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Book Reviews

Tax havens: how globalization really works

Ronen Palan, Richard Murphy and Christian Chavagneux
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248 pp. £16.50 (Paperback)

Tax Havens provides a pertinent introduction to a subject that has seen a surge in popular interest in the face of fiscal austerity. This book gives the reader an up to date assessment of the current status of knowledge about tax havens through an unprecedented synthesis of material, and poses questions that will at once challenge and fascinate economic geographers. By framing tax havens and contemporary financial globalization with new insights from a range of sources and investigation methods, the authors have produced a book at home on the shelves of undergraduates, graduates and researchers alike. Central to the author's argument are the dynamic and multiple capacities of tax havens; they are about far more than tax, providing opaqueness, anonymity and thus the creation of a space for activity not permitted 'onshore'. As the authors clearly explain, the very definition of 'tax havens' is misleading, and disguises the status of major international financial centers such as London within this network. Great care has been taken to ensure that the subject area is made relevant to those for whom the intricacies of tax law are not a primary interest, and the authors draw on their experience in the fields of political economy, economics and accountancy to great effect. Throughout, tax havens are purported to be inextricable from questions of development, political economy, corporate governance, inequality and trade.

The main thesis of the book is that tax havens are not operating on the margins of the world economy, but 'are an integral part of modern business practices' (4). The authors estimate that there are between 50 and 60 tax havens in the world, and approximately 50% of all international bank lending and 30% of the world's stock of foreign direct investment are registered in these jurisdictions. Wealthy individuals are estimated to hold close to $12 trillion in tax havens—an equivalent of the US annual GDP. Tax havens are used extensively by investment banks, hedge funds and other financial intermediaries, and serviced by accountancy firms (with the 'Big Four' in the lead) and tax consultants, often from their offices in London and New York City. The authors argue that tax havens are an important contributor to the power of the City and the Wall Street as the leading global financial centers (see also *Treasure Islands: Tax Havens and the Men who Stole the World* 2011 by Nicholas Shaxson, which develops this point). Central to the existence of tax havens is their use (or rather abuse) of sovereignty, which they sell like a commodity to wealthy individuals and companies looking for opportunities to shed their responsibility toward communities and countries where they actually live and operate. Without the modern state system, founded on respect for sovereignty, there would probably be no tax havens.

Palan, Murphy and Chavagneux have structured the book carefully. Those new to the subject will find the introductory section accessible, beginning with the chapter 'what is a tax haven', before progressing to the statistics on and instruments of tax havens. It is frustrating to discover that evidence is often anecdotal or based on far-fetched estimations. This is well explained by the strict secrecy and poor reporting requirements enforced by the authorities and clients of tax havens, but nonetheless presents an empirical challenge yet to be fully addressed. Perhaps the most important contribution of this section is to provide an irrefutable definition of a tax haven based upon their activities and secrecy as a key logic, which gives short shrift to the loose descriptions designed by the territories themselves in an effort to avoid scrutiny. Unfortunately, the explanation of main instruments and techniques used by tax havens will not be 100% clear to those uninitiated in the subject. Simple examples of various techniques would probably have done a better job.

The second section offers a vivid account of the development of tax havens, accounting for their proliferation since the 1970s in relation to their long historical maturation, often the result of unintended consequence. The emergence of the International Business Company is one such example; British court rulings on the residence status of firms in the colonies created the first notion of non-taxable activity for domestically registered firms. Fascinating questions of geopolitics are raised, which delve to the very heart of the meaning of sovereignty. Why should the Cayman Islands, with the Queen as the head of state, and de facto under British control, be channeling unknown billions away from HM Revenue & Customs? Indeed, Chapter 5 provides an exciting historical account of the role of the British Empire in the tax haven phenomenon, and the UK's continued symbiotic relationship with these alleged renegades. The oft-cited 'race to the bottom' thesis is also confronted. The book suggests that a baseline level of regulation and investor protection is necessary to attract corporate interest—explaining, for example, the failure of the laissez-faire Pacific atoll states. A whole 'pecking-order' of tax havens is revealed. What is not allowed in France can be done in Switzerland, and what is not allowed even in Switzerland can be done in Lichtenstein.

Section three investigates the impacts of tax havens in both the developing and developed world. The leitmotif is the observation that through an incestuous mixture of power, politics and capital, it is a limited global elite of both individuals and businesses who benefit from tax havens. The barriers to entry in the use of tax havens are, the book argues, conducive to the consolidation of capital and a dogged resistance to redistributive attempts. In the developed world this has led to a proliferation of tax competition between states, exacerbated by the structural changes in finance since the 1970s. One of the major theoretical contributions is to demonstrate how neoclassical logics of competition and efficiency fail in relation to international tax competition. The tax haven and secrecy services offered by Switzerland, Luxembourg and Liechtenstein, for example, do not make German politicians deliver public services more efficiently. Rather, they put pressure on the middle and lower classes, as well as small- and medium-sized companies (all less able to use tax havens) to support public infrastructure, with lesser contribution from the upper class and large international companies. As the authors put it 'the aim of an artificial competition between states to reduce taxation is a direct attempt to undermine the ability of electorates to choose between otherwise viable tax alternatives' (158).

Profound problems are identified in the relationship between developing nations and tax havens. Estimates of illicit capital flows are in the region of US$1—1.6 trillion per annum, of which just 3% is estimated to be the result of corruption. Media interest in this small fraction has provided a powerful, but disproportionate, narrative in support of the 'bad governance' thesis. Recent news headlines spring to mind: an aide of Sani Abacha was jailed in July 2010 in Jersey for depositing Nigerian state finances into a private bank account; the location of the Libyan Investment Authority's funds is still unclear, with revelations of nepotism and corruption at the heart of its governance (see the blog post by the Oxford Sovereign Wealth Fund Project – Monk, 2011); Mubarak's assets siphoned illicitly from Egypt into Tax Havens are being frozen. The book rightly laments this narrow focus, which supports the worn liberal argument that 'bad governance' is the main culprit in failed capital account liberalization. Such focus places no blame at the foot of the international financial corporations at the 'supply side' of such corruption charges, and absolutely no perspective on the roughly two-thirds of illicit flows channeled by the corporate practice of transfer pricing. The book finds it unjustified that currently the World Bank and Transparency International define corruption as a purely demand-side issue. In fact, many tax havens feature as some of the best-governed countries in such ratings as the World Bank Governance Indicators.

The final section provides a précis of the fight against tax havens, with an account of the major legislative and institutional responses to their growing impact. It is this section where the most incisive analysis of current policy failures is made, critiquing policies such as mutual assistance treaties made meaningless by a fundamental lack of useful data collection within tax havens. The policy of 'blacklisting' carried out by the Organisation for Economic Co-operation & Development (OECD) and EU is exposed for both its disproportionate focus upon weaker havens and minimalist demands on those states deemed to be uncooperative, ultimately weakening the campaign. Through a careful analysis of many decades of international tax haven policy since the early years of the League of Nations, the authors command significant authority in their final recommendations and predictions. A considerable shift in the geography of tax havens is alluded to, with the EU now leading the multilateral efforts to curb tax avoidance and growth of activity in Asia, and Singapore in particular. The authors, however, seem rather optimistic about President Obama's determination to restrict the activities of tax havens.

This book should not be mistaken for another attempt to weight in on the great 'financial-crisis-book bubble'. Nonetheless, the crisis is given explicit attention, yielding the conclusion that tax havens facilitated it. This is exemplified by Granite Master Issuer Plc & Associates, through which Northern Rock conducted the bulk of its transactions in collateralized debt obligations and short-term borrowing, before they brought the bank to the brink of collapse in August 2007. Granite was registered as a UK charitable trust (!), but used to all intents and purposes as Northern Rock's shadow bank in order to lower the its capital requirements and hide its risky activities from the purview of the Financial Services Authority and the Bank of England. Granite was thus an equivalent of special purpose vehicles used in the US shadow banking. Disappointingly, we may never know how big a part of the shadow banking system operated through tax havens. The impact of tax havens on global financial stability is very much an open research question. In this context, it is disappointing to see that the recent report of the Federal System Reserve Bank of New York (Pozsar et al., 2010) on the shadow banking system does not pay any attention to the spatial structure of the system, the reality of financial centers or the use of tax havens.

The inspiration that economic geographers can draw from the book extends to normative questions and activist geography. The book advocates the introduction of country-by-country (CbC) reporting standards, whereby companies would have to present their financial statements publicly for each country in which they operate, including data on taxes paid. At present international companies are only obliged to publish consolidated statements. Richard Murphy, the CEO of Tax Research and one of the founders of Tax Justice International is the main initiator of this idea, which strikes at the heart of the tax haven phenomenon–secrecy. While it is hardly an option to intervene and influence the level of taxation determined by sovereign jurisdictions, the call for improved transparency of international companies seems justified. These companies already have and use such data, and so the additional costs of disclosure would probably be minimal. While the authors focus on the application of CbC reporting to the mining companies as a priority, in our view, such standards could be applied to all sectors, including finance. In fact, in November 2010 the European Commission opened public consultation on the possible introduction of CbC reporting. Needless to say, reliable CbC financial data would be a goldmine for research in economic geography. Geographers should embrace the call for CbC reporting.

In summary, *Tax Havens* successfully projects its subject matter into the heart of many questions of economic geography and in so doing, provides readers with an indispensable overview of impressive scope and depth. The book oscillates between providing light bulb moments, where a simple insight can elucidate a previously perplexing irregularity in the global financial system, and frustrations, where an idle statement opens up a Pandora's box of unanswered questions. The way the book is edited could be improved. Chapters would benefit from longer introductions and summaries, making the argument easier to follow. There are repetitions in places, overlooked perhaps due to the multi-authorship of the book. Many text boxes and figures are not referenced in the text, thus obscuring their links with the argument. On the other hand, the book should be praised for a brief glossary, with clear definitions of often complex and technical terms. As mentioned, the lack of empirical data is a consistent frustration, but can be seen as an exciting future opportunity for research. Although the empirical evidence used in the book is not as systematic as we wish, the authors probably deliver the best possible picture of the tax haven phenomenon. Economic geographers should surely play a role in the struggle to further the insights into tax havens and secrecy jurisdictions, and this book will be an essential reference point.

Dariusz Wójcik and Christopher Boote
School of Geography and the Environment, Oxford University, Oxford, UK

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