Small Place, Big Money: The Cayman Islands and the International Financial System

Susan M. Roberts
Department of Geography, University of Kentucky, Lexington, KY 40506–0027

Abstract: This paper examines the offshore financial center (OFC) of the Cayman Islands in the Caribbean as part of an attempt, on the one hand, to map emerging geographies associated with rapid and far-reaching changes in the international financial system, and, on the other hand, to further a Marxian understanding of how capital increases its flexibility and averts crisis (not unproblematically) through the financial system. Thus, in this paper, the major industries of the offshore sector in the Caymans are outlined and their development presented. I then examine the Cayman Islands' development and operation as an OFC in two wider contexts: first, changes in the practice of international banking, and second, the regional competition between "entrepreneurial islands" for offshore finance. I argue that the development of new spaces in the global economy—OFCs—cannot be understood without an understanding of changes in the international financial system (new markets, instruments, risks, and others). Furthermore, the changes in the international financial system cannot be understood *except* as operating *through* space and specifically through distinct spaces such as the OFCs. Although the Cayman Islands are a small place, they have strategically positioned themselves at the nexus of the circuits of fast and fungible financial capital and offer a window on the workings of the international financial system.

Key words: international financial system, offshore financial center (OFC), Cayman Islands.

In *The Condition of Postmodernity*, Harvey presented his "basic (though tentative) conclusion" that "if we are to look for anything truly distinctive (as opposed to 'capitalism as usual') in the present situation, then it is upon the financial aspects of capitalist organization and on the role of credit that we should concentrate our gaze" (1989a, 196). A year later Thrift began an editorial in *Society and Space* with the lament: "I simply cannot understand why so little attention is paid to matters of money and finance in human geography: it is a genuine mystery to me" (1990, 1135). Thrift is correct in noting that economic geographers have clung to production as their primary subject matter and have been slow to take up research on the financial system—even as it affects their traditional areas of interest such as urban property markets or production itself.

A small but growing geographic literature now deals with aspects of money and finance. Certainly, the rapid developments in the international financial system during the past 20 years and the associated shifts in the spatiality of capitalism have been difficult to ignore. Prompted by the increased salience of finance, geographers have undertaken empirical work at a variety of scales. A few have focused their attention on the geography of international capital flows (e.g., Daly and Logan 1989; Thrift and Leyshon 1988). Much of this international-scale work was initiated by development geographers who found themselves face-to-face with the multifarious effects of the so-called "Third World debt crisis" in the early 1980s (Fryer 1987; Corbridge 1988a); the asymmetrical international geographies of debt and surplus have been particularly emphasized in this literature (Corbridge 1988b; Corbridge and Agnew 1991). Of course, the 1970s and 1980s also proved to be years of social and economic restructuring in the "developed" world, entailing a marked decline in manufacturing employment and output and a concomitant rise in financial activity. Geographers became intrigued by changes associated with this sectoral shift, notably alterations in employment, urban landscapes, and social life (e.g., Thrift and Leyshon 1992; Pryke 1991; Bond 1990). Recent cross-fertilization with other disciplines (e.g., Budd and Whimster 1992) and especially with cultural studies in Britain (e.g., Bird et al. 1993) has resulted in a rethinking of the relations between financial markets and urban life. Other geographic work on finance has focused on technological innovations, especially those in telecommunications, that enable the increasing speed, scope, and complexity of the financial markets (e.g., Moss 1987; Warf 1989; Code 1991; Hepworth 1990, 1991; Langdale 1991). This literature is also connected to urban studies, especially to inquiries into the emergence of "world cities" (Sassen 1991; Freidmann 1986; Hall 1984).

Not all of the geographic work on finance is informed by a Marxian understanding of money and credit, of course, but it *is* from such a background that Harvey drew his conclusion regarding the significance of credit in understanding the survival of contemporary capitalism. Marxian scholars have developed a theory of finance wherein credit is the crucial feature.[1] Credit itself is understood as an extension of money as it works in circuits of commodity production and exchange. Harvey put it this way: "the credit system emerges as the distinctive child of the capitalist mode of production . . . yet this elaborate world of credit and finance is necessarily erected upon the monetary basis defined by conditions of simple commodity production and exchange" (1982, 253). In Marxian analysis the financial system internalizes all the contradictions of money, and Harvey (1982) has demonstrated the crucial role of interest and interest-bearing capital in compounding these contradictions.

The 1970s and 1980s saw massive reorganization and growth in the international financial system. The development of entirely new markets—fueled by deregulation and technological advances—was a rapid and enormously complex process. Marxian and non-Marxian analysts agree that these financial innovations enabled capital to be much more flexible. In a Marxian framework this enhanced flexibility is seen as allowing capital to overcome (albeit temporarily) its own deep contradictions that tend toward crisis—even as new types of potential crisis are generated. It is through the dynamic financial markets that crisis may be both deferred (temporally) and displaced (spatially). Harvey (e.g., 1985) has shown how temporal and spatial "mismatches" between the demand for and supply of surplus capital can be arbitraged through the financial markets. As this happens, new social understandings and experiences of time and space develop. Moreover, new types of material spaces, such as new financial centers, emerge. Contemporary capitalism, through its

[1] It is often noted that Marx did not fully develop a theory of money applicable to today's money, which is cut loose from a money commodity (such as gold). For an explication of Marx's writings on money see Rosdolsky (1977, 97–166). Marx's insistence on treating money as a social relation remains, however, a coherent and valuable starting point (Foley 1983; de Brunhoff 1976). Members of the regulation school (notably Aglietta 1982, 1987; Lipietz 1985, 1988, 1992) have put forward a neo-Marxian theory in which credit is central to a theory of contemporary capitalism and its crises, including financial instabilities (inflation, for example). Other work that is sociological in orientation combines Marx's ideas about money as a social relation with concepts drawn from Simmel (1990 [1907]) in an understanding of money and social (usually urban) life in modernity (see Frisby 1992). Both the economics-based and the sociological approaches derive from Marx's observations on money, and elements of both are to be found (sometimes combined) in geographers' writings.

hallmark component, the dynamic global financial system, is, to use Lefebvre's (1991) term, secreting distinct new spatial forms.

Indeed, in the 1970s and 1980s, at the same time as the top financial centers such as London and Tokyo were undergoing far-reaching change in the way they functioned and in the spatiality of their operations (see, e.g., Pryke 1991 on London), a series of new financial centers that came to account for a significant portion of the world's cross-border bank claims appeared on the world map (see Hultman 1991). From the Bahamas to Luxembourg to Vanuatu, small and often marginal places became offshore financial centers (OFCs): new and distinctive spaces corresponding to nodes in the circuits of offshore financial markets that developed in the 1970s (Roberts 1994). These new spaces correspond to the uneven global topography of financial regulation, composed of different national spaces of regulation (see Hancher and Moran (1989) on regulatory space(s) and Gentle and Marshall (1992), Clark (1992), and Christopherson (1993) for geographic treatments of economic (including financial) regulation). This paper examines one of these new regulatory spaces characteristic of contemporary capitalism's financial turn: the Cayman Islands.

The Caymans are a British Crown Colony in the Caribbean Sea. They are known as one of the most diversified and "successful" OFCs in the region and, indeed, the world. This paper investigates the rise of the Cayman Islands as an OFC and outlines the basic components of the financial sector in the islands. This empirical material is of interest in its own right as a contribution to a basic "mapping" of previously unmapped phenomena, the OFCs, but the empirics also dialectically inform and are informed by broader theoretical attempts to grasp the workings of the financial system as a most significant element of global capitalism. This investigation focuses on one particular small place, but it seeks to understand that place (the Caymans) as a part of the broader changes occurring in the spatiality of contemporary capitalism. The financial system plays a crucial (although deeply contradictory) role in averting crisis, and offshore financial centers such as the Caymans offer a particularly valuable window on this key process of the capitalist global political economy.

Although geographers have called for work on the international financial system, an enormous amount of basic information remains unknown. This gap retards attempts to grasp the geography of capital flows (for example) and to theorize the spatiality of the dynamic financial system, an urgent task—especially from a Marxian standpoint. Once the main dimensions of the Cayman Islands as an OFC have been discussed, I examine the Cayman Islands center in light of two characteristic developments in contemporary capitalism. The first is sectoral. I look at key changes in the structure and workings of the international financial system through the transformations in the practice of international banking and then consider the implications of these shifts for OFCs. The second context is that of regional competition for a share of offshore activity. Many Caribbean countries cast envious eyes at the Caymans' high standard of living, and many are now promoting themselves as OFCs. I explore the nature and implications of such competition among what I call "entrepreneurial islands."

From Tax Haven to Offshore Financial Center

"Imagine three tiny gems dotted in the azure waters of the Caribbean . . . palm fringed white sand beaches . . . lazy days . . . balmy nights . . . you're almost there . . . The Cayman Islands." So begins a tourist brochure elaborating the tempting pleasures of the Cayman Islands. In 1992, more than 241,00 vacationers stayed in the Caymans and more than 613,000 cruise ship passengers disembarked for a day ashore Grand Cayman (Cayman Islands Government 1993). When these visitors first explore George Town, the Caymanian capital, they may be surprised to find a bustling town with several shiny new office buildings displaying the names of banks from around the globe. They would be perhaps even more surprised if they stepped into the air-conditioned marble lobby of such a building and saw rows of brass or plastic plates bearing the names of the hundreds of companies for which the building is the registered office. These wayward tourists would have stumbled upon the second pillar of the Caymanian economy: offshore finance. With no significant natural resources and little prospect for agriculture, the Caymans have opened themselves up to two kinds of foreign visitors—those lying on the beach and those inscribed on the nameplates in the lobbies of George Town office buildings.

The Cayman Islands, like many other established and aspiring OFCs, built upon their history as a tax haven. A tax haven is "a jurisdiction"

> (a) where there are no relevant taxes; (b) where taxes are levied only on internal taxable events but not at all, or at low rates, on profits from foreign sources; or (c) where special tax privileges are granted to certain types of taxable persons or events. Such special tax privileges may be accorded by the domestic internal tax system or may derive from a combination of domestic and treaty provisions. (Spitz 1983, 1)

Thus the tax haven designation is a relative one. A place or jurisdiction takes on haven attributes only in relation to another place or jurisdiction. The Cayman Islands are one of a number of places in the world that are "no-tax jurisdictions." While duties are levied on imports and there are sales taxes, the Islands have no income, capital gains, or inheritance taxes. The no-tax status of the Cayman Islands has a long history, but it was not until the 1960s that serious attention was given to developing the Islands' tax haven role. The two major obstacles to attracting tourists had been tackled in the previous decade: an airstrip had been opened in 1953, and the notoriously fierce mosquito population was being brought under control. But despite offering some chances for employment, the nascent vacation industry was unable to absorb all the Caymanian men who found themselves displaced from their jobs on merchant vessels as supertankers, containerized cargo, and cheaper, less-skilled labor changed the merchant shipping industry and labor market (Johnson 1990, 141). In the 1960s, faced with this situation, Caymanian business leaders and politicians embarked on a deliberate strategy to develop the Islands' economy based dually on tourism and, by augmenting the tax haven role, offshore finance. Despite attempts at diversification, the Cayman Islands' economy remains almost entirely dependent on these two industries.

Some international banking was already present on Grand Cayman in the 1960s. Barclays Bank had arrived in 1953 and was followed ten years later by The Royal Bank of Canada and the Canadian Imperial Bank of Commerce. The 1960s were a time of laying the political and legislative foundations for an offshore financial sector. In 1962, after heated political battles, the Cayman Islands decided to become a British Crown Colony in their own right and not join Jamaica (of which they had been a dependency) in independence. The new Crown Colony took the first steps toward establishing the framework for a financial sector when, four years later, it refused to continue being a party to Jamaican double taxation treaties. The keystone Banks and Trust Companies Regulations Law and the Exchange Control Regulations Law were also enacted in 1966. In addition, the Caymans began to emphasize several advantageous factors in promoting itself as an OFC: the islands' location in the same time zone as Miami and New York (see Fig. 1); the ease of communication, via frequent flights to the United States, in particular, and a reliable telecommunications service; and, above all, the stable political and social environment of a British Crown Colony. These

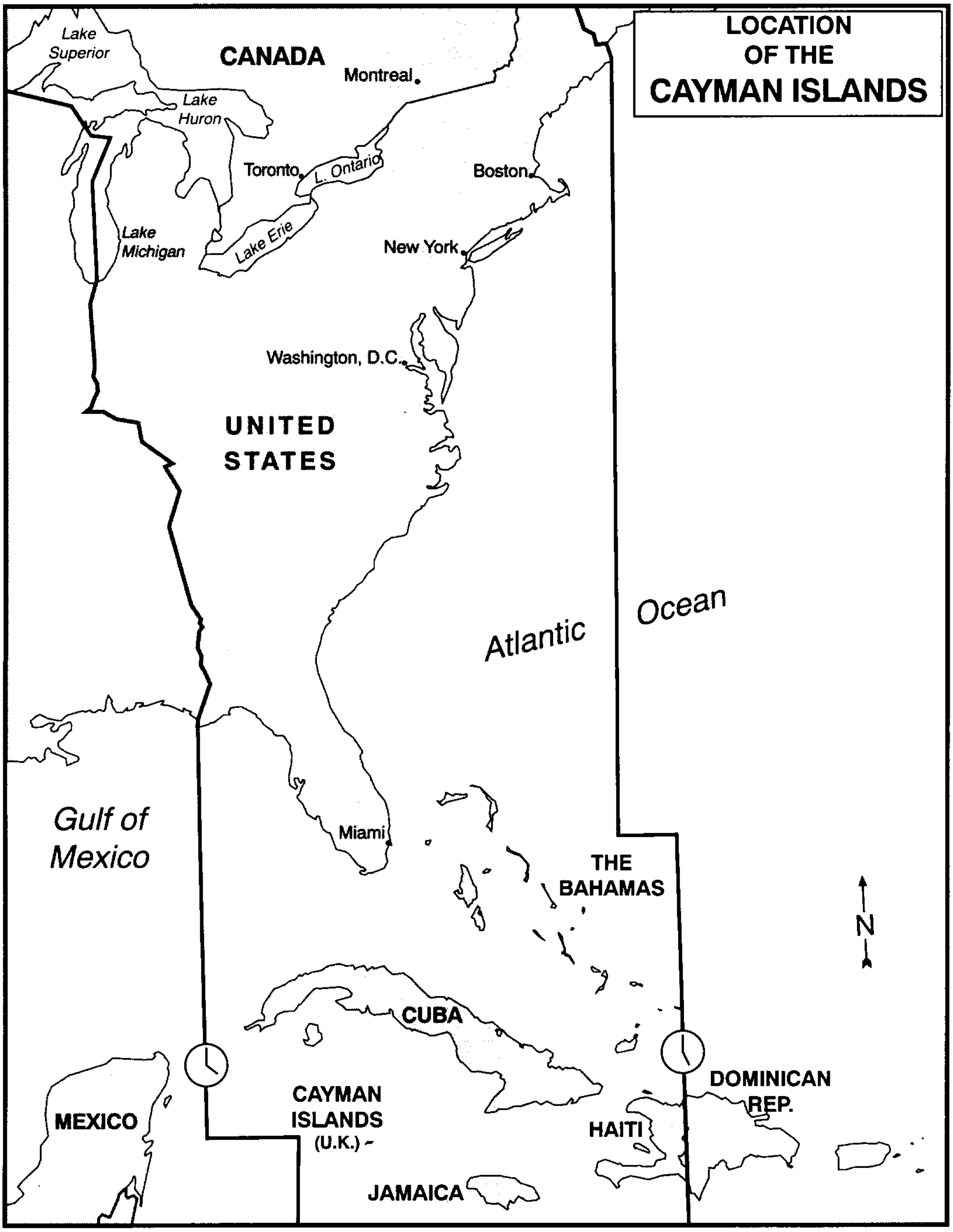

Figure 1. Location of the Cayman Islands.

basic factors are still listed in Caymanian promotional material today.

By 1972, more than 3,000 registered companies and more than 300 trust companies had been established in the Caymans. The Bank of Nova Scotia, First National City Bank (now Citibank), and three private banks were also added to the register (Great Britain 1973, 15–16). The Cayman Islands thus began as an offshore center focused on offshore company formation and trusts. Offshore banking soon developed, however. The Bahamas had been the regional leader in offshore banking, but the financial community there became fearful of restrictive measures when the Bahamas gained independence; the Cayman Islands were waiting with the necessary legal framework (much of it based on Bahamian law) and some basic infrastructure in place. Several companies, some banks and trust companies, and a number of personnel moved to the Caymans from the Bahamas, giving the Caymanian offshore financial sector a timely boost (Jonnard 1974, 165).

The Cayman Islands today rank as a well-established OFC in the Caribbean with a relatively diversified offshore sector. Offshore companies, offshore banking services, trusts, captive insurance, offshore mutual funds, and a variety of complex financial deals are to be found on Grand Cayman. The main offshore industries in the Cayman Islands and their salient characteristics are presented below.

Companies

The establishment of offshore "exempted" companies as trading, investment, or holding operations is a lower-order offshore activity. It does not require much in the way of sophisticated infrastructure or legislation, nor does it require a great number of skilled professionals. The Cayman Islands, with a resident population of about 30,000, have some 25,000 registered companies, of which more than 55 percent are purely offshore entities (Cayman Islands Government 1993). Most offshore companies can be exempted for 20 years from any taxes that may be imposed in the Caymans. Offshore corporations allow a high degree of confidentiality regarding their ownership and are not subject to many reporting or capitalization requirements. A directors' meeting has to be held annually in the Caymans, but "local agents may be appointed to fulfill this requirement" (Gill 1990, 230). Cayman companies are most commonly used as vehicles in contracting—a variant on transfer-pricing. For example, a Cayman company may be set up by a multinational firm as a leasing or rental company, leasing or renting equipment to foreign affiliates. The lease or rent payments are thus amassed in the Cayman company, reinvested tax-free, and may be repatriated at a convenient time (Gill 1982, 7). Along the same lines, a Cayman company may also be used by corporations as a sort of "dummy intermediary," and through double invoicing reserves can be accumulated tax-free. Another popular use for a Cayman company is to hold the title to land where secrecy of ownership is sought (Gill 1982, 9). Cayman companies may also be used to hold patents or film rights, own ships or planes, or as investment companies.

The government obtains fees from company registrations, which in 1988 totaled over \$8 million[2] (*Cayman Islands Yearbook* 1990, 117). About 18 firms specializing in the management of offshore companies operate on Grand Cayman. Various trust companies and law and accountancy firms also manage offshore corporations. In addition to taking care of the registration and incorporation of the entity, offshore company managers can provide a registered office, nominee shareholders, and even directors and officers.

[2] All dollar amounts are in U.S. dollars. The Cayman Islands has its own currency, the Cayman Islands dollar, which is officially fixed at U.S.\$1.20.

Banks

Although a number of Canadian and British banks had located in the Cayman Islands by the early 1970s, the number of banks, especially from the United States, increased dramatically on Grand Cayman during the 1970s. Indeed, from 1972 to 1982 the average annual growth rate in the number of category "B" (offshore) bank licenses was 23.4 percent. From 1982 to 1989 the average annual growth rate was just 3.1 percent (Fig. 2). The explanation for the sudden rise in offshore banking in the Caymans between 1972 and 1982 lies in the development of the Euromarkets (see Yannopoulos 1983, 245–46). The Caymans' experience was not atypical. In fact, the history of the world's OFCs and the Euromarkets are parallel. The Euromarkets are the quintessential offshore market. They arose "off the shore" of the United States as an exogenous market in U.S. dollars.

Although there is debate as to the relative importance of the factors leading to the Eurodollar and eventually the Euromarkets (as other national currencies and bonds were traded outside their home countries), it is clear that in general terms they were a response to the uneven geography of financial regulation in the "developed world." First, in 1957, as a result of the "sterling crisis," the British government restricted the availability of loans in sterling for trade financing outside the sterling area. In order to meet their customers' demands for finance, the banks turned to the unrestricted U.S. dollar. The London-based market for U.S. dollars continued to grow as banks sought ways around U.S. regulations. The Interest Equalization Tax (1963–74) was designed to stem the outflow of dollars, but

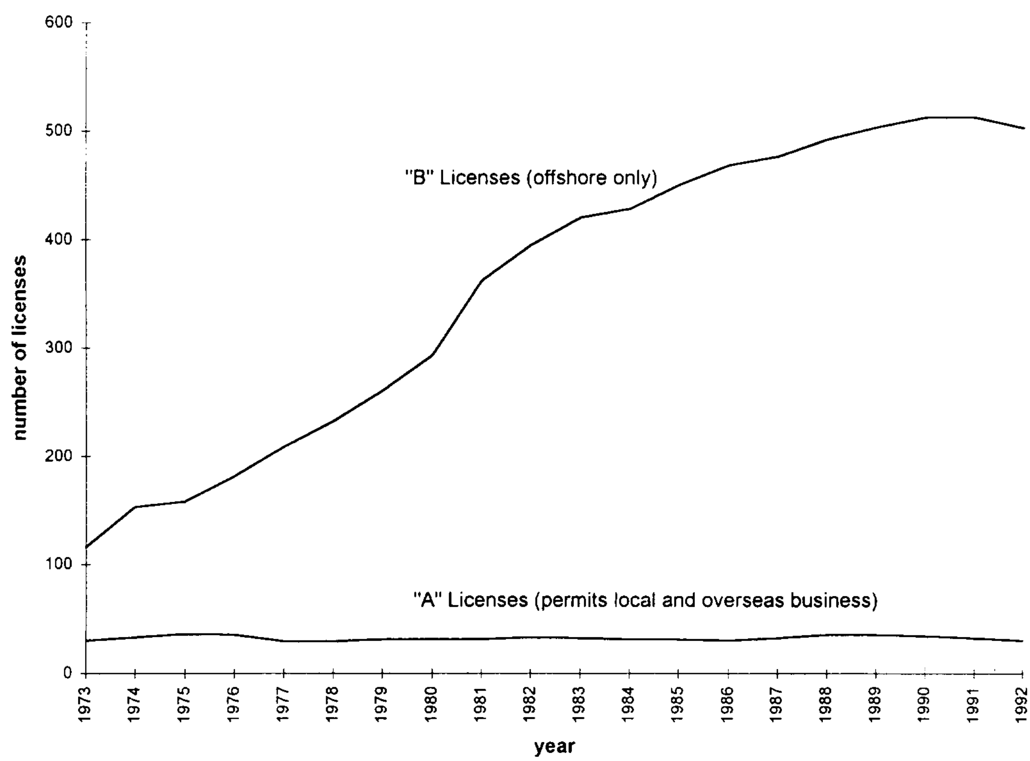

Figure 2. Cayman Islands, banking and trust licenses, 1972–92.

instead acted to herd investors toward the cheaper Eurodollar market (Little 1975, 65; Versluysen 1981, 25). In addition, the so-called Regulation Q gave the Federal Reserve the authority to set a ceiling on interest rates. Before the inflationary 1970s the maximum rates set under Regulation Q remained above the market rates. In the 1970s, however, the market rates rose higher than those the U.S. banks were permitted to offer (Pippenger 1984, 282–84). Partly to circumvent these regulatory rigidities, U.S. banks established branches in London. London became, and remains, the hub of the Euromarkets (see Versluysen 1981, 24–25; Tew 1977, 157; Johnston 1982, 12–14).

Since its establishment, the Eurocurrency market has undergone significant widening. Currencies other than the U.S. dollar are now important. The Japanese yen and some other currencies have grown in share of the Eurocurrency market, and the European Currency Unit (ECU) is also used (BIS 1990, 170–71). In addition to the currency market, there is also a Eurobond market that was originally a market for fixed-interest, long-term borrowing by corporations, governments, and municipalities. Now it includes floating-rate notes and has been the site of tremendous innovation. A host of ingenious financial instruments have been created as part of the global trend toward greater and greater securitization.

The Eurocurrency markets grew spectacularly in the 1970s. The Bank for International Settlements (BIS) estimates that the size of the Eurocurrency market grew from $57 billion in 1970 to a staggering $661 billion in 1981, reflecting the deposits of Organization of Petroleum Exporting Countries' surpluses, or "petrodollars" (Pecchioli 1983, 133). It was during this period that offshore banking in places such as the Cayman Islands took off, as internationalizing banks sought unregulated, "tax-efficient" bases from which to conduct (or at least to which to "book") their Eurocurrency business. Much of the "recycling" of petrodollars undertaken by banks in the 1970s was done in the Euromarket. Syndicated "Euroloans" (such as those to Third World countries) were often routed via an offshore center such as the Caymans (Lever and Huhne 1987, 29).

A bank does not need to set up a staffed office on Grand Cayman to use the Caymans in this way. Indeed, more than 80 percent of the 532 banks registered do not maintain any physical presence in the Islands. These are sometimes called "shell" branches, "booking centers," or "brass plate" banks and are found only as a brass or plastic nameplate in the lobby of another bank or law firm. The Eurocurrencies that are "booked" to Cayman shell branches do not actually come to the Islands but are merely entered into a ledger or a computer file by the parent bank's staff onshore. Although London remains the center of the Eurocurrency market, the Bahamas and Caymans together account for about the same amount of U.S. banks' branches abroad in terms of assets booked there. (For example, in October 1988 31.5 percent of assets were in London, while the Bahamas and Cayman together accounted for 31.45 percent (Khoury 1990, 3).) The leading country of origin is the United States, followed by Switzerland (Inspector of Banks and Trust Companies). Six of the 532 banks are full-service clearing banks (Barclays, Royal Bank of Canada, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Cayman National Bank, and Butterfields). Another 24 banks hold licenses to operate onshore, but the vast majority of registered banks (502) are purely offshore operations. Cayman banks had some $400 billion in external assets in 1992 (Cayman Islands Government 1993). By this measure, the Caymans rank as one of the world's largest financial centers.

During the 1970s the Cayman Islands blossomed as an offshore banking center, hosting international (predominantly U.S.) banks that were busy recycling petrodollars and making loans to the developing world. The 1980s were quite different, of course, as Third World lending dried up in the face of the "debt crisis" and international capital markets underwent far-reaching securitization. U.S. banks now face competition as financial intermediaries as more Japanese banks and securities houses "globalize." The effects of these changes on the Caymans, and the changing role of an OFC in the contemporary dynamic world capital markets, are explored below.

Trusts

The trust is a distinct feature of the Caymanian offshore finance sector. On the basis of principles of English common law, the Caymans enacted a Trust Law in 1967 (Adams 1972, 529). "Essentially a trust is an instrument which allows a person to divest himself [*sic*] of assets by giving them over to a trustee to hold for the benefit of persons (including himself [*sic*]), charities or other entities known as beneficiaries" (Bothwell 1990, 182). More than 40 entities are licensed to conduct trust business in the Caymans; the main ones are owned by large British, American, Swiss, and Canadian banks. Trusts are used to avoid certain taxes, to set up a "bolt-hole" in case a destination should be needed for flight capital, and to avoid certain inheritance laws or to cut out lengthy probate proceedings (Merren 1990, 208). Like offshore companies, and banking to some extent, trusts on the Caymans are attractive because of the legally protected confidentiality that surrounds them.

Insurance

The Caymans rank second in the world (by numbers of companies) as a center for offshore insurance. Bermuda is the world's largest offshore insurance center, and Guernsey is in third place. Offshore insurance is the business of setting up "captives." A "pure" captive is "a wholly owned or controlled company that only insures or reinsures the risks of its non-insurance parent or affiliated companies" (KPMG 1988, 5). Other kinds of captive insurance companies in the Caymans include "association" or "industry" captives, which are "insurance compan[ies] owned by a group of . . . companies or members of a professional association solely to insure or reinsure the risks of . . . shareholders," as well as "agency" and "open-market" captives (KPMG 1988, 5). Self-provided risk management or insurance coverage cuts out another company, thus reducing costs. Forming a captive offshore eliminates the uncertainty of cost and availability of coverage in the notoriously cyclical North American insurance market (KPMG 1988, 7–8). Like offshore companies in general, a captive may also be used as a profit center or as a vehicle for minimizing or deferring taxes.

The first Cayman Islands captive, a medical malpractice captive formed by a group of Boston-area hospitals affiliated with Harvard University, was set up in 1976. At the time Bermuda, the premier site for captive insurance, was not welcoming medical malpractice captives. The fledgling insurance industry on Cayman received a welcome boost when social unrest was feared in Bermuda. As in the case of banking, where the Caymans benefited from fears about an independent Bahamas, they also profited from apprehension over the riots that followed the trial and execution of the murderers of Bermuda's governor (Stelling 1989, 2). Several Bermuda-based captives set up bolt-hole companies in Cayman, which they later found they could operate successfully. Recognizing the need to regulate (at least minimally) the growing insurance industry, the Caymans government passed the Insurance Law in 1979. It came into effect in 1980, and after an initial drop in the number of companies (some did not meet the requirements) the number of captives continued to grow. Under this law captives are required to be managed by a licensed insurance manager, of which there are 28 in the Caymans (Ridley 1990, 6). The majority of captives are medical malpractice captives of U.S. origin. Other kinds of risks that Cayman captives cover include a range of professional liabilities and workers' compensation. In 1992 there were 372 offshore insurance companies licensed in the Cayman Islands (Cayman Islands Government 1993).

Other Offshore Entities

A major trend in the diversification of the offshore financial sector has been the increasing use of the Caymans as a base for mutual funds or unit trusts. In this regard the Caymans benefited when the Channel Islands (Jersey and Guernsey) appeared to be under threat of exchange controls (*Euromoney* 1989b, 65; Ridley 1987, 11). In addition to unit trusts with a London–Channel Islands origin, the Caymans are also host to American operations and increasingly to Japanese funds.

A certain amount of Eurobond business is done via the Caymans. Highly complex financing arrangements involving new financial instruments created in the securitization and repackaging boom of the 1980s also involve the Caymans—often as just one link in a chain of places and transactions.

Not exactly financial, but definitely offshore, Cayman has recently been revamping its ship registry as part of an attempt to compete with the likes of Panama and Liberia in the "flag of convenience" business ("Cayman Islands Ship Registry" 1989). This represents the government's commitment to diversification of the offshore financial sector. Like the shipping registry, the Caymans' aircraft registry is also under the British system and is fairly active.

Effects of the Offshore Sector in Cayman

The overall contribution of the financial industry to the Caymanian economy is hard to assess. In 1992 the government received some $25 million directly in fees and licenses for registration and operation (Cayman Islands Government 1993). Estimating for fees paid by companies and banks that are onshore rather than offshore operations would still make that figure over $20 million, which is more than 15 percent of total government revenue for 1992. Of course the government also has expenditures for the Banking Inspectorate and so forth. These figures are not disaggregated, however. The benefits that the private sector derives from the offshore financial sector are likewise difficult to quantify. There are 25 accountancy firms, including the big transnationals, in the Caymans. There are 18 law firms and approximately 80 lawyers, with an estimated 40 to 50 specializing in offshore finance (Roberts 1992). Nineteen firms specialize in offshore company management, and 28 are licensed insurance managers. Available 1992 data show that, together, banking and insurance (offshore and onshore) account for 10 percent of total employment in the Caymans (Cayman Islands Government 1993). The insurance industry as a whole (including onshore insurance) employs 226 people (of whom 200 are Caymanians) (Cayman Islands Government 1993). About 70 banks and trust companies have a physical presence on Grand Cayman, and insurance managers and company managers all collect fees for their services. There are 1,363 people employed in banking alone, the vast majority (1,062) of whom are Caymanian (Cayman Islands Government 1993). The majority of professionals in the financial sector (such as lawyers and accountants) are expatriates, usually British and usually male.

The large number of non-Caymanians is a highly sensitive political issue (see Pineau 1988a, 1988b). Caymanians now make up only 67 percent of the total resident population of the Caymans, which totals 29,700 (Cayman Islands Government 1993). The tourism industry, which relies on large amounts of imported (unskilled and semiskilled) labor, rather than the financial sector, is seen as the chief culprit. The financial industry is, however, acutely aware of the importance of social and political stability in attracting finance to the Islands, and there are attempts under way to train more Caymanians for some of the better jobs in the financial sector.

The Cayman Islands have become a successful OFC. In part, OFCs profit from volatility and turbulence in world markets. The Caymans have to some extent benefited from open engagement with international capital. Nevertheless, such flexible and open involvement in markets that are characterized as "inherently fickle and shallow" (*Euromoney* 1989b, 9) also entails extreme vulnerability. Changing financial markets and institutions and competition from other "entrepreneurial islands" are two key contexts the Caymans must face. The next section of this paper explores these themes in more detail.

The Cayman Islands' Dynamic Economic and Political Contexts

Banking: Offshore and Off–Balance Sheet

The rise of the Euromarkets as a source of privately created liquidity for the world economy marked a shift from the system that had been set up at Bretton Woods in 1944. The shift from public to private liquidity was paired with a shift from relative stability (albeit strained) to a high degree of volatility. President Nixon's closing of the gold window in 1971 signaled the end of the (more or less) fixed exchange rate system, and currencies began to (more or less) float against one another. Daily fluctuations in exchange rates (the relative "prices" of currencies) have been matched by rapid variations in the other major "prices" in the world economy, including interest rates (the price of credit) and inflation (the price of goods and services) (Strange 1986, 4). Volatile prices have meant that, for the corporation, the "world is a dangerous place in which to live," as a Chase Manhattan advertisement for corporate services puts it. Capital has adopted various measures to manage the risks stemming from volatility, such as hedging in foreign exchange. It is important to remember, however, that the flip side of the risk inherent in volatility is the opportunity to profit from change or difference (arbitrage). Thus corporations that have traditionally been manufacturing firms are increasingly running their treasury or finance departments as "profit centers in their own right" (*Euromoney* 1989a, 8). These departments, staffed with people Wachtel (1986, 153–78) identifies as "the new corporate money mandarins," are actively engaged in profit-making from mergers and acquisition activity, foreign exchange dealing, and interest rate and currency swaps (see Farrell and Light 1990 for examples). Reflecting on this change in corporate structure and goals, a former IBM executive concluded that "speculation has become institutionalized" (Rotenstreich 1985, 51–52). As Thrift noted, "the internationalization of production and finance has forged much closer links between the two" (1989, 72). Corporations are becoming financial institutions in their own right, adding to competitive pressures on banks.

Partly in response to these challenges, banks have undergone significant changes in their structure and practices. Banks no longer just take deposits and make loans, then sit back and watch the interest roll in. They are now highly diversified and are engaged in creating ever-more-complex financial instruments that allow risk management and profit in the face of volatility. This change has been described by *The Economist* as a shift from mass production to flexibility (1990a, 16–21). The move away from "mass-produced loans" has taken the form of a pronounced shift toward various off–balance sheet activities.

Other factors, in addition to increased competition from "nonbanks," have prompted this move. A major impetus has been the Third World debt crisis—or, more particularly, the manner in which the heady days of "recycling" in the 1970s came back to haunt banks in the 1980s. Since 1982, loans made to many Third World countries have looked increasingly risky, and many banks have been attempting to build up their loan loss reserves in response.

Banks are also under pressure to meet capitalization standards as laid out by the Bank for International Settlements (BIS) and endorsed by the Group of Ten countries in 1988. Stipulations require banks to have capital reserves equal to 8 percent of their risk-weighted assets and off–balance sheet commitments[3] (IMF 1989, 7). The BIS requirements are in part a response to the proliferation of off–balance sheet activity and the potential risks entailed (see Cates and Davis 1987; Khambata 1989). Just as off–balance sheet activity was a series of innovations to circumvent regulation, however, banks are being spurred by the BIS requirements to more innovation and hence new risks (*The Economist* 1990b; and see Kane 1987 on the "regulatory dialectic").

On the demand side, the highly volatile world financial system and the increasingly interconnected global networks of investment, trade, and manufacturing have meant that internationalizing capital requires ways to deal with or manage risk. The first customers for global risk management services offered by transnational banks were U.S. institutional investors such as pension funds and insurance companies that sought to manage international portfolios (*Euromoney* 1989a, 21). Now banks compete aggressively for such clients, offering them a package of corporate services under the label "global custody."

> At the heart of global custody are the basic services of settlement, asset safe-keeping, tax reclamation, collecting dividends and reporting information to the customer on anything relevant to his [*sic*] stocks—rights issues, takeover bids and the like. But there are a lot of other services that have developed—stock lending, investor accounting, performance measurement, master trust services, risk analysis. (Sowton 1989, 24)

The Cayman Islands and other OFCs are used as nodes in a network by global custodians, with banks often "cross-selling" jurisdictions to customers (Roberts 1992). In many cases the trading and cash management operations entailed in the management of very large international portfolios may not be executed in the Caymans (they may be done at another offshore center, such as Bermuda) but are booked to the Cayman Islands. Global custody business allows banks to pair the older tax haven attributes of the Caymans (particularly the trust concept) with new financial instruments. Such business is necessarily technology-dependent, and global custody requires massive investments in telecommunications and data management technologies. That the Caymans have a reliable power supply, good quality telecommunications links, and available professional and technical skills means that participation in global custody networks is feasible.

Another newly developed package of services that banks are offering is "international private banking" (IPB). While this sort of service has a long history in banking, it is only recently that banks have reorganized their internal structure in such a way as to be able to offer a cluster of services marketed as IPB. Through IPB banks are "providing a convenient, confidential, and comprehensive program of personal financial counseling, structured to meet the investment, banking, and estate planning needs of wealthy individuals" (Wacker 1989, 71). For example, Citibank, a leader in the promotion of IPB, reorganized internally to tap the resources of targeted so-called

[3] It might be useful to explain the terminology being used here, as a bank's assets and liabilities may initially seem "the wrong way around." A bank's assets are the loans it has made, and banks treat deposits as liabilities. A bank's balance sheet shows its assets (loans) and liabilities (deposits). Banks are increasingly engaged in activities that are not registered on the balance sheet (off–balance sheet activity) but which generate income. These include a variety of fee-based services (financial advising, portfolio management, etc.), some of which are discussed in this paper.

"high net-worth" populations. They targeted people who were self-made, specifically seeking out professional athletes and entertainers, in addition to their traditional targets: those with inherited wealth (Heilshorn 1989). Through their incorporation into IPB networks, the Caymans have benefited from two key developments: first, the huge increase in the wealth of the rich in many countries (including the United States—one aspect of a wider trend Lipietz (1992, 35) calls "Brazilianization") in the 1980s; and second, the internationalization of these private monies as transnational banks compete to sniff out and set them in motion. In an interview, a Cayman Islands banker commented to me that

> People are beginning to realize that there is a fantastic amount of capital in the hands of private individuals. In the past it tended to be static—a historic chain of family money and they were always advised by the same people and the money stayed in the same place. For example, they had a merchant bank in London look after their affairs and the money went into bonds, or perhaps blue chip stocks, and it stayed in Sterling. Now with internationalization and communications, people can have assets in several jurisdictions and in several currencies. The mobility of capital is far greater and they need more services: this is where private banking comes in. People have all sorts of assets all over the place. They might have a stud farm in North Florida, a house in Monte Carlo, a place on Mustique, and so on. It is very diverse. (quoted in Roberts 1992, 132)

The legally guaranteed confidentiality (albeit with exceptions under the Mutual Legal Assistance Treaty (1989) negotiated with the United States) is an important factor attracting IPB to the Caymans. Bankers acknowledge that the biggest risk they face with IPB is "criminal involvement" (Wacker 1989, 79), because there is considerable overlap between funds in IPB and international "hot" money flows. While the exact connections between the gains of drugs trading or securities fraud and IPB are notoriously difficult to trace, the general link between IPB and capital flight is easier to see. Capital flight is difficult to define, but Gulati offers a working definition: "speculative short-term capital outflows based on economic or political apprehensions in the home country" (1988, 166). In his review of attempts to measure capital flight, Gulati notes that a frequently used gauge is the "'errors and omissions' line of the balance of payments as calculated by the IMF" (1988, 171). In addressing the problem of assessing the potential market size of IPB, Wacker writes: "One consultant advises that the best way to determine the size of the global private banking market is to analyze international capital flows, particularly the errors and omissions account. Sadly most of the funds in the international private banking market come from countries experiencing political and economic instability" (Wacker 1989, 73). Through capital flight the Cayman Islands have a double involvement in the Latin American debt crisis: as a booking center for the original Euroloans, and now as a haven for the flight capital, which is probably itself a cause as well as an effect of the debt crisis (Naylor 1987, 332–33). Of course IPB is not all flight capital, and not all flight capital is IPB. Capital flight may take many forms, from smuggling to sophisticated financial deals spread out over a number of centers. The Caymans are a center for flight capital in the form of reinvoicing for corporations, especially from Latin America, worried about the sudden imposition of exchange controls (Roberts 1992).

By examining the changes in transnational banking it may be seen that the Caymans, and OFCs in general, are being used as "platforms" from which banks can enter specialized financial markets. These new markets have exploded in size and variety in the past 20 years or so as circuits of capital, enabled by technological developments and deregulation, have sped up and internationalized. In addition to the new markets, the institutional form of financial intermediation has also been restructured. Multinational corporations (including banks) have undergone substantial changes in their structure and operations and have become more interlinked. Thus, as new spaces in the global political economy, OFCs are components in major shifts in the institutional forms of capital (corporate restructuring) and in the development of new financial markets. In other words, both capital's (particularly financial capital's) restructuring and the creation of new markets have been, in significant ways, achieved *through* offshore financial centers.

Inter-Island Competition in the Caribbean

The Cayman Islands are a component of a regional cluster of OFCs in the Caribbean (Fig. 3). The Caribbean centers range from the relatively old, such as the Bahamas, to the relatively young, such as the Turks and Caicos. Each island country creates or exploits its own particular comparative advantages. As Lee and Schmidt-Marwede (1993, 507) demonstrate, "competition is the condition of existence of all financial centers." The main center competing with the Caymans is the Bahamas and, if the region is stretched northeastward, Bermuda. The Bahamas are known as a banking center, and compared to the Caymans they have a higher proportion of functional (as distinct from "paper") operations, although in size (of foreign liabilities) the Bahamas have fallen behind the Caymans since 1985 (*Euromoney* 1989b, 3). Bermuda and Cayman compete as locations for captive insurance. For a while Barbados enjoyed a comparative cost advantage for captives

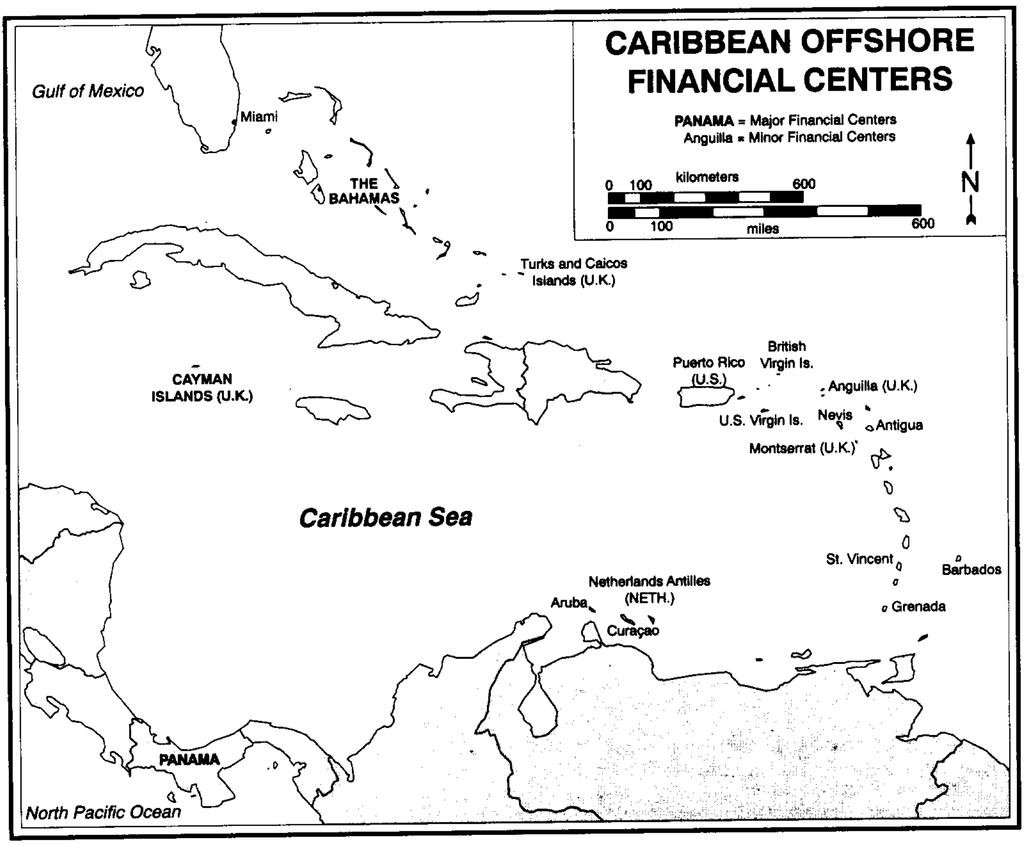

Figure 3. Caribbean offshore financial centers.

under a treaty with the United States, but the treaty is now expired (Shalowitz 1989, 70–71).

The Caribbean Sea is peppered with OFCs, each offering idiosyncratic advantages but sharing basic characteristics. In a special supplement on Caribbean OFCs the journal *Euromoney* (1989b) asked "why so many?" and in answering its own question offered two reasons. One is the demand for particular services which can only be found in particular centers which have developed their advantages in that niche. Second, many people and corporations using offshore financial centers are reluctant to "put all their eggs in one basket" and so spread their interests over several centers.

A full answer to the question "why so many?" must take into account "supply side" factors as well. The island economies of the Caribbean are struggling to find options for development. The only viable strategies appear to be those that open the economies as adjuncts to North America, as vacation spots and offshore bases for finance and manufacturing (or more particularly assembly—e.g., of baseballs and clothing under the Caribbean Basin Initiative). The region's chief industry is now tourism (CDB 1989, 20). Many Caribbean countries see offshore finance as a means to raise government revenue (in hard currency) and are impressed by the success of the Caymans, which boast the highest per capita GNP in the region (estimated at U.S. $20,000 in 1991) (*Euromoney* 1992, 25). Setting up the basic legal framework for an offshore finance sector is not complex. Appropriate legislation is simply copied from another jurisdiction. The British Virgin Islands' International Business Companies Act is exemplary in this respect. It has been copied by such jurisdictions as Montserrat and Aruba. Offering an offshore companies registry is one of the lowest-order offshore activities and compared to operating as a base for offshore banks is considerably less risky.

Companies registration is highly competitive, and the crucial factors in comparing jurisdictions, once similar laws are in place, are the time it takes to set up a company and the fees levied (see Smith 1990). In the cases of banking and insurance, the time and cost factors are rather less important. In offshore centers which specialize in these higher-order industries, much greater attention is devoted to establishing and maintaining an image of respectability, solidity, and confidence. In the Cayman Islands this involves public and private sector cooperation in constantly reviewing legislation to take account of changes in other jurisdictions, in enacting new legislation to accommodate new financial innovations or products, and in general promotion of the Islands' good reputation. A prominent Cayman Islands lawyer made this point in a 1987 address:

> One must always be looking to improve. I believe that the Cayman Islands Government and the financial community are well aware of this and it is incumbent on us all to ensure that the Cayman Islands community understands the highly competitive business we are all in. That means we must watch closely what other jurisdictions are doing or plan to do, particularly in terms of legislation designed to make them more attractive. This is an area in which the legal profession is, of course, crucially interested and involved. Likewise the Cayman Islands Government. (Ridley 1987, 17)

The promotion of the Caymans—or more precisely of a certain *image* of the Islands—as an up-market, respectable financial center is achieved in a variety of ways. The government, together with the Chamber of Commerce or professional associations, has done such things as set up booths at industry conferences, organize one-day seminars in New York and Miami, and publish information on the Cayman Islands as an OFC. In addition, individual banks and corporations make videos to show to potential clients and to colleagues elsewhere who might refer customers to the Caymans. Such videos emphasize the sophisticated and up-to-date financial center, the political and social stability of the islands, as well as the scenic attractions of the beaches and coral reefs.

One source of tension in many OFCs in the region is that in many instances the same people who are responsible for regulation and supervision of the offshore financial industries are also engaged in active promotion and solicitation (Roberts 1992). A further twist on bank regulation and supervision in particular, but on financial regulation in general, is that the regulations and their enforcement are factors which can themselves become comparative advantages as places compete for business (see also *Euromoney* 1992, 4).

While there are considerable parallels between the processes of competition comprehensively studied by Lee and Schmidt-Marwede (1993) in the financial centers in the "developed world" and the processes of competition between the OFCs in the Caribbean region, there are some significant differences. Because island countries such as the Caymans are seeking economic development options that will ensure a basic economic security, they are more willing to compete for an array of institutions, including those that generate only a minimal level of revenue. At the same time, each Caribbean center attempts to attain comparative advantage in certain niches. Also, the world's clusters of offshore centers are in an adjunct relationship to the major economic blocs and the financial centers therein. Thus the Caribbean OFCs only exist as adjuncts to the North American bloc and to the financial centers of the United States and Canada (see Roberts 1994 for a discussion of other clusters).

The competition between OFCs is but one variant of a more generalized process. Geographers have paid particular attention to interlocality (usually interurban) competition in countries or regions of the "developed world" (see Cox and Mair 1988; Cox 1993; Harvey 1989b; Wood 1993). The rise of the "entrepreneurial city" and the development of an urban growth machine politics (Logan and Molotch 1987) have been fairly extensively studied. Development geographers have been aware of intercountry competition for investment, and those studying the Caribbean have seen how islands compete for manufacturing investment, for example (see Klak and Rulli 1993). This interplace competition is part of the competitive impulse of mobile capital in general. In Harvey's words: "Capitalists now have the power to exploit relatively minute spatial differences to good effect. . . . As the friction of distance diminishes as a real constraint, so the variety of what the world's spaces contain also becomes of ever greater significance. Strong coercive laws of competition force capitalists to seek out every relative spatial advantage they can" (1988, 124). In the financial markets spatial advantage may be defined primarily through regulation. The constantly shifting topographies of regulation are the key factor in understanding Caribbean competition for offshore financial businesses. As in North American cities, the process of making the locale attractive to capital (in this case through regulatory adjustments) is a political one. The existence of an elite coalition of public and private interests has been and continues to be crucial to the competitiveness of the Caymans. There are strong links between leading figures in law, accountancy, banking, and insurance and the state (elected officials and civil servants). This allows the state to respond to information from those directly engaged in the financial sector concerning how the Islands might improve their position as circumstances change (particularly as regulations in competitor centers are altered). A further aspect of this process is that because offshore finance is fickle and extraordinarily mobile, any hint of political instability will send it somewhere else. There is considerable pressure on the state, therefore, to maintain social stability (or at least the international image of stability). This is reflected in the Caymans, for example, by the seriousness with which Caymanian (un)employment is taken.

Conclusions

Contemporary capitalism is characterized by the ongoing development of an enormous and unprecedentedly complex international financial system. This system has become the site of rapid innovation as tremendous risks are generated and managed for profit on a firm-by-firm basis. There is much to suggest, however, that risks are cumulating and compounding at the systemic level, and this is a major problem facing regulatory authorities. However, capital has, through international financial markets, met increased volatility with flexibility in an effort to "deal with" this risk. The changing nature of the practice of banking and the proliferation of risk are symptomatic of the ways in which deeper contradictions in contemporary capitalism are being displaced through time (which is the purpose of credit) and space. As the international financial system has grown in sheer size and sophistication, it has "secreted" new and dynamic geographies. Mapping these new geographies shows that a new type of financial center has arisen: the offshore financial center. These are new regulatory spaces through which the new financial markets and institutions operate. The Cayman Islands are only a small place, but they have positioned themselves at the nexus of a series of emergent (and ever-changing) relations between capital and risk.

The Cayman Islands, and OFCs more generally, are new distinct spaces within a changing global political economy. OFCs are spaces that exemplify the contradictory movements toward global integration (as the flows of capital around the globe move faster and faster, for example) and local variation and fragmentation (as places act entrepreneurially to exploit niches in world markets and as capital hones its ability to arbitrage difference). OFCs, however, are not merely the *result* of changes in the financial system. Rather, major shifts in the way in which capital operates internationally simply cannot be understood without reference to the spaces *through which* they are achieved.

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