

Offshore Financial Centres: Parasites or Symbionts?

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Andrew K. Rose, Mark M. Spiegel

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Abstract

This article analyses the causes and consequences of offshore financial centres (OFCs). While OFCs are likely to encourage bad behaviour in source countries, they may also have unintended positive consequences, such as providing competition for the domestic banking sector. We derive and simulate a model of a home country monopoly bank facing a representative competitive OFC which offers tax advantages attained by moving assets offshore at a cost that is increasing in distance to the OFC. Our model predicts that proximity to an OFC is likely to be pro-competitive. We test and confirm the predictions empirically. OFC proximity is associated with a more competitive domestic banking system and greater overall financial depth.

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