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Offshore finance

By Richard W. Rahn

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Grand Cayman -- Some of you reading this maybe thinking, "Ah Cayman, isn't that the place with all the illegal financial activity?"

It is true Cayman is the world's largest offshore financial center, and the world's fifth-biggest financial center, even though it is in the middle of the Caribbean on a small, pleasant island with only 40,000 people.

But contrary to the mythology from movies and novels, Cayman did not become rich by catering to criminals. The truth is just the opposite. Think about it for a moment. If you were looking for a place to put your money, would you choose a bank run by incompetents or criminals in a jurisdiction run by the mob, or would you put your money in a bank run by honest and competent bankers in a country with the rule of law?

The fact is that big offshore financial centers, such as Cayman and Bermuda, and other big financial centers, such as Switzerland, the U.K. and the U.S., are all characterized by having honest courts and competent administrators.

Most of the money in Cayman is institutional rather than individual, and it is more difficult for an individual to open an account in Cayman than in the U.S.

Cayman also has agreements with the Internal Revenue Service and the U.S. Justice Department for exchange of information on suspected criminals, tax evaders and terrorists. If you are a crook, it is not wise to try to open an account in well-run jurisdictions like Cayman and Switzerland, because neither the banks nor the governments will protect you.

Honest people, however, do benefit from reasonable bank privacy in these jurisdictions. Another fact is that more money is "laundered" in New York and London than in places like Cayman and Switzerland.

Many people think there are piles of cash and gold sitting in vaults in places like Cayman. Again, the fact is there is very little physical cash and almost no gold sitting in vaults in places like Cayman.

What Cayman and some of its competitors provide is a place for large companies and financial institutions to consolidate funds -- in electronic form -- without being taxed or subject to unnecessary costly regulation, until these funds are productively reinvested throughout the globe (which can be as little as a matter of seconds).

Most of the money that flows into Cayman is invested in the United States. Something on the order of \$1 trillion now flows through Cayman each year, but this money does not physically reside in this little island, nor do the locals own it. (The locals make their money from providing first-rate legal, accounting, financial and tourist services.)

The money is owned by the millions of people who are investors in both American and foreign companies and who, for the most part, are unaware their retirement incomes are being both protected and enhanced because part of their investments are continuously being repackaged in Cayman as they go off to higher and better uses.

It is not well understood that the world would be poorer and there would be more people in poverty if places, such as Cayman, did not exist.

In the modern world, economic growth is highly dependent on capital investment. Financial capital is necessary to build new plant and equipment, to fund research and development, including medical breakthroughs and to provide the funds to hire workers. Many countries have very heavy taxes on capital, which means lower rates of investment and slower job creation.

Neither individuals nor companies will save if their savings are taxed away. Without savings there is no money for investment.

World economic growth is maximized when capital is invested in those activities and enterprises that provide the highest after tax risk adjusted rate of return. Places like Cayman provide highly efficient and low-cost environments for institutions to acquire and invest capital, protected by the rule of law. This is why most of the world's big banks operate in Cayman, as well as hundreds of insurance companies and thousands of institutional mutual and hedge funds.

Because Cayman and its competitors exist, institutions and individuals are willing to save more because they know they have a safe haven for their funds until they can find another productive and profitable investment. Without these financial centers, there would be less saving and investment and less efficient allocation of capital throughout the globe.

Some politicians in both Europe and the U.S. attempt to scapegoat offshore jurisdictions because they do not punish capital through high taxes in the way many governments in Europe and the U.S. do. These politicians either fail or choose not to recognize that their attempts to keep individuals and institutions from utilizing offshore entities will merely result in less saving and investment, and ultimately slower economic growth in their own countries as well as the rest of the world.

If these politicians do not want funds to flow through Cayman and the other offshores, the constructive thing to do would be to reduce the taxation on productive saving and investment and reduce regulatory red tape in their home countries.

The next time you hear some politician bashing a company or individual who utilizes an offshore financial center, realize the politician is either ignorant of the economic facts or doesn't care if there are fewer jobs and more people in poverty throughout the world.

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