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ABSTRACTS

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Introduktion

Det er næsten blevet kliché for 'førkrisens' overvurderede økonomi at henvise til dengang daværende finansminister Thor Pedersen sagde, at vi var så rige, at Danmark snart ville kunne købe hele verden. Det var i 2006, og det, der er værd at huske, er ikke, at økonomien havde det godt, men at vi troede, at vi vidste hvordan økonomien hang sammen. Der var fuld fart fremad og kursen var lagt. Regeringen fandt rum til at indføre afdragsfrie lån, som skubbede til de i forvejen stigende huspriser samtidig med, at lønningerne steg. Alle talte om friværdi. Der var ikke så meget fokus på vigtigheden af de finansielle markeder og den indflydelse, de havde på den resterende økonomi. Men nu er situationen anderledes. Alle snakker krise, og der er i offentligheden en øget opmærksomhed på finansmarkedernes betydning og problemerne der knytter sig til beskatning af denne sektor. Blandt politikere og i den bredere offentlighed er der således udbredt enighed om, at der skal være bedre regulering af sektoren.

Det er dog kun de færreste, som har overblik over det finansielle system. Volumen af den globale handel med finansielle aktiver har et omfang, de fleste har svært ved at begribe. Værdien af den daglige globale valutahandel steg fra 3,3 billioner US dollar i april 2007 til 4 billioner i april 2010. I april 2013 var tallet oppe på 5,3 billioner (BIS 2013). Om dagen. Når talen falder på de forskellige finansielle produkter, der handles med, såsom *Credit Default Swaps* (CDS) og andre derivater, overtriumfer teknikaliteterne typisk debatten om politiske styringsmuligheder. Ofte er det svært at gennemskue validiteten af argumenter for og imod forskellige typer af regulering netop fordi kompleksiteten er så omfattende. Problemet omkring finansmarkederne er således ikke kun, at vi mangler svar på komplekse spørgsmål. Vi mangler også forudsætningerne for at kunne stille de rigtige spørgsmål. Derfor sætter dette nummer af Politik et politisk fokus på den finansielle sektor.

At vi finder en øget bred interesse for ting vedrørende finans og regulering, bliver understreget af fx DRs aktuelle dokumentar *I Skattely*. Uagtet kritikken af dokumentarens journalistiske metode, har udsendelsen tydeliggjort kompleksiteten omkring handel og beskatning af finansielle aktiver for en bredere offentlighed. Netop spørgsmålet om beskatning er et gennemgående tema i den politiske og den akademiske debat. Beskatning tydeliggør en række dilemmaer omkring den politiske regulering af finansmarkedet. EU har fx kaldt til kamp mod skattely samtidig med, at de fleste lande konkurrerer indbyrdes om at have favorable skattevilkår, hvilket selvsagt gør det svært at finde en fælles politik.

For at begribe kompleksiteten i sådanne spørgsmål er det nødvendigt at anlægge en bred politisk økonomisk tilgang, som ser på spørgsmål om finans som mere end blot en række økonomiske aktiviteter. De fleste forsøg på at forklare finanskrisen og dens eftervirkninger har imidlertid en relativ snæver økonomisk tilgang. Fornylig blev den længeventede 'Rangvidrapport' (Erhvervs- og Vækstministeriet 2013) *Den finansielle krise i Danmark – årsager, konsekvenser og læring* offentliggjort. Den 488 siders lange rapport kom til på baggrund af et ønske om at analysere årsagerne til finanskrisen og give en vurdering af effekten af de opstramninger, som er blevet taget for at understøtte finansiel stabilitet samt vækst og beskæftigelse i dansk økonomi. Rapporter som denne holder sig oftest inden for en relativt snæver faglighed af økonomisk ekspertise og fokus på de eksisterende strukturer.

I bestræbelsen på at brede diskussionen ud og derved se finans som en del af et bredere politisk økonomisk kompleks, går det nærværende temanummer til spørgsmålet om forandringer og regulering af den finansielle sektor med en bredere politologisk tilgang. Vi har samlet en række prominente skribenter, som alle hører intellektuelt hjemme indenfor disciplinen Politisk Økonomi, til at analysere de finansielle markeder og deres sociale og politiske implikationer. Bidragyderne repræsenterer en kombination af etablerede navne og yngre lovende forskere. De gør os alle klogere på nogle af de emner, og flere til, som er opridset ovenfor.

De første tre artikler går i dybden med fænomener som er kommet til at spille en central rolle under og efter krisen: centralbanksaktivisme, derivater, og offshore kapital. I den første artikel demonstrerer **Grahame Thompson** hvordan centralbanker – inkl. den danske nationalbank – verden over er blevet særdeles aktive aktører i forhold til at styre og skabe incitamenter i den finansielle sektor. På den baggrund foreslår han, at vi ser begyndelsen af, hvad han på engelsk kalder, "central bank led capitalism". Det var iøjnefaldende hvordan staten og det politiske kom tilbage på dagsordenen efter krisen slog igennem 2007/8. De fleste rettede blikket mod inter-,

trans- og nationale politiske fora for at få etableret en anden type regulering og politikformulering på det finansielle område. Men i stedet, fastslår Thompson, har bankerne udfyldt et handlingsrum, som opstod p.gr.a. behovet for stimulering af økonomien. Centralbankerne har oparbejdet enorme gældsposter for at frigøre penge til de private banker. Indtil videre, dog uden synderlig effekt idet udlånsvirksomheden ikke er taget mærkbart til. Spørgsmålet er, om den store gæld kan blive et problem for bankerne, og her peger Thompson ligeledes mod innovative politikker når det gælder vurdering af gæld.

Som nævnt har finanskrisen og de efterfølgende økonomiske problemer for stater sat spørgsmål om skatteunddragelse højt på den politiske dagsorden. USA, EU og OECD har alle lanceret nye initiativer for at forhindre enkeltpersoners og virksomheders skattemanipulation. **Duncan Wigan** demonstrerer imidlertid, hvordan policydiskussionerne om de forskellige tiltag generelt har negligeret sammenhængen mellem beskatningssystemer og de finansielle systemer. Wigan argumenterer for, at derivater, som spiller en central rolle i det finansielle system, udgør en ny form for ejendom som er i stand til at undvige staters skatteinddragelseskapacitet. Hermed fremstår derivater som fiskale masseødelæggelsesvåben (*fiscal weapons of mass destruction*). Kompleksiteten bliver udfoldet i artiklen, men grundlæggende udfordrer derivater traditionelle beskatningsmodeller, fordi derivater vareliggører både temporalitet og geografi og dermed destabiliserer dem som forudsætning for beskatning.

I tråd med Wigans artikel analyserer **Ronen Palan** og **Anastasia Nesvetailova** herefter hvordan, det vi ofte ser som unormalt og amoralsk praksis blandt finansfolk, skyggebankvirksomhed og det såkaldte *offshore* (juridiske eller geografiske steder med løsere regulering og mindre skattepligt) fænomen er en integreret del af det finansielle marked. Finansiel kapital har altid søgt andetsteds hen for at undslippe regulering og skattepligt. Siden 2. Verdenskrig er brugen af *offshore* og skattely steget markant. Palan og Nesvetailova knytter det an til Thorstein Veblens begreb om *sabotage*. Begrebet henleder vores opmærksomhed på at visse typer af kommerciel aktivitet saboterer muligheden for en velfunderet offentlig sektor.

De sidste tre artikler vender blikket mod nogle af de konkrete tiltag, der har været for at regulere de finansielle markeder. I den fjerde artikel viser **Andrew Baker,** at orienteringsskiftet mod såkaldt makroprudentiel regulering (der søger at begrænse systemisk risici i det finansielle system i stedet for blot, fx at fokusere på enkelte pengeinstitutters robusthed) har været en af de mest opsigtsvækkende nyskabelser i kølvandet på krisen. Bakers bidrag gør rede for både den makroprudentielle tænknings indhold og oprindelse. Paradoksalt noterer han imidlertid, at dens popularitet som reguleringsfilosofi af forskellige årsager ikke er oversat til praksis.

Herefter vender **Martin B. Carstensen** blikket mod konkrete tiltag for at regulere banksektoren; det der på engelsk betegnes som *special bank resolution regimes* (SRR), som giver myndighederne mulighed for at opløse konkurstruede banker uden at forstyrre markedet eller risikere store offentlige summer. Flere stater har søgt at implementere SRR i forsøget på få bedre styring med distributionen af risici og tab mellem det offentlige og bankernes kreditorer. Det danske SRR system (Bankpakke 3) er indtil videre det eneste, der har været i aktiv brug, og det har været med begrænset succes. Set fra et styringsperspektiv er problemet, at hvis man lader en bank gå konkurs, for derved ikke at bruge offentlige midler på at redde en privat institution, så svækker det i en dansk sammenhæng de øvrige bankers konkurrence internationalt, fordi det påvirker deres kreditværdighed. På trods af deres begrænsede brug indtil videre fremhæver Carstensen, at SRR repræsenterer en vigtig nyskabelse som fremover vil være en del af de offentlige bestræbelser på legitimt at regulere sektoren.

Temanummerets sidste bidrag har et europæisk fokus. **Photis Lysandrou** bidrager til diskussionen om beskatning af finansielle transaktioner. Dilemmaet er, hvorledes man beskatter på en måde, så man stabiliserer uden at mindske produktiv aktivitet. Lysandrou skelner mellem *Financial Transaction Tax* (FTT) og *Financial Activities Tax* (FAT); førstnævnte har været favorit i EU's bestræbelser på at beskatte finansiel aktivitet. Men det er en fejl; artiklen argumenterer for, at FTT ikke vil stabilisere markedet og desuden vil have en negativ påvirkning på bankers og investorers arbejde. I stedet advokerer Lysandrou for en FAT model, som i langt højere grad beskatter ekstraordinære profitter fremfor den samlede aktivitet i systemet. Hermed når vi afslutning, hvor vi kan læse to boganmeldelser.

Til sidst er blot at rette en stor tak til forskningsassistent Sara Dahlman, som har lagt meget arbejde i at redigere og sammensætte manus til dette nummer. Vi er begge ovenud taknemmelige for den hjælp vi har fået.

God læselyst!
Jeppe Strandsbjerg & Duncan Wigan
November 2013

Litteratur

Erhvervs- og Vækstministeriet 2013, *Den finansielle krise i Danmark – årsager, konsekvenser og læring*, København.

Bank for International Settlements (**BIS**) 2013, *Triennial Central Bank Survey. Foreign exchange turnover in April 2013: preliminary global results*, Monetary and Economic Department, September 2013.

TEMA

Creating Credit and Rating it: New Kids on the Block in Post Crisis Global Finance

Grahame Thompson
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„One of the most intriguing developments since the financial crash of 2007/8 is the way it propelled Central Banks to the forefront of financial innovation and policy formation. As the political authorities abandoned activist macro-economic management and set their Treasuries and Finance Ministries the sole task of cutting public expenditure and organizing for austerity, the Central Banks took on any management of the economy that was permissible or that they could get away with. ...“

Introduction

One of the most intriguing developments since the financial crash of 2007/8 is the way it propelled Central Banks (CBs) to the forefront of financial innovation and policy formation. As the political authorities abandoned activist macro-economic management and set their Treasuries and Finance Ministries the sole task of cutting public expenditure and organizing for austerity, the CBs took on any management of the economy that was permissible or that they could get away with. And this was aided by their semi-autonomous status, granted to them by earlier political administration's determination to see CBs independent of direct political control, able to pursue monetary policy as they saw fit, but originally set within the bounds of conservative inflation targeting. This is the legacy CBs like the US Federal Bank (US Fed), the European Central Bank (ECB), and the Bank of England (BoE) inherited as they faced the consequences of financial meltdown and monetary turmoil in the wake of the crisis (I come back to the Bank of Japan (BoJ) in a moment). But far from this inheritance completely constraining CBs it actually presented them with an opportunity: whether by design or fortunate circumstances they have seized the possibility of turning themselves into the premier activists of economic management. We now have what Bowman *et.al*. (2013) have termed a 'central bank led capitalism' on an unprecedented scale and extent. If, as a consequences of prolonged austerity, we add in the likelihood of very low growth rates for many years ahead (which seems feasible, see Alpert 2013) then we may be moving into a new and unusual era for advanced capitalism – *low growth central bank led capitalism*.

This article describes some of these events and tries to assess their possible consequences and implications. The approach adopted here builds upon a 'political arithmetic' that is theoretically parsimonious but empirically rich (see, for example, Englen, *et.al* 2011; Bowman *et. al*. 2013). It shows how central bank led capitalism connects to the rest of the financial system, and how it is being accompanied by interesting and potentially radically different ways of assessing sovereign risk. Indeed, it is the issue of sovereign risk that is posed afresh by the rise of CB activism. Sovereign risk has become a major issue as CBs balance sheets (BS) have exploded in the manner described in a moment, and new ways of calculating such sovereign risk have emerged in its wake.

Central Bank BSs have proved crucial in designing and pursuing economic policies in the wake of financial crises. As we will see CBs have purchased a wide range of financial assets in order to further major macroeconomic and financial stability objectives, which has implied a comparable increase in domestic liabilities. This has led to an unprecedented global expansion of CB BSs. But BSs of the current size could create broad policy risks, beyond the increased exposure of the CB to market de-

The Danish Central Bank, Copenhagen

velopments. These risks include inflation, financial instability, distortions in financial markets, and conflicts with government debt managers. Critics of the CB BS explosion suggest that as huge monetary stimuluses' have accumulated it becomes increasingly difficult for the CBs to reverse their monetary easing policy and shrink their BS from their current size back down to the pre-2008 level. But the argument here will stress that this is not such a problem as it is often made out to be, for reasons outlined in a moment.

Thus this article should act as an antidote to all those who say, first that not much macro-economic activism can be discerned since the financial crisis – 'we are all doomed' by the continued stranglehold of neo-liberal ideology; and secondly, that there has been no, or little, innovation in economic policy making since the crisis. In actual fact we have witnessed a very innovative period, one which continues it will be argued. Quite where all this is going, however, remains unclear. Each CB has its own particular problems to confront – there is no effective 'global policy coordination' and nor is there likely to be. For the moment this is wishful thinking. Whilst the US Fed, the ECB and the BoE still retain a residual primary (but fast disappearing – see below) commitment to low inflation targeting, for the BoJ it is precisely the opposite as it tries desperately to *increase* inflation (interrupt its deflationary experiences and expectations). This all makes international capitalism inherently unstable, particularly in respect to financial and monetary matters (Kindleberger and Aliber 2011; Minsky 1982).

The rest of this article proceeds as follows. The next section outlines the evolution of CB BSs since the crisis. It concentrates upon the four main advance country CBs already mentioned with something on the Danish Central Bank (DCB) for local interest. After that we turn to the innovative policies that have been responsible for the explosion of BSs. This is flowed by a section dealing with the relationship between CBs and assessments of sovereign risk. The responses to this from those institutions dealing with the ratings business is discussed in the penultimate section, where the characteristics of new metrics and those new institutions trying to muscle into the ratings business are discussed. The article ends with a conclusion outlining why this matters and what its ultimate consequences might be.

The Empirics

Broadly speaking a central bank balance sheet gives a snapshot summary of the financial position of the CB at any one time. As BS assets must equal liabilities for convenience in what follows we concentrate upon the asset side. As we will see later, however, 'reserves of commercial banks' appearing on the liability side is very important for an examination of the policy implications of the expansion of assets on the opposite side of the BS.

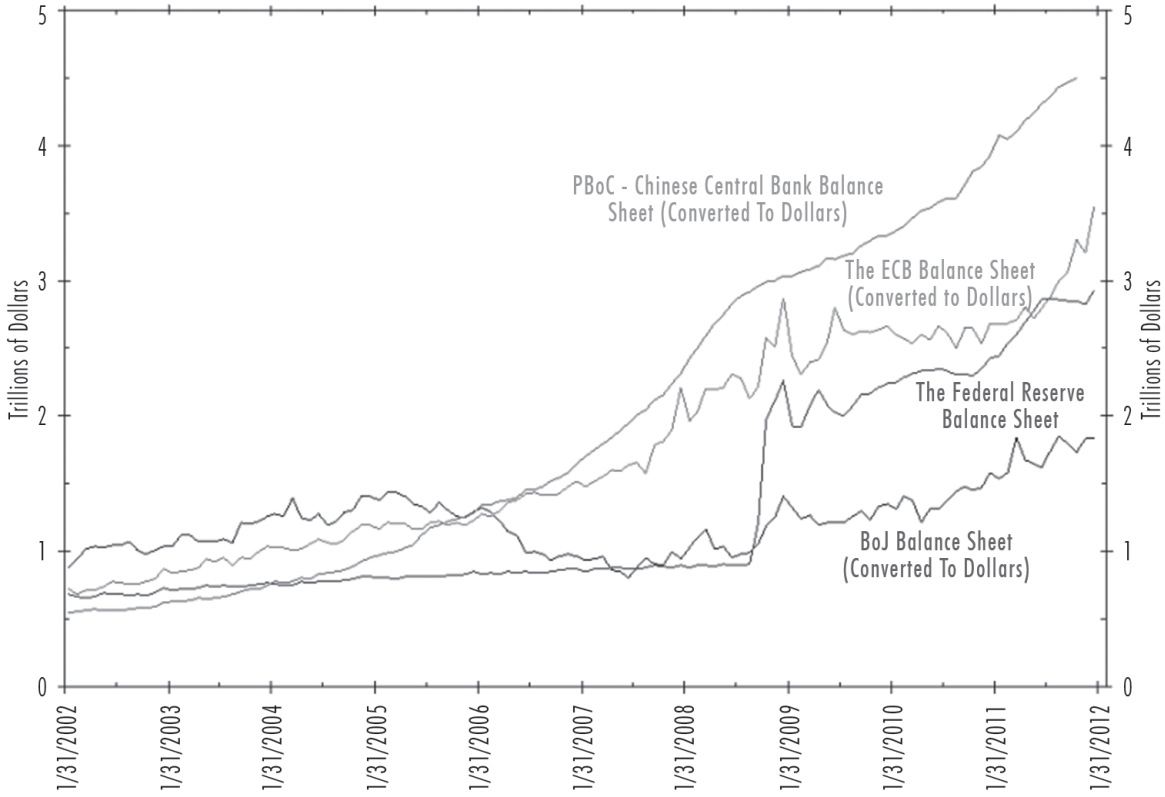
Figure 1 demonstrates what happened to the aggregate assets of the US Fed, the ECB and the BoJ between 2002 and 2012, and for a contrast it includes the Chinese central bank (PBoC). We return to the PBoC in a moment but first we concentrate on the three advanced country CBs.

In absolute terms the ECBs assets more than trebled. There were two main noteworthy episodes: the first in the latter part of 2008 and the second in the early part of 2012. The first was associated with the onset of the crisis as the ECB tried to staunch the loss of liquidity in the Eurozone and support its banks whilst the second had more to do with the sovereign debt crisis amongst mainly the countries in the south. But what this diagram illustrates is that far from being moribund the ECB was very active. Despite a hugely constraining political and organizational environment the ECB continually pressed against these obstacles and extended its mandate considerably.

If we now turn to the US Fed the big push happened just after the original crisis during 2008. This mainly involved supporting the domestic banking and wider financial system via the policy of, first, the Troubled Asset Recovery Program (TARP) – an emergency measure introduced to staunch the liquidity losses in the immediate aftermath of the crises -- and then quantitative easing (QE -- more on this innovative policy later). The key element for the expansion of the asset side are the mortgage backed securities (MBS) which the Fed bought-in to prevent the holders of these going bankrupt as their value fell with the collapse of the US housing market. Subsequently this was overtaken by QE driven bond purchases. But note that unlike for the ECB, there was no subsequent sovereign debt crisis to contend with.

Initially the Fed gave assistance mainly to US financial institutions but not exclusively so. It supported Wall Street *and* the international financial system beyond. Again, this marks out the particularity of the US Fed's role. Keoun and Kuntz (2011) eestimate that between 2007 and 2010 US$ 1 trillion was dispensed by the Fed[1]. Later estimates for overall 'global' support for distressed financial institutions – in the USA and beyond -- suggests this amount was anywhere between *US$7 trillion and nearly US$9 trillion*. This just demonstrates the huge amount of public subsidy that has been pumped towards private financial interests: a veritable corporate welfareism of unprecedented scale.

Figure 1: Assets of the ECB, the US Fed, the BoJ and the PBoC: 2002-2012 (trillions of US dollars)



Source: Thomson Reuters Datastream.

These trends are mirrored in the case of the BoJ (Iwata & Takenaka 2012) though the cycle of expansion is different. The BoJ embarked on a program of QE in 2001, which lasted until 2006 (this had to do with the much earlier onset of domestic financial disruption in Japan). As a consequence between 1997 and 2005 its assets increased from 12.5% of GDP to over 32%. Subsequently other polices were introduced (corporate financial facilitation, comprehensive monetary easing) so that, after a fall in the BS between 2006 and 2007 it began to climb again to be 30% of GDP by 2012 (Iwata and Tanaka 2012, Figure 1).

But look also at the position of Chinese CB. The People's Bank of China (PBoC) has overtaken the Fed, BoJ and even the whole euro system by assets in recent years and has become the largest central bank in the world[2]. Thus the developments outlined in respect to the main advanced capitalist country CB have not been confined just to these.

In addition we could add in the Bank of England, whose assets double between February 2009 and October 2012 (see http://www.bankofengland.co.uk/markets/Pages/balancesheet/default.aspx) and a small open economy like Denmark, the experience of which is illustrated by Table 1.

Table 1: Danish Central Bank Balance Sheet 2000-2012 (assets at year end)

Year end	DKK Billions	% Change	
2000	237.0		
2001	295.3	24,6	
2002	375.4	27,1	
2003	397.3	5,8	
2004	337.1	-15,2	
2005	392.0	16,3	
2006	364.9	-6,9	
2007	424.5	16,4	
2008	635.1	49,6	
2009	550.0	-13,4	
2010	486.1	-11,7	
2011	569.8	17,2	
2012	628.5	10,3	
		Total change	**165,2**

Source: Compiled from various Danish National Bank statistical sources.

There were significant increases in the early 2000s (associated with Denmark's domestic bank bailouts) but the big jump associated with the financial crisis occurred in 2008 when the yearly increase was almost 50%. Things slowed down for a few years after that but then began to increase again in 2011 and 2012 as 'safe haven' money began to flow into Denmark (see below). Over the entire period 2000-2012 there was a 165% increase in assets.

Finally, we have a comparison between the four main Western CBs in Figure 2, expressing their assets as a percentage of country GDP. This illustrates the significance of the BoJs interventions relative to the others despite its smaller overall absolute size. The ECB also looks very exposed, the US Fed the least.

Again, this means the ECB will face a different set of problems in unwinding its position than the US Fed or the BoE (or the BoJ, see immediately below). Different policies will be in order to deal with different circumstances.

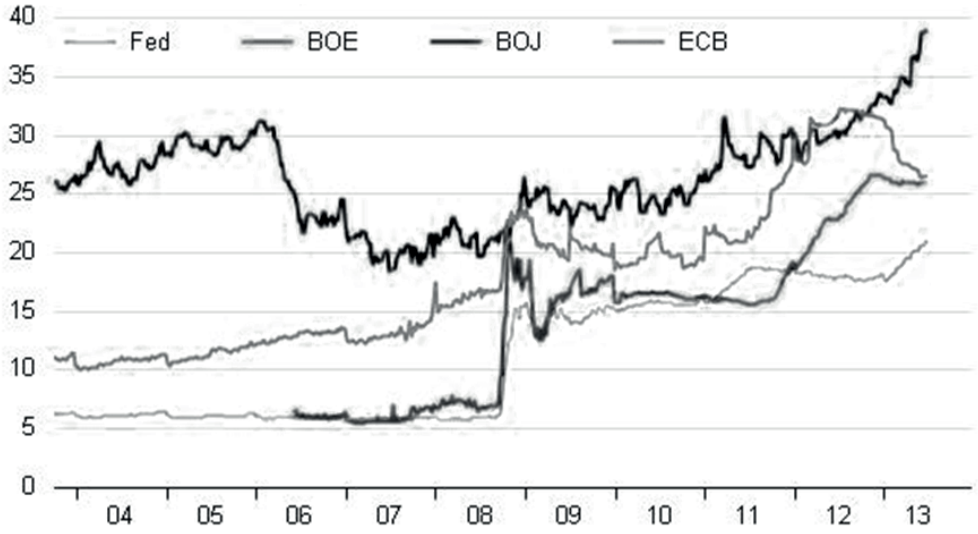
What Have Been the Innovative Policies?

The above data illustrated the consequence of CB actions but what exactly were those actions? This section discusses several of the more important policy developments since 2008. But first we describe how the main CBs are institutionally configured.

The BoE is formally a limited liability company fully owned by the UK Treasury. The US Fed is in a more complicated legal position since it is a Federation of several (12) quasi-independent regional banks (Federal Reserve Districts), which have significant private institutional involvement, making the FRS a mix of public and private interests. However, the Federal Reserve Bank has legislative backing, and is a properly constituted central bank and banker to the US government.

In the UK the BoE's Monetary Policy Committee is the body responsible for conducting monetary policy – setting interest rates and determining the general conditions for lending and borrowing. The parallel body in the US Fed is the Federal Open Market Committee. But CBs also act as the banker to the government. For instance as the government's bank the Fed acts as its fiscal agent: the US Treasury keeps an account with the Federal Reserve, through which incoming federal tax revenues and outgoing government payments are made. It also sells and redeems US Government securities such as savings bonds and Treasury bills, notes and bonds, and it issues the nations coin and currency. In the UK it is the BoE that directly issues TBs on behalf of the government. It also manages the country's foreign exchange and gold reserves. Both CBs also act as a lender of last resort. The ECB is a corporate entity with shareholders and capital stock (€5billion) which is owned by the central banks of all 28 EU member states. It is formally controlled by a Governing Council made up of representatives of the

Figure 2: Balance Sheets Compared: ECB, US Fed, BoE and BoJ (2004-2013 – expressed as a % of GDP)



Source: Thomson Reuters Datastream

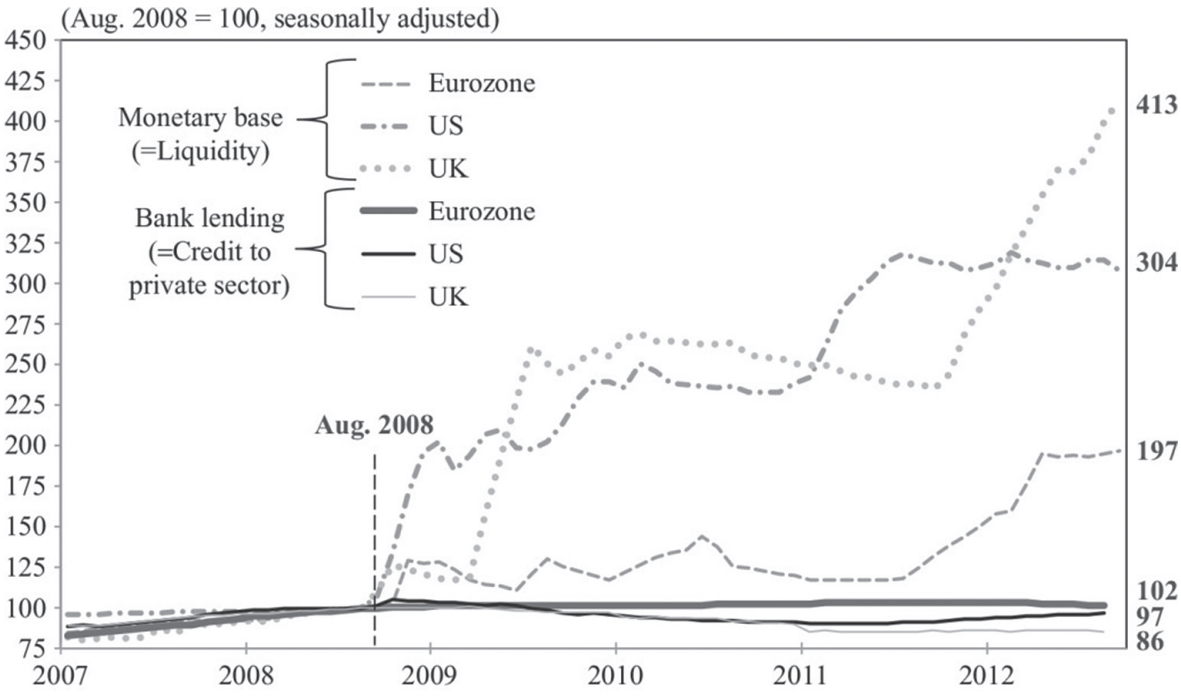
Eurozone countries. In a similar way to the other CBs is acts as the Eurozone's banker, issuing Euro currency, managing the foreign reserves of member states and the exchange rate of the Euro, and devising and conducting monetary policy. But it does not have explicit lender of last resort powers.

Returning to the policies pursued an early caution is in order since it could be argued that there is nothing necessarily radically innovative about these policy developments. In a moment we discuss 'quantitative easing' (QE) – which is the main claim to innovation in this environment – but it could be said it is nothing more than a revamped form of traditional 'open market operations' (OMO) by the CBs. Whilst recognizing this as a possible argument it is suggested here that what we have witnessed since 2008 exceeds traditional OMO in both its extent and range. OMO is essentially a short term policy instrument designed to affect short-term interest rates and the amount of 'base-money' in the economy. The sheer size of the recent interventions and their longevity is unprecedented – and amounts to more than the orthodoxy of financial policy. In addition, as we will see in a moment, the level and variety of 'subsidies for lending' vastly exceeds normal practice. We concentrate upon QE here for convenience[3].

QE (practiced mainly by the US Fed, the BoE and the BoJ, but also the Swiss National Bank) involves the CB 'buying' gilts from the private sector financial institutions in the hope that this will on the one had help 'repair their balance sheets' and on the other hand stimulate the commercial banks to extend loans so as to encourage economic activity generally. By selling their gilts and other paper the commercial banks would now have enhanced credit with the CB, which can act as more solid assets in their own BS, thus affording them the possibility of extending their liabilities in the form of credit creation to the private sector (to firms and individuals). This is the basic mechanism. But it can have all sorts of effects. There have been various rounds of QE – the first of which is generally recognized to have helped support share prices (thus shoring up the stock markets) while the second round is helping to restore balance sheets.

But there is a key theoretical issue at stake in this, which illustrates its possible undoing. It is often claimed that this mechanism involves the CB simply 'printing money' – principally in the form of 'central bank base money' – because how else could it 'purchase' the commercial banks assets/gilts? However, this is not altogether the case or quite that simple. Under these circumstances the CB does indeed extend 'credit' to the commercial banking system (which would appear as an increase in reserve balances on the liabilities side of the CB balance sheet referred to earlier), but it does not print money directly, nor extend credit directly to the household or commercial sector. That is the job -- indeed, the whole the rationale – of the commercial banks themselves. *The CBs policy of QE is based upon a hope and a prayer.* In our financial world it is commercial banks that directly 'control the money supply' not the CB (or, indeed -- and God forbid -- the government). Orthodox monetary policy dic-

Figure 3: Monetary Base and Bank Lending



Source: Koo 2012, Exhibit 10, p.30.

tates that commercial banks should have control over the money supply under capitalism – i.e., private economic agents – not the public authorities: that would be tantamount to socialism, i.e., the administrative control over credit creation and allocation. This capacity to control the money supply by private agents – via the direct extension of credit money to households and firms (creating a deposit for them in their accounts at their commercial bank) -- is jealously guarded by the financial system and even QE could not fully challenge this nostrum. Under a monetized capitalism that agent who controls the money supply has control over economic resources, so it is clear what is ultimately at stake in this process.[4]

Thus what QE amounts to is a very unorthodox form of the orthodoxy. The CB policy of QE may have helped to re-establish the strength and credibility of commercial banks' balance sheets, but there is no necessary link between this and the extension of private credit, i.e., an enhancement of the money supply in the form of loans to the private sector of households and firms. That is a decision left to the commercial banks themselves, and, indeed, much to the frustration of the governments and the relevant CBs, there is growing evidence that they have not done so. As shown in Figure 3, despite the escalation of the monetary base consequent upon bond purchases, the actual bank lending to the private sector has stagnated. Of course this may be because there is no *demand* for loans by the private sector. The private sector is deleveraging to restore credibility to its BSs and increasing savings, which lie dormant in the financial system[5]. Again, this reinforces the idea that the policy is based upon a wish and a prayer.

The alternative would be to issue 'helicopter money' --- where the CB simply drops money directly onto the general public by, say, sending them an individual cheque – but this has been ruled out for fairly obvious reasons. Of course, this whole policy initiative is also predicated on a conception that increasing the (credit) money made available to the private sector will indeed stimulate consumption, commercial activity or investment, or whatever. That is also part of the hope and the prayer. The BoE has purchased £375billions worth of gilts as part of its QE program, which amounts to a direct subsidy to the commercial banks. As mentioned above in the US QE began in 2009, and has been successively extended in various phases. As of December 2012 'QE Infinity' began (sometimes known as QE 4) – infinite bond purchases until the US labour market recovered --see below. But by June of 2013 that labour market improvement was evident and the 'tapering back' of QE was broached by the Fed. The possible reversal of the program threw into stark relief the potential difficulties of unwinding

the CBs BS position quickly and extracting the Fed from its entrenched support of the financial system, something returned to in a moment.

Thus whilst a great deal of effort and energy (political, ideological and economic) has been expended on QE it may have repaid sparse real economic dividends. But what it has done is hugely inflate the CBs BSs -- as shown above -- as they have 'purchased' more and more privately owned assets in an attempt to 'kick start' private sector monetary growth and with it economic activity more generally. Whist the jury still remains out on what the ultimate effect of it will be on economic growth it is towards a discussion of its consequences within the financial system that we turn in a moment. And what happens here may also ultimately affect economic growth, which is returned to in the conclusion.

But first what other policies have of CBs resorted to?

Ever since Ben Bernanke voiced an official concern in 2012 with US unemployment (that had peaked at 10% in October 2009 – see < http://www.federalreserve.gov/newsevents/speech/bernanke20120831a.htm >), CBs have toyed with a range of possible new policy mandates. As unemployment in the US fell to around 7.5% in 2012, an official unemployment objective was established by the Fed at 6.5%. In fact the US Fed has a 'dual mandate': to both establish stable prices and maximize employment, though the inflation objective had up until the recent past been considered its prime task.

The additional innovative part of this policy was to pre-commit the CB to maintain its policy stance on interest rates until the objectives for inflation and particularly unemployment had been met. But this explicit statement by Bernanke set off a debate amongst other CBs as to whether they should also target unemployment like Bernanke was encouraging[6]. Or should they adopt an explicit growth rate target ('nominal GDP' targeting). Or should they engineer negative nominal interest rates? The BoE floated this idea in February 2013. And the Danish Central Bank (DCB) adopted this policy explicitly. Investors would now *pay* the Danish authorities to lodge their money on overnight deposits in Denmark. In Denmark's case this policy – and its general policy of keeping all interest rates at zero or as near as possible to this – is designed to maintain the exchange rate between the Krone and the Euro[7]. Thus here the DCB's policy is principally directed at exchange rate stability, another possible policy target for CBs more generally and another indicator of the different objectives facing different countries in managing their economies. The exchange rate between the Krone and the Euro is the foundation on which all of Denmark's macro-economic policy is based. On the other hand the ECB – which also toyed with this idea on negative interest rates in May 2013 – views this as a policy for stimulating private demand in the traditional manner, not for stabilizing the Euro exchange rate.

Of course the BoJ has also adopted an implicit exchange rate policy, since in keeping interest rates very low the idea is to encourage spending and to see the Yen exchange rate fall, so as to make Japanese exports more competitive. This is viewed as the way out of its deflationary malaise. Although this policy mix is often attributed to the Prime Minister, Shinzo Abe ('Abeconomics'), the recently appointed new governor of the BoJ, Haruhiko Kuroda, was the key player in devising the package.

But most 'innovative' CB policies have been associated with direct subsidies to the banks to try to stimulate lending, like QE discussed above. Further example of this are the UK's 'Funding for Lending' (F4L) program (another £80 billion), or its subsidy on mortgages to help buyers climb the housing ladder announced in the April 2013 Budget.

Amongst all of this, however, what is left of inflation targeting, the original mandate for independent CBs? Very little, or so it seems. Inflation has slipped down the policy agenda as CBs have seized the opportunity to exploit their new found freedoms to experiment with policy making. They may not know quite what they are doing, or what they should do. They may all have different objectives. But they have certainly been active. Some would say over active, and they will reap the downside consequences later (e.g., Stockman 2013). But what might those consequences be? This we turn to in the next section.

Central Banks and Sovereign Risk

I outlined the functions of the CBs above to indicate that they are intimately tied to the financial functions of their respective Treasuries, governments and financial systems beyond. They are part of an elaborate and complex of institutions and mechanisms that are scrutinized for establishing the risks and rewards associated with sovereign debt, for instance. In this, of course, the overall fiscal position of the government is crucial but so too is the state of its banking sector and CB. Indeed, it is just this 'fiscal position' that the explosion of CBs BSs indicates. At the end of the day, QE and all the rest represents a fiscal problem for the government and the public since this is a debt that has to be 'repaid', even though it is formally on the books of the CB. The expansion of the CBs BSs indicated above was a result of a decision about public expenditure, involving a huge public subsidy to the financial system. Several possible consequences follow which are only presented here in outlined (Caruana 2012; Weidmann 2013).

First, will it be possible for the CBs to unwind their newly acquired financial positions as indicated by their BS? This issue was posed acutely in June 2013 as the US Fed hinted at a policy of imminent phased withdrawal of QE. Of course this threw the US financial markets into instant turmoil. The prospect of interest rate rises upsets plans and expectations throughout the financial system. But this policy re-adjustment would have implications beyond the US. The economic cycle in the US is in quite a different phase than in Europe. Europe was still mired in deep recession in mid-2013 whereas the US economy was on a recovery trajectory. So despite anything else, this makes prospects of global policy coordination even more unlikely since these two economic blocks were facing quite different current economic conditions. But these involve essentially short-term consideration. What about the longer term?

Economist would answer 'yes' to the longer term prospect of successful unwinding because of their faith in the market mechanism: as conditions improve and the expansionary BS phase comes to an end the CB can re-package their acquired debts and sell them as market sentiment improves. It might even make a profit on these transcations. There may be something in this as will be indicated in a moment, but the medium term uncertainties are legion and the political cost may be prohibitive – fiscal conservatives are incensed by these policies (Stockman 2013). But there are three somewhat alternative policy options available here: explicitly wind down the position as just suggested; hold on to it and keep things as they are (why should the CB really worry about this since it is a sovereign risk and the CB will not default); relatedly, wait for it to be eroded by inflation in the longer-run.

What about the sovereign debt issue? This is related to what has just been said. Given the dangers associated with such a large and swift 'deterioration' of the CBs BS might this not inhibit investors when thinking about acquiring further sovereign debt? The state of the CBs BS is also an indicator of the state of the sovereigns' BS, since this is ultimately a form of public debt. However, as indicated by the discussion of the Danish case, things are complicated by several other factors.

At this stage it is important to bring in the credit rating agencies, since there are the bodies that actually establish the credit rating for sovereign debt. The three big CRAs are Standard and Poor, Fitch and Moody's (who collectively control 95% of the global credit ratings market). These bodies are important because they have semi-official status as regulatory institutions, fulfilling a public purpose despite them being privately owned (Sinclair 2008). The CRAs assess the risks associated with financial investment in both private corporations and sovereign debt. They rank various institutions and sovereigns -- -- rating the debtor's ability to pay back the debt, make timely interest payments and the likelihood of default. Traditionally, the countries we have been dealing with above were 'Triple A rated' by these agencies: as a result their debt was judged as 'risk-less': they were the ultimate 'safe havens'. Recently, however, there has been some down grading of their debt as their fiscal position deteriorated and growth prospects faltered (e.g., for the US and UK). But a problem here is that there is a growing loss of confidence in these bodies in the wake of their role in the run up to the financial crisis. They failed to spot the emerging problems and were compromised by their dual role as both assessors of risks and advisors/consultants to the very financial institutions they are assessing. This disillusionment with the existing CRAs has provided a space for some potential competitors to emerge in the credit ratings business. And this is a further indicator of potential quite rapid institutional change in this world. New bodies are marketing their indexes, claiming they are superior in their methodology in the new period of CB-led capitalism and are not compromised by past mistakes in the old era. Thus whilst we may have another round of potential 'financial innovation' emerging here, this time it is not one involving yet another exotic financial instrument or form of securitized debt obligation (for the foreseeable future that era is probably over) but, rather, a new and better index of sovereign risks, one suitable for a new era of 'sovereign debt crises', fiscal austerity and CB BS inflation.

Sovereign creditworthiness assessment has developed with the huge expansion of the sovereign credit default swap market in the aftermath of the financial crisis which, like credit ratings more generally, constitutes an extension of corporate methodology into the sovereign sector.

A CDS is a credit protection contract whereby credit risk is sold to a third party that agrees to make a payment in the case of a defined 'credit event' in exchange for a periodic premium. Traditionally CDSs are not traded on exchanges but are privately negotiated between two counterparties. However new clearing solutions are increasingly being offered which consolidate these instruments, track them and offer an instant clearing mechanism[8]. In addition, the huge increase in public borrowing indicated above sparked the creation of several tradable indices that track sovereign credit risk of comparable countries: in 2009 the *iTraxx Europe* for 15 countries in the Eurozone, plus Denmark, Norway, Sweden and the UK; in 2010 the *iTraxx CEEMEA* for 15 countries in central and eastern Europe, the Middle East and Africa; and several other indexes for the G7, BRIC and various other combina-

tions of emerging market sovereigns. These indices are owned, managed and marketed by the financial information group *Markit*[9].

What these particular CDS rating models do is to process the collective market view of issuers' credit condition from CDS prices and convert them into implied rating probabilities of default. Clearly, in normal times the more 'liquid' is this market, the greater is the implied sovereign risk (contrary to the bond market). The traditional CRAs have adopted this methodology for their corporate credit ratings business (Fitch, 2007) and extended it into the sovereign sector. Since 2002 they all began to track sovereign CDS prices in indexes (Gaillard, 2012, p. 172) as well as provide market-implied ratings that translate prices from the CDS, bond and equity markets into standard rating language for both the issuer and the security. Like traditional credit ratings, CDSs are 'independent' from factors such as captive buyers and safe haven dynamics of market turmoil, and the CDS market therefore does not replicate the bond market and often diverges. So, for example, as Germany's cost of CDS protection widened by 20% along with the southern countries of the Eurozone in May 2012, *Markit* pointed out that the CDS market may be reflecting real, fundamental concerns about Germany as it is increasingly becoming clear that the 'powerhouse' of Europe is not immune to the Eurozone turmoil, risk of a messy break-up of the Euro, or the unpopular alternative of quasi-federalism.

Thus in the wake of the crisis a range of alternative organizations, calculative mechanisms and indices are emerging in the sovereign risk business that claim a superior methodology and more accurate assessments. But what these approaches share is, first a commitment to key ratios like the debt to GDP indicator, and/or a 'mark-to-market' pricing valuation arrangement that tracks actual market prices for CDS. The *BlackRock* Sovereign Risk Index, on the other hand, rejects these indicators as being inadequate (though it embraces them in part – see below) and adopts a 'research-led' methodology instead[10]. *Black Rock* is the leading institution claiming a new role for sovereign debt assessment. Initially comprising 44 countries, *BlackRock's* index produces a ranking of sovereigns according to their relative likelihood of default, devaluation or above trend inflation based on four conceptual categories (*BlackRock* 2011, June):

1) *Fiscal space* contains two equally weighted measures for debt sustainability: 'proximity to distress' (the additional debt that would lead to a country defaulting) and 'distance from stability' (the fiscal adjustment required to reach a sustainable debt level for the future), calculated by a formula that stipulates a 60% target debt/ GDP rate for high-income countries and 30% for low-income countries (see a criticism of these ratios below).

2) *External Finance Position* looks at the susceptibility to macroeconomic trade and policy shocks outside the control of the country.

3) *Financial Sector Health* considers the share of financial sector debt as % of GDP as well as 'Credit Bubble Risk', and the degree to which the financial sector of a country poses a threat to its creditworthiness if its liabilities are to be taken over by the sovereign (i.e. nationalized).

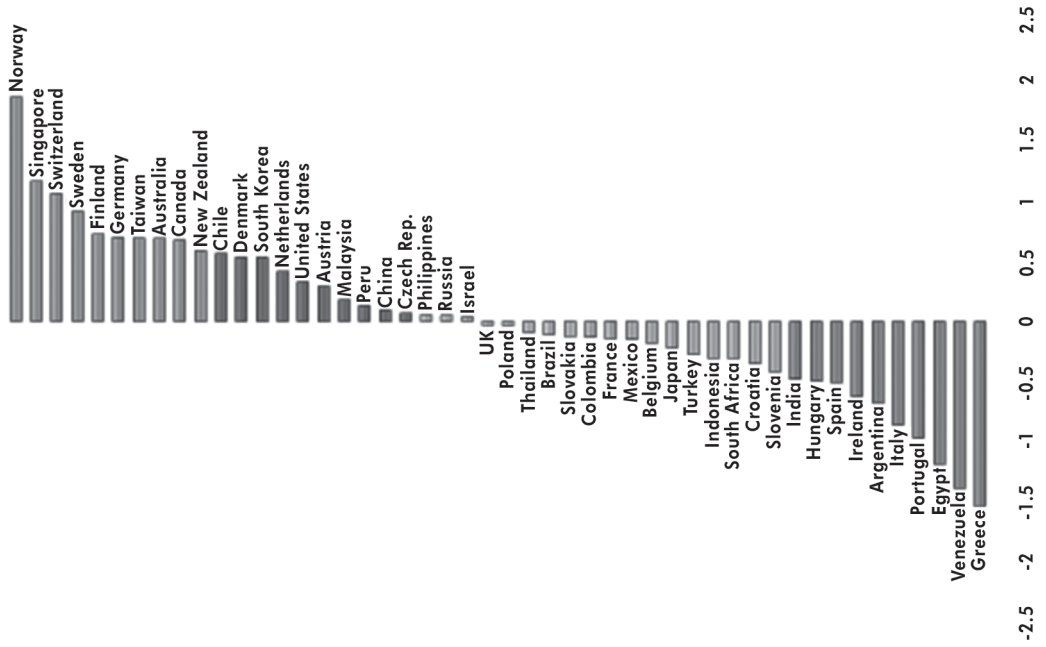
4) *Willingness to pay* assesses the particularity of sovereign creditworthiness by examining the 'qualitative cultural and institutional traits that suggest both ability and willingness to pay-off real debts'.

These features are combined into a weighted index (40:20:30:10 respectively), an example of which is given in Figure 4.

Note that the classic safe haven countries like the US, UK and Germany are not at the top of this list but in the medium range of the index and the most creditworthy countries are not the most liquid but those most isolated from risks associated with external and internal financial shocks. Thus Norway, Singapore, Sweden and Switzerland take the prime spots and Chile and South Korea feature in the top 10. The result is a new sovereign risk world order where the traditional roles of developed and emerging economies are unsettled or even reversed.

BlackRock acknowledges that its sovereign risk index places great emphasis on the relative ranking and ordering of sovereigns and in that respect differs from credit ratings – where countries can share the same absolute ratings[11]. The index is further a conscious move away from 'insurance-weighted indexing' described above, that has until recently dominated bond indexing and weights bond portfolio shares according to those countries who issue the most debt. Market value weighted indexes that favour capitalisation, liquidity and demand over fundamental analysis are argued to overweight large issuers of liabilities, impeding proper 'price discovery' in traded debt markets. With sovereigns in particular much idiosyncratic risk remains that cannot be diversified away and holds no reward for bearing it, so traditional Capital Asset Pricing Model considerations are not relevant. By contrast, *BlackRock* holds that the key advantage of its research driven as opposed to market driven index is that it does not favour the weaker credit issuers with higher portfolio representation. It claims that most bond indices reward failure (giving high weights to heavy issuers) and penalise success – whereas its index rewards success and penalises failure, putting it on a par with equity-based indices.

Figure 4: The BlackRock Sovereign Risk Index (June 2013)



Source: < http://www.blackrock.com/corporate/en-dk/news-and-insights/blackrock-investment-institute-risk-index# > -- accessed October 7, 2013)

So what we are witnessing is a world no longer defined by the bell curve but one in which the average outcomes – for growth, inflation, corporate and sovereign defaults, and the investment returns driven by these outcomes – will matter less and less for investors and policymakers, where the distribution of outcomes is flatter and the tails are fatter and the mean of the distribution becomes an observation that is very rarely realised. Their sovereign risk index is based on a new understanding that while the past empirical experience for developing market economies is limited, going forward the risks are likely to be quite different. Along with traditional interest rate and liquidity premia, compensation for credit risk is now being built more explicitly into the yields of all countries, irrespective of their historical default experience or share of global production. In fact, developed economies can present greater systemic risk because of their deeper financial markets *BlackRock* argues. So a more intelligence based approach is needed, that dispenses with past correlations as indicators of future trends and instead relies on intuition, simplicity and fast repositioning conducted on an almost day by day basis.

This also indicates to a move away from bond markets as the prime site for risk assessment. Thus new financial regulations such as the Basel III banking regulation[12], which stipulate that banks do not have to provide collateral against their investments in government bonds with ratings of AA- or higher and investments in bonds issued by the home government require no buffer regardless of the rating, are totally inadequate, it is suggested. The bond markets are systematically rigged by governments and CBs, it is claimed by the likes of *BlackRock*, captive to an insurance based safe haven dynamic which will only lead to trouble.

Credit rating agencies, for example, unlike the decentralised knowledge production of the market, use methods that show a striking similarity to central planning, it is suggested (Rona-Tas & Hiss 2011). Just like planners, these agencies collect information in a bureaucratic fashion as local knowledge percolates up through standardised forms and reports, and then apply complex, scientific methods to analyse this information. Just as central planners do, these agencies present themselves as actors following only their own principles, unaffected by their social environments. But, perhaps somewhat ironically, the *BlackRock* index could be accused of similar sins.

5. Conclusions

So what is the bottom line in respect to sovereign debt, economic growth and the possible new era? A lot of the *BlackRock* criticism of other calculative methods is, of

course, marketing hype: it needs to justify its product and differentiate this from the competition. There is not going to be a rapid erosion of the traditional CRAs role and a complete undermining of their position. But ultimately does it matter whether governments and their CBs are heavily in debt, or more heavily in debt than they used to be (other than in periods of severe national crisis like Wars). This issue was posed recently in a slightly different context, around the Rogoff and Reinhardt (R&R) dispute over the importance of different debt/GDP ratios for the prospects of economic growth. R&R had argued a debt/GDP ratio of over 90% was historically associated with significantly slower growth rates (R&R 2009, 2010). This has been used by 'fiscal conservatives' to argue the need for severe austerity and a cut back in public expenditure. Subsequently it was discovered that there were several 'errors' in the original R&R analysis, in terms of coding the data (Denmark, along with four other leading OECD countries were left out), in dealing with outliers and with the presentation and interpretation of results (Herndon, *et.al*, 2013). The outcome is that it is disputable whether the '90% rule' is robust and that a causal relationship between high government debt/GDP ratio and low growth can be established (it might go the other way (R&R 2013) – note also that *BlackRock* has its own % rules which seem equally as arbitrary).

However, this tends to ignore a key point about the *demand* for government debt (Lysandrou 2013). In the aggregate investors are desperate for 'safe havens' and good quality public debt because there is a surplus of savings in the international system. In part, this is why Denmark can offer negative or zero interest rates and still attracts funds: it is consider a super-safe haven. The private sector is amiss in providing this – it is not investing much so not issuing new shares, it has been 'buy-back big time' for corporate shares as companies have been trying to boost 'shareholder value' and provide incentives and the right conditions for enhancing executive remuneration, and the corporate sector's BSs are in a complete mess. This means the supply of corporate paper has been diminishing and its reliability challenged. The only alternative 'relatively' safe havens are sovereigns, even though some of them are being slightly downgraded by the established CRAs. So there is no shortage of demand for government debt, indeed there is a deep market for it. This is also because, relative to their growing significance in terms of global GDP, the emerging market economies are much smaller issues of securities, so demand has been concentrated on advanced country securities. Generally, this makes it easy for sovereigns to maintain very low interest rates. But its implication is clear. There is no real 'crises of sovereign debt' so CBs might be able to easily unwind their positions. And governments need not worry unduly about their fiscal position. They could quite easily issue more debt, which would be eagerly absorbed by investors who have 'nowhere else to go'.

Notes

1. Clearly, this figure underestimates the final total for the US financial system as a whole as it does not included support for Freddie Mae, Freddie Mac or AIG, for instance. It just records amounts extended to banks.
2. „During 2008-2012, China's broadly-defined money stock (M2) doubled in size, increasing from 47.5 trillion yuan (7.5 trillion dollars) to 97.4 trillion yuan (15.7 trillion dollars). As a result, the Chinese economy is heavily levered—outstanding bank loans more than doubled, climbing from 30.3 trillion yuan (4.9 trillion dollars) in 2008 to 67.2 trillion yuan (10.8 trillion dollars) in 2012; outstanding bonds also rose from 12.3 trillion yuan (2 trillion dollars) to 23.8 trillion yuan (3.8 trillion dollars); and trust funds increased from less than one trillion yuan (16 billion dollars) to 7.5 trillion yuan (1.2 trillion dollars)" (Yu and Lan 2013, p. 20)
3. In the USA QE was preceded by the Troubled Assets Relief Program (TARP), mentioned above – an emergency measure introduced in October 2008. QE proper began in March 2009. But sometimes TARP is designated QE 1, so the QE policy sequence often discussed in the literature would be shifted along by one digit for each phase.
4. This can account for the basic 'failure' of the orthodox monetarist project of the 1980s of trying to control the economy by controlling the money supply. The only way the authorities could actually have directly controlled the money supply would have been by fully socializing the financial system, not something monetarism could have contemplated. Paradoxically strict monetarism requires financial nationalization.
5. The success or otherwise of the various QE programs in the US remains controversial. It has certainly worked to keep long-term interest rates low. In part this was aided by another novel policy development undertaken as part of QE2, namely 'operation twist': the US Fed's policy of selling short-term Treasuries to fund the buying of the long-term bonds. This 'twisted' the yield curve (short-term rates rose and long-term rates fell).
6. In the UK a huge fuss was made when the new Governor of the Bank of England (Mark Carney) announced a similar pre-commitment strategy to target unemployment (at 7%) by the BoE in August 2013.
7. In May 2013 the overnight deposit rate was -0.1%, and the benchmark lending rate just 0.3%. The background to Denmark's financial problems is admirably sketched by Frances Schwartzkopff: 'ECB Agenda Tests Central Bank Extremes in Denmark: Nordic Credit' *Bloomberg News*, 10 May 2013. < http://www.bloomberg.com/news/2013-05-02/ecb-agenda-tests-central-bank-extremes-in-denmark-nordic-credit.html > (accessed 23 June 2013)
8. For example 'Cleared OTC Credit Default Swaps', marketed by the *CME Group*, see < http://www.cmegroup.com/trading/cds/ >
9. See < http://www.markit.com/en/ > 'CDS Index Pricing and Trade Volume' and < http://www.markit.com/assets/en/docs/faqs/Markit_FAQs.pdf > 'About *Markit* and CDS Data'. *Markit* receives CDS data from market makers off their official books and records. This data then undergoes a process of 'cleansing' to test for stale data, outliers and inconsistencies. *Markit* claims this ensure supe-

rior data quality for an accurate mark-to-market and better risk surveillance.

10. *BlackRock* is a world-wide US based investment company, claiming to be the largest fund management company in the world.
11. Much of the following information about the *BlackRock* approach to sovereign risk assessment comes from its periodic 'investment insights' which can be accessed from < http://www.blackrock.com/corporate/en-dk/news-and-insights/blackrock-investment-institute?page=1 >. I would also like to acknowledge several unpublished papers by Nina Boy, particularly her 'The Emperor's new clothes – or how do political-economic fictions fail? The crisis of sovereign credit', which contain stimulating suggestions about the importance of *BlackRock*'s interventions in the sovereign debt market, many of which are developed here.
12. Basel III is a regulatory mechanism devise by the Basel based Bank for International Settlements which establishes capital adequacy standards for major international banks. As its name implies Basel III is the third such set of regulatory instruments issues by the Bank.

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Financial Derivatives: Fiscal Weapons of Mass Destruction

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Contemporary derivatives mark the development of capital and constitute a novel form of ownership. By reconfiguring the temporal, spatial and legal character of ownership derivatives present a substantive challenge to the tax collecting state. While fiscal systems are nationally bounded and inherently static, capital itself is unprecedentedly mobile, fluid and fungible. As such derivatives raise the specter of 'financial weapons of mass destruction'.

Introduction

Since the eruption of the Global Financial Crisis (GFC) with the collapse of Lehman Brothers in September 2008 two particular policy debates have risen to the top of the agenda. One debate was crystallised in the former head of the UK Financial Services Authority, Adair Turner's comment that the financial sector had, 'swollen beyond its socially useful size… I think some of it is socially useless activity' (Turner 2009: 1). The Turner Review had previously pointed to a financial sector blinded by faith in sophisticated mathematics and the efficient market hypothesis, which had become overblown, over leveraged, over speculative, pro-cyclical and under-regulated (FSA 2009: 11-49). At the same time as politicians were echoing this analysis of the malaise of global finance, an orchestrated attack was launched against the world of 'tax havens'. In April 2009, a G20 communique announced the intention to take action against non-cooperative jurisdictions known parochially as 'tax havens'[1]. The leaders of the G20 nations proclaimed themselves 'ready to deploy sanctions to protect [their] public finances and financial systems', and declared that 'the era of banking secrecy is over' (G20 2009: 4). In the context of widespread austerity policies, both debates have persisted and a host of regulatory initiatives, more or less effective, have been launched. However, while both debates have been intense and persistent, they have remained largely distinct. Despite the G20 statement implicitly linking the problem of adequate public funding to that of the stable provision and allocation of credit, the conversation about the financial system has largely by-passed that about fiscal systems.

International Political Economy has no less failed to forge the link between financial innovation, tax avoidance and the fiscal crisis of the state. The literature on what is now widely known as 'the offshore world' (Palan 2003) has concentrated on the historical development of the international tax architecture, the institutional basis of that architecture in nationally circumscribed mutually exclusive fiscal sovereignty under conditions of economic globalisation, the impact of 'tax havens' on developing countries and multilateral policy efforts to regulate activities in offshore jurisdictions (Burn 1999; Eccleston 2012; Kurdle 2010; Rixen; Palan, Chavagneux and Murphy 2010; Picciotto 1992; Sharman 2006; 2012; Leaman and Warris 2013) This is despite evidence that financial innovation in the form of structured finance[2] and derivatives is in good part driven by the tax advantages that it can create. Early on, the noble laureate Merton Miller, a leading derivative architect and doyen of the Chicago School, emphasised regulatory and tax 'frictions' in explaining financial innovation (1986). In turn, John Finnerty (1988: 18), one of the first to recognize the shift from finance

as analytical science to finance as engineering science, famously proposed three criteria for financial innovation; innovation must reduce or reallocate risk to lower the required offering yield (cost of credit), lower issuance expenses (cost of financial production), or create a tax arbitrage opportunity (cost of political geography). 'Financial innovations symbolise the profit-driven response to the [sic] changes in the economic, regulatory and tax environment' (Finnerty 1988: 31).

The advantages of combining the political economic analysis of financial innovation and the offshore do not rest purely on the empirical level. Knowledge of the role of derivatives in tax planning remains in large cocooned within a limited sphere of financial practitioners and legal experts, and requires the acquisition of a jargon and expertise endemic to the markets. For most, how derivatives are used to create tax advantages is a black box. Complexity, opacity and secrecy constitute formidable barriers to entry. Nor is the combination entirely policy motivated. In the context of large developed states attempts to repair leaking and emaciated fiscal systems the issue carries urgent and developing policy significance (HMRC 2013; JCT 2011; JCT 2013). In addition to making an empirical and policy contribution, this article is motivated by the need to broaden the analysis of offshore to incorporate spaces which are not sovereign nation states, but rather the product of technical innovations in the private sphere. Errant policy and rogue states are not the only issue here. Financial innovations which rearticulate relations between fiscal and financial systems call for attention and Warren Buffet's famous warning in relation to the then emergent credit derivatives market, that derivatives are potentially 'financial weapons of mass destruction' (2002: 16) might be usefully reposed as derivatives are 'fiscal weapons of mass destruction'. Derivatives corrode both the capacity to collect tax due and the categories and concepts upon which fiscal claims are constructed. A second motivation lies in according derivatives historic significance (Bryan and Rafferty 2006; Wigan 2009: 158). Derivatives mark the evolution of ownership and in doing so reconfigure the materiality of finance. Ownership via abstraction has transcended national containers and garnered unprecedented and diffuse disciplinary power over the state, and in turn labour (cf. Bryan, Martin and Rafferty 2010). A conflict between the fiscal state and financial innovation embodies a deeper structural shift wherein capital has evolved beyond its national imaginary.

In making the argument that derivatives ownership challenges and potentially transcends the fiscal capacity of the state the paper is organized in three subsequent sections. Section one briefly provides some basic facts and figures about financial derivatives to facilitate navigation of the argument then argues for a conceptualisation of derivatives as a new form of ownership. The second section outlines the characteristics of this form of ownership, which lend derivatives their utility in tax avoidance. The section illustrates this by drawing upon two high profile cases where the use of derivatives to minimize tax exposures has come to light. The concluding section discusses the implications of the use of derivatives for tax minimization for understanding financial innovation, financial systems and the evolution of capital. Financial derivatives attract scorn, as instruments of speculation, which destabilize markets and generate crises, and admiration, as the means to market perfection. Understood through the lens of this polemic dichotomy, financial derivatives are either the perverse manifestation of a casino economy or the latest manifestation of a simple evolutionary progress towards complete and perfect markets. This article accords derivatives a historic significance, which transcends the bounds of this debate.

Derivatives and Ownership

Financial derivatives, which emerged in the immediate wake of the collapse of the Bretton Woods System as a mechanism to harness and navigate the volatility of market driven finance, are contracts the value of which derives from the performance of underlying securities prices, interest rates, foreign exchange rates, commodities and market indexes. Exchange Traded (ET) derivatives are standardised contracts traded on organised exchanges and rest upon the provision of a guarantee by a clearing house. The clearing house stands between the buyer and seller of the contract, collecting margin payments from contract counterparties according to the performance of the underlying asset. At the outset of the GFC counterparty risk - or the risk that you won't get paid – in the over- the-counter (OTC) credit derivative market caused global financial markets to simultaneously seize up on news of the collapse of the U.S. investment bank, Lehman Brothers. In the wake of the GFC a concerted effort has been made to push the derivative trade onto variously designed organized exchanges in order to mitigate the opaque counterparty risk that was so central to the crisis. Despite these efforts the vast majority of the derivatives trade remains OTC. OTC contracts are privately negotiated contracts often tailor made for the buyer. The basic derivative forms are forwards, futures, options and swaps. Forwards are OTC contracts representing an agreement to buy or sell an asset in the future at a given price, the 'strike price'. Futures are exchange traded and represent an agreement to buy or sell an asset at a specified time and price. In both there is a long position and a short position, with long hoping the value of the underlying

will increase and the short hoping the opposite. Options provide the right to buy ('call') or sell ('put') an underlying asset, but not an obligation to do so. The seller of an option is obliged to sell or buy the asset when the contract matures. Swaps allow two parties to exchange cash flows. For instance, party A may hold a floating interest rate asset and party B a fixed interest rate asset. If party A believes interest rates will go down and party B believes rates will increase there is a rationale for the swap. Notably, while interest rate swaps are the largest part of the swaps market, parties can swap income streams based on virtually any asset. This is ultimately limited only by the contract parties' imaginations.

The derivatives industry is the largest in the world. The notional value of all OTC contracts at end-December 2012 was $633 trillion, down from an all-time high of $706 trillion at end-June 2011(BIS 2013). It is important to note that the derivatives markets actually grew in the wake of the crisis, suggesting that those who perceived the derivatives trade as a perversion of, or cancerous outgrowth from the 'real economy' of production and trade, and as such a temporary aberration awaiting an inevitable downfall, may need to revisit their commitment to an ideal vision of the economy. Exchange traded derivatives markets are smaller, standing at a notional value of $67 trillion at end-June 2013. Notional values reflect the value of the underlying asset referenced. For instance, if a fixed for floating interest rate swap referenced $1 billion, its' notional value would be $1 billion. However, cash flows exchanged between counterparties will represent the value of changes to the interest rate on $1 billion. Accordingly, gross market values record how much it would cost to cancel a contract, or how much money is 'at risk' in a contract, and thus more closely represent the value in the markets at any point in time. At end-December 2012 this figure was $24.7 trillion for the OTC markets (Ibid.). To place this in context the combined GDP for all OECD countries in 2011 was $38.5 trillion (OECD 2013). Behind these facts and figures regarding derivatives markets lies qualitative historical change.

In commodifying uncertainty as risk, derivatives constitute an evolution in the form of property. Derivatives do not entail direct ownership of an underlying asset, but a synthesized ownership of an exposure to the performance of 'attributes of assets' (Das 2005). This ability to synthesise an asset is key to the utility of derivatives in tax planning. Derivatives permit the construction of a position, which mirrors the economics of a position in some underlying asset or assets, but does not carry the same legal obligations as a position taken directly in those assets. Derivatives disaggregate assets, so that, for instance, ownership of a corporate bond is split between an exposure to the currency of the bond's denomination (currency derivative), exposure to a changing interest rate environment (interest rate derivative) and exposure to the risk that the issuer of the bond will default (credit default swap). One way of thinking this through is to consider derivatives as the manifestation of a third stage in ownership (Bryan and Rafferty 2006: 71-77; Wigan 2009).

The category of property is important in understanding derivatives. Firstly, at base property is a politically defined and invidious mechanism of control. Secondly, in this context, the relationship between derivatives and tax constitutes a confrontation between two forms of property; tax is the property of the state, derivatives the property of the market participant. When risk and property are married in derivatives the object of appropriation lies in a new arena and takes a new form. Under industrial capitalism, property and production were intrinsically entwined. In contrast, derivatives appropriate aspects of circulation and afford the control over those dimensions of assets that are valorised and constituted within circulation. As such the equation of property and derivatives transcends a prior conception of property as direct claims on the material world. Thorstein Veblen's (1924) notion of 'absentee ownership' in the limited liability company, marked the opening up of an historical process wherein ownership progressively abstracts from the physical materials underlying it.

Commonly, ownership is understood to take two forms. First, that of direct private ownership, where the worker is separated from owning the means of production and there is no separation between ownership and management (Kay 1982). Owner-managers have but one means to compete and the liquidation of the owner-manager's relationship to the entity is difficult and expensive. When, for instance, a private company loses a dominant competitive position the owner must sell the entire capital of the enterprise to re-invest in another activity. The flexibility of ownership here is considerably encumbered by a very real physicality. This contrasts with the second stage of ownership. Ownership through equity in the public form of the joint stock company, Veblen's 'absentee ownership' (1924), involves the transfer of ownership on the stock market between numerous and dispersed owners one step removed from the underlying productive process. Through shares, ownership is separated from capital, which in the form of the corporation is given the legal form of a person, *persona res*. In an evolutionary institutionalist conception of path dependent but open ended historical change (Hodgson 1999) the centre of capitalist competition gravitated from the production process to processes of circulation, or at least processes of circulation begin to define the competitive outcome

of ownership in tandem with the productive process. The capitalist investor can easily compare the returns on an investment against the returns on all other similar forms of investment and can adjust a portfolio rapidly to beat the average. '[T]here is no place in Big Business for considerations of a more material sort or of a more sentimental sort than net gain within the law. It moves on that plane of make-believe on which the net gain is a more convincing reality than productive work or human livelihood' (Veblen 1924: 217).

Derivatives as a third form of ownership take a distinctly different form. As a second level of abstraction from the underlying capital, derivatives ownership is disconnected from any direct ownership of physical assets, equity or debt[3]. Indeed, this is the very essence of a derivative; ownership takes a form whereby a leveraged exposure to an asset is not predicated on, or limited by, the direct ownership of that asset. It can be synthesized. For instance, a credit derivative, which offers exposure to a firm's performance as debtor – how likely they are to cough up - represents the synthetic ownership of that firm's debt, shorn of other exposures, such as the market interest rate, embodied in a corporate bond. The value of a derivative is determined by movements in the value of the underlying share, bond, currency, or index while bestowing no rights or obligations in regard to the underlying entities. While, the ownership of firms through public equity bridged a division between production and circulation, derivatives render that binary itself problematic in certain terms. The ownership afforded by derivatives rests in circulation unencumbered by direct ties to underlying assets.

Each stage in the evolution of property marks the progressive development of the liquidity and fungibility of ownership (Bryan and Rafferty 2006). In the first stage ownership (and labour) escapes the straitjacket of feudal rights and obligations to be embodied in firms. This is a necessary precondition of liquid ownership and market competition. Ownership must function solely in terms of profit seeking, rather than any alternative value such as kinship or status in feudal hierarchy. In this form ownership is liquid in that firms are compelled to compete or fold. In the form of the joint stock company, equity ownership is separate from control over production. Through shareholding investors obtained a fungible and immanently fleeting form of property. In this context ownership revolves around a share in a company's performance. That performance is gauged against a market average and shares are bought and sold on secondary markets as the owner attempts to 'beat the average'. Ownership now sits between two poles, at one end of which is a particular relation to a company, and the other a more generic relation to accumulation in terms of a claim in the secondary stock market. Here, the owner's legal position bestows upon her no material claim on company property. In the third stage, ownership becomes unencumbered by any linear relationship to specific underlying productive or commercial activity. Derivatives render property eminently fungible. Switching between assets, asset forms and legal jurisdictions is easy and changing the timing of receipts and exposures is integral to the derivative form. As such, derivatives propel the further abstraction of ownership from its 'real economic' basis and lend ownership a truly universal character and novel capacities.

Most importantly in this context, the fungibility and liquidity of ownership via derivatives and the switching and synthesizing functions this affords render derivatives attritional of the fiscal efficacy of the state. Indeed, derivatives effectively transcend legal categories and political geography by integrating them within a contract. When fiscal claims are based on stable categories of asset identity, ownership, jurisdictional competence and timing, derivatives challenge fiscal efficacy. The next section outlines why derivatives might serve these switching and synthesizing functions and in doing so raises the specter of capital transcending the fiscal state.

The Alchemy of Financial Equivalence

Derivatives challenge fiscal efficacy via the capacity to transform when a fiscal claim is applicable (timing) where that fiscal claim should be applied (source) and to what the fiscal claim is applied (income character or asset identity). These capacities are exercised through the ability of derivatives to permit contract parties to synthetically replicate the economics of a position, without taking on the legal form of that position. Simply, a position on a bond can be synthesized through a position in equity options by entering into put and call contracts. In this example the value of the bond, which will be replicated is 100. The put and the call are written so that the investor has a right to sell at a given fixed price and buy at a given fixed price at the same time. If the underlying equity moves below 100 the investor can exercise the put at 100. If the equity moves above 100, the call written with a strike price of 100 will be exercised and the investor will receive 100. In effect a position on a fixed income asset (one that returns a predefined sum, such as the bond) has been replicated by a put and a call. The put and call as opposed to providing fixed returns, provide the investor with contingent returns. A position with fixed returns and one with contingent returns may be taxed differently. Consequently, an investor can choose a preferred tax exposure. Further, a swap allows an investor to switch between asset forms and where an asset is located provid-

ing the investor a choice of where tax is due and on what. Of course tax rates vary across jurisdictions and asset types. Indeed, this legal-geographical differentiation is the grounds upon which the transforming, synthesizing and switching functions of derivatives perform. Further, source, timing and character rules apply differently for equity, debt, options, forwards and swaps but these contracts can be recombined in various ways to produce the returns of any underlying asset. Derivatives 'turbo charge tax shelters' (Sheppard 1999) because they afford the ability to replicate the commercial outcome of a transaction without entering the transaction and incurring the tax exposure associated with such a transaction. This section outlines the challenges posed by derivatives to categories of timing, source, character and identity and explains, on an elementary basis, the mechanics of switching and synthesizing which permit this. The examples given are elementary, but they represent the basic building blocks of derivative based tax arbitrage.

A core fiscal principle is the determination of when an item of income or expense becomes subject to tax. This matters because of the time value of money. A taxpayer is likely to prefer to pay €100 in two years than pay €100 tomorrow. In a situation where a tax charge arises on the basis of a triggering event such as an asset sale, it is possible via a derivative structure to replicate the pay off from the asset sale without making the sale. In effect, income can be realized but tax will not be. This is a function of constructing an artificial sale and postponing a real sale, perhaps almost indefinitely. An investor who holds shares the price of which has increased may wish to realize that profit. If the investor sells the shares a capital gains tax will be imposed. On the other hand, an investor could, where legally admissible, buy a put option on the equity from a bank with a strike price of 100 that matures in two years. The current share price is 100. The investor then sells a call option with the same strike price and maturity. Simultaneously, the investor borrows from the counterparty the full value of all the shares owned using the shares as collateral for the loan. The end effect is stark. The investor realizes gains in the present, but owes no tax now. Further due to the options the investor is no longer exposed to changes in share value. If the share price is higher that 100 when the option matures, the loss on the call offsets this gain. If the share price is lower than 100, the gain on the put option offsets this loss (Martin and Zailer 2001). Eventually the loan will have to repaid, but the contract could be renewed nearing maturity.

The manipulation of source rules follows similar principles. A foreign investor in equities subject to withholding tax on the sale of the equities may turn to an equity swap to alter where the income is sourced for tax purposes. For instance, returns from an investment in U.S. equity by a foreigner will usually be subject to a withholding tax of 30%. However, the investor can receive the same returns through an equity swap in which she receives payments from a counterparty if the value of the equity increases or dividends are paid and makes payments to that counterparty on the basis of interest on the value of equity referenced in the swap and in the event that the value of the equity declines. The source of the income in a swap is based on the residence of the investor, while a direct purchase of equity is sourced where that purchase is made. If that investor is resident, or registered, in an offshore jurisdiction income from the swap may be subject to no tax at all (Levin 2012: 5-6). By artificially replicating a desired equity position a foreign investor can receive the economic benefits of direct ownership without the fiscal obligations attached to it.

Central to fiscal systems and the character of assets for tax purposes is the distinction between income and capital, with income usually taxed at a higher rate than capital gains. Derivatives can transform ownership of an asset from one to the other. Warren (1993) outlines how this can be achieved. As noted, the basis of modern finance theory is that any asset can be replicated with a combination of put and call options on another asset or assets. When assets with fixed returns, like a bond, are taxed as income but those with a contingent return, such as a share, are taxed as capital, an investor is incentivized to replicate the position on a bond via a position in equity combined with put and call options. The investor produces a synthetic zero coupon bond (a bond that pays yield only on maturity), which pays £110 in 2 years. To replicate this position in assets with contingent returns, returns that will be taxed at the lower income tax rate, the investor buys a share of the same value and two options, enacting what is termed 'put-call parity'. The first option is a put, a right to sell a share at a specified time, 2 years, for a specific price, £110. The second option is a call, obliging the investor to sell a share at a specified time, 2 years, for a specific price, £110. If the share price is below £110 in 2 years the investor will exercise the put and 'put' the shares to the market at £110. If the share price is above £110 in 2 years, the holder of the call option will exercise that option and pay the investor £110. The investor has thus replicated a risk free position in a bond. As such the investor will be taxed on these assets as capital rather than income. A tax inspector would need to combine the three separate contracts to recognize this equivalence.

Hybrid instruments blend features of debt and equity. Different jurisdictions will treat an instrument as debt or equity depending on local rules for doing so. Firms that make cross border investments can take advantage

of this identity based differential tax treatment. For example, a U.S. firm may make an investment in a subsidiary that issues a hybrid instrument from Luxembourg. That subsidiary will make payments to the U.S. based parent. In Luxembourg, since the hybrid instrument is characterized as debt, the subsidiary will be afforded tax deductions on the interest it pays for the debt and no withholding tax will be levied on those payments as they exit the jurisdiction. However, in the U.S. that payment is not recorded as interest income, but as dividend income, which is subject to less tax (JCT 2011; Johannesen 2012). In the example of a convertible bond, an issuer may sell a bond with an in-built trigger dictating that when the issuer's share price reaches a certain level, the bond is converted into a certain number of shares. This raises the issue of whether the instrument should be characterized as debt or equity for tax purposes. The instrument provides the issuer with deductions on interest paid, while reducing the level of that interest on the basis of the value imputed to the contingent position on the stock. That the same instrument in another jurisdiction may be treated as equity implies that interest that is deductible in the offshore jurisdiction will not lead to taxable interest income in the second jurisdiction where the instrument is treated as equity. This is a case of 'double non-taxation'.

The UK Public Accounts Committee held a hearing in 2012 investigating the marketing of tax avoidance schemes (UK PAC 2013). Evidence was provided by the Directors of three firms specializing in the sale of 'tax mitigation schemes'; Tax Trade, Future Capital Partners and Ingenious Media. These witnesses stated that they relied upon legal opinions of highly ranked barristers, Queen's Counsel (QC), to ratify the legality of schemes they sold. Rex Bretten, then recently retired from the London firm Tax Chambers, was named as one of a handful of QCs who 'prostitute themselves' to schemes devised to create 'tax relief'. Somewhat ironically, Rex Bretten four months subsequently had an appeal against Her Majesty's Revenue and Customs (HMRC) decision not to allow him to claim tax relief on a £475,000 loss on an avoidance scheme of his own devising quashed. In February 2003, Bretten with family members had become trustees of two trusts set up by Oakwood Consultants, owned by a firm of accountants. Oakwood exchanged loan notes with a face value for £500,000 with Bretten in return for £500,000. The loan notes were constructed to be redeemable for £25,000 15 days after issue, thereby creating the tax-deductible loss. However, the scheme included a call option on the notes held by one of the trustees, which could be redeemed 9 days after issue and before the 15th day of issue for 99.5% face value. This option was exercised resulting in one of the trusts holding £499,500 and liability on the loan notes held by the other trust (UK FTT 189: 2013). HMRC deemed the scheme wholly artificial and therefore disallowed the tax-deductible loss on the notes. This case reveals both actors central derivative driven tax avoidance and the simplicity of some of these schemes. Not all are so simple.

In 2013 the CEO of the UK bank Barclays stated in interview, „There are some areas that relied on sophisticated and complex structures, where transactions were carried out primarily to access the tax benefits. Although this was legal, going forward such activity is incompatible with our purpose. We will not engage in it again" (BBC 2013). The Structured Capital Markets division reportedly contributed as much as £1bn a year to Barclays' profits by selling complex structured products which had the effect of reducing tax charges or providing artificial deductions – accounting items that can be set against taxes due (Lawrence 2013). Project Knight, one of six such structures revealed by the UK's Guardian newspaper in 2009 and subsequently leaked on wikileaks, involved a proposed 'tax efficient' replication of a loan between Barclays UK and BB&T U.S. (Guldberg, Hinrichsen and Nielsen 2013). Barclays first set up a UK holding company with approximately $4bn. The UK holding company then invests this sum in a Luxembourg holding company. The Luxembourg company invests in a further UK limited partnership. The UK limited partnership lends money to BB&T, but since the UK partnership legally received the money from Luxembourg no tax is due on the profits in either the UK or Luxembourg. Barclays in theory would need to hold capital against the credit risk of the loan, but by writing a credit default swap and a call option on the loan this cost and the risk associated with the loan is avoided. In turn BB&T set up three subsidiaries in Delaware and one in the UK in which it invested approximately $1.3bn. This subsidiary invests the money in the UK subsidiary, which has received $4bn from the Barclay's subsidiary. After three years the deal is wound up. The structure as presented here is deceptively simple. There are many more steps involved (see Keeley 2007). However, this reduced explanation shows how derivatives can be used in tailoring cross-border products to minimise fiscal exposures. By doing so, and routing the series of transactions through offshore jurisdictions in the U.S and Europe Barclays could provide a loan to BB&T at below market rate levels and avoid taxation on its profits. Everyone but the taxman is a winner. A comprehensive review of the use of derivatives in tax planning concludes that 'derivatives are appealing because they can replicate financial positions, blur economic substance, and introduce considerable ambiguity in tax reports' and refers to an annual $100bn lost to the U.S. Inland Revenue

Service due to corporate use of derivatives in tax planning (Donohue 2012).

Conclusion

At first glance, the relationship between derivatives and taxation seems to exemplify the regulatory arbitrage so often associated with financial innovation. These associations are not misplaced and sit well with those who might corral the analysis of derivatives within an idealized and somewhat static vision of capitalism and therefore consider derivatives a cancerous outgrowth from some assumed ideal type political economy. Derivatives have been used to avoid or minimize the impact of regulatory impositions, including those of the fiscal state. However, regulatory arbitrage is a symptom of deeper change driven by derivatives and contemporary financial innovation. Derivatives require us to confront extant concepts of capital and even dismantle nationally framed conceptions. As we have seen, distinct concepts such as equity and capital can be collapsed inside a derivative form. In turn, fiscal architectures are constructed on an imaginary in which capital in all its forms bears a linear relationship to place (source), identity (income character and asset) and time (recognition for tax purposes). Derivatives destabilize these categories through their switching and synthesising functions. What is equity can be capital, what is taxable as income can become subject tax as capital, what is taxed in one jurisdiction can be taxed (differently) in another. This capacity to destabilize both concepts of capital and regulatory architectures built upon such concepts points to the historic import of the derivative form. Capital has transcended the fiscal state and our intellectual means of its appropriation. Desperate attempts to reregulate finance in the wake of the GFC have failed to address this substantial issue and tackling derivatives and tax avoidance continues to rely upon a game of cat and mouse between revenue authorities, the courts and the creators of fiscally attritional financial products.

This article has provided an elementary introduction to why this might be so based on the notion that derivatives are eroding the tax collecting ability of the state. Further research is necessary, but some limitations on that project should be highlighted. First, the precise way in which derivatives are used to 'optimize' tax exposures is subject to a process of constant revision and innovation. The researcher is only aware of mechanisms that have been revealed by leaks or court cases. Secondly, more complex structures are a compound of myriad contracts, which will be reported or accounted for as distinct items. When it is the aggregate effect off a basket of contracts that provides the 'optimal' tax position, this cannot be identified without insider knowledge. In turn, insider knowledge is heavily guarded and access to key players in banks, accountancy firms and law extremely limited. Fourth, the issue requires knowledge in diverse fields; accounting, law, political economy, financial engineering and international and national fiscal and financial regulations all bear on the question. Fifth, tax optimization will rarely rely on one tool. Strategies will combine derivatives with idiosyncratic national rules, opportunities within corporate law and accounting conventions. Interaction across these domains is key. Isolating the effect of one is difficult. This said, the issue does open up a host of avenues to pursue. How does the process of tax driven innovation within banks proceed? Who are the main actors involved and how do they interact? Can national and international fiscal rules intersect efficiently in this context? Is the transcendence argued for here limited to the derivative or might the digital economy and the increasingly intangible nature of capital be generating similar historical outcomes? What concepts of capital, fiscal or otherwise, might be adequate to the derivative form?

Notes

1. The term 'tax haven' is highly contested and politicised. Almost any state can act as a haven from another's fiscal claim and many states not commonly understood as 'tax havens', such as the UK or Netherlands, design fiscal regimes that attract mobile capital on the basis of tax advantages.
2. Structured finance describes a range of highly complex products sold to companies with bespoke financing requirements. Structured products are built with derivatives and derivative pricing techniques.
3. Commons (1934) distinguishes corporeal or physical assets, incorporeal or paper assets, and intangible or strategic assets. Derivatives might bridge incorporeal and intangible assets or collapse the distinction between the two. This is more likely thinking through the relationship between derivatives and tax.

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Elsewhere, Ideally Nowhere: Shadow Banking and Offshore Finance

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A common thread across the financial system's evolution is the quest to be located for tax and regulatory purposes elsewhere or, ideally, nowhere. Dynamics and behaviour associated with human failure (greed, exuberance, fraud, incompetence) should best be understood as sabotage. Finance is awash with techniques designed to sabotage clients and governments. These techniques are legal, albeit, as Veblen writes, not in the spirit of the law.

Introduction

To what extent is finance distinct from other spheres of economic activity? What is it about the global financial system that makes it so heavily reliant on obscure and opaque practices and spaces, such as offshore financial havens, shadow banking entities, and specially designed products and innovations? This article aims to address these questions drawing on the insights originally conceived in the old tradition of American institutional economics and developed specifically in the scholarship of Thorstein Veblen.

Thorsten Veblen was a prominent evolutionary thinker whose work has not received its due attention. Veblen's key insight into the study of modern capitalism focused on the dichotomy between 'the alleged imperatives of workmanlike industry' and of predatory 'business' (Hodgson 2004, 202). In particular, he argued that 'any intrusion of business strategy into the conduct of industry will be sabotage' (Veblen 1923, 278, cited in Hodgson 2004, 203). An evolutionary thinker, Veblen inquired into causal explanation of the developments in industry and business; he understood that once a particular practice becomes successful, others will follow suit. Focusing on two major developments in the financial system that have been brought up by the global crisis of 2007-09, we advance Veblen's notion of business sabotage to the sphere of finance to explain why the rather obscure and opaque systems of tax havens and shadow banking have come to play a central role in contemporary capitalism.

Since World War 2, the financial system has gone through a number of phases and transformative moments. Yet if we were to identify one common thread across its stages of evolution, it is the quest for being located for tax and regulatory purposes *elsewhere* or, ideally nowhere (Palan 2010) (Urry Forthcoming). What does this mean? The main structural development in finance has been the emergence and persistent growth of new legal or quasi-legal spaces and financial innovations which were either aimed at and/or resulted in the avoidance or minimization of state regulations. The trend began most markedly with the emergence of the Euromarkets in the late 1950s in London, and strengthened with the development of shadow banking industry in the later part of that century.

Since the late 1950s, the financial system has developed an alternative conduit space that transcends national regulations known as the Euromarkets, or the offshore financial market. The Euromarkets host transactions denominated in currencies other than that of jurisdiction in which the market is located. Originally, it traded dollars seeking to escape attempts by the United States to assert control over the use of its currency. In our terms, the

Euromarkets were a precursor to the now omnipotent phenomena of offshore finance. Offshore finance refers to very specific wholesale financial markets, known otherwise as the Euromarkets that emerged originally in the late 1950s in London that were largely unregulated (Palan 2003). In one way or another, about half of the global stock of money passes through offshore jurisdictions. At the same time, approximately one third of all global FDI passes through these jurisdictions (Palan, Murphy & Chavagneux 2010). Recent estimates place the amount of accumulated private wealth registered in offshore havens in excess of $US 21 trillion, or at nearly 18% of the aggregate global wealth (Henri 2012).

More recently, the global financial crisis of 2007-09 revealed the scale of another set of alternative conduit spaces and entities, collectively known as 'shadow banking' (SB). SB consists of a complex network of financial intermediation that takes place off the balance sheets of the regulated banks, and thus remains largely invisible to regulatory bodies. In the USA on the eve of the crisis, the scale of the shadow banking industry was estimated to be one and a half times larger than the official, 'visible' banking sector. In Europe, recent estimates suggest that SB practices have actually grown in scope after the crisis of 2007-09, while other studies suggest that SB has historically played an important role in the financing of the economy in emerging markets (Ghosh et al 2012; Bakk-Simon et al. 2012). The two intertwined phenomena of offshore financial centres (OFCs) and SB are now drawing the attention of global and national regulators (BIS 2009). We suggest this attention should be guided by the insight that both are defined by the search for being not quite anywhere.

What drives the quest of financial actors for relocation to such spaces? Standard economics approaches this question from a rather conventional angle. Economic agents seek spaces that facilitate the efficiency of the market's capacity to allocate resources, and ensure a minimum of state interference with this process. State interference, in turn, tends to distort markets and hinders efficiency. Actors would naturally shift operations to spaces which fulfilled these requirements. The Veblenian approach, known otherwise as the Old Institutional Economics (OIE), tackles the question from a different angle. In what follows, we focus on one key element in Veblen's thought that can serve, we argue, as the basis for an alternative 'macro theory' of finance, but which has not garnered sufficient attention to date. This may be largely because it is rather simple and obvious. Veblen argued that the modern economy, that is, the economy that he witnessed taking shape in the late 19th century U.S., and that has been internationalized since, was dominated by the personality of the *businessman*, the principal 'habit of thought' of whom in terms of their outlook on profit-making enterprise was, according to Veblen, the technique of sabotage. For Veblen it is the figure of the businessman, as opposed to the capitalist in Marxist framework, who provided a better understanding of trends and developments in the modern economy. The Veblenian approach assumes that finance is a component of business culture that does not seek improvement in efficiency and delivery per se. Instead, the logic of finance is the logic of sabotage. In this perspective, financial actors operate at the very edge of the law, in the twilight zone, in an area that may be still legal, yet not *in the spirit* of the law. In this article, we employ the Veblenian framework to examine some of the causes behind the emergence of twilight zones in the global financial system and indeed, explain why the institution of finance itself has become a twilight zone.

The Challenge of 'Elsewhere': Shadow Banking and Offshore Finance

The phenomena of shadow banking and offshore finance have quite distinct trajectories in contemporary financial discourse and academic debates. The problem of tax havens had been known for a long while; it has generated a range of work in International Political Economy and related disciplines (see for example Palan 2003; Burn 2005; Palan et al. 2010; Sharman 2006; 2011) and inspired a network of civil society organisations aiming to redress the socio-economic injustices that spur from the existence of tax havens, such as Tax Justice Network, UK Uncut, Finance Watch, Public Finance International etc. (see Seabrooke & Wigan 2013).

The term 'shadow banking' in contrast, is relatively new. The concept of shadow banking is commonly credited to Paul McCulley, then of PIMCO, who in a 2007 speech to the Federal Reserve Conference in Jackson Hole observed that the (then unfolding) financial crisis could be attributed to the growth of „unregulated shadow banks that (unlike regulated banks), fund themselves with uninsured short-term funding, which may or may not be backstopped by liquidity lines from real banks. Because they fly below the radar of traditional bank regulation, these levered-up intermediaries operate in the shadows without backstopping from the Fed's discount lending window or access to FDIC (Federal Deposit Insurance Corporation) deposit insurance" (McCulley 2009, 257). Indeed, the crisis of 2007-09 was in many accounts a crisis of shadow credit facilities, shadow financial entities and shadow liquidity.

At the same time however, the two phenomena are not only closely connected with each other functionally,

but combined, represent a significant part of the global financial space. Finance has evolved in a way that until very recently had not been accounted for in any systematic way. We suggest that underlying the evolution of offshore financial havens and the shadow banking universe has been the factor of 'elsewhere': the principle of not *being* recognised, registered, accounted for, taxed, regulated, detected or understood well, has been the engine being the growth of the offshore political economy (Palan et al. 2010), and has provided the fuel for much of financial innovation that culminated in the emergence of the shadow banking industry.

While the concept of 'elsewhere' and even 'nowhere' is well-established in the study of the emergence of offshore finance (Murphy 2009), it has not been widely used in the analyses of shadow banking. At the same time, emergent literature on shadow banking has gone a long way in explaining in some detail the core functions that shadow banking entities perform in the credit intermediation process. Underpinning these functions, we argue, is the ability of financial agents to carve out financial and legal spaces that remain unaccounted for by existing regulations, control systems and academic paradigms. Understanding shadow banking and offshore finance, therefore, implies recognising that credit and consequently, 'money' today can be created out of the sheer idea of 'elsewhere,' or better, 'nowhere.' Being and operating 'elsewhere' in relation to one's official balance sheet or using facilities that are registered 'elsewhere' for taxation and regulatory purposes and are as a result, accountable to no one, has become an important tool of innovation for financial agents today. In other words, as we argue here, being located 'elsewhere' in the global economy, the systems of shadow banking system and offshore finance have come to play a crucial role in the contemporary financial system. This realisation presents both academic and regulatory challenges to finance scholars and policy-makers. In what follows, we address the conceptual dimensions of this problem.

Finance as Business: Lessons from Veblen

How can the notion and functions of 'elsewhere' in the world economy be understood? Mainstream economics offers two contrasting angles on this question. On the one hand, often being linked with illicit financial dealings and activities, the systems of shadow banking and tax havens can be regarded as aberrations and disruptions of normal economic and business activity. Some commentators view the phenomenon of shadow banking as paranormal development in the global economy, often linking it to tax evasion emanating from the underground or unaccounted economy and read derogatory connotations into the practices of shadow banking (Buehn & Schneider 2011). Elsewhere and nowhere in other words, simply do not exist in many orthodox models of economic and behaviour, they are assumed away.

On the other hand, economic theory has no particular difficulties explaining individual economic unit's rationale for operating in these alternative spaces. As profit maximizing units, it is entirely predictable, indeed, incumbent, upon those units to employ legal devices that serve their ultimate goal, which profit is. In competitive market conditions, business would innovate new products and even markets in order to gain a competitive position. Offshore finance and shadow banking are expressions, therefore, of financial markets doing what they do best - allocating resources in the most efficient way available. In particular, most commentators note the very central role that key functions that shadow banking – risk, maturity and liquidity transformation – performs in today's financial system. Whereas the existence of offshore financial centres has typically been interpreted as a healthy element in tax optimisation by competitive economic agents.

Thorstein Veblen, (Veblen, 2001 [1921]) (Veblen, 1923) who may be considered the leading light in this approach, drew his primary data from Congressional Committees reports of late 19th and early 20th century that focused on the predatory practices of American businesses. Veblen concluded on the basis of these reports that the central figure in modern capitalism was neither the rational consumer of standard economics, nor the capitalist as owner of the means of production of Marxist theory, but rather, the figure of *the businessman*. Businessmen were individuals, he argued, with no specialized expertise in production, manufacturing, services or management. They were experts in 'the art of buying and selling'. Veblen's theory amounted in essence, to generalizations of the likely behavioural patterns of the businessmen, as purveyors and traders in property rights under diverse environmental conditions. Following Veblen, in our analysis of finance we propose to start from a simple and straightforward premise. Namely, that banks, as well as the various departments and desks that banks are made of, tend to think and behave like businesses, and they see their interest and function exclusively in pecuniary terms.

What does the concept of bank as a business enterprise entail? First and foremost, businesses are concerned with pecuniary gains. This idea appears self-evident, but its implications run deep. Veblen believed that far from embracing competitive markets, businesses were concerned by the state of equilibrium conditions described in standard economics, since open and 'fair' competition inevitably would result in wafer-thin profits, if any. Businessmen in fact complained about 'ruinous compe-

tition,' and devised an impressive array of techniques, documented in the various Congressional Reports of late 19th century, that were intended to ensure that the free market of standard economics did not apply to their businesses. Best known of these devices were monopolies and cartels, but according to Veblen, these were only the tip of a very large iceberg.

Veblen used a generic term to describe the businessman's techniques for profit generation as *'sabotage'*. Sabotage was, in his words, 'the deliberate, although entirely legal, practice of peaceful restriction, delay, withdrawal, or obstruction used to secure some special advantage or preference' (Veblen, 2001 [1921], 4). Sabotage, he argued, „commonly works within the law, although it may often be within the letter rather than the spirit of the law. It is used to secure some special advantage or preference, usually of a business-like sort. It commonly has to do with something in the nature of a vested right, which one or another of the parties in the case aims to secure or defend, or to defeat or diminish" (Veblen 2001 [1921], 6). Businessmen, Veblen argued, would deliberately seek to disorient their competitors by restructuring and re-organizing the world around them in ways that would sabotage their clients, competitors and/or the governments.

Mainstream economics does accommodate the pecuniary principle and techniques of sabotage: economists habitually argue that capitalists are in the business of maximizing profits. But they tend to argue that it is the governments that, due to their very nature, sabotage business, or function as rent-seeking enterprises that damage the market. In arguing that however, economists tend to neglect two related factors. First, that there are many good reasons for business to and try and sabotage their own governments as well (let alone other governments, often with the aid of their own). Not least among these reasons is the fact that the government is both an absolute and necessary requirement for the economy to operate. But government is expensive. Hence, businessmen use sabotaging techniques as a redistribution tool – in order to ensure that while benefits of government accrue to business, costs fall elsewhere. To use conventional language therefore, we need to recognize that it is not only governments that are rent-seeking, but businesses themselves are rent-seeking enterprises. Veblen's theory predicts that whenever rent-seeking opportunities arise, business will tend to grab those. The most likely source of rent-seeking opportunities, in turn, is the state and the law.

Second, modelled on abstraction, economic theory neglects to ask whether businesses seek to maximize pre-tax or post-tax profits. Considering that corporate taxation in many OECD countries may reach 30 or even 40 per cent of declared pre-tax profits, this is not a trivial question. Maximization of pre-tax profits tells us next to nothing about what businesses, and in particular, their owners and share-holders, truly care about, which is *post-tax profits*. Theoretically, the difference may appear marginal. It is not. The quest for post-tax profits has led to the development of a service economy with lucrative lines in tax and regulatory avoidance. This service sector, run by highly skilled professionals such as lawyers and accountants, is now so large and sophisticated that it functions as an economy in and by itself. Politically, it has also emerged as a powerful international lobby group. It is a service economy that is founded on the desire of economic agents to avoid or evade taxation or regulations. The main source of income to this service economy is the business of avoidance and evasion. At the same time, the development of offshore financial markets since the late 1950s demonstrates that the business of avoidance has reached industrial proportions, and has become one of the key technique for sabotaging the state as well, a process that Veblen did not address in his original writings. This industry of regulatory avoidance, facilitated and dependent on locations and services 'elsewhere' and otherwise known as financial innovation, is now considered one of the main functions of international finance. Regulatory bodies are only beginning to take account on these trends.

To over-simplify somewhat, the rise of the offshore world and the shadow banking industry can be seen as a history of the discovery, often by accident, of opportunities for sabotage, including sabotaging the state.

Shadow Banking and Offshore Finance

The complex and still little understood system of shadow banks, financial-legal entities and their connections are one of the most challenging outcomes of the post-war financial evolution and more specifically, of the endogenous process of financial evolution. Narrow definitions of this phenomenon describe shadow banking as market-based (as opposed to bank-based) ways of funding financial transactions, or in other words, 'money market funding of capital market lending' (Mehrling et al. 2012). More inclusive definitions suggest that shadow banking is simply, 'credit extension outside of the banking system' (FSB 2012). The figures for the shadow banking industry are staggering. According to the data from the Federal Reserve, in 2007, on the eve of the global financial meltdown, the size of shadow banking in the USA was $18 trillion, or $6 trillion above the volume of the regulated banking system. In the aftermath of the crisis, the size of shadow banking system has decreased to an estimated $15.8 trillion (Pozsar et al. 2010). Recent data from the

Financial Stability Board (FSB) puts the size of the global shadow banking system at around $67 trillion at the end of 2011, or roughly a third of the world financial system.

Modern tax havens have existed since the early twentieth century. They were used, and are still being used, primarily but not exclusively, for tax evasion and avoidance purposes. Tax havens are also used however, for other purposes. Since the early 1960s, all the premier tax havens of the world have developed financial centres known otherwise as Offshore Financial Centres (OFC). It is estimated that about half of all international lending and deposits originated in OFCs, of which approximately half again are located in OFCs that double as tax havens. The Bank of International Settlements (BIS) statistics of international assets and liabilities ranks the Cayman Islands as fourth largest international financial centre in the world, while other well-known tax havens/OFCs, such as Switzerland (7th) the Netherlands (8th), Ireland (9th), Singapore 10th, Luxembourg (11th), Bahamas (15th) and Jersey 19th are lower in the ranking. In addition these centres are recipients of approximately 30% of world's share of FDI, and in turn, are the originators of similar amounts of FDIs (Palan, Murphy & Chavagneux 2010).

There is some confusion between the concept of tax havens and OFCs, and is not only a matter of semantics. The contrasting views of the role of tax havens as OFCs derive to a degree from the different understandings of nature of the offshore financial markets, the Euromarkets. Some economists believe that the Euromarkets is simply a wholesale financial market for U.S. dollar that emerged in Europe in the 1950s (Schenk 1998). A very different theory claims that the Euromarkets is a very specific type of market that emerged in late 1957 in London (Burn 2005). According to this theory, the Bank of England came to an informal agreement with the City's merchant banks to treat certain types of financial transactions between non-resident parties and denominated in foreign currency as if they did not take place in London, even though they were in London. Paradoxically, the bank created, in effect, a new regulatory space outside its jurisdiction, and a new concept – offshore finance. But as the transactions that took place in London were deemed by the Bank of England to be taking place elsewhere, they ended up under no regulation at all, or offshore. These transactions, according to this theory, take place in a new unregulated space called the Euromarkets, or the offshore financial market (Burn 2005).

As far as we can tell, the original rationale for the development of the Euromarkets had little to do with taxation. British banks developed the market as a way of coping with the new regulation imposed by the British Treasury that prevented British banks temporarily form lending in the non-Sterling area, apparently with the compliance of the Bank of England. As long as the Euromarkets served that very specific purpose, it remained small and practically unknown for three or four years. Soon, however, U.S. banks discovered the market as well, and they discovered, moreover, that the market can be used to sabotage their own government's regulations. This was the reason for its spectacular development.

Having learned of the new facility offered by London, some of the leading US banks rapidly developed a branch network in London beginning in the early 1960s. They were not motivated by tax – taxation in the UK was particularly high at that time. They were interested in Euromarkets facilities in order to circumvent stringent U.S. banking and financial regulations. In Veblenian language, they set up branches in London, to sabotage their own government's regulatory efforts.

In parallel, in the 1950s, US multinationals began to expand their international operations. Once they discovered the facility of the Euromarkets, corporate clients began to bypass the banks and tap directly into the Euromarkets to earn higher rates of interest while also looking to the same Euromarkets to fund their operations (Burn 2005; Sylla 2002). To stem the flow, in 1963 the Kennedy administration proposed an Interest Equalization Tax to ensure that U.S. citizens did not get preferential interest in the European markets. The results, predictably, were the opposite of what was intended. Instead of stemming the flow of capital out of the U.S., American corporations kept capital abroad to avoid paying the interest equalization tax, fuelling in the process the growth of the Euromarkets. U.S. banks soon learned that the unregulated environment in London allowed them (or their London branches) to circumvent all the New Deal regulations. They were able, therefore, to establish large diverse banks in London, capable of competing in every aspect of finance. German and Japanese banks then followed suit.

We also know from various reports that some of the smaller U.S. and Canadian banks faced with the high infrastructural costs of a London base, realized that the Caribbean OFCs offered a cheaper and equally attractive regulatory environment – free of exchange controls, reserve requirements and interest rate ceilings, and in the same time zone as New York. According to various reports (Sylla 2002), the early spill over of OFCs activities into the Bahamas and Cayman was, like the London Euromarkets, not motivated by tax advantages, but because it was cheaper to set up branches in these locations. They had an additional advantage of sharing New York's time zone. This explains why smaller U.S. and Canadian banks were at the forefront of establishing Cayman's OFC and why some experts use the short hand descrip-

tion that the U.S. and Canadian banks 'established' the Caribbean havens. The offshore financial system emerged and flourished largely, therefore, as mechanism of regulatory avoidance on a massive scale. The notion of being 'elsewhere' for regulatory and tax purposes has been a necessary condition for this development, often leading to financial transactions being in fact regulated nowhere.

These observations bring us to the more well-rehearsed arguments about lack of transparency in modern finance (Best 2004). Secrecy, lack of transparency, complexity and opaqueness has become essential ingredients of today's financial innovation, yet for different reasons than traditionally assumed. While offshore finance has often being linked to illicit financial flows and money laundering (Sharman 2011), and while the notion of shadow banking often relates this phenomena to the underground or grey areas of economic activity, the real significance of shadow banking and offshore finance is that they function as important 'black holes' in the global economy. As Murphy explains, a misconception about financial complexity and secrecy today is the assumption that the secrecy world is geographically located. It is not. As he writes, „it is instead a space that has no specific location. This space is created by tax haven legislation which assumes that the entities registered in such places are 'elsewhere' for operational purposes, i.e. they do not trade within the domain of the tax haven, and no information is sought about where trade actually occurs." As he continues, „to locate these transactions in a place is not only impossible in many cases, it is also futile: they are not intended to be and cannot be located in that way. They float over and around the locations which are used to facilitate their existence as if in an unregulated ether" (Murphy 2009, 2).

Recent financial history suggests therefore, that while 'elsewhere' has been paramount to the emergence of the global financial system and its key nodes, the shadow banking system firmly linked together the idea of 'elsewhere' and 'nowhere' not simply for the conduct of financial transactions, but for the very process of credit creation as well. The two black holes of offshore finance and shadow banking have become functionally central to the daily operation of the global financial system.

'Elsewhere' and Sabotaging the State

The brief history of offshore finance sketched out earlier in this article illustrates the importance of spatial, geographical and political differentiation in modern finance. Trading essentially in incorporeal property titles, debt and risk instruments and the like, the financial system can operate in one location, say London, but then register the transaction in another location. This practice skews official locational statistics of financial activities. In the mid- to late 1990s, a wave of securitization became the major catalyst to the growth of the shadow banking system. Under the existing rules, if banks wanted to engage in a new segment of activities such as for instance, the subprime mortgage market, and thus take on more risk, they needed more regulatory capital to account for these risks. The Holy Grail of financial innovation came in 1994-95, when a technique that would later become known as collateralized debt obligation (CDO) was invented (Tett 2009). The instrument allowed banks (JP Morgan initially) to insure the risk of default of a corporate client and move it elsewhere (sell to a third party, in this case AIG). Soon enough the technique was extended to mortgage products and specifically, to subprime mortgages and eventually, other types of unsecured debt. The practice, now centered on several types of risk trade, reliance on wholesale market funding (or shadow banks) for loans, and offshore financial jurisdictions for the legal architecture of the complex chain of securitization, allowed more risk-prone financial institutions to sabotage their more conservative competitors. On the surface, the mechanism appeared as the perfect example of innovation in the financial market producing efficiencies in intermediation between savers and borrowers. The reality was quite different: the expanding bubble economy and the shadow banking system were bound to implode.

Was the recent wave of financial innovation and securitization an act of financial sabotage? Was it a deliberate action aimed at profit making through subversion, obstruction, disruption or destruction? It is possible to argue, as many economists do, that the concept of a mortgage-backed security (MBS) or asset-backed security (ABS) is a good one, as it ensures continuing liquidity in the housing market. A CDO too, is a brilliant invention as it allows banks to free up capital to employ it more productively. But at the same time, the good rational actor of standard financial economics should have been very careful in dabbling in securitization and re-securitization during 'good times'. The key function of banking institutions, after all, is to ensure the smooth and efficient intermediation between savers and borrowers. They were playing with other people's money and should have been prudent in doing so. In the boom decades of financial innovation, rational actors were swamped by the bullish ones, and subsequently suffered losses.

It is interesting to note that the language of sabotaging the state is also associated with another development of innovation driven finance. Nigel Lawson, former UK Chancellor of the Exchequer under Thatcher and member of the House of Lords selected to sit on a parliamentary investigation into the Libor-rigging scandal

said on the leading BBC program, Newsnight, 30/01/13, that „structured financial vehicles is an euphemism for tax avoidance." Lawson has a point. A good number of Special Purpose Vehicles (SPVs) were registered offshore, presumably to obtain what a BIS study described as 'tax neutrality' – or facilitate tax avoidance in layman's terms (BIS 2009). Everyone loves the idea: those who gained from the facility of tax neutrality (i.e. avoidance, or sabotaging your own government) clearly did. Those who bought the products assumed they were getting better deals as the sellers were not burdened by taxation. Those who provided the facility happily charged for the service.

Let us consider the nature of a not atypical Cayman registered set of Special Purpose Vehicles (or SPVs) that were run by Bear Stearns. SPVs are highly obscure financial entities, and not much is known about them. Bear Stearns maintained two High-Grade open ended investment companies that invested in ABS*),* mortgage-backed securities, derivatives, options, swaps, futures, equities, and currencies. Funds that were registered as Cayman Islands exempted limited liability companies. The funds were administered by PFPC Inc., a Massachusetts corporation, which administered the funds and performed all back office functions, including accounting and clerical operations. The books and records of these funds were maintained and stored in Delaware, a state known as internal tax haven in the U.S. (Sharman 2011). Deloitte & Touché, Cayman Islands, performed the most recent audit of these funds. The investment manager of this fund was Bear Stearns Asset Management Inc., a New York corporation („BSAM") (United States District Court Southern District of New York, 2003).The investor registers were held in Dublin, Ireland (another well-known tax haven) by an affiliate of PFPC Inc. Two of the three investors in one of the Funds were registered in the Cayman Islands as well, but they were both Bear Stearns entities, which appear to have the same minimal Cayman Islands profile as did the two Funds. Accounts receivable were located across Europe and the U.S.; counterparties to master repurchase and swap agreements were based both inside and outside the U.S., but none was in the Cayman Islands.

The courts concluded that the link between Cayman Islands and the two SPVs was tenuous. The funds were registered in the Cayman, and had two ('dummy') directors that were residents of Cayman – but that was about it. Bear Stearns went into the trouble of setting up very complex structures, spanning many jurisdictions, paying hefty fees for licenses, professionals (lawyers, accountant, clerks), and the Cayman Islands dummy directors whose job was to do absolutely nothing.

What exactly was the purpose of complex structures like the one maintained by Bear Stearns in the Caymans? The concept of 'dummy director' is very popular. McCabe's (2012) analysis of 3,232 companies with an address at the Irish Financial Services Sector (IFSC) named individuals, each sitting on the boards of hundreds of companies, a lucrative business for these individuals. The Irish stockbroker firm A&L Goodbody is company secretary for 1,088 companies, including aircraft leasing firm, banks, investment funds, asset management, real estate and energy. Matsack Trust limited is a company secretary for 1,295 companies, and so on. Clearly Goodbody and Matsack cannot possibly execute their task as company secretary in any meaningful way for any of those companies. Similar findings for large scale brass plate companies are found in the Netherlands and in Cayman.

Why then, set up these complex and expensive structures that on surface, do not appear to be the most efficient way of allocating scarce resources? There were a number of reasons for doing so. First and foremost, offshore SPVs facilitate tax neutrality, or tax optimization. In Veblenian language, that amounts to sabotaging your government. The idea of tax minimization is so widespread and built in into our psyche that it is not even seen as problem. The problem arises, however, when the financial system implodes, as it did in 2008, requiring the state to bail it out. But it is the same financial system that already weakened the state to the point at which bailing out the financial system led to very large sovereign debt crisis which ultimately damages the ability of the state to sustain the economy which finance feeds upon.

Our own research into the uses of offshore SPVs revealed a further purpose of sabotage. In the now well-known bankruptcy case involving a British bank, Northern Rock, a Jersey-based SPV called Granite Master Trust was used by the bank to effect a sham process called 'true sale.' True sale tends to means different things in different jurisdictions, but essentially it refers to exchange between two entities that do not share common ownership. The idea is that when two separate entities trade assets they will do so for good economic reasons, hence, the trade may be considered as 'true sale' as opposed to the very common intra-company trade that take place world-wide. Rating agencies were prepared to rate only the products that were sold in the markets under 'true sale' arrangements. The beauty of offshore SPVs was that that no one was able to know for sure who were the ultimate owners and beneficiaries of assets or the SPV, as was the case of Northern Rock (and we have learned subsequently, many other banks). Hence, financial houses could 'sell' a product effectively to themselves or to the entities they controlled offshore at any price they wish to

cite, and the apparent 'true sale' would serve as pointer for other trades that would then follow the original true sale (Nesvetailova & Palan 2012). Was it an act of rogue behaviour by some marginal financial actors, or was it an act of Veblenian sabotage typical of the industry as a whole? Complexity was introduced, as in many other instances in finance, in order to fool gullible investors. Incredibly though, as Veblen noted, it is not illegal, even if not in the spirit of the law.

Andy Haldane of the Bank of England calculates that the 'natural' size of large bank, that is the natural size of the efficient standard economics banking entity, is about $US 100 billion of assets (Haldane 2012). Yet, many banks evolved somehow into much larger entities, some of them had over US$ 1 trillion of assets. Why is that? Veblenians point out that size had become a prime technique of sabotaging both the state and competitors. In the leverage game, banks learned that size does matter, for three related reasons. First, the market factored in their 'too big to fail', which meant that companies could now garner lower rates of interest in the 'open markets' because the markets factored in sovereign support to them. Haldane calculates that the combined advantage of being too big to fail gave these institutions discounted interest rates that would account collectively to about $US 70 billion annually before the crisis.

Second, and more directly, size combined with leverage has increased their economic leverage and apparent profit (Mester 2005; Mishkin 2006). The profits were sustainable however, only for as long as the boom continued. When the music stopped playing, the complex interconnections and the size of leverage created during the boom years, brought down large banking houses and the banking system as a whole. The link between apparent performance during good times and the impact of potential losses during a crisis is the third technique of sabotaging by size. Size, or systemic significance widely understood, appears to give immunity, in a very broad sense, to financial institutions. Our banks have become not only too big to fail, but also too big to jail (Alessandri & Haldane 2009; Mishkin 2006; Pennacchi 2000). Eric H. Holder, Jr., U.S. attorney general, has noted the failure to prosecute multinational banks for various transgressions during the recent boom: „I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if we do prosecute – if we do bring a criminal charge – it will have a negative impact on the national economy, perhaps even the world economy" (Henning 2012). Analysing the possible lessons of such a crisis, Veblen warned that

> „the abruptness of the recapitalization and of the redistribution of ownership involved in a period of liquidation may be greatly mitigated, and the incidence of the shrinkage of values may be more equally distributed, by a judicious leniency on the part of the creditors or by a well-advised and discreetly weighted extension of credit by the movement to certain sections of the business community" [Veblen 1904, 205].

It appears that the age of financial innovation has stretched Veblen's notion of such mitigation to extreme. A study conducted by the New York State Attorney office in the midst of the crisis presents an analysis of the 'Heads I Win, tails Your Lose' bank bonus culture, specifying in detail the size of bonus packages paid out by the banks who were the recipients of Troubled Asset Relief Program (TARP) scheme in 2008. The summary of the investigation is simple enough: „When banks did well, their employees were paid well. When banks did poorly, their employees were paid well. And when banks did very poorly, they were bailed out by taxpayers and their employees were still paid well. Bonuses and overall compensation did not vary significantly as profits diminished" (Cuomo 2009, 1).

Conclusion

Many important developments in the financial system, including financial crises and major regulatory shifts, are often interpreted as outcomes of tensions between finance and the 'real' economy. 'Finance' is often believed to be no longer embedded in the 'real' economy of production, trade and services, and this gulf is seen to have long-reaching and destructive consequences. Within such interpretations, the financial system is also commonly believed to be powerful in its autonomy: the banking sector and the financial industry are able to co-opt the political and social priorities of the state, with influential financial lobbies shaping the agenda of governance, nationally and internationally.

While suggestive, such explanations tell only part of the story of the configuration of financial power and the developments of the financial system. Part of the limitations of juxtapositions of finance and the 'real' economy and politics, is the underlying assumption that the sphere of finance operates according to very particular logic and set of incentives prioritising short-termism and easy gains. Taking issue with such conceptual disjuncture accounts of finance broadly and of the recent financial crisis in particular, in this article we have inquired into the apparent autonomy of finance vis-à-vis the rest of the

political economic system by focusing on the emergence and growing of two ill-understood pillars of the global financial system: shadow banking and offshore financial havens.

The article, in other words, has sought to address the question of the causes of the quest for spatial differentiation and being in regulatory spaces *elsewhere*. Recognizing the limits of mainstream economic models in answering this question, we have drawn on the ideas of Thorstein Veblen and his theory of business civilisation. A Veblenian analysis of this development suggests that the behaviour in finance that is commonly associated with human failure (greed, evasion, fraud), became widespread practice, and can be best understood as sabotage in Veblenian terms. It amounted to techniques of sabotaging clients and the governments who enacted regulations that were supposed to protect the clients. These were legal mechanisms, albeit as Veblen writes, not in the spirit of the law.

Notes

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Explaining the Stunted Rise of Macroprudential Regulatory Philosophies

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In the aftermath of the financial crash of 2008, policy makers operating in international financial regulatory networks discovered macroprudential regulation (MPR), but macroprudential regulation has had a stunted or arrested development that can be explained with reference to five factors that are recounted in this article.

Introduction

In the aftermath of the financial crash of 2008, policy makers operating in international financial regulatory networks discovered macroprudential regulation (MPR) and 'systemic risk'. Indeed, the widespread recognition that financial regulation needed to become more 'macroprudential' was one of the primary regulatory reform impulses to emerge in the post-crash period. During 2009 the G20 leaders and their finance ministers and central bankers provided political support and endorsement of macroprudential regulation, highlighting the procyclicality of financial markets and the need for counter cyclical regulatory policies (G20 2009a, 2009b). The newly expanded and renovated Financial Stability Board (FSB) was given a mandate to develop macroprudential analysis and to monitor and report on macroprudential policy developments from 2009 onwards. A spate of reports produced by the European Commission, the Financial Services Authority (FSA), the G30, the Geneva Commission, the G20 and the FSB all called for the development of macroprudential regulation. Post-crash therefore, there was a rapid ideational shift in a macroprudential direction as an international consensus emerged which repeatedly endorsed the message that national authorities should try to construct macroprudential regulatory regimes and that the analytical and research machinery of various international institutions and bodies should be reoriented to support such efforts by focusing on macroprudential analysis and data collection.

The first part of this article introduces this macroprudential ideational shift and argues that macroprudential was and is a new regulatory philosophy that was substantively different from the pre-crash orthodoxy based on notions of efficient markets (Baker 2013). Its rise to prominence was only possible because it was already being promoted by a number of key individuals in international regulatory networks. These individuals or 'norm entrepreneurs' were largely well placed technocrats linked to central banks, or central bank networks and they found that the general climate of opinion in their own networks and the wider political climate was far more receptive to their ideas in the post-crash period (Baker 2013). This enabled macroprudential ideas to rise to prominence quite rapidly in the aftermath of the financial crash of 2008, but the process of translating these ideas into concrete regulatory practice has proceeded slowly and incrementally (Baker 2014). Consequently, macroprudential regulation has had a stunted or arrested development. The rest of this article sets out to explain why this has been the case, but also points out that macroprudential regulation is here to stay and is unlikely to go away, despite some political difficulties with putting these ideas into practice. In this sense, building macroprudential regulatory regimes is likely to be long term project spanning a decade or more.

The first reason for the stunted development of macroprudential regulation, relates to the mechanics of filling a new technocratic policy frame with functioning policy instruments. How that process proceeds depends on a process of gradual testing, experimentation, analysis, reflection and learning by an emerging cadre of macroprudential technocrats, who are by nature cautious. A second reason relates to the counter cyclical nature of macroprudential policy and the state of the international financial and banking system which remains overleveraged and the wider macroeconomy in which credit remains far from plentiful. Much macroprudential policy will only become apparent in the upswing phase of the credit cycle and is therefore time dependent. Thirdly, there remains much disagreement about how far macroprudential rationales should be extended to change existing business models and the structures of the financial system. These arguments remain to be played out. A fourth reason relates to inter-state disagreement and positions that have slowed the process of macroprudential policy formation and have given the process of developing macroprudential thinking a very uneven quality. Finally, contests over institutional turf and private sector reticence, have also slowed and diluted the process of macroprudential policy formation. These factors should not be viewed as being in opposition to one another, or competing with one another . They coexist and are interacting to produce a slow and protracted process of macroprudential regulatory regime formation, in which substantive policy content is often diluted as a consequence of the interaction of these factors.

The Macroprudential Ideational Shift

> Macroprudential policy is a new ideology and a big idea. That befits what is, without question, a big crisis. There are a great many unanswered questions before this ideology can be put into practice. These questions will shape the intellectual and public policy debate over the next several decades, just as the great depression shaped the macroeconomic policy debate from the 1940s to the early 1970s (Haldane 2009-1).

Macroprudential regulation is, as the Bank of England's Director of Financial Stability, Andrew Haldane notes, a series of new, or different, ideas about how to regulate the international financial system. At its core is the notion of systemic risk. This is the idea that the build-up of risk in the financial system has a systemic dimension that goes beyond any individual institution's risk profile to include the systemic dynamics produced by the interaction of aggregate debt exposures. Containing this build-up of risk therefore, requires a macro systemic view and policy stance, with regulators mandated to check these systemic risks. This contrasts with the pre-crisis regulatory status quo that essentially involved supervisors assessing the risk models of individual financial institutions. Such an approach was referred to as 'microprudential', but it has subsequently been asserted that the focus on individual institutions was blind to the build-up of systemic risks (FSA 2009, Persaud 2009). Macroprudential regulation therefore involves system wide policies that seek to contain and constrain private sector risk taking. According to the former director of the Bank for International Settlements, Andrew Crocket, a macroprudential approach, involves a focus on the financial system as a whole, so as to limit the costs of financial distress in terms of macroeconomic output (Crockett 2000). Such a stance involves regulatory intervention into the activities of private financial markets, including placing a notional ceiling on the rate of credit expansion and activist efforts to slow asset inflation.

Four constituent concepts provide the intellectual underpinning for MPR. First, is the notion of a fallacy of composition (Borio 2011), or the idea that it is aggregate or collective systemic outcomes that matter more than individual incentives and courses of action. Second, within the macroprudential frame, financial markets are seen to be procyclical, with market prices inherently predisposed to extreme movements and volatility (Borio, Furfine & Lowe 2001, Borio & White 2004, White 2006, BIS 2006). Third, market participants are prone to 'herding,' or adopting behaviours close to the overall mean, as they suspend their judgment, based on an observation of and deferral to the judgment and behaviours of others. A fourth and final macroprudential concept relates to the linkages and externalities that proliferate in complex systems. As complexity and interconnections increase, evident in shadow banking and financial innovation for example, externalities proliferate, meaning that relatively small unexpected events can generate increasingly costly explosions and systemic instability and fragility (Alessandri & Haldane 2009; Haldane 2010; Haldane & May 2011; Taleb & Blyth 2011). Moreover, a branch of literature points out that the excessive complexity such interconnections engender, often exceeds the capacity for human cognition, making risk incalculable (Best 2010; Blyth 2011; Haldane 2010; Turner 2011). Analysis of this kind provides a powerful rationale to move the perimeter of regulation to cover shadow banking, but also to modularise or separate financial activities, through Glass-Stegall type legislation, to tax and even prohibit certain financial activities and transactions, because their social

costs in terms of lost output can exceed any economic value they generate (Haldane 2010; Tucker 2010; Turner 2011) Fallacy of composition, procyclicality and herding all have an intellectual heritage that can be traced to the work of Keynes and Minsky, both of whom advocated a much more interventionist policy stance in relation to the financial system, than the dominant orthodoxy or norm of the last thirty years (Datz 2013; Baker 2013).

Intellectually, macroprudential thinking and regulatory philosophy represents quite a movement away from the pre-crash orthodoxy. Largely this took its intellectual lead from Eugene Fama's efficient markets hypothesis (Fama 1991). From this perspective financial markets efficiently process available information, while the self-interested rational decision making of investors, meant that financial markets tended towards equilibrium. Consequently, the principal pre-crash international financial governance challenge was the question of how to increase available information to market participants, so that they could make more informed investment decisions. This rationale and mode of thinking, informed the response to the Mexican peso and Asian financial crises of the 1990s and the launch of the international financial architectural exercises, which were intended to promote the norm of 'transparency' and increased data release by national authorities (Baker 2006; Blyth 2003). Macroprudential thinking however represents a considerable rupture with such an approach and provides a multi-faceted challenge to efficient market theory. For example, fallacy of composition challenges the notion that the rational incentives of individual actors are sufficient to generate financial stability. Procyclicality raises the prospect that financial market prices are prone to extreme swings rather than usually being correct. Herding challenges the notion that individuals have the capacity and inclination to rationally evaluate all information, while complex systems analysis indicates that complex innovative financial systems can be a cause of systemic instability and fragility rather than enhancing durability, as per the market completion hypothesis.

In this sense, the crash of 2008 acted as an event that provided a host of empirical evidence that was damaging to the efficient markets position, but provided support for a macroprudential perspective. Following the collapse of Lehmans in September 2008, the extreme downward movement in a number of interrelated asset classes was difficult to explain through an efficient markets lens. From this perspective systematic mistakes by markets (as the sum of individual rational decisions), as opposed to isolated random ones, could not happen, at least when adequate information was available, because optimising agents would drive prices into equilibrium. In contrast, the macroprudential approach that emphasised the importance of systemic thinking and highlighted the procyclical and unstable tendencies of financial markets, provided a readymade conceptual apparatus for explaining the events of autumn 2008. This conceptual approach also critiqued the dominance of the existing orthodox and its overreliance on Value at Risk (VaR) models, asserting that such an approach was a cause of the crisis, that had further 'hard wired' procyclicality into the financial system (FSA 2009). In this context, the existing orthodoxy became part of the problem that had to be replaced with new thinking. As Claudio Borio of the Bank for International Settlements (BIS), the institution that pioneered the term macroprudential in the late 1970s and began a macroprudential research programme after the Asian financial crisis, has commented, „a decade ago the term macroprudential was barely used and there was little appetite amongst policy makers and regulators to even engage with the concept, let alone strengthening macroprudential regulation" (Borio 2009: 32). Today however Borio has noted that „we are all macroprudentialists now." „This swell of support [for macroprudential regulation] could not have been anticipated even as recently as a couple of years ago. The current financial crisis has been instrumental in underpinning it" (Borio 2009: 2).

Macroprudential ideas had been, „evolving quietly in the background, known only amongst a small but growing inner circle of cognoscenti" (Borio 2011: 1). Macroprudential ideas consequently had a prior intellectual and institutional presence, particularly at the BIS, but also amongst a select number of other economists and central bankers, which meant that many advocates of macroprudential thinking were well positioned and already had a presence in the established financial technocratic research and report writing machinery that politicians called upon to provide them with diagnoses, answers and proposals in relation to the financial crash of 2008. As Walter Mattli and Ngaire Woods have pointed out, „successful [regulatory] change is made more likely where new ideas provide a way to regulate that both offers a common ground to a coalition of entrepreneurs pressing for change and fits well with not-discredited existing institutions." (Mattli & Woods 2009: 4-5). Macroprudential proposals had not discredited institutional and individual backers that were already linked into key policy making networks in the form of Borio's inner circle of cognoscenti. In this respect, following the financial implosion of 2008, macroprudential advocates were not starting from scratch. Individuals such as Borio and his BIS colleague William White, were already recognised and positioned within key policy networks, with a prior track record of advancing macroprudential ideas for nearly decade. The macroprudential

perspective therefore enjoyed an advantage in terms of institutional access and a body of prior work that outlined the inadequacies of the prior efficient markets orthodoxy and was well positioned to fill the vacuum left by the apparent collapse in efficient market thinking.

The rise to prominence of macroprudential was the result of a proactive promotional strategy by a relatively small number of key macroprudential norm entrepreneurs (Finnemore & Sikkink 1998), who engaged in a public process of diagnosis, persuasion and prescription. For example, in the UK, economists John Eatwell, Charles Goodhart and Avinash Persaud, converted Adair Turner, the new head regulator of the Financial Services Aauthority (FSA), to the macroprudential cause in briefings during the summer of 2008. Turner became one of the most forceful and eloquent advocates of the macroprudential position and began to make the macroprudential case at the meetings of the Financial Stability Forum (FSF, later FSB) in Basel[1].

As the FSF prepared reports for G20 meetings, macroprudential references and thinking also began to find their way into G20 communiques, albeit somewhat cryptically under the heading 'mitigating procyclicality' with support expressed for countercyclical capital buffers, for the first time in the Horsham communiqué of 2009 (G20 2009a). William White, formerly a prominent macroprudential pioneer at the BIS had now retired, but was advising and briefing the German G20 team, and also briefing Canadian officials using the frame of MPR analysis (Balzil & Schissel 2009). The increased access to the levers of national state policy making that macroprudential advocates enjoyed in Euro zone states, the UK and Canada, enabled the outlines of a macroprudential consensus to be built through the G20 and the FSB. A crucial G20 working group on regulation in early 2009 chaired by the Canadian central bank official Tiff Macklem and the Reserve Bank of India Governor Rakesh Mokan, produced a report calling for macroprudential regulation, and crucially Canada in the form of a leverage ratio and India in the form of some countercyclical capital requirements had both pioneered and experimented with key macroprudential instruments in the pre-crash period. By the summer of 2009 the new FSB was calling on the Basel Committee on Banking Supervision (BCBS) to commence work on countercyclical capital buffers, and it was agreed that a new Basel III agreement with a macroprudential component would be negotiated.

The significance of this post-crash macroprudential ideational shift was that policy makers' cognitive filter switched to a different setting. Policy makers are now using various combinations of the four key constituent concepts of fallacy of composition, procyclicality, herding, and complex externalities to inform and guide regulatory initiatives and practice. A whole range of policy proposals could now be placed on the table and seriously discussed, that were previously out of reach. These have included: countercyclical capital requirements; dynamic loan loss provisioning; countercyclical liquidity requirements; administrative caps on aggregate lending; reserve requirements; limits on leverage in asset purchases; loan to value ratios for mortgages; loan to income ratios; minimum margins on secured lending; transaction taxes; constraints on currency mismatches; capital controls; and host country regulation (Elliot 2011). The macroprudential shift, therefore represents a potential trajectory change in financial regulation. After three decades of entrusting more and more autonomy to private actors to price and manage their own risk, that trajectory, is potentially, at least, reversed. Macroprudential concepts potentially empower regulators by providing them with the intellectual equipment to set limits to market activities, reducing the scale and restricting the scope of financial transacting (Turner, 2011). However, to date macroprudential policy development has proceeded slowly. The macroprudential regulatory philosophy has not yet translated into a substantively different approach to financial regulation. Its rise to prominence has been characterized by a stunted or arrested development. The rest of this article outlines the reasons for this stunted development.

The Stunted Development of Macroprudential Policy

The task of translating macroprudential concepts and reasoning into concrete regulatory practice and functioning macroprudential policy instruments has been proceeding slowly. Part of the reasons for this relate to the very nature of the macroprudential project itself, but also the patterns of political contestation surrounding macroprudential regulation. Five factors that have slowed and diluted macroprudential policy development are identified here.

Macroprudential as a technocratic control project

As the last section illustrated macroprudential policy was something that was largely conceived of by technocrats at central banks and the BIS. The project of constructing macroprudential regulation is something that has not only been driven and promoted by technocrats, but also involves an expansion of their role in the policy process and rests on the exercise of their expertise and informed judgement. For example, the stated objective of macroprudential policy is to moderate credit supply over the cycle, tightening policy in a boom and lowering it in a bust (Bank of England 2011). The most commonly cited macroprudential policy instrument is the counter cycli-

cal capital buffer, a variant of which had operated in the Spanish and Indian banking systems in the pre-crash period. The idea behind a counter cyclical capital buffer is to lean against the credit cycle based on a reference path of a normalized credit to GDP ratio. Deviations above the path involve a tightening of capital requirements for private lending institutions, while deviations below that path should involve a loosening of those requirements (Haldane 2012). A functioning macroprudential policy regime therefore clearly requires regulators who have the capacity and capability to identify normalized paths of credit to GDP and deviations from that path, based on extrapolations from previous evidence and data. Further, they would also be required to reach judgements on the precise calibrations of these macroprudential policy instruments and how they should be scaled up or down to reflect particular identified phases of the credit cycle. Such a process clearly depends upon the technical capacity of regulators to reach such calculations, the data sets and data collection techniques they have to hand and some discretionary powers to reach judgments on how policy should be adjusted. One aim of the macroprudential project it has been claimed therefore is 'technocratic mastery of financial markets,' driven by a desire to open new possibilities for control of complex adaptive financial networks, through mathematized control technologies (Erturk et al. 2011).

Prior to the financial crash of 2008 there were relatively few functioning examples of macroprudential policy instruments. The Spanish example of counter cyclical capital buffers or dynamic provisioning, and Canadian use of leverage limits were outliers in developed country financial systems, although a number of Asian systems sought to constrain lending and investment activities using macroprudential type financial stability justifications, without actually naming them as such (Borio 2011). Bank of England officials have noted, 'the state of macroprudential policy resembles the state of monetary policy just after the second world war, with patchy data, incomplete theory and negligible experience, meaning that MPR will be conducted by trial and error' (Aikman, Haldane & Nelson 2011: 1). Macroprudential policy authorities, as Haldane acknowledges will not be able to draw on decades of research and experience. Consequently, macroprudential policy is so new, and experience with it is so limited, that we have entered a very fluid phase of policy experimentation based on trial and error. The FSB/ IMF/ BIS report to G20 leaders (FSB, IMF, BIS 2011) on macroprudential policy, described systemic risk identification as a 'nascent field, that requires fundamental applied research, so as to inform the collection of analysis and data, to fill data gaps and to lead to the development of better models'. Furthermore, newly introduced tools, the report suggests, will need to be tried out in different circumstances and their performance evaluated against expectations, as macroprudential institutions are still being introduced nationally and there is no experience of the performance of these institutions to guide their design. The report is clear in stating that, 'there is no widely agreed and comprehensive theoretical framework for the optimal choice and calibration of macroprudential tools. It is still too early to provide a definite assessment of the set of macroprudential tools that will provide most useful further down the road, in part because financial innovation and change within the financial system will give rise to new risks in due course' (FSB, IMF, BIS 2011: 9-10)

Ultimately, macroprudential policy development has been informed by its character as an almost exclusively technocratic project, that initially took the form of an 'insider's coup d'etat', primarily driven forward by technocrats whose aim is to achieve technocratic mastery of financial markets, by 'rethinking' and 'mapping' the financial network (Erturk et al. 2011).

By their nature technocrats like to proceed cautiously on the basis of data sets and empirical evidence, which take time to accumulate. Consequently, the task of filling macroprudential regulators' empty policy arsenal is proceeding gradually as evidence, data and rationales are compiled and tested, as the reports above illustrate. This itself is a slow, gradual process, but it also illuminates how the character of the macroprudential project has been shaped by its technocratic character in ways which have slowed the pace of its development to date.

The counter cyclical nature of macroprudential policies

The specific countercyclical objectives of macroprudential regulation, as time variable policies means that their more interventionist and restrictive character, which require institutions to set more capital aside as macro credit supply expands, only become conspicuous at certain parts of the economic cycle. The crucial test for macroprudential policy will be how it deals with inflating credit and asset bubbles and its ability to restrain private lending, investing and transacting in such circumstances. To date de-leveraging activities and the limited supply of credit to the real economy have been used as arguments to minimise regulatory requirements. For example, this was particularly evident in the case of the Basel III agreement, – a set of international regulatory principles negotiated by central bankers in the aftermath of the financial crash to update the earlier Basel II. Bank of England officials developed a macroprudential argument to make the case for a more expansive stance on capital ratios in Basel III, arguing that capital requirements needed to be set far

above any reasonable estimate of the losses likely to be incurred by an individual bank, because what mattered was the *macro* systemic stability of credit supply, not just the risk of individual failure (Turner 2011; Miles, Yang & Marcheggiano 2011). Basel III capital ratios they claimed would therefore ideally be 15-20% of risk weighted assets, rather than the increase from 2 to 7 per cent in Basel III (Miles, Yang & Marcheggiano 2011; Turner 2011). The objective of moving towards 15-20 per cent is however viewed as a long term one, because 'while higher equity ratios would not in the long run carry an economic penalty, a starting point of sub optimally high leverage means that higher equity ratios could slow recovery from a crisis induced recession' (Turner 2011.) This argument was accepted by more ambitious macroprudentialists such as Adair Turner and the BIS macroeconomic assessment group, whose analysis informed Basel III design. In this sense, macroprudentialists acute sensitivity to the need for countercyclical policies means that in the current circumstances they have accepted lower capital requirements in the short term, but view the task of building adequate capital requirements standards as unfinished business that will require raising requirements over the longer term as a necessary measure for long run financial stability.

Disagreements on the risk weighting system and the universal banking model

The Basel III agreement also maintained the centrality of so called risk weighted assets and the internal risk models of large banks through their complex sophisticated Value at Risk models (VaR), which involve banks assessing their own risks so as to determine the bank's minimum capital requirements. Those sceptical of banks' ability to model their own financial risk, from within the macroprudential camp were not in a position to persuade either the industry or the rest of the international regulatory community to jettison a risk weight asset approach in the Basel III agreement. This fundamental component of Basel II remains unaltered therefore, with Basel III adding a mandatory capital conservation buffer of 2.5% and a discretionary countercyclical capital buffer of 2.5%, during periods of high credit growth. Once the macroprudential ideational shift had taken hold by late 2009, industry representatives were in no position to prevent or oppose a countercyclical element being introduced into the Basel principles. In this sense, Basel III adds to Basel II rather than replacing it in its entirety, meaning that Basel III retains many of the features of Basel II, in a form of path dependent policy 'layering' (Baker 2014; Mahoney & Thelen 2010).

The issue of risk weighted asset calculations recently came to public attention, when Andrew Haldane of the Bank of England criticised the Basel III agreement for producing an overly complex approach to financial regulation because of its reliance on risk weighted assets. In his 'Dog and Frisbee' speech at the most prestigious event in the annual central bank conference calendar, the Jackson Hole Conference of the Kansas City Federal Reserve (Haldane & Madorous 2012; Masters 2012), Haldane made the argument that the shift to a highly-complex risk-weighting system for bank assets had resulted in the average amount of capital banks assigned to those assets halving over the previous 20 years, because complex rules have generated both the incentives and the means to exploit regulatory loopholes. Consequently, he asserted that simple measures of bank leverage, untainted by such complexity, were better at predicting banking failure than complex regulatory alternatives (Haldane & Madouros 2012).

Unfortunately, fellow macroprudentialist, Mark Carney, who recently become Haldane's superior at the Bank of England, may agree that regulatory policy needs to be more countercyclical and recognises the importance of leverage ratios, but does not agree with Haldane's criticisms of Basel III. In particular Carney argues that risk weighting of assets and a leverage ratio need to work in tandem, with the leverage ratio acting as an additional layer of protection from a miscalibration of risk weights, rather than replacing risk weights altogether. Using the leverage ratio as the frontline of defence, would Carney asserts, result in institutions filling the leverage ratio with the riskiest assets (Verma 2012). In this sense, two of the officials who have done most to promote, support and develop a macroprudential approach disagree on the role of risk weighted assets, with Carney's position currently winning the day, in part because of his pivotal position as chair of the FSB, that exercises some oversight of the Basel Committee on Banking Supervision that formulated the Basel III agreement. Furthermore, Carney is less the convinced about the problems of the universal banking model, and has been openly sceptical about the practicalities of the Volcker rule in the United States and its ability to achieve segmentation, or the desirability of doing so (Verma 2012). This position contrasts with Haldane's view that structural change is required, involving robust separation of retail and investment banking arms. Haldane's position in part arises from a macroprudential orientation which is sensitive to complexity and size as a spreader of risk and instability. This has been particularly evident in his collaborations with Oxford Professor of Zoology, Robert May, which compares banking systems to ecosystems and suggesting that intertwined; complex

systems are less robust and less stable than simpler modularised systems (Haldane & May 2011). Haldane consequently supports ring fencing, with full separation as the next logical step (Haldane 2012, 7). Haldane is quite clear that such separation is not just about reducing the size and costs of future financial shocks, but also ensuring and delivering a more stable and steady supply of credit to real economy activities.

Despite the fact that macroprudentialists such as Haldane and Carney share much common ground therefore, on two of the most crucial issues relating to the structure of the financial system, which would challenge existing business models, prominent macroprudentialists cannot agree and are unable to form a decisive coalition to push for long term structural change in the financial system. The differences between Haldane and Carney are symptomatic of this division.

Inter State Disagreement

An obvious and conspicuous interstate disagreement was evident in the Basel III negotiations. While the, US, UK and Swiss representatives argued for a much higher equity capital ratio (Hanson, Kashyap & Stein 2011), EU regulators wanted lower requirements, fearing this would disadvantage their ailing banks. An inter-state, or inter jurisdictional contest in which actors sought to gain competitive advantage for their own financial sector therefore diluted Basel III (Helleiner 2012; Mugge & Stellinga 2010). National differences are also evident in relation to a number of macroprudential concepts and policy instruments. For example, US acceptance of the macroprudential approach, has according to senior international officials, always been 'half-hearted and quite partial', partly for „philosophical" reasons, relating to a faith in markets. Ben Bernanke and many American policy makers take a minimalist view that equates with macroprudential supervision and monitoring. Consequently, there is much less emphasis in the US on procyclicality and more emphasis on Too Big to Fail (Persaud 2010; Confidential interview with official, January 2012). The United States has however displayed much more willingness to embrace leverage ratios than countercyclical capital requirements, while the opposite applies in large continental European countries, such as Germany and France, largely due to heavily leveraged large banks.

In the EU itself there have also been divisions relating to how Basel III should be translated into EU regulatory practice and statute. For example, the Fourth Capital Requirements Directive (CRDIV), which will implement Basel III in Europe raises all kind of issues and has already ignited tensions. From a single market perspective there is a case for having a single set of rules applicable to all. On the other hand, from a macroprudential perspective national regulators need to be able to adjust requirements for countercyclical purposes. The European Central Bank (ECB) position is that this should happen under a framework of constrained discretion, in which prior notification is given to the new European Systemic Risk Board (ESRB), to enable the ESRB to assess the spill over consequences of such a move for other countries. The French position is to go even further, and have a harmonised framework at the EU level, so that national regulators do the same thing in the same circumstances. The European Commission has also argued for a rules based approach, in which countries will have to stick to a rigid set of standards. The Dutch central bank, favours the idea of the ESRB acting as the role of mediator, as suggested by the ECB. However, both the Bank of England, and Scandinavian central banks want national macroprudential freedom and reject the idea of having to make requests to the ESRB, with the Bank of England seeking control over tools concerning leverage, liquidity, funding, lending risks and margin requirements. Currently, the CRDIV is in trialogue discussions with the Council of Ministers, European Commission and European Parliament, led by the Irish presidency, illustrating how interstate and inter institutional disagreement is impeding, or at least slowing the process of macroprudential policy development.

Private sector concerns and national institutional process

A final area of contestation relates to the fact, that while the initial acceptance of a broad macroprudential regulatory philosophy proceeded quite quickly and with relatively little opposition during 2009, the actual detailed practicalities of constructing macroprudential policy is a far more contested process. The quantitative setting of macroprudential policy instruments such as countercyclical capital requirements have implications for the day to day investment strategies and market operations of a variety of market actors. Consequently private sector actors have been far more concerned with contesting the detailed setting of policy instruments, than they have been over broad questions of macroprudential regulatory philosophyy (IIF 2011). Likewise, existing institutional actors – legislators, political parties, other agencies and bureaucracies, are taking a much closer interest in and developing stronger positions on macroprudential institutional questions, and the powers of new macroprudential policy committees, as illustrated in the case of the EU above, as a variety of actors seek to protect their own turf and standing. Furthermore, national legislative processes that enact macroprudential for new macroprudential policy committees and the scrutiny surrounding

them, can be protracted processes. The result is a far more contested, contingent and even controversial sphere of detailed macroprudential policy development, which is likely to lead to political compromises and is liable to dilute macroprudential policy content, in substantive terms. Basel III provided some evidence of this. For example, the first scholarly account of Basel III pin points the influence of the Institute of International Finance (IIF) over the agenda and large European banks such as BNP Paribus, who had 'first mover advantage' in terms of access to the Basel Committee, enabling them to make the case that higher capital ratios would result in stagnant Euro Zone growth. Proposals on higher minimum capital ratios, the international leverage ratio, minimum liquidity ratio, and capital surcharge on systemically important institutions were all diluted in Basel III (Lall 2012: 22). Moreover, the powerful private Institute of International Finance that develops views on regulatory questions on behalf of many leading international banks has suggested that 'the science' in this area (macroprudential) is at an early stage, while using capital as an instrument of macrostabilization was 'unprecedented and untested', requiring authorities to 'exercise great caution ' (IIF 2011: 22).

Conclusion

The five factors highlighted combine to explain why the task of building functioning macroprudential has been a slow, contested and protracted process. This article has highlighted how ideational change does not automatically translate into significant regulatory change. The process of building new financial regulatory orders has historically been a long term process. After the Wall Street Crash of 1929, building the Bretton Woods order was a long run process that consisted of a four phase process, including an interregnum phase of technical refinement and experimentation (Helleiner 2010), which is probably where we are today with macroprudential policy development. In this respect, the first factor explaining the stunted development of macroprudential regulation is quite simply that such a process takes time. Two factors that are specific to macroprudential regulation have been highlighted here. The first is that macroprudential is itself a technocrat project. Technical projects take time to develop in terms of assembling data and evidence and refining what are often referred to as control technologies, while technocrats themselves tend to be cautious, thorough figures who proceed on the basis of evidence and data. A second issue is macroprudential's countercyclical objectives. This means that it responds to the economic cycle. Persistent private sector deleveraging means that there is currently more emphasis on the enabling, rather than the preventative arm of macroprudential policy involving efforts to encourage credit expansion. A further factor constraining macroprudential development is that key macroprudential advocates remain internally divided on important structural questions such as the emphasis given to risk weighted assets and the viability and desirability of universal banking against separated or segmented banking. Finally, political contests over macroprudential points of detail in interstate terms and private sector reticence have acted to dilute macroprudential policy in substantive terms. At the same time, institutional turf struggles are also slowing the process of implementing macroprudential frameworks. Taken together these factors have to date resulted in macroprudential regulatory regimes that have been stunted in their development.

Notes

1. Information revealed to author in private conversations.

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The role of special resolution regimes in post-crisis financial regulation: Four Danish lessons

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What is the best way to avoid that financial institutions become 'too big to fail'? One approach particularly popular among policymakers is the building of special bank insolvency policies that aim to resolve any financial institutions without systemic consequences. Danish authorities are among the first to have actually used the new resolution approach, and the Danish case thus offers a number of lessons about the problems and potentials of special bank resolution regimes.

1. Introduction

The problem of too big to fail (TBTF), i.e. that some financial institutions have grown so big and complex that authorities will not let them fail because of the systemic consequences it would entail, has consistently ranked among the most salient and controversial issues in post crisis financial regulatory debates. The reasons are obvious: TBTF institutions exacerbate systemic risk by creating massive contingent liabilities for governments; TBTF institutions distort competition, notably through the lower funding costs that an implicit state guarantee secures; and TBTF institutions undermine public trust in the fairness of the financial- and political system (Goldstein and Verón 2011). The TBTF-problem has on both an international and national level been addressed through three avenues of reform: Increased capital- and liquidity requirements (implemented internationally through the Basel III accord, complimented by specific national requirements), structural reform (size caps, break-up of large financial institutions, clear shutters between investment banking and deposits, etc.) and the building of special resolution regimes (SRRs). SRRs are increasingly being implemented, especially in the financial systems that were hit hardest by the crisis (BCBS 2011, FSB 2013). The hope and ambition behind implementing SRRs is to combat the TBTF problem by requiring that financial institutions plan for crisis by writing so-called 'living wills', offering authorities early intervention powers and increased discretion in resolving failed institutions, and avoiding taxpayers foot the bill by requiring that financial institutions hold debt subject to bail-in (e.g. by converting debt into equity at a predetermined trigger point) and build up resolution funds ex ante or ex post.

This paper is organised in two parts. Drawing on the international regulatory debate as well as arguments from economics, the next section presents the basic arguments for the central role of SRRs in post-crisis financial regulation. As will become clear, the benefits of SRRs are generally presented in functional terms as a means to avoid 'moral hazard' in the financial industry by offering a credible commitment to wind down financial institutions of any size. As an alternative to the standard approach, the section argues that SRRs should not only be seen as an efficiency enhancing technology but also as a political tool used in distributional battles over who wins and who loses in banking crises. Section three presents a case study of one of the few SRRs that have actually been put to use, namely the Danish SRR implemented in 2010 and used for the first time in 2011. The Danish case offers four lessons: First, the implementation of the Danish SRR has not led to a less active role for the state in banking crises. Rather it signifies an institution-

alization of the very central role of the state in banking crises. Second, following the significant consequences of forcing creditors to accept write-downs on unsecured and uninsured debt in the closing of *Amagerbanken* and *Fjordbank Mors*, the Danish SRR has de facto been put to rest and replaced by a dowry scheme that helps bail out creditors. This demonstrates the difficulties of creating a market conform special resolution regime that can credibly commit authorities to shut down ailing banks and ensures that creditors and shareholders bare the costs related to crises. Third, the Danish case is ripe with examples of how the SRR is used to give special treatment to financial institutions at politically opportune moments. . Fourth, although SRRs can help to provide more powerful resolution technologies, they do not solve the political problem of the strong incentive to let large financial institutions conduct risky businesses in the run-up to a crisis, or make it easier for politicians to accept the serious real economic consequences of letting financial institutions of any size fail. Thus, TBTF financial institutions still enjoy a more or less implicit advantageous position vis-á-vis their smaller competitors and it seems doubtful that SRRs will do much to change this.

2. What is a Special Resolution Regime?

The basic idea behind special resolution regimes for financial institutions is to avoid what is considered two suboptimal solutions to bank crises, namely disorderly bankruptcy or a bail-out of creditors. During the recent crisis, the first kind of solution was used in the case of the investment bank Lehman Brothers, while a couple of days later the second option was used when the insurance company AIG was bailed out using public funds. Both solutions were problematic in their own right. Bail-outs throw public money after failing financial institutions and create an increased incentive for financial institutions to grow bigger and bet on being saved by taxpayers in a future crisis. Bail-outs also break with the principle that taxpayer funding is the last resort, and instead the subordinated creditors that have been paid for taking on risk are ranked ahead of taxpayers when it comes to loss absorption. Bankruptcy, on the other hand, wipes out shareholders and forces hair-cuts on creditors. However, given that bankruptcy procedures work relatively slowly and do not take financial stability into consideration, there is significant risk of creating uncertainty and contagious disruptions in financial markets (see Cihak and Nier 2009; Dewatripont and Freixas 2012).

Viewed from a political perspective, SRRs may be thought of as an institutional innovation in distributional battles between the state, taxpayers and the different financial industry actors. As argued by Mahoney and Thelen (2010), institutions inevitably raise resource considerations and invariably have distributional consequences, and since any „set of rules or expectations – formal or informal – that patterns action will have unequal implications for resource allocation" (p. 8) it is helpful to see the rise of SRRs also as a power struggle. Specifically, to understand the significance of the new resolution policies, we should see them as the state's manipulation of property rights (Campbell and Lindberg 1990). In such a perspective, property rights confer power and are rules that constrain, enable and locate decision-making power over assets (Carruthers and Ariovich 2004), and so bankruptcy law (whether in its standard form or as SRRs) exemplifies latent, property-rights-based regulation that constitutes a central part of a state's capacity to govern and transform a society's economic organization. Thus, property rights not only determine the relation an actor has to his or her property, but also in a broader perspective define the institutional basis for power relations in production, exchange and accumulation (Campbell and Lindberg 1990). In other words, when banks are governed under a special resolution regime that gives the state greater intervention power and discretion at the expense of creditors, shareholders and debtors, this at basis constitutes a potentially significant change in power relations.

To understand the significance of the new resolution policies, it is helpful to compare them to standard bankruptcy law. The fundamental difference between normal corporate bankruptcy procedures and the way special bank resolution regimes function, lies in the coordination problem that they are trying to solve (Marinc and Vlahu 2012, ch. 2). The objective of corporate bankruptcy law is to identify the optimal point of bankruptcy for creditors and create incentives for creditors not to collect their debt prematurely, i.e. cause a run on the corporation by its creditors at a point where the corporation is worth more as a going concern. From an economic point of view, corporate bankruptcy thus aims to promote efficiency in the relationship between debtor and creditor both ex-ante (when the debtor is solvent) and ex-post (when the debtor is already insolvent) (Marinc and Vlahu 2012, 5). As a contrast, the primary objective of special bank resolution policies is to protect financial stability, which often comes at the expense of creditors, shareholders and depositors (with deposits below a certain maximum amount covered by deposit insurance).

Bankruptcy in case of bank failures is more complicated than normal corporate bankruptcy (see Marinc and Vlahu 2012, ch. 3; Attinger 2011). A primary function of banks is to provide liquidity to their creditors (in the form of liquid demand deposits) and to their borrowers

(in the form of loan commitments), and a rapid dismantling of the bank's liability side or a freezing of bank debt cannot be imposed without hindering the liquidity provision function of a bank. This means that in contrast to corporate bankruptcy that aims to provide a breathing space for an insolvent company, special bank bankruptcy policies aim at quickly resolving the institution to lower the costs of illiquidity.

The ultimate goal of safeguarding financial stability can be achieved in three ways: through prevention, early intervention and a number of resolution powers. First, SRRs are supposed to deter financial institutions from taking on too much risk and behaving irresponsibly in the first place. They do so by posing a credible commitment to wind down financial institutions of any size. Moreover, requiring systemically important financial institutions to draw up resolution and recovery plans subject to approval by authorities, reflects the basic intention to reduce the impact of a possible systemic failure. Such a 'living will' would typically be a document that describes the different lines of business of the institution, its assets and liabilities, operational interdependencies like information technology, and more generally how different kinds of crises could be handled in a way that either recovers or resolves the institution (Herring 2011; Avgouleas et al. 2013; FSB 2011)

Second, to avoid systemic consequences of a crisis in a financial institution, SRRs enable authorities to intervene at an earlier point than in the case of corporate bankruptcy and often without the consent of shareholders or creditors. They do so by granting authorities *enhanced early intervention powers*. This is maybe the trickiest part of SRRs, because it directly impacts on the property rights of the owners of financial institutions and their creditors. To avoid systemic consequences of the failure of a financial institution, authorities have an interest in intervening at a pre-insolvency stage, i.e. to avoid actual liquidation of the financial institution and instead restructure and reorganize it as a going concern while it still has positive net worth. This procedure is in important ways different from standard bankruptcy procedures, since the resolution authority can embark on sales and other actions without waiting for a reorganization plan to be developed and approved by a bankruptcy judge (DeYoung et al. 2013). As argued by Attinger (2011, 9), „the bank as a debtor remains in the market and, therefore, it is more difficult to justify why (i) creditors should be deprived of (part of) their claims; and (ii) shareholders should accept an interference in their rights."

Third, SRRs grant authorities a number of *resolution powers*. Though obviously there are variations in which powers each regime has, what is common across all of these tools is the absence of a subsidy to existing shareholders, and the imposition of losses on creditors, relative to a situation where the firm is bailed out (Cihak and Nier 2009). One of the most central tools is the technique of bailing in creditors. In short, this is a restructuring mechanism to recapitalise a firm upon the occurrence of a trigger event through the write-down or conversion of uninsured or unsecured debt instruments into equity (a debt-to-equity-swap) (FSB 2013, 3). The writing down of claims has the envisaged benefit of re-establishing the firm as a going concern by boosting the bank's equity capital, while shielding taxpayers from losses. A certain amount of 'bail-inable' debt is supposed to be part of the Basel III regulation, but exactly how the process would work and how much of such debt would be required remains uncertain at this point.

Another central resolution tool is the 'bridge bank'-tool. Bridge banks are temporary institutions created by the resolution authority to take over the operation of the failing institution and preserve its going concern value, while the resolution authority seeks a permanent resolution of the failure. In the words of Cihak and Nier (2009, 16), „The bridge bank tool allows the resolution authority to 'bridge' the gap between an institution's failure and the time when a suitable purchaser has been found". Other popular tools are a sale of business tool that enables authorities to sell off a failing financial institution without shareholder consent; a good bank/bad bank split, where authorities remove the most healthy assets of a failing institution and sell it off, while toxic assets are placed in a special purpose entity and then more slowly liquidated; and the temporary public control or nationalization of a failing institution.

The increased power of the state that follows from the setting up of SRRs is perhaps most clearly evident in the creation of the early intervention tools and special resolution powers that may enable the state to overrule shareholder and creditor rights. Thus, early intervention powers limit the rights of both creditors and shareholders, because they lose their property even though the bank is resolved as a going concern, i.e. the financial institution or parts of it continue to exist. One example of bypassing fundamental rules of bankruptcy – specifically the rules that govern the distribution of assets in liquidation (see Carruthers et al. 2001, 103) – is found in the resolution tool of partial transfer of deposits and assets to a 'good bank'. The transfer of deposits and assets to a 'good bank' without basis in rules on creditor ranking opens up the possibility that some creditors (e.g. junior debt holders) are 'left' in the bad bank while others (e.g. depositors) have their claim transferred to a good bank. (Cihak and Nier 2009, 16). Though there might be good reasons

from the perspective of financial stability in breaking such rules, it nonetheless constitutes not just a technical fix but also a tool of power for the state to use (or not).

Second, through the institutionalization of certain legal and economic mechanisms that may be used for selectively bailing out creditors and depositors of failing financial institutions, authorities are given enhanced discretion in dealing with claims on a failing institution. With the new policies in place it will be easier to cherry-pick creditors that are to be made whole for example in a bridge bank-construction, because authorities often are given greater administrative discretion at the expense of judicial review. Thus, special bank resolution regimes generally give authorities more power over financial institutions in distress, but do not rule out bailing out failing financial institutions. If anything, it enables a smoother bailout of financial institutions deemed too big to fail. Rather than signal the end of TBTF, the creation of SRRs, then, may instead signal a more explicit realization on the part of the authorities that a system of bailing out large financial institutions requires a stronger institutional foundation than reflected in ad hoc decisions during a crisis.

3. Lessons from the Danish SRR

Danish crisis management consisted of a number of policies put in place with the intention of stabilizing the Danish financial sector. Popularly the policies are called Bankpackage I-V. The first two bank packages sought to help Danish banks re-access international funding – first through a state guarantee of all deposits, excluding covered bonds (Bankpackage I), then through capital injections (Bankpackage II). Bankpackage III is the Danish special resolution regime, while bankpackage IV is a dowry scheme that subsidizes takeovers of weak financial institutions. Finally, Bankpackage V was created more specifically to support a relatively large bank – FIH Erhvervsbank – in liquidating a number of its assets in an orderly way. This article focuses on bankpackage III-V, because these are most relevant for understanding the Danish SRR[1].

3.1 The Danish SRR

In 2010, about a half a year before the state guarantee expired, work started on creating an SSR in Denmark. Parts of the institutional setup for the new SRR had already been created through Bankpackage I, namely the winding up company 'Finansiel Stabilitet' (Financial Stability), which had as a primary task of securing the payment of creditor claims on wound-up institutions and handling the controlled dismantling of financial institutions that no longer met solvency requirements. The authorities had two primary priorities in their work on the new regime: First, that it should ensure that normal costumers were reasonably covered by a deposit guarantee, and that they could access their account and use, for instance, credit cards the Monday after the resolution procedure had begun. Second, that creditors could be bailed in and pay for resolution relieving the taxpayers of the bill for resolving ailing banks. Relating to the latter challenge, the resolution regime was designed – as the only scheme in Europe at that time – to ensure that in a resolution senior bondholders suffer losses before the resolution fund. The scheme was constructed so that if a bank chooses to be unwound under the scheme, a subsidiary company is established under a state-owned resolution company, called Financial Stability, that takes ownership of assets and some liabilities, subsequently wiping out shareholders and giving senior bondholders a hair-cut on their investment.

The new regulation, implemented in October 2010, was first tested when Amagerbanken, at the time Denmark's fifth largest bank, became insolvent in February 2011. The bank was nicknamed 'Armageddonbank' in the international financial press because creditors for the first time in modern European history suffered hair-cuts on their investment. Thus, in accordance with the Danish SRR, Amagerbanken was selectively bailed out with a transfer of assets and a partial transfer of liabilities. Holders of the bank's senior unsecured debt thus swallowed a 41 per cent writedown on their investment (Bloomberg 2011)[2]. The international money markets were quick to respond. With the possibility of encountering a significant hair-cut, investors were suddenly reluctant to lend most Danish banks money (Financial Times 2011a). In May 2011 the credit rating agency Moody's downgraded six Danish lenders, including the country's biggest bank, Danske Bank, citing explicitly the lack of „systemic support" for the banks. These developments made the Danish authorities wary. Supposedly, as reported by Financial Times (2011b), making things tougher for surviving banks 'was not the idea' when the Danish authorities allowed a state guarantee of bank liabilities to lapse two years after it was introduced. Thus, in summer 2011 a first step was made to avoid using the resolution regime, by creating a supplementary 'dowry-scheme' that made it possible to supply a dowry to cover the exposures of a distressed banks' creditors and depositors for a healthy bank interested in taking over the bank. However, in June 2011 it turned out that the dowry-scheme was not effective in getting a buyer for the small bank Fjordbank Mors, which subsequently entered the normal winding-up process of Bankpackage III, once again grabbing the attention of the international capital markets[3].

Following the realisation that the Danish bail-in scheme had been too ambitious at that point of the crisis – exposing Danish banks to unwanted pressure from the capital markets – in August 2011 a new policy envisaged as an alternative to the bail-in scheme was passed in agreement between opposition and government, popularly called Bankpackage IV. The aim of the new scheme was to subsidize takeovers in an effort to ensure that troubled banks were not forced to resort to the new resolution framework. The bill contained two parts. First, the existing dowry-scheme was expanded. Now a healthy bank could take over either the whole of the distressed bank – where the state offers a dowry of the size of the cost that the state would have incurred had the distressed bank been unwound using the SRR – or only take over the good parts and leave the toxic assets to the state. In the latter case, the dowry paid the expenses that the state incurred in winding down the bad loans. The transaction is subsidized by the Danish Guarantee Fund, which is financed collectively by the Danish banking sector. Second, a state guarantee can be granted in two instances: either where a fusion between two banks leads to the maturing of loans taken out by the distressed bank, that the state then guarantees for the remaining period; or when two banks merge and one of the banks already has an individual guarantee as part of previous crisis measures, in which case the banks can obtain a new state guarantee with a maturity up to three years.

The small Max Bank became Denmark's first insolvent lender to test the ability of the new dowry-scheme to sidestep the bail-in laws of Bankpackage III. As such, the authorities were successful as Sparekassen Sjælland ended up taking over the healthy parts of Max Bank while the state assumed the bank's bad loans. Senior creditors were thus spared, while shareholders lost their investments. Bankpackage IV was once again put to use in January 2012, when the two banks Aarhus Lokalbank and VestjyskBANK merged. What made their use of the dowry scheme interesting was that the two banks were both deemed unhealthy, and yet – in contrast to the spirit of Bankpackage IV and only after a quick amendment of the law made it possible – the authorities welcomed the merger and agreed to renew the individual state guarantees of the two banks.

In March 2012, the fifth and so far final Bankpackage was issued in agreement between government and opposition. Though the term 'bankpackages' alludes to a certain degree of generality in the policy, it was actually specifically aimed at strengthening one bank, FIH Erhvervsbank, the fifth largest bank in Denmark. Following Bankpackage V, building sector loans for around 17 billion DKr were taken over by the state liquidation company Financial Stability, with FIH Erhvervsbank making an unlimited guarantee on the losses that the state incurs and the state taking up to 25 per cent of a possible future upside. The background for the initiative was that, as part of Bankpackage II, FIH Erhvervsbank had received individual state guarantees for 42 billion DKr that need refinancing in 2012–13. With the low credit rating of FIH Erhvervsbank and the generally difficult circumstances surrounding financing in international markets, the bank had started an aggressive practice of terminating loans that especially hit the already heavily pressured building sector as well as other creditors (notably small banks). Now that the bank could shift some of its most problematic loans to Financial Stability, it did not have to refinance these loans and could instead focus on its core business of lending to small and midsize companies. Though officially a comparable possibility was open to others 'in a similar situation', the chairman of the board of Financial Stability noted that he knew of no other similar cases in Denmark and openly admitted that the in principal opening for other banks was only for political reasons.

3.2 Danish lessons

The Danish case offers a number of lessons about the role of SRRs in post-crisis financial regulation. First, the regulation and organisation of the Danish SRR seems to signify an institutionalization of a more direct and powerful state role in governing the Danish financial sector. Before the implementation of the Danish SRR, the state played an active albeit more informal role. It did so by fostering private solutions for banks in trouble by putting pressure on other healthier banks to take an active role, for example by offering considerable tax deductions to incentivize the banks to take over their weaker competitors. The institutionalization of the active role of the state in Danish banking crises is perhaps most clearly seen in the development of the resolution company Financial Stability. The aim of Financial Stability developed from a simple liquidation company to a more pro-active and powerful instrument of the authorities, one clear example being the way Financial Stability helped FIH Erhvervsbank survive and develop rather than simply liquidating the institution. Financial Stability turned out to provide more direct access to distressed banks, for example in their role as negotiators of the terms of the individual state guarantees of Bankpackage II as well as overseeing the bidding process in relation to the unwinding of distressed banks (choosing who could bid and at what price) and putting their own people on the boards of banks close to failing. In sum, the Danish SRR is not a move towards a more market conforming approach to bank resolution,

but rather constitutes an institutionalization of the role of the state in bank crises.

Second, the Danish bank resolution regime remains the only regime that has actually used one of the resolution tools that international policy elites put most of their faith in, namely the bailing in of creditors (see section two)[4]. Here the message is generally negative: though the authorities in two cases actually used the resolution regime and forced creditors to take hair-cuts on their investment, the consequences for other Danish banks – whose position the authorities had no interest in hurting – were dire. Part of the reason why the Danish authorities were not more successful in using their resolution regime is that they seem to have disregarded that Denmark is a small open economy and so exposed their banks to 'unfair competition' with other financial systems. If, for example, the American authorities choose to let creditors suffer, other presumably healthy banks in their sectors would not be shut out of the international capital markets as happened in the Danish case. However, studying the American system does not give the impression that the authorities will use the market power of the American or British financial system to force a bail-in of creditors. Rather, they seem keen to keep merging ailing institutions while trying to avoid too much turmoil in the markets (Carstensen 2013a; see also Attinger 2011).

Third, the Danish case is filled with examples of how SRRs may work as a tool for political interests. Among the most prominent are the cases of FIH Erhvervsbank and VestjyskBank. In the case of FIH Erhvervsbank, the authorities broke the principle that Financial Stability was only a liquidation company for destitute banks and instead actively supported the bank by taking toxic assets amounting to 17 billion DKr off their books even though the bank was not close to insolvency. The reason: to avoid that the bank liquidating their assets too fast and in a way that would hurt a large number of struggling farmers and construction businesses. Another case where the SRR was used in a politically opportune way was the case of Vestjysk Bank, where the state gained a majority of the shares in the bank and kept it alive despite being very close to failure a number of times. As mentioned, bankpackage IV was also changed so weak financial institutions could merge and obtain an extension of state guarantees. This was done to keep Vestjysk Bank and the many over-indebted farmers that were customers of the bank afloat. On the other hand, in the case of a number of other banks that have been less politically important to maintain, crisis management has been significantly harsher. The most prominent examples are the cases of Amagerbanken and Fjordbank Mors, where the haircuts on creditors following the sell-off of assets so far have amounted to approximately 15 per cent. This might indicate that the assets in the banks were undervalued by Financial Stability and the Danish FSA and hence that the banks were actually solvent. These cases illustrate how SRRs can lend authorities more flexibility in crisis management, and thus how SRRs may function not just to counter 'moral hazard' in the financial industry but also as a political tool.

Fourth, the Danish case does not lend support to the idea that SRRs can work effectively to avoid bailouts, most notably by illustrating the difficulties of letting creditors of banks of any size suffer losses. Starting from the relatively market conforming approach of letting creditors suffer haircuts in bankpackage III, the Danish authorities ended up adopting bankpackage IV that either bails out creditors through subsidized mergers – funded collectively by the Danish banking sector – or, in a different version of a bailout, offers extensions on state guaranteed bonds to more or less healthy institutions. With the hope of avoiding a crisis in the first place in the largest financial institutions – the so-called Systemically Important Financial Institutions (SIFIs) - the government has proposed stricter capital requirements of up to three per cent of risk weigthed assets (SIFI Committee 2013, Ministry of Business and Innovation 2013). The big question remains if it is realistic that the authorities will accept the real economic consequences of resolving a bank that controls more than 30 per cent of all assets in the Danish financial sector (like Danske Bank), and if it is technically possible to do so without severe systemic knock-on effects.

It is important to acknowledge that the credibility of a commitment to wind down SIFIs is not based solely or even mostly on having the right resolution technologies in place. What might very well turn out to be more important is the politics of such a manoeuvre. That is, to wind down a SIFI it is necessary for the resolution authority to be independent of the ensuing political ramifications, which in turn might be problematic from a democratic point of view. One recent example of this is the bailing in of creditors and some depositors in a number of the largest banks in Cyprus. In that case, one could argue that the Cypriot banks were wound down because the electoral/democratic connection between those deciding to bail in and those suffering from the bail in was severed. Put differently, it was much easier for European leaders to insist on bailing in creditors, because neither their own banks nor their constituents were hurt in the process. That, however, does not make the commitment of the European leaders to wind down their own SIFIs more credible.

4. Conclusion

Policy elites and academic economists generally conceive of SRRs in functionalist terms, i.e. as a technological fix that together with more stringent capital and liquidity requirements may help avoid a future crisis like that recently experienced in the international financial system. Not disregarding the particular merits of this perspective, it is important to see that like most institutions, SRRs entail battles between actors with considerable distributional consequences. SRRs are political tools that to a larger or lesser extent enable authorities to govern the financial system. This means that SRRs may be directed towards other goals than the ones officially sought by public officials. One obvious example is the TBTF problem. SRRs are officially aimed at enabling authorities to wind down financial institutions of any size without serious effects on the financial system and the real economy, but they are also useful in conducting bailouts in a more controlled and institutionalized way. With the implementation of SRRs, authorities can bail out TBTF financial institution using legally institutionalized rules rather than the ad hoc crisis management that characterized crisis management in the recent crisis.

SRRs are a relatively recent add-on to the international financial regulatory framework, and we have yet to see just how effective they will be in deterring risky behavior and avoiding the disorderly resolution of banks in crisis. However, as suggested above, the Danish case offers an interesting first look at how SRRs may work. As such, the Danish case does not support the conclusion that SRRs signal a return to a more market conforming relation between the state and the financial sector. Instead, the otherwise relatively ambitious SRR of bank-package III has been replaced by a dowry scheme that bails out creditors through subsidized mergers. In other SRRs, like for example the American, SRRs embody a more flexible approach to crisis management and not necessarily an end to bailouts. In that light it seems more probable that in the future authorities will take on an even more active role in managing crises and that SRRs will play a central role in legitimizing this move.

Notes

1. For a more general introduction to the Danish financial crisis and the Danish authorities' crisis management, as well as analysis of the first five Danish bank packages, see Carstensen (2013b) and Kluth and Lynggaard (2013). On the sixth bank package – that deals with the identification and regulation of SIFIs – see the Ministry for Business and Growth (2013)
2. This has later been changed to a 16 per cent write-down. Newspaper reports are speculating that the write-down might end up even smaller. If creditors end up getting paid in full this might put in question the evaluation of Financial Stability that led to the closing of the bank.
3. Senior creditors of Fjordbank Mors were expected to suffer haircuts of around 26 per cent. As in the case of Amagerbanken, the haircuts have since been reduced significantly, to 14 per cent.
4. Recently bondholders and depositors not covered by deposit insurance were bailed in in Cyprus. This case, however, was markedly different from normal SRR, because the bail-in was a requirement to receive a rescue package to the economy.

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Why the European Commission is Wrong to Push for a European Financial Transactions Tax

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Short term trading is necessary to the functioning of European commercial banks and asset management firms. Given the importance of these institutions, it follows that a tax that restrains all such trading would undermine the European financial system's ability to service the real economy. It is better to allow financial institutions to perform their functions unhindered and tax any excessive profits made out of the performance of those functions.

Key words: European Commission; financial transactions tax; financial activities tax

1. Introduction

In late September, 2011, the European Commission proposed that a Financial Transactions Tax (FTT) be the preferred method by which European governments should tax their financial systems to recoup some of the losses incurred in the financial crisis of 2007-08.[1] Although the Commission's staff also studied the merits of a Financial Activities Tax (FAT), which is a tax on the profits and wages of financial institutions rather than a tax on transactions in the financial markets, the EC finally decided in favour of the FTT on the grounds that it would both generate revenue for governments and help to stabilize the financial markets by curbing trading volumes. In making this proposal, the Commission effectively made clear its endorsement of the premise that as all short term trading is purely speculative it can only be central to the functions of institutions that are peripheral to the financial system and only peripheral to the functions of institutions that are central to the system.

This paper contests the above premise. While it accepts that some short term trading in the money and capital markets is speculative and thus potentially destabilizing, it also argues that other parts of short term trading are necessary to the day-to-day activities of commercial banks and asset management firms. In view of the importance of commercial banks and institutional asset managers to the European financial system, it follows that the introduction of a European FTT that indiscriminately restrains all short term trading would bring about a result that is the very opposite of that intended by the Commission. Rather than enhance the ability of the European financial system to service the real economy in a stable and cost efficient manner, the proposed tax would on the contrary severely undermine that ability. The conclusion drawn here is that it would be far better to allow important financial institutions to perform their functions unhindered and then tax any excessive profits made out of the performance of those functions.

The structure of this paper is as follows. Section two reviews the reasons behind the Commission's choice of a transactions tax. Section three focuses on the effects of a capital market FTT on European asset managers. Section four focuses on the effects of a money market FTT on European banks. Section five looks at some implications. Section six concludes.

2. The Rationale for a European FTT

As a result of the extensive damage to domestic economies and public finances wrought by the financial crisis,

a number of European governments introduced special tax measures aimed at repairing the state's fiscal position and making the financial sector bear some of the costs of the crisis. Fearing that the lack of coordination of these national measures could fragment the European internal market for financial services, the European Council and the European Parliament called upon the European Commission to prepare a proposal for a common approach to taxing the financial sector[2]. In response to these calls the Commission authorised several studies that compared the relative advantages of two major types of tax instrument, the Financial Activities Tax that would be levied on the value added by financial institutions and the Financial Transactions Tax that would target trading activity in the financial markets[3]. Although at one point it looked as though the FAT would be favoured[4], the Commission finally decided in favour of the FTT on the grounds that not only would this tax be marginally more effective in achieving the revenue raising objective but also that it alone would be able to achieve the second major objective of „*limiting undesirable behaviour and thus stabilizing markets*" (EC 2011b, 3). Central to this conclusion is the identification of 'undesirable behaviour' with 'trading behaviour': while the FTT would have a directly negative impact on trading volumes by raising the cost of financial transactions, the FAT would have no equivalent impact. As the Commission's Impact Assessment states: „*The FAT does not have a direct impact on the trading behaviour in financial markets*" (EC 2011, 6)

The controversy that has followed the proposal for a European financial transactions tax has centred on two broad issues, feasibility and desirability. The strong objections to the FTT voiced by some European governments have served to highlight the risk that if Europe proceeds with the FTT without any global agreement to implement the tax a substantial proportion of financial trades currently conducted in Europe will be redirected to untaxed jurisdictions and markets. In an earlier working paper on financial sector taxation the Commission's staff conceded the point that if a transactions tax „*is not introduced on the global scale it has the potential to divert economic activity ..therefore... the tax has to be as comprehensive as possible*" (EC 2010). Although the required level of agreement for a global FTT has yet to materialise, the Commission has nevertheless decided to change its position and press ahead with a European FTT on the grounds that if a transactions tax is the best possible method of taxing the financial sector in the post-crisis period then everything should be done to win international agreement for the tax.

The Commission is right to rest its case for the FTT on a matter of principle rather than on considerations of expediency. However, its argument raises the question of whether the FTT is in fact the most effective method of taxing the financial sector. Recall the Commission's claim that the FTT's advantage over the FAT is that it can achieve two objectives simultaneously: market stabilisation in addition to revenue generation. The central idea behind this claim is that there is a positive correlation between trading volume and price volatility: by reducing the volume of short term trading the FTT can help to reduce price volatility, which must in turn help to promote the informational efficiency of the financial markets. As the Commission's Impact Assessment study asserts: „*The aspects of dealing with risk and behavioural aspects of the FTT relate to the possibility of the FTT to curb speculation, noise trading and technical trade, and to decrease market volatility*" (EC 2010, 10). The problem with this assertion is that it does not receive unambiguous support either from the empirical evidence or from economic theory. As concerns the former, some studies show a close correlation between trading volume and price volatility, but others show no such correlation. As concerns the latter, while some economists argue that excessive trading can cause price volatility, others put the contrary argument that too little trading can cause prices to be more volatile than usual because of 'market thinning'[5].

In sum, the Commission's case for the FTT is not a powerful, and certainly not a unanimous one. However, if the Commission persists with this tax policy this is in large part because the standard arguments against the FTT also lack sufficient power[6]. Whatever the differences between the critics and supporters of the FTT regarding the merits of speculative trading, both sides in the debate essentially agree that most short term trades are speculative in nature. This consensus explains why all current assessments of the costs and benefits of the FTT only focus on its impact on financial market stability that is transmitted via its impact on *financial prices* while largely ignoring the impact on stability that is transmitted via its impact on *financial institutions, or through dampened liquidity*. This paper takes a different position. While it may be that a significant amount of short term trading is speculative, it is also the case that an equally significant amount has nothing to do with speculation and instead forms an indispensable part of the daily operations of major institutions such as pension and mutual funds on the one hand and the commercial banks on the other. It thus follows that any complete assessment of the costs and benefits of the FTT must also focus on its impact on these institutions.

3. Capital market taxes and the asset management function.

When one looks at recent trends in equity market trading one can understand why the Commission has singled out high frequency trading (HFT) for special attention when making its case for the FTT. As can be seen in figure 1, while trading volumes in the world's largest equity markets grew steadily between the early 1990s and the mid-2000s, there was a sharp upward spike in volumes after this point before they again fell after the financial crisis. There is no doubt that this upward spike was in large part caused by the advent of high frequency trading. Although the electronification of securities trading dates from the early 1970s with the formation of NASDAQ in the US, it was not until the 1990s that securities trading in the EU area began to grow in fully automated exchanges and it is not until the mid-2000s that HFT became established as a significant proportion of automated trading (Gomber et.al., 2011).

Two concessions are made here. First, that HFT is purely speculative in nature as can be seen from the list of its defining characteristics presented in the bottom right box in figure 2, and, second, that the imposition of the FTT will certainly help to curb HFT. However, we also ask two questions that are never raised by the Commission. The first is what is the percentage share of high frequency trading out of all automated trading? The commission's proposal for the FTT gives the impression that HFT is the dominant form of automated trading, but while this may be true in the US where current estimates are that HFT account for 50 to 55% of all automated trading. The remainder is comprised of algorithmic trading. The estimates for the EU are that algorithmic trading continues to account for the majority share of automated trading, 70 to 75% (Valiante and Lanoo, 2011, p.36).

Figure 2 Algorithmic versus High Frequency Trading

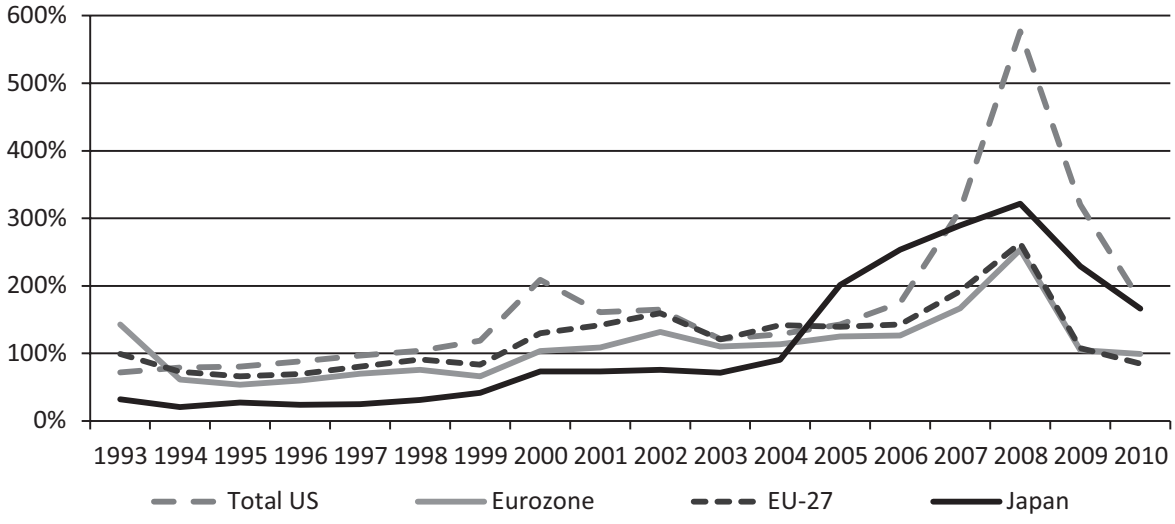
Common for HFT and AT
1) Pre-designed trading decisions
2) Used by professional traders
3) Observing market data in real-time
4) Automated order submission
5) Automated order management
6) Without human intervention
7) Use of direct markets access

Specific for AT excl. HFT	Specific for HFT
1) Agent trading	1) Very high number of orders
2) Minimise market impact (large orders)	2) Rapid order cancellation
3) Goal is to achieve a particular benchmark	3) Proprietary trading
4) Holding periods: days/weeks/months	4) Profit from buying and selling
5) Working order through time and across markets	5) No signification position at day's end
	6) Very short holding periods
	7) Extracting very low margins per trade
	8) Low latency requirement
	9) Use of co-location
	10) Focus on high liquid instruments

Source: Gomber et.al. (2011)

The second question is who are the agents engaging in algorithmic and high frequency trading respectively? The fact that the Commission singles out HFT for special mention when discussing automated trading may give the impression that its other important subset, algorithmic trading, is not all that different from HFT either in terms

Figure 1 Share Trading % of Domestic Market Capitalisation



Source: ECMI (2011)

of the trading players involved or in terms of the central trading purpose. This impression is wrong. While algorithmic and HFT have several common characteristics by virtue of being subsets of automated trading (as shown in the top half of figure 2) the differences between these two subsets are more important because they relate to two contrasting types of financial function performed by two contrasting types of financial institution. Where HFT is speculative trading conducted primarily by hedge funds and other proprietary trading vehicles, algorithmic trading is portfolio trading conducted by institutional asset managers and in particular by mutual funds. As the latter have a fairly long history one may well wonder why it is relatively recently that they have begun to use algorithmic forms of trading on so comprehensive a scale. The answer lies in the new pressures on fund managers as much as in technological advances. Algorithmic trading, like HFT, is a recent phenomenon, but while new computerised techniques have enabled its development, structural changes in the fund management industry have been its chief motivation.

It is a general rule that whenever an industry grows in scale there is a corresponding shift towards more standardized forms of provision in order to accommodate increased demands while containing costs. The fund management industry is no exception. In place of the broad based and discretionally managed portfolio that was previously the norm, what is now more typical is the narrow portfolio managed to a particular investment target. Indexation strategies are at the heart of the new approach to fund management, for it is by taking a market or sub-market index as a benchmark, while varying tracking error limits, that a portfolio can assume the form of a standardized product carrying a specified set of risk-return characteristics. The advantages arising out of the separation and narrowing of portfolios are two-fold: on the one hand there is better 'risk-conservation' as each additional unit of risk is matched more closely to a corresponding additional unit of return; on the other hand there is a more accurate measure of managerial performance because it may be easier to assess this performance and avoid confusing high returns based on risk from those which reflect superior knowledge and judgement.

The rise in algorithmic trading closely ties in with the increasing standardization of fund management because it helps managers to resolve a trading dilemma that has become particularly acute with this development. On the one hand trading for portfolio balancing purposes has greatly intensified: where trading was previously an exogenous activity in that while required to set up a portfolio it was not subsequently necessary to the latter's maintenance, trading has now become an endogenous activity, necessary for keeping a portfolio to a specified investment target. Algorithmic trading facilitates this need for constant portfolio rebalancing by helping to speed up the execution of institutional orders. On the other hand, trading can be very costly even while it is unavoidable: the trading of large institutional orders can cause price disturbances that then create opportunities for poachers to front-run the orders and thereby raise trading costs. Institutional investors have traditionally sought to minimize the price impact of their trades by slicing large 'parent' orders into many smaller 'child' orders that are then fed through the exchanges. Algorithmic trading facilitates this price impact minimization by helping managers to determine how best to slice large orders into smaller orders and where best to execute these orders.

In sum, algorithmic trading is 'portfolio-serving', trading to keep a portfolio to its benchmark, in contrast to high frequency trading that is 'self-serving', trading purely aimed at making a profit. However, a further important thing to note here is that HFT is not only fundamentally antithetical to algorithmic trading but is also parasitic on the latter. Where institutional asset managers typically engage in algorithmic trading to avoid price volatility and thus avoid giving profitable opportunities to poachers, the hedge funds and other speculative vehicles on the contrary are the poachers and engage in HFT precisely in order to feed off any price volatility caused by institutional trading. This is why HFT concentrates on large cap liquid securities, those that dominate the indexes used by the mutual and pension funds as their benchmarks, and this is why hedge funds place their computers in close proximity to those used by the mutual funds in the major trading venues (a practice known as 'co-location').

The upshot of the above discussion is that the imposition of the FTT in the secondary equity markets would be self defeating. The tax would certainly succeed in curbing HFT but in doing so it will also harm algorithmic trading on which HFT is parasitic. To use an analogy, it is like giving a pet dog that has fleas so strong a medicine that it also kills the dog: effective for the fleas but pointless overall. It could of course be argued that this negative side effect may be a price worth paying if HFT volumes can be significantly reduced. However, this argument would only hold if the current trends in portfolio management that give rise to algorithmic trading as an indispensable activity were themselves not an irreversible aspect of the contemporary European financial landscape. The reality is that they are. The greater the pressures on government finances, which have been further severely stretched by the financial crisis, the greater are the government incentives to force increasing numbers of middle and higher

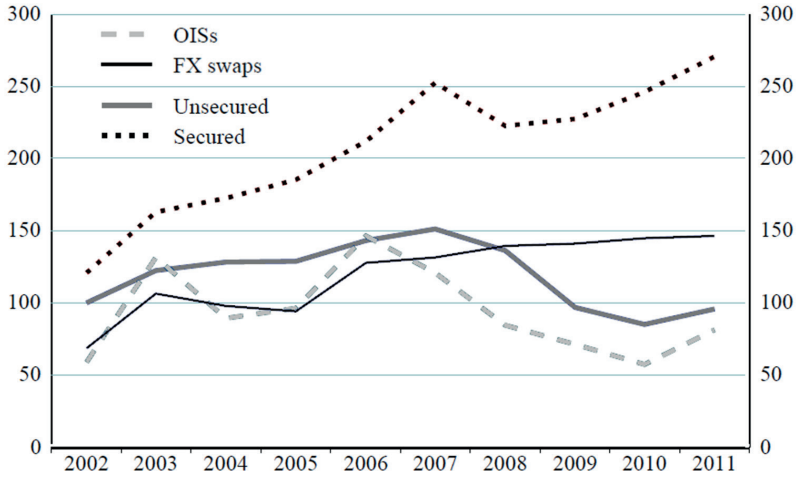
income households to make their own arrangements for supplementary pension and other welfare provision. The greater the drive towards welfare arrangements focussed on protecting lower-income groups and moving them towards median positions, the greater will be the corresponding demands made upon the asset management industry and the greater therefore is this industry's drive towards standardization as a means of coping with these demands. Thus algorithmic trading is set to continue to expand in importance given the ongoing shift towards the standardization asset management and given the endogeneity of trading to portfolios that track market indexes.

4. Money market taxes and the banking function.

Trading volumes in the money markets, like those in the capital markets, have in recent decades grown at rates far in excess of what can be meaningfully explained in terms of real sector activities for which reason the Commission has proposed to bring all money market instruments under the scope of the FTT. In our view, this proposal is wrong because the growth of money market trading has principally been powered by inter-bank transactions that have been linked to the pressures on the banking function emanating from the securities markets. The rapid development and international integration of the money markets is a direct consequence of the increased role of institutional investors and the accompanying shift away from classical bank intermediation towards greater use of the security markets. This shift is not going to be reversed. On the one hand such a move would fragment financial systems at a time when economic systems are increasingly integrated. On the other hand, tighter regulatory constraints on banks will require them to reduce their use of leverage and this in turn will mean that they hold fewer long-term assets and make more use of securitisation. The higher capital ratios to which the banking system is moving are already making it more advantageous to distribute loans via the security markets and disadvantageous to hold them to maturity. Thus large banks and security markets will continue to function in symbiosis, with the banks performing many functions tied to the security markets and especially supplying the transactions balances needed by the agents trading securities. The money market is a key point of tension in this function because of „the paradox of disintermediation"[7]: money is less and less held as an asset but is increasingly needed as a means of exchange to support the growing volume of security trading. The money market resolves the paradox by accelerating interbank transactions to an astonishing degree: huge sums are transferred from bank to bank at enormous speed and at very low cost.

Inter-bank transactions essentially take two forms: unsecured (i.e no use of backing collateral) and secured (i.e use of backing collateral). As unsecured borrowing involves more risk to lenders, this is typically confined to the very shortest of time spans. This said, it should be noted that after the recent financial crisis where the trust between banks has become more fragile, the proportion of unsecured borrowing and lending activity has fallen in favour of securitised forms of activity (see figure 3). The principal form of securitised borrowing is the repo: the sale of collateral such as government bonds for cash, and the repurchase of these same bonds with cash. Now it is

Figure 3 Average daily turnover in various money market segments (index: unsecured transaction volume in 2002 = 100)



Source: ECB (2011)

proposed to apply the FTT to repos on the grounds that a) they are 'transactions' inasmuch as they involve the sale and purchase of securities and b) these transactions are typically short term and hence presumably speculative in nature. This is illogical. Not only did the inter-bank money market break down during the crisis but there also subsequently occurred an even deeper and more comprehensive breakdown in Europe as a consequence of the sovereign debt crisis. This impairment of the money market can only be aggravated by the proposed tax on repo transactions. The suggested rate of 10 basis points is much greater than the interest charged on most repos because they are short-run credits meant only to finance rapidly executed portfolio changes. In consequence the inter-bank market would be seriously attenuated, and security markets affected by the reduced availability and increased cost of transactions balances. Since, as was argued in section 3, much of the trading in securities markets is economically functional and since increased constraints on the banks will make economies more dependent on these markets, the application of the FTT to inter-bank loans is likely to be economically damaging.

The illogicality in the Commission's position is further compounded by the fact that it does not intend to extend the FTT to cover foreign exchange swaps. These foreign exchange (FX) instruments, which combine spot FX transactions with outright forward transactions, account for about 50% of all daily FX trading that is now in the region of $5 trillion. The major users of FX swaps are the dealing banks, and one main motivation is that these instruments represent a cheap, because collateralised, form of borrowing a foreign currency; thus when a eurozone bank wants to borrow dollars short term, it is cheaper to do so through an FX swap, selling euros for dollars in a spot transaction and repurchasing the euros with dollars in the reverse forward transaction. However, a more important reason why banks use FX swaps is that these serve as an alternative type of repo: a Eurozone bank wanting to borrow euros can either engage in a straightforward repo transaction – using government bonds as collateral – or in an FX swap – selling dollars for euros and then repurchasing the dollars with euros, the point here being that dollars not government securities act as the collateral.

Now there is already a perceived tendency to supplement ordinary repo transactions with FX swaps on the part of eurozone banks because of the increasing shortage of good quality government bonds to serve as collateral. Following the introduction of euro, the world's investors did for a time treat all Eurozone government bonds as a more or less homogenous class because of the elimination of currency risk, a development that became manifest in the narrowing of government yield spreads. With the advent of the sovereign debt crisis and the consequent rise in credit risk considerations in the minds of bond investors these yield spreads have again widened as the Eurozone government bond market again fragmented into heterogeneous groups. Among the best quality government bonds are those of the German government but these are in short supply due to the heavy pressure of demand from investors seeking a safe haven (according to a recent survey on the European repo market (ICMA, 2012), the share of German government bonds as collateral in repo transactions fell from 22.4% in June 2011 to 20.7% in June 2012). As a result, the Eurozone banks have had to find alternative assets to use as collateral, including the US dollar. A measure of the extent to which these banks rely on FX swaps less for currency related than for repo type borrowings is indicated by the unusually high ratio of inter-dealer FX transactions in the euro area: 64% (67% for FX swaps) as compared with a rest of the world average of 39% (ECB, 2010).

Given that the Commission proposes to tax repos but not FX swaps, the use of these instruments as alternative credit transactions to the repo will increase further, thus boosting the already large FX swap daily volume. This is ironic because the original Tobin tax that gave inspiration to all subsequent financial transaction tax proposals was specifically directed at FX transactions but here we have a situation where the Commission's imposition of the FTT on ordinary repos will help to swell FX transactions by conferring a tax advantage on them. It was because they recognised this anomaly that members of the European Parliament voted in May 2012 to bring 'currency spot transactions' under the scope of the FTT[8]. However, the fact that the European Parliament did not vote to also bring FX swaps (or outright forward currency transactions) under the scope of the FTT only served to further highlight the inconsistency in the Commission's proposal to tax one form of collateral (repos) but not another (US dollars). This inconsistency is the most worrying feature of the FTT and is likely to make it unworkable as an EU strategy because it would both further undermine the liquidity of euro-denominated bond markets and make the liquidity of the European banking system completely dependent on credit conditions in the US.

A final important observation to make here is that the weakening of the inter-bank money market also has serious implications for the implementation of monetary policy. Monetary policy today relies on the existence of an integrated money market, which gives the central bank's actions in that market macroeconomic significance. This is one reason the ECB is trying to end the exclusion of banking systems in the periphery from the money mar-

ket – until it does so the transmission of monetary policy decisions will be partial and uneven. Indeed, if integral money markets cannot be restored then monetary policy will be ineffective. In the first instance the central bank will have to engage in separate negotiations with each fraction of the divided market and have to judge what the effect of this multiplicity of individual interventions will be. Furthermore, the efficacy of monetary policy depends on the existence of an elastic supply of credit; monetary policy affects the terms on which that credit is issued. If banks and other financial corporations find that credit is not available, then they will accumulate big money balances to reduce the risk of not being able to carry out their desired transactions. Once financial agents have insulated themselves from the credit system in this way they have also insulated themselves against central bank actions – since they are not making use of the money market, changes in money market conditions have no clear impact on their own strategies.

5. Policy Implications

As the economic rationale for the FTT is extremely weak, it follows that the rationale for the tax has ultimately to rest on political considerations. The key political problem is the conflict between strong popular demands for a tax on banks and the equally strong opposition to any form of bank taxation mounted by the banks themselves. The Commission appears to have decided that the FTT represents the most judicious way of resolving this conflict because on the one side it has become fixed in popular opinion through its association with the Tobin tax and because on the other this tax represents less of a threat to banks' interests as compared with a FAT. This is not only because the FAT is a direct tax on bank profits unlike the FTT that taxes trading activities that only form part of the source of profits. It is also because the FAT can be focussed on specific institutions unlike the FTT that indiscriminately affects all types of institution engaging in the transactions that are subject to this tax. The banks, as explained, may be the institutions most affected by a FTT in the money markets, but in the capital markets where it is the large fund managers who do most of the trading it is these non-bank institutions that will be most affected. In the end, the banks prefer the FTT as the least threatening form of taxation because they know that it will be eventually repealed not only because of the refusal of some national authorities to implement the tax but also because of the strong objections to it that are raised by the European fund management industry on account of its negative impact on portfolio rebalancing transactions. Aside from this point, there are two further reasons why the mutual fund and insurance company sectors will raise strong objections to the FTT.

The first is that the fund management sector neither caused the financial crisis nor benefitted from any of the government financial assistance that was given in the aftermath of the crisis. While certain non-bank financial institutions, notably the hedge funds, may have been to some extent complicit in precipitating the subprime crisis that subsequently mutated into a full blown financial crisis, the pension and mutual fund sector could reasonably argue that their role in that initial crisis was more that of the victim than that of the perpetrator. The second reason for this sector's opposition to the FTT is that short term trading was not a root cause of the last financial crisis and thus its curtailment will not necessarily help to prevent a future financial crisis. The Commission argues that the FTT would „*complement regulatory measures aimed at avoiding future crises*" (2011a, 2) but the fact is that trading played no major role in the last financial crisis. The products at the epicentre of the initial subprime phase of the crisis were collateralised debt obligations (CDOs), credit instruments that were so complex and opaque in structure that they could not be easily traded and priced according to any market standard. Indeed, it was precisely because they were difficult to price and consequently difficult to trade that these products helped to precipitate the breakdown in trust between banks that in turn caused the money and interbank markets to freeze up completely in August, 2007. In this second phase of the financial crisis, trading was again to play no major role. Rather, that role belonged to the huge asset-liability mismatches of the bank owned conduits and structured investment vehicles (SIVs). Thus while it was indeed the case that the 'particularly risky behaviour' on the part of the banks and other segments of the financial markets was a root cause of the financial crisis, that risky behaviour had less to do with financial trading than with excessive leverage and capital inadequacy.

The above observations mean that the Commission's logic behind its choice of the FTT as the preferred means of taxing the European financial sector can be stood on its head. If the intention behind a European financial tax is not only to force financial institutions to bear some of the costs of the last financial crisis but also to force changes in their behaviour so as to prevent a future financial crisis then it is not the FTT but the FAT that is superior. The explanation is clear. If it is the prospect of distributing huge financial profits in the form of generous salaries and bonuses that is the chief motivation for excessive leverage and other types of excessive risk taking in the financial sector, then it must follow that the most effective way of

dealing with this problem is to tax financial profits before they can be distributed.

Conclusion

There is a widely held view that as long as the banks are taxed to help repay some of the vast sums of taxpayers' money they have absorbed since the crisis, it does not really matter what type of tax policy is applied. This paper has argued that it does matter enormously what sort of tax or revenue arrangements are applied to finance. Apply the wrong tax and the objective of getting the banking sector to shoulder its part of the post-crisis financial burden will ultimately fail. While the analysis developed here suggests that the challenges of seeking some share in the wealth created and transmitted through financial markets (especially in the wake of the large amounts of national wealth pledged to bail out banks and some financial institutions) is not adequately captured by the current focus, the better tax is the financial activities tax because the better strategy for raising public revenues is to tax the immense private fortunes that have been accumulated by the very same abuse of financial and corporate power that has rendered democratic governments insolvent. It is hard to deny that a FAT would perform this necessary redistributive function far more effectively than a FTT.

Notes

1. Council directive on a common system of financial transaction tax and amending Directive 2008/7/EC; Commission Staff Working Paper (28.9.2011);, Executive Summary of the Impact Assessment (accompanying Directive on a common system of financial transaction tax (28.9.2011).
2. Council of the European Union, 17 June, 2010; Resolution of the European Parliament, March 10, 2010.
3. EU Commission staff working document, Innovative Financing at a Global Level, (1 April, 2010a); EU Commission staff working document, Taxation of the Financial Sector, (7 October, 2010b).
4. See in particular the EU Commission staff working document, Innovative Financing at a Global Level.
5. See e.g. the report to the European Parliament by Kern Alexander et.al. (European Parliament, 2010, p31).
6. See IMF, 2010, pp.17-20, for a list of objections to the FTT. For a critique of each of these objections to the FTT see Schulmeister, 2011.
7. Grahl and Lysandrou, 2003.
8. European Parliament, Legislative proposal to implement enhanced cooperation in the area of financial transactions tax (FTT), February, 2013.

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BØGER

BOGANMELDELSER

Nye politiske relationer i Europa og verdenssamfundet?

Rebecca Adler-Nissen & Ulrik Pram Gad (red.), 2013
European integration and Postcolonial Sovereignty Games. The EU Overseas Countries and Territories
Routledge, Abingdon
272 sider, 969,95 kr.

Denne bog er udkommet som nummer 52 i en serie udgivet på Routledge med titlen *„The New International Relations"*. Seriens titel og de mange udgivelser i serien kunne tyde på, at der må være behov for at gentænke „internationale relationer" som vidensfelt.

Den amerikanske professor i retshistorie, og tidligere Sovjet-forsker, Harold Berman foreslog i en lille artikel i 1995 i Fordham International Law Journal, at man udskiftede begrebet „international ret" med „verdensret", „world law". Han skriver, at man efter anden verdenskrig begyndte at lede efter nye betegnelser, der kunne bruges til at kategorisere retsområder, som overskred „mutual transactions between sovereigns as such". Berman mente, at vi befinder os i en ny æra, som han kaldte „emerging world society". Han mente, at det rette navn for reguleringen i denne æra var „verdensret" som et bredere begreb, der kunne omfatte aktiviteter som handel, finansielle transaktioner, sport og sundhed praktiseret af fx virksomheder og organisationer.

Berman konstaterede, at denne ændrede virkelighed ikke var slået igennem i retsvidenskaben, og det gælder utvivlsomt også for de „internationale relationer", der ligesom jura og **stats**kundskab i lang tid har haft blikket stift rettet mod staten.

Serieredaktøren, Iver B. Neumann, skriver i sit korte forord, at „Good studies of liminals always tell us something about the main categories." Det er en god og fyndig beskrivelse. Bogen er et både interessant og anbefalelsesværdigt studie af nogle af de globale og europæiske udviklinger, der understreger behovet for at fokusere på „nye", mindre statscentrerede relationer og udvikle adækvate begreber til at beskrive tidens organiseringer af politisk samliv. Den har en ny og frugtbar synsvinkel, og den bærer præg af forfattergruppens indsigt og veloplagte engagement.

Den fokuserer på EU og EU's integrationsprocesser, på oversøiske lande og territorier (OCT) med tilknytning til EU via deres metropolstater, og på de „sen-suveræne" relationer og post-koloniale „suverænitetsspil", som karakteriserer disse relationer.

For EU's vedkommende er der tale om det EU, der i det 21. århundrede er blevet udvidet med små og større suveræne stater især fra Centraleuropa, der „frivilligt" har tilsluttet sig unionen.

OCT-enhederne beskrives som unikke „postkoloniale, mikro-, potentielt suveræne *polities*/enheder.". Bogen indeholder 9 case-studier, der alle identificeres i forhold til det *hav*, de befinder sig i: *Det Caribiske Hav* (Cayman Islands, British Virgin Island, Hollandsk Caribien), *Stillehavet* (Fransk Polynesien, Ny Caledonien), *Det Indiske Ocean* (Mayotte) og *Nordatlanten* (Grønland). De ni områder har haft kolonirelationer til Storbritannien, Frankrig, Holland og Danmark og har fortsat relationer til disse lande. Ud fra serieredaktørens beskrivelse er de marginale geografisk, socialt og politisk – og det gælder utvivlsomt i forhold til metropolstaterne og EU. Om det også gælder i forhold til andre verdensdele og samfund er måske diskutabelt.

Disse enheder befinder sig i et verdenssamfund af global og gensidig afhængighed, som de forsøger at få mest muligt ud af. Heri udøver de en del af de „suverænitetsspil", der er bogens teoretiske omdrejningspunkt.

Begrebet suverænitetsspil er inspireret af Wittgensteins diskussion af „sprogspil". Wittgenstein afviste tanken om, at sprog havde en direkte forbindelse til virkeligheden og taler om familier af begreber, og begreber der kan være meningsfulde uden at være klart definerede.

Redaktørerne definerer i introduktionen et suverænitetsspil på følgende måde: Et suverænitetsspil involverer to eller flere spillere, som i deres interaktion fremsætter strategiske krav om autoritet og ansvar med reference til et traditionelt „enten/eller" begreb om suverænitet. (s.10)

Der er altså tale om strategiske krav og strategiske referencer til suverænitet fra spillerne, og det er disse processer, de ni case-studier illustrerer.

Etableringen og udviklingen af EU har i sig selv stillet stadig flere spørgsmålstegn ved forestillingerne om det traditionelle, statsfikserede suverænitetsbegreb. De postkoloniale suverænitetsspil drejer sig om, hvorvidt en af parterne i spillet overhovedet kan betragtes som

en part. I OCT-relationerne drejer spillet sig imidlertid ikke (nødvendigvis) om opnåelse af suverænitet. Her kan man netop stille selvstændige krav om at give afkald på uafhængighed.

Denne strategiske tilgang er både paradoksal og realistisk, eftersom det politiske liv generelt i dag er baseret på gensidig afhængighed som en grundlæggende betingelse. Er stater uafhængige, fordi de kalder sig og har 'ret' til at kalde sig stater? I en verden med næsten 200 stater af uhyre forskellig størrelse er der måske behov for en differentiering af de politiske begreber inklusive statsbegrebet.

Bogen indeholder ud over redaktørernes introduktion tre meget læseværdige almene, teoretiske artikler om *Postcolonial sovereignty: experimentation with statehood and self-determination* (S.N. Grovogui), *Late sovereinty in post-integration Europe: continuity and change in a constitute concept* (Cormac Mac Amhlaigh) og *The micropolity sovereignty experience: decolonizing, but not disengaging* (Godfrey Baldacchino).

Grovogui beskriver bl.a. historiske „multiple regimes of sovereignty". Suverænitet, kan historisk nærmest forstås som autoritet, guddommelig, sekulær og lokal (Det Hellige Romerske Imperium, Hansestæderne, de italienske bystater). Suverænitet må forstås i kontekst, og det gælder også den post-koloniale suverænitet, der bl.a. vedrører symbolske og materielle ressourcer. „Sovereignty takes form through multiple, complex, and differentiated institutions that congeal into formal and informal regimes of authority and practices." (s. 37) Suverænitet reflekterer historiske fordelinger af magt og subjektivitet i den internationale orden og deres modsvarende symbolske og materielle økonomier.

Mac Amhlaigh understreger også *udviklingen* af suverænitet og ser den som en form for *normativ diskurs*, der bl.a. skifter fra at tale om „høj suverænitet" til „sen suverænitet". I den sidste af de to betyder autonomi fx ikke territorial eksklusivitet. Staternes hegemoni udfordres, antallet af deltagere udvides og inkluderer politiske enheder, der som EU ikke passer til den klassiske statsmodel.

„… late sovereignty can be said to relate to an *institutional plausible claim* (X) to ultimate authority over a specific functional domain (Y) in the context of a multilevel political discourse." (s. 43)

Mac Amlaigh mener, at sen-suverænitetsspilsparadigmet kan åbne muligheder for OCT-enhederne i en EU-kontekst for at stille sen-suveræne krav om (overtagelse af) forskellige funktioner, uden at det resulterer i uafhængighed og dermed i risikoen for at blive opgivet af metropolstaten – hvad der kunne blive et uundgåeligt resultat af at stille høj-suveræne krav. Sen-suverænitetsspillet udvider repertoiret for OCT-enhederne, så de kan undgå „the undesired goal of independence". (s. 47)

Baldacchino viderefører denne tanke, når han skriver, at „In the contemporary world, there may be solid definitive advantages in *not* being independent", selvom den værdiladede mainstream political science-diskurs er udtryk for „an enduring obsession with the mantra of sovereignty". (s. 53) Små, autonome territorier kan udnytte deres jurisdiktion strategisk som en ressource, men det behøver ikke at være sammenfaldende med uafhængighed og suverænitet. Ikke-suverænitet behøver ikke at betyde afmagt, selvom det har været den dominerende opfattelse i moderniteten og det meste af afkoloniseringsperioden. Og små stater behøver ikke at være svage, sårbare og uberegnelige. Selvom der er en tendens til at betragte „store stater" som normale, så er der en mere optimistisk tilgang til de små politiske enheder (polities). Den mindre størrelse kan give en fleksibilitet og tilpasningsmulighed, som større stater ikke har.

„The undercurrent leitmotifs here are self-reliance, authenticity, self-management, popular democratic participation, and a plausible reaction against mass anonymity and insignificant peripherality." (s. 58)

Dette synspunkt understøttes måske af, at en del af OCT-enhederne faktisk har en højere gennemsnitsindkomst end de nye EU-medlemsstater. Samspillet med (metropolstaten og) andre enheder og fleksibiliteten gør tilsyneladende uafhængighed til en mindre betydningsfuld værdi i senmoderniteten end i moderniteten. Der er derfor behov for en omtænkning af ældre begreber om suverænitet og af det internationale statssystem i en periode af meget kompleks global, politisk og juridisk geometri.

Uligheden mellem parterne i dette senmoderne landskab får OCT'erne til at foretrække en post-kolonial selvrepræsentation i forhold til EU og til at insistere på videreførelse af en „asymmetrisk afhængighedsrelation", skriver Ida Hannibal, Kristine Holst og Gad og Adler-Nissen i en artikel om EU og OCT'erne (s. 78). Retorikken har i det sidste årti været præget af „partnerskabsbegrebet", uanset om partnerne har været af meget forskellig størrelse. OCT'erne fremstilles – og fremstiller muligvis også strategisk sig selv – som havende meget begrænsede ressourcer og benytter deres privilegerede tilgang til både metropolstater og EU – som til forfatternes forbavselse fungerer både tæt og relativt ukontroversielt. Kommissionen betragtes/fremstilles ofte som monolitisk af OCT'erne. De fremstiller til en vis grad sig selv som en del af den „europæiske familie" (som man ikke lige uden videre kan blive smidt ud af), og som dem der spreder „europæiske værdier" rundt omkring i verden(shavene).

For mange vil det være disse første knap hundrede sider af bogen, der indeholder mere generelle artikler nok være det, man hurtigst vender sig imod som læser. De underbygger i sig selv bogens argument om relevansen

og værdien af at beskæftige sig med postkoloniale suverænitetsspil.

Som anmelder har jeg dog haft fornøjelsen af at læse alle bogens artikler, og det har været en særdeles informativ og interessant læsning.

Ikke mindst beskrivelsen af de britiske oversøiske territorier; især Cayman Islands og British Virgin Islands giver et sjældent og uhyre interessant indblik i disse små enheders udnyttelse af globaliseringsæraens behov og muligheder for at udvikle, hvad jeg vil kalde, „skræddersyede retsforhold". Artiklerne giver et billede af den historiske udvikling af „Euromarkedet" efter 1957, den specielle juridiske status for City of London og dens samarbejde med disse OCT'er, Storbritanniens fortsatte juridiske magt over dem og EU's og G20 og G8s interesser i at kontrollere skattely. Meget intrikate og interessante relationer.

Beskrivelsen af de franske OCT'er er ikke mindst historien om varetagelsen af geostrategiske interesser og spredningen og sikringen af „europæiske værdier". Det „hjemlige" nordatlantiske, grønlandske eksempel sættes i et nyt og interessant lys i denne sammenhæng.

Denne bog er sjældent inspirerende læsning, og den giver et nyt og meget nyttigt indblik i nogle af de praktiske, komplekse relationer af politisk, retlig, økonomisk og social art, som kendetegner den postkoloniale verden i det 21. århundrede. Der er mange faggrupper, der vil kunne få fornøjelse af den.

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Hjælper vi?

Ole Winckler Andersen, Eva Broegaard og Jens Kovsted, 2012

Hjælper vi? En Introduktion til Evaluering af Udviklingsbistand
København, Jurist- og Økonomforbundets Forlag
224 sider, 345 kr.

Udviklingsbistand er de senere år kommet højere op på den politiske dagsorden og har hyppigere været i den offentlige debat. Der er blevet sat spørgsmålstegn ved, om bistanden overhovedet har en effekt, om den bidrager til at reducere fattigdom, og om ikke pengene bare forsvinder i korruption.

Der ligger dog ofte alt for høje ambitioner om, hvad bistanden kan på dette generelle niveau. For at vurdere, om vi hjælper, må man bevæge sig væk fra makroniveauet og se på de enkelte bistandsprogrammer for sig. „Hjælper vi?" giver en introduktion til netop dette; hvordan man vurderer, om de enkelte bistandsindsatser har haft en effekt. I en tid, hvor debatten ofte ender med at være delt i to lejre (for eller imod bistand), er bogen et velkomment bidrag til nuancering. Den er skrevet af tre forfattere, der med deres store erfaring inden for området har de bedste forudsætninger for at skrive en sådan introduktion, og der har været med til at gøre Danidas evalueringsenhed så anerkendt, som den er blandt andre donorer.

Formålet med „Hjælper vi?" er at give en introduktion til de metoder, der anvendes til evaluering af udviklingsbistand, og samtidig beskriver den, hvordan den kontekst, hvori evalueringer foretages, ændrer sig og bliver mere kompleks. „Hjælper vi?" er bygget op, så den først redegør for de forandringer, bistanden har været gennem i de senere år og for de forskellige bistandsmodaliteter, der anvendes. Herefter introducerer forfatterne en række centrale begreber inden for evaluering og de mest anvendte tilgange til evaluering af udviklingsbistand. Efter disse indledende og afklarende kapitler følger tre centrale kapitler, der fokuserer på henholdsvis de kvantitative, de kvalitative og de blandede metoder til evaluering af udviklingsbistand.

Formålet er ikke at undervise læseren i selve metoderne, men mere at fortælle om hvilke metoder der bliver brugt til at evaluere hvilke typer bistandsprogrammer – og hvorfor. Man skal altså ikke læse bogen for at lære metoden, men for, som forfatterne selv udtrykker det, „at blive i stand til at forholde sig kritisk til fortolkning og anvendelse af" metoderne. Kapitlet om de kvantitative metoder diskuterer eksempelvis udfordringerne ved dataindsamling og evaluatorens rolle i indsamlingen af data. Svarer folk helt oprigtigt i spørgeskemaundersøgelser, eller svarer de ud fra, hvad de tror vil passe evaluator bedst?

Kvantitative metoder er gode til mange ting, fx til at vurdere, om der går flere børn i skole, eller om en

indsats med myggenet har ført til et fald i dødeligheden af malaria. Kvantitative metoder kan, når de fungerer, isolere effekten af en bistandsindsats, fordi andre faktorer holdes konstante, men de har svært ved at dokumentere processer eller påpege udfordringer i implementeringen af en bistandsindsats. Her kommer de kvalitative metoder ind, og dette kapitel diskuterer udfordringer ved interviews, case-udvælgelse mm. Det introducerer også en række perspektiver på kvalitative evalueringsmetoder, som fx deltagerperspektivet, der understreger inddragelse af deltagere i projektet, der evalueres.

Blandede metoder, altså en kombination af kvantitative og kvalitative metoder, anvendes i stigende grad i evalueringer, og forfatterne helliger også et kapitel til dette. Kernen er, at de to metoder ikke er gensidigt udelukkende, men kan supplere hinanden på forskellige måder, og at denne erkendelse kan tænkes ind i selve evalueringens design. Fx kan kvalitative interviews bruges til at forklare, hvorfor den kvantitative del har vist, at der ingen effekt har været af et program; eller de kan forklare hvorfor, eller præcist hvad ved en indsats, der har haft en effekt.

Afslutningsvist bruger forfatterne et kapitel på at diskutere evalueringers anvendelse. Hvorfor bliver evalueringer ofte ikke brugt bedre, end de gør? Hvordan fortolkes evalueringerne af de forskellige interessenter? Og ikke mindst, hvordan påvirker det stigende antal aktører inden for og den stigende kompleksitet af udviklingsbistand evalueringers anvendelse? Kapitlet overvejer, hvorfor evalueringer ofte ikke har en høj kvalitet, og skitserer faktorer på både efterspørgsels- og udbudssiden, der kan påvirke evalueringers karakter. Gennem hele bogen er der i adskilte bokse eksempler fra konkrete bistandsprogrammer på nogle af de begreber og udfordringer, forfatterne skitserer.

Formålet med „Hjælper vi?“ er introducerende, og det formål opfyldes fint. Læseren bliver nemlig introduceret til en lang række begreber og eksisterende metoder samt overvejelser om, hvornår den ene metode kan bruges frem for den anden. Imidlertid kunne jeg som læser godt have ønsket mig en lidt anden vægtning: Lidt færre begreber og lidt mere plads til diskussion af udfordringer og dilemmaer i et evalueringsforløb. Forfatterne lægger forholdsvist meget vægt på, at vi stifter bekendtskab med begreber og metoder, men dette sker til en vis grad på bekostning af disse dybe og svære diskussioner. Nogle begreber, for eksempel output, outcome og impact, er helt centrale, og det er nødvendigt at få på plads, hvad forskellen mellem dem er. Andre begreber – som fx ordinal og nominal skalaniveau, eller gennemsnit, median og standardafvigelse – hører efter min mening bedre hjemme i en decideret metodebog. Visse oplistninger af definitioner kunne således have veget pladsen for de lidt sværere diskussioner om for eksempel interessenter og politisk økonomi, som berøres, men ikke behandles særlig dybt.

Forfatternes overvejelser om valg af metode er gode, og der er referencer til den væsentlige litteratur på området. I bund og grund må man, som vi lærer i samfundsvidenskaberne, vælge den metode, som bedst svarer på problemstillingen. Og problemstillingen er vel ofte givet af de, der bestiller evalueringen. I den forbindelse kunne man savne en dybere diskussion af, hvordan det bliver besluttet, hvad der skal evalueres, hvornår, og af hvem, og hvordan disse beslutninger påvirker metodevalg.

Selvom kvantitative metoder i stigende grad anvendes, findes der mange situationer, hvor disse metoder simpelthen kommer til kort. Det gælder især, når implementeringsprocesser skal evalueres. Denne pointe kommer frem i bogen, men man kunne godt savne en mere fyldig redegørelse for case-studier, valg af cases og ikke mindst den komparative metode, som kun kort berøres (s. 139-40). De forskellige måder at udvælge cases på opremses, men uddybes ikke tilstrækkeligt. De er heller ikke på samme niveau og kan derfor ikke sammenlignes. Sneboldsmetoden har eksempelvis mest at gøre med at vælge interviewpersoner, mens den kritiske case er en helt central måde at vælge en case (fx en implementeringsproces) på. Det er godt at forfatterne (i et senere kapitel) behandler potentialet i metaevalueringer. Dette indeholder også komparation, men der efter min vurdering et stort uudnyttet potentiale i at sammenligne relativt ens programmer på tværs af lande. Det kunne være en evaluering af støtte til menneskerettighedskommissioner i to-tre afrikanske lande eller støtte til landbrugsprogrammer på tværs af to eller flere lande. Her kunne man anvende tilnærmede „most different systems designs“ (maksimum varians-metoden som den kaldes i bogen) eller „most similar systems design“ (som slet ikke nævnes).

Forfatterne holder sig klogt væk fra debatten om, hvorvidt og hvordan man kan måle vækst og bistandens effekt på vækst. Det er også spørgsmålet, som indledningsvist nævnt, om man overhovedet kan forlange af ulandsbistanden, at den skal føre til vækst på nationalt niveau. Det er på for eksempel sektorniveau, man må vurdere indsatsers effekt. Forfatterne kunne dog måske godt have brugt lidt mere plads på at diskutere, hvorvidt man kan stole på statistikkerne om for eksempel BNP per indbygger; noget der indenfor de seneste år er skrevet en del om.

Eksemplerne i boksene er virkelig gode og brugbare i forhold til at illustrere de mere abstrakte begreber. Imidlertid kunne disse bokseksempler godt have været suppleret med en mere direkte eksemplificering i selve teksten også. Det kunne være en reference til forskellige fælles-

evalueringer i kapitlet om det stigende antal aktører og anvendelse af evalueringer eller debatten om den nylige store evaluering af Danmarks Afghanistan-bistand.

Det undrer, at der ikke er et indeks, for bogen kunne fungere glimrende som opslagsværk for dem, der leder efter definitioner på nogle af de centrale begreber inden for evaluering. Derudover skæmmes bogen af en række trykfejl, der nemt kunne have været undgået fra forlagets side.

Disse mindre savn til trods kan „Hjælper vi?" anbefales til alle studerende, forskere og praktikere, der interesserer sig for udviklingsbistand. Ud over at den i sig selv er både interessant og en god introduktion til evaluering, er bogens store styrke, at den viser, hvor kompleks bistanden er, og hvor svært det kan være at evaluere den. Den viser dog også, at vi er bedre klædt på til det end tidligere, og den fortæller om en række nye redskaber til formålet. Spørgsmålet om, hvorvidt vi rent faktisk hjælper, får vi ikke svar på, men vi får hjælp til bedre at kunne vurdere det.

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Abstracts

CREATING CREDIT AND RATING IT: NEW KIDS ON THE BLOCK IN POST CRISIS GLOBAL FINANCE

Grahame Thompson

This article examines the evolution of Central Bank (CB) activity since the financial crisis of 2007/8. The huge expansion of CBs balance sheets presents new problems of managing the unwinding of those positions as innovatory policies like quantitative easing are scaled back. This poses problems of institutional credibility and the resilience of CBs as the managers of financial systems and of sovereign debt. A consequence of these events has been a renewed focus on exactly how sovereign risks are assessed in the new era of central bank led capitalism. The article explores the institutional reaction by the traditional credit ratings agencies and a series of new organizations that are trying to muscle in on the credit ratings business with new metrics of calculation and credit risk assessment.

FINANCIAL DERIVATIVES: FISCAL WEAPONS OF MASS DESTRUCTION

Duncan Wigan

Contemporary derivatives mark the development of capital and constitute a novel form of ownership. In abstracting from the object of ownership, the underlying asset, derivatives sever direct material ties between the owner and property and, in doing, transform the capacities of ownership. This transformation is spatial, temporal and legal. This is significant for relations between borrowers and lenders, between the various participants in financial markets, and, indeed, for the overarching institutional fabric of the political economy. However, one relatively neglected aspect of the transformations manifest through derivatives is the relationship between the fiscal state and financial innovation. By reconfiguring the temporal, spatial and legal character of ownership derivatives present a substantive challenge to the tax collecting state. While fiscal systems are nationally bounded and inherently static, capital itself is unprecedentedly mobile, fluid and fungible. In these terms, financial derivatives not only challenge default conceptions of the offshore world in International Political Economy, which have predominantly focused on nationally variegated tax systems, but via abstraction reconfigure the materiality of contemporary capitalism.

ELSEWHERE, IDEALLY NOWHERE: SHADOW BANKING AND OFFSHORE FINANCE

Ronen Palan and Anastasia Nesvetailova

If we were to identify one common thread across the financial system's stages of evolution, it is the quest for being located for tax and regulatory purposes elsewhere or, ideally, nowhere. Recognising the limits of mainstream economic models in providing a comprehensive explanation of this phenomenon, we draw on the ideas of Thorstein Veblen and his theory of business civilisation. A Veblenian analysis suggests that dynamics and behaviour in finance that are commonly associated with human failure (greed, exuberance, fraud, incompetence), and which appear to have become widespread practice, should best be understood as sabotage. Finance is awash with techniques designed to sabotage both clients and the governments who enacted regulations that were supposed to protect clients. These techniques are legal mechanisms, albeit as Veblen writes, not in the spirit of the law.

EXPLAINING THE STUNTED RISE OF MACROPRUDENTIAL REGULATORY PHILOSOPHIES

Andrew Baker

In the aftermath of the financial crash of 2008, policy makers operating in international financial regulatory networks discovered macroprudential regulation (MPR) and 'systemic risk'. Macroprudential ideas rose to prominence quite rapidly in the aftermath of the financial crash of 2008, but the process of translating these ideas into concrete regulatory practice has proceeded slowly and incrementally. The article sets out to explain why this has been the case citing five factors that have been responsible for stunting the development of macroprudential regulation.

THE ROLE OF SPECIAL RESOLUTION REGIMES IN POST-CRISIS FINANCIAL REGULATION: FOUR DANISH LESSONS

Martin B. Carstensen

In wake of the financial crisis, the building of national and international special bank resolution regimes (SRRs) that can shut down failing banks of any size without upsetting systemic functions and putting taxpayers' money at risk, has reached the top of the regulatory agenda. Thus, policy elites hope that SRRs can pose a credible commitment to counter the problem of financial institutions being 'too big to fail'. The article analyses the basic arguments behind SRRs and suggests that they should be viewed as political tools used by authorities in distributional battles between the financial sector and the state. To support this argument, the Danish SRR – the first SRR to actually have been used after the crisis – is analysed.

WHY THE EUROPEAN COMMISSION IS WRONG TO PUSH FOR A EUROPEAN FINANCIAL TRANSACTIONS TAX

Photis Lysandrou

A financial activities tax (FAT) and a financial transactions tax (FTT) represent alternative ways of taxing the financial sector. In preparing a common proposal for the European Union, the European Commission initially appeared to favour the FAT but then swung its weight behind the FTT in late 2011. Its reasoning was that in addition to generating revenue this tax could also help to stabilize the financial markets by curbing excessive speculative trading. This paper takes a different position. It argues that the FTT would amplify rather than dampen market instability by interfering with the functions of important financial institutions. Its conclusion is that the FAT would be superior to the FTT.

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Boganmeldelser formidler, hvad en bogs fokus er, hvad dens grundlæggende argument er, hvad dens teoretiske approach er, og hvilket emne eller case den behandler. Derudover bør der leveres en kritisk evaluering af bogens argument.

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Artikelforslag sendes i wordformat via e-mail til Christian F. Rostbøll (cr@ifs.ku.dk). Aftaler om review-essays og boganmeldelser indgås med Kristoffer Kjærgaard Christensen (Politik@ifs.ku.dk).

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Bøger
Bull, H. 1995 [1977], *The Anarchical Society: A study of Order in World Politics*, 2. edn., Macmillian, London.

Kapitler i bøger
Mitrany, D. 1975, „Prospects og Integration: Federal or Functional?", in AJR Groom & P Taylor (eds.), *Functionalism: theory and practice in international relations*, University of London Press, London.

Artikler
Smolar, A. 1996, „From Opposition to Atomization", *Journal of Democracy*, vol. 7, no. 1, pp. 263-77.

Taler m.m
Rasmussen, P.N. 1999 „Statsminister Poul Nyrup Rasmussens redegørelse ved Folketingets afslutningsdebat torsdag den 27. maj 1999", *Statsministeriet*, København.

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