

Issue 16, Third Quarter 2009

The future of the Cayman financial industry

TOPIC : Letter from Editorial Board

By: Richard Rahn

7, July 2009

If the Cayman financial industry were faced with extinction or only the potential of a diminished role, we would not bother providing you with the third edition of the Cayman Financial Review, which you are now reading. Cayman can continue to grow as a financial centre, provided both the new government and the financial industry do more to protect it from the financial imperialism of foreign governments, and provided the private sector – with the support of government – develops new products and continues to improve existing financial services. The editors and editorial board of the CFR are optimistic that these events will occur and are committed to being a constructive part of the future growth of the Cayman financial industry.

Cayman was able to prosper in the past, in part, due to the mistakes of its neighbours, notably Jamaica and the Bahamas, both of which eroded private property rights and engaged in destructive taxation and regulation in past decades. While many are fearful about what measures the US, the UK and the rest of the EU might take against Cayman, the actions of these governments also provide Cayman with opportunities. Unfortunately for the citizens of the US, the UK and some other countries, their own governments are repeating the mistakes that undermined private property rights, increased taxes on capital and their most productive citizens, and created onerous and destructive regulations.

The result is a rapidly growing demand for jurisdictions that do protect private property rights, do not double tax capital income and have reasonable, clear, and cost-effective regulations. The challenge for the Cayman financial industry is to create legal ways for non-Caymanians to partake of Cayman's economic freedom, in an environment where their home countries are being more restrictive. Cayman's competition for these services is most likely to be jurisdictions in Southeast Asia, notably Hong Kong and Singapore – both of which, like Cayman, are English speaking and have legal systems based on English common law with non-corrupt courts – rather than the traditional European and other UK off-shores.

Measures (such as restrictions on deferral of foreign source income) now before the US Congress will have the unintended effect of actually forcing US multinationals to move their legal homes outside of the US in order to remain internationally competitive. The prospect of rapidly rising inflation in the US and UK, stemming from the unprecedented increase in government debt and new money creation, is driving many of their citizens to move financial assets out of dollars and pounds. The above presents both challenges and opportunities for the Cayman financial industry. Americans, in particular, will be looking for means to protect their assets, and those financial companies and jurisdictions that succeed in providing such financial protection vehicles, which are not in conflict with American law, should have a rosy future.

The increased demand for financial transparency by the OECD member nations is more of a burden on those jurisdictions with a large private banking industry that manages accounts for wealthy individuals than it is for Cayman, which relies much more on institutional banking. Cayman already has information exchange agreements with the US, the UK and an increasing number of others and so the new regulations will have less effect on the existing business.

Cayman has suffered from an undeserved negative image as a place where drug dealers, assorted criminals and tax evaders go to hide their money. This negative stereotype has been so reinforced in movies, TV shows and novels that many politicians outside of Cayman not only believe it, but find Cayman to be a useful scapegoat. The new Cayman government needs to be, and is likely to be, much more aggressive in countering negative references to Cayman in the global media and among the political class.

Specifically, what Cayman needs is a rapid response action team, which would immediately respond to any incorrect characterisation of Cayman in news reports, movies, TV shows, books, statements by politicians, etc. Rapid response teams have been very effective in changing the image of companies, various institutions, political parties and, of course, individual politicians. It would be appropriate for the government to fund such an operation but it should be contracted out to highly-competent international professionals.

All too often, Cayman and many of the other jurisdictions that do not have multiple taxes on capital have reacted in a defensive manner when they have been accused of being 'tax havens'. The fact is that Cayman and virtually all of the other jurisdictions that have been accused of being 'tax havens' impose substantial tax burdens and tax revenues do consume a considerable portion of GDP. Cayman relies primarily on consumption taxes rather than taxes on capital – and most tax economists agree that this is the ideal way to tax. Taxing consumption, in contrast to labour and capital, taxes what people take out of the economy, not what they put into the economy. Taxes on labour and capital are disincentives to work, save and invest and hence they impose a much greater dead weight loss on an economy than do taxes on consumption.

Those who attack Cayman and other jurisdictions that do not double tax capital, explicitly assert, or imply, that there is nothing wrong with nations imposing multiple taxes on capital, even though the evidence is unambiguous that such taxes impose far greater costs than benefits and result in more unemployment, lower wages, less economic growth and innovation, and more human misery. It is perverse that the advocates of high rates of taxation on capital have been allowed to occupy the moral high ground in this debate when, in fact, they are purveyors of human misery.

Most people would oppose enforcing the laws of another country on its soil if those laws supported racial, ethnic or religious discrimination. Tax laws that tax capital at high rates are, in effect, laws that discriminate against the poor and those with less economic opportunity. Rather than defending them, they should be vigorously opposed by all knowledgeable and civilised people. The empirical facts are on the side of Cayman and other jurisdictions that do not have high taxes on capital.

Thus, to ensure the future of the financial services industry in Cayman, the government and the industry must do much more to regain the moral and economic high ground in the debate, which is justifiably theirs. This struggle for the hearts

and minds of the world's opinion leaders needs to be won, not just for Cayman's sake but for the sake of all of those in the world who suffer from unnecessary joblessness and poverty. The world would be poorer without Cayman's financial industry, and those in Cayman must not be shy about letting others know – even if it takes substantial resources.

Cayman has done a better job in tourist promotion than it has in promoting itself as a globally beneficial financial centre. Fortunately, the Cayman Island Financial Services Association has recently been able to obtain greater financial resources, which should help it create a stronger and more positive image for Cayman and the financial industry.

The election campaign had a beneficial effect of making the citizens of Cayman more aware of the importance of the financial industry to the Islands' economy. The new government is likely to capitalize on this increased awareness by putting more emphasis and focus on and support for the financial industry. The financial industry, unlike in other countries, does not need nor should it seek financial aid. What it needs is a government that can quickly respond to the changing global economic environment to ensure that there are no unnecessary regulatory or legislative barriers to the financial industry's meeting the needs of its global clientele.

Cayman has an independent, high-quality and consolidated financial regulatory agency, the Cayman Islands Monetary Authority. CIMA regulates the banking, insurance industries, as well as investments funds, securities businesses and management and trust companies. In addition, it has the responsibility for the issuance of the Cayman currency. To date, CIMA has avoided many of the problems of financial regulatory agencies in a number of the larger countries, particularly the UK and the US. Neither the consolidated financial regulatory authority (the FSA) in the UK nor the multiple financial regulatory agencies in the US have covered themselves with glory during the present financial crisis, given they were all caught by surprise by failures in institutions under their jurisdictions. Cayman, in contrast, has had no major failures of institutions under the watchful eye of CIMA. Underscoring its success is its recent admission to full membership in IOSCO (the international standard setter for the securities and investment fund industries).

In recent years, the highly professional and nimble staff at CIMA has been able to catch potentially damaging situations and take action before systemic damage to the Cayman financial industry or its reputation has occurred. Cayman, unlike many other jurisdictions, can properly claim that the empirical evidence shows it has neither over nor under regulated its financial industry.

Cayman has been the world's most successful off-shore financial centre. Its success was based on the rule of law, an honest and competent court system, taxing consumption rather than capital, and reasonable and responsible regulation. Countries with less economically rational and morally sound policies have tried to blame Cayman for many of their self-induced problems. Some in Cayman are pessimistic about the ability of Cayman to survive and prosper given the attacks upon it. But the fact is that the future of the Cayman financial industry is not in the hands of others but in the hands of the Cayman business and government leaders and the Cayman people. The threats to the future of Cayman come from democratic countries that still have a free press, thus Cayman has a perfect legal and moral right to go directly to the dens of its critics and make the case for sensible tax and regulatory law. And given that the facts are on the side of Cayman, if

sufficient resources are employed to adequately make the case in an intelligent way, Cayman will prevail – and the Cayman financial industry will continue to soar.

<http://www.compasscayman.com/cfr/cfr.aspx?id=1853>