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The anatomy of the Cayman Islands offshore financial center: Anglo-America, Japan, and the role of hedge funds

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ABSTRACT

The Cayman Islands is a key node in contemporary global finance, yet it is severely under-researched. This paper compiles the first ‘anatomy’ of the Cayman offshore financial center (OFC), utilizing all sources of publicly available data about the three main segments: banking, direct investment, and portfolio investment. The analysis is performed both diachronically to see when large inflows occurred and geographically to determine what role certain countries play in different segments. This dissection of the Cayman OFC shows that the United States is the largest counterparty in all segments with Japan playing an important role too. In fact, when excluding long-term Treasuries, Cayman is the largest holder of US securities in the world. Hedge funds are the main factor for this strong Cayman-US link. About 60% of global hedge fund assets are legally domiciled in Cayman – an extraordinary spatial concentration in such a tiny of the Anglo-America/Anglosphere approach. This approach provides one plausible explanation for the unparalleled rise of the Cayman OFC by seeing this jurisdiction as one node in an Anglo-American triangle together with the USA and the UK, Cayman's sovereign power.

KEYWORDS:

Cayman Islands | offshore financial centers | tax havens | Anglo-America | hedge funds | Japan

INTRODUCTION

‘Small place, big money’ was the apt title of one of the first analyses concerning the position of the Cayman Islands in the international financial system (Roberts 1995). Twenty years later, the archipelago south of Cuba is, of course, still small in geographic terms. The amount of foreign capital booked in the Cayman offshore financial center (OFC), however, has become bigger in this period of time – much bigger. Significantly improved availability of data concerning OFCs and their counterpart countries during the last two decades allows for a better understanding of the role that the Cayman Islands plays in international finance. This tiny group of islands in the Caribbean with roughly 58,000 inhabitants and a domestic economy of less than US$3 billion has attracted foreign capital of over US$4100 billion if we take into account banking assets, direct investment and portfolio investment; note that the total stock of external assets is likely much higher, because there are no data available for trusts (see Harrington 2016). Setting the amount of foreign assets in relation to the GDP of a particular jurisdiction results in a specific ‘offshore-intensity ratio’ (Fichtner 2015). According to this ratio, the Cayman Islands is by far the most intensive OFC in the world with foreign assets amounting to over 1500 times Cayman's domestic economy. Moreover, the Cayman Islands is not only large in relative terms, but also in absolute ones; the small Caribbean archipelago has attracted more external assets than advanced industrial countries such as Japan, Canada or Italy, despite them having economies several hundred times Cayman's GDP. Consequently, Cayman is not just any random small island OFC, it is one of the largest financial centers in the world and a central node in contemporary global finance. However, this unique OFC is severely under-researched.

and as the second largest jurisdiction in the world regarding the issuance of asset-backed securities (ABS) from 1983 to 2008 (Cetorelli and Peristani 2012), the Cayman Islands has played a key role for financial 'innovation' in recent decades. From 2004 to 2007, Cayman had even been the largest jurisdiction concerning the issuance of collateralized debt obligations (CDOs), according to Culp and Forrester (2010). Hedge funds as well as opaque CDOs have contributed to the development of the global financial crisis and thus such financial 'innovation' has serious consequences for international financial stability (Lysandrou 2012; Lysandrou and Nesvetailova 2015; Wójcik 2013a, 2013b). Utilizing all sources of publicly available data, this paper compiles the first 'anatomy' of the pivotal Cayman OFC. The aim is to perform a fine-grained analysis of the three main segments of cross-border finance: (1) banking, (2) direct investment, and (3) portfolio investment. This in-depth case study of the Cayman Islands OFC is highly complementary to recent studies in Economic Geography, e.g., on the role of advanced business services for offshore finance (Wójcik 2013a), on offshore jurisdictions and foreign direct investment (FDI) (Haberly and Wójcik 2015a, 2015b), and finally on the political geography of offshore banking (Haberly and Wójcik 2014). In order to further our understanding of the extremely 'successful' development of the Cayman OFC, this paper introduces the Anglo-America/Anglosphere approach from international relations (IRs) and International Political Economy (IPE) to the analysis of the Cayman OFC. Furthermore, I analyze the important role of Japan, which has escaped virtually all existing studies about the Cayman Islands.

The remainder of this paper is organized in six sections. In the first section, I briefly discuss the existing research about the Cayman Islands. The second section analyzes the development of the oldest segment of the Cayman OFC – banking. The following two sections are dedicated to the large domain of investment. Specifically, in the third section I scrutinize the comparatively small but growing segment of direct investment before analyzing the major segment of portfolio investment, including the crucial hedge fund sector, in the fourth section. The fifth section introduces the Anglo-America/Anglosphere approach to the research on the Cayman OFC. Finally, the sixth section concludes by discussing avenues of future research as well as some policy implications.

RESEARCH ABOUT THE CAYMAN OFFSHORE FINANCIAL

Despite the importance of the Cayman Islands OFC, the literature is still surprisingly scant. Scholars from Economic Geography have arguably contributed the most to advancing our understanding of the Cayman Islands and its role in the international financial system. Roberts' (1995, 237) conclusion that the Caymans have created the image of a respectable up-market OFC and 'strategically positioned themselves at the nexus of the circuits of fast and fungible financial capital' is still valid today. Furthermore, Roberts (1995) argues that the status as a dependent territory of the UK is of central importance for the success of the Cayman Islands as an OFC, because this status guarantees political stability. She identifies a series of 1960s laws designed to attract foreign capital as a cornerstone for the development of the Cayman OFC. Rapid growth began in the 1970s after the end of the Bretton Woods system and the concomitant transition to free exchange rates, which included the abolition of capital controls by most Western countries. According to Roberts (1995), the number of foreign banks active in the Cayman Islands grew at an annual average rate of 23% between 1972 and 1982. This is primarily due to the rapid development of the Euromarkets in the City of London (Palan 1998; Burn 1999), which subsequently included OFCs such as the Bahamas and the Cayman Islands (Ridley 2007). Hudson (1998a) has compared the Cayman Islands and the Bahamas and concludes that the specific development of these OFCs can only be explained by analyzing the behavior of transnational actors (e.g., American and Canadian banks and lawyers) and important counterpart countries (primarily the USA). Moreover, he emphasizes the key role of trust by foreign financial actors in the particular OFC, which takes time to develop and in practice limits the mobility of capital (Hudson 1998b). Hudson (2000) confirms the view by Roberts (1995) that the status as a British dependency has been beneficial to the Cayman Islands, because the independence of the Bahamas in 1973 led to a flight of capital from there to Cayman.

Besides Economic Geography, IR and IPE have contributed significantly to the research about offshore finance in general and the Cayman OFC in particular. Palan (1998, 635) coined one of the most cogent definitions of offshore (finance):

> Offshore is legal enclaves distinguished from their 'on-shore' brethren, not necessarily because of their location, but because they define a territory or a realm of activities in which states choose to withhold some or all of their regulations and taxation. In that sense, offshore signals a profound fissure in the life of the state system: it denotes nothing less than the bifurcation of the

Palan et al. (2010), too, stress the importance that the Cayman Islands is a British dependency; in fact, it is still legally correct to refer to the British Overseas Territories as ‘colonies’ of the UK (Hendry and Dickinson, 2011, 4). Moreover, Palan et al. (2010) report that in 2008 Cayman was the fourth largest international banking center in the world, however, concentrating only on short-term financing. An important point that Palan et al. (2010) highlight is that most OFCs, and Cayman in particular, act as secrecy jurisdictions. Secrecy through opaque financial structures played a key role in the corporate scandals of Enron, Olympus and Parmalat as well as in the near-collapse of the large hedge fund LTCM, which all had significant subsidiaries in Cayman. According to the Tax Justice Network, the Cayman Islands is number five in the 2015 Financial Secrecy Index, which combines a secrecy score with a global scale weight in financial services exports (TJN 2015a; Cobham et al. 2015). Cayman's relatively high secrecy score of 65, however, is lower than those of other major OFCs, such as Switzerland (73) or Singapore (69), reflecting regulatory improvements in recent years (TJN 2015b).

The analysis of the Cayman Islands OFC by Freyer and Morriss (2013) focuses primarily on legal aspects, but nonetheless represents one of the most comprehensive endeavors to trace the development of this jurisdiction since the 1960s. Their core argument is that the success of the Cayman OFC stems primarily from what they call the ‘collaborative policy-making process’ that includes local politicians and regulators, foreign experts (mainly lawyers from Canada and the USA) as well as British officials. Moreover, Freyer and Morriss (2013) argue that the high reliability of the Cayman legal system, based on English common law, and – even more important – its ability to ‘innovate’ have been crucial for the rise of the Cayman Islands to one of the largest financial centers in the world. A central example that Freyer and Morriss (2013) discuss is the creation of the Cayman Islands Monetary Authority (CIMA) in the mid-1990s; the legislation for CIMA was developed together with the leading Cayman law firm Maples & Calder (founded by two British lawyers in the 1960s) and the Bank of England. Finally, Harrington (2016, 24) has argued that the creation of the Cayman Special Trust Alternative Regime (STAR) law in 1997 represented a crucial ‘innovation’ as it ‘eliminated the need for a trust to have beneficiaries – another step in the co-optation of characteristics of the corporate structure, making trusts more convenient for use in commercial investment.’

Besides the academic literature on the Cayman OFC, there are analyses from governmental and international organizations. The United States Government citizens and corporations to shift financial activities to the Cayman Islands. In addition to the obvious motivation to save taxes, another reason was to simplify transactions with third countries; the good reputation of the Cayman Islands for stability, legal certainty, and compliance with international standards also seems to play an important role for the success of this jurisdiction (GAO 2008). In 2009, the IMF has assessed the regulation of the Cayman Islands financial center. The locally available expertise in matters of financial law and accounting – mainly provided by large international advanced business services firms – is identified as an important competitive advantage of this jurisdiction. The greatest danger to the success of the Cayman Islands OFC, according to the IMF (2009, 11), is 'reputational risk' – the potential loss of confidence by foreign investors. Finally, the OECD found Cayman to be 'largely compliant' with international standards of tax information exchange (OECD 2013).

The various studies presented here have analyzed a range of important aspects concerning the development of the Cayman Islands OFC. However, the most obvious research gap is that there is no publication that has systematically compiled all available data about this OFC – both diachronically to see when large inflows occurred and geographically to determine what role certain countries play in different financial segments. Such an 'anatomy' of all relevant financial data is a fundamental prerequisite for a profound and comprehensive analysis of this pivotal OFC. The Cayman OFC can be analytically separated in three distinct yet interrelated segments: banking, direct investment, and portfolio investment.

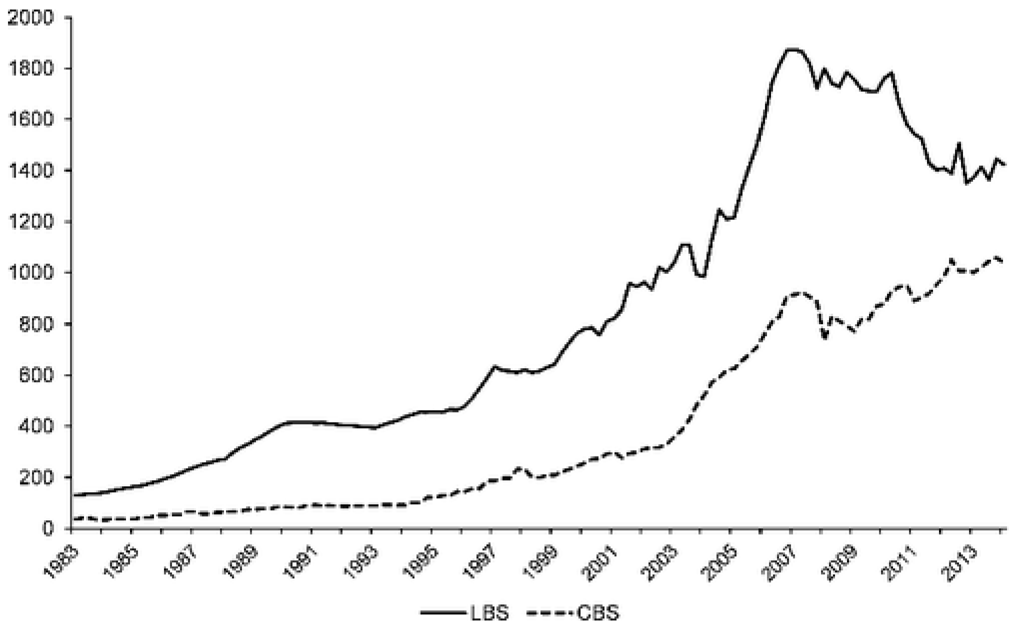
OFFSHORE BANKING

Banking represents the historical foundation upon which Cayman has built its OFC. During the 1960s, the Cayman Islands enacted a series of laws tailored to attract financial business from abroad, especially banks (TJN 2015b). The crucial decision that enabled the later development of the Cayman Islands OFC was to remain under British sovereignty when in 1962 Jamaica (which had governed Cayman) became independent. Expatriate lawyers from Britain and Canada drafted many Cayman laws, either copying them from the Bahamas or adapting British laws (Freyer and Morriss 2013). Through its history as a British colony, the Cayman Islands inherited English common law. This is of central importance to the success of the Cayman OFC, because financial actors from

English legal tradition law evolves in a bottom-up fashion from individual case decisions, thus significantly facilitating transnational finance. The key difference between common law and civil law is that in general Anglophone common law only stipulates what is prohibited, whereas civil law (France, Germany, Japan etc.) identifies what is permitted (Vlcek 2008). The consequence is that new financial 'innovations' (such as ABS, CDOs or hedge funds) can be set up easily, because strict regulation is only put in place in case of conspicuous misconduct or strong pressure from powerful foreign actors.

The Bahamas was one of the biggest offshore banking centers in the 1960s. When, however, Nassau experienced political instability in the late 1960s, leading to the independence of the Bahamas from the UK in 1973, Cayman was ready and took over much of the fleeing business (Hudson 1998a; Freyer and Morriss 2013; Ridley 2007). During the 1970s and 1980s, Cayman experienced rapid growth in offshore banking due to the liberalization and deregulation of finance pursued primarily by the USA and the UK as well as the development of the Euromarkets – themselves a kind of offshore market, because Britain decided to withhold regulations on the trading of foreign currencies in the City of London (Burn 1999). Data on cross-border banking in the Cayman Islands began in 1983 and come from the Bank for International Settlements (BIS). The BIS collects two kinds of statistics, the Locational Banking Statistics (LBS) and the Consolidated Banking Statistics (CBS), each using a different methodology. The LBS capture the positions of all banking offices resident in the reporting countries (44 in 2015, including Cayman) vis-à-vis counterparties located in over 200 countries. Thus, the LBS are based on the principle of residence. Note that in the LBS banks record their positions on an unconsolidated basis, including intragroup claims and liabilities between subsidiaries of the same bank. The CBS, on the other hand, are based on the nationality of banks. These statistics capture the consolidated positions of internationally active banking groups headquartered in the reporting countries (31 in 2015). Data include the claims of foreign subsidiaries of reporting banks but exclude intragroup positions. The CBS can thus be used to analyze the exposure of internationally active banks of different nationalities to individual jurisdictions, such as the Cayman Islands. In other words, LBS measure all international positions of banks resident in Cayman ('inside-out perspective'), whereas CBS measure the consolidated international banking claims vis-à-vis banks and non-banks located in the Cayman Islands ('outside-in perspective'). Figure 1 shows LBS (claims) and CBS data for Cayman

Figure 1 Development of the Cayman Offshore Banking Sector, 1983–2014 (billion US$).



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From 1983 to 1991, the international claims of bank subsidiaries resident in the Cayman Islands (LBS) grew much faster than the consolidated claims of internationally active banking groups from the countries participating in the CBS on counterparties resident in Cayman. From the early 1990s until the mid-2000s both measures grew with approximately the same pace; LBS increased from about US$415 billion to roughly US$1125 billion while CBS increased from around US$90 billion to over US$600 billion. Then, however, LBS grew by 50% in just two years to a peak of over US$1800 billion in 2007–2008, when the global financial crisis began, before stabilizing at around US$1400 billion from 2012 until today. The financial crisis did not stop the upward trend of the Cayman Islands in CBS. Consolidated foreign claims briefly declined from over US$900 billion in 2007 to US$735 billion in late 2008. However, since then claims have increased steadily to a new all-time peak of US$1060 billion in 2014, or roughly 350 times Cayman's GDP. These are astonishing dimensions for such a tiny jurisdiction with only about 58,000 inhabitants. In most segments of cross-border banking Cayman is in the global top five. In one specific measure the Cayman Islands is even the third largest jurisdiction. This is external loans and deposits of reporting banks vis-à-vis individual countries (unconsolidated 'outside-in perspective'; part of LBS). Table 1 shows the 15 largest jurisdictions in this segment of cross-border banking in March 2015.

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Table 1 External loans and deposits of reporting banks vis-à-vis individual countries, March 2015 (billion US$)

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The banking statistics by the BIS provide other useful information about the Cayman offshore banking sector as well. For example, 68% of the claims reported by banking offices located in the Cayman Islands are intragroup, 26% are to non-banks and only 6% are to other banks – and over 91% of all claims are in US dollar (BIS 2015a). These numbers seem to confirm the findings by the IMF (2009) that the largest factor for the Cayman banking sector is US banks that transfer client's funds to overnight sweep accounts in the Cayman Islands (over 57% of all assets in 2008). Such sweep accounts are profitable for banks and their clients (mostly large corporations) because they reduce reserve requirements and because excess funds in checking accounts can automatically be 'swept' overnight in instruments such as Eurodollar deposits, repurchase agreements or money market funds (FDIC 2009). Cayman acts as a pure conduit for foreign banks in this segment; or, in the words of Gonzalo Jalles, the CEO of Cayman Finance, 'a significant part of the banking assets registered in Cayman are US banks placing overnight deposits in their own Cayman registered branch. The money is effectively being transferred between accounts in NY and not being exposed to how a local banker in Cayman decides to invest it' (Klein 2013).

Historically, overnight sweep accounts in OFCs such as the Caymans developed because Regulation Q prohibited US banks from paying interest on demand deposit accounts. Regulation Q was repealed in 2011 and this may partly explain the drop in Cayman LBS from US$1800 billion in 2011 to about US$1400 billion since then (see Figure 1). Existing Regulation D, however, still limits the number of domestic sweeps to six per month (FED 2012). Sweep accounts in the Cayman Islands allow US banks to evade Regulation D. When the Federal Reserve discontinued the reporting of data on domestic sweeps in March 2012, they measured just over US$800 billion. The IMF report suggests that sweeps of US banks to their Cayman branches are about the same magnitude. According to US Treasury International Capital (TIC) data, in June 2015 total US banking and short-term securities claims on the Cayman Islands amounted to almost US$720 billion (or nearly 20% of total US international claims) – the second

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balance, overnight sweep accounts of US banks in the Cayman Islands increase the complexity of the US financial system, reduce reserve requirements of US banks, and potentially increase client's risk because Cayman accounts are not insured by the US Federal Deposit Insurance Corporation.

LBS data can also be used in another way, to analyze (unconsolidated) cross-border positions reported by banking offices located in the BIS reporting countries vis-à-vis counterparties resident in the Cayman Islands. According to these data, the unconsolidated claims by BIS reporting banks to the Cayman Islands measured US$1840 billion in March 2015. Interestingly, over 56% of these claims are on non-banks and only 44% on banks (BIS 2015a). In addition, a surprisingly high share of 17% is denominated in Japanese yen (70% in US dollar and 7% in euro). This is a strong indication that Japan plays a significant, yet hitherto not analyzed role in the Cayman OFC. Then there are also the CBS, which are reported by nationality of banks. The consolidated positions on counterparties resident in Cayman allow for a precise geographical analysis of the Cayman offshore banking center. Specifically, I use consolidated claims on an ultimate risk basis including other potential exposures. In March 2015, these consolidated claims on counterparties resident in the Cayman Islands amounted to US$1074 billion (BIS 2015b). Before we turn to a granular geographical analysis, it is important to note that the vast majority of the claims are on 'non-bank financial' (over 73%), which in all likelihood is mainly hedge funds and other investment vehicles. Table 2 shows the claims of the ten largest countries.

Table 2 Consolidated claims on the Cayman Islands by nationality of reporting banks, March 2015 (billion US$)

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Table 2 clearly shows that banks from the USA and Japan play the dominant role regarding consolidated claims on the Cayman Islands; together they account for 63%. Switzerland also plays a significant role, but mainly due to US$72 billion in guarantees extended to counterparties resident in Cayman (included in other potential exposures). German banks have the largest exposure to Cayman through derivatives contracts (US$18 billion) and American banks have the highest credit commitments with almost US$25 billion. A detailed analysis of the CBS data reveals several other interesting

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contracts, guarantees extended, and credit commitments) all show a strong peak in 2008-09, reflecting the prominent role of derivatives and special purpose vehicles legally domiciled in Cayman in the financial crisis. Furthermore, there are a number of abrupt jumps in the data of some countries; for example, total claims by US banks (excluding other potential exposure) leaped from US$40 billion in December 2008 to US$163 billion in March 2009. Since then US claims have increased steadily to over US$283 billion in March 2015. Japanese claims jumped from US$226 billion in December 2012 to US$284 billion in March 2013. It is unclear whether these leaps only reflect better reporting by banks or genuine increased claims. What is striking in Table 2 is that claims vis-à-vis banks are negligible compared to claims on non-bank financial. This shows that the Cayman Islands do not function as an international banking center in the sense that banks from different nationalities lend to each other but rather that foreign banks (mainly American and Japanese ones) lend money to hedge funds and other investment funds. Foreign banks resident in Cayman mostly conduct intragroup transactions in US dollar. During the last thirty years, the Cayman Islands has become one of the largest international banking centers – the global financial crisis notwithstanding. However, this section has shown that we need to dissect the anatomy of the Cayman offshore banking sector in order to understand its role in the international financial system, which lies mainly in being the offshore jurisdiction of choice for US and Japanese banks. The next section turns towards the dissection of Cayman direct investment.

DIRECT INVESTMENT

Before we analyze the geography of Cayman inward and outward direct investment, it is necessary to briefly discuss what direct investment means. The huge domain of investment is separated into direct investment and portfolio investment. Portfolio investment is defined as equity or debt instruments that are held passively to make financial gains; the characteristic feature of FDI, by contrast, is the aim of the investor to exert control over a foreign company (UNCTAD 2015a). Globally, the segment of portfolio investment is much larger than direct investment. The former amounts to US$48 trillion and the latter measures US$28 trillion (IMF 2015, 2016). This discrepancy is even more distinct for the Cayman Islands, because a significant part of global FDI is greenfield projects, i.e., the building of new facilities. The tiny size of the domestic portfolio investment is much larger than FDI and the vast majority of Cayman direct investment has to be related to finance. Table 3 shows the ten largest counterpart countries of the Cayman Islands for both inward direct investment (IDI) and outward direct investment (ODI). The data are from the Coordinated Direct Investment Survey (CDIS) by the IMF. The Cayman Islands does not participate in the CDIS. However, IDI and ODI counterpart values allow the IMF to derive data for Cayman.

Table 3 Inward and outward direct investment stocks of the Cayman Islands, 2014 (billion US$)

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CDIS data are available only since 2009. Cayman direct investment has more than doubled in just five years (IMF 2015). However, comparable to banking we do not know if these numbers reflect genuine growth or just better reporting. In 2014, total Cayman IDI amounted to about US$550, or over 180 times the GDP of the Cayman Islands – a very high value. Note that Cayman direct investment is likely even higher than these numbers suggest, because we do not have the corresponding direct investment data from other large OFCs, such as Bermuda, the British Virgin Islands (BVI) or Jersey. Cayman ODI (US$540 billion) is lower than IDI; the difference of US$17 billion is either Cayman direct investment into non-reporting OFCs or outward portfolio investment. We can assume this because given the tiny size of the domestic Cayman economy virtually all inward investment (portfolio and direct investment) has to leave the jurisdiction again, possibly changing its form while passing through. Thus, the Cayman Islands and other OFCs with minuscule GDPs are pure entrepôt jurisdictions concerning investment.

The United States is by far the largest source of direct investment with 52% of total IDI into Cayman (see Table 3). Data from the US Bureau of Economic Analysis (BEA) allow us to dissect US ODI to the Cayman Islands more precisely. The BEA only publishes US ODI data for 'United Kingdom Islands, Caribbean', which includes BVI, Cayman Islands, Montserrat, and Turks and Caicos Islands; this amounted to US$288 billion in 2014 (BEA 2015). However, we can infer from the CDIS data on US ODI that Cayman accounts for almost 100% of this stock. Hence, it is reasonable to transfer the details of BEA data on 'United Kingdom Islands, Caribbean' to the Cayman Islands. Thus, in 2014, just two categories accounted for 80% of Cayman IDI from the US, 1) holding companies categories pertaining to manufacturing are negligible (US$185 million). The USA is also the largest destination for Cayman ODI (US$100 billion). The Netherlands is the second largest source of Cayman IDI and the third largest destination for Cayman ODI (US$54 billion, respectively, US$76 billion). The Netherlands is the dominant global direct investment conduit, specializing in 'Special Purpose Entities' (SPEs). Weyzig (2013) has conducted an in-depth case study about the Netherlands and found that Dutch SPEs allow multinational enterprises (MNEs) to avoid paying withholding taxes in many developing and EU countries and enable profit shifting through royalty payments. Table 3 shows that the Cayman Islands is involved in this process via direct investment to/from the Netherlands. Luxembourg, another large global direct investment conduit, plays a similar role as the second largest destination for Cayman ODI (US$88 billion). UNCTAD (2015b) estimates that developing countries face tax revenue losses of US$100 billion per year due to the role of OFCs and SPEs in international direct investment.

Brazil and China also use the Cayman Islands as a direct investment conduit; in fact, Cayman is the largest destination of Brazilian FDI (IMF 2015). A combined China-Hong Kong would be the second largest destination for Cayman ODI. Cayman ODI to China-Hong Kong has more than doubled from 2009 to 2014 (US$41 billion to US$94 billion) (IMF 2015). Chinese MNEs have been found to channel direct investment through OFCs (directly and also indirectly via Hong Kong) not only to minimize taxes ('round-tripping') but also to conceal the ownership of assets and to gain access to foreign capital markets (Vlcek 2013; Buckley et al. 2015). The BVI (also under UK sovereignty) is by far the largest offshore jurisdiction concerning Chinese direct investment; in 2013 an astonishing US$780 billion had flown from there to China-Hong Kong (IMF 2015). The International Consortium of Investigative Journalists has revealed that – with the help of advanced business services firms such as PriceWaterhouseCoopers – many relatives of China's political and economic elite have set up shell companies in the BVI, highlighting the role of OFCs as secrecy jurisdictions (Walker Guevara et al. 2014). The role of the Cayman Islands for Chinese investment seems to be more focused on MNEs from China that seek access to US capital markets. The advanced business services firm PriceWaterhouse has devised a legal 'innovation' in 2000 that allowed many Chinese corporations to circumvent China's restrictions on foreign investment in industries such as IT, e-commerce and education (Gillis 2012). This legal device is called the 'variable interest entity' (VIE). VIEs allow Chinese corporations to publicly list abroad, usually in follows: The Chinese corporation is separated into two parts – the businesses that are open to foreign ownership are transferred to a so-called wholly foreign owned enterprise (WFOE), the restricted businesses are put in the VIE, which is owned and controlled by Chinese individuals. Then, an offshore holding company is created that owns the WFOE, typically in the Cayman Islands because until 2014 it had been the only OFC allowed to publicly list corporations in both the USA and Hong Kong (Sutherland and Anderson 2015). Subsequently, the Cayman holding lists its shares in the USA. However, the problematic aspect had been how to consolidate the restricted businesses that are part of the VIE without violating Chinese rules on foreign investment. The solution devised by accounting firms was to mimic ownership through a series of legal contracts between the Cayman company and the VIE. These contracts give the Cayman holding enough de facto control over the Chinese VIE that it is able to consolidate it under current accounting rules, even though Chinese law actually prohibits foreign investment in this sector. Thus, this legal structure constitutes a grey zone with considerable hidden risk for investors in the Cayman company, because the whole structure rests on the willingness of Chinese authorities to tolerate it. In 2014, the Chinese e-commerce giant Alibaba (the Cayman holding, that is) raised a record US$25 billion with its initial public offering (IPO) in the USA, thus probably perpetuating the VIE structure given the sheer size of the IPO. However, investors in Alibaba have no de jure control over the Chinese corporation, as they only own shares in the Cayman holding. Alibaba describes the situation to investors in a registration statement to the US Securities and Exchange Commission (SEC) as follows: ‘You may face difficulties in protecting your interests, and your ability to protect your rights through the US federal courts may be limited because we are incorporated under Cayman Islands law, we conduct substantially all of our operations in China and most of our directors and all of our executive officers reside outside the United States’ (SEC 2014).

China's government seems to tolerate the use of VIEs in restricted sectors, but only if the offshore holding is controlled by Chinese individuals, through dual class shares or other arrangements (Gillis 2015). This episode shows that Cayman is at the forefront of new developments in finance that often involve enormous risk for some parties (shareholders in this case) while benefiting others (Chinese founders, Cayman itself). Furthermore, the rise of VIEs supports the argument that there is an ‘advanced business services-offshore nexus’ (Wójcik 2013a) that drives the development of OFCs. Haberly and Wójcik (2015b) have found that Cayman is part of the ‘Anglo Alliance’

‘Greater China’ subnetworks. This section has shed new light on the specific characteristics of Cayman direct investment. However, even though it already measures about half a trillion US dollar it represents the smallest of the three financial segments. The largest segment by far is portfolio investment.

PORTFOLIO INVESTMENT

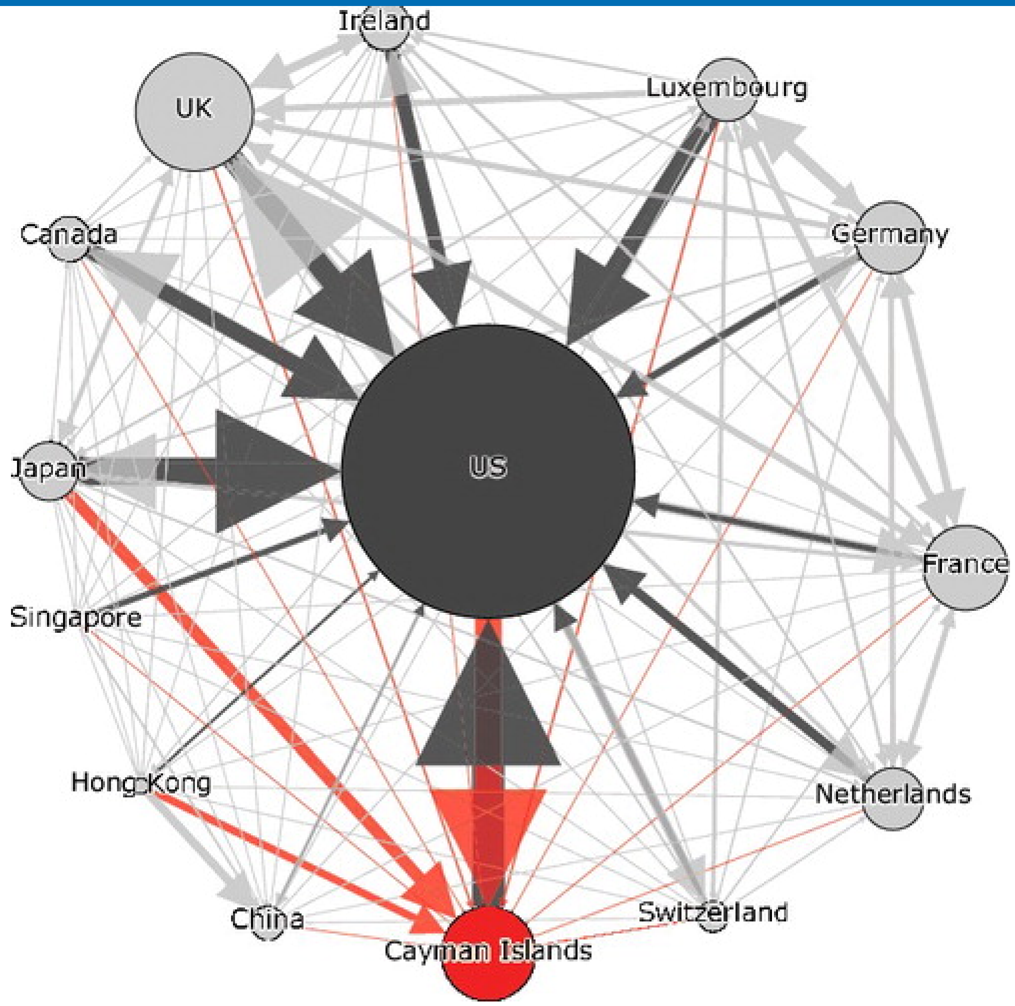
Equity and debt instruments (e.g., shares and bonds) that are held for financial gain (i.e., are below 10% of voting rights) represent the bulk of global cross-border portfolio investment. The most comprehensive data source for this segment is the Coordinated Portfolio Investment Survey (CPIS) by the IMF. In mid-2015, 70 jurisdictions have participated in the CPIS, including Cayman. However, the Cayman Islands reports only portfolio investment held by banks thus excluding the vast hedge fund sector (Lane and Milesi-Ferretti 2010; Zucman 2013). This renders the official Cayman CPIS data virtually useless. In addition to the reported assets, the IMF also publishes derived portfolio investment liabilities. These data are derived from the 70 reporting countries and cover 234 jurisdictions. Especially for non-reporting OFCs or underreporting jurisdictions, derived portfolio investment liabilities are extremely useful. For mid-2015, the Cayman Islands reported (outward) portfolio investment assets of US$61 billion (IMF 2016). The derived portfolio investment liabilities, however, reveal that Cayman (inward) portfolio investment is over US$2574 billion – 42 times more than the official Cayman data suggest. Thus, at mid-2015 the Cayman Islands have been the sixth largest financial center in the world concerning cross-border portfolio investment. The USA has been the largest jurisdiction with US$9790 billion, followed by the UK (US$3728 billion), France (US$3049 billion), Luxembourg (US$2926 billion), and Germany with US$2835 billion (IMF 2016). The huge discrepancy between reported assets (that exclude hedge funds) and derived liabilities (which include them) shows that the hedge fund industry plays a central role for Cayman portfolio investment (Zucman 2013). The financial geography of the Cayman hedge fund sector is analyzed in detail further below. First, I disaggregate Cayman portfolio investment in order to identify the largest counterpart countries. As Coates and Rafferty (2007) have noted, however, the true ‘nationality’ (i.e., the ultimate ownership) of portfolio investment is hard to verify because investment instruments may cross-multiple jurisdictions.

The countries participating in CPIS have reported US$2574 billion of portfolio investment into the Cayman Islands in mid-2015. The largest counterparty by far has been the USA with US$1206 billion (or 47%), followed by Japan (US$558 billion), Hong Kong (US$343 billion), the UK (US$91 billion), and Luxembourg with US$83 billion (IMF 2016). These five countries are responsible for almost 90% of total portfolio investment into Cayman. Due to the severe underreporting of the Cayman Islands, CPIS data are not useful for determining the destinations of Cayman portfolio investment. Japan is the only major counterparty of Cayman that reports portfolio investment liabilities, an encouraged item of CPIS; in mid-2015, Japan measured US$51 billion of inward portfolio investment from the Cayman Islands. Thus, less than one tenth of the Japanese portfolio investment of over half a trillion US dollar to Cayman has flown back. A substantial share has probably ended up in the USA. According to US Treasury data, the value of US securities held in Cayman amounted to a staggering US$1506 billion in mid-2015, making the Cayman Islands the third largest counterpart jurisdiction behind Japan and China (Treasury 2016). In fact, when excluding long-term US Treasuries, of which the central banks (or other public institutions) from both Japan and China hold more than US$1000 billion, Cayman is the largest holder of US securities in the world. US portfolio investment into Cayman amounted to US$1206 billion. Hence, Cayman portfolio investment into the USA is US$300 billion larger than vice versa. It is reasonable to assume that a substantial share of this difference can be ascribed to investors from Japan and Hong Kong that use Cayman as a conduit for portfolio investment into the large American equity markets. In 2003, the Cayman Islands Monetary Authority (CIMA) has created the Retail Mutual Funds (Japan) Regulations in order to enable Japanese financial institutions to launch hedge and mutual funds domiciled in Cayman eligible for Japanese investors. The process included several visits by CIMA personnel to Japan and substantial research to align these specific Cayman regulations to Japanese laws (Solomon Harris 2006). Thus, Cayman acts as a fund conduit for Japanese investors, providing them with a degree of secrecy when they invest in the USA, in emerging markets, and possibly in politically sensitive China (Japan Times 2012).

The combination of US Treasury data (for US securities held in Cayman) and CPIS data (for all other holdings) enables us to visualize Cayman's position in international portfolio investment. Figure 2 shows fourteen large countries in this segment that have significant investment ties with Cayman; the size of the jurisdictions is equivalent to

Cayman Islands and all portfolio investment into this jurisdiction is shown in red. The USA as the dominant country in cross-border investment is put at the center of the graph and colored dark grey (as well as the portfolio investment into the USA); all other jurisdictions are shown in light grey. Jurisdictions have been arranged for maximum visual clarity. The figure makes clear that the USA is still the undisputed center for international portfolio investment, followed by the UK. France, Germany, and Japan play a much smaller role as destinations of portfolio investment. China (for which CPIS data became available for the first time in mid-2015) is still small in portfolio investment due to strong restrictions for foreign investors (see Fichtner 2016 for four novel visualizations of global finance). Figure 2 shows that Cayman is one of the largest global nodes for portfolio investment, but primarily acts as a conduit for investment into the USA, either via American 'round-tripping' or from Japan and Hong Kong. Luxembourg, Switzerland, and the UK also report notable portfolio investment into Cayman but on a much smaller scale than compared to the USA, Japan, and Hong Kong. In mid-2015, portfolio investment from Cayman to the United States (US$1506 billion) has actually been the largest individual cross-border stock of portfolio investment in the world, ahead of US portfolio investment into the UK with US$1336 billion (note that reserve holdings, such as the large amount of US Treasuries held by Japan and China are excluded in CPIS). This massive holding of portfolio investment by Cayman residents can only be understood by analyzing the financial geography of the Cayman hedge fund industry.

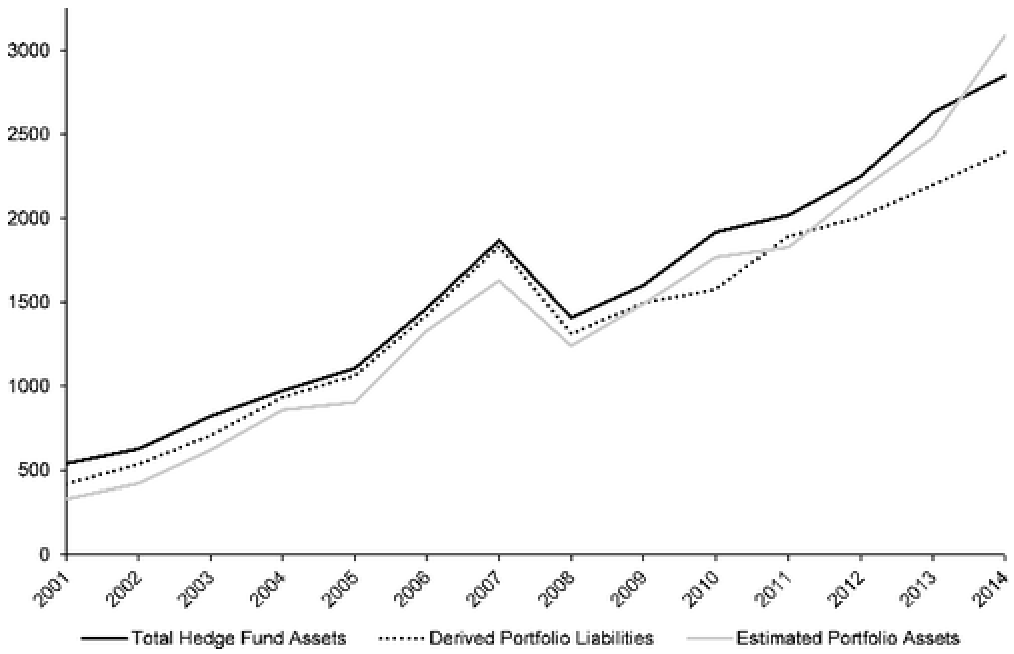
Figure 2 The Cayman Islands' position in international portfolio investment, mid-2015.



Display full size

Until recently, data on the global hedge fund industry had been exclusively collected by private companies such as Hedge Fund Research (HFR). In 2011, the International Organization of Securities Commissions (IOSCO) began publishing biannual hedge fund surveys. These surveys, however, only cover large hedge funds with assets of more than US$500 million. In 2014, over 50% of the 1486 large hedge funds surveyed have been domiciled in Cayman (IOSCO 2015) – for large UK hedge funds the value is even 69% (FCA 2015). According to the consulting firm OliverWyman, in 2013 about 60% of total hedge fund assets have been legally domiciled in the Cayman Islands – 14% in BVI, 12% in Delaware (Clarkson et al., 2014). Hence, both sources indicate that Cayman is the domicile of choice for the global hedge fund industry. The fact that the majority of the entire hedge fund industry is (legally) concentrated in Cayman is remarkable for such a tiny jurisdiction. Figure 3 plots the development of total hedge fund assets and Cayman portfolio investment. Data for hedge funds are from HFR, which maintains a database of over 7500 funds; data for derived portfolio liabilities are from the IMF, and data for estimated portfolio assets are from Zucman (2015).

Figure 3 Development of Hedge Fund Assets and Cayman Portfolio Investment, 2001–2014 (billion US$).



Display full size

The result is astonishing; all lines have moved extremely close together from 2001 to 2014. This suggests that 1) Cayman has been able to maintain its role as the leading domicile for hedge funds throughout this period, and 2) that the hedge fund industry is significantly larger than the data from HFR indicate. Calculations by the author based on CIMA's Investments Statistical Digest suggest that the Cayman hedge fund industry had approximately US$2030 billion in assets under management in 2013 (net asset value of master funds and stand-alone funds divided by 0.82 in order to adjust for the 18% of non-reporting funds; see CIMA 2014). Thus, if Cayman accounted for 60% of total hedge fund assets in 2013, the global hedge fund industry should have amounted to nearly US$3400 billion instead of US$2630 billion – this is consistent with estimates from eVestment for mid-2013, which put global assets under management by hedge funds at US$3411 billion (Baert 2013). The remaining difference between Cayman hedge funds assets of US$2030 billion and Cayman portfolio investment of US$2200 billion is probably attributable to the estimated 15% of global private equity assets that are domiciled in Cayman (Clarkson et al., 2014). Hedge funds domicile in Cayman because there are no direct taxes, because regulation is at once both lax and sophisticated (based on English common law), and finally because the jurisdiction enables a certain degree of secrecy. The Financial Times revealed in 2011 that a small

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virtually impossible for them to effectively fulfill their fiduciary duties to investors; in the words of a quoted expert: 'We have specialist directorship firms building obscenely large portfolios of directorships without even earning a rebuke from the Cayman's regulator' (Jones 2011). A case that illustrates how hedge funds use Cayman secrecy is Tiger Global. This fund created shell companies in Cayman with firm names including the legal suffices of European countries, such as the Dutch 'NV' or the German 'GmbH'. Then 'Blau GmbH', 'Fest NV' and other shells build up short positions in several listed corporations, whose shares fell significantly after negative research reports emerged, which could have been ordered by Tiger Global, netting the fund substantial profits (Johnson 2014). Paradoxically, Cayman regulations have to be loose to a certain extent to give hedge funds enough 'flexibility', but at the same time, the regulatory infrastructure has to be sophisticated to maintain the image of a trustworthy up-market OFC to investors and to avoid pressure by foreign countries.

Probably due to foreign pressure, the Cayman regulator began publishing yearly investment statistics in 2008. These data allow for a granular analysis of the financial geography of Cayman's giant hedge fund sector, which comprised over 11,300 funds at end-2013 (CIMA 2014). I do not use data on all registered funds, but only on master funds to avoid double-counting through funds of hedge funds (detailed data on stand-alone funds are not available). Master funds had net assets of US$1230 billion in 2013, which represents about 60% of total Cayman hedge fund assets. About 75% of master fund assets have been invested in 'North America' (Canada and the USA) and only 19% in 'Europe' (probably mainly in the UK). Thus there is a strong concentration of hedge fund investment in the USA (investment in Canada is likely minor). Hedge funds require a range of services to function, such as net asset calculation as well as registrar and transfer agency services. CIMA data show that the vast majority of these services is being provided in just three jurisdictions, all of which are English-speaking: the Cayman Islands (34%), Ireland (28%), and the USA (22%). Finally, there is detailed information about the location of hedge fund managers; these data are crucial because they show where the investment decisions are actually being made. Again, we find a significant geographic concentration in English-speaking, or Anglophone, countries. The United States is clearly dominant: an extraordinary 70% of all master fund assets have been managed in the USA. The UK (i.e., London) accounted for 16%. This means that approximately 86% of master hedge fund assets have been managed in just these two countries. For the USA, CIMA statistics provide granular data about hedge fund of all net assets domiciled in Cayman, Connecticut accounted for 11%, and California for 7%. Illinois and Massachusetts accounted for about 3% each, while roughly 2% have been managed in Texas, New Jersey and Minnesota, respectively (CIMA 2014). Thus, just two greater regions acted as the management location for at least 70% of total assets: New York-Boston (including Greenwich and Westport in Connecticut) and London. From research about the world city network we know that New York and London are the two dominant global financial centers (Taylor et al. 2011; Taylor and Derudder 2015); Wójcik (2013b) – drawing on Strange (1998) – uses the term 'the New York-London axis', or simply 'NY-LON', to describe the joint dominance of these to interconnected financial centers (see Norfield 2016 for an insightful analysis of London's role in global finance). The extreme concentration of global hedge fund managers in these two greater regions, however, seems unparalleled (with the possible exception of the investment banking industry, which is also concentrated in NY-LON – and strongly connected to hedge funds). The Anglo-America or Anglosphere approach from IR and IPE seems especially apposite to explain the joint dominance of the USA and the UK in global finance. Moreover, this approach provides a plausible explanation for the huge size and the specific anatomy of the Cayman OFC that this paper has dissected.

THE ANGLO-AMERICA/ANGLOSPHERE APPROACH

The Anglosphere approach by Vucetic (2011, 7) builds upon constructivism and conceptualizes the community of the English-speaking countries as based on a shared racialized Anglo-Saxon identity, 'a social kind that exists because people believe it exists'. Vucetic bases his analysis on historical case studies about crucial interactions between the core countries of the Anglosphere (USA, UK, Canada, Australia, and New Zealand). He deliberately chose episodes that directly concern the field of national security as this domain is commonly theorized to represent the least-likely case for cooperation between sovereign states in an 'anarchical' system of IRs. He argues that it clearly is a puzzle for most conventional IR theories how the 'Anglo-American war became 'unthinkable' while peace and cooperation became dependable' (Vucetic 2011, 20). Hence, there is a particularly high level of trust between Anglophone decision-makers because they generally do not perceive counterparts from the Anglosphere as an 'other'. Gamble (2006, 9) uses the term Anglo-America and argues that the center, but consists of different states and nations, such as Australia, Britain, Canada, Ireland, New Zealand, Scotland, Wales, and the United States. He argues that 'Anglo-America is a political space constituted by wider economic, political, ideological and cultural relationships' (Gamble 2003, 86). Scholars have found empirical evidence for the existence of a specific Anglo-American model of capitalism. Hall and Soskice (2001), and Amable (2003) argue that the Anglophone economies constitute a distinct socio-economic model – 'liberal market economies' or 'market-based economies' in which financial markets play a pivotal role. Moreover, the legal systems of all Anglophone countries and territories are based on common law, which facilitates financial activities within this Anglo-American transnational space. Green (2015) has shown that an 'Anglo-American developmental sphere' was crucial to the development of the pivotal Euromarkets in London, which, in turn, led to a 'transatlantic regulatory feedback loop' that induced wider international financial deregulation. Thus, Anglo-America has played a key role for financial globalization. The revelations about the unparalleled cooperation by the Anglophone countries in the extremely sensitive field of intelligence (dubbed the 'Five Eyes') have corroborated the cogency of the Anglo-America/Anglosphere approach significantly (McGregor 2013).

Virtually all international socio-economic statistics treat the Anglophone countries solely on the grounds where they are located geographically, i.e., the UK is seen as part of 'Europe', Australia as belonging to 'Asia-Pacific', and Cayman, BVI and others as 'Caribbean'. The Anglo-America/Anglosphere approach, on the other hand, suggests that these states and territories generally have much more in common with other Anglophone countries than with neighboring countries and, thus, should be analyzed together. Research by Heemskerk and Takes (2016) supports this view. Utilizing community detection through modularity maximization, they analyze how the largest one million global corporations are connected through interlocking directorates. They find evidence for the existence of a globally dominant 'North Atlantic & Commonwealth Community', which integrates the Anglophone countries. Applying the Anglo-America/Anglosphere approach to the Cayman Islands opens new avenues for explaining the extraordinary size and the unique anatomy of this central OFC. The fact that Cayman is under British sovereignty has been seen as central by Roberts (1995) and Hudson (2000) as this status provides political stability. What has not been discussed so far is that this political status also provides a high level of trust to the United States, the predominant counterparty of Cayman. In 2009, London suspended the governor in charge for two years due to evidence for widespread corruption (Reuters 2009; see also Clegg 2012; Hintjens and Hodge 2012). This event demonstrated that the UK will guarantee stability in all of its offshore 'colonies', such as BVI, Bermuda, Jersey or Cayman, which makes them qualitatively different from (aspirant) OFCs that are independent, such as Panama, Belize or the Seychelles.

The development of the Cayman OFC is inextricably linked with its sovereign power, the UK. In the 1960s, the Colonial Office assisted Cayman (as well as the BVI and others) with the adoption of British laws in order to establish OFCs, reportedly to avoid being left with financially dependent territories in the Caribbean (Picciotto 1992; Freyer and Morriss 2013). However, British support for the Cayman OFC continued after London ended development aids to Cayman in the mid-1970s, supposedly because it was thought that Cayman and other British OFCs brought more business to the City of London than they caused tax avoidance in the UK (Freyer and Morriss 2013). London also played a key role in repeatedly assisting negotiations with Washington when the USA complained about conspicuous deficiencies in Cayman regulations. Arguably, only this tripartite relation has made it possible that Cayman became the domicile of choice for the hedge fund industry and the largest holder of US securities (excluding Treasuries) in the world. Thus, the Cayman Islands can be conceived as a quintessentially Anglo-American OFC. A final key link between Anglo-America and the Cayman OFC is the advanced business services-offshore nexus identified by Wójcik (2013a). Virtually all leading advanced business services firms, such as PriceWaterhouseCoopers, KPMG, Ernst&Young, and Deloitte, as well as most large global law firms are Anglo-American, i.e., have the majority of their operations in Anglophone countries (primarily in NY-LON) and are often the result of mergers between American and British firms. Anglo-American advanced business services firms have played a pivotal role for the ascent of the Cayman OFC. In fact, two former heads of the Cayman regulator CIMA have been recruited from such firms, which are involved in the creation of most Cayman laws pertaining to finance (Freyer and Morriss 2013). The nexus between the UK, advanced business services, and Cayman can be also be inferred from the very high value of British services exports to the Cayman Islands, which have amounted to about US$3.5 billion in 2013 (ONS 2015). This value is higher than British services exports to much larger countries such as Denmark, India or Hong Kong.

The Anglo-America/Anglosphere approach presented in this paper as one plausible also differs from, the concept of the ‘Second British Empire’ by Palan (2015). According to that argument, the UK dependencies (Bermuda, BVI, Cayman, Jersey, Guernsey etc.), but also former colonies such as Cyprus, Hong Kong, and Singapore, form a ‘Second British Empire’ in finance, which is centered on the City of London. This concept is indeed very useful to highlight the ancillary role of the UK ‘colonies’ for the strong position of the City of London in international finance (see also Norfield 2016 on this point); however, I would be skeptical to include Hong Kong and Singapore, because both are clearly not under the sovereignty of the UK anymore, and also compete with the City in certain financial segments. The Anglo-America/Anglosphere concept has the advantage to stress the strong trans-Atlantic financial integration of the City with New York (i.e., NY-LON). Whereas the term ‘Second British Empire’ would suggest that London is firmly in control I would argue that in many cases there is a joint Anglo-American leadership in international finance (see Fichtner 2016 for a study of the persistent structural power of Anglo-America in nine key segments of global finance). The analysis of the Cayman Islands OFC in this paper shows that while it is an important factor that this jurisdiction is under UK sovereignty, Cayman primarily caters to the interests of American (and to a lesser degree also Japanese) investors and is not as strongly connected to the City of London.

CONCLUSION

Economic Geography, IR and IPE as well as economics have increasingly engaged the important topic of offshore finance in recent years. The objective of this paper is to analyze one of the largest and most central OFCs in great detail – the Cayman Islands. In particular, I contribute to the literature by dissecting the anatomy of the Cayman OFC in a very precise and fine-grained manner. This novel dissection of the Cayman OFC reveals that in all three financial segments – offshore banking, direct investment, and portfolio investment – the largest counterparty is the United States. American banks utilize Cayman intensively for overnight sweep accounts and other intra-group transactions. Cayman direct investment and portfolio investment is also clearly dominated by the USA. However, the Cayman Islands is not an OFC exclusively catering to the USA. This paper is the first to analyze the important role of Japan for the Cayman Islands. Japanese banking claims on Cayman residents are almost as large as American ones and Japanese portfolio investors have routed half a trillion US dollar to this tiny

50% of US portfolio investment to Cayman, even though the size of the Japanese economy is only about a quarter of the American economy. The reason is that the Cayman regulator has created specific regulations to set up investment and hedge funds for Japanese investors.

Cayman is qualitatively different from most other OFCs, especially from many small aspirant ones. The primary aim of the Cayman Islands seems not to be to attract illicit financial flows (although there is probably a significant amount of black money in Cayman), but to function as a conduit for large international financial institutions, enabling them to reduce taxes as well as evade ‘onshore’ regulation. In that regard, Cayman is probably more comparable to Luxembourg, which acts as a major hub for European investment funds and large MNEs, than to Switzerland, which mainly attracts private funds or the Netherlands, which acts as the largest direct investment conduit. The Cayman Islands is one of the largest OFCs in the world, but, more importantly, it is a central node of contemporary global finance. This tiny group of islands in the Caribbean acts as the global domicile of choice for the hedge fund industry. Other financial ‘innovations’ for which Cayman has played a key role are opaque CDOs that contributed to the financial crisis as well as dubious VIEs used by many Chinese corporations to get access to US capital markets. Most of these ‘innovations’ bring clear benefits to Cayman and certain financial actors, while entailing significant hidden costs and risks for other groups and countries, thus impairing the transparency and the stability of global financial markets. The global financial crisis has caused a temporary decline of the Cayman OFC; however, all three financial segments hit new all-time highs in recent years.

A novel contribution to the analysis of the Cayman OFC by this paper is the introduction of the Anglo-America/Anglosphere approach. Cayman represents one node in a triangle with the USA and the UK – or with NY-LON to be more precise in geographical terms. No other financial industry illustrates this better than hedge funds, which are quintessentially Anglo-American. Hedge fund managers are extremely concentrated in NY-LON; hedge fund support services are being provided mostly by Cayman, Ireland, as well as the USA; and the legal domiciles of these funds are concentrated primarily in the Cayman Islands with BVI and Delaware acting as secondary legal centers. Hence, Cayman acts as a core element of the global Anglo-American hedge fund industry. Drawing on Palan's (1998) definition of offshore, Cayman could be seen as a legal enclave within the Anglo-American transnational juridical space for the benefit of large withholding of regulation and taxation while at the same time guaranteeing political stability and trust. Moreover, the Cayman Islands plays a key role in connecting Japan and China (including Hong Kong) to Anglo-American financial markets. Cayman's ‘strength’ in this context is that it combines relaxed regulation with relatively sophisticated financial authorities that are able to react quickly to international developments. In this way, Cayman enables indirect access to the crucial US financial markets that may be particularly suited for investors from Asia, especially China. Future research should analyze the role of Anglo-America for offshore finance, focusing on key OFCs such as Bermuda, BVI, Delaware and Ireland, and their link to NY-LON. Furthermore, studies on the nexus between Anglo-America, advanced business services firms (e.g., the Big 4 accounting firms), and offshore finance are crucial.

Finally, a few policy implications arise from the findings of this paper. At the very least, all large OFCs such as Cayman should have to participate fully in CDIS and CPIS (without being able to exclude sectors, such as hedge funds) or face serious consequences. Only complete reporting enables regulators and researchers to analyze the complex global network of direct and portfolio investment. In addition, the introduction of mandatory country-by-country-reporting for large multinational corporations would bring much needed transparency concerning their financial activities in OFCs. A more ambitious measure would be to create a comprehensive global financial register as proposed by Piketty (2014) and Zucman (2015), including mandatory participation for tax havens. This would remedy the fact that cross-border financial stocks involving trusts (an Anglo-American common law specialty) are almost completely unaccounted for (Harrington 2016). Large ‘up-market’ OFCs, such as Cayman or Luxembourg, seek to minimize reputational risk and are therefore generally receptive to reforms – if foreign political pressure is strong enough. Thus, the amelioration of offshore finance ultimately depends on the political will of the OECD countries, and particularly that of the USA and the UK.

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