

John Torpey 00:04

In recent years, we've had a series of leaks of documents, showing how the rich hide their wealth around the world and deprive their countries of large amounts of tax revenue in the process. First, there was the Panama Papers in 2016, and the Paradise Papers in 2017. And now we've just had the Pandora Papers, another huge leak by the International Consortium of Investigative Journalists. What do these leaks tell us about the way the world really works?

John Torpey 00:35

Welcome to International Horizons, a podcast of the Ralph Bunche Institute for International Studies that brings scholarly and diplomatic expertise to bear on our understanding of a wide range of international issues. My name is John Torpey, and I'm Director of the Ralph Bunche Institute at the Graduate Center of the City University of New York.

John Torpey 00:56

Katharina Pistor is Edwin B. Parker Professor of Comparative Law at Columbia Law School, where she teaches corporations, comparative law, and law and capitalism. She also serves as a member of the Committee on Global Thought at Columbia. Her research focuses on comparative law and institutional development with special emphasis on corporate governance and financial market development. Professor Pistor has published widely on comparative legal developments and her most recent book is *The Code of Capital: How the Law Creates Wealth and Inequality* published by Princeton University Press in 2019. So thanks very much for taking the time to talk with us today, Katrina Pistor, about these developments in wealth and taxation.

Katharina Pistor 01:50

Thank you so much for having me. It's a pleasure to be here.

John Torpey 01:53

Great to have you. So as I mentioned in the setup, in recent years, we've had all these leaks of huge caches of documents, revealing how wealthy people hide their assets, as we say offshore, at least in other countries, in order to avoid paying taxes on them. And it seems to me at one level, this is hardly news. I mean, the rich always seems to take advantage of opportunities to avoid paying taxes, but maybe you could explain to us what we've learned from these document leaks and what they tell us about, as I say, how the world really works.

Katharina Pistor 02:33

So I think it's really nothing new that the wealthy are trying to avoid paying taxes and sometimes also evade paying taxes. And I think the Paradise Papers and the earlier revelations were in part also about clearly illegal schemes. They might have employed lawyers as well, but not all of what they did was, at least from a formal legal point of view, legal. I think the Pandora Papers, for all the new information about certain individuals, have had less of an impact than probably did the Paradise Papers because the quick defense about almost everybody who had been implicated in the Pandora Papers was especially to claim it is legal, so what's the problem here? And tax lawyers being interviewed in major news outlets also said it's legal, so what's really the problem? So in that sense, what I think the

Pandora papers are telling us is just the scope, the number of people, the breadth of people that are using these kinds of devices to avoid paying tax.

John Torpey 03:41

I mean, Donald Trump famously said that not paying taxes made him smart. To some degree you sort of say, "well, of course, I mean, this is what people with tax lawyers and that sort of thing, that's what they do." But as it happens, there's a piece in this morning's New York Times by an editorial board member named Binyamin Appelbaum, in which he argues that paying taxes is really about solidarity; it's about kind of the foundations in a way of a democratic society that people are making their fair contribution to the way things are paid for. Could you talk a little bit about that idea?

Katharina Pistor 04:22

So I think it's a good idea for democracy, I think we all should make sure that the government has some resources and that we share also our burden in terms of providing the government with relevant resources to provide certain services. I would just remind ourselves that, of course, tax evasion and tax avoidance is much older than democracies are. So the rich have done this for centuries. And in our democratic age, we're trying to think about the law and what you can or can not do in different ways, but we really haven't changed fundamentally the legal tools that are available for the rich to continue what they've always been doing. So for them, democracy might just be another nuisance, sort of. The moral argument that comes with a democratic argument that they really have an obligation to pay --it's not just like an autocratic state that is grabbing their assets-- but it's actually, everybody's sort of here in a legal community in a democratic and a polity together, and we should share the burden is sort of just another argument that tries to put some burden on them, which they're trying to avoid.

John Torpey 05:31

I mean, do you see these schemes of tax avoidance as particularly bound up with our current sense that certainly American democracy is kind of in crisis, and that there are real questions about its survival, that I never imagined myself asking, as I was growing up. Is this part of the crisis that we're having?

Katharina Pistor 06:02

I would say yes, because I think it shows the depth of an unwillingness to share the burden of living in a society together. I mean, in order to do what you can read up in the Paradise Papers is you have to use legal tools, so you want to rely on a legal system. And you want to also rely on the legitimacy and the authority of the law for shifting your accounts to other jurisdictions and to have that recognized by whatever tax authorities are trying to get after the assets.

Katharina Pistor 06:37

So it's not just that you do something that is available in the free market, you actually employing a legal system, which is sponsored by democratic polities, in a particular way, while you're at the same time saying, "but you can't tax me, or you can't regulate me, or I can pick and choose the laws by which I wish to be governed." But not everybody else can do that. And clearly, if everybody was allowed and enabled to pick and choose the laws by which they want to be governed, we couldn't have a community

in society at all. So some who have the resources to do this pick and choose and they avoid everything and then even think that terribly smart, but they clearly have no sense of solidarity or responsibility.

John Torpey 07:17

So I've already mentioned that Donald Trump was one of these people, as we discovered in the course of various investigations. But I wonder whether that isn't, in fact, partially a source of his appeal to his supporters? That, they see him precisely as this successful businessman and what successful businessmen do is avoid paying taxes. I mean, does that seem right to you? And does it tell us anything about populist politicians elsewhere? I mean, you're in Germany, maybe not necessarily in Germany, this might make somebody popular, but maybe in Hungary it does? I don't know.

Katharina Pistor 07:58

So I think there's a combination of several factors. I'm not sure that too many would really agree that not paying tax or evading taxes with very sophisticated schemes is just okay. With Trump, I think it's a combination of the tax avoidance schemes and is also the way he has basically just stuck it to his creditors more generally. Also, private creditors: he went through bankruptcy several times, and basically showed that you can actually as a debtor, you can be a king of debt, and you won't be caught out by either private creditors or tax authorities.

Katharina Pistor 08:34

And I think one has to read this in the context, especially United States, of a country where many people are deeply in debt and can't get out. And seeing somebody who just says, "just get around it, and you can get around it, if you're smart enough, like I am," has a certain appeal. But I think the background story to that as a complicated one; it's one where people are just out on their own, and they're trying to take the system for a ride and take others for a ride so that they can get a little bit ahead of others. And I think the appeal that Trump has, I think gives me a sense of the lack of credibility our political and legal system has. So this goes back to what you just said: democracy is in crisis and these are symptoms of a crisis, of a lack of trust in institutions and a lack of trust in our fellow citizens that they do the right thing as we are trying to do as well.

John Torpey 09:27

Right. Beyond Trump, sort of curious whether there were names that popped up in any of these leaks that sort of surprised you. I glanced through the list of names that were mentioned in the Pandora Papers and came across (I think was the Pandora Papers anyway) the names of Cherie and Tony Blair. Tony Blair, famously prior Prime Minister of the UK, in the Labour Party, no less. Any surprising names that you came across?

Katharina Pistor 10:02

Well, I think Blair stood out to me as well as basically as the You Too moment, right? Not the #MeToo moment but the You Too moment. So you too Mr. Blair, you too are availing yourself of the tools that are typically available for the rich and famous in this world and you have no shame to do the same thing, even if you are the former Labour leader, and you're still trying to portray yourself as a progressive. I think that's probably the, I think, I said earlier, breadth of the problem. For how many

people is this just a normal thing to just avail yourself of these devices, and the defense is the same: it's even not even shameful anymore to do this, which is, it's legal.

Katharina Pistor 10:43

So we just buy a company, we buy the shares of the company rather than the asset itself, and thereby avoid real estate taxes. And, everybody's doing it, we're doing it too. And I think what we're seeing is an erosion of also moral standards of how far you push it. And an erosion also of the sense that, you know, law you can always bend and mold into all kinds of things. There is always the formalistic reading of the law, and there's a more normative reading of the law. And if you push the form, you can just leave the morals and the norms behind, and that people who have had this sort of high level appeal of doing something for labor and for the people otherwise left behind just are part of that. It's like you too, Mr. Blair.

John Torpey 11:28

So it is an interesting permutation of #MeToo. In any case, I wonder if you could talk a little bit about the consequences of these schemes for the countries that lose the income. I mean, I think Emanuel Saez, this economist at [the University of California at] Berkeley, has estimated that it's many trillions of dollars that countries forgo on the basis of these schemes. I mean, could you talk a little bit about the impact of these schemes on the countries that lose out the tax revenue?

Katharina Pistor 12:04

So I think the numbers are really difficult to pin down. So you get different estimates. So it's sort of, some say it's in the 400 billion other say it might be trillions. The truth, of course, is that we don't know everything. Even with all the leaks that have happened, and all the investigative journalists trying to find out how much it really is, who was involved, we're just getting what we are getting through the leaks, and we have no clear idea how deep it is. So it might be somewhere in between 500 billion and going into the trillion.

Katharina Pistor 12:33

And of course, this is, when you just think how you could translate this into public services that could be provided: health services, vaccines that you could buy, nurses that you could hire. It's quite a sum of money. In the scheme of the US federal budget, this might not sort of stand out as a huge huge number, but it's substantial money, and money that is very often cut from social services, and thereby also discredits very often what the government actually does for the people; the government does less and less for the people because it's saving, it has sort of overextended itself in COVID, now we're cutting back. Austerity is looming in the background.

Katharina Pistor 13:08

At the same time, the seeing that the richest people plus those who are sufficiently sophisticated or have lawyers on their side to do this are also trying to get away from the obligations that they owe to others. And so I think, maybe more than just the money itself, I think it's really the erosion of trust in systems, it's the delegitimization of state authority and solidarity amongst people that I find most deeply problematic, because it's really eroding our sense of democratic community.

John Torpey 13:40

Right. So, these series of leaks has told us a lot about how wealthy individuals hide their assets. But we've also recently seen a big deal that came together through the OECD and very much was promoted at the behest of the United States, a 136 country deal, that sets a minimum 15% global corporate tax rate and empowers governments to tax multinational companies, such as Amazon, Facebook, in the countries where their goods or services are sold, regardless of whether or not the company has a physical presence there. Now, the deal has certainly had its critics. So I wonder what you think of the deal?

Katharina Pistor 14:27

So I think my first reaction to the deal coming through is that I was positively inclined, because I think it's a good sign that countries got together and agreed some new principles for international taxation. So the principle for international taxation that we live by or still live by until all these arrangements have been ratified or implemented for different countries, is our tax principles were developed a century ago. And a century ago, everybody agreed that you have to have a physical footprint in a country so that the country can levy taxes on you. And that's an old-fashioned world, right? That's really where people, if they did some transnational activities, they would actually move physically in some way that would have a plant there, they would have people on the ground. And that was the precondition, essentially, for taxing.

Katharina Pistor 15:16

But in our digital age, that's of course foolish to hold on to physical footprints. So the idea that you say, "we will tax you when you actually are making money on our customers who live in this country" is sort of a new way of thinking about international taxation. I think that's important; it's a positive step in the right direction. The OECD has been working on this for many years, Trump tried to get out of it, and then the French and a number of other countries said, but France was in the lead saying, "well, if we don't get the OECD principles through, we do this on our own", and just France will tax.

Katharina Pistor 15:51

And I think the big tech companies don't really want to be taxed differently by 34 different countries or more. And that's why in the end, they supported a deal. But it's under sort of this, this is a bargain, it goes back and forth, that they finally cut the deal and of course, the only way they got all the countries needed on board, including tax haven countries [such as] Ireland and Estonia, also Hungary which are offering tax incentives for companies to come their way, so they had to lower the tax rate. And so at 15%, I would agree with many critics, that's a really low rate. I mean, 12% was in the discussion as well, so it's a bit better than that, but it's clearly much below 24%, 25% and that range, even the 27% that Trump implemented, and his own tax reform earlier in his administration.

John Torpey 16:43

Right. So even though this isn't really meant as an interview about your book, I'm curious how all these issues that we've been discussing so far relate to the arguments of *The Code of Capital*. I mean, it's arresting, particularly the subtitle, I think, is arresting "how law creates wealth and inequality." And at least on the wealth side, you might say, "well, most people think people create wealth." But what's the argument about how law creates wealth?

Katharina Pistor 17:16

Well, law creates wealth, because it basically puts certain types of objects or claims or ideas on legal steroids by giving them certain types of protection: if you have property rights protection, you're better off than if you don't; if you can collateralize an asset, you're better off than if you don't; if you can avail yourself of a trust or corporate form, that's critical for avoiding taxes for both. Especially, if you want to have legal tax avoidance, what you do is you take what I call the modules of the code of capital: certain legal devices, such as a trust, or corporate form, because you can shift assets behind a different legal view; you can separate your assets and put them into different legal persons, because we can create legal persons and you can create multiple legal persons, and you can shift different assets to them and back and forth into the jurisdiction where you have the best tax treatment for them. And you might even organize like reverse mergers that were under discussion during the Obama administration; all kinds of sophisticated transactions. For these transactions, you use what I call the modules of the code of capital. These are legal devices that allow you to avoid responsibility, liability to arbitrage the legal system, while still using its power to create private wealth.

Katharina Pistor 18:37

So the same argument that I made earlier: you need the law, you need the backing of the state to do a legal scheme that is, in principle formalistically, legally and therefore also enforceable, right. But at the same time, you're saying, "but we don't want the state to come after us and impose taxes and impose regulations. We want to have the cake and eat it too." And the code of capital tells you exactly how this is done. Taxes come at the back end, I'm basically describing already how wealth is created. But the the same legal devices are also used to hide wealth, and thereby prevent tax authorities or too many different creditors from putting their hands on that wealth. And that's how you accumulate more. And that's how it grows more. And that's how you have a comparative advantage over everybody else.

John Torpey 19:23

So what about the inequality side of things? I mean, you can sort of see from what you've said, how that might happen. But, you know, that's an even bigger claim it seems to me, that law creates inequality, since, after all, isn't law supposed to be the same for everybody?

Katharina Pistor 19:39

Well, we're basically saying everybody's equal before the law, but it's formal equality before the law. And it doesn't tell you who has better access to transactional lawyers, attorneys, solicitors and others to devise these schemes that allow some to avoid the responsibilities or get better rights. And if you have better rights, the legal system will not look further and simply enforce them. And you might actually have substance-wise normatively not a much better claim, but you just have the legal tools to code them in such a way that you have a stronger claim. And at the back end, those who are on the inequality front, they just don't have the same access to the lawyers, they might not have the resources to even make it worth their while.

Katharina Pistor 20:20

So if you want to use these tax avoidance schemes that we're talking about in the Pandora Papers, you must have tens of millions of dollars to make it really worth your while. Before that, you just pay your

share, you always pay your share, right? And, that's sort of where then income levels also diverge. Because if more wealthy people can avoid taxes in this fashion, everybody else has to pay, then you can't ever catch up right? The divergence increases over time.

John Torpey 20:48

You say in the opening pages of the book, that the whole thing really came to your mind in a way by, as a result of the 2008 financial crisis. And obviously, that was a sort of watershed event, when, as you say, the world economy was sort of hurtling towards disaster, towards the abyss. And we've been living with the consequences of that disaster for a long time.

John Torpey 21:20

I wonder, first of all, the questions are always about politics; I mean, yes, these things get codified in law, but before that, in a certain sense, there's a political process that plays out that results in these laws. And then, of course, there was a lot of unhappiness at the time about bankers being able to keep their houses in the Hamptons, while lots of ordinary people lost their their shirts and their houses. And I guess I wonder whether you see it that way in fact, and to what extent you think we're in a different political climate maybe now.

Katharina Pistor 22:03

So I think the first thing I would like to clarify is that the way the institutions that are described as the modules of the code of capital precede democracy; they're part of the common law. And they actually have a feudal background and have never been changed. So if you like, there's a kind of a shadow legal system, but it's not actually shadowy. It's central to our private law system and it is central to our market economy, but they always evolved outside much of the political intervention. The federal system of the United States doesn't even have jurisdiction over these things; they have them at the state level, they could intervene sometimes, but they rarely actually touch these institutions. They are almost treated like holy cows that you don't touch.

Katharina Pistor 22:50

We regulate sometimes. We're trying to push back the effects of using these institutions, through regulators and administrative means, etc, sometimes also, through taxation, doing some redistribution, but we don't touch the very source of wealth. And that hasn't changed out of the 2008 crisis. The same mechanisms that were used to create fancy derivatives during the crisis have morphed and are now being applied to other types of assets. We're doing this now for ordinary corporations, not only for financial intermediaries, we're just flipping some of the strategies so we can get around the last regulations. But fundamentally, the system that I described in the book has not changed after 2008.

Katharina Pistor 23:30

And again, I think the reason for that is that people still treat the institutions of private law as sacrosanct. And that there has to be private autonomy, people should be able to pick and choose, but the result of that necessarily is something that we read about in the Pandora Papers because these are the tools that they use to get around local tax rules and shift their assets to the Caymans or Jersey or Cyprus or Ireland or whatever jurisdiction you're talking about.

John Torpey 23:58

Interesting. So I mean, one of the things that happened after 2008 was that banks were required to have more assets on hand; they couldn't play around with them as much as they had been doing before 2008. And my sense is that that has also sort of gradually eroded over time. I mean, are you worried that those kinds of, that there are lots of sort of unsecured uncollateralized assets are floating around out there and that we could be in trouble for another kind of 2008 experience?

Katharina Pistor 24:36

So I think that the banks have been made forcefully more resilient through the regulations that you've described; having just more assets on hand basically to have a buffer if things go wrong. And so we have regulated the banks, but the tools that they use that they could embrace much more readily earlier are used now by spin offs from these banks. They sold many of the operations that did this in house; they're now doing it on the market. You see sort of in fintech new kind of vulnerabilities coming about. So the entire what we call the shadow banking system, the banks, the official banks were deeply implicated in participating in the shadow banking system, they had to clean up their balance sheets a little bit, they're still funding them indirectly, but they're creating enough protection so that the banks won't falter.

Katharina Pistor 25:22

And beyond the banks, most regulators as well. That doesn't matter really, because they're not depositors and so we don't have to worry about them losing money, and the other investors should just know what they're doing. But at the same time, they have basically they're tolerating and legitimizing, the very machine, the very tools that allow you to create private wealth with a social resource called law. So that's continuing. And I think it also creates not only that it continues to create inequality, it also creates vulnerability in sectors where we just don't even see it yet. And we don't understand because we don't have disclosure and transparency, what the spillover effect might be even for banks who might have exposed themselves more to some risks, and therefore might be more vulnerable than we can currently see. But I think in general, there has been an improvement for the banks, but not for the financial system as such.

John Torpey 26:11

Right. So what maybe I could ask you, what reform do you think is most important and urgent for us to undertake right now?

Katharina Pistor 26:22

So I don't think that we should --and this goes back to the tax issue --that we should have more thoughts about whether or not we recognize a legal entity that claims to be a corporation that is in the Cayman Island. It's just a shell company, everybody knows it's a shell company; it has the same board of directors like every other company in this jurisdiction, no employees, nothing. Everybody knows it's a shell. Why do we recognize this in law? We should not! We should just cut through and say, well, "who's your parent? And what's the parent of that parent, and we tax you." So that requires a little bit more investigation. But I think we are legitimizing these structures, because we are saying that's just fine. You can abuse the corporate form for this purpose, and we still do as if you operated a real company, which they are not.

John Torpey 27:09

And what sort of reforms do you think would make a difference? There's the inequality part of your subtitle at least, and which obviously is a big problem out there in the world, and seems to be driving a lot of politics these days. I wonder, what kind of reform you think might be made that would make a difference in reducing the levels of inequality that we've been facing for the last 40 years?

Katharina Pistor 27:39

Yeah. So I think one is, of course, that is you're trying to stop helping the wealthy to create even more wealth. That's what I've been talking about so far. I think more generally, we have to make sure that also smaller, medium-sized enterprises can avail themselves of legal devices that protect them against financial downturns. They're just still too many partnerships where they don't have a limited liability privilege to protect themselves from a downturn. You have to think about how to restructure debt for companies who did not default because of their own fault.

Katharina Pistor 28:10

So I think we have a huge issue coming up in the aftermath of the COVID crisis to think about how to restructure debt for small and medium sized enterprises and families. And we have basically postponed it and kick the can down the road, because we say we're just doing moratoria: eviction moratoria, debt collection moratoria. But the reckoning will still come, and I think on that front, we really have to think about how to clean up their balance sheets, too, as we cleaned up the balance sheets of the banks in the 2008 crisis. And the banks have been implicated; they did what they did. And many others have been caught in a storm that they can't control.

John Torpey 28:46

So maybe I'll take a risk and ask you a question, since you're in Germany, and I take it have some German background. And since we've just had this major election in Germany, where Angela Merkel has left the chancellor's office for the first time in 16 years, coming sort of more or less, it seems at the tail end, we hope, of the Coronavirus pandemic. How have these issues affected Germany? How has Angela Merkel dealt with them? What kind of, you know, the inequality problems of the kind that you're talking about linger after her departure? What needs to be addressed in Germany these days?

Katharina Pistor 29:31

So I think inequality is not as stark at first glance as in the United States; the social welfare system was much better. But I think if you look through the numbers, you also see there are very, very wealthy people. And I think the wealth creation over the last several decades has affected Germany as well. And so there are questions about solidarity. I think, you can see in Germany that in the beginning of the COVID crisis that Angela Merkel had a lot of trust, because she could explain to the people what they had to do and they were very disciplined early on. And then at some point they lost it. And she wasn't really able to bring this back together. In part, this is because of different parts of the federal government and the states, of course, going down different paths as well but I think there was also an increasing, just being fed up with the government and not trusting them. Particularly in East Germany, I think, because people there have been left behind for decades and always feel that they're carrying more of a burden than everybody else.

Katharina Pistor 30:32

So I think the new government will really have to make sure that they can deliver to those who have been left behind. And I think that will not be easy, given the traffic light coalition that we're talking about here with the Liberal Party trying to do like more neoliberal moves; the Greens are trying to have more expenditure for dealing with climate change; and the Social Democrats really have to deliver to their base, which they had neglected long enough. So there are certain divisions here as well, but I think a friend of mine in the United States who is from Europe said, "you know, in Germany there's talking to one another; there's coalition talks, and they might not be easy, but they're happening." Imagine coalition talks between the GOP and the Democrats: just inconceivable right now. That's a very different political world. Imagine, it was difficult, but it's not insurmountable.

John Torpey 31:23

Yes, yes, it is. So I know, you happen to have some background in Munich. So I want to kind of tell a personal story that's relevant to a point you made, which is that the social welfare system is stronger and better in Germany than it is here. But I guess my question ultimately will be, how true is that anymore. I mean, so I was in the Munich train station, maybe it's five, six, something like that years ago, and was shocked to see a man probably not so different from my own age now (in his 62, mid-60s perhaps) foraging for food in garbage cans in the Munich train station. I had never seen in all the years that I've spent in Germany, as an adult for the last 40 plus years, I had never seen anything like that. So how is the social welfare system holding up?

Katharina Pistor 32:22

So it has been cut back under these Hartz reforms in the early 2000s. So there's less to go around. I think one also has to add to that the influx of refugees has meant that sort of these pieces of the pie that are available for people who need help have to be shared by more. So the availability of even just housing, etc, has become more complicated, more expensive, etc. So I think that creates, of course, also a resistance and anger amongst many Germans who now have to share with with people who are coming in. So I think there's much less, but I know, quite a few people, refugees, both who came from Syria, I also know a number of German welfare recipients, they all still have a roof above their head. So there are, of course, homeless, I don't want to deny that there are also very often people who are sick and who don't know how to work the system to get what they need, because you have to go through an enormous bureaucracy to make the welfare system work for you. If you can't do that, you end up on the streets in Germany, as you do in the US. But in the US, even if you know how to work the system, you might still end up on the street and I think that's probably currently the starkest difference.

John Torpey 33:37

Right? Well, I would certainly agree with your basic proposition that the social welfare system there is stronger and inequality is less stark and pronounced. But we still have a lot of work to do here in the United States.

Katharina Pistor 33:54

And in Germany, too, you know, it's, but yes, I agree with you.

John Torpey 33:57

Yeah, well, thanks very much. That's it for today's episode. I want to thank Katharina Pistor of Columbia Law School for sharing her insights about the recent revelations of offshore tax avoidance and our attempts to rein them in.

John Torpey 34:12

Remember to subscribe and rate International Horizons on SoundCloud, Spotify, and Apple podcasts. I want to thank Hristo Voynov for his technical assistance and to acknowledge Duncan Mackay for sharing his song "International Horizons" as the theme music for the show. This is John Torpey, saying thanks for joining us and we look forward to having you with us for the next episode of International Horizons.