The Middle-Class: Shouldering the Burden of Corporate Tax Havens and the Encumberment of Economic Globalization

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Abstract

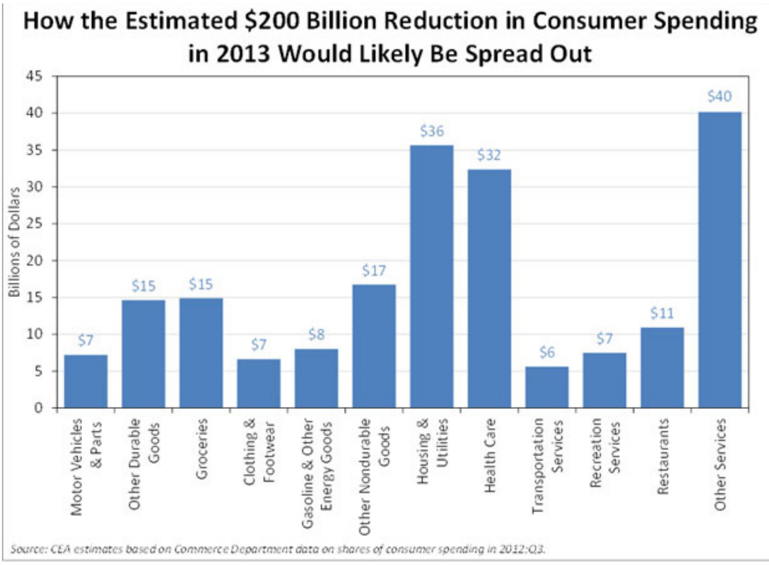
The purpose of this paper is to examine the ways in which corporate tax evasion and other vehicles of economic globalization may infringe upon the prosperity of the middle class. Corporate tax evasion has increasingly taken form in offshore financial centers, allowing wealthy individuals and corporations to engage in tax evasion, resulting in substantial losses in government tax revenues. While this loss is being compensated for by increased taxes upon the middle class, this demographic is also suffering from the slashing of programs and state-sponsored benefits due, in part, to the pervasive losses in government revenue. After exploring the effects of offshore financial centers and economic globalization on national prosperity, I will evaluate counter movements to the phenomenon as well as the legislative response designed to quell its implications, ultimately suggesting a global reform effort for the purpose of middle-class liberalization and increasing economic egalitarianism.

Introduction

Globalization is defined as a process that leads to increased international awareness and interdependence, both fueled by and resulting in the expansion of the global flow of goods, services, culture, money, people, and information. When considering the system as a whole, emphasis tends to be centralized around the cultural and social impacts of the phenomenon provided their applicability to the greatest amount of people. The implications of a spaghetti recipe traveling from Italy to the United States are easier to comprehend than those of a financial crisis' diffusion across the globe, just as the dissemination of language is more relatable to the average U.S. citizen than the effect that globalization has had on historical demographic trends. Though greater emphasis may be placed on certain aspects of the trend, this does not nullify the tangible effects that globalization has on other factors as well. Specifically, the fundamental effects of globalization on taxation are often overlooked, merely as a consequence of the tedious nature of the subject. However, I believe this consequence to be one of great salience considering the extensive repercussions of tax policy on society as a whole. Globalization has permitted corporations, hedge funds, and wealthy private accounts to evade national taxes and outsource wealth to offshore financial centers. As a result, corporate tax revenue has been diminished, leaving the middle-class not only to compensate for the profit loss, but also to suffer from the ramifications of said lost tax revenue on the government's budgetary decisions concerning public services. This paper will advocate for the reformation of international financial policy concerning, in particular, offshore financial centers, so as to liberate the middle-class and place the world on more egalitarian economic footing.

The Middle-Class Burden

Capitalism incentivizes businesses to prioritize profit maximization. So, when government intervention infringes on profits in the form of taxation, businesses and individuals will naturally seek ways to avoid this profit loss. If this ideal were to be practiced on an egalitarian level, then there would be no issue inherent to profit maximization. However, wealthier individuals and corporations are disproportionately able to evade taxes given their increased access to resources and knowledge. The effect of revenue foregone by the government is then concentrated upon the sectors of society without the resources necessary to engage in such evasive practices, the end result being the middle class assuming the monetary burden.



Various issues lie within this reality. However, none are as pertinent as the undue tax burden and the loss of publicly funded benefits, which disproportionately impact the middle class of society. "The middle class is the heartbeat of America" insofar as it comprises a significant portion of the labor force as well as the consumer marketplace that creates the foundation of the U.S. economy.[1] When we choose to raise taxes specific to the middle class, the national economy as a whole suffers. As a 2013 study by the Chairman of the Council of Economic Advisors Jason Furman indicated, allowing middle-class tax rates to rise without parallel compensation on the corporate sector could decrease the growth of real consumer spending by 1.7%, ultimately resulting in a loss in over $200 billion in real consumer spending due to increased taxes. Consumer spending is estimated to make up over 70% of the American economy as measured by GDP, and so it should be clear that any substantial shift in spending patterns has the power to derail the entirety of the national economy.[2]

1. Michael Ettlinger, "The Middle Class and Economic Growth," Center for American Progress, August 1, 2012.
2. Jason Furman, "Increasing Taxes on Middle-Class Families Will Hurt Consumer Spending," The White House, November 26, 2012.

Additionally, the importance of a prolific middle class is also evident within the greater global community. In 2000, for example, only 4% of Chinese consumers held purchasing power parity within the range between the average incomes of Brazil and Italy (the general figure used to represent middle-class income); yet, just twelve years later, this figure skyrocketed to over 68%.[3] As such, China's GDP per capita was a mere $959 USD in 2000 but increased to over $6,337 USD by 2012, noting the parallel relationship between the growth of middle-class purchasing power and a country's relative GDP.[4] Given this demonstrable evidence that the prosperity of the middle class is, at the very least, correlated to greater economic success, by electing to burden the middle class with higher taxes and diminish its access to government public services to compensate for corporate neglect, we are effectively depreciating our nation's own economic value.

Offshore Financial Centers (OFCs)

Considering the potential devastating effects that corporate tax outsourcing may impose on the economy, one may wonder why the U.S. government allows these entities to continue such practices. That answer lies in the system known as offshore financial centers. Offshore financial centers (OFCs, otherwise known as international tax havens) play an indispensable role in enabling the growing liberalization of international finances and shape networks of interactions between corporations, individuals, and nation-states.[5] They offer backchannels through which corporations can reroute their profits such that they may fully evade national taxes. Further, OFCs can also facilitate money laundering, flight of capital, instability and economic underdevelopment, degradation of international regulation, and other serious ills for people and societies everywhere.[6] Since 1980, the number of OFCs has doubled from 30 to 60. The vast majority of OFCs reside on sparsely populated island states or other small enclaves in Europe, the Americas, the Indian Ocean, and Australasia that are lacking major industries or abundant natural resources, leaving them with little option but to trade sovereignty for capital mobility.

3. Dominic Barton, Yougang Chen, and Amy Jin, "Mapping China's Middle Class," *McKinsey Quarterly* 3 (2013), 54-60.
4. Ibid.
5. Prem Sikka, "The Role of Offshore Financial Centers in Globalization," The University of Essex, UK, December 2001
6. Ibid.

Many OFCs operate as British Crown Dependencies, meaning that they enjoy protection from Western hegemons who, in turn, use their island economies as tax havens.[7] They offer low or zero taxes on income, light regulatory and licensing practices, no withholding taxes, and flexible incorporation regimes.[8] Further, OFCs allow corporations and other financial institutions to trade through their systems without tangible physical presence within their borders.[9] And in order to protect the legitimacy of offshore dealings, strict secrecy and anonymity laws characterize these nations' fiscal policies. Thus, OFCs offer the unrivaled ability for corporations and other financial institutions to legally circumscribe national tax policies and maintain the near entirety of their untaxed profits.

The Cayman Islands offer the most affluent and withstanding offshore financial center to date. The Cayman Islands are a small collection of land masses in the Caribbean near Cuba.[10] They boast a population of roughly 50,000 citizens and a GDP totaling no more than $3 billion USD.[11] Yet, despite the Cayman Islands' proportionately minuscule economic, land-mass, and population size in comparison to the world at large, they reside among the five largest global jurisdictions and, when excluding long-term treasuries, are the largest holder of U.S. securities in the world. Their foreign assets amount to over $4 trillion USD, which is almost 1,500 times the islands' total GDP. This, of course, is all indebted to the Cayman Islands' international role as an OFC. Furthermore, the Cayman Islands enjoy the special status as a "British overseas territory," meaning that they benefit from internal autonomy concerning the matters of taxation and regulation. However, London is responsible for the Cayman Islands' national defense and international affairs, allowing them to maintain a position within global discourse. This unique legal status offers crucial political and legal stability coupled with sovereign internal regulation of the island state, initiating trust from foreign investors and guaranteeing minimum international standards relating to financial regulation.

Although the name 'offshore financial center' presents an image of a small, exotic, and far-away island attempting to bolster an economy through flexible regulation and corporate sympathy, this is not always the case. In fact, one of the world's largest offshore financial centers resides

7. Naomi Fowler, "Dissecting the Cayman Islands Offshore Financial Centre: Small Place, Big Money," Tax Justice Network, November 7, 2016.
8. Sikka, "The Role of Offshore," 2001.
9. Ibid.
10. Fowler, "Dissecting the Cayman Islands," 2016.
11. Ibid.

within the United States itself: Delaware. Delaware, the first technical state within our union, is a small mid-Atlantic state with a population of just under one million people.[12] In 2015, Delaware's GDP was just $71.5 billion USD and ranked 41st within the United States.[13] Yet, despite its small size relative to other states, nearly half of all United States public corporations are incorporated in Delaware, and the state boasts more corporate entities, public and private, than it does people—945,326 to 897,934.[14] Companies including American Airlines, Apple, Coca-Cola, Google, and JPMorgan Chase have chosen to conduct business through the state based on its reduced tax policies.[15] Furthermore, Delaware tax code allows for companies to also lower their taxes in another state—such as the one in which they are physically headquartered—by "shifting royalties and similar revenues to holding companies in Delaware," where they are not taxed. This practice is known as the "Delaware loophole" and has allowed corporations to reduce their taxes paid in other states by about $9.5 billion within the last decade.

The state of Delaware has largely chosen to write friendly corporate tax laws based on its strategic location on the northeastern coast of the United States. The financial capital of the world is no doubt New York City, which is conveniently located not one hundred miles away from Delaware's largest city, Wilmington. Thus, Delaware relies on luring companies from New York, New Jersey, and other similarly situated financial metropolises to bolster their own economy. For this reason, while other states were struggling to meet revenue quotas in a difficult economy in 2011, Delaware collected roughly $860 million in taxes and fees from its corporate residents, which accounted for almost a quarter of the state's total budget. Delaware has offered an offshore tax haven considerably more reliable than some international alternatives since the state is domiciled under the United States constitution, thus attracting substantial numbers of corporate and private clients to conduct business through its borders.

Globalization as a Catalyst

Globalization has played an indispensable role in the rise of the Cayman

12. Leslie Wayne, "How Delaware Thrives as a Corporate Tax Haven," *The New York Times*, June 30, 2012.
13. Carolyn B. Maloney, "Economic Snapshot: Delaware," The United States Congress Joint Economic Committee, August 2015.
14. Wayne, "How Delaware Thrives," 2012.
15. Ibid.

Islands, Delaware, and other OFCs. The process of globalization has resulted in a global economy, or the increasing international flow of money, goods, services, and information.[16] This increase in international trade is based on the theory of comparative advantage, or the ability of one nation to more efficiently produce goods or services than another.[17] Comparative advantage has not only given rise to the globalized economy but has also catalyzed international human progress. Nations are now able to prioritize production and innovation within their given sphere of expertise, allowing for the specialization of labor and technological modernization to occur at a more rapid pace.

Numerous factors engendered economic globalization, notably the improvement in global transportation methods. When considering the offshore financial market, improved transportation methods have eased global travel, allowing for business people to meet worldwide and engage in deals and trade beyond the borders of their home nations. Improvements in other technologies, such as telecommunications and the internet, have also contributed to the global economy by facilitating communication and information sharing around the world, allowing for international corporations to conduct business through havens such as the Cayman Islands or Delaware with ease. Economies that were once isolated now possess the power of instantaneous contact, giving rise to an enhanced deal-making environment, generally improving international relations, and opening world markets. A further factor of globalization contributing to the proliferation of the global economy includes the growth of global trading blocs, which have consequentially reduced trading barriers. Established trade blocs such as the European Union, North American Free Trade Agreement (NAFTA), and the Association of Southeast Asian Nations (ASEAN) have facilitated the trade of goods and services within their mandated regions. This has led to an increase in dealings between nations, which nearly perfectly aligns with the definition of globalization. These institutions have influenced OFCs by allowing countries within a given bloc to outsource their profits to other bloc participants that may be considered "tax havens." This is evident in how Canadian corporations and financial players have strategically relocated their wealth to Delaware under NAFTA jurisdiction in pursuit of favorable tax policy.[18]

16. Mauro Guillen, "The Global Economy," University of Pennsylvania Lecture, September 25, 2017.
17. Ibid.
18. Wayne, "How Delaware Thrives," 2012.

The establishment of the multinational enterprise (MNE), or a company with operations in at least two different nation-states, has further incited the globalization process in the economic sphere.[19] These entities take advantage of differing physical, social, and economic conditions in countries in order to maximize profit.[20] While China may offer cheap labor and amicable regulatory standards for production processes, New York can provide stable political and economic conditions for a company to base its headquarters. There are roughly 104,000 MNEs in the world today with 500 of the largest MNEs accounting for 25% of all world production and 50% of world trade. The proliferation of the MNE has led to the global diffusion of goods, services, ideas, and more. Without barriers imposed by international laws, MNEs have the unique ability to transcend a nation's borders. MNEs commonly elect to house their profits in OFCs, thus increasing the presence of tax havens and their relative economic power.

The Paradise Papers

The recent release of the so-called "Paradise Papers" has substantiated the profound effect that OFCs have had on the tax revenues of the U.S. and other nations. The Paradise Papers are a "massive trove of over 13.4 million records" reflecting loan deals, financial statements, emails, and other documents revealing the financial dealings of wealthy corporations and other financial institutions.[21] Many of the papers originated from the offshore law firm Appleby, which operates through various OFCs like Bermuda, the Cayman Islands, Shanghai, and Hong Kong.[22] Appleby's clients have ranged from prominent, wealthy individuals such as Queen Elizabeth to mammoth corporations like Facebook, indicating the diversity and volume of clientele associated with OFCs. One of the more publicized and scrutinized reports involves dealings executed by the Apple corporation—which, notably, is currently the most valuable publicly traded company in the world. According to Bill Chappell, Apple managed to accumulate more than $128 billion in offshore profits, all of which went untaxed by the United States government. Based on Apple's effective tax rate of 25.8%, this evasion amounted to a loss of over $33

19. Guillen, "The Global Economy," 2017.
20. Ibid.
21. Bill Chappell, "The Paradise Papers: Revelations Spring from Leaked Records of the World's Wealthy," National Public Radio, November 6, 2017.
22. Ibid.

billion in tax revenue.[23] This $33 billion in foregone revenue could have enabled populations and been put toward government public services such as healthcare, education, or other forms of social infrastructure in order to benefit the middle class and average-income American citizens.

Another high-profile figure named in the Paradise Papers is Wilbur Ross, the current U.S. Secretary of Commerce under the Trump administration.[24] It is reported that the Appleby firm administered more than fifty companies and partnerships linked to investments made by Ross's private equity firm, WL Ross & Co., LLC.[25] Though Ross reportedly "divested himself of most of his business interests when he joined the Trump Cabinet," this association nevertheless begs some troubling questions. The mission of the United States Department of Commerce is to cultivate economic opportunity and growth for working U.S. citizens. The fact that Ross has opted to outsource his wealth, with the help of these OFCs, seriously calls into question where his loyalties lie. It is verily a difficult enterprise to reconcile his past behavior of avoiding dutifully paying his taxes with his current role as Secretary of Commerce.

International Responses

In light of the Paradise Papers, significant action has been taken in opposition to both OFCs and other economic forces catalyzed via globalization. For instance, lawmakers in Pennsylvania are actively trying to close the "Delaware loophole" in response to the loss of tax dollars.[26] In particular, legislators are concerned with the losses incurred by mining companies drilling for natural gas in the Marcellus Shale region of Pennsylvania that are choosing to incorporate in Delaware instead of their home state of Pennsylvania.[27] In 2016, gross natural gas production (primarily from the Marcellus Shale) in Pennsylvania exceeded more than 5.2 trillion cubic feet, making Pennsylvania the nation's second largest natural gas producer and third largest energy exporter in the United States.[28] Natural gas production – in particular, derived from Marcellus Shale – contributes a

23. Christopher Helman, "What America's Biggest Companies Pay in Taxes," *Forbes*, April 18, 2017.
24. Chappell, "The Paradise Papers," 2017.
25. Ibid.
26. Wayne, "How Delaware Thrives," 2012
27. Ibid.
28. Department of Community and Economic Development, "Natural Gas," The Commonwealth of Pennsylvania, (2017).

significant proportion to Pennsylvania's state GDP. So, if companies elect to move their business to OFCs such as Delaware, they greatly threaten potential tax revenue and the general well-being of their state.

Other more fully encompassing anti-globalization movements have also emerged in response to economic factors. In the 1980s, for example, the formidable Zapatista movement manifested in Mexico, spurred by the ideology of libertarian socialism in order to seek indigenous control over local resources.[29] The movement went public on January 1, 1994, otherwise known as the day that NAFTA came into effect.[30] The Zapatistas considered NAFTA to be a "death sentence" to indigenous communities all across the country considering the ensuing subjugation of labor and resources that would result from liberalized markets.[31] In particular, the Zapatistas opposed NAFTA because its signing resulted in the removal of Article 27, Section VII, from the Mexican constitution, which "guaranteed land reparations to indigenous groups throughout Mexico."[32] Although the Zapatista movement is not one directly protesting OFCs, the underlying principle of economic globalization is the key to their resistance. The Zapatistas are a movement that rejects globalization and the negative effects it may impose upon citizen populations, not unlike Pennsylvania's legislative response to Delaware's OFCs.

Although there is no one answer to combatting global financial outsourcing via offshore financial markets and other vehicles of globalization, substantial legislative steps must be made in order to reform the broken system and return profit to each rightful nation. In 2010, the United States passed the Foreign Account Tax Compliance Act (FATCA) requiring foreign financial institutions and other entities to submit reports on local assets held by U.S. account owners.[33] Depending on their value, the act also required U.S. citizens to report their foreign financial accounts and assets.[34] Since FATCA's enactment, over 77,000 financial institutions

29. Paulina Villegas, "In a Mexico 'Tired of Violence', Zapatista Rebels Venture into Politics," *The New York Times*, August 26, 2017.
30. Ibid.
31. Elizabeth Shell, "Why the Dreams and Nightmares of NAFTA Didn't Come True," Public Broadcasting Station, February 14, 2014.
32. Villegas, "In a Mexico," 2017.
33. Internal Revenue Service, "Foreign Account Tax Compliance Act," The Internal Revenue Service, November 29, 2017.
34. Ibid.

and 80 nations have agreed to the policy.[35] In the case of non-compliance, both countries and investors face dire financial repercussions, which include colossal fines as well as 30% foreign tax withholding and exclusion from U.S. markets.[36]

Although FATCA is a phenomenal start in quelling tax haven activity, it is currently only applicable within the American legal system. Therefore, while other countries like Japan and the U.K. are still able to circumscribe national tax policies and utilize OFCs, foreign banks and other institutions have become less compliant and willing to partner with United States entities with these strict, new regulations in place.[37] Thus, internal backlash to the new FATCA regulations have erupted under the pretense of international American non-competitiveness. In order for meaningful reform to occur, it must happen on an international level. Therefore, I would recommend that the World Bank enter the debate. The World Bank is an international financial institution concerned with providing loans to impoverished countries for capital programs.[38] The bank is "guided by a commitment to the promotion of foreign investment, international trade, and the facilitation of capital investment."[39] Considering the bank's powerful international economic position, they are well equipped to offer a platform that enacts policies imitating FATCA on a global level. It is in the bank's stated goal to reduce global poverty, which is, at least partially, contributed to by OFCs and other forms of economic globalization. I concur that foreign investment and trade are highly beneficial practices within the modern age, yet regulation over these activities must be set in action so that economic world discourse may proceed on a more egalitarian platform.

Conclusion

Offshore financial centers and other forms of economic globalization have presented various threats to the American middle class, namely in the form of tax revenue loss that results in decreased spending on public

35. Robert W. Wood, "10 Facts About FATCA, America's Manifest Destiny Law Changing Banking Worldwide," *Forbes*, August 19, 2014.
36. Ibid.
37. Robert W. Wood, "FATCA Makes Banks Shut Out Americans," *Forbes*, March 23, 2012.
38. The World Bank, "Who We Are," The World Bank, (2017).
39. Ibid.

services. Although conservative economists argue that decreasing corporate taxes will benefit the middle class by increasing business investment in the United States in the form of rising employment rates and boosted wages, there is no tangible evidence of this having occurred in the past.[40] In fact, U.S. corporate profits today are already incredibly high without added tax cuts, and corporations are sitting on nearly $2 trillion in cash.[41] Yet, there has been no measurable increase in job creation or wages that may be attributed to this surplus profit. And so, given that corporations have failed to act upon already existing surpluses, it is highly unlikely that they will do so anytime in the near future. In order for the United States to succeed, it must once again return to the reality that its success is founded upon the strength of the middle class. Instead of burdening the average-income-earning American and rewarding already-wealthy corporations with unnecessary profit, international tax policy must be revised to reflect an emphasis on transparency so that tax revenue may be accurately apportioned. Vehicles of economic globalization, like OFCs, have offered extensive avenues for global exchange, but we must ensure we do not lose the economic foundation of the middle class in the process.
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40. Jeanne Sahadi, “Will Corporate Tax Cuts Help the Middle Class?” CNN Money, August 30, 2017.
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