Global financial North-South dependency revisited

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1. Introduction

Global financial markets have massively grown and accelerated in the last decades. However, the poorest countries have been and are often not strongly integrated into these global financial markets. Growing integration and thus also dependency can be desirable even though it might not be the best option for these countries compared to a domestic financial system (incl. state-owned banks) which are, however, also not an easy goal without caveats. Generally, financial dependency can also be a sign of economic strength rather than weakness: For example, the highest indebted countries include rich countries such as Japan (even though primarily domestic debt) and the USA, and the G20 advanced are currently much higher indebted than emerging and developing countries (see also Graph 2). Furthermore, financial flows are often linked to a business/investment activity and thus the business and finance spheres are not separate. The most important financial markets and services include:

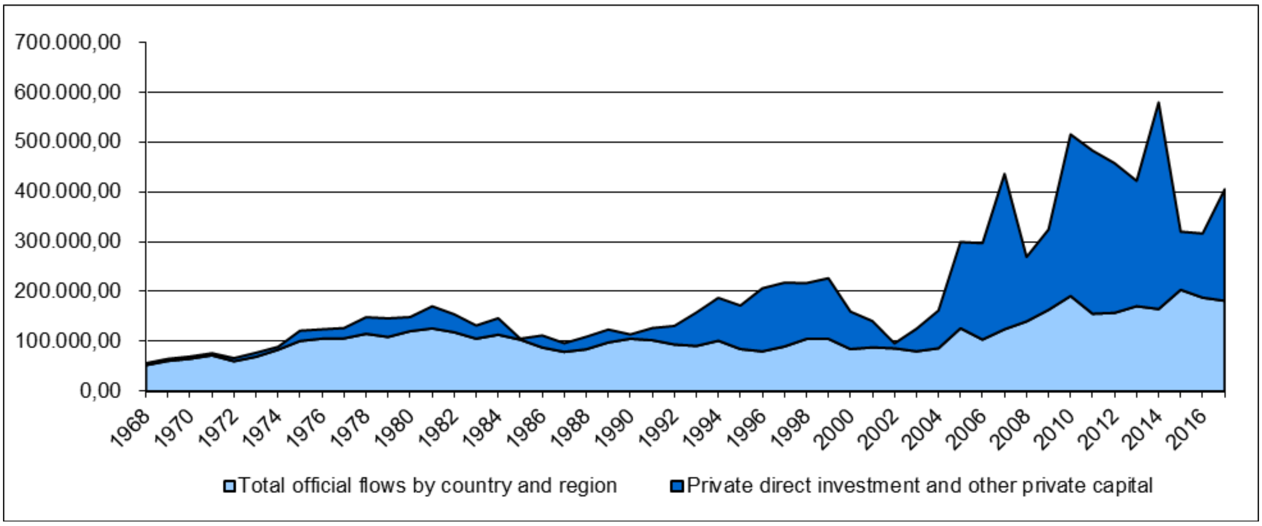
Bank loans	**Capital markets**	**Currency**	**Payment**	**Modern products**	**Insurance**	**Other**
	(bonds, shares, funds, securities)			(derivatives, securitization, e.a.)		(aid, etc.)

Finally, international financial institutions such as the World Bank or the International Money Fund play an important role in international financial relations.

2. Financial markets and services: some details on the developments in the last decades

- **Aid / Official Development Assistance**

Graph 1: Official (public) and (private) investment flows to developing countries (million USD)



Source: OECD

- **Capital markets and direct investments (shares/equity)**

Direct investments are equity investments above a certain threshold (e.g. 10% or 25 %) and normally with interest in active management/business, in contrast to portfolio investments. Direct investments massively increased in last decade in average, but very volatile; much went to China. There is growing South-South investments in recent years.

Illegal/illicit flows related to corporations include trade misinvoicing (wrong/fake invoices to dodge taxes), estimates go up to nearly US$1 trillion in 2014 but the method is – quite convincingly – contested (e.g. Maya Forestater), so this figure seems to be exaggerated.

Another problem with financial flows linked to investments is that tax and investment agreements support profit flows from South to North, and tax havens or secrecy jurisdictions facilitate aggressive tax avoidance. According to UNCTAD, developing Countries loose at least 100 bln. USD a year due to such avoidance; but in the last years some channels have been addressed (G20/OECD project and else), and developing countries are increasingly sceptical as demonstrated by cancellation of tax agreements by Argentina, Mongolia, Uganda e.a., or of investment agreements by South Africa e.a.

- **Capital markets (debt/bonds)**

The relation between South and North less clear than it might seem: While the South is normally borrowing from the North, the North as a whole, in statistics, appears as net debtor; however, the North in fact is probably a net creditor if one takes into account offshore assets (Gabriel Zucman). The USA still is unique as "safe harbour" for global financial debt flows, e.g. China financing U.S. current account balance deficit by buying U.S. treasury bonds (see Graph 3).

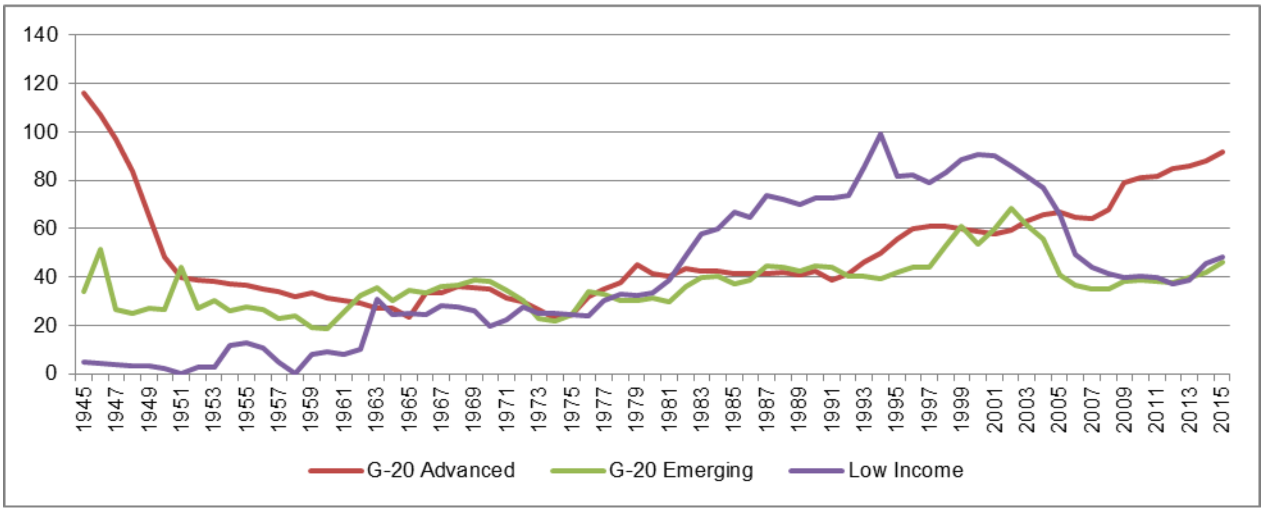
Poor (Southern) countries always face challenges in borrowing in general and particularly in local currency at longer maturities. In Africa, for example, relatively well-developed local currency (government) bond markets only exist in South Africa, Egypt, and Nigeria (88 % of the share of total outstanding local currency bonds in Africa), with some other countries emerging.

Over-indebtedness (particularly in foreign currency) and "hot money" flows (quick in – quick out) have been and probably are the most important issue for the South: Many debt crises are linked to international debt flows, like the debt crisis in South America and Africa in the 1980ies, Mexico 1994, South-East Asia 1997, Russia 1998, Argentina 2000, or Turkey 2001. Limits to financial flows (capital controls) have been and are in force in many Southern countries but have often faced (though now less) pressure by IMF and OECD to be limited or even abolished.

Central bank policy after the financial crisis (Quantitative Easing, QE) with depressed interested rates (also) pushed flows into emerging countries, now with reverse of QE (in the USA since end 2015) growing concerns in these countries about reversal of financial flows.

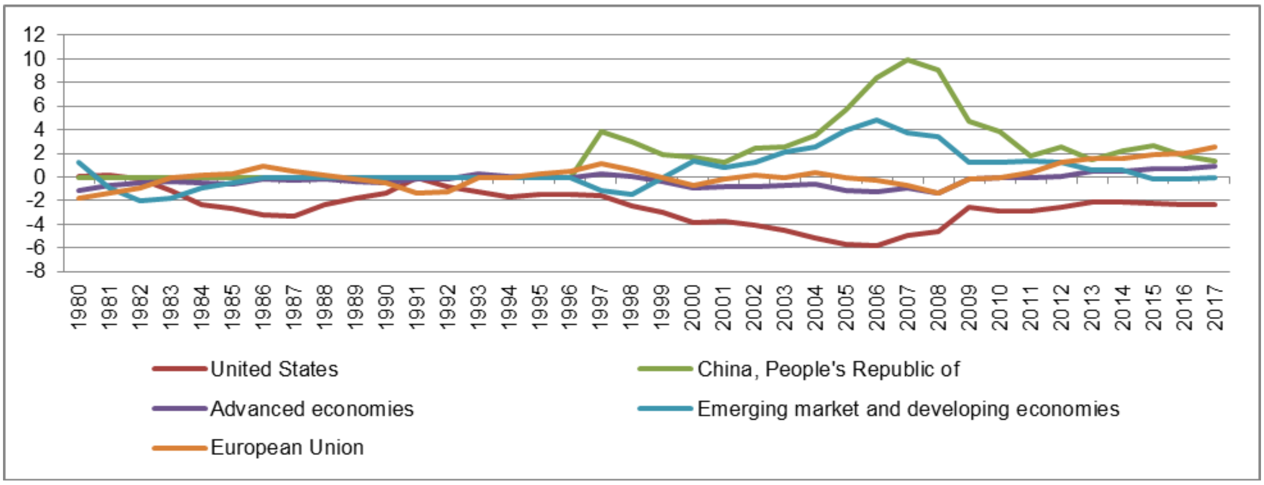
Private investment funds and wealth managers (mutual funds, hedge funds, private equity, money market funds e.a.) are mainly from the North, e.g. Bridgewater, Carlyle, or Blackrock. Sovereign wealth funds mainly from (rich) South like Dubai, Saudi Arabia etc. but also from China, largest from North (Norwegian oil fund)

Graph 2: Public Debt 2018 (% of GDP)



Source: IMF

Graph 3: Current account balance 2018 (% of GDP)



Source: IMF

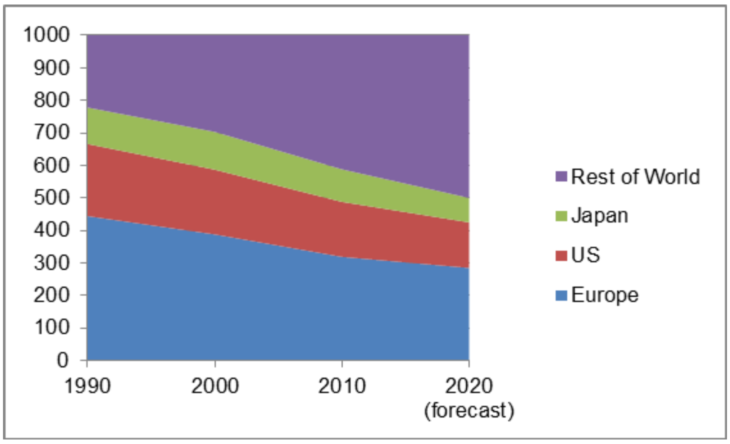
- **Bank loans and bank ownership**

Overall, Northern banks still dominate the global market, but the North will soon have less than 50% of the World's 1,000 top banks (see Graph 4). China now already hosts 5 of 10 largest banks (market value, see Table 1), 4 of 10 (balance sheet, see Table 2). One illustrative example of how finance has changed is Uganda's two latest dams: 2012, the Bujagali dam was financed by WB, ADB, EIB, Barclays, Blackstone, KfW, French/Dutch Development Agencies; the new (in construction) Karuna dam only relies on a Chinese bank and Chines construction company.

Foreign and private ownership of banks has strongly increased over the last 30 years, but both in developed and developing countries. Dependency has mixed effects regarding e.g. performance and (sector) stability. The trend was broken by the financial crisis, apart from South-South engagements (see Graph 5).

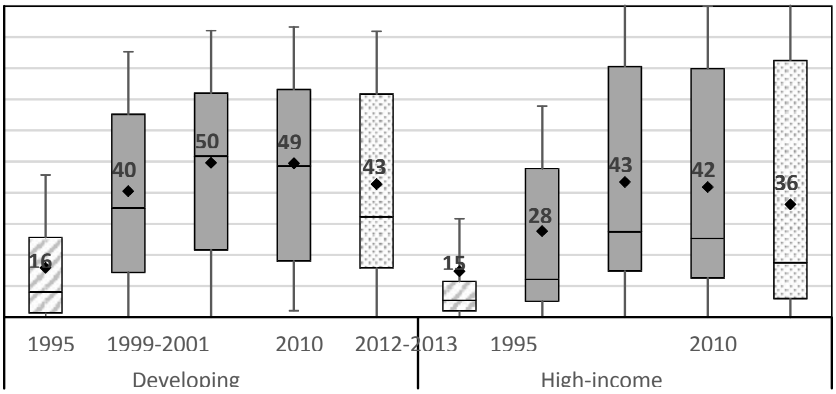
Table 1: Largest banks world-wide, balance-sheet, 2017 (in tn. USD, 31 Dezember 2017)		**Table 2: Largest banks world-wide, market value, 2018** (in bn. USD; 31 May 2018)	
Industrial & Commercial Bank of China	***4.00***	JP Morgan Chase (USA)	364.34
China Construction Bank	***3.40***	***Industrial and Commercial Bank of China***	***308.63***
Agricultural Bank of China	***3.24***	Bank of America (USA)	294.45
Bank of China	***2.99***	Wells Fargo (USA)	263.09
Mitsubishi UFJ Financial Group	2.79	***China Construction Bank***	***253.30***
JPMorgan Chase	2.53	HSBC Holdings (GB)	194.07
HSBC Holdings	2.52	***Agricultural Bank of China***	***181.40***
BNP Paribas	2.36	Citigroup (USA)	170.06
Bank of America	2.28	***Bank of China***	***167.89***
Crédit Agricole	2.12	***China Merchants Bank***	***110.84***
Source: Statista / S&P Global Market Intelligence / Business Insider		*Source: Statista / BanksDaily.com*	

Graph 4: Top 1000 world banks



Source: The Banker

Graph 5: Asset share of foreign-owned banks by income group, 1995-2013

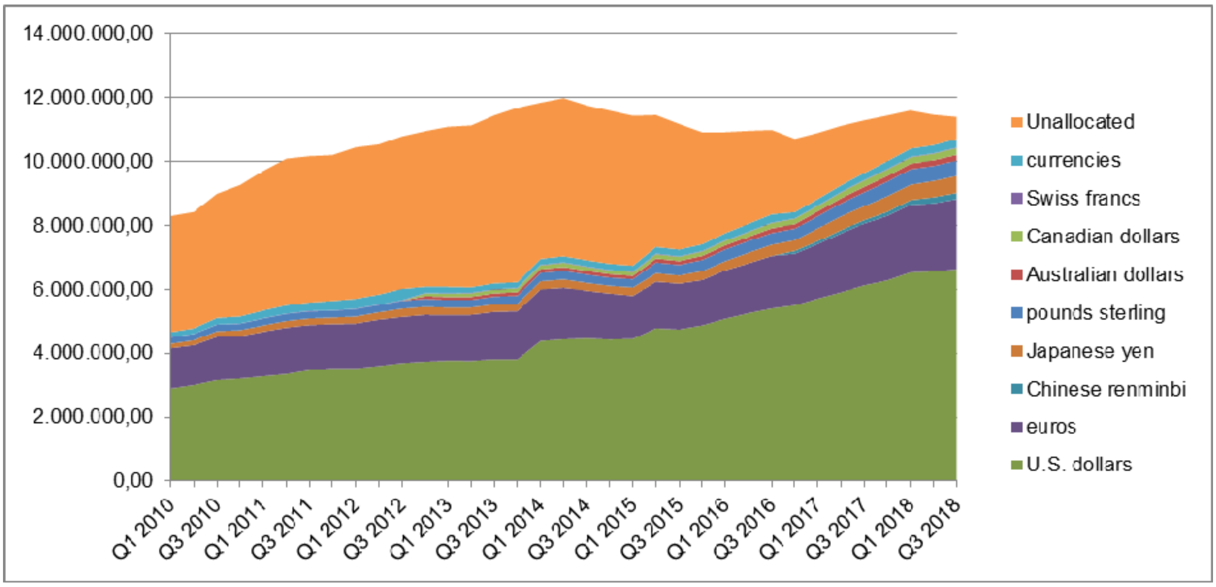


Source: Cull / Martinez Peria / Verrier (2018): Bank Ownership. Trends and Implications. Policy Research Working Paper 8297. World Bank

- **Currency**

Northern currencies are still the strong and the leading ones, with the U.S. dollar by far the most important. All countries in the world involved in international finance and business are still dependent on the U.S. dollar. Southern countries, even emerging ones, lack own strong currencies. Until today, no safe way to stabilize a currency exists: Pegging it to the U.S. dollar has serious risks as various currency crises have demonstrated (e.g. Mexico 1994, Argentina 2000 e.a.). A risk of the integration in international currency markets is also currency speculation: e.g. “carry trades” (exploitation of valuation differences across the globe). Particularly after the Asian (currency) crises in 1997, huge currency reserves were built up by Southern Countries, particularly China. However, they are currently held by 61% in U.S. dollars, by 20% in euros (see Graph 6) which reflects the ongoing dominance of these currencies. At least, in 2017, the Chinese Renminbi was included in IMF currency basket.

Graph 6: Currency Composition of Official Foreign Exchange Reserves (million USD, 28 Dec 2018)



Source: IMF

- **Payment Services**

Electronic payment services (39% of all internet buying according to a recent poll) are globally dominated by Alipay (China, about 600 million users worldwide) and WeChat Pay / Tencent (China, about 860 million users) while PayPal (USA) has only about 250 million, but probably with a stronger presence and influence all around the world. Some countries strongly use on payment trough mobile phones, but e.g. M-Pesa from Kenia is a joint-venture with Vodafone (UK)

For Credit cards (28% of all internet buying), the largest single card provider is UnionPay (China, see Table 3) with strong dominance of 76% in largest market Asia-Pacific, but global coverage probably still strongest by Northern companies (American Express, Visa, Master Card).

For international payments, smaller and thus often Southern banks still regularly lacks own global financial nets and need to use so-called correspondent banks from the North. Over the last years, there have been growing worries at the G20 about the decline of correspondent banking due to anti-money laundering rules and capital requirements; the non-bank money transfer services are probably dominated by Northern companies like Western Union and MoneyGram.

Money laundering for proceeds from crime and corruption is often facilitated by Northern banks, e.g. Malaysia's state fund 1MDB currently embroiled in grand-corruption case involving Goldman Sachs, Deutsche Bank, HSBC, New York Bank of Mellon e.a.

Table 3: Credit card issuance world-wide 2018 (October)	
Private Label (e.g. by banks)	6.74
UnionPay (China)	***6.69***
Visa (USA)	3.15
Mastercard (USA)	1.82
Domestic	1.20
	Source: The Nilson Report

- **Modern financial products**

Includes different types, e.g. derivatives (bets on underlying values), securitization (tradable securities for new types of assets such as mortgages or infrastructures), or high frequency trading: services invented and dominated by Northern companies. Overall, the South is still mainly excluded from the modern financial product world, as 2007 Subprime Crisis has shown (small direct effect, only indirect through trade etc.). But there some important links, e.g. futures markets dominated by Northern exchanges like New York Stock Exchange (NYSE) or Chicago Board of Trade (CBoT); study showed that wheat (future) prices at Mumbai Exchange are led by CBoT.

- **Insurance**

Table 4: Largest insurances world-wide by revenue (in billion USD)	
Berkshire Hathaway (USA)	242.1
Axa (Frankreich)	149.5
Ping An Insurance (China)	***144.2***
Allianz (Deutschland)	123.5
China Life Insurance	***120.2***
Japan Post Holdings	116.6
Prudential (UK)	111.5
Generali (Italien)	100.6
State Farm Insurance (USA)	78.3
People's Insurance Company of China	***71.6***
	Source: Statista / Fortune

3. International Financial Institutions

Most important ones, International Monetary Fund and The World Bank Group, still dominated by North (president of World Bank American, IMF European, USA/North can block decisions); quota reform blocked by USA. Regional Development Banks such as African Development Bank also influenced by North. But, since 2014 Asian Infrastructure and Investment Bank (AIIB) with China as largest shareholder; however, most Northern countries such as UK and Germany also strongly involved, only USA and Japan are missing.

4. Summary

The North with its companies still dominates global finance. But the trend is clearly a declining power of North: Particularly China now makes a difference in many markets and has created, with the AIIB, a serious competitor to the classical international financial institution such as World Bank and IMF. Nevertheless, the U.S. Dollar is still the dominant global currency which is particularly important for poor Southern countries, but also for China. Overall, financial North-South dependency is strongly contested but still not broken.