



## What Makes A Successful Global Financial Centre?

### What Makes A Successful Global Financial Centre?

transcript of a talk by  
**Professor Michael Mainelli, Executive Chairman, Z/Yen Group**  
at  
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[SLIDE: OUTLINE]

**Outline**

- ◆ Financial centres
- ◆ Global or local
- ◆ Analysis
- ◆ Conclusions

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[Source: [http://www2.chinadaily.com.cn/bizchina/2009-08/14/content\\_8571581.htm](http://www2.chinadaily.com.cn/bizchina/2009-08/14/content_8571581.htm)]

"Get a detailed grip on the big picture."  
*Chao Kli Ning*

Good afternoon Ladies and Gentlemen, and welcome to Gresham College's Eastern Campus here over 30 stories above the Docklands. Today we explore the rise and fall of global financial centres. As Gresham regulars know, it wouldn't be a Commerce lecture without a commercial. There are several forthcoming Gresham events on the rise and fall of finance, including tomorrow's London Accord conference at the Museum of London, and a special conference on Long Finance next year on 1 February 2010.

An aside to Securities and Investment Institute, Association of Chartered Certified Accountants and other Continuing Professional Development attendees, please be sure to see Geoff or Dawn at the end of the lecture to record your CPD points or obtain a Certificate of Attendance from Gresham College.

Well, as we say in Commerce – "To Business".

London and New York City vie with Hong Kong or Singapore or Zurich for today's top spots. Is financial centre competition a zero-sum game or can everybody win?

[SLIDE: OZYMANDIAS IS EPHEMERAL]



### Ozymandias Is Ephemeral



#### Ozymandias Lives

Well it's clear that centres win and lose. This colossal bust of Ramesses II, the 'Younger Memnon' (1250 BC), in the British Museum is presumed to have inspired Shelley's 1818 poem "Ozymandias" –

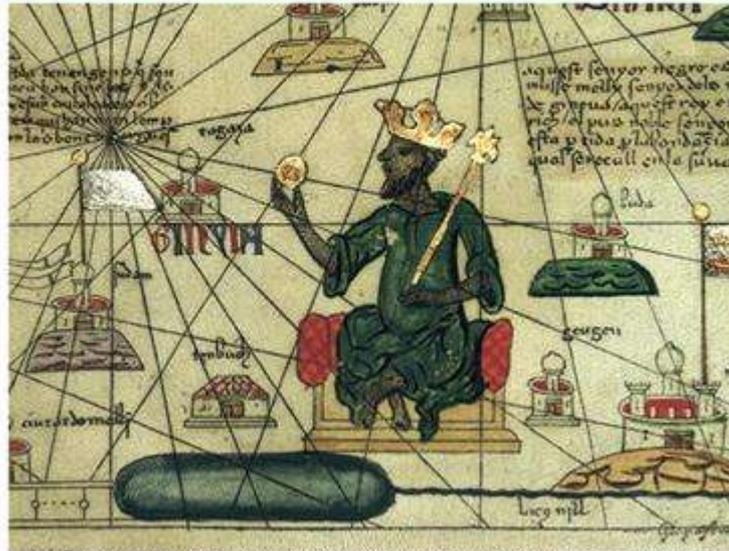
“My name is Ozymandias, king of kings:  
Look on my works, ye Mighty, and despair!”  
Nothing beside remains. Round the decay  
Of that colossal wreck, boundless and bare,  
The lone and level sands stretch far away”

Not far from Egypt, well not far from a London perspective, lies Timbuktu. Timbuktu, a fabled city on the Niger now in the modern west African country of Mali, was an important centre for the gold, salt, cotton and slave trades from the 10<sup>th</sup> to the 17<sup>th</sup> centuries. We have tales from Ibn Battuta in the 1300's and Leo Africanus in the 1500's celebrating its success and praising it as a centre of learning, of universities, of libraries.

[SLIDE: OZYMANDIAS IS ETERNAL]



## Ozymandias Is Eternal



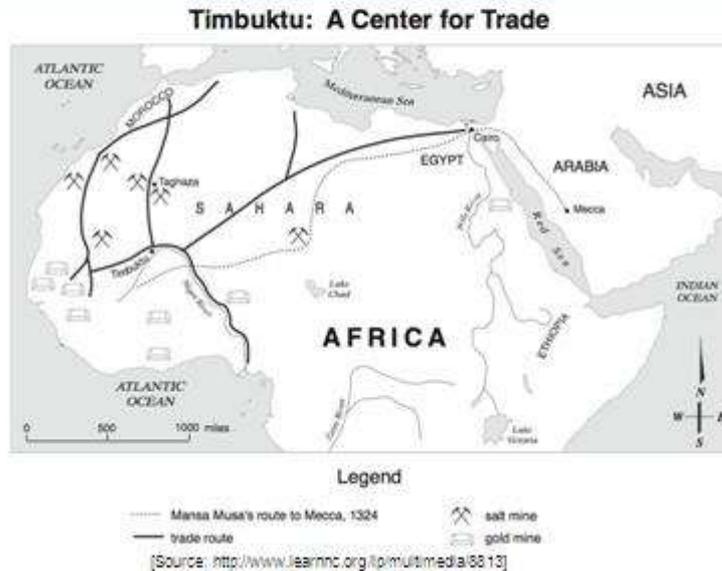
[1375 Catalan Atlas of the known world (mapamundi), drawn by Abraham Cresques of Mallorca]

“Tin” or “tain” is Tuareg for a water well. According to popular etymology, an old Malian woman, Buktu, lived by a well and was known for her honesty. Travellers, including the Tuareg would entrust Buktu with possessions when they were on the road and the location became known as Tin Buktu, meaning Buktu’s well. So Timbuktu started with trust, a familiar theme in Commerce lectures.

This picture is from the 1375 Catalan Atlas of the known world (mapamundi), drawn by Abraham Cresques of Mallorca just after Ibn Battuta died and well before Leo Africanus. The section to the right translates as: “This Negro lord is called Musa Mali, Lord of the Negroes of Guinea. So abundant is the gold which is found in his country that he is the richest and most noble king in all the land.”

[SLIDE: ON THE ROAD TO NOWHERE?]

## On The Road To Nowhere?



But aside from trust why did Timbuktu rise? Timbuktu was rather inaccessible, far upriver. This perhaps enhanced its mystical image, but was a practical hindrance. The native tongue is a Songhay family language Koyra Chiini, hardly a lingua franca, so traders probably spoke many languages, principally Arabic, later enriched with Portuguese and French. Aside from lying on several trade route intersections and having a water supply, Timbuktu challenges many conventional assumptions about why financial centres form – it's not just the location or seapower, not just the language, not just the time zone, not just the local industry needs for finance. Here's a modern speech by the Permanent Secretary for Financial Services and the Treasury:

“What is it ... that attracts investors and financial institutions to this city? The answer lies in our fundamental strengths. These include our simple and low taxes; high-quality services; free flow of capital with no foreign exchange controls, and a stable, fully convertible currency; as well as a free economy buttressed by the rule of law and an independent judiciary. Our regulatory regime is on par with international standards; and our regulators are tasked to ensure a fair, transparent and orderly market.”

But that wasn't a speech from London, that was Miss Au King-chi, at the Hong Kong Investment Funds Association 3rd Annual Conference on 29 September 2009 positioning Hong Kong as an International Financial Centre.

[Source:

[http://7thspace.com/headlines/321747/speech\\_by\\_psfs\\_at\\_hk\\_investment\\_funds\\_association\\_3rd\\_annual\\_conference.html](http://7thspace.com/headlines/321747/speech_by_psfs_at_hk_investment_funds_association_3rd_annual_conference.html) ]

So, how do you get a small financial centre? Start with a large one... The BBC describes Timbuktu differently in our century, “Today, it is a desolate and impoverished town - renowned for its heat, isolation and sand dunes.” [Source: <http://news.bbc.co.uk/1/hi/world/africa/1911321.stm>].

[SLIDE: CITIES & CENTRES]



## Cities & Centres



### Cities & Centres

Before we examine what makes financial centres successful, we should define them. The definition of a financial centre is bound up in the definition of a city. We can start by observing that financial centres are cities or districts of cities where finance is conducted. However, the definition of a city is problematic, as anyone who has tried to compare city populations knows. Is Paris bigger than London? Did you mean the core city, perhaps the medieval walls, the city as defined by political boundaries, the greater metropolitan area? In certain cases, such as offshore centres like the Cayman Islands, the financial centre is really just the jurisdiction.

Likewise, the definition of finance is problematic. All cities have financial transactions. Is a shipping transaction finance? Paying for fuel? When does a shipping transaction become just finance? Are we talking about transactions that are wholly financial. Funding a vessel, insuring it? So much finance is conducted electronically that one might be able to claim that server farms located anywhere are financial centres.

Interestingly, the OECD doesn't define financial centres yet it defines offshore financial centres starting with, "Countries or jurisdictions with financial centres that contain financial institutions...". While the omission of normal financial centres from the OECD glossary strikes me as a large oversight, I do think they point us at the heart of the issue, so my definition might be "financial centres are places with strong concentrations of financial professionals and their firms". It's the people that matter.

[SLIDE: WHY STUDY FINANCIAL CENTRES?]



## Why Study Financial Centres?

- Financial centres add value by directing investment toward innovation and growth
- Vibrant, competitive financial centres give cities economic advantages in information, knowledge and access to capital
- Being part of the global financial network ensures that cities gain from global trade and growth
- Policy decisions can create successful financial centres

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Financial centres funnel investment toward innovation and growth. Vibrant, competitive financial centres give cities economic advantages in information, knowledge and access to capital. A strong financial centre, whether domestic, niche, regional, international or global, connects the wider economy to the global financial community. Cities that are part of the global financial network gain from global trade and growth. Inward and outward investment opportunities increase the wealth of cities that have financial centres and the wealth of their citizens.

‘Traffic’ between the domestic economy and the global financial community is critical to national economic performance. The key function of the domestic financial community is not its ability to service the domestic economy’s needs domestically, rather its ability to service the domestic economy’s needs wherever and however they are best serviced. But after a point a well functioning financial centre attracts global financial transactions in its own right, and this confuses matters.

[SLIDE: FINANCIAL CENTRE ROLES]



## Financial Centre Roles

Centre	Global	International	Niche	National	Regional
London	√	√	√	√	√
New York	√	√	√	√	√
Singapore	√	√		√	
Hong Kong	√	√		√	
Zurich		√	√	√	

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Successful financial centres can and do fulfil more than one role:

- ◆ ‘Global’ financial centres that are truly global foci, where only a few can claim that role, London, New York, Hong Kong and Singapore;
- ◆ ‘International’ financial centres such as Seoul or Shanghai or Frankfurt that conduct a significant volume of cross-border transactions;
- ◆ ‘Niche’ financial centres that are worldwide leaders in one sector, such as Hamilton in reinsurance or Zurich and Edinburgh in fund management;
- ◆ ‘National’ financial centres, often within federal countries, that act as the main financial centre for financial services within one country, such as Toronto or Frankfurt;
- ◆ ‘Regional’ financial centres that conduct a large proportion of regional business within one country, e.g. Boston or Vancouver.

Bank robber Willie Sutton reputedly (he denied this later) replied to a reporter’s inquiry on why he robbed banks by saying “because that’s where the money is”. In a circular fashion, why do we have financial centres? Probably the most important reason is “because that’s where the clients are”. “Global financial centres are places with intense concentrations of financial professionals and their firms transacting international business”. ‘International’ activity involves at least two locations in different jurisdictions. Global deals increase the number of involved parties markedly, e.g. adding lawyers and analysts to a mix of syndicated finance. A direct foreign exchange deal between a retail bank in Korea and a Tokyo investment bank is international, the addition of a third party, e.g. backing with a credit derivative, is likely to make the deal global.

Global financial centres are not hub-and-spoke arrangements. A Sydney mortgage bank may well be working on regional financial deals but the bank’s international dealings could be direct with counter-parties in London or New York City. You cannot compartmentalise financial services distribution neatly into a typical retail model – a central warehouse, then a regional distribution centre and finally a local store.

[SLIDE: HOP TO IT!]

## Hop To It!



[58 Lombard Street - site of Sir Thomas Gresham's goldsmith business, then Martins Bank, later absorbed into Barclays.]

### People Need People

So financial centres are based around people meeting people in an atmosphere of trust. London's financial history retraces the exit and entry of foreign merchants and foreign ideas. Following the expulsion of the Jews in 1290, King Edward I provided expensive land at the heart of the City for goldsmiths from Northern Italy, hence Lombard Street. The Italians made their mark, from coining (sic) the word bank ('banco') to the words for cash, debtor, creditor and ledger, as well as pound sterling - £sd (librae solidi denarii). Moves toward modern banking followed repeal of the usury laws under Henry VIII and further liberalisation under Elizabeth I.

At the risk of seeming to pander to a Gresham College audience, I want to dwell for a moment on the innovation that the Tudor merchant Sir Thomas Gresham imported from the Low Countries, the bourse. Londoners knew how to trade physical goods – Billingsgate for fish, Smithfield for meat, Leadenhall for poultry, Spitalfields for general foods. But in 1565 Gresham opened a London version of the Antwerp bourse, known as the Royal Exchange. For the first time, London had an organized market where intangible things could be sold, such as shares in ships. The concept is astounding. You just go and meet people and do business with them about things that don't exist. From this invisible trade sprang securities, commodities, foreign exchange, futures, and options. Exchanges bring together brokers and dealers. People meet.

A brushstroke history of financial London would move on to the Huguenots, the Empire, the Germans, the Americans, the Asians, pointing out that there are now many exchanges in many cities. London today is a global financial centre based on many types of financial transactions both on exchange and off exchange. Structured betting, stock, shipping, insurance and commodities exchanges are dwarfed by unstructured foreign exchange



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markets operating daily in the trillions. And these exchanges overlap. A lawyer who can help structure an insurance contract can help with a securities insurance hybrid.

[SLIDE: PEOPLE WHO NEED PEOPLE ARE THE LUCKIEST PEOPLE IN THE WORLD]



### People Who Need People Are The Luckiest People In The World



[Source: Gensler – Dubai International Financial Centre]

As an international financial centre grows, staff gain skills and move jobs, the availability of skilled staff grows, thus enabling further growth of the international financial centre. Soon, aspiring financial services job-seekers begin their careers by moving to the international financial centre, further reinforcing its reputation as a place to go to find suitably qualified staff. Studies have shown that experienced international financial staff significantly outperform regional financial staff trying to do international work. Productivity in global financial centres may be above productivity in regional financial centres, despite significantly higher salaries.

A valid question in today's modern world of advanced telecommunications is why do people need to meet physically? If the London Stock Exchange moved its server farm to Iceland would London cease to be a financial centre? There's a joke which goes, "I saw a bank that said it offered 24 Hour Banking. I didn't go in. I didn't have that much time." You might even think that online financial centres ought to displace physical financial centres using their ability to transcend space and time. Physical proximity matters for a variety of reasons in many markets, efficiency, less miscommunication and faster decisions to name three. Despite online chat rooms and instant messaging, face-to-face contact seems to remain at the core of financial transactions. To quote a participant from one of Z/Yen's studies:

*"Access to international financial markets: you can access them from anywhere nowadays: but there's a personal factor which requires proximity to other people..."*

Three weightless factors matter especially for finance – trust, secrecy and chance. Communications via modern telecommunications are still not as trusted as physical contact.



## What Makes A Successful Global Financial Centre?

Financial transactions require some degree of secrecy as well. Physical meetings limit information leakage, while online you're only a broadcast email away from sharing a top secret negotiating point. Modern financial transactions involve bringing together a wide range of skills at particular points – the buyer and seller, their brokers and agents, their lawyers, accountants, actuaries, surveyors, consultants and public relations experts. New opportunities emerge from these physical encounters. An accountant working on a deal mentions to a principal an interesting company that becomes the focus of the next deal. As the team grab a meal in a nearby restaurant, one of them meets a colleague they'd been meaning to call, etc. Everybody likes to 'be in the loop'. As the online world gains trust, increases security and develops alternatives for structured and chance meetings, perhaps all financial centres are in danger, but perhaps not soon.

Analysing successful global financial centres requires analysis of cities and people.

[SLIDE: CITY OR STATE?]

### City Or State?



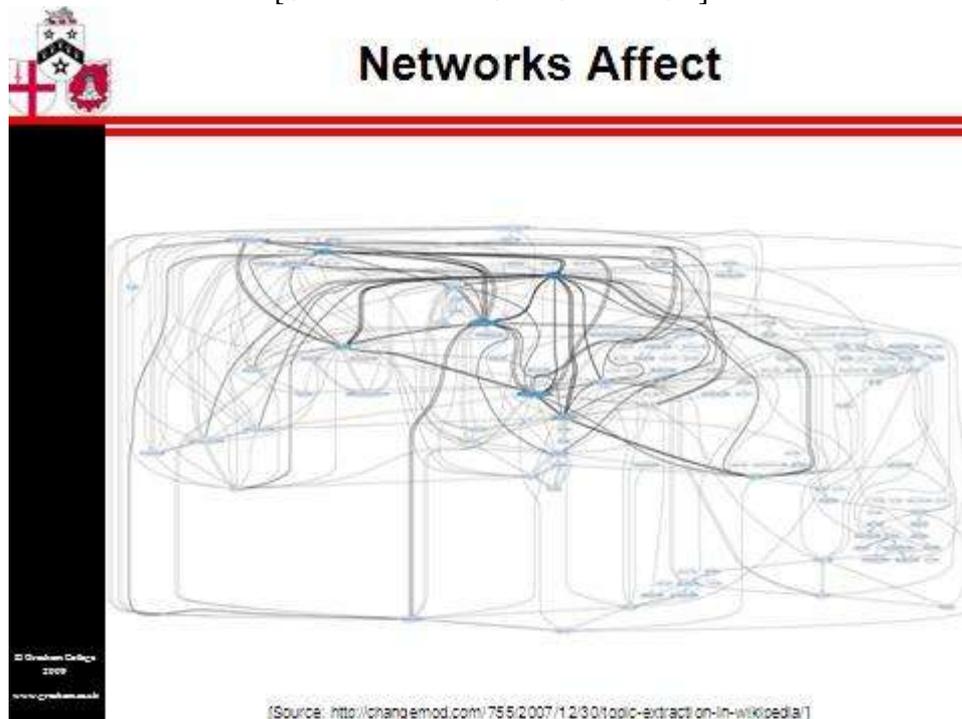
Vatican City

### City or State?

It is difficult to work out what is the appropriate 'unit of analysis' for financial centres. Should we be examining these financial centres at the level of the culture (Anglo-Saxon, Han Chinese, Continental European or Arab), or of the nation-state (USA, UK, Germany or Japan), or at a regional level (Far East, Near East, Europe, North America) or perhaps some economic trade zone? One of the more interesting observations by Jane Jacobs was that cities, rather than nations, have been the drivers of economies [Jacobs, 1984]. Cities are where people go to trade, and live to trade. A city is a unique combination of residential, industrial, business and administrative activity. A city is distinguished from other human habitations by a combination of population density, extent, social importance or legal status. Of course, defining a city is not straightforward and involves cultures and people in ways that can elude straightforward analysis.

Defining a city requires value judgements on what is, or isn't, a city that elude straightforward categorisation. One can try to focus on 'global' cities using ranking systems, for instance the Globalization and World Cities Study Group and Network at Loughborough University (see <http://www.lboro.ac.uk/gawc/index.html>) have published [Beaverstock, Smith and Taylor, 1999] a decade's worth of rankings. Alpha World Cities such as New York City, London, Hong Kong, Paris, Singapore, Sydney, Tokyo, Shanghai, Beijing. Beta World Cities such as Melbourne, Barcelona, Los Angeles, Johannesburg, Manila, Bogota, New Delhi, Atlanta, Washington DC. Gamma World Cities such as Panama City, Casablanca, Chennai, Brisbane, Quito, Stuttgart, Denver, Vancouver. Note that many beta and gamma global cities aren't significant financial centres.

[SLIDE: NETWORKS AFFECT]



The Santa Fe Institute has found evidence of increasing returns to scale in city inventiveness and creativity. These increasing, and accelerating, returns emerge from the fact that the value of connections rises with the number of participants in the network and show up as power laws in things such as the concentration of petrol or gas stations. Each participant connecting to the network improves their productivity markedly, while also contributing to the productivity of those already connected. A thought experiment affirms the idea of network benefits – if there were two world wide webs, wouldn't they be even more powerful if they were connected into one? And network dangers - might they also be more vulnerable? We touched earlier this year in a lecture, "Local or Global: Network Economics And The New Economy" (26 January 2009) [<http://www.gresham.ac.uk/event.asp?PageId=4&EventId=823>], on Professor Geoffrey West's question, "Why are large cities faster?". By implication, how does one take the social temperature of a city? The Boltzmann Constant relates particle energy to temperature of a gas. Is there a Boltzmann Constant linking the energy consumption of a city to its social temperature, or the metabolic rates of cities and villages?

Professor Saskia Sassen at Columbia University studies how globalisation affects cities. She emphasises the difficulty of analysing global cities and their networks; it's complex.



# What Makes A Successful Global Financial Centre?

She looks at the denationalisation effects of globalisation and the increasing tension between nations and cities. She points to the complexity of cities being valued as nodes rather than places of production, the intricate networks of immigrants and diaspora, as well as the way information technology changes social relations. Analysing cities is more akin to analysing ecosystems or biological organisms than any straightforward decomposition analysis.

[SLIDE: RESEARCH, RESEARCH, RESEARCH]

**Research, Research, Research**

**Key areas of competitiveness:**

- People
- Business Environment
- Market Access
- Infrastructure
- General Competitiveness

Competitiveness Factors	Rank
The availability of skilled personnel	1
The regulatory environment	2
Access to international financial markets	3
The availability of business infrastructure	4
Access to customers	5
A fair and just business environment	6
Government responsiveness	7
The corporate tax regime	8
Operational costs	9
Access to suppliers of professional services	10
Quality of life	11
Culture & language	12
Quality / availability of commercial property	13
The personal tax regime	14

The City Of London Corporation needs to know what makes a successful global financial centre. Don't forget that as recently as 2000, people in London worried about the relative ranking of London with Paris and Frankfurt, and the effect on London of the UK being outside the Euro zone. Less than a decade later the challenges are seen as coming from half a world away in Hong Kong and Singapore. One of the first Corporation studies in 2003, compared London, New York City, Frankfurt and Paris, "Sizing Up the City: London's Ranking as a Financial Centre" [Centre for the Study of Financial Innovation, 2003]. The 2003 report considered six main competitive factors (skilled labour, regulatory competence, tax regime, government responsiveness, regulatory "touch" and living environment). A second study in 2005 by our Z/Yen team compared the same four centres considering 14 factors. We soon realised that if one asks for key opinions on financial centres much beyond a handful of cities, surveys become too complicated. If one asks for opinions on too few centres, one excludes respondents' thoughts on emerging centres.

[SLIDE: THE GFCI PROCESS]



In order to better understand what makes a successful financial centre, the City of London Corporation and Z/Yen Group created the Global Financial Centres Index (GFCI) in 2006. GFCI 1 was published in March 2007 and has been updated five times since. The GFCI provides ratings for over 75 financial centres on a 1,000 point scale calculated using a 'factor assessment model' that combines instrumental factors with the responses of financial services professionals to an online questionnaire (the assessments of financial centres):

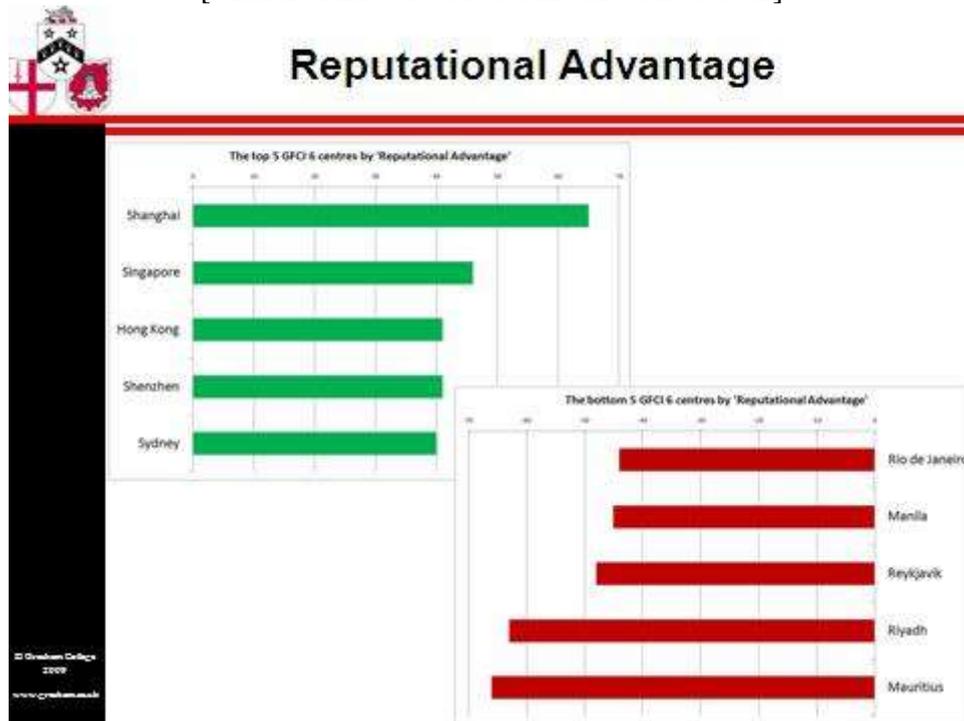
- ◆ *instrumental factors* - over 60 external measures in five areas of competitiveness, i.e. people, business environment, market access, infrastructure and general competitiveness, are used in GFCI. For example, evidence about the infrastructure competitiveness of a financial centre is drawn from a survey of property and an index of occupancy costs. Evidence about a fair and just business environment is drawn from a corruption perception index and a property opacity index, etc.;
- ◆ *financial centre assessments* – the GFCI incorporates responses to an ongoing online questionnaire completed by international financial services professionals assessing financial centres with which they are personally familiar. The online questionnaire runs continuously to keep the GFCI up-to-date with people's changing assessments. Responses are weighted by time, i.e. more recent contributions have more weight.

[SLIDE: GFCI WORLD]



The instrumental factors and financial centre assessments are combined using support vector statistical techniques to build a predictive factor assessment model of financial centre competitiveness. The predictive model is used to answer questions such as: “If an investment banker gives Singapore, Chicago and Sydney certain assessments, then, based on the instrumental factors for Singapore, Chicago, Sydney *and Paris*, how would that person assess Paris?” Two things distinguish GFCI from a straightforward ranking questionnaire – the construction of an index and the instrumental factor methodology. The disadvantage of an index is the large upfront cost of establishing one. The advantage of an index is that, over time, we can correlate changes in factors and perceptions. The factor approach also allows us to remove home biases while stabilising results. We have simpler questionnaires. Naturally, we analyse sub-sectors, e.g. banking, insurance, asset management, professional services and regulators, but we also analyse in new ways, for example looking at implied and actual volatility on factors and assessments. From a tremendous amount of research over the past five years gained from around 40,000 assessments by 2,000 people we’re starting to see how centres compete through time.

[SLIDE: REPUTATIONAL ADVANTAGE]



The instrumental factor approach is potentially a significant innovation in social research. We can see where reputation exceeds fundamental factors or vice versa. We've been able to use this approach, combined with more detailed analysis, to help specific centres answer questions such as when should they be marketing (when their factors are better than their reputation) or when they should soft pedal/peddle (when their reputation exceeds their factors); or improving which factors will make the most difference. Most importantly, we're beginning to see how factors vary in importance as centres advance.

## Evolution Of A Financial Centre

There are five key areas of financial centre competitiveness:

- ◆ 'People' - the availability of good personnel and the flexibility of the labour markets;
- ◆ 'Business Environment' – regulation, tax rates, levels of corruption and ease of doing business;
- ◆ 'Market Access' - levels of trading and direct financial transaction activity where measurable;
- ◆ 'Infrastructure' - the cost and availability of property and transport links;
- ◆ 'General Competitiveness' - the concept that the whole is 'greater than the sum of the parts'.

[SLIDE: COMPETITIVE AREAS]



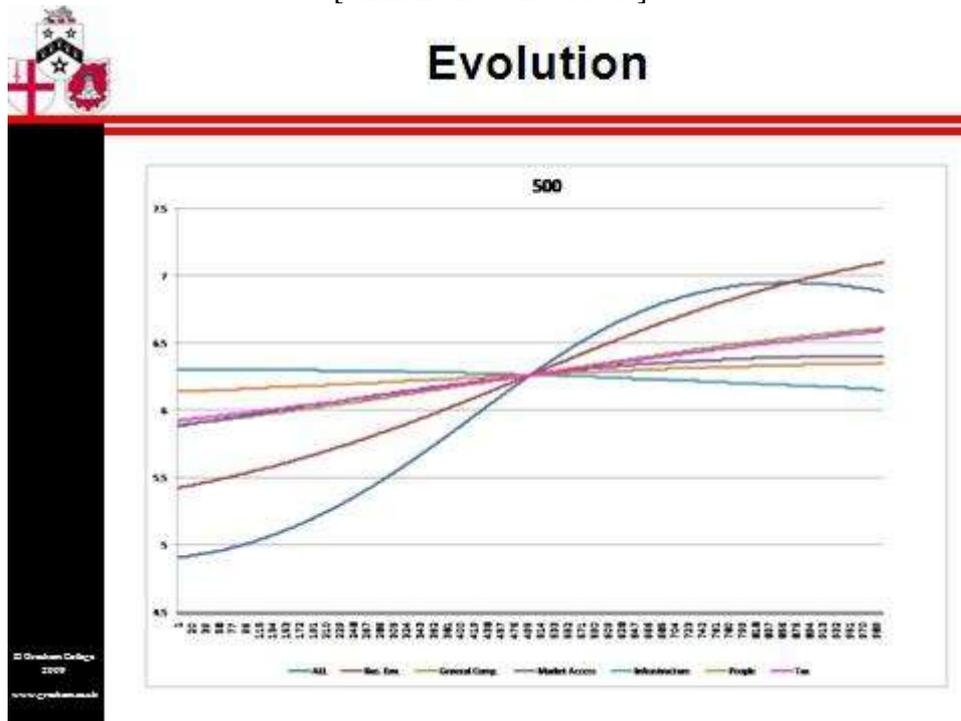
## Competitive Areas

<b>People:</b> <ul style="list-style-type: none"> <li>• Intellectual Capital, PwC</li> <li>• International Crime Victims Survey, UN</li> <li>• Human Development Index, UNDP</li> <li>• Quality of Living Survey, Mercer HR</li> <li>• Lifestyle Assets, PwC</li> <li>• World's Top Tourist Destinations, World Economic Forum</li> </ul>	<b>Market Access:</b> <ul style="list-style-type: none"> <li>• Capital Access Index, Milken Institute</li> <li>• Securitisation Levels, IFSL</li> <li>• Capitalisation of Stock Exchanges, WFSE</li> <li>• Global Credit Rankings, Institutional Investor</li> <li>• External Position of Central Banks, BIS</li> </ul>
<b>Business Environment:</b> <ul style="list-style-type: none"> <li>• Administrative and Economic Regulation, OECD</li> <li>• Index of Economic Freedom, Heritage Foundation</li> <li>• Total Tax Receipts (As a Percentage of GDP), OECD</li> <li>• Ease of Doing Business Index, World Bank</li> <li>• Opacity Index, Milken Institute</li> <li>• Corruption Perceptions Index, Transparency International</li> <li>• Political Risk Index, Exclusive Analysis</li> </ul>	<b>Infrastructure:</b> <ul style="list-style-type: none"> <li>• Office Space Across The World, Cushman &amp; Wakefield, Healey &amp; Baker</li> <li>• Real Estate Transparency Index, Jones Lang LaSalle</li> <li>• E-Readiness Ranking, EIU</li> <li>• City Infrastructure, Mercer HR</li> <li>• Quality of Ground Transport, WEF</li> </ul>
	<b>General Competitiveness:</b> <ul style="list-style-type: none"> <li>• City Brands Index, Anholt</li> <li>• Global Competitiveness Index, WEF</li> <li>• Global Intellectual Property Index, Taylor Wessing</li> <li>• Population Density, City Mayors Statistics</li> </ul>

From running thousands of variations of the predictive model, we now know the order of importance of the areas of competitiveness as we increase from 200 points on the index to 800 points on the index. Before we start to examine each of the five competitive areas, it's important to recognise that a criterion that helped to cause success may not be particularly strong today, but set in train a sequence of positive events. For instance, low taxation might draw participants in, but not persist. Likewise, a criterion that is strong and important today, for instance, the availability of skilled personnel, may be an effect rather than a cause.

Still, using the predictive model at various GFCI ratings we can see what matters at each stage. First, infrastructure. Infrastructure is all the stuff that's taken for granted. In major financial centres, many things are assumed, for instance, reliable electricity supplies and water, an absence of natural threats such as hurricanes or flooding. Yet London used to have significant flood risk, and may again as the Thames Barrier comes to the end of its projected usefulness. A recent report on the future of London warned of looming electricity supply problems [SAMI Consulting, 2009]. Up to 400 points on the scale, basic 'infrastructure' matters. You can't have a financial centre without basic infrastructure. While it might appear that infrastructure ceases to matter after 400 points, it's rather the contrary. Infrastructure tends to get taken for granted as it grows in line with wealth and expectations, yet is crucial. Stuart Fraser at the City of London Corporation believes London must upgrade its infrastructure if it wants to stay ahead. "You don't get to the top by being complacent. You have to be somewhat paranoid." ["On Top Of The World", Sunday Times, 9 October 2009]

[SLIDE: EVOLUTION]



Second, from roughly 400 to 600 points ‘market access’ is what matters. There’s no point in building infrastructure and being open for business without having fundamental market activity. It’s at this point that things such as setting up a stock exchange might make a difference. There are many ways of saying, “we’re open for business”, but commitment, simple financial laws and an open banking and investment regime get things going.

The third area of competitiveness, from 600 to 800 points, is ‘people’. This may seem oddly late, after all people are the most important bit of finance, no? However, the going only starts to get tough after 600 points as more and more advanced skills are required to win and transact more and more complex transactions – transactions of advanced financial, structural or legal complexity in multiple languages.

Finally, after 800 points, and here we’re at the edge of our data envelope, it appears that infrastructure may start to matter again. However, throughout the climb from 200 to 800, business environment is always the key area of competitiveness, always the most important – stable politics, good regulation, low bureaucracy, low corruption. Policy matters. Interestingly, though we have grouped good taxation (i.e. low personal and corporate tax rates, especially the overall GDP taken by tax) in business environment, when you examine taxation on its own, it tracks business environment almost perfectly. So, in summary, always always work on a friendly business environment, then emphasise infrastructure, followed by market access, followed by good people.

[SLIDE: ANNA KARENINA PRINCIPLE]



## Anna Karenina Principle



But what of general competitiveness? General competitiveness is where everything links up, the transport system goes to right places at the right cost, the theatres are attractions for conferences, etc. It is a combination of factors that makes a financial centre successful, not just a single factor. Anyone who has heard me on this subject before knows that I will hark to Jared Diamond's Anna Karenina Principle from the opening line of Tolstoy's novel: "Happy families are all alike; every unhappy family is unhappy in its own way." The Anna Karenina principle describes situations where a number of activities must be done correctly in order to achieve success, while failure can come from a single, poorly performed activity. As one of our respondents noted:

*"I think that the [above] factors cannot be considered in isolation - the combination of factors has a greater impact on a financial centre being competitive than the individual elements."*

General competitiveness is interesting in two ways. First, the GFCI shows that locations need to be good at most things to be a leading centre. People locate their businesses based on a number of criteria at once, so any taxonomic approach has difficulties. London and New York are in the top quartile of over 80% of the instrumental factors used to build the GFCI. London appears to be particularly strong on regulation and the quality of its people. The main negative comments are corporate tax rates, transport infrastructure and operational costs. New York is also very strong in most areas - people and market access are particular strengths. Regulation, such as Sarbanes-Oxley, is the main negative factor for New York.

The second interesting thing about general competitiveness is that the financial centre and the city are inextricably linked. As a city become 'cool' or 'with it' or 'happening' so that helps the financial centre. As a city becomes more recognised as a financial centre, then people presume it is 'cool' or 'with it' or 'happening'.



## What Makes A Successful Global Financial Centre?

So it's all wrapped up then. An easy Meccano or Lego construction set for a financial centre. Well, not so fast. A number of interesting research issues emerge. Let's start with the iconic status of exchanges.

[SLIDE: BUILDING ON EXCHANGE]



### Building On Exchange



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#### The Need For Exchange

As we saw, from 400 to 600 points financial centres need to show they're in the market. In all the discussions about building global financial centres, the role of formal exchanges is increasingly unclear. The concept of transactions in invisibles is so widespread that most trading is actually off-exchange, though there is a new desire to increase on-exchange trading for better regulatory supervision. While there are many financial centres that make much of their exchanges, for others exchanges are peripheral, e.g. Geneva or Boston. In London the scale of OTC foreign-exchange trading dwarfs exchange-based trading. Further, in London the largest exchange by transaction volume (though not value) and probable market capitalisation (still unlisted) is Betfair, not the London Stock Exchange. We may be confusing cause and effect, i.e. because you have a good financial centre you are more likely to have an exchange, but it's not required. Exchanges may be a bit like USA cities' football teams. Development economists claim that football teams add no net value, though they may be nice to have around, yet USA cities often pay to attract or keep a football team.

There are two other relations worth a brief exploration – the relationship of a financial centre with its domestic hinterland and the presumed win-win relationship with other financial centres.

[SLIDE: DON'T FORGET THE HINTERLAND!]



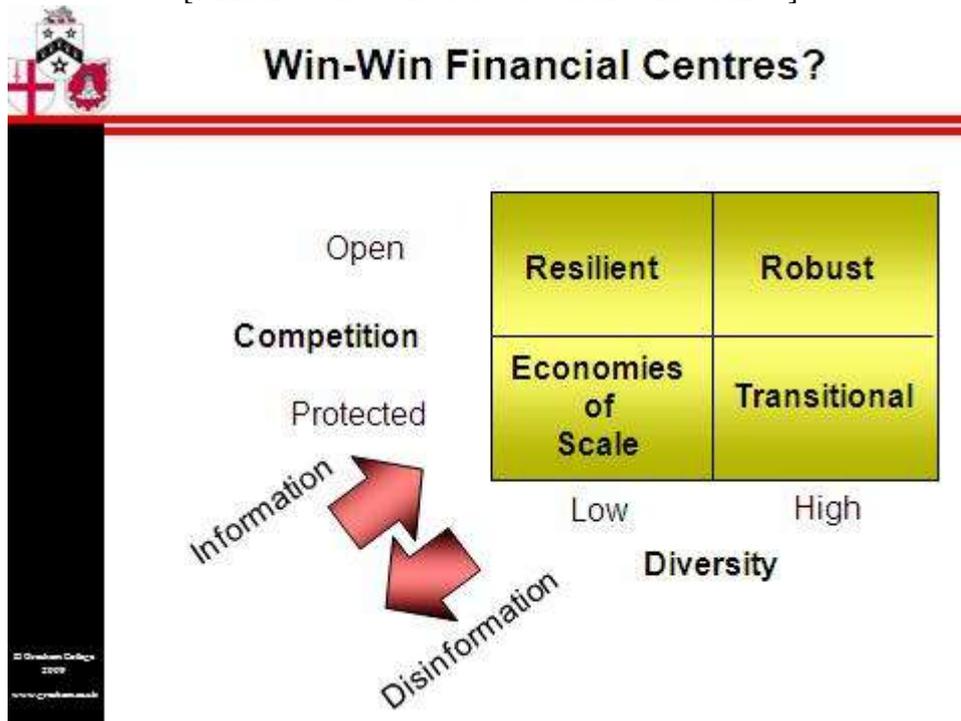
## Don't Forget The Hinterland!



### Front For The Hinterland

A 1990 consensus on the global financial centres would have been London, New York City and Tokyo. The assumption underpinning 1980s literature was that global financial centres grew from large domestic needs and concentration. However, if that were the case, why did Tokyo fall from the top rank when Japan's economy is still over twice the size of the UK's? Why is London comparable to New York City which, generously to the UK, has a domestic economy at least five times as large as the UK's? Perhaps London and other international financial centres are best analysed as two entities – a global financial centre and a domestic financial centre, with little cross-influences among them. This may, at first, appear naïve, but is simply an extension of the earlier argument that transactions change markedly once a number of international parties are involved. More research is needed on whether having a global financial centre leads to more support jobs in country but out of the financial centre, or whether outsourcing out of the financial centre is itself global. There are a number of front-office/back-office pairs whose development complicates both defining a centre and analysing its hinterland relationship, for example London City and Docklands, New York City and New Jersey or Connecticut, Hong Kong and Shenzhen.

[SLIDE: WIN-WIN FINANCIAL CENTRES?]



## Win-Win Financial Centres?

The role of cooperation amongst financial centres is another area worthy of much more study. Although financial centres compete with one another, the competition is not a ‘zero sum’ game. How can financial centre competition be win-win? In theory, a wider, global allocation of risk and reward increases overall economic efficiency. In practice, the ability to tap cheaper capital for inward investment increases overall economic activity for the host country, increases portfolio diversification for the investor, and thus benefits both. More prosaically, a back office in Mumbai supporting a Singapore trading operation benefits both financial centres.

More deals mean a bigger pie for everybody. Business people are attracted to jurisdictions with fair and stable rules (I often wonder if that’s why business people use so many sports metaphors – a firm belief that somebody enforces stable rules fairly seems core to their being). Business people like governments without too much party fanaticism, because party fanaticism means the rules of the game can be changed rapidly. Business people can handle uncertainty, that’s what business constantly entails, but not uncertainty about rules of the game. ‘Fair’ is a system with stable rules and predictable methods for changing rules, not a system that has predictable results. Fair frequently, though not exclusively, implies numerous stakeholders in a wide polity rather than rapid decision-making. I agree wholeheartedly with Ian Luder, the Lord Mayor of London 2008-2009, “...when we have made the significant and necessary changes in the regulatory framework we must resist constant tinkering with the system. Businesses need the 3 Cs: certainty, clarity and consistency.” [The City Banquet, 22 September 2009 - [http://www.cityoflondon.gov.uk/NR/rdonlyres/81B362D6-F144-418A-814D-4351D56FF500/0/MC\\_SP\\_CityBanquet22Sept09.pdf](http://www.cityoflondon.gov.uk/NR/rdonlyres/81B362D6-F144-418A-814D-4351D56FF500/0/MC_SP_CityBanquet22Sept09.pdf)]

An open competitive environment helps to encourage diversity. Open markets may be of increasing significance as governments, now the shamed owners of concentrated banks,

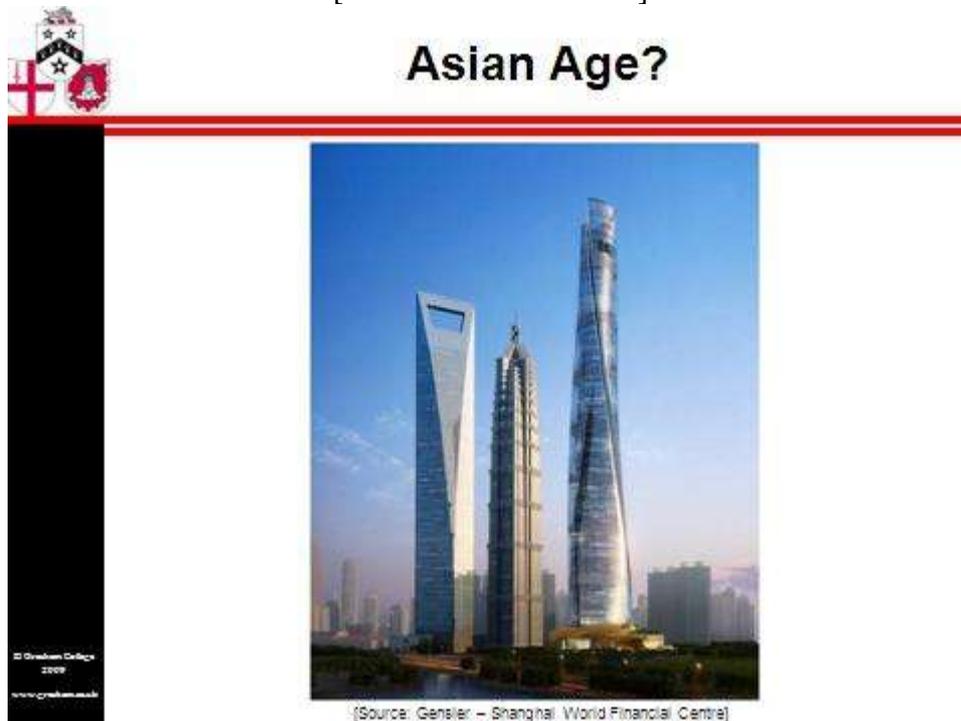


## What Makes A Successful Global Financial Centre?

may be tempted to rewrite rules to favour domestic players. The resulting open and diverse financial centre ecosystem can be very robust. Still, this doesn't explain how moving jobs from London to Singapore helps London. A financial centre has a high fixed infrastructure – expensive ICT, buildings, transport, accommodation, schools. The primary measure of success cannot just be financial centre jobs. The measure for financial centres should be how effective they are at providing choice and access to global financial services. Then domestic and global markets both win. On this measure, protected domestic financial players are clearly a hindrance. Global finance is a non-zero sum game, but only for those centres who paradoxically accept that they have to be open and diverse and lose some business as their comparative advantage evolves.

So where might things be heading? First, the global financial centres.

[SLIDE: ASIAN AGE?]



### Leaders - Plus Ca Change? Well Maybe, And Remember We Told You So

Today it's London and New York City, with Hong Kong and Singapore rising fast. But might things change?

*“Rather than a trinity of equally powerful global cities that have formed in response to a common stimulus, an emphasis on history and structure points to variations in the past and present of the global city.” [Slater, 2004]*

Back in 1999 Sir Willie Purves (former Chairman of HSBC) questioned whether “the UK is to Europe more as Manhattan is to the USA, or more as Hong Kong is to China?” Today we could raise an analogous question, “will China develop an onshore Manhattan or need an offshore London?” As we seem to have gone in 15 years from three to two financial centres, one could make a strong case that soon there will be only one, a “Highlander” imperative from the 1986 film of the same name where “there can be only one” who will win The Prize.

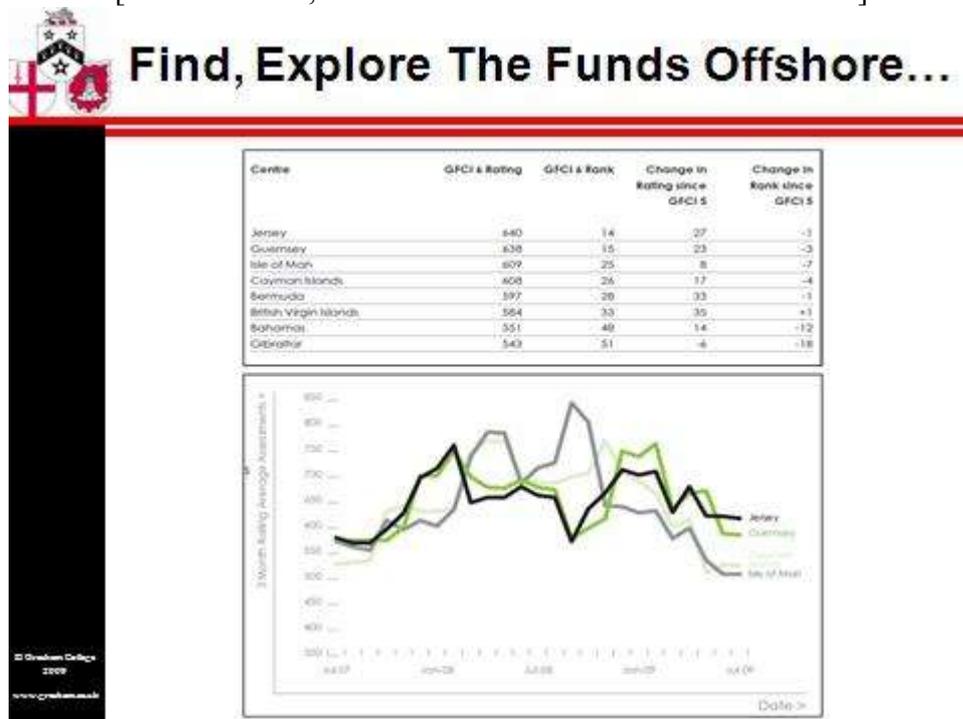


## What Makes A Successful Global Financial Centre?

We could argue for London and the so-called Wimbledon Effect - the local champion may have little chance, but the judging will be fair. We could argue that New York City's proximity to the largest and most liquid domestic economy ensures it will ultimately prevail. On the other hand, we could argue that Europe is London's domestic market as North America is New York City's. Both cases beg the question, where is the equivalent Chinese financial centre? The rise of a Chinese global financial centre is not inevitable. Perhaps, similar to the development of the Euromarkets, there will be a need for an offshore Chinese market. Is that Hong Kong (perhaps not offshore enough), Singapore or Taipei, or more speculatively Sydney, Tokyo or Dubai? Or is offshore already defined by London or New York City.

Second, we need to re-examine niche offshore centres.

[SLIDE: FIND, EXPLORE THE FUNDS OFFSHORE...]



### Offshore – Tax & Secrecy Versus Long Term Finance & Regulatory Simplicity

People seek scapegoats for the Credit Crunch - greedy bankers, incompetent regulators, dopey rating agencies, useless accountants, hysterical journalists, offshore centres. Out of the world's 221 sovereign states and dependent territories in 2009, 67 have a population of less than 1 million (30%), such as the Bahamas, Guernsey, Isle of Man, British Virgin Isles, or Gibraltar. Offshore centres have used their constitutional independence to develop legislation, regulation and tax vehicles that attract non-resident business.

*“It’s fun to charter an accountant  
And sail the wide accountancy,  
To find, explore the funds offshore,  
And skirt the shoals of bankruptcy.”*

(“Accountancy Shanty”, Monty Python, The Crimson Permanent Assurance, 1983)



## What Makes A Successful Global Financial Centre?

Offshore centres have four comparative advantages, long-term finance, regulatory simplicity, tax mitigation and secrecy. Offshore centres are famous for two of their four roles, tax mitigation and secrecy. Secrecy is easily attacked – why do you have something to hide? When looked at from a stable country, this seems a cutting question, but there are many legitimate reasons to desire secrecy. When looked at from an unstable country, secrecy can mean being less vulnerable to extortion or kidnap, or more able to consider positive reforms. Still, secrecy can too easily correlate with criminality, particularly where money laundering is involved. One solution is what Bermuda, Barbados and other offshore financial centres do, have information agreements that allow competent authorities to share essential information responsibly, without risking legitimate people. There are many small states that need to attain these essential levels of transparency, but so too do many larger states.

Tax mitigation, as with all things to do with tax, is more complex. Offshore centres act as “way stations” that facilitate complex international trade and investment flows. Taxes are paid at the beginning of the journey where the activity takes place and when the investors are at the end of the journey, but not along the way. Tax mitigation (legal) can too easily become tax evasion (illegal), particularly where secrecy is too highly guarded.

The comparative advantage of offshore centres is displayed in how they ‘signal’. In biology and economics, animals and people convey information about their abilities and intentions by ‘signalling’. Offshore centres walk a tight-rope signalling that they are both capable of rapid change, and that they are havens of stability. For example, offshore centres simultaneously claim that they can change legal codes rapidly when laws impede sensible decisions, yet also avoid hasty legislation when larger nations are senselessly reacting to domestic calls for action.

A large nation can change tax rules or ownership rules at short notice. ‘Long finance’ structures set up to endure for a generation or two or three benefit from avoiding the capriciousness of larger nations’ domestic agendas. Savvy offshore centres signal that they avoid hasty changes in their own self-interest. Perversely, bouts of regulatory change directed at offshore centres increase the odds that offshore centres thrive.

And what of near-shore or mid-shore?

[SLIDE: CENTRE OR SPIN?]



## Centre or SPIN?



### Up and Coming?

Meanwhile, for potential financial centres in Asia (e.g. India or Indonesia), Africa or South America, closing the gap could take decades as infrastructure and a strong regulatory environment take time to develop. How can these centres further improve their attractiveness? To oversimplify it, SPIN:

- ◆ **Structure:** good quality basic infrastructure is essential. Obviously information systems, communication, telephony, transport links and commercial property must be of significant quality, but 'lifestyle' infrastructure – housing, schools and leisure facilities - must also be good;
- ◆ **People & Business Environment:** financial services skills such as IT, legal, accountancy and actuarial professionals are essential, but a balanced regulatory environment with knowledgeable people overseeing markets is equally necessary;
- ◆ **Information & Interaction:** while a formal stock, commodity or derivatives exchange isn't always required, a "buzz" is - marketplaces need prices;
- ◆ **Networking:** financial centres need to be nexus points for many activities. Thus, a mining conference leads to a property deal, or a legal conference on structured contracts leads to a trial document exchange.

If anything, SPIN emphasises accelerating the frequency of informal contacts – conferences, annual meetings, airport lounges, social and leisure facilities – and then seeing what develops. Which leads to one to question the role of offshore centres, often off the beaten track and not natural nexus points. Yet many offshore centres do well in the GFCI. A good degree of networking can arise if there is a favourable tourist element, for example the Cayman Islands or Bermuda.

This suggests at least two ways for smaller centres to compete. First, make sure that the inducements to explore the centre and set up new businesses are high, e.g. Dubai. After you have the people, help them stay. This approach is an old one, witness the large number of

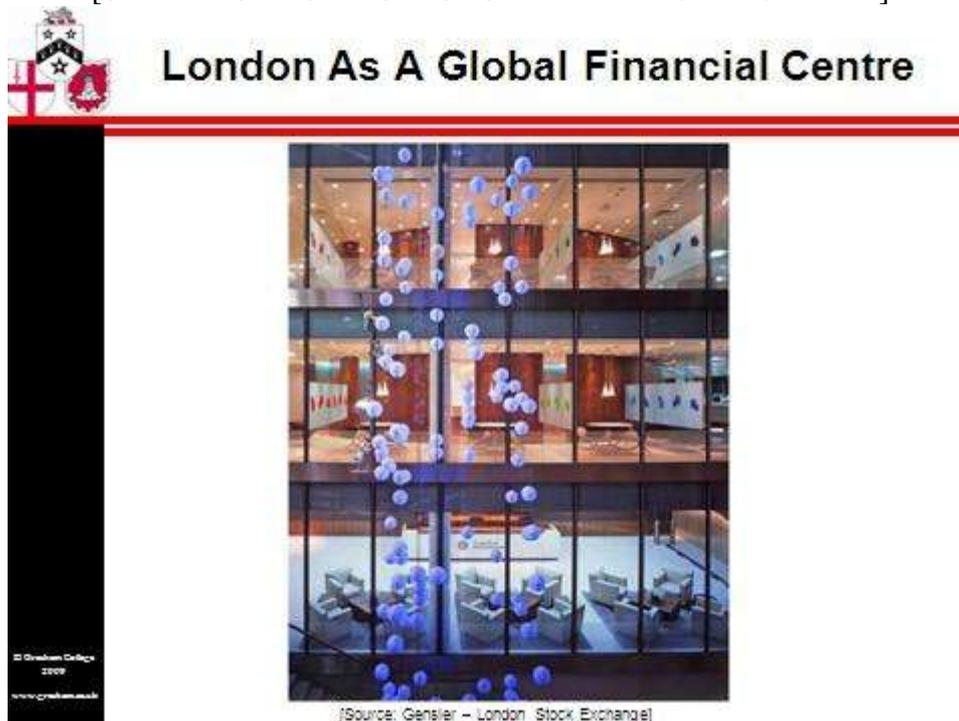


## What Makes A Successful Global Financial Centre?

development agencies, conference subsidies, overseas representative offices and other inducements to help people and organisations make the first big step, any presence at all. To this mix should clearly be added regulatory competitiveness. Second, promote your focal sector with zeal. Rather than stretching credulity by claiming to be a global financial centre across the board, be very specifically honest. Define your competitive sphere so narrowly that you are guaranteed to be 'first in your class'. Then proclaim loudly that you are the pre-eminent centre for that small global financial sector. You can't be the Big Apple overnight, but meanwhile being a "big fish in a small pond" might do nicely.

Given today's venue, I'd like to say a few words on London before we close.

[SLIDE: LONDON AS A GLOBAL FINANCIAL CENTRE]

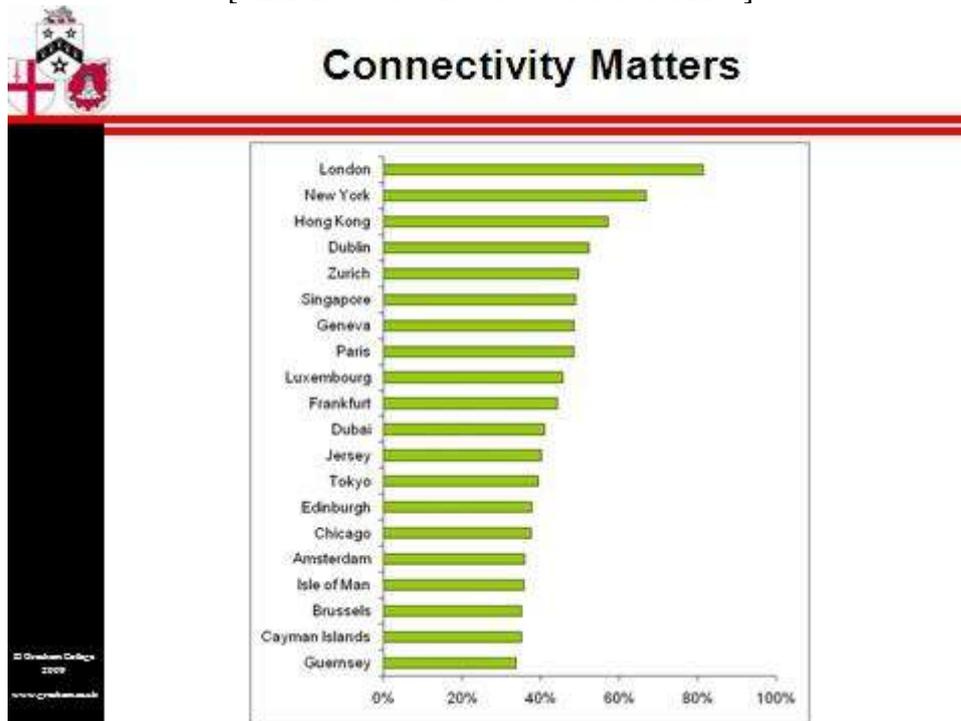


### London - Treating All Comers Fairly

The heritage of London and the UK is treating all comers fairly – the Wimbledon effect. London thrives when it's open to foreigners, from French Huguenots to Hong Kong Chinese. London suffers when it's unfair to foreigners - the expulsion of the Jews in 1290 or the closed shops of brokers and jobbers until 1986.

London has been built on others' mistakes. It's a good discussion point as to whether US litigation itself prevents principles-based regulation in the US. Eurodollar markets grew swiftly in the 1960s when US tax rule changes meant multinationals found it attractive to leave dollars outside the control of US authorities. Then in the 1980s, US companies began to borrow offshore, finding Euro markets an advantageous place for holding excess liquidity, providing short-term loans and financing imports and exports. Sarbanes-Oxley requirements after 2000 increased the attractiveness of London as a 'light touch' regulatory environment. AIM listings increased listings at the expense of NYSE. But when the UK makes mistakes, for example with the shipping industry last year, retribution is non-existent, but exodus is swift.

[SLIDE: CONNECTIVITY MATTERS]



It is unlikely that the credit crunch will change London's underlying attractiveness rapidly - skilled personnel and firm concentration persist. On the other hand, there have been discombobulating changes for foreign financiers and deal-makers that question their faith in the idea that stable old London 'treats all comers fairly'. Since September 2007 rapid changes to non-domiciled resident taxation, foreign dividend income, trusts, capital gains taxes and high earners' taxation rates (first 45%, now a proposed 50%), all raise questions about the predictability of the UK tax system. Equally, 'treats all comers fairly' has suffered from changes to visitors' visa and workers' visa, as well as the introduction of ID cards for non-EU nationals. Finally, the use of anti-terrorist legislation against Iceland and the concentration of government ownership of the financial services industry raise questions about political risk for overseas investors in financial services.

When people are able to enter a financial centre quickly, they rate it highly. This slide shows the percentage of people who are foreign, i.e. outside a financial centre, who rate financial centres. Over half of the GFCI respondents rate London, New York, Hong Kong and Dublin, and nearly half Zurich and Singapore, in many ways just because they are open.

[SLIDE: A GLOBAL PHENOMENON]

## Whither or Wither?

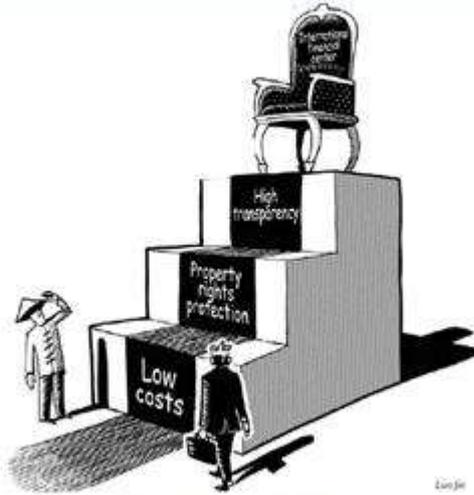
A bad reaction to the credit crunch, particularly for London, would be to assume that lack of regulation was the primary cause when what's probably required is systemic moves to more competition. Today's offshore centres contain good and bad, from money launderers and tax evaders to long-term planners and legitimate but complex wholesale financiers. Still, as US Congressman Thomas "Tip" O'Neil said, "all politics is local", and large electorates out for blood are unlikely to care about the preservation of an international financial services industry.

The current financial crisis allows us to speculate that large states may have a comparative disadvantage in global finance. Large states seem unable to combine wholesale and retail financial regulation without incurring booms and busts. Nor are they paragons of virtue. The largest amounts of recorded money laundering took place through London, Zurich and New York, and there is no shortage of large nations' banking sleaze.

While local electorates call for greater regulation, London and New York City face a tough challenge to stay 'light touch' while Hong Kong and Singapore rise. Financial centres, just like financial professionals, depend on trust. For all financial centres the ultimate challenge may be electronic – if trust can go electronic then all of the rules change. When does a financial professional try and establish an electronic practice in the countryside because online trust is now adequate? The challenge for all aspiring financial centres remains, as ever, "to think global, act local, be social". But trust in technology may change those social relations.

[SLIDE: DISCUSSION]

## Discussion



"Get a big picture grip on the details."  
*Chao Kli Ning*

Thank you.

[SLIDE: THANK YOU]

## Thank You!



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### Further Surfing

History of Martins Bank - <http://www.martinsbank.co.uk/History.htm>



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