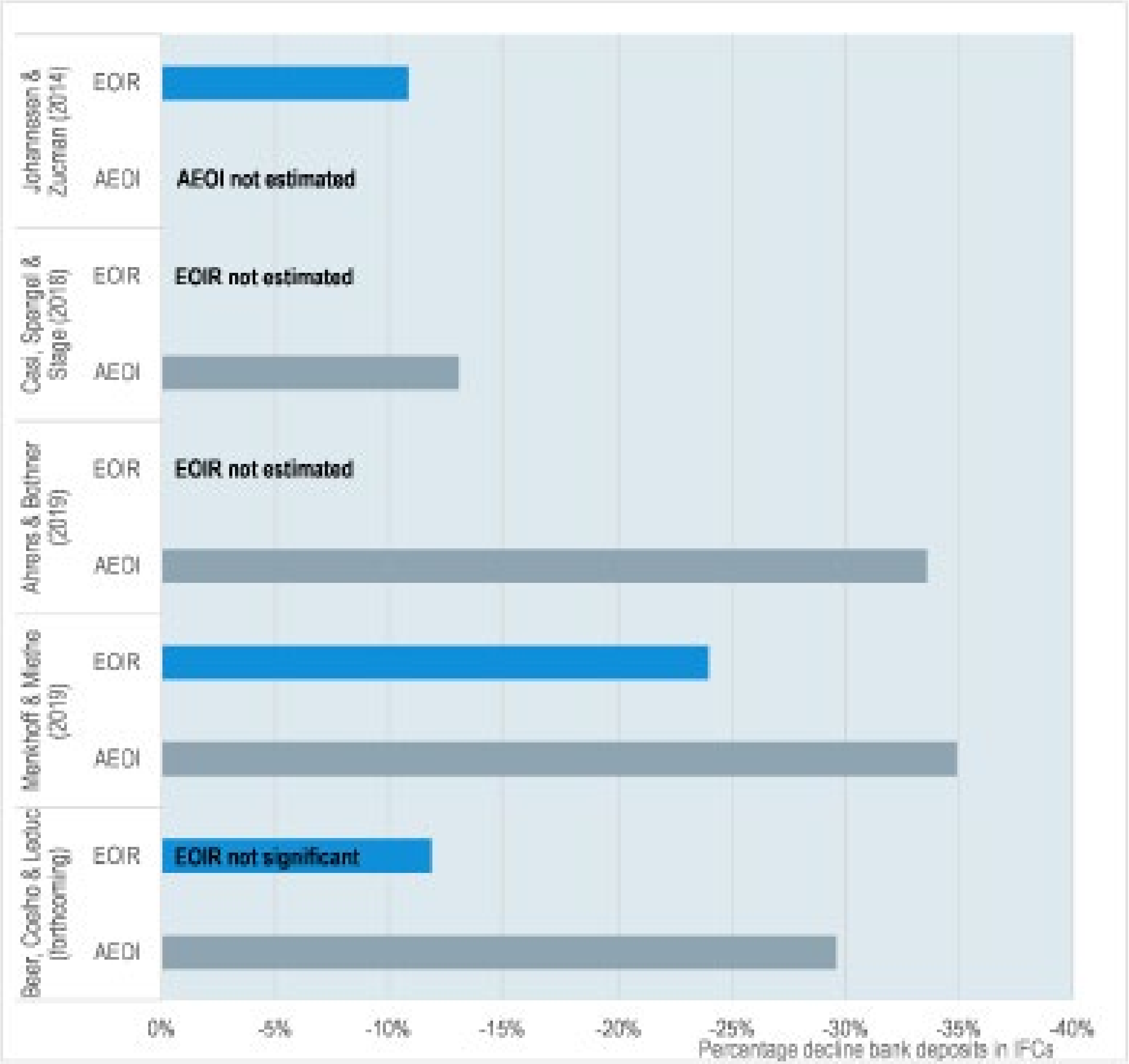
Authors’ punch lines

- The BIS data show a strong decline of over USD 400bn in crossborder bank deposits in IFCs, a 24% reduction, in a period of expanded tax transparency.
- Using a panel regression model following the approach of Johannesen and Zucman (2014), the results show that AEOI commencement is associated with a significant (22%) decrease in foreign-owned IFC deposits.
- “The results suggest that the expansion of EOI in many jurisdictions around the world is having a positive impact on tax compliance and is reducing offshore bank deposits that, at least to some extent, represent hidden wealth”.

Extant studies: Deposit declines from information exchange



This paper’s value added

- Longer time series and higher N than existing studies.
- Lots of new information exchange agreements since Johannesen and Zucman (2014); this paper:
  - accounts for EOIR relationships established through the Multilateral Convention on Mutual Administrative Assistance on Tax Matters (the MAC);
  - accounts for the widespread adoption of the Standard for Automatic Exchange of Financial Account Information (AEOI);
  - representing material changes in the global tax transparency and EOI landscape.

Agenda: 5 questions

- Do deposit declines imply less tax evasion?
- Are policy changes measured with error, and if so, so what?
- Only tax evasion motivates offshore deposits?
- Consider adding left-out variables?
- Why not analyse available decomposition of nonbanks?

Do deposit declines imply less tax evasion?

- Recall: “The results suggest that the expansion of EOI in many jurisdictions around the world is having a positive impact on tax compliance and is reducing offshore bank deposits that, at least to some extent, represent hidden wealth”
- If the money stayed put and depositors paid tax on the interest received, wouldn’t that be less hidden wealth?
- If the money leaves and finds another flag of convenience, is that less hidden wealth?
- Is a deposit decline neither necessary nor sufficient for a positive impact on tax compliance?

Errors in the policy dummies?

- “AEOI agreements are activated on a bilateral basis and exchanges are also bilateral, which is not taken into account in this analysis. Jurisdiction-pairs are coded 1 if both jurisdictions have begun exchanging information under the CRS or under FATCA, and zero otherwise. However, this does not necessarily mean that they are exchanging with each other”. Hmmm....
- Do errors in this variable this suggest that estimated effects are biased toward zero?

Only tax evasion motivates offshore deposits?

- Certainly not:
  - Country risk of home country, including expropriation risk.
  - Limits on deposit rates (“Reg Q”), pre-1980 in US.
  - Unremunerated reserve requirements, pre-2001 in US.
  - Deposit insurance, still in US; base widening by Dodd-Frank (c. 10 bp cost) moved a half trillion dollars out of offshore deposits, as recognised by authors (see Kreicher, McCauley & McGuire, “The 2011 FDIC assessment on bank managed liabilities: interest-rate and balance-sheet responses”, in R de Mooij and G Nicodeme, eds, *Taxation of the financial sector*, MIT Press, 2014).
  - Negative interest rates driving CHF deposits from Switzerland to Jersey today.
- Recognising other reasons is the necessary condition to adding left-out variables or considering possible biases.

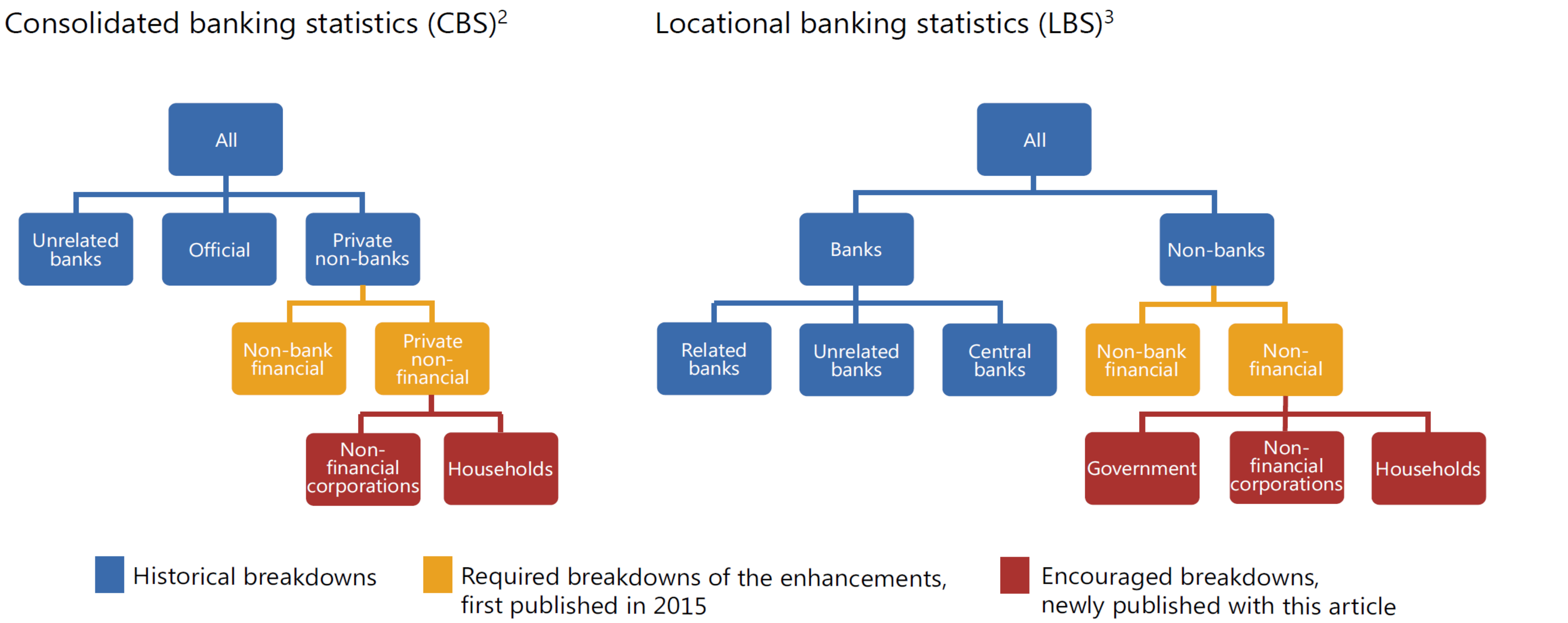
Consider adding left-out variables?

- Sovereign credit rating is certainly a candidate: what if information exchange agreement is associated with a downgrade?
- Thinking of the crisis: McCauley, Bénétrix, McGuire and von Peter, "Financial deglobalisation in banking?" *Journal of International Money and Finance*, vol 95, June 2019, pp 116-131, show that bank *nationality* better explains declines in loans than the loans' booking *location*.
- Similarly, locational data on nonbank deposits by nationality of bank could be used to control for deposit runs on weak bank nationalities in a given IFC.

Why not analyse available decomposition of nonbanks?

Structure of sectoral breakdowns in the banking statistics[1]

Counterparties to banks' claims (LBS and CBS) and liabilities (LBS) Graph 1



Source: Pablo Garcia Luna and Bryan Hardy, "Non-bank counterparties in international banking", *BIS Quarterly Review*, September 2019.

To wrap up, my suggestions:

- Give thought to policy implications of deposit declines.
- Clean up errors in policy dummies, if possible; if not, assess impact on the results.
- Discuss reasons for offshore deposits other than tax evasion.
- Consider left out variables.
  - Add country risk proxy such as sovereign rating to the regression.
  - Integrate information on nationality of banks.
- Use disaggregated non-bank deposits that have become available