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OFFSHORE PILOT QUARTERLY

Commentary on Matters Offshore

June, 2006.

Volume 9

Number 2

The Bloody and Invisible Hand

The former United States of America associate justice of the Supreme Court, Louis Brandeis, thought that privacy was “the most comprehensive of rights, and the right most valued by civilised man”. Conversely, the word for privacy is yinsi in Chinese and the characters that make up the word are associated with shady dealings and selfishness. I am sure that this will partly explain why the Chinese government is looking askance at Hong Kong with its western ways, private bankers and high-profile commercial connections with the British Virgin Islands, a British overseas territory, famous for both its offshore companies and, in the view of many Chinese, its secretive, capitalist activities.

China is, in fact, helping to fuel a growth in offshore activity in places such as the British Virgin Islands because of its economic relationship with the US which many Americans feel threatens their dollar. Americans, of course, already have several compelling reasons to look offshore, not the least of which is asset protection from litigation. As the Spanish proverb says: It is better to be a mouse in a cat’s mouth than a man in a lawyer’s hands. Then there is protection from predatory forfeitures, more privacy and access to a broader international selection of foreign investments free from the constraints imposed by the US Securities and Exchange Commission.

What’s new, however, is this concern about the fate of the US dollar which has spurred the search for an alternative and if moving into other currencies is considered the prudent thing to do, then offshore financial services centres are a beacon for access to foreign currencies.

Being introduced to offshore bankers also brings with it an awareness of other services beyond foreign currency opportunities. Match this with a desire to separate as many offshore investments from one’s domestic economy as possible, including perhaps the consequences of probate, and you will create a healthy interest in offshore companies, trusts and foundations.

What started out, then, as preservation of capital – without any regard for privacy or tax mitigation – might result in something completely different; it is a classic case of what economists and other social scientists have come to know as the law of unintended consequences.

Adam Smith made famous the phrase, “the invisible hand” and argued that each individual, in pursuing his own interests, “is led by an invisible hand to promote an end which was no part of his intention”. The phrase, in fact, comes from Shakespeare’s play, Macbeth, and was used in the context of Macbeth’s devious scheming to cover his murderous tracks. As the appointed hour of the planned murder of Banquo approaches, night descends to cover up “the tender eye of pitiful day,
And, with thy bloody and invisible hand,
Cancel and tear to pieces that great bond,
Which keeps me pale.”

In today’s world, “that great bond” can also refer to US Treasury bonds; but how long the Chinese will see them in that light and continue to invest heavily is another matter.

Buying Suits, Heating the Stove

Why has the greenback started to turn some Americans green? Last year, America ran a record current-account deficit of \$805 billion, up from



\$668 billion in 2004. The deficit rose to 6.4% from 5.7% as a share of GDP and America's trade deficit with China (its biggest) was over \$200 billion. China, for its part, has certainly greased the wheels of commerce with America by, firstly, permitting foreign firms to invest in Chinese factories where cheap labour produces greater profits and, secondly, by investing much of its export earnings in US Treasury bonds, helping to finance America's current-account deficit. In this Byzantine way, China is buying US dollar assets to guarantee that Americans can afford to continue buying its exports. In the words of Jacques Rueff, a French economist, "If I had an agreement with my tailor that whatever money I pay him returns to me the very same day as a loan, I would have no objection at all to ordering more suits from him".

At the same time personal debt in America has grown and it's as if households are impervious to its downside. Perhaps the American consumer's cavalier disregard is underpinned by the rise in house prices which, it should be said, has been an (almost) international phenomenon. Today there are more than 1.3 billion credit cards in circulation in the US and Americans are saving less than 1% of their disposable income, which means that the national savings rate is below 14% of GDP. The equivalent savings rate in the euro zone is over 20% and since 2000, China's overall savings rate (the world's highest) is almost 50% of GDP.

How things change. Between 1820 and 1950 GDP in China per capita fell by around a quarter and by 1973 Chinese income per head was worse than in parts of Africa. But since the reforms initiated in the late 1970s by Deng Xiaoping the country has seen its economy turn around. According to Niall Ferguson, author of *Colossus*, although only limited political changes have been made, China has concentrated on modifying its economic institutions.

India and China make up almost two-fifths of the world's population. America's National Intelligence Council has compared their emergence in this century to the rise of Germany in the 19th century and America's in the last. But even although India, unlike China, is a democracy (the

world's most populous), it does not follow that its relationship with America is plain sailing. M. J. Akbar, editor of the *Asian Age*, comments: "The Indian street has been nourished by the view that America is a democracy at home and a dictatorship abroad... Indians do not make good stenographers. They simply do not like taking dictation." This perspective, unfortunately, is not limited to the streets of India.

It is, however, communist China which has caught the interest more of American businesses because, when compared with India, its economy is two-and-a-half times bigger, it is growing faster and it is more integrated with the rest of the world. In fact, in each of the past four years, the annual increase in China's foreign trade has exceeded India's total merchandise trade. And last year China received approximately ten times as much foreign direct investment as India did.

All of this sits uncomfortably with Washington because China has befriended countries such as Venezuela, Zimbabwe, Sudan and Iran that the US (and many other countries) considers pariahs. China's motive, however, in choosing strange bedfellows has been its search for resources (13 years ago it was a net exporter of oil and today it is the world's second biggest importer).

But if Americans appear (if not literally) to be killing themselves with debt, China is using cars to achieve the real thing in alarming numbers. The death rate on its roads is the highest in the world and the World Health Organisation estimates that about 680 people die and 45,000 are injured every day. Americans, even although they have far more cars, are better drivers; there are some 115 people killed each day in road accidents.

Americans just need to steer their economy like they do their cars and putting agreements with tailors to one side, it would be wise for them to heed the words of Ludwig von Mises, an early 20th century Austrian economist, when considering America's current state of borrowing: "It may sometimes be expedient for a man to heat the stove with his furniture. But he should not delude himself by believing that he has discovered a wonderful



new method of heating his premises”. Cold comfort, indeed.

Name-Calling

Carl von Linné, a Swedish naturalist, invented the modern system of naming living creatures nearly 250 years ago. Taxonomists (this word, for the uninitiated, has nothing to do with taxes) have named a beetle *Ytu brutus* and a snail *Ba humbugi*; clearly, every profession has its humourists. The fact is that millions of animals are needing to be formally named so the ancient science of taxonomy is looking for all the inspiration it can find.

But there are cases where one name appears not to be enough for some living creatures. I was reminded of this when I recently received the regular statement from my bank in the United Kingdom. As it has for the past 30 years or so the bank addressed the envelope to D. R. Sambrook, Esq. An American lawyer reading that envelope address would assume I was a lawyer but would be uncertain, because initials were used, of my gender. The clerk at the bank in the UK, on the other hand, would not assume that I was a lawyer but would know my gender. Unlike the American lawyer, I was familiar with the adjunct to my name from growing up in the second half of the last century in the former British colony of Southern Rhodesia. Similar to many distant British colonies, the settlers (do you remember when there were such people?) usually tried to retain as best they could the traditions, customs and conventions (as well as the memory) of the country which they had left. These were people who identified with Harold McMillan’s belief: “Tradition does not mean that the living are dead, it means that the dead are living”. Unfortunately, some British settlers who chose to retire “back home” got a rude awakening when they set foot once again on Albion’s shores many years later and entered a changed world.

Esq. is an abbreviation of esquire which is a title of courtesy sometimes put after a gentleman’s name, particularly in letters, in the UK. (The subject was briefly mentioned in the December, 1999, issue of the OPQ). Its original intention was to denote a chivalrous, well-bred man and usually one of good

position. The appellation, however, has been appropriated and specifically earmarked for use by the American legal profession – of either gender – as an appendage after their name. That’s why the American lawyer could be easily misled by my envelope and it’s a good illustration of the importance of, what I term, cultural communication. Its significance, when it comes to the management of offshore financial services, is often underrated and yet the last thing needed in offshore business affairs is misinterpretation and misunderstanding. (See the next section).

I confess that, for me, courtesy from another era induces a delicious feeling of nostalgia. It harks back to the British Empire which is no more – despite once having covered 12.7 million square miles with the UK, at its centre, comprising less than 1 per cent of that total. In essence, some 430 million people were taxed and governed by one small island in the east Atlantic that controlled territories on every continent except Antarctica. M. J. Akbar’s Indian subcontinent was ruled at one time by less than a thousand British civil servants, which supports my long-held belief that good administration of offshore financial services is always down to staff competence regardless of staff numbers.

This December the word bachelor will disappear from official wedding records in England when it will be replaced by the word single which will apply to either gender. It has been decided that the word bachelor – once used to depict a young knight – belongs to a bygone era. Perhaps it does and I agree with W. Somerset Maugham that tradition should be a guide and not a jailer; but thinking of my bank statement, any title symbolizing courtesy should not suffer such a fate in a world becoming rapidly devoid of it.

Rules of the Game

It should be remembered that those UK dependencies prominent in offshore financial services are imbued with, and influenced by, British history and tradition. In practical terms, this means that the business approach can run counter to the habits and attitudes of other nationalities.



Not having been natural travellers, preferring the familiarity of home, many Americans have conducted business in British dependencies in the Caribbean which is not far away and in many instances has not even required the production of a passport. The statistics covering American passports are somewhat vague but seems to support this stay-at-home approach because the number issued hovers at around 20% of the population. Only a minute percentage of America's population (around 4 million) are, in fact, non-resident.

So sharing common law doesn't always mean people share common ground and this has presented problems for the client as well as his domestic advisers. One corporate leader has said that if someone is doing business in the Middle East and doesn't understand the difference in values, "they're operating on a baseball field by football rules". Those using the new financial services centre of Dubai take note.

When civil law replaces common law, the problems can be compounded for both businessmen and bureaucrats. Take the Financial Action Task Force (an inter-governmental body) as an example. The FATF has played a prominent role in the way that

offshore centres have been viewed by the industrialised nations and one would expect it to have a firm grasp of all the fundamentals. At its conference in Rio de Janeiro in 2005, whose attendees included representatives of national governments and international bodies, one subject title was "The Misuse of Corporate Vehicles, including Trusts and Company Service Providers". Those attending from civil law jurisdictions displayed little apparent surface knowledge of trusts or their uses – especially those who were representing law enforcement, regulatory and financial investigation authorities who should be concerned about their misuse. Not for the first time do I have to grit my teeth over the FATF and then, afterwards, repeat "nil desperandum" several times. The national game in America may be baseball, but Americans should forget all about its rules when they board their international flight, whether or not their destination is Dubai. And offshore practitioners, for their part, should also exercise tolerance and make allowances. There must be give and take and I don't just mean that clients dip in their pockets and practitioners take.

Offshore Pilot Quarterly has been published since 1997 by Trust Services, S. A. which is a British-managed trust company licensed under the fiduciary laws of Panama. It is written by Derek Sambrook, our Managing Director, who is a former member of the Latin America and Caribbean Banking Commission as well as a former offshore banking, trust company and insurance regulator. He has over 40 years private and public sector experience in the financial services industry. Our website provides a broad range of related essays.

Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice before making offshore commitments.

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