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TOWARDS A GEOGRAPHY OF FINANCIAL RELATIONSHIPS

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Abstract

As we all know, the theories of economic location both in their classic shape and the more recent updatings mainly investigate the distribution of production and exchange in their physical dimension. Although the central place theory deals with the location of services, often immaterial, the attention is focused on the structures. The key concept remains the economic distance, linked to the transfer of goods.

This approach cannot explain a world geography where the friction of space is continuously shrinking while the international distribution of activities is commanded by the management of financial assets.

The paper tries to point out some basic concepts, the objects characterizing this kind of space, and the flows connecting them. The graphic representations tentatively describe some of these peculiar patterns and outline specific features like the circulation of capitals and the profits offshoring schemes.

Keywords: *EUROGEO13, financial geography, financial space, offshoring, tax havens.*

1. A PECULIAR KIND OF ECONOMIC SPACE

In a world where economic relationships are increasingly dominated by finance the researcher is required to perform a significant conceptual improvement, that is to say, to lay out a geography of financial relationships describing such phenomena in the framework of economic geography. Only after this systematization work will we have at our disposal the adequate concepts and metrics to make the procedures adopted by economic operators transparent and the quantities (values) at stake readable.

Since the 19th century the German school of spatial economy has provided us with the tools necessary to describe a simplified economic space, well beyond the concept of economic distance. Nevertheless, the classic and neoclassic location theories have lost their capacity to explain the spatial distribution of activities given the reduced importance of the friction of distance brought about by the revolution in communications in the twentieth century.

Actually, in these authors (especially the triad Thünen-Weber-Christaller) there is much more than what we usually care to admit, especially as far as the adjustments of the spatial structures to the changing framework situation are concerned. Let us remember that the criticism levelled at the time was centered on the assumed staticity of their models. It is the basic Marxian criticism to classical economy. To a closer analysis, however, we can recognize both a generic mechanism in the development of central places (from protocentral places to highest rank post-industrial metropolis), characterized by the evolution in time of these spatial structures and the adaptation of the gravitating urban areas as a consequence of the moving of borders (Christaller 1933, who was writing in Germany in the aftermath of the First World War, clearly mentions it). Even a phenomenon which may seem to be typical of the contemporary world, i.e. the industrial delocalization, finds a valid interpretation in Weber's work.

What anyway location theories in their traditional interpretation totally disregard is the influence of currency. Problems such as the variability of prices in relation to the inflation or deflation phenomena, the effect of variable interest rates, or the competition between production and finance were not mentioned in these reassuring models, nor was it necessary as long as the financial activity remained within the services functional to the carrying out of the productive one. This allowed the scholars to keep the traditional interest in material landscapes within the sphere of economic geography, this way maintaining the unity of geographical disciplines.

Over the last fifty year the emergence of financialization, i.e. an economy based on the management of capitals separated from the needs of production, has changed the term of convenience of economic processes, greatly influencing the international distribution of labour. This has been made possible by the aforementioned revolution of transports, which has significantly loosened all location bounds. In a world where accessibility has hugely increased, however, the specific case of the distribution of capitals needs to be highlighted also in its geographical connotations.

Indeed the informatization of transactions led some authors to speak of the end of geography as for money and finance (O'Brien, 1992). Scholars as well as columnists, hypnotized by the globalization myths, envisaged the taking shape of the economist's dream, the "perfect market", without frictions, lack of information and borders. The emergence of the present world crisis in 2007-2008 did justice to such naïve allegations restoring the vision of a world as a mosaic of geographies variously linked (French, Leyshon and Thrift, 2009; Chapelle-Blancard and Tadjeddine, 2010).

2. THE MOBILITY OF CAPITAL

As we all know, since the invention of currency wealth transformed itself into capital, becoming more and more mobile in its essence. As a consequence, the dynamics of financial relationships occupies a space of its own which is drawn by the movements of capitals. These move through specialized institutions - banks, financial societies, insurances, regulated and not regulated markets - so that a geographical analysis would seem to lead us again to the study of the location of these institutions. In this field, for example, Christaller tells us where the structures which collect and manage savings are located. Weber, in turn, underlines that industries settle wherever they find location advantages, among which of course capitals available at a low cost. All classic and neoclassic authors theorize an isotropic, basically homogeneous space, in which it is possible to quantify and map the ingoing and outgoing flows from the different poles. At this point the problem confronting the researcher is how to propose an explanation not only for the entity and direction of the flows considered, but, what is more relevant, for the role played by these flows.

Such an explanation cannot limit itself to the urban dimensions, i.e. to the metrics of central location. Nor it suffices to study the issues of financial centers (Yeandle et al. 2013). The key question is that financial space is not in fact an isotropic one. Despite being a relation-bearing space, it is characterized from the onset by a remarkable lack of homogeneity. As the capital is a form of measure and at the same time a synthesis of several underlying factors, it is not only a separate part of the system but includes wide portions of economy, if not (albeit always) all of it. As many authors are stressing (Lee, Clarke, Pollard and Leyshon, 2009), what still requires a geographer's work is the study of the relationships existing between finance and the rest of economy, an essential prerequisite for a minimal understanding of that reality which is encompassed in the phrase "money and financial space".

What for the geographer is a space, variously polarized, is a market for the economist. In both cases it is a set of well defined rules that define the geometrical properties of the objects which make it up and of the relationships between them. In essence, these rules are inspired on one hand by the current official regulations, on the other by the current practice followed by the dealers. Both are variable, in time and in space. We are thus experiencing a space whose first and foremost essence seems to be of a legal nature, a sector where partly public, partly private, regulations are in force. This seems to be the final argument against the idea of "neutral" and self-regulating markets.

As such, it allows to draw a simplified representation, similar to the one which characterizes the political-administrative geography, that is to say a set of areas, singled out on the basis of the regulations in force in each of them, separated by boundaries of a linear type. The list of the states belonging to a monetary union, i.e. that comply with the same regulation system of capital movements, are examples of this new geography which gives us a sort of division of the world of an essentially geopolitical nature, similar to the map of military alliances.

Such a representation, albeit useful, can be only the beginning for a proper analysis of the matter. An analysis has to be carried out not only through an increasingly detailed regionalization, but above all going over from the consideration of surfaces to that of relationship networks (see: Klagge and Martin, 2005; Sokol, 2007). To concentrate on the latter it is necessary to become fully aware of the types of functions which are performed by the dealers, that is the specialized economic operators. This way we shall succeed in building an "abstract economic landscape", similar to those proposed since Thünen, but at the same time of a completely new kind.

3. THE SPACE FORMING OBJECTS

The implementation of all this strongly influences anthropogeographic reality, an influence not less important than the physical features of a territory. For the entrepreneurs, the existence of an import duty or a certain interest rate does not substantially differ from the effects of an economic distance comparable in terms of an increase in costs, as Alfred Weber had already underlined. Let us now see what are the "objects" which characterize this space, tentatively represented as in Fig. 1.

a. The producers of capitals, considered as the instrumental forms through which financial capitals are materially created and exchanged (currency, quasi-currency, etc.). Hereby we mean issuing institutes, private and public banks, commodity and stock exchanges, together with other controlled markets, etc.;

b. the consumers of capital: companies, families, individuals, public administrations;

c. the intermediaries in circulation: banks, post offices, stock exchanges, investment funds etc., all functionally related and spatially hierarchized;

d. the areas of circulation of capitals, i.e. the markets. Here we can see one of the properties of financial spaces, compartmentation. This in particular as far as the payment means are concerned, currencies. We have here to distinguish between open, closed and semi-closed currency areas;

e. the passages, or continuity bridges. These are the points that allow the passage between different areas. The introduction of internet has shifted the stress from the physical to the computerized transfer, but owing to the concentration of this service in a reduced number of

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operators the concept does not change. The accessibility moves from the physical to the computerized space, however through well identified channels organized in networks of intermediaries: So this concept partly overlaps category “c”;
f. the “transformers” in the financial spaces. These are the equivalent in economics of the “black holes” in astrophysics. While the latter attract matter and expel energy and water, the former attract capitals, re-sending them under different material and legal forms. They constitute the so-called “offshore system” (Rose and Spiegel, 2007; Marshall, 2008; Palan and Murphy, 2010; Shaxson, 2011), a cluster of places through which the capitals are continuously moving without any stable location. A special case in this field are the so-called “tax havens”, the perfect example of “non-places” (Augé, 1995) from the economic point of view.

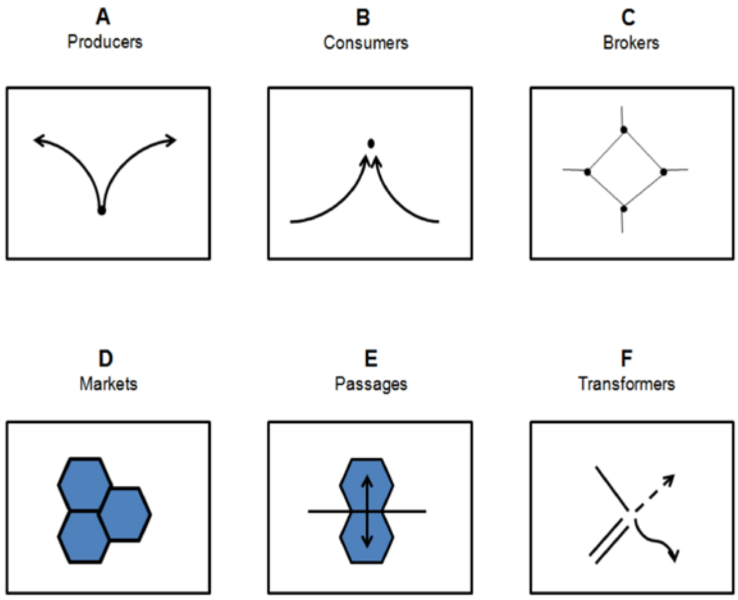

Figure 1. Iconographies of financial space. *Source: author’s elaboration.*

4. AN INTERTWINING OF NETWORKS

What gives coherence and therefore unity to the financial space is the structure functionally linking different local spaces in a sort of “hyperspace” with varying geography. Actually, such networks are originated by the action of multinationals, which endow themselves with a financial structure somehow parallel to that which produces and markets goods and services. The impulse therefore proceeds from real economy, which is the real maker of the financialization process.

So, economic geography has to reconsider its enquiry methods in order to take into account both structures, which are geographically characterized either out of necessity or of choice.
A representation of the intertwining between real economy and finance is shown in Figure 2.

As we can see, each of the “official” macro sectors of activity is matched by a wide parallel sector which lies to a different extent just within the law. This measure is determined by the regulations in force in any specific instance. At the center of the system there are the capitals formally stored offshore, mostly within “secret jurisdictions” (Shaxson, 2011), the statute of which takes on legal value for some regulations and some activities but is still illegal for others. Although all of the structures of the system are interlinked, a direct, one hundred per cent contact is a prerogative of just the offshore sector.

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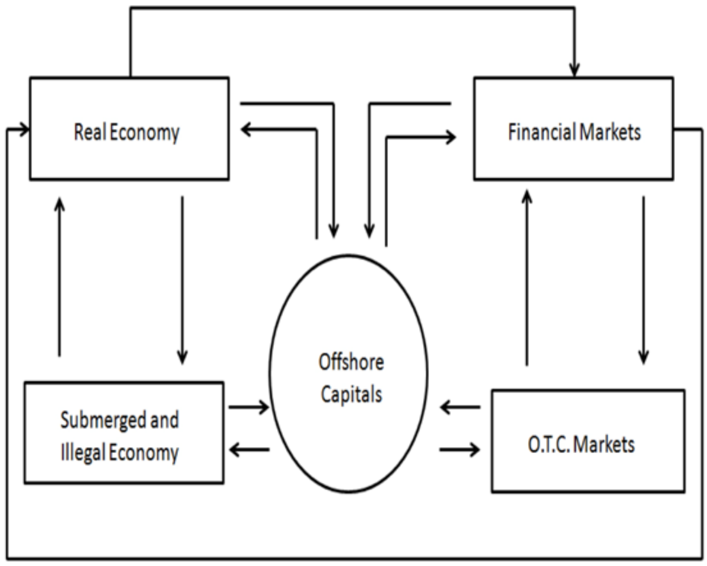

Figure 2. The capital flows in the intertwining of real and financial economy. *Source: author's elaboration.*

The system as such has been modeled by the rushing emergence of multinationals, recognized today as the major operators on the capital market. Figure 3 will help us to understand their spatial structure.

First of all (sub A) let us consider the case of a successful company which wants to expand its activities on the international market and sets up to this aim a number of subsidiaries in several countries. From an initial stage of mere product marketing it often switches to a (partial or total) decentralization of productive activities, taking advantage of the differentials existing as far as production costs and purchasing power on single local markets are concerned.

A deeper knowledge of the local situation now enables the parent company to exploit the differences existing in the fiscal systems it and its subsidiaries have to refer to. The parent company usually works in an economically advanced country and has to pay higher taxes than its subsidiaries. It is therefore advisable to keep abroad part of the profits gained. At a later stage it tries to exploit the whole of the fiscal differentials present within the circuit thanks to the transfer of goods and services among the different company units. As the parent company controls all of its subsidiaries, an overall accounting is easy to manage. Profits are divided among a series of companies which are formally independent, so that each of them is free to fix the prices of the products to be put on the market.

It is here that we can see the difference between the units targeting the consumer markets and those working in the sector of the intermediate goods. The former are compelled by the competition to contain their prices and can do so in that their strategy is basically founded on scale economies, while the latter are encouraged to maximize or minimize prices according to the inputs coming from their parent company. At this point it is important to consider again the fiscal factor. As the single companies are taxed on the base of their balance results, the group finds it advantageous to submit meagre (if not in the red) economic results in the countries with high taxation, good results in those where taxation is low.

This can be easily achieved thanks to the expanding use of transfer pricing, that is by creating paper transactions between subsidiaries of the same company to separately allocate costs, proceeds and profits to selected countries. This means that the subsidiaries, acting as proper departments of one company although legally and geographically separated, can fix their sale prices disregarding the economic laws of supply and demand. As a matter of fact they can work under either monopoly - if compared to the customer company - or monopsony conditions, if compared to the supplier (1).

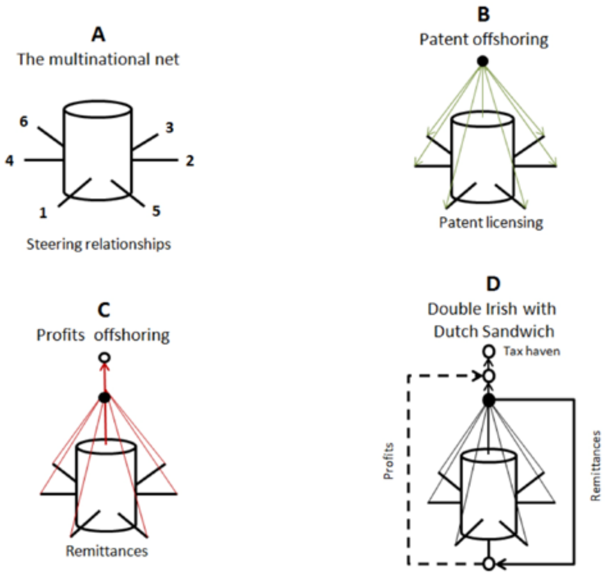

Figure 3. The multinational stages in the offshoring of profits. *Source: author's elaboration*

The final result is a net saving on taxes, which in turns results in higher margins of profit. It is clear that the policy of the multinationals determines, as far as their subsidiaries are concerned, their a) geographical localization, b) range of activity, c) profitability and d) growth prospects. The consequences in terms of distortions of economic structures in the countries considered are remarkable but generally misunderstood, given the control multinationals have over political structures, media and politicians.

5. THE ROLE OF TAX HAVENS

Since the Seventies, in parallel to the explosion of multinationalization, the management of fiscal charges has become of paramount importance, so that the system described above has been further improved. As an example, see Figure 3b.

In some cases - especially in the service sector, but the same is true in the productive sector, through patents and trademarks - it is convenient to externalize the management of intellectual property to a subsidiary, which is given control over a certain geographical area. For very wide areas encompassing several countries the subsidiary can in turn act as a sort of head company towards the sub-licensees. The latters resell the intellectual property on their respective markets and pay the royalties to the licensing company. Using transfer pricing the company profit is almost completely drained, so that profits concentrate in the main subsidiary, usually located in a low taxation country, what enables the parent company to make large extra profits abroad.

Of course all this happens in the framework of an endemic conflict, a sort of "cops and robbers" game, between companies and tax authorities in each country, so that the diagram shown will undergo several changes in time.

The first innovation comes with the entry of one or more "tax havens" (see Figure 3c). These "secret jurisdictions", as Shaxson defines them, basically supply two kinds of services. In the first place, they do not levy any tax on society income, but limit themselves to collect a fixed amount for each society incorporated there. In the second place, they guarantee anonymity to those societies, thus making it impossible to any government to ascertain the real ownership, properties, capitals and exchange value of such a company.

Such benefits enable both natural and legal persons to let capitals leave the country under new legal identities, re-inserting them in the economic circuit, both real and financial, with unrestricted freedom. Moreover, incoming capitals can be invested also in the parent company as loans, for which the society is legally bound to pay large sums - both as interests and capital repayment - to a foreign party which formally acts as a capital lender. This means activating a system of exports of capitals in broad daylight and fully legal. Such was the case of the capital exports by Russian oligarchs to Cypriot banks. As revealed in the financial crisis which hit the island in the first months of 2013, Cyprus was the main country to host foreign capitals invested in the Russian Federation.

A further improvement enables a society to shift the capitals it has amassed this way, from one country to another bypassing the fiscal collection on such movements. To this aim they exploit the existing international conventions which in some cases exonerate from paying taxes on the transfers within or outside the EU, in this case incentivating the flow towards fiscal havens. This system makes it possible to reduce income taxation on foreign revenue to slightly more than 2% against 35-28% for USA and Great Britain respectively. The dodges used to escape taxation are known by the nickname of “Double Irish” (Darby and Lemaster, 2007). In both cases, operations are divided between operating and shell companies located in different countries. In the former case we have a real and a fake company coexisting in Ireland, the former structured so as to appear resident to fiscal aims in a “special jurisdiction”.

In the latter, we have the presence of a convenient society residing to all intents and purposes in an otherwise “normal” country like the Netherlands. It is used for transfers to fiscal havens and is placed between the Irish companies as a slice of meat between two slices of bread, hence the nickname of” Dutch sandwich”.

6. THE GOOGLE CASE-STUDY

The system is well explained in the case of Google Inc., which can be taken as a paradigmatic “company example”. It has increasingly been in the limelight since 2010. The American company sold the licence for the commercial exploitation of its search engine in European, African and Middle East countries to an Irish subsidiary, Google Ireland Holdings. The latter set its headquarters in the Bermudas. As a consequence, according to Irish law it results, also to the US Revenue, as being resident in those islands, notoriously a tax haven. The branch offices remain in Ireland, where the company gives its licence to another company, the Google Ireland Ltd., which is the real, over 2,000 staff strong, seat of the company.

Formally, however, this latter company gives sublicences to other companies of the group: Google Belgium, Google Italy etc., that sell the services on their national markets. These ones collect the proceeds of the activity and send them almost completely to their licensing company as a compensation for the operating costs (paid however in Ireland) and for the royalties. As a consequence, all national licencees submit extremely poor profits. In Ireland, the taxation of society profits does not exceed 12,5%, while in the USA it is 35%. Since the tax residence is in the Bermudas, taxation on the rest is practically nothing. Take notice that Google Ireland Ltd. gets credit for 88% of all Google's overseas revenues.

At present the system is even more refined. If the royalty payments occurred strictly within Ireland they would be taxable. Therefore Google Ireland transfers (free of duty, as it is a infra-EU transfer) the royalty money to a third society, the Google Netherlands Holding BV, where all the accounting formally takes place. It is the Dutch company which carries out the last transfer to the tax haven for the 99,8% of its revenue. This way the Irish tax authorities are deprived of their levy on transfers (20%), and must settle for a Google Ireland's pretax profit

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of less than 1% on its revenues. All in all, it is a brilliant scheme. Through a series of individually legal operations it reduces to a minimum the taxes on activities carried out outside the USA, activities which would account for about 53% of the profits of this company (2008 estimate, Drucker, 2010).

This is the configuration adopted at present by hundreds of companies, among which all the big ones of the informatics, pharmaceutical and technological sectors. This has come to the attention of the public after the outbreak of the economic crisis in 2007, which has induced the authorities in all countries to make every possible effort to bring the escaped capitals back into the taxable basis.

It is estimated that 135 US societies have accumulated 1,000 billion dollar in untaxed foreign profits (data 2009). At the global level the total amount is probably much higher considering that in 2008 alone the 13,000 shell companies established in the Netherlands by foreign multinationals for the purpose of channeling financial assets from one country to another shifted more than 5,4 trillion dollar during 2008.

The outlined system therefore appears to be, to a closer analysis, a mere legal fiction, based on a number of conventions allowing to geographically move the ownership of capitals but as a matter of fact does not require to actually move them. As N. Shaxson says, money is actually parked outside tax havens. These are nothing more than empty shells, where there is no treasure which can be reached through a legal or illegal surprise intervention.

Tax havens are just links, although of the utmost importance, in a network of relationships created to make capitals untraceable, and therefore untouchable. This is why in Fig. 1 we have called them "transformers". The actual structure of the system has recently been revealed by ICIJ (International Consortium of Investigative Journalists). It is a huge network comprising 122,000 offshore companies with 12,000 intermediaries which extends over more than 170 countries. Actually, a globalized network allowing the accumulation of capitals and their conveying to the most profitable locations and activities. The tax havens considered are 10, a small number if compared to the about 60 generally considered. But also this figure is in reality much less than the real number, considering the ambiguous role inherent to the status of "offshore centers".

As we can see, the financial space is just beginning to reveal itself and promises to be an extremely fruitful research field for our disciplines.

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NOTES

(1) It is worth while mentioning that this way multinationals manage to completely disrupt normal market relationships to a much greater extent than the traditional theory of monopoly and monopolistic competition had envisaged. For this reason the endless applications for liberalizations on the basis of alleged "market needs" are in most cases untenable. As a matter of fact, the so-called "market freedom" consists in the progressive disappearance of the system of free competition and its replacement with a system of monopolistic competition between totally integrated sectors which foreshadows in the near future the triumph of a world monopoly for each single macro sector of activity.