

New Dependency Relationships: Offshore, Large Banking Conglomerates and Development

Ronen Palan
City university London
STEAL PROJECT

- Continued net financial transfers from developing countries, 12 x aid flow
- Accumulation of financial assets in offshore accounts and locations
- Beneficiaries are large bank conglomerates, multinational corporations and their shareholders, i.e. a small global elite

Key assumptions I

- Developed world: narrowing tax base to a shrinking 'middle class'
- Pressure on the welfare state and growing wealth gap
- Developing world: poor tax system, large black market, corruption and poor infrastructure

Impact 1

- OECD model of negotiated relationship between government and the governed due to taxation is missing
- Alternative sources of illicit flows to elites and governments encourage negative structural conditions such as fragile state

Impact 2

- Swiss banks in the 1960s and 1970s
- Baker's estimated that the global cross border illicit money flows were in the order of \$1 to \$1.6 trillion 2005
- 70% of all capital flight were conducted by means of transfer pricing.
- Of this – \$500 to \$800 billion a year, or 50% --flows out of developing countries to the large offshore financial centres

Net financial outflows I

- \$854 billion net flow from SSA between 1970 – 2010, Dev and Cartwright-Smith
- \$814 Boyce and Ndikumana figures, or in excess of \$ 1 trillion
- Henri \$21 to \$32 trillion global private wealth or about 18% of all financial assets were registered in offshore locations by 2010.

Financial outflows 2

- 139 low and middle income countries
- private elites in 139 low and middle income countries accumulate at least \$7.3 to \$9.3 trillion of offshore wealth
- these same source-countries' aggregate 2010 gross external debt of \$4.08 trillion
- net of foreign reserves, most of which are invested in First World securities – of minus \$2.8 trillion

Henri's estimates

- net lenders to the tune of \$10.1 to \$13.1 trillion
- gross and net external debts – the most they ever borrowed abroad -- peaked at \$2.25 trillion and \$1.43 trillion respectively in 1998

Henri's conclusions

- Euromarket and funding or 'collecting centres'
- IMF study 2010
- 'The architecture of cross-border finance is one of concentration and interconnections.
- Countries are exposed to certain key money centres or —nodes—common lenders and borrowers—through which the majority of global finance is intermediated.
- These exposures reflect transactions that occur predominantly through a small, core set of large complex financial institutions (LCFIs).
- These were the same institutions identified already by Wachtel in his 1980s study.

2 Large banking conglomerates

- LCFIs are systemic players, measured by importance in global book running for bonds, structured finance, U.S. asset backed securities, syndicated loans, equities, and custody asset holders.
- They operate with global ALM strategies and are engaged, either directly or through affiliates, in banking, securities, and insurance operations.
- LCFI comprised banks as well as nonbank institutions, such as investment banks, money market funds, and structured investment vehicles (SIVs).
- The nonbank entities were often linked to banks, including through credit and liquidity enhancement mechanisms, a behaviour that has been fuelled in part by the desire to avoid regulations.

Large banking conglomerates II

- Subsequent studies by the Federal Reserve of New York have named this shadowy world of complex entities linked to the LCFIs as the shadow banking industry. The study shows that the shadow banking industry is larger than the official banking industry.
- The IMF study also showed that as argued by Park in the 1980s, the infrastructure of payments and settlements in this integrated offshore wholesale market was also highly concentrated, largely occurring over a few systems — including CLS (for foreign exchange), DTC (for stocks and bonds), Target II (for domestic and cross-border payments in the Euro area), Clearstream and Euroclear (for securities), and SWIFT (for common messaging across systems).

The financial system

- Lack of negotiated relationship between government and governed
- Structural pre-conditions for fragility and collapsed states (Moore)

Qualitative Impact