The global offshore system means we can't trust basic economic figures

qz.com/1133984/the-global-offshore-system-means-we-cant-trust-foreign-direct-investment-figures-and-other-basic-data/

Donald Trump doesn't know what he's talking about when he decries America's trade deficits with countries around the world—and that's not his fault. None of us do.

Thanks to offshoring practices like those revealed in the Paradise and Panama Papers, global trade figures are "a big black hole," says Daniel Haberly, an economic geographer at the University of Sussex. "We don't really know what the world economy actually looks like. That's the big burning question for me. We have this picture of what it looks like on paper but in reality it's probably something completely different."

Anglo-Dutch distortions

Look no further than the UK for an example of how crazy trade statistics are. The first name on its list of top foreign direct investors doesn't surprise—it's the world's biggest economy, the United States. Second place, however, isn't such a behemoth. According to British government stats, the Netherlands supposedly shoveled £139.8 billion ($186 billion), 28% of its GDP, into the UK in 2015.

Anglo-Dutch ties run long and deep, but can a country of just 17 million people really be investing so much cash into Britain alone?

Quite simply, no. The Netherlands is not just a smallish European trading nation—it's also one of the world's biggest conduits for cash going to and from tax havens. When the British government broke down its FDI statistics this year (chapter 6), it realized that only 34.5% of that money actually came from the Netherlands; much of the rest being from European subsidiaries of big US companies or… from British companies rerouting their money.

The government also found that Luxembourg's investments in the UK were 80% lower than what they originally looked like. For Jersey, a UK crown dependency and another tax haven, the figure fell by 35%. In total, around 11% of the foreign direct investment routed into the UK originally comes from the UK, Britain's Office for National Statistics (ONS) estimates.

That may even be a low-ball estimate, the Financial Times writes (paywall), since the ONS says much of the money supposedly coming from Luxembourg actually came from companies in Gibraltar, Panama, and the Cayman Islands—which stand a good chance of being shell companies for British firms. It's not clear how much of this cash was put offshore to avoid tax, but French economist Gabriel Zucman estimates that around half a trillion pounds of British money is stashed in tax havens, according to the FT.

This is happening all over the place

The UK is far from the only country where tax havens and secrecy jurisdictions provide an eyebrow-raising proportion of foreign direct investment. Tiny Luxembourg is technically the United States' third-biggest investor and the Netherlands is fifth. That's alongside the fact that the US has plenty of onshore tax havens, like Delaware, Nevada, and South Dakota.

The figures are even more distorted for China, the world's second-biggest economy. Nearly three-quarters of its foreign investment technically comes from Hong Kong, which is basically a "black box," Haberly says. Bizarrely, much of the money seemingly comes from state-owned Chinese companies that are registered in Hong Kong with subsidiaries in tax havens. For example, China Mobile, a global telecoms giant and one of the country's "national champions," is based in Hong Kong, with opaque offshoots in the British Virgin Islands.

Capital flight has long been a serious problem for Russia, hitting a peak of $154 billion in 2014. It's largely characterized as the super rich getting their—often stolen—cash out of Russia; either to avoid tax, get it away from the government's reach, or use it for a life of foreign splendor.

Zucman and fellow economists Thomas Picketty and Filip Novokmet have estimated (pdf, p.2) that rich Russians hold about as much wealth offshore as the rest of the country owns in total combined domestic assets. Perhaps not shockingly, the little island of Cyprus—notorious for laundering Russian money—comes up as Russia's biggest foreign investor by a mile.

The country's next five biggest investors are also tax havens.

What economic data can we trust?

All these figures put a serious question mark not just on trade networks, but on other financial stats. "This is part of a fairly long series of ways in which fairly basic economic data we think we know about turn out to be complete crap once we know what's going on," says Alex Cobham, director of the Tax Justice Network.

Offshore shenanigans account for 30-50% of global foreign direct investment, Haberly has estimated in a paper (pdf) written with Oxford professor Dariusz Wojcik. This isn't just a wonky issue, he says. "It's pretty scary because it's very hard to know what's actually going on at a basic level. Especially when you start looking at developing countries—it's very difficult to tell what actual inward and outward investment is actually doing," he said. "It has implications for countries' balance of payments for understanding what's actually going on there."

Numbers can get particularly distorted when you look at tax havens. Cobham points to Ireland's GDP artificially rising 26% in 2015, likely due to the fact that Apple moved more than €200 billion ($238 billion) worth of intellectual property assets to the country to avoid tax, as reported in the Paradise Papers. Nobel prize-winning economist Paul Krugman dubbed the figures "leprechaun economics." This year Ireland started changing their accounting techniques to account for distortions that stem from the country being used as a tax haven.

These kinds of distortions have troubling implications if we look at them on a global scale, Cobham says. "Profit shifting is probably 5% or more of global GDP each year, which should really worry us," he said. "How many things should we really take for granted if an accountant couldn't sign off on global economic accounts that we imagine to exist? It all suggests we're probably doing it wrong."