Sinking assets

Global reforms pose a threat to those nice little earners.

Illustration by David Simonds

In benign times Britain could smile remotely on its far-flung territories, sending the odd royal to fly the Union Flag. But corruption in the Turks and Caicos Islands, which might soon require direct rule again from London, are a harbinger of what may happen closer to home as the crackdown on offshore tax havens gets tougher, gaining momentum from the G20 summit this week. Jersey and Guernsey, two islands less than 100 miles from Britain, owe 50% and 40% respectively of their income to financial services. How much of that would survive if those businesses were forced to be totally transparent is open to question.

One of Jersey's biggest earners until recently was the securitisation of financial assets; that market is all but dead. One of Guernsey's claims to fame is a trust law that allows the sponsor of a trust to reclaim its assets at will—making a nonsense of the trust concept. Richard Murphy, who campaigns against tax havens, argues that, whatever else they may claim, these two Channel Islands rely on secrecy to attract business. If that is stripped away they are "dead in the water", he says.

A spokesman for Guernsey insists that the island meets three good-housekeeping criteria: on transparency, effective regulation and co-operation with other tax authorities. Recent pressure has encouraged Jersey and Guernsey to sign bilateral information-exchange agreements with a dozen countries. Yet the two islands are still refusing to swap information automatically under the European Union's savings-tax directive, though they collect some tax on behalf of other countries under an option that keeps the beneficiaries' identity secret. Pressure for more disclosure is mounting, but so is competition among tax havens. Jersey and Guernsey recently had to match the Isle of Man (another British dependency, this one in the Irish Sea) by reducing their tax rates on non-financial firms to zero. The Isle of Man stands to lose less from corporate freeloading: it has fewer local companies than Jersey and receives a subsidy of

around £200m ($286 million) a year from pooling value-added tax returns with Britain, Mr Murphy says.

Pressure to reveal all is coming from another direction too. The bail-out of much of Britain's financial sector has prompted a crackdown on the tax-avoidance tricks used by banks, especially those which have the taxpayer as shareholder. The Treasury plans to introduce a "voluntary" code that would require banks to obey the spirit as well as the letter of tax law. Who exactly will determine when the spirit has been infringed is a matter for speculation.

Britain's offshore dependencies were facing a tougher future even before this bout of reforming zeal. In November 2007 the National Audit Office pointed to the "contingent liabilities" that would face the government if any of these territories saw a financial collapse or regulatory failure: at best it would damage Britain's reputation and at worst it would prompt a call for direct aid. A year later the Treasury commissioned a report on British offshore financial centres. Since then the official tone has changed: a simple review of the status quo risks becoming a witch-hunt that threatens the havens' very livelihood, some fear. Michael Foot, the former central banker leading the review, toured the Caribbean last month "mainly to show these territories that I am not the devil incarnate", he says.

Mr Murphy suggests a reason for Britain's volte-face: now that transparency is being forced on tax havens worldwide, the British government may as well swim with the tide and at least collect some revenue. The days when British offshore havens helped to keep sterling and the City afloat are definitely over.

The islands see things differently. They provide legitimate financial services that are quicker and more flexible than even London and New York, they argue. Britain's Cayman Islands, for example, is home to more than half of the world's offshore hedge funds, according to IFSL Research. Rumour has it that the first choice of domicile for fund managers investing, along with the US Treasury, in American banks' toxic assets is Grand Cayman.

The Economist, New York, 2 abr. 2009, Britain, online. Disponível em <www.economist.com>. Acesso em: 13 abr. 2009.