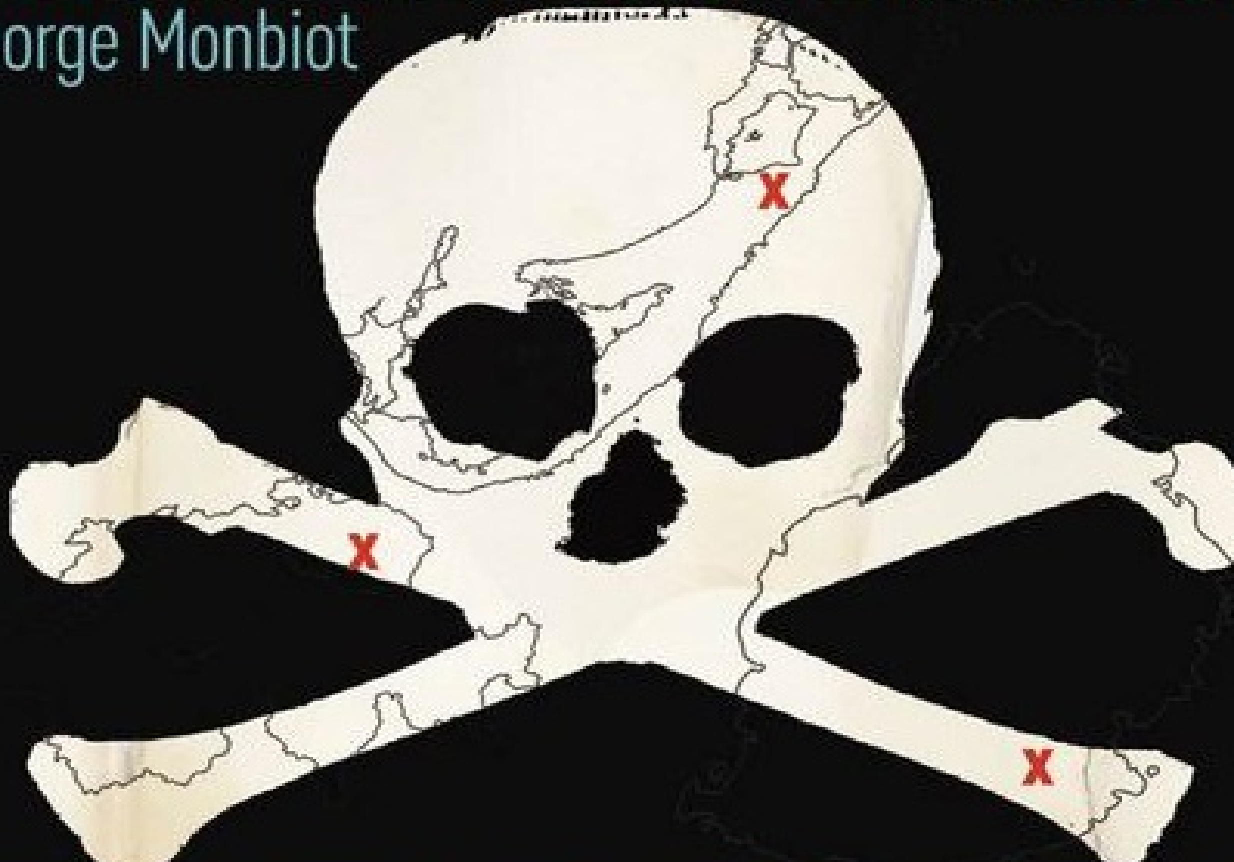
'PERHAPS THE MOST IMPORTANT BOOK PUBLISHED IN THE UK SO FAR THIS YEAR'
George Monbiot



TREASURE I$LANDS

TAX HAVENS AND THE MEN WHO STOLE THE WORLD

NICHOLAS SHAXSON

VINTAGE

"Perhaps the most important book published in the UK so far this year."

—George Monbiot, *The Guardian*

"*Treasure Islands* has prised the lid off an important and terrifying can of worms."

—*Literary Review*

"Shaxson shows us that the global financial machine is broken and that very few of us have noticed."

—*New Statesman*

"In this riveting, well-written exposé, Shaxson goes deep into the largely unexamined realm of offshore money. In the process, he reveals that this shadow world is no mere sideshow, but is troublingly central to modern finance, with the US and the UK as leaders. The resulting abuses are widespread, ranging from tax revenue stripping from African nations to individuals and corporations escaping enforcement and accountability. A must read for anyone who wants to understand the hidden reasons why financial services firms have become so powerful and impossible to reform."

—Yves Smith, creator of Naked Capitalism
and author of *ECONned*

"*Treasure Islands* shines the light on some very dark places. It reads like a thriller. The shocking thing is it's all true."

—Richard Murphy, co-author of *Tax Havens:
How Globalization Really Works*

"At last, a readable—indeed gripping—book which explains the nuts and bolts of tax havens. More importantly, it lays bare the mechanism that financial capital has been using to stay in charge: capturing government policymaking around the world, shaking off such irritants as democracy and the rule of law, and making sure that suckers like you and me pay for its operators' opulent lifestyles."

—Misha Glenny, author of *McMafia: A Journey
through the Global Criminal Underworld*

"Trade and investments can play a profoundly productive role on the world economy. But so much of the capital flows that we see are associated with money laundering, tax evasion, and the wholesale larsony [*sic*] of assets often of very poor countries. These thefts are greatly facilitated by special tax and accounting rules or designed to "attract capital" and embodying obscure and opaque mechanisms. Shaxson does an outstanding and socially valuable job in penetrating the impenetrable and finds a deeply shocking world."

—Nicholas Stern, former Chief Economist
for The World Bank

"The real challenge to America's economy comes not from China—but from the Caymans, the Bahamas, and a whole hot-money archipelago loosely under the control of the City of London. If only as a civics lesson, read this astonishing book to find out the true political constitution of the world."

—Thomas Geoghegan, author of
Were You Born on the Wrong Continent?

"Far more than an exposé, *Treasure Islands* is a brilliantly illuminating, forensic analysis of where economic power really lies, and the shockingly corrupt way in which it behaves. If you're wondering how ordinary people ended up paying for a crisis caused by the reckless greed of the banking industry, this compellingly readable book provides the answers."

—David Wearing, School of Public Policy, UCL, London’s Global University

“An absolute gem that deserves to be read by anyone interested in the way contemporary globalization is undermining social justice. Give it to your sons, daughters, families, favorite legislators, and anyone else needing stimulation of their thought buds. This masterpiece illuminates the dark places and shows the visible hand of governments, corporations, banks, accountants, lawyers, and other pirates in creating fictitious offshore transactions and structures and picking our pockets. This financial engineering has enabled companies and the wealthy elites to dodge taxes. The result is poverty, erosion of social infrastructure and hard-won welfare rights, and higher taxes for ordinary people. Tax will be the decisive battleground of the twenty-first century as no democracy can function without it or provide people with adequate educations, healthcare, security, housing, transport, or pensions. Nicholas Shaxson has done a wonderful job in lifting the lid off the inbuilt corruption that has become so naturalized in the western world.”

—Prem Sikka, Professor of Accounting, University of Essex, UK

TREASURE ISLANDS

Uncovering the Damage of
Offshore Banking and Tax Havens

NICHOLAS SHAXSON

palgrave
macmillan

TREASURE ISLANDS

First published in 2011 by PALGRAVE MACMILLAN® in the United States–a division of St. Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Where this book is distributed in the UK, Europe and the rest of the world, this is by Palgrave Macmillan, a division of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

ISBN 978-0-230-10501-0

Library of Congress Cataloging-in-Publication
Shaxson, Nicholas.
Treasure islands : uncovering the damage of offshore banking and tax havens / Nicholas Shaxson.
p. cm.
Includes index.
ISBN 978-0-230-10501-0
1. Tax evasion—United States. 2. Tax havens. 3. Banks and banking, Foreign. I. Title.
HV6344.U6S53 2011
364.1'338—dc22

2010035424

A catalogue record of the book is available from the British Library.

Design by Letra Libre, Inc.

First edition: April 2011

10 9 8 7 6 5 4 3 2 1

Printed in the United States of America.

CONTENTS

ACKNOWLEDGMENTS

THIS BOOK COULD NOT HAVE BEEN WRITTEN without the help of a great many people around the world. First I must thank John Christensen, who has worked tirelessly with me on this book, and who deserves much of the credit. (Any mistakes, though, are mine.) Alongside him stand several leaders in this field, each of whom has provided remarkable help and insights, and each of whom has contributed in a range of ways. This group, in alphabetical order, includes Jack Blum, Ray Baker, Richard Murphy, Ronen Palan, Sol Picciotto and David Spencer. Special mention must also go to Paul Sagar and Ken Silverstein for their terrific contributions on the history of the British spiderweb and on Delaware, respectively.

A number of others deserve great thanks too, for their time and their help in specific areas. They are Jason Beattie, Rich Benson, Richard Brooks, Michèle, Elliot and Nicolas Christensen, Andrew Dittmer, Sven Giegold, Maurice Glasman, Bruno Gurtner, Mark Hampton, Jim Henry, Dev Kar, Pat Lucas and her merry team, Mike McIntyre and his brother Bob, Andreas Missbach, Matti Kohonen, Markus Meinzer, Prem Sikka, Father William Taylor, and Geoff Tily.

I couldn’t have got this far without Karolina Sutton at Curtis Brown, and I would also like to give special thanks to the staff at Palgrave Macmillan, at Random House, and to Dan Hind. Second last, but by no means least, a particular thank you to the Joseph Rowntree Charitable Trust, and the Tax Justice Network, which made all this possible. And finally, I would like to offer my thanks, appreciation and respect to all those in the tax havens who have spoken out against the consensus, sometimes at great personal risk.

PROLOGUE

An Offshore Awakening

ONE NIGHT IN SEPTEMBER 1997 I RETURNED home to my flat in North London to find that a man with a French accent had left a message on my answering machine. Mr. Autogue, as he called himself, had heard from an editor at the *Financial Times* (whom I was writing for) that I was to visit the oil-rich country of Gabon on Africa's western coastline, and he said he wanted to help me during my visit. He left a number in Paris. Curious as hell, I rang back the next morning.

This was supposed to be a routine journalist's trip to a small African country: I wasn't expecting to find too much to write about in this sparsely populated former French colony, but the fact that English-speaking journalists almost never ventured there meant I would have the place all to myself. When I arrived, I discovered to my surprise and alarm that Mr. Autogue had flown out to the capital of Libreville with an assistant on first-class Air France tickets and they had booked themselves into the city's most expensive hotel for a week—and their sole project, he cheerfully admitted, was to help me.

I had spent years watching, living in, and writing about the curve of oil-soaked African Atlantic coastline that ranges from Nigeria, in North Africa, through Gabon and down to Angola, farther south. Today this region supplies almost a sixth of U.S. oil imports[1] and about the same share of China's; and beneath a veneer of great wealth in each place lies terrible poverty, inequality, and conflict.

Journalists are supposed to start on the trail of a great story somewhere dramatic and dangerous. I found my story here unexpectedly, in a series of polite if unsettling meetings in Libreville. Lunch with the finance minister? No problem: Monsieur Autogue arranged it with a phone call. I drank a cocktail in a hotel lobby with the powerful half-Chinese foreign minister Jean Ping, who later became president of the U.N. General Assembly; the estimable Mr. Ping gave me as much of his time as I needed for my interview and asked graciously about my family. Later, the oil minister clasped me by the shoulder and jokingly offered me an oil field—then withdrew his hand, saying, "No: these things are only for *les grands*—the people who matter."

Never more than five hundred yards from foul African poverty on the streets of Libreville, I spent a week wandering about in a bubble. Mr. Autogue's attempts to keep my diary full made me determined to find out what it was that he might be wanting to hide. My new best friend had opened for me a zone of air-conditioned splendor: I was ushered to the front of queues to meet with powerful people, who were always delighted to see me. This parallel, charmed world, underpinned by the unspoken threat of force against anyone inside or outside the bubble who would disrupt it, is easy to miss in the affluent and easy West. In Africa the jolt was enough to begin to shake me from my sleep.

I had stumbled into what later became more widely known through a scandal in Paris as the so-called Elf affair.

The scandal began in 1994 when U.S.-based Fairchild Corp. opened a commercial dispute with a French industrialist, triggering a stock exchange inquiry. Unlike in more adversarial Anglo-Saxon legal systems, where the prosecution jousts with the defense to produce a resolution, the investigating magistrate in France is more like an impartial detective inserted between the two sides. He or she is supposed to investigate the matter until the end, when the truth is uncovered. In this case Eva Joly, the

Norwegian-born investigating magistrate, found that every time she investigated something new leads would emerge. Her probes just kept going deeper. She began receiving death threats: A miniature coffin was sent to her in the post, and on a raid of one business she found a Smith & Wesson revolver, fully loaded and pointed at the entrance. But she persisted: Other magistrates became involved, and as the extraordinary revelations began to accumulate, they began to discern the outlines of a gigantic system of corruption that connected the French state-owned oil company Elf Aquitaine with the French political, commercial, and intelligence establishments, via Gabon's deeply corrupt ruler Omar Bongo.

Bongo's story is a miniature tale of what happened when France formally relinquished its colonies. As countries in Africa and elsewhere gained independence, the old beneficiaries of the French empire set up new ways to stay in control behind the scenes. Gabon became independent in 1960, just as it was starting to emerge as a promising new African oil frontier, and France paid it particular attention. France needed to install the right president: an authentic African leader who would be charismatic, strong, cunning, and, when it mattered, utterly pro-French. In Omar Bongo they found the perfect candidate: He was from a tiny minority ethnic group and had no natural domestic support base, so he would have to rely on France to protect him. In 1967, aged just 32, Bongo became the world's youngest president, and for good measure France placed several hundred paratroopers in a barracks in Libreville, connected to one of his palaces by underground tunnels. This intimidating deterrent against coup plots proved so effective that by the time Bongo died in 2009, he was the world's longest-serving leader.

In exchange for France's backing Bongo gave two things. First, he gave French companies almost exclusive access to his country's minerals, on highly preferential terms that were deeply unfair to the people of Gabon. The country became known as French companies' *chasse gardée*—their private hunting ground. But the second thing Bongo provided was more interesting. He allowed his country, through its oil industry, to become the African linchpin of the gigantic, secret Elf system—a vast, spooky web of global corruption secretly connecting the oil industries of former French African colonies with mainstream politics in metropolitan France, via Switzerland, Luxembourg, and other tax havens. Parts of Gabon's oil industry, Joly discovered as she dug deeper and deeper in Paris, had been serving as a giant slush fund: a pot of secret money outside the reach of French judicial authorities in which hundreds of millions of dollars were made available for the use of French elites. An African oil cargo would be sold, and the proceeds would split up into a range of bewildering accounts in tax havens, where they could be used to supply bribes and baubles for whatever the unaccountable elites who controlled the system deemed fit.

Out of this pot, money flowed secretly to finance French political parties, the intelligence services, and other well-connected parts of French high society. Elf's secret money greased the wheels of French political and commercial diplomacy around the globe: France's biggest corporations were allowed to use this West African oil pot as a source of easy bribe money to support their bids for giant contracts ranging from Venezuela to Germany to Jersey to Taiwan—and the out-of-sight Gabon connection meant that the money trails did not lead to them. (One man told me how he once carried a suitcase of cash provided by Omar Bongo to pay off a top rebel separatist in the Angolan oil enclave of Cabinda, where Elf had a lucrative contract.)

President Bongo, for his part, was one of the smartest political operators of his generation and tapped into French Freemasonry networks and African secret societies to become one of the most important power brokers in France itself. He was the key to French leaders' ability to bind *les grands*

—opinion-formers and politicians from across Africa and beyond—into France's postcolonial foreign policy. This immensely powerful, corrupt subterranean system helped France punch above its weight in global economic and political affairs and remain significantly in control after independence, behind the scenes. A local journalist summed the relationship up for me most effectively. "The French went out of the front door," he said, "and came back in through a side window."

The system emerged gradually, but by the 1970s it was already serving as a major secret financing mechanism for the main French right-wing party, the Rally for the Republic (RPR).[2] When a Socialist, François Mitterrand, became French president in 1981, he sought to break into this right-wing Franco-African offshore cash machine and installed his man Loïk le Floch-Prigent at the head of Elf to do the job. But the latter was wise enough not to cut out his rivals in the RPR. "Le Floch knew that if he cut the financing networks to the RPR and the secret services, it would be war," explained the French authors Valerie Lecasble and Airy Routier in an authoritative book on the affair.[3] "It was explained that, instead, the leaders of the RPR—Jacques Chirac and Charles Pasqua—did not mind the Socialists taking part of the cake, if it were enlarged." So the Elf system grew. It became more baroque, complex, and layered, and it began to branch out into international corruption so grand that Mitterrand's man le Floch-Prigent was moved to describe France's intelligence services, which dipped freely into the slush, as "a great brothel, where nobody knows any more who is doing what."[4]

The system was a kind of open secret: A few well-connected French insiders knew all about it, and a fair number of educated outsiders in France knew something important was afoot but didn't know the details and largely ignored it. Yet almost nobody could see the whole thing in overview. Everything was connected through tax havens. The paper trails, as the magistrates were discovering during my Libreville trip, were typically sliced among Gabon, Switzerland, Liechtenstein, Jersey, and beyond. Joly admitted that even though she probed deeply she only ever saw fragments of the whole picture. "Endless leads were lost in the shifting sands of the tax havens. The personal accounts of monarchs, elected presidents-for-life, and dictators were being protected from the curiosity of the magistrates."[5]

My trip to Gabon in late 1997 came at an exquisitely sensitive time. On November 7 of that year, less than a week after I left Libreville, Christine Deviers-Joncour, a former lingerie model, was sent to jail in the southern suburbs of Paris, still protecting the secrets of her lover Roland Dumas, the French foreign minister. She was jailed for suspected fraud after magistrates found that Elf had paid her over $6 million to help "persuade" Dumas, a haughty prince of the Paris political clans, to do certain things—notably to reverse his public opposition to the sale of Thomson missile boats to Taiwan. On an Elf credit card she had bought him gifts, including a pair of hand-made ankle boots from a Paris shop so exclusive that its owner offered to wash customers' shoes once a year in champagne. Nobody thanked her for her discretion, and five and a half months in jail gave her time to reflect on her treatment. "A flower, a single flower, even sent to me anonymously [in jail] would have been enough," she later explained.[6] "I would have known it came from Roland." The following year she cast aside the code of silence and published a book, *The Whore of the Republic*, which became a best seller in France.

So when I visited Gabon at that especially tricky moment, the Elf networks must have wondered why this English journalist was nosing around in Libreville. Was I really a journalist? No wonder Mr. Autogue took such an interest in me. Recently, I tried to find him, to ask him about our week together. His old phone numbers no longer work, several Africa experts in Paris hadn't heard of him, Internet searches turned up no trace of him or the company he claimed to represent, and the only person with that name in the French phone book has, a surprised-sounding wife in a rural Dordogne village informed me, never been to Gabon.

The Elf system, when I visited, was dying. The magistrates' investigations were in full swing, and they finally secured 31 convictions in November 2004 after eight years' work. Elf Aquitaine has since been privatized and is now part of the Total group, which has an utterly different character from the old Elf. Still, Elf was not the only creature in the corrupt Franco-African system—myriad smaller pots of offshore money existed too. And though Elf is long gone, it seems that the system is not really dead. When President Nicolas Sarkozy of France came to power in 2007 the first person he called was not the president of Germany or the United States or the European Commission but Omar Bongo. The French troops remain in place in Gabon today, connected by underground tunnels to the presidential palace. In January 2008 the French aid minister, Jean-Marie Bockel, complained that a "rupture" with a corrupt past that French leaders had promised "is taking its time to arrive." He was summarily sacked.[7] If the Elf system is dead, then French elites seem to have replaced it with something else.

Gabon is on no list of tax havens anywhere. But the Elf system that it hosted was part of, and a metaphor for, the offshore world. To understand this, it is necessary to explain some fundamental truths about what a tax haven or offshore jurisdiction is.

Tax havens provide escape routes from rules and laws elsewhere. These two words, "escape" and "elsewhere," will crop up repeatedly in this book. The zero tax rates offered in the Cayman Islands, for example, are not designed for Caymanians but are set up to attract the business of North and South Americans, Europeans, Asians, Middle Easterners, and Africans alike.

In truth, the term *tax haven* is a bit of a misnomer because these places offer an escape not just from taxes but from many other rules and regulations too. If a person or entity wants to do something but is forbidden by law from doing it at home, it escapes to somewhere else to do it. (To be more precise, it isn't usually the entity but its money that escapes.) The common feature of tax havens is that they offer secrecy. Once the escape has been effected, the escapee is very hard to find. The users of tax havens might be escaping any number of different laws or regulations: taxes, criminal laws, insider trading rules, inheritance rules, environmental laws, or financial regulation. If there is a law to stop or regulate it, there will probably be places that offer escape routes from that law. A simple example of an offshore escape is when a U.S. citizen, say, parks $10 million of drug money in a bank account in Panama. It will be exceedingly difficult for the U.S. authorities to find that money, let alone tax it.

The Elf system allowed bribes to be paid and other nefarious acts to be committed *elsewhere*—without the paper trails touching French soil. Offshore. The system did not exactly exist anywhere: It flourished in the gaps *between* jurisdictions. Elsewhere became nowhere.

The Elf affair illustrates another fundamental offshore truth. The escape routes from the rules and laws of society are provided almost exclusively for the benefit of wealthy and powerful insiders—leaving the rest of us to pick up the bill. The Elf system, a gargantuan octopus of corruption, affected ordinary people in both Africa and France in the most profound, if mostly invisible, ways. Ordinary African citizens saw their nations' oil money being siphoned off to the rich world through unfair oil contracts and general corruption, while French protection made Gabon's leaders invulnerable and hence unaccountable to their citizens—at the same time that the Elf system made France's elites unaccountable to that nation's citizens too.

These very same principles apply to the offshore system more generally. Because of tax havens, we have ended up with one set of rules for the rich and powerful and another set of rules and laws for the rest of us—and this applies to citizens of rich and poor countries alike. Just like the Elf system, offshore is a project of elites against their, and our, societies. It is not so much about crime or taxes, important though they are. This is a story about how political power is distributed in the world today.

It is essential to understand from the outset that the offshore system is ultimately not about celebrity tax exiles and mobsters—though they are regular users of the system. It is about banks and financial services industries. This book will show that the offshore system is the secret underpinning for the political and financial power of Wall Street today. It is the fortified refuge of Big Finance.

The offshore system is also about a more generalized subversion of democracy by our increasingly unaccountable elites. "Taxes are for the little people," the New York millionaire Leona Helmsley once famously said. She was right, though in the end she wasn't big enough to escape prison herself. The media baron Rupert Murdoch is different. His News Corporation, which owns Fox News, MySpace, and any number of other media outlets around the globe, is a master of offshore gymnastics, using all legal means available. When *The Economist* magazine investigated in 1999, it reckoned that News Corporation paid a tax rate of just 6 percent—compared with 31 percent for its competitor Disney.[8] Neil Chenoweth, an Australian reporter, probed News Corporation's accounts and found that its profits, declared in Australian dollars, were A$364,364,000 in 1987, A$464,464,000 in 1988, A$496,496,000 in 1989, and A$282,282,000 in 1990.[9] The obvious pattern in these numbers cannot be a coincidence. As John Lanchester wrote in the *London Review of Books:* "That little grace note in the sums is accountant-speak for 'Fuck you.' Faced with this level of financial wizardry, all the ordinary taxpayer can do is cry 'Bravo l'artiste!'"

Much of what happens offshore is technically legal. A lot of it is plainly illegal and often criminal. And there is a vast gray area in between. All of it is profoundly dangerous, corrosive to democracy, and morally indefensible. Eva Joly explains what the Elf affair taught her about the distribution of power in the world. "I realized I was no longer confronted with a marginal thing but with a system," she said. "I do not see this as a terrible, multifaceted criminality which is besieging our [onshore] fortresses. I see a respectable, established system of power that has accepted grand corruption as a natural part of its daily business."[10]

From this strange Franco-African tale emerges one more important point, which will be a recurring theme of this book. In decades and centuries past, colonial systems helped rich countries preserve and boost their elites' wealth and privileges at home. When the European powers left their colonies after the Second World War, they replaced formal controls over their ex-colonies with different arrangements to retain a measure of control behind the scenes. The Elf system was the main way that France achieved this. Britain did it with the modern offshore system, its financial replacement for empire. Citizens of the United States are paying the price.

"It has taken me a long time to understand," explains Joly, "that the expansion in the use of these jurisdictions [tax havens] has a link to decolonization. It is a modern form of colonialism."[11]

Long before my first visit to Libreville I had noticed how money was pouring out of Africa, often into tax havens, but the secrecy surrounding this financial trade made it impossible to trace the connections. Financial institutions, and occasionally their accountants and lawyers, would surface in particular stories, then slip back into an offshore murk of commercial confidentiality and professional discretion. Every time a scandal broke, these intermediaries' crucial roles escaped serious scrutiny. Africa's problems, the story went, had something to do with its nations' rulers, or its cultures and societies, or the oil companies. It was their fault.

The providers of offshore secrecy were clearly a central part of all these dramas—but the racket was very hard to penetrate, and nobody seemed very interested in trying. It was only in 2005 that the threads properly started to come together for me. I was sitting with David Spencer, a New York attorney previously with Citicorp, talking about transparency in the public finances of West African oil-producing nations. Spencer was getting agitated about matters that were not at all on my agenda: accounting rules, U.S. tax exemptions on interest income, and transfer pricing. I was wondering when he was going to start talking about West African corruption when I finally began to make a serious connection. The United States, by offering tax incentives and secrecy to lure money from overseas, had been turning *itself* into a tax haven.

Tides of financial capital flow around the world in response to small changes in these kinds of tax and secrecy incentives. The U.S. government needs foreign funds to flow in, and it attracts them by offering tax-free treatment and secrecy. This is offshore business, Spencer explained, and it had become *central* to the U.S. government's global strategies for financing its deficits. Not only did almost nobody understand this, he continued, but almost nobody *wanted* to know. Once, when he gave a speech at a major United Nations event outlining some of these basic principles, a top U.S. negotiator collared him afterward and told him that his shedding light on this subject made him "a traitor to your country." The negotiator was wrong: Spencer was being disloyal only to offshore interests on Wall Street.

In the Harvard Club with Spencer I began to see how the terrible human cost of poverty and inequality in Africa, Latin America, and other parts of the world connected with the apparently impersonal world of accounting and financial regulations and tax law. Africa's supposedly natural or inevitable disasters all had one thing in common: the movement of money out of poor countries and into parts of Europe and the United States, assisted and encouraged by the tax havens and a pinstripe army of respectable bankers, lawyers, and accountants. Nobody wanted to look beyond poor countries at the system that made this movement possible. The U.S. government and many others have allowed tax havens to proliferate because the elites who use them are the world's most powerful lobbyists.

Martin Woods, a Wachovia bank employee who became a whistle-blower after seeing billions of suspect dollars flowing from currency houses in Mexico in the midst of a drug war, illustrates the problem clearly. "If you don't see the correlation between the money laundering by banks and the twenty-two thousand people killed in Mexico," he said, "you're missing the point."[12] The world has, it seems, been determined to miss the point.

The offshore system hadn't been just an exotic sideshow in the stories I was covering, as I had thought. Offshore *was* the story. It binds together Libreville, Paris, and Jersey; Luanda, Geneva, and Moscow; Moscow, Cyprus, and London; Wall Street, Mexico City, and the Cayman Islands; Washington, the Bahamas, and Riyadh. Offshore connects the criminal underworld with financial elites and binds them together with multinational corporations and the diplomatic and intelligence establishments. Offshore drives conflict, shapes our perceptions, creates financial instability, and delivers staggering rewards to *les grands*, the people who matter. Offshore is how the world of power now works. This is what I want to show you. The offshore system is the greatest fault line in our globalized world.

An impression has been created in sections of the world's media, since a series of stirring denunciations of tax havens by world leaders in 2008 and 2009, that the offshore system has been dismantled or at least suitably tamed. As we shall see, exactly the opposite has happened. The offshore system is in robust health—and growing fast. The crackdown has turned out to be a whitewash.

1

WELCOME TO NOWHERE

An Introduction to Offshore

THE OFFSHORE WORLD IS ALL AROUND US. Over half of world trade passes, at least on paper, through tax havens.[1] Over half of all bank assets, and a third of foreign direct investment by multinational corporations, are routed offshore.[2] Some 85 percent of international banking and bond issuance takes place in the so-called Euromarkets, a stateless offshore zone that we shall soon explore.[3] Nearly every multinational corporation uses tax havens, and their largest users—by far—are on Wall Street.[4]

Tax havens don't just offer an escape from tax. They also provide wealthy and powerful elites with secrecy and all manner of ways to shrug off the laws and duties that come along with living in and obtaining benefits from society—taxes, prudent financial regulation, criminal laws, inheritance rules, and many others. Offering these escape routes is the tax havens' core line of business. It is what they *do*.

Before getting into the real story of offshore, this chapter will lay some basic groundwork for understanding tax havens, offering a few essential principles, some brief history, and a short overview of where the tax havens are located.

Nobody agrees exactly what a tax haven is, but I will offer a loose description here: It is a place that seeks to attract money by offering politically stable facilities to help people or entities get around the rules, laws, and regulations of jurisdictions elsewhere.[5] This definition is quite broad, compared to some others, and I have chosen it for two main reasons. First, I aim to challenge a common idea that it is perfectly OK for one jurisdiction to exercise its sovereign right to get rich by undermining the sovereign laws and rules of other places. Second, I am offering a lens through which to view the history of the modern world. This definition will help me show how the offshore system is not just a colorful appendage at the fringes of the global economy but rather lies at its very center.

I should also make a short point here about some confusion in the language. When I say "offshore," I obviously am not referring to offshore oil drilling. I am also not talking about "offshoring," which is what happens when a company moves a manufacturing plant or, say, a call center from the United States to India or China, perhaps to save on labor costs. When I say "offshore," I am talking about the artificial movement or use of *money* across borders, and about the jurisdictions, commonly known as tax havens, that host and facilitate this activity. Once the money has escaped offshore, it is reclassified in an accountant's ledger and it assumes a different identity—and that means, very often, that the forces of law and order will never find it.

A number of features help us spot tax havens. Here are some important ones.

First, as my colleagues have found through painstaking research, all tax havens offer secrecy, in various forms. The term *secrecy jurisdiction* emerged in the United States in the late 1990s, and in this book I will use it interchangeably with *tax haven*. I will call the whole global structure of these places, and the private infrastructure that services them, the offshore system.

Another common marker for tax havens is very low or zero taxes, of course. People and corporations use them to escape tax, legally or illegally. Secrecy jurisdictions also have very large financial services industries in comparison to the size of the local economy. These places also routinely "ring-fence" their own economies from the facilities they offer to protect themselves from their own offshore tricks. So they might, for example, offer a zero tax rate to nonresidents who park their money there but tax local residents fully. This ring-fencing is a tacit admission that what they do is harmful.

Various other telltale signs exist. Tax havens usually deny what they are and strenuously assert that they are clean. Search for "We are not a tax haven" on the Internet or "We are a transparent, well regulated, and cooperative jurisdiction," and see what comes up. Each has its own way of addressing the critics: In the Cayman Islands, for example, accusations of lax regulation after scandals are routinely dismissed as media stereotypes that do not correspond to objective reality.[6]

But there is one feature of a secrecy jurisdiction that stands out above all: that local politics is captured by financial interests from elsewhere (sometimes these financial interests are criminal interests). This is why I include "politically stable" in my definition: Meaningful opposition to the offshore business model will have been neutered in a serious tax haven, so that such irritants as local politics cannot interrupt the business of making money. And here lies one of the great offshore paradoxes: These zones of ultra-freedom for financial interests are so often repressive places, viciously intolerant of criticism. The offshore world is steeped in a pervasive inverted morality: Turning a blind eye to crime and corruption has become good business practice: a way of attracting money; while alerting forces of law and order to wrong-doing has become the punishable offense. Here in the tax havens, rugged individualism has morphed into a disregard, even a contempt, for democracy and for societies at large.

One of the first things to understand about offshore business is that it is, at heart, about artificially manipulating paper trails of money across borders. To get an idea of how artificial it can be, consider the banana.

A bunch of bananas typically takes two routes into your home: a real route and an artificial offshore paper trail. On the first route a Honduran worker, say, is employed by Big Banana, a U.S. multinational I've just invented, to pick the bananas, which are then packaged and shipped to Britain, sold to a supermarket, and sold on to a customer.

The second route—the accountants' paper trail—is different. When a banana is picked in Honduras and shipped to Britain and sold, where are the final profits generated? In Honduras? In the British supermarket? In the multinational's U.S. head office? And how do you work this out? How much do the corporation's management expertise, or the brand name, or the insurance, or the accounting business, contribute to profits and costs? Which country ought to tax each component of the final profit? Nobody can say for sure, so the accountants can, up to a point, decide for themselves.

Here, in simple form, is what they might do. They advise Big Banana to run its purchasing network from, say, the Cayman Islands, and put a financial services subsidiary in Luxembourg. The Big Banana brand might be parked in Ireland; its shipping subsidiary in the Isle of Man; it might locate certain parts of its "management expertise" in Jersey, and its insurance arm in Bermuda. All are tax havens.

Next, each part of this multinational charges the other parts for the services they provide. So Big Banana's Luxembourg finance subsidiary might lend money to Big Banana Honduras, then charge that

Latin American subsidiary $10 million per year in interest payments for that loan. The Honduran subsidiary will deduct this $10 million from its local profits, cutting or wiping out its local profits (and consequently its tax bill) there. The Luxembourg finance subsidiary, however, will record this $10 million as income—but because Luxembourg is a tax haven, it pays no taxes on this. With a wave of an accountant's wand, a hefty tax bill has disappeared. Who is to say that the $10 million charged by Big Banana Luxembourg is the real going rate—or just an accountant's invention? Quite often it is hard to tell, although sometimes these prices are adjusted so aggressively that they lose all sense of reality: A kilo of toilet paper from China has been sold for $4,121.81, a liter of apple juice has been sold out of Israel at $2,052, and a ballpoint pen has been recorded leaving Trinidad valued at $8,500.

Though most examples are far less blatant than this, the cumulative total of these shenanigans is vast. About two-thirds of global cross-border world trade happens inside multinational corporations. And it is poor countries in particular, with their underpaid tax officials, that always lose out to multinationals' aggressive, highly paid accountants.

What Big Banana has done here is *transfer pricing* (or *mispricing*), a common offshore trick that U.S. Senator Carl Levin calls "the corporate equivalent of the secret offshore accounts of individual tax dodgers." The general idea is that by adjusting its internal prices a multinational can shift profits offshore, where they pay little or no tax, and shift the costs onshore, where they are deducted against tax. In the banana example, tax revenue has been drained out of a poor country and into a tax haven and funneled through to the wealthy owners of a multinational corporation. In October 2010 a Bloomberg reporter explained how Google Inc. cut its taxes by $3.1 billion in the previous three years through transfer pricing games known by names such as the "Double Irish" and "Dutch Sandwich," ending up with an overseas tax rate of 2.4 percent.[7] The problem is getting worse. Microsoft's tax bill has been falling sharply, for similar reasons. Cisco is at it.[8] They are all at it. Transfer pricing alone cost the United States an estimated $60 billion a year[9]—and that is just one form of the offshore tax game.

Worldly readers may still shrug and tell themselves that this is just part of the ugly flipside of living in a rich nation. If they do, in their reluctantly cynical way, they are suckers—for they are victims, too. The tax bill is cut not only in Honduras but in Britain and America too. The annual report of a real banana company listed in New York notes: "The company currently does not generate U.S. federal taxable income. The company's taxable earnings are substantially from foreign operations being taxed in jurisdictions at a net effective rate lower than the U.S. statutory rate."[10] (Rough translation: We don't currently pay U.S. taxes because we use tax havens.)

This may be quite legal—but when it happens, small businesses and ordinary folk must step in to pay the taxes that multinationals have escaped. "Small businesses are the lifeblood of local economies," said Frank Knapp, member of a new group formed in 2010 called Business and Investors Against Tax Haven Abuse. "We pay our fair share of taxes, shop locally, support our schools, and actually generate most of the new jobs. So why do we have to subsidize multinationals that use offshore tax havens to avoid paying taxes?"

Multinationals, it has to be said, find it hard to cut their taxes to zero because governments take countermeasures. But it is a battle the governments are losing. The U.S. Government Accountability Office reported in 2008 that two-thirds of American and foreign companies doing business in the United States avoided income tax obligations to the federal government in the years 1998–2005, despite corporate sales totaling $2.5 *trillion*.[11] Not only this, but the corporate transfer pricing abuses that I have just described are just one of several forms of tax abuse. Subsequent studies suggest the problem is getting worse.[12]

Transfer mispricing is one of the most important reasons that multinationals *are* multinationals and why they usually grow faster than smaller competitors. Anyone worried about the power of global multinationals should pay attention to tax havens.

It is not just your bananas, of course. Much of the food you eat will most likely have taken a similarly twisted route into your home. The water in your tap may have traveled on a similarly ghostly paper pathway en route to your bathtub. Your television, its component parts, and many of the programs it shows also likely took offshore routes into your living room. The offshore world envelops us.

All these offshore games make markets profoundly inefficient. Wealth has been transferred from poor taxpayers to rich shareholders—but nobody has produced a better or cheaper banana here. These are untargeted government subsidies for multinationals, courtesy of the tax havens, and they don't make multinationals more productive. When corporate managers focus on tax dodging they take their eyes off what they do best—making better goods and delivering them more cheaply to market. Add to that the time and billions wasted paying expensive accountants and lawyers to conjure up these schemes. And then there is the secrecy. A fundamental building block of modern economic theory is transparency: Markets work best when two sides to a contract have access to equal information. *Treasure Islands* explores a system that works directly and aggressively against transparency. Offshore secrecy shifts control over information and the power that flows from it toward the insiders, helping them take the cream and use the system to shift the costs and risks onto the rest of society.

David Ricardo's theory of comparative advantage elegantly describes principles that lead different jurisdictions to specialize in certain things: fine wines from France, cheap manufactures from China, and computers from the United States. But when we find that the British Virgin Islands, with fewer than twenty-five thousand inhabitants, hosts over eight hundred thousand companies, or that more than 40 percent of foreign direct investment into India comes from Mauritius, Ricardo's theory loses its traction. Companies and capital migrate not to where they are most productive but to where they can get the best tax break. There is nothing "efficient" about any of this.

The world contains about 60 secrecy jurisdictions, or tax havens, which can be divided roughly into four groups: a set of continental European havens, a British zone of influence centered on the City of London and loosely shaped around parts of Britain's former empire, a zone of influence focused on the United States, and a fourth category holding unclassified oddities like Somalia and Uruguay.

The European havens got going properly from the First World War, as governments raised taxes to pay for their war costs. Switzerland's famous secrecy law, making violation of banking secrecy a criminal offense for the first time, was enacted in 1934 in response to a French tax evasion scandal, though Geneva bankers had sheltered the secret money of European elites since at least the eighteenth century.[13] Picturesque, little-known Luxembourg, specializing since 1929 in certain kinds of offshore corporations,[14] is among the world's biggest tax havens today: Well over $2.5 trillion is parked offshore in Luxembourg.[15] In March 2010 South Korean intelligence officials indicated that North Korea's "Dear Leader" Kim Jong-Il had stashed some $4 billion in Europe—profit from the sale of nuclear technology and drugs, insurance fraud, counterfeiting, and projects using forced labor; Luxembourg, they said, is a favored destination for the money.[16]

The Netherlands is another major European tax haven. In 2006, while the Irish musician Bono browbeat Western taxpayers to boost aid to Africa, his band, U2, shifted its financial empire to the Netherlands to cut its own tax bills. Austria and Belgium are also important European havens of banking secrecy, though Belgium softened its laws in 2009. A couple of other small European micro-state havens are worth noting, including Monaco and Andorra, with occasional cameo roles from odd places like the Portuguese Islands of Madeira, which was central to a major Nigerian bribery scandal involving the U.S. oil service company Halliburton[17] that resulted in the second largest fine ever paid in a prosecution under the Foreign Corrupt Practices Act.

The second offshore group, accounting for about half the world's secrecy jurisdictions, is the biggest. This is a layered hub-and-spoke array of tax havens, centered on the City of London, which mostly emerged from the ashes of the British empire.[18] As I will show, it is no coincidence that the City of London, once the capital of the greatest empire the world has known, is the center of the most important part of the global offshore system.

The City's offshore network has three main layers. Its inner ring consists of Britain's three Crown Dependencies: the nearby islands of Jersey, Guernsey, and the Isle of Man. The authoritative U.S. publication Tax Analysts estimated conservatively in 2007 that just these three havens hosted about $1 trillion of potentially tax- evading assets.[19] At a reasonable annual rate of return of 7 percent and a top income tax rate of 40 percent, the tax evaded on those could be almost $30 billion per year—and income tax evasion is just one of several forms of offshore tax and financial losses. Other losses, which I will explain below, are far bigger.

The next, intermediate ring involves Britain's 14 overseas territories, the last surviving outposts of Britain's formal empire. With just a quarter of a million inhabitants between them, they include some of the world's top secrecy jurisdictions: the Cayman Islands, Bermuda, the British Virgin Islands, Turks and Caicos, and Gibraltar.[20] Like the Crown Dependencies, these places are partly independent from Britain—though Britain controls events behind the scenes. In the Caymans, for instance, Her Majesty the British Queen appoints His Excellency the Governor, the most powerful person on the island. He (never a she, so far) presides over a cabinet of local Caymanians who are elected locally but who have almost no power over the stuff that matters—the money. The governor handles defense, internal security, and foreign relations; he appoints the police commissioner, the complaints commissioner, the auditor general, the attorney general, the judiciary, and other top officials. The final appeal court is the Privy Council in London. MI6, Britain's Secret Intelligence Service, is highly active here[21] (as are the CIA and several other intelligence services).

The Cayman Islands is the world's fifth largest financial center, hosting eighty thousand registered companies, over three-quarters of the world's hedge funds, and $1.9 trillion on deposit—four times as much as in all the banks in New York City. And it has, at the time of writing, one cinema.

To indicate how murky things are here, the Cayman Islands reported in 2008 that institutions based there had $2.2 trillion in borrowings but had only lent out a third of that amount—even though these figures should match each other, more or less. The UK and Caymans authorities have not explained this $1.5 trillion discrepancy.[22]

The third, outer ring is a more diverse array of havens like Hong Kong and the Bahamas, which are outside Britain's direct control but nevertheless have strong historical links to the empire and deep current links to the City of London. One authoritative account estimates that this three-layered British grouping accounts for well over a third of all international bank assets worldwide. Adding the City of London itself brings the total up to nearly a half.[23]

This network of offshore satellites does several things for the City of London. First, it gives it a global reach: These havens scattered around the world attract and catch mobile international capital flowing to and from nearby jurisdictions, just as a spider's web catches passing insects. Money attracted to these jurisdictions, and much of the business of managing that money, is funneled through to London. A lot of U.S. business is attracted to the Cayman Islands, and this gives the City of London the chance to get a slice of the action. Second, the spiderweb[24] lets the City get involved in business that might be forbidden in Britain, giving the financiers in London sufficient distance from wrongdoing to allow plausible deniability. By the time the money gets to London, often via several intermediary jurisdictions, it has been washed clean. The old City of London adage "Jersey or Jail" means that if you want to do a certain type of business but don't want to get caught, you just step out into the Jersey part of the spiderweb and do it there. Sometimes, business too dirty for the Crown Dependencies is farmed out further into the spiderweb. John Christensen, formerly a Jersey financial sector professional, remembers the Overseas Territory of Gibraltar being one particular favorite. "We in Jersey regarded Gibraltar as totally subprime," he said. "This was where you put the real monkey business." Later, a Caymanian character who introduced himself to me only as "The Devil" will help illustrate just how dirty this business can be.

Britain's understated, ambiguous, but ultimately controlling role in these nodes of the spiderweb is the bedrock that reassures flighty global capital and underpins their offshore sectors. The gesture toward local representation keeps Caymanians happy and gives Britain the chance to say "it is not our business to interfere" when something unpleasant breaks the surface, or when other countries complain of abuses being perpetrated out of there. Periodically, the charade of the overseas territories is exposed: In August 2009 Britain imposed direct rule in the Turks and Caicos Islands after corruption there spun too far out of control.[25] Britain plays down these episodes, as far as is possible, to distract attention away from its real control.

The outer reaches of the British spiderweb consist of a more complex and varied set of places that are independent from Britain, but with a history of involvement with the British empire or zones of close influence, and with enduring and powerful links with the City of London. The biggest are Hong Kong, Singapore, the Bahamas, Dubai, and Ireland,[26] though many others exist, like Vanuatu in the South Pacific, whose small offshore center was created by the British government in 1971, nine years before independence. New ones continue to emerge: In February 2006, for example, Ghana said it would set up offshore legislation with help from Britain's Barclays Bank. The thought of a new African secrecy jurisdiction in the midst of a swath of legendarily corrupt African oil-producing nations—and just as Ghana takes its own first steps as a big oil producer—is almost too horrible to contemplate. Botswana, right next to South Africa, is setting up its offshore center too.

One might ask why the United States has more or less tolerated the presence of British-run places parked off its eastern and southern coastline, eroding its tax base and undermining its laws and financial regulations. The answer isn't straightforward. U.S. officials have periodically tried to crack down on offshore tax abuse, at least since 1961, when President Kennedy asked Congress for legislation to drive these tax havens "out of existence,"[27] but have been thwarted each time by powerful interests on Wall Street. A U.S. Government Accountability Office (GAO) report from December 2008 provides a clue as to their power, showing that Citigroup had 427 tax haven subsidiaries, of which 290 were in the British spiderweb. The next biggest user was Morgan Stanley with 273 offshore subsidiaries (of which 220 were in the British zone), then News Corporation with 152, of which 140 were in the British zone.[28]

In these numbers lies another important point to understand from the outset. People have traditionally seen tax havens as marginal players used by mafiosi, drug smugglers, spies, petty criminals, and celebrity tax-dodgers. Plenty of these can be found offshore, it is true.[29] But I need to stress again: The big users of the secrecy jurisdictions are the banks and other financial institutions.

I am struck by similarities between Britain's postcolonial offshore network and what I encountered in oil-rich Gabon, the epicenter of France's own very strange, quasi-offshore postcolonial system. Gabon fits no conventional definition of a tax haven, but it is, like the havens in the British spiderweb, a relic (or even a rebirth) of a colonial empire that is being used by elites to do things—often unpleasant ones—that would not be allowed at home. The Elf system, with its subterranean bargains with African rulers and French politicians, was a way for France to retain a great degree of control over its former colonies after independence. Britain's spiderweb is different—most of its former colonies in Africa, India, and elsewhere really are independent. But what Britain has done instead is to retain a large degree of control of the vast flows of wealth in and out of these places, under the table. Illicit capital flight from Africa, for example, flows mostly into the modern British spiderweb, to be managed in London. In both the French and the British systems, powerful interest groups in the old colonial powers have built secret financial relationships with the local elites, creating global alliances with each other against the ordinary citizens of these poor countries—and against their *own* citizens too.

The United States anchors the third big offshore pole. Before the great global offshore explosion began in the 1960s and the 1970s, the U.S. government was generally hostile to offshore business, and its leaders fought against the British spiderweb and the European havens. But as the 1970s wore on financial interests became increasingly influential in U.S. policymaking, and the country, facing large Vietnam War–era deficits and increasingly adopting an "if you can't beat 'em, join 'em" attitude toward tax havens, began consciously adopting its own offshore characteristics—particularly special tax incentives and secrecy structures available to foreigners—in efforts to attract financial capital into the United States to fill the deficits.

So there are two things going on here: Tax revenues and other money are being drained out of the United States into tax havens elsewhere, and a flow of foreign (often dirty) money is moving in the other direction back into the country. The United States is estimated to be losing $100 billion annually from offshore tax abuses—a gigantic transfer of wealth from ordinary taxpayers to rich people.[30] And that is not to mention the role the offshore system plays as a giant hothouse for international crime and fraud or its role in undermining financial regulation, which I shall get to.

But the money flowing into tax haven USA does not make up for the money and tax revenues being drained out. The inflows have made matters worse still for ordinary U.S. taxpayers, let alone for foreigners being stiffed by their own wealthy and unaccountable elites. As the following chapters will show, the inflows delivered massive rewards to a small financial elite, while helping Wall Street to gain its too-big-to-fail stranglehold on the U.S. economy and the politicians in Washington. "Tax havens are engaged in economic warfare against the United States, and honest, hardworking Americans," says Senator Carl Levin. He is quite right—but we should add that the United States in its role as a tax haven is conducting economic warfare against honest, hardworking people at home and around the world.

Like the British offshore system, the U.S.-based offshore system operates on three tiers.

At the federal level, on the top tier, the United States dangles a range of special tax exemptions, secrecy provisions, and laws designed to attract foreigners' money into the United States in true offshore style. U.S. banks may, for instance, legally accept proceeds from a range of crimes, such as handling stolen property—as long as the crimes are committed overseas. Special arrangements are made with banks to make sure they do not reveal the identities of foreigners parking their money in the United States.

The second offshore tier involves individual U.S. states. A range of different things are happening, in a number of states. Florida, for example, is where Latin American elites do their banking, and the United States generally does not share banking information with those countries, so a lot of this is tax-evading and other criminal money, protected by U.S. secrecy. Florida's banks also have a long history of harboring Mob and drug money, often in complex partnerships with the nearby British Caribbean havens. On a different tack, smaller U.S. states like Wyoming, Delaware, and Nevada have become specialists in offering low-cost and very strong forms of almost unregulated corporate secrecy, which has attracted illicit money, and even terrorist money, from around the globe.

The third U.S. offshore rung is an overseas satellite network, far smaller than the British zone. One is the U.S. Virgin Islands, a U.S. "Insular Area" and a minor haven used by Bank of America, Boeing, FedEx, and Wachovia, among others.[31] A more interesting haven in the U.S. zone is the Marshall Islands, a former Japanese colony under U.S. control since 1947, now under a Compact of Free Association with the United States. It is primarily the host for a "flag of convenience" service that, *The Economist* magazine recently noted, is "much prized among shipowners for its light regulatory touch." The Marshall Islands registry was set up in 1986 with USAID help by Fred M. Zeder II, a golfing buddy of George H. W. Bush who later ran the United States Overseas Private Investment Corp. (OPIC), and its flag of convenience service is run by a private U.S. corporation out of offices in Reston, Virginia, near Washington Dulles Airport. The Marshall Islands provides the anything-goes, unregulated flag for, among many others, the *Deepwater Horizon*, the BP-operated oil rig that caused environmental chaos off the U.S. Gulf Coast in 2010.[32]

A small, opaque tax haven also grew alongside the Marshall Islands shipping registry, which the GAO reckoned was being used by ConocoPhilips, Morgan Stanley, and News Corp. When Khadija Sharife, a South African journalist, posed as a shipping client pretending to be worried about disclosure, she was told that forming a Marshall Islands company could be done in a day for an initial filing fee of $650 plus annual fees of $450, and

> If the authorities . . . come to our Registry and Jurisdiction and ask to disclose more information, regarding shareholders, directors of the company etc.… we are not privy to that information anyway, since all the business organization and conduct of the entity is performed by the entity's lawyers and directors directly. Unless the name of directors and shareholders are filed in the Marshall Islands and become a public record (which is NOT mandatory), we are not in a position to disclose that information.[33]

In Africa, Liberia was set up in 1948 as a "flag of convenience" by Edward Stettinius Jr., a former U.S. secretary of state, and its maritime code was "read, amended, and approved by officials of Standard Oil," according to the historian Rodney Carlisle. Its sovereign shipping registry is now run by another private U.S. corporation out of Vienna, Virginia, about five miles from the Marshall Islands registry.[34] Sovereignty is, literally, available for sale or rent in such places.

The biggest tax haven in the U.S. zone of influence is Panama. It began registering foreign ships from 1919 to help Standard Oil escape U.S. taxes and regulations, and offshore finance followed: Wall Street interests helped Panama introduce lax company incorporation laws in 1927, which let anyone open tax-free, anonymous, unregulated Panama corporations with few questions asked. “The country is filled with dishonest lawyers, dishonest bankers, dishonest company formation agents and dishonest companies,” one U.S. Customs official noted. “The Free Trade Zone is the black hole through which Panama has become one of the filthiest money laundering sinks in the world.”[35]

This strange and little-known U.S.-centered pattern, echoing the neocolonial role of the secrecy jurisdictions in the British zone, provides a pointer to the fact that the secrecy jurisdictions have for years quietly been at the heart of neoconservative schemes to project U.S. power around the globe. And almost nobody has noticed.

It should be clear by now that the offshore world is not a bunch of independent states exercising their sovereign rights to set their laws and tax systems as they see fit. It is a set of networks of influence controlled by the world’s major powers, notably Britain, the United States, and some jurisdictions in Europe. Each network is deeply interconnected with, and warmly welcomes offshore business from, the others. Wealthy U.S. individuals and corporations use the British spiderweb extensively: Enron, for example, had 881 offshore subsidiaries before it went bust, of which 692 were in the Cayman Islands, 119 in the Turks and Caicos, 43 in Mauritius, and 8 in Bermuda, all in the British spiderweb. The United States returns the favor to wealthy British interests investing tax-free, in secrecy, via Wall Street.

Not only that, but the world’s most important tax havens in their own right are not exotic palm-fringed islands but some of the world’s most powerful countries themselves. Marshall Langer, a prominent supporter of secrecy jurisdictions, neatly describes the misperceptions that have grown up about tax havens. “It does not surprise anyone when I tell them that the most important tax haven in the world is an island,” he said. “They are surprised, however, when I tell them that the name of the island is Manhattan. Moreover, the second most important tax haven in the world is located on an island. It is a city called London in the United Kingdom.”[36]

Jason Sharman, an Australian academic, checked how easy it was to set up secrecy structures, using the Internet and those seedy offshore advertisements that infest the back pages of business publications and airline magazines. In his report published in 2009 he records making forty-five bids for secret front companies. Money laundering controls seem to be in operation patchily, but of those 45 bids, 17 companies agreed to set them up without even checking his identity. Only four of these were in the “classic” havens like Cayman or Jersey, while the other 13 were in countries from the wealthy Organisation for Economic Cooperation and Development (OECD), including seven in Britain and four in the United States.

What Sharman was encountering, *The Economist* magazine noted, was not traditional Swiss banking secrecy, where discreet men in plush offices promised to take their clients’ names to the grave. “This is a more insidious form of secrecy, in which authorities and bankers do not bother to ask for names…. For shady clients, this is a far better proposition: what their bankers do not know, they can never be forced to reveal. And their method is disarmingly simple. Instead of opening bank accounts in their own names, fraudsters and money launderers form anonymous companies, with which they can then open bank accounts and move assets.”[37] The United States, Sharman noted, was offering nonresident foreigners all the elements of a tax haven, notably no taxes and secrecy. As he put it, "The United States, Great Britain and other OECD states have chosen not to comply with the international standards which they have been largely responsible for putting in place."

Rich OECD nations have worked hard to persuade their publics that there has been a major crackdown on the secrecy jurisdictions. "The old model of relying on secrecy is gone," said Jeffrey Owens, head of tax at the OECD. "This is a new world, with better transparency and better cooperation."[38] Many people believed him. French president Sarkozy went further. "Tax havens and bank secrecy," he said, "are finished."[39] Yet big OECD member states are the guardians and promoters of the offshore system. It continues to process vast tides of illicit money—yet an OECD blacklist of tax havens is effectively a whitewash, as I will explain later.[40] And to the very, very limited extent that rich countries have tried to address the problem, low-income countries are being left on the sidelines as usual.

When the fox announces that it has done an excellent job of beefing up the security of the henhouse, we should be very cautious indeed.

The offshore world is an endlessly shifting ecosystem, and each jurisdiction offers one or more offshore specialties. Each attracts particular kinds of financial capital, and each develops a particular infrastructure of skilled lawyers, accountants, bankers, and corporate officers to cater to their specific needs.

Yet few people are even aware that such businesses exist. You may well have heard of the Big Four accounting firms KPMG, Deloitte, Ernst & Young, and PricewaterhouseCoopers. But have you heard of the Offshore Magic Circle? Its members are made up of highly profitable multijurisdictional law firms mostly originating in Britain or its Overseas Territories and Crown Dependencies: a smartly dressed regiment of accountants, lawyers, and bankers forming a private global infrastructure that, in league with captured legislatures in the secrecy jurisdictions, makes the whole system work.

Offshore services range from the legal to the illegal, with a huge gray area in between. In terms of tax, the illegal stuff is called tax *evasion*, while tax *avoidance* is technically legal, though, by definition, it also involves getting around the intent of elected legislatures. To distinguish between evasion and avoidance is a slippery business, and it often takes vast, lengthy court cases to find out which side of the law a multinational corporation's tax shelter lies on. Former British chancellor Dennis Healey gave a neat definition of where the dividing line lies. "The difference between tax avoidance and tax evasion," he said, "is the thickness of a prison wall."[41] Even when offshore is not technically illegal, it is often a problem. Secrecy jurisdictions routinely convert what is technically *legal*, but abusive, into what is seen as *legitimate*. Of course what is legal is not necessarily what is right: think slavery, or apartheid.

Illegal offshore services and structures include tax-evading private banking or asset management, sham trusts, corporate secrecy, illegal reinvoicing, regulatory evasion, fraud concealment, and many, many other nefarious possibilities. These are often hidden behind soothing bromides like "tax optimization" or "asset protection" or "efficient corporate structure."

On the tax side, one important matter concerns something known as double taxation. Say a U.S. multinational invests in a manufacturing plant in Brazil and earns income there. If both countries taxed the same income, without giving credits for the other country's taxes, the multinational would get taxed twice. Tax havens do help companies eliminate this double taxation—though you don't need tax havens for this: It can be ironed out with appropriate treaties and tax credits between countries. But when tax havens eliminate double taxation, something else happens too: double *non*taxation. In other words, not only does the corporation avoid being taxed twice on the same income. It also avoids being taxed at all. I will explore this strange and complex area in a little more detail later.

Each jurisdiction tolerates different levels of dirt. Terrorists or Colombian drug smugglers would probably use Panama, not Jersey—though Jersey's trust company sector in particular, handling several hundreds of billions of dollars' worth of assets, continue to make the island a sink for nefarious activity and illicit, tax-evading loot, notwithstanding Jersey's routine claims to be a "transparent, well-regulated and cooperative jurisdiction." Bermuda is a magnet for offshore insurance and reinsurance, frequently for the purpose of avoiding tax; the Caymans are favored locations for hedge funds, frequently for the purposes of escaping tax, legally or illegally, but more often to get around certain kinds of financial regulation. In securitization, the practice of packaging up mortgage loans and other assets to sell on to investors—a major contributor to the latest financial crisis—Wall Street has long favored locating its Special Purpose Vehicles (SPVs) in the Caymans and Delaware; in Europe the preferred locations for SPVs are Jersey, Ireland, Luxembourg, and the City of London. All are, as this book will show, major secrecy jurisdictions.

Tax havens often target specific other large economies, usually nearby. Switzerland's wealth managers focus quite heavily on getting business from tax-evading rich Germans, French, and Italians—corresponding to Switzerland's immediate neighbors and to Switzerland's three main language groups—though they are open to all comers from around the world. Monaco caters especially to French elites, while some wealthy French and Spaniards use Andorra, sandwiched in the eastern Pyrenees between the two larger countries. Rich Australians often use Pacific havens like Vanuatu; a lot of illicit North African money finds itself routed through Malta, another former British outpost in the Mediterranean Sea. U.S. and Latin American corporations and wealthy individuals use Panama and the Caribbean havens for a lot of their business, while wealthy Chinese tend to use Hong Kong, Singapore, and Macau.

Some jurisdictions specialize as conduit havens: way stations offering services that transform the identity or character of assets in specific ways, en route to somewhere else. The Netherlands is a big conduit haven: About €4.5 trillion (US $6.6 trillion) flowed through Dutch Special Financial Institutions in 2008—equivalent to over nine times the Dutch GDP.[42] Mauritius, off the African coast in the Indian Ocean, is a new and fast-growing conduit haven that is the source of over 40 percent of foreign investment into India. It also specializes in channeling Chinese investments into Africa's mineral sectors. Money does not always flow through obvious geographical routes, however: Russian dirty money has favored Cyprus, Gibraltar, and Nauru, all with strong historical British links, as stepping-stones where it can be legitimized before entering the mainstream global financial system in London and elsewhere. A large amount of foreign investment into China goes via the British Virgin Islands.

Offshore financial structures typically involve a trick sometimes known as laddering—a practice also expressed by the French word *saucissonage*, meaning to slice something into pieces like a sausage. When you slice a structure among several jurisdictions, each provides a new legal or accounting "wrapper" around the assets that can deepen the secrecy and the complexity protecting the assets. A Mexican drug dealer may have $20 million, say, in a Panama bank account. The account is not in his name but is instead under a trust set up in the Bahamas. The trustees may live in Guernsey, and the trust beneficiary could be a Wyoming corporation. Even if you can find the names of that company's directors, and even get photocopies of their passports—that gets you no closer: These directors will be professional nominees who direct hundreds of similar companies. They are linked to the next rung of the ladder through a company lawyer, who is prevented by attorney-client privilege from giving out any details. Even if you break through *that* barrier you may find that the corporation is held by a Turks and Caicos trust with a flee clause: The moment an inquiry is detected, the structure flits to another secrecy jurisdiction. Even if a jurisdiction cooperates with inquiries, it can drag its feet for months or years. "Even when they cooperate to eliminate the fraud," Robert Morgenthau, until recently the Manhattan district attorney, said of the Caymans, "it takes so long that when the door is finally closed, the horse has been stolen and the barn has burned down."[43] At the time of writing, Hong Kong is preparing legislation to allow incorporation and registration of new companies within minutes.

In 2010 Luxembourg's authorities pleaded this laddering as an excuse for potentially harboring North Korean money. "The problem is that they do not have 'North Korea' written all over them," a spokesman said. "They try to hide and they try to erase as many links as possible."[44] That is, after all, the point. Magistrates in France only ever saw a limited part of the Elf system because of this *saucissonage*. "The magistrates are like sheriffs in the spaghetti westerns who watch the bandits celebrate on the other side of the Rio Grande," wrote the magistrate Eva Joly, furious about how tax havens stonewalled her probes into the Elf system. "They taunt us—and there is nothing we can do."

Even if you can see parts of the structure, the laddering stops you from seeing it all—and if you can't see the whole, you cannot understand it. The activity doesn't happen *in* any jurisdiction—it happens *between* jurisdictions. "Elsewhere" becomes "nowhere": a world without rules.

I already mentioned some ballpark numbers suggesting how big the offshore system has become: half of all banking assets, a third of foreign investment, and more. But there have been very few attempts to quantify the damage that this system causes. This is partly because it is so hard to measure, let alone detect, secret, illicit things. But it is also because nobody wants to know.

Recently, however, a few organizations have sought to assess the problem's scale. In 2005 the Tax Justice Network estimated that wealthy individuals hold perhaps $11.5 *trillion* worth of wealth offshore. That is about a quarter of all global wealth and equivalent to the entire GDP of the United States. That much money in hundred-dollar bills, placed end to end, would stretch twenty-three times to the moon and back. The estimated $250 billion in taxes lost each year on the income that money earns is two to three times the size of the entire global aid budget to tackle poverty in developing countries.

But that sum just represents the taxes lost on money wealthy individuals hold offshore. A much bigger transfer of wealth is occurring through illicit financial flows across borders from developing countries into secrecy jurisdictions and rich countries. The most comprehensive study of this comes from Raymond Baker's Global Financial Integrity (GFI) Program at the Center for International Policy in Washington. Developing countries, GFI estimated in January 2011, lost a staggering $1.2 trillion in illicit financial flows in 2008—losses that had been growing at 18 percent per year since 2000.[45] Compare this to the $100 billion in total annual foreign aid, and it is easy to see why Baker concluded that "for every dollar that we have been generously handing out across the top of the table, we in the West have been taking back some $10 of illicit money under the table. There is no way to make this formula work for anyone, poor or rich." Remember that the next time some bright economist wonders why aid to Africa is not working. We are clearly talking about one of the great stories of our age.

In a separate study subsequently endorsed by the World Bank,[46] Baker estimated that only about a third of total illicit cross-border flows represent criminal money—from drug smuggling, counterfeit goods, racketeering, and so on. Corrupt money—local bribes remitted abroad or bribes paid abroad—added up to just 3 percent of the total. The third component, making up two-thirds, is cross-border commercial transactions, about half from transfer pricing through corporations. His research underlines the point that illicit offshore flows of money are far less about the drug smugglers, mafiosi, celebrity tax exiles, and fraudsters of the popular imagination and mostly about corporate activity.

And out of this emerges another profoundly important point. The drug smugglers, terrorists, and other criminals use *exactly* the same offshore mechanisms and subterfuges—shell banks, trusts, dummy corporations, and so on—that corporations use. "Laundered proceeds of drug trafficking, racketeering, corruption, and terrorism tag along with other forms of dirty money to which the United States and Europe lend a welcoming hand," said Baker. "These are two rails on the same tracks through the international financial system." We will never beat the terrorists or the heroin traffickers unless we confront the whole system—and that means tackling the tax evasion and avoidance and financial regulation and the whole paraphernalia of offshore. It is hardly surprising, in this light, that Baker estimates that the U.S. success rate in catching criminal money was 0.1 percent—meaning a 99.9 percent failure rate.

And that is only the illegal stuff. The legal offshore tax avoidance by individuals and corporations, which further gouges honest hardworking folks, adds hundreds of billions of dollars to these figures.

Almost no official estimates of the damage exist. The Brussels-based nongovernmental organization Eurodad has issued a limited-edition book called *Global Development Finance: Illicit Flows Report 2009*, which seeks to lay out, over a hundred pages, all of the comprehensive official estimates of global illicit international financial flows.[47] Every page is blank.

Eurodad's gimmick underscores a vital point: There has been an astonishing blindness on the part of the world's most powerful institutions to this system that has effected the greatest transfer of wealth from poor to rich in the history of the planet. As the sociologist Pierre Bordieu once remarked, "The most successful ideological effects are those which have no need for words, and ask no more than complicitous silence."

Language itself encourages the blindness. In September 2009, the G20 group of countries pledged in a communiqué to "clamp down on illicit outflows." Now consider the word *outflows*. Like the term *capital flight*, it points the finger at the *victim* countries like Congo or Nigeria or Mexico—which, this language subtly insists, must be the focus of the cleanup. But each flight of capital out of a poor country must have a corresponding inflow somewhere else. Imagine how different that pledge would be if the G20 had promised to tackle "illicit *in*flows."

Bad tax systems are pushing some nations toward becoming failed states. "Countries that will not tax their elites but expect us to come in and help them serve their people are just not going to get the kind of help from us that they have been getting," Hillary Clinton said in September 2010, to widespread and bipartisan applause. "Pakistan cannot have a tax rate of 9 percent of GDP when land owners and all of the other elites do not pay anything or pay so little it's laughable, and then when there's a problem everybody expects the United States and others to come in and help."[48] Leave aside for a moment the hypocrisy involved when the United States preaches to developing countries about abusive tax systems while welcoming tides of their illicit money and wrapping it in secrecy. Clinton's basic point is still valid. Wealthy Pakistanis are as enthusiastic about tax havens as elites in any other poor country, and their ability to escape from any responsibility to their societies while leaving everyone else to pick up the tab is one of the great factors corrupting the state and undermining its citizens' confidence in their rulers. This is a security issue as much as anything else.

Even this is not all. The global offshore system was one of the central factors that helped generate the latest financial and economic crisis since 2007. Offshore did not exactly *cause* the financial crisis: It created the enabling environment for the conditions underlying the crisis to develop. "Trying to understand the role that offshore secrecy and regulatory havens have in the crisis," Jack Blum explains, "is like the problem a doctor has treating a metabolic disease with multiple symptoms. You can treat several symptoms and still not cure the disease. Diabetes, for instance, causes high cholesterol, high blood pressure, and all sorts of other problems. There are plenty of discrete aspects of the meltdown to talk about and many possible treatments for symptoms, but offshore is at the heart of this metabolic disorder. Its roots reach back decades, in bankers' attempts to escape regulation and taxation and make banking a highly profitable growth business that mimics the industrial economy."[49]

I will explore this in more detail later—but here is a very short summary of some basic reasons why offshore is implicit in the latest economic crisis.

President Roosevelt's New Deal in the 1930s inflicted a lasting defeat on financial capital, blaming it for the horrors of the Great Depression and tying it down with constraints that would ensure that the financial services sector would contribute to economic development, not undermine it. The New Deal was a great success, but it began to unravel properly just before the 1960s, when Wall Street found its offshore escape route from taxes and domestic regulations: first in London (the subject of chapter 4) then further afield in the British spiderweb and beyond. The offshore system provided Wall Street with a "get out of regulation free" card that enabled it to rebuild its powers overseas and then, as the United States turned itself in stages into a tax haven in its own right, at home. The end result was that the biggest banks were able to grow large enough to attain "too big to fail" status—which helped them in turn to become increasingly influential in the bastions of political power in Washington, eventually getting a grip on both main political parties, Democrat and Republican—a grip that is so strong that it amounts to political capture.

Part of this process has involved a constant race to the bottom between jurisdictions. When a tax haven degrades its taxes or financial regulations or deepens its secrecy facilities to attract hot money from elsewhere, other havens degrade theirs too, to stay in the race. Meanwhile, financiers threaten politicians in the United States and other large economies with the offshore club—"don't tax or regulate us too heavily or we'll leave," they cry—and the onshore politicians quail and relax their own laws and regulations. As this has happened, onshore has increasingly taken on the characteristics of offshore. In the large economies, tax burdens are being shifted away from mobile capital and corporations onto the shoulders of ordinary folks. U.S. corporations paid about two-fifths of all U.S. income taxes in the 1950s; that share has fallen to a fifth.[50] The top 0.1 percent of U.S. taxpayers saw their effective tax rate fall from 60 percent in 1960 to 33 percent in 2007, while their share of the income pie soared.[51] Had the top thousandth paid the 1960 rate, the federal government would have received over $281 billion more in 2007.[52] When the billionaire Warren Buffett surveyed members of his office he found that he was paying the lowest tax rate among his office staff, including his receptionist. Overall, taxes have not generally declined. What has happened is that the rich have been paying less, and everyone else has been forced to take up the slack. The secrecy jurisdictions, in partnership with changing ideologies, are the biggest culprits.

The next factor behind the latest economic crisis is the huge illicit cross-border flows of money that have on a net basis flowed very significantly into deficit countries like the United States and Britain, adding very substantially to the more visible macroeconomic imbalances that fostered the crisis. Meanwhile, zero-tax offshore incentives helped encourage companies to borrow far too much, injecting more risk and leverage into the financial system. In addition, financial and other firms have been festooning their financial affairs around the world's tax havens for reasons of tax, regulation, or secrecy—and the resulting complexity, mixed with offshore secrecy, made their financial affairs impenetrable to regulators and investors alike, eventually feeding the mutual mistrust between market players that helped trigger the crisis.

And now, to cap it all, the system is providing our richest citizens and corporations with escape routes from tax and regulation, meaning that it is ordinary people who will have to pay the costs to clean up this giant mess. The harm that stems from all this is incalculable.

Yet this is not a book about the financial crisis. It is about something older and deeper.

Deregulation, freer flows of capital, and lower taxes since the 1970s—most people think that these globalizing changes have resulted primarily from grand ideological shifts and deliberate policy choices ushered in by such leaders as Margaret Thatcher and Ronald Reagan. Ideology and leaders matter, but few have noticed this other thing: the role of the secrecy jurisdictions in all of this—the silent warriors of globalization that have been acting as berserkers in the global economy, forcing other nations to engage in the competitive race to the bottom, and in the process cutting swaths through the tax systems and regulations of nation states, rich and poor, whether they like it or not. The secrecy jurisdictions have been the heart of the globalization project from the beginning.

Finally, a word about culture and attitudes. In January 2008 the accountancy giant KPMG ranked Cyprus at the very top of a league table of European jurisdictions, according to the "attractiveness" of their corporate tax regimes.[53] Yet Cyprus, a "way station for international scoundrels," as one offshore promoter admits, is among the world's murkiest tax havens: possibly the biggest conduit for criminal money out of the former Soviet Union and the Middle East into the international financial system. If Cyprus is ranked as the "best" in an international league table on tax, something is clearly wrong with the world. When transparency rankings list Switzerland and Singapore, two great sinks for illicit loot, as among the world's "cleanest" jurisdictions, then we seem to have lost our way.

Tax is the missing element in the corporate social responsibility debate. Modern company directors face a dilemma. To whom are they answerable—to shareholders only or to a wider set of stakeholders? There are no useful guidelines.[54] Irresponsible players treat tax as a cost to be minimized, to boost short-term shareholder value alone. Ethical directors recognize that tax is not a cost of production but a distribution out of profits to stakeholders, ranking on the profit and loss account alongside dividends. It is a distribution to society, and it pays for the things like roads and education that help the corporations make their profits.

The corporate world has lost its way, and nowhere is this more true than with the Big Four accountancy firms. Paul Hogan, the star of the film *Crocodile Dundee*, put his finger on something important in 2010 when talking about an investigation by Australian tax authorities into his offshore tax affairs. "I haven't done my own tax for thirty years," he said. "They talk about me going to jail. Erm, excuse me: There's about four law firms and about five accounting firms—some of the biggest ones in the world—that'd have to go to jail before you get to me."[55] On this point, Hogan is right—or at least he should be. These firms, responding to their clients' wishes to escape taxes and other duties that come with living in democratic nations, have grown to become steeped in an inverted morality that holds tax, democracy, and society to be bad and tax havens, tax dodging, and secrecy to be good. Serial tax avoiders are made knights of the realm in Britain and promoted to the top of high society in the United States; journalists seeking guidance in this complex terrain routinely turn to these very same offshore cheerleaders, the accountancy firms, for their opinions. Bit by bit, offshore's inverted morality becomes accepted into our societies.

The fight against the offshore system will differ from other campaigns to fix the global economy. Like the fight against corruption, this struggle does not fit neatly into the old political categories of left and right. It does not involve rejecting cross-border trade or seeking solace in purely local solutions. This fight needs an international perspective, where countries try not to engage in economic warfare against each other. And it will provide a rubric for taxpaying citizens in both rich countries and poor to fight for a common cause. Wherever you live, whoever you are, or what you think, this affects you.

Millions of people around the world have for years had a queasy feeling that something is rotten in the global economy, though many have struggled to work out what the problem is. This book will point to the original source of where it all went wrong.