

**THE END OF OFFSHORE?
REGAINING PUBLIC CONTROL OF FINANCE AND TAXATION IN THE
ERA OF GLOBALIZATION**

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ABSTRACT

The emergence of 'offshore' statehood acted as a catalyst for the undermining of the classic liberal international system, which was reinstated within a framework of multilateral institutions after 1945. 'Offshore' statehood was created by international investors (especially TNCs) and their advisers, responding to and exploiting the elastic scope of state sovereignty based on regulatory jurisdiction and legal fictions of residence and incorporation. It was initially encouraged by the authorities in the main capitalist countries, within tolerated limits, for competitive advantage, and to manage the growing contradictions engendered by the commitments to liberalisation under the Bretton Woods system. As the fictions of 'offshore' became more generally exploited, it greatly accelerated the loss of efficacy of public economic control, especially in relation to financial intermediation, and contributed to the fiscal crisis (the increased difficulty of legitimizing public expenditures from general taxes, in particular direct taxes on income). The paper will examine the emergence in the 1990s of a new approach to global regulation, based on multilateral enforcement of internationally-agreed standards (e.g. in relation to shipping, and financial supervision), which offers a prospect of abolishing 'offshore'. However, the key element remains taxation, where competition between states hinders a global approach. The recent initiatives through the EU and the OECD to combat 'harmful tax competition' may remain cosmetic unless they can be given a broader basis of legitimacy from a wider global

constituency extending to developing countries and civil society. From this perspective more radical proposals are being and could be generated: e.g. taxes on global transactions (the 'Tobin tax' on financial transactions; and a tax on pharmaceutical drug sales proposed by MSF); or a global tax on TNC profits based on formula apportionment.

INTRODUCTION: FICTIONS OF STATEHOOD AND SOVEREIGNTY

The phenomenon of ‘offshore’ statehood has been an important catalyst in the transformation of the international system. By providing a channel for routing global flows through the use of artificial persons and transactions, ‘offshore’ has helped to dislocate the international state system, and induce its substantial reconstruction. Any project for the reconstruction of the public sphere must begin from a fuller understanding of the ways in which statehood has been transformed than is provided by most discussions of the state. Commonly ‘the state’ is reified and personified, which makes it hard to understand statehood as a way of organising society, a set of social relationships involving specific, historically-developed institutional forms and cultural practices.

The sovereignty of the state consists of an impersonal power, wielded by public authorities, and mediated by abstract concepts. These concepts are fluid and subject to interpretation, so that the exercise of state power is adaptable and contestable, through interpretative practices. Hence, the modern state is an abstract form of political power, a kind of fiction, the substantive content of which can be continually reimagined and rewritten.

Jurisdiction, nationality, citizenship

The classical liberal international system of Kant and Smith conceptualised the national state as the fulcrum between the global realm of the world market structured by a ‘horizontal’ community of equal sovereign states, and the domestic national sphere dominated by the ultimate ‘vertical’ authority of state law. The scope of the national state’s exercise of its sovereign powers is referred to as its jurisdiction. The modern state is defined in terms of its territory, so that each state has the monopoly of legitimate coercion within its own territory.

However, the scope of effective exercise of states’ powers is far from being circumscribed in precise and mutually exclusive terms. Its jurisdiction, which is the substance of sovereignty, is flexible, overlapping, and negotiable. The power of the state is mediated by laws directed to subjects (citizens/nationals/residents) defined by abstract, and hence fictitious, categories. Citizenship, nationality and residence are not natural attributes but elastic concepts, and they can also be used to extend the state’s requirements, and its protection, to conduct outside its borders. Conversely, a state’s regulations do not apply only to its nationals, but to all activities taking place within its borders, even only partially, and to persons with any presence there, even temporary. The existence of a world market generates private economic and social relations which transcend state boundaries, so that claims to the exercise of powers and functions by different states inevitably intersect and overlap. Concurrent, and sometimes conflicting, claims to jurisdiction inevitably result when an international transaction or activity is exposed to the regulatory requirements of more than one state, each of which may also have effective powers of enforcement against some of the persons or property involved in it. Conversely also, trans-national mobility of persons or assets may mean that a state must rely on the assistance of another to ensure enforcement of its claims to jurisdiction. Thus, the ‘interdependence’ of states is central not only to their external interactions but, most importantly, in the internal

exercise of ‘sovereignty’. This creates a competitive tension between states in the exercise of the functions of statehood.

Thus, the potential scope of state jurisdiction is very broad, and can be asserted against all persons and property within the territory, thus including activities with only a partial connection with it, or even none at all. However, extensive claims to prescriptive jurisdiction depend on the availability of effective enforcement, either by state officials within its territory, or by cooperation with other states within their territory. (e.g. for the obtaining of evidence, extradition of suspects, or enforcement of decisions). This depends on an acceptance by other states of the requesting state’s claim to jurisdiction. However, the liberal international system has been reflected in a permissive view of jurisdictional claims in international law, which leaves states free to make extensive prescriptive claims, although their effective powers of enforcement may be restricted by refusal of others to cooperate.¹

This elasticity of the state’s claims to jurisdiction is even greater in relation to business activities, since they entail another layer of fiction, the legal personality given to business entities such as the corporation, trust, or partnership. Freedom of incorporation, which emerged in the main capitalist countries in the last third of the 19th century, permitted the institutionalisation of capital. Corporate personality very quickly became a malleable form, in the hands of creative lawyers, to be used to accommodate formal legal requirements to the strategies of capital accumulation. In particular, the acceptance of the right of one company to own another provided a great degree of flexibility for business lawyers to construct complex international corporate networks, which could be designed to take advantage of the diversities of national laws and the complexities of their interaction, exploiting the indeterminacy of abstract legal concepts (McCahery and Picciotto 1995).

Legal fictions and monetary relations.

Thus, the scope of the state’s power to regulate private activities and transactions in world markets is elastic. It is mediated by processes of interpretation of abstract legal concepts, or fictions: nationality, citizenship, legal personality, residence. Limits are placed on the potentially broad scope of jurisdiction by the overlaps and conflicts with the claims of other states, and the limitation of the state’s legitimate coercive power to its territorial borders. But international economic activity inevitably entails some contacts within the borders of many states, especially the largest or most economically developed, and this can give rise to extensive jurisdictional claims (sometimes attacked as ‘extraterritorial’: Picciotto 1983). On the other hand, the multiplicity of states makes it possible for economic actors not only to relocate

¹ The International Court’s decision in the well-known *Nottebohm* case (1955 ICJ Reports) appears to restrict states’ freedom, by requiring a ‘genuine link’ for the grant of nationality to be recognised by other states. However, the decision was that Guatemala was not obliged to accept a diplomatic protection claim by Lichtenstein which had granted its nationality to Nottebohm; it had the effect of legitimising Guatemala’s freezing of his assets there, on the grounds that he was considered still to be German and hence an enemy alien. A converse claim by Guatemala, requesting that Nottebohm’s assets in Lichtenstein be frozen, would undoubtedly have been denied since the same liberal principle would indicate acceptance of the validity of Lichtenstein’s grant of its nationality also.

activity, but more importantly to redefine the forms it takes so as to negotiate the degree of exposure to the jurisdiction of specific states.

This potential for jurisdictional negotiation is particularly great in relation to the most abstract (and hence also most fictitious) forms of economic relations, those mediated by money.² Monetary relationships are doubly fictional, since they are expressions in abstract legal terms of abstract economic relations. Legal forms can be used to redefine such relationships, to relocate where and by whom payments are made, or monetary assets (such as bank accounts, or stocks and shares) are owned. The relocation or redirection of such transactions through ‘offshore’ jurisdictions has therefore been a process of creation and exploitation of fictitious legal categories.³ Essentially, it is an expression of the limits that capital can impose on the forms and functions of the state. These limits are fluid and contestable, but nevertheless expressions of real relations of economic and social power.

THE INTERACTION OF JURISDICTIONS AND THE CREATION OF HAVENS

It is not surprising that the main spur for the creative exploitation of disjunctures in the international state system has been the avoidance of taxation, since taxes are both the main link between state and citizen, and are experienced as the most direct intervention by the state in economic activity. With the emergence and consolidation of the modern liberal state in the last third of the 19th century, and especially the growth of its revenue needs for both welfare and warfare, the primary form of taxation shifted to ‘direct’ taxes on income. These are legitimated by the liberal notion that all should contribute to the state proportionately to the benefit each derives from being part of it.

Corporate residence or nationality.

However, the conceptualisation of what constitutes ‘participation’ in the state differed, according to the historical development of each state and its position in relation to international flows. The UK, which had a dominant position in the international circulation both of goods and then of finance, imposed its income tax on all residents and in respect of all their income from worldwide trade or business. With the spreading use of the corporate form by the end of the 19th century, the

² I would include in monetary relations both contractual and incorporeal property rights.

³ The part played by the fictional character of money in the creation of offshore as a fictitious space has been pointed out, e.g. by Roberts, 1994. My argument here is that social relations are mediated not only by money but also by law, which plays its own part in the fictionalisation. Hence, the processes of interpretation of abstract or fictional legal categories are central to the mediation of state power, just as money forms are central to private economic relations. My argument is also different from the common and misconceived view about the ‘mobility’ of capital, which neglects the nature of capital as a social relation. In its most abstract form as money it can certainly undergo some fantastic transformations, especially in today’s era of global electronic financial transactions. Although in the money form capital has a great potential power to relocate, the circulation of money does not itself involve a relocation of the social relations of capital, but entails transformations which may be regarded as fictional. Thus, the existence of immense bank deposits in the Cayman Islands does not mean that ‘capital’ has relocated there.

British judges decided that the question of company residence should be interpreted on the analogy of an individual:

‘A company cannot eat or sleep, but it can keep house and do business. ... An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a company. [A] company resides for purposes of income tax where its real business is carried on ... and the real business is carried on where the central management and control actually abides.’⁴

This apparently self-evident interpretation led to the surprising conclusion that De Beers Consolidated Mines Ltd, although incorporated in South Africa and engaged in diamond mining there, was liable to UK tax on all its profits, on the grounds that its operations were ‘controlled, managed, and directed’ by the meetings of the Directors in London. This was obviously very helpful for the British Revenue, since London was in this period the major international financial centre, and many companies financed there carried out activities in all parts of the world.

However, businesses could and did adapt to avoid the consequences of this interpretation. For instance, a company formed in London in 1904 to develop land in Egypt, decided in 1907 (the year of the De Beers decision) to transfer its place of control to Cairo under a new Board made up of Egyptian residents.⁵ So long as a business entity was seen to be managed wholly outside the UK, its foreign earnings could be sheltered from UK taxes, even if they resulted from the activities of UK residents. Thus, much later, the Revenue lost an attempt to tax the entertainer David

⁴ Lord Loreburn, in De Beers v. Howe [1906] AC 455. The rule was first laid down in Calcutta Jute Mills v. Nicholson; Cesena Sulphur v. Nicholson (1876) 1 T.C. 83. However, until the Boer War and the arms race leading to the Great War, tax rates were low, and since the income tax was considered to be a single tax, companies were permitted to deduct at source the tax due on dividends paid to (and taxed as the income of) shareholders, and credit the amounts against their own liability. The losers were foreign-resident shareholders who were thereby obliged to pay UK taxes. In the 1876 cases the British court said (with an Imperial confidence in London’s position as the main entrepot for global finance) that if foreigners wished to place their money in London, they ‘must pay the cost of it’. This may be contrasted with the move by Britain and the USA in 1984 to exempt non-residents from withholding tax at source for interest on quoted Eurobonds (discussed below). Although this facilitates evasion by such non-residents of their home-country tax, it was considered necessary if London and New York were to continue to compete as international finance centres with offshore havens.

⁵ Egyptian Delta Land & Investment Co. v. Todd [1929] AC 1. Similarly, English Sewing Cotton, which had been found in 1911-13 to control its majority-owned affiliate the American Thread Company, changed the arrangement so that it was managed from the USA (Bradbury v. English Sewing Cotton (1923) 8 T.C. 481). A UK resident was liable to taxation under Schedule I on the profits of a trade even carried on in the UK or elsewhere, as they ‘arose’. However, if the company was resident abroad, its UK-resident shareholders were liable under Case IV or V on the dividends declared, as income from securities or ‘possessions’, which until 1914 applied only when remitted to the UK. The complexity of the rules was exacerbated by confused and conflicting judgements in the courts, especially in Mitchell v. Egyptian Hotels (1914) 6 T.C. 542; Picciotto, 1992: 6-7. Nevertheless, the Inland Revenue relied on this leading case for its interpretation (ibid, and Naess, 1972: 2). Legislation in 1951 introduced a requirement of Treasury permission for any UK company either to transfer its residence abroad or transfer any part of its trade or business to a non-resident, or even to raise capital through a non-resident affiliate. These broad powers were the basis for a secretive administrative procedure under which the Revenue in effect negotiated an acceptable rate of taxable remittances from UK-owned TNCs: Picciotto, 1992: 102-6.

Frost who in 1967 set up a foreign partnership with a Bahamian company to exploit his media activities outside the UK, since the courts accepted that the non-resident company was entitled to the earnings from his 'personality'.⁶ The concept of company 'residence' has long been a key one in British tax law, yet it has never been given a statutory definition. This ambiguity provided a flexibility within which the Revenue and tax planners could negotiate mutually acceptable levels of taxation of profits from foreign investments. Yet it also created the anomaly that a company incorporated in the UK would not be liable to UK taxes if controlled from abroad. This created opportunities to avoid or evade other countries' taxes, by channelling business transactions through a company formed in but 'controlled' from outside the UK.⁷

Other capital-exporting countries also developed broadly-based income taxes which applied to the worldwide income of residents, but in the case of companies the test of residence was more often the location of the 'seat of management', which was often required to be within the state of incorporation, and generally placed the emphasis on organisational rather than financial control. The German Corporate Tax Law of 1920 introduced the new test of the 'place of top management', and the Tax Court extended the application of the 'organic unity' (*Organschaft*) principle, so that German-based corporate groups could be taxed on their worldwide profits including those earned through foreign subsidiaries; while the taxation of the local subsidiaries of foreign firms could be based on computing their profits as a proportion of the group's income. The test of 'organisational integration' focused on business management and not the strategic direction of investments as in the UK. Nevertheless, this could also be avoided, by channelling the profits to a holding company set up in a convenient jurisdiction such as Switzerland or Luxembourg. Other countries with residence-based income taxes were willing to exempt business profits if earned (or sometimes only if taxed) abroad. In the US, the income tax was based on citizenship, so that US citizens and corporations formed under US laws were taxed on income from all sources worldwide. However, this meant that subsidiaries incorporated abroad were not liable to US tax, so their profits were taxed only when remitted as income to the parent.

In contrast, France and some other continental European countries emphasised taxation at source of the revenue derived from an activity, or from moveable or immovable property. This enabled a more differentiated approach to the question of jurisdiction, based on the location of the property or the earnings of a business establishment. However, this system of *impôts cédulaires* encouraged manipulation between different types of source, and the lower yields led to greater reliance on indirect taxation. Tax reforms following the Second World War generally introduced

⁶ The courts rejected the view that the company was a mere sham to avoid tax on Frost's global earnings as a professional, since the company and partnership were properly managed and controlled in the Bahamas and their business (exploiting his personality) was carried on wholly abroad: Newstead v. Frost [1980] 1 WLR 135 H.L. Until 1974 income derived by a UK resident person from the carrying on of a trade, profession or vocation abroad was taxable under Case V only on remittance (ICTA 1970 s. 122 (2)(b)), but this was repealed by FA 1974 s. 23.

⁷ This possibility, reputedly extensively used by groups such as self-employed Italians, was not ended until the Finance Act of 1988 (s.66), which provided that companies incorporated in the UK are always to be considered UK-resident.

an integrated income tax, and the tax paid by companies on the proportion of profits distributed as dividend could be at last partially imputed to shareholders as a credit against their personal income tax liability.

Overlapping tax jurisdictions and tax treaties.

From the point of view of taxpayers, the choice of convenient jurisdictions for incorporating a company or the location of its residence was no more than a rational reaction to high tax rates and broad and overlapping assertions of tax jurisdiction by states. States could define their jurisdiction territorially, and yet justify taxation of income both if it was earned within the territory (at source), and by persons resident within the state. This created the possibility that the same income stream could be taxed by two states.

Hence, complaints about 'international double taxation' were made by wealthy families and companies with international investments, from the time that income taxes spread and rates increased, during the First World War. The varied approaches adopted by countries also led to complaints by firms of inequality in the conditions of international competition. Hence, some states (notably the USA) unilaterally allowed a credit for foreign taxes paid on income remitted home, and later began to negotiate treaties attempting to allocate tax jurisdiction.

This work was undertaken by the League of Nations, which commissioned reports from both Economists and Technical Experts, and convened an inter-governmental conference in 1928. This did not succeed in agreeing a single multilateral convention, due to the differences between national approaches to taxation, but drew up several Model draft treaty texts, and recommended that the League set up a Fiscal Committee. Between 1920 and 1939 almost 60 bilateral treaties for the avoidance of double taxation of income and property were concluded (and there were many more on specific matters such as shipping).

France was particularly active in concluding such treaties.⁸ An important reason for this was the decision of the French authorities to apply the *impôt sur le revenu des valeurs mobilières* (dating back to a law of 29 June 1872) also to dividends paid by foreign companies doing business in France, even though their shares were not issued in France. Furthermore, the tax was calculated by reference to the proportion of the dividends represented by the companies' assets in France, rather than the profits made in France. This was resented by foreign firms and their governments as being both extraterritorial and double taxation. The French rejected these views, since the source of the income was seen as France, and French companies were also liable to tax on both their commercial profits and on the dividends paid to shareholders. The proportional approach was also defended as the only way of determining the contribution of the business done in France to the overall profits derived from the investments. Following negotiations, the resulting treaties generally preserved the French right to tax the profits of the French establishment, but in lieu of the tax on dividends the source country was allowed to tax the 'deemed dividend' as 'diverted'

⁸ France agreed treaties with Italy (1930), Belgium (1931), USA (1932), Germany (1934), Sweden (1936), and Switzerland (1938); a draft treaty with the UK was on the verge of signature in 1939.

profits. Thus, the French treaties with Italy, Belgium and the USA in 1931-2 included the important provision allowing each state to reallocate any profits or losses transferred between related enterprises due to their relationship being conducted in conditions other than those which would apply between related enterprises. This also involved a shift from the 'proportional' approach to a focus on profits 'diverted' to a related entity, enacted in a French law of 1933 and reproduced in almost exactly the same terms in the famous s.57 of the Code Général des Impôts. This, and a similar provision in the US Revenue Act of 1928, were the origins of the 'Arm's Length' principle for dealing with transfer pricing between related enterprises.

The UK Treasury was reluctant in the 1930s to abandon its strong residence rule. Finally, the Foreign Office took the lead in negotiating a treaty with the USA in 1944-5, after British firms with US affiliates had pointed out that the lack of such a treaty had obliged them to have recourse to 'unsatisfactory expedients such as invoicing goods at higher prices to the subsidiary or leaving profits to accumulate in the US'.⁹ The UK-US agreement led to the rapid growth of a network of treaties in the postwar period, many of them with the British Dominions, colonies and other dependencies. The main work of coordination was taken over by the OECD's Committee on Fiscal Affairs, and by the mid-1980s a network of bilateral treaties covered all developed countries. The stronger emphasis of developing countries, as importers of capital, on source taxation has hindered their conclusion of treaties. However, the model treaty drawn up in 1980 by the UN Expert Group differed only in minor respects from that of the OECD (Picciotto 1992, p.56), and in recent years the competition to attract investment has led to further relaxation and an ever-broadening web of bilateral treaties.

These treaties generally gave the primary right to tax income from capital to the country of residence of the investor. Countries were allowed to tax at source only the business profits of a permanent establishment (i.e. a branch or office). The right to tax at source, by a 'withholding tax', payments of interest, dividends, and royalties or fees, was generally 'capped', and often reduced to zero for payments made between related entities. However, taxation was based on the fictitious legal personality of companies and other legal entities. An internationally-organised firm operating through a network of subsidiaries must deliver separate accounts for each jurisdiction in which any of its affiliated companies are resident or doing business through a permanent establishment. To re-establish this fictitious separation, the tax treaties included provisions allowing the 'reallocation' of any profits which the tax authorities considered to have accrued to an enterprise as a result of conditions made or imposed in its relations with a related enterprise differing from those which would be made between independent enterprises. This 'independent enterprise' criterion is the famous Arm's Length rule. To deal with any double taxation which may result from such a unilateral reallocation, the treaties also permitted complaints from taxpayers that taxes have been applied contrary to the convention to be resolved by mutual agreement between the 'competent authorities' of the two states.

The 1928 conference had also drafted a separate model treaty for mutual administrative assistance, although it was a modest affair, to avoid the appearance of

⁹ British Foreign Office File FO371/38588, in the Public Records Office.

an 'organised system of fiscal inquisition'. But instead of a multilateral treaty for cooperation, it was reduced to a single clause for exchange of information and administrative assistance (Picciotto, 1992, 251). Although bilateral tax treaties are supposed to be aimed at both the prevention of double taxation and tax avoidance, many states are reluctant to assist others to enforce their taxes. Thus, they limit their cooperation to the exchange of information which they already have in relation to their own taxpayers (this is the case for the UK), and the targets may be given prior notification and a right to object (legally required in Germany). The information exchange provision is generally useless in relation to legal persons whose income is exempt from taxation in the treaty partner-state.

Origins and development of tax avoidance and tax havens.

Much of the debate and research about international taxation generally assumes that investments are made directly by a resident of one country in a business operating in a second country. This is far from capturing the reality of internationally-integrated business activities coordinated through TNCs (transnational corporations) which have dominated the world economy especially in the past half-century. It also ignores the reality that international business operates legally through a chain of companies, formed or resident in convenient jurisdictions. Transactions can be designed, on paper, to select which legal person owns an asset, makes a loan, or receives a payment, to ensure that the overall tax liability of the corporate group is minimised. As sketched out in the previous section, the elastic scope of jurisdiction led to complaints of double taxation, which the network of double tax treaties was designed to prevent. In the meantime, however, wealthy individuals and powerful corporations had employed the fertile minds of lawyers and accountants to construct devices taking advantage of the flexible and fictitious nature of legal categories to get around their tax liabilities. From their viewpoint, they were merely avoiding the unfairness of double taxation due to overlapping jurisdictional claims, and attempting to restore equality in the conditions of competition. However, the development of a 'tax planning' industry shifted the nature of the game, from mitigating the burdens of double taxation, to minimising tax liability, if possible to zero.

The result has been greatly to weaken the effectiveness of income taxation, and hence attenuate the solidarity between citizens and the state, based on the liberal principle of equal contributions by all proportionate to their revenues. Taxes on incomes or profits are vulnerable to semi-legitimate avoidance, by changing the timing or recipient of a revenue, especially through the use of artificial legal persons. The possibilities become even more expanded by the exploitation of convenient jurisdictions as places of creation or residence of artificial persons, acting as intermediaries between the beneficial owner and the place of exploitation of an asset. This is the role of tax havens.

Tax havens had been developed in the interwar period mainly by wealthy families and criminal gangs (Naylor, 1994, 20), and began to be more widely exploited to facilitate the postwar growth of foreign direct investment by transnational corporations (TNCs). Tax 'shelters' had been constructed in the 1920s and 1930s mainly for family fortunes, by setting up foreign trusts or using private investment companies, in countries which exempted foreign-source income. In the 1920s the British Treasury investigated the use of the Channel Islands for the formation of investment companies with nominee directors. Under pressure, the Island authorities agreed to measures for

cooperation in tax enforcement, provided they applied throughout the Empire; but business opposition forced the government to withdraw a proposal for such cooperative powers which was due to be put to Parliament. Instead, unilateral provisions were introduced in 1936 and 1938 giving the Revenue very broad powers to tax UK residents who transferred assets abroad on any income which they had ‘power to enjoy’.

However, these provisions were very hard to enforce without the cooperation of the foreign jurisdiction, to provide information. Even when the tax authorities discovered the existence of such situations they could still fail, as they did most spectacularly in cases against the Vestey family. The Vestey brothers had taken up residence in Buenos Aires in 1915 to avoid British taxation of income from their global meat and food processing business. Having failed to persuade the British government to introduce tax exemption for foreign income, they established a family trust in Paris, to which they leased the global assets of their British company, Union Cold Storage Ltd. They gave the Paris trustees broad powers to use the income from the rents for the benefit of their family members (but not themselves); they, however, could give directions to the trustees on investments, and the trustees lent large sums to an investment company in Britain which they controlled, and which allowed them to draw whatever sums they needed. They resumed residence in Britain, but the Revenue did not learn of the existence of the trust until 1929, and did not take action until its new powers were enacted, after 1938. Then they assessed the brothers to £4m taxes due for 1937-41. Although the assessment was upheld by the courts up to the Court of Appeal, it was struck down by the House of Lords. Perhaps disturbed by the potential breadth and arbitrariness of the powers given to the Revenue, the Lords of Appeal interpreted them narrowly, and held that the right to direct the trustees on investments did not amount to a ‘power to enjoy’ the income.¹⁰

Tax minimisation and foreign direct investment.

The tax authorities were less active in pursuing corporate income sheltered abroad, partly because they had less legitimate basis to do so. Individuals could be considered portfolio investors, and thus perhaps should not benefit from investing abroad, in countries with lower tax rates. However, after 1945 international investment became predominantly foreign direct investment (FDI), especially by American TNCs. They lobbied for total exemption of foreign income, but proposals to this effect by the Eisenhower administration failed to gain Congressional approval. In practice, exemption was unnecessary, since the US tax system already provided a strong incentive for the characteristic form of FDI, which relied mainly on loans from the parent company plus reinvestment of foreign earnings (Barlow and Wender 1955). Since the profits of subsidiaries incorporated abroad are taxable only when remitted, US TNCs benefit from tax deferral on retained earnings. This acted as a spur to self-financed expansion abroad. The firms built on the deferral of home country taxes, by minimising source taxation as well, by using intermediary companies located in convenient jurisdictions to supply finance and other inputs which could be charged as costs, so reducing source taxation of business profits. Only that part of gross profit

¹⁰ For an entertaining account see Knightley 1981, especially chs. 3 and 7. Similar battles were waged between the tax authorities and the wealthy of other countries.

needed to fund payment of the parent company's dividend needed to be remitted where it would be liable to tax, and that liability could be reduced by the credits for any foreign taxes that had been paid.

Indeed, this could be said to have been an important factor in the emergence of TNCs as the dominant form of global business, pioneered by US firms. One of the main organisational advantages which could be said to explain the emergence of TNCs (Williamson, 1985: ch.1) has been their ability to use a network of often fictional subsidiaries to exploit all the possibilities of the interaction of tax systems, as well as the growing tax treaty network.

So, as FDI began to grow in the 1950s, new jurisdictions began to offer convenient facilities, often devised by enterprising lawyers or accountants who could persuade government officials or legislators to enact the necessary provisions. Small statelets (often islands), which generally had been (and sometimes still remained) colonial dependencies, could offer numerous advantages. Their colonial heritage generally gave them a modern-style legal system, a currency tied to that of the mother country, and in many cases the benefit of tax treaties which had been extended to them. Their small populations could not easily generate revenues to finance the government. Rather than push up tax rates on their own people, and more lucrative than printing exotic-looking postage stamps, an appealing alternative was to charge a small fee on company registrations. This could generate substantial sums if attractive rules for incorporation, as well as suitable tax exemptions for foreign-source income, could be devised. Foreigners could be offered a cloak of confidentiality to throw over their wealth or business dealings, by bank secrecy obligations, as well as company laws which permitted unregistered 'bearer' shares and nominee directors, and widely-drafted trust laws.¹¹ Tax laws which exempted foreign-source income, or applied zero or low tax rates to specific types of entity such as holding companies (which carried on no active business but merely owned assets of some kind), would increase the attraction. These facilities could be discreetly publicised among the small group of international tax specialists which had emerged as advisers to the rich and international businesses in the inter-war period (Picciotto, 1995).¹²

OFFSHORE REGULATORY SHOPPING

By the 1960s, the uses of offshore jurisdictions were diversifying, to include other types of regulation in addition to tax. In some respects this was aided by the willingness of some state authorities in more highly-regulated jurisdictions to tolerate, or in some respects encourage, this development. In setting national regulatory

¹¹ Most notably, Liechtenstein was the only civil law country to adopt the trust concept, and even develop it, by allowing purpose trusts for non-charitable purposes, as well as a special category of Trust Enterprise combining legal personality and a trust relationship. Liechtenstein refuses cooperation in tax matters and rarely enforces foreign judgments, and in the early 1990s had over 70,000 trusts and trust companies enjoying low-tax status (Schurti, in Special Issue, 1995: 213 ff). Notoriously, Robert Maxwell concealed the murky operations of his business empire behind Liechtenstein family trusts set up from 1951: Bower 1988.

¹² For example, the *Bulletin for International Fiscal Documentation* noted in 1953 (pp. 7 and 21) that the Netherlands Antilles, which benefited from some tax treaties extended to it by its mother-country Holland, had announced low tax rates for holding companies.

standards, governments are subject to competing pressures, from producers and consumers, owners and workers, large and small businesses. They have sometimes found it easier to reconcile these conflicts by establishing high standards within national regulatory space, but mitigating their effects by allowing some categories of activity (explicitly, or by turning a blind eye) to make use of a more lightly-regulated environment 'offshore'. This was especially the case for internationally-oriented business, which could threaten to relocate altogether if the grip of the national authorities did not relax. Firms could argue their need to retain competitiveness in global markets to help justify taking advantage of offshore facilities. However, as these facilities developed and became generalised, they were taken up by a wider range of customers. The onshore regulators then often found that they had helped to create a monster they could not properly control.

Flags of convenience

An early case was international shipping. Flags-of-Convenience (FoC) registration for ships was a facility that mushroomed rapidly in the 1950s, especially after the Korean war, although US ships were first registered in Panama in the 1920s to avoid the liquor prohibition laws. They were joined in 1928 by a Norwegian, Erling Naess, who had set up a whaling company in London. He discovered that he could easily re-register his ships in Panama, and by relocating the residence of the British company to Paris, the company's shipping profits would not be taxed at all, and dividend payments to its non-British shareholders were also free of withholding tax (Naess, 1972: 2-3). After the War, American shipowners, including oil companies needing tankers to bring crude from the expanding Middle East oilfields, also took up the Panama registry. When that became controversial, they shifted to Liberia; Honduras was also briefly used, giving rise to the term Panlibhon registries. The Americans were followed by Greek shipowners, who found that the US financial institutions supplying mortgage finance preferred a Panlibhon registry to the Greek one, which at that time was considered politically unstable. The US government accepted or encouraged the trend, by allowing US-built vessels to be flagged out, subject to an agreement that they would be made available in time of war (Sturmeay, 1962: 223-4).

Lower running costs, due to cheaper crews and lighter regulation, became as important as the tax advantages, since in order to compete with the FoC countries, other states added new tax benefits to the depreciation allowances and shipbuilding subsidies that many already offered. This fiscal competition contributed to overcapacity, which further accelerated the pressure to reduce costs. From under 4% in 1948, the percentage of the world's tonnage under FoC registration grew to 14% in 1960, 26% in 1970, and 34% in 1990 (Kassoulides, 1993: 83). The leading FoC state, Liberia, offered an attractive combination of features, including corporate law rules that guarantee anonymity, strong mortgage security, and zero taxation for foreign-source income. No physical contact with Liberia is necessary, since registration and inspection are carried out entirely outside the country,¹³ a system which proved

¹³ This could be said to involve an 'extraterritorial' exercise of Liberia's jurisdiction, but it is generally tolerated by other states, since it is exercised with the consent of the shipowners to whom it applies. It also involves privatisation of state regulatory functions.

especially convenient during the civil war which devastated that country, but had a relatively slight effect on its use as an offshore facility.

Much can be learned from the attempts to combat FoC jurisdictions, in which the trade unions, mainly through the International Transport-workers Federation (ITF), have been very active. Initially, efforts were directed at the legal fiction of the nationality of ships, by building on the concept of the 'genuine link'; thus, a requirement was made in the 1958 Geneva Convention on the High Seas that there must be a genuine link between a ship and its flag state, and that the flag state must exercise effective jurisdiction and control over its ships. However, 'genuine link' was not defined, and indeed the article states that 'each state shall fix the conditions for the grant of its nationality to ships'.¹⁴ The campaign continued through UNCTAD, to find a means of 'phasing out' the so-called 'open registries'; but a long and conflictual negotiation showed that a strict genuine link criterion was impossible to formulate or enforce. Indeed, a number of developed states reacted by introducing special registries of their own, for nationally-owned vessels. Some of these are through offshore dependencies, such as the Isle of Man, Madeira, the Netherlands Antilles, or the French Kerguelen Islands; while others (such as Denmark, Germany, Luxembourg and Norway) are special facilities, sometimes established in cooperation with other states (Luxembourg, which is landlocked, established its registry as a facility for Belgium).

More recently, an alternative strategy has emerged, which promises to be more successful, aiming at enforcing internationally-agreed standards. This involves a range of organisations, public, semi-public and private, operating transnationally, and having different concerns and priorities, some of which coincide and help to create alliances. The new approach involves establishing internationally-agreed standards to be applied to all ships regardless of nationality, and the enforcement of which is not left to the flag state. Under pressure from the ITF, the International Labour Organisation (ILO), in 1976 adopted Convention 147 on Minimum Standards in Merchant Ships. This requires flag states to exercise effective jurisdiction over their ships and to establish laws and regulations covering a range of safety standards and shipboard employment conditions 'substantially equivalent' to those in a specified list of related ILO conventions. But most importantly, article 4 gave jurisdiction for port states to enforce these standards, including taking measures necessary to rectify conditions 'clearly hazardous to safety or health', though they must also not 'unreasonably detain or delay the ship'. This provided encouragement and authority for the development of a network of arrangements for inspection to enforce international standards using Port State Control (Kassoulides 1993), beginning with the Paris group of European countries, followed by Asia-Pacific, Caribbean and Latin American groups. In this way, cooperating maritime authorities have established sophisticated inspection systems, based on checklists of internationally-agreed standards, deficiency reporting, a computerised database, and the ultimate sanction of detention. This has been further strengthened by the reorientation of the International

¹⁴ The nationality of ships provision was repeated in identical terms in art. 91 of the 1982 UN Convention on the Law of the Sea, while article 94 of that convention strengthened the obligations of flag states to administer their fleets, and added obligations to take measures to ensure safety at sea, although only in general terms.

Maritime Organisation (IMO), which was long committed to the principle of regulation by the flag state, to accepting that its standards should be internationally enforceable. In 1993 it adopted an International Management Code for the Safe Operation of Ships and for Pollution Prevention, and in 1995 amendments to its Convention on Standards of Training, Certification and Watchkeeping for Seafarers, together with Resolution A.787(19) establishing procedures for port state control.¹⁵

Financial services

The biggest boost to the offshore system came with the development of tax havens into offshore financial centres. This came about as the contradictory elements in the postwar arrangements for international monetary regulation became unravelled, leading to the ending of the fixed exchange-rate system in 1971-3. The postwar monetary system under the IMF left national authorities responsible for monetary policy and financial supervision, but within a system of international payments based on the dollar and its link to gold. This established the dollar as a global currency acceptable outside the USA, thus creating the so-called Eurodollar. The IMF agreement required convertibility of currencies, although national controls over capital movements were allowed and even expected. Controls on current account payments were gradually relaxed in the 1950s, and full convertibility for non-residents was introduced by the leading states from 1958. This gave TNCs and others with significant international operations an increased ability to manage their currency and financial flows. They already had a great incentive to do so, as discussed above, in order to minimise taxation of retained earnings. They could also exploit the hazy distinction between current and capital account payments, and use the flexibility of intra-firm international transfers by 'leading and lagging' payments, and adjusting transfer prices.¹⁶ The resulting 'short-term capital flows' undermined the effectiveness of capital controls, and eventually broke the fixed-rate system itself as large scale currency movements forced the British devaluation of 1967 and pushed the major currencies into floating in 1969-71 (Williamson, 1977: 3-8).

The system of offshore finance was effectively created, in this transition period from fixed to floating rates, by the monetary policies of the main developed countries, especially the US and the UK acting symbiotically. The US took measures to protect its low domestic interest rates by blocking access by foreigners to US capital markets, and encouraging US TNCs to fund expansion abroad from their foreign earnings. Since the Federal Reserve's interest rate ceiling applied only to domestic balances, US banks were encouraged to set up branches abroad to service the growth of US TNCs, especially in the booming European markets. This created the rapid growth of the Eurodollar market, as an intercorporate and interbank financial market, expanding

¹⁵: See 1996 Annual Report of the Paris Memorandum of Understanding on Port State Control, and other material available on <http://www.parismou.org>.

¹⁶ So-called 'transfer pricing' (see Picciotto 1992b) has generally been considered to be a tax avoidance device; however, the celebrated case of Hoffmann La Roche, which in 1973 sparked off international concern on the issue, was due as much to the firm's concern to ensure rapid repatriation of its revenues into the strong Swiss franc.

from an estimated £7bn in 1963 to about \$91bn by the end of 1972.¹⁷ London was especially attractive since the Bank of England, keen to boost the balance of payments and encourage the rebirth of the City as a global financial centre, applied its informal but strict monetary controls differentially as between the clearing banks (which were subject to a 28% liquid asset and 8% cash ratio) and secondary banks. Foreign-owned banks were treated even more lightly and exempt from all credit and interest rate requirements, except in sterling transactions with residents. The reforms of 1971 introduced a 12.5% reserve assets ratio for all banks, but only on sterling liabilities.

The City of London was established in this way as the leading 'onshore' financial centre, and it benefited further from exploiting the facilities of the related 'offshore' centres. The features which made them tax havens were also convenient for a broader role as financial centres, and could be further developed. The commercial secrecy provided by company and trust laws could be enhanced by bank secrecy, which was already substantial in English common law as 'received' in British dependencies, but could be augmented by statute and by prescribing criminal penalties for disclosure of confidential information (Effros, 1982; Picciotto, 1992: 262-3). Membership of the sterling area or another hard-currency link provided a stable currency, while deposits by non-residents could be offered freedom from exchange controls and bank reserve requirements. Thus, international bank deposits attributed to tax haven areas grew to \$10.6 bn by 1968, half held by banks and half by non-banks; and by a decade later, non-bank deposits had further grown 17 times and bank-owned international deposits nearly 30 times (US Treasury, 1981).

However, the financial sector in an offshore centre is essentially a segregated and largely fictitious realm. The banking and other financial business supposedly carried out through these centres involves transactions 'booked' on paper (or electronically) and attributed to 'shell' branches which generally exist only as brass plates. Thus, by 1989 the Cayman Islands, with a population of under 30,000 people, was said to be the world's fifth largest banking centre in terms of deposits; but of over 500 licensed banks only 70 had any physical presence there other than a nameplate, and only 8 carried out local business (UK Gallagher Report, 1990: 90). Nevertheless, financial business was estimated to account for about one-third of total employment on the Island (*ibid.*: p.94). In contrast, the financial business carried on through the City of London involves a more substantial physical presence, but it is nevertheless a wholesale business mainly servicing global activities, which many argue has a distorting effect on the UK economy and on monetary policies. Despite the importance of the specialised skills of the various increasingly professionalised strata of the City (Thrift 1994; Leyshon and Thrift, 1997: 314-320), the employment attributable to wholesale financial services there was estimated at 150,000 in 1991 (City Research Project, 1995: 2-5), which is about 0.6% of total UK employment. Paradoxically, the employment effects and economic impact of an offshore centre are proportionately much greater in the small island centres, especially those which have pushed on to become 'functional' centres, offering a range of related services such as trust and fund management, stockbroking, reinsurance, and even stock exchanges.

¹⁷ The figures normally cited are estimates by the Bank for International Settlements (BIS), which first included an analysis and data on this market in its 1964 annual report.

The system of globalised finance exploiting offshore centres has essentially functioned as a means of low-cost financial intermediation for those fortunate enough to have access to it. Exemption from reserve requirements enabled banks to offer low-cost loans while paying good rates to depositors. The tax avoidance facilities of the offshore system were further developed, so that Eurobonds and other financial instruments could offer advantages to both borrowers and lenders. Finance is raised by issuing a bond in the name of a company specially formed in a jurisdiction which allows interest to be paid without any deduction of tax to non-residents. These are then on-lent through a conduit company in a jurisdiction which has a tax treaty with the country of the ultimate borrower, to ensure deductibility of the interest from operating profits, and a minimal withholding tax, at source. More complex devices could ensure further tax reductions, such as dual-resident companies to allow 'double dip' deduction of the same interest against tax liability in two countries, or the sale and leaseback of assets to a captive offshore company to reduce operating profits. The tax authorities of the developed countries have done their best to combat each device as it became known (Picciotto, 1992: ch. 7), but working in the dark and with only rudimentary forms of international cooperation, they have hardly challenged the fertile minds and flexibility of the 'tax planning' industry. Developing countries have far less expertise to deal with such devices, and are in any case reluctant to discourage investors through strict tax enforcement. Indeed, many have been tempted to develop 'offshore' facilities themselves.

Thus, the offshore industry was created by combining tax avoidance with other types of regulatory avoidance, especially of controls over financial services. A wide range of financial services could make use of the fictions of offshore intermediation. Some, such as real-estate investment and insurance, are essentially avoiding taxes. Others, notably investment funds, were initially set up offshore to benefit also from bypassing exchange controls, and then to avoid restrictions on authorised investments (Hampton, 1996: 26-27). However, the facilities offered offshore, especially secrecy, facilitated not only avoidance, but evasion, fraud, and concealment of the proceeds of crime. These advantages had long been known to the cognoscenti, but now became more generally available for the price of a plane ticket or a long-distance phone call.

The convenience of offshore facilities could be used to make it easier to negotiate the often murky requirements of regulations whose ambiguities reflected legal or moral uncertainties. However, the easy concealment provided especially by secrecy helped to lure many into activities that were more clearly reprehensible, and illegal, by any standards. A key case was 'insider trading', which leapt into prominence with the scandals on Wall Street in the late 1980s. Criminal proceedings showed that the easy availability of secret offshore accounts had helped to fuel greed and facilitate illicit dealings. For example, Dennis Levine, the investigation of whom led to Boesky and Milken, used accounts in Swiss banks in Geneva and the Bahamas, and tempted his broker contacts by showing them how easily such facilities were available (Frantz, 1988; Stewart, 1991). The secrecy that is the essential feature of the offshore system makes it hard to distinguish legitimate and prudentially-run business from reckless and criminal activities. Thus, the Vatican's Istituto per le Opere Religiose was involved in the financial malpractices for which Michele Sindona was eventually jailed, having contributed to the failure of the Franklin National Bank, while his collaborator Roberto Calvi similarly destroyed the Banco Ambrosiano through its offshore operations (Naylor, 1994). The Bank of Credit and Commerce International

was charged for complicity in laundering drugs money in the US even prior to its closure by the banking supervisors in July 1991, due to evidence that it encouraged the use of its facilities for widespread frauds, many involving international tax evasion (Adams, 1992).

Supermarkets, boutiques, and back-street traders

With the generalisation of the facilities of the offshore system came routinisation, competition, and wider availability. From relatively obscure and discreet arrangements known to the select few, they became institutionalised into providers of a wider range of transactional products, marketed by a variety of internationally-active specialists in financial and legal services. Thus, the outlets offering these products, the centres themselves, also became differentiated. Some (generally those longer established) still aimed to provide a broad gamut of services, others developed niche product specialities, while newcomers aiming to break into the market hesitated between up-market high-quality and down-market more dubious products. With this growth and differentiation came a further increase and diversification of the customers they attracted.

The offshore phenomenon is not just a matter of a few rogue jurisdictions but the result of the mutual interactions of states more generally. As we have seen, it is this jurisdictional interaction which is exploited by the devices for regulatory avoidance, which are designed by lawyers and other specialists who operate at the interface between the market and the state (Dezalay, 1993), or rather states, since international regulatory avoidance entails exploiting disjunctures in the interaction of the regulatory systems of different states. This makes it very difficult to define and identify offshore havens, since almost any state may offer avoidance possibilities in relation to the regulations of another jurisdiction.

Nevertheless, it is possible to identify some states or statelets offering arrangements specifically devised for avoidance purposes of one sort or another, and these are often listed in publications put out by professionals and academics. The competition among them makes it hard for action to be taken to prevent their use, since if one state is targeted, another is likely to take its place. This competition also leads to differentiation. Typically, states which established themselves early as leaders, such as Liberia for shipping, or Switzerland for private banking, or the Cayman Islands for offshore accounts, are more willing to safeguard their reputations by ensuring high regulatory standards in other respects, such as maritime safety or prudential regulation of banks. Their later competitors entering the market are likely to be less scrupulous, and perhaps willing to relax some standards. They are therefore more likely to become the targets of international counter-measures, which paradoxically results in the leading offshore states being held up as good examples, and legitimising their use for avoidance of other rules, especially taxes.

Specialisation can also result from the anti-avoidance measures taken by target states. A good example is provided by the lengthy attempts by the US to combat tax 'treaty shopping' by the use of conduit companies. As a specialist reporter pointed out, the result would be that from tax avoidance 'supermarkets' these islands would become 'boutiques', each with its own lines on offer (Davidson, 1986).

Offshore comes onshore

An alternative approach is for targeted states to compete by offering 'onshore' facilities themselves. Thus, in 1984 the US and UK Treasuries made a concerted move against the Netherlands Antilles and Aruba, first by making simultaneous announcements ending the withholding tax exemption of payments made to service Eurobonds there. However, this was of limited effect in itself, since such payments could be routed via another convenient country, in particular the Netherlands. At the same time, however, the UK also introduced an inducement for borrowers to access the Eurocurrency markets in London directly, without the need for a Netherlands Antilles intermediary, by allowing interest on Eurobonds to be paid gross by a UK company, but only on proof by the paying agent that the bondholder is not a UK resident. Thus, while trying to attract bond flotations to London, where they could be more effectively policed as regards UK taxpayers, a cloak of secrecy was effectively offered for foreign taxpayers, thus facilitating evasion of other countries' taxes.

As with the introduction of 'captive' shipping registries by 'onshore' states, London's success in re-establishing the City as a financial centre stimulated others to compete. Thus, the US Treasury agreed in 1981 to introduce an International Banking Facility in New York, accepting a degree of bank deregulation in order to compete with the offshore banking system based in London and its related jurisdictions (Hawley, 1984). Japan also created offshore facilities in Tokyo in 1986, by allowing freedom from interest rate controls, bank reserve requirements, and tax regulations for yen transactions outside Japan (Adam, 1992: ch.20). Another example is Ireland's combination of tax incentives for foreign investors with its launching of an International Financial Services Centre in Dublin in 1987, taking advantage of its participation in the EC's liberalised market for financial services to attract offshore business such as captive insurance. Yet such facilities also create dangers: one of the factors which contributed to the Asian crisis of 1997 was dollar borrowing by Thai banks, facilitated by the creation in 1993 of the Bangkok International Banking Facility aiming to promote Bangkok as an international financial centre (BIS, 1998b: 124; Errico and Musalem 1999: 34).

Other countries went further, and aimed to stimulate investment in manufacturing industry, by establishing Export Processing Zones (EPZs), such as Mexico's duty-free *maquiladora* zone, Special Economic Zones (SEZs), or Enterprise Zones. Building on the older concept of free ports, which allowed duty-free importation of goods in transit, the EPZs aimed to facilitate the establishment of industries based on assembly or processing of imported inputs for re-export; but often they went further, and created enclaves in which other laws and regulations did not apply, especially employment protection requirements.

Thus, an offshore jurisdiction can be of many types. Some statelets (usually small island economies) have become so dominated by offshore activities, usually financial services, that they are essentially 'captive' states (Christensen and Hampton, 1999). Others may develop an offshore enclave, to try to attract or retain funds from international business or 'high net worth individuals'. These may be physically and politically semi-autonomous, such as Labuan in Malaysia (Abbott, 1999), or regulatory enclaves, created by laws giving privileges to special categories of persons such as non-residents, or 'international business corporations'. Many 'onshore' jurisdictions now also offer some such privileges, as well as other legal provisions which facilitate the use of offshore facilities elsewhere. It is this ensemble of

provisions and practices, generated by the competitive tension between states in a world of increasingly mobile money, that constitutes the offshore system.

DILEMMAS OF NEOLIBERAL RECONSTRUCTION

In these various ways, the generalisation of the offshore concept became part of the neo-liberal ideology of 'deregulation'. In its fundamentalist versions, neo-liberalism tends to characterise all rules or regulations as unnecessary 'interventions' by the state, and considers that 'free' market forces will inevitably find ways around such interference.¹⁸ Thus, regulatory avoidance is justified with the argument that the problem lies not with the havens' (lack of) regulations, but with the inappropriate, ineffective or unfair character of the regulations being avoided. This has long been a theme used in defence of tax havens and international tax avoidance. Luigi Einaudi, who was one of the economists consulted by the League of Nations on international taxation in 1923, later argued that the existence of haven states puts pressure on others whose taxes are badly administered to make their taxation 'fairer' (Einaudi, 1928: 35-6). Later, as international tax planning developed the techniques which enabled TNCs to minimize their global tax liability on retained earnings, their defenders or apologists argued that this was a legitimate measure to achieve an average international tax rate on their global business, reduced as far as possible to the lowest rather than the highest national rate (Bracewell-Milnes, 1980). The lauding of offshore reached its apogee with the generalised categorisation of all state regulation as an unnecessary and bureaucratic impediment to economic efficiency embodied in the 'free' market.

Competitive liberalisation and reregulation

What is clear is that the offshore phenomenon greatly contributed to the creation of a dynamic of regulatory competition between states, which has acted as an important catalyst in undermining the classic liberal international state system, by helping to destabilise the various regulatory arrangements based mainly on national states. This competitive interaction helps to explain the apparent paradox that it was decisions by national state authorities themselves which at various key moments created a globalised financial system outside the existing means of control (Helleiner, 1995). In the liberal international system which emerged in the latter half of the 19th century, international coordination of economic regulation between states was loose and based on voluntarism, leaving considerable leeway to individual states. Its re-establishment after 1945 relied even more strongly on national states to manage their domestic social consensus, but within a strengthened international institutional framework aiming to facilitate greater liberalisation (what Ruggie has called 'embedded liberalism': Ruggie, 1982). The increased difficulties of internal socio-economic management were exacerbated by the exploitation of the opportunities which the liberal international system provided for international avoidance of national regulation: for example, the populist tax revolts in many states had their roots in the increasing tax burden on wages and salaries, while the share of tax revenues from the corporate sector stagnated or fell (OECD, 1987; Clark and de Kam, 1998), due largely

¹⁸ This appears to be the essence of the theory of tax havens put forward by Johns, based on the notion that taxation and other state rules create 'friction' (Johns 1983).

to the greater opportunities for avoidance. This led to national measures aiming to strengthen each state's international position, which further facilitated and encouraged international avoidance.

Thus, those social groups and classes with the greater power or ability to organise on an international scale, or gain access to relevant arenas and mobilise global ideologies, have been able to play a dominant role in the remodelling of the international state system, along neo-liberal lines. This remodelling has entailed the dismantling of many of the remaining border barriers to international flows, notably the virtual elimination of tariffs in the 1970s, and the ending of exchange controls and many other overt restrictions on movements of money in the 1980s. This has been accompanied or followed by other measures creating more 'open' economies, through the liberalisation of economic regulation by reducing or ending direct forms of state economic intervention.

However, far from entailing a reduction of regulation, there has been an extensive process of re-regulation (Majone, 1990), or regulatory reform (OECD, 1996). This process has had a transnational character, involving extensive interactions between public, semi-public and private bodies and groups, through national, regional and global forums and institutions, which can be said to form complex networks (Picciotto, 1997b). In relation to taxation, especially of TNCs, a loose network of specialists and tax officials (mainly in developed countries) negotiate the tax liability of global businesses and its allocation among jurisdictions, although based on inadequate principles and secretive procedures (Bird, 1988; Picciotto, 1992: ch. 10). For financial matters a maze of provisions have emerged, centering on internationally-agreed prudential requirements for banking laboriously developed through twenty years of efforts mainly through the Basle Committee on Banking Supervision (BCBS, 1997). This has overlapped with coordination of the regulation of related markets such as securities and insurance (BIS, 1998), the harmonisation of accounting standards, the promulgation of checks against money-laundering through the Financial Action Task Force (FATF) set up by the G7 and based at the OECD, and the more informal spread of rules against insider trading (Picciotto, 1997b). However, the Achilles' heel of this patchwork of measures is still the problem of offshore.

COUNTERACTING OFFSHORE STATUS

Avoidance and legitimacy

State regulation depends on its legitimacy, which entails interrelated elements of acceptability and effectiveness. To the extent that regulatory arrangements lack fairness they lose acceptability, and will also fail in effectiveness as enforcement becomes difficult and non-compliance grows. Effectiveness can also be undermined by avoidance, a term used to distinguish the use of apparently legal means to circumvent a requirement (such as tax liability), from illegal evasion. Avoidance of legal regulation of economic activities is rooted in the divergence between the legal form and the economic substance of transactions - the possibility to achieve substantially the same economic result by formally different legal means. This can be done by exploiting the indeterminacy of legal concepts, and the possibilities of redefinition offered by the fictional nature of abstract legal categories.

As regulation has become increasingly important and complex, avoidance has grown in importance, since regulators have been reluctant to stigmatise the behaviour of respectable people as criminal. Evasion generally requires proof of intention to deceive, including knowledge that the transaction was invalid. Where avoidance is based on professional advice, it is hard to impugn as deliberately deceptive. Hence, regulatory enforcement generally revolves around negotiated compliance. Nevertheless, the denunciation of clearly deviant or criminal practices is important in setting acceptable limits to avoidance.

Thus, the stigmatisation of havens and of their use in concealing criminal and other illegitimate activity has been the main impetus towards dealing with the offshore problem. This has certainly resulted in some success in bringing offshore centres into the more important international regulatory networks, especially those dealing with money-laundering (Gilmore, 1995), and with the systemic stability of financial markets. However, it does not adequately deal with the underlying dynamic of regulatory competition and avoidance, which is due to the different perspectives and priorities of the various regulators in the states targeted by avoidance. Hence, the result tends to legitimise the continued use of the offshore system for avoidance of regulation which has not been stigmatised, especially tax. However, tax avoidance depends on facilities such as corporate and banking secrecy, which undermine regulatory cooperation on other matters (IOSCO, 1994).

This dilemma is seen most clearly in British government policy towards offshore centres, many of which are in fact UK dependent territories. Indeed, the development of many of these jurisdictions as offshore financial centres was encouraged and facilitated by UK authorities, especially the Bank of England. Their rapid growth led to inevitable difficulties, and each bank collapse or financial scandal has led to fresh attempts to improve financial supervision. Thus, following the crash of the Savings and Investment Bank in 1982, a Bank of England official was sent to improve regulatory arrangements in the Isle of Man; yet the Barlow Clowes collapse of 1988 showed that, although Peter Clowes had been refused permission to buy banks in the Isle of Man, he had had no difficulty in conducting his fraudulent selling operations from Gibraltar under a licence from the Department of Trade and Industry. Both the Barlow Clowes affair and US complaints about the use of Montserrat as a base for frauds led to the commissioning of the Gallagher report on offshore centres in Caribbean dependent territories in 1990, leading to some tightening of regulation especially in Montserrat and Anguilla. Yet at the same time, the Bank of Credit and Commerce International (BCCI), operating through holding companies in Luxembourg and the Cayman Islands, managed to evade effective supervision by the Bank of England until the dramatic decision to put it into liquidation in July 1991.

The announcement in January 1998 of fresh reviews of both British Crown Dependency¹⁹ and dependent territory²⁰ offshore centres is the latest chapter of the

¹⁹ These are Jersey, Guernsey, and the Isle of Man, which are dependencies of the British Crown although not part of the UK. Nor are they members of the EU, although under Protocol 3 of the UK's Treaty of Accession they are treated as part of the EU for Customs purposes and for trade in agricultural commodities; hence the EU laws relating to financial and tax matters do not apply to them. The UK is responsible for their defence and international relations, and 'in general terms, for their

saga. These were once again aimed at improving the standards of financial supervision, to establish the respectability of these offshore financial centres, and reduce the risk that they could become a burden to the British exchequer. The result is therefore likely to be to maintain most of the facilities which make them attractive for a wide range of avoidance activities, while trying to curtail some of the most blatant criminality. Many of them certainly have become reliant on the revenues generated from this business, and would find it very hard to break this dependency. The British government's primary concern is that their demands on the British should be minimised or eliminated. This was confirmed by the publication of the Edwards Report on Financial Regulation in the Crown Dependencies.²¹ This was carried out by a former Treasury official, who was specifically excluded from considering tax issues. Inevitably, the report concentrated on improving oversight of financial services and trying to prevent use of these facilities for money-laundering, drug-trafficking or other criminal purposes. The concern is to try to prevent scandals which might threaten their viability as offshore centres. There are strong vested interests in maintaining the offshore business, on which a large proportion of these islands' inhabitants rely for both legitimate and illegitimate income, even if it also distorts and corrupts their economies.

This process of attempted legitimisation of OFCs is commonly defended by pointing to the danger that, if the attractiveness of the more respectable centres were reduced, the same activities would move to more delinquent jurisdictions which would be harder to control. It is certainly true that there is no shortage of statelets attempting to break into the offshore market, and that the lack of other economic opportunities makes many of them very vulnerable to corruption. Nevertheless, concerted action by the majority of states could effectively outlaw them, by refusing to validate the fictional entities and transactions that they authorise. In effect, this has been started in relation to FoC shipping through the Port State Control systems that have been initiated. In relation to activities widely stigmatised as criminal, the dramatisation of a global war against narcotic drugs and organised crime has provided the motive power for the relatively speedy and successful efforts to criminalise money-laundering. Although the FATF is a body with no formal powers, it appears to have succeeded in establishing its code of Forty Recommendations as an international standard, enforced through national laws, and monitored through a system of multilateral surveillance

good government', but by constitutional convention refrains from intervening in domestic policy (Edwards report., 5.2.1).

²⁰ Following the return of Hong Kong to China, there remain 13 overseas dependent territories, including well-developed offshore centres such as Gibraltar, Bermuda, the Cayman Islands, and the British Virgin Islands. The UK government is represented in the territories by a Governor, who is generally responsible for external affairs, defence, law and order and the public service. All but the smallest have powers of self-government devolved by the UK Parliament and are responsible for raising their own revenues; but these powers could be repealed, and the British government has powers, held in reserve, to disallow Dependent Territory legislation, and to make laws for the peace, order and good government of any Territory except Bermuda. EU laws are applied in Gibraltar, although there is a backlog in implementing directives. In four of the Caribbean territories regulation of the financial sector is carried out directly by the Governor, in the others the local authorities are said to work closely with the Foreign Office. See UK House of Commons, Public Accounts Committee, 37th Report, 1998-9, *Foreign and Commonwealth Office: Contingent Liabilities in the Dependent Territories*.

²¹ *Review of Financial Regulation in the Crown Dependencies*, November 1998.

and peer review.²² But the crucial matter is clearly to establish a similar degree of coordination in relation to financial regulation and tax enforcement.

The End of Offshore?

I have argued here that the offshore phenomenon has acted as a catalyst for dissolving the classical liberal state system, involving a contested redefinition of the forms and functions of statehood. The international system based on international coordination of nationally-defined standards, has been undermined, and is gradually being replaced by internationally-defined standards, administered by complex sub-state global networks (Picciotto, 1997b). However, the relationship and roles of the public and private spheres are still in flux, contested through the debates and strategies of national competitiveness and globalisation. The availability and legitimacy of offshore facilities is a key element in these struggles. Effective measures to counteract the use of Offshore require international agreements defining regulatory standards, and the rejection of the jurisdictional claims of offshore states if they violate these standards. However, consensus on such standards is hard to achieve, in the competitive context of the global economy in which states presently exist. This can be seen in relation to the two main types of avoidance facilitated by the offshore system, finance and taxation.

For finance, the efforts have been limited to ensuring adequate prudential supervision to minimise dangers to the financial system as a whole, and even there progress has been slow. Procedures to ensure the prudential supervision of the offshore branches and subsidiaries of international financial firms are only gradually being established, especially since the aftermath of the BCCI affair.²³ These include arrangements for on-site inspections, 'subject to appropriate protection for the identity of customers' (BCBS, 1996: para. 19 and Annex A). However, no agreement has yet been reached on how to evaluate countries' supervisory standards (ibid.: para. 32): peer review seems to have been rejected, although suggestions that such an evaluation should be part of the IMF's role (Dale, 1994) have been taken up more seriously after the Asian financial crisis (IMF, 1998). Nevertheless, rather than grasp the nettle of reform of international financial institutions, world leaders have preferred to create new (although only semi-formal) bodies: the G7 Finance Ministers and Central Bank Governors; the Financial Stability Forum, and the G20 of advanced economies.

²² Its Reports and details of FATF activities are available from the FTAF website at <http://www.oecd.org/fatf/>.

²³ In 1992, after the BCCI affair, the Basle Committee specified that international banking groups should be supervised on a global consolidated basis, and accepted that a host country could impose restrictive measures, including refusal to admit a bank, if it considers that its home country regulator is falling short of the standards for consolidated supervision (BCBS, 1992: Principle 4). Procedures have been put forward to enable the home country regulator of an international bank or banking group to be able to exercise effective supervision of its foreign establishments, including a 'shell' branch offshore, in a joint report with the Offshore Group of Banking Supervisors (BCBS, 1996). The Offshore Group was established in 1980, and now includes as members Aruba, Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands, Cyprus, Gibraltar, Guernsey, Hong Kong, Isle of Man, Jersey, Lebanon, Malta, Mauritius, Netherlands Antilles, Panama, Singapore, and Vanuatu.

Furthermore, this focus on supervisory procedures fails to tackle the conditions creating the offshore financial system itself, the differences in substantive prudential requirements. Thus, the BCBS's capital adequacy rules do not specify that its capital requirements must be applied to all branches and subsidiaries in a group on a consolidated basis. Although within Europe, the EC's Capital Adequacy Directive does require this, it does not specify how such consolidation should be done, and has been interpreted by the UK authorities (in relation to non-banking business) not to apply to subsidiaries incorporated outside the EU. This has been described as 'an open invitation for UK investment firms to escape ... any or all UK rules that are found to be onerous, simply by routing business offshore' (Dale, 1996: 214). Aside from capital adequacy, little attempt is being made to establish international prudential standards for investment activities. As long as the regulatory authorities consider that the competitiveness of 'their' financial centre depends on minimising regulatory burdens there will always be an incentive for them to tolerate the use of offshore shell branches or subsidiaries by the financial firms they are supposed to supervise, to circumvent other countries' requirements, or even their own.

Above all, little progress has been made towards international standards to deal with what is in many ways the heart of the offshore phenomenon, international tax avoidance. Since taxation is regarded as the most jealously guarded aspect of national sovereignty, the harmonisation of tax rules is excluded, although there has been considerable convergence through emulation. However, even the establishment of a coordinated approach has been hampered by tax competition. The main coordinating body has been the OECD's Fiscal Committee, which has inevitably favoured the tax rights of the home state of an investor, and thus capital-exporting countries generally. More seriously, it has strongly resisted any attempt to treat the taxation of TNCs on a unitary, or global consolidated, basis. Instead, it has preferred to rely on the 'arm's length' principle, which attempts to treat the various national operations of a TNC in the same way as unrelated companies. This ignores the integrated nature of the TNC, and results in continual conflicts between the main tax authorities over the proper allocation of costs (especially fixed costs such as R&D and headquarters expenses), and hence of profits.²⁴ It also greatly hampers a joint approach to ending the use of tax haven intermediary companies, which would lose their purpose if TNCs were taxed on a unitary basis.

Nevertheless, fiscal pressures even on developed countries have led to an initiative to combat 'harmful tax competition', led especially by the German and French governments, in both the EU and the OECD. In the EU, a new approach initiated in Verona in April 1996, resulted in a package on taxation policy in December 1997 around 3 main proposals. First, a Code of Conduct for business taxation has been adopted, as a 'political commitment' not a legal obligation. A procedure has been established to identify 'potentially harmful' tax measures which provide for a

²⁴ A decade ago one of the main officials involved stated that he had feared for the previous two decades the outbreak of a 'general open clash between tax authorities in the field of arm's length pricing' (Menck, *Tax Notes*, 11 August 1986: 585). Since then, although coordination procedures have been strengthened (through simultaneous examination and joint Advanced Pricing Agreements), the arbitrariness of the criteria for allocation still leads to battles over allocations (see e.g. Baik and Patton, 1995), which remain zero-sum games as long as the problem of avoidance through havens is not tackled.

significantly lower effective level of business taxation, and to subject these to standstill and rollback, supervised by a Group (chaired by a UK Treasury minister). This allows any member state the right to request discussion and comment on tax measures of another which may fall within the scope of the code, and member states undertake to promote adoption of the Code in other territories, and to ensure 'within the framework of their constitutional arrangements' that its principles are applied in their dependent or associated territories. The secretive process of drawing up the lists of 'harmful' measures has been lengthy, and the British government for one has stated that it intends to defend 'robustly' its tax provisions identified by others as harmful.²⁵

This process is in any case greatly hampered since the Code is a voluntary arrangement, resulting from the strict interpretation of the Treaty of Rome provision that double taxation is to be dealt with by negotiation between the member states. However, the European Commission made a separate but obviously related move, using its powers to enforce EU competition laws. Guidelines issued in November 1998 laid down criteria which the Commission would apply in deciding on the acceptability of tax subsidies under the Treaty's state-aid rules, and these were publicised as being aimed at low-tax offshore banking centres. This approach has already been applied to Ireland's 10% corporation tax, and a proposal requiring it to be phased out gradually by 2010 was published by the Commission on 18/12/98.

The second proposal to emerge from the Verona approach was for a system to ensure a 'minimum of effective taxation of savings income in the form of interest payments within the Community' (subsequently published as a draft Directive in COM(1998) 295final, OJ C212, 08.07.1998). These would require member states either to apply a minimum withholding tax of 20% on interest income payable to a person resident anywhere in the EU, or to implement a system for supplying information on such payments to the EU country of residence of beneficiaries of such payments. The third entailed proposals for a Directive on intra-firm interest and royalty payments to be brought forward by the Commission, although Belgium, Italy and Portugal said they would not support such a directive before the directive on taxation of savings is adopted. The Withholding Tax proposal has been vehemently resisted by the City of London, and the UK government has taken the view that it would not agree to anything which damaged it as a financial centre. However, its arguments against the proposal have been unconvincing,²⁶ although its view that the problem should be tackled through strengthened information exchange may provide a good alternative, if taken seriously.

²⁵ In a House of Commons debate dominated by Euro-phobic denunciations of attacks on British sovereignty, the Minister mentioned that the initial list of measures produced by the Group includes 5 UK tax measures and 5 others relating to Gibraltar, and that the Government intended to defend these 'robustly' (Hansard Parliamentary Debates HC 9/12/98). See also House of Lords Select Committee on the European Communities, 'Taxes in the EU: Can Co-Ordination and Competition Co-Exist?' 15th Report 1989-99, HL 92, 20 July 1999.

²⁶ The UK Treasury took 15 months to produce a paper aiming to explain the damage the proposal might cause, and when it appeared, the only source for data cited was the industry itself: HM Treasury, 'International Bonds and the Draft Directive on Taxation of Savings', September 1999.

A more comprehensive approach is being attempted by the OECD, which in April 1998 adopted 15 Recommendations put forward in a report by its Fiscal Committee (OECD, 1998), including the setting up of a Forum under the auspices of that committee to monitor their implementation. The proposals for strengthening the anti-avoidance provisions in tax treaties are noticeably only hortatory in tone. However, it does include a commitment by member states to evaluate their own tax provisions against the listed criteria of 'harmful tax practices', to report any which come within the criteria, and to remove them within 5 years. In case a member is less than fully scrupulous, doubtful cases may be referred to the Forum by any state, but the Forum's opinion on such cases is 'non-binding' (ibid.: 57). Not surprisingly, Luxembourg and Switzerland refused to be bound by the recommendations (though they did not block the decision adopting them), claiming that they were defective in targeting only geographically mobile activities such as financial services and unreasonable in seeking to restrict bank secrecy. It remains to be seen, however, whether other OECD members (notably the UK and Eire) will give enthusiastic cooperation even to these limited initiatives. So far, the Forum has operated secretively, in identifying an initial list of 47 potential tax havens (of which 9 are UK dependencies, and another 15 former dependencies) allocated to four Study Groups, the authorities of which are being invited for 'consultations', aimed at persuading them 'to re-examine their fiscal regimes and increase their international cooperation on fiscal matters'.²⁷

The difficulties involved in a genuinely international approach to combating tax avoidance are seen most clearly in the minimalist approach adopted to cooperation in tax enforcement. International agreements for mutual assistance in judicial, administrative, and even financial supervision matters commonly exclude taxation.²⁸ Although the impetus for cooperation in tax matters began early (as mentioned above) and included proposals to combat fiscal evasion and assistance in tax collection, tax treaties have dealt largely with prevention of double taxation, and included only minimal provisions for exchange of information. A view has become entrenched in the laws of many countries, including the UK, on the basis of dubious precedents, that a state should not use its powers of compulsion to assist another to enforce its taxes. Thus, many states (including the UK) understand treaty information exchange provisions as limited to information already available to the state in collecting its own taxes. Since avoidance generally entails routing income through legal entities that are tax-exempt, this is a fatal flaw. The information needed for effective tax enforcement is also often concealed under a cloak of banking and commercial confidentiality. Thus, the British Revenue is at present hampered by the reluctance even of those offshore centres which are UK dependencies to provide financial information for the purposes of enforcing UK taxes. Yet these centres are more likely to be used to avoid taxes of other states, while British tax liability is more likely to be concealed through havens whose links, if any, are with other developed countries.

²⁷ 'Tax Coordination and Competition', Memorandum from HM Treasury and Inland Revenue to House of Commons Select Committee on Treasury, 20 July 1999.

²⁸ However, the G7 Finance Ministers in May 1998, in a move designed to support the OECD initiative against harmful tax competition, committed their countries to extending the arrangements for gathering and sharing information on money-laundering to include tax-related crime. However, it does not seem that this extends to tax avoidance, nor even to tax evasion as such, but merely aims to ensure that criminal proceeds are not concealed under the pretext that the transactions are tax-related.

An important step could be taken if political pressures could persuade states to adhere to the multilateral Convention on Mutual Assistance in Tax Matters, drawn up through the OECD and the Council of Europe and opened for signature in 1988. This agreement drew such violent criticisms from the business lobby that until now few states have adhered to it.²⁹ More emphasis has been put on improving the arrangements for obtaining and exchanging information to defeat unlawful tax evasion. The stigmatisation of havens as disreputable centres facilitating the concealment of criminal activities and financial irregularity (Blum et al., 1998) has provided legitimation for provisions to strengthen the rights of criminal justice authorities to obtain information, extending also to tax evasion and fraud. However, prosecutions for criminal tax evasion are relatively rare in most countries, and convictions are difficult to obtain, because of the need to prove a deliberate intention to defraud the revenue.³⁰ Firms can therefore shelter behind the legal advice they receive. As outlined earlier in this paper, the ineffectiveness of taxation of international business is largely due to the creativity of 'tax planners', who can use secrecy to keep ahead of tax enforcers. Stricter provisions to obtain and exchange information will only be a real danger to blatant criminals who are poorly advised, rather than the sophisticated international tax planners.

The underlying problem is that tax authorities have made it harder to generate political support for a more comprehensive arrangement for tax cooperation, due to their failure to develop a stronger set of standards to define and allocate the tax base of internationally-operating businesses. For example, they continue to emphasise that the problem of 'transfer pricing' between affiliates of TNCs must be dealt with by adjustment of accounts of the individual companies based on the 'arm's length' principle. This in fact generates conflicts between national tax authorities over the allocation of fixed and overhead costs (such as R&D) and fails to tackle the synergy profits of globally-integrated firms (Baik and Patton, 1995). It also requires sophisticated audit techniques which few tax administrations are able or willing to apply (especially developing countries, which are desperate to attract foreign direct investment). Above all, it does not provide an adequate basis for a joint multilateral

²⁹ Ten years later it has been ratified by only 8 states: Denmark, Finland, Iceland, The Netherlands, Norway, Poland, Sweden, and the USA. However, Poland and the USA made reservations excluding the provision of assistance in the collection of taxes or the service of documents. The Netherlands, which ratified in 1996 also on behalf of the Netherlands Antilles and Aruba, made the same reservation on their behalf, but also went further and specified that they would only observe the Convention in relation to those parties to it with which they also have a bilateral double tax treaty. This reservation is of dubious validity under article 30 of the Convention, and probably negates its applicability to those territories. It remains to be seen whether the OECD initiative against 'harmful tax competition' will lead to a more positive attitude towards cooperation in tax enforcement.

³⁰ Perhaps due to the restriction of information exchange to criminal tax evasion, there is evidence that revenue authorities are making stronger attempts to criminalise dubious activities. Thus, the UK Inland Revenue in 1997 obtained convictions in a case for conspiracy to cheat the public revenue against both a British lawyer and a Jersey administrator of offshore companies, for helping to conceal information about profits made using Jersey-registered companies from supplying military equipment to South Africa while it was subject to embargoes. The convictions were upheld by the Court of Criminal Appeal (unreported judgment of 7th July 1999), creating some concern amongst UK financial advisers and tax planners, who felt that the criminal court judges had dealt very crudely with some of their sophisticated arguments showing that the Jersey companies were not liable to British corporation tax, so it could not be an offence to fail to report the income (Rhodes, 1999).

approach to assessing the tax liability of internationally-organised business. An alternative approach based on global formula apportionment has been bitterly opposed by business; but national tax authorities have also resisted it, since they reject the possibility of an international agreement on the definition and allocation of the tax base which it would require (Picciotto, 1992b).

Clearly, determined international cooperative efforts could succeed in curtailing and eventually ending the more exotic fictions of offshore jurisdiction. However, such efforts require a strong political impetus, mobilised on an international basis. Such a process of mobilisation is already well under way, and achieved a significant success with the abandonment in 1998 of the attempt to negotiate a Multilateral Agreement on Investment (MAI) at the OECD. This proposal was strongly criticised as providing extensive rights without any responsibilities for international investors. The problems posed by international avoidance of tax and financial regulations would be more easily overcome by linking the advantages of an investment protection agreement to acceptance of rules for cooperation in tax enforcement and elimination of harmful tax practices. Also included in such a package deal should be participation in systems for regulation of financial markets and prudential supervision of financial firms, as well as money-laundering and financial fraud. The international debate on the Tobin tax makes it clear that such proposals to restrain speculative financial movements could only be possible within a multilateral cooperative framework.

The framework could also include agreements to combat bribery and illicit payments, corporate governance and disclosure requirements, and marketing rules for products such as drugs, tobacco, and babyfood. Principles of environmental protection, and minimum social and employment standards, could also be associated within the framework, by creating a presumption that an investor is responsible for ensuring compliance with such standards by the businesses involved with the investments. The arrangements which have been developed at the international level so far are far from perfect, but their inclusion in a broader multilateral framework would facilitate their acceptance and make it easier to strengthen them. This would reverse the presumption of the MAI, which would have encouraged the continued use of offshore centres and havens for tax and regulatory avoidance, by offering protection to investments even if routed through such jurisdictions (Picciotto and Mayne, 1999).

Above all, what is needed is a recognition that globalization is not merely a matter of unrestricted market forces. It requires a strengthening of international standards and cooperative arrangements, to provide a strong regulatory framework for the increasingly interdependent world economy.

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