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BACHELOR THESIS

Government Spending in Tax-Havens

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Abstract

This thesis deals with the impact of the business of tax evasion on government spending in tax havens. The existing literature reveals two opposing views on tax havens: Some scholars found out that tax havens use their revenue generated by the business of tax evasion, and that tax havens are statistically better governed than non-havens. Meanwhile, other scholars portray tax havens as corrupt states that enable criminal tax evasion and facilitate terrorist funding. Thus, this thesis aims to answer the question "how does the business of tax evasion impact government spending in tax havens?" with the help of the cases of Liechtenstein, Belize and Vanuatu. The first hypothesis states that tax havens have a significantly higher expenditure per capita on services such as healthcare and education. The second hypothesis states that tax havens are corrupt and have issues with clientelism. The analysis finds that the first hypothesis can be accepted only for Liechtenstein. Meanwhile, the second hypothesis can be accepted for Vanuatu and Belize. Thus, the level of corruption seems to have an influence on government spending in tax havens.

Keywords

Contents

Government Spending in Tax Havens

1. Introduction

In order to attract foreign capital, there is a race to the bottom in terms of taxation among states (Dharmapala & Hines, 2009; Vlcek, 2009). However, since large states cannot afford vast tax cuts, small states with a population under 1.5 million are mostly those who win that race. Due to the resulting worldwide disparity in tax rates, individuals and companies can benefit from shifting their income and profits into tax jurisdictions with lower tax rates. Thereby, they only pay the lower tax rate and keep the difference as a premium. The resulting tax evasion and tax avoidance are important topics in international politics since they lead to billions of euros in losses for tax authorities every year (Tax Justice Network, 2020). These losses leave a significant gap in government's budget forecasts, hindering development and social planning and, in turn, harming society. The tax scandals exposed by data leaks in the past decades – including the Cum-Ex scandal, the Panama Papers or the Luxembourg Leaks – illustrate the severity of the problem. For example, the Cum-Ex files exposed €55 billion of tax evasion in Europe alone (Collier, 2020). The Organisation for Economic Cooperation and Development (OECD) estimates the annual cost of tax evasion to be between $100 billion and $250 billion worldwide (Trautman, 2016, p. 844).

Therefore, it makes sense that there is an extensive amount of research on the effects of tax evasion and tax avoidance on the world economy, and national economies. However, there is little literature on how this business' revenue impacts the havens themselves. This gap is interesting since earlier literature indicates opposing views. On one side, Corbett and Veenendaal (2018, p. 30) established that small states used their revenue from the business of tax evasion to fund huge welfare states and Dharmapala and Hines (2009) found that tax havens are better governed than states that are not tax havens – non-havens. On the other side, scholars portray tax havens as corrupt states and territories that enable the world's elite to evade taxes and help fund terrorists (Obermayer & Obermaier, 2016). Under business of tax evasion, this paper understands taxing shifted profits and benefiting from assets in the own offshore financial centres (OFCs).

This thesis aims to close the literature gap by researching how the business of tax evasion impacts government spending in tax havens. First, it will provide a theoretical background on the issue leading to a research question and hypothesis. Second, this thesis will operationalise

and conceptualise the variables central to this research and explain the research design, justify the case selection, and elaborate on the research methods and techniques employed. Third, it will qualitatively and quantitatively examine the cases of Lichtenstein, Belize, and Vanuatu. Last, this paper will present a conclusion of the findings including an outlook on further research and a critical analysis of the limitations of this thesis.

2. Theoretical Background

Due to increasing global capital flows and the emergence of the internet as a banking tool, the world experienced a rise in tax evasion and tax avoidance since the end of the Cold War (Vlcek, 2009). To avoid or evade taxes, people or companies transfer their assets or shift their profits to OFCs and to the tax jurisdictions of tax havens. Thus, they shift their assets and profits from one tax administration to the other. Rose and Spiegel (2007) define OFCs as "jurisdictions that oversee a disproportionate level of financial activity by non-residents" (p. 1310). That means that an OFC is a financial centre with clients who are primarily not residents of the respective state or territory. There, individual people can hide their assets from tax authorities, or companies can benefit from lower or even zero tax rates on their profits (Allingham & Sandmo, 1972; Burns & McConvill, 2011; Srinivasan, 1973). Small states and territories have been very active in providing services that can be used for legal purposes, such as facilitating mergers and joint ventures or ensuring equitable legal treatment in a neutral jurisdiction (Jancsics, 2018, pp. 1-2). However, those services can also be used for illegal tax evasion and money laundering (Charles, 1997).

Since small states and territories are often at a comparative economic disadvantage compared to larger states, they must exploit opportunities in niche markets (Baldacchino, 2000; Katzenstein, 1985; Vlcek, 2009). They are at a comparative disadvantage because their economies are less diverse, they have limited financial resources and a smaller domestic market (Armstrong & Read, 2003; Easterly & Kraay, 2000; Panke, 2010). Easterly and Kraay (2000, p. 2021) found that small states experience higher volatilities than larger states due to their openness. According to Armstrong and Read (2003, p. 103), the theory suggests that the size of small states hinders economic growth since they cannot create sufficient domestic economic activity. Meanwhile, Panke (2010) states that small states have limited financial resources, making international bargaining more difficult. However, Armstrong and Read (2003, p. 117), found that higher vulnerability does not lead to any economic disadvantages.

This niche of enabling financial services at a high level of secrecy and low to zero tax rates is extraordinarily profitable for the tax haven itself (Kamakura et al., 2002). The niche is profitable because even low tax rates on the shifted profit bring some revenue to the local government. Furthermore, local banks gain access to a large quantity of assets that they can use for investments and thereby generate further revenue in the tax haven. Because small states have smaller economies than large states, even small amounts of money can make significant differences. Once these revenue streams constitute a significant proportion of a government's income, a tax haven depends on its financial service sector (Armstrong & Read, 2003). Furthermore, administrations in tax havens make money by selling licenses to set up a company or other vehicles, like a holding company or a foundation. However, since there is competition among the tax havens, a standard company can be set up for as little as $350 in the territory of the British Virgin Islands, for example (Burns & McConvill, 2011).

Tax havens exist in sovereign states and autonomous territories that are still, to some degree, dependent on their metropolitan state. Nonetheless, territories enjoy certain autonomies, enabling them to establish OFCs with strict banking secrecy laws. Therefore, the particular niche that states and territories exploit when offering OFCs is their resource of jurisdictional power and their asset is banking secrecy (Baldacchino, 2006, p. 50; Picard & Pieretti, 2011). Thus, states and territories make use of their sovereignty and autonomy, respectively. This tactic is convenient since small states' jurisdictional competencies are as significant as the largest states' jurisdictional competencies. They are equal since the United Nations Charter ensures all members' sovereignty and equality under normal circumstances (Hurd, 2018). Likewise, the metropolitan states cannot interfere with the clearly defined autonomies of their territories. Hence, larger states or metropolitan states cannot make small and powerless states or territories change their policies. However, they can pressure and threaten them with sanctions (Johannesen & Zucman, 2014; Picard & Pieretti, 2011). For example, the G20 countries pressured various tax havens into signing at least twelve treaties to facilitate the exchange of information under the threat of economic sanctions, although Johannesen and Zucman (2014, p. 2) question the effectiveness of those treaties.

Baldacchino (2006, p. 54) even considers small states' strict banking secrecy laws combined with OFCs as one of five unorthodox ways for small states to secure economic development. Baldacchino (2006) called his model that describes the five unorthodox development methods for small states the PROFIT model. In this abbreviation, P stands for the people's reflection on

citizenship, residence, and employment, R stands for resource management, O stands for overseas engagement, FI stands for finance, and T stands for transportation (Baldacchino, 2006, p. 54). The model argues that small states can compensate for their small size by aiming for a diverse economy while applying policy and governance tools to exploit niches in the world economy (Baldacchino, 2006; Corbett & Veenendaal, 2018, p. 28). Unlike other models like MIRAB, TOURAB and SITE, PROFIT argues that it is disadvantageous for small states to rely solely on external funding or on a singular product like tourism (Corbett & Veenendaal, 2018, p. 28-29). Nonetheless, offshore finance and tourism businesses come with immense vulnerabilities due to their dependence on the world market (Connell, 2013).

It is crucial for a tax haven to have little to no regulation and high banking secrecy (Palan et al., 2010). Therefore, OFCs must be able to contact regulators and have the opportunity to influence them. Both requirements are given more regularly in small states than in large states, since small populations work as a single community (Burns & McConvill, 2011). Often regulators work hand in hand with the OFCs to react to the demands of the market; however, this does not mean that regulators always work on behalf of the OFCs. Therefore, it is not surprising that small states are reluctant to reduce their secrecy institutions and avoid any international regulation policy, despite the international community's constant effort (Johannesen & Zucman, 2014; Picard & Pieretti, 2011). Nonetheless, the OECD has led a massive crackdown on tax havens since the late 1990s, and consequently, the offshore financing sector decreased over the last two decades globally (Corbett & Veenendaal, 2018; Trautman, 2016, p. 840).

For tax evasion to be a profitable endeavour for a company, its productivity must meet a certain threshold (López, 2017, p. 111). In times of an economic recession, the level of profitability is lower and might be under the required level to make tax evasion profitable and worth the risk. As a result, if a small state depends on the revenue from its financial sector, it depends on the cycles of foreign economies as well. Thus, the business of tax evasion can only work if other countries are sufficiently productive. Therefore, the business is dependent on the state of other countries' economies. This connection contrasts to the finding of Easterly and Kraay (2000, p. 2023) that small states' economies do usually not correlate with the world's business cycle.

Furthermore, private individuals often use law firms that arrange a complicated net of holding companies, shell companies, nominee directors, nominee beneficial owners, real ultimate

beneficial owners and sometimes even nominee shareholders to effectively hide assets (Obermayer & Obermaier, 2016, p. 22-23). Since those services are complicated and frowned upon, if not illegal, they are expensive to set up. Since an individual who wants to hide their assets must cover the costs, the benefits of tax evasion must be at least enough to pay the expenses plus a premium that is worth getting caught. Therefore, tax evasion is only profitable if people do it on a grand scale. Here again, small states that rely on their attraction as tax havens are dependent on wealthy foreigners, who want to hide their money from tax authorities, ex-spouses, or constituents (Obermayer & Obermaier, 2016, p. 16; Picard & Pieretti, 2011).

While Corbett and Veenendaal (2018, p. 30) argue that small states, like Liechtenstein and Monaco, use the considerable profits, generated by their OFCs, to fund welfare states, Baldacchino (2014) argues differently. Baldacchino (2014, pp. 248-249) states that small states sell their sovereignty for international capital, which leads to a high probability of corruption (Hebous & Lipatov, 2014). In combination with a higher degree of clientelism, this potential for corruption and the massive amount of revenue might lead to the self-enrichment of the state's elite instead of investments to benefit the boarder public (Veenendaal & Corbett, 2020). Clientelism translates to a relationship between a patron and a client, where the patron distributes goods goods to the client in return for loyalty and allegiance (Ezrow et al. 2016, p. 150). However, Dharmapala and Hines (2009) established a linear relationship between the governance indicator[1] by Kaufmann et al. (2005) the logarithm of the respective state's GDP per capita (Figure 1). Thus, the wealthier a state is, the higher its quality of government is. However, almost all tax havens lie above the regression line (Figure 1). Thus, they have a higher governance index than they should have, according to their GDP per capita. Here we see a tension in the literature: Tax havens seem to be well governed on the one hand, but scholars often display them as corrupt states that help billion-dollar companies, terrorists, and the global elite (Dharmapala & Hines, 2009; Jones & Temouri, 2016; Obermeyer & Obermaier, 2016). Those two perceptions seem to contradict each other.

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[1] Kaufman et al. (2005, p. 5) include voice and accountability, political instability and violence, government effectiveness, regulatory burden, rule of law and control of corruption into their governance indicator.

Figure 1

Governance and GDP for Tax Havens and Non-Havens
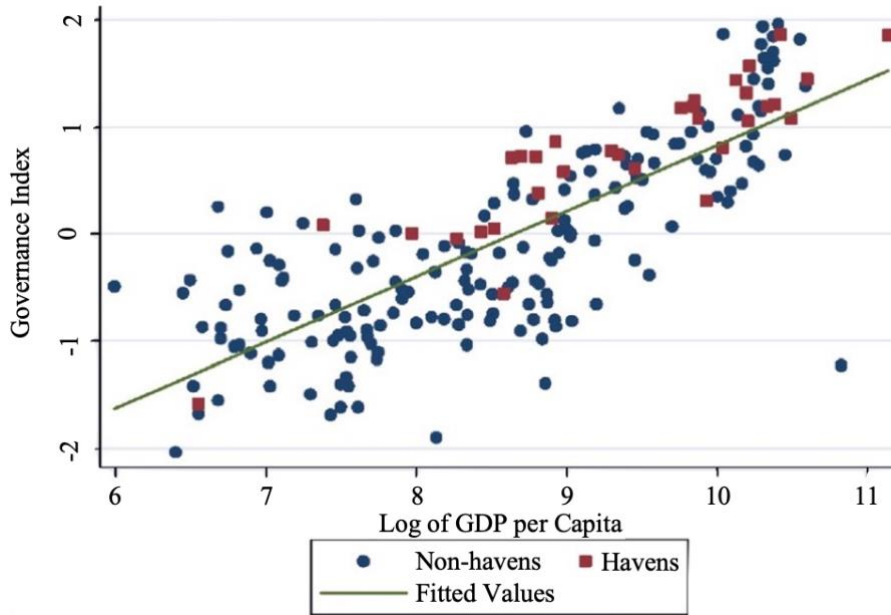
Note. Plot of government index for 2004 (Kaufmann et al., 2005) against the log of GDP per

capita based on PPP in 2004 (World Bank, 2021-c).

Source: Dharmapala & Hines, 2009

3. Research Puzzle & Hypothesis

As already mentioned, there are numerous books and articles that deal with the impact of tax evasion and tax avoidance on the world economy and the following costs for the taxpayer. However, there is a clear gap in the literature when it comes how tax havens use their profits from tax evasion and how the profits impact government spending. This gap is interesting to look at since the existing literature has opposing views on tax havens: One the one hand, Veenendaal and Corbett (2020) argue that tax havens invest the revenue from the business of tax evasion in the welfare state, and Dharmapala and Hines (2009) found that tax havens are statistically better governed than non-havens. On the other hand, scholars describe tax havens as corrupt states that enable financing of terrorism and let billionaires get away with evading taxes (Jones & Temouri, 2016; Obermeyer & Obermaier, 2016). To analyse this tension, this thesis will research the expenditure of governments on health and education. Therefore, the research question of this thesis is "How does the business of tax evasion impact government spending in tax havens?".

According to the opposing views in the literature, this paper has two hypotheses: The first hypothesises is based on Corbett and Veenendaal (2020) and Dharmapala and Hines (2009). It

states that tax havens have higher expenditure per capita on services such as education and healthcare than non-havens. Therefore, this research expects that tax havens have significantly higher healthcare and education expenses per capita compared to non-havens. The second hypothesis is based on the less favourable view by scholars like Jones and Temouri (2016) and Obermeyer and Obermaier (2016). It states that tax havens are corrupt and have issues with clientelism.

4. Conceptualisation & Operationalisation

Scholars generally consider tax evasion as the illicit behaviour where individuals or companies understate their income or profit to pay lower taxes (Selmrod & Yitzhaki, 2002; Srinivasan, 1973). Even though tax evasion and tax avoidance differ in their definition[2], this research will use these terms interchangeably since it does not make a difference for this argument.

In their 1998 report that initiated the global crackdown on tax havens, the OECD states four main factors that define a tax haven: no or low effective tax rates, a lack of effective exchange of information, a lack of transparency and no substantial activities (Organisation for Economic Cooperation and Development, 1998, pp. 23-24). The first is a starting point to define a jurisdiction as a tax haven. The second factor refers to strict laws of banking secrecy that complicate cooperation between tax authorities. The third factor alludes to the difficulties of the home countries to take defensive measures. The fourth and last factor indicates that the attraction of investments is purely tax-driven or that the jurisdiction does not provide the necessary environment for the respective business. However, due to pressure by the U.S. Bush administration, the OECD abolished the fourth factor (Jackson, 2010, p. 11). Therefore, today the OECD defines a tax haven as a state to which apply two out of the three remaining factors.

To determine a country's income level, this research uses the gross national income (GNI) per capita that the World Bank provides and its definition of income levels[3] (World Bank, 2021-a). The World Bank's GNI per capita metric uses the Atlas Method, which adjusts for exchange rates and inflation, and due to its per capita calculation, it accounts for the size of the

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[2] The definitions of the terms, especially the details, vary in the different jurisdictions. Generally, in contrast to illegal tax evasion, tax avoidance does not pose a crime since most states deem it a legal strategy to reduce tax payments (Selmrod & Yitzhaki, 2002, p. 1429).

[3] Income levels in GNI per capita: Low-income: > $1035; lower-middle-income: $1036 - $4045; upper-middle-income: $4046 - $12535; high income: $12536

population. When comparing expenditures on health and education, this research will use expenditure per capita based on the purchasing power parity (PPP). This measurement accounts for size of the population and different living costs, ensuring the comparability of expenses (World Bank, 2021-b). This thesis will report all sums in US dollars and based on PPP.

The last variables left to conceptualise are corruption and clientelism. Lawton et al. (2013, p. 109) define corruption as the action when a principle betrays the agent's concern to further the own interests. This act is possible, because there is an asymmetry of information between the principle and the agent. Meanwhile, as already mentioned, clientelism refers to patrons distributing favours to clients in return for loyalty and allegiance (Ezrow et al. 2016, p. 150). Errow et al. (2016, p. 151) state that the lines between clientelism and bribery are often blurred. Furthermore, Veenedaal (2019) finds that small states are prone to employ clientelist politics.

5. Research Design and Case Selection
In order to answer the research question, this thesis will conduct a comparative study of three cases, using a Most Different System Design (MDSD). An MSDS employs cases that differ in every variable, except one independent variable and the dependent variable (Seawright & Gerring, 2008, p. 306). Therefore, this thesis will analyse three states that differ in almost every variable, except in being small and in being a tax haven, whereby the size translates to the independent variable and being a tax haven translates to the dependent variable.

More concretely, the analysis focuses on one high-income country from Europe (Liechtenstein), one upper-middle-income country from the Caribbean (Belize), and one lower-middle-income country from the Pacific (Vanuatu). Apart from their different geographic location, the states have different political systems. Liechtenstein is a semi-constitutional monarchy in which the monarch still holds considerable power (Corbett et al., 2017). Belize is a constitutional monarchy, with Queen Elizabeth II as its head of state (Moya, 2016, p. 178). Vanuatu is also a constitutional democracy, although it has a president as head of the republic and a prime minister as head of government (Veenendaal, 2021). Unlike Liechtenstein and Belize, there are concerns about instability and mismanagement in the Vanuatuan government and an increasing ideology of traditionalism (Huffer & Molisa, 2019, p. 101). As the qualitative analysis will show, the mismanagement and traditionalism relate to corruption in Vanuatu. Geographically, Liechtenstein is landlocked between two other landlocked states – Austria and Switzerland. Belize is part of continental Central America with direct access to the Caribbean

Sea. Vanuatu is an island state. In 2000, the OECD considered all three states tax havens (Organisation for Economic Cooperation and Development, 2000). Even though they all committed to measures against harmful tax practices since then, recommendations from more recent reports indicate that the OECD still considers the states to be tax havens (Organisation for Economic Cooperation and Development, 2014; 2019-a; 2019-b).

Using three very different cases, the observed relationships, if similar, should apply to most other tax havens as well. Thereby, using an MDSD should lead to high generalizability if the results are fitting. Furthermore, Liechtenstein is particularly interesting because it has the highest GNI per capita worldwide, based on PPP (United Nations Development Programme, 2020). Additionally, tax havens generally have a high-income level, so Vanuatu is interesting because it deviates from the norm as a lower-middle-income country. Meanwhile, Belize is the only state of the three that has border issues with a neighbouring state – Guatemala (Perez et al., 2009). This dispute, which endangers Belize's territorial sovereignty, makes Belize dependent on outside help against its much bigger neighbour (Wiegand, 2005). Since this help came from the British military in the past decades, it is interesting that the UK has not used that leverage to crack down on harmful tax practices in Belize.

6. Research Methods & Techniques

The analysis of this research will split into two parts: one quantitative analysis to research the first hypothesis and one qualitative content analysis to research the second hypothesis. To check whether or not the expenditure on health and education in Liechtenstein, Belize and Vanuatu is significantly different, this thesis will calculate the mean and the confidence intervals on the 95 % level for the respective expenditures of non-havens. A confidence interval provides a range around the mean of a distribution by giving a value for the upper bound and the lower bound. The level of 95% relates to the fact that 95% of the values inside a sample are within the range between the interval's lower and upper bound (Field, 2018, p. 114). Because the probability that a value does not fit inside 95% confidence interval is only 5%, such values are significantly lower or higher from the mean of the sample. Since the dataset includes almost the entire population, this paper will translate directly from the sample to the whole population. As the expenditure on health and education per capita differs among the income levels, this research will calculate separate confidence intervals for the three income levels (World Bank, Development Indicators, 2021-a, 2021-b).

Neuendorf (2017, p. 1) defines a content analysis as a systematic, quantitative, and objective analysis of message characteristics. However, since the second part of the analysis will conduct a purely qualitative analysis, it will define a qualitative content analysis as a systematic and objective analysis of message characteristics. Neuendorf (2017, p. 9) acknowledges that the lines between qualitative and quantitative content analyses are blurred. Furthermore, she argues that a quantitative analysis does not depend on a single scholar, while a qualitative analysis does (Neuendorf, 2017, p. 9). However, since this analysis does not aim to interpret the underlying meaning of the sources, but rather their manifest content, a biased interpretation should not be an issue. To gather information, this thesis will analyse reports by international organisations to provide an in-depth analysis, to give a meaningful answer to the research question. Using secondary sources is not optimal but reports and statistics that potentially corrupt states publish might not be accurate (Thies, 2002, p. 335). In addition, due to a shortage of available information on small states, this thesis will draw back on scholarly essays and articles. By analysing multiple reports from trustworthy organisations such as the World Bank, Transparency International and the United Nations Office on Drugs and Crime (UNODC), the results should be reliable, if they are similar for each case. If different sources lead to similar case results, they have a higher validity due to the concept of triangulation (Carter et al., 2014).

7. Analysis

As stated above, the following analysis consists of two parts: a quantitative and a qualitative part. This analysis begins by considering the first hypothesis in the quantitative analysis before considering the second hypothesis in the qualitative analysis.

7.1 Quantitative Analysis

The quantitative analysis aims to determine whether or not the expenditure on health and education per capita in Liechtenstein, Belize and Vanuatu is significantly different to the expenditures of non-havens with similar income levels. To do so, the necessary data was compiled from the World Bank and other sources into one dataset. The data for health expenditure per capita is directly available (World Bank, Development Indicators, 2021-a). Meanwhile, the World Bank only publishes the percentage of education expenditure of the respective state's GDP. To get to the expenditure per capita, the values are multiplied with the GDP per capita, based on PPP. The World Bank publishes all information that is necessary for the calculation, except the data for Liechtenstein's expenditure on health (World Bank, Development Indicators, 2021-b, 2021-c). Therefore, it is necessary to inspect the state's

records, and to include the expenditures into the dataset. This paper uses the data from 2018 for health expenditure and data from 2017 for education expenditure. Both years are respectively the latest years for which the World Bank has well-maintained records on most states. Nonetheless, the records are not exhaustive. The list of countries included in this research includes the three tax-havens mentioned and all non-havens from the dataset. States that are non-havens were determined by the inversion of the EU's black and grey list of tax-havens from March 2018 (European Union, 2021). Since is no comprehensive list including reviews from all states and territories before 2018, the used list is the best available option to determine which states and territories are tax havens. After setting up the dataset, this paper used the program SPSS to calculate the 95% confidence intervals (Table 1 & Table 2) and used Microsoft Excel to produce the boxplots of the distributions for a better graphic interpretation (Figure 2 & Figure 3).

As stated above, the range between the lower and the upper bound of a 95% confidence interval indicates whether a value is significantly different to the mean. Therefore, expenditures on health and education outside the confidence interval's range indicate a statistically significant difference to the non-havens' expenditures (Table 1 & Table 2). The analysis of the health expenditure includes 43 high-income-countries, 34 middle-income-countries and 44 lower-middle-income countries (Table 1). The analysis of education expenditure includes 38 high-income-countries, 19 middle-income-countries and 31 lower-middle-income countries (Table 2). While the confidence intervals are based on the mean, the boxplots work on the basis of the median (Figure 2 & Figure 3). Thus, the middle line of the boxplots translates to the median of the sample. The coloured bars above and under the median are the second and the third interquartiles. Thus, the bar represents the span from the values from the 25th percentile until the 75th percentile. The lines coming out of the bars, the so-called whiskers, represent the 1.5-fold interquartile range. Every value outside the whiskers is considered an outlier (Field, 2018).

Liechtenstein's budget states that the country spent $10,125.66 on health per capita, and $4789.03 on education per capita (Regierung des Fürstentums Liechtenstein, 2019). Belize spent $506.32 on health per capita, and $547.60 on education per capita according to the World Bank (World Bank, Development Indicators, 2021-a, 2021-b, 2021-c). Vanuatu spent $108.67 on health per capita, and $145.17 on education per capita (World Bank, Development Indicators, 2021-a, 2021-b, 2021-c).

Table 1

Expenditure on Health per Capita, based on PPP in US$

Income level	N	Mean	95% Confidence Interval	
			Lower	*Upper*
High	43	4179.10	3562.40	4795.80
Upper-middle	34	1013.97	844.75	1183,18
Lower middle	44	296.54	236.88	356.20
Total	121			

Note: Results of the Statistical Analysis of the Expenditure on Health per Capita Based on PPP in Non-Havens in Current US$.

Source: European Union, 2021; Regierung des Fürstentums Liechtenstein, 2019; World Bank, Development Indicators, 2021-a,2021-b, 2021-c.

Table 2

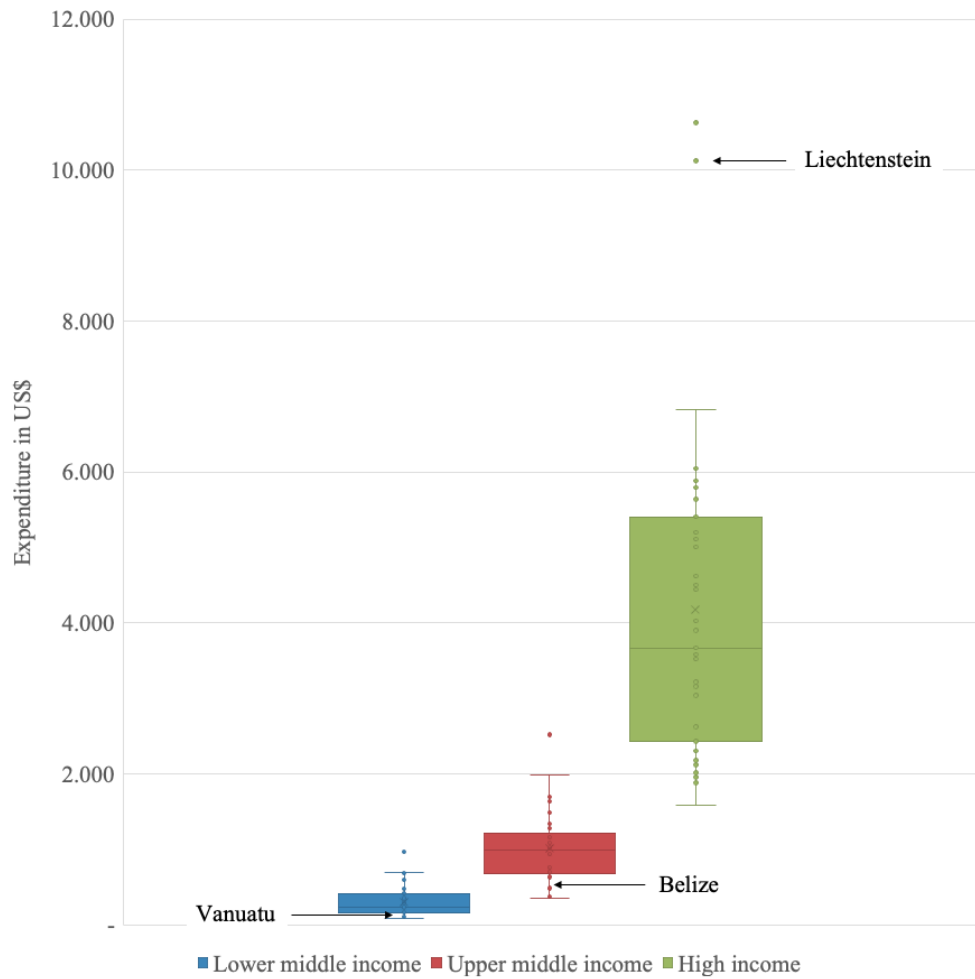*Expenditure on Education per Capita, based on PPP in US$*

Income level	N	Mean	95% Confidence Interval	
			Lower	*Upper*
High	38	2601.38	2220.78	2982.00
Upper-middle	19	802.46	627.57	977.34
Lower middle	31	254.70	186.56	322.84
Total	88			

Note: Results of the Statistical Analysis of the Expenditure on Education per Capita Based on PPP in Non-Havens in Current US$.

Source: European Union, 2021; Regierung des Fürstentums Liechtenstein, 2019; World Bank, Development Indicators, 2021-a,2021-b, 2021-c.

Figure 2

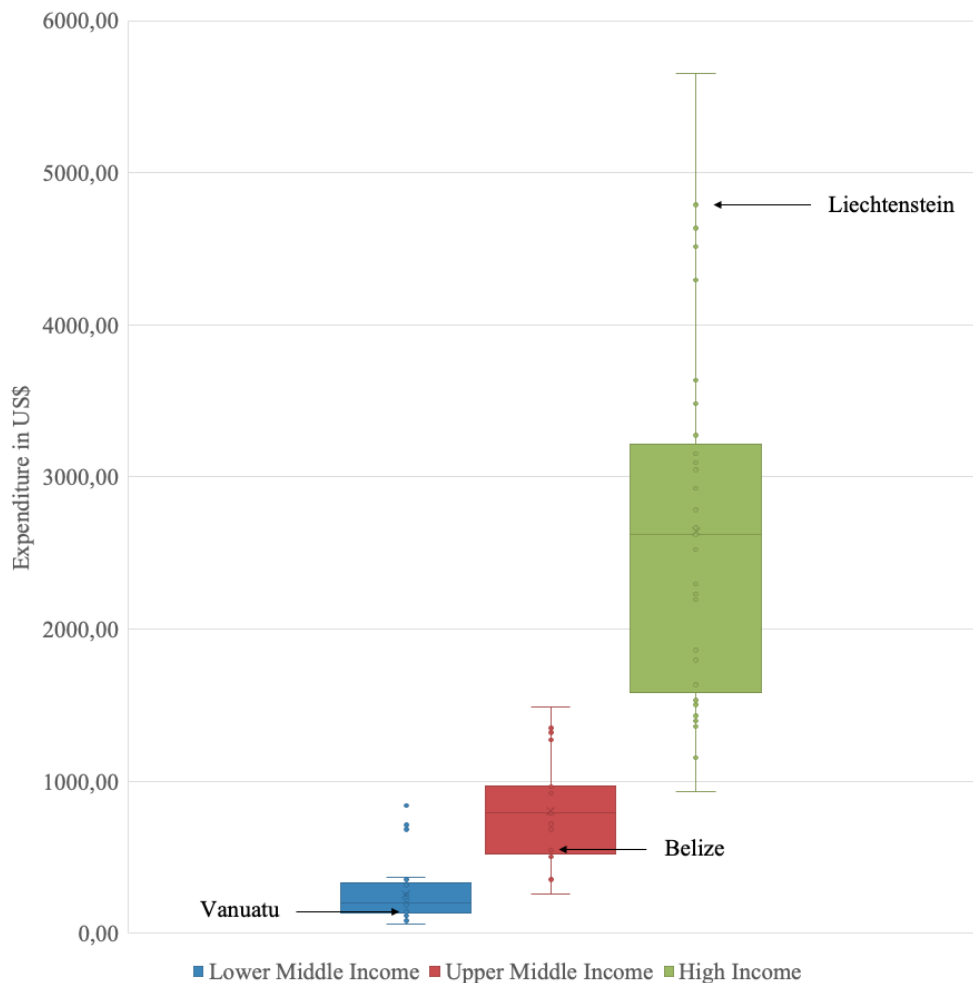*Boxplot of Health Expenditure per Capita, based on PPP in US$*

Note: Boxplot of Non-haven's Expenditure on Health per Capita, Based on PPP in Current US$,

Sorted by Income Level

Source: European Union, 2021; Regierung des Fürstentums Liechtenstein, 2019; World Bank,

Development Indicators, 2021-a,2021-b, 2021-c.

Figure 3

Boxplot of Education Expenditure per Capita, based on PPP in US$

Note: Boxplot of Non-haven's Expenditure on Education per Capita, Based on PPP in Current US$,

Sorted by Income Level.

Source: European Union, 2021; Regierung des Fürstentums Liechtenstein, 2019; World Bank,

Development Indicators, 2021-a,2021-b, 2021-c.

Liechtenstein

As one can see in the Table 1 and in Figures 2, Liechtenstein's expenditure on health per capita is higher than the upper bound of the 95% confidence interval and even over the 1.5-fold range of the third quartile. Similarly, the expenditure on education per capita is higher than the upper bound of the 95% confidence interval as well, even though it marks the border of the 1.5-fold range of the third quartile (Table 2 & Figure 3). Thus, Liechtenstein's expenditures on health and education per capita are significantly higher than the expenditure of non-havens with the same income level. Therefore, the data indicates that this paper can accept the first hypothesis for Liechtenstein. It states that tax havens have significantly higher expenditures on health care

and education than non-havens. Thus, the state seems to invest its profits, generated by the business of tax evasion on its people in the form of an exceptionally costly health and education sector.

What the data does not show and what this research does not consider is whether the state spends the money wisely or not. Since there is no information given about the quality of medical care or education, there is no way to evaluate whether Liechtenstein's significantly higher expenditure in health and education leads to a better quality of healthcare and education. An example of this paradox is a costly but deficient medical care system in the United States (U.S.) – the only state in the data set with a higher expenditure on health per capita, based on PPP than Liechtenstein. In the U.S., 8.5% of the people had no health insurance during the year 2018, leading to 27.5 million uninsured people (United States Census Bureau, 2019). Therefore, despite having an extremely costly health sector per capita, not every citizen is insured and enjoys the benefits of a high-quality health system.

Belize

Meanwhile, Belize's expenditure for health per capita is outside of the interquartile range but still within the whiskers (Figure 2). Furthermore, the health expenditure of Belize is lower than the median and even under the lower bound of the 95% confidence interval (Table 1). Those findings are not in accordance with the first hypothesis since they state that Belize's expenditure on health is not significantly higher than the average of its income level. In fact, quite the contrary is the case, as the expenditure on health is significantly lower in Belize in comparison to upper-middle-income non-havens. The state's expenditure on education per capita however, is inside the second quartile (Figure 3). Nonetheless, it is still lower than the median, and as Table 2 shows, the budget for education is under the lower bound of the 95% confidence interval. Thus, the findings regarding Belize's expenditure on education do not support this thesis' first hypothesis either, since the expenditure on education is significantly lower than the average of the same income level.

The first hypothesis states that those expenditure should be significantly higher related to non-havens. Therefore, based on the data, this paper cannot confirm the first hypothesis for the case of Belize since its expenditures on health and education were not significantly higher than the expenditures of non-havens with the same income level. However, it is noteworthy that the analysis of the education expenditure in Belize is based on only on 19 data points. Even though,

the small case number makes the data less reliable, the outcome nevertheless raises the question of where the money generated by the business of tax evasion goes. The second part of the analysis will aim to answer that.

Vanuatu

Like Belize, Vanuatu's expenditure on health per capita is outside of the interquartile range, and under the lower bound of the 95% confidence interval, contrary to the first hypothesis (Table 1 & Figure 2). Nonetheless, the value for the health budget is still inside the 1.5-fold range of the second quartile, meaning that it is still inside the range of the whiskers (Figure 2). Meanwhile, its expenditure on education per capita is inside the interquartile range yet lower than the median (Figure 3). Additionally, the value is under the lower bound of the 95% confidence interval, which opposes the expectation set in the first hypothesis as well, similar to the case of Belize (Table 2). Thus, the data presented in this paper does not suggest that the research should accept the first hypothesis for the case of Vanuatu. The findings raise the question of where the profits from the business of tax evasion in tax havens go to since the expenditures on health and education are significantly lower than the average of lower-middle-income-countries.

7.2 Qualitative Analysis

The second hypothesis states that tax havens suffer from high levels of corruption and clientelism. Therefore, the second part of the analysis, will aim to quantitively study the corruption levels of the three cases, Liechtenstein, Belize, and Vanuatu. Since state records of potentially corrupt states are likely to be biased, information in the form of reports by Intergovernmental Organisations (IGOs) or Non-Governmental Organisations (NGOs) provide more accurate data. Unfortunately, the most-used indicator for corruption, the Corruption Perception Index (CIP) by the NGO Transparency International, is only available for Vanuatu. However, there is still data available to evaluate corruption in the states, although the comparability using a single metric is not possible.

Liechtenstein

The Group of States against Corruption (GRECO) claims that there are practically no known cases of people who hold a public office enacting in corrupt behaviour in Liechtenstein (Group of States against Corruption, 2020). Accordingly, perception of corruption is extremely low in Liechtenstein. Nonetheless, GRECO notes that there is still considerable room for

improvement; for example, there is no code of conduct for members of the Landtag, the Liechtenstein Parliament (Group of States against Corruption, 2020, p. 8). However, GRECO also praises Liechtenstein's action and execution of earlier recommendations, stating that it had implemented all advice carefully.

Furthermore, the UNODC states that Liechtenstein's lack of regulation on party financing may be problematic (United Nations Office on Drugs and Crime, 2017). Nonetheless, the report praises the state's recruitment system and its implementation of the United Nations Convention against Corruption. Taking all those statements into account, it is not surprising that Freedom House (2021-a) gave Liechtenstein four out of four possible points for effective and strong safeguards against corruption in 2018. Furthermore, for the year 2018, the World Bank gave Liechtenstein a 2.0 for its Control of Corruption on a scale from -2.5 up to 2.5, where -2.5 means poor control, while 2.5 stands for excellent control; the mean across all states is 0 (World Bank, 2021-c). Since this paper already accepted the hypothesis for Liechtenstein, it is not surprising that the reports for corruption do not indicate that the second hypothesis is correct in this case.

Belize

Conversely, the World Bank awarded Belize with a -0.2 on its Control for Corruption scale for the year 2018, indicating grave problems (World Bank, 2021-c). Accordingly, the United Nations Development Program (UNDP) reports that corruption and patronage are highly influential in political procedures of all kinds (United Nations Development Program, 2012). In its report on gender and equality in Belize, the UNDP quotes an unnamed political candidate in Belize who stated that "the level of corruption is so high, you either have to roll with it, or you shut up" (United Nations Development Program, 2012, p. 69). Even though this report is almost ten years old, newer sources confirm its message. The governing parties often manipulate party financing, making it even harder for outsiders who are not corrupt to enter politics (Gennity, 2021). Furthermore, the "Prevention of Corruption in Public Life Act" from 1994 has never been enacted, and therefore it has never led to prosecution. The act also establishes a list of publicly reported assets and financial positions, which has not been published since 2005 (Gennity, 2021). The Integrity Commission has not been staffed since 2011 either. Those issues indicate an institutionalisation of corruption and political clientelism in Belize. Freedom House (2021-b) awarded Belize with two out of four points for safeguards

against corruption. It notes, among other already mentioned points, that the state struggles with corruption and that the will to improve the situation is minimal.

Nonetheless, the state signed and ratified the Organisation of American States' (OAS) Inter-American Convention against Corruption. The latest report by the OAS from 2018 indicates that Belize has made some progress, but there is still much work left to do (Organisation of American States, 2018). For example, Belize successfully established a registry of contractors of goods, services and works and drafted bills on government procurement. However, the report notes that it has yet to develop a framework for a fair compensation for public officials in all three branches of government, for example. Furthermore, the 2018 annual report of the UNODC states that Belize agreed to become a pilot country of the UNODC's Judicial Integrity toolkit and to implement ethical behaviour courses in law schools' curricula (United Nations Office on Drugs and Crime, 2018). This decision underlines some commitment to improve the situation. Nonetheless, the UNODC's Country Review Report of Belize from 2020 states that there are still various unsolved issues in Belize's legal framework, let alone in the political culture, as indicated by the earlier quote (UNODC, 2020).

Furthermore, since the World Bank classifies Belize as an upper-middle-income country, it has a relatively high GDP per capita of around $4800 (World Bank, 2021-c). Nonetheless, the state has significant issues with poverty. The United Nations International Children's Emergency Fund (UNICEF) estimates that 42% of the Belizean population lives in poverty, and even 49% of children do (United Nations International Children's Emergency Fund, 2019). These numbers indicate that the profits from tax evasion do not benefit the people, but instead may be falling into the hands of the state's elites due to corruption. Furthermore, according to the World Bank's income classification from 2017, only 29% of the people from upper-middle-income countries live in poverty (Ferrerira & Sánchez-Páramo, 2017). The difference to the 42% of the poor Belizeans seems immense. This ranking leads to a further strengthening of the idea that politicians have not used the monetary benefits from the business of tax evasion to benefit the Belizean people. The high levels of corruption reinforce this idea. Therefore, this paper accepts the second hypothesis for the case of Belize. The second hypothesis states that tax havens have high levels of corruption and clientelism.

<u>Vanuatu</u>

Similar to Belize, Vanuatu faces immense corruption issues as well. Transparency International (2020) noted in its 2020 report that the political instability, following frequent successful no-confidence votes, led to a state of bribery, nepotism and misuse of public funds. Additionally, the World Bank awarded the state with a score of -0.3 on its Control of Corruption scale in 2018 (World Bank, 2021-c). The UNODC report on Vanuatu even recommends criminalising bribery in the private sector, which means that it is not a crime in the current legal system (United Nations Office on Drugs and Crime, 2016). Furthermore, the report indicates an insufficient protection of whistle-blowers who report reasonably and in good faith on acts of corruption. Nonetheless, Vanuatu made some progress in the field of training and the establishment of a reintegration program (United Nations Office on Drugs and Crime, 2016).

The parliament's website and recent news reports reveal multiple corruption cases and misuses of the so-called Constituency Development Funds (CDFs). Every Member of Parliament (MP) and member of government receives CDFs to distribute them in their community, based on their discretion (Cox et al., 2007). Supporters say that CDFs are an easy and unbureaucratic way to provide financial aid for much needed development projects in the rural areas of Vanuatu. Meanwhile, critics say that they are a form of an institutionalised system of clientelism since there is no legal framework on how to distribute the ~$30,000, let alone an observatory body to check on the ethicality of the distribution (Cox et al., 2007). Especially since illicit enrichment is not a criminal offence in Vanuatu, the lack of a regulatory framework is problematic (United Nations Office on Drugs and Crime, 2016).

Moreover, clientelism is deeply entrenched in the Vanuatuan society. This relationship is apparent through the connection between a tribal chief and individuals (Cox et al., 2007). This relationship between leaders and individuals translates to constituencies' expectations of their elected officials, leading to a systemic problem, not to individual cases of misconduct. Therefore, it is not surprising that people often elect MPs for local reasons, not party allocation. Frequently, MPs join a party even after getting elected. Thus, the struggle for power among parties is not winning over voters but elected MPs in Vanuatu's parliament.

In a recent high-profile example from 2015, Vanuatu's former Prime Minister (PM), Moana Carcasses Kalosil, was involved in a major corruption scandal. Carcasses and a colleague bribed thirteen other MPs to gain their support in a no-confidence vote to oust the sitting PM

(Baker, 2015; Forsyth & Batley, 2016). Among the conspirators were two former PMs and the speaker of Parliament. Before the conviction of the 15 MPs (almost one-third of the parliament), the speaker of parliament used his temporal powers as acting President while the President was abroad to pardon himself and his colleagues. However, this manoeuvre failed, and the President nullified the pardon. Nonetheless, it is noteworthy that the judiciary convicted the MPs, despite such deeply enrooted corruption. Thus, the judicial system seems to be stable and independent and, most importantly, widely respected by politicians (Forsyth & Batley, 2016; Veenendaal, 2021).

Almost 40% of the ni-Vanuatu live in poverty, according to a survey from 2010 (United Nations Development Program, 2013). Therefore, similar to Belize, the money generated by tax evasion does not seem to benefit the general population. Based on the 2017 World Bank's income classification, 46% of the people in lower-middle-income countries were living in poverty (Ferreria & Sánchez-Páramo, 2017). Even though there is no recent Gini coefficient available to measure the inequality, the fact that Vanuatu performed only slightly better than the average indicates that the profits from the business of tax evasion must go somewhere else than to the benefit of the people. However, since the data on poverty in Vanuatu is more than ten years old, the situation may have improved since then. Nonetheless, the institutionalised system of clientelism in Vanuatu gives massive incentives to misuse public funds for private purposes. Thus, this paper accepts the second hypothesis for the case of Vanuatu. That means that this paper finds severe signs of corruption and clientelism in Vanuatu.

8. Conclusion

The presented research aimed to analyse how far the business of tax evasion impacts government spending of tax havens. Since tax havens are on average better governed than non-havens, this paper hypothesises that expenses that directly benefit the people, such as health and education, are significantly higher in tax havens than in non-havens (Dharmapala & Hines, 2009). To test the first hypothesis, this research tested whether the expenditures of the three chosen tax havens significantly differ from the expenditure of non-haves with the same income level. The analysis found that only Liechtenstein had a significantly higher expenditure than non-havens. Meanwhile, both other cases, Belize and Vanuatu, did not only lack a higher expenditure, but it was also significantly lower. Therefore, this paper can accept the first hypothesis only for the case of Liechtenstein and not for the cases of Belize and Vanuatu. The second hypothesis states tax havens suffer from high levels of corruption and clientelism (Jones

& Temouri, 2016; Obermayer & Obermaier, 2016). Not surprisingly, the analysis accepted the second hypothesis for Belize and Vanuatu, but not for Liechtenstein. As poverty is a big issue in Belize and Vanuatu, paired with a high degree of corruption, it is evident that the additional monetary resources that the business of tax evasion provides do not benefit the people but rather the elite. Meanwhile, Liechtenstein does not have any known problems of corruption. Thus, this paper can generally accept neither the first hypothesis, nor the second hypothesis.

Therefore, further research on the topic is necessary. For example, a statistical analysis with a larger N could improve the analysis on whether the expenditure in health and education is significantly higher in tax havens that are not corrupt than in non-havens. Meanwhile, it is possible to further study whether health and education expenditures in corrupt tax havens are significantly lower than in non-havens. However, such an analysis could prove to be difficult because most tax havens are small states and territories. The smallness and the characteristic of being a territory are problematic since the most popular indicator for corruption, the Corruption Perception Index, is often unavailable for small states and territories, as indicated earlier. Furthermore, this thesis did not consider the quality of healthcare and education and thereby cannot give a meaningful evaluation of the services. Therefore, further research could focus on the question of whether or not the quality of healthcare and education in tax havens is better than in non-havens. Furthermore, the conclusion that the profits generated by the business of tax evasion disappear due to corruption in Belize and Vanuatu assumes that those profits exist, and they are large enough to fund costly healthcare and education. However, this research questioned neither the existence nor the size of the profit. Therefore, further research could evaluate if the business of tax evasion in a lower or upper-middle-income country is as profitable as in high-income countries.

As previously stated, tax havens are, on average, better governed than the rest of the world (Dharmapala & Hines, 2007). However, two out of the three cases that this paper discusses show severe issues with corruption that have not translated to a high quality of government. Since most tax-havens are high-income countries, they are likely to behave similarly to Liechtenstein, and not show grave signs of corruption, like Belize and Vanuatu. Thus, the case selection might have led to a considerable bias in this research. Furthermore, a careful analysis of the budget allocations of the three cases showed that Belize and Vanuatu included their costs for the ministry of education and health into their expenditures, among other things (Department of Finance and Treasury, 2021; Ministry of Finance, 2021; Regierung des

Fürstentums Liechtenstein, 2021). Meanwhile, Liechtenstein excluded its expenditure for nursing homes and insurance from their health expenditure. Such specific allocations differ from state to state and thereby make the data to some degree unreliable due to a lack of consistency. Furthermore, the data provided by the World Bank is not exhaustive, as data for a variety of states are missing. If the missing data points are not random, this is problematic as well.

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