International Financial Centers: The British-Empire, City-States and Commercially Oriented Politics

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Nearly forty percent of the world's financial assets are located in loosely defined British Empire city-state jurisdictions. This article seeks to provide an explanation for this odd development. My explanation of the rise of such a British Empire-centered economy links the development of the Euromarket, or the offshore financial market, to three sets of theories. The first is the hinterland theory that explains why small city-state types of jurisdictions are in an advantageous position when it comes to trading in Euromarket financial assets in comparison to other states. Second is the dependent jurisdictions theory, which suggests that dependent jurisdictions are perceived as safer locations for investment than independent islands, in addition to which they are able to offer better treatment of nonresident capital because they are subsidized by the motherland. As the British Empire was the largest Empire the world has ever seen, it is perhaps not surprising that the British state has inherited the greatest number of such dependent jurisdictions, and that they, in turn, have taken advantage of their "Britishness" to develop their financial centers. Third, I advance a related argument that suggests that the hegemonic position of the British Empire in the world economy prior to the rise of the United States was an important factor as well. Here, I draw on the idea that

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city-states and, more generally, trading centers tend to be dominated by commercially outward-oriented elites.

INTRODUCTION

Today, finance is thought of as a hyperactive mobile, decentralized and globalized web of impersonal units of risk trading. In this web, London is usually ranked as either the largest or the second-largest wholesale financial market in the world.[1] London is considered, however, the undisputed leading *international* financial center.[2] By the second quarter of 2008, banks located in the UK held 21.1% of international bank assets and 21.5% of international bank liabilities on their books. The United States was the second-largest international banking center with a 12.0% share of international liabilities on the books of banks located in its territory, followed by France, Germany, the Cayman Islands, Ireland and Switzerland, each in the range of 3 to 10% of market share (see Table 1).

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1 For a discussion of London's position as an international financial center see MARK YEANDLE, MICHAEL MAINELLI & ADRIAN BERENDT, THE COMPETITIVE POSITION OF LONDON AS A GLOBAL FINANCIAL CENTRE (2005).

2 Financial centers have traditionally developed, normally in the large cities, primarily to serve the financial needs of a domestic market. International Financial Centers (IFCs), by contrast, are centers with a primary orientation of business toward nonresidents. The concept of IFC is often confused with the concept of offshore financial center (OFC). They both specialize in nonresidents' business, only that OFCs are normally, but not always — and this is the cause of the confusion — associated with tax havens as well. The IMF has sought to clarify the conceptual confusion only to conclude that the concept has no more use in contemporary conditions. For a discussion, see Monetary and Exch. Affairs Dep't, Int'l Monetary Fund, Offshore Financial Centers IMF Background Paper (June 23, 2000), http://www.imf.org/external/np/mae/oshore/2000/eng/back.htm; Ahmed Zoromé, *Concept of Offshore Financial Centers: In Search of an Operational Definition* (Int'l Monetary Fund, Working Paper No. WP/07/87, 2007), *available at* http://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf. The Bank for International Settlements continues to use the concept of IFC, but adopts what it describes as a network approach defining international financial centers as global hubs of banking activities. *See* Bank for Int'l Settlements, *International Banking and Financial Market Development*, BIS Q. REV., Dec. 2007, at 33. For a discussion of the relationship between IFCs, OFCs and tax havens see RONEN PALAN, RICHARD MURPHY & CHRISTIAN CHAVAGNEUX, TAX HAVENS: HOW GLOBALIZATION REALLY WORKS ch. 1 (2009). For a discussion of London's position as an international financial center see Int'l Fin. Servs. London, International Financial Markets in the UK (Apr. 2007), http://www.ifsl.org.uk/output/ReportItem.aspx?NewsID=42.

Conventional rankings of international financial centers are founded, however, on a debatable assumption, namely, that British Crown Dependencies such as Jersey, Guernsey and the Isle of Man, as well as British Overseas Territories such as the Cayman Islands, Bermuda, British Virgin Islands (BVI) or Gibraltar, are independent and separate from the UK. Remove this assumption, and a far larger UK-centered complex of international centers emerges, accounting for a nearly 29.6% share of the world's cross-border bank liabilities in 2008. Add former colonies of the British state such as Singapore and Hong Kong, and the impact of a political entity normally considered defunct, the British Empire, on the contemporary financial system appears decisive, accounting for a nearly 36.1% share of the all-international banking liabilities.[3]

Why are so many of the world's financial assets located in loosely defined British Empire jurisdictions such as the Channel Islands, Gibraltar, the Cayman Islands, Bermuda, British Virgin Islands, Singapore and Hong Kong? This development is particularly intriguing in light of two common

3 The relationship between the British state and its various dependencies is complex, fluid, and appears to have evolved on the basis of tacit understandings between the two sides. The Channel Islands, which include Jersey, Guernsey and the Island of Man, are Crown dependencies. They are possessions of the Crown and, strictly speaking, are not part of the UK or the EU. Executive power in the three Channel Islands is exercised by the representatives of the British Crown, and hence primarily through the British Home Office. The relationship, however, has evolved over time and the Islands today possess greater autonomy. Le Hérissier describes the relationship between the British State and the Channel Islands as pragmatic, with the UK exercising prudence. In financial matters, however, the British Treasury would appear to exercise far greater control over the islands than is normally admitted. For a discussion, see Roy Le Hérissier, *Jersey: Exercising Executive Power in a Non-Party* System, 18 PUB. ADMIN. & DEV. 169 (1998). For additional discussion, see Austin Mitchell & Prem Sikka, *Jersey: Auditors' Liabilities Versus People's Rights*, 70 POL. Q. 3 (2002); Mark P. Hampton & John E. Christensen, *Treasure Island Revisited. Jersey's Offshore Finance Centre Crisis: Implications for Other Small Island Economies*, 31 ENV'T & PLAN. A 1619 (1999). In addition, the UK retains responsibilities for fourteen Overseas Territories, eleven of which are permanently populated and remain under British sovereignty. The territories are not constitutionally part of the UK, but the UK government maintains responsibilities towards them, and the Foreign and Commonwealth Office is the department mainly responsible for dealing with them. Among these Overseas Territories, the Cayman Island, Bermuda and British Virgin Islands have emerged as very significant OFCs, while Turks, Caicos and Gibraltar are medium-size centers and Anguilla, Montserrat, and Pitcairn Islands possess insignificant offshore financial centers. For details, see COMPTROLLER & AUDITOR GEN., FOREIGN & COMMONWEALTH OFFICE, MANAGING RISK IN THE OVERSEAS TERRITORIES, REPORT, 2007-8, H.C. 4.

assumptions in financial literature. The first is associated with the so-called global cities thesis, which stresses the connection between large, populous cities, globalization and the financial sector.[4] Here we find, by contrast, that, with the exception of London, small city-states, often with miniscule populations, have emerged as successful international financial centers. The second is U.S.-centered accounts of the origins and continuing development of a largely unregulated, international financial system.[5] A deregulated international financial system is typically seen as a central component of U.S. hegemony, or even of a "Wall Street" hegemony, an impression sustained not least by the most recent and disastrous U.S. origins of the current global meltdown. Why, then, does Bank of International Settlements (BIS) data suggest that a British Empire-centered financial system has emerged during the high period of American hegemony?

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). The Euromarket is an international financial market (or rather a series of markets) specializing in nonresident finance. It is estimated that at present fully 80% of all international financial activities are conducted through these markets.[6] The Euromarket gave rise, in turn, to a network of financial centers specializing in nonresident finance, the majority of which are small island economies and city-states. The question arises, then, as to why the Euromarket has stimulated the rise of such geographically small and specialized financial centers. More specifically, why do they tend to be British-linked city-states? Moreover, what precisely is the link between the Euromarket, city-states and the British Empire?

My answer to all these questions is that there were good reasons for the emergence of a British Empire network of city-state international financial centers. My explanation draws on three sets of theories. First, the theory that small city-state jurisdictions are in an advantageous position when it comes to trading in Euromarket financial assets. The theory suggests that small jurisdictions lack vast and expensive hinterlands and hence are able to offer

4 There is by now a vast literature on global cities. Best known among them is SASKIA SASSEN, THE GLOBAL CITY: NEW YORK, LONDON, TOKYO (rev. ed. 2001).

5 There is a vast literature on this topic as well. For a good summary, see Roy Kreitner, *The Jurisprudence of Global Money*, 11 THEORETICAL INQUIRIES L. 177 (2010).

6 For a discussion see Harold Rose, *Mastering Management — Part 5 (13): Euromarkets. Their Uses and Worth*, FIN. TIMES, Nov. 24, 1995.

fiscal and regulatory incentives to nonresident finance.[7] This theory goes a long way toward explaining the relative success of city-states in contemporary finance.

Second, I will try to explain the specific advantages that British-linked city-states possess *vis-á-vis* similar city-states, islands and enclave economies. My explanation draws on the theory that dependent jurisdictions are perceived by financial actors as safer locations than other enclave economies because they share their mother country's political, economic and legal stability.[8] This theory may explain the relative advantages not only of British-held jurisdictions, but also of other such small jurisdictions with strong foreign links such as Liechtenstein, which has close ties to Switzerland, Monaco that relies on France, Luxembourg that relies on the European Union, and the Netherlands Antilles that rely on the Netherlands. In light of the fact that the British Empire was the largest the world has ever seen, it is perhaps not surprising that the British state has inherited the greatest number of such dependent jurisdictions, and that they, in turn, have taken advantage of their "Britishness" to develop their financial centers. In addition, the emergence of the Euromarket in London, under the auspices of the common law, gave a distinct advantage to British-linked jurisdictions. This theory may also explain the relative decline of the financial centers in those British jurisdictions, such as the Bahamas or the New Hebrides (Vanuatu), which chose the path of full independence in the past three decades.[9]

Third, I advance a related argument that suggests that the hegemonic position of the British Empire in the world economy prior to the rise

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7 For a discussion, see Godfrey Baldacchino, *Managing the Hinterland Beyond: Two Ideal-Type Strategies of Economic Development for Small Island Territories*, 47 ASIA PAC. VIEWPOINT 45 (2006); Adrian E. Tschoegl, *The Benefits and Costs of Hosting Financial Centers*, *in* INTERNATIONAL BANKING AND FINANCIAL CENTERS 175 (Yoon S. Park & Mark Essayyad eds., 1989).

8 PALAN ET AL., *supra* note 2. I use here the term 'perceived' because there is evidence to suggest that businesses and individuals have tended to view such jurisdictions as safer locations to place their assets than politically independent small jurisdictions. There is no corroborative research or otherwise evidence to suggest, however, that such jurisdictions are indeed in any way "safer" than others.

9 For a discussion of the relative decline of the Bahamas economy since independence see Barbara J. Nowak, *Keeping It better in the Bahamas: A Nation's Socioeconomic Response to Juvenille Crime*, 31 J. BLACK STUD. 483 (2001). For a discussion of the performance of Pacific havens see JASON SHARMAN & PERCY MISTRY, CONSIDERING THE CONSEQUENCES: THE DEVELOPMENT IMPLICATIONS OF INITIATIVES ON TAXATION, ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (2008).

of the United States was an important factor as well. The argument is that hegemonic states go through historical cycles, known as the hegemonic cycle theory.[10] According to the theory, hegemonic states rise to power on the back of a vibrant manufacturing sector; they then develop a strong commercial sector; and finally they end up with a strong financial sector. The result is that during a period of decline, a hegemonic power tends to maintain a disproportionately bloated, politically powerful commercial and financial sector. This was true of the declining Dutch, as well as the British hegemonic, states. Nevertheless, while Amsterdam was the largest financial center of its day, and experienced the first serious financial crises (the Tulip mania),[11] Holland was still largely a trading state and as a result was dominated during and after its decline by commercially oriented elites. London, by contrast, emerged as a truly global financial center during the heyday of the British Empire, and as a result the British state has been dominated politically by a financial elite.[12] This theory may then explain the specific British link discussed in this article.

Trading and financial centers tend to be dominated by commercially outward-oriented elites. Such entities have made a smooth transition from trading centers to tax havens and OFCs. This may explain not only the rise of city-states, but also the role played by other traditional entrepôt economies such as Beirut, Montevideo, Panama, Hong Kong and Singapore as international financial centers as well.

The series of explanations that I advance in this article contrast with the more traditional theories, which place their emphasis on agglomeration of skills, English common law and the English language. These theories do not explain why, for instance, the United States and its dependencies, which share all of the above attributes, have not dominated the international financial market sector; they also explain neither the rise of the Caymans or Bermuda or Singapore, nor, correspondingly, the decline of the Bahamas and Nauru.

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10 For a discussion, see GIOVANNI ARRIGHI, THE LONG TWENTIETH CENTURY: MONEY, POWER AND THE ORIGINS OF OUR TIMES (1994); Immanuel Wallerstein, *The Three Instances of Hegemony in the History of the Capitalist World-Economy*, 24 INT'L J. COMP. SOC. l00 (1983).

11 For a discussion see Peter Garber, *Tulipmania*, 97 J. POL. ECON. 535 (1989).

12 A well known theory in British political science circles; its classical formulation can be found in GEOFFREY INGHAM, CAPITALISM DIVIDED? THE CITY AND INDUSTRY IN BRITISH SOCIAL DEVELOPMENT (1985).

I. INTERNATIONAL FINANCIAL CENTERS

The concept of an international financial center has gone in and out of fashion in the past three decades, and remains highly contested.[13] Whereas in the 1990s, London, New York and Tokyo were considered the three largest financial centers in the world, a more recent study commissioned by the Corporation of London concluded that London and New York are the only two remaining truly global financial centers.[14] A different study commissioned by the Corporation of London has demonstrated that whereas New York draws large volume of business from its domestic market, London has the largest share of many international financial markets — hence London is considered the largest international financial center.[15]

In a recent report, the BIS, the so-called central banks' banker, has incorporated the concept of "network" into its definition of international financial centers. The BIS stresses the relationship between centers and acknowledges that none of the international financial centers operates alone.[16] BIS is following a theme already developed in an excellent study by Liz Dixon, which was commissioned by the Bank of England, that charts the various linkages between the City of London and other financial centers.[17] In contrast to research conducted by the corporation of London, the BIS has opted to use primarily one set of statistics on cross-border external bank assets and liabilities as the best available proxy for the size and rank of international financial centers. The decision is not incontestable, but these statistics arguably provide us with the "cleanest" indication of the role of a location as an international financial center. In this paper, I adopt the BIS's methodology for ranking international financial centers.[18] Different methodologies used for ranking international financial centers achieve more

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13 *See* Bank for Int'l Settlements, *supra* note 2; *see also* YOUSSEF CASSIS, CAPITALS OF CAPITAL: A HISTORY OF INTERNATIONAL FINANCIAL CENTRES, 1780-2005 (Jacqueline Collier trans., 2006); Charles P. Kindleberger, *The Formation of Financial Centres: A Study in Comparative Economic History*, PRINCETON STUD. INT'L FIN., Nov. 1974, at 36.

14 YEANDLE ET AL, *supra* note 1.

15 Int'l Fin. Servs. London, *supra* note 2, at 2.

16 Bank for Int'l Settlements, *supra* note 2.

17 Liz Dixon, *Financial Flows via Offshore Financial Centers*, 10 FIN. STABILITY REV. 104 (2001).

18 Bank for Int'l Settlements, *supra* note 2.

or less the same results; the BIS methodology is the simplest and most widely used.

Table 1 presents the rankings of international financial centers based on the latest locational statistics published by the BIS in March 2008. In addition to the unassailable position of London, the table shows that the Cayman Islands, which were in fourth position in 2006, were ranked fifth in 2008. The table also shows the importance of other tax havens such as Jersey, Guernsey and the Bahamas.

Table 2 is based on a little exercise that involves regrouping some of these disparate centers in Table 1 on a thematic basis. Such an exercise reveals a number of interesting trends that are obscured in the conventional method of ranking financial centers. The most obvious lacuna in the conventional statistics is the role played by the UK in global finance. The UK financial center consists of the Square Mile, Canary Wharf, Mayfair and the Home Counties), as well as subsidiary financial centers located on the British Isles, such as Edinburgh and Manchester.[19] The figures for the UK, however, exclude territories that are either under direct British rule or, according to all available reports, still closely linked to the City of London due to lingering imperial connections. Indeed, the British state maintains jurisdiction over some of the world's most significant financial centers such as the Channel Islands, Gibraltar and, most importantly, the Cayman Islands. It also maintains jurisdiction over the world's largest captive insurance center, namely Bermuda[20] (currently the third-richest country in terms of GDP per capita), a jurisdiction that lacks a thriving offshore banking center and hence does not appear in Table 1 at all. If we consider these jurisdictions to be part of the UK, which they are, then the British State accounts for a whopping 29.6% of international market transactions. Add to this the three outposts of the British Empire which have relatively recently obtained their independence, Singapore, Hong Kong and the Bahamas, and the share of what may be described loosely as a British Empire link, or British Empire-centered international financial services, rises to 36.1%!

By extending this little exercise, it is possible to identify another interesting fact revealed by the data, namely the importance of a unique type of political entity often considered extinct in the modern world, the city-state. Singapore is often treated as a modern variant of this medieval

19 YEANDLE ET AL., *supra* note 1.

20 Captive insurance companies are insurance companies established with the specific objective of financing risks emanating from their parent group. The idea was innovated in Bermuda, but has spread now to other jurisdictions including some of the U.S. states such as Vermont.

political format.[21] However, the Caymans, the Bahamas, Jersey, Guernsey, Bahrain, Dubai, Abu Dhabi, and Monaco are also modern variants of the city-state format. The combined share of such city-state financial centers by March 2008 was 17.1%. However, if we consider the City of London, by which I mean the Square Mile, as a city-state as well, the figure may rise to approximately 27.9%.[22]

Table 2 contains a significant amount of double counting. I submit, however, that it offers a more accurate and honest depiction of the geopolitical character of the international financial market than Table 1. Table 2 reveals the overwhelming significance of the British Empire in shaping international financial activities. It also reveals, more generally, that the international financial market — the market that is supposed to be the most advanced, sophisticated and modern — exhibits a preference for entities that may be considered anachronisms: the British Empire and its remnants, and city-states.

In the rest of this article, I will try to explain the role of city-states, specifically, and those of the British state and the British Empire in the evolution of contemporary finance.

II. GLOBAL CITIES AND GLOBAL CITY-STATES

The debate on the nature and character of globalization has undergone an interesting process of evolution during the late 1990s. The dominant perception of globalization in the late 1980s and early 1990s, as articulated by writers such as Kenichi Ohmae and Robert O'Brien, was that the state was withering away, paving the way for an entirely new global economy and global polity.[23] This so-called hyper-globalization thesis inevitably stimulated revisionist accounts of globalization. In international relations

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21 *See, e.g.*, GEOFFREY MURRAY & AUDREY PERERA, SINGAPORE: THE GLOBAL CITY-STATE (1996); LINDA LOW, THE POLITICAL ECONOMY OF A CITY-STATE: GOVERNMENT-MADE SINGAPORE (1998).

22 The two leading contemporary historians of the London financial center consider the city of London as a form of city-state. *See* RICHARD ROBERTS & DAVID KYNASTON, CITY STATE: A CONTEMPORARY HISTORY OF THE CITY OF LONDON AND HOW MONEY TRIUMPHED (2002). The London financial center is roughly half of the UK financial services economy, hence the above figure. *See* YEANDLE ET AL., *supra* note 1.

23 There is a vast literature on this theme. Best known are KENICHI OHMAE, TRIAD POWER: THE COMING SHAPE OF GLOBAL COMPETITION (1985); ROBERT O'BRIEN, GLOBAL FINANCIAL INTEGRATION: THE END OF GEOGRAPHY (1992).

and international political economy, these revisionist accounts took the view that the state, far from disappearing, was changing rapidly, assuming a role described as the "competition state."[24] In geography, by contrast, revisionist accounts of state decline led to a renewed interest in sub-national units and in the Marshallian district theory in particular. Marshallian district theories suggest that agglomeration economies explain the successes of district and regional economies such as Silicon Valley in California, Route 128 in Boston, or "Third Italy" in the era of globalization.[25] These theories were soon supplemented by another important revisionist account founded on the observation of the rapid urbanization of the world and the role played by large, populous cities as the motor of the new global economy.[26]

The same literature began to appreciate the role played by large cities as nexuses of production, services and consumption, and as the driving force behind the change and growth of the world economy. Saskia Sassen produced an interesting synthesis of the two debates, globalization and the city, suggesting that globalization has engendered a hierarchy among cities and regions. She argued that the global hierarchy of cities and regions was led by the large financial centers, which she dubbed "global cities," such as London, New York and Tokyo. The theory not only integrated various strands of globalization theory, but also placed finance at the apex of the world economy.[27]

Two of these global cities were easy to account for, the third less so. New York and Tokyo were the financial centers serving, respectively, the largest and the second-largest economies in the world. It made sense that the high volume of commercial and manufacturing activities in these economies would give rise to equally strong financial centers serving these economies. London, however, does not fit the pattern. The third-largest economy in the world in the past three decades had been Germany and not the UK. In fact, the UK manufacturing base was in decline throughout the twentieth century. If the Euro area is taken as a single economic unit, then logically either

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24 *See* PHILIP C. CERNY, THE CHANGING ARCHITECTURE OF POLITICS: STRUCTURE, AGENCY AND THE FUTURE OF THE STATE (1990); JOHN STOPFORD & SUSAN STRANGE, RIVAL STATES, RIVAL FIRMS: COMPETITION FOR WORLD MARKET SHARES (1991).

25 For a discussion, see Ann Markusen, *Sticky Places in Slippery Spaces: A Typology of Industrial Districts*, 72 ECON. GEOGRAPHY 293 (1996); ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 (1994).

26 JANE JACOBS, THE ECONOMY OF CITIES (1969).

27 SASSEN, *supra* note 4.

Frankfurt or Paris, but not London, should have been the third global city, serving the Euro area.

What then, explains London's great success? The Corporation of London, the municipal governing body of the City of London, commissioned a series of studies on London's financial centers throughout the years. These studies tend to attribute London's success to the city's history, to the agglomeration of knowledge and institutional specialization in international finance, including banking, insurance (Lloyds of London), shipping, and the legal and accounting professions. London's geographical location between the Asian and the American markets combined with the flexibility of English common law and the proliferation of the English language are also important reasons for London's success. Finally, yet importantly, these studies tend to attribute London's success to "a proportionate regulatory regime that's effective, fair and focused on the future, principled and risk based."[28]

It is this latter assertion that is subject to much dispute. The story that the Corporation of London likes to tell is of a highly flexible and successful self-regulatory environment promoted by its very self, which has led to the rise and continuing success of London as the world's premier financial center. The Corporation, however, is less keen to recount the reasons why, for instance, many banking and financial institutions moved out of the Square Mile, first to Canary Wharf and then to other areas of London. The reason for the emigration out of the Square Mile was quite simple: the Corporation was reluctant, in the name of tradition, to sanction the building of modern and appropriate office space as demanded by the banks and other financial institutions flocking to London. As a result, even very mediocre office space was subject to spiraling costs. Such dynamics are very typical of areas that are controlled by vested interests seeking to maintain high rental income, as is the case with the Corporation of London.[29] Such stories suggest that the Corporation was not always on top of its game and although it certainly advocated and supported what is euphemistically called, the British system of flexible regulation, it may not have been the main driver behind that system. The unique regulatory regime that has made London into the world's premier financial center emerged, in fact, for reasons that neither the Corporation nor the Bank of England would like to advertise too widely. It had to do with the emergence of a unique type of unregulated financial market in the late 1950s, the Euromarket.

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28 Int'l Fin. Servs. London, *supra* note 2, at 4.

29 *See* Peter Daniels & John Bode, *Extending the Boundary of the City of London? The Development of Canary Wharf*, 25 ENV'T & PLAN. A 539 (1993).

III. THE RISE OF THE EUROMARKET

The growth of the Euromarket is described by Philip Cogan as "probably the single most important development in the international financial markets since the Second World War."[30] Yet despite its importance, a great deal of confusion surrounds the Eurodollar market otherwise known as the Euromarket. There is not even any agreement as to what it is. Some very distinguished economists believe that the Euromarket is simply any wholesale financial market, or an inter-bank market, trading in nonresident denominated currencies and assets. According to this view, the Euromarket evolved as trading in U.S. dollars in European markets took off in the 1950s.[31] In time, the Euromarket has come to denote, according to this view, any market trading in nonresident "hard" currencies, such as the British pound sterling, the yen, the Swiss franc, the Deutschemark and the Euro.

There is a different theory, however, suggesting that the Euromarket is a very specific type of market that emerged in late 1957 in London.[32] Gary Burn has conducted a detailed archival study of the origins of the Euromarket in London His findings were that faced with mounting speculation against the pound after the Suez Canal crisis, the British government imposed strict restrictions on the use of the pound sterling in trade credits with nonresidents. City banks, which had evolved for more than a century as specialists in international lending, particularly to British Commonwealth countries and the so-called British informal empire in Latin America, thus saw their core business disappear overnight. They responded by using U.S. dollars in their international dealings, arguing, presumably, that such transactions have no bearing on the UK balance of payment issues. At this point, the precise policy and legal steps that gave rise to the Euromarket become somewhat vague. It appears that the Bank of England's decision not to intervene in these sorts of transactions was interpreted in the context of the English common law to imply that the Bank regards certain types of financial transactions between nonresident parties undertaken in foreign currency as if they do not take place in the UK.[33] As these transactions took place in London, they

30 PHILIP COGGAN, THE MONEY MACHINE: HOW THE CITY WORKS 102 (5th ed. 2002).

31 *See, e.g.*, Catherine R. Schenk, *The Origins of the Eurodollar Market in London 1955-1963*, 35 EXPLORATIONS ECON. HIST. 221 (1998); Ralph C. Bryant, *Eurocurrency Banking: Alarmist Concerns and Genuine Issues*, 1 OECD ECON. STUD. 8 (1983).

32 GARY BURN, RE-EMERGENCE OF GLOBAL FINANCE (2005).

33 For a discussion, see Oscar Altman, *Eurodollars*, *in* READINGS IN THE EURO-DOLLAR 134 (Eric B. Chalmers ed., 1969); BURN, *supra* note 32.

could not be regulated by any other regulatory authority and therefore ended up in a regulatory vacuum, which is called the Euromarket, or the offshore financial market. As a result, reserve depository requirements were not applied to Euromarket transactions, as indeed any other restrictions and regulations including the use of Certificates of Deposits (CDs) and the like.

The Euromarket emerged, therefore, due to a tacitly accepted understanding by which the Bank of England regarded certain types of financial transactions as if they were taking place elsewhere. That is why some experts describe the Euromarket as a booking device; it exists only in the accounting books of banks and financial institutions, but is not actually "offshore."[34]

IV. THE EUROMARKET AND THE BRITISH EMPIRE

Nevertheless, how was such a thing possible? How could major international financial institutions have created an offshore facility devoid of regulation right in the middle of the Bretton Woods system dedicated to the strict regulation of finance? The attitude of the Bank of England has led some observers to claim that the British state established the Euromarket.[35] Burn believes, however, that the concept of the "British state" must be treated with some caution. The market remained small and practically unknown for about three or four years. In Burn's examination of the Bank of England's archives, he failed to unearth any mention of the market in Treasury correspondence earlier than May 1960. Before that date, he found no evidence either that the Treasury understood the significance of the market, or that Treasury officials even knew of its existence. It is even less likely that politicians of the day knew or understood the new market. Furthermore, many private banks were unsure about the significance of the new market during its early days, some predicting confidently that it would dissolve in very little time. It is difficult, therefore, to sustain the argument that the British state knowingly and intentionally established the Euromarket in order to achieve some predetermined policy goals.

At the same time, Burn has demonstrated that the Bank of England, which is an arm of the British state, could have intervened and opposed the

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34 Masamitsu Hanzawa, *The Tokyo Offshore Market*, *in* JAPAN'S FINANCIAL MARKETS 121 (1991).

35 ERIC HELLEINER, STATES AND THE REEMERGENCE OF GLOBAL FINANCE (1994).

expansion of this new, unregulated market.[36] The Bank, however, chose not to intervene and never objected to its rise. To the best of my knowledge, the Bank never issued any statement acknowledging or disproving the existence of the market. Yet the Italian historian Gianni Toniolo shows that in fact the Bank consistently sought to calm fears expressed by other central banks about the market in the BIS. It is inconceivable, therefore, that the market could have flourished without the blessing of the Bank of England.[37] The Bank of England in fact appears to have been positively predisposed towards the market, and was able at the very least to block any attempts to regulate the offshore market that developed in London.

Burn raises the highly relevant question in this context as to why the Euromarket never developed in Paris. Paris was a relatively thriving center for dollar exchanges by the mid-1950s, on a par with, if not larger than London. The Euromarket, however, Burn insists, was not simply a market trading in dollar-denominated assets as conventionally understood, but an unregulated financial market. Here Burn stresses the importance of English common law. It appears that the tacit understanding between the Bank of England and commercial banks, according to which transactions between nonresidents in foreign currencies are excluded from the Bank of England's supervision and regulation, was possible only in a common law country. It was up to the British state, or anyone else for that matter, to take the case to court to discover whether such an agreement or an arrangement, tacit or not, was legal or not, but until such a case was brought before the courts, the perceived obscurity of the matter was used advantageously to avoid British regulation.

This raises another interesting puzzle. Even if the Euromarket originated accidentally, as economic historians now believe, in London, why did it fail to migrate swiftly to the U.S.? The United States was by the far the largest economy at the time, and possessed the largest and most thriving financial center in Wall Street. The United States also has its own version of English common law. Why then, didn't the United States quickly adopt the Euromarket and develop as the center for Euromarket operations? There were apparently good reasons for the United States to adopt the market or a variant of it. Just as the Euromarket was taking off in London in the late 1950s, U.S. banks, some of them among the world's largest, were beginning to strain against existing U.S. regulations. The regulations ensured

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36 BURN, *supra* note 32.

37 GIANNI TONIOLO, CENTRAL BANK COOPERATION AT THE BANK FOR INTERNATIONAL SETTLEMENTS, 1930-1973 (2005).

that "even the largest of them individually possessed no more than about three per cent of U.S. bank assets."[38] They had difficulties in servicing their large and fast-expanding corporate clients. They were caught in a funding squeeze. On the one hand, under U.S. regulations they could not lend more than 10% of their capital to any one customer. On the other, they could not offer Multinational Enterprises the rate of return on deposits that foreign banks could pay. U.S. banks were therefore straining against the New Deal financial regulations.

Not surprisingly, once U.S. banks' corporate clients discovered the Euromarket, they began to bypass the U.S. financial system and earned higher rates of interest on the Euromarket; meanwhile clients were also looking to the same Euromarket to fund their operations.[39] U.S. banks followed their customers. By the early 1960s, they began setting up branches in London for Euromarket operations. It soon became clear that the market was useful not only in overcoming the specific Act of the Bank of England in 1956 that forbade British banks from lending to non-residents but also, crucially, in overcoming the very strict capital control regulations that were imposed under the Bretton Woods regime. The unregulated environment in London allowed U.S. banks (or their London branches) to circumvent, in addition, many of the New Deal financial regulations. They were able to establish large and diversified banks in London, capable of competing in every aspect of finance. German and Japanese banks followed suit.

It was with great alarm that the U.S. Treasury observed the emigration of American banks to London and the rise of parallel markets in U.S. dollars. The Treasury was under enormous pressure from Wall Street to liberalize the domestic market and develop domestic Euromarket facilities. The U.S. government, however, responded negatively to the challenges posed by the Euromarket. In 1963, the Kennedy administration introduced what is still considered one of the most misinformed financial policies adopted by any administration, proposing a tax that achieved exactly the opposite of what it intended. It introduced the Interest Equalization Tax, a 15% tax on interest received from investments in foreign bonds, in order to make investment in such Euromarket bonds unattractive to U.S. investors. The tax was intended to stem the flow of capital out of the United States to the Euromarket. In fact, it achieved the opposite (as predicted at the time). American corporations

38 Richard Sylla, *United States Banks and Europe: Strategy and Attitudes*, *in* EUROPEAN BANKS AND THE AMERICAN CHALLENGE: COOPERATION IN INTERNATIONAL BANKING UNDER BRETTON WOODS 53, 54 (Stefano Battilossi & Youssef Cassis eds., 2002).

39 BURN, *supra* note 32; Sylla, *supra* note 38.

refused to repatriate capital to avoid paying the interest equalization tax and, in the process, fueled the growth of the Euromarket.

In addition, the U.S. treasury put forward a proposal to the BIS for the re-regulation of the Euromarket in 1979.[40] In the face of stiff resistance from Britain and Switzerland, however, the United States made a *volte face* and in 1981 allowed the creation of a more restrictive type of Euromarket operation on its territory, the International Banking Facilities (IBFs). Tokyo responded in turn by establishing its own type of offshore market, the Japanese Offshore Market (JOM) in 1986.[41] Each of the three "global cities," then, has developed since then largely as a central node in this open capital market, free of capital controls and other restrictions, which is called the Euromarket. The resistance of the United States to the Euromarket demonstrates very clearly that common law was perhaps a necessary but not a crucial reason for the establishment of the Euromarket. The key to London's success as the center of Euromarket operations was politics, a theme to which I now turn.

What might explain the radically divergent responses of the UK and the United States to the rise of the market? Mark Hampton says that the differences are due to the divergent political and economic structures of the two countries.[42] The 1929 depression was a grave blow to Wall Street international financiers, such as J.P. Morgan and Co., and as a result they lost considerable power in U.S. politics. Philip Burch believes, for instance, that the New Deal administration was decidedly anti-Morgan.[43] The decline of the financial sector was matched by the rising power of a coalition of manufacturing-oriented interests, an "internationalist" wing, or what Charles Meier calls the politics of productivity.[44] Correspondingly, successive U.S. administrations, from the New Deal onward, were committed to a strict principle of financial regulation.

The UK, by contrast, inherited from its Empire days a bloated, but politically powerful financial center in London. Indeed, British domestic politics in the twentieth century is often interpreted in terms of the famous

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40 ETHAN KAPSTEIN, GOVERNING THE GLOBAL ECONOMY: INTERNATIONAL FINANCE AND THE STATE (1994).

41 RONEN PALAN, THE OFFSHORE WORLD: SOVEREIGN MARKETS, VIRTUAL PLACES, AND NOMAD MILLIONAIRES (2003).

42 MARK HAMPTON, THE OFFSHORE INTERFACE: TAX HAVENS IN THE GLOBAL ECONOMY (1996).

43 2 PHILIP BURCH, ELITES IN AMERICAN HISTORY (1980).

44 Charles Maier, *The Politics of Productivity: Foundations of American International Economic Policy After World War II*, 31 INT'L ORG. 607 (1977).

City-industry divide.[45] The City of London developed at the heart of the British Empire, somewhat divorced from the UK's mainland economic needs, to finance trading and manufacturing throughout the formal and informal British Empire. Although nationalized in 1948, the Bank of England remained effectively under the control of the City's commercial banks. The Bank of England consistently pursued policies that favored the City's position as a world financial center, even when such policies were seen as harmful to the UK's mainland manufacturing needs. The pound was consistently overvalued, interest rates relatively high, in a country that saw a declining manufacturing sector.

The divergent treatment of the financial sector by the two important Anglo-Saxon and common law economies can be explained, therefore, in terms of their position in the hegemonic cycle. As a rising hegemonic power, the United States has assumed the role of hegemony once the fledgling manufacturing and commercial sector had become politically dominant, and its policies were largely oriented towards the needs and interests of that sector.[46] 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. Its policies and institutions had a greater predisposition to advance the interest of the financial sector as opposed to the manufacturing sector.

V. The Euromarket and City-States

The development of the Euromarket in London as opposed to New York can be explained, therefore, in historical terms due to the two countries' relative positions in the hegemonic cycle. By the early 1980s, observers began to notice that the Euromarket had given rise to a new "division of labor" and a hierarchy among different types of financial centers, many of which were newly developed financial centers. The core activities in the Euromarket were taking place in what Y.S. Park described as "primary financial centers," such as London, followed by the American IBFs, soon

45 INGHAM, *supra* note 12.

46 The U.S. arguably never followed exactly the trajectory predicted by the hegemonic cycle theorists. In fact, at the turn of the century, U.S. economy was dominated by the financial sector and it took the Great Depression to establish the political dominance of the manufacturing sector.

to be joined by Japan's JOM.[47] These centers served a worldwide clientele and acted as international financial intermediaries for their market regions. Park also noted the rise of what he described as "booking centers" such as the Bahamas or the Cayman Islands. These centers were used primarily for booking or registering Euromarket transactions. They served, in effect, as legal domains for the registration of contractual relationships that were taking place elsewhere (although they collected license fees and other revenues in return). As Marvin Goodfriend explains, "financial transactions are conceived and set up in the main financial centers of London, New York, Frankfurt and so on, they are 'booked' in the Cayman, and hence a large portion of the profits from the transaction can also be 'booked' in the Cayman."[48] As the Euromarket itself was described as a "booking device," it was an easy step to make to register or "book" transactions as if they take place in these small jurisdictions. Indeed, Park may have coined the term "booking centers" echoing the idea that these centers are merely booking platforms for the Euromarket transactions, itself a "booking device." Park unfortunately does not explain the origins of the term.

Park also noticed a third type of centers that he described as "funding centers" such as Singapore or Panama, which play the role of inward financial intermediaries, channeling (Euromarket) funds from outside their markets toward local or regional uses. In 1968, Singapore set up a specialized market called the Asian Currency Unit (ACU), in response to a request from the Bank of America to act as a local branch to handle Euromarket transactions. Finally, a fourth type of center emerged: "collection centers" like Bahrain that engage primarily in outward financial intermediation.

Booking, collecting and funding centers had two distinct characteristics. First, they developed as centers specializing in Euromarket or nonresident transactions. Second, they were all small, city-state type jurisdictions. This begs the question: why has the Euromarket stimulated the rise of such geographically minute jurisdictions as financial centers? This trend, as we saw, stands in opposition to the emergence of financial centers historically in the great cities of the world. What, then, were the advantages of such small jurisdictions?

Financial markets trade in what John R. Commons describes as

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47 Yoon S. Park, *The Economics of Offshore Financial Centers*, 17 COLUMBIA J. WORLD BUS. 31 (1982). Charles Irish estimates that a third to a half of the volume of activities in New York and Tokyo are routed through their respective IBFs. *See* Charles Irish, *Tax Havens*, 15 VAND. J. TRANSNAT'L L. 449 (1982).

48 Marvin Goodfriend, *Eurodollars*, *in* INSTRUMENTS OF THE MONEY MARKET 48, 50 (Timothy Cook & Robert Laroche eds., 1988).

"incorporeal property," shares, currencies and various debt instruments.[49] As such, financial instruments are highly mobile; the main cost placed on transactions is tax and regulations. The London Euromarket center emerged as the world's premier international financial center because it had some important advantages in reducing these costs as described above; London, however, had a number of disadvantages vis-á-vis the city-states. First, while Euromarket transactions were unregulated, London-based banks and other financial institutions still pay considerable corporate tax on their profits, whereas corporate taxation in tax havens is inconsequential. Hence, booking transactions through these jurisdictions proved an attractive proposition. Second, the Euromarket was open only to nonresidents, placing British banks and corporations paradoxically at a disadvantage. They therefore sought residency in other British-dominated jurisdictions to allow them to participate in the Euromarket. Third, while London's geographical position made it an ideal intermediary between Asia, Europe, the Americas, and latterly also the Middle East, there was a need, nonetheless, for local centers in each of these time zones. This explains the growth of Caribbean centers, sharing New York's time zone, the Asian centers of Hong Kong and Singapore, and Middle East centers such as Bahrain and more recently Dubai as booking, funding, and collecting centers.

Many small city-state jurisdictions responded enthusiastically to the new developments by amending their fiscal and financial legislation to attract Euromarket operations. Why have these small jurisdictions sought to specialize as Euromarket booking centers? Baldachino and Tschoegl each explains this trend, arguing that whereas large, heavily populated states have a great many instruments of competition at their disposal, the smallest states cannot realistically compete for large-scale production or manufacturing facilities, nor can they compete in high-value sectors. Besides locational advantages, such as splendid sandy beaches and beautiful mountains that attract tourists, their only "competitive advantage" is their smallness and their sovereign right to write the law.[50] They also have relatively low infrastructure costs, as many of them have few roads and no universities or big hospitals to maintain. In addition, dependencies under the protection of the UK government receive subsidies for basic infrastructure costs even

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49 JOHN COMMONS, THE LEGAL FOUNDATIONS OF CAPITALISM (1959).

50 Ronen Palan, *Tax Havens and the Commercialization of State Sovereignty*, 56 INT'L ORG. 151 (2002); Baldachino, *supra* note 7; Tschoegl, *supra* note 7.

when their nominal income per head is higher than that of the UK.[51] The cost of maintaining the state and government is, therefore, relatively small.

Baldachino points out that many well-known tax havens gained their independence in the years between 1960 and 1970. They quickly realized how difficult it is to survive without the support of the mother country.[52] Britain was also unwilling to subsidize not only its former dependencies, but also current dependencies. The British government charged the Department for International Trade (DFID) to find a viable solution for the British dependencies. DFID in turn commissioned an in-depth report, the so-called Edwards report published in 1998, which recommended, among other things, continued support for the offshore sector.[53] The Edwards report pointed specifically at the absence of a substantial hinterland as the major problem faced by these jurisdictions and hence at a lack of alternatives for development. The offshore sector is largely "virtual," involving few significant domestic transactions, and does not require considerable human resources. The British government adopted the Edwards report, yet many argue that it continued to offer a complex and often hidden forms of subsidies to its dependencies.[54]

The absence of a hinterland inhibits the formation of a land-owning peasantry or plantocracy seeking protection from cheaper imports and contributing to higher costs of food products to consumers. As a result, many such jurisdictions are dominated by an internationally oriented merchant class that has moved with ease from the import-export business to the provision of financial services. Similarly, due to their size, many of these jurisdictions are dominated by wealthy families with a concentration of oligarchic power in their hands, and who seem to find it easier to introduce liberalized financial laws in their countries. Hence, small jurisdictions such as city-states proved far more agile than their larger brethren in competing in these markets.[55]

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51 The Foreign and Commonwealth Office observes that the UK subsidizes civil aviation in the British Virgin Islands by £600,000 a year even though the BVI has considerably higher income per head than the UK. COMPTROLLER & AUDITOR GEN., FOREIGN & COMMONWEALTH OFFICE, MANAGING RISK IN THE OVERSEAS TERRITORIES, REPORT, 2007-8, H.C. 4.

52 Baldacchino, *supra* note 7.

53 HOME OFFICE, DEPARTMENT FOR INTERNATIONAL TRADE, REVIEW OF FINANCIAL REGULATION IN THE CROWN DEPENDENCIES, 1998, Cm. 4901 (The Edwards Report).

54 For a discussion of British subsidies see PALAN ET AL., *supra* note 2.

55 For a discussion of this theory see Don D. Marshall, *Understanding Late-Twentieth-Century Capitalism*, 31 GOV'T & OPPOSITION 193 (1996); Baldacchino, *supra* note 7.

VI. THE EUROMARKET AND BRITISH COLONIAL POSSESSIONS

The Euromarket, then, was not only a unique, unregulated financial market, but also stimulated the development of new types of financial centers in very small states and jurisdictions. There were good reasons why British-held city-state economies proved particularly attractive to British and American banks. British jurisdictions shared all of London's attributes, such as English common law, and with one or two notable exceptions, the British government's attitude to finance, the stability offered by the British state and the English language, but, interestingly enough, as we shall shortly see, limited entry to the Euromarket.

The spillover from London to the various city-states began in the early 1960s and followed a clear geographical path. It began with British jurisdictions adjacent to the UK such as the Channel Islands, followed soon by the Caribbean Islands, then the Asian city-states, and ending with attempts to develop small British Pacific islands as OFCs. Although the history of the development of the Channel Islands as OFCs remains to be told, London banks appear to have taken the lead and begun to set up subsidiaries in Jersey, Guernsey, and the Isle of Man in the early 1960s.[56] Unlike bank branches, subsidiaries may share a similar name with their head office banks, but legally they are separate entities. It appears that the spillover into the Channel Islands from London was motivated initially by tax and other advantages that may accrue due to setting up subsidiaries.[57] By 1964, the three big American banks — Citibank, Chase Manhattan and the Bank of America — had arrived on the scene as well.[58]

Yet the Channel Islands could not develop as major OFCs until the 1970s. Although the Channel Islands are constitutionally not part of the UK, they were subjected to a Special Statutory Instrument, the 1947 UK Exchange Control Act, which in practice "gave considerable overriding power to the Bank of England through the vetting and monitoring procedures that

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56 The Island of Man was proactive, the rest followers. On the Island of Man, see Corkill Cobb, *Global Finance and the Growth of Offshore Financial Centers: The Manx Experience*, 29 GEOFORUM 7 (1998). For a discussion of the Islands' growth as financial centers, see RICHARD ANTHONY JOHNS & C.M. LE MARCHANT, FINANCE CENTRES: BRITISH ISLE OFFSHORE DEVELOPMENT SINCE 1979 (1993); Hampton & Christensen, *supra* note 3; HAMPTON, *supra* note 42.

57 For discussion see Goodfriend, *supra* note 48.

58 TONIOLO, *supra* note 37, at 454.

this involved."[59] Through these special provisions, the islands were in effect regulated and controlled from the UK mainland.

One of the unintended effects of the 1947 act was that Channel Island banks and subsidiaries had great difficulties in accessing the Euromarket when the latter was created in 1957. Companies were regarded by the Bank of England as resident for exchange control purposes unless specifically designated as nonresident by the Bank — in other words, they were barred from accessing the fledging Euromarket. In order to access the market, companies had to apply to the Bank to obtain the status of "non-resident" and provide detailed information on proposed share structure and other financial matters.[60]

Two pieces of legislation proved to be of great importance to the development of the offshore economies of the Channel Islands. The first, the little-known Sterling Rescheduling Act of 1972, was particularly significant in that it liberated the Channel Islands from such restrictions. "The islands were literally at the stroke of a pen accorded an unprecedented privileged status."[61] In response, merchant banks began to develop both in Jersey and Guernsey as booking centers for their Euromarket operations. The years 1972-75 are considered by Johns and Le Marchant the "take off" period for their offshore centers.[62]

In 1979, exchange controls in Britain were suspended, ending the Bank of England's control over offshore financial centers in the British Isles. British and Channel Island residents could henceforth invest anywhere in the world.

U.S. and Canadian banks began to develop the Caribbean British-held jurisdictions as OFCs only a year or two after the spillover from London to the Channel Islands began. Caribbean British jurisdictions such as Bermuda and the Bahamas had been carving a name for themselves as tax havens since the 1930s.[63] By the 1980s, Cayman and Bermuda were under intense investigation by the U.S. IRS for tax evasion and money laundering. Nevertheless, British Overseas Territories proved particularly attractive to North American banks because they were not under the Special Statutory Instrument arrangement (that applied to the Channel Islands) and hence their companies and banks could easily access the Euromarket. The Caribbean booking centers had the further advantage of sharing New York's time zone. They were developed by the North American banking community to serve as a conduit for Euromarket

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59 JOHNS & LE MARCHANT, *supra* note 56, at 58.
60 *Id.* at 51-58.
61 *Id.* at 55.
62 *Id.* at 55.
63 PALAN ET AL., *supra* note 2.

transactions. It appears that the early development of these Caribbean OFCs was due to the cost of relocation to London and the advantages of sharing U.S. time zone, and not, as often assumed, due to the tax advantages they offered. The early spillover into the Bahamas and Cayman, reckons Sylla, "was, like the London Euromarket, not motivated by tax advantages, but because it was cheaper to set up branches in these locations."[64] Bhattacharya calculates that by 1980,

> the average annual wages for a bookkeeper in the Bahamas are a meager $6,000, and the annual fee for an offshore banking (Category "B") license in the Cayman Islands is only $6,098.7 The total cost of operating a branch in these islands is much lower than in the primary centers of Eurocurrency operations.[65]

Three Caribbean centers, the Caymans, the Bahamas, and Panama in particular, benefited from the rapid expansion of the Euromarket. By the late 1970s, the region accounted for one-fifth of the gross size of total Eurocurrency operations. By the 1980s, U.S. bank branches in the Caribbean comprised more than one-third of the assets of all U.S. foreign bank branches in the American region.[66]

VII. Expansion to Asia

By the mid-1960s, Asian markets began to flourish as well. The widening of the Indo-China war in the mid-1960s led to increased foreign exchange expenditures in the region, while a tightening of credit occurred in 1967 and 1968, contributing to rising interest rates in the Eurodollar market. Tapping exiting dollar balances in the Asia-Pacific region became an attractive pursuit for many banks. The Bank of America was the first to hit on the idea of setting up a specialized facility for Eurodollar operations in East Asia.

One Asian jurisdiction stands out by virtue of sharing many of the characteristics described above, such as city-state status, being under British control and run indirectly from London. It was Hong Kong. Unsurprisingly,

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64 Sylla, *supra* note 38.

65 Anindya Bhattacharya, *Offshore Banking in the Caribbean*, 11 J. INT'L BUS. STUD. 37, 37 (1980); Alan Hudson, *Reshaping the Regulatory Landscape: Border Skirmishes Around the Bahamas and Cayman Offshore Financial Centers*, 5 REV. INT'L POL. ECON. 534, 541 (1998).

66 Bhattacharya, *supra* note 65, at 37.

when the Bank of America decided to develop an Asian location for Euromarket transactions, it initially approached the colonial government of Hong Kong. What was perhaps surprising was that the Hong Kong colonial government was not particularly encouraging. It in fact placed various restrictions on the financial sector dating as far back as the early 1950s. In its response to the Bank of America, the colonial government refused to abolish the interest withholding tax on foreign currency deposits and effectively barred Hong Kong from participating in Euromarket transactions.[67]

Having failed to persuade the Hong Kong government, the Bank of America turned to the next available jurisdiction that shares many of the above characteristics, this time a former British colony, Singapore, which proved far more accommodating. Singapore responded in 1968 by setting up facilities, called the Asian Currency Unit (ACU), which gave incentives for branches of international banks to relocate to Singapore. Singapore licensed the first branch of the Bank of America to set up a special international department to handle transactions for nonresidents. As with all other Euromarket operations, the ACU created a separate set of accounts in which all transactions with nonresidents are recorded. Although the ACU was not subject to exchange controls, banks were required to submit detailed monthly reports of their transactions to the exchange control authority. In that sense, the ACU is a more restricted type of offshore financial center.[68]

The moratorium on the establishment of new banks in Hong Kong was lifted in 1978 and that proved a great success. In February 1982, the interest withholding tax on foreign currency deposits was abolished. In 1989, all forms of tax on interest were abolished. With the government becoming more proactive, by 1995-96 Hong Kong had become the second-largest OFC in the Asia-Pacific region, and between the sixth and seventh largest IFC in the world.[69]

VIII. PACIFIC JURISDICTIONS

The development of the Pacific havens followed the same pattern, but with a twist. Here, the Australian and New Zealand governments sought to intervene in the development of these OFCs havens and, as a result,

67 The story is told in Y.C. Jao, *The Rise of Hong Kong as a Financial Center*, 19 ASIAN SURV. 674 (1979).

68 Zoran Hodjera, *The Asian Currency Market: Singapore as a Regional Financial Center*, 25 INT'L MONETARY FUND STAFF PAPERS 221 (1978).

69 Jao, *supra* note 67.

created their own unique model of a managed offshore environment. The first Pacific tax haven was established in 1966, in Norfolk Island, a self-governing external territory of Australia, although the Norfolk Islands never developed into a major financial center.[70] However, in the case of the British and Australian dependencies, the offshore sector was developed as part of a deliberate policy to reduce the cost of maintaining the islands. The British government's Department for International Development (DFID), apparently unaware of the broader picture, is proud of its record of having advised the Caribbean and Pacific regions on "improving" their offshore sector.[71] A study by Greg Rawlings of the origins of the Vanuatu tax haven/OFC demonstrates this point well.[72] The first British legal firm opened an office in the New Hebrides (later renamed Vanuatu) in 1967. The Secretary for Financial Affairs in the New Hebrides, a Mr. Mitchell, visited Bermuda and the Cayman Islands to learn about the offshore sector.

> As a result of these wide-ranging talks and discussions, the British Administration took a policy decision that since the private sector was determined to use Vila as an international investment centre, there was no alternative but to enact legislation to control the situation and seek to gain much-needed revenue to keep down the spiraling grant-in-aid.[73]

In 1970 and 1971 the British administration introduced the Banks and Banking Regulations, Companies Regulations, and Trust Companies Regulations. By 1976, Vanuatu was a thriving "offshore" center.[74] Vanuatu, however, never developed as a major center for Euromarket transactions, but rather as a suspected money laundering center.[75]

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70 Anthony Van Fossen, *Norfolk Island and Its Tax Haven*, 48 AUSTL. J. POL. & HIST. 210 (2002).

71 Author's personal communication with DFID personnel.

72 Greg Rawlings, *Laws, Liquidity and Eurobonds: The Making of the Vanuatu Tax Haven*, J. PAC. HIST. 325 (2004). For additional information, see SHARMAN & MISTRY, *supra* note 9.

73 Rawlings, *supra* note 72, at 334.

74 SHARMAN & MISTRY, *supra* note 9.

75 Rawlings, *supra* note 72.

CONCLUSION

This Article has put forward the proposition that the UK, or even the dismantled British Empire, has left an indelible imprint on the modern financial system. The impact of the British Empire on modern finance is not reducible to one cause, but arose out of a combination of discrete set of historical and structural dynamics. As a polity, by the end of the nineteenth century the British Empire and the British state were dominated by a powerful commercial and financial sector, centered on the uniquely "anachronistic" guild-type organization of the Corporation of London. The decline of the City after WWII was halted and soon reversed by London bankers' introduction of a new, unregulated financial system. As the Euromarket began to expand, UK and U.S. banks began to develop small colonial outposts and UK dependencies that shared many of the formal and informal characteristics of the City as secondary or "offshore" financial centers. They did so for a number of reasons, of which avoiding tax must be counted as the principal one. The success of this process can be gauged by the results, which are a British-led international financial system.

Table 1: International Financial Centers, 2008, 2nd quarter, in billion of dollars

	All countries	$27,904.9 bn	% share
1.	UK	6,021.5	21.5
2.	U.S.	3,369.4	12.0
3.	France	2,268.6	8.1
4.	Germany	1,705.6	6.1
5.	Caymans	1,669.9	6.0
6.	Ireland	1,296.3	4.6
7.	Switzerland	1,231.6	4.4
8.	Netherlands	1,217.9	4.3
9.	Italy	1,058.2	3.8
10.	Belgium	1,004.9	3.6
11.	Spain	790.0	2.8
12.	Singapore	748.0	2.6
13.	Japan	732.6	2.6
14.	Luxembourg	711.5	2.5
15.	Hong Kong SAR	460.9	1.6
16.	Bahamas	408.7	1.5
17.	Jersey	300.0	1.1
18.	Canada	274.2	0.9
19.	Portugal	254.2	0.8
20.	Sweden	228.3	0.8
21.	Guernsey	207.8	0.7
22.	Bahrain	205.0	0.7
	Isle of Man	74.2	
	Other	140.8	0.5

Source:
Bank for Int'l Settlements, *International Banking and Financial Market Developments*, *Statistical Annex*, BIS Q. REV., Mar. 2009, at A-12 tbl3A (External loans and deposits of banks in all currencies vis-à-vis all sectors in individual reporting countries, 2008. Liabilities).

Table 2: International Financial Centers, 2008, Thematic

All countries	$27,904.9 bn	% share
British Empire (i)	10,095.5	36.1
British state (ii)	8,272.9	29.6
City-States + London (iii)	7,796.5	27.9
City-States (iv)	4,786.0	17.1
U.S.	3,369.4	12.0

i. UK, Caymans, Singapore, Hong Kong, Bahamas, Jersey, Guernsey, Isle of Man.
ii. UK, Caymans, Jersey, Guernsey, Isle of Man.
iii. Caymans, Singapore, Hong Kong, Luxembourg, Bahamans, Jersey, Guernsey Bahrain, Isle of Man + London, assumed to be roughly 50% of UK financial services.
iv. Caymans, Singapore, Hong Kong, Luxembourg, Bahamans, Jersey, Guernsey Bahrain, Isle of Man.