Money Laundering, Global Financial Instability, and Tax Havens in the Pacific Islands

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Pacific Islands offshore financial centers (OFCs) are battling for their survival against the danger that international organizations will cut them off from the global financial system.[1] This threat is supported by accusations that offshore centers in Oceania promote money laundering, harmful tax practices, and instability in the world financial system.[2] The multilateral programs of the Financial Action Task Force on Money Laundering, the Organisation for Economic Cooperation and Development on harmful tax competition, and the Financial Stability Forum have been distinct but related and coordinated attacks on centers in the Pacific Islands and elsewhere. These assaults have gained momentum since the mid-1990s. The image of tax havens in the region has been shaped most by the "horror story" of Nauru—the mass media's account of how Nauru was involved in the Bank of New York scandal and other cases of facilitating tens of billions of dollars of Russian money laundering, tax evasion, and illegal capital flight.

The most powerful media critiques of Pacific Islands offshore financial centers have asserted their complicity in "money laundering"—a new term that emerged in the 1970s to define a social problem. It has been associated in the popular consciousness with reports that tax havens around the world help to hide the origins of and legitimate hundreds of billions of dollars of illegal drug profits every year. Public hostility toward offshore centers has been connected with media images of drug lords acquiring tremendous wealth, laundered through secretive tax havens, while narcotics ruin lives, addict babies, produce street crimes, and spread HIV/AIDS.

Many members of the public are only vaguely aware that since the mid-1980s some countries have broadened the legal definition of money

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laundering to include illegal capital flight, tax evasion, insider trading, bribery, fraud, corruption, misappropriation of public funds, racketeering, arms trafficking, terrorism, prostitution, and a growing number of other crimes as "predicate offenses" (ie, transgressions for which money can illegally be laundered). The widening range of offenses covered by the term has helped to produce constant reports that money laundering (particularly for non-drug crimes) is growing very rapidly—helping the media to create the impression of a "crime wave."

While many aspects of money laundering are real threats to human welfare, these problems are subjected to collective definition. Many harmful activities existed before they were considered to be problems or defined in terms of money laundering. Countries differ in their exact definition of money laundering because they cannot agree on what constitutes a predicate crime. Capital flight or Internet gambling may be illegal in one country but perfectly lawful in another. Terrorism is defined differently in Israel than in Arab countries. Furthermore, there is considerable debate *within* countries (eg, the United States; see Adams 2000) about which of a widening range of predicate crimes should be prosecuted under existing money laundering statutes.

Some scholars, such as Robin Thomas Naylor (1999) and Petrus C van Duyne (1998), have suggested that relatively little is actually known about money laundering, and what is known is often ignored by law enforcers and the media. The issue is highly emotional, and increasingly the phrase "money laundering" is a stimulus eliciting unreflective conditioned responses rather than thought or insight. Anti-laundering measures make citizens feel better (with cleaner consciences) and it may not be in the interests of well-funded law enforcement agencies and their allies in the media to develop a more accurate and rational view of the issue. The threat of money laundering is politically, economically, and socially constructed (see Best 1989). Those accused of money laundering may be not the worst offenders but only the easiest targets.

Growing Tensions

The reality of money laundering is elusive, but perceptions of laundering are concrete products of the way the media inform the world. In the late 1990s the anti-laundering campaign shifted from attempting to identify suspicious transactions toward naming suspicious countries. Pacific Islands offshore financial centers have increasingly been portrayed in the media as unrepentant "enemy deviants" (Gusfield 1967)—being socially organized to operate in a deviant manner, challenging the campaign against money laundering, and deserving stronger legal restriction, but rarely being punished.

Pacific Islands offshore financial centers have been stigmatized episodically for a number of years. The remoteness of havens in Oceania from most people's experience means that the audience is unlikely to be critical of the media's interpretations. In the early and mid-1980s the US Senate Permanent Subcommittee on Investigations (under William Roth) exposed the criminal use of offshore banks in the Northern Marianas (US Senate 1983), but this did not generate much media or political interest at the time. However, this work formed an early part of the subcommittee's findings, which eventually prompted passage of the Money Laundering Control Act of 1986.[3] This legislation (the first in the world to criminalize money laundering) became the model that the United States encouraged or pressured all countries to replicate. Anti-laundering crusaders have become convinced that criminals seek the laxest jurisdictions and that law enforcement must be global and uniform.

In 1988 the United Nations adopted the Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention), which was the first international agreement to require the criminalization of narcotics-related laundering[4]—although the term "money laundering" was not used. Well over one hundred states have become parties to the convention—including an increasing number that host offshore centers. The Vienna Convention created a solid base in international law for extending the fight against laundering to financial centers around the world (Alexander 2001; Gilmore 1995).

Bad publicity for Pacific Islands offshore financial centers became far more common after the Financial Action Task Force on Money Laundering (FATF) was created by a G-7 summit in 1989 and this new international organization began its extraordinarily successful campaign to draw attention to global money laundering. Nauru and Vanuatu had occasionally been listed as suspected laundering locations in the Australian and Pacific Islands media (eg, *South Sea Digest,* 19 April 1985; *Sydney Morning Herald,* 4 April 1985), but their reputations were damaged more extensively as *Time Magazine* highlighted their alleged role as centers for laundering in a feature article on the subject published around the world (18 Dec 1989). The same accusations were reiterated in another prominent US periodical (*US News and World Report,* 19 Feb 1990). In 1991 New

Zealand's Serious Fraud Office aired its suspicions that offshore banks in Nauru, Vanuatu, and Tonga were laundering drug money, although it could find no evidence that this was the case in the Cook Islands (*Pacific Magazine,* Sept 1993). In 1990 Nauru and Vanuatu were labeled as centers for narcotics money laundering, in the US Senate (1990a; 1990b, 1). Senator John Kerry, a Democrat from Massachusetts, at that time the principal anti-laundering crusader in the US Congress, strongly criticized Nauru, Vanuatu, the Marshall Islands, and "Micronesia" for their banking secrecy (US Senate 1990a, 62).

Even publications for OFC promoters and clients claimed that Vanuatu's offshore companies were registered without any requirement for character references or checks of Interpol's lists of criminal subjects (*Offshore Centres Report,* Autumn 1994). Tax haven promoter William Hill saw Nauru and Vanuatu as attracting money launderers—many of whom he considered to be romantics intrigued by such exotic locales (1994, 66–68). This bad image among some financiers showed no signs of disappearing, as indicated by an article in the 4 August 1997 issue of *The American Banker,* which labeled Vanuatu as one of four "quasi-outlaw banking centers."

In February 1998 the Financial Action Task Force on Money Laundering claimed that Vanuatu was increasingly involved in laundering circuits and that its legislation had created favorable opportunities for launderers (*Australian Financial Review,* 17 Feb 1998). In May 1998 the Pacific Islands offshore centers were criticized in the hearings of the US House of Representatives, and Niue was especially condemned for providing $5,000 charters for offshore banks—whose titles could be in Russian or Chinese and which could be used by launderers to gain protected access to the US financial markets through virtually unsupervised correspondent (bank-to-bank) accounts (US House of Representatives 1998, 68). In March 1999 the task force observed that a heavy concentration of financial activity related to Russian organized crime (apparently using US intermediaries) had been observed, specifically in Western Sāmoa,[5] Nauru, Vanuatu, and the Cook Islands (*Australian Financial Review,* 1 June 2000).

In March 1999 the US Department of State gave very low ratings to Nauru, Niue, Vanuatu, Sāmoa, Palau, the Cook Islands, the Marshall Islands, and Tonga (in descending order of criticism) for their actions against launderers—considerably lower ratings than for nine other offshore centers and even inferior to the rating for Russia (US Department of State 1999). Jonathan M Winer (deputy assistant secretary of state, narcotics, and law enforcement during the Clinton administration, and a frequent expert witness at congressional hearings) declared: "The islands of the South Pacific, one of the new centers of the world's offshore industry and, not coincidentally, home to a large percentage of Russia's offshore banks . . . have sprouted vigorous financial services industries whose sole purpose would seem to be financial crime" (1999, 354).

While the details of the US Department of State's recent investigations of Pacific Islands havens were never reported in the popular media, Winer summarized some of the State Department's findings in an article intended for a specialist audience (1999). At that time Nauru had registered 288 banks, and its offshore bankers included a number of suspect Russians and Ukrainians; a Latvian whom Riga authorities were investigating for allegedly stealing $20 million; a Malaysian who was being investigated for serving as a conduit for laundering cocaine profits from Cali in Colombia; and an Australian whose occupation was moving large quantities of Iranian currency. Sāmoa had registered only fifteen offshore banks at the time, but its offshore bankers included a Russian man who was then in jail in Europe; a Russian who carried both Honduran and Russian passports and had registered about three hundred offshore companies in Sāmoa; a Russian and a Greek whom Maltese authorities had arrested for forgery, misappropriating funds, and operating a bank that had not been licensed; a notorious Ukrainian; a suspect Lebanese based in Beirut; a Swiss banker of whom Swiss authorities had an unflattering view; another man with a criminal record in Switzerland; and some offshore bankers who listed false addresses in the United States. Among Cook Islands offshore bankers were some politicians from Brazil who were under investigation in that country for laundering the proceeds of drug trafficking; six suspect Paraguayans; several Russians whose operations were headquartered in Cyprus; and some dubious Indonesian banks, such as the Lippo Group, which was accused of laundering money and being involved in unlawful campaign contributions in relation to the 1996 US presidential election. Finally, Cook Islands offshore bankers included members of a notorious Italian family that was under investigation by authorities in Italy in relation to assaults, conspiracies, contraband, receiving, banking and currency offenses, company offenses, illegal bankruptcies, and frauds.

While Pacific Islands offshore promoters conceded that some of the regional offshore financial centers had been involved in laundering, they generally contended that these were exceptional events and that they have taken appropriate measures against them. Let us consider some cases from

Vanuatu, the largest offshore center in the region. Drug money has been laundered in Vanuatu, but government officials and OFC promoters there have also cooperated with metropolitan police. In 1989 the Vanuatu parliament passed laws criminalizing money laundering and allowing for fines, prison sentences of up to fifteen years, confiscation of assets, mutual assistance in criminal matters, and extradition.

Richard Carpenter, the British barrister who was Vanuatu's financial services commissioner from 1992 to 1995, said that while in Washington DC, he asked Senator Kerry to prove his allegations that Port Vila had laundered money, but apparently Kerry refused to provide any evidence (*Islands Business Pacific,* July 1994). Ian Smith, when he was manager of the Westpac Bank and chairman of the Vanuatu Finance Centre Association (the principal OFC promotional organization there), made the often-repeated claim in Port Vila that the US attack was "malicious bullying" that had little or nothing to do with drugs. Instead it was said to result from the frustrations of US governmental agencies when they failed to obtain confidential information from members of the finance center who were concerned to defend its integrity (*Vanuatu Weekly,* 18 May 1990).

Port Vila's offshore promoters may even appear to be more scrupulous than members of the metropolitan legal profession, at least when it relates to a transfer of money from Vanuatu. A Vanuatu trust company raised objections to a Brisbane law firm's attempts to gain access to funds of clients who had been accused of the trafficking of A$11.4 million of hashish in Australia between 1985 and 1987. They had laundered most of the proceeds through companies created in Vanuatu's offshore center—either with bank checks posted to Vanuatu companies under the control of syndicate members or cash carried on Lear Jet flights from Queensland for deposit in a Port Vila bank. In what some have seen as over-lawyering, the firm billed well over A$1 million to litigate the case, even though the chief defendants apparently had wanted to plead guilty for over a year. Responding to a bill from the Brisbane lawyers, Melitco, a trust company in Vanuatu, was reluctant to pay the law firm with funds that may have been laundered proceeds of drug trafficking. Melitco stated, "It was not our business to protect drug dealers . . . the whole matter smells as far as Melitco is concerned." This was countered by the legal firm's instructions: "PLEASE REMIT FORTHWITH ALL FUNDS" (ABC 1993).

However, the conception that, to hire their own lawyers, defendants in Australia should be able to use assets subject to a restraining order for money laundering was solidified by an Australian Court of Appeal decision. This decision concerned another drug trafficker who laundered some of his proceeds through the Vanuatu offshore center, Ian Hall Saxon (NSWLR 1992). In 1989 Saxon was at the center of Australia's largest detected case of money laundering (involving A$77 million) from the proceeds of trafficking hashish or cannabis resin with a street value of A$100 million to A$120 million. Several of this former rock-tour promoter's principal partners (including a Colombian-born naturalized American gold dealer with connections to Vanuatu) were sentenced to long terms of imprisonment (of ten to fifteen years) for illegal drug importation or money laundering. The National Crime Authority of Australia and the Australian Federal Police received cooperation from the government of Vanuatu after they identified its offshore financial center as a recipient of funds.

In another case, over the course of a few weeks in mid-July 1999, Vanuatu's European Bank received $7.5 million from the illicit proceeds of one of the greatest credit card frauds in history. The criminally derived funds had been forwarded to Port Vila from the Cayman Islands offshore center. European Bank officials (including bank president Tom Bayer) claimed that they were suspicious and alerted the police in May 1999. After Cayman Islands police closed down a bank associated with laundering the funds, a Vanuatu court froze the money in late July 1999. The US District Court of California ordered that the money be returned to reimburse 900,000 people worldwide whom a Malibu company had billed for over $49 million of Internet services (including pornography) that they did not order. Conflicts with the United States emerged over a freeze order by the Vanuatu Public Prosecutor's Office—creating the possibility that the Vanuatu government might confiscate and retain the funds (*Pacific Islands Monthly,* Jan 2000).

In February 2001 the minority (Democrat) staff of the US Senate Permanent Subcommittee on Investigations issued a widely publicized report titled *Correspondent Banking: A Gateway to Money Laundering,* which used this Vanuatu example as one of ten case studies (US Senate 2001a). Its version of events contrasted with the statements of offshore promoters in Vanuatu. According to the US Senate report and subsequent testimony at Senate hearings, the European Bank soon knew that the $7.5 million was suspect, but it did nothing about it for two months and it failed to notify the office of its correspondent bank, Citibank, in Sydney. It transferred the money from Citibank to a Vanuatu bank after the US government filed a suit to freeze the $7.5 million in Australia (US Senate 2001a;

2001b). While this story was circulated in metropolitan countries among very powerful people, Bayer's response was confined to the local media. Bayer reiterated that the European Bank had taken the first action to freeze the funds and added that US authorities had retained a "bounty hunter" who arrived in Vanuatu in August 1999 and obtained another freeze order. According to Bayer, Vanuatu authorities have been assisting the United States, and the delay in the case had been caused by the Vanuatu Public Prosecutor's view that the US prosecutor would fail because of lack of proper evidence (*Vanuatu Trading Post,* 24 Feb 2001).

Nauru and the Bank of New York Scandal

Of all Pacific tax havens, Nauru has been the most closely associated with the largest money laundering case in world history, the Bank of New York's so-called "Russiagate" scandal. The Bank of New York is a major international bank, founded by Alexander Hamilton in 1784, a hallowed pillar of the US establishment. Its name connotes its central position in the most important city for global finance, which has meant that its activities are closely covered in the media. The bank's problems began in the summer of 1998 when a competitor, the Republic National Bank of New York, reported to the US Treasury about suspicious transactions involving the Bank of New York. Republic was under suspicion for its own extensive Russian operations (Friedman 2000, 219–225).

On 19 August 1999 the *New York Times* (arguably the most respected and influential US news medium) broke the story of the Bank of New York scandal—its possible laundering of billions of dollars that it received from Russia, often through offshore intermediaries. Law enforcement agencies contended that the bank case involved at least 87,000 electronic transfers of up to $15 billion (some for capital flight, some for tax evasion, but also some from criminal activities such as contract murder, narcotics trafficking, and prostitution). They identified their problem as getting cooperation from foreign jurisdictions—especially some of the secretive and remote Pacific Islands. Of these recalcitrants, Nauru was the most criticized. Nauru's Sinex Bank alone was reported to have deposited $3 billion at the Bank of New York (*Australian,* 31 March 2001), and half of the bank's funds from Russia were said to have gone through Nauru. DKB, the Russian parent of Sinex, had a questionable client base; Lucy Edwards, the Bank of New York vice president who entered a guilty plea to charges of money laundering, conceded: "I was aware that personnel from DKB were on occasion . . . afraid to leave the bank because they said customers with machine guns were waiting for them" (*New York Times Magazine,* 10 Dec 2000).

The Bank of New York scandal crystallized western moral outrage. As Russia lurched from one crisis to another and its people became increasingly impoverished and anti-American, its corrupt leaders were presented as stealing western aid and Russia's resources and using banks in remote Pacific Islands offshore centers (employing their correspondent relations to channel funds into western banks) to complete the fraud—with the risk that the Russian elite would increasingly corrupt the United States and its European allies.

Nauru's position was further damaged when Victor Melnikov, deputy chairman of the Russian Central Bank, stated that $70 billion had been transferred to Nauru from Russia in 1998, compared to total Russian exports of $74 billion. In March 1999 Alexander Pochinok, head of the Russian Finance Department, claimed that 90 percent of Russian banks maintained 6,600 offshore banking accounts in Nauru, which was receiving $10 billion of Russian flight capital each month (*Banks and Exchanges Weekly,* 22 March 1999; *Moscow Times,* 30 March 1999; *Prime Tass,* 29 March 1999; *Segodnya,* 12 March 1999).

Initially, these announcements about Nauru did not have much impact on the western media, until the influential *Washington Post* made this Nauru story the centerpiece of its front page story, "Russians Use Tiny Island to Hide Billions," on 28 October 1999—reviving and giving a new slant to the Bank of New York story that had been front-page news from mid-August to early October 1999. The notion of $70 billion of Russian money being sent to the Nauru "laundry" in one year simplified the complex issue of Pacific Islands offshore centers into an easily understood form that attracted public and political attention and elevated the issue on the international policy agenda. Nauru's $70 billion from Russia was a "trigger event," a cue to action (Dearing and Rogers 1996, 77–87). Other centers in the Pacific Islands were soon implicated, and banks that had been heavily involved in Russia came under pressure to do something to repair their reputations.

The increasing panic about capital flight from the former Soviet Union soon involved Palau and Vanuatu, although these two Pacific Islands countries did not receive nearly as much media attention as Nauru. On 23 August 1999 Russia increased surveillance and control over illegal currency transfers to Palau even before action was taken in October 1999 against Mosprom, a Palau-registered bank. Latvian tellers at Mosprom had reportedly received at least $50 million at its Moscow office, which was allegedly designed to expedite illegal tax evasion and capital flight. Russian authorities were confined to taking indirect action against Mosprom, because its Russian office was in a hotel located in the compound of the Latvian Embassy in Moscow and hence was protected by diplomatic immunity (*Baltic Business Weekly,* 26, 31 Oct 1999; *Komersant,* 27 Oct 1999; *Trud,* 26 Oct 1999). Vanuatu was targeted when the central bank in Ukraine stated that Palau and Vanuatu were, respectively, the second and fourth most popular offshore centers for massive capital flight (BBC, 12 Nov 1999; Infobank, 11 Nov 1999).

In December 1999 it was reported that on 17 November 1999 the Bank of New York, the Republic Bank of New York, Deutsche Bank, and its newly acquired subsidiary Bankers Trust had suspended all US dollar transactions with Nauru, Palau, and Vanuatu because these countries were allegedly not taking sufficient precautions to prevent money laundering through their offshore financial centers. This was the first time that these banks had taken such independent and unprecedented action against any country. In January 2001 Niue became the target of JP Morgan Chase and the Bank of New York, which refused to have financial dealings with the country. Both banks had recently been criticized in the US Senate for what they were accusing Niue of—taking inadequate measures against laundering. There had been media reports that Niue was laundering money for cocaine traffickers and that its offshore entities were involved in "letters of guarantee" frauds.

Four relatively small Pacific Islands havens (rather than the larger offshore centers in which these six banks had prominent offices) were being singled out for special attention. In Port Vila, ANZ Bank (though not Westpac Bank) reported feeling some impact from the four metropolitan banks' sanctions (*Australian Financial Review,* 27 Jan 2000). However, there were doubts expressed as to whether JP Morgan Chase and the Bank of New York actually imposed a general embargo on Niue, or whether it had confined itself to blocking only transfers of funds to the Niue government from the offices of Mossack Fonseca, the Panamanian law firm that has exclusive rights to register Niue's offshore companies (*Cook Islands News,* 28 March 2001). In any case, while the sanctions might adversely affect Pacific countries (not least with reputational damage), they would have little effect on many of the offshore entities registered there since these maintained accounts in metropolitan banks.

Julian Ala, then the head of Vanuatu's Financial Services Commission, said that the four banks had not responded to his requests for explanations of their reasons for imposing the bans. Port Vila's leading offshore promoter, Tom Bayer, led a delegation from Vanuatu to the United States in late January 2000, meeting representatives of the sanctioning banks, the Federal Reserve, the US State Department, and the International Monetary Fund (IMF). Bayer contended that no one at the US banks knew anything about Vanuatu's anti-laundering activities (eg, that Vanuatu had been one of the first countries to criminalize laundering), but (being under pressure to be seen to take action) they picked a small, unknown, and distant target with which they did no substantial business. Bayer further emphasized that the misleading negative publicity about Vanuatu was created purposely because the country had asserted its independence from control by foreign powers. Nevertheless, Port Vila's proactive approach was well received at all the US banks and government departments, which received substantial "fact files" (including legislation and details of supervision) from the offshore promoters. Vanuatu agreed to a US State Department visit to the country in late February 2000 and a weeklong evaluation of its offshore center in March by the Asian Pacific Group on Money Laundering (an FATF affiliate). It encouraged a UK international banking examiner to come to Port Vila to inspect offshore banks with Russian connections. Vanuatu's offshore promoters saw their cooperative approach as being successful. The four banks dropped their sanctions against Vanuatu, but some of the correspondent banks, which had been notified by the four that they should also stop transacting with Vanuatu, maintained sanctions that were still in force over one and a half years later.[6]

Nauru's approach was less diplomatic and open than Vanuatu's. Nauru's President René Harris was ignoring the growing concerns about laundering. "What's it got to do with you?" he angrily asked a *Washington Post* reporter before hanging up. He later did the same to a group of top Pacific Islands authorities, adding that the real problem rested with Europe and North America because they were buying the services—drugs and prostitution—that others were profiting from (*Pacific Islands Monthly,* Jan 2000). While Nauru's Finance Minister Kinza Clodumar agreed that Nauru needed stronger anti-laundering measures and that US experts should assist the country in reviewing its banking laws, he also contended that the majority of the money laundering connected with Nauru banks had actually been performed in the United States and Europe and that enacting anti–money laundering legislation did not have high priority for his country's parliament (Radio Australia, 28 Jan 2000). Nauru was reported to have demanded $10 million from the United States to reform its offshore center (*Age,* 15 March 2001; *New York Times Magazine,* 10 Dec 2000).

Palau's strategy was similar to Vanuatu's. Palau strongly denied that it was involved in laundering and claimed it was not clear why it had been cited. Government representatives noted that a US Bureau for International Narcotics and Law Enforcement Affairs report earlier in the year did not have Palau on its watch-list and that the US government had never listed Palau as an area of concern. They expressed shock that the four banks would launch such sanctions without any serious investigation. But after the Palau government sued the Bank of New York, the bank replied that at least six questionable banks were registered in Palau and that one of them had handled over $1.7 billion in transactions over an eighteen-month period. Despite the controversy and further questions about the country's twenty-seven banks (in 1999—with four new banks added in 2000), Palau (like Vanuatu) successfully managed public relations on the money laundering issue, eagerly seeking advice from the US government and the International Monetary Fund and passing new banking legislation in October 2000 and June 2001.[7] In late 1999 and 2000 the more successful offshore centers learned how to play a new game—in a very short time moving from the language of marketing, self-promotion, and advocacy to the language of international diplomacy (*Offshore Investment,* June 2001).

Niue followed Nauru's more confrontational approach. Sani Lakatani, the premier of Niue, accused the international community of using bullying tactics. In response to Lakatani's claim that the US Treasury had used its influence to prevent US banks from doing business with Niue, a treasury representative said it had merely advised them to be careful (Dow Jones International News, 8 May 2001). Lakatani's accusation followed his suggestion that if the G-7 countries were serious about opposing money laundering they should consider contributing several million dollars a year to Niue's budget in exchange for it closing its offshore financial center (*Vanuatu Weekly,* 11 March 2000).

Further revelations consolidated the negative image of Pacific Islands havens. In December 1999 the Nauru-registered Cassaf Bank was reported to have provided at least some of the capital for Mosprom (the Palau-chartered bank that rented premises at the Latvian embassy) and to be the secret channel for substantial illegal capital flight and tax evasion schemes. Prosecutors claimed that Cassaf had at least 1,500 clients (who needed a special pass to be admitted to the small private Moscow apartment where it was located), including oil tycoons, underground liquor producers, and organized crime chiefs. Cassaf was said to have handled tens of billions of dollars of deposits even though it did not have permission to operate in Russia. The Cassaf case led to a very high-profile financial crimes trial from June 2001 to January 2002 in Moscow, where the Nauru connection was frequently discussed. In the end, Cassaf's former president and four employees were convicted of illegally removing $300 million of undeclared funds from Russia, but were granted immediate amnesty, while charges of money laundering, counterfeiting, and associating with criminal groups were dropped (Agence France-Presse, 31 Jan 2002; *Komersant,* 18 Feb 2000; 7 June 2001; *Moscow Times,* 1 Feb 2002; *Segodnya,* 11 Dec 1999).

A German version of the Bank of New York scandal emerged in the media in 2001 with reports that Russian companies in 1999 used the United Global Bank in Sāmoa (which is no longer registered there as an offshore bank) to transfer DM1.2 billion to the West Deutsche Landesbank as part of DM7 billion that Russians deposited there (*Der Speigel,* 15 Jan 2001). This was soon followed by the announcement in February 2001 that the Ukrainian tax police had completed an investigation in which they accused the country's former deputy prime minister and current opposition politician, Ms Yulia Tymoshenko, of arranging the illegal transfer (via Latvia) of about $1 billion from United Energy Systems of Ukraine to the Nauru-based First Trading Bank (controlled by Ukraine's former Prime Minister Pavlo Lazarenko) when she was the head of United Energy during 1996–1997. The $1 billion transfer was to have purchased Russian gas, and the failure to pay for the gas later hurt relations between Russia and Ukraine. The tax police charged that the gas funds had been transferred to the private accounts of Tymoshenko, Lazarenko, and others—who denied the charges, claiming that they were politically motivated (Infobank Ukraine, 5 Feb 2001; Interfax, 4 Feb 2001). Numerous reports of other multimillion-dollar frauds linked to Nauru offshore banks (but not necessarily connected with the former USSR) appeared in newspapers around the world from 1999 onward.

The disparagement of Pacific Islands countries was sometimes generalized beyond attacks on money laundering. London's *Independent on Sunday* characterized the "blacklisted haven, the tiny Pacific offshore island of Niue" as "little more than an accretion of bird guano" (4 March 2001, 5)—seeming to confuse Niue with Nauru, which was later described as "little more than a phosphate mine" (Reuters, 25 June 2001). Vanuatu was inaccurately belittled as "a tiny rock sticking out of the Pacific" (*Time Magazine,* 22 Oct 2001). Reporters made a habit of denigrating Pacific Islands offshore financial centers, which they presented as deviant and obstructing the expanding battle against money laundering. The Nauru story was often repeated and embellished over time, for instance by the Manchester (UK) *Guardian:* "Nauru . . . an eight-square-mile lump of coral reef covered with fossilised bird droppings . . . has changed itself into the world's premier banking regime purpose-designed for criminals" (23 June 2001, 15). The *Economist* speculated, "Presumably, it [Nauru] is by now a holiday destination for Russians and tax accountants" (23 June 2000). Reports added South American drug dealers to the Russian Mafia as important clients of Nauru's offshore center (*Islands Business,* Feb 2000), which was labeled as a safe haven for the proceeds of drug trafficking, people smuggling, prostitution, and other rackets by gangs in Russia, the United Kingdom, and the United States (*Sunday Times,* London, 5 Dec 1999). The media's aura of independence and impartiality tended to legitimate the attacks on Pacific Islands offshore centers.

While large banks, the US government, and international organizations obtained regular access to the global mass media, Pacific Islands offshore financial centers did not—especially as the islands' centers have a history of avoiding inquiry and defending financial secrecy. Protesting Pacific Islands countries were often not taken as seriously as those who made the charges, and reports of the complaints of relatively un-newsworthy Pacific Islands offshore promoters were almost entirely confined to the regional media of Oceania. The effects of the accusations against Pacific Islands havens were strengthened when a very important agenda-setting person and a dominant newspaper were both involved, as when the *Wall Street Journal* reported that US Treasury Secretary Lawrence Summers identified Nauru as one of the four most popular destinations for the proceeds of crime and suggested that the passage of the Clinton administration's anti-laundering bill would give him the power to prohibit transactions between US banks and such offshore centers (2 March 2000).

Newspapers and other media around the world repeated the *Washington Post*'s account of Nauru's $70 billion from Russia, if only in very short briefs. The story continued to be newsworthy for years—as exemplified in a long article and colorful pictorial on the Nauru offshore center appearing in the *New York Times Magazine* on 10 December 2000 and numerous media references to it during 2001 and 2002. This helped to support the anti–tax haven policy agenda. Government officials and politicians often interpret the amount of media attention to an issue as an indirect expression of public interest (Linsky 1986).

The Clinton Administration

In the eyes of members of the Clinton administration, the case of Nauru "laundering" tens of billions of dollars highlighted the threat posed by the anarchic international system. Even the powerful US government could not control the illicit activities of such small countries, much less the more traditional challenge represented by Russia for most of the twentieth century.

The image of the sudden prominence of remote Pacific havens in laundering excused many of the past failures of the US Departments of Treasury and Justice, the Internal Revenue Service, the Federal Bureau of Investigation, and Customs to deal with the problem (since the new threat had taken the novel form of Russians in Oceania rather than, say, the more traditional images of Colombians in Caribbean offshore financial centers). All these governmental organizations gave testimony at US congressional hearings in support of new Clinton administration legislation to broaden the definition of laundering and impose stricter controls over transactions with offshore centers. The new Russian–Pacific Islands threat served to justify granting new powers (and budgetary allotments) to these government departments, which had during the final years of the Clinton administration begun to create the appearance of unity and common purpose. In the first major joint report on anti-laundering strategies by Treasury and Justice (US Departments of Treasury and Justice 2000), they explicitly linked laundering, tax avoidance, and a weakening of the global financial architecture as related problems for national and international organizations to pursue with offshore centers.

The primary purpose of the proposed law (the International Counter–Money Laundering Act of 2000) was to allow the secretary of the treasury to restrict or even prohibit US financial institutions' ability to transact with selected foreign countries or financial institutions. The changes would involve the expansion of the definition of laundering to cover foreign offenses,[8] and the extraterritorial extension of many of the key elements of US anti-laundering laws—forcing offshore centers to abandon financial secrecy for their clients if they wanted access to the US banking system. The existing laws criminalized US laundering of the proceeds from only three types of foreign crime—drug trafficking, bank fraud, and violent crimes linked to terrorism. The Clinton administration (with the support of moderate Republicans such as James Leach, chairman of the House Committee on Banking and Financial Services from the traditionally anti-bank state of Iowa) sought to define many more foreign crimes as predicate offenses for laundering. This was intended to limit the volume of foreign criminal proceeds flowing into the US financial system (US House of Representatives 1999, 16) and to allow the United States to assist foreigners in the way that it asked foreigners to assist the United States in anti-laundering actions (US House of Representatives 2000b, 8–9). The voluntary actions of the six US banks against Pacific Islands havens took the same form that supporters of the bill were attempting to legislate.

But there was considerable opposition to the new initiatives, which sought to regulate the porous boundaries and unrestricted financial flows favored by free market advocates of globalization, including most Republican congressmen. Democrats supporting new controls over offshore centers attempted to appeal to Republicans by framing the problem in terms of drugs and a new Cold War against (Russian) organized crime, which would necessarily require some abridgement of the principles of a perfectly free market. Laundering and financial crimes were identified as the "dark side of globalization" (US House of Representatives 2000b, 10).

The new Russian threat was connected with Pacific Islands offshore centers. It drew on fear of organized crime (the new Russian Mafia) and moralized neo–Cold War images (the new Russian elite of criminal billionaires and corrupt politicians working in collaboration with the successor to the KGB). The fear was that they were contaminating the US economy and politics through secret OFC channels, particularly in the Pacific Islands, from which they could send their money into the United States without its dangerous source ever being identified. R James Woolsey, former CIA director, testified in congressional hearings that Russian capital flight and laundering had the potential to corrupt US institutions, destabilize Russia, and increase anti-American sentiments there. Woolsey concluded that too much power to formulate policy toward Russia had been given to orthodox economists, who overemphasized the virtues of free markets and colluded in covering up the importance of Russian organized crime and corruption because they did not have the analytical tools to deal with this serious problem (US House of Representatives 2000a, 61–67). A prompt extension of state power was seen as warranted to deal with this pressing, insidious, and ever more dangerous peril—the laundering that the Clinton administration declared a national security threat. The Pacific Islands were seen as a new danger. Leach said, "Money laundering . . . has become as large an issue in international politics as there is. . . . [I]n recent years, authorities in this country have noted a migration of unsavory operators from havens in the Caribbean to remote islands of the South Pacific, such as . . . Nauru, that did not even register on their collective radar screen five years ago" (US House of Representatives 2000c, 4, 30). Nauru and Vanuatu were repeatedly mentioned as laundering havens (eg, US House of Representatives 2000a, 90, 322; 2000c, 27).

Congressional hearings on Russian money laundering (relying particularly on testimony from those associated with the Central Intelligence Agency [CIA]) constructed a vision of how the new Russian threat had evolved out of the KGB and the former USSR. The clandestine theft of Russia's assets began as early as 1985 when key members of the Soviet Communist Party anticipated the collapse of communism and turned to the KGB to move precious metals, stones, art, and liquid assets abroad. By 1989 many Communist Party and KGB leaders had already become capitalists. The former KGB leaders were as powerful in post-communist Russia as they had been in the old USSR. They were experts in large-scale money laundering through their banks, which have become the channels for the theft of Russia's national assets. In the US House of Representatives hearings Vladimir Putin (now the president of Russia) was portrayed as a major player in the looting of the Russian state over a number of years and as having overseen KGB capital flight operations—rebuffing the Duma's attempts to investigate them. The media later reported that Putin had launched an extensive personal investigation into deals involving Nauru's offshore center during the summer of 1999, shortly after he became the director of the Russian Federal Security Service, formerly the KGB (*Fortune International,* 24 Jan 2000). By the mid-1990s, 70 to 80 percent of Russia's private banks were said to be controlled by organized criminals. Secrecy havens in the Pacific Islands were presented as repositories for funds illegally taken out of Russia—providing cover and safety from threats of retrieval by subsequent Russian governments as well as funds to purchase western banks and business and to buy political influence in the United States (US House of Representatives 2000a).

International Actions and Reactions

In the late 1990s, the left-of-center governments of the United States, France, and Germany led international organizations toward a much more aggressive attack on offshore financial centers. In 2000 international organizations began blacklisting offshore centers and threatening them with sanctions. This involved challenging financial secrecy provisions, which are useful to both money launderers and tax evaders. Because laundering generally provokes more public indignation than tax minimization (but see Wishart 1995 and 1999 for the outrage in New Zealand about the Cook Islands "Winebox Affair"), laundering has been the most prominent ostensible theme of the anti-OFC campaign. The quest to "take the profit out of crime" was targeting bankers, lawyers, accountants, and professional advisors (who created offshore structures for their clients), just as much as more conventional criminals. In the face of a coming crisis of welfare provision for a rapidly aging population, the anti–tax haven movement was particularly attractive to social democratic governments that opposed the wealthy escaping taxation (Avi-Yonah 2000; Bosworth-Davies 1997; Samuels and Kolb 2001). Law enforcement agencies, former Cold Warriors and spies were offered prominent roles in the campaign, as well as the confiscated assets of the accused (Naylor 1999). All this was coordinated by international organizations demanding legal and administrative reform in offshore centers (see table 1).

Financial Stability Forum

The first direct assault on Pacific Islands offshore financial centers from an international organization came on 5 April 2000 when the Financial Stability Forum (FSF) claimed that the Cook Islands, the Marshall Islands, Nauru, Niue, Sāmoa, and Vanuatu were among twenty-five offshore centers that had the lowest quality of financial supervision (placing them in "Group III").[9] They were therefore considered weak links in an increasingly globalized financial system, capable of provoking an international monetary crisis. The forum sharply differentiated Pacific Islands offshore centers from "Group I" offshore centers (eg, Hong Kong, Luxembourg, Singapore, and Switzerland), which it said were well supervised, cooperative, and of no danger to global financial stability.

The Financial Stability Forum suggested that countries that did not comply with its standards might face tighter criteria for obtaining loans and funds from international bodies. However, the sanctions threatened by the forum were relatively minor; it set no deadline for sanctions; and the issue could be temporized. The International Monetary Fund was given responsibility for consulting with Pacific Islands other offshore centers in "Group III" (FSF 2000), despite the fact that some of them were not IMF members.

OFC promoters criticized the FSF report for being merely a collection of anecdotal views of a number of metropolitan onshore regulators (*The Lawyer,* 4 June 2001). Conservatives berated FSF paternalism: "Some places do have dangers but companies are grown-ups which can call on expert advice and so are in a position to decide whether the risk is worth the savings and the convenience of lower regulatory burdens" (*Daily Telegraph,* 29 June 2000, 74).

Financial Action Task Force

On 22 June 2000 the world's leading anti–money laundering agency, the Financial Action Task Force (FATF), published a blacklist of fifteen countries considered to be uncooperative in the fight against laundering, including four Pacific Islands offshore financial centers: the Cook Islands, the

Table 1. Organizations at One Time Blacklisting Pacific Islands Tax Havens, 1999–2001

	Organizations			
	Private Banks	FSF[1]	FATF[2]	OECD[3]
Nauru	•	•	•	•
Niue	•	•	•	•
Cook Islands		•	•	•
Marshall Islands		•	•	•
Vanuatu	•	•		•
Sāmoa		•		•
Tonga				•
Palau	•			

[1] Financial Stability Forum
[2] Financial Action Task Force on Money Laundering
[3] Organisation for Economic Cooperation and Development

Marshall Islands, Nauru, and Niue.[10] As a first step, the task force called on all member countries to ask their financial institutions to give special attention to transactions with parties connected to these jurisdictions. Sanctions from member countries were threatened against jurisdictions remaining on the FATF blacklist in June 2001. The proposed measures included restriction or prohibition of all financial transactions with the blacklisted jurisdictions.

Pacific Islands offshore financial centers were attractive targets because they had relatively little power to oppose the measures being taken against them. Compared to some other havens that were not blacklisted, they were less likely to serve powerful transnational companies or the old rich and they had a larger proportion of Russian and overseas Chinese clients, who had relatively little political leverage or ability to retaliate through the media.

Some contended that Pacific Islands offshore centers were disproportionately stigmatized not because they were necessarily more prone to laundering than some jurisdictions that were not named and shamed but because of their lack of powerful allies. Intensive lobbying by France was said to be responsible for the exclusion of Monaco from the FATF blacklist. The United Kingdom insisted that Bermuda, the British Virgin Islands, Gibraltar, Guernsey, the Isle of Man, and Jersey not be included, but it had to concede the Cayman Islands (which was listed in June 2000 but later removed from the blacklist in June 2001). Canada successfully intervened to have the Caribbean countries that it represents at the International Monetary Fund (Antigua and Barbuda, Belize, and St Lucia) dropped from the blacklist. Mexico, an FATF member country that is sometimes considered to be a major non-OFC laundering center, interceded to help Panama, which was removed from the blacklist in June 2001 (*Independent,* London, 23 June 2000; *Los Angeles Times,* 23 June 2000; *Wall Street Journal,* 26 June 2000). The military importance of a notorious offshore center such as Panama gives it greater latitude to launder money (Hampton and Levi 1999), whereas being aid-dependent, lacking significant military power, having relatively few large corporate sponsors, and not being strategically central makes an offshore financial center vulnerable to blacklisting (sometimes on flimsy evidence).

The Cook Islands (like Niue and the Marshall Islands) quickly took action to get off the FATF blacklist. Rarotonga passed anti–money laundering legislation in August 2000 and later committed itself to a regional framework for combating money laundering by joining the Asia Pacific

Group on Money Laundering, a sort of branch of the Financial Action Task Force, in May 2001 (*Money Laundering Monitor,* July 2001). But on 22 June 2001 all four Pacific Islands offshore centers remained on the revised FATF blacklist of seventeen jurisdictions. The task force recommended that transactions with the Cook Islands, the Marshall Islands, and Niue should continue to be scrutinized (FATF 2001). Nauru was considered to have made no significant progress and was reported to be one of the three worst offenders in the world (the other two being Russia and the Philippines). Of these three severely stigmatized countries, Nauru got the worst press. While there was media coverage of the Russian and Philippines embassies taking issue with the FATF attacks on their countries' measures against money laundering, "Nauru does not have an embassy in Washington, and the ambassador at the mission to the United Nations was not available for comment" (*Washington Post,* 23 June 2001).

Organisation for Economic Cooperation and Development

In 1998 the Organisation for Economic Cooperation and Development (OECD) created the Forum on Harmful Tax Practices, which identified forty-seven tax havens. OECD members Luxembourg and Switzerland (both very large offshore financial centers) abstained from the process. Each non-OECD tax haven was encouraged to signal that it would curtail "harmful tax practices"—allowing the possibility that it would not be included on the first published OECD blacklist. Six countries (none in the Pacific Islands) quickly complied, and the OECD forum unilaterally removed six other countries after it was satisfied that they were not practicing "harmful tax competition"—including the Pacific Island state of Tuvalu.[11]

The first OECD blacklist was published on 26 June 2000 and consisted of thirty-five countries, including seven in the Pacific Islands—the Cook Islands, the Marshall Islands, Nauru, Niue, Sāmoa, Tonga, and Vanuatu —but not OECD members Switzerland and Luxembourg. The organization threatened economic sanctions against blacklisted countries if they did not meet three conditions: increase financial disclosure and exchange of information by July 2001, set out by the end of 2001 a two-year timetable for dismantling their most harmful tax practices, and commit themselves to effective exchange of information on all tax matters by the end of 2005. Although all OECD members were reportedly committed to eliminating specified features of harmful tax competition by April 2003, those members that failed to comply were not threatened with sanctions. Sanctions against noncompliant non-OECD members might include OECD member nations using domestic tax laws to deny all deductions, exemptions, allowances, and other credits for taxpayers or entities doing business there; imposing civil and criminal penalties to require new, extensive reporting of all activity involving it; introducing new withholding taxes on payments or transfers to such a center; and increasing tax audits on all offshore business activity associated with it (OECD 2000).

A few more countries stated their intention to cooperate fully with OECD requirements after the blacklist was published. There was a notable tendency for offshore financial centers with low levels of sovereignty (particularly British or Dutch territories) to comply, while independent countries such as Vanuatu tended to put up the strongest resistance (see van Fossen 1998). However, independent countries with very small offshore centers might also surrender to the OECD demands. In August 2001 Tonga repealed its offshore banking legislation and became one of five countries removed from the blacklist since June 2000—the others being the Seychelles, the Netherlands Antilles and Aruba (both Dutch territories), and the UK territory of the Isle of Man (*AFX News,* 23 Aug 2001).

The possible FATF sanctions could destroy an offshore center, but of the three international organizations, the Organisation for Economic Cooperation and Development posed the greatest threat and the most troubling dilemma to the largest number of Pacific Islands centers—and, moreover, seemed to be the dominant international organization. The newborn Financial Stability Forum was just finding its way, but the coinciding OECD and FATF memberships (despite formal administrative separation, their headquarters were in the same building in Paris); the short interval between their reports; and the frequent confusion in the media between tax minimization and laundering, all consolidated the impression among OFC promoters that the anti-laundering campaign was primarily aimed at the tax advantages offered by offshore centers. Proposed OECD sanctions for "harmful tax practices" seemed massive and imminent. Yet acquiescence to the OECD demands seemed to threaten an offshore center with rapid decline. Elements of the conservative press deplored the OECD campaign to "bully [Vanuatu,] a microdot in the South Seas" (*Daily Telegraph,* 1 July 2000, 30), while the pro-OECD *Washington Post* published an article entitled "The Threat from Vanuatu" about "one of the biggest threats to governments"—the increasing difficulties they were facing in collecting taxes from corporations and the wealthy (*Washington Post,* 2 July 2000).

Most Pacific Islands offshore centers became increasingly defiant, emphasizing that they were sovereign states with rights to determine their own tax laws and that the Organisation for Economic Cooperation and Development had no right (in international law) to impose its own tax rules on them. Vanuatu protested that the organization (consisting of thirty core countries) was not truly global and that if global tax policy was to be formulated it should be done by a forum that recognized the sovereign equality of states (*Offshore Investment,* Sept 2001). Palau, which was not on the OECD blacklist, criticized the international organization's tax initiative as an "improper and unacceptable exercise in economic imperialism" (*Palau Horizon,* 24 Aug 2001). Scholars presented detailed criticisms of the OECD initiative as, among other things, an unacceptable attack on the principle of sovereignty (Dwyer 2000; Hartman 2001). Some tax haven promoters proposed that the issue of OECD "fiscal colonialism" should be taken to the UN General Assembly to increase the cost to OECD political leaders of such policies and practices (Bendelow 2000, 2). In late 1999 the UN Offshore Forum had advocated conciliation with offshore centers and proposed that the best policy for metropolitan countries was to offer them assistance rather than threaten them with sanctions (*Money Laundering Monitor,* Jan 2000).

Offshore financial centers saw the OECD initiatives as attempts to protect the privileged positions of its own financial centers (eg, Paris, Frankfurt, New York) against the increasing incursions of other centers with comparative tax advantages in a period of growing financial deregulation and mobility. They insisted that tax competition was the same as any other type of competition and rewards should go to the most competitive. The Organisation for Economic Cooperation and Development was attempting to change the rules of a free market and proposing to enforce a comprehensive system of protectionism with an array of punitive sanctions. Furthermore the proposed OECD sanctions would violate international trade law's nondiscrimination provisions because they would not apply to OECD member countries that had similar "harmful tax competition" features. The OECD offshore centers competed directly with the non-OECD havens that were being threatened with imminent incapacitation. It seemed ironic that the states of Montana and Colorado had passed offshore banking laws (in 1997 and 1999 respectively) that appeared to violate OECD demands—and that the first offshore bank in the United States (First Colorado Depository Corp) was opening in 2001, with a second (First Montana Depository) scheduled to follow—the latter including the king of Tonga as a prominent potential investor (*Asian Wall Street Journal,* 7 June 2001). Various offshore centers in the Pacific and Caribbean threatened to take the matter to the World Trade Organization (*Money Laundering Monitor,* Aug 2000).

OECD meetings with Commonwealth, Pacific, Caribbean, and British Overseas territories in Barbados on 8–9 January 2001 (attended by the Cook Islands, Vanuatu, and Tonga); with all blacklisted countries in London on 23–25 January 2001; with Asia Pacific countries on 15–16 February 2001; and with the seven blacklisted Pacific Islands havens in Suva on 24–28 April 2001 led to increasing dissatisfaction and opposition to the organization on the part of Pacific Islands and other offshore financial centers. A thirteen-nation working group (including Vanuatu and the Cook Islands) was created at the Barbados meeting and charged with seeking a mutually agreed solution to the impasse. As negotiations reached a stalemate in March 2001, non-OECD offshore centers in eleven small and developing countries (mostly Commonwealth countries—including Vanuatu and the Cook Islands, with the Pacific Islands Forum Secretariat as an observer) formed the International Tax and Investment Organisation (*Financial Times,* 7 June 2001). In the same month Don McKinnon of New Zealand, the Secretary-General of the Commonwealth (whose membership includes a large proportion of blacklisted offshore centers) attacked the OECD approach—saying that it was turning into the world's financial policeman and wished to be "prosecutor, judge, jury and jailer" (*New Zealand Herald,* 3 March 2001).

The Cook Islands, which (unlike Vanuatu and Sāmoa) was on all three blacklists, increasingly shaped the regional response. The country's reaction to the Organisation for Economic Cooperation and Development became increasingly defiant. In February and March 2001 the Cook Islands government announced that it did not accept the terms of the OECD initiative, that the organization had failed to show any empirical evidence that offshore financial centers caused any actual harm, and that the Cook Islands would not meet the OECD deadline of 31 July 2001 (*Cook Islands News,* 1 March 2001). Cook Islands Prime Minister Dr Terepai Maoate denied that the Cook Islands was laundering money (Radio New Zealand International, 12 July 2001);[12] criticized the media for confusing laundering and legitimate international tax competition (Cook Islands Government Website, 3 April 2001); and described the OECD demands as a "discriminatory sweep across the face of small island states struggling to build and uplift themselves" (*Money Laundering Mon-*

itor, Jan 2001). Maoate said that the Cook Islands could not possibly close its offshore center because it was a "huge income earner for the country" (*Pacific Magazine,* July 2001).[13] He urged Pacific Islands solidarity against the OECD attack on offshore centers. In May 2001 the Pacific Islands Forum Secretariat agreed to a unified front—emphasizing that member countries should only negotiate as a bloc and demanding the removal of the threat of OECD sanctions (*Money Laundering Monitor,* June 2001).

Shift in the United States

For offshore promoters, the disposition of the United States was crucial, because FSF, FATF, and OECD policies were seen as being US-dominated (Bendelow 2000, 1). The Marshall Islands, with strong ties to the United States, protested to Washington, claiming that laundering had never happened there (Radio New Zealand International, 29 June 2001) and that accusations by the US State Department that some Marshall Islands firms were involved with the Russian Mafia were completely unsubstantiated (*Marshall Islands Journal,* 23 Feb 2001).

In the United States, a new organization—closely associated with the right-wing Heritage Foundation and funded by unnamed wealthy supporters ("The Center for Freedom and Prosperity")—emerged in October 2000 to fight the OECD initiative. The OECD program was presented as a ploy to raise global taxes, with politicians from European welfare states colluding to create a protectionist high taxing cartel (a kind of OPEC for bureaucrats); violating international traditions of fiscal sovereignty and individual financial privacy; and victimizing and impoverishing many small, less-developed countries with offshore centers.[14]

The Clinton administration's anti–tax haven campaign began to falter. It had two weaknesses: it did not come from the "grassroots," and the remoteness of havens (not least in Oceania) meant that they were very distant from most people's direct experience and concerns. The Clinton administration spearheaded the campaign but had difficulty convincing most Republicans, who, in opposition, appealed to US voters' more immediate and visceral aversion toward taxes, increased government surveillance, and filling out new forms revealing more personal information.

Although popular among Democrats, Clinton's anti-laundering initiatives were blocked in the Senate by the chairman of the banking committee, Phil Gramm, a Republican from Texas, a state where banks feared losing their lucrative cross-border business with Mexico. The advent of the conservative George W Bush administration in the United States defused a number of the OECD threats to offshore centers. Banks and financial institutions were very significant contributors to his presidential campaign and President Bush was close to those interests and people with little motivation to eliminate access to tax havens. One frequent barrier to US anti-OFC activities over the decades has been the lobbying by US banks that benefit from tax evasion, capital flight, and money laundering by foreigners—since the preeminence of the US dollar as the world's currency has resulted in huge flows into their deposit bases (and has helped the United States to meet its large balance of payments deficits).

The dominant view in the Republican Party was that anti-OFC measures had gone too far in compromising people's due process rights, the presumption of innocence, and financial privacy, as well as impeding the global mobility of capital and loading banks and other businesses with expensive, unnecessary, and ineffective reporting requirements. Representative Ron Paul of Texas, a Republican who was particularly hostile to the proposed new anti–money laundering legislation, added that it would damage relations with countries that hosted offshore centers and that it would impede progress toward digital money, which would reduce robberies and murders (US House of Representatives 2000c, 76–83). Republicans tended to emphasize the dangers of violent street crime rather than the relatively invisible offenses performed by the wealthy.

After Bush became president, doubt arose about the US commitment to OECD anti–tax haven policies. An unusual combination of Republican congressmen and all twenty-six members of the Congressional Black Caucus (allying with Caribbean offshore financial centers) urged new Treasury Secretary Paul O'Neill to withdraw US support for this OECD initiative. House Majority Leader Richard Armey from Texas characterized the Organisation for Economic Cooperation and Development as "a global network of tax police" and many Republicans emphasized that its initiative was not in the national interest because the United States had a lower tax burden than most OECD countries and was in fact a kind of tax haven for overseas investors benefiting from tax competition. The Bush administration had given top priority to cutting taxes and O'Neill was troubled by the supposition that low income-tax rates were somehow suspect.

On 10 May 2001 the Bush administration attacked two of the three basic principles of the OECD initiative—the goals of reducing global tax competition and ending discriminatory tax regimes. The administration also sought to confine international information exchanges to specific cases. The OECD initiative was seen as floundering (or at the point of collapse) after the United States withdrew its support (Global Information Network, 7 June 2001) and the June 2001 meeting of the OECD Fiscal Affairs Committee failed to publish the expected updated blacklist. The OECD threat of blanket economic sanctions against delinquent jurisdictions by July 2001 rang hollow and its campaign against discriminatory tax practices seemed fatally wounded. In July 2001 Bush's chief economic advisor, Lawrence Lindsey, confirmed that the White House was considering the complete abolition of personal and corporate income taxes in the United States as an ultimate objective (*New York Times,* 16 July 2001). Greater transparency (or limited international information exchange) remained the only goal of the ravaged initiative that had any possibility of surviving (*Money Laundering Monitor,* July 2001). The Organisation for Economic Cooperation and Development soon conceded that no sanctions would be introduced until April 2003, at the earliest. The Bush administration's attack on the OECD tax effort further frayed its relations with left-of-center governments in Europe (which saw the US administration as having been captured by corporate interests)—following conflicts over policies ranging from global warming to missile defense.

The net results of the Bush administration's actions were to move from threatening multilateral sanctions to encouraging bilateral treaties and agreements in relation to taxation and money laundering, while preserving OFC fiscal sovereignty. Bilateral agreements between the United States and offshore centers have not been seen as meeting OECD objectives. The Marshall Islands have been on all of the OECD blacklists, but the Islands had a bilateral treaty to exchange tax information with the United States for a number of years before the first blacklist appeared. The international organization continues to expect the United States to use its close links with the Marshalls under the Compact of Free Association to encourage the Islands to end OECD-defined "harmful tax practices" (Samuels and Kolb 2001, 252). There has been little support for this multilateralism in US Republican circles.

Soon after Bush took office, his administration also considered significantly cutting US support for the FATF initiative. Although conservatives often find measures against money laundering to be more acceptable than actions against international tax avoidance (Helleiner 1999), Bush ordered the Treasury Department to review US anti-laundering laws and enforcement (which were seen by some Bush allies as a violation of privacy and a wasteful burden on the US government, the US economy, and the financial industry). Pressure from the Bush administration had led to a delay in the original FATF deadline of 31 June 2001 for sanctions against blacklisted countries (*Financial Times,* 1 June 2001). Nauru, which was granted a reprieve from FATF sanctions until 31 September 2001, was then given another—until 30 November 2001—after passing some anti–money laundering laws. The Financial Stability Forum and its concerns have not yet become prominent on the Bush agenda.

11 September 2001

Most Democrats remained committed to strengthening the FSF, FATF, and OECD initiatives and have advocated firmer actions against offshore financial centers. They saw the terrorist attacks in the United States on 11 September 2001 as a new opportunity to connect the dangers posed by offshore centers with the funding of illegal organizations and threats to national security. It is ironic that some of the victims in the World Trade Centers in New York were involved in offshore finance.

International relations since the end of the Cold War have been unpredictable, and the terrorist attacks of 11 September completely changed the US view of Russia—from its being the target of deep US suspicion to becoming an essential ally in the war against terrorism. Media reports of Russian criminality subsided as the Kremlin welcomed the US military into its sphere of influence in central Asia. The United States supported Russia's efforts to be removed from the FATF blacklist (*Prime Tass,* 4 April 2002).

However, the sudden disappearance of the Russian threat did not rehabilitate the reputations of Pacific Islands offshore centers that had been linked with Russian clients. Instead, the anti-laundering movement refocused to view offshore financial centers (including those in Oceania) as expediting the financing of terror. The media reflected the new emphasis after 11 September, as when *Newsweek* reported: "While tiny Caribbean and Pacific-island banking centers like to portray themselves as discreet harbors for the wealth of the rich and powerful, investigators believe they have become money-laundering havens for terrorists and other criminals" (15 Oct 2001, 68). The Pacific Islands media asked questions such as, "Should Christian countries play host to an industry with proven links to organised crime and now terror?" (*Pacific Magazine,* Feb 2002, 27). Reports began circulating in the international media that about one third of Nauru's offshore banks were owned by Middle Eastern interests (Agence France-Presse, 27 Sept 2001).

On 5 December 2001 the Financial Action Task Force decided (for the first time in its twelve-year history) to recommend that countermeasures be imposed on a country, namely Nauru. In February 2002 it suggested that the sanctions be continued. Nauru's government threatened legal action against the task force, claiming that it had already met the original FATF demand by passing extensive anti–money laundering legislation (Asia Pulse, 6 Feb 2002). European countries (especially France and Germany) were reported to be imposing countermeasures on Nauru. Socialist Lionel Jospin, the French prime minister at the time, contrasted the enthusiasm of Europe for ending the financial flows that support terrorism with the alleged inaction of the United States against the Pacific nation—and questioned the reality of US commitment to the cause (Agence France-Presse, 11 Feb 2002).

Following 11 September lawmakers in Washington demonstrated their determination to fight terrorism by passing anti–money laundering legislation that was largely based on the Clinton administration's initiatives. There were some significant alterations: The bills proposed by Clinton and the Democrats had explicitly identified tax havens as being of "primary money laundering concern" (and, as such, they could be sanctioned by the US Treasury secretary). However, after the assaults on New York and Washington, prominent House Republicans and the Bush administration initially attempted to eliminate all anti-laundering provisions from the anti-terrorism bill (*American Banker,* 15 Oct 2001)—agreeing with bankers that anti-laundering measures would have done nothing to prevent the 11 September attacks because the funds going to the terrorists had not been derived from crime and hence had not been laundered (*The Banker,* Nov 2001). After that strategy failed (as the Democrats had recently won control of the Senate), the Republicans still managed to remove any mention of tax in the bill that eventually passed into law in October—under the striking title of the USA Patriot Act of 2001 (*CQ Weekly,* 6, 13, and 20 Oct 2001).

This represented a problem for the Organisation for Economic Development and Cooperation, which was attempting to define its tax-oriented campaign as part of a financial effort to stop terrorism and money laundering. The terrorist attacks had not increased the Bush administration's real support for the OECD campaign, even in the emasculated form that it had assumed. As the result of pressure from the Republicans in the United States, the international organization had (at least temporarily) abandoned three of its initial goals. Its explicit agenda no longer included the elimination of (1) unfair tax competition; (2) systems that gave tax advantages to entities with no substantial activities or presence; or (3) ring-fencing (where offshore tax and financial arrangements are available only to outsiders, not to residents). Even the remaining OECD projects—calling for transparency (the ability to produce information when requested) and information exchange—had been weakened.

The Organisation for Economic Development and Cooperation had set a 28 February 2002 deadline for tax havens to commit themselves to this program, but by that date only eleven of the thirty-five jurisdictions blacklisted in June 2000 had made the commitment. The organization decided to ignore its deadline and engage in intensive negotiations with the remaining twenty-four countries before issuing a new blacklist. It emphasized that it was extending its deadline for the Pacific Islands offshore centers in particular (Radio New Zealand, 20 March 2002). A change in government in the Cook Islands in March 2002 led to a significant weakening of anti-OECD sentiment there, and this also had some effect on Sāmoa and then Niue, which all reached agreements with the organization shortly before the new OECD blacklist was to be released.

On 18 April 2002 the Organisation for Economic Cooperation and Development claimed victory—indicating that all but seven recalcitrants had agreed to cooperate with its global campaign. On the same day, it issued a new blacklist of only these seven countries—Nauru, Vanuatu, and the Marshall Islands in the Pacific; Liechtenstein, Monaco, and Andorra in Europe; and Liberia in Africa. While the three Pacific countries had legislated and established new systems against money laundering to placate the Financial Action Task Force, their attitude toward the OECD was quite antagonistic. All of them announced in February and March 2002 that they would not be signing agreements to reform their tax policies (and thereby compromise their sovereignty) along the lines that the OECD recommended (*Offshore Investment,* March 2002; Radio New Zealand International, 14 March 2002; Reuters, 27 Feb 2002).

As the metropolitan media reported the OECD victory, two important features of the commitments given by the twenty-eight countries were frequently ignored or given little prominence. Firstly, the agreements covered only the sharply reduced OECD goals of transparency and information exchange. Secondly, they contained a potentially debilitating "Isle of Man" clause—specifying that these commitments were not binding unless all OECD countries agree to the same rules. OECD member countries (including the "permanent abstainers" Switzerland and Luxembourg) had been given until April 2003 to eliminate "harmful tax practices," while the non-

OECD offshore centers that signed commitments were given until 2005 to do so.

Tax haven promoters considered agreement within the Organisation for Economic Cooperation and Development to be highly unlikely and they switched their attention to defeating impending tax harmonization measures within the organization itself. In particular they worked for the anticipated defeat of the Savings Tax Directive of the European Union (EU), which would require automatic and mandatory information sharing among all EU members and would be ineffective without the cooperation of non-EU members such as Switzerland and the United States that seemed unlikely to sign similar agreements (*Offshore Investment,* March 2002). The rejection of this measure was seen as derailing the entire OECD campaign against tax havens, and offshore promoters warned countries with offshore centers that they must resist any OECD attempts to invalidate the "Isle of Man" clauses in their commitment agreements.

Meanwhile, the Bush administration was distancing itself from the European Union and the Organisation for Economic Cooperation and Development by concluding new bilateral tax treaties with a number of offshore financial centers. These treaties differed substantially from the multilateral models that European social democracies supported. These US treaties (which US Treasury Secretary Paul O'Neill was seeing as a way of changing the OECD focus) called for a rather limited form of information exchange (*Financial Times,* 19 Feb 2002). Offshore promoters felt that if a country as powerful as the United States could be satisfied with relatively little, then the greater OECD demands, or demands of European countries such as France, could be more easily resisted or at least temporized until there was a shift to the right in European politics. In the meantime, prominent Republicans in the United States continued to attack the OECD anti–tax haven campaign, even in its weakened form.

Further conflicts with the Bush administration can be anticipated if the Organisation for Economic Cooperation and Development pushes forward with more challenges to offshore centers. The organization plans to launch new initiatives against flag-of-convenience shipping (see van Fossen 1992), insurance, mutual funds and closed-end investment funds, leasing companies, debt-issuing vehicles, and abusive corporate vehicles in offshore financial centers, as well as international moves against lawyers, accountants, and other professionals who create offshore structures (*Offshore Investment,* June 2001; Aug 2001).

What remains to be seen is whether the Organisation for Economic

Cooperation and Development can continue to link its attack on tax minimization with the FATF campaign on the much more emotive issue of money laundering. While the OECD initiative encountered widespread resistance from targeted countries (at least until it was greatly weakened and substantially qualified), the FATF initiative met no such opposition and its recommendations were generally being followed. The Financial Action Task Force has left its mark on offshore financial centers in the Pacific Islands and elsewhere—most visibly in new legislation. But here again a change in direction is possible.

Conclusion

The future of Pacific Islands offshore financial centers may rest on the outcome of political struggles in the United States, other core countries, and international organizations. Without a high degree of international cooperation, sanctions against offshore financial centers in Oceania are unlikely to be very effective. Obtaining global cooperation may be difficult—especially if the goals are substantial and time is short. On the other hand, hostility to tax havens from social democratic governments has become intense and organized since the mid-1990s. Two things are clear—that the dominant media images of a number of Pacific Islands states may continue to be shaped by socially constructed perceptions of their offshore financial centers (making them targets of moral indignation) and that their international relations may at times be held hostage to the issue of their tax havens.

Notes

This article was written in April 2002. The situation described continues to change.

1 A tax haven is a jurisdiction that allows residents or foreigners to minimize their tax payments. An offshore financial center is a tax haven jurisdiction that has at least one significant institution primarily oriented toward accepting deposits and investment funds, and where intentional government policy is oriented toward attracting the business of foreigners by creating legal entities and structures, or facilitating immigration, naturalization, residence, or the acquisition of passports, to allow foreigners to minimize taxes, regulation, loss of assets, unwanted financial disclosure, and forced disposition of property. All offshore financial centers are tax havens. Not all tax havens are offshore financial centers

(eg, the Federated States of Micronesia and Pitcairn Island are tax havens, but not offshore financial centers). For the first comprehensive overview of the internal development of all Pacific Islands offshore financial centers—the major ones (Vanuatu, the Cook Islands, Sāmoa, the Marshall Islands, Niue, and Nauru) as well as the minor ones (Tonga, Palau, Norfolk Island, Guam, and the Northern Marianas)—see van Fossen 2002.

2 Money laundering is the practice of channeling illegally obtained funds through a third party in order to conceal their true source and make them appear to be legitimate.

3 The Bank Secrecy Act of 1970 was an initial effort to identify laundering activities, but it did not criminalize laundering itself. Its reporting requirements were poorly enforced by the US government and often flagrantly ignored by banks until the mid-1980s, when a "moral panic" associated with the Bank of Boston case assisted the passage of new laws (Nichols 1997).

4 In 1980 the Council of Europe, amid concern about the growing problem of kidnapping, adopted a formal recommendation (Measures Against the Transfer and Safekeeping of Funds of Criminal Origin), which was the first thorough international attempt to move against laundering, but it received little real support (Alexander 2001; Gilmore 1995).

5 While Erna Va'ai, the head of Sāmoa's offshore financial center, had heard many allegations and speculations about Russian businessmen appearing in the Pacific Islands, the story about the US middleman acting on behalf of the Russians was one she had not come across (*Islands Business,* Feb 2000).

6 *Australian Financial Review,* 27 Jan 2000; *Fortune International,* 24 Jan 2000; *Islands Business,* Feb 2000; *Offshore Investment,* Sept 2001; *PITCO Vanuatu Update,* April 2000; Radio Australia, 14 Feb 2000; Radio New Zealand International, 23 Dec 1999; 12 Jan 2000; Reuters, 11 Feb 2000.

7 *Australian,* 24 Dec 1999; *Guam Business,* April 2001; *Pacific Islands Monthly,* Feb 2000; *Palau Horizon,* 24 Dec 1999; 14 Jan 2000; 9, 23 June 2000; 7 July 2000; 26 Oct 2000; 22 June 2001.

8 The bill proposed criminalizing the laundering of proceeds of foreign crimes such as fraud, bribery, misappropriation of public funds, arms trafficking, and crimes of violence (US House of Representatives 2000b, 3). It was similar to the anti-laundering bills proposed by the Clinton administration in 1998 and 1999 (Fendo 2000), which the Republican-dominated Congress did not adopt.

9 The G-7 established the Financial Stability Forum in the wake of the Asian and Russian financial crises on 20 February 1999. It has 40 members: 25 representing the G-7 countries and their financial authorities, 6 the international financial institutions, 6 the international regulatory and supervisory groupings, and 2 the committees of central bank experts.

10 The task force has twenty-nine members, including the offshore centers of Hong Kong (China), Ireland, Luxembourg, Singapore, and Switzerland.

11 The only US preferential tax regime subject to OECD attack (the Foreign Sales Corporation legislation) had a Pacific connection but was repealed in 2000. This came after the World Trade Organization found, in favor of the European Union, that Foreign Sales Corporations—7 percent or 346 of which were in Guam—produced an illegal export subsidy of $1.4 billion to $2.5 billion a year (van Fossen 2002).

12 A few months before, however, there were reports that two Scotland Yard detectives had spent a week on Rarotonga in January 2001 investigating a case of suspected money laundering (*Cook Islands News,* 2 Feb 2001).

13 Despite the vast amounts of money that nominally flow through Pacific Islands offshore financial centers, they have in fact made relatively modest direct contributions to government revenues: Niue 6.5 percent (1999), Vanuatu 6.4 percent (2000), Cook Islands 4.5 percent (1997), Sāmoa 2.1 percent (1999), Nauru 2.0 percent (1999), Marshall Islands 1.6 percent (1996), and Guam 0.2 percent (1994). There are also lesser indirect contributions (van Fossen 2002).

14 This is despite Oxfam's claim that offshore centers drain $50 billion a year from developing countries (see Naylor 1994).

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Agence France-Presse <http://www.afp.com>
Asia Pulse <http://www.asiapulse.com>

BBC, British Broadcasting Corporation <http://www.bbc.co.uk>
Dow Jones International News <http://www.dowjones.com>
Global Information Network <http://www.ginfo.net>
Interfax <http://www.interfax-news.com>
Radio Australia <http://www.abc.net.au/rad>
Radio New Zealand <http://www.radionz.co.nz>
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Abstract

Pacific Islands offshore financial centers (OFCs) are battling against the danger that international organizations will cut them off from the global financial system. Since 1999 the image of the region's tax havens has been most shaped by the "horror story" of Nauru—the media's account of how Nauru has been involved with the Bank of New York and other banks in tens of billions of dollars of Russian money laundering, tax evasion, and illegal capital flight. In the late 1990s left-of-center governments led international organizations toward a much more aggressive attack on offshore financial centers. Soon international organizations began blacklisting offshore centers and threatening sanctions—with Pacific Islands being prominent targets. The advent of the conservative Bush administration in America defused a number of threats to offshore centers from international organizations, as the United States began to object to Europe's anti–tax haven agenda. While the attacks of 11 September 2001 led international organizations to rebuke offshore centers for helping to finance terrorism, OFC promoters contended that the anti-OFC campaign had been so weakened and qualified since the Bush presidency that it might soon collapse. The future of Pacific Islands offshore centers may rest on the outcome of political struggles in the United States, Europe, and international organizations. Two things are clear: that the dominant media image of a number of Pacific Islands states may continue to be shaped by perceptions of their offshore financial centers (making them targets of moral indignation), and that their international relations may at times be held hostage to the issue of their tax havens.

KEYWORDS: tax havens, offshore financial centers, money laundering, Pacific Islands, sanctions, international relations, social construction