

# Global Finance: The British Empire and European welfare State

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# Offshore financial centres

- 70 or so offshore financial centres (or tax havens)
- Cayman Islands considered the fourth or fifth largest international financial centre
- Approximately 50% -65% of all international banking assets and liabilities are routed through these types of centres
- They are recipients of approximately 30% of world's share of FDI, and in turn, are the originator of similar amounts of FDIs. (Palan, Murphy, Chavagneux, 2010)
- The majority of hedge funds are registered in these locations
- Majority of Special Purpose Vehicles (SPVs) are registered offshore
- BP ex-oil rig was registered in the Marshall Islands

# International financial centers, 2009

Reporting Countries		Amounts outstanding			
		External loans	% share	deposits	% share of total
	All countries	21,394.1		23,296.4	
1.	UK	4,495.4	21.0	4,890.2	20.9
2.	US	2,658.2	12.4	3,014.2	12.9
3.	Germany	2,092.5	9.8	1,300.9	5.6
4.	Caymans	1,546.8	7.2	1,576.3	6.7
5.	France	1,345.1	6.3	1,737.4	7.5
6.	Japan	954.9	4.5	883.4	3.8
7.	Switzerland	923.0	4.3	987.5	4.2
8.	Netherlands	774.8	3.6	811.3	3.5
9.	Singapore		654.2	3.0	617.0
10.	Luxembourg	624.2	2.9	590.0	2.5

# International Financial Centers, geographical aggregates, March 2009

	LOANS		SHARE	DEPOSITS		SHARE
ALL COUNTRIES	21,394.1			23,296.4		
British Empire + European Havens	12,257	57.2%		13,216	56.7%	
British Empire	8,551	39.9%		8,705	37.3%	
The British state	6,635	31.0%		6,902	29.6%	
European Havens	3,706	17.3%		4,511	19.4%	
City-States	4,623	21.6%		4,406	18.9%	
U.S.	2,652	12.4%		3,014	12.9%	

- Source: BIS Figures for the British Empire include the UK, Caymans, Singapore, Hong Kong, Bahamas, Jersey, Guernsey, Isle of Man
- UK, Caymans, Jersey, Guernsey, Isle of Man
- Switzerland, Netherlands, Ireland, Belgium, Luxembourg, Austria.
- Caymans, Singapore, Hong Kong, Luxembourg, Bahamans, Jersey, Guernsey, Bahrain, Isle of Man



# Political economy

- John R. Commons: The primacy of the economic transaction
- Economic transactions take place simultaneously in two realms:
- Actual exchange of goods, services, including labour exchanges
- Exchange of property titles or contracts
- Economists treat the two realms as one
- the second realm, the exchange of property titles, is key to understanding the dynamics of economic systems

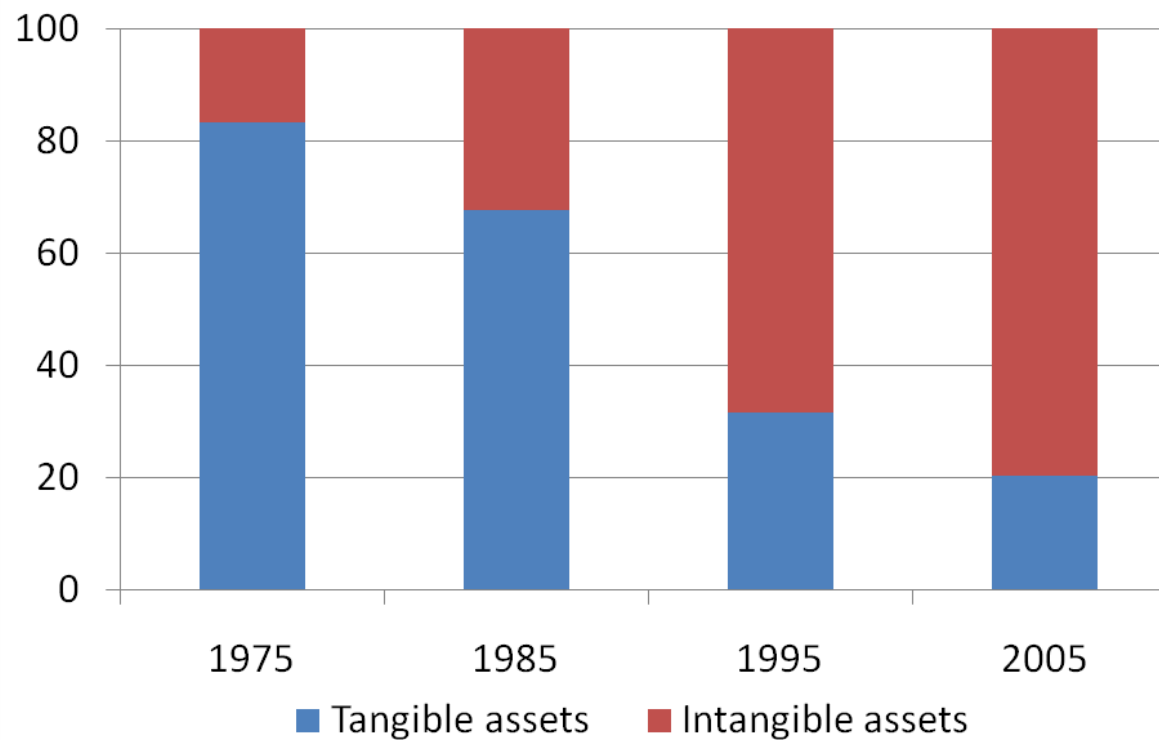


# Property titles

- Commons identified three types of property titles that are traded in markets
- Corporeal assets, or 'goods'
- Incorporeal assets, i.e. debt instruments
- Intangible assets, primarily 'goodwill', but also brand name, and so on.
- Marx thought that labour sells labour power
- Actually, labour contracts are 'goodwill' futures contracts, alas most of us have apparently little goodwill to sell

# Share of tangible versus intangible assets in US S&P 500

Figure X: Share of tangible versus intangible assets in US S&P500 market capitalization. Source: Pagano and Rossi, 2009:671





# Property after Commons

- We discovered that every title exchanges transfers an ‘excess baggage’ of risk
- Risk supposedly can be separated and traded as well (derivatives)
- Markets trade in corporeal, incorporeal, intangible and risks;
- The less corporeal the asset, the more its value and function hinges on an authority, the institutions of sovereignty and the state





# It's political economy, stupid

- In contractual economy, the state encodes every aspect of life with its brand
- Individuals = citizens; corporate = corporate personality in law; moving vehicles (cars, ships, airplane) are licensed; goods are assigned 'made in'; land ownership must be registered; even ownership of gene pool is licensed.
- All such entities either belong to individual sovereign states
- Or inhabit a space that belongs to humanity at large: such spaces include the oceans, space, the offshore financial market and possibly the web.
- Legally speaking, we own the entire universe



# Capturing the economy

- The intimate relationship between authority and contract ensures a complex dynamic relationship between the two that goes to the very essence of the meaning of 'profit'
- Corporate taxation could easily reach 30% or more on 'profit'
- How profits are calculated, including amortisation etc, is not trivial
- Subsidies and sweeteners amount to an average of 4% of GDP among OECD countries, but fuller account probably more like 12-18%.
- One motivation of state policy is capturing trading relationships in the different assets within their territory for tax purposes, job creation, and government revenue.
- In an 'open economy', there are different dynamics to these relationships per each type of property titles



# US Hegemony, LTD.

- US was able to set the rules of the game in the international transactions of corporeal assets
- It tried to take the lead also in setting up the international rules of transaction in incorporeal assets, the Bretton Woods fable
- Some intangible were discussed only in later rounds of GATT
- Major currencies entered into fixed exchange under the Bretton Woods rules only in 1958, by then it was too late
- The Sterling Area, 40% of international trading denominated in sterling, survived until early 1960s



# 20<sup>th</sup> century web of contracts

- International structure is perception of spread of opportunities, penalties and rewards
- Incorporeal and intangible aspects of any trade migrate to lower tax, less regulated jurisdictions
- Trend had been to dissect the contract into smaller and smaller portions, each portion is located elsewhere
- Contracts may be denominated in one currency, 'located' under the legal space of another, and located for adjudication purpose in another state altogether
- Synergies between different supposedly independent authorities to capture various aspects of these



# The Euromarket

- Emergence of Euromarket, 1957 London
- Known otherwise as the 'offshore' financial market
- The Euromarket encourages the use of financial subsidiaries for tax and regulatory avoidance purposes
- It emerged 'spontaneously'



# Origins of Euromarket

Events that took place in September 1957, City of London

Largely to do with pressure on the UK pounds following the Suez canal fiasco

To allow the city to continue trading, without adding to the pressures on the pound as certain tentative agreement was reached in the backrooms of the bank of England

Commercial banks could continue international trade but as long as it was in foreign currency and as long as they intermediated between non-residents

The Bank did not ask for government or parliamentary approval, simply agreed that it would treat such transactions 'as if' they do not take place in UK territory, and hence not under UK's regulatory sovereignty



Yet, with these dollar deposits not needing, necessarily, to be swapped into sterling, (or any other currency), before being traded and, hence, not coming under exchange control regulations.

But as they were taking place in the UK, no-one else could regulate these transactions (or the assumption was that they were regulated by UK authorities).

What marked the start of the City's role as an entrepot centre, also heralded the beginning of the offshore Euro-dollar market proper.

- The creation of the Eurodollar market had, in effect, provided the City with a "way back" into business, allowing it to continue to act as a centre for international finance without imposing a strain on Britain's depleted gold and exchange reserves.







# London develops British isles

- Euromarket is a regulation free zone: no capital requirements; no need to use CDs, etc.
- American discovered London as haven from New Deal financial regulations (Glass-Steagall etc.)
- Euromarkets activities, however, are taxed
- London financiers beginning to develop British islands as offshore financial enclaves for tax purposes
- Development follows geographical path
- London 1957,
- Channel islands early 1960s
- Cayman, Bermuda, 1964/5
- Singapore 1967
- Pacific Islands, late 1960s, early 1970s



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- Development follows an institutional path
  - London has a unique status in British urban law, maintaining many of its medieval privileges
  - Jersey, Guernsey have fairly similar institutional mix, an odd 'democracy' ; no party system and that does not separate legislative and executive role.
  - As the Euromarket shifted geographically, also migrated to islands with slightly less affinities to London

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- The result is effectively a London-centred integrated global financial centre
  - Covers all the major time zones
  - Thrives on lack of regulation and taxation
  - Specialist in incorporeal and increasingly ‘risk’ assets
  - English common law encourages ‘financial innovation’
  - Certain regulatory arbitrage, for instance, the use of Special purpose vehicles, trusts and other financial vehicles is encouraged in the smaller offshore centres




## US reaction: Cannot fight them..

- Such large integrated centre impact on all the others who had to emulate many of its features to remain competitive
- US treasury fought the Euromarket
- Introduced the tax equalization act in 1963
- The use of Dutch Antilles during the 1980s to encourage US corporations to maintain more activities on US mainland
- But the US failed to stem the flow and gave up, setting up its own offshore, international banking facilities



# Specialist harvesters of intangibles

- Euromarket and internationalization financed the expansion of multinationals world wide
- Shift from manufacturing to licensing agreements and sales driven by ‘intangible’ like logos, trade marks and intellectual property rights
- Coca Cola, Intel, Microsoft and the like

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- They too were looking for places to harvest their world-wide income from intangibles in low tax jurisdictions
  - The preferred method is an 'holding company', many of which became specialist in 'treasury operations' they are purely accounting devices
  - Such companies existed in the Benelux countries for historical reasons since late 19<sup>th</sup> (the Netherlands) and 1929 (Luxembourg)


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- They proved ideal locations for such purposes
  - Low taxation; available skilled work force; politically stable jurisdictions; considered far more 'legitimate' than small Caribbean islands
  - Belgium, Ireland and Switzerland followed the same model
  - That Intel or Apple have offices in the Netherlands or Ireland

Table 1.3.

### Select Foreign Affiliates in the Irish financial Service Centre, assets and number of employees

Source: Stewart 2005, 281.

Name of ultimate parent company	Name of Affiliate	Pre-tax Profits millions	Gross Assets Millions	Number of employees
3Com.	3Com. (Cayman)	\$4.6	\$153	0
Inter.	A1 fin. service (Switzerland)	E 3.0	E117	0
	Airbus, fin. ser ()	0	E 2	0
Analog Development,	Annalog Development Int. finance ()	\$11.6	\$592	6
	BBA finance ()	0	\$433	0
Scientific,	Bost. S. Int. Fin (Netherlands)	\$2.8	\$312	0
Tyco Inter. Bermuda	Brangate (Lux)	\$26.6	\$907	6
Bristol-Meyers Squibb,	BR. Mey, Sq. Int ()	E 15.1	E947	4
Cisco Systems,	Cisco Fin Int. ()	\$-109.0	\$235	27
	Coca-Cola holding ()	E-3.7	E2179	0
CNH,	CNH, Capital ()	-6.3	E 94	49
	IBM, Int. fin. holding ()	\$50.2	\$2653	4
Eli Lilli,	Kinsale Fin. ()	\$32.9	\$1409	1
	Prizer, Services (Pfizer int bank, Europe ())	\$33.6 \$23.6	\$6501 \$485	10 0
	Polygram int. ()	\$22.0	\$3919	0
Sea Container,	See Container, fin. ()	E 0.5	E 26	0
	Black & Decker, int. ()	\$5.9	\$888	7
	Volkswagen, inv. (Cayman)	E 15.9	E 566	7
	Xerox leasing ()	E 29.7	E 645	0
General Motors,	RFC ()	\$2.1	\$108	0
	Sigma-Ald. serv ()	£1.2	E 645	0
INGKA, Holdings, Netherlands	IKEA, Invest. ()	SEK 53.7	2052 SEK	1



# News Corporation declared profits

- News Corporation declared profits in Australian
- 1987 A\$364,364,000
- 1988 A\$464,464,000
- 1989 A\$496,496,000
- 1990 A\$282,282,000