



Offshore Finance, Onshore Complicity

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I. Offshore Finance

Introduction

Offshore financial centers (OFCs) are jurisdictions that adopt low taxes or thin financial regulatory regimes as a shelter for foreign investors. Usually very small countries or territories, OFCs may be islands like the Bahamas or the Caymans, but they may also be continentally-based territories like Monaco or Liechtenstein. Administratively, they may be sovereign states (like Barbados), colonial territories (like Dutch Antilles) or a part of the national territory of a large state that enjoys partial autonomy (like the Isle of Man or the Channel Islands, both part of the UK).

Often under the political influence or control of major money-center governments such as the United States or the United Kingdom, OFCs' policies have usually developed in concert with money-center financial institutions. These policies allow foreign clients to set up banks, corporations, trusts and other legal entities and to move money in and out with no taxation, minimal oversight and maximum secrecy. OFCs' financial policies might seem a legitimate route to economic growth and financial success for impoverished small states. However, most of the benefit of OFCs accrues to foreigners, not to local residents. Further, OFCs create conditions for corrupt and illegal practices by businesses, criminals and dictators. They heighten international financial instability. And they contribute to tax avoidance, tax evasion and downward tax pressure on the governments of the "onshore" countries. The financial systems of offshore financial centers have little relation to the real economic requirements of their own domestic economies. The Cayman Islands, with a population of just 40,000, hosts more than 450 banks [1] holding \$500 billion in assets. [2] In the Caymans

as in all OFCs, the overwhelming majority of financial sector assets and liabilities are owned offshore, most transactions initiate elsewhere, and non-residents control nearly all the institutions. [3]

The list of tax havens identified by the Organization for Economic Cooperation and Development (OECD) in 2000 provides an overview of OFCs. [4] Though most of these countries are no longer considered by the OECD to be 'uncooperative,' and some prominent tax havens (such as the Cayman Islands) are not represented, the list shows the geographical distribution and range of OFCs. Islands and other small countries dominate the list, which includes countries from all over the world.

Andorra – a small country in Western Europe;
 Anguilla – a group of islands in the Caribbean Sea, an overseas territory of the UK;
 Antigua and Barbuda – a group of islands in the Caribbean Sea;
 Aruba – a Caribbean island, part of the Kingdom of the Netherlands;
 The Bahamas – a group of islands off the coast of Florida;
 Bahrain – an group of islands off the coast of Saudi Arabia;
 Barbados – a Caribbean island;
 Belize – a small country in Central America;
 British Virgin Islands – a group of islands in the Caribbean Sea, an overseas territory of the UK;
 Cook Islands – a group of islands in the South Pacific Ocean, self-governing but in free association with New Zealand;
 Dominica – a Caribbean island;
 Gibraltar – a small country in Southwestern Europe, an overseas territory of the UK;
 Grenada – a group of islands in the Caribbean Sea;
 Guernsey/Sark/Alderney – a group of islands in the English Channel, a dependency of the British Crown;
 Isle of Man – an island in the Irish Sea, a dependency of the British Crown;
 Liberia – a West African country;
 Liechtenstein – a small country in Western Europe;
 Maldives – a group of islands in the Indian Ocean;
 Marshall Islands – a group of islands in the Pacific Ocean;
 Monaco – a small country in Western Europe;
 Montserrat – a Caribbean island, an overseas territory of the UK;
 Nauru – a small South Pacific island;
 Netherlands Antilles – a group of islands in the Caribbean Sea, part of the Kingdom of the Netherlands;
 Niue – a small South Pacific island, self-governing but in free association with New Zealand;
 Panama – a country in Central America;

Samoa – a group of islands in the South Pacific Ocean;
 Seychelles – a group of islands in the Indian Ocean;
 St. Kitts and Nevis – a group of islands in the Caribbean Sea;
 St. Lucia – a Caribbean island;
 St. Vincent and the Grenadines – a group of islands in the Caribbean Sea;
 Tonga – a group of islands in the South Pacific Ocean;
 Turks and Caicos – a group of islands in the North Atlantic Ocean, an overseas territory of the UK;
 US Virgin Islands – a group of islands in the Caribbean Sea, an external territory of the US;
 Vanuatu – a group of islands in the South Pacific Ocean. [5]

Operations and Impacts

OFCs' clients are individuals and organizations who use OFCs to increase, protect or hide their wealth. Individual users of OFCs have ranged from stars such as Boris Becker to dictators such as Mobutu Sese Seko. OFCs have had business from famous companies such as Rupert Murdoch's News Corporation, and infamous ones such as Enron. Drug cartels, terrorist networks, and other types of underground organizations also use OFCs for many of their financial operations.

What attracts such a wide variety of clients to OFCs? Offshore financial centers offer numerous services to attract capital from abroad. In addition to engaging in traditional banking operations, OFCs' clients may acquire offshore banking licenses, form offshore corporations, open captive insurance companies, and take advantage of offshore warehousing and favourable tax policies, among many other provisions. These services open the door for individuals and corporations to avoid taxes, regulations, asset seizure or criminal prosecutions in their home countries.

Offshore Banks and Corporations

Offshore banks are one of the most popular uses of OFCs, as evidenced by the burgeoning banking sectors in many OFCs, such as the Cayman Islands. Many different types of users are attracted to offshore banking. For example, a multinational corporation might set up an offshore bank to handle its foreign exchange operations or to facilitate financing of an international joint venture. Likewise, an onshore bank might establish a wholly owned subsidiary (or sister 'parallel' bank) in an OFC to provide offshore fund administration services or

other services.

The key to offshore banks' success lies in the immense regulatory and taxation concessions that they offer to their users. Offshore banks are often exempt from taxes such as capital taxes, withholding taxes on dividends or interest, taxes on transfers, and capital gains taxes. They generally have minimal exchange controls, light regulation and supervision, less stringent reporting requirements and fewer trading restrictions than would be found in 'onshore' countries. In many cases, offshore banks are not required to keep any financial records at all. The attraction of such lax conditions for MNCs and banks from more heavily taxed and regulated countries is obvious. Offshore corporations, or International Business Corporations (IBCs) are usually offered with the same types of enticements as offshore banks. IBCs are generally limited liability companies that are exempt from taxes and regulated very lightly. They may be used to own and operate businesses and raise capital, and may issue shares and bonds.

Obviously, the benefits of offshore banks and IBCs for the host countries are not accrued through taxes. Usually, OFCs will instead charge user fees. For example, an offshore corporation in Panama can be purchased through a company called the Canette Group at \$800 for one year. [6] The scale of OFCs' business relative to their size is what makes this low-cost system possible. When one notes that there are 300000 companies registered in the Virgin Islands (only 9000 of which have local activities) [7] , it becomes obvious that user fees can yield significant funds.

It is hardly surprising that not all offshore banks and corporations are legitimate institutions, performing conventional banking or business functions. Offshore banks are often set up as 'shell banks'—institutions with no real presence in the OFC or anywhere else—and simply used to hold, transfer or hide money. Similarly, offshore corporations may be 'shell corporations' or 'brass plate companies', so named because their only physical presence is a brass plate on a door. These may be setups, with residents of the host OFC country acting as nominee directors. Indeed, the Canette Group's \$800 Panama Corporation Package includes arrangement of nominee directors for the corporation, as well as their resignation letters. Both shell banks and shell corporations in OFCs are obviously useful tools for those who have something to hide, and indeed have been extensively used by tax evaders and criminals from all over the world.

Shell banks and other offshore banks may do business with banks in some "onshore" countries through correspondent (or pass-through) accounts. The system of correspondent accounts allows a bank from one country to open an account with a bank from another country, so as to have greater access to foreign currency, or to facilitate international transfers of money. However, if a

offshore bank opens a correspondent account with a more legitimate bank, the legitimate bank may not be able to trace the money's origins, due to lack of regulation of the shell bank. Therefore, offshore banks can create great problems because of their ability to move 'dirty' money in and out of other countries. Shell banks are often created by criminals just for this purpose.

Individuals in "onshore" countries may also move money to trusts or "personal holding companies" offshore to protect it from local lawsuits or economic problems. For example, some OFCs have legislation that protects people who transfer property to a personal trust from forced inheritance provisions in their home countries. People who fear the loss of their assets or government asset seizure may also use OFCs to protect them. Thus, OFCs may help criminals facing prosecution to protect their ill-gotten gains, or avoid legal compensation. Wealthy individuals and enterprises in countries with weak economies and fragile banking systems also tend to transfer assets overseas; for example, to protect themselves against the collapse of their domestic currencies and banks. This category, of course, includes corrupt leaders who stash their money abroad. For example, Raul Salinas, a brother of a former president of Mexico, and now in prison for murder, moved over \$87 million out of Mexico using correspondent accounts and a shell corporation. Meanwhile, the sons of General Sani Abacha, the former military leader of Nigeria, used shell corporations with correspondent accounts at Citibank to move over \$110 million out of Nigeria. [8] The list of leaders of developing countries who have used OFCs to embezzle money is a long one.

One of the principal attractions of some OFCs is their dedication to bank and corporate secrecy. Some OFCs do not require their banks to publicly disclose any information about their clients, even when asked to do so in connection with a criminal investigation. Offshore companies in some OFCs may not have to reveal their owners, directors or assets.

In fact, some OFCs may not even require their banks or corporations to collect basic information about their operations.

European OFCs are at the forefront of such secrecy practices. Andorra uses numbered accounts, "said to be known only to 'the customer, the banker and God'" [9] , to protect the identity of its customers. Meanwhile, Liechtenstein legally "commits all institutions and employees to the strictest confidentiality with regard to the financial circumstances of bank clients" [10] , including those evading taxes in their home countries. For these reasons, as of January 2004, both countries continue to be identified as 'uncooperative' tax havens by the OECD.

Luxembourg, the richest country in the world in per capita terms,[11] became

infamous in 2001 when a book by a former employee of the clearinghouse Clearstream revealed the extent to which financial secrecy is possible there. If banks or corporations wish to transfer money secretly, they may simply open an unpublished account at Clearstream, make the transfer, and then ask Clearstream to wipe out the appropriate records. Without either account information or transaction records to examine, law enforcement officials have no way to trace ill-gotten funds. [12]

Obviously, then, OFCs with secrecy laws leave their offshore banking and corporate sectors even more open to abuse by people with something to hide. During the 1980s, the infamous entrepreneur Robert Maxwell embezzled millions of pounds from the pension funds of his companies in the UK, and deposited some of it in banks in Liechtenstein. When the UK looked for the funds in Liechtenstein, the relevant banks refused to waive their secrecy policies, and the government was similarly uncooperative. [13] Of course, this was because both Liechtenstein, a country with more offshore financial institutions than people [14], profited from its secrecy laws. Unfortunately, these profits were shared with Robert Maxwell and many other criminals.

Wider Impact: Money Laundering

Perhaps the most important and most maligned impact of offshore banks and corporations is to make criminal profit possible worldwide by expediting the process of money laundering. While illegal activities such as arms sales, drug trafficking, financial embezzlement and bribery may generate enormous profits, that money can be put to use only if the illegal source of the funds can be successfully disguised. Money laundering is the name for the process of channelling illegal wealth into legitimate forms.

Typically, money laundering goes through three major stages (see Figure 1). First, illegal profits are introduced into the financial system, typically by breaking up the money into smaller bundles and depositing it into a bank account. This is called 'placement'. Then, a series of conversions or movements of funds are performed to distance them from their source and thus 'launder' them, typically by wiring the funds through a series of accounts across the globe. The international EFT system (Electronic Funds Transfer) sees 500,000 transactions (a value of over \$1 trillion) performed daily, making it exceedingly difficult to trace individual transfers. OFCs tend to play a large part in this "layering" stage, as funds often move through shell banks, correspondent accounts and IFCs. Finally, the funds are 'integrated' into the legitimate economy, where they are invested in assets such as stocks and real estate.

An excellent recent example of the money laundering process is provided

by the huge amounts of Russian mafia funds laundered in the 1990s. In one case, \$3.5 billion of 'dirty' money was deposited in two Russian banks, DKB and Flamingo, transferred to a shell bank in Nauru and wired to a correspondent account at the Bank of San Francisco. The money was then moved to shell corporations with accounts at the Bank of New York. By the time these funds were again transferred to other offshore accounts, the money was effectively laundered. In other words, it had moved through so many financial institutions that it was no longer traceable to its origins in Russian criminal activity, and having moved through legitimate financial institutions in the United States, the money could be considered 'clean'. [15]

Money laundering is a very serious problem; indeed, estimates of the amount of money laundered globally range up to \$5 trillion. [16] OFCs' roles in the money laundering process are often crucial. Criminals wishing to launder funds can open shell banks or shell corporations with few questions asked, making it easy to move money without leaving records of transactions or ownership behind. Without the participation of offshore financial institutions, dirty money would be harder to launder, and criminals' money trails could be followed more easily by law enforcement officials.

Tools for Tax Evasion

Offshore banks and corporations are not the only category of services offered by OFCs. In fact, OFCs might be most famous for helping individuals and corporations, especially those in rich countries, to avoid taxes. Indeed, OFCs offer a wide variety of tools to facilitate tax evasion. This is why OFCs are often known as tax havens. The simplest tax avoidance method made possible by OFCs is also the most effective. Some individuals move away from their home countries and take up residence in OFCs such as Monaco and Bermuda to avoid taxes on their wealth. This is a route taken mostly by the very rich, including international sports stars such as Michael Schumacher. Individuals in high-tax countries who do not want to leave home have other methods available. Some may hide some of their money in offshore banks, particularly those with strict secrecy laws, thus illegally avoiding taxes. In the US, the Internal Revenue Service has found that many Americans illegally use debit and credit cards tied to unreported offshore accounts. Indeed, New York's Chief Assistant District Attorney estimated in 2003 that 115,000 Bahamas and Cayman Islands credit cards are used by people in New York, New Jersey and Connecticut alone. [17] Even more than individuals, corporations avoid taxes through the use of OFCs' services. It is often the largest and most profitable corporations who are the most skilful at avoiding taxes. Rupert Murdoch's News Corporation, with at least 60 subsidiaries in tax havens, is a successful example, earning \$2.1 billion in profits in the UK from 1988-1999, but paying no net corporate tax there. [18]

Before its demise, Enron also made extensive and effective use of tax havens, yielding tax refunds from the US government. [19] Enron's elaborate schemes will be discussed further below.

Corporations, like individuals, may go so far as to relocate to OFCs to save taxes. Usually, though, such moves are in name only; companies may reincorporate in an OFC, but maintain most of their operations in their home countries. The US energy industry provides good examples of the advantages to companies of such "corporate inversions." Schlumberger, a company incorporated in the Dutch Antilles, pays tax to the US government at, on average, a 25% rate, while Halliburton, which is incorporated in the US, paid at a 40% rate in 2001. This is not to say, however, that Halliburton is not making use of OFCs, with 30 subsidiaries in the Cayman Islands and others in St. Lucia, Liechtenstein, Barbados, Cyprus, the Dutch Antilles and the UK Virgin Islands. Generally, the US energy industry reflects both high use of OFCs and low tax bills relative to other major US sectors. [20] Reincorporation abroad is not the only sleight-of-hand that corporations in onshore countries may use to reduce their bills. A company may use subsidiaries in OFCs and creative accounting to make sure that its profits are concentrated in low-tax countries. For example, the UK's Inland Revenue agency was scandalized in 2002 upon discovering that a company called Mapeley Steps Contractors had sustained a £12 million loss in 2001 despite £136 million payments from the agency, a financial situation that was heavily affected by an £81 million transfer to Bermuda-based Mapeley Steps Inc. Mapeley Holdings, the parent of both companies, thus succeeded in winning a contract with the UK government and at the same time avoiding its taxes. [21]

'Earnings-stripping' of this kind can be accomplished through various types of asset transfers and accounting techniques. A company based in an onshore country may transfer ownership of some of its assets to a subsidiary or parent in an OFC. It would then pay its offshore counterpart for use of the assets. Intellectual property is commonly used in such schemes; for example, a US-based company might contrive to pay a related company in the Cayman Islands for the use of its own logo or patents. Corporations may also base some of their support functions offshore, so that they can pay fees to their offshore partners for payroll and marketing tasks. Some companies separate the sales and production components of their organizations, placing the sales branch in an offshore country so that more profits can be made there. [22] Corporations sometimes escape taxes by separating their production operations from their storage and distribution arms. Some OFCs offer duty-free zones or storage facilities, offering companies a chance to avoid storing their products in high-tax countries. Still others allow companies to establish 'captive' insurance companies to manage risk and minimize taxes.

Another common tax-saving manoeuvre used by multinational corporations is

transfer pricing. Transfer pricing is a mechanism by which products are transferred between different parts of a business (or within one business unit, but across different countries) in a way that creates profits for the business. For example, a company that needs to move a product from one country to another might sell the product at an artificially low rate to a shell company in an OFC, which would then sell it to the recipient country's branch at an artificially high rate. Such a procedure increases the company's costs in the high-tax sender and recipient countries, and helps to push the company's income into low-tax offshore countries.

Special Purpose Entities are one of the fastest-growing services provided by OFCs. Typically, an onshore corporation establishes an SPE in an offshore center to engage in a specific activity. The onshore corporation may assign a set of assets to the offshore SPE (for example, a portfolio of mortgages or loans). The SPE then offers a variety of securities to investors based on the underlying assets. Enron sold some of its own assets—including its headquarters building—to SPEs and leased them back so that the debt corresponding to those assets could be kept off Enron's balance sheets. [23] Many of these transactions were illegal. Enron also used SPEs to borrow money illicitly, using its own stock as guarantees. [24]

Indeed, Enron provides perhaps the greatest example of all of these tax-saving techniques, and their dangers to the public of the onshore countries. Enron used hundreds of subsidiaries in tax havens, including 662 in the Cayman Islands, 119 in Turks and Caicos, 43 in Mauritius and 8 in Bermuda. [25] Without using OFCs, Enron would have had far greater difficulty in disguising its growing debts, its ballooning losses, and its executives' huge payments to themselves. Thus, but for the existence of OFCs, Americans might have been spared the damage done by Enron, and might yet be spared the next damaging corporate scandal.

Wider Impact: Onshore Taxation

Obviously, OFCs' facilitation of tax evasion has an impact on the countries whose taxes are being evaded, and the scale of the impact is significant. The IRS accuses tax havens of funnelling away up to \$70 billion in US tax revenues from personal accounts alone. [26] Moreover, OFCs' policies have forced some countries to compete with their low-tax regimes, giving rise to what the OECD calls 'unfair tax competition'. It has been estimated that the developing nations alone lose over \$50 billion annually from tax competition. [27]

This downward pressure on taxes threatens to adversely affect the quality of public services that can be provided by onshore governments. At a macro-economic level, tax competition and tax escape are contributing to two subtle

shifts in the tax structure:

The tax base is moving from the mobile to the immobile. With wealthy individuals and corporations enjoying a greater ability to move their money to OFCs and minimize their tax burden, it has fallen upon the immobile (who have lower incomes to begin with) to bear an increasing burden of public service financing.

The tax base is shifting from income to consumption. While the share of income tax has fallen in many countries, corporate tax continues to remain stagnant, and indirect taxes (especially taxes on goods and services consumed) have increased. Indirect taxes also tend to hurt middle- and lower-income earners the most, since a higher proportion of their income is spent on consumption.

Thus, by facilitating tax escape and tax competition, OFCs have adversely affected the bulk of the population of the onshore countries. When most tax haven users are big businesses and rich people – the Australian Tax Commissioner once claimed the number to be 95 percent [28] – it is the middle and lower classes of the onshore countries who are negatively affected by the existence of tax havens. However, as we shall see, the scale of the problem has hardly spurred onshore governments to take strong action in the past, because of the few but powerful onshore actors who benefit the most from OFCs.

II. Onshore Complicity

Measures Taken

It should now be clear that OFCs, through the tax evasion and criminal profit that they facilitate, have a strong negative effect on the great majority of 'onshore' countries' populations. Thus, it would seem that onshore countries have a great interest in cracking down on OFCs, and indeed, recent years have seen many regulations enacted and bodies formed among onshore countries to fight OFCs and their effects. The Organization for Economic Cooperation and Development, a coalition of thirty of the world's rich and middle-income countries, has long led the way in anti-OFC policy. The OECD has published reports on harmful tax practices since 1998. It has also run the world's leading anti-money laundering body, the Financial Action Task Force (FATF), since 1990. The OECD's main approach to OFCs is to 'name and shame' those who maintain the most flagrant tax evasion services and the worst money laundering controls, and set guidelines for them to improve their practices. For the FATF, enforcement of these suggestions is provided by the threat of sanctions, or even exile from the world's financial services network, for those on the list of non-cooperative countries.

The OECD has succeeded in changing the behaviour of many OFCs, particularly when backed up by direct US pressure. For example, Nauru, cut off from the international financial network by FATF sanctions, disavowed offshore services and delivered thousands of financial documents to US officials in 2003. [29] Even Liechtenstein, discussed above for its secrecy laws, loosened its regime somewhat in 2002. The bank owned by Liechtenstein's royal family introduced 'know your customer' rules - and withstood the loss of 9% of its assets. [30] All in all, from the 35 countries on the OECD's original 2000 list of uncooperative tax havens (see the introduction to chapter 1), only five remain as of January 2004.

Many onshore countries have also made changes to their financial regimes that could reduce participation in money laundering and tax evasion by their own financial sectors. In the 2001 USA Patriot Act, the US banned its banks from offering correspondent accounts to shell banks and required them to implement stricter anti-money laundering surveillance. Meanwhile, in the UK, the Proceeds of Crime Act and Financial Services Act of 2001 strengthened the UK's anti-money laundering regime. Accountants and bankers are required to tip off the government's Financial Services Authority if they suspect clients of laundering money. If they fail to do so, they face jail terms. Banks that do not implement adequate money laundering measures, such as customer identification procedures, are fined. Indeed, the Royal Bank of Scotland was fined £750000 for this reason in 2002 [31] and Northern Bank was fined £1.25 million in 2003. [32]

Reluctant Reformers

Unfortunately, the measures listed above have been the exception rather than the rule of onshore countries' treatment of OFCs. That some onshore governments have been less than ruthless opponents of offshore tax havens in the past should quickly become obvious upon examination of the OECD's 2000 tax haven list. That list included five overseas territories of the UK, three dependencies of the British crown, two substates of the Kingdom of the Netherlands, and one US external territory. It seems that until recently, the UK, US and Netherlands have not even been able to successfully crack down on their own dependencies' offshore activities. Did these three countries lack the power to rein in their territories, or were their governments uninterested in trying?

The behaviour of the US government is instructive. The Clinton administration supported the OECD's anti-tax haven program when it was created in 1998, but members of Congress, led by House Majority Leader Dick Armey and Senate Banking Committee chairman Phil Gramm, opposed it. [33] The Bush administration then disavowed the OECD program in May 2001, essentially killing the initiative. [34] The US government was, however, forced to reverse itself

after September 11, 2001, when terrorist financing suddenly became an unavoidable issue. Many observers suspected that al-Qaeda and other terrorists used OFCs to hold and transfer their funds (a judgment which may not have been accurate; al-Qaeda seems to have used other methods) [35], leading the US, the UK and other onshore countries to take the actions discussed above.

However, even those recent measures have mainly addressed only the aspects of offshore services most relevant to the tracking of terrorist financing: some OFCs' adherence to bank and corporate secrecy, and offshore and onshore involvement in money laundering. In fact, the removal of thirty countries from the OECD's list of uncooperative tax havens since 2000 has not been based on those states' elimination of all of their dubious financial services. Instead, it is increased transparency and commitment to information exchange with OECD countries, and especially the US, that has rehabilitated them.

At the same time, the US continues to ignore, and even facilitate, other OFC services, such as those encouraging corporate tax evasion. Indeed, the US has been condemned by the WTO for its own pro-offshore tax laws, the Foreign Sales Corporation and Extraterritorial Income benefits, which allow US corporations to save taxes by channelling their exports through OFCs. [36] As of January 2004, the US had stepped to the brink of a trade war with the European Union over the provisions. Meanwhile, far from condemning US companies who reincorporate abroad, the US government continues to reward them with government contracts, to the tune of \$1 billion in 2002. [37]

Even when the US and UK have passed anti-offshore laws, their enforcement has not always been up to par. The UK's money laundering laws, though laudable in theory, have been hamstrung in practice by "a chronic lack of resources in tackling money launderers, disjointed handling of suspicious activities by the authorities and a low police priority for money laundering prosecutions." [38] At the same time, despite the increasing use of illegal offshore tax evasion techniques by its 30 million taxpayers, the UK Inland Revenue prosecutes only 60 fraudulent tax returns each year. [39]

The fact is that the governments of onshore countries, and in particular the US and UK—the world's two financial giants—have on the whole failed to discourage the harmful effects of OFCs. When they have attempted to take action, they have done so reluctantly. They have targeted OFCs themselves in only a limited way, and allowed their own citizens, corporations and financial institutions to use OFCs' services.

Vested Interests

The inaction of the onshore states stems from the deep connections of some of their most powerful actors to offshore finance. After all, the money that fuels offshore economies originates almost entirely from onshore countries. It is onshore assets that lie in offshore banks, and onshore banks, corporations and individuals who maintain offshore financial positions. Meanwhile, though the use of tax havens results in lower tax revenues for governments, it means greater wealth or higher profits for certain individuals and corporations.

Indeed, all of the examples of OFC services discussed earlier in this paper involved profit for individuals or corporations based in onshore countries. It was onshore institutions who used Clearstream's secret account system: according to the former employee who broke the story, Barclays maintained 200 separate unpublished accounts, and Citibank had 271. [40] Citibank also profited from Raul Salinas' and Sani Abacha's embezzlement of funds from their native countries, as the bank was involved in complex OFC transactions on behalf of both individuals. [41] Meanwhile, it was a Bank of New York vice president and her husband who ran the scheme to launder Russian mafia money discussed earlier. They made \$1.8 million before being caught – and stashed it in the Isle of Man, an OFC. [42]

It is not only such illicit uses of OFCs that yield profits for onshore institutions and individuals. As stated earlier, many onshore corporations make a great deal of money by using OFCs' tax avoidance services. Moreover, their CEOs and directors may also profit personally from the use of OFCs. For example, in 2002, the US toolmaker Stanley Works hatched plans to reincorporate in Bermuda, to save millions of dollars in taxes. Journalists quickly discovered that in the first year after such a move, Stanley Works' CEO would profit from it by an amount equivalent to 58% of those tax savings. [43] Meanwhile, by moving to OFCs such as Bermuda, directors of a company may reduce their personal accountability to investors; indeed, Bermuda's laws make it difficult for investors to bring class-action suits against company directors or officers. [44]

With such powerful actors – the largest banks, the largest corporations, and their CEOs and directors – able to profit so greatly from the existence of OFCs, it should come as no surprise that any proposed measures to crack down on offshore finance tend to meet with overwhelming opposition. Furthermore, since the political classes in countries such as the US are largely made up of rich individuals – who themselves may use OFCs to increase their wealth – with important connections to major corporations, it is unsurprising that few such measures are even proposed. The end result of such an environment is a lack of action by onshore countries against OFCs and those who use them.

For example, the phenomenon of correspondent accounts with shell banks, which created obvious and significant risks of money laundering, lasted so long in the United States because US banks made so much money from the system, and lobbied so hard against changes to it. US banks used the system of easy links to offshore banks for their 'private banking' services. [45] These were (and still are) geared to rich individuals seeking to hide their money in the offshore system. These individuals deposit large amounts of money in the bank, and the banker assigned to their account then moves it through a complex network of secret offshore accounts. For onshore banks, private banking services often result in twice the profits that they receive from other areas. [46] Large and powerful banks thus had no interest in any changes to the correspondent account system, and certainly resisted – and continue to resist – US-imposed changes to OFCs themselves.

When private banking has been used for money laundering – as has often been the case – US and UK authorities have failed to hold either the financial system or the relevant banks responsible. The Citibank scandals of Raul Salinas and Sani Abacha resulted in no prosecutions of top banking officials. [47] Worse still, the UK government failed even to publicly name all of the British banks who handled \$1.3 billion of Abacha money. [48]

Both OFCs and the onshore financial industry continue to get away with their crimes. The Enron scandal should have resulted in a US crackdown on OFCs, and revealed the extent to which the offshore system was used and protected by the US establishment. Indeed, the scandal implicated major political actors, whose campaigns were funded by the company, and who resisted the Treasury Department's anti-Enron measures at every turn. Yet those people have without exception escaped prosecution, as have most of the company's top executives. This "permissive political environment", as Paul Krugman calls it, was crucial to Enron's "sense that it could get away with just about anything". [49] That environment, Krugman notes, has not changed. [50]

Fighting Back

With the political classes of the onshore countries immobilized by their dependence on OFCs' allies, it has been left to those most affected by OFCs' negative effects to fight back against them. While financial insiders such as Ernst and Young advise companies' leaders to reincorporate in offshore havens, their shareholders and employees – who benefit from domestic programs funded by corporate taxes – are resisting the moves. [51] Indeed, Stanley Works' aforementioned proposal to reincorporate in Bermuda was successfully defeated by pressure from its employees. [52] Meanwhile, public pension funds and labour groups are attempting to push US companies incorporated in OFCs to move back

home, and make the public better aware of the consequences of corporate inversions. This effort made inroads in 2003, as 41.4% of Ingersoll-Rand's shareholders voted in favour of moving back to the US, less than two years after the same shareholders voted overwhelmingly to move to Bermuda. At the same time, the boards of Bermuda-based companies Tyco and McDermott International agreed to study the tax implications of reincorporation in the US. [53]

Notes

- 1 Cayman Islands Monetary Authority, www.cimoney.com.ky, Jan. 4, 2004.
- 2 Joseph Stiglitz and Leif Pagrotsky, "Blocking the Terrorists' Funds: The Global Financial System Provides Hiding Places for Dirty Money", *Financial Times*, Dec. 7, 2001.
- 3 International Monetary Fund, "Offshore Financial Centers", June 23, 2000.
- 4 OECD, "Towards Global Tax Cooperation", 2000.
- 5 Ibid.
- 6 www.anti-taxes.com, Jan. 5, 2004.
- 7 Joseph Stiglitz and Leif Pagrotsky, "Blocking the Terrorists' Funds: The Global Financial System Provides Hiding Places for Dirty Money", *Financial Times*, Dec. 7, 2001.
- 8 US Senate Sub-Committee on Investigations, Hearings on "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerability", chaired by Sen. Carl Levin, Nov. 9, 1999.
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