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Abstract.
This paper examines offshore finance centres and tax havens that are hosted by small island economies (SIEs). In many cases, hosting offshore finance has been a lucrative activity for SIEs since the 1960s in terms of employment (direct and indirect), and overall contribution to GDP and government revenues (Hampton and Christensen, 2002). Despite the scale and reach of the global offshore economy, at present many SIE hosts face an unsettled future in light of significant international pressure from nation states, international organisations such as the EU and OECD and, increasingly, from civil society in both the developed and less developed world.

Given the economic importance of hosting offshore finance for many SIEs around the world, the paper discusses the development options facing many island jurisdictions. The paper poses the fundamental question: what has changed since the major initiatives around the year 2000, and then discusses the situation facing many SIEs hosts, the changing global political economy and their shifting negotiations and alliances within it.

Key words: tax havens, political economy, economic development, Jersey

Introduction.

Facing sustained pressure from the US Obama Administration, the Organisation for Economic Cooperation and Development (OECD), and the European Union, the Swiss authorities look likely to abandon or significantly modify their banking secrecy laws in the near future (International Herald Tribune, 2009). Other tax havens are coming under similar pressure to modify their laws and treaty arrangements to improve international cooperation on tax information-sharing. In January 2010 the OECD announced that tax havens had signed more than 300 tax information exchange agreements in the preceding 12 months, signalling what they described as "one of the big success stories of the G20"(Houlder, 2010a, p.1). The European Court of Justice has also taken a lead in tackling harmful tax practices, and its landmark judgement of April 2005, the Halifax Case, ruled against transactions which have tax avoidance as their sole purpose[1]. Additionally, the British, French and other OECD governments are supporting new accounting rules that will require multinational companies to publish accounts for all subsidiaries in the countries where they operate; rules designed to radically reduce the scope for shifting profits to tax havens (Houlder, 2010a, p.2).

Cumulatively these pressures seem likely to have significant impact on small island economies hosting offshore financial centres (OFCs), some of which were already facing budgetary crises arising from other factors. For example, in September 2009 the government of the Cayman Islands, a British Overseas Territory, sought emergency backing from the UK Foreign and Commonwealth Office to borrow £278 million on the private markets. In response, a Foreign Office minister proposed radical reform of their tax arrangements, stating: "I fear you will have no choice but to consider new taxes, perhaps payroll and property taxes such as in the British Virgin Islands" (Mathiason, 2009). In October 2009 UK Treasury officials advised senior politicians from the British Crown Dependencies that the EU Code of Conduct Group on Business Taxation would not accept their proposed tax reforms, placing Guernsey and Jersey in potential fiscal crisis (Quérée, 2009). In February 2010, in response to a statement from the UK Secretary to the Treasury about multinational company reporting requirements[2] the business correspondent of the *Jersey Evening Post* commented: "It's not only banking secrecy that's dead. Tax avoidance – the industry that helped Jersey become so prosperous – now appears to be on its last legs as well",

concluding that “it would be a good idea to start planning now for this brave new world.” (Body, 2010).

Unlike the multilateral initiative in the 1990s against tax havens, spearheaded by the OECD, which fizzled out when the US Bush Administration withdrew its support in 2001 (Palan et al, 2010, p.224) the current initiatives are being driven by three power blocs, the Group of 20 countries, the EU and the US, all of which are confronted by the deepest recessions experienced since the 1930s. Domestic budgetary pressures within these economies have played an important part in swinging the pendulum away from tax havens. In this context, preparing development strategies that reduce dependence on rent incomes from what the OECD terms ‘the tax industry’ (OECD, 1998) should be regarded as a priority for small islands.

Theorising island hosts: path dependence.

Whilst there is a growing literature on small island economies (SIEs),[3] this working paper focuses on one aspect, path dependence, as an analytical tool to examine SIE hosts of offshore finance. Scott (2001, p.367) defines path dependence as “systems in which early choices or actions, often determined by transient conditions, bias subsequent development in favour of particular outcomes.” Martin and Sunley (2006, p.402) add “The past thus sets the possibilities while the present controls what possibility is to be explored”.

For small islands that are former colonies, path dependence was applied by Acemoglu et al (2002) who discuss the ‘reversal of fortune’ concept, however, they were criticised by Austin (2008) for over-simplifying the lines of causation over time. Feyrer and Sacerdote (2009) examined the links between colonialism and the modern-day income of islands pointing to an overall positive correlation between islands being colonial possessions and present national income levels. However, Bertram (2007) argues that the type of approach used (econometrics) had key flaws in its data-gathering and demonstrated a limited understanding of the specifics of SIEs.

MacKinnon et al., 2007, argue that when analysing a particular phase in a region’s development it is crucial to also consider the existing social relations which shape localised practices and operational routines. This requires a focus on specific circumstances that can give rise to ‘lock-in’ to a particular form of development in which local economic actors pursue a course of action that may ultimately lead to an ‘economic cul-de-sac’. This paper follows this line of logic arguing that actions and

decisions at certain times, in this case to allow OFC firms to 'locate' in SIEs, are likely to have 'locked-in' these jurisdictions to development path that may indeed prove to be what MacKinnon et al. (2007) dub an 'economic cul-de-sac'.

Here we develop this notion further and argue that events since 2007 and 2008, including exogenous shocks, have exacerbated this trend. According to Grabher (1993) and Hassink (2005) there are three distinct aspects of 'lock-in': functional, cognitive and political. Functional lock-in arises from the web of relations between firms, forms of production or economic activity, and the links created between customers and suppliers. Cognitive lock-in (or world view) arises from failures to correctly interpret signs of external change, and the failure of collective learning mechanisms. Finally, political lock-in refers to social relations and the power dynamics that underpin economic development, and especially failures of political, business and labour leaders to adapt policy mechanisms to allow local innovation and learning. Of these three aspects, Hassink (2005) argues that cognitive and political lock-in are closely related and, significantly, can cause outcomes that "paralyse competition and tranquillize large industries (p.523). An example of this can be found in the case of Swiss private banks which, faced with mounting pressure to abolish the protective mechanism provided by that country's banking secrecy law, feel themselves unable to compete effectively at global level (Zaki, 2010). Here, we would agree with MacKinnon et al. (2007, p.5) who comment that the net effect of these aspects of lock-in further leads to 'collective myopia', that is, a legacy of inherited social infrastructures which actively discourages innovation and new business start-up. Arguably this can be observed in Jersey and many other SIE hosts of offshore finance.

Within the path dependence literature, a link can also be established to *place* dependence (Martin and Sunley, 2006), since despite the so-called 'end of geography' notions (O'Brien, 1992) physical location, by which we mean proximity to major financial centres like London or New York, remains a key attraction for the largest OFCs (Hampton, 1996a; Hampton and Christensen, 2007; Markoff, 2009).

Hampton and Christensen (2002, p.168) argued that SIE hosts "have become locked into their relationships with the offshore finance industry by their dependence upon the earnings potential of predominantly imported skills and expertise, and their lack of skills and knowledge in alternative sectors. This means that any attempts at

diversification into other sectors would be constrained by the need for wholesale re-skilling and the acquisition of new knowledge bases."

Contrary to Park's argument (1982), the experiences of SIEs like the Channel Islands, Cayman, and Turks and Caicos, demonstrate that hosting OFCs does not lead to transferable knowledge gains or increasing entrepreneurial flair since the majority of the activities located in these OFCs consists of what could be termed 'wrapper' activity, that is, creating and administering structures that give the form but not the substance of a functional presence. Even where these islands have created niche markets for themselves (e.g. securitisation in Jersey, captive insurance in Guernsey) the majority of the specialists working in these fields have been imported from elsewhere.

The emergence of Offshore Finance.

Offshore finance's rise since the 1960s[4] has been detailed by Hampton (1996a); Palan (2003); Palan et. al. (2010) and Sharman (2006) but here we can note certain key points. First, there has been the instrumental role played by OECD states (particularly the UK) in creating and supporting tax havens and offshore finance[5] in many small jurisdictions, especially former colonies and continuing dependencies such as the Cayman Islands in the 1960s and Vanuatu in the 1970s.

Second, this explicit support from mainland states, combined with the expansion of globalising financial capital (initially US and Canadian banks plus UK merchant banks) met the rising international demand both for specialist retail banking (asset management for wealthy individuals) and wholesale banking (Eurocurrency and Eurobonds markets) for other banks and multinational corporations.

Third, such initiatives over-lapped with the personal interests of key local actors such as the lawyers Vassel Johnson in Cayman and Reg Jeune in Jersey; the latter's practice going on to become a prominent member of the 'Offshore Magic Circle'[6] of law firms, with Jeune taking a leading political role as President of the States of Jersey's Policy and Resources Committee. These pioneer law firms were able to make sizeable profits in the new world of offshore finance as it grew in the island hosts. By the 1990s the so-called shadow economy of offshore finance was host to an estimated US$11.5 trillion of assets belonging to wealthy individuals (TJN, 2005), and including differing types of financial structures (varieties of foundations,

trusts, tax exempt companies, international business companies, offshore funds, hedge funds, structured investment vehicles, captive insurance etc).

However, after two decades of benign neglect by the international community, and despite ad hoc and relatively small-scale initiatives from individual countries' revenue authorities to combat the most blatant tax dodging, by the mid 1990s the international context within which tax havens operate was beginning to change. Initially the islands were able to resist most of the pressures for change. The 1998 Harmful Tax Competition initiative (OECD, 1998) - launched by the OECD at the behest of the G7 - was strongly opposed by the 35 tax havens, mostly SIEs, subsequently blacklisted in 2000 (Saunders, 2002; Vleck, 2007). Their opposition was supported by the incoming George W Bush administration, whose Treasury Secretary, Paul O'Neill, effectively ended the initiative when he withdrew US support in May 2001 (Palan et al, 2010, p.217). Lacking the necessary political support, the OECD persevered through its Global Forum process with negotiating agreements with so-called 'cooperating jurisdictions' to remove some of their harmful tax practices. Other changes were also underway, for example the European Court of Justice ruling mentioned above, but political agreement on the need to tackle banking secrecy and strengthen international cooperation with tax information exchange was effectively stalled until April 2009, when the G20 nations, led by British Prime Minister Brown, French President Sarkozy, German Chancellor Merkel and US President Obama, launched a new initiative against tax havens with the OECD as the prime agent (La Tribune, 2009).

The 2009 initiative differed in several respects from the 1998 Harmful Tax Competition programme. First, the OECD targeted a broader range of tax havens, including OECD nations like Austria, Luxembourg and Switzerland. Crucially, by this stage amendments to Article 26 of the OECD's Model Agreement for Tax Information Exchange included a facility for over-riding banking secrecy laws where evidence existed of criminal activity, including tax evasion. Second, the OECD made a distinction between cooperating jurisdictions, specifically those that had already negotiated a minimum of 12 tax information exchange agreements (the so-called White List jurisdictions), from those that had agreed to cooperate but had not achieved the minimum threshold (Grey List jurisdictions), and those that still resisted cooperation (Black List jurisdictions). Third, the public mood had also swung against tax havens, with civil society coalitions in Europe, North America and various

developing countries calling for measures to close the loopholes exploited by those who use tax havens.[7] In August 2009 OECD Secretary-General Angel Curria felt sufficiently optimistic to state: “It seems almost unbelievable, but the era of banking secrecy for tax purposes will soon be over. In tomorrow's world, there will be no more havens in which to hide funds from the taxman” (Gurria, 2009).

Critics such as the Tax Justice Network, however, have argued that the OECD initiative lacks coherence since it fails to target main players like the UK and US (Le Monde, 2009). The TJN, a global civil society coalition that coordinates advocacy efforts for international cooperation on tax matters, published an alternative list of ‘secrecy jurisdictions’ in November 2009 which ranked the US at the top, and included the UK in the top five.[8] Critics have also argued that the bilateral tax information exchange agreements at the heart of the OECD programme are weak and ineffective in deterring the use of tax havens as centres for tax evasion (Financial Times, 2009). As an alternative they propose the automatic information exchange model adopted by the European Union in 2005(Global Financial Integrity et al, 2009) which they claim has a stronger deterrent effect than the ‘upon request’ system used in the OECD Model Agreement. Importantly, the jurisdiction of the EU Savings Tax Directive extends beyond the Member States to include their dependent territories like the British Crown Dependencies and the Dutch Antilles.

With strong political pressure from France and Germany (La Tribune, 2009), and from powerful coalitions within the European Parliament, in early 2010 the European Commission tabled proposals that, once implemented, will strengthen the STD and extend its scope.[9] Specifically, the revised STD includes provisions requiring information exchange for trusts, foundations, shell companies and other legal persons. This amendment radically transforms the activities of many SIE tax havens, which use Anglo-Saxon trust laws and nominee company directors as the principal basis for shielding clients from external investigation.

The strengthened STD is likely to be agreed in 2010 and implemented by 2012. The revised model will probably become the global standard for international information exchange, with a number of Latin American countries indicating that they would like an opportunity to pilot this standard with EU support.[10] In addition to strengthening its STD, the EU’s Code of Conduct Group on Business Taxation has required the removal of tax measures deemed harmful to the Single Market. The powers of this Group have also extended to dependent territories, some of which have

been required to radically alter their tax regimes to remove preferential treatments targeted at companies registered but not trading in tax havens. The British Crown Dependencies, for example, have had their domestic corporate tax regimes over-turned on the basis that they 'ring-fence' preferential treatments from local investors (Houlder, 2009). EU intervention has forced Guernsey, the Isle of Man and Jersey to transform their tax regimes, with the latter facing significant structural budget deficits as it struggles to finance public spending while also retaining some attractions as a tax haven.

Unlike in 2000, tax havens are now finding it difficult to resist international pressure for reform (Palan et al, 2010). This is partly because some of them, the Cayman Islands and Jersey, for example, themselves face severe budgetary pressures. As noted earlier the former has been required by the UK Government to introduce new taxes to overcome a severe structural budget deficit (Mathiason, 2009). Attempts to coordinate a counter-attack against anti-tax haven measures have been inhibited by strong campaigns in France, Germany and UK sparked by revelations of how banks operating from Liechtenstein and Switzerland have actively supported tax evasion by wealthy clients.[11] In the US, public opinion was mobilised during the 2008 Presidential campaigns by Barack Obama's regular references to an office block in Grand Cayman which houses over 12,000 registered businesses: "either this is the largest building in the world or the largest tax scam in the world. And I think the American people know which it is. It's the kind of tax scam that we need to end." (Evans, 2009)

It is unlikely that the initiatives set in motion in 2009 will cause the demise of all tax havens. But there is little doubt that the combination of measures by the OECD and EU will restrict the activities of existing actors and radically reduce their ability to resist requests for international cooperation in tackling tax evasion. As a result of international pressure, banking secrecy laws will probably be degraded to the point of being disabled within the course of the coming decade (Financial Times, 2009), and calls are being made for trusts and shell companies to be made more transparent (Global Financial Integrity et al, 2009). Cumulatively this will reduce the scope of many SIE tax havens that rely heavily upon secrecy as their prime attraction.

It is not clear whether the islands will be able resist the current wave of initiatives against tax evasion as they did in the early 2000s. Their successful counter-attack against the OECD Harmful Tax Competition initiative used accusations of

‘fiscal colonialism’ against the OECD countries, and portrayed the battle as a ‘brave fight’ of the small and ‘powerless’ against the ‘cartel’ of OECD countries (Mitchell, 2001; Sanders, 2002). More recently, accusations have been made about a ‘witch-hunt’ against Caribbean tax havens (Hutchinson-Jafar, 2009), but the inclusion of Austria, Luxembourg and Switzerland on the 2009 Grey List undermines the earlier arguments about OECD tax havens ‘ganging-up’ against their SIE rivals, and additionally, many of the functional SIE tax havens wish to shed their image as bolt-holes for tax evaders and consequently do not want to be seen to be publicly resisting pressures to negotiate tax information exchange agreements with third party countries.

What happens next?

In 2005, Richard J. Hay, a London-based lawyer acting as adviser to SIE tax havens, strongly advised his clients to support the OECD’s ‘on request’ model for information exchange, since the alternative, the EU’s automatic exchange process, would significantly impact on demand for offshore private wealth management (Hay, 2005). OECD countries have sought to establish the on request model as the global standard, and the majority of tax havens listed on the OECD Grey List in April 2009 are negotiating the minimum of 12 TIEAs required to secure upgrade to the White List. Meantime, however, the goal posts are rapidly moving. The OECD has already indicated that it regards 12 TIEAs as the absolute minimum and expects the bar to rise. It has also initiated a peer review process to monitor how effectively the tax havens are meeting their treaty obligations. At the same time political pressure in support of automatic information exchange has increased significantly since the 2009 G20 London Summit. By end-2010 the OECD intends to release its guidelines on country-by-country reporting by multinational companies, which will make it significantly easier for national tax authorities to detect profits shifting to tax havens. Cumulatively these pressures are eroding the secrecy space that many tax havens depend on to attract their clients (Hampton, 1996b).

In the course of the past decade several of the less functional SIE tax havens have retrenched from financial services (e.g. Samoa, Vanuatu and the Cook Islands: ABC Radio Australia, 2009), or closed down their OFCs entirely (Niue, Nauru and the Marshall Islands). In the western hemisphere, the Turks and Caicos Islands were placed under direct rule from Whitehall in 2009 after a British government Commission of Enquiry concluded that there was “a high probability of systemic

corruption" by elected members of the Turks and Caicos Islands.[12] The Cayman Islands are struggling to bridge a structural budget deficit, and the British Crown Dependencies face EU pressure to replace their 'harmful' corporate tax regimes and also join the automatic information exchange system of the EU's STD. Unlike in 2001, when a friendly US administration rode to their rescue, the SIE tax havens lack powerful political allies who will intervene on their behalf.

Jersey case study.

In 2009, in the midst of global financial market crisis, the value of deposits held in Jersey fell by approximately 20 per cent, and the value of funds under administration fell by 30 per cent (McRandle, 2010). The island's OFC had already been hit the previous year by falling demand for securitised debt: two Jersey law firms, Ogiers and Mourants, were leading specialists in these debt instruments. In May 2009, a panel of economic advisers to the island's Chief Minister warned that a £60 million pound 'black hole' structural deficit is likely by 2012 (JEP, 2009), and in October 2009 the Chief Minister reported that after consultation with a UK government minister he had been advised that "the UK felt that other Member States are increasingly unlikely to accept their stance that the fiscal regimes in the Crown Dependencies are fully compliant with the EU Code of Conduct on Business taxation"(Le Sueur, 2009). For the first time in decades, Jersey faces the possibility that its OFC industry might not be sustainable at its current scale: a plan B is required (Body, 2010).

However, Jersey displays many of the problems of 'collective myopia' noted by MacKinnon et al.(2007). Echoing Hassink's observations elsewhere (2005, p.253) having previously been able to rely on large taxable profits of the multinational banks and law firms, the States of Jersey were under scant pressure to attract investment in other sectors or pay anything more than lip service to economic restructuring. The island's tourism industry has been largely crowded out (Hampton and Christensen, 2007) and talk of attracting inward investment into new sectors, including information technology, a full-service university, or 'creative industries' (McRandle, 2010) appears wishful thinking.

At the level of functional lock-in, the OFC sector, which directly accounts for around one quarter of the economically active population and over 50 per cent of gross value added in the local economy, dominates the labour and commercial property market, and crowds-out prospects for diversification: "financial capital

appears to be able to out-compete other industries, particularly tourism, to gain dominance within the local political economy.” (Hampton and Christensen, 2007, p.1014).

Considering the issue of political lock-in, Christensen and Hampton (1999, p.186) described the sector’s capture of the island’s polity: “Having established predominance, the financial services sector used its political power to secure additional fiscal and regulatory advantages.” Political power is exerted through a number of players, including Jersey Finance (the OFC’s marketing arm), plus a large number of industry associations representing banks, law firms, trust and company administrators, hedge funds, the local branch of the Institute of Directors, the Jersey Chamber of Commerce and Industry, and powerful labour unions representing staff employed in the sector. These actors have been highly successful in securing favourable regulatory and tax treatment, even to the extent that they have been able to draft and dictate financial laws (Mitchell et al., 2002). Palan et al. (2010, p.187) argue that the political independence of Jersey and similar islands “is more apparent than real, for their developmental and social goals are subject to the whim of foreign capital. Senator Stuart Syvret, a senior politician in the States of Jersey, described its government as a “legislature for hire” (BBC, 1996).

Concerning cognitive lock-in by decision makers in Jersey, Hampton and Christensen (2007, p.1011) described how “key players (in Jersey) failed to comprehend the long-term implications of the crowding-out issue and lacked the political power to represent their interests”. For many decades Jersey’s key politicians have assumed that the EU could not extend its powers to include Crown Dependencies and that the UK government would intervene to protect their autonomy on tax matters. This is clearly no longer the case: the powers of the EU Code of Conduct Group on Business Taxation extend to the Crown Dependencies and the Group has required their respective governments to remove “harmful tax practices” such as the ‘ring-fencing’ of tax exempt status to non-resident companies.

Despite clear evidence that their existing tax regimes constituted harmful tax practices as defined by the EU, Jersey officials are largely dismissive of efforts to strengthen international cooperation. For example, the Chief Executive Office of Jersey Finance, Geoffrey Cook (2009), commented that: “An unlikely alliance of tax hobbyists, left wing newspapers, trades unions, and development agencies has catalysed around calls for greater concentration of the means of wealth creation in the

hands of governments, and implicitly greater taxation of business and wealthy individuals through the outlawing of wealth structuring and planning, together with restrictions on cross border capital flows. They hope that their own constituencies will be beneficiaries of this new 'contract', with the authors; the tax hobbyists, gaining fame and funding, and their supporters feeling validated in their enduring distrust of the wealthy and their advisers." Despite having been warned in 2006 by a number of experts, including one of the authors of this paper[13], that proposed amendments to their corporate tax regime (the so-called Zero-Ten tax policy) would be rejected by the Code of Conduct Group, in 2007 the States of Jersey adopted measures that were indeed deemed unacceptable in 2009.

Similarly, the Jersey authorities continue to refuse to adopt automatic information exchange within the framework of the EU's Savings Tax Directive. This decision, confirmed in November 2009, runs counter to their claims to be a transparent and well-regulated jurisdiction that co-operates with combating cross-border crime. In practice, Jersey's lack of financial market transparency, its weak international treaty arrangements for information exchange, and its unwillingness to cooperate with the EU, led to its being ranked eleventh out of 60 in Tax Justice Network's 2009 Financial Secrecy Index (Financial Secrecy Index, 2009). While the tide appears to have shifted significantly against tax avoidance (Blackhurst, 2010), the Jersey authorities remain committed to business as usual, indeed during discussions in March 2010 between one author and Members of the States of Jersey, he was told that the expectation was that a change of UK government in mid-2010 would reverse the tide of EU measures against tax havens[14]. But even so, Jersey has been badly affected by the severe tax competition between the Crown Dependencies, and now faces having to implement considerable tax hikes in the short- to medium-term to cover the missing revenue.

Conclusions.

Tax havens have, in the recent past, shown an ability to successfully resist external attempts to close down their activities (Palan et al., 2010). However, the powerful coalitions of interests involved in initiatives launched since the mid-2000s are strongly motivated to take action, not least because of the budgetary crises facing so many developed and less developed countries. For this reason it would be unwise for small islands hosting significant OFCs to ignore the stronger international cooperation

measures being promoted by the EU and the OECD, and the potential changes to international financial reporting standards for multinational companies. Cumulatively these measures could radically strengthen the international financial architecture and significantly increase transparency, which will inevitably diminish opportunities for corporations and individuals to use tax havens for tax avoidance. It would equally be unwise for small islands to count upon being able to muster the political support they were able to draw upon when resisting the 2000 OECD anti-tax haven initiative (Palan et al., 2010), since the focus for political change no longer lies on blacklisting specific jurisdictions, but on targeted measures designed to increase financial market transparency and strengthen international cooperation on tax matters. Examples of such measures include the tax information exchange treaties being promoted by the G20 and the OECD, and the international financial reporting standard for country-by-country reporting by multinational companies that the OECD has committed to adopt as a guideline before end-2010 (Houlder, 2010c).

Some tax haven islands, including Jersey, are already facing unprecedented budgetary pressures. But they have limited scope for reducing their dependence on offshore financial services. With approximately one quarter of its economically active population directly employed in the OFC, and the majority of the remaining workforce employed in secondary sectors like construction, distributive trades and catering, there is virtually no alternative skills base on which new industries can draw. This path dependence has been reinforced by the extraordinary high costs of land and labour, which have crowded-out pre-existing industries. Taking measures to diversify the local economy will therefore require politically unpalatable steps to significantly reduce the domestic cost base.

Unlike Vleck (2008) - who appears broadly optimistic arguing that the 'pessimism' of Hampton and Christensen (2002) concerning the OFCs' future did not happen and that they are in fact thriving - we have argued here that the present context is radically altered. Specifically, this paper has argued that tax havens hosted in small islands can not ignore the exogenous shock to global financial capitalism caused by banking crises in 2007 and 2008, or the subsequent economic crises that have engulfed many countries in what is likely to be the most protracted recession since the 1930s. Recognition of this new world, and the implicit exogenous shock, is even seen in the (otherwise arguably timid) Foot Review (2009a, 2009b) of the UK's offshore centres.[15]

Small island hosts of offshore finance can not just hope that the status quo might somehow be maintained, or that the new international coalitions will somehow dissipate leaving them free to remain as hosts of lucrative tax haven activity. Path dependency theory would suggest that the past actions and policy choices of the small island hosts themselves have contributed significantly to the serious predicament that they now find themselves in, and consequently, the extremely limited economic development possibilities that remain open to them.

We would suggest that the future may be austere for many small island hosts of offshore finance. In the worst case scenario, islands could face a crash of real estate and land prices, significant emigration off-island where the most mobile leave (as in the recent cases of Iceland and Ireland) and a deep financial crisis of the local state. For non-independent island economies such as the UK Overseas Territories - or conceivably Crown Dependencies such as Jersey - this could result in increased direct control from the UK. For independent small island jurisdictions, the economic crisis could require IMF emergency loans to keep the economy afloat. In many cases, we would suggest that the outlook for small island hosts of offshore finance is bleak since there is scant evidence of the existence of a practical or realistic alternative plan.

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Notes.

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[1] A comment on the ECJ ruling is available at: http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=21603&SID=622016&TYPE=20

[2] The speech is available at http://www.hm-treasury.gov.uk/speech_fst_270110.htm

[3] Approaches range from conventional neoclassical orthodoxies (World Bank, 2005; Armstrong and Read, 2006) via 'vulnerabilities' (Briguglio, 1995) to broadly political economy type writings (Baldacchino, 2006; Hampton and Christensen, 2002).

[4] Offshore finance and tax havens have earlier origins with notable and organised commercial activity from at least the 1920s (Hampton, 1996a) but significant changes in the scale and scope of activities dates from the 1960s.

[5] The argument over definitions of 'tax havens' versus 'offshore finance centres' has been discussed across the literature (see Hampton, 1996a; Palan et al, 2010 etc) and by civil society groups such as TJN who have popularised the term 'secrecy jurisdictions (see www.secrecyjurisdictions.com).

[6] This description is given to themselves by the so-called leading offshore legal firms. It appears in recruitment adverts e.g. on the www.legalweekjobs.com web site. One job advert dated 22 February 2010 (US $180-210,000 "tax free") was entitled: 'Senior Structured Finance Associate – Cayman Islands – Offshore Magic Circle Client'.

[7] Approximately 120 civil society organisations, including development NGOs, human rights organisations, trade unions, faith groups and others, agreed by an overwhelming majority at a meeting in Paris on 12 January 2009, that tackling tax havens was the number one priority for campaigning around the April 2009 G20 summit in London.

[8] See www.financialsecrecyindex.com

[9] See http://register.consilium.europa.eu/pdf/en/09/st16/st16473-re01.en09.pdf).

[10] In January 2010 the Tax Justice Network, working in partnership with the Inter-American Center of Tax Administrations, launched a pilot project involving three Latin American countries that have indicated interest in negotiating multilateral information exchange treaties with the EU countries.

[11] See civil society letter to G20 Finance Ministers on 28 October 2009 in the run-up to the G20 Saint Andrews conference, signed by Eurodad, LatinDad, TJN, CIDSE,

GFI, Christian Aid, Oxfam, Action Aid and the Plateforme Paradis Fiscaux et Judiciaires.

[12] The Commission of Enquiry report is available at: http://www.fco.gov.uk/en/news/latest-news/?view=PressS&id=20517220

[13] John Christensen was Economic Advisor to the States of Jersey from 1987 to 1998.

[14] Personal communication with John Christensen, March 2010. Interestingly, the Liberal Democrat-Conservative Coalition government from May 2010 saw the Liberal Democrat Vince Cable given a senior Department of Business ministerial role to oversee reforms to the City of London and the UK banking sector. Cable has been highly critical of offshore finance and so his appointment is unlikely to be what the offshore sector had been expecting (Sibcy, 2010).

[15] Interestingly, the Foot Review remit did not include London, arguably the largest and most significant offshore finance centre (and tax haven) in the global financial system.