



Merchants of Misinformation

by *Richard W. Rahn*

CRITICS OF ROMNEY'S CAYMAN ISLANDS FUNDS PROBABLY HAVE MONEY THERE, TOO

Last week, ABC News ran a story that led with the statement, "Mitt Romney has millions of dollars of his personal wealth in investment funds set up in the Cayman Islands, a notorious Caribbean tax haven." What the reporters failed to mention was that ABC, a unit of the Disney Corp., also has millions of dollars in Cayman-registered funds. Probably most employees at ABC, including the reporters who wrote the story, have some of their money in Cayman-registered funds, as probably do many of you reading this column, even though you don't know it.

This is how the real world works. Most large- and midsize companies, unions, universities and other nonprofit organizations, including environmental organizations and state and local governments, have pension plans for their employees. Most often, the plan administrators allocate the funds among corporate stocks, bonds and various types of hedge funds and venture capital. They typically hire expert firms to manage pieces of the portfolio. Some specialize in growth stocks, utilities and government and corporate bonds, and some specialize in funding high-risk ventures, such as new companies or companies that are in trouble and need "turnaround" experts.

The fund administrators properly diversify the risk of the pension monies and maximize the return by allocating portions of the funds

to the various types of fund managers. Mr. Romney's Bain Capital is an example of the type of firm that specializes in new companies and troubled companies. Those are high-risk businesses and take great expertise. If they succeed, the firms are well-compensated, but if they fail too often, they will go out of business. Anyone who has any interest in a pension, university endowment or reserve funds of both for-profit and nonprofit organizations benefits by having skilled and successful investment managers.

I have a friend who runs a very successful investment management company - in the \$20 billion range. He and his colleagues have been able to produce much-higher-than-average returns for all of those who are directly or indirectly invested with them, which include many different types of pension funds, university endowments, corporate funds, etc. My friend determined that more than 100 million people are beneficiaries in some form of the funds his firm manages. When my friend's firm delivers a higher return, it means individuals will get higher pensions (or have to contribute less), or the cost of school tuition is reduced for their children if a university's endowment performs well, and companies that have invested their reserves will have more money to hire new workers, giving everyone greater job opportunities.

Bain Capital is larger than my friend's firm, so it reasonably can be assumed that more than 100 million people also have benefited in some form from the highly successful and hard work of Mr. Romney and his colleagues. In fact, if one properly accounted for all of the jobs that were directly or indirectly created by Bain, by providing superior rates of return to all their millions of indirect investors, it would be far higher than the 110,000 direct jobs the campaign is claiming. The Romney campaign should make an estimate of the indirect number of jobs Bain has created and publicize it.

Mr. Romney probably has no idea of how much of his own money is in Cayman-registered funds because most of his money is held in a blind trust. I expect that all of the other major candidates and even President Obama also have some of their money in Cayman-registered funds (through their blind trusts) even though they may not know it because their money managers are likely to have allocated some of their investments into Cayman-registered funds, which is the responsible thing to do.

For Americans, income from Cayman-registered funds is fully taxable, and there is no evidence that Mr. Romney, Mr. Obama or any of the other candidates have not paid all of the

taxes due on such funds. The Cayman government has an information-sharing agreement with the Internal Revenue Service, so one would be ill-advised to try to avoid taxes by using Cayman. As Cayman expert Andrew Morriss, who is a professor of law and economics at the University of Alabama, has noted: "Many investors in Cayman funds are tax-exempt organizations (charities, for example). Since these entities owe no taxes, they aren't in Cayman to evade taxes but for some other reason. What could that reason be? Cayman has a sophisticated and cheaper-to-comply-with regulatory structure than the U.S. for hedge funds. Cayman laws are better suited to hedge-fund oversight than U.S. retail-oriented regulation."

As a result, Cayman registers a very large percentage of the world's hedge funds. Under the Cayman regulatory system, Ponzi scams like Bernard L. Madoff's and the commingling of clients' money with the firm's money, as in Jon Corzine's company, would be very difficult, if not impossible. Arguably, the Cayman regulatory system gives far better investor protection than the Securities and Exchange Commission or Commodity Futures Trading Commission at a fraction of the cost and bureaucracy.

If I were advising Mr. Romney, I would tell him to stop being defensive about being rich and challenge the other candidates and members of the news media to prove that they have no money directly or indirectly in Cayman-registered funds, insurance companies or trusts - a test most almost certainly would fail - for good reason. Cayman prospers, in part, because of the failure of the United States to provide a nondestructive financial regulatory and tax system. Without Cayman and the other international financial centers, we would all be poorer and there would be fewer U.S. jobs. All of the candidates should say so and explain what they would do to make the U.S. financial regulatory and tax systems more like Cayman's rather than vice-versa.

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