City-states as international financial centres: towards a political economy of the city-state

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Towards a Political Economy of the City-State

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Introduction

Financial centres have always been at the centre of capitalism. They constitute its pulsating heart, pumping money through the economy and regulating these financial flows. According to Woo, modern international financial centres represent the convergence of three contemporary developments in the global economy: *Globalisation, financialization and agglomeration*.[1] As such, these centres are the epitome of capitalism in our times. However, despite a new quality of globalisation and financialization, the underlying mechanisms of these developments are hardly new. Fernand Braudel writes about the phenomenon of financialization, which occurred as far back as in 18th century Amsterdam and renaissance Italy: *"…the city's* [Amsterdam] *social oligarchy became inward-looking, withdrawing as in Venice and Genoa, from active trade and tending to turn into a society of rentier investors…*"[2] As for globalisation and international trade, Fratianni and Spinelli show that "*commerce and international trade were the key*" to the success of the thalassocratic city-states Venice and Genoa.[3] As the following pages will show, it is no coincidence, that it was the Italian renaissance cities, as well as the Dutch United Provinces which gave birth to the leading European financial centres of their time. These examples illustrate the historically important role of financial centres, especially in trade. Given this relevance of financial centres for our understanding of the economy in the past, present and future, it is worth examining why some cities emerge as leading regional or even global centres, while others do not. While existing literature often focusses on specific cases, the question remains whether one can identify a general pattern, as well as common characteristics and circumstances that lead to the emergence of a financial centre. What can explain the fact that big countries, like the United States and China, have important financial centres, as well as small countries like Singapore and Liechtenstein? Moreover, rich countries, like Switzerland, Japan and Qatar host financial centres, as well as considerably less wealthy countries, such as China and Mauritius.

All this leads to the starting question which gave birth to this paper and which sets the framework for the following pages:

Why do some cities become important financial centres, while others do not?

Research question

Going back to the examples in the introduction, one can observe, albeit on a small sample set, a curious pattern. All mentioned illustrations, Genoa, Venice and the cities of the United Provinces and Dutch Republic were independent or autonomous cities and exhibited, to varying degrees, features of a city-state, rather than being part of an empire or nation-state. Venice, the *Serenissima*, emerged as a city in the 5th century AD and affirmed its independence from the Holy Roman Empire in 1177 when it hosted the reconciliation between Holy Roman Emperor Friedrich Barbarossa and Pope Alexander III, as it was recognised as "neutral

[1] Woo J.J. (2017), "*3-in-1: Governing a Global Financial Centre*", World Scientific: p.4

[2] Braudel F. (1984), "*Civilisation and capitalism, 15th – 18th century: The perspective of the world*", Collins: pp.266 & 267

[3] Fratianni M. & Spinelli F. (2007), "*Did Genoa and Venice kick a financial revolution in the Quattrocento?*", Österreichische Nationalbank working papers: p.13

ground".[4] Later, it became the centre of its own thalassocratic empire, but it always kept the characteristics of a truly sovereign city-state. Genoa, on the other side of Northern Italy, was its fiercest commercial competitor until the two cities both fell prey to Napoleon Bonaparte, who ended their independence. The United Provinces, on the other hand, were "*a cluster of city-states*"[5], which was controlled by Amsterdam and its merchants.

Nowadays, clearly, the age of the city-state seems to lie in the distant past. The contemporary world and its politics are overwhelmingly dominated by countries, which are, at least nominally, nation-states. This Westphalian order seems to leave little to no political and geographical space for the ostensibly anachronistic phenomenon of sovereign cities. While this is certainly true for most parts of the world, as well as for traditional high politics, a look at the world of international finance offers a strikingly different perspective on the issue. The Global Financial Centres Index, published by British Think Tank Z/Yen and the China Development Institute, features at least three cities, which enjoy a high degree of autonomy, in the top ten of its September 2019 list of the world's most important financial centres.[6] Hongkong, with its internal autonomy granted under the *one country, two systems* arrangement, is ranked third in the list, just behind New York and London. Singapore, arguably being the most "complete" city-state in the world, is placed just behind Hongkong in 4th place. Finally, Dubai features on rank 8 in the index. Although it is part of the United Arab Emirates, it is granted a high degree of internal autonomy and thus exhibits some characteristics of a city-state. Importantly, as these three examples demonstrate, the concept of *city-state* can be defined in various ways and can encompass a surprisingly diverse range of polities. The paper will deal with this issue of conceptualisation in a later part.

As the previous paragraph showed, historically, financial centres have often emerged in independent city-states, such as Genoa and the leading city of the Dutch United Provinces, Amsterdam. And still today, city-states feature prominently among the world's leading financial centres. Thus, this paper's research question will consist of two parts:

Are city-states actually relatively more important and competitive financial centres?

Secondly, and more of more importance for this paper, if the answer to the previous question turns out to be a *yes*, then what are the reasons for this phenomenon? Hence, the second research question will be the following:

Why do city-states feature so prominently among the world's most important financial centres?

[4] Parker G. (2004), "*Sovereign city – The city-state through history*", Reaktion Books: pp.78 & 82

[5] ibid: p.178

[6] Z/Yen & China Development Institute (2019), "*The Global Financial Centres Index 26*", September 2019

Literature review

Owed to the topic at hand, the existing literature can generally be divided into two thematic camps. One body of literature is on city-states and the other one on financial centres. While the former is relatively rare, there is a more sizeable amount of research on the latter.

Existing work on city-states was usually produced by historians or other scholars of the humanities, such as philologists. A good overview on the concept of the city-state is provided by Geoffrey Parker's "*Sovereign city: The city-state through history*"[7], which traces the origins of the city-state back to the Philistines in the ancient Near East. The book follows the city-state through history, engaging with the Greek *Polis*, medieval Venice and Florence, the German *Hanse* and, finally, modern-day city-states in South East Asia and the Arabian Peninsula. The book gives a comprehensive and insightful historical overview of the seemingly out-dated concept of city-state. However, it does not provide an analysis of city-states as financial centres and puts little effort in exploring the political economy of this kind of polity. Furthermore, its focus clearly lies on the history of the city-state, and less so on contemporary issues and developments. Another overview of city-states can be found in "*A comparative study of thirty city-state cultures: An investigation*", which was edited by philologist Mogens Hansen. The book offers an insight into thirty distinct civilisations, across space and time, which were based on the city as primary political entity. While being primarily historical research and without discussion of any contemporary form of city-states, the book nevertheless provides some added value. In the introductory chapter, for example, Hansen lines out several characteristics of this form of political organisation. While his requirement concerning the size of a city-state – "*the typical city-state has a four digit and a large city-state a five-digit population figure*"[8] – seems to be adequate for historical cities, this boundary shows to be outdated in modern times. The ICT revolution facilitated communication between – and identification among – many people and urban dimensions have greatly changed. Concerning self-government, however, his insight is still highly applicable: "*A city-state is a self-governing polity, but not necessarily an independent or autonomous state*." This is an important detail, because it broadens the array of modern city-states significantly. It extends the concept of city-state to cities like Dubai, Geneva and others. As mentioned before, I will come back to the issue of definition and conceptualisation of the city-state at a later point in this paper.

Unlike city-states, financial centres have been more widely discussed in academic, as well as popular, literature. Here, again, a large part of existing books and articles have a distinctively historical dimension, out of which two stand out: Youssef Cassis' "*Capitals of capital: A history of international financial centres: 1780 – 2005*"[9] and Charles Kindleberger's "*The formation of financial centres: A study in comparative economic history*"[10]. The former provides a comprehensive and in-depth overview of the history and evolution of financial centres. Starting with Amsterdam in the late 18th century, it follows the world of financial centres through more than two centuries. Being a historical study, with in-depth investigations into multiple cases, it does not explicitly provide a general explanation for the success of certain

[7] Parker G. (2004), "*Sovereign city – The city-state through history*", Reaktion Books

[8] Hansen M.H. (2000), "*A comparative study of thirty city-state cultures: An investigation*", C.A. Reitzels Forlag: p.18

[9] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press

[10] Kindleberger C.P. (1973), "*The formation of financial centres: A study in comparative economic history*", working paper department of economics, No. 114, Massachusetts Institute of Technology

financial centres. Furthermore, its focus does not lie on political structures and their influence on the development of financial centres. The latter, Kindleberger's work, attempts to provide more general and explicit explanations of why some cities become financial centres, while others do not. In this regard, his approach is closer to the one applied in this paper. However, his work only explains the success or failure of different financial centres within given countries and economies. He aims at explaining why London, instead of Liverpool or Birmingham, became the dominant financial centre in the United Kingdom and why Milan instead of Rome took this position in Italy. Very little focus is put on global financial centres and international competition. Thus, while his approach explains why only certain cities in a country can become financial centres, it does not seem to question whether only certain countries and economies can give birth to important and global financial centres. Another distinguished scholar writing on financial centres is Saskia Sassen. In an article for *Foreign Affairs*, Sassen argues that we have been experiencing consolidation and internationalisation of financial centres[11]. She argues that the two most important factors in the emergence of financial centres are national consolidation (which favours one dominant centre in a given country) and liberalisation and deregulation of the financial sector, especially in emerging markets.[12] However, the first point cannot explain why certain countries host several important global financial centres, while others host none and the second point does not investigate the institutional and political reasons and drivers for such deregulation.

The other common approach to financial centres is purely economic. It often puts a focus on economic efficiency and agglomeration forces. Furthermore, the emergence and creation of financial centres is usually not at the centre of economic analyses. According to Woo, economists are "*more interested in the economic gains and implications of establishing a financial centre.*"[13] That this neglect is not a new phenomenon is demonstrated by Kindleberger, writing in 1973, that "*it is a curious fact that the formation of financial centres is not studied today in economics.*"[14] An expanding body of literature does deal with the phenomenon of offshore financial centres and tax evasion, however. Among it, most notably, the work of Gabriel Zucman. Interestingly, Zucman's work *"The Hidden Wealth of Nations: The Scourge of Tax Havens "*[15], features in its discussion of tax havens many entities, which I will define as "city-states ". Among others, Zucman's paper talks about Hongkong, Luxembourg, Singapore and the Cayman Islands.[16] Being an economic work, however, it does not go further into the direction of linking political organisation to the fact of being a tax haven. Furthermore, as the title suggests, it focusses solely on one function or aspect of financial centres: Tax evasion and avoidance. As such, Zucman's work is not a work on financial centres generally, but on a very specific form of them.

Finally, there is some, although little, literature that combines the two topics and concepts, treating city-states as financial centres. These works, however, overwhelmingly

[11] Sassen S. (1999), "*Global Financial Centres*", Foreign Affairs, Vol.78, No.1, pp.75 – 87, Council on Foreign Relations

[12] ibid: p.76

[13] Woo J.J. (2017), "*3-in-1: Governing a Global Financial Centre*", World Scientific: p.4

[14] Kindleberger C.P. (1973), "*The formation of financial centres: A study in comparative economic history*", working paper department of economics, No. 114, Massachusetts Institute of Technology: p.1

[15] Zucman G. (2015), "*The Hidden Wealth of Nations: The Scourge of Tax Havens*", Chicago University Press

[16] ibid: p.35

focus on one or two specific examples. Singapore, as the clearest exponent of a modern city-state, is the subject under investigation in Murray's and Perera's "*Singapore: The Global City-state"*[17], as well as Woo's "*3-in-1: Governing a Global Financial Centre*".[18] Another case that has been explored is London, for example in "*City-state: A contemporary history of the city and how money triumphed"*[19]. Their insights are compelling, but do not necessarily allow a generalisation on the topic of city-states as financial centres. Yet another body of work deals with city-states and their role as financial centres but abstains from analysing contemporary centres and stays purely historical. This literature encompasses the works of the likes of Fernand Braudel[20] and Henri Pirenne[21].

However, the closest to answering my research question comes Ronen Palan in his work. In "*The Second British Empire: The British Empire and the re-emergence of global finance*"[22], Palan talks about the "second British Empire", which is the fraction of international financial markets located in current and former parts of the British Empire. According to him, there are two main geographical poles in international finance: The British pole (the "second empire", including the British Isles, British Overseas Territories in the Caribbean, Cyprus, Bahrain, Hongkong and Singapore) and a pole constituted of medium-sized countries in Europe (Benelux, Ireland, Austria and Switzerland).[23] He observes "*a preference for small and often somewhat anachronistic polities, including [...], city-states, [...]."*[24] Furthermore, he acknowledges the need to search for explanations for this phenomenon in factors like regulatory and geographical differences.[25] Palan becomes even more explicit concerning city-states and their role in international finance in one of his other works, "*International Financial Centres: The British Empire, City-states and commercially oriented politics"*[26] In this paper, he brings forward the *hinterland theory* and the tendency of city-states to be dominated by "*commercially outward-oriented elites*".[27] In my own paper, I will heavily draw on his insights and make use of the above-mentioned theory. Furthermore, I will partially resort to Palan's classification of countries and cities as modern city-states to support my own case. Despite close resemblance and heavy inspiration by the work of Palan, I will nevertheless adopt a

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[17] Murray G. & Perera A. (1996), "*Singapore: The Global City-state*", Routledge

[18] Woo J.J. (2017), "3-in-1: *Governing a Global Financial Centre*", World Scientific

[19] Kynaston D. & Roberts R. (2010), "*City-state: A contemporary history of the city and how money triumphed*", Profile Books

[20] Braudel F. (1984), "*Civilisation and capitalism, 15th – 18th century: The perspective of the world*", Collins

[21] Pirenne H. (1946), "*Medieval cities: Their origins and the revival of trade*", Princeton University Press

[22] Palan R. (2015), "*The Second British Empire: The British Empire and the re-emergence of global finance*", In: Halperin S. & Palan R., "*Legacies of Empire: Imperial roots in the contemporary global order*". (pp.40-68), Cambridge University Press

[23] ibid: pp:1 & 2

[24] ibid: p.5

[25] ibid: p.7

[26] Palan R. (2010), "*International Financial Centres: The British Empire, City-states and commercially oriented politics*", Theoretical Inquiries in Law

[27] ibid: pp.53 & 54

slightly different focus, a distinct methodological approach and diverging case selection, due to conceptual differences.

Conceptualisation

In order to treat this subject, certain terms and concepts, which will be employed throughout the paper, need to be clarified beforehand. Similar to the literature review, this part will be split between the terms city-state and financial centre. At first, this section of the paper will treat the concept *of city-state*, which is the part of this paper that comes the closest to being political theory. To achieve further clarification, and justify the case selection in this paper, the concept will be applied to several examples. The reader will realise that the concept of city-state turns out to be vaguer and more widely applicable than customarily assumed. The second part of the conceptualisation will treat the notion of *financial centre* and will further elaborate differences between different categories of financial centres.

City-State

Having talked a lot about city-states, this paper has thus far still not provided a definition of this type of polity. There are several approaches to this issue. Pure and obvious cases of city-states are extremely rare in today's geopolitical environment. Singapore might be the clearest case, since it is the most famous completely independent city-state in our contemporary international system. Hongkong has enjoyed great autonomy until now, even though it is not formally independent. Luxembourg is a micro-state dominated by its capital, and so are several British Overseas Territories in the Caribbean. To again refer to Palan, he considers a broad array of polities, ranging from Bahrain to the Isle of Man as city-states (including Dubai, Monaco, Cayman Islands, Hongkong, Luxembourg and more)[28]. Adding to my own conceptualisation of city-states, I will consult the works of Palan to further support my case selection. I will use the term "city-state" as a proxy for a common set of circumstances, various types of differing polities are subjected to. These circumstances are usually the pre-eminence of an urban centre and the dominance of a commercial urban elite, as opposed to landed aristocracy. Furthermore, a lack of resources and land, as well as a scarcity of labour and, lastly, a small domestic market foster an economy with a distinctively international orientation and an integration into international markets. In the financial realm, this results in a focus on international financial markets, instead of a (small) domestic one. These characteristics apply to political entities as different as Singapore and the Bahamas, Dubai and Monaco. Thus, in order to be accounted for as a city-state in this paper's analysis, a political entity needs to fulfil three necessary conditions in order to be considered a city-state:

1. High autonomy in tax, financial and regulatory policies
2. Homogenous elite interests, facilitating political consensus
3. Incentives to focus on the international market with trade and financial services, due to a lack of land and resources.

Entities only fulfilling the second and third attribute tend to be cities in territorial states. Due to their urban nature, their economic strategies are usually rather limited and interests more

[28] ibid: pp.61 & 80

homogenous than they are in their surrounding territorial state (due to the absence of landed interests). However, they do not hold any form of autonomy, and are thus not considered city-states. A polity meeting only the first requirement, would be a sovereign country with diverging economic interests within society and its elite, as well as economic alternatives, such as manufacturing and agriculture. This applies to most modern territorial states.

Thus, for this paper, the reader is advised to abstain from thinking of a *city-state* as a completely independent, UN recognised country and polity. One of the goals of this paper is to further introduce the city-state into the field of International Political Economy and to provide a more general political economy of this polity. For this research I will consider a set of 23 city-states[29], which I identify as such and which feature in the Global Financial Centres Index of September 2017.[30]

A second category are small-or medium-sized countries which are often dominated by one city economically, politically and demographically. These cities are neither officially city-states (like Singapore), nor do they have a great deal of autonomy within their country (like Dubai, London or Geneva). However, they exert important economic and political power and tend to be the political, cultural and commercial capital in their respective countries. As such, we expect them to have above-average political power and possess a certain advantage in attracting international finance. This second category comprises the likes of Cyprus, Tallinn, Riga, Panama and Reykjavik. This paper does not include them as city-states in its analysis, but it might be worth taking a closer look at how these centres perform compared to other jurisdictions. It has to be noted that the conceptualisation of this category is hardly possible in a satisfactory way and that it represents a grey area between actual city-states and territorial states. As such, it will not be part of the paper's focus in its analysis and it does not categorise them formally. Rather than a unit of analysis, like the city-state, this type of polity will thus serve as a reminder of the existence of the mentioned grey area. Consequently, these entities may exhibit some of the features and advantages of city-states, without actually being one. In this category we expect a broader spectrum of results, reflecting in-group differences regarding the leverage and power of the respective financial centre.

Financial Centres: International, Domestic or Global?

Financial centres are the spatial concentration of financial capital, services and employment. Historically, they often started as commercial centres, which raised the need to develop finance to service trade. Despite the existence of financial centres for a long time – as mentioned in the introduction, Venice, Florence and Genoa can be counted among them – the first truly global financial centre can be considered Amsterdam in the 17th and 18th century, before it was replaced by London at the turn to the 19th century. Though briefly challenged by Paris in the 19th century, London retained its pole position, which was later shared with New York. Yet another challenger – this time it was Tokyo – was unsuccessful in overtaking the two Anglo-Saxon hegemons and they remained the leading financial centres up to this day. However, a series of smaller financial centres managed to specialise in specific market segments and geographic regions, and they were able to catch a significant market share. Switzerland and Singapore developed into wealth management hubs; Luxembourg became a centre for mutual funds; Bermuda is a considerable insurance centre; Hongkong is one of the world's leaders for

[29] Singapore, Hong Kong, London, Luxembourg, Zurich, Geneva, Dubai, Abu Dhabi, Bermuda, Cayman Islands, British Virgin Islands, Jersey, Guernsey, Bahrain, Qatar, Isle of Man, Gibraltar, Liechtenstein, Monaco, Bahamas, Malta, Mauritius, Trinidad and Tobago;

[30] Z/Yen & China Development Institute (2017), "*The Global Financial Centres Index 22*", September 2017

initial public offerings and several British Overseas Territories developed as important booking centres.

Crucially, there is a distinction to be made between *international* financial centres and other important financial centres. Tokyo, for example, is undoubtably an important financial centre, but it predominantly serves the domestic market. Its exposure to the international market and attraction of foreign business is limited, compared to centres like Hongkong. Big centres, which mostly serve their domestic market include Tokyo, Shanghai and New York. This kind of financial centre will henceforth be referred to as a *domestic* financial centre. An *international* financial centre, on the other hand, is a financial hub with a large share of foreign (i.e. international or non-resident) business. Traditionally, London has been a large *international* financial centre, especially after the emergence of the Eurodollar market in the 1950s and '60s. Other important centres with predominantly foreign business include Singapore, Hongkong, Switzerland and Luxembourg. This distinction – between *international* financial centres and *domestic* financial centres – will be one of the crucial elements and concepts of this paper.

Lastly, as opposed to *international* financial centre, the term *global* financial centre, as used in this paper, attributes (global) importance, rather than *international* orientation to a centre. Thus, while London is an *international* and a *global* financial centre, Tokyo is only a *global* financial centre, but no *international* financial centre. It is of global importance, as one of the biggest and most important financial centres in the world, but its area of business is predominantly domestic. A small, internationally oriented centre like Mauritius, on the other hand, is an *international* but no *global* financial centre. Thus, the term *international* refers to a centre's geographic orientation, while the term *global* acts as a judgement of importance.

Hypothesis

The existing literature on the topic, especially the work of Ronen Palan, would indeed suggest a striking prevalence of city-states in the international financial system. Despite the dominance of two big global financial centres, New York and London, there is a series of highly successful small - and medium - sized cities, which constitute crucial nodes in the global financial network. Interestingly, these cities are often located within polities which can be considered city-states to some degree. As for the reasons for this phenomenon, this paper will adopt a political economy approach. A combination of demand and supply factors, tends to push city-states towards outward-looking economic policies, which include both, trade and finance. A lack of alternatives for economic development, due to a lack of resources and scarcity of labour, as well as a strong political dominance of commercial and urban elites (as opposed to landed aristocracy, dominating many territorial states) account for a strong commercial and financial orientation of city-states. This orientation, in turn, results in open and liberal policies and regulations, which give these polities a competitive advantage in the international competition to attract financial (and commercial) flows. This advantage naturally and inevitably also increases the dependence of these states on foreign customers and suppliers. Far from being a modern phenomenon, Venice, Genoa, the Phoenician city-states and the Hanseatic cities in the North and the Baltic sea demonstrate the historical dimension of this argument.

Thus, the hypothesis of this paper will be the following:

Due to their unique political economy – a mix of constraints and opportunities – city-states adopt more outward-oriented and liberal policies, which make them internationally competitive and foster their development as international financial centres.

More generally, we will now come back to the previously made distinction between *international* financial centres and *domestic* financial centres. Intuitively, one would expect domestic centres to depend on the size of the domestic market. Since they predominantly serve the domestic market, their importance should roughly correlate with the size of the country's economy. Without a doubt, there are many other factors playing a role in the evolution of such centres, but for practical reasons, this paper will focus on a country's gross domestic product, which should serve as a good indicator for the strength of domestic financial centres. City-states on the other hand, are not expected to necessarily correlate with the size of their national economy. Their focus is on international business and foreign clients, and as such, they are not dependent on their domestic market, which tends to be rather small. This independence can be advantageous, when interpreted as a lack of constraint by a small domestic economy, as well as an independence from domestic economic troubles. However, the same phenomenon can also be understood as a dependence on foreign markets and actors. This, in turn, can create problems during global crises, to which *international* financial centres are expected to be more exposed than *domestic* financial centres. Furthermore, as Dani Rodrik shows, complete dependence on international markets can negatively affect state sovereignty and the margin for economic policy decisions.[31]

In the following paragraph, the expected mechanism and the political economy of city-states, which was briefly summarised above, will be explained more in-depth. Any given city-state tends to have, due to the dominance of an urban area and a small, if existent, countryside, few natural resources and arable land. Furthermore, due to a generally small population, labour is relatively scarce and expensive. This leads to an economic specialisation in non – labour – intensive activities, such as trade. Additionally, international trade is often even required to satisfy domestic food and energy needs. The elites of these polities tend to form out of merchants, who became rich, and consequently powerful, due to the city's commercial specialisation. These elites, in turn, have a vested interest in fostering and supporting trade, which is their economic base. This creates a common elite interest in encouraging an open and outward-oriented economic policy. Due to the mentioned lack of land, there tends to be only a small landed aristocracy, if any, with no substantial political weight. Furthermore, because of the lack of economic alternatives, such as cheap labour and agriculture, this elite interest is more readily supported by non – elite groups within society. As the share of peasants in the general population is considerably smaller than in territorial states, their political heft is limited. The largely urban population should also have an interest in an open economy, which provides the economic base for the whole domestic economy. Thirdly, the first two factors – common elite interests and lack of economic alternatives – create a commercial tradition in many city-states over the long-run. This creates a lock – in effect or path dependency, which makes a shift away from open international economic policies unlikely. Finally, the switch from trade to finance is made relatively simple by their similar political economy implications, with no substantial change of winners and losers in their economy. One can reasonably expect former long-distance traders and merchants to become involved in trade finance or banking more easily than the landed aristocracy. Historically, this development can be observed in Genoa, whose merchants "*were moving out of trade and exclusively into finance.*"[32] It consequently developed from a medieval commercial city-state into an international financial centre with influence across Europe, enabling its "*merchant-bankers (…), through their handling of capital*

[31] Rodrik D. (2007), "*The inescapable trilemma of the world economy*", Dani Rodrik's weblog, June 27th, 2007

[32] Braudel F. (1984), "*Civilisation and capitalism, 15th – 18th century: The perspective of the world*", Collins: p.166

and credit, to call the tune of European payments and transactions."[33] And while, "*shortly before 1600, Genoa virtually became the financial capital of the catholic world (...)*", another city-state, "(…) *Amsterdam was becoming the financial capital of the protestant world".[34]* A more contemporary example is Singapore, which, after its independence, developed from an important entrepôt port into an internationally significant financial centre. Thus, the political economy of a financial centre is highly similar to the one of a more traditional commercial centre, and both apply to city-states. These three factors – common elite interests, lack of economic alternatives and commercial tradition – lead to open and liberal economic policies. Venice and Genoa, for example, "*were extremely open economies* (…)."[35] This is due to the elite pushing for such policies, large parts of society accepting them and path dependency locking them in. These policies can include the lack of capital controls, low taxes on financial transactions and capital gains, as well as liberal immigration policies, which are important to attract a highly educated pool of human capital. As Braudel, talking about the success of 17th century Amsterdam, put it: "*The expansion of the Dutch economy called, indeed demanded, foreign workers: It was in part their achievement."[36]* Amsterdam benefitted immensely from the arrival of refugees from all parts of Europe: French Huguenots, Sephardic Jews from Spain and Portugal (among them, the ancestors of David Ricardo and Baruch Spinoza) and, most importantly, merchants from Antwerp. The latter bringing "*capital, competence and commercial contacts*", resulting in the fact that "*fifty per cent of the first deposits in the Bank of Amsterdam, created in 1609, came from the Southern Netherlands.*"[37]

These policies, in turn, give the respective polity an edge in attracting international capital flows. Cassis writes that "*more than any other factor, state intervention and the regulatory framework have been put forward to explain the performance of financial centres."[38]* One can reasonably expect that international investors and capital owners prefer, ceteris paribus, jurisdictions with less taxes and lax financial regulations. Having the choice between otherwise two identical jurisdictions, they are expected to choose the one with lower taxes and less restrictive regulations. This preference can more easily be served by city-states than other polities, because of the above-mentioned factors. As a consequence, such a centre will attract more capital, exert more influence and receive more trust and prestige in the long-run. Thus, the political organisation (city-state) translates into policies (liberal and open), which serve international demand (for low taxes and few regulations) and result in success as an *international* financial centre (high market share and prestige).

Hence, one can expect two distinct categories of financial centres. One is expected to correlate positively with their domestic economy and the other one is expected to predominantly apply to city-states and similar polities. This would suggest, that in order to become an internationally important – or *global* – financial centre, a city either has to be located in – and serve a – big national economy, such as the United States, China or Japan, or,

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[33] ibid: p.157

[34] Fratianni M. & Spinelli F. (2007), "*Did Genoa and Venice kick a financial revolution in the Quattrocento?*", Österreichische Nationalbank working papers: p.14

[35] ibid: p.31

[36] Braudel F. (1984), "*Civilisation and capitalism, 15th – 18th century: The perspective of the world*", Collins: p.187

[37] ibid.

[38] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.283

alternatively, has to exhibit the characteristics of a city-state and its political economy. Centres, which have neither of these characteristics, should decrease in importance positively correlated with the size of their national economy.

Illustrating this hypothesis with concrete examples, would suggest that the emerging financial centre Mumbai will indeed rise to become one of the leading financial centres of the world, following the example of New York and Tokyo.[39] This will solely be possible because of the immense size of the Indian economy. Nur-Sultan, on the other hand, which has been undertaking tremendous efforts to prop up its reputation as a financial centre in the past years, is not expected to be able to gain significantly among financial centres. It can merely strive to do the best possible to grow in importance within the limits set by its political and economic environment (namely, its status as a non – autonomous city and Kazakhstan's national GDP). To be clear, the mechanism behind the developments of these two centres is the same - the only difference is the size of the correlating factor, the Gross Domestic Product of their national economy. Thus, while Nur-Sultan, and similar centres, still have a wide set of variables to influence, it will be fundamentally restricted by the size of its national economy and its political embeddedness into a territorial state.

Methodology

In order to answer the research questions - are city-states the more successful financial centres and if so, why is that the case – this paper will work with a Pearson correlation, to find a correlation between the size of a country's economy and the importance of its financial centre(s). This type of correlation measures the strength of a linear relationship between two variables. As an indicator for the importance of a financial centre, I will use its point score in the Global Financial Centre Index by Z/Yen. The size of the domestic economy will be measured by its Gross Domestic Product in Purchasing Power Parity terms. The outcome should show the above-mentioned correlation between a country's GDP and the importance of its financial centre(s). This mechanism would account for one of the two paths to success for a financial centre. We should also be able to observe the success of the other path – being a city-state – by determining the political organisation of centres that are outliers in the correlation. This position – meaning, an importance as a financial centre exaggerated relative to a country's GDP – should be predominantly reserved for city-states and similar polities. While Palan uses international debt issuance of countries, the Global Financial Centre Index includes a broader range of indicators to determine the importance of a financial centre. Most importantly, it will not be purely based on the size of a centre (i.e. market share) but also reputation and other factors. Furthermore, since it is not based on international debt issuance, it will be less biased towards *international* financial centres than Palan's methodology.

The second variable used in this paper will be a country's Gross Domestic Product in Purchasing Power Parity terms. This will serve as an indicator for the size and importance of a national economy and a proxy for the domestic market size available to any financial centre. Furthermore, Purchasing Power Parity reflects domestic market size better than Gross Domestic Product in nominal terms, and thus will be used in this paper.

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[39] ibid: p.239: "*The Tokyo centre's arrival was, above all, due to Japan's rise to the rank of economic superpower, as had been the case for Berlin in the 1880s and for New York at the turn of the twentieth century.*"

After determining whether there exists a correlation between a country's GDP and the importance of its financial centre(s), as well as the performance of city-states, I will investigate the second part of this paper's research question. I will analyse the theoretical mechanisms of this phenomenon and have a more qualitative look into specific cases. For this, I will employ several theories that could explain the issue. For that section of my paper I will rely on secondary literature by authors like Ronen Palan, Godfrey Baldacchino and Youssef Cassis.

Data

For the countries' GDP (PPP), I will use data from *The World Factbook* of the CIA[40]. The newest data available there is predominantly from 2017, with some exceptions for smaller countries[41]. I resorted to *The World Factbook* because the International Monetary Fund, the United Nations and the World Bank do not provide GDP data for several of the smaller countries under investigation. Since the vast majority of data on GDP is from 2017, I will use the September 2017 Global Financial Centre Index as point of comparison.[42] This Index features the world's most important and competitive 92 financial centres. Thus, my sample set will consist of these 92 cities, out of which this paper identifies 24 as some form of city-state. Furthermore, I will use the number of points the centres scored in the ranking, not their rank as a proxy for their importance. This illustrates the differences between financial centres better than the number of their rank. For example, London ranks first with 780 points and New York second with 756 points. While there are 24 points between them, the difference between, say, Hongkong (rank 3) and Singapore (rank 4) is only 2 points (744 and 742 points respectively).

Observations

The following empirical part will look at the correlation between a financial centre's importance, as measured in the Global Financial Centre Index of September 2017, and the GDP (PPP) of its national economy. Running a Pearson correlation coefficient using the SPSS Statistics program for the 92 cases featured in the index (see *Annex*), we do indeed observe a relatively weak, yet statistically significant positive correlation between the two variables. This can be seen by the Pearson's correlation number 0.214 presented in table 1 below.

Table1

Correlations

		Points	GDP
Points	Pearson Correlation	1	.214*
	Sig. (2-tailed)		.040
	N	92	92
GDP	Pearson Correlation	.214*	1
	Sig. (2-tailed)	.040	
	N	92	92

*. Correlation is significant at the 0.05 level (2-tailed).

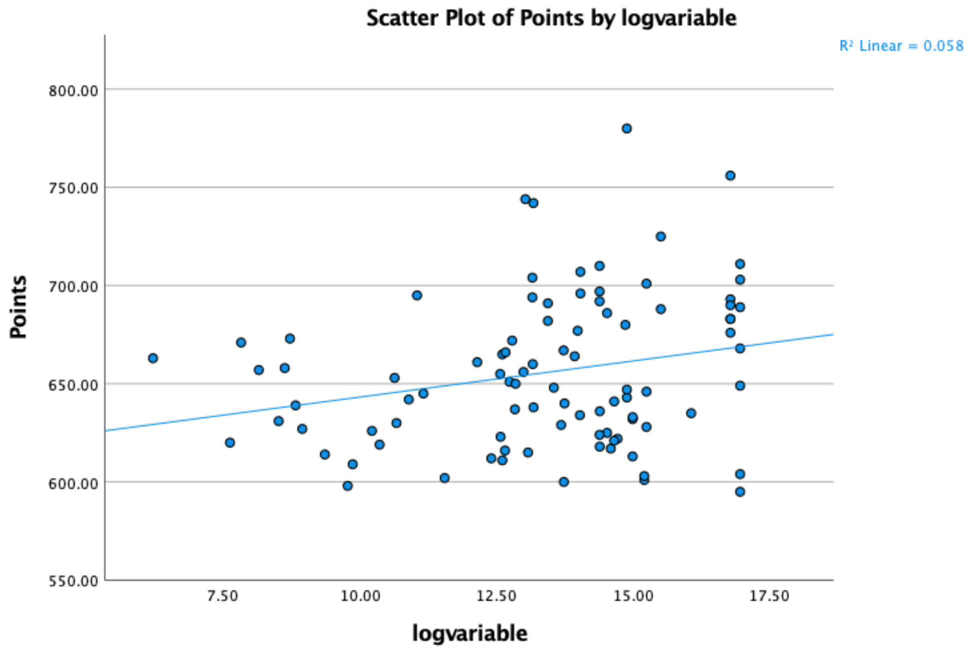
[40] Central Intelligence Agency (2020), "*Country Comparison: GDP (Purchasing Power Parity)*", The World Factbook

[41] Monaco (2015), Isle of Man (2015), Bermuda (2016), Jersey (2016), Liechtenstein (2014), Guernsey (2015), Cayman Islands (2014) and Gibraltar (2014);

[42] Z/Yen & China Development Institute (2017), "*The Global Financial Centres Index 22*", September 2017

Visualising the correlation in graph 1, one can observe the positive correlation between the two variables. However, in order to achieve better visualisation, I will use a semi-logarithmic plot. This is conducive since the GDP data ranges from $500,000,000 for the British Virgin Islands to $25,360,000,000,000 for China. Besides observing a positive correlation, there are several other phenomena observable in graph 1. London is ranked the highest, followed by New York and the two Asian cities Hong Kong and Singapore. As the point score declines, centres' national GDP generally decline with it – with the notable exception of non-primary financial centres in the big economies. One can clearly see these secondary and tertiary financial centres in China and the United States, lined up vertically on the right side of the graph. These are financial centres which are not the primary financial centre in their national economy. We will come back to them in the following paragraph.

Graph1



Next, we are omitting above-mentioned countries' secondary and tertiary financial centres – that means every centre, which is not the highest-ranked centre in its national economy in the Global Financial Centres Index. These centres score too low in the index relative to their GDP. However, this is due to national competition from a more competitive centre and is thus less relevant for this paper's thesis. The reason they are not ranked higher in the index is the fact that they are not the primary financial centre in their country and another, more important, centre in the same economy captures a large part of domestic business. An outstanding example of this is Dalian, which occupies the lowest rank in the index (ranked 92nd with 595 points), while being located in the biggest economy, China. The second correlation, thus, considers only one financial centre per country. This results in the omittance of centres like Beijing, San Francisco, Montreal and Hamburg. The number of observed cases (*n*) consequently drops from 92 to 69. The result can be observed in table 2 below with a Pearson´s correlation of 0.354, showing a stronger correlation than the one observed in table 1.

Table2

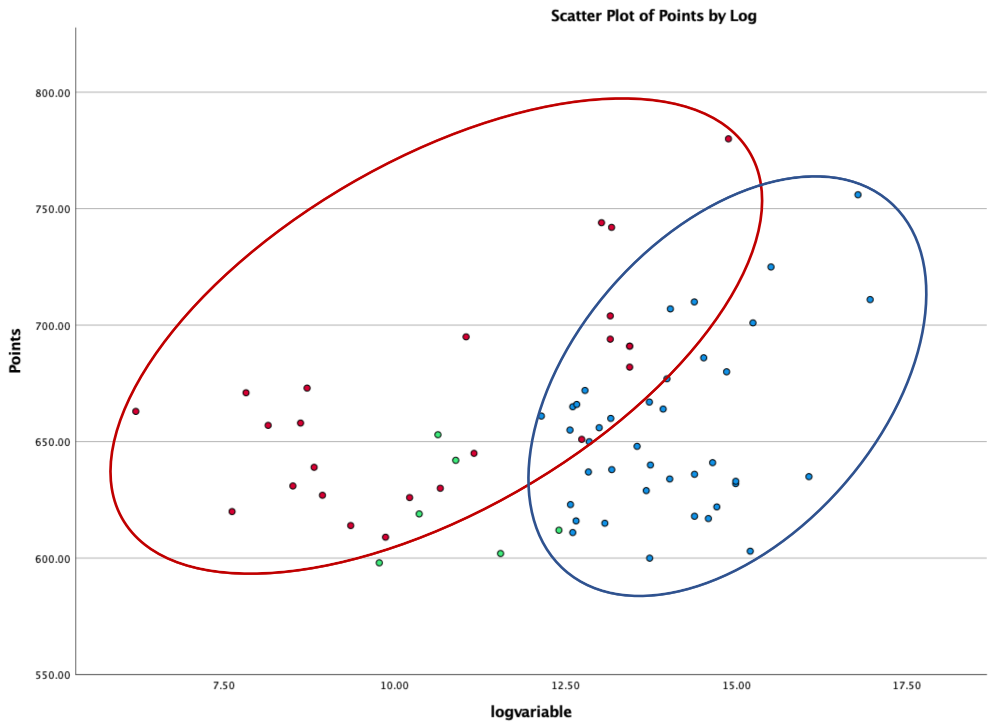
Correlations

		Points	GDP
Points	Pearson Correlation	1	.354**
	Sig. (2-tailed)		.003
	N	69	69
GDP	Pearson Correlation	.354**	1
	Sig. (2-tailed)	.003	
	N	69	69

**. Correlation is significant at the 0.01 level (2-tailed).

Below, the correlation from table 2 is visualised in graph 2 – once again as a semi-logarithmic plot. As can be seen in this graph, another non-orthodox group are, as expected, city-states. Jurisdictions, which are considered city-states in this paper are represented in red. The previously mentioned centres, which fall into the grey area between city-state and territorial state are marked in green. The city-states are overwhelmingly skewed to the left, relative to the other centres, illustrating the big share of international business they rely on. Thus, they are able to achieve equal, and sometimes even higher, scores as centres with a considerably higher GDP. Their point score in the financial centre index is relatively high, compared to the size of their domestic economy. This thus answers the first research question of the paper and supports its hypothesis. City-states tend indeed to be more important and competitive financial centres than their size would suggest. Interestingly, however, they also seem to roughly follow the correlation between GDP and points in the index, simply on a different level than other countries, since they tend to have a relatively higher score compared to their GDP. The prime exponent of this group are the British Virgin Islands, which have the lowest GDP of all featured countries, but rank 37th in the index with 663 points. Grouping them together, city-states (in the red oval) have, relative to non-city-states (in the blue oval), a tendency towards a lower GDP but relatively higher point score. This demonstrates on a group level, their exaggerated position as financial centres relative to their size. Hence, GDP cannot explain the above-average performance of city-states. Another reason must account for their relatively high scores. This will be investigated in the next chapter. Non-city-states, on the other hand, tend to lean towards the right of the graph, indicating higher GDP with a comparable score in the financial centres ranking.

Graph2.



Lastly, we will – adding to the investigation of only one financial centre per country - also remove city-states from the data set for the correlation. This third data set will thus not feature cities like London, Dubai, Singapore and Zurich. Here, the number of *n* drops from 69 to 46. The aim is to show a general pattern which applies to "ordinary" (i.e. non-city states) jurisdictions, which rely on their domestic market. The results can be seen in table 3 with a Pearson´s correlation number of 0.505, showing a higher degree of correlation than the two previous tables.

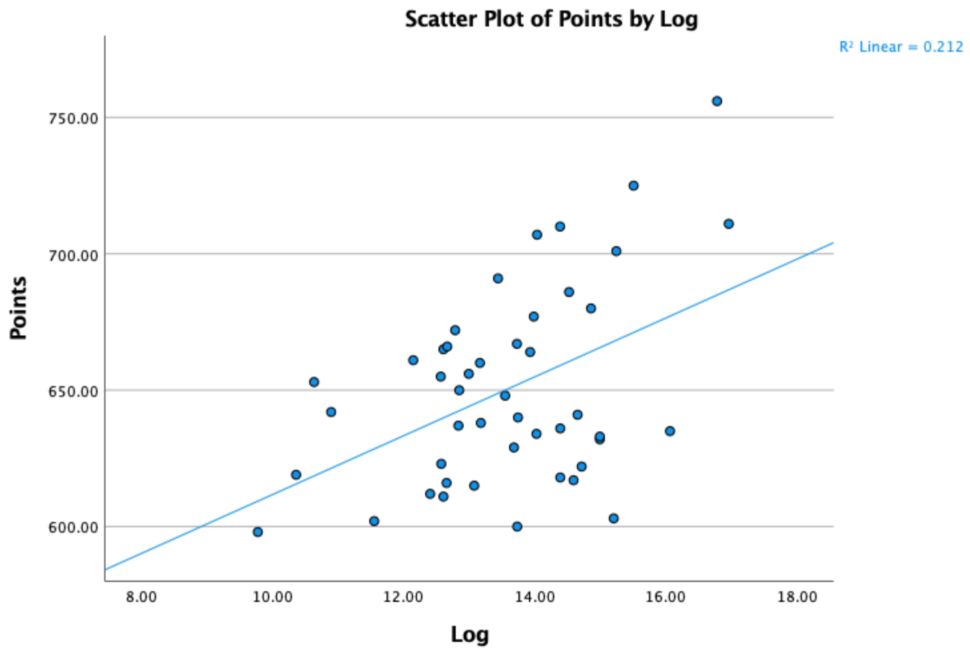
Table3

Correlations

		Points	GDP
Points	Pearson Correlation	1	.505**
	Sig. (2-tailed)		.000
	N	46	46
GDP	Pearson Correlation	.505**	1
	Sig. (2-tailed)	.000	
	N	46	46

**. Correlation is significant at the 0.01 level (2-tailed).

Graph3



The positive correlation observed in graph 1 and 2, is even clearer in graph 3. Having omitted London (as a city-state), New York is now the apex of the financial centre ranking. Notable is the absence of Chinese and American second and third financial centres (the previously mentioned Dalian, among others), as well as the outliers represented by city-states. Five of the centres in medium-sized countries, which were mentioned in the conceptualisation, represent the smallest economies now: Reykjavik (598 points), Cyprus (619), Riga (642), Panama (602) and Tallinn (653). Centres still lying significantly below the trendline tend to be in emerging economies, such as India (Mumbai, 635 points), Russia (St. Petersburg, 603 points), Argentina (Buenos Aires, 600 points) and Mexico (Mexico D.F., 622 points). This suggests that financial centres take longer to establish themselves than emerging economies take to grow economically. We expect most of them to slowly catch up over time, adapting to their growing domestic market. This is what has happened with Tokyo in the 1970s and 1980s and with Shanghai over the past decade.

Overall, the observations support the hypothesis of the paper and seem to be bad news for ambitious financial centres in medium-sized economies. The high scores of city-states relative to their GDP, support the hypothesis of city-states' importance as financial centres. Relative to their GDP, they occupy an outsized role in the financial centre network. Another observation is the trend of centres in emerging economies to generally lie below the trendline. This shows the more stable and long-term architecture of the international financial network system, compared to the sometimes stunning GDP growth of certain emerging economies over the past decades. Cassis wrote already that "*the ranking of the centres and that of the economies do not match exactly, since the emergence of a major international financial centre follows, with some degree of time-lag, a nation's rise to being a great economic power.*"[43] Becoming a financial centre takes time and a set of trust, reputation, appropriate regulations and a developed financial market. Thus, centres like Mumbai, for example, have not been able to rise with the same speed as the Indian economy did. We expect those centres to catch up over time and reach the trendline, where they are expected to stay.

Thus, there seem to be two sets of circumstances under which a financial centre can achieve a high international status. Either it is located in one of the big economies in the world (assuming it is the foremost financial centre in that economy) or it has or adopts characteristics of a city-state. In the next section of the paper I will investigate more in-depth the mechanisms that lead to this situation.

Analysis

This qualitative part will talk about several mechanisms that can explain the observations in the previous section of the paper. As such, this chapter aims at answering the second research question: Why are city-states relatively more important financial centres? While the correlation between a country's GDP and the importance of its most important financial centre seems to be relatively easily explained with market access and the size of domestic business, the phenomenon of city-states as financial centres, and especially as *international* financial centres, requires further clarification and a more in-depth analysis. The following part will look at two theories that have been employed in other papers to explain the political economy of micro-states. At first, we will get a deeper insight into the *hinterland theory*, as seen in Baldacchino[44] and Palan.[45] After that, we will have a brief look at another theory of International Political Economy, adopted by Palan, the *hegemonic cycle theory*.

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[43] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.280

[44] Baldacchino G. (2006), "*Managing the hinterland beyond: Two ideal-type strategies of economic development for small island territories*", Asia Pacific Viewpoint, Vol.47, No.1: pp.45-60

[45] Palan R. (2010), "*International Financial Centres: The British Empire, City-states and commercially oriented politics*", Theoretical Inquiries in Law

Hinterland theory

The singularly most important theory in explaining the phenomenon of city-states as financial centres is the so-called *hinterland theory*. Palan claims, that it "*goes a long way toward explaining the relative success of city-states in contemporary finance.*"[46] I would go even further and suggest that it not only goes almost *all* the way in explaining their success, but also that this explanation is by no means constrained to *contemporary* finance. In short, this theory suggests that the domination of an urban territory and a lack of surrounding countryside has a profound influence of political interests and coalitions in a political entity.

Baldacchino applies this theory to small island territories, in his paper "*Managing the hinterland beyond: Two ideal-types strategies of economic development for small island territories.*"[47] However, the political economy mechanism is expected to be very similar for small islands and city-states, due to their common geographic circumstances. He suggests that the lack of *Hinterland* ("the land behind") "*inhibits the formation of a land-owning peasantry or plantocracy which can become a formidable lobby in domestic and regional politics, seeking protection from cheaper imports and contributing to higher costs of food items to consumers.*"[48] Furthermore, it shows how small states, especially city-states, depend on "*extra-territorial resources as its hinterland.*"[49]

City-states throughout history were in a special geographic and political situation. They usually did not have a significant *hinterland*, or surrounding countryside. When they did possess some land surrounding the urbanised centre, then this countryside was not politically and economically powerful but merely served as an appendix to the city itself. This unique situation, radically different from the situation faced by territorial states like France, the United States and China, brought and brings with itself a peculiar political economy. This lack of land and resources generally results in a political and economic elite focused on commerce and finance. According to David Stasavage:" *The literature on state development in Europe has emphasized that city-states were often politically dominated by merchant groups. Merchants either had substantial influence in state politics, or in many cases they actually directly ruled a city.*"[50] More generally, the state's economy will be based to a large extent on the secondary and increasingly tertiary sector. As such, there is a broader political consensus in favour of an open economy, specialising on international business and exports. This political consensus, in turn, facilitates and fosters liberal policies, which give the state a competitive advantage in attracting highly sought-after international business. Countries, on the other hand, which have to make political compromises, because of special interests of landowners and others, have less discretion in liberalising and opening up their economy. "*There are far fewer suggestions that merchants were as politically dominant in larger territorial states such as France or Castile. In larger states one would expect merchants to have been a small minority of the political*

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[46] ibid: p.57

[47] Baldacchino G. (2006), "*Managing the hinterland beyond: Two ideal-type strategies of economic development for small island territories*", Asia Pacific Viewpoint, Vol.47, No.1: pp.45-60

[48] ibid: p.46

[49] ibid: p.45

[50] Stasavage D. (2007), "*Cities, Constitutions and Sovereign Borrowing in Europe, 1274 – 1785*", International Organization, vol.61, no.3 (Summer, 2007), Cambridge University Press, pp.489-525: p.499

elite."[51] As a consequence, they will be less competitive, ceteris paribus, than their city-state counterparts. Thus, this mechanism is in accordance with this paper's hypothesis.

Hegemonic cycle theory

This theory analyses the development of empires through different stages. At first, empires such as the British or the American one, built up their manufacturing base and specialised on that economic segment. Over time, their specialisation, and the focus of the elites, shifts to commerce. Eventually, the financial sector becomes the most important part of the economy. Thus, after the empires collapse, they leave behind a bloated financial sector, which consequently makes up an important part of their successor economies. This importance brings with itself political power for the financial sector. Consequentially, this power of financial and commercial elites plays a role in deregulation and other policies. As Palan suggests, "*The British Empire was a declining hegemonic state, and hence it possessed a by then weakened manufacturing sector and declining commercial sector, but correspondingly a relatively powerful, and more importantly, internationally-oriented financial sector.*"[52] Thus, as a consequence, "*a rapidly collapsing trading empire such as the British left behind a bloated financial center in the City of London that has been traditionally politically powerful.* "[53] While this theory is certainly an interesting approach to former empires and their remnants, such as the British Overseas Territories and London, its explanatory power for centres like Luxembourg, Liechtenstein and Geneva is decisively less strong. As such, it seems like the imperial heritage is more a reinforcing, rather than a necessary factor for the success of a city-state as a financial centre.

Theoretical mechanism

In order to succeed as a financial centre, one needs first and foremost a market. The bigger the market, the more potential customers, as well as suppliers (of human and financial capital) are accessible for a specific financial centre. As Cassis states, "*a first conclusion prompted by long-term historical analysis is that the rise of a major centre is closely linked to the economic power of the country that hosts it.*"[54] A financial centre located in a big economy, such as New York in the United States, has access to a sufficiently big customer and supplier base within its borders. As such, it can specialise as a *domestic* financial centre and does not rely on international business. This means it is exposed to less international competition, than a centre which is competing for foreign business. Consequently, pressure and incentive to liberalise the financial sector, open up the capital account and generally deregulate to attract international business are lower. In the case of New York, for example, domestic business, which dominated the New York financial markets, offset the losses in foreign business, when the United States

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[51] ibid.

[52] Palan R. (2010), "*International Financial Centres: The British Empire, City-states and commercially oriented politics*", Theoretical Inquiries in Law: p.69

[53] Palan R. (2015), "*The Second British Empire: The British Empire and the re-emergence of global finance*", In: Halperin S. & Palan R., "*Legacies of Empire: Imperial roots in the contemporary global order*". (pp.40-68), Cambridge University Press: p.7

[54] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.279

introduced stricter financial regulations.[55] A financial centre in a small economy, on the other hand, faces similar constraints as producers of goods in that economy. The domestic market is too small to generate sufficient revenue and the focus shifts to exporting (for goods) and attracting international business (for financial services). This puts this economy in direct international competition with other small and medium-sized economies. In order to gain an edge over its competitors, deregulation and liberalisation are crucial tools for such an economy. However, this deregulation of the financial sector, and more generally the economy, is usually subject to a political struggle and comes at a political cost. In a situation resembling the British corn laws in the 19th century, some parts of society and the elite might be opposed to an open economy – this group will typically include landowners but can also comprise industrialists – while others are in favour (the financial and commercial sectors). This struggle will generally shift the political balance constantly from one side to the other and prevent a durable political equilibrium, which provides a stable political environment for international financial business. This, in turn, will lead to a loss of competitiveness relative to more stable and open financial centres.

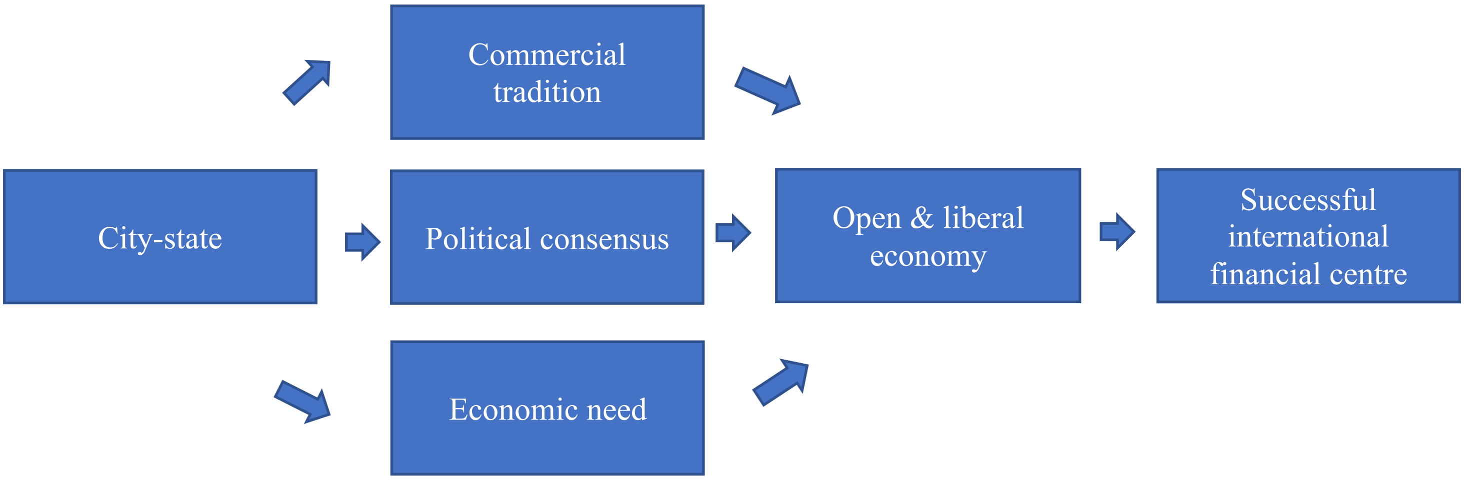
A solution for this problem would be homogenous economic interests, if not of society overall, then at least among the elite. An elite, which is unified in its support for deregulation and the opening up of the economy, will provide a stable political basis for such measures. As a result, this open and stable financial centre will attract, ceteris paribus, more international business. Due to their unique geographic and economic situation, city-states have a clear advantage over other polities regarding common elite interests. Due to a lack of land, they do not have an important landowning elite and historically their political and economic elites were engaged in trade and finance. Due to this, city-states are more likely to deregulate their economy and open up to international business, which makes them more competitive in the international struggle to attract foreign financial business. Furthermore, due to a lack of resources and land, economic alternatives are rare, which gives supporters of liberalisation a higher bargaining power.

Following, I am clarifying the theoretical mechanism of the success of city-states as financial centres. However, before, I will show the mechanism of a *domestic* financial centre in a big economy. This process is fairly intuitive and is not the focus of this paper. However, it will be used as an instrument to show the peculiarities and challenges of city-states. Thus, it should be considered a contrasting mechanism, which clarifies the explanation of the political economy of city-states. The dependent variable (success as a *domestic* financial centre) is achieved through the independent variable (high GDP).

The mechanism for city-states works differently, however. They lack the single most important feature of big domestic centres – a large domestic market. If they relied on their domestic market, their success as financial centres would be negligible. Thus, the independent variable of (high) GDP is non-existent and will be replaced by their unique political organisation. Here, the independent variable is the status as a city-state, which makes the dependent variable (success as an *international* financial centre) possible. The mechanism connecting the two

[55] ibid: 284

variables are the strong political consensus, commercial tradition and lack of economic alternatives, as well as the resulting above-mentioned open and liberal policies.



Ronen Palan traces the advantage of city-states back to the Eurodollar market. "*My explanation centers on the unusual characteristics of the financial system since the late 1950s, which have emerged due to the rise of a specialized international financial market otherwise known as the Euromarket or the offshore financial market (OFC).*"[56] My paper, on the other hand, is suggesting that this phenomenon is much older and has constituted the economic specialisation of city-states throughout history. The Eurodollar market has certainly reinforced and changed the quality of this phenomenon, but the fundamental political economy of city-states, and, as a result, their finance – and commerce – centred economic model have been existing for centuries.

Additionally, Palan talks about a "*British Empire network of city-state international financial centers*"[57]. He advances two theories, the above-mentioned *hegemonic cycle theory* and the *dependent jurisdictions theory*, which I did not discuss in this paper, to explain the advantages of British empires remnants. However, my analysis shows that city-states overall, indiscriminately of their imperial heritage and past, seem to be more competitive and disproportionally represented among the important financial centres. Thus, as mentioned previously, non-sovereignty (*dependent jurisdictions theory*) and an imperial past (*hegemonic cycle theory*) are supporting and reinforcing factors, rather than necessary conditions for the observed phenomenon.

Types of city-states

"*The international financial market — the market that is supposed to be the most advanced, sophisticated and modern — exhibits a preference for small and often somewhat*

[56] Palan R. (2010), "*International Financial Centres: The British Empire, City-states and commercially oriented politics*", Theoretical Inquiries in Law: p.56

[57] ibid.

anachronistic polities including the British Empire and its remnants, city-states, or European dukedoms and monarchies."[58]

After the general and theoretical part of the paper, talking about city-states as one group as opposed to non-city-states, the next part will provide a more in-depth and qualitative insight into the different types of city-states that were under investigation in the previous chapter. This chapter will serve as both, a more tangible illustration of the phenomenon and a justification and explanation for the designation of certain cities as city-states. It will group city-states into different categories. These categories range from comprising one singular financial centre (London) to seven of them (Remnants of the British Empire). They are grouped after geographic, economic and political factors. The aim is to capture and portray the different types of modern city-states and to demonstrate their differences and similarities. Additionally, these different categories each perform differently in this paper's empirical analysis. Baldacchino writes that while *"the apex of jurisdictional powers (...) has been achieved (...) by sovereign small, often island states: (...) banking policy in Luxembourg and Liechtenstein (...)."* However, "*(...) the political economy of success is even clearer among non-sovereign island territories. Discretion over taxation and offshore finance has been behind the success of such territories as (...), Bermuda, British Virgin Islands, Turks and Caicos, the Isle of Man and the Channel Islands.*"[59] By grouping similarly performing financial centres, common characteristics can potentially explain these differences. Interestingly, while being all considered *city-states*, their domestic political organisation differs greatly. This ranges from the parliamentary republic Malta to the absolute monarchy Qatar. Some, like Liechtenstein, are sovereign nations, while others, like Bermuda, are non-sovereign but autonomous political entities. The list features a monarchy which is among the most democratic states in the world, the Grand Duchy of Luxembourg, and a parliamentary republic, which is in fact dominated by one party and often considered authoritarian, the Republic of Singapore. Some of these centres have been established financial centres for centuries, like Geneva, while others, like Qatar, have only recently tried to attract financial services, as part of their economic diversification strategy. Lastly, their imperial and colonial connections differ. While some are still part of the United Kingdom, such as the Isle of Man and the Cayman Islands, others gained independence in the second half of the 20th century (e.g. Mauritius and Singapore), and yet others, like the Swiss centres and Luxembourg, have never been part of a colonial empire and vary significantly in their historical heritage. Their common denominators are their small area and relatively small population, commercial, often maritime, or financial tradition, common elite interests, large discretion in fiscal and regulatory matters and lack of resources (with the exception of the oil-rich monarchies around the Persian Gulf).

[58] Palan R. (2015), "*The Second British Empire: The British Empire and the re-emergence of global finance*", In: Halperin S. & Palan R., "*Legacies of Empire: Imperial roots in the contemporary global order*". (pp.40-68), Cambridge University Press: p.5

[59] Baldacchino G. (2006), "*Managing the hinterland beyond: Two ideal-type strategies of economic development for small island territories*", Asia Pacific Viewpoint, Vol.47, No.1: p.50

London

"The City of London is a unique political entity, described invariably as quasi-feudal or quasi-democratic."[60]

London might well be the most surprising, and confusing, entry in the list of city-states in this paper. Obviously, London is neither a sovereign nation like Singapore, nor a former colony, which achieved internal self-governance, despite not being a sovereign entity, like the British Overseas Territories. Also, while London clearly dominates the United Kingdom economically, contributing 21% of the British Gross Value Added in 2011[61], its political weight within British politics is more limited. As seen during the Brexit referendum, its economic dominance does not always translate into omnipotence in the political arena. Despite a clear vote for "remain" in London, the national win of "leave" kicked London, together with the rest of the country, out of the European Union. Why, then, is London considered a "city-state" in this paper? To be sure, the political entity under investigation here is the City of London. While having been the traditional financial heart of London, it faces competition from other areas, like the London East End these days. The "city-state" of London, however, does only comprise the Square Mile, not other financial areas, like Canary Wharf. The City is governed by the *City of London Corporation*, which assumes unusual responsibilities for a local government and is to be distinguished from the Greater London Authority, headed by the Mayor of London. Crucially, the City of London Corporation "*exists outside many of the laws and democratic controls which govern the rest of the United Kingdom."*[62] This enabled the City "*to establish itself as a kind of offshore state, a secrecy jurisdiction which controls the network of tax havens housed in the UK's crown dependencies and overseas territories*."[63] Thus, its unique tax and regulatory autonomy makes it an offshore jurisdiction within the United Kingdom and on British soil.[64] Stunningly, in the corporation's electoral system, not only natural persons, but also businesses have the right to vote[65], which gives the business sector, in this case the financial services sector, unique power and influence. While London has been a global financial centre for over 200 years, its current profile is heavily owed to the rise of the Eurodollar market in the 1950s and '60s. Its current success is due to its "*unrivalled international openness."*[66] As Cassis put it: "*It could only become, and can only remain, a global financial centre in the same vein as New York and Tokyo by being completely internationalised. The alternative is a financial centre commensurate with the British economy – that is to say, bearing in mind a number of competitive advantages, slightly larger than Paris*

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[60] ibid: p.13

[61] City of London (2011), "*London's competitive place in the UK and global economies*", Economic Research and Information, 20th January 2011

[62] Monbiot G. (2011), "*The medieval, unaccountable Corporation of London is ripe for protest*", The Guardian

[63] ibid.

[64] Kaminska I. (2015), "*How the City of London really does make up its own rules*", Financial Times, September 18th, 2015

[65] ibid.

[66] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.281

or Frankfurt."[67] This, in turn, was made possible and fostered by the City's unique status and lack of regulation. According to Palan, "*the City of London is run more like a guild in the control of the financial and business interests resident in the Square Mile*".[68] This is reminiscent of the political structure and interest representation of medieval Italian city-states. The guilds in these cities became important political actors and units of political organisation, especially concerned with trade and finance.[69] Furthermore, the City shares several characteristics of centres in the category "remnants of the British Empire".[70] Thus, the City of London does meet, to some extent, the above-mentioned necessary conditions to be considered a *city-state* in this paper.

Swiss city-cantons

"In contrast to other financial centers (…) the money market in Switzerland is not concentrated in any one city. This fact is chiefly due to the political organization of Switzerland as a confederation of twenty-five states (cantons) which have wide powers of local government."[71]

The two Swiss financial centres ranked in the index are Geneva (15th) and Zürich (9th). While clearly not true city-states, they are nevertheless included in the category of city-states because of the strong decentralisation of the Swiss political system, especially in the fiscal realm. The high fiscal autonomy enjoyed by the Swiss cantons fosters fiscal competition among them. According to Braun, "*Switzerland has tax competition and exhibits characteristics of decentralised federalism.*"[72] The Swiss federal constitution explicitly codifies the sovereignty of the Swiss cantons.[73] While this equally applies to rural and urban cantons, the urban ones (or *city-cantons*) are furthermore characterised by urban commercial elites and a long commercial and banking tradition. Thus, Geneva and Zurich both fulfil, to some extent, the previously-mentioned conditions to be considered city-states in this paper's analysis: High fiscal discretion, homogenous elite interests and a lack of economic alternatives. The Swiss centres are among the oldest and most established financial centres in the world. *"Switzerland remains a hub in the world of finance, attracting foreign capital and reinvesting it outside the country, which enables it still to play a major role in international banking business. "*[74]

[67] ibid: p.267 & 268

[68] Palan R. (2015), "*The Second British Empire: The British Empire and the re-emergence of global finance*", In: Halperin S. & Palan R., "*Legacies of Empire: Imperial roots in the contemporary global order*". (pp.40-68), Cambridge University Press: p.14

[69] Parker G. (2004), "*Sovereign city – The city-state through history*", Reaktion Books: p.96

[70] ibid: p.13

[71] Kindleberger C.P. (1973), "*The formation of financial centres: A study in comparative economic history*", working paper department of economics, No. 114, Massachusetts Institute of Technology: p.48

[72] „*Die Schweiz besitzt Steuerkonkurrenz und weist Züge eines dezentralen Föderalismus auf.*"; Braun D. (2003), "*Dezentraler und unitarischer Föderalismus. Die Schweiz und Deutschland im Vergleich*", Swiss Political Science Review 9(1): 57-89: p.81

[73] ibid: p.61

[74] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.273

Famous for its laws on banking secrecy, Switzerland is currently ranked third in the financial secrecy index by the NGO tax justice network.[75] According to Deloitte's international wealth management centre ranking, Switzerland is the world's biggest and most competitive wealth management hub.[76] "*Geneva in particular is widely seen as the world's capital of private banking.*"[77] Additionally, Geneva is one of the world's most important trading centres for oil and other commodities.

Remnants of the British Empire

"*A third remarkable fact about the British Empire is that while it disappeared completely from most contemporary maps of the world, it remains very much alive in one crucial such map, the map of contemporary international finance.*"[78]

This category comprises the British Overseas Territories (Cayman Islands, Bermuda, British Virgin Islands, Gibraltar) and Dependencies of the British Crown (Isle of Man, Guernsey, Jersey) that made their way into the Global Financial Centre Index. These territories are not independent but are granted internal self-governance. All their economies heavily rely on tourism and financial services. Services represent between 86%[79] (Isle of Man) and 100%[80] (Gibraltar) of their respective Gross Domestic Products. This category of financial centres and city-states generally exhibits the strongest disproportionality between gross domestic product and ranking in the Global Financial Centres Index among all types of city-states analysed in this paper. As argued by Palan, their strong connection to the United Kingdom, especially London, and their status as non-sovereign entities, give them an additional advantage over other centres. Their dependency helps them being seen as safer regions to invest than independent islands, which used to be part of the British Empire in former days.[81] These centres developed as outposts of the City of London financial centre during the 20th century. According to Palan, this is due to two principal reasons. As having established above, the City of London was mostly unregulated and, as such gave birth to the Eurodollar markets. It was, however, heavily taxed. Thus, moving accounts and operations to territories like the Channel Islands and the British possessions in the Caribbean avoided British taxes, while still benefitting from the lack of regulation. Secondly, these centres share time zones with other big financial centres and markets in the Americas and Asia. This "*offered logistical advantages (…)*", and "*the City*

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75 Tax Justice Network (2020), "*Financial secrecy index 2020*"

76 Deloitte (2018), "*The Deloitte International Wealth Management Centre Ranking 2018*"

77 Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.27

78 Palan R. (2015), "*The Second British Empire: The British Empire and the re-emergence of global finance*", In: Halperin S. & Palan R., "*Legacies of Empire: Imperial roots in the contemporary global order*". (pp.40-68), Cambridge University Press: p.1

79 The World Factbook (2020), "*Isle of Man*", Central Intelligence Agency

80 The World Factbook (2020), "*Gibraltar*", Central Intelligence Agency

81 Palan R. (2010), "*International Financial Centres: The British Empire, City-states and commercially oriented politics*", Theoretical Inquiries in Law: p.53

of London could become through colonial outposts, a 24 hours integrated financial center present everywhere in the world."[82]

European micro-states

"The story of how a marginal and relatively powerless country [Luxembourg] has survived world wars, economic crises and cataclysmic technological advances to become a banking and finance powerhouse tells us a lot about how far a small country can go if it devotes itself to anticipating and accommodating the needs of global capital."[83]

This category consists of four small European countries (Monaco, Luxembourg, Liechtenstein and Malta), mostly dominated by one city. In contrast to the other European centres discussed in the paper (London and the Swiss centres) and the centres discussed thus far, they are sovereign states. Another characteristic, separating then from most other modern political entities is the fact that three out of the four states are monarchies of some form (Monaco, Luxembourg and Liechtenstein). Their economies are dominated by services, with a strong focus on financial services. They tend to be wealth management hubs, with Luxembourg also being a centre of mutual funds. This group is characterised by significant differences in the global financial centre ranking, with Luxembourg ranked 14th with 695 points and Malta ranked 85th with a score of 609 points. Another indicator where these four micro-states differ is their urbanisation rate and the share of the tertiary sector in GDP. While Liechtenstein has an urbanisation rate of only 14.4% according to The World Factbook[84], Monaco's rate is 100%[85]. The GDP share of the tertiary sector ranges from 52% in Liechtenstein (2014)[86] to 88.7% in Malta (2017).[87] Another European monarchic micro-state, which strives to become a financial centre but has yet to achieve being ranked in the global financial centre ranking, is Andorra.

Asian Entrepôts

"*One of the most striking differences between globalisation prior to 1914 and at the turn of the twenty-first century is the rise of the Asia-Pacific centres to become centres of truly international calibre (...).*"[88]

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[82] Palan R. (2015), "*The Second British Empire: The British Empire and the re-emergence of global finance*", In: Halperin S. & Palan R., "*Legacies of Empire: Imperial roots in the contemporary global order*". (pp.40-68), Cambridge University Press: p.8

[83] Abrahamian A.A. (2017), "*How a tax haven is leading the race to privatise space*", The Guardian

[84] The World Factbook (2020), "*Liechtenstein*", Central Intelligence Agency

[85] The World Factbook (2020), "*Monaco*", Central Intelligence Agency

[86] The World Factbook (2020), "*Liechtenstein*", Central Intelligence Agency

[87] The World Factbook (2020), "*Malta*", Central Intelligence Agency

[88] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.275

Singapore and Hong Kong are the two dominant global financial centres in Asia and among the most important in the world. These two city-states successfully managed the transformation from manufacturing and trading hubs into financial centres. While Singapore is a sovereign nation, Hong Kong is granted a high degree of autonomy under the "one country, two systems" principle of China. These two city-states boast the highest GDP of any single city under investigation in this paper. This is because for London, the GDP of the United Kingdom is counted, for the Swiss centres, the GDP of the whole of Switzerland and for Dubai and Abu Dhabi, the United Arab Emirates' gross domestic product. Also, the two Asian centres have continuously been ranked in the top 4 in the Global Financial Centres Index since its inception in 2007 (with the exception of the index in March 2020, where Singapore is ranked 5th and Hongkong 6th), demonstrating an impressive stability. This confirms the two cities' standing in the world of global finance and their success as *international* financial centres. Singapore's economic development after its independence in the 1960's, first as a trade hub and later as a financial centre, despite a lack of resources and even domestic freshwater sources is, especially remarkable. Despite their many similarities, the two are distinctively different financial centres. This is most prevalent in their economic strategy to becoming a financial centre. While Singapore relied on state intervention and a strong developmental state[89], Hong Kong pursued a laissez-faire policy and its economy is one of the freest in the world.[90] A *Bloomberg* article puts the difference between the two entrepôt cities the following way, talking about Singapore's aspirations: "*For all its ambitions to turn itself into the London of Asia, it looks a lot more like the region's Zurich — dominated by the discreet worlds of private banking and commodities trade, rather than the colorful chaos of capital markets and dealmaking found in its northern cousin.*"[91] Their financial specialisation differs slightly as well. While Hong Kong has developed into an international hub for initial public offerings, as well as a gateway to the vast Chinese market, Singapore has become one of the world's foremost wealth management, currency trading and commodity trading centres. Furthermore, it serves as the financial hub of emerging South-East Asia.

Petro-States

"*Each of the members of the United Arab Emirates is technically a sovereign state and in practice is in charge of all its own internal affairs.* "[92]

Another world region with a comparatively high density of city-states is the Persian Gulf, where we find Qatar, which is dominated by its capital Doha and Bahrain with its capital Manama. Furthermore, Palan considers both, Dubai and Abu Dhabi as modern variants of the city-state as well.[93] Considering the United Arab Emirates with Dubai and Abu Dhabi, there

[89] Woo J.J. (2016), "*Business and politics in Asia's key financial centres: Hong Kong, Singapore and Shanghai*", Springer Science & Business Media, Singapore: p.135

[90] Leung K. (2020), "*Hong Kong loses ranking as world's freest economy due to months of unrest*", South China Morning Post

[91] Fickling D. (2019), "*Hong Kong's dimming light poses an urgent question*", Bloomberg.com, 2nd December 2019

[92] Parker G. (2004), "*Sovereign city – The city-state through history*", Reaktion Books: p.220

[93] Palan R. (2010), "*International Financial Centres: The British Empire, City-states and commercially oriented politics*", Theoretical Inquiries in Law: p.61

are two ways one could interpret them as city-states. According to the first one, Dubai and Abu Dhabi form part of a federation but are sufficiently autonomous, especially in financial and commercial matters, to be considered city-states, according to this paper's definition. The second interpretation sees the United Arab Emirates itself as a form of city-state, since it is politically, economically and demographically dominated by Dubai, its commercial centre, and Abu Dhabi, its capital. "*Abu Dhabi has been historically, and remains today, the politically predominant emirate because of its size, population, oil and gas wealth, portfolio of overseas assets (…). The emirate of Dubai holds a secondary position by virtue of being the hub of private-sector activity.*"[94]According to this second interpretation, the elites of Dubai and Abu Dhabi dominate politics and business of the United Arab Emirates enough for the latter becoming an extension of the two cities' interests and politics.

The Gulf countries have not been financial centres traditionally. After centuries of existence as fishing and pearl diving towns, the region rapidly developed into high-income economies enabled and spurred by the discovery of oil in the Persian Gulf in the 20th century. Their emergence as financial centres is part of their diversification strategy to prepare themselves for the time after the exhaustion of their oil reserves. While Dubai has progressed significantly in this endeavour, creating an economy predominantly based on services, with only a very small part of national income generated by oil, others, like Abu Dhabi, still depend to a large extent on oil industries. Dubai, furthermore, is comparable to Hongkong, as it acts as a gate into Gulf countries, such as Saudi-Arabia.[95] This category consists entirely of monarchies, similar to the category of European micro-states, which was discussed previously (again, with the exception of Malta). However, the *Petro-States* are predominantly absolute monarchies, which differentiates them from democratic monarchies like Luxembourg. Another city-state in the region is Kuwait, which features in the September 2019 global financial centres index on rank 65.[96]

The tropics

"*In the four decades since Trinidad and Tobago gained independence, its financial sector has emerged from an embryonic stage to playing a pivotal role in channelling capital throughout the Caribbean.* "[97]

The last category of city-states consists of three small island states in the Caribbean and the Indian Ocean, which were formerly part of the British empire (Mauritius, The Bahamas and Trinidad and Tobago). They achieved upper middle- and high-income status over the past decades, with international financial services playing an important role in their development strategy. In Mauritius, for example, financial services and insurance contributed 11.8% to

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[94] Library of Congress (2007), "*Country Profile: United Arab Emirates (UAE)*", Federal Research Division, July 2007: p.20

[95] The Economist (2018), "*How Dubai became a model for free trade, openness and ambition*", Special Report, 21st June, 2018

[96] Z/Yen & China Development Institute (2019), "*The Global Financial Centres Index 26*", September 2019

[97] Rambarran A.J. & Bhagoo V. (2006), "*Great expectations or feasible initiative: Trinidad and Tobago as a pan-Caribbean financial centre*", Business, Finance & Economics in Emerging Economies, Vol. 1, No. 1, pp.114-128: p.114

national GDP in 2019.[98] While being the only sovereign islands featured in this paper's analysis, their performance in the financial centres ranking is less impressive than that of the non-sovereign British Overseas Territories and Crown dependencies. This can be explained with the *dependent jurisdictions theory*, which was briefly lined out in the category of the *remnants of the British Empire*. In the global financial centres ranking of March 2020, Barbados joins this group of micro-states.[99]

City-States?

Lastly, there are several states, which occupy a grey area between city state and territorial state. This category comprises the island states of Cyprus and Iceland, the Baltic countries Latvia and Estonia and infamous[100] Panama. These are essentially small countries - ranging from a population of 350 734 (2020)[101] in Iceland to 3 894 082 (2020)[102] in Panama - dominated by a big city or metropolitan area. They do not completely fit within the city-state paradigm, but they often do have similar political economies. Their economy and politics are usually dominated by their capital and, similar to most city-states, many of them have long-standing commercial or financial traditions. They are sovereign nations with a relatively small, resource-scarce and economically relatively unimportant hinterland. Consequently, some of them, like Tallinn, overperform in the global financial centre index. They represent a middle ground between real city-states and territorial states. In this category, political and institutional details matter and can determine a country's performance. Thus, while not being counted among the group of city-states, it is insightful to further investigate the performance of these hybrid-states.

Historical city-states: Repubbliche marinare & Low countries

The status of city-states as influential financial centres is by no means new and is not exclusively due to the "new" globalisation since the 1980s and the Eurodollar market since the 1950s and '60s. As briefly mentioned in the introduction and the hypothesis, two historical clusters of city-states stood out in the history of finance. The Italian city-states during the 15th and 16th centuries and the Dutch United Provinces, more specifically Amsterdam, in the 17th and 18th century. "*In a sense, the Dutch Republic can be described as a league of city-states dominated by merchants.* "[103] More specifically, this league of city-states was dominated by the merchants from Amsterdam, the overwhelmingly dominating city of the provinces.[104] These two clusters of city-states were significant innovators in the history of finance and had a distinctively international orientation as commercial and financial centres. All of them started as trading hubs and consequently moved into finance. Venice was a commercial aristocracy,

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[98] Financial Services Commission Mauritius (2020), "*Contribution to GDP*"

[99] Z/Yen & China Development Institute (2020), "*The Global Financial Centres Index 27*", March 2020

[100] Obermayer et al. (2016), "*Das sind die Panama Papers*", Sueddeutsche Zeitung

[101] The World Factbook (2020), "*Iceland*", Central Intelligence Agency

[102] The World Factbook (2020), "*Panama*", Central Intelligence Agency

[103] Stasavage D. (2007), "*Cities, Constitutions and Sovereign Borrowing in Europe, 1274 – 1785*", International Organization, vol.61, no.3 (Summer, 2007), Cambridge University Press, pp.489-525: p.503

[104] Parker G. (2004), "*Sovereign city – The city-state through history*", Reaktion Books: p.177

with a government dominated by the wealthy merchants of the city.[105] After the infamous fourth crusade, the Venetian gold ducat became Europe's main trading currency.[106] Like London and Singapore nowadays, "*Venice was also in the tradition of the city-state in its essential globalism (...).*"[107] Genoa became powerful as a quasi-satellite state of the Spanish monarchy, first financing Spanish trade with its American colonies and later providing Spanish government loans.[108] Also in Genoa, was the creation of Europe's first public debt and the world's first public bank, the *Banco di San* Giorgio.[109] During the 17th century, however, the Northern merchants-bankers from Amsterdam slowly replaced the Italian city-states as Europe's financiers.[110] It was in Amsterdam were the world's first joint stock company was founded[111] (The VOC, or Dutch East India Company) and Dutch *bank guilders* became the world's predominant currency.[112]

Illustrating the *domestic – international* framework: The cases of Germany and London

The development of financial centres in Germany is an interesting historical case study in the competition between *international* and *domestic* financial centres. Germany's "original" financial centre, Frankfurt, was a free imperial city, with mostly international business (keeping in mind that Germany has not yet been unified). It had strong connections to, and served as bankers of, the Austrian emperors and other European states, such as Bavaria.[113] Second to Frankfurt was Hamburg, which was also a free imperial city with a long history of international trade and a commercial elite. While Frankfurt was a banking centre, Hamburg's financial activities were strongly trade related.[114] After the rise of Prussia and the unification of Germany an emergent national economy provided a big domestic market, which fostered the rise of its capital Berlin as a *domestic* financial centre.[115] "*Berlin's rise to the top ranks in the hierarchy*

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[105] ibid: p.88 & 89

[106] ibid: p.82

[107] ibid: p.86

[108] Braudel F. (1984), "*Civilisation and capitalism, 15th – 18th century: The perspective of the world*", Collins: p.164

[109] Mosselaar J.S. (2018), "*A concise financial history of Europe*", Robeco: p.30

[110] Braudel F. (1984), "*Civilisation and capitalism, 15th – 18th century: The perspective of the world*", Collins: p.173 & 174

[111] Mosselaar J.S. (2018), "*A concise financial history of Europe*", Robeco: p.59

[112] ibid: p.54

[113] Cassis Y. (2006), "*Capitals of capital: A history of international financial centres, 1780 – 2005*", Cambridge University Press: p.32

[114] ibid: p.31

[115] ibid: p.114

of international financial centres seemed a natural consequence of Germany's economic weight following unification and the country's extremely vigorous economic growth during the forty years preceding the First World War. (...) its focus was national rather than international, and industrial – whether in the activity of its banks or its stock exchange – rather than financial (like Frankfurt) or commercial (like Hamburg). "[116] Frankfurt, on the other hand, suffered a steady decline. This was in part due to the loss of its autonomy, following its annexation to Prussia in 1867 and the introduction of the common currency *Mark*, as well as the foundation of the Reichsbank, in the 1870s.[117] Only because of the vicissitudes of history, manifested in the division of Berlin and its geographic position on the outskirts of the Western world during the 20th century, Frankfurt was able to reclaim its title as Germany's foremost financial centre. While Hamburg seemed to have been better prepared to take over as Germany's leading financial centre, this role fell to Frankfurt. According to Cassis, "*the city's [Frankfurt] best qualification at the time was to be the administrative centre of the Bizone – formed at the beginning of 1947 by amalgamating the American and British military occupation zones – and as such the potential capital of the future West German state.*"[118] This time, however, Frankfurt served as a predominantly *domestic* financial centre, instead of being an *international* one. Thus, the reasons for its success do not lie in the status as a city-state anymore (since, despite Germany's federal political system, the age of German factual city-states is over) but in the strength of the German economy and its domestic market.[119]

A possible direction for further research would be the application of this paper's framework of *domestic* and *international* financial centres to the development of the City of London as a financial centre over the centuries. London's ascent as a financial centre was closely linked to Britain's emergence as the dominating European and global economy. Although already exhibiting an international character, London's position as a financial hub was strongly supported by the dominant role of the British economy in the 19th century. Could the London of the 19th century be described as a *domestic* financial centre, similar to today's New York or Tokyo? In the 20th century, on the other hand, its role seems to change. As Cassis writes, "*the City's rebirth in the 1960s and its current rank of leading financial centre for international activities are out of all proportion to Britain's economic weight in the world.*"[120] London is a leading *international* financial centre, seemingly out of touch with its domestic economy. Can London serve as a historical case study of a financial centre, which has adapted to changing circumstances and shifted from being a *domestic* financial centre to being an *international* financial centre? If so, then its unique political status played a crucial role in its metamorphosis. This further implies that its development cannot be easily, if at all, be reproduced by centres in other relatively declining economies, such as Tokyo and Frankfurt. The City's unique identity gave it the flexibility and political discretion for this transformation.

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[116] ibid: p.108

[117] ibid: p.71

[118] ibid: p.216

[119] ibid: p.203

[120] ibid: p.280

Outlook

In this paragraph, the findings of this paper will very briefly be applied to current issues in international politics. Notably, concerning financial centres, Brexit and the protests in Hongkong stand out. Both are highly successful financial centres, which have been experiencing political turmoil over the past years. Will these political issues pose a danger to their standing as financial centres? The findings suggest a greater danger for Hongkong's financial centre due to recent Chinese policies than for London's square mile due to Brexit. Since London is identified as a "city-state" in my work, its comparative advantage does not lie in a big market, but in its international orientation and light regulations. Brexit will most likely not threaten London's autonomy, and thus will probably not impact the city considerably. Similarly, to London, Hongkong's advantage is its autonomy, which results in an open and liberal economy. This autonomy, however, seems to be increasingly under threat due to a more assertive China. If Hongkong wants to transform into a *domestic* financial centre, taking advantage of the huge Chinese market, it would need to compete against increasingly successful centres like Shanghai, Shenzhen and Beijing. If Hongkong wants to stay a highly successful *international* financial centre, on the other hand, it greatly depends on mainland Chinese grace concerning its future political autonomy and right to self-governance. Thus, the crucial factor in both centres' performance, is their autonomy. Any political event, which threatens this autonomy, will be a potential threat to their standing in the global financial system.

Conclusion

Financial history and news are plastered with city-states. The Italian *repubbliche marinare* Venice and Genoa were important innovators in the field of finance and are credited with triggering a financial revolution.[121] To the North, 17th century Amsterdam became the foremost financial centre of its time. The emergence of the Eurodollar market, as "*probably the single most important development in the international financial markets since the second world war*"[122], cemented London's role as the leading *international* financial centre of the global economy. Many of history's most successful and famous banking dynasties came from current or former city-states. The Rothschild family originated in Frankfurt a.M., which was a free imperial city back then. Germany's financial heart started its emergence as a financial centre as a city-state. Even though this status is gone nowadays, history was favourable to the city on the Main and it is, once again, the financial centre of Europe's biggest economy. Other prestigious banking dynasties hailing from a city-state are the Warburg family from Hamburg, who have original Venetian ancestry, and the Oppenheim from Cologne. The Berenberg family is from Hanseatic Hamburg as well. Their British counterparts, the Baring family, originated in Groningen and rose to prominence as merchant bankers in London. The originally Scottish Hope family moved to the Netherlands, "*where they built large canal and country houses*

[121] Fratianni M. & Spinelli F. (2007), "*Did Genoa and Venice kick a financial revolution in the Quattrocento?*", Österreichische Nationalbank working papers: p. 30 & 31

[122] Coggan P. (2002), "*The Money Machine: How the city works*", 5th edition: p.102

(...)"[123], leaving their mark on the cities of Amsterdam and Haarlem. Their predecessors were tight-knit banking families from Genoa, such as the Doria and Pallavicini, as well as the pinnacle of renaissance glory in Italy's city-states, the Medici in Florence. Another ancient Genoese family, the Grimaldi, is still ruling one of the few remaining truly sovereign city-states: Monaco. But still today, city-states are highly visible in international finance. Contemporary financial news voice concerns about Hongkong's autonomy status, its role as an international financial centre and corresponding opportunities for its great rival Singapore.[124] [125] In other news, the Cayman Islands and Luxembourg are criticised for their lax tax and regulatory regimes[126] [127] and Dubai's role as a commercial and financial centre for the Middle East is pointed out.[128]

In this paper we saw that these anecdotes of history and current affairs are no coincidence. The previous pages show above-average success of city-state jurisdictions as financial centres. I identified 23 jurisdictions, which were ranked in the Global Financial Centres Index 2017, as city-states. These political entities vary from sovereign nations like Singapore, through internally autonomous, semi-independent entities like the Cayman Islands, to Swiss city-cantons, which are firmly integrated into a territorial state. Thus, the array of modern city-states is much broader than is commonly believed. Their score in the index tends to relatively outperform the (often minuscule) size of their domestic economy. Thus, this supports the hypothesis of above-average success of city-states as financial centres. This is due to a lack of land and resources, which results in an incentive to specialise in trade and finance due to a lack of alternatives, as well as common elite interests in favour of an open and liberal economy. Additionally, this political consensus creates, through path dependency, a commercial and financial tradition in many city-states. These factors, in turn, result in liberal and outward-oriented policies, especially in the commercial and financial realm. Through these policies, city-states are able to satisfy international demand for low taxes and few regulations and can consequently compete successfully for international business. They rely on this international business as a result of their small domestic market. More generally, we saw a correlation between the size of an economy and the importance of its financial centre(s). This correlation becomes even stronger once city-states are omitted from the data set. This results in the creation of two categories of financial centres: *Domestic* financial centres, which are found in territorial states and *international* financial centres, which exist in city-states. The former benefit from a relatively large domestic market, and thus do not rely on international business. Due to their political economy, an opening up to the international markets, to the extent city-states do it, is politically complicated and difficult to achieve. The latter, as mentioned above, depend on foreign business. In the global competition to attract international financial funds, city-states generally prevail, due to their unique political economy. Thus, since

[123] Mosselaar J.S. (2018), "*A concise financial history of Europe*", Robeco: p.90

[124] Fickling D. (2019), "*Hong Kong's dimming light poses an urgent question*", Bloomberg.com, 2nd December 2019

[125] The Economist (2020), "*Can Hong Kong remain a global financial centre?*", June 6th, 2020

[126] Boffey D. (2020), "*In wake of Brexit, EU to put Cayman Islands on tax haven blacklist*", The Guardian

[127] Brooks R. (2014), "*Havens like Luxembourg turn 'tax competition' into a global race to the bottom*", The Guardian

[128] The Economist (2018), "*How Dubai became a model for free trade, openness and ambition*", Special Report, 21st June, 2018

market size is an important condition for the success of a financial centre, an aspiring centre either has to have access to a large enough domestic market, which is the case for centres like Tokyo, Shanghai and New York, or be able to attract foreign business, which exposes them to competition with other internationally competing centres. City-states, lacking the former, have to specialise on the latter.

Despite their apparent significance in the global financial system, city-states have been almost completely neglected in the area of International Political Economy. However, due to their unique situation, as well as an increasing awareness of cities as political entities, further study on this type of polity can be greatly rewarding and fruitful. As Parker put it:

"*(…) they may prove to be better adapted than the twentieth-century nation-states ever were to exist and to prosper in the increasingly globalized world of the twenty-first century.* "[129]

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[129] Parker G. (2004), "*Sovereign city – The city-state through history*", Reaktion Books: p.224

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Annex

Financial Centre	GFC Rank	GFC Points	GDP PPP in $Mil. 2017(ii)
London (i)	1	780	2914000
New York	2	756	19390000
Hongkong (i)	3	744	454900
Singapore (i)	4	742	527000
Tokyo	5	725	5429000
Shanghai	6	711	23160000
Toronto	7	710	1769000
Sydney	8	707	1246000
Zurich (i)	9	704	517200
Beijing	10	703	23160000
Frankfurt	11	701	4171000
Montreal	12	697	1769000
Melbourne	13	696	1246000
Luxembourg (i)	14	695	62730
Geneva (i)	15	694	517200
San Francisco	16	693	19390000
Vancouver	17	692	1769000
Dubai (i)	18	691	686800
Boston	19	690	19390000

Shenzhen	20	689	23160000
Osaka	21	688	5429000
Seoul	22	686	2029000
Los Angeles	23	683	19390000
Chicago	24	683	19390000
Abu Dhabi (i)	25	682	686800
Paris	26	680	2836000
Taipei	27	677	1185000
Washington DC	28	676	19390000
Bermuda (i)	29	673	6127
Dublin	30	672	357200
Cayman Islands (i)	31	671	2507
Guangzhou	32	668	23160000
Amsterdam	33	667	916100
Tel Aviv	34	666	316500
Casablanca	35	665	298600
Warsaw	36	664	1121000
British Virgin Islands (i)	37	663	500
Wellington	38	661	188600
Stockholm	39	660	520900
Jersey (i)	40	658	5569
Guernsey (i)	41	657	3465
Vienna	42	656	439600
Copenhagen	43	655	286800
Tallinn (iii)	44	653	41560
Doha (i)	45	651	340600
Oslo	46	650	380000
Qingdao	47	649	23160000
Johannesburg	48	648	765600
Glasgow	49	647	2914000
Munich	50	646	4171000
Bahrain (i)	51	645	70440
Edinburgh	52	643	2914000
Riga (iii)	53	642	53910
Milan	54	641	2311000
Kuala Lumpur	55	640	930800
Isle of Man (i)	56	639	6792
Brussels	57	638	528500
Prague	58	637	375700
Madrid	59	636	1774000
Mumbai	60	635	9459000
Bangkok	61	634	1234000
Jakarta	62	633	3243000
Sao Paulo	63	632	3240000
Liechtenstein (i)	64	631	4978
Trinidad and Tobago (i)	65	630	43010

Manila	66	629	875600
Hamburg	67	628	4171000
Monaco (i)	68	627	7672
Mauritius (i)	69	626	27460
Busan	70	625	2029000
Calgary	71	624	1769000
Budapest	72	623	289000
Mexico City	73	622	2458000
Rome	74	621	2311000
Gibraltar (i)	75	620	2044
Cyprus (iii)	76	619	31590
Riyadh	77	618	1774000
Istanbul	78	617	2173000
Lisbon	79	616	313400
Almaty	80	615	477600
Bahamas (i)	81	614	11600
Rio de Janeiro	82	613	3240000
Helsinki	83	612	244000
Athens	84	611	298700
Malta (i)	85	609	19310
Chengdu	86	604	23160000
St. Petersburg	87	603	4008000
Panama (iii)	88	602	103900
Moscow	89	601	4008000
Buenos Aires	90	600	920200
Reykjavik (iii)	91	598	17620
Dalian	92	595	23160000

Sources: Global Financial Centre Index September 2017 (Z/Yen & China Development Institute); The World Factbook (Central Intelligence Agency)

(i) City states

(ii) except Monaco (2015), Isle of Man (2015), Bermuda (2016), Jersey (2016), Liechtenstein (2014), Guernsey (2015), Cayman Islands (2014), Gibraltar (2014);

(iii) medium-sized countries with dominant city