Is the shadow banking system the beginning of the end f...

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I'm in Copenhagen today. I was talking about tax evasion and information capture yesterday; today I chaired a session on shadow banking at Copenhagen Business School.

I'm not going to discuss details of that session now but trust me, this is an intellectually fascinating and simultaneously deeply depressing stuff, especially when the overall theme of the conference is locating global value chains.

What is readily apparent is that right now the US might know something about its shadow banking structures. Outside the US we have no clue what it is, where it is, why it is, precisely how much it has, what the flows through it are and how we tax it.

Suffice to say that the EU shadow banking sector - centred more on the City of London, Luxembourg, the Netherlands and Ireland - may be worth $20 trillion or more. And it may well be that it plays a real role in providing some liquidity. But as clearly, much of the market may well be wholly artificial. We have no clue how much of this market is real and how much is simply intra-group trading that is designed to create flows of the type decribed in Panorama last week that result in profit relocation to places like Luxembourg.

But perhaps most interesting was the contention from Anastasia Nesvetailova from City University who argued we're seeing a real change in capitalism itself, although she was not alone. Once we assumed (maybe even knew) that capitalism was structured around the idea of trade, where the idea was that value was added within the process of creating, transformation and exchange. But that may no longer be where global capitalism sees much of its return arising; the whole shadow banking structure of repo markets, securities lending and securitisation may actually be all about capturing a synthetic profit that may redistribute wealth (as I am sure it does) but where in fact the whole process is, as Minsky would have it, a giant Ponzi scheme which is not only not zero sum but is actually destructive.

That destruction might happen for three reasons. First, clearly substantial resources are being dedicated to this shadow market which deny real human capital to real markets and those people are being paid.

Second, if this process records synthetic value creation, as I think it might (although finding where the records are is of course part of the process) then it undermines the whole credibility of wealth recording.

But most of all, thirdly, if this sector is reallocating resources to a rent seeking behaviour that seems to pay rewards without creating value the implication of this by reducing the capital available to real value creation to delver human need is enormous: this destroys real value by denying capital to real value creation that meets human needs.

Now I'm aware of the Marxist nature of this analysis - that it looks like as Marx predicted that capitalism has reached a phase where it actually begins to destroy itself. Well, I'll ignore Marx - but the fact remains that this process of value destruction does at least appear to be plausible - and that means two things. First it adds enormously to the case for a financial transaction tax. Second it suggests there are enormous research issues here that need attention to be focussed not just on the regulatory issues of this market but on its macroeconomic consequences.