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Colonialism Redux: How the EU Is Punishing a Tiny Island Nation for Not 'Playing Fair'

The unequal matchup between a bureaucratic behemoth and Vanuatu reveals more about history and geopolitics than it does about financial irregularities.

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Credit: Depositphotos

In January 2015 the Asia/Pacific Group on Money Laundering (APG) reported one of its member jurisdictions for serious anti-money laundering and counterterrorist financing (AML&CTF) deficiencies. The member in question was Vanuatu: a sprinkling of volcanic islands in the South Pacific, with a population of barely 300,000 Ni-Vanuatu. The Financial Action Task Force (FATF), responding to the APG at its February 2016 plenary session in Paris, placed Vanuatu on its dreaded grey list.

The FATF represents 39 member nations and organizations, including the APG, and was created in 1989 by the G-7 to spearhead anti-money laundering and, later, counterterrorist financing efforts. By setting world standards for financial compliance, it also functions as the gatekeeper for international trade. And that's precisely where this story begins.

The FATF black list is a formidable instrument. Only North Korea and Iran enjoy full pariah status on the list. But even grey-listing has ramifications, complicating international fund transfers, foreign direct investment, and correspondent banking. It's tantamount to a global bureaucratic shunning, as other financial centers embargo the listed party.

In Vanuatu's case, Australian and U.S. banks responded by closing their correspondent accounts in Vanuatu and thereby tarring this island nation as a high-risk place for business. For a small though resolutely independent country struggling to achieve developing nation status, grey-listing amounted to full-on economic sanctions.

It's worth noting that the FATF listing was not because of any evidence of money laundering. The punishment was for legislation and oversight deemed not tough enough.

But the stigma did have immediate consequences, and the country's leaders were acutely aware that Vanuatu could soon plunge into an economic abyss. Only an all-out effort at full compliance would turn the tide. So began an ambitious drive to overhaul Vanuatu's financial system.

Cleaning House

A National Coordinating Committee was struck to address AML&CTF deficiencies by shoring up policies, legislation, and institutions. In a rare act of unanimity, government and opposition quickly passed dozens of legislative amendments and laws as part of the FATF's prescribed action plan, including a strong Financial Investigation Unit, a robust Financial Services Commission, and a trusted Reserve Bank. By 2018 these institutions were comparable to those in more developed countries. Indeed, the compliance burden for Vanuatu's banks and exporters is today actually higher than for Australia or Canada.

In June 2018, the FATF formally announced Vanuatu's delisting due to "significant progress." For the citizens of Vanuatu, this was nothing short of a triumph, as the engines of economic growth could once again restart, and the stain on Vanuatu's reputation begin to recede.

The story should have ended there. It was only a procedural matter for the IMF, the World Bank, the ADB, and all FATF members to follow suit and remove their own restrictions. Indeed, they all reinstated Vanuatu, except for one FATF member – the EU.

The complications that shadow Vanuatu to this day began five months after the FATF's original 2016 grey-listing, when the European Commission issued its own list of "high-risk third countries with strategic deficiencies." The list included Vanuatu.

Over the next several years, drafts of the EU list went through several iterations. Without inquiry or explanation, tiny Vanuatu remains stubbornly and inexplicably marooned in EU purgatory. When pressed on the matter, EU leadership has only come up with Kafkaesque obfuscation and shifting rationales and reasoning.

Clearly, the island nation (with a 2019 GDP of $900 million) represents some kind of menace to the EU (2019 GDP $21.4 *trillion*). But why? What precisely strikes so much fear in the heart of bureaucratic Brussels? I hope to answer that below.

A Tale of Two Lists

To gain clarity on this baffling issue, it's important to note that the EU actually wields *two* lists.

The first, the AML-CTF list, which covers money laundering and the financing of terrorism, is the most reputationally damaging of the two. Vanuatu's exile to the AML-CTF should have been rendered null and void immediately upon FATF's declaration that, following successful reforms, Vanuatu now complied with the letter and spirit of all recommendations. But that never happened.

That's because there is a *second* EU list, this one for "non-cooperative tax jurisdictions" that "consistently refuse to play fair on tax matters."

So, in plain words, EU countries believe this tiny island nation's fiscal regime has an unfair advantage in the global competition to attract foreign investment.

As it now emerges, the EU is using the far more damaging AML-CTF list as leverage to pressure Vanuatu into "playing fair" on tax matters. In other words: Bow to our notion of what's fair by changing your taxation model to something we like, and we'll reward you by removing you from the list of nations that support money laundering and finance terrorism. This sounds very much like extortion.

From the EU's perspective, "lack of fairness" comes down to this: Individuals and companies, whether domestic or offshore, pay zero income tax.

In common parlance, this makes Vanuatu a "tax haven," which carries unfortunate associations in Western culture. But these are moral and therefore subjective characterizations, with no basis in law. After all, every sovereign nation has the right to create a tax regime that's in its best interests. By contesting that right with sanctions, the EU is declaring itself to be the arbiter of what's fair. But fair for whom?

After all, blacklisting carries a host of investor-chilling penalties, such triggering a withholding tax on payments received in

Vanuatu by European companies. But the biggest penalty, of course, is reputational.

Every sovereign nation does what it must to thrive, or in Vanuatu's case, simply survive. When it comes to taxation, Vanuatu is fully transparent: zero tax. But this is more than can be said for many EU countries and territories.

According to IMF research, "the eight major pass-through economies—the Netherlands, Luxembourg, Hong Kong, the British Virgin Islands, Bermuda, the Cayman Islands, Ireland, and Singapore—host more than 85 percent of the world's investment in special-purpose entities, which are often set up for tax reasons." Three of these are British territories and three are European member countries. None is blacklisted.

Many EU members and neighbors also appear high on the Tax Justice Network's Corporate Tax Haven Index. Vanuatu doesn't even crack the Top 70. These higher income countries account for 98 percent of tax losses worldwide, or over $419 billion in lost tax annually. As for lower-income countries, of which Vanuatu most certainly is one, they account for less than 2 percent.

Non-Cooperative… or Just Sovereign?

So far, Vanuatu has resisted the EU's demands for a couple of reasons.

First, an income tax makes little sense in a country of 300,000, of whom some 20 percent participate in the formal economy – or even have electricity. The tax base would be between 10,000 and 15,000 businesses and individuals, barely enough to cover the administration costs alone.

Second, imposing a tax regime that's better suited to developed nations would be both intrusive and economically disastrous, erasing Vanuatu's chief competitive advantage. The next generation of Ni-Van would likely see their range of career choices shrink to agriculture or tourism: essentially harvesting coconuts or serving them poolside.

For Vanuatu, then, it's far better to be blacklisted as an uncooperative tax jurisdiction and lose potential European corporate inflows, than to jettison its tax advantage and dash any hope of developing its tertiary sector.

By collecting no income tax on individuals or corporations, and providing no industry subsidies, Vanuatu is "government-light." But for the decidedly government-heavy EU, this is heresy. If poverty-stricken Vanuatu were to prosper, what message would that send to neighboring New Caledonia, and to French Polynesia? Vanuatu's success could positively ruin the established order. The natives might get dangerous ideas.

This is the nub of the matter. For centuries, Europeans saw themselves as benefactors, bringing their bounty of civilization, Christianity, and commerce to the less enlightened. It's a powerful and insidious self-image, one tainted with righteousness and, with the passing years, tinged with nostalgia. It's hard to let go.

Tiny, But Sovereign

Maybe I should have picked up our story a little earlier, when the Republic of Vanuatu was founded on July 30, 1980. Before that, during the 74-year Franco-British Condominium of the New Hebrides, the European powers spent more time quarrelling than doing much for their subjects. Like many peoples around the world, Ni-Vanuatu eventually broke free – but not as entirely as they would like.

Vanuatu has received a steady flow of foreign aid ever since, mostly from Australia, the U.K., France, and New Zealand. More recently, non-OECD donors like China and India and private philanthropic organizations have also pitched in.

Their generosity has been vital to Ni-Vanuatu and deeply appreciated, especially during natural disasters. But foreign aid is not a sustainable revenue model for an independent country, especially one with a stagnant economy. Growth in 2017-2018 was 2.7 percent and per capita income just over $3,000 in 2019 (and that was before COVID-19 hit). The only way forward for Vanuatu is to cut the cord of foreign aid, which has an outsize potential for political interference.

But how does a poor island nation with few natural resources and little geostrategic value do that? Agriculture is at subsistence levels, and tourism is limited to regional markets. Nevertheless, sustainable growth is possible, especially in today's world.

Financial services, software development, biopharmaceutical research, and other knowledge industries need only an educated workforce and an internet connection to thrive. Vanuatu's business-friendly tax regime is therefore the country's best shot at attracting foreign investment, entrepreneurs, and skilled workers who will train the next generation of Ni-Vanuatu to join them. It's the best shot at building economic self-sufficiency.

As in any sovereign democracy, government policies should reflect the will of the people, in line with their identity and values (or *kastom* as the Melanesians say), not the over-reach of former colonial powers.

Vanuatu complied with all the FATF's demands and did what's right. Now it's being wronged. The European AML&CTF blacklist, ostensibly set up to fight financial crime, is instead eroding Europe's credibility. The real crime is to blacken Vanuatu's reputation and tie its hands, all in the service of a shameless tangle of geopolitics, sanctimonious posturing, and blatant self-interest.

The real crime is treating Vanuatu like a vassal state when it is in fact a sovereign one.

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