THE TAX HAVEN MODEL: A FRAGILE ECONOMIC FOUNDATION

feature

Nicholas Shaxson

The Tax Justice Network likes to remind people how tax havens impoverish other countries using secrecy, zero (or ultra-low) taxes or weak regulation to attract wealth-creating capital out of them, depriving the victim nations' governments of tax revenue for development.

Defenders of tax havens point to high income growth and wealth in several tax havens as evidence of their success (see box). Yet although tax havens extract wealth, they have failed to demonstrate how or where they add value in the process of wealth creation. And behind the headline numbers on economic growth, a different story emerges, which is especially pertinent for island havens. John Christensen's article in this edition of TJF examines his native Jersey to highlight some of the human costs of being a tax haven, and reveal similarities with a "Resource Curse" afflicting many mineral-rich economies, where strong headline GDP growth and high wealth per capita mask high domestic inequality, poverty, social tensions, corruption, and the withering away of alternative industries.

This excerpt from Britain's *Daily Telegraph* newspaper in December, illustrates the lives of ordinary people in one of the Caribbean's prime tax havens:

> *Tony Black lives on the richest island on Earth. Today is a typical day: after driving a taxi for eight hours, he will head to a warehouse, where he has an evening job operating machinery. Late tonight, he will move on to his third job, as a nightclub bouncer. At weekends, Tony, 28, drives a truck. "I'm a young black man who's still working four jobs," he said. "I still can't afford my own home."*
>
> *Tony's story is not unusual. Bermuda has the highest GDP per capita in the world – 50 per cent higher than America's – and it has zero unemployment. Mega-wealthy Britons, among them actress Catherine Zeta Jones and insurance magnate John Charman, rub shoulders with even wealthier American tycoons such as Ross Perot and Michael Bloomberg. Meanwhile, the average black Bermudian takes two or three jobs just to make ends meet. And the problem is worsening. Now the issue of inequality has spawned a power struggle that some say risks destroying the tax haven's economy overnight. One Brit - who, like most executives, does not want to be named for fear of making matters worse – said: "My son got home and said: 'Dad, am I a racist?'*

Global top-10 countries by GDP

1	**Luxembourg**	$71,400
2	**Bermuda**	$69,900
3	**Jersey C.I.**	$57.000
4	**Equatorial Guinea**	$50,200
5	**U.A.E**	$49,700
6	**Norway**	$46,300
7	**Guernsey**	$44,600
8	**Ireland**	$44,500
9	**U.S.A.**	$44,500
10	**Cayman**	$43,800

Source: CIA, 2007; note: countries in red are tax havens.

Tony Black's story reminds me of a man I once met in the corrupt oil emirate of Equatorial Guinea. He was helping chop down part of a forest to make way for an oil terminal in the once-beautiful port of Luba. He worked a fifteen-hour day, on pitiful wages, and was lucky to get that. The oil-rich island's once-proud cocoa industry, one of the biggest employers, had all but collapsed in the face of the oil boom. In the UN's latest Human Development Index, Equatorial Guinea has the dubious distinction of having the world's third worst negative difference – 54 places – between its ranking in terms of human welfare and its income per capita.

When well-funded libertarian institutes proclaim that being a tax haven will make you rich – look behind the headlines, and never forget the harm tax havens cause to other countries. And remember, of course, that international initiatives aimed at curbing tax haven abuses focus on protecting the tax systems of rich countries, leaving poor, more vulnerable countries unprotected.

The tensions in Bermuda highlight one of several reasons why tax haven economies – especially small islands with little else to fall back on – are inherently unstable. But there are other reasons. Murphy's article, on page 5, highlights intense rivalry and tax competition between three jurisdictions of the UK Crown Dependencies, which is destabilising their economies and politics. In a past edition of TJF,[1] Sheila Killian described how pressure from other tax havens has forced her native Ireland into a second round of tax competition, with worrying implications

"Tax havens extract wealth, but have failed to demonstrate how they add value in the process of wealth creation."

[1] Vol. 3, Issue 1: First Quarter 2007, p6

"Island tax havens are heavily exposed to boom-bust swings in international finance; if the current international "credit crunch" proves to be as deep and durable as some fear, many havens face a bitter future."

for Ireland and with sinister implications for poor countries elsewhere.

As Christensen describes, when the financial sector becomes dominant in an island economy the result is political "capture" by the lobbyists and cheerleaders for financial services. The dominant sector also sucks skilled personnel out of the others, eroding them further; and by raising prices locally, people in other sectors are effectively poorer and further marginalised.The dominant sector thus becomes yet more dominant.Again, this is a bit like like mineral-rich economies afflicted by the Resource Curse, where the natural resource sectors crowd out other productive sectors like agriculture, manufacturing or tourism, leaving politicians to rail impotently about the receding dream of economic diversification. Like oil-dependent economies vulnerable to world oil prices, island tax haven economies are heavily exposed to boom-bust swings in international finance; if the current international "credit crunch" proves to be as deep and durable as some fear, many havens face a bitter future.

These are not the havens' only vulnerabilities. In the past few months we have noticed a sharp increase in interest in tax justice issues. In the UK, non-governmental agencies and journalists are fast catching on to the scandal of offshore: an example of the awakening is TJN's ongoing campaign against abusive tax privileges being offered to wealthy "non-domiciled" UK residents, which has caught the public imagination and forced changes in the law. At the time of writing this, Barack Obama had just won the first U.S. Democratic primary in Iowa, with John Edwards in second place. Obama has co-sponsored the "Stop Tax Haven Abuse Act" in the U.S. Congress; Edwards has said that "as president, I will declare war on offshore tax havens." The race is still wide open, but more and more Americans would agree with him. Chavagneux and Palan, writing in the last edition of Tax Justice Focus (page 1) describe a palpable mood swing in the European Union in the last two or three years against tax havens and tax abuse.

The global mood is shifting against tax havens, and TJN is working to push it further. Gambling an economic future on being an island tax haven looks like a risky bet.

Nicholas Shaxson is a consultant to TJN and an editor of Tax Justice Focus, an Associate Fellow of Chatham House, and author of the book "Poisoned Wells: the Dirty Politics of African Oil," Palgrave MacMillan, 2007.

news and research

Letter from Geneva

2007 Meeting of the UN Tax Committee: Link with FfD Process?

This year's meeting of the UN Tax Committee between 29 October and 2 November in Geneva disappointed the TJN delegation that attended. The Committee is not driving a development-centred global tax agenda forwards, and is far short of realising its potential. Yet it is, unlike the far more influential OECD, the only multilateral institution dealing with global co-operation on tax.

After the UN conference on 'Financing for Development' (FfD) in Monterrey in 2002, the UN Economic and Social Council decided that the Committee would be administratively and politically linked to the FfD process, and the Committee's mandate was clarified in 2004, stating that the committee "give special attention to developing countries and economies in transition." Its mandate unequivocally allows it to address all major tax issues, such as capital flight and tax havens, exchange of information, the adequate taxation of multinational corporations, and so on.

The Committee (whose full name is the UN Committee of Experts on International Cooperation in Tax Matters) consists of 25 experts, mostly high-ranking officials of their national finance ministries, acting in their 'personal capacity'. Delegates from many UN member states also attend and actively participate in meetings. Yet it was clear that most Committee members (and tens of delegates from UN member states) have little affinity with the FfD process – and representatives from important countries bluntly admitted this when asked how they could contribute to Doha. This is regrettable, since a high-level FfD follow-up Conference is scheduled in Doha, Qatar from November 29 to December 2, 2008, and the Committee could have a substantial positive input.

Instead of firmly addressing political questions, the discussions were highly technical. The Committee traditionally spends most of its time modifying the 'UN Model Double Taxation Convention between Developed and Developing Countries' which guides how taxing rights are allocated between tax payers' home and host countries. (Double taxation conventions or treaties are enormously important: among other things they dictate where multinationals pay tax, and many of them let multinationals shift tax payments out of poor countries where their activities are located and into rich ones or tax havens – depriving poor countries of many billions of dollars in potential revenues.) The Committee holds extensive technical discussions on the wording and phrasing of a document that is important, but is also not binding, and only