

Isle of Man
Economic Research Report
May 2012

Ernst & Young LLP

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1. Executive summary

“Too few people who now seek to impose regulation on offshore jurisdictions truly understand how those jurisdictions actually operate, their positive ranking of compliance with major international regulatory standards or their beneficial role in promoting investment and growth in the wider economy”

Mark Field, MP for Cities of London and Westminster

Speech during parliamentary debate on offshore centres, Westminster (July 2010)

“The UK and the Isle of Man benefit from each other’s success and it is in the interests of the UK to see the Isle of Man do well”

Lord Bach - past parliamentary Under-Secretary of State at the UK Ministry of Justice, with responsibility for the Crown Dependencies.

Speech delivered during the Chief Minister’s International Lecture (November 18, 2009)

1. The Isle of Man Government has commissioned Ernst and Young LLP to prepare a report that discusses the Isle of Man’s economic strengths and also the beneficial role it plays in the global economic system, the UK and the City of London in particular. The report, and the evidence presented, is based on an objective and independent analysis of the facts and data currently available and the results of a series of interviews conducted with key stakeholders.
2. The Isle of Man is a well balanced and diversified economy with a modern infrastructure and thriving business environment. It has transformed from a rural and less developed economy during the 1970s, to a modern, balanced and diversified AAA economy with per capita income higher than the EU average.
3. The Isle of Man is one of the most diversified of the Crown Dependencies and small International Business Centres (IBCs) worldwide. The initial presence of financial, professional and business services was pivotal to the development of other high value added sectors such as advanced engineering and ICT.
4. Approximately 34% of Isle of Man income, amounting to about £1.1bn, is generated by financial services, with much of the remainder generated by high value added and high tech industries such as ICT, aerospace and advanced engineering. The wide diversification of the economy has helped to mitigate the impact of the global financial crisis. The Isle of Man economy has experienced average annual growth of 6% over the past decade and unemployment is currently under 2.5%.
5. The Isle of Man has led the way amongst IBCs in establishing a modern regulatory system aligned to world best practice international regulatory standards in both tax compliance and transparency, and the safeguarding and supervision of the financial system. It stands among the most well regulated jurisdictions in the world on the OECD’s international compliance lists and has been a leader among IBCs in signing up to tax and transparency agreements with trade partners. The Isle of Man has also cooperated with the OECD in developing international regulatory frameworks. The recent OECD’s Tax Transparency Report published in November 2011 has placed the Isle of Man amongst the top eight jurisdictions meeting all of the standards required for the “effective information exchange” on people suspected of harbouring undisclosed assets. The Financial Stability Board also ranked in 2011 the Isle of Man in the top tier group of jurisdictions for the adherence to banking and insurance regulatory standards.
6. The Isle of Man is a key commercial partner that delivers many benefits to the global economy and in particular to the UK. It is contended in some quarters that IBCs tend to divert economic activity and cause distortions in the global economic and financial system. However, this report draws on a large body of independent economic research that has strongly proved the opposite is in fact true. It shows how IBCs play a key role in contributing to investment, employment and growth in neighbouring countries in particular, and the global economy in general.
7. The UK is a key trade partner for the Isle of Man. Whilst necessarily small in absolute terms given the relative size, in per capita terms the Island is among the top importers of goods and services.
8. The Isle of Man economic growth strategy is aligned with and can support many of the goals of the UK’s national growth strategy - to grow in a sustainable, balanced and shared way “*across the country and between sectors of the economy*” as suggested by the UK Department for Business Innovation and Skills. The Isle of Man provides significant benefits to the City and UK economy, for example by:
 - a. **Providing liquidity.** The Isle of Man has outperformed many IBCs in the provision of liquidity over the past years and in particular during the financial crisis period when liquidity was most needed in the UK financial markets. The Isle of Man provided approximately \$35bn in liquidity to the UK financial system during the 2008q1 and 2011q2 period when liquidity was most needed.

- b. **Facilitating the diversification of the UK economy.** The Isle of Man has the largest number of AIM (Alternative Investment Market) listed companies thanks to an infrastructure able to support companies wishing to list on AIM or the LSE (London Stock Exchange). Most of the AIM and LSE companies' capitalisation is in sectors aligned to the UK growth strategy such as alternative energy, industrial engineering, industrial transportation, etc.
 - c. **Strengthening the relationship with emerging markets and attracting Foreign Direct Investment (FDI).** Many of the Isle of Man listed companies are from emerging economies such as India and China, bringing in investment to the region which might have been diverted elsewhere without the Isle of Man's infrastructure. China is a continuing focus of Isle of Man efforts to developing general economic links in the Far East.
9. The Isle of Man proved to be resilient during the recent financial crisis; and to the benefit of the City the Island was able to maintain the flow of funds into UK institutions and businesses when liquidity was in short supply.
10. The Isle of Man's role in supporting the UK economy's growth and its financial sector is often underestimated. A reduction of this role is very likely to lead to unintended negative consequences, which might be overlooked by policy decisions.

2. Introduction

In many respects, the growth and development of the Isle of Man is similar to that in other economies that have used a key sector of the economy such as finance or natural resources to diversify and grow. The majority of current mature economies have been through various phases of development whereby a key sector of the economy with a clear competitive advantage tended to be pivotal to their growth strategy. Sectors that were key to countries' growth traditionally have characteristics like low manufacturing costs, high value added or highly skilled people, natural resources and financial services.

The Isle of Man Government has commissioned Ernst and Young LLP to prepare a report that discusses the Isle of Man's economic strengths and also the beneficial role it plays in the global economic system, the UK and the City of London in particular. The report begins by providing an overview of the Island's economic structure. It reflects on how diversified and balanced the economy is, looking at the GDP contribution of various sectors, old and new, and the historical performance of the economy in terms of economic growth. The report then provides an assessment of the Isle of Man's regulatory standards and how these standards measure up to international expectations for tax compliance and transparency (for example the OECD transparency and exchange of information rules). It discusses the processes the Isle of Man applies to ensure financial supervision and safeguarding of the financial system. It compares the Isle of Man to other OFCs and financial centres' regulatory history and current performance. The next section of the report discusses the benefits that the Isle of Man brings to the world economy through assisting flows of capital into areas providing for greatest economic benefit. It explores its linkages with the world economy in respect of terms of trade and the markets (other than the UK) it operates in, in particular emerging markets.

Finally the report looks at the benefits that the Isle of Man provides to the UK economy and the City of London. In particular it assesses how it helps the UK trade in goods and services, and how well it aligns with and can support the UK growth strategy in terms of sector and regional growth. This section provides evidence on and includes a discussion around the Isle of Man's role as a provider of financial flows in three main areas: liquidity, listed companies and investment.

The report, and the evidence presented, is based on an objective and independent analysis of the facts and data currently available and the results of a series of interviews conducted with key stakeholders.

3. Analysis of the structure and functioning of the economy

3.1 Economic structure overview

3.1.1 A diversified and balanced economy

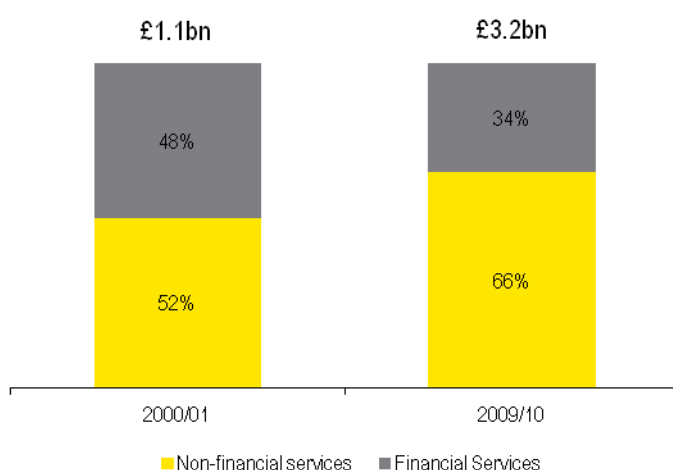
The Isle of Man has been a remarkable economic story in the past three decades and has benefited from 28 years of continuous economic growth. The Isle of Man has been transformed from an economy mostly based on agriculture, tourism and fishing, with unemployment exceeding 10% and GDP per capita standing at only 57% of the UK level, into a well diversified and balanced economy. Income today is generated by a diverse number of sectors from financial services to high tech manufacturing and online businesses.

The main driver behind this economic growth has been the Government strategy pursued since the 1980s to support the diversification of the economy away from low value added and, at that time, declining sectors such as tourism, agriculture and fishing. The economy started by embracing financial and professional services and developing a business friendly environment with a modern regulatory framework aligned to international standards. This has proved to be pivotal in supporting the development of modern infrastructures and a highly skilled workforce. This in turn fostered inward investments and entrepreneurial initiatives in high value added sectors with a strong competitive edge such as high tech aerospace manufacturing and engineering, precision engineering, Information and Communications Technology (ICT), e-business, international shipping, and even film production.

There are clear synergies between the development of financial and professional services in the Isle of Man and the growth of high value added sectors over the years. The financial services sector today accounts for 34%¹ of Isle of Man income, as shown in Figure 1, and consistently supports the growth of high value added sectors such as ICT, high tech manufacturing and e-business. This represents a significant shift away from reliance on financial services, which accounted for 48% of GDP in 2001.

The limited supply of labour and the reliance on imports often restrict a small economy's ability to diversify. However the Isle of Man has over time managed to diversify in sectors that are characterised by low volumes but high value added production. Current and future roles of these sectors and their ability to provide benefits to the neighbouring countries as well as the wider economy will be discussed in more detail throughout the report.

Figure 1: Isle of Man Economy - GDP composition, 2001 and 2010



Source: Isle of Man - National Income Accounts, 2000/01, 2009/10

3.1.2 GDP contribution and performance

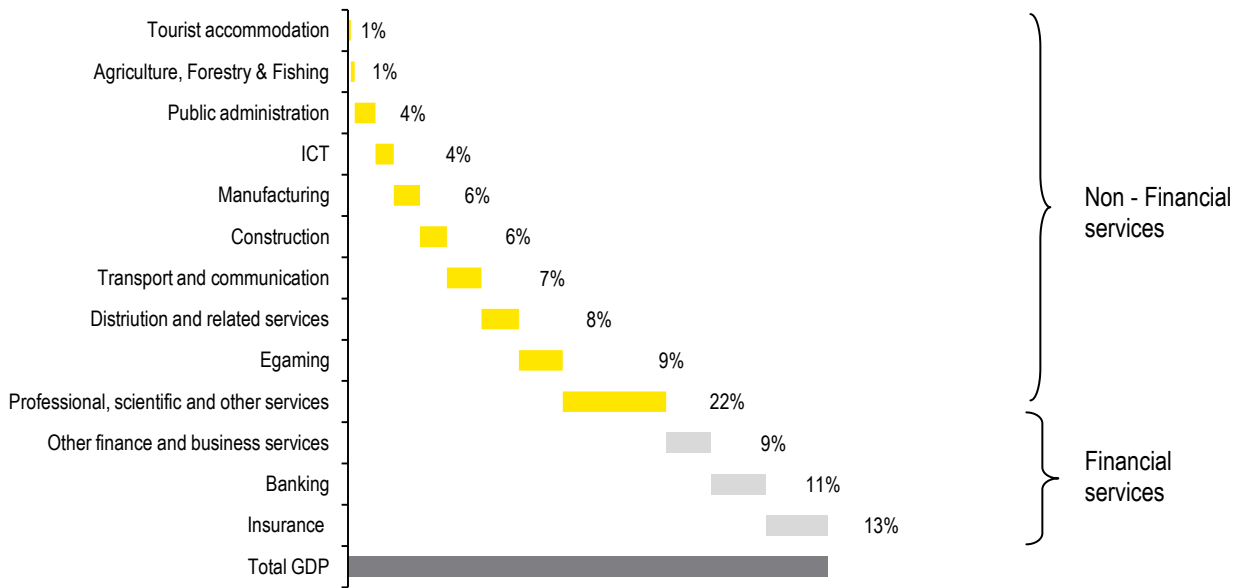
The Isle of Man economy has experienced strong average annual growth of 6% over the past decade, with stable prices and very low unemployment levels. Per capita national income is significantly higher than the UK

¹ Isle of Man National Income Accounts 2009/10

and EU15 averages, a reflection of the high value added nature of the economic activity conducted on the Island, particularly in its key exporting sectors. The global financial crisis brought some difficulties to the Isle of Man – for example with a contraction in the GDP generated by the banking and the funds sectors. However the diversified nature of the economy allowed the Isle of Man to mitigate the impact of the crisis. Unemployment is currently just 2.3% of the workforce. In addition, the strength and resilience of the economy to the crisis, together with the relative ease of the flow of labour between the Island and the UK, meant that the Island’s success has created employment for other than the indigenous population. Indeed, the non-Manx born British working population accounts for over half of the workforce

The graph below shows a breakdown of Isle of Man national income by sector (2009/10). The structure of the economy is split between financial and non financial services, with ICT, manufacturing and professional and scientific services accounting for 47.7% of the Isle of Man economy.

Figure 2: Composition of Isle of Man national income by sector,² 2010

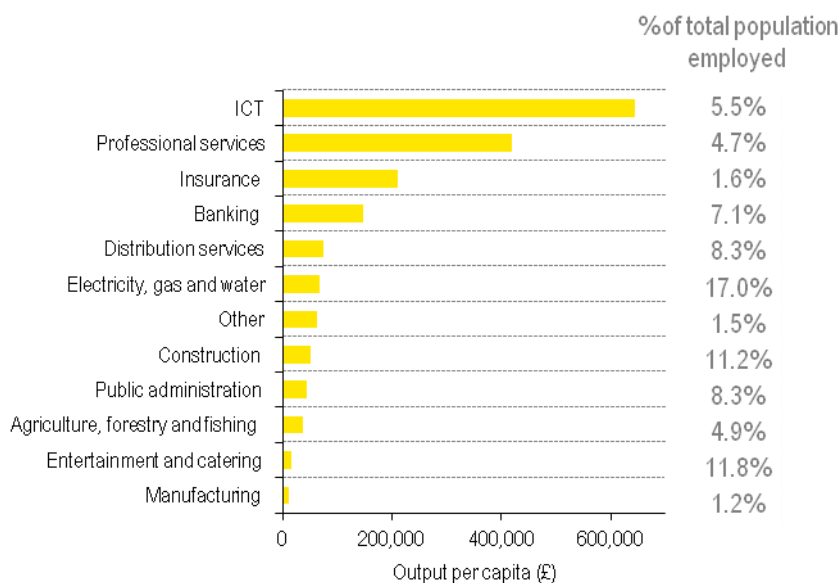


Source: Isle of Man - National Income Accounts, 2009/10

The average industry per capita output is approximately £90,000. Most of the job growth over the past decade has been in the high value ICT, e-business, and high tech manufacturing sectors, in line with the Government policy of diversification of the economy.

² PSO is made up of medical & health services, corporate service providers, education, legal and accountancy services, other professional and misc services.

Figure 3 - Employees output per sector (2009)



Source: Digest of Economic and Social Statistics, 2011

Note: Census data for 2006 used as a proxy for employment figures, with output per sector from 2009

3.2 Key sectors of the economy

3.2.1 Financial services

The Isle of Man financial services sector has a strong reputation internationally for its level of sophistication and for its transparency, information exchange policy, anti-money laundering regime and financial supervision.

The financial services sector has been pivotal to the growth of the economy and its diversification. In 2000, the financial services sector accounted for 41.5% of the Isle of Man's income of which half was generated by the banking industry. In 2009/10, the Isle of Man's financial sector was worth £1.1bn, of which banking was 34%, insurance 38%, and the remaining from other finance and business services such as investment management and administration, and actuarial services. The financial services sector had experienced an average annual growth rate of 6.2% before the financial crisis. This performance was broadly in line with the strong global growth trends, in particular the UK experienced annual growth of 14% during this period. The financial services sector is still an important part of the Isle of Man economy and is among the major contributor to income, jobs and taxes.

The Isle of Man has historically been the location of choice for expatriates to manage their financial arrangements. The ability to hold accounts in multiple currencies with both debit and credit card facilities, or to hold high interest special deposit accounts for savings (which allows flexibility in managing financial arrangements) in the Isle of Man have all helped the Island to attract large volumes of overseas wealth and liquidity also supported by the early introduction of the depositor compensation scheme relative to other jurisdictions. A survey of bankers in the Isle of Man undertaken in 2010³ showed that the Isle of Man financial services sector is preferred by the international community for the "excellence of its customer service, brand, image and reputation". The survey also shows that the Isle of Man is probably the most international of the Crown Dependencies with the deposits and funds managed focused on rapid growth regions such as Africa and Asia Pacific.⁴ Total deposits excluding interbank holdings in the Isle of Man were £50.2bn and funds under management were £37.4bn as of the end of March 2011.⁵ Insurance funds totalled another £55.2bn.⁶

³ "Offshore Financial Services in the Isle of Man" - Datamonitor (2010)

⁴ "Offshore Financial Services in the Isle of Man" - Datamonitor (2010)

⁵ Isle of Man Financial Supervision Commission Annual Report 2010-11 (figures as of 31/3/2011).

⁶ www.gov.im/ipa/insurance/insurancestatistics

Though not technically classified as part of the finance sector in official statistical classifications, the Island's corporate service providers are critical to a great deal of what the sector does. The providers are a mix of small licensed enterprises, international financial institutions and advocates, all operating under licence under the supervision of the Island's Financial Supervision Commission. Their many functions include company formation, company management, and corporate and personal financial advice.

It is important to note that the Isle of Man did not rely or focus only on the financial services sector to generate the overall growth in the economy.⁷ However, the presence of the financial sectors and the related professional services strongly supported the development of high value added industries such as aerospace and advanced engineering, clean tech and ICT that rely on financial and professional services to grow.

3.2.2 Aerospace and advanced engineering

The Isle of Man Aerospace Cluster (IOMAC) represents and provides support to 17 aerospace and engineering related businesses of different sizes and has generated nearly £400m in the past three years.⁸ The support includes sharing best practice, marketing responsibilities, skills and knowledge, procurement procedures and quality standards.

The IOMAC has proved to be particularly significant in supporting the engineering sectors – which have experienced 50 per cent growth over the past four years. IOMAC has also proved important in the development of the British aerospace industry. For example, Isle of Man manufactured components are currently used by Rolls-Royce, BAE system and Airbus and an Isle of Man company produced the laser optics that helped the NASA Phoenix Lander find traces of snow in Mars during the 2008 mission. The presence of IOMAC has supported further development in the aerospace and advanced engineering industry and it is now a key partner to the UK's North West Aerospace Alliance (NWAA). Through its relationship with companies like Airbus and Rolls Royce the Isle of Man is now viewed within the aerospace industry as a core part of the British supply chain. The NWAA and IOMAC are now investigating how their individual strengths can be leveraged to benefit both the Isle of Man and UK economies.

"The Isle of Man is host to one of the most agile and dynamic clusters of aerospace and engineering companies in and around the UK region"

Martin Wright – North West Aerospace Alliance
"Aerospace Industry Leading the World" - Business World (2011)

The reputation and activities of the Isle of Man aerospace industry led the aerospace consultancy "ASCEND" to confirm in their recent report that the Isle of Man is the "fifth-most likely country to land on the moon".⁹ The Space Data Association - a body established by commercial satellite operators in order to improve the safety and efficiency of space operations – has recently located the Space Data Centre (SDC) on the Isle of Man. The SDC is an automated space situational awareness system where satellite operators share their orbital data that provides information about the physical proximity of objects in space, and performs data gathering and sharing. The presence of such advanced skills and technologies in the Isle of Man proved to be useful in contributing to the development of technologies and solutions for the production in the airline, defence, oil industry and food manufacturing sectors, making the Isle of Man an important player in the world supply chain.

With the reduction in funding, UK universities are now under pressure to maximise the value of any Intellectual Property (IP) that has been internally generated. It now makes sense for those institutions to establish their "spin offs" in the lowest cost jurisdiction to ensure optimal returns and in many cases this means that technology and jobs are being exported to places like India and China. Adrian Moore, Chairman of the Isle of Man Aerospace Cluster, believes that the Isle of Man can help to protect UK technology and jobs if those institutions choose to establish their headquarters and register their IP in the Isle of Man. This will enable them to lower costs to a level where investment in the UK is sustainable, thereby protecting jobs and technology from the unlicensed copying so prevalent in some jurisdictions.

3.2.3 Cleantech

The cleantech business is another sector that has significant growth potential in the Isle of Man, thanks to existing precision manufacturing capabilities and knowledge. In a recent survey¹⁰ about the clean-tech sector, 67% of Isle of Man based respondents said they were preparing their company to grow in the clean-tech

⁷ For example the ICT sector experienced a 6% growth over the same period, and the manufacturing and professional and scientific services grew at 9% and 10% respectively.

⁸ ASCEND (2010)

⁹ Ibid.

¹⁰ 'Results of the survey on the economic impact of the Isle of Man Clean Tech sector', June 2011

sector. This demonstrates that the Isle of Man has a strong foundation of expertise, upon which the cleantech sector can develop. Other reasons given were that the Isle of Man is a “stable place to do business” and has a favourable location. The aerospace, carbon trading and commercial space projects, alongside fuel modification technologies, have been contributors to the existence of the Isle of Man’s developing cleantech cluster. Cleantech is a high tech sector and a key growth area for many developed nations, and the Isle of Man is positioning itself well to be involved in the future of the industry. The Island has developed a unique selling proposition to attract businesses in the sector, the key benefits being a location to trial technology, existing precision manufacturing sector to assist with developing new technology, and a location to protect and maximise financial benefit from intellectual property.

Through the British-Irish Council, of which the Isle of Man is a full member, the Isle of Man is working in partnership with the UK and Irish governments to bring offshore supplies of energy to the UK and Ireland, and in the future Western Europe. The Isle of Man is seen as an enabler for the industry both in terms of technology and job creation. By offering a solution to UK universities who wish to maximise the value of their research the Isle of Man can help to ensure UK technology stays within the British Isles, and that jobs are created in the UK rather than India and China.

The focus of the Isle of Man in supporting the development of green technology and businesses is also reflected by the introduction of green technology in well established activities such as the world famous TT motorbike races. For example, the original TTXGP race has been replaced by the TT Zero for bikes powered without the use of carbon based fuels.¹¹

3.2.4 Information and Communications Technology (ICT) and e-business

The Isle of Man currently features a very progressive environment for ICT and a world class telecommunications infrastructure. The Isle of Man has gained significant achievements in the ICT sector. For example, it served as a test for the Europe’s first operational third generation (3G) wireless system. The Isle of Man also benefits from one of Europe’s largest cable fibre “rings” and one of the most advanced digital phone networks, which is currently being upgraded to next generation technology to deliver super fast broadband speeds. The Island’s high bandwidth connections with the UK and Ireland provide the network with enough capacity to handle the Internet traffic between the two sides of the Atlantic 10 times over.

The Isle of Man is an important location for e-commerce and e-gaming due to its advanced and secure ICT infrastructure, stable business environment and legal framework. E-gaming provides nearly 645 jobs, and grew 41% in 2010.¹² This growth is aligned to the global trend and online gaming is the fastest growing segment of the gaming market. Some estimates expect it will double in size from its 2008 level by 2013.¹³

Several EU jurisdictions are facing challenges with regulating and implementing the licensing and tax regime for online gaming. The Isle of Man approach to regulating the e-gaming industry has been to create a business friendly, consumer protected environment without creating significant distortions in the international markets. The excellence of the Isle of Man offering and the quality of the regulatory regime were key in the Island being one of only three jurisdictions listed in a “White List” of jurisdictions originally permitted to supply their services into the UK under its Gaming Act.

¹¹ REGULATIONS TT ZERO – 2010 International Tourist Trophy – Isle of Man 29 May – 11 June p27 ACU Events Ltd (2010)

¹² Manx eGaming Association (MeGA) (2010)

¹³ European Commission (2008)

3.2.5 Other sectors

Shipping registry	<p>Today the Shipping Register is among the most respected in the world and rated among the top 16 “quality” registers in the world by the US Coast Guard.¹⁴ It now attracts among the most prestigious maritime names in the industry such as Vships, Dohle, Bibby, Maersk and Shell.</p>
Agriculture and fishing	<p>Though generating only c.1% of income to the economy, the Isle of Man’s mixed farming industry accounts for some 80% of land use. Dairy farming is the most important type of farming, followed by beef and sheep farming. Cheese, beef and lamb are the main agricultural exports with the majority going to the UK.¹⁵</p>
Film production	<p>The Island’s film production industry is a major success story of the government’s diversification policy plan. The Government has a film division (Isle of Man Film) dedicated to the co-production and financing of film and TV dramas, providing opportunities for British and international film makers.</p> <p>The Isle of Man incentivises film productions to come to the Island, particularly those in needs of funding, and ensures that they contribute to the local economy. In the past a Media Development Fund has provided funding for films that may have been unsuccessful in attracting finance in other jurisdictions with the understanding that 20% of that budget will be spent on filming in the Isle of Man. Since the fund began in 1995, it has provided funding to over 80 films and TV shows.¹⁶</p> <p>Each film produced on the Island broadly supports the movie industry in the region by employing both UK and foreign actors and resources, and promotes the Island as a whole, raising its profile amongst a wider audience and generating revenues and jobs for the local activities.</p>
Tourism	<p>The Isle of Man’s tourism industry was worth £122m in 2009, 4% of the Island’s income. In 2011, the Island received over 230,000 tourists (not including business related visits), split evenly between those staying in paid accommodation and those staying with family and friends.</p> <p>A main attraction for tourists is the “Manx TT Festival”. It is an annual motorcycle festival held on the island held across May and June. The 2011 festival attracted an estimated 37,700 visitors. The event brought in £20m of revenues to the Island.¹⁷</p>
Aircraft register	<p>The Isle of Man introduced its Aircraft Register in 2007, focussing on corporate and private jet registrations. It is the only dedicated corporate register in Europe and has greatly exceeded expectations in recently registering its 400th aircraft.</p>
Space and Satellites	<p>One of the very recent areas of development in the Manx economy has been in the leading-edge technology of space and satellite communications. In partnership with private enterprise the Island is concerned with the filing, with the International Telecommunications Union, of orbital positions and associated radio frequencies. The</p>

¹⁴ QUALISHIP21 (Quality shipping for the 21st Century) – US Coast Guard.

¹⁵ <http://www.isleofman.com/businessandfinance/whyiom/economy/agriculture.aspx>

¹⁶ www.isleofman.com/businessandfinance

¹⁷ <http://www.bbc.co.uk/news/uk-england-hampshire-13872698>

wider industry is involved in a number of initiatives including space tourism, and the Island is now host to global not-for-profit organisations the International Institute of Space Commerce and the Space Data Association. Reflecting further how the sector has rapidly developed links with, and opportunities for, enterprises in other sectors, one local hi-tech manufacturer company has even supplied parts for the recent Mars Phoenix mission,

4. Assessment of the Isle of Man international tax and regulatory standards

4.1 Isle of Man alignment with international tax and regulatory standards

The Isle of Man has developed a modern regulatory system that is aligned to worldwide best practice and meets, in places exceeding, international standards. The Isle of Man has often outperformed other major financial centres in many areas of compliance such as tax transparency and anti-money laundering legislation. Many assessments that have been undertaken by international bodies on the Isle of Man's alignment to international regulatory standards have praised the Government's pro-active role in implementing regulation.

It is important to emphasise that the Isle of Man's meeting of evolving supervisory and regulatory standards has often been unprompted and indeed the Isle of Man Government has led the way in certain areas. For example, many jurisdictions strengthened their anti-money laundering legislation in response to pressures arising from the 9/11 events and the concern that money laundering activity and lack of transparency around transaction flows and beneficiaries could foster the financing of terrorism. The Isle of Man Government had already introduced legislation leading to stronger transparency during transactions among companies and trusts in 2000. In particular, new regulation ensured that intermediaries would have information available about the ultimate beneficial owners of all companies administered in the Island and identify all settlors, beneficiaries and other individuals associated with trusts.

The pro-active role and attention to implementing transparent regulation aligned with international best practice and prescriptions has made, the Isle of Man, in the words of Angel Gurría, the OECD Secretary General, "a model jurisdiction for others to follow".¹⁸

A detailed assessment of the Isle of Man alignment to international regulatory standards and best practice could be performed under two primary areas:

1. Tax compliance and transparency
2. Financial supervision and safeguarding of the financial system stability.

4.1.1 Tax compliance and transparency

The Isle of Man has always been highly compliant in areas of transparency and exchange of information. The Isle of Man has substantially implemented the Tax Information Exchange Agreements (TIEAs) signed at the G20 London Summit in April 2009 and developed within the context of the OECD's work on transparency and effective exchange of information.¹⁹

At the recent G20 meeting in Cannes (November 2011) two reports highlighted the Isle of Man's strengths in tax compliance and transparency. In one, the OECD Tax Transparency Report (2011),²⁰ it was found that only eight jurisdictions had all the key elements against which jurisdictions' legal and regulatory framework and actual implementation of the standards are assessed (as determined by the Global Forum for Tax Transparency) in place. The Isle of Man was one of these eight jurisdictions.

An 'internationally agreed tax standard' was developed by the OECD in co-operation with OECD and non-OECD members and endorsed by the G20 Finance Ministers and UN Committee of Experts on International Cooperation in Tax Matters in 2009. The standard requires the exchange of information in all tax matters on request, as well as the enforcement of domestic tax law disregarding domestic tax interest requirements or bank secrecy for tax purposes. The OECD has published a list of countries grouping them according to their degree of compliance to the internationally agreed tax standard.

There are three main categories ranging from 'White List' (countries that substantially implemented the 'tax standard') to 'Black List' (countries that have not committed to the tax standard). The Isle of Man is grouped in the 'White List' together with what are regarded as the most highly regulated jurisdictions such as the UK and the US.

¹⁸ Angel Gurría – Secretary General OECD (2009)

¹⁹ "Final report of the independent Review of British offshore financial centres" Michael Foot (2009)

²⁰ OECD Global Forum 'Tax Transparency 2011: Report on Progress'

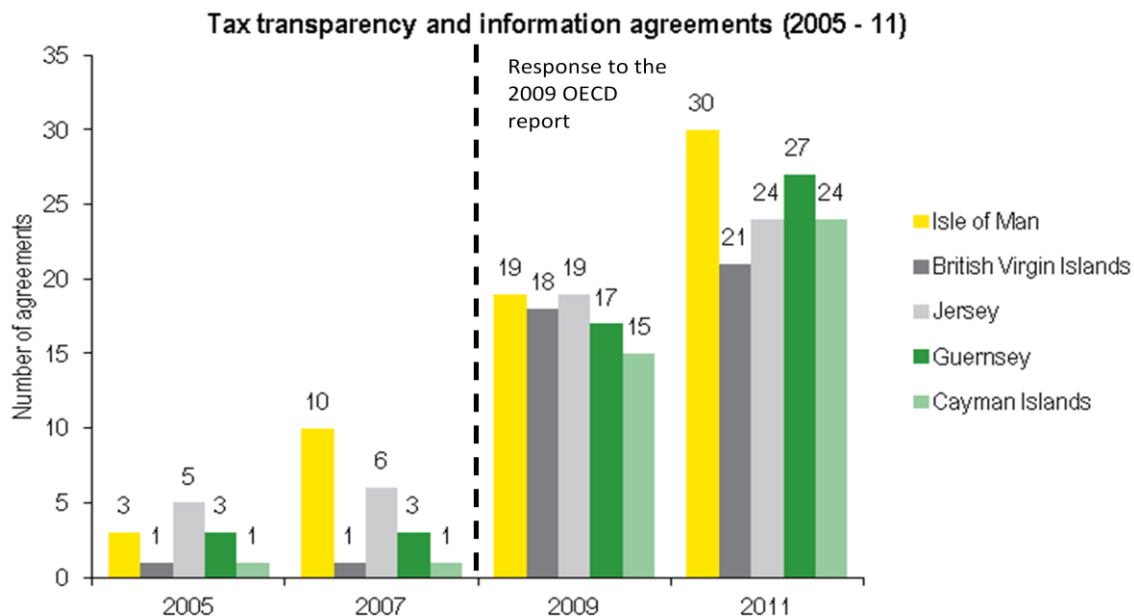
Table 1: OECD lists (selected countries)

White	Grey	Black
Australia	Austria	Cost Rica
Canada	Belgium	Malaysia
France	Luxembourg	Philippines
Germany	Singapore	Uruguay
Ireland	Switzerland	
Isle of Man	<u>Tax Havens</u> ²¹ :	
Japan	Aruba	
Netherlands	Bahamas	
New Zealand	Bermuda	
United Kingdom	British Virgin Islands	
United States	Cayman Islands	
Jersey	Liechtenstein	
Guernsey	Panama	

Source: OECD (2009)

In 2005, the Isle of Man was second only to Jersey in the number of tax agreements it had signed in line with OECD recommendations. After that, it took an active step in signing agreements and since 2007 it has led the way and outperformed most other IBCs in terms of OECD transparency and exchange of information rules. There was a big increase in the number of signed agreements across all jurisdictions in 2009. However the Isle of Man had already been pro-active in creating good levels of transparency with its trade partners, putting itself at the forefront of the development of a comprehensive network of TIEAs between small jurisdictions. The agreement is based on mutual economic benefit. In particular, the Isle of Man has signed up TIEAs with OECD and non-OECD members including the UK, France, Germany, the US, Japan, Indonesia, Australia²² and China as of August 2011²³. The Island is also in discussion with a number of other G20 countries, as well as other OECD and non-OECD members, in respect of further TIEAs.²⁴

Figure 4: Total number of tax transparency and exchange of information agreements signed by selected IBCs, 2005-11



Source: Organisation for Economic Cooperation and Development (OECD) (2011)

²¹ Tax Haven definition and criteria can be found in the 1998 OECD report

²² http://www.tax-news.com/news/Isle_Of_Man_Signs_TIEAs___50057.html

²³ <http://www.gov.im/treasury/incometax/sections/practitioners/internationalagreements.xml>

²⁴ Initial submission to Michael Foot Review – “Review of British Offshore Financial Centres” (2009)

In June 2011, the Isle of Man was commended for the way it exchanges information with other countries in a peer review carried out by a team of experts on behalf of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, which involves over 90 countries including the Isle of Man. The report states that:

"The feedback provided by the Isle of Man's information exchange partners is very positive. The information requested is provided quickly and exchange of information partners are appreciative of the open and transparent relationship they have with the Isle of Man competent authority".

The report notes that the Isle of Man has been exchanging information in accordance with the international standards since its first tax information exchange agreements came into force in 2006 and concludes that the Island's sharing of tax information has been 'effective and expeditious'.

The Global Forum report confirms that the Island has a legal and regulatory framework in place to make information available, and that the power of the Isle of Man tax authorities to obtain information for exchange is clear. The report also recognises the active oversight to which all major financial sector industries are subject.

In November 2011 during the recent G20 meeting in Cannes, the OECD produced an assessment (Tax Transparency Report)²⁵ of over fifty jurisdictions around the world including mature economies, emerging markets and IBCs regarding the automatic exchange of information for tax purposes. In particular, the level of compliance on three main areas was assessed: Availability of information, accessibility to this information, and the modality how the information is exchanged. The Isle of Man was among the only eight countries (Australia, France, India, Ireland, Isle of Man, Italy, Japan and Norway) found to be fully compliant all three areas and no "significant improvements" were required.²⁶ This further highlights the Isle of Man's strengths in tax compliance and transparency.

At the EU level the Isle of Man is also party to the European Union Savings Directive and was among the first of the non EU countries to adhere. The EU directive aims to address the reporting of savings income generated in countries different from the country of residence. This is achieved through an automatic exchange of information between authorities or deduction of withholding tax at source for onward distribution to relevant EU authorities. Again the Isle of Man led the way amongst IBCs when announcing it was to remove the withholding tax route to compliance earlier than initially indicated.

4.1.2 Financial supervision and safeguarding of the financial system

Following the introduction of stronger attention on issues such as money laundering and financing of terrorism, the International Monetary Fund (IMF) undertook a comprehensive review of the major financial centres' alignment to international standards and best practice. The IMF assessed the Isle of Man compliance with regulatory and financial supervision international standards in 2002/03 and it was found to have a "high level of compliance" and it distinguished itself for the attention given to:

"upgrading the financial regulatory and supervisory system to meet international supervisory and regulation standards in banking, insurance, securities, and anti-money laundering and combating the financing of terrorism"²⁷.

The Isle of Man has also been assessed by the Financial Action Task Force (FATF)²⁸ on money laundering and the prevention of terrorism financing. The FATF twice judged the Island as being cooperative and in compliance with all key FATF recommendations in respect of anti-money laundering. In particular, the first assessment concluded that:

"the Isle of Man has a robust arsenal of legislation, regulations and administrative practices to counter money laundering. Perhaps more importantly, the authorities clearly demonstrate the political will to ensure that their offshore financial institutions and the associated professionals maximise their defences against money laundering, and cooperate effectively in international investigations into criminal funds"²⁹.

²⁵ Tax Transparency 2011: Report on Progress – OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (2011).

²⁶ Ibid.

²⁷ "Compliance Assessment of the Isle of Man" (2003) – International Monetary Fund

²⁸ The FATF is an international body whose purpose is the development of policy to combat money laundering and terrorist financing

²⁹ FATF Annual Report 2000/2001

In addition an IMF assessment on the Anti-Money Laundering and Combating of the Financing of Terrorism performed in 2009 for the Isle of Man emphasised how “*money laundering is criminalized broadly in line with international standard*”³⁰ and:

“the Isle of Man’s legal framework underpinning the seizure and confiscations system related to proceeds of crime is generally solid and comprehensive”.³¹

The Isle of Man also plays a role in helping other small nations to develop effective regulatory frameworks through their sponsorship of the Small Countries Financial Management Centre³² in partnership with the World Bank and the Commonwealth Secretariat. The aim of the Centre is to promote the sustainable development of the economies of small states with particular emphasis on financial integrity and improved regulation. The Centre was established through a generous financial commitment from the Isle of Man Government as the primary sponsor. A short course tutoring programme is executed with the support of the Said Business School, University of Oxford. That a small nation would seek to use its own limited financial resource to assist other small nations to meet the challenges of the ever changing global regulatory landscape demonstrates the Isle of Man’s commitment to better regulation.

An assessment performed by the IMF on the Isle of Man’s effort to safeguard the financial system reported that the institutions operating in the Isle of Man are compliant with the Basel Core Principles and found that capital requirements were very high.³³ This further supports the strong track record and attention of the Isle of Man in developing a regulatory framework able to properly safeguard the financial system. Already back in 2000, the Financial Stability Board (FSB) rated the Isle of Man as having a good supervisory practice and level of cooperation, and therefore placed the Isle of Man in the “Group 1” category of offshore jurisdictions together with Hong Kong and Singapore and ahead of Jersey, Guernsey, Bermuda and the Cayman Islands. The high quality of Isle of Man regulatory standards have further been confirmed by the most recent FSB report released in 2011.³⁴ The FSB report assessed over 60 jurisdictions around their adherence to internationally agreed information exchange and cooperation standards in the areas of banking and insurance supervision, and securities regulation. The FSB has divided the jurisdictions evaluated into three groups: jurisdictions demonstrating sufficiently strong adherence, jurisdictions that are making progress towards sufficiently strong adherence, and non-cooperative jurisdictions. The Isle of Man is together with the G7 economies and very few other IBCs in the top tier group among the jurisdictions that demonstrate sufficiently strong adherence.

“This is a clear indication of [the Isle of Man’s] commitment to high standards of regulation and tax-transparency and shows that they lead the way in terms of how small jurisdictions with financial services centres should operate”

Lord Bach, Ministry of Justice – Minister Responsible for Crown Dependencies (2009)

“[The Island’s] evident commitment to stay in line with rising international expectations on the regulation of the financial services industry as well as the pace of setting work on tax information exchange agreements has certainly helped the UK’s position in the wider international debate on strengthening the global financial system”

Lord Bach, Parliamentary Under-Secretary of State at the UK Ministry of Justice
Chief’s Minister International Lecture (November 18, 2009)

Since 1991, the Isle of Man has had a deposit protection scheme in place. All licensed banks are members of the scheme setting out a compensation limit at £50,000 of net deposit for individual current and deposit accounts and up to £20,000 for most other categories of depositor including companies and trusts. Similar schemes were introduced in other jurisdictions³⁵ only many years later and often as a result of the recent financial crisis.

³⁰ Isle of Man: Financial Sector Assessment Program Update – Detailed Assessment of Observance of AML/CFT – IMF (2009)

³¹ Ibid.

³² <http://www.scfmc.im/>

³³ “Isle of Man: Financial Sector Assessment Program Update – Detailed Assessment of Observance of AML/CFT” - IMF (2009)

³⁴ “Global adherence to regulatory and supervisory standards on international cooperation and information exchange” - Financial Stability Board (2011)

³⁵ Guernsey introduced a similar scheme in 2008 and Jersey is currently assessing its options.

5. Benefits to the world economy

5.1 Isle of Man linkages with the world economy

The Isle of Man's main trade partner is the UK. The relationship between the two countries is discussed in more detail in Section 6. The Isle of Man's other trade partners are mostly from within Europe and the Isle of Man maintains a unique relationship with the EU and through that the European Economic Area (EEA). It is not a member state or an associate member of the EU, but is entitled to the free movement of goods between itself and EEA member states. The ability of the Isle of Man to act as a gateway into Europe for both emerging and developed economies is useful in providing the European supply chain with many cheap inputs of production that enable reduced production costs and helps maintain competitiveness in international markets.

5.1.1 Beneficial customs arrangements

The Isle of Man Customs and Excise has a facility (an Entry Processing Unit) for the clearance of goods entering the UK whereby companies can import to (and then export from) the Isle of Man without bringing the products onto the Island. This system decreases delivery times and provides the benefits of trading through the Isle of Man, which is an attractive prospect for a company importing into Europe on a large scale. To supplement this, there are now companies on the Island offering support services to assist these traders throughout the process. For example they will manage the relationship with Customs and Excise on the behalf of exporters or provide logistical support for importing goods into mainland Europe. The goods remain under the jurisdiction of the Isle of Man throughout.³⁶ Within the next 3 to 5 years it is expected that goods bound for anywhere in the EU will be able to be processed for entry in any member state. The existence of the Isle of Man facility will greatly support the UK's offering.

Companies are also taking advantage of the Isle of Man Freeport, the only offshore Freeport in Europe. The Freeport enables businesses to use the Isle of Man as a base from which to trade into Europe. It is available for a number of uses, such as the assembly of goods for export or the storage, loading and unloading of shipments. For example, goods can be stored on the Isle of Man duty free for indefinite periods of time until conditions are right for a company to enter into the European market. This is a benefit for companies, based in China or India for example, who wish to store goods on the Isle of Man before releasing them into the European market.

5.1.2 Promoting trade and investment in diverse global markets

The Isle of Man has always been proactive in developing its relationship with the emerging economies. The Department of Economic Development (DED) was set up to 'provide a successful and diversified economy'³⁷ on the Isle of Man. The Isle of Man Government has a clear strategy to diversify across markets and sectors, which could ultimately benefit also the UK and the EU. It has invested heavily in high tech and precision manufacturing in order to reduce its reliance on financial services. The trade in those sectors and their ability to compete at international level will foster the productivity of the entire region, delivering significant benefits.

To demonstrate this intent across world markets, in April 2011 the Isle of Man Government further strengthened efforts to attract new business from the Middle East, China and Russia. The Isle of Man already has strong links with India, with the majority of Indian companies that are listed on the Alternative Investment Market being incorporated on the Isle of Man³⁸ (See section 6.2.2).

The Isle of Man has identified China as a key market to target. China also strongly considers the Isle of Man as an important trading partner and views the Isle of Man as a conduit for its 'Going out' strategy.³⁹ A delegation from the Isle of Man visited China in 2010 to promote the advantages that the Isle of Man can offer to companies exporting to the EU. The Chinese economy relies heavily on income from exports and the Chinese Government are looking for ways to increase exports into Europe. The Chinese Government hopes to encourage Chinese businesses to find overseas opportunities and develop efficient ways of providing inputs to the European supply chain and production process. A Chinese report about this strategy suggested that investing in the Isle of Man was a sound option for businesses.⁴⁰ In particular, Mr He Wan Peng, a chief researcher at Forecast Think Tank, said:

³⁶ The Lawyer, 'Prime Location', July 2010

³⁷ <http://www.gov.im/ded/>

³⁸ The Lawyer, 'Give Thanks for the Manx', May 2011

³⁹ The Lawyer, 'Give Thanks for the Manx', May 2011

⁴⁰ The Lawyer, 'Prime Location', July 2010

“The Isle of Man, with its special investment environment, allows China to choose it as the bridgehead to the EU market”⁴¹

This is a huge development in the Isle of Man’s potential to work with diverse global markets and may provide impetus for other economies to follow similar strategies.

Recent investments in strengthening trade are part of a medium term marketing strategy aimed at developing the Isle of Man’s status across global markets. In addition, the Isle of Man Government is carrying out country-by-country analysis to create an offering which best meets the needs of each market.⁴² It is focused on trade and investment from emerging markets and will benefit the UK and the EU if the Isle of Man is used as a gateway into Europe for companies which would have not otherwise traded or invested in the region.

5.2 The beneficial role of International Business Centres in the world economy

There is a belief that IBCs divert economic activity which leads to distortions in the global economic and financial system. This is attributed to tax policy in these centres. However, a large body of independent research over the past 15 years has provided evidence to the contrary. This evidence, which is grounded in sound economic theory, suggests that IBCs play a key role in contributing to investment, employment and growth in neighbouring countries in particular, and the global economy in general. This research reports that the benefits delivered by IBCs are in at least two primary areas:

1. **Greater investment activity.** Improved tax efficiency in IBCs makes the location of economic activities in neighbouring countries more attractive. This ultimately translates into higher investment, job creation and greater output.
2. **Positive competition.** Positive competition spurs the modernisation of the business environment in neighbour countries as well as producing positive spill-over effects in the banking sector and wider economy.

5.2.1 Greater investment activity

Tax policy is partially implemented by governments in response to national and international economic circumstances and also to achieve specific policy objectives around public finance and growth. Taxation is therefore an important policy instrument and it influences the behaviours of firms in their investment decisions and consumers demand via the impact it can have on prices. These changes in behaviour have wider national and international economic implications.

Tax policies pursued by IBCs have often been a contentious area and subject to criticism, as they are thought to lead to large distortions in the allocation of real and financial resources which have detrimental knock-on effects to neighbouring countries. In order to assess the validity of these criticisms there are three areas that should be examined:

1. *Whether the choice by IBCs to pursue specific tax policy is not efficient or aligned to the experience of other comparable economies such as small countries exposed to international competition.* Modern theory of taxation⁴³ demonstrates that efficient taxation by small open economies is achieved when levels of taxation are very low, if not zero, on the tax bases that are highly mobile such as personal and corporate income. Empirical evidence⁴⁴ confirms the predictions of this theory, showing that countries with small populations and exposed to international competition rely much less on personal and corporate income and more on expenditure type taxes to fund government activities. Therefore IBCs’ tax policy choices are aligned with the policies pursued by other small economies which face similar challenges when competing in the world economy.
2. *Whether the choice by IBCs to pursue a specific tax policy is detrimental to neighbour countries.* Economic analysis and research supports the idea that tax efficient economies such as IBCs contribute to the economic performance of neighbouring countries, and in particular the performance of high tax countries

⁴¹ Ibid.

⁴² Financial Times, ‘Financial Services: Expanding range of expertise wins clients’, May 2011

⁴³ “Optimal taxation and public production, I: production efficiency; II: tax rules” Diamond, P. A. and J. Mirrlees. American Economic Review, March and June 1971, 61(1,2), 8-27, 261-278.

⁴⁴ “How globalization affects tax design” Hines, J.R. and L. Summers in Tax Policy and The Economy edited by J.R. Brown and J.M. Poterba. Chicago University Press (2009)

such as the G7 group,⁴⁵ as opposed to diverting it.⁴⁶ There are two primary channels through which economic activity in neighbouring countries can be boosted:

- Activity in IBCs can boost activity in neighbouring countries by providing valuable inputs, or as in the case of the Isle of Man provide support from an R&D and IP perspective. For example, the UK North West aerospace cluster strongly benefits from the R&D and IP presence of the aerospace Isle of Man cluster. A detailed discussion of these benefits can be found in Section 6.
- An IBC can provide a local, low cost, low tax, location for certain functions of a multinational company, improving prospective group profitability to the benefit of both the corporation and the public revenues of the home country.⁴⁷

3. Whether the taxation is the main driver in determining the allocation of resource, and whether this has potentially negative consequences such as by diverting economic activities from neighbouring countries. Research on the decisions affecting the location of economic activity shows that the choice around where to allocate an investment does not only depend on tax related issues, but on wider aspects affecting the profitability of the investment such as the access to market, the infrastructure network, skills, labour market regulations and the business environment.⁴⁸ This implies that even if small open economies or IBCs might have a competitive advantage from a tax perspective, the lack of a large labour force to support large scale production processes and the limited market size tend to offset the benefits related to lower taxation. Data seem to support the view that taxation has not been a primary driver in attracting investment in the EU. Empirical evidence suggests that large economies such as the UK or Germany have not suffered much from tax competition from smaller economies.⁴⁹ In particular, corporate tax rates in both countries remained fairly stable despite pressures from neighbouring smaller countries. This is because large economies are able to attract investment in manufacturing activity based on their ability to provide the necessary labour force and immediate access to market, which is less likely to be the case for small economies with small population size.

In summary, economic research and empirical analysis⁵⁰ suggest that IBCs provide a reduction in operating costs and deliver positive spill-over effects, resulting in increased investment and increased economic activity in neighbour countries that would be most likely absent if the IBC did not exist.⁵¹ In other words IBCs actually complement onshore jurisdictions by increasing investment and economic activity there as opposed to substituting for them. This implies that any reduction of an IBC's relevance to a neighbour economy might lead to 'unintended consequences'.⁵²

5.2.2 Positive competition

The presence of a well developed and modern financial services sector in IBCs provides strong incentives to neighbouring countries and major developed economies to align their offering and quality of services to compete properly and attract resources. There is considerable empirical evidence⁵³ suggesting that commercial banks in countries with nearby IBCs tend to have lower interest rate spreads (the difference between borrowing rates and the rate received on deposits), a measure generally used to assess the degree of competition in the banking sector. The stronger level of competition tends to have positive growth implications. Empirical and theoretical studies show that economies with a more competitive financial sector tend to have higher productivity which translates into higher growth rates and per capita income.⁵⁴ This is because the stronger competition in financial services leads to larger availability of capital to the private sector, which tends to foster investment and productivity increases.⁵⁵

⁴⁵ "International and financial centres and the world economy" Hines, J. STEP Report (2009)

⁴⁶ "Do tax havens divert economic activity" Desai, M.A., C. Fritz Foley and J. Hines. *Economic Letters*. (2006)

⁴⁷ "The demand for tax haven operations" Desai, M.A., C. Fritz Foley and J. Hines. *Journal of Public Economics*. (2006)

⁴⁸ "What problems and opportunities are created by tax havens?" Dharmapala, D. *Oxford Review of Economic Policy*. (2008)

⁴⁹ "Do tax havens divert economic activity" Desai, M.A., C. Fritz Foley and J. Hines. *Economic Letters*. (2006)

⁵⁰ "The demand for tax haven operations" Desai, M.A., C. Fritz Foley and J. Hines. *Journal of Public Economics*. (2006)

⁵¹ For a comprehensive discussion on FDI determinants see: "Determinants of Foreign Direct Investment" Bloningen B.A. and J. Piger (2011)

⁵² Garretsen and Peeters Central Bank of Netherlands.

⁵³ For a detailed discussion see "Do tax havens divert economic activity?" Desai, M.A.C, Fritz Foley and J. Hines – *Economic Letters* (2006)

⁵⁴ "International and financial centres and the world economy" Hines, J. STEP Report (2009)

⁵⁵ Ibid and "Unintended consequences" – *The Economist* (22 February 2007).

⁵⁶ "International Business Centres: Parasites or symbiots?" Rose, A.K. and M.M. Spiegel. *Economic Journal*, 117, 1310-1335 (2007).

⁵⁷ "Government ownership of banks" La Porta, R., F. Lopez-de-Silanes, and A. Shleifer. *Journal of Finance*, 57(1), 265-301 (2002)

⁵⁸ "International Business Centres: Parasites or symbiots?" Rose, A.K. and M.M. Spiegel. *Economic Journal*, 117, 1310-1335 (2007).

This positive competition also applies to sectors other than the financial services sector. For example, the presence of high value added sectors such as advanced engineering and aerospace and clean-tech, as in the case of the Isle of Man, provides important positive spill-over effects benefiting the whole region and spurring innovation.

5.2.3 Conclusion

Very often economic activity and investment is considered as a zero-sum game where the increase in activity in one part of the world would come at the expense of others in neighbouring countries. A persuasive volume of research has proved that this line of thinking is highly likely to be flawed and that there are actually important positive externalities and synergies that can and should be considered in the context of the financial and real resources channelled by IBCs.

The offshore centres' beneficial role is often underestimated and a reduction of their role in the world economy is very likely to lead to unintended negative consequences which are often overlooked by policy makers.

“Too few people who now seek to impose regulation on offshore jurisdictions truly understand how those jurisdictions actually operate, their positive ranking of compliance with major international regulatory standards or their beneficial role in promoting investment and growth in the wider economy”

Mark Field, MP for Cities of London and Westminster (July 2010)

Speech during parliamentary debate on offshore centres, Westminster (July 2010)

6. Benefits to the UK economy and the City

The UK and Isle of Man have a close relationship in terms of trade and investment in three main areas:

1. Alignment of the Isle of Man's growth strategy with the UK's regional and national strategies (in terms of sectors of the economy and policies to promote growth)
2. Mutual trade in goods and services
3. Similar aims and alignment of the two countries' trade and investment strategies and a focus on emerging markets.

The relationship was emphasised by Lord Bach in 2009, when he said:

"The UK and the Isle of Man benefit from each other's success and it is in the interests of the UK to see the Isle of Man do well"

Lord Bach, Parliamentary Under-Secretary of State at the UK Ministry of Justice
Chief's Minister International Lecture (November 18, 2009)

This relationship of mutual benefit is perhaps best illustrated by Census data which show that around half the Island's workforce is of UK born individuals. Many have found employment on the Island, in turn aiding in the development of the economy.

6.1 Alignment of the Isle of Man growth strategy with the UK's national and regional strategy

6.1.1 Alignment with the UK's national growth strategy

The UK's national growth strategy is outlined by the Department for Business, Innovation and Skills (BIS).⁵⁶ The UK growth ambitions are around four key areas.⁵⁷

1. To create the most competitive tax system in the G20
2. To make the UK one of the best places in Europe to start, finance and grow a business
3. To encourage investment and exports as a route to a more balanced economy
4. To create a more educated workforce that is the most flexible in Europe

There are a number of specific areas that the UK is targeting that also align to the Isle of Man national growth strategy and where Isle of Man efforts will help the attainment of UK objectives. A selection of these is shown below:

Table 2 – Isle of Man alignment to the UK national growth strategy

UK national growth strategy items	Isle of Man alignment to the UK national growth strategy
To create the most competitive tax system in the G20	<ul style="list-style-type: none"> ▪ The presence of the tax efficient system in the Isle of Man facilitates the location of headquarters in the UK that may otherwise locate elsewhere. ▪ The Isle of Man tax system has helped to provide a stable and business friendly environment, and one that is compliant with OECD and EU standards. ▪ The absence of a tax on company profits outside of core banking activity and land dealings leaves more profit liable to tax by the group's home country authority.
To make the UK one of the best places in Europe to start, finance and grow a business	<ul style="list-style-type: none"> ▪ The Isle of Man is widely known for the modern infrastructure and business friendly environment that, while fostering entrepreneurial business, is still aligned with major

⁵⁶ "The plan for growth" HM Treasury and BIS (2011)

⁵⁷ Ibid.

regulatory standards and best practice. The certain and stable economic and regulatory environment together with the modern and state of the art ICT infrastructures have placed the Isle of Man at the competitive edge in helping Isle of Man small companies compete at an international level. The Isle of Man experience could be particularly valuable in help shaping policies to support the SME growth in the UK. The Isle of Man could be an important partner for the UK in helping to shape and develop a business and regulatory environment conducive to private sector activity and to support entrepreneurial spirit.

- The UK benefits from a reliable source of finance from the Isle of Man and utilises the Isle of Man's resources to improve access to finance for UK based companies. The Isle of Man has the largest number of AIM listed companies thanks to an infrastructure able to support companies wishing to list on AIM or the London Stock Exchange (LSE). Most of the AIM and LSE companies' capitalisation is in sectors aligned to the UK growth strategy such as alternative energy and advanced engineering.
- In general, the Isle of Man is also a net provider of finance to the UK. Its robust financial services sector allowed it to continue providing liquidity during the recession in the region of around \$35bn between 2008q1 and 2011q2, when the UK financial sector needed it the most and where most other IBCs were unable to do so.

To encourage investment and exports as a route to a more balanced economy

- The Isle of Man infrastructure and business friendly environment is an important platform to attract investment to in the Irish Sea region that most likely would go to other jurisdictions. As discussed in Section 5.2 there is robust and strong evidence that the attraction of investment to IBCs tend to provide large and significant benefits in terms of employment and GDP to neighbouring countries.
- The Isle of Man has already well established relationships in major emerging economies where the UK will need to focus export efforts in the future.
- The Isle of Man is a well balanced and diversified economy with high levels of private sector participation. Most of the areas where the Isle of Man is diversified are in sectors aligned and complementary to the UK regional growth strategy. An important example of the strong contribution of the Isle of Man to UK regional development can be found in the UK North West aerospace cluster as discussed later in this Section.
- Planned investment in green energy is expected to raise turnover by 130% (to £10.6m) by 2014.⁵⁸ The Isle of Man is reducing its carbon usage and developing a foundation for the growth of a cleantech sector (see section 3.1.5 for more details). The 2009 Renewable Energy Directive set the UK's target of 15% by 2020. The Isle of Man is aiming to achieve the benchmark earlier than the UK, possibly providing a smaller scale blue print for the UK to replicate. In June 2011, the UK, Ireland, Channel Islands and Isle of Man signed up to an All Islands Approach to energy use. It is an agreement to work together to produce integrated energy and renewable resources and exploit the vast sources of energy available in the Irish Sea. The Isle of Man is partnering with the UK to develop and share clean energy and encourage investment in low carbon power.⁵⁹ In addition the development of the clean-tech industry in the Isle of Man could foster the growth of cleantech UK industry, replicating a similar experience for the aerospace cluster.
- The Isle of Man does not have its own IP register and the UK's patent and trademark laws extend to the Isle of Man. There is one registration to cover both jurisdictions, so less administration for companies registering their products, designs and ideas. There are several firms on the Isle of Man which provide support for companies wanting to register IP, simplifying the process. The integration of the Isle of Man system with the UK's means it has to keep up to date with changes in UK IP

⁵⁸ 'Results of the survey on the economic impact of the Isle of Man Cleantech sector', June 2011

⁵⁹ Department of Energy and Climate Change, 'All island approach to open up renewable opportunities', June 2011

law and provide its companies with the appropriate support. Therefore, if the UK is targeting an improvement in support for UK businesses, then the Isle of Man will follow suit and ensure it is equally well equipped on the most up to date IP laws and aligned with the UK regulations to support the innovation in the region.

- The Isle of Man counts ICT, e-gaming and e-business as among its fastest growing industries. Favourable IP laws and existing high tech infrastructure are enhancing the ability to develop a strong platform for developing advanced solutions and this aligns with the UK's digital and high tech growth aspirations.
- The Isle of Man companies in advanced industries such as precision engineering and aerospace are aware of the importance of developing a skilled workforce. This is the reason why they have led the way in supporting apprenticeships in aerospace companies of the IOMAC. Time spent on these apprenticeships can be carried forward as credits towards related university degrees. This could be an important example of how to provide training on the job for advanced skilled professionals and bridge the gap between university education and practical applications. Relationships between IOMAC and UK counterparts will ensure that the benefits of this investment in human capital are felt beyond the Isle of Man.

To create a more educated workforce that is the most flexible in Europe

The over-arching aim of the UK's national strategy is to grow in a sustainable, balanced and shared way – 'across the country and between sectors of the economy.'⁶⁰ The Isle of Man economy, its diversification in many sectors and its link with the UK regions, provides a natural strategic partner able to support the UK's national growth strategy. In particular, the Isle of Man has similar targets to those of the UK – to provide a successful and diversified economy - and by working alongside each other; these policies will supplement and benefit both jurisdictions. For example the Isle of Man could provide support in areas such as Intellectual Property development and aerospace. The case study at the end of this section explores this further.

6.1.2 Alignment with the UK's regional growth strategy

The Isle of Man's ability to diversify into several high value-added and highly skilled economic sectors has resulted in positive spill-over effects to its neighbouring regions. In particular this applies to the North West and Northern Ireland. The trade in e-gaming, clean tech and manufacturing have increased, alongside advanced engineering and other high-tech industries over the past years in the Irish Sea region creating an important hub to foster regional growth.

A number of the North West industries are complemented by those on the Isle of Man, and there is potential for further synergies to arise from trade between the Isle of Man and the region. As Table 3 shows the Isle of Man's key growth areas are represented well in the North West of the UK and Northern Ireland.

Table 3 – Number of companies in selected UK regions, by sector

Number of companies	E-commerce	Film	Advanced Engineering
Liverpool	100 - 249	100 - 149	250 - 499
Manchester	250 - 499	250+	750+
Leeds	250 - 499	150 - 249	750+
Belfast	100 - 249	150 - 249	500 - 749
London	500+	250+	750+

Source: UK Trade & Investment⁶¹

The North West growth strategy encourages SME growth, a policy which is consistent with both the Isle of Man and UK growth strategies. The Isle of Man believes that the opportunity for growth in businesses and employment is significant as a result of these mutually beneficial policies,⁶² and is are looking for ways to build stronger and more successful clusters, using the expertise already developed independently to generate hubs of knowledge and expertise in the long term.

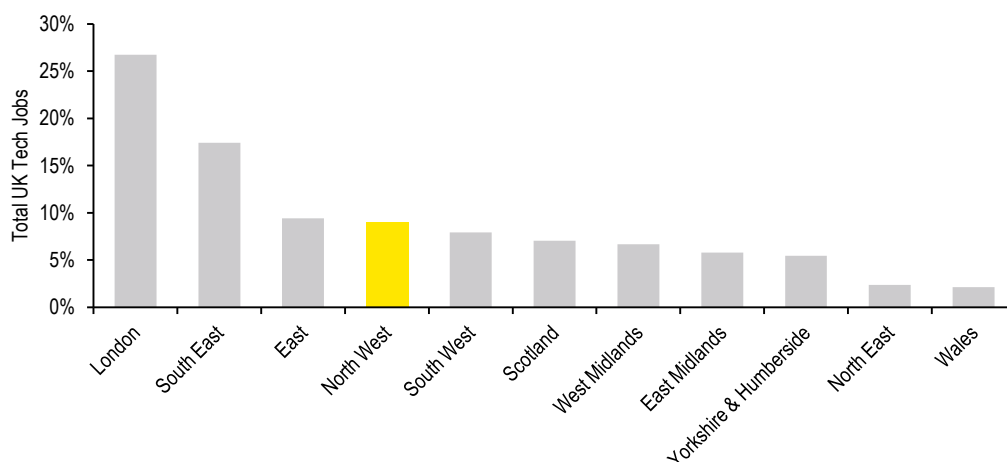
⁶⁰ Department for Business, Innovation and Skills (BIS) – The UK Plan for Growth, 2011

⁶¹ <http://www.ukti.gov.uk/investintheuk/investorsmap.html>

⁶² The Smith Institute, 'The Future of the North West', February 2010

For example, Figure 5 shows that as of March 2011, 9% of total UK technology related jobs were based in the North West. Whilst London and the South East are also the location for a high proportion of technology jobs, they are supported by many other industries from within those regions, such as finance and administrative support and educational services. The North West technology cluster relies on support from its surrounding areas - for example, resources from the Isle of Man, Ireland and the South West. Since 2008, this support has enabled the North West to generate a high tech cluster producing high value output for the sector.

Figure 5 - Regional technology jobs as a % of total UK technology jobs, March 2011



Note: Tech jobs are professional, scientific and technical services and ICT

Source: Office for National Statistics – Labour Force Survey, March 2011

Case study I: Aerospace cluster

The Isle of Man Aerospace Cluster (IOMAC) is an example of an extremely successful industry providing significant benefits not only to the Isle of Man but to the growth and development of the UK aerospace industry and the UK North West region where most of the UK's aerospace activities are located.

The UK aerospace industry is currently number one in Europe and number two in the world. This has been achieved via knowledge sharing, dissemination of best practice and enabling of the supply chain across the North West region. The UK aerospace industry strongly benefits from the share of knowledge and expertise from the IOMAC, which is regarded as a centre for some of the world's most cutting-edge technologies. The IOMAC is strongly linked to the NW Aerospace Alliance in the UK and cooperates on many high profile projects involving aerospace and precision engineering technologies. The North West hosts approximately 30% of the UK's aerospace industry and it fosters the growth of approximately 800 smaller companies in the West region and around 43,000 jobs in the West and South West region involved in high profile international projects such as Airbus A380, A350 and A400M, Eurofighter, Typhoon and the Rolls-Royce engines powering them.

The IOMAC has also taken important actions to overcome the future potential skills-gap in the industry and the region by developing an apprenticeship scheme. This is likely to provide future significant benefits not only to the Isle of Man but to the wider UK North West aerospace cluster. In the coming years avoiding a skills gap in these industries is a top priority in the UK economic policy agenda.

The IOMAC vision includes planning to establish a technology park where FDI in the technology sectors across the world can be located in an IP friendly and safe environment. This will enable the development of ideas by using existing skills and competencies and R&D will benefit from the state of the art infrastructure and like-minded companies and skills. The objective is to act as a lever to attract tech companies to the UK since the IOMAC is part of the UK supply chain.⁶³ In addition, the limited size of the Island would mostly allow the development of the R&D department whilst keeping the production in the UK where there are the necessary infrastructures and manufacturing skills for advanced engineering productions, delivering clear benefits to the UK in terms of Gross Value Added and job creation.

⁶³ "The Isle of Man could teach its larger neighbour a thing or two about technology development", Adrian Moore, Chairman of the Isle of Man Aerospace Cluster, The Engineer – 23 May 2011.

Case study II: E-business

Microgaming

Microgaming is a technology company that develops and licences gaming software.⁶⁴ It manages online casinos, poker rooms and bingo sites worldwide. It was a market leader in online gambling when it was set up around 10 years ago. It is involved in developing independent standards for the e-gaming industry through its Regulation and Assurance Company eCOGRA. Microgaming has its headquarters located on the Isle of Man, attracted by the Island's leadership in the online gaming industry and its well respected IT cluster with highly skilled personnel.

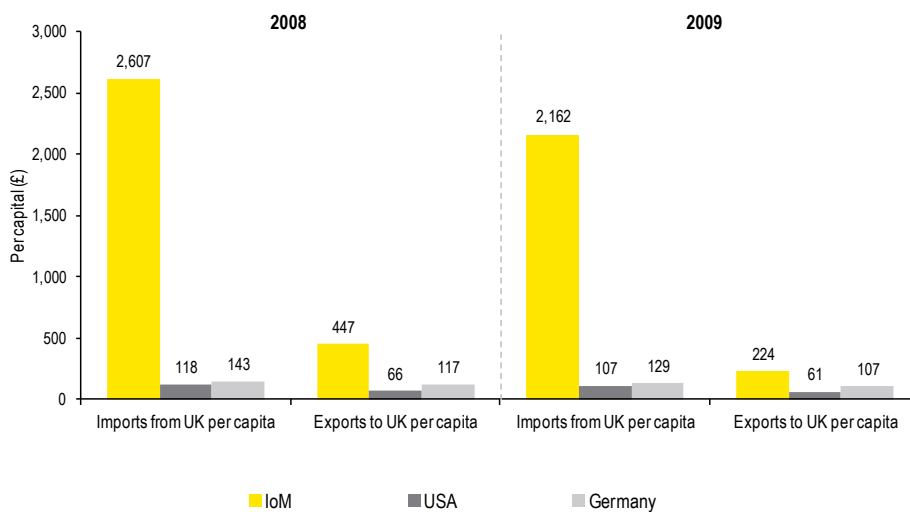
Neteller

Neteller Plc is the largest independent online money transfer business in the world, with over \$7bn in annual transactions.⁶⁵ It is based on the Isle of Man and operates globally via its regional offices in Europe, Asia Pacific, North and Central America. In moving its global headquarters to the Isle of Man, Neteller cited the robust telecommunications infrastructure, central location in Europe and the Government's commitment to e-commerce as key reasons for the move. In addition, the Island provided a framework for regulation within which Neteller would be able to operate efficiently and at the scale it desired.

6.1.3 Mutual trade in goods and services

The UK is the Isle of Man's key trade partner. The main exports from the Island to the UK are financial services, engineering products, dairy produce and meat. Using per capita trade data provides a clear picture of the importance of this trading relationship for both economies. In 2009, the Isle of Man was the second highest destination for UK service exports, and the highest source of UK imports in per capita terms. Trade is facilitated by the Customs and Excise Agreement between the two countries which, through the equating of indirect tax rates, allows for the absence of customs barriers.

Figure 6 –UK imports/exports with Isle of Man and top 2 trading partners (per capita, 2008 – 09)



Source: Isle of Man Initial Submission, Foot Report. UK Pink Book, 2010

The strong trade relationship between the Isle of Man and the UK is related to the large financial flows and the trade of inputs of production in advanced manufacturing and precision engineering. This has proved to be particularly relevant in fostering the UK economy and the North West region in particular. Examples of this are provided throughout the report.

⁶⁴ <http://www.gov.im/ebusiness/microgaming.xml>

⁶⁵ <http://www.gov.im/ebusiness/casestudies/neteller.xml>

6.1.4 Trade and investment strategy

The BIS UK Trade and Investment plan⁶⁶ is aiming to increase the influence of UK companies in the emerging and high growth economies of China, India and Brazil.

China

The UK government is targeting policies that provide better market access for UK firms in China and policies that encourage Chinese investment into the UK. As previously noted, China has identified the Isle of Man as a gateway to the EU market; the UK can take advantage of this relationship to assist their trade relationship with China and to increase inward investment. For example China's main exports are electrical goods and machinery, which complement production of high technological goods in both the Isle of Man and the UK. The provision of cheaper inputs from China to production processes will help the UK minimise the cost of production and maintain competitiveness in the international markets.

India

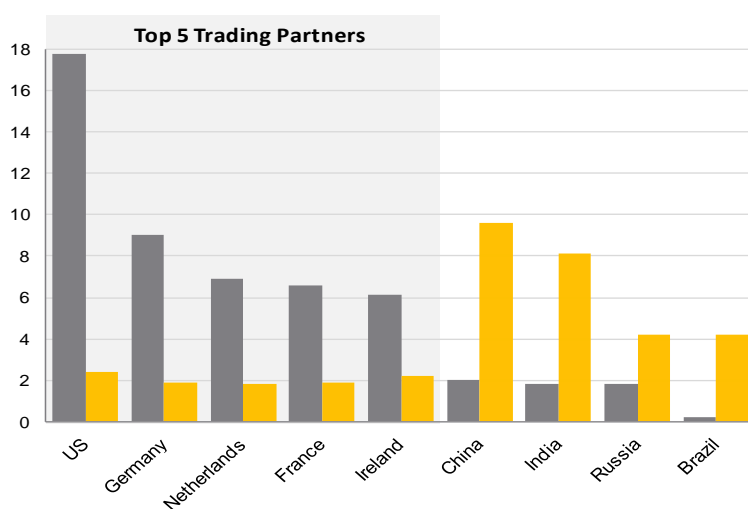
The UK is a partner in the negotiations for an EU-India Free Trade Agreement (FTA) which aims to increase economic relations between the Europe and India. The agreement has not yet been finalised but it was reported that substantial progress was made during a meeting in February 2012⁶⁷. The UK and India currently work together on education and skills, green energy generation, science and research, and advanced manufacturing such as aerospace. These are sectors the UK is targeting as part of its national growth strategy. Due to its recent rapid and expected ongoing growth, India is considered a key partner for the UK. The Isle of Man can help the UK to pursue this relationship. It has to date, received a large amount of investment from India with the majority of Indian companies listed on the Alternative Investment Market and incorporated on the Isle of Man. The companies are split between real estate and equity investment firms, and energy companies.

6.1.5 Conclusion

The UK has historically relied on mature markets for its exports. However, in response to slowing demand from these markets, as well as slowing domestic demand, UK exports policy is currently aiming to shift towards emerging markets where GDP growth is expected to be much higher (as shown in Figure 7). The Isle of Man could be an important strategic partner with the UK during its market diversification process. The UK could complement its market access policies by leveraging the Isle of Man's existing and future trade infrastructures and relationships. This is likely to deliver large and significant benefits to both the UK and the Isle of Man – for example common trade strategies that identify synergies to exploit each country's advantages around the acquisition of new technologies. In addition, this common trade strategy could be applied to augment the success in entering and expanding in emerging markets and therefore better support the domestic economies. The chart demonstrates the inconsistencies between the UK's main trading partners and the countries with the highest expected GDP growth over the next five years.

Figure 7 – UK main trading partners and expected GDP growth

■ Share of UK exports (% of total) ■ GDP growth forecast (average growth rate 2011-2016)



⁶⁶ BIS 'Trade and Investment for Growth' February 2011

⁶⁷ <http://www.bbc.co.uk/news/world-asia-india-16978295>, 'Progress' on free trade deal at EU-India summit', 10 Feb 2012

6.2 Benefits to the City and financial flows

The Isle of Man has a strong reputation as a well regulated and professional financial centre and it provides support and finance for companies located in the UK and, more specifically, the City of London (the 'City'). The Island is among the main offshore providers of liquidity to the UK. Its proximity to the City and its financial infrastructure attracts investment from abroad from companies who wish to list on the Alternative Investment Market or London Stock Exchange.

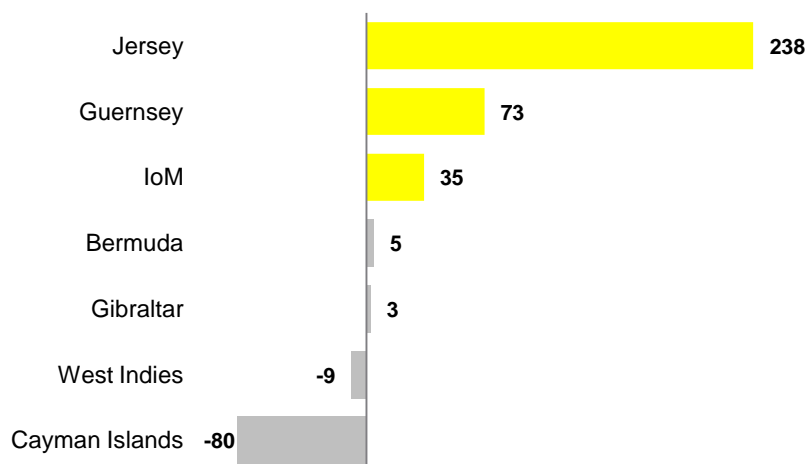
The Isle of Man provides significant benefits to the City and UK economy around:

- Providing liquidity
- Facilitating the diversification of the UK economy
- Strengthening the relationship with emerging markets and attracting FDIs

6.2.1 Liquidity

The Isle of Man and other Crown Dependencies outperformed many IBCs in the provision of liquidity over the past years and in particular during the financial crisis period when liquidity was most needed in the UK financial markets. The Crown Dependencies jointly provided net financing of over \$300bn to the UK financial system from the outset of the crisis in 2008 until the second quarter of 2011 as shown in Figure 8. In particular, the provision of liquidity from the Isle of Man to the City had been steadily increasing over the past decade as shown in Figure 9.

Figure 8 – Average net financing provided to the UK by selected IBCs during 2008q1 – 2011q2 period (\$bn)

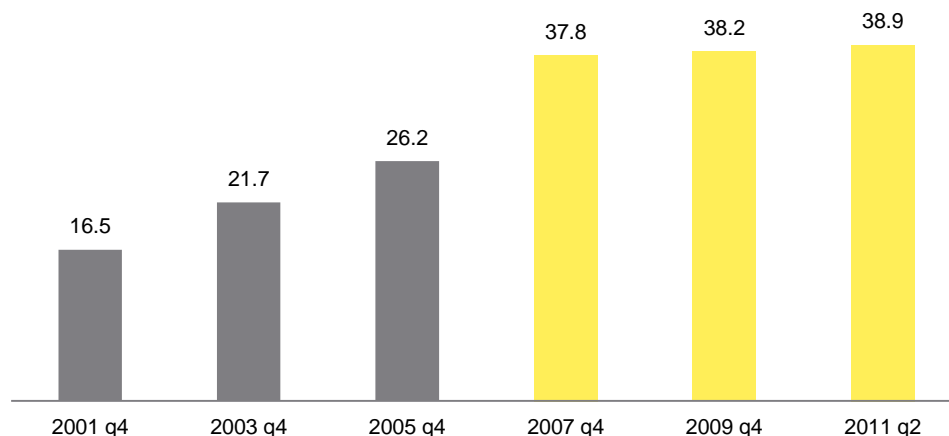


Source: Bank of England, Monetary and Financial Statistical Database

The lower provision of liquidity by the Isle of Man than the other Crown Dependencies in absolute terms can be explained by the Isle of Man's wider economic base and the other jurisdictions' greater focus on financial services. Jersey and Guernsey's financial services contribute 43% and 42% respectively to their GDP, compared to the Isle of Man's 34%.⁶⁸

⁶⁸ Jersey National Accounts 2010, data for 2009. Guernsey Annual Economic Overview 2010, data for 2009. Isle of Man National Income Accounts 2009/10

Figure 9 UK net financing position vis-a-vis the Isle of Man (\$bn)



Source: Bank of England, Monetary and financial statistics (2011Q3)

6.2.2 Listed companies

The Isle of Man has the largest number of AIM listed companies worldwide. Most of the AIM and LSE companies that are registered in the UK have capitalisation that is in sectors aligned to the UK growth strategy such as alternative energy, industrial engineering and industrial transportation. What is more, they also originate from emerging economies, an area of focus for UK growth already discussed. The Isle of Man therefore provides a useful platform to help the UK economy diversify in sectors other than financial services and strengthen the relationship with emerging markets.

Facilitating the diversification of the UK economy

Three other offshore centres that are highly represented on the AIM are the British Virgin Islands, Bermuda and the Cayman Islands. Companies from these centres each have a higher total market capital value than those from the Isle of Man. However, they are dominated by a few large companies concentrated mostly on mining, oil and gas and real estate which are traditionally highly capital intensive and do not directly align to the future UK national growth strategy.

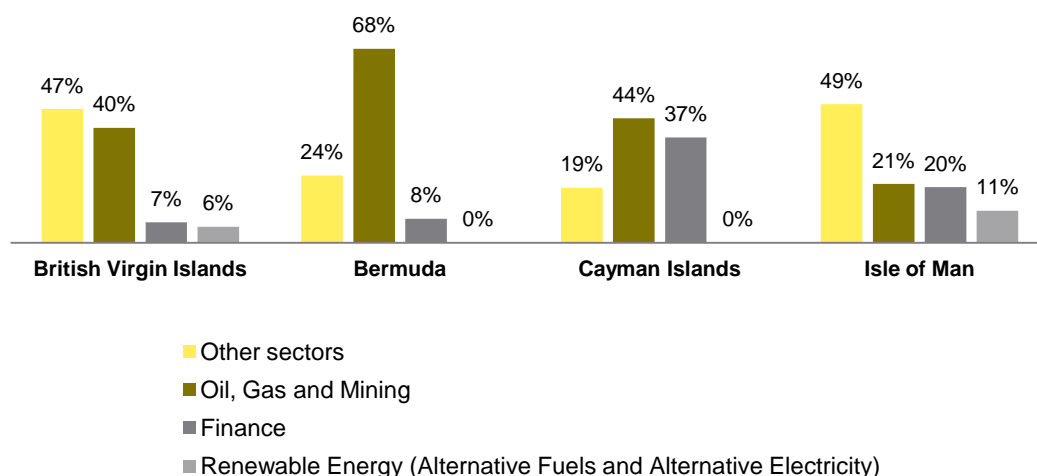
Table 4 – AIM Listed Companies

Top AIM countries by number of companies	Number of companies	Market-cap per capita	% of total market cap concentrated in top valued company	% of total market-cap concentrated in 4 top valued companies
Isle of Man	40	33,465	10%	37%
Cayman Islands	36	84,793	23%	49%
British Virgin Islands	35	125,911	26%	55%
Bermuda	21	109,760	24%	70%

Source: London Stock Exchange Online Database (2011)

For example, Bermuda's top 4 companies contribute 70% of market capital, whereas the equivalent for the Isle of Man is 37%. The other IBCs are dominated by large oil, gas and mining companies, which have high market capitalisation so the value of companies based on these IBCs is high. In contrast, the Isle of Man has a far more diverse spread of mid-sized companies (up to £300m) in sectors which complement the UK. In particular, the Isle of Man has the highest market capital of renewable energy companies of its competitor offshore centres; it attracts green and renewable energy companies to the UK market, which aligns it with the UK's push for renewable energy investment.

Figure 10 - Market-Cap per capita of selected industries for the top 4 AIM listed countries, 2011



Source: London Stock Exchange

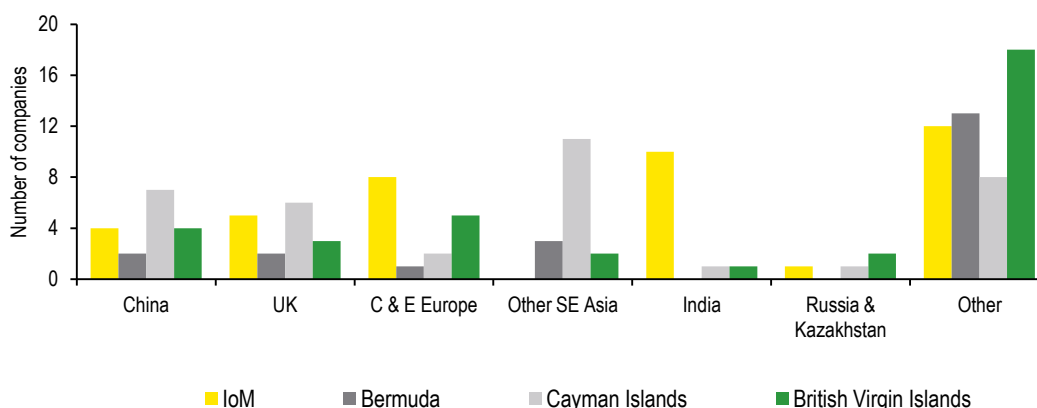
Note: "Other" includes alternative energy, industrial engineering, industrial transportation, media, non-equity investment instruments, real estate investment trusts (REITs), travel and leisure

The Isle of Man provision of capital to the UK economy can be strategic in facilitating the diversification of the UK economy in sectors other than financial services and construction as well as helping to support access to capital for SMEs. Therefore the Isle of Man is proving to be a strategic partner in helping SMEs entering new sectors of the economy as well as accessing finance, recognised as among the main challenges to achieving growth.⁶⁹

Strengthening the relationship with emerging markets and attracting FDIs

Of the 40 companies registered in the Isle of Man, 15 originate from India, China and Brazil (10, 4 and 1 respectively). This is a fair representation of the current relationship between the Isle of Man and the high growth economies examined in 6.1.3.

Figure 11 – Sources of investment for top AIM listed companies



Source: London Stock Exchange

Note: Other includes Central America, Middle East, USA & Bahamas, South Africa, East Africa, West Africa, Brazil, Hong Kong, Australia, South East Asia, Turkey

There is scope for further investment from China and Brazil as their relationship with the UK and Isle of Man develops and the Isle of Man is well positioned to accommodate this. In particular, the Indian companies have been one of the key beneficiaries of the Island's AIM infrastructure, with a total of £1.6 billion raised for India-

⁶⁹ "Growth challenges for Small and Medium sized Enterprises : A UK-US Comparative Study" HM Treasury and BERR (2008)

based companies since 2006. With Indian and Chinese companies featuring heavily, AIM is swiftly becoming a hotbed for rapidly growing companies from emerging markets.⁷⁰

In addition to facilitating business from China and India, 50%⁷¹ of the companies from within mainland Europe that are involved in Real Estate investment use Isle of Man's infrastructure to assist with the management/running of their business. The relationship between the IBCs above and Russia and Kazakhstan is still in its infancy, but as Russia spreads its investment influence over the coming years, IBCs are prepared to cope with demands from the region.

There are 13 companies listed on the London Stock Exchange (LSE) that are incorporated in the Isle of Man. The Isle of Man has the second highest market capital per capita of listed companies of all countries listed on the LSE. The Isle of Man companies are concentrated in the energy sector, and the top 4 companies contribute 83% of total market capital. This is less complementary to the UK's strategy, but viewed alongside the encouraging AIM position, this creates a positive outlook arising from the Isle of Man's position as a location for investors listing in the City of London.

Conclusion

Most of the growth is expected to occur in the emerging markets in the coming years, as this is where the majority of the capital available for investment is located. The Isle of Man is already an important conduit of capital from emerging markets and can prove to be a strategic partner in strengthening the relationship with emerging markets and attracting FDIs. Many of the Isle of Man listed companies are from emerging economies such as India and China, bringing investment to the region which might have been diverted elsewhere without the Isle of Man's involvement.

⁷⁰ www.aim.co.im

⁷¹ www.aim.co.im

Appendix A The economic growth pattern of the Isle of Man

The economic growth pattern of the Isle of Man

In many respects, the growth and development of the Isle of Man is similar to that in other major economies that have used a key sector of the economy such as finance or natural resources to diversify and grow. The majority of current mature economies have been through various phases of development whereby a key sector of the economy with a clear competitive advantage tended to be pivotal to their growth strategy. Sectors that were key to countries' growth traditionally have characteristics like low manufacturing costs, high value added or highly skilled people, natural resources and financial services.

The size of the economy and historical economic factors have often provided countries with a particular form of competitive advantage and therefore their growth has been normally driven by one specific industry at first. For example, rapid growth economies have focused mostly in their initial stage of development on low production costs and the ability to easily access an expanding market. China and Far East Asia (eg. Indonesia and Vietnam) are clear examples whereby the initial focus was on low cost manufacturing. India, on the other hand, benefited from both low production costs and the ability to develop labour with advanced skills in computing and engineering, as well as their strength in and use of the English language. This proved to be an important competitive advantage in receiving major outsourcing activities from companies located in mature economies.

In both of these examples, the scale of their economies and the size of their population or markets have proved to be important factors in channelling resources and entering the global economy in terms of both trade and financial flows. However, smaller economies often struggle to access global trade flows or the outsourcing of major production activity because they are constrained by either their physical capacity or the size of their local market (demand). The alternative has been to leverage those financial flows to develop high value added skills which in turn would then slowly develop and diversify their economies in a more balanced manner. The Channel Islands, Andorra, Liechtenstein, the British Virgin Islands all had similar growth stories when they first entered the international markets and were attempting to compete globally.

A growing literature about small island economies discuss the growth patterns followed and the path dependency related to the initial growth sector, and the proximity to major financial centres such as London and New York.⁷² Path dependency is a situation whereby the early choices, such as, which sectors to focus on, or how to attract investment tend to bias future development opportunities. This is likely to lead to an "economic cul-de-sac" whereby only one sector of the economy tends to grow to the detriment of other forms of investment in other sectors because of established business relationships or misconceptions with regard to economic potential.

Some countries prove to be more successful than others in diversifying their economy, and the Isle of Man is a clear example of such a growth story. In particular, the Isle of Man is quite unique compared to other major financial centres because it has managed to diversify and balance its economy in many different sectors which are more aligned with the recent global growth trends in areas such as high tech and e-business. This diversification has reduced the Isle of Man's exposure to a single sector, and therefore the Isle of Man has proved to be better placed to cushion sector specific negative shocks such as the recent financial crisis.

Therefore, the Isle of Man has followed a growth pattern that is very different from other small islands hosting major financial centres. In particular, it can be argued that criticism from some commentators⁷³ that small islands that host offshore financial centres are unable to diversify their economy because of the dependence on earning potentials from the financial sectors and constraints by the need to re-skill and acquire a new knowledge base do not apply to the Isle of Man. The Isle of Man has, on the contrary, managed to successfully leverage the benefits generated by high skill bases and entrepreneurial spirit to develop a diversified and balanced economy.

⁷² "Reversal of fortune: Geography and institutions in the making of the modern world income distribution" Acemoglu, D., Johnson, S., and Robinsons, J. (2002) *The Quarterly Journal of Economics*, 117(4) 1231 – 1294.

"Evolution in economic geography: Institutions, regional adaptation and political economy" MacKinnon D., Cumbers A., Pike A., and Birch K. Working Paper 12, November, Centre for Public Policy for Regions, University of Glasgow (2007)

⁷³ "Offshore pariahs? Small island economies, tax havens and re-configuration of global finance" Hampton, M.P. and Christensen J. *World Development* (30) 9 1657 – 1673 (2002).

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