Exploring the offshore interface *

The relationship between tax havens, tax evasion, corruption and economic development

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Abstract. The connections between economic development, corruption, and the increasingly globalised financial system are not yet fully understood. This article examines the offshore interface—tax havens and offshore finance centres—that lies between the developed countries and Less Developed Countries (LDCs), part of the international financial system where legitimacy meets corruption. The central argument is that the existence of the offshore interface facilitates and can even encourage onshore corruption. New technology, in combination with strict bank secrecy in the "private banking" offshore networks of major banks, allows rapid international flows of funds, illustrating an increasing synergy between the offshore interface, globalisation and onshore corruption.

Introduction

Tax Havens and Offshore Finance Centres (OFCs) play an important role in the circulation of international financial capital, acting as satellites orbiting the global financial centres of London, New York and Tokyo. OFCs, with their high levels of bank secrecy, attract flight capital from Less Developed Countries (LDCs) that are commonly facing international debt. Ironically, deposits often flow back to the offshore branches of the same international banks that were lenders (Lessard and Williamson 1987). These connections between development, corruption, tax evasion and the increasingly globalised financial system are not yet fully understood. This article explores what could be called the offshore interface—tax havens and OFCs—that lies between the developed countries and LDCs, the international financial system, and the geopolitics that characterises the late twentieth century.

In comparison with other areas of development studies, offshore finance is a somewhat problematic area to research given the nature of offshore

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financial activities based upon secrecy and confidentiality. Customers using OFCs demand secrecy from revenue authorities, governments and sometimes their own next of kin. This criterion applies even for legitimate business customers, transnational corporations (TNCs) and wealthy individuals who seek confidentiality. Additionally, there are two further aspects that can hinder the collection of comparative data: first, the various OFC host governments' attempts to continually portray themselves in the best possible light, and second, the fact that financial services, especially banking, are fundamentally based on the fragile notion of "confidence". This leads to all players wanting to promote the probity and respectability of their OFCs. In combination with the host government's stance, this can lead to a reluctance to reveal much information about offshore activities. This results in a lack of good, international comparative data both for offshore finance in general, and specifically for different OFCs. The problems of measurement of offshore finance are similar to researching the so called "black" or hidden economy, and so estimates of size are often no more than "best guess" activities.¹

Given this lack of data and secrecy, "snowballing" interviews were used in two OFCs – Jersey and The Bahamas. This "snowballing" technique enabled access to the OFC networks, as initial personal and family contacts led to other interview respondents. The author was then able to conduct a series of semi-structured interviews in the two OFCs.² This mass of primary (albeit qualitative) data was then augmented with extensive use of existing secondary sources.

Recent literature includes studies by the Economist Intelligence Unit (Doggart 1993) and the writings of various tax lawyers and other practitioners (Langer 1988; Spitz 1990; Diamond and Diamond 1990; Grundy 1994; Yule 1994). However, most are technical works, written for international tax specialists and generally lacking conceptual depth. In general offshore finance and OFCs seem to be an under-researched area, possibly because of the lack of data and the problem noted above. The few academic studies of offshore finance are R.A. Johns’ monographs (1983; and Johns and Le Marchant, 1993), Walter 1985; Naylor 1987 and Ehrenfeld 1992. Johns approaches offshore finance from a broadly neoclassical viewpoint, arguing that onshore frictions – such as fiscal, banking and commercial regulations – push funds offshore to "zero friction" OFCs. However, his neoclassical assumptions have been criticised by Hampton (1993) who argues that an analysis of the political economy of the relationship between onshore state and offshore jurisdiction is fundamental, as this relationship underpins the possibility of an offshore jurisdiction enacting fiscal or bank secrecy legislation to attract international financial capital.