Radio Luxembourg and the Eurodollar Market Are Both Offshore Stations

Radio Luxembourg developed in the late 1940s as a commercial broadcasting station that would supply its programs to more than 100 million potential listeners in two markets, Britain and France. At the time neither the British Government nor the French Government permitted commercial broadcasting. Broadcasting was a government monopoly and the programs in each country reflected what the producers – the bureaucrats at the British Broadcasting Corporation (BBC) and at Radio Diffusion Française (RDF) – felt their listening publics should have. Perhaps these government officials had correctly gauged their public’s wants and needs. Perhaps, but unlikely. If they had, they would not have needed monopoly power to limit the public’s choice of programs.

Radio Luxembourg found a market niche by producing consumer-oriented programs as a way to sell commercials – a profitable activity. Although the radio signals were produced in Luxembourg, they were ‘consumed’ in Britain and in France; neither country was willing to raise ‘tariffs’ or other barriers to the import of foreign broadcasts. (At the time only the Russians and the Albanians ‘jammed’ airwaves.) Transport costs for radio waves were low. Radio Luxembourg prospered. Predictably, numerous competitive stations were established. Radio Caroline, for example, parked its transmission facilities on a tugboat just outside the 3-mile limit of British jurisdiction.

Offshore stations and externalized activities

Radio Luxembourg is a classic example of an externalized activity – a good or service produced in one legal jurisdiction is consumed in another. The sale of alcohol and tobacco products at duty-free airport shops is another example; buyers do not pay a tax on their purchases since the products will be consumed abroad. Buyers do not pay transport costs nor do they pay import duties (hence duty-free). Washington, DC is ‘a duty-free shop’ because taxes on purchases of alcohol are much lower than those on purchases of comparable products in Maryland and Virginia. Residents of both states buy their booze in Washington. The importation of these untaxed products into Maryland and Virginia is illegal, but is not significantly regulated; once or twice a year the revenue agents from these states nab
someone for ‘illegal imports’ in the hope that the newspaper headlines will deter others.

An externalized activity occurs because two different governments regulate the same transactions or activities in different ways. Production occurs in jurisdictions with low taxes or minimal regulation to satisfy the demands of individuals resident in jurisdictions with higher taxes or more severe regulation. For example, Americans travel to Mexico and to Canada to buy specific pharmaceuticals that are not available in the United States. New Hampshire does not have a sales tax, and the residents of Maine, Massachusetts, and Vermont who live near the Granite State shop there to avoid the sales taxes in their home states.

Differential regulation is necessary for an externalized activity, but these activities occur only if both the costs of transporting the goods or services from the production area to the consumption area and the barriers to these movements together are smaller than the differences in the costs of regulation.

The external currency market, née the Eurodollar market

Today the largest external transactions involve the production of bank deposits denominated in the US dollar in London, Frankfurt, Zurich, and other financial centers outside the United States and the production of bank deposits denominated in the British pound in Frankfurt and Zurich and other financial centers outside Britain. The generic term for this market is the ‘external currency market’; the popular terms are the ‘Eurodollar’ or ‘Eurocurrency’ market. The unique feature of this market is that a banking office in a particular city produces a deposit denominated in a currency other than that of the country in which the office is located. Thus a deposit denominated in a currency other than the British pound and produced in London is a Eurodollar deposit – even if the deposit is denominated in the Swiss franc or the Japanese yen.

A bank that produces an external currency deposit is a Eurobank. A bank in London becomes a Eurobank whenever it sells a deposit denominated in the US dollar or the Swiss franc – or indeed in any currency other than the British pound. Similarly, a bank in Zurich is a Eurobank if it sells a deposit denominated in a currency other than the Swiss franc. A Eurobank need not be located in Europe. Singapore is a thriving center for the Asian branch of the Eurodollar market, while Panama City performs the same function in Latin America. Virtually all Eurobanks are branch offices of a major international bank.

Box 6.1 What Banks Produce

Ask 100 friends two similar questions – what do automobile firms like General Motors and Mercedes and Toyota produce and what do banks like JP Morgan Chase, HSBC, and Deutsche Bank produce? You’re likely to find virtually identical answers to the first question and many different answers to the