CAPITAL ECONOMICS

JERSEY'S VALUE TO EUROPE

Investigating the linkages between Jersey and investment and prosperity in the European Union

October 2016

SUMMARY REPORT

A report by Capital Economics for Jersey Finance

Melanie Debono
Alexandra Dreisin
Andrew Evans
John Phelan
Mark Pragnell

Capital Economics Limited
5th Floor, 100 Victoria Street, Cardinal Place ,London, SW1E 5JL
www.capitaleconomics.com
Registered office: as above. Registered in England No. 2484735 VAT No. GB 198 2919 50

FOREWORD

Jersey Finance published a report on Jersey's Value to Britain which analysed the Island's contribution to the British economy. We had always felt that our contribution was significant, and the report confirmed that we provide vital liquidity to the British economy, facilitate inward investment from around the world and support a significant number of jobs in the UK. We now publish this study on Jersey's Value to Europe which draws similar conclusions about our contribution to the other 27 European Union member states.

As with the UK study, the analysis has been carried out by Capital Economics, a leading international research consultancy. Until now, there has been no rigorous research on the subject but this report breaks new ground with its analysis of existing information, statistics and research. This has been complemented by a major survey of a large sample of Jersey's financial and related businesses, which provides a comprehensive review of the sources and uses of EU assets managed by the Island's financial services industry.

The report begins by saying that Jersey is unambiguously European, with unique and complex relationships with the UK and the EU. Its role as an international financial centre – not part of the UK and outside the EU – has allowed it to develop mutually beneficial relationships with the UK, the EU and its other 27 member states. Jersey's finance industry typically gains access to EU markets by means of EU legislation providing third party access for an Island that demonstrates equivalent standards of regulation and supervision.

Unsurprisingly, Jersey's contribution to the economies of the other EU countries is not on the same scale as that to the UK, which is our biggest trading partner. But it has still attracted accumulated investment to them from non-EU sources of €188 billion, a significant 4 per cent of the EU's total stock of liabilities. And the report estimates that this investment has the potential to support 88,000 jobs.

These figures are impressive for an Island of 118 square kilometres with a population of just over 100,000. But as the report demonstrates, they are a consequence of the growing globalisation of the world's economy, in which international trade has increased steeply and people across the globe are becoming more mobile. In this economic environment, individuals, businesses and institutions operating across borders want specialist financial services that help them to operate on a global scale.

As a small jurisdiction, Jersey has the flexibility and freedom to provide the taxation, regulatory and supervisory regimes required by clients with cross-border asset portfolios. It offers a safe harbour for those carrying on business in unstable and risky countries.

That is why Jersey has become a leading international financial centre. And even though our footprint is nowhere near as large as centres such as Luxembourg and Switzerland, the Island has attracted a mix of skills and financial businesses that account for a quarter of its 59,000 jobs and two-fifths of its economic activity.

One issue commonly raised in the context of Jersey's role as an international financial centre is whether individuals and businesses use the Island to evade or avoid tax. The report unequivocally backs what Jersey Finance has been saying for years: Jersey is not a tax haven, and nor is it a centre for corporate profit-shifting.

The most likely method that might be used to avoid tax through Jersey could produce a theoretical maximum tax loss in EU countries other than the UK of €70 million a year. However, that method would have to be used for all the money and assets in Jersey from those countries, so the actual figure will be much smaller. Overall, the report estimates that no more than €100 million of taxes due in the 27 EU countries excluding the UK could possibly be avoided or evaded through Jersey each year. And the extra €1 billion a year of tax estimated to be generated in the 27 member states as a result of the economic activity created by foreign investment intermediated by Jersey more than outweighs that total.

As the report rightly points out, Jersey has in fact been at the forefront of international measures to improve transparency and clamp down on criminality such as money-laundering and tax evasion. So the Island would be an ill-advised and unlikely choice for such activities, especially with the launch of automatic exchange of information on which Jersey has been a pioneer.

As for corporate profit-shifting, Jersey's small number of bilateral tax treaties and double taxation agreements limit the extent to which the Island can be used for such activities. And our transparent tax system means that what you see is what you get: the published tax rates are what taxpayers pay. With many larger jurisdictions, the headline rates of tax can be reduced considerably or even to zero by using reliefs available under their many double taxation agreements.

To conclude and in the aftermath of the UK's vote to withdraw from membership of the European Union, we believe that our constitutional relationship with the UK will not change. More important in the context of this report, we also believe that the Island will continue to make the valuable contribution to the remaining EU economies that is outlined in this report.

I hope that you will find the report an interesting read, for its insights into the true nature and value of Jersey – now and in the future.

Geoff Cook
Chief Executive Officer
Jersey Finance

KEY FINDINGS

Capital Economics has been commissioned by Jersey Finance Limited to research and report upon the economic, financial and fiscal linkages between Jersey and the European Union.

The key findings of the research are:

- Offshore centres have evolved to meet the needs of global businesses and internationally footloose individuals, and this demand looks set to grow
- Jersey is a significant offshore financial centre although smaller than the likes of Switzerland and Luxembourg. Its economy is concentrated in financial services, but its scale of specialisation in a single sector is not unusual for a geography of its size
- Jersey is unambiguously European, with unique and complex relationships with the United Kingdom and the European Union
- Roughly one third of all fund assets administered and managed in Jersey are located in European Union countries other than the United Kingdom. Funds are an important mechanism for foreigners to invest in businesses and assets in the European Union
- Three-fifths of all assets administered or managed across the whole of the island's financial and wealth management industry originates from ultimate beneficial owners who are domiciled in Europe
- Jersey is a conduit for an estimated almost **€**188 billion of foreign investment in to the European Union (excluding the United Kingdom), which is equivalent to four per cent of the total stock of liabilities in the bloc and supports in the order of 88,000 European jobs[1]
- Jersey is almost entirely self-sufficient, with it only benefiting from the United Kingdom's defence and foreign representation activities to which it makes an agreed contribution. Jersey does not benefit from or contribute to the European Union budget
- Jersey is not a tax haven nor is it a material centre for corporate profit shifting. There are few ways for European Union citizens and businesses to use the island to avoid or evade their domestic taxes. We estimate the theoretical maximum loss of tax to member states (other than the United Kingdom) through the most likely method of tax avoidance to be **€**70 million per annum. In practice, the actual figure will be a small fraction of this

[1] The data were collected in pound sterling for information relating to the year 2014 and were converted to euros at £1 per €1.24.

- Tax generated by economic activity stimulated in member states (other than the United Kingdom) and facilitated by investment mediated through Jersey is in the order of €1.0 billion per annum yielding a net fiscal benefit to the European Union governments, other than the United Kingdom's, of around €0.9 billion per annum

In research of this nature, there is room for debate over the methodologies deployed and approaches taken, while there are, of course, margins of error associated with any survey results and consequent quantitative analysis. Nevertheless, overall our analysis unquestionably shows that Jersey facilitates significant foreign investment into the European Union, assists European investors in making decisions on investments across the globe and provides a net boost to government finances in the bloc.

CONTENTS

JERSEY'S VALUE TO EUROPE

Capital Economics has been commissioned by Jersey Finance Limited to research and report upon the economic, financial and fiscal linkages between Jersey and the European Union.

This report combines new and innovative analysis of existing information, statistics and research with the results from a major quantitative and qualitative research exercise conducted among a large and representative sample of senior executives in Jersey's financial and related businesses. The purpose of the exercise has been to provide first order estimates of the general scale and shape of the many ways in which the economies of Jersey and the European Union are linked, so the results should be treated with the appropriate caution. This work goes further than any previous study and, importantly, provides a thorough review of the sources and uses of assets administered or managed by the island's banks, funds, and trustees. It also provides seminal estimates of Jersey's impact on European governments' coffers.

Throughout this report, we focus on the relationship between Jersey and the European Union excluding the United Kingdom (although we also comment on its links with all 28 members of the European Union and with Europe defined more widely).[2] This is not a comment on the position of the United Kingdom within the bloc or on the eventual outcomes of the Brexit negotiations. It reflects the different scale and nature of relationships between the island and the United Kingdom, and between the island and elsewhere. We report separately on 'Jersey's value to Britain'.[3]

1 A European economy

We evaluate Jersey's connections with the European Union and examine its economy in detail.

Jersey is unambiguously European, with unique and complex relationships with the United Kingdom and the European Union. Situated just 22 kilometres off the Normandy coast of France, Jersey's share of European-born residents exceeds that of the United Kingdom. The bailiwick is not part of the United Kingdom and remains outside of the European Union, yet has established mutually beneficial arrangements with the bloc and its member states. Most of these arrangements will remain even after the United Kingdom formally exits the union as they were not dependent on the island's constitutional links with Britain. Part of the island's relationship with the European Union is codified formally in Protocol 3 of the United Kingdom's 1972 *Act of Accession* and so will change after 'Brexit'. Changes will include different trade agreements for the trade in goods for which Jersey is treated as being part of the single market.

[2] Throughout this report, Europe refers to all countries within the European Union (including the United Kingdom), the European Economic Area, Guernsey, Isle of Man, Switzerland, Russia, and mainland Europe

[3] Alexandra Dreisin, Andrew Evans, John Phelan and Mark Pragnell, *Jersey's Value to Britain* (Jersey Finance, St Helier), 2016.

Nationals from the union or European Economic Area are free to live and work in the island, and Jersey voluntarily implements many of the bloc's regulations or the international standards on which they are based.

The economy of Jersey has seen a great deal of change over the last century. While the mainstays of the island have historically been tourism and agriculture, the development of the financial services sector has out-paced the more traditional sectors to become the dominant industry on the island.

Jersey's freedom to legislate and govern, and determine its own taxes, has allowed it to become established as a leading centre for international financial services — a so-called 'international financial centre'.

Jersey is a significant player in the offshore market although its footprint is nowhere near as large as the likes of Luxembourg, Switzerland and the Cayman Islands. Its scale is reflected in the mix of jobs and businesses found on the 118 square kilometre island. Financial and related businesses dominate, and account for a quarter of all jobs and two-fifths of economic activity. But this level of specialisation in a certain sector is not unusual in an economy with only 59,000 jobs.

2 Investment, growth and cross-border finance

We evaluate the importance of investment for economic growth and the changing global context within which international financial centres operate.

To understand offshore finance, it is essential to recognise the growing impact of globalisation – whereby trade between countries gets ever larger, people are more mobile and willing to relocate abroad, and capital flows are increasingly international. In a world like this, where national boundaries have ever decreasing significance to people and to businesses, it should come as no surprise that there is strong demand for services that facilitate efficient and secure cross-border transactions. Jersey and other offshore centres provide environments in which international business can be conducted without fear of double taxation, or legislative and administrative bias in favour of a 'home' counterparty. They often provide regulatory and supervisory regimes better tailored to the needs of their specific clientele, and can provide security for those carrying on business in unstable and risky countries. Jersey, in particular, has robust legislation for the creation of trusts and other asset and investment management and pooling vehicles, which makes it attractive to individuals, businesses and institutions with cross-border asset portfolios.

Jersey's status and structures help to facilitate long term investment. Jersey vehicles are important players in secondary markets, as they allow individuals and institutions access to a broader credit base by enabling them to access capital in foreign markets. Active secondary markets connect investors around the world with a diverse range of other investors, and provide them with an avenue to buy and sell their assets at any time they desire. This ability and flexibility to buy and sell helps add liquidity to the market, and provides much needed support to the primary markets while allowing investors to maximise their returns. Secondary markets also facilitate foreign capital to enter markets that would not otherwise be open to them, which in turn drives increases in the recipient country's potential output.

3 Combating tax leakage and financial crime

We discuss the regulatory initiatives coming out of Europe and the rest of the world and demonstrate Jersey's commitment to addressing tax evasion and avoidance.

The fallout from the global financial crisis has reshaped the face of global regulation. The post-crisis period has been characterised by an abundance of regulatory activity, intended to safeguard financial systems from a similar event occurring again. There has been a renewed focus from international organisations and governments on fighting tax evasion and avoidance, which has implications for international financial centres.

Jersey has been at the forefront of international developments to improve transparency and clamp down on criminality, including tax evasion. The bailiwick has a transparent and simple tax system – what you see is what you pay. This straightforward system is in contrast to other jurisdictions whose headline tax rates are different from their effective tax rates, which can provide more opportunity for tax avoidance schemes. Jersey's position as one of the world's best regulated international financial centres has been acknowledged by independent assessment from some of the world's leading bodies, including the Organisation for Economic Co-operation and Development, the International Monetary Fund, the G20 and the Council of Europe's MONEYVAL committee.

The negative connotation associated with the word 'offshore' is misplaced. International financial centres have evolved to meet the needs of businesses and people who operate across national borders – to assist trade, mobility and globalisation, and the improvements in world growth and prosperity that these stimulate. There may be some offshore centres that provide secretive shelter from other jurisdictions' domestic taxes, but not Jersey (nor the other Crown Dependencies). Tough anti-money laundering laws and robust regulation make the bailiwick an ill-advised choice for would-be tax evaders – while efforts on both sides of the Channel means that the scope for unwanted avoidance schemes to use the island is all but eliminated.

4 The financial linkages

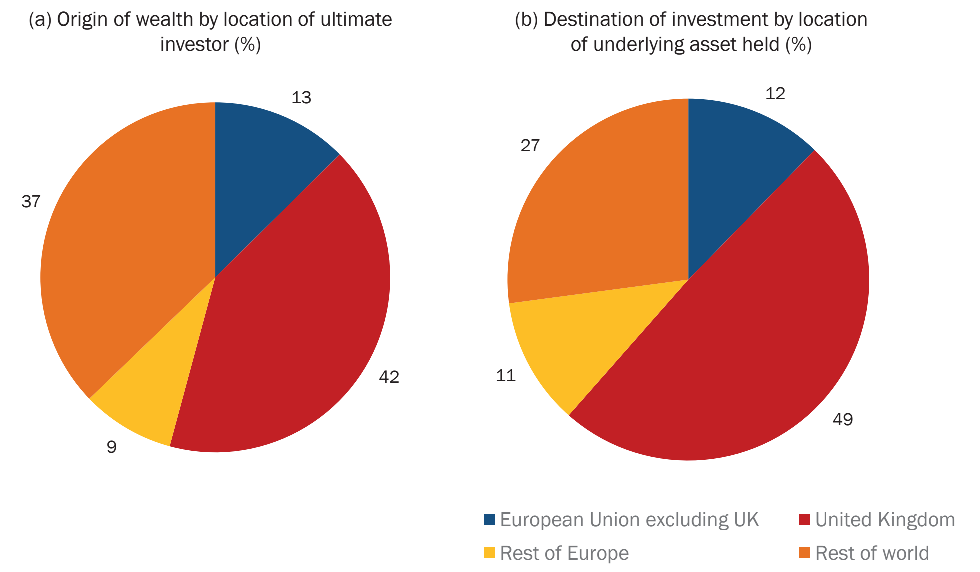
We consider the business conducted by Jersey as an international financial centre, and explore its implications for the European Union.

In addition to using extant data from regulatory, government and industry sources, we conducted a detailed quantitative survey and programme of in depth interviews with banks, trust companies, fund administrators and managers, corporate service providers, legal practices and accountancies in Jersey – in order to capture insight into who their customers are and who benefits from their activities. Our survey covered businesses employing two-thirds of all the island's finance workers – and is a robust and representative sample.

Overall, we estimate that Jersey is custodian of €1.7 trillion of wealth: €185 billion in banks; €500 billion in trusts established by private individuals; €800 billion in specialist structures for businesses and institutions; and almost €300 billion in administered or managed funds.

The sources and destination of this wealth are truly international. We estimate that three-fifths of it originates from ultimate investors (as depositors, investors and settlors) who are domiciled in Europe and nearly 75 per cent ends up back there. (See Figure 1.)

Figure 1: Summary of sources and destination of Jersey managed wealth



Source: Capital Economics' survey 2015/6. May not add up to 100 due to rounding.

Our survey also provides insight into the global nature of the different types of financial services activities undertaken on the island.

Jersey's banks largely service the needs of the expatriate 'mass affluent' and internationally footloose high net worth individuals, as well as associated corporate and institutional clients. They attract deposits and funding from across the globe. One-eighth of the island's €185 billion of banking funds come from deposits in European Union states other than the United Kingdom. There is, though, little lending business conducted from the island. Instead, the banks upstream the bulk of funds to their parent companies, which are typically in the United Kingdom but also in mainland Europe. The European Union (excluding the United Kingdom) is bolstered by almost €3 billion of funding received this way.

The island's legislation allows for the creation of trusts and other asset holding vehicles. A variety of firms – from bank subsidiaries through legal practices to independent specialists – offer services to clients from across the world to assist in the establishment and operation of such entities. An estimated €500 billion of private individuals' assets and €800 billion of corporate and institutional assets have been settled in Jersey trusts or similar vehicles. This is another of Jersey's highly international business activities. Almost half of the private individuals' assets come from beneficial owners who are residents of countries beyond the European Union – while roughly two-fifths of corporate and institutional assets are from outside the union.

Jersey is also a centre for the investment funds industry, with roughly €280 billion of net assets administered and managed there. The fund industry in Jersey has grown in size and shape over the last decade. The range of options and flexibility that Jersey provides, combined with its concentration of fund expertise has encouraged a growing number of fund managers to re-domicile to, or establish management businesses in, the island. While the funds presence in Jersey was previously dominated by administration activities, it has now started to shift toward more management with an increasing number of managers relocating all or part of their business there. Roughly one third of all fund assets administered or managed in Jersey are located in European Union countries other than the United Kingdom. Funds are therefore an important vehicle for foreign investors to access the European Union.

Overall, Jersey's financial services sector intermediates almost €190 billion worth of foreign investment into the European Union, excluding the United Kingdom, which is potentially supporting over 88,000 European jobs. (See Figure 2 and Figure 3.)

Figure 2: Investment in non-United Kingdom European Union assets by foreigners mediated by Jersey vehicles, 2014 (€ million)

Net Asset Value, € million, 2014	Investment in European Union (excluding the UK) assets by foreigners mediated by Jersey				
	by private trusts	by corporate and other non-private vehicles	by funds	by banks	**Total**
Total value	42,947	57,211	78,729	8,658	**187,544**
as share of:					
European Union liabilities (as in net international investment position)	0.9%	1.1%	1.6%	0.2%	3.7%

Sources: Capital Economics' survey 2015/6 and Office for National Statistics

Figure 3: Indicative number of jobs supported by investment into the European Union (excluding the United Kingdom) mediated through Jersey

2014	Stock of investment (€ million)	Indicative number of jobs supported by investment into Jersey
All investment in non-UK EU assets	204,234	95,990
All investment from foreign clients in non-UK EU assets	187,544	88,146
Investment originating outside London time zones[1]	87,429	47,054

[1] This includes everything outside of United Kingdom, European and Dubai/Middle East and Africa time zones i.e. New York/Carribean time zones and Tokyo/HK/Shanghai time zones

Source: Capital Economics' survey 2015/16.

5 The fiscal linkages

We address the fiscal linkages between Jersey and the European Union, especially potential tax leakage.

Jersey's own taxpayers fund its entire public expenditure and domestic public services. Islanders fund their own health system. The island's schools, colleges and childcare provisions are all funded locally. It receives no funds from the United Kingdom, the European Union or any member state. The government in London is only responsible for the island's defence and its representation to governments abroad, with Jersey's British passport holders also able to access consular support from United Kingdom embassies and consulates. The island makes a voluntary contribution to help cover these costs. In all other respects, the States of Jersey operate separately, and at their own expense – albeit often with close coordination with their British counterparts.

Jersey does not receive any form of funding from the European Union institutions or their budget; likewise Jersey does not contribute to the Brussels budget. It is completely independent financially (other than funds it has provided to member states as part of the *Savings Directive* arrangements).

Jersey is not a tax haven. Its criminal code and regulatory regime, and their practical implementation, are as tough, if not tougher, on money laundering and tax evasion as the European Union member states – while thorough beneficial ownership records are transparent to other jurisdictions' competent authorities across the widest range of financial vehicles.

The island is tax neutral. While there are income, property and other taxes on residents and domestic business, authorities do not charge local taxes on transactions conducted or assets held in Jersey that relate to economic activity elsewhere. This does not reduce or eliminate any tax liability in other jurisdictions.

Jersey is not a material centre for corporate profit shifting. Multinational companies that use their transfer pricing arrangements to shift profits into the bailiwick will likely not be sheltered from taxes due elsewhere. This is in sharp contrast to arrangements in the likes of Luxembourg and Ireland, where profits brought there through transfer pricing from elsewhere in the union would be out of reach of other member states' tax authorities.

There may remain some scope for individuals and businesses to use Jersey to legally and legitimately reduce their tax liabilities in member states. We estimate the theoretical maximum loss of tax to member states (other than the United Kingdom) through the most likely method of tax avoidance to be €70 million per annum. In practice, the actual figure will be a small fraction of this.

Meanwhile, European governments benefit from the taxes they levy on the jobs and economic activity stimulated in their countries through Jersey's financial and trade links. Indeed, the tax receipts from the Jersey-catalysed activity alone, for European governments (other than that of the United Kingdom), could be in the order of €1.0 billion per annum – substantially out-weighing any potential tax leakage to the tune of €0.9 billion per annum.