Funding the Future

Of course there are trillions offshore – and now ...

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The Wealth Bulletin has reported:

Research has found huge discrepancies in the amounts declared by offshore centres

The amount of undeclared money languishing in offshore financial centres has always been difficult to quantify: the very nature of it being undeclared makes it hard to trace. But work by economists at the International Monetary Fund has shed new light on the cash involved, confirming it runs into trillions of dollars.

Gian Maria Milesi-Ferretti, an economist for the IMF in Washington, said statistical information on Luxembourg, one of the largest offshore financial centres in Europe, illustrated the extent of the problem. He said: “Luxembourg is one of the few offshore centres that disclose detailed statistics on assets and liabilities held in the financial sector, which makes it invaluable to understand cross-border money flows.”

The latest available IMF figures show portfolio assets held by foreigners in Luxembourg to be worth $1.5 trillion at the end of 2008. But looking at statistics provided by the Luxembourg Government on portfolio investment liabilities for the country — the mirror image of the asset information held by the IMF — there is a big discrepancy. The investment liabilities in Luxembourg were $2.5 trillion — $1 trillion (â,¬726bn) more than the assets reported.

Milesi-Ferretti said: “This is a huge difference, almost 40%, and is unlikely to be entirely accounted for by the fact that some countries do not report their portfolio investments or their destination to the fund.” China, Taiwan and many of the oil-exporting countries do not participate in the IMF’s survey.

The IMF found a similar discrepancy in the Cayman Islands data, whereby the $2.2 trillion in equity liabilities reported by the country, a British overseas territory, at the end of 2007 — the latest figures available — bears little resemblance to the $750bn of portfolio assets reported to the international organisation.

Taken together, the data for the two offshore centres alone shows at least $2 trillion remains unaccountable for. And the fact that many undeclared funds in offshore accounts are held in cash deposits, not in portfolio investments, means the sum is likely to be much higher.

Switzerland — the biggest offshore financial centre — has only a small discrepancy between what it reports as portfolio liabilities and what it reported to the fund as assets, but the Government admits to having at least $600bn in undeclared accounts.

I admit I can’t resist the temptation to say that some of us have been saying this for a long time. The Tax Justice Network published my research on this in 2005, suggesting there were £11.5 trillion of assets offshore. Time and again this has been attacked by organisations that should have known better and by academics with a right wing axe to grind. But now, like so much else I and others have argued, it is being validated. And the issue itself, once dismissed as inconsequential is now being considered seriously:

Although the IMF is concerned about the undeclared assets held in offshore centres from a tax perspective, it is particularly concerned about how this money affects cross-border financial interaction and contributes to shocks in the global economy such as the recent credit crisis.

Milesi-Ferretti said: “The Cayman Islands were the largest foreign holder of private-label US mortgage-backed securities on the eve of the financial crisis. More information on the ultimate holders of these securities could clearly provide valuable insights on the transmission of the â€šÃ„Ã²sub-prime shock’ and the financial crisis more generally.”

The IMF believes the sum of the external assets and liabilities of what it calls small international financial centres — which includes all the offshore centres except Switzerland — is $18 trillion.

Well, in that case apologies are in order — as ever, we were too cautious in our estimates.

The figure is higher than those of big investing countries such as France, Germany or Japan and is a multiple of those of other large economies such as China.

Milesi-Ferretti said: “What is even more striking is that this number is likely to be an underestimation given the data problems with offshore financial centres.”

That is an especially timely admission: I am in Washington to discuss this data issue with the IMF later this week. I’,m now looking forward to constructive dialogue, debate and a programme for action.