

Taxes and Transnational Treaties: Responsive Regulation and the Reassertion of Offshore Sovereignty

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Regulatory dialogue between states with widely diverging tax systems has emerged as a key feature of Organization for Economic Cooperation and Development (OECD), International Monetary Fund (IMF), and European Union (EU) initiatives on Offshore Finance Centers (OFCs) or tax havens. This has brought together states of differing dimensions in size, population, economy, and power. Where there is such a discrepancy in power between states there is often a temptation to assert a command-and-control regulatory approach. This was the initial reading of the OECD's Harmful Tax Practices Project that demanded tax havens—mostly small states in Europe, the Pacific, Indian Ocean, and the Caribbean—repeal financial secrecy legislation and commit to Tax Information Exchange Agreements (TIEAs). As these initiatives have unfolded there has been a transition away from regulation by command-and-control towards responsive regulatory dialogue in which tax havens have been encouraged to cooperate through engagement and active participation. Based on qualitative research with key stakeholders in OFC jurisdictions and multilateral organizations, this article explores this transition towards meta-principles of responsive regulation. The preservation of tax bilateralism has limited the capacity of multilateral organizations to deploy the full range of regulatory techniques, particularly those involving penalty and coercion. Instead all parties, tax haven states and multilateral institutions alike, have been confined to the broadest base of the regulatory pyramid. Responsive regulation can end up having the opposite effect from what is intended where the enforcement peak of the regulatory pyramid is absent. This has resulted in strengthening the sovereignty of small OFC states and has increased international tax competition, rather than reduced it.

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I. INTRODUCTION

In 2003 Marc Forme, the Prime Minister of Andorra, commenting on the European Commission's Savings Tax Directive, observed that "The whole thing does not end with Andorra, Monaco or Liechtenstein. I would like to know what other countries like the United States, Singapore and Taiwan think about the fiscal directive on savings, *because money is volatile and if in the end Europe applies the directive it will see capital flee to these other countries*" (Forme, cited in Lomas: 2003, emphasis added). The Prime Minister was pointing to the fact that while financiers may use global circuits for transnational business transactions they still follow bilateral routes, moving from country to country in the pursuit of the most advantageous conditions for tax-free investment. The mobility of capital is bound by few multilateral agreements, but is rather liberated by the multiple bilateral policies and conditions set by national governments and their tax systems.

Since 1990 Offshore Finance Centers (OFCs)—more commonly known as tax havens—such as Andorra have come under pressure to abolish excessive bank secrecy and implement Tax Information Exchange Agreements (TIEAs) with countries that believe their tax revenues are being undermined by offshore products and services. Tax-oriented initiatives pursued by the Organization for Economic Cooperation and Development (OECD) and the European Union (EU) are paralleled by the Financial Action Task Force (FATF) and the International Monetary Fund (IMF); the former concerned with money laundering, the latter with the systemic risk that poorly regulated OFCs pose to the world's financial markets.

This article is concerned with three multilateral initiatives in offshore finance: the OECD's Harmful Tax Practices Project (2001), the EU's Savings Tax Directive, and the IMF's offshore financial assessment program. These initiatives have brought together states of widely differing dimensions in size, population, economy, and power. Where there is such asymmetry between states there is often a temptation to assert a command-and-control regulatory approach. As these initiatives have unfolded, however, there has been a transition away from regulation by *control-and-command* towards responsive regulatory dialogue in which OFC states have been encouraged to cooperate through engagement and participation.

This article considers this transition from command-and-control to responsive regulation of the offshore involving *meta-regulation*, which Braithwaite defines as the "risk management of risk management" (2003: 1). Tax-haven states have made commitments through Memoranda of Understanding (MOU) rather than a legally enforceable multilateral agreement. The international public law principle of *estoppel* makes the enforceability of these MOU commitments doubtful (Gilmore 2001). The combination of meta-regulation, estoppel, and the asymmetrical regulatory relationship between the "offshore" and the "onshore" has resulted in multilateral initiatives being replaced with bilateral TIEAs that have their origins in the worldwide

system of Double Taxation Agreements (DTAs). This reinvigorated bilateralism, at the expense of multilateralism, has enhanced the sovereignty of many OFC states, leading to their continued appeal as locales from which to organize low-tax transnational business ventures.¹

This article argues that through allowing OFCs to demonstrate their good governance to the world through compliance, they maintain their client base and sustain an ongoing fiscal competition between states for tax revenues. They build upon existing bilateralism in international taxation and the diffuse and fragmented character of international capitalism and in doing so reassert their own sovereignty (Braithwaite & Drahos 2000: 97–99, 108–14; Palan 2003: 181–91).

II. METHODS FOR META-REGULATION

This article is informed by interviews with 48 accountants, lawyers, regulators, fund managers, insurers, CEOs, legislators, and fiduciaries in Australia, Andorra, Guernsey, France, Samoa, and Singapore between December 2002 and October 2004. Most research participants were either lawyers or accountants. Interviews were semi-structured and open-ended, allowing interlocutors to raise issues that were meaningful and relevant to them. These interviews canvassed the effects of multilateral initiatives to regulate OFCs, changes in client profile and market response, motivations for using offshore structures, and cross-border tax planning techniques. They also covered the way firms were dealing with self-regulation in response to international initiatives.

McCahery and Picciotto (1995) show that the specialized knowledge of professionals, particularly lawyers, allows them to mediate the abstract domain of formal rules on the one hand and the financial aspirations of their clients on the other. They are able to interpret unclear laws and take advantage of regulatory diversity that characterizes OFC states and national tax regimes for wealthy individuals and corporate clients. Through the practice of “lawyering” (and this can be extended to cognate professions such as accountancy), rules and regulations can be transformed by a process of “indeterminacy,” taking advantage of legal ambiguity (McCahery & Picciotto 1995: 244). This is crucial in understanding multilateral initiatives aimed at curtailing tax-haven use. The principles (such as transparency) and rules (for instance, that records must be maintained to an acceptable standard) devised by multilateral organizations and offshore financial authorities are subject to divergent interpretations between regulators and regulatees. It is social actors—lawyers, accountants, fund managers, tax compliance regulators—who frame these contests, through their daily deeds and narrated reflections on their practices.

These actors are involved in processes of meta-regulation. Through their socially mediated professional practices they are increasingly adopting or absorbing meta-principles in the regulation of “the offshore.” The interlocutors interviewed for this research are crucial in the management of this

risk. The IMF views OFC states as potentially destabilizing markets. They must be strengthened in order to minimize this risk. Tax administrators in OECD countries and the EU perceive them as risks to the integrity of national revenue-collection systems. These two risks are not identical and in the arbitrage between the two, key actors within OFC states in both public and private sectors manage the intersection of competing risks to sustain offshore viability. In this way, multilateral organizations and supranational institutions have increasingly invested self-regulatory capacities in leading OFC states. The methods employed for this research invoke actor-centered descriptions and accounts of the processes involved in this self-regulation.

Offshore Financial Centers are moving towards a position whereby they regulate themselves with organizations such as the OECD and IMF having broad oversight functions. Offshore finance designed to minimize taxes involves volatile risks. By establishing best-practice principles and applying them offshore, these regulatory standards are enhanced and given increased credibility. OFC states that can not implement these principles face crisis, and in some cases (for instance Tonga and Niue) have closed down. However, this is not a predicament for states that have adopted meta-principles as a consequence of complying with international best standards of practice in the financial sector. For example, as one regulator observed, they “used to focus on money transfers to and from the Netherlands Antilles.” Now that the Netherlands Antilles have committed to the OECD’s Harmful Tax Initiative, that “jurisdiction is not so much of a problem” (Interview Sydney, August 2002). It does not follow however, that the Netherlands Antilles can no longer offer attractive tax concessions to transnational citizens.

Braithwaite (2003: 3) observes that meta-regulation involves “shaping the risk management systems of other organisations in the taxpaying environment.” For the OECD this means that OFC authorities must provide a regulatory framework for fund management companies, banks, insurers, trustees, and stock exchanges that is transparent and accountable. This is an inter-subjective endeavor involving actors networked in both onshore and offshore sectors. Offshore organizations (companies and state agencies) must enforce rules for due diligence that establish the true identity of their clients (see Maurer 2005 for more details on due diligence offshore). Know Your Customer rules need to be implemented. Offshore financial providers must demonstrate that they can identify the beneficial owners of the entities that they manage.

Strategies of regulatory devolution are most successful when the meta-regulator has the capacity to escalate “interventions of ever-increasing intrusiveness” (Ayres & Braithwaite 1992: 6; see also Braithwaite 2003: 13). Braithwaite (2003: 14) shows that in their monitoring competencies, meta-regulators scan for risks and move to those areas of highest risk. However, when dealing with OFC states this option is problematic because they are protected by the barrier of sovereignty and the option of bilateralism. These international initiatives have brought small OFC states into a fiscal conversation,

and in this dialogue small OFC states have won important concessions from organizations representing some of the most powerful nations on earth. They have been able to devise “proliferating alternative models of regulation” whereby “the weak create opportunities for themselves to change existing regulatory orders” (Braithwaite & Drahos 2000: 7).

The methods used in the research for this article are useful for assessing the efficacy of responsive regulation offshore. Meta-regulation, as an important technique of responsive regulation involves reflexivity, consultation, dialogue, and a responsive appreciation of industry sector that can best be appreciated by inter-subjective research techniques that a cross-section of stakeholders involved in offshore and onshore sectors articulate. These actors are in an ideal position to comment on the offshore, because their practices and social networks make macro structures possible. It allows the micro to be reconciled with the macro. As Braithwaite and Drahos affirm: “The methodological prescription is to gather data on the most macro phenomena possible from the most micro source possible—individuals, especially individuals who act as agents for larger collectivities” (2000: 14). In this way methods for studying meta-regulation are provided.

III. OFFSHORE FINANCE CENTERS AND MULTILATERAL INITIATIVES: AN OVERVIEW

Offshore Finance Centers have come under increasing international scrutiny as sites of questionable tax planning activities and potential money-laundering conduits, gaining pace in 1998 with the release of the OECD’s report on “harmful tax practices.” The initiatives of the OECD, the EU, and the FATF have been well documented (Eden & Kudrle 2005; Gilligan 2003; Gilmore 2001; Hampton & Christensen 2002; Maurer 2005; Palan 2003; Rawlings 2005; Sharman 2005, 2006; Sikka 2003; Van Fossen 2003). The OECD has focussed on exchange of tax-related financial information between OFCs and OECD member states in efforts to reduce “harmful tax competition” by lowering barriers of bank secrecy.

The OECD opened its campaign against OFCs by announcing that “defensive measures,” including a range of sanctions, could be imposed on non-compliant states, limiting their ability to participate in world financial markets (OECD 1998, 2000, 2001). The IMF has taken a more conciliatory approach and has concentrated on improving prudential regulation in OFCs (Erico & Musalem 1999). The EU Savings Tax Directive issued in 2003 gave both member (particularly Austria, Belgium, and Luxembourg) and non-member states (Switzerland, Liechtenstein, Andorra, Monaco, San Marino, the British Overseas Territories, and the Crown Dependencies of Guernsey, Jersey, and the Isle of Man) the option of exchanging information with other EU member states *or* levelling a withholding tax on interest income in lieu of information exchange (Commission of the European Communities 2001,

2003). The EU has limited its negotiations to only a small number of non-member jurisdictions. It does not apply to independent Caribbean, Pacific, or South East Asian OFCs.

These initiatives provoked widespread opposition when they were first announced. For example, Owen Arthur, the Prime Minister of Barbados, protested that the OECD and related organizations were “institutional imperialists” and the proposals were “tyrannical” (Hetherington-Gore 2000). Despite this initial opposition, 33 OFCs² have now entered into dialogue with the OECD over these proposals, leading to a series of global and regional meetings bringing together both parties between 2000 and 2005. They are now engaged in ongoing talks to establish common principles of transparency and standards for exchange of information. The OECD has moved away from a command-and-control regulatory style to one involving dialogue, with prospects for coercion moved to the background.

All three of these initiatives have brought powerful states and multi-lateral institutions into negotiations with small OFC states. As one regulator from an OECD country remarked:

At least once a year governments of places where you'd normally think “where is that?”, basically get to sit down with the large economies and discuss issues that are relevant, including tax legislation. At least they get the attention of people they normally wouldn't get the attention of. This has two advantages for them. For one, they are at the table with the largest, most developed countries. Second, *they are inside the process and they can influence it.* (Interview Paris, February 2004, emphasis added)

The transition away from enforcement to a management regulatory approach, whereby the “largest most developed economies” have moved from attempting to dictate policy to small OFC states to incorporating them into policy formulation has been a key characteristic of OECD efforts in offshore tax regulation. The EU has taken a similar approach. The IMF has gone even further, and arguably augmented the market position of key OFCs, through its collaborative capacity-building assessments of offshore regulatory regimes.

IV. FISCAL BILATERALISM AND THE GLOBAL MARKET FOR DOUBLE TAXATION AGREEMENTS

Weak states are particularly adept at developing their own alternative regulatory models when they build into a pre-existing system (Duursma 1996). Globally, taxation has been the preserve of the nation-state, emblematic of national sovereignty (Braithwaite & Drahos 2000: 89; Picciotto 1999: 70). Braithwaite and Drahos (2000: 89) show that the national system of separate taxation systems has “cost states dearly.” Yet multinational corporations and High Wealth Individuals (HWIs) are not constrained by nationality or sovereignty. Contrasts in national tax regimes, sustained by the intersection of state sovereignty, generate opportunities for tax minimization on a massive

scale. In 1998 a British Parliamentary report estimated that over US\$6 trillion is kept offshore (Edwards 1998: 4). Approximately US\$800 billion alone is domiciled in the Cayman Islands (US\$20 million per island resident) (Sikka 2003: 367). Between US\$3 and US\$4 trillion of HWI savings are believed to be domiciled in tax havens (Oxfam 2000: 3). In 2000 the IMF estimated that there was a US\$1.7 trillion discrepancy between reported portfolio assets and liabilities caused by channelling funds through OFCs (IMF 2000). In 2001 the US Internal Revenue Service (IRS) estimated that it loses US\$70 billion per annum as a result of tax-haven activity (IRS 2001: 1). In a study of tax return data from 235 HWIs in Australia, Braithwaite, Pittelkow and Williams (2003) found that the use of offshore entities in a jurisdiction that may be a tax haven is a significant risk factor in aggressive tax planning strategies.

OFCs take advantage of the bilateral system of Double Taxation Treaties, or Double Taxation Agreements (DTAs) concluded between states. There are now some 1,000 DTAs between states (Braithwaite & Drahos 2000: 106). They were designed as a way of giving relief to companies for foreign-source income to ensure that they would not be taxed twice. While commendable in some respects, the bilateral system of DTAs is fraught with dilemmas for national authorities, and rich with opportunities for transnational citizens.

As tax regulation was never internationalized by way of a multilateral agreement, but rather dichotomized between states in an ever-increasing number of DTAs, multinationals could take advantage of diversity in types, rates, and definitions of tax. Braithwaite and Drahos note that one consequence of this was that "Poorly designed and enforced double tax treaties often meant that tax was paid in neither state" (2000: 94). OECD states responded by introducing ever more complex legislation, such as Controlled Foreign Corporation (CFC) rules, which simply exacerbated the problem for them and created more opportunities for multinationals and HWIs to engage in arbitrage and reduce their tax liabilities (Burns 1992; OECD 1996; Inglis 2002). One interviewee explained it by saying "In Singapore you have gift and estate tax, but in the US you only have estate tax, and there, there you have it; the difference in between the two immediately creates opportunities for tax planning" (Interview Singapore, February 2004). In Andorra, accountants interviewed specialized in using DTAs. All transactions had to be declared to a client's home revenue authority. DTAs could then be invoked to reduce tax liabilities in one's home country from 35 percent to 5 percent (Interview Andorra La Vella, December 2003).

Between 2002 and 2004 these multilateral initiatives have unfolded in such a way as to encourage bilateral DTAs rather than a multilateral agreement on tax exchange of information and related matters. Moreover, until the initiatives of the OECD, EU, and IMF were launched many OFCs did not have DTAs. OECD and EU states avoided entering into DTAs with OFC states on the grounds that they were "tax havens." The U.S. even terminated a number of DTAs that it had with Caribbean countries in the 1980s because

of their status as tax havens (Eden & Kudrle 2005: 114). Now however, DTAs, either as part of or separate to TIEAs are proliferating as a direct consequence of OECD, IMF, and EU initiatives. Even if exchange of information agreements do not have the full suite of reciprocal rights and obligations as DTAs, Braithwaite & Drahos note that “Mutual Assistance and information exchange have followed the same path ways laid down by bilateral treaties” (2000: 109). These bilateral agreements have increased the legitimacy of specific OFC states, while undermining the legitimacy of others. They have allowed key OFC states to build upon a key resource that has been deployed in attracting HWI and multinational clients for the past half century: political stability and its accompanying “good reputations.”

V. COMPLIANCE AND SOVEREIGNTY

Through complying with these initiatives OFC states have reinscribed their reputation and political soundness in the eyes of investors and have become jurisdictions characterized by “good governance” meeting the highest international standards. They continue to be ideal locales for structuring transnational business ventures. Thus, these multilateral initiatives have had the reverse effect of what they originally intended: through allowing OFCs to demonstrate their good governance to the world they maintain their client base and sustain an ongoing fiscal competition between states for tax revenues. The preservation of fiscal sovereignty and a redefinition of reputation and governance enhances the viability of key OFCs, such as the Cayman Islands, Bermuda, Jersey, Guernsey, and the Isle of Man. These initiatives reinforce the sovereign, because they demonstrate that their systems are robust and well-regulated. MOU declarations followed by the more discrete, confidential, and private negotiations involved in drafting bilateral exchange of information treaties end up legitimizing many of the key features that make OFC states so attractive to transnational business and HWIs.

These international initiatives also strengthen the position of many of these states because they allow them to play upon their own constitutional ambiguity. For example, the capacity to conclude bilateral and multilateral treaties is usually confined to fully independent states. In the case of Guernsey, the United Kingdom would normally sign treaties on behalf of the island. In February 2003, however, Guernsey (together with the Isle of Man and Jersey) signed a bilateral tax information exchange agreement with the United States. While 60 percent of respondents on Guernsey reported that these initiatives, leading to greater participation in bilateral exchange of information agreements, were having an impact on their firms, not one said that they were affecting the long-term viability of their business or the offshore sector. The most noticeable effect was increased compliance costs associated with due diligence checks, an increased number of mergers and acquisitions,

and a consolidation of the very wealthy end of the market (Rawlings 2005). One trustee said that these initiatives are “going to be good for Guernsey,” because they are proving that small trust companies can compete and retain clients, while enabling them to diversify into the HWI market (Interview Guernsey, January 2004). Another said these initiatives allow OECD and EU countries:

to strike up bilateral relationships with smaller territories. The EU Savings Tax Directive allows us to have treaties of information exchange with the EU members proving that the island can deal internationally. The EC can make prejudicial rulings that disadvantage members in their international relationships, for example a tax agreement between Dublin or Luxembourg and Brazil. This does not apply to the Channel Islands. We can deal directly with Brazil if we want to. The more bilateral relationships we have the better. They also provide a contribution as to how one should regulate to the best standards internationally. This is good for Guernsey. (Interview Guernsey, January 2004)

The explanation for the transition away from command-and-control towards responsive regulation therefore does not necessarily lie in either OFC opposition or a decision by multilateral organizations to be more conciliatory in their approach. Rather, enforcing uniform fiscal standards at the top of the regulatory pyramid (see Braithwaite, introduction to this issue, for a discussion of the regulatory pyramid) in a global system of bilateral tax agreements is fraught with difficulties. It has made regulation by persuasion and cooperation at the base of the regulatory pyramid vital.

VI. COMPLIANCE BY PRESS RELEASE AND PRECLUSION BY ESTOPPEL

Listed jurisdictions have been able to make a commitment to the OECD’s harmful tax practices project by way of MOU using a press release or a public letter. This included a time-line on commitments to transparency, information exchange, the abolition of ring-fencing (where domestic companies are taxed at a different rate to offshore companies that are taxed at a lower rate, if at all) and refraining from introducing additional harmful tax measures. While commitment by MOU signalled an intention of compliance, it was not legally binding like a treaty.

Gilmore (2001: 555) shows that this has significance for public international law. He suggests that agreements between states using an MOU can have legal consequences given the public international law principle of estoppel. That is, if state A signals an intention of commitment to state B and state B relies on it (and relies on it to its detriment if state A reneges on its commitment) then state A is precluded, or *estopped*, from rescinding its obligation. However, estoppel is only relevant in bilateral relations between states. Gilmore (2001: 555) points out that the legal position of the listed OFC states and their MOU commitments is unclear, given that the OECD initiative is multilateral and that it initially emphasized participation by the OECD as an organization rather than its member states.

Compliance by MOU also assumes that there is a set of international standards for cooperation in civil and criminal matters. There is not. There is variation within the OECD itself. For example, the OECD Model Tax Convention on Income and Capital circumscribes cooperation between member states. A state can refuse to exchange information on the basis that there is a lack of reciprocity, if the risk of disclosure would jeopardize business secrets and if disclosure is contrary to public policy (Gilmore 2001: 559). The OFC states, through MOU, are asked to go beyond the existing minimum standards that apply to and between OECD states themselves.

The listed jurisdictions argued that this was unfair because there was no level playing field between themselves and the OECD. They were asked to implement policies that OECD countries, notably Switzerland and Luxembourg, were not committed to. Most interviewees emphasized that a level playing field was fundamental, and MOU commitments were ultimately contingent on its materialization. One interviewee in Guernsey said that a level playing field was “absolutely vital” (Interview Guernsey, December 2003). Another added “we have insisted throughout our negotiations that we won’t implement these commitments if the OECD members don’t do so themselves. These larger countries do not enforce the laws that they have sought to impose on other countries such as ourselves” (Interview Guernsey, January 2004).

This provision was made explicit in some of the MOU commitments. For example, in 2002 the commitment from Anguilla stated that the British territory “considers the establishment of a level playing field among all OECD countries and also those non-member jurisdictions with which it is materially in competition in the provision of cross-border financial services to be essential” (Banks 2002: 2). The lack of a level playing field globally has been a major impediment to implementing the MOU commitments. One interviewee, noting this, remarked that “the concept of a global level playing field will take a long time, if ever, to achieve.” In the absence of a level playing field “there are still a lot of opportunities” for finance centers such as Guernsey to take advantage of (Interview Guernsey, December 2003). Gilmore (2001) suggests that commitments to the OECD set a framework within which dialogue can take place. He states that commitment by MOU can “more appropriately be described as reflecting either standards of an evolving or aspirational nature of perceived ‘best practice’” (ibid.: 560).

With limited multilateral enforcement capacities the OECD and the jurisdictions have now established a framework whereby bilateral TIEAs can be negotiated and ratified between individual OFC and OECD states. The OECD *Model Agreement on Exchange of Information on Tax Matters* affirms that “the agreement is presented both as a multilateral instrument and a model for bilateral treaties or agreements. The multilateral agreement is not a ‘multilateral’ agreement in the traditional sense. Instead, it provides a basis for an integrated bundle of bilateral treaties” (2002: 2, emphasis added). This goes to the core of the problem as it allows OFC states to make a number of important modifications using bilateral instruments.

The OFC states have been brought into the negotiations and in doing so have succeeded in changing a number of OECD requirements on a state-by-state basis, providing precedence for other states to follow suit. For example, in its June 2004 Global Forum on Taxation in Berlin, which brings OFC states and the OECD together, St. Vincent and the Grenadines successfully tabled two proposals. The first was that the imposition of defensive measures be suspended until a level playing field was achieved. The second was that the discourse of OECD policy was changed. The requirement that countries “should” exchange information by 2006 has been replaced. They were instead “encouraged” to exchange information by that date. St. Vincent and the Grenadines interpreted this by deciding not to exchange information by 2006 until the issue of a level playing field is resolved (Lomas 2004). The MOU commitments have been substantially modified by these negotiations. This reflects the difficulty of implementing meta-regulatory principles that make full use of both cooperation and coercion within a global system of bilateral tax treaties that use OFC states.

VII. REGULATORY DIVERSITY

Cross-border international regulation is heterogeneous, not homogeneous. There is substantial regulatory divergence. The regulatory agenda of the OECD, the Australian Taxation Office (ATO), or the Internal Revenue Service (IRS) is distinct from the regulatory agenda of a financial services authority located in an OFC state. The offshore financial services authority is mandated to provide a “tax neutral” (no or minimal taxes) regulatory environment that is conducive for transnational business. The national revenue authority is commissioned to collect correct amounts of taxation, while multilateral organizations act as forums to facilitate regulatory coordination between national revenue systems. These are divergent regulatory interests, reflecting multiplicity at national (the revenue authority and the offshore financial services regulator) and supranational (the multilateral organization) levels.

There may be points of convergence between these competing regulatory agendas. For example, all might agree that transparency is important and that prudential controls should protect investors and guarantee minimum standards for depositors. It is at these points of convergence that collaborative strategies of regulation can be devised. It is these intersections of interest that give the best opportunity for building responsive regulation.

Sensationalist media accounts of tax havens usually imply that they are forms of unregulated fiscal space permitting almost any form of financial dealing imaginable. By implication, they are centers of “hot money,” which is transmitted and remitted across and through their porous borders with no regulatory oversight. Industry stakeholders in leading OFC states disagree with these assessments. One interviewee on Guernsey, commenting on the OECD initiative remarked: “Initially some thought that we were some sort of

cowboys who came from Texas, but they soon discovered that we are as professional as anywhere else in the world” (Interview Guernsey, January 2004).³

OFCs could not successfully operate if they were completely unregulated as more sensationalist reports imply. For example, the decision by the British government to turn Vanuatu, then the New Hebrides, into a tax haven in 1971–73 was not evidence of deregulation, but rather regulation. From 1906–70 there were no banking regulations in the New Hebrides. When investors started noticing the potential of the New Hebrides as a tax haven in the 1960s there were few regulations of any kind controlling business activity over and above the British Companies Act of 1948. Banks could be incorporated under this act even though it was never designed for that purpose. It was the lack of regulation in the New Hebrides that encouraged the British colonial authorities to pass legislation to convert the territory’s tax free status into an OFC (Rawlings 2004: 30).

OFC states are regulated. Their regulations maybe at variance with OECD states and they maybe minimal, but they do provide for security of contract and for the protection of property. Andorra, for example, has bank reserve requirements to guarantee deposits (IMF 2002). Guernsey has a comprehensive system of trust regulation (the only formal regulation of trusts anywhere in the world over and above common law provisions of equity and property) while Jersey has an income tax rate of 20 percent. It is thus a misnomer to suggest that all OFC states represent unregulated or poorly regulated spaces. The recognition that OFC states are regulated financial spaces has been an important starting point for emerging regulatory dialogue with the OECD and its member states.

When a government decides to take an existing state of fiscal affairs (for instance, no or low taxation) and enacts legislation to provide for an OFC this is enhanced by the formation of a regulatory authority to supervise transnational business. Leading OFC states, namely the Cayman Islands, Bermuda, Jersey, Guernsey, and the Isle of Man, have followed this pattern. By complying with international initiatives they have prospered with increasing business. For example, from 2004 to 2005 the Isle of Man recorded a 42 percent increase (UK£3.3 billion or US\$5.7 billion) in funds under management and a 16 percent increase in bank deposits to UK£33.1 billion (US\$58 billion) (Aitken 2005; Hall 2005: 2). The value of assets managed by hedge funds in the Cayman Islands increased by 23 percent between 2004 and 2005, approaching US\$2 trillion (Cayman Islands Monetary Authority 2005: 30). Between 2003 and 2004 the value of bank deposits in Jersey increased by 6 percent to UK£158 billion (US\$276 billion), the number of collective investment vehicles increased by 33 percent to 833 with their net assets increasing by 2 percent to UK£104 billion (US\$182 billion) (Jersey Financial Services Commission 2004: 12). In neighboring Guernsey the value of funds under administration and management increased by 35.9 percent, or UK£26.4 (US\$46.3 billion) in 2005 to reach UK£100 billion (US\$175 billion) (Guernsey Financial Services Commission 2006). In Bermuda the net value of collective investment funds

grew from US\$115.84 billion to US\$158.18 billion from 2003 to 2004, representing a 37 percent increase (Lowtax Net 2006a). Other centers such as the Bahamas, the British Virgin Islands, and Dubai have also reported strong growth in offshore and transnational financial services (Lowtax Net 2006b; Bahamas Financial Services Board 2006; Dubai International Financial Centre 2006). Unlisted jurisdictions such as Singapore have also recorded strong growth, with the city state's financial services industry expanding by 6 percent in 2004, up from 4 percent in 2003 (Monetary Authority of Singapore 2005: 48).

By contrast, OFC states that have not been able to effectively supervise offshore business have not been successful. For example, Tonga, which had a complete suite of offshore legislation in 2000, did not have effective regulatory capacities to monitor offshore business. One of the few ships flying the Tongan flag outside the Pacific was found to be gun-running for the Palestinians, while another had transported members of al-Qaeda, undermining the reputation and viability of the kingdom's OFC.⁴ After the OECD published its list of tax havens in 2000, Tonga closed down its offshore facilities altogether. Niue has followed this pattern and has repealed its International Business Company legislation, taking effect from the end of 2006.

VIII. CONCLUSION

When these initiatives were first announced scholars argued that the offshore faced a significant threat of erosion (Hampton & Christensen 2002: 1667). This assessment is salient as a number of states have abolished their offshore facilities, reduced the number of offshore financial products, or experienced a serious loss of business to the point where their continued viability is doubtful. Reports from some Caribbean OFC states indicate that the compliance costs of enhanced due diligence now exceed government earnings from hosting an offshore facility (Interview Sydney, September 2003). Yet other OFC states continue to prosper, particularly Guernsey, Jersey, the Isle of Man, Bermuda, the BVI, and the Cayman Islands, alongside unlisted centers of international private banking such as Singapore. Through complying with the OECD, the EU, and the IMF, offshore sovereignty has been enhanced, sustaining its continued appeal for international finance. The move towards responsive regulation has had the opposite effect of what multilateral initiatives had originally intended. But without strong enforcement capacities from the very outset, the multilateral approach was vulnerable to bilateralism from the very beginning.

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NOTES

1. Multilateralism refers to political, economic, and/or diplomatic relationships between more than two states, and usually involves agreements between a large number of countries (for example United Nations treaties and conventions). Bilateralism can be defined as political, economic, and/or diplomatic cooperation between two states only.
2. These are: Anguilla, Antigua & Barbuda, Aruba, Bahamas, Bahrain, Bermuda, Belize, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Malta, Mauritius, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, San Marino, Seychelles, St. Lucia, St. Kitts & Nevis, St. Vincent & the Grenadines, Turks & Caicos Islands, US Virgin Islands, and Vanuatu (OECD 2004: 11).
3. As one anonymous reviewer of this article has pointed out, it is not just the media that have contended that that some OFCs have been virtually unregulated and have permitted almost any form of financial dealing imaginable. This perception is also often portrayed in official government reports in OECD and non-OECD member states. Leading OFCs have been far more concerned than Nauru, Northern Cyprus, and other heavily stigmatized OFCs with maintaining the appearance of respectability. There is evidence that leading OFCs are parties to schemes and transactions that would offend the general public if it were made aware of them as it is from time to time through the media. However, I suggest this is a factor for *all* financial centers including those located in OECD countries, not just OFCs. Corporate collapses such as that of Enron and Parmalat involved regulatory failings in both OFC and onshore states.
4. I am grateful to an anonymous reviewer for pointing out the links between Tongan registered ships and al-Qaeda.

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