The Finance Curse: exploring the possible impacts of hosting an oversize offshore financial centre

Authors: John Christensen and Nicholas Shaxson

The paradoxical situation whereby resource rich countries depending on earnings from natural resources like oil and gas frequently suffer from lower economic growth, higher inequality, entrenched corruption, political repression, and relatively high rates of absolute poverty is recognised and widely known as the Resource Curse. This paper explores a similar and related phenomenon which appears to afflict some countries with oversized financial centres serving both domestic and offshore markets. Emerging evidence suggests that beyond a certain size relative to the domestic economy, growth of the financial services sector harms the host country in a variety of ways, including lower long-term growth, greater inequality, a propensity towards rent-seeking rather than productive investment, corruption and state capture. Citing case study material from three tax havens - Cyprus, Jersey and London - the paper explores how economic crowding-out (akin to the Dutch Disease), brain drain and financialisation create path dependence problems, which reinforce a tendency for the powerful lobbies associated with the financial services sector to dominate the local polity. This combination of economic and political capture results in country capture, which we have termed the Finance Curse, that in many respects resembles the principal elements of the Resource Curse.
The geography of investment management contracts: the UK, Europe and the global financial services industry

Author: Gordon Clark

Abstract:
Contract is crucial for governing the relationships between asset owners and the many types of agents that underpin the production of financial services. We distinguish between discrete contracts for financial services and investment management contracts that are better described as relational in the sense that they are open-ended and subject to renegotiation between the parties. Emphasis is placed upon the significance of risk and uncertainty in financial markets and the ways in which the parties to contracts adapt to these conditions. This provides the backdrop for understanding three different types of contractual arrangements apparent in the investment management industry, bringing to the fore the significance of the choice-of-jurisdiction when writing contracts for investment services. We explain how and why the UK is a favoured destination for European institutions just as offshore jurisdictions, such as the Cayman Islands, may be the favoured ‘home’ jurisdictions for certain types of UK and global investment managers. At the heart of the relationship between asset owners and asset managers is the power of these parties when choosing the type of contract and the jurisdiction which is the favoured location for formalising these relationships.
Territorial Politics Meets Global Finance: The Case of the New Nigerian Sovereign Wealth Fund

Authors: Adam D. Dixon, Ashby H.B. Monk, and Jason Mosley

One increasingly popular mechanism for dealing with the ‘resource curse’ is the commodity-based sovereign wealth fund (SWF). However, any optimism for the potential of SWFs in resource-revenue management should be limited, as implementing and sustaining the SWF ‘solution’ to the resource curse is inherently complex. Simply maintaining a long-term risk-adjusted rate of return on global markets requires a form and function akin to other high-performance institutional investors. As such, a particular set of governance principles needs to be met, and the fund needs to be able to operate with a degree of relative autonomy, such that it is insulated from partisan politics and bureaucratic encroachment. This requires a broad package of institutional reforms that buttress a country’s political capacity to manage its resource wealth. However, for many countries, such virtuous political conditions are limited. This is particularly the case in Nigeria. In this paper, we discuss the general challenges of establishing a SWF. This is followed by an in-depth analysis of the current contested development of the new Nigerian SWF.
Institutional conversion or how the infrastructure for fiscal arbitration was 'discovered' by TBTF banks for regulatory arbitrage purposes - the case of Lehman Brothers Treasury BV

Authors: Ewald Engelen & Rodrigo Fernandez

The world of finance progressively moved away from traditional banking in the decades preceding the financial crisis of 2008. Particularly since the 1990s, innovative forms of intermediation, like securitization and Repo markets were instrumental for the increase in leverage in developed economies. These complex forms of credit intermediation outside the traditional banking system were coined shadow banking in 2007. It was shown to consist of a network of intermediaries that interact from across different jurisdictions. Essential to this geography is the role of offshore financial centers (OFC’s), like the Netherlands, Luxembourg and Ireland that act as conduit jurisdiction. These jurisdictions enable financial institutions to create levels of complexity that allow for regulatory arbitrage and tax avoidance at the same time. In this paper we present the case of Lehman Brothers Treasury BV, a Dutch shell company that served important funding functions for the global Lehman Group and which after its bankruptcy turned out to be its largest claimant, to show how a consortium of legal entities operated from across EU jurisdictions to setup a funding operation that largely operated outside the scope of any regulatory body. This architecture fits a broader pattern of TNC’s and investment banks that use shadow banking entities for external funding. This study tries to contribute to the debate on shadow banking by pointing to the role of OFC’s and tries to trace the recent history of shadow banking to identify the mechanisms behind this case of institutional conversion.
Regional Blocks and Imperial Legacies: Mapping the Global Offshore FDI Network

Authors: Daniel Haberly & Dariusz Wójcik

While FDI is generally assumed to represent long-term investments within the “real” economy, approximately 30-50% of global FDI is accounted for by networks of offshore shell companies created by corporations and wealthy individuals for tax and other purposes. To date, there has been limited systematic quantitative research on the global structure of these networks. Here we address this gap by employing Principal Component Analysis (PCA) to decompose the global bilateral FDI anomaly matrix into its primary constituent sub-networks. We find that this matrix is dominated by four interlocking networks linking together groups of offshore and real economies. Most prominent are two networks corresponding to enormous round trip offshore FDI flows generated by the former communist Eastern Block and Greater China regions. These are followed by two networks defined by American and other OECD multinational corporate activity, and the former British Empire respectively. Each of these networks is characterized by ties to both specialized offshore centers, and a global offshore network “core” dominated by the Low Countries, Switzerland, and the UK along with several of its colonies.
Managing private wealth and the OFC: some exploratory observations

Authors: Sarah Hall and Jonathan V Beaverstock

The private wealth management industry represents one of the most buoyant areas of international financial services activity in the wake of the global financial crisis. Developing out of historic private banking to include a range of advisory and investment functions, it has a strong office network presence in a range of established and emerging offshore financial centres. However, beyond documenting its presence in OFCs, the rationale and implications of the wealth management industry’s use of the offshore world has been comparatively neglected in interdisciplinary research on the contemporary international financial system. In this paper, we respond to this oversight by combining earlier work on the geography of OFCs with practice-based research into the concentration of business services in a small number of global cities. Using this theoretical approach, we reveal how a focus on the practice of service delivery in private wealth management demonstrates the relational nature of both on and offshore financial centres as they are co-produced through corporate practice. Empirically, the paper will interrogate a number of secondary sources on the scale and scope of private wealth management in the global economy and OFCs. Data will be drawn from: official data sources on private wealth distribution (e.g. HMRC; IMF); industry-specific reports on the industry (like for example, Scorpio Partnership); professional service firms that offer expert intelligence on private wealth management to the industry itself (e.g. PwC; KPMG); and a forensic analysis of the genesis of private wealth providers in different OFC jurisdictions. We conclude the paper with a strong evidence-based argument that positions private wealth management as one of the significant facets of the vitality and sustainability of OFCs in the contemporary architecture of the international financial system.
Offshore jurisdictions (including Cyprus), corruption money laundering and Russian round-trip investment

Authors: Päivi Karhunen & Svetlana Ledyaeva

This paper investigates the link between corruption money laundering and round-trip investment via offshore jurisdictions. Using a rich dataset of firms with foreign ownership registered in Russia (1997-2011) we find that round-trip investors (namely, from Cyprus and British Virgin Islands (BVI)) tend to locate in more corrupt Russian regions than genuine foreign investors and that the fraction of round-trip investment in total foreign investment is significantly higher in corrupt regions. In general our results highlight a strong link between Russian round-trip investment via Cyprus and BVI and corruption money laundering. Further, we develop a two-sector model of the impact of round-trip activities in financial and real estate sectors on the growth in processing industries which shows that it is negative. Our empirical test based on Russian data confirms this proposition.
The Level of Corporate Transparency among World’s Largest Multinationals

Author: Barbara Kowalczyk-Hoyer

In its recent study, Transparency International evaluated the level of public disclosure among 105 largest publicly listed multinational companies.

Two out of three evaluated dimensions - organisational transparency and country-by-country reporting - are important to trace how money is generated and how it flows within large multinational corporate structures. Such information should be available to all stakeholders, especially to the citizens of countries, in which the companies operate, bid for licences, sign governmental contracts, generate revenues and pay or not pay taxes.

The study shows several interesting results, which are worth deeper consideration. First, the level of organisational transparency is relatively high but mostly limited to the material fully-consolidated holdings. Second, country-by-country reporting of financial data is still very rare. Third, there are already some companies, which decided to introduce country-by-country reporting for all countries, in which they operate. Fourth, the often quoted argument, that country-level reporting is not possible in some “difficult environments” is not defendable, because one can find examples of good disclosure in many such countries.
The Future of Offshore Finance as a Policy Problem

Author: Bob Kudrle

All governments are scrambling for revenue, and the close association of offshore with the wealthy has fueled popular anger and government action. Offshore here means any jurisdiction through which financial claims pass to avoid legal constraints elsewhere; offshore finance refers to those claims. Foreign constraints are avoided by a combination of selectively lower taxation, opacity, sham activity, and lighter regulation. From that starting point, attention can focus either on those jurisdictions where offshore is conspicuous relative to the economy as a whole, Offshore Financial Centers (OFCs), or on significant offshore elements wherever they occur. As policy evolves, the OFCs will provide no barrier to improved prudential regulation aimed at global financial stability. The OFC role in corporate tax avoidance will decline with greater restriction, but nothing can be done to prevent the competitive erosion of the tax itself. Cooperative policy to decrease tax evasion through OFCs and other jurisdictions will likely succeed, at least among the developed countries. Farther in the future, both tax policies and location suggest that OFCs might play an important role in tax escape by the wealthy.
THE FINANCIAL SECRECY INDEX:

SHEDDING NEW LIGHT ON THE GEOGRAPHY OF SECRECY?

Authors: Markus Meinzer and Alex Cobham

In this paper we present the Financial Secrecy Index, which ranks countries and jurisdictions according to the lack of financial transparency, and their global scale. We explore the absence of an objective definition for the term ‘tax haven’, and consider the extent to which this may underpin the failure of efforts to ‘crack down’ on financial secrecy. In doing so we propose objective criteria for a related, alternative category, of ‘secrecy jurisdictions’. This definition forms the basis for the construction of the Financial Secrecy Index, from its two components: a secrecy score, which draws upon multiple international sources to create fifteen sub-components reflecting individual aspects of financial secrecy such as the provision of anonymous companies, and the extent of international judicial cooperation; and a global scale weight, reflecting the importance of each jurisdiction in providing financial services to non-residents.

We then show how applying an approach of this type – including related indices, such as the Basle Anti-Money Laundering Index – reveals a quite different geography of financial secrecy from the image of small island tax havens that may still dominate popular perceptions. In part, this is because the major economies now come into focus. In addition, the Index reveals that rather than splitting jurisdictions into ‘sheep and goats’ – tax havens and not – it is helpful to think of a secrecy spectrum, on which all jurisdictions can be situated. Finally, we explore how the Index leads directly to policy insights that would not be evident from a less rigorous approach, and consider the implications of these for the current policy debates at the G8, G20 and OECD.
Asiatic capital across an onshore/offshore divide

Author: William Vlcek

The question considered here involves the increasing role, and potential increasing influence, of capital from China in the circuits of offshore finance. The process establishing the ‘workshop of the world’ at the same time transferred wealth to party cadre and well-connected entrepreneurs. In some instances, individuals accumulated significant wealth and now utilise financial facilities already familiar to the wealthy citizens of other countries for managing and maintaining that wealth ‘offshore’. The accumulation of private Chinese capital is situated in this analysis as a ‘postmodern’ finance capital with echoes of early 20th century imperialism. The nature of the capital involved is considered through reports that attempt to measure the scale of Chinese capital flight and the Chinese private wealth that is increasingly relocated to the offshore realm. The challenge before China is two-fold, on the one hand there appears to be limited enforcement capacity for existing legislation (though the penalties include capital punishment), and on the other hand China’s absence from international forums producing global financial governance (e.g. OECD) limits opportunities to incorporate its concerns in the production of that governance. The challenge before us is to incorporate China in current international efforts to address corporate tax avoidance and tax havens.
Emerging onshore-offshore industries: The case of asset-backed securities markets in Europe

Author: Thomas Wainwright

Researchers from economic geography and the social sciences have recently renewed their interest in the roles that offshore financial centres (OFCs) play in the global financial system, particularly in the wake of the recent economic crisis. Previous work often framed OFCs as being situated in small island economies, carefully constructed to foster secrecy and low rates of taxation. This research base has often criticised OFCs for their lack of transparency and role in facilitating money laundering, tax avoidance and planning. This paper draws upon in-depth interviews with professionals working in European asset-backed securities (ABS) markets to investigate the emergence of this industry and its associated spaces. Specifically, this paper seeks to extend earlier framings of OFCs to examine the convergence of ‘offshore’ and ‘onshore’, through the emergence of European onshore-offshore spaces which became established in existing financial centres in the 2000s. The key findings are that the growth of ABS markets stimulated the emergence of new professional service providers and tax spaces through new legislation. In addition, it is argued that European governments actively restructured financial spaces and promoted their tax planning virtues to develop competitive advantages over other European onshore-offshore financial centres and ‘traditional’ OFCs.

Key words: offshore financial centres; tax planning; securitization; emergence; financial services; onshore financial spaces
Intangible Assets, Profit Shifting and Unbundling the (Multinational) Corporation: Towards an Understanding of Capital in Motion

Authors: Dick Bryan, Mike Rafferty, Duncan Wigan

In 1989, Walker, wrote what he called a 'requiem for corporate geography'. While the growth of the multinational corporation was reaching the point that it was becoming the standard organisational form of capital, the actual forms and scales of the international mobility of capital and corporations seemed to be undermining existing spatial and institutional concepts of capital. One aspect of this paradox related to the growth of finance not just as industry, but also through what we might term the ‘financialisation’ of finance – the growth of financial instruments and logics ('ways of seeing' to paraphrase Berger) across the finance-industry divide. Confronting aspects of this process, Clark (2005) suggested that finance had become an essential lens through which to study contemporary capitalism. Taking recent developments in offshore finance as its empirical focus, this paper explores the implications of interactions between changes in the cross border organisation of the multinational corporation, the proportion of corporate value accounted for by intangible assets and the international tax architecture. In particular, we focus on developments in the digital and intangible economy and recent high profile distributional conflicts between states (on and off-shore) and international firms. The paper first outlines the mechanics of value and profit shifting in the intangible/digital economy. We then address the disaggregation and unbundling of attributes of the firm across space and time and the consequent blurring of the boundaries of firm. Using network mapping analysis of international capital flows we highlight how they reveal how these new mobilities of capital have come in important ways from financial transformations. These harness the abstract nature of capital, and its ability to change the spatial and temporal attributes of capital (and therefore permit transfer pricing and profit shifting), and permit a weaving of network and fluid forms through the international lattice of double taxation treaties. This allows us to present a cartography of profit shifting through jurisdictions which provide legal systems (known variously as ‘enclaves’, ‘offshore’ and so on) to attract forms of mobile capital not simply through an expanded concept of financial arbitrage, but as the proximate cause of this new expression of capital's mobility.

The paper moves on to argue that the interactions and developments we are observing therefore signify more than an aberration or temporary form of regulatory obsolescence, awaiting adequate policy evolution to re-regulate. Instead, considered in this light, they are also an expression of the historical evolution of capital. The increasing mobility, fluidity and abstraction of capital not only challenges our understandings of the relationship between the state and capital, but forces us to confront extant theories and imaginaries of capital itself. Notably, while the abstraction, fluidity and mobility of capital can be too easily read as suggestive of decoupling and dematerialization, we emphasise that the abstraction and materiality of capital remain inextricably entwined. Indeed, one of the conclusions of our analysis is that whereas we used to debate concepts of capital largely through abstraction, the developments we present here give us access to those concepts both as abstraction and
observable material phenomenon. Important implications for disciplinary fields including economic geography, international relations and political economy follow.