2011-7

From Boom to Doom to Boom: Offshore Financial Centres and Development in Small States

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Accomplishing sustainable development is fraught with complications. For small jurisdictions these nuisances are exacerbated by shortages of human and natural resource endowments, pint-sized domestic markets, and concentration on a handful of economic sectors defenceless against the whims of larger states and the mutability of global capitalism (Armstrong and Read 2003; Commonwealth Secretariat 1985; Commonwealth Secretariat/World Bank Joint Task Force on Small States 2000; Peretz et.al. 2001). Small island jurisdictions encounter additional uncertainties, not least outlying export markets and exposure to natural and man-made catastrophes such as earthquakes, volcanic eruptions, hurricanes and rising sea levels (Dommen 1980; Srinivasan 1986; Kakazu 1994; Briguglio 1995; Read 2004). Recently, however, some authors have suggested 'smallness' confers resilience as well as vulnerability (Briguglio and Kisanga 2004; Baldacchino 2006; Baldacchino and Bertram 2009) with many territories manipulating their sovereign or autonomous powers to establish rules pandering to the requirements of niche markets. Nowhere is this more ostensibly illustrated than in the field of offshore finance.

Egged on by former colonists and the international financial institutions (Hampton 1994; UK House of Commons Treasury Select Committee 2009: 72) offshore financial services have, over five decades, become an integral part of development strategies in a multitude of small jurisdictions. Moreover, small territories hosting offshore financial centres (OFCs) frequently populate the upper echelons of rankings listing GDP per capita and human development (see Table 1), outperforming corresponding economies without OFCs and lending credence to claims that the provision of offshore financial facilities "appears to be a successful economic development strategy for those countries that are able to make this choice" (Dharmapala 2008: 665). Nonetheless, in the 1990s, the international communities' acquiescent attitude towards the offshore world underwent a dramatic transformation. The developmental perks harvested by small jurisdictions were increasingly outweighed by the damage being wrought by policies designed to lure capital offshore. The lenient regulations, low or no taxation, and opacity emblematic of the offshore world were thought to be triggering or aggravating financial crises, stifling development by offering plutocrats a conduit to pillage the aid budgets, tax and mineral earnings of countries in the global South, permitting the laundering of the proceeds of illegal activity and, lately, monies linked to terrorist conspirators (Lilley 2006; Farah 2004). Places with OFCs were pilloried as "parasites" (Palan and Abbott 1996) and "pariahs" (Hampton and Christensen 2002) of the international financial system and subjected to a string of initiatives by the Group of Seven/Eight (G7/8), the Financial Stability Forum (FSF), the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD), and the European Union (EU) calculated to hoist their tax and regulatory regimes up to internationally agreed standards. Small states with OFCs were anxious that compliance with these templates would violate the conditions that had made these secluded spots profitable, an apprehension heightened by their voices being unheard in the Northern dominated crucibles in which these stencils were forged.

For reasons explored below, this "clampdown" did not trigger the demise of OFCs. Ironically by burnishing their regulatory credentials the standing of OFCs with international investors may have improved. Nevertheless, small states remained wary, believing that OFCs would be scapegoats for future crisis, especially if Northern states needed to deflect attention from their own regulatory foibles (Persuad 2009). Sure enough, amidst the present economic tempest, the offshore world has found itself under the microscope. Though they have refrained from incriminating OFCs in causing the crisis, critics argue they “contributed powerfully to it” by boosting liquidity, providing tax inducements that persuaded financial institutions to amass debt and leverage, supplying sanctuary to crooks and swindlers, adulterating tax and regulatory standards by engaging in harmful competition, and exaggerating mistrust between financial institutions unable to verify the creditworthiness of their counterparties (Tax Justice Network 2009; see various submissions to the UK House of Commons Treasury Select Committee 2009). In the run up to their Summit meeting in London in April 2009 several Group of 20 (G20) leaders articulated a desire to decimate tax havens and the Summit Communiqué promised “the era of banking secrecy is over” (G20 2009).

The remainder of this chapter examines the impact the regulatory onslaught against OFCs and the contribution of North-South and South-South politics to the process. Ruminations surrounding offshore regulation portray it as a predominantly North-South issue with institutions commanded by Northern states pursuing projects intended to reinforce the competitiveness of their own financial centres while subjugating OFCs in the South. The reality is more complicated. Some small state OFCs are found in the North and many others are too developed to warrant inclusion amongst what might conventionally be regarded as the ‘South’ (see Table 1). Furthermore, to weather the pre and post-millennial whirlwind whipped up by the G7/8, IMF, FSF, FATF, OECD and EU, small states with OFCs aligned themselves with Northern states and interests. The South-South dimension of the debate centred on the developmental impact of OFCs and, in particular, whether development in small state OFCs came at the expense of developing countries elsewhere because the former offered a place to which kleptocratic regimes could siphon the assets of the latter. The steady trickle of economic power towards states, corporations and individuals in the global South has introduced new dimensions to the South-South offshore debate. Most notably a growing proportion of the world's High Net Worth Individuals (HNWIs) and corporate actors, the core consumers of offshore financial services, hail from the South. The picture is misty, but to placate these interests the emerging powers in global governance may prove enthusiastic proponents of offshore finance. For all the current bluster about the "end" of tax havens and offshore finance this chapter argues that OFCs, aside from a few marginal players, will flourish. Ultimately, the closure of tax havens and OFCs is in everyone's interests apart from their hosts, the rich and the powerful (be they states, corporations or individuals). Unfortunately it is the rich and powerful, irrespective of their geographical location, who write the rules.

The following section defines 'offshore' and describes the blooming of offshore financial services and centres before going on to assess their contribution to small state development. Next, the chapter outlines and discusses the impact of the first round of initiatives minded to tauten the offshore regulatory net, paying particular attention to how this enterprise was perceived as attempts by Northern bodies to browbeat Southern jurisdictions into submission. The fourth section prognosticates about the bearing of contemporary events and schemes, including that promulgated by the G20, on small jurisdictions with OFCs.

The offshore development strategy and small states

To the layperson, "offshore" conjures up images of serene island paradises whose adjacent seas act as an unbridgeable moat shielding denizens from the privations of the onshore authorities. In fact, this metaphor is misleading. The distinguishing feature of offshore activities is not their physical location but the *rules* governing them. Offshore alludes to "special territorial or juridical enclaves characterised by a reduction in regulations.....marking off activities or territories in which the state's regulation and taxation (but not the law) are fully or partially withheld" (Palan 1998: 626). Offshore transactions may occur in mainland states but under rules more indulgent than their onshore equivalents. The tolerance afforded by offshore rules finesses the ease and lowers the cost with which business can be executed. Offshore manifests itself in a variety of ways (see Palan 2003) but arguably it is in the financial sphere where it has advanced furthest. OFCs offer non-residents a blend of tax and regulatory dispensations. Vitally these privileges are complemented by a cloak of secrecy. Offshore authorities routinely fail to collect information on the genuine beneficiaries of assets or, if they do, iron-clad confidentiality legislation prohibits divulging it to their foreign counterparts. This camouflages offshore assets and their owners, shielding them against their onshore fiscal and regulatory obligations.

The dearth of a universally agreed definition and the inscrutability of OFCs hamper efforts to gauge offshore financial activity. The evidence, though incomplete, indicates that since the late 1960s offshore finance has blossomed driven by capital account liberalisation, financial deregulation, technological progress, and upheavals such as the oil crises. In the 1970s, one of the first reviews of the offshore world listed 31 OFCs (Diamond and Diamond 1974). Today 91 jurisdictions appear on lists of OFCs produced by regulatory agencies, lobbyists, and academics of which 56 merit "serious consideration as tax havens"

(UK House of Commons Treasury Select Committee 2009: 29-30). Between 1968 and 1978 the deposits of offshore banks ballooned from $11 billion to $385 billion (OECD 1987: 27). By the end of the 1980s, Caribbean islands alone harboured $400bn of bank deposits (Peagam 1989) and Kochan (1991: 73) speculated that "as much as half of the world's stock of money either resides in, or is passing through, tax havens." At the turn of the century, estimates of offshore assets ranged from $5.1 trillion (Diamond and Diamond (quoted in Palan 2002: 156)) to $7 trillion (Oxfam 2000) and have continued to spiral. Using data from global wealth surveys, the Tax Justice Network (2005) reckoned that HNWIs alone had assets worth $11-12 trillion stashed offshore. If categorised by the magnitude of the external assets of their banks, the Cayman Islands is the world's fifth biggest financial centre with Singapore and Jersey also nestling inside the top 15 (BIS 2009: 36-7) (see Table 2). Although they are managed onshore, in 2006 half of hedge funds were domiciled offshore of which two-thirds were in the Caymans, followed by 11% in the British Virgin Islands and 7% in Bermuda (International Financial Services London 2009).

Offshore strategies are ideally suited to the constraints and opportunities of small states. OFCs can operate with a minimum of physical infrastructure, do not compete directly with native businesses, and small states can harness their jurisdictional capacities to erect a fiscal and regulatory enclave conducive to investment (Baldacchino 2006; Woodward 2004). Owing to their diversity (see Table 4) generalisations pertaining to the contribution of OFCs to small state development are laden with problems. Hampton (1996: 4-8) usefully distinguishing amongst 'notional' and 'functional' OFCs. Notional OFCs are "booking centres" the crux of whose business is recording transactions taking place elsewhere. This high volume, low margin business makes a negligible contribution to the host's economic wellbeing. Functional OFCs are fully-fledged financial centres offering an assortment of tailored, high value added services sourced from financial services companies and professionals, the so-called “pinstripe infrastructure” (Hampton and Christensen 2007: 1002), that maintain a tangible presence. These centres contribute significantly to employment, income, and government revenue.

Some broad observations about the efficacy of the offshore strategy are possible, however. Contemporary tribulations notwithstanding, the upbeat performance of financial services contrasts sharply with the primary sector upon which many small states, especially tropical islands, traditionally depended. Armstrong and Read (1995) demonstrate that financial sector activity is amongst the leading explanations for the economic success of European micro-states, and numerous studies show that in the last quarter century economic growth in small states hosting OFCs has outstripped that of comparable jurisdictions without and that of the world as a whole (Durney, Li and Magnan 2009; Dharmapala 2008: 663-5; Hines 2005). Higher salaries for skilled finance professionals generate multiplier effects when spent in the locality (Commonwealth Secretariat 2000: 4), spur indigenous labour to upgrade their skills, and alleviate the emigration of talented individuals that afflicts small states (Biswas 2001). Finally, there are infrastructural symbioses between OFCs and other industries, principally tourism, with airports, hotels and telecommunications amongst the amenities indispensable to both.

Opponents posit that the economic remuneration is muted. OFCs chiefly employ expatriates, fettering the benefits to the local community (Hampton and Levi 1999). Moreover, the economic returns are overshadowed by the attendant maladies of offshore finance. Christensen and Hampton (1999) depict OFCs as a “cuckoo in the nest” disgorging existing industries and capturing the state apparatus. Vertiginous house prices, chronic labour shortages, and the attenuation of agricultural land are just three symptoms associated with the growth of OFCs in small states. Far from diversifying small state economies OFCs make them more dependent on one sector. In once relatively diverse economies such as Jersey and Guernsey financial services now account for sizeable proportions of GDP, employment, (see Table 4), and government revenue (Williams, Suss and Mendis 2005; "Sinking assets" 2009). Such reliance leaves the political machinery vulnerable to capture by vested interests. Individual financial firms exert more influence than the electorate in many small states. In others, criminal interests subvert effective public administration (see Connell 2006) jellifying the integrity upon which successful financial centres are built.

Phase 1 – OFC re-regulation as a mostly 'North-South' issue

The enormity of assets transiting OFCs combined with a (sometimes unfair) notoriety for flouting best practices ensured the offshore realm became pivotal to efforts in the 1990s and 2000s to refurbish the international financial architecture. Offshore was not a pure North versus South issue. Fissures amongst North states frustrated and occasionally eviscerated action against OFCs and fierce competition amongst OFCs of the 'South' meant they rarely presented a united front. There were rumblings about the effects of OFCs on Southern development, but for the moment this concern was secondary. Nonetheless, North-South clashes dogged endeavours to toughen offshore regulation. The work was delegated to an epistemic community dominated by experts drawn from Northern states and which coalesced around organisations controlled by and reflecting Northern interests (Marshall 2007). OFCs cleverly exploited this to elicit sympathy for their case.

Hostilities against OFCs were fought on different fronts but shared a methodology. Each proceeded on the premise that membership of the global financial community was contingent on obedience to its rules. OFCs were appraised against rules prescribed by the relevant, typically Northern, organisation. Jurisdictions not attaining stipulated standards were hurled onto ‘blacklists’ (see Table 3) in the belief that ‘naming and shaming’ would induce them to address regulatory deficiencies. Territories failing to mend their ways would be excommunicated because either (a) business, fearing the reputational repercussions, would shy away from outcast jurisdictions; or (b) would liable to countermeasures which would raise the cost of or outlaw transactions there. In short, OFCs had a stark choice: conformity or closure.

FATF spearheaded action on money laundering and terrorist finance. Created by the 1989 G7 Summit and housed at the OECD, FATF is renowned for its 40 Recommendations to counter money laundering and the 9 Special Recommendations to combat terrorist financing devised after 9/11. In recent years, the BRICSAM countries have joined FATF but the 34-strong membership parades a stalwart Northern bias. During its debut decade, FATF mainly pondered the anti-money laundering antics of the members. In 2000, however, it launched the Non-Cooperative Countries and Territories (NCCT) initiative directed at non-members. By September 2001, 47 jurisdictions had been evaluated, 23 were found wanting, blacklisted, and prone to FATF Recommendation 21 which asks financial institutions to pay “special attention” to business relationships in the territory. Jurisdictions were delisted once FATF deemed the blemishes rectified. If FATF judged territories not to be remedying faults further countermeasures, including enhanced reporting requirements, applied. Over half the territories investigated, and 11 of the 23 blacklisted, were small state OFCs.

The FSF, exclusively populated by central bankers and regulators of Northern countries, led the battle against supposedly inferior offshore regulation. Official diagnoses of the 1997-98 Asian financial crisis ascribed a prominent role to defects in prudential oversight of offshore finance (IMF 2000). The FSF's Working Group on Offshore Financial Centres insisted that obedience to a portfolio of international standards would lessen the likelihood of OFCs jeopardising financial stability (FSF 2000). Responsibility for this was transferred to the IMF's Offshore Financial Centres Program which weighed "the supervisory and regulatory arrangements relevant to reducing potential vulnerability in the jurisdiction and internationally" (IMF 2002: 4) on a quadrennial or quintennial basis. The inaugural phase of assessments was completed in 2005.

The final prong, piloted by the OECD and EU, was harmful tax competition. States from these Northern organisations believed they were haemorrhaging revenue because HNWIs and corporations were stashing assets in OFCs. Each year HNWIs were thought to avoid $255bn in tax (Tax Justice Network 2005) through offshore shenanigans. The extent of offshore corporate tax avoidance is unknown but the $350bn profits repatriated by American companies during George Bush's 2004-2007 tax amnesty implies it is sizeable ("All together now" 2007). In 1996, the travails of EU led efforts to stifle tax competition resulted in the emergence of a parallel process in the OECD. All OECD members bar Switzerland and Luxembourg endorsed a 1998 report vouching them to extinguish harmful tax practices (defined as the combination of low or no rates of taxation with a lack of transparency or disinclination to exchange information for tax purposes) within five years (see OECD 1998). Controversially a new OECD body, the Global Forum on Harmful Tax Practices, was tasked with producing a list of non-members perpetuating harmful tax regimes. Forty-seven jurisdictions, virtually all small territories, were inspected. Six were exonerated, 6 made commitments, and the remaining 35 dumped on a list of 'uncooperative tax havens' and set a deadline of July 2001 to commit or face 'countermeasures' from OECD countries (see OECD 2000). The onset of the Bush administration derailed the OECD locomotive. Lobbied intensely by libertarian think tanks, corporations and the transnational tax planning industry the Bush administration withdrew support for key parts of the project. To save the initiative the OECD made compromises, the most significant being that countermeasures could not be enforced against non-members unless they applied to OECD members who were contravening the rules. The initiative survived but had reached an impasse. All but three listed non-members signed up safe in the knowledge that no action would be taken against them while tax secrecy persisted in OECD countries, something that Switzerland and Luxembourg amongst others exhibited few signs of dismantling. In 2005, after a lengthy gestation, the EU concluded a deal on tax competition, the Savings Tax Directive. The Directive applied to all EU members and selected non-members including Switzerland and many small state OFCs. In one respect the Savings Tax Directive was more radical than the OECD's approach insofar as it envisaged automatic exchange of tax information on interest reaped by assets belonging to non-residents rather than the exchange of information on request. Nevertheless, to close the deal the EU had made concessions, agreeing to an interim period in which countries could levy a withholding tax on non-resident income in lieu of information exchange, an offer seized upon by Austria, Luxembourg, Belgium, Switzerland and six small states.

These programs extracted rumbustuous ripostes from small jurisdictions who accused Northern states of "bullying" (Persuad 2001) and "colonialism" (Sanders 2002). Their foremost objection, echoing other areas of global governance (see for example Grynberg and Silva 2006), was small Southern states were excluded from, or second-class citizens in, processes whose impact disproportionately affects them (Sharman 2004). This further skewed the already uneven playing field towards the North and threatened to sabotage the OFC-led development strategy. First, there were iniquities in the processes. For instance, when FATF and the OECD canvassed anti-money laundering and tax competition rules their members were granted the luxury of self-assessment or assessment by their peers. By contrast, non-members endured sometimes belligerent inquisitions by external investigators. Second, the standards and time scales for small Southern states were more exacting than for the developed countries of the North. For example, despite infringing FATF yardsticks and recurrent money laundering scandals, FATF members were not hauled onto blacklists or menaced by countermeasures. Likewise, while small states cowered in the silhouette of sanctions for not committing to the harmful tax competition initiative, the OECD protected its members who were not committed from a similar fate and refused to countenance a blacklist for OECD countries (Woodward 2006). Small states were fretful that this would cajole business into fleeing to OFCs based in OECD countries. Third, the palpable choice between conformity and closure offered to OFCs was, in actuality, no choice whatsoever. OFCs pointed out that conformity with international rules would precipitate their closure. For example, eradicating secrecy provisions as the OECD's tax plans decreed would spark an exodus of offshore activity. Moreover, small states are lamentably short of the staff qualified to assemble a regulatory edifice capable of meeting the strictures of the international financial institutions (IMF 2002: 3). Complex financial instruments can outfox the most lavishly resourced regulators let alone those, such as Anguilla, which has just four full time regulatory employees (UK National Audit Office 2007: 22-3). This is insufficient to keep abreast of international standards raising the spectre of future blacklisting. Equally, territories able to manufacture competent regulatory bodies suffer a pincer movement of rising compliance costs and decreasing revenue as offshore transactions are deterred. In some cases, the costs of compliance exceed any economic benefits resulting from an enhanced status in the eyes of global investors (Sharman and Mistry 2008; Vlcek 2008).

Unsurprisingly, many forecast a severe diminution, or even the disappearance, of small state OFCS (see for example Christensen and Hampton 1999). Certain notional centres, Tonga, Niue and Nauru, for example, decided the extra compliance costs would overwhelm any benefits, repealed their offshore legislation and ceased to operate as OFCs. Vlcek (2007a) reports that some functional OFCs also underwent some retrenchment in employment and revenues as they liquidated specific sectors and institutions in response to exigencies of the international financial institutions. The number of licensed banks in the Bahamas shrank from 395 in 1999 to 226 in 2006 and in the Cayman Islands from 475 in 1997 to 265 in 2007. In St. Vincent and the Grenadines the store of International Business Corporations dwindled from 2175 in 2000 to 620 by 2004 (Vleck 2007b). Nevertheless, as Kurdle's (2008) and Dharmapala's (2008) dissection of the OECD initiative shows, the overall impact of the North's newfound regulatory aggression against OFCs was subdued. As the figures in the previous section attest, flows of money to offshore locations continue to mushroom. Bank licenses in the Caribbean may be scarcer but the value of deposits hoarded there vaulted from $1.3trillion in 1998 to $3.3trillion in 2006 (Vleck 2007b: 1). In the year after the installation of the EU Savings Tax Directive bank deposits in the Isle of Man leapt, 20%, life assurance business 32%, and the value of funds under management 60% ("Vigour and confidence" 2006). Research by Rawlings (2007) reveals that other functional centres in the Channel Islands and the Caribbean also prospered. Partly this reflects the migration of legitimate business seeking to avoid being tarred by association with smaller, notional OFCs incapable of complying with international initiatives. That said, some of the bonanza went to minnows like Samoa, Belize, the Seychelles and the Marshall Islands.

By the end of 2006, with the exception of the Andorra, Liechtenstein, the Marshall Islands, and Monaco who loitered as non-cooperative countries with the OECD, all small state OFCs had been expunged from international blacklists and won plaudits from the international financial institutions for the improvements they had made. In the first round of IMF reviews, small state OFCs were compliant with 80% of standards for cooperation and exchange of information in banking and insurance, frequently outshining their onshore brethren (IMF 2005: 5-6). Their record in securities and prevention of money laundering and terrorist financing were middling. Nevertheless, in 2005 the FSF said the emendations were such that its list was obsolete and in November that year the last small state OFC (Nauru) was erased from the FATF list.

This leaves us to decipher how and why small state OFCs have thrived despite subservience to new international standards. The chapter has already referred to one ingredient, namely that the lustre of regulatory cleanliness is a competitive advantage used by small state OFCs to woo business from less well regulated financial centres both onshore and offshore. The fees derived from supplementary activities can be used to bolster their regulatory provision and reinforce their advantage. Second, international benchmarks were non-prescriptive and riddled with loopholes and exemptions. This was a godsend to OFCs, particularly those teeming with the expertise of tax planners and other financial wizards, where fanciful imaginations resulted in a conveyor belt of fresh products and techniques to neuter the effects of, or excavate benefits from the gaps and inconsistencies in, the updated regulatory environment (Woodward 2006). Automatic information exchange under the aegis of the EU Savings Tax Directive applied only to interest paid on personal savings paid within the EU to EU residents. Straightforward avoidance tactics comprised shifting capital to a limited company, trust or investment fund, splurging on products not penalised under the Directive such as shares, or using financial alchemy to turn interest into capital gains (again something omitted from the Directive). Within weeks the internet was awash with byzantine products guaranteeing to flummox the even the most indefatigable of tax sleuths. The paltry €210 remitted by jurisdictions applying the withholding tax under the Directive ("All together now" 2007) and the fact that it applies to only 11% of EU cash resident in Jersey (UK House of Commons Treasury Select Committee 2009: 70) substantiates these claims. Third, there is evidence of "mock compliance" (Walter 2008) where rules exist but are either selectively implemented or not fully utilised. The UK National Audit Office's (2007) interrogation of its overseas possessions believes the very low rate of suspicious transaction reporting (used to document possible cases of money laundering and terrorist financing) were out of kilter with quantity of financial transactions. Conceivably this reflected a paucity of staff or the absence of awareness about the need for such reports. TIEAs have proliferated but lie dormant for the most part. Under their TIEAs with the United States, the Cayman Islands and Jersey have exchanged information on only ten and seven occasions in the best part of a decade (UK House of Commons Treasury Select Committee 2009: 64; "Jersey fears for a future without tax schemes" 2009).

The foregoing raises issues of why international initiatives were not watertight and why international institutions have stomached the continuation of confidentiality in small state OFCs. The answer, in the opinion of this author, is a simple one. Namely, Northern states and formidable interest groups dwelling within them need OFCs. Recall that the OECD initiative was defanged not by insurrection in the South but contretemps amongst the North. Lobbying sensitised Northern states to the fact that they had much to lose from the extirpation of small state OFCs. They supply the stream of cheap capital needed by Northern states to bridge endemic trade and budget deficits (see Palan 1996). They amplify the profitability of corporations allowing them to reinvest at home fabricating jobs and augmenting productivity. More cynically, governments are reticent to offend the executives of corporations who are generous benefactors to political parties, a factor motivating the UK's decision to shelve reform of its non-domicile rules for the umpteenth time. The "war on secrecy" sometimes clashed with the United States idiosyncratic "war on terror." Funnelling money to convert operations through OFCs and the need to keep allies off international blacklists hindered consistent and coordinated efforts to thwart OFCs.

Phase 2 – OFC re-regulation as a North-South and South-South issue

Small state OFCs continue to adjust adroitly to the injunctions of Northern dominated international financial institutions. The second tranche of IMF reviews have again eulogized about the regulatory enrichments of small state OFCs. So much so, the IMF Executive Board has merged its meditations upon OFCs with its Financial Sector Assessment Program (FSAP) and jettisoned the offshore label declaring that elevation of offshore standards renders otiose its distinction with the onshore world (IMF 2008).

Just as it appeared the squalls besieging small state OFCs were abating, the perfect storm engulfed them. The near implosion of the global banking system and rescues of, or tacit guarantees to, entities such as Northern Rock's offshore Special Purpose Vehicle, Granite, brought OFCs to the attention of a wider audience. For governments scrabbling around for funds to staunch the bloodletting on their public balance sheets, a further crackdown on tax shirkers was fiscally and electorally appealing. A whistleblower volunteered information to the German authorities about the murkier deeds undertaken by several prominent figures in Liechtenstein. Within weeks the scandal had claimed copious scalps, starting with the CEO of Deutsche Post, and a dozen countries had enunciated plans to probe tax payers with Liechtenstein connections. Shortly afterwards the lid was also prised off Switzerland's furtive banking arrangements when UBS, the largest Swiss bank, coughed up $780m and the names of 300 clients to sidestep prosecution over conniving to help pecunious US citizens to evade taxes. Concurrently the EU disseminated a roll of territories with anti-money laundering mechanisms matching UK standards. The list noted the Channel Islands "may" meet the standards whereas others, conspicuously the Cayman Islands and the British Virgin Islands, were censured by their exclusion. Next, in January 2009, George W. Bush's Republican administration, an inveterate supporter of OFCs, was replaced by a Democratic regime headed by a President that co-sponsored the Stop Tax Haven Abuse Act during his time as a Senator. Finally, revelations about the offshore escapades of Bernard Madoff's defunct Ponzi scheme, and Allen Stanford's allegedly fraudulent frolics in Antigua completed the blustery outlook.

The communiqué of the G20 Summit in Washington in November 2008 contained the first outward sign that further strikes against OFCs were imminent. Leaders promised to "vigorously address" the lack of tax transparency and shortcomings in the exchange of tax information (G20 2008). Detecting the way the wind was blowing small state OFCs signed a slew of TIEAs. Of the 85 TIEAs inventoried by the OECD (2009d) 57, all involving at least one small country, were concluded since 27 October 2008. This prompted Jeffrey Owens, the Director of the OECD Centre for Tax Policy and Administration, to crow that "since the G20 Summit in Washington, there has been more progress on tax havens in three months than in 30 years" ("Why tax havens make such great scapegoats" 2009). This momentum carried into the subsequent G20 Summit April 2009 where leaders pledged "action against non-cooperative jurisdictions, including tax havens," stood "ready to deploy sanctions to protect our public finances and financial systems," and proclaimed "the era of banking secrecy is over" (G20 2009).

The basis for the G20's action was a new register published parallel with the Summit as part of the OECD's harmful tax competition initiative. The OECD bracketed jurisdictions according to their commitment to, and implementation of, its internationally agreed tax standard which "requires exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes" (OECD 2009a). Forty jurisdictions were on a "white list" denoting that they "substantially implemented" the internationally agreed tax standard. Thirty jurisdictions were on a "grey list" designating those who were "committed but have not yet substantially implemented" the internationally agreed tax standard." Four countries (Costa Rica, Malaysia, Philippines and Uruguay) were blacklisted for not committing to the internationally agreed tax standard. Finally, and most curiously, there was a cabal labelled "other financial centres" but no commentary recounting their commitment or otherwise to the initiative. Fascinatingly the group included Austria, Belgium, Luxembourg and Switzerland, the recalcitrant OECD members. Table 3 summarises the latest positions of small states vis-a-vis the OECD.

The reanimation of the OECD programme provoked more squawking from a small states already being pummelled by competition from Asia's low wage economies, the culling of trade preferences, and the squeezing of surrogate sources of income such as tourism by the global recession (Erikson and Lawrence 2008). In fact, small state OFCs probably have little to worry about. The OECD's has not overcome its erstwhile irritants. If the OECD's aim is to exterminate offshore secrecy, then its proposals remain fundamentally flawed. Northern states still defy the rules they wish to foist on others and bicker over the details of the programme. The process remains susceptible to accusations that the OECD, perceived as a rich country's club, is victimising fragile economies in the South. Lastly, there are now more South-South facets to the subject. In particular, the BRICs now have vested interests in the buoyancy of small state OFCs.

The Tax Justice Network (2009d) has poured scorn on the OECD's optimism, dismissing its international tax standard as "hopelessly weak." First, the standard does not mandate the automatic exchange of information. Instead supplicant countries must request information. The bugbear is that in order to request information applicants must have precise knowledge about the data they crave to obtain. In other words, before countries can ask for the hidden records they already need to know the contents. Second, the G20's statement about the annulment of banking secrecy is flatly contradicted by Article 26 of the OECD's Model Tax Convention, which provides the blueprint for TIEAs. The OECD concedes that "bank secrecy is not incompatible with Article 26.....meeting the standard of Article 26 requires only limited exemptions to bank secrecy" (OECD 2009c). Third, countries can escape the grey and blacklist with ridiculous ease. Less than a month after the OECD published its lists all countries had exited the blacklist. Moreover, the signing of a dozen TIEAs seem to be the criteria for shifting from the grey list to the white list. Of the 57 TIEAs signed by small states, 34 are with Scandinavian countries or appendages such as Greenland or the Faroe Islands. When combined with the fact that TIEAs are seldom invoked the Tax Justice Network (2009c) is justified in calling the advent of TIEAs a "modest" move in the fight against offshore secrecy. Finally, corporate taxes are spared attention.

Many OECD countries, bizarrely including some of those the OECD believes have substantially implemented the agree tax standard, are hardly paragons of transparency. Equipped with Google and $20,000 Australian academic Jason Sharman made 45 solicitations to open shell companies. On 17 occasions he succeeded, 13 of these were in OECD countries ("Haven hypocrisy: The G20 and tax" 2009). Switzerland and Luxembourg are famed for their furtiveness but the United States too is a serial offender. Despite the Stop Tax Haven Abuse Act the United States has no appetite for tackling the tax havens extant within its borders. The state of Delaware, for example, hosts mailboxes for 60% of Fortune 500 companies and over half of US corporations ("Tax haven London" 2007). The UK also winks at a range of frowned upon secrecy practices including issuing bearer shares and allowing nominee directors (UK House of Commons Treasury Select Committee 2009: 73-5). As the *Economist* remarks "the most egregious examples of banking secrecy, money laundering and tax fraud are not found in remote alpine valleys or on sunny tropical isles but in the backyards of the world's biggest economies" ("Haven hypocrisy: The G20 and tax" 2009). This would be worrying for small state OFCs who would be at a competitive disadvantage against OECD countries, except that they all inserted clauses into their commitments precluding sanctions against them before analogous penalties apply to OECD members. More than a decade from the inception of the harmful tax competition initiative, neither the OECD lacks the proclivity to burden its own members with the tax haven badge ("Swiss counters impact of tax haven listing" 2009), preferring the whitewash referred to previously whereby they are classed as 'other financial centres'.

The other lingering difficulty is that Northern states need small state OFCs. Already the Stop Tax Haven Abuse Act has lost impetus, attracting support from just four Senators and 62 Congressman (Offshore centres remain resilient" 2009) and having been diluted by the chair of the Senate Finance Committee ("Tax havens batten down as the hurricane looms" 2009). Obama is reluctant to act because he is hostage to identical snags and pressures as his predecessors. The United States Senate Committee on Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations (2008: 4) think avoidance to tax havens cost the US exchequer $100bn in lost revenue per annum. The counterargument, regularly aired by libertarian lobbies, is that the US owes much to being the world's biggest tax haven whose composite of low tax and secrecy has lured trillions of dollars from overseas to finance trade and budget deficits. All Northern countries face upward pressure on healthcare and pensions expenditure because of ageing populations and may come to rely on OFCs for cheaper sources of capital to fund these outgoings. Furthermore, if states may make citizens responsible for funding their own retirement this might spawn demand for the more exotic and higher yielding investment strategies available offshore. Moreover, US corporations make extensive use of small state OFCs. In 2007, 83 of the largest 100 publicly traded US companies operated subsidiaries in tax havens. They claim offshore units boost their profits allowing them to plough back more investment into the US, creating more jobs and better productivity that raise total tax revenues. It would take great political courage to withdraw these raiments in the midst of an economic downturn. A caucus of black Congressman uttered concerns about how curbing OFCs will affect the United States' Caribbean and Latin American backyard. Narcotics are a tempting proposition for small states searching for high value added substitutes to financial services. This is an unpalatable prospect for a country dispensing millions of dollars to confound Mexican drugs cartels.

The search for a consensus upon matters of tax transparency is now further complicated by the injection of the large industrialising states from the South. To the extent that these countries have had discernable policies towards OFCs, they are customarily adverse with Southern states believing OFCs stunt their tax take by facilitating avoidance, trade mispricing and other forms of mischief. An Oxfam (2009) report calculated that developing countries could raise another $124bn per annum if they could tax income arising from assets buried offshore, a figure greater than the global aid budget. Christian Aid (2008) puts it brutally; observing that the estimated $160bn revenue lost to corporate tax cheats slays 350,000 children each year. Initially, the development dimension drove the South-South agenda with reference to offshore. The 2002 Monterrey Consensus begged the international community to assist developing countries to “mobilise domestic financial resources for development.” Tax avoidance and evasion amputates an essential prop of good governance. Taxation encourages governments to be responsive to their populace and, moreover, having the wherewithal to stow assets offshore removes incentives for the well-heeled to agitate for reforms at home.

The G20’s blessing for another anti-OFC campaign might be thought to reflect the backing of large Southern states that belong to the club. If anything, however, the G20 Summit revealed that Southern states are softening their stance towards OFCs. The swelling affluence of these countries may be reshaping domestic interests, and hence their international preferences, in a manner that is more supportive of OFCs. Specifically, there are burgeoning numbers of HNWIs and corporations hankering to divert money offshore rather than shut it down. As the paymasters of governing cliques in poorer states, HNWIs and corporations are in commanding position to influence policies towards OFCs. Furthermore, those holding official positions might be involved in self aggrandising activities which they can conceal in offshore bolt holes. That the issue of tax did not gain traction in the 2009 Indian general election could be attributed to the candidates, a fifth of whom were crorepatis, people with personal fortunes exceeding ten million rupees ($200,000). In the longer term, Southern states confront similar problems to their Northern compatriots. Namely, they have ageing populations and may accrue deficits that can be financed more economically through OFCs. At this stage this is more of a hypothesis than an empirically testable theory, but some anecdotal evidence does point in this direction.

First, if we look at the G20 Summit in London, China was the singular blockage to a deal on tax transparency because it could not abide the OECD's (2009a) decision to place Macau and Hong Kong, two of China's Special Administrative Regions (SARs) hosting OFCs, on its grey list. Eventually, President Obama brokered a fudged eleventh hour deal. China signed on but strikingly Macau and Hong Kong were missing from the published OECD lists. This is more astonishing when the footnotes to the report state that the SARs "have committed to implement the internationally agreed tax standard" (OECD 2009a, 2009b). China also made its signature dependent on the Communiqué reading that the G20 "take note" rather than "endorse" the OECD list. Together these amendments open up a smorgasbord of opportunities for alert minded financial practitioners.

Second, HNWIs and corporations devour the bulk of offshore financial services and a small but mounting minority of them are Southern inhabitants. The swooning global economy has temporarily halted the trend (India's millionaire count crumbled by a third in 2008) but the twenty-first century is set to have a record total of HNWIs. Ten years ago breakdowns of global wealth paid scant notice to Southern states. Fuelled by surges in commodity, property and stock market prices however, the first five years of the new millennium witnessed the number of Chinese and Indian millionaires bulge by 15% per annum and Brazilian and Russian millionaires by 10% per annum. By 2008, roughly one in thirteen of the world's millionaires lived in the BRICS, China had the world's fourth largest concentration of millionaires (surpassing France and the UK) and Brazil’s 131,000 millionaires meant it figured as one of the ten largest abodes for the opulent (figures derived from Cap Gemini and Merrill Lynch 2008, 2009). MNCs emanating from the South are dwarfed in number and scale by those from the North. Nevertheless, while Tata, Gazprom and Lenovo are not yet ubiquitous household names there are signs of them gate crashing the established order. Since 2003 the numbers of firms from BRIC economies in the Fortune Global 500 has doubled to 62 (“A bigger world” 2008) and Accenture (2006) predicts that by 2018 they will make up a third of the world’s largest companies. For Southern MNCs, OFCs have advantages over and above secreting money from grasping onshore authorities. OFCs tend to have more sophisticated financial markets than those in developing countries, they provide a conduit to dodge capital controls, and diminish red-tape.

Presently Chinese individuals and companies are the leading users of OFCs with India treading a similar path. Now that China has smoothed out some of the ambiguities concerning property rights the main use of offshore centres is the phenomena of round-tripping. In China, international investment receives preferential treatment compared with domestic investment. To take advantage of this, domestic investors route money to a subsidiary in an OFC thereby switching the national identity of the assets to their new ‘home’ locale. When these funds are repatriated they are catalogued as international investment and treated less onerously. Four-fifths of China’s outward investment flows are destined for Hong Kong or Caribbean tax havens (Morck, Yeung and Zhao 2008: 340). Equally, between 2002 and 2005 the British Virgin Islands originated 12.1% of China’s accumulated capital inflows, a proportion greater than any G8 economy. Over the same timescale, the Cayman Islands and Samoa originated a greater proportion of inward FDI into

China than the UK, Germany and France (Chen 2007: 202, 204). Additionally, there are local peculiarities fortifying small state OFCs. The make a convenient point for Taiwanese companies yearning to circumvent their government's restrictions concerning investments on the mainland. Finally, offshore veils "spontaneous privatisation" a process referring to managers of state-owned corporations engineer subsidiaries capitalised with using assets belonging to the state-owned enterprise, often for the purposes of embezzlement.

Conclusion

For the last 30 years of the twentieth century small states with OFCs were one of the world's development success stories. Commencing in the 1970s and latently supported by the industrialised North the booming offshore financial services industry became a major breadwinner for small states lifting them "from the poverty of the developing world to levels of affluence few would have believed within their grasp" (Hampton and Abbott 1999: 1). Towards the end of the 1980s, however, the scourge of money laundering alerted the selfsame Northern states to the downsides of offshore secrecy. When accusations that offshore secrecy sponsored financial crises, tax evasion and terrorist finance were added to the charge sheet Northern states felt compelled to act. By the end of the 1990s, the mood of optimism amongst developing states with OFCs had been superseded by one of impending doom as Northern dominated international financial authorities unleashed a series of initiatives set to slice through their economic umbilical cords. As it has turned out these fears were unfounded. Some marginal small state OFCs were driven from the sector but for the majority funds have rolled in on an unprecedented scale. Quarrels amongst Northern states, the decision to apply minimum standards of international best practice, and the dilution of anti-tax haven programmes in response to pressure from lobbyists led to pockmarked agreements that could be exploited and circumvented by financial entrepreneurs. Paradoxically, because were able to comply with these adulterated agreements, OFCs benefited from an enhanced reputation that corralled extra business. As one doyen of IPE presciently opined in 1998 as the first bout of pressure on OFCs was rising:

> if the Group of Seven were to announce that they would be publishing a blacklist of the known tax havens and another blacklist of firms and individuals actively making use of tax havens, and would impose fines or other sanctions on them unless the accounts were closed within a specified time, there can be little doubt that most could not survive for very long. The reasons why this does not happen are, once again, political rather than technical (Strange 1998:132).

A decade later and the latter part of this quotation holds true. Current exertions to crowbar open the clandestine offshore world by the G20 and the OECD is running aground on familiar political objections. The OECD's anaemic international tax standard is likely to be ineffectual and, in any case, its own members are treating it with disdain. Until OECD countries are wrenched into line, something that is a remote prospect, the pledge made at the G20 to end banking secrecy is toothless. The relevance of the former part of the quotation has waned somewhat. Shutting down OFCs now will necessitate a much broader coalition of countries. As money and hence power float southwards on the currents of the global economy, so these countries, the HNWIs and corporations will become important arbiters in the ongoing story of global financial centres. The hypothesis advanced in this chapter is that as these countries grow richer they will become voracious consumers of offshore financial services and, as such, are likely to rally to the defence of OFCs rather than buttress programmes that will lead to their demise.

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