Instituto Superior de Economia e Gestão
UNIVERSIDADE TÉCNICA DE LISBOA
DESDE 1911

MASTER IN
INTERNATIONAL ECONOMICS AND EUROPEAN STUDIES

FINAL MASTER'S PROJECT
DISSERTATION

JURISDICTION AND ECONOMIC COMPETITIVENESS IN A EUROPEAN OUTERMOST REGION: THE CASE OF THE AUTONOMOUS REGION OF MADEIRA.

MIGUEL SILVA PINTO CORREIA

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SUPERVISION:

JOAQUIM RAMOS SILVA, PHD, COORDINATOR OF THE MASTERS IN INTERNATIONAL ECONOMICS AND EUROPEAN STUDIES

GODFREY BALDACCHINO, PHD, CANADA RESEARCH CHAIR IN ISLAND STUDIES, UNIVERSITY OF PRINCE EDWARD ISLAND

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"All islands, even known ones, are unknown until we set foot on them."

José Saramago, The Tale of the Unknown Island, 1997.

Abstract

Title: Jurisdiction and Economic Competitiveness in a European Outermost Region: the case of the Autonomous Region of Madeira.

Madeira, which is an Autonomous Region of Portugal and an Outermost Region of the EU, is currently facing problems regarding the sustainability of the Regional Government's finances. The Government of the Republic was asked to provide assistance in exchange for the implementation of an austerity plan.
Madeira's International Business Center, encompassed by the International Business Center and the Industrial Free Trade Zone created in the 80s, is considered by the Regional Government as a powerful mechanism to increase economic growth, attract FDI and generate fiscal revenue in a period where the "contraction of the [Portuguese] economic activity is unprecedented".
As the power of regional authorities are limited by para-constitutional law, full fiscal autonomy from the mainland is non-existent, therefore cannot be used as a jurisdictional tool to promote development.
What is its impact on the RAM's budget, as the fiscal regime can be improved to decrease budget dependence from the Portuguese central government while maintaining the current supply of public goods and services by the Regional Government?
Being an explanatory and argumentative thesis, it aims to come up with a policy proposal regarding what can be done to improve the archipelago's economy through the Center; methodologically consisting of literature review, economic data and reports produced by regional, national and European authorities along with interviews to those directly involved with the Center.

Author: Miguel Silva Pinto Correia

Keywords: *Small Island Economy; Offshore Financial Center; State Aid; Regional Development; Island Studies; Outermost Regions.*

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Dedication

For my great-great-grandfather: the Very Reverend Francisco Salvado Leal, Roman-Catholic Prior and Parish Priest of Alcaide[1]. May his courage, love for his children and grandchildren as well as his loyalty to his parishioners, never be forgotten.

In loving memory of my grandparents, Mrs. Elvira de Freitas Rodrigues Pinto Correia and Mr. Jorge Sérgio Pinto Correia.

For my always supporting family.

[1] Village in the city of Fundão, Castelo Branco District, Portugal.

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This thesis would not be possible if it was not for the guidance, encouragement, and support from my two supervisors: Professor Joaquim Ramos Silva and Professor Godfrey Baldacchino. I also want to thank Professor Baldacchino for the opportunity of presenting this thesis as a paper at the 12th Islands of the World Conference in Tortola, British Virgin Islands.

To the Regional Government of Madeira and to *Sociedade de Desenvolvimento da Madeira* (MDS) for their support and guidance in pointing out documents and data, fundamental to the conclusions reached in this thesis, that otherwise would not be possible to be obtained. As for the Regional Government of Madeira, I am grateful to Mr. António Lurdes Valério Luís da Purificação e Souza[2], to Mr. João Machado[3], and to Mrs. Sílvia Maria Silva Freitas[4]. In MDS I am grateful to Mr. Francisco Costa[5], Mrs. Cláudia Câmara Vasconcelos[6], Mr. Filipe Manso Teixeira[7] and Mrs. Marina Pimenta[8].

Thank you to all my friends. A special thanks to Margarida Freitas, thanks to her I was able to take some economic statistics into consideration and learn with her. I want to thank Ana Maria Moniz and Ricardo Fernandes for their support in this project. I'm also grateful to Joana Homem da Costa for her always cheerful mood; and to Rubina Berardo for bringing my attention to KPMG studies regarding Madeira and to the Solbes Report on the EU's Internal Market and the Outermost Regions. I would also like to thank Graça Sardinha, Ana Paula Sardinha and Filipa Spínola Fernandes. A special thanks to Ana Paula Freitas Mendes, for the precious proofread. Thank you to Lín XiāoXiāo for being there, despite the distance.

Last but not least I want to thank to my parents, Jorge and Isabel for their patience, unconditional support and belief in my capability and the importance of this project; to my brother Martim for reminding me to relax when I was most stressed; to my grandparents Lourdes and Fernando, to my great-aunt Adriana and my cousins for always supporting me.

[2] Regional Inspector-General of Finances.
[3] Director of the Regional Bureau of Tax Affairs
[4] Chief of Staff of the Regional Secretary of Planning and Finance.
[5] Chairman and CEO of MDS.
[6] Executive Senior Manager in the Marketing Department at MDS.
[7] Executive Senior Manager of the Industrial Free Trade Zone.
[8] Tax Lawyer and Marketing Assistant at MDS.

Glossary of terms and abbreviations

ALRAM – *Assembleia Legislativa da Região Autonóma da Madeira* (Legislative Assembly of the Autonomous Region of Madeira)

CJEU – Court of Justice of the European Union

CTR – Corporate Tax Rate

EC – European Commission

EU – European Union

GVA – Gross Value Added

IFTZ – *Zona Franca da Madeira* (Industrial Free Trade Zone)

MAR – International Shipping Register of Madeira

MDS – *Sociedade de Desenvolvimento da Madeira* (Madeira's Development Society)

MFPA – *Ministério das Finanças e da Administração Pública* (Ministry of Finance and Public Administration)

MIBC – Madeira's International Business Center

OFC – Offshore Financial Center

OMR – Outermost Region of the European Union

PASRAM – Political-Administrative Statute of the Autonomous Region of Madeira

RAA – *Região Autónoma dos Açores* (Autonomous Region of the Azores)

RAM – *Região Autónoma da Madeira* (Autonomous Region of Madeira)

RDPF – *Secretaria Regional do Plano e Finanças* (Regional Government's Department of Planning and Finance)

SIE – Small Island Economy

SNIJ – Subnational Island Jurisdiction

VAT – Value-added tax

I. Introduction

The problem and its importance

The Autonomous Region of Madeira (RAM), a Non-Sovereign Island Jurisdiction of the Portuguese Republic and Outermost Region of the European Union, faces today one of its most difficult period in its history regarding the sustainability of the Regional Government's finances.

Due to the financial liquidity problems and unbalanced finances the Regional Government has asked the Government of the Portuguese Republic for assistance in exchange for an austerity plan to be implemented in the RAM, similar in solutions to the ones that Portugal has agreed to with the European Commission (EC), the European Central Bank and the International Monetary Fund on 2011.

The backbone of the Madeiran economy, tourism and construction (Hager & Levin, 2002), is not capable of generating enough revenue[9] for the Regional Government and its International Business Center (MIBC) and the industrial free trade zone (IFTZ) has lost many companies to their international competitors as a result of their fiscal regime change[10].

Being a non-sovereign, or sub-national, island jurisdiction (SNIJ) the regional authorities' powers are limited by para-constitutional law known as Political-Administrative Statute of the Autonomous Region of Madeira (PASRAM) similar to that of Canarias Autonomous Community. This implies that full fiscal autonomy (capability of creating an independent fiscal system) from the mainland is non-inexistent and cannot be used as jurisdictional tool to promote development.

Taking the economic recession forecast by *Banco de Portugal*[11] into account, the MIBC and IFTZ are considered by the Regional Government as a powerful mechanism to diversify small island economy, and the national economy as whole (Garcês, 2012), promoting qualified employment, increasing economic growth, attracting foreign direct investment and generating fiscal revenue (Jardim, 2012) in a period where the "contraction of the economic activity is unprecedented" (Banco de Portugal, 2012).

Subsequently, one asks the following questions: "What is the importance of this special fiscal jurisdiction for the economic development of the RAM?" How do the MIBC and IFTZ contribute to the island economy, what is their impact on the RAM

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[9] All revenue generated in the RAM goes to the Regional Government (Pereira, Arcanjo, Afonso, & Santos, 2009). The construction sector is now in decline due to the fact that all major infrastructures are now completed and those planned to be constructed are stopped due to fiscal austerity.

[10] The current regime already predicted the change in fiscal incentives, however it was laid down through negotiations between the Government of the Republic and the European Commission, as it is considered State Aid, and can only be changed through re-negotiations.

[11] Portuguese central bank.

budget, who are their direct European competitors and how the fiscal regime can be improved to decrease budget dependence from the Portuguese central government and EU funds while maintaining the current supply of public goods and services by the Regional Government? What do other small European jurisdictions - such as the British Crown Dependencies, Malta, Cyprus, Luxembourg and the Netherlands[12] do that the RAM could use to promote economic growth and public finances sustainability? Can resourcefulness of jurisdiction unlock economic potential and resilience?

Methodologically, the investigation consists of a literature review from diversified sources regarding small island economies (SIEs), their economic development strategies and paradigms, statistical and economic data as well as economic reports produced by regional, national and European authorities, along with open interviews with those directly involved with MIBC and IFTZ[13].

It is important, however, to warn that this thesis is more of a case study and therefore a combination of explanatory and argumentative thesis rather than an analytical one, since I intend explain the reasons for the existence of such a fiscal regime and assess its economic importance as well as a policy proposal regarding what can be done to improve the island's economy.

The thesis will be divided into two parts. The first part is mainly theoretical: aiming to evaluate through the literature review the costs and benefits of "islandness" and remoteness and its impacts on the island's economic development; I also plan to present the main differences between the two concepts of island economic development, the MIRAB and PROFIT model/paradigms and their ramification when the tourism sector is included. The second part will focus on the case of the RAM and the state aid fiscal regime[14] in its present form, its importance to the economy, and what can be done to improve it in order to complement the tourism sector and boost the regional economy.

II. Brief Historical and Economical Context

From Political Autonomy to the present

The Archipelago of Madeira was granted Political Autonomy, shortly after the Carnation Revolution, by the Assembly of the Republic of Portugal[15] through

[12] Despite the fact that some of these jurisdictions are not SIEs, they will be analyzed since they directly compete (Vasconcelos & Oliveira, Madeira International Business Center, 2012), in fiscal terms, with MIBC (Vasconcelos, Jesus, Gouveia, & Silva, 2005).

[13] Interviewees include: MDS's President, MDS's Director of Marketing, Fiscal lawyers and companies operating in MIBC/IFTZ.

[14] MIBC and IFTZ.

[15] In that time it was the Constituent Assembly. The Archipelago of Azores was also granted political Autonomy in the same year.

unanimity and acclamation in 1976, being provisional until 1990, the year it became definitive.

The PASRAM turns the Archipelago of Madeira into an Autonomous Region of the Portuguese Republic, a territorial legal entity under public law with its own governmental organs: the Regional Government of Madeira[16/i] and the Legislative Assembly of the Autonomous Region of Madeira[17]. Political, administrative, financial, fiscal[18] and economic autonomy is exercised in accordance and within the limits set forth by the PASRAM. There's no Regional Judicial System, however the Ministry of Justice has transferred administrative competences to the legal register and notaries.

Apart from the limitations set by the PASRAM, the RAM has the possibility to legislate on areas in which the regional interest arises, and that are not under the Sovereign Organs' own competence[19]; develop, in accordance with regional interest, Basic Laws and adapt national legislation and general laws except if the power is reserved to the Sovereign Organs.

Since the first election for the Legislative Assembly of the Autonomous Region of Madeira (ALRAM) in 1976, the islands have enjoyed political stability through absolute majorities of the Social Democratic Party of Madeira[20]. From this date on, the RAM has also enjoyed great social stability with no major strikes and or labor-management conflicts.

From the first days of its Political Autonomy, the RAM has seen, until very recently, an economic boom[ii], actively promoted by the Regional Government through the use of European funds and transfers from the Government of the Republic. These proceeds allowed the Regional Government to compensate for the privation of social and economic development in all civil parishes of the Region by equipping them with electricity[21] and sewerage system, and equipping all municipalities[22] with health centers, secondary schools and sports venues (Nepomuceno, 2006).

The Regional Government, along with ALRAM, created a set of policies that promoted the growth of tertiary sector activities (mainly tourism[23] and the

[16] The Regional Government's Cabinet is composed of a President, a Vice-President and the Regional Secretaries, each of them heading a Regional Government's Department. Regional Government's Departments are then subdivided into Regional Bureaus headed by a Director appointed by the Secretary of the corresponding Department (please see Annex I).
[17] The ALRAM is composed by 47 members.
[18] This is limited to legally regulated adaption of the national fiscal system, in accordance with the law defined by the national authorities.
[19] The ALRAM has to ask authorization of the Portuguese Assembly of the Republic in order to do so.
[20] Member of the European People's Party and the Centrist Democratic International.
[21] A total of 54.
[22] A total of 11.
[23] The tourism on the Archipelago of Madeira started early in the 19th century, when Funchal began to be a compulsory port of call for the Royal Navy that was on its way for the West Indies, and then when the European royalty and aristocracy began to visit Madeira for therapeutic reasons. Royal

IFTZ/MIBC) and a great effort[24] has been made to build divided highways to connect all municipalities in order to reduce distances[25] as well as transport costs and promote internal trade, thus increasing the regional internal market size (Behrens & Gaigné, 2006), although without much diversification.

The economic performance of the RAM shows a sustained growth of its GDP, employment and standards of living (Augusto Mateus & Associados, Sociedade de Consultores Lda., 2009), thanks to the timing of political options taken by the regional authorities in tapping into European funds and transfers from the central government.

However, the Keynesian economic policies followed by the regional authorities have, nevertheless, led to strains[26/iii] in the regional public finances of the RAM which are complemented by central government transfers and EU funds. In 2007 only 0.23% of the Portuguese State Budget was transferred to Regional Budget and in 2010 only 26.06% of the revenues of Regional Budget were transferences from the State Budget and EU funds (Secretaria Regional do Plano e Finanças, 2010). It is important to say that these policies were not counter cyclical. As a result, regional public debt has soared in the last few years.. Problems with financial liquidity arose in 2011 and this situation has led the Regional Government to ask the Government of the Republic for a loan, as previously mentioned.

III. Economic Sustainability of the RAM: Madeira as part of Portugal and the European Union

Structural Constraints to the Economic Development vs. the Benefits of Being an Island

In 2009 the Treaty of Lisbon[27] made specific provisions for several overseas territories of its Member States that were known by the EU as Outermost Regions (OMRs), the Portuguese RAM and RAA being OMRs were covered by these provisions:

"Taking account of the structural social and economic situation of Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy, Saint-Martin, the Azores, Madeira and the Canary Islands,

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and aristocratic visits include: H.M. Queen Adelaide of the United Kingdom, H.I.M Empress Elizabeth of Austria, H.I.M. Empress Carlota of Mexico, H.I.M. Empress Amélia of Brazil, H.H. Princess Maria Amélia of Brazil, H.F.M. King Luís I of Portugal, H.I.M Emperor Charles I of Austria, H.I.M. Empress Zita of Austria, all of them marketing Madeira, by word of mouth, in their courts.

[24] Using EU funds.

[25] For example: in 1966 the travelling time (by car) between the São Vicente, in the north of the island of Madeira, and Funchal, the capital, was 8 hours for a distance of 32.4 km. Today the same distance is done in 34 minutes.

[26] These strains are represented by an increase of dependency, in terms of budget, mainly from the central government.

[27] The Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community.

which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which severely restrain their development, the Council[28]l, on a proposal from the Commission and after consulting the European Parliament, shall adopt specific measures aimed, in particular, at laying down the conditions of application of the Treaties to those regions, including common policies. Where the specific measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act on a proposal from the Commission and after consulting the European Parliament.

The measures referred to in the first paragraph concern particular areas such as customs and trade policies, fiscal policy, free zones, agriculture and fisheries policies, conditions for supply of raw materials and essential consumer goods, State aids and conditions of access to structural funds and to horizontal Union programs."

In other words (Observatory of the European Islands, 2002):

"The ultra-periphery is characterized by two specific features – size and isolation. The outermost regions do not have access to the main European centers on which they rely at political, economic and historical level, nor are they linked to the major world centers. (…) Their small size makes them totally dependent on external resources, markets and services, and their absolute remoteness increases significantly their overall costs, condemning them to extreme isolation."

These specific provisions regarding the above mentioned territories are in line with the Development Committee of the WBG and the IMF recognition, in 1982, of the inherent problems that small islands and landlocked states[29] face in terms of economic development (Srinivasan, 1986).

Remoteness[30/iv], or insularity, creates "locational disadvantages that end up being reflected[31] in the significant additional production costs"[32] that when combined with small economic size prevents achievement of economies of scale (Behrens & Gaigné, 2006) due to "indivisibilities and limited scope for specialization" (Briguglio, 1995).

SIEs are synonymous with small domestic markets, these are predisposed to "lack of competition in traded commodities" (Tisdell, 2009) since "small size does not support a large number of firms producing similar products" (Briguglio, 1995);

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[28] By Council Decision 91/315/CEE, the EU recognizes that free zones can be an appreciable instrument of economic development in the remote island regions of the Azores and Madeira.

[29] Exception is made to the French Overseas Territory of the French Guiana. However one can argue that the French Guiana is "landlocked" by the Amazon Forest.

[30] OMRs are cases of extreme remoteness. Notice that in 2012 only the Canary Islands have a regular and continuous passenger shipping links. All the other OMRs are dependent on air links.

[31] Higher transportation costs.

[32] Relatively higher per-unit transportation costs allied to reduced mobility of goods and people (land transportation is not available) and exclusion from main major sea and air transport routes. (Briguglio, 1995). Other reasons for higher productions costs include: "size of the regional territory, high costs of agricultural land under competition from tourism, shortage of available manpower for the primary and secondary sectors and the lack of capital available for productive investments (in light of the possible gains in the real estate or commercial sectors)" (Observatory of the European Islands, 2002).

dependence on export markets and limited ability to influence domestic prices[33] are also characteristic of SIEs. This dependence on export markets is an evidence of absence of a local hinterland[34] (Baldacchino, Managing the hinterland beyond: Two ideal-type strategies of economic development for small islands territories, 2006). Transportation costs are higher due to remoteness along with distribution costs (Observatory of the European Islands, 2002):

- Due to the fact that islands are end destination markets, suppliers tend to dispatch only quantities that they know they are sure to sell; this creates pressure on prices and creates preventive purchase of goods.

- Greater storage needs than the mainland, because of its economic dependence from the mainland and because of the necessity to assure that needs of domestic consumption in a situation of bad weather, strikes, (etc…) are met.

- Small size of the companies that are responsible for the distribution of goods leads to the increase in the costs of production.

Such costs[35] have a similar economic effect on welfare as a tariff; this means that the real income of a SIE will be lower than that of an otherwise identical economy (Srinivasan, 1986). Extreme remoteness verified with OMRs means that transportation costs to these regions are higher and aggravated by the fact that "choices of means of transportation, or transport companies, are even [more] limited in these regions"[36] (Observatory of the European Islands, 2002).

The small market size of SIEs and that of its companies make it difficult to provide diversity and different levels of remuneration that qualified workers aspire as well job promotions, therefore making it difficult to attract a highly qualified and young workforce. Also their size makes it costly for them to internationalize their operations and attract a skilled labor force, while their location generates higher production costs as mentioned above. Taking into account all of these factors local companies face great competition in the local market against national or foreign producers that benefit from economies of scale due to the fact that they are operating in the mainland.

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[33] "Tend to be price-takers to a much higher degree due to the relatively small volume of trade in relation to the world markets in products they import and export." (Briguglio, 1995)

[34] Situation (lack of natural resources and natural harbors) recognized by the United Nations Organization.

[35] These costs are also impossible to be avoided, meaning that when facing an economic transaction with the OMRs these costs are always present and cannot be removed (Gil, 2008).

[36] "…owing to the lack of "cheap" alternatives, and, in some of these regions, it is equivalent of almost one month's salary" (Observatory of the European Islands, 2002). This is verified in the RAM, despite that fact that the air route has been liberalized, and the existence of low cost companied operating flights between Madeira and Lisbon. Maritime transportation is not subsidized. (Martins, Ludlow, & Ferrer, 2000)

Access to capital for these economies is also difficult. Because companies on an island are smaller than their mainland peers, they are also more prone to suffer from economic recessions.

In addition, SIEs usually depend on few products[37] and services[38], consequently "a crisis in the dominating activity as a great impact on unemployment and can easily create a social crisis and promote strong emigration fluxes" (Observatory of the European Islands, 2002).

All of these structural constraints are also reflected on "the per-capita cost of public services and goods" (Observatory of the European Islands, 2002) and higher predominance of the public sector on SIEs.

Therefore it is easy to recognize why economic performance and sustainability of small islands, is highly exposed to economic forces over which they have partial control (Tisdell, 2009)

Bearing in mind all of the listed above, the World Bank and the IMF recognized that "mechanisms and adjustments prescriptions" must take into account the permanent constrictions that these regions face (Srinivasan, 1986). The acknowledgment of such structural constraints that can never be separated, only mitigated or compensated, from these regions (Augusto Mateus & Associados, Sociedade de Consultores Lda., 2009). There is a clear sign that "normal" strategies and theories of development are not enough or have little relevance for SIEs as a way to promote a sustainable social and economic development (Prasad, 2003).

SIEs' capacity to be flexible, adapt strategies to their needs and come up with other development possibilities depends on whether they are given or have the possibility to become autonomous policy-making units[39] (Baldacchino, Bursting the Bubble: The Pseudo-Development Strategies of Microstates, 1993). What can be available to a SIE?

Economic development opportunities can be summed up in the following list (Baldacchino, Managing the hinterland beyond: Two ideal-type strategies of economic development for small islands territories, 2006):

- Strategic location
- Investment potential
- Fishing rights

[37] In the RAM's case: bananas, sugar cane, flowers, wine and embroidery.

[38] In the RAM's case: tourism, IBC-M and IFTZ.

[39] The resourcefulness of jurisdiction is powerful economic resource a SIE (Baldacchino, Islands enclaves: offshoring strategies, creative governance, and subnational island jurisdictions, 2010) to overcome "fragile growth prospects of the successful sectors [in the case of the RAM, tourism and construction] and the virtual absence of any alternative economic activity" (Hager & Levin, 2002).

- Tax differentials
- Tourism products

However, the mentioned economic constraints should not be an excuse to SIEs to be fully dependent on the support of mainland[40] patron, either national or supranational, unless they're not given autonomous policy-making, jurisdictional and legislative powers. A highly developed form of self-government (or *in extremis*, sovereignty) is a key asset to rapidly adapt to changes affecting the external markets, allowing SIE to react in time to challenges and regain competitiveness (Vasconcelos, Jesus, Gouveia, & Silva, 2005). This means "using local rules to tap non-local resources" (Baldacchino, Islands enclaves: offshoring strategies, creative governance, and subnational island jurisdictions, 2010)leading to an "endogenously created resilience as a response to the exogenously imposed vulnerability" (Baldacchino & Bertram, The Beak of Finch: Insight into the Economic Development of Small Islands Economies, 2009).

"Capacity to adapt laws and regulations to suit the requirements of the micro-insular economy, even if these laws and regulations differ from those of the metropolis in which the smaller territory finds itself politically incorporated" is of great importance since it compensates the effects associated to remoteness and the lack of conventional economic assets. Such practices are in accordance with the Principle of Subsidiarity[41] present in the Lisbon Treaty and verified through many states, either federal or unitary[42].

The existence of such mechanisms allows greater economic openness and hyper-specialization of the economy, allowing external resources to be drawn in therefore sustaining a higher *per capita* income and foreign exchange to sustain the economy (Bertram & Poirine, 2007)

Mainland patrons must question whether they want to continuously "subsidize" and induce these economies into perpetual economic dependence, instead of giving them jurisdictional mechanisms so they can develop of economic self-resilience.

[40] It can also be large economy neighbors.

[41] Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level. In other words "…Will we never heed the principle of subsidiarity (in which our fathers were bred), namely that no public agency should do what a private agency can do better, and that no higher-level public agency should attempt to do what a lower-level agency can do better – that to the degree the principle of subsidiarity is violated, first local government, the state government, and then federal government wax in inefficiency…" (Buckley, 2008)

[42] The United Kingdom as a unitary state, has constitutionally and statutorily given a great degree of self-government to its Overseas Territories and Crown Dependencies.

Strategies for Island Economic Development

Before accessing the main strategies for island economic development discussed in literature it is important to bear in mind that sustainability of such economic development cannot be done "without drawing in resources and assets from, while flushing out excesses and undesirables" (Baldacchino, Islands enclaves: offshoring strategies, creative governance, and subnational island jurisdictions, 2010) to the outside. Although this preposition is true to any open economy, economic welfare in islands is even more reliant on these fluxes, so to say, than large mainland economies.

Taking into account the empirical evidence from the Pacific Ocean Islands economies and their behavior towards the inherited constraints to economic development, the Migration, Remittances, Aid and Bureaucracy (MIRAB) model was developed in 1985 and 1986 considering this four variables has source of (in)direct income for SIEs in the Pacific rim (Baldacchino, Innovative Development Strategies for Non-Sovereign Islands Jurisdictions? A Global Review of Economic Policy and Governance Practices, 2006). In the "rent-dependent" MIRAB model we observe that:

- Migration is seen as an alternative to a small labor market with few perspectives of big salaries, promotion and diversified job offers or in extreme cases to avoid poverty. In a nutshell migration is seen as a mechanism that improves personal and family standards of living.

- Remittances from overseas resident migrants once settle are expected to flow into the SIE has a form of "strategic microeconomic family plan", this form of family microeconomic planning ends up affecting the entire SIE since it affects the highly indebted balance of payments (John, 2010).

- Aid requested to the international community in order to cope with major infrastructural projects and public sector salaries (bureaucracy). Aid transferences are often executed in exchange for UN votes[43], cultural assets or military uses (McElroy & Pearce, The advantages of political affiliation: Dependent and independent small-island profiles, 2006).

The MIRAB model should not, however, be considered a model of island economic development, since there is no notion of autonomous economic growth as it shows that these economies "have moved from subsistence to subsidy" (Baldacchino, Managing the hinterland beyond: Two ideal-type strategies of economic development for small islands territories, 2006).

As a counter-response to the MIRAB the People, Resources, Overseas Engagement, Finance and Transportation (PROFIT) model came into existence as an alternative

[43] This is the case of sovereign island states.

to two decades of MIRAB dominant academic literature. The PROFIT model does not substitute the MIRAB model, instead it is argued a SIE can shift from one to other or assume elements common to each individual model. The success of the PROFIT model depends on how the islanders capitalize their jurisdictional capacity and tools to overcome the permanent economic constraints.

The five areas which SIE should have jurisdictional capacity in order to fully pursue the PROFIT model are the following (Baldacchino, Innovative Development Strategies for Non-Sovereign Islands Jurisdictions? A Global Review of Economic Policy and Governance Practices, 2006):

- Powers over Finance: Mainly Banking, Insurance, Taxation and Gaming
- Powers over Environmental Policy, Particularly Natural Resources
- Powers over Access, Particularly in Relation to Air and Sea Transportation
- Power over Free Movement of Persons
- Powers over Tourism

Of all these powers that are behind an effective PROFIT economic strategy, there is a strong reasoning for SIEs to have a differentiated tax and a more liberal, yet highly supervised, regulatory policies. Since the main objective of the PROFIT economic model is to assure the SIE economic self-resilience, the most important thing is to assure that government sector is not a burden to the private sector while it still provides a vast array of public services and goods to an isolated community, while depending minimally on a metropolitan patron. Self-resilience is dependent on tax competitiveness, since economic agents take this factor into account when relocating or investing in another country, such competitiveness is even more important to OMRs (KPMG, 2008).

Tax policy can and should be used as an instrument of economic development. In reality, one of the extra-fiscal objectives of taxation is to promote economic development and not to hamper it (Gil, 2008). Moreover the use of the tax policy as the main driver of economic development is one of the most emphasized, since through tax policy a government can accomplish the three main objectives of economic policy: stabilization, redistribution and efficient allocation of resources (Gil, 2008).

Consequently the use of the tax policy is extremely significant since its primordial aim is to support the existing bureaucracy and at the same time it should be used to foster economic development in two ways: reduction of production costs and attraction of FDI.

Compensation of the production costs can be done in several ways. Firstly it can be done through corporate taxation and therefore reducing the marginal cost of production per unit. This will also increase overall competitiveness of the goods and services produced. Another way to reduce these production costs is through the import duties on raw materials and capital goods, and through the taxes on services and goods that support production. Reduction of taxes in any of these areas also leads to corporate savings (Gil, 2008), this can be important for firms wishing to internationalize their activities but lack access to capital to do it.

In order to attract FDI to a SIE, taxes should be lowered in the transactional services[44] sector and in the industrial[45] sector. Such a system of reduced or inexistent taxes is commonly known as offshores centers and free trade zones. Such finance centers have been successful in many SIEs and even more when "backed up by a large reliable patron state"[46] (Baldacchino, Managing the hinterland beyond: Two ideal-type strategies of economic development for small islands territories, 2006). This is the case[47] of the UK the 1960s/1970s when it supported several colonies to become OFCs in order to decrease the costs that it had with these territories (Hampton M. , The Offshore Interface: Tax Havens in the Global Economy, 1996). In fact such tax systems widen the tax basis, and assure greater fiscal revenue to the government.

Although such fiscal benefits seem to violate the provisions of the European Single Market and European Competition Law it is important to remember that in the case of OMRs, these are territories belonging to the Single Market and without adaption of several European policies it would not be possible to fully incorporate them it (Gil, 2008). Such jurisdictional resourcefulness is needed in the economic field in order to cope with such constraints. EU authorities must also bear in mind that their goal is "to make lagging regions, including the ultra-peripheral [OMRs], largely self-sustaining in the long run, notably as regards large transfers from structural funds" (Hager & Levin, 2002), even if that might involve nontraditional development measures, given their special (remote and insular) conditions.

In the end what is needed for the PROFIT model to work is a "… jurisdictional… capacity", this can be achieved with "Autonomy without Sovereignty" (Baldacchino, Managing the hinterland beyond: Two ideal-type strategies of economic development for small islands territories, 2006). With Autonomy SIEs should be able to have responsibility and power over economic and political decisions while not having the burden associated with the costly mechanisms of a nation-state, such as defense, courts, and diplomacy. In fact jurisdictional capacity to attract FDI

[44] As identified by Baldacchino (2010): banking and financial services, online gaming, insurance, shipping, ship register, trading, holdings, etc…
[45] Attraction of industrial FDI is easier if the SIE is strategically located, is member of trade area, such as the EU, or both.
[46] This is as happened with the Isle of Man, supported by the United Kingdom of Great Britain and Northern Ireland, and the Federal Territory of Labuan, supported by Malaysia.
[47] The Foreign and Commonwealth Office considers that "the people of the Overseas Territories must exercise the greatest possible control over their own lives…" (Cook, 1999).

and assets to SIEs is an effective way for remote insular regions to diversify their economies (Baldacchino & Bertram, The Beak of Finch: Insight into the Economic Development of Small Islands Economies, 2009).

The power over free movement of persons by Non-Sovereign Island Jurisdiction can be a tool used to allure wealthy and qualified immigrants and if combined correctly with a competitive tax policy can diversify and expand the luxury tourism sector. Para-diplomacy if granted, or engaged informally by SIE in the economic and cultural areas reveals to be a powerful complement to the previous two policies.

These models (MIRAB and PROFIT) are methods that focus on insular economic development via the tertiary sector (Baldacchino, Islands enclaves: offshoring strategies, creative governance, and subnational island jurisdictions, 2010), though it is important to say that there will never be fully MIRAB or PROFIT economy[48/v], rather there will some degree to which a SIE will be more MIRAB or more PROFIT oriented.

Additionally tourism can be present in both types of economies, and is seen as an activity that complements/supports these two economic models. Some literature puts forward that SIEs that are able to host tourism have the conditions to host offshore centers[49] since both share prerequisites to develop (Hampton & Christensen, Competing Industries in Islands - A New Tourism Approach, 2007):

- Both economic activities tend to require being in the "pleasure periphery", the same is to say a maximum of 4 hour flight from large countries;
- Existing infrastructure for tourism activities can be used by offshore activities: airport, communications network and even buildings;
- Political stability is another prerequisite, in fact a fundamental one, without this any economic activity that is dependent on the outside will not develop.

Moreover there are SIEs, known as Small Island Tourism Economies (SITE[50]), these rely heavily on tourism since they are the world's most tourism penetrated economies (Baldacchino & Bertram, The Beak of Finch: Insight into the Economic Development of Small Islands Economies, 2009).

[48] Having present the information on this table and the Political-Administrative Statute of the Autonomous Region of Madeira we can say that the RAM is much more close to be a PROFIT economy with a strong tourism sector rather than a MIRAB economy. In fact the RAM only lacks in legislative powers/capability on para-diplomacy and financial management.

[49] Normally tourism precedes offshore financial activities (Hampton & Christensen, Competing Industries in Islands - A New Tourism Approach, 2007).

[50] Main features of SITE economies: affluent, citizens enjoy higher mobility, higher life expectancy, higher literacy, lower fertility and lower infant mortality rates (Baldacchino & Bertram, The Beak of Finch: Insight into the Economic Development of Small Islands Economies, 2009).

The case of the RAM: Economic and Jurisdictional Constraints.

Located in the north Atlantic Ocean between 32°22.3′N 16°16.5′W and 33°7.8′N 17°16.65′W. The archipelago includes the islands of Madeira, Porto Santo, the Desertas and the Savage Islands, but only the first two islands are inhabited, and the four together form the RAM. Funchal, the capital is located 980km away from the Portuguese capital, Lisbon. According to literature the RAM is considered a SIE[51] (McElroy, Small island tourist economies across the life cycle, 2006).

RAM's Gross Value Added, according to *Instituto Nacional de Estatística*[52] (INE) is characterized by the predominance of the tertiary[vi] sector and a "steady contribution decrease of the primary sector since 1995" (Vasconcelos, Jesus, Gouveia, & Silva, 2005).

Madeira Island and Porto Santo Island lack natural resources[53] that could be used for economic activity[54], although the non-existence of a long continental platform gives both islands good natural harbors. Development of a sound primary sector is difficult for the RAM, not because of its fertile volcanic soil and the existence of several micro-climates, but due to its topography. Primary sector production costs are even higher (Martins, Ludlow, & Ferrer, 2000) due to its topography the introduction of machinery "is virtually impossible". "Almost 50% of the territory is above 700m of altitude, one fourth of it is above 1000m and 11% of it has steep grades above 16%" (Vasconcelos, Jesus, Gouveia, & Silva, 2005). Terraces are the main structure composing the agricultural landscape, already limited by the natural reserve forest[vii] that occupies two thirds of Madeira Island; consequently 95% of the farms are less than half a hectare in size. These numbers lead to the fact that "less than 10% of the surface could be used for agriculture" (Wishlade & Yuill, 2009).

The banana production in the RAM, although successful in terms of exports, has steadily declined[55], between the 2000 and 2009 period. Such numbers are explained by the aging in the farmers but also, that then translates into a decrease in the reduction of the number production sites, and by the competition from the banana production in the Autonomous Community of the Canary Islands (Azevedo, 2010).

Transportation costs in the RAM are aggravated because: exclusively dedicated airfreights are not available; instead airfreights consist of "pallets in the back of

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[51]RAM has an area of 801 km^2 and a population of 267,302 inhabitants (estimated).
[52] National Statistical Institute of Portugal.
[53] Although all year round spring like weather is the islands main asset. Porto Santo lacks hydric resources (Vasconcelos, Jesus, Gouveia, & Silva, 2005) and is 42km^2 in size
[54] In addition to the lack of natural exploitable resources, only one-third of the Madeira Island can be occupied with economic activities and housing, the other two-thirds belong to natural reserve, and therefor are untouchable (Parque Natural da Madeira, 2012). Porto Santo island agriculture is of the subsistence type due to its arid climate and sandy soils.
[55] From 20880 tons to 13953 tons, respectively.

scheduled passenger flights to Lisbon several times a week" (Hager & Levin, 2002). This affects negatively any high value added manufacturer's decision to locate its production in the RAM. This is due to the small scale economics that affects SIEs.

Energetic dependence from the outside is a great problem. Unlike the RAA (Açoriano Oriental, 2009), the RAM is also highly dependent on oil imports to generate its energy, since there is no geothermal electrical production, wind power is mainly limited to the Porto Santo Island[56] and hydroelectric power plants are very small, this makes the RAM a "relatively high-cost energy location" (Hager & Levin, 2002). Albeit this, investment by the regional authorities and *Empresa de Electricidade da Madeira*[57] have made it possible for 28% of the electricity produced in 2011 to be from renewable sources (Caires, 2011).

Despite remoteness, communications infrastructure well developed because Madeira is at the crossroads[viii] of major North-South and East-West Atlantic fiber optic cables. However this is not enough to assure competitive prices regarding telecommunication services, nor enough band width due to low demand. Such infrastructure would become a valuable asset if jurisdiction over maritime public domain was available, enabling the Regional Government to demand more band width supply at competitive prices as a counterpart for the cables presence in the territory, therefore increasing supply and enhancing economic competitiveness of the RAM in telecommunications.

The current jurisdictional status of the RAM rules out fishing rights, however the rest are available[58] to be followed by the regional authorities in order to promote economic sustainable growth. However, the specific constraints that affect the RAM mean that it is not enough to have similar tax rates to those of its main European-linked counterparts. Tax policy would also need to compensate Madeira's inherent disadvantages in order to attract a service based industry (Hager & Levin, 2002).

It is important to safeguard in fact political affiliation to a metropolitan patron has several advantages to Non Sovereign Island Jurisdictions, such as the RAM, since the metropolitan patron, in this case the Portuguese Republic, act as "an insurance against some of the vagaries of the world market, political upheaval, invasion and natural disasters". Other substantial economic advantages for SIEs of such political links are: "free trade, social welfare assistance, ready access to external capital through special tax concessions, availability of external labor market through migration and higher quality health and educational system" (Baldacchino, Islands enclaves: offshoring strategies, creative governance, and subnational island jurisdictions, 2010).

[56] Due to Madeira's limited space and topography.
[57] RAM's electricity operator.
[58] To a certain degree, depending on whether the PASRAM allows it.

Diversification of the RAM's economic structure to a combination of the SITE and PROFIT type of economy, similar to other SIEs[ix], is needed. RAM's economy is tremendously short of economic development options since its main dynamic sectors face prospect of stagnation, in the case of tourism, and decrease in the case of construction[59] (Hager & Levin, 2002). The tourism sector growth is now dependent on returning to up-market in order to generate added value, since increase of the number of beds is highly constrained.

The majority of employment opportunities are narrowed to tourism[60], construction and Government sector[61] plays a major role. However the (Wishlade & Yuill, 2009) RAM could be also classified as a SITE economy; the tourism sector accounted, in 2000, for 30% the regional GDP (Daniel & Rodrigues, 2010)

Therefore promoting a sector/activity that attracts FDI widens the tax base assuring Regional Government financing without central government transferences or tax increase on the island (which aggravates the cost of living) must be welcomed and encouraged (Portuguese Permanent Representation to the European Union, 2009). Because the "attractiveness of an island's environment and life style is not always sufficient to counterbalance the constraints of insularity" (Observatory of the European Islands, 2002).

Insularity costs[x] total a 16,7% of the Regional GDP (Molle, 2005), although the EC recognizes that this estimative are very conservative because there are costs that are difficult to quantify (Portuguese Permanent Representation to the European Union, 2009).

Economic development opportunities are therefore restricted to Funchal[62], in the tertirary sector, and to Caniçal[63], in the secondary sector (Wishlade & Yuill, 2009).

Due to PASRAM, the RAM has no power whatsoever over the movement of persons since this area is under national, rather than Regional, jurisdiction.

Powers over tax policy are limited[64] to (KPMG, 2008):

- Creation and regulation of taxes only applied in the RAM. Definition of tax incidence, rate, settlement, collection, benefits, and tax payer guarantees;

[59] All major infra-structural investments are now completed.
[60] This sector is prone to economic downturns arising in the main issuing countries of tourists flows and is characterized by being "relatively low-skilled and low-paid" (Wishlade & Yuill, 2009).
[61] Due to fiscal austerity measures the Regional Government will have strong limitations in terms of hiring personnel (Governo Regional da Região Autónoma da Madeira, 2012).
[62] The capital already has limited capacity for expansion.
[63] Civil parish where the industrial free trade zone is located.
[64] These powers derive from the PASRAM and from the Regional Finances Law. Lawmaking of the Regional Finances Law is competence of the Assembly of the Republic, the national Parliament.

- Adaption of national taxes, due to regional specificities, in terms of tax incidence, tax benefits and tax payers guarantees, take into account the limits set out by law;
- Reduction of national taxes regarding those over income and VAT, to a limit of 30%.

Fiscal powers of the RAM are also limited by the Court of Justice of the European Union (CJEU) jurisprudence[65] regarding sub-national jurisdictions and their tax systems. According with EU Law[66], Treaty[67] Article 107 (1): any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market. This article applies to a tax measure if such tax measure according to (European) Commission Notice 98/C 384/03:

"provides in favor of certain undertakings in the Member State an exception to the application of the tax system. The common system applicable should thus first be determined. It must then be examined whether the exception to the system or differentiations within that system are justified 'by the nature or general scheme` of the tax system, that is to say, whether they derive directly from the basic or guiding principles of the tax system in the Member State concerned. If this is not the case, then State aid is involved".

In addition, Treaty[68] Article 355 (3) states that provisions of the Treaties shall apply to the European territories for whose external relations a Member State is responsible. Taking into account EU and Portuguese Law and the CJEU has produced jurisprudence stating non-existent capacity of the RAM and the RAA to create its own tax system. Such analysis of jurisdictional capacity, carried out by the CJEU, is based on the following criteria (Portuguese Republic v. Commission of the European Communities, 2006):

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[65] Case C-88/03 (Portuguese Republic v Commission): Action for annulment – State aid –Decision 2003/442/EC– Tax measures adopted by a regional or local authority – Reductions on the rate of income tax for natural and legal persons having their tax residence in the Azores – Classification as State aid – Selective nature – Justification by the nature and overall structure of the tax system – Obligation to state reasons – Compatibility with the common market. And Joined Cases T-211/04 and T-215/04 (Government of Gibraltar and United Kingdom v Commission): State aid – Aid scheme notified by the United Kingdom regarding the Government of Gibraltar's reform of corporate tax – Decision declaring the aid scheme incompatible with the common market – Regional selectivity – Material selectivity.

[66] EU Member States recognize primacy of EU Law trough CJEU jurisprudence: "It follows (...) that the law stemming from the treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question." (Flaminio Costa v E.N.E.L., 1964).

[67] Treaty on the Functioning of the European Union.

[68] Idem. Derogations regarding State Aid concerning the OMRs and UK's Overseas Territories and Crown Dependencies are mentioned in Treaty Article 355.

- Tax reform has been devised by a regional or local authority which has, from a constitutional point of view, a political and administrative status separate from that of the central government of the Member State;
- The tax reform has been devised without the central government of the Member State being able to intervene directly as regards its content;
- The financial consequences for regional or local government of introducing the tax reform must not be offset by aid or subsidies from other regions or from the central government of the Member State.

If all these three criteria were fulfilled, the RAM (and the RAA) would be able to create its own tax system, however due to the PASRAM and the Portuguese Constitutional and national laws, these criteria are not met, therefore the Portuguese Autonomous Regions lack resourcefulness of jurisdiction regarding their financial and tax systems (Wishlade & Yuill, 2009). Low tax in the case of outermost regions should not be considered a distortion of competition but a mechanism of leveling the playing field.

IV. The importance of MIBC and IFTZ for RAM's economic development.

History and General Framework

Given the economic and jurisdictional constraints of the RAM, the Regional Government asked the Government of the Republic for the creation of a special fiscal regime to foment economic development, and in 1980[69] the IFTZ was created[70], but its full functioning only began in 1987[71]. Since Portugal's accession to the EU, the IFTZ/MIBC regime has been subject to several revisions[72/xi] and approvals from the EC[73], as such regime is considered State Aid in accordance to EU Law and jurisprudence and is thus subject to the Regional Aid Guidelines issued by the EC for each EU's Multiannual Financial Framework.

As such the MIBC/IFTZ fiscal regime is fully integrated and regulated under EU and Portuguese law, such regulation means that (Sociedade de Desenvolvimento da Madeira, 2009):

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[69] The creation of the IFTZ was prior to Portugal's accession to the EU. The IFTZ was maintained, after accession, thanks to provisions on the Accession Treaty, under the preposition that the IFTZ was an important instrument of regional economic policy (that should be maintained and developed).

[70] Decree-Law n. 500/80 (20th of October), Regulatory Law n. 53/82 (23rd of August) and Decree-Law n. 108/2008 (26th of June).

[71] Regional Regulatory Law n. 21/87/M (5th of September), Decree-Law n. 234/88 (5th of July).

[72] All of them re-negotiated with the EC. Each revision consists in a new tax benefit/incentive regime.

[73] Such negotiations have produced three different regimes.

- There is full implementation of EU law regarding business activities admitted to the MIBC or the IFTZ;
- Full application of norms arising from the Treaties signed by Portugal or by international organizations to which Portugal is member, especially OECD, FATF[74], ILO and IMO[75] apply to the regime.
- All business activities within MIBC and IFTZ are subject to the same rules and proceedings regarding customs, tax and financial activities in terms of control, inspection and supervision. Consequently the regime has "onshore" characteristics, since terms and conditions are identical to those of the RAM and the Portuguese mainland;
- Additional measures exist regarding the improvement of the rules applied to the IFTZ;
- Complete access to double taxation agreements signed by Portugal, except with the Brazil and the USA;
- Relationship with resident entities without fiscal benefits is allowed.

In fact Portuguese investors can take full advantage of MIBC if they aim to internationalize their activities or develop activities. Investor activities' income, whether the investor is foreign or national, will be taxed[76] at normal rate if income derives from activities with residents in Portuguese territory and reduced tax rate will be applied if income derives from activities with non-residents (Sociedade de Desenvolvimento da Madeira, 2009). As for the IFTZ, residents in Portugal and non-residents will benefit from fiscal incentives regardless of the fact that their income derives, or not, from activities with residents.

Because of the reasons mentioned (Freitas S. M., 2011) above MIBC/IFTZ fiscal regime cannot be considered, legally, technically and conceptually, an OFC; due to its characteristics it must be considered a preferential tax regime (Ferreira, 2011). In fact the MIBC/IFTZ has none of the OFCs characteristics (KPMG, 2008):

- Inexistent or insignificant taxation;
- Lack of information exchange between other countries our tax regimes;
- Lack of transparency concerning legal and administrative aspects;
- Lack of economic "substance" regarding the licensed businesses.

[74] Financial Action Task Force (FATF) is an "inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering, the financing of terrorism and proliferation of weapons of mass destruction."
[75] International Maritime Organization.
[76] Corporate tax.

Such characteristics allowed the MIBC/IFTZ to never be listed in OECD "black list" (Vasconcelos & Oliveira, Madeira International Business Center, 2012). In fact MIBC/IFTZ regimes are in line with the Code of Conduct Regarding Corporate Taxation (KPMG, 2008) and financial activities[77], during Regime I and received positive evaluation in the Primarolo Report on the mentioned code of conduct (Secretaria Regional do Plano e Finanças, 2010).

In addition, all inspections lead by the Regional Bureau for Tax Affairs, have not led to any license revoking due to improper conduct by companies (Secretaria Regional do Plano e Finanças, 2010).

The objectives behind such tax benefits are (Sociedade de Desenvolvimento da Madeira, 2009):

- Diversification and international orientation of the production structure of the economy;
- Reduction of vulnerabilities, dependences and inefficiencies resulting from the traditional productive structure;
- Strengthening competitiveness in external markets, in a sustainable and long-term oriented way, taking into account an open economy context;
- Stimulating: professional training, job opportunities for qualified young adults, and return of Madeiran educated abroad[78];
- Attract FDI.

This fiscal regime devised for the RAM consists of a package of incentives, in which the main element is corporate taxation with a "three-pillar-like-structure" in terms of the activities encompassed by it (Sociedade de Desenvolvimento da Madeira, 2009): the IFTZ, the MIBC and the MAR[79]. The administration and promotion of these incentives are done by MDS, on behalf[80] of the Regional Government of Madeira. It is a company that is made up of public and private investors. MDS is responsible for infrastructure construction in the IFTZ and receiving and issuing

[77] Financial activities included in the MIBC/IFTZ Regime I include banking activities, insurance companies, leasing and factoring entities and other financial activities.
[78] Despite the existence of the University of Madeira (UMa), many young people still go to the Portuguese mainland for higher education (Wishlade & Yuill, 2009).
[79] Decree-Law n. 96/89 (28th of March), Order in Council n. 715/89 (23rd of August) and Decree-Law n. 192/2003 (22nd of August).
[80] MDS has public concession of the fiscal regime for a period of 30 years. Concession was granted on 1987.

licenses for companies to operate within this fiscal regime, in articulation[81] with the Regional Government's Departments.

The IFTZ is the industrial free trade zone, which includes activities that encompass physical movement of goods, and it is the oldest fiscal structure. The IFTZ is geographically limited to an area of 138 hectares located in the civil parish of Caniçal, in Machico city[82]. IFTZ's regime allows for the import of capital goods and raw materials free of customs duties and low taxes[83] on profits, companies may also benefit from a reduction of a 50% on taxable income when fulfilling two of the following criteria:

- Contribution to the modernization of the economy through technical innovation, new products and procedures;
- Diversification of the regional economy by introducing new activities of added value;
- Fixation of qualified human resources;
- Contribution to the improvement of the environment;
- Creation of 15 jobs for a period of 5 years.

These companies will also benefit from a suspension regime, under whose provisions import duties will be charged on the non-EU incorporated raw materials and components only when the final products leave the IFTZ.

As for the MIBC encompasses the tertiary sector: international services, which include management and international trade activities, and until 2000[84] financial services[85].

Finally the MAR consists of an international shipping registry that enables the registration of commercial or leisure ships, oil platforms, commercial yachts and other ships enabling them to operate under Portuguese flag, consequently EU Member State flag and grating advantages on related services. The MAR registry has always been placed on The Paris Memorandum of Understanding on Port State Control "white list" (Vasconcelos & Oliveira, Madeira International Business Center, 2012).

[81] MDS also operates as a bureaucracy intermediary between potential operators and the Regional Government's Departments, therefore reducing investors' time spent dealing with red tape (Teixeira, 2011).
[82] Located in the eastern end of Madeira Island.
[83] Tax rates have varied with the regimes approved by the EC.
[84] In terms of licenses granted.
[85] Excluded, since Regime II, by the EC with regime revisions, these included: financial activities, financial intermediation and intra-group type activities. Exclusion of these activities was based on the EC's views that such activities have "very limited likelihood of promoting regional development, but a very high risk of distorting competition…" (Wishlade & Yuill, 2009)

Licenses[86] during the first regime (hereafter Regime I) were issued before 2000 and granted zero corporate tax until 2011, after 2000 the "licenses will be subject to a new regime under which a reduced rate of corporate tax (5%) applies to profits up to a given employment threshold and the standard rate applies to the remainder" (Wishlade & Yuill, 2009). Regime II applies to licenses issued after[87] 2000 and a reduced tax is applied to profits (3%), the reduced rate is also subject to an employment threshold. Finally the current Regime III is applied to companies licensed to operate between 2007 and 2013, however the benefits from the regime continue to 2020.

Note that companies wishing to change from Regime I to Regime III will be fully scrutinized by the Fiscal Administration in order to assure that they fully comply with the new tax benefits rules (Secretaria Regional do Plano e Finanças, 2010).

"Portuguese Pure Holding companies (SGPS) qualify for the full participation exemption on E.U. sourced dividends, provided they comply with the requirements set by the E.U. Directive EC/90/435 and by Article 46º of the Portuguese Tax code, namely a minimum holding period of one year. Capital gains are not included in the taxable income of the SGPS, provided that the shares are held for a minimum period of 1 year (or 3 years in certain circumstances) and represent a minimum shareholding of 10%. Non–EU sourced dividends will be subject to 3% to 5% taxation." (Sociedade de Desenvolvimento da Madeira, 2009)

Due to negotiations and conditions imposed by the EC, tax benefits associated to Regime III must also comply with either create one to five jobs in the first six months of operation and investment of at least €75.000 in the first two of operations, or create at least six jobs in the first six months of operation.

Impact on the RAM's Economy:

The MIBC/IFTZ is of utmost importance to the regional economy (Portuguese Permanent Representation to the European Union, 2009), thanks to regimes implemented, the RAM was able to attract "four of the 100 largest exporting companied and the 1000 largest Portuguese companies by volume of operations" all of them multinational in nature and according to 2007 data worth €500 million in taxable profits[88] (Wishlade & Yuill, 2009).

Another important contribution to regional economy was the creation of highly skilled jobs, reaching in the 2002-2007 period to 3000 direct jobs (Wishlade & Yuill, 2009), 40% of the jobs employ people with bachelor degree or higher (Secretaria Regional do Plano e Finanças, 2010). The regime, specially the MIBC,

[86] Licenses are granted from the 1st of January of the first year until the 31st of December of the last year of the licensing period.
[87] Licensing period was from 2003 to 2006, since between 2000 and 2002 MIBC/IFTZ was suspended due to negotiations between EC and Portugal.
[88] These go directly to the Regional Government of Madeira.

has turned out to be an opportunity generator for professional and internationally-oriented careers on Madeira, apart from public sector[89].

As well as job opportunities generated for Madeirans, the MIBC has attracted second-generation migrants[90] from South Africa and Venezuela (Sociedade de Desenvolvimento da Madeira, 2010). In a nutshell, by creating job opportunities, the MIBC/IFTZ provides "dynamic contributors to the social and economic life of the island", although contributions to these numbers from the IFTZ are very modest[91] (Wishlade & Yuill, 2009).

The underestimated number of indirect jobs created by support activities to the MIBC companies, especially in the IT field, logistics services[92], law, software development, procurement, international promotion, and other firms (Portuguese Permanent Representation to the European Union, 2009) must be added to these numbers. The creation of indirect jobs by the MIBC's Regime I is bigger than in the other regimes, due to the fact that the first regime did not require compulsory job creation, hence companies subcontracted labor (Secretaria Regional do Plano e Finanças, 2010) through outsourcing in the regional labor market. Such outsourcing also reflects today's global tendency in international enterprises.

The tourism sector also benefits from the existence of the MIBC/IFTZ, leading to a potential reinforcement of high-end tourism due to the fact that two-thirds of the clients and owners of MIBC/IFTZ companies "visit the island at least once year and nearly one-fifth" visit it three times a year (Wishlade & Yuill, 2009). Data also shows that 70% stays in five-star hotels for 3 or 4 nights.

Diversification of the regional economy has improved since the implementation of the MIBC/IFTZ regime giving allowing to pharmaceutical, biotechnology, metallurgy, energy, maritime transportations, aircraft management, e-commerce, telecommunications, and other companies to emerge in the regional market (Portuguese Permanent Representation to the European Union, 2009).

Such economic diversification has led to 21% contribution[93] of the MIBC/IFTZ to the regional GDP in 2002 and that is estimated to have remained unchanged

[89] Nowadays job qualified job creation potential is even more important, since the Regional Government is not able to hire, except for very few reasons, as a condition of the austerity plan to be implemented.

[90] 70% of the employees of MIBC/IFTZ are Madeirans or second-generation migrants (Secretaria Regional do Plano e Finanças, 2010).

[91] Please see Annex XIV.

[92] FedEx and DHL only operate in Madeira thanks to the companies licensed in the MIBC and IFTZ (Wishlade & Yuill, 2009).

[93] "Taking into account the regulations set out by the European System of National and Regional Accounts (ESA 95) and the System of National Accounts of the United Nations (1993 SNA), the International Monetary Fund Balance of Payments Manual (5th edition) and EC's Decision 91/450/CEE, Euratom defining the territory of each Member State for harmonization purposes in order to determine GDP at market prices following Directive 89/130/CEE; it is possible to conclude that all companies located in MIBC/IFTZ, that are active and report to INE information about their

(Secretaria Regional do Plano e Finanças, 2010). In terms of GVA, despite the lack of more recent data, financial activities licensed in MIBC contributed to RAM's GVA 70%, 48% and 49% for the years 2000, 2001 and 2002, respectively; while the non-financial activities contributed to 23%, 22% and 27%, the same years (MCRIT, 2002).

However the impact in the RAM's economy has decreased, meaning that it is now negative due to Regime III. The new regime is prone to attract speculative developments with a very limited contribution to the regional economy, especially in terms of job creation opportunities (Wishlade & Yuill, 2009). Adding to Regime III, the fiscal instability regarding VAT rates[94], 2011 National Budget Law[95], suspensions of negotiations with the EC regarding a new Regime for the MIBC/IFTZ and late re-opening of those negotiations led to relocation of licensed companies to RAM's competitors (Dias, 2010).

Importance to the Regional Government's Finances

The main criticism of the MIBC/IFTZ regime is the foregone revenue[xii] that Regional Government loses every year due to the low taxes. Foregone revenue is calculated presupposing that that firms that benefit from the Regimes *would otherwise* have paid tax at full rate. Such concept does not make sense because, if these companies paid such rates, "the reduced rate would have been a windfall gain and would not have altered the location decision" (Wishlade & Yuill, 2009). This is not the case, since if normal tax rate was applied companies would have not relocated to the RAM. Despite this void concept, these "doubtful calculations" (Wishlade & Yuill, 2009) are used by the EC to decide the proportionality of the Regimes as State Aid.

In fact such argument is a fallacy, in terms of EU Competition Law (Costa, 2012), territorial discontinuity from the mainland[96] and permanent handicaps to the SIEs makes it impossible to fully implement EU Competition Law as a way to provide sustainable economic development and with it stable fiscal revenue. Consequently what should be presented as an argument to the EC is the reduction of budgetary dependency of RAM towards Central Government and EU funds. However the fact that Portugal supports diplomatically other EU Member-states that defend fiscal

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activities in the Region must be considered on RAM's businesses statistics, as well as in the national and regional accounts." (MCRIT, 2002)

[94] Due to austerity measures in the Portuguese mainland and more recently in the RAM. The RAM sets its own VAT rate however it will reach 22% in April, when in 2008 had the lowest VAT rate in the EU (KPMG, 2008).

[95] Law 64 B/2011 ends exemption of withholding taxes regarding interests on shareholders loans and dividends, a benefit that was granted by the EC until the 31st of December of 2020, that will now be taxed at a normal rate of 25% (unless Double Taxation Agreement applies) to non-residents. This "change of games rules" led to an increase in number of relocations and is perceived as fiscal instability, although not provoked by Regional authorities.

[96] The RAM virtual distance to the Europe's center (represented symbolically by Maastricht) is the equivalent of the Madeira Archipelago being located in the Amazonas State of the Federative Republic of Brazil (Observatory of the European Islands, 2002).

harmonization makes it difficult, diplomatically, to defend a differentiated regime with the EC. None the less, outermost region status and provisions should prevail over fiscal harmonization, given the economic constrictions affecting the RAM.

The MIBC/IFTZ has contributed to an average of 21,9% of the total VAT revenue collected in RAM in the 2005-2010 period[xiii]. Assuming that economic activity indicators remain constant, an average fivefold increase of VAT revenues for the same period would be enough to suppress national budgetary dependence of the RAM. In terms of companies licensed in the MIBC/IFTZ this fivefold increase of the VAT revenue would be roughly equivalent to a total of 14316 companies[97], with an average of one employee[xiv] per company[98]. This would only be possible; at least, if the MIBC/IFTZ regime maintained a VAT rate of 15% and a corporate tax rate between 3% and 4% for an undetermined period of time.

The coverage rate of the corporate tax rate in relation to the national budget transferences is irrelevant, especially when compared with coverage of the VAT rate in relation to the same set of transferences. Thus attractiveness of the MIBC/IFTZ regime should depend on a low corporate tax rate, since it does not compromise the regional tax revenues[xv].

Maintenance of the *Status Quo* or Fiscal Sovereignty?

Due to EU Law it is not possible for a State Aid Regime, with the conditions of the MIBC/IFTZ, to be permanent or implemented for an undetermined period of time.

Periodic negotiations of the MIBC/IFTZ regime along with indexation of the regional taxes to the national taxes, which constantly vary every year, creates a high level of uncertainty to foreign investors. These negotiations of benefits with the EC do not reflect the regional authorities positions (Costa, 2012) regarding the MIBC/IFTZ because of the EC inflexibility regarding implementation of EU Competition Law, since such law does not take into account SIEs permanent development constraints.

The current employment threshold system of benefits also drives away possible investors and promotes the fragmentation of several companies (Dias, 2010) in order for them to continue benefiting from the regime while inducing regional authorities to wrong statistical figures about the MIBC/IFTZ.

Having these three points been explained, maintenance of the *status quo* is counterproductive (Costa, 2012) since “relocation of a significant number of firms with substantial operations” (Wishlade & Yuill, 2009) has occurred since the beginning of 2011 (Machado, 2012).

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[97] Assuming that average number of companies in the period of 2005-2010 is 2863 and the average number of employees in the same period is 3437.
[98] This does not include indirect employment figures.

Another option regarding competitiveness of the MIBC/IFTZ discussed by the regional and national authorities is related to a reduction of the job-related thresholds to the tax benefits; however such measure would be incoherent in terms of the precedent affecting the Canary Special Zone[99].

Despite these alternatives for the MIBC/IFTZ future regime, such measures are still not enough to turn the MIBC/IFTZ into a complementary sustainable source of tax revenue for the Regional Government of Madeira.

This simple calculus sets the debate to whether or not the RAM would be better off if it had the jurisdictional capacity, i.e. fiscal sovereignty, respecting CJEU and EU Law. Taking into account such possibility of fiscal sovereignty such would mainly imply:

- Tax rates and regime are set independently from the national government.
- Flexibility of adapting tax rates according to economic cycles.
- No more uncertainty regarding negotiations processes with the EC, since it would no longer be required.
- Different market regulation, and more in-line with an investment friendly economic setting, yet still in line with EU, Portuguese regulations and OECD good practices in order to avoid political counter-measures to the new regime.
- Possibility to create new sources of revenue, apart from the services sectors, namely gambling.
- End of national budgetary dependency and transferences from the national government, in accordance with CJEU jurisprudence.
- Because the RAM would not cease to be an European Union territory, such fiscal sovereignty would be in line with EU law requisites, as well OECD requisites regarding tax systems, making it attractive to foreigner investors who now seek, due to pressures from political players and tax-payers (Hampton & Christensen, Small Island Economies: Exploring Alternative Development Strategies to Hosting Offshore Finance, 2010), transparent and well regulated investment friendly tax systems (Costa, 2012).

[99] Similar to the MIBC/IFTZ regime.

Simple linear calculations were made using tax data[100/xvi] made available by the Regional Bureau for Tax Affairs and the Regional Bureau of Budget and Accounting of the RDPF, assuming the following hypothesis:

- Tax bases (VAT and CTR) from MIBC/IFTZ regimes and "normal regime" are added up forming a single VAT and CTR tax base;

- Tax proportion (VAT divided by CTR) was calculated for the given period in order to assess the size of one tax in relation to another;

- VAT rates remained unchanged due to the nature of the tax itself and difficulty of assessment regarding the respective tax base;

- It was assumed that fiscal sovereignty would implement a tax system similar to the MIBC/IFTZ to all taxable entities in the RAM;

- Based on the previous assumptions CTR revenue was calculated assuming 4% and 5%; VAT revenue was then calculated multiplying the respective tax proportion (of each respective year) by the new CTR revenues.

- 4% and 5% CRT to all economic activities were considered because these are the more competitive when comparing the MIBC/IFTZ regime to its main European competitors[xvii].

Considering these hypothesis, foregone revenue[101] due to non-existence of fiscal sovereignty was obtained. If a 5% CTR would have been applied to the 2005-2010 period, revenues arising from this tax along with those from the VAT would generate a regional budget surplus for each year in the period considered. The same calculations show that for a 4% CTR, CTR and VAT revenues would generate regional budget surpluses only for the years 2006, 2008 and 2010; still the regional budget accumulated balance for the period 2005-2010 would be around €M 12 deficit.

Such calculations are under-estimated since if such regime was applied to the RAM as whole, companies would probably[102] have relocated from RAM's competitors to the island. Also, these calculations do not include the revenues from other taxes such as customs and excise taxes[103], gambling taxes and personal income taxes; nor the possibility of a more relaxed, yet in accordance with EU guidelines, regulatory environment. Multipliers effects, in terms of impact in the regional

[100] 2005-2010 period.
[101] Similar concept to that applied by the EC, but not a fallacy since a lower tax rate would in fact attract more taxable entities to the RAM, and those already there would not leave.
[102] This would most likely be true regarding the financial sector companies, which now pay 10% of corporate tax rate in several jurisdictions.
[103] Tobacco, alcohol, etc…

government's finances and in the Madeiran economy, arising from the fiscal sovereignty are not taken into account since those are highly complex to be calculated. However, experience can be drawn from other jurisdictions such as the British Crown Dependencies[104], and one can find many academic papers on the issue. Academic research also shows how problems, such as legislature capture and financial sector overpowering the tourism sector (Hampton & Christensen, Offshore Pariahs? Small Island Economies, Tax Havens, and the Re-configuration of Global Finance, 2002) can shed a light on how these problems can be avoided by other jurisdictions. One of the cases with most success in implementing an investment friendly tax regime is the Isle of Man. The success of the Isle of Man is translated into twenty-one successive years of continuous growth[105] across all sectors accompanied by low unemployment rates (Carse, 2005) and stable population growth, since there are few incentives to emigrate.

Fiscal sovereignty, taking into account these figures, is much more efficient economically speaking and assures that the Regional Government does not need to depend on national government's nor EU's transfers to complement its budget. However CJEU jurisprudence (Government of Gilbraltar v. Commission of the European Communities, 2008) is not fully explicit on whether fiscal sovereignty would imply that the RAM would have to create a Regional Social Security fund to assure pensions to the elderly, as well as sustain the judicial system and the law enforcement without any subsidies or compensations from the national government. Despite this extra burden on the regional finances, such risk is ought to be low due to the multiplier effects regarding fiscal sovereignty.

The new tax system arising from such fiscal sovereignty would have to be competitive enough, in comparison with other European low tax regimes[106], and would have to include the financial sector activities since these are responsible for generating most of the tax revenue, as showed by the CTR base from Regime I.

A different tax and regulatory system from the mainland poses no threat to the Portuguese economy. Examples of good "fiscal relationships" between different jurisdictions are the United Kingdom and its British Overseas Territories and Crown Dependencies; and the Kingdom of Denmark with Greenland and the Faroe Islands. These countries have, through home ruling and similar constitutional arrangements, granted legislative powers (and responsibilities) for these territories to achieve economic and public finances sustainability.

Complexity arising from differentiated fiscal, and possibly regulatory, system between the RAM and the Portuguese Republic is not an issue since different tax rates are already applied. Further development of such systems would be the

[104] Isle of Man, Bailiwick of Jersey and Bailiwick of Guernsey

[105] Data concerns GDP and GNP at constant prices for the time period of 1983-2007.

[106] See annex XVI.

equivalent, for economic agents, to deal with an “external” jurisdiction, as it happens with the examples mentioned in the previous paragraph.

Such tax system would allow long term economic and fiscal sustainability to the RAM without investment from the Regional Government, Portuguese Government or EU institutions since such would be attainable through law making powers; fiscal sovereignty can only be attained by constitutional amendment by a two-thirds majority in the Assembly of the Republic.

V. Conclusion

The RAM has exhausted its sources of tax revenue, since the main sectors of economic activity are stagnated or show poor outlooks regarding their growth due to interdependence between them and due to economic and financial crisis in Portugal.

In order to promote economic development in the RAM, one of the poorest Portuguese regions of Portugal, the MIBC/IFTZ was created with the support of the regional, national and European authorities.

The MIBC/IFTZ soon became one of the important sectors in the regional economy, which suffers from permanent constraints to its economic development and consequently to its government's finances. However, due to lack of resourcefulness of jurisdiction made the regime to always been negotiated between the national government and the EC.

The MIBC/IFTZ consists in a tax benefit system highly regulated; in fact it is a system that has "the best of both worlds": low tax, regulation, supervision, money laundry legislation, no bank secrecy and cooperation between jurisdictions. Exactly what the international community is seeking to implement on the *real* offshore centers, without cutting SIEs from a source of economic growth (Hager & Levin, 2002) and financial independence.

Economically and in terms of fiscal revenue the MIBC/IFTZ proved to be important since its creation, however the economic and financial crisis makes it clear the RAM needs to step forward towards its jurisdictional capacity in order to cope with the current financial situation.

Tax data shows that there is possibility of the RAM to fully finance its own regional authorities without depending on the national or European authorities (external help) (Freitas G. , 2012), therefore alleviating financially these authorities. Therefore it is not understandable why negotiations have been dropped by the XVII and XVIII Portuguese Constitutional Governments.

This step forward towards jurisdictional capacity, in the form of fiscal sovereignty, must be carefully evaluated, namely when implementing such system in order to assure that it is competitive enough to produce the desired effects in the island's economy.

Evidence shows that a 4% or 5% CTR towards all taxable entities would be competitive because it would attract financial services, which pay in other jurisdictions a 10% CTR, while providing a full EU regulatory and transparency environment.

All in all it is not understandable, economically and financially speaking, why fiscal jurisdictional capacity has not been developed sooner. Therefore central authorities must deliver such jurisdictional capacity when it would clearly alleviate them financially and at the same time provide mechanisms to the Autonomous Region to quickly and without "external" help pay its debt, achieve long term financial and economic sustainability.

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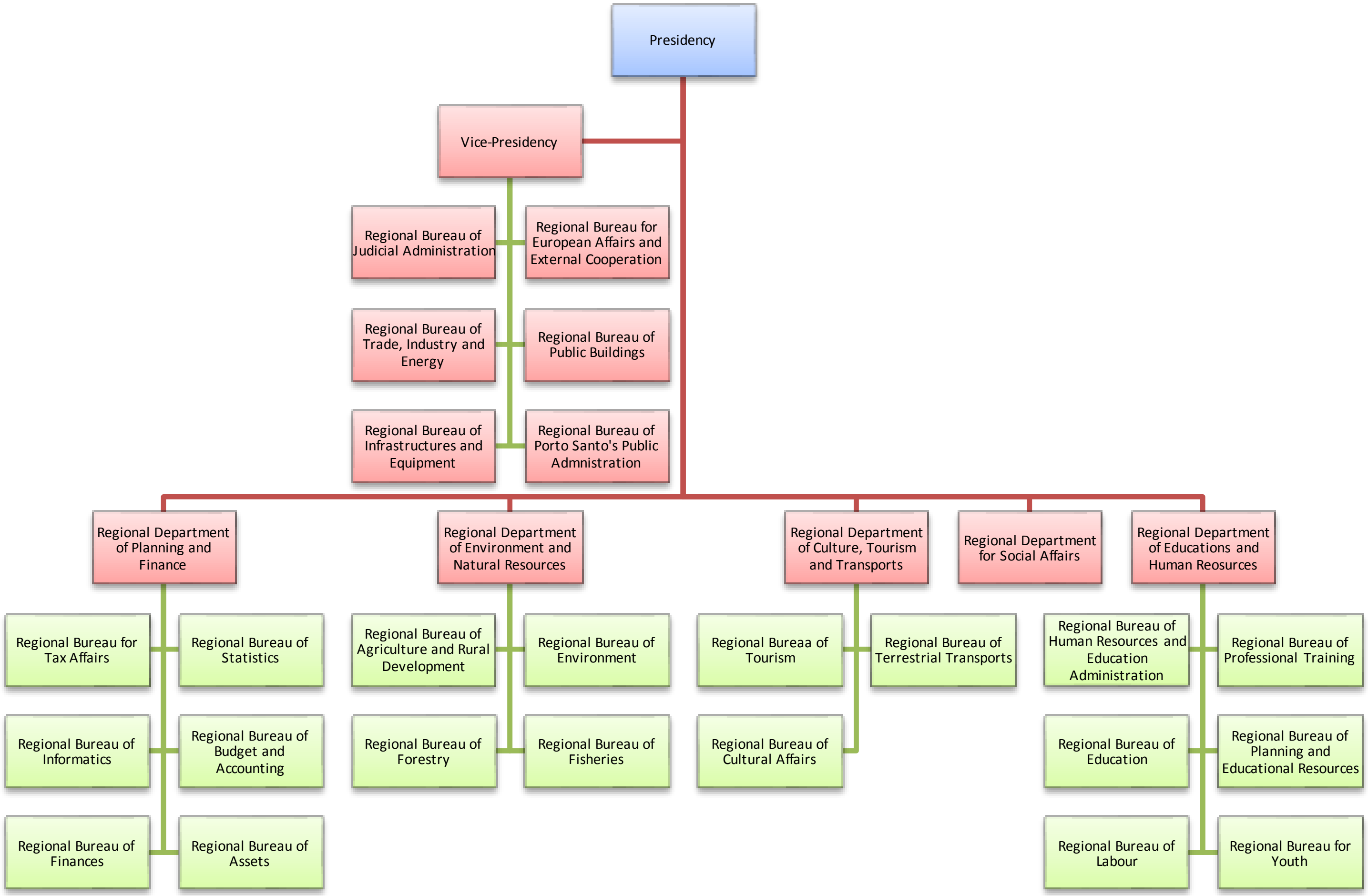
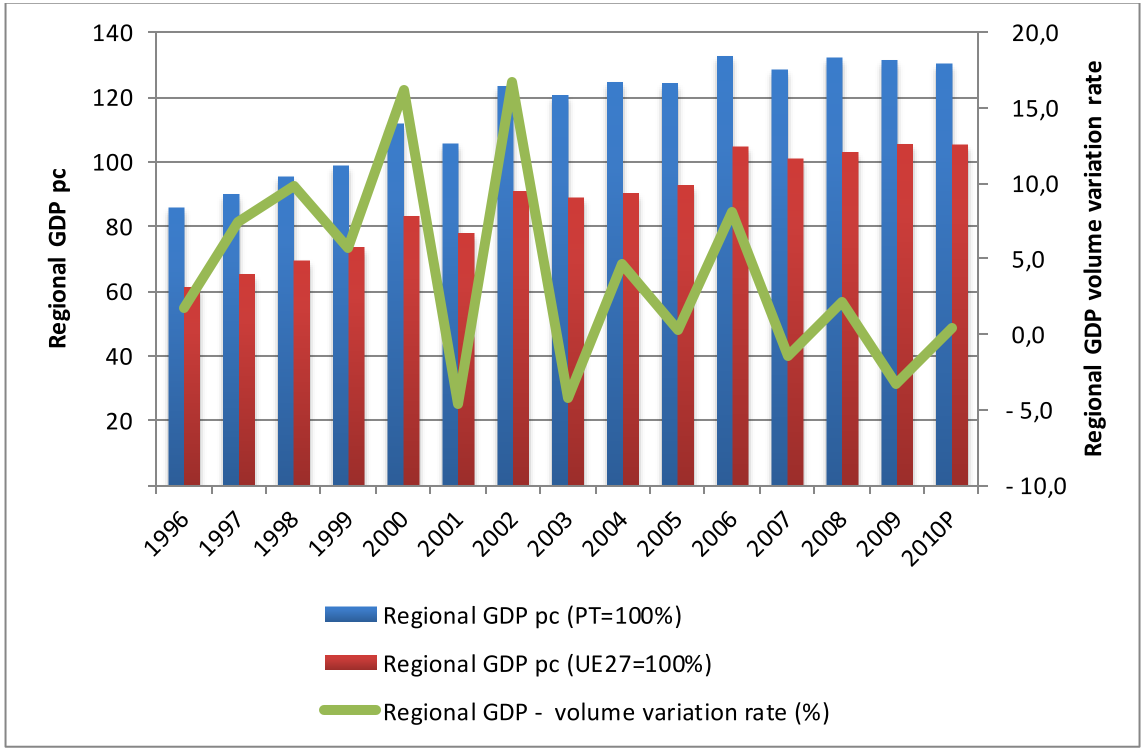
Wishlade, F., & Yuill, D. (2009). *The Reform of the Madeira Free Zone: Impact and Implications of Regime Change - Final report to the Sociedade de Desenvolvimento da Madeira SA.* Glasgow: European Policies Research Centre, University of Starthclyde.

Annexes

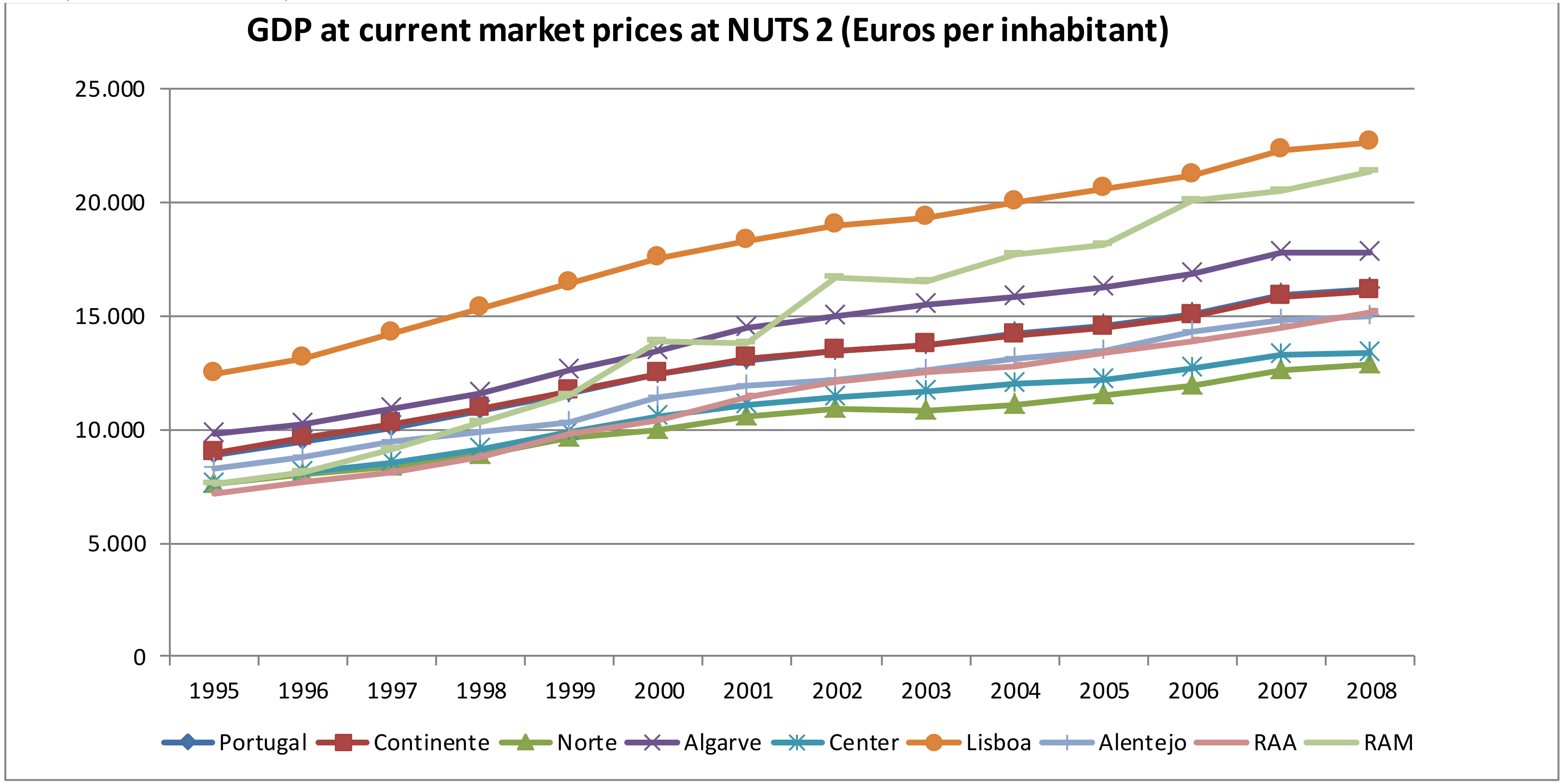
[i] Organization chart of the Regional Government of Madeira. This chart does not include agencies, regional institutes or Region's owned companies.



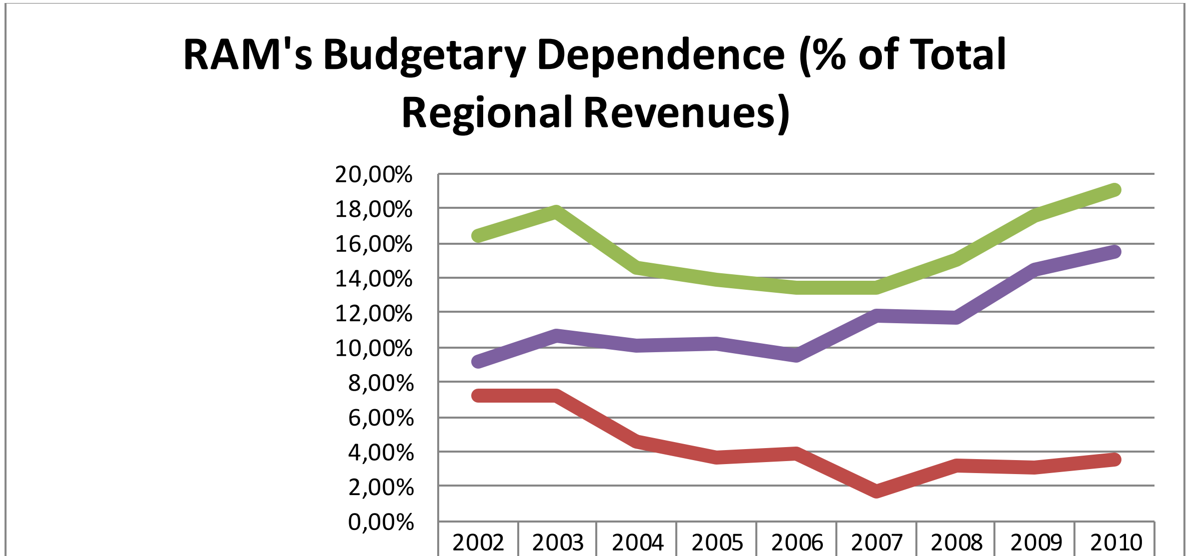
[ii] Source: Direcção Regional de Estatística da Madeira, Secretaria Regional do Plano e Finanças.
Note: Base year is 2006.



Source: Eurostat (22-02-2012 18:50:12)



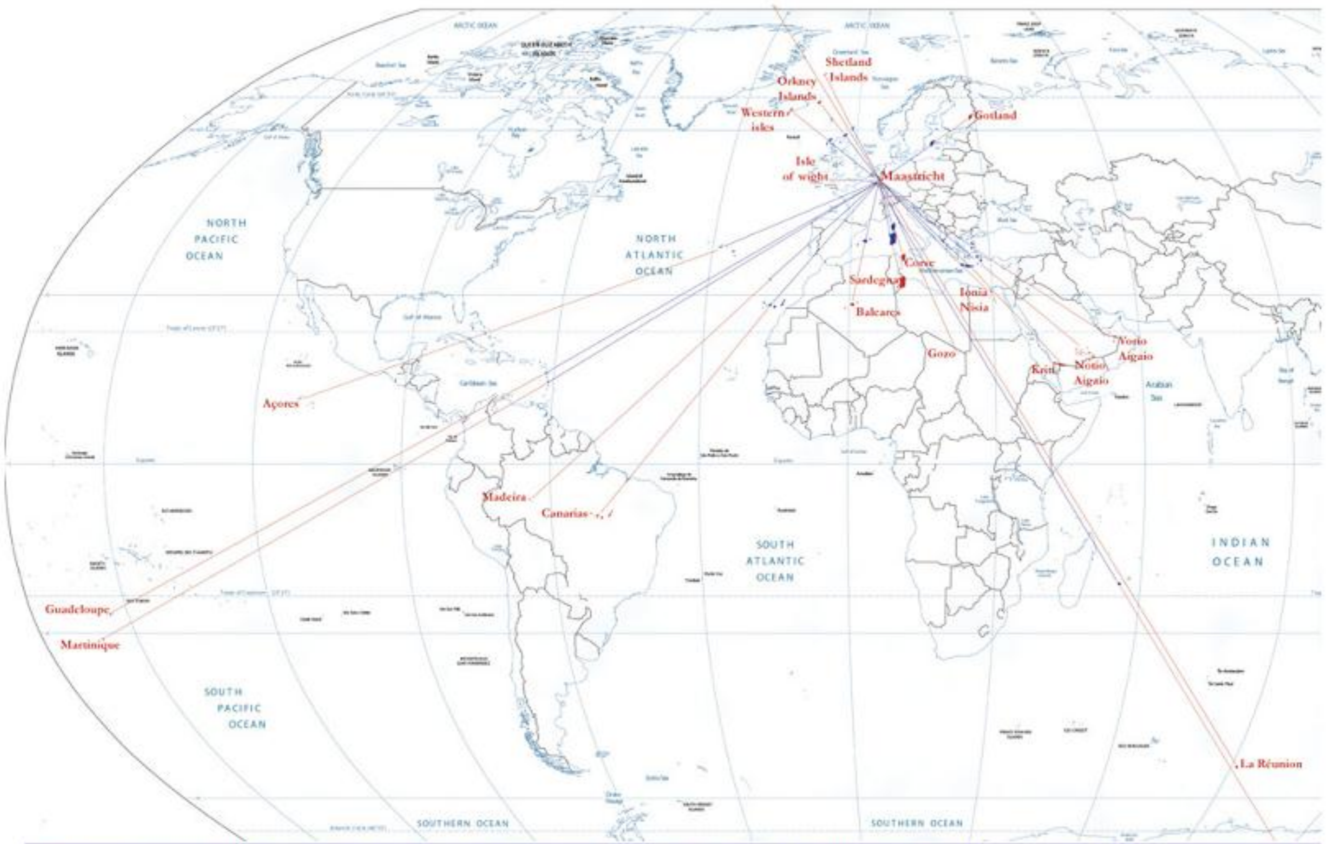
iii Source: Secretaria Regional do Plano e Finanças. <u>Note</u>: Direct debt concerns to debt contracted by the Regional Government. Indirect debt concerns only to guarantees by the Regional Government. Total debt, in the following graph, is the sum of these two types of debts.



	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total Budgetary Dependence	16,43%	17,83%	14,58%	13,85%	13,42%	13,46%	14,99%	17,52%	19,03%
Budgetary Dependence from Central Government	9,17%	10,65%	10,06%	10,18%	9,57%	11,80%	11,75%	14,44%	15,48%
Budgetary Dependence from EU	7,26%	7,18%	4,51%	3,67%	3,85%	1,66%	3,24%	3,08%	3,55%

[iv] Virtual distances of islands from the center of the EU (symbolized by Maastricht). Source: Observatory of the European Islands. (2002). *Off the Coast of Europe: European Construction and the problem of the Islands.* Conference of the Peripheral and Maritime Regions, Islands Commission

A TOTALLY DIFFERENT SPATIAL CONTEXT

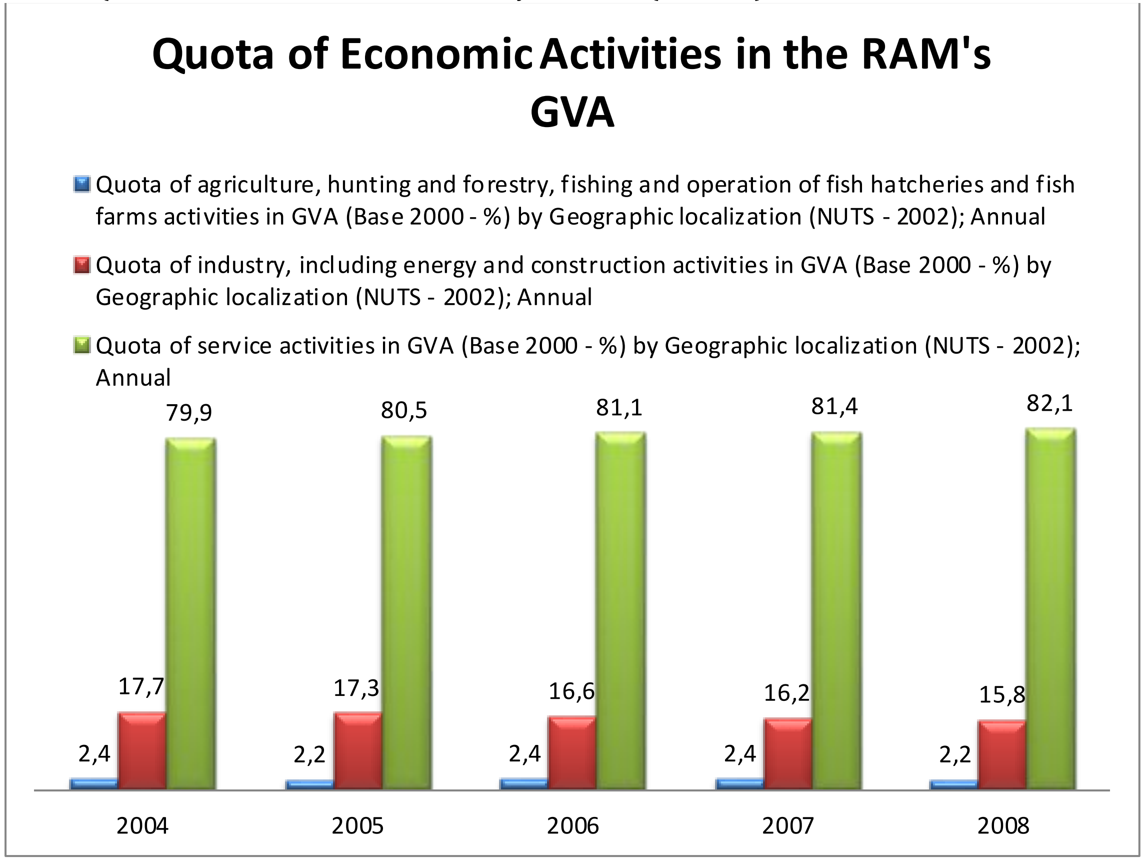


This map represents the virtual distances of the islands from the Centre of the EU, symbolised by Maastricht. We added the travel time of a semi-trailer by road, the crossing time by ferry, the waiting time and a frequency coefficient. This total travel time was converted into Km on the basis of the average speed of 60 Kph for a truck on the Continent.

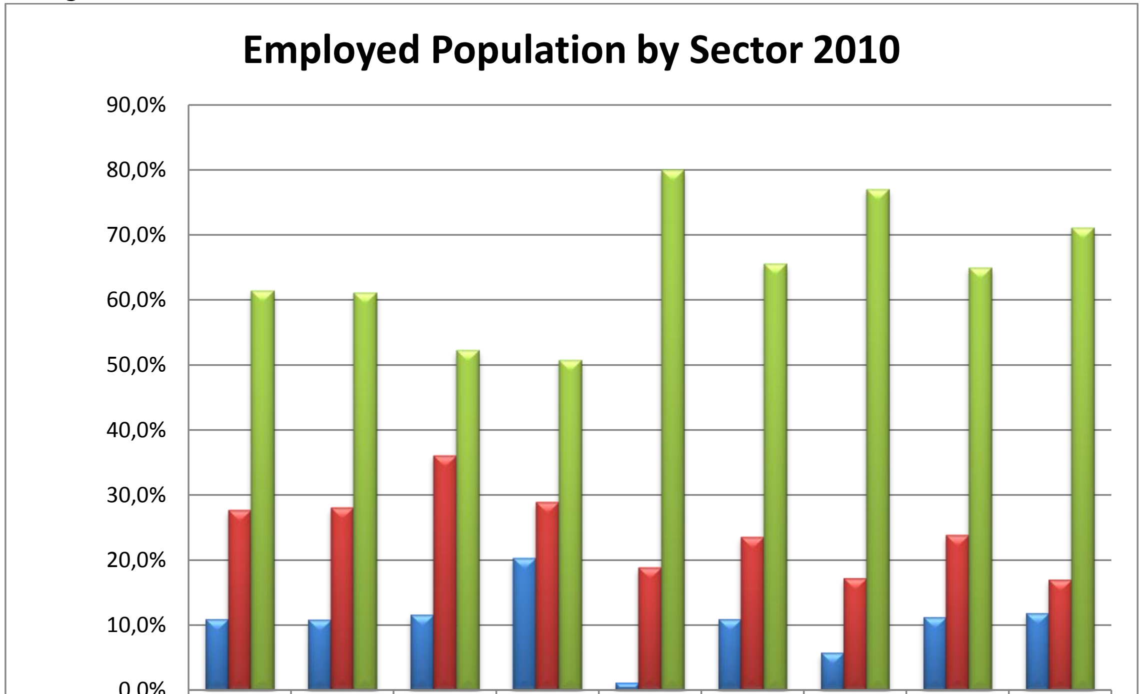
[v] Source: Baldacchino, G. (2010). *Islands enclaves: offshoring strategies, creative governance, and subnational island jurisdictions.* Montreal, Québec, Canada: McGill's University Press.

Main Scope	Sourcing Subsidies	Enhancing Domestic Political Capacity
	MIRAB Economies	PROFIT Economies
Migration Flow	Out	In/Out
Remittances	High	Medium/Low/Nil
Aid	High	Low/Nil
Bureaucracy	High	Medium/High
Resource Management	Low/Nil	Medium/High
(Para)Diplomacy	Aid seeking	High
Financial Management	Low	Medium/High
Transportation Management	Low	Medium/High
Agriculture	High (cash crops)	Low/Nil/Niche or Gourmet Products
Manufacturing	Low/Nil	Medium/Niche

vi Quota of Economic Activities in the RAM's GVA and Employed Population by Sector.
Source: Instituto Nacional de Estatística (Statistical data extracted on February 17, 2012 (11:56:49).

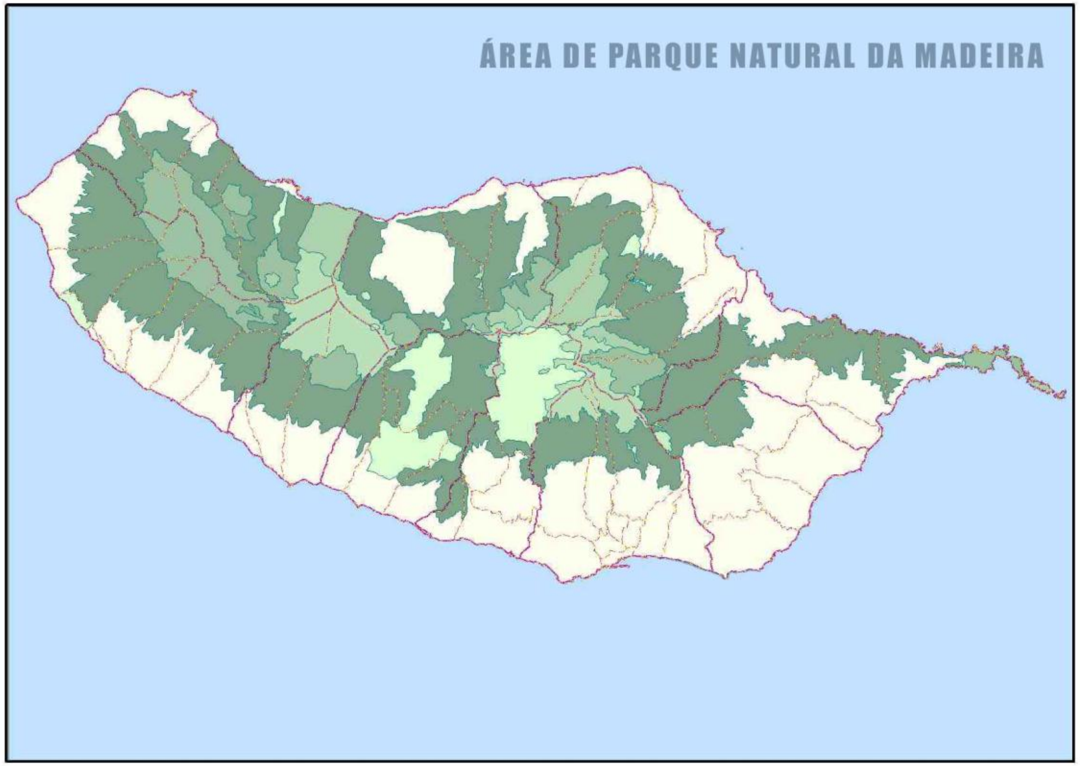


Source: Statistical Yearkbook of Portugal 2010.



	Portugal	Mainland	North	Center	Lisbon	Alentejo	Algarve	RAA	RAM
Agriculture	10,9%	10,9%	11,6%	20,3%	1,2%	10,9%	5,7%	11,2%	11,9%
Industry	27,7%	28,0%	36,1%	28,9%	18,9%	23,6%	17,2%	23,8%	17,0%
Services	61,4%	61,1%	52,3%	50,8%	80,0%	65,5%	77,0%	64,9%	71,1%

vii Natural Reserve Area in green.



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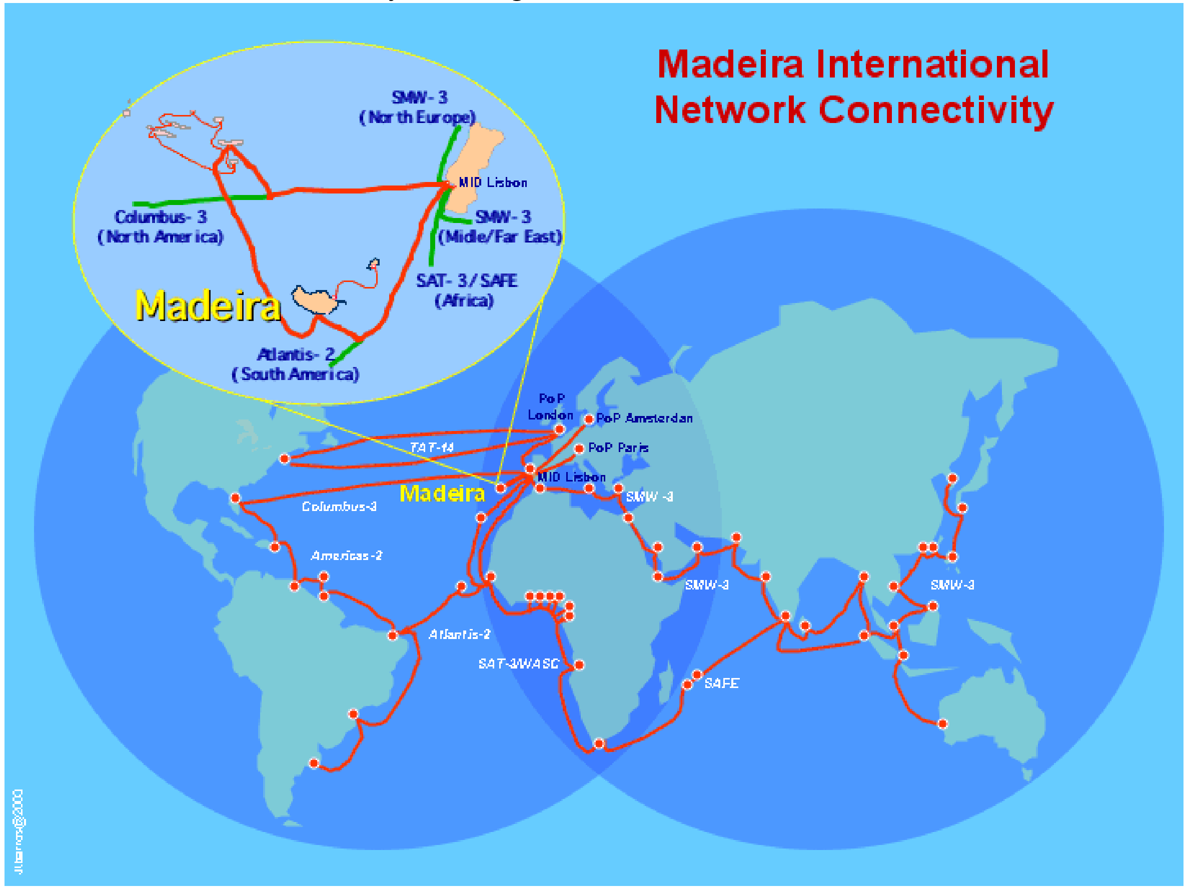
viii Madeira's underwater cable connections. Source: Vice-Presidency of the Regional Government



[ix]Different types of island economies. Source: Baldacchino, G., & Bertram, G. (2009). The Break of Finch: Insight into the Economic Development of Small Islands Economies. *The Round Table, XCVIII*(401), 141-160

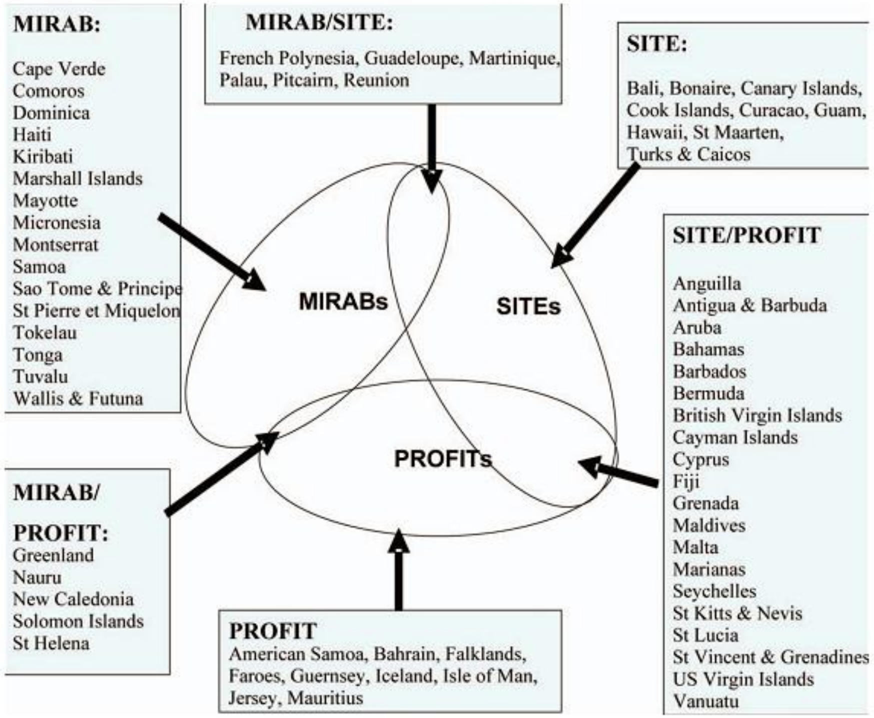


Figure 1. The structures of small economies: a threefold taxonomy (with overlaps).
Sources: Adapted from Bertram (2006) and Bertram and Poirine (2007).

[x] Additional costs incurred by the private sector in Madeira (1998). Source: Wishlade, F., & Yuill, D. (2009). *The Reform of the Madeira Free Zone: Impact and Implications of Regime Change - Final report to the Sociedade de Desenvolvimento da Madeira SA.* Glasgow: European Policies Research Centre, University of Starthclyde.

Additional Costs incurred by the private sector in Madeira (1998)			
	% of Private Sector GVA	€ millions	% of GDP
Transport	7,9%	121,60	5,1%
Business trips	0,6%	9,20	0,4%
Stocks	4,0%	61,60	2,6%
Human Resources	6,7%	103,10	4,3%
Installations	0,4%	6,20	0,3%
Financing	4,0%	61,60	2,6%
Marketing	2,4%	36,90	1,5%
Total	26%	400,10	16,7%

[xi] Corporate tax rates under the MIBC/IFTZ regimes and jobs thresholds
Source: Wishlade & Yuill (2009) based on Tax Benefits Statutes Law.

Tax Year / Date of License	2007	2008	2009	2010	2011	2012	2013-2020
From 1987 to 2000 Regime I	0	0	0	0	0	n.a	n.a
From 2003 to 2006 Regime II	3	3	3	3	3	n.a	n.a
From 2007 to 2013 Regime III	3	3	3	4	4	4	5

Source: Wishlade & Yuill (2009) based on Tax Benefits Statutes Law

Profit taxed at reduced rate (€ million)		
Number of Jobs	**Regime II**	**Regime III**
1 to 2	**1,5**	**2**
3 to 5	2	2,6
6 to 30	**12**	**16**
31 to 50	20	26
51 to 100	**30**	**40**
More than 100	125	150

[xii] Foregone revenue computed by the RDPF. "Based on several prepositions: number licensed companies grows every year (according to rate already mentioned to the EC); normal corporate tax rate does not change (stays at 20%), therefore effective tax rates do not change; revenues from Regime I are based on an average effective revenue of €125698; new Regimes have an effective average revenue of €62240" (Secretaria Regional do Plano e Finanças, 2010)

Ano	Total Foregone Revenue (Corporate Tax Rate)
2009	**415.173.320 €**
2010	368.783.921 €
2011	**328.934.180 €**
2012	202.373.491 €
2013	**174.822.216 €**
2014	168.835.248 €
2015	**161.454.929 €**
2016	154.378.984 €
2017	**147.607.413 €**
2018	141.064.122 €
2019	**134.825.204 €**
2020	128.814.566 €
TOTAL	**2.527.067.594 €**

[xiii] Source: Secretaria Regional do Plano e Finanças, Direcção Regional dos Assuntos Fiscais.

Year Period	Nº of Entities (Total RAM)	Nº of Entities (MIBC/IFZ)	VAT MIBC/IFZ (tax)	VAT Total RAM (tax)	Normal VAT rate	CINM/IFTZ VAT in % of Total VAT
2005	19449	2815	43.110.384,06 €	248.368.322,49 €	15%	17,4%
2006	19817	2830	73.118.987,77 €	246.777.022,33 €	15%	29,6%
2007	19758	2840	68.259.540,28 €	243.951.636,50 €	15%	28,0%
2008	19614	2864	54.291.319,53 €	242.049.979,01 €	14%	22,4%
2009	19090	2906	37.448.997,60 €	222.014.818,50 €	14%	16,9%
2010	18491	2924	38.475.907,71 €	221.274.333,62 €	15%	17,4%

[xiv] Source: Sociedade de Desenvolvimento da Madeira

[xv] Source: Secretaria Regional do Plano e Finanças, Direcção Regional dos Assuntos Fiscais.

Year Period	National Budget Transferences	Corporate Tax Revenue	Coverage Rate of Corporate Tax
2005	111.700.000,00 €	295.829,38 €	0,3%
2006	99.200.000,00 €	748.775,57 €	0,8%
2007	162.000.000,00 €	575.512,65 €	0,4%
2008	162.900.000,00 €	487.686,99 €	0,3%
2009	167.000.000,00 €	1.382.763,17 €	0,8%
2010	163.200.000,00 €	11.827.639,72 €	7,2%

xvi Source: Direcção Regional dos Assuntos Fiscais e Direcção Regional do Orçamento e Contabilidade

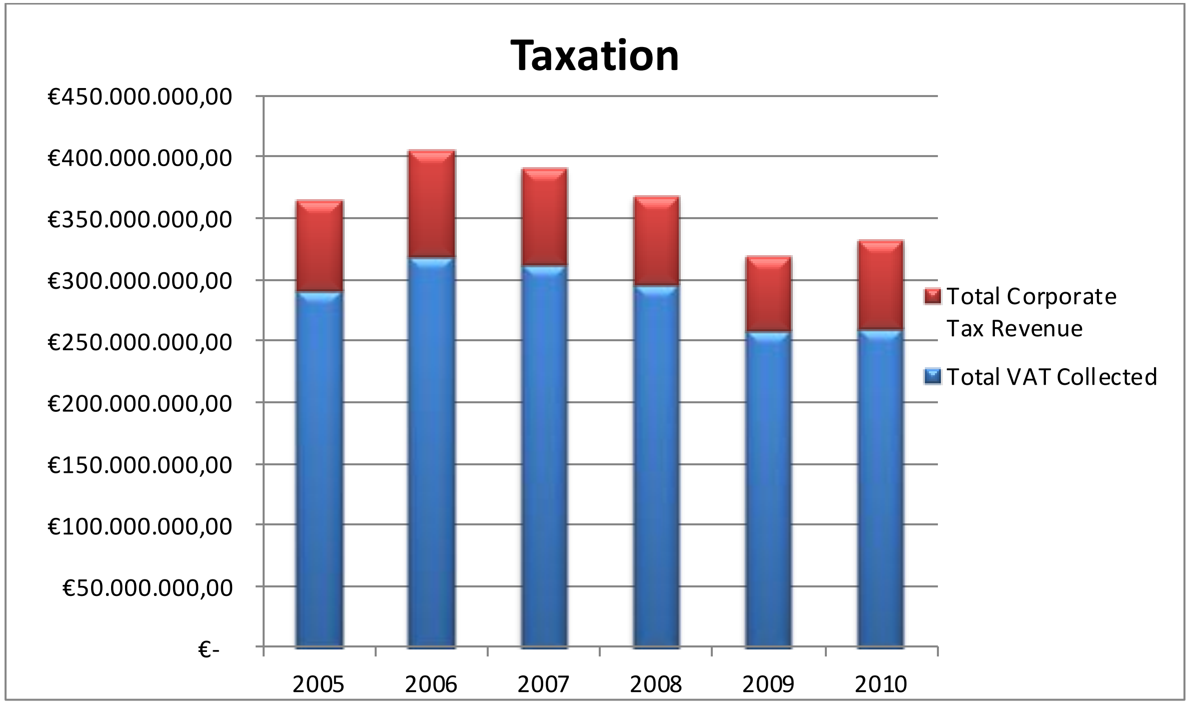
Value Added Tax Data							
Year Period	Nº of Entities in RAM (excluding MIBC/IFTZ)	Nº of Entities (MIBC/IFZ)	Collected VAT MIBC/IFZ	Collected VAT in RAM (excluding MIBC/IFTZ)	Normal VAT rate	CINM/IFTZ VAT in % of Total VAT	Total VAT Collected
2005	19449	2815	43.110.384,06 €	248.368.322,49 €	15%	17,4%	291.478.706,55 €
2006	19817	2830	73.118.987,77 €	246.777.022,33 €	15%	29,6%	319.896.010,10 €
2007	19758	2840	68.259.540,28 €	243.951.636,50 €	15%	28,0%	312.211.176,78 €
2008	19614	2864	54.291.319,53 €	242.049.979,01 €	14%	22,4%	296.341.298,54 €
2009	19090	2906	37.448.997,60 €	222.014.818,50 €	14%	16,9%	259.463.816,10 €
2010	18491	2924	38.475.907,71 €	221.274.333,62 €	15%	17,4%	259.750.241,33 €
						21,9%	Average

Corporate Tax Rate Data										
Year Period	Nº of Entities in RAM (exlcuding MIBC/IFTZ)	Nº of Entities (MIBC/IFZ)	Tax Base (excluding MIBC/IFTZ)	Tax Base Regime I	Tax Base Regimes II & III	Total Tax Base	Corporate Tax Revenue (exlcuding MIBC/IFTZ)	Corporate Tax Revenue Regime I	Corporate Tax Revenue Regimes II & III	Total Corporate Tax Revenue
2005	9693	2693	403.582.755,16 €	4.746.979.344,98 €	14.791.468,94 €	5.165.353.569,08 €	73.431.380,44 €	0 €	295.829,38 €	73.727.209,82 €
2006	9763	2753	281.497.056,02 €	6.797.061.459,68 €	37.438.778,42 €	7.115.997.294,12 €	85.575.754,60 €	0 €	748.775,57 €	86.324.530,17 €
2007	10241	2738	322.289.123,32 €	5.152.871.688,59 €	19.183.755,15 €	5.494.344.567,06 €	77.826.548,00 €	0 €	575.512,65 €	78.402.060,65 €
2008	10202	2681	333.648.727,47 €	6.239.952.742,84 €	16.256.232,94 €	6.589.857.703,25 €	70.877.785,80 €	0 €	487.686,99 €	71.365.472,79 €
2009	10240	2652	330.062.325,78 €	3.845.123.228,48 €	46.092.105,58 €	4.221.277.659,84 €	58.932.184,55 €	0 €	1.382.763,17 €	60.314.947,72 €
2010	9986	2600	280.018.180,97 €	6.868.230.747,40 €	302.042.010,67 €	7.450.290.939,04 €	61.102.818,60 €	0 €	11.827.639,72 €	72.930.458,32 €

Year Period	MIBC/IFTZ Corporate Tax Rate
2005	2%
2006	2%
2007	3%
2008	3%
2009	3%
2010	3% (RII) and 4%(RIII)

Year Period	Tax Proportion (VAT/CTR)	
2005	3,95	
2006	3,71	
2007	3,98	
2008	4,15	
2009	4,30	
2010	3,56	
	3,94	Average

Foregone Fiscal Revenue due to inexistence of Fiscal Soverengty								
Year Period	Total Tax Base	Corporate Tax Revenue (4%)	Corporate Tax Revenue (5%)	Estimated VAT (for 4% CTR)	Estimated VAT (for 5% CTR)	Total Regional Budget Expenditure	Regional Budget Balance (5% CTR)	Regional Budget Balance (4% CTR)
2005	5.165.353.569,08 €	206.614.142,76 €	258.267.678,45 €	816.843.920,12 €	1.021.054.900,14 €	1.096.801.500,00 €	182.521.078,60 €	-73.343.437,12 €
2006	7.115.997.294,12 €	284.639.891,76 €	355.799.864,71 €	1.054.800.593,91 €	1.318.500.742,39 €	1.166.251.900,00 €	508.048.707,10 €	173.188.585,68 €
2007	5.494.344.567,06 €	219.773.782,68 €	274.717.228,35 €	875.178.926,98 €	1.093.973.658,73 €	1.248.565.400,00 €	120.125.487,08 €	-153.612.690,34 €
2008	6.589.857.703,25 €	263.594.308,13 €	329.492.885,16 €	1.094.561.228,38 €	1.368.201.535,48 €	1.317.101.500,00 €	380.592.920,64 €	41.054.036,51 €
2009	4.221.277.659,84 €	168.851.106,39 €	211.063.882,99 €	726.366.416,21 €	907.958.020,27 €	1.059.285.500,00 €	59.736.403,26 €	-164.067.977,39 €
2010	7.450.290.939,04 €	298.011.637,56 €	372.514.546,95 €	1.061.402.828,93 €	1.326.753.536,16 €	1.194.768.500,00 €	504.499.583,11 €	164.645.966,49 €
						TOTAL	1.755.524.179,78 €	-12.135.516,18 €


Taxation
€450.000.000,00
€400.000.000,00
€350.000.000,00
€300.000.000,00
€250.000.000,00
€200.000.000,00
€150.000.000,00
€100.000.000,00
€50.000.000,00
€-
2005
2006
2007
2008
2009
2010
Total Corporate Tax Revenue
Total VAT Collected

xvii Source: MDS, February 2012.

Comparative Tax Systems Analysis

General Aspects of the Regimes				
	Madeira (MIBC / IFTZ)	Isle of Man	Bailiwick Jersey	Bailiwick of Guernsey
Integration within the EU	Member State of EU (access to internal market)	Crown Dependency of the UK Non-EU Territory	Crown Dependency of the UK Non-EU Territory	Crown Dependency of the UK Non-EU Territory
Regime Status	State Aid (EU approved)	General Tax System	General Tax System	General Tax System
Implementation of EU Directives	Full implementation	Do not apply	Do not apply	Do not apply
Corporate Tax Rate	4% (2010 - 2012) 5% (2013 - 2020)	0 % General Tax 10% Financial Activities 20% Earnings derived from real estate in the Isle of Man	0 % General Tax 10% Financial Activities 20% Earnings derived from real estate in the Jersey 20% Public Services Companies	0 % General Tax 10% Financial Activities 20% Earnings derived from real estate in the Guernsey
Tax on Capital Gains	General Tax - 4% In case of reinvestment - 2% SGPS (held for at least 1 year) and Non-Residents - 0%	0%	0%	0%
VAT (or similar tax on consumption)	16% (22% from 1st April 2012)	17,50%	3% or 0% (under special exemption regime)	0%
Stamp Duty	0%	0%	3% for Jersey's real estate related business	2% to 3% Guernsey's real estate related business
Double Taxation Agreements	56	1 with UK and 3 waiting ratification (Malta, Belgium and Estonia) Regarding income tax: Ireland, Denmark, Sweden, Norway, Finland, Iceland, Greenland and Faroe Islands	2 with UK and Guernsey Regarding airships and ships income: France	2 with UK and Jersey regarding income tax: Ireland, Denmark, Sweden, Norway, Finland, Iceland, Greenland, Faroe Islands and the Netherlands
Withholding Taxes				
Dividends	EU and EEA: 0% Others: 25%	0%	0%	0%
Interests	0%	0%. If beneficiary is EU resident exemption only applies if it agrees to exchange information, otherwise 35% tax applies	0%. If beneficiary is EU resident exemption only applies if it agrees to exchange information, otherwise 35% tax applies	0%. If beneficiary is EU resident exemption only applies if it agrees to exchange information, otherwise 35% tax applies
Royalties		0%	0%	0%
Anti-abuse Provisions				
Transfer Pricing Controlled Foreign Companies Capitalization Rules	Yes	No	No	No
Labor Market				
Hiring Regime	Flexible	Flexible	Flexible	Flexible
Possibility of Hiring Foreigners	Admissible	Admissible	Admissible	Admissible
Working hours per week	40h	There is no legal maximum number of working per week	There is no legal maximum number of working per week	There is no legal maximum number of working per week
Compulsory holidays	11	11	11	10
Vacation days	22	28	14	Depends on employment contract
Minimum wage	€ 497,70	€ 1 265,15	€ 1289, 64	€ 1 254,94
Red Tape and Other Aspects				
Fiscal Year	Equal to civil year (12 months)	6 of April to the following 5 of April	Equal to civil year (12 months)	Equal to civil year (12 months)
Tax Declarations	Annually and electronically	Annually and electronically	Annually and electronically	Annually and electronically
Access to Rulings	Yes (binding information)	No	Yes	Yes
Licensing Requirements Payment of fees	Yes	Yes		
Exit taxes	No	No	No	No
Bank Secrecy (Tax Justice Network Rating)	51/100	65/100	78/100	65/100
Constitution of a company				
Types of companies admitted	Sociedade por Quotas (SQ), Sociedades Anónimas (SA), Sucursais	Exempt / International LLC	International Business Companies / Exempt	Exempt / International LLC
Number of partners/shareholders	1	Exempt: 1 International LLC: 2	2	2
Minimum social capital	SQ - €1 SA - €50.000	Exempt: € 2.366,92 International LLC: € 2,36	€ 11.834,61	There's no such requirement.
Admission of foreign managers Compulsory commercial registry	Yes	Yes	Yes	Yes

Comparative Tax Systems Analysis

	Madeira (MIBC / IFTZ)	Malta	Cyprus	The Netherlands	Luxembourg
General Aspects of the Regimes					
Regime Status	State Aid (EU approved)	General Tax System	General Tax System	General Tax System	General Tax System
Corporate Tax Rate	4% (2010 - 2012) 5 % (2013 - 2020)	35% After taxation, shareholder can ask for reimbursement of: 6/7 (if profit was distributed in dividends) 5/7 (if majority of profit comes from royalties and interests) 2/3 (in case of double taxation credits)	10 % 20% - over dividends if participation exemption is not applicable	Earnings up to €200.000 - 20% Earnings above €200.000 - 25%	Earnings up to €15.000 - 20% Earnings above €15.000 - 21% Additional 5 % for unemployment fund
Withholding Tax on Dividends	EU and African Countries of Portuguese Official Language: 0% General Tax Rate: 4%	Participation Exemption: 0% Applicable Tax: 5% - 35%	Participation exemption: 0% General Tax: 20%	Participation exemption: 0% General Tax: 20% - 25%	EU: 0% General Tax: 25% - 26%
Tax on Capital Gains	General Tax - 4% In case of reinvestment - 2% SGPS (held for at least 1 year) and Non-Residents - 0%	General Rule - 35% (Exemption is possible with participation exemption)	Disposal of ownership interest - 0% Sale of estate and societies owning estates in Cyprus - 20% Others - 10%	General Rule - 25% Participation exemption - 0%	General Rule - 26% Participation exemption - 0%
Tax Deductions	Yes	Yes	Yes	Yes	Yes
Stamp Duty	0%	Sale of real estate - 5% Sale of some types of stake holdings - 2% Other cases - 0%	Yes - Limit of €17,086 per document Formation of a company and capital increase - 0,6%	0%	Yes
VAT (or similar tax on consumption)	16% (22% from 1st April 2012)	18%	15% (17% from 1st of March 2012)	19%	15%
Double Taxation Agreements	56	57	48	80	64
Costums Duties	EU Common External Tariffs Duties	EU Common External Tariffs Duties	EU Common External Tariffs Duties	EU Common External Tariffs Duties	EU Common External Tariffs Duties
Municipal Taxes, Estate Taxes and Surtaxes	No	No (see stamp duty)	Property tax - 0 up to 0,8%	Yes (municipal taxes on real estate)	Surtax - 4%
Withholding Taxes					
Dividends	Parent Subsidiary EU Directive: 0% Tax Treaties: 5% - 15% General Rule: 25%	General Tax: 0%	General Tax: 0%	Participation exemption: 0% Tax Treaties: 10% - 15% General Tax: 15%	Parent Subsidiary EU Directive and Non-EU with participation exemption: 0% Tax Treaties: 5% - 15% General Tax: 15%
Services	0%	0%	10%	0%	0%
Interests			0%		0%
Royalties			10% Filming Royalties - 5% Royalties whose rights are exercised outside Cyprus - 0%		0%
Anti-abuse Provisions					
Transfer Pricing	Yes	No	Yes	Yes	Yes
Controlled Foreign Companies			No	Limited application	No
Capitalization Rules				Yes	No But in practice authorities apply a 85:15 ratio
Red Tape and Other Aspects					
Fiscal Year	Equal to civil year (12 months)	Equal to civil year (12 months)	Equal to civil year (12 months)	Equal to civil year (12 months)	Equal to civil year (12 months)
Tax Declarations	Annually and electronically	Annually and electronically	Annually and electronically	Annually and electronically	Annually and electronically
Access to Rulings	Yes (binding information)	Yes (rulings)	Yes, but only regarding law interpretation	Yes (rulings)	Yes (advance tax analysis)
Licensing Requirements	Yes	No	No	No	Business Licenses for commercial activities
Payment of fees					No
Exit taxes	No				
Bank Secrecy (Tax Justice Network Rating)	51/100	48/100	58/100	49/100	68/100
Labor Market					
Hiring Regime	Flexible	Flexible	Flexible	Flexible	Flexible
Possibility of Hiring Foreigners	Admissible	Admissible	Admissible	Admissible	Admissible
Working hours per week	40h	40h	48h	45h	48h
Compulsory holidays	11	16	15	9	10
Vacation days	22	25	25	24	25
Minimum wage	€ 494,70	€ 685,14	€ 909	€ 1.446,60	€ 1.801
Constitution of a company					
Types of companies admitted	Sociedade por Quotas (SQ), Sociedades Anónimas (SA), Sucursais	Limited liability Co, Partnership en nom collectif, Partnership en commandite, Sucursais	Private limited liability Co, Public limited liability Co	BV (private owned company), NV (public company, Sucursais	SA (société anonyme), SARL (société à responsabilité limitée), Sucursais
Number of partners/shareholders	1	Limited liability Co - 1 Partnership en nom collectif - 2 Partnership en commandite - 2	Public - 7 Private - 1	1	1
Minimum social capital	SQ - €1 SA - €50.000	€ 46.587,47	There's no such requirement. In practice minimum required is €1000	BV - €18.000 NV - €45.000	€ 31.000
Admission of foreign managers	Yes	Yes	Yes	Yes	Yes
Compulsory commercial registry					