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## Overview of the Characteristics of Tax Havens

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### Abstract

Tax havens have become a subject of great interest among policymakers, scholars and the general public, and are central to many important current policy debates. This chapter provides an overview of the scholarly literature on the characteristics and origins of tax havens. The earlier literature, used cross-country analysis and found evidence that tax havens tend to have stronger governance institutions than comparable nonhaven countries. The more recent literature analyzes the historical origins of tax havens and undertakes longitudinal analysis of their adoption of haven-like laws. This chapter also presents a descriptive analysis of the relationship between tax haven status and quantitative measures of countries' historical characteristics. This descriptive analysis suggests that tax haven jurisdictions are not appreciably different from nonhavens in their historical experience of foreign rule and in other historical characteristics. This suggests some caution in attributing tax havens' status to their colonial history or to other historical variables.

JEL Codes: H87; O10

Keywords: Tax havens; International taxation; Colonial history; Governance; Economic development; Comparative economics

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## 1) Introduction

Tax havens have attracted dramatically increased interest among policymakers, scholars and the general public in recent decades. Today, tax havens are central to many of the most important policy debates relating to international taxation, tax competition, multilateral tax cooperation, and inequality among and within nations. For example, the current multilateral initiatives led by the Organisation for Economic Cooperation and Development (OECD) and the G-20 group of governments – in particular, what is known as Pillar Two or the GloBE proposal (OECD 2019, 2021) - seek to neutralize the impact of havens on the activities of multinational corporations (MNCs) by imposing a global minimum tax on MNCs that will disincentivize the shifting of profits to tax havens.

In general terms, tax havens can be defined as jurisdictions with zero or very low tax rates and other favorable tax attributes. This chapter provides an overview of a growing scholarly literature that analyzes the characteristics of tax haven countries and territories and seeks to derive wider implications from this analysis. It builds on prior surveys of the literature on tax havens (e.g., Dharmapala 2008; Hines 2010; Hebous 2014; Dharmapala 2021a). However, its scope is more extensive in that it considers the research questions and findings of a wider range of academic disciplines. It also incorporates current developments in the literature (subsequent to the prior surveys). In addition, it provides some original descriptive analysis of the historical characteristics of tax haven jurisdictions.

The early phase of the scholarly literature on tax havens undertook cross-sectional analysis of these jurisdictions' characteristics. In particular, this research found (perhaps somewhat counter-intuitive) evidence that tax havens tend to have stronger governance institutions (i.e., more robust political and legal systems and lower levels of corruption) than comparable nonhaven countries (Dharmapala and Hines 2009). More recently, historians, political scientists, economists and others have sought to better understand the historical origins of tax haven status (e.g., Ogle 2017, 2020; Dainoff 2021; Sævold 2022). Some of this research engages in the longitudinal analysis of the determinants and consequences of jurisdictions' adoption of the legal and policy framework associated with tax haven status (Laffitte 2023). A particularly prominent theme in this recent work is the relationship between colonial history (and decolonisation) and the emergence of tax havens.

This chapter reviews and discusses this literature. It also reports an original analysis of the relationship between tax haven status and various quantitative measures of colonial history and other historical characteristics (such as state antiquity and past exposure to military conflicts) that have been constructed in the empirical literature on comparative long-run economic development. The current literature suggests that the timing of the adoption of tax haven status tended to follow decolonization (Laffitte 2023). However, this chapter shows that – even if that is the case - tax haven jurisdictions are not appreciably different from comparable nonhaven jurisdictions in their historical experience of foreign rule and in other historical characteristics. While this evidence is merely descriptive, it suggests some caution in attributing tax havens jurisdictions’ status to their colonial history or to other historical variables.

Section 2 discusses how to define tax havens. Section 3 describes the geographical and institutional characteristics of tax havens (as defined in Section 2). Section 4 discusses the recent literature on the historical determinants of tax haven status and presents descriptive evidence on the historical characteristics of tax havens. Section 5 concludes.

## **2) Defining Tax Havens**

There is no universally accepted definition of tax havens. For the purposes of this chapter (in particular, for the descriptive analysis of the characteristics of havens and nonhavens), the list of havens follows that constructed by Dharmapala and Hines (2009). They define tax havens as “locations with very low tax rates and other tax attributes designed to appeal to foreign investors.” (p. 1058). There are about 40 havens in the list that they report (Dharmapala and Hines 2009, Appendix A, p. 1067). In constructing this variable, Dharmapala and Hines (2009) begin with the list of jurisdictions in Hines and Rice (1994, Appendix 2, p. 178, based on lists of havens produced by the US tax authorities).<sup>1</sup> This list is matched with jurisdictions for which economic and institutional data was available for 2004. The resulting classification of havens has been widely used in the subsequent academic literature. However, there have been some subsequent political and jurisdictional changes since the construction of this list. Most notably, the Netherlands Antilles

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<sup>1</sup> Hines and Rice (1994) take as their starting point the haven jurisdictions listed in the US Internal Revenue Service (IRS) publication known as the *Internal Revenue Manual*. They supplement this list with additional jurisdictions identified in Beauchamp (1983). Then, they eliminate those countries and territories in which the average tax rate faced by the affiliates of US MNCs exceeds 20%, as calculated using data from the US Bureau of Economic Analysis (BEA) based on surveys of US MNCs (see Hines and Rice 1994, Appendix 1 for further details).

(which appears on this list) was dissolved in 2010, with the territories that were formerly part of this jurisdiction (primarily Curaçao and Sint Maarten) becoming separate jurisdictions within the Kingdom of the Netherlands.

Tax havens, so defined, are typically small countries and territories that tend to be clustered in particular regions of the world. This geographic clustering of tax haven activity has been widely remarked upon. For instance, MNCs' use of havens appears to be influenced by geographical proximity (with Caribbean havens appearing to be important for US MNCs, and European and Mediterranean havens appearing to be important for European MNCs). Consistent with this geographical segmentation, Laffitte (2023) finds that regional demand shocks (as proxied by increased tax rates or the introduction of direct taxes by other countries in the same geographic region) are associated with jurisdictions adopting the legal framework characteristic of tax havens. This geographical segmentation seems surprising in light of the largely frictionless nature of modern communications technology, and because MNCs' haven activity is thought to be mostly financial in nature (rather than involving real economic activity). However, it may reflect geographically specific expertise among law firms and accounting firms.

There is a more fundamental question of why tax havens take the form of distinct geographical and jurisdictional entities. In essence, a corporate tax haven can be viewed as simply a mechanism for establishing a low or zero tax rate on certain types of income earned by MNCs. Any jurisdiction could, in principle, create domestic tax law provisions to achieve this aim (and the "haven" would then not be geographically distinct). Indeed, many nonhaven countries have in recent years introduced patent box regimes – which impose low tax rates on income derived from patents – as an element of their tax law. These regimes can perhaps be understood as creating "internal" havens. However, there may be advantages to the geographically, jurisdictionally and legally separate character of havens (e.g., Dharmapala 2021a). For example, small jurisdictions may be reliant on incorporation fees for financing public services. Their choice of low tax rates may be more credible than would be the case in larger countries because small jurisdictions lack a political constituency for high corporate tax rates; this may be due to having a very small domestic corporate sector to tax, or to the absence of a personal income tax (as discussed below).

The recent literature on tax havens uses the term "legal architecture" to refer to the combination of legal provisions that are thought to be associated with tax haven status (e.g., Ogle 2017; Laffitte 2023). This architecture is defined to include not only low or zero tax rates, but also

laws relating to the confidentiality of financial accounts, along with a variety of other provisions. The relevance of this idea, however, hinges on the important distinction between individual evasion via tax havens and MNCs' use of tax havens.

Individuals' use of tax havens often involves tax evasion (as opposed to tax avoidance) – i.e., the “nonpayment of legally owed taxes, where it is assumed that the law clearly specifies the obligations of the taxpayer.” (Dharmapala 2017, p. xv). The tax laws of most countries that implement personal income taxation require that income generated in foreign financial accounts is reported to the residence country (and taxed by the residence country). Individuals who hold financial accounts in havens (or other foreign countries) and fail to report the income these accounts generate to their home government are thus engaged in tax evasion. The confidentiality laws of tax havens facilitate such evasion by reducing the likelihood of detection by the residence country's tax authority. Serving individual evaders thus requires a haven to be what is often termed a “secrecy jurisdiction” with the type of legal architecture described in this recent literature.

However, it is important to note that several recent developments (notably, the spread of automatic exchange of information regarding financial accounts among governments, including those of many tax haven jurisdictions) imply that individual evasion via foreign accounts may be largely a phenomenon of the past. In 2010, Congress created the Foreign Account Tax Compliance Act (FATCA) regime, which essentially compels non-US financial institutions to report to the US income generated in accounts held by US individuals. The OECD and G-20 have also developed a multilateral approach to information exchange known as the Common Reporting Standard (e.g., Dharmapala 2016; Cusi, Spengel and Stage 2020).

In contrast, secrecy is not generally relevant for MNCs' use of havens. MNCs' activities in havens are typically lawful (although tax planning may sometimes involve taking aggressive positions in the face of legal uncertainty). Moreover, they are publicly disclosed where required under securities law, and are subject to (sometimes intense) public scrutiny. Thus, it is important to distinguish between MNCs' and individuals' use of havens (e.g., Dharmapala 2008).<sup>2</sup> Moreover, the limited role of secrecy for MNCs also implies that the notion of a “legal architecture” (beyond favorable tax rates) has limited application to MNCs' haven activities. In principle, it is possible

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<sup>2</sup> It should be noted, though, that there is some recent evidence that some MNC activity in havens may be sensitive to information exchange agreements (e.g., Braun and Weichenrieder 2015; Bennedsen and Zeume 2017). However, it remains unlikely that the core activities of MNCs in havens rely on secrecy.

for a jurisdiction that happens to not have a corporate income tax to become an “accidental” corporate haven. An MNC that incorporates a subsidiary in that jurisdiction will have an incentive to shift profits to that subsidiary from other subsidiaries facing positive tax rates, regardless of the “accidental” haven’s other legal features (of course, a company law regime that permits the incorporation of the subsidiary is required, but this is likely to exist for other reasons, such as enabling domestic persons to establish corporate entities).

This point is not merely a theoretical curiosity. One of the leading theories of why the corporate income tax exists is that it prevents corporations from serving as tax shelters from the personal income tax (see e.g., Desai and Dharmapala 2018 for a discussion). Absent a corporate income tax, individuals could establish corporations that would receive their income and disburse dividends to the individual owner for consumption purposes (while otherwise deferring taxation by accumulating cash within the corporation, thus obtaining the equivalent of consumption tax treatment for the owner). In this view, the corporate tax is arguably required (as what is sometimes termed a “backstop”) to protect the integrity of the personal income tax. However, not all jurisdictions impose personal income taxes, and establishing a system of personal income taxation and effective enforcement entails a large fixed cost (independent of the amount of revenue collected) that may not be worthwhile for small jurisdictions to incur.

Desai and Dharmapala (2018) present some descriptive evidence broadly consistent with the idea that personal income taxation tends not to exist without being accompanied by the corporate income tax. Using IMF data on tax systems and structures,<sup>3</sup> they show that all countries with a personal income tax also have a corporate income tax, while half of countries that do not have personal income taxes also do not have corporate income taxes. In the same dataset, there are 19 countries and territories (most of them small, as might be expected) that have no corporate income tax over the 2004-2013 period and also have nonmissing data on personal income tax rates and revenue. Of these, 13 have no personal income tax. Thus, for over two thirds of countries without corporate income taxes, this absence can plausibly be attributed to their lack of a personal income tax. It follows that there is arguably an “innocent” explanation for their zero corporate income tax rate. Nonetheless, these countries can potentially serve as corporate tax havens, without any particular wider legal architecture. Of course, forward-looking governments presumably expect that a zero corporate tax rate would attract MNC activity with its attendant benefits;

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<sup>3</sup> This is the World Revenue Longitudinal Dataset (WoRLD), available at: <http://data.imf.org/revenues>

however, they may well choose a zero corporate tax rate even absent such benefits (if large fixed administrative costs result in personal income taxation not being worthwhile). Another important caveat is that MNCs' tax planning opportunities often arise from the interaction of different jurisdictions' tax laws, rather than from low tax rates or other provisions in isolation (e.g., Phillips, Petersen and Palan 2021). Havens may choose their tax laws deliberately to generate such interactions, but it is also possible in principle that these arise by accident.

### **3) The Geographical and Institutional Characteristics of Tax Havens**

Having arrived at a pragmatic working definition of tax havens in Section 2 (following the list in Dharmapala and Hines 2009), this section reviews what is known in the academic literature about the geographical and institutional characteristics of havens compared to nonhavens. Dharmapala (2008) and Dharmapala and Hines (2009) provide quantitative measures of many of these characteristics (see in particular Figure 1a and 1b in Dharmapala 2008 and Table 1 in Dharmapala and Hines 2009). The general patterns they report are robust whether considering all countries and territories, or confining attention only to small havens and small nonhavens (i.e., countries and territories with populations below one million in 2004).

Tax havens tend to be substantially more affluent than nonhavens, as measured by GDP per capita. As is well-known, havens are small in population size, and more likely to be islands (and, partly as a consequence, have a larger fraction of their population located within 100 km of the coast) relative to nonhavens. Tax havens' geographical characteristics tend to cause them to be exogenously more open economically, as compared to nonhavens. For example, they tend to be located in closer proximity to major capital exporters (measured as the distance by air from the closest of New York, Tokyo or Rotterdam). Havens also have a relatively sophisticated communications infrastructure, as measured (for instance) by the number of telephone lines per capita. On the other hand, haven jurisdictions are poorly endowed with natural resources. The value of their subsoil assets per capita, as estimated by the World Bank, is substantially smaller than for the typical nonhaven country.

Tax havens differ substantially from nonhavens in their legal origins and political institutions. In particular, havens are more likely to have British legal origins and less likely to



have French legal origins than are nonhavens.<sup>4</sup> Havens are also more likely to use English as an official language than are nonhavens. The former have a greater propensity to be governed by parliamentary rather than Presidential political systems. As suggested by some of the recent literature on colonialism and tax havens, havens are somewhat more likely to be dependent territories rather than sovereign states. Havens thus have a lower rate of membership in the United Nations (UN) compared to nonhavens (however, UN membership is slightly higher for small havens than for small nonhavens).

Dharmapala and Hines (2006) analyze in particular the relationship between tax haven status and the quality of governance institutions. They use an index of governance institutions created by the World Bank (Kaufmann, Kraay and Mastruzzi 2005). This governance index measures many different dimensions of governance quality, including political stability, the absence of official corruption, respect for the rule of law, government effectiveness and democracy. The index is normalized to have a mean of zero across all countries and a standard deviation of one, with higher values indicating stronger governance institutions. Tax havens, on average, have substantially higher values of this index relative to comparable nonhaven countries. Moreover, tests using a variety of statistical approaches show a highly robust conditional correlation between governance quality and tax haven status.

Using an index of bureaucratic efficiency that is available for the early 1980s for a small number of havens and other countries shows that governance characteristics in the past are predictive of current tax haven status. This finding indicates that the governance institutions relevant for tax haven status relate to long-run characteristics of countries that tend to be stable over time. Moreover, they tentatively suggest that a causal interpretation (i.e., that countries with stronger governance tend to become tax havens) may be warranted. However, it should be borne in mind that the analysis in Dharmapala and Hines (2009) is essentially cross-sectional, with a time-invariant classification of tax havens. This reflects the difficulty of identifying when countries become havens, and more fundamentally the absence of longitudinal data on relevant variables for haven jurisdictions. The more recent literature (e.g., Laffitte 2023) seeks to overcome these

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<sup>4</sup> Various mechanisms have been proposed for the possible role of British legal origins, ranging from specific tax law precedents that apply in the common law world with regard to corporations' tax domicile (e.g., Ogle, 2017) to the general style of social control associated with the common law tradition (e.g., La Porta, Lopez-de-Silanes and Shleifer 2008).

challenges by coding the legal characteristics of haven jurisdictions over time (as discussed in Section 4 below).

The relationship between tax haven status and governance is open to multiple interpretations. The preferred interpretation of Dharmapala and Hines (2009) places this finding in the context of the standard result in public finance that a small open economy should not levy a source-based tax on foreign investors. As the global after-tax rate of return is fixed for a small open economy, a source-based tax of this type would entail higher pretax rates of return for investors, and so would be shifted to domestic workers in the form of lower wages. A more direct (and economically equivalent) way to raise revenue would be to tax workers. This result may not apply when there are significant location-specific rents, for example due to natural resource endowments or agglomeration externalities.

This theoretical framework suggests that all small countries should seek to become tax havens (at least in the sense of imposing low or zero tax rates on foreign investment). However, of 75 countries and territories with populations less than a million in the Dharmapala and Hines (2009) dataset, only 31 are tax havens. Dharmapala and Hines (2009) argue that good governance is a prerequisite for countries to be able to credibly commit to low tax rates and other favorable policies (as MNCs care not simply about announced tax rates but also about certainty regarding future policies). Small countries that lack strong governance cannot become havens because their proclamation of the relevant policies would lack credibility. Indeed, Dharmapala and Hines (2009, Figure 2) present some limited but intriguing evidence that inbound foreign direct investment is substantially more sensitive to corporate income tax rates in countries with stronger governance institutions relative to this sensitivity in countries with poor governance.<sup>5</sup>

#### **4) The Historical Characteristics of Tax Havens**

##### ***4.1) A Review of the Recent Literature***

As described in Section 3, the early phase of the scholarly literature on tax havens undertook primarily cross-sectional analysis of the characteristics of haven jurisdictions. A particularly important finding, as discussed above, is that tax havens tend to have stronger

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<sup>5</sup> Slemrod (2008) conceptualizes tax havens within the broader context of what is termed the “commercialization” of state sovereignty. He suggests a more general interpretation in which stronger governance leads not only to greater policy credibility but also to a greater capacity to undertake welfare-enhancing government activities.

governance institutions (i.e., more robust political and legal systems and lower levels of corruption) than comparable nonhaven countries (Dharmapala and Hines 2009). However, a cross-sectional approach has clear limitations in terms of generating causal inferences. Moving beyond cross-sectional analysis is challenging, though, because of the limited availability of longitudinal data on variables of interest. For instance, data on foreign investment in havens and on foreign accounts held in havens is very limited for past years. Moreover, some variables of interest – such as governance quality – change very slowly (if at all) over time, and so are not readily amenable to longitudinal analysis.

Despite these challenges, a new literature in history, political science, economics, and other disciplines seeks to shed new light on the historical origins of tax haven status. Historians have used archival material to propose new hypotheses about the reasons that particular jurisdictions became havens and about the sources of demand for their services. Political scientists have used detailed case studies to provide new insights on the choice to adopt policies associated with tax haven status. Economists have sought to quantify the legal characteristics of havens and to measure them over a long time period in order to undertake a longitudinal analysis of the determinants and consequences of jurisdictions' adoption of the legal and policy framework associated with tax haven status. A particularly prominent theme in this recent work is the relationship between colonial history (and decolonisation) and the emergence of tax havens. This section reviews this recent literature. It also reports below an original analysis of the relationship between tax haven status and various quantitative measures of colonial history and other historical characteristics (such as state antiquity and past exposure to military conflicts) that have been constructed in the empirical literature on comparative long-run economic development and economic history.

Ogle (2017, 2020) places the emergence of tax havens in the period from the end of World War II to the 1960s in the historical context of the decolonisation of European colonial empires during that period. She argues that capital flight from newly-independent countries ensued, associated with the withdrawal of investments in these countries by European companies and individuals fearful of potential expropriation by post-independence governments. The high tax rates imposed in the European home countries of these investors meant that they were not perceived as attractive places to invest this withdrawn capital. This created demand for alternative (low-tax) venues for investment in the wake of decolonization. According to this account, tax havens emerged to satisfy this demand.

However, Farquet (2021) uses evidence from Swiss archives to establish that the growth of funds invested in Swiss banks over this period was due primarily to inflows from other European countries. Flows from newly-independent developing countries played only a minor role, according to the evidence reported by Farquet (2021). Instead, Farquet (2021) attributes the growth of offshore banking in Switzerland to the liberalisation of capital flows in Europe from the end of the 1950s. The growth of MNC activity over the same period was, he argues, driven by US MNCs' expanding European operations.<sup>6</sup>

Another thread in this literature that links the colonial era and tax havens is the claim that the emergence of tax havens that were associated with the British Empire (or that in some cases are still British overseas territories or Crown dependencies) was encouraged, facilitated, or instigated by British officials. This is thought to be variously motivated by desires to encourage the end of fiscal dependence on the UK government, to foster local economic development, or to further the interests of metropolitan (i.e., UK-based) interest groups. For instance, Ogle (2017, p. 1441) argues that “British officials condoned and sometimes encouraged the emergence of tax havens as a means for resource-poor territories to attract foreign capital and achieve economic uplift.”<sup>7</sup> Palan, Murphy and Chavagneux (2010) also emphasize the centrality of the British Empire and imperial officials and financial institutions in the construction of a global system of tax havens.

Recently, Sævoid (2022) has challenged this interpretation of the rise of tax havens. She draws on archival material from the Bank of England and other British institutions to shed light on the process by which British colonial territories (primarily in the Caribbean) became tax havens. Rather than a conscious policy seeking to establish a global system of tax havens, this process is characterized by Sævoid (2022) as the result of ad hoc responses to highly specific circumstances facing each territory. She concludes that: “These findings support the conclusion that UK tax haven responses were not so much the result of a strategic policy design as they were the consequence of

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<sup>6</sup> In addition, it is not clear that the timing of the emergence of havens in the developing world is fully consistent with this account, at least given the role of geographic proximity in tax haven activity that was discussed above. For instance, if decolonisation in Africa in the 1960s was a causal factor in the emergence of tax havens, then one might perhaps expect that some African havens would have emerged at that time. However, the only African countries that are viewed as havens – Mauritius (Behuria 2023) and the Seychelles (Ellis 1996) – appear to have adopted haven-like policies only at a later time (the 1980s).

<sup>7</sup> Though this literature tends to view this putative policy negatively, it should be noted that its normative evaluation is unclear. It is possible that such policies may be optimal from the perspective of the haven jurisdiction. Indeed, Laffitte's (2023) results suggest a greater propensity to adopt haven-like policies for post-independence governments relative to colonial officials.

a chaotic experience based on ad hoc responses . . . The end result was an unstable and inconsistent UK tax haven position throughout the period.” (p. 4).

Dainoff (2021) also analyzes the question of how jurisdiction become tax havens, focusing on case studies of several important examples (such as the Bahamas). He then addresses the puzzle of how havens have been able to survive in spite of a concerted multilateral effort to combat havens in recent decades. In particular, Dainoff (2021) focuses on two episodes: the OECD’s campaign against “harmful tax practices” in 2000 and the OECD and G-20 efforts to develop lists of uncooperative havens in 2009. He analyzes the impact of each on FDI inflows into havens. He finds no evidence that these campaigns reduced FDI inflows.

It was noted earlier that there is very limited availability of longitudinal data on variables of interest, such as foreign investment in havens and foreign accounts held in havens. To overcome this challenge, Laffitte (2023) codes changes in the laws of haven jurisdictions over time. In particular, he codes legal reforms that introduce provisions associated with havens, such as special legal regimes for trusts or holding companies, financial secrecy laws, and laws enabling the creation of corporations with limited disclosure requirements. There are 148 such reforms across 48 jurisdictions during the twentieth century. These reforms are interpreted as indicating when a jurisdiction became a tax haven.

Laffitte (2023) finds that jurisdictions tend to become havens when demand for haven services increases. The latter is measured using regional demand shocks, as proxied by increased tax rates or the introduction of direct taxes by other countries in the same geographic region. Laffitte (2023) also finds that havens respond to supply shocks by undertaking further reforms. Supply shocks are identified using decolonisation as an exogenous event that increases the supply of havens. An event study approach suggests that decolonisation has a positive causal impact on the likelihood that a jurisdiction carries out legal reforms that make it a haven. This is an important result in the light of the wider literature on havens and colonialism; it suggests that colonial rulers constrained the ability of the jurisdiction to adopt haven-like laws (possibly because such rulers did not fully internalize the benefits to the local population of becoming a haven, or because they placed some weight on possible costs to other jurisdictions). Laffitte’s (2023) event study analysis also finds – consistent with the prior cross-sectional literature such as Hines (2005) – that becoming a tax haven increases countries’ GDP per capita.

#### *4.2) Some New Descriptive Evidence on the Historical Characteristics of Tax Havens*

In view of the prominent role of historical factors – especially those related to colonial rule and decolonisation – in the recent literature surveyed above, this section presents some new descriptive evidence on the historical characteristics of tax havens. In particular, it illustrates the relationship between tax haven status and various quantitative measures of colonial history and other historical characteristics (such as state antiquity and past exposure to military conflicts) that have been constructed in the empirical literature on comparative long-run economic development. The data are drawn from the dataset used in Dharmapala (2021b).<sup>8</sup> On the whole, this descriptive evidence suggests that tax haven jurisdictions are generally not appreciably different from comparable nonhaven jurisdictions in their historical experience of foreign rule and in other historical characteristics.

There are several different measures of countries' colonial history that have been constructed in the academic literature. A widely-used measure is from Acemoglu, Johnson and Robinson (2001; hereafter AJR). The context for their measure is that they use European settler mortality in the colonial era as a source of exogenous variation in the extent of European settlement. Their claim is that higher settler mortality led to extractive colonial structures that tend to have a persistent negative impact on the quality of institutions (and hence on the level of economic development). The results reported in AJR primarily use data on a sample of 64 former colonies. However, they also report data on what they term their “whole world” sample (AJR, Table 1, p. 1377). For this larger sample (of both ex-colonies and other countries), they construct a binary classification of the countries' former colonial status.<sup>9</sup> About two thirds of these countries are ex-colonies according to their coding.

Another coding of colonial history is found in the Issue Correlates of War (ICOW) database constructed by Paul Hensel.<sup>10</sup> This data “seeks to identify colonial or other dependency relationships for each state over the past two centuries.” The ICOW data reports the former colonial ruler for a large sample of countries and territories. The ICOW dataset makes a determination as to the “primary” former ruler in cases where a country had multiple foreign rulers at different times. A binary ICOW-based “foreign rule” variable is constructed in Dharmapala (2021b) by

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<sup>8</sup> This dataset is available at: <https://doi.org/10.1111/ecin.12959>

<sup>9</sup> The dataset is available at: <https://economics.mit.edu/faculty/acemoglu/data/ajr2001>

<sup>10</sup> This dataset is available at: <https://www.paulhensel.org/icowcol.html>

coding all countries that have a former colonial ruler in the ICOW dataset as ex-colonies. About 85% of the countries in the ICOW data are ex-colonies by this definition.

Dharmapala (2021b) constructs a novel measure of foreign rule that is continuous rather than binary. This measure uses the genetic distance between ruling elites (including, but not limited to, European colonial rulers) and the ethnic majority population of the jurisdiction in the year 1900. This distance is computed drawing on bilateral genetic distance data for countries and populations constructed by Spolaore and Wacziarg (2009, 2018). Genetic distance provides a measure of the time that has elapsed since two populations last shared common ancestors. It is based on random drift in neutral characteristics, rather than on traits selected for fitness. In sufficiently large populations, random genetic drift occurs at a predictable rate. Thus, genetic distance - as measured using random genetic drift - will be larger for populations that have been separated for longer periods. It is important to emphasize that, in this literature, genetic distance serves as a proxy for proximity in cultural traits among populations; as the measure is based on random genetic drift, there is no suggestion that traits relevant to economic development or other outcomes are transmitted genetically.

Dharmapala (2021b) identifies the ethnicity of ruling elites and ethnic majorities in 1900 for a large sample of 228 countries and territories, drawing on a variety of historical sources. This historical information is then combined with the Spolaore and Wacziarg (2009, 2018) genetic distance data to construct a measure of “elite-population genetic distance” in 1900 (EPGD). Dharmapala (2021b) shows using principal components analysis that EPGD contains substantial additional information and variation beyond the dichotomous measures of foreign rule (the AJR and ICOW indicators) described above.

An important issue discussed widely by scholars of colonialism is the distinction between direct and indirect rule. This is a concept that is not straightforward to quantify. However, Lange (2004) constructs an index of the role of legal and administrative institutions characteristic of indirect rule for 33 formerly British-ruled territories. This index represents the number of court cases recognizing customary law in 1955 relative to the total number of court cases in that territory in that year. The basic idea is that more extensive legal recognition of customary law is likely to be associated with a greater degree of indirect rule.

An important variable in cross-country studies of long-run economic and political development is state antiquity. This was originally constructed by Bockstette *et al.* (2002). An

updated and extended version of this variable is reported by Borcan *et al.* (2018). The index provides a measure of societies' state-building capabilities, as realized over recorded history in the form of historically-attested state structures. For each country, the measure assigns a score for each 50-year period from the year 1 of the Common Era to 1950 based on the existence of a large-scale state and the extent of independent local control. An ancestry-adjusted version of the index measures the state-building history of populations currently resident in a country, by taking account of population flows since 1500. The index also discounts past state-building history at a 1% annual discount rate. A potential concern with the index is that post-1500 values of the index may partly reflect state-building activities conducted by European colonizers or other foreign rulers. To address this, Hariri (2012) constructs a version of the state antiquity index that only represents state history up to 1500. This is used in the analysis below (although the results are not substantially affected by using the standard version of the index that ends at 1950).

A longstanding theme in the study of taxation is the role of external military conflicts in stimulating the development of tax capacity. Dincecco and Prado (2012) use various historical sources to construct a series of variables that provide quantitative measures of countries' military history over the period 1816-1913. These include the number of wars fought, the number of deaths in war, and the number of years during which the country was engaged in war. The country coverage of these variables is relatively limited, with observations on 96 countries (of which very few are havens). Nonetheless, the relative values of the number of years during which the country was engaged in war for havens and nonhavens are reported below.

Figure 1 illustrates the relative values of each of the historical variables described above for havens and nonhavens. This sample uses all countries (regardless of population size). Using the AJR measure, the fraction of havens and nonhavens that are former colonies is virtually identical (slightly over two thirds for both groups of countries). Using the ICOW measure, havens are slightly less likely to be former colonies relative to nonhavens: about 81% of havens are former colonies, while about 86% of nonhavens are former colonies. Using the EPGD measure of foreign rule, there is again no substantial difference between havens and nonhavens. Havens are slightly more likely to have been ruled by genetically distant elites, but the difference is by no means large.

The ICOW dataset reports the specific colonial power, and so it is possible to construct a measure of past British rule (rather than of colonial rule in general). As shown in Figure 1, havens are substantially more likely to be former British colonies than are nonhavens. About three fifths



of havens are former British colonies, compared to about a quarter of nonhavens. This may seem to be consistent with the literature in history and political science that emphasizes the role of the British Empire in the creation of tax havens. However, as discussed above, that characterization is contested within that literature (e.g., Sævold 2022). Moreover, it is unclear how to interpret the correlation between British rule and tax haven status. It may be, for instance, that this is simply an artifact of the propensity of havens to have common law origins (as reported in Dharmapala 2008), reflecting the collinearity of past British rule and common law origins. In any event, this correlation does not necessarily imply any deliberate British policy to create tax haven jurisdictions.

Among British ex-colonies, havens are substantially more likely than nonhavens to have been subject to direct rather than indirect rule. However, a caveat here is that the sample size is small (with six havens and 27 nonhavens). The state antiquity measure from Hariri (2012) for the period up to 1500 is very similar for havens and nonhavens. However, there is quite limited coverage of havens in this data. Finally, havens appear to have a relatively peaceful history. They have experienced zero years of war over 1816-1913, while nonhavens have experienced wars in about 17% of years over that period. Again, however, there is very limited coverage in this dataset, especially of havens.

Figure 2 illustrates the same variables, but with the sample restricted to small havens and nonhavens, specifically those countries and territories with population below one million in 2004. Again, there is little difference in the various measures of past foreign rule across havens and nonhavens. Indeed, small nonhavens are somewhat more likely to have been colonies than small havens, and the small nonhavens were on average ruled by somewhat more genetically distant elites than were small havens. The sharp difference across havens and nonhavens in the likelihood of being a former British colony is robust to considering only small havens and small nonhavens. Among former British colonies, direct rule remains more likely among small havens relative to small nonhavens. Results for state antiquity and past involvement in external military conflicts are not shown in Figure 2 because coverage of small countries (both havens and nonhavens) is too limited in these datasets to make meaningful comparisons.

Figures 1 and 2 illustrate some relevant descriptive facts about the historical experience of tax haven jurisdictions in relation to the rest of the world. As noted above, the current literature suggests that the timing of the adoption of tax haven status tended to follow decolonization

(Laffitte 2023). The descriptive evidence summarized above shows that – even if the timing of the adoption of haven-like laws followed decolonisation - tax haven jurisdictions are generally not appreciably different from comparable nonhaven jurisdictions in their historical experience of foreign rule and in other historical characteristics. That is, it is entirely logically consistent for colonial history to have had a limited impact on which countries become havens, and yet for those ex-colonies that became havens to have done so shortly following their decolonisation. Of course, the evidence presented here is merely descriptive. However, it suggests some caution in attributing tax havens jurisdictions’ status as havens to their colonial history or to other historical variables.

Another conceptual issue to consider is whether – even if colonial history does play a significant role in determining tax haven status – there are any present-day policy implications of this claim. There is of course considerable intrinsic intellectual value in understanding the historical origins of important phenomena. However, the recent literature on the colonial origins of tax havens has not focused very much on how such an understanding might inform current policymaking. This remains an important area of inquiry for future research.

## **5) Conclusion**

Tax havens have become a subject of great interest among policymakers, scholars and the general public. They are a central focus in current policy debates on a variety of issues related to the reform of international taxation. This chapter has provided an overview of the scholarly literature across several academic disciplines on the characteristics and origins of tax havens. It has also presented a descriptive analysis of the relationship between tax haven status and various quantitative measures of historical characteristics. On the whole, this descriptive analysis suggests that tax haven jurisdictions are not appreciably different from comparable nonhaven jurisdictions in their historical experience of foreign rule and in other historical characteristics. This suggests some caution in attributing tax havens jurisdictions’ status to their colonial history or to other historical variables.

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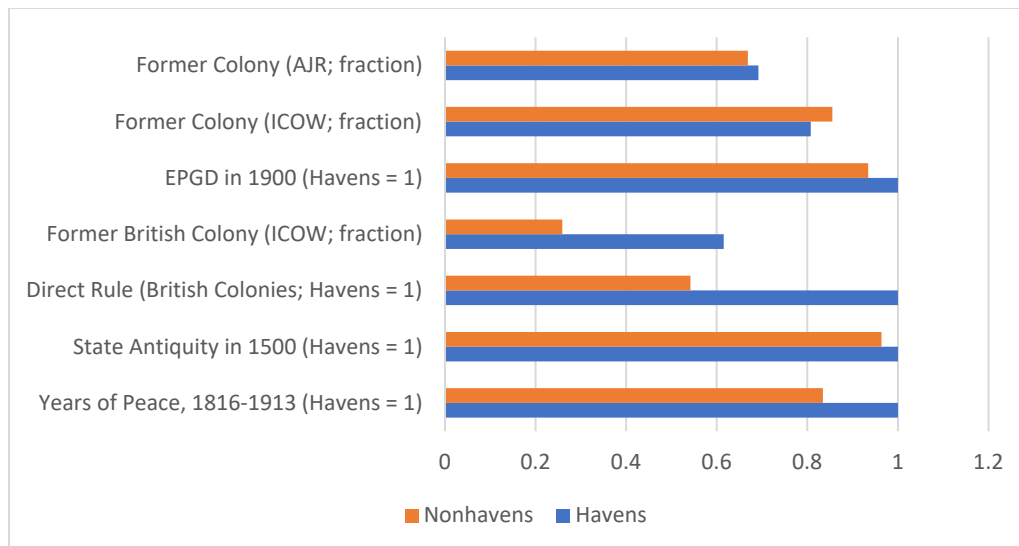
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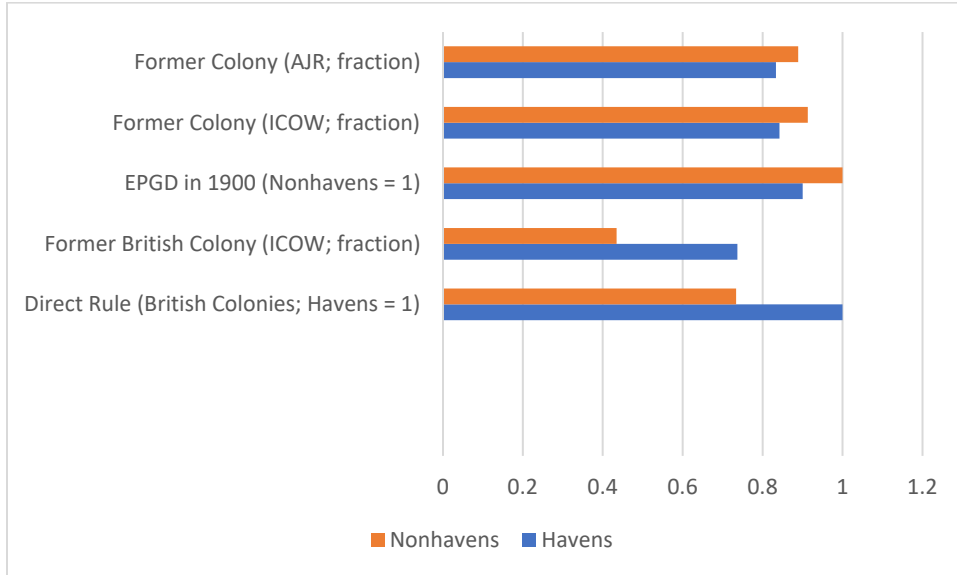
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**Figure 1: Historical Characteristics (All Countries)**



Note: The AJR ex-colony variable is a binary classification of countries formerly under foreign rule from Acemoglu, Johnson, and Robinson (2001). The ICOW measure is also a binary classification of countries formerly under foreign rule, based on the Issue Correlates of War (ICOW) colonial history database constructed by Paul Hensel. EPGD is the measure of the genetic distance between a country’s ruling elite and its ethnic majority in the year 1900, from Dharmapala (2021b). The classification of direct versus indirect British rule is from Lange (2004), who constructs an index that represents the number of court cases recognizing customary law in 1955 relative to the total number of court cases in that territory in that year. The index of state antiquity is from Hariri (2012). It assigns countries a score for each 50-year period of history up to the year 1500, based on the existence of a large-scale state and the extent of independent local control. The number of years during which the country was not engaged in war (for external wars over 1816-1913) is from Dincecco and Prado (2012).

**Figure 2: Historical Characteristics (Small Countries)**



Note: The AJR ex-colony variable is a binary classification of countries formerly under foreign rule from Acemoglu, Johnson, and Robinson (2001). The ICOW measure is also a binary classification of countries formerly under foreign rule, based on the Issue Correlates of War (ICOW) colonial history database constructed by Paul Hensel. EPGD is the measure of the genetic distance between a country's ruling elite and its ethnic majority in the year 1900, from Dharmapala (2021b). The classification of direct versus indirect British rule is from Lange (2004), who constructs an index that represents the number of court cases recognizing customary law in 1955 relative to the total number of court cases in that territory in that year.