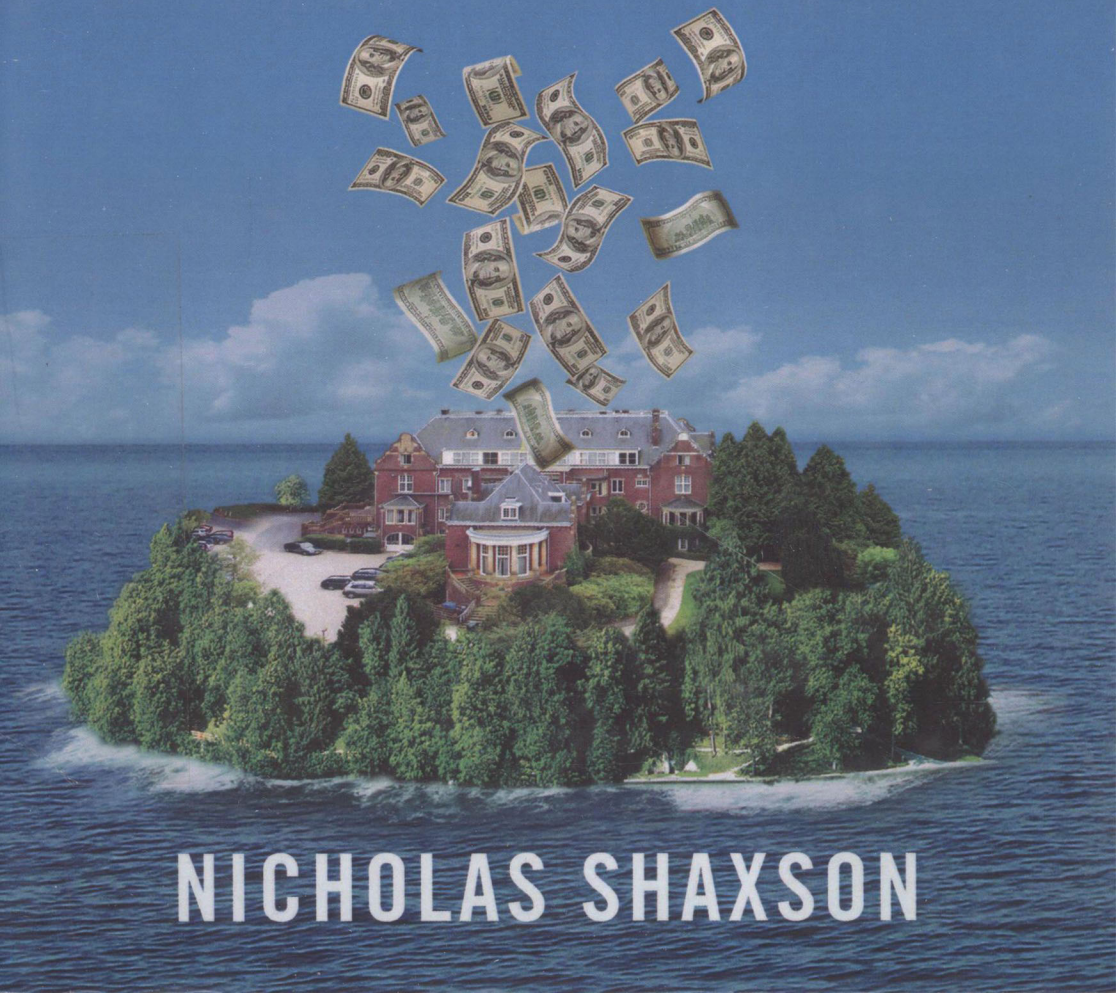


TREASURE ISLANDS

UNCOVERING THE DAMAGE OF
OFFSHORE BANKING AND TAX HAVENS



NICHOLAS SHAXSON

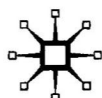
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"Perhaps the most important book published in the UK so far this year."

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"*Treasure Islands* has prised the lid off an important and terrifying can of worms."

—*Literary Review*

"Shaxson shows us that the global financial machine is broken and that very few of us have noticed."

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"In this riveting, well-written exposé, Shaxson goes deep into the largely unexamined realm of offshore money. In the process, he reveals that this shadow world is no mere sideshow, but is troublingly central to modern finance, with the US and the UK as leaders. The resulting abuses are widespread, ranging from tax revenue stripping from African nations to individuals and corporations escaping enforcement and accountability. A must read for anyone who wants to understand the hidden reasons why financial services firms have become so powerful and impossible to reform."

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"Trade and investments can play a profoundly productive role on the world economy. But so much of the capital flows that we see are associated with money laundering, tax evasion, and the wholesale larceny [*sic*] of assets often of very poor countries. These thefts are greatly facilitated by special tax and accounting rules or designed to "attract capital" and embodying obscure and opaque mechanisms. Shaxson does an outstanding and socially valuable job in penetrating the impenetrable and finds a deeply shocking world."

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—David Wearing, School of Public Policy, UCL,
London’s Global University

“An absolute gem that deserves to be read by anyone interested in the way contemporary globalization is undermining social justice. Give it to your sons, daughters, families, favorite legislators, and anyone else needing stimulation of their thought buds. This masterpiece illuminates the dark places and shows the visible hand of governments, corporations, banks, accountants, lawyers, and other pirates in creating fictitious offshore transactions and structures and picking our pockets. This financial engineering has enabled companies and the wealthy elites to dodge taxes. The result is poverty, erosion of social infrastructure and hard-won welfare rights, and higher taxes for ordinary people. Tax will be the decisive battleground of the twenty-first century as no democracy can function without it or provide people with adequate educations, healthcare, security, housing, transport, or pensions. Nicholas Shaxson has done a wonderful job in lifting the lid off the inbuilt corruption that has become so naturalized in the western world.”

—Prem Sikka, Professor of Accounting, University of Essex, UK

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PROLOGUE

An Offshore Awakening

ONE NIGHT IN SEPTEMBER 1997 I RETURNED home to my flat in North London to find that a man with a French accent had left a message on my answering machine. Mr. Autogue, as he called himself, had heard from an editor at the *Financial Times* (whom I was writing for) that I was to visit the oil-rich country of Gabon on Africa's western coastline, and he said he wanted to help me during my visit. He left a number in Paris. Curious as hell, I rang back the next morning.

This was supposed to be a routine journalist's trip to a small African country: I wasn't expecting to find too much to write about in this sparsely populated former French colony, but the fact that English-speaking journalists almost never ventured there meant I would have the place all to myself. When I arrived, I discovered to my surprise and alarm that Mr. Autogue had flown out to the capital of Libreville with an assistant on first-class Air France tickets and they had booked themselves into the city's most expensive hotel for a week—and their sole project, he cheerfully admitted, was to help me.

I had spent years watching, living in, and writing about the curve of oil-soaked African Atlantic coastline that ranges from Nigeria, in North Africa, through Gabon and down to Angola, farther south. Today this region supplies almost a sixth of U.S. oil imports¹ and about the same share of China's; and beneath a veneer of great wealth in each place lies terrible poverty, inequality, and conflict.

Journalists are supposed to start on the trail of a great story somewhere dramatic and dangerous. I found my story here unexpectedly, in a series of polite if unsettling meetings in Libreville. Lunch with the finance minister? No problem: Monsieur Autogue arranged it with a phone call. I drank a cocktail in a hotel lobby

with the powerful half-Chinese foreign minister Jean Ping, who later became president of the U.N. General Assembly; the estimable Mr. Ping gave me as much of his time as I needed for my interview and asked graciously about my family. Later, the oil minister clasped me by the shoulder and jokingly offered me an oil field—then withdrew his hand, saying, “No: these things are only for *les grands*—the people who matter.”

Never more than five hundred yards from foul African poverty on the streets of Libreville, I spent a week wandering about in a bubble. Mr. Autogue’s attempts to keep my diary full made me determined to find out what it was that he might be wanting to hide. My new best friend had opened for me a zone of air-conditioned splendor: I was ushered to the front of queues to meet with powerful people, who were always delighted to see me. This parallel, charmed world, underpinned by the unspoken threat of force against anyone inside or outside the bubble who would disrupt it, is easy to miss in the affluent and easy West. In Africa the jolt was enough to begin to shake me from my sleep.

I had stumbled into what later became more widely known through a scandal in Paris as the so-called Elf affair.

The scandal began in 1994 when U.S.-based Fairchild Corp. opened a commercial dispute with a French industrialist, triggering a stock exchange inquiry. Unlike in more adversarial Anglo-Saxon legal systems, where the prosecution jousts with the defense to produce a resolution, the investigating magistrate in France is more like an impartial detective inserted between the two sides. He or she is supposed to investigate the matter until the end, when the truth is uncovered. In this case Eva Joly, the Norwegian-born investigating magistrate, found that every time she investigated something new leads would emerge. Her probes just kept going deeper. She began receiving death threats: A miniature coffin was sent to her in the post, and on a raid of one business she found a Smith & Wesson revolver, fully loaded and pointed at the entrance. But she persisted: Other magistrates became involved, and as the extraordinary revelations began to accumulate, they began to discern the outlines of a gigantic system of corruption that connected the French state-owned oil company Elf Aquitaine with the French political, commercial, and intelligence establishments, via Gabon’s deeply corrupt ruler Omar Bongo.

Bongo’s story is a miniature tale of what happened when France formally relinquished its colonies. As countries in Africa and elsewhere gained independence, the

old beneficiaries of the French empire set up new ways to stay in control behind the scenes. Gabon became independent in 1960, just as it was starting to emerge as a promising new African oil frontier, and France paid it particular attention. France needed to install the right president: an authentic African leader who would be charismatic, strong, cunning, and, when it mattered, utterly pro-French. In Omar Bongo they found the perfect candidate: He was from a tiny minority ethnic group and had no natural domestic support base, so he would have to rely on France to protect him. In 1967, aged just 32, Bongo became the world's youngest president, and for good measure France placed several hundred paratroopers in a barracks in Libreville, connected to one of his palaces by underground tunnels. This intimidating deterrent against coup plots proved so effective that by the time Bongo died in 2009, he was the world's longest-serving leader.

In exchange for France's backing Bongo gave two things. First, he gave French companies almost exclusive access to his country's minerals, on highly preferential terms that were deeply unfair to the people of Gabon. The country became known as French companies' *chasse gardée*—their private hunting ground. But the second thing Bongo provided was more interesting. He allowed his country, through its oil industry, to become the African linchpin of the gigantic, secret Elf system—a vast, spooky web of global corruption secretly connecting the oil industries of former French African colonies with mainstream politics in metropolitan France, via Switzerland, Luxembourg, and other tax havens. Parts of Gabon's oil industry, Joly discovered as she dug deeper and deeper in Paris, had been serving as a giant slush fund: a pot of secret money outside the reach of French judicial authorities in which hundreds of millions of dollars were made available for the use of French elites. An African oil cargo would be sold, and the proceeds would split up into a range of bewildering accounts in tax havens, where they could be used to supply bribes and baubles for whatever the unaccountable elites who controlled the system deemed fit.

Out of this pot, money flowed secretly to finance French political parties, the intelligence services, and other well-connected parts of French high society. Elf's secret money greased the wheels of French political and commercial diplomacy around the globe: France's biggest corporations were allowed to use this West African oil pot as a source of easy bribe money to support their bids for giant contracts ranging from Venezuela to Germany to Jersey to Taiwan—and the out-of-sight Gabon connection meant that the money trails did not lead to them. (One man told me how

he once carried a suitcase of cash provided by Omar Bongo to pay off a top rebel separatist in the Angolan oil enclave of Cabinda, where Elf had a lucrative contract.)

President Bongo, for his part, was one of the smartest political operators of his generation and tapped into French Freemasonry networks and African secret societies to become one of the most important power brokers in France itself. He was the key to French leaders' ability to bind *les grands*—opinion-formers and politicians from across Africa and beyond—into France's postcolonial foreign policy. This immensely powerful, corrupt subterranean system helped France punch above its weight in global economic and political affairs and remain significantly in control after independence, behind the scenes. A local journalist summed the relationship up for me most effectively. "The French went out of the front door," he said, "and came back in through a side window."

The system emerged gradually, but by the 1970s it was already serving as a major secret financing mechanism for the main French right-wing party, the Rally for the Republic (RPR).² When a Socialist, François Mitterrand, became French president in 1981, he sought to break into this right-wing Franco-African offshore cash machine and installed his man Loïk le Floch-Prigent at the head of Elf to do the job. But the latter was wise enough not to cut out his rivals in the RPR. "Le Floch knew that if he cut the financing networks to the RPR and the secret services, it would be war," explained the French authors Valerie Lecasble and Airy Routier in an authoritative book on the affair.³ "It was explained that, instead, the leaders of the RPR—Jacques Chirac and Charles Pasqua—did not mind the Socialists taking part of the cake, if it were enlarged." So the Elf system grew. It became more baroque, complex, and layered, and it began to branch out into international corruption so grand that Mitterrand's man le Floch-Prigent was moved to describe France's intelligence services, which dipped freely into the slush, as "a great brothel, where nobody knows any more who is doing what."⁴

The system was a kind of open secret: A few well-connected French insiders knew all about it, and a fair number of educated outsiders in France knew something important was afoot but didn't know the details and largely ignored it. Yet almost nobody could see the whole thing in overview. Everything was connected through tax havens. The paper trails, as the magistrates were discovering during my Libreville trip, were typically sliced among Gabon, Switzerland, Liechtenstein, Jersey, and beyond. Joly admitted that even though she probed deeply she only ever saw fragments of the

whole picture. “Endless leads were lost in the shifting sands of the tax havens. The personal accounts of monarchs, elected presidents-for-life, and dictators were being protected from the curiosity of the magistrates.”⁵

My trip to Gabon in late 1997 came at an exquisitely sensitive time. On November 7 of that year, less than a week after I left Libreville, Christine Deviers-Joncour, a former lingerie model, was sent to jail in the southern suburbs of Paris, still protecting the secrets of her lover Roland Dumas, the French foreign minister. She was jailed for suspected fraud after magistrates found that Elf had paid her over \$6 million to help “persuade” Dumas, a haughty prince of the Paris political clans, to do certain things—notably to reverse his public opposition to the sale of Thomson missile boats to Taiwan. On an Elf credit card she had bought him gifts, including a pair of hand-made ankle boots from a Paris shop so exclusive that its owner offered to wash customers’ shoes once a year in champagne. Nobody thanked her for her discretion, and five and a half months in jail gave her time to reflect on her treatment. “A flower, a single flower, even sent to me anonymously [in jail] would have been enough,” she later explained.⁶ “I would have known it came from Roland.” The following year she cast aside the code of silence and published a book, *The Whore of the Republic*, which became a best seller in France.

So when I visited Gabon at that especially tricky moment, the Elf networks must have wondered why this English journalist was nosing around in Libreville. Was I really a journalist? No wonder Mr. Autogue took such an interest in me. Recently, I tried to find him, to ask him about our week together. His old phone numbers no longer work, several Africa experts in Paris hadn’t heard of him, Internet searches turned up no trace of him or the company he claimed to represent, and the only person with that name in the French phone book has, a surprised-sounding wife in a rural Dordogne village informed me, never been to Gabon.

The Elf system, when I visited, was dying. The magistrates’ investigations were in full swing, and they finally secured 31 convictions in November 2004 after eight years’ work. Elf Aquitaine has since been privatized and is now part of the Total group, which has an utterly different character from the old Elf. Still, Elf was not the only creature in the corrupt Franco-African system—myriad smaller pots of offshore money existed too. And though Elf is long gone, it seems that the system is not really dead. When President Nicolas Sarkozy of France came to power in 2007 the first person he called was not the president of Germany or the United States or the European

Commission but Omar Bongo. The French troops remain in place in Gabon today, connected by underground tunnels to the presidential palace. In January 2008 the French aid minister, Jean-Marie Bockel, complained that a “rupture” with a corrupt past that French leaders had promised “is taking its time to arrive.” He was summarily sacked.⁷ If the Elf system is dead, then French elites seem to have replaced it with something else.

Gabon is on no list of tax havens anywhere. But the Elf system that it hosted was part of, and a metaphor for, the offshore world. To understand this, it is necessary to explain some fundamental truths about what a tax haven or offshore jurisdiction is.

Tax havens provide escape routes from rules and laws elsewhere. These two words, “escape” and “elsewhere,” will crop up repeatedly in this book. The zero tax rates offered in the Cayman Islands, for example, are not designed for Caymanians but are set up to attract the business of North and South Americans, Europeans, Asians, Middle Easterners, and Africans alike.

In truth, the term *tax haven* is a bit of a misnomer because these places offer an escape not just from taxes but from many other rules and regulations too. If a person or entity wants to do something but is forbidden by law from doing it at home, it escapes to somewhere else to do it. (To be more precise, it isn’t usually the entity but its money that escapes.) The common feature of tax havens is that they offer secrecy. Once the escape has been effected, the escapee is very hard to find. The users of tax havens might be escaping any number of different laws or regulations: taxes, criminal laws, insider trading rules, inheritance rules, environmental laws, or financial regulation. If there is a law to stop or regulate it, there will probably be places that offer escape routes from that law. A simple example of an offshore escape is when a U.S. citizen, say, parks \$10 million of drug money in a bank account in Panama. It will be exceedingly difficult for the U.S. authorities to find that money, let alone tax it.

The Elf system allowed bribes to be paid and other nefarious acts to be committed *elsewhere*—without the paper trails touching French soil. Offshore. The system did not exactly exist anywhere: It flourished in the gaps *between* jurisdictions. Elsewhere became nowhere.

The Elf affair illustrates another fundamental offshore truth. The escape routes from the rules and laws of society are provided almost exclusively for the benefit of

wealthy and powerful insiders—leaving the rest of us to pick up the bill. The Elf system, a gargantuan octopus of corruption, affected ordinary people in both Africa and France in the most profound, if mostly invisible, ways. Ordinary African citizens saw their nations' oil money being siphoned off to the rich world through unfair oil contracts and general corruption, while French protection made Gabon's leaders invulnerable and hence unaccountable to their citizens—at the same time that the Elf system made France's elites unaccountable to that nation's citizens too.

These very same principles apply to the offshore system more generally. Because of tax havens, we have ended up with one set of rules for the rich and powerful and another set of rules and laws for the rest of us—and this applies to citizens of rich and poor countries alike. Just like the Elf system, offshore is a project of elites against their, and our, societies. It is not so much about crime or taxes, important though they are. This is a story about how political power is distributed in the world today.

It is essential to understand from the outset that the offshore system is ultimately not about celebrity tax exiles and mobsters—though they are regular users of the system. It is about banks and financial services industries. This book will show that the offshore system is the secret underpinning for the political and financial power of Wall Street today. It is the fortified refuge of Big Finance.

The offshore system is also about a more generalized subversion of democracy by our increasingly unaccountable elites. "Taxes are for the little people," the New York millionaire Leona Helmsley once famously said. She was right, though in the end she wasn't big enough to escape prison herself. The media baron Rupert Murdoch is different. His News Corporation, which owns Fox News, MySpace, and any number of other media outlets around the globe, is a master of offshore gymnastics, using all legal means available. When *The Economist* magazine investigated in 1999, it reckoned that News Corporation paid a tax rate of just 6 percent—compared with 31 percent for its competitor Disney.⁸ Neil Chenoweth, an Australian reporter, probed News Corporation's accounts and found that its profits, declared in Australian dollars, were A\$364,364,000 in 1987, A\$464,464,000 in 1988, A\$496,496,000 in 1989, and A\$282,282,000 in 1990.⁹ The obvious pattern in these numbers cannot be a coincidence. As John Lanchester wrote in the *London Review of Books*: "That little grace note in the sums is accountant-speak for 'Fuck you.' Faced with this level of financial wizardry, all the ordinary taxpayer can do is cry 'Bravo l'artiste!'"

Much of what happens offshore is technically legal. A lot of it is plainly illegal and often criminal. And there is a vast gray area in between. All of it is profoundly dangerous, corrosive to democracy, and morally indefensible. Eva Joly explains what the Elf affair taught her about the distribution of power in the world. "I realized I was no longer confronted with a marginal thing but with a system," she said. "I do not see this as a terrible, multifaceted criminality which is besieging our [onshore] fortresses. I see a respectable, established system of power that has accepted grand corruption as a natural part of its daily business."¹⁰

From this strange Franco-African tale emerges one more important point, which will be a recurring theme of this book. In decades and centuries past, colonial systems helped rich countries preserve and boost their elites' wealth and privileges at home. When the European powers left their colonies after the Second World War, they replaced formal controls over their ex-colonies with different arrangements to retain a measure of control behind the scenes. The Elf system was the main way that France achieved this. Britain did it with the modern offshore system, its financial replacement for empire. Citizens of the United States are paying the price.

"It has taken me a long time to understand," explains Joly, "that the expansion in the use of these jurisdictions [tax havens] has a link to decolonization. It is a modern form of colonialism."¹¹

Long before my first visit to Libreville I had noticed how money was pouring out of Africa, often into tax havens, but the secrecy surrounding this financial trade made it impossible to trace the connections. Financial institutions, and occasionally their accountants and lawyers, would surface in particular stories, then slip back into an offshore murk of commercial confidentiality and professional discretion. Every time a scandal broke, these intermediaries' crucial roles escaped serious scrutiny. Africa's problems, the story went, had something to do with its nations' rulers, or its cultures and societies, or the oil companies. It was their fault.

The providers of offshore secrecy were clearly a central part of all these dramas—but the racket was very hard to penetrate, and nobody seemed very interested in trying. It was only in 2005 that the threads properly started to come together for me. I was sitting with David Spencer, a New York attorney previously with Citicorp, talking about transparency in the public finances of West African

oil-producing nations. Spencer was getting agitated about matters that were not at all on my agenda: accounting rules, U.S. tax exemptions on interest income, and transfer pricing. I was wondering when he was going to start talking about West African corruption when I finally began to make a serious connection. The United States, by offering tax incentives and secrecy to lure money from overseas, had been turning *itself* into a tax haven.

Tides of financial capital flow around the world in response to small changes in these kinds of tax and secrecy incentives. The U.S. government needs foreign funds to flow in, and it attracts them by offering tax-free treatment and secrecy. This is offshore business, Spencer explained, and it had become *central* to the U.S. government's global strategies for financing its deficits. Not only did almost nobody understand this, he continued, but almost nobody *wanted* to know. Once, when he gave a speech at a major United Nations event outlining some of these basic principles, a top U.S. negotiator collared him afterward and told him that his shedding light on this subject made him "a traitor to your country." The negotiator was wrong: Spencer was being disloyal only to offshore interests on Wall Street.

In the Harvard Club with Spencer I began to see how the terrible human cost of poverty and inequality in Africa, Latin America, and other parts of the world connected with the apparently impersonal world of accounting and financial regulations and tax law. Africa's supposedly natural or inevitable disasters all had one thing in common: the movement of money out of poor countries and into parts of Europe and the United States, assisted and encouraged by the tax havens and a pinstripe army of respectable bankers, lawyers, and accountants. Nobody wanted to look beyond poor countries at the system that made this movement possible. The U.S. government and many others have allowed tax havens to proliferate because the elites who use them are the world's most powerful lobbyists.

Martin Woods, a Wachovia bank employee who became a whistle-blower after seeing billions of suspect dollars flowing from currency houses in Mexico in the midst of a drug war, illustrates the problem clearly. "If you don't see the correlation between the money laundering by banks and the twenty-two thousand people killed in Mexico," he said, "you're missing the point."¹² The world has, it seems, been determined to miss the point.

The offshore system hadn't been just an exotic sideshow in the stories I was covering, as I had thought. Offshore *was* the story. It binds together Libreville, Paris, and

Jersey; Luanda, Geneva, and Moscow; Moscow, Cyprus, and London; Wall Street, Mexico City, and the Cayman Islands; Washington, the Bahamas, and Riyadh. Offshore connects the criminal underworld with financial elites and binds them together with multinational corporations and the diplomatic and intelligence establishments. Offshore drives conflict, shapes our perceptions, creates financial instability, and delivers staggering rewards to *les grands*, the people who matter. Offshore is how the world of power now works. This is what I want to show you. The offshore system is the greatest fault line in our globalized world.

An impression has been created in sections of the world's media, since a series of stirring denunciations of tax havens by world leaders in 2008 and 2009, that the offshore system has been dismantled or at least suitably tamed. As we shall see, exactly the opposite has happened. The offshore system is in robust health—and growing fast. The crackdown has turned out to be a whitewash.