Where governance fails : Advanced business services and the offshore world

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Prog Hum Geogr published online 9 October 2012
DOI: 10.1177/0309132512460904

Article

Progress in Human Geography
1–18

DOI: 10.1177/0309132512460904
phg.sagepub.com

Where governance fails: Advanced business services and the offshore world

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Abstract

The paper revisits the literatures on financial geographies, advanced business services, world cities and offshore financial centres. Linking these bodies of research, the paper argues that the advanced business services hold considerable power, which they exercise by operating legal and financial vehicles designed to escape the control of governmental or intergovernmental organizations through the use of offshore jurisdictions. This nexus of advanced business services and the offshore world has negative consequences for stability and equity, and represents an important area of governance failure.

Keywords

advanced business services, finance, governance, investment vehicles, offshore jurisdictions, world cities

I Introduction

The global financial crisis that started in 2007–2008 and has stalled development in a large part of the world economy has been diagnosed in a myriad of ways. Some blame myopia in private and public sectors as a trait of human nature. Robert Shiller (2008) focuses on irrational behaviour in financial markets leading to asset price bubbles. Richard Posner (2010) blames the short-termism of democratically elected politicians who have few incentives to run countercyclical economic policies. Another camp blames the excessive power of the financial sector in domestic and international economies, financialization and financial globalization, with financial special interests colluding with politics, and unrestricted cross-border financial flows destabilizing the global economy (Bhagwati, 1998; Engelen et al., 2011; Johnson and Kwak, 2010). Others find faults in economic globalization in general, criticizing free-market fundamentalism encouraged by modern economics, and calling for a rethink of economic globalization, leaving nation states more policy space (Rodrik, 2010) or redressing the balance between market and state in a move towards a 'new capitalism' (Stiglitz, 2010). Yet others stress the lack of global institutions coordinating economic development around the world as the reason for imbalances in global trade and financial flows, with rampant export-led growth in some countries, mainly China, leading to excessive indebtedness in others, mainly the USA (Rajan, 2010). Among geographers, David Harvey (2010, 2011) has interpreted the global financial crisis as a crisis of over-accumulation.

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This paper contributes to the debate on what went wrong in the global economy of the last decades. It analyses the problems of the last decades as an issue of governance, focusing on the nature of institutions and actors that affect economic outcomes, as well as relationships among those institutions and actors (Amin and Hausner, 1997; Jessop, 1997). Specifically, the objective is to revisit the role of advanced business services (ABS) and their spatiality in the major economic changes of the last 20–40 years. The central claim of the paper is that ABS, as a complex, hold considerable power, which they exercise in a large measure by operating legal, accounting and financial vehicles designed partly to escape the control of governmental or intergovernmental organizations through the use of offshore jurisdictions. This nexus of ABS and the offshore world is argued to have negative consequences for stability and equity in the world, in both developed and developing countries. As such the ABS-offshore nexus represents a potentially important area of governance failure, which requires investigation from economic, political and cultural perspectives, through both a positive and a normative research agenda. The ABS-offshore nexus links world cities, where ABS firms interact with each other and their key customers, with offshore jurisdictions. The former offer all types of economies of agglomeration, while the latter offer flexible sovereignty with low levels of taxation and regulation. Thus, the nexus is a functional concept that operates at multiple scales, defined by its function in the global economy (Amin, 2002; Jones, 2005). It is also a concept that embraces the integrationist approach to finance, which has been called for recently by Pike and Pollard (2010: 29) in order to 'retain political economies of states, markets, and social power in our interpretations of geographically uneven development'.

In the last 20 years geographers have made major inroads into the study of ABS and offshore finance. The ABS literature has documented the central role played by ABS firms in globalization (Faulconbridge et al., 2011; Harrington and Daniels, 2006), as well as their agglomerated and networked nature (Cook et al., 2007; Taylor, 2004). Literature on offshore finance has offered rich case studies of offshore financial centres and tax havens (Cobb, 1998; Hudson, 1998, 2000; Roberts, 1994, 1995; Warf, 2002). Geographers' contribution has been recognized in interdisciplinary literature on offshore by political scientists (Sharman, 2010), sociologists (Donaghy and Clarke, 2003), anthropologists (Maurer, 2008) and legal scholars (Picciotto, 1999). There are, however, major gaps in this otherwise positive picture. First, different types of ABS have attracted different levels of attention from geographers, with conspicuously little research on accountancy and ABS services for individual, in contrast to corporate, customers (Beaverstock et al., 2011; Jones, 2003, 2008). Second, research on offshore in geography seems to have lost momentum in the 2000s, at the time when offshore finance has arguably become more important to the global economy than ever before (Sarre, 2007). With few exceptions, recently offshore finance seems to have been treated as a mere footnote to financial geography (Wainwright, 2011). Third, and most importantly, there is little engagement between literature on the ABS sector and that on offshore finance. This paper argues that bringing the study of offshore to the fore of financial geography, marrying it with insights on the ABS sector, and grounding the marriage in a broad geographical perspective on economic change and uneven development offers a significant potential for future research.

Two levels of analysis are used to identify the ABS-offshore nexus: financial and spatial. Section II starts at the financial level, where the production of investment vehicles is identified as a neglected aspect of financial geographies, and an area that brings into focus collaboration among different parts of ABS, with finance, law

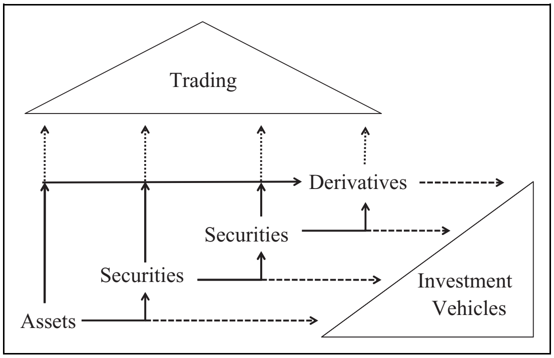

Figure 1. Financial instruments and investment vehicles

and accountancy in the lead. Section III, focused on the spatial level of analysis, demonstrates that ABS play a key and often underestimated part in reproducing a stylized map of the world economy consisting of relations between three building blocks: world cities, offshore jurisdictions, and developed and developing economies. Section IV draws implications of the ABS-offshore nexus for economic stability, equity and power. Section V presents elements of an empirical, theoretical, positive, and normative research agenda centred on the ABS-offshore nexus. The agenda, for which this paper is just a starting point, seeks to broaden and deepen our understanding of the ABS complex and its spatiality as a vital but neglected insight into the trajectory of the world economy.

II Financial level: the neglected link of investment vehicles

Let us distinguish between three layers of financial instruments (Figure 1). The first consists of assets: tangible (such as cash or real estate) and intangible (e.g. patents or brands); owned by households, the public or the private corporate sector (including loans owned by banks). The second layer consists of securities – claims on issuer's future income or assets, which come into being through the process of securitization (Wójcik, 2011a). Corporate ownership becomes securitized by converting a company into a joint stock company and the issuance of stocks; government borrowing through the issuance of bonds; bank loans (including mortgages) are securitized by the issuance of securities backed by pools of loans, giving rise to mortgage- and other asset-backed securities (MBS). Almost any future stream of income can be securitized, including royalties on music sales or tolls for using infrastructure such as motorways or bridges (Leyshon and Thrift, 2007). To be sure, there are multiple layers of securities, which can be backed by combinations of assets and other securities. Collateralized Debt Obligations (CDOs), for example, are issued based on a pool of MBS and other securitized debt like student, car or credit card loans. CDOs-squared are based on a pool of CDOs, MBSs and other securitized debt (Pozsar et al., 2010). Derivatives (forwards, futures, options and swaps) constitute the top layer of financial instruments, deriving their values from the prices of underlying instruments on which they are based (Harris, 2003). As we move from assets, through securities, to derivatives the level of financial abstraction increases.

Assets can be traded directly but the creation of securities and derivatives gives a real boost to the trading activity. Securities and derivatives can be sold and bought without change in the ownership of underlying instruments. Stocks, as corporate ownership titles, can be traded with no need to sell any piece of the underlying corporate plant or inventory. Stock options can be traded without changing ownership of stocks. Put differently, owners of securities and derivatives gain exposure to changing values of underlying instruments without the need to own these instruments. This function can be used for hedging or for speculation.

There is, however, a missing link in this picture of financial instruments. Assets, securities and derivatives have to be assembled into investment vehicles (IVs) – legal entities and simultaneously booking devices, out of which financial instruments are traded. IVs can serve different functions. First, they can be used for the purpose of legal isolation, creating a pool of financial instruments separate from the property of the sponsor. This is the case with trusts, whereby assets are put aside by the sponsor under the care of a trustee (typically a lawyer) to be managed in the interest of specified beneficiaries. Another example is Special Purpose Entities (SPEs) set up by companies, and used by many banks to hold MBS and CDOs, which in principle can go bankrupt without the sponsoring company going bankrupt. Another purpose of an IV can be to pool funds from a large number of investors to enable them to invest collectively in a diversified portfolio managed by a professional investment manager. Typical examples here are mutual funds and hedge funds. Third, IVs can be used to consolidate the ownership of a range of assets and securities, for example through a holding company, which owns stocks in other companies. All IVs need a source of funding. Some IVs borrow funds on their own behalf or leverage their investments by using derivatives. SPEs, for example, often borrow money by issuing short-term securities to fund their investments. Mutual funds, in contrast, do not borrow. If the value falls of securities in which a mutual fund invests, so automatically does the value of units held by its investors. Pyramiding of IVs is possible, with IVs becoming owners of other IVs, with funds of funds as an example.

While performance of IVs attracts a lot of attention, their design and creation is neglected in research. Finance textbooks focus on different types of financial assets, securities, derivatives and markets in which they are traded, but have few references to IVs (Mishkin, 2006). This neglect is also reflected in social scientific research on finance, with few exceptions. Clark (2002) made a distinction between the geography of financial production and the geography of financial trading, which correspond to primary and secondary markets. There is, however, a third type – the geography of IVs – which Clark did not mention in this instance, but to which he has made a contribution with empirical research on pension funds and real estate investment trusts (Clark, 2000). It appears that IVs remain in the realm of highly technical knowledge, left to the business of professionals. After all, IVs are legal, accounting and financial abstractions superimposed on each other (Picciotto, 1999).

Key to the existence and functioning of IVs are financial, legal and accountancy firms. There is, however, a hierarchy within the trio. Arguably, at the very core of the financial structure presented in Figure 1 lies the securities and derivatives industry, involved in the production, distribution and exchange of securities (mainly stocks and bonds) and derivatives (based on prices of underlying assets and securities). The main players in the industry are investment banks, hedge funds and other investment managers and advisors. The securities and derivatives industry is composed of stand-alone investment firms (like Goldman Sachs or Morgan Stanley) and parts/departments of financial conglomerates (like JP Morgan Chase or Deutsche Bank). The average salary in the industry is much higher than in the rest of the financial sector (Wójcik, 2012). While titles of distinction are a common feature of ABS in general, investment banking epitomizes it, with levels of vice-presidents, senior vice-presidents, directors, managing directors, partners and executive partners (Ho, 2009). This generous use of titles reflects and reinforces the position of investment bankers in relation to customers and other ABS firms. An investment banker visiting a client company is likely to meet a CEO or CFO. An auditor from an accountancy firm is more likely to end up interacting only with a Chief Accountant.

Investment banks take securities to the market by underwriting their issuance, advising issuers on the price, and distributing securities among key investors (Wójcik, 2011b). Other ABS firms assist them. No initial public offering of stocks is possible without accountants reviewing the financial statements of the issuer, and lawyers overseeing the compliance of the process and documentation with laws and regulations. Beyond primary markets, investment banks lead the business of trading securities and derivatives on their own account and on behalf of other traders and investors (e.g. acting as prime brokers for hedge funds). The activities of securitization, creation of derivatives and trading have grown at an astonishing rate since late 1970s. Many studies have summarized this process as one of disintermediation, whereby the focus of financial transactions shifted from direct lending and borrowing via banks to trading in securities and derivatives markets (Mishkin, 2006). Disintermediation, however, is a misnomer. The last 30 years (at least until 2007) have seen a phenomenal rise of securities and derivatives industry, engaged in producing and distributing securities and derivatives, but also dominating their trading (Wójcik, 2011a).

The dominant role of the securities and derivatives industry in the ABS complex is also reflected in research on financialization of ABS in the last two decades. Faulconbridge and Muzio (2009), for example, document the increasing focus on profits per equity partner in international law firms. In order to boost profits per equity partner law firms have tended to employ more salaried (non-equity) partners and associates. This particular application of leverage to human capital resulted in an escalation of remuneration for equity partners and increased the pay gap within firms and the whole sector. In a recent review of financial services development in the UK, French et al. (2010) actually bring law and accounting under the umbrella of financial services, which serves as another implicit recognition of the growing financialization of these components of the ABS. An earlier study on financial services clustering in London included accounting, law and management consulting as integral parts of the financial cluster (Cook et al., 2007). This complementarity and overlap between finance, law and accountancy is central to understanding the role of the ABS in relation to IVs.

ABS firms facilitate the use of IVs by both individual and corporate customers. With regard to services for individuals, law firms specialize in the establishment of trusts, management of trusts and estates, and advice on cross-jurisdictional tax law. Accounting firms offer tax advice, financial planning and trust/estate management (NESTA, 2006). Large accountancy firms typically conduct these operations through their private client teams. Financial firms, with private banks and investment banks in the lead, specialize in investment management, which with regard to individual clients is often referred to as wealth management. Insurance firms are also involved as IVs often serve to preserve intergenerational family wealth (Beaverstock et al., 2011). The list of IV-related services for corporate customers is longer. In addition to tax advice, financial planning and investment management, finance, law and accountancy firms assist non-financial corporations in setting up and running their own financial, insurance and investment arms. In the last decades it has become common among manufacturing and other non-financial companies to set up captive insurance operations and financial services departments. Consider the example of General Electric, where financial services grew from a negligible level in the 1980s to nearly half of the turnover of the corporation in the early 2000s (Froud et al., 2006).

In addition to general financial, law and accountancy firms that offer IV-related services, there is a whole sector of firms dedicated to this market. A prime example here is OCRA Worldwide, whose advertisements can be found in *The Economist*. The company 'establishes and administers secure and efficient corporate and trust structures for expatriates, businesses, entrepreneurs, private individuals and families' (www.ocra.com). Specifically its services include: offshore company formation, establishment of trusts, corporate tax planning, compliance and risk assessment, accounting, yacht registration and management, e-commerce and e-gambling. The executives of the company combine expertise in law, accountancy and investment management.

The extent to which different types of ABS are involved in IV-related services differs significantly. ABS is a broad category which, beyond financial services, law and accountancy, includes advertising, human resources consultancy and management consultancy (Dicken, 2011). While advertising and HR firms are involved in promoting IVs and hiring people managing them, their engagement in IV-related services is only indirect. Management consultancy firms can be considered to have more direct exposure to IVs, as the use of investment vehicles in the form of trusts, SPVs or SIVs or basic corporate subsidiaries, as well as their tax, legal and regulatory implications, are important elements of corporate strategy. In fact, management consultancy and accountancy (and sometimes also legal and other professional services) are often offered under the roof of one company, as is the case with the Big Four (Ernst and Young, Deloitte, KPMG, and PwC). In his research, Jones (2005), for example, considers Big Four companies as part of management consultancy.

The larger the array and number of IVs, the more deals and jobs are available for ABS professionals. The demand for IVs in turn is stimulated by the supply of new types of financial assets, securities and derivatives and by trading activity. The larger the quantity and diversity of financial instruments, the larger is the opportunity to combine these instruments through IVs. Investment bankers earn revenues from proprietary trading, from fees on trading conducted on behalf of others, and from fees on the deals involving the creation of new securities, derivatives and IVs. Accountants and lawyers, again second in the pecking order after investment bankers, earn revenues from the creation of new securities and IVs. Rating agencies earn revenues from assessing the quality of new instruments and IVs and their viability for investors (Pryke, 2011). The more trading, derivatives, securities, IVs, and the higher the value of assets, the more business at the disposal of the elite of ABS.

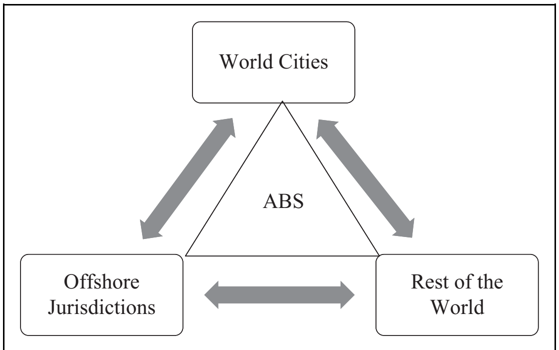

Figure 2. The ABS-offshore nexus

III Spatial level: world cities and the ABS-offshore nexus

The basic structure of financial instruments, with ABS as key intermediaries, assumes specific spatial characteristics, affecting the map of the world (Figure 2). At the crown of this map are world cities, where ABS firms take advantage of proximity to the headquarters of non-ABS firms, proximity to each other, a large and deep pool of labour, and general urbanization economies. It is of secondary concern here whether we refer to these concentrations of ABS as world cities (Friedmann, 1986) or global cities (Sassen, 1991). World cityness is a matter of function and degree, not a matter of status, which a city simply has or has not (Taylor, 2004). The quintessential world cities are New York and London, hosting the largest and most influential ABS sectors in the world, with cities next in line including Hong Kong, Tokyo, Singapore, Paris and Chicago (Wójcik, 2011c).

ABS firms are the main actors on the stage of world cities, and the structure of world cities reflects a hierarchical and networked nature of the ABS sector. To provide global services to their customers, and to combine global with local information, ABS firms operate large branch networks, which constitute the spanners of the world city network (Taylor, 2004). Trading of financial instruments as well as the design of new types of instruments takes place in world cities, but in order to issue new securities ABS firms need to interact directly with issuers wherever the latter are (Wójcik, 2011a). ABS firms learn from their own corporate networks, from interaction with other ABS firms, and from customers (Jones, 2002). This emphasis on interactions does not, however, imply a flat structure of world cities, where only connectivity matters. The securities and derivatives industry and the financial sector in general are at the centre of ABS, and accordingly global financial centres are at the top of the hierarchy of world cities. The securities and derivatives industry in New York City and Greater London have more employees in the securities and derivatives industry than the whole of China and Germany, respectively (Wójcik, 2011a).

While trading, securities and derivatives activity is concentrated in world cities, and assets follow the distribution and dispersion of corporate sector, household wealth and public sector, the geography of investment vehicles is distinctive. We find them domiciled in a range of places, with a degree of specialization depending on the type of vehicle. Holding companies are commonly incorporated in the Netherlands, Belgium and Switzerland; trusts in the Channel Islands; hedge funds and SPEs in the Caribbean; collective investment funds in Luxembourg and Ireland (Palan et al., 2010). Very often the jurisdiction (country or autonomous region) of domicile is different from the jurisdiction where the sponsor of the IV is incorporated or resident. Sponsors are typically financial firms, large non-financial firms and wealthy individuals. What attracts sponsors to set up IVs in certain jurisdictions is low or no taxation applicable to revenues from the IV; secrecy, whereby little or no information is required on the identity of the sponsor and/or the source of funds; and regulation that involves few or no restrictions on investment and/or borrowing (funding) activity, and low regulatory compliance costs. These jurisdictions are referred to in literature as tax havens, secrecy jurisdictions or offshore financial centres. Estimates of the number of such jurisdictions, with an absolute majority being sovereign states, range between 30 and 60, a significant share of the total number of sovereign jurisdictions in the world (Larudee, 2009). Here, the term offshore jurisdictions (OJs) is used, and defined as jurisdictions that specialize in attracting the registration of IVs with foreign sponsors.

Whether a jurisdiction is an OJ cannot be answered with a simple yes or no. Just like world cityness, it is a matter of degree. Factors that affect the OJ character such as taxation, regulation and secrecy operate on a spectrum. Table 1 contains a list of OJs based on the frequency with which the jurisdictions concerned have been included in 11 influential listings of tax havens since 1977.

OJs tend to be small, mostly with less than 1 million population, with the majority being small island states (Dharmapala and Hines, 2009). Small size matters. To be attractive an OJ cannot charge large fees, not to mention taxes. Typical annual fees per IV are between US$100 and 10,000 (Shaxson, 2011). It is only by hosting thousands of IVs that significant revenue can be gained. Second, sponsors mostly seek OJs for little else than registration, with real management of IV conducted outside of OJs, mostly in the country of the sponsor. As a result, hosting IVs does not generate a large demand for skilled labour or physical infrastructure. Consequently, it is a particularly attractive economic strategy for small jurisdictions, with small labour markets, for which every US$

Table 1. Offshore jurisdictions of the world. Compiled by the author based on data table 1.4 from Palan et al. (2010: 43–44). Score in the second column simply totals the number of times a jurisdiction was included in 11 influential listings of tax havens: International Bureau Fiscal Documents 1977, Charles Irish 1982, Hines Rice 1994, OECD 2000, IMF 2000, FSF 2000, FATF 2000/2, TJN 2005, IMF 2007, STHAA 2007, Low-TaxNet 2008. For details, see Palan et al. (2010).

Jurisdictions	Frequency of listing as a tax haven
Bahamas, Bermuda, Cayman Islands, Guernsey, Jersey, Malta, Panama	11
Barbados, British Virgin Islands, Cyprus, Isle of Man, Liechtenstein, Netherlands Antilles, Vanuatu	10
Gibraltar, Hong Kong, Singapore, St Vincent & Grenadines, Switzerland, Turks & Caicos Islands	9
Antigua & Barbuda, Belize, Cook Islands, Grenada, Ireland, Luxembourg, Monaco, Nauru, St Kitts & Nevis	8
Andorra, Anguilla, Bahrain, Costa Rica, Marshall Islands, Mauritius, St Lucia	7
Aruba, Dominica, Liberia, Samoa, Seychelles	6
Lebanon, Niue	5
Macau, Malaysia (Labuan), Montserrat	4
Maldives, United Kingdom	3
Brunei, Dubai, Hungary, Israel, Latvia, Madeira, Netherlands, Philippines, South Africa, Tonga, Uruguay, US Virgin Islands, USA	2
Alderney, Anjouan, Belgium, Botswana, Campione d'Italia, Egypt, France, Germany, Guatemala, Honduras, Iceland, Indonesia, Ingushetia, Jordan, Marianas, Melilla, Myanmar, Nigeria, Palau, Puerto Rico, Russia, San Marino, Sao Tome e Principe, Sark, Somalia, Sri Lanka, Taipei, Trieste, Turkish Republic of Northern Cyprus, Ukraine	1

million makes a significant difference to the economy, making it worthwhile to adjust the legal, tax and regulatory system to the demands of IV sponsors. Another common feature of OJs is colonial heritage. Most OJs are former British colonies (though French, US and other colonies also feature), and some, like Cayman or British Virgin Islands, are dependent territories. The colonial legacy is conducive to offshore activities for several reasons. The former metropolis can act as a patron of an OJ, offering military and political protection, e.g. on the forum of international organizations. This patronage makes OJs more politically stable and predictable – advantages in the eyes of IV sponsors. Colonial heritage also implies common language and similar legal institutions (common law), making it easier for sponsors from the former metropolis to operate. Furthermore, given recent colonial history, the elites of OJs are often still the people who came from the metropolis. In sum, not being able to offer significant agglomeration economies that world cities can offer, OJs instead offer flexible sovereignty to attract IVs. Small size is crucial to this flexibility. IVs can be moved from one OJ to another with ease, putting competitive pressure on OJs to adjust. This adjustment makes more sense economically, and is more politically feasible in small jurisdictions.

ABS intermediate between companies and individuals that sponsor IVs and OJs, but they are also important sponsors themselves. Financial firms, for example, use OJ-domiciled IVs for their clients' and their own financial instruments. Existing evidence, although scant, suggests that companies and individuals hardly ever come to OJs on their own, and OJs hardly ever approach sponsors directly. Potential customers seek services of the ABS firms, and the latter offer offshore services proactively to their client companies and individuals (Palan et al., 2010). ABS firms can present their clients a menu of OJs, with different specializations and risks. A larger menu is obviously better than a smaller one. Thus, the multitude of OJs is not just a matter of competition between OJs or demand for diversification among sponsors; it is also shaped by how offshore services are intermediated.

ABS play a central role in the relationship between world cities and OJs. World cities are major concentrations of IV sponsors, particularly in the financial sector, but with leading ABS firms they are also conduits that connect sponsors from the rest of the world to OJs. For example, a wealthy individual from Russia is likely to obtain advice on offshore services from ABS firms in or from London. In fact, as long as their jurisdictions are attractive in relation to OJs, world cities can host foreign IVs themselves. This was the case in the 1950s and 1960s in London, welcoming the branches of US and other foreign banks with their foreign-currency denominated accounts. These simple assets were later extended with foreign-currency denominated securities and derivatives, giving rise to London-centred Euromarkets (Strange, 1986). With time and regulation responding to the rise of Euromarkets, IVs were largely moved to OJs. Design and trading of these instruments,, however, remained with the ABS sector in London (Shaxson, 2011). Other world cities have their own connections with OJs, forged by ABS (e.g. New York-Cayman Islands, Paris-Monaco, Madrid-Andorra, Frankfurt-Liechtenstein, Sydney-Vanuatu and Mumbai-Mauritius).

The geography of financial instruments can also operate at a subnational level, as long as national politics allow significant regional autonomy in legal and financial affairs. In the USA, while New York is the leading world city, the state of Delaware, midway between New York City and Washington, DC, has made a business of hosting IVs. It is the main centre of incorporation for US listed companies, holdings, investment funds and SPEs, feeding a large local ABS industry with corporate and financial law in the lead. In China, Hong Kong is a world city, but at the same time an important OJ where many holding companies and investment funds operating in mainland China are domiciled (Lai, 2012).

In the last three decades we have witnessed a buoyancy of world cities and OJs. Small countries hosting offshore finance and world cities have boasted high levels of income and wealth per capita. Competition among governments around the world for the creation of world cities, and financial centres in particular, has been intense (Jarvis, 2011). At the same time many countries have joined competition among OJs (e.g. Singapore, Mauritius, Cyprus). Some countries and cities have carved out a piece of their territory to serve as an OJ, as in the case of the International Financial Services Centre in Dublin (Reddan, 2008). Other countries, such as USA and Japan, allowed their banks to set up IVs subject to relaxed regulation on their computers, to lower the attraction of registering IVs abroad (Hudson, 1999). The latter strategies brought little success, however, highlighting the importance of political separation and sovereignty in offshore finance. IV sponsors need the security of a jurisdiction dedicated to the environment of low taxation, regulation and secrecy, which large democracies do not offer within their own jurisdictions.

The ABS-offshore nexus is a useful concept not only because OJs cannot be understood without the agency of ABS, but also because OJs shed light on the rise of the ABS and its position in the global economy. The multiplicity of OJs and differences of regulation, taxation and secrecy, of which considerable advantage can be taken, represent an incentive for the globalization and consolidation within the ABS sector itself. Geographers studying the ABS have documented the processes of globalization and oligopolization in the sector, and the role of world cities in these processes, without, however, paying much attention to the role of IVs and OJs (Beaverstock, 2004; Faulconbridge, 2008; Jones, 2003). The centrality of OJs to the rise of ABS, a rather neglected topic in geographical studies of ABS, is perhaps most striking with regard to legal services. As Dezalay and Sugarman put it:

> The invention of the off-shore haven and its expansion due to 'regulatory shopping' has been, even according to these concerned, a veritable 'lawyers' paradise'. And those other professionals who put their skills at the service of entrepreneurs are not left out. (Dezalay and Sugarman, 1995: 2)

Lawyers play a dual role in international regulation, advising governments on how to build it and businesses on how to circumvent it.

To summarize, the ABS-offshore nexus involves governance that is highly networked, but also hierarchical, dominated by large ABS firms (with financial firms in the lead) with nodes in the world cities (with New York and London in the lead). Consequently, it is also a mode of governance with strong Anglo-American characteristics, emanating from the USA and the UK, with Wall Street and the City of London as its decision-making centres (Wójcik, 2011c). As Doreen Massey (2007: 9) stated, 'Cities are central to neoliberal globalization'. If we add ABS to cities, we may get a broader picture, which has the advantage of explaining wealth in OJs – countries and places that offer little in the way of agglomeration economies or even cityness.

IV Implications for stability, equity and power

The ABS-offshore nexus has significant implications for the stability and equity of the world economy. With regard to financial and economic stability, the exponential growth in trading of securities and derivatives in relation to the base of the underlying assets, and its impact on increasing frequency of financial crises, has been documented (Stiglitz, 2002; Strange, 1998). Less known, however, is the role of IVs designed by ABS firms and 'parked' in OJs. Existing evidence is both historical and contemporary. In the 1920s, the IVs used for speculation and leverage in stock markets, which ultimately led to the Great Crash of 1929, were investment trusts and holding companies. The former allowed investment banks with Goldman Sachs in the lead to leverage their investments in the stock market boom with minimum own capital; holding companies facilitated financial speculation by non-financial companies (Galbraith, 1954). As this had happened before the wave of financial regulation of the 1930s, there was no need for Goldman Sachs and other companies to take these IVs offshore. In the 1990s, the Thai government established International Banking Facility, a lightly regulated OJ within Thailand to serve as a conduit of foreign investment, putting Bangkok on the map of financial centres. Seven years later, in the wake of a real estate and stock market bubble and bust, Thailand became the epicentre of the Asian financial crisis (Clark and Wójcik, 2001).

OJs feature prominently in the recent global financial crisis. Madoff Investment Securities operated through offshore subsidiaries, with a risk management and control office registered in Bermuda. Northern Rock used Granite, a trust registered in Jersey, to securitize the most risky UK mortgages and invest in the US subprime mortgage instruments (Palan et al., 2010). Bear Stearns and Lehman Brothers had hedge funds and SPEs registered mostly in Ireland and the Cayman Islands. Abacus, an IV subject of the fraud investigation by the SEC into Goldman Sachs, was registered in Delaware. As the Basel Committee on Banking Supervision reported, some large financial institutions had more than 2000 affiliated SPEs (BCBS, 2009). The contribution of OJs to the ability of financial firms to use high leverage and escape regulatory oversight warrants more research. While details remain shrouded in mystery, the ABS-offshore nexus has been significant to the operation of the shadow banking system.

The role of the ABS-offshore nexus in the recent global financial crisis, however, goes beyond banking and the financial sector. As Arnold (2009) describes, the major accounting firms were also directly involved in the process of securitization and structured finance, often through dedicated structured finance departments. In addition, accounting firms conducting audits of banks have never warned the investors and the public at large about the dangers of excessive leverage enhanced through the use of IVs including SPEs. Hopwood (2009: 797) writes about 'the apparent failure of the audit industry to identify any of the emerging banking crises and failures', and accuses the sector of 'trying to promote rules, regulations and standards that facilitate its commercial operation rather than necessarily provide a more transparent and accurate insight into corporate functioning' (p. 798). In addition, we should consider the role of law firms, which were signing off investment banks' contracts as not only legal but also undertaken in good faith.

A major channel through which the ABS-offshore nexus affects equity is taxation. The nexus is key to the avoidance and evasion of any type of taxation: personal, corporate, indirect, and special taxation on financial profits and transactions. According to a recent survey, only two out of the 100 largest UK companies did not have a subsidiary in a jurisdiction classified as a tax haven (Provost, 2011). The role of Big Four companies in designing and promoting aggressive tax planning to their customers has been documented (Kuderle, 2009; NESTA, 2006). The growing role of intangible assets on corporate balance sheets creates added opportunities for creative accounting and tax planning (including accounting for brands, intellectual property rights, know-how and goodwill), as does the fact that more than 50% of world cross-border trade is now intra-firm (Dharmapala, 2008). Implications are hard to overestimate. As Dani Rodrik put it:

> International mobility of firms and of capital also restricts a nation's ability to choose the tax structure that best reflects its needs and preferences. In particular, this mobility puts downward pressure on corporate tax rates and shifts the tax burden from capital, which is internationally mobile, to labour, which is much less so. (Rodrik, 2011: 193)

There has been a remarkable reduction in corporate tax rates, with the average CIT rate in OECD (excluding the USA) falling from approximately 50% in 1981 to 30% in 2009. As a result the burden of sustaining welfare shifts from large companies and wealthy individuals to small companies and ordinary citizens who pay payroll taxes and VAT, and cannot afford subsidiaries or trusts in OJs (Avi-Yonah, 2000). Within the corporate sector this creates an uneven playing field, with small companies, vital to employment and innovation, at a disadvantage. Lower CIT rates also make it difficult to maintain progressive PIT (with higher rates for higher income brackets), because wealthy individuals can register their income under the guise of a company, taking advantage of lower CIT rates (Kellerman and Kammer, 2009). The problems of tax avoidance are further exacerbated by flows of money obtained through illegal activities (including tax evasion, fraud and the drugs trade), channelled by ABS via OJs, often depriving developing countries of income. Illicit money flows from developing countries are estimated at US$1 trillion a year (Kar and Curcio, 2011).

To give one further specific example of the contribution of the ABS-offshore nexus to both instability and inequity, Enron, subject of the largest corporate scandal in recent history, operated through a global web of 3500 domestic and foreign subsidiaries, including 441 registered in the Cayman Islands. 'Enron's highly complex tax avoidance schemes were designed by Arthur Andersen, Deloitte & Touche, Chase Manhattan, Deutsche Bank, Bankers Trust and several major law firms, who according to the Senate report received around $88 million in fees' (Sikka and Hampton, 2005). Complex financial instruments booked in opaque IVs helped Enron's executives and their ABS collaborators make fortunes while concealing the real financial standing of the corporation. When Enron collapsed the resulting losses of pension funds alone were estimated at US$5–10 billion (Blackburn, 2002).

Ultimately, the role of the ABS-offshore nexus is an issue of power, which is exercised mainly by the ABS sector, not by OJs or world cities. Power is understood here broadly as the economic, political and cultural influence of the ABS. It is something made and remade rather than structural and independent from anyone's will, underpinned by the position of the ABS at the centre of the circuits of capital (Allen, 2009). It is based on the soft power of consent, persuasion and intellectual leadership rather than corruption or coercion (Arrighi, 2010). The original source of ABS power is closely related to the functions of the state. The business of ABS, including handling payments, creating credit, auditing and assisting with legal contracts, is to a large degree created and guaranteed by the state. In the last 20–40 years, however, the ABS complex has assumed a central role in the global economy, coordinating and guiding activities of firms, individuals and governments themselves (Sassen, 1991). It has assumed considerable intellectual leadership, as a purported motor of universal expansion, with the implication that what is good for the ABS sector is good for the world economy at large. This popularity is not surprising given the growing inseparability of intellectual elites and the ABS sector.

The soft power of the ABS is reflected in their share among the destinations of graduates from top universities or their contribution to university endowments (Ho, 2009). Offering fast-track careers and attractive pay packages, they have gained prestige among graduates of top universities, which few non-ABS firms can match. Working in ABS became almost synonymous with being a professional and attaining a high status on the labour market. ABS were at the core of the yuppie culture of the 1980s (McDowell, 1997). The fashion aspect may have faded away in the 1990s, but the pay packages and influence have only grown, making ABS a key mechanism for the reproduction of and promotion to the middle and upper class (Leyshon and Thrift, 1997). The successful professionals leaving ABS often expect to become directors or executives of non-ABS companies. From the realm of relatively dull jobs, with an air of civil service about them, finance, law, accounting and other business services have been elevated to the status of exciting and financially rewarding jobs, in the thick of globalization. In addition, ABS firms and their associations are important business standard setters in the global economy, with a key input into determining what profitability means, and how it should be measured and achieved (Braithwaite and Drahos, 2000). Many have raised the issue of power in the ABS before, but mainly with regard to the financial sector (Epstein, 2005). The argument here is that the problem is more severe than that, as the ABS-offshore nexus goes beyond financialization (French et al., 2011; Pike and Pollard, 2010). Just as there are revolving doors between big banks and financial regulators, there are revolving doors between tax authorities and Big Four companies. Regulatory and cognitive capture applies to ABS at large (Arnold, 2009; Hopwood, 2009).

V Elements of a research agenda

The concept of the ABS-offshore nexus developed in this paper is based on admittedly limited empirical evidence. As such, it is rather a series of propositions that require further elaboration.

This section highlights the potential of the concept by sketching some ideas for both a theoretical and empirical agenda, with positive and normative elements.

First of all, research on offshore should be brought to the fore of financial geography and married more effectively with research on the ABS sector. Research on OJs, which lost momentum in the early 2000s, needs to be re-established and extended with research on world cities, as central nodes of the nexus, as well as that on intermediaries and customers of offshore services. This could take the form of studying value chains in specific offshore services, identifying the role of different ABS firms (finance, accountancy, law and others) in linking companies and wealthy individuals with OJs. The value chain approach has been applied in financial geography, but not to tax management (Grote et al., 2002). Focusing on customers, one could study the propensity of companies to use tax, secrecy and regulatory havens, using data on corporate subsidiaries in OJs, to uncover how this propensity varies with corporate size, sector and across countries. Another strategy would be to document the treatment of tax management and 'regulatory shopping' in business education and professional certification, including Master of Business Administration, Chartered Financial Analyst and Certified Public Accountant, thus extending existing geographical research on business education (Hall and Appleyard, 2011).

Studying the use of OJs could also be integrated into research on financial decision-making and behaviour, with emphasis on myopia. Myopia is temporal as well as spatial, involving our inability to consider not only the long term but also factors beyond our immediate environment (Clark, 2011). We should consider the impact of our behaviour beyond our immediate environment as an aspect of myopia, and treat tax evasion as irresponsible social and corporate behaviour (Christensen and Murphy, 2004). After all, social responsibility is not about compliance with law, but about contribution to society. Taxation may be considered the simplest form of this contribution, much simpler in a sense than charitable activity or direct support to environmental and social projects. The absence of taxation from the array of corporate social responsibility issues is indeed telling and perhaps a sign of how the debate has been captured by the corporate sector, including the ABS.

The ABS-offshore nexus is also close to the heart of the debate on shareholder value as a model of corporate governance (Clark and Wójcik, 2007). First, the ABS-offshore nexus is instrumental in helping companies to maximize profits for shareholders by minimizing tax, and maximizing leverage through hiding risky transactions from the purview of regulators (Lazonick and O'Sullivan, 2000). Second, shareholder value – often presented as a sword of creative destruction applied by the ABS sector to the rest of the corporate sector (Jensen, 1998) – seems to have led instead to a collusion between the ABS sector and corporate executives, with the remuneration of the latter enhanced with stock options and skyrocketing to unprecedented levels (Rose, 2007). Third, the ABS sector itself has been transformed to serve the shareholder value, with ABS firms, traditionally operating as partnerships acquiring limited liability, as large firms go public, often rewarding their own executives with stock options. Leading US investment banks went public in the late 1990s, which arguably added to their short-term behaviour in the run-up to the global financial crisis (Roubini, 2010). The first law company went public in Australia in 2007. In the UK, the last restrictions on law firms going public have been lifted in 2011. This organizational transformation of ABS firms, and its impact on strategy and society need to be better documented.

At an international level, the shareholder value ideology has affected international accounting standards, which prioritize the needs of shareholders as the main audience of corporate financial statements over the needs of tax authorities and regulators (Nobes and Parker, 2008). One particular aspect of this problem is the emphasis on consolidated statements, whereby international companies are not obliged to break down their statements by country of operation. As a result no reliable information exists on how much revenue an international company earned in each country, how much expenditure it incurred, how many people it employed or how much tax it paid. The International Accounting Standards Board, dominated by the interests of the Big Four accountancy firms, has opposed a proposal by Richard Murphy and Tax Justice International to introduce compulsory country-by-country reporting (Palan et al., 2010). Arguably, this initiative should be supported by geographers, as new standards could be used to correct otherwise distorted data on foreign trade and cross-border financial flows, mapping hitherto hidden circuits of capital and producing research that informs policy-makers and citizens.

In terms of geographical coverage, the City of London seems to be the best starting point for an empirical exploration of the ABS-offshore nexus (Shaxson, 2011), but it should be stressed that the nexus is gaining influence in emerging markets. In 2009, more than 12% of Chinese outward foreign direct investment (OFDI) was channelled through the Cayman Islands and the British Virgin Islands (Luo et al., 2011). In the same year 57% of Russian OFDI was concentrated in Cyprus, the British Virgin Islands and Luxembourg (Kuznetsov, 2011). In 2008, the Cayman Islands accounted for 43% of Brazil's FDI (Cuervo-Cazurra and Stahl, 2010). In 2009, Mauritius was the main recipient of India's OFDI (Reserve Bank of India, 2010). Chinese authorities are considering the idea of turning Shanghai into an offshore financial centre to challenge London and New York. Many Chinese corporations traded on the London Stock Exchange are registered in the British Virgin Islands (Wójcik and Burger, 2010). It is estimated the top 1% of households in China have accumulated US$3–5 trillion of wealth (Shih, 2011). At present most of this wealth is invested in Chinese real estate and stock market, but if these overheated markets stagnate or crash a huge outflow of funds enabled by the ABS-offshore nexus may follow, with economic consequences for China and the rest of the world. In other words, while the ABS-offshore nexus has roots in the British Empire, no country is insulated from it. In fact, we might suspect that after the introduction by the OECD of some measures regulating tax havens and curbing illicit financial flows in the late 1990s and early 2000s, the focus of the ABS-offshore nexus has shifted to emerging economies and developing countries.

On a theoretical level, while the paper refers to ABS-offshore as a nexus in order to stress the bonds and connections between the ABS sector and the offshore world, the concept can be considered compatible with that of Global Production Networks (GPN) (Henderson et al., 2002). With the apparent dominance of the securities and derivatives industry among the ABS firms, multiplicity of OJs and heterogeneity of customers (corporate versus individual), the ABS-offshore network consists of both vertical and horizontal connections. Understanding networks as hybrid collections of human and non-human agents – with no need to distinguish between structure and agency, an approach promoted by the GPN – is also compatible with the ABS-offshore phenomenon, where electronic money and IVs play a central part. While the ABS-offshore can be researched as a GPN in its own right, it is arguably also a phenomenon that permeates the operation of other GPNs, as its impact cuts across different industries. In particular, it affects corporate power and the ability of places to capture value from GPNs.

Another way to theorize the ABS-offshore nexus would be within an evolutionary framework, as a part of an economic regime, in combination with such elements as shareholder value ideology, corporate reporting systems driven by financial markets, and competition between nation states (Geels, 2002). Shareholder value justifies tax and regulatory arbitrage as taking place in the best interest of shareholders, while consolidated corporate reporting helps to obscure the practices of tax and regulatory arbitrage. Initiatives such as country-by-country reporting could then be interpreted and analysed as 'nudges' aimed at unsettling the interlocking elements of the existing regime, using the global financial crisis and calls for 'new capitalism' as a window of opportunity (Stiglitz, 2010).

Ultimately, the ABS-offshore nexus is central to the discussion on the reform of the global economic governance (Rodrik, 2011). Many hoped that the OECD Harmful Tax Practices initiative of 1998 and other internationally agreed measures would contain the negative impact of offshore finance on the global economy. Empirical research, though struggling with data availability, shows that illicit financial flows have only grown in value (Kar and Curcio, 2011; Kuderle, 2009). One problem here is the inherent difficulty of bringing multiple OJs under control. Even as some OJs close down their offshore activities, as Andorra announced in 2011, the competition for the OJs left on the stage becomes less intense, and the stake (potential share in the global supply of offshore services) grows larger (Elsayyad and Konrad, 2011). Another problem is that measures aimed at regulating OJs undertaken by the OECD, BIS or the IMF suffer from a deficit of legitimacy, as the organizations involved are seen by OJs as representing the interests of ex-colonial powers and their home ABS firms (Palan et al., 2010). A genuine reform seems to require international governance structures more representative of the interests of emerging and developing economies, as well as an effort on the side of advanced economies to regulate the ABS-offshore nexus at home. Geographers have a lot to offer to this discussion.

Funding

This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

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