The importance of international finance centres in the global economy

Key points

- International finance centres (IFCs) have developed to facilitate cross-border activities in a world in which global trade is increasingly significant
- IFCs serve an important role in the global economy. By providing efficient and effective neutral platforms for facilitating cross-border investment, parties around the world with differing laws, regulations and tax systems can do business with each other
- The economic and fiscal benefits of the investment mediated by IFCs are clear. They facilitate trillions of dollars of investment, which supports jobs, growth, and consequent tax revenues around the globe

1. International finance centres have developed to provide services that facilitate cross-border activities in a world where global trade is increasingly significant

International finance centres (IFCs) are part of a global economic system that facilitates more efficient trade in goods and services between nations, and helps to increase overall levels of wealth and prosperity in both developed and developing economies.

The world's economies continue to move closer together. Over recent decades, global prosperity has been boosted by greater trade and investment across borders, with international trade growing from 25% of global GDP in the 1970s to 60% today.[1] This is positive for the global economy. Trade is a mutually beneficial process that has enriched almost every nation on Earth in recent decades and centuries.

In a world where national boundaries have ever-decreasing significance to people and to businesses, it should come as no surprise that there is demand for services that facilitate efficient and secure cross-border transactions. Exports are strongly correlated with possessing more developed financial markets, with countries where banks lend 100% more of GDP to business exporting 6.5 times as many product lines internationally.[2] However, with many countries lacking the financial infrastructure to facilitate that lending, IFCs have evolved to meet the needs of global businesses and investors.

Increased cross-border trade and mobility isn't restricted to goods, services, or people. Capital markets are increasingly global – with investors seeking diversification beyond national borders to reduce risk and borrowers accessing wider sources of finance to reduce borrowing costs. IFCs play a vital role in helping these global investment flows.

[1] Robert Feenstra, Robert Inklaar, and Marcel Timmer (2015): "The Next Generation of the Penn World Table". *American Economic Review* **105**(10), pp.3150-3182
[2] Kalina Manova (2013): "Credit Constraints, Heterogeneous Firms, and International Trade". *The Review of Economic Studies* **80**(2), pp711-744

Substantial investments by businesses and governments in new housing, industrial and commercial premises, airports and roads, computers and telecoms infrastructure, or plant and equipment – as well as softer intangibles like research and development – are increasingly financed internationally. Meanwhile, the local banks and financial services firms that offer the credit cards, overdrafts, mortgages, and lease agreements to support consumers' purchases of their cars, consumer goods, and homes increasingly depend upon international capital markets to provide liquidity and keep costs down.

In this way, what appears to be the obscure and remote world of international finance provides the 'financial investment' that helps to deliver the 'economic investment' that matters to the real lives of employees, families, and businesses. Globalisation of capital brings material advantages to investors, firms, and consumers. These include:

- Reducing the cost of borrowing by providing access to deeper capital markets and increasing competition between lenders
- Increasing returns to investment by facilitating the pooling of investments and their diversification across a wider range of international assets: reducing risk
- Providing investors with greater opportunities to match their portfolios of investments to their desired profiles of risks and expected returns
- Making insurance cheaper by allowing risks to be reinsured cost-effectively around the world by investing in geographies or assets with differing risks
- Preventing domestic credit crunches by facilitating borrowing from abroad to offer respite during temporary recessions or natural disasters
- Providing investment into less developed countries with limited domestic capital, thereby promoting economic growth in countries with low savings potential

At the global level, international capital markets channel the world's savings to their most productive uses – irrespective of location. IFCs have developed the expertise and specialisation to foster these cross-border flows.

2. International finance centres offer a wide array of benefits, and serve an important role in the global economy

IFCs offer this wide array of benefits by providing highly-specialised environments that are tailored to cater for the needs of international commerce and the pooling of international investments:

- **Jurisdictional neutrality.** A location that is independent of the home jurisdictions of the various counterparties where transactions can be conducted, whilst adding little or no additional cost. This can be important, for example, when forming joint venture vehicles between organisations from different countries.
- **Tax neutrality.** Tax neutrality means that investments do not pay additional taxation just because they are pooled in such a neutral jurisdiction, although they still pay taxes where funds are invested and where the investor is based. Assets and investment funds can be

pooled, grown, and distributed across borders without imposing any additional taxation. This is important, for example, when developing fund structures to attract international investors and/or to invest in a portfolio of assets across borders.

- **Regulatory specialisation.** Bespoke regulation that allows specific sectors located in IFCs to avoid the unintended inefficiencies of 'catch-all' regulation of larger jurisdictions that are often aimed at protecting retail investors that are based there. IFCs may be able to concentrate resources on regulating specific types of financial sector activity effectively, while larger countries have to spread regulatory resources across a wider range of activities.

- **Country risk mitigation and protection of wealth.** Keeping assets protected from potential loss, damage, or sequestration resulting from socio-political instability or delinquent legal, regulatory, or enforcement institutions in a particular country.

- **Specialist and expert services.** Many IFCs offer particular niche services, such as private banking, asset management, and reinsurance. These centres often focus in a particular business sector and even market segment, providing a high degree of specialisation and expertise attractive to clients and providing a neutral location for administrative tasks

- **Access to capital markets**. IFCs have strong links with capital markets across the globe. Banks, trust companies, legal practices, and accountancy firms are closely networked into their counterparts in major cities across the world, and can provide their clients with access to these centres' liquidity and expertise.

3. **International finance centres support jobs and economic activity. Governments around the world benefit significantly from the economic activity that is supported by international investment mediated through these centres**

The investment mediated by IFCs supports economic activity, jobs and incomes around the world. It provides the underlying finance that enables real world economic investment in housing, businesses, or infrastructure – or the essential liquidity for the secondary markets that underpin and provide confidence in these real world primary investments.

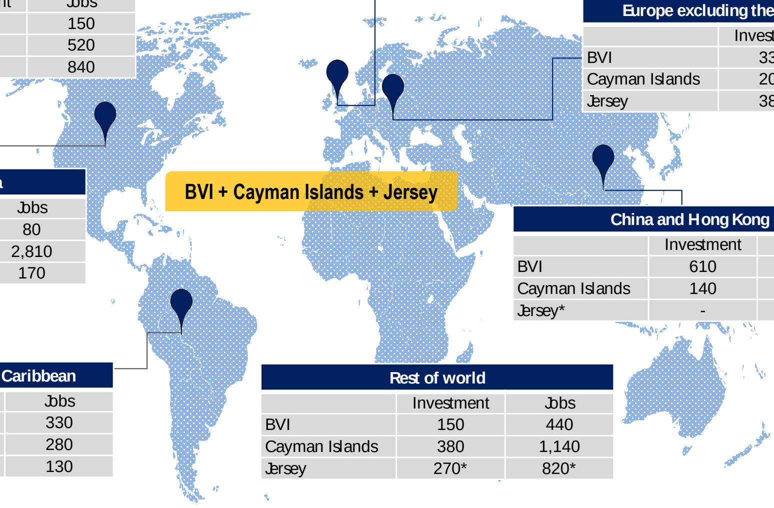
We examine the global value of the British Virgin Islands (BVI), the Cayman Islands, and Jersey's finance centres as examples. We estimate that the foreign investment mediated through the BVI, the Cayman Islands, and Jersey in 2016 was $1.5 trillion, $4.5 trillion, and $1.8 trillion respectively. The investment mediated by the BVI and Jersey supports 2.2 and 2.3 million jobs respectively, while the investment mediated by the Cayman Islands supports in the region of 5.0 million jobs (see Figure 1).

The economic activity and jobs supported by the investment mediated by these jurisdictions will generate tax revenues for governments around the world. Governments benefit significantly from the economic activity that is supported by international investment mediated through these jurisdictions.

For example, our estimates suggest that investment through the Cayman Islands, supports tax revenues for the United States government to the tune of roughly $60 billion, while the United Kingdom government benefits in the region of $20 billion from Jersey's activities.[3]

[3] These are indicative estimates based on the best evidence available and are intended to provide an idea of the broad scale of the benefits rather than be precise estimates.

Figure 1: Investment mediated by the BVI, the Cayman Islands and Jersey's international finance centres by location of underlying asset ($ billion) and employment related to investment (thousand people), 2016



United Kingdom

	Investment	Jobs
BVI	170	150
Cayman Islands	590	520
Jersey	1,000	840

Europe excluding the United Kingdom

	Investment	Jobs
BVI	330	290
Cayman Islands	200	170
Jersey	380	330

United States and Canada

	Investment	Jobs
BVI	90	80
Cayman Islands	3,100	2,810
Jersey	180	170

China and Hong Kong

	Investment	Jobs
BVI	610	870
Cayman Islands	140	140
Jersey*	-	-

Latin America including the Caribbean

	Investment	Jobs
BVI	110	330
Cayman Islands	100	280
Jersey	40	130

Rest of world

	Investment	Jobs
BVI	150	440
Cayman Islands	380	1,140
Jersey	270*	820*

Source: Capital Economics. *Note: The investment mediated through Jersey from China and Kong Hong is included in the Rest of World estimates.