



## **Extinction or Evolution: The Future for Offshore Centres**

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The title of this lecture asks the wrong question. The question is not whether the Isle of Man and other offshore centres will survive. We most certainly will survive, because we will evolve.

The question is how well we will prosper? And to a large extent that depends on how well the City of London prospers. The existence of offshore centres greatly benefits the City of London and the entire UK economy. David Lewis, former Lord Mayor of London has said that we are in fact a core asset for the City

From our perspective, we the Isle of Man need London to stay competitive and keep its position as one of the top global finance centres.

The subject for this evening is the future of what are often referred to as offshore centres, tonight I'll refer to them as Small International Finance Centres, In fact that's a bit of a mouthful so I'm going to say 'small IFC's'.

In a globalised economy, where capital and trade transcend national boundaries, I believe it is inevitable that small IFC's will be players in that economy.

I have two core propositions tonight:

- Firstly that small IFC's - and particularly the Isle of Man - have a right to be competitive players in global trade, as long as we fully embrace developed international standards.
- Secondly, I also say that small IFC's need to redefine their relationships with larger centres, such as the City of London.

You could describe that relationship as being like nodes or spokes around a hub. So, small IFC s have a valuable role in international finance. Tonight I am going to tell you why.

But first, I need to provide a brief outline of the Isle of Man and its economy. The Isle of Man is not and never has been part of the United Kingdom. It is an internally self governing dependent territory of the British Crown. Along with the Channel Islands, it is known as a 'Crown Dependency'.

The Isle of Man has the world's oldest continuous Parliament. The Island is not part of the European Union. It does have a limited relationship with the EU, which allows for the free movement of goods, but not services, between the Isle of Man and the EU.

The Isle of Man economy has had over a quarter of a century of consecutive growth, with last published figures for 2008-9 showing growth in real terms of 4.7%.

The key sectors in generating this performance have been financial, professional and scientific services. Banking now generates around a sixth of the Island's gross domestic product, with the rest of the finance industry led by the offshore life insurance sector adding another 20%.

A key feature of the Isle of Man's economy that differentiates it from other Small IFC s is its diversification. Aside from banking, insurance and wealth management, it has a fast growing e-gaming sector, high tech manufacturing, as well as thriving shipping and aircraft registers.

An important element of the Island's fiscal strength is the long established and self imposed legislative requirement that Government must budget for a surplus in respect of its annual revenue spending.

At the same time as meeting this requirement Government has continued to invest in developing and

updating the Island's infrastructure and services.

The strength and prudent handling of the public finances has meant that we have achieved and kept triple credit ratings from both Moody's and Standard & Poor's.

But enough background. Back to my core contention:

Small IFC's have a valuable role in international finance. I know that there are people, organisations and even countries that question that statement. And they question it pretty vehemently. Over a period of years and particularly since the global financial crisis, small IFC's have endured political attacks and what I consider to be misguided criticism.

Also, a series of myths have developed and I am going to put you right on some of those myths tonight.

An important step in rebalancing the argument took place in July with a debate on Offshore Financial Centres in the Westminster Hall.

In that debate, Mark Field, the Member of Parliament for the Cities of London and Westminster argued that it is critical for politicians and policy makers to formulate policy in a consistent, balanced and informed manner. He also said that the benefits of small IFC's should be considered dispassionately.

He went on to summarise the reasons why the global financial community uses small IFC s like the Isle of Man. Those reasons include:

- Political stability
- A familiar legal system, based on English Common Law
- A high quality of service providers
- An ability to meet important investor requirements such as the legal infrastructure for share selling
- A lack of foreign exchange controls.

As well as all that, there is Tax neutrality, something not to be confused with tax evasion.

This enables investors from multiple jurisdictions to ensure they don't meet multiple layers of taxation as funds pass through the global financial system. There is also legal neutrality that ensures no one nationality is given special treatment.

In his review of British Offshore Financial Centres for HM Treasury published in October 2009, Michael Foot also concluded: 'The Crown Dependencies make a significant contribution to the liquidity of the UK market. Together they provided net financing to UK Banks of 332 and a half billion dollars in the second quarter of 2009. These funds are largely accounted for by the 'upstreaming' to the UK Head Office of deposits collected by UK Banks'

So what are the popular myths that need to be dispelled?

Myth - That small IFC's have a negative impact on growth in the global economy

Fact - Small IFC's offer stable, well regulated and neutral jurisdictions that make it easy to do international and cross border business. Investment channelled into Small IFC's provides much needed liquidity, further investment opportunities, and access to capital markets for businesses in both developed and emerging countries.

Myth - That Small IFC's played a part in causing the global financial crisis.

Fact - Everybody loves to target a convenient scapegoat - especially one whose voice is small and easily drowned out. At the height of the crisis, this unfair and inaccurate targeting diverted attention away from the real causes.

Indeed it could be argued that the liquidity supplied by small IFC's was of great benefit to the UK during the crisis.

Myth - That small IFC s have a negative impact on transparency, regulation and information exchange.

Fact - Tax transparency is high on the G20 agenda and small IFC's are at the forefront of the OECD's work in this area through the Global Forum on Transparency and Exchange of Information.

The Isle of Man has just signed its seventeenth Tax Information Exchange Agreement, this time with

China.

In addition it has signed 3 Double Taxation Agreements all with EU member states. We have a number of further Agreements in the pipeline for signing. The Isle of Man has for many years been, and continues to be an active participant in the OECD's work on Transparency and Exchange of Information, through the work of what is called the Peer Review Group. In relation to regulation, the Isle of Man and other small IFC's have undergone extensive scrutiny by the IMF and have been found to have higher standards than many much larger countries.

Myth - That small IFC's don't benefit developing countries.

Fact - The Commonwealth Secretariat acknowledges that Small IFC's often play a very important role by enabling developing countries effectively to 'rent' financial expertise from other countries whilst they develop financial centres of their own. The Isle of Man has initiated and run for the last two years, a very successful 'Small Countries Financial Management Programme', aimed at capacity building at senior level in small and developing countries. The Isle of Man is certainly willing to consider requests for Tax Information Exchange Agreements with developing countries, either bilaterally or within a multi lateral framework developed, perhaps, by the OECD.

Whether it is listing, upstreaming, asset management, insurance, or shipping - or even the space industry - everything the Isle of Man does, materially and positively supports the larger centres, or hubs. This is why the Isle of Man is a core asset to the City of London. And so, onto the future.

In an economic sense, I was particularly interested in comments made by Michael Geoghegan, Group Chief Executive of HSBC Holdings PLC, back in April.

He highlighted that emerging markets are set to grow three times faster than developed ones this year and that within three years, for the first time, the economic firepower of emerging markets will overtake the developed world, measured by purchasing power parity. This is a defining moment.

He reminded his audience that the term BRIC was invented only ten years ago and that in that period Brazil, India and China's roles are secure on the world stage, with Russia's economic story still unfolding.

But for the coming decade he said that CIVETS are the new BRICSs.

For those of you who are not jargon junkies, the countries he was referring to were Columbia, Indonesia, Vietnam, Egypt, Turkey and South Africa - each with large, young growing populations and diverse and dynamic economies. Any company with global ambition needs to get into these markets now. You cannot wait for business. You have to go where the business is.

The latest edition of The Global Financial Centres Index highlights that Hong Kong has now joined London and New York as a genuinely global financial centres. Singapore may well join this trio soon.

So, in an economic sense the direction is clear, but small IFC's still have to face something else. The disinterest, lack of knowledge or even active opposition of larger countries. We must also expect to hear continued rhetoric targeting alleged 'tax havens', 'secrecy jurisdictions' and other similar dark phrases.

Our challenge will be to separate reality from that bleak rhetoric. G20 and its growing influence illustrate the increasingly globalised political environment to which both Small IFC's and the City have to respond.

The developing international regulatory architecture is an important illustration of this. As in the immediate crisis period, the voices of small states and developing countries are in danger of being unheard.

There is a risk that the solutions arrived at do not take into account, or can possibly even actively damage, the interests of those small states.

Small IFC's and small states in general, have to work very hard to have our voices heard and our legitimate interests recognised.

In the case of the Isle of Man, that involves constructive engagement with the UK Government, the development of existing relationships with the EU and the OECD, the extension of tax agreement programmes and enthusiastic adherence to international regulatory standards.

Sticking to international standards is absolutely vital for the survival of small IFC's. This will bring with it higher costs and greater pressures. The Isle of Man is of a size that can manage these pressures; not all small IFC's are as fortunate.

However, we'll also need international bodies to take into account the views and interests of small states.

I take some comfort, not a lot yet, but some comfort, from recent statements from the Commonwealth Secretariat and Robert Zoellick, President of the World Bank.

They both acknowledge that the views of small states need to be properly channelled into the powerful decision making bodies, particularly the G20. They also see themselves fulfilling that role. Early days, but some hopeful signs. A question for small IFC's to address is how best to represent their interests, if such channels become available. In essence do they seek to act in isolation, or do they seek to develop alliances to better make their voices heard? In my view it is going to be essential that small IFC's form such alliances, but I believe it's going to be a particularly challenging process, both because of the competitive nature of relationships and also because of the reputational issues it's bound to create.

Which leads me neatly back to where I started. The basic answer is of course yes, small IFC's certainly can more than survive. They can prosper. But how?

At a Governmental level, a small IFC has to work as hard as it can to understand the environment in which it operates, how it is changing and position itself accordingly. It has to decide how the whole package that it offers to the international business community should be adapted and improved to make it more competitive, whilst also meeting ever evolving international regulatory standards.

This competitive package should contain five key ingredients:

- 1) People - which means the availability of good quality, highly qualified and skilled staff within a flexible labour market
- 2) Infrastructure - with well-priced property together with good telecommunications and transport links
- 3) A positive Business Environment - with the right levels of regulation and taxation, a friendly place to do business with integrity, run by a responsive government
- 4) Market Access
- 5) General Competitiveness - with synergy delivered by the integration and interaction of the other parts.

To be able to adapt or evolve that package and provide a successful small IFC, the Government needs to bind together, like single strands into a strong rope, five elements.

- Awareness
- Engagement
- Co-operation
- Acceptance of international standards
- Positioning

Personally, I have to constantly try to understand what influential Governments and international bodies are really seeking to achieve and how it affects the Isle of Man.

I try to separate the underlying policy drivers from the rhetoric and differentiate between the permanent shifts and the ephemeral ones. Essentially, I am looking beyond the immediate hurdle and what it might mean for my country.

For example, I have recently seen an IMF document which includes the following gem and I quote:

'More co-ordination is needed among tax administrations of various countries and among tax policies, in a globalised economy. Maybe it is time to revive the idea of a World Tax Organisation to address these co-ordination issues.'[1]

We'll certainly be keeping an eye on that. But remember that whatever international standards become the norm the Isle of Man will always be ready to meet those standards. There are some other things that a small IFC should be thinking about.

As the pace of globalisation quickens, the relationships between small IFC's and central hubs become ever more important. Small IFC's can, in fact need, to develop relations with more than one hub. For instance, the Isle of Man is now eligible to list Isle of Man vehicles in Hong Kong, to complement the permission we already have in Singapore. What will distinguish those small international financial centres that flourish

from those that fade will be their willingness to work closely with the strategic ambitions of their hubs. So, the key future commercial relationships for a small IFC will be those it has with its hubs. This means that the Isle of Man will need to work more and more closely with the City, constantly asking the question 'How can we help you compete?'

It is important to us that the City shows the BRIC and other developing countries, that it's a relevant player that adds value to them and to the new economic order.

I am going to give you an image.

The Government of a Small international financial centre, in the form of a Minister like me, has to conduct the orchestra whilst walking a tightrope on a windy day. The orchestra consists of commercial, fiscal, regulatory, legislative and international relations sections, each with a variety of instruments. The weather is determined by external economic and political conditions. Success involves both staying on the tight rope and producing a pleasant sound. Evolution involves improving the instruments, the abilities of the players, the ear, communication skills and balancing ability of the conductor. If the various skills of all parties don't evolve the orchestra doesn't improve. If the conductor falls off the tight rope - the orchestra becomes extinct.

The Isle of Man is a professional orchestra that has the training and the skills to play in tune with the World symphony and adds the vital components that make the melody unique.

If the City and the Isle of Man work together like this both will survive, both will evolve and both will prosper.

Thank you.

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[1] Long-Term Trends in Public Finances in the G-7 Economies Carlo Cottarelli and Andrea Schaechter  
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