A Passport of CONVENIENCE

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Offering citizenship in return for investment is a win-win for some small states

"ARE *you a Global Citizen? Let us help you become one.*" You may have seen such an advertisement in an in-flight magazine designed to lure some business class passengers, largely from less-developed economies, into acquiring a passport that can smooth their entry at the border of their next destination. A whole new industry of residence and citizenship planning has emerged over the past few years, catering to a small but rapidly growing number of wealthy individuals interested in acquiring the privileges of visa-free travel or the right to reside across much of the developed world, in exchange for a significant financial investment.

A growing phenomenon

The rapid growth of private wealth, especially in emerging market economies, has led to a significant increase in affluent people interested in greater global mobility and fewer travel obstacles posed by visa restrictions, which became increasingly burdensome after the terrorist attacks of September 11, 2001. This prompted a recent proliferation of so-called citizenship-by-investment or economic citizenship programs, which allow high-net-worth people from developing or emerging economy countries to legitimately acquire passports that facilitate international travel. In exchange, countries administering such programs receive a significant financial investment in their domestic economy. Also contributing to the rapid growth of such programs is the pursuit of political and economic safe havens, in a deteriorating geopolitical climate and amid increased security concerns. Other considerations include estate and tax planning.

Economic citizenship programs are administered by a growing number of small states in the Caribbean and Europe. Their primary appeal is that they confer citizenship with minimal to no residency requirements. Dominica, St. Kitts and Nevis, and several Pacific island nations have had such programs for years: the St. Kitts and Nevis program dates back to 1984. More recently, a number of new programs have been introduced or revived, including by Antigua and Barbuda, Grenada, and Malta, with St. Lucia the most recent addition to the list. While some of these programs have been in place for years, they have only recently seen a substantial increase in applicants, with a corresponding surge in capital inflows.

Similarly, economic residency programs were recently launched across a wide range of (generally much larger) European countries, including Bulgaria, France, Hungary, Ireland, the Netherlands, Portugal, and

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Spain. Almost half of EU member states now have a dedicated immigrant investor route. Also known as golden visa programs, these arrangements give investors residency rights—and access to all 26 Schengen Area countries, which have agreed to allow free movement of their citizens across their respective borders—while imposing minimal residency requirements (see table). Although these programs differ in that one confers permanent citizenship while the other provides just a residency permit, they both allow access to a large number of countries with minimal residency requirements, in return for a substantial investment in their economies (see Chart 1).

In contrast, some advanced economies, such as Canada, the United Kingdom, and the United States, have had immigrant investor programs since the late 1980s or early 1990s, offering a route to citizenship in exchange for specific investment conditions, with significant residency requirements. In 2014, Canada eliminated its federal immigrant investor program, but the provinces of Quebec and Prince Edward Island continue to run a similar scheme that leads to Canadian citizenship. And the United Kingdom and the United States continue to run and expand their programs.

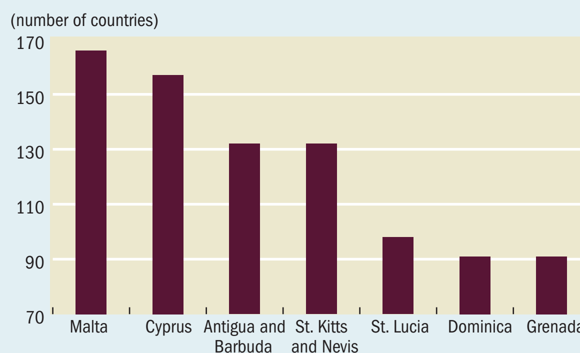
The cost and design of the programs vary across countries, but most involve an up-front investment, in the public or the private sector, combined with significant application fees and an amount to cover due diligence costs. The programs in the Caribbean allow for either a large nonrefundable contribution to the treasury or to a national development fund, which finances strategic investment in the domestic economy, or an investment in real estate (which can be resold after a specified holding period). Other programs provide the option to invest in a redeemable financial instrument, such as government securities. In Malta, the program requires contributions in all three investment routes.

Chart 1

Pick a country, any country

Among the countries offering citizenship programs, Maltese and Cypriot passports offer visa-free access to the most countries.

(number of countries)



Source: Henley & Partners Visa Restriction Index 2014.
Note: Ranking reflects the number of countries to which the country's passport offers visa-free access. The program is not yet launched in St. Lucia.

The price of citizenship

The conditions for acquiring a passport via economic citizenship/residency vary by country.

	Country	Inception Year	Minimum Investment[1]	Residency Requirements[2]	Citizenship Qualifying Period[3]
Citizenship Programs	Antigua and Barbuda	2013	US$250,000	5 days within a 5-year period	Immediate
	Cyprus	2011	€2.5 million	No (under revision)	Immediate
	Dominica	1993	US$100,000	No	Immediate
	Grenada	2014	US$250,000	No	Immediate
	Malta	2014	€1.15 million	6 months	1 year
	St. Kitts and Nevis	1984	US$250,000	No	Immediate
Residency Programs	Australia	2012	$A 5 million	40 days/year	5 years
	Bulgaria	2009	€500,000	No	5 years
	Canada[4,5]	Mid-1980s	Can$800,000	730 days within a 5-year period	3 years
	Canada–Prince Edward Island	Mid-1980s	Can$350,000	730 days within a 5-year period	3 years
	Canada–Quebec[5]	N.A.	Can$800,000	730 days within a 5-year period	3 years
	France	2013	€10 million	N.A.	5 years
	Greece	2013	€250,000	No	7 years
	Hungary	2013	€250,000	No	8 years
	Ireland	2012	€500,000	No	N.A.
	Latvia	2010	€35,000	No	10 years
	New Zealand	N.A.	$NZ 1.5 million	146 days/year	5 years
	Portugal	2012	€500,000	7 days/year	6 years
	Singapore	N.A.	S$2.5 million	No	2 years
	Spain	2013	€500,000	No	10 years
	Switzerland	N.A.	Sw F 250,000/ year	No	12 years
	United Kingdom	1994	£1 million	185 days/year	6 years
	United States	1990	US$500,000	180 days/year	7 years

Sources: Arton Capital; Henley & Partners; national authorities; UK Migration Advisory Committee; and other immigration services providers.
[1]Alternative investment options may be eligible.
[2]Explicit minimum residency requirements under immigrant investor program; residency criteria to qualify for citizenship may differ.
[3]Including the qualification period for permanent residency under residency programs.
[4]Program suspended since February 2014.
[5]Although not specific to the immigrant investor program, retaining permanent residency requires physical presence of 730 days within a five-year period.

Economics of citizenship

The inflows of funds to countries from these programs can be substantial, with far-reaching macroeconomic implications for nearly every sector, particularly for small countries (see Chart 2). Inflows to the public sector alone in St. Kitts and Nevis, which has the most readily available data, had grown to nearly 25 percent of GDP as of 2013. Antigua and Barbuda and Dominica have also experienced significant inflows. In Portugal, inflows under the country's golden visa program may account for as much as 13 percent of estimated gross foreign direct investment inflows for 2014; in Malta, total expected contributions to the general government (including the National Development and Social Fund) from all potential applicants—which are capped at 1,800—could reach the equivalent of 40 percent of 2014 tax revenues when all allocated passports are issued.

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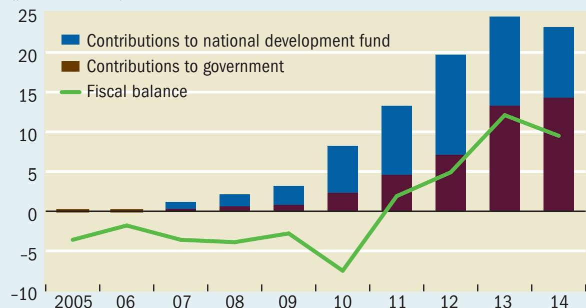
Chart 2

A big boost

St. Kitts and Nevis's economic citizenship program accounts for significant inflows.

(percent of GDP)



Sources: National authorities; and IMF staff estimates.

The macroeconomic impact of economic citizenship programs depends on the design of the program, as well as the magnitude of the inflows and their management. The foremost impact is on the real sector, where inflows can bolster economic momentum. Programs with popular real estate options generate an inflow similar to that of foreign direct investment, boosting employment and growth. In St. Kitts and Nevis, inflows into the real estate sector are fueling a construction boom, which has pulled the economy out of a four-year recession—to a growth rate of 6 percent in 2013 and 2014, one of the highest in the Western Hemisphere. The rapid increase in golden visa residency permits in Portugal, which has issued more than 2,500 visas since the program's inception in October 2012, has reportedly bolstered the property market, leading to a steep rise in the price of luxury real estate.

However, a large and too rapid influx of investment in the real estate sector could lead to rising wages and ballooning asset prices, with negative repercussions on the rest of the economy. And the rapid expansion in construction could erode the quality of new properties and eventually undermine the tourism sector, since most of the developments include (or are repurposed for) tourist accommodations.

Moreover, inflows under these programs are volatile and particularly vulnerable to sudden stops, exacerbating small countries' macroeconomic vulnerabilities. A change in the visa policy of an advanced economy could suddenly diminish the appeal of these programs. It's conceivable that advanced economies could act together to suspend their operations, triggering a sudden stop. Increasing competition from similar programs in other countries or a decline in demand from source countries could also rapidly reduce the number of applicants.

If they are saved rather than spent, inflows from these programs can substantially improve countries' fiscal performance. In St. Kitts and Nevis, budgetary revenues from the program boosted the overall fiscal balance to more than 12 percent of GDP in 2013, one of the highest in the world. But these inflows can also present significant fiscal management challenges, similar to those caused by windfall revenues from natural resources (see "Sharing the Wealth" in the December 2014 *F&D*). Such revenues can lead to pressure for increased government spending, including higher public sector wages, even though the underlying revenues may be volatile and difficult to forecast. The resulting increase in dependence on these revenues could lead to sharp fiscal adjustments or an acute increase in debt, if or when the inflows diminish.

A country's external accounts are also significantly affected by large program inflows. The budgetary revenues can improve the country's current account deficit, and substantially so if they are saved, and the capital account can be strengthened by transfers to development funds and higher foreign direct investment. But increased domestic spending as a result of higher government expenditures and investment will substantially boost imports, particularly in small open economies, offsetting some of the initial improvement in the balance of payments. Risks to the exchange rate and foreign currency reserves are also magnified as these inflows become a major source of external financing. In addition, rising inflation from economic overheating can cause the real exchange rate to appreciate, lowering the country's external competitiveness over the long run.

Large program inflows can also boost bank liquidity, especially if the bulk of the budgetary receipts are saved in the banking system. At the same time, they can threaten financial stability in small states. While some increase in liquidity may be welcome, large accumulation of program-related deposits presents new financial risks, reflecting small banking systems' limited and undiversified options for credit expansion. Risks to financial stability may be magnified if banks face excessive exposure to construction and real estate sectors already propped up by investments from the economic citizenship program. In that case, a sharp decline in program inflows could prompt a correction in real estate prices, with negative implications for banks' assets, particularly if supervision is weak.

Another challenge is the risk to governance and sustainability. Cross-border security risks associated with the acquisition of a second passport are likely to be the main concern of advanced economies. Reputational risks are also magnified: weak governance in one country could easily spill over to others, since advanced economies are less likely to differentiate between citizenship programs. In addition, poor or opaque administration of programs and their associated inflows—including inadequate disclosure of the number of passports issued, revenues collected, and mechanism governing the use of generated inflows—could prompt strong public and political resistance, complicating, or even terminating, these programs. Programs have indeed been shut down in the past as a result both of security concerns and domestic governance issues.

Weeding out the risks

Country officials can implement policies to reduce and contain the risks small economies face from large economic citizenship program inflows while allowing their economies to capitalize on the possible benefits.

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Prudent management of government spending has an important role in containing the impact of these inflows on the real economy, but it should be accompanied by sufficient oversight and regulations to pace inflows, particularly to the private sector. For example, annual caps on the number of applications or the size of investments would limit the influx of investments to a country's construction sector. A regulatory framework for the real estate market would reduce risk and limit potentially damaging effects of price distortions and segmentation in the domestic property market as a result of investment minimums imposed by these programs.

A rigorous due diligence process for citizenship applications is essential.

Changing key parameters of the program can also be an effective way to redirect investments to the public sector, allowing countries to save the resources for future use and to invest in infrastructure.

Saving is a virtue

Large fiscal revenue windfalls tend to trigger unsustainable expansions in expenditure that leave the economy exposed if the revenue stream dries up. Given the potentially volatile nature of these inflows, program countries—and small economies in particular—need to build buffers by saving the inflows and reducing public debt where it is already high. Prudent management of citizenship inflows would allow for a sustainable increase in public investment and accommodate what economists call countercyclical spending—spending when times are bad—and relief measures in the face of natural disasters. As in resource-rich economies, managing large and persistent inflows is best undertaken via a sovereign wealth fund. This would help deal with fluctuations in program revenues and stabilize the impact on the economy, possibly also providing scope for intergenerational transfers.

In any case, all fiscal revenue from economic citizenship programs, whether application fees or contributions to development funds, should be channeled through the country's budget to allow for proper assessment of the fiscal policy stance and avoid complications in fiscal policy implementation. In particular, development funds financed by economic citizenship programs should have their role properly defined and their operations and investments fully integrated in the budget.

Effective management of inflows, combined with prudent fiscal administration, will also reduce risk to the external sector, by containing the expansion of imports, limiting the rise in wages and the real exchange rate, and accumulating international reserves—to serve as a buffer in case of a sharp slowdown in program receipts. Strengthening banking sector oversight is also needed to moderate risks arising from the rapid influx of resources to the financial system. Caps on credit growth, restrictions on foreign currency loans, or simply tighter capital requirements may be needed to dampen the procyclical flow of credit.

Managing a reputation

Preserving the credibility of the economic citizenship program is perhaps the most critical challenge. A rigorous due diligence process for citizenship applications is essential to preclude potentially serious integrity and security risks. And a comprehensive framework is needed to curtail the use of investment options as routes for money laundering and financing criminal activity. Such safeguards are integral to the success of economic citizenship programs. A high level of transparency regarding economic citizenship program applicants will further enhance the program's reputation and sustainability. This could include a publicly available list of newly naturalized citizens. Complying with international guidelines on the transparency and exchange of tax information would reduce the incidence of program misuse for purposes of tax evasion or other illicit activities and minimize the risk of adverse international pressure. Countries with similar programs should also collaborate among themselves and with concerned partner countries to improve oversight and ensure that suspicious applicants are identified.

Moreover, to help garner necessary public support for these programs, the economic benefits should accrue to the nation as a whole. They should be viewed as a national resource that may not be renewable if the nation's good name is tarnished by mismanagement. A clear and transparent framework for the management of resources is necessary, including a well-defined accountability framework with oversight and periodic financial audits. Information on the number of people granted citizenship and the amount of revenue earned—including its use and the amount saved, spent, and invested—should be publicly available.

The ever-surprising effects of globalization have given rise to a new dynamic whereby passports can carry a price tag. Economic citizenship programs facilitate travel for citizens of emerging and developing economy countries in the face of growing travel restrictions and are an unconventional way for some countries, particularly small states, to increase revenue, attract foreign investment, and bolster growth. Keeping these programs from being shut down calls for efforts to ensure their integrity, and the security and financial transparency concerns of advanced economies must be duly addressed. Small states offering these programs must develop macroeconomic frameworks to deal with the potential volatility and inflationary impact of the inflows, by saving the bulk of them for priority investment in the future and by pacing and regulating their flow into the private sector. ■

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This article is based on a 2015 IMF Working Paper, "Too Much of a Good Thing? Prudent Management of Inflows under Economic Citizenship Programs," by Xin Xu, Ahmed El-Ashram, and Judith Gold.

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