Knowledge, evidence and learning for development

Mapping Financial Centres

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15 May 2018

Question

What are the key financial centres that affect developing countries?

Contents

1. Overview
2. IFCs and developing countries
3. Key IFCs
4. References

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1. Overview

International financial centres (IFCs) are characterised by favourable tax regimes for foreign corporations. They are theorised to affect developing countries in three key ways. First, they divert real and financial flows away from developing countries. Second, they erode developing countries' tax bases and thus public resources. Third, IFCs can affect developing countries' own tax policies by motivating governments to engage in tax competition. The form and scale of these effects across different countries depend on complex interactions between their national tax policies and those of IFCs.

In order to better understand the relationship between national tax regimes and development, in 2006, the IMF, OECD, UN and World Bank recommended to the G-20 that all members undertake "spillover analyses" to assess the impact of their tax policies on developing countries. The fact that only two well-recognised IFCs (the Netherlands and Ireland) have done so prevents a rigorous comparative analysis of which centres most affect developing countries and how.

This review provides suggestive evidence of key IFCs for developing countries by analysing capital movements to and from selected regions and economies. While these capital flows are not driven by tax considerations alone, their concentration in certain jurisdictions is suggestive. Through this analysis, it identifies five global IFCs that serve countries across the developing world. These key centres are:

- **The Netherlands.** The Netherlands is a key source and/or destination of investment for every developing region. For example, nearly one third of inward and outward investment in the Middle East is channelled via the Netherlands. Three features of Dutch tax policy make the Netherlands an attractive conduit for global foreign direct investment (FDI). These include the extensive network of bilateral tax treaties, the low withholding taxes levied on cross-border flows and the special tax treatment of special purpose entities. There is evidence that these features facilitate tax avoidance by multinational corporations (MNCs) operating in developing countries, including treaty shopping and profit-shifting. The resulting public revenue loss for developing country governments is estimated to be between EUR 150-550 million per year.
- **The Cayman Islands.** The Cayman Islands rank among the top ten sources and/ or destinations of FDI for all developing regions except North Africa. A fifth of South America's outward FDI goes to the Cayman Islands, at least initially. There is suggestive evidence that the Cayman Islands are an important destination for profit-shifting by MNCs due to the low-tax, highly secretive environment. However, the jurisdiction's impact on developing countries remains under-researched.
- **The UK.** The UK is a key source and destination of investment for most developing regions, particularly Sub-Saharan Africa and Central and South Asia. Four features of the UK tax system contribute to its status as a major IFC. First, the UK has one of the world's largest tax treaty networks. Second, the UK has jurisdiction or sovereignty over ten territories that are recognised as tax havens. Third, the UK offers an increasingly favourable corporate tax regime. Fourth, the UK hosts various corporate structures and arrangements that may help facilitate tax avoidance. The UK government has resisted lobbying to conduct spillover analysis for various aspects of its tax regime. However, in 2012, Action Aid estimated that UK reforms of controlled foreign company rules, which aimed to improve the corporate tax environment further, could cost developing countries £4 billion in annual tax revenues.

- **The US.** The US is the second largest recipient of global FDI and the largest source. It is a major provider of inward FDI for all developing regions (with the exception of the Gulf Economies for which it doesn't report data) and a top destination for most. While this pattern reflects the relative size of its economy, the US also provides a wide array of secrecy and tax-free facilities for non-residents that may facilitate profit-shifting and other illicit financial flows. Additionally, it has not committed to international standards on exchange of information for tax purposes. Evidence on the impact of these policies on developing countries is not available.
- **Singapore.** Singapore is a top source of inward FDI for Central and South Asia, East Asia, North Africa, the Middle East and Sub-Saharan Africa. Its top sources of FDI are IFCs and/ or tax havens, while its top country destinations are mostly emerging economies in Asia (China, Indonesia, India and Hong Kong). Singapore provides full tax exemptions on most foreign income as well as various secrecy offerings, which make it a popular conduit for inward investment to Asia.

2. IFCs and developing countries

Defining IFCs

The term "international financial centre" is often used interchangeably with "tax haven" or "secrecy jurisdiction" but there are no broadly agreed definitions of these terms (Fichtner et al., 2017; Waris, 2014: 2). Territories labelled IFCs typically share several characteristics: a high concentration of financial intermediaries and service providers, plentiful foreign investment opportunities, connections with other centres, sophisticated regulatory and legislative frameworks and, crucially, favourable tax regimes for foreign income (Waris, 2014: 2). Tax havens or secrecy jurisdictions also tend to share these features and additionally offer very low or zero taxes and bank secrecy laws (Waris, 2014: 2). The OECD identifies tax havens using four criteria: no or nominal income taxes, a lack of effective exchange of information on taxpayers with other jurisdictions, a non-transparent tax system and the absence of substantial activities (OECD, 1998: 23).[1] The lack of common definition means that different global rankings of IFCs and/ or tax havens provide very different results depending on which criteria they emphasise. Table 1 compares some key rankings that are commonly cited in the literature.

[1] The OECD no longer publishes lists of countries meeting these criteria (Hearson, 2014: 9). However, its Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) reports on the second criteria by monitoring jurisdictions' compliance with two internationally agreed standards on tax-related information exchange. These are the exchange of information on request (EOIR) standard and the automatic exchange of information standard (AEOI). The Global Forum monitors compliance with EOIR though a phased peer review process in which countries receive a rating of "Compliant" "Largely Compliant" "Partially Compliant" and "Non Compliant". Work is currently underway to implement AEOI by 2018 (see OECD, n.d.).

Table 1: Selected global rankings of IFCs, tax havens and secrecy jurisdictions

Name	The Global Financial Centres Index (GCFI) 23 by Z/Yen Group	The Financial Secrecy Index 2018 by Tax Justice Network (TJN)	FDI stocks relative to gross domestic product (GDP)
Description	The GCFI rates over 50 financial centres against five criteria: (i) human capital availability, (ii) business environment, (iii) market access, (iv) infrastructure and (v) general competitiveness. Details of these criteria and the GCFI's scoring system can be found here.	The Financial Secrecy Index ranks jurisdictions according to their secrecy and the scale of their offshore financial activities. A full description of the methodology is here.	The IMF (2014) and Fichtner et al. (2017) identify key IFCs by examining jurisdictions' FDI stocks as a percentage of GDP.
Results	1. London 2. New York 3. Hong Kong 4. Singapore 5. Tokyo 6. Shanghai 7. Toronto 8. San Francisco 9. Sydney 10. Boston 11. Beijing 12. Melbourne 13. Montreal 14. Chicago 15. Vancouver 16. Zurich 17. Los Angeles 18. Shenzhen 19. Dubai 20. Frankfurt	1. Switzerland 2. USA 3. Cayman Islands 4. Hong Kong 5. Singapore 6. Luxembourg 7. Germany 8. Taiwan 9. United Arab Emirates (Dubai) 10. Guernsey 11. Lebanon 12. Panama 13. Japan 14. Netherlands 15. Thailand 16. British Virgin Islands 17. Bahrain 18. Jersey 19. Bahama 20. Malta	1. Luxembourg 2. Marshall Islands, 3. Samoa 4. Cyprus 5. Bahamas 6. Barbados 7. Mauritius 8. American Samoa 9. Liberia 10. Netherlands 11. Seychelles 12. Malta 13. Ireland 14. Hong Kong 15. Singapore 16. Switzer-land 17. Belgium 18. United Kingdom 19. Tokelau Islands 20. Hungary

Source: Z/ Yen Group (2018); TJN (2018); Calculations from IMF (2018) and World Bank (2018).

IFCs can be categorised in at least three ways. These categorisations are helpful for discussing their impact on developing countries. The first typology distinguishes between offshore, hybrid and integrated IFCs. Offshore centres do not allow for interaction between foreign and domestic investment markets (e.g. Dubai); hybrid centres allow for specific and conditional access of domestic investors to the international market (e.g. Qatar); and integrated centres allow for full access of international investors to domestic markets, with preferential treatment (e.g. London) (Waris, 2014: 2). The second typology divides IFCs into global centres that serve clients from all over the world; regional centres that serve regional markets; and local IFCs that cater mainly to the needs of their national economies (Waris, 2014: 2). The third typology distinguishes between "sink" IFCs, which attract and retain foreign capital, and "conduit" IFCs, which act as intermediate destinations (often en route to sinks). Sinks generally offer lower taxes and higher levels of secrecy, while conduits tend to have numerous tax treaties, low or zero withholding taxes on foreign income and "reputations for enabling the quiet transfer of capital" (Fichtner et al., 2017).

There is some debate over the usefulness of the concept of IFCs and tax havens. For example, Hearson (2014a: 10) notes:

> Classifying jurisdictions as tax havens… can sometimes obscure the different and more complex ways in which tax laws in one country can affect others. For example, while the Obama administration withdrew its suggestion that the Netherlands is a tax haven, it is nevertheless widely acknowledged that the Netherlands' tax treatment of certain types of transactions, combined with its extensive and beneficial tax treaty network, makes it a popular jurisdiction for tax planning structures.

Implications for development

The IMF (2014: 12-3) identifies three key impacts of IFCs on developing countries. These "fiscal spillovers" arise from the favourable corporate tax laws and practices that characterise centres and havens. They include:

- *Diversion of real and financial flows.* Countries' tax laws play a significant role in shaping both the destination and route of international flows (IMF, 2014: 15). IFCs with very low and secretive tax rates attract capital from higher tax jurisdictions, while centres with favourable and extensive bilateral tax treaties act as conduits through which investments passes. Indicative evidence of this effect is the observed concentration of global FDI stocks in relatively small countries (see Table 1, column 3), a pattern that is "impossible to understand without reference to tax considerations" (IMF, 2014: 6). Additional direct evidence includes a 2008 meta-analysis of the investment effects of tax changes which found that a 10-percentage point reduction in a country's effective tax rate increases its stock of FDI by over 30 percent on average (IMF, 2014: 16). The implication for developing countries that are not IFCs is a loss of capital, which negatively affects investment, growth and macroeconomic stability (IMF, 2014: 12).
- *Erosion of tax bases.* IFCs reduce other countries' tax bases by affecting the location of both real activities and "paper" profits (that is, the location where profits are recorded for tax purposes). Evidence of the first effect is provided in the previous bullet, while the IMF's review (2014) similarly finds strong evidence of extensive profit-shifting in response to tax laws. For example, it is "highly suggestive" that more than 42 percent of the net income earned by US majority-owned affiliates is recorded in countries commonly termed tax havens while less than 15 percent of their value added is created there (IMF, 2014: 17). Developing countries typically derive a greater proportion of their public revenue from corporate tax than advanced countries, so the implication of base erosion is to substantially reduce their fiscal performance (IMF, 2014: 7).
- *Tax competition.* Governments in developing countries often respond to favourable tax regimes abroad by lowering headline tax rates or offering tax incentives, such as reductions on corporate income tax, liberalisation of import and export duties, tax holidays or tax exemptions for certain sectors (IMF, 2014: 21). They do this in order to attract foreign capital or to retain domestic capital. Evidence of competition in countries' tax-setting includes the steady decline in statutory corporate tax rates across all developing regions since 1970, as well as the proliferation of various types of tax incentive in Sub-Saharan Africa (Hearson, 2014a: 21). Tax competition is problematic because most economists agree that fiscal incentives do not attract sufficient inward investment to outweigh the cost in lost revenue in developing countries (Hearson, 2014a: 27). Additionally, they can lead to economic distortions and corruption when granted on the basis of politicians' or officials' personal discretion (Hearson, 2014a: 28).

Ultimately, these spillovers lead to an inefficient allocation of resources based on optimising tax savings rather than economic returns (IMF, 2014: 14; Weyzig, 2014: 4). In addition to these direct investment and fiscal effects, IFCs may also distort competition between MNCs and domestic companies, undermine governance by sapping public resources and weakening taxpayer morale and impede poverty alleviation (Weyzig, 2013: 4).

The form and severity of spillovers across different countries depend on the complex interactions between their national tax policies (IMF, 2014: 13-4). These policies include "headline" statutory

tax rates, tax incentives, bilateral tax treaties intended to avoid double taxation; definitions of entities, instruments and transactions, and controlled foreign corporation (anti-avoidance) rules. Variations in these policies across countries create incentives and opportunities for taxpayers to engage in tax planning strategies, the aim of which is reduce their total tax payments (IMF, 2014: 11). There are many types of tax planning strategy and an MNC or individual may combine several of these across multiple jurisdictions (IMF, 2014: 11). Table 2 provides some common examples.

Table 2: International tax planning strategies

Strategy	Description
Abusive transfer pricing	Transfer pricing happens whenever two companies that are part of the same multinational group trade with each other. Abusive transfer pricing occurs when MNCs misprice these transactions in order to allocate income to the company that incurs lower tax rates.
Exploiting mismatches	MNCs can take advantage of tax arbitrage opportunities that arise if different countries classify the same entity, transaction, or financial instrument differently. For instance, one country may regard an instrument as debt so allow an interest deduction, while the country in which payments are received regards it as equity, and so imposes no or little tax.
Treaty shopping	Treaty networks can be exploited by MNCs to route income so as to reduce taxes. This is discussed further in the section on the Netherlands below.
Locating asset sales in low-tax jurisdictions	MNCs locate asset sales in low-tax jurisdictions to avoid capital gains taxes.
Deferral	MNCs resident in countries operating worldwide systems can defer home taxation of business income earned abroad by delaying paying it to the parent.
Inversion	MNCs may be able to escape repatriation charges or controlled foreign corporation rules by changing their residence.

Source: IMF (2014: 11).

However, while the overall effect of spillovers is to reduce collective efficiency, some jurisdictions, including some developing countries, benefit from them (IMF, 2014: 14). This is clearest in relation to profit-shifting: moving taxable income from a high tax jurisdiction to a low tax one will reduce the collective revenue of both countries, but increase the revenue of the latter. Indeed, Hearson (2014a: 11) observes that the number of developing countries attempting to establish themselves as IFCs has grown, particularly among small island states and African economies (e.g. Ghana and Kenya). For these countries, the offshore finance industry could provide significant capital inflows, as well as employment and income opportunities (Hearson, 2014a: 11; Waris, 2014: 2).

Recognising the complex relationship between tax policies and development, in 2006, the IMF, OECD, UN and World Bank recommended that all G-20 countries undertake "spillover analyses" to assess the impact of their tax systems on developing countries (Hearson, 2014a: 36). This "famous" recommendation has since become an increasingly common civil society demand (Hearson, 2015).[2] However, only the Netherlands and Ireland have so far conducted spillover analyses.

[2] For example, in 2012, Action Aid led a group of NGOs and parliamentarians in lobbying the UK government to conduct a spillover analysis of its reforms to controlled foreign company rule. The government refused on the grounds that it was "not feasible to produce an estimate that would be sufficiently robust or accurate to be of value" (Hearson, 2014a: 37). The Treasury told the International Development Committee: "[To conduct the analysis] one has to have a full understanding of the interactions between multinational companies located in developing countries and those developing countries and their tax systems, which is a very complex matter [and] not something that, frankly, either HM Treasury nor HM Revenue and Customs is well placed to make an assessment on" (Hearson 2014b).

3. Key IFCs

The preceding section highlights a number of challenges in identifying which IFCs are key for developing countries. These include (i) a lack of definitional clarity, (ii) the complexity of the hypothesised relationship between national tax policies and development, and (iii) the absence of analysis of this relationship at the country level. Nevertheless, this section provides suggestive evidence of key IFCs by analysing capital movements to/ from developing regions and economies. Table 3 provides the top sources and destinations of investment for eight developing regions. In other words, it shows where outward investment from a region immediately goes to and where inward investment immediately comes from. Table 4 provides this data for selected developing countries, including the “BRICS” economies and five low and lower middle income countries. While these capital flows are not driven by tax considerations alone, their concentration in certain source or destination countries is suggestive. In particular, the following observations can be made:

- Five countries stand out as global IFCs serving much of the developing world. The Netherlands is a key source and/or destination of investment for every developing region. For example, 31 percent of inward and outward investment in the Middle East is channelled via the Netherlands. Other countries that rank in the top 10 for inward + outward investment for most regions include the Cayman Islands (all regions except North Africa), the UK (all except the Gulf Economies and North Atlantic and Caribbean), the US (all except the Gulf Economies and North Africa) and Singapore (all except the Gulf Economies, North Atlantic and Caribbean and South America). Additionally, the British Virgin Islands are a key conduit of financial flows for four regions: Central and South Asia, East Asia, North Atlantic and Caribbean and South America.
- There also appear to be important regional centres. In East Asia, 30 percent of inward investment comes from or via Hong Kong. Qatar is the source of 56 percent of inward investment to the Gulf Economies, while the United Arab Emirates is the source of 35 percent to North Africa. In North Atlantic and the Caribbean, half of outward investment goes to Aruba and Bonaire, Sint Eustatius and Saba, at least initially.
- Finally, Table 4 highlights that many emerging and developing economies have important bilateral relationships with other IFCs/ tax havens listed in Table 1. For example, 39% of Russia’s combined inward and outward FDI is channelled through Cyprus, while 30% of India’s is via Mauritius. For the selected low and lower middle income countries, as well as China and South Africa, it is notable that the majority of their cross-border investment is with just one or two countries.

Table 3: Top 10 destinations and sources of FDI by developing region.*

Outward FDI

Central and South Asia	East Asia	Gulf Economies	North Africa	Atlantic and Caribbean	Other Middle East	South America	Sub-Saharan Africa
Singapore (16)	China: Mainland (27)	Saudi Arabia (17)	France (20)	Aruba (25)	Netherlands (49)	Cayman Islands (20)	India (26)
Netherlands (11)	United States (18)	Cayman Islands (12)	Cote d'Ivoire (18)	Bonaire, Sint Eustatius and Saba (24)	United States (12)	Virgin Islands, British (15)	China: Mainland (22)
Mauritius (9)	Virgin Islands, British (18)	Iraq (13)	Luxembourg (9)	Trinidad and Tobago (21)	Turkey (11)	Bahamas, The (11)	United Kingdom (6)
United Kingdom (6)	United Kingdom (5)	Bahrain (12)	Benin (5)	Canada (5)	Switzerland (4)	Austria (10)	Singapore (5)
Cayman Islands (6)	Netherlands (4)	Turkey (7)	United Kingdom (5)	Virgin Islands, British (4)	United Kingdom (3)	Panama (9)	Netherlands (3)
Indonesia (6)	Cayman Islands (3)	United Arab Emirates (7)	Gabon (4)	Jamaica (4)	Georgia (3)	United States (7)	Mauritius (3)
United States (6)	Australia (3)	Tunisia (5)	Switzerland (3)	Netherlands (4)	Canada (3)	Brazil (6)	United States (3)
China.: Hong Kong (4)	Thailand (2)	Netherlands (5)	Mali (3)	Curacao (3)	Japan (2)	Luxembourg (5)	United Arab Emirates (2)
Virgin Islands, British (4)	Singapore (2)	Jordan (4)	Netherlands (3)	United States (3)	Germany (2)	Argentina (5)	Luxembourg (2)
Australia (3)	China: Hong Kong (2)	United Kingdom (3)	Cameroon (3)	Sint Maarten (2)	Cayman Islands (2)	Peru (4)	South Africa (2)

Inward FDI

Central and South Asia	East Asia	Gulf Economies	North Africa	Atlantic and Caribbean	Other Middle East	South America	Sub-Saharan Africa
United States (15)	China: Hong Kong (30)	Qatar (56)	France (39)	Barbados (24)	United States (19)	Netherlands (20)	United Kingdom (15)
Japan (11)	Virgin Islands, British (21)	Bahrain (14)	United Arab Emirates (35)	Netherlands (21)	Netherlands (15)	United States (19)	United States (13)
Netherlands (10)	China: Mainland (9)	Saudi Arabia (10)	Spain (3)	Cayman Islands (10)	United Kingdom (9)	Spain (11)	Netherlands (12)
Singapore (8)	Japan (5)	United Arab Emirates (8)	Kuwait (3)	United States (10)	Cayman Islands (7)	Luxembourg (6)	Cayman Islands (8)
United Kingdom (7)	United States (5)	Oman (6)	Netherlands (3)	Canada (9)	Turkey (6)	Canada (4)	India (4)
Mauritius (5)	Cayman Islands (4)	Jersey (2)	Singapore (2)	Trinidad and Tobago (6)	Russian Federation (4)	United Kingdom (4)	South Africa (4)
China: Mainland (4)	Singapore (4)	France (2)	Switzerland (2)	Anguilla (6)	Singapore (4)	France (4)	Singapore (4)
Virgin Islands, British (4)	Netherlands (4)	China: Mainland (1)	United Kingdom (1)	Virgin Islands, British (3)	Luxembourg (4)	Japan (4)	Bermuda (3)
China: Hong Kong (4)	Republic of Korea (2)	Republic of Korea (0.4)	Gibraltar (1)	St. Lucia (3)	Canada (4)	Switzerland (3)	United Arab Emirates (3)
Switzerland (4)	Bermuda (2)	Cayman Islands (0.2)	United States (1)	Argentina (2)	Norway (3)	Germany (2)	France (3)

Inward + Outward FDI

Central and South Asia	East Asia	Gulf Economies	North Africa	Atlantic and Caribbean	Other Middle East	South America	Sub-Saharan Africa
United States (14)	Virgin Islands, British (20)	Saudi Arabia (15)	France (37)	Aruba (18)	Netherlands (31)	United States (16)	India (13)
Netherlands (10)	China: Hong Kong (18)	Qatar (13)	United Arab Emirates (31)	Barbados (18)	United States (16)	Netherlands (12)	United Kingdom (11)
Japan (10)	China: Mainland (16)	Bahrain (12)	Spain (3)	Netherlands (15)	Turkey (8)	Spain (9)	China: Mainland (10)
Singapore (9)	United States (10)	Cayman Islands (11)	Netherlands (3)	Canada (9)	United Kingdom (7)	Cayman Islands (6)	Netherlands (9)
United Kingdom (7)	Cayman Islands (4)	Iraq (10)	Kuwait (3)	Cayman Islands (7)	Cayman Islands (4)	Luxembourg (6)	United States (9)
Mauritius (6)	Netherlands (4)	United Arab Emirates (7)	Cote d'Ivoire (2)	Trinidad and Tobago (7)	Canada (3)	Virgin Islands, British (6)	Cayman Islands (5)
Virgin Islands, British (4)	Singapore (3)	Turkey (6)	Singapore (2)	United States (7)	Switzerland (3)	United Kingdom (3)	Singapore (5)
China: Mainland (4)	United Kingdom (3)	Tunisia (4)	Switzerland (2)	Anguilla (4)	Luxembourg (3)	Bahamas, The (3)	South Africa (3)
China: Hong Kong (4)	Japan (3)	Netherlands (4)	Luxembourg (2)	Virgin Islands, British (3)	Russian Federation (3)	France (3)	United Arab Emirates (3)
Cayman Islands (4)	Korea, Republic of (2)	Jordan (3)	United Kingdom (2)	Bonaire, Sint Eustatius and Saba (2)	Singapore (2)	Canada (3)	Mauritius (2)

Source: Calculations from IMF (2018)

*Figures in parentheses are the percentage of total inward/ outward regional FDI attributable to that country.

Table 4: Top 5 counterparts of FDI, selected developing countries

Inward + Outward FDI: BRICS				
Brazil	**Russia Federation**	**India**	**China: Mainland**	**South Africa**
United States (15)	Cyprus (39)	Mauritius (20)	China: Hong Kong (54)	China: Mainland (27)
Netherlands (14)	Netherlands (13)	United States (15)	United States (7)	United Kingdom (23)
Spain (9)	Virgin Islands, British (7)	United Kingdom (12)	Japan (6)	Netherlands (12)
Cayman Islands (8)	Bahamas, The (6)	Singapore (11)	South Africa (5)	United States (5)
Luxembourg (8)	Switzerland (4)	Japan (7)	Germany (4)	Mauritius (4)
Inward + Outward FDI: Low and lower middle income economies				
Democratic Rep. Congo	**El Salvador**	**Myanmar**	**Morocco**	**Pakistan**
Mauritius (76)	United States (27)	Thailand (51)	France (37)	United Kingdom (35)
South Africa (13)	Panama (26)	Republic of Korea (32)	United Arab Emirates (31)	Switzerland (21)
Zambia (8)	Spain (10)	Singapore (13)	Spain (3)	Cayman Islands (6)
France (3)	Mexico (10)	Italy (2)	Netherlands (3)	Netherlands (6)
Belgium (1)	Colombia (9)	China:: Mainland (1)	Kuwait (3)	United Arab Emirates (6)

Source: Calculations from IMF (2018)

The following sub-sections provide case studies of the five global IFCs identified in the preceding analysis. Each study provides an overview of the centre's financial flows and tax policies. Where available, a summary of analysis and evidence on the effects of the IFC's policies on developing countries is also given.

The Netherlands

Financial flows

The Netherlands is the top recipient of FDI globally and the second largest source (Table 5). In 2016, it had a total of $4.1 trillion in inward direct investment positions (roughly five times its GDP) and had invested $5.1 trillion abroad (roughly 6.5 time its GDP). The Netherlands' top investors are the US, Luxembourg, Bermuda, the UK and Switzerland. These countries are also the largest recipients of Dutch investment, with the exception of Bermuda which is surpassed by Germany.

Table 5: The Netherlands' FDI, 2016

	Inward FDI	Outward FDI
Gross positions (US$ Million)	4,083,833	5,093,952
Share of national GDP (%)	525	655
Share of world FDI (%)	13	17
Global ranking of gross FDI	1	2
Top five sources/ destinations	United States (19%) Luxembourg (18%) Bermuda (10%) United Kingdom (9%) Switzerland (7%)	Luxembourg (12%) United Kingdom (12%) United States (11%) Switzerland (8%) Germany (5%)

Source: Calculations from IMF (2018) and World Bank (2018)

Tax policies

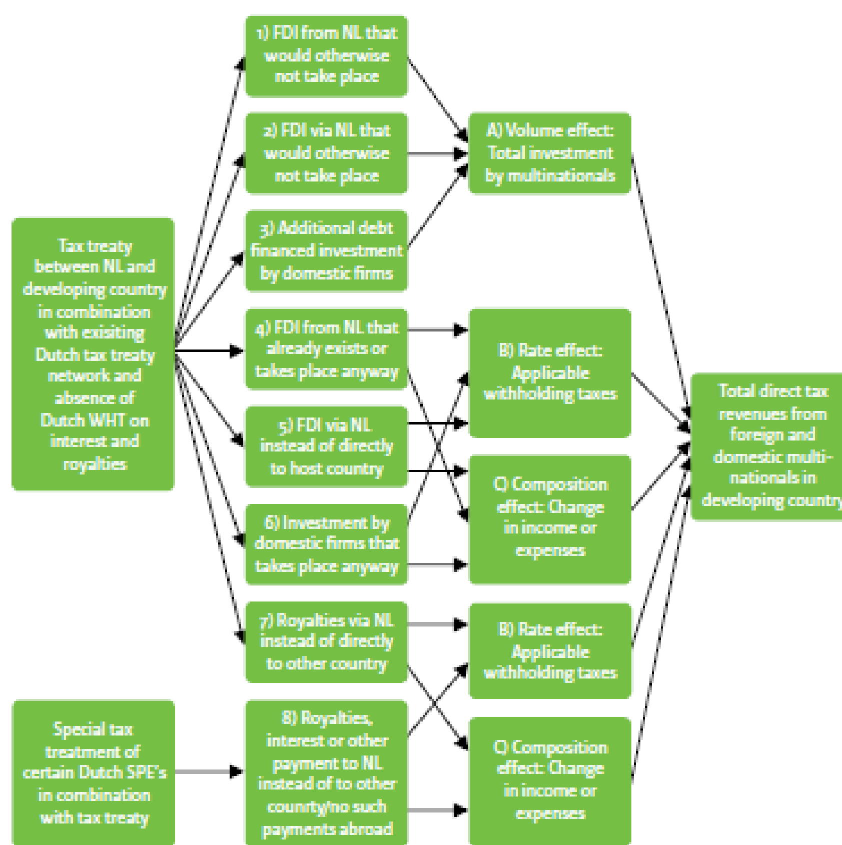
Three features of Dutch tax policy make the Netherlands an attractive conduit for global FDI (Weyzig, 2013: 13; Hearson, 2014a: 31). First, the Netherlands has an extensive network of bilateral tax treaties which protect MNCs against double taxation. Second, withholding taxes levied on cross-border flows via the Netherlands are low. Under Dutch treaties, the rate of withholding tax that source countries may levy on foreign income tends to be particularly reduced. For example, the UK's treaty with Ghana specifies a 7.5 percent withholding tax on UK MNCs' dividend earnings there, while the Dutch treaty sets a 5 percent rate (Weyzig, 2013: 65). Additionally, the Netherlands does not levy withholding taxes on outgoing interest payments, royalties and certain types of profit (Weyzig, 2013: 64). Third, Special Purpose Entities (SPEs) registered in the Netherlands benefit from various special tax treatments (Weyzig, 2013: 58). These three features mean that a large number of MNCs have established Dutch SPEs in to order to invest in foreign countries, diverting a significant proportion of global FDI via the Netherlands (Weyzig, 2013: 13).

Impact on developing countries

Weyzig's spillover analysis (2013: 57-9) identifies multiple pathways by which Dutch tax policy may affect investment and tax revenue in developing countries, both positively and negatively (Figure 1). A tax treaty between the Netherlands and a developing country may generate additional FDI in the developing country (Figure 1, boxes 1 and 2), thus increasing the total volume of inward FDI (box A). In addition, if withholding tax reductions lower the cost of external borrowing, a tax treaty can increase investment by domestic MNCs in the developing country (box 3). For investments that already exist or would take place anyway (boxes 4 and 5), there is a tax rate effect (box B) if the tax treaty limits the host country's withholding tax rates on interest or dividend payments. The treaty can then also affect the composition of investments (box C) because withholding taxes influence the relative costs of debt and equity. These rate and composition effects exist for domestic MNCs that raise funding in international capital markets as well (box 6).

Finally, the Figure shows potential negative effects resulting from other aspects of the Dutch tax system. The absence of Dutch withholding tax on outgoing interest and royalty payments in combination with reduced taxes on incoming payments can result in the Netherlands being used as a "royalty conduit" (box 7). MNCs may send royalty and interest payments from a developing country to their resident country via the Netherlands rather than directly in order to reduce their withholding tax payments. This is known as treaty shopping, and it reduces the developing country's tax base (box B). Additionally, the Netherlands' special tax treatment of SPEs may result in MNCs shifting assets and profits to Dutch subsidiaries (box 8). In this instance, the Netherlands acts as a sink rather than a conduit, but the overall effect is to reduce the developing country's corporate tax base further.

Figure 1: Potential spillovers of Dutch tax policy on developing countries



Source: Weyzig, 2013: 58

Weyzig (2013: 13-4) evaluates these potential pathways against the available evidence. Regarding volume effects, econometric studies on the effect of tax treaties on bilateral FDI have produced mixed results. Various studies find positive effects but these sometimes appear to be temporary or limited to middle income countries. However, the only study that specifically focuses on the effect of Dutch tax treaties on inward FDI in five developing countries (Philippines, Bangladesh, Ghana, Uganda, and Zambia) found no significant impact. Although it is possible that Dutch tax treaties with other developing countries have had a positive volume effect on FDI, evidence is currently unavailable. Regarding rate effects, a few academic analyses provide evidence of tax treaty shopping via the Netherlands by MNCs seeking to avoid withholding tax. They estimate that these effects lead to forgone withholding tax revenues in developing countries of between EUR 150-550 million per year. Additionally Weyzig (2013: 69-70) provides some examples of MNCs that have engaged in profit-shifting via or to Dutch SPEs from developing countries. However, estimates of the resulting revenue loss for source country governments are unavailable.

Weyzig (2013: 14) notes that a limitation of his analysis is that it does not consider the wider potential impacts of Dutch tax policy on development outcomes, including the redistribution of capital from developing countries to the Netherlands and the distortion of competition between MNCs and developing country firms. These negative effects on broader economic development may be "as important as the direct negative effect on public revenue mobilisation".

The Cayman Islands

Financial flows

The Cayman Islands is a self-governed overseas territory of the UK (OECD, 2017: 23). It attracts 2% of inward FDI and provides 2% of outward FDI globally (Table 6). Its top source of inward investment is the US, which provides 43% of the total, while its top destination is China, according to IMF data. However, a number of countries do not report their bilateral FDI with the Cayman Islands for confidentiality reasons, including Cyprus, Malta and Switzerland. Additionally, there is no data on the amount of inward investment from Mainland China and Singapore to the Cayman Islands.

Table 6: The Cayman Islands' FDI, 2016*

	Inward FDI	Outward FDI
Gross positions (US$ Million)	620,806	579,628
Share of national GDP (%) **	..	..
Share of world FDI (%)	2.1	2.0
Global ranking of gross FDI	14	15
Top five sources/ destinations*	United States (43%) Netherlands (10%) Brazil (10%) China, P.R.: Hong Kong (9%) Canada (6%)	China, P.R.: Hong Kong (19%) United States (15%) Luxembourg (14%) Singapore (10%) China, P.R. Mainland (8%)

Source: Calculations from IMF (2018).
*The Cayman Islands do not participate in the IMF Coordinated Direct Investment Survey. Data is derived from counterpart economies' reported direct investment to/ from the Cayman Islands.
** GDP data is unavailable for the Cayman Islands in the World Bank World Development Indicators

Tax policies

The Cayman Islands meet some of the OECD's criteria for identifying tax havens (see Section 2) The jurisdiction has no direct tax on income, capital gains or sales (OECD: 2017: 24). Instead, government revenues are derived from the imposition of fees on the financial services industry, customs duties, work permit fees and tourist accommodation charges. The Cayman Islands were rated "largely compliant" with international standards for the exchange of tax information and transparency by the Global Forum's 2017 peer review (OECD, 2017: 13). The rating was lowered from "compliant" due to patchy implementation of certain company laws, including requirements that all entities maintain beneficial ownership data and accounting information (OECD, 2017: 14-15). However, the Cayman Islands score poorly against the TJN's Financial Secrecy Index (FSI), ranking as the third most secretive jurisdiction worldwide after Switzerland and the US (TJN, 2018a: 13). This is due to its low score against several indicators of corporate transparency, ownership registration and tax regulation integrity.

The Cayman Islands' low-tax and regulation-light environment supports a high concentration of financial services (TJN, 2018a: 1). The territory is the world's eighth largest banking centre with total bank assets valued at $1.0 trillion (TJN, 2018a: 1). It is by far the largest offshore domicile for hedge funds, hosting 60% of global hedge fund assets, and the second largest for captive insurance companies (Fichtner, 2016: 1034; OECD, 2017: 25). Additionally, there is much suggestive evidence that MNCs take advantage of the Cayman Islands' tax policies to engage in

profit-shifting strategies. For example, research by the US Congress' Joint Committee on Taxation found that in 2010, 6 percent of all US corporate foreign earnings and profits were recorded by subsidiaries located in the Cayman Islands (TJN, 2018a: 1). However, despite the Cayman Islands' reputation as a leading IFC/ tax haven, Fichtner's recent review of the evidence on the centre's cross-border activities (2016: 1034) finds that its aggregate effect on global financial flows and tax revenues is "severely under-researched".

The UK

Financial flows

The UK is the sixth largest recipient of global FDI and the fourth largest source (Table 7). The value of its inward and outward FDI is just under $1.5 trillion, approximately half its GDP. The US is the top source and top destination of British FDI, followed by the Netherlands and Luxembourg.

Table 7: The UK's FDI, 2016

	Inward FDI	Outward FDI
Gross positions (US$ Million)	1,388,273	1,439,067
Share of national GDP (%)	52	54
Share of world FDI (%)	5	5
Global ranking of gross FDI	6	4
Top five sources/ destinations*	United States (33%) Netherlands (12%) Luxembourg (7%) Jersey (6%) France (6%)	United States (25%) Netherlands (12%) Luxembourg (9%)) France (7%) Ireland (5%)

Source: Calculations from IMF (2018) and World Bank (2018)

Tax policies

The Tax Justice Network and Action Aid (TJN, 2018b; Action Aid, 2016; Action Aid, 2013) identify at least four features of the UK tax system that give the jurisdiction "an 'offshore' tax haven character" and contribute to its status as a major IFC. First, the UK has one of the world's largest tax treaty networks (Action Aid, 2016: 2). Second, the UK has jurisdiction or sovereignty over ten territories that are generally recognised as tax havens: Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Montserrat and the Turks & Caicos Islands (Action Aid, 2013: 7). Third, the UK offers an increasingly favourable corporate tax regime. For example, since 2010, it has lowered its headline corporate income tax rate from 28 percent to 18 percent in 2019; relaxed controlled foreign company rules designed to deter MNCs from profit-shifting; and introduced new tax incentives such as the Patent Box, which allows companies to pay reduced income tax (10 percent) on profits derived from products that incorporate a patent (TJN, 2018b: 9). Fourth, the UK hosts various corporate structures and arrangements that may help facilitate tax avoidance, such as UK Limited Liability Partnerships (TJN, 2018b: 9).

These features of the UK tax system, combined with the jurisdiction's progressive deregulation of financial markets since the mid-1980s, have made London both a leading IFC and a major conduit of corporate offshore investment to/from "tax havens" (TJN, 2018b: 1; Fichtner et al., 2017). The TJN estimates that the UK accounts for 17 percent of the global market in offshore financial

services, second only to the US (see below). London hosts the largest international insurance, foreign exchange and professional services markets in the world (OECD, 2013: 17). The UK's banking sector conducts half of Europe's investment banking activity and hosts the third largest deposits globally (OECD, 2013: 17). However, there is evidence that the UK is also a key conduit for MNCs engaging in profit-shifting. Fichtner et al. (2017) analyse firm-level ownership data for 98 million firms and find that 14% of corporate offshore investment in tax havens is channelled via the UK. This is second only to the Netherlands, which routes 23% of total investment to tax havens.

Impact on developing countries

Action Aid (2012) conducted an analysis of the impact of the relaxation of the UK's controlled foreign company rules on developing countries. Under the old rules, a British MNC that shifted profits into a tax haven in order to lower its tax bills would have to top up its payments at home, bringing it into line with the UK rate. Following government reforms in 2012, controlled foreign company rules would only apply to MNCs engaging in profit-shifting that was costly to the UK. They no longer applied to companies avoiding tax in developing countries (Action Aid, 2012: 2-4). Action Aid (2012: 4) estimated that the new rules would cost developing countries £4 billion annually in forgone tax revenue.

The US

Financial flows

The US is the second largest recipient of global FDI and the largest source (Table 8). The UK, Japan, Luxembourg and the Netherlands are among its top counterparts for inward and outward investment.

Table 8: The US's FDI, 2016

	Inward FDI	Outward FDI
Gross positions (US$ Million)	3,725,418	5,332,225
Share of national GDP (%)	20	29
Share of world FDI (%)	12	18
Global ranking of gross FDI	2	1
Top five sources/ destinations*	United Kingdom (15%) Japan (11%) Luxembourg (11%) Canada (10%) Netherlands (10%)	Netherlands (16%) United Kingdom (13%) Luxembourg (11%) Ireland (7%) Canada (7%)

Source: Calculations from IMF (2018) and World Bank (2018)

Tax policies

The US ranks second in the TFN's Financial Secrecy Index due to two key features of its tax system (TJN, 2018c: 1). First, the US has not joined the Global Forum's Common Reporting Standards (CRS) programme, which is working to implement the internationally agreed AEOI standard (see section 2) (TJN, 2018c: 5). The CRS programme commits jurisdictions to obtaining certain taxpayer information from their financial institutions and automatically exchanging that information with other jurisdictions on an annual basis (OECD, n.d.). The US's failure to join weakens information exchange for assets held in its jurisdictions (TJN, 2018: 6). Second, because

company law is enacted at the state, rather than federal, level, several states host anonymous "shell" corporations and other secret, tax-free entities in order to attract investment (TJN, 2018: 6). Indeed, almost two million anonymous corporations and limited liability companies are formed in the US each year, many by foreigners (TJN, 2018: 7). Ownership anonymity facilitates tax avoidance, money laundering and other illicit activities. As a result of these features of the US tax system, TJN (2018: 1) concludes:

> The U.S. provides a wide array of secrecy and tax-free facilities for non-residents, both at a Federal level and at the level of individual states… While it has pioneered powerful ways to defend itself against foreign tax havens, it has not seriously addressed its own role in attracting illicit financial flows and supporting tax evasion. It is currently a jurisdiction of extreme concern for global transparency initiatives.

Singapore

Financial flows

Singapore is the eight largest recipient of global FDI, with inward stocks valued at three times its GDP (Table 9). It shows more discrepancy in its top sources and destinations of investment than the previous case studies. While its sources of FDI are dominated by advanced economies and tax havens, its top destinations are mainly emerging economies in South and East Asia.

Table 9: Singapore's FDI, 2016

	Inward FDI	Outward FDI*
Gross positions (US$ Million)	975,790	526,413
**Share of national GDP (%) ** **	329	177
Share of world FDI (%)	3	2
Global ranking of gross FDI	8	17
Top five sources/ destinations*	United States (18%) Japan (8%) Netherlands (7%) Virgin Islands, British (6%) Cayman Islands (6%)	China, P.R.: Mainland (20%) Indonesia (12%) Luxembourg (11%) India (7%) China, P.R.: Hong Kong (7%)

Source: Calculations from IMF (2018) and World Bank (2018)
* Singapore does not provide the IMF Coordinated Direct Investment Survey with outward FDI data. Outward FDI data is derived from destination economies' reported direct investment from Singapore.

Tax policies

Singapore ranks fifth on the TJN's Financial Secrecy Index. The TJN justifies this ranking thus (TJN, 2018d: 5):

> Singapore has, in line with evolving international standards on transparency, made some significant moves to reform for the better. In addition, Singapore currently chairs the Peer Review Group in the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. The most notable regulatory changes include:
>
> - Committing to the OECDs "on request" standard for information exchange; this was followed by the passing of a bill in November 2011 allowing Singapore to exchange information under its Tax Information Exchange Agreements (TIEAs)

- The passage in October 2009 of the Income Tax (Amendment) (Exchange of Information Bill to allow for the exchange of some bank and trust information
- Including tax offences as predicate offenses for money laundering, from July 2013
- Criminalising asset managers and bankers who wilfully conceal, possess or use proceeds of foreign tax offences “if they had reasonable grounds to believe that they were assisting the tax offender in retention or control of the proceeds of the foreign tax evasion”, effective 1 September 2014
- Signing the multilateral agreement implementing the Common Reporting Standard on automatic exchange of information in June 2017

However, Singapore continues to offer a range of secrecy offerings, including the popular Private Trust Company (PTC), which acts as a trustee for secretive trusts. A PTC, as one practitioner describes it, allows the wealthy individual a “higher level of control and discretion” than with standard trusts managed by a professional trustee.

Singapore offers other tax exemptions too. There is full tax exemption for foreign-sourced income received in Singapore by any individual not resident in Singapore; there is an absence of capital gains, gift or estate taxes; and Singapore also boasts a quasi-territorial tax system that exempts from individual income tax all foreign-sourced income not remitted to Singapore. Various other tax incentives and loopholes exist for corporations too. In addition, Singapore has quite a wide array of tax treaties with other countries, and, partly as a result of this, it has become a major turntable for so-called ‘round-tripping’ into and out of India and other countries, competing against other centres like Mauritius. Round tripping occurs when an investor from, say, India, sends capital to Singapore, where it is hidden behind legal secrecy and subsequently returned to India via a Singaporean shell company, disguised illegally as foreign investment, in order to obtain tax and other benefits from the tax treaty that would not otherwise have been available to the Indian investor. [In summary,] Singapore also offers plenty of opportunities for tax arbitrage.

In addition… Singapore has sought to provide a regulatory haven to help financial sector players escape financial regulations elsewhere.

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Suggested citation

Timmis, H. (2018). *Mapping financial centres.* K4D Helpdesk Report. Brighton, UK: Institute of Development Studies.

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