South Pacific tax havens: From leaders in the race to the bottom to laggards in the race to the top?

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Abstract

This paper examines the fortunes of South Pacific tax havens in light of recent international campaigns to raise minimum regulatory standards. The paper is structured around three puzzles. The first is that although offshore sectors have generated meagre returns and are now associated with rising costs, this has not prevented existing players mounting a spirited defence of their offshore sectors. Secondly, although Pacific islands states would seem to be highly vulnerable to international pressure, they have also been the most recalcitrant in response to international regulatory initiatives. The third puzzle is that although onshore countries and international organisations bemoan the negative consequences of Pacific tax havens, they have been unwilling to offer the tiny sums necessary to buy out these offshore centres.

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The smallest and most remote states in the world are found in the South Pacific, and these countries starkly represent the tension between the special prerogatives accorded to all sovereign units in international society, and the challenges developing states have in matching these legal prerogatives with effective governance and economic viability. Having little else to fall back on, South Pacific island states have attempted to sell or rent out some of these sovereign rights to meet development goals. This has taken the form of selling international phone codes, country internet codes, passports, flags of convenience...
for commercial shipping and, most importantly for this article, countries setting themselves up as tax havens (Hampton & Abbott, 1999; Palan, 2003). While the physical and economic destruction of Nauru, an island state which for all but a 200 m strip around its coastline, is an abandoned phosphate mine, or the political collapse of the Solomon Islands that produced an Australian-led intervention in July 2003, illustrate the potential for state failure in the South Pacific, tax haven status has seemed to offer a world of promise. Island states and territories in other parts of the world, with equally tiny populations and even more scarcely endowed with natural resources, have achieved a high level of development through selling offshore financial services. Success stories like the Cayman Islands and Bahamas are seen as demonstrating the potential benefits to aspiring tax havens, which hope to overcome the handicaps of size and remoteness.

The hopes generated by setting up as a tax haven have, however, largely failed to materialise in the South Pacific. The offshore sector relative to Caribbean countries is much smaller, with a greater concentration on lower-margin, lower skilled and ‘brass plate’ or ‘booking centre’ activities, which involve providing a legal address for foreign investment. Until around 2000 competition had occurred mainly by trying to under-cut the competition both inside and outside the region by lowering prices and regulatory demands, which in turn had tended to produce a ‘race to the bottom’ effect. Revenue flows to governments in the region have been very small, both in absolute terms and relative to the overall economy, and few of the hoped-for spin-off benefits have materialised. Not only have the rewards from offshore activity generally been disappointing, in the last 5 years the costs of being a tax haven, both economic and political, have greatly increased. A series of international initiatives have been launched by such bodies as the Organisation for Economic Co-operation and Development (OECD), the Financial Action Task Force (FATF) and the Financial Stability Forum (FSF) to impose higher regulatory standards on tax havens (Gilligan, 2004). Pacific tax havens are now faced with a daunting scissors effect, whereby the regulatory costs associated with providing offshore financial services are being forced up, while declining financial secrecy and more demanding regulatory requirements are causing a decline in business and associated government revenue from licencing fees.

In these circumstances, this article aims to examine three puzzles relating to Pacific island tax havens. The five countries examined (the Cook Islands, Nauru, Niue, Samoa and Vanuatu) offer extreme instances of the broader conflict between the demands of new global regulatory standards for the cross-border market in financial services, and the traditional powers of states (see Van Fossen, 2002a, 2003). The first puzzle is that Pacific havens have all been disappointed in the progress and proceeds from their offshore financial centres, which have nowhere met expectations and contribute very small sums even relative to the small size of the rest of the economy. However, this has not prevented a spirited defence of existing offshore sectors, as alternative prescriptions for economic viability have been lacking. Despite the scant evidence so far, island states continue to hope for substantial and generalised benefits to arise from their offshore sectors. The second puzzle is that Pacific tax havens, which are in many ways poorly placed to resist recent multilateral initiatives relative to targeted jurisdictions in the Caribbean and Europe, have nevertheless put up the most determined resistance. Because South Pacific offshore sectors are so marginal, the new multilateral standards have often been seen as tantamount to a death sentence for the
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