In Focus

Offshore Financial Centres

Jan Fichtner and **Benjamin D. Hennig** chart the size of the foreign assets in the world's largest offshore financial centres.

The International Monetary Fund defines offshore financial centres (OFCs) as jurisdictions that provide financial services to non-residents on a scale that is excessive compared to the size and the financing of their domestic economies. All OFCs share one characteristic feature in common: they offer very low tax rates and lax regulations in an effort to attract foreign financial assets.

OFCs essentially undercut 'onshore' jurisdictions. The main beneficiaries of offshore financial centres are high net worth individuals and large multinational corporations that have the capital and expertise required to utilise their low tax rates and loose regulatory framework.

Some important OFCs are in fact located 'onshore', for example in the US state of Delaware and the City of London. However, many OFCs have historically literally developed 'off-shore', mostly on small islands. The most salient aspect of the 'offshore' phenomenon is the withdrawal of public regulation and control, primarily over finance.

The graphic shows combined data on the most important components of financial centres: securities (Coordinated Portfolio Investment Survey by the International Monetary Fund) and deposits/loans (Locational Banking Statistics by the Bank for International Settlements) at the end of 2011. This data provides a reasonable approximation of the real size of OFCs while avoiding double counting. The larger the size of the circles on the map, the more foreign financial assets have been attracted to the particular jurisdiction. The vast majority of the almost US$70 trillion foreign financial assets are concentrated in North America, Europe and Japan. Areas with assets of less than $US50 billion are not shown due to their relative insignificance in the global context.

The chart on the top left shows the foreign financial assets divided by the gross domestic product (GDP) of the jurisdiction, the so-called 'OFC:intensity ratio'. Here it becomes obvious that the Cayman Islands – the sixth largest international financial centre according to the data – are by far the most intensive offshore financial centre in the world. The foreign financial assets are more than 1,560 times larger than the GDP of this tiny archipelago under UK sovereignty. The top ten of the most intensive OFCs is dominated by jurisdictions that are under the sovereignty of the UK or that are (formally independent) Commonwealth realms.

While it is extremely difficult to say above which value a financial centre has a scale that is incommensurate with the size of its domestic economy, it could be argued that jurisdictions with an OFC:intensity ratio of more than three could already be classified as offshore financial centres. By this definition, even the UK and the Netherlands would be OFCs. However, the more common perception takes the absolute size into account, where smaller jurisdictions with a very large OFC:intensity ratio matter more than very large ones such as the United Kingdom, despite it having very similar characteristics as other OFCs.