Effective sanctions against oligarchs and the role of a European Asset Registry

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This note provides data on wealth inequality in Russia and advocates for a European Asset Registry. Russia exhibits the highest wealth inequality in Europe. Further, Russia's wealthiest nationals conceal a large share of their wealth through tax havens. The current architecture of the global financial system impedes comprehensive knowledge on beneficial ownership across asset types and jurisdictions. Under the roof of a European Asset Registry, the already existing but currently dispersed information could be gathered. This would change the state of play, resulting in better-targeted sanctions and effective tools to curb money laundering, corruption and tax evasion. The European Union could have a pioneering role in taking the next step towards more financial transparency.

Wealth Inequality in Russia and Offshore Wealth

Russia exhibits the highest wealth inequality in Europe. The top 10% wealthiest Russian residents own about 74% of total household wealth. In comparison, the 10% wealthiest in France own about 59%. In the U.S. this share amounts to about 71%, in Poland to about 62%, and in China to about 68%. The wealthiest 1% in Russia own about half of Russian household wealth (48%). In comparison, this share is about 27% in France, 35% in the U.S., 31% in China and 30% in Poland (see Figure 1). The foundations of this strong wealth concentration among a small group were laid by the rapid and highly unequal privatization process in Russia in the early 1990s after the collapse of the Soviet Union.[i]

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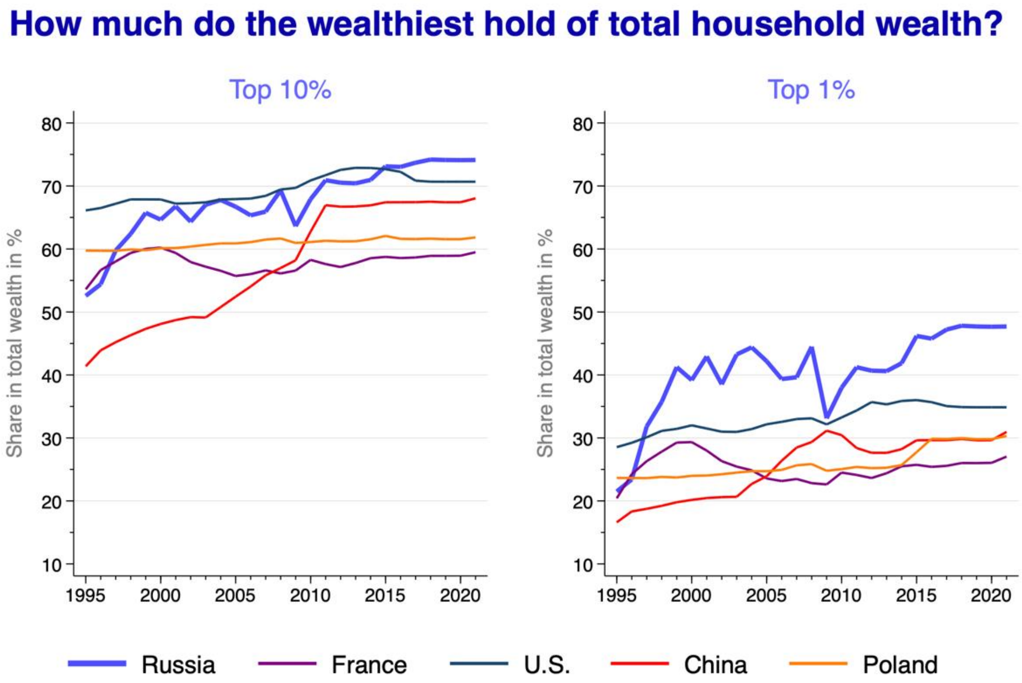

Figure 1: Own visualization based on data on the World Inequality Database (*https://wid.world*).

Much of Russians' wealth is held in offshore centres. Offshore wealth is wealth that is held outside of the country of residence, in many cases in jurisdictions known as tax havens. Despite the limited availability of data, a number of recent studies provide estimates on the magnitude of offshore wealth of Russian nationals (and of nationals of other countries). Novokmet, Piketty, and Zucman (2018) estimate that about half of total Russian household wealth is held abroad. To give a sense of scale, "there is as much financial wealth held by rich Russians abroad—in the United Kingdom, Switzerland, Cyprus, and similar offshore centers—than held by the entire Russian population in Russia itself".[ii] This offshore wealth of Russian nationals amounted in 2015 to roughly 85% of national income; that is, 85% of what Russian residents earn in an entire year.[iii]

Recent sanctions, which aim at isolating the Russian economy, have a large impact on the general population. The latest projections on the macroeconomic impact of the sanctions point to a modest economic contraction (about 1.5% in 2022 and 2.5% in 2023) under current measures.[iv] Prospects might worsen further as more sanctions are announced in the coming weeks. This impact, in combination with the ongoing exodus of Western firms, international isolation of Russian banks and severance of their financial ties from the rest of the international financial system, is expected to worsen labour market conditions, and lead to a gradual deterioration in standards of living in the Russian population. In addition, a 37% devaluation of the rouble (against the Euro) since the start of the war, has destabilized the economy substantially.[v] With at least half of Russia's foreign reserves frozen, the central bank was forced to increase its key interest rate from 9.5% to 20% overnight, with significant impact on borrowers.[vi] Moreover, the instability in the rouble works its way to consumers' and firms' purchasing power through import-led inflation, while the imposition of capital controls in Russian banks erodes trust, strangles the real economy and restricts the population's access to their savings. The combination of these factors will most likely affect savers, wage-earners and pensioners in Russia disproportionately.[vii] Undoubtedly these measures increase the pressure on the Russian government to change course on Ukraine, but they come at the expense of lower standards of living and economic hardship for the general Russian population.

In contrast, part of the wealth of rich Russian nationals is hidden in tax havens. Sanctions directed towards the wealthiest Russians are targeting the so-called "oligarchs". The EU list comprises about 680 Russian nationals & 53 entities.[viii] Part of these oligarchs' wealth is held in foreign financial & non-financial assets (therefore, not in roubles), which are hard to trace due to financial secrecy and lack of a comprehensive record of beneficial owners. In terms of targeting, the group of rich Russian nationals or residents benefiting from keeping wealth offshore is considerably larger than the 680 sanctioned individuals: Alstadsæter, Johannesen and Zucman (2018) estimate that in 2007 the richest 0.01% of Russian nationals (about 10,000 individuals) owned more than 12% of the total Russian household wealth and held 60% of their wealth in offshore tax havens (see Figure 2). According to the latest data from the World Inequality Database, there were about 20,000 individuals in Russia (0,02% of the adult population) with net wealth above 10 million euros in 2021[ix] and about 50,000 individuals (0,05% of the adult population with net wealth above 5 million euros.[x] About one-half to two-thirds of these individuals' assets are held offshore.[xi]

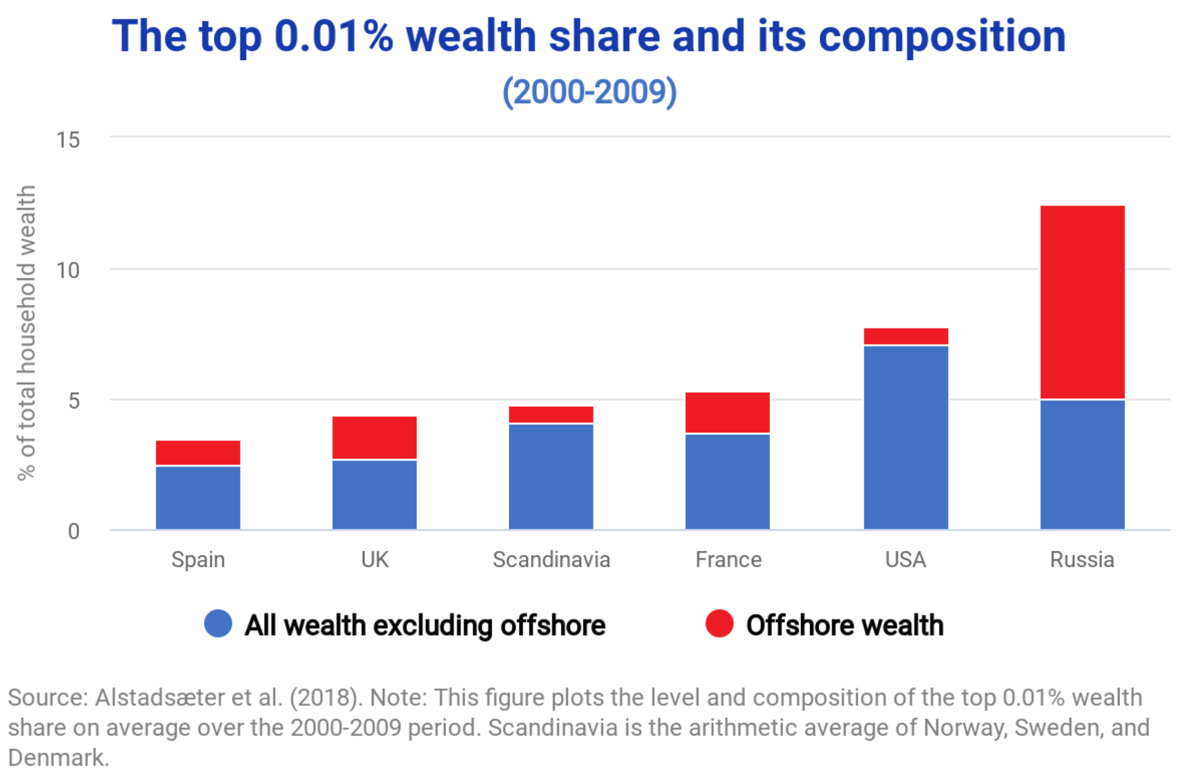

Figure 2: Visualization by the EU Tax Observatory reproducing results by Alstadsaeter et al. (2018).

Offshore wealth and financial transparency

Hiding wealth is more pervasive in Russia due to the high concentration of wealth, but by no means does it constitute a Russian-specific phenomenon. Alstadsæter, Johannesen and Zucman (2018) estimate that the equivalent of 10% of global GDP is held as offshore wealth. This share has been relatively stable throughout the 2000s and 2010s. About $8.3 trillion were held in tax havens in 2016.[xii] Recent leaks from offshore financial institutions underline that the users and beneficiaries of shell companies come from all over the world.[xiii] The international dimension of this practice requires a broader, more systematic approach: EU countries can improve the effectiveness of sanctions by addressing long-standing problems in the financial governance structure. Namely, addressing the existence and role of tax havens, the use of financial and asset secrecy, and the use of shell companies to hide company ownership and wealth.

Evidence of worldwide interlinkages of Russian wealth to tax havens are abundant. In recent years the use of different schemes, many of which in European countries, was common practice. Firstly, García-Bernardo et al. (2017) find that Russian companies used chains of shell companies via the British Virgin Islands and Cyprus to invest.[xiv] Secondly, evidence draws a link between Russian nationals investing in real estate in many European countries – often via shell companies.[xv] And thirdly, Russian nationals (among many other nationalities) utilised golden visa schemes offered by several European countries, e.g. Malta, Cyprus and the UK, thereby acquiring residence or citizenship in exchange for investments.[xvi] With the current sanctions in place and with European countries hardening their stance, Russian wealth might start shifting to non-European tax havens. Currently, anecdotal evidence points to Russian investors reallocating their wealth towards destinations outside of the sanctioning countries.[xvii]

A comprehensive database tracking where and by whom wealth is held could increase the efficiency of targeted sanctions. Information on asset ownership of different asset types is held in private companies, banks, national beneficial ownership registries (yet incomplete), central securities depositories, and financial authorities. Governments find themselves in a disadvantaged position since databases are not comprehensively linked and restricted in access. As a result, they lack key information that can prove crucial in designing and implementing sanctions. Access to this information must be gained first in order to make sanctions more effective. The dispersion of information across different locations and institutions currently facilitates tax avoidance and evasion as well as money laundering.

Systematic collection of asset ownership information would close gaps further and facilitate the ongoing development of national registers. For instance, information on real estate is typically held in land registers, but in many countries reporting obligations do not require the individual beneficiary of a property. The use of shell companies is regularly employed to report only the legal entity and to disguise the individual controlling it. Moreover, national commercial registers record the ownership of companies registered in the country. However, their access is sometimes restricted and the registered ownership structures remain obscure (for instance, due to a lack of reporting obligation for minor shareholders). Lastly, information on securities (bonds and stocks) is recorded by national and private central security depositories (e.g. the Depository Trust Company in the U.S. for securities issued by

U.S. companies, and Clearstream and Euroclear for securities issued in the European Union), the access of which is not always free or publicly available.[xviii] In the past years, many countries have been developing government-held beneficial ownership registries. Despite substantial progress, these still exhibit blind spots and exceptions from registration obligations.[xix]

In recent years, EU laws and a number of OECD policies have improved the framework of financial transparency in Europe:

- The 5th Anti-Money Laundering Directive introduced public beneficial ownership registries in Member States for companies, trusts and other legal arrangements. However, in practice gaps in the ownership records remain. For instance, evidence from the Open Lux investigation indicates that the identity of the final beneficial owner oftentimes continues to remain hidden from the public.[xx] In addition, a number of exceptions exist, such as on the ownership structure of listed companies in the stock market. To this date, not all EU Member States have made their registries available.
- New regulations are currently being discussed on setting up a new EU Anti-Money Laundering Authority, complemented by a 6th Anti-Money Laundering Directive. This will seek to harmonise rules and procedures while enhancing cooperation between the Member States' Financial Intelligence Units. Importantly, the scope of the new regulations extends beyond Member States since they will require "foreign entities" (i.e. shell companies in tax havens outside the EU) to register their beneficial owners when purchasing real estate in the EU.[xxi]
- At the EU, there is renewed effort to tackle the misuse of shell companies by ensuring real economic activity and automatic exchange of information. The "Unshell" proposal seeks to establish more rigorous criteria to identify shell companies, and exclude them from tax reliefs and benefits of Member States' tax treaty networks.[xxii]
- At the OECD level, the automatic information exchange under the Common Reporting Standard provides information to tax authorities regarding certain financial assets, namely bank accounts, securities, and interest income in

investment entities. However, the current Common Reporting Standard leaves several loopholes that allow beneficial owners to keep their wealth undetected.[xxiii]

A guide for a European Asset Registry

A Task Force for Asset Ownership could be set up to collect information on hidden wealth in a unified structure in the EU. The task force will collect, cross-check and analyse all available information on wealth and assets held in EU Member States by wealthy individuals (above a given threshold). To utilise information in the Member States, the task force can be mandated by EU leaders and supervised by the Eurogroup. Its form can follow that of the Task Force for Coordinated Action — a special working group of the Eurogroup that has coordinated the setup of even more ambitious EU structures such as the Banking Union and the European Stability Mechanism.

This task force could pave the way for establishing a permanent European Asset Registry, tasked with systematically gathering and linking wealth information across all asset types. The ultimate objective of the registry would be to record comprehensively the ownership and movement of assets. Thus, the registry would provide highest-quality data on the total amount of wealth held by individuals. It would combine information from all available national and international sources, while establishing new sources in the case where information is currently neither present nor sufficiently recorded. Importantly, it should leave no gaps in the type of assets held and it should rely on automatic exchange of information procedures between the different sources. The medium-term goal in the EU would be a new institution (based on EU law or created by a new inter-governmental treaty) tasked with collecting and analysing information centrally.

Information gathered in the new structure could be cross-checked by specialised personnel and be made available to all Member States to fight financial crime. If beneficial ownership information includes information on nationality and country of residence, hidden wealth would be revealed and sanctions targeting wealthy individuals could become more efficient.

The work of the task force could be complementary to an ongoing feasibility study. The study was ordered by the European Commission last autumn, with expected deliverables in April 2023.[xxiv] The task force could create a fast-track pilot project that will implement the registry and run in parallel to the findings of the feasibility study.

A European Asset Registry could prove key in addressing long-standing issues of financial secrecy such as tax avoidance and evasion, money laundering and corruption. By and large, most recent developments against tax evasion and tax avoidance have rested on increased transparency and cooperation between countries. The current juncture provides a unique opportunity for European countries to play a pioneering role in establishing this powerful instrument.

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[i] Novokmet, Piketty, Yang, Zucman (2018); Novokmet, Piketty, Zucman (2018). Further see World Bank (1996): From Plan to Market. World Development Report 1996, p. 55.

[ii] Novokmet, Piketty, Zucman (2018): From Soviets to oligarchs: Inequality and property in Russia 1905-2016. J of Economic Inequality, 16: , p.191. The term "Russians" includes Russian residents and Russian nationals living abroad in this study.

[iii] Novokmet, Piketty, Zucman (2018).

[iv] See for example the projection of the British National Institute of Economic and Social Research which assume the current sanction regime in which energy exports from Russia persist and the price of gas and oil increase: https://www.niesr.ac.uk/wp-content/uploads/2022/03/PP32-Economic-Costs-Russia-Ukraine.pdf .

[v] The EUR vs RUB exchange rate stood at 85 RUB for 1 EUR before the war and currently stands at 117 RUB for 1 EUR (12.03.2022).

[vi] See official announcement on 28th of February 2022 by Bank of Russia: https://www.cbr.ru/eng/press/keypr/ .

[vii] The effects, however, also depend on the reaction of the Russian government to support the population or certain groups via regulation or fiscal policy.

[viii] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0269&from=EN

[ix] See the numbers on the World Inequality Database.

[x] See the numbers on the World Inequality Database.

[xi] Alstadsæter, Johannesen and Zucman (2018).

[xii] Zucman, G. (2017). La richesse cachée des nations. Enquete sur les paradis fiscaux. Seuil.

[xiii] See here for example the Panama Papers (2016): https://www.icij.org/investigations/panama-papers/ & https://offshoreleaks.icij.org/investigations/panama-papers; the Pandora Papers (2021): https://www.icij.org/investigations/pandora-papers/ & https://offshoreleaks.icij.org/investigations/pandora-papers, the Paradise Papers (2017): https://www.icij.org/investigations/paradise-papers/ & https://offshoreleaks.icij.org/investigations/paradise-papers.

[xiv] García-Bernardo, J., Fichtner, J., Takes, F.W. and E.M. Heemskerk (2017): Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network. Scientific Reports **7,** 6246.

[xv] Many real-estate purchases from abroad are channelled through offshore vehicles which obscure the identity of the natural ultimate beneficial owners and thus his/her nationality. Badarinza and Ramadorai (2018) find that about 85% of properties purchased by foreign entities are conducted through offshore centres like the British Virgin Islands, Cyprus etc. Several papers try to identify nationalities via indirect deduction. See for France D. Cvijanovic and C. Spaenjers (2020), for the London real estate market: C. Badarinza and T. Ramadorai (2018).

[xvi] C. Badarinza and T. Ramadorai (2018) find the use of the investor's visa scheme of the UK by Russian residents following high-risk events in Russia. K. Surak and Y. Tsuzuki (2021) find, based on government reports and statistics by Member States, that significant numbers of Russian citizens have applied for residence-by-investment

programs e.g. in Spain. Sunak (2020) finds based on data mainly requested from national immigration offices that "Of the total applications approved in the EU, China accounts for the greatest demand, with nearly 50%, followed by Russians with 27%". Scherrer and Thirion (2018) give an overview of Citizenship-by-Investment and Residency-by-Investment programmes in the EU but underline that much of the evidence remains anecdotal. For Latvia, see this journalistic piece presenting data from the Latvian Immigration and Citizenship Office: https://www.occrp.org/en/goldforvisas/latvias-once-golden-visas-lose-their-shine-but-why.

[xvii] Reported e.g. in the Financial Times, and Reuters.

[xviii] For more information on existing data sources, see Zucman (2015): The hidden wealth of nations. University of Chicago Press, Chapter Four; Tax Justice Network (2022): 10 measures to expose sanctioned Russian oligarchs' hidden assets.

[xix] See for a comprehensive assessment Harari et al. (2020).

[xx] https://www.occrp.org/en/openlux

[xxi] See European Commission (2022): https://ec.europa.eu/info/publications/210720-anti-money-laundering-countering-financing-terrorism_en.

[xxii] https://ec.europa.eu/taxation_customs/taxation-1/unshell_en

[xxiii] Several behavioral reactions were reported such as the relocation of financial assets to uncooperative tax havens (Johannesen & Zucman, 2014; Johannesen, 2014) or to jurisdictions not participating in the agreement such as the U.S. (Casi et al. 2020). Further, its coverage excludes for example real estate assets. This loophole has probably led to shifts from financial to more real estate wealth to avoid detection (see Bomare, Le Guern Herry (2021): Automatic Exchange of Information and Real Estate Investment. Mimeo.)

[xxiv] See https://etendering.ted.europa.eu/cft/cft-display.html?cftId=8792.