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## HOW OFFSHORE FINANCIAL CENTRES WILL SAVE COUNTRIES AFTER THE COLLAPSE OF THE WELFARE STATE

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*The year 2013 might well go down in history as the year that the major democratic welfare states collapsed. Every major developed democratic country in Europe (with the exceptions of Switzerland, Sweden and oil-rich Norway), in the Americas (with the exceptions of Chile, Canada and Mexico), and in Asia (with the exceptions of Australia and South Korea) is on an unsustainable fiscal downward slope.*

The great curse of democracies is that eventually a majority of the people become addicted to and demand ever more government benefits that cannot be funded by the diminishing numbers of taxpayers or through borrowing. The politicians, in order to please the majority to ensure their own re-election, make promises that neither they nor their successors can keep, ultimately leading to fiscal ruin.

As politicians resort to ever increasing taxes and borrowing, the higher taxes drive away those who are being required to bear the burden, thus diminishing economic output and in turn making the state increasingly un-credit worthy. Governments that print their own money increasingly turn to the printing presses to cover the excess spending until the inflation makes the currency almost worthless. Those governments that do not print their own money, such as Greece or California, are forced into ever increasing austerity and economic decline.

Many countries have experienced what is referred to as a financial collapse in the last half century – which, at its end stage, is almost always accompanied by a hyper-inflation. The world has experienced a couple of dozen hyper-inflations in just the last three decades, most notably Russia, the countries of the old Soviet Union, and many of those in Eastern and Central Europe. In 2008, the inflation rate in Zimbabwe reached a level where the government ended up printing a hundred trillion dollar banknote, which was almost worthless.

High and hyper-inflations wipe out most of the government debts but at the same time also wipe out much of the savings of the people. The real value of pensions becomes miniscule. Bonds, money market funds and cash deposits in financial institutions lose most of their purchasing power. Both private and government debts are extinguished at the expense of the creditors. But then what happens?

Private individuals find ways of coping by engaging in barter or use of foreign currencies or using gold coins, etc. Governments radically downsize by firing most of their employees and dropping almost all transfer payments. As with individuals, they subsist by selling assets and borrowing from foreign governments or international institutions until they are able to set up new monetary and tax systems.

The euro, the Japanese yen, the British pound and the US dollar will all lose most of their purchasing power (ie, suffer high inflation) unless the issuing jurisdictions make radical political changes, which seems unlikely at the moment. The currencies will decline at different rates, causing massive currency flows from the weaker currencies to the stronger which will delay the collapse of the stronger – but only temporarily.

All of the above is well understood by those who have read economic and financial history.

The offshore financial centres (OFCs) are likely to prove to be the salvation after the financial collapses. To restart their economies relatively quickly, governments, private individuals and businesses are going to need seed corn – that is, new sources of financial capital. Not all of the world's financial capital is going to be destroyed. As the situation in the major democratic welfare states continues to worsen, both individuals and businesses will increasingly move some of their

wealth to places where it is likely to be legally protected from rapacious governments and tax authorities – to OFCs.

This process has already begun. Switzerland is correctly viewed as being fiscally sound, with a very stable government and a strong commitment to the rule of law.

As a result, financial wealth has been flooding into Switzerland at a rate greater than the Swiss can profitably invest it, so many Swiss financial institutions are now only offering negative interest rates to foreigners – that is, the foreign parties must pay the Swiss to hold their money. In a world of increasing financial instability where the probability of confiscation of financial assets through inflation or taxation is rising, a small annual loss on financial assets can rationally seem to be a better alternative than a less certain, but major, loss.

The collapse of the Soviet Union and Eastern Europe gives us a historical roadmap of what is likely to happen when governments are left with currencies with little or no value. At first, the people increasingly used foreign currencies, the US dollar and D-mark being the currencies of choice in Eastern Europe. They obtained such currencies through official loans and grants to their governments and other institutions, through remittances of nationals who had left the country, and through legal and black market commercial activities.

Most OFCs allow financial and other institutions to hold assets in a variety of currencies, and most do not have any “toll charge” for taking funds in any currency in and out of the OFC. Most OFCs also have institutions for providing safe keeping for both bearer and registered securities, deeds and other legal forms of ownership. The major successful OFCs also have judicial systems that provide clarity, and honest and competent judges and other legal officers, enabling them to legally protect assets.

These assets can then be used both in the form of loans and equity capital to assist the countries whose currencies have collapsed to help them start over. Countries that have tangible assets, such as gold or land, will be able to use those in part or whole to back a new currency. Countries that do not have much in the way of real assets that can be sold will need to obtain loans to fund either new central banks or currency boards, and likely sources of such funds are assets that have been placed in OFCs.

OFCs that use the currency of a major debtor nation, or have currency boards, whose reserves largely consist of the sovereign debt of one or more major debtor nations, might be forced for their own financial survival to change the backing of their currency and move to a floating exchange rate. But such changes are readily doable if the OFC is basically sound and well managed.

Those who wish to rebuild, restart or create new businesses in the countries that have suffered the currency meltdown and whose financial institutions have been destroyed or greatly diminished are likely to find sources of capital in the OFCs.

The OFCs can be viewed as the financial equivalents of “strategic petroleum reserves” which can be tapped into during a time of crisis to help profligate governments transition to sound economic policies.

By not taxing financial capital and providing the rule of law with a sensible regulatory environment, OFCs enable individuals and companies to be places to park financial assets until the crisis has abated and/or profitable investment opportunities emerge.

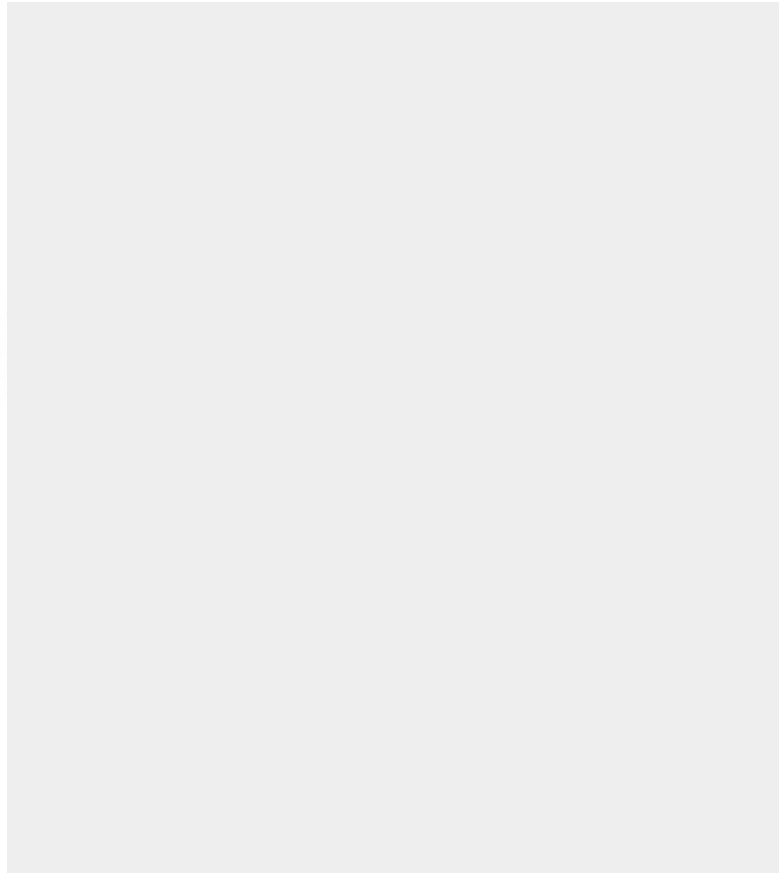
Unfortunately, the leading profligate nations are waging a regulatory war against the OFCs. They are demanding that they too engage in destructive taxation and submit to corrosive and unsound international financial regulation. In the same way that poorly managed businesses or abusive unions seek tariffs or other barriers against better managed and more consumer friendly competitors, the high-tax and regulatory states are trying to crush OFCs with false charges that OFCs endanger the world economy.

Arguably, the leading academic expert on OFCs, University of Michigan Professor James Hines, writes “the evidence strongly suggests that the policies of the OFCs contribute to investment, employment, and efficient functioning of markets and government policies in other countries”.

The OFCs need to strongly resist the global financial imperialism primarily coming from the US, the European Union and international financial institutions, such as the OECD. Resistance is necessary for OFCs’ own survival, for the preservation of global economic growth, and as the financial seed corn depository in cases of financial meltdowns in the bigger countries.

Is the world better off having a Switzerland, the Channel Islands, Cayman, Hong Kong, Dubai, etc or worse off?

The answer should be obvious.



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