Jersey's value to Britain

2 July 2013

CAPITAL ECONOMICS

Evaluating the economic, financial and fiscal linkages between Jersey and the United Kingdom

Stronger together — A symbiotic relationship

Summary report

- Jersey runs £½ billion trade surplus with global exports
- 100,000+ jobs in Britain supported by Jersey
- £118 billion of UK banks' funding from Jersey
- £½ trillion of foreign investment in UK comes via Jersey
- More British tax generated by Jersey than lost through it
- Globalisation means demand for offshores here to stay

Jersey's value to Britain

Evaluating the economic, financial and fiscal linkages between Jersey and the United Kingdom

A report by Capital Economics for Jersey Finance Limited

SUMMARY REPORT

Andrew Evans

Rachel Lund

Mark Pragnell

2 July 2013

Capital Economics Limited

150 Buckingham Palace Road, London SW1W 9TR

www.capitaleconomics.com

FOREWORD
BY GEOFF COOK, JERSEY FINANCE

We commissioned this report from Capital Economics to assess the value of Jersey to the United Kingdom. We believed that Jersey is a benefit to the United Kingdom, but did not have the data to demonstrate it. For the first time, this report provides the evidence base, confirming that Jersey is an overwhelming benefit to the UK.

The report argues that Jersey provides vital liquidity to the UK economy, facilitates inward investment from around the world and consumes UK exports, all of which support UK jobs. It also provides evidence that our constitutional role plays an essential part in delivering those benefits: if Jersey, and the other Crown Dependencies, ceased to be international financial centres, much of the finance we mediate would no longer find its way to the UK economy.

The research also addresses, openly and honestly, other aspects of Jersey's relationship with the UK, and in particular, the perceived 'tax gap'—the belief that UK residents use the island to evade or avoid tax. This report demonstrates convincingly that a very small proportion of Jersey's business relates to private individuals domiciled in Britain. It does, however, accept that there may be some tax leakage, a small portion via tax evasion (illegal), but primarily through tax avoidance (legal tax planning but under significant scrutiny, with focus, quite rightly, on aggressive avoidance schemes). However, the possible losses from tax evasion and avoidance are far outweighed by the taxes generated through the activity in the UK supported by Jersey.

It cannot be reiterated enough that Jersey has no interest in fostering abusive tax practices or money laundering. The standards and regulations in the island have been judged by the International Monetary Fund and the OECD, both identifying Jersey as one of the best regulated jurisdictions in the world. We are thus happy to share the full report to demonstrate our commitment to openness and transparency in our relationships with the UK and the wider global community.

This report is the first of its kind and, as such, Capital Economics had to find original solutions to some of the issues that arose. We feel that their methods were fair and their assumptions appropriate, but as with all research of this nature there is room for healthy debate over methodologies employed and approaches taken. Therefore, as part of our commitment to transparency, details of the data and methodologies used can also be found in the report. Readers can thus judge for themselves the quality of its findings.

The Jersey finance industry is diverse, robust and exceptionally international in its focus. We have a global reputation for being well-regulated, open and transparent, key attributes for the current and continued success of our financial services sector. Its client base is growing ever more global and that only serves to help the United Kingdom. I sincerely hope this report will resonate with policymakers, businesses and individuals, helping them in understanding the importance of supporting and preserving a world class financial centre in Jersey.

Geoff Cook
Chief Executive Officer
Jersey Finance Limited

2 July 2013

CONTENTS

SUMMARY REPORT

Capital Economics has been commissioned by Jersey Finance Limited to research and report upon the economic, financial and fiscal linkages between Jersey and the United Kingdom, and to ascertain the extent to which the Channel Island is an overall benefit or cost to its neighbour's economy.

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 United Kingdom 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 trade position as well as the bailiwick's impact on the British government's coffers.

This summary report sets out the key arguments and findings, while further detail can be found in the full report.

1. Austerity is the context

Since their high in 2009, average real household incomes in the United Kingdom have fallen by 3.8 per cent and have subsequently only recovered 1.5 of those percentage points.[1] Despite tough austerity measures, government debt remains high, at 73.5 per cent of national income, and its net borrowing for 2012/13 was £66.9 billion.[2] It is not unsurprising then that the attentions of both the political and media worlds have been drawn to people and organisations being seen as not taking their fair share of the nation's pain, especially those not paying their fair share of the tax burden.

The Times' revelations in June 2012 about comedian Jimmy Carr's tax affairs may not have been the first uncovering of an unpalatable tax avoidance scheme, but it did put offshore financial centres centre stage in a then exploding debate. The 'K2' scheme, in which Mr Carr was reportedly enrolled, used Jersey as its home for a tax mitigation vehicle that pushed British tax law to its elastic limit, if not beyond, and may now be described as 'aggressive' tax avoidance. And since then, we have seen a string of stories

1 Source: Office for National Statistics website. Latest data are for third quarter of 2012.
2 Source: Office for National Statistics website. Figure is for eleven months; it excludes March 2013.

about the corporate tax bills of major multinational companies like Google and Starbucks, where internal 'transfer pricing' regimes are apparently used to ensure that offshore subsidiaries accrue much of the groups' profits thus attracting lower tax charges – although, in these instances, the offshore jurisdictions often turn out to be countries like Switzerland and The Netherlands.

For politicians in Westminster, the issue of offshore financial centres is further vexed – as a number of them are dependencies or peculiars of the British Crown. Indeed, in December 2008, the then Chancellor, Alistair Darling, tasked Michael Foot, a former executive director for banking supervision at the Bank of England and managing director of the Financial Services Authority, to report on the potential risks faced by British offshore financial centres.[3] More recently, the National Audit Office examined the potential impact on public finances of the British Overseas Territories, which comprise fourteen dependent administrations across the Caribbean, the Mediterranean, and the South Atlantic, Indian and Pacific Oceans, as well as the Antarctic.[4]

The focus of this report, though, is Jersey – situated, along with the islands of the bailiwick of Guernsey, off the Normandy coast of France. These Channel Islands and the Irish Sea's Isle of Man have a unique relationship both with the British monarchy and the Westminster government as 'Crown Dependencies'. They are self-governing, self-legislating, self-administering and self-financing but are loyal to the British Crown, with their courts subject to the decisions of the Judicial Committee of The Privy Council. The London parliament has only limited jurisdiction over the islands, while the islanders have no representation there. By custom, Westminster only legislates for the islands with their consent, and the United Kingdom government's responsibilities are restricted to defending the dependencies, maintaining their international relations and providing them with consular and diplomatic services abroad – although there is extensive cooperation in many other areas.

2. Jersey as an offshore financial centre

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 'offshore financial centre'.

To understand offshore finance, it is essential to recognise the growing impact of globalisation – whereby trade between countries gets ever larger, people

3 Michael Foot, *Final report of the independent review of British offshore financial centres* (HM Treasury, London), October 2009

4 National Audit Office, *Tax avoidance: tackling marketed avoidance schemes* (The Stationery Office, London), 21 November 2012

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 a safe haven 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.

Notably, these drivers of offshore demand have little to do with evading or avoiding domestic taxation. 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 mean that the scope for unwanted avoidance schemes to use the island is all but eliminated.

Jersey is a significant player in the offshore market although its footprint is nowhere near as large as the likes of Luxembourg, Switzerland or the Cayman Islands. Its scale is reflected in the mix of jobs and businesses found on the 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 55,000 jobs; indeed, it would be quite typical among British local authorities of a similar size.

3. The economic linkages

We now turn to the economic linkages between Jersey and the United Kingdom.

Although only fourteen miles off the French coast, the island's physical connections are mostly to southern Britain. The schedule of aeroplane flights in and out of Jersey airport is overwhelmed by British destinations. There are more ferry sailings to and from France than England, but almost all cargo and freight capacity goes north as does the majority of international telephone and digital traffic.

But these physical links to Britain mask a very different global pattern of trade conducted by the island's businesses. Through international trade, Jersey brings value into the sterling area from across the world and shares the spoils with the United Kingdom.

We estimate that Jersey ran an overall trade surplus broadly in the region of £0.6 billion in 2010, which is equivalent to sixteen per cent of its national output, and compares to the United Kingdom's trade deficit of two per cent for that year. Although there are tourism, agricultural and other revenues, export performance is dominated by financial services – with its trade conducted with many far flung markets as well as Britain and Europe. Indeed, the share of Jersey's non-sterling exports going to the higher growth emerging markets of Asia, South America and Africa compares favourably to Britain's recent achievements. But, as the island's imports come almost entirely from southern England initially, its balance with the United Kingdom alone is likely to be quite different. Indeed, we estimate that the island ran a trade deficit broadly in the region of £0.4 billion with it in 2010 – supporting 11,000 British jobs.

4. The financial linkages

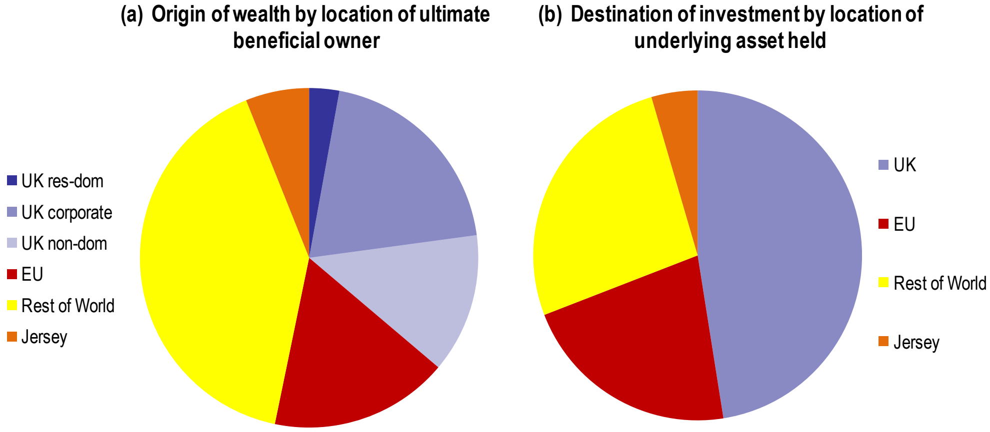
We now consider the business conducted by Jersey as an international financial centre and explore its implications for the United Kingdom.

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 new insight into who their ultimate 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 £1.2 trillion of wealth: £200 billion in banks; £400 billion in trusts established by private individuals; £400 billion in specialist structures for businesses and institutions; and £200 billion in administered or managed funds.

The sources of this wealth are truly international. We estimate that three quarters of it originates from ultimate beneficial owners (as depositors, investors and settlors) who are not domiciled in the United Kingdom – with North America, Asia Pacific and the Middle East all being major contributing regions. Over £150 billion are the foreign assets of individuals currently resident in Britain but not liable for tax there on their foreign source income, the so-called 'non-doms'. This makes Jersey a major conduit for non-dom foreign wealth, which has been a consistent plank of British policy for attracting wealth and talent under successive governments. (See Figure 1.)

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



Sources: Capital Economics' survey 2012/3

But the uses of these funds disproportionately benefit the United Kingdom. We estimate that almost one half of the combined value held in the stewardship of the island's trusts and other structures, funds and banks has been invested in assets located in Britain. By this, we mean ultimately located in Britain, and not assets with funding simply intermediated through the City of London. Overall, Jersey's financial services sector intermediates almost one pound in every twenty of investment by foreigners into the United Kingdom. This scale of investment could potentially support 112,000 British jobs.

Much of this investment into Britain depends upon the status of Jersey and the other Crown Dependencies. Jersey's practitioners believe that four-fifths of their business would leave the sterling zone if the Crown Dependencies didn't exist and relocate to other offshore centres. These other centres are unlikely to have the same affinity with the City of London and the United Kingdom as Jersey; their locus of operation could just as easily be New York, Hong Kong or Dubai.

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. Almost three-fifths of the island's over £200 billion of banking funds come from deposits and other instruments ultimately provided by customers from beyond the European Union, while less than a quarter arise from 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 London. The United Kingdom's banking sector is bolstered by almost £120 billion of funding received this way, which is equivalent to 1½ per cent of its total balance sheet or two-fifths of the overall customer funding gap. The up-streaming model brings real economic benefits to the United Kingdom, both through the extra liquidity it provides and through the revenue it generates from intermediation. Moreover, in recent years, the ability of the part-nationalised banks to secure funding through Jersey has eased the burden on British taxpayers.

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 £400 billion of private individuals' assets and £450 billion of corporate and institutional assets have been settled in Jersey trusts or similar vehicles, with clients attracted by Jersey's tax neutrality, robust regulation of service providers, and well-established and tested legal framework. This is another of Jersey's highly international business activities. Two-fifths of the private individuals' assets come from United Kingdom non-doms, and a slightly larger share from beneficial owners who are residents of countries beyond the European Union – while over half of corporate and institutional assets are from outside the sterling area.

Jersey is also a centre for the investment funds industry, with almost £200 billion of net assets administered or, less often, managed there. Two fifths of the investment into Jersey funds comes from the United Kingdom. Over 40 per cent of investors are located outside the European Union, with one quarter of the total asset value originating in North America.

5. The fiscal linkages

We now address the fiscal linkages between Jersey and the United Kingdom, especially supposed tax leakage.

The impression that some have that, because it is a 'dependency' of the Crown, Jersey is a drain on British public services is unfounded.

Whitehall is responsible for the island's defence and its representation to governments abroad, with Jersey's British passport holders also accessing consular support from the United Kingdom's embassies and consulates. The two governments have negotiated an appropriate contribution from Jersey for these services, which is paid in the form of a Territorial Army unit funded by the bailiwick. On a simple per capita calculation, the islanders' proportionate use of defence and foreign representation could be estimated to 'cost' British taxpayers in the region of £60 million per annum. But such an allocation of costs is only notional; even if the United Kingdom stopped defending and representing Jersey, it is unlikely to spend any less on its armed forces or diplomatic service.

In all other respects, the States of Jersey operate separately, and at their own expense – albeit often with close coordination with their British counterparts. Islanders fund their own health system. The island's schools, colleges and childcare provisions are all funded locally – while the tuition fees and maintenance costs for local young adults studying in British universities and colleges are borne entirely by the bailiwick. Jersey funds its own policing and jail. And, Jersey households watching television have to purchase the same license as those in Britain, in order to fund the BBC. It is also sometimes argued that the island benefits from an implicit insurance policy underwritten by the Westminster government under which it would bail-out the bailiwick if it got into severe trouble. But, no 'claim' has ever been made against such a 'policy' and it is unclear whether there is any real enforceable obligation on the United Kingdom to do so – or whether it is ever likely to be needed. This then begs the question whether an informal and unused guarantee is worth the paper it isn't written on.

The elephant in the room, though, is tax.

There is a widespread belief that Jersey, Guernsey and the Isle of Man are tax havens and are used by businesses and individuals both legally and illegally to reduce the tax they pay to British authorities. This belief appears to be based largely on impressions set during the Super Tax era of the 1970s and sporadic media exposés on the tax affairs of big companies and celebrities. The extent to which there are revenues rightfully due to the government that are leaking away has become a turbulent political issue in the current context of fiscal austerity.

There is little hard evidence about the actual scale of offshore tax abuse and almost no assessment whatsoever of the role of Jersey or the other Crown Dependencies. This lack of evidence should be no surprise in itself. Those involved in tax avoidance and, especially, evasion will have little desire to publicise the activity, and every interest in hiding it. Meanwhile, those trying to demonstrate the 'cleanliness' of their jurisdictions find it almost impossible to prove that little or no such activity takes place there because you can't prove an absence of something simply by failing to find it.

We can't and don't offer a watertight solution to this research conundrum. It can, though, be explored from different directions in order to draw meaningful conclusions about the envelope within which there may be leakage of what might otherwise be legitimate British tax revenues.

Little of Jersey's business relates to private individuals domiciled in Britain. Less than a tenth of bank deposits and only four per cent of private trust assets originate from them. The introduction of the European Union savings directive and tough anti-money laundering legislation in Jersey, combined with successive strengthening of the tax code in Britain, means that there is now limited scope for unlawful evasion of British taxes there.

In the 2013 Budget, HM Treasury estimate a combined benefit of £210 million per annum to the exchequer of the three new inter-governmental agreements with the Crown Dependencies. These agreements, based on the provisions of the United States' *Foreign Account Tax Compliance Act* ('FATCA'), provide for automatic information exchange between the three jurisdictions' tax authorities and HM Revenue and Customs, and ensure that the Jersey, Guernsey and Isle of Man-held interests of British taxpayers are reported fully.

Our own calculations, based on cautious assumptions and prior to the adoption of a new FATCA-type reporting regime, suggest that the maximum level of tax evasion plausibly facilitated through Jersey was £150 million per annum in 2011. The actual level was probably much lower.

Automatic information exchange will not necessarily banish all evasion of British tax from the island – but, given the States' tough anti-money laundering regulations and its criminalisation of the handling of the proceeds of tax evasion as well as the comprehensive coverage of the FATCA regulations, whatever will be left will likely be immaterial.

There is, though, the open question of tax avoidance, which may be defined as the lawful under payment of tax through means that are against the spirit of the law and/or intention of parliament.

HM Revenue and Customs' tax gap analysis suggests that nationally there is £2.9 billion of tax lost annually through avoidance of income tax, national insurance, capital gains tax, inheritance tax and stamp duty. Even on the basis of the most aggressive assumptions, we calculate that no more than £0.4 billion of this can be mediated through Jersey and, in all likelihood, it is much less. Furthermore, as a 2009 report commissioned from Deloitte by HM Treasury demonstrated, Jersey does not offer firms operating in the United Kingdom with meaningful opportunities to mitigate their corporation tax liability there.

Overall, we judge that, based on 2011 data, a maximum of £0.6 billion per annum of British taxes can leak through evasion or avoidance using Jersey vehicles – although, in all probability, the actual number is much lower.

Meanwhile, the Westminster government benefits from the taxes it levies on the jobs and economic activity stimulated in Britain through Jersey's financial and trade links. Indeed, the tax receipts from the Jersey-catalysed activity alone could be in the order of £2½ billion per annum – substantially outweighing any tax leakage.

6. Overall benefit of Jersey to the United Kingdom

Finally, we pull together the various strands of our research and make a tentative attempt to evaluate the overall benefit or cost of Jersey to the United Kingdom economy.

As with any exercise of this nature, there are margins of error. However, we have approached this task cautiously – and, where necessary, have given the benefit of the doubt in favour of Jersey being a cost to the United Kingdom.

Bringing these various factors together, we find that Jersey is a benefit to the United Kingdom economy, and on the basis of our broad calculations could be supporting in the order of 180,000 British jobs. (See Figure 2.)

Some may argue that, without Jersey or the other Crown Dependencies, the foreign investment, bank funding, etc currently routed via the islands would come to the United Kingdom regardless. This would be dangerous complacency.

The wide geographical spread of Jersey's client base means that it is attracting investment from businesses and individuals who wouldn't necessarily see the City of London as their first choice of financial centre. Around 30 per cent of the investment through Jersey originates from outside the London time zone, and would more likely have a locus around New York, Hong Kong or Dubai; this alone is worth an estimated 51,000 British jobs. Moreover, the results of our survey indicate that 84 per cent of the bailiwick's financial services business would be at risk of leaving the sterling zone if Jersey did not exist. This business (and the consequent investment) is likely to migrate to other offshore centres – and not London, and could cost the equivalent of around 150,000 British jobs.

With research of this nature, there is always room for healthy debate over the methodologies deployed and approaches taken. There are also, of course, margins of error associated with any survey results and consequent quantitative analysis. Nevertheless, taken together, the various strands of analysis point unquestionably to Jersey being a material overall and additional benefit to the United Kingdom economy.

Jersey and the United Kingdom are linked in a symbiotic relationship. One benefits and supports the other, and vice versa. And, what harms one will also harm the other.

Figure 2: Summary of Jersey's indicative impact on the United Kingdom economy

Indicative estimates of jobs supported in the United Kingdom, 2011	Gross	Net additional
Trade	11,200	2,700 - 7,400
£0.4 billion trade deficit with United Kingdom		
Banking (intermediation)	13,700	2,500 - 6,900
£120 billion of deposits upstreamed and intermediated in the United Kingdom		
Investment	111,800	34,400 - 93,900
£560 billion foreign investment in United Kingdom assets through Jersey		
Business referred	3,600	900 - 3,000
£230 million of business referred from Jersey to the United Kingdom		
Tax generated	51,600	13,900 - 39,000
£2½ billion United Kingdom tax generated from activity catalysed by Jersey		
Tax leakage	*(14,200)*	*(2,300)*
£0.6 billion maximum potential tax leakage through Jersey		
Provision of defence and foreign assistance	*(1,400)*	*(1,400)*
£60 million maximum pro-rata allocation of United Kingdom public spending to Jersey		
Total jobs supported in the United Kingdom	**176,300**	**50,700 - 146,500**

Source: Capital Economics

This is a summary report. Further details of our research and findings can be found in the full report, which is available from Jersey Finance.

CAPITAL
ECONOMICS

Capital Economics Limited
150 Buckingham Palace Road, London SW1W 9TR
www.capitaleconomics.com
Registered office: as above. Registered in England No. 2484735 VAT No. GB 713 8940 25