

## *Offshore Financial Centers: Parasites or Symbionts?*

**Andrew K. Rose and Mark M. Spiegel\***

Your local crime-lord has one. So do most drug-dealers, white-collar criminals, and Mafioso. Have you got an offshore bank account? Offshore financial centers are often accused of facilitating tax evasion, money laundering, and any number of nefarious activities. Prominent offshore centers have reputations for facilitating all manner of these unsavory practices, though ample opportunities for such activities may also exist for local banks with branches in Gibraltar, Guernsey, Jersey, and the Isle of Man. All told, there are some forty offshore financial centers (OFCs) spread around the world, mostly in Europe and the Caribbean. There is widespread suspicion that most of them reduce the costs of illicit activity in their neighbors, leading many to characterize OFCs as parasites.

While OFCs might encourage bad behavior, their net impact may not be bad for the economy. By providing competition for domestic banks, offshore banks also (inadvertently) lower costs for anyone using the domestic financial system. In their forthcoming article "*Offshore Financial Centers: Parasites or Symbionts?*" Rose and Spiegel quantify the indirect competitive *benefits* of OFCs, and show that they more than offset the costs. That is, OFCs are more accurately viewed as symbionts than parasites.

Offshore financial centers (such as the Cayman Islands or Panama) are jurisdictions that oversee a disproportionate level of financial activity by non-residents. Financial activity in OFCs is usually dominated by the provision of intermediation services for larger neighboring countries. In this paper, the authors ask two distinct questions concerning the causes and

consequences of OFCs. First, why do some countries become OFCs? Second, what are the consequences of OFCs for their neighbors?

What makes a country likely to become an offshore financial center? The authors approach this question using a number of different data sets. Unsurprisingly, countries that are tax havens and money launderers host more assets and are more likely to be OFCs. These results are intuitive; one attraction of moving assets offshore is the ability to pursue activities that are prohibited in source countries.

Do OFCs make bad neighbors? One might expect proximity to an OFC to be bad for the neighborhood, since OFCs may encourage tax evasion and other illegal activities. However, the presence of nearby offshore financial centers also has the beneficial effect of increasing the competitiveness of a source country's banking sector. The tradeoff between the positive and negative externalities of OFCs lies at the heart of the paper.

To analyze this tradeoff, the authors develop a theoretical model where OFCs have the benign effect of encouraging competition in the domestic banking sector. They then take the predictions of the model to the data, and examine the impact of OFC proximity on banking-sector competitiveness and financial depth. The prediction that OFCs have a pro-competitive impact on their neighbors is robustly confirmed. Simply by being close to Andorra and Monaco, France has a more competitive banking system which provides more credit at lower interest rate spreads.

To summarize, Rose and Spiegel find that countries identified as tax havens and money launderers are likely to be OFCs, encouraging tax evasion and nefarious activity in neighboring source countries. Nevertheless, OFCs still provide substantial offsetting benefits in the form of

competitive stimulus for their neighbors' financial sectors. This benign impact on local banking conditions tends to mitigate the adverse effects of OFCs on tax evasion and illegal activity.

**Offshore Financial Centers  
Caribbean**

Aruba	Bahamas	Barbados	Belize
Bermuda	Brit. Virgin Islands	Cayman Islands	Costa Rica
Dominica	Neth. Antilles	St. Kitts & Nevis	Turks and Caicos Is.

**Europe**

Andorra	Cyprus	Gibraltar	Guernsey
Isle of Man	Jersey	Liechtenstein	Malta
Monaco			

**East Asia**

Hong Kong	Macau	Malaysia	Marshall Islands
Philippines	Singapore	Thailand	

**Middle East**

Bahrain	Israel	Kuwait	Lebanon
Oman	United Arab Emir.		

**Other**

Liberia	Mauritius	Morocco	Panama
Russia	Uruguay		

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