
Flight Capital

How to do it...

This essay, "Wealth Protection and Foreign Exchange Controls," is by a financial planner specializing in illegal movement of funds out of Ibero-America.

Foreign exchange controls are customarily used by politicians as a wealth-freezing device to prevent assets from fleeing their jurisdictions.

Corporations who suffer the greatest capital exposure will normally deal with the nuisance of exchange controls by utilizing shrewd intra-company accounting methods. This technique is developed as follows:

1) The mother corporation will "secretly" establish a consulting company outside of the country and in a freer jurisdiction. This decoy subsidiary should appear to have no relation to the mother corporation at all.

2) The only purpose of this decoy subsidiary is to be employed "in a business consulting capacity" for the mother corporation. The function of the decoy subsidiary is to be compensated by the mother corporation for its counsel and advice. In other words, invoices presented to the mother corporation as accounts payable have to be paid. Even the government cannot tell you not to pay.

3) The real function of the decoy subsidiary should be known only by the mother corporation's board of directors. . . . When bills are paid to the decoy subsidiary, wealth will flow to the new jurisdiction. Thus, the mother corporation will diversify her capitalization into a safer currency, while the company's books will display declining profitability.

Customarily, a jurisdiction will not allow its citizens to take out more than a few thousand dollars worth of currency. This sometimes will apply to the tightly controlled regulation of all accounts payable. . . . The only means of bypassing this constraint is through establishing many decoy subsidiaries . . . quite often by opening a bank account under fictitious corporate names in various countries. For example, if Mr. Gonzalez wanted to take out \$100,000 worth of pesos from Mexico, the government would most likely step in and permit outflows of only \$5,000. The remaining \$95,000 would require decoy subsidiaries in Costa Rica, Guatemala, Belize, etc. . . .

We can apply this technique equally well for individuals who have had their wealth "frozen" by greedy politicians. The only prerequisite for individuals is to establish a justifi-

able need for "foreign consultation." These two words, and any of their synonyms, are the tools required should one desire to move wealth across national borders. Consultation fees are just another entry under accounts payable. . . . Once they are paid, the wealth is free to flow into the new jurisdiction.

When the capital reaches the new jurisdiction, the corporation or individual can do with it as they choose. However, one strategy that I recommend to businesses and individuals alike . . . is that they consider the possibility of purchasing a low-cost foreign insurance term policy. Insurance by its very definition should be a guarantee against loss or harm. Unfortunately, once exchange controls have been imposed the damage is already in an advanced state. For example, during the volatile economic climate of the late 1970s, Brazil was plagued with triple-digit inflation. In 1977, there were 16 Brazilian cruzeiros to the U.S. dollar. Today, that same U.S. dollar will buy you approximately 2,100 cruzeiros. For all intents and purposes, only seven years later the Brazilian cruzeiro is virtually worthless. . . .

Once the basic concept is understood, the possibilities for wealth protection are quite numerous. It is no wonder that the consulting business has expanded so dramatically in Latin America today. Furthermore, foreign corporations that have established Executive Fringe Benefit Programs, Salary Continuation Plans, or Disability Insurance through decoy subsidiaries for their key employees have reaped the benefits a hundred-fold.

The great advantage of U.S. law is that it allows for the postponement of U.S. taxes due on a foreign corporation, if at least half of it is owned by a non-resident "alien." Thus, as an American, you may not have majority ownership of the decoy subsidiary foreign corporation to escape taxes on the decoy subsidiary's profits or declared dividends.

Unfortunately, the IRS requires any American investors to file an information return, so that the information will not remain a secret to the U.S. government. This could arise in many sleepless nights, so my advice is to forget about the IRS. The less anybody knows the better. There is the possibility of criminal fraud penalties, civil fines, back taxes, and substantial interest retribution; however, if the secrecy aspect is adhered to religiously, all this trouble can be avoided. It is when the secrecy is dismissed as status-oriented cocktail-party talk that the problems arise.

If sums of money less than \$50,000 need to be smuggled out of the country, it is best to purchase collectibles, numismatic coins, rare stamps, and marketable pieces of art to transport out of the country on your own person and sell in the new locality. This can prove to be highly effective in deceiving border authorities; however, it does require an expertise for quality. Under normal market conditions, the difference between the bid-ask (buy-sell) price can be as high as 25%. . . . But 75% of something is always going to be worth more than 100% of nothing.

How to stop it

The foregoing account accurately describes some aspects of flight-capital operations. It leaves out some techniques permitted under loopholes, e.g., establishing a local-currency deposit in an offshore bank which may convert the local currency into dollars. The resident shows only, for example, a bank balance in Brazilian cruzeiros; but the cruzeiros have already been sold for dollars held in a second account. Presuming that the cruzeiro depreciates, the depositor comes out ahead, by putting pressure on his country's exchange rate through an offshore sale of its currency.

However, the most important omission in this account is the context. The principal organizer of flight capital is the International Monetary Fund, which demands that countries devalue their currencies in return for small loans. The moment it is rumored that a developing nation will have to accept IMF terms, devaluation is viewed to be inevitable, and the great round of speculation begins. Since developing countries cannot sustain massive capital outflows without disastrous consequences, the secondary effects of such speculation produce immediate and drastic deterioration of the country's external and internal financial position, leading to further flight capital.

That is the secret of the huge devaluations of Ibero-American currencies during the past several years. Because the rate of return on equity investment in, for example, Brazil or Mexico, has been much higher than in the industrial nations, it doesn't wash to argue that economic mismanagement is the cause of flight capital.

Therefore, the elimination of flight capital requires that developing-sector governments do two things:

First, get rid of the IMF and replace it with something else.

Second, begin to play really dirty in the meantime.

The starting-point for Ibero-America is Lyndon H. La-Rouche, Jr.'s "Golden Peso" proposal, published in October 1983. Rather than conduct international transactions in dollars, the continent as a whole should adopt a common, gold-based "heavy currency" as the unit for such transactions, and firmly peg all local currencies to this common unit. The sound economic basis for such a currency must be an Ibero-American customs union, joint renegotiation of foreign debt on economically acceptable terms, and multi-nation infrastruc-

tural projects designed to crack the power, transportation, water resources, and other productivity bottlenecks of the entire region.

Once such a context is established, the attractiveness of private investment in these nations will rise dramatically from the present miserable levels dictated by the International Monetary Fund's austerity policy. The confidence of private investors may be won back.

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However, in the meantime, the problem of keeping capital in the country, perhaps under conditions of virtual economic war between the IMF and a group of developing nations, boils down to enforcement.

As described on the adjoining page, the flight capital operators seek to swamp enforcement. No government has the capacity to investigate every dummy subsidiary of every corporation in the country, and brass-plate companies and bank accounts multiply faster than competent, or honest, inspectors.

The argument is often heard that the corruptibility of government personnel rules out effective controls. This can work in both directions, however. The same incentives, applied through a system of rewards and penalties, can shift the balance decisively to the side of the governments.

Merely announce that illegal exporters of capital will lose some terrifying multiple of the money sent abroad, or even face total expropriation of their businesses, and most wealthy private individuals will think hard about the risks. Offer, in addition, a bounty to informants amounting to 10 to 20% of the total amount of capital involved. In a nation like Mexico, where secretaries in many offices are issued uniforms because pay is too low to permit them to buy their own clothing, there is a potential army of clerks, telex operators, receptionists, and secretaries prepared to betray flight capital if suitable incentives are available.