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Competition and Complementarity of International
Financial Centres from A Historical Perspective

Ayumu Sugawara

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TOHOKU MANAGEMENT & ACCOUNTING RESEARCH GROUP

GRADUATE SCHOOL OF ECONOMICS AND
MANAGEMENT TOHOKU UNIVERSITY
KAWAUCHI, AOBA-KU, SENDAI
980-8576 JAPAN

Competition and Complementarity of International Financial Centres from A Historical Perspective¹

Ayumu Sugawara² (Tohoku University)

1. Introduction

An article, on 19 December 2013 NIKKEI Asian Review newspaper, showed an aspect of the relationships between international financial centres, which is competition of them, or more precisely how the relationships of the centres is perceived by people³. Then, interestingly, just within half a year after the news telling they lost the competition in the foreign exchange business to Singapore, Japanese policy makers have gone to be a helter-skelter and suddenly said they would try to strengthen the Tokyo financial centre⁴. Japanese policy makers tend to show such a behavior sometimes and, as I will mention later, a similar thing happened in 1996.

This Japan's case could be an extreme one. But, of course, competition itself is very important not only for the financial world but also for the economic world as a whole. Therefore, the concept of competition among international financial centres is accepted as a natural view point.

On the other hand, another view point to economic things and also in basic micro economics, that is complementarity, have been paid less attention. Of course, experts on financial history have not overlooked it. They carefully have dealt with both competition and complementarity between the centres. However the latter have attracted less attention so far. But, I think, in depth of the history of international financial centres, we can find an important role of complementarity of them as a sound base for financial activities such as international banking operations.

Of course, competition is one of the most basic and important concepts in the

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² An Associate Professor at the Graduate School of Economics and Management, Tohoku University.

³ "Sun sets on Japan's status as Asia's financial centre", *Nikkei Asian Review*, 19 Dec. 2013.

⁴ "Governor wants Tokyo to be a global financial hub", *Nikkei Asian Review*, 30 May. 2014.

history of economics, but complementarity is a much for it. For example, complementarity can be said, in other words, the division of labour, and that is also one of the main idea in Adam Smith's *Wealth of Nations*. Therefore, I would like to deal with complementarity with equal importance compared to competition among international financial centres at least.

2. Definitions of International Financial Centre

As the beginning of the details in a paper which is interested in the relationship between international financial centres, it is reasonable to begin with searching for the definition of international financial centre. In 1992, Geoffrey Jones said, in his very sophisticated paper about the history of financial centres in Asia-Pacific and the Middle East, "financial centres are much discussed but rarely defined."⁵ However, Youssef Cassis' definitions in his grand work on the topic can be a good starting point. He defined a financial centre in two ways; firstly, "a financial centre can thus be considered the grouping together, in a given urban space, of a certain number of financial services" and secondly, "or in a more functional way, it can be defined as the place where intermediaries coordinate financial transactions and arrange for payments to be settled."⁶

However above mentioned definitions can be applied to all financial centres both domestic and international. Therefore, Cassis carefully continued to distinguish the levels of financial centre based on geographical scope; "this concentration (of financial industry) can be found at national, regional...and world levels, depending on the extent of the geographical area served by on financial centre."⁷

After focusing on international financial centres, there is a lot of approaches to group them into some types. Among them, we follow Jone's typology. He divided international financial centres into three categories; sub-regional, regional, and global centres.⁸ We chose the typology firstly because it is clear and avoids unnecessary complexity and secondly because, though its simple appearance, it is thoroughgoing prepared to explain the rises and falls of international financial centres.

⁵ Jones (1992), p.405.

⁶ Cassis (2010), p.2.

⁷ Cassis (2010), p.2.

⁸ Jones (1992), pp.405-406. There, it is said that a sub-regional financial centre focuses on serving to bilateral trades of the host country and other economies. However, rather we prefer the definition that a sub-regional international financial centre has relationship with a global financial centre bilaterally.

3. Peking Orders of International Financial Centres: A Current Example

Grouping of international financial centre based on its geographical scope leads to put the centres on a pecking order. From such a view point, there is a lot of rankings of international financial centres about each period, not only current but also historical. Firstly, we take “the Global Financial Centre Index” as an example of current rankings of international financial centres in the table 1. However, the Index does not divide the centres like sub-regional, regional, and global. It just gives scores to each centres.

As a result of the scoring, the Index put the international financial centres in an order in the table 1. In the table 1, London and New York occupied 1st and 2nd places through the years. More interestingly, Hong Kong and Singapore, two Asian centres, established their 3rd and 4th places in the global financial world. Among Asian centres, Tokyo has fallen behind Hong Kong and Singapore though until the 1990s it was said that Tokyo was one of the three global financial centres with London and New York.⁹

As Jones and Cassis mentioned financial centres provide a wide variety of financial services,¹⁰ therefore researchers are interested in the volumes of each type of trade in order to put centres in an order based on an quantitative criteria. Because I cannot deal with the data of the wide variety of services, I pick up an example of international financial services, foreign exchange turnover in the figure 1 and 2. The figure 1 shows foreign exchange turnovers of five largest trading countries, the United Kingdom, the United States, Japan, Singapore, and Hong Kong, in the service. Although the former three countries are not just the centers in them, London, New York, and Tokyo, we deal with country names as proxies of each centre due to the data’s limitation.

In the figure 1, here also London and New York are the largest centres being worthy of their name as a global financial centre. And recent further concentration on the UK (London) is also eye catching. On the other hand, in the figure 1, three Asian economies looks very small, although they are third, fourth, and fifth largest foreign exchange trading places in the world. Switzerland follows them as the sixth largest trading country and she has 3.2 per cent share.

Due to the difficult looking of three Asian economies in the figure 1, we put just three Asian economies’ shares in the figure 2. The figure 2 shows that Japan, Singapore, and Hong Kong are equally matching in the field. However, when we make our perspective pretty wider, it is impressive that Japan has declined in the field since 1989, when the BIS provided the first survey on the global foreign exchange turnover. At that

⁹ Jao (1997), p.101.

¹⁰ Jones (1992), p.405; Cassis (2010), p.2.

time, Japan dealt with US\$ 111 billion foreign exchanges per day compared to the UK's 184 billion, the US's 115 billion, Switzerland's 56 billion Singapore's 55 billion, and Hong Kong's 49 billion. In the figure of 1989, Japan was catching up with the United States and having the double size turn over to Singapore and Hong Kong. Thus, the distribution of foreign exchange business in Asia has changed dramatically.¹¹

4. Peking Orders of International Financial Centres: A Historical Example

In the academics on financial history, Howard Reed(1981) compiled long term rankings of international financial centres. He decided the rankings based on quantitative data. Under the limitation of data availability for 80 years, He forged the term, international "banking" centre, because the available data are just included the number of the headquarters of domestic banks in a centre, the number of "direct links" of domestic banks¹², and the number of the offices of foreign banks in the centre.¹³ The results of Reed's research on the international "banking" centres is shown in the table 2. Like the table 1 on current rankings, in the table 2, London and New York had dominated their 1st and 2nd status. Through the years, Paris, Hong Kong, German centres (Berlin, Hamburg, or Frankfurt), and Japan's centres (Yokohama and Tokyo) had appeared in the 3rd through 5th status.

In the table 2, for example, the ranks of New York and Paris in 1900 probably attract skeptical views most. It takes place because on 1900 Reed could just used two types data, the number of private (merchant and investment) banks in a centre and the number of correspondences of domestic banks in the centre.¹⁴ Especially, the type of private banks which Reed chose led a serious bias, because his selection excluded Paris "haute" banks. The same thing might happen about Berlin in 1900 because famous Germany private banks like Bleichroeder.¹⁵

With the extended data availability, Reed compiled the ranking of international "financial" centres from 1955 to 1980¹⁶ and the result is shown in the table 3. In order to make the rankings in the table 3, Reed used foreign assets and liabilities of a centre's domestic banks or center's host economies in the case of like Hong Kong or Singapore,

¹¹ "Sun sets on Japan's status as Asia's financial centre", *Nikkei Asian Review*, 19 Dec. 2013.

¹² Reed (1981), p.10. However, the definition of "direct links" is unclear. It seems the number of correspondents.

¹³ Reed (1981), pp.17-25.

¹⁴ Reed (1981), p.17.

¹⁵ On Paris, see Cassis (2010), pp.57-58. On Germany, Cassis (2010), p.59.

¹⁶ Reed (1981), pp.25-31.

the number of branches and agencies of domestic banks in a centre, and the number of branches of foreign banks in the centre¹⁷, in addition to the data of the table 2. On the years from 1955 to 1980, the results in the tables 2 and 3 are basically similar, particularly the positions of London, New York, Paris and Tokyo. One prominent character of the table 3 is the presence of San Francisco in 1955 and 1965. It probably comes from the global presence of the Bank of America headquartered at the city at that time.

In sum of these historical development, at least after the First World War, there have been two global financial centres, London and New York, in the world, and Asia has not had such type of centres. Instead, Asia has had three regional financial centres, Hong Kong, Tokyo, and Singapore after the Second World War, and before the War, Shanghai was added to them.¹⁸ However, setting positions of Paris and Berlin before World War II, and of Tokyo in the 1980s is still difficult because sometimes they looked playing global roles respectively. In Europe, at least Zurich has been a prominent regional financial centre.¹⁹

5. Competition of Centres: A Focus in the Development of Researches

With the historical development of relationships between international financial centres, researches on it had also developed. Charles Kindleberger is regarded as the founder of the modern research on the topic, although his book in 1974 mainly focused on the historical formations of national financial centres. His main interests were whether single or plural financial centres each country had, why so, and how the centers were formed. Then in 1981, Howard Reed, as we have already seen, had done the first organized research on rankings of international financial centres in the long term.

After the beginning by Kindleberger, literature in the field has tended to focus on competition between international financial centres. One reason is that Kindleberger emphasized a pressure to concentrate financial transactions in a single centre in a country and suggested to apply the idea about a country to the global economy. He said "the same concentration that produces a single dominant financial center within a country (with the possible exception of Canada) tends to result in the emergence of a single worldwide center with the highly specialized functions of lending abroad and

¹⁷ Reed (1981), p.10. However, it is unclear the difference between an office of a foreign bank and a branch or an agency of the bank.

¹⁸ Jones (1992), p.407, Table 21.1.

¹⁹ Cassis (2010), *passim*. He also emphasizes the role of Geneva.

serving as a clearinghouse for payments among countries."²⁰ It can be taken as a message that become a single centre, or fade away in the global finance by following researchers and policy makers. In other word, some can regard the relationship of international financial centre as a zero-sum game.

Such pessimists could have their theoretical foundation. It was provided by a Nobel laureate Paul Krugman in his *Geography and Trade* in 1993. In the book, he presented "a model of geographic concentration" in order to explain the logic of making a single manufacturing centre in a country. In the two-places model, while economic resources distributed equally, each place has manufacturing capacity respectively, when the balance of resources between the places is lost, the place with more resources becomes the single manufacturing 'centre'.²¹

Japan presented an example of such a competition-oriented and pessimistic view. In 1996, Kazuo Ueda sounded an alarm bell of fear of disappearance of an international financial centre. He modified two-places model of Krugman in order to apply to the financial industry and use the modified model as the base of his argument.²² In a real political world in Japan, Ueda and his colleague's pessimistic view could pave a road to Hashimoto government's Japanese version of financial "big bang" deregulation policy in 1996. Behind the case of Japan, had been the competition between Asia's three international financial centre, Tokyo, Singapore, and Hong Kong and latter two's faster growth.

6. Complementarity of Centres: Another Focus of the Researches

Although there has been the focus on competition of the centres in the development of researches and it has brought the fear of disappearance of a centre, in historical reality no disappearance of an established international financial centre has not taken place expect for fading away due to a war, a civil war, and a communist revolution. Reed and Jones clarified some spectacular falls of international financial centres respectably. The table 2 based on Reed tells the fall of Berlin concurrently with the defeat of Germany in World War II and the partition of the city by four victorious nations.²³ In the article dealing with Asia-Pacific and the Middle East, Jones gave clear-cut explanations to the rises and falls of Shanghai and Beirut. Shanghai was forced out of the status as a

²⁰ Kindleberger (1974), p.247.

²¹ Krugman (1993), pp.14-33.

²² Ueda (1996), pp.218-228.

²³ See also Cassis (2010), pp.215-217.

regional financial centre by the Communist Revolution in China in 1949.²⁴ Beirut flourished as a regional financial centre during the late 1940s to the 1960s attracting foreign banking operations from Europe and America even including the pro-type of Euro-currency business. However, the outbreak of the Lebanese Civil War in 1975 ended the role of Beirut as a regional financial centre.²⁵ Thus it were severe political events that have destroyed international financial centres. On the other hand, just economic competition between centres have not led an international financial centre disappeared.

In the long history, a lot of international financial centres has been co-existed rather than has tried to ruin each other even though they have competed between themselves. Therefore, it is reasonable to shift our focus on the other side of the relationship between international financial centres; the complementarity of them. Actually, some leading scholars have already embarked on paying more attention to the complementarity; for example, Chaterine Schenk and Youssef Cassis, both in the 2000s.²⁶

Yet, long ago, as a forerunner, in 1931 Paul Einzig sometimes emphasized the complementarity of centers in his book although whose title was *the Fight for Financial Supremacy* and actually his main interests were in challenges of New York and Paris to London respectively after World War I. For example he said, "in the past, the two Anglo-Saxon countries have found it easy to create a common basis for financial co-operation..."²⁷ Further, "there is indeed wide scope for co-operation between the three countries; none of them is at present strong enough to support any really large international loan transaction without the assistance of the others" and "another field in which co-operation should produce useful results is that of acceptance credits."²⁸ Thus, in both long term capital and short term money markets, it is worthwhile searching for mechanisms of complementarity of international financial centres.

More recently, Schenk pointed out the very significant idea about the complementarity of London and New York markets in the 1960s; "the financial activities of Frankfurt and Paris were dwarfed, however, by the enhanced integration of New York and London."²⁹ As mediators connecting the two centres, she attaches the importance of the roles of American banks; "the regulatory environment...generated the

²⁴ Jones (1992), p.410.

²⁵ Jones (1992), pp.408-409, 412.

²⁶ Recently, an IMF working paper also emphasizes the complementarity between current Hong Kong and Singapore financial centres. Le Lesle et al (2014).

²⁷ Einzig (1931), p.129.

²⁸ Einzig (1931), pp.131-132.

²⁹ Schenk (2002), p.97.

multinational expansion of US banks and the intensification of their activities in European financial centres, in particular London.”³⁰ Although still there is a room to be filled like the meaning of “the integration of New York and London”, the idea is an excellent jumping-off point for further researches about complementarity of international financial centres.

Finally, Cassis’ grand work about the history of international financial centres also have seriously and usefully dealt with the complementarity of centres. On the international financial centres particularly about capital markets before World War I, he said, “cooperation among financial centres, or rather among the banking houses operating in different centres, thus seemed to be the dominant characteristics...”³¹ Here also, like Schenk, the role of banking operation is emphasized. Further, in detail of capital markets, he added “on the level of primary market, one of the clearest indicators of this integration was the simultaneous floating of an issue in several financial centres” and “on the level of the secondary market, the financial centres grew closer through international arbitrage operations.”³²

7. Points for Empirical Researches on the Complementarity of the Centres

With these developments of the history of the international financial centres and researches on it, we can set our points for empirical researches on the relationship between the centres. There are three point. Firstly, we pay special attention to banking operations as mediators between the centres. As mentioned partly in the previous section, both Schenk and Cassis emphasized the roles of banks to connect financial centres, and even Einzig did the same about relationship between London and New York in the 1920s.³³ Among banking operations, we deal with both money and capital markets because financial centres contain wide variety of financial services as literature mentioned.

Secondly, on long term capital markets, we pay attention to the roles of merchant and investment banks and also borrowers. In such a view point, simultaneous issues in multiple international financial centres are particularly important as Einzig and Cassis have already mentioned.³⁴

³⁰ Schenk (2002), p.97.

³¹ Cassis (2010), p.133.

³² Cassis (2010), pp.131-132.

³³ Einzig (1931), p.73. "The same cordial relationship that developed between the monetary authorities have also existed between banks in London and New York."

³⁴ The case of Japanese government bond issues, see Suzuki (2015).

Finally, on short term money and foreign exchange market, we focus on the operations of commercial banks and exchange banks. Money and foreign exchange markets provide places for accommodating banks' liquidity, especially not only for putting their reserves in a wider sense and for putting their working capital, but also for borrowing funds temporarily.³⁵ On the other hand, banks choose the places for their accommodation of liquid assets and for borrowing short term funds.³⁶

We present an example about the roles of money and foreign exchange markets, because the roles of such short term markets have been mentioned less than the roles of capital markets in literature about the relationship between the international financial centres. A case of a Japanese exchange bank, Yokohama Specie Bank in 1930, is picked up.³⁷ The situation of the balance sheets of Yokohama Specie Bank in the year broken down by branches was clarified by a group of Japanese researchers. Here, we just deal with the geographical distribution of the Yokohama Bank's liquid assets at that time. On bankers balances, 44 per cent was put in the Tokyo branch, 31 per cent in the New York agency, and 14 per cent in the London branch respectively. Bonds were allocated in the Yokohama headquarter with 93 per cent of them and in the New York agency with 6 per cent. Therefore, for the Yokohama Bank, in 1930 New York was more important than London at least from the view point of the quantity of liquid assets. Being different from these two items, gold and silver were mainly concentrated in China; the Shanghai branch held 38 per cent of them and the Dalian branch had 9 per cent. Yet the Yokohama headquarter also held 36 per cent of their assets in the form of precious metals. In China, the precious metals particularly silver were the most liquid means for settlement at that time. In order to scrutinize the centers such as London, New York and Shanghai in the 1930s from the international banking view point, we can compare Yokohama Specie Bank to the Chartered Bank of India, Australia and China about their liquid asset distributions in the centres, for example.³⁸

³⁵ On the concepts of bank's reserve and bank's running capital, see Hicks (1989), Chap. 8, pp.66-67.

³⁶ Keynes (1923), pp.103-109. Keynes (1923) said "the difference between the spot and forward rates is...the measure of the preference of the money and exchange market for holding funds in one international centre rather than in another...". (p.103.)

³⁷ Yamazaki (1988), pp.92-97. The balance sheets in Jan. 1930 are in pp.94-95.

³⁸ On the Chartered Bank's Shanghai branch relationship with the London headquarter and the New York agency, see Siu (2015).

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Table 1

Ranking of International Financial Centres: A Current Example

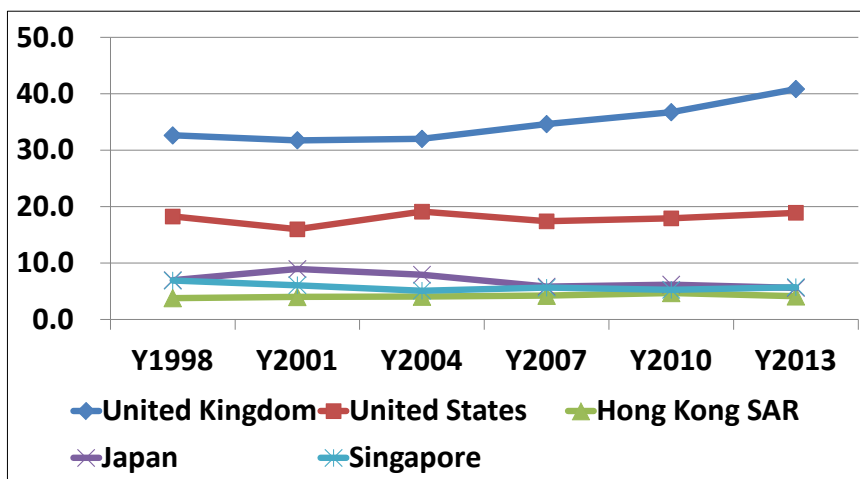
Y2011	Y2012	Y2013	Y2014
London	London	New York	New York
New York	New York	London	London
Hong Kong	Hong Kong	Hong Kong	Hong Kong
Singapore	Singapore	Singapore	Singapore
Zurich	Zurich	Zurich	San Francisco
Seoul	Tokyo	Tokyo	Tokyo

Source: *The Global Financial Centres Index*, 14-16, 2011-2014

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Figure 1

Sizes of A Financial Service: Foreign Exchange Turn Over (% of Global Trade)

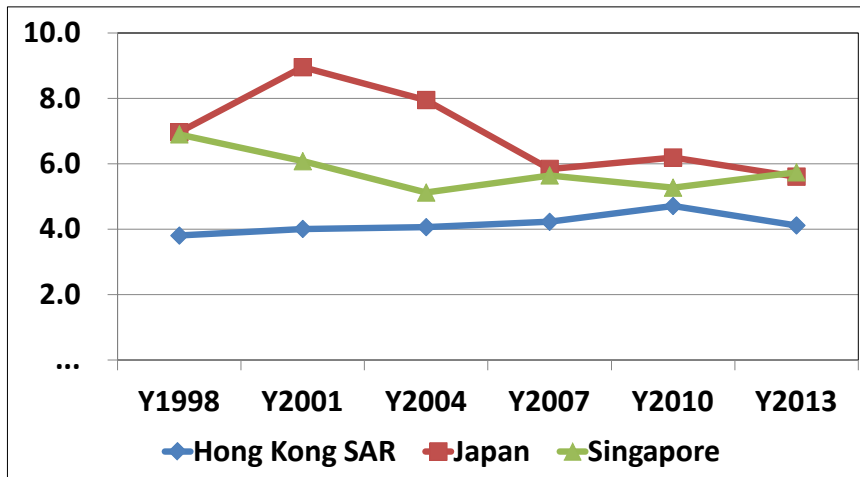


Source: BIS, *Triennial Central Bank Survey*, each year.

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Figure 2

Size of A Financial Service: Foreign Exchange Turn Over (% of Global Trade)



Source: BIS, *Triennial Central Bank Survey*, each year.

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Table 2

Ranking of International Financial Centres: A Historical Example

International 'Banking' Centres by Reed, *The Preeminence of International Financial Centers*, 1981

Y1900	Y1915	Y1930	Y1940	Y1947	Y1960	Y1975	Y1980
London	New York	London	London	London	London	London	London
New York	London	New York	New York	New York	New York	New York	New York
Paris	HongKong	Paris		Paris	Paris	Tokyo	Paris
HongKong	Paris	Yokohama			Tokyo	Paris	Frankfurt
	Berlin	Berlin			HongKong		Tokyo
		HongKong			Hamburg		Hamburg
		Amsterdam			San Francisco		HongKong
		Montreal					Zurich
		Tokyo					San Francisco

7

Table 3

Ranking of International Financial Centres: A Historical Example

International 'Financial' Centres by Reed, *The Preeminence of International Financial Centers*, 1981

Y1955	Y1965	Y1975	Y1980
New York	London	London	London
London	New York	New York	New York
Paris	Paris	Tokyo	Paris
HongKong	Tokyo	Paris	Tokyo
San Francisco	San Francisco	Frankfurt	Frankfurt
Osaka	HongKong		Zurich
Tokyo	Frankfurt		Amsterdam

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