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# Why worry? The impact of the OECD harmful tax competition initiative on Caribbean offshore financial centres

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## Abstract

The economies of small states are vulnerable to a variety of external factors—economic, political and environmental. One economic/financial factor confronting those small states with offshore financial centres has been the effort by the OECD to eliminate tax arbitrage (harmful tax competition). A related initiative to eliminate money laundering and combat the financing of terrorism has increased the regulatory responsibilities and costs to these small jurisdictions and represents an example for the potential consequences of the OECD project. Using economic data from several Caribbean jurisdictions, this article investigates the direct impact of these international programmes to increase financial regulation upon their financial services industries. Two specific outcomes are demonstrated: a reduction in employment opportunities and

a decline in government revenues. At present this situation bodes ill for the continued operation of offshore financial centres as a method towards achieving economic development.

Key words:

Small states

offshore finance

harmful tax competition

money laundering

OECD

FATF

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## Notes

1. A brief note on terminology. Offshore financial centres are found within sovereign states and non-self-governing territories (such as the Cayman Islands, Jersey and Hong Kong). The term 'jurisdiction' is used when both territorial entities are the topic of discussion.
2. An offshore financial centre provides more than just banking services. In the Caribbean various jurisdictions also specialize in providing international business company registrations, insurance company registrations, shipping registrars, and mutual and hedge funds.
3. This determination of 'global welfare' is demonstrated by a singular example suggesting that "global welfare enhancing cross-border capital flows" was a process that had "improved welfare and living standards around the world by creating a more efficient allocation and utilisation of resources." (OECD, [1998](#), p. 14)

4. In addition to the jurisdictions covered here, Williams et al. ([2005](#)) briefly discussed the offshore financial centres of Anguilla, Antigua and Barbuda, Barbados, the British Virgin Islands, Grenada, and St Kitts and Nevis.
5. The remaining jurisdictions are: the sovereign states of Antigua and Barbuda, Barbados, Grenada, St Kitts and Nevis, and St Lucia; the British non-self-governing territories of Anguilla, the British Virgin Islands, Montserrat, and the Turks and Caicos Islands; the Dutch non-self-governing territories of the Netherlands Antilles and Aruba; and the USA-associated Commonwealth of Puerto Rico. To this list of Caribbean offshore financial centres, the North Atlantic island of Bermuda is often added.
6. Space does not permit a full exploration of the tax competition literature, which goes back at least to Charles Tiebout's ([1956](#)) article 'A pure theory of local expenditures'. Let it simply be noted here that, while there is general agreement on the existence of tax competition, there is no agreement on whether it is in fact harmful, rather than beneficial. See Edwards and Keen ([1996](#)); Schulze and Ursprung ([1999](#)); and Wilson ([1999](#)).
7. For example, Oxfam argues that for developing states alone the lost taxes amounted to \$50 billion annually (Oxfam, [2000](#)). More recently the Tax Justice Network has estimated a tax loss of \$255 billion from wealth deposited offshore (Tax Justice Network, [2005](#)).
8. The other jurisdictions identified on this first 'blacklist' were Belize, the Cook Islands, Cyprus, Gibraltar, Guernsey, the Isle of Man, Jersey, Israel, Lebanon, Liechtenstein, Malta, the Marshall Islands, Mauritius, Monaco, Nauru, Niue, Panama, the Philippines, Russia and Samoa.
9. As of October 2005 the FATF blacklist had been reduced to Burma and Nigeria (FATF, [2005](#)).
10. In 1983 Richard Johns identified five major offshore financial centres in the Caribbean basin—Bermuda, the Bahamas, the Cayman Islands, the Netherlands Antilles and Panama. (Johns, [1983](#), p. 191).
11. Percentages calculated from Eastern Caribbean Central Bank data on GDP by economic activity at factor cost, in constant prices. See Eastern Caribbean Central Bank Research Department ([2004](#)). Total GDP in 1988 was 351.7 million Eastern Caribbean dollars, and grew to 415 million (constant prices) by 2003.

12. The Category 'B' Banking and Trust licence is issued specifically to firms providing services to international markets and performing inter-bank transactions.

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