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## 'The Rise of Hong Kong and Tokyo as International Financial Centres after 1950'

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One of the most striking aspects of the 1960s and 1970s was the dramatic increase in the volume of international financial activity and the acceleration of the pace of financial innovation. Accompanying these two linked developments was the geographical dispersion of financial activity and the rise of new international financial centres. This paper examines this process in Hong Kong and Tokyo. Particular emphasis is placed on how the very different regulatory frameworks of these two cities affected their prospects and the different models of their emergence as IFCs. For Tokyo, the case of the Hongkong and Shanghai Bank is used as an example of the nature of foreign bank activity. The paper concludes with some reflections on how the historical record informs our understanding of the performance of these two centres during the 1990s.

## Comparison of Hong Kong and Tokyo as international banking centres

Hong Kong and Tokyo both emerged in the 1980s and 1990s as important international financial centres but the basis for their prominence was very different. Hong Kong had a long historical legacy as a financial and commercial centre for Asia since the mid-19<sup>th</sup> Century. It is a small, resource-poor island entrepot that developed its strength in manufacturing industry only in the post-war period. Most importantly, the regulatory environment with its low tax rate, free exchange market and convertibility was ideal for international financial and commercial activity in the otherwise tightly regulated international system of the 1950s and 1960s. It operated as a net importer of capital as well as financing trade and payments throughout Asia.

Japan, in contrast was already a highly developed industrial nation by the time of the second world war, experiencing a meteoric rise to prominence following the Meiji restoration of 1868 and playing one of the most successful games of 'catch up' in terms of industrialisation in history. Also in direct contrast to Hong Kong, the Japanese government operated a tightly regulated domestic financial system to promote the mobilisation of capital for domestic expansion in the post-war period. Exchange and trade controls, particularly controls on capital flows, narrowed the opportunity for both foreign banks and Japanese banks to offer international financial services. In the 1950s and 1960s capital was scarce in Japan, but once the floating exchange rate system was introduced in 1971, Japan found itself with considerable surplus funds and a sharply appreciating currency that generated pressure from Japanese banks for liberalisation of controls to allow profitable utilisation abroad. Japan's foreign exchange reserves grew from \$US2b March 1968 to \$US18b by March 1973. Continued exchange controls drove Japanese banks to the Eurodollar market to borrow short term for international lending. From the mid-1970s international financial transactions were gradually liberalised, allowing the huge Japanese banks to make their presence felt in international markets to a much greater extent and pushing Tokyo to its prominence as an international financial centre to rival Hong Kong.

Foreign bank presence has always been marginal and controlled in Japan, despite the initiative to open an offshore banking centre in Tokyo from 1986. International financial activity has also not attracted the consistent support of a government whose

priority was domestic industrial growth. In addition to government regulation, the close relationship between business and banks and the cultural barriers to entry by foreign banks has inhibited internationalisation. For all these reasons, the cost of doing business remained much higher in Tokyo than in Hong Kong. By the 1990s Hong Kong had more foreign banks and insurance companies, greater cross-border credit to non-banks, syndicated loans and note-issuing facilities and qualified actuaries. However, Hong Kong's position was weaker relative to Tokyo when other financial activities are considered, especially the stock exchange and derivatives market which are limited in scope.<sup>2</sup>

A result of their different historical and economic foundations is that the pattern of international banking for Japan is different than that of Hong Kong. Most importantly, Hong Kong was primarily a host for foreign banks while Tokyo was primarily a base for Japanese banks' international activities. Under the protection of administrative controls in the 1950s and 1960s Japanese banks became very large very quickly, and many operated extensive branch networks in overseas international financial centres to channel funds back to Japan. As Jao notes, 'the eminent status of Tokyo as a Global Financial Centre derives basically from the sheer size of Japan's domestic economy, banking system and financial markets, in which entry barriers are pervasive and significant' and not from an outward international focus by institutions in Tokyo itself.<sup>3</sup> In 1970 Tokyo had 17 banks in the top 300 while for Hong Kong there was only HSBC.<sup>4</sup> By 1970, Japanese banks had 35 branches or representative offices in international financial centres around the world, while Hong Kong banks had only 7.<sup>5</sup> By 1971 the stock of Japanese overseas FDI in banking, insurance and commerce amounted to just over US\$2b, which was 21% of the total stock of Japanese FDI.<sup>6</sup> Hong Kong banks are generally much smaller, reflecting the size of the domestic economy. The HSBC Group (referred to here as the Hongkong Bank) is Hong Kong's only real international bank, although its extensive global reach means it is now one of the largest banks in the world.

Table 1 shows the relative position of Hong Kong and Tokyo in terms of foreign bank operations. Hong Kong had more regional banks and more European banks as is evident in Table 2. The latter were slower to branch in the early 1950s before restrictions on entry were enforced more rigorously in Japan and so they did not gain

a foothold in Tokyo until the market was liberalised in the 1970s. Table 3 shows the movement in the ranking of Hong Kong and Tokyo as international banking centres.

A comparison between Hong Kong and Tokyo is to some extent a spurious exercise since one is comparing a small city-state to the capital city of one of the world's largest economies. A further difficulty for comparison of Tokyo and Hong Kong is that there have always been considerable links between the two centres. In the decades immediately after the war, these arose from the finance of trade between Hong Kong and Japan and between Japan and elsewhere in Asia. Because of controls imposed by the USA on China's access to US\$, and on US banks' direct contact with the Chinese communist government, the Japan-China trade that emerged in the 1950s was denominated in sterling and arranged mainly through the Hongkong Bank. Japanese also used the free dollar market in Hong Kong in this period. In the second half of 1952, for example, the Tokyo black market rate for US\$ was about 5% below the Hong Kong rate because of the disposal of surplus US\$ by Japanese. As a result, arbitrageurs operated between the Hong Kong and Tokyo market, generally increasing the supply of US\$ notes in Hong Kong.<sup>7</sup>

Hong Kong's regional role included being a vital early link for the recovery of Japan's international trade. From March 1948, Hong Kong operated a 2-way account system with Japan aimed at balanced bilateral trade and outstanding balances were converted to \$US on a six-monthly basis. The general pattern of the trade was that Hong Kong re-exported Chinese goods to Japan in exchange for imports of non-essential Japanese products. This arrangement was particularly valuable for Japan in the late 1940s and early 1950s when Japan was very short of foreign exchange. Most of Japan's trading partners would only import essential goods, but this was not the case for Hong Kong. As a result, Hong Kong provided Japan with an opportunity to import essential raw materials in return for 'exports of gastronomical delicacies and bazaar goods which no other country will take; and it pays her to buy at higher prices through Hong Kong commodities which she could get cheaper from the country which produces them'.<sup>8</sup> Soon, however, Hong Kong became an irritant to the Japanese since the free exchange market allowed Hong Kong to re-export Japanese goods to the USA at cheaper prices than Japan could directly.<sup>9</sup> In September 1953, for example, Hong Kong's re-exports of Japanese goods to Thailand and Indonesia was running at a rate of £250,000 and £900,000 per month respectively.<sup>10</sup>

In the 1960s, the Hongkong Bank operated 4 branches in Japan while several Japanese banks opened in Hong Kong. The Bank of Tokyo replaced the pre-war Yokohama Specie Bank in Hong Kong after the war. In October 1962 the Dai-Ichi Bank bought one third of the capital of the Chekiang First Bank of Commerce in Hong Kong (an investment of Y126m) and appointed two Japanese officers to the bank's board of directors. The co-operation was intended to increase local and Southeast Asian foreign exchange operations.<sup>11</sup> Sumitomo subsequently opened in Hong Kong in December 1962, an event which the Director described as realising 'a 10-year dream to set up an office in the economic centre of South East Asia'.<sup>12</sup> Sanwa Bank opened a branch in 1964.

As a final observation, it must be noted that the integration of these two international banking centres has accelerated after Japan's liberalisation. In 1980 Japan accounted for 5.5% and 5.7% of Hong Kong banks' external bank liabilities and claims respectively. By 1985, on the eve of the launch of Japan's offshore market, these proportions had risen to 13% and by 1993 to 65%, representing about US\$300b by 1993 compared with less than US\$2b in 1980.<sup>13</sup> There is no doubt that the acceleration of the offshore market in Tokyo has also had a positive impact on inter-bank transactions between Tokyo and Hong Kong.

One of the most important determinants of the development of international banking is the regulatory environment. The contrasting experience of Hong Kong and Tokyo in the post war decades is a stark example of the importance of regulation and controls on international banking. Section II shows that contrary to the common stereotype, Hong Kong was not a completely liberal environment from 1965 and that in fact the acceleration of the IFC took place despite increased controls on the banking system. Conversely, again contrary to the common stereotype, Section III will describe the considerable international activity in Tokyo before the relaxation of regulations began in the 1970s. A final section concludes with a summary and some observations on the relevance of the historical record to events in the 1990s.

## II Regulatory framework and developments in Hong Kong

Hong Kong's role as a regional and international financial centre arose from the strong commercial heritage of banking and financial services, which continued to

dominate the activity in the colony throughout the 1950s and 1960s, and positioned Hong Kong as the regional centre for the exchange of information and expertise on Asian and Western market opportunities. In this sense, Hong Kong clearly fits into the model of an IFC emerging from an international commercial entrepot.<sup>14</sup> As Meyer notes, the continuity in Hong Kong's century-long history as 'the great Asian regional financial centre' allowed it to transcend competitors such as Tokyo or Singapore after the opening of China at the end of the 1970s.<sup>15</sup>

In the post-war period, the importance of Hong Kong as an international banking centre shifted to a new level. The absence of exchange control in the colony contrasted with a global environment of tight controls on capital account convertibility and fixed exchange rates. I have argued elsewhere that the 'window' of opportunity that Hong Kong offered as a gap in the sterling area exchange control attracted substantial financial flows from North America and Europe as well as Asia.<sup>16</sup> Hong Kong operated a freely convertible and floating exchange rate market for many regional currencies as well as for the US\$. This freedom from exchange control attracted inflows of capital from around the world as investors and traders sought to evade the extensive exchange controls that operated in their home countries.<sup>17</sup> Low tax rates (15% corporate tax), the prevalent use of English in financial circles, as well as the application of English law and a well developed communications infrastructure all enhanced the attractions of Hong Kong as a regional headquarters for international companies including banks. In addition, Hong Kong hosted a vibrant gold market and a stock exchange that generated international investment flows.

Immediately after the war, the Hong Kong authorities were very reluctant to regulate the financial and banking sector, and foreign and domestic banks were treated equally. Banking legislation was first introduced in 1948 after claims that small, under-capitalised banks were springing up in response to flight capital from China to engage in unstable speculative activity arising from the monetary and political collapse of China during the Civil War from 1946-49<sup>18</sup>. The Banking Ordinance of January 1948 defined 'banking' very loosely, and included many small institutions that provided only a limited range of financial services<sup>19</sup>. There were no reserve requirements, nor statutory liquidity ratios. So long as the HK\$5000 license fee could be raised, individuals or groups were free to attract deposits and operate as

banks. Until the revision of the ordinance in 1965, therefore, there was no effective banking regulation.

A further regional advantage for Hong Kong in these years was the antipathy to international banking and financial activity that prevailed in neighbouring centres in Southeast Asia and also in Japan. In Southeast Asia, this was a product of nationalistic governments that viewed international banking as inconsistent with strong indigenous development. As independent governments took power throughout the region, they often sought to exclude immigrant Chinese and other foreign economic activity to protect indigenous interests. The acceptance and indeed support of Chinese banking and enterprise by the Hong Kong government was in direct contrast to the hostile environment elsewhere and led to substantial inflows of capital as well as entrepreneurs to the colony.

Nine foreign banks established in Hong Kong before 1939 reopened their offices after 1945. A further six foreign banks arrived in Hong Kong from 1948-57, and roughly two per year opened offices until 1965. About half of the foreign banks opened additional branches beginning in 1959, so that by 1965 there were 46 branches of foreign banks in Hong Kong, plus 17 local branches of the Chartered Bank. After the Chartered Bank, Banque Belge pour l'Etranger had the most aggressive branching policy. It opened its first branch in Hong Kong in 1935, its second in 1960, and had a total of five offices by 1965. In addition, the Chinese government operated ten banks in Hong Kong, mainly to finance trade and remittances.<sup>20</sup>

The regulatory environment in Hong Kong changed profoundly after banking crises in the early 1960s led banks and the authorities to believe that Hong Kong was 'over-banked'. A weak banking ordinance was introduced at the end of 1964 but it was tightened considerably after 1967 and provided for statutory liquidity ratios, provision for bad debts, and regular reporting to the Banking Commissioner. In addition, after the banking crisis of 1965 (that involved the failure of 2 banks and the take-over of the largest Chinese-controlled bank) the government imposed a moratorium on new bank licenses. It was lifted briefly in 1972 but foreign banks were restricted to having only one office of operation in the colony. Barclays Bank was the only one to benefit from this brief respite and the moratorium was reintroduced in 1975 for a further three years. Even after the moratorium was lifted,



incoming foreign banks were restricted to maintaining offices in only one building, (increased in September 1999 to 3 buildings), a restriction that lasted through to November 2001. At the end of 1998 only 37 out of 144 foreign banks in Hong Kong had multi-branch status left over from the 1960s.<sup>21</sup>

The second long-term outcome of the banking crises of the 1960s was the imposition of an interest rate agreement aimed at containing competition for deposits. This agreement was negotiated among the banks themselves at the instigation of the Hongkong Bank.<sup>22</sup> The Financial Secretary was opposed to such inhibition of competition. In the end, however, a scheme was finally agreed in July 1964 which established a ladder of rates with 'basic' interest rates offered by foreign banks and the leading Hong Kong banks, and a graduated scale for other categories of banks stepping up by ½% on the basic rate.<sup>23</sup> It was designed to enable smaller banks to compete for deposits with the larger banks, but also to constrain such competition to avoid upward drift in interest rates. The interest rate agreement remained in force in Hong Kong until July 2000, six years longer than controls on deposit rates in Japan.<sup>24</sup>

With the rapid expansion of the international financial market in the 1960s and 1970s, and the high rates of externally financed economic growth in many Asian countries, the demand for international banking and financial services in the region expanded. The impact of the regulations in Hong Kong was to promote new institutions that operated outside the purview of the banking ordinance and the interest rate agreement. In the early 1970s, the financial services sector experienced an unprecedented boom with over 2000 local and overseas non-banking financial institutions opening to meet the demand for the services of merchant banks and finance companies. These so-called Deposit Taking Companies did not come under the Banking Ordinance nor the interest rate agreement and were left unregulated until a new DTC Ordinance was enacted in 1976, after which their number dropped dramatically.<sup>25</sup> The moratorium on new bank licenses was lifted in 1978 and in the next four years the number of licensed banks increased from 74 to 128, the number of banking offices almost doubled from 759 to 1474, and the number of DTCs increased from 179 to over 350. In this mushrooming environment the Ordinance was amended in 1981, leading to the Three Tiered System; licensed banks offering a full range of services, licensed DTCs and Registered DTCs. The DTCs were not subject to the interest agreement but could not accept deposits less than HK\$50,000. The

proliferation of financial institutions despite regulatory constraints suggests that the demand for wholesale banking was great enough to offset the costs of regulation.

A final factor inhibiting Hong Kong by the 1970s was the refusal of the Financial Secretary to lift the withholding tax of 15% on interest earned in Hong Kong. In 1968 the Singapore government abolished their 40% tax on interest earned on overseas bank deposits, thus allowing the Bank of America to launch the Asian Dollar Market and achieving a significant advantage over Hong Kong. In 1970, Hong Kong's Financial Secretary, J.J. Cowperthwaite argued that the tax was low, that it did not apply to interest earned abroad by Hong Kong banks, and that Hong Kong had 'no ambitions to be a tax haven nor to attract the kind of money that flows into tax havens. We are not fond of gimmicks.'<sup>26</sup> In the same interview, Cowperthwaite asserted that this was not a blow to Hong Kong's role as an international financial centre since 'the use of a substantial proportion of the Asian dollar deposits in Singapore are in practice managed by the Hong Kong offices of the banks concerned.'<sup>27</sup> Nevertheless, the tax gave Singapore the advantage in the establishment of the off-shore Asian dollar market, and by 1980 Asian Currency Units accounted for 65% of the total assets of the financial sector in Singapore.<sup>28</sup> By 1982, the growth of the market prompted tax reductions in Hong Kong. By 1986, Hong Kong had surpassed Singapore in terms of the size of the Asian Dollar Market and Asian Dollar Bond issues.

In summary, the major regulatory attractions of Hong Kong were freedom from exchange control, non-discrimination against Chinese or foreign business, and relative political stability. Even after the advent of current account convertibility by Europe, controls on capital flows remained prevalent and so Hong Kong's advantage was not eliminated. From 1965, however, controls on deposit interest rates, prudential regulation and barriers to entry were imposed. Still, a surge of unregulated financial institutions that appeared in the early 1970s successfully evaded these controls, and it took several years for the regulatory authorities to respond. Despite the increase in interference in the market from the mid-1960s, therefore, Hong Kong retained many of its advantages over Tokyo and Singapore through the 1970s, leaving it in a strong position to launch itself as China's international financial centre from 1979. Table 3 shows a fall in the ranking of Hong Kong in terms of foreign bank offices but this does not accurately reflect the foreign non-bank presence in the colony.

## Regulatory framework and developments in Tokyo

Little is written specifically about international banking in Japan before the liberalisation process began in the 1970s.<sup>29</sup> Certainly, regulatory constraints and the government's preference for a protected market prevented Tokyo emerging as a regional or international financial centre in the 1960s in the way that Hong Kong did during that decade. However, the scarcity of capital drew banks in Tokyo into international financial markets despite the tight restrictions on the range of these operations. Controls on foreign banks' operations in Japan were gradually relaxed but not eliminated until February 1985. The domestic banking sector was also tightly controlled through administrative guidance and the compartmentalisation of banks into different categories in order to reduce competition and enhance lending to domestic industry. Interest rates were usually high in the 1960s and the Bank of Japan rationed credit through window operations, to which foreign banks did not have access.

Yen-denominated bonds were not issued in Japan by non-residents until 1970 (so-called samurai bonds) and foreign currency denominated bonds were not issued by non-residents until 1972 (so-called shogun bonds). From 1973/74, the pressure for liberalisation of international financial flows arose from the increasing surplus in Japan that created a demand for overseas investment opportunities among banks and financial institutions, and calls from the USA to 'internationalise' the Yen.<sup>30</sup> Also, the spread of Japanese banks into other IFCs put pressure on the Japanese government to relax its own barriers to entry as a reciprocal gesture.<sup>31</sup> This section explores the development of regulation and the nature of international banking that did occur during these decades.

Immediately after the war, the Japanese banking system was reformed and banks were grouped functionally into city banks, local banks and various specialised lending institutions. In 1953 the Ministry of Finance started to consider naming the Bank of Tokyo as Japan's special foreign exchange bank. During the war the Yokohama Specie Bank had performed this role exclusively and the Bank of Tokyo hoped to inherit this advantage. This generated considerable hostility among the Bank of Tokyo's rivals, who together handled two thirds of Japan's foreign exchange business

in 1953 against 20% by the Bank of Tokyo.<sup>32</sup> Nevertheless, in April 1954 the Bank of Tokyo was named the only specialised foreign exchange bank while a small group of 12 Class A banks were given foreign exchange bank status to allow them to engage in this business alongside their other activities. The Bank of Tokyo lost its specialised status only in 1996 after a merger with Mitsubishi Bank. Because of its status as the only specialised foreign exchange bank, the Bank of Tokyo became Japan's main international bank. By 1961 it had 17 branches in the U.S., Brazil, Argentina, U.K., West Germany, Pakistan, India, Laos, Malaya, Singapore and Hong Kong. It had 16 other representative offices in Canada, Mexico, France, Belgium, Lebanon, Iraq, Iran, India, Burma, Cambodia, Vietnam, Indonesia, Philippines and Australia, performing effectively the business executed by its predecessor, the Yokohama Specie Bank.

After the end of the US Occupation in 1952, branches of several other Japanese banks were opened in London, New York, San Francisco, Chicago, Karachi, Calcutta, Bangkok and Taiwan as well as Hong Kong. From 1963 Japanese banks were again allowed to open new branches abroad and overseas expansion accelerated. The fact that foreign banks were prohibited from opening new branches in Tokyo while Japanese banks moved aggressively abroad did generate friction.<sup>33</sup> In 1962 Sumitomo bank was refused entry into Hong Kong until the Japanese government allowed the Hongkong Bank to open an office in Nagoya.<sup>34</sup> In 1963 the Japanese government had to allow Singapore's Overseas Union Bank to open a branch in Tokyo in return for letting Mitsui open a branch in Singapore.<sup>35</sup> By January 1971, Japanese banks had 58 foreign branches and owned 17 locally incorporated banks operating in international financial centres, most in London.

In 1970 the Ministry of Finance authorised the formation of two international banks made up of consortia of banks and securities companies to be located in London primarily to collect Eurodollars to finance Japanese companies moving into international markets. The International Joint Bank was formed by the Sanwa, Mitsui and Kangyo Banks and Nomura Securities, and the Japan International Investment Bank by the Fuji, Mitsubishi, Sumitomo and Tokai Banks and the Daiwa, Nikko and Yamaichi Securities.<sup>36</sup> These initiatives were also part of the gradual blurring of the legal separation of security and banking business that had been imposed along the model of the Glass-Steagall Act in 1948. Further liberalisation of the controls on Japanese banks' movement overseas was begun in 1982.

Trade and exchange began to be liberalised from 1959 and in April 1964 Japan adopted Article VII of the IMF, making the Yen convertible for current account purposes. As in other countries at the time, short-term capital flows were considered dangerously destabilising and remained tightly controlled.<sup>37</sup> Authorised foreign exchange banks administered the controls and residents were required to sell all foreign exchange to these banks within 10 days, with some exceptions for trading firms. By this time 15 foreign banks and 12 Japanese banks were nominated Class A Banks dealing in international exchange. The 50 or so Class B banks could act as intermediaries between their customers and Class A banks but were not permitted to have correspondent business with foreign banks abroad. From June 1962 exchange banks, including foreign banks, had to keep a ratio of specified liquid assets against liquid foreign liabilities to curb short-term capital inflows with their inflationary effects. The ratio was reduced from 25% to 15% in April 1966. Foreigners could invest in share equity of Japanese companies up to 15% of total equity (10% of banks and utilities). Long-term borrowing required permission, but this was relatively freely granted. Outward flows of investment were allowed where it would demonstrably promote Japanese production and exports.

In the late 1940s Chase Manhattan, Bank of America and National City Bank were invited into Tokyo by Supreme Commander of the Allied Powers.<sup>38</sup> Because of the domination of USA in SCAP and the importance of dollar financing, these banks played the most prominent role among foreign banks in Tokyo during the 1950s. They financed trade between the USA and Japan and were the depository for a substantial part of Japan's central reserves. By 1966 the Bank of America and First National City Bank each had 4 branches in Japan, while Chase Manhattan and Continental Illinois each had 2 branches.<sup>39</sup> Manufacturers Hanover, Morgan Guaranty, and Chicago Crocker Citizens each had a representative office in Tokyo. As late as 1970, First National City Bank, Chase Manhattan and Bank of America controlled more than half of the foreign banking business in Tokyo.<sup>40</sup> This domination was partly due to the fact that 90% of Japan's exports and about 80% of imports were still invoiced in US\$ in 1970.<sup>41</sup> At the end of the 1960s the Chase was the largest and most profitable of the American banks, and was the depository of US\$100m of the Bank of Japan's central foreign exchange reserves. These official deposits served as collateral for the US banks to open letters of credit for Japanese banks to cover imports from the

USA.<sup>42</sup> However, when the Chase decentralised its management in 1979, the senior executive in charge of activities in the Far East moved to Hong Kong, not to Tokyo.<sup>43</sup>

British banks like the Hongkong Bank, The Chartered Bank of India, Australia and China, and the Mercantile Bank of India operated on a much smaller scale, financing Japan's trade with the sterling area countries like the UK, Australia and Hong Kong. The Hongkong Bank had 4 branches in Japan (Tokyo, Osaka, Yokohama and Kobe). The Mercantile Bank opened in Tokyo and Osaka in 1949, and reaped the benefits of being the first foreign bank to open in the latter centre.<sup>44</sup>

### Constraints on foreign banks in Tokyo

In the 1950s and 1960s, the activities of foreign banks in Japan included providing loans and credits for industry and trade, including so-called Impact Loans (term loans in foreign currency guaranteed by local banks). The small deposit base for foreign banks, restrictions on borrowing from the Bank of Japan limited foreign banks' yen-denominated business. Foreign banks also provided commercial services such as confirming letters of credit, and accepting drafts validated in overseas money markets, and acted as intermediaries for Japanese companies, arranging bond issues and investments.<sup>45</sup> Through the 1960s, however, Japanese banks came to take over more of these duties themselves, squeezing out the foreign banks. In the debt oriented, bank dominated finance of industry, foreign banks made very little inroad against the domestic competition, comprising on only 1% of the advances to Japanese business by the 15 largest banks in Japan by 1970.<sup>46</sup>

Although there was no legal discrimination against foreign banks, exchange controls and administrative practices limited entry and branch expansion. From 15 foreign banks in 1964, the total had only reached 18 by 1969, operating 37 branches. It was widely acknowledged that many more banks wanted entry into the market but the Ministry of Finance kept a tight control on licenses until the end of the 1960s. There were fewer restrictions on representative offices, of which there were 23 in 1968 and 35 in 1969. From September 1970 foreign banks could enter Japan through joint ventures in which they had less than 50% equity, by expanding networks of their own branch offices in Japan, or by buying up to 15% of the shares of a Japanese bank. The Hongkong Bank manager complained that 'in effect, however, this means very

little' since approval of the Ministry of Finance was still required for extending branches under the Banking Law which was not affected by the new Foreign Capital Investment Law.<sup>47</sup>

Beyond direct regulations, high taxes and rising wages were major obstacles for operations in Tokyo. Corporate tax rate was raised from 35% to 36.75% in 1970 compared to a 15% corporate tax rate in Hong Kong. The labour unions were strong and militant throughout the 1950s and 1960s and managed to negotiate large annual wage rises. The Hongkong Bank, for example, was hit by a strike in 1955, although it managed to keep its Tokyo office running with foreign staff brought in specially.<sup>48</sup> High local wages and rents increased overhead costs to the point where they consumed a substantial amount of revenue. Powerful local unions negotiated large annual rises, especially at the end of the 1960s and early 1970s. In 1971, for example salary costs rose 20% at the Hongkong Bank. The Osaka and Tokyo branches each kept about 90 local staff in the mid-1960s compared to 8 foreign staff at the Tokyo office and 4 at the Osaka office. Along with the much smaller Kobe and Yokohama offices the total numbers were 11 foreign staff, 2 regional officers and 212 local staff in Japan by June 1971.<sup>49</sup> At the end of 1970, however, the Tokyo office decided that 'as a long term policy all new staff recruited are females, who do not expect to be employed for life, as do the men. This will eventually make it easier to reduce the numbers when necessary' i.e. when, as was expected, local interest rates fell against rising Eurodollar rates.<sup>50</sup>

#### Foreign banks' activity; the case of the Hongkong Bank

In the 1960s and 1970s the tight controls on lending and shortage of capital created a demand for loans that drew Japanese banks vigorously into the newly established Eurodollar market. By September 1960 Japanese banks had obtained Eurodollar deposits in London amounting to more than \$US200 million, most of which was converted to Yen to finance Japanese industrial expansion. Because of higher perceived risks, Japanese banks offered 2 per cent over the usual rate to obtain the funds but this was still cheaper than borrowing in Japan.<sup>51</sup> Japanese also became important international borrowers on longer term. In 1961 Sumitomo Metals and Kawasaki Steel issued Japan's first bonds abroad.<sup>52</sup> In the two years 1963-64 US banks' long term lending Japan amounted to US\$260 million.<sup>53</sup>

The huge demand by Japanese industry for investment funds, initially for recovery from the war and later to finance accelerating growth, also created considerable opportunities for profitable international financial intermediation for foreign banks in Tokyo.<sup>54</sup> The Hongkong Bank provides an example of the nature of this business and the obstacles that banks encountered.

Even before the Eurodollar market was established, profit on exchange was still the major source of income in Tokyo, accounting for more than half of income in the first half of 1956 (an increase of 41% over 1955) after the Tokyo and Osaka offices were linked to set sales against purchases rather than balancing each set of books. Any surplus was lent on through the lucrative inter-bank market in Tokyo where interest rates were high.<sup>55</sup> In 1957 it was noted that 'income from this source is Tokyo's lifeblood accounting for 60% of their income'.<sup>56</sup> Even with the high taxation on profits, this was a lucrative business, although from 1958-60 the spread on exchange narrowed and profits were squeezed.

The Hongkong Bank was relatively slow to engage in the Eurodollar market. King describes how the Tokyo manager had to fly to Head Office for a crash course in how the market worked after being alerted to its potential by a French bank.<sup>57</sup> In June 1963 the Tokyo office began operations on the Eurodollar market in London which generated 'free yen' deposits in Tokyo. In the second half of 1963 working profit increased 40% and total resources were 60% greater than the same period of 1962 due to Free Yen deposits by London and New York. The profit on the utilisation of Eurodollar funds was about Y31m for the six months to December due to a gross interest differential of 4.9% pa between the cost of borrowing Eurodollars and the higher Japanese interbank rate. By June 1964, the gross return on Eurodollar operations was over 7% when the call money rate in Japan rose to 11.55%. Short loans to banks increased from Y70m in 1963 to Y3.5b in June 1964. The call money rate peaked in the second half of 1964 at 12.8% generating a gross return after the cost of forward cover on Eurodollar lending of 8%. But this peak soon passed as money eased in Japan and grew tighter in London and New York. By December 1965 the rate on loans to banks and brokers was down to 6.62% pushing the return on Eurodollar operations to 2%. Easier money also increased the competition for domestic loans by Japanese banks and so net profits slumped from Y159.4m in 1964 to Y54.1m in 1966, although there was some recovery in the second half of 1967



when profit on Eurodollar business amounted to Y75m compared to Y4m in the same period of 1966.

Foreign banks also used borrowed Eurodollars for loans to first class Japanese companies, usually with a guarantee from a local A Class Bank, so-called 'Impact Loans'. The Hongkong Bank started this in the second half of 1970 and by the end of the year such loans amounted to Y8.7b generating a profit of about 3.5% p.a. The huge demand for local capital ensured that this business continued and expanded. When the domestic interest rate on loans was too low, the Japanese borrowers made compensating interest-free deposits, increasing liquidity and loanable funds and thereby raising the banks' return beyond the nominal rate.<sup>58</sup> Most of the Hongkong Bank's loans were arranged in Osaka, but they were transferred to Tokyo's books from April 1970 and Osaka was paid 1% commission for all such business brought to the bank.

In the years of uncertainty and tight money in the early 1960s the Hongkong Bank loaned only to the largest Japanese companies and to reliable foreign companies, mainly related to their commercial trade.<sup>59</sup> By the end of the decade the Hongkong Bank reported increasing competition from both Japanese and American banks.<sup>60</sup> In April 1967 the Tokyo manager noted that 'Many of our customers tell us that they are frequently approached at managerial level to transfer their business from foreign banks; many inducements are offered even to personal account holders'.<sup>61</sup> A few months later he noted that 'it is almost impossible for our constituents to refuse in cases where, for example a trading firm of the Mitsubishi Group refuses to place an order unless the relative business is directed through the Mitsubishi Bank. We, on the other hand, cannot attract business from Japanese banks since we are not eligible for the cheap re-finance which they obtain from the Bank of Japan'.<sup>62</sup> In 1963, the Hongkong Bank decided to close the branch of its subsidiary the Mercantile Bank in Tokyo to avoid excessive competition and rationalise the Group's business.<sup>63</sup>

About 40% of the profits for all foreign banks in Tokyo arose from foreign exchange business in the 1970s as they took exploited their advantage in offering foreign currency impact loans compared to their domestic competitors. Foreign banks accounted for about 60% of these loans when the market was opened up to domestic banks in 1980. Thereafter, local banks quickly made inroads on the market, pushing foreign banks back to a 19% market share by 1984.<sup>64</sup>

## The Tokyo Stock Exchange

The Tokyo Stock Exchange also attracted foreign attention. The exchange had been quite volatile, experiencing a boom during the Korean War and again in mid-1961 fuelled by newly formed investment trusts. The ensuing fall in the market in mid-1965 rocked the largest securities company (Yamaichi Securities) requiring a bail-out by the government and increased regulation of the market.<sup>65</sup> In April 1968 a surge of foreign investment on the Tokyo Stock Exchange began as foreigners sought to profit from Japan's rapid growth. There were record purchases of US\$20m in that month but this quickly accelerated to US\$34.5m by June and \$60.5m in July.<sup>66</sup> Most came from the American trust funds but also from European institutional investors buying shares in first class electronics, automobile, insurance and camera companies. During 1968 the Ministry of Finance granted clearance for \$US429m of foreign share purchases.<sup>67</sup> The market seemed to peak in the first quarter of 1969 but began to rise again in the fourth quarter. In September 1969 alone, US\$291m flowed in from abroad of which 65% was from Europe, 28% from the USA and the rest from elsewhere in Asia.<sup>68</sup> However, foreign ownership of shares in listed companies in Japan remained below 5% throughout this period and foreign firms were prohibited from becoming members of the TSE until 1982.<sup>69</sup> Figure 1 shows the stock exchange boom in this period. The boom only broke with rising interest rates after the first OPEC oil shock in 1973.

## Changes in the 1970s: activity of Japanese banks

After the advent of floating exchange rates in 1971 and the accumulation of substantial trade surpluses in the early 1970s, Japanese banks became much more aggressive in international finance and Japan became a net exporter of capital. The changing position of Japan is clear in the movement of interest rates during the post-war period shown in Figure 2.<sup>70</sup> During the tight money years from 1956-65 call money rates in Japan averaged 7.8% p.a. compared to 3.8% p.a. on the Eurodollar market. From 1966-75 money eased in Japan and tightened up elsewhere so that by the late 1970s short term rates in Japan were considerably lower than in the US, the UK, or the Eurodollar market and Japan became a net international long term lender

funded by short term capital inflows as the Yen rose in international markets with the mounting current account surplus.

With increased liquidity and a rising yen, Japanese banks moved onto a new plane of international finance, borrowing heavily on the Eurodollar market to make longer term loans at lower interest rates than their competitors in the expectation that the US\$ would continue to slide against the Yen. At the end of 1971 a consortium of four Japanese bank plus Morgan Guaranty Trust made the first long-term loan to a foreign company, lending \$15.2m to the Trans-Ocean Gulf Corp. Japanese financial institutions also began to arrange syndicate loans and bond issues in Japan for foreign governments and institutions, either in concert with foreign banks or independently.<sup>71</sup> By 1973, Japanese banks in London accounted for 8.5% of total banks' non-sterling obligations, rising to 12.3% by May 1974 as they accelerated their Eurodollar borrowing.<sup>72</sup> The bubble soon burst, however, as Eurodollar rates increased sharply and the Bank of Japan imposed new restrictions to curtail this activity. The new international environment also affected foreign banks in Tokyo. From 1975-79 profits of foreign bank branches and their share of the Japanese market fell as their traditional activities were overtaken by Japanese banks and official controls constrained their diversification.<sup>73</sup>

In summary, through most of the period the restrictions on international banking frustrated those foreign banks hoping to act as intermediaries with Japanese industry. The reluctance of the Bank of Japan and the Ministry of Finance to allow the yen to be an international currency further inhibited yen-denominated offshore business. Despite the controls, however, there were considerable profits to be made in Tokyo by foreign banks re-lending Eurodollars and there was a frustrated demand among foreign banks to expand their operations in Japan. The enthusiastic (but risky) activity of Japanese banks in the Eurodollar surge in the early 1970s provoked accusations of 'dumping' by other international financiers and in the end sparked a regulatory backlash by the Japanese authorities. As a result, the Tokyo financial sector remained tightly protected through the next decade. Nevertheless, up to 1980 Tokyo rose in the IFC league tables mainly on the strength of the dramatic growth of the economy as a whole while Hong Kong maintained its middle-weight position despite having only one international bank and a relatively small (although fast-growing) domestic economy.

## Conclusion

International banking and financial centres arise for a variety of interconnected reasons; tax rates, regulation, economies of scale and scope, and domestic demand for services. Their location also depends on factors such as language, culture and institutional transparency. This account has shown that all of these factors influenced the performance of Hong Kong and Tokyo in the post-war period. This paper has also tried to add some texture to the characterisation of Hong Kong as a laissez-faire paradise and Tokyo as a centre that effectively excluded foreign banks until the 1980s. The characterisation of Hong Kong as a free-wheeling and uncontrolled international banking market is really only true for the decade up to 1965. However, the huge demand for wholesale financial services in East Asia by this time meant that these new restrictions did not prevent a massive influx of foreign financial institutions into Hong Kong both through representative offices, equity partnerships and buy-outs of existing banks, and by new merchant banks and deposit-taking companies that engaged in wholesale business exempt from the moratorium and the interest rate agreement. The one aspect where tax policy was disadvantageous also did not have a fatal impact. Hong Kong's free exchange market, long historical record in international commerce, the agglomeration of banks and supporting financial services and the use of English remained important sources of advantage for Hong Kong through the difficult years of the 1970s. From 1980, the opening of China and the restructuring of the Hong Kong economy away from manufacturing gave further impetus to the expansion of the international financial centre.<sup>74</sup> Despite its regulatory disadvantages after 1965, therefore, the free exchange market ensured that Hong Kong persisted as an IFC and was well poised to flourish in the late 1980s during the restructuring of the economy after the exodus of Hong Kong's manufacturing enterprise to China.

This account has also shown that foreign banks in Tokyo did have opportunities to make profits during the 1950s and 1960s despite being much more hampered by controls and changes in the pace of liberalisation both before and after the oil crisis of 1973/4. However, the operation of Tokyo as an international financial centre was hampered by exchange controls, constraints on offshore business, and the state's resistance to internationalisation of the Yen. The costs of international banking in

terms of tax rates and corporate culture remained high relative to Hong Kong. The Japanese authorities initially encouraged international activity by Japanese banks in foreign banking centres, but after the first oil crisis these activities were reigned in until a further initiative toward liberalisation in the 1980s. Nevertheless, the huge size of the Japanese economy and of Japanese banks pushed the absolute value indicators of Tokyo's international activity into third place in the world as an international financial centre.

In the 1990s, the Japanese banking system was exposed as having a large balance of non-performing debt when the 'bubble' economy of the 1980s burst. Lack of transparency and inadequate disclosure and risk assessment weakened the Japanese banking system and undermined confidence in the Japanese economy as a whole, aspects the Big Bang initiative launched in November 1996 aimed to rectify.<sup>75</sup> This weakness and a consequent drop in profits by foreign banks led to a significant deterioration in Tokyo's status as an international banking centre, causing it to fall from third to fifth place between 1990 and 2000. Hong Kong meanwhile replaced Tokyo in third place. This change was due to a decline in Tokyo both as a headquarters for international banks and as a host for foreign banks. The number of the world's top 300 banks headquartered in Tokyo fell 30% from 20 in 1990 to 14 in 2000. In the same period the number of offices of foreign banks also fell in Hong Kong, but to a lesser extent – from 65 to 48.<sup>76</sup>

The fall in the number of foreign banks represented in Hong Kong reflects that it also was challenged by financial crisis in the 1990s, particularly the Asian financial crisis of 1997 that has had serious longer term repercussions on the domestic and regional economy. The banking system, however, emerged relatively unscathed due to the underlying strength and diversification of portfolios.<sup>77</sup> Nevertheless, the experience has led to a reassessment of the regulatory and supervisory regime in Hong Kong. The response is a continued relaxation of regulations, particularly barriers to entry by foreign banks and controls on interest rates. This liberalisation is to be accompanied by strengthening the Hong Kong Monetary Authority's supervision, again aimed particularly at foreign banks operating in Hong Kong. At the same time the HKMA has committed itself to measures to formalise deposit insurance and lender of last resort functions (former planned for 2002 and latter completed June 1999) to lessen the chances of a future run on the banking system.<sup>78</sup>

Table 1: Banks' Foreign Assets: Share in total reporting countries' foreign assets

	1961	1965	1970
UK	16.71	17.1	25.1
USA	29.52	23.6	8.58
Japan	5.03	5.70	4.42
France	-	4.33	6.79
Switzerland	8.71	8.33	9.46
Luxembourg	0.74	0.89	2.48
Bahamas	-	-	4.83
Lebanon	-	1.34	0.43
Bahrein	-	-	0.4
Singapore	-	-	0.35
Hong Kong	1.16	1.14	0.83

Source: *IMF International Financial Statistics Yearbooks*

Table 2: Branches of foreign banks in Tokyo and Hong Kong in 1965: Source Region

	USA	UK	Europe	Other Asia
Tokyo	6	1	1	7
Hong Kong	5	2	5	29 (+6 PRC Chinese)

Source: *Bankers' Almanac* 1965/66





# Short Term Interest Rates

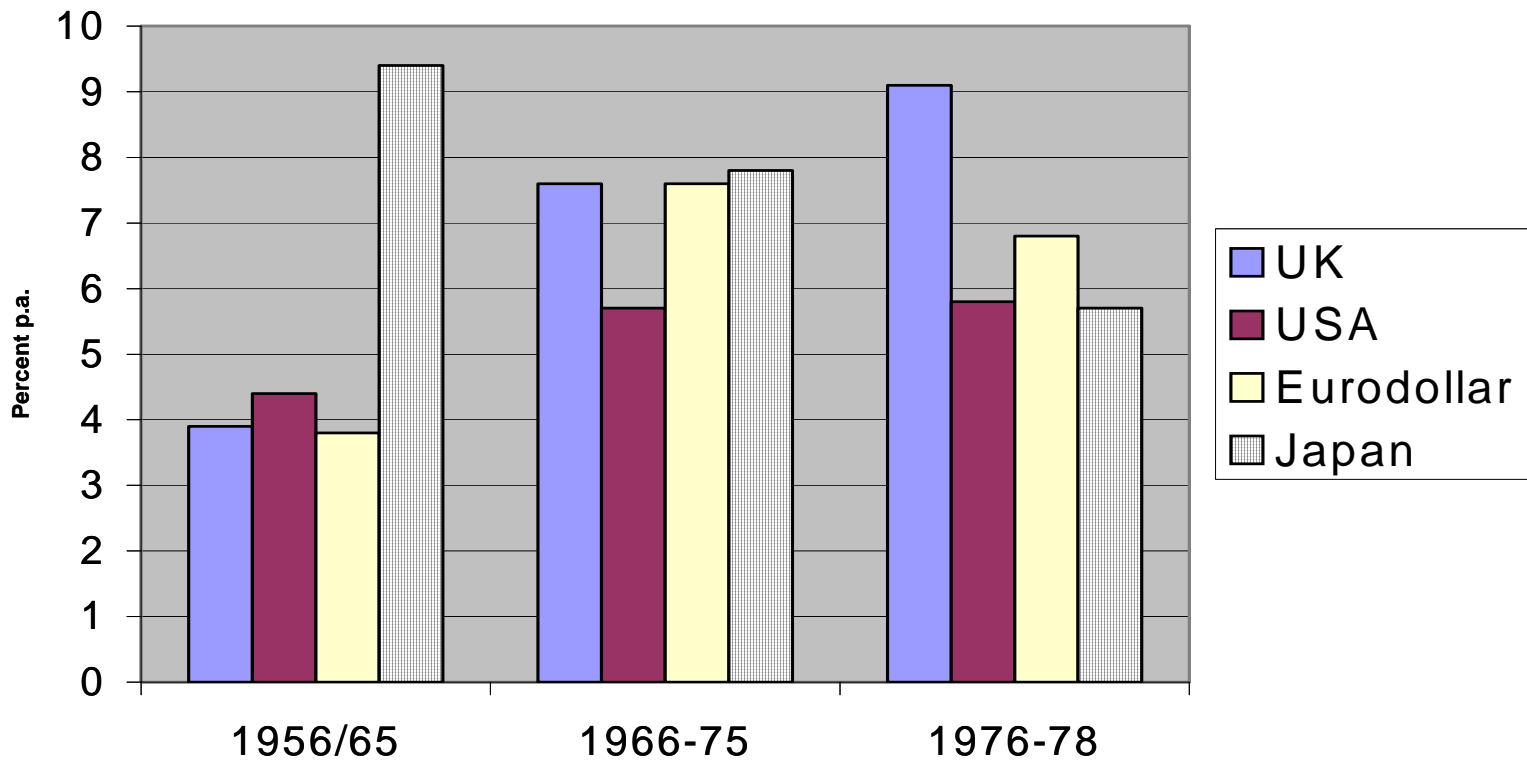


Figure 1: Tokyo Stock Exchange Price Indices 1967-70

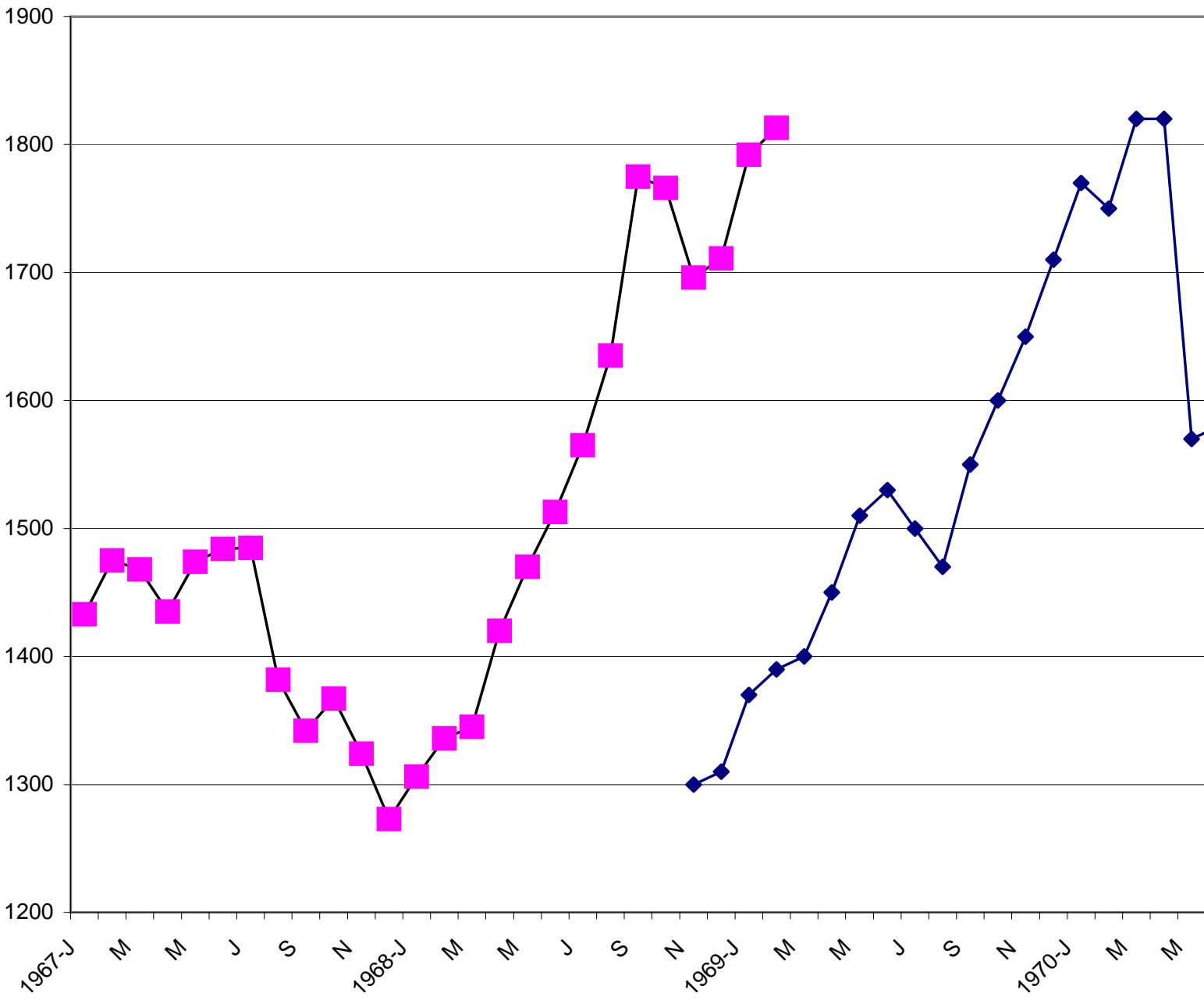


Table 3: World Rankings Based on Number of Foreign Bank Offices

	Hong Kong	Tokyo	London	New York	Paris
1955	4	8	1	2	3
1965	3	7	1	2	4
1970 (Choi et. al)	8	3	1	2	3
1980	5	2	3	1	7
1990	4	3	1	2	7
2000	3	5	2	1	8

Source: 1955 and 1965 Bankers' Almanac. Other dates include only the world's top 300 banks. SR Choi, A.E. Tschoegl and C.M. Yu, 1986, 'Banks and the World's Major Financial Centers, 1970-1980', *Weltwirtschaftliches Archiv*, CXXII, 1988, 48-64. SR Choi, DK Park and A.E. Tschoegl, 1996, 'Banks and the World's Major Banking Centers, 1990', *Weltwirtschaftliches Archiv*, CXXIII, 774-793. SR Choi, DK Park and A.E. Tschoegl, 'Banks and the World's Major Banking Centers, 2000', *Weltwirtschaftliches Archiv* 130 (3): (Forthcoming).

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<sup>2</sup> Y.S. Jao, *Hong Kong as an International Financial Centre: evolution, prospects and policies*, City University of Hong Kong Press, 1997. p. 103.

<sup>3</sup> Ibid. p. 102.

<sup>4</sup> Banks headquartered outside Tokyo (like Sumitomo, Sanwa and Daiwa headquartered in Osaka) centred their international operations in Tokyo. HC Reed, 'Financial Center hegemony, interest rates and the global political economy', (1989) in R. Roberts, *International Financial Centres: concepts, development and dynamics*, Cheltenham: Edward Elgar, 1994.

<sup>5</sup> SR Choi, AE Tschoegl and CM Yu, 'Banks and the World's Major Financial Centers, 1970-1980', *Weltwirtschaftliches Archiv*, CXXII, 1986. This analysis included 14 centers and the world's 300 largest banks.

<sup>6</sup> *Salient Features and Trends in Foreign Direct Investment*, UN Centre on Transnational Corporations, United Nations, New York, 1983. This represented about half of the value of FDI in banking and insurance by the UK, although this sector only accounted for 5% of UK FDI.

<sup>7</sup> *Far Eastern Economic Review*, [hereafter FEER] 16 October 1952, p. 511.

<sup>8</sup> 'Report of Negotiations in Tokyo' by KMA Barnett, 11 February 1950. Bank of England [hereafter BE] OV14/5.

<sup>9</sup> M.T. Flett to Brittain, 27 October 1952. Public Records Office, London [Hereafter PRO] T236/5113.

<sup>10</sup> Telegram from Chandler (Exchange Controller in Hong Kong), 12 September 1953. BE OV14/9.

<sup>11</sup> *FEER*, 11 April 1963, p. 81.

<sup>12</sup> Ibid.

<sup>13</sup> A. Kohsaka, 'Interdependence through Capital Flows in Pacific Asia and the Role of Japan', in T. Ito and A.O. Kreuger eds., *Financial Deregulation and Integration in East Asia*, Chicago: University of Chicago, 1996, pp. 107-42, p. 134.

<sup>14</sup> For the classic historical account of the rise of IFCs, see C.P. Kindleberger, *The Formation of Financial Centers*, Princeton, N.J.: International Finance Section, Princeton University, 1974. See also G. Dufey and I.H. Giddy, *The international money market*, Englewood Cliffs, N.J.: Prentice Hall, 1978), Y.S. Park and M. Essayed, *International Banking and Financial Centres*, Boston: Kluwer Academic Publishers, 1989. G. Jones, 'International financial centres in Asia, the Middle East and Australia; a historical perspective', in Y. Cassis ed., *Finance and Financiers in European History, 1880-1960*, Cambridge: Cambridge University Press, 1992.

<sup>15</sup> D.R. Meyer, *Hong Kong as a Global Metropolis*, Cambridge: Cambridge University Press, 2000, p. 199.

<sup>16</sup> CR. Schenk, *Hong Kong as an International Financial Centre: emergence and development 1945-1965*, London: Routledge, 2001. Inevitably, the section on Hong Kong draws heavily on this work.

<sup>17</sup> CR Schenk, 'Closing the Hong Kong Gap: Hong Kong and the free dollar market in the 1950s', *Economic History Review*, XLVII(2), 1994, 335-53.

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- <sup>18</sup> TK Ghose, *The Banking System of Hong Kong*, London: Butterworths, 1987, p. 63.
- <sup>19</sup> The official definition was an institution which engaged 'in the receipt of money on current or deposit account or in payment and collection of cheques drawn by or paid in by a customer or in the making or receipt of remittances or in the purchase and sale of gold or silver coin or bullion'.
- <sup>20</sup> For an account of Hong Kong's banking structure see Schenk, 'Banking Groups in Hong Kong 1945-65', *Asia Pacific Business Review*, 7 (2), 2000, pp. 131-154 and Schenk, 'Banks and the emergence of Hong Kong as an international financial centre', *Journal of International Financial Markets, Institutions and Money* Vol 12, Nos 4-5, October/December 2002, pp. 321-40.
- <sup>21</sup> KPMG Berents, *Hong Kong Banking into the New Millennium; Hong Kong Banking Sector Consultancy Study*, December 1998.
- <sup>22</sup> For more detail on the genesis and mechanics of the Interest Rate Agreement see, Schenk, 'Banking Groups'.
- <sup>23</sup> The State-controlled Chinese banks and banks incorporated in Malaya were part of the A1 group. There were no restrictions on deposits over 12 months.
- <sup>24</sup> Liberalisation of interest rates was part of the US-Japan Yen-Dollar Committee agenda in 1984 and was largely achieved in 1993, with remaining regulations on all but current deposits removed in October 1994. The Hong Kong deregulation includes current account deposits.
- <sup>25</sup> For the main features of the Ordinance see Ghose, *Banking System*, pp. 80-82.
- <sup>26</sup> Interview with J.J. Cowperthwaite in *The Banker*, 120, July 1970, pp. 734-45, p. 739.
- <sup>27</sup> *Ibid*, p. 744.
- <sup>28</sup> Ngiam Kee Jin, 'Singapore as a financial center; new developments, challenges, and prospects', in T. Ito and A.O. Kreuger eds., *Financial Deregulation and Integration in East Asia*, Chicago: University of Chicago Press, 1996, pp. 359-83. p. 363.
- <sup>29</sup> An exception is J.R. Brown, *Opening Japan's Financial Markets*, London: Routledge, 1994 which draws on archives of several US banks. S. Ogura, *Banking, the State and Industrial Promotion in Developing Japan 1900-1973*, London: Palgrave, 2002 offers an historic study of domestic banking based mainly on Mitsui records and interviews. MJB Hall, *Financial Reform in Japan; causes and consequences*, Cheltenham: Edward Elgar, 1998 is a more broad ranging study, again with emphasis on the domestic sector.
- <sup>30</sup> D. Scholey, 'Essential features of international financial centres,' (1987), in R. Roberts, *International Financial Centres; concepts, development and dynamics*, (1994).
- <sup>31</sup> Hall, *Financial Reform*, p. 23-5.
- <sup>32</sup> Political and Economic Reports from Tokyo Branch Office, 1 September 1953. GHO186. HSBC Group Archives [hereafter HSBC]. See also, *FEER*, 21 Jan 1954, p. 82.
- <sup>33</sup> L.W. Pauly, *Opening Financial Markets; banking politics on the Pacific Rim*, Ithaca: Cornell University Press, 1988, pp. 68-69.
- <sup>34</sup> C.R. Schenk, *Hong Kong as an International Financial Centre*, p. 52.
- <sup>35</sup> A. Tschoegl, 'The Internationalisation of Singapore's Largest Banks', *Journal of Asian Business*, forthcoming. The OUB opened a branch in Hong Kong in 1959.
- <sup>36</sup> The banks involved were Sanwa, Mitsui, Dai-Ichi and Nippon Kangyo. GHO186, HSBC.

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<sup>37</sup> 'Outline of Foreign Exchange and Foreign Trade System' by Bank of Japan, 1 May 1964. GHO186 HSBC.

<sup>38</sup> See, Brown, *Opening Japan's Financial Markets*, Chapter 2 for a colourful account of foreign banking under the US Occupation.

<sup>39</sup> Continental Illinois bought its branches from the Chase for US\$1m after the latter's take-over of Nationale Handelsbank's Asian offices in 1963. JD Wilson, *The Chase; the Chase Manhattan Bank, N.A., 1945-1985*, Harvard Business School Press, 1986, p. 168.

<sup>40</sup> *FEER*, 17 Sep 1973.

<sup>41</sup> The percent of exports denominated in US\$ declined to 49% and for imports to 72% by 1993. S. Fukuda, 'The structural determinants of invoice currencies in Japan; the case of foreign trade with East Asian countries', in T. Ito and A.O. Kreuger eds., *Financial Deregulation*, pp 147-63. p. 148.

<sup>42</sup> Wilson, *The Chase*, p. 182. Foreign banks' share of total Japanese deposits was 8% in 1952 but fell to less than 1% by 1980. AE Tschoegl, 'Foreign banks in Japan, *Bank of Japan Monetary and Economic Studies*, 6, 1, May 1988, pp. 93-117. p. 99.

<sup>43</sup> Wilson, *The Chase*, p. 284.

<sup>44</sup> E. Green and S. Kinsey, *The Paradise Bank; the Mercantile Bank of India, 1893-1984*, Ashgate, 1999. p. 115.

<sup>45</sup> *FEER*, 17 Sep 1973.

<sup>46</sup> *FEER*, 3 Apr 1971, p. 98.

<sup>47</sup> Letter from Tokyo Branch Office to BJN Ogden (Hong Kong), 12 October 1970. GHO186, HSBC.

<sup>48</sup> FHH King, *The Hongkong Bank in the Period of Development and Nationalism, 1941-1984; from regional bank to multinational group. Volume IV of The history of the Hongkong and Shanghai Banking Corporation*, Cambridge, 1991, p. 436-7.

<sup>49</sup> Half Yearly Reports from Japan Offices 1968-71, GHO348, HSBC.

<sup>50</sup> Half Yearly Reports from Japan Offices, June 1970. GHO348, HSBC.

<sup>51</sup> Note from GW Lucas to RL Workman (HMT), 21 July 1961. Bank of England Archives [hereafter BE] EID10/21. The 2% surcharge for funds was imposed also after the 1974 crisis, and generated 'painful memories' for Japanese banks. EW Hayden, 'Internationalizing Japan's Financial System', in DI Okimoto ed., *Japan's Economy; coping with change in the international environment*, Westview Press, 1982, pp. 89-122. p. 97-98.

<sup>52</sup> A. Horiuchi, 'An evaluation of Japanese financial liberalization; a case study of corporate bond markets', in T. Ito and A.O. Kreuger eds., *Financial Deregulation*, pp. 167-91. p. 175. Horiuchi notes that the total capital raised was only 1.7% of Japanese corporate financing in the 1970s.

<sup>53</sup> *Federal Reserve Bulletin*, March 1965. Vol. 51, No. 3., p. 365.

<sup>54</sup> For an account of American banks in Tokyo in the 1960s and 1970s see Brown, *Opening Japan's Financial Markets*, Ch 3-4.

<sup>55</sup> Half Yearly Reports from Tokyo, 30 June 1956. GHO244, HSBC.

<sup>56</sup> Half Yearly Report from Tokyo, December 1957. GHO244. HSBC.

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- <sup>57</sup> King (1991), p. 672.
- <sup>58</sup> So-called ‘compensating balances’ were also used by Japanese banks to circumvent interest-rate controls. Hayden, 1982, p. 91. See also Wilson, *The Chase*, p. 182.
- <sup>59</sup> Letter from Tokyo Branch Office to HE Clarke (Hong Kong), 30 October 1964. GHO186. HSBC.
- <sup>60</sup> Political and Economic Letter from Tokyo to NHT Bennett (Hong Kong), 19 October 1967. GHO186, HSBC.
- <sup>61</sup> Letter from Tokyo to Head Office Hong Kong, 12 April 1967. GHO186, HSBC.
- <sup>62</sup> Letter from Tokyo to Head Office Hong Kong, 16 July 1967. GHO186, HSBC.
- <sup>63</sup> King, *The Hongkong Bank*, p. 603.
- <sup>64</sup> A. Viner, *Inside Japan’s Financial Markets*, London: The Economist, 1987, p. 167.
- <sup>65</sup> *Ibid.*, pp. 46-48.
- <sup>66</sup> Letter from Tokyo to Head Office Hong Kong, 17 October 1968. GHO186, HSBC.
- <sup>67</sup> Letter from Tokyo to Head Office Hong Kong, 15 April 1969. GHO186, HSBC.
- <sup>68</sup> The percentages relate to the total for April-August 1969 of US\$329m. Letter from Tokyo to Head Office Hong Kong, 1 January 1970. GHO186, HSBC.
- <sup>69</sup> J. Thorsten Duser, *International Strategies of Japanese Banks; the European perspective*, London: Macmillan, 1990. p. 89
- <sup>70</sup> These rates are from HC Reed, *The Pre-eminence of International Financial Centres*, New York: Praeger, 1981, p. 50.
- <sup>71</sup> *FEER*, 13 Sep 1974.
- <sup>72</sup> *FEER*, 25 Apr 1975.
- <sup>73</sup> *FEER*, 21 Sep 1979, p.65. Brown, *Opening*, pp. 64-68.
- <sup>74</sup> In 1980 Financing, Real Estate and Business Services accounted for 24% of GDP. This fell to 16% in 1984 during the banking and currency crisis, but then surged to nearly 27% of GDP by 1994. Manufacturing as a proportion of GDP fell from 25% to 9% from 1980-95. J Dodsworth and D Mihaljek, *Hong Kong, China; growth structural change, and the economic stability during the transition*, Washington DC: IMF, 1997.
- <sup>75</sup> T. Saga, ‘Financial Reform in Japan’, in M. Tsurumi ed., *Financial Big Bank in Asia*, London: Ashgate, 2001, pp. 37-62.
- <sup>76</sup> Choi, Park and Tschoegl, ‘Banks and the World’s Major Banking Centers, 2000’, *Weltwirtschaftliches Archiv* 130 (3): (Forthcoming 2003). Part of the reduction in the number of Top 300 bank in Tokyo was due to mergers.
- <sup>77</sup> Y.C. Jao, *The Asian Financial Crisis and the Ordeal of Hong Kong*, Westport CT: Greenwood Publishing, 2000.
- <sup>78</sup> KPMG-Barents, *Hong Kong Banking into the New Millennium; Hong Kong Banking Sector Consultancy Study*, December 1998. This report was commissioned by the HKMA. The response to

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the consultancy study was published as HKMA, *Hong Kong Banking into the New Millennium; Policy Response to the Banking Sector Consultancy Study*, July 1999.