PECC International Conference

Competition among Financial Centers in the Asia-Pacific: Prospects, Benefits, and Costs – Stumbling Blocks or Building Blocks towards a Regional Financial Community?

Westin Chosun Hotel, Seoul, Korea
October 15-16, 2007

DAY 1. Case Study Reports: Vision, Strategies, Roadmap, and Progress

SESSION I. Hong Kong and Singapore

International Financial Centres in East Asia and Beyond: A Perspective from Hong Kong

Prof. Jesús SEADE
Department of Economics, Lingnan University, Hong Kong

PECC International Conference

Competition among Financial Centres in the Asia-Pacific: Prospects, Benefits, and Costs – Stumbling Blocks or Building Blocks towards a Regional Financial Community?

Seoul, Korea, October 15-16, 2007-09-30

International Financial Centres in East Asia and Beyond: A Perspective from Hong Kong[1]

by

Jesús Seade

Department of Economics, Lingnan University, Hong Kong

October 2007

1. Introduction

The importance of financial activity for East Asia cannot be overstated. The enormous and fast-growing regional economy requires to be underpinned by a strong, modern and diversified financial sector. The 1990s crisis is a receding memory, but many observers agree that two important contributing factors behind it were too much dependence on bank finance and inadequate corporate accountability and regulation — both of which variables again speak of the need for a strong, reliable and well diversified financial sector. And indeed, several cities in the region have developed strong positions as national, regional or international financial centres, and many city authorities have made plain their determination to see their cities remain or become major global players in the area.

Modern banking entered the region through Hong Kong and Shanghai, both in the mid-19th century. While these always remained important banking and financial centres over the next 100 years, several other centres soon developed that joined them in the region's top ranks: in particular Tokyo and Singapore, but also Beirut,

[1] This paper is part of research on international financial centres (IFCs) and Hong Kong's place therein being conducted by a team at Lingnan University's Department of Economics that also includes Professors Chen Lin, Ping Lin, Xiandong Wei, and Yifan Zhang. The author thanks his collaborators and the university for encouragement and support, Chen Lin for helpful suggestions, Betty Ngai for excellent research assistance, and his students in his courses on IFCs for their interest and contributions. This is a first and preliminary delivery from the referred research underway. Views expressed and any errors or omissions are the author's alone.

Bombay (Mumbai), Seoul, Sydney. Two observations are worth drawing from the historical perspective:

First, like the major financial centres that developed early on in Europe – London, Paris, Berlin, Amsterdam – those that arose and took an early lead in Asia were also major trading centres, on major trading routes. But there is a striking contrast. The European cases were all *also* major cities and centres of power. In a European context it is natural to wonder which of those two factors was the key to their ascent as financial capitals: the centre of power or the centre for trade. Causality in this area is an impossible task, but Asia tells an interestingly different story. In Asia some cases were similar: for example Tokyo; perhaps Shanghai. But Hong Kong, Singapore, Beirut? As in Europe, these are all major trading centres. But most are in small countries: well connected, trade-bound, strategically located places. The historical development of financial centres in Asia seems to suggest that **the trade connection is a key determinant**. This is not meant to deny that other factors are crucial too, particularly when it comes to gaining a position in the global market place: we return to these issues below.

Second, all the financial centres that developed and gained importance early on in the process of European financial development remained important forever after. But *one* of them came clearly on top. Here we have a sharp but intriguing difference between Asia and the other major economic regions of the world – Asia never developed an early and sustained dominant player in the financial arena.

Indeed, London took the lead in Europe gradually from the early 19th century and decisively after 1870 – boosted by Paris having to decree a suspension of payments in the face of its war with Germany, and the latter ending up with large claims in sterling. London's lead in the European context was never to be lost, despite a weak economy and an acrimonious political climate throughout much of the 20th century, and important challenges such as the creation of Frankfurt-based Euroland. Similarly New York City, after an initial head-start by Philadelphia as the commercial, banking and political capital of the nascent USA, soon took the lead as its country's prime financial centre, and retained that position ever since.

In contrast, the four lead financial centres in Asia have remained the same and have alternated in relative importance over the last 100 years, with no firm leader emerging. Tokyo was ahead in the 1910s and 20s, but lost out through nationalism and war in 1930s and 40s, to Shanghai, and to Hong Kong and Singapore that were and remained important players all along. Shanghai on its part saw vigorous growth in the 1910s to 30s, sharply increasing the number of its foreign banks and trebling its population in that period. Its international role as a financial centre went into suspense with China's shift in economic model in the late 1940s, and the following decades of strong regional economic growth saw the return of Tokyo to centre stage while Hong Kong and Singapore consolidated and consistently continued to develop their strong international positions.

This brings us to the present. Shanghai has of course made a spectacular return as a major financial centre, already boasting the second largest stock exchange in Asia-Pacific with a market capitalization of US$2,382 bn in August 2007, after a meteoric increase greater than five-fold (in USD) in the last year alone. On its part Hong Kong is a sophisticated and highly diversified financial centre, very strong in banking, equities and a range of areas of financial activity. A recent report commissioned by the City of London[2] rated Hong Kong as the third strongest international financial centre, behind only global leaders London and NYC, on the basis of its strong performance across all areas of finance and all factors that make a financial centre succeed. Very similar remarks apply to Singapore, rated fourth and just behind Hong Kong by the said report, which again has a very strong presence overall and is actually ahead of Hong Kong and growing very strongly in key and dynamic sectors such as Forex markets and OTC Derivatives[3]. Last but by no

[2] City of London (2007)
[3] BIS, *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2007*, Preliminary Global Results, Sep 2007.

means least, among the top tier of financial centres in the region, is of course Tokyo, which with the second largest economy in the world behind it, has the largest stock exchange and forex and derivatives turnovers in the region.

Table 1
Leading East Asian Stock Exchanges:
Domestic Market Capitalization
(Aug 2007, in USD)

1. Tokyo	$4,518 bn
2. Shanghai	$2,382 bn
3. Hong Kong	$2,276 bn
4. Korea	$1,102 bn
5. Shenzhen	$707 bn
6. Taiwan	$678 bn
7. Singapore	$483 bn

Source: World Federation of Exchanges, www.world-exchanges.org

Alongside these four regional financial leaders, Taipei and particularly Seoul also are important participants in regional financial business, with large stock exchanges serving strong economies, and the latter fuelling their financial sectors more broadly. Other major centres in the broader Asia-Pacific region – particularly Sidney and Mumbai – also frequently compete for East Asian business or for bilateral financial business within it, as of course do the global giants in Europe and North America.

This paper will examine the lay of the land in the region in three major areas of financial activity: banking, foreign exchange, and debt. The choice of these is arbitrary: equities (and IPOs) are hugely important to the regions' financing and financial centres. Derivatives are an extremely dynamic component of modern financial markets, and in the performance of major financial centres in the region. But in order to be able to go into some depth and detail in the analysis, we restrict ourselves here to the three areas mentioned, all of them highly important too.

In sections 2 – 6 we discuss the state of competition in the three areas mentioned. For each, our focus will be on the participation of the region's major financial centres relative to the leading centres of Europe and America. Finally section 7 briefly discusses potential scenarios for the future of locational structure in the region and offers some comments on the form cooperation in selected areas might take – against the background of continuing consolidation in financial industries globally and the region's strong economic dynamics, both of which point to the need for global players in the provision of financial service to the region.

2 Cross-border banking: where is the business?

Two different sets of data on cross-border banking activity are collected and made available by the BIS, each geared at answering different kinds of questions. These are:

> ***Locational statistics***, which concentrate on ***the role of banks and financial centres in the intermediation of international capital flows.*** These therefore provide data on the gross international financial claims and liabilities of banks *resident in a given country* regardless of the nationality of headquarters, recording all positions including those vis-à-vis own affiliates; and,
>
> ***Consolidated statistics***, which concentrate on ***the global activities and risk positions of banks themselves as consolidated entities.*** These therefore provide data on banks' contractual lending (on-balance-sheet financial claims) by the head office and all its branches and subsidiaries worldwide, netting out inter-office accounts.

These two sets of data address different questions and may be used to complement each other in the analysis. Our primary interest, trying to measure the scope and scale of international financial activity operating from different centres, lies with locational statistics, which tell us what and how much all those (domestic and foreign) banks that are based in a given financial centre are doing. But consolidated statistics shed useful additional light, as they inform us about the global activities of financial institutions headquartered in given centres. The main purpose of consolidated statistics, however, is to provide a measure of the risk exposures of lenders' national banking systems, which is not our focus here.

In what follows we present summary data for East Asian countries as available, alongside selected major western markets or locations for comparison.

The overall picture for international banking as a whole is one of continuing healthy development and a steady growth. In March 2007, BIS reporting banks' cross-border claims stood at US$28,476.3 billion, having grown by 18% on a year-on-year basis (Dec 06 on Dec 05). Cross-border liabilities stood at US$26,595.4 billion in March 2007, increasing 17 % (again Dec 06 on Dec 05).

The locational distribution of claims is summarized in Tables 2 and 3 below. The figures are somewhat striking: notice the disparity between western and East Asian cross-border banking figures. Japan's, for example, are much lower both on the assets and the liabilities sides than those for the three European countries on those tables, despite its larger economy. Even Hong Kong and Singapore, whose financial systems are much more strongly focused on international activity, have cross-border bank positions roughly in proportion to the relative sizes of their economies compared to those of the European countries reported.

Table 2
Locational statistics: external positions of banks

LIABILITIES

Selected countries, in all currencies
(amounts: March 2007; percent changes: Dec 06 on Dec 05)

	bn USD	% change		bn USD	% change
Hong Kong	346.8	15.4	France	2,391.2	18.6
Japan	659.4	(-4.7)	Germany	1,798.8	17.0
Singapore	646.1	11.3	UK	6,145.0	24.2
			USA	3,312.8	27.5

Table 3
Locational statistics: external positions of banks

ASSETS

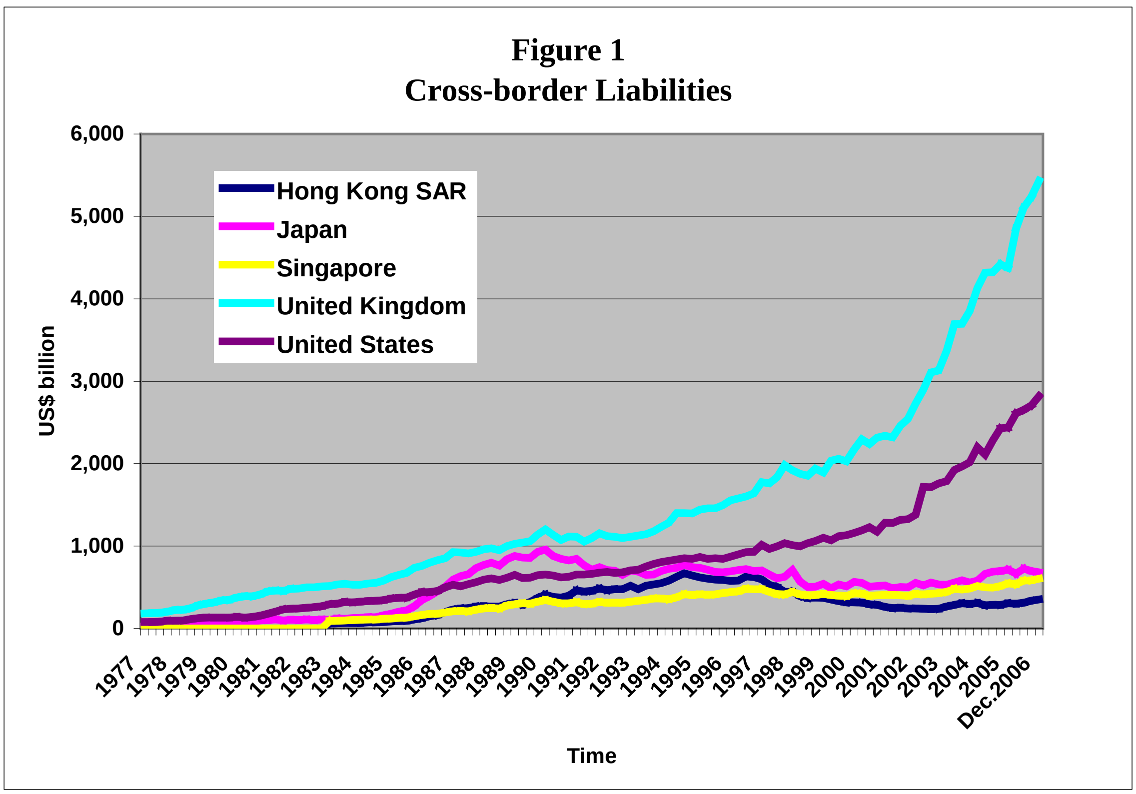
Selected countries, in all currencies
(amounts: March 2007; percent changes: Dec 06 on Dec 05)

Hong Kong	619.7	21.2	France	2,475.3	14.4
Japan	1,955.3	7.2	Germany	2,948.4	31.0
Singapore	642.6	11.5	UK	5,830.8	25.4
			USA	2,596.0	23.9

Source: BIS, *Locational Banking Statistics*, Sep 2007, http://www.bis.org/statistics/bankstats.htm

Of course, these relatively small outstanding volumes of assets and liabilities can be explained at least partially by the Asian financial crisis that broke out only a decade ago now, and by Japan's economic slump through much of the period immediately before and since. But then, one would expect that, with such catching-up still waiting to be done (recovering from those events, and catching up on the levels), and with the much faster economic growth that East Asia has consistently achieved in recent years and on balance in recent decades compared to western counterparts, the recent *rates of growth* of their cross-border banking activities would have been correspondingly higher than the West's. It is again striking that this is not the case — on balance the opposite is true. *Local and resident banking in East Asia still has considerable room to expand to fully profit from the opportunities that the region's economic size and growth represents.*

The above table contains only the latest figures available. Time paths for liabilities and for assets are shown in figures 1 and 2 respectively:

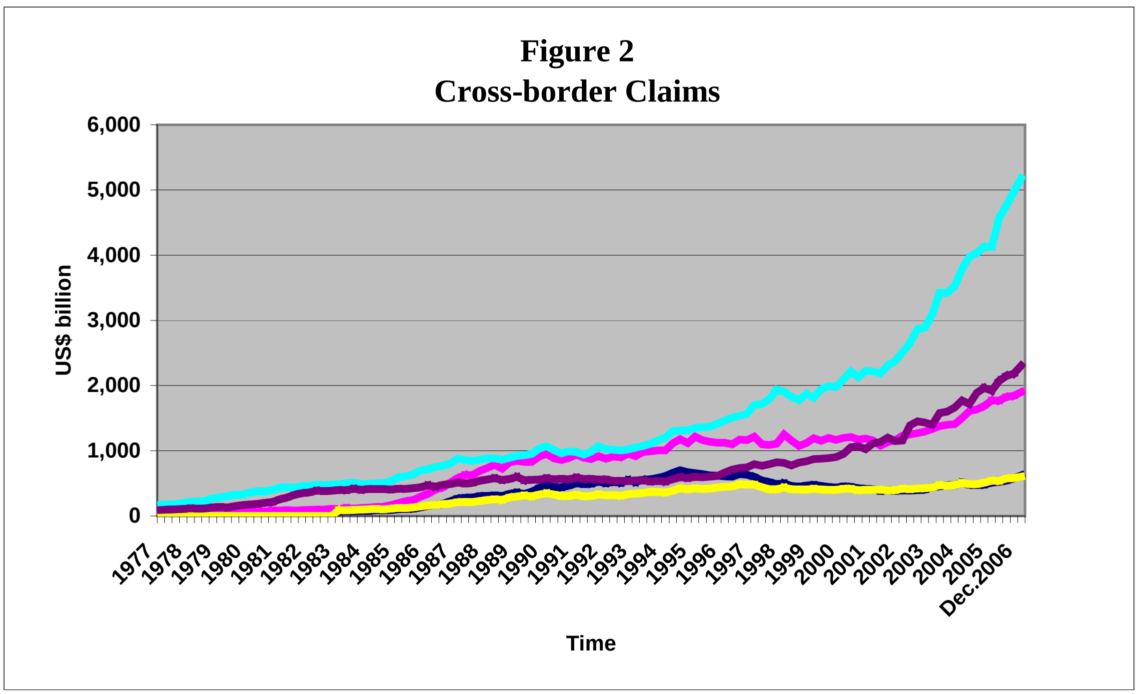


Based on BIS, *Locational Banking Statistics*, http://www.bis.org/statistics/bankstats.htm

The percentage **shares in total global cross-border liabilities** as of March 2007 are:

1	United Kingdom: 23.1% (6,145.0 / 26,595.4)
2	United States: 12.5% (3,312.8 / 26,595.4)
3	France: 9% (2,391.2 / 26,595.4)
4	Germany: 6.8% (1,798.8 / 26,595.4.8)
11	Japan: 2.5% (659.4 / 26,595.4)
12	Singapore: 2.4% (646.1 / 26,595.4)
17	Hong Kong: 1.3% (346.8 / 26,595.4)

where the left column provides the *rank*, out of the 40 jurisdictions in the BIS reporting system. As for assets, time paths are given in figure 2:



Based on BIS, *Locational Banking Statistics*; http://www.bis.org/statistics/bankstats.htm

The percentage **shares in total global cross-border assets** as of March 2007 are:

1	United Kingdom: 20.5% (5,830.8 / 28,476.3)
2	Germany: 10.4% (2,958.4 / 28,476.3)
3	United States: 9.1% (2,596.0 / 28,476.3)
4	France: 8.7% (2,475.3 / 28,476.3)
5	Japan: 6.9% (1,955.3 / 28,476.3)
12	Singapore: 2.3% (642.6/ 28,476.3)
13	Hong Kong: 2.2% (619.7/ 28,476.3)

where again the listing number is rank, out of the 40 reporting jurisdictions.

The above figures 1 and 2 show dramatically how the decade following the mid-90s was a rather dormant one for the industry in East Asia. In both lending and deposits, Japan fell from rank 3 to rank 6 globally over that period, while Singapore and Hong Kong fell several places too. Japan's withdrawal from HK was major: in 1996 it had 86 bans in HK: the largest concentration outside Japan and accounting for 55.6% of HK banking sector's loans. By 2003, these had withered to 22, and their market share had shrunk accordingly.

Concerning western markets, it is interesting to also look at Europe as a whole, given the large extent of formal and de-facto (or de-jure and economic) integration that increasingly binds European countries together. To this effect one would add the external positions of the European countries taken together, and of course net out the parts of those positions that pertain to intra-European flows. No such data is published by the BIS but the IFSL reports[4] that even if 60% of European banks' external positions are with other European countries the external position of

[4] International Financial Services (IFSL) is a private financial industry organization in London. Reference from IFSL's *Market Trends Europe vs. US 2006*, Oct 2007.

European banks with the rest of the world would be three times larger than the US's.

The above analysis speaks to the level and geographical distribution of financial activity as conducted from the respective financial centres, with numbers based on locational statistics, treating a local branch as a local bank. The picture is rather different if we look at banks' positions on a consolidated basis, that is, remitting the accounting of loans and deposits back to headquarters. For these, very briefly, the picture is as follows:

Table 4
Consolidated statistics:
Claims of reporting banks
(immediate borrower basis; in bn USD; March 2007)

Hong Kong	363
Singapore	207
Japan	852
France	1,702
Germany	2,125
UK	4,244
US	6,429

Source: BIS, *Locational Banking Statistics*, Sep 2007, http://www.bis.org/statistics/bankstats.htm

Compared to the locational figures, the relative participation of US banks increases hugely, which is what one would have expected given their size and importance, much of which is exercised through foreign locations – surely dwarfing cross-border lending done from the US by non-US banks. Within the East Asian region, the opposite correction is observed concerning in particular the figures for Singapore, whose participation is much more important at the locational level.

The dominant position of European and US banks reflected in the above figures conforms with the more direct impression one gets by looking at numbers of banks in different jurisdictions:

Table 5
Number of banks in major banking centres

	US	**UK**	**Japan**	**Hong Kong***	**Singapore**
1995	9,940	481	150	243 (179)	
1996	9,527	502	146	249 (186)	
1997	9,143	500	145	244 (182)	
1998	8,774	468	138	243 (177)	154
1999	8,580	464	137	228 (168)	142
2000	8,315	431	137	207 (154)	140
2001	8,079	428	136	203 (155)	133
2002	7,888	390	133	190 (142)	120
2003	7,770	382	134	180 (135)	117
2004	7,630	360	131	178 (136)	115
2005	7,540	347	129	172 (133)	111
2006				166 (133)	108
2007				167 (137)	

* First figure: total number of licensed and restricted license banks. In brackets: licensed alone.
Sources: Hong Kong Monetary Authority, Monetary Authority of Singapore, IFSL from Japanese Bankers Association, Federal Reserve, Bank of England, Financial Services Authority, British Bankers' Association and IFSL estimates.

Total number of banks has decreased substantially in all five jurisdictions all along this period, almost without even one-year reversals in the direction of change. The changes partly reflect the progressive consolidation the industry has been undergoing. In East Asia, this has also reflected the battering the industry suffered with the crisis of the 90s, particularly so Japanese banks, and the considerable extent of withdrawal of Japanese banks from regional markets in turmoil, particularly from Hong Kong.

The number of branches is not a relevant indicator among economies of very different sizes, but has some interest as among economies of broadly similar size. It is interesting for instance to note how much fewer branches than all other large western countries the UK has, and Japan even fewer, while the US and particularly Germany endow themselves with many branches even after accounting for their respective sizes:

Table 6

Number of banks and branches in largest banking centres, 2004

	Number of banks	Number of branches
US	7559	72822
Japan	129	12539
Germany	2171	47581
France	897	39825
Italy	778	30944
UK	405	14015
Switzerland	299	2630

Source: IFSL, from European Banking Federation, US Federal Reserve, Insurance Information Institute.

On the other hand, a more interesting indicator of the international engagement of financial centres is the presence of foreign banks in it, from among the totals listed in Table 5 above. The numbers are shown in Table 7:

Table 7 **Number of foreign banking institutions** (March 2005; * March 2003)	
London [o]	264
New York [o]	228
Paris [1]	179
Frankfurt [1]	129
Tokyo [o]	69
Hong Kong [2]	116
Singapore [3]	103

[o] March 2005; [1] March 2003; [2] March 2007 (inc. 13 restricted licence); [3] March 2006.
Sources: Hong Kong Monetary Authority, Monetary Authority of Singapore, Bank of England, IFSL, The Banker, BIS

London is thus the most popular centre with 264 foreign banks, followed by New York City with 228 foreign branches. The smaller number of foreign banks in New York is largely an indicator of the nature of the US banking industry which is more oriented towards serving the domestic market.

In the same vein, we note the much smaller number of foreign banks in Tokyo compared to Hong Kong and Singapore, again reflecting the Japanese banking industry’s greater relative orientation towards serving the domestic economy.

3 Global banking and global concentration

Alongside the expansion of banks' cross-border flows and establishment in other markets, discussed in the previous section, the globalisation of finance has brought with it a relentless movement towards increasing concentration in the industry, both globally and in most individual markets. Consider the following figures:

Table 8

Cumulative distribution of asset holdings among the world's 1000 largest banks measured by assets

	Top 10	**Top 20**	**Top 50**	**"Bottom" 950**
1995	14	24	45	55
2005	**19**	32	56	44

Source: IFSL, The Banker

The figures are impressive: as a result of consolidation in the banking sector,

- the share of assets of the largest **ten banks** worldwide has increased from 14% to 19% in only a decade, from 1994/95 to 2004/05;
- in terms of concentration of capital and profits (not shown), the six largest banks in the world by Tier 1 capital (core equity) account for 15 % of global banking capital and 17.2% of aggregate profits;
- back to asset distribution, the top fifty banks have well in excess of half of all banking assets worldwide;
- the share of the remaining 950 banks consequently declined in this period from 55% to 44%.

With this process, the largest banks in the world have become very large:

Table 9 **The 15 Largest banks in the world** by Tier 1 Capital* (in US$bn, 2006)		
1. Citigroup	US	79.4
2. HSBC Holdings	UK	74.4
3. Bank of America Corp	US	74.0
4. JP Morgan Chase & Co.	US	72.5
5. Mitsubishi UFJ Financial Group	Japan	63.9
6. Crédit Agricole Groupe	France	60.6
7. Royal Bank of Scotland	UK	48.6
8. Sumitomo Mitsui Financial Group	Japan	39.6
9. Mizuho Financial Group	Japan	38.8
10. Santander Central Hispano	Spain	38.4
11. China Construction Bank Corporation	China	35.6
12. HBOS	UK	35.6
13. UniCredit	Italy	34.0
14. Barclays Bank	UK	32.5
15. ABN Amro Bank	Netherlands	32.3

* Core Equity Capital, as defined under Basel I and II. Source: The Banker

In 2006 Citigroup was (as in the seven previous years) the largest bank in the world, in terms of both tier-one capital and assets. It also had the most profits (US$29.4 bn) and is one of the most profitable banks in the world, with 37% return on capital. HSBC is now a close second, with US$74.4 of capital and a return of 28.2%.

Regions and countries with most banks among the Top 1000 were the EU (with 286 of the 1000, accounting for 50.7% of banks' aggregate assets and 37.4% of aggregate profits); the US (with 197 of the 1000, accounting for 26.5% of aggregate profits), Japan (106), Germany (94) and the UK (36).

The Asian crisis ten years ago and the bad times Japan and its banking sector had in the 90s and earlier this decade had a substantial impact on the largest Japanese banks. Their number has declined since the mid-1990s, when Japanese banks held the top six places in the rankings of largest banks, to a rather respectable three banks among the largest ten last year.

The number of US and European banks at the top of the rankings has increased during this period, with a solid presence of three US banks among the top four and four European among the top ten (and four more in the next five) – including one by Spain, the latest newcomer in the top league. China's presence is beginning to be felt in the heights of this league CCBC ranking just outside the top ten, and will doubtless become stronger in years to come.

Alongside the banks becoming larger, their business is becoming more global, facilitated by the reduction in barriers to international trade as well as technological developments. The world's most international banks come from a greater diversity of backgrounds than the ten or fifteen largest, as shown in Table 10:

Table 10 **Banks with most assets abroad** Percent share, 2002 / 03			
		Assets abroad	**Staff abroad**
1. American Express Bank	US	86	85
2. UBS	Switzerland	84	58
3. Arab Banking Corporation	Bahrain	84	n/a
4. Credit Suisse Group	Switzerland	80	56
5. Standard Chartered	UK	70	n/a
6. Deutsche Bank	Germany	66	49
7. ABN Amro Bank	Netherlands	65	67
8. BNP Paribas	France	63	41
9. Investec	S. Africa	63	44
10. KBC	Belgium	58	52
11. RZB Group	Austria	58	79
12. HSBC Holdings	UK	57	59
13. ING Bank	Netherlands	56	61
14. Allied Irish Banks	Ireland	53	60
15. Erste Bank Group	Austria	51	74

Source: The Banker

The proportion of overseas assets and income generated abroad is an indicator of the international presence of a bank. By this criterion, European banks rank high, with a solid participation of 12 among the world's 15 banks with the most assets abroad (in 2003). The top place, however, went to American Express Bank. It is also interesting to note that *only two* among the world's largest 15 banks count among the geographically most diversified in their asset base: these are HSBC and ABN Amro. [5]This may come as somewhat of a surprise, since a major means to gain scale is through M&A, and these, where crossing borders, also add to the geographical diversity in question. Clearly, much as M&A have advanced internationally in the banking industry, they have done so more within national borders.

4 Competitive environment: domestic market concentration and regulation

Is the global concentration of banking observed in Table 8 above reflected in high or increasing concentration of the sector in individual countries?

Global concentration has in many cases followed from the adoption of more open regimes, which can lead to mergers and acquisitions among domestic banks or involving foreign entrants thus creating fewer and larger operators. But in other cases the national processes of liberalization has arisen from highly concentrated structures, allowing for the entry of new participants thereby reducing concentration.

In turn, concentration old or new, if enjoyed behind a veil of tolerance towards monopoly practices, can be a source of inefficiency, affecting performance. But concentration can have the opposite effect if it arises out of M&A by domestic or foreign but more efficient market operators, who bring with them technology transfer and international best practice. Over and beyond its prime function of

[5] Admittedly this is a comparison between lists referring to different years, but Table 10 is the latest information we have under this criterion. However, if the same comparison is made between this table and the ten or fifteen largest banks in 2003, the comment still stands but with a different pair of banks: namely HSBC and BNP Paribas.

safeguarding the health and stability of the system, the regulatory framework is crucial in all cases to ensure efficient and competitive performance by the industry – to ensure the market is *contestable* by alternative domestic or foreign operators if they detect monopoly rents or the opportunity to improve results.

The careful examination of the performance of financial centres in East Asia that the above issues call for is well beyond the scope of the present paper. Those are the central questions being addressed in the research program underway at Lingnan University of which this paper is a preliminary first delivery. But it is of interest at this point to look briefly at some illustrative numbers and facts. Table 11 presents figures on concentration of banking activity in selected East and Southeast Asian countries as well as major developed financial centres in various regions.

Table 11
Share of Domestic Assets and Deposits Held by the Five Largest Banks
in Selected Asia Pacific and Western Countries: 2001

	Deposits[1]	**Assets [1]**		**Deposits[1]**	**Assets [1]**
Hong Kong	58	42	**Canada**	87.4	80
Japan [2]	45.7	46.4	**France**	70	60
Korea	77.3	75.2	**Germany [3]**	21	20
Malaysia	57.1	55.7	**Luxembourg**	27.8	27.9
Philippines	45.9	43.0	**Spain**	43.7	53.2
Singapore	N/A	N/A	**Switzerland**	69	72
Thailand	70.1	64.8	**UK**	24	23
Australia	74	76	**US**	29	30
New Zealand	85.7	85.6			

[1] End 2001; [2] End March 2002; [3] End-2002. Source: Database from Barth et al. (2006)

No clear-cut pattern is discernible to relate concentration with scale or performance, but some broad observations may be warranted. For a given level of underlying competition and concentration, one expects larger markets to have lower measured concentration levels.[6] In this sense it is fair to say from the table that the UK's level of concentration is lower than for all other major industrial countries, its size or bigger. This greater nominal competition, plus the fact that the UK's regulatory framework ensures that vicinity in the market place translates into actual competition, is consistent with London's extraordinary success as a financial centre in recent decades. Other low levels of concentration to note are Germany's and Luxembourg's.

From the Asian centres on the list, Hong Kong has among the lowest measured concentration levels on the list, and lower still if we again apply the above logic – which would cast it as the most fiercely competitive of the Asian banking markets, which its success in the sector seems to be consistent with.

The previous table gave us concentration defined in a certain way and from a certain source. Table 12 presents analogous figures but from another source, this time for the top three asset holders, and over time. In addition, this source also includes China, not available in the previous source. The period covered is interesting: before and after the Asian crisis, Japan's problems, much of the post-Big Bang (1986) and broader reforms era for the UK. We have selected to show data for the same countries as in the previous table for comparability plus China, and selected years spanning the period available. Consider then Table 12:

[6] Think of ten regions with identical levels of overall concentration among 100 banks, but with different distributions of market shares to individual banks. The banks' shares in the sum of the regions (the larger "country") are the average values of their shares in the various regions. The numbers at the country level converge towards the mean (more sharply the more the banks differ in their respective regional strengths.) But the strength of competition in High Street has not changed with the mere erasing of the borders.

Table 12
Share of the Three Largest Banks in all Commercial Bank Assets
1990-2005

	1991	1996	2001	2003	2005
East/Southeast Asia					
China	96	89	78	60	79
Hong Kong, China	94 [1]	75	76	68	74
Japan	52	49	46	41	41
Korea	56 [1]	48	53	52	50
Malaysia	-	49	44	39	50
Philippines	95 [2]	72	64	50	60
Singapore	--	97	97	93	100
Thailand	64	54	52	52	48
Selected Industrial					
Australia	89	64	64	64	69
Canada	93	60	54	53	59
France	23	57	58	56	73
Germany	80	74	63	64	83
Luxembourg	29	26	25	28	36
New Zealand	-	81	75	70	80
Spain	99	91	82	84	70
Switzerland	37	31	87	87	37
UK	62	50	41	48	66
US	32 [2]	34	28	26	31

[1] 1992; [2] 1993; Source: Beck et al (2000) database, from Fitch's BankScope database

Sources and definitions differ between these two tables and we will not focus too much on comparisons except to note that both Hong Kong's and the UK's levels of concentration are less clearly lower than for countries of similar size compared to Table 11 – and have both gone up in recent years. Presumably the strong competition their open banking systems face internationally, and their regulatory systems both often cited as market friendly, ensure that competitiveness is upheld with the shrinking level of competition domestically. But not too much can be read from these numbers in isolation. Two striking fact to note here are the strong movements up and down in Switzerland's reported shares, and France's sharp rise in measured concentration over the period.

We have referred earlier to the importance the regulatory framework has for competition and performance, over and beyond its primary prudential function. Regulations can hinder competition in a number of ways, deterring entry directly, increasing costs for operators, or creating unnecessary forms or levels of uncertainty. Regulations are extremely diverse in their nature, form and incidence, and their proper study – let alone quantification of their effects – is an enormous task currently underway in our project. On an purely ***illustrative*** basis let us look at a few indicators of the different forms regulations can come into play in affecting performance, presented in Table 13.

The second row of the table indicates the broad line of effect on competition the regulation in question might have. The first two columns, on whether more than one agency is involved in granting licenses to banks, and whether more than one license is required to engage in different banking activities, touch on the ease with which a new operator can enter the industry or an established operator can diversify into new banking business. On the first of these, most countries on the list responded *No*, the exception being the US, which has a more complicated structure of jurisdiction between the federal and state levels. The second criterion gives us a richer and more

Table 13 **Selective Regulatory Indicators, 2006**						
	ease of entry		active entry by foreigners		burdensome supervision	effective supervision
	1 **Is there more than one agency that grants licenses to banks?**	**2** **Is more than one license required? (e.g. for each banking activity)**	**3** **Number of commercial banking license applications received from foreign entities (last 5 years)**	**4** **Of these, number denied**	**5** **Is there a single supervisory agency for the financial sector?**	**6** **Are supervisors legally liable for their actions? (e.g. can they be sued for an action taken against a bank)**
Hong Kong	No	No	25	0	No	No
Japan	No	No	21	0	Yes [a]	No
Korea	No	Yes	5	0	Yes	Yes
Malaysia	No	Yes	0 [1]	N/A	No	No
Philippines	No	Yes	0	0	No	Yes
Singapore	No	Yes	N/A	N/A	Yes	No [2]
Thailand	No	Yes	0	0	No	Yes
Australia	No	Yes	10	0	No	No
N. Zealand	No	No	6	0	Yes	No
Canada	No	No	169	N/A [3]	No	No
France	No	No	N/A	N/A	No	Yes
Germany	No	Yes	135*	0	Yes	No
Luxembourg	No	No	19	0	Yes	No
Spain	No	No	38	1	No	Yes
Switzerland	No	Yes	50	N/A	No	No
UK	No	No	N/A	N/A	Yes	No
US	Yes	Yes	84	0	No	No

[a] Except for credit cooperatives and government banking institutions; [1] Not permitted; must be locally incorporated; [2] "Unless acted in bad faith"; [3] Not tracked; * Covers licenses granted, and for domestic and foreign together (neither applications and denials, nor domestic and foreign, are tracked separately)

Source: Database from Barth et al. (2006)

interesting division of responses among our countries. France, Luxembourg, Spain, Canada and New Zealand join the UK in having the more liberal practice here, while Germany, Switzerland and Australia share the slightly less pro-competitive approach with the US. In our region the dichotomy is sharper, with only Hong Kong and Japan espousing universal licenses while Korea and all the ASEAN countries in the sample share the more traditional approach of Australia and the US on this issue.

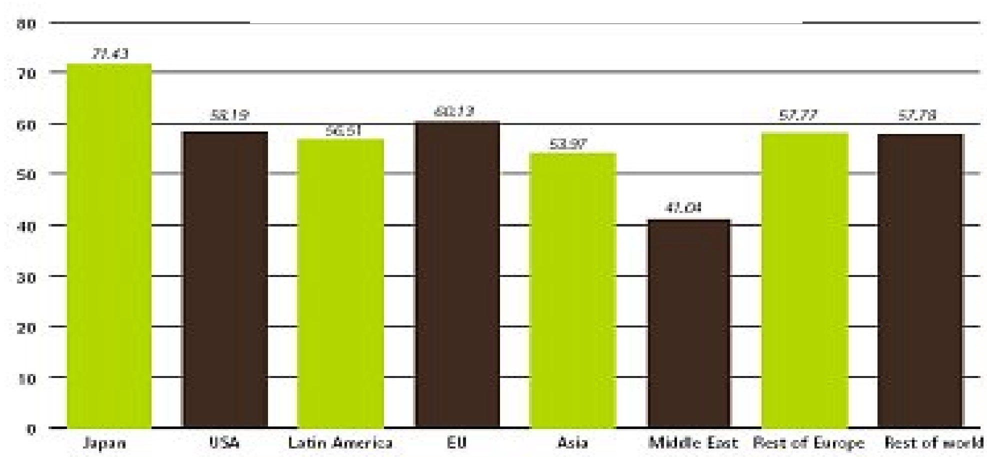
The second block of questions in columns 3 and 4 on applications received and denied is partly about regulatory response, and partly about (foreign entities') interest into entry in the sector. With the volume of applications reported being mostly in line with the size with the respective financial sectors and with virtually no denied applications reported, no further comment is offered and we simply leave the information here for consideration.

The third block of issues is important and interesting. Column 5 asks whether there is a single supervisory agency for the financial sector, along the lines of the *one stop shop* London created in the Financial Services Authority, regulator of banks, insurance companies, financial advisors and (since 2004-5) mortgage businesses and other insurance intermediaries. While this system has been criticised by some as creating a race to the bottom with its light approach to regulation, most agree that the system has worked well, and may have been the single most important factor behind London's formidable success as a financial centre over the last decade. Other countries have different arrangements and allocations of responsibilities to regulatory organs, but those on the list responding in the affirmative in column 5 have established the essentials of this streamlined approach to regulation, that considerably reduces reporting costs and uncertainties to participants in the market.

Finally, column 6 refers to the legal assurance supervisors need to have in order to discharge their duties without special consideration to power or influence. Outside the region, most countries listed do grant this protection to supervisors, the exceptions being France and Spain only, perhaps reflecting the greater weight the French civil law tradition gives to upholding institutions including the firm. It is also interesting to note the greater dispersion of answers on this question among the countries of East and Southeast Asia compared to the western countries listed, although the three leading financial-centre countries in the region fall on the same camp on this issue.

Whatever the factors may be that determine costs of financial activity in different locations, at the end of the day efficiency does differ among centres and regions, and these differences are central to determine performance. With this our bottom-line priority in our work underway at Lingnan University on Hong Kong and the financial centres of the region, let us only mention at this point some aggregate figures reported by The Banker in a recent assessment on relative bank efficiency by regions, using cost/income ratios as the measure. See Figure 3.

Figure 3
Average cost/income ratio by region
(2006)



Source: The Banker

The figures suggest that Japanese banks performed relatively badly in 2006 – the weakest of the country or region groupings they report, whereas Middle Eastern banks did rather well (as they did the previous year). Although broadly in line with average performance in other regions, non-Japan Asia did fairly well at least marginally, coming second overall.

Lastly, a footnote on two novel factors beginning to intensify competition in the banking sector, with the potential to increasingly affect relative performance by different locations. These are Internet banks, and financial activity by institutions whose parent companies are not part of the traditional banking sector, including supermarket banks, insurance companies, utilities companies, transportation companies and others. While any individual bank would probably always prefer that these competitors were not there, their effect on financial markets is not necessarily negative: this competition may take market share in some cases, but this can also be market creation rather than diversion, and banks can have new opportunities in the process. Table 14 provides some numbers on levels of activity and rates of growth of Internet banking:

Table 14
Number of online banking users by region

	Europe	**Asia**	**US**	**Other**	**Europe**	**Asia**	**US**	**Other**
	Penetration (in millions)				**Growth** (% y-o-y)			
2000	18.6	9.9	4.9	1.0	-	-	-	-
2001	28.0	14.7	10.9	1.7	50.5	48.5	122.4	70.0
2002	37.8	17.1	18.7	3.1	35.0	16.3	71.6	82.4
2003	47.7	20.4	29.4	5.1	26.2	19.3	57.2	64.5
2004	57.9	22.8	35.6	6.1	21.4	11.8	21.1	19.6

Source: Datamonitor

Growth of this business in different regions of the world has progressed unevenly, as IT developments have often done. The numbers speak of still quite a minority of banking customers, but are beginning to be considerable: already in excess of 100 million worldwide back in 2004, with rates of growth of 20 percent or so. Note also that penetration was from the beginning much greater in Europe than in the other two main market regions. Nevertheless, in the US it is catching up, while for some reason both the base and the growth rate are somewhat lower in Asia.

5 Foreign Exchange

The foreign exchange market is the world's largest financial market. Global average daily turnover in foreign exchange now stands at no less than US$3.2 trillion. This is around 11-12 the size of the combined daily turnover on all the world's equity markets, which in 2006 stood at around US$277 billion.[7] The volume of foreign exchange that is traded globally is around 40 times what the volume of international trade would warrant. This market is also extraordinarily *dynamic*: the foreign exchange traded globally increased by 71% (at current exchange rates) between 2004 and 2007.[8]

Foreign exchange markets are much larger, more liquid, and less regulated than all other financial markets. But at the same time the foreign exchange market is a leading and broad indicator of status as an IFC. Its volume of business depends on the presence of many banks, openness to international trade and having a large international business base generally.

Equally important is the policy environment: not only freedom of currency convertibility and capital mobility, but also broader market-friendly policies – as Singapore critically did forty years ago when, upon request, agreed to grant tax-exemption to non-residents' deposit income (which HK had refused on fiscal

[7] Own estimate based on World Federation of Exchanges information.
[8] April-to-April. BIS' Triennial Survey Preliminary Global Results, Sep 2007.

grounds. It thereby gained first-mover advantages in the new *Asiadollar* market and was well-placed to profit from petro-dollars following the 1973-4 oil crisis — and gave Singapore a particular edge on foreign exchange, which it has continued to retain and develop ever since.

Because of the lack of a central organizing body, the size and scope of the global foreign exchange markets are not known with exact precision. But the Bank for International Settlements (BIS) conducts a triennial survey of the foreign exchange markets — or more precisely it leads, designs and coordinates an enormous effort conducted in participating jurisdictions by their central banks and monetary authorities. The latest such survey was conducted in April 2007, with the participation of 54 countries or territories, and its preliminary results were announced in late September 2007. The results from these surveys are the acknowledged prime source of data and information on the matter.

Market Turnover. As mentioned above, the BIS 2007 Survey shows that there has been a huge increase in activity in foreign exchange markets in 2004-07, which at 71% even exceeds, but also compounds with, the also very large 57% global growth of the previous triennium, 2001-04.[9] This large increase in foreign exchange trading was probably fuelled by increased activity by investor groups, including hedge funds, whose intensive search for profit in and out of markets was encouraged by the recent low levels of financial volatility, which played well into their already low levels of risk aversion. These recent sharp increases more than reversed the substantial fall in global trading volumes that took place between 1998 and 2001.

Foreign exchange trading takes places through several different sub-markets. The so-called "traditional foreign exchange markets" consist of spot transactions,

[9] These figures refer to growth at current exchange rates and correspond to growth of 65% (2004-2007) and 36% (2001-2004) when volumes are measured at constant exchange rates.

outright forwards, and foreign exchange swaps. It is these that are reported in analyses and in the BIS data on the foreign exchange market. Foreign exchange is also traded embodied in derivatives, first and foremost foreign exchange options, which we will not be looking at in this paper.

As among the components of traditional foreign exchange market, the BIS data reveal that swaps were the strongest performers in this period, in contrast to the previous triennium when spot transactions and outright forwards were the stronger. We will also not look any further into these components of traditional foreign exchange market to concentrate on the trends and locational structure of the totals. Consider Table 12:

Table 15
Global foreign exchange market turnover
Daily averages, in April, in billions of US dollars

	at current exchange rates		**constant exchange rates [2]**	
	volume	**growth [1]**	**volume**	**growth [1]**
1989	590	-	675	-
1992	820	40	880	30
1995	1,190	45	1,150	31
1998	1,490	25	1,650	43
2001	1,200	(-20)	1,420	(-14)
2004	1,880	57	1,950	37
2007	3,210	71	3,210	65

[1] Percent, over the 3-year period. [2] April 2007 exchange rates Source: BIS

As much as the size and vitality of the sector, the geographical distribution of foreign exchange trading is of particular interest to us here: what that distribution looks like and how is it evolving.

Table 13 lists daily foreign exchange transacted in the largest markets and the region, including shares and ranks. Three points in time are shown: 1995 for comparisons with the market structure that existed prior to the Asian financial crisis; 2004 to assess the state of current growth in each market, and the present.

Table 16
Geographical distribution of foreign exchange market turnover
Daily averages, in April, in billions of US dollars, percentages, and ranks

	2007			2004			1995		
	rank	amount	share	rank	amount	share	rank	amount	share
UK	1	1,359	34.1	1	753	31.3	1	464	29.5
USA	2	644	16.6	2	461	19.2	2	244	15.5
Switzerland	3	242	6.1	8	79	3.3	6	87	5.5
Japan	4	238	6.0	3	199	8.3	3	161	10.3
Singapore	5	231	5.8	4	125	5.2	4	105	6.7
H. Kong	6	175	4.4	6	102	4.2	5	90	5.7
Australia	7	170	4.2	7	81	3.4	9	40	2.5
France	8	120	3.0	9	64	2.7	8	58	3.7
Germany	9	99	2.5	5	118	4.9	7	76	4.8
Korea	17	33	0.8	15	20	0.8	-	4[1]	0.2[1]

Source: BIS. [1] April 1998.

Interesting changes can be seen first of all among the market leaders at the top of the table: numbers 1 and 2 remain the same – UK and US – throughout the period. Nevertheless the UK has consistently been gaining market share all along, in fact quite considerably so, and it now represents more than one third of the world total. Its *growth* in these three years exceeds the entire size of the German market share, despite the latter being a much larger economy, a major trading power, and boasting the seat of the European Central Bank — whose currency the Euro is exchanged in greater volumes in London *than in all Euro-zone countries combined.* The second place, the US, having also increased its market share sharply between 1995 and 2004, showed a considerable decline of almost three points in the last triennium.

On its part, Japan showed a healthy growth in business since the last survey, of 20% over the period. This, however, was not enough to fend off the challenge from Switzerland, which more than trebled its volume transacted to jump five places to number 3 in the listings. Switzerland's spectacular performance in this period begs an explanation which we do not have. We can only note that the Swiss public release of the results of the survey mentions that "This development is also due to trading desks for spot transactions having been shifted to Switzerland."[10] Whatever the cause for such relocation may have been, attracting it is what building up a world class financial centre is al about.

With Japan, also Singapore and Hong Kong were overtaken by Switzerland. But in fact their growth in business was very strong in the triennium: 85% and 72% respectively, both of them increasing global market share in the process: Singapore by a fair 0.6% of the world market and Hong Kong gaining an additional 0.2%. *But all three East Asian main players remain at well below the market shares they had in 1995, which placed them as participants numbers 3, 4 and 5 in this sector at that time.*

[10] "Turnover in foreign exchange and derivatives markets in Switzerland – 2007 Survey" (p. 2). Swiss National Bank, http://www.snb.ch/en/iabout/stat/statpub/umdev/id/statpub_umdev_hist

In search of explanations for relative market shares, one factor to be looked at is the extent to which there is a link between the currencies that are transacted and the venue where this is done. The link is not tight: we referred above to the Euros' trading taking place more in London than in Euroland. Surely the same applies to the

Table 17
Currency distribution of foreign exchange market turnover

Currency	1992	1995	1998	2001	2004	2007
US dollar	82.0	83.3	87.3	90.3	88.7	86.3
Euro	-	-	-	37.6	37.2	37.0
Japan Yen	23.4	24.1	20.2	22.7	20.3	16.5
UK Pound	13.6	9.4	11.0	13.2	16.9	15.0
Swiss Franc	8.4	7.3	7.1	6.1	6.1	6.8
Australian $	2.5	2.7	3.1	4.2	5.5	6.7
Canadian $	3.3	3.4	3.6	4.5	4.2	4.2
Swedish krona	1.3	0.6	0.4	2.6	2.3	2.8
Hong Kong $	1.1	0.9	1.3	2.3	1.9	2.8
Norwegian krone	0.3	0.2	0.4	1.5	1.5	2.2
New Zealand $	0.2	0.2	0.3	0.6	1.0	1.9
Mexican peso	-	-	0.6	0.9	1.1	1.3
Singapore $	0.3	0.3	1.2	1.1	1.0	1.2
Korean won	-	-	0.2	0.8	1.2	1.1

1 %shares in daily trades, April. Shares add to 200%: two currencies in each trade,. Source: BIS

US dollar: very strong as US participation is in foreign exchange **transactions**, with close to 17% of the global total last April, this is nowhere the participation in such transactions of the US dollar itself, which is involved in a massive 86.3% of all transactions at present. One might wonder whether this connection that is not true for the leading venues and currencies, might be truer for others.

Table 14 presents the numbers for a range of currencies, to help us better shed light on the point at hand. Not many surprises from this table, nor significant changes over time. Two main observations seem to arise. One, one notes the loss in the share of the third most important currency in the last three years, the yen, after having held its level through much of the period covered. This loss, however, is pure measurement, as it is likely to reflect the downward movement of the yen in this period and not a fall in volume of use.

Second, and this is the main lesson one draws from this table from the perspective of this paper, is to note the very weak relationship that seems to exist between the use of currencies and the location of financial activity. Important as it is as a currency, sterling is numerically not the star that London is among venues. Similarly, Hong Kong and Singapore have greater shares of trade in foreign exchange than their currencies do. Interestingly, Korea shows the opposite relation in the numbers. Finally, one notes the sharp ascent of the Australian dollar over the period, more than doubling the market share of its currency – in this case whilst also increasing its participation as a location for currency trading.

6 Bonds markets

East Asia’s financial structure has traditionally been unique among major areas of the world in its significantly lower reliance on bond rather than other forms of government and particularly corporate finance. This picture is changing, however, perhaps more than is commonly recognized. Bond finance has been growing very significantly throughout the region and now has broadly comparable levels of operation relative to GDP compared to other regions of the world – which does not deny that the sector cannot still develop and grow considerably as we will argue below. But first things first: is the sector weak in the region?

While Bank financing has long been the pillar of Asian financial systems, the 1997-98 financial crisis in Asia prompted considerable reconsideration of the role of bond markets in the region's economic progress, which had historically and until recently continued to be inadequate. It was recognized and we should stress that *bonds are important.* They are not merely one additional source of financial intermediation and funding – which they are, and a rich one – but have a critically important role to play in the overall financial architecture of a modern and complex economy. Well-developed bond markets provide participants with useful information on interest rates[11]; allow better risk management[12]; lowers funding costs; and introduce enhanced competition to the banking sector.

But the fact of the matter is that East Asia's present level of overall (public and private) funding from bonds is no longer unusually low. Please refer to Table 18 below, which contains data for 2005.

We notice that it is Japan and not the US or a European country that has, by a wide margin, the largest bond market as a share of GDP in the full list, which includes 26 industrial, emerging and East Asian economies. With the only exception of the US at number 2, Japan's bond ratio is over twice as large as any other country's. But not only Japan has a large bond sector in the region: Korea, Malaysia and Singapore have higher total bond ratios than do all non-Asian emerging markets on the table, and the first too of them are among the leaders more generally.

[11] The bond market produces a yield curve, a market-determined term structure of interest rates, which serves as a benchmark for pricing bank loans, credit risk, and equity shares.
[12] Barry Eichengreen (2004, p.12) has put it very effectively: "...equity finance encourages risk taking, since holders of equity stakes share in super-normal returns whereas their losses are truncated on the down side, while debt holders, who do not share in exceptional profits, encourage risk aversion."

Table 18
Bonds Outstanding as a Share of GDP
Selected countries, 2005

	Bond Market Capitalization / GDP		
	Private [1]	**Public**	**Total: Public + Private**
1. China	10.4	15.2	**25.2**
2. H. Kong, China	17.8	9.1	**26.9**
3. Indonesia	2.4	16.6	**19.0**
4. Japan	42.4	150.2	**192.6**
5. Korea, Rep.	52.8	25.3	**78.1**
6. Malaysia	52.2	38.2	**90.4**
7. Philippines	0.3	38.4	**38.7**
8. Singapore	18.8	39.2	**58.0**
9. Thailand	20.2	21.1	**41.3**
10. Australia	39.3	12.6	51.9
11. Canada	18.7	51.3	70.0
12. France	41.4	53.8	95.2
13. Germany	34.1	41.0	75.1
14. N. Zealand	-	22.2	22.2
15. Spain	42.0	38.9	80.9
16. Sweden	42.8	42.2	85.0
17. Switzerland	32.3	32.3	64.6
18. UK	15.9	31.1	47.0
19. US	111.8	46.3	158.1
20. Brazil	12.0	44.6	56.6
21. Chile	19.9	17.2	37.1
22. Mexico	4.8	22.1	26.9
23. Czech Republic	5.9	46.1	52.0
24. India	1.0	32.9	33.9
25. South Africa	10.8	31.3	42.1
26. Turkey	-	49.1	49.1

[1] Financial institutions and corporations

Source: Beck et al (2000) database, from BIS, World Bank and IMF

We will presently se some numbers on past evolution, which will confirm the impressions we are bring out. But let us first stay with the present position of bond finance in different countries and regions and ask how does it compare relative to bank and equity finance. Even if East Asian bond finance has reached similar levels to those in other regions relative to GDP, has it also reached some balance with equities and bank lending, sectors that are so highly developed particularly in the more advanced countries in East Asia? See Table 19:

Table 19
Relative composition of finance: bank lending, equities and bonds
Selected East Asian and other countries, 2005

	1 Private Bank Credit/GDP	**2 Stock Market Capitalization / GDP**	**3 Bond Market Capitalization [2] / GDP**	**4 Share of Bonds in total = 3/(1+2+3)**
Hong Kong	141.9	528.1	26.9	3.7
Japan	98.0	93.8	192.6	50.1
Korea	89.1 [3]	72.9	78.1	32.5
Malaysia	103.0	143.6	90.4	26.8
Singapore	96.5	163.4	58.0	18.2
Australia	101.8	113.5	51.9	19.4
France	90.4	85.2	95.2	35.2
Sweden	106.3	110.9	85.0	28.1
Switzerland	161.6	242.4	64.6	13.8
UK	155.4	134.7	47.0	13.9
US	46.1	134.6	158.1	46.7
Czech Rep.	33.1	28.4	52.0	45.8
Brazil	29.0	50.8	56.6	41.5
Mexico	145.9	26.8	27.7	13.8
S. Africa	80.1	213.5	42.1	12.5

[1] Financial institutions and corporations [2] Private + Public [3] 2004
Source: Beck et al (2000) database, from BIS, World Bank and IMF

We observe that also in terms of shares of bonds in overall finance the East Asian countries' numbers are comparable to those in other regions. With one striking exception which is Hong Kong. If we first look at Hong Kong's entry in column 1, we notice that its bank credit relative to GDP is one of the largest on the table, behind only the UK and Mexico and close to both. But even with such large numbers for banking, that sector is not even close to dominating the scene as far as financing in Hong Kong is concerned: the real giant is in column 2, its stock market, which is very large in absolute terms and more so relative to the size of the Hong Kong economy. The territory's market capitalization as a share of GDP is thus several *times* higher than the next places on the table.

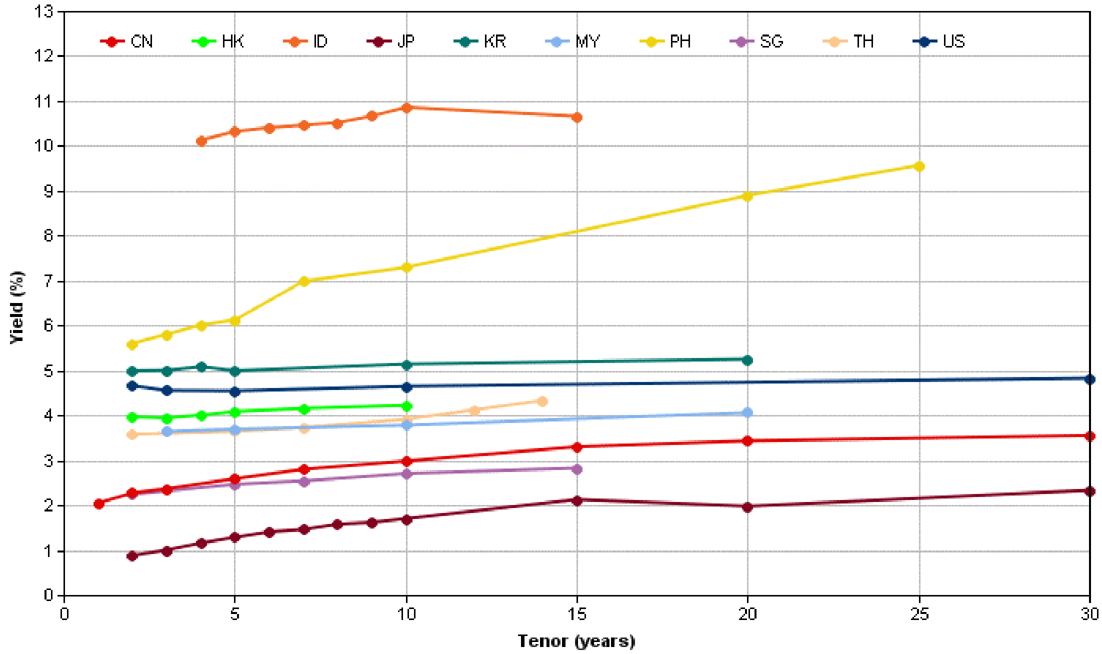
Nevertheless it must be recognized that Hong Kong's relative smallness in bonds relative to equities and lending is not only due to the bigness of these, but to the fact that the bond market has not taken off in earnest in the territory. One reason for this is evident from Table 18: the only single-digit entry for public bond issues in the whole list is Hong Kong's. This in turn deprives the territory of the strong catalytic effects that large volumes of sovereign bond issuance have in Singapore or indeed the US. Such issues provide a basic volume of activity and momentum to their respective markets, and they in addition help set the pricing too. Nevertheless, what the figures in Table 19 say is that Honk Kong has the depth of liquidity, the market talent and expertise, and the banking and financial infrastructure needed to handle a much greater volume of prime bond issues and trading than it has attracted to date.

Let us briefly turn our attention to the evolution of the bond business over the last decade. Table 20 shows very clearly how much the situation has changed in those ten years throughout the region: with the only exception of Malaysia, which by 1995 already had a higher bond/GDP ratio than the rest of the region (but still grew by a further 40% over GDP in the next decade), all the other East Asian economies on the list roughly doubled up their bond debt outstanding relative to GDP.

Table 20 **Bond finance 1995-2005: shares in GDP** Totals outstanding: Public, Corporate and Financial				
	1995	**2000**	**2005**	**% Growth (‘05 on ’95)**
Hong Kong	14.1	25.4	27.0	91
Japan	86.8	124.2	192.5	121
Korea, Rep.	40.0	52.6	78.1	95
Malaysia	65.6	78.4	90.4	38
Singapore	25.5	43.0	58.1	128
Australia	48.4	49.3	51.9	7
France	66.2	80.7	84.8	28
Sweden	100.9	91.5	84.0	(-17)
Switzerland	66.7	65.9	64.6	(-3)
UK	47.0	50.7	47.0	0
US	138.9	145.1	158.1	14
Czech Rep.	15.0	42.5	52.0	3.5
Brazil	28.8	49.5	56.5	96
Mexico	12.2	13.4	26.9	120
South Africa	64.8	47.9	42.1	(-35)

Despite the region’s growth in bond finance in recent years, with the exception of Japan’s the region’s bond markets are young and not very deep. One problem in particular is the fact that yield curves in some cases are short, certainly shorter than in mature markets, situation that notably affects Hong Kong whose bond market is extends only to 10 years: see Figure 4, showing yield curves for all countries in the region plus the US. Hong Kong’s lack of depth arises because of its heavy reliance on short-term bank deals and absence of longer sovereign issues to benchmark. Singapore’s bond market yield curve is longer, extending to 15 years, led by the issuance of longer-term government bonds, while China’s and Japan’s yield curves are long, extending to 30 years.

Figure 4
Benchmark yield curves – LCY bonds
(2006)



Source: Reuters

7 Concluding remarks

International financial centres (IFCs) is a topic of considerable interest throughout East Asia, and rightly so given the size of the stakes and the fluid nature of the industry. The region's phenomenal and sustained economic growth and its long tradition of financial excellence seem to have convinced many people that its leading financial centres can only move forward towards the top of the global leagues—the question being only which one will get there first and how fast. The well publicized announcement a few months ago by a major London report[13] that Hong Kong and Singapore are the undisputed occupants of places numbers three and four in the highest firmament of IFCs only reinforced, in Hong Kong and I am sure the same happened in Singapore, the perception that ultimate success is at hand if not inevitable: graduation into the top elite of world finance. The reality is complex, however, and the real challenge might be different from what many believe it is.

[13] City of London (2007).

As I noted at the outset of this paper the locational structure of financial industry in Asia is unusual. The rest of the world is used to having dominant players in London and New York, but neither Tokyo nor Singapore or Hong Kong meet that description, nor is Shanghai likely to get there, despite its formidable ascent which has yet to play itself out in full.

I happen to believe that the delivery of financial service exhibits strong economies of scale in many ways. Once a successful operation gets established, with a strong leadership and headquarters and an efficient back office, the sky is the limit. In addition, finance is all about trust, and clients and associates prefer to feel that they are dealing with the strongest and the best. Scale is appreciated. All this speaks of continuing concentration, among banks and operators but also among locations where business is done. In that light, how is the locational structure of financial industry to unfold in East Asia?

One conclusion I do draw from the above reasoning is that East Asia's present distribution of business may be unsustainable in the long run: the premium for further consolidation will be high. With China and the East moving from their present status as a very important economic area of the world, to their future as first-tier power houses, the business case for such consolidation is likely to become irresistible. But, does that need to take the form of consolidation within those present, with Hong Kong, Tokyo or Singapore taking the global mantle? Not necessarily. This would mean one of them actually beating London and New York and not only its regional peers at the hottest game to come: namely, to take pride of place as the *financial centre for the core global needs of this region.*

The leading banks are all headquartered in London and New York, and it is they who are benefiting the most from the relentless concentration taking place in world finance. We saw above that in area after area and indicator after indicator, Asia's position of strength in the spectrum of financial centres is relative, and most often not growing in relation to the dominant world players. And if this is the trend at present I see no basis to confidently predict it to change in future but perhaps rather the contrary. Business is increasingly global and anonymous, not needing physical proximity for its conduct. The staggering increase in the last three years in FOREX trade that we discussed in the paper, to its present US$3.2 trillion per day, seems to have been caused in significant measure by the expansion of *algorithmic investments* by hedge funds and other institutional investors. Internet banking too is taking off. With all these qualitative changes in the way financial business is done it could well happen that the lions' share of global business with this geographical area is increasingly done by global giants from headquarters elsewhere.

My point in all this speculation is to stress that that the common question of who in East Asia will be the next global financial leader is one that I increasingly do not ask myself. In my view, the key concern should be with the real possibility that all the centres in the region end up relative losers in the long run, assured of a fair amount of regional and local business but not the lion's share of future exponential growth.

Of course, the scenario just described is the *bearish* one for the issues at hand. The more common *bullish* possibility is also real: that one or other of the leading regional financial centres will gradually grow into an equal of today's two global giants, across the board or in selective sectors of finance. In any case, the region can be assured of a large fraction of its own financial business, as the well-known "time difference" factor demands a full array of financial service providers to be located in East Asia itself, as does the "local knowledge" factor—local and regional providers of finance will always have an advantage when it comes to the needs of medium size business and local markets. But none of this speaks for the bulk of mega-business in future global markets, which can perhaps increasingly be located in only the fittest and the best, wherever these may be located.

For this reason the topic of this conference seems to me extremely appropriate and timely. It is incumbent on the financial centres of East Asia, and on us their observers, to identify ways of making business in the region better and stronger: to identify ways to collectively survive and win.

With proper cooperation and aggressive betterment of the business infrastructure in East Asia, the region's FCs can create a superbly nimble and effective network that can operate as the most efficient of IFCs—***a global network-IFC***. For the same reason that I find it perfectly possible to service much of the higher-end financial needs of the region from London or New York, as I expressed in my bearish remarks above, I see it equally feasible to do that servicing from a network of locations in Asia, constituted as a collective mega-IFC. This probably requires an aggressive and wise mixture of **competition and cooperation** among the region's FCs: competition as at present, because that is the mother of enhanced creativity and efficiency, and cooperation to bring markets and pull scale together wherever possible, thus increasingly becoming a magnet that can match the power of the global leaders.

What would that cooperation need to be, to ensure the region does not lose out in future waves of consolidation? An excellent instance of cooperation that has delivered very good results actually on the ground has been the region's Asia Bond Initiative that created the Asia Bond Fund, which I am pleased to note Hong Kong was very involved in. Joint development of the regional bond market is a natural area for cooperation, and schemes to further enlarge the scale and impact of these initiatives would be highly desirable. A second excellent area of potential cooperation would be among stock exchanges in the region, with dual listings and other forms of cooperation. Shanghai and Hong Kong have been showing the way here and there is no reason the same could not happen in a deliberate and systematic way across national borders too. The striking recent marriage between NYSE and Euronext should serve as inspiration for the bold and powerful steps that the challenges ahead require.

But my main recommendation for cooperation is broader: to effectively create an ***East Asian financial area*** through coordination and regulatory harmonization – *a common integrated space for financial operators in the region*. This could include:

i. Throughout financial industry, moving aggressively towards the regional development and adoption of **common codes and standards;**
ii. Creating a working group among financial industry participants and regulators to identify the core elements and main stumbling blocks towards the establishment of **common regulatory frameworks**;
iii. Making it a priority to negotiate effectively and speedily the fullest **freedom of financial business establishment** throughout the region, in particular among (and starting with) its major centres; and,
iv. Establishing the fullest operational and technical **cooperation framework among supervisors.**

Such a scheme of cooperation would effectively create a single economic space in the region for matters of financial industry. The region's operators, whether domestic or "guest", would gain profitability through larger scale and avoidance of duplication. This means adding together the separate strengths of the region's financial centres, in a context that *might* otherwise be evolving towards the increasing development of the top tier of global business elsewhere.

With *cooperation* firmly in place to expand scope within the region, yet in a relationship of vigorous *competition* among its centres to maximize incentives and creativity, East Asia's financial industry would gradually reorganize itself into complementary, specialized and efficient niches in different locations. *Collectively* they would have, sector by sector, a leading global role — effectively adding to a global financial centre based not in a city but in a region and network, spread out as much as the region is vast. Present individual power-houses big and small would all have a place in this more cohesive whole, as activities go to places in pursuit of the human and locational resources that those have to offer.

References

Asian Development Bank, 2007. *Asian bonds online,* from
http://asianbondsonline.adb.org/administrative/abm_overview.php

Bank for International Settlements (BIS), September 2007, *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2007,* Preliminary Global Results. http://www.bis.org/publ/rpfx07.htm

BIS, September 07, *Locational Banking Statistics*.
http://www.bis.org/statistics/bankstats.htm

Bareau, Paul, "The International Money and Capital Markets", in Roberts, Richard, *International Financial Centres*, vol II, pp. 26-42.

Barth, James R., Gerard Caprio, Jr. and Ross Levine, 2004, "Bank supervision and regulation: what works best?" Journal of Financial Intermediation 13, 205-248.

Barth, James R., Gerard Caprio, Jr. and Ross Levine, 2006, *Rethinking Bank Regulation: Till Angels Govern*, New York: Cambridge University Press.

Beck, Thorsten, Asli Demirgüç-Kunt and Ross Levine, 2000, "A New Database on Financial Development and Structure", World Bank Economic Review 14, 597-605.

City of New York with McKinsey and Co., 2007, *Sustaining New York's and the US' Global Financial Services Leadership,* New York, N.Y.

Corporation of London, 2005, *The Competitive Position of London as a Global Financial Centre*, London: Z/Yen Limited, 2005.

City of London, 2007, *The Global Financial Centres Index 1,* London: Z/Yen Limited, 2007.

Eichengreen, Barry, 2004, *Financial Development in Asia: The Way Forward,* Singapore: Institute of Southeast Asian Studies.

International Financial Services (IFSL) , March 2006, *Banking*, London.
http://www.ifsl.org.uk/uploads/CBS_Banking_2006.pdf

International Financial Services (IFSL) , October 2007, *Financial Market Trends Europe vs. US 2007,* London.
http://www.ifsl.org.uk/uploads/RP_Europe_vs_US_2007.pdf

Jao, Y.C., “Hong Kong and Shanghai as International Financial Centres: Historical Perspectives and Contemporary Analysis”, Working Paper, University of Hong Kong, 2003.

Jiang, G., Tang, N., & Law, E. (2001). “The Costs and Benefits of Developing Debt Markets: Hong Kong's Experience” (BIS Papers No. 11) from http://www.bis.org/publ/bppdf/bispap11h.pdf

Jones, Geoffrey, 1992, “International Financial Centres in Asia, The Middle East and Australia: a Historical Perspective”, in Roberts, Richard, *International Financial Centres*, vol I, 301-24.

Lamberte, Mario B., 2003, “Developing the Fledgling Debt Securities Markets in Southeast Asia”, in Freeman, Nick J., *Financing Southeast Asia’s Economic Development*, Singapore: Institute of Southeast Asian Studies.

Plender, John, “London’s Big Bang in International Context”, ibid., pp. 87-96.

Robbins, Sidney M., and Nestor E. Terleckyj, “The Rise of New York as a Money Market”, in Roberts, Richard, *International Financial Centres*, vol II, pp. 137-162.

Roberts, Richard (ed) , 1994, *International Financial Centres*, Vols. I to IV, Aldershot: Edward Elgar Publishing Ltd.

Sagaram, J. P. A., & Wickramanayake, J. (2005). “Financial centres in the Asia-Pacific region: an empirical study on Australia”, Hong Kong, Japan and Singapore. *Banca Nazionale del Lavoro Quarterly Review, 58*(232), 21-51, from ProQuest database.

Weithers, Tim, 2006, *Foreign Exchange: A Practical Guide to the Fx Markets*, John Wiley & Sons.

Wright, C., Haddock, F., & Lee, J. (2001). Three local markets compared. [Electronic version]. *Asiamoney, 12*(5), 29-32, from EBSCOhost database.