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IMF finds "trillions" in undeclared wealth

<http://www.wealth-bulletin.com/portfolio/tax-trust-and-legal/content/4058538961/>

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 (€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. Swiss finance minister Hans-Rudolf Merz has said the Government wants to find a solution for the estimated \$600bn-\$700bn of undeclared assets in the country. Most of this money is held in cash. Undeclared money has become an increasingly contentious issue.

The G20 group of countries has launched initiatives to crack down on tax havens and UK Financial Secretary to the Treasury Stephen Timms this year called offshore tax evasion “morally unacceptable”. Fiona Fernie, tax investigations partner at accountancy firm BDO Stoy Hayward in London, said: “The tax climate is becoming harsher generally and the authorities have made it very clear that people who do not come forward will be penalised.”

As a result of the pressure, some offshore centres are taking action on undeclared money. Liechtenstein, which is believed to have at least €200bn (\$276bn) of offshore money in its banking sector, has signed numerous bilateral tax information exchange agreements. It has also implemented innovative initiatives such as the Liechtenstein Disclosure Facility with the UK. This allows UK citizens to be let off with lighter sanctions if they declare their offshore accounts in the principality.

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 ‘sub-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.

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.”