

The Cayman conundrum: why is one tiny archipelago the largest financial centre in Latin America and the Caribbean?



Analysing how millions of multinational corporations structure their global ownership chains reveals that Cayman acts as a 'sink' offshore financial centre where foreign capital accumulates and data trails often end, writes [Jan Fichtner](#) (University of Amsterdam).

Try to guess what the top destination of outward foreign direct investment (FDI) from Brazil is! Could it be the United States as the largest economy in the world, neighbouring Argentina, or maybe fellow BRIC country China?

All wrong! It's the Cayman Islands, a tiny group of islands in the Caribbean just south of Cuba. In 2015, the stock of FDI from Brazil into the Cayman Islands [amounted to](#) a staggering US\$52 billion (with US\$2.5 billion going in the opposite direction). This represents over one third of total outward FDI from Brazil. What's more, investors domiciled in the Cayman Islands hold portfolio investment in Brazil worth over US\$26 billion (with US\$2.6 billion in the opposite direction).



There is increasing scrutiny of what's going on beneath the surface in the Cayman Islands ([Ocean Frontiers](#), [CC BY-NC-ND 2.0](#))

Even if work by the [FickleFormulas project](#) is showing how problematic and imprecise macroeconomic indicators such as FDI are, these are astonishing numbers: the Cayman Islands has a population of only 60,000 and a domestic economy of just US\$3 billion. Moreover, Brazil is not the only country in Latin America which has strong bilateral investment ties to Cayman. Chile, for example, has FDI into the Cayman Islands of US\$7.5 billion while Cayman holds US\$1.5 billion of FDI into Chile.

But Cayman is not only a large financial centre for countries in Latin America. Rather, the jurisdiction arguably acts as a central node of contemporary global finance. The combined value of banking activity from abroad, foreign portfolio investment, and foreign direct investment is over US\$4,000 billion. That is, this tiny Caribbean archipelago has attracted more foreign assets than various advanced industrial countries such as Japan, Canada, or Italy, even though they have economies generating several hundred times Cayman's gross domestic product. How can we explain that such a miniscule jurisdiction, far removed from the centres of global trade and finance, is in fact the largest international financial centre of all Latin America and the Caribbean?

As I have argued in a recent [research paper](#), the Cayman Islands should be seen as a key node in an [Anglo-American financial triangle](#) that also involves the United States – its major counterpart jurisdiction in banking and investment – and the United Kingdom – its sovereign power.

It should be remembered, contrary to many media reports, that Cayman is not an independent country, but a British overseas territory. Cayman controls domestic matters such as taxation and regulation, and London takes care of international affairs and defence.

Remarkably, in legal terms it is still correct today to refer to the Cayman Islands and other British dependencies, such as Bermuda or the British Virgin Islands (also large offshore financial centres), as [‘colonies’ of the United Kingdom](#). This status provides Cayman with a level of political and economic stability that competing jurisdictions like Belize or Panama cannot offer. The Cayman Islands also inherited a very business-friendly legal system based on English common law, which is attractive to multinational corporations and investors such as hedge funds. Beyond that, there is a [very strong presence of the Big Four](#) global accounting firms, always eager to help draft Cayman laws and facilitate financial activities.

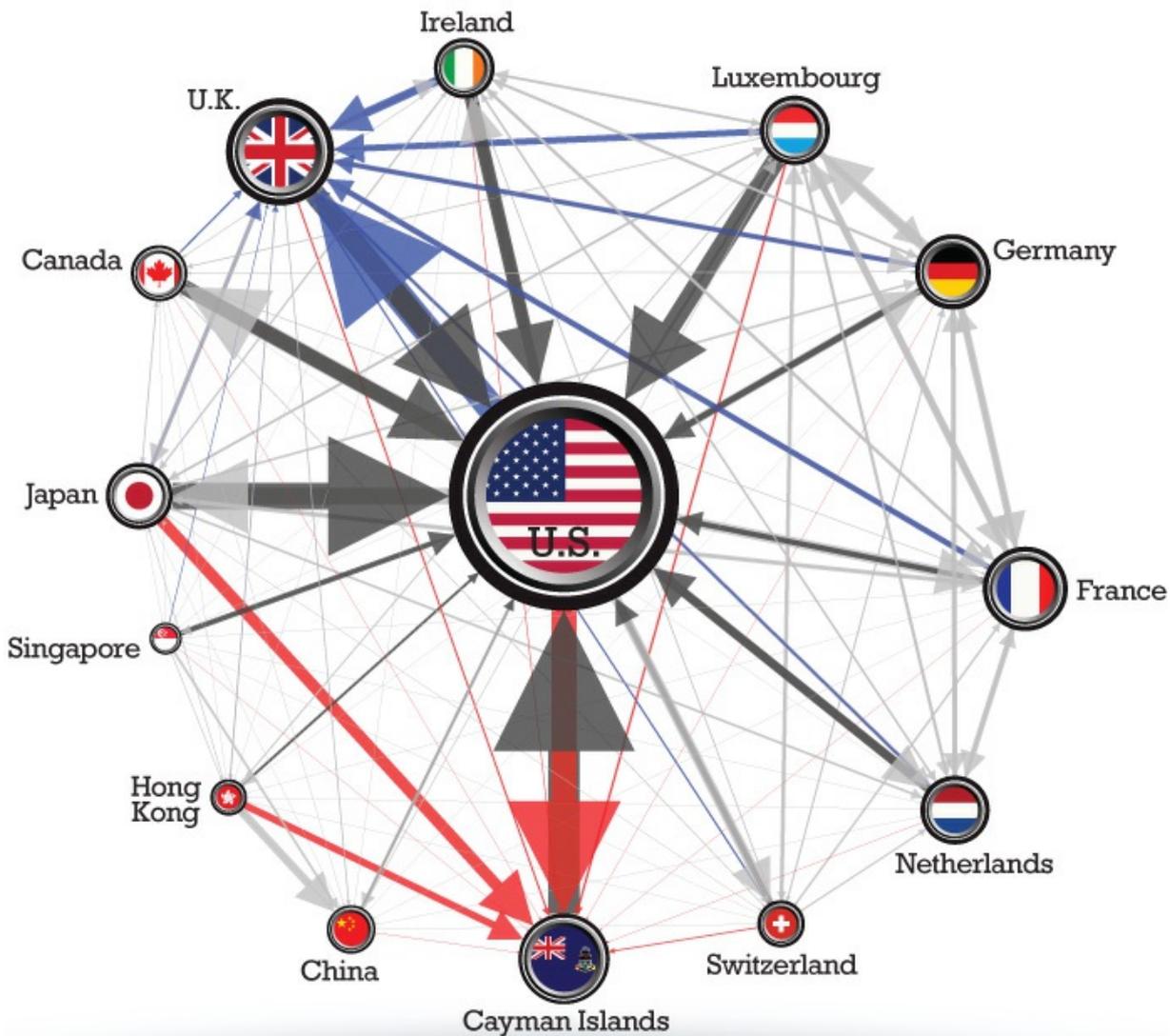
[Hedge funds](#) – lightly regulated ‘alternative’ investors that primarily cater to wealthy individuals and large institutions – illustrate the status of the Cayman Islands as an ‘upmarket’ offshore financial centre particularly well.

More than 50 per cent of all global hedge funds are [legally domiciled in the Cayman Islands](#), benefiting from zero taxation and tailored regulation, even if the actual hedge fund managers work almost exclusively in New York and London (or [NY-LON](#)). This makes hedge funds a quintessentially [Anglo-American financial industry](#). Since hedge funds almost exclusively buy financial securities for short-term trading, most of their activities show up in statistics on portfolio investment.

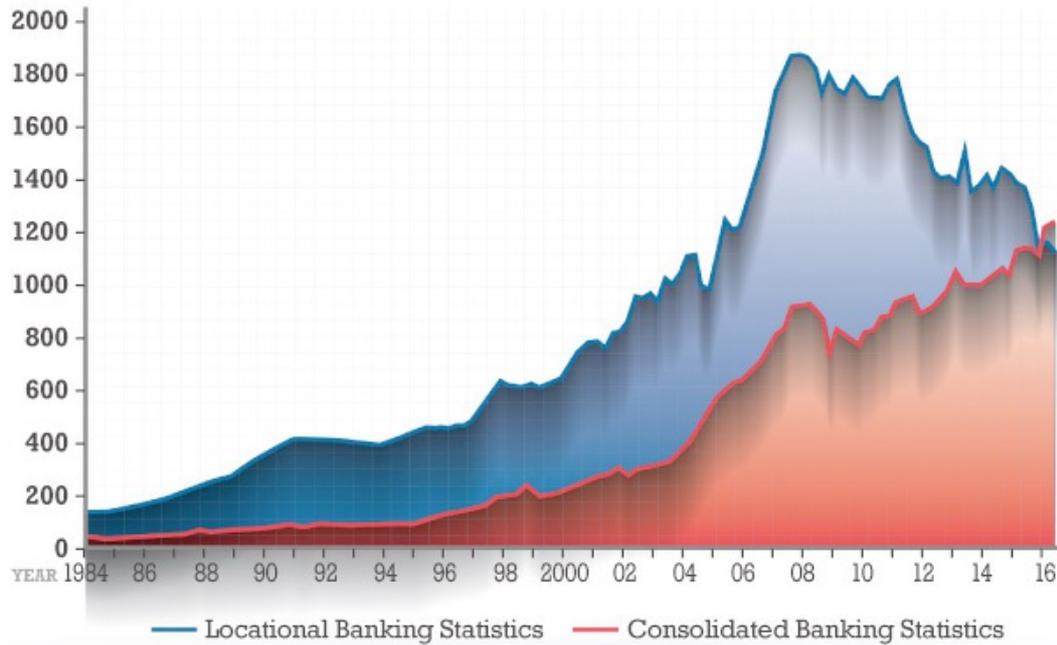
According to data from the IMF, in mid-2016 Cayman was the world’s fifth largest financial centre in terms of foreign [portfolio investment](#), which was worth an astonishing US\$2,640 billion at that point. Thus, Cayman has attracted more portfolio investment than Germany, the Netherlands, and Japan.

Combining data from the IMF and the US Treasury has allowed me to visualise the role of the Cayman Islands in international portfolio investment.

Figure 1 (below) shows that Cayman primarily acts as a kind of conduit to US financial markets for investors from Japan and Hong Kong. American investors have invested massively in hedge funds, which are legally domiciled in Cayman. In turn, these hedge funds have mainly bought US securities, closing the financial loop between the US and the Cayman Islands. This unique financial loop explains why Cayman is the largest holder of US securities in the world (excluding US long-term debt, of which the Japanese and Chinese central banks hold more than US\$1,000 billion each).



Another huge segment for the Cayman offshore financial centre is banking. Here, both Japan and the US act as the dominant counterpart countries. American and other foreign banks use the Cayman Islands for intra-group transactions in US dollars. However, according to the [Locational Banking Statistics](#) of the Bank for International Settlements (BIS), intra-group transactions by foreign banks peaked in 2011 and have been declining ever since (see Figure 2, below).



The [Consolidated Banking Statistics](#) of the BIS provide another perspective on the Cayman Islands banking centre. They show claims by foreign banks on counterparties resident in Cayman (e.g. hedge funds). In 2016, foreign banks had consolidated claims on Cayman counterparties of over US\$1,200 billion – a new all-time high. Quite surprisingly, Japanese banks account for over 40 percent of that large number, which is the highest share of all countries, while American banks are responsible for about 30 percent.

But is the role of the Cayman Islands as one of the largest offshore financial centres relevant to people outside of high finance?

In a recent [research paper](#), the [CORPNET project](#) analysed how millions of multinational corporations structure their global ownership chains. We found that Cayman acts as a ‘sink’ offshore financial centre that attracts and ‘retains’ foreign capital and/or where data trails often end. Large multinational agriculture commodity companies such as Bunge or Cargill that are active in the Amazon basin (e.g. in soy production) use the Cayman Islands in their global corporate ownership chains, thus most likely undermining the sustainability of a key global environmental commons.

The [Offshore Shell Games 2017](#) study recently found that Cayman subsidiaries of the top 500 American multinationals have reported profits of over US\$46 billion – 13 times Cayman’s GDP! In this way, these large corporations save billions of taxes in the United States.

In 2015, the [Tax Justice Network](#) classified Cayman as a secrecy jurisdiction. Hence, even though it has increased regulation in recent years due to international pressure, the Cayman Islands still provides foreign corporations and investors with a considerable degree of secrecy – in addition to zero taxation, of course. Therefore, Cayman continues to facilitate opacity and tax avoidance.

As an ‘upmarket’ offshore financial centre, Cayman is reacting to international pressure in order to avoid reputational damage. London, as Cayman’s sovereign power, could arguably force the jurisdiction to become much more transparent – if the political will existed.

But there lies the real Cayman conundrum: why do short-term financial interests in Britain still dominate over long-term concerns for society and the environment?

Notes:

- *The views expressed here are of the authors and do not reflect the position of the Centre or of the LSE*
 - *This post draws on the co-authored article "[Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network](#)" (Nature, 2017)*
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