

# Conference on Economic Growth, Development, and Macroeconomic Policy

## Offshore Financial Centers (OFCs): Opportunities and Challenges for the Caribbean

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# Content

- Why the focus on OFCs?
- How important are they?
- Do OFCs foster economic growth?
- Taxonomy of global initiatives and implications for OFCs?
- What are the implications of compliance/non-compliance?
- Takeaways

# Why the focus on OFCs?

## In the Caribbean

- Faced with a more challenging global environment, including more subdued tourism related growth prospects, search for areas to diversify economies
- Offshore financial services seen as important and vital part

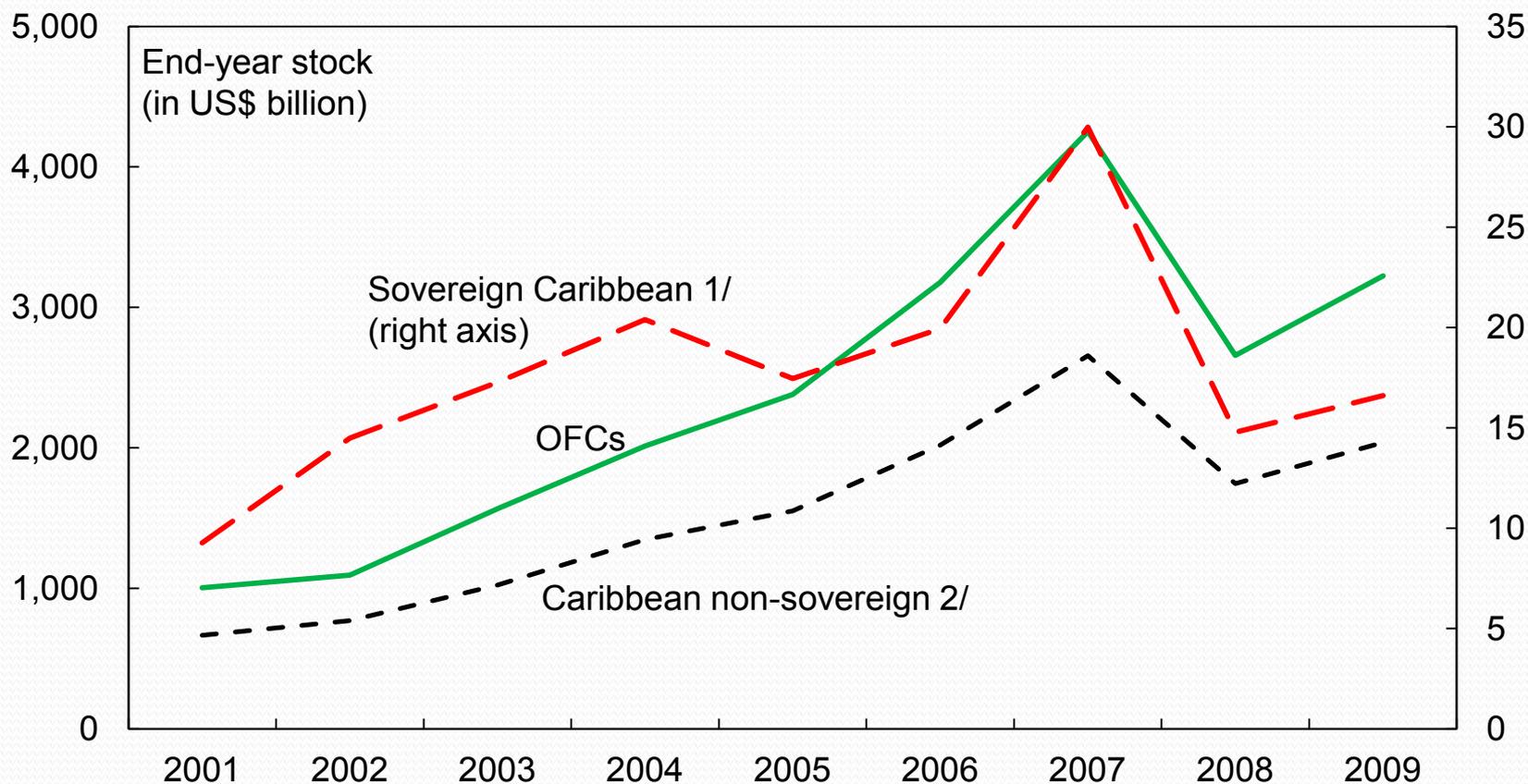
## Global level

- Implications of global economic and financial crisis have accelerated efforts by advanced economies to increase revenue and strengthen global financial systems
- Global initiative are targeting OFCs and the tax and regulatory environments in which they operate

# Financial services offered by OFCs

- Advantages of OFCs: relatively low start-up costs, attractive tax regimes, and privacy/secretcy rules
- International Banking
- Headquarter Services
- Foreign Direct Investment
- Structured Finance
- Insurance
- Collective Investment Schemes
- Other services

# OFCs balances sheets increased

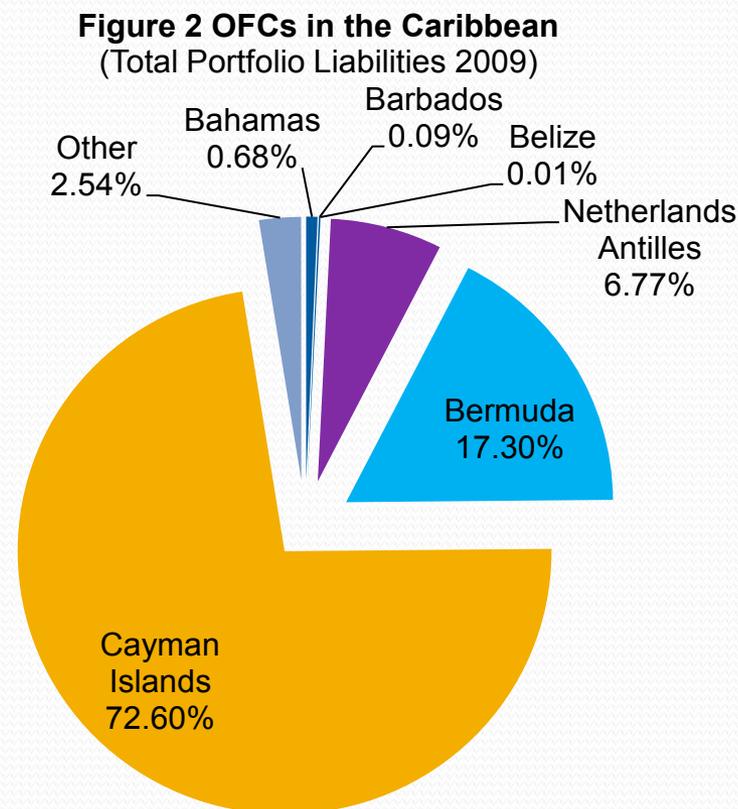


1/ Sovereign Caribbean includes 8 countries: Antigua & Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, St Kitts and Nevis, St Vincent and the Grenadines.

2/ Caribbean non-sovereign includes 6 regions: Aruba, Bermuda, British Virgin Islands, Cayman Islands, Netherland Antilles, Turks and Caicos.

# Caribbean accounts for a large share of OFCs

- CPIS: Assets and liabilities of the 40 reporting OFCs are about U.S.\$ 2.7 trillion and U.S.\$3.2 trillion respectively (8 percent of world cross-border holdings)
- The wider Caribbean held about 60 percent of the estimated balance sheets managed of OFCs (BIS similar picture)
- Within the Caribbean, non-sovereign jurisdictions account for the largest stock OFC assets/liabilities
- Barbados and the Bahamas are the most important countries



# What are the benefits of OFCs?

- Income from direct employment
- Benefits via spillovers to other sectors in the economy including other services (such as tourism) and infrastructure (e.g. telecommunication and transportation)
- Government revenue from taxes and fees

Caribbean Countries: Selected Indicators of Economic Contribution of OFCs, 2008

	Antigua and Barbuda	Bahamas	Barbados	St Kitts and Nevis
Total Assets (US\$ billions)	2	800	50	...
in percent of GDP	64	105	1,300	...
Government revenue from sector				
in percent of total revenue	0.2	0.05	11	2.1
in percent of GDP	0.05	0.01	4	0.8
Employment in the sector	271	1,163	3,500	...
in percent of banking sector employment	...	23	...	...
in percent of total labor force	...	...	2.5	...
Average salary in sector (US\$)	9,630	74,200	...	...
ratio with domestic sector	...	1.7	...	...
Contribution of sector to GDP (in percent) 1/	1	7.4-9.2	7.8	...

1/ Staff estimates based on contribution of this sector to revenue flows, employment and services.

# Do OFCs foster economic growth?

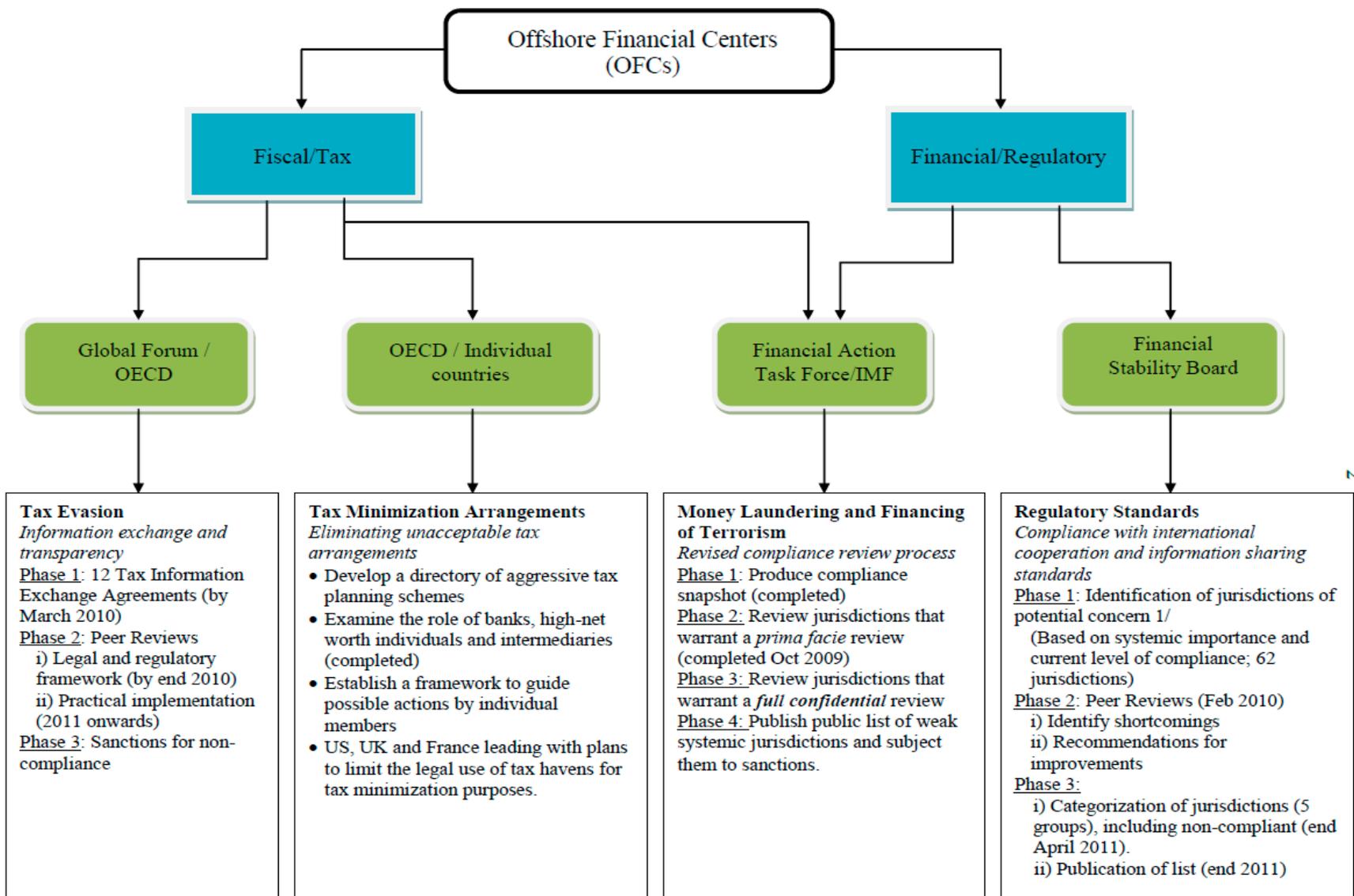
- Empirical evidence that higher OFCs-related capital inflows have a positive impact on economic growth
- Results in line with Hines (2010)
- The results hold irrespective of whether a country/jurisdiction is classified as a tax-heaven or not

Dependent Variable: Real GDP Growth Rate (in percentage points)

	Model1	Model2	Model3	Model4	Model5	Model6
Growth Rate of PIL	0.009** (2.39)	0.009** (2.43)	0.011* (2.44)	0.010* (2.51)	0.011* (2.43)	0.010* (2.50)
Growth Rate of Export	0.062*** (4.03)	0.058*** (4.30)				
Gross FDI (USD mln)	0.036** (2.44)	0.027* (1.86)	0.040** (2.66)	0.029* (2.00)		
L.Growth Rate of Export			0.042* (2.12)	0.034 (1.62)	0.043* (2.19)	0.034 (1.64)
L.Gross FDI (USD mln)					0.039 (1.89)	0.024 (1.19)
Tax Haven		-0.67 (-1.45)		-0.846 (-1.57)		-0.924 (-1.71)
Constant	3.877*** (11.29)	4.254*** (13.76)	4.150*** (12.23)	4.650*** (11.29)	4.183*** (12.28)	4.731*** (11.36)
N	160	160	160	160	160	160
R <sup>2</sup>	0.23	0.24	0.15	0.17	0.14	0.16
F-Stat	10.74	9.06	8.33	6.46	6.77	5.45

# Concern that global initiatives might undermine opportunities

- In search for revenue, advanced economies have focused on closing loopholes including by going after so-called tax havens
- Efforts to strengthen global financial system, including increased pressure for OFC host countries/jurisdictions to raise their adherence to financial standards and information sharing
- Despite differences, global initiatives share many of same objectives, with similar implications:
  - Risk of “naming and shaming” (black list)
  - Severe reputational risks
  - Possible sanctions
- Good understanding of initiatives is needed to minimize adverse implications



# Commitment to international standards

- Caribbean countries have demonstrated commitment to meet international standards (e.g. TIEAs)
- While a number of Caribbean countries fared relatively weak in the FTAF snapshot list, they are making efforts to increase compliance
- FSB—has not yet published a list of non-compliant countries/jurisdictions
- Increased efforts need to ensure continued compliance increase costs

**Table 2. Status of OECD's List: International Tax Standard**

<i>Sovereign</i>	Number of Agreements		<i>Latest Status</i>
	<i>April 09</i>	<i>Jan 11</i>	
The Bahamas	1	12+	White
Barbados	12+	12+	White
Belize	0	12+	White
Antigua and Barbuda	7	12+	White
Dominica	1	12+	White
Grenada	1	12+	White
Panama	0	10	Grey
St. Kitts and Nevis	0	12+	White
St. Lucia	0	12+	White
St. Vincent and the Grenadines	0	12+	White
<i>Overseas Territories</i>			
Aruba	4	12+	White
Bermuda	3	12+	White
British Virgin Islands	3	12+	White
Cayman Islands	8	12+	White
Netherlands Antilles	7	12+	White
US Virgin Islands	12+	12+	White
Montserrat	0	11	Grey
Turks and Caicos Islands	0	12+	White

Source: OECD (As of January 19, 2011)

# Adverse implications of “grey” / “blacklisted” OFCs

- Large international financial institutions exited from OFCs in countries placed on “grey” / “black” lists
- Grey/black listed OFCs experienced a decline in their share of global capital flows relative to their “white” listed competitors
- Signing of TIEAs has had a positive impact on portfolio capital flows

Dependant variables: growth rate of shares in world total (country FE)

	Assets	Liabilities	Adj_Balance
Grey	-0.1514 (-1.14)	-0.0463** (-2.30)	-0.0314** (-2.46)
Black	-0.1791 (-1.33)	0.0467 (0.53)	-0.0462** (-2.27)
Constant	0.0978 (1.36)	0.0270** (2.39)	0.0207*** (2.98)
N	120	120	120
Number of groups	30	30	30
R <sup>2</sup> overall	0.0054	0.0570	0.0134
F-Stat	1.45	3.24	3.45

Note: Coefficients in parentheses are t values.

\*, \*\*, \*\*\* denote significance level at 10, 5, 1 percent, respectively

# Good regulatory standards positive for capital inflows

- Some evidence that countries/ jurisdictions that adopt higher regulatory standards benefit from higher capital flows
- Countries/jurisdictions that intend to expand OFCs, should strive to adopt good regulatory standards

Dependent variable: countries' PIL share in the world

	Model1	Model2	Model3	Model4	Model5
Tax Haven	0.005** (2.86)	0.000 (0.58)	0.006** (2.75)	-0.005 (-1.37)	-0.009 (-1.92)
Regulatory Quality			0.000*** (4.48)	0.000** (3.07)	0.000 (1.91)
TaxHaven*RegQuality				0.000* (2.10)	0.000 (1.90)
Caribbean		0.011*** (3.53)			0.013*** (3.62)
Constant	0.003*** (7.76)	0.002*** (5.07)	-0.011*** (-3.49)	-0.004 (-1.78)	-0.003 (-1.11)
R2	0.019		0.089	0.097	0.165
N	320	320	258	258	258
R <sup>2</sup>	0.02	0.09	0.09	0.10	0.17
F-Stat	8.21	6.27	14.11	8.04	5.68

Note: Coefficients in parentheses are t values.

\*, \*\*, \*\*\* denote significance level at 10, 5, 1 percent, respectively

# Takeaways

- Increased focus on OFCs both as a source of growth but also global initiatives
- Countries/jurisdictions with OFCs account for a large share of cross-border holdings of financial assets/liabilities
- Evidence that OFCs contribute to growth
- Global initiatives (Global Forum, G-20, FSB, FATF) increase compliance costs
- Non-compliance adverse implications (risk of “naming and shaming”, reputation, possible sanctions) and lower capital flows
- High regulatory quality and compliance (TIEAs) benefit OFCs
- Countries/jurisdictions need to be proactive with respect to global standards/initiatives to maximize benefits; benefits and costs

# The role of the IMF

- Supports the objectives of the international initiatives to foster transparency and the adoption of global standards
- As a member of the FSB is an advocate to support a level playing field
- Provides assistance (TA) to help members in upgrading standards
- Does not support “naming and shaming”, i.e. black/grey lists

*Thank you*

# Fixed effects

Dependent variable: Real GDP Growth Rate, country FE

	Model1	Model2
Growth Rate of Export	0.040** (2.40)	0.040** (2.40)
Gross FDI (USD mln)	0.012 (1.13)	0.012 (1.13)
Growth Rate of PIL	0.007** (2.08)	0.007* (2.43)
Tax Haven		Omitted
Constant	4.344*** (14.87)	4.344*** (14.87)
R2	0.226	0.236
N	160	160

# Signing of TIEAs has had a positive impact

	Total TIEAs signed with country FE		
	Assets	Liabilities	Adj_Balance
Total number of TIEAs signed	0.0139 (1.34)	0.0046* (1.96)	0.0039** (2.42)
Constant	-0.0503 (-1.10)	-0.0216** (-2.08)	-0.0202*** (-2.80)
N	96	96	96
Number of groups	24	24	24
R <sup>2</sup> overall	0.0039	0.0042	0.0014
F-Stat	1.8	3.84	5.85

Note: Coefficients in parentheses are t values.

\*, \*\*, \*\*\* denote significance level at 10, 5, 1 percent, respectively

