Dix Sandbeck
dix@dixsandbeck.ca
ZMagazine, May 2004

A View of Globalization from a Caribbean Beach

The Comrades' Gift to Capitalism

It is an ironic fact, that one of the key features of modern globalized capitalism, offshore banking, was invented by some obscure comrades in charge of managing the foreign reserves of the old Soviet Union. During the early Cold War years, they were apprehensive about depositing their accidental dollar holdings in American banks where they risked being frozen if a political confrontation arose. The solution the comrades came up with were to deposit the dollars in London, since the Brits have never been quick to mix the sacred art of banking with the base art of politics. And while they were at it, why not open their own bank in what was still the banking center of the World? In this way, the Russians ended up having a bank in London, mainly dealing in "red" dollar deposits and lending.

For America's big corporations a dollar is always green, no matter whence it comes. They quickly saw the advantage of having access to dollars outside of America, where the banking system at the time was strictly regulated. Nor did it take long time for the British banks to realize that the Russian comrades in their midst had hit upon a significant financial innovation. Therefore, they hurriedly followed in their steps and started to open department specializing in unregulated dollar deposits and lending. Offshore banking as a wider phenomenon was born.

In the early days, tax considerations weren't an important facet of offshore banking. It started out mostly catering to corporate customers, that were interested in the lower rates and quick decisions available to customers with the right corporate credentials. In the early period, this new market for eurodollars (as it came to be called) was mostly used for corporate America's expansion in post-war Europe. But it didn't take long for wealthy individuals to realize that the low level of regulations also was beneficial for what today is euphemistically termed "tax planning".

In London, while regulations for foreign accounts were low there was still a demand for a paper trail documenting all transfers. Therefore, when the focus started to shift towards deposits, for which the main objective was tax evasion and even money laundering of criminal income, offshore banking activities started to move to new destinations. The preferred choice became small jurisdictions with no prior international banking activities and thus no laws covering them. Most importantly, many of these small jurisdictions saw the luring of these deposits to their shores as a potential bonanza for moribund and underdeveloped economies, and were thus ready to protect the deposits by refusing to engage in information sharing with authorities in the depositors' home countries.

The Outsourcing of Jobs and Profits

In recent decades, another prominent feature of the ongoing globalization has been the outsourcing of manufacturing to developing economies where labor costs are much lower. However, the question of labor cost is not as simple as it appears. The direct labor cost going into a product can be as low as one percent of its final sales price, as recent revelations regarding manufacturing conditions for Nike products have shown. It is also worth noting that products, when they are brand names, as Nike's are, have higher price inelasticities, which translates into higher abilities to absorb labor costs. Thus, seen only from a price consideration, much of the outsourced production could probably—using normal profit standards—be kept in the US by accessing the growing pool of workers within its borders forced to accept whatever minimum wage work they can get. Clearly, it appears that there are other factors behind the trend of offshore outsourcing of the corporate production activities.

Here the tax havens come back into the picture. Offshore production in a global economy creates new possibilities for reducing tax liabilities, that don't exist if a company both produces and sells within its home country only. To take advantage of this, when moving a production offshore, it is typically accompanied by the establishment of a subsidiary in a tax haven to which ownership of the so-called soft assets, such as patent rights, brand names and company logos, are transferred. The tax haven subsidiary will thereupon invoice the offshore manufacturer for the "right" to use these soft assets.

This transform the soft assets from balance sheet items into costs embedded in the products when they return to the home country. Since the tax haven subsidiary is fully owned and operationally controlled, the cost structure of the whole process can be geared up and down so that profits in the home country disappear no matter what sales prices can be fetched in the home market. Sometimes the process is refined by moving the main company itself—either as an empty shell registration or as a skeleton corporate headquarter—to the tax haven. This leaves a subsidiary with all the rest of normal corporate functions, such as design, marketing, distributing, and the majority of the corporate executive staff, in the original home country.

A key aspect of the whole process is that it is increasingly tailored to the interests of top corporate executives, at the expense of ordinary shareholders. For example, the corporate elite can have part of their remuneration hidden as "consulting" fees paid to shell companies and bank accounts the executives themselves have set up in the tax haven, with the money coming from the revenue accruing to the subsidiary that holds the soft assets.

The Culture of Free Riders

Interpolating from a sample of credit card transaction records, the IRS concluded that upwards of two millions Americans access funds held in tax haven bank accounts by credit cards, while tax returns only reported 170,000 accounts. In the Cayman Islands alone, deposits totaled more than $800 billion, which equals one-fifth of all deposits within the US. A conservative estimate is that upwards of $70 billion in taxes are lost every year due to the hiding of income in the tax havens. However, since the Bush Administration cut the IRS' auditing staff drastically, the IRS has essentially been reduced to the role of an onlooker.

The growing problem of tax evasion occurring in tax havens spurred the OECD into action in 1998, with the Clinton Administration signing onto the process. Forty-three identified offshore tax havens were notified that they would have to comply with a certain level of information exchange, otherwise they would be the target of countermeasures. Despite the fact that both the OECD demands and the contemplated countermeasures were very weak, they were too much for the Bush Administration, who in 2001 gave the activities in the tax havens another free pass by declaring that the OECD demands were "not in line with this administration's priorities." Anybody surprised here?

The OECD initiative had brought all the market extremist behind the Bush Administration out on the war path with Tom DeLay leading the charge. According to him, tax "planning", as everything else, should be left to free, unregulated market forces. Let the chips fall where they may. That we are talking of forces exhibiting asymmetries of almost incomparable proportions doesn't matter. Forget about the fact that a large, developed country burdened with upholding a sophisticated socio-technical infrastructure must raise taxes to pay for it. On the other hand, a tax haven like the Cayman Islands (with barely 40,000 inhabitants, many of them expatriates connected to the tax haven activities) has as its main socio-technical responsibility keeping the golf courses green, burdening it with no serious need for levying taxes. It is not hard to figure out where the "market" choice for having their taxable income show up is for everybody with a billion dollars in income and no concept of social responsibility.

In this case, the market extremist logic is barely a fig leaf for the culture of free riders prevailing among the current elite. The reality is, that outsourcing profits and income to the tax havens has become another nail in the coffin for the dying principles of the welfare state. As Janes Addiction's singer, Perry Farrell, coined it: "Your true nature is how you treat the weak". Using that measure, there is not much doubt about the true nature of the crowd that took over the White House during the Floridian coup d'état of 2000.