What Have We Learned About Political Participation Changing a Financial Centre's Competitiveness?

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Abstract

What role does polyarchy (and thus increased democracy) play in aiding the development of an international financial centre? Little research has addressed to date. In this paper, we look at that literature in preparation for econometric analysis in the future. The evidence, such as it exists, suggests that some jurisdictions use autocracy (less polyarchy) to help grow out their financial centres. These results could impact decisions ranging from Brexit to Hong Kong's autonomy in its post-2047 period.

Keywords: international financial centres, finance juntas, financial competitiveness.

JEL Codes: D72, F55, F33, P48

We acknowledge the Hong Kong University Grant Council's Theme-Based Research Scheme for partially funding this research. All ideas, as well as any omissions and mistakes, remain our own. We do not claim to represent the views of any institutions we affiliate with, and nothing in this paper represents investment advice. Co-authors have worked on separate sections of the paper (as a multi-disciplinary project), thus each co-author may not necessarily agree with all the material in the paper.

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Introduction

Democratic institutions seem antithetical to building world-class international financial centres. Most famously, Shaxson (2012) – in his survey of tax havens – notes the extent to which secret cabals in The City (in London), Delaware, Jersey and other places dominated financial services lawmaking. Regulatory capture has resulted in financial regulations which have made several international financial centres far more competitive – if far less robust to crises -- and less consumer-friendly (Sheng, 2009).[1] The need to grow local financial centres into internationally competitive international financial centres has subsumed local politics in many places – resulting in the tacit or explicit restriction of certain political ideas and polities (Jarvis, 2011). Even in places not usually considered as financial centres until recently, the design of regulatory institutions has encouraged such capture, as in Ireland (Turner *et al.*, 2016). As Arner (2015) notes, politics -- dominated by elites, specialists and/or special interest groups -- has determined the extent and type of financial regulations in international financial centres. Indeed, some like Sikka (2003), have argued that policies aimed at making an international financial centre more competitive have helped some of these groups stay in power and forestall political rivalry. To what extent does international financial centres' competitiveness incentivize/enable such restrictions on political pluralism? To what extent does the reverse happen – as restrictions on political participation boost the competitiveness of the financial centres which legitimizes certain politically powerful groups?

The purpose of our paper is to provide a competent review of the lessons learned about political participation and financial centre competitiveness -- so that other authors will not need to retrace these steps when doing advanced econometric modelling. Our paper shows that political participation in adjusts to a financial centre's competitiveness, and visa versa. For example, Hong Kong lawmakers and politicians may keep a close eye on how many assets London, New York and Singapore-based asset managers attract from abroad – shutting down groups vying for other interests (like income redistribution) when Hong Kong's own competitiveness changes.

We structure the paper as follows. First, we review the scant theorising about international financial centre competitiveness (size, growth, market niches and so forth) and their political plurality. Hundreds of political theorists, historians and geographers have written about the way that political interest groups use financial policies to obtain and keep political power. Yet, we could find none looking at the use of these policies at the global level (between financial centres themselves). Second, we look at trends in the raw data, setting the stage for the intuitions and

[1] Hong Kong, for example, has always had a strong pro-business lobby in government (known even now as the Establishment). The city's own mini constitution (the Basic Law) even enshrines narrow financial interests as an object of constitutional law in article 109, requiring the government to "provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre."

insights needed to assess later analyses by us and others. We avoid conducting advanced econometric analysis -- saving this for other/future work. The final section concludes.

We should caution the reader about some assumptions we make before beginning our argument. First, following the lead of authors like Omarova (2012), we must assume that political polyarchy at the ballet box in some way reflects polyarchy of those groups, cabals, juntas, bureaucrats and bankers who make financial policy. We understand the limitations of assuming that Swedish financial interests must vary more than Chinese ones – even though China has far more stakeholder groups interested in the outcomes of financial policy than Sweden has, as He (2016) shows. Even though Saudi Arabia (for example) does not hold open elections often, elite rivalries do shape financial policy, as patrons on behalf of their clients and supporters – and they influence financial policies polyartically at the Cabinet of Ministers and ministerial levels. Where possible, we provide references to previous research showing the usefulness and likely validity of such an assumption on the macro-level. We may also slip by associating more polyarchy with more democracy – a fact true by definition except when a jurisdiction changes from a position of greater to less democracy (thus becoming more autocratic). Despite Boese's (2018) warning, we may also slip by talking about V-Dem's polyarchy measure as a more reliable measure of the polyarchy want to understand than it is.

Finally, we often must talk about international financial centres (like Frankfort or Paris) using data for their nation-state (Germany and France respectively). For jurisdictions with multiple financial centres -- like the US, China, and Germany – using national polyarchy hardly represents a fair portrayal of polyarchy on Wall Street (New York) versus Sand Hill Road (San Francisco). Doha, Seoul or Tokyo might (or might not) account for most of these jurisdictions' banking centrality. Lack of data at the city-level forces us to elide entire jurisdictions with the city that appears on Z/Yen's index of top international financial centres. We try to refer to the country as a whole, rather than individual financial centres – leaving it up to the reader and future researchers as to the extent to which the jurisdiction's whole represents its parts as metropolitan financial centres.[2]

The Blundering Literature on Political Institutions and International Financial Centres

From regressions on democracy to political cycles

None of the studies of international financial centres look directly, quantitatively or econometrically at the way local political institutions respond to the competitiveness of their international financial centres. Did Singapore's and Lee Kwan Yew's People's Action Party's resistance to outside and variegated political participation help the nation-state's elites build a world-class financial centre? How much did the politics of Wall Street's elites drive Ronald Reagan's liberalisation programme (and his chocking off to participatory policymaking institutions like labour unions' input into policy)?

[2] We wish to avoid the debate about the extent to which national policy makes an international financial centre (though we deal with the inverse question in our paper as the effect of an international financial centre on national policy). From sceptics like Yildirim and Mullineux (2015) to cheerleaders like Abramov and co-authors (2011), a multitude of varying positions keep the debate going.

The first blunder of the literature consists of a narrow focus on regressions looking at the relationship between democracy and financial development.[3] For example, studies like Doces (2010) looked at the extent to which differing levels of a survey indicator designed to proxy the extent/level of 'democracy' correlated with levels of foreign direct investment. Girma and Shortland (2008) might find that the degree of democracy (or elite capture of political decisions) affects financial sector development, as measured by indicators such as private sector credit-to-GDP ratios, stock market capitalisation-to-GDP ratios and stock market value traded-to-GDP ratios. Democracy and "good" political institutions – holding other variables fixed – aid in financial sector development, and thus the likely emergence of international financial centres (Bhattacharyya, 2011).[4] Yet, the consensus – if one can call it a consensus – finds that democracy helps promote the development of large financial sectors using measures like these, only for countries with robust legal and governance institutions in place -- if one believes Ghardallou and Boudriga (2013) . Democratic development and financial sector/market development have gone together since the industrial revolution, and will likely continue to do so.[5] Of course, dissenters and hedgers -- such as Yang (2011) -- will always remain, given the messy nature of the world and the data. The nature of these measures also pose problems, as indicators measuring the exten to which a country has an autocratic versus democratic governance institutions, as well as measures which try to measure the durability of those institutions, remain highly problematic.[6] Yet, these studies fail in a more fundamental way. They fail to look at dynamics – or how the extent of democracy and self-determination change over time in response to changing investment needs.[7]

The literature's second blunder consists of ignoring the dynamics of changing financial sector competitiveness and political participation. Many works – particularly by geographers – talk about cycles of political participation and financial sector competitiveness over time, from an economic, political and sociological perspective. Any study of a financial centre, like Singapore, would show the constant competition with other financial centres, the need for politicians to restrict or expand democratic participation as needed, and the way that such participation affects an international financial centre's competitiveness.[8] In the US context, scholars and pundits like Johnson (2016) see a dichotomy between "democratic participation" in finance and a more centralised one, focused around finance-sector interest groups. Many of these focus on events

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[3] The almost hundreds of similar studies handle the econometric issues involved with varying degrees of aplomb. Rajan and Zingales (2001), for example, completely fail to show any kind of link, mixing anecdotes with regressions of macroeconomic variables…only obliquely related to either politics or financial development. While readers might dismiss this as an old, flawed approach – similar studies like Papaioannou (2009) keep emerging in this vein of the literature.

[4] Huang (2010) provides a description of the effect of these supposedly "good" political institutions.

[5] Eichengreen and Leblang (2006), as early as 2006, provide amble evidence for such an assertion.

[6] The 'polity' measure -- as in Quintyn and Verdier (2010) -- in particular maps country polities onto a numerical scale, somewhere between pure autocracy and pure democracy. The variables 'durability [of] autocracy' and the 'durability [of] democracy' represent the longevity of such a system (brackets ours). 'Negative regime change' represents the extent to which such a variable reflects a more autocratic government. A 'positive regime change' shows a jurisdiction exhibiting more democratic tendencies. While such a measure at least tries to incorporate time into the analysis, such variables hardly replace a time series or other dynamic analysis looking at change over time.

[7] As if to cap off this section, a doctoral dissertation done more than a decade ago by Liscano (2007) finds no reliable pattern between the extent of democratic governance and the performance of financial policy. Despite the hundreds of studies conducted since then, we have not really made much progress since.

[8] Woo (2017) reflects many writing in this tradition. He analyzes domestic factors leading to Singapore's financial centre, but ignores the international impetus leading to the presence of these factors in the first place.

which depend as much as historical accident as any deliberate policies arising after, or in reaction to, these accidents. Subsequent policy may encourage the development of a financial centre, as in London's case (Lysandrou and co-authors, 2017). Yet, few authors provide a working, testable model of political and financial sector change in international financial centres. Some exceptions do exist -- like Oatley *et al.* (2013) and Winecoff (2013) . Yet, many like Masciandaro (2008) describe such accidents as "path dependencies" (meaning we do not know really know if their causes can be replicated). Yet, a large literature -- in its recent incarnation summarized by Lee (2017) -- even exists admonishing academics with quantitative research skills to pay attention to the inter-relationship between politics and finance in the development and growth of these international financial centres...leading to our third blunder.

The third blunder committed by the literature in our subject consists of depoliticising both the national and international aspects of international financial centres.[9] At their most extreme, models of financial centres - like Gandrud (2013) -- see different policies 'diffusing', with financial authorities copying policies from other jurisdictions, like the spreading of a fad or hit song. Yet, because these models do not contain agents, they do not contain agency. Such diffusion has no room for politics, either within or between jurisdictions. For authors like Hampton and Christensen (2002), the politics of these international financial centres extends only so far as such lobbying (usually targeted at tax havens) helps or hurts other – particularly larger – countries, like the US. They -- like Sharman (2009) -- describe how the International Monetary Fund (IMF), the OECD and even countries like the US, call for financial and other reforms in the international financial centres. These institutions draft the rules that countries can follow – or not.[10] Many even argue that international elites use and abuse these centres and their places – in effect usurping their politics.[11] Others like Dorry (2016) and Hall (2009) argue that local elites manipulate the political process – without ever describing who or how -- to create an international financial centre serving their own interests. These elites' better understanding of the complexities of finance (better than even national regulators) supposedly facilitate their ability to manipulate the political process and the government itself. If international financial centres do compete, authors like Hall (2017) would have us believe that they do so through apolitical government policies.[12] Wang and authors of his ilk (2016) present the results of such political machinations and movements as *faits accomplis* (the inevitable result and cause of "political will").

Worse still, they ignore the strong political, as well as economic, harms many of these reforms would cause if local politicians did more than pay these reforms lip service. For these authors, the most that can happen is that, "the cumulative pressures for reform will significantly re-configure

[9] For authors like Woo (2016), this represents one of the largest failings of current efforts to study international financial centres (9-24).
[10] Authors like Deeg and O'Sullivan (2009) unhelpfully propose a dichotomy between international financial rule-makers and rule-followers (or breakers, as they describe). Such a false dichotomy – a problem that runs through the literature – creates a normative framework and club to which jurisdictions should aspire. Academics' tasks thus involve trying to explain why countries do not follow these international regulations.
[11] See van Fossen (2012) for foreign elites using these centres and Palan (2010) for local elites using and abusing them.
[12] While Hall accepts the existence and pressures of national politics in forming these policies, her paper makes such passing references to such politics as to make the rough-and-tumble of actual fights over power and principles something that happens in the background.

the offshore finance industry. Offshore finance may return onshore to the large, functional financial centers such as London or New York" (*ibid*., 1667). Such a reshoring would kill many political careers in these centres. Many international financial centres seem to exist to serve as offshore international financial centres – making their success a prime political objective. Authors that claim that such competition simply represents "jurists' and policymakers' attempts to resolve an inherent contradiction between insulated state law and the rapidly integrating world market" have been as misled as these politicians' constituents into believing financial law represents a non-political, non-competitive 'policy area.'[13]

To understand the dynamics of political change, given economic/commercial change in an international financial centre, we must turn toward the historical literature. Recent case study and historical treatments of financial centre development have particularly shown the waving and waning nature of democracy and financial sector development. Financial, and thus economic, performance represents a strong electoral issue in many countries – just as electoral results represent strong drivers of international portfolio and direct investment. As Choo (2017) and Jarvis (2011b) note, politicians and any/all interested parties keep an eye on the rhetoric and policies foreign investors want. Sometimes, such competition between international financial centres may imperil the viability of the policies these jurisdictions have put in place to compete internationally in the first place.[14] While many emerging markets, "simply do not exist for global financial market investors," some financial centres absolutely do (Santiso, 2017: 27). Many of these political and foreign investment decisions follow <u>cycles</u>. Most scholars like Bak (2016) have assumed that the uncertainty in these cycles drive investment. But what if the decisions taken in these cycles reflect the nature of the cycle itself? Namely, what if the disposition toward particular political practices and institutions (particularly democratic ones) cause changes in investment – which in turn – causes changes in political preferences?

Looking for democratic/polyartic cycles as politicians promise more foreign investment

The British Virgin Islands provides one concrete example, showing how the politics of an international financial centre depend on that centre's ranking vis-a-vis other centres (and the difficulty of empirically detecting such dependency). Like many of the top international financial centres, the British Virgin Islands (BVI) has inherited a historical focus on international finance due to its position along trading routes and its specialisation in a larger political/economic entity (the British Empire).[15] In the classical telling of BVI's inherited position as an international financial centre, as told by authors like Christensen *et al.* (2016), the jurisdiction – like the other crown dependencies – had served as an extension of the City of London. Like in the Cayman

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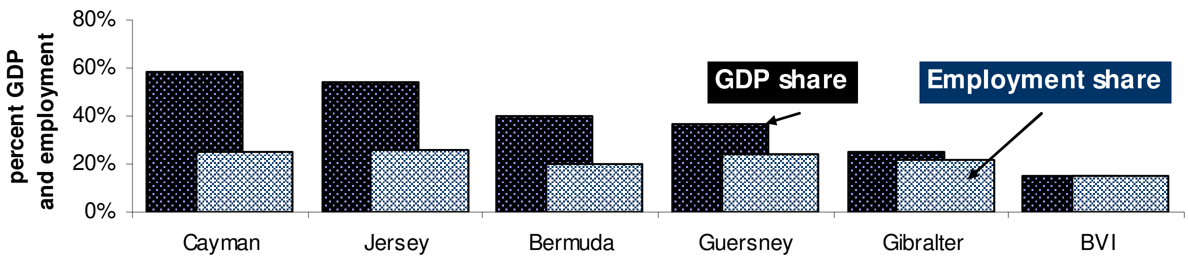
[13] As Palan (2002) notes, at the time of this writing, literally hundreds of senior officials loot their states treasuries – looking for every possible loop-hole to help their own interests and avoid taxes and competition abroad. Who could see policymakers engaged in commercializing state sovereignty as the innocent victims of some abstract contradiction in global capitalism?

[14] Bragues (2018) provides a useful example of a jurisdiction's senior politicians passing foreign investor-friendly rules to the detriment of locals.

[15] Picciotto (1999) provides a discussion of the role the UK's offshore dependencies and territories played in international finance (and the way they used their legal status to fulfil their offshore finance mandates). Sikka (2003) puts it succinctly, "despite the veneer of liberal democracy, some OFCs [overseas financial centres] are captured by the finance industry and advance the interests of financial capital. Many OFCs are nurtured and protected by leading Western hegemons with developed capital and financial markets" (390, italics ours).

Islands, groups vied for power by giving foreigners tax and other benefits in exchange for bringing their money to the island.[16] Yet, as shown in Figure 1, these policies had less impact then similar policies in the Cayman Islands, Jersey, Bermuda and the other jurisdictions shown in the figure. The BVI's GDP and employment share of finance hovered at around 10% of GDP at the start of this decade. Doubtlessly, the BVI's falling behind other financial centres at the time of the global financial crisis, and long before then, influenced the Island's politicians far more than this sector's meagre size suggests. The financial sector almost certainly influences local politicians more than its small size to GDP suggests. [17]

Figure 1: Aspirations for a Greater Offshore Market Share Make Financial Sector Development Far More Politically Important than Simple Measures Suggest



The figure shows the share of financial services-to-GDP and employment in the UK Crown dependencies for the period 2007-2008. For jurisdictions like the British Virgin Islands (BVI), the size of the financial services sector influenced politicians/policies. Yet, the size they were not (but could be) probrably influenced them more -- magifying this sector's political influence well beyond its importance in/to production and employment. Such an effect makes international financial centres particularly sensitive to changes elsewhere in the global financial centre network.
Source: Data from Foot (2009).

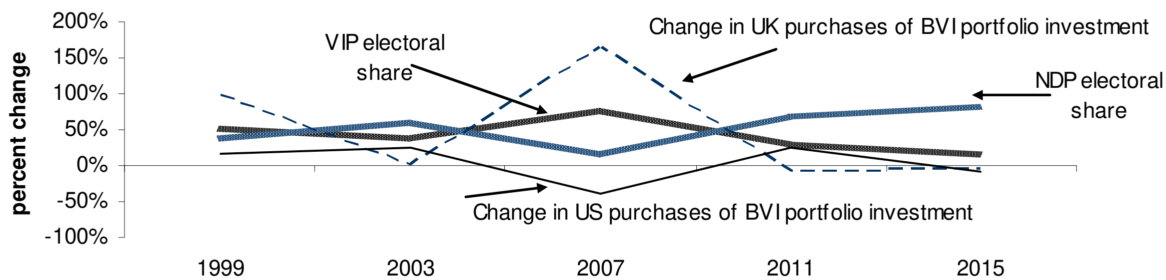
In fact, national politicians used the jurisdiction's nascent financial development as both political end and means. Orlando Smith, premier of the BVI at the start of the millennium, intensified the trend already underway of cooperating with business interests, cleaning up corruption, and most prominently working to grow the Island's offshore financial industry (Lewis-Ambrose, 2013). His National Democratic Party won the 2003 general election (having formed to run in the previous election of 1999). While he and his party did not win the next elections in 2007, they proved instrumental in ratifying a new constitution by the time of the 2007 election. True to BVI politics, neither the National Democratic Party, nor the incumbent Virgin Islands Party focused on the development of offshore finance…on ideological grounds. Instead, as noted by several commentators, politics had focused on personal connections, charisma and most importantly -- patronage. As such, the new constitutional project did not appear out of some deep-seated philosophical struggle. The effects of the new constitution – and subsequent laws passed under it – included putting foreign investors and financiers at ease by offering protections against arbitrary seizure/nationalisation of their property rights and investments as well as unwelcome interference from the UK.[18] As in other places, foreign politicians fed this internal political

[16] Freyer and Morriss (2013) provide one of the best studies of this process.
[17] Some might go so far as to claim that setting up as an international financial centre helped to cement the national identity and culture of the Island. According to this telling, as in Maurer (1995), the passing of laws encouraging the development of offshore financial services represented a step toward greater national autonomy and self-determination.... namely a political act of fomenting national identity.
[18] While the impetus for the new constitution came from the broader negotiations between the British Government and the Overseas Territories, the effect of the new constitutional structure remains as we describe. The separation of

dynamic, as these financial centres served their personal and national pecuniary interests (Sikka, 2003).

Yet, even for a small jurisdiction like the BVI, finding any direct link between politics and foreign investment proves difficult. Figure 2 shows the electoral share of the National Democratic Party (NDP), its main rival the Virgin Islands Party (VIP), and portfolio investment from the US and UK.[19] Despite over-whelming support for the VIP around 2007, US investment shrank (with UK investment radically rising). At the beginning of the 2000s and in recent years, the NDP has won elections, coinciding with slower growth (or even shrinkage) of such portfolio investment. The 2004 BVI Business Companies Act came on the books on the NDP's watch -- though fully implemented by the time the VIP won power (Tax Justice Network, 2018: 6). Offshore finance – and offshore company registrations – provided about 55% of total government revenues (amounting to a bit over US$187 million) around that time (IMF, 2004). No matter which political party held power, the BVI represented a "captured state" (*ibid*., 4). The particular party in power mattered far less for the passage of competitive legislation like the 2003 Virgin Islands Special Trusts Act or non-enforcement of due diligence rules than the **extent of political competition.**[20]

Figure 2: Little Obvious Connection Between Electoral Success and Portfolio Investment in the British Virgin Islands



The figure shows the extent to which electoral success led to increased holding of the British Virgin Island's portfolio assets. We would have perferred the measure we adopt throughout the study (bank liabilities). Unfortunately, the BVI does not provide this information to the Bank for International Settlements.
Source: Portfolio share data from the IMF's Coordinated Portfolio Investment Survey with electoral data from Wikipedia.

The lack of political competition and thus effective democracy in many international financial centres, has given financial interests very large influence over financial policies. As Christensen and Hampton (1999) shockingly depict, the BVIs do not quite epitomize the state capture attributed to Jersey. Centres like Jersey allow us to witness the way such capture transcends borders – showing the dependence of financial centres' politics and policies on each other. International services firms' (like Price Waterhouse and Ernst & Young) push to expand the rules which enable financial centres like Jersey, show the extent of global pressure on financial centres (Sikka, 2008). Jersey, in this case, clearly reacted to developments in other jurisdictions. Just like

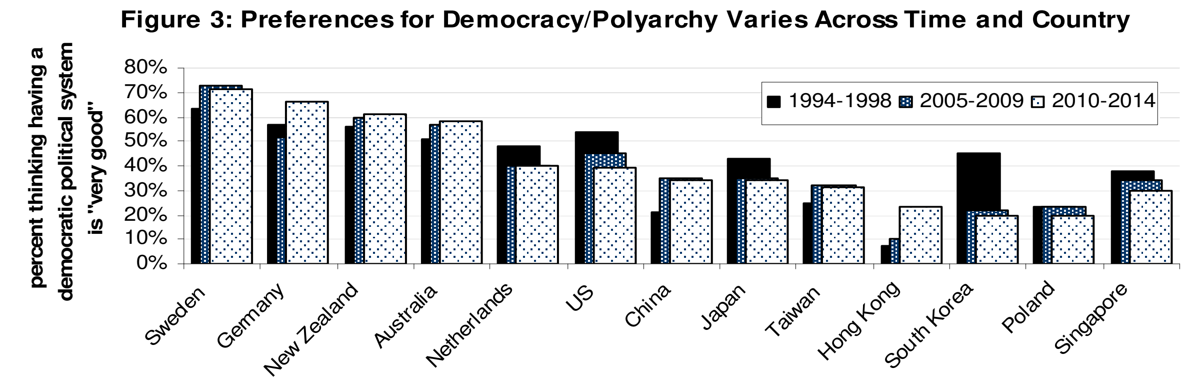
powers, the extensive devolution of powers from the UK to implement self-rule on the island, and even the creation of a constitutionally mandated complaints-commissioner helped provide the appearance – if not the actual implementation – of democratic safeguards protecting property rights.

[19] These two major parties have won most of the votes in BVI elections in the previous 30-ish years.

[20] Such a result appears time and time again, as Burgoon and his co-authors (2012) show.

Jersey, other financial centres' politicians point to the BVIs as model, rival and legitmiser.[21] The lack of effective multi-party democratic decision-making in some places leaves them open to influence from/through these other channels. As Davis (2011) shows, politics represents a contest over financial policy – and finance itself. Less vigorous political competition may allow the state capture which promotes the financial sector competitiveness of places like the BVI and Jersey. Yet, preferences for such political competition do not exist in a vacuum.

Economic forces affect the extent of political competition. Figure 3 shows support for a democratic political system in the jurisdictions housing most of the financial centres we study. US and Japanese voters/citizens view democracy less favourably after the global financial crisis. Relatively untouched jurisdictions like Sweden and Hong Kong have had greater support for democracy over time. A simple bar chart does not prove that democratic or polyartic governance responds to changes in economic factors, or a jurisdiction's financial sector's competitiveness. Yet, preferences for – and responses to – democratic and polyartic governance do change over time in response to economic change and visa versa.[22] What do the data tell us?



The figure show s the percent of survey respondents classifying a democratic political system as "very good" (rather than fairly good, fairly bad, or very bad) for the jurisdictions show n. The overlapping boxes show the w ay these values have changed over time - w ith fast grow ing financial centres exhibiting a distain for democracy.
Source: World Values Survey (2017) at question v 130.

The Stylized Facts: The Link between Democratic Inclusion and Financial Centre Competitiveness

Democracy in Y/Zen's top international financial centres

Superficial data show that international financial centres need just the right amount of democracy at just the right time to thrive.[23] Figure 4 shows the most simplistic analysis available – a popular survey-based measure of international financial centres' competitiveness versus a measure of the

[21] Hampton and James Christensen (1999) and Vogel *et al.* (1979) have shown the role of such a legitimiser in domestic political discourse in other financial centres.
[22] While we have our suspicions, Coccia (2010) seems to have figured it all out.
[23] As noted previously, we do not conduct any kind of advanced econometric analysis…leaving this for the upcoming papers which this paper serves as a plug-and-play literature review for.

extent of democracy in the international financial centres' jurisdiction.[24] 'Authoritarian' (their words, not ours) leaders -- countries like China and the United Arab Emirates -- sit at one end of the spectrum.[25] Legitimacy-by-performance might drive any attempt to create an international financial centre (as authoritarian governments seek to bolster their rule by creating sectors that push up national income).[26] Gibraltar and the Bahamas, as 'contender democracies,' sit at the other end of the spectrum.[27] According to this static picture, taken in 2016, the largest number of highly competitive 'leader' jurisdictions came from 'flawed' democracies.[28] 'Hybrid democracies' had the hardest time breaking into the ranks of the international financial centre leaders. Such difficulty probably reflects both their fragility and the resources going into 'stage managing' the political/electoral system.[29] **Most importantly, different political regimes statistically significantly correspond with a particular type of financial centre.**[30] In other words, leader financial centres grow up around democratic governments statistically significantly more often than they do in authoritarian governments.

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[24] The terms qualifying/ranking authoritarianism versus democracy come from the Economist Intelligence Unit (2018). Only 12% of countries (or 19 jurisdictions) qualify as "full democracies" – a sample size too small to make any definitive statements about democracy and international financial centre development.

[25] As Cheung (2010) shows, governments like these expressly grew their financial centres to provide surrogates for Western markets. Thus, these centres did not develop simply to capture a share of existing international financial assets – but to provide an alternative market in which to trade those assets.

[26] Levitsky and Way (2002) refer to this as competitive authoritarianism. In an international financial centre context, political elites supporting the establishment of such financial centres could provide far more resources than those supporting alternative sectors like agriculture or livestock.

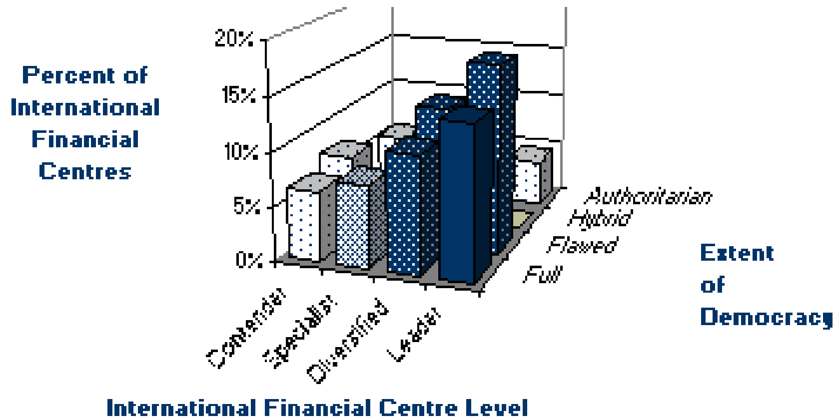
[27] Such a classification seems tongue-in-cheek, as most scholars like Nakajima (2004) might argue that the development of a financial centre in these jurisdictions requires the opacity and lack of democracy needed to serve larger financial centres like London's City.

[28] We use 2016 data, as this gives enough time to look at longer trends, without being blinded by more recent and changeable data.

[29] Menocal *et al.* (2008) provide more details on the fragility of hybrid democratic regimes, while Petrov *et al.* (2010) talk more about the stage management aspect of hybrid democracy, and the growing importance of policy in supporting the illusion of free and fair elections.

[30] Running a simple analysis of variance (ANOVA) on the data shown in Figure 4 shows statistically significant differences across the extent of democracy in these financial centres. Between group sums of squared errors corresponded to around 0.025 (with 3 degrees of freedom) and 0.016 within groups with 12 degrees of freedom). On an F-distribution (showing the likelihood these groups have the same type of financial centre), a value of 6.05 corresponds to a 0.0094 probability they are all the same.

Figure 4: Authoritarian Rule Does Not Seem to Offer Some Kinds of International Financial Centres a Competitive Advantage

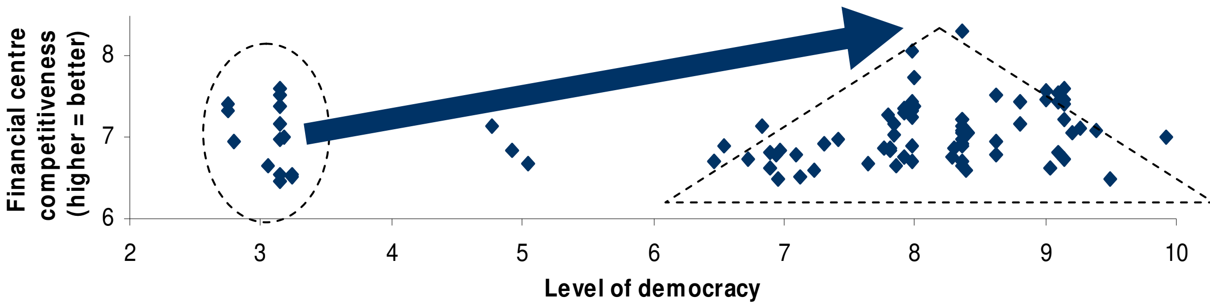


Sources: Y/Zen (for data on each international financial centre's "level") and the Economist Intelligence Unit (for data on the extent of democracy in the country or jurisdiction where the financial centre sits), both for 2016.

More specific data seems to show that democracy hurts financial centre competitiveness. Figure 5 moves from comparing categories to comparing numerical measurements of the extent of democracy and the competitiveness of international financial centres. The same rough pattern emerges. From such a static picture, we see that relatively uncompetitive financial centres have all kinds of governments – from the very democratic to the not-so-much. Yet, the most competitive financial centres in the mid-2010s had more democratic governments (as represented by the countries at the top of the pyramid of dots on the right hand side of the figure). Such figures immediately dispel any monolithic theory positing that globalisation somehow leads to the degeneration of democracy.[31] Nothing in these data point to a supposed contradiction between financial globalisation and democracy.

[31] Cerny (1999) provides the opposite, misguided view.

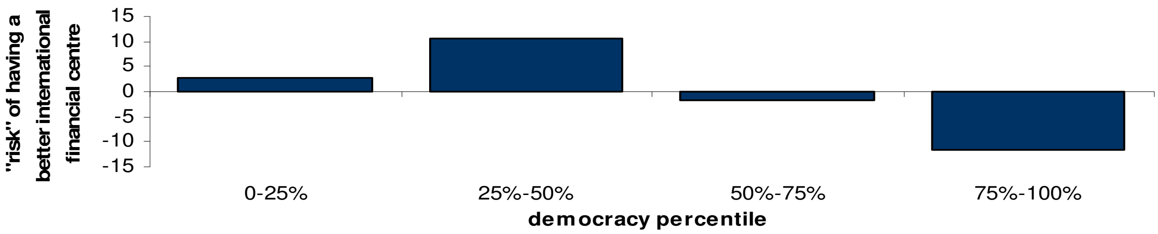
Figure 5: Odds Are Politicians Will Get Pretty Uncompetitive Financial Centres (but Need Democracy to Rival the Best Centres)



The figure shows the relationship between the level of democracy (ranked on a 1-10 scale) and these international financial centres' competitiveness. Refusing to draw a misleading line of best fit, we have clustered the data into two groupings, and an arrow showing the tendence for centres wishing to rank among the most competitive centres. Sources: Z/Yen for international financial centre competitiveness and Heritage Foundation for data on democracy (both for 2016).

What happens to the odds of an international financial centre becoming more competitive as it becomes more democratic? Figure 6 shows the "risk" of an international financial centre improving its competitiveness ranking for various levels of democracy. For example, international financial centres scoring highly in the 75% to 100% percentile on the democracy scale tend to have lower odds of increasing their rating as an internationally competitive financial centre. Yet, for the 2nd lowest percentile, relatively low levels of democracy correspond with higher odds of becoming more competitive. Such a view contradicts the view of international policy networks as a monolithic structure aimed at pushing financial openness one way or the other, as discussed by authors like Underhill and Zhang (2008). Such a view also contradicts the binary view of democracy as only good or bad for financial centre growth. Clearly, a certain level of democracy corresponds to a certain level of financial centre competitiveness for any particular jurisdiction -- a finding that authors like Derudder and his colleagues (2011) find as well.

Figure 6: Full-On Democracy Bad For Growing an International Financial Centre?



The figure shows the extent to which an international financial centre's (IFC's) level of democracy corresponds with its ranking among IFCs. We construct these figures by rescaling the Z/Yen and Economist Intelligence Unit's ratings of IFCs and the extent of democracy in those jurisdictions between 0 and 1. We then bin these scaled values into 4 categories (as shown in the figure). We subsequently divide the scaled IFC rating by the scaled democracy index score -- showing the relative extent or likelihood of an IFC's high competitiveness rating relative to its having a high democratic rating. For values less than one, we show the negative of the inverse value (basically showing the extent to which democracy hurts an IFC's competitiveness ratings). For example, roughly 50% of the IFCs ratings fall in the top quartile (in the 75%-100% bin), but only 4% of their democracy ratings do. The "risk" of having an IFC's democracy rating in the top quartile relative to its competitiveness rating thus comes to about 0.09 -- a number well below unity (1). We show the negative reciprical, rightly pointing out that highly democratic IFCs have a 1/11-ish likelihood (risk) of also having top quartile IFC competitiveness scores.
Sources: Z/Yen for IFC competitiveness ratings and Economist Intelligence Unit for ratings of the jurisidictions' political instiutions' democraticness.

Polyarchy and international financial centres

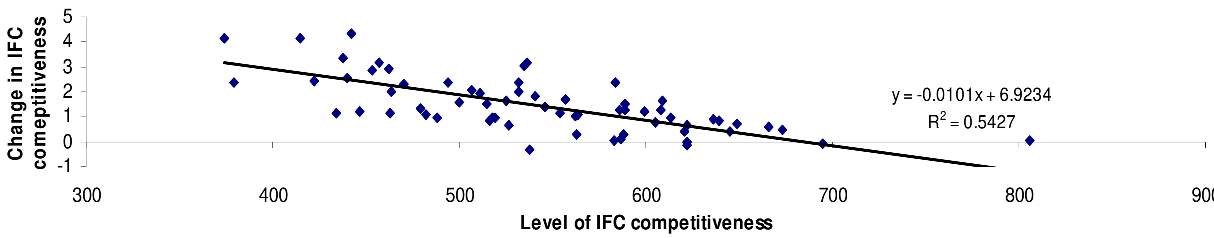
Polyarchy probably represents a better measure of the extent of political participation in deciding an international financial centre's policies. Polyarchy describes the rule of multiple groups in a political or decision-making system (Williams, 2012). A more polyartic political system includes larger numbers of individuals/organisations taking decisions about a jurisdiction's financial policies/laws, as well as a more even 'distribution' of power between these individuals and groups, as authors like Pagliari and Young (2014) find. While many see such a polyarchy as a benign combination of bureaucrats, financial supervisors, financiers themselves, and even consumer activists; others like Omarova (2012) see such rule as the contest for political power, which it is. Many authors like Sapinski and Carroll (2017) have argued that an increased role for financial institutions in financial policymaking would necessarily crowd-out and diminish democratic governance – as "researchers on both sides of the Atlantic started expressing concern about the threat to democratic process posed by the emergent corporate form, the potential for collusion allowed by the growing practice of interlocking directorate, and the general concentration of power in the hands of large firms and banks" (176).

What do the preliminary data show about polyarchy and international financial centre competitiveness? Figures 7 point to a likely balance, or best relationship, between international financial centre competitiveness and polyarchy. Figure 7a shows the relationship between the measure of polyarchy we use in our study and Y/Zen's simple measure of financial centre competitiveness. While many theories would predict that big financial centres should get bigger, few would predict the decreasing returns to scale seemingly shown in the figure.[32] Such a

[32] We say "seemingly" because these data do not control for macroeconomic fluctuations and other factors. Indeed, a gravity model would predict the opposite – namely larger financial centres should get larger still (Cheung and Yeung, 2007). Yu (2012) might attribute a size advantage to the "exorbitant advantage" of holding a central position in global financial networks.

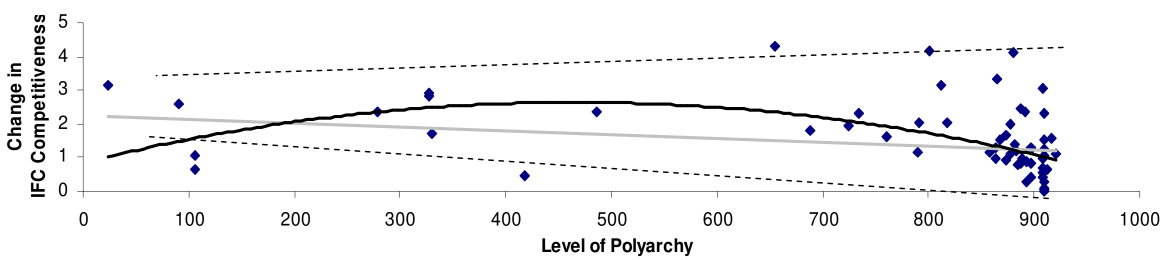
dependence on size, though, means we must use special mathematics later to account for these size effects.[33] Figure 7b looks at this same change in IFC competitiveness, compared with the extent of polyarchy in the international financial centres we analyse. The shotgun pattern in the data shows that more polyartic jurisdictions represent both highly competitive and less competitive financial centres. Yet, the wedge we drew in dotted gray lines suggests that no clear pattern seems to exist in these data. In contrast, Figure 7c flips this relationship on its head. The figure shows the change in polyarchy for international financial centres starting with a certain level of competitiveness. Again, a slightly positive pattern seems to exist between democracy and financial competitiveness. Yet, as we saw already, a golden medium or optimal level appears to exist.

Figure 7a: Larger IFCs Can Not Escape Diminishing Returns to Scale -- Making their Renewal/Rebirth a Political Priority?



The figure shows the relationship between the competitiveness of an international financial centre (as measured by Y/Zen's 2007 rating of these IFCs') and the average geometric change in that IFC's competitiveness over the next 10 years. See the main text of this paper for the list of jurisdicctions we examine and other details about the study. A correlation coefficient of -0.73 shows the tightness of this correlation and with 63 observations, the probability of no relationship is less than 1 in 10,000.
Sources: Y/Zen for IFC competitiveness ratings and the Varieties of Democracy Database (various years).

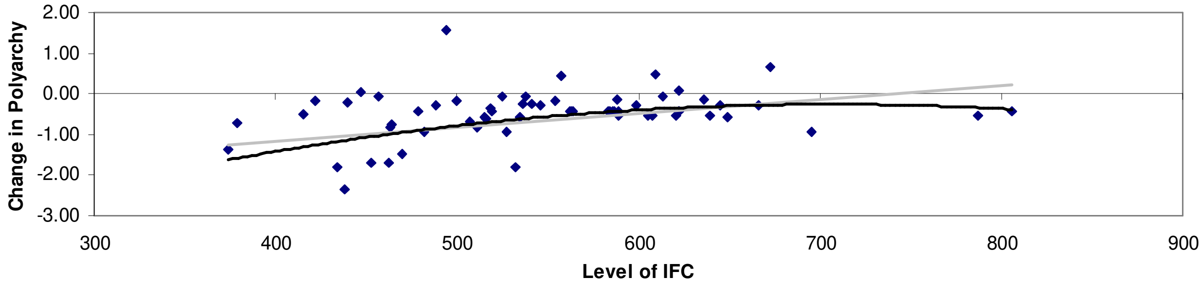
Figure 7b: Does IFC Competitiveness Top Off For Polyarchy Scores Which Are Neither Too Low Nor Too High?



The figure shows international financial centres' 2007 level of polyarchy (basically a measure of the extent to which an international financial centre's jurisdiction possesses and applies rules and procedures aimed at encouraging the political participation of several groups or broader populations). We compare these "starting" levels with the 10 year average geometric change in these jurisdictions' IFC competitiveness. See paper for list of the jurisdictions we analysed and other details.
Sources: Y/Zen for IFC competitiveness ratings and the Varieties of Democracy Database (various years).

[33] These mathematics refer to differential equations. A financial centre's initial position and speed of growth plays a profound role in deciding how the centre responds to other factors like political polyarchy.

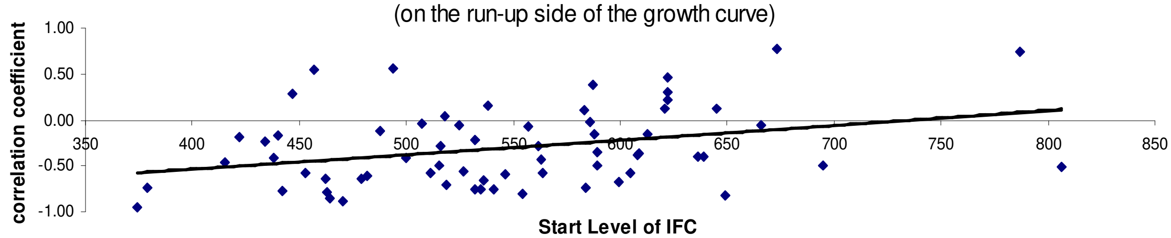
Figure 7c: Maybe Polyarchy Is Better for Financial Centre Competitiveness Than the Previous Figure Suggested?



The figure shows the geometric change in polyarchy in international financial centres' jurisdictions compared with their 2007 level of IFC competitiveness. In other words, we have reversed the x-axis and y-axis from the previous figure - and look at the change in polyarchy as the dependent variable, rather than as the independent variable. The negative dependent variable scores reflect falling polyarchy from 2005 to 2015. See paper for a list of jurisdictions and other details.
Sources: Y/Zen for IFC competitiveness ratings and the Varieties of Democracy Database (various years).

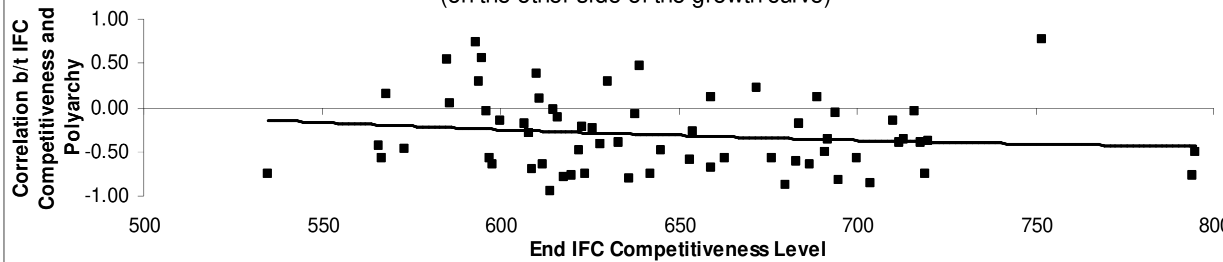
Not only does polyarchy and level of an IFC vary across jurisdictions, these correlations vary across time. Figures 8 illustrate how the correlation between polyarchy and IFC competitiveness can positively correlate in one year, but negatively correlate in another year. Figure 8a, in particular, shows the correlation coefficients across the jurisdictions we studied for 2007. In these data, IFC competitiveness increases with the extent of polyarchy. Yet, as shown in 8b, the correlation between polyarchy and IFC competitiveness decreases across countries. Such results highlight the variable nature of the relationship between polyarchy and IFC competitiveness. The first impression from these data might point to a positive correlation between polyarchy and IFC competitiveness for lower ranked financial centres, and negative correlations for higher ranked financial centres. If we interpret these data more conservatively, however, we might notice change, without trying to shove the data into a pattern. No matter what you/we think about these data -- **polyarchy and IFC competitiveness clearly adjust to each other somehow over time.**

Figure 8a: More Competitive IFCs become More Democratic (or At Least More Polyarchic) Over Time As They Get Larger
(on the run-up side of the growth curve)



The figure shows the correlation coefficient between each international financial centre's competitiveness (its Y/Zen rating) and the level of polyarchy measured by the Varieties of Democracy Project for the period 2007 to 2016 on the y-axis. The x-axis shows each IFC's competitiveness rating in 2006 (as an "start" level, which we contrast in the figure below by an "end" level 10 years later in the next figure). If IFCs became more polyarchic (democratic?) as they became more competitive, maybe such polyarchy started growing as these IFCs reached a certain size? We show the simple line of best fit for reference. See paper for list of jurisdictions and other details.
Sources: Y/Zen for IFC competitiveness ratings and the Varieties of Democracy Database (various years).

Figure 8b: Most Competitive IFCs Want (Need?) Less Polyarchy As They Struggle With Larger Sizes
(on the other side of the growth curve)

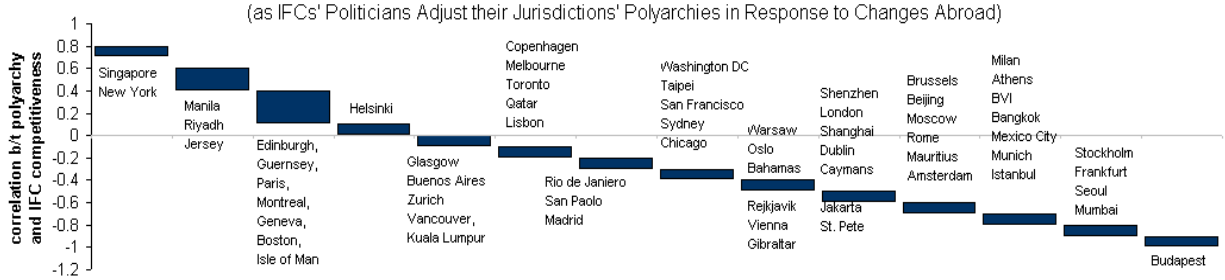


The figure shows the correlation coefficients for each international financial centre's competitiveness (its Y/Zen rating) and the level of polyarchy measured by the Varieties of Democracy Project for the period 2007 to 2016 on the y-axis. The x-axis shows each IFC's competitiveness rating in 2016 (as an "end" level which we contrast in the figure above by a "start" level 10 years earlier). If IFCs became more polyarchic (democratic?) as they became more competitive, maybe polyarchy started shrinking as these IFCs reached a certain size? We show the simple line of best fit for reference. See paper for list of jurisdictions and other details.
Sources: Y/Zen for IFC competitiveness ratings and the Varieties of Democracy Database (various years).

Other evidence seems to point toward polyarchy helping more competitive international financial centres than less competitive ones. Figure 9 shows the correlations between polyarchy and IFC competitiveness for specific jurisdictions. If each metropolitan financial centre reflects the polyarchy and IFC competitiveness of its host jurisdiction, Singapore and New York, in this sample, had increasingly polyartic institutions with increasingly competitive international financial centres.[34] Jurisdictions from Jakarta to Budapest had decreasingly polyartic political participation, perhaps in a bid to increase their financial centres' competitiveness? Figure 10 bolsters such an interpretation by looking at how the achievement of electoral democracy has responded in various international financial centres in response to the global financial crisis – or visa versa.[35] Naturally, the extent of polyarchy (and possible electoral democracy) would affect the economic response to the crisis – and thus the ranking of a jurisdiction's international financial centre.[36] Yet, as with most social economic questions, the converse might also hold. The crisis – and thus an international financial centre's competitiveness -- affects the extent of polyarchy. More participation in many cases means a replacement of incumbents, rather than an increased diversity of voices and preferences at the political bargaining table. **Regardless of which way causality lies, polyarchy and the size/growth of international financial centres affect each other.**

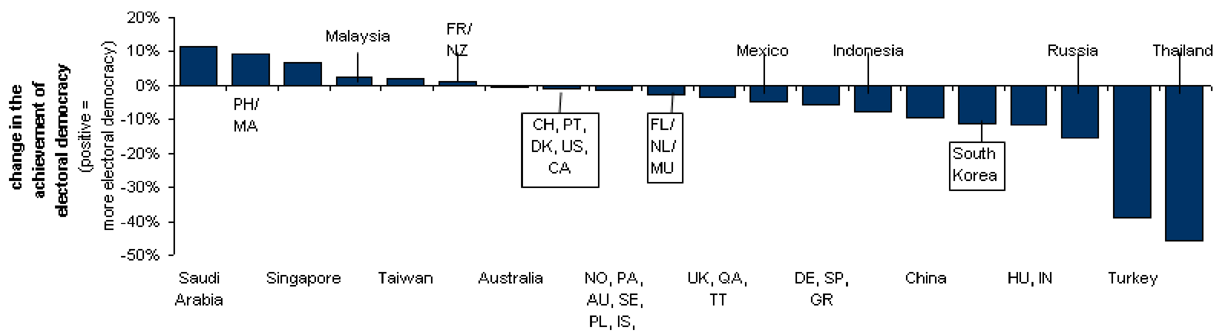
[34] Readers will notice we use the names of Z/Yen's financial centres (as metropolitan areas rather than as nation-states). We do this to make these data directly comparable with the jurisdictions Z/Yen's reports describe.
[35] We do not want to delve into the issue of causality (whether polyarchy helped reduce the effects of crisis or whether crisis reduced polyarchy). We only want to say that crisis provided an impetus for political adjustment, irregardless of the nature and robustness of such adjustment.
[36] Lipscy (2017) finds that "democracies are about twice as likely to experience a crisis as autocracies." Autocracies particularly help fragile economies (fragilized by high debt-to-GDP ratios) reduce the likelihood of economic/financial crisis.

Figure 9: Does the Level of Polyarchy in One IFC Actually Influence Polyarchy in Another?
(as IFCs' Politicians Adjust their Jurisdictions' Polyarchies in Response to Changes Abroad)



The figure shows the correlation coefficient between international financial centre competitiveness and polyarchy for each jurisdiction shown in the figure from 2007 to 2016. We show these data as a precursor to our more rigorous analysis of cross-correlations in polyarchy across jurisdictions. Even before apply more rigorous methods though, we can see that some jurisdictions likely respond to changes in polyarchy abroad (intentionally or indirectly) more than others.
Sources: Z/Yen (for IFC competitiveness) and Varieties of Democracy Project (for measures of polyarchy).

Figure 10: Trends in Electoral Democracy Match Those in/of Polyarchy



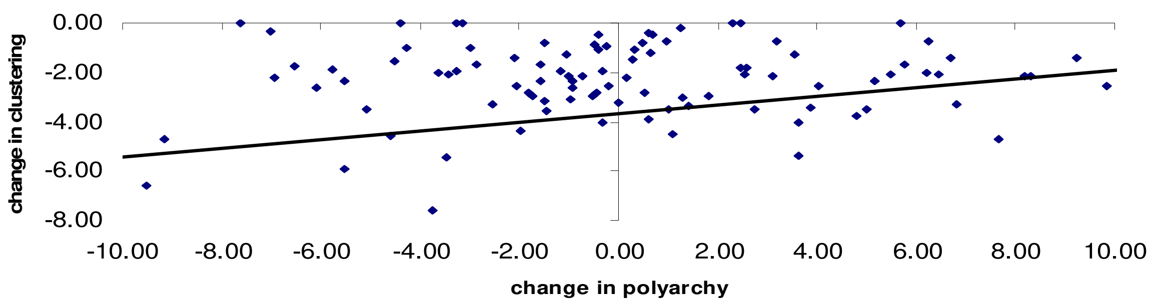
The figure shows the change in an index of polyarchy (answering the question to what extent is the ideal of electoral democracy in its fullest sense achieved)? The bars show the change in this 0 to 1 measure for 2015 compared with 2006. Judging by the number of countries showing negative change in this measure, we can deduce that polyarchy has diminshed, if ever so slightly in the recent decade. Whether such electoral democracy correlates with increasing polyarchy in/of the obscure, untrackable groups making financial policy remains an open question.
Source: Varieties of Democracy, VDem database (2017).

The centrality of a financial centre among the flow of funds in the network of international financial centres best measures an IFC's competitiveness. Academics like Fichtner (2015) and Corbett and Xu (2015) have long theorised about – and even mapped -- the networks of financial capital flowing across/between international financial centres. Such network maps have included measurements of financial centres' degree of linkage, betweeness and other network statistics common to all graphs.[37] Such network measurements have allowed academics and international organizations like the IMF (2011) to measure things like the extent of systemic risks to the entire global banking system. In such a network, geographic distance and physical centrality matters far less than network centrality (Fernandez, 2009). Figure 11a, for example, shows the changes in polyarchy and changes in international financial centres' clustering coefficients (or the extent to which a jurisdiction connects its banking partners without these other banking partners necessarily having linkages between themselves). More polyartic international financial centres cluster more with other financial centres, as measured by their clustering coefficient (basically a

[37] Mathematicians and increasingly social scientists like von Peter (2007) refer to networks as graphs. The degree of linkage refers to the number of other jurisdictions that jurisdiction's banks do business with. Betweenness refers to the extent to which an international financial centre sits on the shortest path between financial flows going between other financial centres.

measure of their centrality or importance in the international financial centre network).[38] Figure 11b shows the same data – fit to a non-linear curve instead of a simple line. Such a curve suggests that polyarchy increases in/for weakly and strongly clustered international financial centres. Singapore represents an increasingly important (as measured by its clustering coefficient) jurisdiction becoming more polyartic over time. Japan's clustering coefficient rose, while polyarchy fell. The trend seems to show that polyarchy remains stable for jurisdictions losing importance over time (like Austria and Canada). Does a stable, equilibrium-level of polyarchy correspond with ever-decreasing clustering importance? Or put conversely, do some jurisdictions need to become more polyartic before they can gain network centrality?

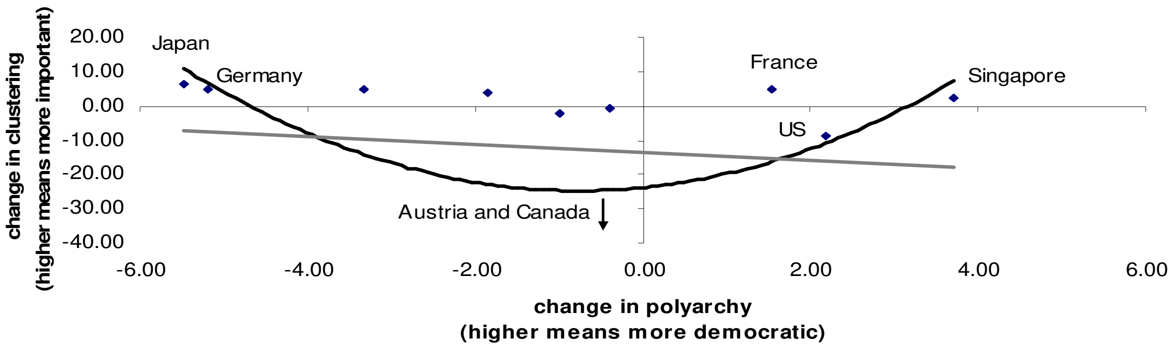
Figure 11a: Global Trend Toward a Larger Global Role for Investment Centres As They Become More Democratic?



The figure show s the predicted relationship betw een the change in polyarchy and clustering coefficients for 165 jurisdictions from 2005 to 2015. Polyarchy (in theory) measures the extent to w hich several interests exert influence over policy (as electoral democracy). Clustering coefficients represent the jurisdiction's importance in the netw ork of cross-border liabilities exchanged among all institutions. The general story points to more democracy coinciding w ith greater importance of that jurisdiction in international investment.
Sources: BIS (2017) and V-Dem Institute (2017).

[38] The predominantly negative values in the figure signify the increased linkages forming across financial centres during the time period we studied. We do not show the sparse data in the positive part of the graph, as we use this figure as background to illustrate our larger point.

Figure 11b: Did Reductions in Polyarchy Help Solidify International Financial Centres' Importance in the Network of International Finance?

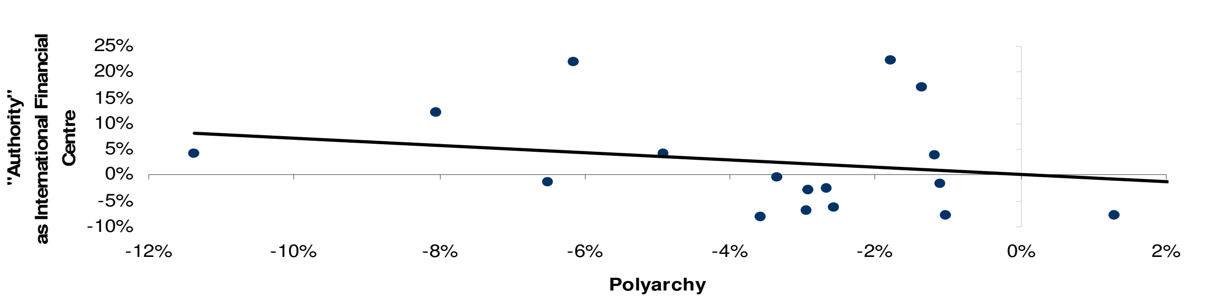


The figure shows the predicted relationship between the change in polyarchy and clustering coefficients for jurisdictions hosting major financial centres from 2005 to 2015. Polyarchy (in theory) measures the extent to which several interests exert influence over policy (as electoral democracy). Clustering coefficients represent the jurisdiction's importance in the network of cross-border liabilities exchanged among all institutions. The jurisdiction gains importance among the cluster of financial centres as polyarchy decreases. These jurisdictions consist of Australia, Austria, Belgium, Canada, China, France, Germany, Japan, Singapore, the UK and USA.
Sources: BIS (2017) and V-Dem Institute (2017).

Without controlling for other factors like macroeconomic fluctuations and the demand for capital, the network data seem to display contradictory trends. Figure 12 shows the relationship between international financial centres' authority (or the extent to which other financial centres place money with their banks). Over the period we studied, international financial centres' authority decreased as polyarchy in these international financial centres rose.[39] Some like Chinazzia and his colleagues (2013) might argue that highly connected financial centres feel crises and other large changes in their competitiveness less – attenuating the need for the polyarchy which helps boost competitiveness. Others like Cerutti and Zhou (2017) argue that regional links have replaced global links. Yet, without controlling for other factors though, these data could say anything (or nothing at all). Other factors likely interfere too badly for us to draw any conclusions about these data…thus the need for more advanced econometric modelling.

[39] Authority usually contrasts with 'hub' values – the extent to which a financial centre serves as a source of funds or conduit for these financial flows, basically 'referring' these funds to high authority centres.

Figure 12: International Financial Centres Gained "Authority" in the International Financial Network of Overseas Investment/Banking as Their Governments Reduced Political Pluralism after the Global Financial Crisis



The figure shows the change in network 'authority' and polyarchy for international financial centre (IFC) jurisdictions ranked by Z/Yen's International Financial Centres Index from 2005 to 2015. Authority refers to the network theory concept measuring the extent to which each jurisdiction attracted banking liabilities from other IFCs, after tracing through the way these funds flow through the global financial network. Positive changes mean the jurisdiction's financial institutiokns gained assets/funds from 'hubs' (jurisdictions specialised on sending funds on). Polyarchy refers to the extent to which multiple political actors can express their views on politics and policy. We took both measures in 2015 and found their proportion of 2005 levels. Even before controlling for outside infuences (like economic growth rates, share price fluctuations or other factors which could cause political divisiveness and capital flight), we observe a -0.25 correlation coefficient between these varianbles. Sources: Varieties of Democracy database (2017) for data on polyarchy and the Bank for International Settlements (2017) for data on each jurisdictions' financial institutions' total cross-border liabilities.

Conclusion

International financial centres like Doha, Dubai, Shanghai, and even more recently Moscow and Istanbul, seem to show that limits on national and/or local democracy help promote financial centre growth. New York and London, the world's two leading international financial centres, sit in relatively democratic jurisdictions. Yet, even historians could argue that their growth came from government/political support – not from freely democratic, autonomous development. What does the literature -- and what do the data -- say about the role of political plurality as a means (or at least conductive to) building an international financial centre?

Our paper had modest ambitions - to serve as a stand-in literature and data review for future authors doing advanced econometric analysis. Specifically, we have looked at the role of polyarchy (and thus increased democracy) in aiding the development of an international financial centre. We find support for decades of theorising that financial centres' rely on increased autocracy (less polyarchy) to help grow out their financial centres. Yet, these results do not support more autocratic (or even authoritarian!) government. The successful international financial centres of today limited polyarchy in the past (if even ever so slightly) in order to help grow out their financial centres.[40] Yet, they also enfranchised other groups in their polyarchy to generate political support for the financial centre, bring in new ideas and financial innovations, and balance out national economic growth. These financial centres' policymakers restricted and expanded polyarchy (either intentionally or unintentionally) to grow their financial centres.[41]

[40] Changes in our polyarchy dataset occurred in such small intervals that we had to multiply the original variable by 100 to derive large enough changes needed to compare with the other variables in our study. We do not want to give the impression that these financial centres went through large-scale political change during the time of our study.

[41] Our study did not look at optimal policy responses (or even equilibrium ones). Thus, we can not say what policymakers *should* do, only what they *did* do.

Our results inform several debates of the day. Activists for or against Britian's exit from the European Union (Brexit) or Hong Kong's total reunification with China in 2047 and others praise or condemn the effects of polyartic government on their financial centres' performance. Yet, before our study, they had little empirical evidence for doing so. Our study suggests that they should try to choose (!?!) a level of democracy or polyarchy which maximises the performance of their financial centre overall…or at least understand it.[42] Instead, they should worry about when polyarchy changes vis-a-vis other financial centres. Successful financial centres seem to adjust their polyarchy counter-cyclically with other centres – means that no level of polyarchy will always be best for a financial centre. Hong Kong's success as an international financial centre – like Britain's – will depend on whether they restrict or expand polyarchy at the right time in response to other financial centres. Little surprise there. Now all we need is a rigorous econometric study to add the details.

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[42] As we do not want to give policy advice here, we insert a fair amount of skepticism in such a policy recommendation. Yet, no one can argue for a better understanding of the way polyarchy and financial centre competitiveness bob up and down in relation to each other - and these factors in other international financial centres.

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