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Changes of Tokyo Financial Market:

From a Perspective of a Global Financial Center

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At the end of the 1980s, Tokyo was one of the three largest global financial centers on a par with London and New York. Now it is said to have stepped back to the third in Asia. During the past three decades, many initiatives had been successively compiled to enhance the status of Tokyo as a global financial center realizing some improvements in individual financial markets and products. However, these improvements were just a necessary condition for an improved status, but not a sufficient condition for it. In this regard, the initiatives recently published by the Tokyo Metropolitan Government (TMG) may be expected to satisfy the sufficient conditions that have been still left over.

The Past Initiatives for a Global Financial Center

The Initiative on Global Financial City: Tokyo that the TMG announced on November 10, 2017, was a compilation of measures aiming to revitalize Tokyo as a financial center. Looking back, there were various initiatives with the same objectives proposed since the middle of the 1980s to date,

In this article, the author would like to review how those initiatives contributed to the improvement of the Tokyo financial market, and how the position as a global financial center has changed.

Bubbles Pushed up Tokyo to One of the Three Largest Centers

It was the report of the US Japan Yen Dollar Committee released in May 1984 that triggered to push up Tokyo to an international financial center. The report listed up the measures for Japan to take toward financial liberalization and internationalization of the yen. They included among others (i) liberalization of interest rates on deposits, (ii) liberalization of euro-yen market, (iii) permission of entry of foreign banks into trust business, (iv) permission of dealing of the Japanese government bonds by foreign banks located in Japan. In response to this report, liberalization and internationalization of the Japanese financial and capital market gained momentum at once. The entry of foreign financial institutions into the Tokyo market was encouraged, and soon Tokyo came to be regarded as one of the global financial centers[1].

As more and more foreign financial institutions gathered to Tokyo, it emerged as an agenda how to enhance Tokyo's functions as a global financial center. The initial target was to make Tokyo one of the three largest global financial centers (hereafter referred to as three largest centers) in the world rivaling London and New York, and it was perceived that the target had been already achieved at the end of the 1980s when the Japanese bubble economy peaked. Specifically, the market capitalization at the Tokyo Stock Exchange and daily turnovers of foreign exchange transactions, that had gathered much attention, became the largest in the world for the former, overtaking New York in 1987 and the following few years, and almost caught up at $110.8 billion with New York's $115.2 billion for the latter, although it fell short of London's $184 billion.

In the panel discussion at the financial study group held in June 1989 by the Institute for Monetary and Economic Studies, Bank of Japan, the ways to further raise the status of Tokyo were debated based on the common perception that Tokyo had already been one of the three largest centers. The specific measures proposed included an improvement of the government short-term finance bill (FB) market, lowering the cost of bond issuing, permission of floating rate notes and zero-coupon bonds, establishment of a central securities depository, international harmonization of taxation, and introduction of futures and options markets.

Dropout of the Tokyo Market and Its Efforts to Come Back in the 1990s

In the 1990s, mainly due to the burst of bubbles, the market capitalization and trading values of stocks and foreign exchange turnovers largely decreased to lag behind London and New York, and it became a general view that Tokyo dropped out of the three largest centers.

The Japan's Big Bang initiative, which was proposed by the Second Hashimoto Administration in 1996, aimed at restoration of Tokyo market by 2001 again as a global financial market comparable to the London and New York markets, focusing on the three

[1] Naito Kunio and Midorikawa Kazuo: "International Financial City: Future of Tokyo" TOYO KEIZAI, INC,1987

principles of free (free market that market principles function well), fair (transparent and fair market), and global (market that is globalized and goes ahead of the times). Specifically it proposed (i) promotion of mutual entering among banks, securities houses, and insurance companies, (ii) removal of financial product regulation that separated them into long-term products and short-term products, (iii) liberalization of fees and charges, and (iv) liberalization of foreign exchange transactions (abolishment of involvement requirement[2] of authorized foreign exchange banks).

Competition with Hong Kong and Singapore

The measures of Japan's Big Bang initiative were implemented in sequence. Nonetheless, it became more obvious in the 2000s that it was not easy for the Tokyo market to catch up with the London and New York markets as a global financial center. Then a new objective that aimed at securing a central position of a global financial center in Asia was introduced. It was Hong Kong and Singapore that were targeted as rival.

Looking into the "Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets", published by the Financial Services Agency in December 2007 based on the "Asian Gateway Initiative" of the first Abe Administration, Japan (the Tokyo market) was positioned to be a financial market with various characteristics different from those in London and New York and it was viewed as an important challenge to build a "cross-border market that was most attractive to the Asian customers". For that purpose, such measures were proposed as diversification of exchange traded funds (ETF) and Japan's Real Estate Investment Trust (J-REIT), revitalization of transactions limited to professionals (introduction of TOKYO PRO-Bond Market), introduction of real time gross settlements (RTGS) in fund settlements, straight through processing of bonds clearing, and expansion of repo market.

The Third Market in Asia

As stated above, since the middle of the 1980s, many improvements of system and regulations had been proposed on individual financial markets and financial products almost in every decade, and many of them had been steadily implemented. As far as the improvement of the institutional systems is concerned, it can be evaluated that the globalization of the Tokyo financial market has been achieved almost fully.

Nevertheless, it is often said that the status of the Tokyo market in comparison with other cities has fallen to "the third among the Asian markets" from "one of the three largest centers" at the end of the 1980s.

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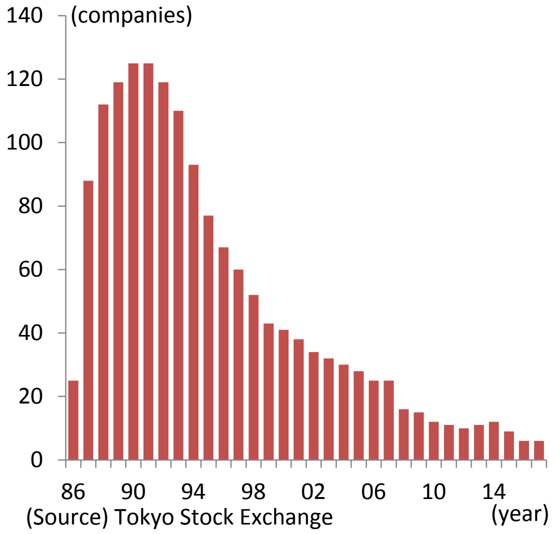
[2] Policy required that the foreign exchange transactions should be made with authorized foreign exchange banks as one of the parties.

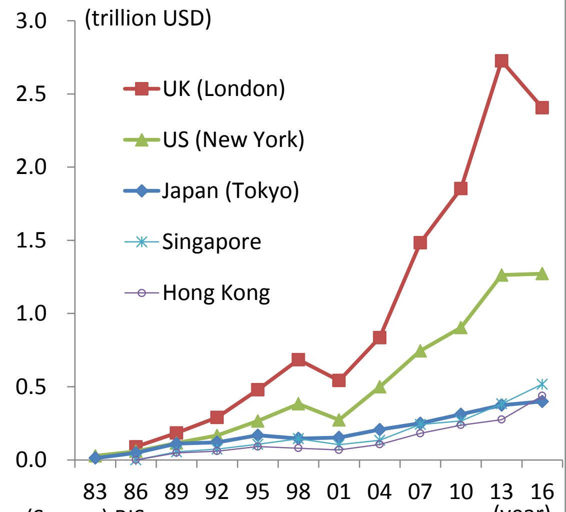
The fall of the status of the Tokyo market is most clearly seen in the number of foreign companies listed on the Tokyo Stock Exchange. The number exceeded 120 at a peak time at the start of the 1990s, but dropped to just 6 most recently (Figure 1). On the other hand, the New York market embraces 873 companies, London 271, Hong Kong 101 and Singapore 278[3]. Also in the area of foreign exchange transactions, the gap in the daily turnovers has been constantly widening since the 1990s between the London and New York markets and the Tokyo market and in 2016 the Tokyo market was overtaken even by the Hong Kong and Singapore markets (Figure 2).

Figure 1: Number of foreign companies listed on Tokyo Stock Exchange



(Source) Tokyo Stock Exchange

Figure 2: Daily turnovers of foreign exchange transactions



(Source) BIS

Of course those mentioned above are only a few aspects of functions to be performed in the global financial centers. However, according to the Global Financial Center Index (released by the UK think tank Z/Yen Group) which surveys such many aspects as business environment, human resources, infrastructures to compile the competitiveness of the individual cities, the top four ranks have constantly been occupied by London, New York, Hong Kong and Singapore. Tokyo rose to the fifth once in 2010, but afterwards it continues to stay at the fifth or sixth (the third in Asia) (Table 1).

3 For New York, total of NYSE Group and Nasdaq (as of the end 2016), for London, LSE Main Market (as of November 2017) , for Hong Kong and Singapore as of the end 2016.

Table 1: Ranks of Global Financial Center Index

	Mar. 2007	Mar. 2010	Mar. 2013	Mar. 2016	Sep. 2017
1st	London	London	London	London	London
2nd	New York	New York (tied for 1st)	New York	New York	New York
3rd	Hong Kong	Hong Kong	Hong Kong	Hong Kong	Hong Kong
4th	Singapore	Singapore	Singapore	Singapore	Singapore
5th	Zurich	**Tokyo**	Zurich	**Tokyo**	**Tokyo**
6th	Frankfurt	Chicago	**Tokyo**	Zurich	Shanghai
	(9th Tokyo)				

(Source) Z/Yen Group

Strengths of the Top Four Cities

It seems to be very hard for the Tokyo market to catch up with the top four cities just with the past measures and efforts. Then what will be the strengths of these cities? According to the previous studies[4], London has strength in (i) abundant human resources, (ii) user-friendly regulatory environment, and (iii) openness of the financial market. New York is strong in (i) well-developed investment banking business, (ii) human resources with high level of education backed by the business schools in the U.S. As for Hong Kong, (i) good location to access to China, (ii) fewer regulations, and (iii) high proficiency in English are pointed out and for Singapore, (i) user-friendly regulatory environment, (ii) low tax rates, and (iii) high proficiency in English are highlighted.

These strengths suggest that the remaining challenges for the Tokyo market will be in such areas as abundant human resources, user-friendly regulatory environment and high proficiency in English. It may be understood that the improvement of institutions and systems of financial market and products that were promoted in the past three decades was just a necessary condition, but not a sufficient condition, for an improved status of the Tokyo market as a global financial center.

Towards Asian Number One

Based on the above, the current “Initiative on Global Financial City: Tokyo” seems to be a very pertinent one. The Initiative first of all proposes the strengthening of assistance in English

4 Edited by Tanaka, Shosuke, and compiled by Mitsubishi Research Institute, Inc. “Strategies for Tokyo Financial Center: Beyond the Invisible Regulations”, The NIKKEI, 2008 and Akabane, Hiroshi: “Comparison of Cities for International Financial Center”, a Report presented at the 73rd Annual Meeting of The Japan Society of International Economics (October 2014)

for administrative procedures related to financial matters. This will meet the above-mentioned challenges of "user-friendly regulatory environment" and "high proficiency in English." Also the initiative aims at improving the living environment for foreign financial professionals and fostering the highly skilled financial professionals, which will contribute to create "abundant human resources." It is also one of the features of the current initiative that it has given an importance to attracting and fostering new players of the market (asset management companies and FinTech companies) instead of referring to the improvement of institutional arrangements for financial market and products that have been already sufficiently promoted.

It may be only by this occasion that the Tokyo financial market can be expected to shine again as Number One in Asia, by satisfying the remaining sufficient conditions with the new initiative.

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